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EU ETS: LAST CALL BEFORE THE DOORS CLOSE ON THE NEGOTIATIONS FOR THE POST-2020 REFORM

Assessment of options to reform the EU ETS



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INTRODUCTION | THE CONTEXT

The EU ETS reform takes place in a fast-changing context both at the EU and the international levels

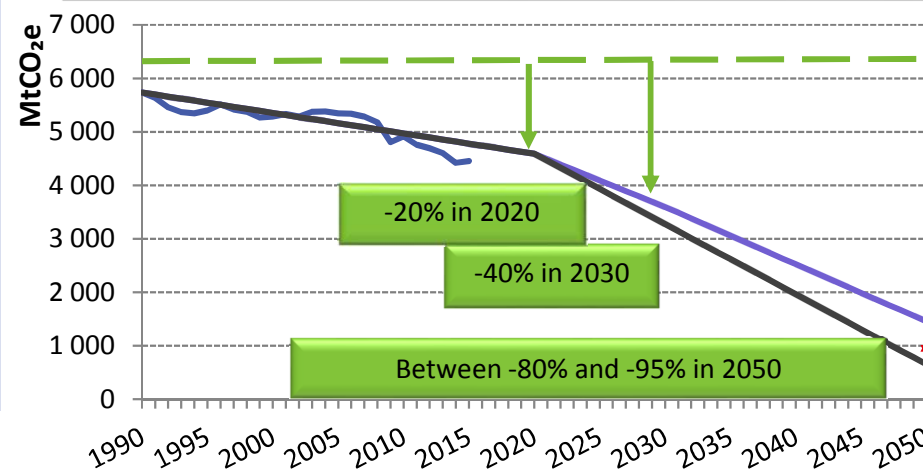
- A significant EUAs surplus + depressed prices = undermining the credibility of the EU ETS
- A window of opportunity to reform the EU ETS is currently open but closing soon : the trilogue negotiations started in April 2017 is expected to succeed in October 2017.
- Other pieces of the 2030 climate and energy framework are under negotiation: the EC released legislative proposals on renewable energy, energy efficiency, the organization of the electricity market, emissions from non-ETS sectors
- The Brexit adds uncertainty to the revision of the EU ETS directive
- The EU ratified the Paris Agreement : EU 2030 and 2050 targets should now reflect this increased ambition.

EUA spot price – phase III



Source: I4CE, with data from ICE Futures Europe

Historical GHG emissions and EU 2050 GHG pathways



Source: I4CE, with data from EU Commission



1 | Assessment of options discussed in the trilogue negotiations to strengthen the EU ETS

1 | Options to strengthen the EU ETS : context

Positions of EU Parliament and Council

- In April 2017, trilogue negotiations started with counterproposals from the EU Council and EU Parliament adopted in February 2017.
- The analysis is based on three scenarios which model the EU ETS in the long term, taking into account other policies of the Climate and Energy Framework: **Parliament**, **Council** and **LRF +**.

	EU COMMISSION'S PROPOSAL/ MSR DECISION	EU PARLIAMENT'S AMENDMENTS	EU COUNCIL GENERAL APPROACH
Linear Reduction Factor 2021-2030	2,20%	2,20%	2,20%
Review Linear Reduction Factor	/	Possibility to increase the LRF after 2024 to 2,4%	/
Intake rate of the MSR	12%	24% until 2021(incl.)	24% until 2023 (incl.)
Cancellation of allowances in the MSR	/	800 million in 2021	Yearly cancellation of allowances after 2024 above the number of allowances auctioned the previous year
Cancellation of allowances by Member States	/	Possibility to cancel a volume of allowances corresponding to the closure of electricity generation in their territory capacity due to national measures	/

1 | Options to strengthen the EU ETS : Results

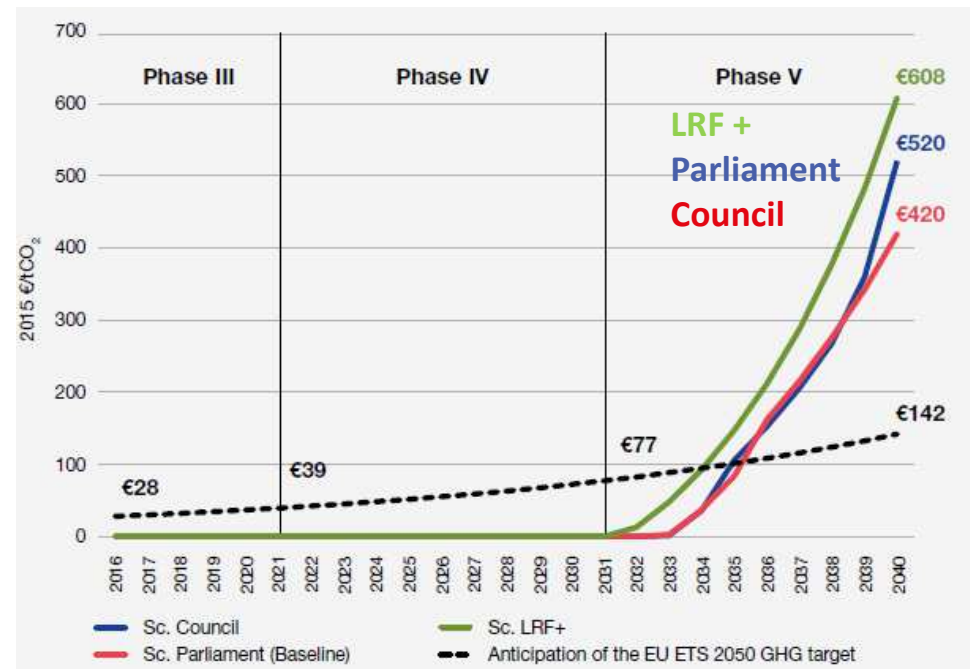
EU Parliament and Council's reform proposals are not sufficient to create an effective ETS by 2030

- The proposals to strengthen the EU ETS **fail to make it a driver of decarbonization** in energy and industry sectors over its Phase IV.
- **GHG emissions reductions notably driven by renewable energy and energy efficiency policies** are sufficient to respect the EU ETS target in Phase IV.
- The EU ETS does not constrain emissions reductions and **the carbon value (cost of GHG reductions) is thus equal to zero.**

Estimating the cost of CO2 reductions required: the carbon value

The carbon value in POLES is **not** the EU ETS market price. It represents the cost of GHG emissions reductions required to respect the constraint set by the EU ETS considering a sliding 5-years carbon budget.

EU ETS carbon value in the scenarios Council, Parliament and LRF +



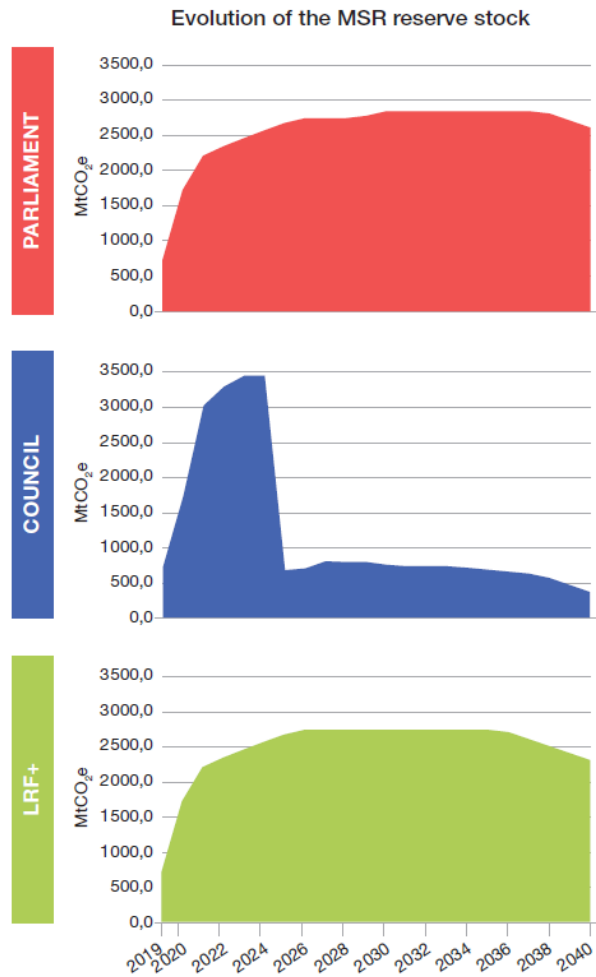
The line « Anticipation of the EU ETS 2050 target » in the graph corresponds to a sensitivity analysis on the carbon budget. In this modelling exercise, stakeholders have a vision of the 2016-2050 carbon budget set by the EU ETS: future emissions reductions needed are perfectly anticipated.

1 | Options to strengthen the EU ETS : Results

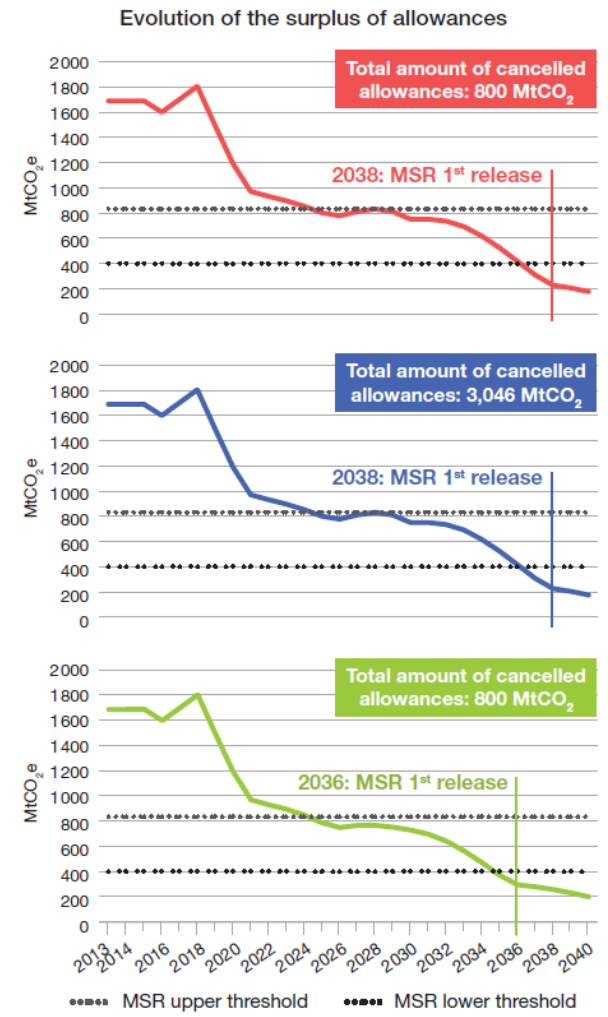
The MSR is not sufficient to mitigate effects between the EU ETS and renewable energy and energy efficiency policies

In spite of the doubling of its withdrawal rate in the first years of its functioning, the MSR is not able to mitigate the effect of complementary policies on the EU ETS during its Phase IV while absorbing the historical surplus of EUAs.

MSR stock: 2019-2040



EU ETS surplus 2013-2040

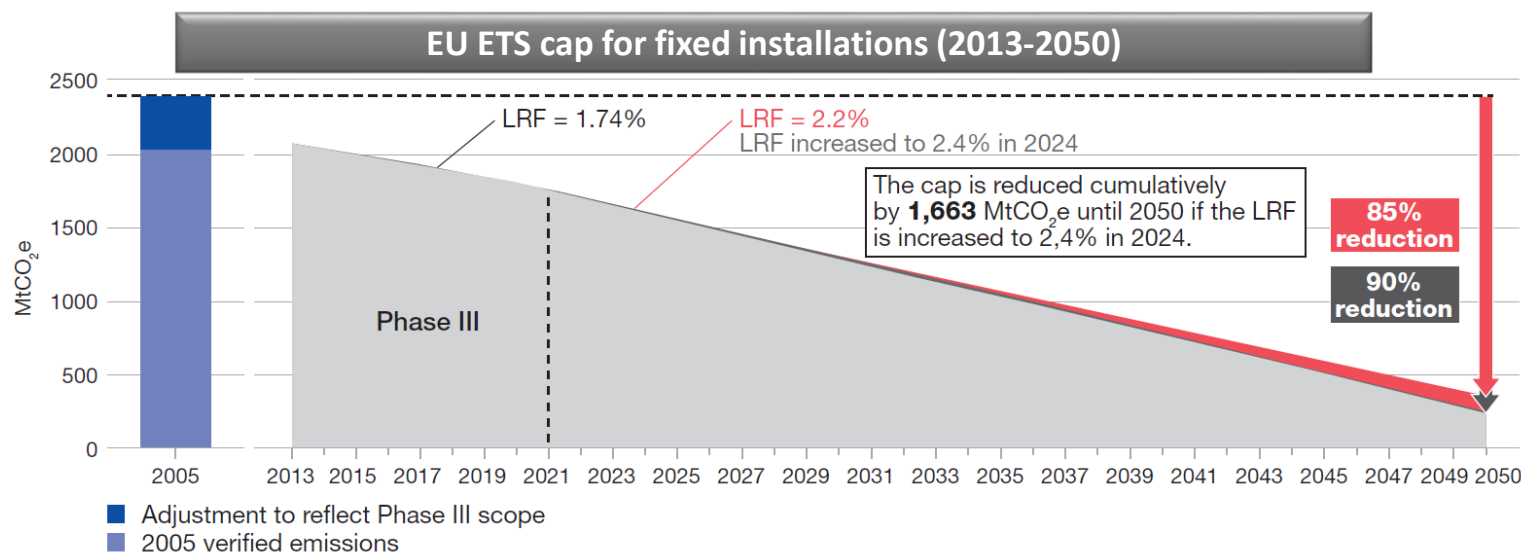


Source: I4CE & Enerdata, 2017

2 | Options to strengthen the EU ETS: long-term perspectives

By 2050, the EU ETS requires a drastic decrease in GHG emissions from industry and energy sectors

- As currently discussed in the trilogue negotiations, the EU ETS trajectory is aligned on the low end of long-term EU climate ambition
- Long-term EU climate objectives and the EU ETS trajectory should now be updated to integrate the objectives of the Paris Agreement
- And still, the EU ETS requires a drastic decrease in GHG emissions
- From the early 2030s, the cost of abatement required to respect the EU ETS target increases significantly.



Interpretation of the graph:

The grey area represents the EU ETS emissions cap in the case where the LRF is increased to 2.4% in 2024. The red area represents additional emissions in the cap in the case where the LRF is equal to 2.2% from 2021.

1 | Options to strengthen the EU ETS : how to manage a sustainable transition pathway

Long-term climate targets need to be anticipated for a sustainable low-carbon transition

- If the long-term constraint is not anticipated from today :
 1. In Phase IV, **EU ETS market prices would be too low** to give the right signals;
 2. In the longer term, higher EU ETS market prices would risk **leading policy-makers to alleviate the constraint set by the EU ETS**, and thus decrease its ambition
- With a proper anticipation of the EU ETS long term target, the need for further GHG emissions reductions would appear from today and would result in **a sustainable and politically acceptable decarbonization pathway.**
- **An updated 2050 EU roadmap**, integrating the objectives of the Paris Agreement, would be necessary to give more visibility to all
- Attention should be paid to the **environmental integrity of the MSR on the long run:**
 - Even with the cancellation of 800 million allowances in the MSR, as proposed by the Parliament, there would still be **more than 2 billion allowances** in the MSR in 2040
 - The proposal of the EU Council empties the MSR by **2044.**



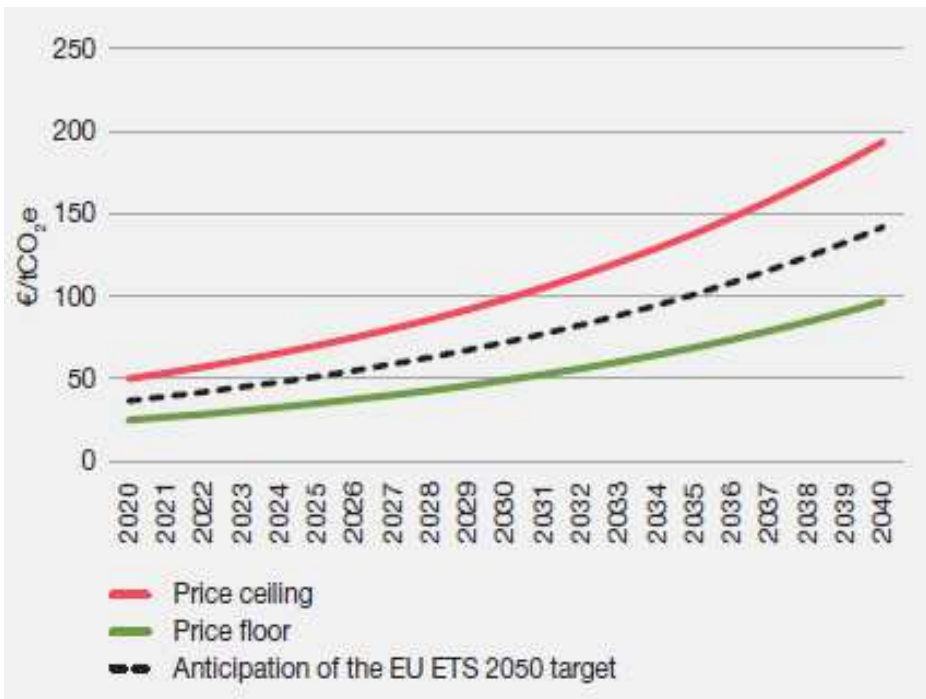
2 | Assessment of prospective scenarios:

- The implementation of a price corridor on the EU ETS**
- An exit of the UK from the EU ETS**

2 | A EU carbon price corridor in the EU ETS

A price corridor as a solution to the lack of anticipation of EU ETS operators

EU ETS carbon price corridor trajectory



In this scenario, a Price Corridor is implemented through an additional reserve on the EU ETS

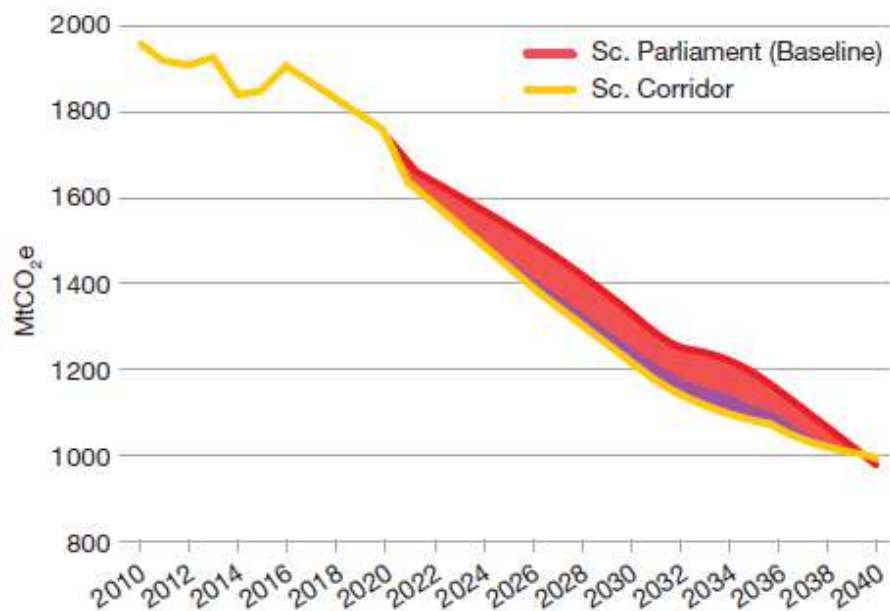
- This scenario does **not** model a price-based MSR
- Auctions are cancelled until the carbon value reaches the floor and corresponding allowances are transferred to a dedicated reserve (the “Price Corridor Reserve (PCR)”)
- Allowances are released from the PCR when the carbon value is higher than the ceiling
- The MSR and the PCR work independently from each other,

The trajectory of the carbon price are based on the recommendations of the Canfin-Grandjean-Mestrallet report (2016)

Price floor : starting at **25€** in 2020 / Price ceiling : starting at **50€** in 2020 / Both increasing by **7%** annually,

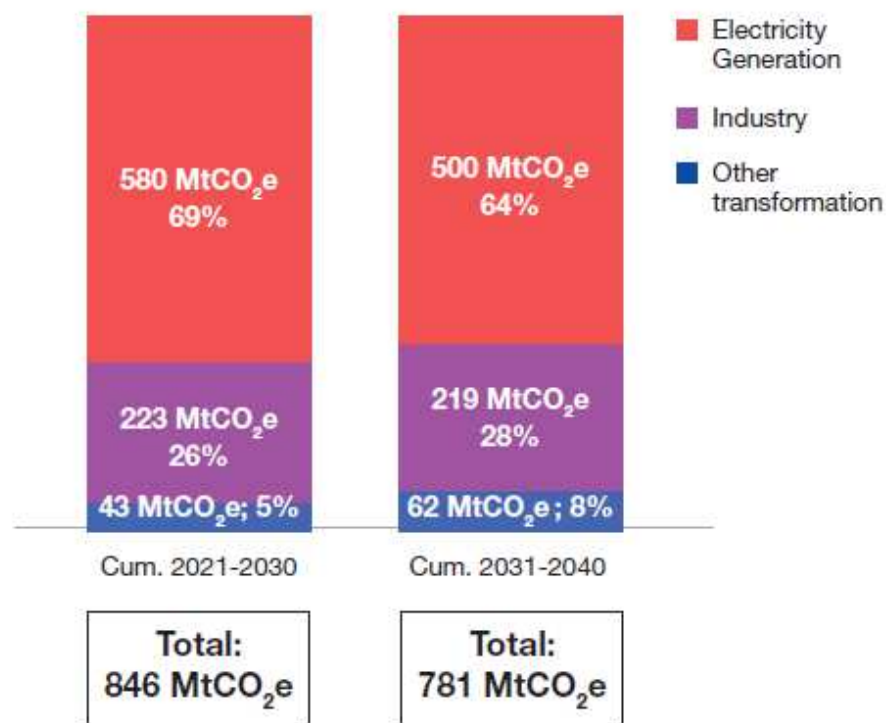
2 | A EU carbon price corridor in the EU ETS

The implementation of a Price Corridor leads to earlier mitigation efforts in EU ETS sectors



Note:

Other transformation includes the refining of mineral oil and the production of coke.



Source: Enerdata, 2017

- The implementation of a price corridor leads to **earlier mitigation actions in EU ETS sectors** and reduces cumulatively emissions by around **1,6 GtCO₂e** by 2040.
- **More than half** of these additional emissions reductions are achieved in the power sector.

TAKEAWAYS

1. The revised EU ETS directive **will not be sufficient to make the EU ETS a driver of decarbonisation in industry and energy sectors** during its Phase IV, unless an unexpected proposal comes out of the trilogue negotiations.
2. The MSR will not be sufficient to **mitigate the interactions of renewable energy and energy efficiency policies with the EU ETS**.
3. The implementation of an EU-wide price corridor on the EU ETS would be **a solution to the lack of anticipation of ETS operators** and would lead to **earlier mitigation efforts in EU ETS sectors**.
4. The revision of other EU legislations thus appears as an opportunity to **create an ambitious and consistent policy mix** and **manage the interactions** between the different policy instruments.
5. In particular, the **Governance Regulation**, which, as proposed by the EU Commission, aims at ensuring the achievement of EU targets while ensuring policy coherency, could be enhanced to specifically address overlapping policies with the EU ETS.

CONTACT

Merci de votre attention!

N'hésitez pas à télécharger notre rapport et le Point Climat correspondant:

“EU ETS - Last call before the doors close on the negotiations for the post-2020 reform”



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