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European Commission

INCEPTION IMPACT ASSESSMENT

Inception Impact Assessments aim to inform citizens and stakeholders about the Commission's plans in order to enable them to provide feedback on the intended initiative and to participate effectively in future consultation activities. Citizens and stakeholders are in particular invited to provide views on the Commission's understanding of the problem and possible solutions and to make available any relevant information that they may have, including on possible impacts of the different options.

TITLE OF THE INITIATIVE	*Amendment of the EU Emissions Trading System (Directive 2003/87/EC)*
LEAD DG (RESPONSIBLE UNIT)	DG CLIMA, Units B1 (EU ETS Policy Development and Auctioning) and B3 (International Carbon Market, Aviation and Maritime)
LIKELY TYPE OF INITIATIVE	Legislative, through the ordinary legislative procedure
INDICATIVE PLANNING	Q2 2021
ADDITIONAL INFORMATION	https://ec.europa.eu/clima/policies/ets_en

The Inception Impact Assessment is provided for information purposes only. It does not prejudge the final decision of the Commission on whether this initiative will be pursued, or on its final content. All elements of the initiative described by the Inception impact assessment, including its timing, are subject to change.

A. Context, Problem definition and Subsidiarity Check

Context

The European Green Deal[1], adopted by the Commission in December 2019, has tackling climate change, including more ambitious action in the coming decade and reaching the objectives of the Paris Agreement, and other interrelated environmental issues, at its core. This transition must be just and inclusive. The climate neutrality objective, which the Commission proposed in 2018[2] and the European Council[3] and Parliament[4] endorsed, is one of its central elements. The Commission has proposed to enshrine climate neutrality into EU law[5]. In order to set the EU on a sustainable path to achieve climate neutrality by 2050, with the Communication on stepping up Europe's 2030 climate ambition[6] the Commission has proposed a EU-wide, economy-wide net greenhouse gas emissions reduction target by 2030 compared to 1990 of at least 55% and set the stage for this initiative together with other legislative initiatives in the field of climate and energy.

To reach the increased climate target, all sectors will need to contribute. The Commission is reviewing the relevant policies at the EU level. The European Green Deal already indicated that the Commission will propose including maritime emissions in the emissions trading and assess expanding the use of emissions trading to other sectors. Even without changing the scope of the EU ETS, the legislation would have to be revised in line with a higher climate target. The ETS revision will also include the first review of the Market Stability Reserve (MSR), foreseen within three years of the date of its start of operation. While aviation is covered by the EU ETS, a separate initiative/inception impact assessment is considering how to amend the ETS to implement the carbon offsetting and reduction scheme for international aviation (CORSIA) in a way that is consistent with the EU's 2030 climate objectives and how to increase the share of allowances auctioned under the system for aircraft operators to further contribute to reducing greenhouse gas emissions.

The EU ETS has proven to be an effective tool in reducing greenhouse gas emissions. Emissions trading raises

1 COM(2019)640 final.
2 COM(2018)773 final
3 European Council conclusions, 12 December 2019.
4 European Parliament resolution of 14 March 2019 on climate change and resolution of 28 November 2019 on the 2019 UN Climate Change Conference in Madrid, Spain (COP 25).
5 COM (2020)80 final
6 COM (2020) 562 final

revenues that can be re-invested in the economy leading to better overall economic outcomes. However, carbon pricing does not address all barriers to the deployment of low and zero emissions solutions. Other complementary policy actions, notably transport, energy and other sectoral policies, are needed to ensure that the incentives align and to trigger further investments in clean energy technologies and infrastructure or to overcome financing difficulties for low-income households. The existing legislative framework, the ongoing reviews and announced revisions of other related pieces of legislation, including the Effort Sharing Regulation, on energy efficiency in buildings to boost renovation rates, renewables, mobility, transport fuels, carbon border adjustment mechanism, state aid guidelines or Energy Taxation Directive, will be taken into account to ensure synergies of instruments in the sectors of potential expansion of EU emissions trading.

This initiative will take into account the potential impacts of the COVID-19 crisis and recovery.

Problem the initiative aims to tackle

The current EU ETS legislation delivers a 43% emissions reduction in ETS sectors by 2030 compared to 2005, coherent with an EU economy-wide emissions reduction target of at least 40% by 2030. In light of the proposed increased climate ambition for 2030, the levels of reductions under the EU ETS need to be increased and corresponding changes in the legislation be made. Action is also urgently needed in sectors such as navigation and aviation, whose EU international emissions have grown by more than 50% since 1990. The Commission will therefore assess how the ETS should be strengthened to contribute to achieving at least 55% net greenhouse gas reductions for the EU by 2030 compared to 1990.

The Market Stability Reserve rules under the ETS aim at tackling structural supply-demand imbalances. This initiative will also analyse whether the rules governing the MSR operation remain appropriate in the context of the higher climate target and potentially expanded scope.

In view of the increasing emissions from maritime transport and the limited decarbonisation options available, action in this sector is urgently needed, including as it recovers from the current crisis. While emissions from EU's international maritime bunkers, a growing sector, are being monitored, reported and verified, they are not covered by the EU ETS or other EU climate legislation, contrary to the EU's international commitment to economy-wide action under the Paris Agreement. The EU will need to carefully consider its own measures on maritime, next to any global action. In line with the Communication on stepping up Europe's 2030 climate ambition, the Commission will assess the extension of the EU ETS to maritime transport and examine whether and how emissions from buildings and road transport, and potentially all emissions from fossil fuel combustion, could be addressed more efficiently, expanding the use of emissions trading in the EU.

Any expansion and strengthening of emissions trading will need to act in synergy with other EU and national policies. Distributional impacts among Member States and in different income groups will have to be addressed based on evidence. In addition, to achieve climate neutrality by 2050, over the coming decade we will still need to decarbonise our industries. The deployment and scaling up of existing innovative low-carbon technologies will need support, as will research into further innovative solutions. For these reasons, the impact assessment will look at how the ETS, including the Innovation and Modernisation Funds, can contribute to addressing specific challenges related to just transition and innovation.

Basis for EU intervention (legal basis and subsidiarity check)

The legal basis of this initiative is in Article 192(1) of the Treaty on the Functioning of the European Union.

Climate change is a trans-boundary problem and both international and EU action can effectively complement and reinforce regional, national and local action. Coordination at the European level enhances climate action and EU action is justified on grounds of subsidiarity, in line with Article 191 of the TFEU. The EU has worked since 1992 to develop joint solutions and drive forward a global agreement to fight climate change.

Action at EU level is therefore indispensable and has a much bigger chance of leading to the necessary transformation, acting as a strong driver for cost-efficient change and upward convergence. Implementing a similar measure nationally would result in smaller, fragmented carbon markets, risking distortions of competition and likely lead to higher overall abatement costs.

B. Objectives and Policy options

This initiative addresses the increasing concern of European citizens, and particularly younger generations, that urgent action is needed on climate change to ensure the wellbeing of future generations. The general objective of this initiative is to revise the EU ETS Directive in a manner commensurate with the 2030 climate ambition and with a long-term trajectory towards climate neutrality by 2050, in a cost-effective way, while taking into account the need for a just transition and the need for all sectors to contribute to the EU climate efforts, including maritime. The baseline for this initiative is the current ETS Directive for 2021-2030 ('phase 4')[7].

To achieve this, the following specific objectives could be identified

- Strengthening the EU ETS, while reviewing the Market Stability Reserve in line with the corresponding legal obligation and examine possible amendments to its design; and ensuring continued effective protection for the sectors exposed to significant risk of carbon leakage while incentivising the uptake of low carbon technologies
- Including at least intra-EU emissions of the maritime sector to ensure the sector contributes to the emission reductions needed, in accordance with EU's international commitment to economy-wide action under the Paris Agreement, and deciding whether to include emissions from other sectors such as buildings and road transport into emissions trading at EU level and assessing if a transitionary system is needed
- Addressing the distributional effects of this transition, by reviewing, as appropriate, the low carbon funding mechanisms and solidarity aspects in the distribution of allowances

This impact assessment will be undertaken in close coordination with the Impact Assessment that is underway to revise the EU ETS Directive in respect of specific aviation issues identified in Articles 3d and 28b, and a coherent approach will be taken. General improvements proposed to the EU ETS may be applied across the whole system.

The impact assessment will explore a broad variety of options, including on:

- The linear reduction factor to meet the higher 2030 target of at least 55%, a one-off reduction of the cap that would put it closer to the actual emissions level, as well as the interaction with the MSR.
- The parameters for the operation of the MSR, including the predefined range triggering adjustments to annual auction volumes, as well as the percentage rate applied to the total number of allowances in circulation.
- The extension of emissions trading to maritime emissions, potentially emissions from buildings and road transport or all fossil fuels combustion and waste incineration, as well as the interactions with the existing regulatory and non-regulatory framework applicable to these sectors.
- Improving support for low-carbon and carbon removal investment and innovation such as carbon contracts for difference[8] e.g. through the existing Innovation Fund.
- The ETS' contribution to addressing specific distributional and innovation challenges related to the transition to climate neutrality and its impacts, including the use of auction revenues and the Modernisation and the Innovation Fund
- Carbon leakage provisions, such as free allocation rules and updating emission benchmarks, coherence with a potential carbon border adjustment mechanism, indirect cost compensation.

C. Preliminary Assessment of Expected Impacts

The Impact Assessment for the Communication on stepping up Europe's 2030 climate ambition contains a first analysis of the possibility of reinforcing and expanding emissions trading as one of the tools to achieve greenhouse gas emissions reductions at the EU level. The analysis shows that a carbon price signal (in the current or extended scope) plays a key role in achieving the increased climate ambition. A further analysis will be performed in the Impact Assessment for this initiative.

7 https://ec.europa.eu/clima/policies/ets/revision_en
8 A scheme in which the producer of the low-carbon product has a guaranteed carbon price for a certain limited period of time.

Likely economic impacts
The transition to a climate-neutral economy will be transformative. This initiative is likely to contribute to higher investment and growth in ETS sectors in accelerated clean energy transition and in more sustainable products and processes. With a large EU internal market created for low-carbon solutions, both small and medium-sized enterprises and larger companies have the opportunity to gain a first-mover competitive advantage by innovating in sustainable products and processes. Also energy security will be improved and energy imports bill reduced, freeing resources for investments in energy transition or in other sectors of the economy. A stronger carbon price signal can affect households currently experiencing or vulnerable to energy poverty, and emission intensive industries and other high-emitting activities, which can in turn result in an increased risk of carbon leakage. Therefore, a just transition and the measures necessary to avoid the risk of carbon leakage are an important aspect in the overall analysis. This initiative aims to provide a consistent carbon price signal across the Single Market. The Impact Assessment for the Communication on stepping up Europe's 2030 climate ambition found that the possible extension of emissions trading to new sectors is expected to provide additional abatement options across the EU, drive emission reductions where they are overall most cost-efficient and create a new source of revenue for governments and providing resources for climate action or for addressing social and distributional concerns. Expanding emissions trading in an appropriate policy context would provide for harmonised economic incentives to reduce emissions. The increased emission reduction target is expected to be more challenging for industry innovation and the energy sector transition in low-income Member States with a higher share of fossil fuels in the energy mix, higher greenhouse gas emissions and energy intensity. Hence, the EU ETS-based support instruments, the Innovation Fund, the Modernisation Fund, but also instruments financed by the EU budget, including Horizon Europe and the Just Transition Fund have the potential to further incentivise innovation and research in sustainable technology, products and processes, modernisation, including of the energy, maritime transport and aviation sectors and carbon removal solutions in the EU will be necessary to reach climate neutrality in 2050. The impacts on isolated regions resulting from the competition of maritime with other modes of transports will also be assessed.

Likely social impacts
A stronger carbon price signal is likely to affect employment in regions and communities particularly dependent on high-emission energy and industrial sectors with high carbon intensity. These regions and communities will need the development of new economic sectors, as well as training and re-skilling in some areas to minimise adverse distributional effects. The ETS framework today already recognises the asymmetric distribution of its impacts on certain regions and Member States with lower GDP and provides tools to address these impacts, and it is imperative that it continues to do so. The transformation is likely to affect education and vocational training systems as re-skilling can enable impacted regions to capitalise on all possible new opportunities in sustainable technology development, products and processes through the transformation of their labour forces. An expanded use of emissions trading to include road transport and buildings, and potentially all fossil fuel combustion, would affect individual spending on transport and heating fuels in the short or medium term, potentially creating challenges in terms of acceptability for the measure, distributional effects and impacts on vulnerable citizens. However, it can also raise revenue for the public sector, providing resources for climate action or for addressing social and distributional concerns. Attention will be paid to higher cost impact for low-income households. As regards the extension of the EU ETS to maritime emissions, previous analysis showed the limited impacts of carbon pricing applied to maritime emissions on commodity prices compared to normal price fluctuations, but an updated analysis will be carried out, taking also into account the situation of remote islands and peripheral regions. This initiative is likely to improve health and its linked costs by reducing air pollution caused by fossil fuels and high-emission industrial processes, such as carcinogens and particulate matter. It will need to be considered that the EU budget, together with the Next Generation EU package and the related proposed national recovery and resilience plans can be a strong driver for transformation and leverage sustainable private and public investment, if resources are well-deployed, and are also designed in a way to address distributional concerns between Member States in order to ensure a fair transition.

Likely environmental impacts

With its GHG emissions cap guaranteeing the pre-defined level of emissions reductions, the EU ETS is one of the EU's main instruments in the fight against climate change. By putting a price on carbon and thus providing a strong incentive to invest in more greenhouse gas efficient activities, significant positive environmental impacts can be expected. Applying carbon pricing potentially to all fossil fuel use, in combination with other measures, will be beneficial to achieve increased climate and air quality ambition and achieve an overall favourable economic outcome.

Other positive impacts are improving air quality and reducing health damage due to pollution thanks to reducing fossil-fuel use, fostering efficient natural resource use by improving energy and material efficiency; and fostering investment in renewable energy and carbon removal solutions.

Covering road transport emissions by the emissions trading would provide a more level playing field in terms of carbon pricing of fossil-fuelled road transport and rail with electric vehicles and electrified rail, which may lead to lower fuel consumption.

Likely impacts on fundamental rights

This initiative advances environmental protection, Article 37 of the Charter of Fundamental Rights of the European Union, pursuing a high level of environmental protection and the improvement of the quality of the environment.

Likely impacts on simplification and/or administrative burden

The EU ETS legislation has consistently favoured approaches that minimise the regulatory burden for both economic operators and administrations. The same approach should be applied in this initiative.

The Impact Assessment accompanying the Communication on stepping up Europe's 2030 climate ambition has looked at the administrative impacts of covering additional sectors, notably expanding emissions trading to emissions from buildings and/or road transport, and concludes that this is possible and has both advantages and disadvantages.

For the maritime sector, the initiative will limit administrative burden by building on Regulation (EU) 2015/757 on the monitoring, reporting and verification of CO_2 emissions from maritime transport, which was developed as a first step before the pricing of these emissions.

D. Evidence Base, Data collection and Better Regulation Instruments

Impact assessment

The impact assessment for this initiative will build on the Communication on stepping up Europe's 2030 climate ambition and the supporting Impact Assessment. It will consider the impacts of increasing the EU ETS emissions reductions target in line with the overall target of at least 55% by 2030 compared to 1990. In the context of the increased climate ambition, it will assess the impact on sectors currently covered by the ETS, particularly on energy intensive industrial sectors, as well as the maritime sector and the ones assessed for increased use of emissions trading (e.g. road transport and buildings) and the actions required in these sectors. It will assess economic, social and environmental impacts in the economy at large. It will assess economic, social and environmental impacts, also in view of the COVID-19 crisis and recovery. It will be prepared in coordination with other relevant impact assessments that are part of the same package of initiatives for Q2 2021.

Evidence base and data collection
This initiative builds upon evidence gathered in the Impact Assessment accompanying the Communication on stepping up Europe's 2030 climate ambition, the previous ETS revision concluded in 2018, the in-depth analysis in support of the Commission's Long-Term Strategy and any relevant evidence compiled in other concurrent Green Deal initiatives. For the maritime sector, the initiative will build on an ongoing external impact assessment study, previous analysis, emissions data and experiences from the implementation of the EU monitoring, reporting and verification system, as well as the relevant international initiatives, in particular within the International Maritime Organisation. The Commission will also conduct new analysis using the extensive data and verified emissions collected during previous phases. In addition, an updated EU Reference Scenario, which includes COVID-19 impacts will allow to further update policy scenarios, building upon the scenarios developed for the Communication on stepping up 2030 climate ambition. Assisted by support contracts, the Commission will also look into the functioning of the MSR and whether reflecting the EU's increased 2030 climate ambition in the EU ETS requires changes to the MSR rules and design features. Similarly, the Commission will look into how reflecting the increased ambition in the EU ETS and the extension of its scope may impact the risk of carbon leakage in the industrial sectors, looking at the techno-economic potential to achieve further GHG reductions in industrial sectors under different incentive structure design options. The Commission will also consider modifications of the ETS Directive based on the EU's 15 year experience with this instrument.
Consultation of citizens and stakeholders
A first set of stakeholder views has been collected between 31 March and 23 June 2020 as part of the open public consultation on Stepping up the EU's 2030 climate ambition. With a subsequent consultation, the Commission will seek stakeholder views, opinions and preferences on the range of issues and design choices for a strengthened EU ETS and its extension to maritime and potentially other sectors. Main stakeholders include businesses currently and prospectively participating in the EU carbon market, as well as citizens, social partners, trade and professional organisations, NGOs, consultancies, research and academic institutions and national, regional and local authorities and groups. The consultation will consist of: - Collecting online feedback on this inception impact assessment over a 4-week period - A 12-week open online public consultation consisting of a questionnaire of multiple choice and open questions, as well as the opportunity to submit open feedback - Welcoming the submission of stakeholder documents such as position papers, policy briefs or roadmaps - A targeted stakeholders' consultation for the maritime initiative, potentially including a stakeholders meeting
Will an Implementation plan be established?
The Impact Assessment will consider whether an implementation plan is necessary.