

# Benchmarks for free allocation of emission allowances 2021-25

## Feedback on the Implementing Regulation

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### 1. Distortion of competition

The EU ETS benchmarks often support high-carbon incumbent installations at the expense of lower-carbon competitors, as they often treat differently (or even exclude) the latter, thereby disincentivising low-carbon alternative technologies and products. For example, steel benchmarks grant the producer either 0.3 EUA or 1.3 EUA per tonne of product depending on whether the steel is produced from iron ore through a blast furnace (BF) or from scrap metal through an electric arc furnace (EAF). Generally, the EAF route produces lower-grade steel than the BF route because current steel recycling methods do not create the high-quality scrap needed to produce high-grade steel. With improved circularity, EAF steel could compete with BF steel (producing the same quality product) but would still earn producers only 0.3 free EUAs per tonne, compared to 1.3 for highly polluting BF steel. **Free allocation should therefore be based on the actual product and not create silos between production methods.**

### 2. Benchmark values are out of touch with net zero target

The proposed benchmark trajectories for the reduction of free allowances under the EU ETS do not align with a 2050 net-zero trajectory for the cap (see Figure 1). This creates a misleading emissions trajectory for industries which avail of free allowances, causing them to delay short-term actions to reduce emissions. This will leave businesses facing a cliff-edge scenario, required to make rapid changes from 2030 onwards. We therefore call for **benchmarks to be aligned with a 2050 carbon neutral target.**

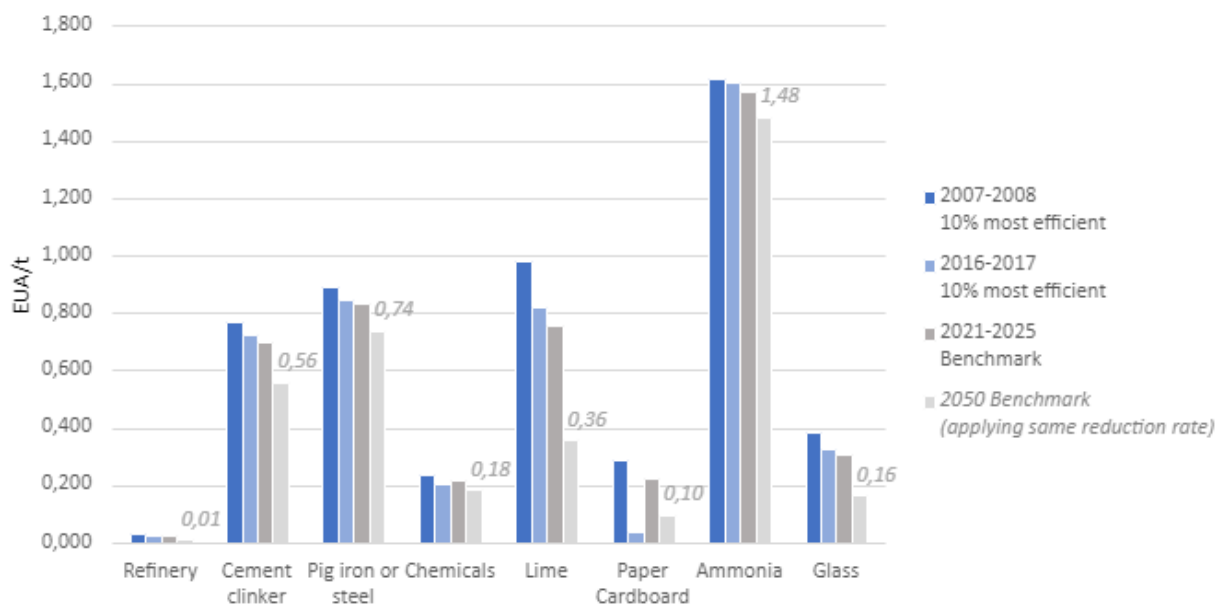


Fig. 1 Average benchmarks for the most emitting sectors in 2019. (The average benchmark of a sector is the weighted average of the sectors' product benchmarks. Own figures based on production data from the European Commission or Eurostat, when available.)

### 3. Benchmark values may be out of touch with industrial reality

The upper and lower limits for the annual reduction rate are set at 0.2% and 1.6%. This reduction rate is based on the carbon efficiency of the 10% most efficient installations in 2007-2008 and 2016-2017. However, reduction rates of some installations are much higher than 1.6%. The 10% most efficient installations have reduced their emissions intensity by a median value of 3.6% annually across sectors, including 24.2% for the pulp or cardboard sector, however the benchmark only decreases by an annual 1.6%. This means that installations with greater carbon efficiency will continue to receive large amounts of free allowances for little additional effort. While this can have a certain decarbonisation incentive effect, there is still **considerable room for a higher upper limit to the benchmark reduction rate**. This should be addressed in the upcoming EU ETS reform. A finer analysis is not possible without data on the distribution of carbon intensity across installations, such as average carbon intensity improvements in different sectors.

The draft act could also present an opportunity to improve the heat benchmark, used for Combined Heat-&-Power plants (CHP) but also as a fallback benchmark for the chemical and other sectors. The heat benchmark is currently based on the assumption that heat is generated in a high-efficiency boiler using natural gas (62.3tCO<sub>2</sub>/TJ historically), to which a 1.6% annual discount is proposed for the Phase IV period. This is out of touch from the reality of many sources of heat, which run on biomass. Data from the Commission shows that the 10% most efficient plants had a carbon intensity of 2.8tCO<sub>2</sub> per TJ of heat, but it still proposes a benchmark value of 47.3 tCO<sub>2</sub> per TJ. As a result, many installations will receive more free allowances than they need, to the detriment of other sectors or the Member States that could have otherwise auctioned those allowances.

We therefore propose to **urgently reform the heat benchmark** to use a larger annual reduction rate which reflects an updated carbon intensity (e.g. based on years 2016-17), rather than the current reduction rate which relies on data from 2007-08.

### 4. Consequences for the Innovation Fund

The EU ETS benchmarks have consequences exceeding the scope of free allocation within the scheme. One critical example concerns the eligibility and level of support for projects under the Innovation Fund, which are based on the EU ETS benchmarks. Under this rule, some projects that are far from low-carbon may get selected and supported by the Fund.

### 5. Lack of Transparency

Sandbag is concerned that this consultation takes place in a context of a lack of transparency on the distribution of carbon intensity data across sectors, information which the Commission holds but is yet to disclose. Without access to this information, civil society is not able to provide any meaningful opinion. Free allocation is an entitlement worth €20bn per year given away by EU taxpayers (as the allowances could otherwise generate auction revenues) and should accordingly be subject to the highest transparency standards. At the very least, we suggest that aggregated production data used to determine free allocation be provided for all benchmarks (currently this data is only provided for 36 out of the 52 benchmarks for 2005-2010). As these data are presented in an aggregated manner and not at the installation level, this data should not be considered overly sensitive.

*Sandbag is a non-profit think tank which uses data analysis to build evidence-based climate policy. We focus on EU policies such as the EU ETS, the Effort Sharing Regulation and emissions reductions in industrial sectors.*

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