Opinion of the European Economic and Social Committee on the 'Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/87/EC to enhance cost-effective emission reductions and low-carbon investments'

(COM(2015) 337 final — 2015/0148 (COD))

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Rapporteur: Antonello PEZZINI

On 7 September 2015 the European Parliament, and on 21 September 2015 the Council, decided to consult the European Economic and Social Committee, under Articles 192 and 304 of the Treaty on the Functioning of the European Union, on the:

Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/87/EC to enhance cost-effective emission reductions and low-carbon investments

(COM(2015) 337 final — 2015/0148 (COD)).

The Section for Agriculture, Rural Development and the Environment, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 18 November 2015.

At its 512th plenary session, held on 9 and 10 December 2015 (meeting of 9 December), the European Economic and Social Committee adopted the following opinion by 138 votes to 1 with 1 abstention.

1. **Conclusions and recommendations**

1.1 The Committee is convinced that sustainable reindustrialisation with competitive growth that creates new and better jobs is crucial to Europe, and that in this respect the EU's CO_2 trading system should constitute a key European policy instrument for combating climate change and for moving towards a carbon-free world economy.

1.2 The Committee considers that, as an instrument for reducing the EU's energy emissions, the EU's Emissions Trading System (EU ETS) should provide a carbon price signal while also boosting sustainable investment in new low-carbon technologies.

1.3 In the EESC's view the carbon market needs to be made more stable, flexible and open to all the main global partners, as part of a detailed and coordinated framework, so as to achieve the objective of a competitive and sustainable industrial manufacturing system.

1.4 The Committee would argue that the Commission must comply strictly with the mandate set out by the 2030 Climate and Energy Policy Framework agreed by the European Council on 23 and 24 October 2014, in particular regarding its clear indications on the carbon leakage provisions to be developed as part of the EU ETS reform.

1.5 In the Committee's view, proper transition mechanisms must be put in place so as to protect the competitiveness of European industry and offset the risks of investment flight and of exposing European industry to unfair competition from countries with no comparable climate regulations.

1.6 The EESC recommends the establishment of a proper framework of rules, particularly regarding free allocation levels, carbon leakage admissibility, the review of benchmarking parameters and compensation for costs passed on to electricity prices, so as to secure 100 % free allocation and full compensation for indirect costs in all Member States for the 10 % most efficient plants in sectors exposed to a high risk of carbon leakage.

1.7 The EESC recommends the following as key aspects of the reform:

— abolition of the cross-sectoral correction factor for direct costs,

— harmonised European-level mechanisms to compensate for indirect costs throughout the EU, in order to prevent distortions of competition ([1]),

— rather than penalties, reward schemes for best performers however the results are achieved, including carbon capture and use,

— benchmarks based on solid industrial data, set once only at the beginning of a given period,

— the allocation of free allowances for sectors on the basis of actual as opposed to past production levels,

— the possibility of a fall-back approach in Phase 4 for sectors with no pre-existing benchmarks,

— a looser definition of carbon leakage with up-to-date qualitative risk criteria without introducing threshold values,

— use of part of the Market Stability Reserve to support the phasing out of sectors that have been removed from the carbon leakage list,

— extension of the exemption from the mechanism to plants with emissions below 50 000 t CO_2,

— full mainstreaming of the social dimension within the EU ETS in order to support the transfer of industrial and employment processes and skills towards a carbon-free economy,

— examination of how to extend reward schemes for best performers to civil society, awarding ***ETS bonuses*** to households, communities and official bodies which significantly reduce their own consumption of CO_2-generating energy or offset their emissions with ***green investments***,

— an independent preliminary study to establish the operating mechanisms through which the EU ETS will best contribute to reaching the climate goals set.

1.8 Lastly, the Committee calls for maximum consistency, full synergy, minimum overlap between requirements, and the elimination of excessive red tape in the new rules revising the EU ETS and the parallel and accompanying rules with which they interact.

1.9 The EESC considers that a framework for trading international credits should be set up: these credits should have a part to play in achieving the broader aims of reducing emissions in Europe, with the support of multilateral and bilateral international agreements.

1.10 The Committee considers it important to draw up an own-initiative opinion on this subject once the Paris Conference in late 2015 has concluded.

([1]) See *State aid Modernisation for an integrated EU energy market*, Joaquín Almunia, Vice-President of the European Commission responsible for Competition Policy, Brussels, 2 December 2013, *Energy: the sector where 'more Europe' is most needed*. Development of common principles for the assessment of State aid. For aid to be compatible, it needs to — Contribute to a common EU objective — Correct proven market failure/address equity concern — Be an appropriate instrument — Ensure an incentive effect — Be proportional/limited to the minimum — Avoid undue distortions of competition and trade. See also *Guidelines on State aid for environmental protection and energy 2014-2020* (OJ C 200, 28.6.2014, p. 1).

2. **Introduction**

2.1 The EU Emissions Trading System came into operation on 1 January 2005, and is one of the EU's most important climate policy instruments, in the light of the opportunities it provides to cut greenhouse gas emissions.

2.2 Since it was set up, the EU ETS has sought to provide a reference point for carbon, with the aim of enabling emissions to be reduced in all sectors of the European economy that are responsible for approximately half of the EU's greenhouse gas (GHG) emissions.

2.3 The EESC has always considered the EU ETS to be a key instrument in EU climate and energy policy for reducing the EU's industrial emissions, and has called for its genuine reform with a view to achieving the EU's climate objectives for 2030 while safeguarding the Union's industrial competitiveness and avoiding investment leakage.

2.4 The **European Council of 21 March 2014** called for measures to compensate in full for the direct and indirect costs arising from EU climate policies for sectors exposed to global competition, until such time as an international climate agreement succeeds in establishing a level global playing field.

2.4.1 The EESC would nevertheless reiterate the observations made by the European Court of Auditors, according to which there are 'significant weaknesses' in the implementation of the EU ETS, and would make a number of recommendations with a view to improving the integrity and implementation of the system, while boldly asserting the notion of industrial efficiency to ensure that the EU economy is fully competitive.

2.5 On **23 and 24 October 2014, the European Council** laid down the 2030 Climate and Energy Framework. It also adopted conclusions, and in particular endorsed a number of important targets:

— a binding EU target of reducing greenhouse gas emissions by at least 40 % by 2030 compared to 1990 levels, with a linear reduction in the annual rate of 1,74 %,

— a binding target of at least 27 % for consumption of renewable energy in 2030, but without binding targets for the Member States,

— an indicative target of improving energy efficiency by at least 27 % — non-binding, but subject to revision with a view to raising it to 30 %,

— support for the urgent completion of the internal energy market, meeting the existing electricity interconnection target of 10 %, no later than 2020.

2.5.1 The EU's target of reducing domestic greenhouse gas emissions by at least 40 %, formally adopted at the Environment Council meeting of 6 March 2015, represents the basis for the EU's contribution to the negotiations on a new global agreement on climate change.

2.5.2 All these aspects of the framework will be reviewed from time to time by the Council, which will continue to provide strategic guidelines for both sectors covered by the ETS and those not, and for interconnections and energy efficiency.

2.5.3 Instruments and measures must take a comprehensive and technologically neutral approach to promoting lower emissions and energy efficiency.

2.6 On **13 May 2015** agreement was reached between the Council and the European Parliament on reform of the EU ETS, with a decision on a market stability reserve (MSR):

— a market stability reserve will be established in 2018, to be operational from 1 January 2019,

— 'backloaded' allowances (the 900 million allowances whose auction was postponed from 2014-16 until 2019-20) will be placed in the market reserve,

— unallocated allowances will be transferred directly to the MSR in 2020 and their future usage is to be considered under the wider EU ETS review,

— the *10 % solidarity component* of allowances will be temporarily exempt from the scope of the MSR until the end of 2025,

— the EU ETS review will take account of the possible use of a limited number of allowances before 2021 in order to make use of existing resources for promoting CCS (CO_2 capture and storage),

— the EU ETS and market stability reserve reviews will take account of:

— the relocation of CO_2 emissions and competition-related aspects, and

— employment and GDP issues.

2.7 As part of the Energy Union strategy and with a view to the Paris climate conference, the Commission has proposed a package of measures intended, inter alia, to revise the EU Emissions Trading System in accordance with the indications laid down by the Council, retaining the reindustrialisation of the European economy and the international competitiveness of those industrial sectors most exposed to the risk of relocation of production, as priorities.

2.8 The measures to revise the EU ETS touch upon many other EU policies apart from energy.

2.9 The EESC commissioned a study on the impact of measures financed by EU environmental protection instruments ([2]), which emphasised the importance of the effective utilisation of revenue from market based instruments to achieve environmental improvements in line with the promotion of the green economy, as well as revenue generated by the EU ETS, which represent a particularly significant opportunity to fund such improvements and to move industry and employment towards a carbon-free economy.

3. **The Commission's proposals**

3.1 The Commission initiative modifying EU ETS directive 2003/87/EC sets out by means of a series of interlinked proposals to increase the annual reduction level for allowable emissions, so that the quantity of allowances released each year across the European Economic Area (EEA) declines by a linear factor of over 2,2 %, from 2021 onwards, to achieve a reduction of 43 % in 2030 compared to the 2005 level.

3.2 The proposal contains several funding mechanisms to support economic actors who must combat carbon leakage and meet the major challenges posed by the innovation and investment needed to modernise their plants and to achieve energy efficiency to help reduce emissions.

4. **Global emissions trading systems**

4.1 Emissions trading systems are expanding across the world outside the EU, with national and sub-national systems already operating in various countries.

4.2 In the **US**, President Obama has announced the rules for the Clean Power Plan (CPP), which will lay down individual standards for each state to reduce carbon emissions from power stations — mainly coal and gas burning — by 2030.

4.2.1 A 'cap-and-trade' programme was launched in **California** in 2012. The Regional Greenhouse Gas Initiative (RGGI) is in force in **Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New York, Rhode Island** and **Vermont**.

([2]) www.eesc.europa.eu/envistud

4.3 **Australia** has an emissions trading system that will be linked to the European one by 2018, under a 2012 agreement with the European Commission.

4.4 In **Canada**, Quebec's Cap-and-Trade System for Greenhouse Gas Emissions was introduced in 2012, covering 85 % of Quebec's emissions from 2013.

4.5 **New Zealand** launched the NZ ETS in 2008, which includes forestry and agriculture, liquid fossil fuels, electricity generating plants and industrial processes.

4.6 At their bilateral summit in June 2015, the EU and **China** reached an agreement on cooperating to combat climate change.

4.7 Since January 2015, the KETS programme has been underway in **South Korea**, the first national-level system in operation in Asia and the second in the world after the EU ETS.

4.8 The Tokyo Cap-and-Trade Programme (TMG ETS) is **Japan**'s first mandatory emissions trading scheme, launched in April 2010.

4.9 In **Switzerland**, the ETS-CH was launched in 2008 on a 5-year voluntary basis as an alternative option to the CO_2 tax on fossil fuels: since 2013 the scheme has been mandatory for large energy-intensive industries.

5. General comments

5.1 The Committee considers that the EU ETS can be an efficient, key instrument for reducing the EU's energy emissions, provided it follows a market-driven approach that should provide a carbon price signal commensurate with ambitions and at the same time boost investment in low-carbon technologies, foster the development of renewable energies and enhance energy efficiency.

5.1.1 The EESC is concerned by the potential acceleration in investment leakage as a particular form of carbon leakage in vulnerable sectors. This process could further reduce the competitiveness of these sectors and their ability to adopt the measures needed to achieve a low-carbon, resource-efficient economy, in line with the comments made in recent opinions ([3]).

5.2 The EESC is convinced of the need to make the carbon market more stable, flexible and open to all its main global partners.

5.3 The 2030 Climate and Energy Policy Framework agreed by the European Council on 23 and 24 October 2014 sets ambitious targets for unilateral reductions, and also provides specific guidelines for the carbon leakage mechanisms to be developed as part of the EU ETS reform.

5.3.1 The EESC also considers that the EU ETS reform should represent a framework for coordinated policy, particularly in combination with reform of the non-ETS sectors (Effort Sharing Decision — ESD) and policies on renewable energies (Renewable Energy Directive — RED) and energy efficiency (Energy Efficiency Directive — EED and Energy Performance of Buildings Directive — EPBD).

5.4 The EESC would argue that key aspects of the reform should include:

— abolition of the cross-sectoral correction factor for direct costs,

— harmonised European-level mechanisms to compensate for indirect costs,

([3]) *Market-based instruments — Low carbon economy in the EU* (OJ C 226, 16.7.2014, p. 1), *Policy Framework for Climate and Energy 2020-2030* (OJ C 424, 26.11.2014, p. 39) and *The Paris Protocol* (OJ C 383, 17.11.2015, p. 74).

— rather than penalties, reward schemes for best performers however the results are achieved, including carbon capture and use,

— the establishment of benchmarks based on solid industrial data and set once only at the beginning of a given period,

— the allocation of free allowances for sectors based on actual production,

— possibility of a fall-back approach in Phase 4 for sectors with no pre-existing benchmarks,

— a looser definition of 'carbon leakage' with up-to-date qualitative risk criteria,

— use of part of the Market Stability Reserve to support the phasing out of sectors that have been removed from the carbon leakage list,

— exemption from the mechanism for smaller plants with emissions below 50 000 t CO_2,

— complete mainstreaming of the social dimension within the EU ETS in order to fully support the transfer of industrial and employment processes and skills towards a carbon-free economy.

5.4.1 Companies at risk of relocation should be allocated a number of free emission allowances.

5.5 In the Committee's view, proper mechanisms should be put in place for the transition towards a balanced reduction in free CO_2 emission allowances in order to protect European industries' competitiveness and offset the risks of investment flight and of exposing European industries and employment sectors to unfair competition from countries lacking comparable regulatory frameworks.

5.5.1 In particular there needs to be a package of appropriate rules on free allocation levels, carbon leakage admissibility, the review of benchmarking parameters and compensation for costs passed on to electricity prices, so as to secure 100 % free allocation and full compensation for indirect costs in all Member States for the 10 % most efficient plants in sectors exposed to a high risk of carbon leakage.

5.5.2 Thought should also be given to the possibility of extending reward schemes for best performers to civil society, awarding ***ETS bonuses*** to households, communities and official bodies which significantly reduce their own consumption of CO_2-generating energy or offset their emissions with ***green investments***.

5.6 The EESC considers that the Clean Development Mechanism (CDM) should be retained, improved and extended, and the links between the European ETS and new systems emerging in other parts of the world must be given sufficient support.

5.7 Climate change calls for a global solution based on an agreement with clearly-defined and secure objectives for all the major world economies.

6. **Specific comments**

6.1 The Committee recommends reviewing the procedures for subdividing allowances, guaranteeing a sufficient percentage of free allowances to meet demand from eligible operators. The definition of sectors at risk of relocation from 2020 could result in a significant cut with a 0,18 threshold as a prerequisite for eligibility.

6.2 The EESC is concerned that tightening the benchmarks would further penalise companies that are up against difficult circumstances: the across-the-board reduction of the benchmark by means of a single linear correction factor, set between a minimum of 0,5 % and a maximum of 1,5 % on an annual basis, does not give consideration to the lifespan of machinery and technological reality in sectors that are highly diverse.

6.3 The EESC considers that the carbon-leakage benchmarking parameters should be technically and economically viable so as to reflect actual technological progress and would recommend that the methodology for cutting back the number of sectors on the carbon leakage list from 177 to 52 for the 2021-2030 period be approved by both sides of industry and accompanied by phasing out measures.

6.4 The EESC also considers that the cross-sectoral correction factor should be abolished. A poorly-calculated correction factor would generate uncertainty as to free allocation and would leave those plants at greatest risk liable to undue costs.

6.5 According to the EESC, provision should be made for a harmonised European-level mechanism for compensation for indirect costs, to be distributed on the basis of pre-existing parameters ([4]), avoiding the current internal market distortions, rendering the current system based on State aid compulsory and obliging Member States to earmark at least part of the revenue from auctions for adequate compensation of indirect costs sustained by environmental best performers in vulnerable sectors.

6.6 The EESC calls for more flexible and dynamic allocation of free allowances to be based on up-to-date levels of actual production, supporting units that improve their efficiency by retaining the same number of free allowances for them.

6.7 The criterion for defining carbon leakage risk needs to be made more flexible in order to reflect as accurately as possible the impact of the carbon price on the competitiveness of the various sectors, particularly for SMEs, using the qualitative criterion, as defined in 2008.

6.8 The EESC considers that the EU ETS funds — the Market Stability Reserve, the Innovation Fund and the Modernisation Fund — should be seen as part of a single framework, in order to ensure that they function properly and are equipped with appropriate management/control systems, to avoid accumulation and overlaps.

6.9 The EESC takes the view that:

— part of the Market Stability Reserve should be used to support the phasing out of sectors removed from the carbon leakage list,

— the Modernisation Fund should be open to electricity production measures in NUTS 2 areas as well as in countries with a GDP that is under 60 % of the EU average, for the transparent promotion of investment without distorting the internal energy market,

— the Innovation Fund should be brought into play for new technologies and low-carbon industrial processes, particularly in sectors that are being phased out,

— *voluntary carbon auctions should be supported*, e.g. CarboMark, as additional commitments taken on voluntarily by forestry owners in order to maximise the indirect environmental benefits produced by wooded areas, and which allow the climate-related function of the forest ecosystem to be recognised, not least in economic terms.

6.10 The Committee would urge that the measures planned for small plants with emissions below 25 000 t CO_2 be extended to plants with emissions lower than 50 000 t CO_2, which account for approximately 75 % of ETS installations at European level but only 5 % of total emissions.

6.11 The potential for operators to reduce emissions generated by mineralogical processes is negligible and they should benefit from full allocation of free allowances.

([4]) *Guidelines on State aid for environmental protection and energy 2014-2020* (OJ C 200, 28.6.2014, p. 1).

6.12 As the EU ETS review measures involve many other EU policies besides energy policy, the Committee calls for maximum consistency and the elimination of excessive red tape in the new rules and in those with which they interact.

Brussels, 9 December 2015.

The President
of the European Economic and Social Committee
Georges DASSIS