

Annex

Structural issues related to EU ETS

1. Policy coherence, a single target to achieve cost-efficient CO2 reduction

Many policy makers are not convinced that the current design of ETS gives a proper incentive for companies to invest in the low carbon economy, including renewable energy and energy efficiency. Instead of structurally improving ETS, the response of many politicians and policy makers is to add new low carbon deployment instruments, making the problem worse. The result is a variation of European, national and sometimes even local climate policy instruments for the industry and energy sector. These policies often contradict EU ETS: the scheme becomes less efficient and companies face additional financial and administrative burdens. Moreover, these additional policies tend to favour the deployment of specific low carbon technologies, such as energy efficiency or renewable energy, whereas ETS doesn't make a specific technology choice. In our view a technology neutral approach does not only makes sense from a market and cost efficiency perspective, it also improves the consistency of climate policies. A well-functioning ETS would make specific targets for renewable energy redundant.

2. ETS should give long term investment stability for companies

Investments in the industry and energy sector and notably in low carbon technologies are capital intensive. A prerequisite for such investments to take place in Europe is regulatory stability. Flaws in the current design of the scheme however significantly reduce investment stability.

- First of all, there is continuous uncertainty about ETS after 2020.
- Secondly, the cap in 2020 has been calculated in 2008 on the assumption of around 2% economic growth, which is not matched in reality. As it is impossible to predict economic growth, especially on such a long term, setting a cap without a structural correction mechanism for the real economic developments will result in very low or very high abatement ambitions and affect prices accordingly. This flaw resulted in the currently low CO2-price, and resulted in discussions about a “set aside” of allowances, but can equally result in very high CO2-prices.
- Last but not least, on the short term there is much regulatory uncertainty for the “carbon leakage” industry about the free allocation of allowances (review of the carbon leakage list) and compensation of indirect costs (optional for Member States). This regulatory uncertainty is even bigger for those who want to invest because the rules for the New Entrant Reserve and the guidelines are unclear. Also the Reserve is limited in providing for growth and new investments.

3. ETS should deal with different competitive positions of sectors

ETS should better take into account the differences between sectors that compete globally (many industries and aviation) and companies that compete in a European market (such as the power production sector). It might be realistic to define an ambitious EU reduction target in 2030 for the power industry sector which competes within the EU; as such sectors will suffer only to a limited extent from a reduced competitive position and will be able to pass on some costs to their customers. For sectors competing on a global scale however, such a unilateral move could be detrimental to their competitive position. The current ETS design already provides a basis to deal with different competitive positions. In designing ETS post-2020, this distinction should be better taken into account, not only to prevent carbon leakage, but also to prevent leakage in terms of economic growth, innovation and jobs in the EU. Also, a better framework is needed to ensure an EU harmonised compensation of indirect ETS costs for industry.