

Align EU climate and growth goals through ETS reform

The European Union has set an ambitious CO₂-reduction target of -40% in 2030 compared to 1990 levels. At the same time, it faces the imperative of creating economic growth and jobs in order to maintain and improve the welfare of its citizens.

These goals can and should reinforce each other. However, within the current design of the EU ETS they do not. As a consequence, the most energy- and CO₂-efficient companies do not fully realize their potential to create jobs and growth.

This is the reason why Europe has to develop a proposal to substantially improve the EU ETS. According to both the Dutch and Polish governments and industries this proposal should be based on the principle that the cap of total allowances in the system could be tightened only if the competitiveness of Europe's most CO₂-efficient companies will be fully safeguarded.

Whereas the European Council in October 2014 decided to tighten the cap, the European Commission is currently preparing a legislative proposal to improve the working of the EU ETS. The Heads of State, provided already guidance on the conditions that should be met in the upcoming proposal. The Council stated that in order to safeguard European industrial competitiveness and strengthen the investment climate in Europe, the system of free allocation should be continued to provide appropriate levels of support for sectors at risk of losing international competitiveness.

What are the features of the current EU ETS?

- To maintain a global level playing field and prevent carbon leakage industry is allocated allowances for free. Allocation is based on historical production and efficiency benchmarks.
- A cross-sectoral correction factor is applied to ensure the CO₂-emissions stay under the predetermined CO₂-ceiling. This means that regardless of efficiency, production levels or risk of carbon leakage all companies are, or will be, allocated significantly less allowances.

What are the consequences of these features?

- Companies have limited incentive to increase production because they do not receive additional allowances. In effect, there is an incentive to decrease production and earn windfall profits by selling the allowances on the market.
- The cross-sectoral correction factor means that even the world's most CO₂-efficient installations do not receive 100% of their allowances for free. This hampers the competitiveness of even Europe's most CO₂-efficient energy intensive companies.
- As a result of the above, EU ETS lead to a poor investment climate for industry in the EU, especially for the CO₂-efficient industrial installations. At the same time, focusing the investors' attention on other investment destinations such as the US and China, lowering economic growth and losing employment opportunities in the EU..

How can the EU ETS be improved?

- Allowances should be allocated based on actual production and realistic benchmarks so as to give an incentive for growth and prevent windfall profits.
- The cross-sectoral correction factor should be abolished. To ensure alignment with the emissions ceiling a reserve with allowances could be set-up.
- These two measures will ensure that the most CO2-efficient installations receive 100% of their allowances for free. This would prevent carbon leakage and mean a most necessary improvement of the investment climate in the EU.