

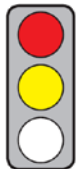
CHANGE OPTIONS FOR THE EU EMISSIONS TRADING SYSTEM

CEP Policy Brief No. 2013-03 of 21 January 2013

KEY ISSUES

Objective of the Report: The Commission proposes "options" for eliminating structurally and sustainably what it perceives as a "supply-demand imbalance" in the EU emissions trading system (ETS).

Parties affected: The entire economy, in particular energy suppliers, industrial companies and airlines.



Pros: The inclusion of further carbon emitting sectors into the ETS strengthens its efficiency enhancing effect.

Contra: (1) A drop in the price of allowances does not justify any structural changes to the ETS.

(2) Raising the reduction target without an international agreement does not ensure any benefits in terms of climate policy.

(3) Statutory price and quantity regulations interfere massively with the ETS market process and therefore should be categorically rejected.

CONTENT

Title

Report COM(2012) 652 of 14 November 2012: **The state of the European carbon market in 2012**

Brief Summary

► Background: EU emissions trading system

- Within the framework of the EU emissions trading system (ETS), the companies of certain sectors may emit greenhouse gas emissions only if they possess the corresponding emission allowances (Art. 12 (2a) and (3) ETS Directive 2003/87/EC; s. [CEP-Dossier](#), p. 12 et sqq.). This has applied
 - since 2005 to certain fixed installations (e.g. for electricity and heat supply, metal production and processing, paper production and the chemical industry) and
 - since 2012 to air traffic.
- As of 2013, emission allowances for fixed installations are to be auctioned, unless they are allocated free of charge (Art. 3d (1–3) and Art. 10 (1) ETS Directive). Emission allowances for air traffic have been auctioned since 2012.
- The procedure and timescale for the auctioning of emission allowances are stipulated in the Commission's Auctioning Ordinance (No. 1031/2010, s. [CEP Policy Brief](#)).
- The EU has committed to reducing its greenhouse gas emissions by 20% by 2020 as compared to 1990 levels (Art. 28 (1) Directive 2009/29/EC). To this end, from 2013 onwards the EU-wide total volume of emission allowances will be reduced annually by 1.74% compared to the average annual total amount for the period 2008–2012 ("linear reduction factor", Art. 9 Directive 2009/29/EC).
- Instead of emission allowances, operators may also use international emission credits acquired in connection with emission reduction measures pursuant to the Kyoto Protocol (Art. 11a and 11b ETS Directive).

► Problems and targets

- Due to the weak economic development of recent years, the demand for emission allowances is much lower than originally expected.
- Between 2008-2011, emission allowances and international emission credits for approx. 8.7 billion tons of CO₂ were faced with actual emissions of approx. 7.8 billion tons, which created an emission allowances "surplus" of 955 million tons of CO₂, which in future may also be used by operators. This surplus consists of
 - surplus emission allowances for 406 million tons CO₂ and
 - surplus international emission credits for 549 million tons CO₂.
- The supply of allowances will increase "in the short term" (p. 5) and international emission credits will "probably increase" even more (p. 5).
- The low demand for and the increasing supply of emission allowances has led to a "marked reduction of prices" (p. 5).

- The Commission has submitted a proposal resolution to amend the ETS Directive (2003/87/EC) and a draft amendment to the Auctioning Ordinance (No. 1031/2010) (s. [CEP Policy Brief](#)). Its aim is to change the schedule for auctions in that 900 million emission allowances
 - are for the time being not auctioned between 2013–2015 (“backloading”) but instead
 - added for auctioning between 2018–2020.
 - However, shifting the timing of auctions does not remove the surplus of emission allowances permanently.
 - In this report, the Commission presents “options” for “tackling” in a sustainable way the growing structural “supply-demand imbalance” that it perceives to exist (p. 7).
 - It wishes to discuss and examine these options with all stakeholders.
- **Option a along with either option b or option c: increasing the reduction target**
- The carbon reduction target for 2020 has been increased from 20% to 30%, compared to 1990 (option a).
 - This is to be achieved by
 - permanently retiring emission allowances in the period 2013–2020, whereby the amount of cost-free allocations and the existing holdings of allowances remain untouched (option b), or
 - in accordance with the stricter reduction target of 30%, by tightening the annual linear factor currently set at 1.74% to a value that is also to apply after 2020 (option c).
- **Option d: Extension of the scope of the EU ETS to other sectors**
- The ETS is to be extended to include fuel consumption and/or other carbon emissions of further sectors (p. 8 et sqq.).
- **Option e: Limit access for European emitters to international credits**
- As of 2021, access to international emission credits will either be ruled out or limited. There can only be flexible access to international credits if there is a “strong and sustained” price increase (p. 9).
 - For according to the Commission, the maximum amount of international emission credits “has turned out to be rather generous and is a major driver for the build-up of the surplus” (p. 9).
- **Option f: Price or quantity regulation**
- The carbon allowance price is regulated for a “fixed period”. This is possible through:
- the introduction of an emission allowance price floor or
 - the establishment of a “price management reserve” consisting of emission allowances. These shall be
 - deposited in the reserve if the price falls below a certain level and would thus “affect the orderly functioning of the market” (p. 10);
 - released from the reserve if the price exceeds a certain level; or
 - retired permanently if the size of the reserve exceeds “a certain magnitude”.

Statement on Subsidiarity by the Commission

The Commission does not address the issue of subsidiarity.

Policy Context

The EU emissions trading system (ETS Directive 2003/87/EC) will gain in relevance as of 2013 due to the changes to the climate package of 2009 (Directive 2009/29/EC, s. [CEP-Dossier](#), p. 11 et sqq., *in German only*): whereas to date each Member State has set its own national ceiling for available allowances, as of 2013 an annual EU-wide total quantity (“EU-Cap”; 2013: 1.926.876.368 allowances per tonne CO₂ equivalent) will be issued, which by 2020 will be gradually decreased by 21% compared to 2005 [Art. 9 ETS Directive; Commission Decision C(2010) 4658]. Therefore, as of the third trading period (2013–2020), the allocation of emission allowances, which in the first two ETS trading periods (2005–2007 und 2008–2012) were carried out by the Member States individually as part of the “national allocation plans” (NAP), will be regulated consistently throughout the EU. The system of cost-free allocation will gradually be converted to auctioning, so that as of 2013 at least 50% and as of 2027 almost all allowances will be auctioned. As an exception, energy-intensive sectors with whom there is a “significant risk” of “carbon leakage” (moving to non-EU-countries for cost reasons) will also receive cost-free emission allowances after 2013 (Art. 10a (12)).

Options for Influencing the Political Process

Leading Directorate General:

DG Climate Protection

ASSESSMENT

Economic Impact Assessment

Ordoliberal Assessment

With ETS the EU has chosen an efficient instrument to reduce greenhouse gas emissions. It defines an overall economic reduction target but leaves it up to the market actors to find out where reductions are possible at the lowest costs.

The allowance price, which is currently lower than politicians expected and does not match the price they wanted, **does not justify any structural changes in the ETS**. Low prices only create low incentives to invest in climate-friendly technologies. However, this does not change the fact that in terms of climate policy the ETS is and remains sound: it ensures that the politically set reduction target is achieved. **The drop in prices is not caused by a dysfunction in the market** but by a drop in emissions.

This in turn is, as the Commission itself admits, on the one hand a result of the poor economic development of recent years and on the other hand of the politically forced development of renewable energies and increases in energy efficiency [Communication on the reduction of greenhouse gas emissions by more than 20% COM(2010) 265, s. [CEP Policy Brief](#); Impact Assessment SEC(2011) 779 on the proposal for an Energy Efficiency Directive COM(2011) 370, p. 29 et sqq., 75 et sqq.; s. [CEP Analysis](#)]. In taking these measures, governments basically decided how carbon emissions were to be avoided and thereby took away a good share of the controlling function of emissions trading. As the Commission has been pushing for politically forced energy efficiency and the development of renewable energies for years, it cannot now assess the resulting price damping effect on emission allowances negatively. Besides, the Commission is ignoring the fact that the drop in emission prices was brought about by substantial additional costs incurred by the inefficient subsidising of renewable energies and energy efficiency measures.

Increasing the carbon reduction target to 30% for as soon as 2020 removes the planning safety essential to investment decisions in the pertaining sectors. Instead the EU should set a climate protection target for 2030 which also takes account of the global environment. For a unilateral strict commitment to reducing greenhouse gas emissions **without the existence of an international agreement cannot ensure any benefits in terms of climate policy**. On the one hand, carbon leakage can be expected; on the other hand, a substantial share of the fossil fuels not used in the EU are not saved globally but simply burnt elsewhere. A fall in the demand for fossil fuels in the EU results in a drop in the world market price for fossil fuels, which in turn creates an increased demand in other parts of the world.

Statutory price and quantity regulations such as a price floor or a price management reserve **undermine the market-based character of ETS**, compromise its functionality **and therefore are to be categorically rejected**. For the price of emission allowances would, as the Commission itself admits, “become primarily a product of administrative and political decisions (...), rather than a result of the interplay of market supply and demand” (p. 10). However, pricing of all things should not be the result of political wishful thinking but should be based on political decision regarding the number of allowances in relation to actual demand behaviour.

Impact on Efficiency and Individual Freedom of Choice

The inclusion of further – ideally all – **carbon emitting sectors into the ETS** and a simultaneous increase in the number of allowances **strengthens its efficiency enhancing effect**. For the more sectors of an economy are included in the ETS the broader is the scope to discover possibilities to realise the cheapest prevention potentials. In particular, including the sectors that use fossil fuels leads to a considerable increase in efficiency. In addition, this would render obsolete existing regulations, such as carbon limits for cars [COM(2012) 393; s. [CEP Policy Brief](#)], which do not ensure the reduction of carbon emissions. A practicable approach to the inclusion of fossil fuel use is “upstream emissions trading”, which operates at the first trading level, i.e. refineries and importers of fossil fuels (see [CEP-Dossier](#), p. 20).

Limiting access to international emission allowances weakens the reliability of future agreements and thus the acceptance of climate policy as a whole. Above all, how emissions are saved is irrelevant for climate policy.

Impact on Growth and Employment

Higher prices for emission allowances make production in Europe more expensive and have a negative impact on growth and employment.

Raising unilaterally the reduction target for the EU also has a negative impact on growth and employment, as companies simply move to countries with a less expensive climate policy without deriving any benefits in terms of climate policy.

By including further sectors in the ETS, existing taxes in these sectors would have to be cut or eliminated in order to avoid any double burdening, which would have a negative impact on growth and employment.

Impact on Europe as a Business Location

Higher prices for emission allowances make the production in Europe more expensive and have a negative impact on Europe as a business location.

Legal Assessment

Competency

Unproblematic. The EU may adopt environmental policy measures to protect the climate (Art. 192 TFEU).

Subsidiarity

Unproblematic.

Proportionality

Currently not assessable.

Compatibility with EU Law

Unproblematic.

Compatibility with German Law

Unproblematic.

Conclusion

A drop in allowance prices does not justify any structural changes in the ETS, as this drop is not caused by a dysfunction in the market. Raising the carbon reduction target to 30% without an international agreement does not ensure any benefits in terms of climate policy, since it simply leads to carbon leakage. Statutory price and quantity regulations undermine the market-based character of ETS and therefore should be categorically rejected. The inclusion of further carbon emitting sectors in the ETS fosters its efficiency enhancing effect.