

**Introduction**

The Commission's Strategic Vision "A Clean Planet for all" indicates that deep CO<sub>2</sub> emissions reductions in the steel sector are possible through a combination of technological pathways, including steel recycling, carbon capture utilisation and storage, process integration, and electricity/hydrogen-based metallurgy. At the same time, the Commission document confirms that the steel sector is the most exposed to carbon leakage among all energy intensive industries, both in terms of possible impact on output and on investment.

The transformation of the steel industry will require significant investment in the technologies required to decarbonise while the sector needs to remain competitive throughout the entire transition and beyond. External factors not directly controlled by the industry will play a crucial role, most importantly access to CO<sub>2</sub>-low energy/electricity and feedstock, as well as CO<sub>2</sub> storage capacity, where available, at affordable prices. Considering the additional time required for technology uptake and deployment, it is essential that the most promising breakthrough technologies are tested and implemented at industrial scale as soon as possible in the coming decade.

The EU needs a stable and predictable policy framework that delivers on the climate objectives and preserves the competitiveness of its industrial basis while providing security for planning and investment.

**2030 climate ambition**

The success of EU climate leadership does not rely only on its level of ambition (which is already now not matched by any other large trading partner) but mainly on its ability to demonstrate that it is possible to combine environmental sustainability with economic growth and social acceptance.

As a whole, the challenges of a higher 2030 target appear more tangible and sizeable, in particular in the short timeframe by 2030, while opportunities are more uncertain and could materialise more prominently in longer term, provided that the enabling conditions are put in place.

The level of the target should be set on the basis of a thorough impact assessment that takes into account and balances the following elements:

- The recent crisis due to the COVID outbreak and its impact on financial ability of EU industry and society to make the investments required by the target;
- The level of climate ambition by third countries and its effective impact on regulatory costs for extra EU competitors;
- The enabling conditions, including the availability of competitive low carbon energy;
- The long-time horizon of investment cycles and elevated risks associated with these investments in industry;
- The non-linear trajectory of disruptive breakthrough technologies needed for the climate-neutrality objective, which require sufficient time to be developed, upscaled and commercialised;
- The implications of the negotiations on Brexit on the level of the effort required by the EU and its distribution among member states.

**Fair effort-sharing between ETS and non-ETS sectors**

All sectors of EU economy need to contribute fairly to the overall climate ambition. So far, ETS sectors have reduced emissions at a much faster path than non ETS sectors. As a result of that, it should be noted that the share of ETS emissions have dropped to around 40% of total EU emissions; hence, higher ambition, if agreed, requires a bigger effort for non ETS sectors. Already the current target of reducing emissions by 40% compared to 1990 entails a much larger effort on ETS sectors (-43% vs. 2005) in comparison to non ETS sectors (-30% vs. 2005).

Preliminary assessments by independent analysts<sup>1</sup> indicate that with the existing burden sharing between ETS/non ETS sectors, an increased ambition to 50% or 55% would have a significant impact on the EU ETS market, with a respective reduction in available allowances by 1.2 and 1.8 billion. In the absence of further adjustments, that would translate in reduction of free allowances respectively by around 500M and 750M, which would more than nullify the 3 % auctioning/free allocation shares' flexibility agreed in the recent ETS revision after almost 3 years of negotiations. According to other analysts<sup>2</sup>, carbon prices would rise to levels around 50€-75€ by 2030 for an ambition at 50% or 55%.

Taking into account this information as well as the need to address intertemporal efficiency of emissions reduction, it is important to focus any possible additional measures on non ETS sectors like buildings and transport. The details of such measures for these sectors– carbon pricing through taxation or cap and trade, at EU or at national level- need to be optimized for the desired level of ambition. We do not support the proposal to include in the existing EU ETS sectors resilient to carbon abatement such as transport since they would drive up the carbon price, with a major impact also on sectors exposed to international competition and carbon leakage risk. If it is decided to include them in a cap and trading system in order to increase their effort and regulate them more easily at European level, this should be done with a separate ETS. Finally, a more detailed assessment on the impact of the possible inclusion of maritime sector in the EU ETS is necessary in order to appreciate its possible implications for the overall carbon market and in particular for sectors exposed to carbon leakage.

### **Avoiding carbon and investment leakage**

In the context of persisting and widening divergence of climate ambition across the world, a strengthened framework of carbon leakage provisions needs to be urgently applied. As stated in the Green Deal Communication, carbon leakage can occur “*either because production is transferred from the EU to other countries with lower ambition for emission reduction, or because EU products are replaced by more carbon-intensive imports*”. Measures to prevent carbon and investment leakage should address both forms of risk, coming from direct and indirect carbon costs.

If a higher target is agreed, its implementation needs to avoid any impact on the ability of the system to mitigate the risk of carbon leakage for sectors exposed to international competition such as steel. Under no circumstances, existing carbon leakage measures (free allocation and indirect costs compensation) should be reduced. Furthermore, the impact of climate ambition on the carbon price needs to be assessed, since this also has an important direct impact on the direct and indirect carbon costs. This requires on one side free allocation and indirect costs compensation at the level of benchmarks and on the other side the rapid development and implementation of a carbon border measure that complements such provisions in order to tackle emissions linked to international trade and foster climate ambition in third countries. In addition, the carbon leakage framework needs to address also the big challenge of abatement costs that EU producers must face in order to implement the investments in low carbon technologies.

### **Options for possibly strengthening the EU ETS**

As mentioned above, if a higher climate target is agreed, it should be applied to non ETS sectors such as buildings and transport. Nonetheless, if strengthening of the EU ETS is considered, the following preliminary assessment of the options listed in question 5.2 should be taken into account:

1. *Increase the linear reduction factor and as such reduce faster the amount of allowances available each year:* this solution provides a transparent tool to achieve the higher 2030 target as it can be

<sup>1</sup> <https://www.linkedin.com/pulse/what-55-2030-emission-reduction-target-means-eu-ets-marcus-ferdinand/>

<sup>2</sup> <http://climatecake.pl/wp-content/uploads/2020/03/Impact-on-the-reduction-target-for-2030-and-on-the-EUA-prices.-Summary.pdf>

easily compared with the current 2.2% LRF. However, if the share of free allocation is not increased further (i.e. more than the 3% flexibility already foreseen), it will reduce the amount of free allowances available to mitigate the risk of carbon leakage. If this option is pursued, it should be clarified that the increased LRF is applied temporarily until 2030, while a new assessment would be necessary for post 2030.

2. *Increase the linear reduction factor as well as lower the starting point on which the linear reduction factor is applied (i.e. shifting the total allocation downwards):* this solution would modify not only the level of ambition by 2030 but also the overall trajectory through the “rebasing” of the starting point. Due to the “rebasing”, it is not possible to compare easily this solution with the current regulatory framework, since the new LRF would be based on a different calculation. While more details are necessary for a final evaluation, this is likely to reduce the available allowances in the period 2021-2030 by more than option 1, hence impacts more also the free allocation.
3. *Introduce a pricing policy (e.g. minimum price floor):* this solution would modify further the cost-competitive “cap and trade” nature of the EU ETS, which has been already affected by the introduction of the Market Stability Reserve; the reserve indirectly influences the carbon price through quantitative interventions that interfere with the demand and supply balance of the system. While it would not impact directly the free allocation volumes, the minimum price floor would likely increase artificially the price beyond the cost-effective level and would not provide the legal certainty of attaining the requested level of ambition.
4. *Reduce or eliminate the share of free allocation:* this solution would be inappropriate both from the viewpoint of environmental integrity as well as industrial competitiveness, since it would not provide the legal certainty of reaching a higher target (which is secured by the overall ETS cap, not by the amount of free allowances) and it would increase exponentially the risk of carbon, jobs and investment leakage to third countries.
5. *Strengthen the Market Stability Reserve rules (e.g. update feed rates) but allow other policies to be the primary drivers to increase greenhouse gas reduction ambition:* this solution would be mainly a strengthening of provisions that are already in the current legislation while rather retaining cost-free allocation. The reserve would intervene to balance the impact of other policies by (possibly) removing allowances available for auctioning without interfering with the free allocation. If allowances are cancelled from the reserve, this would have an impact on the trajectory and the overall amount of allowances in the period 2021-2030 but still without affecting the free allocation. While the higher climate ambition would be secured mainly by the other policies, the main role of the reserve would be to counterbalance the impact of such policies on the demand-supply equilibrium and to sustain the ETS carbon price. While this option would not affect the free allocation, its impact on the carbon leakage mitigation would depend on the achieved level of carbon price and its economic sustainability for sectors exposed to global competition.