

Consultation on revision of the EU Emission Trading System (EU ETS) Directive

1. Free allocation and addressing the risk of carbon leakage

1.1 The European Council called for a periodic revision of benchmarks in line with technological progress. How could this be best achieved in your view and, in particular, which data could be used to this end? How frequently should benchmarks be updated, keeping in mind administrative feasibility?

The European Council also called for future allocations to be better aligned with changing production levels in different sectors, which the WKÖ strongly supports. Only in the context of a more “dynamic” allocation of free allowances based on more recent output data should benchmarks be updated accordingly.

Austrian and European businesses are constantly attempting to be at the forefront of technological progress; however, major technological shifts in industrial sectors do not occur frequently, are not always economically feasible initially and cannot be triggered by the EU-ETS alone. Benchmarks must therefore reflect this business reality and not be revised too often.

Also, long-term planning security is a necessary prerequisite for investments, including in innovation, research and development. Therefore, the regulatory framework, including benchmarks, must be stable and predictable for a significant period of time. Furthermore, administrative burdens must be kept to a minimum. It is also important for benchmarks to be realistic and achievable.

To sum up, the frequency of benchmark updates should reflect actual technological cycles in specific sectors and be technically, economically and administratively feasible for ETS-installations.

In our view, benchmarks, rather than high carbon prices, should be the sole incentive in the industrial ETS sectors. In other words, the installations which set the benchmark should not face any CO₂-costs and instead receive 100% of their required allowances for free, without subsequent deductions. All other installations would then have the incentive to become as CO₂-efficient as the benchmark. They thus have a choice: invest to achieve the (realistic & feasible) benchmark or face costs associated with purchasing allowances.

1.2 The European Council has defined guiding principles for the development of post-2020 free allocation rules which provide inter alia that "both direct and indirect costs will be taken into account, in line with the EU state aid rules" and that "the most efficient installations in these sectors should not face undue carbon costs leading to carbon leakage" while "incentives for industry to innovate will be fully preserved and administrative complexity will not be increased" and while "ensuring affordable energy prices". Do you have views how these principles should be reflected in the future free allocation rules?

Unfortunately, we remain - and we will continue to remain even after COP21 in Paris - far away from a global level playing field regarding CO₂-costs. Therefore, industry requires

strengthened and more robust rules to prevent carbon leakage, especially as we increase our EU targets and reductions path until 2030. This means that in those sectors which face international competition, the most CO₂-efficient installations must receive all of their allowances free of charge, without deductions. WKÖ strongly believes that the most efficient installations, i.e. which set the benchmark, should not face any carbon costs.

Incentives to innovate are important, but we believe innovation in energy-intensive sectors cannot be achieved through increased carbon pricing. They require highly targeted technology policies in terms of goals and resources, including public funding to incentive investments. The ETS auctioning revenues would be an obvious source for supporting these necessary targeted technology policies (see also 5.5). Within the ETS system, realistic benchmarks would ensure that incentives to innovate and become more efficient would be fully preserved (see also 1.1).

Regarding indirect carbon costs, we agree with the European Council that these must be taken into account when revising the rules for free allocation. While energy producers can pass on carbon costs to consumers, including to energy intensive industries, this is not possible for industrial sectors competing globally. This reality must be reflected to create a more fair and balanced system. Therefore, indirect carbon costs must be compensated.

Ensuring that the ETS does not lead to higher energy prices is absolutely essential and should be a priority for climate policy post-2020. EU businesses face significantly higher energy costs than their competitors in the USA and the Middle East. This energy price gap, especially regarding natural gas, must be bridged rather than increased due to climate regulations. The ETS must therefore be consistent with EU energy and industrial policy and the stated aim to ensure competitive and affordable energy prices.

Finally, we fully agree with the European Council that it must be ensured that administrative burdens are kept to a minimum as a matter of priority. However, regarding a more “dynamic” allocation, certain additional administrative requirements might be necessary and justified to ensure the better and fairer functioning of the ETS.

1.3 Should free allocation be given from 2021 to 2030 to compensate those carbon costs which sectors pass through to customers? How could free allocation be best determined in order to avoid windfall profits?

Costs that energy producers pass on to energy-intensive ETS businesses must be compensated in order to prevent so-called indirect carbon leakage. This would alleviate a disadvantage that European industrial sectors currently face compared to their non-EU competitors. This is especially important as European industry face significantly higher gas and electricity prices than most of their non-EU competitors.

Windfall profits are best avoided through a more dynamic and flexible allocation of free allowances. Flexibility in the allocation of free allowances considers more recent activity levels (e.g. with lags up to 1.5 or two years) and possibly certain ex-post adjustments if necessary. Allocation based on more recent activity level could avoid perverse effects generated by fixed volumes of free allocations despite substantial output fluctuations.

The switch from historic to more recent activity levels reduces variation of the stringency of free allocation on installation level and eliminates therefore a lot of uncertainty as to

the impacts of carbon costs from output fluctuations. Flexible supply of free allowances enables to respond to changes in output and technologies and thus avoids horizontal imbalances among installations. Instead of using a cross-sectoral correction factor, flexible allocations can be reconciled with the target path volume each year by adjusting the auctioning volume. This would make the ETS fairer, instead of punishing growth.

The allocation of free allowances can be made more effective by targeting the allocations to the factors that increase the risk of carbon leakage. These are in particular the exposure to international trade, non-energetic emissions from processes, e.g. for cement and steel, and indirect emissions via the use of electricity. All industry sectors should be eligible for free allocations, but with a sector-specific allocation mechanism that is based on:

- exposure to export competition
- exposure to import competition
- non-energetic emissions
- indirect emissions via use of electricity

Furthermore, based on the observed division of the market for the ETS allowances, different reduction targets could be considered for power and non-power sectors. Further sectoral differentiation is possible according to abatement capabilities.

1.4 Are there any complementary aspects you would like to add to the replies given to the previous written consultation in the light of the European Council conclusions?

The European Council decided to set a fixed and (over-)ambitious 2030 target of -40% CO₂-emission reductions, without realistically assessing the economic implications of such a target. However, the Council conclusions regarding carbon leakage are vague and unclear. In the interest of planning and investment security, it is absolutely vital that clear, robust and strengthened provisions to protect EU industry from the risk of carbon leakage are presented, decided and implemented as quickly as possible!

We therefore urge the EU commission to present its proposal for a revised ETS, including the necessary carbon leakage provisions, before the summer. There is no good reason to wait for Market Stability Reserve to be passed before the ETS proposal is presented.

2. Innovation fund

2.1 Do you see reasons to modify the existing modalities applied in the first two calls of the NER300? Are there any modalities governing the NER 300 programme which could be simplified in the design of the innovation fund? If you see the need for changes, please be specific what aspects you would like to see changed and why.

We explicitly welcome the creation of the innovation fund, especially the extended scope to include low-carbon innovation in industrial sectors! WKÖ strongly believes that funding is necessary to incentivise and accelerate low-carbon innovation and technology in industry. Coupled with a more robust carbon leakage regime, which we see as

complementary, this will certainly boost innovation in these sectors if the funding is used intelligently.

2.2 Do you consider that for the extended scope of supporting low-carbon innovation in industrial sectors the modalities should be the same as for CCS and innovative renewable energy technologies or is certain tailoring needed, e.g. pre-defined amounts, specific selection criteria? If possible, please provide specific examples of tailored modalities.

It is very important that sufficient funds are available for low-carbon innovation in industrial sectors. Industrial sector projects should certainly not be treated worse than renewable or CCS technologies - on the contrary, the innovation fund should prioritise these projects. This support mechanism has the potential to incentivise much-needed research, development and implementation of low-carbon technologies in industry.

The Council conclusions very clearly state that: “investment projects in all Member States, including small-scale projects, will be eligible.” This is an absolutely vital issue for WKÖ and must be clearly and rigorously implemented. The Council conclusions were generally very favourable for lower income Member States in both ETS and non-ETS sectors. Therefore, it should be ensured that funds from the NER400 are available especially for those Member States with an above average GDP. Also, it should be guaranteed that smaller-scale industrial projects are discriminated against regarding funding.

2.3 Are there any complementary aspects regarding innovation funding you would like to add to the replies given to the previous written consultation in the light of the European Council conclusions?

WKÖ strongly believes that ETS auctioning revenues must be earmarked to fund innovation, technology, research and development in low-carbon technologies in industrial sectors. Currently, some Member States use at least part of their auctioning revenues for this purpose, while others, including Austria, do not. Not only do we strongly believe this to be a vital measure to support low carbon transition in industrial sectors, we are very concerned about the inequalities and internal market distortions that result from currently fragmented national policies in this regard. It is therefore essential that the review of the ETS Directive makes the earmarking of auctioning revenues for industrial sector innovation mandatory for all EU Member States.

3. Modernisation fund

3.1 Implementation of the modernization fund requires a governance structure: What is the right balance between the responsibilities of eligible Member States, the EIB and other institutions to ensure an effective and transparent management?

WKÖ rejected the creation of this fund, as we believe it to be a type of “subsidy” for certain Member States while discriminating against others. In our view, this is an unjustified distortion of the internal market.

It is important that the governance structure is transparent to ensure that the funds are used to fulfil the targets of the 2030 climate and energy targets, rather than being a subsidy for lower-income Member States.

Regarding governance, we believe that the active participation of Member States that are not eligible for funding is ensured. This would increase transparency and minimise distortions.

3.2 Regarding the investments, what types of projects should be financed by the modernisation fund to ensure the attainment of its goals? Should certain types of projects be ineligible for support?

It must be ensured that this fund results in the least possible disruption and distortion of the internal market and does not give businesses of in certain Member States an unfair and unjustified advantage.

Projects which have an added-value to all Member States, including those not eligible for funding, should certainly be prioritised.

3.3 Should there be concrete criteria [e.g. cost-per-unit performance, clean energy produced, energy saved, etc.] guiding the selection of projects?

3.4 How do you see the interaction of the modernisation fund with other sources of funding available for the same type of projects, in particular under the optional free allocation for modernisation of electricity generation (see section 4 below)? Would accumulation rules be appropriate?

Again, distortions and discriminations must be avoided as a matter of priority. Any rules and provisions that ensure that these funds for lower-income Member States do not negatively affect businesses in higher-income Member States are welcome and necessary. This would require certain accumulation rules.

3.5 Do you have views how the assessment of the projects should be reflected in the forthcoming 2030 governance process (e.g. national climate programmes, and plans for renewable energy and energy efficiency)?

3.6 Should the level of funding be contingent on concrete performance criteria?

Again, distortions and discriminations must be avoided as a matter of priority. Any rules and provisions that ensure that these funds for lower-income Member States do not negatively affect businesses in higher-income Member States are welcome and necessary. This would require strict performance criteria.

4. Free allocation to promote investments for modernising the energy sector

4.1 How can it be ensured that investments have an added value in terms of modernising the energy sector? Should there be common criteria for the selection of projects?

WKÖ is very critical of free allocation for the power sector in lower income Member States, as we believe that it prolongs the inequalities in what should be a fair and level internal energy market.

And it could also dis-incentivise the transition to low-carbon energy production in these Member States. But after this was decided by the European Council, it is all the more important to ensure that this mechanism disrupts free and fair competition within the EU in the least possible form - as with the modernisation fund.

This is only possible if there are common and transparent criteria for the selection of projects. This must include the active participation of Member States that are not eligible for this subsidy. The criteria must guarantee that these allocated allowances really promote the transition to more carbon-efficient energy system in these Member States.

4.2 How do you see the interaction of the free allocation to energy sector with other sources of funding available for the same type of projects, e.g. EU co-financing that should be made available for the projects of common interest under the 2030 climate and energy framework? Would accumulation rules be appropriate?

It is crucial that projects in the power sector that receive free allocation are not eligible for any further EU funding, co-financing, etc. Otherwise it would only increase distortions within the internal energy market, creating an unfair competitive advantage.

4.3 Do you have any views how the assessment of the projects should be reflected in the forthcoming 2030 governance process (e.g. as regards improving transparency)?

4.4 The maximum amount of allowances handed out for free under this option is limited. Do you think eligible Member States should use the allowances for a period of time specified in advance (e.g. per year), or freely distribute them over the 2021-2030 period? (Please explain your motivation.)

It would be preferable if the time period was specified in advance, so that all EU market participants can adapt. Also, this would increase transparency.

4.5 Should there be priorities guiding the Member States in the selection of areas to be supported?

yes
no

If so, which of the following areas, if any, currently supported through investments for modernisation of electricity generation up to 2020 should be prioritised for support up to 2030 and why?

Interconnectors
Smart Grids

Super-critical coal
Gas
Renewable energy
Energy storage
Energy efficiency
Other (please elaborate)

Prioritising interconnectors would be beneficial to the completion of the internal energy market and would increase EU security of supply. It would also allow Member States which are not eligible for funding to benefit from the resources, creating win-win situations.

4.6 How can improved transparency be ensured with regard to the selection and implementation of investments related to free allocation for modernisation of energy? In particular regarding the implementation of investments, should allowances be added to auctioning volumes after a certain time period has lapsed in case the investment is not carried out within the agreed timeframe?

In the interest of transparency and fairness, if investments in the power sector in low-income Member States are not carried out as agreed, these allowances should be used for the overall free allocation for carbon leakage sectors in all Member States. We are extremely concerned that the required free allocation for industrial sectors will not be sufficiently available in the future. Therefore, allowances not used in these and other funds and facilities should be used to protect EU industry in all Member States against carbon leakage.

5. SMEs / regulatory fees / other

5.1 Are there any EU ETS administrative requirements which you consider can be simplified? Do you see scope to reduce transaction costs, in particular for SMEs? If yes, please explain in detail.

5.2 Member States had the possibility to exclude small emitting installations from the EU ETS until 2020. Should this possibility be continued? If so, what should be the modalities for opt-out installations to contribute to emission reductions in a cost-effective and economically efficient manner? Should these be harmonised at EU level?

The current divide between ETS and non-ETS should not be further complicated by possibly including a third category.

Rather, the regulatory framework should be simplified and, if necessary, harmonised to avoid nationally fragmented solutions.

5.3 How do you rate the importance of a high level of security and user-friendliness of the Union Registry? Do you think the costs for providing these services should be covered via Registry fees?

User-friendliness and improved security are certainly vital. However, the costs for businesses should be increased.

5.4 Do you consider discrepancies in Registry fees in different Member States justified? Should Registry fees be aligned at EU level?

No, we do not believe that these discrepancies regarding registration fees are justified; instead, we argue that they should be aligned at EU level. This would create a more equal and level playing field within the EU. It should be ensured that all businesses in the ETS have the same costs for Registry fees and that these are kept as low as possible!

5.5 Under the current EU ETS Directive, at least 50% of the revenues generated from the auctioning of allowances should be used by Member States for climate-related purposes. For the calendar year 2013 Member States have reported to have used or to plan to use 87% on average to support domestic investments in climate and energy. Do you consider the current provisions regarding the use of the revenues adequate for financing climate action? If not, please explain why?

WKÖ strongly believes that ETS auctioning revenues must be earmarked to fund innovation, technology, research and development in low-carbon technologies in industrial sectors. Currently, some Member States use (at least part of) their auctioning revenues for this purpose, while others, including Austria, do not. Not only do we strongly believe this to be a vital measure to support low carbon transition in industrial sectors, we are very concerned about the inequalities and internal market distortions that result from currently fragmented national policies in this regard.

It is therefore essential that the review of the ETS Directive makes the earmarking of auctioning revenues for industrial sector innovation mandatory for all EU Member States. The current provisions must be changed as a matter of priority to ensure that all Member States fully use their auctioning revenues in this manner.

6. General evaluation

6.1 How well do the objectives of the EU ETS Directive correspond to the EU climate policy objectives? How well is the EU ETS Directive adapted to subsequent technological or scientific changes?

The EU ETS has generally managed to implement a functioning market infrastructure for more than 11,000 installations (and 3.000 aircraft operators). This is manifested in a liquid market with a carbon price. Most importantly, the system will deliver the intended emission cap and will thus ensure that the ex-ante set environmental target is met. Amidst all the critique, it should therefore not be forgotten that the ETS will overachieve its primary target, namely the reduction of GHG emissions as intended. The ETS is partially responsible that the EU is one of the only areas in the world, where CO₂-emissions have consistently fallen and ambitious climate objectives, such as the 20% target until 2020, will be reached.

Unfortunately, the market-oriented nature of the ETS, focused on cost-efficient emission reductions (as set out in Article 1 of the Directive!), has increasingly been lost due to

consistent political interventions into the market - most notably the “backloading” decision. Regrettably, changes and adaptations to the ETS have solely had the purpose to raise the price. It is important that the ETS provides long-term planning security and regulatory certainty investors. An instable framework and changes within a trading period unsettle investors and prevent necessary innovation and investments- also in the interest of investments in low-carbon technologies. Therefore disruptions to the market must be kept to an absolute minimum.

Also, the carbon leakage list should not be adapted every five years; instead, strong protection against carbon leakage should remain until other economic areas have similarly stringent climate regulations. This will certainly not be the case until 2030.

6.2 What are the strengths and weaknesses of the EU ETS Directive? To what extent has the EU ETS Directive been successful in achieving its objectives to promote emission reductions in a cost-effective manner compared to alternatives, e.g. regulatory standards, taxation?

The main strength of the ETS is that it is a market-based system, which (at least in theory) places cost-effectiveness at the heart of EU climate policy. Therefore, the cap-and-trade system should - along with protection against carbon leakage, targeted technology policies and incentives - remain the cornerstone of our efforts to further decarbonise industrial and energy sectors. However, it must be ensured that the market-based nature of the ETS is not lost.

A major weakness of the ETS is its use of outdated historic production levels as data for the allocation of allowances. This “undynamic” allocation creates the absurd situation that a decrease of production is rewarded, while growth is punished- and therefore disincentivised. We therefore call for the use of more recent output data to ensure a more “dynamic” allocation. This would be fairer and incentivise increasing production.

Also, it must be ensured that the most efficient industrial installations at risk of carbon leakage do not incur any carbon costs. The main weakness of the current ETS Directive is therefore the Cross-Sectional Correction Factor (CSCF), which we believe to be unjust, arbitrary and counterproductive. A review of the Directive must therefore eliminate the CSCF as a matter of priority!

In our view, there is currently no value in discussing a possible CO₂-tax; especially since this could not be implemented at EU level (the EU does not have such a mandate). We reject the re-nationalisation of climate policies via national taxation measures. This would result in a fragmented playing field and inequalities within the EU.

6.3 To what extent are the costs resulting from the implementation of the EU ETS Directive proportionate to the results/benefits that have been achieved, including secondary impacts on financing/support mechanisms for low carbon technologies, administrative cost, employment impacts etc.? If there are significant differences in costs (or benefits) between Member States, what is causing them?

6.4 How well does the EU ETS Directive fit with other relevant EU legislation?

It has become evident that the ETS has been influenced by other EU policies, in particular those for renewables and for improving energy efficiency. Some of these interactions point toward counterproductive results. The subsidies for renewables not only lowered the demand for fossil fuels but also lowered the wholesale price for electricity and made electricity generation from coal cheaper than electricity from gas (with negative impacts on CO₂-reduction).

As a matter of priority, it must be ensured that EU climate policies, and in particular the EU ETS, are compatible with the overall aim of the EU to increase competitiveness, growth and jobs. Furthermore, it must be guaranteed that the initiatives to increase the share of industry in the EU by former Commissioner Tajani are fostered and not hindered by climate legislation.

Therefore, the review of the ETS Directive must be checked for its impact on competitiveness, growth and jobs. Only if climate policy fosters industrial growth and creates jobs will EU industry continue to be able to deliver innovative, low-carbon technologies with positive economic effects. This will ensure that Europe finally achieves a highly-competitive, prosperous, low-carbon economic model that, in turn, can be an example for other economies worldwide. To this end, the risk of carbon leakage must be fully alleviated.

6.5 What is the EU value-added of the EU ETS Directive? To what extent could the changes brought by the EU ETS Directive have been achieved by national measures only?

WKÖ strongly believes that the ETS should not be scrapped in favour of national, fragmented measures. Despite the shortcomings of the current ETS system, it is vital that EU industry, which competes across borders, is subject to a harmonised EU-wide system. It is important to keep the playing field within Europe as level as possible. Therefore, a reformed ETS should remain the cornerstone of EU climate policy.

6.6 Do you have any other comment on the revision of the EU ETS Directive that you would like to share?

The role of industry and business in the revision of the ETS Directive should not be limited to stakeholder workshops and public consultations. It is vital that the voice of the affected companies and sectors, which have years of real life experience with the current ETS, is heard and taken seriously. Especially in times of low growth, high unemployment and stagnating investments, the concerns of business ARE the concerns of Europe.