

5 February 2021

ETS Review: Eurometaux Policy Brief supporting the ETS Public Consultation Response

Executive Summary

This document complements our public consultation response and our recent response to the inception impact assessment¹. We elaborate on some of the topics raised in the consultation in more detail.

In this response, we comment on:

- 1. Indirect cost compensation – auction revenues and system:** The recently agreed ETS Guidelines represent the most optimal way to protect electro-intensive producers against carbon leakage due to increased electricity prices stemming from higher CO₂ costs passed on in their electricity bill. To provide regulatory stability, the system should remain in place till 2030. In addition, auction revenues, which are needed to compensate industries from the indirect costs of the EU ETS and encourage industrial electrification should remain with Member States and not go to the EU budget.
- 2. The need for improved carbon leakage protection for the most exposed electro-intensive industries because of the increased 2030 target:** Given the increase in climate ambition (and resulting increase in ETS allowances) the existing carbon leakage framework must be strengthened. The current indirect compensation scheme should remain in place and with regards free allocation, a sufficient level of free allocations must be ensured. Alongside this, additional protection measures are needed for electro-intensive industries such as the non-ferrous metals sector who are the most exposed sector to carbon leakage. Having analysed the measure, our assessment is that a carbon border adjustment measure (CBAM) covering non-ferrous metals will not be effective in preventing carbon leakage for our sector.
- 3. Revision of the Market Stability Reserve (MSR):** Adjusting the MSR while remaining within the ETS cap, can be a way to avoid the introduction of the Cross Sectoral Correction Factor (CSCF) towards the end of ETS Phase IV. This would support emission reduction target and reduce carbon leakage risk. We propose to keep aside that surplus accumulated because of the economic downturn due to the COVID crisis and the financial crisis and protect such volume from the invalidation clause. These EUAs are highly needed surplus to cope with economic recovery and industrial growth.
- 4. Contributions of the ETS sectors & changes to the CAP:** More ambitious 2030 target should primarily focus on ensuring sectors currently covered by the Effort Sharing Regulation (ESR) deliver emission reductions. Rebasing should not be pursued as an option and the LRF should remain the only instrument to set the cap.
- 5. Designing a carbon removal system that addresses negative emissions:** The European Commission should develop new a certification system for rewarding negative emissions. Possible solutions could be measures such as allowing offsite removal of emissions to be used to balance industries' remaining emissions under the ETS.
- 6. Extending to other sectors:** If emission trading is extended to other sectors, it is important that these remain separate systems, with no interaction in the start-up years.

¹ Accessible [here](#).

1. Indirect cost compensation – auction revenues and system

The recently agreed ETS Guidelines² represent the most optimal way to protect electro-intensive producers against carbon leakage due to increased electricity prices stemming from higher CO2 costs passed on in their electricity bill. To provide regulatory stability, the system should remain in place till 2030.

In addition, auction revenues, which are needed to compensate industries from the indirect costs of the EU ETS and encourage industrial electrification should remain with Member States and not go to the EU budget. The current debate on filling the EU budget via the ETS auction revenues risks undermining the potential of industrial decarbonisation. The Commission 2018 Clean Planet Strategy attached particular importance to electrification as one of the key routes for decarbonisation. With increased carbon prices, indirect carbon costs for the industry will increase and thus, it is essential that adequate state aid for indirect carbon costs is provided. If these revenues instead go to the EU budget, then, fewer resources would be available to provide compensation.

2. Improved Carbon leakage protection measures to protect most electro-intensive industries

Until other regions show the same climate ambition as Europe and comparable industries pay the same climate costs, policymakers need to ensure that high climate ambition is met with reciprocal measures to protect the most exposed against carbon leakage.

The existing framework must be strengthened. The indirects compensation system should remain in place till 2030 and with regards free allocation, a sufficient level of free allocations must be ensured to avoid a CSCF³, and any type of reduction avoided. In addition, complimentary measures are needed to protect the most exposed electro-intensive industries from carbon leakage.

Having analysed the measure, our assessment is that a carbon border adjustment measure (CBAM) covering non-ferrous metals will not be effective in preventing carbon leakage for our sector given; 1) the inability to design a CBAM to cover indirect emissions costs (Not emissions), 2) our complex value chain, 3) the potential lack of an export rebate. Instead, other additional carbon leakage measures should be explored for the most exposed electro-intensive industries.

3. Revision of the Market Stability Reserve (MSR)

From our experience, the MSR has not delivered on its main objective as it has mainly worked as an imbalanced demand-supply instrument, rather than a stability instrument. Overall, the MSR has functioned as an additional cap reduction instrument, de-facto artificially increasing the CO2 price, both in an oversupplied market and in a short market.

Therefore, to improve the functioning, the invalidation clause starting in 2023, must be reviewed putting aside part of the ready to be invalidated EUAs.

These put-aside EUAs should be differentiated due to their different nature. Some of them e.g., those accumulated due to economic downturn - should be brought them back into the market to avoid CSCF in Phase 4 and to add into the New Entrants Reserve if needed (see below).

² The Guidelines of State Aid for Indirect Costs of the EU ETS post 2021 can be accessed [here](#).

³ The European Commission's 2030 Climate Target Plan Impact assessment states that the CSCF risk is small even in 55% emissions reductions scenarios (pg. 111 – 112). However, several other recent studies such as the ERCST "2020 State of the EU ETS" report on the other hand show that a 55% 2030 target a rather a rather significant CSCF of 35% compared to the current 2030 target.



An MSR fit for green industrial growth

The new 2030 target will put the current system of free allocation under considerable pressure, increasing exponentially the risk to trigger the cross sectorial correction factor (CSCF). Therefore, the revision must ensure improved carbon leakage protection through total avoidance of the CSCF in Phase 4.

Despite the Commission stated in its 2030 Climate Target Plan Impact Assessment⁴ that the CSCF risk is small even with an at least 55% target, several studies⁵, conclude that a 55% target could trigger a significant CSCF of -35% compared to the current 2030 target. It is crucial that the new ETS target does not lead to a situation where installations performing at benchmark level face any carbon cost. It is vital that the higher ambition does not result in unbearable EUA price for industries.

Adjusting the Market Stability Reserve (MSR), while remaining within the ETS cap, can be a way to avoid the CSCF. This would support emission reduction targets and reduce carbon leakage risk.

We believe a robust review of the present MSR Regulation could serve the purpose, while supporting industrial growth. First, we look at the MSR's initial intentions and structure and consider whether it has achieved its objectives so far:

- The MSR was developed as a stability instrument to tackle structural supply-demand imbalances. However, it has been functioning as an asymmetric balance correcting instrument, due to the high intake rate (24%), versus a low additional supply correction: 100 Mt per year and only for 4-years. This means that the potential supply withdrawals from the market, annually affecting the auction volume, are structurally much higher than the auction supply injections into the market. By removing allowances from the market when there is a surplus, the MSR is de-facto functioning as a yearly incremental re-basing of the cap over Phase 4.
- Due to its unbalanced structure, the MSR currently serves mainly as a price increase instrument both in an oversupplied market and in a short market and is counterproductive regarding avoiding carbon leakage and encouraging growth.
- Further, the current MSR regulation determines that from 2023 onwards the number of allowances held in the reserve will be limited to the auction volume of the previous year. Holdings above that amount will lose their validity (so-called invalidation clause). This invalidation will work as a permanent cap reduction instrument, de-facto increasing the ETS sectors contribution to the new higher climate target.

Based on the above, we believe the MSR has not fully achieved its objectives, hence some adjustments are required.

Our proposal

We recommend introducing more flexibility to the invalidation clause, to improve the MSR functioning as a better stability instrument. We propose that part of the ready-to be invalidated volume be set-aside and released later if necessary, to avoid the risk of CSCF during Phase 4. The set-aside volume should also be released in case needed to top up the New Entrants Reserve (NER), in order to stimulate and not punish industrial growth.

The surplus accumulated in the MSR has different natures. Today the MSR removes allowances from the market regardless of their nature (economic downturn, emission reductions, use of international credits). We believe we should differentiate between surplus accumulated due to economic downturn resulting in lower EUA demand, versus, for instance, accumulated allowances surplus due to international credits used for compliance reasons.

⁴ See [p. 112](#) EC Impact Assessment on 2030 Targets Plan Communication

⁵ See [ECRST 2020 State of the EU ETS Report](#), April 2020



We propose to keep aside that surplus accumulated because of the economic downturn due to the COVID and the financial crisis and protect such volume from the invalidation clause. These EUAs are highly needed to cope with economic recovery and industrial growth.

The split between the two MSR surpluses need to be calculated on an annual basis. Hence, we suggest that the good surplus should be released back to the market in case needed to 1) avoid the CSCF and 2) to potentially adding volume to the NER.

This will ensure the ETS principle of free allocation based on updated benchmark levels is maintained as well as the cap reduction in accordance to the LRF. Furthermore, it will give flexibility and ensure the MSR functions as a better stability instrument also in case of economic growth.

It is important to note that re-injecting part of the set-aside allowances in the market would not interfere with the overall ETS cap as these are already existing allowances under the cap. It will also contribute to reducing global emissions by avoiding carbon intensive import. European climate regulation over the years has made European industries among the lowest carbon intensive industries in the world, if not the lowest.

Finally, re-establishing a supply-demand balance would ensure better carbon leakage protection where the need has been acknowledged; better serve the European Green Deal growth objectives and better protect best performers.

4. How to meet the 55% reduction target

ETS vs ESR- where to reduce emissions

Achieving more ambitious emission reduction targets by 2030 requires reductions in all sectors of the economy. Since 2005, EU ETS sectors and non-ETS sectors (covered by the Effort Sharing Regulation) have been reducing CO₂ emissions at significantly different rates, with ETS-sectors compelled to strive towards a -43% reduction target against the -30% for ESR sectors compared to 2005. It is noteworthy that EU ETS sectors have kept reducing their emissions at a faster pace than ESR sectors.

The abovementioned Commission impact assessment continues to foresee marked differences in the reduction targets as well for 2030. The projections show -65/-69% in each of the scenarios for ETS-sectors and -39/-41% for non-ETS (in Part 1, table 28, page 129). This threatens the current functioning of the ETS system and the competitiveness of industry. The sole -65% GHG reduction target is expected to decrease the cap level by 2 billion allowances, in turn translating into a decrease of 800 million free allowances.

Hence, the Effort Sharing Regulation and the ETS Directive need to address sectors currently covered by the Effort Sharing to deliver a fair share of emission reductions.

Linear Reduction Factor & Rebasing

A 55% reduction target might lead to a dramatic reduction of the cap over the Phase IV period. Amongst the options presented in the IIA, a one-off cut, referred to as “rebasing”, should not be supported because it will represent an additional cap burden, further to the already existing invalidation clause under the MSR.

The proposal for rebasing the cap in 2021 also represents a dramatic supply cut which would take place at the same time as a large volume is taken out of the auction platform and put into the MSR. This will have a great influence on the supply level and liquidity in the market and would likely lead to a price spike. Therefore, the price and cap consequences need to be evaluated, as such options would represent a large increase in compliance costs and carbon leakage risk and will not pursue the objectives of green growth.



5. Designing a scheme to address negative emissions

To reach climate neutrality by 2050, investments in negative emissions should be encouraged and rewarded. Recognising negative emissions investments would allow efficient industries, with high transformation costs, to operate in a longer transition period. Therefore, we believe new regulatory instruments for financing and rewarding negative emissions should be developed. New emission abatement measures may include, for instance, measures allowing off site removal of emissions to be used to balance industries' remaining emissions under the ETS.

6. Extension of ETS to other sectors

While we welcome the increased focus on non-ETS sectors to accelerate their contribution to emission reductions, which do not support including sectors such as road transport and buildings in the EU ETS. These sectors have considerably higher carbon abatement costs than the EU ETS, and thus would likely considerably drive up the EU ETS price.

We thus believe that separate carbon pricing schemes for these new sectors would be a more suitable solution. In particular, the extension of emissions trading to maritime emissions, should be evaluated based on the maritime sectors abatement cost possibilities, meaning the delta between present abatement solutions in the existing ETS sectors and maritime sector.

ABOUT EUROMETAUX

Eurometaux is the decisive voice of non-ferrous metals producers and recyclers in Europe. With an annual turnover of €120bn, our members represent an essential industry for European society that businesses in almost every sector depend on. Together, we are leading Europe towards a more circular future through the endlessly recyclable potential of metals.

Contact: Cillian O'Donoghue, Climate & Energy Director | odonoghue@eurometaux.be | +32 2 775 63 12



Annex. An accurate carbon leakage assessment of our sector's risk

Before, increasing the 2030 targets, the European Commission should carry out a proper impact assessment looking at the exposure of sectors to carbon leakage in the event of a 55% GHG reduction target. We have recently written to the Commission to highlight our concerns with regards an upcoming study publication 'Assessment of sectors vulnerable to carbon leakage in Phase IV'. The report will play a major role in forming the basis for upcoming EU policy initiatives linked to the EU's strengthened climate ambition for 2030 (55% GHG), since it will provide insight on the carbon leakage risk faced by energy intensive sectors in Phase IV of the EU ETS (2021 – 2030). Therefore, it is very important that the findings and methodology employed are accurate.

However, we have the following concerns with the study's findings and methodology:

- **Indirect carbon costs not assessed:** The methodology's rationale employed by the consultants does not assess the impact of indirect carbon costs on carbon leakage in a meaningful manner, if at all. Indeed, as outlined in the Council Conclusions of October 2014 'both direct and indirect carbon costs lead to carbon leakage'⁶. However, only direct carbon costs seem to have been assessed. As Europe's most electrified energy intensive sector, indirect carbon costs are greater than direct carbon costs for our sector. Failure to look at the impact of indirect carbon costs leaves a completely distorted picture of carbon leakage risk.
- **Price-taker market characteristics:** While the study does look at the ability of each sector to pass on carbon costs, the specific market characteristics of a sector are not adequately assessed. In assessing market characteristics, a key question is whether a sector can pass on carbon cost to its customers. For price-taker sectors, this is not feasible. Indeed, our sector's products are traded on global commodity exchanges such as the London Metal Exchange. Given that prices for non-ferrous metals are set globally, we cannot pass on any unilateral regulatory costs – such as ETS carbon costs, both direct and indirect – to our customers without losing significant market share to competitors operating in other regions of the world, who are not burdened with the same costs. An assessment of whether a sector is a 'price-taker' is fundamental for an accurate assessment of a sector's carbon leakage exposure.
- **The cost of abatement technologies not adequately taken into account:** Another flaw of the study is that cost abatement is not taken into account. The study first checks to see if there is a 'substantial allowance shortage' and if so, whether these emissions can be abated to cover the shortage. However, it is inaccurate to assume that abating emissions is a simple and inexpensive process. Indeed, one cannot ignore the costs of implementing these investments aimed at abatement. Often these are massive investments where there is not even a business case. Thus, the cost of proceeding with these investments must obviously be considered when assessing the feasibility of abatement.
- **Lack of evidence of carbon leakage:** The study seems to indicate that carbon leakage has not occurred nor will not occur in Phase IV. We strongly disagree with the overall conclusion that there is no evidence for any carbon leakage. Indeed, we are a sector already experiencing carbon leakage. If we take the example of primary aluminium production, more than a third of Europe's primary aluminium plants have closed since 2008, while Europe's demand and imports of aluminium have increased. It should be noted that metals production in Europe is already up to eight times less carbon-intensive than metals produced in China. Overall, looking at the trends in the level of production of non-ferrous metals in both Europe and China over the past 20 years, and considering the average carbon intensity of the metals produced in each of these two regions, it is impossible to conclude that carbon leakage has not already occurred.

⁶ EUCO 169/14

