Preparing for the review of the EU ETS

Division and use of revenues + reflecting on December EUCO conclusions

21 January, 2021

Andrei Marcu, ERCST
Jean-Yves Caneill, ERCST
Domien Vangenechten, ERCST

ERCST

Roundtable on Climate Change and Sustainable Transition

Structure of the webinar

ERCST
Roundtable on Climate Change and Sustainable Transition

- 10:00 **Welcome** Andrei Marcu, Director of ERCST
- 10:05 **Presentation**
  - Domien Vangenechten, ERCST
- 10:25 **Opening remarks**
  - Adam Guibourge-Czetwertynski, undersecretary of state, Polish Ministry of Climate and Environment
- 10:35 **Roundtable discussion**
  - Fredrik Hannerz, Swedish Environmental Protection Agency
  - Wanda Buk, PGE Group
  - Katie Treadwell, WWF
  - Cillian O'Donoghue, Eurometaux
- 11:25 **Moderated discussion with participants**

Reactions by Hans Bergman, DG CLIMA, European Commission

Introduction: phase 4 revision (2018) – division

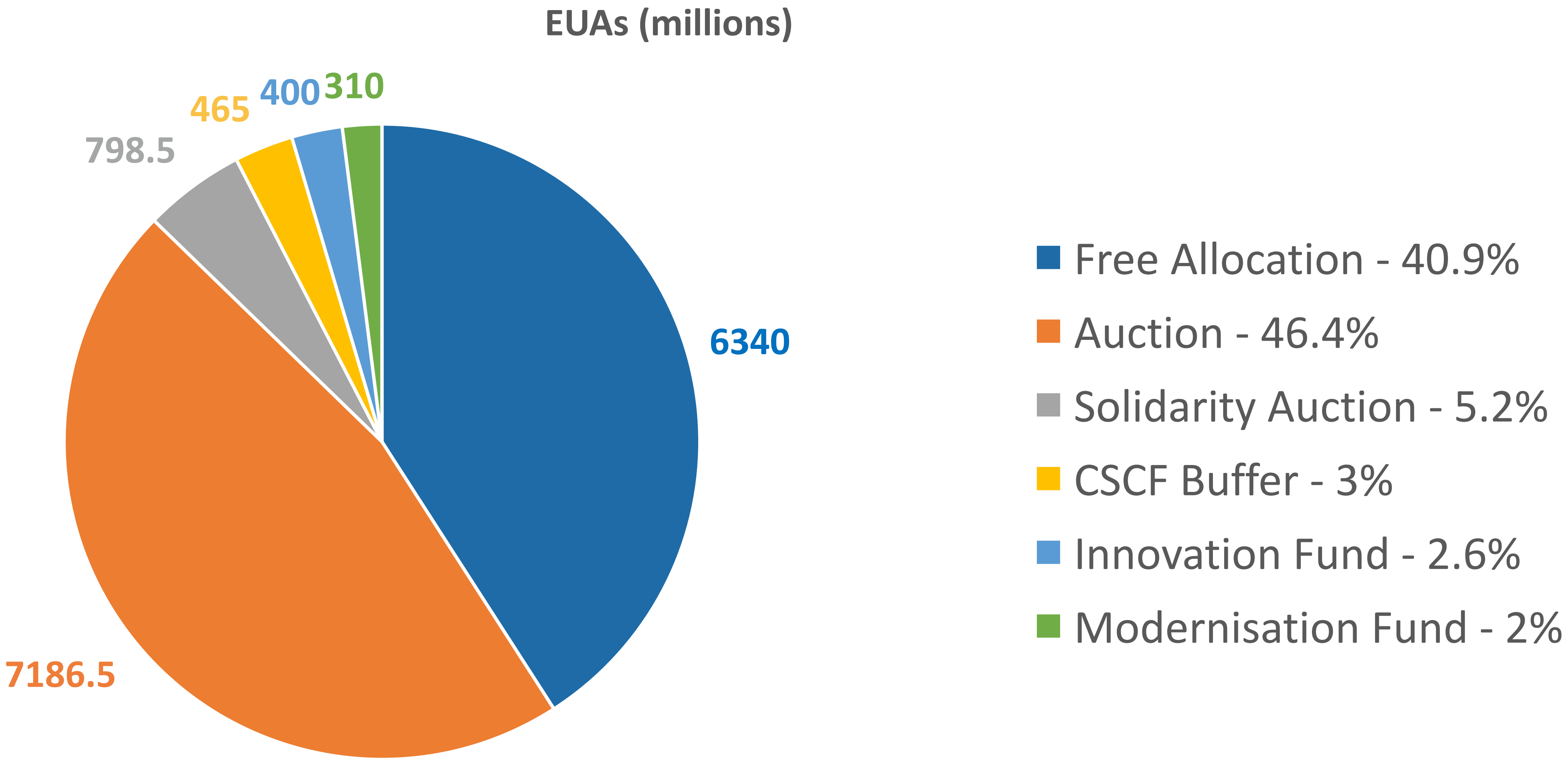
ERCST

Roundtable on Climate Change and Sustainable Transition

- **Free Allocation**: 43%
- **Auctioning**: 57%
  - 90% divided according to Member States share of verified emissions in the baseline period *(2005 or 2005-2007 average)*
  - 10% redistributed to 16 lower GDP per capita Member States
- **Buffer to avoid application of Cross-Sectoral Correction Factor**: 3%
- **Innovation Fund**: 400m allowances *(325m from free allocation, 75m from auctioning)*
  + 50m from MSR
- **Modernisation Fund**: 2%

Introduction: phase 4 revision (2018) – division

ERCST
Roundtable on Climate Change and Sustainable Transition



Introduction: phase 4 revision (2018) – use

ERCST

Roundtable on Climate Change and Sustainable Transition

- ***At least 50%*** of the revenues generated from the auctioning of allowances, or the equivalent in financial value of these revenues, should be used for **climate and energy purposes**

- Member States shall seek to use ***no more than 25%*** of the revenues generated from the auctioning of allowances for the **compensation of indirect costs**

Introduction: phase 4 revision (2018) – use

Figure 1: ETS revenue and share of climate spending in EU Member States in 2016-2018

Year	Auctioned allowances (millions)	Revenue spent on climate action (€ million)	Total revenue (€ million)	Average revenue share spent on climate per Member State[9]
2016	721	3,295	3,795	92%
2017	956	4,679	5,533	79%
2018	922	9,265	13,895	64%
SUM	2,599	17,29	23,223	79%

Source: WWF based on Member State reports

Table 6: Indirect carbon cost compensation paid out in 2019

Country	Duration of the scheme	Compensation disbursed in 2019 for indirect costs incurred in 2018 (in EUR million)	Number of beneficiaries (installations)	Auction revenue 2018 (in EUR million)[58]	Percentage of auction revenues spent on indirect cost compensation
UK[59]	2013 - 2020	22	60	1607	3.7%
DE	2013 - 2020	219	898	2565	8.5%
BE (FL)	2013 - 2020	35.9	107	379	11.4%
BE (WL)	2017 - 2020	7.5	29		
NL	2013 - 2020	40.3	92	501	8.0%
EL	2013 - 2020	16.8	50	519	3.2%
LT	2014 - 2020	0.3	1	80	0.3%
SK	2014 - 2020	6	8	229	2.6%
FR	2015 - 2020	102.1	286	818	12.4%
FI	2016 - 2020	29.1	61	250	11.6%
ES	2013 - 2015	172.2	183	1291	13.3%
LU	2018-2020	4.2	4	18	23.2%

Source: Countries' submissions to DG Climate Action

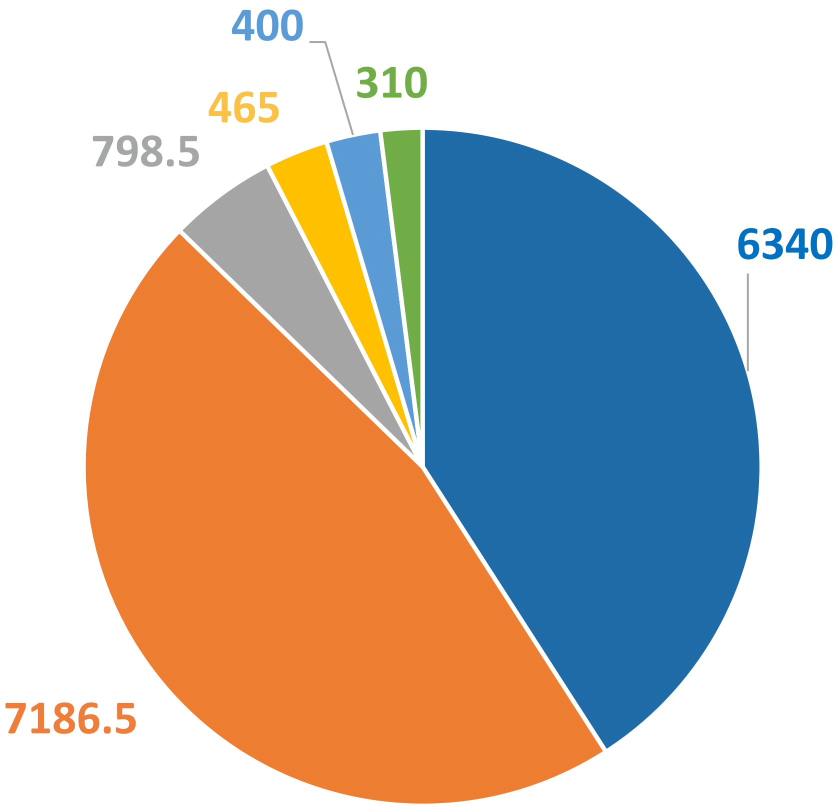
Source: European Commission

ERCST

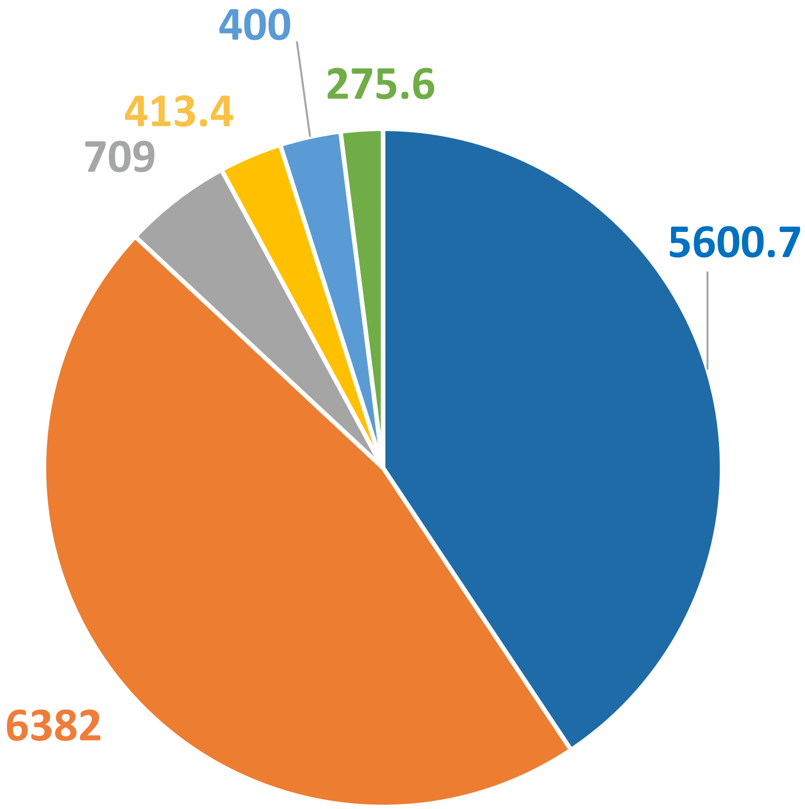
Roundtable on
Climate Change and
Sustainable Transition

Introduction: a shrinking pie…

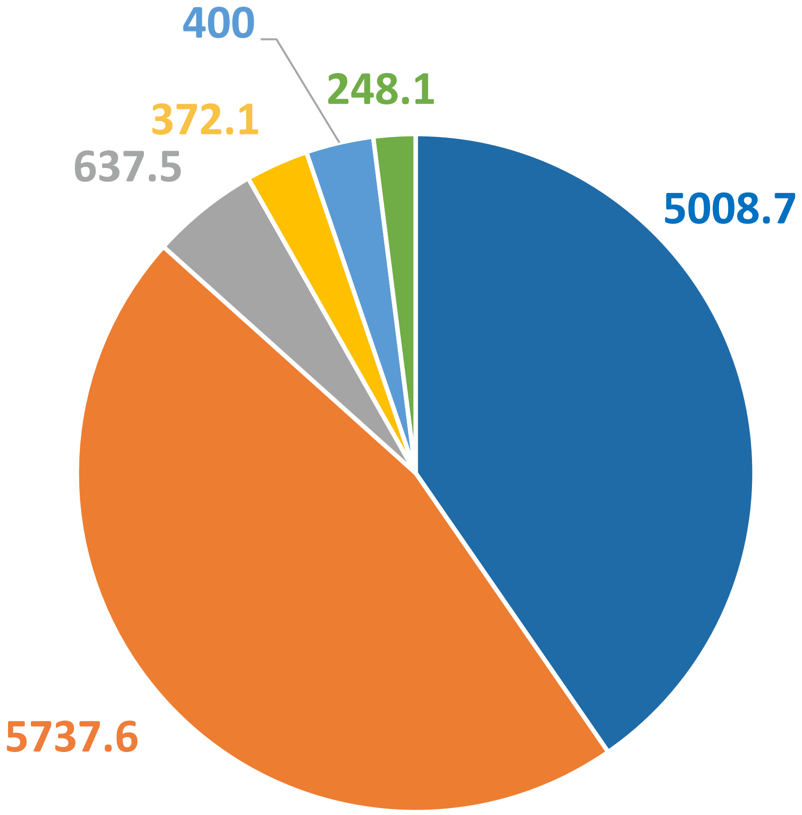
Phase 4 review
(15 500 million EUAs)



BREXIT
(13 780 million EUAs)



BREXIT + new target
(12 404 million EUAs)



<u>Source</u>: ERCST estimates based on data from the European Commission

Introduction: a shrinking pie… worth increasingly more

ERCST
Roundtable on Climate Change and Sustainable Transition

- Revenues dependent on both the quantity of EUAs and the carbon price

2030 Climate Target Plan impact assessment

	Baseline *(Current target)*	REG scenario (-55%)	MIX scenario (-55%)	CPRICE scenario (-55%)
2030 CO2 price	€ 32	€ 32	€ 44	€ 62

Source: EC 2030 Climate Target Plan – Impact Assessment

EU ETS Analysts

	April 2019 (before elections)	October 2019 (before European Green Deal)	October 2020	January 2021
Phase 4 average CO2 price	€ 30.45	€ 36.85	€ 44.5	€ 53.85

Note: Average of selected analysts' forecasts

Source: Carbon Pulse

Revision of the EU ETS: state of play regarding revenues

ERCST
Roundtable on Climate Change and Sustainable Transition

European Commission – Public Consultation

- How should ETS revenues be used?
- Are stricter rules necessary to ensure Member States spend their ETS auction revenues in line with climate objectives?
- Harmonise Indirect Costs compensation at EU level?
- Size of the Innovation Fund?
- Size of the Modernisation Fund?

European Council – December EUCO conclusions

- The new 2030 target needs to be achieved in a way that […] takes account of Member States' *different starting points* and specific *national circumstances* and *emission reduction potential* […] *as well as efforts made;*
- *addressing concerns raised in relation to the distribution of efforts, fairness and cost- effectiveness* […] ;
- The problem of *imbalances for beneficiaries of the Modernisation Fund in not receiving revenues that are equivalent to the costs paid by the ETS installations* in those Member States will be addressed as part of the upcoming legislation.

Revision of the EU ETS: state of play regarding revenues

ERCST
Roundtable on Climate Change and Sustainable Transition

European Council – December EUCO conclusions

- The problem of <u>*imbalances for beneficiaries of the Modernisation Fund in not receiving revenues that are equivalent to the costs paid by the ETS installations*</u> in those Member States will be addressed as part of the upcoming legislation.

<u>**Possible interpretation 1**</u>

→ Correct the situation where **auctioned allowances < allowances bought by ETS installations** *[verified emissions – free allocation]* for the Modernisation Fund beneficiaries

- *Relatively straightforward to calculate this 'imbalance'*
- *This imbalance only exists for 3/10 Modernisation Fund beneficiaries (based on 2017, 2018 EEA data)*

<u>**Possible interpretation 2**</u>

→ Higher targets will increase the additional investments necessary to decarbonize and comply, and more revenues should be made available for the Modernisation Fund beneficiaries

- ***Q1****: how high are the additional investment needs?*
- ***Q2:*** *what share of the investment needs should be covered by redistributing auctioned allowances?*
- ***Issue****: currently no Impact Assessment at Member State level.*

Way forward (1): increase size of Modernisation Fund

ERCST
Roundtable on Climate Change and Sustainable Transition

1) Increase size of the Modernisation Fund

- More resources for energy system and energy efficiency investments in low-income Member States
- Clear investment rules and governance

→ *Easy way forward?*

Phase 4 revision impact assessment (2014):

- additional investment needs estimated at € 8.4 billion per year due to the 2030 climate and energy framework in the 10 eligible Member States
- Modernisation Fund: revenues ranging € 2.1 – € 7.75 billion = <u>3% - 9% of the additional investment needs</u>

Q: If the Modernisation Fund is increased, should it cover a similar share of the additional investment needs?

Q: Modernisation Fund is currently divided based on <u>*2013 GDP (50%) and verified emissions (50%),*</u> is this a suitable allocation key for a potential increase in size, or should it be adapted?

Way forward (2): a new separate pool of allowances?

ERCST
Roundtable on Climate Change and Sustainable Transition

2) Part of allowances could be set aside and divided as to e.g.:

- Adjust for current ‘imbalance’ in costs vs. revenues
- Ensure % coverage of the additional investment needs
- Other elements that *could* be included in de allocation key:
  - **Efforts made?**
  - **Relative capabilities?**
- Specific spending rules could be adopted for these allowances.

Similar to Solidarity Provision

- 10% of allowances to be auctioned redistributed for “the purpose of solidarity, growth and interconnections within the Union”
- Relatively ‘complicated’ allocation key: *“The distribution of this 10 % should take into account levels of <u>income per capita in 2005</u> and the <u>growth prospects</u> of Member States, and be higher for Member States with low income levels per head and high growth prospects”.*

Way forward (3): change auctioning allocation key?

3) Change allocation key to divide auctioned allowances

The current allocation key to divide allowances to be auctioned = share of verified emissions in the baseline period *(2005 or 2005-2007 average)*

Two possible elements to change the allocation key for auctioned allowances:

1. **Exclude emissions covered by free allocation from the baseline**
    - *Would in part resolve the issue of some MS "not receiving revenues equivalent to their costs paid"*
2. **Update reference period to a more recent year**
    - *Would also better align allowances to be auctioned with verified emissions, but*
    - *Would fail to recognise efforts made and different starting points.*

ERCST

Roundtable on Climate Change and Sustainable Transition

Way forward (3): change auctioning allocation key?

Element	1) Update reference to a more recent year?	2) Discount Free Allocation for baseline emissions?
Austria		
Belgium		
Bulgaria		
Croatia		
Cyprus		
Czechia		
Denmark		
Estonia		
Finland		
France		
Germany		
Greece		
Hungary		
Ireland		
Italy		
Latvia		
Lithuania		
Luxembourg		
Malta		
Netherlands		
Poland		
Portugal		
Romania		
Slovakia		
Slovenia		
Spain		
Sweden		

Source: ERCST based on EEA data

Interpretation Member State will win/lose allowances to auction compared to the current situation in case this element is introduced in the auctioning allocation key.

Way forward (3): change auctioning allocation key?

ERCST
Roundtable on Climate Change and Sustainable Transition

Two possible elements to change the allocation key for auctioned allowances:

1. **Exclude emissions covered by free allocation**
2. **Update reference period to a more recent year**

What other elements could potentially be considered?

3. **Investment needs?**
4. **Efforts made?** *e.g. reductions in verified emissions compared to baseline period*
5. **Relative capabilities?** *e.g. GDP/capita*

All of these elements can of course be combined.

ERCST

Roundtable on Climate Change and Sustainable Transition

Way forward (3): change auctioning allocation key?

Element	4) Efforts made? *(e.g. vs current baseline)*	5) Relative capabilities? *(e.g. GDP/capita)*
Austria		
Belgium		
Bulgaria		
Croatia		
Cyprus		
Czechia		
Denmark		
Estonia		
Finland		
France		
Germany		
Greece		
Hungary		
Ireland		

Element	4) Efforts made? *(e.g. vs current baseline)*	5) Relative capabilities? *(e.g. GDP/capita)*
Italy		
Latvia		
Lithuania		
Luxembourg		
Malta		
Netherlands		
Poland		
Portugal		
Romania		
Slovakia		
Slovenia		
Spain		
Sweden		

Source: ERCST based on EEA and Eurostat data

Interpretation Member State will win/lose allowances to auction compared to the current situation in case this element is introduced in the auctioning allocation key.

Way forward (3): change auctioning allocation key?

ERCST
Roundtable on Climate Change and Sustainable Transition

Two possible elements to consider in updated allocation key:

1. **Exclude emissions covered by free allocation**
2. **Update reference period to a more recent year**

What other elements could potentially be considered?

3. **Efforts made?** *e.g. reductions in verified emissions compared to baseline period*
4. **Relative capabilities?** *e.g. GDP/capita*
5. **Investment needs?**

<u>Questions for discussion</u>:

- Which elements should be taken into account in dividing auctioning revenues between Member States?
- How to best change relative allocation between member states: through dedicated funds (e.g. Modernisation Fund), a new pool of allowances, through adapting the auctioning allocation key, or a combination of these options?

Use of revenues: trade-offs between options

ERCST

Roundtable on Climate Change and Sustainable Transition

Many options are being considered – inevitable trade-offs between objectives:

- Stricter rules to ensure that Member States spend their auctioning revenues in line with climate objectives;
- Ensure compensation for indirect costs, which are expected to increase in the short to medium term as EUA prices increase;
- Additional money for low-carbon support mechanisms (e.g. innovation fund)
- Auctioning revenues as a future ‘own resource’ for the European Union

Other options?

<u>Question for discussion</u>:

- Where should the priorities be in terms of using revenues?

Preparing for the review of the EU ETS

Division and use of revenues + reflecting on December EUCO conclusions

This meeting is under Chatham House Rules

21 January, 2021

Andrei Marcu, ERCST
Jean-Yves Caneill, ERCST
Domien Vangenechten, ERCST

ERCST

Roundtable on Climate Change and Sustainable Transition