securing competitive energy for industry

IFIEC's position on

EU consultation on Climate change – updating the EU emissions trading system (ETS)

08/11/2021

IFIEC welcomes the opportunity to participate in the consultation and supports the EU Commission's plans for an improved the revision of the EU Emissions Trading Scheme (ETS).

It must be ensured, that the planned reform of the EU ETS does not lead to a decrease in competitiveness of the European industry. This leads to a move of production and investments to non-European countries, so-called carbon leakage. The carbon leakage risk is more pressing than ever given the recent evolution of the carbon price reaching high values and considering a further increase expected in the fourth trading period. Therefore, while delivering higher climate ambition, the revision of the EU ETS Directive must provide strengthened carbon leakage measures. Any weakening of such measures, for instance through free allocation reduction, would have a disruptive impact on Energy Intensive Industries (EIIs) and undermine their financial ability to invest in low carbon technologies.

To achieve the emission reduction goals and to protect the competitiveness of energy intensive industries, we would like to raise the following concerns and recommendations.

1 Maintain global competitiveness and prevent carbon leakage

It is important to stress the importance of continuing to ensure effective carbon leakage protection for European industry. The measures envisaged in the EU ETS revision to achieve higher climate ambitions such as increasing the LRF, strengthening the MSR as well as the "re-basing" will have the effect of diminishing free allocations as well as higher certificate prices. In addition, the increase of the annual reduction rate for benchmarks as well as the proposed conditionality for free allocation will put further pressure on the competitiveness of European industries and increase the risk of carbon leakage.

Furthermore, the risk of a CSCF and the envisaged MSR mechanism will lead to a reduction in certificates which in turn will reduce carbon leakage protection.

In this context, existing measures such as free allowances should be maintained and indirect cost compensation should be improved and legally protected in the EU legislation. A further reduction in free allocation would damage the competitiveness of European industry. Electricity at competitive prices should be made available in order to drive electrification.

In particular, the following elements should be considered:

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1.1 Maintain investment certainty and no retroactive changes in free allocation and other carbon leakage protection measures

The debates and negotiations for the EU ETS revision are envisaged to last until 2023. This should not lead to uncertainty for industry about the emission trading rules that are currently in effect. It is vital that retroactive changes to the EU ETS, such as amendments to the LRF, the benchmarks and re-basing which could then be backdated to take effect from the beginning of 2021, are explicitly excluded. For the European industry, it is of utmost importance that the framework conditions are set, especially in this crucial phase of transformation.

1.2 Maintain and improve proven instruments such as free allocation and indirect cost compensation

To reach the new climate targets of 55% of greenhouse gas emissions by 2030, both the linear reduction factor (LRF) and the market stability reserve (MSR) will be amended. A re-basing, i.e., a one-off cancellation of allowances, is also proposed. These measures will result in a faster shortage of allowances, which in turn will lead to an increase in CO_2 prices. Since global competitors do not bear these extra costs, this will put additional pressure on the competitiveness of European industries and the risk of carbon leakage will increase. Carbon leakage protection measures must be guaranteed in all Member States. The mechanism of the fixed auctioning share, installed to guarantee a certain income level when the EUA prices were still low, must be removed to guarantee the level of protection for industry and to improve the investment climate.

1.3 Interventions in allowances availability needs to be avoided

The climate ambition of the EU ETS will be supported by lowering the 2030 cap. This needs to be achieved in the most efficient way to reduce costs for industry as well as the whole EU society. Re-basing and strengthening of the Market Stability Reserve (i.e. putting more allowances in the reserve) will artificially increase the costs for the same level of climate ambition. Regarding the re-basing proposal, IFIEC would like to request better clarity and definition of the methodological approach and the way it would be established.

With regards to adjusting the market stability reserve, IFIEC would also like to point out that this will render the market for allowances in Europe unpredictable and will lead to high costs for the energy-intensive sector in particular. Again, it must be stressed that reliable legal and economic framework conditions are of the utmost importance for the energy-intensive industry to maintain international competitiveness while at the same time enabling investment in climate-friendly technologies.

To mitigate the increased shortage of allowances as well as the foreseen price increases, the levels of free allocation should be maintained to continue to ensure adequate protection against carbon leakage. Furthermore, the risk of a CSCF and the envisaged MSR mechanism will lead to a reduction in certificates which in turn will reduce carbon leakage protection. This is disincentivising industrial investments and operations in the EU.

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1.4 Benchmark tightening should not lead to non-competitiveness

The draft proposes a more stringent benchmark approach by increasing the maximum update rate to 2,5 % per year as of 2026 instead of the current 1,6 %. IFIEC would like to point out that this will lead to a further decrease in free allocation and thus additional pressure on the competitiveness of European industry. Also, more clarity and definition are required on how these reductions will be put into effect. Since the benchmark approach is based on installations, it is important to exclude certain types of plants, e.g. pilot plants for green steel production which might be low in emissions but have not yet been proven to be viable and economical at large scale, from the calculation of the average benchmarks.

Further, small and commercially optimized recycling plants e.g. aluminium plants, for which alternative fuel sources are in theory available, but operationally and/or financially difficult to implement, should also be excluded.

1.5 Emission reduction by efficiency and biomass gains must be credited

For installations using biomass, the draft proposes a threshold value of 95 % for zero-rated biomass combustion above which installations are excluded from the EU ETS. The reason is that installations combusting a high share of biomass have obtained so-called "windfall profits" by receiving free allowances exceeding actual emissions. IFIEC would like to point out that it is a fundamental principle of the emissions trading mechanism that investments that lead to CO_2 emission savings will generate surplus allowances, which can then be sold to finance the investments. Declaring these surpluses as windfall profits and eliminating them, regardless whether they originate through the usage of biomass or any other methods, is counterproductive as it will discourage any climate-friendly investments and constitutes a breach of trust in the trading system. Efficiency gains must be credited to the installations that achieved them; rather than punished they need to be rewarded to create further incentives for the transformation.

1.6 Free allocation should not be conditional to investment efforts

The draft proposes to make the free allocation conditional on decarbonisation efforts to incentivise the introduction of low-carbon technologies.

Under the revision, the rules on benchmarks that set the basis for free allowances would be strengthened and their allocation would be made conditional on decarbonisation efforts. This would severely limit the effect of the aid on beneficiaries' total costs. Compensations are granted as financial support and primarily serve to maintain international competitiveness; they should not be linked to conditions on re-investment. Any investments should take place where they can be established in an optimal and economical manner. Investments in transformation projects must remain an independent decision of the respective company in line with a company's decision on business strategy, liquidity planning and investment portfolio. External requirements on investment decisions that are not in line with a company's strategy will inevitably lead to inefficient capital allocation.

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In addition, financial resources for re-investment are not necessarily available, as the free certificates are required to be handed in at the end of the year. IFIEC recommends that compensations for companies, including indirect compensation, should be granted as financial support and not be linked to certain conditions of re-investments as this would deter emission reduction measures and ultimately hinder the transformation towards climate neutrality.

1.7 Including maritime transport in EU ETS requires careful assessment

Regarding the option of extending emissions trading to maritime transport, it is important to create a level playing field in international maritime transport. Efforts to find a solution at European level will likely disadvantage European maritime transport and thus lead to carbon leakage. In addition, the CO_2 emission reduction in the maritime transport sector will only happen over a longer period, as there are few alternative technologies available. Furthermore, any changes or improvements to be installed in the current shipping fleet are being constrained by limited shipyard capacities. These factors will increase the price pressure on the ETS.

2 CBAM introduction is closely linked with EU ETS carbon leakage measures

We welcome the commission's acknowledgement of the carbon leakage issue by proposing another safeguard measure. But, the proposed Carbon Border Adjustment Mechanism (CBAM) is regarded as an untested and uncertain measure, whose effectiveness relies on the robustness and reliability of data provided by third countries, whereas the current system of protection against carbon leakage provides more legal certainty and stability to EU producers. Therefore, the plan to replace a proven method for protection against carbon leakage through free allocations with a new, extremely complex and untested system is viewed critically by IFIEC. It is, vital that both drafts, i.e., the EU ETS review and the CBAM proposal, are not treated as separate entities, but discussed/negotiated simultaneously as they are closely interlinked and affect each other. Should a Carbon Border Adjustment Mechanism (CBAM) be introduced, it should include a solution for exports and co-exist with the current system of full benchmark-based free allocation at least until 2030, to provide certainty for low-carbon investments and avoid market distortions. Any subsequent modification of the rules needs to be conditional to a monitoring system assessing and ensuring the effectiveness of the CBAM both for imports and exports.

3 Separate emissions trading system for transport and buildings

IFIEC welcomes the fact that this should constitute a separate system, since an extension of the current EU-ETS to these sectors would have led to a further distortion of competition because of a significant imbalance in CO_2 costs and avoidance measures. The separate emission trading system needs to consider that these imbalances also exist between the traffic and the building sector.

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4 ETS revenues should support industrial transformation

For the revised ETS system to meet its emission reduction targets sustainably, it is of utmost importance to increase the financial support and enabling framework for the development and market uptake of low-carbon technologies in line with the technology neutrality principle. It is crucial for the revision to allow the development of new climate-friendly technologies and applications based on, e.g., carbon circularity. IFIEC welcomes the fact that the revision intends to increase the Innovation Fund, and also to extend the range of measures that the Innovation Fund can support to projects such as Carbon Contracts for Difference (CCDs). Financial support should not only be given to the first-of-a-kind installations within a sector, but also to the transformation of the sector.

In this context, the commission plans to increase the innovation fund, currently sourced from 450 million allowances from the existing ETS in 2021-30, by 50 million allowances and an additional 150 million allowances from the new system covering emissions from road transport and buildings. IFIEC would like the commission to ensure that funds that originate from industry budget will in turn be available to industry. Care should be taken that those funds that are intended to realize the decarbonization of industry are not re-allocated to other sectors or purposes other than decarbonizing the industry.

Industry will be the driver on the way to climate neutrality through innovation, but needs support for increasing and additional CO_2 costs as well as a predictable framework to deliver low-carbon investments

In conclusion, IFIEC re-emphasizes that secure legal and economic framework conditions with effective and sufficient carbon leakage protection are crucial for the energy-intensive industry to maintain international competitiveness and at the same time enable the transformation towards a climate-neutral economy.

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