

ERCST EXPLANATORY NOTE

EU ETS Auctioning & REPowerEU.

Highlights

General remarks:

- In May, EU institutions adopted the REPowerEU Plan as a way to reduce Europe's dependence on Russian fossil fuels and mitigate the volatility in prices driven by the energy crisis.
- REPowerEU is set to be financed through the utilisation of EU Emissions Trading System's (ETS) revenues. Starting in 2023, this funding mechanism will have direct implications for the distribution and supply of allowances in the European carbon market.
- In this explanatory note, ERCST summarises the features of REPowerEU, with a direct impact on the distribution of EU ETS allowances, and expound the next steps in the policymaking process.
- We shed light on the fact that REPowerEU, which was promoted as an extraordinary measure to address an extraordinary energy supply shortage and escalating energy prices, is actually setting a precedent for future interventions in the European carbon market.

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To reference:

Marcu, A., López Hernández J.F., Romeo, G. (2023): "EU ETS auctioning & Repower EU". ERCST. July 2023.

1. The legislative impact of REPowerEU on the EU ETS.

REPowerEU was announced in 2022 to reduce the EU block's dependency from Russian fossil fuels, and to ensure price affordability and security of energy supply¹. Adopted in 2023, the REPower EU entails saving energy, diversifying energy supplies, accelerating the rollout of renewables, reducing fuel consumption in industry and transport, and boosting smart investment measures.

With REPowerEU, Member States will be entitled to add new REPowerEU chapters to their national recovery and resilience plans (RRPs) under Next Generation EU. This will allow them to finance up to EUR 300 billion in key reforms aligned with REPowerEU objectives. From this amount, EUR 20 billion will be taken from EU ETS future revenues.

To finance REPowerEU, the legislation proposed amendments to the EU ETS Directive². In its adopted framework, the Plan raises EUR 20,000,000,000 until 31 August 2026. Once the EUR 20 billion target is achieved the mechanism should stop, and no additional EU ETS revenues should be used to finance REPowerEU activities. The EU ETS funding originates from two separated auction pots. Table 1 homogenises the amounts provided by the official sources (in black).

Table 1: REPowerEU amendments to the EU ETS Directive and auctioning dynamics.

EUA Auctioning due to Repower EU	EUAs (tCO ₂)	EUR (€)	Auctioning period
Frontloading	106,567,203 ⁱ	8,000,000,000	July 2023 to August 2026
Innovation Fund	159,850,806 ⁱ	12,000,000,000	
• <i>Market Stability Reserve (MSR)</i>	27,000,000	2,026,890,000 ⁱ	Until 31 December 2030
Total	266,418,009ⁱ	20,000,000,000	

ⁱ Assuming a share of the MSR of around 10% of the total of the Innovation Fund contribution to REPower EU, thus a price of 75,07 €/tons of CO₂. This estimation is based on the historical carbon price by the time of writing the Regulation (EU) 2023/435, while no carbon price is provided in the Regulation. With the EU ETS now trading closer to 90 - 100 €/tons of CO₂, the carbon price could be adjusted in future sales, and the REPowerEU's EUR 20 billion target could be achieved sooner than initially expected.

• Innovation Fund – 60%

This pot utilises European Union Allowances (EUAs) otherwise auctioned for the Innovation Fund³ until the amount of revenue obtained from such auctioning has reached EUR 12 billion, and before 31 August 2026. Until 31 December 2030, 27 million EUAs from the Market Stability Reserve (MSR), otherwise invalidated, will replenish the Innovation Fund budget.

• Frontloading – 40%

This pot front-loads⁴ EUAs auctioned by Member States until the revenues obtained from such auctioning reach EUR 8 billion. Front-loading refers to a shift in allocation from future to present consumption, hence it does not imply any change in the total volume allocated for the full period. Such a dynamic is expected to have several market implications:

¹ Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions REPowerEU: Joint European Action for more affordable, secure and sustainable energy. COM/2022/108 final

² Regulation (EU) 2023/435 of the European Parliament and of the Council of 27 February 2023 amending Regulation (EU) 2021/241 as regards REPowerEU chapters in recovery and resilience plans and amending Regulations (EU) No 1303/2013, (EU) 2021/1060 and (EU) 2021/1755, and Directive 2003/87/EC. Article 5.

³ Art 5 (2). Regulation (EU) 2023/435.

⁴ Art 5 (3). Regulation (EU) 2023/435.

- (1) In the short/medium-term (2023-2026), it is likely to increase market supply, with bearish consequences on the EUAs' price.
- (2) A potential accelerated effect by the MSR. The frontloading of EUAs will extract higher intake volumes of EUAs due to the MSR than would have been extracted without frontloading.
- (3) After 2026, it should reduce auction volumes scheduled for 2026-2030, hence tightening the carbon market supply of EUAs.
- (4) REPower EU could also contribute to accelerate the deployment of renewables in the EU, thus potentially relieving carbon emissions and demand for EUAs.

2. EUAs re-distribution due to REPowerEU and next steps.

A question raised by stakeholders pertains to the timing and method of monetising EUAs for financing REPowerEU. So far, there is only certitude on the 2023 EUAs auctioning calendar, while the auctioning calendar for 2024-2026 allows for estimation based on the legislative provisions in place.

In June, EEX published the 2023 calendar for EUA auctions⁵ providing more clarity to the distribution of allowances in the same year following the REPowerEU provisions. From the Innovation Fund pot, EEX announced 19,126,000 EUAs will be auctioned in 2023, contributing to the EUR 12,000,000,000 target. As for the front-loaded auctions, 16,199,000 EUAs are to be auctioned starting on 3 July 2023, contributing to the EUR 8,000,000,000 target.

The conditions for the auctioning of EUAs are given in the Commission Delegated Regulation (EU) 2019/1868⁶. In Article 24 (e), the Auctioning Regulation sets out that the volumes of allowances pursuant to Article 10a(8) of Directive 2003/87/EC [Innovation Fund] shall, in principle, be auctioned in equal annual volumes over the ten-year period beginning from 1 January 2021.

In 2021 and 2022, auctioning volumes to finance the Innovation Fund totaled 40 million EUAs, while the auctioning of additional EUAs volumes implied by REPowerEU will require amendments to the current Auctioning Regulation so additional Innovation Fund EUA quantities can be solved above in 2024-2026⁷.

In fact, the European Commission has recently confirmed the update of the Delegated Auctioning Regulation. This will involve timing, administration, and other aspects of emission allowances' auctions. While a feedback period of a potential draft is upcoming⁸, the updated EU ETS Auctioning

⁵ EEX (2023) EEX Customer Information - Publication of revised 2023 calendar for EUA auctions. 21 June. Available at: https://www.eex.com/en/newsroom/detail?tx_news_pi1%5Baction%5D=detail&tx_news_pi1%5Bcontroller%5D=News&tx_news_pi1%5Bnews%5D=7227&cHash=eb7520b8b72f7a386c37a0c975225b49 (Accessed on 29 June 2023).

⁶ Commission Delegated Regulation (EU) 2019/1868 of 28 August 2019 amending Regulation (EU) No 1031/2010 to align the auctioning of allowances with the EU ETS rules for the period 2021 to 2030 and with the classification of allowances as financial instruments pursuant to Directive 2014/65/EU of the European Parliament and of the Council (Text with EEA relevance).

⁷ Currently, the regulation allows 40 m allowances to be auctioned for the fund in 2023, while EEX announced, while 20.874.000 EUAs for the Innovation Fund are to be auctioned in 2023 and 19.126.000 EUAs due to RePower EU. Source: EEX Auction Calendar 2023 . Pp. 11 2023-06-21. Available at: https://www.eex.com/fileadmin/EEX/Downloads/Trading/Calendar/Auction_Calendar/EEX_Auction_Calendar_21.06.2023.pdf (Accessed on 4 July 2023).

⁸ European Commission (2023): EU emissions trading system (ETS) – update of emission allowances auctioning rules. European Commission website. Available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13758-EU-emissions-trading-system-ETS-update-of-emission-allowances-auctioning-rules_en (Accessed on 29 June 2023).

Regulation is expected to be adopted in October 2023. The amendments will enable the additional sale of EUAs for REPowerEU.

The auction calendar for 2024 is expected to be published towards the end of 2023, once the revised Auctioning Regulation is officially adopted⁹. A draft version is already being discussed in the European Commission Expert Group on Climate Change Policy¹⁰.

3. EU ETS as a revenue source: Setting a precedent for the future.

REPowerEU has set an important precedent for the future of the EU ETS, showcasing its potential as a revenue source and a proven instrument for generating funding. A case in point is the European Commission's recently adopted proposal for a Regulation establishing the Strategic Technologies for Europe Platform ('STEP')¹¹.

STEP aims to boost the uptake and scaling up of development and manufacturing of strategic technologies in the EU. By leveraging existing EU tools, STEP aims to facilitate financial support for business investments, utilising EU funding available through various programs, including EU ETS revenues from the Innovation Fund. It is worth mentioning that, following the revision of the EU ETS Directive, 100% of EU ETS revenues will have to be earmarked for climate action.

This strategic approach aims to stimulate investments in critical technologies and foster the growth competitiveness, and success of companies operating within the EU. Through STEP, the EU aims to reach up to €160 billion in investments in the coming years, of which 5 billion extra euros will be added to the Innovation Fund.

As with REPowerEU, STEP will have direct implication in the current EU ETS legal architecture and will require additional amendments to article 10a (8) of the EU ETS Directive. Within the framework of STEP, the Commission is proposing the allocation of EUR 5 billion to support investments that align with its objectives, in addition to the 530 million allowances already outlined in the latest revision of the EU ETS Directive.

This funding is intended to be utilised for supporting STEP-related initiatives between 2024 and 2027¹². While STEP is currently in preparatory phase in Parliament and Council, it will have to be negotiated by EU institutions afterwards¹³.

Initiatives such as REPowerEU and STEP highlight the growing recognition of EU ETS revenues as a valuable funding source for policymakers. Indeed, it is not surprising that EU ETS revenues are becoming and increasing and attractive funding pot for policy makers.

⁹ DG CLIMA (2023). Revised 2023 auction calendar published. News Article. 21 June. Available at: https://climate.ec.europa.eu/news-your-voice/news/revised-2023-auction-calendar-published-2023-06-21_en (Accessed on 29 June 2023).

¹⁰ European Commission (2023): CCEG Meeting on Auctioning. 10 May. Available at: <https://ec.europa.eu/transparency/expert-groups-register/screen/meetings/consult?lang=en&meetingId=47918&fromExpertGroups=true> (Accessed on 10 July 2023).

¹¹ Proposal for a Regulation of the European Parliament and of the Council establishing the Strategic Technologies for Europe Platform ('STEP') and amending Directive 2003/87/EC. COM (2023) 335.

¹² '(...) the Innovation Fund shall also implement a financial envelope for the period from 1 January 2024 to 31 December 2027 of EUR 5 000 000 000 in current prices for supporting investments contributing to the STEP objective (...). Article 9. COM (2023) 335 final.

¹³ European Parliament Legislative Observatory (2023). 2023/0199(COD). Establishing the Strategic Technologies for Europe Platform ('STEP'). Available at: [https://oeil.secure.europarl.europa.eu/oeil/popups/ficheprocedure.do?reference=2023/0199\(COD\)&I=en](https://oeil.secure.europarl.europa.eu/oeil/popups/ficheprocedure.do?reference=2023/0199(COD)&I=en) (Accessed on 30 June 2023)

As higher carbon prices are permeating the expectations, increasing revenues make the EU ETS an ever more attractive and targeted tool to support EU initiatives. This observation had been already raised by the ERCST¹⁴ when the discussions on REPowerEU were taking place last year.

Total auctioning revenues generated by the EU ETS amounted to EUR 31 billion in 2021¹⁵. In June, the European Commission released its proposal for the next generation of own sources and proposed to increase to 30% the contribution of the EU ETS revenues to EU budget, following the revision of the Fit for 55 Package. The proposal foresees EU ETS revenues above EUR 46 billion from 2028¹⁶.

¹⁴ See Marcu, A., López Hernández J.F., (2022): "EU ETS Review: Under the shadow of the energy crisis". ERCST. October 2022.

¹⁵ Marcu, A., López Hernández J., Romeo, G., Alberola E., Faure, A., O. Chimdi., Qin B., O'Neill, M., Caneill J-Y., Schleicher S. "2023 State of the EU ETS Report." ERCST, BloombergNEF, Ecoact, and Wegener Center. Available at: <https://ercst.org/2023-state-of-the-eu-ets-report/#:~:text=Caneill%2C%20Stefan%20Schleicher.,April%2026%2C%202023,is%20%E2%80%9Cfit%20for%20purpose%E2%80%9D>. (Accessed on 30 June 2023).

¹⁶ European Commission (2023): EU budget: Commission puts forward an adjusted package for the next generation of own resources. Press release. 20 June.