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European Stakeholders' Perspectives on the EU ETS

Noriko Fujiwara, Charikleia Karakosta, Aleksander Szpor, Andreas Tuerk and Erwin Hofman[1]

The EU has set the overall greenhouse gas emissions target for 2030 and the associated targets for the various sectors covered by the EU emissions trading system (ETS). To meet these challenges and to improve its performance, the EU is currently reviewing some design features of the system. Based on a stakeholder consultation process, this POLIMP Policy Brief shows an overview of perceptions held by stakeholders in five member states (Poland, Greece, Austria, Hungary and the Netherlands). It highlights the diversity of their views across sectors and across countries on salient aspects of the ETS: the role of the ETS and the ETS sectors' contribution to the 2030 policy framework, the factors that had a major impact on the EUA price, the ETS reform and stakeholder support for the ETS.

The POLIMP Project aims to address gaps in knowledge and to inform policy at various decision-making levels regarding the implications of international climate policies currently under discussion.

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1 Noriko Fujiwara is Associate Research Fellow at Centre for European Policy Studies, Charikleia Karakosta is Research Associate at University of Piraeus Research Center, Aleksander Szpor is Analyst at Institute for Structural Research (IBS), Andreas Tuerk is Expert at the University of Graz, Austria, and Erwin Hofman is Researcher/Policy Advisor at JIN Climate and Sustainability. The authors thank Vlasis Oikonomou and Mak Dukan for their contributions and Christian Egenhofer for his comments on a previous version of this paper.

Noriko Fujiwara (CEPS), Chara Karakosta (UPRC), Aleksander Szpor (IBS), Andreas Tuerk (University of Graz), and Erwin Hofman (JIN).

1. INTRODUCTION

In its meeting of October 2014, the Council of the European Union agreed on a decision to adopt an EU climate and energy policy framework for 2030 (Council of the EU, 2014). In this framework, the EU agreed to reduce GHG emissions by at least 40% by 2030 from 1990 levels. In order to meet this target, the sectors covered by the EU emissions trading system (EU ETS) will have to reduce GHG emissions by 43% by 2030 from 2005 levels. Currently, the EU is reviewing some ETS design features to meet this challenge.

Due to the economic crisis since 2008, GHG emissions have fallen and the demand for ETS allowances (European Union Allowances, EUA) has decreased, which lowered their prices. In order to address this issue, the EU heads of state and government adopted a proposal to temporarily take allowances from the market and to reintroduce these into the market at a later date (so-called 'back-loading') (Council of the EU, 2014). Since back-loading is only a temporary measure, the European Commission proposes to establish a market stability reserve (MSR) to take allowances out of or reinsert them in the auctioning schedule at the beginning of the next trading period in 2021 (European Commission, 2014).

This POLIMP Policy Brief reports on the perceptions of stakeholders from multiple member states concerning the ETS as it is and to what extent these perceptions differ from one member state to another, especially in countries affected by the economic crisis. This also includes views on the current discussions on how to reform the ETS.

2. APPROACH

The POLIMP project has developed a methodology for stakeholder consultation in the form of physical meetings and online platforms. Preparatory dialogue, one of the main consultation tools to reach out to key stakeholders (e.g. policy-makers, business persons, researchers and NGOs) in EU member states, has been implemented in the period October 2013-March 2015. By the end of March 2015, stakeholders from five countries (Poland, Greece, Austria, Hungary and the Netherlands) had participated in the dialogues organised by four POLIMP partner organisations (Institute for Structural Research, University of Piraeus Research Center, University of Graz, and JIN Climate and Sustainability) and coordinated by the Centre for European Policy Studies.

The POLIMP Project allowed each dialogue organiser to select the topics, with some variation in interpretation of topical questions, depending on national circumstances or priorities, and to develop its own method in accordance with the basic framework that is common to all dialogue processes. The POLIMP research team aimed at an iterative process of stakeholder consultation through a series of interviews or/and group discussions, which enabled the stakeholders to make contributions. For further detail, please see Annex 2 of POLIMP Working Document No. 2 (forthcoming).

3. OUTCOME OF STAKEHOLDERS CONSULTATION

From March 2014 to March 2015, POLIMP dialogue focused on the EU ETS, engaging about 50 stakeholders in five EU member states (Poland, Greece, Austria, Hungary and the Netherlands). It covered a diverse range of sub-topics and level of details, with some focusing on more general and contextual issues, and others on technical design elements. We present below an overview of the outcome of the dialogue conducted across the targeted countries, highlighting several sub-topics, namely, the ETS within the 2030 policy framework, the role of the ETS as a market mechanism or regulatory tool, the impact of the economic crisis and supply of international

offsets on the EUA price, possible ETS reform towards enhanced effectiveness and stakeholder support for the ETS. Descriptions of the five targeted countries refer to the dialogue outcome while additional information on the EU and Central and Eastern Europe was obtained from workshops held in Brussels.

3.1 The ETS within the 2030 climate and energy policy framework

The main **stakeholders in Poland** are critical of the current form of the EU ETS and the reforms proposed by the European Commission and are almost unanimous in their view of the EU ETS. This is largely due to the consolidation of the energy and industry companies, their strong link with the state and, most importantly, their high dependence on a coal-based energy system. The stakeholders unequivocally underline that there is no need to adapt the ETS, i.e. to adopt backloading or the MSR.

Some **stakeholders in Greece** (consultants and researchers) were mostly sceptical of the 2030 climate and energy policy framework. However, industry and power-sector representatives were more positive, viewing it as a hopeful opportunity for investments in the low-carbon transformation of the European energy sector, on the condition that an international agreement is established in 2015.

Regarding the EU ETS within the 2030 framework, it was noted that Greek consultants and researchers generally supported more ambitious commitments, in contrast to industry and power-sector representatives, who stood by the adoption of a more moderate approach that would address specific de-carbonisation needs of the sectors it covers.

Austrian stakeholders, particular industry, such as the steel sector, voiced the wish for well-planned policy decisions and no short-term snap decisions in the context of the 2030 framework. Extremes should be avoided. A long-term stability in terms of policies is of critical importance for low-carbon investment decisions as was mentioned also by stakeholders in **Hungary**.

Stakeholders in the ETS dialogue in **the Netherlands** almost invariably support the EU ETS as the central instrument of European climate policy. Pricing CO_2 is seen as a crucial requirement to provide incentives for emissions reductions by all stakeholder groups. Industry stakeholders in particular would like to see a global level playing field with other economies. Within the EU, a risk is seen for competition between policies, as policies and targets, e.g. for renewable energy, can undermine the EU ETS. Policies supportive of the EU ETS should therefore be shaped at EU rather than member-state level.

The European Commission regards a well-functioning and reformed ETS as the main instrument for the 2030 climate and energy policy framework. Among **EU stakeholders**, the power sector, technology providers and a non-profit business organisation support the ETS as the flagship of EU climate policy and the enhancement of the system in the new framework. Among energy-intensive industry sectors, however, the steel sector finds the framework extremely challenging in the absence of similar constraints on competitors worldwide. The non-ferrous metal sector is concerned with indirect emissions costs as global price-takers. An NGO finds that the approved framework, including the GHG target and the ETS reform, does not go far enough towards the goal of de-carbonisation.

3.2 The role of the EU ETS

The role of the EU ETS, according to **Polish stakeholders**, should remain in accordance with its market nature. In their view the ETS should do what it is meant to do, i.e. to reduce GHG emissions in a cost-effective way, and should not be used for interventions in the market.

The ETS dialogue in **Austria** showed very mixed result in term of sector coverage and the role of the EU ETS in decarbonising the

economy. While the steel sector claimed that the EU ETS is not the appropriate instrument for industry, business perspectives called for an expansion of the EU ETS to other sectors. The carbon price in the EU ETS would be far lower in the EU ETS than in the non-ETS sectors, where the mitigation costs are higher. Stakeholders also mentioned that there is no link between these two parts of the economy. Thus, before reforming the EU ETS, harmonisation or standardisation of carbon prices would be of greater importance. In **Hungary, stakeholders** did not attribute the EU ETS with any specific role for de-carbonisation of the economy.

Although **Dutch stakeholders** support broadening of the EU ETS to other sectors, difficulties are expected as the MRV standards are thought to be too strict. Domestic offsets, under Article 24a, are seen as a possibility for participation of non-ETS sectors in the EU ETS.

The power sector and observers such as researchers and consultants call for a more 'realistic' allocation of allowances, decreasing free allocation and increasing auctioning. On the other hand, stakeholders from energy-intensive industries call for adequate carbon leakage measures.

3.3 The carbon price and the effectiveness of the ETS

For **Polish stakeholders** the price of the EUAs adequately reflects the economic crisis. They oppose further regulatory interventions. In their view the European Commission should let the EUA prices grow along with the economic recovery of the EU.

Greek stakeholders in research and NGO sectors questioned the future stability of the ETS, highlighting that it can only be ensured by further measures. However, the industry and power-sector representatives as well as most researchers were optimistic about the future of the ETS, expecting an 'amelioration'.

Regardless of their sector of expertise, Greek stakeholders agreed that that a low carbon price weakens the ETS, which has been undoubtedly affected by the economic crisis. Power sector representatives also identified large uncertainties over the future allowance supply as another factor preventing market participants from having longer-term price expectations, and therefore weakening the system.

Austrian stakeholders in academia and industry question the EU ETS as an appropriate instrument for technological change. Industry instead supported technology-based policy. Academics asserted that speculative market participants were influencing the market price, calling into question a market-based instrument to achieve CO_2 emissions reductions. A carbon tax was mentioned as a more suitable and predictable instrument. The effectiveness of the EU ETS was also questioned by stakeholders **in Hungary**.

Dutch stakeholders see the inflexibility of allowances supply as the main factor explaining the current low carbon prices. In addition, many stakeholders from all groups recognise the problem of EU ETS interaction with policies for renewables and energy efficiency. Despite the low prices, stakeholders agree that the EU ETS works, as the fixed cap and LRF (linear reduction factor) ensure emissions reductions. However, the low prices do not put pressure on companies to innovate. Focused innovation support policies are therefore needed, in order to bring technologies towards market-readiness.

In general, the European Commission finds that ex-post impact assessment is especially useful. **EU stakeholders** have recognised impacts of over-supply of EUAs, AAUs and associated ERUs as well as certain member states' measures to meet other related policy objectives, such as renewable energy promotion. In particular, the power sector has additional concerns with impacts of overlapping policy objectives on the ETS.

Among energy-intensive industry sectors, both steel and non-ferrous metal sectors are concerned with the extent of compensation for indirect CO_2 costs.

3.4 The ETS reform

Polish stakeholders are concerned about overregulation and consequently the lack of its predictability for business. Another problem raised is the over-protection of the energy sector in Poland (via free allocations) at the cost of other branches, such as heating or energy-intensive industry. The extensive administrative burden of the EU ETS, which is especially difficult for small companies to handle, was also seen as a problem.

The current reform proposals were seen as insufficient by most stakeholders **in Austria** and some stakeholders stressed the need to take additional EUAs out of the market in order to significantly increase the carbon price. In Hungary the reforms were also perceived as insufficient.

In the Netherlands, although the proposed MSR is seen as a step in the right direction, its effectiveness is questioned as the existing surplus is too large. While several consultants, researchers, policy-makers and power-sector stakeholders support the concept of the MSR as an automatic system based on predefined rules, other consultants and researchers as well as energy-intensive industries prefer to see a reserve operating as a sort of 'central bank', as proposed in Borkent et al. (2014). The main substantial reform proposed by industry stakeholders is the shift from ex-ante to ex-post allocation of allowances.

Among **EU stakeholders**, the power sector and technology providers advocate the structural reform and the MSR. Technology providers and the environmental NGO network argue for starting the MSR before 2020 and, together with market participants, for putting backloaded allowances directly into the MSR instead of the market. Technology providers also suggest using part of the MSR to top up NER400. The environmental NGO network argues for full reform such as full cancellation of the surplus and further raising the rate of the annual linear reduction factor. Both steel and non-ferrous sectors argue for full compensation for indirect CO_2 costs in all member states and free allocation reflecting recent production and based on technically and economically achievable benchmarks and without a cross-sectoral correction factor.

3.5 Support for the ETS

In Poland, although some stakeholders (mostly related to coal mining and energy sectors) have contested the EU ETS since its beginning, others started to essentially oppose it only after the decision about backloading. Further ideas of MSR or returning idea of set-aside reduced its credibility for wider group of experts.

In Greece, political instability and the lack of a solid framework were mentioned as factors other than the economic crisis currently affecting the carbon price, by a group of stakeholders representing a broad range of sectors, including research, consulting, NGOs, and the power sector.

The support for the EU ETS is limited **in Hungary**. The ETS is seen as one of a range of directives the country had to implement after its accession to the EU. **In Austria**, most stakeholders support the system in principle, even if it is not perceived to have worked well so far.

In the Netherlands, the EU ETS is publicly accepted. However, interventions such as backloading and the MSR are regarded as artificial price interference by industry stakeholders. This reduces credibility from their point of view, but it increases the confidence of policy-makers in the scheme, and therefore it decreases the risk of additional EU and member state policies that interact with the EU ETS.

Stakeholders from member states in **Central and Eastern Europe** suggest that there is a lack of institutional and administrative capacity to implement the ETS in certain countries. They observe that the capacity of regulators or administrators and operators of covered installations has been constrained in small member states. They also find that transaction costs associated with the EU ETS are sometimes too high for small and medium enterprises and that MRV requirements would be additional burdens on the latter. This leads to a strong need for capacity-building and support programmes targeted at these member states and installations.

4. KEY FINDINGS

The stakeholders interviewed in **Poland** almost unanimously oppose any interventions in carbon markets such as backloading or set-asides. The idea of further reduction of emissions is not actively opposed, but the EU ETS is not seen as an appropriate solution. In their view, the EU ETS should remain a market mechanism serving to reduce the cost of low-emissions transformation. The level of emissions and choice of particular low-emissions pathways for each country should be made in a flexible manner. It should respect the individual circumstances of each member state.

In Greece, regarding the EU ETS within the 2030 framework, it was noted that researchers and consultants generally supported more ambitious commitments, in contrast to industry and power-sector representatives, who stood by a tailor-made approach to de-carbonisation needs of ETS sectors. Stakeholders from a broad range of sectors commented that the carbon price is also affected by political instability and the lack of a solid framework, apart from the economic crisis.

Among **Austrian stakeholders** there is mixed support. Industry in particular questions the usefulness of the EU ETS for technological change and calls for a targeted technology policy. Also academics claim that higher carbon prices are needed to bring new technologies to the market. A long-term stable climate and energy framework with predictable carbon prices was mentioned in **Austria and Hungary**. Regarding the sectoral coverage, views were diverse, seeing the EU ETS coverage being either too broad – with a need to limit it to the energy-producing sector – or too narrow – leading to imbalances of carbon prices between ETS and non-ETS sectors, which cause inefficiencies in CO_2 mitigation costs. The current reform proposals were seen as insufficient by most stakeholders in Austria and Hungary.

Among **Dutch stakeholders**, there is widespread support for the EU ETS as the central instrument of European climate policy. This support, however, was qualified by the recognition that the inflexibility of the system, in combination with the economic crisis and interaction with renewable energy policy, has led to a large surplus of allowances. The ultimate goal would be an integrated global scheme with economy-wide auctioning of allowances. For now, however, free allocation is still seen as necessary to prevent carbon leakage. Industry stakeholders propose to reform the allocation from 'ex ante', based on historical benchmarks, to 'ex post', based on actual production levels. The introduction of an MSR is seen by most stakeholders as a step in the right direction, but there are doubts about its effectiveness.

EU stakeholders broadly support the continuation of the ETS as the main instrument of EU climate policy and as a part of the 2030 climate and energy policy framework. The power sector and technology providers support the proposed reform designs, such as MSR, and a network of environmental NGOs even called for a more ambitious reform. Energy-intensive industry emphasises the need for full compensation for indirect CO_2 costs in all member states, free allocation based on recent

production and achievable benchmarks among other issues.

Across all member states, stakeholders expect the EU to improve the ways in which the ETS is currently implemented. There is a broad concern that the market is not functioning as well as it was expected to do, i.e. to promote reductions of greenhouse gas emissions in a cost-effective and economically efficient manner (Article 1, EU ETS Directive). The greatest challenge is to strike a balance between the expectation that the ETS will provide incentives for investments in low-carbon technologies and innovation on the one hand, and the need to address concerns over the competitiveness of energy-intensive industry and the risk of carbon leakage in global markets on the other hand. This challenge has especially crystalised in the ongoing debate over designing the MSR.

Moreover, there remains an insufficient level of understanding about the ETS in some of the 28 EU member states. Not all stakeholders are fully informed about or fully understand exactly how the ETS works. There is a divergence in stakeholders' views about the roles of the ETS being a regulatory tool or a market mechanism. Even if the ETS is expected to function as a market instrument, stakeholders may regard it as de-facto carbon tax.

Stakeholders from member states in **Central and Eastern Europe** suggest that there is a lack of institutional and administrative capacity to implement the ETS in certain countries. This leads to a strong need for capacity-building and support programmes targeting these member states and installations.

The POLIMP project shows a wide variety of views held by stakeholders across sectors and EU member states, implying that there is no consensus about the EU ETS. As far as POLIMP researchers are concerned, no similar exercise has been previously carried out, which makes this analysis unique and valuable. The most instructive observation is that there remains a diversity of perceptions about the nature of outstanding questions and how to address these questions through the structural reform proposed by the European Commission.

This observation was obtained through a two-step approach to stakeholder consultation. The POLIMP project proposed to hold preparatory dialogue before the ETS workshop with a view to transferring stakeholders' views from the member-state to the EU level. This approach aimed to facilitate EU discussions based on some common understanding and assumptions while taking into consideration national circumstances or contexts that would influence the performance of the ETS. The process, however, revealed that the diversity of their perceptions would make it difficult to structure discussions on the direction of the reform.

Lastly, this Policy Brief highlights the need to accelerate the flows of information from member-state stakeholders to EU policy-makers, and to improve dissemination and communication from the latter to the former. Consequently, the next steps could include the European Commission: i) encouraging informed stakeholders based in member states to actively participate in EU consultation processes and ii) supporting interested member states in organising workshops for outreach, awareness or capacity-building.

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The key findings of this policy brief were presented at the third stakeholder workshop of the POLIMP project: ***European stakeholders' perspectives on the EU ETS***. The workshop was organised in Brussels on 11 February 2015 and attended by the following experts:

Emilie Alberola, CDC Climat
Eleonora Arcese, Climate Strategies
Istvan Bart, Hungarian Energy Efficiency Institute
Sarah Baeumchen, Wirtschafts Vereinigung Metalle
Birgitte Bay, DONG Energy
Krzystof Bolesta, Ministry of Environment, Poland
Sarah Deblock, IETA
Anna Dimitrova, CEPS
Mak Dukan, University of Graz
Noriko Fujiwara, CEPS
Jean-Theo Ghenda, Eurofer
Corinna Grajetzky, RWE
Polona Gregorin, DG Climate Action, European Commission
Erwin Hofman, JIN Climate and Sustainability
Peter Horvath, DG Research, European Commission
Catrinus Jepma, University of Groningen
Robert Jeszke, The National Centre for Emissions Management, Poland
Joost Kanen, Gryphon Carbon Consultancy
Charikleia Karakosta, UPRC
Mariia Khovanskaia, REC
Sanjeev Kumar, Change Partnership
Juliette Langlais, Alstom
Ksenia Ludwiniak, Ministry of Economy, Poland
Marco Mannocchi, Confindustria
Axel Michaelowa, University of Zurich
Julia Michalak, demosEUROPA
Arnold Mulder, Energy Delta Institute – Energy Business School
Jeppe Wraae Nielsen, Danish Energy Association
Vlasis Oikonomou, JIN Climate and Sustainability
Aurelie Pattyn, Hydro
Nicola Rega, CEPI
Apostolos Siskos, ECOCERT
Aleksander Szpor, IBS
Wendel Trio, CAN-Europe
Andreas Tuerk, University of Graz
Jernej Vernik, Eurometaux
Piotr Zaremba, Ministry of Economy, Poland


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Authors

Noriko Fujiwara
(noriko.fujiwara@ceps.eu)
Centre for European Policy Studies (CEPS)

Charikleia Karakosta
(chakara@unipi.gr)
University of Piraeus Research Centre (UPRC)

Andreas Tuerk
(Andreas.Tuerk@joanneum.at)
University of Graz

Aleksander Szpor
(aleksander.szpor@ibs.org.pl)
Institute for Structural Research

Erwin Hofman
(erwin@jiqweb.org)
JIN Climate and Sustainability.

Project Coordinator

Vlasios Oikonomou
JIN Climate and Sustainability
www.jiqweb.org

Editor

Noriko Fujiwara
Centre for European Policy Studies (CEPS)

Project Dissemination

Alexandros Flamos
Charikleia Karakosta
University of Piraeus Research Centre (UPRC)

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