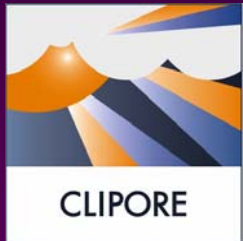




The Centre for European Policy Studies
Thinking Ahead for Europe



The European Climate Platform



Strategic aspects of the EU ETS review

Introduction to the seminar and the Background Report

By

Christian Egenhofer & Lars Zetterberg

Representation of Baden-Württemberg,
Brussels, 5 April 2006



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The European Climate Platform

Established in 2005 to establish a structure to improve interaction between research, policy making and stakeholders within Europe and between Europe and the rest of the world.

An initiative by MISTRA' Climate Policy Research Programme (CLIPORE) and CEPS



The ECP

- **Strong link to the policy processes at national, EU and international level;**
- **Pan-European platform**
- **Broadly representative for Europe**
- **Independence from vested interests**
- **Ambitious, but realistic short-term objectives**

ECP objective: Process Research

Process research: concrete (relevant, realistic, operational) policy recommendations based on Background Papers and Dialogue between policy-makers, researchers and stakeholders

- **Discussions are off-the-record**
- **participants speak in personal capacity**
- **Responsibility lies with ECP and chairs**
- **Transparency**

ETS seminar 5 April

- **Presentation of Background Paper**
- **Informal but structured *discussion***
- **Final ECP Report with policy recommendations**

Proposed procedures after 5 April meeting

- **Draft of ECP report based on Background Papers, seminar discussions and Chairs' conclusions**
- **Circulation of Draft report for comments by early May**
- **Incorporation of comments**
- **Publication (with Disclaimer) at SBSTA in Bonn**



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ECP Background Paper # 3

The EU ETS: Taking stock and looking ahead

by

**Christian Egenhofer, Noriko Fujiwara, Lars Zetterberg and
Markus Ahman, CEPS & IVL**

ETS is still work in progress: too early for final judgement

- **Infrastructure delayed (registries, allocation, ITL)**
- **Market development issues (accounting, VAT, investment services)**
- **CDM slow to develop (CDM Executive Board; implementation of Linking Directive)**

Vicious circle of high gas prices, gas/coal spread, lack of registries and new member state allocation have kept EUA high.

Initial experiences

- **Lack of consistency risk distortions in internal market (e.g. definition of small installations; new entrants, closure and transfer rules; allocation methodologies)**
 - **Allocation rules do not provide investment incentives**
 - **Limits of “grandfathering”?**
-
- **Small installations – drag on system (55% installation under 25K tonnes of CO₂ = 3% of emissions)**
 - **Lack of transparency of National Allocation Plans (NAPs), phase I**
 - **Monitoring & reporting still complex – revisions under way**
 - **Verification parochial**

No doubt that power prices have increased *and* that high power prices affect some industries significantly

- Sectors with low pass-through capacity (**aluminium, cement, some paper and pulp processes, steel** (if China boom falters)) will lose market share or have reduced profits → *analysis shows that moderate increases in production costs has long-term implications for investment patterns*
- Power prices depend on many factors including fuel prices, available generation capacity, euro/dollar exchange rate, investment cost, power imports, weather conditions, heat demand ('must runs'), the flexibility of gas contracts, market expectations and more. → Even the CO₂ pass-through varies by market, load factor and the power market in question (see: Sijm et al 2005; 2006).

There is no perfect solution to address power price issue

- **Addressing the root cause (“alleviation”) will be very difficult as it risks undermining the incentive structure of the ETS and/or power markets**
- **Subsidies (“Compensation”) measures do not address root cause and companies might decide to “take the money and run” → Outcome is uncertain**



Options for including transports in emission trading

EU COM is analysing whether aviation can be included in the EU ETS

Main issue: if transports should be in the same cap as industry

A) under the same cap:

- lower total costs for reaching climate targets
- higher price on allowances, electricity, risks of carbon leakage

B) in separate caps:

- we can protect industry from high prices
- higher costs to reach climate targets

C) hybrids: gateways, tax on transport



Options for including transports in emission trading

Crucial where we place the divider between sectors

- Where we place the divider between sectors will have significant implications on costs to reach climate targets, distribution of these costs, electricity price and carbon leakage risks

“We need to control the growth of the transport sector”

- find solutions that we believe lead to an optimal development of the society

Review issues

- **Streamlining the scheme (predictability & certainty)**
Ideas: stable baseline year, longer allocation periods? Relative targets for industry? Ceiling on allowance price? Other ?
- **Allocation: more harmonisation of allocation rules**
Ideas: benchmarking, auctioning or yet grandfathering?
- **Harmonisation of new entrants rules**
Ideas: EU benchmarks? EU NER default rules? Transfer rules for the internal market?
- **Making the ETS fit for post-2012**
Ideas: ???

Some more (far-reaching) ideas

- Review (incl. reduce) sector coverage to *make* ETS simpler
- Freeze allocation for post-2012 based on 2008-12 allocation minus (commitment factor) and one-off correction factors for burden-sharing and sector differences, and so on...
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- Sectoral approaches for industrial sectors
- Linking with other national and regional emissions trading schemes
- Greening of AAUs (e.g. GIS)