Meeting Notes- CEPS Carbon Market Forum

Task Force: EU ETS

2nd meeting of the Task Force, July 4th, 2012

Warsaw, Poland

This meeting was hosted by the Polish Ministry of the Environment and was attended by Polish and non-Polish participants from EU Member States, business, environmental NGOs, think tanks, and international multilateral organizations. It was the second in a series of meetings of the "CEPS Carbon Market Forum (CMF) Task Force on "EU Emissions Trading System", chaired by Teresa Ribeira, former Secretary of State for Climate Change for Spain.

This Task Force will focus initially on building consensus on the type of issues facing the ETS in the broader sense, and try to understand, among other things, if short term fixes, which are necessary, are also sufficient to address the issues that continue to emerge in the carbon markets in the EU.

The forthcoming report of the CEPS Task Force on ETS Price (Draft Executive Summary) serves as a document informing this debate of the short-term fixes that are possible.

Following the future issuance by DG Clima of the market report and the accompanying expected proposals to address market issues, it is the intention of the CMF to design a process that will address any short term, as well as long term, more structural type of proposals, that will be put forward by the EC.

The meeting was divided into three segments that were designed to address the following important issues (annotated agenda attached)

- EU Climate policy and the EU ETS, with focus on objectives, instruments, achievements and challenges
- EU climate change policy and the ETS in the wider context, with focus on consistency of short and long-term EU climate change targets and objectives, as well as looking beyond the carbon price to targeted policies to accompany the ETS
- What is the debate needed to move the EU ETS forward, looking at issues such as energy policy for Poland, low-carbon development strategies under low carbon prices, the role of an international climate change agreement, etc.

A number of issues emerged during the presentations and the discussions that followed, which point to general agreement among participants in some areas, with divergent views on other topics. The summary presented below represents views expressed by the participants as captured by the Rapporteurs, but are not meant to represent consensus or support for those views.

- The EU ETS has been designed to be the cornerstone of the EU climate programme and has generally responded to market conditions, especially as they relate to economic conditions. The EU ETS has
    - Set a CO2 price
    - Been a pioneer in carbon markets
    - Provided a foundation for international carbon markets
    - Been seen as having been cost effective[1], at least in the short term, i.e. until 2020.
- The EU ETS is long, likely until 2020-2022, due to economic conditions, but not exclusively. Other factors that were seen as playing a role included a high volume of international credits, as well as overlapping EU policies on renewables and energy efficiency. An economic high growth scenario of about 4.3% per year was seen as needed in order to eliminate this surplus by 2020, without any outside intervention.
- Low EU ETS prices were seen as a logical consequence of these conditions, but they could result in a series of "risks" notably
    - Adoption of other and additional measures,
    - Marginalization and possible loss of credibility of ETS,
    - Insufficient drive for low-carbon investments

  This will blur the EU-wide carbon price signal, doing away with an undistorted carbon price across the EU internal market and thereby making EU climate change policy more costly *by design*.
- In addition, a low level of carbon price is seen as providing insufficient incentive to drive investment towards low-carbon technologies. Furthermore, the current low price level contributes to making carbon finance at project level difficult. At the same time, it was acknowledged that the lack of investment in the energy sector that can currently be witnessed is not only related to carbon price, but to many more economic factors such as product demand, energy prices, uncertainties relating to the energy transition in general and the NIMBY phenomenon.
- Many contributors reiterated the tension that arises from a common 'carbon policy' and a nationally-oriented energy policy, raising the question on approaches and mechanisms to better coordinate the two.

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[1] i.e. "to promote reductions in cost-effective and economically efficient manner" (Art. 1 of the ETS Directive)

- Carbon price signal seen as critical, but in the absence of a single EU energy policy, detaching the price of carbon from the overall economic situation is almost impossible.
- The EU ETS was seen as having deviated from its original mandate to optimize efforts i.e. minimize costs, to one where it maximizes profits ("rent seeking") for certain activities that would otherwise not be competitive such as supporting innovative but unprofitable technologies. Several contributors criticised complexity and rent seeking, which undermine the cost-effectiveness principle.
- One of the challenges that the ETS has exhibited is its perceived or real lack flexibility, notably as to supply. This rigidity has prevented it from adapting to changing economic conditions.
- The ETS can be seen as a young market whose well functioning, including liquidity, can be challenged. Discussions have brought out that different uses were made of the term "liquidity" (in this case oversupply), clearly outside the more customary use of the word in a market context (ability to get in and out of a market, a tight spread, many players present, etc.)
- The EU climate change program and the ETS were designed under conditions that are at great variance in 2012, compared with what we had in 2008:
    - Low economic growth for the last years
    - No global climate agreement
    - Minimum following in other ETS around the world
    - Low carbon price
    - EU falling behind in green technology race
- From a Polish perspective the importance of (low) energy, notably power, prices was stressed several times. The level of prices in Poland and other Central and Eastern European EU member states are more critical because of significantly lower (disposable) incomes of households and – despite huge energy efficiency improvement in the past – the relative energy inefficiency of the economy.
- Poland has made great strides in dealing with climate change but it must be recognized that Member States have different circumstances, starting with fuel mix, which for Poland has high-coal content. It was pointed out that Germany had a similarly high-coal content when it stared to move off coal, and has the ambition to change its energy mix totally in next decades.
- Poland, and Polish companies, has achieved success in innovation as well as in decoupling the economy from GHG intensity. Lower intensity came from restructuring, as well as an increase in energy efficiency, but, where, as in Germany, much more can be done.

- The ETS was seen as facing challenges in the short term (ST) and Long Term (LT), but there were different views of the diagnostic, causes and remedy.

- The current low prices were perceived, by some, as creating the risks listed above, while others felt that the ETS was meeting its stated environmental objective, and that no other objective was justified.

- A simple intervention in the ETS in the form of back loading, with or without a set aside, was deemed as politically necessary, by some. Others saw it as an ad hoc intervention in the market, one that would only lead to further interventions down the road, raising regulatory risk, and discrediting the ETS.

- ETS was seen as an important instrument, but one that need to be surrounded by a broader policy package notably including a technology and innovation compact. The debate was inclusive of whether technology or innovation policies are needed in addition to R&D Framework Programmes, SET-Plan, NER 300 etc. are needed or whether one should first concentrate on making those work, notably ensure appropriate funding under the EU Multiannual Financial Framework (MFF). A single carbon price in a EU carbon market cannot exist without a well functioning energy market.

- A single energy market, with the appropriate infrastructure, including transmission corridors, were seen as critical to growth and creating the condition for investment, which in turn would also allow the return to the basic assumption of high growth behind the EU ETS.

- Fixing the short term ETS price signal should not be confused with fixing the market or the ETS. A longer-term intervention should be envisaged. Some saw a ST intervention as necessary, but not sufficient. Such longer term intervention should consider some of the following elements/conditions

    - Provide flexibility to the ETS to easily respond to future deviations from the parameters of the ETS design, such as economic conditions or supply of international credits. Some argued that there are too many factors influencing the short-term ETS price for a one off intervention to fix the problem.

    - Any comprehensive changes must ensure that the ETS is aligned with the international process.

    - Long term climate change and energy policy with 2030 targets

    - Allow for measures to compensate for increase in electricity prices and address leakage; in this context fuel-specific benchmarks were mentioned

    - Ensure coherence among the different EU level policies on climate change, energy efficiency and renewables

- Consider economic growth as one of the key parameters in the ETS; there was a sense of feeling that climate change policy either will need to become a driver for economic growth ("e.g. green growth") or at least will require the return of growth.
- KP arrangements must be recognized under the EU ETS and AAU value must be accounted for.
- Climate policy and ETS must be aligned with energy policy and R&D policy
- The discussion needs to include the type of tools that need to be deployed both in the EU and globally – GHG reductions is not an outcome to be achieved in isolation, but together with energy security and competitiveness. ETS provides a price signal for reaching mitigation targets but other instruments are needed for other goals that EU and MS have, and need to be tailored to MS situation.
- Creation of a EU wide energy transportation network and single energy market

The next meeting of the Task Force on New Market Mechanism will is scheduled for Fall 2012 in Berlin in cooperation with the Government if Germany. We anticipate issuing a work full work program in anticipation for that meeting, following the issuance of the proposals by the EC. The WP will be discussed on that occasion.

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