EU ETS reform agenda

« Shrinking carbon leakage provisions?! »

CEPS Carbon Market Forum, Brussels, 29 June 2015

cefic

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Reform Agenda

COMMISSION dilemma:

Two objectives:

- **Ensure reaching GHG reduction objective (-43% for ETS sectors compared to 2005)**
- **Keep the relative proportion auctioning/free allowances as is: means '*shrinking cake*' of allowances for free allocation**

Reaching the ghg target is undisputed, EU needs to make a choice:

- **Either trimming EU ETS to serve as governments' cash cow; further increasing carbon leakage risk for EU manufacturing – ETS revenues are uncertain…**
- **…or providing proper CL safeguards - enabling economic recovery and growth: revenues from prospering EU economy…**

Reform Agenda

ETS EU carbon price bites when allowances scarcity kicks in (MSR)
…**With current or even further reduced carbon leakage prevention;**

= **Investment- show stopper**

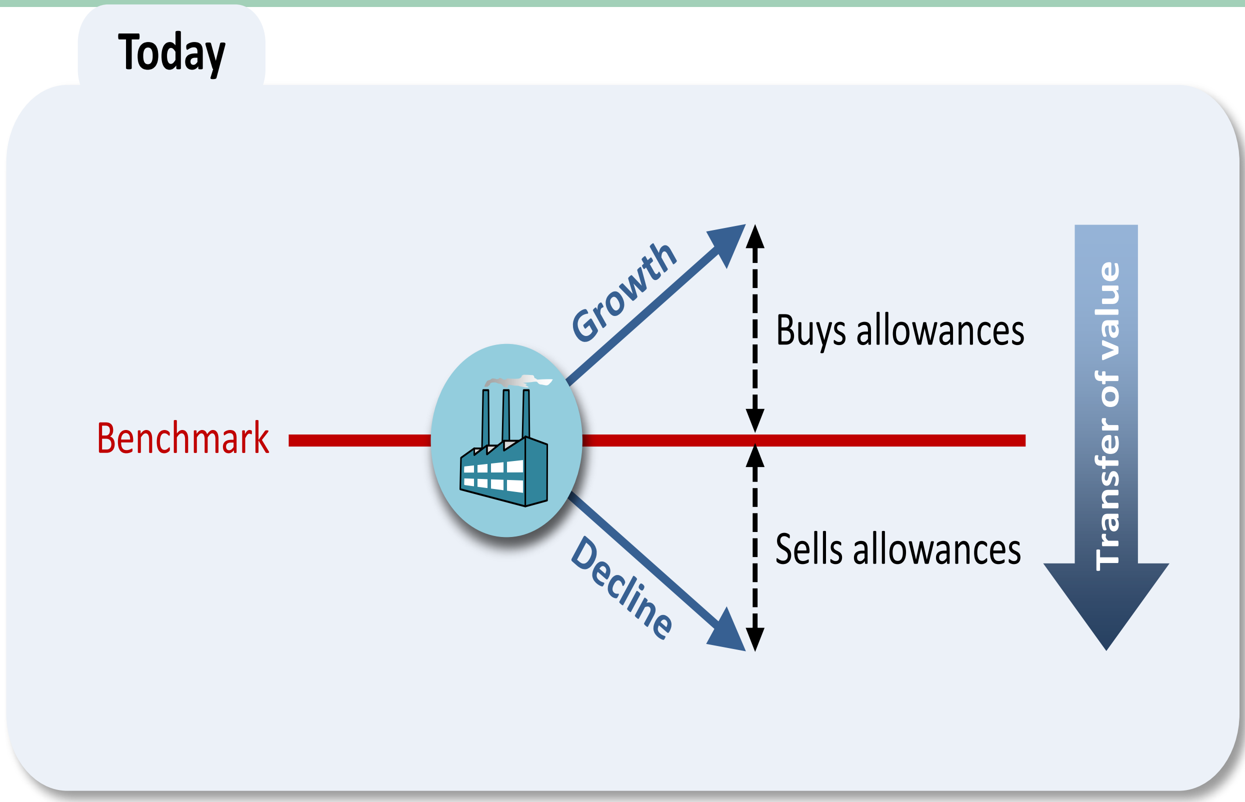
- **EU needs top class manufacturing economy= growth and investment**
  = Prohibits uncompetitive EU carbon cost for exposed sectors

- **In view of slower than anticipated global climate policy change (i.e. COP 21)**
  = Precautionary EU ETS carbon leakage approach advisable

KEY OBJECTIVE: **ETS to achieve agreed EU carbon emission reductions cost-effectively**

Allow for efficient growth in Europe (flexibility, no extra shrinking allocation below total ETS cap)
No more ETS reward for
loss of EU production or
loss of EU investment

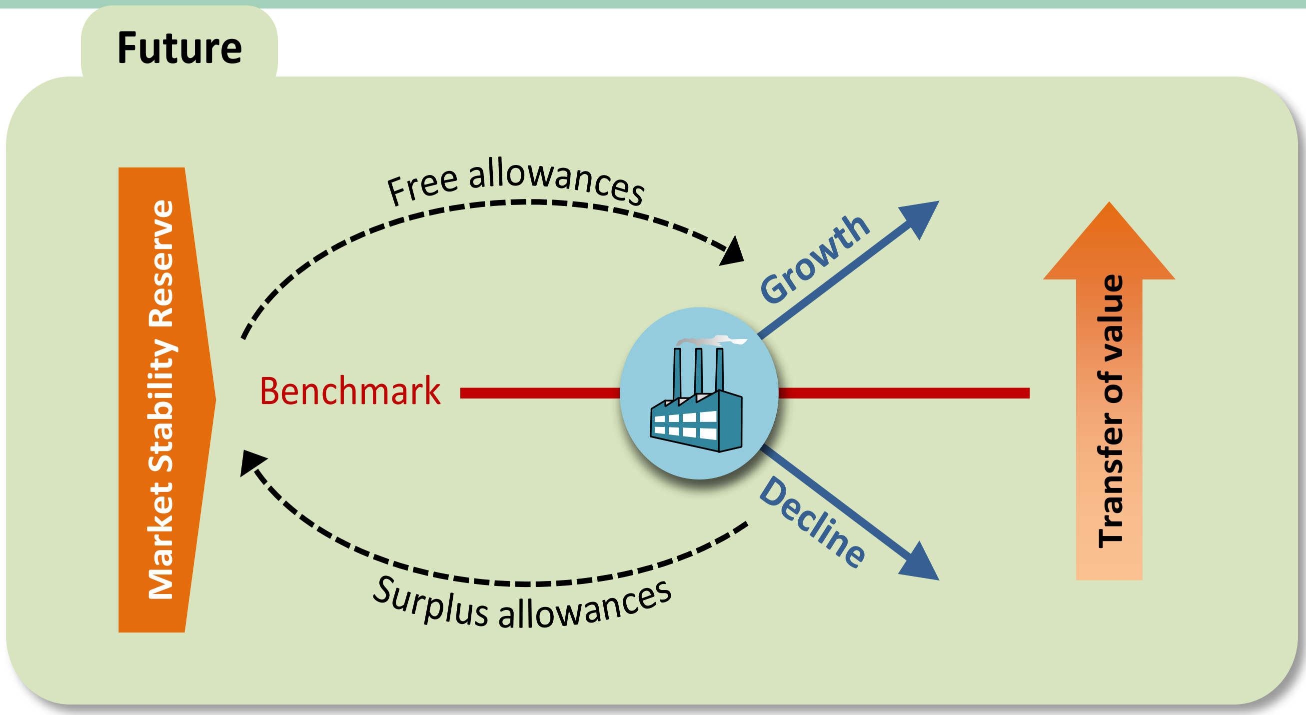
Challenge: Outdated EU ETS with perverse incentives…



'Ex-ante' allocation means: A company at benchmark level must buy allowances when it grows, can sell allowances when it reduced production in Europe…

This means penalising growth and rewarding decline.

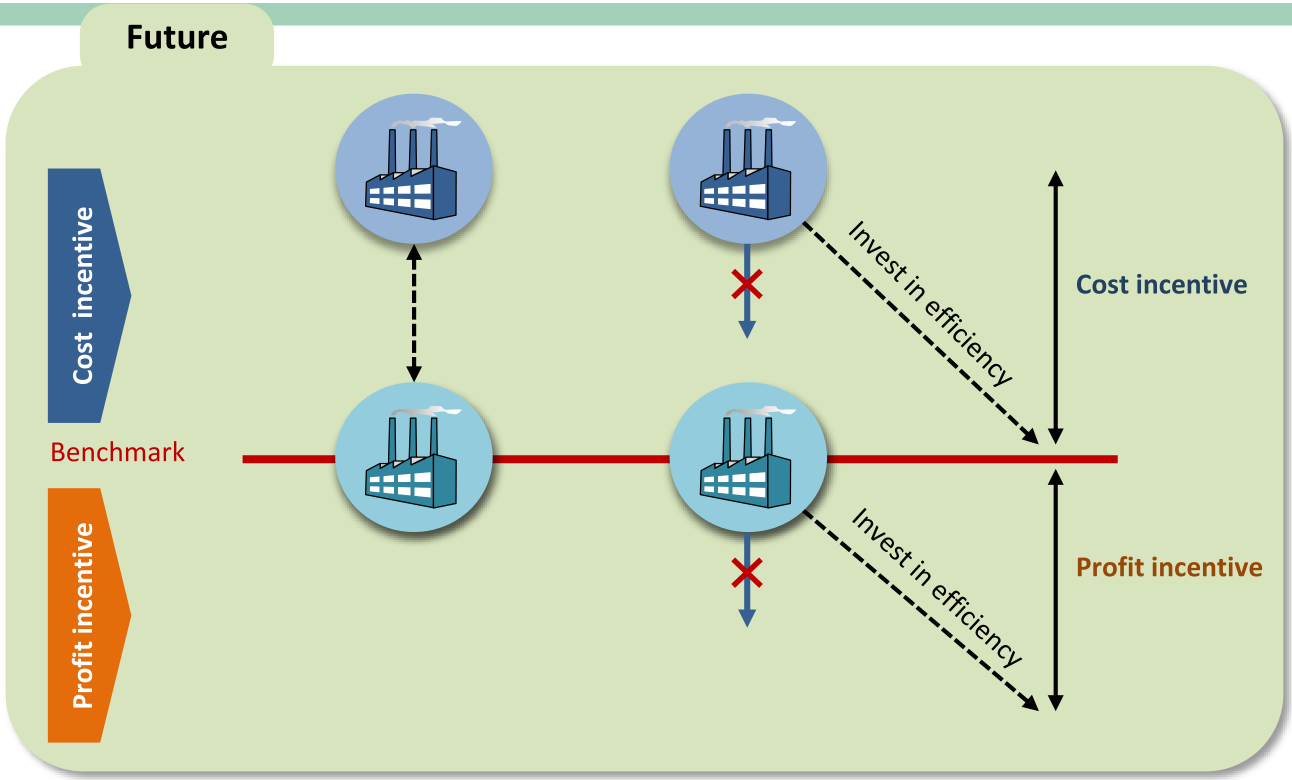
Solution: Reformed EU ETS enabling growth in Europe



Output-based allocation means: A company at benchmark level receives 100% free allowances when it grows, cannot sell allowances when it reduces production in Europe… Not needed allowances go back to reserve!

This means enabling efficient growth in Europe whilst meeting the agreed ghg emission reductions.

Solution: Reformed EU ETS rewarding Performance

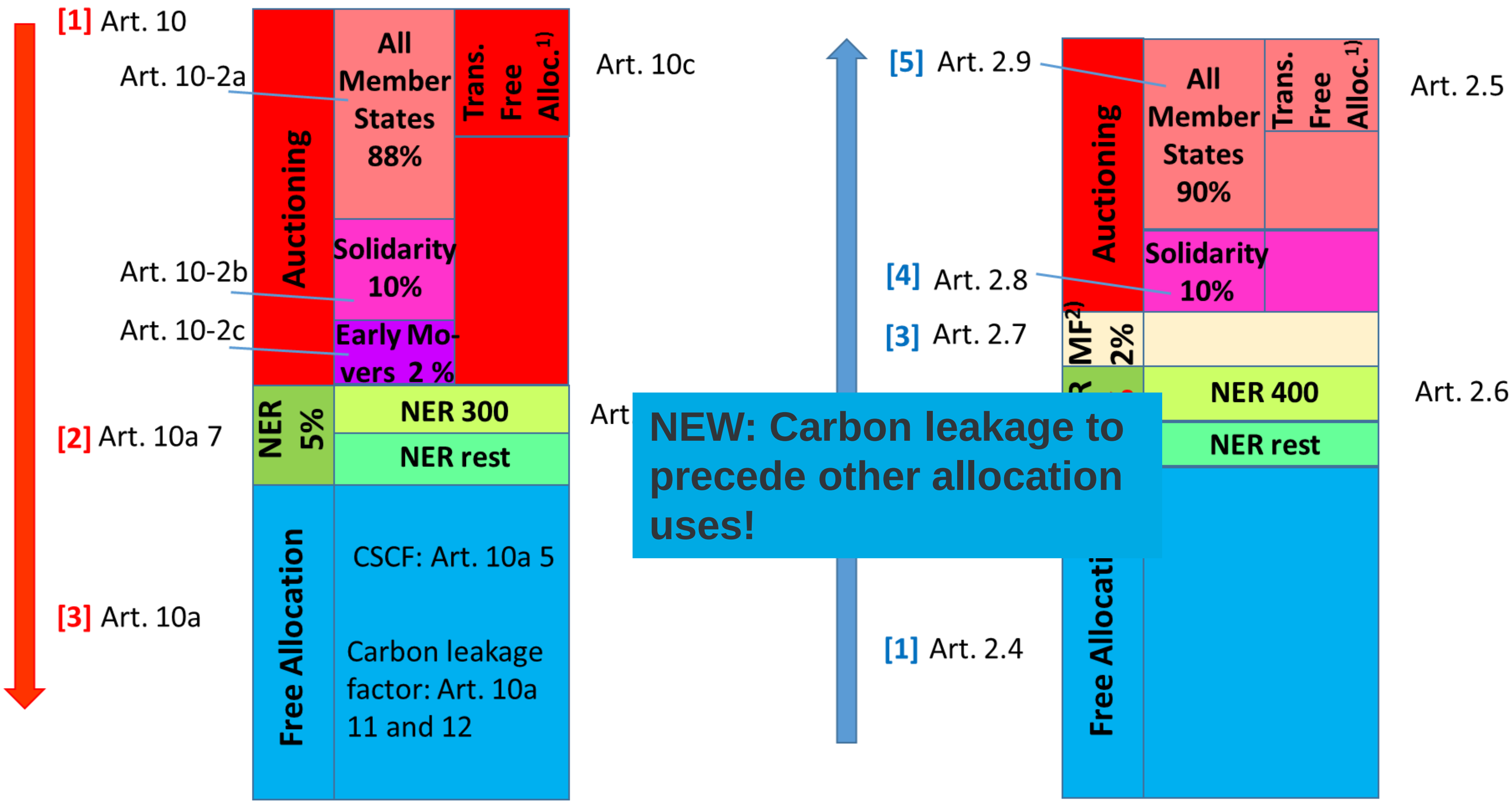


A company with emissions above benchmark level (underperforming) can no longer reduce output to avoid carbon costs. It needs to invest in efficiency or has to buy allowances (cost).
A company at the benchmark level can still invest in better performance and can then sell gained allowances surplus. This means rewarding top class efficiency.

Solution: Reversing sequence of allocation *

EU ETS Phase III
EU ETS Directive

EU ETS Post-2020
EU Council conclusions of October 2014



1) Transitional free allocation for modernization of electricity generation
2) Modernisation Fund for energy systems in low GDP Member States
* Simplified representation