– Consultation Response –

Setting a 2040 climate target which builds on the success and integrity of the EU ETS

Brussels, 23 June 2023 | Europex welcomes the Commission's consultation on setting the EU climate target for 2040. As Europe works towards implementing the recently adopted Green Deal policies in order to reach its 2030 target, it is increasingly important to have the end goal of net zero in sight. Setting the correct level of ambition for 2040 based on a thorough impact assessment is important to ensure a clear investment outlook as well as to build on the existing decarbonisation framework in a well-structured manner. Ideally, this should be done as a single clear-cut target which covers the entire economy and is underpinned by relevant, and if necessary sector specific, policies.

From this perspective, we would like to particularly comment on the role of the EU Emissions Trading System (EU ETS) in meeting climate targets as the EU moves towards net zero. The EU ETS is Europe's cornerstone instrument to ensure greenhouse gas (GHG) emissions are reduced at least cost and will need to evolve to tackle new challenges as the sectors which it currently covers decarbonise. To this end, it is important that the ETS framework remain underpinned by strong market principles that safeguard the undistorted price signals, efficiency, transparency and liquidity of the emissions market.

The consultation questionnaire aims to address a wide scope and each question on its own merits nuance and explanation. As such, we aim to add context to the responses provided to the questionnaire in this position paper.

1. The EU ETS should be expanded to cover all economic activity and greenhouse gases

Europex sees benefit in expanding the scope of the EU ETS to all suitable economic activity and all different greenhouse gases for reaching net zero targets and increasing the efficiency of the ETS. Emissions trading in the largest scope of sources will ensure an economically efficient decarbonisation and provide market participants with a strong price signal to guide their economic activity and financial investments.

From a market perspective, the preferred option for incentivising carbon abatement and implementing carbon pricing in additional sectors such as LULUCF or the remaining sectors under the Effort Sharing Regulation is their inclusion in the single European Emissions Trading System. Wide sectoral coverage encompassing a great number of diverse market participants optimises the efficiency of emissions reductions through a cross-sectorial price signal. Such an expansion would also ensure these sectors decarbonise efficiently. With an EU ETS expansion, the market as a whole, including all market participants, directly benefit from a larger, more efficient market with increased liquidity. With this in mind, all covered sectors, including those covered by the ETS II, should ultimately be integrated into a single EU ETS. To do this, a comprehensive timeline with indicators could be useful to provide guidance for future integration. Finally, additional sectoral coverage can support linking of trading schemes as the system becomes more attractive for global partners to link with.

2. Options to link the EU ETS with other compliance markets should be pursued

The EU accounts for roughly 10% of global GHG emissions, to reach the targets set in the Paris Agreement international cooperation will be crucial. Over the last few years, new emissions trading schemes have been developing globally, increasing the carbon price alongside. While national differences will need to be considered, the EU ETS can serve as a guide for these nascent systems.

The linkage of different frameworks requires robust political support. Jurisdictions must accept the need to share control over the ETS at the benefit of having a larger, more robust carbon market. Moreover, a linked ETS needs to be largely aligned on fundamental aspects of its design in terms of scope and ambition level. At the same time, linkage should not compromise the (environmental) integrity of the EU ETS.

For example, the EU and UK systems should be most convenient to link given their technical parallels, overlap of market participants and similar environmental ambition of the two jurisdictions. Whilst we welcome the 'serious consideration' to linking given in the Trade and Cooperation Agreement (TCA), this potential has yet to transpire concretely. Linking these systems in particular would have immediate benefits in terms of liquidity, price discovery, creating a level playing field between the two regions and avoiding competitive distortions.

3. Role of carbon removals

Carbon removals will have a role to play in the EU's 2050 net zero ambition and therefore also in the EU ETS. With the current scope and parameters of the EU ETS, the annual allocation is expected to fall to zero around 2040. Including carbon removal credits in the EU ETS could add to the underlying supply, maintaining healthy market conditions. However, the addition of carbon removals should not come at the expense of the EU ETS and its allowances. There are multiple design options to gradually establish a link between carbon removals, their credits and the EU ETS. A thorough impact assessment based on academics and market expertise should explore the most efficient option. In any case, the integrity of removals should be beyond question and should not negatively impact the trust that has been created in EUAs.

Efficient, transparent and reliable energy markets also play a key role in delivering the energy transition at least cost. While this response focuses primarily on the role of the EU ETS and carbon removals, energy markets more broadly will continue to be an important tool for facilitating decarbonisation and incentivising investment. Competition in unbundled wholesale and retail energy markets provides incentives for participants to act efficiently, minimise costs and innovate. As Europe increases its climate ambition, the challenges around integrating renewable energy sources and the need for further demand side flexibility will grow alongside.

In physical markets, transparent price signals which reflect the best use of available capacities allow market participants (generation, DSR, storage etc.) to respond effectively, ensuring efficient dispatch in the short-term and providing investment signals in the long-term. The EUA market also provides the necessary price signals for encouraging decarbonisation and offer covered entities the possibility to hedge their position. It is important the underscore the importance of market-based tools in reaching both the current 2030 targets as well as net zero in 2050 and everything in between. To achieve increased ambition, all sectors will need to make their contribution in a coordinated way with regulatory certainty and clear timelines.

About

Europex is a not-for-profit association of European energy exchanges with 34 members. It represents the interests of exchange-based wholesale electricity, gas and environmental markets, focuses on developments of the European regulatory framework for wholesale energy trading and provides a discussion platform at European level.

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