

eFUEL ALLIANCE – POSITION PAPER

EUROPEAN CARBON PRICING: REVISION OF THE ENERGY TAXATION DIRECTIVE AND THE EMISSIONS TRADING SYSTEM

The Revision of the Energy Taxation Directive (ETD) as well as the Revision of the Emissions Trading System (ETS), presented by the European Commission as part of the Fit for 55-package on July 14th 2021, are the key instruments regulating the CO₂ pricing in the European Union. The eFuel Alliance welcomes their revisions as an important step towards reducing CO₂ emissions and reaching the ambitious European climate goals. However, we believe that certain amendments are necessary to accelerate the transition from fossil fuels to sustainable renewable alternatives:

RECOMMENDATIONS

- ▶ *A harmonised approach should be adopted for the Energy Taxation Directive's ten-year tax exemption for hydrogen and eFuels, which needs to be introduced cross-sectoral, not only for maritime and aviation.*
- ▶ *In order to benefit from small-scale, decentralised hydrogen production in Europe, the free certificate allocation threshold in the ETS for electrolyzers producing green hydrogen needs to be amended from 25 tons to 2.5 tons per day.*
- ▶ *The Commission's proposal to grant a zero-emission factor to biomass for stationary installations and aviation in the ETS needs to be extended to road transport and buildings and other renewable fuels that are in line with the Renewable Energy Directive.*

CREATING A BUSINESS CASE AND LEVEL PLAYING FIELD FOR RENEWABLE FUELS¹ IN THE EUROPEAN TAXATION DIRECTIVE

The eFuel Alliance welcomes the European Commission's long overdue review of the Energy Taxation Directive (ETD), presented as part of the Fit for 55-package on July 14th 2021. Such a reform is urgently needed, as the EU's climate goals and regulations, as well as energy markets and technologies, have evolved significantly since the current directive was adopted in 2003. Although we support the departure from a volume-based taxation, **the eFuel Alliance still prefers a CO₂ basis for the ETD** to the proposed net calorific value based taxation in order to better reflect the CO₂ footprint of energy carriers and to clearly distinguish renewables from fossil fuels. Positive examples of this shift can already be seen today in the national energy taxation systems of countries like Finland, Sweden, and France.

On a positive note, we **strongly support the proposed alignment of tax rates for electricity and motor fuels**. In this way, fair competition and a level-playing field between the various mobility options can be ensured. Every customer can choose the option that suits them best, thus enabling individual climate-friendly mobility for every use. Such technology-neutral legislation is essential to encourage investment in all available options for reducing CO₂ in the transport sector.

The eFuel Alliance also **supports the low minimum tax rates for eFuels and the clear distinction between them and the tax rates for fossil fuels**. Such a distinction in tax rates between renewable and conventional fossil fuels is paramount to achieve a steering effect away from fossil energy carriers, to incentivise large-scale production of renewables, and to accelerate their process of becoming price competitive with their existing fossil counterparts. For example, the German energy taxation does not currently provide a tax exemption for carbon-neutral eFuels and levies the same tax rate of 65 ct/l on both, fossil fuels and eFuels alike. Considering that renewable fuels currently face higher initial investment and production cost, an energy tax exemption would partly compensate for these higher costs per litre. Using the aforementioned example of the German energy taxation, a tax exemption for renewables would lead to a price advantage of 65 ct/l compared to fossil fuels. This would provide both a business case for producers and lower and more competitive prices for environmentally friendly fuel

¹ We count all sustainable and advanced biofuels, recycled carbon fuels, hydrogen and eFuels as renewable fuels.

alternatives for end costumers. In the long term, such a supported market-ramp up creates incentives for investments in the industrial production of renewable fuels, which subsequently leads to a falling price per litre due to economies of scale. Using this major potential economic lever within the ETD to support renewable energy carriers is particularly important, as many hard-to-abate sectors depend on the economic viability and availability of eFuels to meet their sector specific CO₂ emission reduction goals.

ADOPTING A HARMONISED CROSS-SECTORAL APPROACH IN THE EUROPEAN TAXATION DIRECTIVE

The revision of the ETD also offers the opportunity to adopt an EU-wide harmonised approach to the application of tax rates in order to avoid distortions or fragmentation in the EU. Unfortunately, the European Commission has not used this possibility with regard to renewable fuels:

First, although the European Commission's proposal stipulates that Member States shall replicate the ranking of the minimum tax levels for each specific use, national governments can still individually adjust tax rates when implementing the ETD provisions at national level. **We encourage the Member States to apply the minimum tax rates for sustainable and renewable fuels** as proposed by the European Commission and to at least maintain, if not increase, the proposed gap between the tax rates for renewable and fossil fuels. Not only replicating the ranking for the different energy carriers, but above all a sufficiently large ratio between renewable and fossil fuel tax rates is needed to send the right environmental signals. Maintaining the proposed differentiation between fossil and renewable tax rates in national implementations of the ETD has the potential to create a clear steering mechanism and business case for climate-friendly mobility options and would ensure a harmonised application across the EU. This is the only way to give priority to climate protection, and at the same time to grant Member States the right to amend their tax rates individually.

Second, while the eFuel Alliance is supportive of **granting a ten-year zero tax rate for hydrogen and eFuels** in maritime and aviation, it is incomprehensible why the same approach has not been adopted also outside these two sectors. Here, too, we call for a harmonised, cross-sectoral policy: A cross-sectoral ten-year tax break offers the opportunity to create a level playing field for renewable fuels, thus facilitating their uptake, and making a significant contribution to reducing CO₂ emissions and achieving the European climate goals. CO₂ emissions need to be reduced everywhere, regardless of the sector in which they originated, and renewable fuels can contribute significantly to this – if the ETD allows them.

ENABLING LOW-THRESHOLD CONDITIONS FOR GREEN HYDROGEN IN THE EUROPEAN EMISSIONS TRADING SYSTEM

We welcome the revision of the Emissions Trading System as well as its extension to transport and buildings as a technology-open and market-based approach. Emissions trading can be an effective tool for reducing CO₂ emissions in the long-term, incentivising investment in more energy-efficient and climate-neutral alternatives, and thus making the achievement of the EU climate goals more realistic. Especially in the transport sector, a sector with a high willingness to pay, the ETS cap will guarantee that CO₂ emissions will decrease in the long run. This cap and its linear reduction factor can also ensure that climate-neutral mobility will be reached, without limiting the possible fulfilment options as the CO₂ standards for new cars and vans does.

The eFuel Alliance is also strongly in favour of supporting the development towards climate-neutral alternative energy carriers, such as eFuels, under the Innovation Fund. We particularly welcome the inclusion of the road sector as a use case for renewable fuels, given that a cross-sectoral use of renewable fuels is essential to initiate their industrial production and to achieve the necessary economies of scale to make eFuels economically viable for sectors such as aviation and maritime that face global competition.² However, the ETS in its currently proposed form has two major shortcomings, which hamper the uptake of renewable fuels:

Even though the electrolysis of hydrogen would not normally fall under the scope of the ETS, the proposal provides free allocations for the production of hydrogen by electrolyzers instead of hydrogen

² The ETS states that "The Innovation Fund may also support break-through innovative technologies and infrastructure to decarbonise the maritime sector and for the production of low- and zero-carbon fuels in aviation, rail and road transport." COM(2021) 551 final, pp 47f.

produced from natural gas. This sends an important signal for defossilisation, as these free allocations can be sold in order to compensate for higher operating and investment costs in comparison to hydrogen production from fossil fuels. While the eFuel Alliance welcomes this proposal in principle, the **threshold for free allocations for electrolyzers producing green hydrogen needs to be amended**. Unfortunately, the currently proposed limit for free allocation is a daily production capacity of at least 25 tons of hydrogen, which corresponds to an electrolysis capacity of 50 MW, thereby excluding smaller production facilities. Especially in Europe, additional opportunities for decentralised and small-scale energy and hydrogen production thus remain untapped. This limitation should be urgently adjusted: In order to support the ramp-up of green hydrogen also for smaller suppliers and to enable decentralised investment, this threshold should be lowered to a minimum production of 2.5 tonnes of hydrogen per day, which corresponds to an electrolysis capacity of 5 MW.

Also, the current ETS proposal requires further clarification in terms of eFuels: While biomass that meets the sustainability and greenhouse gas reduction criteria of the Renewable Energy Directive³ is assigned a zero-emission factor for stationary installations and aviation, this revision has not been extended to road transport and buildings, nor were renewable fuels such as eFuels included – even though they meet the same requirements of the RED sustainability and GHG criteria. Instead, emission factors from the IPCC Guidelines for National Greenhouse Gas Inventories are to be used for the road sector and buildings. However, the IPCC does not provide a definition for eFuels. Policy makers should be clear and set a zero-emission definition for all renewable fuels in all applications in the ETS. At the same time, this would lead to an alignment of the ETS with the RED and thus further simplification and harmonisation across regulations, for example by using the RED's classification of so called RFNBOs – renewable fuels of non-biological origin. **The eFuel Alliance therefore calls for an emission factor of zero for biomass and RFNBOs that meet the REDII criteria in all ETS sectors**. These sustainable and renewable fuels do not emit additional CO₂ emissions and can contribute significantly to switching away from fossil fuels and reaching the ambitious climate goals – in every sector. Additionally, a preferential treatment of climate-friendly options can provide planning security for companies, which is essential for establishing industrial production and achieving the necessary economies of scale.

Additionally, the question of whether or not allowances need to be surrendered when renewable fuels are produced from captured CO₂ under one of the activities under the ETS is yet to be answered. Here, the Commission proposal is very unclear, with seemingly contradicting phrases in recital 40 and article 15e. Therefore, the implementing act, which is foreseen to specify how to account for emissions of eFuels in order to avoid double counting, needs to be released as soon as possible. Due to long planning horizons in the production of eFuels, knowledge of whether allowances need to be surrendered when producing eFuels or if they can be kept and sold to create a competitive advantage compared to fossil fuels is crucial. **We therefore call on the Commission to publish this Implementing Act as soon as possible to guarantee planning security and provide clarity for producers.**

KEEPING THE ENERGY TRANSITION SOCIALLY JUST AND INDIVIDUAL MOBILITY AFFORDABLE

One of the most important levers to ensure a successful energy transition in the transport sector is to **keep sustainable mobility affordable for everybody** as well as to mitigate any social impacts that the ETD and the ETS might cause. Especially the initial drop in available allowances foreseen in the ETS for transport and buildings will have a big impact on auction prices and thus fuel prices for the end consumer, as it starts with additional 30% of allowances in 2026, which are taken from the available allowances from 2028 to 2030. This negative impact could and should be dampened by a less steep reduction of allowances in the first years of the additional ETS. It is also important to mention that a multiple pricing of CO₂ should be avoided – for example in national and European emissions trading schemes as well as in the form of other taxes or levies like tolls.

With regard to socially just mobility, the eFuel Alliance would like to highlight that introducing a CO₂ tax base in the ETD would allow for a socially just transition while shifting the market share in favour of renewable fuels, since the CO₂ price would rise above the level of the one generated by the ETS without affecting the cost per litre for the end consumer.⁴ One example for the success of this approach is

³ Directive (EU) 2018/2001 on the promotion of the use of energy from renewable sources

⁴ <https://www.mwv.de/wp-content/uploads/2021/01/210112-Website-Position-Von-der-Energiesteuer-zum-CO2-Preis.pdf>

Sweden, which has achieved an impressive share of renewable energy in the transport sector, also thanks to a CO₂ price integrated in the energy taxation.⁵

Since the ETD also offers the possibility of setting separate tax rates for certain sectors, a higher taxation of transport would not impair other sectors such as heating and thus make the energy transition more just and socially acceptable. From a social point of view, therefore, a change in energy taxation proves more effective than an additional ETS. Nonetheless, a combined approach of the two directives is necessary to reach emission reduction targets in the transport sector, while taking social aspects into account at the same time. It is essential to support low-income households in the energy transition and to expand their options for environmentally friendly mobility. The energy transition can only be successful if no one is left behind. The eFuel Alliance therefore strongly supports the proposed allocation of revenue to the Social Transition Fund as well as the Innovation Fund.

ABOUT THE eFUEL ALLIANCE

The eFuel Alliance is a stakeholder initiative committed to promoting the political and social acceptance of eFuels and to securing their regulatory approval. We represent more than 150 companies and associations along the value chain of eFuel production. We stand for fair competition and a level-playing field for all relevant emission reduction solutions. We are clearly committed to more climate protection and aim to win broader recognition of the significant contribution eFuels can make in the drive for sustainability and climate protection. Our goal is to facilitate the industrial production and widespread use of carbon neutral fuels made from renewable energy sources.

⁵ Already today, some Member States make use of a CO₂-based energy taxation, e.g., Finland, Sweden, and France. These models should be assessed also with respect to social impacts and could function as starting point for discussion. See also: https://www.iwkoeln.de/fileadmin/user_upload/Studien/policy_papers/PDF/2019/IW-Policy-Paper_2019_Verkehr_Schweden.pdf