CAN EUROPE POSITION: THE EU ETS REFORMS THE PARIS DEAL REQUIRES

February 2016

Climate Action Network (CAN) Europe is Europe's largest coalition working on climate and energy issues. With over 130 member organisations in more than 30 European countries - representing over 44 million citizens - CAN Europe works to prevent dangerous climate change and promote sustainable climate and energy policy in Europe.

PARIS IS A CALL FOR ACTION!

Climate action in Europe before and after 2020 needs to be substantially increased if we are to achieve the goals that governments agreed to in Paris.

In the Paris Agreement all countries agreed to hold the temperature increase well below 2°C and furthermore to pursue efforts to limit it to 1.5°C. But the emission reduction contributions that countries have agreed to still leave us with emissions that lead to 3°C warming.

If the European Union wants to walk its talk, it must act now to ensure that the Paris deal results in real additional action.

Governments agreed in Paris to come together to take stock of the collective efforts in 2018, and resubmit potentially improved targets latest by 2020. In order to remain true to its commitments, the EU needs to revise it greenhouse gas emission reduction targets for 2020 and for 2030.

Currently the EU's goal is to reduce its greenhouse gas emissions by 80-95% by 2050, with the current 2030 climate targets on a trajectory to meet 80% domestic emission reductions only. According to recent research, Europe would have to reduce its emissions more than 95% below 1990 levels by 2050 to ensure a more than 50% chance to have no more than 1.5°C warming by 2100.[i]

In stark contrast, the current 43% ETS reduction target for 2030 below 2005 levels would only lead to an 84% reduction in the ETS sectors by 2050.

Only emissions reductions of at least 95% or higher by 2050 can ensure some chances of staying below 1.5°C warming. This requires faster and significantly more reductions in the ETS.

THE EU ETS IS FAILING TO DELIVER

The ETS aims to help the EU achieve its long-term greenhouse gas reduction goals more cost-effectively and is meant to encourage investments in low-carbon technologies. Despite being hailed as the flagship of European climate policy, the ETS has failed to deliver on these objectives, mainly due to intensive lobbying of a small number of energy-intensive industry federation lobby groups.

A weak reduction target, the massive use of international offsets, and inflexible policy design have led – together with the economic recession – to an enormous oversupply of pollution permits. The price for these permits (called emission allowances) has therefore dropped so much that it no longer drives change to a low carbon economy.

The Market Stability Reserve (MSR) is an important but insufficient first step to improve the ETS. The surplus is only temporarily removed and models predict that the market will be oversupplied until 2025 or later.

Europe is currently discussing how it should revise its Emissions Trading Scheme (ETS) for the post 2020 period. In July 2015, the European Commission released its proposal on the revision.[ii]

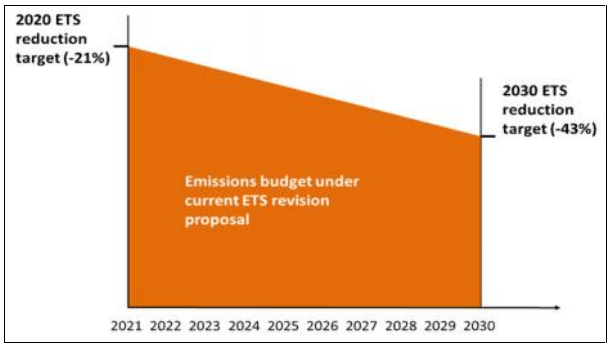
Absent reforms that go well beyond what the Commission is proposing, companies can delay or cancel investments in cleaner and more efficient production. The sectors that cause almost half of Europe´s greenhouse gas emissions could continue polluting at business-as-usual levels for the next 10 years or longer. This risks a lock-in of carbon intensive infrastructure for years to come, making Europe's climate goal more time-consuming and costly to achieve.

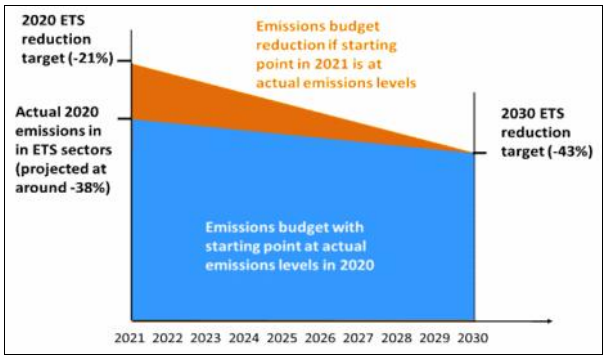
MAKING THE ETS FIT FOR PURPOSE

The EU is actually reducing its emissions far faster than its 2020 reduction target of 20% relative to 1990. Recent modelling shows that by 2020, Europe is on track for a 30% cut in economy-wide emissions. The ETS target for 2020 is minus 21% compared to 2005 emissions. But projections show that by 2020 emissions will be down 38%![iii]

The starting point for 2021 should be at actual emissions. If the emissions will be, as projected, at minus 38% in the ETS sectors by 2020, starting at actual emissions levels would significantly reduce total emissions under the ETS, see graphs on next page.

Illustrative graphs to show current proposed emissions budget and effect of starting at actual emission levels

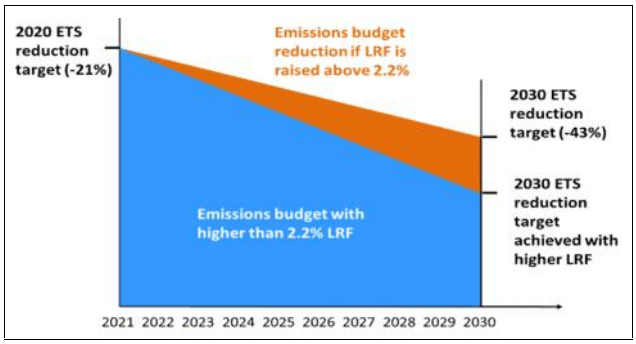




Permanent cancellation of pollution permits. By 2020, the EU ETS surplus will have grown to between 2.6 and 4.4 billion allowances.[iv] Permanent cancellation of this surplus can bring Europe back onto the least-cost path towards its climate goals.[v] The billions of surplus pollution permits that will have accumulated by 2020 can, under current rules, be fully carried over to the next trading period. This huge carry-over very significantly increases the total volume of greenhouse gases that can be emitted until 2030. Therefore the ETS revision must include the permanent cancellation of surplus allowances. This can for example be achieved by permanently cancelling the around two billion surplus allowances that will have accumulated in the MSR by the end of 2020. Furthermore, to avoid a large accumulation of allowances in the MSR a ceiling should be established above which allowances should be automatically cancelled. Alternatively, allowances should be cancelled after they have been in the MSR for a limited and pre-defined number of years.

A linear annual reduction factor which leads to a cost effective reduction of at least 95% of emissions until 2050. The Linear Reduction Factor (LRF) determines by how much the number of available allowances are reduced every year. Raising the linear reduction factor has a longer term effect and is also an important option, especially in combination with the first two recommendations above. The linear reduction factor should be raised well above the 2.2% currently suggested.

Illustrative graph to show effect of raising the LRF



Increasing ETS targets every five years. The Paris Agreement includes the requirement for all countries to come up with contributions to reduce emissions every five years. Accordingly, the ETS trading periods should also be five years. The current proposal is to have a ten-year trading period. This is longer than any ETS trading period so far. Such a long trading period can lead to inflexibilities and make it difficult to improve the ETS during that period.

Including bunker emissions. All maritime emissions should be included in the 2030 ETS emissions reduction target. The EU ETS should furthermore cover 50% of all outgoing and 50% of all incoming international flights from 2017 onwards.

INDUSTRY HANDOUTS AND WINDFALL PROFITS HAVE TO STOP

188 countries have submitted their climate commitments (INDCs), accounting for over 97 percent of global emissions. The argument that EU is acting alone on climate is certainly no longer valid as more and more countries are establishing climate and energy policies that cover similar sectors as captured by the EU ETS.

The success of the ETS revision hinges on its ability to make the polluter pay, rather than paying the polluter. Handing out free pollution permits contradicts the EU Treaty principle that polluters should pay. Generous exemptions in the form of free pollution permits have led to windfall profits for large energy intensive companies on the backs of EU citizens. Some energy-intensive industry lobbyists are scare-mongering and heavily exaggerating the risk the ETS is posing for EU competitiveness.

Carbon leakage is a term used to describe the hypothetical situation where stringent climate policies would force companies to move their production abroad to countries with less ambitious climate

measures to lower their production costs. This can lead to a rise in global greenhouse gas emissions.

There is no evidence for carbon leakage![vi] The European Commission's own impact assessment[vii] shows that there is no evidence that there has been carbon leakage due to the ETS, and research indicates that future risks are minimal.[viii] On the contrary, industrial sectors accumulated a surplus of over one billion pollution permits, worth over €11 billion.[ix] Many industries enjoyed huge windfall profits from passing on the price of pollution permits they received for free. As a result, the ETS has rather been an extra subsidy than a cost to many energy intensive industries.

The Commission's proposal would hand out about 6.3 billion free pollution permits, worth €160 billion to subsidize carbon pollution of industry from 2021-2030.[x] EU taxpayers would be picking up the bill as governments forego revenues, being unable to use revenues from auctioning these pollutions permits for other climate protection measures.

CAN Europe is against such blanketed pollution subsidies and supports a move to 100% auctioning. We are calling for fairer and stricter rules which would ensure that free pollution permits are significantly limited through a tiered and focused system. Free pollution permits should not be given to industries that do not face significant proven competitiveness risks.

REVENUES FOR CLIMATE ACTION IN THE EU AND ABROAD

All ETS auctioning revenues must be earmarked for more ambitious climate action, inside the EU and internationally.

Reinvestments of auctioning revenues into clean technologies and the smart and effective use of the modernization and innovation funds can create a virtuous cycle. The application of the 'polluter pays' principle can support investments in the tools needed for further decarbonisation and climate resilience, in the EU and internationally.

The ETS offers an excellent opportunity to mainstream climate policy into industrial policy to build a cleaner, more innovative and competitive future. Therefore auctioning revenues should serve to support the large-scale deployment of renewable energy and energy saving technologies and support long-term industrial policies targeted at the development of cleaner ways of producing and consuming goods. Dedicated financing should be used to support regional transition to sustainability with specific focus on workers and communities requiring tailored support.

Internationally, auctioning revenues should fund deeper emission cuts and support adaptation to an already changing climate in countries of the global South, including dealing with loss and damage.

We propose the establishment of an International Climate Action Fund managed by the EIB and replenished with a portion of ETS allowances, with revenues automatically and predictably channelled to UN climate funds such as the Green Climate Fund.

THIS REFORM WILL MAKE OR BREAK THE EU'S CLIMATE POLICY

The ETS has been in operation for more than 10 years and is still not delivering on its goals. The post-2020 review of the ETS Directive offers a last chance for EU policymakers to prove that pollution pricing can work for the climate.

Absent meaningful ETS reforms, fragmentation of climate policy may increase as it would be then in the hands of national governments to implement national policies and measures to tackle climate change effectively.

Decision makers and stakeholders in many countries are watching the success or failure of the biggest emission trading system of the world. Many of them see the EU's commitment to a meaningful ETS reform as an example for carbon regulation in their respective countries.

A clear signal that the EU is willing to implement a meaningful and forward looking ETS reform will therefore strengthen decarbonisation efforts in other regions of the world. It will also bolster European investments in a clean and competitive economy as it advances investment certainty. It will send a strong signal that the EU is serious about raising its climate ambition. That will help ensure that the whole world will put the Paris promises into action.

Last but not least, even if the reforms were to be bold and swift we will need other strong policies, such as for renewable energy and energy efficiency, and binding bioenergy sustainability criteria that accurately account for emissions from biomass[xi].

The ETS can at best support achieving the necessary long-term decarbonisation. A price signal is important. But a price signal alone, even if it was considerably higher, will not be sufficient to facilitate transformational change.

i Joeri Rogel's preliminary modeling results. He is based at IIASA.

ii http://ec.europa.eu/clima/policies/ets/revision/documentation_en.htm

iii https://sandbag.org.uk/site_media/pdfs/reports/EU_on_track_for_30_cuts_by_2020_9Dec15.pdf

iv EC (2014), SWD(2014)17, Impact Assessment accompanying the Proposal for a Decision concerning the establishment of a market stability reserve (see http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52014SC0017&from=EN) UK government: 3.1 billion, (see https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/364992/UK_MSR_position_gov.uk.pdf); estimates by Sandbag: 4.4 billion, (see https://sandbag.org.uk/site_media/pdfs/reports/EU_on_track_for_30_cuts_by_2020_9Dec15.pdf)

v COM (2011): A Roadmap for moving to a competitive low carbon economy in 2050: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52011DC0112

vi Carbon leakage refers to the situation where activities that are currently under EU ETS are transferred, for reasons of carbon costs, to areas where they do not fall under climate change policies. (See recital 24 of Directive 2009/29/EC, and p.7 of COM(2008)0016).

vii http://ec.europa.eu/clima/policies/ets/cap/leakage/docs/cl_evidence_factsheets_en.pdf

viii Recent research by the London School of Economics finds that the future impact of more ambitious climate policies on EU companies moving their production abroad is likely to be "extremely limited". A ten-fold increase in the carbon price and assuming 100% auctioning would cause exports to fall by only 0.5% and would increase imports by 0.07%.

ix Sandbag: Estimate for accumulated EUAs including offsets surrendered until 2012: 1.17 billion. The net worth is estimated to be €11.27 billion and is based on yearly averages for EUAs and offset prices.

x COMM (2015) European Commission's Impact Assessment.

xi CAN Europe et al., Pitfalls and potentials. The role of bioenergy in the EU climate and energy policy post 2020.

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