Options for structural measures to strengthen the EU Emissions Trading System: Main outcomes of the public consultation

On 14 November 2012, the European Commission adopted a Report on the State of the European Carbon Market in 2012 (Carbon Market Report).[1] This document served as a consultation document for a twelve-week online consultation on the options for structural measures to strengthen the EU Emissions Trading System (ETS, which lasted until the end of February 2013, allowing stakeholders, Member States and other EU institutions to express their views.

The Carbon Market Report gave an overview of the current functioning of the market with a large and growing supply-demand imbalance of emissions allowances in the EU ETS, followed by a non-exhaustive list of six options for structural measures:

(a) Increasing the EU reduction target to 30% in 2020;

(b) Retiring a number of allowances in phase 3;

(c) Early revision of the annual linear reduction factor;

(d) Extension of the scope of the EU ETS to other sectors;

(e) Use of access to international credits;

(f) Discretionary price management mechanisms.

The information submitted to the consultation is a fundamental part of the impact assessment and has been taken into due account in the Commission's preparations of more concrete proposals for a structural measure.

This document summarises the responses to the consultation. It is available on the webpage of the online consultation[2], together with the individual contributions received.

1. PROCESS

The online consultation lasted from 7 December 2012 to 28 February 2013. A dedicated webpage including the link to the Carbon Market Report was created and announced on the centralised "Your Voice in Europe" page.

The following general groups replied to the consultation:

- Organisations consisting of business associations; trade unions; representatives of civil society; such as non-governmental organisations (NGOs); organisations representing other stakeholders groups; and individual companies;
- Public authorities consisting of national and sub-national authorities;
- Citizens;
- Stakeholders, who identified themselves as organisations representing certain interests but could not be verified in the EU Transparency Register.

In addition, two dedicated full-day consultation meetings were organised on 1 March and 19 April 2013 in Brussels. An expert meeting on an additional option, which emerged from the consultation, of a reserve mechanism to render the auction supply more flexible was

[1] COM(2012) 652

[2] http://ec.europa.eu/clima/consultations/articles/0017_en.htm

organised on 2 October 2013. The results of all meetings were taken into due consideration together with the results of the online consultation in preparing this summary.

Box 1: Consultation meetings

The Commission organised two full-day consultation meetings to examine with the stakeholder community in detail the merits and drawbacks of the six options set out in the Carbon Market Report. The agenda was defined in a way to move forward the reflection on three options in each meeting. In addition, the second meeting looked at possible additional options supported by several stakeholders in the online consultation.

1st meeting on 1 March 2013

Welcome and introductory remarks were given by the Commission and the Irish Government. The Commission also presented a summary of the results of the online consultation.

The first session was dedicated to option (b) of retiring a number of allowances in phase 3. The panel was composed of a representative of Centre for European Policy Studies (CEPS) acting as a lead discussant, followed by representatives of BusinessEurope and International Emissions Trading Association (IETA).

The second session was dedicated to option (f) of discretionary price management mechanisms. The panel was composed of a representative of Bloomberg New Energy Finance (BNEF) acting as a lead discussant, followed by representatives of Glass for Europe and Eurelectric.

The third session was dedicated to option (a) of increasing the EU reduction target to 30% of 2020. The panel was composed of a representative of University College Dublin acting as a lead discussant, followed by representatives of Cembureau and The Prince of Wales's EU Corporate Leaders Group on Climate Change.

A video recording is available at the following webpage:

https://scic.ec.europa.eu/streaming/index.php?es=2&sessionno=4ecb679fd35dcfd0f0894c399590be1a

2nd meeting on 19 April 2013

Welcome and introductory remarks were given by the Commission.

The first session was dedicated to option (c) of early revision of the linear reduction factor. The panel consisted of a representative of Tschach Solutions acting as a lead discussant, followed by representatives of Confederation of European Paper Industries (CEPI) and Climate Action Network Europe (CAN-Europe).

The second session was dedicated to option (d) of extension of the scope of the Eu ETS to other sectors. The panel consisted of a representative of Öko-Institute acting as a lead discussant, followed by representatives of Europia and Department of Climate Change and Energy Efficiency, Australia.

The third session was dedicated to option (e) of use of access to international credits. The panel consisted of a representative of Center for Clean Air Policy Europe (CCAP Europe) acting as a lead discussant, followed by representatives of Eurofer and European Trade Union Confederation (ETUC).

The fourth session was dedicated to additional options supported by stakeholders. The panel consisted of representatives of Thomson Reuters Point Carbon and European Chemical Industry Council (CEFIC).

The meeting also included an item on competitiveness and risk of carbon leakage presented by the Commission.

A video recording is available at the following webpage:

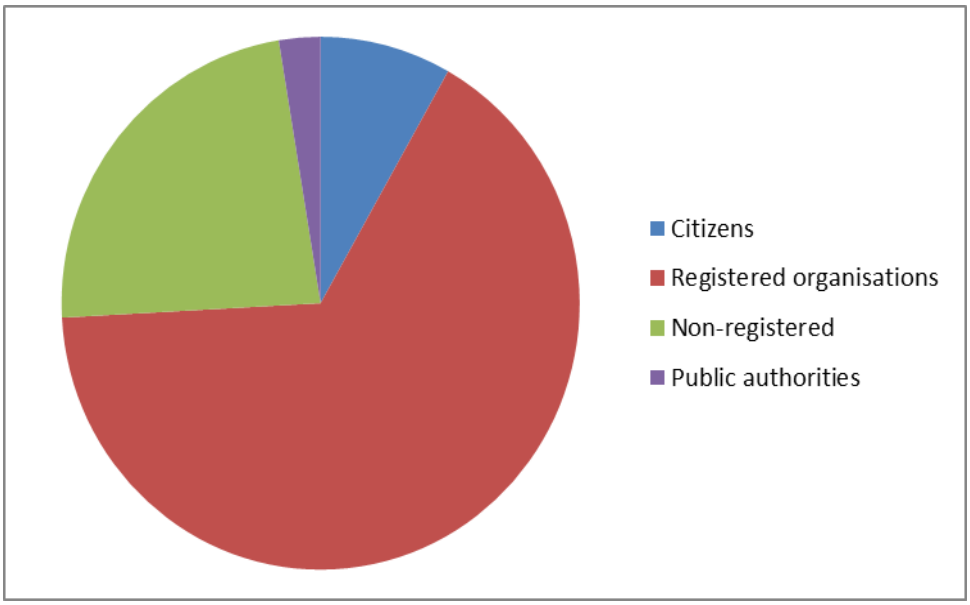
https://scic.ec.europa.eu/streaming/index.php?es=2&sessionno=b607ba543ad05417b8507ee86c54fcb7

2. DISTRIBUTION OF REPLIES TO THE ONLINE CONSULTATION

In total 232 responses were received. One stakeholder requested that their submission remains confidential.

The consultation registered a strong participation by organisations, with around 66% of overall replies from registered[3] organisations and 23% from non-registered organisations. 8% replies came from citizens and 3% from Member States and other public authorities (see Figure 1).

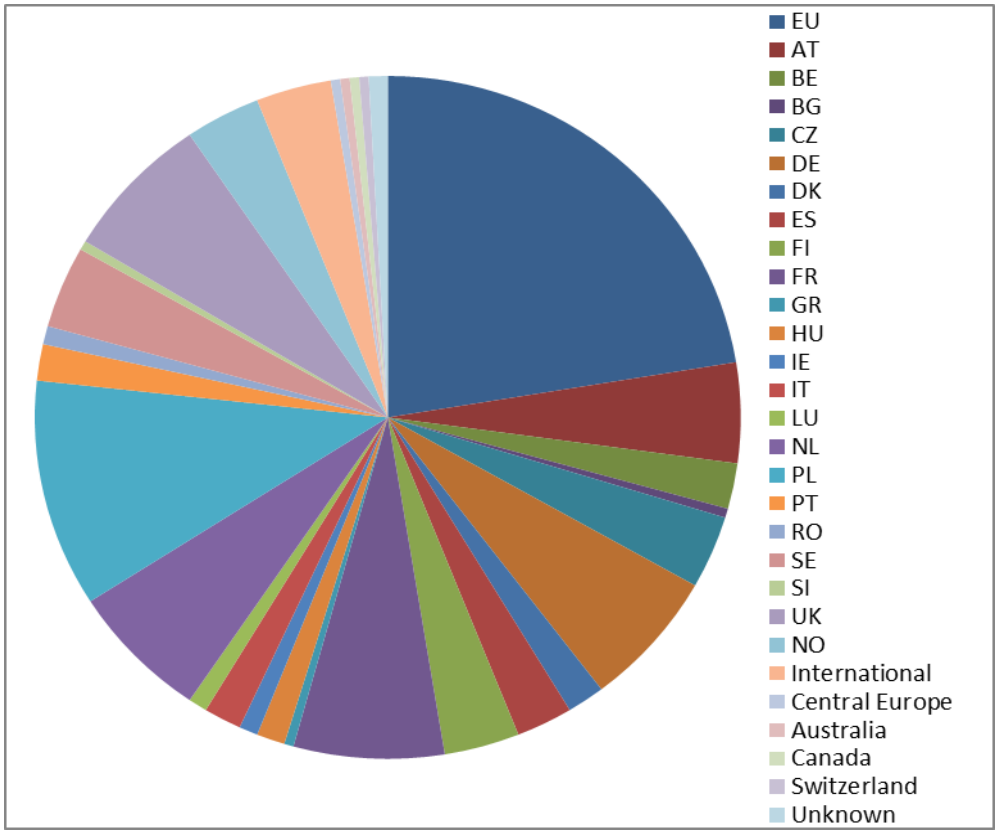
Figure 1: Replies per affiliation



Concerning the geographical distribution, European level organisations represent the highest share of responses (22% of all replies). At Member State level, stakeholders from the biggest Member States are also generally best represented: Poland (11%), France (7%), United Kingdom (7%), Germany (6%) and The Netherlands (6%). Among non-European countries, Norway represents the highest participation (3%). Equally strong participation can also be noted from international organisations with members from both EU and third countries (3%).

[3] In the interests of transparency, the Commission asks organisations who wish to submit comments in the context of public consultations to provide the Commission and the public at large with information about whom and what they represent by registering in the Transparency Register and subscribing to its Code of Conduct.

Figure 2: Geographical distribution of replies



3. EU REMAINS THE BEST INSTRUMENT FOR ACHIEVING THE EU OBJECTIVE OF AN ECONOMY-WIDE 80-95% REDUCTION

The public consultation showed that a large majority of stakeholders continued to hold the view that the EU ETS is the best instrument for the covered sectors to contribute to achieving the EU objective of an economy-wide 80-95% reduction in greenhouse gas emissions by 2050 within an internal market.

Stakeholders are asking for a stable, predictable legislative framework, which they believe necessary for business investment. Utilities, gas companies, organisations in the renewables sector, non-energy intensive companies, NGOs, academia, think thanks and some Member States think that because of a large surplus of allowances, the market does not work in every aspect in a satisfactory way. Some energy-intensive industry organisations feel a structural reform of the EU ETS first needs to bring a structural solution to EU's competitive position. Nevertheless, stakeholders, including most industrial organisations, recognise that there is a large and growing surplus in the carbon market.

Some energy-intensive industry organisations thought that the Carbon Market Report puts forward the options because the carbon price signal does not generate enough revenue for Member States. Many regretted that the options set out in the Carbon Market Report were not explicitly linked to a clear process on the 2030 framework. Some stakeholders felt that the options appeared to concentrate on the short-term action and did not sufficiently address the underlying issues. According to some, there are significant differences between the economies of Central Europe and the rest of the EU.

Stakeholders have mixed views on the extent to which the success of the EU ETS depends on a robust carbon price signal. Many argue that a significant carbon price is necessary so that the low-carbon investment results in a positive business case. Others emphasised that a low

carbon price simply indicates that there is little need for additional abatement to meet the current target. Accordingly, views differ on the need for measures in phase 3. Most energy-intensive industries prefer no action before phase 4 (2021-2028), while the power sector, non-energy intensive industries and NGOs hold the view that a measure in the short-term is necessary.

4. OPTION (A): INCREASING THE EU REDUCTION TARGET TO 30% IN 2020

It is frequently pointed out that this option is not deployable fast enough and would hence have too little impact in order to address quickly enough the surplus in the market. Although the energy-intensive industry organisations support the conditional position to increase the target in case other industrialised countries commit to comparable emission reductions, they emphasise that only the EU, Australia, Norway and Switzerland and a few other countries agreed to binding emission reductions.

Others, including the organisations from the renewables sector, see the increase of the target not only as a solution to the climate challenge, ensuring that the EU policy complies with the 25-40% domestic reductions needed in the industrialised nations to keep global warming below 2°C, but also as a solution to economic and energy crises. However, throughout the second consultation meeting, there was a strong acknowledgement by the proponents of more ambitious action that pursuing this option may use up all political capital for the negotiations on the 2030 framework.

5. OPTION (B): RETIRING A NUMBER OF ALLOWANCES IN PHASE 3

Throughout the consultation, there was a strong support by those advocating a measure in phase 3, for a permanent retirement of a number of allowances. Electricity companies support this option as it addresses the problem in a direct manner. Similarly, gas companies support a permanent retirement (of at least 1.2 billion allowances) to reinforce the effect of back-loading, as the definition of a emission reduction target for 2030 and consistent revision of the linear reduction factor take time. The option is also seen as the simplest.

The options also seems attractive to the academia, however they highlight the possibly difficult political process the option may require. Part of the some energy-intensive industry representatives see it as only addressing the symptom – the surplus in the EU ETS – but not the underlying problem.

6. OPTION (C): EARLY REVISION OF THE ANNUAL LINEAR REDUCTION FACTOR

By some of the energy-intensive industry organisations, this option is seen as having a double negative effect on its competitiveness by higher scarcity of allowances leading to higher carbon prices and by reducing the free allocation to industry. But otherwise there is a broad consensus among other stakeholders that the revision of the factor should be accelerated (to as early as 2014).

Non energy-intensive companies support the increase of the factor from 1.74% to 2.5%. The NGOs agree that the current factor is not consistent with the EU agreed long-term objective of 80-95% reduction by 2050. However, most stakeholders believe that even an early revision of the factor would not have a material impact on the imbalance in the market much before 2020. Hence, many stakeholders believe that the factor should be revised early consistently with a 2030 GHG reduction target, and if necessary accompanied by a permanent retirement to swiftly address the surplus.

7. OPTION (D): EXTENSION OF THE SCOPE OF THE EU ETS TO OTHER SECTORS

Some stakeholders note that extension to sectors, such as transport, including perhaps maritime, and households would increase liquidity in the market. It is considered by many as consistent with the goal of cost-effective economy-wide reductions.

But specifically in terms of road transport, part of the NGOs oppose its inclusion in the system, as would not deliver economic benefits. There is also a general agreement that this option will take longer to implement and is thus only relevant for post 2020. Many replies also suggest that a thorough impact assessment must be made.

8. OPTION (E): USE OF ACCESS TO INTERNATIONAL CREDITS

Some stakeholders see this option as not having a significant impact on the ability of the EU ETS to meet the EU long-term target of 80-95% reduction in a cost-effective manner. Other stakeholders oppose limiting the access to international credits.

On the other hand, some NGOs and citizens emphasise many concerns regarding their use in the EU ETS. Some feel access to international credits should not only be limited but not allowed altogether. Outcome of the international negotiations is seen as one of the principle considerations in terms of this option.

9. OPTION (F): DISCRETIONARY PRICE MANAGEMENT MECHANISMS

The vast majority of stakeholders highlight that the process for determining the true economic cost of abating greenhouse gas emissions is best determined through market principles and not via discretionary price management. Still, a few stakeholders, including project developers for international credits, would be supportive of a creation of a mechanism, which creates a reserve to buy allowances under a defined policy. A preferred choice that clearly emerges from the online consultation to address part of the surplus due to the economic crisis is to establish, not a price-based, but rather a volume-based supply-management mechanism.

Building on this, an additional option of a reserve mechanism to render the auction supply more flexible appeared at the 1st consultation meeting. Hence, the Commission organised an expert meeting to explore this option further (see Box 2).

Box 2: Expert meeting on flexible auction supply

The Commission hosted a panel of experts on 2 October 2013 to discuss technical aspects related to the possible creation of a reserve mechanism to render auction supply in the EU ETS more flexible. The agenda was focused five questions, which were defined in a way to encourage a structured debate. Welcome remarks were given by the Commission and an introductory presentation by a representative of Tschach Solutions/ICIS. The panel of experts was comprised of experts from industry, power generation, finance, research, market analysis, non-governmental organisations and Member States. They participated in their personal capacity.

The conclusions were as follows:

A rule-based approach that makes auction supply more flexible is seen as part of the necessary structural reform of the EU ETS. The general view was that the objective behind more flexible auction supply is to improve efficiency in the market. More precisely, the participants often referred to inter-temporal efficiency, to address the current situation where the diluted short-term carbon price signal is expected to be followed by an unnecessarily higher price in the mid- and long-term, and possible higher cost in total. There was some

hesitation about the mechanism, primarily because of possible data constraints to set the triggers at appropriate levels.

Three types of triggers were discussed: volume-based (e.g. based on surplus), output-based (e.g. based on GDP) or price-based. There seems to be a clear preference for volume-based triggers, specifically based on thresholds related to the cumulative surplus of allowances. Unlike output-based triggers, they can capture changes both in output as well as due to impact of other policies delivering abatement (renewables and energy-efficiency). The triggers should not be based on the carbon price.

In terms of data, the mechanism should be based on actual historical data, such as verified emissions, and not on forecasts.

Another important conclusion was that the mechanism should not be overly complicated in general.

What is clear is that the trigger values should ensure that the mechanism applies in cases of large market imbalances only, and not whenever there is a minor surplus in the market.

Regular review of the triggers is needed, but not too often to ensure market certainty. Two concrete periods that were mentioned were every 5 years or once per 8-year trading period.

The mechanism should avoid unnecessarily further destabilising the market by following large changes in the demand by large changes in the supply. Hence, there should be limits on the amount of adjustment that is possible in a year.

There seems to be a general preference for having the same "mirror" rules apply for putting allowances into the reserve and releasing them from the reserve. Nevertheless, some participants acknowledged that there may also be good alternative approaches.

10. OTHER PROPOSALS

By some energy-intensive industry organisations, the options referred to in the report were perceived as incomplete. However, apart from the additional option of flexible auction supply, there were hardly any suitable options proposed to address the supply-demand imbalance. Instead, most other proposals concerned measures to address the risk of carbon leakage. Business organisations called for:

- Supporting industry with recycling of auction revenue;
- Adequate evidence-based support to sectors deemed to be exposed;
- Maintaining a stable carbon leakage status;
- Forward looking industrial policy giving priority to boosting research and innovation;
- Indirect free allocation for electro-intensive sector;
- More achievable benchmarks, e.g. based on weighted average of performance of EU installations;

Redesigning the EU ETS from a static to a dynamic one, allocation to operators based on actual production.