European Energy & Climate Outlook for 2030: Is the EU ETS up to the Task?

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The EU ETS at 10: A Retrospective

- Volatility and “supply and demand imbalance”
- Overlap with complementary policy instruments
- Balancing competitiveness concerns and political rent seeking
- Governance challenges
- Global expansion and integration
EUA Spot Prices 2013-2014

Source: World Bank, 2014
Instrument Overlap

Source: Climate Strategies, 2012
“Backloading”

- Postponement of allowance auctions scheduled for 2013, 2014 and 2015 until 2019 and 2020 to decrease short-term supply by 900 million EUAs

- 400 million EUAs will be withheld from scheduled auctions in 2014, 300 million EUAs in 2015, and 200 million EUAs in 2016

- Withheld EUAs are reintroduced towards the end of the Third Trading Period: 300 million in 2019 and 600 million in 2020
EUA Surplus to 2030

Source: European Commission, 2014
Long-term Response

• European Commission communication of 14 November 2012 sets out six options for long-term structural reform
  • Increasing the EU’s greenhouse gas emissions reduction target for 2020 from 20% to 30% below 1990 levels
  • Retiring a certain number of phase three allowances permanently
  • Revising the 1.74% annual reduction in the number of allowances to make it steeper
  • Bringing more sectors into the EU ETS
  • Limiting access to international credits
  • Introducing discretionary price management mechanisms such as a price management reserve

• Legislative proposal of the European Commission of January 2014 opts for establishment of a Market Stability Reserve, to start in 2021
Market Stability Reserve

- 12% of EUAs in circulation (i.e. the surplus) from year n-2, as published in May n-1, will be moved into a reserve each year, unless the number of allowances to enter the reserve would be less than 100m (i.e. surplus that year below 833m)
- If surplus falls below 400 million EUAs, 100 million EUAs allowances from the reserve would re-enter the market through auctioning
- If Art 29a of ETS Directive is triggered (price of EUAs more than 3 times the average price of allowances during the two preceding years), then 100m allowances would be released from the reserve into the market
Addressing Leakage Concerns

• Allocation formula to vulnerable sectors:

\[ A = Bm_e x P[x \alpha_{cap}] \]

- \( A \): free allocation [EUA]
- \( Bm_e \): emission benchmark [t CO_2/t product]
- \( P \): historic production
- \( \alpha_{cap} \): adjustment factor to adjust allocation to the cap

• Determining trade exposure and leakage risk:
  - 5% cost increase and 10% trade exposure
  - 30% for one of the two
Leakage and Rent-Seeking

Companies at risk of carbon leakage

- 27 sectors
- 117+ sectors

Additional cost as % of gross value added

Trade exposure ($\Sigma Ex + Im$ as % of $\Sigma Turnover + Im$)

- 5%
- 30%
- 10%
Linking: Vision vs. Reality

• Existing links only between largely identical emissions trading systems
  • Norway-EU ETS in Phase 1
  • California-Quebec

• Linking between largely compatible systems more difficult than expected:
  • 2012 linking agreement with Australia in question following 2013 Australian election outcome
  • Ongoing negotiations with Switzerland have proven difficult
Persistent Questions

• Uniform target vs. uniform instrument
• Quantity control vs. price control/short-term vs. long-term perspective
• Options for increased ambition and safeguarding competitiveness
Thank you for your attention!

Questions?
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