

FIT FOR 2030 : OPTIMISING EU ETS REVENUES FOR PEOPLE AND CLIMATE

We have entered the last crucial decade where we can limit the global temperature increase to 1.5°C and effectively address the climate emergency. The EU must rapidly transition away from fossil fuels and harmful economic activities, towards a sustainable and climate-friendly economy. Carbon pricing through the EU ETS is a key instrument for this shift, but it must be applied in a just way, ensuring all sectors of society and all European regions move forward together.

The EU Emissions Trading System is a cornerstone of the EU's climate policy architecture, covering 45% of the EU's emissions reduction. As the EU has increased its 2030 climate target to "at least 55% net", the ETS must now contribute more to reducing greenhouse gas emissions in a sustainable manner. Ahead of the 2021 revision of this system, WWF European Policy Office provides a detailed analysis of EU ETS collection, distribution and use of revenues over the last seven years of available data.

Our analysis shows that between 2013 and 2019, Member States raised EUR 49 billion in revenues through the EU ETS while EUR 54 billion was foregone to free allocation. Of those EUR 49 billion raised, EUR 13,3 billion were reported as not spent on climate action, and what is left might still have financed activities which are counterproductive to a clean and just transition. With our ten recommendations, we aim to enforce the 'polluter pays principle' while increasing ETS revenues for Member States; and to ensure that revenues are spent in a more transparent and effective manner, driving the transition to climate neutrality.

The von der Leyen Commission, EU Member States at home and in the Council, and Members of the European Parliament cannot count on the next mandate or legislature to fix the problem. The EU ETS must be made fit for the EU's 2030 target and steer the transition to climate neutrality.

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.

INTRODUCTION

Implementing the enhanced 2030 target of at least net 55% emissions reductions compared to 1990 levels through European Union (EU) legislation will require far-reaching and astute lawmaking, seeking not only to increase the level of efforts invested in mitigating the climate emergency but also to maximise the effect of our action and ensure the best balance between costs and efforts. Strong governance is essential in sustaining our decades-long endeavour to decarbonise the entire EU economy. The manner in which we decide to reduce emissions now will set the course for the next decades, and inadequate planning will have long lasting repercussions.

Since its establishment in 2005, the EU ETS has been the cornerstone of the EU's action to meet its climate targets: it covers around 45% of the EU's greenhouse gas (GHG) emissions in the EU, Iceland, Liechtenstein and Norway, and has managed to reduce these emissions by over 35% until 2019¹, in line with the EU ETS regulation's objective. The EU ETS is a market-based mechanism which puts a price on each tonne of carbon emitted in the intra-EU aviation², power and manufacturing sectors. Polluters must 'pay to pollute' by purchasing emissions allowances - the amount of which decreases over time, leading to an increased pollution price. Each EU Member State receives emissions allowances in proportion to their historical share of emissions - with some of these allowances being transferred, from 2020 and 2021 onwards, into an EU-wide Modernisation Fund and Innovation Fund. Roughly half of these allowances have been given for free, and unused allowances can also be set aside for future use or sold to other companies. Those EU ETS allowances that are auctioned provide a significant revenue stream to EU Member States, which are then encouraged to spend at least 50% of the revenues on domestic or international climate projects.

In its 2019 European Green Deal Communication³, the European Commission committed to propose a revision of the EU ETS directive by June 2021 in order to deliver the additional GHG emissions reductions required under the enhanced 2030 climate target. The climate-neutrality objective makes it clear that GHG pollution must essentially stop. It is no longer a matter of whether or of when, but rather how to decarbonise in the most effective and beneficial way. Putting a price on carbon in certain economic sectors can help ensure that the cost of pollution is reflected on the polluter's balance sheet instead of society's, including those most vulnerable.

The political context underlying the EU ETS revision can bring about significant change in the way the EU ETS operates. The European Commission is currently considering extending the scope of the EU ETS to other sectors, such as road transport, buildings, international aviation and shipping. Moreover, the Commission will propose a carbon border adjustment mechanism which would alleviate concerns over carbon leakage and make free allocations of ETS allowances redundant. Throughout the EU, greater citizen awareness has increased public scrutiny over the consistency of public spending with climate objectives, and under the recent European Climate Law, the Commission will regularly assess (in September 2023 and every subsequent five years) the consistency of EU and Member States' measures towards achieving climate neutrality. In its EU ETS review, the Commission will seek to strengthen rules on spending EU ETS revenues in line with climate action - an objective which stands in stark contrast with the Commission's intention to seize part of EU ETS revenues as an own-resource to repay debt contracted under the Next Generation EU instrument. Finally, the all-time high EU ETS price underlines the need for greater scrutiny and accountability for the many billions of ETS revenues spent and reported by Member States.

This WWF publication takes stock of the use of EU ETS revenues from 2013-2019⁴. It aims to inform policy-makers of shortcomings in the way the EU ETS applies the polluter pays principle and the way ETS revenues are used and accounted for. In the context of the 2021 legislative revision, it provides 10 policy recommendations for remedying these shortcomings. The climate crisis escalates slowly but steadily, and today is more than ever the moment to tighten the rules for spending public funds in a way consistent with a just and meaningful transition to climate neutrality.

¹ European Environment Agency (EEA), EU ETS data viewer, <https://www.eea.europa.eu/data-and-maps/dashboards/emissions-trading-viewer-1>.

² Only intra-EU aviation is currently covered by the EU ETS, meaning flights both departing from and arriving to EU or EEA countries. Flights between an EU or EEA Member State and a third country are exempted from any obligation until 2023.

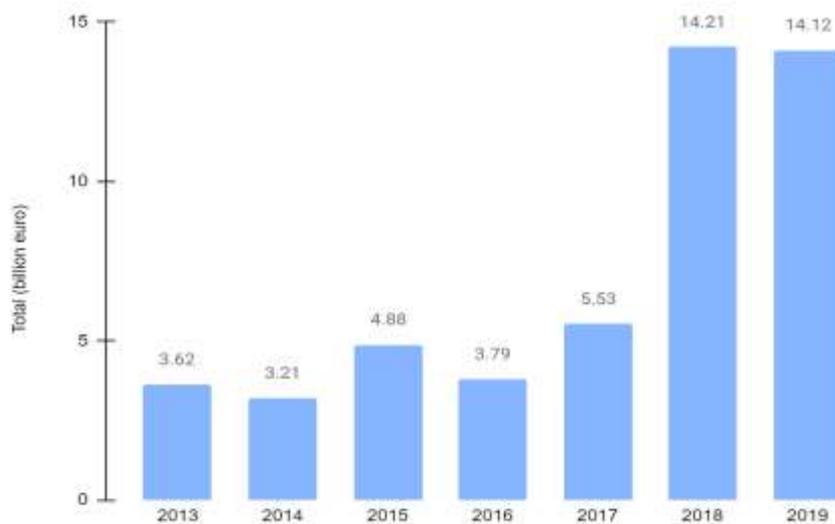
³ European Commission, Communication on the European Green Deal, 11 December 2019, p. 15, https://ec.europa.eu/info/sites/info/files/european-green-deal-communication_en.pdf.

⁴ Full data for the year 2020 is not available at time of publication. According to art. 19 of Regulation on the Governance of the Energy Union, Member States have until 31 July of each year to submit their report for the previous year.

1. ENFORCING THE POLLUTER PAYS PRINCIPLE

The economic benefits of the transition to climate neutrality are substantial. These include more and better jobs, avoided health-related costs from fossil fuel pollution, and averted economic and human catastrophes induced by the global increase in the Earth's temperature. Yet the European Commission estimates that meeting the revised 2030 climate target will require, from 2021, an average yearly investment of EUR 375 to 438 billion depending on the policy scenario⁵. Parallel to searching for new streams of public funding, the EU needs to steer existing public and private investments away from activities which are counterproductive to the transition to climate neutrality. The EU ETS can and should unlock a significant share of these investments.

Figure 1: Total annual auction revenues in the EU between 2013 and 2019



Over the last seven years of available data, the EU ETS raised EUR 49 billion in revenues across EU Member States⁶, although the revenues are not evenly split among Member States. Furthermore, the full potential of the EU ETS is yet untapped since a significant share of revenues is foregone to free allocation and another share is not redistributed in the form of climate action. In the years 2018 and 2019, ETS revenues roughly tripled compared to previous years, and preliminary evidence on the ETS price in the years 2020 and 2021 indicates a steady increase. In 2019, the total amount of revenues slightly decreased compared to 2018, but this is only due to the UK, second highest recipient of ETS revenues with nearly 12% of all ETS revenues in 2018, leaving the EU.

The purpose of the EU ETS is to cut emissions

The logic behind the EU ETS is that a price signal on GHG emissions will lead rational market operators to reduce their pollution in order to decrease their costs. In the long-term, it enforces a principle that the cost of pollution is not to be shared by society as a whole but that it is the responsibility of polluters themselves. In reaction, polluters must integrate the cost of pollution into their business plans in the long-term, and reflect the certainty of the carbon price increase in investment decisions benefiting low-carbon investments. A successful EU ETS will see the total amount of emission allowances decrease over the years - by a linear reduction factor set in the directive, and a withdrawal rate of allowances which are withheld from auctioning (temporarily or permanently) and put into a so-called Market Stability Reserve. This in turn will create scarcity and cause the carbon price to increase. The long-term certainty that the carbon price will increase is key to a well-functioning ETS since business operators will seek to avoid locking-in polluting fossil fuel infrastructures which can appear profitable today but will certainly become a financial burden in the future. The ETS price increase since 2017 is clearly visible in Figure 2 below.

⁵ European Commission, Impact Assessment accompanying the Communication "Stepping up Europe's 2030 climate ambition: Investing in a climate-neutral future for the benefit of our people", 17 September 2020, p. 69, https://ec.europa.eu/clima/sites/clima/files/eu-climate-action/docs/impact_en.pdf.

⁶ In this publication, for figures involving reporting for the entire European Union, years 2013 to 2018 integrate spending from the United Kingdom. Data for the year 2019 only covers the EU27. The data is extracted from the EEA's ETS data viewer (April 2021) and Member States' yearly 'MMR Article 17 report' available on the European Environment Information and Observation Network (EIONET).

Figure 2: The average EU ETS allowance price in euro, per ton of CO₂, between 2013 and 2019



Over recent years, the price of EU ETS allowances has increased manifold, jumping from an average EUR 5.5 in the year 2016 to an average EUR 15 in 2018 and to EUR 24.7 in 2019. In May 2021, the carbon price spiked to a record high of EUR 56⁷. This has led operators to complain that the increasing ETS price is hindering their ability to invest in low-carbon solutions⁸. But the foreseeable and inevitable increase in the carbon price is exactly what the EU ETS aims to achieve, and a credible price signal is precisely what can drive investments in clean production processes. Moreover, as will be expanded on in subsequent sections, the revenues from the auctioning of these allowances can be recycled to support game-changing investments.

While the carbon price is one very visible indicator of a functioning EU ETS, the price signal constitutes only a means to an end: the overarching purpose of the EU ETS is to reduce GHG emissions, and this is done by making polluters pay a price for their emissions.

Article 1 of the EU ETS directive (2003) - Subject matter:

“This Directive establishes a scheme for greenhouse gas emission allowance trading within the Community (hereinafter referred to as the ‘Community scheme’) in order to promote reductions of greenhouse gas emissions in a cost-effective and economically efficient manner”.

This Directive also provides for the reductions of greenhouse gas emissions to be increased so as to contribute to the levels of reductions that are considered scientifically necessary to avoid dangerous climate change”.

The central aim of the ETS must remain driving down GHG emissions in line with the EU’s climate targets and the objective under the Paris Agreement to limit global temperature increase to 1.5°C. In the current legislation, the EU ETS aims to decrease emissions by 43% by 2030 in relevant sectors, compared to 2005 levels. This objective needs to be revised in light of the enhanced 2030 climate target. For the WWF, the EU ETS must achieve an emissions reduction target of 70% of covered emissions compared to 2005, in order to be fit for 1.5°C⁹. Within the relevant sectors, all operators should be subject to a carbon price, but extending the EU ETS to certain sectors may be counterproductive compared to other means of reducing emissions.

⁷ Ember Carbon price viewer, <https://ember-climate.org/data/carbon-price-viewer/>.

⁸ Interview with Wanda Buk, Vice-President for Regulatory Affairs at PGE Group by Energy Post, “An EU ETS that lifts carbon prices too high can make clean energy transitions harder”, <https://energypost.eu/an-eu-ets-that-lifts-carbon-prices-too-high-can-make-clean-energy-transitions-harder/>.

⁹ Öko-Institut, “Raising the climate policy ambition of the European Union: Reforming the EU Emissions Trading”, funded by WWF Germany, April 2021, <https://www.wwf.de/fileadmin/fm-wwf/Publikationen-PDF/Klima/WWF-Studie-Emissionshandel-englisch.pdf>.

Ending free allocation

Despite its objective of driving down emissions by making the polluter pay, the EU ETS has since its inception in 2005 been giving more emissions allowances for free than at an auctioned price, in direct contradiction with the polluter pays principle. As a result, economic operators profiting from free allocation (mostly the energy-intensive industry and aviation sectors) feel no incentive to reduce their emissions, and those who receive an excess of allowances for free even make windfall profits¹⁰. Precious time has been lost in handing over permits to pollute for free in times of a climate crisis, and although the ETS has fulfilled its (relatively low) emissions reduction objective, it has failed to drive the urgently needed transformation of industry towards climate neutrality. Failure to signal a carbon price can prevent leapfrog change from a fossil-based to a decarbonised economy and hinder the path towards the transition to climate neutrality.

Figure 3: Revenues foregone due to free allocation and total auctioning revenues (2013 - 2019)

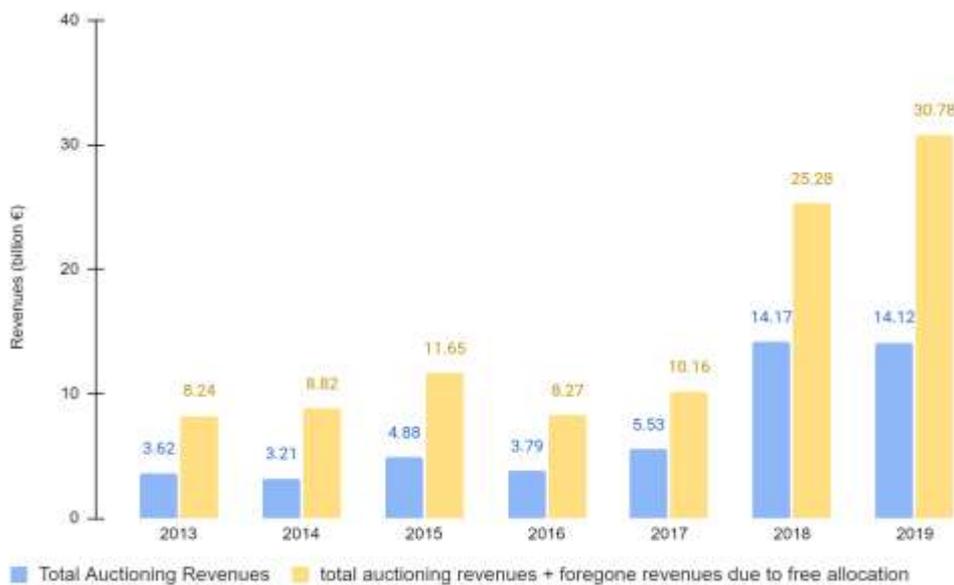


Figure 3 shows that over the past years, the EU ETS has only worked at roughly half its maximum potential, exempting entire sectors from a carbon price on pollution. In 2019 alone, allowances worth EUR 16.6 billion were given for free to economic operators whereas Member States received only EUR 14.1 billion in revenues. Between 2013 and 2019, 5,000 million and 200 million allowances were given away for the industrial and aviation sectors, respectively¹¹.

This expensive practice has yielded little result. Today, roughly 94% of industrial and 82% of intra-EU aviation allowances are covered by free allocation¹², and emissions in energy-intensive industries have stagnated since 2012¹³. Most of the emissions reduction efforts in the ETS since 2013 were borne by the power sector – where auctioning is the default method of allocating allowances and which was also supported by sectoral policies on renewable energy. According to the European Court of Auditors, deciding not to apply a carbon price has in fact rendered “ineffective results” in the power sector (in the relatively few instances where free allocation was applied) and “tended to slow decarbonisation” in the industry and aviation sectors.

Free allocation exists to counteract the alleged risk of carbon-leakage, meaning the risk of companies relocating whole or parts of their production outside Europe to escape the carbon price. The existence of the phenomenon remains unproven. Regarding aviation, the European Commission’s own evidence found little risk of carbon leakage¹⁴, putting into question the rationale for granting free allocations to this sector, but also for the energy-intensive sectors¹⁵. In fact, current evidence suggests that free allocation simply generates windfall profits for

¹⁰ Carbon Market Watch, “The phantom leakage: industry windfall profits from Europe’s carbon market 2008-2019”, June 2021, <https://carbonmarketwatch.org/publications/the-phantom-leakage/>.

¹¹ European Court of Auditors, “The EU’s Emissions Trading System: free allocation of allowances needed better targeting” 2018, p. 10, <https://www.eca.europa.eu/en/Pages/DocItem.aspx?did=54392>.

¹² *Ibid.*, pp. 11, 29.

¹³ Sandbag, “Feedback to Inception Impact Assessment on the EU ETS revision”, November 2020, <https://sandbag.be/wp-content/uploads/2020/12/Sandbag-Feedback-to-ETS-Roadmap.pdf>.

¹⁴ European Commission, “Impact assessment accompanying the proposal amending the EU ETS directive”, *op. cit.*

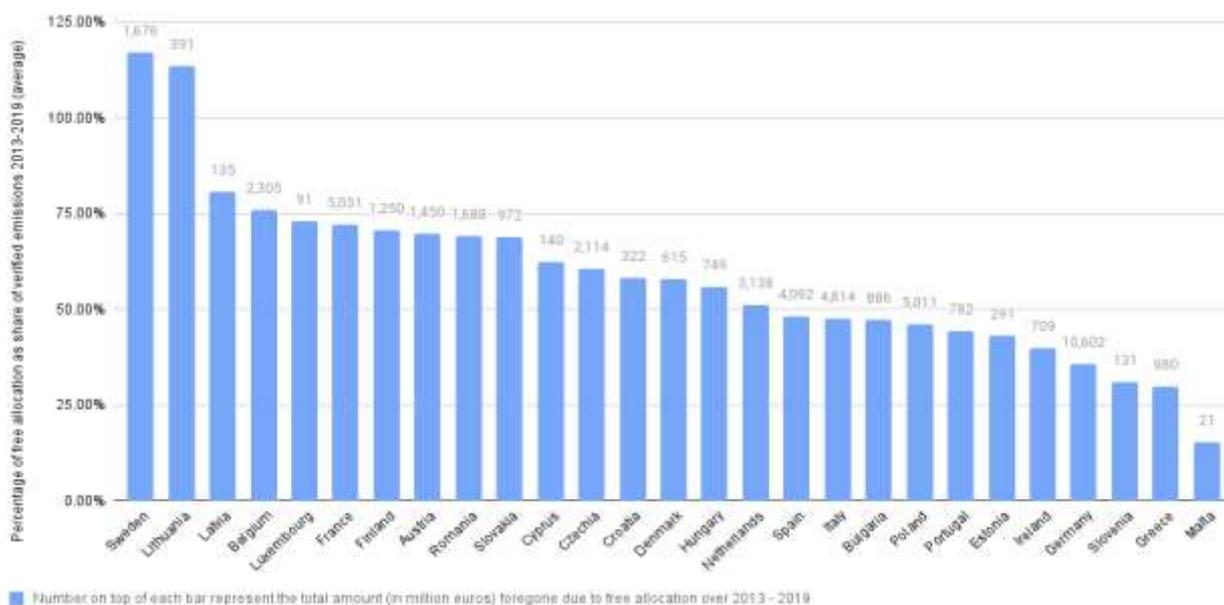
¹⁵ Ecorys, Öko-Institut e.V., Cambridge Econometrics, TNO, “Carbon Leakage Evidence Project”, Study for the European Commission, September 2013, https://ec.europa.eu/clima/sites/default/files/ets/allowances/leakage/docs/cl_evidence_factsheets_en.pdf.

industry, which has passed the carbon cost over to consumers even when receiving free allocation¹⁶. According to the European Court of Auditors, “requiring operators to pay for their allowances through auctions respects the “polluter pays” principle and provides a stronger incentive for them to reduce GHG”¹⁷.

Polluters who bear no financial incentive to decrease emissions simply do not unlock decarbonisation investments. With 94% of industrial emissions poised to be largely exempted from carbon pricing up to 2030 under the current ETS, one cannot expect industrial emissions to fall as they should and need to during this decade, nor the European industry to transition into climate neutrality without economic incentives: why should they, if sectors eligible for 100% free allocation continue to cover the mining of hard coal and extraction of crude petroleum¹⁸?

In addition to hampering the effectiveness of the EU ETS, free allocation constitutes an important loss of revenue for EU Member States. But this foregone revenue is not evenly split among Member States, as figure 4 shows. For a majority of Member States, over 50% of verified emissions covered by the EU ETS between 2013 and 2019 were emitted for free.

Figure 4: Total foregone revenue per Member State between 2013 and 2019, and average 2013 to 2019 proportion of free allocation as share of verified emissions



The number of allowances given for free in a Member State depends on the number and type of industries located in the country, including whether the said industries belong to a sector deemed at risk of carbon leakage (with the exact formula for making this determination included in article 10(b) of the directive). The amount of free allocations per installation is determined by a benchmark-based system which rewards the most efficient installations. Installations that meet the benchmarks (therefore some of the most efficient in the EU) will in principle receive all the allowances they need to cover their emissions. Others will receive fewer allowances than they need and will have to make up the difference by reducing emissions and/or buying additional allowances. The benchmark system is subject to many flaws, including that it supports high-carbon installations at the expense of cleaner competitors whose alternative technologies and products do not benefit from free allocation¹⁹.

Figures 3 and 4 have highlighted that an important share of Member States’ revenue is foregone each year as a result of free allocation, with Lithuania and Sweden receiving even more free allocations than their verified emissions. Free allocation violates the “polluter pays” principles and ultimately undermines the ability of the EU ETS to reduce emissions. WWF therefore recommends ending free allocation - with additional auctioning revenues generated being invested in the transition to climate neutrality.

¹⁶ CE Delft, “Additional profits of sectors and firms from the EU ETS: 2008-2019”, Study for Carbon Market Watch, May 2021, <https://cedelft.eu/publications/additional-profits-of-sectors-and-firms-from-the-eu-ets/>.

¹⁷ *Ibid.*, p. 8.

¹⁸ European Commission, Delegated Act concerning the determination of sectors and subsectors deemed at risk of carbon leakage for the period 2021 to 2030, 15 February 2019, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019D0708&from=EN>.

¹⁹ Sandbag, “Benchmarks and Free Allocation: Details reveal problems in the EU ETS”, 15 January 2021, <https://sandbag.be/index.php/2021/01/05/benchmarks-and-free-allocation-details-reveal-problems-in-the-eu-ets/>.

Recommendation 1: End free allocation and switch to full auctioning of ETS allowances as of 2023

Moving to full auctioning of emission allowances will contribute to ensuring a more stable carbon price, facilitating the long-term, strategic spending of EU ETS revenues. It will roughly double EU ETS revenues collected by EU Member States while making all polluters pay for their carbon emissions, putting an end to unjust exceptions which have been recognised as detrimental to the functioning of the carbon market. Additional revenues generated from full auctioning should be entirely invested in the transition to climate neutrality, including through massive investments in industrial decarbonisation through the Innovation and Modernisation Funds (see recommendation 7). Counting as ETS revenue the sums that industries would otherwise have received in free allocation will ensure that these sums truly support industrial decarbonisation and are not simply turned into windfall profits.

EU Member States cannot decide themselves to abandon free allocation and to instead auction allowances granted to sectors deemed at risk of carbon leakage. The upcoming revision of the EU ETS therefore constitutes a historic opportunity to put an end to free allocation. It is crucial that the European Commission and co-legislators put their weight behind ending free allocation and amend articles 3(d) and 10(b)²⁰ of the EU ETS directive. Besides, the risk of carbon leakage could be mitigated through the implementation of a carbon border adjustment measure (CBAM) which the Commission will propose to phase in by 2023 for targeted sectors. This measure would protect the EU industries' competitiveness by ensuring that any import pays a carbon price equal to the price paid by EU companies, thereby suppressing the risk of carbon leakage and so the claim that free allocation is needed. Retaining free allocation in addition to the CBAM would provide double subsidies to industry and reduce consent to a carbon price which will be seen as arbitrary and unfair. Furthermore, under World Trade Organisation (WTO) non-discrimination rules, the EU would have to grant the same advantage to exporters located outside the EU, and so the CBAM would fail to achieve its main objective of fighting climate change by tackling imported emissions. Even in the absence of a CBAM, free allocation should be phased out as of 2023.

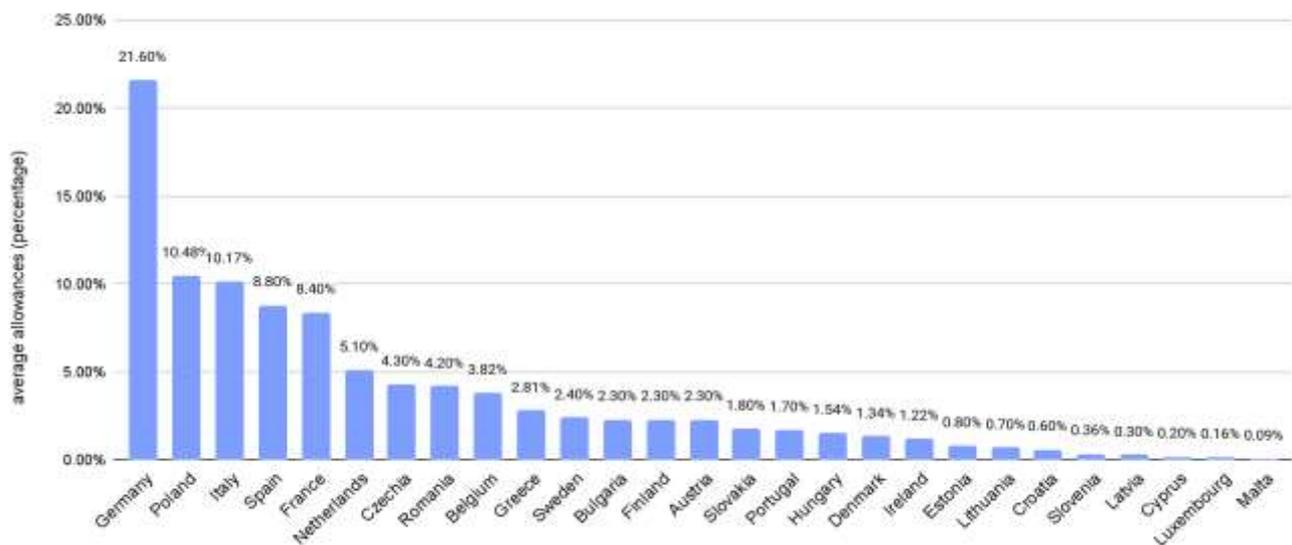
Removing excess ETS allowances from the market

EU Member States do not receive equal proportions of ETS allowances. Allowances are received in proportion to Member States' domestic emissions covered by the system. However, since 2013, a so-called 'solidarity clause' has entered into play. Under this correction mechanism, only 90% of allowances are distributed among EU Member States on the basis of historical emissions, taking the years 2005 and 2007, or an average between them as a baseline. The remaining 10% are distributed to the 16 lower-income Member States and, until 2020, to some higher income Member States (Belgium, Luxembourg, Spain and Sweden) "for the purpose of solidarity, growth and interconnections within the Union"²¹. This mechanism ensures that these countries receive a significantly higher share of allowances. Figure 5 below displays the amount of allowances distributed to each EU Member State between 2013 and 2019.

²⁰ See specific amendment suggestions provided by Carbon Market Watch (CMW): CMW, "A New Hope: Recommendations for the EU Emissions Trading System review", April 2021, p. 7, https://carbonmarketwatch.org/wp-content/uploads/2021/04/A-New-Hope_recommendations-for-the-EU-ETS-review-2.pdf.

²¹ Under art. 10(2)(b) of the EU ETS directive, the 16 lower-income Member States are: Bulgaria, Croatia, Cyprus, Czechia, Estonia, Greece, Hungary, Latvia, Lithuania, Malta, Poland, Portugal, Romania, Slovakia, Slovenia, Spain.

Figure 5: Share of allowances (free and auctioned) distributed to Member States (2013-2019)



Despite the solidarity clause, the allocation key for the distribution of allowances was recently called into question by Poland - though second highest beneficiary of the ETS in number of allowances - in an unpublished paper circulated to the Council in October 2020. The paper argues that some Member States receive allowances in excess of their verified emissions, and Poland proposes to amend this by changing the allocation key. Although there is a possible case for redistribution, it should be avoided that Member States are punished for having acted early and succeeded in reducing their emissions, with the spare allowances being given to those countries who have contributed less. Furthermore, an excess of allowances in some Member States leads us to the conclusion that these allowances should be removed from the market, since the purpose of the ETS is to reduce emissions. This would strengthen the effectiveness of the EU ETS and also solve the underlying state aid issue of operators selling excess allowances when prices are higher. WWF therefore recommends removing excess ETS allowances from the market.

Recommendation 2: Remove excess ETS allowances from the market

In theory, the total amount of emission allowances allocated under the EU ETS is capped and is meant to decrease over time, in line with a linear reduction factor of 2.2% per year. Scarcity would therefore increase the carbon price and put pressure on economic operators to reduce emissions and costs. In reality however, the cap has been higher than installations' verified emissions since 2009, leading to a constant low carbon price until recent years. On top of that, emissions falling more steeply than allowances - as is the case for example during an economic crisis or when a Member State decides to phase out coal - has caused the market to malfunction. Therefore, the historical surplus allowances should be removed from the market, not least because an increase of the surplus is already foreseen in light of the consequences of the Covid-19 pandemic.

WWF recommends a combination of three options to make the instrument fit for the revised 2030 climate target of "at least net 55%". First, the Market Stability Reserve, which began operating in 2019, should be strengthened. Second, the linear reduction factor should be increased to 3.57%. Finally, a one-off reduction of the cap of at least 350 million allowances is necessary to decrease the risk of a future surplus. A combination of these options must be undertaken during the upcoming legislative revision of the EU ETS and take effect at the latest in 2023²².

²² See Öko-Institut, "Raising the climate policy ambition of the European Union", *op. cit.*

Extending the scope of the EU ETS?

The EU has set for itself the objective of achieving climate neutrality by 2050. Emissions reduction efforts covering economic sectors are essentially governed by three sets of legislation. The Effort-Sharing regulation sets binding national emission reduction targets in sectors comprising transport (except aviation and international maritime shipping), buildings, small industry, agriculture and waste. EU Member States decide how best to reduce emissions in these sectors, including through regulatory policies which do not involve carbon pricing. The EU ETS aims to reduce emissions in the electricity sector, large industrial installations and intra-EU aviation through a carbon price. Thirdly, the land use, land use change and forestry (LULUCF) regulation governs emissions from land use and forestry. Additional policies help drive the clean transition across sectors, with directives on renewable energy and energy efficiency, or within specific sectors, acting for example on the energy performance standards for buildings or CO₂ emissions from cars and vans.

Using different modus operandi to achieve meaningful emissions reductions in different economic sectors - for example through binding emission reduction targets or an ETS carbon price - is very sensible insofar as all sectors are not equally receptive to the ETS price. The polluter pays principle should apply unequivocally and without exception to sectors covered by the EU ETS (with no free permits to pollute), but considerations around extending the scope of the EU ETS require balancing the benefits and disadvantages of this policy option. The scope of the EU ETS should be strictly limited to sectors that are receptive to an ETS price and for which the ETS price will be the most effective policy option for reducing emissions while shielding the most vulnerable.

In its recent statements and public consultation on the EU ETS, the European Commission suggested extending the scope of the EU ETS to international aviation and shipping, which are currently not covered by any carbon pricing instrument. WWF recommends such an extension.

Recommendation 3: Extend the scope of the EU ETS to international aviation and shipping

WWF supports extending the EU ETS to international aviation and shipping (and, as per Recommendation 1, through full auctioning), meaning to emissions from flights and vessels departing from or to the EU/EEA. This idea previously gained support from EU Leaders who requested the European Commission to look into such an extension during the June 2020 European Council²³. The current EU ETS only covers intra-EU/EEA flights (meaning flights both departing from and arriving to EU or EEA countries), with a 'stop-the-clock' measure exempting flights to or from third countries until 2023²⁴. For the period after 2023, the revision of the EU ETS will decide whether these emissions are to be regulated under the EU ETS or the international CORSIA regime under negotiations at the International Civil Aviation Organisation (ICAO). Emissions related to international shipping are currently not regulated under EU law.

Currently, there are no effective and globally agreed policies in force tackling emissions from international aviation or shipping. According to the European Parliament, by 2050, global international aviation emissions are projected to increase by 300-700% and CO₂ emissions from shipping by 50-250% compared to 2005 levels²⁵. Not addressing these emissions would make it very challenging to achieve climate-neutrality in the EU by 2050. As the European Parliament expressed in a 2019 resolution, attempts to regulate these emissions at global level through the ICAO and the International Maritime Organisation (IMO) fall far below the targets that the emissions reduction targets the EU has set²⁶ - and in the case of ICAO, it only aims at an offsetting scheme instead of an emissions reduction mechanism. The cost of these emissions on society must be accounted for through a price signal affecting the polluter. This is especially important because aviation kerosene sold in Europe is currently tax-free²⁷, meaning there is again no price signal attached to pollution.

²³ European Council, Conclusions of 17-21 July 2020, para A29, <https://www.consilium.europa.eu/media/45109/210720-euco-final-conclusions-en.pdf>.

²⁴ Sandbag, "Now boarding for better climate action under EU ETS aviation rules", January 2021, <https://sandbag.be/index.php/2021/01/20/now-boarding-for-better-climate-action-under-eu-ets-aviation-rules/>.

²⁵ European Parliament, resolution on the 2019 UN Climate Change Conference (COP25), 28 November 2019, para. 70, https://www.europarl.europa.eu/doceo/document/TA-9-2019-0079_EN.html.

²⁶ *Ibid.*

²⁷ Transport & Environment, "Leaked European Commission study on aviation taxes", 13 May 2019, <https://www.transportenvironment.org/publications/leaked-european-commission-study-aviation-taxes>.

Under the current EU ETS, only 15% of intra-EU aviation allowances are auctioned, which amounted in 2019 to 5.5 million tons of aviation allowances (roughly EUR 136 million)²⁸. Extending the EU ETS to international aviation and shipping through full auctioning of allowances would bring about important revenues to Member States at a bearable cost for economic operators, which should be able to pass on the price to consumers²⁹. As for EU-related CO₂ emissions from maritime transport, they have reached 144 Mt in 2019³⁰, which would have represented an additional EUR 3.42 billion in revenues for EU Member States in light of the average carbon price that year. These two sectors have already benefited from over a decade-long tax-free grace period from any regulatory measure, which showed little results from an emissions reduction perspective. The surplus of auctioned revenues should be redistributed to EU citizens in the form of climate action, with the social impact determining where revenues are redistributed. For example, the European Parliament proposed an 'Ocean Fund' to support marine ecosystems and the decarbonisation of the maritime transport sector³¹. The ETS price alone will not decarbonise the aviation and shipping sectors, but it will introduce the 'polluters pay principle' in these sectors and largely support supplementary policies to reduce GHG emissions.

Recourse to the EU ETS to drive down decarbonisation in a given sector only makes sense if the said sector is responsive to the ETS price and that the disadvantages do not outweigh the benefits. The European Commission has also floated the idea of extending the EU ETS carbon pricing mechanism to road transport and buildings. WWF has critical concerns about such an extension for the reasons outlined below.

Recommendation 4: Do not apply the EU ETS to road transport and buildings

WWF has strong reservations about extending the EU ETS to road transport and buildings for three main reasons:

- **These sectors would likely not respond adequately to the ETS price:** While extending the EU ETS to road transport and buildings would increase Member States' revenue stream, it will not adequately reduce emissions. In fact, the effect of the EU ETS price alone in those sectors would either be too low to create an actual incentive to switch to a cleaner vehicle or to refurbish a house, or so high (i.e. 180€/ton³²) that it would create other problems of social acceptability which redistribution would unlikely mitigate fully, potentially threatening support for the European Green Deal. A carbon price will likely not favour the uptake of better alternatives, due to non-monetary barriers such as high transaction costs, incomplete information, lack of adequate alternatives at scale etc.
- **Without adequate redistribution of revenues, an ETS carbon price for road transport and buildings would unfairly burden the vulnerable and poorer consumers:** Most consumers do not have the financial means to adopt cleaner alternatives, which often require substantial upfront capital investment. Adding a carbon price on fuel and heating would result in shifting the cost of the transition onto the end-users, trapping them into unsustainable lifestyles - especially in the poorest Member States where heating and fuel costs make up a larger share of poor households' expenses³³. Such a measure would not target the economic actors who

²⁸ EEA, EU ETS data viewer, *op. cit.*

²⁹ A Commission study found that there was little risk of carbon leakage in the aviation sector. See European Commission, "Impact assessment accompanying the proposal amending the EU ETS directive (2003/87/EC)", 3 February 2017, <https://ec.europa.eu/transparency/regdoc/rep/10102/2017/EN/SWD-2017-31-F1-EN-MAIN-PART-1.PDF>.

³⁰ Transport & Environment (T&E), Maritime ETS public consultation: Detailed T&E briefing on the design options", December 2020 p. 3, <https://www.transportenvironment.org/sites/te/files/publications/Maritime%20ETS%20public%20consultation%20briefing.pdf>.

³¹ European Parliament, negotiating position on the proposal for a regulation amending Regulation (EU) 2015/757 in order to take appropriate account of the global data collection system for ship fuel oil consumption data, 16 September 2020, article 3gc, https://www.europarl.europa.eu/doceo/document/TA-9-2020-0219_EN.html.

³² Cambridge Econometrics, "Exploring the trade-offs in different paths to reduce transport and heating emissions in Europe", funded by the European Climate Foundation, May 2021, <https://www.camecon.com/what/our-work/exploring-the-trade-offs-in-different-paths-to-reduce-transport-and-heating-emissions-in-europe/>, p. 4.

³³ Ecologic, Implementing new EU climate targets for 2030 and 2050: Preliminary considerations on ETS extension", 9 March 2021, <https://www.ecologic.eu/17788>.

have the means to take action, unless heating expenses were to be shared between tenants and landlords (as currently foreseen in Germany).

- **Focusing efforts on carbon pricing for these sectors might very well delay progress:** It is unclear whether any extension of the EU ETS to cover these two sectors would be operational before 2030. At the same time, **there is a major risk that regulating these sectors under the EU ETS leads to reducing the regulatory burden for these sectors** in the Effort-Sharing regulation and sector-specific measures which have delivered proven results (such as energy efficiency measures, or CO2 standards for cars and vans).

There is in theory a narrow path for partially addressing these concerns through an EU ETS for road transport and buildings. These sectors should be covered by both the Effort-Sharing regulation (which would set the emissions reduction objective) and the EU ETS (which would be one of several coexisting means to implement this objective), meaning the EU ETS would be the “icing” on a strong policy mix which includes nationally binding targets³⁴. The ETS for road transport and buildings should be separated from the current EU ETS, with the price for allowances being set and revised by policy-makers rather than the market. Finally, collected revenues would be entirely redistributed to affected households in the form of financial incentives designed to change their consumption behaviours - through, for example on buildings a low-income renovation fund to alleviate energy poverty. This option presents important underlying political risks and may yield little reward on emissions reduction.

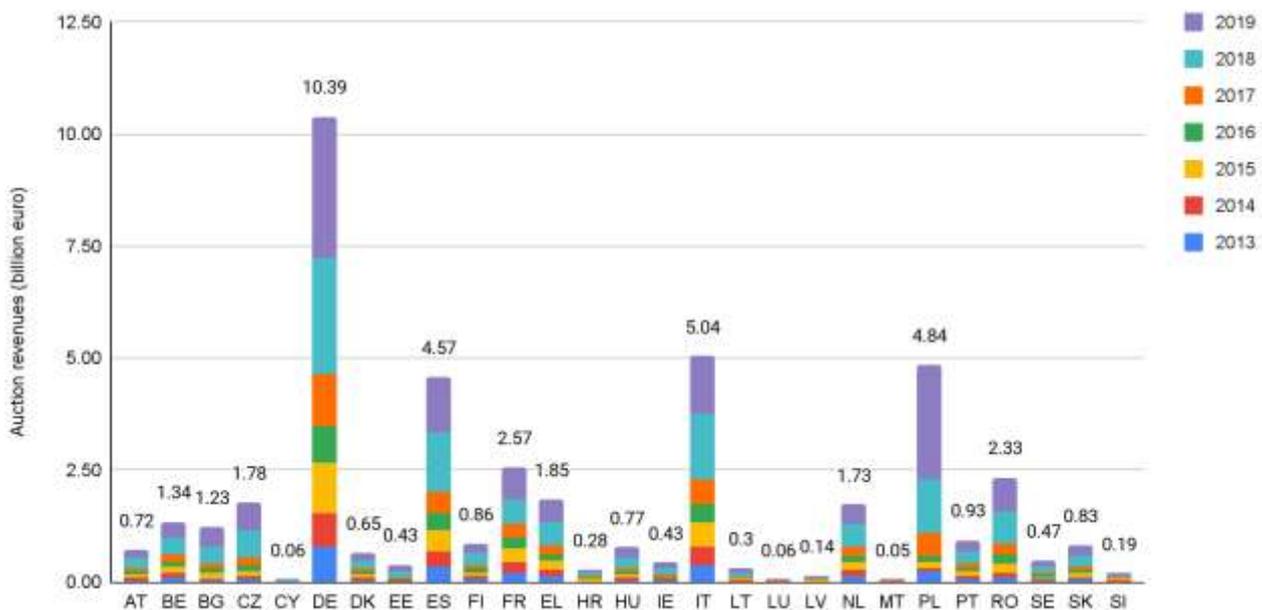
³⁴ On buildings specifically, see Regulatory Assistance Project (RAP), “Pricing is just the icing: The role of carbon pricing in a comprehensive policy framework to decarbonise the EU buildings sector”, June 2021, <https://www.raonline.org/knowledge-center/pricing-just-icing-role-carbon-pricing-comprehensive-policy-framework-decarbonise-eu-buildings-sector/>.

2. SPENDING EU ETS REVENUES

In 2019 alone, EU Member States received collectively over EUR 14 billion in EU ETS revenues. While raising revenues is not the main purpose of the EU ETS (that is emissions reduction), the revenues generated from auctioning should be used to further increase the ETS impact on the transition to climate neutrality. Recycled in a targeted way, the revenue can be used to support and accelerate the game-changing investments that we need, and contribute to the achievement of significant emissions reductions while increasing the acceptability of the ETS price.

In recent years, revenues raised under the EU ETS have increased significantly and today the issue of how best to use this financing stream is at the forefront of political discussion. In its seminal European Green Deal Communication, the European Commission even floated the idea of seizing 20% of all auctioned revenues to repay debt contracted under the Next Generation EU instrument³⁵. This may not be to the liking of EU Member States, despite, or because of, the surge in revenues since 2018.

Figure 6: Total auction revenue raised by EU Member States (2013 -2019)



As a direct consequence of the increased carbon price, all Member States have seen their revenue increase in 2018 and 2019, compared to previous years. Interestingly, 2019 revenues compared to 2018 only significantly increased in Poland, Germany and France. In the case of Poland, this increase can largely be attributed to more limited use (coinciding with the entry into force of stricter rules) of a derogation under article 10(c) allowing some Member States to provide free allocation to electricity generators to finance investments. Unused allowances initially allocated under article 10(c) were then auctioned in years 2019-2021.

While the effect of the increasing carbon price certainly contributes to reducing emissions, it also has distributional effects which risks placing disproportionate costs on those least able to pay. As a result, the revenues raised should be fully redistributed to citizens and economic operators in the form of additional, just and clean climate action. What constitutes just and meaningful climate action is not fully defined in the EU ETS directive, and details of Member States' spending show that what is counted as 'climate action' is sometimes counterproductive to a just transition.

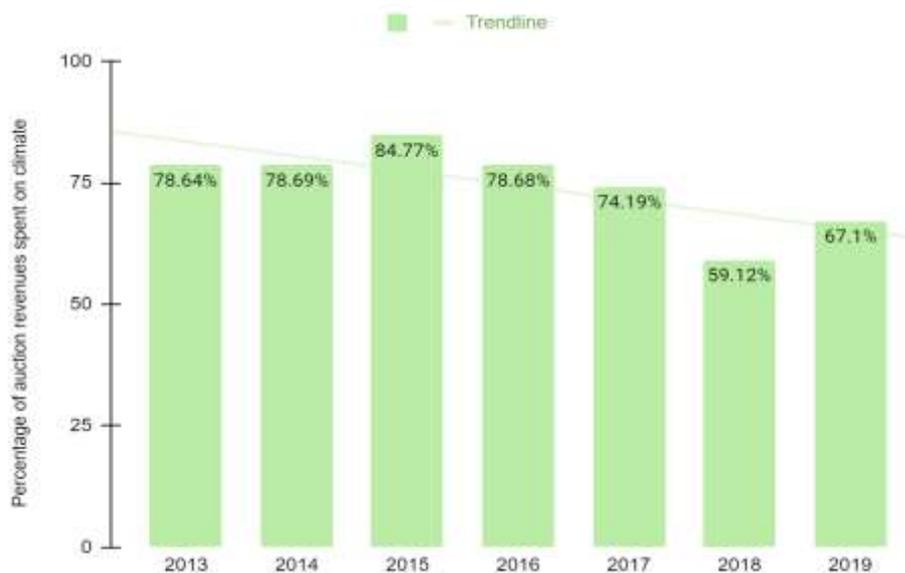
³⁵ Communication on the European Green Deal, *op. cit.*, p. 15.

All ETS revenues should be spent on the transition to climate neutrality

Climate change exacerbates inequalities, and negatively affects those who are already most vulnerable in our societies and least able to adapt. However, an ETS price can also represent a disproportionate burden on some groups, without measures to ensure equitable redistribution of the costs and benefits. This is a risk whether the ETS price is direct or indirect, because of the risk of cost pass-through. Policy instruments to incentivise climate action by imposing a carbon price should therefore be designed sensitively to not add an additional burden on the most vulnerable by requiring them to pay for mitigation costs. Instead, they must help by distributing the costs in a fair way. Hence, redistribution should be a cornerstone of the EU ETS: it contributes to gain the acceptance of citizens and operators to assume the cost of pollution, by placing them at the heart of the transition, and not leaving them as its victims.

Fully recycling ETS revenues into the transition to climate neutrality would remove the risk that revenues are invested in activities that undermine climate objectives, instead boosting the impact of the ETS in achieving emissions reductions. Yet Member States' reporting shows that part of EU ETS revenues generated each year is not redistributed in support of the transition to climate neutrality.

Figure 7: Share of auctioned revenues reported as spent on climate action in EU Member States (2013-2019)³⁶

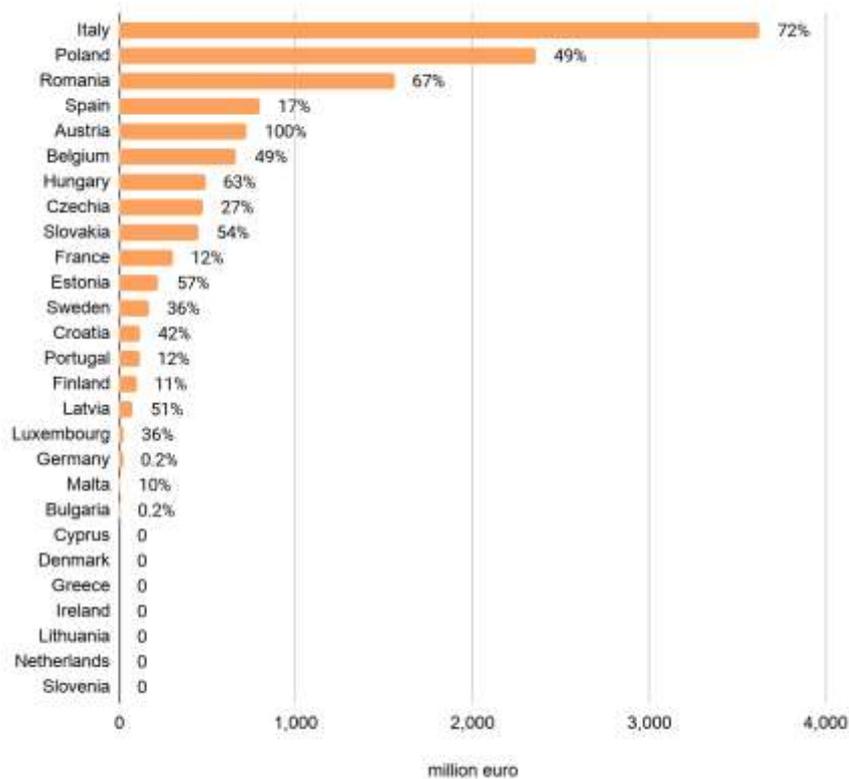


Although revenues have increased across the years - and with that climate spending - the percentage of revenues spent on climate peaked in 2015 at 85% and fell in subsequent years, creating a slight but steadily decreasing trendline between 2013 and 2019. Over these years, 2018 revealed the lowest spending on climate amongst Member States, with 59% of auctioning revenues being spent on climate action. This increased to 67% the year after, still far from previous years and what it should be.

Currently, the language in the directive detailing how ETS auctioning revenues are to be spent is very weak, providing that "Member States should use at least 50% of auctioning revenues or the equivalent in financial value for climate and energy-related purposes". Despite this rather weak recommendation, a large number of Member States have repeatedly failed to achieve this 50% mark.

³⁶ The data displayed in this figure slightly differs from a previous WWF publication of December 2019. This is due to a change in our methodology for analysing Member States' reports. While in our past report we aimed at correcting inconsistencies found between different tables in each report, we have decided in this analysis to only consider overall spending reported by Member States as 'climate action' in the first reporting table (unless Member States only filled in the subsequent tables). Climate action spending is also capped to 100% of reported auctioned revenue to prevent Member States from claiming that they spent more ETS revenues on climate action than they have of revenues. In this report, data reported in Member States' subsequent reporting tables is only considered when we analyse domestic and international climate spending specifically, in figures 8 and 9. The linear trendline, or 'line of best fit' shows that the percentage of auctioned revenues spent on climate undergoes a decline across the seven years.

Figure 8: EU ETS revenue not spent on climate action in each Member State (2013 - 2019) compared to total ETS revenues



Between 2013 and 2019, EU Member States missed the opportunity to invest EUR 13.3 billion of revenues in climate action. In 2019, seven countries failed to meet the 50% climate spending floor recommended in the directive, and Croatia, Italy, Slovakia, and Romania spent less than 20% of their auctioning revenue on climate³⁷. Additionally, Austria did not report its climate spending so it cannot be known what percentage of auctioning revenue it spends on climate-related purposes. This behaviour stands in stark contrast with regular calls from some Member States for increasing EU funding and national support to unlock green investments.

As the ETS price rises, it is all the more important to ensure that revenues are redistributed for the benefit of climate action and citizens. Aligning EU ETS revenue with climate spending is largely to the benefit of EU Member States and EU citizens. Targeted right, it can help to justify and counter the social and political impact of a higher carbon price and demonstrate that Member States are not only using carbon pricing as a punitive instrument. Redistributing revenues through climate action confers positive recognition towards governments and trust in their capacity to spend resources in a just, transparent and environmentally-sound way. It provides credibility to Member States' ability to align spending with climate objectives while leaving no one behind. Finally, it benefits climate action and contributes to meeting binding national and EU climate targets. WWF therefore recommends spending all EU ETS revenues on climate action and the transition to climate neutrality. Overall public funding on climate action should however not be limited to EU ETS revenues only, as it plays a limited role in financing the overall transition to climate neutrality in many Member States.

³⁷ The other three countries who failed to meet the 50% climate spending floor were Estonia, Hungary and Latvia.

Recommendation 5: Spend 100% of EU ETS revenues on the transition to climate neutrality

WWF recommends that 100% of EU ETS revenues be spent on climate action. The EU ETS directive could be amended in article 10(3) to state that “Member States shall determine the use of revenues generated from the auctioning of allowances. 100% of the revenues (...) should be used for one or more of the following *climate activities, consistent with a transition to climate neutrality*”. Since ETS revenues will themselves not be sufficient to complete the transition towards climate neutrality, any ETS revenue spent on climate action should be strictly *additional* to existing climate spending provided by the EU and its Member States. In practice, Member States should seek, beyond the scope of ETS revenues, to allocate additional national resources to the transition to climate neutrality and to align all budgetary spending with climate commitments.

There have been indications that the European Commission is planning to dedicate part of EU ETS funds to its ‘own resources’ and to use the revenues to repay debt contracted under the Next Generation EU instrument. This is not acceptable: EU ETS revenues should be entirely dedicated to climate action. To do otherwise would fail to address large investment gaps in e.g. renewables deployment, coal regions, or industrial decarbonisation. It would also place the burden of the ETS price on the most vulnerable who would remain exposed to the costs of the transition while already feeling the visible effects of climate change. In turn, this could also undermine the consent of consumers and industries to pay a higher carbon price and to embrace the clean transition.

Quality spending: just and meaningful climate action

Not only should EU ETS revenues be spent on climate action - the directive identifies categories deemed constitutive of climate action - but it must be guaranteed that spending labelled ‘climate spending’ actually contributes to reducing GHG emissions in line with the EU’s 2030 target, 2050 climate neutrality objective and long-term commitment under the Paris Agreement to limit the global average temperature increase to 1.5°C above pre-industrial levels³⁸. EU ETS revenues should also strive to be redistributive to avoid aggravating inequalities and, wherever possible, should help deliver a just transition.

Under art. 10(3) of the current EU ETS directive, revenues are spent on climate action if they fall within at least one of 11 categories below:

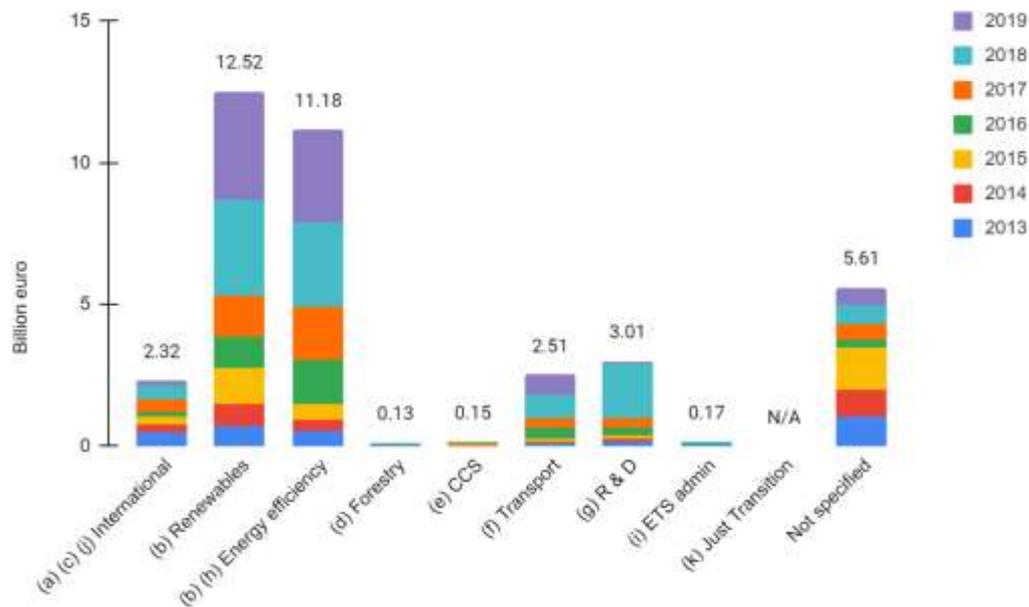
- International climate spending, through (a) contributing to international funds (Global Energy Efficiency, Renewable Energy Fund, Adaptation Fund); or financing climate action in developing or vulnerable countries, including on (j) adaptation or (c) to avoid deforestation and increasing afforestation and reforestation;
- (b) renewable energy and energy efficiency ((b) and (h));
- (d) forestry sequestration;
- (e) Carbon Capture and Storage (CCS), in particular from solid fossil fuel power stations and the industrial sector, including in third countries;
- (f) transport;
- (g) research and Development in energy efficiency and clean tech;
- (i) administrative expenses of the management of the EU ETS;
- (k) to promote skills formation and reallocation of labour in order to contribute to a just transition to a sustainable, climate neutral economy, in particular in regions most affected by the transition of jobs, in close coordination with the social partners.

³⁸ Article 2 of the Paris Agreement, 2015.

Domestic climate spending

EU Member States are free to choose in which climate-related activities ETS revenues should be spent. Historically, Member States have not dedicated the same amount of revenues to all categories mentioned in the directive.

Figure 9: Auctioning revenues spent on individual domestic climate activities listed in the EU ETS directive article 10(3) in 2013-2019³⁹



Spending categories correspond to those mentioned in article 10(3) of the EU ETS directive.

As seen in figure 9, domestic revenues are mostly spent in the sectors of renewable energies and energy efficiency. Investing ETS revenues into targeted structural measures such as energy efficiency is a very positive use of auctioning revenues since it can help reduce energy poverty and permanently reduce the energy bills for low-income households. However some spending categories, such as forestry restoration or biodiversity-friendly climate adaptation, are largely overlooked. Revenues spent on each category can also change rapidly from one year to another, as can be seen with Research and Innovation spending which amounted to EUR 1,9 billion in 2018 and only EUR 108 million in 2019 - despite the fact that slightly more revenues were spent on climate action in 2019. The way the reporting is designed has limits. For example, over EUR 5.6 billion between 2013 and 2019 do not strictly fall within a single category in the reporting, either because the spending was cross-cutting or because the Member States considered it was falling under another category not included in the template. More importantly, revenues are not earmarked and it is often not clear whether Member States strictly report on the use of ETS revenues or on a selection of climate spending financed through their national budget (more details on the issue of additionality are provided in the following section).

Furthermore, the reporting template makes it impossible to ascertain whether spending is consistent with the just transition. Although there is a dedicated sub-category (k) in the EU ETS directive for spending designed “to promote skill formation and reallocation of labour in order to contribute to a just transition to a low carbon economy,...”, there is no means of addressing whether other climate spending is consistent with, or contributes to, the just transition and no way of acknowledging redistributive actions which support the synergistic achievement of social and environmental goals beyond reskilling and labour reallocation.

EU ETS revenues must fund climate action in line with a just transition, ensuring that those most impacted by climate action are not left to bear the burden unsupported. This will bolster support for EU climate and energy policies in general, as communities seeing first-hand the benefits of such tools in their localities will be much more positively disposed towards climate action. While it is not possible to fully assess whether current specific climate spending is consistent with a clean and just transition, we can identify activities in the Member States’ reporting which are evidently counter-productive to a clean and just transition and would delay climate action. For the year 2019 alone, they include for example:

³⁹ The total domestic spending on climate action in this figure slightly differs from the total climate spending which could be calculated in figure 8 because of inconsistencies in Member States’ reporting tables, with overall amounts reported as spent on climate action not corresponding, in many cases, to the detailed climate activities funded through ETS revenues. Spending categories correspond to those mentioned in article 10(3) of the EU ETS directive.

- Member States such as Germany providing EUR 218,6 million in subsidies to electricity-intensive companies (meaning 7% of all Germany's revenue dubbed 'climate spending') or Belgium providing EUR 31,7 million to industries in Flanders (9% of Belgium's revenue dubbed 'climate spending'), as indirect compensation for higher electricity costs due to the EU ETS. In total, 12 Member States have pursued such state aid schemes between 2013 and 2020⁴⁰, and they have increased significantly between 2018 and 2019⁴¹. These compensations, allowed under art. 10(c) of the EU ETS directive, constitute a form of indirect free allocation applying to electricity use, with some operators ultimately paying a lower electricity price. They create undue distortions of competition in the single market and lead to the burden of the transition falling most heavily on those who do pay the costs of carbon price increases.
- Poland (11,6 million) and Hungary (EUR 25,2 million) allotting ETS revenue for national programmes financing oil boilers and gas powered convectors, the problem being that it is unclear whether they are updating them with new oil boilers and gas radiators or upgrading them to truly climate friendly solutions.

To remedy this worrying practice of Member States branding EU ETS revenue as 'climate action' spending without clear criteria as to what constitutes climate action - some of which, as we've seen, are ultimately delaying the clean and just transition - the EU ETS directive should set out detailed guidance as to what can and cannot be considered as compatible with a just transition towards 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

It is not sufficient that projects are only labelled at the discretion of Member States as contributing to 'climate action' in order to be counted as such. The EU ETS directive should be strict in the requirement that only projects truly aligned with a clean and just transition can be financed by ETS revenues. The directive should hence clearly define what constitutes 'climate action' for the purpose of spending ETS revenues, in line with the criteria of the EU Sustainable Finance Taxonomy devised by the EU Technical Expert Group on Sustainable Finance⁴². In order to be eligible, projects will have to:

- 1) *Contribute substantially to at least one of the six environmental objectives listed in the Taxonomy⁴³, and fall within at least one of the categories in article 10(3) of the EU ETS directive. The scope of the 'just transition' category should be clearly defined, for example with the eligible activities mentioned in article 8(2) of the regulation establishing the Just Transition Fund⁴⁴.*
- 2) *Do no significant harm to any of the six environmental objectives listed in the Taxonomy.*
- 3) *Demonstrate that they are consistent with Member States' objectives set in National Energy and Climate Plans (NECPs) and, if relevant, Territorial Just Transition Plans (TJTPs)⁴⁵.*
- 4) *Comply with minimum social safeguards, starting with upholding the European Pillar of Social Rights⁴⁶.*

The first three criteria will help ensure consistency and create synergies between the use of ETS revenues and climate objectives and other EU instruments such as the Taxonomy, NECPs and TJTPs. Member States will revise their NECPs by 30 June 2024, which corresponds to the time when the revised EU ETS directive may enter into force. The fourth criteria recognises that while

⁴⁰ These Member States are Belgium, Finland, France, Germany, Greece, Lithuania, Luxembourg, the Netherlands, Slovakia, Spain and (formerly) the UK. See the Commission's Report on the functioning of the European carbon market, 16 January 2020, p. 19, [https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52019DC0557R\(01\)](https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52019DC0557R(01)).

⁴¹ ERCST, "2021 State of the EU ETS Report", p. 23, <https://secureservercdn.net/160.153.137.163/z7r.689.myftpupload.com/wp-content/uploads/2021/04/20210414-2021-State-of-the-EU-ETS-Report-vfinal-1.pdf>.

⁴² 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.

⁴³ The six environmental objectives defined under the Commission's legislative proposal for an EU sustainability Taxonomy are: (1) climate change mitigation; (2) climate change adaptation; (3) sustainable use and protection of water and marine resources; (4) transition to a circular economy, waste prevention and recycling; (5) pollution prevention and control; (6) protection of healthy ecosystems.

⁴⁴ Regulation establishing the Just Transition Fund, 26 May 2021, <https://data.consilium.europa.eu/doc/document/PE-5-2021-INIT/en/pdf>.

⁴⁵ Under art. 7 of the Just Transition Regulation, Member States are required to produce Territorial Just Transition Plans in order to receive EU funding under the Just Transition Fund.

⁴⁶ 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'.

overall climate action will have net positive effects, it may have negative repercussions at the local levels, especially in terms of jobs. The use of revenue should therefore be redistributive and prioritise actions that reduce the exposure of the poorest to the costs of the transition (and to the ETS price).

Revenues placed in the Modernisation and Innovation funds

In addition to the solidarity clause which redistributes 10% of EU ETS allowances towards the 16 lower-income Member States - mentioned in a previous section - two funds were introduced in 2020 and 2021 to support specific investments across Member States:

- The **Modernisation Fund** has entered into operation in 2021 and redistributes 2% of all allowances - that is 275.6 million allowances over 2021-2030 - towards 10 lower-income Central and Eastern Member States. The fund will support the financing of small-scale investment projects, the modernisation of energy systems and improvement of energy efficiency. In practice, eligible Member States present prospective investments for approval to an EIB investment committee (in which 10 of the 15 members are representatives of the eligible Member States themselves), with the EIB deciding which of the approved investments are “priority projects”. Under art. 10(d)(2) of the EU ETS directive:
 - at least 70% of the fund’s resources are dedicated to priority projects - which include renewable energy, energy efficiency, energy storage and the modernisation of energy networks, and a just transition. These projects can be financed at 100% through the Modernisation Fund.
 - The remaining 30% of the fund’s resources can be spent on non-priority projects which can include gas investments as long as they are approved by the investment committee and are deemed consistent with the 2030 climate target and the long-term objectives of the Paris Agreement; and they receive financing of up to 70% of the projects’ costs.
- The **Innovation Fund** started functioning in 2020 and the selection of first projects is ongoing. The fund will consist of revenues from 450 million allowances over 2020-2030 taken from the pools of free allowances, auctioned allowances and of allowances held by the Market Stability Reserve. It aims to support innovation in low-carbon technologies, including carbon capture and utilisation (CCU), carbon capture and storage (CCS), products substituting carbon-intensive ones (such as hydrogen), and innovative renewable and energy storage technologies. The Commission manages the application process (with the support of a public implementing body), and up to 60% of the ‘*relevant project costs*’ can be financed, meaning the additional costs that are borne as a result of the application of the innovative technology⁴⁷.

Both the Modernisation and Innovation funds are essential to help industry and the electricity sector build up viable alternatives for their high carbon-intensive activities. Making polluters pay for the price of pollution does not mean that they alone should bear the cost of the transition. On the one hand, a carbon price provides an economic imperative to engage in clean investments, and on the other hand part of the revenues raised should support such clean investments and support industrial decarbonisation. Yet the funding available in these funds is insufficient. In the first call for projects in the Innovation Fund, demand was exceeded by 20 times the amount of available funding⁴⁸. In the Commission’s recent public consultation on the revision of the EU ETS, several stakeholders supported an increase in funding for the Modernisation and Innovation funds⁴⁹. **The real problem faced by European installations covered by the EU ETS is not an alleged risk of carbon leakage but a genuine risk of investment gap⁵⁰. As we must move towards the end of free allocation and full auctioning of ETS allowances as soon as possible, the increased revenue streams would permit a considerable increase of funding for the Modernisation and Innovation Funds.** WWF therefore calls for a substantial increase in the size of these funds, provided that they comply with spending conditions attached to EU ETS revenues.

⁴⁷ See art. 5 of the Commission delegated regulation with regard to the operation of the Innovation Fund, 26 February 2019, https://ec.europa.eu/clima/sites/default/files/innovation-fund/c_2019_1492_en.pdf.

⁴⁸ CMW, “A New Hope”, *op. cit.*, p. 8.

⁴⁹ Industries supporting the increase of the Modernisation Fund included: the Confederation of Industry of the Czech Republic, Elettricità Futura, ETUC, EUROFER, HYBRIT, Norwegian Oil and Gas Association, Polish chamber of chemical industry, Siemens Energy, SolarPower Europe, Union Française de l’Electricité (UFE). Industries supporting the increase of the Innovation Fund included: Central Europe Energy Partners (CEEP), ETUC, Eurelectric, Eurima, Polish Chamber of Chemical Industry, Polish Electricity Association (PKEE).

⁵⁰ European Investment Bank (EIB), “Investment report 2019/2020: accelerating europe’s transformation”, p. 6, November 2019, https://www.eib.org/attachments/efs/economic_investment_report_2019_key_findings_en.pdf.

Recommendation 7: Increase the size of the Modernisation and Innovation funds with green and social conditions attached

Revenues from full auctioning of allowances should partly be redistributed to support industrial transformation through the Modernisation and Innovation funds, provided that green and social spending conditions are attached.

In the year 2021, the Modernisation Fund will be financed through an estimated 69 million allowances⁵¹ (or EUR 3.45 billion in current ETS price) while the Innovation Fund will benefit from 40 million allowances (or EUR 2 billion in current ETS price of EUR 50/ton). On the other hand, we estimate that a maximum of 676 million allowances will be foregone in free allocation in 2021⁵², which amounts to EUR 33.8 billion in current ETS price. In line with this report's first recommendation, moving to full auctioning would bring about a considerable amount of revenues which should, at least partly, be invested in the industrial transformation, thus delivering far more efficient results than free allocation.

But this increase should only come if the funds are subject to the same green spending conditions which WWF calls to be attached to EU ETS revenues (see recommendation 5). These are:

- 1) *Contribute substantially to at least one of the six environmental objectives listed in the Taxonomy, in addition to the respective scope of each Fund.*
- 2) *Do no significant harm to any of the six environmental objectives listed in the Taxonomy.*
- 3) *Demonstrate that they are consistent with Member States' objectives set in National Energy and Climate Plans (NECPs) and, if relevant, Territorial Just Transition Plans (TJTPs).*
- 4) *Comply with minimum social safeguards and uphold the European Pillar of Social Rights.*

The application of these rules in the EU ETS directive should result in corollary changes in the rules currently governing the Modernisation Fund. The Fund should only finance so-called priority projects and explicitly exclude any fossil fuel investments, such as in natural gas and gas transmission infrastructure, which are at odds with the European Green Deal. This will make the Modernisation Fund truly transformative, implementing projects that will drive regions and poorer member states forward to the forefront of the transition. These rules will also prevent any discretionary assessments, when assessing projects, discretionary assessments of what constitutes a 'just transition' (which the Modernisation Fund does not further define) or vague requirements that projects must "contribute to achieving emission reductions well below the benchmarks"⁵³ (Innovation Fund).

To further drive forward compliance with the principles of a green and just transition, additional conditions could also be placed on large enterprises benefiting from these funds (or even those benefiting from ETS revenues generally) to commit them to developing just transition plans for their workers. Advisory support could be foreseen to assist enterprises in meeting and implementing these conditions.

⁵¹ Based on the European Energy Exchange (EEX) auction calendar 2021, 21 December 2020 p. 11,

https://www.eex.com/fileadmin/EEX/Downloads/EUA_Emission_Spot_Primary_Market_Auction_Report/Auction_Calendar/EEX_Auction_Calendar_21.12.2020.pdf.

⁵² In 2021, 1.57 billion ETS allowances will be issued, of which a maximum of 43% will be allocated for free. See European Commission, "Decision on the Union-wide quantity of allowances to be issued under the EU ETS for 2021", 16 November 2020,

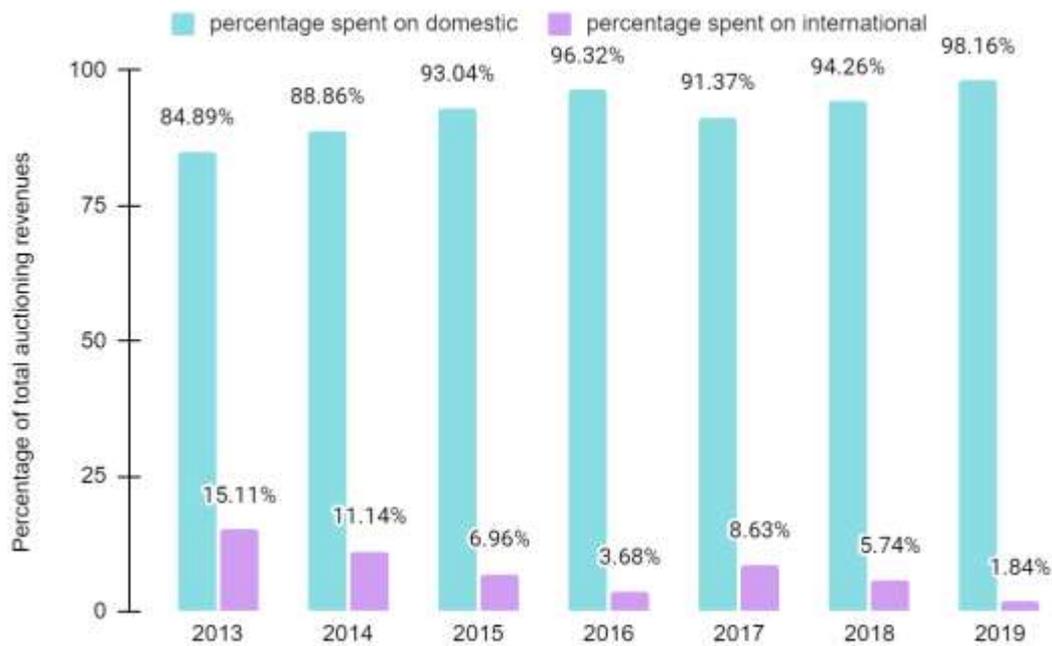
https://ec.europa.eu/clima/sites/clima/files/news/docs/c_2020_7704_en.pdf.

⁵³ Art. 10(a)(8) of the EU ETS directive.

International climate spending

Under current rules, Member States are free to spend their auctioning revenue however they choose, and to disregard certain categories when disbursing EU ETS funds. Since we started analysing the data in 2013, EU Member States have largely prioritised domestic climate spending over international climate spending.

Figure 10: Share of ETS climate spending spent on domestic and international climate action



As illustrated in Figure 10, for those ETS revenues spent on climate action, the proportion spent on domestic climate action outweighs by far the proportion of international climate spending. On average between 2013 and 2019, only 7.5% of ETS climate revenues were allocated to international climate action. However, it is important to note that this figure only accounts for EU ETS revenues spent on international climate action and it does not reflect the magnitude of international climate finance provided by the EU and its Member States, even as a share of all climate action spending.

In 2021, the Commission will present its legislative proposal for a CBAM. WWF recommends that any revenue collected from this mechanism is returned to third countries in need, in the form of international climate finance.

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

International climate finance is essential because the EU is a historic polluter and it bears a larger responsibility for global warming than developing countries which have comparatively emitted less over time. The revenues raised by a carbon border adjustment mechanism (CBAM) would offer an important and rational resource to contribute to these financial flows. Not only would a CBAM represent a significant source of revenue (assuming that it would be similar to the value of current free allocation to EU industry), using CBAM revenues for international climate finance would also represent an equitable solution. A direct link between the *international* origin of the revenue and how they should be spent (i.e. on international climate finance, supporting developing countries) can directly mitigate any regressive effects of a policy.

As a CBAM would penalise third countries' industries with a lower emissions performance than EU industries, it is only fair that the revenues raised are then returned to developing countries

to enable them to unlock the significant investments which will allow them to reduce their carbon emissions. Redistributing the revenues to incentivise climate positive change in third countries will double the impact of a carbon price policy while making it clear for international partners that the objective (and legal basis) for the CBAM is primarily environmental, and not of fiscal nature.

100% of the CBAM revenues should therefore be invested in international climate finance and come in addition to existing contributions by the EU and its Member States. These revenues should not be used to reimburse debt contracted under the Next Generation EU instrument, as is being considered.

3. ENSURING ACCOUNTABILITY FOR HOW EU ETS REVENUES ARE USED

As has been mentioned throughout this report, reporting of Member States' spending is overwhelmingly of poor quality, which has prevented a full understanding and accountability for how EU ETS revenues are spent. Member States systemically submit inconsistent information, or fail to include enough details to ensure what a specific spending contributed towards exactly, including whether it was truly consistent with the transition to climate neutrality. This has been a recurring issue since WWF began reporting on the use of EU ETS revenues, and the quality unfortunately seems to be declining over the years rather than improving. Reasons for this are two-fold: lack of proper earmarking and additionality of ETS revenues, and failure from most Member States to submit detailed, consistent and accurate information. Improving the quality of reporting must be a key objective of the upcoming legislative revision.

Moving to mandatory earmarking and additionality of EU ETS revenues

One of the most effective ways to better ensure transparency and accountability regarding how Member States spend their auctioning revenue is to ensure that revenues can actually be traced to the projects they have been spent on. If this basic requirement is not met, and it is not in most Member States, then yearly reports on EU ETS revenues are a fool's game.

At present, most Member States do not earmark their revenue and arbitrarily report that a share of their EU ETS revenue (for example 100%) were spent on climate action. They then select climate spendings from their national budget (which have not necessarily been financed by ETS revenues and are not necessarily additional) and identify them in their yearly report in order to comply with EU legal obligations. Others simply leave the required details of their climate spending empty. Our analysis on the 2019 reports show that:

- Owing to the definitions provided by Member States of 'committed' or 'disbursed' amounts, we are only confident that four Member States (Croatia, Czechia, Italy and Spain) have earmarked ETS revenues in their national budget, meaning that they are able to say precisely which ministries spent ETS revenues and on which projects.
- Other Member States (Austria, Finland, Germany, Luxembourg, and the Netherlands) confess the lack of earmarking in the report. Refusing to earmark ETS revenues is not a violation of the ETS directive but it puts into question the very purpose of reporting on expenses which are not directly linked to ETS revenues. It also questions the credibility of Member States' claims in the reports that they spent 100% of their revenue in climate action. For example Finland explains in its report that it does not earmark revenue but has nevertheless decided to report 100% ETS revenue spending on climate action. Besides, lack of national earmarking is used as an excuse for submitting empty entries in the reports.
- In some other reports, it is not specified whether Member States earmark, but the selection of random expenses from the state budget is quite obvious as it results in the details of climate spending exceeding the total auctioned revenue reported: Slovenia reported climate spending representing 227% of its total auctioned revenue, with the same issue occurring in Cyprus (220%) and Lithuania's (161%) reports.

When funds are not earmarked, it is difficult or even impossible to decipher whether they constitute additional spending to what would have been spent on climate through the national budget without ETS revenue, or if the ETS revenue simply replace spending that would have occurred otherwise. Consequently, we cannot know whether Member States have cut climate spending in their national budgets and replaced this with ETS auctioning revenue, resulting in no increase in overall climate spending. If this were the case, EU ETS revenues would not be fairly redistributed to those citizens who are feeling the ETS price. To overcome this issue and ensure that ETS revenues come on top of existing spending, WWF recommends earmarking them.

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

To ensure that 100% of ETS revenues is spent on climate action, Member States should be required to earmark the revenues from ETS allowance auctioning for climate action in their national budgets. This could be done by deleting the sentence authorising Member states to use either ETS revenues “or the equivalent in financial value of these revenues” from article 10(3) of the EU ETS directive and from the Commission implementing regulation⁵⁴. Earmarking will help ensure transparency in the use of revenues and encourage strategic planning for using such revenues.

But earmarking alone will not, in most cases, ensure that climate activities financed through the ETS are additional to those that Member States would anyway have engaged in. Spending of EU ETS revenue must be monitored across the whole national budget. Member States should report on a set of indicators proposed by the Commission showing how revenue is spent on climate action projects additional to those that would have been financed under their state budget. The European Commission has a role to publicly highlight non-additionality, whilst potentially praising model cases.

For Member States who claim that they are unable to earmark ETS revenue, and in order to guarantee full additionality across all Member States, the Commission could propose options for direct management or channelling of ETS revenue, unlocking the revenues upon application by Member States mentioning the specific projects eligible for the spending (see recommendation 10).

Improving Member States' reporting quality and consistency

The quality and transparency of ETS revenue use must urgently be addressed if the EU and its Member States are to increase public and investors' confidence in the realisation of commitments made to engage in the transition to climate neutrality. It should be clear how ETS revenue is being used to complement existing decarbonisation and clean transition programmes and how they contribute to climate action and redistribution.

Yet at present, a significant lack of transparency and accuracy in Member States' reporting makes it difficult to ascertain whether the EU ETS is operating properly and whether the carbon price revenue is used in a sound manner. The issues identified below are generalised throughout the Member States and reporting years:

- **Financial information submitted is inconsistent throughout the report.** In their 2019 reports, Cyprus, Lithuania and Slovenia entered detailed climate spendings which are even higher than their total auctioned revenue. Croatia, Estonia, Germany, Italy, Poland and Slovakia make similar inconsistencies with a smaller variation between the total climate spending reported and the detailed list of spending. Belgium failed to complete the total reported spending on climate action but did fill in the section on detailed climate spending.
- **Basic and visible accounting mistakes are made.** For example, the reporting template requires spending to be indicated in thousand euros but in 2019, Estonia, France, Finland, Latvia, Malta and Portugal did not consistently report amounts in thousands, leading to gross exaggeration (and untrue) of their reported auctioned revenue. For example, Finland and Latvia reported receiving EUR 217,4 billion and EUR 4,2 billion respectively of auctioning revenue in 2019 - to be compared with the revenue raised by the top participating Member State, Germany's EUR 3,2 billion). Estonia also reported figures with a comma instead of a dot to indicate the decimal separator, leading to similar problems. Bulgaria forgot to carry out the conversion of local currencies into euro, as required by the template. In such aforementioned cases, we had to 'correct' these mistakes in order to properly analyse the data.
- **Member States do not define 'committed' or 'disbursed' amounts, as required under the template.** Neither the EU ETS directive nor the implementing regulation include a definition, and Member States have interpreted it to mean different things. In some reports 'committed' amounts represent the entire spending dedicated to a project (some of which might have been disbursed already) whereas in others, 'committed' amounts refer only to spending which has not yet been disbursed. Portugal, Romania, Croatia, Hungary and Lithuania use both 'committed' and 'disbursed' entries but do not provide a definition, making it time-consuming and sometimes challenging to understand how much spending was allocated to a project.

⁵⁴ See art. 24 and Annex XIII of the Commission implementing regulation 749/2014 on structure, format, submission processes and review of information reported by Member States pursuant to Regulation 525/2013, 30 June 2014, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014R0749>.

- **Entries and even entire tables in the reporting are left empty** in the reports of Austria, Belgium, Finland, Luxembourg and the Netherlands. In certain cases, Member States claim that since they do not earmark ETS revenue, they are not able to properly fulfil their reporting obligation.

This list of grievances makes it very difficult to get a clear and correct picture of how ETS revenues are spent, and the quantity of inaccuracies in the data supply casts doubt on the accuracy of the European Commission's assessment of the functioning of the EU ETS, based on the same dataset. There are in fact discrepancies between the latest Commission report (2020)⁵⁵ and our analysis. Whereas the Commission found that 77% of ETS revenues in 2019 had been spent on climate-related action, we found only 67.1%. For 2013-2019, the Commission found 78% whereas our calculations showed 74.4% of revenues were used for these purposes. In light of the current quality of reporting, oversight and verification of the data provided is impossible.

The difference in numbers is likely owing to the necessary level of subjectivity in deciphering Member States' reports, which could have been avoided if reports had been financially accurate. As mentioned in the above, we have been careful in avoiding double counting of funds which Member States report as 'committed' and 'disbursed' (with different interpretations of their meaning throughout the reports). Furthermore, when calculating the percentage of auctioning revenues spent on climate-related purposes in a given year, we capped the percentages at 100%, although some Member States which do not earmark ETS revenue claim that they have spent more revenue than they actually have. This may be due to backloading of allowances – which would explain that auctioning revenues dipped in 2014⁵⁶.

Why is information on the use of billions of public revenue provided by the EU ETS so scarce and incomplete? Under article 19 of the 2018 Governance regulation⁵⁷, Member States are only required on 31 July of each year⁵⁸ to provide to the Commission "*information on the use of revenues generated*" under the EU ETS during the previous year, with an Annex VIII to the Governance regulation clarifying that such information should include the category (under art. 10(3) of the EU ETS directive) in which climate spending has been used, and a mention of any carry over (i.e. revenue committed but not disbursed at the time of reporting). Furthermore, the details of Member States' reporting obligations were outlined in a binding template incorporated in a 2014 Commission implementing regulation⁵⁹. The template includes five tables covering information on auctioning revenue, the amount spent on climate action, and within this category, the amount of domestic and international climate spending. Member States are legally required to submit these reports to the Reporting Obligation Database (ROD) which is managed by the EEA as part of the European Environment Information and Observation Network (EIONET). But **Member States have no legal obligation to ensure that their reporting is financially sound, and it seems that neither the European Environment Agency nor the European Commission - which are respectively publishing and analysing the data - have yet convinced Member States to submit credible reports.**

Member States overall have clearly not dedicated enough efforts into ensuring that they report sufficient quality information on the use of ETS revenue. Lack of earmarking in many Member States has complicated the exercise and taken away most of the utility of reporting, which is to provide information on how ETS revenues are spent. One could question the relevance behind the ETS regulation allowing Member States to select climate expenses from their national budget and paste them into their report on the use of EU ETS revenue. As a result of this practice, any account of the use of ETS revenues - be it from Commission's publications or any others which, like ours, is based on Member States' reporting - should be taken with a pinch of salt.

WWF recommends revising the EU ETS regulation to improve the quality of reporting, and ensure more transparency on how ETS revenues are spent.

⁵⁵ European Commission, "Report on the functioning of the European carbon market", 2020, https://ec.europa.eu/clima/sites/default/files/news/docs/com_2020_740_en.pdf.

⁵⁶ Fewer allowances were auctioned in 2014 than in 2013 due to the "backloading" of allowances to the end of the trading period, as Commission Regulation (EU) No 1210/2011 stipulated the reduction of the auctioning volume by 400 million allowances in 2014.

⁵⁷ This article replaces article 17 of the 2013 so-called 'MMR regulation' setting up a mechanism for monitoring and reporting greenhouse gas emissions, with the only substantial change that the Commission shall be assisted by a Climate Change Committee composed of Member States when adopting implementing acts.

⁵⁸ Over the past years, the deadline has not always been met, and we had to specifically address requests for compliance concerning reports from Slovenia and Bulgaria several months past the deadline.

⁵⁹ See art. 24 and Annex XIII of the Commission implementing regulation 749/2014 on structure, format, submission processes and review of information reported by Member States pursuant to Regulation 525/2013, 30 June 2014, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014R0749>.

Recommendation 10: Improve the quality of Member States' reporting

Reporting on the use of EU ETS revenues should not be viewed by Member States as a 'tick the box' exercise or an insignificant reporting requirement from Brussels. Spending public funds comes with responsibilities, and it is high time that Member States, but also the European Commission and to a lesser extent the EEA, assume their role. At the very least, the EU ETS revision should revise reporting rules (e.g. by way of amendment to article 19 and Annex VIII to the Governance regulation) to ensure that Member States are deemed to have fulfilled their reporting requirement if the report contains complete, quality and consistent information. The reporting template must also be reviewed and require sufficient information to ascertain whether spending is consistent with the transition to climate neutrality. Activities that do not fall within the definition of 'climate action' should not be able to count as climate spending and hence should not be eligible for funding using EU ETS revenues.

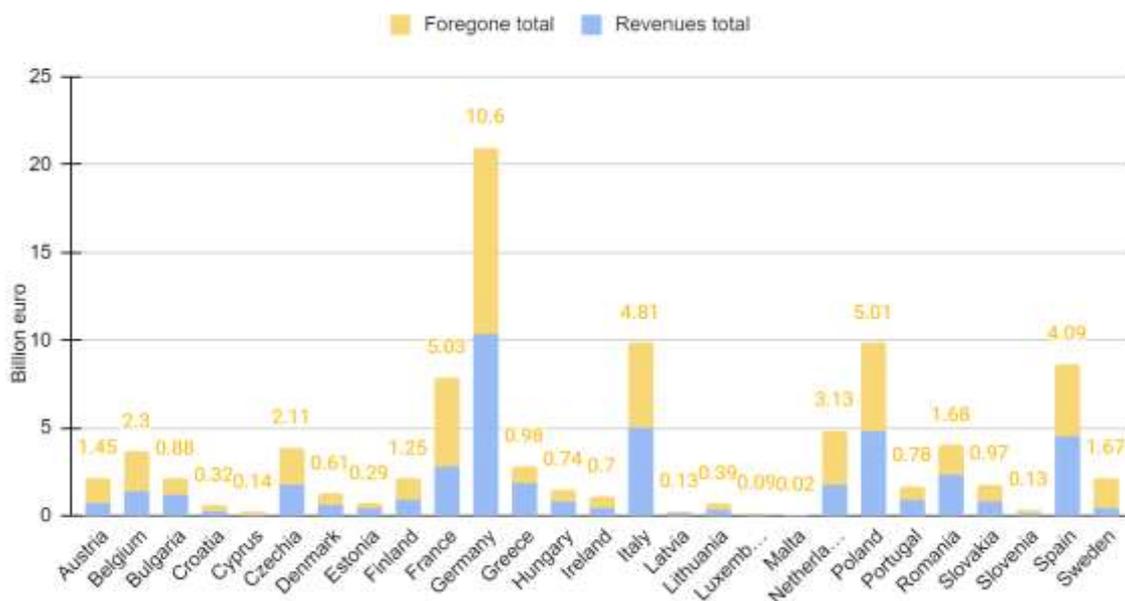
The information provided by Member States in their report must truly account for how ETS revenue was spent. If earmarking is not deemed a viable option for Member States, then another way for improving the quality of information on the use of ETS revenues would be to opt for direct management or channeling of ETS revenues, meaning that EU ETS revenues would be received by the Commission and unlocked through Member States' yearly application for spending the revenue on additional climate action projects, in line with a clean and just transition. The advantages for Member States are that they would no longer need to worry about earmarking and additionality requirements, as the 'reporting' as we know it would be essentially conducted by the European Commission, with Member States submitting information of where the revenue will be used prior to spending the money. This solution would enable the Commission to ground its reports on the use of ETS revenues on solid and quality data, and also to check whether spending is consistent with the categories set by the EU ETS directive, and to request additional details or reject spending which are deemed counterproductive. Member States would retain full decision-making power and accountability for how revenue is spent, but the Commission would guarantee compliance with the spending rules. Without earmarking of ETS revenue or Commission's direct management, transparency and accountability for how ETS revenue are being spent will likely always be lacking.

CONCLUSION

The EU ETS has proved effective for reducing GHG emissions in line with the directive's objectives, although we consider the objectives in question to have been relatively weak. However, our analysis of EU ETS revenues over the past 7 years has revealed deficiencies in the way the EU ETS functions, which should be remedied as we prepare to accelerate our journey towards the transition to climate neutrality. Free allocation is hampering decarbonisation efforts and suppresses the carbon price signal which drives down GHG emissions; it should hence be phased out as of 2023, with a possibility for a CBAM to address the alleged risk of carbon leakage. Revenue raised through the CBAM should be redistributed to those developing countries from whom we expect climate action. Moving to full auctioning of ETS allowances will make the carbon pricing system more effective, but this alone will not suffice to align the EU ETS with our enhanced 2030 climate target. Policy-makers must drastically remove excess ETS allowances from the market and decrease the cap in line with the objectives of the Paris Agreement⁶⁰. International aviation and shipping are not currently subject to any carbon price and extending the ETS to these two sectors will increase decarbonisation efforts. However, the EU must resist the temptation to extend the ETS to road transport and buildings, since it would have little effect on emissions but important and negative repercussions on the most vulnerable.

As ETS revenues are set to increase even further, not least with moving to full auctioning and expanding the ETS to more sectors, it is crucial that Member States spend their revenue in a more effective manner, and in line with a clean and just transition. As the two figures below show, **Member States have forfeited EUR 54 billion revenues between 2013 and 2019 in free allocation, and an additional EUR 13.3 billion of their auctioned revenues was not spent on climate action.** The yellow numbers at the top of the columns in figure 11 represent the total revenues foregone due to free allocation for each Member State between 2013 and 2019.

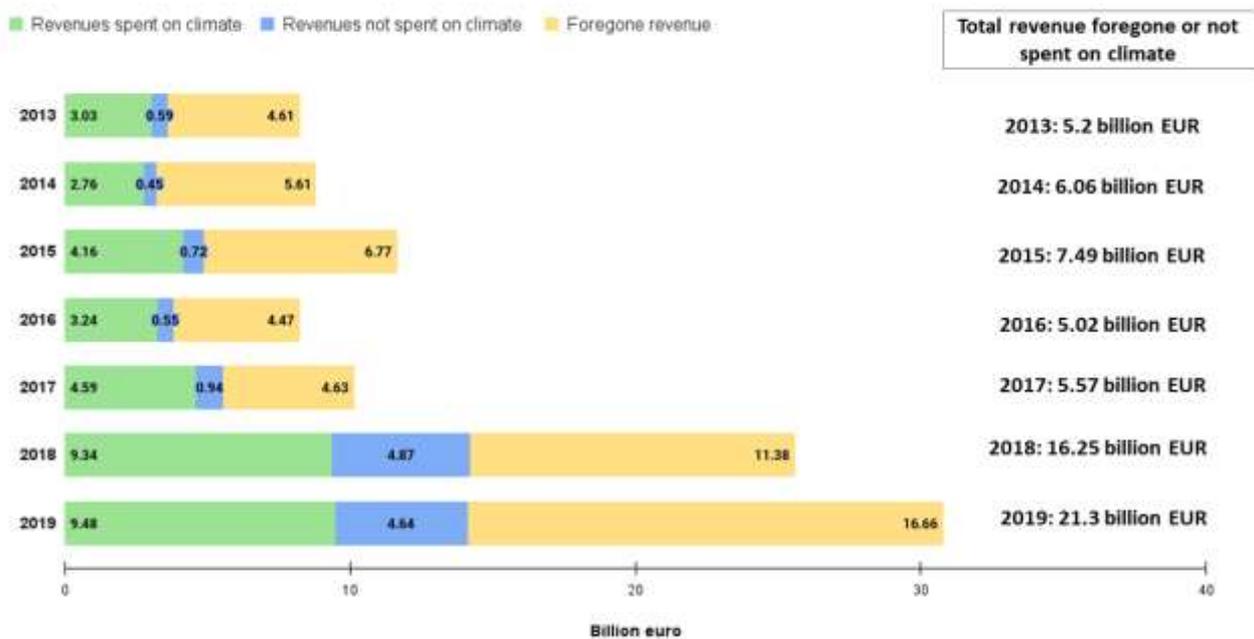
Figure 11: Total auctioning revenue per Member States and foregone revenue due to free allocation (2013-2019)



The yellow numbers at the top of the columns represent the total revenue foregone due to free allocation for each Member State between 2013 and 2019.

⁶⁰ Öko-Institut, "Raising the climate policy ambition of the European Union", *op. cit.*

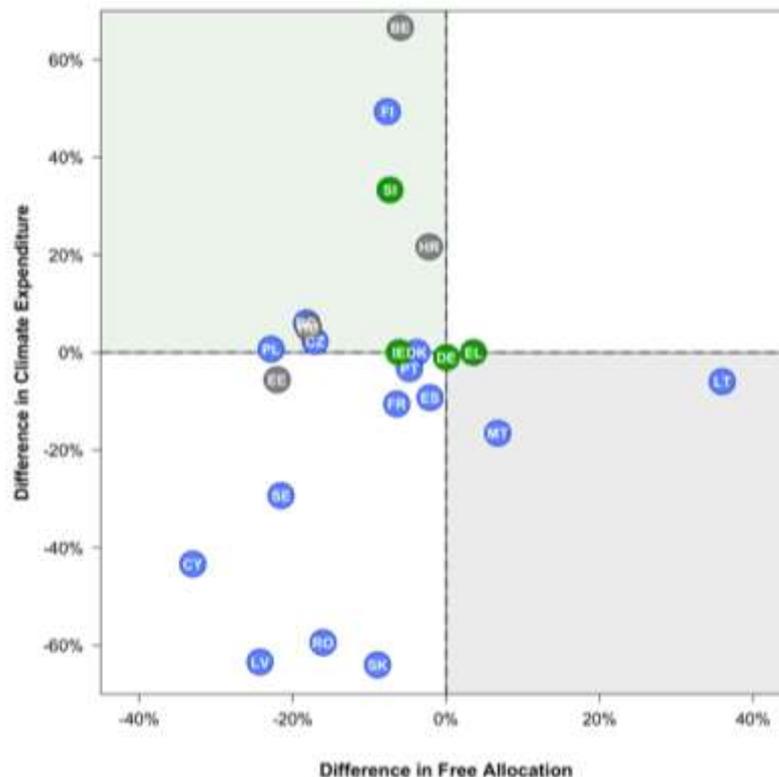
Figure 12: Total auctioning revenues, compared with amount spent on climate and the sum of total auctioning revenues plus revenues foregone via free allocation (2013 - 2019)



The carbon price is not meant to burden EU citizens and economic actors but instead to provide them with the means to embark on a transition to climate neutrality which leaves no one behind. ETS revenues should therefore be entirely redistributed in the transition to climate neutrality. The size of the Modernisation and Innovation funds should be increased as long as green conditions are attached to spending, meaning that fossil fuel investments such as in natural gas and gas transmission infrastructure are excluded. Spending should be aligned with Member States' National Energy and Climate Plans (NECPs) and, if relevant, Territorial Just Transition Plans (TJTPs). Crucially, ETS revenues must be considered additional spending on top of existing national climate spending and never used in substitution to national climate spending. In order to ensure additionality, revenues should be earmarked in Member States' national budgets, or the Commission could manage ETS revenues and unlock them upon Member States' application for specific projects. Finally, Member States currently shy away from their responsibility to provide transparent and accurate reports detailing how they spend ETS revenue. It is crucial to restore accountability and citizens' confidence by ensuring that the revenues are actually invested in fixing the problem it purports to tackle.

Our analysis shows that time alone will not fix the EU ETS and make it fit for 2030. Only a policy intervention can put an end to free allocation and ensure that all Member States spend 100% of ETS revenue in just and meaningful climate action. According to figure 13, most Member States have not managed to significantly reduce free allocation while increasing the share of revenue spent on climate action over the years 2013 to 2019. This shows that stricter rules are needed to increase climate spending under the EU ETS and make it more effective than it has been over the seven year period analysed in this report.

Figure 13: Evolution of Member States' proportion of auction revenue spent on climate, and proportion of free allocation as share of verified emissions (2013 - 2019)



The Member States denoted in green have, on average between 2013 and 2019, over 80% climate spending and less than 43% free allocation. Member States in blue have either over 50% climate spending or below 43% free allocation. Member States in grey are below the 50% climate spending and over 43% free allocation.

The figure above displays over the 2013-2019 period the difference in percentage of auctioning revenue spent on climate-related action for each Member State, and the difference in amount of free allocations (as share of verified emissions). Member States represented at the centre of the figure have overall not changed their behaviour on free allocation or climate expenditure over the seven years. Member States have overall reduced free allocation (left side of the graph) but they have also tended to decrease the proportion of auctioning revenue spent on climate (bottom half of the graph).

We have entered the last crucial decade where we can limit the global temperature increase to 1.5°C and effectively address the climate emergency. The von der Leyen Commission, EU Member States at home and in the Council, and Members of the European Parliament cannot count on the next mandate or legislature to fix the problem. The EU ETS must be made fit for the EU's 2030 target and steer the transition to climate neutrality.

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