EWEA position on the urgent need for structural reduction of supply in the EU ETS

The total supply of allowances on the carbon market must be permanently reduced to re-establish scarcity. EWEA favours the following three structural solutions proposed by the Commission as possible options as they have the best potential to deliver:

- **Retire a sufficient number of EUAs in phase 3;**
- **Increase the EU domestic greenhouse gas reduction to 30% in 2020;**
- **Early revision & increase of the annual linear reduction factor.**

EWEA therefore recommends that discussions focus on these three options and urges the European Commission:

- **in 2013 to retire an amount of allowances close to the estimated oversupply;**
- **in 2013/2014 to publish a 2030 climate and energy package to provide a structurally sound Emissions Trading System which would include an increase in the EU domestic greenhouse gas reduction to 30% in 2020, and an increase of the annual linear reduction factor.**

Structural measures urgently needed to permanently address oversupply

Confidence in the ETS has been fundamentally undermined and it neither drives new investments, nor plant operation today. Backloading is a necessary first step, but will only delay and not solve the structural problem of oversupply in the ETS. A permanent solution must be agreed to adjust supply to the lower demand resulting from the economic downturn and re-establish scarcity on the market. Without such a permanent reduction of supply, market actors will anticipate the re-introduction of the backload and the carbon price will not recover.

Structural measures must reduce supply throughout phase 3 (2013-2020)

Only options having an impact on supply before 2020 should be considered. Firstly, only action before 2020 will avoid backloaded EUAs returning to market and causing a price crash. Secondly, with a 2bn oversupply – worth one year of ETS emissions – a post-2020 adjustment will not start reducing the surplus significantly and increase prices before later that decade (2025-2027). The result would be a carbon price that has no impact of investment decisions for a further 15 years, resulting in a fossil fuel lock-in. Thirdly, following this lock-in a significant increase in climate ambition will be much harder to achieve than if the signal is given today – delayed investments are costlier.

Valid structural solutions: move to 30%; increase of linear factor; or retire EUAs

- EWEA has long advocated a move to 30% domestic reductions by 2020 as a solution to the climate, energy and economic crisis, while ensuring that EU policy complies with the 25-40% domestic reductions needed in the industrialised nations to keep global warming below 2°C.
- Action to increase the linear factor limits legislative action to ETS sectors only, which is a second-best option as this is where the main issue lies.
- Reducing the amount of EUAs to be auctioned further limits impacts to mostly the power sector, leaving heavy industry unaffected by the changes in supply. While this solution does

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not have the positive long-term effect of the previous two, it has the advantage of speed and could be implemented fairly quickly.

EWEA recommends that discussions focus on these three options as they have the best potential to deliver.

A 2030 climate and energy package can solve oversupply if it reduces supply before 2020

An ambitious and binding target for renewable energy should be the cornerstone of a 2030 climate and energy package. Agreeing to an ambitious GHG reduction target complementing the renewable energy target in such a package could increase demand and reduce the EUA surplus. Current EC estimates show that without additional action, the ETS surplus could remain until 2030. But even with an additional post-2020 reduction, the surplus will not be soaked-up before well into the next decade (2025-2027). To provide an effective investment driver, any decision on a GHG target for 2030 must therefore:

1. Be part of a package including an ambitious 2030 target for renewable energy continuing to drive investments in a broad range of renewable energy technologies post-2020;
2. Reduce supply faster than current legislation provides for;
3. Include a re-alignment of the 2020 target to match the new 2030 target (cap reduction).

Extension of the scope of the ETS to new sectors risks further undermining the system

Ideally, all GHG emissions should be covered by the system, to avoid unintended arbitrage and consequences and to ensure technology neutrality. However, adding new sectors in the ETS through a cap increase (i.e. additional allowances) is risky and should be avoided in the short term: ETS history tells us that new sectors tend to be over-allocated when first cap estimates are made and this risks further increasing oversupply rather than reducing it. Including new sectors without increasing the cap would lower the surplus. However, this would not be without opposition and would add complexity to the system. New sectors are in theory a welcomed inclusion, but only into a system that already delivers incentives, which is not presently the case.

Price floors and automatic downward adjustments can provide investment certainty

Before implementation of the ETS, EWEA advocated for a carbon tax as the most stable, transparent economically efficient and effective way to provide investment signals. A price floor would be a welcome addition to the currently ineffective system, preventing disappearance of investment signals in times of oversupply, while still incentivising emission reducing investments – generating surplus EUAs for the investor to sell. Similarly, an automatic downward adjustment of the cap is welcome and could be e.g. triggered by a specific price.

As a general rule, however, price intervention should be avoided, Ceiling prices, and automatic upward cap adjustment, should be avoided, as they go against the idea of a limit on emissions. To reach our commitment to reduce emissions by 80-95%, the power sector needs to be completely decarbonised by 2050. This means an ambitious and regularly decreasing limit to absolute emissions, from today onwards. Price spikes merely reflect a lack of investment, which are not a valid reason for intervention.

Agreeing on structural measures requires new modelling to 2020

As discussed above, the economic outlook is a major source of uncertainty as to how much cumulative surplus will remain in the system 2020-2030. Today's projections for ETS emissions to 2020 are significantly lower than in the 2010 scenarios. The modelling done in the EC's 2010 "Low Carbon Roadmap 2050" used for the backloading needs updating to reflect economic conditions. Given the current trends, re-assessing the surplus by 2020 is likely to yield a figure well above 2bn.