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DIRECTORATE GENERAL FOR INTERNAL POLICIES
POLICY DEPARTMENT A: ECONOMIC AND SCIENTIFIC POLICY

Proceedings of the Workshop on the ETS Market Stability Reserve

Brussels, 05 November 2014

STUDY

Abstract

This report summarises the presentations and discussions during the workshop on the ETS Market Stability Reserve (MSR), held on the 5th November 2014. The aim of the workshop was to allow an exchange of views between MEPs, the European Commission, stakeholders from energy and industry sectors and NGOs on the need to intervene in the EU ETS in order to address the current oversupply of allowances that are undermining the effectiveness of the policy instrument. There was a general consensus amongst all participants for greater supply-side flexibility of allowances in the EU ETS with the majority of speakers arguing in favour of an earlier implementation date for the MSR and the prevention of backloaded allowances from re-entering the market before 2020 to create a stronger and more stable price signal for low carbon investments. This document was provided by Policy Department A for the Committee on the Environment, Public Health and Food Safety.

This document was requested by the European Parliament's Committee on the Environment, Public Health and Food Safety.

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LINGUISTIC VERSIONS

Original: EN

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Manuscript completed in November 2014.
Brussels, © European Union, 2014.

This document is available on the Internet at: <http://www.europarl.europa.eu/studies>

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LIST OF ABBREVIATIONS

CCS	Carbon capture and storage
EUAs	European Union Allowances
EU ETS	European Union Emissions Trading Scheme
GHG	Greenhouse gas
GDP	Gross domestic product
MSR	Market Stability Reserve
NGO	Non Government Organisation

EXECUTIVE SUMMARY

On the 5th of November 2014, a workshop was held at the European Parliament that discussed the proposal of the European Commission to introduce a Market Stability Reserve (MSR) to address the lack of flexibility in the supply of European Union Allowances (EUAs) in the European Union's Emissions Trading Scheme (EU ETS). As a consequence of the economic recession, there has been an over supply of EUAs that is currently undermining the price signal of the EU ETS and resulting in market participants delaying emission abatement and investment decisions in low carbon technologies. Over the long term, such delays in decision making may result in increased abatement costs as we experience the technological 'lock in' effect of the high carbon investments of today. Several of the experts and stakeholders argued at the workshop that it is therefore necessary to intervene in the EU ETS to enable it to respond better to unforeseen events and to create a strong and stable price signal to encourage low carbon investments.

Opening remarks by both MEP Ivo Bellet (ENVI Rapporteur) and Hauke Hermann (Senior Researcher at the Öko-Institut) emphasised the importance of the recent Council Conclusions, which confirms that the EU ETS will remain the main instrument for achieving the EU's greenhouse gas (GHG) target of 2030. However, both acknowledged that the current EU ETS needs to be reformed and Hauke Hermann demonstrated in his presentation that the current surplus of EUAs is likely to continue to grow in the third phase of the EU ETS without a market intervention due, in part, to the re-introduction of backloaded EUAs. Hauke Hermann outlined how the introduction of the MSR could reduce the surplus of allowances by providing supply-side flexibility that allows EUAs to be removed or injected into the market depending upon whether the surplus is above or below a specified threshold (i.e. 400 Mt to 833 Mt as proposed by the Commission). Hauke Hermann also explained reforms to the MSR (i.e. earlier start date, placing backloaded EUAs into the reserve, adjustments to the upper and lower thresholds of the MSR) that have been advocated by stakeholders.

The impact of the MSR proposal and the improvements introduced by Hauke Hermann were analysed by several experts in Part 1 of the workshop (chaired by MEP Matthias Groote). Marcus Ferdinand (Head of EU Carbon Analysis at Thomson Reuters) presented a modelling exercise that assessed the impact of the MSR in terms of EUA supply and EUA price. Based upon the Commission's proposals for the MSR, Marcus Ferdinand estimated that the surplus will decline over time from 2021 onwards with 1.3 billion EUAs expected to be taken out of the market by 2026 and EUA prices are expected to gradually increase from 2021 onwards to a level of 35 €/tonne by 2030. In comparison, a reference scenario without the introduction of the MSR would lead to a higher and longer lasting surplus. Marcus Ferdinand emphasised that the average EUA price between 2021 and 2030 under the reference scenario would be 9 €/tonne lower than under a scenario that included the MSR.

Andrei Marcu (Head CEPS Carbon Market Forum) remarked that the largest impact on EUA supply and EUA price from the modelling results occurred when a combination of options were selected. For example, if an earlier MSR start date is assumed and backloaded EUAs are prevented from re-entering the market before 2020, the surplus of allowances would decline at a much faster rate (reaching the upper threshold of 833 Mt by 2022 compared to 2025 with the MSR proposed by the Commission and 2030 without the introduction of the MSR). Andrei Marcu explained that such an intervention would create a strong pricing signal to the market. Luca Taschini (economist at the LSE) further elaborated that the increased scarcity of EUAs induced by the MSR would encourage earlier abatement, leading to a more optimal outcome with regards to cost effectiveness in the long term.

In the stakeholder discussion (chaired by MEP Ian Duncan) the four panellists (Jason Anderson from WWF, Peter Botschek from CEFIC, Dirk Forrister from IETA and Jesse Scott from Eurelectric) were given the opportunity to outline their position on the MSR proposals. There was a consensus amongst all of the panellists on the potential benefits of introducing greater supply-side flexibility in order to respond to unforeseen shocks to the system and to reduce EUA price volatility. On the issue of implementing an earlier start date for the MSR and preventing backloaded EUAs from re-entering the market before 2020, only Peter Botschek expressed reluctance suggesting that more information, such as the outcome of COP 21, is required before making a decision. Peter Botschek also suggested that the MSR should be negotiated in parallel with carbon leakage provisions post 2020, although this was rejected by the other panellists who argued that this would be a distraction and that the MSR is a separate issue.

Closing remarks by both MEP Ivo Bellet (ENVI Rapporteur) and Jos Delbeke (Director General for Climate Action) referred to the urgent need for reform of the EU ETS and regarded the MSR as an important step in the right direction to address previous design flaws. Jos Delbeke made five concluding statements. Firstly that there was broad support for the basic approach of the Commission for a rule based system that is managed by a set of parameters. Secondly that there is an urgency to legislate the MSR as soon as possible as there is no point in delaying given that the ETS is currently underperforming. Thirdly, Jos Delebeke claimed that energy intensive industry should be reassured by the Council Conclusions and the continuation of free allocation beyond 2020. Fourthly, the implementation of the MSR should once and for all end discussions on the interaction of external policies with the EU ETS due to the introduction of supply-side flexibility. Finally Jos Delebeke expressed a willingness to explore further improvements to the MSR. Ivo Bellet closed the workshop by outlining the next procedural steps in the Parliament.

WORKSHOP PROCEEDINGS

Opening remarks

MEP Ivo Belet, ENVI Rapporteur

Mr Belet welcomed everybody to the workshop and explained that the MSR has been proposed by the European Commission on the 22nd of January 2014 and is part of the 2030 package (the political guidance of which has recently been elaborated further by the European Council). Mr Belet suggested that the EU ETS has been the subject of intense debate and scrutiny within the EU and he welcomed the work that has been undertaken by the European Commission to propose measures to address the very substantial over supply of EUAs that are currently in the system in order to allow it to function as originally envisaged. Mr Belet reminded the audience that the Council Conclusions on the 24th of October confirm that the EU ETS remains the main instrument to achieve the EU's GHG emission reduction target and that incentives for industry to innovate must be fully preserved without increasing administrative complexity. Before tabling a draft report in the ENVI committee and before starting the political debate, Mr Belet emphasised the importance of bringing together a range of experts to examine the Commission's proposal.

Hauke Hermann, Öko-Institut

Mr Hermann thanked everyone for attending the workshop and added that the Öko-Institut have helped to organise the event on behalf of the policy department and especially thanked his colleague Sean Healy for his role in preparing the agenda for the workshop. He then proceeded to discuss the recent Council Conclusions, which provided strong support for the MSR, however he also emphasised that the outcome is not necessarily set in stone and he expected that the European Parliament will have their own views on the MSR.

Hauke Hermann firstly presented an illustration of the surplus of allowances until 2020, outlining the impact of the backloading measure on the surplus of allowances in 2014, 2015 and 2016. He showed two different emission scenarios based on 1) constant 2013 emission levels until 2020 and 2) a 1% annual decline in emissions from 2013 until 2020 to illustrate simply how the surplus of allowances may develop in the future. The surplus was calculated by comparing the emission level from the scenario with the availability of allowances and Hauke Hermann explained that in 2013 the surplus was approximately 2,000 Mt. He suggested that the surplus will decrease in the short term due to the backloading measure, however depending upon the emission scenario selected one may have a higher or a lower surplus but nevertheless towards the end of the third trading period the surplus will increase again as backloaded allowances are expected to re-enter the market.

Hauke Hermann explained the functioning of the MSR as follows. It will start in 2021 and there will be an upper and lower threshold with a hedging corridor. As long as the allowances in circulation are above the upper threshold of the hedging corridor – 12% of the surplus will be removed from circulation and when allowances are below the hedging corridor 100 Mt of allowances will be re-introduced into the market. Hauke Hermann proceeded to illustrate three important options that are currently on the table to reform the Commission's proposal:

- The MSR could be introduced earlier, for example 2017 has been proposed by several stakeholders, which would result in the surplus being reduced more quickly with less opportunity to grow before the measure is currently planned to be

introduced. This would mean that when starting the MSR the surplus will not be 2.5 or 3 billion EUAs but more likely closer to 2 billion EUAs.

- Backloaded allowances moved into the MSR rather than re-introducing these allowances back into the market as currently planned – this would reduce the surplus by 900 Mt.
- The hedging corridor could also be adjusted over time, which depends on the emissions in the system that are expected to reduce over time along with the development of the EU ETS cap – therefore the demand for hedging will decrease.

Part 1: Impacts of the MSR on the functioning of the ETS?

Introduction

(Matthias Groote, MEP)

Mr Groote opened Part 1 by expressing his pleasure at seeing so many people present at the workshop on the MSR. Mr Groote stated that backloading was a measure that has only bought policy makers more time to address the problems of the EU ETS and to make it fit for purpose so that all market agents have clear indications of how they should conduct themselves. Mr Groote added that the market needs to be very transparent and implemented properly over all 28 Member States.

Impact of the MSR on the carbon price and the surplus

(Marcus Ferdinand, EU Carbon Analysis at Thomson Reuters)

Marcus Ferdinand introduced a tool to model the impacts of the MSR on the carbon market balance (i.e. market oversupply) and on EUA prices. The tool enabled multiple parameters of the proposal to be changed, such as start date, withdrawal rate, threshold levels and how backloading was handled. Mr Ferdinand demonstrated the tool outlining several scenarios, all of which, were based on the recently announced 2030 Framework targets.

Scenario 1: MSR Commission proposal

Marcus Ferdinand firstly replicated the Commission's proposal in the modelling tool (represented by a grey line in both charts) and explained how the backloading measure only had a temporary effect on the surplus, which led to a slight decrease on the market oversupply. However the re-introduction of backloaded allowances into the market towards the end of the third trading period would result in the surplus increasing to 2.3 Gt in 2020. Then with the MSR starting to operate in 2021 he showed how the surplus declined over time and then gradually stabilised around 2030. The modelling exercise expected that 1.3 billion allowances would be taken out of the market by 2026 with the first release of these allowances only occurring in 2030. The price of EUAs in this scenario was expected to hover around 10 €/tonne for the majority of the third trading period, although EUAs prices would become more volatile when backloaded allowances came back into the market. With the MSR starting to operate in 2021, and with the decreasing cap, Marcus Ferdinand expected prices to gradually increase and to reach 35 €/tonne by 2030 (in real 2010 terms).

Scenario 2: No MSR scenario

In order to simulate the impact of the MSR, Marcus Ferdinand explained that it was necessary to model a scenario without the MSR in place. When he changed the parameters of the modelling tool to no longer implement the MSR, an additional orange line (representing a scenario) appeared in both the market balance and carbon price charts. In a scenario whereby the MSR was not implemented Marcus Ferdinand explained that substantially greater and longer lasting oversupply would occur and EUA prices would stay at very low levels in 2020, which was due to the full reinjection of backloaded allowances. Marcus Ferdinand suggested that EUA prices would then only rise as a factor of the decreasing cap (which would be at a much lower rate than with the MSR). So he concluded that the MSR would clearly support the carbon price, which would, on average be 9 €/tonne higher between 2021 and 2030. Mr Ferdinand also argued that the EU ETS with the MSR would also trigger 40 % more abatement until 2030. So without the MSR in place the oversupply of allowances would persist for a long time into the future and delay investments in low carbon technologies.

Scenario 3: Early MSR implementation

Marcus Ferdinand explained that there has been a discussion about changing the parameters of the MSR design. He therefore simulated a scenario with an earlier start date (2018) for the implementation of the MSR. This would result in the surplus beginning to fall in 2018, although the return of the backloaded allowances towards the end of the third trading phase would hamper the ability of the MSR to reduce the oversupply immediately. Marcus Ferdinand suggested the same effect is also observable with the carbon price, the EUA price would increase already by 2020 but would remain quite steady for several years due to backloaded allowances coming back to market and an early start date would only partially deal with backloaded allowances still waiting to be re-introduced at some point.

Scenario 4: Early MSR implementation + Transfer of backloaded allowances to the MSR

Marcus Ferdinand repeated that the return of backloaded allowances to the market would reduce the impact of the MSR so one option would be to put the backloaded allowances directly into the MSR and implement an early start date of 2018 for the MSR. Showing this scenario Marcus Ferdinand demonstrated that the market surplus would decline immediately when the MSR became operational which was because backloading was no longer interfering with this mechanism anymore. Such a proposal would likely lead to a gradual and higher price trajectory compared to the current MSR proposed by the European Commission.

Scenario 5: Changing the withdrawal rate and the upper and lower thresholds

In a final scenario, Marcus Ferdinand showed the impact of changing the withdrawal rates. He illustrated the impact by changing the withdrawal rate to 10% from the 12% proposed by the Commission and argued that such a change would result in a slight shift in the trajectories for both the development of the market balance and for the development of prices. An increase in the rate of withdrawal at the same rate would have similar impacts in the opposite direction. Marcus Ferdinand also demonstrated the potential effect of increasing the current thresholds of the MSR (i.e. 400 to 833 Mt) to 600 Mt and 1000 Mt and suggested that this would result in an effect shortly before 2030. In this scenario the effect would mainly result from the lower threshold, which would decide when allowances re-entered the market.

Marcus Ferdinand concluded that alternative designs of the MSR could impact on how soon the surplus would be diminished, what trajectory the carbon price would follow and how much abatement would be incentivised through the EU ETS. He found that moderate changes to parameters such as thresholds or withdrawal rates would only have a minor impact on the surplus and carbon price up until 2030 whereas his modelling exercise showed that the start date of MSR implementation and the removal of backloaded allowances were the most important parameters.

Impact of the MSR on the behaviour of market participants

(Luca Taschini, London School of Economics)

Luca Taschini started his presentation by asking the audience why we are discussing the MSR, which he proceeded to answer by suggesting that there is a problem with designing policy under the conditions of uncertainty. He emphasised that when decision makers design a policy, whether it be to set a fixed tax or a quota, it is not possible to completely foresee the future. Luca Taschini suggested that this has been observed with the EU ETS and referred to the very large unforeseen event of the economic recession that has had permanent effects on the demand for allowances. He therefore suggested that policy makers need to design a system that is able to be predictable in its response to future shocks or unforeseen technology advancement.

Luca Taschini introduced the concept of an optimal outcome for GHG abatement, suggesting that under no uncertainty and complete information one could determine an optimal outcome for emission abatement. He emphasised that the optimal abatement pathway (i.e. low cost abatement) may be associated with a high surplus due to earlier abatement by firms that expect higher abatement costs in the future. Given that the cap is fixed, Luca Taschini explained that the way in which abatement and emissions are distributed across time is very important. For example, he acknowledged that in reality businesses operate under uncertainty about the economy and future policy development and this leads to companies postponing their abatement until the end of the time horizon. However, Luca Taschini considered this to be a sub-optimal outcome that was not desirable.

Luca Taschini argued that shocks to the system impact the number of allowances in circulation (i.e. surplus of allowances due to a decrease in demand following the economic recession). To overcome this he suggested that it is necessary to offset the impact of shocks to the system by changing the demand for allowances by encouraging earlier abatement. Luca Taschini believed that the MSR proposed by the Commission will create scarcity in the market and will therefore increase abatement and reduce emissions, which is observable in the final graph that he showed in his presentation (entitled 'the role of the MSR'). The blue bars in the graph represented what Luca Taschini referred to as the optimal outcome, the red line represented the sub optimal outcome where companies abate less and emit more during the early stage and abate more and emit less in the latter stage (this is a suboptimal outcome as it is less cost effective). The dark line in the graph represented the outcome with the MSR, which approached nearer the optimal outcome. Luca Taschini suggested that the design of the parameters should be carefully considered in the future to mitigate sub-optimality over the time horizon.

Luca Taschini concluded by saying that uncertainty and incomplete information lead to sub-optimal outcomes. Therefore he argued that it is necessary to intervene in the system to make sure that the EU ETS can respond to unforeseen events and shocks to the system. Luca Taschini stated that supply of allowances needs to be adjusted as events change (i.e. technological advancement). He remarked finally that the MSR can reduce this sub-

optimality by inducing earlier emission reductions and avoiding the need for more costly abatement later in the time horizon.

Key insights from the MSR modelling

(Andrei Marcu, Head of the CEPS Carbon Market Forum)

Andrei Marcu started his presentation by stating that the objective of the EU ETS is to promote GHG emission reductions in a cost effective and economically efficient manner, which implies that the role of the EU ETS is to establish a price signal for the EU's decarbonisation goal for 2050 (80% to 95%). He emphasised that the effectiveness of the EU ETS should therefore be evaluated over the long term.

A key design flaw of the EU ETS identified by Andrei Marcu is a lack of supply-side flexibility in the provision of allowances. He suggested the market does not therefore function like conventional markets with supply not currently adjusting to demand as it is fixed in accordance with the auctioning schedule and via the allocation of allowances for free based on historical information.

Andrei Marcu found that the EU ETS price level is affecting the long term effectiveness of the EU ETS in terms of finding the most economically effective way to reduce emissions. This is what the presentation from Luca Taschini explained. Andrei Marcu said that the price is not reflecting the long term scarcity in the market due to a number of factors: 1) market design, 2) nature of the market – it is young and does not have the depth and long history of the other commodity markets such as oil and 3) the EU ETS has a short term view to address what is a long term constraint, or in other words, the short term view does not provide the framework to think about the long term marginal cost relevant to the 2050 goals. And at the same time the long term goal is not seen as legally binding. Andrei Marcu suggested that policy makers need to agree upon a mechanism that can reconcile the short and long term perspective in order to avoid that the short term view destroys confidence in the EU ETS.

In summarising the modelling exercise, Andrei Marcu remarked that the largest impact on EUA supply and EUA price occurred when an earlier MSR start date was adopted and backloaded EUAs were prevented from re-entering the market before 2020, which resulted in the surplus declining at a much faster rate (reaching the upper threshold of 833 Mt by 2022 compared to 2025 with the MSR proposed by the Commission and 2030 without the introduction of the MSR). Andrei Marcu explained that such an intervention would create a strong pricing signal to the market due in part to the greater clarity of the regulations. He also suggested that the increase in the EUA price due to the intervention from the modelling exercise were reasonable, especially considering the carbon leakage price of 30 €/tonne that is currently used for the carbon leakage list. Andrei Marcu concluded with several questions for the stakeholder panel:

- What is the purpose of the MSR? What problem does it attempt to solve?
- Can the MSR solve the whole problem or parts of it and do we need a reset button (i.e. to get rid of the surplus of allowances too?)
- If the MSR addresses a real problem, what is the rationale for waiting?
- Do the parameters of the MSR need to be adjusted over time (i.e. hedging corridor change in relation to decarbonisation of energy sector)?

Question & Answers

Matthias Groote invited the following questions from the audience:

Question 1:

The first questioner asked whether the design parameters of the MSR, such as injection thresholds, should not be fixed for the long term. In addition, the audience member asked each of the panellists to respond to the concerns of industry regarding increasing carbon prices as a consequence of the policy intervention.

Question 2:

The second questioner was more hostile towards the EU ETS and expressed his scepticism about a further attempt to 'fix' the system (referring to previous interventions such as backloading). He concluded by asking whether it was acceptable to regularly intervene in the functioning of the EU ETS.

Question 3:

The third questioner refuted the claims made by the previous questioner before proceeding to ask the extent to which we could expect carbon prices to rise as a consequence of the policy intervention.

Question 4:

The fourth questioner responded also to the second questioner by arguing that interventions in financial markets have been justified in the past and that it is now necessary to intervene to improve the functioning of the emissions trading market. With reference to the carbon leakage list, the questioner asked whether the price of 30 € was a realistic price for assessing the risk of sectors and sub-sectors to carbon leakage.

Question 5:

The fifth questioner emphasised that it may not be sensible to introduce the MSR in 2021 only after backloaded allowances have re-entered the emissions trading market. He therefore proceeded to ask whether the stability of the EUA price would improve with an earlier start date for the MSR and preventing backloaded allowances from re-entering the system.

Matthias Groote invited the experts to respond to the questions from the audience:

Marcus Ferdinand:

Marcus Ferdinand responded first to the issue raised about the costs of the policy intervention for industry participants. Given that the MSR will increase scarcity in allowances, he argued that it is likely that EUA prices would increase. However, he emphasised the benefits of the intervention in the long term, which he suggested would reduce abatement costs towards the end of the 2050 time horizon. Based upon modelling scenarios, Marcus Ferdinand estimated that the average price between 2021 and 2030 would be 24 €/tonne (the average price in real terms) based upon an assumption of GDP growth of 1.7% per year until 2020 and 1.9% per year between 2021 and 2030. Based upon less or more ambitious GDP growth assumptions he estimated that the average EUA price between 2021 could vary between 15 €/tonne and 48 €/tonne. Marcus concluded by responding to the issue raised about the stability of the carbon price and agreed that his modelling suggested that an earlier start date for the MSR and preventing the re-entrance of backloaded allowances would result in a gradual EUA price increase.

Luca Taschini:

Luca Taschini firstly confirmed that he believes that the design parameters should not be fixed in the long term and need to be reviewed to ensure that the intervention is achieving the objective set for the policy. He accepted that the MSR should not be considered as a solution to all the problems experienced with the EU ETS, however he argued that the MSR would reduce sub-optimality in the system. Luca Taschini then agreed with the previous comments from Marcus Ferdinand that the purpose of the MSR is to remove permits early and inject permit later – so they do not necessarily increase the price but rather remove the volatility of prices in response to positive or negative shocks and thus stabilising the prices instead. Luca Taschini concluded with the following statement, 'the cap is fixed, if we were just to live in a certain world the price would be fixed at the equilibrium price, we need to understand that this is an artificial market with a quota designed to achieve a particular target, that target now due to an unforeseen event is no longer optimal and so we need to intervene to change that.'

Andrei Marcu:

Andrei Marcu emphasised that there would need to be an adjustment to the design of the policy intervention over time in order to reflect increasing levels of decarbonisation. With regards to carbon leakage, Andrei Marcu firstly defined the reference price of 30 €/tonne applied in the carbon leakage risk assessment as, not only reflecting the price of carbon today, but also reflecting investment leakage. He suggested that if we do not have a 30 €/tonne price within a five to ten year time horizon then it could be argued that the reference price applied in the carbon leakage list was incorrect.

Andrei Marcu concluded by saying that the MSR proposal will enhance the transparency and clarity with which the EU ETS deals with future shocks to the system by correcting a previous design flaw not to originally have flexibility in allowance supply.

Part 2: Stakeholder discussion

Introduction

(Ian Duncan, MEP)

Ian Duncan welcomed everyone to the second part of the workshop. He acknowledged that 'the danger for MEPs inside of Parliament is that we can sometimes be accused of seeming very distant and in fact the more that you can tell us the more we will understand and it will be a critical time right now for us to understand what we need to do to make the emissions trading scheme work.' Ian Duncan proceeded to introduce all of the stakeholder panel and explained the format of the stakeholder discussion. He then invited each panellist to present their position on the MSR.

Jason Anderson

(Head of EU Climate & Energy Policy at WWF)

Jason Anderson firstly expressed the understanding of the NGO community to the 'teething problems' that were initially experienced with the EU ETS. He acknowledged that with the creation of a new market, problems were to be expected and NGOs engaged with other stakeholders in order to find solutions. However, Jason Anderson suggested that the EU ETS is now moving from 'infancy' to 'adolescence' and that the MSR proposal would be a necessary (but not sufficient) first step in ensuring that the EU ETS functions correctly. He proceeded to refer to a number of proposals by Climate Action Network (CAN) to further improve the existing MSR as proposed by the Commission.

Firstly, Jason Anderson argued in favour of an earlier start date of 2016 for the MSR – emphasising that the surplus of allowances will continue to grow until 2021 and it would be preferable to address the situation now rather than later when the situation is worse. Secondly, he argued against the re-entrance of backloaded allowances towards the end of Phase III claiming that this would further exacerbate the existing problem with the surplus of allowances in the system. He stressed the importance of also acknowledging the risk of oversupply that exists from the unused allowances from the new entrant reserve and other flexible mechanisms (approximately 800 Mt). Jason Anderson reaffirmed that the position of CAN is to have these allowances cancelled rather than ballooning the size of the MSR. Thirdly, he suggested that a technical adjustment of the upper and lower thresholds of the MSR may be necessary over time as hedging requirements decline.

Jason Anderson concluded by stating that the MSR offers only a partial solution and that a permanent solution to the oversupply of allowances in the system is still needed. To emphasise this point he referred to a recent study from Sandbag, which suggested that the expected surplus in the system may be underestimated. Jason Anderson also stressed the importance of a stronger GHG reduction target and the need to address concerns about carbon leakage in a rational manner.

Jesse Scott

(Head of Unit Environment & Sustainable Development at Eurelectric)

Jesse Scott expressed her previous support for the backloading proposal, as an emergency measure, but always acknowledged that the temporary intervention was not considered a long term solution. In contrast, she claimed that Eurelectric were very supportive of the

MSR proposal and suggested the following improvements. Firstly, she advocated an earlier start date (2017) for the implementation of the MSR for the same reasoning provided previously by Jason Anderson. Secondly, she argued in favour of preventing backloaded allowances from re-entering the market towards the end of Phase III. Jesse Scott was keen to prevent a 'zig zag' effect from occurring with the surplus as a consequence of reloading the market with backloaded allowances and only afterwards removing these allowances via the MSR from 2021 onwards. On the question of parameters, Jesse Scott said that Eurelectric have completed many analyses – however she believed 'it will be a learning by doing exercise' and so the other crucial element of the position of Eurelectric is a review clause on the MSR five years after its start date.

Jesse Scott proceeded to provide some further context to the discussion by outlining the policy alternatives to emissions trading. While carbon taxes would provide greater price certainty, she suggested such a carbon tax could only be implemented at the national level and would have implications for the internal energy market. Emission performance standards were considered less flexible than emissions trading in design and led Jesse Scott to conclude that emissions trading represents the best compromise solution. In particular, she suggested that the benefit of the EU ETS is in its creation of a price signal and the potential it offers to become a global model via the linking of emission trading schemes. However, Jesse Scott acknowledged that the EU ETS today faces three significant problems that must be solved if it is to have credibility to deliver long term GHG reductions and to impact operational and investment decisions of the sectors participating:

- Problem 1: The excess supply of allowances in the system – the surplus. Commission's expectation of 2.5 billion allowances by 2020 is already a very big number (other predictions vary);
- Problem 2: It is not a real market: Supply is fixed while demand changes;
- Problem 3: The current cap and carbon budget in the EU is not coherent with the EU's 2050 goals.

Jesse Scott stated that the MSR could address problem 1 and 2, however problem 3 would need to be addressed during the discussion of the 2030 package. She concluded by saying 'if we are to have change we need to have investments and the loud and clear message from my sector has been that you need a strong clear policy signal. The best possible price signal will come from the ETS – however today at 6 €/tonne it is not currently a strong signal to the market – every delay in ETS reform will delay investment decisions, therefore we need to act now to strengthen the price signal.'

Peter Botschek

(Director Energy, Health, Safety & Environment at CEFIC)

Peter Botschek focused attention on energy intensive industries arguing that they 'are supposed to pay the price.' He compared the power and energy intensive sectors and suggested that it is easier for power producers to pass on carbon cost, whereas for industrial producers 'it is a matter of life and death'. Peter Botschek acknowledged the positive aspects of the MSR proposal and claimed that the industrial sector has always argued for greater supply-side flexibility in the EU ETS. However, he proceeded to argue that the policy intervention would increase EUA prices (disputing the projections provided in the previous section of the workshop) and would bring greater carbon leakage risks and therefore the free allocation of allowances for vulnerable sectors should be discussed in parallel with the MSR proposal. Furthermore, Peter Botschek hesitated against an earlier start date for the MSR due to the uncertainty that surrounds the outcome of the COP 21. Peter Botschek concluded by saying that 'there should be increased flexibility of the

allocation and we should make the ETS growth proof. We should not only talk about negative shocks but also about growth and shocks to the consumers because what we have heard so far will increase power prices for the consumer and we have a growing issue with energy poverty. So we say that we should improve the ETS but we want to do it in one go with greater flexibility of allocation and carbon leakage provisions.'

Dirk Forrister

(President & CEO of IETA)

Dirk Forrister informed the audience that IETA had evaluated a number of alternatives for how to deal with the surplus ranging from leaving it alone completely to cancelling allowances. He claimed that the MSR proposal was the preferred option for the majority of IETA members as it 'bridged the current differences between extreme positions and used the surplus more wisely over the long term.' Dirk Forrister suggested that there is a disconnect with regards to timing, 'companies plan investments on long term horizons of 15, 20 and 30 years – however when dealing with trading markets most companies only have up to a three year time horizon.' He suggested that this is one of the reasons why market participants in the EU ETS are not currently purchasing EUAs that would be valuable later in the time horizon. Dirk Forrister said that companies do not buy that far in advance, in part due to cash constraints but also due to their own risk management parameters and therefore believed that increasing the surplus now would not be a good way to manage a public asset and deliver good value over time.

Dirk Forrister echoed what others said on the panel suggesting that the MSR should be implemented earlier and backloaded allowances moved into the MSR. He also believed that the technical parameters requires more analysis however the starting point of the Commission is reasonable.

Question & Answers

Ian Duncan invited the following questions from the audience:

Question 1:

The first questioner asked Peter Botschek directly how best to estimate the risk of carbon leakage and what provisions are necessary for the energy intensive industry to support the MSR proposal.

Question 2:

The second questioner explained that his question was actually more of a statement outlining the need to consider the consumers that are bearing the cost of energy increases as a result of the EU's energy and climate policies.

Question 3:

The third questioner asked Dirk Forrister directly how to best respond to the concerns of the energy intensive industry especially with regards to the future availability of free allowances for best performers according to ambitious benchmarks.

Question 4:

The fourth questioner claimed that representatives of Shell were in favour of the MSR and therefore questioned whether Peter Botschek was representing the views of the chemical sector. He asked Peter Botschek to explain why his views were different to the representatives from Shell. In a further question to Peter Botschek, he claimed that the biggest chemical company (BASF) never needed to purchase allowances until 2013 and asked how many free allowances until 2013 were allocated to the chemical sector as a whole.

Ian Duncan invited the experts to respond to the questions from the audience:

Peter Botschek:

Peter Botschek started his response by suggesting that the design of future benchmarks in the next phase of the EU ETS may be where compromises can be found amongst different energy intensive sectors. However he reaffirmed that the carbon leakage policy is an important 'insurance policy that provides a band of protection for these industries' and that this should not be removed. He responded to the question regarding the views of Shell by suggesting that the power sector is not in unanimous support of the MSR with Polish companies, for example, not in favour. He proceeded to imply that Shell may have a vested interest in the MSR as they have invested a lot of money into CCS and that this strategy is not necessarily shared by other firms in the sector. He emphasised that his views represented the position of the Alliance of Energy Intensive Industries. In response to the questioner that raised the issue of free allowance allocation in the chemical sector he said 'if it is true that BASF have not had to buy allowances then congratulations to BASF as this means that they meet the benchmarks and they obviously have high performance and then they get the allowances they need – so the system works for them and that is what we want. Equip them with allowances even enough for further growth. There is the potential to improve the flexibility of the scheme.'

Jason Anderson:

Jason Anderson argued that 'we have to show that the effect of the MSR is to smooth out price volatility, if we implement it sooner and prevent backloaded allowances re-entering the system, we have much greater price clarity going forward and what you are avoiding is a price spike later on.' He suggested that the MSR would provide a smoother more rational price signal, however repeated his earlier position that there is currently no proposal on the

table that removed allowances from the system permanently. Jason Anderson concluded by saying that the link between carbon leakage and MSR should not be too strong implying that policy makers have previously given too many concessions to industry 'to avoid a problem that has not been proven to exist in many cases'.

Dirk Forrister:

Dirk Forrister was unsure whether the MSR is the place to fix the issue regarding carbon leakage and emphasised that IETA 'took great encouragement from the Council Conclusions that refer to a continued approach for addressing carbon leakage with appropriate remedies'. He concluded that it was important not to lose momentum with the MSR as it is designed to resolve a different problem to the carbon leakage issue.

Jesse Scott:

Jesse Scott agreed with both Dirk Forrister and Jason Anderson with regards to the impact of the MSR on 'smoothing of the price' which she repeated is the purpose of the MSR. On the issue of carbon leakage, Jesse Scott argued that 'carbon leakage addresses two problems, one is the issue of energy costs and a global level playing field and frankly there never has been and can't be a level playing field. Saudi Arabia has a lot of oil, other countries have very little. The Dutch have a lot of gas, the Italians have a lot of sunshine. The geography is different and there never will be a level playing field.' She continued to say that Europe was not in 'a particularly good situation' and needed to have a different strategy compared to regions with an abundance of cheap energy. Jesse Scott also highlighted the significance of investment leakage, which she suggested is a problem given that companies are increasingly transnational and are increasing investments outside of Europe. This trend was due to the lack of certainty in policy and therefore many electricity companies are waiting for a stronger price signal before investing in Europe. Jesse Scott also added that 'Shell is a highly intelligent company and I would take seriously any position that they take very seriously.'

Ian Duncan invited further questions from the audience:

Question 5:

The fifth questioner alluded to recently published public data that showed that the chemical sector received 28 million spare allowances in 2013. He remarked sarcastically that it was encouraging to hear that CEFIC are open to the possibility of declining free allowance allocation.

Question 6:

The sixth questioner asked whether it will be possible to agree on the 2030 Package in a timely manner if we have a quick resolution to the MSR proposal.

Ian Duncan invited the experts to respond to the further questions from the audience:

Jesse Scott:

Jesse Scott agreed that the sooner the MSR is resolved (preferably by early next year) the sooner the 2030 Framework could be successfully negotiated. She thought that the 2030 Package would take longer to agree than the previous 11 month co-decision process experienced for the 2020 package – estimating that an agreement could take two years or even more.

Dirk Forrister:

Dirk Forrister agreed that speedy action on the MSR is preferable and the proposal has already undergone a lot of rigorous analysis.

Jason Anderson:

Jason Anderson expected the 2030 legislation would be agreed as soon as possible and would not be held up by the MSR proposal, as important as it is, he stressed that it is only a necessary but not sufficient step for reforming the EU ETS.

Peter Botschek:

Peter Botschek concluded the question and answer session by highlighting that the EU ETS is a system that is meant to reach an agreed level of emission reductions in a cost efficient manner, however the MSR, if unchanged, will change the objective of the EU ETS to one where emission reductions are delivered at 'certain' costs. He questioned whether such a change in emphasis is what the EU needs.

Closing remarks

Closing remarks by both MEP Ivo Bellet (ENVI Rapporteur) and Jos Delbeke (Director General for Climate Action) referred to the urgent need for reform of the EU ETS and regarded the MSR as an important step in the right direction to address previous design flaws. Jos Delbeke made five concluding statements. Firstly that there is broad support for the basic approach of the Commission for a rule based system that is managed by a set of parameters. Secondly there is an urgency to legislate the MSR as soon as possible as there is no point in delaying given that the ETS is currently underperforming. Thirdly, Jos Delebeke claimed that energy intensive industry should be reassured by the Council Conclusions and the continuation of free allocation beyond 2020. Fourthly, the implementation of the MSR should once and for all end discussions on the interaction of external policies on the ETS due to the introduction of supply-side flexibility and finally Jos Delebeke expressed a willingness to explore further improvements to the MSR. Ivo Bellet closed the workshop by lastly outlining the next procedural steps in the Parliament.



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**Organised by the Policy Department A: Economy and Scientific Policy
Committee on the Environment, Public Health and Food Safety (ENVI)**

Workshop on the ETS Market Stability Reserve

Wednesday, 5 November 2014 - 16.30 - 18.30
European Parliament (Brussels), József Antall (4Q2)

The event is open to the public and will be web-streamed:

<http://www.europarl.europa.eu/ep-live/en/schedule>

AGENDA

Setting the scene

Chaired by Ivo Belet, MEP, Rapporteur

16.30-16.35

Introduction

Ivo Belet, MEP

16.35-16.42

Setting the context for the discussion

Hauke Hermann, Senior Researcher at Öko-Institut

Part 1

Impacts of the MSR on the functioning of the ETS?

Chaired by Matthias Groote, MEP, S&D Shadow

16.43-16.48

Introduction

Matthias Groote, MEP

16.48-16.55

Impact of the MSR on the carbon price and the surplus

Marcus Ferdinand, EU Carbon Analysis at Thomson Reuters

16.56-17.03

Impact of the MSR on the behaviour of market participants

Luca Taschini, Grantham Research Institute, London School of Economics

17.04-17.11

Key insights from the MSR modelling

Andrei Marcu, Head CEPS Carbon Market Forum

17.12-17.27

Question & Answers

Part 2 Stakeholder discussion on the MSR

Chaired by Ian Duncan, MEP, ECR Shadow

17.27-17.32 **Introduction**

Ian Duncan, MEP

17.32-18.02 **Stakeholder Discussion**

Jason Anderson, Head of EU Climate & Energy Policy at WWF

*Jesse Scott, Head of Unit Environment & Sustainable Development,
Eurelectric*

Peter Botschek, Director Energy, Health, Safety & Environment CEFIC

Dirk Forrister, President & CEO IETA

18.02-18.17 **Question & Answers**

Closing remarks

Chaired by Ivo Belet, MEP, Rapporteur

18.18-18.25 *Jos Delbeke, Director General DG Climate Action*

18.25-18.30 *Ivo Belet, MEP, Rapporteur*

SHORT BIOGRAPHIES OF EXPERTS

Hauke Hermann

Hauke Hermann is a Senior Researcher at Öko-Institute and leads different projects in the field of emissions trading, electricity market design and progress towards emission reduction targets. His key competence is quantitative analysis. During his work he has gained an in-depth knowledge of the power sector and the energy-intensive industry. He joined Öko-Institut in 2009. Prior to this he was working for Ecologic Institute, Berlin. At the latter, he was involved in research projects on the improvement and review of the European Union Emissions Trading Scheme (EU ETS) for the European Commission and the German Environmental Ministry. Hauke Hermann holds a Master degree in Environmental and Resource Management from the Technical University in Cottbus, Germany. He also studied at the Bosphorus University in Istanbul.

Marcus Ferdinand

Marcus Ferdinand heads the 'Carbon Market Trader EU' team at Thomson Reuters Point Carbon an independent provider of analysis and forecasting for the energy and environmental markets. He has followed European and global carbon politics closely since 2009, providing regular policy and market analysis to governments and participants in regional and global carbon markets. He is a much used speaker at market events and he has also given presentations to advise the European Commission as well as other EU institutions and governments. Previously he worked with E.ON's headquarter as well as E.ON's Energy Trading business. Marcus studied Energy and Environmental Management in Flensburg (Germany) and Lima (Perú) and holds a Diploma as industrial engineer.

Luca Taschini

Luca is an economist, working at the intersection of environmental economics, energy markets, and industrial organisation. His current research investigates how market-based environmental regulations –and emissions trading schemes in particular – are working in theory and in practice. More specifically, he is studying the functioning of price containment mechanisms, participation restrictions, the linkage of markets and the investigation of policy controls able to promote technology adoption. Luca is Chair of the Dahrendorf Economic Working Group, looking at economics and climate change and he is leading the FP7 Entracte project on the EU ETS reform. He is also a visiting scholar at the Joint Program on the Science and Policy of Global Change (MIT) and at the Research Center for Sustainability Science (Ritsumeikan University – Japan).

Andrei Marcu

Andrei Marcu is currently Senior Advisor and Head of the CEPS Carbon Market Forum at the Centre for European Policy Studies. Mr. Marcu has been one of the corporate sector pioneers in the area of climate change, greenhouse gas (GHG) markets and related areas on sustainable development. Since 1993, Mr. Marcu has been actively involved in many areas of climate change related initiatives, including as Chief Executive Officer of BlueNext, the environmental exchange, based in Paris. Mr. Marcu joined Mercuria Energy in September 2009 in the role as Head of Regulatory Affairs, Environment and Climate Change. Mr. Marcu was the Founder and President and CEO of International Emissions

Trading Association (IETA, a world-class business association with offices in Geneva, Brussels, Washington and Ottawa. IETA is dedicated to the creation of an efficient and environmentally robust market for greenhouse gases to address the issue of global warming and climate change. He is currently a Board Member of IETA.

Jason Anderson

Jason Anderson is Head of EU Climate Change and Energy Policy at the WWF European Policy Office, managing a team in Brussels and leading European policy among a network of 15 offices. Previously he was a policy officer at Climate Action Network Europe in Brussels, and then the head of the climate programme at the Institute for European Environmental Policy. He was a lead author of the IPCC special reports on ozone and climate, and on CCS. He is a contributing author to the reference text Environmental Policy in the EU, and has contributed to five editions of the Manual of European Environmental Policy.

Peter Botschek

Peter Botschek has served since 2006 as director of energy & health, safety and environment with Cefic – the European Chemical Industry Council. Before joining Brussels-based Cefic in 2001, Botschek was seconded from HYDRO Agri, today known as YARA, to the European Fertilizer Manufacturers Association (EFMA) in Brussels, as an issue manager for agriculture and environment. Before then, he was part of the application consultancy department Thomasdünger GmbH in Germany after managing fertilizer application experiments at the company's research & development station. Botschek is a member of EU and international bodies such as Business Europe, the European Alliance of Energy-Intensive Industries, the European Commission Stakeholder Meetings on Climate Policy, the IEA energy and greenhouse gas efficiency initiative, Observer Focal Point with UN Climate Change Convention (UNFCCC). He received his doctorate in agriculture in Bonn, Germany, specialising in plant nutrition and environment issues.

Dirk Forrister

Dirk Forrister is President and CEO of the International Emissions Trading Association (IETA). Previously, he was Managing Director at Natsource LLC, the manager of one of the world's largest carbon funds. Earlier in his career, Mr. Forrister served as Chairman of the White House Climate Change Task Force in the Clinton Administration and Assistant U.S. Secretary of Energy for Congressional, Public and Intergovernmental Affairs. Previously, he was legislative counsel to Congressman Jim Cooper of Tennessee. He was also Energy Program Manager at Environmental Defense Fund.

Jesse Scott

Jesse Scott is Head of Environment at EURELECTRIC since January 2012. Previously Jesse Scott has held positions at Demos Europe as the Director for Energy (between May and December 2011), E3G as the Head of the EU Office (between 2008 and 2011) and at White and Case LLP as an Associate (between 2007 and 2008). Jesse Scott has also attained a BA Hons and MPhil from Cambridge University.

SPEAKERS' PRESENTATIONS

Presentation by Hauke Hermann

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Institute for Applied Ecology

Workshop on the ETS Market Stability Reserve: Setting the scene for the discussion

Hauke Hermann (Öko-Institut)

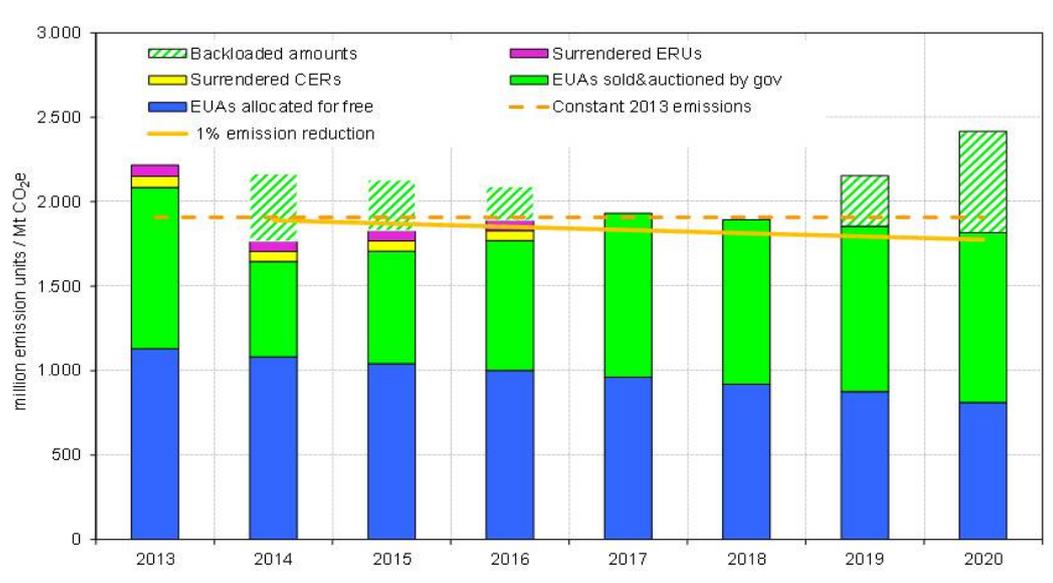
European Parliament
Brussels, 05/11/2014



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Perspective of the surplus until 2020



Year	EUAs allocated for free	EUAs sold & auctioned by gov	Surrendered ERUs	Surrendered CERs	Backloaded amounts	Total
2013	1100	1000	100	100	0	2300
2014	1050	600	100	100	400	2250
2015	1000	750	100	100	300	2250
2016	950	800	100	100	200	2150
2017	900	950	100	100	100	2150
2018	850	950	100	100	100	2100
2019	800	950	100	100	300	2250
2020	750	1000	100	100	600	2550

Workshop on the ETS market stability reserve | Hauke Hermann | Brussels, 05/11/2014

Sources: EUTL; EEA data viewer; EEA (2014) Trends and Projections in Europe; Öko-Institut calculations

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European Council Conclusions on 2030 Climate and Energy Policy Framework

The conclusions of the European Council provide strong backing for the introduction of the MSR:

2.3 a well functioning, reformed Emissions Trading System (ETS) with an instrument to stabilise the market in line with the Commission proposal will be the main European instrument to achieve this target; the annual factor to reduce the cap on the maximum permitted emissions will be changed from 1.74% to 2.2% from 2021 onwards

What parameters make the MSR well functioning?

Workshop on the ETS market stability reserve | Hauke Hermann | Brussels, 05/11/2014 Source: European Council (2014) SN 79/14 2

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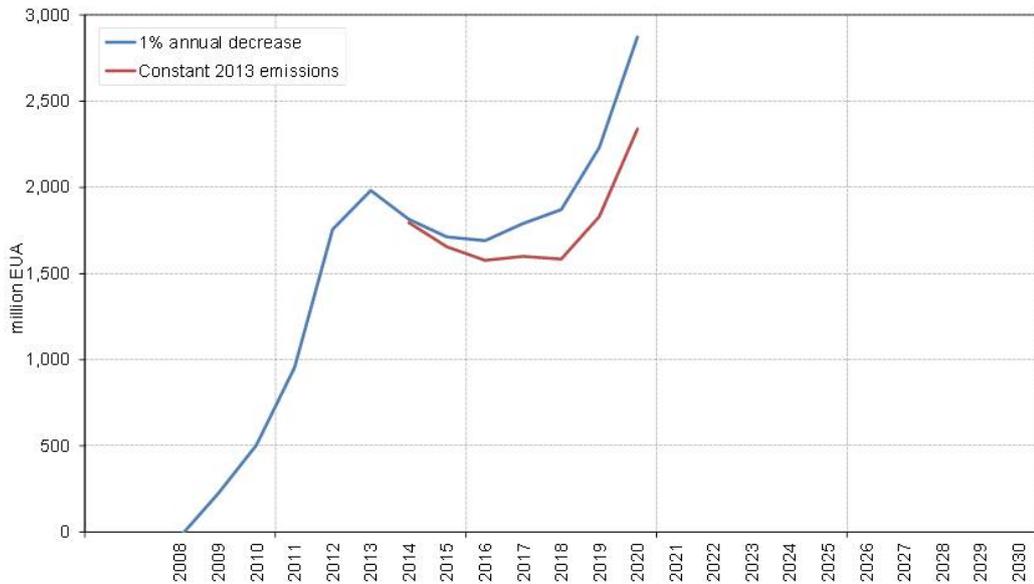
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Functioning of the MSR (1): The surplus is an important issue

Year	Cumulated surplus (million EUA)
2008	0
2009	~100
2010	~300
2011	~600
2012	~1,700
2013	~2,000
2014	~2,000
2015	~2,000
2016	~2,000
2017	~2,000
2018	~2,000
2019	~2,000
2020	~2,000
2021	~2,000
2022	~2,000
2023	~2,000
2024	~2,000
2025	~2,000
2026	~2,000
2027	~2,000
2028	~2,000
2029	~2,000
2030	~2,000

Workshop on the ETS market stability reserve | Hauke Hermann | Brussels, 05/11/2014 Sources: COM (2014) 20/2; EUTL; EEA data viewer; EEA (2014) Trends and Projections in Europe; Öko-Institut calculations 4

Functioning of the MSR (2): Evolution of the surplus until 2020

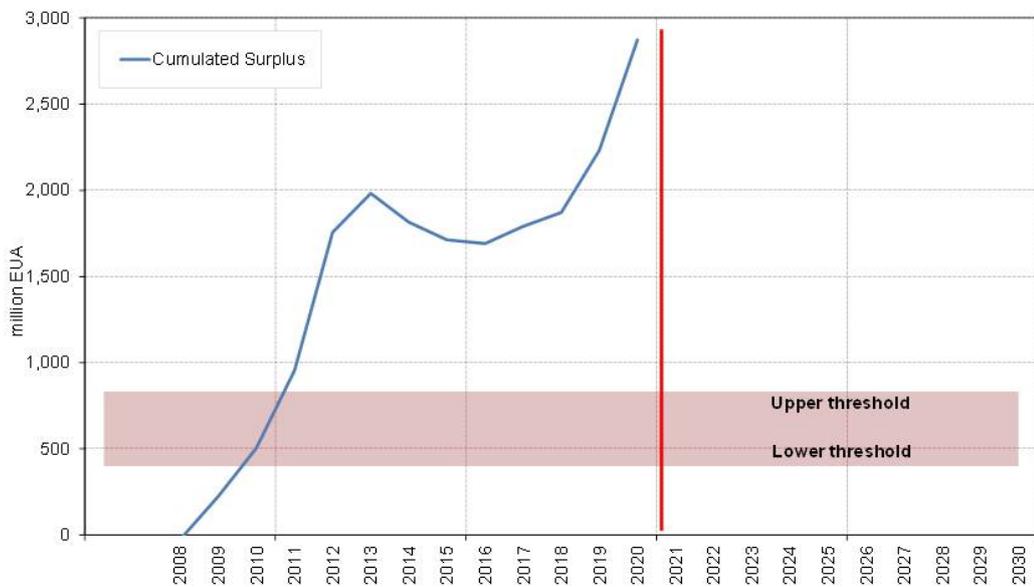


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Sources: COM (2014) 20/2; EUTL; EEA data viewer; EEA (2014) Trends and Projections in Europe; Öko-Institut calculations

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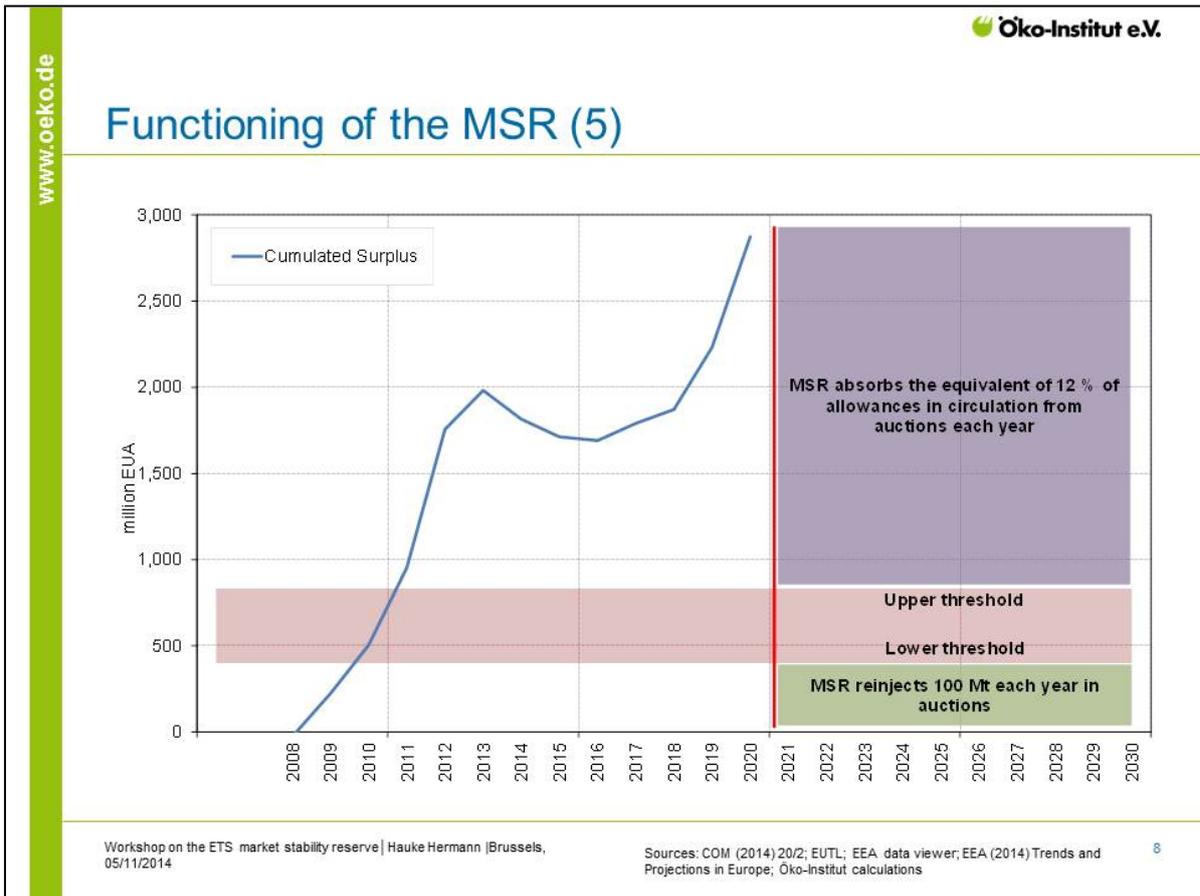
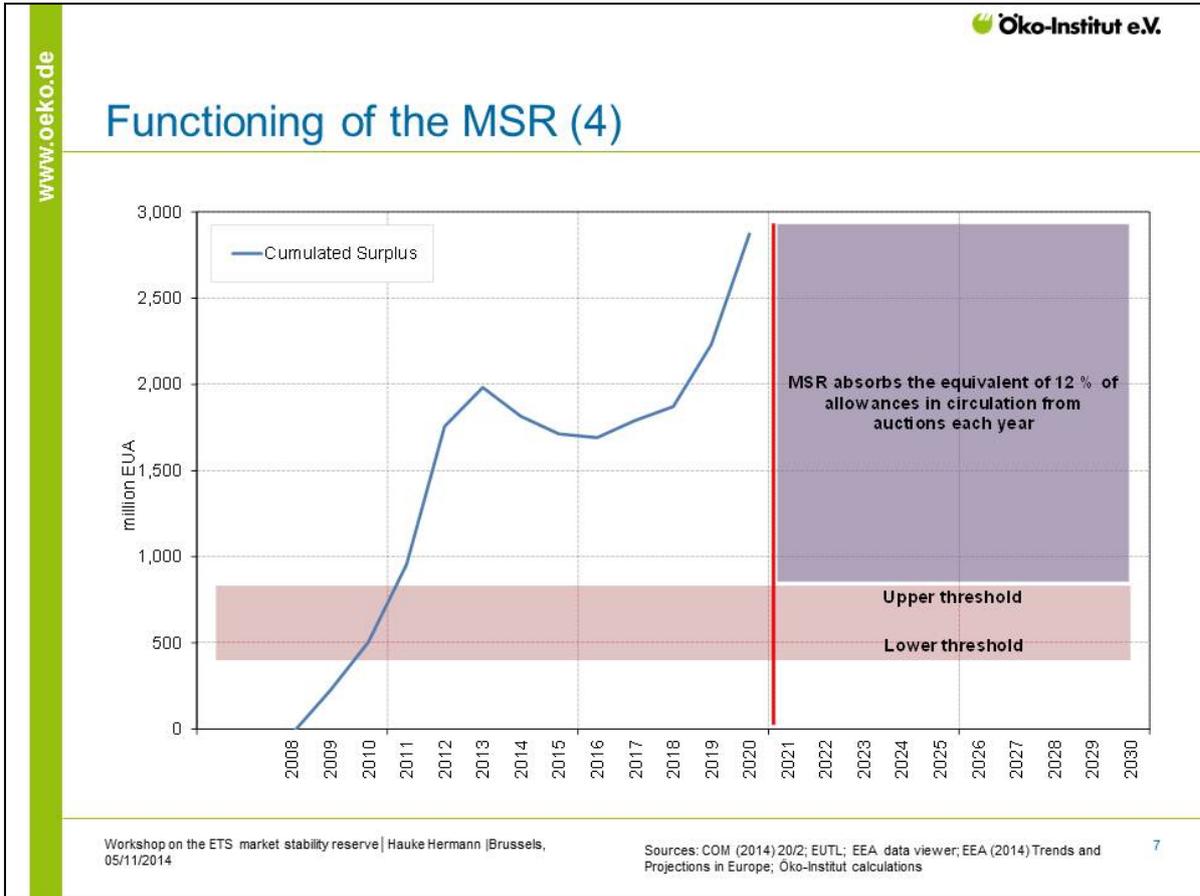
Functioning of the MSR (3): The hedging corridor

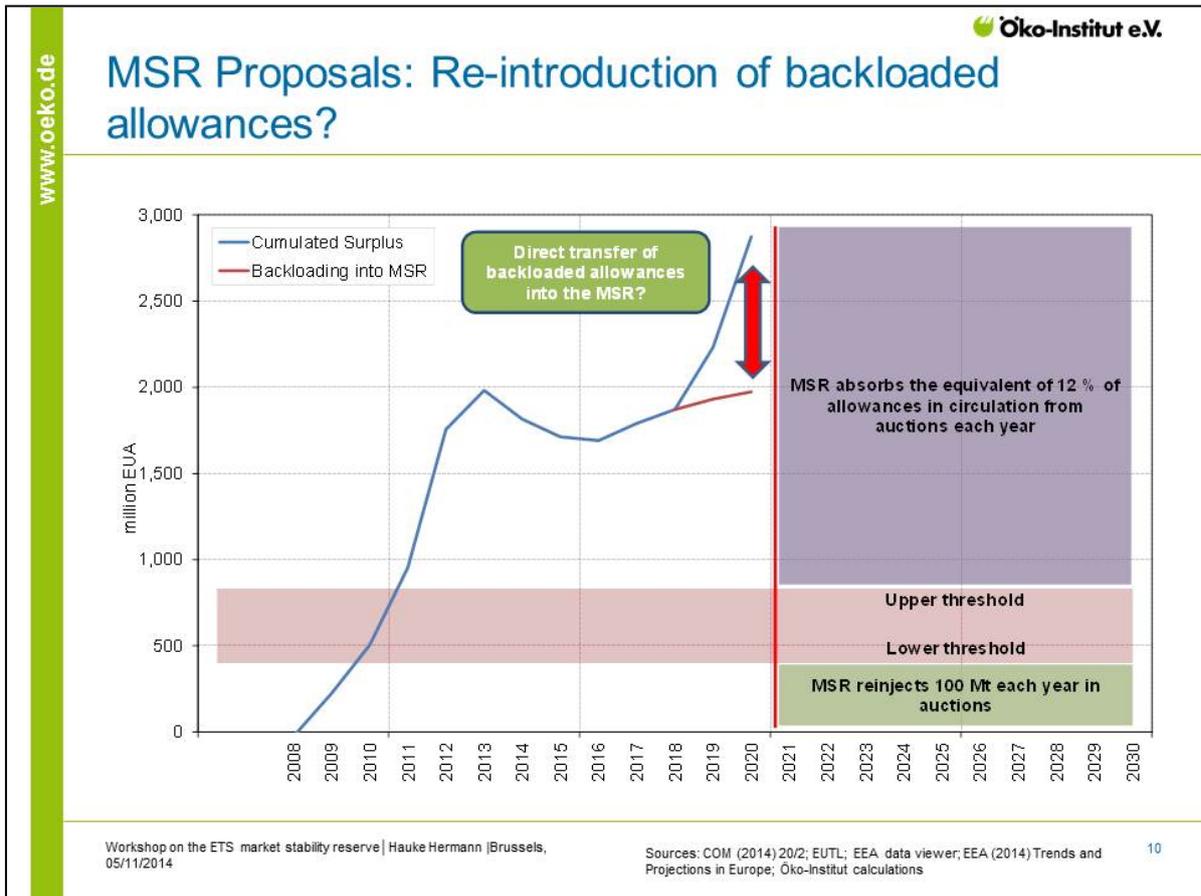
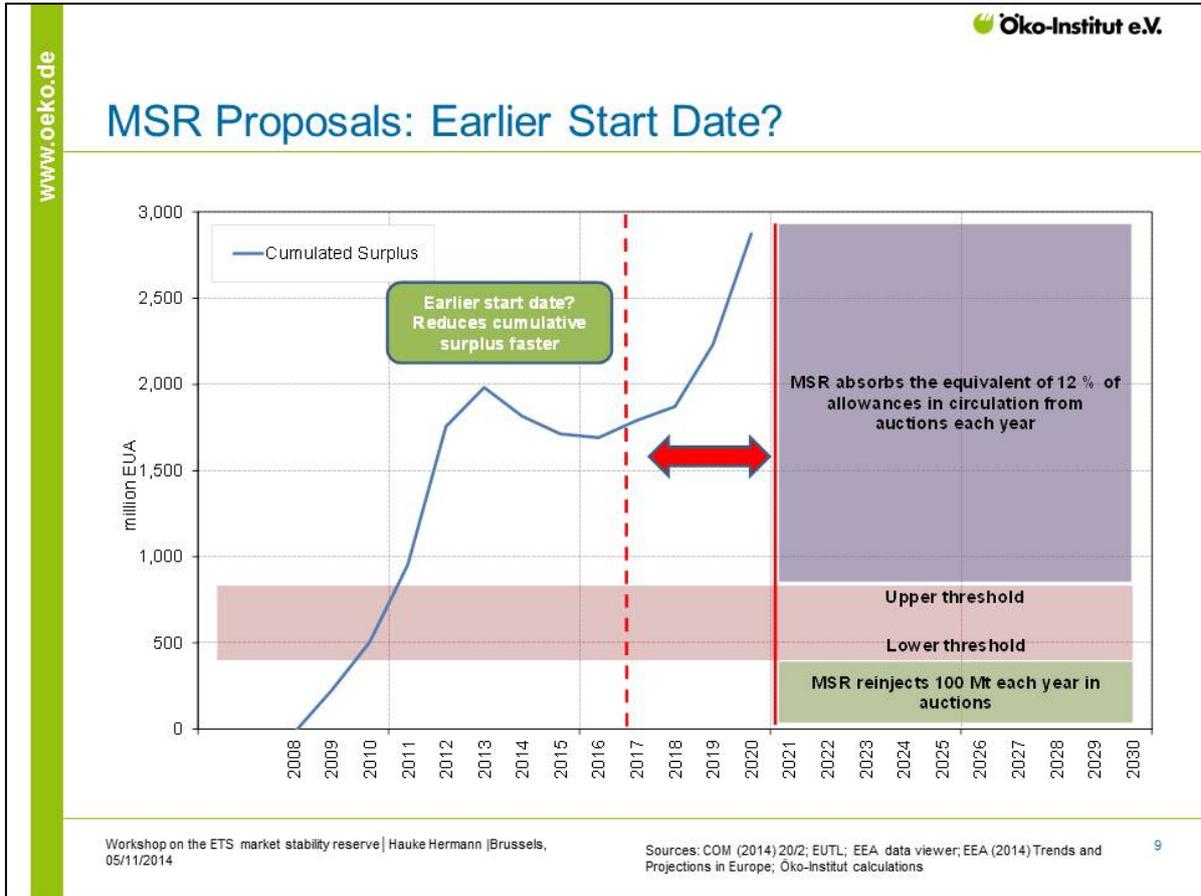


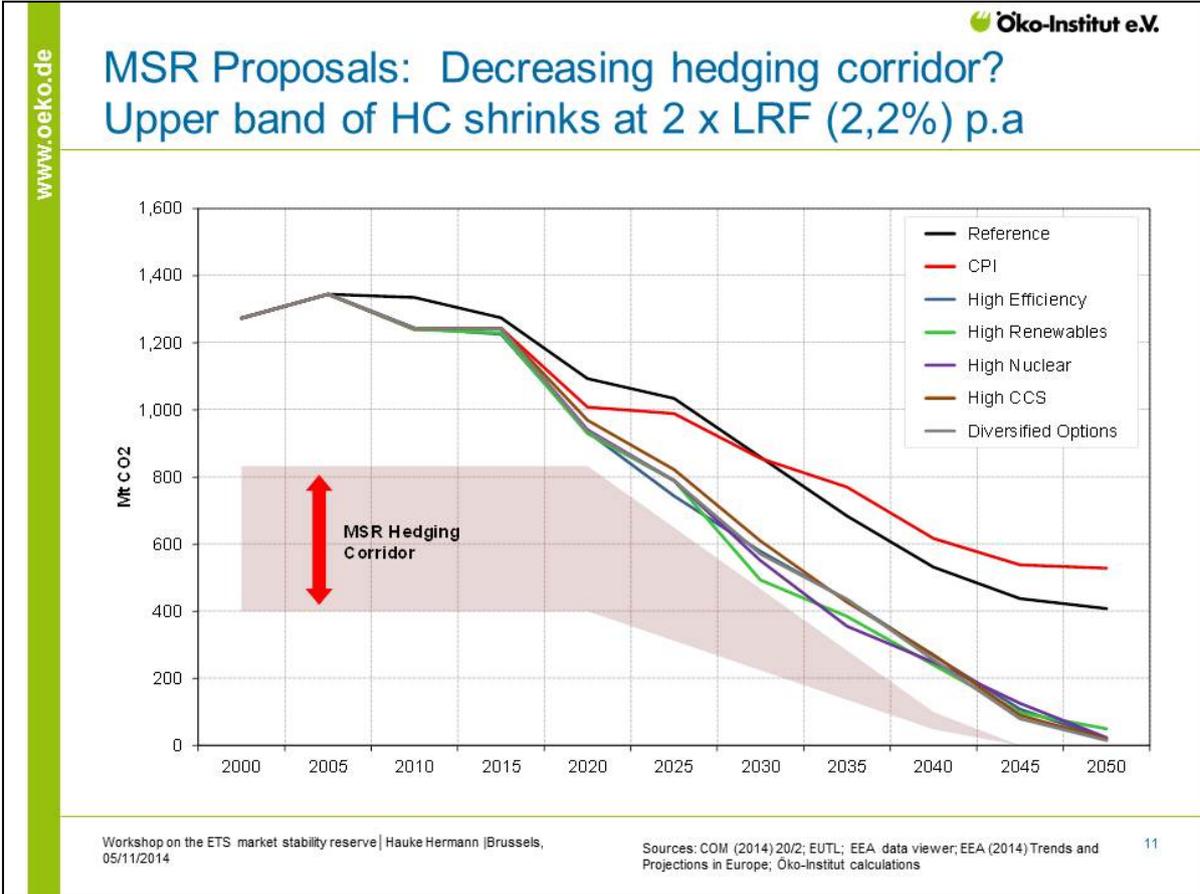
Workshop on the ETS market stability reserve | Hauke Hermann | Brussels, 05/11/2014

Sources: COM (2014) 20/2; EUTL; EEA data viewer; EEA (2014) Trends and Projections in Europe; Öko-Institut calculations

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Thank you for your attention!

Presentation by Marcus Ferdinand



The Market Stability Reserve Impact on EU ETS market balance and prices

Marcus Ferdinand
Head of EU carbon analysis

POINT CARBON



Conclusions

- Speed of oversupply reduction mainly dependent on
 - Handling of backloaded volume
 - Start date
- Resilience against future shocks: MSR will partially mitigate effects of lower economic growth
- The MSR will incentivise more abatement via the EU ETS
- Without MSR, oversupply remains high towards 2030

POINT CARBON



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Thank you very much for your attention!

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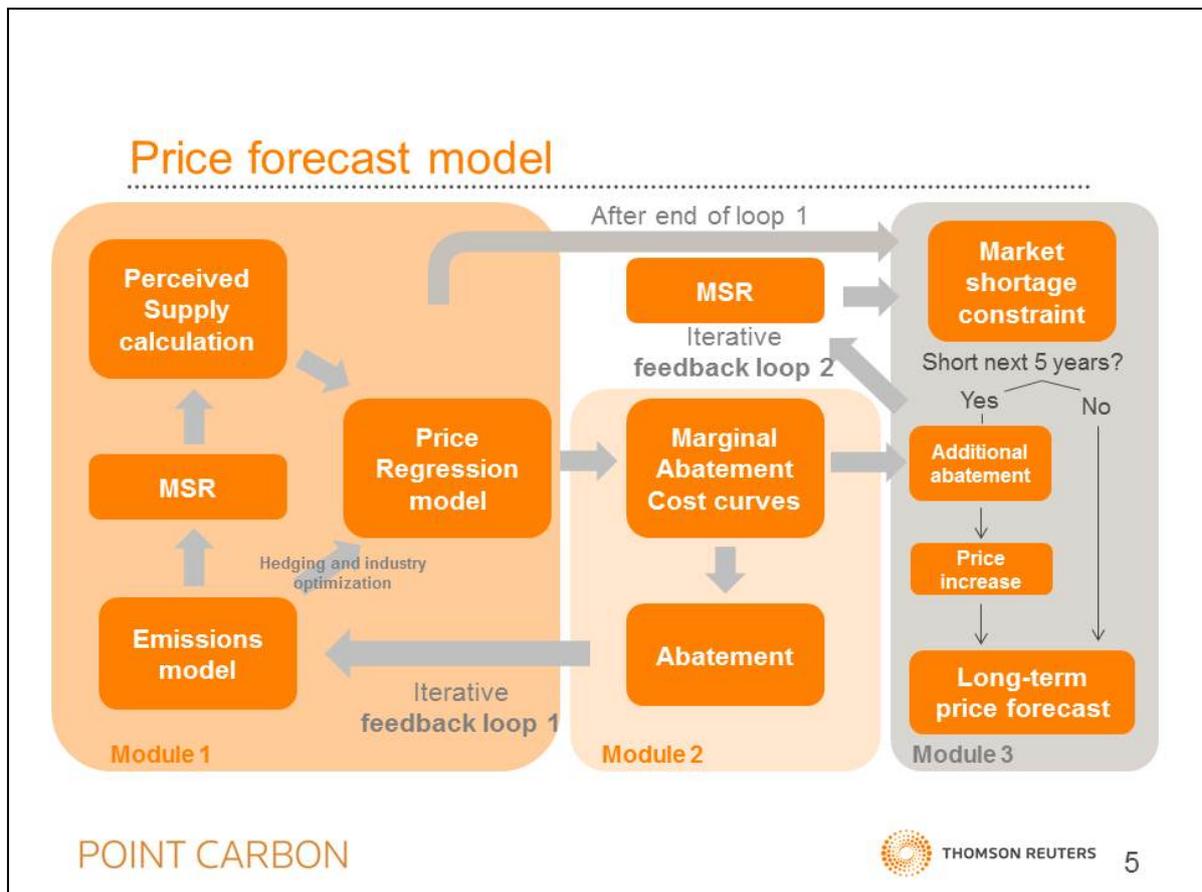
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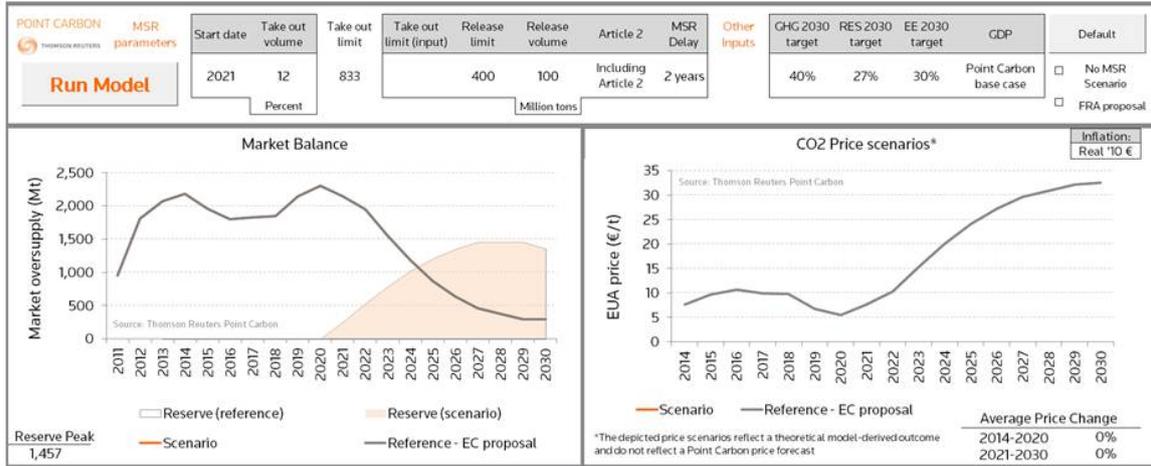




Interaction between prices and abatement

- Models annual abatement resulting from annual average carbon price
- Power sector:
 - Abatement represented by fuel switching
- Industry sector and aviation:
 - Abatement sector specific
 - Abatement technologies are irreversible
 - Delayed investments
- A numerical optimization algorithm used to model the interaction between price and abatement

EC proposal

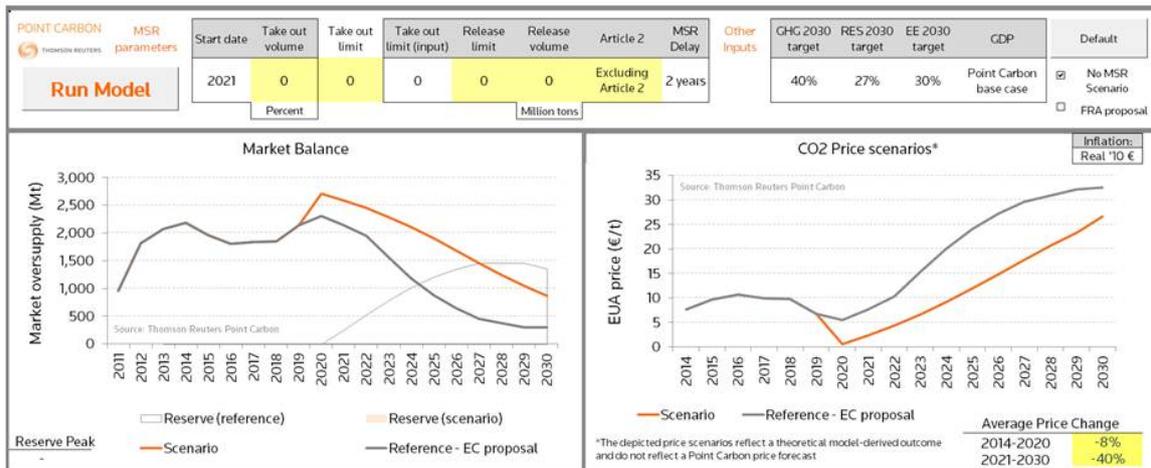


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No MSR

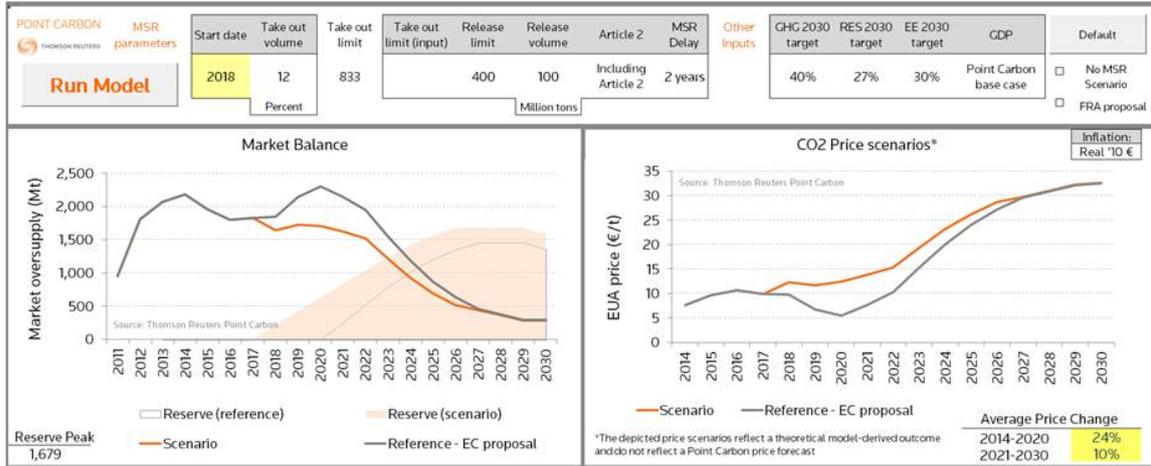


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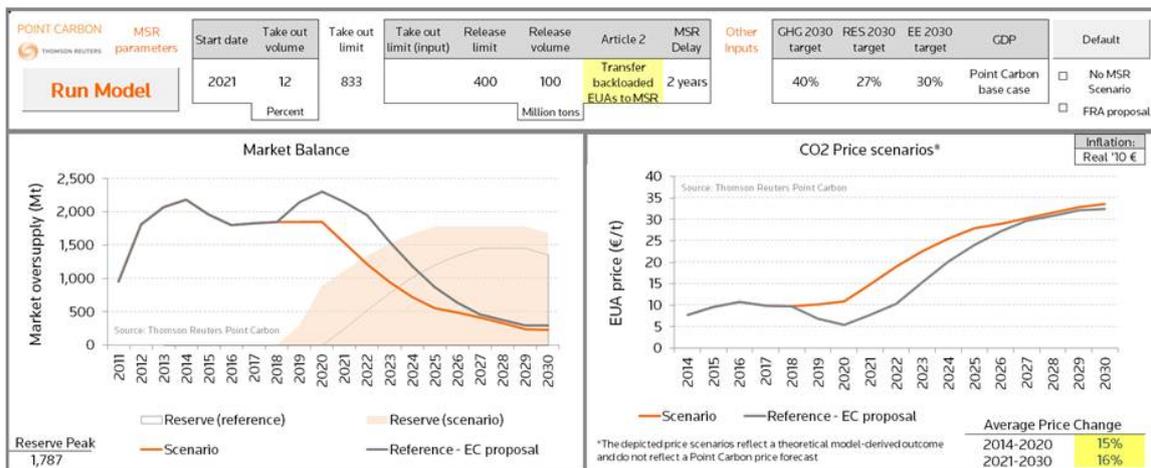
Early implementation (2018)



POINT CARBON

THOMSON REUTERS 9

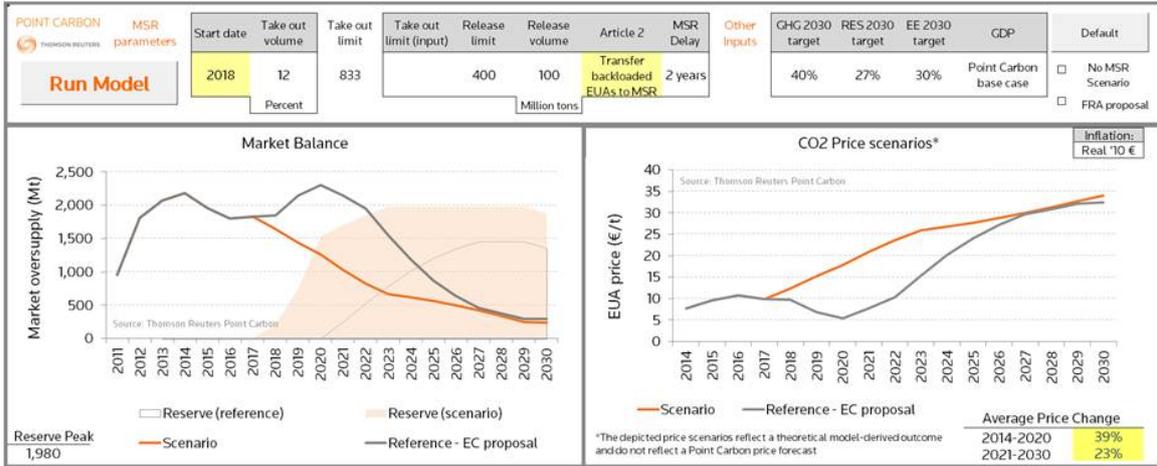
Transfer of backloaded allowances to reserve



POINT CARBON

THOMSON REUTERS 10

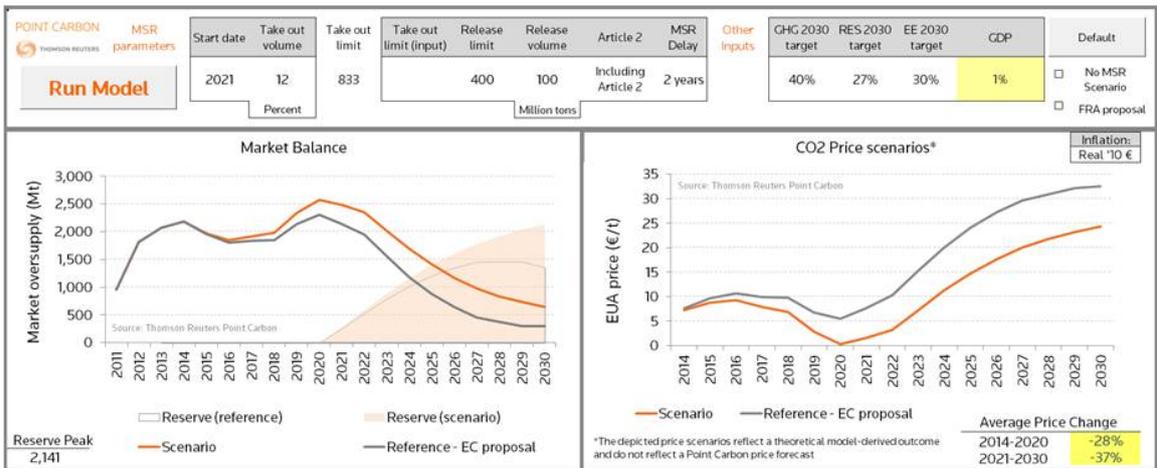
Transfer allowances + 2018 start



POINT CARBON

THOMSON REUTERS 11

Low GDP growth scenario (1% p.a. 2014-2030)



POINT CARBON

THOMSON REUTERS 12

MSR Scenarios	Year when surplus falls within chosen surplus band	Average 2014-2020 price (€/t)*	Average 2021-2030 price (€/t)*	Abatement triggered by EU ETS (2014-2020) (Mt)	Abatement triggered by EU ETS (2021-2030) (Mt)	Allowances in reserve in 2030 (Mt)
Commission proposal	2026	-9	-23	116	1,564	1,357
Early Start (2018)	one year earlier	+2	+2	+41	+170	+222
Transfer of 900 Mt backloaded allowances to the MSR	two years earlier	+1	+4	+22	+235	+330
German proposal	four years earlier	+3	+5	+70	+399	+523
French proposal	two years earlier	No change	No change	No change	-44	-359
Alternative thresholds (1,000 Mt - 600 Mt)	one year earlier	No change	-1	No change	-61	-204
Alternative thresholds (600 Mt - 200 Mt)	one year later	No change	No change	No change	+36	+177
Alternative size of MSR adjustments (20% take out)	two years earlier	No change	+3	No change	+214	+170

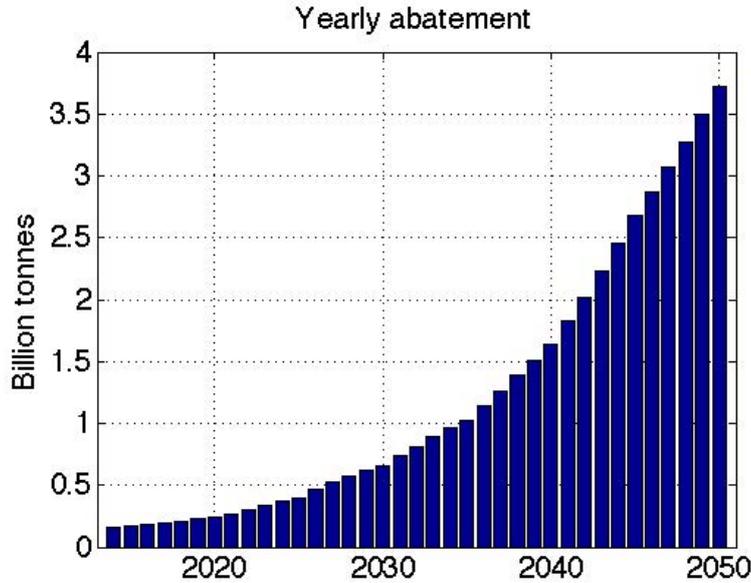
POINT CARBON



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Uncertainty and incomplete information

- ▶ In reality businesses operate under uncertainty about the economy and the future policies.



Navigation icons: back, forward, search, etc.

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The EU ETS Market Stability Reserve: A Responsiveness Mechanism

Luca Taschini

The problem

Optimal outcome

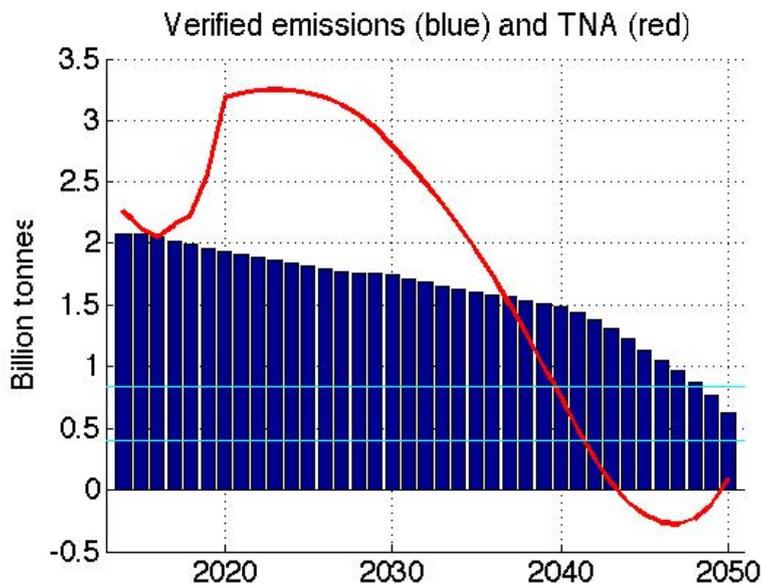
Uncertainty

Policy considerations

Contact details

Uncertainty and incomplete information

- ▶ Uncertainty and large-scale unforeseen events lead to sub-optimal outcomes.



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The EU ETS Market Stability Reserve: A Responsiveness Mechanism

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Optimal outcome

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Policy considerations

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What is the role of the MSR?

- ▶ The allowance demand-supply imbalance – as measured by excessive *surplus* – may be the result of large-scale unforeseen events and higher perceived uncertainty.

The EU ETS Market Stability Reserve: A Responsiveness Mechanism

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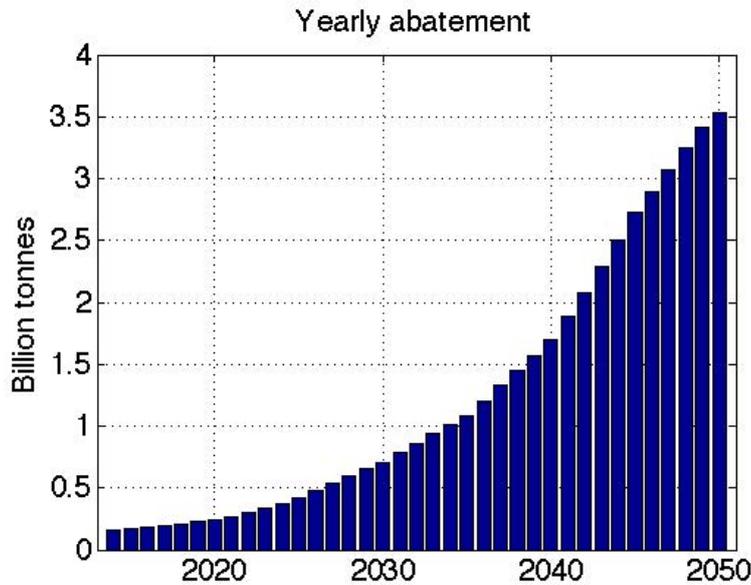
The problem

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Navigation icons

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What is the role of the MSR?

- ▶ The MSR aims at making the EU ETS responsive to shocks in the future and thereby minimise the possible deviations from the optimal pathway.

The EU ETS Market Stability Reserve: A Responsiveness Mechanism

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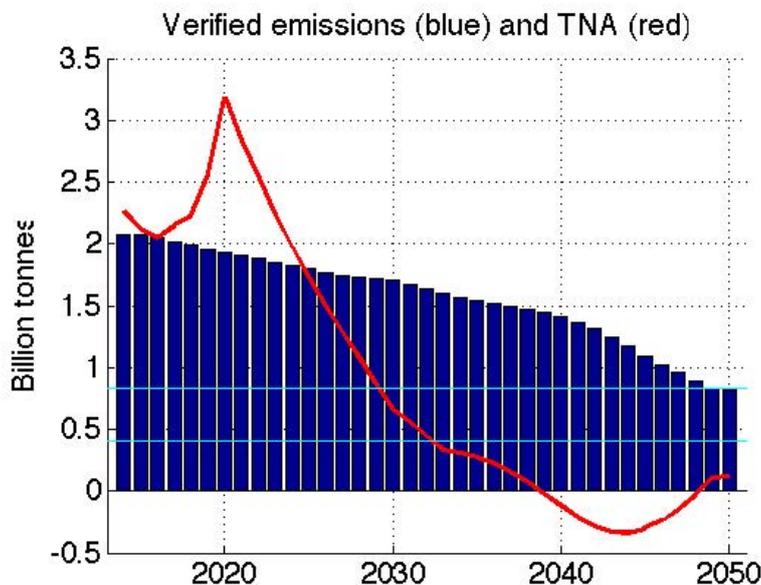
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Thank you very much for your attention.

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Figures based on the paper Kollenberg and Taschini (2014)

Presentation by Andrei Marcu



Market Stability Reserve

Environment Committee Workshop

November 5, 2014, Brussels

Andrei Marcu

Head, CEPS Carbon Market Forum



What problem are we solving?

- EU ETS objective: promote reductions of GHG in a cost effective and economically efficient manner
- Design flaw: lack of supply side flexibility in the EU ETS
- Symptom: prices that are unlikely to represent 2050 GHG limits and affecting LT effectiveness of the EU ETS
- Loss of effectiveness of the EU ETS is a concern as it provides the case for ET
- Price not reflecting LT scarcity due to
 - Market design
 - Nature of market – young
 - A ST view of a LT problem



MSR as solution

- MSR solves the AUCTIONING part of the problem
- Current EC proposal has an impact in the long-term, but no significant immediate impact
- Parameters that influence the MSR impact
 - Start date
 - Treatment of back loaded amount
 - Bandwidth (thresholds)
 - Removal (and injection) rates
- Separately Early Start and No Back loaded reinjection don't have a quantum impact, more marginal
- Treatment of back loaded amount seems to have more impact
- The joint approach would represent a visible change
- A number of questions that may benefit from further reflection here or outside this workshop

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Question for reflection from presentations

- What is the purpose of the MSR, what does it try to solve?
- Can the MSR solve the whole problem, what is missing?
- What is the rationale for waiting, if the MSR addresses a flaw?
- What adjustments are needed and how is that adjustment addressed?
- Impact of Council conclusions on the debate?

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