Some much needed momentum is finally building behind the EU’s emissions trading system

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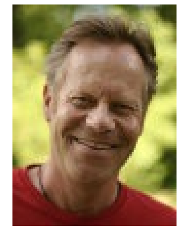

The EU emissions trading system (ETS) is a key component of the European Union’s policy for tackling climate change. The ETS works using a ‘cap and trade’ system, with a progressively tightening limit set on the amount of greenhouse gases that can be emitted by factories, power plants and other actors. **Jørgen Wettestad** *and* **Torbjørg Jevnaker** *write that after a difficult period in which the ETS has struggled to meet its aims, the system finally looks to be building some momentum with greater consensus among EU governments and actors in the European Parliament on the way forward.*

The EU emissions trading system (ETS) was established in 2003, when rules for the pilot phase (2005–2007) and Kyoto Protocol commitment phase (2008–2012) were decided. In 2008, improved rules for the third phase (2013–2020) were adopted as part of the climate and energy package, introducing a more harmonised, auctioning-based system. In 2008 the carbon price peaked, at just below €30. However, almost the whole post-2008 period has been plagued by problems. The financial crisis hit Europe in late 2008, lowering economic growth and reducing production – and demand for allowances. The 2009 Copenhagen summit also failed to adopt a new global climate accord, which was followed by the scrapping of a proposal for a US nation-wide ETS.

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A growing surplus of allowances and the carbon price dropping well below 10 euros led the European Commission to propose tightening measures in autumn 2012. These actions included a temporary withdrawal of allowances and movement toward a number of structural reforms. A nadir was reached in April 2013 when the European Parliament rejected even temporary ‘tightening’ (i.e. delay the auctioning of 900 million allowances to 2019-20, in ETS-speak: ‘backloading’) of the cap on emissions. Policy-makers and analysts saw an ETS on its deathbed and the situation seemed at an impasse, with key actors divided as to ETS reform.

The Commission had not been able to form a solution to these problems which could meet with the approval of decision-makers and stakeholders. Member-states were divided, with the UK wanting a strong ETS, Germany on the fence, and heavily coal-dependent Poland strongly resisting proposals. The Parliament, equally unable to find a common position, was subject to heavy lobbying from representatives of energy-intensive industries who were critical of anything that could entail higher costs and worsen their global competitive position. All of this occurred in the midst of stalling international climate negotiations, adding to general concerns about the impact of stricter EU climate policy on competitiveness.

Finally some momentum behind the EU’s emissions trading system?

Today, less than two years on, there is newfound optimism. After lengthy debate, 'backloading' has been agreed, and the European Council has adopted a new 2030 climate and energy framework, aiming for at least a 40 per cent reduction in greenhouse gas emissions. The framework advocates an increase in the annual 'tightening' of the cap on emissions. Originally, the ETS was intended to reduce the cap on emissions by 1.74 per cent every year from 2013 on, however the new framework put this reduction at 2.2 per cent per year from 2021 on. The introduction of a Market Stability Reserve (MSR) has also been proposed, which would entail an automatic tightening mechanism from 2019, or at the latest 2021. The MSR looks set to be adopted by June this year.

Given the previous gloomy atmosphere and recent gridlock in negotiations, a key question that could be raised in this context is what has changed to produce this new agreement. Our research, which will be elaborated on in an upcoming book, points to at least five key changes.

First, member states have become less divided. Poland and other Central and Eastern European countries remain largely sceptical of a more ambitious EU climate policy as long as it is still uncertain if and how other key economic competitors will follow suit. However, Poland has become a more constructive player, relying more on analysis and argumentation than straightforward obstruction. Central and East European countries got a good deal at the European Council summit last October, including the continued possibility of distributing free allowances to the power sector post-2020.

However the most pivotal change concerns the role of Germany – the biggest emitter and 'ETS allowance king'. From being an ambivalent bystander, Germany has taken on a leading role, becoming the first country to support a fast-tracking of the MSR (to 2017). This is very much (but not only) the result of the 2013 re-shuffling of the Merkel government, where the ETS reform-sceptic Rösler and the FDP were replaced by the Social Democrats.

Second, the Commission, now less internally split, has regained the initiative. After the launch and discussion of the Carbon Market Report in 2012, a new policy option emerged for tightening the ETS: the MSR. This has changed the framing and dynamics of the debate on ETS reform in a positive direction. The MSR is intended to automatically set aside or release allowances, depending on the number of allowances in circulation (and size of surplus). Thus, the Commission has put aside the most politically controversial options (like more short-term permanent retirement, or establishing a 'carbon bank'), opting for a more long-term, technical, de-politicised approach. In a sense, the lengthy process of discussing various reform ideas 'bought' the Commission time to develop a more politically acceptable solution.

Third, the European Parliament has also become less divided. The influx of new left-wing and right-wing smaller factions after the May 2014 elections seems to have produced better dynamics between the two main groups in the Parliament (the EPP and the Social Democrats), who have often cooperated as a 'grand coalition'. This was also witnessed in the ETS reform context.

Fourth, industry actors now hold less diverging positions. The power industry has upheld and strengthened its positive attitude to ETS tightening. Power-industry actors also contributed to the launching of an MSR as a central tightening mechanism. The energy-intensive industries, exhausted from the fight over backloading, have somewhat reluctantly accepted the MSR. The clarification of the 2030 climate and energy policy framework achieved at the European Council meeting in October 2014 contained elements which have appeased these industries – including a promise that free allocations will continue after 2020, to prevent the risk of carbon leakage, and a new fund of 400 million allowances to support low-carbon innovation in industrial sectors.

Finally, there has been greater help offered from 'outside'. The approaching 2015 United Nations Climate Change Conference in Paris, which is due to be held between 30 November and 11 December, has added greater urgency to efforts aimed at getting the MSR adopted by June.

The EU's ability to discuss and, importantly, agree on common positions has improved. This is due to a combination of multi-level factors, including elections and a change of tactics that created new dynamics. Moreover, having had more time to work on a new and more sophisticated proposal, the Commission has helped set the new terms of the debate, which is now more constructive. While an MSR alone may not be enough to fix the ETS, it will be an important element, with additional reform steps now on the way.

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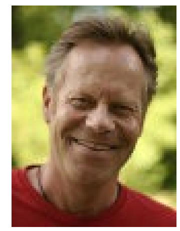

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