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WWF Response to the European Commission public Consultation on structural options to strengthen the EU Emissions Trading System

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WWF welcomes the opportunity to contribute to the discussions on structural options to strengthen the EU Emissions Trading System (EU ETS). This input complements our reply dated 16th October 2012 to the public consultation on review of the auction time profile for the EU Emissions Trading System.

Introduction

This contribution is presented as complementary to our views on a broader set of issues related to the establishment of a post-2020 climate and energy policy framework. In this context, WWF calls on the European Commission to reach agreement on the need for post-2020 climate and energy legislation that builds on the successes, and corrects the failures, of the current 20-20-20 package. An emissions reduction target supported by the EU ETS and effort sharing is necessary but not sufficient. Instead, a comprehensive package that includes binding energy targets will be more effective and cheaper than an approach that is either non-binding, or reduced to a greenhouse gas-only approach.

This reply focusses on the structural options and views reflected in the European Commission report "The state of the European carbon market in 2012", and presents some additional viewpoints[1]. We agree with the Commission's stated aim to analyse the functioning of the carbon market and to consider whether regulatory action is needed as foreseen under Art.29 of the ETS Directive EC/2003/87. We will therefore not elaborate on short term emergency measures (ie. changing the auctioning time profile), nor on aspects where other policy instruments overlap with the EU ETS in a post-2020 context as outlined above.

The EU ETS: rich past, promising future?

The EU ETS is at a crossroads. Nearly 10 years after the publication of the ETS Directive it is still the world's largest emission trading scheme and a pillar of EU climate policy up to 2020 and beyond. In the course of 2011 it became apparent that the ETS framework contains outdated parameters. Due to the economic recession and decreased industrial production, as well as an unprecedented inflow of international offset credits (coming from often questionable emission reduction projects outside of the EU), a massive surplus of emission allowances has flooded the carbon market. This surplus

[1] Sections of this response are drawn from a joint ETS briefing by CAN-E, Greenpeace, Sandbag and WWF: http://www.sandbag.org.uk/site_media/uploads/EU_ETS_at_a_crossroads_NGO_briefing_01.2013_FINAL.pdf

will have a structural character across the third trading period of around 2 billion emission allowances. A welcome proposal to review the auction time profile was published as an emergency measure to start recalibrating the EU's carbon market and correct for this oversupply. However, the problems faced by the EU ETS by 2020 won't be solved since neither the scale, nor the timeframe of this emergency step is adequate.

A key risk of the current status quo is the extremely weakened carbon price signal. Installations covered by the EU ETS therefore need to pay very little for their CO_2 emissions and have no incentive to switch from high-emitting fossil fuels to cleaner production. Much-needed investments in renewable innovation and more energy efficient technologies are being delayed. In combination with record low coal prices, a weak carbon price signal is putting the EU at risk of a lock-in into high emitting infrastructure. In 2011 coal consumption grew by more than one third in EU Member States, with a record 52% increase in Spain[2]. 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[3]. In many Member States, including Germany, Poland and the Netherlands, new coal-fired power plants are either planned or under construction.

Without effective repair of the ETS, it is likely that EU governments will take the matter into their own hands at national level. Already some Member States, including the United Kingdom and the Netherlands, have decided to complement the EU carbon market with their own regulations. This risks distorting the internal EU market and fragmenting climate and energy policies. In the absence of consistent, EU-wide rules, costs and risks for investors would increase, jeopardising much-needed investments in modernisation of the EU energy sector.

WWF views on 6 options presented by the European Commission

The options presented by the Commission are not *alternatives.* A combination of measures will be necessary, as indicated.

Option a: Increasing the EU reduction target to 30% in 2020

WWF is a long standing and strong supporter of an increase of the EU's 2020 climate objective to 30% domestic emission reductions as part of a total 2020 obligation of 40% cuts. Such a climate target has the potential to create a new, sustainable economy, where Europe can play a leading role. The economic advantages are unmistakable[4] – independent of action by other countries.

The problems faced by the ETS are symptomatic of a European climate target that has been overtaken by both the current economic situation and international developments. While

[2] Compared to 2010, BP June 2012, Statistical Review of World Energy.
[3] The unwelcome renaissance, The Economist, 2013.
[4] PIK et al. 2011 "A new growth path for Europe", http://www.european-climate-forum.net/fileadmin/ecf-documents/Press/A_New_Growth_Path_for_Europe__Synthesis_Report.pdf

developed and developing countries worldwide recently advance their climate policies[5,6], the EU has practically reached its 2020 climate target in 2011, nearly 10 years ahead of time[7]. Given the 30% target is a no-regrets position for Europe economically, and that retaining 20% does nothing to advance international adequacy, it is logical to now move to a 30% target. At the same time, this would alleviate the majority of the oversupply of emission allowances faced by the EU ETS in a medium term pre-2020 context and would put the European target on track for the long term commitment of reducing greenhouse gas emissions by 80-95% up to 2050.

Option b: Retiring a number of allowances in phase 3

In addition to enhancing the environmental effectiveness with benefits of the EU ETS as in option a, this measure has the merits of relative legal simplicity to be implemented by a separate decision, rather than broader changes to the EU ETS Directive.

In order to make the EU ETS deliver its fair share of on overall 30% domestic emission reduction target, WWF supports a retirement of in total 2.7 billion emission allowances across the third trading phase[8]. This measure could be achieved by ensuring that allowances reduced from a shorter term review of the auction time-profile are permanently cancelled, in combination with additional retirement of allowances by cancellation and/or as described in the next option.

Option c: Early revision of the annual linear reduction factor

The current linear reduction factor leads to an inadequate reduction in the ETS cap by 2050 and is not aligned with the EU's objective of 80-95% reduction by 2050 compared to 1990. WWF supports an increase in the emission reduction trajectory to at least 2.6% per year as of 2014. That change would remove almost 500 million emission allowances from the phase 3 cap, while achieving the upper range of the EU's 2050 climate objective. Under these conditions the EU ETS could become a predictable zero carbon action plan for Europe's industrial sectors by 2050. It is important to stress that any delay in implementing a higher linear reduction factor will require steeper annual emission reductions later on.

Option d: Extension of the scope of the EU ETS to other sectors

The EU ETS was designed to cover large point sources of greenhouse gas emissions in the EU and we see several barriers and risks in case extension of its scope to other sectors is considered. First, extension of the current oversupply of emission allowances and the weak carbon price signal could

[5] Climate Action Tracker Update, 2012 http://climateactiontracker.org/assets/publications/briefing_papers/CAT_Bonn_update_2012_05_24.pdf
[6] GLOBE International, Climate Legislation Study: A Review of Climate Change Legislation in 33 Countries, Third Edition, 2013 http://www.globeinternational.org/images/climate-study/3rd_GLOBE_Report.pdf
[7] Climate Action Network Europe, Closing the ambition gap, What can Europe do?, 2012 http://caneurope.org/resources/doc_download/2127-closing-the-ambition-gap-what-europe-can-do-dec-2012-
[8] Hermann H., Matthes, F. Chr. (2012), Strengthening the European Union Emissions Trading Scheme and raising climate ambition, Öko-Insitut, commissioned by WWF and Greenpeace (download)

slow down the deployment of mitigation options in other sectors as well. Second, other policy instruments and measures (eg. emission standards and minimum requirements) could be much easier to administer and deliver a certain outcome of driving technological innovation in a more targeted way.

For example, fuel consumption in the road transport and residential sector is in many cases already taxed at national level up to 10 times the current EU carbon price per tonne CO_2 emitted[9]. It is therefore unlikely that extension of the carbon price signal to these sectors would drive additional emission reductions. In addition, such a system would likely be cumbersome to administer and disproportionately affect low income households. Adequate CO_2 standards for road transport and energy performance standards for buildings seem to be more appropriate tools to drive decarbonisation in these sectors.

Option e: Limit access to international credits

As outlined by the Commission, access to international credits is a major driver of the current surplus of emission allowances. In the context of EU climate policy, international credits were allowed in order to lower overall compliance cost, and deliver clean technologies to developing countries. First, WWF has grave concerns that the majority of international credits have likely not contributed to additional mitigation efforts in the host country, while sustainable development goals are often completely overlooked. Second, international credits have allowed companies to reap extensive additional profits by using the allowances which they were allocated for free in other ways and substituting them for cheaper international credits to meet their obligations under the EU ETS. Also during the third ETS trading phase, EU compliance buyers may at large scale surrender very cheap (currently <0.5 €/t CO_2) international credits and at the same time sell excess EU emission allowances (5-10 €/t CO_2). This economically rational behaviour is very likely to increase global greenhouse gas emissions. In Germany alone, the largest ETS companies were in this way able to garner profits of € 42 million in 2008 and 2009 and are estimated to make further profits of approx. € 1 billion by 2020[10].

WWF supports only an effective use of international credits in the EU ETS after 2020 which goes beyond the logic of offsetting as –at best- a zero sum game. The aim of international credits to achieve a net mitigation impact has also been endorsed in the recent recommendations by the CDM Policy Dialogue[11]. For example, this could be achieved in practice by applying a discount rate (eg. 3:1) on the use of international credits to compensate one tonne of GHG emissions by installations covered under the ETS. This would not only bring additional net emissions reductions but also enhance the price for international credits substantially and support more qualitative projects into international carbon markets. Finally, we believe that international credits in the ETS

[9] OECD, Taxing Energy Use, 2013, http://www.oecd.org/tax/taxpolicyanalysis/taxingenergyuse.htm
[10] Öko-Institut, 2010, Free allocation of emission allowances and CDM/JI credits within the EU ETS. Analysis of selected industries and companies in Germany, http://awsassets.panda.org/downloads/cdm_study_oeko_institut__wwf_14_dec_2010.pdf
[11] http://www.cdmpolicydialogue.org/report/rpt110912.pdf

should only be allowed when coming from a positive project list prioritising clean energy efficiency and renewable technologies in most vulnerable and least developed countries.

Furthermore, WWF recommends urgently to include additional quality criteria for international credits available to the EU ETS sectors for compliance before 2020. Current use of international credits undermines the environmental integrity of the EU ETS and aggravates weakening of the carbon price signal in an already oversupplied EU carbon market. In particular, projects should be excluded that have likely shortcomings with regards to additionality, sustainable development benefits, perverse incentives and double counting.

Option f: Discretionary price management mechanisms

The Commission rightly outlines several design issues and implementation hurdles in order to achieve a type of price management mechanism. In addition, WWF believes the symptom of an oversupplied EU carbon market would better be alleviated by policy interventions that clearly fall under the objectives referred to in Article 191 of the Treaty on functioning of European Union.

Additional remarks on industrial competitiveness and carbon leakage

One of the most commonly repeated – and greatly exaggerated - arguments against adequate pollution pricing is that an increased carbon price signal will hurt industrial competitiveness and cause it to leave Europe, risking jobs and resulting in higher emissions outside of the EU. Yet, for manufacturing sectors, climate policy is a far less relevant factor in investment decisions than other aspects, like differences in tax structure, labour costs or local market conditions[12]. Only a very limited number of energy-intensive installations may be potentially exposed to competitiveness impacts as a result of climate policies. The EU ETS already addresses and even over-compensates them for possible adverse effects of carbon pricing[13].

The list of sectors exposed to carbon leakage was assessed and agreed on the basis of a carbon price of €30 per tonne and did not take into the account the legislation that countries outside Europe are putting in place by 2015. Considering that most options proposed by the Commission will not reduce the amount of free allowances available to installations, and the moderate impact on the carbon price of options for intervention, WWF calls for a full re-assessment of sectors at risk of carbon leakage as soon as possible, with the aim to shorten the list of sectors eligible for free allocation.

An adequate EU carbon price and accelerated rate of green investments will play an important role in stimulating innovation and boosting demand for products from industrial sectors. Contrary to some industries' claims, a wide range of technological options is still available to reduce emissions in energy-intensive sectors, both in the short and long term. In the steel sector, recycling as well as

[12] Stern Review on the Economics of Climate Change, 2006, Part III: The economics of stabilisation, Chapter 11 Structural change and competitiveness.
[13] Climate Strategies, November 2009. Ten (plus one) insights from the EU Emissions Trading Scheme

different retrofit measures can significantly improve energy efficiency of production and in consequence cut GHG emissions[14]. Most of the available options to decrease energy intensity are cost-negative, meaning that the investments pay themselves back within the lifetime of the improvements that were made. In the longer- term, new technologies such as the "Hisarna" coke-free steelmaking process or use of magnesium-based clinker in the cement sector are likely to reach market maturity before 2030. These options can contribute to delivering 80 to 95% emission reductions by 2050[15].

In order to guide needed investments, WWF believes that revenues from auctioning ETS allowances should play much more prominent role in driving further decarbonisation of the European economy and in developing countries. We therefore continue to support the principle of full earmarking of auctioning revenues to support deployment of innovative renewable energy and energy saving technologies, including in energy-intensive industrial sectors. Half of these revenues are to be invested in developing countries in adaptation and mitigation activities which also provide sustainable development benefits.

[14] International Energy Agency, Paris, 2007. Tracking industrial energy efficiency and CO2 emissions. Energetics Inc., 2005, Steel industry marginal opportunity study, prepared for the US Department of Energy.
[15] CAN-Europe, 2010. Horizon 2050: steel cement and paper, based on research by CE Delft.