

Explanatory Memorandum

“Policies reflecting a high price on emissions are necessary in models to achieve cost-effective 1.5°C pathways (high confidence).”¹

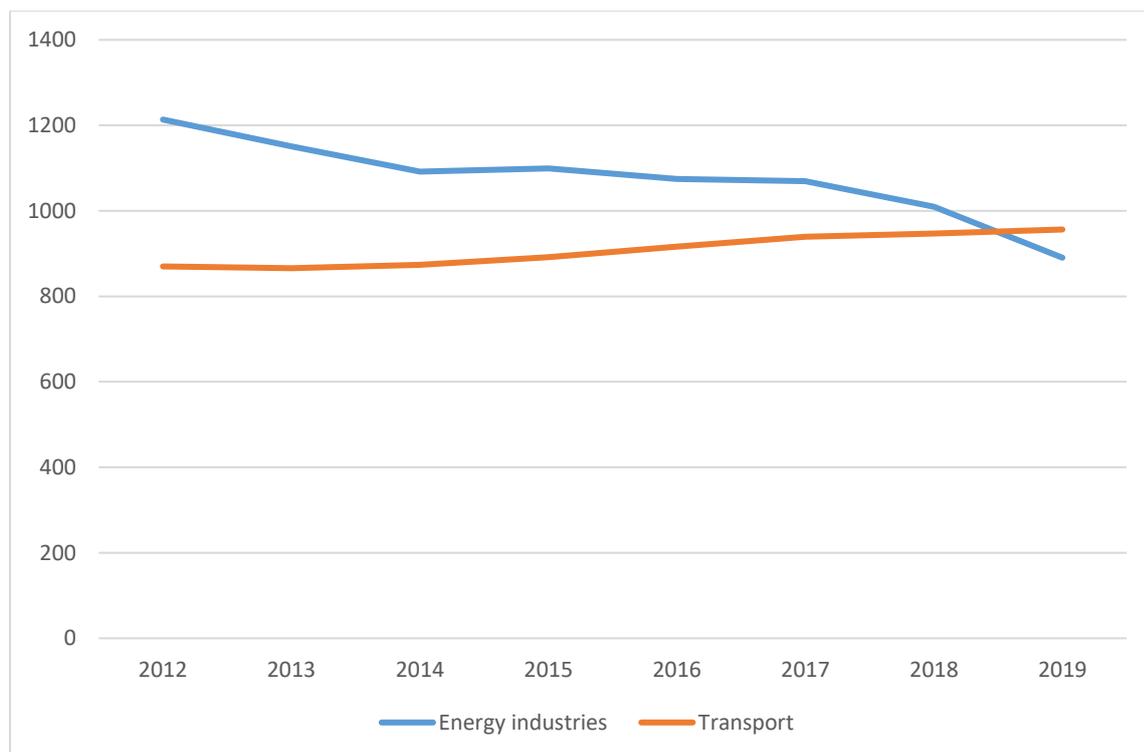
IPCC Special Report “Mitigation Pathways Compatible with 1.5°C in the Context of Sustainable Development”

“Carbon should be given a price.”²

António Guterres, UN Secretary-General, at COP26

The ETS is the core of the European climate policy. In the areas where it has been introduced, especially in the electricity sector, it has triggered dramatic reductions of emissions, especially in the last three years when mayor reforms were implemented. In other areas such as the transport sector where carbon pricing did not exist at European level, emission have increased.

Figure 1. Co2 Emissions EU27 by sector (million tonnes)



Source: European Environment Agency (EEA), June 2021

¹ IPCC Special Report: “Mitigation Pathways Compatible with 1.5°C in the Context of Sustainable Development. In: Global Warming of 1.5°C. An IPCC Special Report on the impacts of global warming of 1.5°C above pre-industrial levels and related global greenhouse gas emission pathways, in the context of strengthening the global response to the threat of climate change, sustainable development, and efforts to eradicate poverty”,

https://www.ipcc.ch/site/assets/uploads/sites/2/2019/02/SR15_Chapter2_Low_Res.pdf, p. 95.

² <https://news.un.org/en/story/2020/11/1077712>.

Carbon pricing alone will not enable us to achieve the EU's climate reduction target as it is necessary to have a policy mix. Without carbon pricing, however, we will probably not be able to achieve the targets especially not at reasonable cost.

The Commission proposals in the Fit for 55 package includes the advancement of alternative fuels infrastructure, the increase of renewable energy and a lot of other elements that will altogether enable us to achieve our targets. The rapporteur in principle supports the Commission proposal and at the same time, he thinks it is necessary to improve the texts following the statement by EPP Chairperson Manfred Weber: "We say yes to the Fit for 55 package and we don't say 'yes but' but we say 'yes and we can even make it better.'"

Carbon pricing through the ETS is crucial. Everybody who has a good idea to reduce CO₂ emissions and implements it, should be better off. This holds true for companies but also private people. Command and control measures alone cannot do the trick because the 447 million people living in the EU definitely have more and better ideas than politicians in the capitals or Brussels only. Command and control measures also come with a cost that is much higher than carbon pricing sometimes but these costs are not transparent. The ETS in contrast will not only create costs but also revenues that can be used to support new technologies and especially support people in need. Many new technologies are already available but the relatively low taxes and fees on gas, oil, diesel and gasoline compared to the relatively high taxes and fees on electricity hinder the market uptake of these technologies including heat pumps or electric vehicles.

To really make the Fit for 55 package a success, carbon pricing must be combined with targeted use of the revenues. Among other points, excessive taxes and fees on renewable energies should be reduced as these hinder innovation and are a particular problem for low-income households that spend a bigger share of their income on electricity than the average population.

ETS1 - Decarbonise European Industry, Not Deindustrialise Europe

The rapporteur agrees with the general approach of the European Commission and the ambition of the proposed text. It is in line with the net 55% target for 2030. However, he suggests targeted improvements for innovation and carbon leakage protection.

Decarbonise European Industries: More Targeted Support for Innovation

The Commission proposal already includes some very important tools to support breakthrough technologies, for example, the climate-neutral production of steel. Companies that no longer use fossil fuels will anyhow benefit from free allowances for five more years to incentivise these breakthrough innovations. A new benchmark will be created to include new technologies such as hydrogen-based steel. The rapporteur proposes a clarification to make sure that this new benchmark will in fact be implemented no later than 1st January 2026.

On top of the Commission proposal, the rapporteur introduces two new elements roughly described as a bonus-malus-system. Those installations that not only operate at benchmark level but perform better than the 10% best in any given product class should be given an additional bonus. The rapporteur suggests that all participants in the ETS must provide climate neutrality plans. This is an important tool to make sure that everybody understands that finally all economic operators must assure climate neutrality. Free allowances should be significantly reduced for companies that do not have convincing plans for the future and only want to produce in old strongly-emitting installations until they are not receiving free allowances anymore. Free allowances should be a tool to enable decarbonisation and climate neutrality but should not be a tool to keep traditional plants alive forever. National state aid to support the transition in line with the climate neutrality plans should not be considered as illegal state aid.

Not Deindustrialise Europe - Intelligent Combination of Free Allowances and CBAM

Unfortunately, the Commission proposal does not exclude the risk that even the best performers will have to purchase additional allowances by the end of phase 4 as a result of the cross sectoral correction factor (CSCF) kicking in. This decreases predictability for operators, will discourage investments in Europe and may lead to carbon leakage. That is why it is important to make additional allowances available to avoid the CSCF application up to the extent that at least the best performers can be sure that they will not be burdened with additional costs until 2030. To make these allowances available, the rapporteur proposes an accelerated phase-in of the maritime sector and wants to engage with the rapporteur and the other responsible colleagues on the aviation sector. Should these additional allowances still not be sufficient to prevent the application of the CSCF, then any leftover should be taken from the MSR.

It is very important to ensure the best possible interplay between free allowances and CBAM. The Commission proposal foresees a step by step increase of CBAM protection and a step by step decrease of free allowances. The rapporteur is convinced that it is necessary to have a safeguard clause in case the CBAM cannot be implemented as foreseen. The free allowances that are no longer given to the CBAM sector as the CBAM kicks in, should not be cancelled or used otherwise but put into a reserve for any given year and only be auctioned if CBAM has been working effectively in that respective year. In case CBAM has not been working effectively, they should be given to affected installations retroactively. This reserve should not reduce the overall amount of the Innovation Fund. That is why the Innovation Fund should be stabilised by other revenues that are taken from the member states' share.

Yes to Solidarity but More Targeted

The rapporteur supports the most important solidarity elements of the Commission proposal. Since the beginning of the ETS 10% of the revenues are redistributed among member states mainly from Western to Central and Eastern Europe to acknowledge the particular challenges in these countries in the green transition. Assuming a carbon price of

50€, this 10% would mean 30.65 billion euro from 2021 to 2030. The rapporteur does not intend to touch this solidarity clause.

The second element of solidarity is the Modernisation Fund from which 10 member states currently benefit. 2% of the revenues are used for this fund. The Commission suggests a top up of the Modernisation Fund of additional 2.5% and argues that two more member states need to benefit from it for calculation reasons. This however, increases a problem already existing in border regions. The Modernisation Fund is limited to national borders while also regions in other member states are tremendously challenged and not all regions in beneficiary member states are equally challenged. One example is the border between Spain and Portugal. According to the Commission proposal, Spain would not benefit at all from the fund while Portugal would benefit substantially (up to 850 million euro until 2030, assuming a carbon price of 50€). The same applies for Slovenia that does not benefit from the fund in contrast to its neighbouring member states Hungary and Croatia (up to 792 million euro until 2030 combined, assuming a carbon price of 50€). That is why the rapporteur suggests the following compromise:

2% of allowances shall remain in the Modernisation Fund and be redistributed in the same way as in the past. The top up will be divided. Half of the top up will be used for the Modernisation Fund but not according to national borders but to regions. The regions that can benefit should be the same as those under the Just Transition Fund. The distribution among member states will be the same. The other half of the top up should be used to increase the Innovation Fund as this will be available for all member states and enable the transition wherever it is needed.

The third element is the Article 10c which allows some member states to give free allowances to their power sector. This possibility is banned for the vast majority of member states since 2013 and it is obvious that free allowances to fossil fuels are not in line with the ambitious targets of the European Union. For this reason, the rapporteur suggests to delete the possibility of free allowances in Article 10c. Member states that benefit from this provision may use the money for the Modernisation Fund or auction the allowances and use the revenues according to their national priorities in line with this directive.

Waste Incineration - Immediate Inclusion Problematic, Long-Term Inclusion a Must

It has been suggested to include municipal waste incineration in the ETS. This cannot be done overnight because sometimes the alternative to incineration is landfilling which is very environmentally un-friendly due to the methane emissions or export of waste to countries where the EU has not yet enough control over how it is processed. However, it is very important that all emitters are finally subject to a carbon price in the European Union and waste incineration is definitely not the best possible option. Adding a carbon price to the incineration, it will incentivise recycling, reuse and other environment friendly choices in line with circular economy. That is why the rapporteur suggests that after an impact assessment and after assuring that negative effects due to landfills and exports can be ruled out as much as possible, waste incineration will be included in the ETS on 1st January 2028.

Maritime ETS - High Time for Carbon Pricing

It is a long standing demand of the European Parliament that emissions from the maritime sector should be included in the EU ETS. Therefore, the rapporteur generally supports the proposal of the European Commission. To cover not only intra-European routes but also 50% of trips from and to the European Union is an intelligent approach.

The rapporteur proposes to strengthen the international dimension of the proposal. The Commission, the Parliament and the member states should engage to convince third countries not only to accept the proposal including the 50% incoming and outgoing trips but to work with third countries to also cover the rest of the 50%. The efforts of the IMO are more than disappointing. In the long-term, a global solution is of course preferable but the EU ETS can only be transferred to the global level or replaced by a global solution if its ambition is higher or at least as high.

The European Parliament in its report on the MRV by Jutta Paulus, asked with a strong majority for a dedicated fund to support innovation and carbon neutrality in the maritime sector. The rapporteur supports this demand and suggests to use all revenues from maritime that are not used for own resources, which equals 75% of the revenues from maritime, for a dedicated fund to support climate neutrality innovations in shipping. There is no reason to transfer money to other sectors as shipping is the most environmental friendly mode of transport and modal shift from shipping to other modes of transport should be avoided.

In line with the position of the Parliament on MRV, all gases should be covered, especially methane. The European Parliament has never foreseen a phase-in of auctioning in the shipping sector. That is why the proposal of the Commission has been strongly criticised as full-auctioning will only be applicable from 2026. The rapporteur suggests a compromise that includes a short phase-in period until 2025. The additional free allowances that are made available should be used for carbon leakage provisions in the stationary ETS sectors. Every tonne of steel or every tonne of chemicals that is produced in Europe can be replaced by imports. Shipping is not subject to similar challenges because goods and persons that need to be transported inside of Europe or from Europe to third countries cannot be easily replaced by extra-EU ports, especially when the ETS₂ for road transport is implemented and goods cannot arrive at European countries from ports outside the EU without a significant cost increase. Various impact assessments of the European Commission have analysed specific cases such as the ports of Tanger, Southampton, Haydarpasa or Kaliningrad and have come to the conclusion that the risk of carbon leakage is low³. At that time a road ETS had not been assessed yet so that the risk is significantly lower now.

Pollutor-pays-principle and Arctic Navigation

³ See summary on p. 146 of Commission IA (option MAR 1, MEXTRA 50 = Commission proposal); https://ec.europa.eu/clima/system/files/2016-11/ghg_maritime_annex_en.pdf.

Member states in Northern Europe argue that due to their weather conditions they have a higher burden through the ETS navigating in ice waters. The rapporteur suggests to make funds available from the Ocean Fund especially for this problem and give ships that navigate in arctic areas a slower phase-in in 2027.

The European Parliament has insisted on the ‘polluter-pays-principle’ and made clear that the operator of a ship should be the final responsible for the payment of the EU-ETS price. This has not been taken into account by the European Commission. To address this problem the rapporteur suggests that the final responsibility of the commercial operator be ensured through a contractual requirement between the ship owner and commercial operator to pass on the costs. This solution ensures that whoever is the operator is the final responsible for the carbon price, while the need for authorities to trace down commercial operators, which would be challenging for such companies based outside the EU because there is no international registry of commercial operators in shipping.

The New ETS - an Indispensable Part of the Fit for 55 Package

As in other areas, carbon pricing is also key to enable the green transition in transport and heating. Command and control measures only cannot or only with many additional problems enable us to achieve the climate targets.

“A new ETS will not be the main tool to decarbonise road transport. However, it can play an important role to both tackle demand but most importantly to generate new revenues to help the most vulnerable to transition away from fossil fuels.”⁴

Transport & Environment

“CER believes that the creation of a separate ETS for road transport fuels is unavoidable to internalise negative externalities with a concrete application of the polluter-pays principle and to incentivise passengers and logistics companies to use climate-friendly transport modes. At the same time, the Social Climate Fund will have to be used to support those who need it the most and invested in a way that promotes the access to low and zero-emission collective mobility services.”⁵

Community of European Railway and Infrastructure Companies (CER)

The Commission’s Impact Assessment on the ETS revision concludes that “the most important instrument for tackling these issues are CO₂ emission standards for vehicles, for which the revision is the object of a parallel IA, which indicates that strengthened standards as of 2030 could deliver alone around 40 to 50% of the additional emission reductions in road transport in 2030.”⁶ Conversely, this estimate indicates that additional policies beyond command-and-control measures are necessary and the ETS for road transport and buildings is needed to bring about the remaining 40-50% emission reduction.

⁴ https://www.transportenvironment.org/wp-content/uploads/2021/12/Road-to-road-ETS-10-ETS2_SCF-criteria.pdf

⁵ <https://www.cer.be/media/press-releases/eu-emissions-trading-system-ets-cornerstone-eu-climate-policy>

⁶ https://ec.europa.eu/info/sites/default/files/revision-eu-ets_with-annex_en_o.pdf

A strong link with the Social Climate Fund is important to address the challenges for low-income families. In agreement with the co-rapporteur for the Social Climate Fund, the rapporteur not only insists that 25% of the revenues are used for the Social Climate Fund but also the 75% remaining revenues should be spent in line with the criteria of the Social Climate Fund in the respective member states. Special attention should be given to the reduction of taxes and fees for environment friendly products such as renewable energy. It is imperative to create a level playing field for all commercial operators in the European market. The Commission proposal rightly foresees the new ETS to apply to commercial transport and the heating for commercial buildings. Unfortunately, other important commercial operations are not subject to the new ETS such as non-road machinery and process heating. They should be covered and appropriate carbon leakage protection should be introduced. The challenge for private households are a particular concern for many colleagues. While the rapporteur thinks that the Commission's proposal is a good way forward, he reacts to the proposals by his colleagues and proposes an opt-out for private buildings and private transport for a limited time under specific criteria to allow member states to better prepare themselves and use other instrument to achieve their national target. Inversely, the ETS for commercial operators should be introduced one year earlier and the Social Climate Fund should also be introduced one year earlier than suggested by the European Commission.