

Technology Industries of Finland: Viewpoints on Revision of the EU Emission Trading System (ETS)

TIF supports the increased ambition level of 2030 and 2050 EU emission reduction targets and recognizes the need to adjust the ETS system accordingly. We consider RDI activities and investments to low carbon industrial processes and solutions as key elements to achieve both sustainable recovery and growth.

Industrial RDI and investment cycles are very long, and they may span well over a decade. It is crucial, that amendments to the ETS directive supports regulatory stability and predictability. A favorable market environment for low-carbon and carbon-neutral innovations and investments is needed for optimal planning of investment decisions.

While assessing the 2030 reduction target and the respective revision of the ETS, it needs to keep in mind, that the linear trajectory from now to 2050 is not likely nor the most cost-efficient path, because the major emission reductions follow only when new technologies reach their maturity and are implemented widely. It has been estimated that in order to reach the carbon neutrality target, investments needed in new infrastructure, industries and energy system in the EU are as high as 520-575 billion euros by 2050. Most of this money must come from the private sector industries.

Cost efficient achievement of the ETS target without rebasing and MSR strengthening

It is also important to ensure the MSR's ability to function with additional surplus allowances generated by updated climate policies and targets and the effects of the economic volatility. Since the new fossil-free industrial processes will play key role in the technology industries low-carbon roadmaps, increasing the intake rate will be necessary to ensure the functioning of the ETS with new, more ambitious targets. An updated MSR should address the supply/demand balance to stabilize the carbon price, decrease uncertainty and trigger investments in these fossil-free steel technologies.

A new Linear Reduction Factor (LRF) in line with the increased EU 2030 and 2050 climate ambition should be agreed and take effect as soon as possible. TIF also supports strengthening the ETS allowance cap through the application of a higher annual LRF that provides visibility and long-term guidance for the private sector and the investor community. However, the free allocation share should be increased proportionally. We believe that this revision should be scheduled as early as possible. Ideally the new LRF should start from 1 Jan 2023.

Current ETS should not be extended to new sectors

Achieving more ambitious emission reduction targets by 2030 requires reductions in all sectors of the economy.

There are new ideas in the Green deal communication where road traffic, maritime and building heating will be perhaps moved to ETS. Generally, TIF does not support extending the current ETS to new sectors. It is likely that they have a much higher carbon abatement

costs than sectors currently under the ETS and may lead to duplication of the obligation schemes.

It is crucially important that competitiveness of European industries is being taken care of and we'll further enforce the carbon leakage prevention measures like free allocation and indirect compensation within ETS.

Creating an independent ETS for transport, maritime and building sectors

Transport, maritime and building sectors have different CO₂ abatement costs, elasticities and risks of carbon leakage as well as limited or no exposure to international competition compared to energy-intensive industries. Their full inclusion in the ETS system is, therefore, expected to drive carbon prices up substantially. This would exacerbate carbon costs and carbon leakage risks for sectors exposed to international competition.

There are multiple national and the EU-level instruments already in place in road traffic and building sector, and necessarily the ETS will not bring the more results. Overlapping policies usually create inefficiencies. If cap-and-trade -system is chosen, there should be separate systems. As maritime is global business and its regulation takes place at IMO, any EU mechanism should consider a risk for carbon leakage and view merger in global systems as soon as available.

Strengthened carbon leakage protection for EU ETS sectors

The replacement of European production by imports from foreign countries with lesser carbon constraints negatively affects both the Union climate action efforts worldwide and the competitiveness of its industrial basis. As demonstrated by increasing rates of substitution of domestic products with high-carbon footprint imports across the whole value chain, carbon leakage is indeed a solid reality for many EU industries. For sectors exposed, it is then essential that the ETS system will be able to mitigate the risks of carbon leakage.

To this extent, it is crucial that:

- The provision linking the overall ETS cap level and the intensity of carbon leakage protection (i.e. the share of free allowances distributable), to the CO₂ abatement potentials of EU ETS sectors is reviewed. The revision needs to avoid the overall carbon leakage protection to drop considerably at a pace faster than our capacity to cope. Energy-intensive industries have a lower abatement potential (22%) compared to the power sector (70%). This results in the latter driving the cap level down speedily.
- Furthermore the current free allocation system is based on benchmarks which decrease in parallel with GHG reductions. The cost of low carbon technologies are not reflected in carbon leakage measures based on GHG.

- A sufficient level of free allocations must therefore be maintained, and any type of reduction avoided, along with the provision of complementary policies supporting investment' efforts in clean technologies development and deployment. In particular, in the revised ETS the application of the cross-sectoral-correction factor for Phase IV shall be impeded.
- The amount of free allocations needed to prevent carbon leakage needs to be calculated before engaging in other regulatory initiatives potentially impacting the number of free credits; the decarbonisation of the power sector (which is the reference of the auctioning share) leaves the room for increasing the free allocation share and avoid the cross sectoral correction factor. This is to provide certainty for low-carbon investments and avoid market distortions. Should any other instrument, such as for example a Carbon Border Adjustment Mechanism, be introduced, it should include a solution for exporting sectors like e.g. a carbon rebate, and it should co-exist with the current system of free allocation at least for a transitional period, to provide certainty for low-carbon investments and avoid market distortions.
- Like direct costs, also indirect costs create a high risk of carbon leakage in sectors highly exposed to international competition such as steel. Therefore, like with free allocation for direct costs, also indirect costs shall be fully off-set at benchmark level via harmonized rules in all member states. Under no circumstances, harmonization at EU level shall lead to a further reduction of the maximum compensation level allowed by the recently revised EU ETS State aid guidelines. On the contrary, it should ensure that all activities of the steel value chain, (including also iron ores and industrial gases) receive compensation in all member states at the maximum level fully addressing the risk of carbon leakage.

The allocation of ETS revenues to support industrial decarbonisation

For the revised ETS system to meet its carbon-neutrality targets sustainably, it is of utmost importance to increase the financial support for the development and market uptake of low-carbon technologies.

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 a one of the key means for decarbonisation. With increased carbon prices, indirect carbon costs for 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, less resources would be available to provide compensation.

Avoiding undue impact of the COVID pandemic on free allocation

According to the existing rules, after affecting the emissions/free allocation balance in 2020, present COVID pandemic will impact post 2020 free allocation both in the first sub-trading period.

As soon as comprehensive data on the full impact of the outbreak become available, we urge the Commission to take the necessary initiatives to ensure that production and emissions reductions related to the COVID-19 outbreak will not unduly reduce the amount of post-2020 free allocation.

Finally, we'd like to remind that priority objective for all regulatory framework should be set to decarbonization and to strive to be technology neutral and not based on current dominant technologies or business models. Fast-emerging new synthetic fuels and P2X-solutions which present a new paradigm of cross-sectoral and circular activity that operates under a business logic that differs from currently dominant fuel and energy production are good examples for that. Care must be taken to ensure that the market is open to these new models and solutions. All measures complementing the ETS system should place particular focus on increasing demand and lowering market entry barriers for these new low-carbon and carbon-neutral innovations.

The Technology Industries of Finland (TIF) represents Finnish technology industries, comprised of 1,600 firms spanning the electronics and electrotechnical engineering, mechanical engineering, metal technology branches as well as health and information technologies and consulting engineering. Together they represent the Finland's largest manufacturing sector, generating annual turnover of over €77 billion euros and providing 311 000 jobs in Finland.