EU ETS Public Consultation -

WWF European Policy Office response (February 2021)

WWF’s asks for a revised EU Emissions Trading System that is fit for purpose

WWF fully supports the revision of the EU ETS Directive in line with an increased 2030 emissions reduction target. Emissions from Energy Intensive Industries (EIIs) have been stagnating since 2012 (see recent European Court of Auditors report). Carbon pricing can drive deep reductions in the EIIs only if it ensures that the negative externalities of carbon emissions are fully reflected in the price of pollution. In order to strengthen the current carbon pricing framework, avoiding stranded assets tomorrow, and guarantee an EU ETS that is fit for purpose (i.e. delivers its share of emission reductions by 2030 and the full decarbonisation of the sectors in the long term) the reform proposed by the European Commission must respect the following key principles:

1. **Increase the pace at which pollution is reduced annually by increasing the Linear Reduction Factor (LRF) while rebasing the cap**

An increase of the Linear Reduction Factor (LRF) and a one-off reduction of the cap, with the aim to reach zero emissions by 2040 to make the EU ETS compatible with the goals of the Paris Agreement.

2. **Strengthen the Market Stability Reserve (MSR)**

The intake rate should be increased to 36% from 2024 onwards, declining thresholds should be adopted and an automatic cancellation for allowances held in the MSR for more than five years should be set.

3. **Apply the Polluter-Pays-Principle and move away from free allowances to 100% allowance auctioning**

Since the introduction of the EU ETS Directive and the carbon market in 2005, most of the allowances issued under EU ETS have been given for free.[1] It resulted in 5000 million free allowances being allocated to Industry between 2013-2019. Plus a large number of sectors classified at ‘risk of carbon leakage’ benefited from additional free allowances. Beside the introduction of the benchmark rules in 2013 and the reduction of the number of sectors on the updated carbon leakage list, most of the polluting industries are still receiving their allowances for free. The current system fails to drive the urgently needed transformation of industry towards climate neutrality and efficient use of resources. Polluting for free in times of a climate crisis is unacceptable. Moreover, from a redistributional perspective, rather than avoiding costs being passed on to consumers, they instead result in windfall profits for industries, which can

[1] See the report from the European Court of Auditors, page 9.

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sell their allowances on at a higher price. Moving to 100% auctioning of emission allowances will contribute to ensuring a more stable carbon price, facilitating the long-term, strategic spending of the revenues from auctioning allowances.

4. **Avoid windfall profits by ending immediately free allowances If a Carbon Border Adjustment Measure (CBAM) is to be implemented**

In order to achieve the objectives of the EU Green Deal while protecting industry's competitiveness, it is necessary to ensure that a CBAM - if put in place - **is an alternative to free allocation under the EU ETS.** In addition to being double subsidies to industry, it is also unclear and doubtful that applying both provisions to the same sectors (CBAM and free allocation) would be compatible with WTO rules. Any phase-in of CBAM must imply a phase out of free allocation (with a clear phase-out date).

5. **No extension of EU ETS to road transport & buildings**

Any extension of the sectors covered under the EU ETS must be limited to shipping, the full integration of the aviation sector and the possible integration of municipal waste incineration. Under no circumstances should the ETS be extended to road transport & buildings. The key reasons are: 1) these two sectors have higher levels of abatement costs and show overall lower price elasticities. 2) other tools would be more effective and must be strengthened for these sectors, such as energy labelling, minimum energy performance legislation and standards for cars. 3) due to the low price elasticities and low demand elasticity - particularly for vulnerable and poorer consumers, including these sectors in the ETS could unfairly shift the cost of transition onto the most vulnerable in society. Redistributional measures, supporting energy efficiency to reduce energy consumption for example would be fairer and likely have more impact.

6. **Spend 100% of EU ETS revenues on Climate Action in line with the 2030 and 2050 climate targets and to deliver a just transition**

The ETS Directive must mandate 100% spending of revenues on climate action and unambiguously exclude finance to unsustainable biomass and fossil fuels. Furthermore, the Commission should consider issuing guidance on priorities for ETS revenue use, such as energy efficiency investments to complement reforms addressing energy poverty. The EU Sustainable Finance Taxonomy presents new opportunities to verify what constitutes a "clean investment" and what does not harm climate and environmental objectives – as well as improve member state reporting of revenue use. Revenues raised should always be spent in a fair and redistributive way, to mitigate the risk of driving or deepening inequalities and to reduce existing ones between EU citizens.

7. **Earmark 100% of EU ETS revenues for additional Climate Action in member state budgets**

To ensure that 100% of ETS revenue is spent on climate action, member states should be required to earmark the revenues from ETS allowance auctioning for climate action in their national budgets. Earmarking will help ensure transparency in the use of revenues, as well as encourage their use to be planned strategically. Moreover, well-implemented and monitored across the whole budget, it can help to ensure that use of ETS revenues is additional to that which a member state would otherwise have spent from its public budget on climate action.

8. **Ensure transparency in reporting & monitoring of revenue spending**

A recent WWF report on revenue spending by member states from 2016-2018 underscored the variation and generally abysmal quality of reporting of ETS revenue spending by Member States. In order to encourage effective use of revenues and to improve public and investor confidence in the commitment of governments to the transition, the quality and transparency of revenue spending must urgently be addressed. It should be clear how ETS reveues will be used to complement existing decarbonisation and clean transition programmes and how they will contribute to climate action and redistribution. The use of EU ETS revenues is a key element for the delivery of strategic objectives overall and the implementation of plans at national level, such as the territorial just transition plans, national reform and investment plans and updated NECPs. These strategies and plans must in turn be developed openly and inclusively, in full respect for the Partnership Principle as defined by the European Code of Conduct on Partnership.

9. **Exclude fossil-fuel based projects from the Modernisation Fund**

Financing fossil fuel based projects with Modernisation Fund money would run counter to the very principle of the Modernisation Fund, entrenching fossil based systems and setting up stranded assets which will increase the burden of the transition on consumers. The Modernisation Fund should be transformative, implementing projects that will drive regions and poorer member states forward to the forefront of the transition in order to maximise the impact of the ETS on emissions reduction. **A clear exclusion of projects which include natural gas and gas transmission infrastructure must be established to prevent revenues financing fossil fuel investments.**

10. **Build a strong EU Industrial Policy to drive decarbonisation of EIIs beyond the EU ETS Directive**

The European Commission must push for decarbonisation of EIIs and build a successful low carbon industry in the EU by developing a strong EU Industrial policy that goes beyond reforming the EU ETS (as this alone won't drive the full decarbonisation of the EIIs). It must contain the following measures: a strong public innovation policy, targeted towards market introduction of low carbon technologies through a robust innovation fund, develop contracts for difference or alternative measures (such as to mitigate investment risks and support heavy industries dealing with higher operational costs of low carbon technologies).[2]

[2] As a protection against carbon leakage effects and higher costs, EIIs received free allowances under the Emissions trading scheme. While the power sector, which must purchase its allowances, has decarbonised steadily year after year, industrial emissions have stagnated since 2012. A recently published report by the European Court of Auditors concluded that the current EU ETS free allocation system did not provide an incentive to the EU Industries to be decarbonised.

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