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Changes to the EU ETS

Executive summary

Key points at a glance

- AK is committed to innovative industrial production that meets society's needs and provides good jobs within the EU. It considers this objective compatible with the EU's goal of achieving climate neutrality by 2050.
- The ETS price signal is important; however, it is not sufficient to trigger a far-reaching transformation of the industry at the necessary pace. It has to be complemented by active government intervention. The state (including the EU) plays a central role in planning, coordinating, financing, building and regulating the infrastructure needed for this transition, particularly electricity and hydrogen transmission networks and facilities for transporting and storing CO₂.
- In AK's view, the revenues generated from the auctioning of allowances should primarily be used to fund these cross-cutting infrastructure projects, which are essential to business decarbonisation.
- Reducing the linear reduction factor would increase the number of allowances allocated to industry by around 2.8 billion. However, there is a risk that industry will still not reduce its emissions quickly enough. Moreover, this reduction in the requirements placed on businesses in the EU ETS means correspondingly higher emission reduction targets for the non-ETS sector. This results in a dramatic shift in the burden of reduction from the ETS sector to the non-ETS sector.
- Free allowances are neither an effective nor an efficient means of protecting against carbon leakage (the relocation of businesses due to higher CO₂ costs in the EU). The Carbon Border Adjustment Mechanism (CBAM) is a much more targeted approach. To protect the EU's exporting industries, it should be complemented by an export CBAM.
- In future, the allocation of free allowances is to be made conditional upon the submission and implementation of investment plans. AK supports this provision. In addition, free allowances should be subject to further conditions, such as guarantees regarding the location and employment of staff, skills development plans for employees, and restrictions on profit distribution.
- AK regards the inclusion of certain international aviation sectors in the EU ETS as a welcome step towards fairer accounting of greenhouse gas (GHG) emissions.
- AK opposes including waste incineration in the EU ETS because it plays a key role in reducing pollutant loads and supplying electricity and district heating, while the CO₂ price signal would not have the intended effect.
- From an EU-wide perspective, state aid for emission-reducing measures at ETS installations only has an emission-reducing effect if the corresponding quantity of allowances is cancelled. Otherwise, allowances freed up by the measure will be bought by other operators and used to cover their emissions (the so-called 'waterbed effect'). This is a challenge which, in the view of AK, requires an EU-wide solution.
- AK has repeatedly called for EU-wide uniform rules as regards protection for electricity-intensive industries against 'indirect' carbon leakage. Such uniform rules would prevent Member States from competing through subsidies. The EU ETS revision should be used to establish this common approach.

AK's position

1. Key provisions of the draft

With the European Climate Law, the EU has committed itself to achieving climate neutrality by 2050. The EU Emissions Trading Scheme (EU ETS) is a key pillar of this effort. Following current legislation, emissions from ETS installations are to be reduced to zero by 2040. The remaining emissions – primarily from transport, agriculture and space heating – are to reach net zero by 2050.

It has become increasingly clear in recent times that some industrial companies are struggling to reduce their GHG emissions. To accommodate these businesses, the Commission is proposing a far-reaching overhaul of the EU ETS. The emissions cap will be reduced annually by much less than previously planned. This means that new allowances will be available for ETS installations by 2050. It implies a massive shift in the reduction requirements from the ETS sector to the non-ETS sector (the so-called 'effort sharing' sector) if the target of climate neutrality by 2050 is to be met.

The proposal includes a number of further provisions, such as extending free allowance allocations, requiring investment plans from companies seeking them, stabilising allowance prices through the market stability reserve, including certain segments of international air traffic and waste incineration in the EU ETS, and recognising international credits, as well as a number of other measures. However, in AK's view, the proposed increase in the total volume of allowances through reducing the Linear Reduction Factor (LRF) is, of course, the most far-reaching change and has profound implications for the EU Emissions Trading Scheme.

2. Proposed amendments

Some of AK's demands can be met by amending the Commission's proposal:

- The allocation of free allowances is to be made subject not only to investment plans but also to further conditions (guarantees regarding location and employment, skills development plans for employees, and restrictions on profit distributions) (new Article

10a(3b)).

- Member States should use the revenues generated from the auctioning of allowances primarily to finance the infrastructure necessary for the transition (transmission networks for electricity and hydrogen and facilities for transporting and storing CO₂) (Article 10(3)).
- International credits should not be used to offset emissions under the EU ETS; the new Article 9b is to be deleted.
- The incineration of municipal waste should not be included in the EU ETS (in particular, deletion of the new Articles 12a and 12b).
- Protection against indirect carbon leakage should be harmonised across the EU in order to prevent harmful state-aid competition between Member States. Article 10a(6) should therefore establish a binding, EU-wide framework.

Some issues require a more detailed discussion and an assessment in light of the other changes:

- In AK's view, a balance is needed between the emissions reduction pathway in the ETS sector and that in the non-ETS sector. The massive shift of the burden of emissions reductions from the ETS sector to the non-ETS sector could lead to serious social upheaval.
- If the inclusion of municipal waste incineration into the EU ETS cannot be averted, its inclusion should be made conditional upon the Landfill Directive being implemented and enforced in all Member States in order to prevent the unauthorised landfilling of municipal waste.

AK considers further changes to the EU ETS to be necessary; however, the current proposal does not provide any starting points for such changes:

- Avoiding the 'waterbed effect' in investment subsidies for ETS installations: Where state aid is granted

for investments that reduce emissions from ETS installations, it is essential for its effectiveness that an equivalent quantity of allowances must be withdrawn from the market and cancelled in order to ensure that there is an overall reduction in emissions.

- The Commission has not put forward any proposal as to reimbursing CO2 costs for businesses that export emissions intensive goods manufactured in the EU ('Export-CBAM'). Such a proposal is needed in order to ensure a level playing field for the exporting industry.

3. Industrial transformation - guiding principles for AK

AK supports the goal of EU-wide climate neutrality by 2050. It represents the EU's fair contribution to a global reduction in GHG emissions, in line with the United Nations Framework Convention on Climate Change (UNFCCC) and the Paris Agreement. AK is convinced that this target is compatible with the continued existence of a strong, innovative industry in the EU and in Austria, one that creates high-quality jobs in sufficient numbers and whose production is geared towards the needs of society. Industry relocating to third countries is neither environmentally nor economically desirable and is therefore not a viable option. Industrial production in the EU is compatible with climate neutrality, but requires a far-reaching transformation of many production processes, particularly in the basic materials sector.

Over the past twenty years, the EU ETS has played a significant role in the substantial reduction in greenhouse gas emissions from generating electricity in the EU. By contrast, emissions from the manufacturing sector in the EU remained largely unchanged. This demonstrates that the expectation of a shortage of allowances alone is not a sufficient incentive for industrial businesses to make the long-term investments required for decarbonisation.

Clarity regarding climate and energy policy objectives is a prerequisite for a stable, reliable investment climate for the transition. To this end, it is important that the CO2 price in the EU follows a credible and largely predictable trajectory over the medium and long term. The public sector can support these investments by making it easier for businesses to access investment funding. Moreover, it can take steps to reduce the risk to businesses arising from excessive volatility in the CO2 price.

However, beyond individual company investment, industrial transformation requires infrastructure whose development must be coordinated at a broader

level. This primarily involves transmission networks for electricity and hydrogen, as well as facilities for transporting and storing CO2. The state has a central role to play in planning and coordination, financing, constructing and regulating this infrastructure. Clear state planning and coordination are essential to ensure that the infrastructure is built within the required short timeframe.

Finally, the transformation of European industry towards innovative and decarbonised production also requires instruments that reliably and effectively protect EU companies from carbon leakage (the relocation of production to third countries due to the higher CO2 price in the EU).

The present draft fails to meet several of these requirements. The increase in allowances for the ETS sector by around 2.8 billion tonnes means that the CO2 price will be significantly lower than to be expected under the current reduction pathway. This undermines the credibility of the reduction pathway and makes investments in the transition less economically viable. The weakening of the EU ETS price signal also harms businesses that have, relying on the EU's reduction targets, already invested; conversely, it benefits those who so far have remained inactive.

The resulting shift of the burden of emission reductions to the non-ETS sector means that private households will bear a much larger share of the burden. This could lead to massive financial burdens and corresponding social upheaval for low-income households. For this reason, too, AK regards the shift of reduction obligations from businesses to private households as a major social problem in the medium term.

4. Details of the proposal

4.1. Attenuation of the linear reduction factor

Under current legislation, allowances for stationary installations will cease to be available around 2040. By contrast, the new proposal sets the annual reductions to be significantly lower, meaning that over 300 million tonnes of allowances will still be issued in 2040. The point at which no new allowances are issued will not be reached until around 2048. As a result, the emissions budget for the ETS sector will increase by around 2.8 billion allowances, cumulatively over the period from 2030 to 2050.

This proposal will therefore significantly increase the cumulative volume of allowances in the EU ETS. However, the total emissions budget available until the 2040 climate target and carbon neutrality by 2050 are achieved remains unchanged. Therefore, the non-ETS

sector must, in turn, reduce emissions by an equivalent amount.

According to a Commission estimate, the net emissions budget available to the EU for 2030 to 2050 is approximately 16 billion tonnes (16 Gt CO₂ eq; see SWD(2024) 63 final, Part 5, page 10). The 2.8 billion tonnes that the ETS sector is permitted to emit additionally under the proposal, must be offset by reductions in the non-ETS sector. AK considers shifting responsibility for roughly one-sixth of the emissions budget extremely problematic. The fact that the present proposal places a much greater burden of emissions reduction on private households could lead to massive financial burdens and corresponding social upheaval for low-income households.

This effect is still further exacerbated by the fact that the Commission has tabled a separate proposal to repeal the existing provision whereby allowances are removed from the market stability reserve if their volume exceeds 400 million tonnes. This change, too, will result in higher emissions from the EU ETS sector, which will have to be offset by greater reductions in the non-ETS sector.

As explained above, the ETS price signal alone is not sufficient to trigger transformation within industry. Active government intervention is required. Without a clear transition strategy, firm technology choices, and agreement on socially desirable and beneficial production, the proposed extension for industry is unlikely to achieve net-zero industrial emissions before 2050. It is therefore necessary to set out a reduction pathway in which the state plays a central role in terms of planning and coordination.

4.2. Extension of the allocation of free allowances

Under current legislation, the allocation of free allowances as a safeguard against carbon leakage is to be gradually replaced by the Carbon Border Adjustment Mechanism (CBAM), with no further free allowances being allocated from 2034 onward. The new proposal extends this transition phase to 2038.

Free allowances are a welcome subsidy for businesses, as they are currently not linked to any performance requirements on their part. Nor do they prevent businesses from relocating due to CO₂ costs (so-called 'carbon leakage', CL). AK shares the view that the Carbon Border Adjustment Mechanism (CBAM), which Austria also supported at EU level, is instead the far more effective and targeted measure. This mechanism ensures that imports and EU-produced goods are on an equal footing with respect to CO₂ costs.

AK criticises the proposal for extending free allowance allocations and further delaying the full implementation of an effective, targeted CBAM. However, it welcomes the proposal's introduction of conditions for free allowances, including the submission of 'Invest in EU decarbonisation plans' and the use of funds for decarbonisation measures. It should also be possible to withhold a portion of the free allowances if the investments have not been carried out. According to the proposal, these requirements are to come into force in 2031.

In AK's view, public aid – and the allocation of free allowances is, in effect, a form of such aid – must be subject to conditions that oblige the recipients to provide benefits to the public (conditionalities). The requirement that companies must submit an investment plan is only one part of this. AK believes these requirements should also include guarantees on location and employment, employee skills development plans, and restrictions on profit distributions. In AK's view, employee representatives (works council members) have a key role to play in drawing up these plans. It must therefore be ensured that they are closely involved in drafting the plans from the very outset.

These conditionalities must be applied where companies receive public funding. AK therefore considers it unjustified to exempt companies from these conditionalities, including the requirement to prepare an investment plan.

4.3. Use of auction revenues

Since 2023, Member States have been required to use ETS auction revenue for climate and energy measures; however, according to the Commission's assessment, the contribution to the decarbonisation of industry has been insufficient. Under the present proposal, the use of these funds is to be directed towards more specific decarbonisation projects.

Estimates of the total investment required for the transition vary widely, particularly for the 2050 timeframe. In the impact assessment accompanying the proposal for the 2040 target, the Commission cites a figure of €660 billion per year as the benchmark required for the transformation of the energy system. It should be noted that auction revenues account for only a fraction of this (2025: approx. €43 billion). It must therefore be apparent that, even if auction revenues were used in their entirety to finance the transition, they would not be sufficient to fund it.

Explicit objectives regarding the use of funds seem sensible provided that they trigger investments which individual companies would not otherwise have

made. The auction revenues should therefore be used primarily to finance public infrastructure projects that are essential for the successful transformation of the economy. These include, in particular, electricity transmission grids, pipelines for the transport of hydrogen for industrial uses, and infrastructure for transporting and geologically storing CO₂. The rapid implementation of these projects requires clear planning by the Member States and effective cooperation between Member States at the intergovernmental level.

The transition to a climate-neutral economy can only succeed if it is socially just. Therefore, in addition to infrastructures, ETS revenues must be targeted specifically at socio-ecological transition, for example for skills development and further training programmes, the preservation and creation of good jobs, support for affected workers and regions as well as measures to provide a social safety net during the transition. Only if climate protection and social justice are given equal consideration, can the necessary decarbonisation gain lasting social acceptance.

In AK's view, auction revenues should not fund non-repayable grants to support manufacturing investment unconditionally. The problem of the 'waterbed effect' is the first argument against this (see 4.7). Furthermore, provided there is a sufficient price signal, the manufacturing sector will need to make the investments even without subsidies. Finally, the claim that these funds come from industry and should therefore be spent on it is unconvincing. The majority of auction revenues do not, in fact, come from industrial firms, but from energy companies, which do not receive free allowances. However, it may nevertheless be worthwhile to use government liquidity schemes to help businesses make these investments.

4.4. Recognition of international credits

Under the proposal, part of the higher emissions from the ETS sector is to be 'offset' by an EU facility purchasing international credits amounting to up to 260 million tonnes. It may use the revenues from the auctioning of 260 million allowances for this purpose. ETS companies cannot use these credits themselves to meet their obligations; rather, the mechanism reduces the overall scale of the necessary reductions across the EU. Should the European Commission determine, as part of a planned analysis, that international credits are not available in sufficient quantity or quality, the linear reduction factor (LRF) will be increased from the planned 1.7 per cent to 2.7 per cent from 2036 onwards.

In principle, AK has reservations about international credits, as many studies show that these credits often

fail to deliver on their promises in terms of scale and permanence of greenhouse gas reductions. Whilst the EU's 2030 climate target is to be achieved solely through measures within the EU, it was decided this year that international credits may also be used to meet the EU's 2040 climate target in sectors outside the EU ETS. Under this proposal, the reduction requirements within the EU ETS are being lowered in favour of international credits. The proposal's only merit is that a government body, rather than the companies, would purchase the credits.

4.5. Adding part of international air traffic to the EU-ETS

The Commission proposes that certain international flights are to be included in the EU ETS. To date, only air traffic within the EU (including the EEA) and flights to the UK and Switzerland have been covered by the EU ETS. In future, all flights whose destination airport is no more than 5,000 km from Frankfurt will require ETS allowances for aviation fuel.

AK agrees with the Commission's analysis that CORSIA, the system for offsetting CO₂ emissions from international aviation promoted by the International Civil Aviation Organisation (ICAO), is of limited effectiveness and that it therefore makes sense to introduce more effective measures to limit CO₂ emissions from aviation. In the longer term, the aim should be to extend the EU ETS to cover all international flights departing from the EU.

4.6. Incorporating municipal waste incineration

The Commission proposes that waste incineration should be gradually incorporated into the EU ETS by 2035. This proposal must be rejected on several grounds: waste incineration cannot be compared to the manufacturing industry, as it has no control over the amount of CO₂ produced during the incineration process. This is because that amount depends solely on the composition of the feedstock, which is residual waste. During waste incineration, fossil carbon in the waste - mainly from plastics - is converted into CO₂, leaving no scope for efficiency gains.

Instead, fossil carbon in waste should be addressed at source. This could be achieved, for example, through a system which, similar to ETS II, requires those placing plastics of fossil origin on the market to surrender CO₂ allowances for the emissions resulting from their incineration.

Furthermore, waste incineration plays an important role in reducing pollutant loads. An increase in the cost of waste incineration would heighten the pressure to

dispose of waste in ways that are not in line with sustainable waste management, such as through landfill. This would represent a dramatic step backwards and a burden on future generations.

4.7. Subsidies for emission-reduction measures ETS installations

Under EU state aid law, state aid for investment is deemed compatible with the internal market if it 'results, on balance, in a reduction in greenhouse gas emissions. CISA, paragraph 141 requires: "Projects must deliver overall greenhouse gas emissions reductions. They must not merely result in the displacement of greenhouse gas emissions from the industrial sector concerned to the energy sector or from one industrial site to another." For state aid to effectively reduce emissions from ETS installations, an equivalent quantity of allowances must be withdrawn from the market and cancelled. This is because, within the scope of the EU ETS, it is exclusively the total quantity of allowances that determines the EU's emission level; the aid would therefore merely result in the equivalent quantity of emissions being emitted by another ETS participant. It would thus be ineffective in terms of overall emissions.

This effect is referred to in literature as the 'waterbed effect' (e.g. Rosendahl 2019). It can only be prevented if the equivalent quantity of allowances is permanently withdrawn from the market (cancelled). The market stability reserve does not prevent this effect, as it reacts too slowly to changes in the quantity of allowances on the market. AK therefore proposes an EU-wide solution, i.e. making subsidies for investments aimed at reducing greenhouse gas emissions at ETS installations conditional upon the corresponding quantity of allowances being permanently withdrawn from the market (cancelled).

In this context, the quantity of allowances to be cancelled should be regarded as the total quantity of greenhouse gas emissions avoided as a result of the investment. This quantity must be determined by comparison with the counterfactual scenario (the scenario without the relevant aid). If the investment's lifespan exceeds the current trading period or the period during which a legally binding cap on total emissions is set under the EU ETS, the quantity of emissions avoided must be taken into account at least until the end of that period.

4.8. Protection against indirect carbon leakage (CO₂-costs included in the electricity price)

CO₂ costs in the EU also increase the price of electricity in the EU to a certain extent compared with third countries. For electricity-intensive businesses, this cost can create a competitive disadvantage relative to firms in third countries. Consequently, EU state aid law permits cost compensation for these businesses but leaves the decision on whether to introduce it to the Member States.

AK does not oppose compensation for indirect CO₂ costs in principle but has repeatedly called for a uniform EU-wide approach. Like all subsidies to businesses, it must also serve a clear purpose – in this case, preventing companies from relocating to third countries due to high CO₂ costs within the Union (carbon leakage).

Such a measure must be restricted to those companies facing a genuine risk of relocation. Admittedly, compensating for the CO₂ costs included in the electricity price is not particularly effective. It would be welcome if, in electricity-intensive industries too, compensation for indirect CO₂ costs were replaced by a mechanism similar to the CBAM (carbon border adjustment mechanism under the EU ETS). In any case, this should be implemented uniformly across the EU. This revision provides an opportunity to clarify the relevant provision in Article 10a(6) and to ensure its uniform application across all Member States.

4.9. Export-CBAM

At present, there is an imbalance between imports and exports in respect of aligning CO₂ costs with those in other economic areas. The CBAM levy on imports offsets the price advantage of goods produced in third countries without CO₂ costs over EU goods that incur such costs. Conversely, CO₂ costs are not reimbursed on exports, resulting in a cost disadvantage for EU products on the global market. AK has repeatedly stated that reimbursing CO₂ costs for exports could remedy this situation. This would prevent EU manufacturers serving global markets from being placed at a competitive disadvantage for CO₂-intensive products.



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About us

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The main objectives of the 1991 established AK EUROPA Office in Brussels are the representation of AK vis-à-vis the European Institutions and interest groups, the monitoring of EU policies and to transfer relevant Information from Brussels to Austria, as well as to lobby the in Austria developed expertise and positions of the Austrian Federal Chamber of Labour in Brussels.