

Task Force: EU ETS Market Stability Reserve
Understanding the Commission Proposal and its impacts
10 April 2014, Brussels

Market Stability Reserve and interrelationship with other policies

A large red arrow pointing to the right, containing the text 'Stringency of allowances'.

**Stringency
of
allowances**

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Have we already asked the relevant questions?

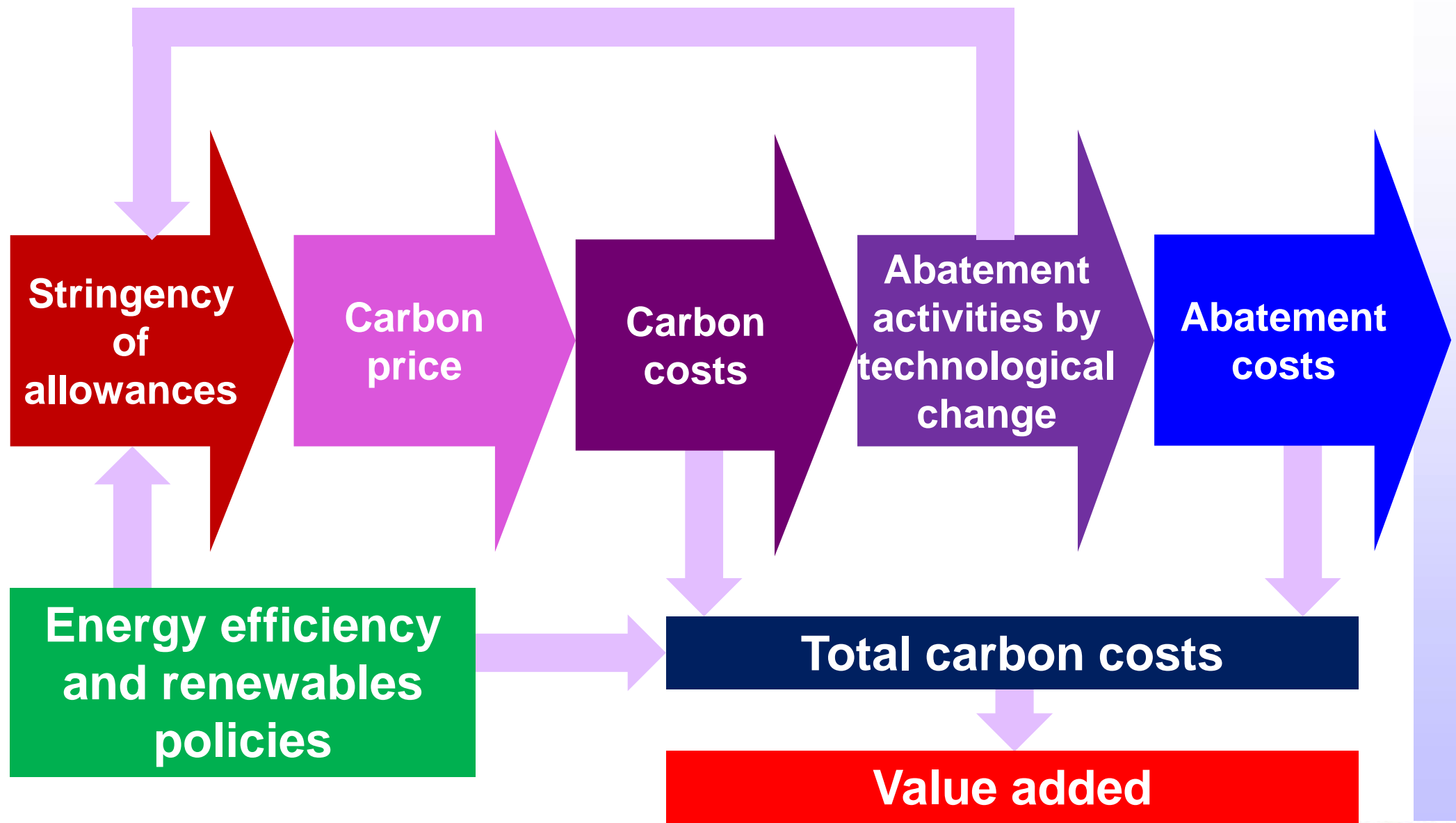
- **Do we have a conceptual framework for the proposed Market Stability Reserve (MSR) mechanism?**
- **Are there alternatives to the MSR of the Proposal?**
- **(How can a market stabilisation mechanism be embedded into a structural reform of EU ETS?)**

**Proposal of the European Commission
COM(2014) 20**

**Do we have already a conceptual framework
for analysing the impacts of the
proposed MSR mechanism?**



A conceptual framework for the basic interactions

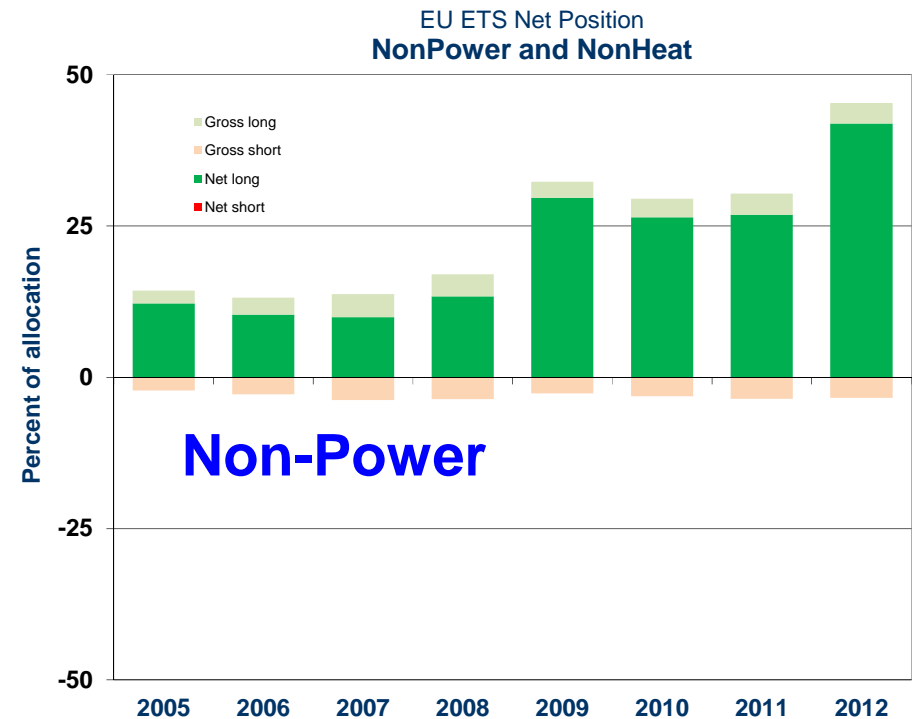
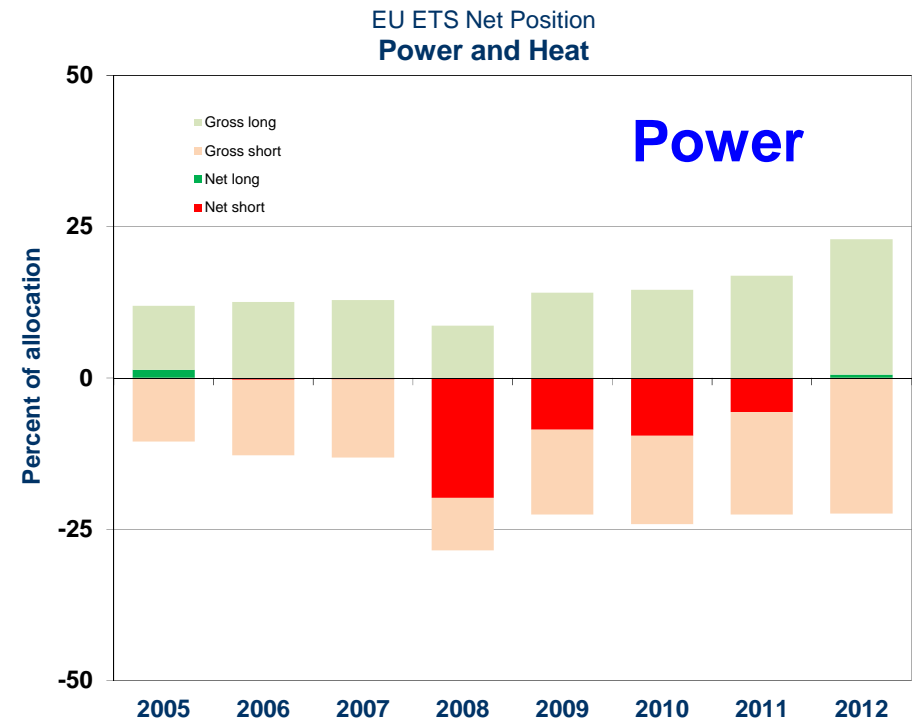
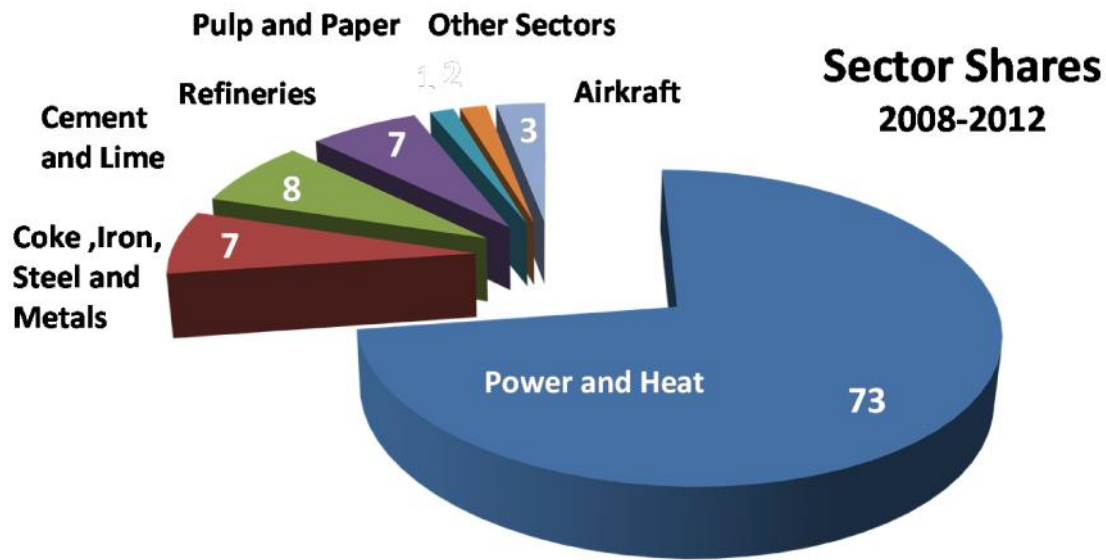


**Stringency
of
allowances**

Stringency
is a measure of physical scarcity
of allowances

- **Stringency is relevant on all levels of EU ETS**
 - **Installations, sectors, Member States, total market**
- **Operational measure for stringency**
 - **(Relative) Net position =
(allocated allowances - actual emissions) / allocated allowances**

Stringency by sectors



Maintaining a (long-term) stringency target is the main purpose of a market stability mechanism

- This motivation serves both the interests of installations and the targets of climate policy
- But this is not obvious in the Proposal
 - “could help address the current imbalances ”
- The main issues for designing a market stability mechanism
 - (1) Agreeing on a stringency target path
 - (2) Adding a (flexible supply) mechanism for maintaining this stringency target path



Carbon
price

Carbon price
reflects not only the stringency of the
EU ETS but also the behaviour of actors
on the financial markets

- We do not sufficiently understand the impact of changes in the stringency on the carbon price
- We understand even less the reactions of the financial markets

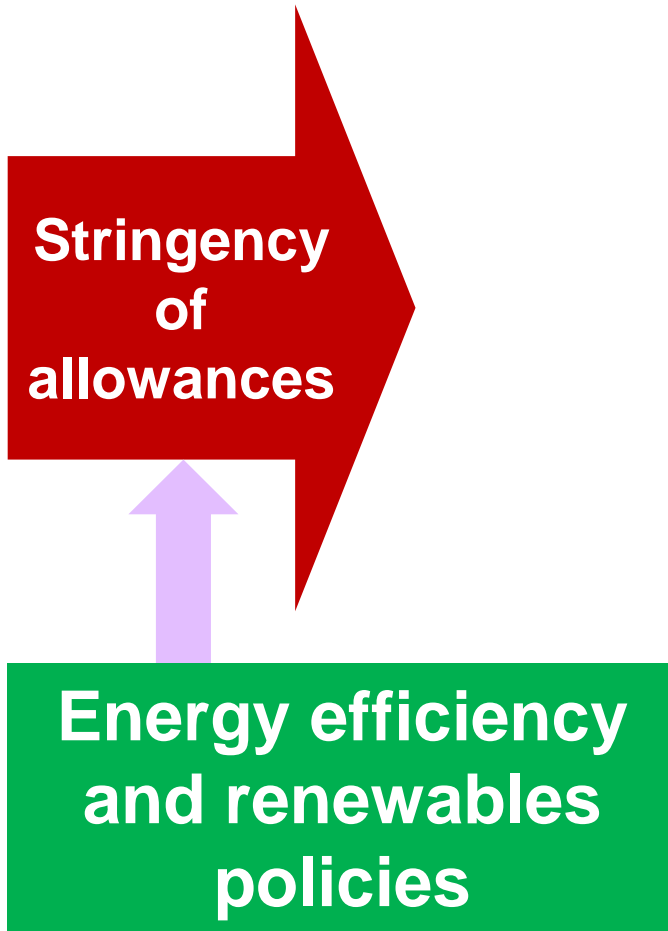
**Stringency
of
allowances**

**Carbon
price**

**Carbon
costs**

**Carbon costs
result both from the
stringency and the
carbon price**

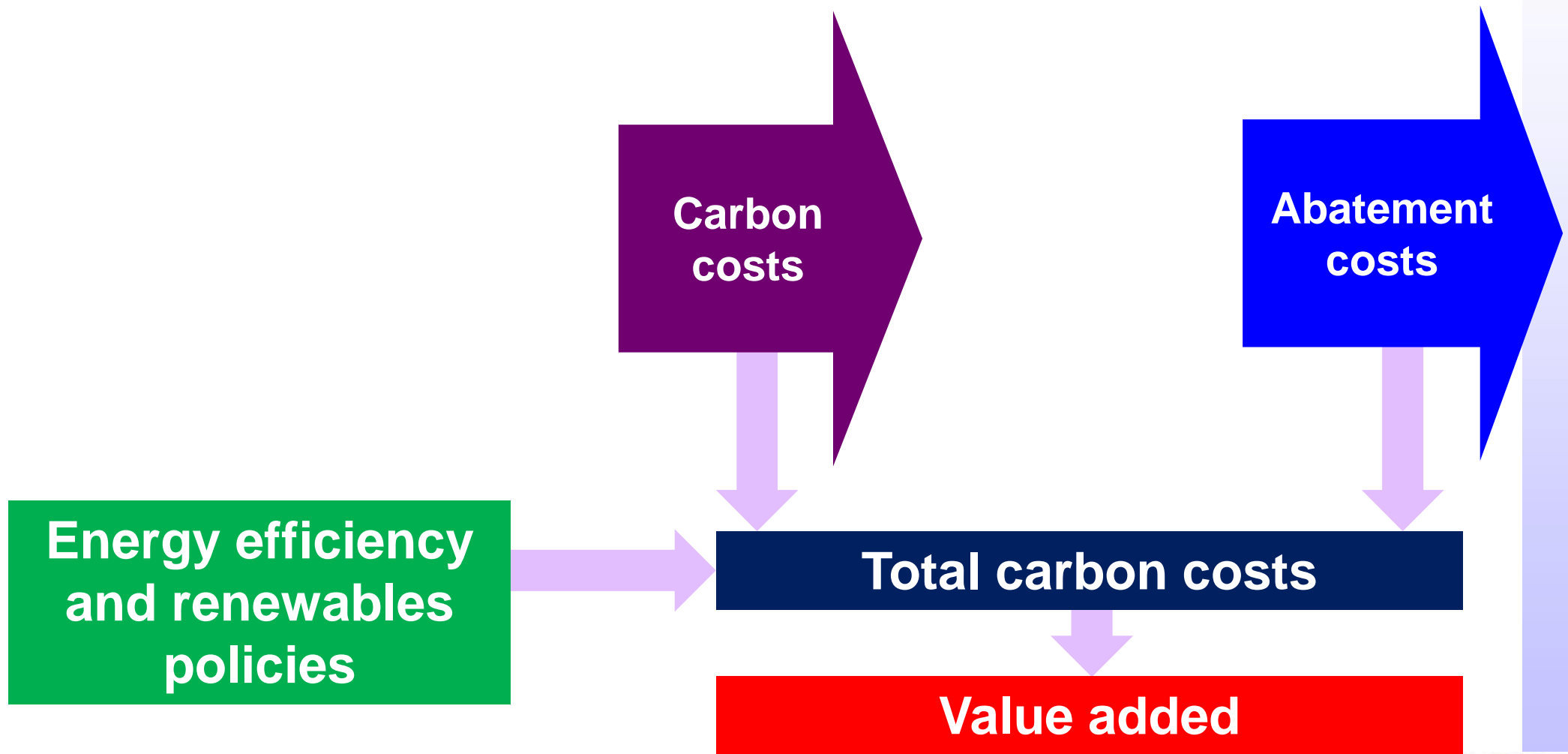
Energy efficiency and renewables policies lower – if successful – the stringency



- There may be, however, perverse market reactions
 - The case of Germany:
Renewables induce switch from gas to coal in a merit order market design

Cost impacts

from carbon, abatement, efficiency, and renewables



**Are there alternatives to the
Market Stability Reserve mechanism
of the Proposal?**



Deficiencies of the MSR mechanism of the Proposal

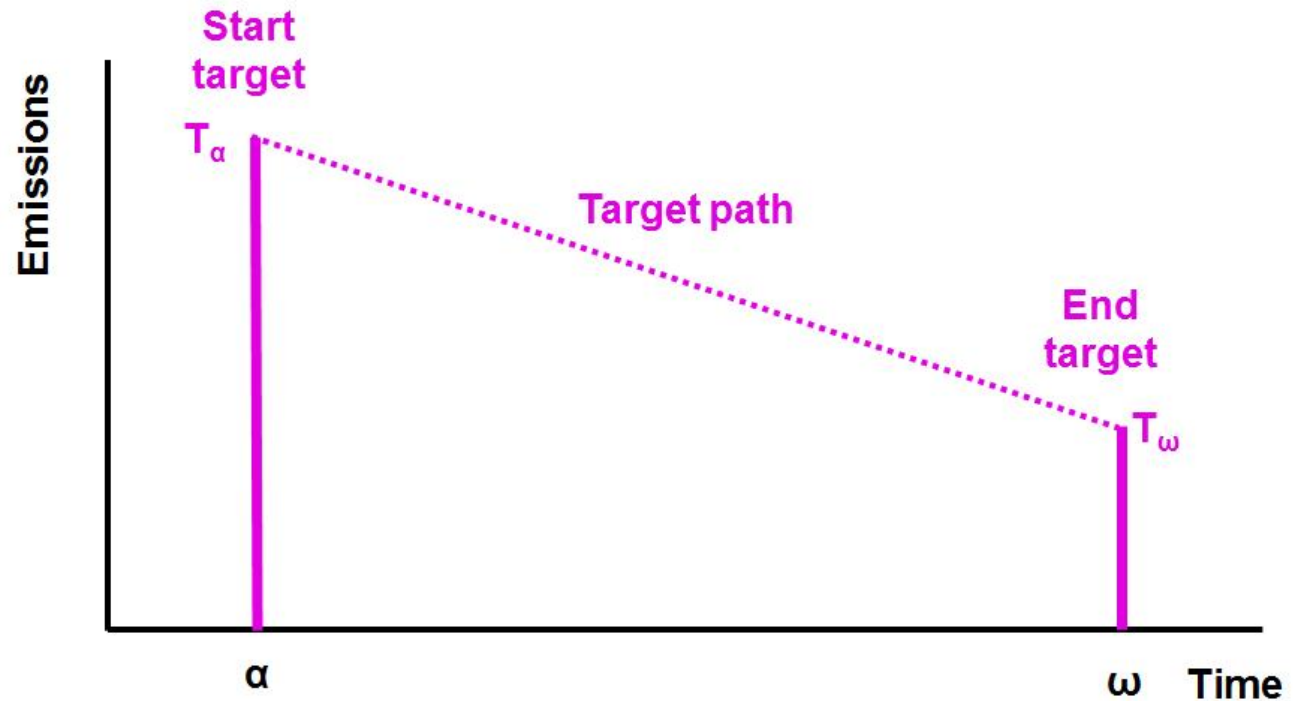
- **Will not substantially lower the market imbalances way into Phase 4**
- **Proposed MSR mechanism needs many parameter which are rather ad hoc quantified**
- **Severe current market imbalance and future unexpected demand shocks need to be treated differently**

Design of a modified market stability mechanism (MSM)

- **Need not be based on another reserve**
- **Could be implemented earlier**

Element 1 of a modified MSM

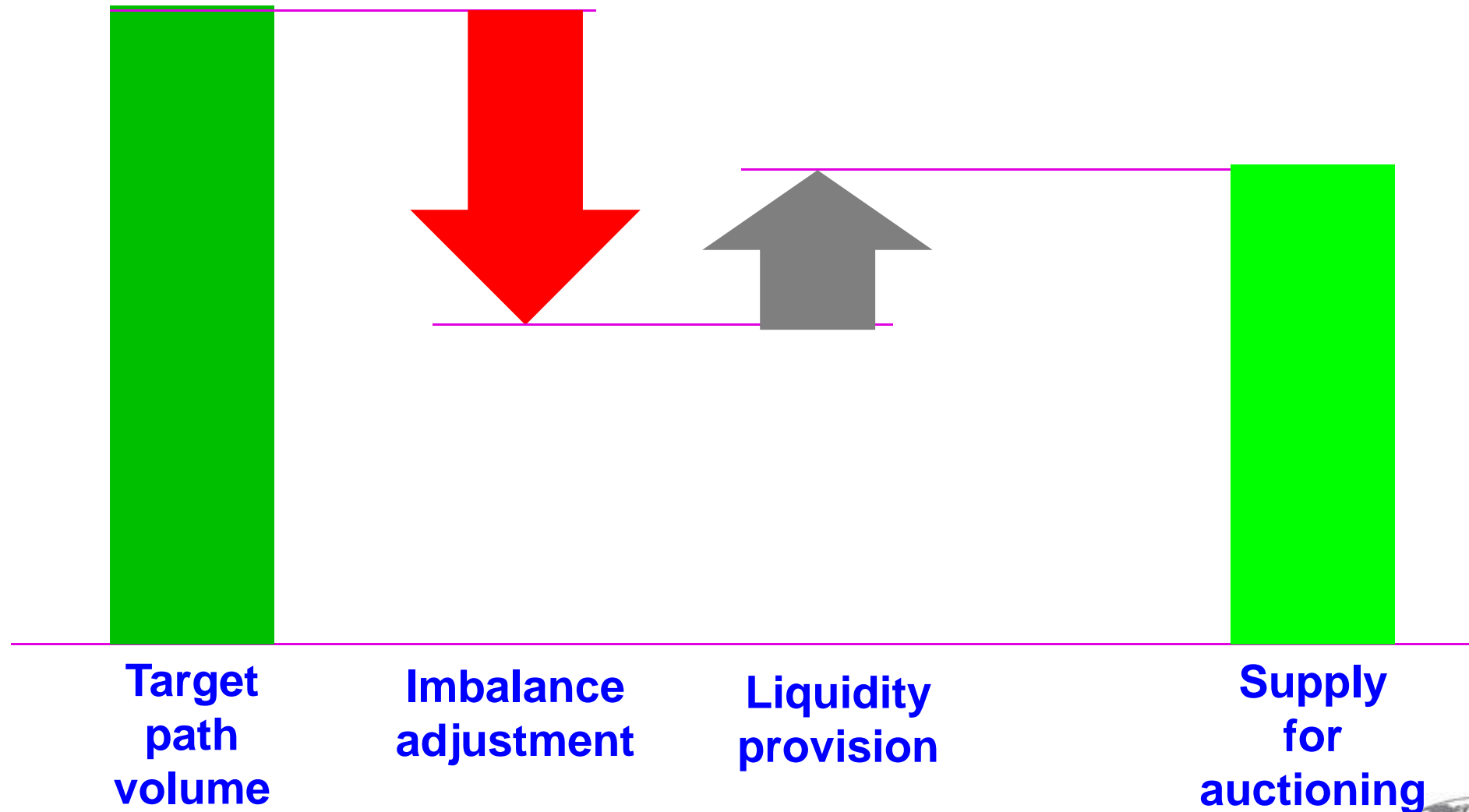
Long-term stringency path



- This could be the current or a modified linear reduction path
- There is no need for fixed trading periods

Element 2 of a modified MSM

Stringency-maintaining supply mechanism

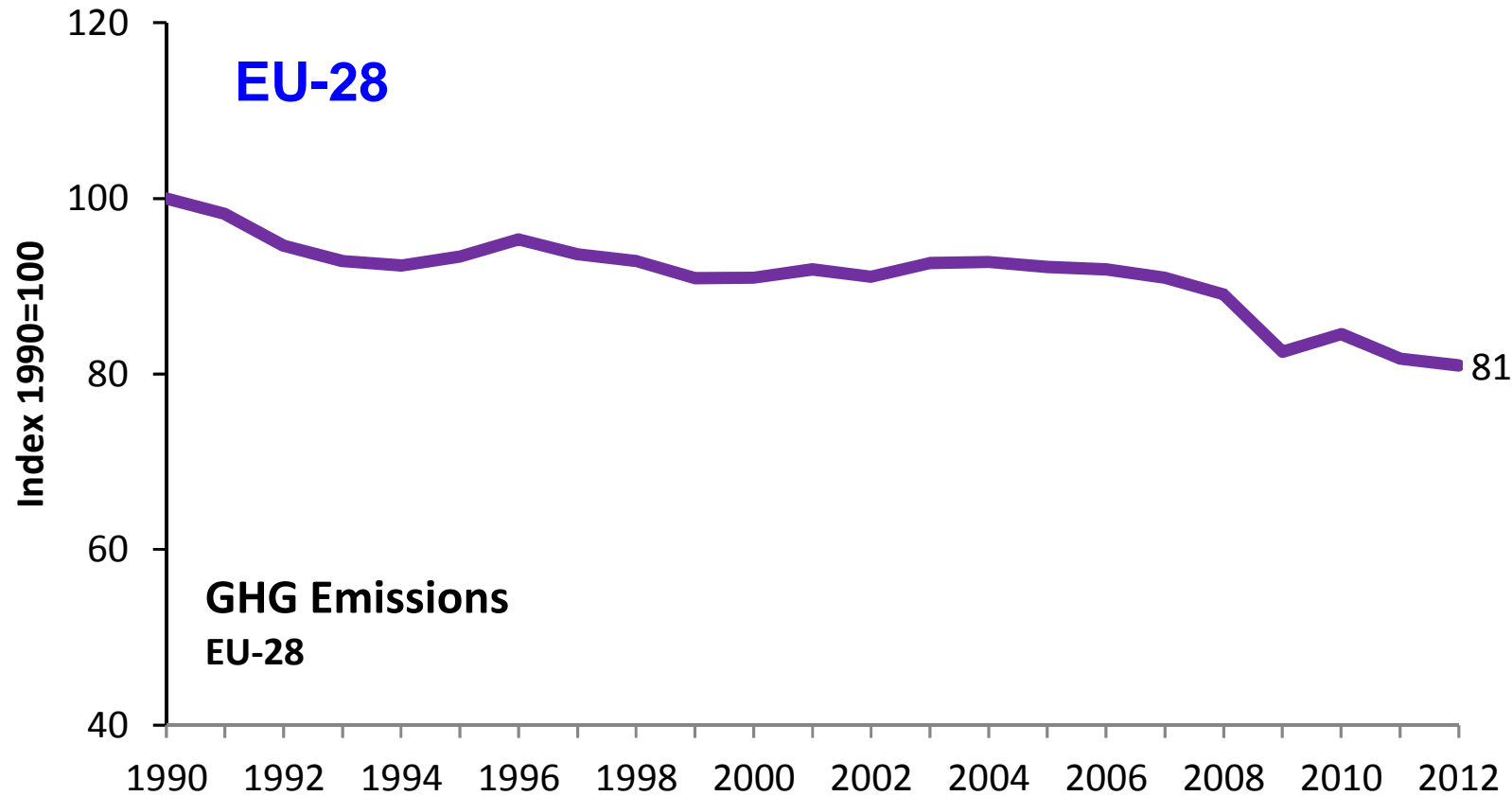


Stringency-maintaining supply mechanism

Formula-based implementation

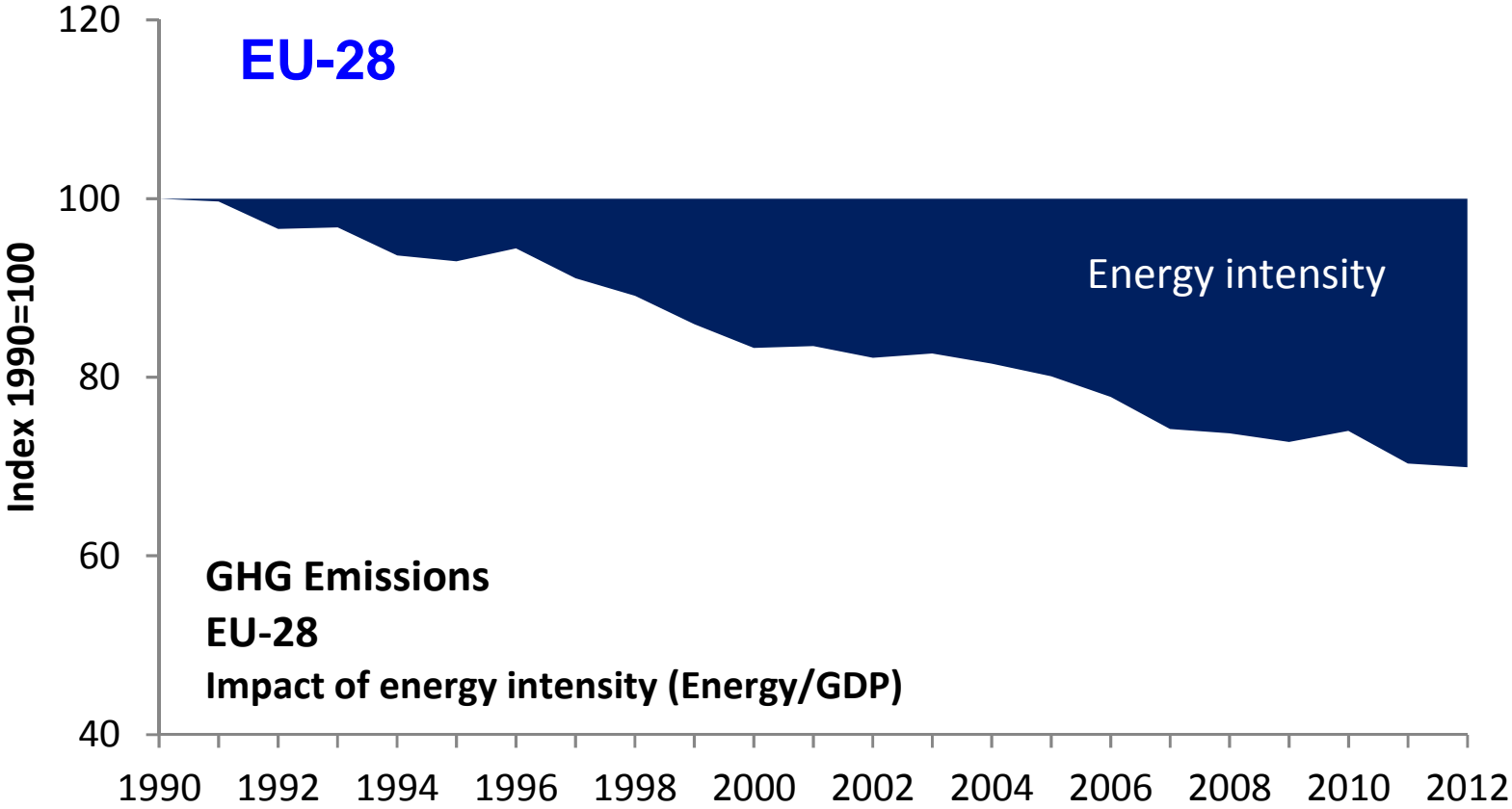
- **Allowances auctioned in year x =**
Target path volume in year x
minus Imbalance adjustment
plus Liquidity provision
- **Imbalance adjustment =**
(imbalance adjustment factor) * (cumulated imbalances)
- **Liquidity adjustment =**
(liquidity provision factor) * (market volume in year x-1)

What do we know about the impact of overlapping policies on emissions?



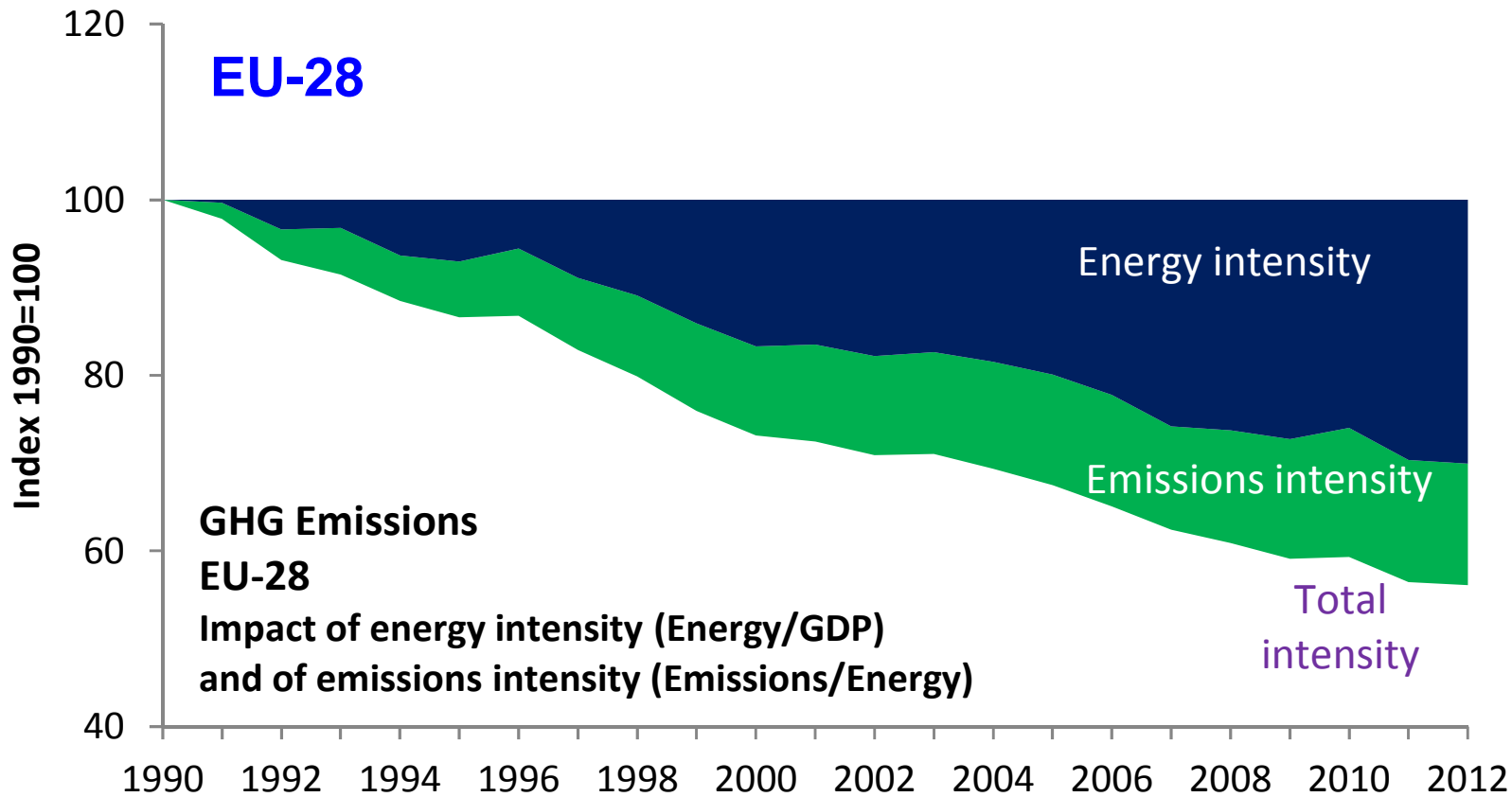
The impact of energy intensity

Emissions reductions from increased energy efficiency



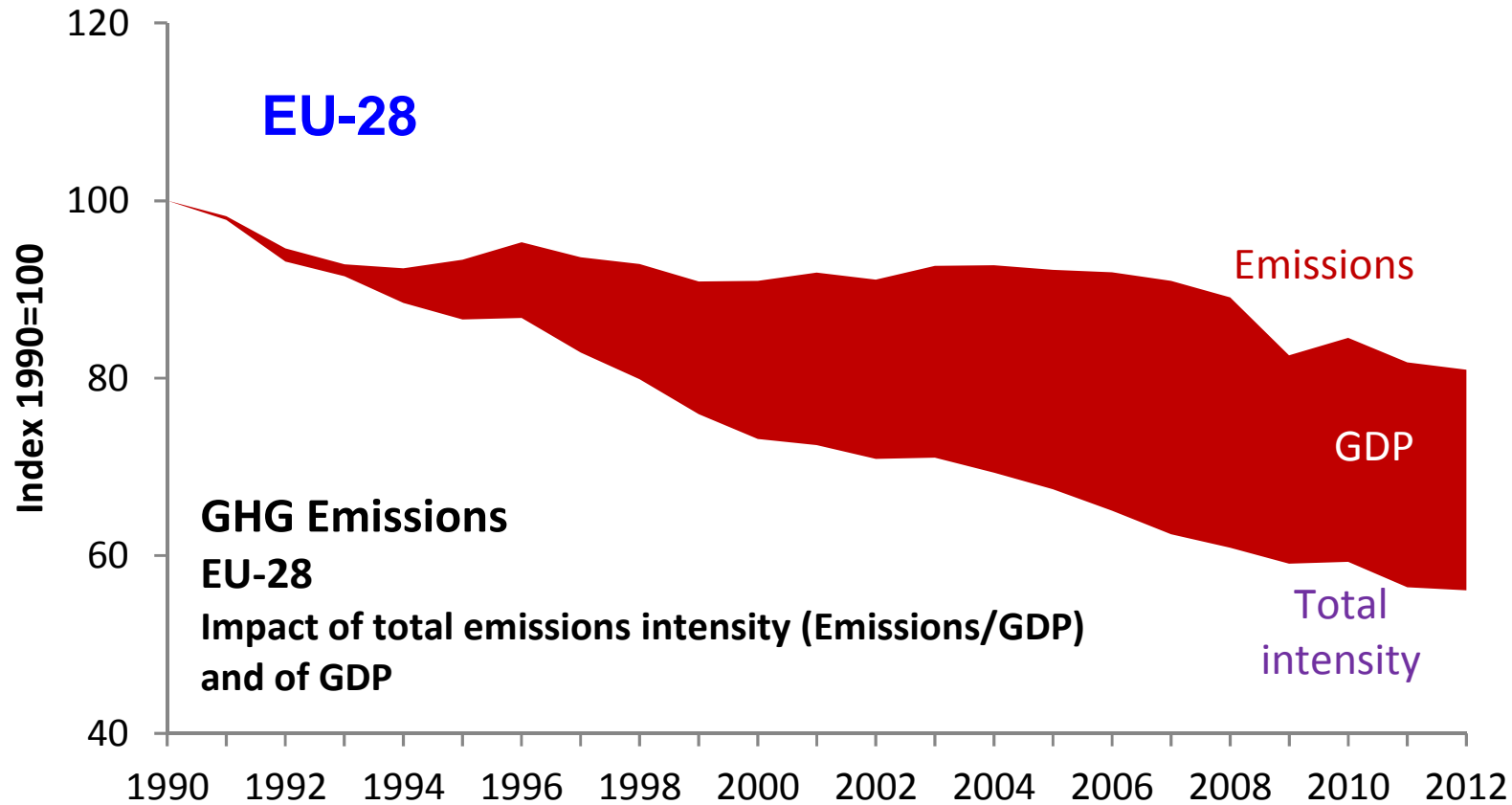
The impact of emissions intensity

Emissions reductions from increased share of renewables



The impact of economic activity

Emissions expansions from increased GDP



Impact of other policies as energy efficiency and renewables policies

- **These policies – if successful – reduce the stringency for installations, sectors, and the total market**
- **This will create imbalances in the market**
- **Depending on the imbalance adjustment factor these imbalances will be compensated and thus will have only limited impact on the carbon price**

Some advantages of the proposed modified market supply mechanism

- No need for an additional reserve
- Transparent because of fewer parameters
- Flexible implementation possible starting in Period 3 depending on the choice of the imbalance adjustment factor
- Encompasses and extends the current fixed supply mechanism

Thank you.

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