



# Strategic Challenges to the EU ETS in the long-term

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**ERCST**

Roundtable on  
Climate Change and  
Sustainable Transition

# ERCST work – strategic challenges to the EU ETS

- June 2019 - Initiated a first discussion
- September 2019 - Brainstorm session in Brussels
- October 2019 - Produced a *reflection note* highlighting some of the challenges discussed during the September brainstorm session
- **Today:** continuation of the process to discuss some of the main challenges

# Context

EU ETS continuously has to internalise new (political) developments

→ **Can be domestic:**

- The announcement of a 'European Green Deal'
  - Increase of 2030 target and potential inclusion of new sectors in the EU ETS
  - Border Carbon Adjustments
- Member State climate policies

→ **But also international:**

- Article 6 of the Paris Agreement
- Carbon pricing initiatives in other countries
- Level of ambition in other countries

# Reflection note on strategic challenges

**Objective:** reflect on issues raised during the last meeting, and elaborate on how they fit in the EU ETS framework / Directive.

A political agreement to increase the overall level of ambition (2030/2050), and how that is translated for the EU ETS, is not explicitly discussed here, as it will influence all identified issues.

# 1. Review and revision of the MSR

- The functioning of the EU ETS has long been impacted by a structural surplus of EUAs, which contributed to prices not representative of long-term scarcity.
- MSR reviews scheduled in 2021 and 2026 are the key tools to improve the supply-demand balance.
- Questions include:
  - Identifying the goals of the MSR
  - Identifying the components of the MSR review
  - Identifying indicators to monitor towards the review
  - Identifying what warrants a change of the MSR parameters

## 2. Addressing competitiveness concerns in the long-term

Carbon leakage concerns have always been a prominent issue within the ETS debate.

Two questions are important to consider:

### 1. What mechanism is best suited to address carbon leakage?

- The current system of free allocation does not seem to be an indefinite solution
- Introducing a Border Carbon Adjustments is now high on the political agenda
  - Where applied?
  - Level of complexity?
  - Geopolitical/diplomatic impact?
  - How to transition from free allocation to BCAs?

### 2. To what extent is carbon leakage protection necessary?

- Paris Agreement requires action from all Parties
- How can levels of efforts taken in different jurisdictions be compared and reflected in the EU ETS carbon leakage protection system?

## 2. Addressing competitiveness concerns in the long-term

Article 30 of the Directive can be seen as a placeholder for these two questions: it gives the Commission a mandate to ‘review the support measures for energy-intensive industries in light of climate measures made by other major economies’.

**However, Article 30 is currently not operationalized:**

- When would it be triggered?
- How do you perform a *review* under Article 30?

### 3. Exploring the role of using domestic offsets

Currently there is no link between the EU ETS and ESR, besides for the one-off flexibility mechanism for some Member States to use EUAs to achieve their ESR target (one-way link).

Article 24a of the Directive does foresee a placeholder for allowing domestic offsets – it gives the Commission a mandate to adopt measures to issue GHG reduction credits from projects not covered by the EU ETS.

**What could be the role of domestic offsets in the future?**



## 4. International links to the EU ETS

International links do exist in the EU ETS :

→ International offsets (Article 11a) are currently being phased out – the overall experience has been contentious

- However, the Paris Agreement world is a new world – what could be the role of international offsets, if any, given a desirable outcome of Article 6 negotiations?

→ Linking/coordinating with other emission trading systems (Article 25)

- Link with Switzerland expected to enter into force in 2020
- What are the prospects for the EU ETS to interact with other/new emission-trading systems in the future?

## 5. Managing policy fragmentation through effective governance

EU ETS builds on the ideas of simplicity and efficiency – introducing a single price signal ensuring emission reductions take place where they are cheapest.

<=> a desire for all sectors to contribute to the decarbonization effort.

**Introducing new sectors to the EU ETS** (*e.g. Maritime, Transportation*)

**vs.**

**Increasingly more climate policies introduced at various levels of policymaking**

*(e.g. Sectoral climate policies, including national carbon markets for certain sectors; markets/incentives to help deploy/mature specific technologies deemed important for the transition)*

**Can be managed through** - MSR? Cancellation? Governance of the Energy Union?

→ does not tackle the root cause of fragmentation

## 6. Explore mechanisms to incentivize the deployment of carbon dioxide removal technologies

CDRTs deemed necessary to reach objectives in many climate scenarios.

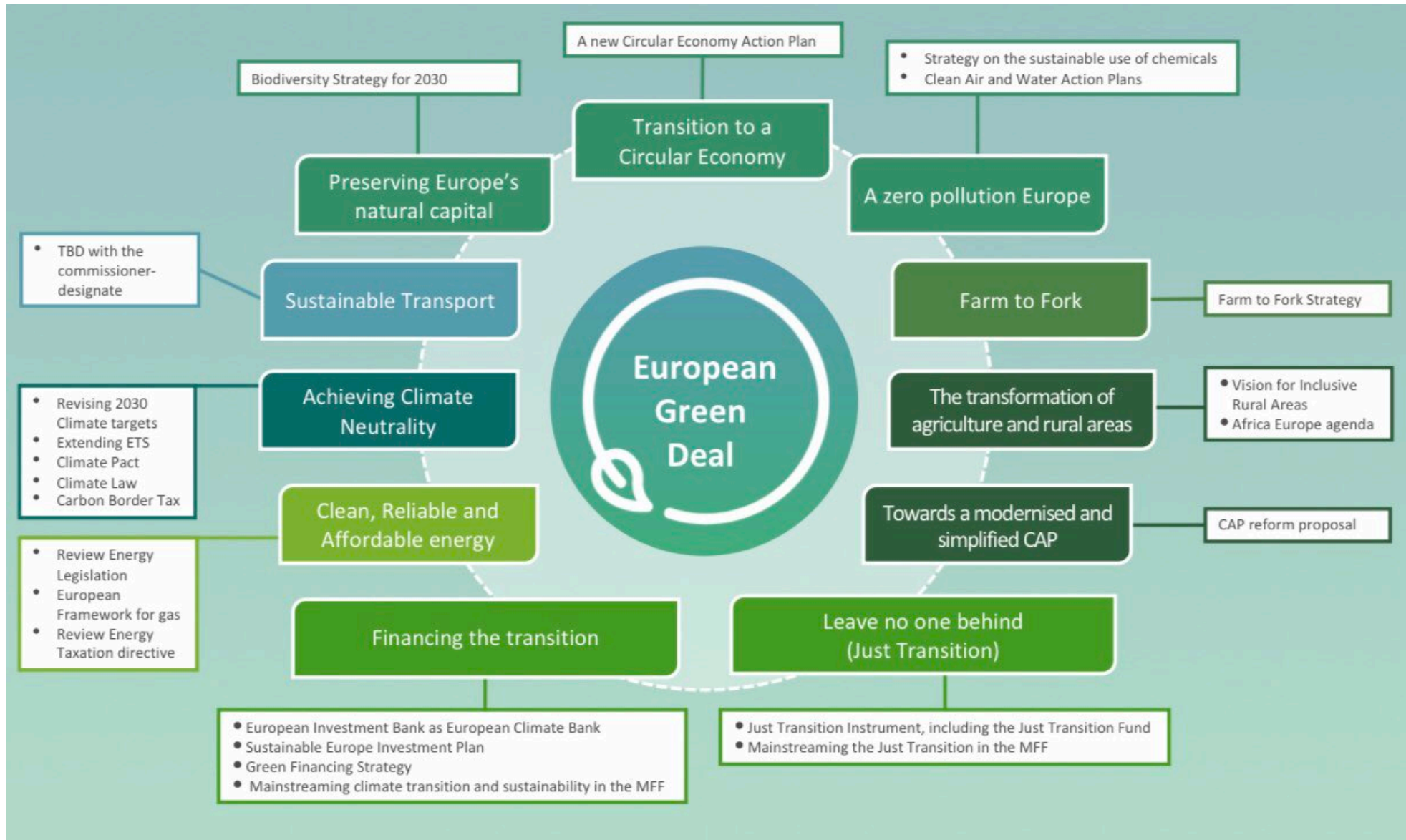
An incentive does exist for on-site capture under Article 49 of the Commission Regulation 601/2012. However, the current EUA price is not sufficient to trigger the necessary level in investments.

### **Create incentives under the EU ETS framework for the deployment of CDRTs?**

E.g. Introduce targets for technologies like CCS?

E.g. Use Article 24a to allow CDRT credits?

## Going forward – impact European Green Deal





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