Making the EU ETS fit for 55

A Eurelectric position paper

May 2021

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powering people

Eurelectric represents the interests of the electricity industry in Europe. Our work covers all major issues affecting our sector. Our members represent the electricity industry in over 30 European countries.

We cover the entire industry from electricity generation and markets to distribution networks and customer issues. We also have affiliates active on several other continents and business associates from a wide variety of sectors with a direct interest in the electricity industry.

We stand for

The vision of the European power sector is to enable and sustain:

- A vibrant competitive European economy, reliably powered by clean, carbon-neutral energy
- A smart, energy efficient and truly sustainable society for all citizens of Europe

We are committed to lead a cost-effective energy transition by:

investing in clean power generation and transition-enabling solutions, to reduce emissions and actively pursue efforts to become carbon-neutral well before mid-century, taking into account different starting points and commercial availability of key transition technologies;

transforming the energy system to make it more responsive, resilient and efficient. This includes increased use of renewable energy, digitalisation, demand side response and reinforcement of grids so they can function as platforms and enablers for customers, cities and communities;

accelerating the energy transition in other economic sectors by offering competitive electricity as a transformation tool for transport, heating and industry;

embedding sustainability in all parts of our value chain and take measures to support the transformation of existing assets towards a zero carbon society;

innovating to discover the cutting-edge business models and develop the breakthrough technologies that are indispensable to allow our industry to lead this transition.

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WG Climate Change & Decarbonisation
Generation & Environment Committee

Contact:
Eivind STEEN, Senior Advisor hydropower and climate –
esteen@eurelectric.org

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KEY MESSAGES

- The Fitfor55 package must enable Europe to reduce emissions by at least 55% net by 2030 and put the EU on the right pathway towards achieving its climate-neutrality goal by 2050. The EU Emissions Trading System (EU ETS) must continue to be a core instrument to reach the increased climate ambition in the sectors that it covers.[1]

- Eurelectric and its members have been continuous supporters of a strong market-based EU ETS for delivering cost-effective GHG reductions across Europe. A well-functioning EU ETS policy must deliver a carbon price signal that can spur investments to decarbonise the energy system and enable Europe to meet its climate targets cost-effectively.

- Different starting points of Member States need to be taken under consideration in the spirit of solidarity. Proportionally to the new climate commitments, the ETS Directive should foster compensatory measures to mitigate associated compliance costs.

- Chiefly, the EU ETS in its current scope should be reinforced through a combination of three measures: increasing the linear reduction factor (LRF), updating the parameters of the Market Stability Reserve (MSR), and a one-off reduction (rebasing) of the ETS cap trajectory. Each of the proposed measures needs to be analysed carefully before its final application in the context of reflecting modifications to other EU ETS parameters as well as the revisions of other climate- and energy-related legislation within Fit for 55 Package.

- Eurelectric generally supports the enhanced application of carbon pricing in other sectors, but is wary about how it should be implemented. Eurelectric believes any extension of the ETS must be carefully assessed before an integration of new sectors into the existing ETS are considered. Therefore, a revision of the current ETS and a possible extension of the system must be addressed separately at this point. In order to mobilise non-ETS sectors to effectively reduce their emissions, potential flexibilities between the current ETS and the non-ETS sectors should remain limited. GHG emissions reduction measures included in the Effort Sharing Regulation and in sectoral policies at EU and national levels should continue to apply and even be strengthened.

This position outlines the key policy priorities to ensure cost efficiency, fair effort-sharing and predictability for the electricity sector while achieving EU climate goals.

[1] Powering the Green Deal, Stepping up Europe’s 2030 climate ambition

Updating the existing EU ETS to gear it for 2030

Allocation of the new 2030 climate target between ETS and non-ETS sectors

- All sectors must contribute to reaching the 2030 climate target
- The new target has to be allocated between ETS and non-ETS sectors based on the new target according to the Green Deal Impact Assessment taking into account cost-efficiency and fair distribution across Member States and sectors.

Our principles for the ETS revision

- The aim of the revision is to ensure that the ETS contributes to emission reductions in a cost-effective manner needed for achieving the EU's new and more ambitious 2030 climate target.
- Eurelectric recognises the interdependencies between rebasing, adjustment of the Linear Reduction Factor and the revision of the MSR. Changing one of them will influence the others.
- Early action yields stable price development and provides necessary signal for low-carbon investments and minimises cumulative emissions in the atmosphere.

Our take on the Linear reduction Factor

- The linear reduction factor (LRF) of the ETS must be revised in line with the revised 2030 climate target, suggesting a significantly higher LRF than today.
- Early action before the mid-20s is key for predictability. The earlier the LRF is adjusted, the less steep it must be. With no early action, the LRF needs to be steep[2] after 2026 to reach the climate target for 2030.

Rebasing as part of the reform

- Eurelectric supports a one-off reduction, considering the nominal cap considerably higher than actual emissions. A one-off reduction would align the cap with actual emissions levels. This would alleviate some of the pressure on the MSR (that has been the main cause for scarcity in the EU ETS so far), alternatively the LRF would need to be correspondingly higher in order to reach the same point in 2030.
- Eurelectric supports an early rebasing to reduce the LRF well before 2026 while avoiding retroactive changes.

Updating the Market Stability Reserve

The Market Stability Reserve will remain a key element towards 2030. It has reinforced the stability of the ETS, but should be further reformed to align with the current provisions. Any changes to the MSR must be carefully introduced to ensure a predictable price trajectory.

- To avoid a weakening of the MSR after 2023, the MSR intake rate should be maintained at 24% in order to keep a strong potential for tacking new EU ETS market imbalances that may occur in the future.
- The thresholds of the MSR triggering adjustments to annual auction volumes have a significant influence on the effectiveness of the MSR and should be updated to reflect an increasingly decarbonised economy and gradually declining hedging requirements in the power, industrial and aviation sectors.

[2] The linear reduction factor will likely be above 5% according to ICIS study 2021.

- The rule-based invalidation rule of the MSR should also be kept in place, but it should be investigated whether present rules of cancellation will not squeeze the market after 2030

Auction share to be maintained

- Auction share could be maintained at 57% at least under present condition but should be adapted in case a CBAM is put in place, depending on its final design.

Funding mechanisms to be strengthened

- Proportionally to the new EU climate ambitions and additional carbon costs, the revised ETS Directive has to increase the number of allowances dedicated to the Modernisation Fund and the share of allowances dedicated to the “solidarity pool”.
- It should be directly stated in the ETS Directive that a certain percentage of the national carbon revenues should be earmarked solely for the transformation of the energy generation in Member States concerned.
- Any new investments that might be considered in opposition to the Green Deal goals should come with a credible plan for how they become carbon neutral over time, and that availability of electric alternatives should be properly assessed before. Retroactive changes should be avoided. As the Modernisation fund will increase, the IA should therefore assess the potential effects on the energy transition for countries eligible for the fund as well as other carbon dependent regions currently not eligible for the fund and if necessary envisage further measures.
- The size of the Innovation Fund should also increase.

Overlapping policies to be assessed and addressed

Eurelectric would like to draw policymakers’ attention to the need to not only strengthen the ETS, but also to protect the ETS from the unintended and weakening effects of overlapping policies, while also fully acknowledging the benefits that a strengthened ETS will have on the achievement of other EU policy targets.

The European electricity sector therefore reiterates its call for proper recognition and management of the impact of European policies and implementing instruments on the overall economic efficiency and environmental effectiveness of the EU ETS.

The Commission should analyse the introduction of measures to address potential distributional effects of carbon pricing among the different sectors and consumers. Moreover, the Commission should assess the sustainability of the price trajectory until 2030, keeping in mind the risk of volatility in the ETS market and the distributional effects this entails.

Addressing extension of the EU ETS to new sectors separately while ensuring contribution to 2030 target

The non-ETS sectors must also contribute to the increased 2030 target. Sectors which are not exposed to any CO2 price, such as maritime, or an insufficient CO2 price, such as the buildings sector, should be addressed. This can be done either by extending the ETS scope or through other carbon pricing measures, using the most efficient tool for each sector. However, the EU ETS in its current form took many years of development. It is crucial not to disturb the stability and the resilience of the EU ETS system. Non-ETS sectors need to start delivering carbon reductions as soon as possible to catch up with the ETS sector well before 2030. It must also be remembered that some sectors will move into the ETS through electrification.

At this point, in order to ensure progress is made by Member States in reducing emissions in the non-ETS sectors, the ESR must be maintained. National policies are key drivers for GHG emissions reductions in these sectors today, as well as EU policies particularly covering transport.

New carbon pricing systems for other sectors could be explored in parallel for possible future integration of new sectors into the ETS as and when needed. However, further assessment must take place with thorough testing and standalone systems.

Criteria for the stand-alone systems

- Standalone systems would allow for gradually setting up the required regulatory framework and administrative capacity, in particular in terms of verification and monitoring.
- The existing ETS and the new standalone system should stay independent and no relationship between them should be established.
- Sectoral scope, responsibilities and liabilities need to be concise and consistent for the various activities to avoid overlapping CO2 pricing of emissions with the existing ETS.

Criteria for assessing a possible inclusion after testing

- In order for all sectors to contribute, the abatement costs must converge to a large extent in order for an inclusion to be assessed.
- The carbon price signal must be carefully assessed to decarbonise road transport or the heating of buildings
- It should be assessed if the observed reductions are driven by carbon pricing or by existing domestic provisions
- If the trading system for the new sectors has proven effective for GHG reductions, they could be assessed for possible integration in the ETS and the required changes in the cap trajectory, MSR parameter, price impacts must be studied.

Analyse the introduction of measures to address potential distributional effects of carbon pricing among the different sectors and consumers.

A Careful approach to Carbon Border Adjustment Mechanism

Eurelectric believes that the Green Deal should promote mechanisms which could make domestic industries more carbon efficient whilst simultaneously encouraging third parties to become more climate friendly, in line with EU trade policy objectives. Before setting up a CBAM, the EU should strive for cooperative solutions on defining a uniform carbon price between the relevant industry nations (“Club of the Willing”). Europe should put forward complementary policies and tools with the ultimate goal of developing a more global carbon market.

Eurelectric pursues in all its activities the application of the following sustainable development values:

Economic Development

- Growth, added-value, efficiency

Environmental Leadership

- Commitment, innovation, pro-activeness

Union of the Electricity Industry - Eurelectric aisbl
Boulevard de l'Impératrice, 66 – bte 2 - 1000 Brussels, Belgium
Tel: + 32 2 515 10 00 - VAT: BE 0462 679 112 • www.eurelectric.org
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