EU ETS: fit for 55?

June 8, 2021

Andrei Marcu, ERCST Director
Stefano Cabras, ERCST

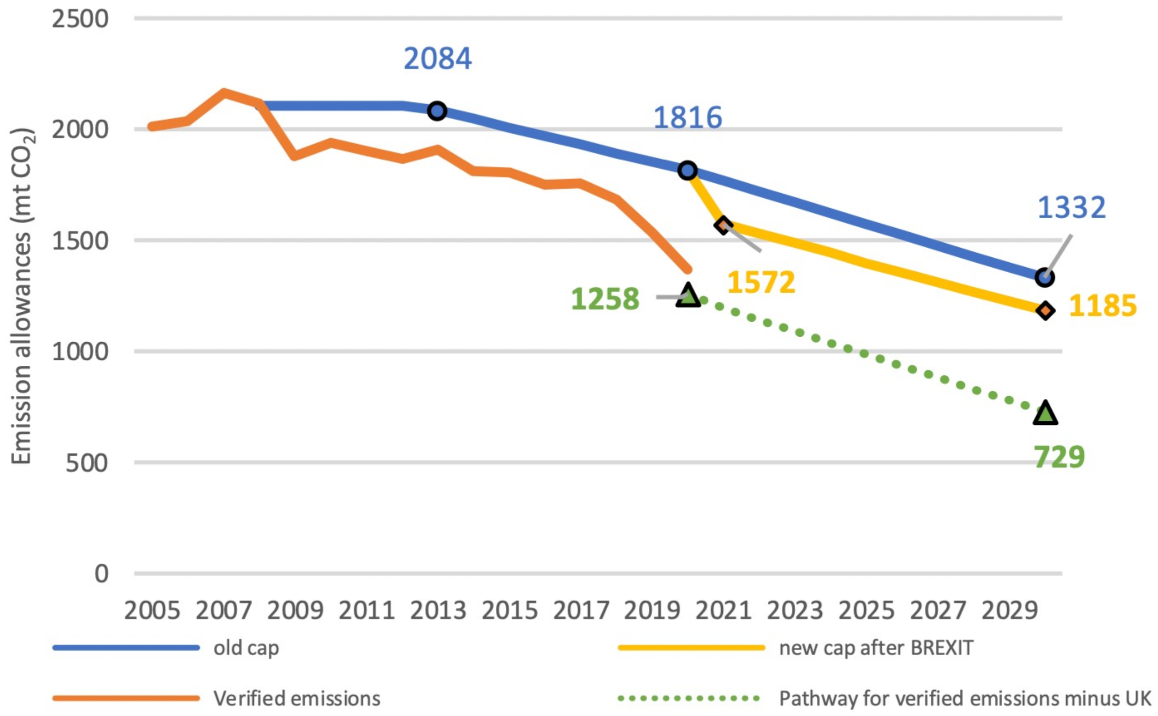
ERCST

Roundtable on
Climate Change and
Sustainable Transition

Setting the scene for the ETS Review

- ETS needs a **significant leap forward in ambition** to achieve a target coherent with -55%
- ETS sectors are expected to reduce their emissions by 62% (42.2% so far)
- Under the EGD, ETS must deliver **67.5% of the additional emissions reductions by 2030**

Pathway required for verified emissions to reach an increased 2030 target



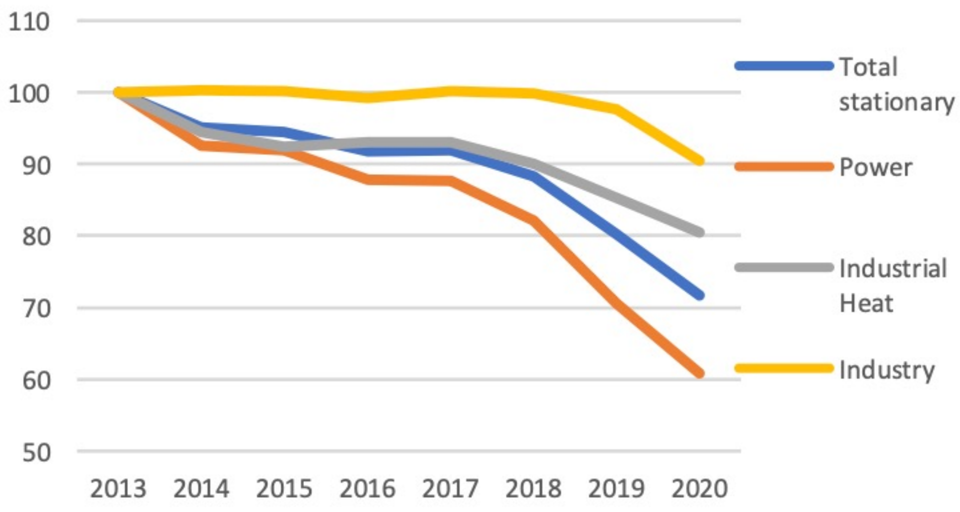
To achieve the target, ETS emissions need to decline by 2.65% per year

Source: *2021 State of the EU ETS Report*

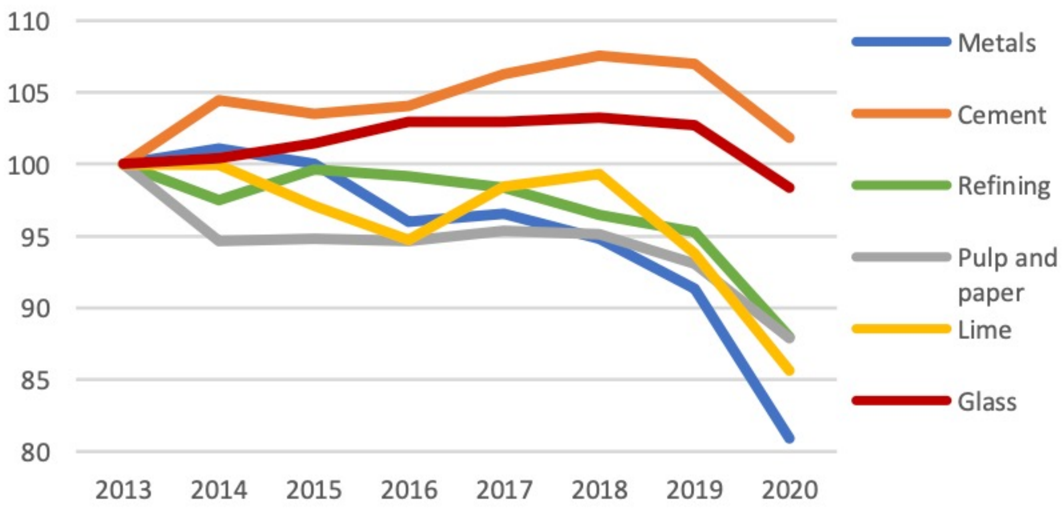
Navigating uncharted waters

- ETS: **from a tool to decarbonize power to a tool to decarbonize industry**?
- ETS has reduced its emissions by 42.2% vs 2005
- 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 verified emissions



Index of verified emissions for selected industrial sectors



Average yearly emissions reductions since 2013:
Power: - 5.6% // Industrial heat: -2.8% // Industry: -1.4%

Source: *2021 State of the EU ETS Report*

Known Unknowns

ERCST
Roundtable on Climate Change and Sustainable Transition

- *The balance of power* in the ETS will change
- **Industry will likely become a key GHG price driver**
- Utility hedging declines while industry hedging is expected to increase.
- What will the overall impact be? What about CBAM? Increase financial investors’ market participation?
- **A complex and shifting environment**: The review must take a holistic approach and consider how the various components of the ETS interact with each other and with the other pieces of the EU climate legislation.

Industry, Competitiveness and Carbon Leakage

ERCST

Roundtable on Climate Change and Sustainable Transition

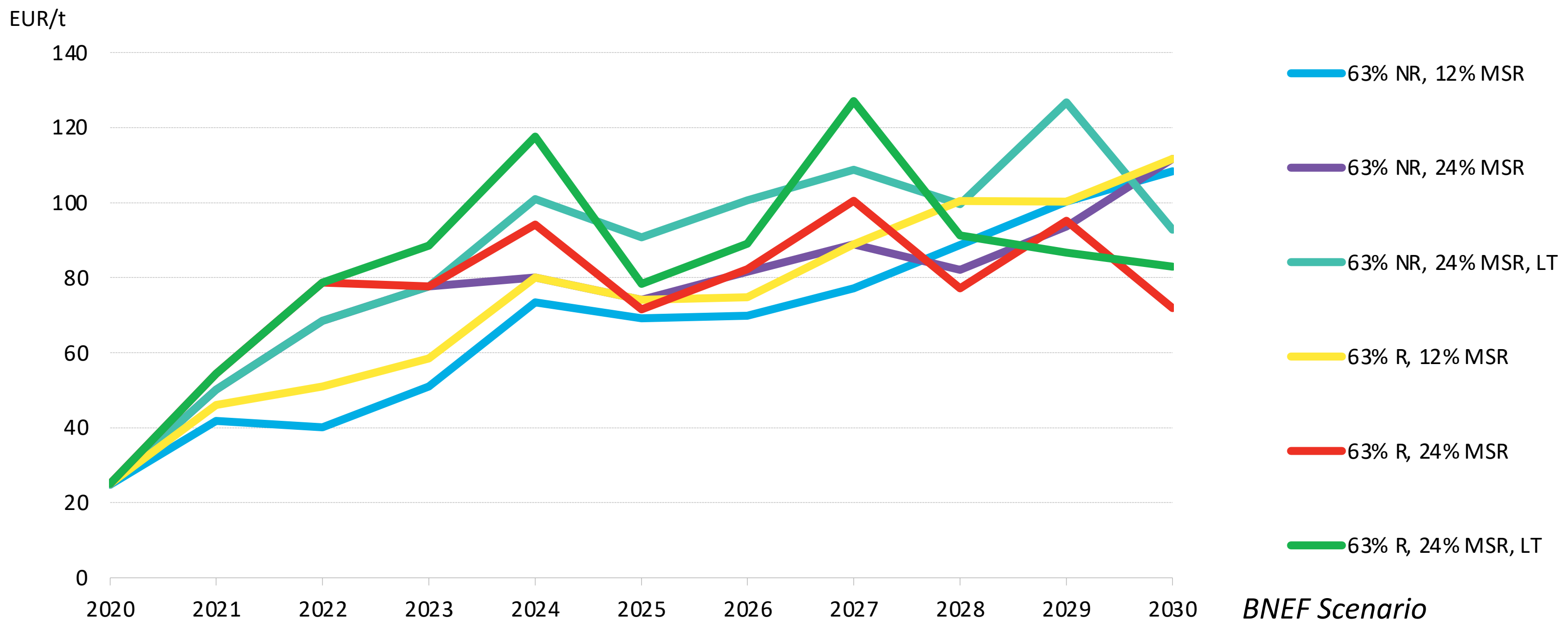
How to make sure that a strengthened ETS does not hamper the competitiveness of the EU industry? What should be the future of the free allocation regime and its relationship with CBAM?

- ETS review strictly intertwined with the issue of **preserving the competitiveness of EU manufacturing while enhancing the bloc's climate ambitions**
- ETS parameters should as much consistent as possible with a smooth and predictable carbon prices trajectory.
- CAP rebase in 2023 and then lower LRF?
- What will the **relationship between CBAM and Free Allocation be**? Can the two be complementary?
- How will the international political environment affect a EU CBAM?

The MSR Review

What should be the priorities when setting the new MSR parameters? What adjustments, if any, should be made in the TNAC calculation? What other issues need to be considered?

- 12% post-2024 MSR intake rate seems to involve a more gradual and steady increase of prices
- How will changes in hedging behaviour affect the functioning of the MSR?
- Does **TNAC** risk to trigger procyclical intakes?
- **Aviation** in TNAC calculations?
- More **flexibility?**



BNEF Scenario

ETS Extension

Is an extension of carbon pricing to new sectors appropriate? Are maritime, road transport and buildings the right sectors to extend carbon pricing? What the modalities of this extension should be?

- Eu Commission proposal for a review of the EU ETS is likely to propose an **extension of carbon pricing to three non-ETS sectors, notably maritime, road transport and buildings**
- Transports and Buildings have **higher abatement costs and lower price elasticity**
- What's the **impact on EUA prices and on existing ETS sectors**?
- **Social equity** and **energy poverty concerns** are important
- What role for complementary policies and ETS revenues recycling?
- Would a separate ETS be a desirable transitory solution?

Flexibility

ERCST

Roundtable on
Climate Change and
Sustainable Transition

In light of the increasing tightness of the EU carbon market, should the Commission provide actors with more flexibility when fulfilling their ETS obligations? Can international carbon credits, domestic offsets under Art 24a and negative emissions play a role?

- Commission has **excluded the use of internatinal carbon credits for ETS compliance after 2020**
- However, as the CAP radidly decreases, **installations might need more flexibility to comply with their ETS obligations**
- A robust **oversight mechanism** should be created to check additionality and perform quality controls
- International credits would also contribute to the implementation of those *cooperative approaches* outlined in **article 6 of the Paris Agreement**
- Can negative emissions play a role?

Indirect Costs

ERCST

Roundtable on
Climate Change and
Sustainable Transition

As electrification is promoted as key, indirect ETS costs will become increasingly important in the transition. Should the system of indirect cost compensation be harmonized at the EU level ?

- **Indirect costs compensation is a growing source of revenues demand**
- As electricity prices are set at the margin and the EUA price continues to increase**, indirect costs will continue to rise until most of the EU's electricity is produced by renewables**
- The current **unharmonized approach** could create **distortions in the single market**
- **Intra-EU leakage** could become an increasingly important issue

ERCST

Roundtable on
Climate Change and
Sustainable Transition

Other Issues

- **Carbon Contracts for Differences** (CCfDs) and impact on market functioning
- **Scope 3** emissions
- Relation with **other EU legislations**