

EURACOAL Position Paper

on allowance “set aside” under the EU Emissions Trading Scheme (ETS)

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The political climate does not currently favour any amendment to the EU 20-20-20 targets, as demonstrated by votes in Parliament and Council on the adoption of a 30% GHG reduction target. Tightening the EU ETS, for whatever reason and by whatever means, should similarly be seen as politically unacceptable. It would place new burdens on EU industry at a time when the economy is already fragile. Policymakers should be satisfied that the 2020 targets agreed for the ETS will be achieved: economic recovery should not be compromised by imposing new targets or changing ETS rules prior to the scheduled review before 2020 and subsequent decisions by 2025.

EURACOAL opposes any set aside of ETS allowances and urges Parliament to vote against amendments to the Energy Efficiency Directive that propose reductions to the number of allowances issued or the cancellation of allowances in circulation.

Background

In its “Roadmap for moving to a competitive low carbon economy in 2050”,¹ the European Commission refers to the “set aside” of ETS allowances during Phase 3 of the scheme (2013-2020). This, the Commission says, may be necessary to maintain the carbon price incentive even when complementary actions on energy efficiency and renewable energy sources reduce demand for ETS allowances and hence drive down allowance prices.

In June 2011, the Commission proposed a new Energy Efficiency Directive² which aims to achieve the EU’s agreed 20% reduction in energy use by 2020.³ There are concerns that the new efficiency measures will put further downward pressure on an already depressed EU carbon market. Allowance set aside has therefore become a pressing issue in the EU climate and energy debate. Among the many amendments to the Energy Efficiency Directive are a number directed at setting aside ETS allowances from those due to be auctioned during Phase 3 or even cancelling today’s surplus allowances.

¹ COM(2011) 112/4

² COM(2011) 0370

³ saving 368 Mtoe from a projected consumption of 1 842 Mtoe

EU Emissions Trading Scheme

The Commission has set the rules under which allowances will be auctioned when Phase 3 begins in 2013.⁴ Initially, 2,039,152,882 allowances will be issued⁵ and this number will decrease linearly each year by 1.74% of the baseline (*i.e.* 37,435,387 fewer allowances each year), according to Article 9 of the ETS Directive.⁶ The initial baseline of 2,151,459,043 allowances for 2010 was calculated by aggregating the average number of allowances issued during Phase 2 under national allocation plans submitted by Member States.

“Set-Aside” Proposals

In 2010, a Commission Communication on moving beyond a 20% GHG reduction target postulated a 15% or 1.4 billion reduction in the number of Phase 3 allowances.⁷ More recently, on 1 February 2012, a Commission Staff Working Paper⁸ examined how to manage an equitable reduction in the number of auctioned allowances. High-income Member States would reduce the number of allowances they auction by 38%. Low-income Member State governments would benefit because allowance prices would be boosted, but they would not need to reduce the number that they auctioned.

The ETS Directive, “provides for the reductions of GHG emissions to be increased so as to contribute to the levels of reductions that are considered scientifically necessary to avoid dangerous climate change” (Article 1). Some have argued that new scientific information justifies a new decision, amending those that set the number of allowances issued. It is clear to EURACOAL that the scientific information has not changed in any way that could justify such an action that would, in any case, have no perceptible impact at the global level. Moreover, there has been no international agreement that would allow the Commission to move beyond the agreed 20% GHG reduction target and there is no political agreement on further unilateral action.

Nevertheless, the ETS Directive does not prohibit set-aside measures: the auctioning of allowances could be postponed by a Commission Decision under Article 10(1) from the early years of Phase 3 until a later date within the same phase. Cancelling allowances or carrying them over to the next phase would require amendments by legislative process, and would therefore create uncertainty. It could be argued that set aside is necessary to safeguard the efficiency of the scheme, as required under Article 1(5). However, the ETS Directive aims at predictability – see Article 10(4) – so the Commission would have to make timely revisions to the Auctioning Regulation⁹ to ensure that the

⁴ Commission Regulation No. 1031/2010

⁵ Commission Decision 2010/634/EU, since complemented by 2011/149/EU on aviation-sector emissions

⁶ 2003/87/EC as amended by 2009/29/EC

⁷ COM(2010) 265

⁸ SWD(2012) 5

⁹ 1031/2010

ETS continues to be viewed as a credible market-based scheme and not a scheme subject to political interference.

In the European Parliament, the Environment Committee narrowly passed amendments on 20 December 2011 calling for 1.4 billion allowances to be cancelled and for the annual reduction to be increased to 2.25% of the baseline from 2014.¹⁰ On 31 January 2012, compromise amendments to a non-legislative report by the Environment Committee, in response to the Commission's 2050 low-carbon roadmap called for, "recalibrating the ETS before the commencement of the third phase by setting aside a significant number of allowances so as to restore scarcity".¹¹ Similar proposals are now among the 1 810 amendments to the Industry Committee's report on the Energy Efficiency Directive.¹² This Parliamentary report will be subject to a committee vote on 28 February prior to a vote in Plenary on 17 April or 22 May 2012.

Achievement of Targets

Achievement of the EU's 20% GHG reduction target for 2020 can be taken as a given because of a combination of the economic downturn and massive government support for renewable energy sources. There is already a surplus of ETS allowance which reflects this over achievement – estimated to be 1.8 billion allowances. The scheme has proven to be cost-effective and economically efficient, as required by Article 1 of the ETS Directive. Indeed, it has to an extent compensated for the difficult economic situation that the EU now finds itself in by lowering the cost of carbon at a time when any additional cost burden would be unwelcome. Of course, it is possible that 2020 is an unusually cold year or that banked allowances are suddenly surrendered such that an unexpectedly large quantity of fossil fuel is consumed. This is a remote possibility, but does highlight why a target for a single year is not ideal (*c.f.* the Kyoto Protocol five-year commitment period).

The EU has agreed to longer term GHG reduction targets for 2050. After Phase 3 of the ETS, it will be necessary to adapt the linear reduction to the number of emission allowances issued each year so that the ambitious 2050 targets are achieved. A decision on this should be taken as envisaged by Article 9 of the Directive which foresees a review and proposal before the end of Phase 3 in 2020 and a decision by 2025. This future review should not influence the agreed reductions for Phase 3.

Concern has been expressed about the international credibility of the ETS if carbon prices are seen to be very low and thus not acting as an incentive for investment in low-carbon technologies. EURACOAL agrees that the scheme's credibility is at risk. However, the risk comes not from low carbon prices, but from the signs of *ex post* political interference which would discredit the scheme

¹⁰ rapporteur Peter LIESE, EPP, DE

¹¹ rapporteur Chris DAVIES, ALDE, UK

¹² rapporteur Claude TURMES, Verts/ALE, LU

and, more generally, from the Commission's multi-layered climate and energy policy with sometimes conflicting measures and initiatives. The ETS would function well if it were the only measure used to reduce emissions: adding energy efficiency measures and renewables support will naturally weaken the ETS.

Carbon Tax or Carbon Trading?

EURACOAL warns that any interference through the set aside of allowances will discredit the ETS. The scheme will be viewed no longer as an efficient market-based mechanism, but as a scheme subject to political manipulation to achieve *a certain carbon price*, and not a scheme to achieve *an agreed carbon reduction*. If policymakers wish to set a certain carbon price, then the ETS is the wrong structure. Carbon taxation gives a predictable carbon price, but, in the EU, it has already been decided that achieving targets takes priority over price.

Moral Hazards and Corporate Dilemmas

The Commission states that this would be a "one-off intervention". However, it would be impossible to give the market a guarantee that there would be no future interventions. There is an obvious moral hazard that a one-off intervention is repeated by a future Commission.

Many companies have "banked" allowances under Phase 2 with the intention of carrying them over to Phase 3, as allowed under Article 13(2). This creates a dilemma for some companies: should they seek a quick fix to the ETS to improve the value of their "long" positions in ETS allowances, or should they seek a stable ETS that can become the main instrument of EU climate and energy policy in the long term?

A rather clear position is seen from the oil and gas sector which says that the ETS needs tightening to raise carbon prices. Given that oil and gas consumption accounts for two-thirds of CO₂ emissions from fossil fuel consumption in the EU, this is a curious position. It makes sense only when coupled with the knowledge that fuel switching from coal to gas in the power sector is a strategic priority for the oil and gas industry. Carbon pricing encourages such fuel switching and thus the ETS is a very effective natural gas marketing tool.

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