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Is there a need for supply-side management measures in the EU-ETS?

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Passion to Perform

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What is the EU-ETS for?

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- "*This Directive will **encourage the use of more energy- efficient technologies***" (Oct 2003)
- *the Commission assesses the second period plans in a manner which ensures (…)**sufficient scarcity of allowances in the EU ET**, thereby in turn **ensuring that emissions reductions are delivered** and that the emerging carbon market is strengthened*." (Nov 2006)
- "*The Commission mainly requires changes where: (…) the proposed cap is not consistent with the Member State's expected emissions and its **technological potential to reduce** these*" (Mar 2007)
- *« Contributing to transforming Europe into a low greenhouse-gas-emitting economy and creating the right incentives for forward-looking, low-carbon investment decisions by reinforcing **a clear, undistorted and long-term carbon-price signal**." " (Jan 2008)*
- *"The European Council, held on 8-9 March 2007 in Brussels, endorsed these objectives. It also acknowledged the "**central role of emissions trading** in the EU's long-term strategy for reducing greenhouse gas emissions" and underlined that the European Union Emissions Trading System (**EU ETS) is and will remain one of the most important instruments** for the EU's contribution towards achieving the significant emissions reductions which are necessary to meet the strategic objective of limiting the global average temperature increase to not more than 2 degrees C above pre-industrial levels." (Jan 2008)*
- "(…) *ensuring that the **emissions trading system delivers gradual** and predictable **reductions of emissions over time***" (Dec 2008)
- "*As the primary tool to drive emission reductions, the ETS should be the starting point for options for going beyond 20%*" (May 2010)

(Source: European Commission)

The EU-ETS is the spearhead of EU climate policy

=> the objectives that underpin it transcend EU climate targets alone:

(i) reducing EU GHG emissions by at least 20%/1990 levels by 2020

(ii) promoting CCS such that it becomes commercially viable by 2020

(iii) fostering a genuinely global carbon market

Upward Risks to EUAs supply.
Do we need to do something?

Upward risks to our estimates for the supply of EUAs

- **NAP-2 legal cases**
  Ongoing Phase-2 NAPs legal cases that could end up in our worst-case scenario with 110m additional EUAs

- **Aviation**
  Strong opposition from third countries.
  Growing likeliness of the Commission and MSs using the exemption provision that was originally established in article 25a of the Aviation Directive

- **Recession?**
  The risk of a further material deterioration in EU sovereign debt and inter-bank lending markets

- **Energy Efficiency**
  In June the Commission proposed far-reaching measures to allow achieving the 2020 target and floated the idea of setting mandatory targets in the future if insufficient measures are developed by Member States.

=> Downward pressure on prices

The rationale for supply-side measures

Re-establishing the supply-demand balance for Phase 3 of the EU-ETS that it originally envisaged when it published the ETS review

- Unlike other commodities markets, the supply of EUAs is fixed many years in advance

- Make up for emission reductions to come from complementary measures

- Reinforce the carbon-price signal (price trend)

- Reinforce confidence in EU-ETS institutions

- Reinforce predictability: predictability is not necessarily achieved via an arbitrary fixed cap; could be achieved by a certain level of prices long term.

=> Need for supply-side management measures

What could we do?

Main options to support prices

- Reducing the long-term linear reduction factor in the EU-ETS
- Setting a price floor/ceiling for Phase-3 auctions (beyond 2020?)
- Increasing the EU-wide 2020 emission-reduction target (beyond 2020?)
- Setting aside allowances from the pot of allowances to be auctioned in Phase-3
- Creating a carbon Central Bank

The idea of a set-aside

Above and beyond increasing the 2020 EU-wide emission-reduction target, the idea of a set-aside has been floated. However, it might not be the panacea.

- Would it be legally feasible?
- Is a set-aside desirable?

In the end, as far as Phase-3 is concerned, the regulatory lead-time will dictate the tool to be chosen.

Supply-side management measures could also help in redispatching EUAs supply over a given period, thus avoiding today's surplus dampening prices, although the scheme will likely be short EUAs by 2020.

Appendix 1
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Additional Information Available upon Request

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