

EEB comments on the Inception Impact Assessment of the revision of the EU ETS

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The EEB welcomes the possibility to comment on the IIA on the review of the EU ETS Directive. We believe that the regulatory overhaul of the climate and energy framework to step up 2030 climate ambition is a unique opportunity to improve policy coherence and address the existing loopholes. The EU ETS is an important driver of decarbonisation but it needs to be strengthened and cannot work alone. The market mechanism must be reinforced and go in hand with a stronger regulatory approach and by no means replace it.

The revision of the EU ETS Directive must address several parallel inefficiencies in a coherent way:

- **Set a Paris Agreement Compatible Pricing of CO₂**
- **Ensure policy coherence and a combined approach to cut all emissions**
- **Set a dynamic emissions cap**
- **Address loopholes in benchmarks rules**
- **Address emissions embedded in imports: free allowances and carbon border adjustment**
- **Phase out compensation for ETS indirect costs through State Aid**
- **Extend the ETS to other sectors: include maritime sector, strengthen the rules for the aviation sector and include incineration of municipal solid waste in the scope**
- **Reinvest 100% of auctioning revenues for climate purposes only**

A Paris Agreement Compatible Pricing of CO₂

According to a report of the High-Level Commission on carbon prices, the explicit carbon price level consistent with achieving the Paris temperature target is at least US\$40–80/tCO₂ by 2020 and US\$50–100/tCO₂ by 2030. In order to fully account for the negative externalities caused by greenhouse gas pollution, and to fully implement the Polluter Pays Principle, **a price level of at least 100€/ton GHG should be achieved by 2030**. We believe that such a level of price is needed to mobilize industry towards climate neutrality with high Capex investments and production change, as opposed as BAU scenario with offsetting via the purchase of emissions certificates obtained in other sectors.

Policy coherence and a combined approach to cut all emissions

GHG emissions from resource and energy-intensive industries, such as steel, cement and chemicals, currently represent 19% of total European GHG emissions. Emissions from these sectors, which are in the magnitude of

some 425 million tonCO₂ per year, have not decreased since 2012, and according to the EEA, are not foreseen to do so until 2030.

In 2012, the top five air pollutants (excluding GHGs) alone emitted from the largest installations covered by the Industrial Emissions Directive (IED) generated an annual health cost of up to €189 billion. Just 1% of all 14,325 assessed facilities were responsible for 50% of the total damage costs, and just 11% were responsible for 90% of total damage costs. Those are Large Combustion Plants (LCPs), refineries and iron and steel plants where significant combustion activities take place, predominantly from fossil origin. The energy sector (combustion) is responsible for the highest damage cost share of all activities covered by the IED.

The EU-ETS revision must take “a combined approach” to apply performance-based standards (e.g. as set in EU BREFs/IED and Ecodesign) with market-based instruments.

We therefore propose the following main changes on point sources subject to the IED: **delete Article 26 of the EU ETS (also in Art 9 of the IED)** and replace it by:

- an Emission Performance Factor (EPF) acting as a performance-based multiplication factor to apply for EUA price
- make energy efficiency requirements binding and complement the EU Safety Net to address the largest pollution sources (e.g. Energy Intensive industries)
- require the inclusion of GHG in Annex II of the IED and set dedicated Best Available Techniques on decarbonisation
- include methane emissions from other activities e.g. methane from coal mines and landfills

For more information: See our paper <https://eeb.org/library/industrial-emissions-directive-and-climate-action-key-elements-for-a-review/> and <https://eeb.org/library/an-eu-industrial-strategy-for-achieving-the-zero-pollution-ambition-set-in-the-european-green-deal/>

Further to this, it is time to take the EU ETS approach to the next level by extending the scope and addressing **emissions embodied in consumption of goods and materials**. This will require setting **a methodology to capture the carbon footprint of products placed in the EU market**.

Setting a dynamic emissions cap

This part is directly linked to the comments made on Benchmarking and Free allocations further below.

The sectoral benchmarks are currently used under the ETS Directive to provide ‘free allowances’ and correspond to GHG emissions performance on the basis of the 10% most efficient performers in the EU. The benchmark is set on the Best Achievable Techniques (BAT) approach of the IED, and corresponds to GHG emission performance already achieved under economically and technically viable conditions. First, it is not right to treat those sectors as “free riders”, since these installations still do emit GHG, even if considerably less than the other installations.

The emissions cap should therefore be derived on the “as if assumed” performance levels of the whole sector in accordance to the benchmark evolving over time. The cap should integrate the desired CO₂ reduction target (based on a Paris Agreement Compatible reduction scenario of 65% GHG emissions by 2030), with the required linear reduction obligation that would have to be met respectively in 2030/2040 and 2050

(climate neutrality goal). Climate action does not stop at borders and the cap should also be translated to represent a maximum GHG atmospheric concentration cap set to [300ppm].

In order to incentivize progress on pollution prevention/reduction, an Emission Performance (multiplication) Factor should apply to the purchase of EUAs for those operators not aligned to the sector benchmark, which may also apply at the country performance level.

Article 12 will have to require the immediate cancellation of pollution allowances no longer needed, e.g. due to fossil fuel phase outs.

Free allocation based on 'carbon leakage' should be replaced by a differentiated pricing approach on "essential activities": some industrial activities that are considered as life-essential for public interests and for which substitution methods are not technically possible or economically bearable, could receive a "discount" to the EUA pricing mechanism, e.g. drinking water purification and supply industry, organic food production, energy production.

For the CBA assessment a shadow cost of 100€/CO₂ emitted should be assumed. This could replace the current provision for "energy modernisation" and is built on the "Modernisation fund" provision, currently too focused on energy generation and not considering the wider EU Green Deal and Zero Pollution ambition.

Any EUA pricing mechanism or reward scheme should be proportionate to efforts made at country level e.g. if the country overshoots its Energy Efficiency and RES targets, the sector is beyond Union Standards and benchmark performance, [in that case the country should be able to compensate efforts with priority access to the Modernisation fund payouts]

The emissions cap shall also include the embedded carbon footprint of the outputs of an industrial activity. Currently, only the site and process GHG emissions are covered (emissions from the "installation" defined in Annex I, but not the embedded GHG in the products of the same activity or directly related to the activity and occurring offsite). A scope revision should apply in particular to those sectors where the GHG are embedded in the outputs (products) and will get emitted in the products use phase, e.g. Annex I lists "Refining of mineral oil" and would therefore cover the process related emissions from refining, but not the high share of GHG emissions occurring when the outputs of that activity (natural gas, petroleum products etc) are used (combusted) outside of the EU-ETS covered activities (i.e. households, other exempted uses such as maritime transport etc).

Another example is fertiliser production and use (GHG emissions occurring on the field). Those downstream GHG emissions shall be assumed as occurring and re-allocated back to the polluter that shall be eligible to receive a EUA permit to cover the whole LCA carbon debt costs of its activity. Similar consideration should apply to biomass. In order to level the playing field, those embedded product emissions should apply to imports (e.g. Carbon Border Adjustment Mechanism).

Address loopholes in benchmarks rules

While the market-based CO₂ price has proven effective in driving down emissions from the power sector, **more than 90% of industrial GHG greenhouse gas emissions are still covered by free emissions allowances**. Free allowances are allocated according to sectoral ETS benchmarks (art. 10a of the ETS Directive). The benchmarks are meant to strengthen the incentives for carbon emission reductions and innovation and reward the most efficient installations. However, the stagnating emissions from industrial installations make it clear that these benchmarks, and the associated allocation of free allowances, provide virtually no incentives to industries to reduce their emissions. This situation is aggravated by the fact that the issuance of free emissions allowances has led to significant windfall profits in the covered industrial sectors, amounting to over €25 billion during the 2008-2015 period.

Lack of transparency on benchmarks setting must be addressed. We understand that benchmarks are built upon self-declared performances data from the industry itself, with no possibility from other stakeholders, including academia, to verify those data, building on a high confidentiality policy of the EC. While we do not question the role of institutions to set such benchmarks, this secrecy is clearly undermining the value of the process and jeopardising its credibility, as this relates to the very mechanism put in place to enact change, i.e. the Polluter Pays Principle. See our paper <https://eeb.org/library/eeb-input-to-e-prtr-impact-assessment/>

Addressing emissions embedded in imports: free allowances and carbon border adjustment

The EU ETS Directive (Recital 24) of 14 March 2018 mentions the CBA as an instrument *"to adapt or complement any existing measures to prevent carbon leakage with carbon border adjustments or alternative measures, provided that such measures are fully compatible with the rules of the WTO, so as to include in the EU ETS importers of products which are produced by the sectors or subsectors determined in accordance with Article 10a of Directive 2003/87/EC"*. We endorse this provision as we need to address emissions embodied in imports of materials and goods. See our paper <https://eeb.org/library/towards-a-carbon-border-adjustment-in-europe-eeb-response-to-public-consultation/>

However, once it is introduced, the CBA will have to replace the granting of free CO2 allowances to industries to avoid double protection. This would create a veritable level playing field and make sure the CBA does not evolve into a protectionist tool and can be subsequently challenged by the WTO.

Phase out compensation for ETS indirect costs through State Aid

The EC has adopted ETS State Aid Guidelines for Phase IV. We believe State aid under the EU ETS is inconsistent with the EU's Environmental Protection Acquis objectives and the key principles of environmental policy. Therefore, we call for a review of Art. 10 Par. 14 of the ETS Directive allowing for compensation of indirect costs. **The implementation of EU ETS State aid through national compensation schemes is de facto contrary to the "polluter prevention and pays" principle**, which is the foundation of European environmental legislation. See our paper <https://eeb.org/library/response-to-public-consultation-on-eu-ets-state-aid-guidelines/>

Extend the ETS to other sectors

The inclusion of maritime emissions and the tightening of the measures for aviation (no more free allowances and inclusion of international flights in the ETS scope) are key to reform the system. As a consequence, a revision of the current MSR rules is paramount to eliminate the supply-demand unbalance of quotas and ensure a strong price signal. **Emissions from all fuel combustion should be addressed**, but this should go in hand and not weaken or play against other effective current policy tools, where they already exist (Effort Sharing Regulation, regulatory frameworks for buildings and transport, such as the EED, EPBD, CO2 performance standards for LDV and HDV etc.)). For sectors not yet addressed by a robust regulatory framework such as **agriculture**, we believe emissions should not fall under an ETS system but **must be addressed under a new AFOLU regulation** and in no way be used to compensate emissions in the ETS sectors.

See our paper <https://eeb.org/library/a-cap-for-a-climate-neutral-europe/>

Incineration of Municipal Solid Waste

Incineration of Municipal Solid Waste (MSW) should be included in the upcoming review of the EU ETS Directive. These industrial activities (regardless of their energy recuperation) have a growing negative impact on climate, and without being part of the EU ETS, these incinerators are not compensating for the resulting climate damage. GHG emissions from the incineration of Municipal Solid Waste have grown by 288% (1). Since burning MSW results in much higher CO₂ emissions than burning fossil fuels (2), continued use of incineration is delaying a much needed transition to less carbon-intensive power generation infrastructure (3) and make it impossible to facilitate ambitious emissions reduction in the energy sector that would align with the Paris Agreement. The inclusion of incineration in the EU ETS would make waste incineration also more expensive, thus encouraging other more sustainable and low-carbon waste treatment options more in line with waste management hierarchy such as prevention, reuse recycling and other treatment options for residual waste e.g. material recovery and biological treatment facilities, thus driving better waste management

See references:

1. <https://www.eea.europa.eu/publications/european-union-greenhouse-gas-inventory-2019/european-union-greenhouse-gas-inventory-2019/viewfile#pdfjs.action=download>
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Reinvest 100% of auctioning revenues for climate purposes

Auctioning revenues from the sale of CO₂ allowances under the ETS Directive (Art. 10) must entirely (100%) be reinvested for climate purposes only. Currently, the ETS Directive establishes that Member States are bound to destinate only 50% of ETS auctioning revenues to climate-related purposes. This is **an example of very bad redistributational policy** and should be addressed in the first place. Many MS have used auctioning revenues for other budget purposes, including amongst other State aid to support ETS sectors, which already receive generous free allowances.