

EU ETS

Market Stability Reserve

Options

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Objectives ?

What are we trying to achieve?

- Objectives?
 - 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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