Brussels, December 2024

EU ETS revenues from polluters to the people

Dear Executive Vice-President Commissioner Ribera, dear Executive Vice-President Commissioner Séjourné, dear Commissioner Hoekstra, dear Commissioner Jorgensen, and dear Commissioner Tzitzikostas,

First of all congratulations on your appointment to the new College of Commissioners. At the start of your new mandate, the undersigning organisations urge you to take into careful consideration the opportunities that EU Emission Trading System (ETS) revenues can offer to member states.

In 2023 alone, €43.6 billion was raised through the EU ETS, according to the annual Carbon Market Report issued by the European Commission.

Member states are set to raise over €193 billion for their national budgets between 2024 and 2030 through the auctioning of two billion emission allowances to industry, power, shipping and aviation[1] sectors. Between 2027 and 2032 a further €260 billion euros[2] will also be generated from the new ETS2, covering emissions from buildings and road transport. As the cap decreases towards 2039, the available amount of emission allowances will diminish. The time we have to raise and spend ETS revenues wisely is limited.

During the last revision of the EU ETS Directive, co-legislators agreed that all auction revenues should now be used for climate-related purposes. The organisations undersigning this letter call on EU policymakers to ensure that public spending of ETS1 auctioning revenues is effectively and fairly distributed to deliver climate mitigation, while ETS2 revenue is enabled to deliver both climate and social benefit through facilitating socially inclusive access to decarbonisation measures.

Industries and big polluters are not the only actors in need of funding. Supporting mitigation and adaptation measures, assisting households impacted by energy poverty and natural disasters, developing clean transport and energy-efficient housing, creating skilled green jobs, protecting and improving biodiversity, promoting more sustainable

[1] Assuming an average price of €85/tonne of CO_2
[2] Assuming an average price of €45/tonne of CO_2

agriculture and forestry practices, all need to be prioritised and funded from a variety of sources to mitigate the climate crisis and adapt to the unavoidable consequences.

In addition, as highlighted by the outcomes of the UNFCCC negotiations at COP29, there is a pressing and urgent need for the EU to step up its international climate finance commitments to meet the needs of the most vulnerable developing countries. The EU must make better use of the revenues generated by its carbon market to finance climate actions in vulnerable third countries, including the adaptation to the impacts of climate change.

By encouraging member states to prioritise revenues in terms of emissions avoided, the EU can adopt a “people first” approach to award ETS revenue funding to projects and policies that would directly benefit the lives of communities in the EU and internationally.

Below you can find our recommendations for a fair and effective use of ETS revenues that allows the EU to reach its most ambitious climate goals.

ETS1 revenue used in line with our targets: investing in overall decarbonisation of society

Improved earmarking through a targeted revision of the EU ETS Directive

The current definition for the earmarking of ETS revenues laid out in Article 10(3) contains an extensive list of untargeted and partially outdated spending actions. For example, it allows for investments in Carbon Capture and Storage for coal-fired power plants, when phasing out those plants should be the priority.

ETS revenues were also spent on energy efficiency measures that led to further fossil fuel lock-in including on infrastructure to switch from coal to gas under the Modernisation Fund, diesel cars and fossil based heating systems. Current rules also still allow for revenues to be spent on ineffective state aid subsidies for certain sectors covered by the EU ETS. Going forward, if ETS revenues benefit companies in sectors covered by the EU ETS, more stringent criteria must be applied in assessing how a project will deliver the EU's direct emission reduction targets. While member states should select suitable projects and activities for their own decarbonisation objectives, they need to favour the most efficient investments, able to deliver multiple environmental and social co-benefits, compatible with a goal of EU-wide net-zero emissions by 2040.

Moreover, analysis of previous EU ETS revenues spending highlighted the wasteful use of revenues to cover existing member state programmes or initiatives instead of investment in new climate action and projects. In order to make a tangible contribution to the reduction of greenhouse gas emissions, ETS revenues should be additional to - i.e. supplement - available national funding for climate action, and not as a replacement for such national funding streams.

What we recommend:

In the next EU ETS review, Article 10(3) of the Directive must be amended to focus on policies and activities that most reduce CO_2. Supported projects should respect criteria of additionality, climate impact, system effects, reasonable timeframe, efficiency[3], zero pollution ambition and the 'Do No Significant Harm' principle.

- ➔ The Commission must clearly define in the Directive and subsequently assess **additionality** in climate spending by Member States.

[3] Other initiatives are also calling for similar criteria to be applied.

- Particularly, explicit inclusion of the "**Do No Significant Harm**" principle[4] needs to be in the Article;
    - As a consequence, all subsidies for fossil fuels must be banned, and investment in infrastructure leading to further carbon lock-in needs to be avoided;
    - Projects leading to Indirect Land Use Change (ILUC), should not be supported;
    - Overall investments should be aligned to the Zero Pollution ambition (integrated approach on pollution prevention at source). The focus should remain on the prevention of harmful consequences of economic activities and the restoration of historical -environmental damages. For example, construction of new hydropower should not be supported, as well as bioenergy that doesn't deliver significant, near-term GHG savings.
- EU ETS revenues could temporarily cover part of the investment needed to **foster lead markets** for clean technologies and activities and sustainable cleaner base products.
    - Public procurement rules should include mandatory performance requirements standards in the selection criteria with regard to carbon, environmental and material footprints of a product's greenhouse gas emissions, as well as material efficiency. Also there must be consideration of whether rules enable ETS revenues to pay the cost differential, when present, for a limited timeframe (i.e. until the cost differential decreases).
    - Accelerate the setting of minimal performance requirements under the Ecodesign for Sustainable Products Regulation (ESPR) to correctly direct private demand for base products and intermediate products that have high environmental and climate footprint reduction potential.

Meaningful investments instead of untargeted carbon leakage measures

Article 10a, stating the temporary nature of free allocation was continually prolonged with each revision, meaning free allowances still cover half of the total emissions falling under the EU ETS. The phase-in of the Carbon Border Adjustment Mechanism will allow for these freebies to gradually decrease, and it's essential to ensure all sectors are fully exposed to the carbon price for the ETS to work as intended.

[4] Article 17 of Regulation (EU 2020/852).

Intra-EEA aviation will be fully exposed to the carbon price by 2026 and shipping won't be receiving any free allowances, but not all industries will be paying their due price: the steel sector received for free over 35 million excess allowances in 2023, the fertilisers manufacturing industry 4 million, and the cement sector covered the entirety of its emission with free allowances[5]. This doesn't even take into account the historical overallocation to these sectors, and the windfall profits they accrued.

Industries are also asking for access to abundant and affordable energy and dedicated funds to subsidise their investments in net-zero technologies. While EU public support will be essential in achieving the transition, the ETS must not be viewed as a blank cheque for high emitters. Funding from the ETS auctioning revenues therefore needs to be allied with strong social and environmental conditionalities (e.g. clear decarbonisation pathways with set milestones, calculation of potential residual emissions by 2040, in line with the decreasing ETS cap).

Moreover, as allowances that were previously allocated freely will now feed into the Innovation Fund, it's essential to ensure the Fund is able to deliver necessary cleantech innovation by not cutting its sources. Potential future extensions of the EU ETS, for instance the coverage of extra-EEA flights from 2027, among others, could also create important revenues to the EU and member states for climate action: the existing support scheme for Sustainable Aviation Fuels (SAF), will need increased funding and extended timeline to bring meaningful benefits.

What we recommend:

- ➔ Uphold the **agreed upon phase-out timeline** for free allocation and don't delay the implementation of the Carbon Border Adjustment Mechanism;
- ➔ Guarantee that free allocation phased out from all sectors will be directed to the **increase of the Innovation Fund**;
- ➔ Expand EU ETS to extra-EEA flights and **extend the SAF support scheme** beyond 2030;
- ➔ When funding heavy polluters, member states should ensure strict enforcement of **Climate Neutrality Plans, Transformation Plans and sectoral decarbonisation paths**, introducing clawback clauses if the decarbonisation milestones are not respected;
- ➔ The next ETS review should foresee a **full phase-out** of the use of ETS auctioning revenues **for indirect cost compensation**.

[5] EU Transaction Log data.

An ETS2 from and to the people: complementary policies and support to the most vulnerable citizens

ETS2 begins in 2027 and requires citizens to pay for the CO_2 emissions from the fuel used within buildings and road transport. The new carbon pricing scheme brings a clear climate benefit by levelling the playing field between the cost of renewable energy and fossil fuels.

Using all ETS2 revenue to invest in affordable access to renewable energy, energy savings, zero emissions transport and to protect lower and middle income groups from higher prices will be crucial not only to ensure the fairness of the system, but also to secure public acceptance. Only a small portion of ETS2 revenues (roughly 25%) are allocated to the Social Climate Fund (SCF) which is capped at €86.7 billion including member state co-financing of 25%.

The spending of the SCF must be approved by the Commission through the Social Climate Plan process (due June 2025), and will combat increases in energy and transport poverty as a result of ETS2 through additional structural investment and income support (up to 37% of the fund). However, the remaining ETS2 revenue can be allocated by the member states for climate action, with far less strict spending, accountability and transparency criteria.

To ensure the ETS2 delivers its aim of funding fair and effective climate action, all ETS2 revenue should be spent on measures that deliver both climate and social benefits such as investment in energy efficiency, home renovation, green social housing, zero emissions public transport, renewable energy communities, social leasing of electric vehicles and vouchers for green public goods.

By ramping up investment in complementary policies now, such as the implementation of the Energy Performance of Buildings Directive and the Sustainable and Smart Mobility Strategy, emissions will be lowered, lower income groups protected and pressure on the ETS2 price reduced.

As ETS2 revenue is limited in size and timebound it must be used to mobilise additional finance streams through guarantee funds, subsidised loans and on-bill schemes to provide support to middle income groups to decarbonise, while direct subsidies must be provided to the lowest income groups.

In the case of a high carbon price, a certain proportion of the ETS2 revenue can be used to provide income support through direct transfers but this should be socially targeted, reduce over time and should not replace investment in complementary policies to reduce fossil fuel usage and encourage participation in the energy transition.

What we recommend:

- ➔ Beyond the requirements of the Social Climate Fund, member states should dedicate remaining ETS2 revenues to **increase the affordability of emissions reductions** in buildings and road transport and provide support to lower income groups.
- ➔ Earmarking of ETS revenue at **Article 10(3) must be improved** to ensure transparent reporting of spending measures. Details of the resulting environmental and social impacts must be made available to ensure that the ETS2 is fair and effective.
- ➔ As the Social Climate Fund is capped at €86.7 billion it is not enough to offset the impact of the ETS2, and proportionately less funds are available relative to the ETS2 price as it rises. This must be combatted through an **extension and expansion of the SCF** beyond 2032.

Transparent and enforceable, climate spending for a pollution-free European Union

The quality of member state spending can be monitored through the review of their reports on ETS spending by the European Commission, shared publicly through the Climate Action Progress Report and by direct access through the European Environmental Agency.

Pursuant to Article 19(2) the Governance Regulation and Annex II of the Reporting Implementing Regulation, member states should make their reports on ETS revenue use available to the public. The publication of these reports, as well as the assessments made by the Commission, ensures scrutiny on member state spending.

For this reason, enforcement of the principles set out in Article 10(3), and monitoring of the spending by member states are essential: the European Commission should refuse to endorse reports that do not reflect the principles of the EU ETS Directive.

What we recommend:

- ➔ The European Commission should **duly monitor member states spending** in the view of the full earmarking towards climate action as foreseen in the latest reform, and take appropriate action towards member states when the Article 10(3) principles are not respected[6].

➔ Member states should introduce **clawback clauses** when the principles of Article 10(3) is not fulfilled by the project receiving funding.

Sincerely,

[6] Regulation 2018/1999, Implementing Regulation 2020/1208.

SASHA
Skies and Seas Hydrogen-fuels Accelerator Coalition

OPPORTUNITY GREEN

For any further information or to sign the letter,

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