

T&E's response to the EU's Emissions Trading System Inception Impact Assessment

November 2020

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A. Extending the ETS to the full MRV scope of maritime emissions

European shipping is a large source of greenhouse gas (GHG) emissions and air pollution. EU related CO₂ emissions from maritime transport reached 144 Mt in 2019¹ and analysis has shown that its contribution to air pollution can be larger than those of all passenger vehicles in Europe.² In 2018, maritime emissions represented 3.7% of total EU CO₂ emissions, making its climate impact comparable to that of Belgium, and 13% of the EU's transport emissions.³ In pace with expected growth in global trade, shipping's global emissions are projected to increase by up to 50% between now and 2050.⁴

Yet at the same time, EU law rewards the sector with €24 billion per year in fossil fuel tax subsidies for international journeys.⁵ The sector also benefits from exemptions from ticket taxes (passenger ships), VAT and corporate taxes. The latter has been replaced by a mediocre 'tonnage tax' system, which is applied to the fleet's cargo carrying capacity as opposed to regular corporate income or profits. Tonnage tax is considered a favourable tax treatment to shipowners, as under this system shipping companies pay much lower than regular corporate actors. Some call this 'zero taxation' for shipping.⁶ In addition to fuel tax subsidies for international journeys, a recent report by the International Transport Forum (ITF) found that *"at least €3 billion per year is spent on just three maritime subsidies in OECD countries: tonnage taxes, tax exemptions for fuels for domestic shipping, and fiscal measures to reduce wage costs of seafarers"*.⁷ The report concluded that these maritime subsidies have failed to deliver their expected aims, inter alia, increasing local flags, seafarer employment and short-sea shipping.⁸

By signing the Paris Agreement, the European Union has committed to 'economy wide' GHG emission reduction efforts. While ships have been required since 2018 to monitor and report, among other

¹ This number is based on the EU MRV scope (see chapter 1.1.) and reflects the 95th version of the 2019 THETIS-MRV database. This database is permanently updated, meaning there might be more recent versions available. Outliers have been filtered out in order to take into account that some ships report their emissions inconsistently. Note that the MRV scope includes less emissions than the UNFCCC scope, with the former based on real life monitoring of emissions and the latter based on fuel sales in Europe.

² T&E. (2019) [One Corporation to Pollute Them All: Luxury Cruise Air Emissions in Europe](#).

³ European Commission. (2020) [2019 Annual Report on CO2 Emissions from Maritime Transport](#).

⁴ International Maritime Organization. (2020) Fourth GHG study.

⁵ T&E. (2019) [EU shipping's €24 bn a year fossil tax holidays: Maritime ETS is urgent to cut shipping's fuel subsidies](#).

⁶ Knudsen, K. (1997) The economics of zero taxation of the world shipping industry. *Maritime Policy and Management*, Vol. 24:1, pp. 45-54.

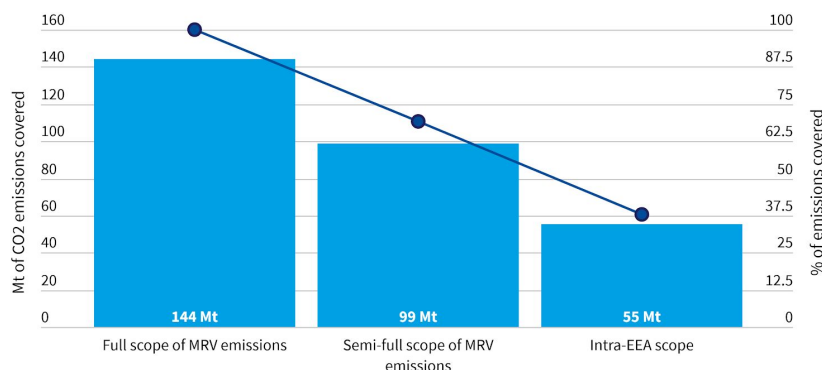
⁷ International Transport Forum. (2019) [Maritime Subsidies: Do They Provide Value for Money](#).

⁸ BRS Group. (2019) [Shipping and Shipbuilding Markets, Annual Review 2019](#).

metrics, their CO₂ emissions and operational efficiency, to this day shipping is the only transport sector not subject to GHG emission reduction targets or measures in the EU. As such international shipping stands in the way of the EU fulfilling its Paris commitment. When adopted in 2015, the idea was that this Monitoring, Reporting and Verification Regulation (MRV) would be the first step of a staged approach for the inclusion of maritime CO₂ emissions in the EU's climate policy. With the adoption of the European Green Deal in December 2019, the European Commission committed to taking some of the next steps, one of which would be the extension of the European emissions trading system (ETS) to cover the maritime sector.⁹ This commitment should now materialize.

A maritime ETS should include all emissions covered under the EU MRV regulation. For 2019, this would entail the inclusion of 144Mt of maritime CO₂ emissions. Limiting the ETS to an intra-EEA scope would undermine the effectiveness and the very environmental rationale of the ETS. This is because such an intra-EEA scope would only include 55Mt of CO₂ emissions or 38% of all EU trade related maritime emissions.

Breakdown of CO₂ emissions from EU shipping in 2019







Source: EU THETIS MRV, extract: 2019-v95-05112020-EU MRV Publication of information.xlsx. Outliers have been filtered out in order to take into account that some ships report their emissions inconsistently.

As the sector has already benefited from a decade-long grace period, it should no longer have the right to a pilot phase. Equally, there should be no free allowances. Analysis shows that a maritime ETS would be very much carbon leakage proof and CO₂ costs can easily be passed through to the final consumers.

⁹ European Commission. (2019) [The European Green Deal](#).

Insignificant impact of shipping ETS on consumer goods

Product	Origin	Destination	Distance	Ship CO2 emitted per item	Additional costs with shipping in the ETS with €50/tonne CO2	Old Price in Belgium* without ETS	New price in Belgium* with ETS	Price increase due to ETS
 Banana (single)	Ecuador	Netherlands	10464 km	22 g	0.11000 € Cents	1.200	1.207 €/kg of banana	0.5500%
 iPad (single)	China	Denmark	19327 km	55 g	0.27500 € Cents	550	550.003 €/iPad	0.0005%
 Grain (1 kg)	Brazil	Holland	10416 km	21 g	0.10500 € Cents	0.16	0.161 €/kg of grain	0.6562%
 Diesel (1 litre)	USA	Italy	8575 km	24 g	0.12000 € Cents	1.4	1.401 €/litre of diesel	0.0857%

Source: Estimates by T&E based on the product emissions data from Danish Shipping, <http://www.navigatingresponsibly.dk/>

* Product prices in Belgium were found based on desk research.

T&E supports the European Parliament's proposal to create a so-called Ocean Fund that reinvests part of the maritime ETS revenues into the decarbonisation of the sector. The revenues of the Fund could be used to finance the uptake of energy saving technologies on ships, the deployment of innovative technologies and zero-carbon fuels (e.g. green hydrogen, ammonia) in vessels and relevant infrastructure in European ports. A 'contracts for difference' support scheme (CfD) should be set up in order to support either producers of sustainable alternative fuels to lower their market price or ship owners/operators to carry the more expensive fuel bills. Fossil based fuels and biofuels should be excluded from any support.

However, the ETS price alone will not be enough to bridge the price gap between sustainable marine fuels and fossil fuels, nor will it sufficiently drive energy efficiency. Additional regulatory initiatives will be necessary to ensure the uptake of energy efficiency measures and zero-emission fuels, both on the demand and supply side. Ideally the FuelEU Maritime initiative addresses both of these goals hand in hand. Additionally, a multiplier - requiring the surrendering of e.g. double the quantity of allowances and thus increasing the cost of emitting CO₂ - could be considered in order to truly turn the maritime ETS into a decarbonisation tool.

B. Strengthening the aviation ETS, by making it bigger and better

Summary

While every other sector's climate emissions have decreased since 1990, transport emissions have increased by almost 30% and **aviation emissions have more than doubled**. If the European Green Deal is to radically reduce the EU's climate impact, it has to reshape [European](#) aviation by using all necessary carbon pricing tools at its disposal, including revising the Emission Trading System (ETS).

The European Commission should ensure that it defends the EU ETS as the main tool to regulate aviation emissions, and further strengthens its ambition, especially if it wants to guarantee aviation's sustainable recovery post COVID19. As a result, it should not integrate ICAO's cheap and environmentally ineffective carbon offsetting scheme (Corsia) into EU law at the expense of its own climate targets for aviation. This paper contains T&E's views on the main elements to take into account for the next revision of the ETS for aviation in 2021. These recommendations aim at making the ETS better and bigger, which include:

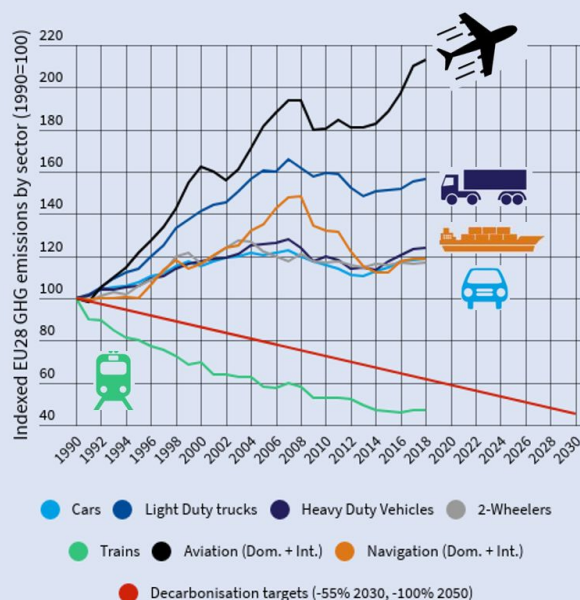
1. Strengthening the EU ETS for aviation by:

- Removing free allowances for aviation and using the revenues to develop & deploy clean fuels
- Applying discounting factors to aviation emissions
- Reducing the aviation ETS cap & limiting the use of allowances from the stationary ETS
- Establishing a minimum price for CO2 allowances
- Enabling voluntary cancellation of allowances by member states to take into account any future reduced aviation demand

2. Countering any international attempts to undermine the ambition of the EU ETS as a tool to regulate aviation emissions

- Consider options to reintegrate long haul aviation emissions through the ETS

Aviation: biggest effort to reach -55% 2030 target among all transport modes



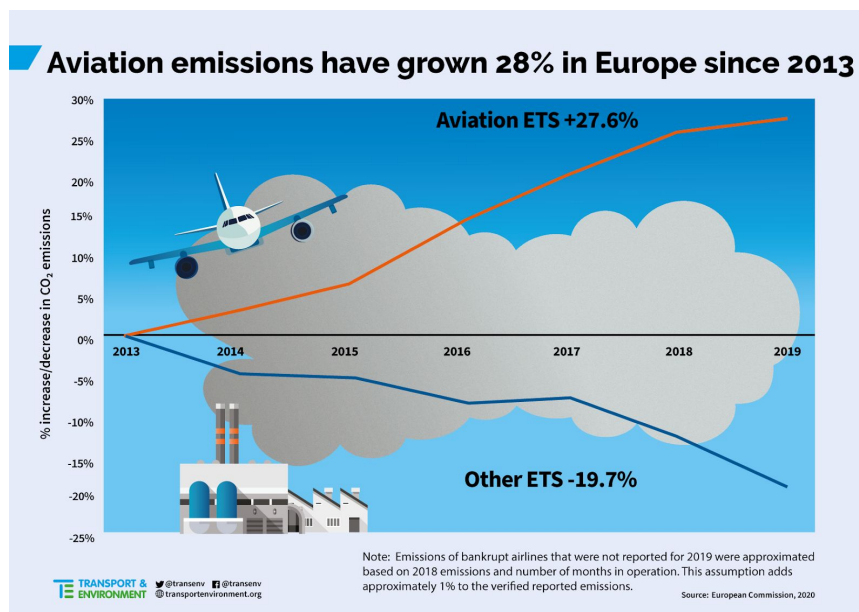
Data source: Member State reporting to the UNFCCC. 2018 data from EEA proxy GHG emission database.

- Reject any attempts to replace the EU ETS by Corsia's ineffective offsetting scheme
- Assess the possibility of applying both ETS & Corsia on the same routes

1. Aviation emissions expected to continue rising post COVID19 without effective carbon pricing

Aviation emissions continued soaring right up until the start of the COVID19 crisis. In 2019, CO2 emissions from European aviation increased by 1.5% compared with a 8.9% decrease from all other sectors covered by the ETS (the stationary installations such as coal, steel and concrete plants). Since 2013, European aviation emissions have increased 27.6% compared to a 19.7% decrease for other sectors in the ETS.

Although all sectors must decarbonise, the aviation sector has so far escaped its responsibility compared to other sectors. **It will be increasingly socially and politically untenable for the aviation sector to continue to grow despite measures in place to decarbonise other sectors.**



Despite COVID19 causing a temporary fall back in aviation traffic, aviation's emissions are expected to bounce back once the crisis recedes, unless the sector begins to effectively pay for its actual impact on the environment. Industry data has shown that passenger numbers have repeatedly broken records in the aftermath of global shocks such as the 2008 financial crisis.¹⁰ Despite the limited contribution of aviation to national budgets in normal times, governments across Europe have agreed to **at least €32**

¹⁰Boeing, Commercial Market Outlook 2018-2019.

billion in bailout support for the sector with environmental conditions in only a limited number of cases. Without pricing policies that encourage fairer fares, emissions of the sector will continue soaring like they did right up until the start of the COVID19 crisis, especially as some airlines¹¹ are already expecting to engage in price wars to stimulate passenger traffic, further cheapening the price of flying. Airlines have also claimed to be “international” in nature, requiring climate policies to be established at international level (i.e. the UN aviation agency, ICAO). However their reliance on national support during the Covid19 crisis belies this myth.

A number of reports have shown that flying remains a mode of travel that is used by a limited number of citizens, in the UK for example, 70% of all flights are taken by 15% of the population¹² and only 4% of the German population engages in five or more holiday trips per year¹³. The impact of carbon pricing is expected to mostly impact parts of the population with higher incomes, as the vast majority of flights are taken by frequent flyers¹⁴ who can more easily absorb the extra cost or afford other modes of travel. Analysis¹⁵ shows that in Europe, **households with the highest carbon footprints are by large the households with the highest levels of income and expenditure**, and that the **contributions of air transport is disproportionately large among the top emitting households**. The same research shows that any action to address the carbon footprint of aviation is likely to **affect those with the highest incomes and expenditures most**. Therefore when considering the social implications of reforming the EU ETS, the European Commission should understand that increasing the cost of air travel is likely to impact mostly a wealthier part of the population, who fly often and can take on the impact of effectively paying for their pollution.

In view of better addressing aviation’s climate impact, the revision of the EU ETS should make it better (2) and bigger (3), strengthening its key features while extending its scope.

2. Time to strengthen the EU ETS for aviation

Allowances under the ETS, in 2019, [traded at](#) €25 on average and airlines received a large portion of their emission permits (32 million, almost half) for free. This resulted in a cost to airlines of around €900 million a negligible cost given that airlines benefit from a jet fuel tax exemption estimated at [€27 billion a year](#) if applied to all European outbound (intra and extra-EU) flights. Combined with the fact that only flights within Europe are included in the EU ETS, accounting for only around 40% of the

¹¹ Yahoo Finance (June 2020), [Coronavirus: Wizz Air promises 'ultra low fares' as price war looms](#)

¹² [A free ride](#) (2020), [Infographics](#)

¹³ Stefan Gössling, Martin Lohmann, Bente Grimm, Daniel Scott (2017), [Leisure travel distribution patterns of Germans: Insights for climate policy](#)

¹⁴ Independent (September 2019) [Only the rich fly regularly – and now they've got to pay to tackle climate change](#)

¹⁵ Cambridge University, Diana Ivanova & Richard Wood (June 2020), [The unequal distribution of household carbon footprints in Europe and its link to sustainability](#)

regions' emissions¹⁶, **the ETS for aviation needs to be revised to align the price of flying with its actual environmental impact.**

- **Getting rid of free allowances for airlines**

The airline sector received an estimated 32.3 million tonnes¹⁷ of free allowances in 2019. President Von der Leyen's European Green Deal has committed to reducing these free allowances, a move already encouraged by several member states. The principle of free allocation was implemented to counter the risk of carbon leakage, where production moves from the EU to third countries. But the principle of carbon leakage does not apply to the aviation sector, as the "product" (i.e. transporting passengers) cannot be "moved" to another third country.

In order to ensure the EU ETS is in line with the EU's 2030 increased climate objectives, the European Commission should propose **to move towards full auctioning of allowances for aviation as soon as possible, as requested by Poland¹⁸ earlier in 2020.** On top of ensuring airlines pay the real price for their pollution, abolishing free allocation would also reduce administrative costs both for airlines and member states as there would be no need for benchmarking anymore and all airlines would be treated equally.

The revenues generated by putting an end to 32.3 million tonnes of free allowances could help finance **contracts for difference (CfD) promoting the development and use of sustainable alternative fuels¹⁹.** These CfDs are agreements whereby public subsidies are used to meet the gap between what it costs to produce such a fuel, and what the market is willing to pay. CfDs have been used effectively in the past to support novel alternative technologies such as renewable electricity (wind, solar), and through an auctioning process can be awarded to the producer offering the lowest cost, therefore ensuring public money is put to the most efficient use.

- **Reducing the aviation ETS cap & limiting the use of allowances from stationary ETS**

Currently the cap for aviation is set at 95% of average 2004-06 emissions until 2020, meaning that aviation ETS allowances (EUAs) available to buy for airlines are limited. But in reality this is not a hard cap on aviation emissions, because airlines are free to go over this aviation cap, by buying allowances from the stationary sector (EUAs). The relative size of the aviation sector compared to the stationary market and the willingness to pay for transport by consumers means that there is in effect

¹⁶ EASA (2018) [Figures and Tables | European Aviation Environmental Report](#)

¹⁷ T&E (2020), [State of the Aviation ETS](#)

¹⁸ Council of the EU (2020), [Implementation of full auctioning for the aviation sector under EU ETS](#)

¹⁹ T&E (2020) [Legislating for aviation alternative fuels](#)

an unlimited supply of allowances for air transport. Currently around 50% of the surrendered allowances from aircraft operators come from the stationary ETS.

However, the impact of COVID on aviation emissions in 2020 and the rate at which the industry is likely to bounce back²⁰, coupled with growing deployment of technology and societal shifts from air travel, creates an opportunity to make 2019 the “peak” year for aviation emissions in Europe, and that peak should be reflected in the scheme’s cap.

In order to ensure aviation emissions’ growth is limited, the aviation cap could be further reduced for 2030 and the possibility for airlines to buy EUAs could also be limited. From 2021 onwards the linear reduction factor (LRF) applied in the stationary ETS also applies for the aviation sector, which would lead to the 2030 cap being 27% below the historic value (2004-2006). Decreasing the rate of available allowances to buy by increasing the LRF to 3.8% instead of the current 2.2% could help further lower this cap and increase the rate of aviation emissions reduction. In addition, a limit on the quantity of allowances from the stationary sector that airlines can buy, would also introduce a hard cap on aviation emissions. Given that airlines can today buy as many EUAs as needed to cover for their growing emissions, by limiting the number of EUAs they can purchase, airlines would be forced to cap their emissions. This would be a way to ensure 2019 remains the peak year for aviation emissions and would provide certainty for all operators on the reduction pathway to take in the medium to long term.

- **Applying a multiplier to aviation emissions**

In order to further encourage emissions reduction in the sector and also address irregularities in the way the sector has been treated over the past years, **a multiplier could be applied to increase the amount of allowances airlines would actually need to surrender.** This would drive emissions reductions by creating sufficient price signals to contribute to the achievement of carbon neutrality in aviation by 2050. The Market Stability Reserve (MSR) should however take into account demand from aviation with these discounting factors, in order to adapt the amount of allowances it would need to absorb and avoid having a surplus or a shortage of allowances on the market. There could be two main arguments justifying the use of a multiplier for aviation emissions:

- ❑ **Compensation for lack of kerosene taxation:** The minimum kerosene tax of 33 cents/litre in the Energy Tax Directive equals a CO₂ price of 130 EUR/ton. Based on the current CO₂ prices a discounting factor of 5 could be applied to compensate for the energy tax exemption for kerosene fuel.

²⁰ ACI Europe (2020) [European airports revise recovery projection to 2024 whilst reporting only marginal traffic increase for June](#)

- ❑ **Compensation for non-CO2 impact of aviation:** Aviation's impact on global warming is estimated to be 3-5 times higher than the effect of its CO₂ emissions alone, a discounting factor of 3 could be applied, as flights covered by the ETS have lower non-CO₂ impacts than long distance flights.

- **Minimum price for CO2 allowances**

In order to ensure the ETS price signals resist any excessive fluctuations caused by future crises, a minimum price for auctions could be implemented both in the aviation and the stationary sector. The price could be set in a way that it increases over time and thus also reducing uncertainty for investors whether emission abatement technologies will be economical. The UK introduced a minimum CO₂ price for energy installations covered by the ETS in 2013, and this contributed to reducing the carbon intensity of the UK's energy mix by phasing out investments in coal²¹.

- **Voluntary cancellation of allowances**

Under Art. 12(4) of the ETS Directive member states have the right to voluntary cancel allowances in the event of a policy driven coal phase out. Such a voluntary cancellation ensures that no other power plant can use the newly available certificates from the closed installation to increase emissions and output. The right to voluntary cancellation could be expanded to the aviation sector, for example to take into account reduced demand for aviation, when air travel shifts to rail, or whenever member states withdraw subsidies for regional airports.

3. Integrating Corsia without undermining the EU ETS

- **International distractions will not solve aviation's climate problem**

Due to issues inherent to offsetting and Corsia's lack of environmental integrity, integrating the system in Europe represents a threat to its existing climate commitments under the Paris Agreement (read more of our analysis [here](#)). **Implementing Corsia only instead of the ETS should not even be an option for the revision of the EU ETS**, given its expected inability to address growing aviation emissions.

Offsetting allows for aviation to continue polluting: Corsia relies on airlines buying offsets to compensate for their emissions growth, which will [never be enough](#) to offset the known damage of flying. The fact that Corsia does not include an actual reduction target is also at odds with the Paris

²¹ House of Commons (UK) (2018) [Carbon Price Floor \(CPF\) and the price support mechanism](#)

agreement goals and the European Climate Law proposal, where all sectors of the economy are expected to contribute to a climate neutrality objective by 2050. Offsetting is also in contradiction with the functioning of EU ETS, as international offsets cannot be used for ETS compliance as of 2020.

Corsia’s oversupply of cheap offsets will not incentivise aviation to reduce emissions: Current and potential supplies are [expected to be between 2 and 4 times higher](#) than demand estimated in the International Air Transport Association’s (IATA) latest COVID19 scenarios. With offsets expected to cost a few cents, the financial impact of Corsia for airlines is expected to be minimal. ICAO even [expected](#) the cost of compliance to range between 0.2 to 0.6% of total revenues from international aviation in 2025. In comparison, the carbon price in the EU’s ETS averaged around 25€/tonne CO2 in 2019 and according to the European Commission’s own [Inception Impact Assessment](#), even these carbon prices have ‘so far led to estimated minimal increases in airfares’ which in turn fail to encourage a shift to cleaner modes of transport.

Corsia’s COVID baseline change renders the scheme ineffective for the next 5 years (at least): By changing Corsia’s baseline year to 2019 only and depending on the rate at which the industry is expected to bounce back after COVID, airlines will likely [not have any offsetting requirements](#) in the pilot phase (2021-2023), and possibly even in the first phase of the scheme (2024-2026). So Corsia is expected to further delay mitigation obligations for the industry by several years at least until 2027 when the mandatory phase starts. In addition, as explained above, if 2019 is the peak year for aviation emissions, Corsia will be rendered useless, as airlines would never have emissions above 2019 levels to compensate for. However, if air traffic and emissions bounce back above 2019 levels, it is key to ensure the ETS is strengthened and broadened as Corsia will never provide enough of an incentive to reduce aviation emissions, which is why options to integrate Corsia in the ETS are limited.

- **Limited options to integrate Corsia into the EU ETS**

The European Commission’s IIA includes different options to integrate Corsia in EU law, however very few of these actually have the ability to fully address aviation’s climate impact.

- ❑ **Option 1** (ETS full scope): Given Corsia and ICAO are failing to deliver an effective scheme to account for extra-EU aviation emissions, the EU could show true environmental leadership by strengthening the ETS and reverse the “Stop the Clock” clause to re-integrate extra-EU emissions until Corsia actually starts requiring airlines to reduce emissions. In order for ICAO to have a stronger incentive to deliver on climate, the EU should start as of 2021 reintegrating extra-EU emissions in the ETS up until at least 2027, if and whenever Corsia becomes effective & mandatory.

- ❑ **Option 2** (No Corsia): Corsia’s flaws should encourage the Commission to re-integrate extra-EU emissions into the ETS. By not addressing extra-EU aviation emissions at all, the Commission would continue to ignore long haul aviation’s climate impact, which actually contributes heavily to aviation pollution, given it causes of aviation’s CO2 emissions (60%) and non-CO2 emissions²².
- ❑ **Option 3** (only Corsia): As stated above, applying only Corsia as a tool to reduce emissions is contrary to the EU’s climate ambition and legislative autonomy.
- ❑ **Option 4** (ETS/Corsia clean cut): Despite being logical on paper because it ensures the EU ETS continues to apply on intra-EU routes and Corsia on extra-EU routes, this option would still deliver much less benefits from a climate perspective than option 1, given that Corsia itself will not actually incentivise the sector to reduce its emissions on extra-EU routes, despite it constituting the major bulk of EU aviation emissions.
- ❑ **Option 5** (ETS/Corsia mix): This option would lead to the EU ETS no longer applying on intra-EU routes when airlines report emissions above 2020 levels and instead use Corsia’s ineffective offsetting scheme to address intra-EU emissions. This not only undermines the EU’s legislative autonomy when it comes to regulating its own aviation emissions but also goes against the EU’s ambition to be climate neutral by 2050, as it would acknowledge aviation emissions can continue growing indefinitely. This option should not be considered as a policy choice.

Another mix option would be to apply the ETS to intra and extra EU routes with airlines having to respect ETS obligations until emissions go above 2019 levels. Of course intra-EU emissions would still only be covered by the ETS, but on extra-EU routes, whatever is above 2019 levels would then become part of airlines’ Corsia offsetting obligations. This would also match Corsia’s change of baseline year.

Ultimately, Europe’s climate policy should be about peaking and cutting aviation emissions from a 2019 level. An effective ETS can achieve this through a hard cap and decline in a way that Corsia’s ineffective offsetting cannot.

- ❑ **Option 6** (ETS/Corsia mix based on licence of operators): This option could lead to a difference in treatment between third country and european operators, despite them operating on the

²² T&E (2019), [Why is aviation's true climate impact being kept under the radar?](#)

same territory. Addressing aviation emissions should be based on routes operated by airlines instead of their country of origin.

The IIA mentions the possibility of assessing other options to integrate Corsia, T&E would suggest evaluating **the possibility of applying Corsia and the EU ETS on intra and extra EU routes**. Given the international scheme's limited cost impact, especially given recent developments related to COVID19, T&E believes the Commission should analyse the actual cost of applying both schemes.

4. Policy recommendations

T&E recommends that the European Commission takes into account the policy recommendations below when revising the EU ETS rules for aviation, in order to make the EU ETS for aviation better and bigger.

❖ **Strengthening the EU ETS for aviation by:**

- Removing free allowances for aviation and using the revenues to develop and deploy SAF
- Applying discounting factors to aviation emissions
- Reducing the aviation ETS cap & limiting the use of allowances from the stationary ETS
- Establishing a minimum price for CO2 allowances
- Enabling voluntary cancellation of allowances to take into account any future reduced aviation demand

❖ **Countering any international attempts to undermine the ambition of the EU ETS** as a tool to regulate aviation emissions

- Consider options to reintegrate long haul aviation emissions through the ETS until Corsia actually starts requiring airlines to purchase quality offsets (not before at least 2027)
- Reject any attempts to replace the EU ETS by Corsia's ineffective offsetting scheme (i.e. options 3, 5 and 6 of the Inception Impact Assessment)
- Assess the cost impact of applying both ETS & Corsia on the same routes given the change to Corsia's baseline year due to COVID19 has further cheapened the scheme, resulting in next to no financial impact for complying airlines

C. The inclusion of road transport would set back existing climate efforts

Summary

Analysing the three options described in this consultation, **T&E expresses concerns:**

The Commission seriously envisions the possibility to repeal national targets and integrate road transport, as well as buildings, into the ETS. **These options, based on a theoretical vision of carbon pricing will not deliver emissions reductions in the real world.**

T&E regrets that the Commission did not include the option of maintaining the current architecture by raising both the ambition of the ETS and the ESR.

The risk is high that the whole architecture may crumble for lack of ambition. In these conditions, the target of 55% may never be achieved by 2050.

1. Context

In December 2019, the European Commission announced the European Green Deal, a renewed ambition to make the EU's economy sustainable by turning climate and environmental challenges into opportunities.

As a part of the European Green Deal, the European Commission suggested strengthening the European-wide climate ambition, raising the target from 40% of emissions reductions (against 1990) to 55% by 2030.

This new climate ambition implies much more than a quick fix. The overall climate architecture must be adapted and most of the European measures for climate change must be strengthened (CO2 standards, AFID etc.). The European Commission is now planning to pursue these discussions in the “Fit for 55%” package.

The European climate architecture, at the heart of the revised ambition, will need to be adapted.

Historically this climate architecture is composed of two pillars:

- The European-wide Emission Trading Scheme for large industries and the power sector
- National targets for road transport, buildings, waste, the agriculture and small industries in the framework of the Effort Sharing Regulation.

Last October, the Commission published an Inception Impact Assessment on the ESR. In this consultation, the European Commission proposes three ways forward to build a new architecture.

Analysing the three options described in this consultation, T&E expresses concerns. The Commission seriously envisions the possibility to repeal national targets and integrate road transport, as well as buildings into the ETS - a scenario based on carbon pricing theories, designed by economists and that deliver emissions reductions only on paper, but not in the real world.

The risk is high that the whole architecture may crumble for lack of ambition. In these conditions, the target of 55%, although adopted on paper, may never be achieved by 2050.

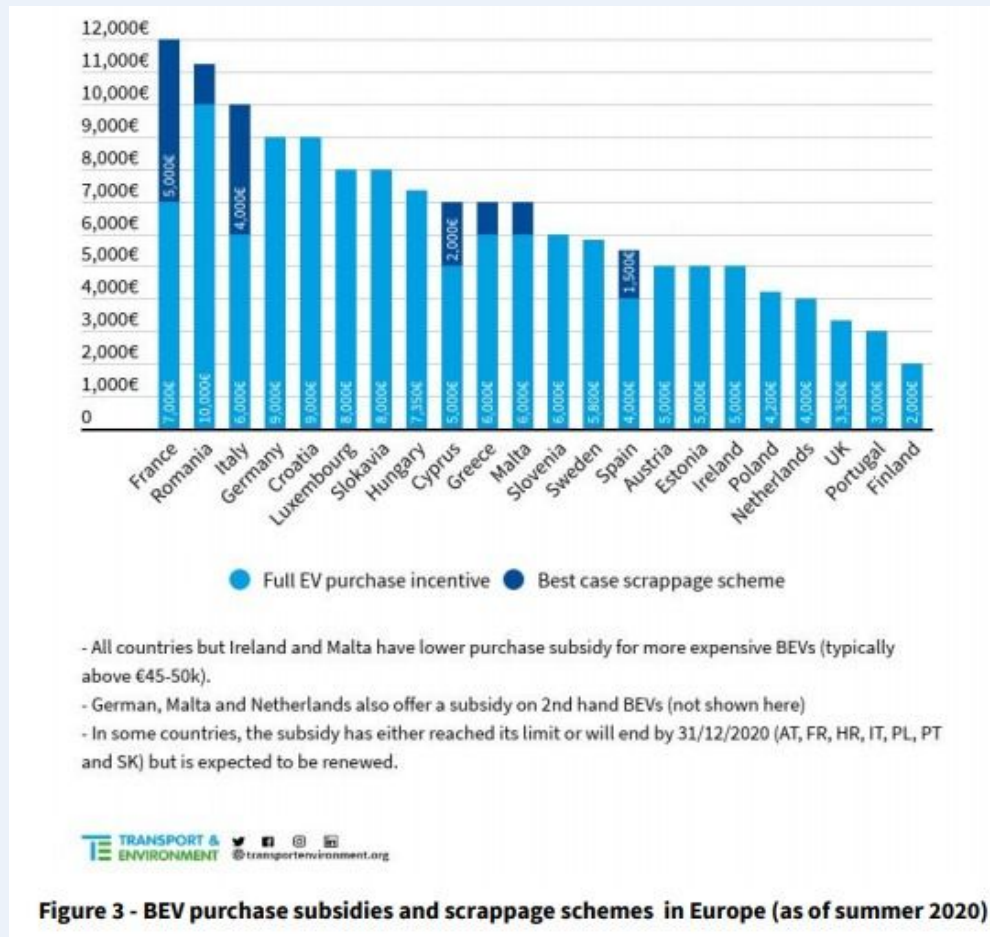
2. The missing “Option zero”, maintaining the existing climate architecture, strengthening the ESR

T&E regrets that the Commission did not include the option of maintaining the current architecture by raising both the ambition of the ETS and the ESR.

The ESR has proved to be an efficient tool to incentivize climate action:

- At national level, the targets have been - and will continue to be - an important driver for domestic investment in infrastructures such as charging, low emission zones and building renovation. They have led to ambitious taxation reform in some countries (see graph below)
- At EU level, member states have supported ambitious EU regulatory measures (e.g. CO2 standards) to more easily achieve their national objective.

Purchase subsidies and scrappage schemes in favor of electric vehicles (EV) in 2020. ²³



The ESR faces some challenges. T&E identified weak governance and inefficient flexibilities as main issues to address in this review:

- An improved governance that includes more transparent annual carbon budgets, and a strengthened compliance framework, including fines and annual checks.
- Although cross-country exchanges are allowed, the mechanism is rarely used. A joint projects platform for cost-effective projects EU-wide should be created, with the help of e.g. the EIB.

²³ Source : Transport & Environment (2020). Mission (Almost) Accomplished. Available at <https://www.transportenvironment.org/publications/mission-almost-accomplished-carmakers-race-meet-202021-co2-targets-and-eu-electric-cars>

Wealthy countries with highest targets may be able to support investments in countries with low abatement costs and benefit from the reductions.

3. Options 1 and 3: why carbon pricing is not the holy grail

Repealing the ESR

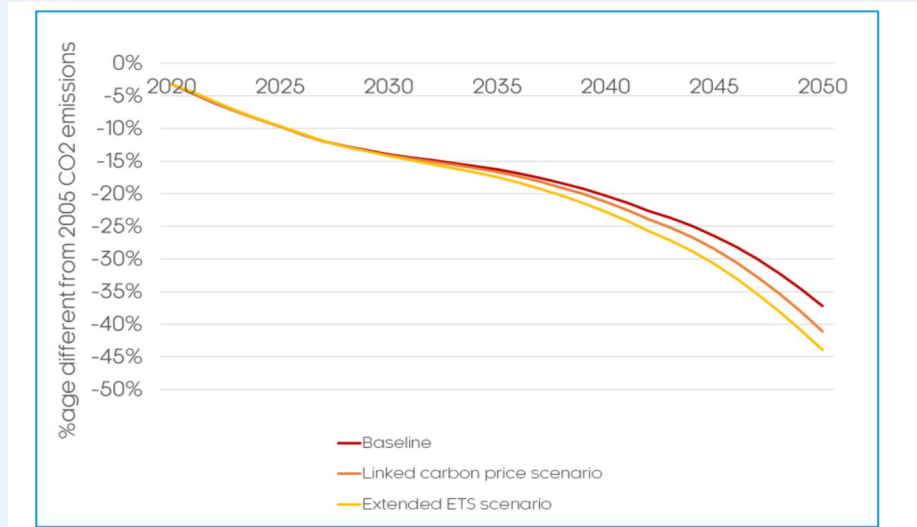
- National targets at risk. The ESR contributed to the adoption of national policies, and more will be needed this decade. The EC must factor the risk of domestic policies to slow down in the case where national targets would be repealed.
- EU policies in danger. The repealing of the ESR will also alter the motivation of the Council to adopt ambitious EU sectoral measures. The Commission should factor the potential for an extended ETS to jeopardize increased ambition in many other climate regulations.

Extended ETS

- Inefficient measure for the climate. Analysis shows that under an extended ETS, additional emissions reduction in road transport will be about zero in 2030 and less than 10% in 2050 due to its inelastic demand (see graph below). Additionally, within an extended ETS, a carbon price significant enough for road transport would be exorbitant for energy intensive industries.
- The fuel price increase resulting from the inclusion of road transport into the ETS will hit the low-income population the most, without addressing existing market barriers. The EC should really consider if it wants to link the Green Deal with impacts on the most vulnerable.
- Carbon pricing in road transport does not lead to fuel switching or timely investments into zero emission technology. To achieve 2050 targets, the last ICE car should be sold in 2035 at the latest. The Impact Assessment of the Climate Target Plan shows that ambitious CO2 standards compete politically with the road ETS. Standards have been the only tool that brought the transition from combustion to electric cars.
- A European-wide ETS will leave the door open to domestic compensations, as illustrated by the German system. Starting in 2021, Germany will start a “cap and trade” for road transport. While this cap and trade resemble a tax (the CO2 price is determined by law - unlike), compensation measures have already been announced by the German ministry to compensate lorries for the additional cost.²⁴

²⁴ <https://www.cleanenergywire.org/news/german-government-wants-reimburse-heavy-lorries-co2-price>

Extended ETS : an inefficient solution for road transport decarbonisation Source: Cambridge Econometrics²⁵



4. Option 2: Limited damage under conditions

A carefully-crafted and fair carbon pricing could be explored for road transport if some conditions are met:

- If national targets remain in place and are strengthened.
- If car CO2 standards become annual and reach 65% in 2030. Other measures must be taken to accelerate road transport CO2 cuts. If not, the carbon price will spiral out of control.
- If it is a system exclusively for road transport, with clear considerations on how the revenues could be used to contribute to the transition in the sector, particularly the most vulnerable.
- If no flexibility exists between this system and LULUCF and the EU ETS.

²⁵ Cambridge Econometrics (2020). Decarbonising European transport and heating fuels. Available at https://www.transportenvironment.org/sites/te/files/publications/2020_06_Decarbonising_European_transport_and_heating_fuels_report.pdf

Administratively, it is possible to maintain road transport in the ESR and create a separate carbon pricing mechanism. Article 2 should be modified to integrate the list of sectors covered in the ESR, using UNFCCC categories.

Further information

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