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REGULATORY SCRUTINY BOARD OPINION

Impact assessment (with back-to-back evaluation) / EU Emissions Trading System for maritime, aviation and stationary installations, and Market Stability Reserve

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EUROPEAN COMMISSION
REGULATORY SCRUTINY BOARD

Brussels,
RSB

Opinion

Title: Impact assessment (with back-to-back evaluation) / EU Emissions Trading System for maritime, aviation and stationary installations, and Market Stability Reserve

Overall opinion: POSITIVE WITH RESERVATIONS

(A) Policy context

The EU Emissions Trading System (EU ETS) is a cornerstone of the EU climate policy. The ETS Directive lays down the rules for greenhouse gas emission allowance trading within the EU, setting an emission reduction target of 62% for stationary installations, aviation and maritime by 2030 compared to 2005. The Market Stability Reserve (MSR) for the EU ETS was established by the MSR Decision in 2018. The European Climate Law sets a legally binding climate target for 2040 which requires a revision of the climate and energy acquis for the post-2030 period.

The EU ETS review is the first of a broad package of initiatives to deliver the post-2030 framework. It includes back-to-back evaluation and impacts assessment and assesses how the EU ETS sectors could contribute to the 2040 target in the most cost-effective way. The review evaluates the performance of the ETS Directive and the MSR Decision and addresses specific review clauses linked to aviation, maritime and stationary installations. It analyses the possible integration of carbon removals and the inclusion of waste management processes.

(B) Key issues

The Board notes the additional information provided and commitments to make changes to the report. However, the report still contains significant shortcomings. The Board gives a positive opinion with reservations because it expects the lead Service to rectify the following aspects:

(1) The benefits and the costs attributable to EU ETS during the evaluation period, including their distribution and the cost pass-through, are not clearly presented. The evaluation does not provide a sufficient quantitative analysis of the development of abatement costs, carbon price signal and effects of free allocations to inform the impact assessment.

This opinion concerns a draft impact assessment which may differ from the final version.

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(2) The problem, its drivers and its magnitude are not sufficiently demonstrated. The specific objectives are not defined in SMART terms.

(3) The link with the 2040 Climate Target impact assessment is not clearly established in the description of the baseline and the design of an appropriate baseline scenario is not clear enough to understand the impact of the policy options.

(4) The rationale behind the packaging of measures into options lacks clarity. The interplay between measures is not sufficiently analysed. The analysis of impacts on competitiveness, SMEs and affordability is underdeveloped.

(5) The costs and benefits of the policy options are not sufficiently detailed and quantified. As a result, this does not allow a proper comparison of the options in terms of effectiveness and efficiency.

(C) What to improve

Evaluation:

(1) Based on available observational evidence, the evaluation report should elaborate on the contribution of the ETS interventions under evaluation with sufficient granularity of the observed effects in terms of GHG emissions. The report should further present the attributable observed effects in terms of investments leading to decarbonisation in different sectors and it should provide a clear analysis of cost pass-through and subsequent effects on end-users. The evaluation should also provide evidence-based conclusions on the relationship of carbon price signal and marginal costs of abatement. It should include in the main report how the observed developments relate to the modelled expectations and demonstrate to what extent the marginal abatement costs had equalised between actors and sectors over the evaluation period. The report should clearly present the observed costs and benefits, quantified and monetised to the extent possible, of the intervention during the evaluation period, rather than focusing on theoretical advantages of the cap-and-trade system. Appendix IV should include the overview table of costs and benefits identified in the evaluation. Based on the appendix, the main report should include the quantitative evidence of the effects of the free allowances, in particular on GHG reductions, carbon price and investments in decarbonisation in sectors covered by ETS. The effect on competitiveness of the EU industry should be further developed, including in view of recent evidence of carbon leakage.

Impact Assessment:

(2) The problems should be more clearly defined, and the report should better demonstrate their magnitude. Regarding problem 1, the report should analyse the identified inconsistency of residual emissions with the EU ETS cap trajectory. The report should improve the analysis of the problem related to the insufficient carbon price signal to drive the business case, also taking into account whether increased carbon price can lead to reduced total production rather than to investments in abatement technologies, as seems indicated in the evaluation. The analysis of problem 1 drivers should be explicit about economic viability of necessary technologies. Regarding problem 2, the report should support with evidence and analyse the expected inefficiencies and the related costs in ETS market. The report should analyse

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other factors, beyond the shrinking market size, that may contribute to the risk of market inefficiencies. The report should better demonstrate whether the current system is not sufficient to meet the agreed 2040 climate target. Based on improved problem definition, the specific objectives should be revised and defined in SMART terms. The report should be clear how cost-effective contribution to decarbonisation is defined and how its temporal dimension has been considered.

(3) The report should explain and illustrate the key differences between the different baseline scenarios considered, including with the relevant scenario supporting the proposal on the EU Climate target for 2040. Apart from the choice of the 85% scenario for assessing the policy measures and options, it should set a benchmark allowing to assess the total costs and benefits of reaching the target compared to a scenario starting from the present situation and based on realistic assumptions. To the extent possible, key elements of the baseline (e.g. scope, development of abatement costs in different sectors, emission reduction, compliance cost, economic impact, competitiveness) should be presented in quantitative and absolute terms. The report should explain how present developments including decrease in production levels factored in the modelling of the dynamic baseline. In doing so, the stakeholders' claims that they would not be able to comply with the emission targets should be considered.

(4) The annexes should be clearer whether a full range of measures and their impacts has been considered. Regarding the choice of the cap, the annex should provide more details on the selected cap and the interaction with the policy options. Regarding MSR, the report should analyse in more detail the uncertainty related to the needs for market participants, including under each policy options. It should explain why more flexibility in relation to the rule-based option was not considered for intake and release rates. It should also discuss how predictability in terms of price signal for investors will be ensured given potential combined effects of uncertainties. Regarding removals, the report should make it clear how a staged approach to the integration of removals would impact the emission space. Regarding the IDB, the measures should be also assessed in quantitative terms as far as possible, e.g. considering WACC and related results for cost-effectiveness. In addition, the risks distribution between public and private actors under different financing modalities should be analysed in a more structured way. The analysis of IDB could also take into account the temporal profile of various allocation mechanisms and forms of support. Regarding stationary installations, the report should clarify the link of detailed measures with policy options and discuss the preferred option. Regarding waste, the report should ensure the consistency between the measures on waste and the measures on carbon capture and utilisation (CCU) when combining them in the policy options. Each annex assessing measures should include a summary of the costs and benefits.

(5) Based on the assessment of the measures in the annexes, the report should provide a brief description of the logic behind the combination of measures into the three policy options and discuss how the measures interact. The report should discuss if the extension to other sectors would have impacted the carbon price and therefore the choice of the preferred option for MSR. The report should be clearer about the interplay between IDB, free (conditional) allowances and compensation of indirect emissions, in terms of their economic impact on operators in targeted sectors, competitiveness (including downstream sectors), effects on decarbonisation.

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(6) The impact analysis should more clearly demonstrate the magnitude of the identified impacts and include key quantitative data on environmental impacts, economic impacts including cost-effectiveness, and distributional impacts for each policy option. An overall table with those elements should be presented for each policy option as compared to the baseline. The report should briefly identify and discuss the key trade-offs between the options and clearly identify the most impactful measures that would drive the overall impact for each of the three options. The costs and benefits should be discounted.

(7) The report should present a more detailed analysis of the distributional impacts, including on private consumption. Based on an improved analysis of the marginal costs for different types of economic operators, the report should reinforce the analysis of impact on the competitiveness, including on downstream sectors. The analysis of competitiveness should better reflect the long-term profitability and economic sustainability of the actors concerned and related unintended consequences in terms of economic security.

(8) It should make it clear which model and how has been used to assess the different impacts. The level of uncertainty of the modelling and the robustness of the results should be further assessed. The key assumptions and the main uncertainties should be reflected and referenced in the main report. The report should provide in annex further information on the parameters and model outputs used in the modelling (i.e. discount rate, carbon price, technological assumptions, abatement costs). It should be clear at what level of granularity the behaviour of 'agents' is modelled and how the discontinuity in abatement costs due to the change of key technologies is considered System level preconditions, including related to electrification should be better explained in the main report.

(9) The submitted report is not informative enough for decision makers. It should be streamlined to avoid repetitions and theoretical claims not sufficiently supported by evidence, e.g. in the discarded options section. Essential elements from the annexes should be reflected in the main report, which should be made more accessible for decision makers. It should summarize all key impact elements underpinning the effectiveness, efficiency, coherence and proportionality assessment.

Some more technical comments have been sent directly to the author service

(D) Conclusion

The lead Service may proceed with the initiative.

The lead Service must revise the report and its executive summary in accordance with the Board's findings, including technical ones, before launching the interservice consultation.

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