The EU Emissions Trading System

Insights into the latest political developments

Brussels, 22 July 2014

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Our background

Carbon Market Watch (formally CDM Watch est. 2009) was established in 2012 to scrutinise carbon market mechanisms.

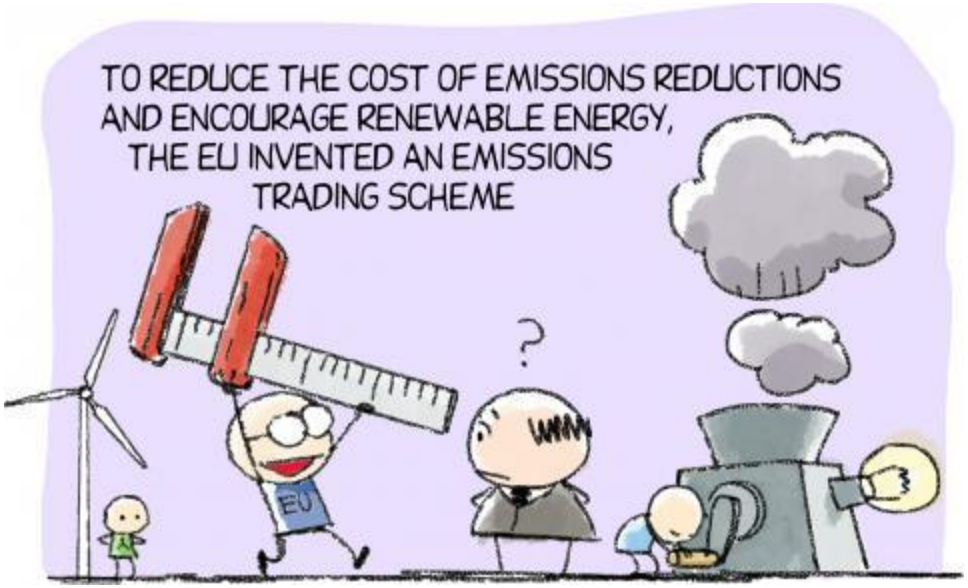
We work on 3 levels:

- International climate negotiations UNFCCC/ICAO
- EU climate policy – EU's Emissions Trading System and Effort Sharing Decision
- Carbon Market Watch Network – over 800 members in 70 countries. Our civil society partners play an active role in shaping the carbon market debate.

Some of you may know us from our earlier campaigns on the HFC-23 debate that successfully removed these highly potent and profitable credits from the EU ETS.

Content

- The EU’s 2020 and 2030 climate framework
- The problems and solutions for the EU ETS
- Carbon leakage: myth or reality?



Elements of the 2020 climate framework

The EU Emissions Trading System (ETS):

EU's carbon market covering 11.000 installations (around 40% of EU's GHG emissions) from the power sector and industrial sectors

The Effort Sharing Decision (ESD):

EU legislation that sets emissons reductions targets for sectors not covered under the EU ETS (around 60% of EU's climate emissions), including the transport, building and agriculture sector

Land-use, land-use change and forestry (LULUCF):

Excluded from EU's 2020 climate objectives

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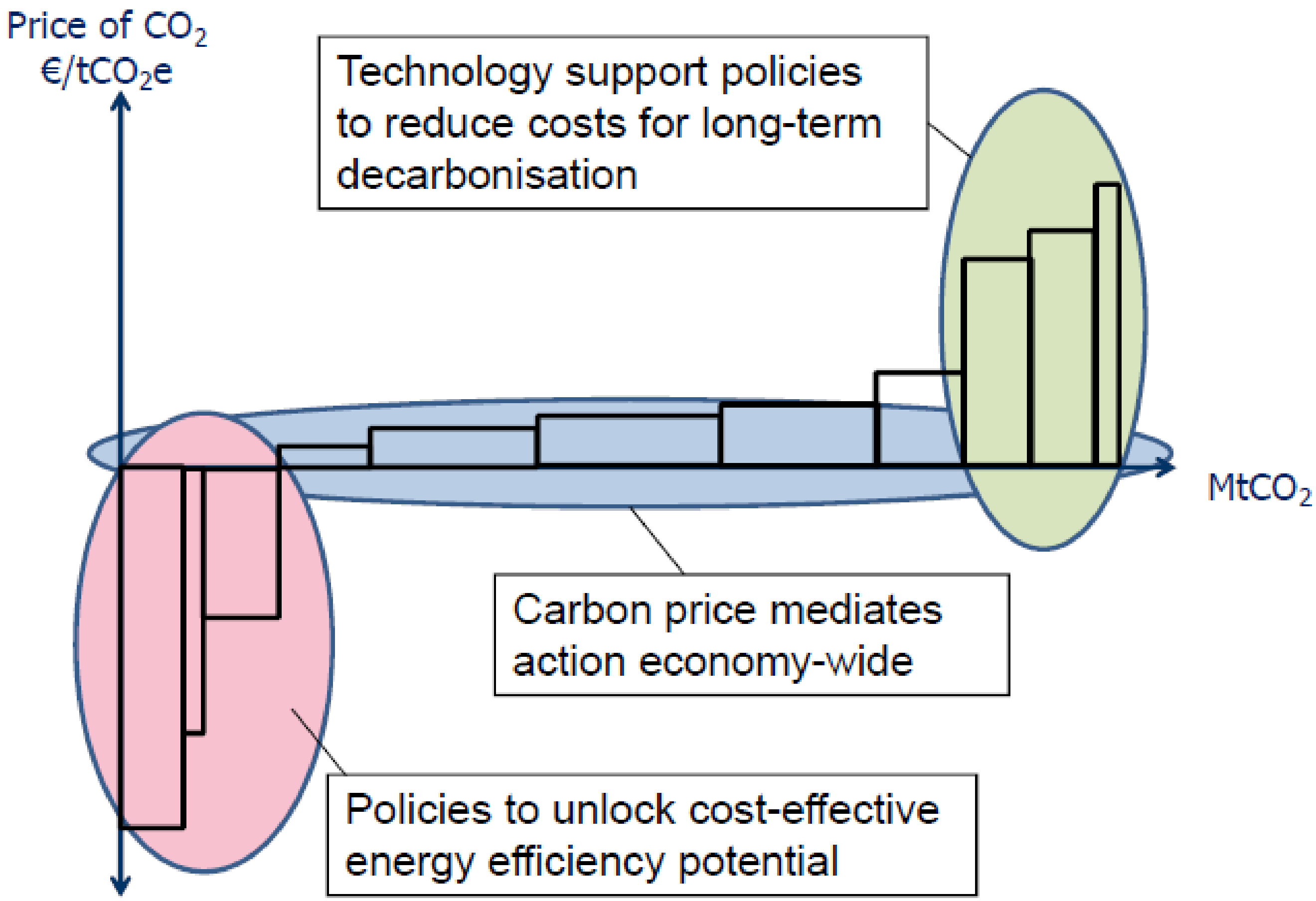
The EU ETS' role in the overall climate and energy policy framework: it cannot do the job alone



[International Energy Agency (2011), Summing up the parts]

The EU's 2030 climate policies: what you can expect in the next year(s)

Jan 2014: Commission presents 2030 climate + energy package, including:

- GHG reduction target for domestic EU emissions of 40% in 2030
- ETS reform proposal to enact a Market Stability Reserve

Oct 2014: Heads of States reach agreement on main elements of the 2030 climate + energy package including confirmation of the 2030 domestic GHG reduction target.

Early 2015: Commission presents new legislation to implement the 2030 climate target. For the EU ETS, this includes:

- Changing the percentage by which the caps are reduced each year to bring the EU ETS in line with the 2030 GHG target.
- Introducing provisions to reduce the potential risk of carbon leakage in the post-2020 period.

The EU ETS: why the MSR is not enough

1. The large oversupply of CO_2 allowances undermines the 2030 climate target
2. The inflow of carbon offsets has crowded out domestic investments in clean technologies
3. The EU ETS currently fails to reach EU's long-term climate objective

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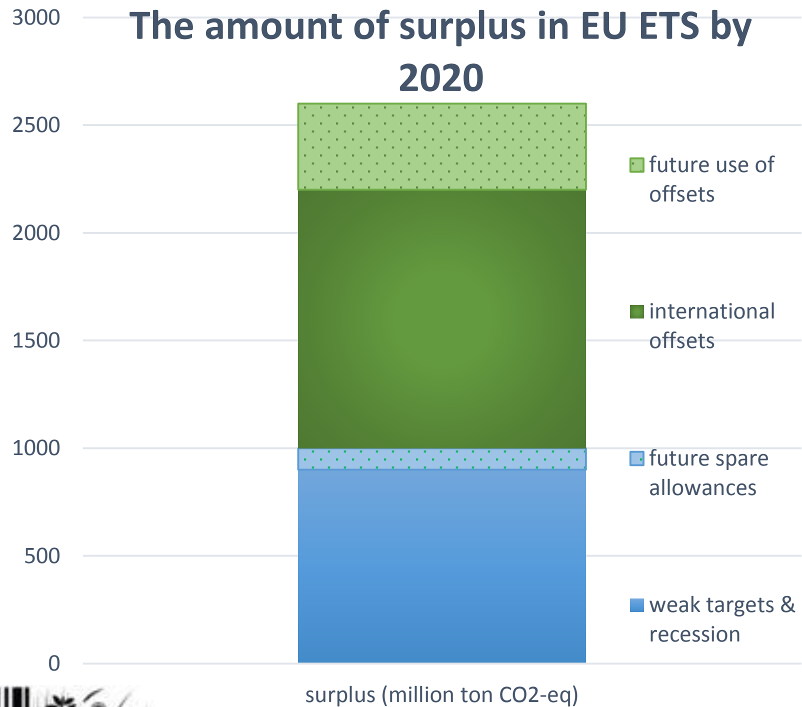
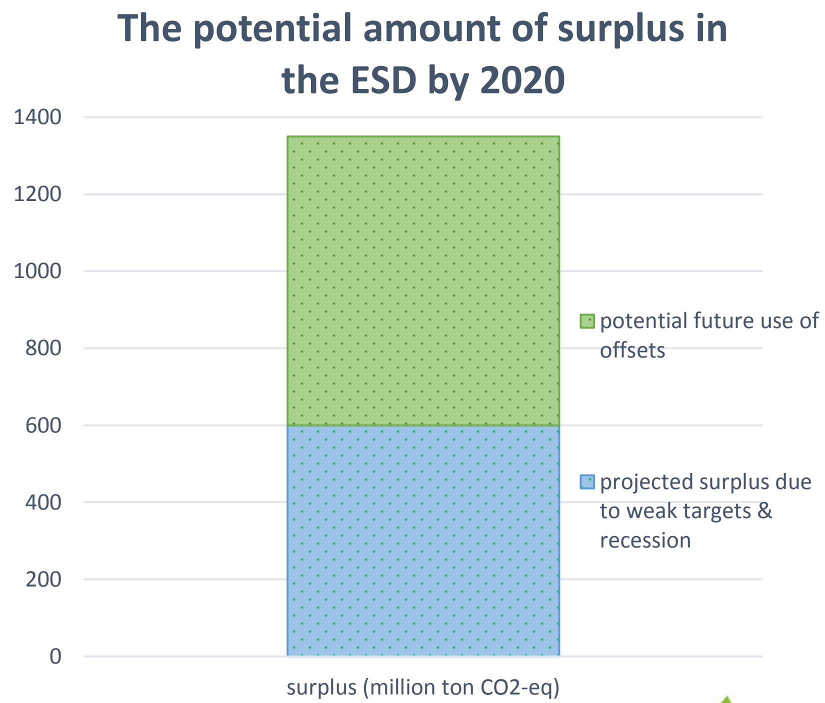
Problem 1: large oversupply of CO_2 allowances

By 2020: 3.2-3.9 billion surplus under ETS + ESD

Under the EU ETS :
- **2.6 billion** surplus allowances
- **1.6 billion** of these are offset credits



Under the ESD :
- **0.6 - 1.35 billion** surplus allowances
- **up to 0.75 billion** of these are offset credits



By comparison: the yearly emissions of the EU-28 Member States: 4.5 billion CO_2-eq

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Problem 1: carry-over of oversupply threatens the 2030 target

- The total oversupply (ETS+ESD) of 3.2-3.9 billion when carried-over could mean that a 40% GHG target represents only **26% - 29%** GHG reductions.
- Under the EU Emissions Trading System, the 2.6 billion surplus is automatically banked into the post-2020 period, transforming the surplus allowances into future rights to pollute

[Under the Effort Sharing Decision, there is no automatic carry-over of surplus]

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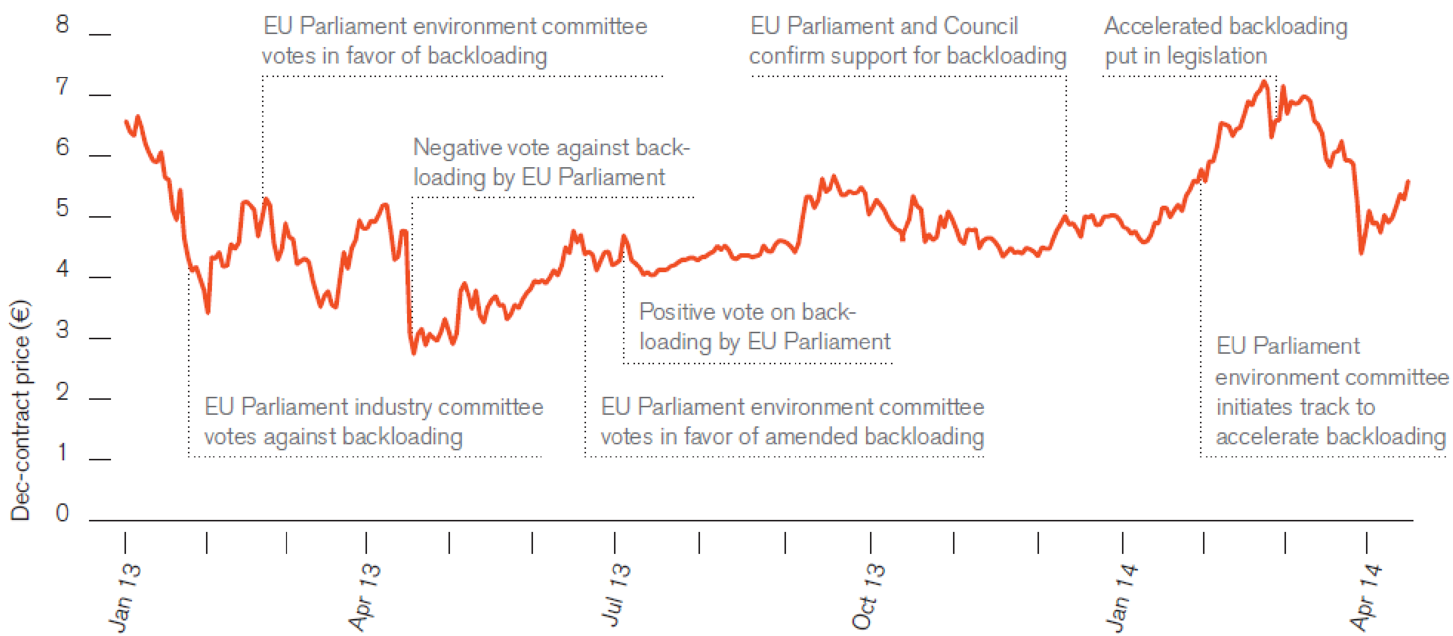
The Market Stability Reserve will not do the trick

The Market Stability Reserve (e.g. automatic backloading) does not reduce the surplus as it will return the allowances from the reserve to the carbon market over time



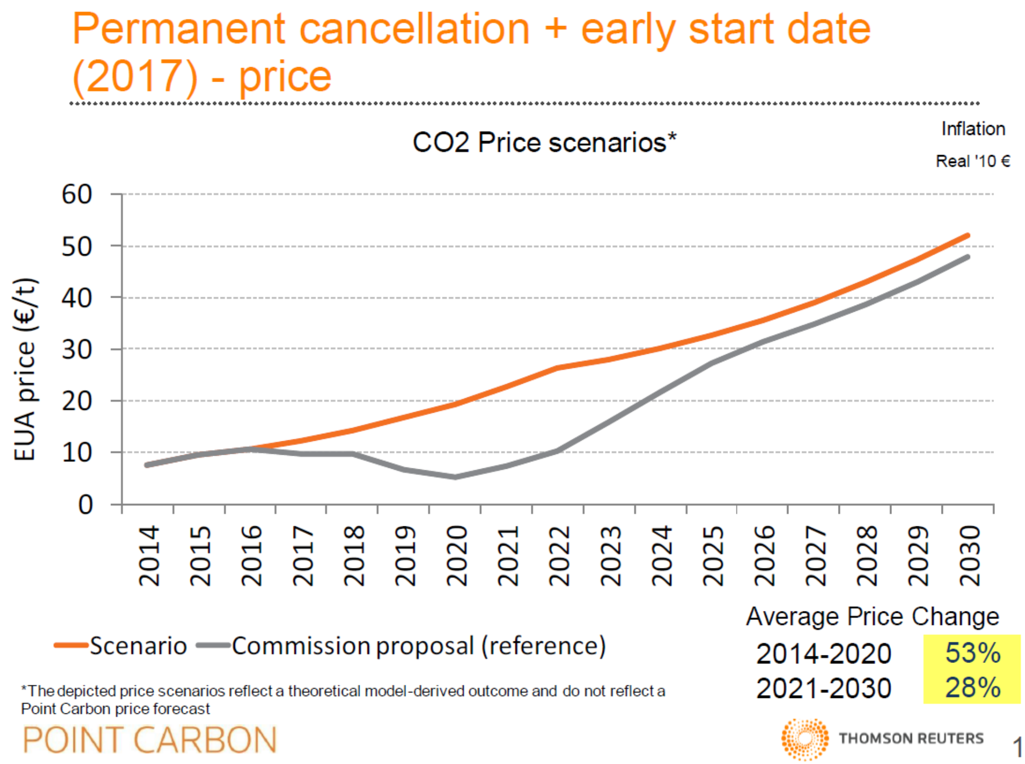
Source: Thomson Reuters Point Carbon

The solution: permanently remove surplus allowances

Complement the Market Stability Reserve with cancellation of surplus allowances. This also leads to a more stable carbon price development

Proposal:

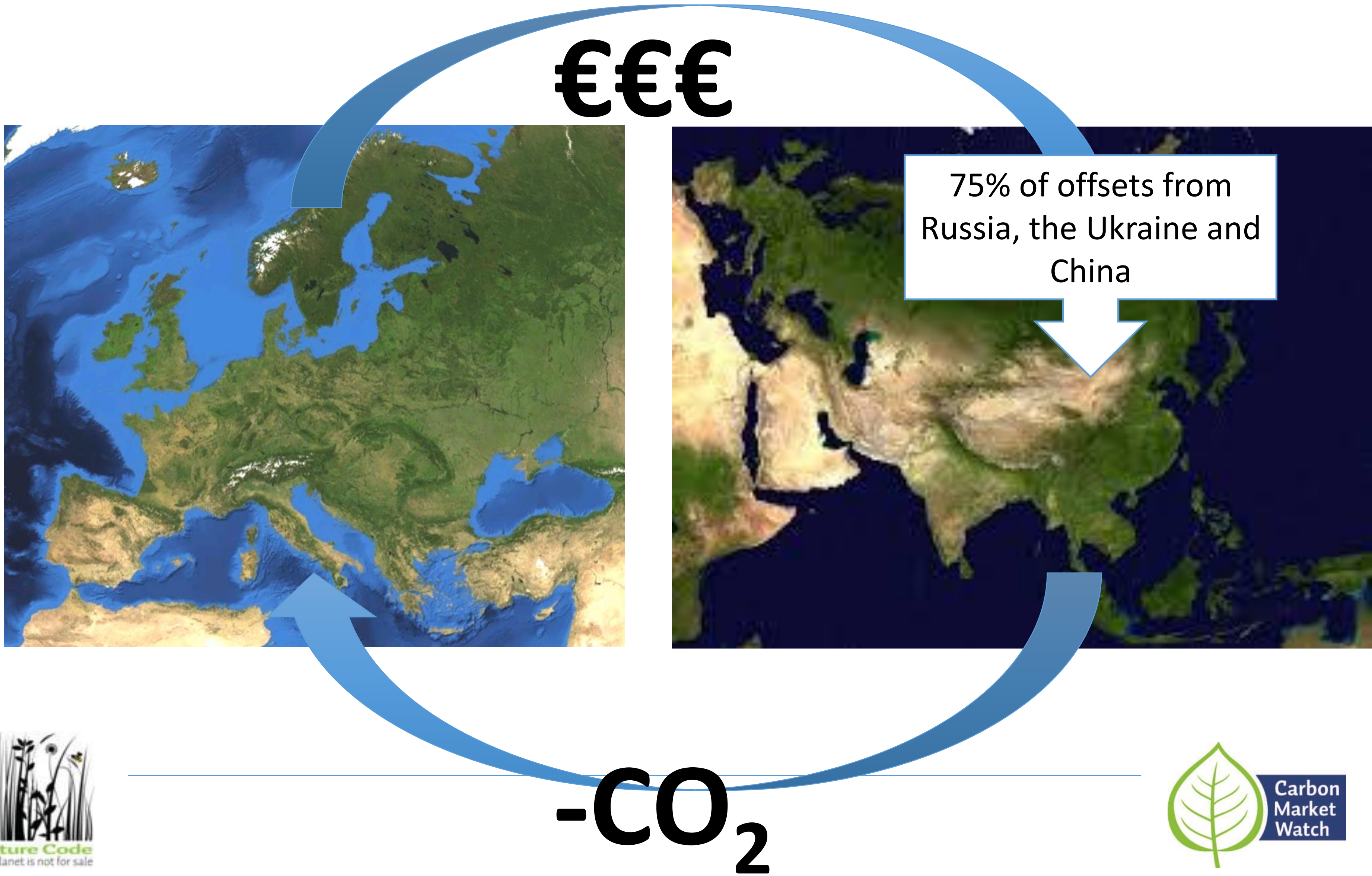
- Earlier start date (2017)
- Cancellation of surplus allowances



Orange line = removal 900 million allowances + start 2017

Grey line = Commission proposal

Problem 2: the large inflow of carbon offsets



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The solution: promote domestic action by disallowing carbon offsets post-2020

Under the EU ETS:

→ Carbon offsets crowd out domestic investments that increase EU's competitiveness

In general:

→ Demand for **offsets under a 2015 int. agreement** is problematic because all countries are expected to contribute to the global effort (risk of **double counting**)

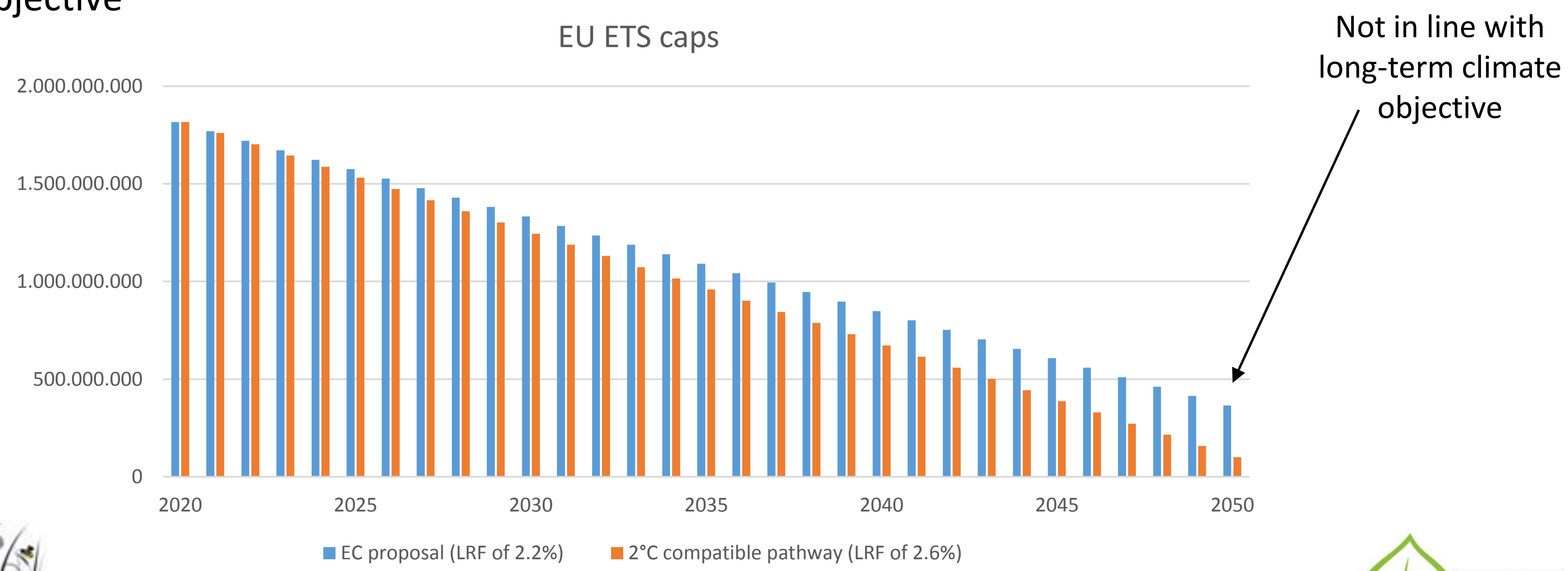
→ The EU has **climate finance obligations** so public climate budget of MS may not be best spent on offsets with questionable benefits

Problem 3: the EU ETS is not in line with EU's 2°C pathway

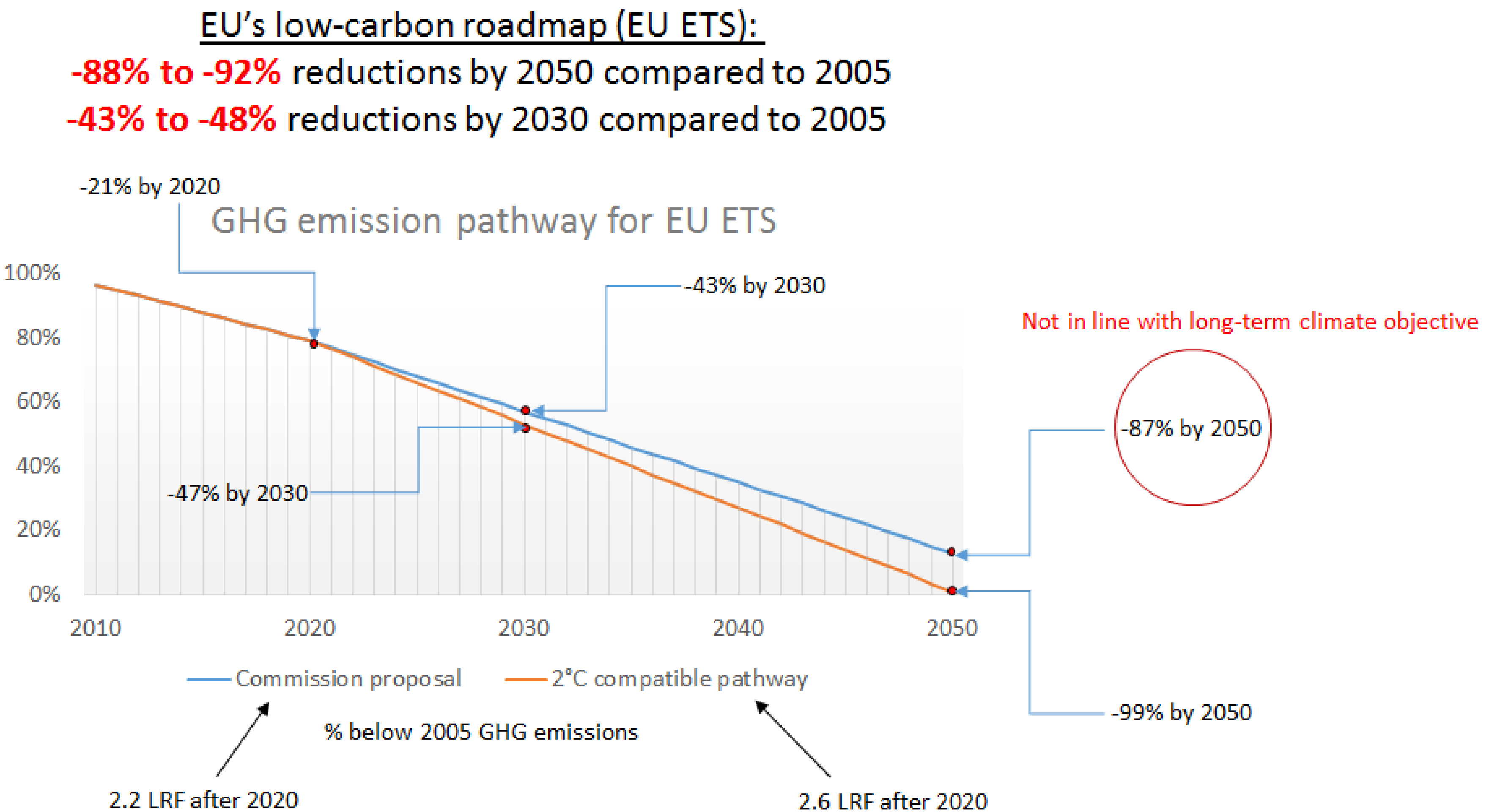
Each year the EU ETS cap is reduced by a certain percentage: the so-called linear reduction factor (LRF). This is currently 1.74% so that each year the cap is reduced by 38 million CO_2 allowances.

To implement EU's 2030 GHG target, this percentage needs to be increased from 2020 onwards.

Problem: the percentage proposed by the Commission fails to reach EU's long-term climate objective

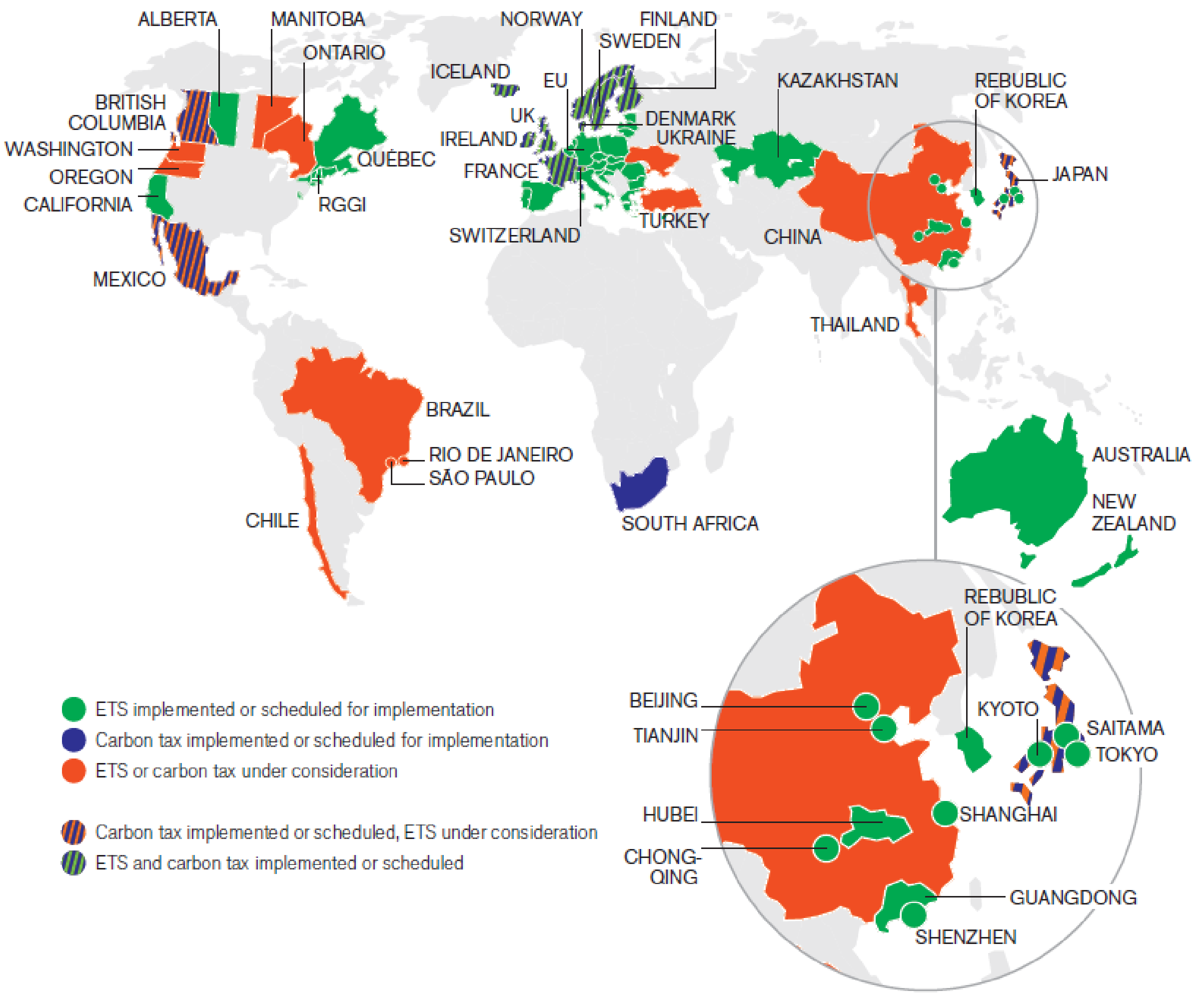


The solution: bring the EU ETS in line with EU's 2°C pathway



After 2020, the LRF needs to be increased to 2.6% to be in line with the objective of keeping climate change below 2°C. This is still consistent with a 40% GHG target.

Carbon leakage: carbon can only leak if there is a country where it can leak to…



[The World Bank (2014), State and Trends of Carbon Pricing]

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Carbon leakage: transfer of money from taxpayers to industry

During 2005-2008, industry gained windfall profits in the order of <u>14 billion euros</u> at the expense of taxpayers (CE Delft, 2010)

"No evidence detected for the occurrence of carbon leakage as defined by the ETS Directive in the period of application of the EU ETS, 2005-2012" Ecorys, 2013

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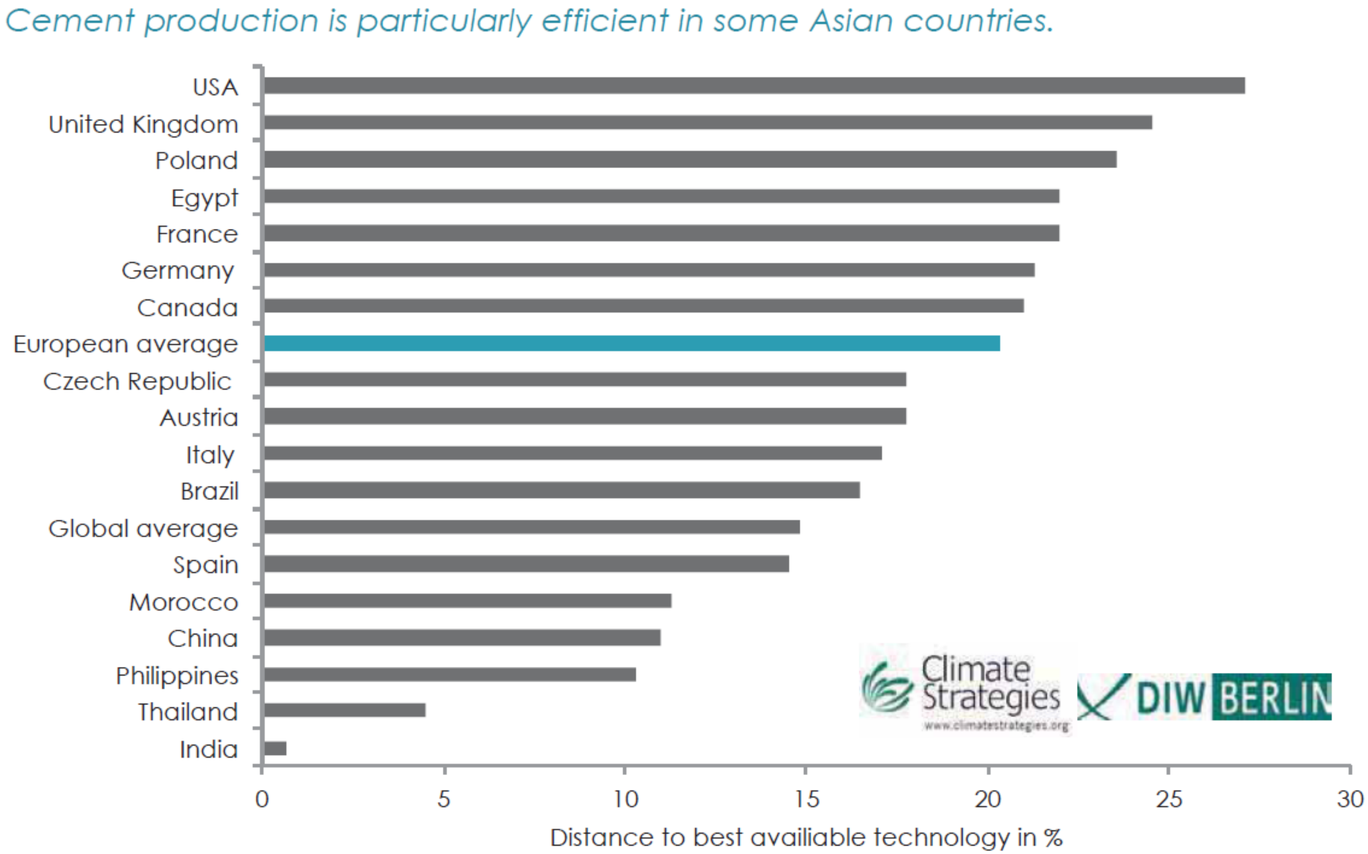
Europe is falling behind in deploying low-carbon technologies

Energy consumption per tonne of cement clinker above benchmark in 2011



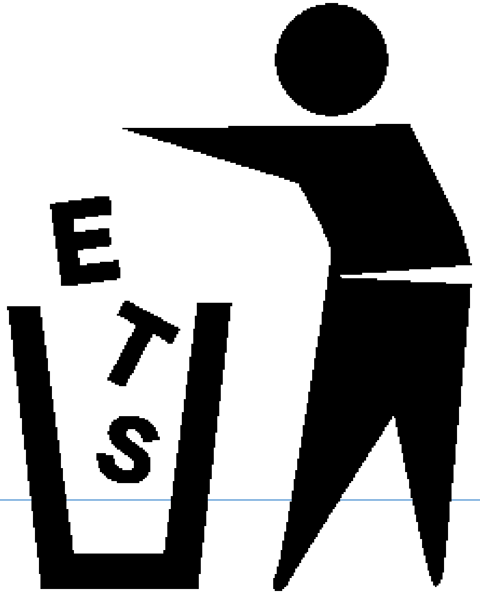
Europe is at a turning point …

… which future for the EU ETS?

WE CALL ON THE EUROPEAN PARLIAMENT TO SUPPORT THE EU EMISSIONS TRADING SCHEME 'BACKLOADING' PROPOSAL

The 42 companies and associations above represent more than €875 billion turnover, €7.5 trillion assets under management and 1.5 million employees. We cover a wide spectrum of industries ranging from power generators to institutional investors, technology developers, large energy consuming industry and many more. We call for urgent action to correct Europe's carbon market.

We ask Members of the European Parliament to vote in favour of the Environment Committee report on the EU Emissions Trading Scheme (EU ETS) Auction time profile 'backloading' amendment. The EU ETS was designed to be the most cost-effective means to reduce greenhouse gas emissions in line with the EU's 2050 climate target. Simultaneously, it was meant to create incentives for investments in low-carbon technologies by reinforcing a clear, long-term carbon price signal. However, its effectiveness has been undermined by a surplus of allowances. The current carbon price (about €4/t) will not stimulate low-carbon investments or innovation. Without agreement on the backloading proposal the price will fall further threatening the long term survival of the EU ETS and lead to fragmentation of the single energy market through a patchwork of national regulations.



How to fix the EU ETS?

As part of the MSR proposal:

- ➢ Permanently remove surplus allowances to stop them from turning into future rights to pollute

As part of the ETS revision:

- ➢ Disallow the use of international offsets post-2020 as it crowds out domestic investments
- ➢ Change the linear reduction factor to 2.6% to bring the EU ETS in line with EU's 2°C pathway
- ➢ Let the polluter pay and stop windfall profits through free allocation

- ➢ Reject the carbon leakage list for the 2015-2019 period

Thank you!

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