

CEPS – The State of the EU ETS Interactions with the EU ETS

Stéphanie Croguennec

Deputy-Director for climate change

Directorate general for Energy and Climate Change

French Ministry of Ecology,
Sustainable Development and Energy

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What perspectives?

1. Carbon pricing : an important tool to develop a low-carbon economy
2. Importance of setting complementary tools
3. A reformed European carbon market : the market stability reserve
4. Interaction with national Policies



Perspective 1: Carbon pricing - an important tool to develop a low-carbon economy

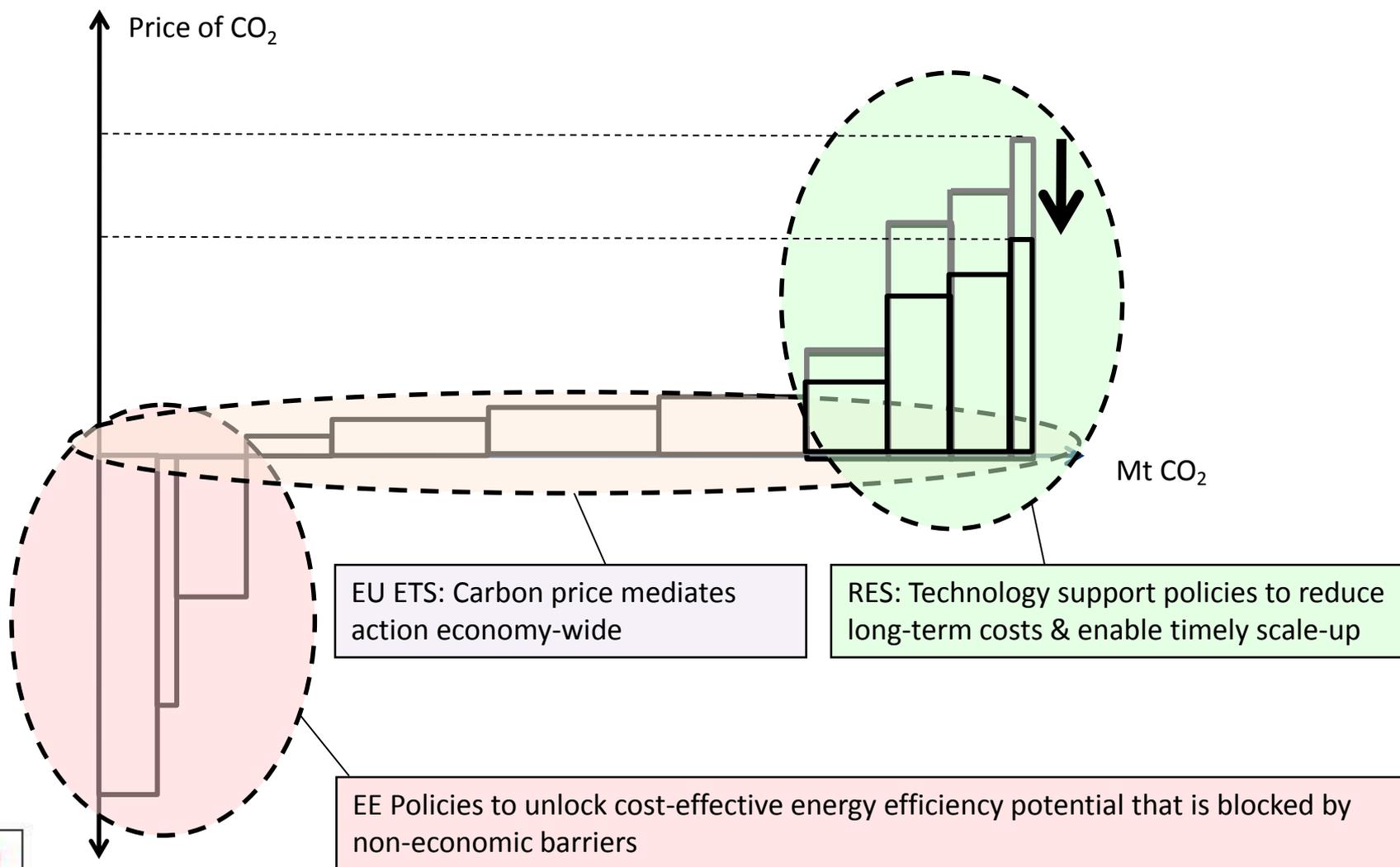
*“The ambitious target adopted by Europe to reduce greenhouse gas emissions by at least 40% between 1990 and 2030 goes hand in hand with an efficient carbon pricing”
– Ségolène Royal at the Environmental Council, 26 October 2015*

- More and more companies ask for a carbon price to incentivise their green investments.

- Ségolène Royal proposed a number of instruments for an efficient carbon pricing, including:
 - A corridor for carbon price to give visibility and guide investments
 - Expand carbon pricing tools to a maximum number of sectors
 - Increase green investments notably through requirements for institutional investors to report on their exposure to climate risks in their portfolio and to increase the green part of their portfolio
 - Phase out fossil fuels subsidies

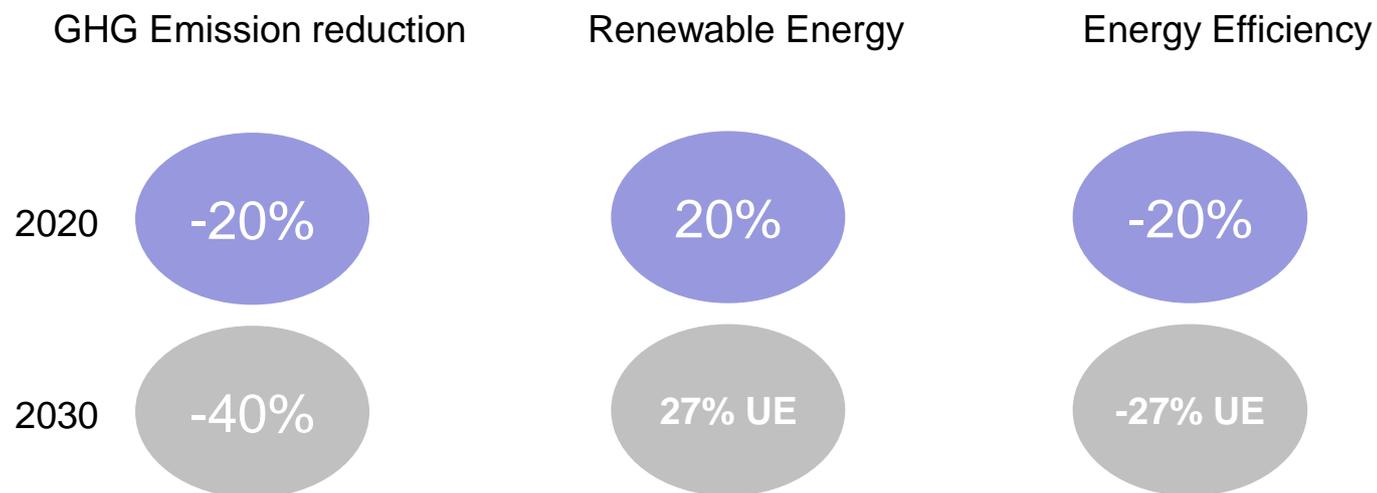
Perspective 2: Complementary tools to carbon price are necessary

In theory there is a rationale for “package” approach: every policy has a purpose and a place



Perspective 2: Complementary tools to carbon price are necessary

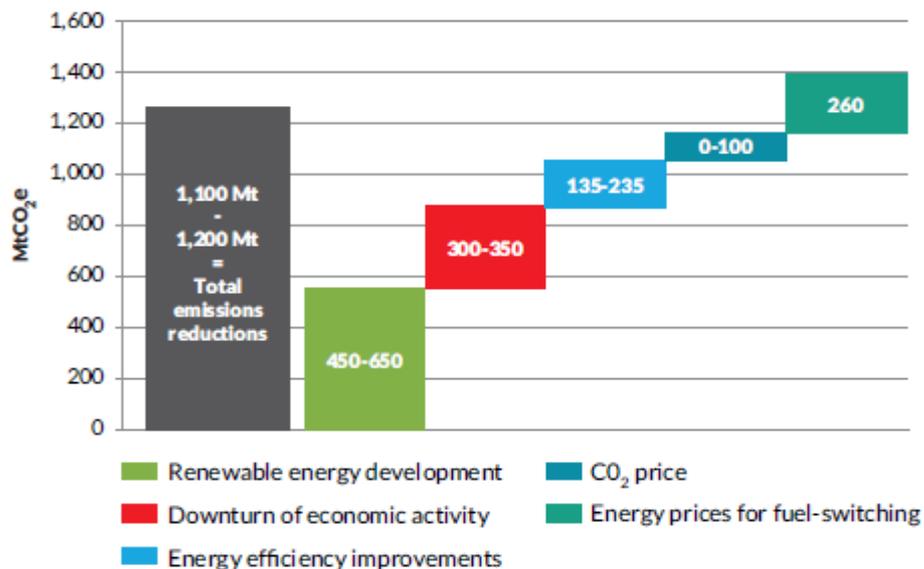
- The carbon market is key for climate transition and reorientation of investments but can not do everything all alone.
- **Need for a combination of policies and measures :**
 - Carbon pricing to reduce emissions
 - Development of new technologies
 - Renewable energy
 - Energy efficiency



Perspective 2: Complementary tools to carbon price are necessary

- On the question about interactions with other policies, the issues are:
 - Whether they are carefully assessed ex ante and included in the cap setting;
 - Whether market participants believe in the achievement of the other policies;
- If those issues are solved, the only outstanding issue is overachievement.
- A study from I4CE on Contributing factors to the accumulation of the surplus from 2008 until 2014 shows that:
 - Renewable deployment accounts for 40% of the EU ETS abatement effort, but was factored in when setting the emissions cap unlike offsets and energy efficiency;
 - Major part of the surplus comes from : Kyoto offsets not considered in the cap (1 457MtCO₂ in 2014) and economic downturn and other abatements (1 200 MtCO₂ in 2014);
 - Renewable energy target was included in the cap setting and is responsible only for its overachievement (10 Mt CO₂) and energy efficiency measures for 20 MtCO₂ of the surplus.

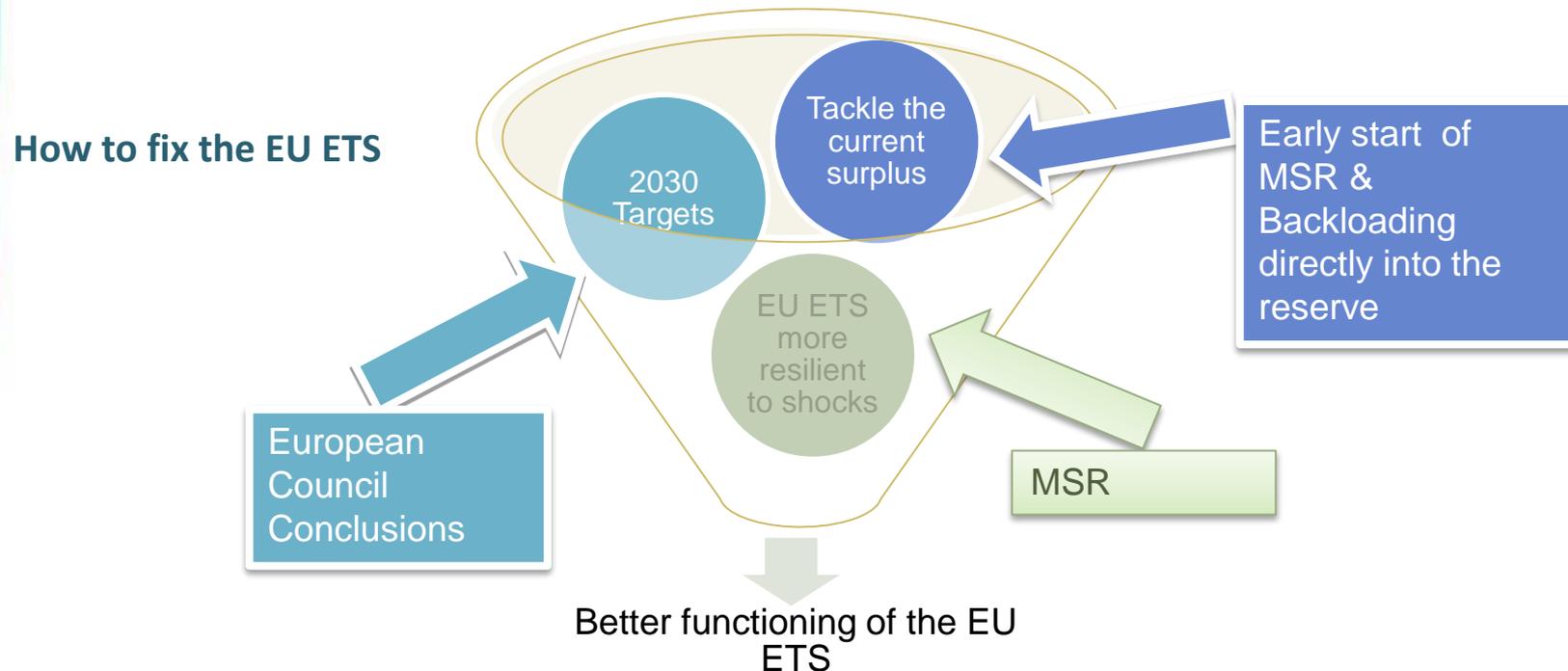
Contributions to CO₂ emissions reductions between 2005 and 2011.



Source: I4CE – Institute for Climate Economics, 2013.

Perspective 3: a reformed and more flexible European carbon market with the market stability reserve (MSR)

- The European carbon market works well technically.
- But concerns exist since 2010 : growing surplus and prices decreasing
 - Issues regarding its ability to trigger investments necessary to meet GHG emission reductions target of the European Council of at least 80% by 2050



▪The MSR should:

- Address the current surplus of allowances
- Improve the system's resilience to major shocks by adjusting the supply of allowances to be auctioned (including to some extent interactions with other policies)
- Although one should also ask themselves whether the MSR is enough to deliver an efficient carbon price before 2020

Perspective 4: Interactions with national policies

- The case for carbon tax or carbon contribution
- Carbon taxes should be offset through alleviation of existing taxes (e.g. on labor)
 - Sweden (CO2 tax + TVA increase): in 1991 decrease in income tax amounting to 9.5Mds of € (4.5% of GDP)
 - Ireland: partial recycling for household compensation
 - Switzerland: 1/3 Building EE program (300MCHF limit / year), 25MCHF for Innovation

How carbon taxes revenues are used in Europe

	Denmark	Sweden	Finland	Norway	Switzerland	Ireland
Flat rate compensation for households	●	●	●		●	●
Reduction in taxation on work or capital	●	●			●	
Reducing budgetary imbalances		●	●	●		●
Environmental expenditures	●	●			●	

Perspective 4: Interactions with national policies

▪ Interaction with the EU ETS

- In Europe, usually, installations covered by the EU ETS are exempted

▪ In France, increasing importance of carbon in the tax system

▪ Since 2014 : carbon component

- Aims at greening energy taxation system (Article 32 project for the Financial Law 2014)
- Introduction of a carbon share in domestic consumption taxes
- Evolves between 2014 and 2017 (for 2014, without increase for TICPE rates exceeding 7 € / tCO₂)
- 30,5 € in 2017, 39 € in 2018 and 47,5 € in 2019

▪ Pathway to 56€ per tonne of CO₂ in 2020 and 100€ in 2030 ;

Perspective 4: Interactions with national policies

- **Funds recycled for tax credit for competitiveness and employment (CICE) and could help finance the energy transition**
- **Installations covered by the EU ETS are exempted to avoid double taxation**
- **Emissions reductions projected by 2017**
 - 1MtCO₂ in road transport
 - 2MtCO₂ for buildings

Perspective 5 - Direct Linking

- **Advantage of ETSs: they offer the opportunity to connect systems across borders**
 - ➔ Helps carbon price coverage to increase
- **This 'linking' of two or more emission trading systems (ETS):**
 - creates a larger carbon market,
 - provides the participants with more options to reduce their emissions,
 - If full linking, can lead to price convergence ➔ efficiency gains, reduce competitiveness distortion.
- **But, ex ante, need to carefully assess compatibility issues especially regarding:**
 - Ambition : cap / target
 - Regulation : clear and transparent rules and information needed on both sides
 - Governance : how to manage the linking

Perspective 5 – Direct Linking

- **Positive experience on full linking is happening right now with California and Québec (+ maybe other WCI partners to come)**
 - Underlines the importance of preparation (compatibilities in registries, auctioning systems, regulation etc.)
 - Underlines the importance to initially get very similar EtSs design (ambition, sectors covered etc.)
 - Shows that linking can work with price floors in both systems (if very closed ones)
- **Europe & Switzerland currently negotiating the possibility of linking their systems through direct linking**

Perspective 6 – Indirect Linking, perspectives from international negotiations

▪ Paris Agreement - Article 6 on mechanisms :

- Introduces voluntary cooperation arrangements (exchange of mitigation outcomes),
- with the establishment of a centralized mechanism under the auspices of the UNFCCC
- to help reduce greenhouse gas emissions (§4 to § 7)
- and exchange mitigation outcomes

▪ Key design elements:

- Environmental integrity,
- No double counting,
- Robustness of accounting

+ confirms the recognition of the importance of non-market approaches and defines a framework (§ 8 and 9)

Perspective 6 – Indirect Linking, perspectives from international negotiations

- **European council conclusions on the 2030 energy and climate framework**
 - Target of « at least » 40% GHG emission reductions domestically → no international offsets
 - Some discussions on the opportunity to change the numbers or to go beyond
- **If discussion goes further, need to take in consideration the political agenda:**
 - For now, Council conclusions are not translated into directive with:
 - EU ETS revision for post 2020 on going
 - ESD revision to come
 - Need to ratify Paris agreement quickly.

Thank you for your attention

