Non Paper ETS-1

Response by the Netherlands to the Call for Evidence for:

- an Evaluation and Impact Assessment run in parallel for the Review of the EU ETS for maritime, aviation and stationary installations and of the Market Stability Reserve;
- an Evaluation of the operation of the Innovation Fund;
- an Evaluation of the operating rules of the Modernisation Fund;

The EU ETS is the backbone of the Union's climate policy architecture and has consistently delivered significant emission reduction at low societal costs. To keep the EU climate goals within reach, the ambition of the EU ETS should at least be retained at the current level. The EU ETS price signal should be the main driver of investments in emission reduction across the EU, ensuring a level playing field. Through the incorporation of safeguards against carbon leakage, the instrument has demonstrated that competitiveness and climate action can go hand in hand. Given the above, scope extension should be considered wherever possible. The effectiveness and credibility of the system depends on its environmental integrity. International credits should therefore be kept outside op the system, in order to keep the allowance price stable and foster innovation within the EU**.**

Financial incentives for carbon removals should swiftly be developed and implemented for instance through public procurement, using ETS revenues. At present, integration of permanent carbon removals into the EU ETS could lead to mitigation deterrence and insufficiently stimulates technologies with a lower technology readiness level due to relatively high costs. Given the current stage of development, public procurement could be examined and considered to strike a better balance between stimulating innovation and scale while avoiding mitigation deterrence, for instance through reverse auctions financed by ETS revenues. Dedicated funding per removal technology may prevent counterproductive competition and allow for early development of new methods, while still allowing proven technologies to grow to scale. Auctions-as-a-service should allow Member States to supplement the efforts at the European level. The ETS and/or other instruments could potentially fit the market for carbon removals better at a later stage of development.

Waste incineration should be part of EU ETS from 2028 onwards to enhance the business case for recycling, CCS and BECCS. It is necessary to, as soon as feasible, make the waste sector fit for a circular and net zero economy. With the right incentives, the waste sector has the potential to become net zero or even net negative due to its large share of biogenic emissions. Additional ETS revenues (or an equivalent amount) should at least partly be earmarked to support the sector in realizing this potential. The adoption of municipal waste incineration into the EU ETS should be part of a larger policy package. First of all, evasion via landfills should be reduced and prohibited, e.g. through EU-wide standards or binding targets for member states. Bringing landfills under EU ETS is not a feasible solution. Secondly, the risk of increased export towards third countries with lower environmental standards needs to be managed by stricter regulation. Thirdly, we welcome the intention to assess the risk of oversurrendering in relation to non-permanent CCU and fuels with recycled carbon content in the ETS. It remains paramount however, to ensure the environmental integrity of the ETS and avoid introducing loopholes that could lead to undersurrendering.

CBAM is a durable and effective instrument to reduce the risk of carbon leakage, as free allocation is not sustainable with a gradually decreasing amount of allowances. The CBAM scope should be extended to indirect emissions embedded in the production of all CBAM sectors. This provides effective carbon leakage protection in the context of increasing electrification of industrial processes, while contributing to a level playing field and not facing budgetary constraints as compared to indirect cost compensation.

Free allocation towards sectors that are currently not covered by CBAM, should be targeted towards sectors with the highest risk of carbon leakage. This should be effectuated by removing free allocation for sectors not or minimally at risk for carbon leakage, in any case including district heating which is not liable for carbon leakage.

Beyond 2030 the MSR should continue its vital contribution to a stable and effective EU ETS. For the MSR to effectively balance supply and demand and minimise price volatility, the parameters of the reserve regarding the thresholds, intake and release rates, will need to be

updated reflecting a lower ETS cap. The application of the linear reduction factor to the thresholds would make for a durable adjustment, providing long term clarity to the market in line with the rule-based functioning of the MSR. In addition to balancing supply and demand, the MSR has been essential in mitigating the waterbed effect of additional emission reduction through national policy in ETS sectors. The Commission should allow for the MSR to continue performing this function in the future. Possible adjustments that may further improve the performance, include an increase of the intake rate and a strengthening of the cancellation mechanism.

The Netherlands maintains its support for the assessment of CORSIA in relation to the contribution of international aviation to the climate goals of the Paris Agreement. The Netherlands strongly prefers action at a global level, coordinated with ICAO. However, if action at the global level proves to be insufficient, additional EU policy will be necessary. In its assessment of the effectiveness of reducing CO_2 emissions caused by international aviation through the global system of CORSIA and the possible application of the EU ETS to departing flights to third countries, the European Commission should also consider potential economic and aero-political consequences of a possible accompanying proposal.

In view of the IMO Net Zero Framework and the Paris agreement, possible amendments to EU ETS maritime should be considered in detail in the Impact Assessment, considering potential overlaps and gaps in scope, and assessing benefits and downsides of global and EU systems in parallel. The Netherlands strongly prefers action at a global level to create a level playing field and avoid possibilities of evasion and is therefore encouraged by the recent agreement at the IMO, to be adopted in October. However, should the IMO instruments prove to be insufficient, additional EU policy would still be necessary. To ensure an adequate contribution from the EU to the Paris goals in an efficient and feasible manner, clarity is required on the main regulatory driver or drivers of emission reduction and the energy transition in shipping. Therefore, an assessment of the IMO instrument, ETS-Maritime, FuelEU Maritime and all their various possible combinations, ranging from the IMO instrument only to all instruments together, is of great importance in the upcoming revision. Next to emission reduction goals, other elements to reflect on include simplicity, administrative burden for the sector, financial implications, robustness of the EU ETS system and the timing of the instruments and their combinations.

To lower the risk of evasion and further stimulate climate action in the maritime sector, smaller vessels above 400 GT need to make a contribution equivalent to vessels above 5000 GT. Given that this category of vessels is not covered by the IMO NZF, the assessment should cover the effects of a possible scope extension to FuelEU Maritime and EU ETS Maritime for this category. For any system to function well, monitoring, reporting and verification are essential elements. The Netherlands therefore stresses with great urgency the need to use the review of the MRV regulation for shipping for the necessary improvements, also given the inclusion of offshore per 1 January 2027.

The Innovation Fund functions well, and its focus should remain on the most innovative, cost efficient and climate effective projects in the EU. The Auction-as-a-Service instrument under the fund should also be used for scaling up permanent carbon removal technologies. The announced new financing mechanism as part of the Clean Industrial Deal, referred to as the Industrial Decarbonisation Bank, should not operate at the expense of investments in innovative decarbonisation projects. Within the Innovation Fund, it is important to stimulate a diversity of sectors and activities. Considering that the Innovation Fund is already significantly oversubscribed, possibilities for expansion should be explored, for example through financing from other underutilized EU funds.

The Modernisation Fund should focus exclusively on priority investments. Non-priority investments under the fund can create reliance on fossil fuels. Limiting the scope to priority investments would also simplify the governance of the fund.

The Netherlands support the Commission's intent to revise only the provisions concerning the ETS1, including aviation and maritime, during the next revision of the Directive. The ETS2 is vital for reaching the collective 2030 climate target of the EU as well as national targets of Member States under the ESR. Revising the directive with respect to ETS2 before its full entry into force risks undermining the system's credibility and effectiveness, and by

extension, risks failing 2030 climate targets. To mitigate the risk of excessive prices in the first years of ETS2, various safeguards have been adopted.

Any amendments to these safeguards before the start of ETS2, should only be made through a revision of the MSR decision. A revision to make the ETS2 fit for purpose after 2030, should follow only once the system is in force and experience on its administration and implementation has been collected.