Energy Transition: A Multifaceted Challenge for Europe

3rd Symposium: Reforming the EU ETS: Striking the right balance between the EU objectives of decarbonisation and competitiveness

- Report -

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On the 8th of September 2015, Egmont – The Royal Institute for International Relations and the Development Group held the 3rd Symposium of the 2015 series of events dedicated to the European Energy Transition. Around 120 representatives from EU institutions, the economic sector, Member States and other key stakeholders discussed the reform proposal of the EU Emissions Trading System in order to evaluate if it strikes the right balance between the EU objectives of decarbonisation and competitiveness.

Keynote address: Reforming the EU ETS

The keynote address was provided by **Mary Veronica Tovšak Pleterski**, Director for European and International Carbon Markets in the DG CLIMA of the European Commission. After outlining how the Commission had tried to align the reform proposal to the political intentions set out by the October 2014 Council Conclusions, she presented the three key areas of the ETS reform. The first area is environment. In line with the objective of reducing emissions by at least 40% by 2030, the linear reduction factor of the cap will be increased. The second area is carbon leakage. She explained that free allocation has effectively addressed carbon leakage as there is no evidence of carbon leakage in the two first phases of the scheme. Therefore, the free allocation mechanism will be maintained but it will become more targeted on the most exposed sectors. Benchmarks will be updated to avoid windfall profits and reflect technological progress. The third area is the increase of innovation and modernisation funds, particularly in the least wealthy Member States, in order to incentivise the transition towards a low carbon economy.

Session 1: Lessons learned from the previous EU ETS period(s)

As the first panellist, **Sarah Deblock**, European Policy Director of the International Emissions Trading Associations (IETA), argued that there are two topics of importance for the revision of the ETS directive. The first is the though balance to strike between providing sufficient protection against the risk of carbon leakage and ensuring the ETS continues to provide incentives to innovate. The second topic is the EU ETS overlap with other European climate policies that increase the structural oversupply. As a minimum, greater transparency has to be ensured for the emissions reduction costs of these other policies to allow comparability with the EU ETS. Finally, she pointed out that even if it is right to limit international credits to tackle the surplus of allowances in the market, we have to remember that these international credits encourage global participation and lower compliance costs for EU companies.

Then **Alessandro Bartelloni**, Policy Director of Fuels Europe, underlined that the ETS is not really a market-based mechanism given the public interventions with the back-loading decision and the establishment of a Market Stability Reserve (MSR). He explained that his sector - the refining industry – did not benefit from an effective carbon leakage protection due to an under-allocation in phase 3. Therefore, he recommended preserving the competitiveness of EU industries by allocating free allowances on the basis of current level of production and representative benchmarks. In addition, the issue of indirect costs due to the EU ETS' impact on electricity prices should be addressed at EU level.

Pavel Řežábek, Chief Economist at ČEZ, pointed out that the power sector has high potential to decarbonise provided it has stable and robust market signals. Like Mrs. Deblock, he also highlighted the danger of overlapping climate policies with the EU ETS in the future. But he went further by proposing to mitigate this issue by decreasing the annual EU ETS cap by the emissions saved thanks to other climate policies.

Finally, as discussant, **Stefan P. Schleicher**, Professor of Economics at the Wegener Centre on Climate and Global Change at the University of Graz, raised interesting points on the three constituent layers of the system, namely, market, sectors and installations. For the market, he outlined the challenge of making the stringency between supply and demand of allowances more predictable. According to his research, current emissions will remain below the target path for a while. This will have a major impact on the cumulative surplus, which should not hit the target path before 2025. Regarding the sectors, he showed that the fixed allocation of allowances in the cement sector created major distortions between installations of participating countries. Concerning the installations, he explained that the benchmarks on which free allocations are based are not well targeted. Indeed, the cement installations in most participating countries were over-allocated, while a few of them were under-allocated.

Session 2: The Reform of the EU ETS and its impact on EU competitiveness and other climate policies

Yvon Slingenberg, the EU ETS expert in the cabinet of Commissioner Arias Cañete, opened the second session by saying that the Commissioner is concerned about the slowness of the negotiations but is confident that an agreement will be reached by the end of the year. She pointed out that the EU ETS reform is a difficult political process and that compensations have already been made for not wealthy Member States. She explained that the proposed allocation of allowances has been made as targeted as possible according to updated benchmarks. Consequently the exposed sectors will be protected, while preserving the incentive for investment. Regarding the indirect costs, she explained that a 'one-size-fits-all' European approach is not feasible because the situation differs from one Member State to another. But Member States will have the opportunity to use part of their auctioning revenues to address this issue nationally.

Next, **Anders Marvik**, Vice-President of EU Affairs at Statoil, stressed that although it is a good reform, it does not go far enough. Indeed, it will not raise the carbon price to a functional level that would stimulate investment and innovation in low carbon technologies. According to assumptions, the carbon price will raise from current levels to about € 25/€ 30 by 2030. But then it is supposed to shoot up to around €186 by 2050. Considering the huge difference between both prices, this scenario seems quite unrealistic. In Mr. Marvik's opinion, a price of around 50€ per ton is needed by 2030 to incentivise investment. Moreover, he does not believe that carbon leakage really exist given that investment decisions are based on many more factors than carbon costs alone. Therefore, he prefers using the terminology investment leakage rather than carbon leakage. He also pointed out that although CO_2 production is decreasing in the EU, CO_2 consumption is increasing, because EU citizens are increasingly buying goods manufactured outside the EU. In conclusion, the ETS reform work has to continue until the price signal is there.

Sandrine Dixson-Declève, Director of the Prince of Wales' Corporate Leaders Group, invited the stakeholders to take a step back out of the euro-bubble. While the EU ETS has served as an example for other ETS around the world, the EU could now learn a lot from these schemes, such as the Californian ETS. Both Mr. Marvik and Mrs. Dixson-Declève insisted on the fact that investment leakage is not just a problem of the EU ETS. EU growth is stagnating and the lack of competitiveness of EU industry is not due to the EU ETS but most of all to labour, transport and bureaucracy costs. Rather than discussing the avoidance of carbon leakage, the main question is "how can we address investment leakage in the EU?" Then she explained that, according to a recent study[1], the EU ETS had been a success in the views of EU companies, which have increasingly taken into account the carbon factor in their daily business. However, she argued that the ETS had not realised its full potential. Consequently a stronger linear reduction factor, more targeted carbon leakage options, a larger innovation fund and more frequent reviews of the system are needed.

[1] *10 years of Carbon Pricing in Europe*, CISL, 2015

Finally, **Damien Morris**, Head of Policy at Sandbag, drew most of his discussion points from *harder, better, faster, stronger: The easy route to increased EU climate ambition,* a report recently published by Sandbag. He believes that the EU ETS reform introduces significant progresses but is clearly not enough. According to him, the surplus of allowances will grow to 4.4 billion by 2020 with around 2.1 billion of this stored in the MSR. The latter is thus not sufficient to maintain scarcity of supply. Moreover, a major part of allowances placed in the MSR will be purposed for the New Entrants Reserve. The new percentage by which the cap will decline will not be sufficient to maintain the right pace either. Therefore he proposed the adoption of a 25% target in 2020 by cancelling allowances from the MSR and a 50% target in 2030 through a tighter ETS cap and state-level offsets.

To conclude, all speakers agreed that the EU ETS must remain the central pillar to decarbonise the European economy cost-effectively. However, it is the level of carbon price over the following years that will decide if the EU ETS is able to fill such a role. A strong agreement at the COP21 in Paris at the end of this year will be crucial in this regard.

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