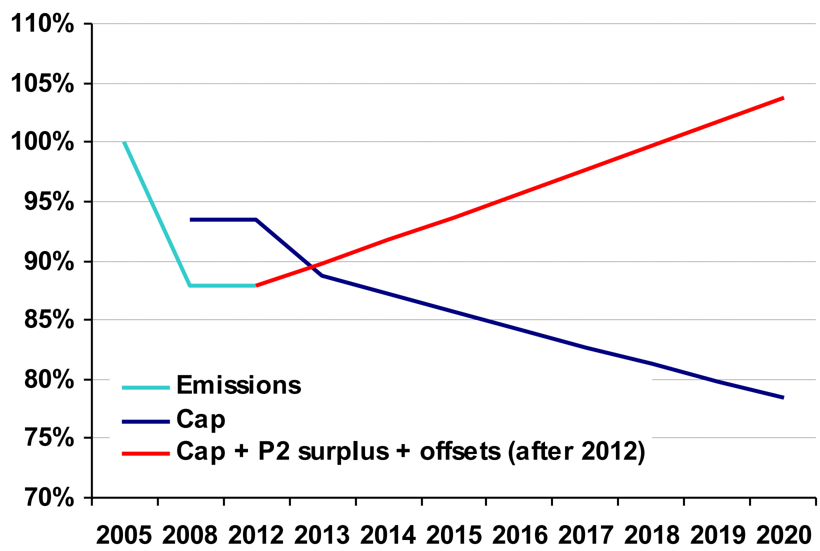
Climate Markets and Investment Associations Transparency Register ID Number - 66155959707-88

CMIA welcomes the European Commission's initiative to propose options to strengthen the EU Emissions Trading Scheme. CMIA believes that the EU ETS should be the cornerstone of Europe's climate change and energy policy, as a credible and robust carbon pricing policy has to be at the heart of any policy which is designed both to reduce GHG emissions and drive a transition to a low-carbon economy. It is for these reasons that we support the backloading intervention on the ETS, as we set out in our submission to the commission stakeholder consultation last autumn. We also agree with the Commission that the EU ETS is plagued by a huge surplus of emission permits, and the backloading measure can only be a temporary fix We believe that the primary cause of this surplus is a structural flaw, allowing for the accumulation of excess supply which undermines its core objectives. However CMIA does not agree that the options proposed by the Commission could permanently address this problem, and reiterate its proposal for a mechanism to cap any excess/surplus of emission permits.

The EU has committed both internally and internationally, to reduce its emissions by 20% under 1990 level by 2020. To meet this objective, the EU ETS was set up with an **original target** to reduce industrial emissions by -21% from 2005 levels. Yet the accumulation of a large surplus has changed the scheme's target, allowing emissions to gradually increase by 18% compared to Phase II, and by 4% compared to 2005 (this is the scheme's **effective target**, as illustrated below). The EU ETS cap to 2020, as expressed by the availability of allowances will allow a +4% growth in emissions against 2005 rather than a -21% cut.

The EU ETS original target vs. effective target



Source: CMIA

CMIA believes the EU ETS' target should be reset at its original level. The current wrong calibration may oblige European Member States to double up the EU ETS with other, costlier policies to achieve its 2020 reduction target, at the expense of competitiveness for European producers and harmony in energy policy.

CMIA believe that this situation is the combined consequence of low emissions in the second phase of the EU ETS and the scheme's flexible mechanisms allowing to use emission permits unused in past years for compliance in later years. CMIA also believe that these mechanisms can be, and should be reformed to correct these kind of inconsistencies and prevent them from happening again.

CMIA's response to proposed options

1. A move to a 30% pathway

A move to 30% is not a solution to the current problem. Without cancelling any surplus, a change in the EU target to 30% would only absorb a small part of this surplus and lead to an effective constraint of only about 6% under 2005 levels. In such conditions, there is significant risk that member states will feel the need to implement even more costly national policies to actually achieve this 30% target, instead of using the EU ETS. This would make the EU ETS even less relevant in achieving its objective as well as increasing costs.

2. Permanently retiring phase III allowances to address the imbalance

This option could possibly correct the inconsistency between emission permit supply and the 21% reduction target if the amount of surplus retired equaled the surplus amount. In effect, it would turn the temporary fix of backloading into a permanent measure by removing the risk of the "set-aside" quantity of allowances returning to the market. However, it would not prevent the possibility of a surplus from building up again, eg in another recession, and re-establishing another major supply-demand imbalance in the EU ETS.

3. An early revision of the linear reduction factor to reflect the desired 80-95% 2050 objective

This would be similar to a move to 30%. The new emission pathway would be more stringent but the surplus would allow large deviations from it. As a result, other policies might be implemented to actually follow the desired pathway, sidelining the EU ETS.

4. Expansion to other sectors

CMIA generally supports extending the EU ETS, provided it is done in a way that keeps transaction costs low and does not overlap with other policies. However, the only way to shrink the surplus by expanding the EU ETS to other sectors would be to grant no or very few free allowances to new sectors. The new sectors would then be disadvantaged and put legal pressure on the system.

5. A reduction in the ability to use international credits in Phase IV

This option would only have an impact after 2020. It might help prevent more surplus from building up in the system but would not reduce the current one.

6. Discretionary price management mechanisms

The discretionary price management reserve concept is not an appropriate solution. If the price were low in the presence of a cap which was genuinely constraining, then there would be no need for intervention. The ongoing low EUA price is indicating a diluted cap and excessive supply, this is what the European Commission needs to address, not the price at which EUAs are trading, which is a symptom not a cause. We strongly believe that implementing a mechanism that predictably addresses the fundamental problem of oversupply rather than addressing the indicator of price is the key to realigning the EU ETS with its goals.

CMIA's proposal

Of the six options proposed by the Commission, only one (option 2) can address the surplus problem immediately and none would prevent it from happening again.

This is why CMIA reiterates its proposal for a mechanism to cap the accumulation of surplus emission permits in the EU ETS to no longer than three years and that any number of permits beyond that limit should be removed permanently from later supply of auctioned volumes. The table below illustrates the number of EUAs to be removed from auctioned volumes each year using such mechanism, in an emission scenario given by a market analyst.

	2008	**2009**	**2010**	**2011**	**2012F**	**2013F**	**2014F**	**2015F**
Cap	2003	2052	2079	2099	2334	2256	2218	2181
CERs/ERUs usage	80	80	135	250	400	150	175	200
Cap + offset usage	2083	2132	2214	2349	2734	2406	2393	2381
Emissions	2119	1882	1937	1893	2117	2126	2146	2156
Surplus (yearly)	**-36**	**250**	**277**	**456**	**617**	**280**	**247**	**225**
Cumulative surplus	-36	214	491	947	1564	1844	2091	2316
Max surplus allowed (3y)	**-36**	**214**	**491**	**947**	**1350**	**1353**	**1144**	**752**
To remove from auction permanently	**-**	**-**	**-**	**-**	**214**	**277**	**456**	**617**

Source: CMIA, Barclays Capital (22 June 2012)

The EU ETS Directive[1] stipulates that the decreasing cap on the quantity of allowances should "ensure that the emissions trading system delivers gradual and predictable reductions of emissions over time". Clearly, some of the scheme's features are preventing this from happening.

In amending the Kyoto Protocol in Doha, the international community corrected a key design flaw by banning the use of AAUs which would corresponds to an emission increase. It is time for Europe to follow

[1] Directive 2009/29/EC of 23 April 2009 amending Directive 2003/87/EC

this example by correcting the design flaws of its own ETS. Only this could give the EU ETS the relevance it deserves to ensure Europe meets its emission reduction commitments at the cheapest cost.

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About CMIA:
The Climate Markets & Investment Association (CMIA) is an international trade association representing over 60 companies that finance, invest in, and provide enabling support to activities that reduce emissions. CMIA's membership accounts for an estimated 75 per cent of the global mitigation market, valued at USD 130 billion in 2009. Solely representing organizations that provide services to and invest in the environmental sector, membership does not include any entities with compliance obligations under cap-and-trade schemes. This results in a unique advocacy platform with emphasis on the environmental integrity of market mechanisms and climate change policies.

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