Published on *Ecologic Institute: Science and Policy for a Sustainable World* (https://www.ecologic.eu)

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EVENT

Climate Talk
Climate
Energy

EU ETS – From Slumping to Jumping?

[1]

Due to the ongoing decline of the carbon price set by the EU ETS, the EU is considering an intervention in its carbon mar ket. While a fundamental reform of the scheme would be necessary, political feasibility only seems to allow temporary fixes.

The 24th edition of the Climate Talk, held on 25 February 2013, discussed the future of the European Emissions Trading Scheme (EU ETS). The event, jointly organised by the Ecologic Institute and the German Institute for International and Security Affairs (SWP), featured as discussants Dr. Jochen Diekmann (DIW Berlin), Dr. Uwe Neuser (Ministry of the Environment) und Dr. Joachim Hein (Federation of German Industries).

The EU ETS entered into its third trading perion on 1 January 2013. It is generally seen as the flagship instrument of European climate policies. But the low price of CO2 allowances does not set an adequate incentive to invest in low-carbon technologies. Due to the ongoing slump of the carbon price, there has been intensive discussion about the need to reform the EU ETS. The European

Commission put forward a concrete proposal for reform in November 2012. The European Parliament is currently discussing the option of a so-called "backloading" of allowances, meaning that 900 million emission allowances, initially slated for auctioning in the coming years, will instead be sold only in 2009, at the end of the trading period. The Climate Talk provided for a lively discussion of the problems of the ETS and the current reform proposals.

There is currently a huge surplus of emission allowances in the market – estimated at up to 2 billion tonnes, equivalent to one whole year's worth of emissions. The resulting, low price of emission allowances does not provide any incentive for innovations or investments. As a consequence, the ETS fails to give direction for economic development at the time when it is most needed. In addition, the low price of allowances also translates into low revenues from auctioning, which is felt in the different funds that have been set up to finance the low-carbon transformation and support energy efficiency-improving investments. Other participants argued that the ETS is doing exactly what it should do: it is making sure that the emissions of the capped sector stay within the limits, as defined ex-ante. The low prices are not a sign of failure, but are due to the fact that emissions have fallen markedly since 2008. Whether this is due to climate policy or due to the economic recession is irrelevant for the instrument.

Different reform proposals for the ETS were discussed, also in the light of their legal feasibility and their economic implications. Already in 2010, when the EU was debating to up its climate target from a 20% to a 30% reduction, the Commission proposed to cut the ETS cap by 1.4 billion tons of CO2. This "set-aside" would have implied a permanent lowering of the cap, whereas the currently discussed "backloading" proposal only means that allowances are parked, to be brought into the market later than originally foreseen. In either case, the reforms are about correcting the mistakes of the past: in the second trading period, allocation of allowances far exceeded the actual emissions, and the cap was further inflated through the generous inclusion of offset credits from third countries (CDM and JI). This surplus from the second trading period is now carried on to the third period ("banking") – which was already sufficiently endowed with credits to begin with.

Discussants cautioned that interventions such as backloading would necessarily create uncertainty among firms, who would then have to anticipate further interventions in the future. This would damage the credibility and integrity of the EU ETS. Other participants pointed out that the backloading was in fact already anticipated by market participants, and factored into the prices. But as it is equally anticipated that the allowances will eventually be returned into the market, the price effects of the backloading may well be smaller than expected – except where backloading creates a real, shortterm scarcity on the market.

Further, structural reform options include a lowering of the linear reduction factor – the automatic, annual lowering of the cap that is already foreseen in the instrument; the extension of the ETS to other sectors; and stricter limits on the use of international offset credits in the EU ETS. Last not least, even the price itself could be addressed through a direct intervention, e.g. by setting a floor price for CO2 emissions. The different options for price management were discussed vividly. In the current situation, though, backloading appears to be the only feasible option, as all other options would require a change of the EU Emissions Trading Directive. For this, there is not only a lack of political support – but simply a lack of time, as the term of the current EU Commission ends in 2014.

All things considered, participants argued that no reform of the ETS, however comprehensive it might be, would suffice by itself to integrate energy and climate policies, and create certainty for investors. Such certainty is not only a matter of an adequate carbon price, but also stems from the consistent alignments of the various instruments and targets (including the promotion of renewables and energy efficiency). This underlines the importance of the EU Commission's green book on climate and energy policies, expected in the spring of 2013.

After the event, the lively debate continued in a more relaxed setting in a nearby restaurant.

25 February 2013
Berlin
Dr. Jochen Diekmann
Dr. Uwe Neuser
Dr. Joachim Hein

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Date

25 February 2013

Location

Berlin, Germany

Language

English

Number of Participants

20

Keywords

Emissions Trading, EU ETS, ETS, Backloading, CO2, set aside, Europe

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Links

[1] https://www.ecologic.eu/sites/files/event/2013/climate_talk_web_27.jpg