

## **Reform of the EU Emissions Trading System: *Eurogas Response to Consultation on the Carbon Market Report***

### **Introduction**

Eurogas is a supporter of the Emissions Trading Scheme (ETS) and welcomes the Carbon Market Report. Eurogas has considered the six options for structural reform of the EU ETS. We would like to share our view on the way forward to reducing greenhouse gas emissions by 80-95% by 2050 compared with 1990 and to creating a secure, competitive and sustainable low-carbon energy system.

We also note also the importance of putting the reform of the ETS in the context of other European policy objectives, in particular the Internal Energy Market. This is the subject of the recent Commission Communication, *Making the Internal Market Work* and the public consultation on generation adequacy, capacity remuneration mechanisms and the internal market in electricity. Eurogas responded to both.<sup>1</sup>

Eurogas considers that failure to bring about effective reform of the ETS will tend to undermine the internal market:

- There is a risk that alternative, nationally-based measures will be introduced to address climate objectives through energy policy measures.
- Such measures would be likely to range from carbon floor prices, to specific energy or carbon taxes.

Distortions of trade in gas and of the pattern of gas flows to European customers could be the inevitable consequence of such measures.

In contrast, a well-functioning ETS offers a level playing field for European gas marketers, and helps consumers make choices on energy investment and consumption that are in line with the internal market principles and also work towards the low-carbon objectives that have been set by the Council.

At the same time, the ETS maximises the choice of low-carbon options and puts them into competition as well as partnership with each other. For example, gas is enabled to compete with higher carbon fossil fuels on the one hand and to

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<sup>1</sup> *The Internal Energy Market - A Eurogas Position Paper Eurogas Response to the European Commission's consultation on Generation adequacy, capacity mechanisms and the internal market in electricity*

complement with backup power generation further penetration of intermittent renewable energy sources on the other hand.

The ETS should be the key driver of climate policy and the main instrument for a market-based approach in connection with a greenhouse gas reduction target for 2030. Falling back on developing national and sub-national policies to encourage low-carbon investment at the expense of the level playing field and transparency that the ETS provides is a sub-optimal option.

The EU-wide ETS together with the internal energy market will ensure that greenhouse gas reductions are cost-effective and that the energy market is competitive, which addresses the concern about the competitiveness of European industry in an optimal manner.

## **A coherent, effective and efficient approach**

Eurogas' view is based on the position that in seeking to achieve the above goals the overarching guiding principle should be to reduce carbon dioxide emissions cost-effectively at all times as the key part of a long-term and predictable energy and climate policy. To achieve this, an overall ambitious and binding greenhouse gas reduction (GHG) target is required for all sectors for 2030, in line with the 2050 reduction target, for the whole economy. In the interest of establishing a sound framework for investment choices, Eurogas proposes that the GHG target should be at least 40% below the 1990 or base year levels, with a view to credibility and political acceptability. For climate action to be successful, the EU reduction target and the EU effort should be part of a global, international effort. It will require a technology-neutral approach both in ETS and non-ETS sectors that provides the flexibility to make use of all current and future low-carbon technologies in the most cost-effective way. In such an approach, cost-effective energy efficiency measures will be part of the picture and the share of cost-effective renewable energy will continue to grow naturally.

A robust energy system that provides security of supply, competitiveness and maximum cost-effective emissions reductions can be attained through diversity of technology and a level-playing field for economic actors and competitive choice for energy customers. Trust in what a well-functioning EU-wide energy market can do in support of a wide range of policy objectives is essential. Market distortions and incoherent or undue overlapping policy instruments should be avoided wherever possible when (re)considering the regulatory environment.

The Carbon Market Report unfortunately does not address the need for such a clear objective and framework in which structural measures could be taken; an overall market framework must be the basis from which any of the options is derived.

## The ETS as the key instrument

The ETS is designed to reduce emissions in a technologically-neutral way and in a way that minimises market-distortions that can arise from national policies. It is therefore consistent with a single EU internal energy market. It is also widely supposed to create incentives for low-carbon investment. Eurogas supports these objectives, and would therefore like to see an ETS that is fit for this purpose, with clarity and visibility up to 2030 and beyond. The cap-and-trade approach to carbon reduction is now well-established in Europe, and there are clear signs that it is likely to be copied in other parts of the world. The international dimension is important, and the cap-and-trade policies and pilots that are now being taken in a number of countries represent significant steps independently of any 'ideal' multilateral framework. From this perspective, now is not the time for the EU to consider alternative approaches to low carbon energy policy. Efforts should therefore be made in Europe to support and improve the functioning of the ETS. As a policy it remains the tool most likely to achieve low-carbon results in the sectors to which it applies while imposing the least economic cost on customers and companies.

## The Options

Eurogas has already responded to the earlier consultation on the auction back-loading proposals and recommended that they should only be considered in the context of the role they can play in relation to further, longer-term reforms to support the functioning of the ETS, such as those that the Commission outlines in its Carbon Market Report.

In the remainder of this response Eurogas discusses and gives its views on the Commission's proposed six options, Options A to F. We do not consider here other possible options for structural reform of the ETS although we recognise that other ideas may be brought forward by the academic community, by industrial actors, or by national or European policy makers.

### **Option A: Increasing the EU reduction target to 30% in 2020**

Eurogas remains optimistic that progress can be made at international level, especially now that a single track has been agreed for the negotiation of a post-2020 regime at COP-21 in 2015. It is imperative that CO<sub>2</sub> is reduced more broadly than just in the EU and other Kyoto signatories. The Option A proposal stems from article 28 of the ETS Directive that states that an adjustment is applicable upon approval by the Community of an international agreement on

climate change which would also entail a revisiting of the effort sharing/burden sharing agreement among the EU Member States. This option has been proposed in the recent past in the absence of an international agreement, but failed to get political backing. If this option were to be adopted, there are questions as to what can practically be achieved by 2020. Longer term investment signals are more important.

This option does not propose significant reductions after 2020, but it could potentially be a good option if:

- A new target is set for 2030 - this should be at least 40% below the base years;
- Equitable burden sharing between ETS and non-ETS sectors is agreed;
- The annual percentage reduction for the ETS cap is increased to track the 2050 objective better.

### **Option B: Retiring a number of allowances permanently in phase 3**

Eurogas is in favour of measures that address long-term structural reform. Any short-term measure without clarification of the longer term may be unconstructive; following Option B alone does not place the EU on track to reach its 2050 decarbonisation goals, but as part of a package, Eurogas could support this option as it solves the problem by a direct approach.

By design, this option leaves the amount of free allocation or existing holdings of allowances untouched; taking out allowances only of the amount foreseen to be auctioned will therefore not change any allocation to installations in industry that are on the carbon leakage list.

### **Option C: Early revision of the annual linear reduction factor**

This option will tighten the whole scheme. It would mean, however, that the ETS sector will have to make a much stronger effort than the other sectors.

It is therefore important that the Commission also decides rapidly on the non-ETS sectors. It may be sub-optimal first to set the linear reduction factor for the ETS sectors and then to look at what the other sectors can do and how they all inter-relate. Ideally, measures are put forward as a package that proposes an overall ambitious and binding GHG target for all sectors for 2030, including both Option B and C.

### **Option D: Extension of the scope of the EU ETS to other sectors**

We agree that generally it is crucial to address the non-ETS sectors in particular post 2020. However, the ETS does not lend itself to all sectors and should only be applied where this proves to be appropriate.

To extend the scope to heating might be difficult as there will be compliance function problems and Member States might have issues addressing these. Expanding the scheme to airlines and shipping is proving an enormous challenge already. Extending the scope to further modes of transport might prove even more challenging as there are already a considerable number of measures affecting the transport sectors for example taxes and mandates and energy efficiency measures that may be better suited to deal with those sectors. Already in passing the Energy Efficiency Directive there was strong resistance from Member States, and the residential sector is struggling to realise all of the requirements in the Energy Efficiency Directive. One would need to look at the other schemes (Renewables and Energy Efficiency) to analyse how they interfere with each other. The overall cap setting must also be taken into account.

### **Option E: Limit access to international credits**

This measure mainly applies to Phase IV. Option E could be an additional measure to option B and C in the future. It tightens the supply side but is currently not a viable option on its own. There are a number of uncertainties at this stage; even if there is an international agreement, there will be no guarantee for CDMs. CDMs will continue in any case, with or without the EU, and the use of CDMs contributes to the current oversupply of allowances.

In order to promote the ETS internationally, links to the ETS-systems that are in development in other parts of the world may be tightened by allowing the transfer of EUAs back and forth to other emissions trading 'currencies'. For this, an exchange mechanism should be created consisting of a well-defined exchange rate between the ETS.

### **Option F: Discretionary price management mechanisms.**

Eurogas cannot be in favour of option F on principle because the measure would not be market-based. The ETS is not a tool for price management; it manages volumes. Besides, it is unclear how this could work internationally, as the ETS was intended and still has potential as an international tool.

The ETS is the only market mechanism which has a pre-defined fixed supply, facing varying demand. Eurogas could support a supply adjustment mechanism,

i.e. adapting the supply of EUAs to economic circumstances, other policies (RES, EE) and other unexpected events, based on well-defined and predictable criteria, to avoid a reoccurrence of the current oversupply.