EU ETS structural measures

A response to the European Commission's consultation
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The Change Partnership was established as an *association sans but lucrative (ASBL)* in 2013 to provide independent thought and organisation of political solutions to advance sustainable development and avert dangerous climate change.

Change Partnership
23 Rue de la Science
1040
Brussels
Belgium

www.changepartnership.org

For further information please contact:

Sanjeev Kumar
sanjeev@changepartnership.org
+32 499 539731

Executive Summary

The Change Partnership welcomes the opportunity to contribute to this important discussion on a key feature of European climate and energy policy. Considerable time has already been spent on debating the many problems that have blighted the EU ETS.

The carbon market is in urgent need for intervention. 30 leading companies and associations recently called on the European Council and Parliament to agree this intervention to pave the way for structural measures to be introduced[1]. It is vitally important for the Commission to start the legislative process as soon as this stakeholder dialogue is completed.

Structural measures should address:

1. **Current problems pre-2020:** A move to the 30% GHG target, cancellation of at least 2 billion allowances and an alignment of the annual linear reduction to meet the 80-95% GHG goals in 2050 are essential first steps. If these are not introduced the EU ETS could become obsolete before 2020;
2. **Post-2020 delivery, certainty and inclusivity:** Dynamic Supply Updating, innovative financing for commercial-scale demonstration and incorporating a Just Transition mechanism to support workers are vital to making the carbon market an important driver for decarbonisation.

The fundamental problem with the EU ETS centres on an inflexible supply which does not respond to demand as one would expect in a conventional market. An over supply of international credits that can be banked across from Phase II (2008-2012) to Phase III (2013-2020) together with the economic recession have caused the current crisis. If there is no intervention the Commission estimates the surplus could reach about 2 billion allowances by 2020[2] which will significantly undermine the relevance of the carbon market in addressing climate change. It is impossible to have complete accuracy of foresight in predicting economic cycles, investments undertaken by governments and the breakthrough technologies. ***Dynamic Supply Updating*** is a means to correct for these unknown unknowns. Annually recalibrating supply with demand ensures scarcity in the market and provides certainty to investors to boost European growth, jobs and competitiveness.

[1] See http://www.alstom.com/press-centre/2013/2/alstom-with-leading-utilities-and-other-industry-urge-eu-policy-makers-to-save-flagship-emissions-trading-scheme/
[2] European Commission SWD(2012) 234 Final'

Competitiveness concerns are the biggest political obstacle to any legislative proposal. Focus must move away from scaremongering on 'leakage' to identifying and encouraging the actual drivers of European competitiveness. Of upmost importance is to alleviate fears that the industrial and fossil-fuel intensive workforce on the upcoming change by ensuring them than no one will be left behind. This element has been missing from the ETS and low-carbon debate but cannot continue any longer. Without detracting needed support for low-carbon technology demonstration and deployment incorporating the '***Just Transition***', a means of supporting workers, their families and communities in the fight against climate change must be a priority area for action.

Overview of the 6 options

Option A: Increasing the EU reduction target to 30% in 2020
Recommendation: Support.

Greenhouse gas emissions continue to increase globally. Although there is considerable movement in key developed and developing countries the pace of action is insufficient to meet the challenge. Turning down the Heat: Why a 4ºC world must be avoided', a report by the World Bank, concluded that "Despite the global community's best intentions to keep global warming below a 2 ºC increase above pre-industrial climate, higher levels of warming are increasingly likely".[3] It confirms that if the Copenhagen Pledges are implemented in full there is a 40% probability of temperature rises exceeding 4ºC with a possibility that this could occur as early as 2070.[4] Emphasis must therefore be on addressing the pace of decarbonisation. The EU, which has successfully led over 20 years of diplomacy on the global fight against climate change can inject this pace and ambition into the global debate moving to the 30% GHG target before this current mandate expires. This option has considerable support from 26 of the 27 governments in the EU[5] as well as over 80 leading global brands[6].

However, as has been mentioned, the surplus of allowances in the EU ETS is far greater than 1.4bn allowances that this option entails. Therefore additional measures will be required to maintain the investment signal from the EU ETS.

Option B: Retiring a number of allowances in Phase III
Recommendation: Support but for a number in the region of 2 billion tonnes of CO_2.

[3] World Bank, 'Turning down the heat: Why a 4ºC world must be avoided'. Washington 2011.Page xiii
[4] Ibid Page 23.
[5] European Council, 7478/12 PRESSE 99 PR13. 2010
http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/envir/128883.pdf
[6] For further information see http://www.theclimategroup.org/eu-30-percent-initiative/

This is an important option and should be coupled with Option A. With the surplus of allowances and credits is estimated to be above of 2 billion by 2020[7] retiring only 900 million which are to be 'backloaded' would not be sufficient. Instead, this option should be seen as a means to top up the 30% GHG decision that would remove 1.4 billion allowances from the EU ETS to address the full scale and the surplus. There are 2 factors that need to be taken into consideration:

- Whose allowances are retired? In the interests of solidarity and growth the allowances of the EU15 should be retired. This could be facilitated through a Commission proposal or through Enhanced Cooperation at Member State level.
- Retire EUAs or CER/ERUs? The burden on retirement on ETS allowances can be elevated somewhat by introducing a multiplier for offsets surrendered for compliance pre-2020 so that more than 1 CER/ERU is the equivalent of 1 tonne of emissions for compliance purposes in the EU ETS.

Options C: Early revision of the annual linear reduction factor
Recommendation: Support.

The current linear reduction factor outlined in Article 9 does not meet the EU's goal of an 80-95% reduction by 2050 and should be adjusted by 2014 to ensure a smoother pace of reduction.

Option D: Extension of the scope of the EUE ETS to other sectors
Verdict: No comment.

Option E: Limit access to international credits
Verdict: Support but for pre-2020 volumes.

International offsets were introduced into the EU ETS as a means of dampening the price of EUAs. They have successfully delivered this objective to the point where the EU ETS is on the verge of collapse again and will remain at low levels for many years to come unless structural measures are introduced. The National Allocation Plans for Phase II (2008-2012) set a cap of 2.08 billion tonnes of CO_2 but allowed CDM and JI credits to come on top of this cap thereby increasing it dramatically.[8] This surplus has a significant impact on current depressed prices. Therefore a restriction on international offset volumes prior to 2020 has to be taken into consideration because:

a) They do not provide additional incentives for developing countries to introduce climate legislation. China's 12th 5 Year Plan introduced a

[7] Various sources: Contributions to the online consultation on backloaading from E3G (estimate 2.1 billion), Sandbag (estimate 2.2 billion), SSE Ltd (estimate 2.6 billion), German Institute for Economic Research, DIW Berlin.
[8] See http://ec.europa.eu/clima/policies/ets/pre2013/nap/index_en.htm

commitment for seven regional pilot emissions trading schemes to be developed. These are expected to be launched later in 2013 with a view to a national emissions trading scheme by 2015. The EU ETS has had considerable positive impact in driving emissions trading in China through international offsetting. The next stage is to explore linkages between the two trading schemes. Conventional CDM/JI hinders this real step forward in the fight against climate change.

b) Quality issues: There are considerable quality issues about CDM credits especially around additionality and the extent to which actual emission reductions take place[9]. This is justification for a multiplier to be used in order to protect deletion of ETS allowances outlined in Options A and B.

In post-2020 targets there is no justification offsetting due to the need for domestic abatement. Therefore, a second, separate international financing and offsetting mechanism should be established which mandates specific sectors and/or technologies to finance emission reductions in least developed countries. This provides a predictable and steady income stream for least developed countries.

Option F: discretionary price management mechanisms
Verdict: Needs further analysis.

Price management through the use of international offsets already exists. If a carbon price floor is to be introduced into the EU ETS the following issues need to be clarified:

- Will this change the legal basis of the EU ETS? The UK government recommended in an annex to Council conclusions in April 2009 "The UK notes that the adoption of the Directive on the sole legal base of Article 175(1) of the Treaty establishing the European Community (TEC) is inappropriate for a measure which contains significant provisions on fiscal policy. In line with observations the UK has made in similar circumstances previously, the UK continues to take the view that where EC legislation includes fiscal measures the legal base should include, either solely or, where appropriate, jointly, one of the Treaty articles dealing with fiscal issues. In this case the UK takes the view that Article 175(2) TEC should have been included as a legal base for the Directive."[10]
- How will the price floor be determined? Price will inevitably be linked, if it is to stimulate action, to the marginal cost of a particular technology such as onshore/offshore wind, coal-to-gas fuel switching or CCS deployment or offshore wind deployment. The other alternative is to constantly change the price level on an annual basis or create an accelerator as is the case with a Carbon Floor Price tax in the UK which increases in a predetermined path from April 2013.

[9] Carbon Market Watch, 'Hydro power projects in the CDM', Brussels 2012.
[10] Council of the European Union 8496/09 ADD 1

- Is it possible to introduce a price floor without agreeing a price ceiling? A ceiling undermines the effectiveness of the market and could limit innovation as well as the overall functioning of the market.

Quantity management and regulation are viable alternatives to price management:

- **Regulatory measures**: An Emission Performance Standard (EPS) based on x% CO_2 per unit of output has many advantages. For example, it is not subject to fluctuations in economic growth. It provides greater certainty to participants, innovators and ensures a level-playing field among competitors. The CO_2 in vehicles regulation[11], which was introduced alongside the EU ETS in 2009 has spurred considerable fuel savings, greenhouse gas abatement and is making the European economy competitive in electric car technology development and deployment. A series of EPS for electricity generation, steel production, cement and chemical products would complement the EU ETS as well as ensuring emission reductions.
- **Dynamic supply updating:** This is the preferred option as it is operationally the easiest and most transparent means of delivering agreed reductions. At the end of compliance year the supply of EUAs is adjusted to remain at or a percentage possibly determined by Article 9 of Directive 29/2009/EC below these verified emissions. Surplus allowances are deleted avoiding the uncertainty that would happen if they were stored away in a registry account.

Incorporating a Just Transition mechanisms within the EU ETS

A Just Transition mechanism is designed to support any employee in an ETS sector. It operates in a manner similar to the NER300. It could also be extended to support families and local communities which are also in at risk when a company closes a plant or facility. This way no worker, family or community is left behind in the move to a low-carbon society.

Design aspects

- A proportion of the total EU ETS allowances are allocated into a Just Transition mechanism.
- In the event of a plant closure, allowances are drawn from the account and used to provide additional support for workers and their families for re-skilling, transferring to a new sector or creating new business adventures.
- Any worker can also access this mechanism for re-skilling, up-skilling or transitioning to another sector.
- The Just Transition Mechanism comes in addition to support that might be given from the European Globalisation Fund and European Social Funds.

[11] EC 443/2009

'Carbon insurance'

This is based on a concept developed by the Australian Workers' Union[12]. In the event of a plant closing down allowances for that compliance year are given to directly to the workers and/or the local community to provide immediate support for skills, new business opportunities as well as adjustments to

Furthermore, ETS allowances given to free to industry are done so on a conditional basis. Conditions include pre-agreed levels of low-carbon investment in the specific plant, employment levels and/or operational hours. This conditionality is already the case for many electricity generating companies that are subject are given free ETS allowances on the basis of conditional modernisation investments[13].

[12] Australian Workers' Union, 'Working to getting the ETS right for Australian industry, exports, investments and jobs' 2008

[13] See Article 10C of Directive 29/2009/EC and subsequent decisions by the Commission on its website http://ec.europa.eu/clima/policies/ets/cap/auctioning/documentation_en.htm#transitional