

ERCST's response to the European Commission's public consultation for the review of the EU Emissions Trading System (EU ETS)

5 February 2021

The European Roundtable on Climate Change and Sustainable Transition (ERCST) welcomes the opportunity to provide feedback on the European Commission's **public consultation for the Revision of the EU Emissions Trading System (EU ETS)**.

In its [feedback to the Inception Impact Assessment](#) for the review, ERCST put forward 6 issues that are important to be assessed and addressed in the upcoming review:

1. Write a story for the decarbonisation of industry, incl. carbon leakage protection;
2. Address EU ETS policy overlap and supply-demand imbalance, incl. through the MSR and cap review;
3. Assess how to price carbon in other sectors and assess the articulation between ETS, ETD, CBAM and other instruments;
4. Assess the use of flexibility mechanisms such as domestic and international offsets;
5. Assess division and use of auctioning revenues; and
6. Ensure long-term visibility and predictability for market participants.

In light of these 6 elements, ERCST wishes to highlight a few key messages for each part of the questionnaire. Attached to this position paper are ERCST's responses to the questionnaire, including a short 'rationale' for some of the answers given.

A. The Contribution of the EU ETS to the overall climate ambition for 2030

ERCST supports the European Green Deal and the overall ambition of an at least 55% GHG reduction target by 2030. In principle, we are supportive of setting targets based on cost-efficiency considerations, and using cost-efficient policy tools to reach these targets. While the Impact Assessment is a good basis for an informed discussion on the target, transparency on the cost assumptions and data used should be increased.

Other considerations next to cost-efficiency also need to be considered, including the sustainability of the speed of decarbonisation, carbon leakage concerns and distributional impact considerations. For example, a -63% target would result in a Linear Reduction Factor leading to a net-zero target for the current ETS sectors by the late 2030s / early 2040s (depending on other design elements) - well ahead of the EUs net-zero target of 2050.

ERCST also believes that the level of ambition in any carbon market should be set through the overall target and through the yearly decreasing cap on emissions, the Linear Reduction Factor (LRF). This approach is the most transparent for both market participants and other stakeholders, and allows for a clear public debate.

A one-off reduction in combination with a strengthened LRF could also be considered. A well-designed rebase has the potential to improve other elements of the EU ETS (e.g. allowing for a more gradual reduction in emissions and slowing the build-up of oversupply in the market throughout Phase 4). However, interactions with other issues such as the availability of free allocation and the intake of the MSR should be carefully considered and assessed.

While the combination of the functioning of the MSR with the automatic invalidation mechanism can de facto decrease the overall ambition (reduce the overall budget) of the EU ETS, ERCST does not think this to be a good way forward as it would increase ambition in a non-transparent way ‘through the backdoor’, and through playing with the parameters of a mechanism that was never intended to increase the ambition of the EU ETS. Indeed, the MSR was created, as outlined in its objectives, to manage structural existing market imbalances, as well as future imbalances.

B. Addressing the risk of carbon leakage

Protecting European industry that is facing a genuine risk of carbon leakage should be a core objective of the EU ETS review. However, ERCST recognises that the current system of free allocation and indirect costs compensation is not sustainable in the long-term, as there will not be sufficient free allocation available to cover the needs of industry, and thus welcomes the Commission’s work in searching for alternatives, including through carbon adjustments at the border, such as designing a Carbon Border Adjustment Measure. A comparison of the effectiveness of the current measures vs. a CBAM should be assessed, as well as the implications of a potential transition from one measure to the other.

In the meantime, assurance of protection through free allocation and indirect costs compensation is necessary and might even need to be continued depending on the design of a CBAM. The application of the Cross-Sectoral Correction Factor (CSCF) should be avoided or at least minimized.

ERCST believes that support should be as targeted as possible and amounts of free allocation received by installations should mirror their activity level changes as close as possible.

C. An increasing role for emissions trading

ERCST believes that putting a price on carbon can be an important part of the toolbox to decarbonise any sector. It is however not the only tool, and other supply- and demand-side policy tools need to be developed or maintained to address other barriers to the

decarbonisation of these sectors, as well as address concerns regarding distributional impacts.

While ERCST recognises the benefits of the inclusion of additional sectors to the EU ETS, such as increased economic efficiency, reduction of overall costs and increased liquidity, we believe that the risks of immediately integrating these sectors in the current EU ETS would outweigh the potential benefits.

If the EU wants to accelerate emission reductions in other sectors, ERCST would support a cautious and stepwise approach in which a separate ETS is first developed for other sectors, ensuring similarities in key design elements such as MRV and required pace of emission reductions, followed by a phase where flexibilities are gradually introduced between both systems, ultimately striving for an integration of both systems.

D. Extension to Maritime greenhouse gas emissions

Similar to aviation, maritime emissions are a complex issue given the international nature of both the activity itself, as well current efforts to reduce emissions. While ERCST is an advocate of an international mechanism to address maritime emissions, we support its integration in the EU ETS given the lack of action and progress currently observed at the international level.

ERCST supports the full-scope integration of maritime GHG emissions in line with the current EU MRV system, including non-CO2 emissions, which are becoming increasingly important.

Given the international sensitivity of the issue, and potential for international repercussions similar to what happened to the inclusion of international aviation, limiting the application of the EU ETS to 50% of both the incoming and the outgoing journeys would seem a possible solution.

E. Market stability

The main objectives of the MSR are outlined in the Decision, and ERCST understands the goals to be the following:

- Eliminate the historical structural supply-demand imbalance within a reasonable amount of time;
- Bring the TNAC within range of the MSR thresholds in case of new events within a reasonable amount of time.

ERCST believes that MSR has worked well so far but that improvements are necessary. For example, the current intake rate is insufficient to ensure a balanced market within a reasonable amount of time. At the same time, thresholds should be made dynamic and dependent on changing hedging behaviour of all market participants.

It has to be noted that both the backloading decision and MSR were initially presented by the regulators as a measure that would initially take out, but ultimately return allowances to the market. However, the 2018 review introduced the invalidation mechanism, permanently invalidating allowances, and thus contradicting this initial presentation.

In ERCST's view, the MSR is wrongfully being seen by some stakeholders as a tool to increase ambition.

However, a case could certainly be made that when a significant number of allowances accumulate in the MSR over time, together with a consistent increase in the TNAC, should the absorption power of the MSR not match the decrease in demand. This is certainly a legitimate reason to examine the amounts in the TNAC and in the MSR and potentially take action. However, such an examination should not be undertaken without understanding its origins and causes, as well as determine how to best treat it. A regular, qualitative assessment is emerging as an appropriate approach.

Lastly, ERCST supports the inclusion of aviation in the calculation of the TNAC. Aviation is a source of demand for EUAs which impacts the actual availability of allowances on the market. Given that aviation has consistently been 'short' and is expected to remain so in the future, the TNAC as it is currently defined will increasingly be a less accurate indicator of the actual surplus of the market.

F. Revenues

Though economic theory indicates that using auctioning revenues to lowering labour taxation would have the best GDP impacts, ERCST believes that ETS revenues should be recycled in order to speed up the transition and help alleviate the distributional impacts associated with its functioning, in order to ensure a sustainable transition and increase support for the policy instrument. This can either be done through increasing the funding available for dedicated funds or by ensuring that Member States spend their revenues in line with these objectives.

G. Low-carbon support mechanics

In order to help EU industry decarbonise, a coherent ‘story’ needs to be written outlining the policies and supporting tools that will be introduced to ensure this, and what role the EU ETS has to play in this story. Low-carbon support mechanisms can be an important element in the toolbox to reach this objective and help create a market for low-carbon products.

ERCST fully supports an increase in the resources available in the Innovation Fund, and believes that using part of the revenues from a future CBAM to achieve this may be a solution. The large interest of project developers during the first call for proposals for the Innovation Fund shows that the willingness and capabilities are there, but support is necessary. Additional support mechanisms and innovative financing tools, such as carbon contracts for difference, should be explored as well.

At the same time, the amount of support available to finance investments in lower-income Member States should be enhanced as well. Additional investment needs will rise as the EU increases its ambition, and it is important to show solidarity and help those Member States with lower capabilities and different starting points in their energy systems to decarbonise.

Lastly, ERCST wants to highlight two elements that are missing from the public consultation:

1. Flexibility and negative emissions

It is a missed opportunity that the public consultation (as well as the IIA) does not look into the possibility of using flexibility mechanisms in the EU ETS, nor assess the role of EU ETS sectors to drive the deployment of negative emissions technologies.

ERCST supports an assessment of the possible benefits and limitations to the use of flexibility mechanisms, both through international and domestic offsets. Several motives in favour of introducing such flexibility exist, including increasing overall efficiency, addressing competitive concerns due to increasing EUA prices, or increasing liquidity as the cap continues to tighten, thus ensuring proper market functioning.

The use of international offsets is a contentious issue with some given the mixed views about the Clean Development Mechanism. However, the Paris Agreement world is a new world. Article 6, which is still being negotiated, could be a game changer, potentially alleviating many of the concerns stakeholders currently have.

The EU should develop a clear vision, strategy as well as a clear roadmap on future linkages with other ETS schemes.

Lastly, the potential benefits from allowing for domestic offsets, as is captured in Article 24a of the Directive, should also be assessed. Domestic offsets' have similar benefits as international, while not being detrimental to achieving the EU's overall GHG reduction targets, which are entirely domestic. Moreover, they can create demand for deploying vital technologies such as negative emissions.

Domestic offsets need to be also seen in the context decarbonising companies' value chains, as we witness increasing demands for reduction of Scope 3 emissions, as well as the management of the relationship between regulatory and voluntary obligations, regulatory and voluntary markets as well as the repartition of efforts between ETS and ESR.

A long-term vision is necessary for the use of flexibilities in the ETS, and ERCST calls upon the European Commission to assess their potential benefits in the upcoming impact assessment.

2. Long term considerations

Nothing in the public consultations seems to point to that the revision will take into consideration the post-2030 time-period, includes assessing the long-term supply-demand balance. Compliance actors and other market participants have little information as to the post-2030 cap and envisaged role of the EU ETS in decarbonising the EU's economy, hampering their ability to make long-term investment decisions.

On the short term there also exists a lot of uncertainty and lack of predictability for market participants. As a case in point, while it was recently announced that free allocation for 2021 will be delayed due to the fact that the update of the benchmarks was not yet finalised, the IIA raises the possibility to have another revision of those benchmarks in Phase 4.

This uncertainty for compliance actors caused by continuous regulatory changes should be addressed. Taking a longer-term perspective in the revision of the EU ETS, including an explicit target beyond 2030, could be part of the solution.

A. The Contribution of the EU ETS to the overall climate ambition for 2030

1. With the increased 2030 GHG reduction ambition of at least 55%, what should be the current EU ETS sectors' contribution to the increased 2030 target (i.e. without the accounting for the possible inclusion of new sectors)?

- The current ETS sectors should increase their current ETS contribution (compared to 2005) in line with the new target. Based on cost-efficiency considerations as calculated in the Impact Assessment accompanying the Communication on stepping up the EU's 2030 climate ambition ([table 26](#)), the current ETS sectors should contribute around -63% compared to 2005
- The contribution of the current ETS sectors should be more than what their potential for cost-efficient emissions reductions would indicate
- The contribution of the current ETS sectors should be more than 43% reductions (compared to 2005) but less than what their potential for cost-effective emissions reductions would indicate
- Other

Rationale/comments

- In principle, ERCST is supportive of setting targets using cost-efficiency considerations, and using cost-efficient policy tools to reach these targets.
- While the Impact Assessment is a good basis for an informed discussion on the target, transparency on the cost assumptions and data used should be increased.
- Other considerations next to cost-efficiency also need to be considered, including the sustainability of the speed of decarbonisation, carbon leakage concerns and distributional impact considerations.
 - For example, a -63% target would result in a Linear Reduction Factor leading to a net-zero target for the current ETS sectors by the late 2030s / early 2040s (depending on other design elements) - well ahead of the EUs net-zero target of 2050.

2. A strengthened EU ETS 2030 ambition can be achieved through different combinations of policy options. Considering the current EU ETS sectors, please rate the following aspects in terms of relevance? Please rate from 1 (not important) to 5 (very important):

	1	2	3	4	5
Strengthen the cap through the increase of the linear reduction factor	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>
Strengthen the cap through a one-off reduction ('rebased the cap')	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
A combination of increasing the linear reduction factor and a one-off reduction	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>
Cancelling allowances held in the Market Stability Reserve (MSR) [The Market Stability Reserve is further explained in section E of this survey]	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Maintain the increased feeding rate of the MSR after 2023	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Early application of a strengthened cap (e.g. 2023 instead of later)	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>
Other, please specify in the box below	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

Rationale/comments

- ERCST believes that the level of ambition in any carbon market should be set through the overall target and through the yearly decreasing cap on emissions: the Linear Reduction Factor. This approach is the most transparent for both market participants and other stakeholders, and allows for a clear public debate.
- ERCST supports an early application of a strengthened cap, as it would both allow for early visibility of the increase in ambition to market participants and a more gradual pathway towards net-zero emissions beyond 2030.
- Other policy options can indeed result in lowering the cumulative amount of emissions (budget) that may be emitted in the EU ETS. A one-off reduction or rebase would be a valid option as it is one way to transparently adjust the cap.
 - Given the fact that verified emissions have been consistently well-below the cap is another argument in favour of a rebase. This would also lower the pressure on the Market Stability Reserve to balance the market.
 - A well-designed combination of a rebase and increased LRF could be a good solution, addressing multiple issues at once.
 - However, the interplay with other ETS design elements needs to be kept in mind: the combination of a one-off reduction and the MSR intake will lead to a very tight market that year; the automatic invalidation mechanism will lead to a larger than expected amount of allowances being invalidated; a rebase of the cap will also reduce the availability of Free Allocation compared to a higher ambition that is achieved solely through adapting the LRF.

- While the combination of the functioning of the MSR with the automatic invalidation mechanism can de facto decrease the overall ambition (= reduce the budget) of the EU ETS, ERCST does not support this approach as it would increase ambition in a non-transparent way, ‘through the backdoor’.
 - The MSR was never intended to increase the ambition of the ETS - it was created, as outlined in its objectives, to manage structural existing market imbalances, as well as future imbalances.

3. In view of a strengthened ETS cap and thus a decreasing absolute volume of allowances available for auctioning and free allocation, how should the total cap be divided?

- The current auction share of 57% should be maintained
- The auction share should be increased and free allocation decreased
- Other

Rationale/comments

- ERCST recognises that the current system of free allocation compensation is not sustainable in the long-term (as it will start to ‘run out’ in the near- to mid-term with the current rules, and might even surpass the cap in the longer-term), and thus supports the Commission’s work in searching for alternatives, including through carbon adjustments at the border, such as designing a Carbon Border Adjustment Measure. A comparison of the effectiveness of the current measures vs. a CBAM should be assessed, as well as the implications of a potential transition from one measure to the other.
- In the meantime, assurance of protection through free allocation is necessary, and the application of the CSCF should be avoided.
- If alternative approaches are operationalised to ensure protection against carbon leakage, ERCST supports the phase-out of free allocation and gradual increase in the auction share. However, if alternatives which are currently being considered fail to materialise and the risk of carbon leakage due to asymmetrical climate policies persists, the amount of free allocation available might even need to be increased..

B. Addressing the risk of carbon leakage

4. Do you believe the current carbon leakage framework addressing direct carbon costs, consisting of free allocation, should be maintained, amended or replaced? Multiple answers are possible

- The current carbon leakage protection framework should be maintained without changes
- The current carbon leakage protection framework should be modified by targeting the support even more to the sectors most at risk
- For selected sectors, the current carbon leakage framework should be replaced by a Carbon Border Adjustment Mechanism
- Free allocation should be made conditional to beneficiaries carrying out investments for reducing their GHG emissions
- Other measures to further incentivise GHG reductions should be introduced

Rationale/comments

- ERCST recognises that the current system of free allocation compensation is not sustainable in the long-term (as it will start to 'run out' in the near- to mid-term with the current rules, and might even surpass the cap in the longer-term), and thus the Commission's work in searching for alternatives, including through carbon adjustments at the border, such as designing a Carbon Border Adjustment Measure. A comparison of the effectiveness of the current measures vs. a CBAM should be assessed, as well as the implications of a potential transition from one measure to the other.
- ERCST believes that support should be as targeted as possible:
 - Changes in activity levels from installations should better be reflected in the amount free allocation received. While progress has been made compared to Phase 3 in the 2018 review, more can be done as current rules will still result in some levels of over- and under-allocation to installations.
 - The ability for certain industries to pass-through carbon costs should be taken into account when assessing the risk of carbon leakage.
 - The current approach of applying a cross-sectoral correction factor (CSCF) when not sufficient free allocation is available is not a good approach. If policymakers decide to continue the application of a hard ceiling on the amount of free allocation, a uniform cut in free allocation over all sectors would not be fit for purpose as the risk of carbon leakage is not equal in different sectors. This risk should be taken into account.
- ERCST supports exploring the use of further supportive measures to incentivise GHG reductions, including through the innovation fund and CCfDs.

5. In view of the likely lower amount of allowances available for free allocation, (due to increased ETS target) which of the following aspects in relation to the benchmark-based allocation do you consider most relevant? Please rate from 1 (not important) to 5 (very important):

	1	2	3	4	5
Modified method to determine benchmark values to ensure faster incorporation of innovation and technological progress (e.g. by not limiting the annual reduction rate for each benchmark when updating benchmark values)	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>
Additional product benchmarks	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>
Revised definitions of product benchmarks to incentivise innovation	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Increased transparency regarding benchmark values and process via mandatory publication of underlying data by industry	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>
Other, please specify in the box below	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

Rationale/comments

- ERCST supports increasing transparency and making available underlying data to stakeholders.
- Where possible and feasible, additional product benchmarks should be developed as this would result in the most targeted allocation of allowances, resulting in the lowest risk of over- or under-allocation.
- While limiting the annual reduction rate for each benchmark can create an incentive for installations to adopt the best available technologies, ERCST recognises that the current maximum annual reduction rates are not in line with the targets of the European Green Deal.

6. Should the approach to indirect cost compensation be modified?

- Yes, the rapidly on-going decarbonisation of the electricity production in the EU will sufficiently reduce indirect costs and therefore, indirect cost compensation can be gradually phased out
- Yes, indirect cost compensation should be further harmonised in Europe, sectors exposed to the risk carbon leakage due to indirect costs should be compensated equally regardless of the Member State where they are active
- Yes, the approach to indirect cost compensation should remain the same, but additional requirements should be set to ensure that Member States granting it do not spend more than a given percentage of their auctioning revenues on it
- No, Member States should maintain flexibility to grant indirect cost compensation or not, subject to State Aid control

Rationale/comments

- Indirect costs will rise in the near- to mid-future as carbon prices are expected to continue to increase and price setting in the electricity market is done at the margin. As industry continues to electrify, indirect costs will increasingly become a more potent risk for carbon leakage to occur.
- The current approach of letting Member States decide is not suitable as it risks distorting the internal market. Although increasingly more Member States are providing compensation for indirect costs, experience has shown that mostly richer Member States have provided compensation throughout Phase 3. Moreover, Member States have to reconfirm their schemes for Phase 4, creating uncertainty for beneficiaries.
- As such, ERCST supports the further harmonisation of indirect costs compensation. Ideally, an EU-wide scheme should be setup, financed through e.g. auctioning revenues or future revenues from a CBAM.
- Moreover, putting a hard ceiling on the amount of compensation that can be given relative to auctioning revenues does not make sense as both are dependent on different factors
 - The magnitude of indirect costs are dependent on the electro-intensity of industry in a Member State, as well as the national/regional emissions factor or GHG intensity of power production – on the contrary, auctioning revenues are a function of the cap and a Member State's verified emissions in the baseline period.
 - Thus, this rule can turn out beneficial for some Member States while being detrimental to others, depending on national circumstances.

C. An increasing role for emissions trading

7. Carbon pricing alone does not address all barriers to the deployment of low and zero emissions solutions. Which other policies should be deployed when extending the use of emissions trading to emissions from buildings, road transport or all fossil fuel combustion? Please rate from 1 (not important) to 5 (very important):

	1	2	3	4	5
Polices addressing energy performance of buildings, the energy savings obligation, or other energy efficiency policies to be specified in the box below	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
CO2-standards for cars and vans	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Transport policies	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Renewable energy policies	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Energy taxation	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Other, please specify in the box below	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

Rationale/comments

- ERCST believes that putting a price on carbon can be an important part of the toolbox to decarbonise any sector. It is however not the only tool, other supply- and demand-side policy tools need to developed or maintained.

8. Emissions trading for road transport and buildings or all fossil fuel use could be integrated into the existing EU ETS so that there would be one single system covering emissions from all these sectors. If the new sectors are integrated into the current EU ETS such integration would be (multiple answers are possible):

- Positive, because it would capture the emissions under the cap and facilitate more cost-effective abatement by increasing abatement options
- Positive, because including buildings into an extended EU ETS would provide a level playing field for all modes of heating and cooling
- Positive, because including fossil fuels used in road transport into an extended EU ETS would provide a level playing field for all modes of road and rail transport, including electric rail which is already subject to indirect carbon pricing
- Positive, because setting a separate ETS for road transport and/or buildings or all fossil fuel use would lead to higher administrative costs for administrations and regulated entities
- Positive, because including emissions from all fossil fuel use into an extended EU ETS would provide a uniform carbon price signal for all industries
- Negative, because there could be an insufficient price signal for the transport and building sector to decarbonise
- Negative, because the new sectors are too different from the current sectors and abatement effort will mainly materialise in the current ETS sectors
- Negative, as the integration of the new sectors in the current ETS might disrupt and undermine the stability of the current ETS
- Other

Rationale/comments

- While all positive and negative outlined above are true to some extent, in the end the potential benefits need to be weighed against the potential downsides and risks.
- ERCST believes that the risks of integrating these sectors in the EU ETS currently outweigh the potential benefits outlined above. ERCST supports a cautious and gradual approach in which a separate ETS is first developed for other sectors, which can be integrated over time.

9. A separate EU-wide emissions trading system for road transport and buildings or all fossil fuel use could be established as a parallel system to the current EU ETS. Flexibilities could be built in, e.g. to allow partial fungibility between the allowances of the separate systems. What is your preferred design option for the relationship between these two systems:

- Both systems should stay independent and no relationship between them should be established
- One-way flexibilities between the systems will increase cost-efficiency
- Two-way flexibilities between the systems will increase cost-efficiency
- Other

Rationale/comments

- As per economic theory, two-way flexibilities will increase overall cost-efficiency, and should be explored especially if the ultimate goal would for both systems to integrate to one. Limits should be put in place to what extent these flexibilities can be utilised, which can gradually be removed over time.
- However, conflicting considerations have to be taken into account: as marginal abatement costs are higher in the road transport and buildings sector, having access to allowances from the current ETS sector could reduce overall costs – this could alleviate some of the distributional impact and energy poverty concerns, at least in the short to medium term.
- At the same time, as prices would converge through flexibilities, installations in the current ETS would face higher costs. Seeing as carbon leakage concerns are mostly limited to the current ETS sectors, this increase in costs has to be considered as well.
- In the longer-term, flexibilities will become increasingly important if ultimately an integration of both systems is desired, and liquidity and other market functioning considerations come into play.

10. Establishing a separate EU-wide emissions trading system for road transport and buildings or all fossil fuels will require choosing its main features. Which of the following aspects of the new ETS do you consider should be similar to the current ETS in order to allow for a later integration?

Please rate from 1 (very similar) to 5 (very different):

	1	2	3	4	5
The level of ambition for emissions reduction	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>
The linear reduction factor	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Provisions to address distributional aspects, i.e. how revenues are divided and used	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>
Provisions to address carbon leakage issues in the energy intensive industry where appropriate	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Monitoring, reporting and verification rules	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
The infrastructure to be used (e.g. the use of the existing EU ETS infrastructure such as the Union Registry)	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Application of the market stability provisions	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

Rationale/comments

- ERCST believes that some fundamental characteristics of the market, such as MRV rules, the infrastructure, the market stability rules and the pace of reductions need to be similar to the current ETS in order to be able to integrate them eventually.
- The other elements included are less important as they do have less impact on the functioning of the market and behaviour of market participants.

11. Emissions trading for road transport and buildings or all fossil fuels could be gradually integrated into the existing EU ETS. Should the ETS revision already determine when and how such integration will take place?

Yes, the market needs certainty and legislation should determine that integration will happen at a specific time within , e.g., 5 years from its entry into force

- Yes, the legislation should foresee a review to determine whether and when integration is desirable
- No, in view of the risks associated the legislation should not foresee such integration
- Other

D. Extension to Maritime greenhouse gas emissions

12. What is your opinion on the most appropriate measure to put a price on GHG emissions from EU maritime transport activities?

- Extension of the EU ETS to cover maritime transport
- A specific ETS system just for maritime transport
- A tax at EU level on GHG emissions from maritime transport
- Other

Rationale/comments

- While ERCST is an advocate of an international mechanism to address maritime emissions, we support its integration in the EU ETS given the lack of action and progress currently observed at the international level.

13. Decarbonisation of the maritime transport to ensure its fair contribution to EU climate targets will require a basket of measures across different policy areas, including putting a price on carbon emissions from shipping. Do you think that EU carbon pricing measures in the maritime sector (such as an ETS or a tax on GHG emissions from maritime transport) should be combined with EU emission standards for ships (notably technical or operational carbon intensity standards)?

at most 1 choice(s)

- Yes
- No, emission standards are sufficient and should be implemented alone
- No, carbon pricing is sufficient and should be implemented alone
- I do not know

14. The impacts of EU carbon pricing for the maritime sector, in particular its environmental effectiveness, will directly depend on the design elements for the selected measure. Please select the most appropriate design option for a EU carbon pricing policy for maritime transport under each of the categories listed below.

Regulated Entities

- Carbon price should be paid by ship commercial operators
- Carbon price should be paid by ship owners
- Other

Exemptions

- The International Maritime Organisation has energy efficiency measures (the Energy Efficiency Design Index for new ships and the Ship Energy Efficiency Management Plan for existing ships) in place for ships of 400GT and above. Therefore, only ships below 400 GT should be excluded.
- In line with the EU MRV System for shipping, ships below 5000 GT should be excluded, as they are only responsible for about 10% of emissions.
- Other

Geographical scope

- Emissions from intra-EU (from an EU port to another EU port) and extra-EU voyages (departing and incoming between an EU port and a port outside the EU) should be addressed by carbon pricing
- Emissions from intra-EU voyages (from an EU port to another EU port) should be addressed by carbon pricing

Rationale/comments

- While ERCST is an advocate of an international mechanism to address maritime emissions, we support its integration in the EU ETS given the lack of action and progress currently observed at the international level.
- As long as no international mechanism exists, extra-EU voyages should be addressed through carbon pricing.

Type of emissions covered

- In line with the EU MRV System for shipping, only CO₂ emissions should be accounted for, as they are responsible for 98% of all GHG emissions from maritime transport.
- Not only emissions of CO₂, but also of methane, nitrous oxide and black carbon emissions should be accounted for in view of their important increase over the 2012-2018 period.
- Other

15. The Climate Target Plan Impact Assessment presented various scenarios where the extra-EU scope of the maritime sector is included in the EU GHG target. In line with these scenarios, if the EU were to apply carbon pricing to emissions from extra-EU voyages, on which basis should this be done?

(select one option)

- Departing journeys only (from an EU port to a port outside the EU)
- Incoming journeys only (from a port outside the EU to an EU port)
- 50% of both the incoming and the outgoing journeys
- 100% of both the incoming and the outgoing journeys

Rationale/comments

- Given the international sensitivity of the issue, and potential for international repercussions similar to what happened to the inclusion of international aviation, limiting the application of the EU ETS to 50% of both the incoming and the outgoing journeys would seem a possible solution.
- This would also allow for other countries to put in place similar policy tools for 'their' share of the journeys.

E. Market stability

16. Has the MSR delivered on its main objective (the stability of the ETS), and is it likely to fulfil its goals in the future, or should its structure or parameters be changed?

- Yes, the approach has worked well and should not be changed
- Yes, the approach has worked well and should be continued, but parameters (e.g. volume-based thresholds, intake rate) should be modified
- Yes, the approach has worked well but a carbon price floor is necessary
- Yes, the approach has worked well but should be improved to be able to react faster to address unexpected demand or supply shocks
- No, the approach did not work well and it should be reconsidered in the future
- Other

Rationale/comments

- The main objectives of the MSR are outlined in the Decision, and ERCST understands the goals to be the following:
 - Eliminate the historical structural supply-demand imbalance within a reasonable amount of time;
 - Bring the TNAC within range of the MSR thresholds in case of new events within a reasonable amount of time.
- What exactly is meant by 'stability' is unclear.
- Having said that, we believe that MSR has worked well so far but that improvements are necessary. For example, the current intake rate is insufficient to ensure a balanced market within a reasonable amount of time. At the same time, thresholds should be made dynamic and dependent on changing hedging behaviour of market participants.

17. Should the MSR thresholds (minimum of 400 and maximum of 833 million allowances) used to determine whether allowances are placed in the MSR or released, be kept as they are? Please explain your answer.

- The thresholds as they are fit for purpose
- The thresholds should be increased
- The thresholds should be reduced

Rationale/comments

- The system of thresholds should be kept, as they are supposed to give an indication to what level of surplus the market 'needs' to properly function (e.g. ensure liquidity, allow for hedging, allow for some speculation).
- Both the options to increase/decrease have been selected here as the thresholds should be set following a transparent assessment to determine whether the current thresholds are fit for purpose or not, taking into account the changes in hedging behaviour/needs of the power sector, as it has been decarbonising, as well as hedging behaviour of industrial players, which has started to emerge. While it can be generally expected that the hedging needs will decrease as covered entities decarbonise, the behaviour of market participants can also change over time (e.g. emerging hedging behaviour from industry)

18. Should the MSR intake rate be kept as it is or should it be increased or decreased?

at most 1 choice(s)

- The MSR intake rate should be kept at 24% and fall back to the level of 12% as of 2024 as per current regulation
- The MSR intake rate should be kept at 24% beyond 2023
- The MSR intake rate should be higher than 24%, in order to reduce the surplus faster
- The MSR intake rate should be decreased, to lower than 12% from 2024 onwards
- Other

Rationale/comments

- The intake rate should be sufficiently high, as to ensure that the MSR can bring the TNAC back within the thresholds in a reasonable amount of time.
- Given current dynamics, and known sources of expected surplus in the years to come (e.g. coal phase-outs) the intake rate might need to be kept considerably high in order to cope.
- At the same time, a very high intake rate might reduce the short-term availability of allowances (as auctioning is reduced considerably) and put more market power in the hands of those entities that are holding on to allowances currently. These considerations should also be taken into account.
- In the longer term, it would make more sense to make the intake rate as a percentage of the 'bad' surplus (the amount above the upper threshold) rather than a percentage of the total surplus/TNAC
- Periodic reviews (more frequent than currently) should be introduced to ensure the right/necessary intake rate is set based on the outlook of the market.

19. Current regulation determines that as a long-term measure to improve the functioning of the EU ETS, and unless otherwise decided in the first review of the MSR in 2021, from 2023 onwards the number of allowances held in the reserve will be limited to the auction volume of the previous year. Holdings above that amount will lose their validity. Do you believe this invalidation rule should be kept in place? Please explain your answer.

- Yes, the rule should remain in place
- No, the rule should be abolished
- Yes, the rule should remain in place but be amended please explain how in the box

Rationale/comments

- It has to be noted that both the backloading decision and MSR were initially presented by the regulators as a measure that would initially take out, but ultimately return allowances to the market. However, the 2018 review introduced the invalidation mechanism, permanently invalidating allowances, and thus contradicting this initial presentation.
- In ERCST's view, the MSR is wrongfully being seen by some stakeholders as a tool to increase ambition.
- However, a case could certainly be made that a significant number of allowances may accumulate in the MSR over time, together with an increase in the TNAC, should the absorption power of the MSR not match the decrease in demand. This is certainly a legitimate reason to examine the amounts in the TNAC and in the MSR and potentially take action. However, such an examination should not be undertaken without understanding its origins and causes, as well as determine how to best treat it. A regular, qualitative assessment is emerging as an appropriate approach.

20. At the moment, emission allowances for aviation are not taken into account for the calculation of the EU ETS surplus and therefore do not influence the amount of allowances fed into or released from the MSR. Should aviation allowances and emissions be taken into account in the future?

- Yes
- No

Rationale/comments

- Aviation is a source of demand for EUAs which impacts the actual availability of allowances on the market. Given that aviation has consistently been 'short' and is expected to remain so, the

TNAC as it is currently defined will increasingly be a less accurate indicator of the actual surplus of the market.

21. Should voluntary cancellation of allowances become mandatory for Member States that implement national measures to close fossil fuels power plants or other measures that substantially reduce demand for allowances, for instance by promoting breakthrough technologies or banning polluting technologies?

- No, it should be left to the Member State to decide what to do with the resulting allowances
- Yes, these allowances should be cancelled proportionally, taking into account the emissions of the replacing power generating technology
- Other, for instance placing the allowances in the MSR.

Rationale/comments

- While ERCST does not believe that voluntary cancellation should become mandatory, as it might hamper Member State's willingness to introduce additional policies, we also think that the current system leads to too much uncertainty for stakeholders.
- ERCST supports that cancellation should take place in order to mitigate the impact of overlapping policies, but that this would better be carried out at EU-level based on regular assessments. Moreover, rather than immediately cancelling these allowances, ERCST would support placing them in the MSR.

F. Revenues

22. In your opinion, how should the ETS revenue be used? (Multiple answers are possible)

- Facilitating just transition and the social impacts of the climate transformation
- Addressing social and distributional impacts related to the review of ETS
- Energy efficiency, in particular the renovation of buildings
- Low-carbon and zero-emissions mobility
- Support for clean investments in ETS sectors
- Providing financial incentives for consumers to buy more climate friendly goods and services, including more fuel efficient vehicles/ vehicles not using fossil fuels
- More support to innovation
- Lowering taxes such as labour taxation and increasing transfers to EU citizens, in particular low-income households

Rationale/comments

- Though economic theory indicates that lowering labour taxation would have the best GDP impacts, ERCST believes that ETS revenues should be recycled in order to speed up the transition and help alleviate the distributional impacts associated with the ETS, in order to ensure a sustainable transition and increase support for the policy instrument.

23. Are stricter rules necessary to ensure Member States spend their ETS auction revenues in line with climate objectives?

- Yes, the ETS Directive should require Member States to spend more revenues on climate-related purposes
- Yes, the ETS Directive should require that Member States spend ETS revenues in a way compatible with the climate neutrality objective ('do no harm')
- No, Member States should be free to determine how they want to spend the revenues, taking into account that 50% should be used for climate-related purposes.

Rationale/comments

- Based on Member State's reports we can conclude that so far during Phase 4 of the EU ETS, around 80% of revenues has been spent on climate and energy purposes. At the same time,

this percentage has been decreasing recently as auctioning revenues have risen considerably, and large differences exist between different Member States.

- As was outlined earlier, ERCST supports to recycle ETS revenues to further investments in ETS covered sectors and address distributional impacts caused by the ETS. This can either be done through increasing the funding available for dedicated funds or by ensuring that Member States spend their revenues in line with these objectives.

G. Low-carbon support mechanics

24. What should be the size of the Innovation Fund?

- The size of the Innovation Fund should remain unchanged
- The size of the Innovation Fund should increase by using more allowances from the auction share
- The size of the Innovation Fund should increase by using more allowances from the free allocation share
- The size of the Innovation Fund should increase significantly regardless of the source of allowances. Please indicate by how much (e.g. double or triple) in the box

Rationale/comments

- The first call for proposals has shown that the interest from project developers for the Innovation Fund is high: 311 proposals were submitted, requesting in total €21.7 billion while the entire Innovating Fund is only expected to provide around €10 billion over Phase 4 at current market prices.
- As ERCST considers the Innovation Fund to be a vital tool in helping industry decarbonise, we believe that its size should at least be doubled, with the option to increase further if the interest from project developers persists or increases.
- If a CBAM is implemented, ERCST proposes that (part of) the revenues should be used to finance the increase in size of the Innovation Fund

25. Currently the ETS Directive foresees that the maximum funding rate for projects financed by the Innovation Fund is 60% of the relevant costs. Should this rate be changed?

- No, some of the risk of innovation has to be borne by the project proponent
- Yes, it should be increased to allow better risk-sharing for risky and complex projects
- Yes, it should be increased but only in case of competitive bidding (e.g. Carbon Contracts for Difference)
- Other

26. Should additional supporting instruments be introduced to support full market deployment of low-carbon products through the Innovation Fund? For example, as Carbon Contracts for Difference, whereby beneficiary projects would be guaranteed a fixed carbon price in case the ETS price is not high enough.

at most 1 choice(s)

- Yes, additional support (e.g. covering the gap in operating revenues) is needed to create markets for low-carbon products
- No, the existing support is sufficient

Rationale/comments

- CCfDs offer an assurance about the future trajectory of carbon prices in the form of a fixed price for certain emissions reductions. Current prices are too low to make carbon-neutral technologies for many EITE industries economically viable, a CCfD will serve to guarantee the substantially higher carbon price needed to enable investments in technologies producing low- and ultra-low carbon materials.
- ERCST believes that CCfDs, among other support mechanisms, should be part of the ‘toolbox’ to help industry decarbonise and will help create a market for low-carbon products
- ERCST would support some kind of competitive bidding process, such as reverse auctioning, to ensure a market element is included

27. What should be the size of the Modernisation Fund?

- The size of the Modernisation Fund should remain at 2% of the cap
- The size of the Modernisation Fund should remain unchanged as an absolute amount
- The size of the Modernisation Fund should increase
- Other

Rationale/comments

- ERCST believes that the size of the Modernisation Fund should increase.
- It was set up to help finance energy investments needs in the 10 beneficiaries, and was initially estimated (based on the Commission’s 2014 impact assessment) to cover between 3-9% of the additional investment needs associated with the 2030 climate and energy framework.
- ERCST believes a similar discussion is warranted to determine what size the Modernisation Fund should be increased to. First, an impact assessment is necessary to estimate the additional investment needs associated with the European Green Deal in these Member States. Next, an informed decision can be made as to what percentage of these investments are to be covered through the Modernisation Fund. Given the likely scale of necessary investments, and increase in absolute terms, ERCST believes 15% to be a fair amount.

28. Should the types of investments that can be financed by the Modernisation Fund be streamlined and the coherence with the Green Deal be enhanced? (Multiple answers are possible)

- No, the investments that can be supported by the Modernisation Fund should remain unchanged.
- Yes, the exception for financing coal-fired district heating in certain Member States should be removed
- Yes, the Modernisation Fund should be allowed to finance only non-fossil fuel based heating and cooling systems
- Yes, the Modernisation Fund should be allowed to finance only priority projects to simplify the administration
- Other

Rationale/comments

- ERCST believes that, based on the work it has undertaken previously on the Modernisation Fund and interactions with policymakers and stakeholders, the large majority of the Modernisation Fund will be used to finance the so-called ‘priority projects’. As such, we do not see the need to revise the investment rules at this stage, especially since a revision is already scheduled to take place by the end of 2024.
- At the same time, gas is still considered as a transitional technology which could be vital to ensure a sustainable transition and ensure security of supply in some of the Member States that benefit from the Modernisation Fund.