Council of the European Union
General Secretariat

Interinstitutional files:
2021/0214(COD)

Brussels, 04 November 2021

WK 13245/2021 INIT

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MEETING DOCUMENT

From:	General Secretariat of the Council
To:	Delegations
Subject:	Revision of the EU ETS: presentation by the European Commission

Delegations will find attached the presentation made by the European Commission at the AHWP CBAM meeting on 4 November 2021.

Delivering our 2030 climate target

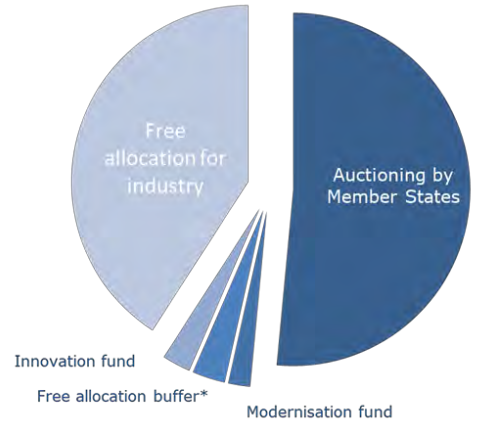
Revisions of the EU Emissions Trading System
Free allocation proposed amendments

Ad-hoc CBAM Working

4 November 2021

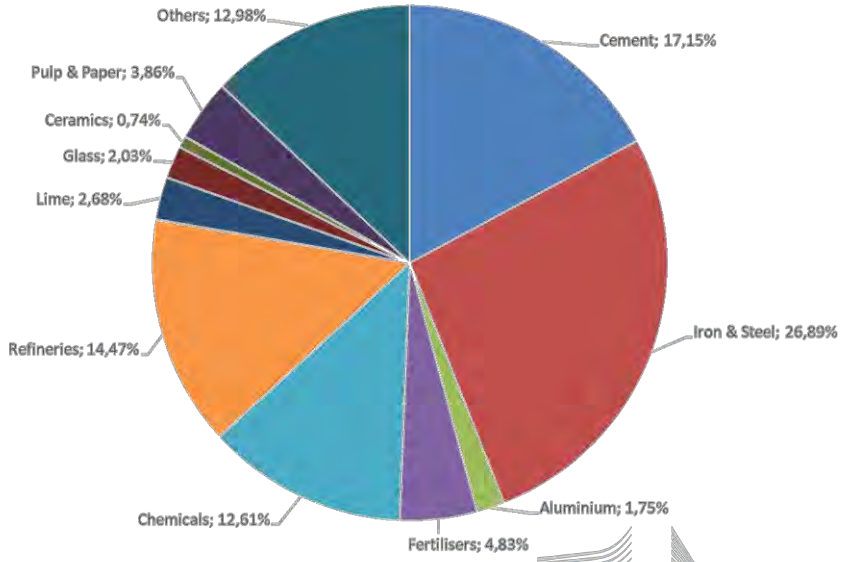
Free allocation / auctioning

- Since 2013, free allocation takes into account the performance of the best installations in Europe (benchmarks).
- Installations may receive free allowances up to the level of the best performers. The maximum amount also depends on if the sector is at risk of carbon leakage.
- For less exposed sectors, free allocation is foreseen to be phased out by 2030.
- The list of sectors deemed to be at the risk of carbon leakage for the period 2021-2030 was **updated in 2019**.



* Allowances dedicated for auctioning that may be converted

Share of preliminary free allocation per sector (2021 - 2030)



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General allocation calculation

Allocation = BM * AL * CLF * (CSCF or LRF)

Benchmark

Activity Level (production)

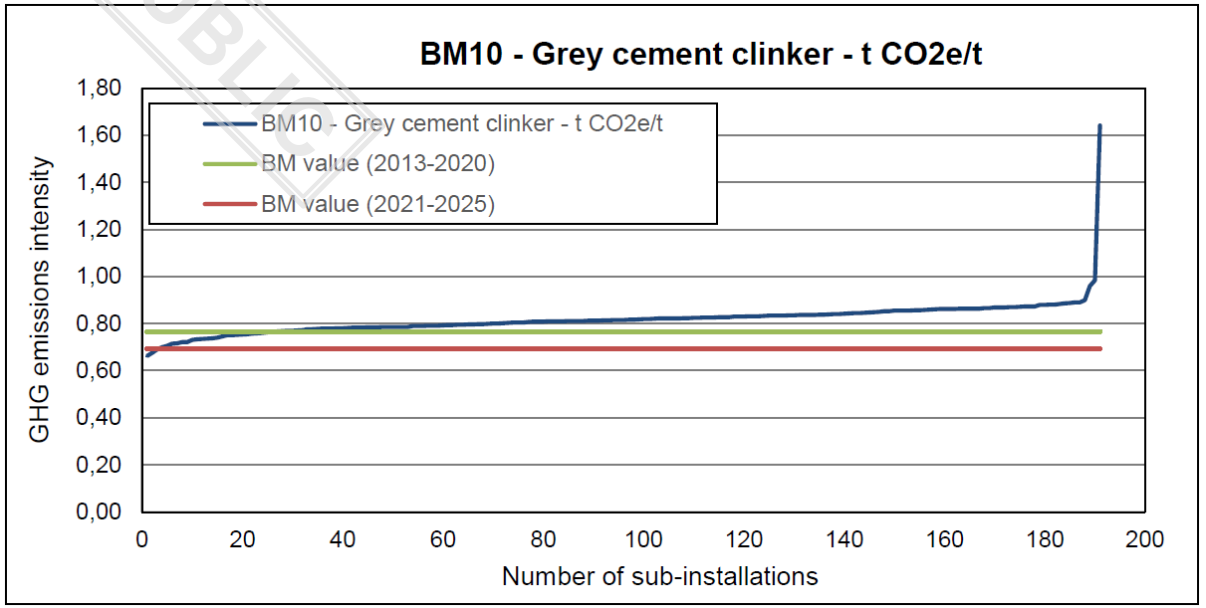
Carbon Leakage Factor

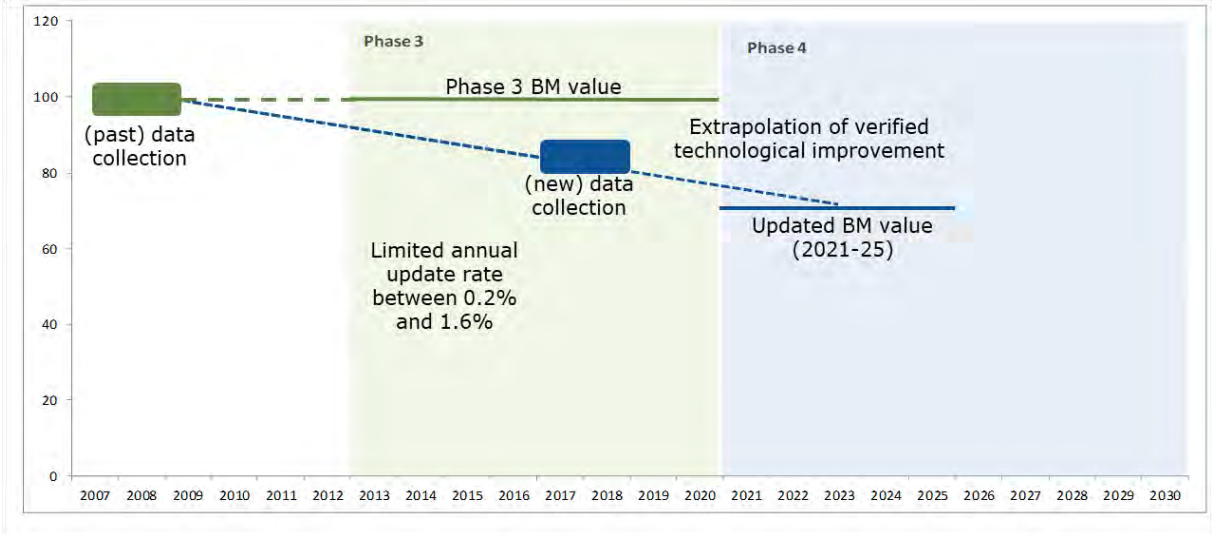
Cross Sectoral Correction Factor

Linear Reduction Factor

Benchmark determination

- Total of 54 benchmarks. 52 product BMs and 2 fall-backs (heat and fuel).
  - Refineries (1);
  - Iron & Steel (6);
  - Non-ferrous metals (2);
  - Cement and lime (5);
  - Glass (4);
  - Ceramics (4);
  - Other construction products (4);
  - Pulp & Paper (11);
  - Chemicals (15);
  - Fall-backs (2).
- The 54 existent benchmark values will be **updated twice in phase 4** to avoid windfall profits and reflect technological progress since 2008. Updates based on 2016-2017 and 2021-2022 data.



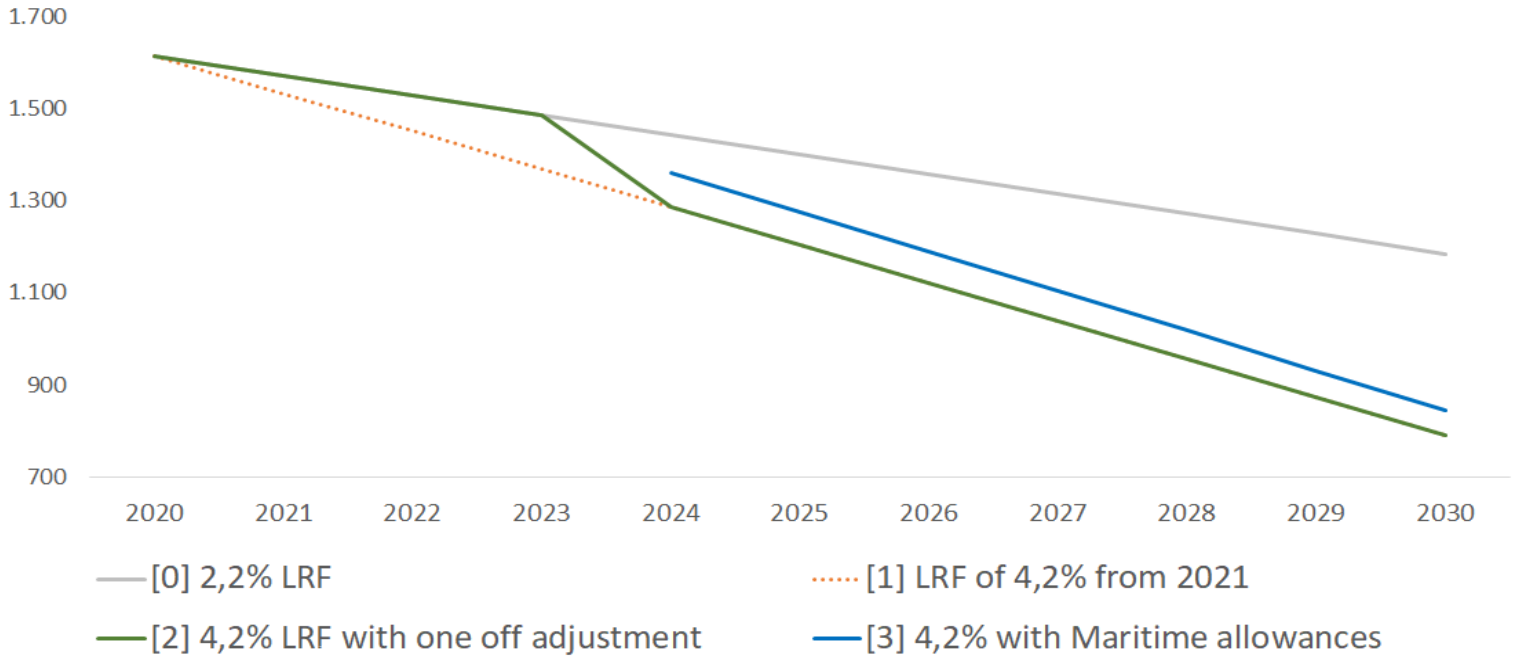


The European Climate Law

- The European Climate Law Regulation of 30 June 2021
- Union-wide climate-neutrality objective 2050
- New **2030** target of at **least 55% net** greenhouse gas emissions reduction
- Recognition of the need to enhance the EU's **carbon sink**

Strengthening of the ETS cap: Proposal

- Basis: straight cap trajectory from 2021 to 2030 consistent with the 2030 climate target: new linear reduction factor (LRF) of 4.2%
- New LRF applies from the year following the entry into force combined with a one-off reduction to meet the trajectory from 2021 (-117 M allowances if in 2024)
- Increase of ETS cap due to inclusion of maritime transport (+79 M allowances if in 2024)



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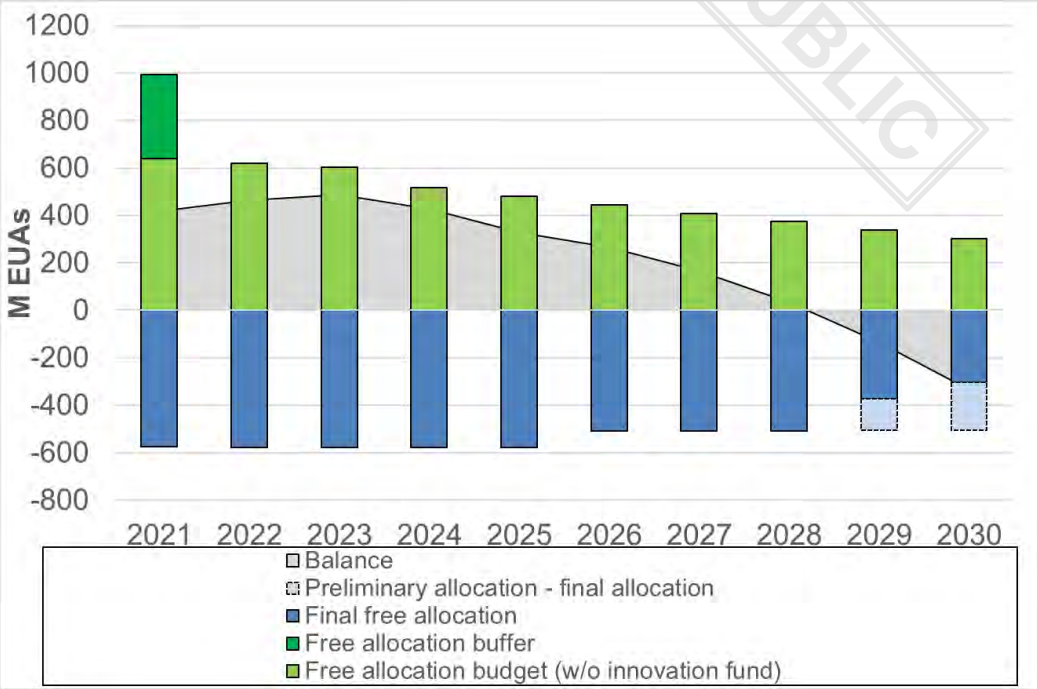
Carbon leakage risk: Uniform cut of free allocation likely in 2026–2030



Cap option AMB2c	
Year in which cross-sectoral correction (CSCF) factor is first used	2028
Average CSCF in 2026-2030 (without maritime)	80%

Risk of poor targeting of free allocation

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Carbon leakage risk: Options

- CL0. Baseline. Current provisions.
- CL1. More targeted free allocation with tiered approach. Differentiated level of free allocation for sectors at “medium” and “high” risk of carbon leakage.

CL0		CL1	
Carbon Leakage Indicator (CLI)	**Level of Free Allocation**	**Carbon Leakage Indicator (CLI)**	**Level of Free Allocation**
CLI ≤ 0.2	30% (→ 0%)*	CLI ≤ 0.2	30% (→ 0%)*
CLI > 0.2	100%	0.2 < CLI ≤ 2	60%
		CLI > 2	100%

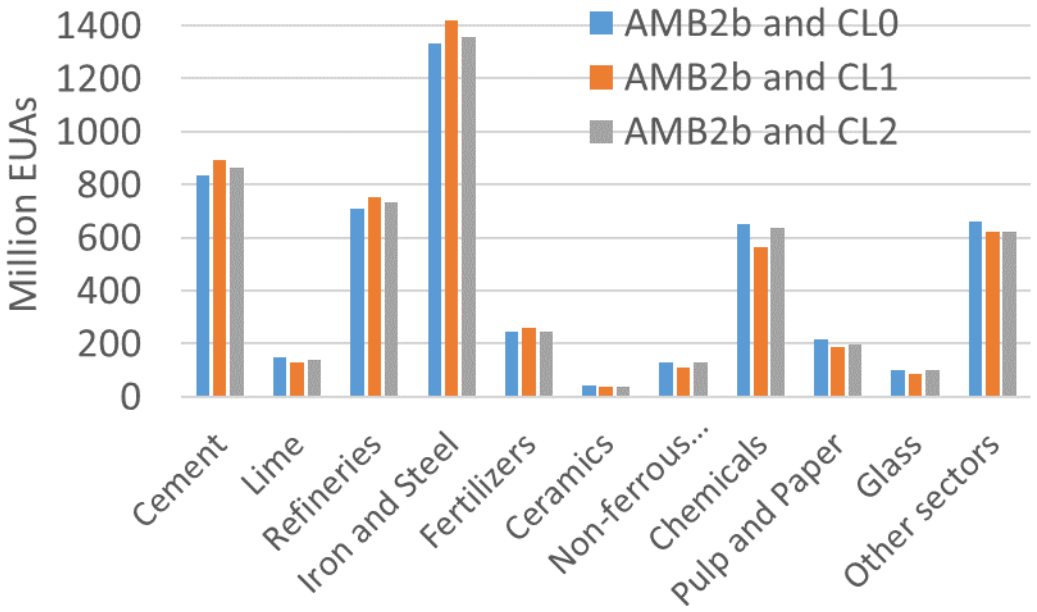
* 30% until 2026 and then declining to 0% in 2030, as in the current ETS Directive.

- CL2. More targeted free allocation with strengthened benchmarks. Maximum annual update rate for benchmarks increased to 2.5%

Carbon leakage risk: Assessment of options

- Example of cap trajectory AMB2b combined with tiered approach (CL1) or strengthened benchmarks (CL2).
- No change in total cumulated free allocation, but shift of free allocation between sectors.
- CL1 and CL2 reduce the impact of the CSCF. Effects of CL1 more pronounced.
- CL1 shifts free allocation to sectors at highest risk of carbon leakage.
- CL2 decrease faster free allocation for sectors needing less, so focus remain on sectors that are harder to decarbonise. Simplicity of implementation

	AMB2c and CL0	AMB2c and CL1	AMB2c and CL2
Average CSCF in 2026-2030 (without maritime)	80%	93%	87%
Total cumulated free allocation	5062 million EUAs (in 2021-2030)		



Carbon leakage risk: Proposal (1/2)

- Free allocation continues to be **based on benchmarks**. No changes to the free allocation (FA) share (43% + 3% buffer).
- **Better targeted FA**: Maximum annual reduction rate of the benchmarks increased from 1.6% to 2.5%. Shifts some free allocation to sectors that are harder to decarbonise.
- More targeted free allocation and inclusion of maritime sector **limit the risk / size of the factor** reducing free allocation across all sectors. Delays application of the cross-sectoral correction factor (CSCF) by around 1 year and reduces its value by around 6% as average for the period 2026–2030.

Carbon leakage risk: Proposal (2/2)

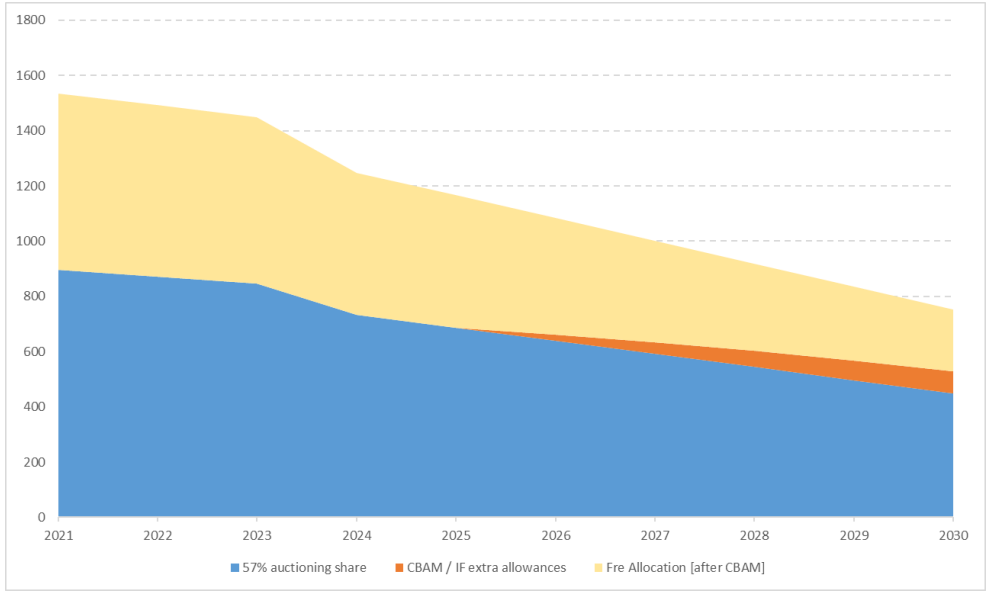
- **Broaden the scope of free allocation**: Remove barriers for the deployment of new technologies such as green hydrogen or hydrogen-based steel to guarantee a level playing field among technologies.
- **Conditionality**: Free allocation reduced by 25% for installations not implementing recommendations identified in audits under the Energy Efficiency Directive (unless equivalent measures are implemented). No additional audit requirements.
- **Electricity generators**: Concept of electricity generators abandoned to guarantee a level playing field between cogeneration power plants and industrial installations. No free allocation to electricity generation (no change).

Carbon leakage: ETS link with CBAM

- **Separate impact assessment** for the Carbon Border Adjustment Mechanism (CBAM) covering e.g. sector selection, CBAM design, impact modelling.
- CBAM will impose a levy on embedded carbon in imports of **iron & steel, cement, fertilisers, aluminium and electricity** as of 2026. Gradual introduction 2026–2035.
- **Gradual phase-out of free allocation for CBAM sectors**: starting at 90% in 2026, reduction by 10 percentage points each year and reaching 0% in 2035.
- Allocation not granted to CBAM sectors, to be auctioned and used to increase the size of the innovation fund (estimation, around 280 million allowances for 2026–2030).

Carbon leakage: ETS link with CBAM

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
CBAM factor	100,0%	100,0%	100,0%	100,0%	100,0%	90,0%	80,0%	70,0%	60,0%	50,0%
Reduction in FA of CBAM sectors	0,0%	0,0%	0,0%	0,0%	0,0%	10,0%	20,0%	30,0%	40,0%	50,0%
Reduction of FA demand due to CBAM	0,0%	0,0%	0,0%	0,0%	0,0%	5,3%	10,6%	15,8%	21,1%	26,4%
Free Allocation [without 3% buffer]	43,0%	43,0%	43,0%	43,0%	43,0%	43,0%	43,0%	43,0%	43,0%	43,0%
Auctioning share	57,0%	57,0%	57,0%	57,0%	57,0%	57,0%	57,0%	57,0%	57,0%	57,0%
Cap scenario [AMB2c]	1571,58	1528,58	1485,58	1284,57	1202,06	1119,56	1037,05	954,55	872,04	789,54
FA contribution to Innovation Fund	36,50	36,50	36,50	36,50	36,50	36,50	36,50	36,50	36,50	36,50
Free Allocation [before CBAM]	639,28	620,79	602,30	515,86	480,39	444,91	409,43	373,96	338,48	303,00
Free Allocation [after CBAM]	639,28	620,79	602,30	515,86	480,39	421,42	366,20	314,72	266,99	223,01
CBAM / IF extra allowances	0,00	0,00	0,00	0,00	0,00	23,49	43,24	59,23	71,49	79,99
57% Auctioning share	895,80	871,29	846,78	732,20	685,18	638,15	591,12	544,09	497,06	450,04
Estimated share of FA demand of CBAM sectors (2026 - 2030)	53%									



Unit: million allowances [equivalent to million ton CO_2]

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CBAM / ETS - Interaction

- **Verification**: Article 8 CBAM / Article 15 ETS. Both proposals build on the development of implementing acts. Regulation (EU) 2018/2066 develops the provisions on monitoring and reporting of GHG under the ETS. Aspects developed include monitoring plans of emissions, monitoring methodologies, emission factors to be used…
- **Accreditation**: Article 18 CBAM / Article 15 ETS. Both proposals build on the development of implementing acts. Regulation (EU) 2018/2067 develops the provisions on verification of reports under the ETS Directive and for the accreditation and supervision of verifiers.
- Both CBAM and ETS have an Annex further developing the criteria regarding the verification of the data to be submitted.

Thank you

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