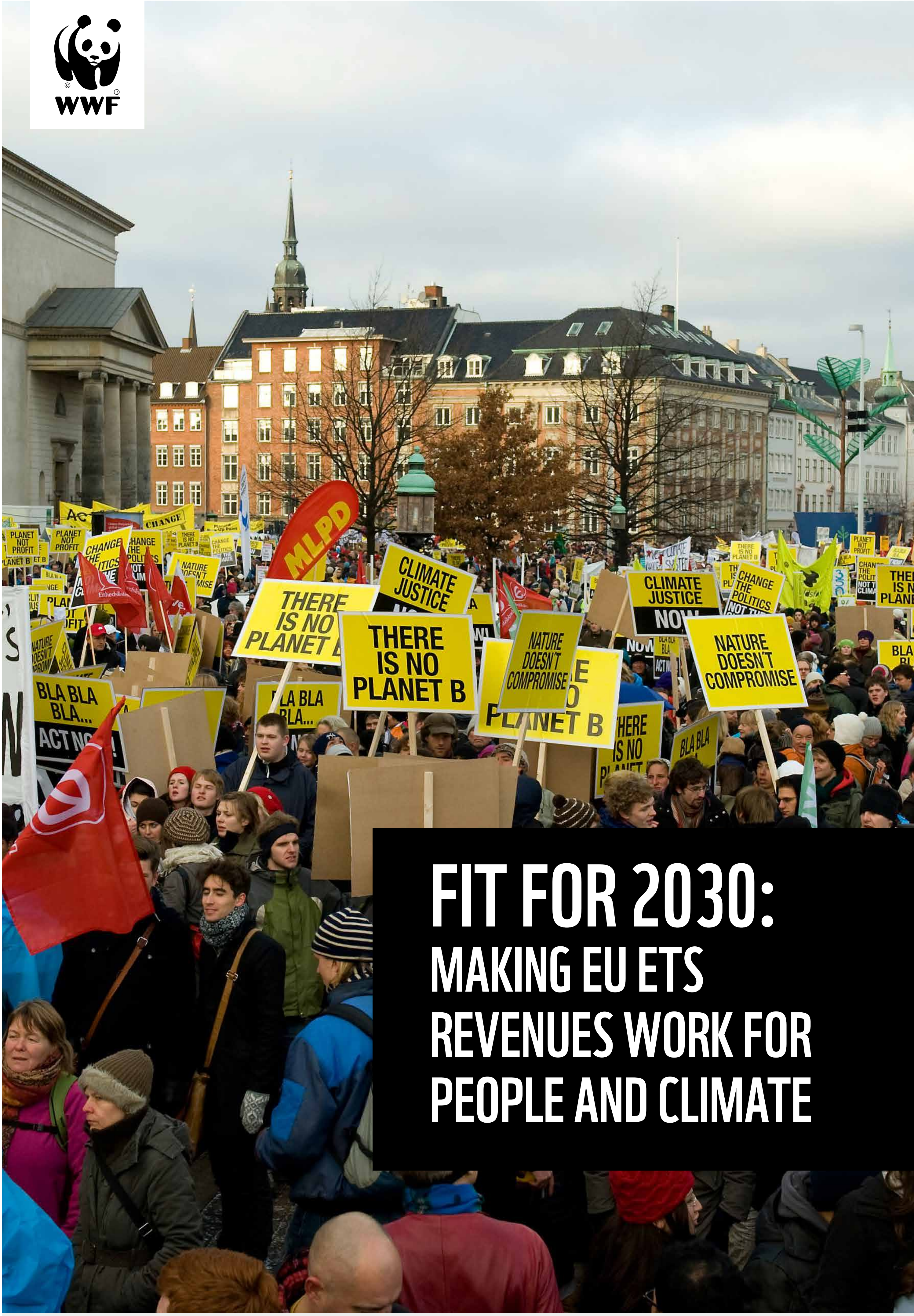

FIT FOR 2030:
MAKING EU ETS REVENUES WORK FOR PEOPLE AND CLIMATE

Lead authors:
Romain Laugier (WWF European Policy Office)
Lyndsay Walsh (WWF European Policy Office)
Imke Lübbeke (WWF European Policy Office)

Editing and communications:
Sarah Azau (WWF European Policy Office)

Design:
JQ&ROS Visual Communications

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ABOUT WWF

WWF is an independent conservation organisation, with over 30 million followers and a global network active through local leadership in nearly 100 countries. Our mission is to stop the degradation of the planet's natural environment and to build a future in which people live in harmony with nature, by conserving the world's biological diversity, ensuring that the use of renewable natural resources is sustainable, and promoting the reduction of pollution and wasteful consumption.

The European Policy Office contributes to the achievement of WWF's global mission by leading the WWF network to shape EU policies impacting on the European and global environment.

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INTRODUCTION

The EU Emissions Trading System (ETS) is a cornerstone of the EU's climate policy architecture. It covers **45%** of the EU's emissions reductions - those of the power sector, energy-intensive industries and internal flights. Its aim is to make polluters pay by putting a price on carbon and having them trade carbon allowances.

But for years, **the ETS has not made polluters pay**. It has been plagued by a too low carbon price and design flaws like 'free' allowances for some industrial sectors, which have limited its effectiveness while putting much of the cost of pollution onto others. This means the emissions have not decreased sufficiently and the revenues **have not been as high as they could be**. What's more, not all Member States have spent their revenues in the best way for the climate.

The European Commission will propose a revision to the ETS this July, as part of its 'Fit for 55%' draft climate and energy laws. Ahead of this, WWF has analysed how ETS revenues have been raised, distributed and used between 2013 and 2019.

We look at how much money Member States have lost due to free allocation of allowances, and how much they have raised and spent - as well as what they have spent it on.

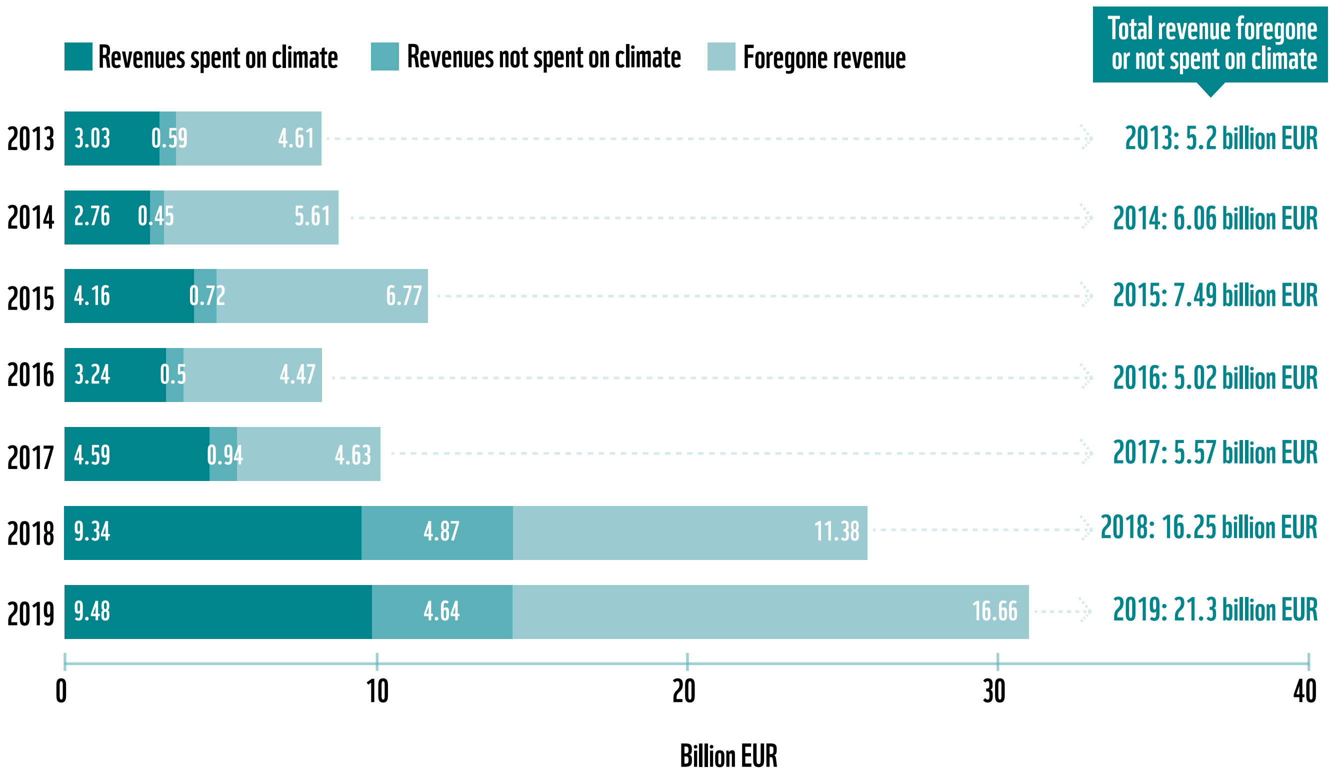
We then make **ten recommendations** to EU policy-makers. These aim to enforce the 'polluter pays principle', increase ETS revenues for Member States to fund the transition to climate neutrality, and ensure that revenues are spent in a more transparent and effective manner.

MAKING THE POLLUTER (ACTUALLY) PAY

Between 2013 and 2019, Member States raised €49 billion in revenues through the EU ETS. However, a potential €54 billion more was 'foregone' or lost due to free allocation of emissions allowances. Of this €49 billion, €13.3 billion was not spent on climate action, and part of the rest may even have financed activities which are counterproductive to a clean and just transition.

Huge investments will be required to meet the revised 2030 climate target. Rather than looking for new public funding streams, the EU needs to redirect existing public and private investments towards activities which are conducive to a transition to climate neutrality. In 2019 alone, EU Member States could have spent over €30 billion of ETS revenues on climate action, but ended up spending only €9.48 billion.

Figure 1: Auctioning revenues, foregone revenues and climate spending (2013-2019)



The EU must end free allocation as of 2023 and switch to full auctioning of emission allowances.

The raison d'être of the EU ETS is to drive down emissions by making polluters pay a price on them. Yet half of the targeted pollution has been emitted for free in the last seven years. A massive 94% of allowances in the industrial sector, and 82% of allowances in the aviation sector, are covered by free allocation and largely given out for free. The ETS emissions reductions that were achieved were mostly in the power sector, where free allocation is very limited.

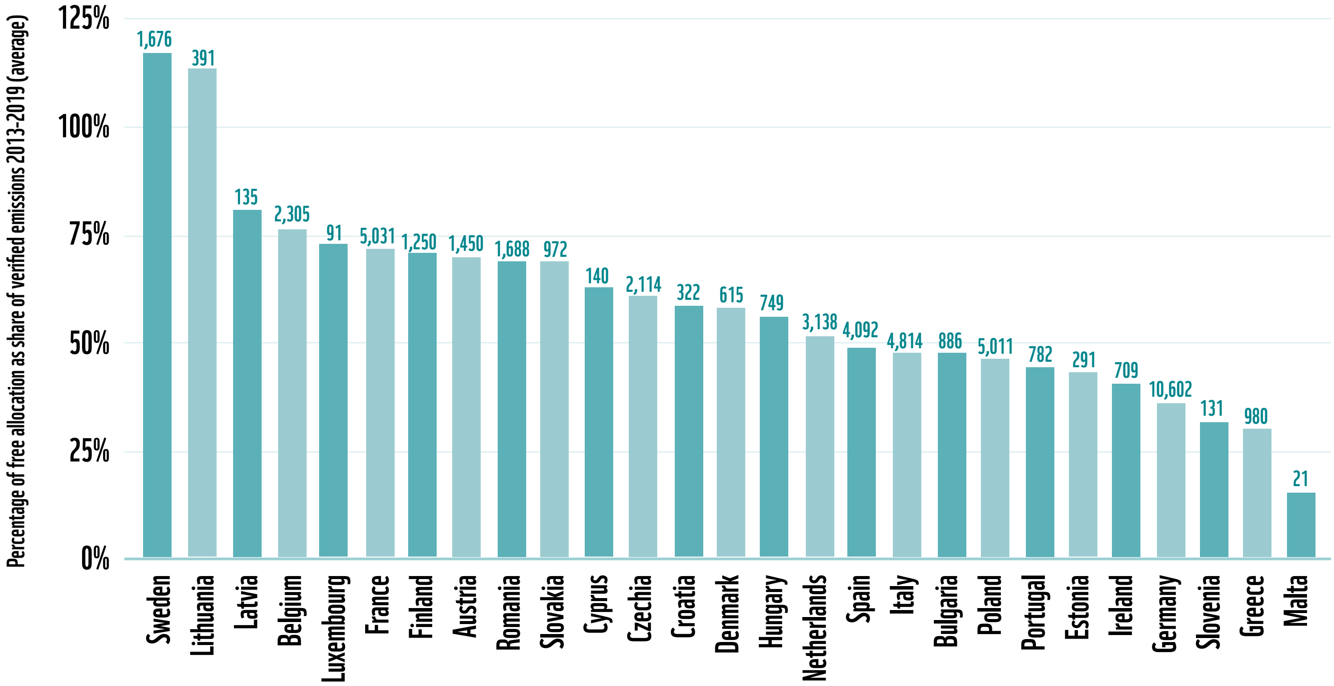
Some industries are even making profits out of free allocation, as they are passing on the carbon cost to consumers, and then also sell the allowances they don't need for profit. According to the European Court of Auditors, free allocation has led to "ineffective results" in the power sector and "tended to slow decarbonisation" in the industry and aviation sectors.

Phasing out free allocation is a chance for industrial transformation.

Additional revenues would allow policy-makers to substantially increase the size of the ETS Modernisation Fund - set up by the EU to modernise the energy systems of 10 lower income EU countries - and the Innovation Fund - which helps finance low-carbon technologies. In 2021 these funds are financed by 69 and 40 million allowances respectively. Part of the 676 million freely allocated emissions allowances could be redirected towards these funds and help industry and the electricity sector build up viable alternatives for their high carbon-intensive activities. The remaining ETS revenues should be invested in domestic climate activities such as renewable energy, energy efficiency, or research and development.

HALF OF THE TARGETED POLLUTION WAS EMITTED FOR FREE FROM 2013-2019

Figure 2: **EU ETS revenues foregone due to free allocation (2013 - 2019)**

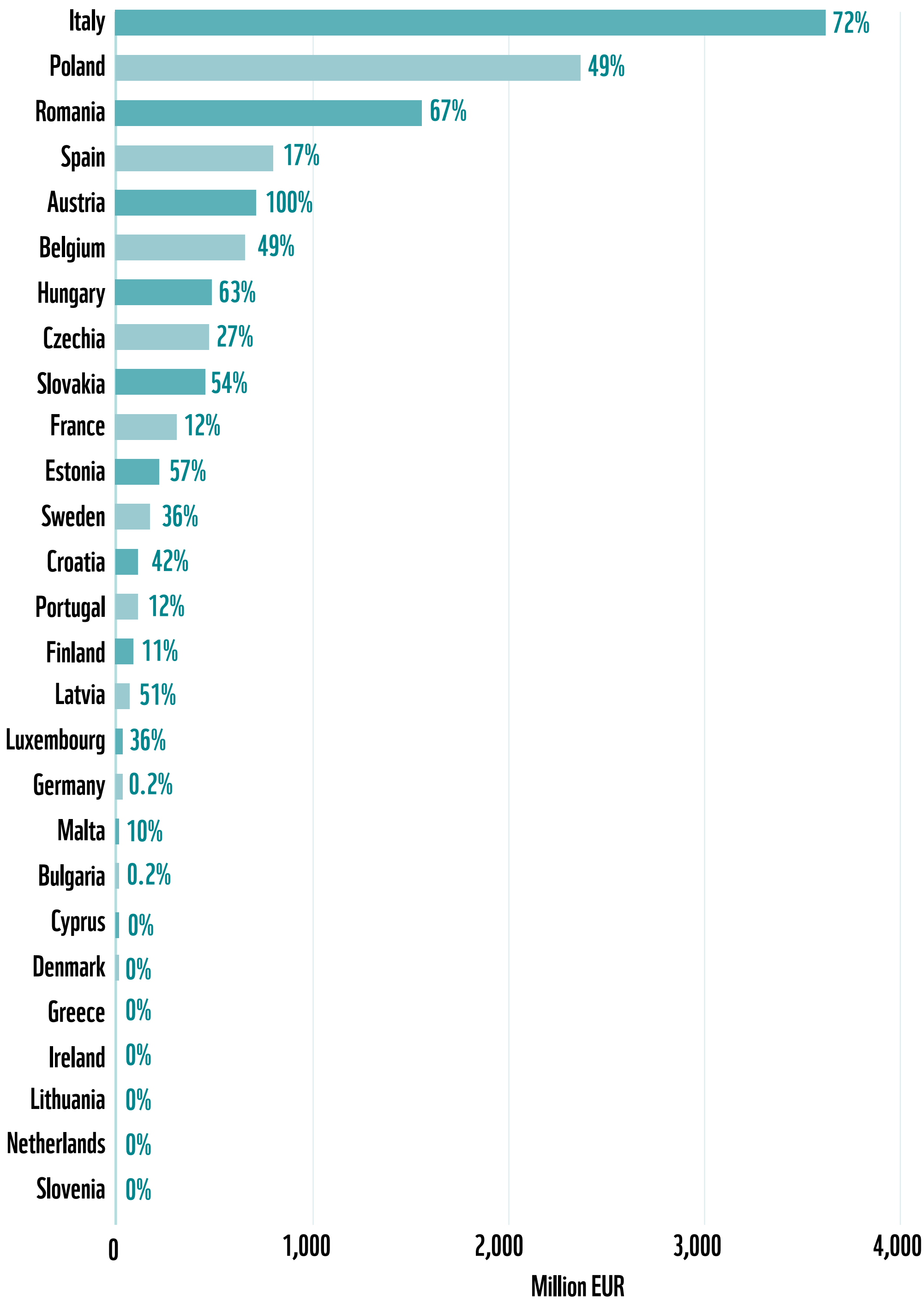


Number on top of each bar represents total amount (in million euros) foregone due to free allocation over 2013 - 2019

SPENDING EU ETS REVENUES: DRIVING THE TRANSITION TO CLIMATE NEUTRALITY

While the increasing carbon price reduces emissions, it also risks placing disproportionate costs on those most vulnerable and least able to pay if sectors push increased prices onto the consumer. As a result, **all ETS revenues should be fully redistributed to EU citizens and industries in the form of just and sustainable climate action**. Spending all ETS revenues in the transition to climate neutrality would boost the impact of the ETS in achieving emissions reductions and remove the risk that investments end up undermining climate objectives.

Figure 3: Member State ETS revenues not spent on climate (2013 - 2019)

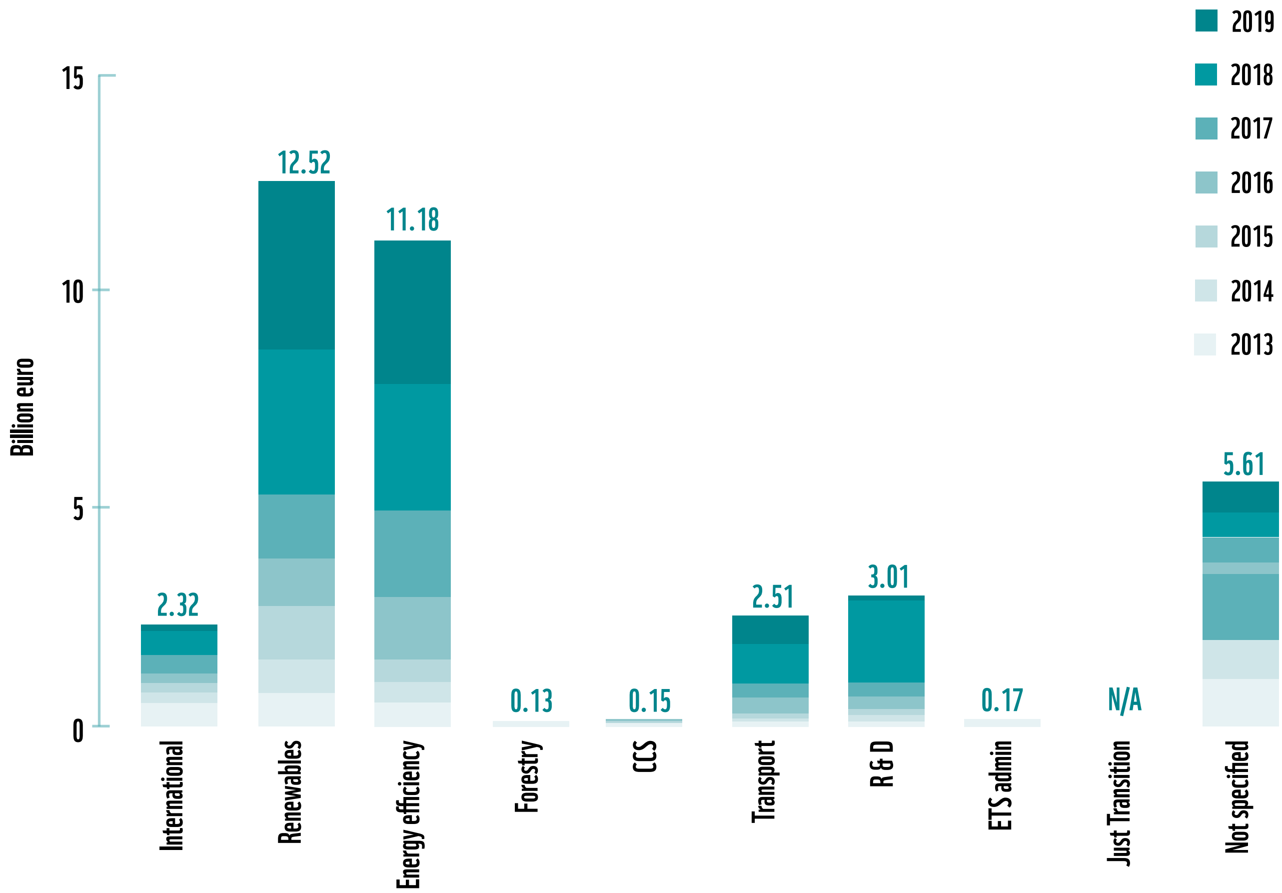


% = proportion of total revenues not spent on climate

In 2019, Estonia, Hungary, Latvia, Croatia, Italy, Slovakia and Romania failed to meet the 50% climate spending floor recommended in the ETS directive, with the latter four not even making it to 20%. Before calling for increasing EU funding, they should seek to better align ETS revenues spending with climate objectives.

EU Member States should remain free to choose the climate-related activities their EU ETS revenues are spent on. The ETS directive provides categories for so-called ‘climate action spending’. From 2013-2019, spending in renewables, closely followed by energy efficiency measures, topped the list:

Figure 4: Auctioning revenue spent on individual domestic climate activities listed in the EU ETS directive article 10 (3) in 2013-2019



Data from years 2013 to 2018 integrates spending from the United Kingdom. Data for the year 2019 only covers the EU27. Spending categories correspond to those mentioned in article 10(3) of the EU ETS directive.

Existing reporting under these categories clearly has limits, no least because the lack of detail makes it impossible to ascertain whether spending is consistent with a just transition. In fact, our report identified part of the ‘climate action spending’ as counterproductive to a clean and just transition, such as financing oil boilers and gas powered convectors in Poland and Hungary.

Spending ETS revenues, either through the Modernisation and Innovation funds or directly at national level, must come with green and social strings attached. In order to be eligible for ETS funding, any project should:

- Contribute substantially to at least one of six environmental objectives, and do no significant harm to any of the other, as per the EU Sustainable Finance Taxonomy devised by the EU Technical Expert Group on Sustainable Finance[1];
- Be consistent with Member States’ objectives set in National Energy and Climate Plans (NECPs) and, if relevant, Territorial Just Transition Plans (TJTPs);
- Comply with minimum social safeguards, starting with upholding the European Pillar of Social Rights[2].

[1] See the final report of the Technical Expert Group (TEG) on Sustainable Finance Final report on the EU Taxonomy, March 2020: https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-final-report-taxonomy_en.pdf.

[2] The European Pillar of Social Rights was proclaimed by the EU institutions in 2017 and sets out 20 key principles which represent ‘the beacon guiding us towards a strong social Europe that is fair, inclusive and full of opportunity in the 21st century’.

ENSURING ACCOUNTABILITY FOR HOW EU ETS REVENUES ARE USED

Member States' reporting lacks transparency and accuracy, making it difficult to ascertain whether ETS revenues are spent properly. Member States constantly submit erroneous or inconsistent information throughout various tables of their report, and they are in fact not bound by any quality requirements. Member States should be deemed to not have fulfilled their reporting requirement unless the report contains complete, quality and consistent information.

What's more, a loophole in the directive governing the ETS allows Member States to report not on how ETS revenues have actually been used but on national climate spending which is "*equivalent in financial value*"[3] . **This sentence should be deleted from the revised directive, which should require Member States to earmark EU ETS revenues in their budgets, and ensure that these revenues are truly additional to national climate spending.**

10 RECOMMENDATIONS FOR MAKING THE EU ETS FIT FOR 2030

ENFORCING THE POLLUTER PAYS PRINCIPLE

RECOMMENDATION 1
End free allocation and switch to full auctioning of ETS allowances as of 2023.

RECOMMENDATION 2
Remove excess ETS allowances from the market.

RECOMMENDATION 3
Extend the scope of the EU ETS to international aviation and shipping.

RECOMMENDATION 4
Do not apply the EU ETS to road transport and buildings.

SPENDING ETS REVENUES IN THE TRANSITION TO CLIMATE NEUTRALITY

RECOMMENDATION 5
Spend 100% of EU ETS revenues on the transition to climate neutrality.

RECOMMENDATION 6
Revisit the definition of 'climate action' spending in the EU ETS directive to align it fully with a clean and just transition.

RECOMMENDATION 7
Increase the size of the Modernisation and Innovation funds with green and social conditions attached.

RECOMMENDATION 8
The revenues raised by a Carbon Border Adjustment Measure should be returned to developing countries in the form of international climate finance.

ENSURING ACCOUNTABILITY FOR HOW EU ETS REVENUES ARE USED

RECOMMENDATION 9
Require Member States to earmark EU ETS revenues and prove that revenue is additional to existing climate spending from the national budget.

RECOMMENDATION 10
Improve the quality of Member States' reporting.

[3] Art. 10(3) of the EU ETS directive.

OUR MISSION IS TO STOP DEGRADATION OF THE PLANET'S NATURAL ENVIRONMENT AND TO BUILD A FUTURE IN WHICH HUMANS LIVE IN HARMONY WITH NATURE

WWF

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WWF European Policy Office, 123 rue du Commerce, 1000 Brussels.

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