



Council of the
European Union

Brussels, 13 October 2020
(OR. en)

11766/20

LIMITE

**CLIMA 227
ENV 589
ENER 332
TRANS 459
IND 170
COMPET 465
MI 397
ECOFIN 905**

NOTE

From: General Secretariat of the Council
To: Delegations
Subject: Proposal for a reform of the EU ETS
– *Information from the Polish delegation*

Delegations will find in the Annex an information note from the Polish delegation on the above subject, to be dealt with under 'Any other business' at the Council (Environment) meeting on 23 October 2020.

Poland's proposal for a reform of the EU ETS

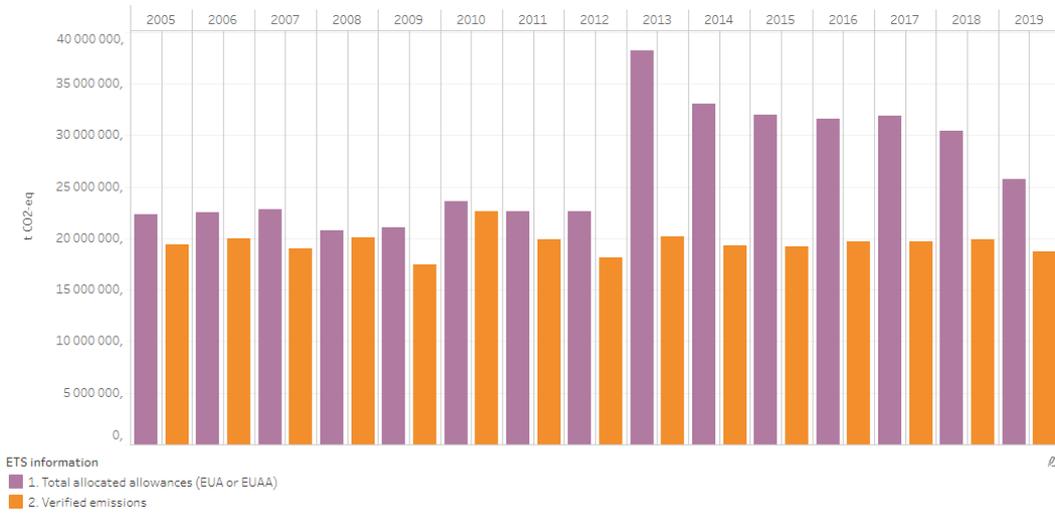
The EU ETS is the main tool of EU climate policy that allows for emission reductions. As the EU is currently planning how to recover from the COVID-19 crisis and at the same time exploring the possibility of an increased 2030 target, it is the right time to rethink the way the EU ETS functions and to introduce improvements that would more effectively drive transformation towards climate neutrality in the EU.

What we need is an EU ETS that drives investments to regions and sectors located in less wealthy Member States with lower levels of capital, reducing their ability to transform. Polluters should pay for their emissions and these resources should be used by Member States to finance new projects which can reduce emissions. Unfortunately, what we have is a system that actually drives out resources from the Member States with the biggest reduction potential, which impacts EU's climate-friendly transition as a whole. Funds should be driven to areas that need them the most and where they will be best used. The ETS becoming a source of the EU's own resources would be contrary to this approach and that is why we do not support it.

Challenges

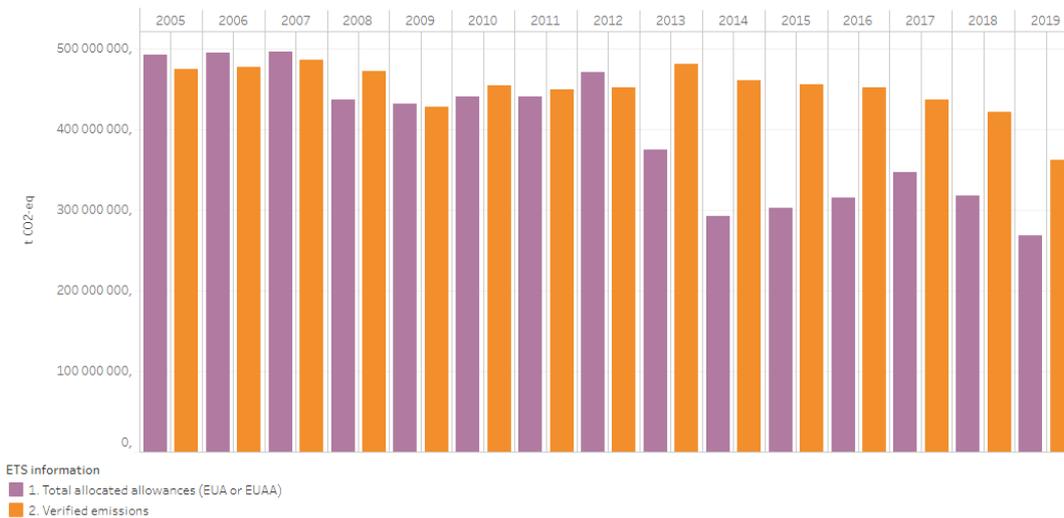
The current allocation key does not allow for a fair and balanced distribution of allowances. Member States that do not require allowances receive them in the current system. The distortion is illustrated below by case study examples of two Member States with an unequal distribution of allowances. The volume of allowances allocated to verified emissions substantially differs in the two cases, with one Member State regularly receiving much more than it emits (case study 1).

Case study 1. Member State with allowances surpassing emissions



Source: EEA. Webpage: <https://www.eea.europa.eu/data-and-maps/dashboards/emissions-trading-viewer-1>

Case study 2. Member State with less allowances than needed to support transformation



Source: EEA. Webpage: <https://www.eea.europa.eu/data-and-maps/dashboards/emissions-trading-viewer-1>

The total amount of allowances (distributed for free to the industry and auctioned by the Member State) can even surpass the amount of verified emissions by 35 to 55% (case study 1). This creates a distortion in the system, as it benefits certain economies without justification (easing their way to move forward with their emissions reduction ambitions) and leaves other economies with substantial costs to cover and without providing the capacity for the Member State to support the necessary investments (making it difficult for them to move forward with their ambitions). Such a situation may also distort competition between companies in the EU's internal market.

To effectively support transformation in the EU, it is crucial to have a tailored, optimal mechanism for emissions trading that constitutes a response to real needs and is both an efficient and a just tool for emissions reductions. Revenues from auctioning should be invested in the areas with the most potential for reductions and for which investments are needed the most. Therefore, we see reform of the EU ETS as an important element of EU climate policy.

Possible ways forward

When discussing potentially higher reduction targets for 2030 we should talk about creating supporting tools which would address the following problems:

- A. the lack of investment in transformation (due to necessary purchases of allowances in deficit, which lowers companies' investment capacities, and to allowances not being allocated to the Member States that need them the most in order to ensure the necessary change),
- B. the unbalanced distribution of the allowances themselves (with some Member States receiving more than they require, while involuntarily placing an additional burden on those that need them the most),
- C. the distortion caused by using outdated reference periods (using the outdated, historical reference periods of 2005-2007 for the allocation key, which is not a credible element for measuring future progress, is against the general trend whereby all other important parameters (such as benchmarking) tend to be revised from time to time in order to reflect the current situation better).

As a response, we propose three potential pillars of EU ETS reform:

(1) An increased Modernisation Fund (MF) and/or the creation of an Energy Solidarity Fund (ESF)

Currently, for the period 2021-2030 the MF is meant to be supplied by 2% of the total amount of available allowances and can be increased by an additional 0.5 percentage point. However, when compared with investment needs, it must be emphasised that even such an increase would not be sufficient.

Poland believes that a substantial increase in the MF would allow sufficient financing of modernisation needs. The COVID-19 pandemic has taken an exceptional toll on the energy sector and has led to an increase in investment needs. The current MF pool will not be sufficient to ensure the required modernisation of the sector and will put at risk the feasibility of many investments.

An alternative, complementary option would be to create a new fund which would allow for a larger number of Member States to relieve the poorest and most vulnerable citizens from negative impacts of increased ETS prices. The high costs associated with meeting more ambitious emission reduction targets in the EU ETS will further burden national economies. A significant part of the burden of higher energy prices will be borne by the end users, in particular households, which could deepen energy poverty and undermine social acceptance of ambitious climate policy in many Member States.

For this reason Poland would like to propose the creation of an Energy Solidarity Fund (ESF). The objective of the ESF would be to support the poorest Member States in eliminating the negative social effects related to the increase in energy prices and minimising the future rise in energy poverty by easing investments in climate-friendly infrastructure, such as renewable energy and energy efficiency. The funds would not be used to supplement budgets or modernise old installations. The beneficiaries of the ESF would be those Member States with GDP per capita below the EU average, as they will have less capacity to cope with the challenge. The distribution key should reflect the size of the population and the share of energy spending relative to the household final consumption expenditure. The funds, as in the case of the MF, would come from the sale of the prescribed amount of allowances and would be used to create programmes for households to decrease their energy expenses, for example by increasing the energy efficiency of buildings.

(2) Change to the allowance allocation key

Another issue is changing the current allowance allocation key. The current distribution pattern does not allow for a just and balanced allowance distribution to those that need the allowances the most. This is due to the unjustified inclusion of emissions already covered by free allowances within the current allocation key. Not only do installations receive free allowances as part of the EU ETS, but the Member States also receive allowances for these emissions as part of the auction allocation key. This leads to double counting of emissions from industrial installations; therefore, these two issues should be clearly separated and the auction allocation key should not contain emissions corresponding to installations already benefiting from free allocations.

(3) Updating of the reference period to 2016-2018

The use of the 2005 or 2005-2007 period has become outdated, especially because since that time we have witnessed two unprecedented global crises that have completely changed the economic environment. As we move toward the exploration of an updated 2030 target and the EU's collective goal of climate neutrality by 2050, more up-to-date data should be used as a reference to illustrate reduction options undertaken. We are comparing our actions against a historical benchmark that goes too far back in time, failing to take into account the current challenges and obstacles. This does not correspond to reality and it lacks credibility with regard to current and future emission reduction efforts. Poland believes that updating the allocation key to the average for 2016-2018 ETS emission data would constitute a significant and necessary improvement.

Conclusion

Poland believes that the implementation of the above changes would lead to an improved and more effective EU ETS. It is crucial in order to fulfil our collective ambition to reach our climate neutrality target. An updated trading system based on current data, as well as an actual need-based allocation key which avoids double counting and takes into account financing needs and Member States' different circumstances, is the way forward. In rapidly changing times we should ensure that the EU ETS has the flexibility and adaptability that it requires to become a stronger and more resilient mechanism, tailored to changing reality. The EU ETS should be a key tool for reaching EU climate goals, not only for the EU as a whole but for all Member States as well.