

EUROPÄISCHES PARLAMENT

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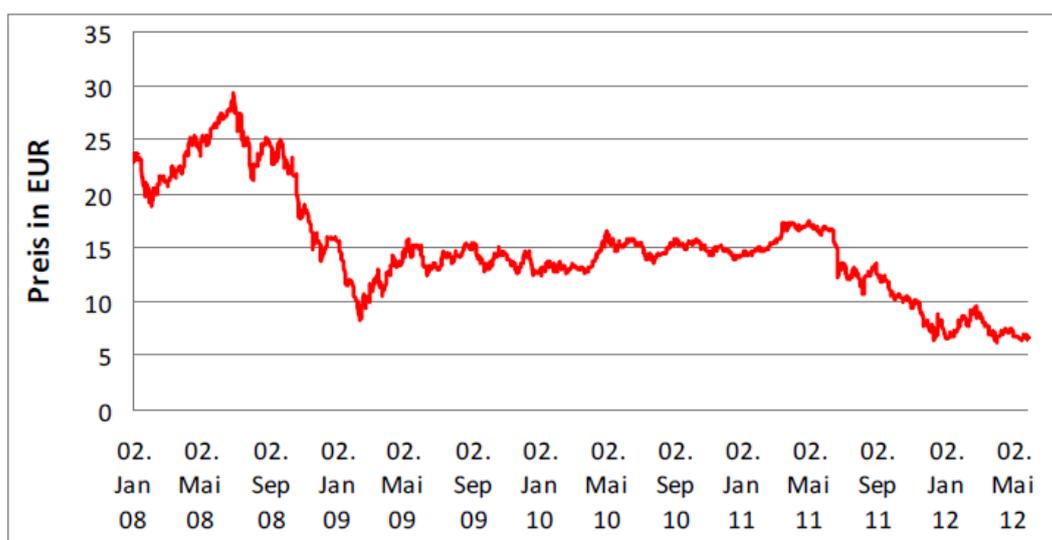
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Background paper: Crisis of the European Emissions Trading Scheme - why a moderate intervention is crucial

The Emissions Trading Scheme is the core of the European climate policy. As the prices for allowances dropped heavily over the last months and will remain on a very low level for years without an intervention, politics must act if the European Union wants to keep practicing active climate policy instead of completely withdrawing from this field or leaving it to the Member States.

When the reform of the emissions trading system was adopted in 2008, the EU assumed a price of **30 Euros** (see impact assessment of the Commission). Recently, the price dropped to **less than three Euros**. Experts say it can also go down to zero if politicians do not intervene.



Disclaimer:

The statements in this paper do not reflect the position of the EPP Group in the European Parliament. Peter Liese speaks as a member of the Environment Committee and rapporteur of the Environment Committee on the Energy Efficiency Directive. The position is, however, shared by a number of EPP members and in particular those of the CDU in charge of the subject in Berlin.

352 Mio Euros). If the certificate price increased, the certificates would have a higher value. If a company fulfils the benchmark, it doesn't have to buy certificates. Therefore, many who are protesting now seem to work with outdated technology¹.

2. National measures lead to market distortions

The failure of the ETS makes national measures much more attractive. A national measure to stabilize the price is already adopted in the UK. On 1 April 2013, a so called Carbon Floor Price will be introduced. Norway, participant of the ETS though it is no EU member, has also introduced a national tax. Similar measures have been discussed or decided in the Netherlands and Spain. Other countries may follow. National initiatives lead to distortions on the European single market.

3. Not enough revenues for important projects

The European directive demands that the revenues of the ETS are invested for climate protection, for example for energy efficiency measures. This is implemented in many member states. Due to the low prices, some measures have already been cut. Some lacks were compensated by money from the general household, but this is no long-term solution. Options for member states are raising new debt, which the EU massively opposes, or introducing national taxes, which distorts competition, or cutting the programs, which would jeopardize the member states' climate goals and damage the concerned economic branches seriously. Therefore, the best solution is to stabilize the EU ETS.

4. Climate targets are in danger

As opposed to common assumptions, it is by no means granted that the 2020 goal would also be achieved without a functioning ETS. Firstly, the ETS refers to two periods, from 2008 to 2012 and from 2013 to 2020. If fewer emissions are produced in 2009, this is credited against the goal for 2020, because period 2 and 3 are connected. Therefore it could be that the verified emissions of the EU in 2020 will not be 20 percent under the level of 1990 but only 17 percent. However, this will be hard to explain at international negotiations. Secondly, the ETS only covers 50 percent of all emissions. The other 50 percent are achieved by the member states through national action plans, e.g. in the housing of traffic sector. The cutting of revenues from certificate trading therefore also endangers the goal achievement here.

¹ An exception are electricity-intensive companies such as aluminum production. There is indeed a problem, since according to the decisions of the European Commission, only 80% of the costs are compensated, even if the benchmark is met. Amendment 26 of Anja Weißgerber and Peter Liese in ENVI addresses this issue.

5. Long-term perspective

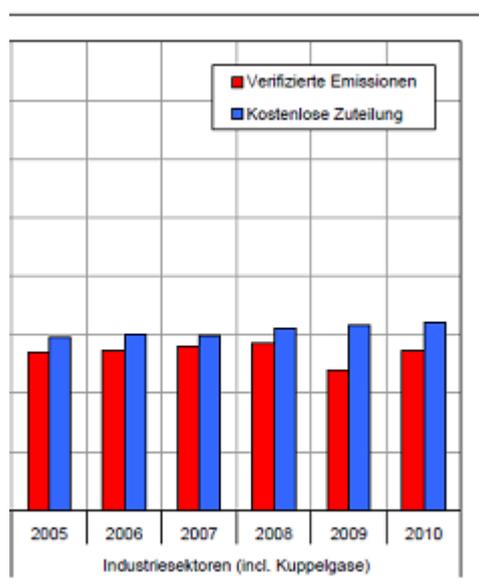
What is even more important is the perspective beyond 2020. If climate policy is meant to be pursued also after 2020 - which is also a question in the present debate - companies must already prepare for it now.

However, low prices lead to climate damaging investments which make climate protection impossible or very expensive for years. Regarding 2030, it will be said that these goals would be presently unrealistic. We have experienced something similar with the CO₂ limits in the car industry, where a voluntary declaration was signed first, which then was not met. Finally, it was said that the industry would need more time to fulfil the requirements. Planning safety is crucial for the industry, which is why it must be clear that European companies won't be successful in the long run with technologies harming the environment.

Reasons for the low certificate price

1. Overallocation of certificates through member states

During the periods from 2005 to 2007 and especially from 2008 to 2012, many certificates have been allocated free of charge. The member states were very generous: in all years from 2005 to 2010, the amount of distributed certificates was higher than the amount which would have been necessary (latest numbers are not yet available).



Source: Community Independent Transaction Log, April 2011.

In a first review in 2007, the Research Service of the German Bundestag concluded that far too many allowances were distributed. In 2006, the Fraunhofer Institute came to the assessment that in the UK, in the Netherlands and in Germany (these countries were examined), the budgets for the emissions trading sector were too high.

The economist Axel Ockenfels of the Institute of Energy Economics at the University of Cologne, said: "Especially the European Energy companies gain from Emissions trading. They get valuable certificates from their governments". Even during the transition to phase 2 (2008), there was criticism of the free allocation. Otto Steinmetz (Deutsche Bank) in a commentary for the Financial Times: "Previous attempts to reduce CO₂ emissions through tradable emission permits are toothless and sometimes

counterproductive. The certificates must be scarce in the future, and auctioned”.

Thanks to this distribution system, European companies could book large extra revenues.

(Thyssen Krupp for example 352 million euro. This example shows that not the European environmental policy, but catastrophic management errors are responsible for the problems. Thyssen Krupp lost several billions last year, though it was not strained by the ETS, but even benefitted from it).

The free certificates which were distributed until 2012 can be used in all following years. therefore, companies don't have to buy certificates even if their technology is outdated.

2. Economic crisis of 2009 and the Durant economic weakness, especially of the southern European economies

The economic crisis of 2009 and the current economic problems in some member states are another main cause for the surplus of allowances in ETS. In 2009, there was a severe economic recession in large parts of Europe. The certificates which weren't used in this time can still be used during the next years without limitation. The economic crisis was a one-off interruption which was unique since World War II, and we must do everything possible to avoid the repetition of such a disruption. Therefore, one should be careful with the argument that such a situation could always occur again.

3. The CDM certificates

The CDM certificates, i.e. certificates taking into account climate protection measures in the Third World, have played a more important role than expected.

Moreover, the quick expansion of renewable energies (which could only be remarked in Germany) and energy efficiency measures had a small, nearly negligible effect.

Doesn't an intervention in the ETS lead to an exodus of companies to non-EU states?

The European Parliament and I personally have always stressed that the ETS should not cause a relocation of companies. This is exactly why benchmarks have been introduced. **Companies meeting them due to modern technology standards are not strained by a backloading, but they profit.** The benchmarks have been developed under the assumption that the CO2 price was 30 euro. The effect of a backloading would increase the price to not more than 8 or 9 euro, i.e. a small part of what was originally expected. Hence, relocation cannot be expected because of this reason. An exception is the electricity intensive industry - here, an amendment is necessary.

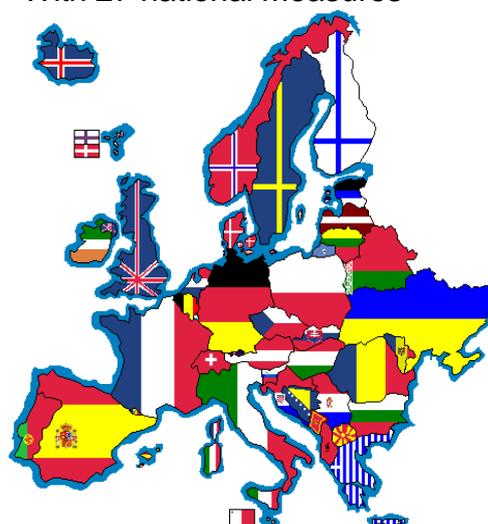
Doesn't an intervention lead to an unjustifiable increase of power prices?

The ETS allows attaining climate protection at a very low price. It is yet a problem that companies have included the freely distributed certificates in the power price. The new system of auctioning and benchmarks prevents this effect. In the future, additional costs in comparison to the last years are not justified. The price at European stock exchanges has decreased over the last years. Compared with other climate protection instruments, the ETS is the cheapest. **The strains for the German power consumer caused by the feed in law for renewable are, for example, twenty times as high as the ETS costs.** It is important to find European solutions. National solutions are always more expensive for the consumer and distort competition.

With EU ETS



With 27 national measures



Position of the European Parliament

The European Parliament has argued for an intervention into the ETS several times. On 15 March 2012, the deputies accepted a resolution for a long-term climate strategy with an astonishing majority (398:132). Part of the resolution was also a passage concerning the revision of the ETS, which was accepted at the request of the Christian Democrats and Liberals. Further demands of the Lefts and the Greens were rejected, but the report was unambiguous.

A quote from the report says:

24. Recognises that the ETS is experiencing problems not originally anticipated, and that the accumulating surplus of allowances will depress the incentive to promote low carbon investments for many years to come; notes that this endangers the effectiveness of the ETS as the EU's principal mechanism to reduce emissions in a manner that creates a level playing field for competing technologies, gives companies flexibility to develop their own mitigation strategy, and provides for specific measures to combat carbon leakage. Calls on the Commission to adopt measures to correct the failings of the ETS and to allow it to function as originally envisaged.

Already on 28 February 2012, the representatives of the industry and environment committee agreed on a compromise text on the energy efficiency directive saying:

"As soon as possible but no later than the date of entry into force of this directive, the Commission shall present a report to Parliament and Council. This report shall examine, amongst others, the impacts on incentives for investments in low carbon technologies and the risk of carbon leakage. Before the start of the third phase, the Commission shall, if appropriate, amend the regulation referred to in article 10 (4) of Directive 2003/87/EC in order to implement appropriate measures which may include withholding of the necessary amount of allowances".

In the course of the negotiations with the Council, it turned out that this demand could not be adopted, but a declaration of the Commission precisely describes the procedure:

3. In relation to Art. 19 (5), the Commission can put forward the following draft declaration:

In the light of the need to maintain the incentives in the EU's Emissions Trading System the Commission undertakes:

to urgently present the first report pursuant to Article 10 (5) of Directive 2003/87/EC on the carbon market accompanied by a review of the auction time profile of phase 3

to examine in this report options, including among others permanent withholding of the necessary amount of allowances, for action with a view to adopting as soon as possible further appropriate structural measures to strengthen the ETS during phase 3, and make it more effective.

This declaration was part of the compromise on the energy efficiency directive and was not only accepted by the industry committee, but by the whole plenary. Positions from the European parliament saying one should not intervene in the ETS at all are thus not coherent with the so far decision-making. They are also not very convincing because the price once again fell by more than 50 percent since this decision.

Proposal of the Commission

On July 25th, the European Commission presented **a clarification proposal on the Emissions Trading Directive** after severe internal debates. Until this time, it was thought that a temporary withdrawing of certificates (backloading) would be possible without co-decision procedure in comitology. This was contested in the Commission. A legal opinion of the energy intensive industry has apparently met its target here. Therefore, the Commission made a **co-decision proposal**, which mainly consisted of one sentence, the so-called clarification proposal:

Article 1

In the first subparagraph of Article 10(4) of Directive 2003/87/EC the following sentence is added:

"The Commission shall, where appropriate, adapt the timetable for each period so as to ensure an orderly functioning of the market."

In November, the Commission then issued a proposal which, if the co-decision proposal is accepted, will be accepted in the comitology process, i.e. by experts from the member states and the Commission. The Parliament has a veto right.

900 millions of certificates are supposed to be withdrawn from the market for a certain time. This number stays significantly below the requests of environmental organizations and the Greens. That is why the price will only increase moderately. The Commission proposal is a compromise between the further reaching demands of the NGOs and parts of the economy and resisting companies. For many stakeholders the proposal is not progressive enough. At the same time, the Commission presented the so-called Carbon Market Report, which presents options for long-term solutions of the problem. The Commission is therefore 100 percent in accordance with its obligations towards the Parliament and the public. Criticism of the Commission saying there would be no holistic concept and backloading would be inefficient anyway is, according to my view, unfair or affected by a lack of knowledge.

State of the discussion in the Council

The majority of the member states has either already spoken in favor of the Commission proposal or has a positive attitude towards it. It is remarkable that these are not only Northern European countries, but also countries like Italy, Lithuania, Latvia or Romania. Only Poland, Greece and Cyprus are against the proposal. The German position is not clear yet. The German environmental minister Peter Altmaier obviously backed by the Chancellor's office supports the proposal, but economic minister Rösler keeps resisting.

Procedure in the Parliament

It was decided not to choose a simplified procedure, though the clarification only consists of one phrase. There is an intense discussion. The opinion giving industry committee has rejected the Commission proposal on 24 January 2013. In the leading environmental committee, there is a compromise proposal of the rapporteur and committee chairman Matthias Groote, mainly intending to limit the Commission proposal **to a one-off intervention**. This shall prevent that the Commission can, without asking the Parliament, intervene every year or, as some joke, every month, if it doesn't like the prices. The Commission stated that this is not its intention anyway, but a clarification is certainly reasonable. Further measures have to be taken in the sense of the Commission's declaration and the Parliament's demand for a prudent debate and an impact assessment. This might also include a definite withdrawing of certificates from the market. However, this is not covered by

the present proposal. There are different positions in nearly every group of the European Parliament concerning this issue.

On Tuesday, 19th February, the leading ENVI committee adopted the report of the rapporteur Matthias Grootte with 38 votes in favour, 26 votes against and 1 abstention. Now, the report will be voted on in Plenary in March or April.

Assessment:

The Commission proposal is very moderate. Extreme claims that have been raised by environmental groups and parts of the economy, have not been accepted by the Commission. The Commission responded to pressure from the European Parliament. A rejection of the proposal would therefore damage the credibility of Parliament.

Many arguments against the Commission proposal for Backloading don't withstand a thorough assessment from my point of view. Companies which already use state-of-the-art technology and benefit of a benchmark regarding to the direct emissions should be in favor of it. The question is whether we can achieve our climate goals in the long run if there is no incentive for climate-friendly investments for years and the member states don't get the expected financial means. Therefore, it is not a technical question, but a fundamental question of European climate policy.

Do we want to resign and not do anything, or do we want to keep protecting the environment? Does Europe want to tackle this challenge with joined forces, or shall every member state work alone, with all the disadvantages for its citizens and industry included?

I plead thoroughly for the acceptance of this proposal for backloading and afterwards for a solid discussion about the future design of the ETS. From my point of view, it is unfortunately an illusion that we will get this fundamental debate if we reject the proposal. Instead, the opponents of the European climate policy will feel confirmed and perhaps there will be no further Commission proposals. The matter is, in a certain sense, about the question whether or not we want to have a European climate policy, yes or no?

I am confident that a large majority of the citizens and the deputies will answer this question with yes.