

EU ETS Consultation Response

A new context

Bellona Europa welcomes the invitation for feedback on the Roadmap for the EU ETS revision.

It is essential that this revision recognises the new policy context created by the EU's Green Deal. The EU Green Deal aims to put the EU on track for carbon neutrality by 2050, and introduces a package of policies aiming to rewire our economy and competitiveness around sustainability principles. The EU ETS covers a range of sectors essential to the transformation towards a low-carbon, net-zero economy. This implies that the development of the EU ETS must play a central part of the Green Deal agenda, giving the right signals and setting in motion some of the quintessential dynamics necessary to achieve set targets.

The EU ETS must recognise Europe's commitments under the Paris Agreement. The revision from 2016-2018 did succeed in ensuring some elements of alignment with the Paris Agreement. For example, it shortened the time scale with which the Market Stability Reserve would be returning allowances to the market (which otherwise would have been past 2050) by several decades using a cancellation clause.

However, the overall scheme has not yet been revised to reflect the increase in ambition that would be required under the Paris Agreement. Furthermore, certain elements of the scheme which had been proven to create counter-incentives to innovation were sadly continued for yet another decade (2020-2030) - these blockages must be removed. Supporting and advancing innovation at scale ought to be at the heart of this revision. It is now high time that the EU seeks to address this core issue.

The importance of 2030 and 2050 goals

The EU Climate Law transcribes the goal of climate neutrality by 2050 into EU law. A key part of this pathway is the decade up to 2030, which will be matched by several increases of the EU's Nationally Determined Contribution (NDC), as part of the Paris Agreement process and in line with its agreed timeline of the global stocktakes.

The EU ETS's revised parameters must be designed carefully to ensure that the scheme robustly supports the rapid decarbonisation of the economy foreseen for the next 3 decades. The Paris compatibility check should be one of the core criteria guiding the policy choices about the EU ETS parameters. The overall robustness and dynamism of the scheme must also be increased, with a view to ensure resilience when facing future shocks.

Furthermore, as we look ahead and new technologies and processes develop, it will be of utmost importance to ensure that the accounting of CO₂ and equivalents under the scheme is properly and correctly carried out, ensuring consistency and coherence, or else the 'cap' element of the scheme will continue to be ineffective. As the cap is the scheme's trajectory to net-zero, it is of utmost importance its parameters are in line with goals of carbon neutrality.

Strengthening the EU ETS to achieve its goals

By 2030 the EU ETS will have been in place for 25 years, and be half-way through its effective life. In another 25 years, we will have gone beyond the 2050 milestone. Looking back at lessons learned from the development of EU ETS, we no longer have time on our side and the design resulting from the ongoing revision must result in a robust and mature mechanism, as outlined in the points below.

1. Errors of the past which led to the scheme's poor performance over several years must be avoided at all costs going ahead, as there is not as much time for the scheme to overcome them a second time. This will require, first and foremost, safeguarding the changes introduced by the 2016-2018 revision (informed by more than 10 years of poor market functioning) and building any other ambition elements on top of them.
2. Any exemptions from TFEU Art. 191, the very basis of the EU ETS, can only be temporary. However, by 2030, a quarter-of-a-century long temporary exemption can barely be called compliant. As such the handing of free allowances to the covered installations beyond this timeline should cease.
3. The system has moved from a rigid cap, disconnected from the level of real emissions (and therefore from an ineffective system in its first 2 phases), to a market mechanism that in the last 3 years of Phase 3 was able to rebound. It is of utmost importance, as we look ahead towards an uncertain future, that the elements which have ensured the high performance of the EU ETS over the past 3 years are safeguarded at all costs. This will be essential to the effective operation of the system. It can also pave the way for carbon markets around the world to implement systems which will be quickly adaptable to rapid deployment of innovative technologies, and rapidly increase annual rates of emission reductions.
4. The EU ETS Phase III has revealed it performs best alongside other policies. In particular the MSR built-in cancellation must be maintained to encourage Member States to deploy a range of available solutions, without concern about damaging the integrity of the EU ETS through the so-called 'waterbed effect'. We must accelerate all policies in the race to net-zero and an EU ETS that can cancel from its reserve as we go ahead, is the only one that can cope with the sheer scale of the transformations ahead.

Revision of the cap is essential. However, as we approach new reforms of the scheme, we also risk creating new loopholes – therefore massive changes in design must be carefully considered. We therefore encourage the European Commission and the two co-legislators to build on the currently existing smart design of the EU ETS and introduce changes with caution. We must go boldly in the direction of the Paris Agreement but operate with great caution around the EU ETS, to avoid any chance of reverting it from an enabler of the transition to a blocking element as it has previously been.

Bellona Europa identifies the following set of areas of focus for future improvements and recommends the following choices:

EUETS reform agenda

Issue	Bellona position	Summary of rationale
Objective	Supports the objective of consistency with the newly agreed 2030 target and the 2050 target of climate neutrality, seeking to implement the Paris Agreement and therefore incorporating the principles embedded therein (progressive downward ratcheting, seeking to accelerate reductions towards the ambitious 1.5 degrees limit on global temperature increase, etc.)	The EU ETS is a cornerstone of EU climate policy, and so its consistency with overall targets is essential to meeting them. Compliance with the Paris Agreement principles must be the check test for all policy options considered in this revision.
Scope	<p>Recommends inclusion of maritime emissions in the absence of global action</p> <p>Recommends inclusion of waste incinerators</p> <p>Recommends the inclusion of the small industrial emitters below the current threshold of inclusion into the wider scheme [installations emitting less than 2 500 tonnes or less of CO₂eq]</p> <p>Opposes the extension of scope to buildings or road transport, at least before 2030.</p>	<p>Electrification of road transport and targets set to support this goal, will over time effectively include road transport in the ETS anyway. Similar considerations apply to buildings. The two sectors have price elasticity ranges and volatility elements that hinder the EU ETS from providing effective incentives. Therefore, it would not be wise to include them in the system, at this stage.</p> <p>The latter is to a certain extent also correct for the maritime sector, yet given the lack of any meaningful international action, there is a clear need for the EU to send a clear signal. However, that signal needs to be complemented with targeted measures that may enable and drive decarbonisation of maritime transport in the near to medium term. Measures could include port electrification and carbon-free fuel (e.g. hydrogen, ammonia) facilities to incentivise and enable timely investments into the required transition.</p> <p>In contrast carbon pricing provides useful incentives for waste incineration.</p>

<p>MSR</p>	<p>Recommends extending the doubling of the intake rate to the end of Phase 4</p> <p>Recommends keeping reforms previously agreed, especially the built-in, automatic, cancellation of EUAs in the MSR. This is essential to the effectiveness of the EU ETS and consistency with the 2030 and 2050 targets.</p>	<p>MSR reform has been central to the increased effectiveness of the EU ETS. These reforms must be retained and strengthened for compatibility with 2050 goals. In particular it is essential that none of the current accumulated surplus is used to dilute efforts towards future targets. Furthermore, as Phase IV will overlap with a nearly complete EU-wide coal phase-out, the MSR will be of vital importance in ensuring the stability of the scheme by rapidly absorbing the surplus generated.</p>
<p>Monitoring, reporting and verification</p>	<p>Considers that the MRV which is the backbone of the EU ETS must retain its integrity.</p> <p>Opposes the introduction of novel emission accounting principles such as the accounting of emissions which are 'avoided' elsewhere.</p>	<p>It is essential that the integrity of the EU ETS is maintained and that all emissions are priced at source, as to avoid loopholes where CO2 enters the atmosphere without being accounted for anywhere.</p>
<p>LRF and rebasing</p>	<p>Supports some combination of revision of the LRF and rebasing to real emissions levels will be necessary to reach the 2030 target;</p> <p>Recommends the adoption of an LRF above 3.3% to support a cap trajectory more closely aligned with the goal of net-zero by 2050;</p> <p>Recommends a sectorial target for industrial sectors of –40% reductions by 2030 as to create a more linear transition to net-zero after the 2030 milestone;</p> <p>Recommends rebasing urgently at the start of Phase IV, reflecting real emissions levels following the departure of the UK from the EU, noting that 2026 is too late and also introduces instability in the scheme half-way through Phase IV;</p>	<p>The revised 2030 target represents a large change to the cap. This will require very rapid reductions in the cap between 2026 and 2030. The two main ways this can be achieved – a single rebasing and adjustment to the LRF – both have merit and various combinations are possible. However, the timing is critical – rebasing in 2026, half-way through Phase IV gives not just investor certainty, but promises 5 more years of a cap allowing the cumulative surplus to increase. For the MSR to function properly and absorb the Phase IV surplus as it accumulates due to coal phase outs, rebasing has to be done before the Phase begins; current delays in auctioning and allocation procedures allow for this to happen and the UK departure</p>

	Notes that any revision to the scope of the EU ETS will necessitate a new cap	from the EU invites this to take place.
Innovation	<p>Supports expansion of the innovation fund</p> <p>Considers that additional allowances should be taken from both auction volumes and free allocation, but the proportions are not yet clear</p> <p>Recommends the removal of barriers to innovation, especially where these have been demonstrated through evidence;</p> <p>Recommends free allocation to be phased out by 2030 or soon after and be replaced with CBAMs which price emissions more fully and consistently</p>	<p>Innovation is central to transforming the economy and the EU ETS auction revenue will be a key source of funding. This will be necessary at larger scale than allowed for in the current innovation fund.</p> <p>We expect there to be opportunities to reduce free allocation, in line with the recommendations of the European Court of Auditors from September 2020.</p>

Additional considerations:

Scope expansion:

Any major change in scope half-way through Phase IV is not just premature but ill-timed. Large changes to scope, even if preferred, should only happen after 2030, as the EU ETS needs more time to stabilise. This is because, for example, a more ambitious target now set, the MSR only started operation quite recently, and important reforms have yet to take effect.

Avoiding “Avoided Emissions”

‘Avoided emissions’ is an arbitrary accounting concept where one product allegedly avoids emissions in another sector, with the assumption that those ‘avoided’ emissions should be discounted from the production emissions of said product.

However, as all sectors must go to net zero, this would either imply double counting, or remove any incentive and acknowledgement of the emission reduction in the other sector in question. This is a very powerful and potentially damaging concept, as it can erase fossil CO₂ emissions on paper, with no basis in reality. The avoided emissions concept can be used to discount the emissions from (1) the product produced and (2) the fuels burnt at the ETS installations:

Claims of emission reductions	Potential outcomes for ETS accounting
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<p>Conversion of plastics-to-fuels would 'avoid' production of fossil fuels somewhere else.</p>	<p>Burning plastics in an ETS installation or other sectors would be considered carbon neutral. Fossil emissions to the atmosphere would not be counted.</p> <p>Relabelling waste burning as low-carbon will not reduce emissions.</p>
<p>Conversion of fossil waste gas from steel into fuels would 'avoid' production of fossil fuels somewhere else.</p>	<p>Blast furnace gas, the fuel with the highest emission factor in the ETS, commonly used to produce electricity, would now be rebranded as carbon neutral.</p>
<p>Conversion of fossil CO₂ to plastics (CCU) would 'avoid' virgin fossil carbon use.</p>	<p>Fossil CO₂ temporarily stored in plastic before being released in the atmosphere would be accounted equivalent to permanent geological storage of CO₂.</p>

In an increasingly complex system of solutions and overlapping strategies, it is imperative that any loopholes in accounting are avoided. Otherwise, existing practices could be relabeled and recounted as mitigation and new processes that have fossil carbon flows to the atmosphere could be systematically unaccounted for. Including avoided emissions into the ETS will not deliver a circular economy that reduces emissions, as avoided emissions are too arbitrary to be considered as a climate change mitigation tool.

Recommendations

- 1. Novel emission accounting principles, such as the accounting of emissions which are 'avoided' elsewhere, should not be included into the EU ETS.**
 - 2. The burning of fossil waste-based fuels or fossil waste should not be zero-rated. Avoided emissions should not be used to change the physical metrics within the EU ETS and the MRV Regulation (i.e., emission factors).**
 - 3. The EU ETS should continue to track all emissions at the point source. Avoided emissions should not be used to change the concept of when the CO₂ is emitted, as is described in e.g., the CO₂ storage Directive.**
 - 4. If CO₂ or carbon are converted to a different product (e.g., plastics or fuel), the double counting of emission reduction must be avoided. Any methodology which allows for emissions created in EU ETS installations to exit the EU ETS without being accounted for should be prevented. Installations must be fully accountable for emissions generated under the EU ETS.**
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