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POSITION OF THE LITHUANIAN CONFEDERATION OF INDUSTRIALISTS ON THE EUROPEAN COMMISION'S PROPOSED REVISION OF THE EU EMISSIONS TRADING SYSTEM (EU ETS) AS PART OF THE 'FIT FOR 55' LEGISLATIVE PACKAGE

This document sets out the main principles and concrete policy recommendations to the European Union institutions and national decision makers on the European Commission's proposed revision of the EU Emissions Trading System (EU ETS) as part of the 'Fit for 55' legislative package.

LPK firmly supports a strong EU ETS, which is a key instrument for reducing greenhouse gas (GHG) emissions in the EU and which plays a significant role in achieving EU's long-term ambitious Green Deal targets.

LPK emphasizes that to reach the 2030 greenhouse gas emission reduction targets, the ETS must be as far as possible market-based and economically efficient, ensuring adequate protection against carbon leakage, adequate financing arrangements and favourable investment conditions. It is also very important to take into account existing differences among industry sectors, as well as differences in their capacity to transform, including development and availability of low-emission technologies.

The projected increase in the price of ETS emission allowances should motivate the green transformation, i.e., promote innovation, creation, development, and application of new technologies. At the same time, this projected increase should be sustainable and stable, without compromising competitiveness of EU companies and not causing carbon and investment leakage.

Key elements in more detail:

I. The linear reduction factor (LRF) is a reliable and predictable tool for determining the rate of GHG emission reduction, especially if it is combined with a robust level of carbon leakage protection. At the same time, excessive growth of LRF (sharp reduction in overall emissions threshold) must be avoided: LRF should encourage decarbonization of a part of industries, but too rapid growth would reduce availability of free allowances, would cause a rapid increase in the price of allowances and the cost of production, therefore,

significantly reducing capacity of many companies to invest in research and development, as well as new technologies. This would in turn hamper sustainable and stable transformation, negatively affecting competitiveness.

II. Given the prospects of further recovery of the EU economy after the COVID-19 pandemic and the necessity to ensure the competitiveness of EU industry in the EU and third markets, a decrease in the auctioning share (currently 57%) should be considered when necessary to ensure the availability of freely allocated allowances and to avoid the application of the cross-sectoral correction factor (CSCF).

III. We question whether the European Commission's proposals to limit the Market Stability Reserve (MSR) to 400 million allowances and eliminating all the allowances over this limit will contribute to the stability and resilience of the ETS market and will allow for sustainable development, as well as long-term investment planning to achieve decarbonization goals.

IV. The EU Carbon Border Adjustment Mechanism (CBAM) should be a *complementary* measure to the ETS protection against carbon leakage until CBAM, as a new and untested mechanism, proves its effectiveness, i.e., aligns the CO2 costs of third country producers with the price paid by the EU companies and does not lead to carbon leakage. According to LPK, a decision on the gradual reduction of benchmark-based free allocation to CBAM sectors should be made no earlier than 2030 and only after thorough assessment of effectiveness of this new instrument. After 2030 the pace and intensity of phasing-out of free allowances should be conditional on an assessment of CBAM's effectiveness, situation in the global markets and competitiveness of EU producers in domestic and third markets (this element of the position is further developed in the CBAM chapter (I(ii)).

V. As the annual correction factor for the sectoral and sub-sectoral benchmarks is intended to apply to the whole ETS, *flexibility* in the application of this factor to certain (sub)sectors is necessary to take into account their real economic and technical situations, i.e., development and availability of resources, infrastructure, and technology. According to LPK, the current proposal to increase to 2.5% maximal annual reductions in the benchmarks from 2026 does not acknowledge the problem of applicability of technological advances to certain *production processes*: for modernization of technologies in these processes (e.g., production of ammonia in Lithuania), to reduce GHG emissions while maintaining the same production volumes, currently there are no available technical and commercial methods. This prevents companies from meeting at least the emission limit values set by the benchmarks.

Similarly, there is no sufficiently available infrastructure for 'greening' these technologies. For example, production of green ammonia from green hydrogen requires a great deal of green electricity, but so far there is no developed infrastructure available to all industries. Production of green ammonia by electrolysis is currently commercially available, but only on a very small scale. In order to modernize production and maintain existing production volumes (for example, 1500 t/day), the technical measures currently being tested need to be improved and further developed.

Therefore, according to LPK, when determining the rules for benchmark calculation, it is necessary to consider the graduality of transition to new technologies – a process that depends on development, commercialization, and availability of technologies as well as related externalities such as raw materials or logistics. It is therefore necessary to ensure that the latest new technologies are not included in the benchmarks too quickly, as this would reduce free allocation of allowances to the entire sector, would reduce investment capacity and would not make technologies more accessible.

VI. LPK takes a negative view of the proposal to reduce free allowances by up to 25% in case of non-compliance with energy audit recommendations. Free allocation as a measure is meant to counteract carbon leakage – and the audits mandated by the Energy Efficiency Directive (EED) are distinct policy measures pursuing different aims, and as such the two should not be intertwined (although it is clear that ETS itself motivates investment not only in GHG emissions reduction but also in improving energy efficiency). Linking these measures together would place additional administrative burden on companies and would interfere with the autonomy of their investment decisions. One-size-fits-all approach for different industries is also problematic, given the possible massive variation in the speed and cost of industrial decarbonisation as well as the different potentials for efficiency gains in different industries (as set out in Point V).

VII. LPK firmly believes that it is necessary to ensure that the funds generated from the ETS are as much as possible used directly through the EU Member States for energy, industrial decarbonization and transformation related purposes.

It would be appropriate to further strengthen the Modernization Fund and to actively seek other funding instruments at the EU and Member State level. As it is likely that the allocation from the Modernization Fund may be insufficient for certain industrial sectors seeking to reduce their emissions in order to 'catch up' with their benchmarks, these sectors will need adequate support for investment in new, transition technologies (not yet in breakthrough technologies, dealt by the Innovation Fund).

It would be worth to consider setting up a financing mechanism for low-carbon technologies not only in small and medium-sized enterprises but also in large ones (for which the state aid's *de minimis* mechanism is often not available due to insufficient access to financial assistance).