

Strengthening the EU ETS price signal

Implementing an explicit, predictable and steadily increasing auction reserve price on carbon within the EU ETS to favor low-carbon investments

The EU ETS shows a surplus of allowances, and several issues related to the price signal: it is too weak, lacks predictability, and risks collapsing at any time despite increasing climate ambitions.

We support the Market Stability Reserve and we recommend implementing an auction reserve price starting at €20/tCO₂ and increasing over time. In addition to the “quantity-only” reform set in motion by the European Commission, this “price also” approach would prevent the market from “revealing” higher prices too late – i.e. at a time when carbon-intensive solutions are already locked-in.

This paper shows that all 2°C scenarios converge towards a robust and steadily increasing price on carbon, reaching \$140 in 2040. The ETS will not reach that price level on its own, especially since the EU has been increasing fossil fuel subsidies. We therefore recommend reinforcing country- and sector-specific measures together with the ETS, in order to generate implicit and explicit carbon prices at a level compatible with EU climate ambitions.

This paper also highlights the co-benefits of an auction reserve price, as it would bear a positive impact on sustainable development, economic “green” growth, innovation, and Member State auctioning revenues in a predictable manner. More specifically, this paper shows that an auction reserve price would create rewarding opportunities to reduce emissions within ETS sectors while protecting ETS prices from external demand shocks and would not directly affect the secondary market.

Implementing an auction reserve price within the EU ETS would serve as a reference level for other jurisdictions setting a price on CO₂ emissions.

8 KEY MESSAGES

1. Long-term, low carbon investments in ETS sectors will not be triggered as long as there is no guarantee on the return on investment. Implementing an explicit, predictable and steadily increasing auction reserve price on carbon within the EU ETS would solve this issue and avoid locking-in carbon intensive technologies. It would enable nearly all investors to assess risks and opportunities without requiring expertise on EU Allowances. An auction reserve price would also increase the predictability and the amount of Member States revenues.
2. More specifically, the 2°C climate goal requires a CO₂ price of about \$ 140/ton by 2040 (according to IPCC, IEA etc.). Such a price trajectory cannot be achieved solely through the ETS price, and is hampered by negative carbon prices induced by fossil fuel subsidies (FFS).
3. We recommend the implementation of an explicit, predictable and steadily increasing price in the form of an auction reserve price starting at €20 per ton of CO₂ and increasing – in addition to the Market Stability Reserve. This would solely affect the primary market, while preserving the secondary market.



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4. We also recommend the drastic reduction of fossil fuel subsidies in Europe. IMF data show a significant increase (+12%) in fossil fuel subsidies across almost all EU ETS participating Member States from 2013 to 2015, reaching \$335 billion in 2015 and thereby further straying from climate goals. Reverting that trend will probably take years and call upon the consideration of major economic, social and environmental impacts (e.g. addressing energy poverty issues).
5. We recommend combining the EU ETS with other climate and energy policies inducing implicit positive carbon prices, such as regulating industrial emissions, setting carbon performance standards, supporting low carbon research and innovation, supporting low carbon energy sources etc. The idea is to flood the economy with positive prices on carbon – similar to fossil fuel subsidies currently flooding the economy with negative ones.
6. We recommend proceeding with respect to national circumstances and sectoral specificities, starting with the power sector in countries connected to the UK grid, and combining this with measures to limit the extent of the “waterbed effect” (i.e. unused allowances resulting from the switch from coal to gas can be auctioned to power or industrial installations in other countries). We wish to emphasize the fact that the auction reserve price limits the adverse impacts of the waterbed effect on market prices resulting from the UK national tax.
7. We recommend reviving domestic projects (intended here as projects hosted by EU Member States) and we propose preliminary design features that meet the following requirements: not adding to the surplus; not releasing allowances from the MSR; not reducing Member States auctioning revenues; and ensuring that these domestic projects actually achieve more emission reductions than would otherwise have occurred had Member States auctioned allowances instead of crediting projects and recycled auctioning revenues.
8. We recommend carefully looking at the potentially adverse impacts on sustainable development associated with an increase in CO₂ prices, including on power supply and energy sources. Increasing the price of CO₂ does not always trigger emission reductions, and when it does, it can induce other forms of negative impacts. Sustainable development safeguards should play a key role when phasing out CO₂ emissions.

The Shift Project is a think tank which advocates a shift to a low-carbon economy. It seeks to provide guidance to companies and public institutions to help shape climate and energy policies on a national and European level. Committed to serving the general interest through scientific objectivity, The Shift Project brings forward innovative proposals and engages in lobbying initiatives to accelerate the transition to a post-fossil economy.

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