Strengthening the EU ETS

In July 2012, the European Commission is expected to publish its first annual report on the EU's Emissions Trading Scheme (EU ETS), assessing the current functioning of the EU ETS and presenting emergency measures and structural adjustments to strengthen it. Greenpeace and WWF also anticipate that the European Commission will propose an amendment to the Auctioning Regulation[1] in order to review the auction time profile, i.e. an adjustment to the timing and volumes of auctioned emission allowances.

This briefing summarises the findings of a recent report on the functioning of the EU ETS, developed by the Öko-Institut[2] . Furthermore, the briefing puts forward a set of policy recommendations by Greenpeace and WWF for the upcoming first annual EU ETS report and necessary amendments to the Auctioning Regulation.

---

[1] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32011R1210:EN:NOT

[2] Hermann H., Matthes, F. Chr. (2012), *Strengthening the European Union Emissions Trading Scheme and raising climate ambition*, Öko-Insitut, commissioned by WWF and Greenpeace (download).

CURRENT SITUATION

The **lack of adequate emission reduction targets, combined with the economic downturn, has led to a surplus of European Union Allowances** (EUAs), causing significantly falling allowance prices in the EU ETS[3]. Greenpeace and WWF engaged the Öko-Insitut to develop an in-depth analysis assessing the causes of the crunch in the EU ETS, including the size of the surplus.

The main findings of the Öko-Insitut on the current situation include:

- Considering the cumulative surplus of emission allowances of 950 million in 2011, Öko-Insitut projects the **surplus to reach 1.42 billion emission allowances by 2020**. The surplus would undermine the effectiveness of the EU ETS price signal until 2024.
- The main causes of the surplus are the major inflow of external emission reduction credits from the Clean Development Mechanism (CDM) and Joint Implementation (JI) and the long-term impacts of the economic crisis, while support for renewable energy sources had a negligible effect.

The EU ETS, a sinking flagship policy instrument

Greenpeace and WWF are strongly concerned that due to low carbon prices and lack of scarcity of emission allowances in the market, the EU risks locking in high-carbon infrastructure and will fail to support cleaner investments and economic recovery.

OPTIONS TO STRENGTHEN THE EU CARBON MARKET

The Öko-Insitut has assessed **different policy options and combinations thereof to strengthen the EU ETS**. The effect of the measures, both in terms of availability of emission allowances and carbon price has been assessed. The assessed options are:

- A set-aside ("backloading") of 1,400 million allowances. Both an early re-introduction of the allowances in 2017-2020, and a reintroduction of the allowances in 2023-2026 have been assessed.
- A permanent set aside ("retirement") of 1,400 million allowances.
- Adjustment of the linear reduction factor. The current linear reduction factor in article 9 of the EU ETS Directive reduces the amount of allowances in the scheme annually by 1.74%. Öko-Insitut has assessed the effect of adjusting the factor from 2014 onwards to 2.25%, as well as to 2.6% and 3.9% (corresponding respectively to 25% and 30% EU domestic emission reductions by 2020).

In legal terms, the first option, backloading, is conceivable within the scope of amending the Auctioning Regulation by a "comitology" proposal. The other two options require the adoption of an amendment to the EU ETS Directive by the ordinary legal procedure (co-decision) at some point.

[3] Current prices fluctuate around €7 per tonne CO_2

Conclusions from the Öko-Institut analysis:

- A **stand-alone set-aside ("backloading") that is fully reintroduced to the market in 2017-2020 will have no price effect**. The allowance price would remain at a same level of less than €8 per ton in 2013 and approximately €14 per ton in 2020.
- A **set aside with reintroduction of the allowances between 2023 and 2026 will increase prices** to €10.50 per ton in 2013 and to €18.40 per ton in 2020.
- With a **stand-alone increase in the linear reduction factor** to 2.25% (without set aside) the **price effect in 2013 would be very low** (+€1 per ton) and slightly higher in 2020 (+€2 to +€3 per ton).
- A **set aside with reintroduction of allowances between 2023 and 2026 combined with a steeper linear reduction factor of 2.25%, would have a price effect** leading to €12.70 per ton in 2013 and about €31.10 per ton in 2020. The carbon price effects of a long-term set aside and an increase of the linear reduction factor to 2.6% could increase the price in 2013 to €13.40 per ton and to €32 per ton in 2020.

The analysis did not take into account complementary policies. Further adjustments, beyond those outlined above, are required to complement the additional incentive for emission reductions delivered by, for instance, the Energy Efficiency Directive.

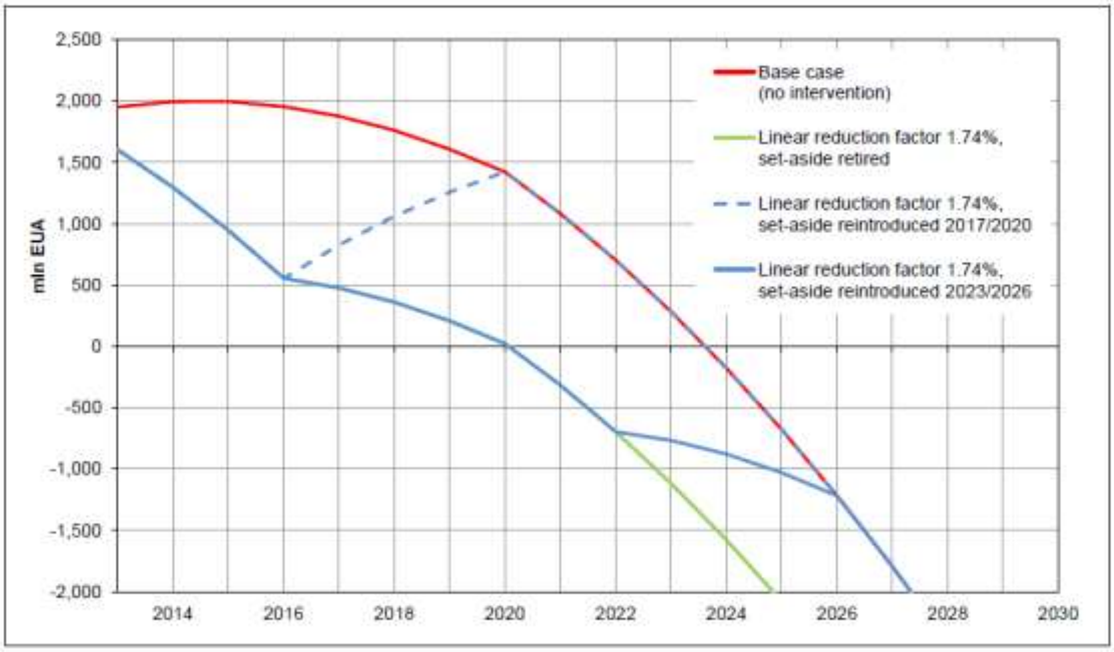

Figure: Overview of intervention options and their impact on the surplus of emission allowances (EUAs). Without intervention the EU's Emissions Trading Scheme (EU ETS) would suffer from a lack of scarcity until 2024. Source: Calculations Öko-Insitut

RECOMMENDATIONS BY GREENPEACE AND WWF

Based on the findings of Öko-Insitut, and exchanges with different stakeholders and businesses impacted by the EU ETS, Greenpeace and WWF urge decision makers to implement the following package of recommendations to strengthen the EU ETS:

- The European Commission's first annual report on the EU ETS should examine **a combination of emergency measures (such as backloading of emission allowances) and structural adjustments (such as a change of the linear reduction factor, and retirement of emission allowances).**

- In an amendment to the Auctioning Regulation, **a postponement to the auctions of at least 1,400 million allowances should be proposed** (additional measures to reward energy savings under the Energy Efficiency Directive or other complementary policies would lead to a higher number). A reintroduction of these allowances in the fourth phase (for instance 2023-2026) is strongly recommended over a reintroduction in the third phase (for instance 2017-2020). However a **full retirement would be the best option**.

- The **long-term supply of emission allowances should be tightened by a significant increase of the linear reduction factor** (as soon as possible). This likely requires an amendment to the EU ETS Directive. An **increase of the linear reduction factor to less than 2.6% will be not consistent with a 25% domestic emission reduction by 2020** required to deliver the cost-efficient pathway to the lower end of the EU's objective of cutting greenhouse gas emissions 80-95% by 2050 compared to 1990 levels[4]. Greenpeace and WWF **support cutting domestic emissions by at least 30% by 2020**.

- **No further possibilities for the use of international emission reduction credits** (CDM and JI) should be introduced.

- The list of sectors exposed to carbon leakage[5] was assessed and agreed on the basis of a carbon price of €30 per ton and did not take into the account the legislation that countries outside Europe are putting in place by 2015. Considering that any backloading or permanent set aside proposed by the Commission will not reduce the amount of free allowances available to installations, and the moderate impact on the carbon price of options for intervention, Greenpeace and WWF call **for a full re-assessment of sectors at risk of carbon leakage as soon as possible.**

For further information:

Sam Van Den Plas,
Policy officer climate & energy
WWF European Policy Office
Tel: +32 (0)2 7400932
E-mail: svandenplas@wwf.eu

Joris den Blanken
EU climate policy director
Greenpeace European Unit
Tel: +32 (0) 2 2741919
E-mail: joris.den.blanken@greenpeace.org

[4] As outlined in the European Commission's Roadmap for moving to a competitive low carbon economy in 2050 : http://europa.eu/rapid/pressReleasesAction.do?reference=IP/11/272

[5] Commission decision of 11 November 2011 as regards the sectors and subsectors which are deemed to be exposed to a significant risk of carbon leakage: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32011D0745:EN:NOT