Climate Alliance

Introduction

The Resolution adopted by Climate Alliance Members in Luxembourg, in May 2014 tackles the issue of ETS reform and recommends the following:

"A fundamental reform of the Emission Trading Scheme (ETS) is needed - *A stronger signal than the options for an EU ETS reform currently proposed is needed to reduce CO2 emissions. Above all, immediate action is required. Only a reform that takes effect well before 2020 will emit an effective price signal and trigger the investments that are so urgently needed. The linear reduction factor determining the allowances available on the market every year must be increased to reduce over-allocation. Moreover, the proposed backloading of 900 million allowances merely constitutes a postponement and not a real solution. Permanent deletion of at least twice as many allowances is required. If this is not achieved by the end of 2015, a carbon tax should be introduced to replace the European Emission Trading Scheme."*

1. Free allocation and addressing the risk of carbon leakage

We advocate for full auctioning as it is the most cost-efficient, simplest, fairest, and most transparent way to allocate emission allowances. It generates revenues to support further climate policies in the EU and abroad. Auctioning also prevents over allocation of free allowances to specific sectors. Over allocation has been a serious issue in the past and current trading phases.

The EU should phase out the out dated and disruptive policy of providing free permits to companies to smoothen their transition towards a low-carbon society. Evidence has shown that the current EU policy to assess carbon leakage is ill-defined and market-distorting[1].

The ETS should provide clear and trustworthy market incentives to lead industries and market players in the direction to reach the EU 2030 targets and the 2050 roadmap (decreasing 80-95% of GHG emissions). However, it is still an illusion to believe that the market, with current carbon pricing under the ETS, will adequately change business models towards this path. Therefore Climate Alliance calls upon the in-depth reinforcement of the ETS with other instruments implementing carbon pricing that takes into account the actual long-term costs of emissions in the different sectors.

[1] Source: Anderson et.al, Centre for Economic Performance, LSE 2011

2. Innovation Fund

The Innovation fund should be based on the EU 2030 climate and energy policy – as well as support the newly formed Energy Union. There should also be clear link with the Horizon 2020 – and its policy objectives. It is important to ensure policy coherence between different innovation instruments.

The innovation fund should prioritise investment flows to energy efficiency improvements and renewable energy generation technologies. Market uptake and deployment should be considered as a priority in such a fund, as many of the innovations are already available and wide implementation schemes are required.

The revision of the ETS should take into account the non-economic barriers to realise the EU targets, and the innovation fund can earmark financing for this. For instance, energy efficiency is widely recognized as the most cost-effective solution for the transition to a sustainable energy system. The innovation fund and ETS revenues should be made available to trigger developments in this direction and support both local authorities and SMEs in this field. However, capacity-building and awareness raising is necessary in order to bring together local energy and climate projects ready for investments and the capital market looking for projects to invest in. Real innovation would be to tap into these local potentials with tailored financing solutions for energy efficiency measures.

3. Modernisation Fund

The modernisation fund should also focus on supporting energy efficiency and renewable energy projects. When appropriate such a support scheme should find synergies with other financing instruments available, in particular structural funds.

4. Free allocation to promote investments for modernising the energy sector

The energy system is likely to become much more decentralised and democratic, therefore ETS alone is not an appropriate tool for modernising the energy sector.

Cities and their citizen are becoming important actors in the energy system. Local authorities posses the necessary power to play a key role in moderating energy consumption and using local energy resources to satisfy local energy demand and by doing so stimulating investment and creating sustainable local jobs. For example the EU Covenant of Mayors is a movement led by local and regional authorities with an aim to meet and exceed the European Union 20% CO_2 reduction objective by 2020. The Covenant counts more than 6,000 signatories, 4,000 Sustainable Energy Action Plans and a firm commitment to reducing close to 30% of greenhouse gas emissions by 2020.

"There is great potential to involve the Covenant not just to help us reach our climate targets, but also to strengthen the power of consumers", was recently stated by Commissioner Canete at last week's Energy Forum. Local authorities, as being closest to the citizen, have an important role in creating active consumers for example via information and advisory services, providing incentives and participatory planning. New initiatives are emerging all over Europe and citizens start to take their future in their own hands. The New Deal for European consumers will provide help for collective schemes and community initiatives which are a growing part of the future market design and the energy transition process.

The continuation of transitional free allocation for power generators can distort competition, hinder the completion of the EU Internal Energy Market and endanger the EU's long-term decarbonisation objective. From 2020 onwards, the preferred approach should be to ensure power producers in all EU Member States buy 100% of their allowances at auction. The ETS Directive requires a stronger degree of EU institutional oversight, to ensure that it is used in the right way to promote the decarbonisation of our society.

5.5 Using ETS auctioning revenues to support climate policy

All ETS auctioning revenues should be earmarked for supporting climate policies, inside the EU and internationally. The reporting obligations under the Monitoring Mechanism Regulation can serve as a good basis to make this earmarking mandatory for all. Reinvestments of auctioning revenues into renewable and energy saving technologies, as well as adaptation action can create a virtuous cycle where application of the 'polluter pays' principle can support investments in the tools needed for further decarbonisation and climate resilience, in the EU and internationally.

The ETS auctioning revenues should also be used to support local action, implementation of local climate plans or Sustainable Energy Action Plans (SEAPs) in the context of Covenant of Mayors. Such financing schemes could be linked either to actions / measures in such plans or the emission reductions foreseen with these measures (See examples from Norway and Finland).

6. General evaluation of the ETS

Due to various factors (static policy design without built-in adjustments if significant demand changes occur, a weak reduction target and the massive use of international offsets) the ETS has not delivered its objectives. An enormous oversupply of emission allowances has built up and the price for allowances has dropped so significantly that the EU ETS cannot facilitate the transition towards a low carbon economy. Companies can delay or cancel investments in cleaner and

more efficient production, risking a costly lock-in in carbon intensive infrastructure for years to come.

Despite these significant failures, the EU and its Member States have been unwilling to implement the necessary reforms to turn the EU ETS into a functioning policy tool. Only if the EU ETS is reformed immediately and significantly can it become a working policy instrument, play a role in EU mitigation policy and be in line with the EU's long-term objective of 80 to 95% emission reductions by 2050.

This requires permanently addressing the current surplus in emission allowances. Although important, the Market Stability Reserve will not provide a permanent solution to the surplus of EU ETS allowances, which may grow to over 4 billion by 2020. It only temporarily removes allowances and returns them to the market over time. Instead, surplus allowances need to be permanently removed as they weaken future climate targets and undermine an adequate pollution price signal. Legislation that ensures the cancellation of surplus allowances is absolutely vital.

However, even a well functioning EU ETS alone will not be able to deliver the necessary incentives to decarbonise the EU. The majority of EU's greenhouse gas emissions (58%) are not covered by the current ETS system. Therefore various policy instruments at EU and National level are a necessity.

Conclusions

ETS must be considered as a tool that tackles part of the EU decarbonisation. But it is only one tool and therefore other policy instruments are necessary. If this revision does not provide the fix needed, it is high time to start working on other solutions such as the carbon tax.

Also the energy system is changing. Decentralisation and energy transition with an increasing number of smaller actors will further change the role of ETS in the decarbonisation efforts of the EU. Cities and their citizens are key actors in the new low carbon society.

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Climate Alliance

ABOUT Climate Alliance (Transparency Register ID: 83923664694-38)

"Climate Alliance of European Cities with the Indigenous Rainforest Peoples" is the largest city network committed to climate protection and preservation of the tropical rainforests. Since 1990, Climate Alliance has supported a total of now almost 1,700 members from 24 European countries in attainment of their voluntary commitments to reduce CO_2 emissions by ten percent every five years and to halve per capita emissions by 2030 at the latest (base year 1990).