EU ETS

Market Stability Reserve Options

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Objectives?
What are we trying to achieve?

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  Ensure good market functioning
  - Ensure good price discovery – i.e. price to 2050
  - Ensure price stability
  - Provide for the lack of market flexibility on the supply side
  - Recognize changes in design parameters of the ETS
  - Allows to distinguish between “good” and “bad” changes in demand & market liquidity
What is the problem we are solving?

What are the symptoms and what is cause?
*Root cause is a market imperfection from the way this regulatory market was designed*

What is the imperfection?
*Lack of flexibility on the supply side of the market resulting in changes in liquidity*
Supply side variability

What can cause departure in liquidity from design parameters?

- Lower economic performance
- Overlap with other policies
- Technological changes
- Mitigation of carbon leakage risk

Cyclical vs. Structural

Can we differentiate between causes (cyclical vs. structural)?

In the short term – no
In the long term – yes
Market Stability Reserve – in context

EU ETS – in need of structural changes. What is the package?
• Supply side flexibility - MSR
• Carbon leakage post 2020.
• Change in slope
• 2030 cap
• How to treat back loaded amount
Main Question to be answered

- Is the MSR needed? Why?
- What are the main principles?
- What does it do?
- How does it interact with other elements of EU ETS restructuring?
- When does it start?
Main Questions to be answered

Is the MSR needed? Why?

- To address liquidity imbalances caused by
  - Significant cyclical economic shocks
  - Supply side inflexibility

What are the main principles?

- Work with market forces – ensure good market functioning
- Consistency – not one off
- Transparency – easy to understand
- Flexibility – able to respond to unforeseen conditions
- Resilience – work with long and short conditions
Main Questions to be answered

**What does it do?**

- Captures changes in liquidity beyond what is deemed to be “good market functioning”
- It cannot distinguish between different types of liquidity variations in the ST
- In the ST it acts (absorbs) ALL liquidity variations
- It needs a mechanism to permanently discard what is structural, if needed
- It needs to bring back liquidity to the “good market functioning” level
- Can it do it in one step – or does it need multiple steps?
Main Questions to be answered

How does it interact with other elements of EU ETS restructuring?

• It interacts with anything that impacts liquidity
  – Follow up to back loading
  – Carbon leakage risk mitigation measures
  – Article 29a of the EU ETS Directive
  – Domestic offsets

• MSR and ASR (Ecofys proposal) both respond to economic changes in economic cycle

• Adjustments from CL risk mitigation and MSR act in the same direction

• Timing is critical for interaction
Main Questions to be answered

When does it start? Advantages and disadvantages of starting in P3 vs. P4

• Is the MSR good functioning dependent of other elements of the EU ETS restructuring package?

• What are the issues for consideration
  – Technical
  – Political
MSR Scenarios

Scenario 1

• *Start MSR in 2020*

• *Maintain current parameters (for removal& insertion)*

• *Put all BL in MSR in 2020 when it starts*
  a. Without nothing inserted in 2018/2019
  b. With as is in 2018/2019

• Risk another slump at end of P3

• Another one off intervention
MSR Scenarios

Scenario 2

• *Start MSR in 2016*
• *Maintain current parameters (for removal & insertion)*
• *Put all BL in MSR in 2020 when it starts*
• *Another one off intervention*
MSR Scenarios

Scenario 3

- *Start in 2016*
- *Change parameters to remove & insert to the bandwidth*
- *Creates consistency*
- *Interferes with P3*

Scenario 4

- *Start in 2020*
- *Change parameters to remove and insert to bandwidth*
- *Creates consistency*
- *Price uncertainty 2018/2018*
MSR Scenarios

Scenario 5

- **Start the earliest of**
  - a. 2016/2017 OR
  - b. Post 2020 CL provisions

- Change parameters to remove & insert to the bandwidth
- Creates consistency
- Interferes with P3
Thank you for your attention

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