

How do stakeholders view the EU ETS? Diversity and differentiation of interests

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Abstract

The EU emissions trading system (ETS) is expected to make a major contribution towards achieving the EU's target to reduce greenhouse emissions by at least 40% by 2030 compared with 1990 levels. Moreover, there is a strong need to address an accumulated over-supply of emissions allowances and to improve the performance of the ETS without waiting for the start of the next phase in 2021. Consequently, the EU ETS has been subject to a series of proposed reform, such as back-loading allowances for auctions, creating a market stability reserve (MSR), and long-term structural reform. Based on the stakeholder consultation process, this POLIMP Working Document gives an overview of perceptions held by major stakeholders in five member states (Poland, Greece, Austria, Hungary and the Netherlands). It highlights the diversity of their views across sectors and across countries on different aspects of the ETS: the ETS sectors' contribution to the 2030 policy framework, the role of the ETS, factors that impact on the EUA price, the ETS reform and stakeholder support for the ETS. As a complement to the POLIMP Policy Brief No. 3, "European Stakeholders' Perspectives on the EU ETS", this paper also provides further information on the definition of stakeholders, a decentralised approach to consult stakeholders and the distribution of stakeholders' responses.



Contents

Introduction.....	1
1. Key concepts: Cost-effectiveness, market confidence, political acceptability and perceived fairness.....	3
2. Approaches.....	4
3. Overview of stakeholders' perspectives	5
3.1 The ETS within the 2030 climate and energy policy framework.....	6
3.2 The role of the EU ETS.....	7
3.3 The carbon price: ETS effectiveness and market confidence.....	9
3.4 The ETS reform	12
3.5 Support for the ETS	14
4. Conclusions.....	16
References.....	19
Annex 1. Target groups of stakeholders.....	21
Annex 2. Preparatory dialogue outcome	22

List of Figures and Table

Figure 1. Industry - value added (% of GDP, 2013) in 24 EU member states.....	10
Figure 2. Annual activity level in 2013 compared to HAL for industries in Greece	11
Figure 3. Share of electricity, gas and other fuel spending in overall consumption of households in 15 EU member states (2010).....	15
Table 1. Coverage of POLIMP dialogue focusing on the ETS (final)	5

How do stakeholders view the EU ETS?

Diversity and differentiation of interests

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Introduction

The European Union's roadmap for moving to a low-carbon economy in 2050 aims at largely decarbonising the European economy by 2050 (European Commission, 2011). More importantly, the EU agreed on a decision to adopt an EU climate and energy policy framework for 2030 (Council of the EU, 2014). In this framework, the EU agreed to reduce GHG emissions by at least 40% by 2030 from 1990 levels.

The emissions trading system (ETS) continues to be the EU's flagship instrument. This is also evidenced by the requirement that the ETS sectors¹ will have to reduce GHG emissions by 43% by 2030 from 2005 levels. Currently, the EU is reviewing some ETS design features to meet this challenge.

The EU started the ETS with an initial learning phase in 2005, which was followed by a second and third phase in 2008-2012 and 2013-2020. Among the most important features of the ETS development in Phase III (EU, 2009; European Commission, 2012a) have been the following:

- EU-wide cap on emissions for the ETS of 21% GHG emissions reduction by the year 2020 below 2005 emissions levels²
- Decrease in the number of allocated allowances by 1.74% per year
- Introduction, in ETS Phase III, of auctions for the allocation of emissions allowances within the electricity sector, to be followed later by auctioning of allowances in industrial sectors,
- Harmonised rules for free allocation based on pre-determined benchmarks,

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¹ The ETS sector mainly consists of power generators and energy-intensive industrial sectors as well as the [aviation sector](#).

² See also: <http://carbonmarketwatch.org/category/eu-climate-policy/eu-ets/>

- Stricter rules on the type of international credits that are allowed to be used and
- Replacement of 27 national registries by a single Union registry.

These features were expected to help the EU achieve the target of reducing GHG emissions by 20% by 2020 from 1990 levels as part of the climate change and energy package (20-20-20). Moreover, it is important to note that “these changes imply from a regulatory perspective a fundamental transformation of the European carbon market”, largely setting in place the regulatory infrastructure (European Commission, 2012a).

At the same time, this framework accommodates provisions for carbon leakage and competitiveness concerns. Energy-intensive industry sectors facing international competition from industries outside the EU, which are not subject to comparable carbon constraints (carbon leakage), will receive a higher share of free allowances based on benchmarking.

Due to the economic crisis since 2008,³ GHG emissions have fallen and the demand for ETS allowances (European Union Allowances, EUAs) has decreased, which caused a fall in EUA prices.⁴ Since 2013, EUA prices have remained below €6.⁵ In order to restore market balance, the EU Council adopted a proposal to temporarily take allowances from the market and to re-introduce these into the market at a later date (so-called ‘backloading’) (European Commission, 2014a). As backloading is only a temporary measure, the European Commission proposes to establish a market stability reserve (MSR) at the beginning of the next trading period in 2021 (European Commission, 2014b). The proposed MSR would ensure that when certain pre-selected levels of EUAs in circulation are broken (both floor and ceiling), then allowances would be taken out of the auction schedule, and put in the MSR (in case of excess supply), or re-inserted in the auctioning schedule (in case of insufficient amount in circulation) (Marcu, 2014).

This POLIMP Working Document reports back from stakeholders’ views from multiple member states about how they perceive the ETS as it is and to what extent this perception differs across member states, especially in countries affected by the economic crisis. This includes as well views on the current discussions on how to reform the ETS.

³ Among others, the economic crisis resulted in a decline in industrial production within the EU of 22% between April 2008 and April 2009 (Eurostat, 2013).

⁴ As a result, the EUA price decreased from €30/allowance around mid-2008 to less than €10/allowance in early 2009 and, after a slight recovery, from €17 in May 2011 to around €5 per allowance in 2012. See “Uncertain Times for the EU ETS – Can the Market Imbalance be Repaired?”, [Joint Implementation Quarterly](#), Vol. 18, No. 4, pp. 2-3.

⁵ CDC Climat Research, *Tendances Carbone*, No. 87, January 2014.

1. Key concepts: Cost-effectiveness, market confidence, political acceptability and perceived fairness

POLIMP researchers, based on a literature review, identified four basic concepts that are particularly important in analysing how the ETS works: cost-effectiveness, market confidence, political acceptability and perceived fairness. Among others, the European Commission's 2008 impact assessment recognises cost-effectiveness and fairness as key principles to implement the EU objectives on climate change and renewable energy by 2020 (European Commission, 2008). POLIMP researchers further translate the four concepts into the ETS context, adding market confidence and acceptability to the list:

- How can the ETS help installations achieve cost-effective emission reductions?
- How to strengthen market confidence?
- How to ensure political acceptability of the ETS?
- How to ensure that the ETS functions with adequate fairness?

For each concept, this document provides a brief explanation of what it means in the context of EU climate policy and the ETS.

Cost-effectiveness

The European Commission believes that achieving the agreed objectives can have significant economic impacts and that therefore the implementation of *cost-effective* policy instruments is crucial (European Commission, 2008). The main objective of the ETS is to enable installations to comply with their commitments under the scheme in a cost-effective manner (European Commission, 2013). Given the number of allowances within the ETS and the resulting prices, installations have an opportunity to either reduce their own emissions to remain within the limits of the allowances or purchase allowances from other installations, whichever is the cheapest option. This cost-effectiveness potential was further enhanced by allowing installations to purchase emissions reduction credits or allowances from outside the scheme (e.g. the Kyoto Protocol flexibility mechanisms) (EU, 2004). In the ETS Phase III, however, the scope of using these credits has been reduced (EU, 2009). Another option is to link the ETS with other schemes (e.g. such as envisaged links between the EU ETS and Australian or other emissions trading schemes) (European Commission, 2012b).

Market confidence:

The relatively low prices in the EU ETS since the economic crisis have resulted in a reduced confidence of the market and investors in the scheme. The current oversupply of allowances is almost as big as one year's allocation of allowances in the EU (around 2 billion EUA) (Gilbert et al., 2014; European Commission, n.d.). In order to restore the balance, the European Commission has proposed measures to (temporarily) remove allowances from the market (i.e. postponed auctions with backloading and a market stability reserve, MSR) (European Commission, 2014a; European Commission 2014b; see also Gilbert et al., 2014).

Political acceptability

While the ETS, once operational, is typically a market instrument, its design, including the allocation of allowances, requires political decisions, such as the ETS cap of 21% emissions reduction by 2020 below 2005 emissions (EU, 2009; see also European Commission 2013; Gilbert et al., 2014; Sopher & Mansell, 2013). For example, a member state may be reluctant to support a strict emissions caps for the ETS when it has relatively carbon-intensive installations within its borders and realises that strict caps could have economic and social implications (predominantly employment loss) (Schreuder, 2009). Moreover, some ETS-covered installations are relatively flexible, for instance, in terms of relocating businesses, so that they may be inclined to move to countries without carbon pricing schemes (Borkent et al., 2014). As this would reduce employment, countries may be politically less supportive of strict allowance-allocation procedures for such sectors and installations.

Perceived fairness

The European Council in March 2007 recognised that for the sake of fairness it is necessary to take into account member states' different circumstances and the reality that different levels of prosperity have an impact on member states' capacity to invest (European Commission, 2008). The EU ETS is an EU-wide scheme with installations' levels of GHG emissions as a main criterion for inclusion (European Commission, n.d.). This approach does not consider that for some installations and sectors it is relatively easy or difficult to reduce emissions, as they may depend on availability of technologies, consumer preferences, interaction with other EU/national environmental or other policies, and opportunities to relocate production processes (Ellerman, 2010). While some operators (for instance electricity producers) serve domestic markets and/or are able to pass through costs to end-consumers, other industries cannot do so easily, and may find it difficult to compete on global markets with additional costs on their production facilities that are covered by the EU ETS.⁶ Implicitly and explicitly this has resulted in different treatments of installations (Ellerman et al., 2011).

2. Approaches

The POLIMP project has developed a methodology for stakeholder consultation involving physical meetings and online platforms. Preparatory dialogue, is one of the main consultation tools to reach out to key stakeholders (e.g. policy-makers, businesses, researchers and NGOs, as profiled in Annex 1) in EU member states, has been implemented throughout the period October 2013-March 2015. By the end of March 2015, more than 70 (tbc) stakeholders from five countries (Poland, Greece, Austria, Hungary and the Netherlands) in total have participated in the dialogue processes organised by four POLIMP partner organisations (University of Piraeus Research Center, Instytut Badan Strukturalnych,

⁶ The European Commission submitted a report on the list of energy-intensive industry sectors that are likely to be subject to carbon leakage. "This report should base its analysis on the assessment of the inability of industries to pass on the cost of required allowances in product prices without significant loss of market share to installations outside the Community which do not take comparable action to reduce their emissions" (see ETS Directive Recital 25, EU 2009).

University of Graz and JIN Climate and Sustainability) and coordinated by the Centre for European Policy Studies.

Each dialogue organiser selected the topics corresponding to the most immediate stakeholder workshop, but allowed some variation in its interpretation of topical questions depending on the national circumstances or priorities, and developed its own method in accordance with the basic framework that is common to all dialogue processes. The POLIMP research team aimed at an iterative process of stakeholder consultation through a series of interviews or/and group discussions that enable the stakeholders to make contributions. For further details, please see Annex 2 to this document.

3. Overview of stakeholders' perspectives

From March 2014 to March 2015, POLIMP dialogue focused on the EU ETS, engaging about 50 stakeholders in five EU member states (Poland, Greece, Austria, Hungary and the Netherlands). It covered a diverse range of sub-topics and level of details, with some focusing on more general and contextual issues and others on technical design elements. We present below an overview of the outcome of the dialogue across the targeted countries, highlighting several sub-topics, namely, the ETS within the 2030 policy framework, the role of the ETS as a market mechanism or regulatory tool, the impact of the economic crisis and supply of international offsets on the EUA price, possible ETS reform towards enhanced effectiveness, and stakeholder support for the ETS. Descriptions of the five targeted countries refer to the dialogue outcome while additional information on the EU and Central and Eastern Europe are provided from workshops held in Brussels.

Table 1 shows the coverage of the POLIMP dialogue focusing on the ETS. This is our result (but not necessarily our original intention), reflecting constraints on the outreach in terms of our capacity and resources. Nevertheless, POLIMP researchers believe that the participation of some 50 stakeholders was reasonably well distributed across sectors and across countries, which could serve as a sound basis for informing EU and member states policy-makers about their priorities and interests.

Table 1. Coverage of POLIMP dialogue focusing on the ETS (final)

	Policy-makers	ETS-covered sector			Observers			
	National governments and agencies	Power sector	Energy-intensive industry	Other ETS sectors (e.g. aviation)	Consultants	Researchers	NGOs	Other
Austria	-			-	1	2		-
Greece	-	2	1	1	3	4	1	-
Hungary	1	-	-	-	1			-
Netherlands	4	1	3	-	5	4		-
Poland	5	2	1	-	-	2	2	2

3.1 The ETS within the 2030 climate and energy policy framework

The first stakeholder workshop for the POLIMP project addressed the importance of predictability about long-term investment decisions to finance low-carbon technologies. The 2030 climate and energy policy framework, which remained a legislative proposal at the time of the workshop (April 2014), together with the associated GHG target, provided a structure for the ETS reform in both the short-term and in the mid- to long-term. The first dialogue in **Poland** (March 2014), which was scheduled as a seminar to discuss the conclusions of the Spring Council, suggested, however, that the rationale behind the decisions taken at the EU level often seemed unclear, leaving questions unanswered, such as the burden-sharing and cost-benefit analysis of climate policy.

The Polish participants agreed that the EU ETS system has no alternative tool for cost-effective reduction of emissions. In line with the official stance of the Polish government, a large majority of panellists argued for considering the results of international climate negotiations when setting EU climate goals. The stakeholders unequivocally underlined that there is no need to adapt the ETS, i.e. to adopt back-loading or the MSR. They also advocated embedding a mechanism for differentiating the effort-sharing in the EU ETS across individual member states. The further dialogue conducted in February and March 2015 confirmed the main conclusions expressed during the seminar. It also revealed approbation for the single-target approach in the Climate and Energy Package 2030.

In the ETS dialogue in **Greece** (December 2014-January 2015), some of interviewed stakeholders, mainly researchers, were not fully aware of the 2030 framework and could not relate its content to the EU ETS. However, they identified the need for an integrated policy framework to ensure regulatory certainty for investors and a coordinated approach among member states.

Regarding the 2030 framework, the majority of interviewed stakeholders were optimistic that the EU ETS would be reformed and become more ambitious. Concern was raised, however, regarding the system's future ability to trigger the right effect by lowering the cap, as any surplus in allowances will need to be absorbed quickly, so that industries can react to cap reductions by transforming their technology and adopting greener procedures. A few stakeholders, particularly researchers, consultants and those from the NGO sector, were of the opinion that efforts should be intensified and more ambitious commitments made. An equally large group, however, representing mainly industry and the power sector, expressed the opposite view, suggesting that the ETS should consider a more moderate approach that would address specific de-carbonisation needs of the sectors it covers. They specifically highlighted the need for a framework capable of ensuring internal and external consistency in the planning and achievement of member states' energy goals.

Stronger criticism was expressed by some researchers, stating that the 2030 framework will not only lack support for the further development of the green economy and related technologies, but it will also hinder their advancement, causing problems of political acceptability for the countries that have invested significantly in this direction. Negativity towards the 2030 framework was detected among a small group of consultants and researchers, who viewed the necessary political commitment as inadequate and the need for further incentives for innovation as crucial.

The ETS dialogue **in Austria** was carried out between February 2014 and February 2015 with stakeholders in industry, academia and NGOs. In particular, industry, such as the steel sector, voiced the wish for well-planned policy decisions and no short-term snap decisions in the context of the 2030 framework. Extremes should be avoided. Long-term stability in terms of policies is of critical importance for low-carbon investment decisions, as also mentioned by stakeholders in Hungary.

Stakeholders in the ETS dialogue in **the Netherlands** almost invariably supported the EU ETS as the central instrument of European climate policy. Pricing CO₂ is seen as crucial to provide incentives for emissions reductions. Stakeholders, however, are cautious about the effectiveness of the EU ETS as the sole instrument. Specific policies and targets for renewables and energy efficiency should be supportive, and therefore it is important that these are not more ambitious than the CO₂ target. Thus far, other policies have not raised the carbon price, but acted against the scheme. In order to avoid competition between policies, they should be shaped by the EU, rather than at the Member State level. Industry stakeholders would like to see a global level playing field in place with other economies and the overlapping policies and targets abolished. In general, stakeholders agree that, even if support for RE and EE is ended, support for innovation should be continued and strengthened, in order to enable emissions reductions in the long term. Furthermore, RE and EE policies should in fact serve to set the baseline upon the ETS target (thus making the actions additional). For the Netherlands specifically, the majority concluded that the ETS is not sufficient to lead to decarbonisation, with the uncertainties it incurs in the medium run. It should stop being considered as a cost and rather be adjusted to trigger investments. Additional instruments are required to capture the externalities of R&D and innovation, which are normally not pricing tools (i.e. subsidies).

Two thematic POLIMP workshops for the **EU-level stakeholders** first introduced the 2030 climate and energy policy framework, then located the ETS with the associated GHG target within the framework. EU policy-makers outlined the framework that was based on the impact assessment and accompanied by support programmes such as the New Entrant Reserve (NER300) under the EU ETS. A well-functioning and reformed ETS should be the main instrument. The power sector and technology providers support the ETS as the flagship of the EU climate policy and the enhancement of the system in the new framework. Among energy-intensive industry sectors, however, the steel sector finds the framework extremely challenging in the absence of similar constraints on competitors worldwide. The non-ferrous metal sector is concerned with indirect emissions costs as global price-takers. An environmental NGO network finds that the approved framework, including the GHG target and the ETS reform, does not go far enough towards the goal of decarbonisation.

3.2 The role of the EU ETS

In **Poland**, the assessment of the results of the 2014 Spring Council ranged from too modest to overly-ambitious. Some of the stakeholders (researchers, experts representing the government and business organisations) agreed that the dominant approach to the ETS distorts its original idea, which was to minimise the cost of meeting the desired level of reduction, and that public subsidies for renewable energy have resulted in 'crowding out' and 'carbon leakage'. Although the higher price of EUAs is

assumed by the Polish government itself in its energy sector transformation strategies, the stakeholders were arguing that this forecast was not sufficiently decisive for the future transformation.

Polish stakeholders also pointed that the EU ETS has suffered from the way it was implemented. From an economic instrument that aims at lowering the cost of low-emissions transition, it was transformed into a central-planning regulatory tool aimed at reducing the level of emissions. As a consequence it became vulnerable to various lobbying groups with an interest in promoting particular RES or the creation of a complicated market (e.g. trading organisations, banks or consultancies).

The ETS dialogue in **Austria** (2014-15) showed mixed result in terms of sector coverage and the role of the EU ETS in decarbonizing the economy. While the steel sector claimed that the EU ETS is not the appropriate instrument for industry, business voices called for an expansion of the EU ETS to other sectors. The carbon price in the EU ETS would be far lower than in the non-ETS sectors, where the mitigation costs are higher. While technologies for emissions reduction in heating are available, these have not been developed to the same degree as in transport, where the carbon price is regarded to be the highest in the economy. Stakeholders also mentioned that there is no link between these two parts of the economy. Thus, before reforming the EU ETS, harmonisation or standardisation of carbon prices would be of great importance.

Austrian stakeholders in academia and industry are questioning the EU ETS as an appropriate instrument for technological change. Industry instead supported technology-based policy. Academia accused speculative market participants of influencing the market price, calling into question a market-based instrument for CO₂ emissions reductions. A carbon tax was mentioned as a more suitable and predictable instrument. We found similar arguments in **Hungary** where stakeholders questioned the effectiveness of the scheme. The EU ETS would not impact technological change at current prices.

In general, **Dutch** stakeholders support, as a matter of principle for the longer term, the broadening of the EU ETS to other sectors and other world regions, especially the United States and major emerging economies. Although especially important for energy-intensive industries, since more opportunities for low-cost abatements would be provided, 'global fair play' is seen as ideal to improve efficacy by all stakeholder groups. Stakeholders, however, see difficulties in linking the EU ETS to other sectors, as the MRV standards are too strict for smaller sectors and installations. Domestic offsets under Article 24a could then be a possibility for encouraging the participation of non-ETS sectors in the EU ETS and also for raising awareness.

As long as no similar emissions trading schemes are operational in major competing markets, carbon leakage rules apply in the EU ETS. With regard to the allocation methods of allowances, there are widely divergent opinions. The power sector, researchers and consultants call for a more 'realistic' allocation of allowances, decreasing free allocation and increasing auctioning. On the other hand, stakeholders from energy-intensive industries call for adequate carbon-leakage measures. The best-performing installations in the carbon-leakage group should not be confronted with costs for CO₂ emissions.

The current carbon leakage measures are seen as ineffective, as there is uncertainty about exact rules, the treatment of indirect emissions is incomplete, and the ex-ante allocation system provides “inbuilt incentives for carbon leakage”. Since the benchmarks are based on historical production, lowering production leads to surplus free allowances and the possibility to reap windfall profit. This is an incentive to reduce production in the EU. Growth beyond the historical benchmark, on the other hand, is inhibited. Industry stakeholders therefore call for *ex-post* dynamic allocation of allowances, based on the realised production.

3.3 The carbon price: ETS effectiveness and market confidence

A new proposal of the MSR was criticised by **Polish** stakeholders as an attempt to ‘manually’ control the EU ETS which, as one of the academics underlined, leads to a decrease in its predictability and transparency. As a consequence, the EU ETS being a market mechanism, designed to reduce the cost of low-emission transformation, is being used for political purposes to set the level of emissions and to promote selected sources of energy. The mechanism, however, in its economic nature, cannot effectively replace the courageous political decisions that should be made in order to lower the emissions.

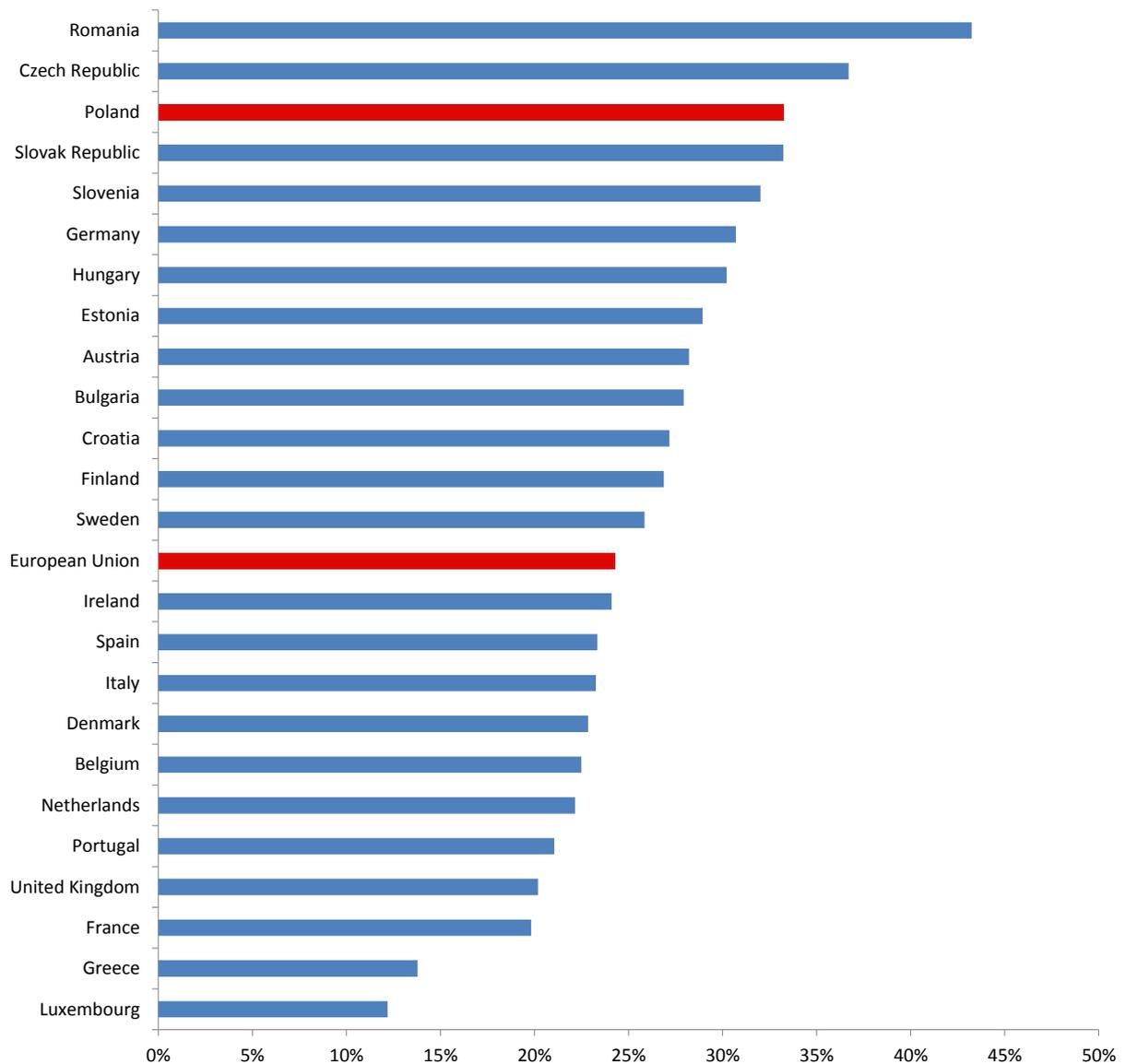
A cleavage between the Polish stakeholders remains over the way the government distributed the national effort in the reduction of emissions. Energy was the only sector to receive the full amount of free allocation and support from the modernisation fund. Representatives of the heating sector and energy-intensive industries expressed their doubts about the fairness of the solution. They pointed out that the energy sector, acting locally, would be able to offset the cost of higher energy prices, whereas other sectors, acting at the global market level will have no additional protection against companies that have no burdens related to pricing the emissions.

The business stakeholders stress the argument that the impact of the growing price of the EUAs will affect Polish economy harder than other countries due to the large share of industry in Polish economy, as shown in Figure 1, compared to other EU economies.

The POLIMP dialogue with stakeholders particularly focused on countries affected by the economic crisis. Increased interest in the ETS and its expansion was observed during the first dialogue in **Greece** (October 2013-August 2014), although stakeholders identified the need for further exploration of the way in which the 2050 low-carbon economy roadmap affects carbon prices.

In the ETS dialogue in **Greece** (December 2014-January 2015), the stakeholders interviewed were asked whether the economic crisis is responsible for the current status of the ETS. **Greek stakeholders** in research and NGO sectors questioned the stability of the ETS in the future, highlighting that it can only be ensured by further measures. However, power-sector representatives as well as most researchers were optimistic about the future of the EU ETS, expecting an ‘amelioration’. Recorded arguments for this positive approach included, among others, their confidence that more sectors will be added to the system, that a single cap for European countries will replace the national ones, as well as their observation that the surplus of allowances is gradually consumed.

Figure 1. Industry - value added (% of GDP, 2013) in 24 EU member states



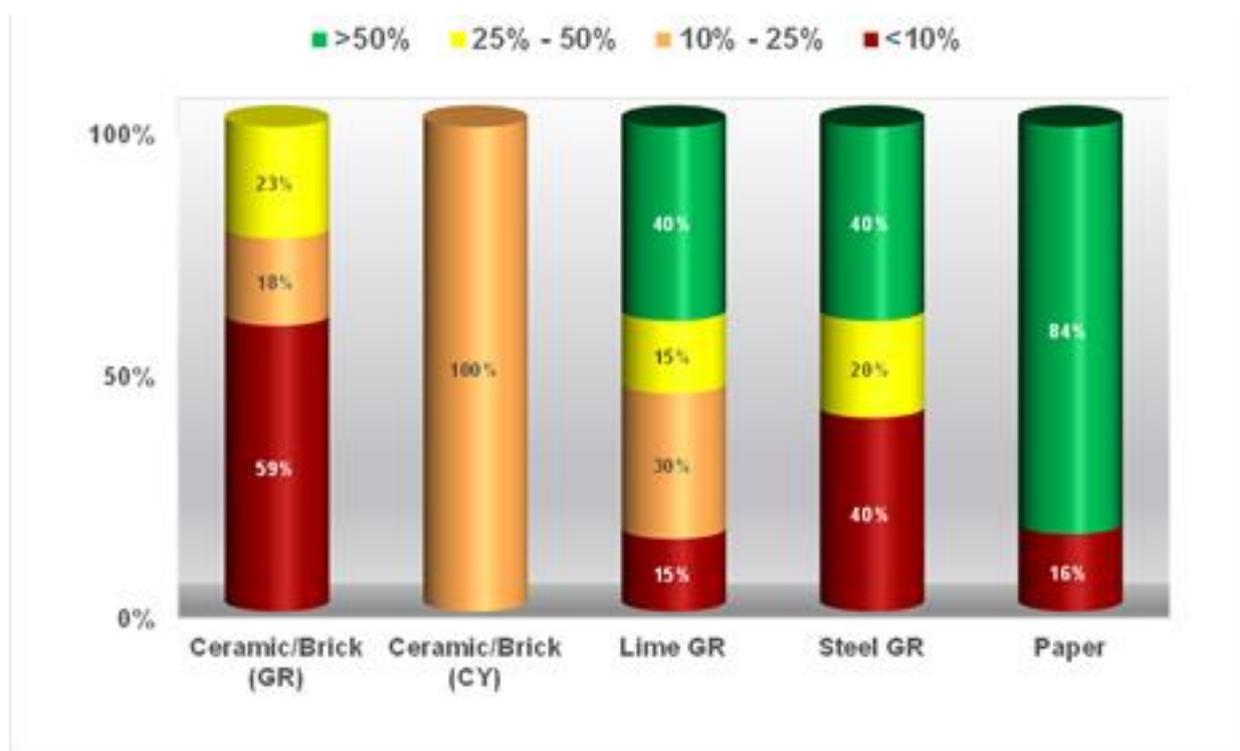
Notes: Industry comprises value added in mining, manufacturing, construction, electricity, water, and gas. Value added is the net output of a sector after adding up all outputs and subtracting intermediate inputs. Four countries are omitted from the figure due to a lack of data.

Source: World Bank (<http://data.worldbank.org/indicator/NV.IND.TOTL.ZS/countries?display=default>).

The vast majority of Greek stakeholders agreed that the economic crisis had led industries to produce at a lower scale. With less-intensive operations, they comply with the ETS cap anyway, without having to transform their procedures to greener ones, therefore causing carbon prices to decrease significantly due to low demand. All stakeholders referred to the problem of allowances surplus from previous periods as another factor affecting the carbon price, while carbon leakage was identified as a reason for causing this surplus by certain researchers. This downfall trend is illustrated in the figure below, when comparing the annual activity levels of an industrial sector to its Historical Activity Level

(HAL). The figure concerns energy-intensive industrial sectors that also represent the largest share of the ETS in Greece (in terms of installations), as well as the higher risk for carbon leakage. It is easily understood that e.g. more than half of the ceramic/brick industrial installations have an activity level (in 2013) under 10% of their HAL.

Figure 2. Annual activity level in 2013 compared to HAL for industries in Greece



Source: ECOCERT (www.polimp.eu/images/eventsPDF/Session_2.7_Ecocert.pdf).

All stakeholders referred to the problem of allowances surplus from previous periods as another factor affecting carbon price, while carbon leakage was identified as a reason for causing this surplus by certain researchers.

It was a common belief that a low carbon price weakens the EU ETS, which has been undoubtedly affected by the economic crisis. The power sector and other ETS sector representatives also identified large uncertainties over the future allowance supply as another factor for preventing market participants from having longer-term price expectations, therefore weakening the system.

Stakeholders participating in the dialogue in **Austria** argued that the European Commission should be stricter and simply remove the extra allowances from the market. Academics also considered plans of a MSR as insufficient to increase the CO₂ price.

There is general agreement among **Dutch** stakeholders that the inflexibility of allowances supply is the main factor inducing low carbon prices. The system is unprepared for unpredictable events and economic volatility. As economic growth was lower than expected, there were too many ex-ante

defined allowances in the system. The economic crisis is therefore an important reason for the low prices, because the allowances supply does not react to such fluctuations. Therefore, automatic adjustment during the trading period should take place (like in Australia). In addition, approximately half of the respondents see existing renewables policies and subsidies as the key factors driving down prices. Policies for renewables (and energy efficiency) should be supportive of the ETS, but they currently contribute to the allowances surplus.

The effectiveness of the EU ETS is twofold. The system works, as the fixed cap and linear reduction factor ensure emissions reductions. Policy-makers therefore see that the EU ETS is factored into business planning. However, low prices do not motivate companies to innovate, as there is no certainty and confidence. Stakeholders reiterate that the EU ETS itself is not focused on innovations, but on emissions reductions, and observe that historically innovative breakthroughs have been induced by regulations, rather than by emissions trading.

Since the EU ETS does not prompt innovation, many stakeholders stress the importance of targeted innovation support. R&D and especially large-scale pilot projects are crucial, and focused policies should support these. Policy-makers see the need for a shift from large-scale deployment of certain technologies to a 'portfolio approach'. In such an approach, a wider range of technology development and innovation is supported towards market-readiness. The EU ETS can then work to make market-ready technologies competitive.

EU policy-makers find in general that ex-post impact assessment can be especially useful. Impacts on GDP are always taken into account in the assessment. There was early recognition by both EU policy-makers and ETS-covered sectors of the possible impacts of economic recession on compliance with the EU's overall GHG target, the ETS cap and subsequent demand for EUAs. Given the scale of surplus Assigned Amount Units (AAUs) and associated Emission Reduction Units (ERUs) as well as the lack of demand for EUAs, it became clear that under the current target of achieving reductions of GHG emissions by 20% by 2020 from 1990 levels, there would remain an imbalance between demand and supply in the ETS by 2020 (Fujiwara & Georgiev, 2012 and European Commission, 2012a). In addition, the power sector is concerned with impact on the ETS of national RES support measures and other energy-policy instruments and measures. Among energy-intensive industry sectors, both steel and non-ferrous metal sectors are concerned with an insufficient and inadequate compensation for indirect CO₂ costs, provided that State Aid regime caps the level of that compensation and compensation is granted by only a few member states.

3.4 The ETS reform

The majority of the **Polish stakeholders** are opposed to any fundamental modification of the EU ETS before 2020. The MSR is seen as an unnecessary complication and as a factor that will deprive the EU ETS of its ability to act in accordance with economic trends. Even more negative opinion is expressed about back-loading and the prospect of transforming it into a set-aside measure. Academics question the legality of such step and the governmental experts feel this option would not be fair in view of the agreements made in negotiations over the last few years.

The stakeholders insist on developing political instruments, aimed at reducing emissions and working in accordance with democratic procedures. Stakeholders involved with energy and heating and those associated with government insist on a greater flexibility in planning the reduction of emissions at the country level. In particular, the European Commission should not exclude the coal-mining sector entirely. Development of carbon technologies should be encouraged and the role of coal should be limited in a smooth manner.

In the ETS dialogue in **Austria and Hungary** (November-December 2014), it was mentioned that the EU ETS may be suitable only for the energy-production sector. Although in future a total separation of industry from the energy sector within the EU ETS would be preferable, at present it was too early to take steps towards total separation and more realistic to work within the system that exists. Some of the stakeholders interviewed in this process suggest that the MSR will be needed within the ETS to stabilise the carbon price. However, if the policy objective is to stabilise the carbon price, a carbon tax could be an option. Generally, the representatives of the carbon-intensive industry interviewed in these countries refuse to accept the concept of a carbon tax. If the carbon price under the ETS is squeezed into a narrow corridor, it will go into the direction of a carbon tax. The EU could focus on controlling either the price or the volume, but it is not possible to control both. In practice, the implementation of a carbon tax is not necessarily realistic before 2030 as the continuation of the EU ETS itself is not questioned by stakeholders. In Hungary the reforms were also not perceived as sufficient.

Dutch stakeholders are in general positive about the Commission's EU ETS reform proposal for the fourth phase, including the MSR. The MSR can help to reverse the downward price trend by creating a feeling of scarcity, thereby reducing some risk uncertainty. However, since a significant surplus of allowances is expected to still exist at the start of the fourth phase, the MSR might be ineffective. There is general agreement that the MSR might not be of any use if a new economic crisis arises. If it is expected to function, six years is way too long to wait for its implementation. Furthermore, stability in the policy discussion is important to avoid carbon lock-ins while rules are changing in the meantime.

Various ideas were expressed about how to operate a stability reserve.

While several consultants, researchers, policy-makers and power-sector stakeholders support the concept of the MSR as an automatic system based on predefined rules, other consultants and researchers as well as energy-intensive industries would prefer to see a reserve operating as a sort of 'central bank' (enabling continuous adjustment of allocation) (Borkent et al., 2014). They point out that the MSR is not a genuine reform, but rather just a price interference. Some energy-intensive industry stakeholders therefore argue that the MSR undermines market confidence, and thus works in a counterproductive fashion. The main substantial reform to the system proposed by industry stakeholders is the introduction of ex-post allocation of allowances. Other policy institutions referred to the price corridor idea for the industry, with a minimum and maximum price (as in California) to adjust to the scarcity of allowances.

The ETS impact assessment focuses on carbon leakage, allocation, MSR and other design options. In response to **the European Commission's** ETS reform proposal, the power sector and technology

providers advocate the structural reform and the MSR. Technology providers and an environmental NGO network agree that the MSR should be put in place before 2020 and back-loaded allowances should not be put back into the market but directly into the MSR. In addition, technology providers suggest using part of the MSR to top up NER400. The NGO network argues for full reform, such as a complete cancellation of surplus and raising the rate of the declining annual linear reduction factor beyond 2.2%.

Both steel and non-ferrous sectors argue for an extension of carbon-leakage provisions, full compensation for indirect CO₂ costs in all member states and free allocation reflecting recent production to better align with changing production levels and based on technically and economically achievable benchmarks and without a cross-sectoral correction factor.

3.5 Support for the ETS

Ecological organisations and minor business associations are the only substantial stakeholders in **Poland** that openly support the 2030 Climate and Energy Package, as proposed by the European Commission in October 2014.⁷ The majority of the stakeholders, however, are critical of the EU ETS (as opposed to the emissions trading systems in general). They underline that several mistakes have been made in implementing the instrument by the Commission but also by the Polish government over the last decade.

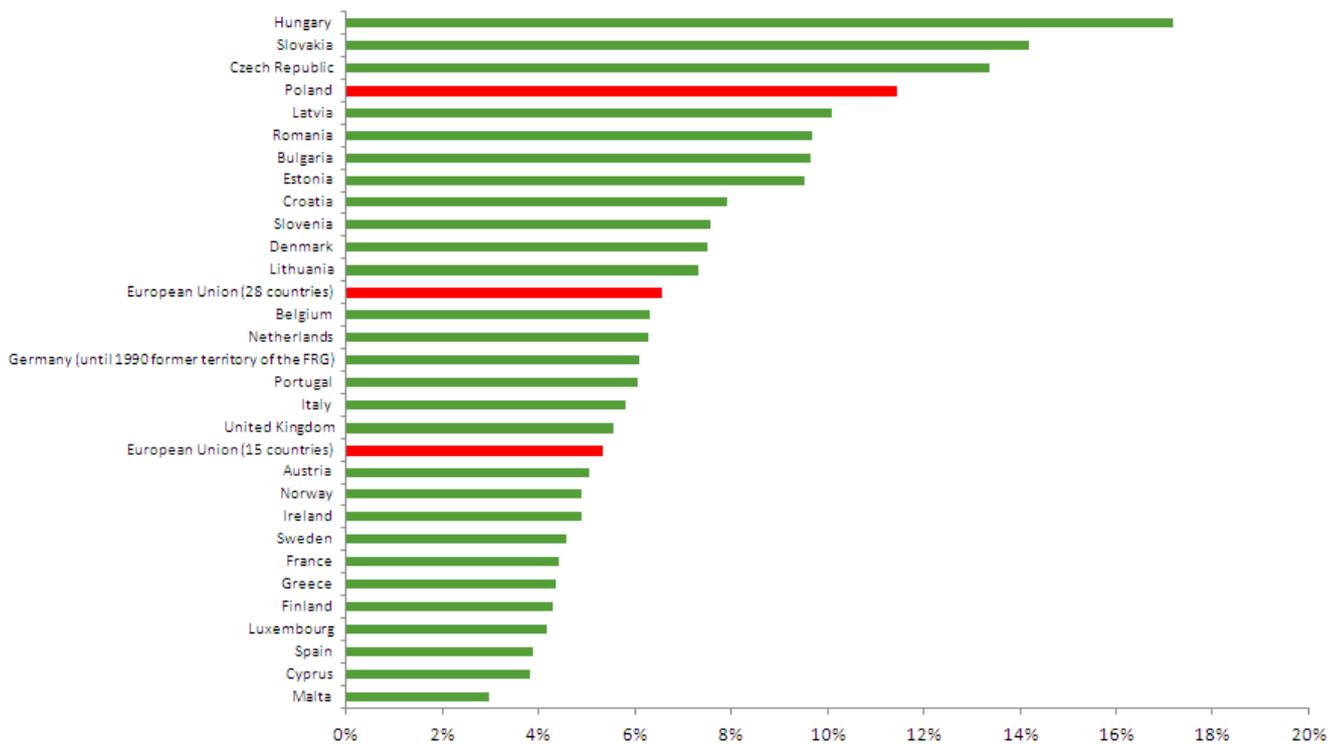
As underlined by the interviewed stakeholders related to industry, forecasting the long- or even medium-term prices of EUAs is increasingly based more on access to decision-makers than on econometric methods. It undermines trust in the proper functioning of this instrument.

Coal-mining and to a certain extent the energy sector in general are currently experiencing major difficulties, and the EU ETS is seen as posing additional burdens and not as a part of a solution in lowering the costs of transition towards the low-emissions economy. It is thought that modernisation of both sectors (through further limitation of production and employment) will require more funds and political intervention on the part of the European Commission. The EU ETS is regarded as unfair in its distribution of effort among the member states.

As shown in the figure below, the share of electricity, gas and other fuel spending in overall consumption of Polish households is one of the highest in the EU. As a consequence, the stakeholders representing the energy sector expect certain social repercussions to ensue. They point to the potential growth of energy poverty as a result of the growing price of carbon emissions.

⁷ See www.koalicjaklimatyczna.org/lang/pl/page/listy_otwarte/id/100/file/371/option/save/

Figure 3. Share of electricity, gas and other fuel spending in overall consumption of households in 15 EU member states (2010)



Source: Eurostat.

In the ETS dialogue in **Greece** (December 2014-January 2015), a significant percentage of stakeholders interviewed mentioned political instability and the lack of a solid framework as factors other than the economic crisis currently affecting the carbon price. This group consisted of stakeholders representing a broad range of sectors, including research institutes, NGOs, consulting, as well as the power and industry sectors.

Support in **Hungary** for the EU ETS, which is seen as one of numerous directives the country had to implement after its accession to the EU, is limited. In **Austria** most stakeholders in principle support the system even if it is not perceived to have worked well so far.

In the Netherlands, the EU ETS is publicly accepted and companies have become accustomed to using the CO₂ accounting system and the concept of carbon markets (via the JI/CDM past experience) during this period. There is a high awareness of the incumbent players in the ETS sector as companies are aware of the CO₂ limit, but in the non-ETS sectors, the government is responsible for handling all related emissions/allowances and higher awareness is required. For the new entrants in the Netherlands, due to the complicated character of the system with many rules and exceptions, has proven quite difficult to explain the level playing field.

In general, the main perception is that the reduction in CO₂ emissions still has to take place in the industries, even if the latter have used cleaner technologies (for their own cost reduction). Concerning

fairness, however, in the Netherlands 80% of emissions come from firms and a large amount from small firms. For the latter, the administrative costs are huge, which puts them at a competitive disadvantage.

Stakeholders from member states in **Central and Eastern Europe** suggest that there is a lack of institutional and administrative capacity to implement the ETS in certain countries. They observe that the capacity of regulators or administrators and operators of covered installations has been constrained in small member states. They also find that transaction costs associated with the EU ETS are sometimes too high for SMEs and that MRV requirements would pose additional burdens on the latter. This leads to a strong need for capacity-building and support programmes targeted at these member states and installations.

4. Conclusions

Polish stakeholders, with the exception of ecological organisations, are reluctant to accept more ambitious climate and energy goals. Although limiting GHG emissions and fighting climate change are generally accepted, the EU ETS in its current form is seen as an unfair and overly-politicised instrument. Many experts believe that the efforts made by Poland so far in lowering its emissions are largely ignored. In their view, the fast pace of the low-emissions transformation imposed by the European Commission seem to encumber Poland more than other countries.

Regarding the EU ETS within the 2030 framework, it was noted that **Greek** researchers and consultants generally supported more ambitious commitments, in contrast to industry and power-sector representatives, who stood by an approach that would be tailored to the de-carbonisation needs of the ETS sectors. Stakeholders from a broad range of sectors commented that the carbon price is also affected by political instability and the lack of a solid framework, apart from the economic crisis. The future of the ETS was optimistically viewed by a majority of stakeholders, based on indications for an improvement of the system.

Among **Austrian stakeholders** there is mixed support. Its industry in particular questions the usefulness of the EU ETS for technological change and calls for a targeted technology policy. Also academia claims that higher carbon prices are needed to bring new technologies to the market. Importance was attached in **Austria and Hungary** creating a long-term stable climate and energy framework with predictable carbon prices.

Regarding the sectoral coverage, views were very diverse, seeing the EU ETS coverage as being either too broad with a need to limit it to the energy-producing sector or too narrow leading to imbalances of carbon prices between ETS and non-ETS sectors, causing inefficiencies in the cost of CO₂ mitigation. The current reform proposals were seen as insufficient by most stakeholders in Austria and Hungary.

Among **Dutch stakeholders**, there is widespread support for the EU ETS as the central instrument of European climate policy. The inflexibility of the system, in combination with the economic crisis and interaction with renewable energy policy, however, has led to a large surplus of allowances. The ultimate goal would be an integrated global scheme with economy-wide auctioning of allowances, but

now, free allocation is still necessary to prevent carbon leakage. Industry stakeholders propose to reform the allocation from ex ante, based on historical benchmarks, to ex post, based on actual production levels. The introduction of an MSR is seen by most stakeholders as a step in the right direction, but there are doubts about its effectiveness.

EU stakeholders have recognised the impact of over-supply of EUAs, AAUs and associated ERUs as well as certain member states' measures to meet other related policy objectives, such as the promotion of renewable energy. Nevertheless, they broadly support the continuation of the ETS as the main instrument of the EU climate policy and as part of the 2030 climate and energy policy framework. The power sector and technology providers advocate the proposed reform designs such as MSR, and an environmental NGO network even called for a more ambitious reform. In contrast, energy-intensive industry emphasises the need for full compensation for indirect CO₂ costs in all member states, free allocation based on recent production and achievable benchmarks, among other issues.

Across member states, stakeholders expect the EU to improve the way in which the ETS is currently implemented. There is a broad concern that the market is not functioning as well as it was expected to do so, i.e. to promote reductions of greenhouse gas emissions in a cost-effective and economically efficient manner (Art. 1, EU ETS Directive). It is particularly challenging to strike a balance between the expectation that the ETS will provide incentives driving investment in low-carbon technologies and innovation on the one hand, and the need to address concerns over the competitiveness of energy-intensive industry and the risks of carbon leakage in global markets. This challenge is especially crystallised in the ongoing debate over designing the MSR.

On the other hand, there remains an insufficient level of understanding about the ETS in some of the EU-28 member states. Not all stakeholders are fully informed about or fully understand exactly how the ETS works. There is a divergence in stakeholders' views about the appropriate role of the ETS as either a regulatory tool or a market mechanism. Even if the ETS is expected to function as a market instrument, stakeholders may regard it as a de-facto carbon tax.

Stakeholders from member states in **Central and Eastern Europe** suggest that there is a lack of institutional and administrative capacity to implement the ETS in certain countries. This leads to a strong need for capacity-building and support programmes targeting these member states and installations.

The POLIMP project shows a wide variety of views held by stakeholders across sectors and EU member states, implying that there is no consensus about the EU ETS. As far as POLIMP researchers are aware, no similar exercise has been carried out to date, which would make this analysis unique and valuable. The most instructive observation is that there remains a diversity of perceptions about the nature of outstanding questions and how to address these questions through the structural reform proposed by the European Commission.

This observation was obtained through a two-step approach to stakeholder consultation. The POLIMP project set out hold preparatory dialogue before the ETS workshop with a view to transferring stakeholders' views from the member state level to the EU level. This approach aimed to facilitate EU

discussions based on some common understanding and assumptions while taking into consideration national circumstances or contexts that would influence the performance of the ETS. The process revealed, however, that the diversity of stakeholders' perceptions would make it difficult to structure discussions on the direction of the reform.

Lastly, this Working Document highlights the need to accelerate the flows of information from member-state stakeholders to EU policy-makers, and to improve the dissemination of information and communication from the latter to the former. To this end and in light of our findings, the European Commission is advised to consider taking the following next steps:

- i) encourage informed stakeholders based in member states to participate in EU consultation processes and
- ii) support interested member states in organising workshops for purposes of outreach, awareness and capacity-building.

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Annex 1. Target groups of stakeholders

The POLIMP project aims to be beneficial for various target groups that are defined not only by their direct interest for the project results, but also by their institutional, scientific and educational status. The users and other stakeholder categories, identified as having a particular interest in the project's outputs, are described (with the benefits they achieve) below:

⑩ **Producers of Knowledge:** Such network participants include private or public, regional, national or international institutions, national ministries, industrial or trade organisations, NGOs and individual experts. These mainly provide data in exchange for 'mutual benefit'. These stakeholders will find POLIMP important since it provides briefs on energy solutions, based on scientific and multidisciplinary assessments, and that therefore rest on stable ground and leave little room for dispute.

⑩ **Users and Implementers:** These are decision-makers who need to process data in order to make better-informed decisions in politics and in business. They include policy-makers at EU, national and also regional level, e.g. Members of Parliaments (including the European Parliament) and the Committee of the Regions, amongst others. These stakeholders will find POLIMP of particular importance for supporting their decisions as well as for the provision of information in a format that is suitable for their initiatives.

⑩ **Communicators:** This group refers generally to the concerned public, which includes both the audience of specialists and the concerned citizens. Communication is primarily conducted via media. Also for this group, POLIMP outputs are of interest if they are understandable and (reasonably) beyond dispute.

The POLIMP consortium has secured the involvement of representatives from all these layers and intends to involve additional participants to supplement the initiative's activities, during the project implementation phase and based on the specific needs that will emerge.

Source: D7.1 Communication and Dissemination Plan (http://polimp.eu/images/results/D7.1-POLIMP_Communication-and-Dissemination-Plan_Final.pdf).

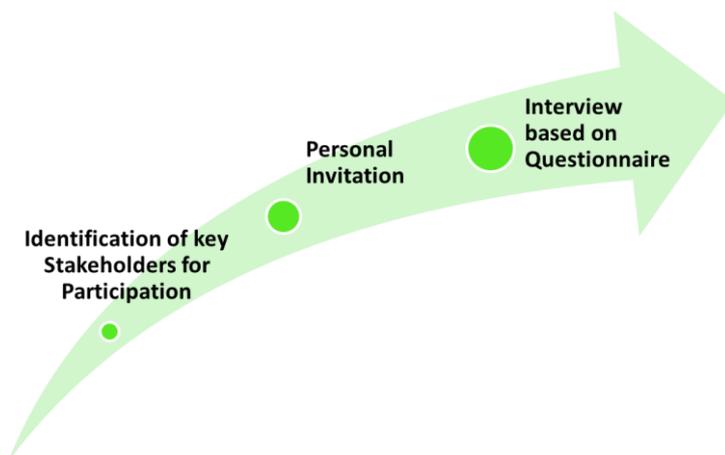
Annex 2. Preparatory dialogue outcome

In its first round of preparatory dialogues, the University of Piraeus Research Center (UPRC) in **Greece** focused on the role of carbon markets mechanisms in climate negotiations (market mechanisms, renewables, Article 9 Renewable Energy Directive), targeting 19 experts from academia, research institutes, the business-private sector, the public sector and NGOs. Questions concerned carbon markets, the CDM and the EU ETS, inter alia.

For the ETS dialogue, UPRC consulted 12 stakeholders in Greece from academia as well as from research institutes and businesses in the energy sector, combining a questionnaire with follow-up interviews. UPRC focused on the assessment of economic impacts on the cost-effectiveness of the EU ETS, increasing harmonisation in the implementation of the EU ETS, and national stakeholders' views on how the 2030 framework will influence the political support for the EU ETS. Key findings are incorporated into the main body of the paper.

The steps followed for the dialogues and input elicitation began with the identification of key stakeholders for participation, followed by a personal invitation that was sent to the identified stakeholders. After receiving a positive answer, UPRC conducted interviews with them based on a questionnaire developed for this purpose. Then UPRC analysed their feedback and identified the key outcomes. The process of the dialogue preparation and implementation was completed in consecutive steps, as diagrammed in the figure below.

Figure A1. UPRC dialogue process



The IBS conducted two sets of qualitative studies within the preparatory dialogue stage in **Poland**. The first was an expert seminar carried out under the Chatham House rule. The discussion involved 12 experts from the government sector, employer associations, research institutes and NGOs that are specialised in energy, environment, emissions trading, green technology or climate economy, and two other observers. Participants of the seminar discussed the proposals of the European Commission in the field of climate policy goals in 2030, reform of the EU ETS, as well as the structure and new

instruments of climate policy. The second set of studies was carried out through individual in-depth interviews with three experts chosen in purposeful sampling, focusing on the EU ETS. The interviews concentrated on four topics: the cost-effectiveness of the EU ETS, market confidence, political acceptability and perceived fairness.

The interviews **in Austria and Hungary** were carried out in a semi-structured way. An interview guidance with questions was sent ahead of teleconferences that lasted between 30 minutes and one hour.

The University of Graz (UniGraz) in Austria conducted the first set of interviews focusing on the RES target and regional cooperation on RES in the spring of 2014, interviewing six senior experts, from industry, academia, NGOs and consultancies in Austria and four in Hungary related to energy policy. In November and December 2014, the researchers conducted the second set of interviews on emissions trading with three stakeholders in Austria and two in Hungary out of the above-mentioned stakeholders.

JIN Climate and Sustainability in **the Netherlands** completed two interviews on public acceptance with researchers based in spatial planning and energy sectors in March 2014. It completed 17 interviews in the Netherlands on the ETS in January-March 2015, targeting experts from consultancies, research institutes, the emissions authority and policy-makers, as well as business stakeholders from energy-intensive industries and the power sector. Most of the stakeholders were interrogated through bilateral semi-structured interviews, based on a predefined list of themes and questions. Some of the stakeholders answered the questions by email instead. The five themes discussed in the interviews and questionnaires were: 1) factors influencing the EU ETS allowance price; 2) interaction of the EU ETS with other policies, instruments and targets; 3) the ETS per sector; 4) efficacy of the EU ETS and 5) reform of the EU ETS.

About POLIMP



“POLIMP – Mobilising and transferring knowledge on post-2012 climate policy implications” aims at identifying and addressing the knowledge needs and gaps about implications on the possible directions of international climate policies, for a broad group of stakeholders.

POLIMP will fill in these knowledge gaps through the production and communication of “knowledge packages”, in order to support evidence-based policy-making. These packages will be derived from a broad range of existing reports, research, climate policy decisions, as well as from stakeholder consultation. POLIMP will provide an overall, on-line platform for information exchange of a wider list of contemporary and future climate policy initiatives.

POLIMP is run by a consortium led by Joint Implementation Network (JIN) with six partners, Centre for European Policy Studies (CEPS), University of Piraeus Research Center (UPRC), Universitaet Graz (UniGraz), Ecologic Institute (EI), Climate Strategies (CS), and Instytut Badan Strukturalnych (IBS). For more information see: <http://polimp.eu/>



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