

CAN Europe's contribution to the European Commission's public consultation on options to strengthen the EU Emissions Trading System

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INTRODUCTION

CAN Europe welcomes the opportunity to participate in a debate about much-needed adjustments to the functioning of the EU Emissions Trading Scheme (EU ETS) and to provide comments on the options for ETS structural reform, outlined in the European Commission's *Report on the state of the European carbon market in 2012*. CAN Europe is seriously concerned about the current underperformance of the ETS and extremely weak carbon price signal, which in combination with record low coal prices, decrease the attractiveness of green investments and in consequence puts the EU at risk of dangerous high carbon lock-in¹.

In its contribution to the European Commission's public consultation on review of the auction time profile for the EU ETS, from November 2012, CAN Europe highlighted that back-loading of allowances must be urgently followed by structural adjustments for ETS². Delayed auctioning of any quantity of allowances, combined with their reintroduction onto the market, is alone not enough to robustly and permanently tackle the oversupply of allowances and to ensure that the ETS is on track to deliver on its principal objectives. In that context CAN Europe recommends that the necessary ETS reform must be designed to strengthen the Scheme's performance in the short and long term perspective:

- To adjust the linear reduction factor governing the ETS cap with the EU's stated objective to reduce emissions by at least 80-95% by 2050;
- To ensure that the ETS delivers an uninterrupted and meaningful carbon price signal, which provides investors with certainty that low-carbon investments are cost-efficient in the long-term perspective.

In this context CAN Europe believes that structural measures for the ETS should not only address the problem of accumulated surplus allowances, but also reform the Scheme to ensure it delivers cost-efficient abatement, necessary to achieve a 30% domestic emission reduction target by 2020 and the upper end of 80-95% emissions reductions by 2050.

¹ In 2011 coal consumption grew in more than one third of EU Member States, with a record 52% increase in Spain. The amount of electricity generated from coal in France and in the UK has increased by almost as much as 50% in the first quarter of 2012, compared to 2011. In many Member States, including Germany, Poland and the Netherlands, new coal-fired power plants are either planned or under construction.

EU ETS at a crossroads: recalibrating an oversupplied market to spur investments and innovation, CAN Europe, Greenpeace, WWF, Sandbag (2012), http://www.climnet.org/resources/publications/can-europe-publications/climate-finance/doc_download/2134-eu-ets-at-a-crossroads-ngo-briefing-january-2013

² CAN Europe contribution to the European Commission's public consultation on review of the auction time profile for the EU ETS: http://ec.europa.eu/clima/consultations/0016/organisation/can_en.pdf

CAN EUROPE VIEWS ON THE OPTIONS PROPOSED BY THE COMMISSION

a. Increasing the EU reduction target to 30% in 2020

CAN Europe strongly supports an increase of the EU's 2020 climate objective to 30% domestic emission reductions. Strengthening of the EU climate ambition would result in several benefits like expansion of low-carbon investments and increased auctioning revenues and would put the EU on a cost-efficient emission reduction trajectory by 2050.

The EU's pre-Copenhagen conditional offer to increase its 20% climate target to 30% - if other big emitters commit themselves to comparable action – has to be reassessed in the light of the recent developments: climate policy initiatives emerging worldwide and the latest data on the EU's emissions, indicating that the EU already reached its 2020 climate target in 2011, nearly 10 years ahead of time. As outlined in CAN Europe's briefing *Closing the ambition gap*³, if EU Member States fully implement already agreed policies, it is very likely that the EU will eventually reach 25% domestic emissions reductions by 2020. An EU domestic climate target of 30% can therefore be achieved with a little additional effort. Moreover, at the last UN climate conference in Doha parties agreed to review their targets for the 2nd Kyoto Protocol commitment period, which urges the EU to increase its mitigation ambition in the context of global efforts to tackle the climate change challenge.

Increase of the EU's 2020 climate objective to 30% domestic GHG cuts by 2020 would have to be translated into additional emission reductions in both ETS and non-ETS sectors. In the ETS moving to a 30% climate target would require cancellation of emission allowances, an increase of the linear emissions reduction factor or a combination of both. The optimal solution should support the cost-efficient achievement of the upper end of the EU's 2050 mitigation objective. Taking this into account, CAN Europe recommends achieving the 30% domestic climate target through the permanent retirement of 2.2 billion allowances combined with an increase of the linear reduction factor to at least 2.6%⁴. Cancellation of allowances would have to happen before the end of Phase III and the linear emissions reduction factor would have to be increased from 2014 onwards.

b. Retiring a number of allowances in Phase III

As indicated above, the cancellation of a number of allowances is one of the technical solutions that could be implemented to increase the EU climate target to 30% domestic emission reductions. To allow the ETS to deliver its fair share in reaching 30% domestic GHG cuts by 2020, the total volume of allowances in Phase III would need to be decreased by 2.7 billion. While the Commission did not propose a concrete number of allowances to be permanently removed from the market, CAN Europe is calling for a retirement of 2.2 billion allowances (in combination with an increase of linear emission reduction factor to reduce the volume of Phase III allowances by an additional 500 million). Set-aside of 2.2 billion allowances might be achieved gradually with the permanent withdrawal of 900 million back-loaded allowances as a first step, followed by cancellation of the remaining 1.3 billion between 2015 and 2020.

³ *Closing the ambition gap: What can Europe do*, CAN Europe, (2012), http://www.climnet.org/resources/publications/position-papers/doc_download/2127-closing-the-ambition-gap-what-europe-can-do-dec-2012-

⁴ Calculations based on: *Strengthening the EU emissions trading scheme and raising climate ambition*, Oeko Institut report, commissioned by WWF and Greenpeace (2012), <http://www.greenpeace.org/eu-unit/Global/eu-unit/reports-briefings/2012%20pubs/Pubs%20%20Apr-Jun/Strengthening%20the%20EU%20ETS%20and%20Raising%20Climate%20Ambition.pdf>

c. Early revision of the annual linear reduction factor

CAN Europe suggests a review of the linear emission reduction factor to be accelerated to 2014. *The state of the European carbon market in 2012* report rightly points out that "the current annual linear reduction factor leads to just over 70% reduction in the ETS cap by 2050 which is not consistent with the EU's agreed long term objective of 80-95% reduction by 2050". The emission reduction trajectory in the ETS sectors should be adjusted to put the EU on track to reach the upper end of the EU's 2050 climate target but also to address the surplus of allowances expected to accumulate by 2020, in case no action or insufficient action to tackle this problem is taken. A 2014 early review of the linear reduction factor should result in its increase to 2.6%, assuming simultaneous cancellation of 2.2 billion allowances. A 2.6 % annual reduction factor from 2014 would remove 500 million allowances from Phase III and would lead to full decarbonisation in the ETS sectors by 2050. Nevertheless if correction of the emission reduction trajectory gets delayed beyond 2014, or if the number of retired allowances is lower than 2.2 billion, the linear reduction factor would have to be steeper than 2.6%, to compensate for a delayed action. Increase of the factor governing the ETS cap should be taken into account in preparations of the post 2020 climate and energy framework to ensure that targets for emission reductions, renewable energy and energy savings are mutually supportive.

d. Extension of the scope of the EU ETS to other sectors after 2020

CAN Europe has strong reservations about this option. Expanding the ETS to other sectors - like surface transport - may result in weakening of environmental standards that are already imposed on sectors not covered by the ETS. For instance, in the transport sector the existing regulations are likely to be more effective in reducing emissions, increasing sustainability and boosting innovation than the ETS would be. Similarly, emissions in the heating and cooling sector can be reduced more effectively through other policies such as increased energy saving targets, efficiency standards and requirements as well as carbon taxes. Expanding the scope of the ETS may hamper future linking of the EU's carbon market with other schemes worldwide. The linkages and interactions between ETS and other existing policies and measures in other sectors need to be further explored, before looking into such an extension. CAN Europe is open to participate in the discussions related to this issue, however this option is unlikely to be implemented early enough to affect the EU's climate ambition before 2020.

e. Limit access to international credits

CAN Europe recognises that by 2012 the use of international credits have become a major driver for the build-up of the current surplus accumulated on the EU carbon market. According to the European Commission offset credits are responsible for "two thirds of the EU ETS over-supply" and could represent as much as three quarters of the expected glut of credits by 2020, if no action is taken⁵. CAN Europe members' views on limited access to international credits after 2020 diverges and while many support a full ban on offset credits, some propose the use of the discount factor combined with strong quality restrictions.

CAN Europe recommends an urgent review of the quality criteria of offset credits available in the EU ETS for compliance before 2020. Use of offset credits undermines the environmental integrity of the EU ETS, if credits are generated by business-as-usual "non-additional" projects⁶. Research recently released under the CDM Policy Dialogue highlights that in the current CDM important project types, such as large-scale

⁵ *The state of the European carbon market in 2012*, European Commission (2012), http://ec.europa.eu/clima/policies/ets/reform/docs/com_2012_652_en.pdf

⁶ Projects that would be realised even in the absence of the CDM mechanism.

power supply and methane projects are unlikely to be additional⁷. CAN Europe supports banning offset credits coming from such projects before 2020.

Moreover CAN Europe recognises that limited access or a full ban on international credits after 2020 may result in decreased financial support for clean investments in developing countries, that must be properly addressed. For instance a reformed ETS could centrally retain a certain proportion of allowances before distributing them to Member States for national auctioning. Revenues from auctioning could then be used as international climate finance, with the large majority directly fed into the Green Climate Fund⁸.

f. Discretionary price management mechanisms

CAN Europe does not support this option and considers a cap on emissions to be the fundamental feature of the EU ETS, guaranteeing that the Scheme delivers on its environmental objectives and provides a robust carbon price signal. The carbon price reflects demand and supply of allowances and a change of one of these parameters should be the primary way to affect the CO₂ price. The cause of the current Scheme's weak performance is over-supply of allowances, not a weak carbon price signal which merely reflects the market's imbalance. Therefore to ensure that the ETS provides a carbon price signal that incentivises low-carbon investments, a cap on emissions has to be tightened. *The state of the European carbon market in 2012* report noted that price management mechanisms, "would alter the nature of the EU ETS being a quantity-based market instrument," while CAN Europe believes that a cap on emissions - set up in line with the scientific requirements - should remain the main tool impacting carbon price developments. Furthermore, CAN Europe is concerned that the establishment of the price management mechanisms may hamper future linking of the EU's carbon market with other schemes worldwide.

CONCLUSIONS

CAN Europe supports the ETS structural reform that would improve functioning of the EU's carbon market in the short (2020) and long-term perspective (2050). The ETS reform needs to address the surplus of allowances accumulated on the market and it should also correct current emission reduction trajectories for the ETS sectors. This would ensure that they deliver cost-effective abatement to reach the EU's stated 2050 climate objective. In order to ensure clarity and certainty as to the next steps, CAN Europe calls on the European Commission to present the timeline for implementation of the ETS structural reform by the end of May 2013.

CAN Europe supports a robust post-2020 climate and energy framework, including a coherent set of ambitious targets for GHG emission reductions, renewable energy and energy savings. The ETS should play an important role in the post-2020 climate architecture and should be complemented by other policy instruments.

⁷ If credits generated by these type of projects are used for compliance, they could increase cumulative global GHG emissions by up to 3.6 Gigatonnes CO₂eq by 2020. Several countries which are currently developing domestic emissions trading schemes, including Switzerland and South Korea address these concerns: South Korea does not allow use of international credits and Switzerland is considering to introducing quality restrictions.

⁸ Such an arrangement would help the EU to meet its international climate finance obligations.

CERTAIN FEATURES OF DIFFERENT STRUCTURAL MEASURES OUTLINED IN “THE STATE OF THE EUROPEAN CARBON MARKET IN 2012” REPORT

Option	Impact on:				
	Emission reductions	Ability of the EU ETS to meet the EU target of an 80-95% reduction in a cost-effective manner	Your activities or the activities of the business under your jurisdiction, including estimated changes in compliance and administrative cost	Employment and households	Others
a. Increasing the EU GHG target to 30%	POSITIVE Increase of the ambition level before 2020; 30% target should be achieved domestically;	POSITIVE If achieved through sufficient increase of the linear reduction factor (alone or in combination with other measures), would put the EU on track to cost-effectively achieve 80-95% GHG cuts by 2050;	DOES NOT APPLY TO CAN EUROPE	POSITIVE Increased climate target would boost jobs and investments in energy efficiency and low-carbon technologies. Increased auctioning revenues could be reinvested to create new jobs as well as could be used to compensate the most vulnerable households for electricity price increase;	<ul style="list-style-type: none"> • Would increase Member States auctioning revenues⁹; • Would increase European GDP the growth rate of the European economy¹⁰; • Would deliver robust and predictable carbon price signal, providing certainty to investors; • Would address excessive free allocation; • Would improve air quality and provide a number of health co-benefits¹¹; • Would be in line with the review of KP targets, agreed at the last UN climate conference in Doha¹²;
b. Retiring a number of allowances	POSITIVE However depends on a number of allowances to be retired;	PARTLY POSITIVE Would accelerate pace of emission reductions by	DOES NOT APPLY TO CAN EUROPE	POSITIVE Depends on a number of allowances to be retired and whether set-	<ul style="list-style-type: none"> • Would fully or partly address surplus of allowances expected to accumulate in the system (depending on a number of

⁹ Analysis of options to move beyond 20% greenhouse gas emission reductions and assessing the risk of carbon leakage, The European Commission, May 2010.

¹⁰ A New Growth Path for Europe, PIK, 2011.

¹¹ Analysis of options to move beyond 20%.

¹² UNFCCC document FCCC/KP/CMP/2012/L.9

		2020, if combined with other measures may put the EU back on track to achieve cost effective emission reduction by 2050 ¹³ ;		aside is combined with other measures. If retirement is ambitious enough, it may strengthen carbon price signal and boost jobs and investments in energy efficiency and low-carbon technologies;	allowances to be retired); <ul style="list-style-type: none"> • Would deliver moderate carbon price signal and increase Member States auctioning revenues; (depending on the volume of allowances to be cancelled); • Would not affect excessive free allocation; • Could be the first step on the way to further ETS reforms;
c. Early revision of the linear reduction factor	POSITIVE However, depends on the scale of the increase and other complementary measures (for instance in the case where no other measures are implemented an increase of linear reduction factor would compensate for the surplus currently accumulated in the ETS);	POSITIVE If increase of the linear emission reduction factor is significant enough (and would lead to achieving the upper end of 80-95% emissions reductions by 2050;	DOES NOT APPLY TO CAN EUROPE	POSITIVE Would boost jobs and investments in energy efficiency and low-carbon technologies due to strengthened carbon price signal;	<ul style="list-style-type: none"> • Would deliver strong carbon price signal, providing certainty to investors (depending on the scale of increase of the linear reduction factor); • Would increase Member States auctioning revenues; • Would address excessive free allocation; • Would send a strong signal to international community that the EU is committed to maintain the effectiveness of its carbon market;
d. Extension of the scope	POSSIBLY NEGATIVE: There is a risk that extension of the ETS would result in weakening of environmental standards that are already imposed on the sectors not covered by the ETS;	DIFFICULT TO ESTIMATE There is a risk that extension of the ETS would result in weakening of environmental standards that are already imposed on sectors not covered by the ETS;	DOES NOT APPLY TO CAN EUROPE	DIFFICULT TO ESTIMATE	<ul style="list-style-type: none"> • May result in weakening of environmental standards that are already imposed on sectors not covered by the ETS; • May hamper future linking of the EU's carbon market with other schemes worldwide;
e. Access rules to international credits	POSITIVE: Both ban and limitations on the use of offset credits would	POSITIVE: Both ban and limitations on the use of offset credits would	DOES NOT APPLY TO CAN EUROPE	POSITIVE: Would incentive emissions reduction in	<ul style="list-style-type: none"> • Could Possibly decreased financial support for clean investments in developing countries;

¹³ Strengthening the EU ETS, Climate Strategies (2012), <http://www.climatestrategies.org/research/our-reports/category/60/343.html>

	incentivise domestic emissions reductions;	accelerate the rate of domestic abatement;		Europe, boosting jobs and investments in energy efficiency and low-carbon technologies;	
f. Discretionary price management	NO DIRECT IMPACT: Would not affect the cap on emissions however could help to avoid the risk of high-carbon lock-in;	NO DIRECT IMPACT: Would not affect the cap on emissions;	DOES NOT APPLY TO CAN EUROPE	DIFFICULT TO ESTIMATE	<ul style="list-style-type: none"> • May hamper future linking of the EU's carbon market with other schemes worldwide; • Would provide long-term certainty to investors; • Would help to avoid the risk of high-carbon lock-in;

For more information, please contact:

Julia Michalak, CAN Europe Policy Officer,
E-mail address: julia@caneurope.org
Telephone number: +32 (0) 2 894 46 88