How to align the EU ETS with the Paris Agreement?

Outi Haanperä, Project Director, Climate Solutions
Global emissions need to be **HALVED** by 2030 …if we want to limit warming below 1.5 degrees.
How to align the EU ETS with the Paris Agreement?

The role of the EU ETS in increasing EU climate ambition: Assessment of policy options. Verena Graichen, Jakob Graichen, Sean Healy (Öko-Institut e.V.), Sitra Studies 161, 2019.
What was studied?

1. What would an appropriate emission reduction target for the ETS be if the EU-wide target for 2030 was increased from 40% to either 55 or 60%?

2. What are the policy measures to deliver the new target?

3. How the measures differ in abatement potential and political feasibility?

4. Conclusions and recommendations going forward
An updated EU-wide 55-60% emissions reduction target would require **reducing emissions by 61-65%** from 2005 level under the ETS sector.
Strengthening the cap: rebasing

Tonnes of CO₂

2021

2030
Strengthening the cap: LRF

Tonneja CO2

2021 2030
Strengthening the cap

1

**Background**
If we want to reduce emissions in the ETS sector faster, we must reduce the amount of emission allowances put into circulation. This would strengthen the emission cap.

**How?**
- Rebasing the cap
  - 205 million allowances
- Applying a higher linear reduction factor (LRF)
  - 3.63% from 2021 or 5.07% from 2026

**Abatement potential:** high
Altering the rules of the MSR

**Background**
Market Stability Reserve (MSR) is the key measure to enhance the resilience of the system to external shocks, such as economic recessions, by tackling the surplus of allowances.

**How?**
- Altering the rules so that the MSR is also able to address the expected future surplus.
  - Maintain the intake rate at at least 24% from 2024 onwards
  - Applying the linear reduction factor (LRF) to the MSR thresholds (inflow and outflow)

**Emissions reduction potential**: medium-high
Unilateral cancellation of allowances

Background
After a reform to the ETS directive, the member states have the right to unilaterally cancel allowances. For example, if a member state decides to phase out coal power plants, the demand for EUAs decreases. The MS has then the option to cancel the redundant allowances to avoid increasing surplus in the market.

How?
- The member states have the right to withhold from auctioning allowances due to national abatement measures in the electricity sector (e.g. coal phase-out)
- Does not require EU-wide regulation—can be implemented nationally

Emissions reduction potential: high
Carbon price floor

**Background**
The ETS can be enhanced both by reducing the amount of allowances in circulation and by increasing their price. A price floor for carbon improves the competitiveness of clean technology and lowers the risk in clean investments.

**How?**
- A carbon price floor can be established nationally—no EU-wide regulation needed.
- An EU-wide minimum price for carbon (EU-wide regulation needed) can be implemented either through a surrender charge (i.e. price floor) or through an auction reserve price. If an auction reserve price is in place, EUAs at an auction are only sold if a certain price level is reached.

**Emissions reduction potential:** medium-high
WHICH MEASURES WERE NOT INCLUDED IN THE POLICY RECOMMENDATIONS?
EXTENDING THE SCOPE OF THE EU ETS

**Background**

There is an ongoing discussion about whether additional sectors should be included in the ETS, e.g. building-specific heating and cooling, land transport and maritime transport.

**How?**

- An obligation to surrender EUAs could be attributed upstream to the transport or heating fuel providers (or downstream to consumers) to cover the emissions
- The end consumer would carry the costs

**Emissions reduction potential:** low
The risks versus expected benefits of the scope extension

- Which factors should be taken into consideration:
  - Expected emissions reductions
  - Low demand elasticity
  - Non-price barriers
  - How to best use our political capital?
None of the measures alone is able to deliver the change required. We need a comprehensive policy package.

1. Strengthening the cap aligned with the enhanced targets. This is done by rebasing the cap and increasing the LRF.

2. Enhancing the resilience through the MSR.

3. A group of countries taking the lead by implementing a carbon floor price and cancelling the maximum amount of allowances under the unilateral cancellation.
RISE TO SHINE!
Political feasibility captures the relative “ease” of the associated legislative process.

The political feasibility was assessed through the following questions:

1. Has the legislation previously been adopted?
2. Are there plans currently in place to amend the existing legislation?
3. What is the decision procedure for amending the legislation?
4. Is the policy option targeted at certain sectors (auction vs free allocation)?

In addition, all reforms need political will to be implemented.
Measures differ in their abatement potential and political feasibility

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Note: numbers are presented in the report page 53
Strengthening the cap to reach new 2030 target