

February 2021

REVIEW OF THE EU EMISSION TRADING SCHEME

EXECUTIVE SUMMARY

- ✓ CEMBUREAU supports the upcoming revision of the EU Emission Trading Scheme (ETS) as part of the “fit for 55% package” to align it with an increased 2030 climate ambition. In this paper we highlight a number of key principles that need to be considered for a successful outcome of a revised EU ETS.
- ✓ ETS revenues should be used to unlock investments in breakthrough technologies and innovative financing mechanisms. In that respect, the upcoming review provides an opportunity to include Carbon Contracts for Difference which will be needed to make breakthrough technologies economically viable. Furthermore, fair accounting rules for CO2 capture and re-use as well as other updated rules to incentivise investments need to be applied. In particular, investments in carbon capture should be rewarded whether that CO2 goes on to be stored, mineralised or converted into other uses such as synthetic fuels.
- ✓ An increased ambition for ETS sectors needs to be accompanied by a reinforcement of the existing carbon leakage measures. In addition, a Carbon Border Adjustment Mechanism should co-exist with the current system of free allocation, to provide certainty for low-carbon investments and avoid distortions on the EU internal market.
- ✓ An increase of the Linear Reduction Factor is the best way to make the EU ETS “fit for 55%” provided it is based on a fair effort-sharing between all sectors of the EU economy, and takes into account the technical pathways proper to each of the energy-intensive industries.
- ✓ The expansion of carbon pricing to other sectors such as road transport and buildings is necessary, but these sectors have different price elasticities and should be placed in a separate scheme to avoid any negative impact. Waste incineration should be included in the current EU ETS.
- ✓ CEMBUREAU strongly believes that any change to the EU ETS should be introduced gradually. The EU ETS was just revised in 2018, phase IV of the EU ETS is just starting, and investors need predictability to realise low-carbon investments.
- ✓ Last but not least, whilst CEMBUREAU supports the need to review the EU ETS to make it fit for an increased EU 2030 target, this must be undertaken in the spirit of the Green Deal that rightly introduces the need to integrate entire value chains and lifecycle performance in order to reach carbon neutrality across the economy. In this respect, CEMBUREAU believes that the EU ETS review is an opportunity to consider how the current systems can integrate a transition towards economy-wide carbon pricing mechanisms such as CO2 consumption charges.

1. The European cement industry and the EU ETS

The European cement industry as key enabler for the EU's low-carbon ambition at a 2030 horizon and beyond

CEMBUREAU is determined to contribute strongly to the EU's vision for a carbon neutral society, and to an increased 2030 Greenhouse Gas (GHG) reduction target. The cement industry is a key enabler to a carbon neutral society through its end-product, concrete, that is the material of choice for building the renewable energy assets (including wind turbines and hydro-electric dams), and the sustainable buildings and infrastructure of tomorrow. Cement and concrete will therefore play a decisive role in supporting the EU's climate change ambition at a 2030 horizon and beyond.

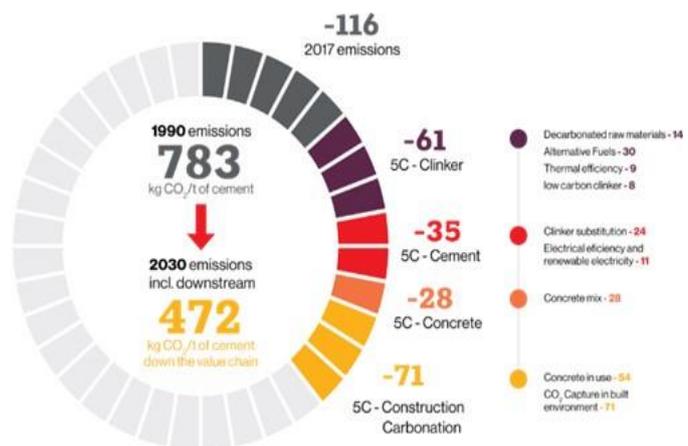
In May 2020, CEMBUREAU published its [Carbon Neutrality Roadmap](#) setting out its ambition to reach net zero GHG emissions along the cement and concrete value chain by 2050. The Roadmap sets out different innovation and investment pathways for each part of the cement-concrete value chain.

Today, the European cement industry accounts for 7% of the carbon permits traded on the EU ETS, and over 200 cement plants are covered by the scheme throughout the EU. Since 1990, the cement sector has reduced its CO₂ relative emissions by about 15%.

CEMBUREAU represents a hard to abate sector with a mayor part of the emissions stemming from natural raw materials. Our roadmap aspires to a 30% gross CO₂ emissions reduction for cement by 2030, with breakthrough technologies being commercialised on a large scale after this date, reaching carbon neutrality along the value chain by 2050.

CEMBUREAU's [Carbon Neutrality Roadmap](#) sets out in detail the technological pathways to reach net zero GHG emissions along the cement and concrete value chain by 2050, and includes a specific target at a 2030 horizon. Importantly, technological pathways for 2030 and 2050 differ significantly. Indeed, CO₂ emissions reductions between 2020 and 2030 will be largely based on existing technologies, whilst breakthrough technologies will be commercialised on a large scale after 2030.

Our Carbon Neutrality Roadmap anticipates a reduction of gross CO₂ emissions by 30% by 2030 for cement and 40% down the value chain. As summarised in the attached chart, emissions reduction happening between now and 2030 will be largely based on existing technologies such as improvements to the thermal efficiency of cement kilns; replacement of fossil fuels by non-recyclable waste and biomass waste; use of decarbonated raw materials; lower clinker-to-cement ratios as well as increased electrical efficiency.



It is therefore important that the upcoming EU ETS review takes into account the decarbonisation pathways faced by energy-intensive industries like cement, and features realistic objectives. As explained below, the ETS review is also an opportunity to pave the way and accelerate the deployment of breakthrough technologies such as Carbon Capture, Use and Storage (CCUS) through dedicated rules and incentives.

The cement industry is exposed to carbon leakage and this exposure will increase under an increased EU GHG reduction target

Already today, the European cement industry is exposed to carbon leakage. Imports of cement to the EU have doubled between 2016 (2.5 million tonnes) and 2020 (5.1 million tonnes). This trend is very likely to continue during phase IV of the EU ETS under the influence of different factors:

- An estimated 70 million tonnes cement capacity is currently being built in countries neighbouring the EU between 2018-2025; the existing capacity is significantly under-utilised;
- New business models are emerging, whereby clinker, the most CO₂-intensive part of cement, is produced outside the EU and ground in grinding installations at the border to be brought into the EU;
- As the current EU ETS rules foresee a gradual reduction of free allowances under tighter benchmark rules, EU cement producers' CO₂ costs will rise whilst third countries' competitors will not face such costs, unless a Carbon Border Adjustment Mechanism is put in place. This will inevitably make imports to the EU cheaper than EU domestic production.

Carbon leakage in the cement industry will significantly rise over the coming years, despite the existing carbon leakage protection measures such as free allocation. Under a scenario based on the existing EU 40% GHG reduction target using the current EU ETS rules (1st case in the table below), carbon leakage would still occur as CO₂ costs from EU cement companies would gradually rise over time. A 55% GHG reduction target (2nd case in the table below) will exacerbate this trend, with an even higher impact on production, job losses, sites closures and increased CO₂ emissions.

Scenario	Year	Production (mT)	#Total Jobs	CO ₂ Emissions suppl. (kT)	Sites
Actual	2019	193 ⁽¹⁾	~135 000 (incl. 35 000 direct)	120 000	200
1 st Case without CBAM	2030	-39.4	-9,600	+2,200	-34
2 nd Case without CBAM	2030	-84.0	-20,500	+4,640	-69

Source: CEMBUREAU

2. EU ETS review – views from the European cement industry

CEMBUREAU supports the upcoming revision of the EU ETS in light of an increased EU 2030 GHG target. We highlight a number of key principles which need to be taken into account for a successful outcome of the revised EU ETS.

- An increase of the Linear Reduction Factor, based on a fair effort-sharing, is the best way to make the EU ETS “fit for 55%”**

An increased 2030 target will require a revision of some of the parameters of the EU ETS, but it is important that the upcoming review is based on a fair effort-sharing, and offers predictability to investors.

Any ETS review should indeed foster an acceptable effort sharing between EU ETS and non-ETS sectors, based on the analysis of decarbonisation pathways, marginal abatement costs, and exposure to international competition. So far, ETS sectors have reduced emissions at a much faster path than non-ETS sectors: today, the current ETS is set to achieve a 43% reduction of carbon emissions by 2030 compared to 2005 levels, whereas non-ETS sectors are on a 30% trajectory over the same time period. In its 2030 impact assessment, the European Commission indicates that ETS emissions would have to be reduced by up to 65% by 2030 as a result of a 55% GHG target. We believe that such analysis is unbalanced and would put a disproportionate burden on ETS sectors, with significant implications on the overall scheme. **We therefore strongly suggest that the upcoming legislative proposals on the EU ETS and effort-sharing rebalance what is today an uneven sharing of responsibilities to reach an increased 2030 target.**

In terms of the different tools provided to achieve a higher 2030 target, **CEMBUREAU believes that an increase of the Linear Reduction Factor (LRF) provides the most visibility and transparency to investors.** Such an increase must be combined with the flexibility for a sufficiently high enough share of free allocation to avoid a negative impact on the existing carbon leakage measures and the triggering of the cross-sectoral correction factor. **It is indeed essential that the best performers continue to receive 100% of their allocations to incentivise investments in low-carbon technologies.**

CEMBUREAU does not support the other options such as applying a one-off reduction of the ETS cap, which would be disproportionate, removing any flexibility from industry. As an alternative to a one-off reduction, CEMBUREAU proposes to increase the outflow rate of the Market Stability Reserve (MSR), in order to make the ETS better fit for economic cycles.

Finally, any amendment to the EU ETS rules, such as an increase of the LRF, should be introduced gradually and not bring any brutal change. The EU ETS has indeed just been revised and phase IV has started early 2021. **Any retroactive change should be avoided and any ETS amendment should be introduced in time not to alter the market.**

b. Carbon leakage provisions should be enhanced, and co-exist with a Carbon Border Adjustment Mechanism (CBAM)

As explained above, the European cement industry is already facing carbon leakage. Despite the positive announcements from some of the EU's key trading partners on their climate ambitions, carbon leakage will only increase under phase IV of the EU ETS, as long as European industries are exposed to carbon costs whilst their competitors are not.

CEMBUREAU therefore strongly believes that, regardless of a CBAM, the EU ETS should strengthen the existing carbon leakage measures planned under the EU ETS. This must be ensured through:

- **Ensure planning security by maintaining the carbon leakage list.** The carbon leakage list for phase IV of the EU ETS was updated in 2019: it is critical to maintain the current list, avoid unnecessary debate and provide certainty to investors.
- **A revision of the current ETS approach that links the volume of free allocation to the overall cap.** As recognised in the European Commission 2030 impact assessment, the power and industry sectors have vastly different abatement potentials by 2030 (70% for the power sector VS 25% for energy-intensive industries). The current ETS approach would greatly penalise energy-intensive industries and exacerbate carbon leakage.

When it comes to the interaction between the EU ETS and CBAM, CEMBUREAU strongly opposes the view that the existing carbon leakage measures should be phased out when introducing a CBAM. On the contrary, CBAM should co-exist with ETS free allocation. Such co-existence can be done without any risk of “double protection”, by taking into account the existing carbon leakage measures when calculating the CBAM paid by importers¹. This will:

- Provide a clear legislative framework where CBAM addresses the carbon content of EU imports, whereas the risk of relocations of industries is addressed through free allocation under the EU ETS, and indirect cost compensation. EU suppliers will be continuously incentivised to reduce emissions, as per the existing rules on free allocation and benchmarks;
- Ensure a smooth implementation of CBAM: CBAM is untested, could be challenged at WTO and lead to trade tensions – keeping the existing carbon leakage measures protects the EU industry from these risks;
- Mitigate distortions on the EU internal market: ETS sectors compete with each other, e.g. cement competes with other materials on the market for construction products. Removing free allocation for only some ETS sectors, on the motive that they are covered by a CBAM, would create unacceptable distortions on the EU market;
- Safeguard the competitiveness of EU exports to third countries: a phase-out of free allocation would inevitably lead to increased production costs for the covered sectors, impacting exports;
- Limit the impact of CBAM on European value chains (taking free allocation into account when determining the CBAM levy will induce smaller cost impacts for European value chains) and ease trade tensions surrounding the implementation of a CBAM (as the scheme would start with a smaller levy).

c. The expansion of carbon pricing to other sectors should be supported, but sectors with different price elasticities should not be covered in the same ETS scheme than energy-intensive industries

CEMBUREAU generally supports the idea of expanding carbon pricing to other sectors. However, with regards to the proposed inclusion Road transport together with buildings into the existing Emissions Trading System (ETS), we do not believe this will achieve the desired reduction in GHG emissions as for these sectors it will be relatively easy to pass on the cost of allowances to consumers. The abatement targets would then ultimately fall back on industry within ETS where the increased cost of allowances will make industry more vulnerable to carbon leakage, and impact on the ability for industry to make future investments to move to climate neutrality. At the same time, necessary CO₂ reductions in other sectors would be delayed. **CEMBUREAU is therefore opposed to an expansion of the current ETS to the road transport and buildings sectors. If carbon pricing is to be applied to these sectors, this should instead be done through a separate ETS where the cap can be adjusted to ensure they achieve the necessary GHG emissions reduction.**

With regard to waste incineration, CEMBUREAU agrees that this should be included with the other energy intensive sectors within the existing ETS, taking into account the same monitoring & reporting obligations. Such inclusion is desirable, both to level the playing field between waste incinerators and other energy producers which are covered by the EU ETS, but also to create a healthy competition between waste incinerators and cement kilns, which both use waste

¹ Please see CEMBUREAU’s full position paper on CBAM, and joint [letter](#) from EUROFER, CEMBUREAU and FertilizersEurope on CBAM.

in their production processes. In the revision of the ETS MRR the biogenic content of waste fuels and residues should not be subjected to sustainability and emissions saving criteria in the ETS.

d. The review of the ETS should seek to accelerate the deployment of breakthrough technologies through the right incentives and mechanisms.

Finally, CEMBUREAU strongly believes that the upcoming review of the EU ETS is a key opportunity to support the early deployment of breakthrough technologies, such as Carbon Capture, Utilisation and Storage (CCUS). As explained above, such technologies are essential to allow for deep CO₂ cuts in key sectors such as cement, but are expected to be commercially deployed from 2030 onwards. It is important to accelerate their deployment, both to ensure that the EU preserves its industrial leadership, and to allow for deeper CO₂ cuts in a shorter timeframe. This can be done through a broad range of measures:

- EU ETS carbon prices and a carbon border adjustment will not be enough to create a business case for key low-carbon technologies. Many “breakthrough” technologies will require higher carbon prices if they are to be competitive. To make these technologies economically viable, supplementary policies such as carbon contracts-for-difference will be needed. Therefore **the use of Carbon Contracts for Difference (CCFDs) to support industrial decarbonisation should be supported in the EU ETS**. Such innovative form of financing has the potential to lead to an early take-up of key technologies by shielding investors from uncertainty risks. We believe their use at a European level (through the ETS Innovation Fund and other EU financing mechanisms) and national level must be explored.
- **The EU ETS Monitoring, Reporting and Verification Rules (MRR) should be adapted to incentivise breakthrough technologies such as CO₂ capture and re-use**. Today, a significant number of pilot projects in connection with CCUS are deployed in the European cement industry across the EU, looking at using CO₂, either through mineralization (permanent capture of CO₂ through carbonation) or through the re-use of CO₂ (for instance, as synthetic fuel through the blending with hydrogen, or for chemical purposes). Captured CO₂ (not emitted to the atmosphere by an installation) must be coherently accounted for within the future ETS MRR, and deducted from emissions under the EU ETS, whether stored geologically, reused or used to produce calcium carbonate or other carbon-based products.
- **Revenues from the purchase of ETS allowances should be used by Member States to finance the transition to a low carbon economy, as is done in some EU countries**. Particular attention should be given to the necessary infrastructure within the Member States to facilitate the transition to a carbon neutral society, including the necessary grid connections for renewables, CO₂ transport and storage infrastructure for CCUS technologies and hydrogen pipelines. CO₂ capture by industry is only one part of the CCUS value chain; transport and storage infrastructure will be required too.
- Investment in low carbon technology at a site level is most likely to take place on existing sites and not on green field sites due to the availability of suitable raw materials and also the protracted period to gain all the permissions to open a new quarry and cement plant. **It is therefore important in the revision of ETS that allocation for a large-scale expansion on an existing site is treated in the same way as the same expansion on a green field to facilitate the necessary investments to be made**. However, existing ETS installations that invest into a large-scale retrofitting in order to reduce CO₂ emissions should keep their legal status as “existing ETS installation” and not be classified as “new ETS installation”. A classification as “new installation” would otherwise come as a disadvantage in many ways (e.g. allocation, biomass use) that could discourage low carbon investments in the first place.

e. The updated EU ETS should include an option to evolve towards other types of pricing mechanisms such as consumption charges.

CEMBUREAU acknowledges the need to review the EU ETS to make it fit for the increased 2030 EU target, but we believe that a broader reflection on an evolution of carbon pricing schemes should also be considered. The European Green Deal rightly introduces the need to integrate entire value chains and lifecycle performance in order to reach carbon neutrality across the economy. In this perspective, strengthening the EU ETS is necessary, but due consideration should be given to the expansion of market-based carbon pricing mechanisms in order to make carbon pricing relevant in decision-making processes across entire value-chains and amongst consumers. This would translate into increased demand for low-carbon solutions and a strengthened business case for low-carbon investments.

In this regard, the EU ETS review is an opportunity to consider how the current systems can integrate a transition towards economy-wide carbon pricing mechanisms such as carbon consumption charges. **CEMBUREAU therefore strongly recommends that the updated ETS features a clear 'rendez-vous clause' for the introduction of a CO2 consumption charge over the coming years as a replacement of ETS.**
