



# Preparing for the review of the EU ETS

*The plan to decarbonise industry  
while protecting against the risk of carbon leakage*

**10 March 2021**

**Andrei Marcu, ERCST**  
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**ERCST**

Roundtable on  
Climate Change and  
Sustainable Transition

# ERCST – revision of EU ETS work

- Accompany the Commission’s process: stakeholder meetings on a regular basis and provide inputs for the debate through (position) papers
- Organise activities on some of the core topics/issues that are important in light of the ETS revision:
  - **29 September 2020** – [the EU ETS in the Commission’s 2030 climate target plan](#)
  - **23 November 2020** – [Stakeholder views on the Commission’s Inception Impact Assessment](#)
  - **16 December 2020** - [Dealing with supply-demand imbalance, including the review of the Market Stability Reserve](#)
  - **21 January 2021** – [division and use of auctioning revenues + reflecting on the December EUCO decisions](#)
  - **28 January 2021** – [Public consultation for the review of the EU ETS](#)

# ERCST – revision of EU ETS work

## Recent papers and policy contributions:

- **June 2020** – [The EU ETS Market Stability Reserve: Coping with COVID-19 and preparing for the review](#)
- **November 2020** – [the role of the EU ETS funding mechanisms in financing the European Green Deal](#)
- **November 2020** – [Feedback to the Commission's Inception Impact Assessment](#)
- **February 2021** – [ERCST's response to the Commission's public consultation](#)
- **February 2021** – [Division and use of revenues in Phase 4 of the EU ETS - options to operationalise the December 2020 EUCO conclusions](#)
- **February 2021** – [Addressing the supply-demand imbalance in the EU ETS through the Market Stability Reserve](#)

# Background

## European Green Deal

- “Achieving a climate neutral and circular economy requires the full mobilisation of industry. It takes 25 years – a generation – to transform an industrial sector and all the value chains. **To be ready in 2050, decisions and actions need to be taken in the next five years.**”
- “EU industry needs ‘climate and resource frontrunners’ to **develop the first commercial applications of breakthrough technologies** in key industrial sectors by 2030.”

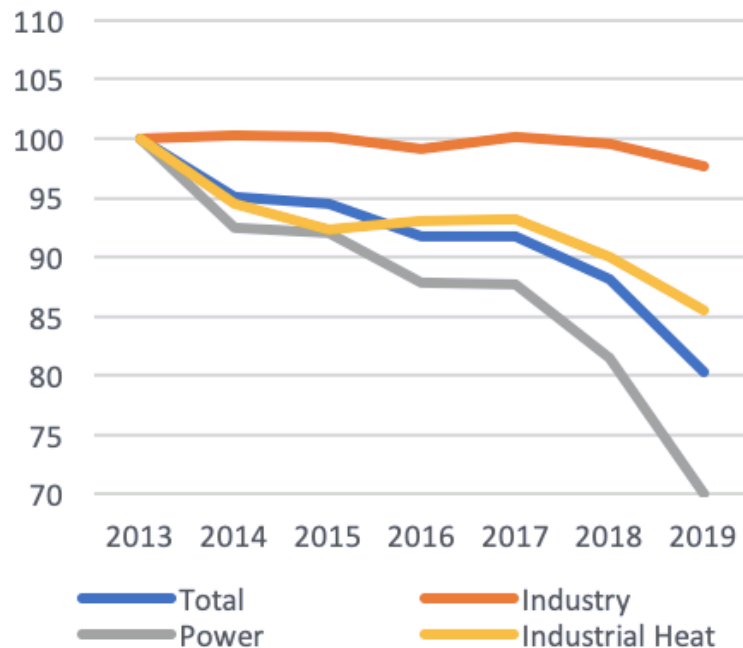
## 2020 Industrial Strategy

- “The European Green Deal is Europe’s **new growth strategy**. At the heart of it is the goal of becoming the world’s first climate-neutral continent by 2050.”
- “All relevant players should work together to **create lead markets in clean technologies** and ensure our industry is a global frontrunner.”

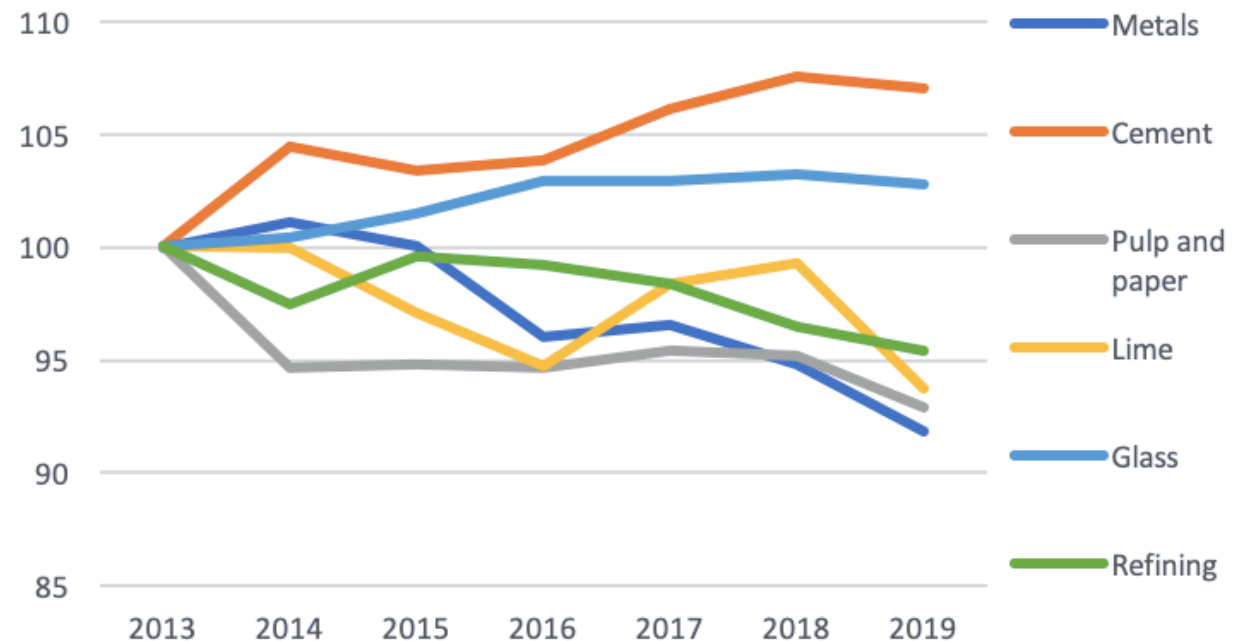
# Industrial decarbonisation: track record

Industry has reduced its emissions by over 30% since 1990, and over 20% since 2004. However, emissions have mostly **stagnated since 2013** (*at least until 2018*)

Index of emissions



Index of emissions for selected industrial sectors



## Average yearly emissions reductions since 2013:

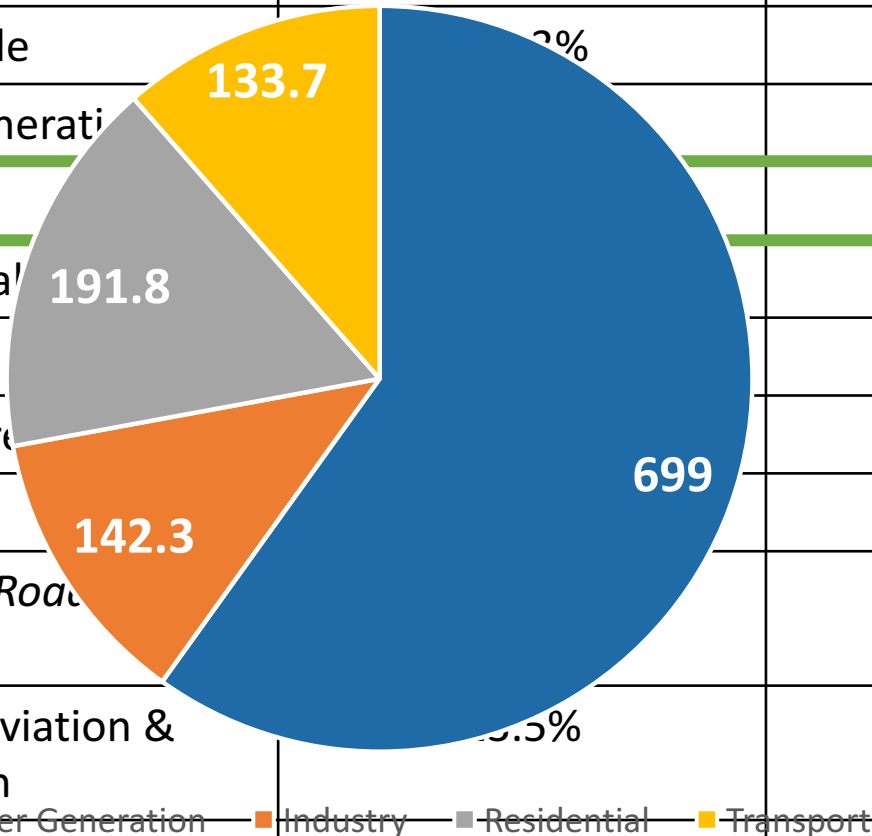
Power: - 5.6% // Industrial heat: -2.5% // Industry: -0.4%

Source: 2020 State of the EU ETS Report

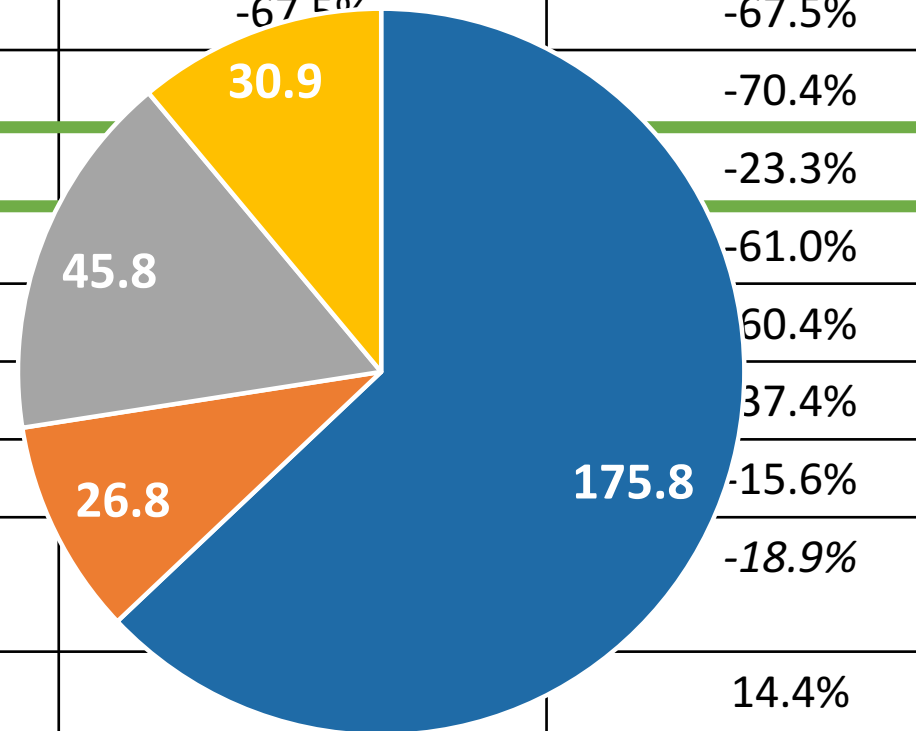
# Industry in the 2030 Climate Target Plan

	BSL (baseline)	REG	MIX	CPRICE
<b>% change 2030 GHG emissions versus 2015</b>				
<b>Additional efforts under European Green Deal</b>				
CO2 emissions	-32.7%	-42.7%	-42.6%	-42.6%
Supply side	-32.7%	-67.3%	-67.5%	-67.5%
Power generation	-32.7%	-69.6%	-70.4%	-70.4%
<b>Industry</b>	<b>-21.0%</b>	<b>-21.0%</b>	<b>-23.3%</b>	<b>-23.3%</b>
Residential	-63.6%	-63.6%	-61.0%	-61.0%
Services	-53.5%	-53.5%	-60.4%	-60.4%
Agriculture	-37.0%	-37.0%	-37.4%	-37.4%
Transport	-17.6%	-17.6%	-15.6%	-15.6%
Of which Road Transport	-20.7%	-20.7%	-18.9%	-18.9%
Intra EU aviation & navigation	11.6%	11.6%	14.4%	14.4%
Non-CO2 emissions	-22.3%	-31.0%	-31.0%	-31.0%

GHG reductions vs. 2015 (mt CO2e)



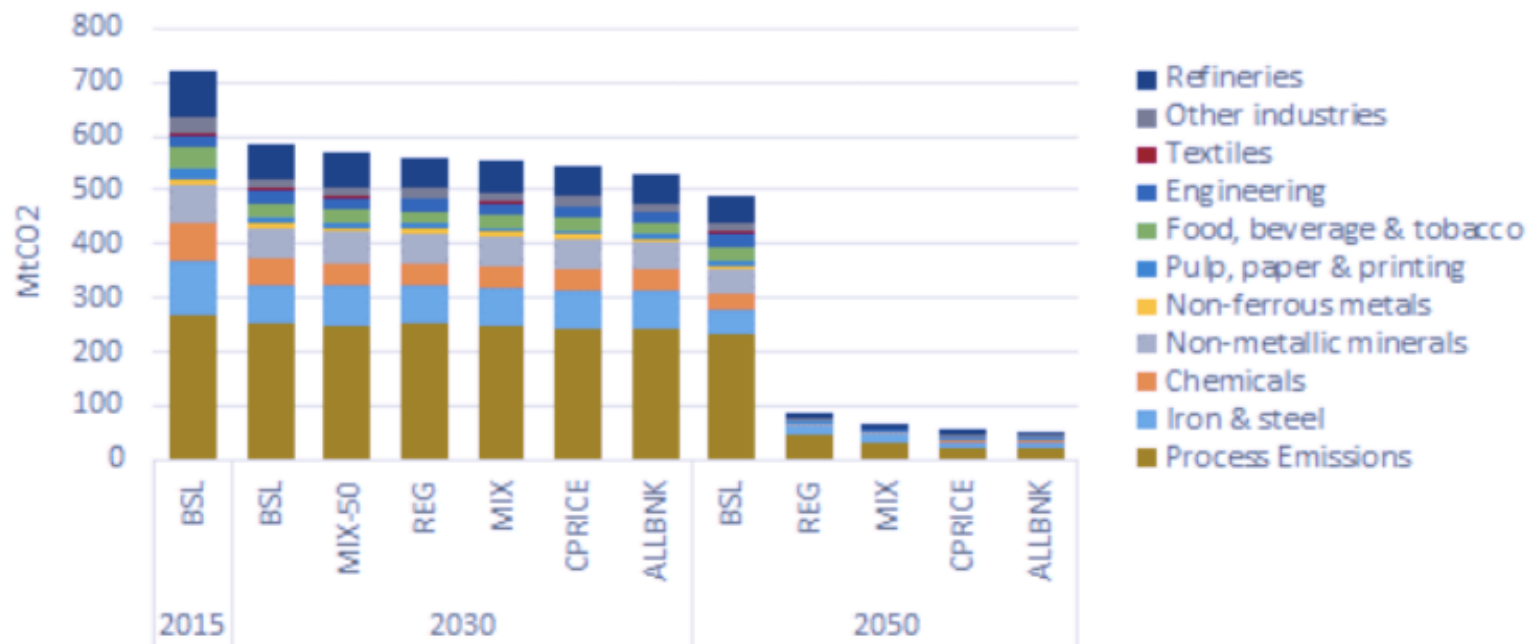
Additional efforts under European Green Deal



# Industry in the 2030 Climate Target Plan

- According to the impact assessment, the necessary reductions by 2030 can be achieved through further adopting more energy efficient processes, and through fuel switching (from fossil fuels to electricity/biomass)
- However, this would not put industry on the right trajectory towards 2050

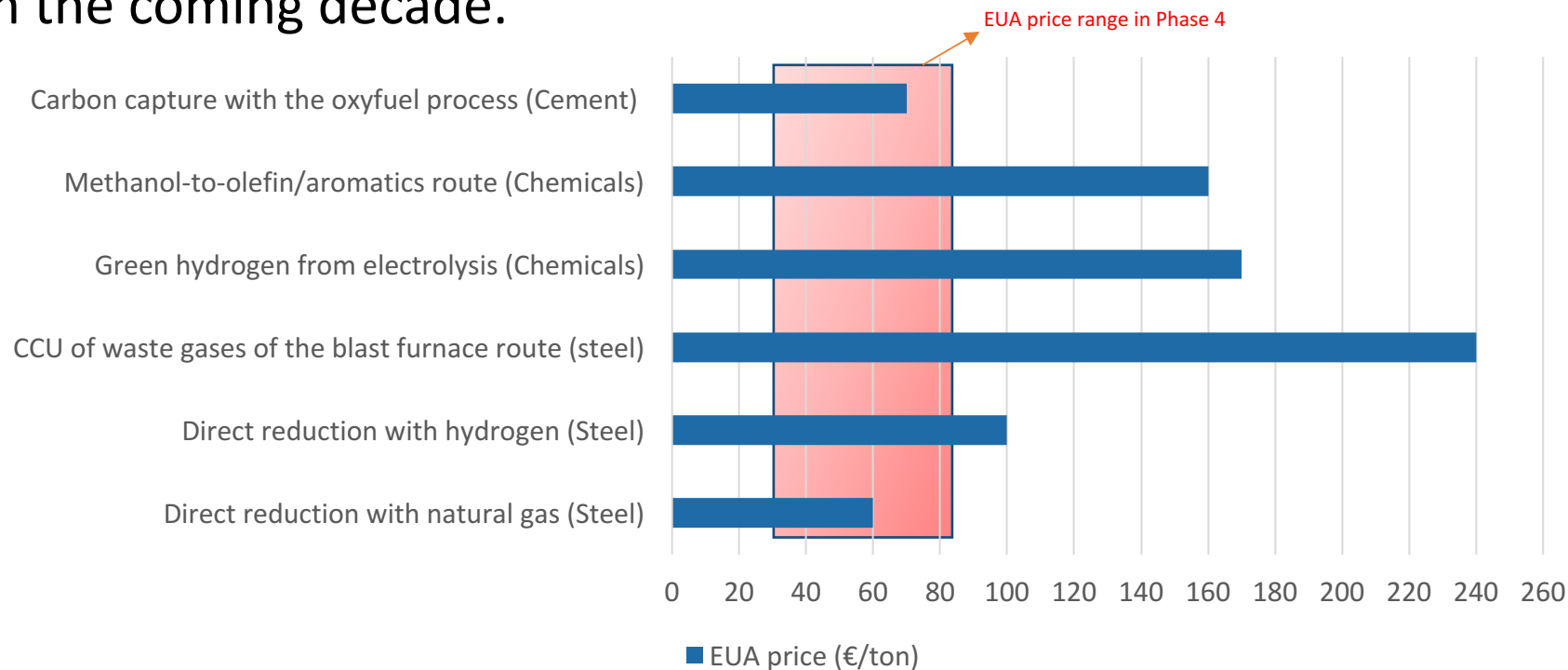
Figure 65: CO<sub>2</sub> emissions in industry by sector and type (sectoral emissions refer to energy-related emissions)



Source: Commission impact assessment accompanying the 2030 climate target plan communication

# Industry: preparing for 2050

- To prepare for 2050 and ensure the uptake of breakthrough low-carbon technologies after 2030, the economic and technical feasibility of these technologies has to be proven at scale in the coming years.
- While the carbon price plays an important factor, it will not reach the levels necessary to do this in the coming decade.





## Industry: preparing for 2050

- Not only the carbon price level, but also its uncertainty impacts investment decisions
- Other crucial elements include: mobilizing necessary investments; availability of clean energy; energy prices; uptake of low-carbon products, etc.
- What will be the policy toolbox to help start deploying these low-carbon technologies in the coming decade? Both ‘pull’ and ‘push’ policies necessary, and many being discussed:
  - EU ETS Innovation Fund;
  - Carbon Contracts for Difference;
  - Consumption Charge;
  - Labels and standards;
  - Public procurement;
  - Infrastructure;
  - Etc.

**What should be part of this *policy toolbox* for industry in the coming decade(s), and how does the EU ETS fit in?**

# The future of carbon leakage protection

- As long as climate change policies continue to be asymmetrical, the risk of carbon leakage will persist.
  - So far, this risk has been mitigated through the system of free allocation and monetary compensation of indirect costs
  - **The use of free allocation is facing pressure from multiple fronts:**
    - It mutes the carbon price signal going through the value chain;
    - It has lead to windfall profits due to inflexible rules as well and passing-through of carbon costs;
    - Not being sustainable in the long-run under current rules: at some point in the (near) future, there will not be sufficient free allocation available as the cap continues to go down → application of CSCF
    - Other countries are also undertaking climate action – comparability of efforts required (how?)
- Simultaneous efforts to better target current carbon leakage protection and design alternatives (CBAM)

Design and implementation of alternatives will take time and not happen instantaneous: free allocation is here to stay in the near to mid term?

# The future of carbon leakage protection: Free allocation

## Changes introduced in the 2018 review:

- Update of the carbon leakage assessment and list;
- Update of the benchmarks based on past improvement rates (+ mid-phase update);
- Free allocation more in line with production changes (>15%)

## What additional changes, if any, are needed?

- EC Public Consultation:
  - Share of Free Allocation vs. Auctioning;
  - ‘revised definition of product benchmarks to incentivize innovation’?;
  - Better target Free Allocation – E.g. Court of auditors recommendations (2020):
    - Take into account sectors’ ability to pass through costs?
    - Tiered approach for free allocation based on relative risk of carbon leakage?
- Ex-post correction to ensure free allocation is in line with output changes?
- ...

# The future of carbon leakage protection: Indirect costs

## Different story than free allocation

- Decentralized approach: at Member States' discretion
- Decreasing aid intensity: no/limits overcompensation

## Phase 4 changes:

- 75% aid intensity for the entire period
  - Additional compensation possible if indirect costs > 1.5% of GVA = effectively a tiered approach
- Compensation based on actual output
- Conditionality to meet certain requirement for covered entities

### Start of P3 situation (5 MS)

- ETS Emissions : 53.6%
- Electricity use by industry: 47%

### End of P3 situation (14 MS)

- ETS Emissions : 83.9%
- Electricity use by industry: 73.6%

*Source: ERCST  
based on Eurostat  
and EU TL, 2021*

## What additional changes, if any, need to be introduced?

- Harmonized approach at EU level?
- (Additional) conditionalities to use compensation received for certain purposes?
- Higher/lower aid intensity?



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