



QUERCUS contribution to the European Commission's public consultation on options to strengthen the EU Emissions Trading System

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Introduction

Quercus welcomes an opportunity to participate in a debate about several needed adjustments to the functioning of the EU Emissions Trading Scheme's (EU ETS) and to provide comments on the options for the ETS structural reform, outlined in the European Commission's "Report on the state of the European carbon market in 2012". Quercus, as other NGOs around Europe, is seriously concerned about the current underperformance of the ETS and significantly weakened carbon price, which in combination with record low coal prices, decreases attractiveness of green investments and in consequence puts the EU at risk of dangerous high carbon lock-in.

In that context Quercus recommends that necessary ETS reform must be designed on the way to strengthen the ETS performance in the short and long term perspective:

- To ensure that the ETS delivers uninterrupted and meaningful carbon price signal, which provides investors with a certainty that low-carbon investments are cost-efficient in the long-term perspective.
- To adjust the linear reduction factor governing the ETS cap with the EU's stated objective to reduce emissions 80-95% by 2050.

In this context Quercus believes that structural measures for the ETS should not only address the problem of accumulated surplus of allowances, but also to reform the scheme so to ensure that it delivers cost-efficient abatement necessary to achieve the upper end of 80-95% emissions reductions by 2050.

QUERCUS views on the options proposed by the Commission

a. Increasing the EU reduction target to 30% in 2020

Quercus, as other NGOs around Europe, strongly supports an increase of the EU's 2020 climate objective to 30% domestic emission reductions. Strengthening of the EU climate ambition would result in several benefits, like increased auctioning revenues and expansion of low-carbon investments, and would put the EU on the cost-efficient emission reduction trajectory by 2050.

The EU's pre-Copenhagen conditional offer to increase its 20% climate target to 30%, in case if other big emitters commit themselves to comparable action, has to be reassessed in the light of the recent developments: climate policy initiatives emerging worldwide and the latest data on the EU's emissions, indicating that the EU almost already reached its 2020 climate target, nearly 10 years ahead. As outlined in CAN Europe's briefing "Closing the ambition gap" (Quercus is a full member of CAN Europe), if EU Member States fully implement already agreed policies, it is very likely that the EU will eventually reach 25% domestic emissions reductions by 2020. EU's domestic climate target of 30% can be therefore achieved with a little additional effort. Moreover at the last COP conference in Doha parties agreed to review their targets for the 2nd Kyoto Protocol commitment period, which also obliges the EU to increase its mitigation ambition in the context of global efforts to tackle climate change challenge.

Increase of the EU's 2020 climate objective to 30% domestic cuts by 2020 would have to be translated into additional emission reductions in both ETS and non-ETS sectors. In the ETS moving to 30% climate target would require cancellation of emission allowances, increase of the linear emissions reduction factor or combination of both of these options. The optimal solution should align the ETS with 30% domestic GHG cuts by 2020 and would also support the cost-efficient achievement of the upper end of EU's 2050 mitigation objective. Taking that into account Quercus and other NGOs recommends to achieve 30% domestic climate target through permanent retirement of 2.2 billion of allowances combined with an increase of the linear reduction factor to at least 2.6%. Cancellation of allowances would have to happen before the end of Phase III and the linear emissions reduction factor would have to be increased from 2014.

b. Retiring a number of allowances in phase III

As indicated above, the cancellation of a number of allowances is one the technical solutions that can be implemented to increase EU's climate target to 30% domestic emission reductions. While the Commission did not propose a concrete number of allowances to be permanently removed from the market, Quercus and other NGOs are calling for retirement of 2.2 billion allowances (in combination with an increase of linear emission reduction factor). Cancellation of 900 mln allowances, so the volume proposed by the Commission for back-loading, would not be enough, although retirement might be achieved gradually and permanent withdrawal of back-loaded allowances can be possibly the first step, followed by a second wave cancellation. Additionally to 900 mln allowances, the retirement of 1.3 bn additional credits would be needed: the volume of auction allowances would need to be decreased further between 2015 and 2020.

c. Early revision of the annual linear reduction factor

Quercus suggests a review of the linear emission reduction factor to be accelerated to 2014. "The state of the European carbon market in 2012" report rightly points out that "the current linear reduction factor leads to a just over 70% reduction in the ETS cap by 2050 which is not consistent with the EU's agreed long term objective of 80-95% reduction by 2050". Emission reduction trajectory in the ETS sectors should be adjusted to put the EU on track to reach the upper end of 2050 target of 80-95% emission reductions but also to address the surplus of allowances expected to accumulate in the system by 2020, in case if no

other action or not a sufficient action to tackle this problem is taken. 2014 early review of the linear reduction factor would allow to limit its increase to 2.6%, assuming simultaneous cancellation of 2.2 bn allowances. In case if the correction of emission reduction trajectory gets delayed beyond 2014, or if the number of retired allowances is lower than 2.2 bn, the linear reduction factor would have to be steeper than 2.6%, to compensate for a delayed action. Increase of the factor governing the ETS cap should be taken into account in preparations of post 2020 climate and energy framework to ensure that targets for emission reductions, RES energy and energy efficiency are mutually supportive.

d. Extension of the scope of the EU ETS to other sectors after 2020

Quercus has several reservations toward this option. Expanding ETS to other sectors - like surface transport - may result in weakening of environmental standards that are already imposed on industries not covered by the ETS. For instance, in the transport sector the existing regulations are likely to be more effective in reducing emissions, increasing sustainability and boosting innovation (e.g. CO₂ car emissions regulation), than the ETS may be. Furthermore, expanding the scope of the ETS may hamper future linking of the EU's carbon market with other schemes worldwide. Quercus is open to participate in the discussion about an extension of the scope of the ETS to other sectors, however as such a debate is not likely to be finalised soon, this option is unlikely to be implemented early enough to affect climate ambition before 2020.

e. Limit access to international credits

Quercus and other NGOs strongly supports a ban on use of offset credits in the EU ETS after 2020. By 2012, international credits have become a major driver for the build-up of the current surplus accumulated on the EU carbon market. According to the European Commission offset credits are responsible for “two thirds of the EU ETS over-supply” and could represent as much as three quarters of the expected glut of credits by 2020, if no action is taken¹. A ban on offset credits after 2020 is needed to avoid the similar problem in ETS Phase IV and to preserve the environmental integrity of post-2020 global climate agreement. From the next decade, both developed and developing countries are expected to adopt binding emissions reduction targets (except the least developed countries) and the continuous use of offset credits would risk in double counting. While flexible mechanisms are a short to medium-term mitigation policy tool, long-term climate policies need to go beyond offsetting and guarantee deep GHG cuts, required to stay below 2°C warming. Furthermore, limited access to offset credits would incentivise domestic emission reduction, boosting investment and employment in renewable and energy efficiency sectors.

Quercus also recommends an urgent review of quality criteria of offset credits available in the EU ETS for compliance and supports ban on offset credits coming from coal and large hydro investment, as well as credits generated by business as usual, “non-additional” projects² which do not deliver additional emission reductions and undermine ETS environmental integrity and increase the over-supply in an already flooded EU carbon market³. At the same time, the EU must ensure that decreased financial support for clean investments in developing countries, a consequence of ban of offset credits after 2020, will be properly addressed and other financing mechanisms, will be put in place to assist developing countries in low-carbon transition.

¹ European Commission (2012). The state of the European carbon market in 2012. http://ec.europa.eu/clima/policies/ets/reform/docs/com_2012_652_en.pdf

² Projects that would be realised even in the absence of the CDM mechanism.

³ Several countries currently developing domestic emissions trading schemes, including Switzerland and South Korea are in the process of addressing these concerns: South Korea does not allow the use of international credits and Switzerland is considering restricting the use of offset credits from large hydro projects

f. Discretionary price management mechanisms

Quercus does not support this option, considering cap on emissions to be the fundamental feature of the EU ETS, guarantying that the scheme delivers on its environmental objectives and provides a robust carbon price signal. Carbon price reflects demand and supply of allowances and change of one of these parameters should be the primary way to affect CO₂ price. The cause of the current scheme's weak performance is over-supply of allowances and weak carbon price signal merely reflects market's imbalance. Therefore ensure that the ETS provides strong carbon price signal the cause of the problem (too weak cap on emissions) has to be tackled. "The state of the European carbon market in 2012" report noted that price management mechanisms "would alter the nature of the EU ETS being a quantity-based market instrument" while Quercus and other NGOs believe that cap on emissions, set up in line with the scientific requirements, should remain the main tool impacting carbon price developments. Furthermore, Quercus is concerned that establishment of may hamper future linking of the EU's carbon market with other schemes worldwide.

Conclusions

Quercus and other NGOs support ETS structural reform that would improve functioning of the EU's carbon market in the short (2020) and long-term perspective (2050). The ETS reform needs not only to address the surplus of allowances accumulated on the market, but also correct the current emission reduction trajectory implied for the ETS sectors, to ensure that they deliver cost-effective abatement to reach EUs' stated 2050 climate objective. In order to ensure clarity and certainty of the next steps, Quercus and other NGOs call on the European Commission to present by the end of March 2013 the timeline for implementation of the ETS structural reform.

Quercus also supports a robust post-2020 climate framework, including GHG emission reduction target, target for renewable energy and energy savings target, with the ETS playing an important role in post-2020 climate architecture and being complemented by other policy instruments.

Certain features of different structural measures outlined in "The state of the European carbon market in 2012" report

Option	Quercus position	Impact on:				
		Emission reductions	Ability of the EU ETS to meet the EU target of an 80-95% reduction in a cost-effective manner	Your activities or the activities of the business under your jurisdiction, including estimated changes in compliance and administrative cost	Employment and households	Others
a. Increasing the EU GHG target to 30%	+	POSITIVE: Increase of ambition level before 2020; 30% target should be	POSITIVE: If achieved through an adequate increase of the linear	DOES NOT APPLY TO QUERCUS	POSITIVE: increased climate target will boost jobs and investments in	- Would increase Member States auctioning revenues; - Would deliver robust and

		achieved domestically;	emission reduction factor (alone or in combination with other measures) would put the EU on track to cost-effectively achieve 80-95% GHG cuts by 2050;		energy efficiency and low-carbon technologies. Increased auctioning revenues can be reinvested creating new jobs as well as can be used to compensate the most vulnerable households for electricity price increase;	predictable carbon price signal, providing investment certainty to investors; - Would address unjustified free allocation; - Would provide a number of health co-benefits - Would be in line with the review of KP targets, agreed on the COP conference in Doha;
b. Retiring a number of allowances	+	POSITIVE: however depends on a number of allowances to be retired	PARTLY POSITIVE: if combined with other measures may put the EU back on track to achieve cost effective emissions reduction by 2050	DOES NOT APPLY TO QUERCUS	POSITIVE: due to strengthen carbon price signal will boost jobs and investments in energy efficiency and low-carbon technologies.	- Would increase Member States auctioning revenues; - Possibly would deliver moderate carbon price signal (depending on the volume of allowances to be cancelled); - Could be the first step on the way to further ETS reforms; - Would not affect unjustified free allocation;
c. Early revision of the linear reduction factor	+	POSITIVE: however depends on the scale of an increase and other complementary measures (for instance whether in case no other measures are implemented an increase of linear reduction factor would compensate for the surplus currently accumulated in the ETS);	POSITIVE: if increase of the linear emission reduction factor is significant enough (and would lead to achieve the upper end of 80-95% emissions reductions by 2050);	DOES NOT APPLY TO QUERCUS	POSITIVE: would boost jobs and investments in energy efficiency and low-carbon technologies due to strengthen carbon price signal;	- Would deliver strong carbon price signal, providing certainty to investors (depending on the scale of the linear reduction factor); - Would increase Member States auctioning revenues; - Would address unjustified free allocation; - Would send a strong signal to international community that the EU is committed to maintain the effectiveness of its carbon market;
d. Extension of the scope	-	DIFFICULT TO ESTIMATE:	DIFFICULT TO ESTIMATE,	DOES NOT APPLY TO	DIFFICULT TO ESTIMATE	- May result in weakening of

		depends on the details of an extension (which sectors would be covered, how an extension would impact the cap, what rules would govern auctioning in the new sectors, etc.);	however as it is unlikely to be implemented before 2020, its value to contribute to put the EU on the cost effective pathway to reach EU's 2050 climate objectives, is lower than options a-c;	QUERCUS		environmental standards that are already imposed on industries not covered by the ETS; - May hamper future linking of the EU's carbon market with other schemes worldwide;
e. Access rules to international credits	+	POSITIVE: would incentivize domestic mitigation and address a risk of double-counting of emission reductions after 2020 (when both developed and developing countries are expected to have binding climate targets);	POSITIVE: would accelerate the rate of domestic abatement;	DOES NOT APPLY TO QUERCUS	POSITIVE: would incentive emissions reduction in Europe, boosting jobs and investments in energy efficiency and low-carbon technologies;	- Would incentivize emission reductions in Europe, boosting jobs and investments in energy efficiency and low-carbon technologies; - May decrease financial support for clean investments in developing countries; - Would guarantee environmental integrity of the future, post-2020 global climate agreement (to avoid double counting of emission reductions);
f. Discretionary price management	-	NO DIRECT IMPACT: would not affect the cap on emissions; however would help to avoid the risk of high-carbon lock-in;	NO DIRECT IMPACT: would help to avoid the risk of high-carbon lock-in;	DOES NOT APPLY TO QUERCUS	NO DIRECT IMPACT	- May hamper future linking of the EU's carbon market with other schemes worldwide; - Would provide long-term certainty to investors; - Would help to avoid the risk of high-carbon lock-in;