Increasing environmental ambition in the EU Emissions Trading Scheme: a review of amendments in the ENVI committee

CAN Europe briefing for ENVI MEPs ***November 2016***

EXECUTIVE SUMMARY

In this briefing CAN Europe reviews and compares the amendments tabled in the European Parliament's Committee on Environment (ENVI) which concern environmental ambition in the EU ETS. We attempt to review all of the amendments which seek to improve environmental ambition compared with the European Commission's legislative proposal. We highlight the best of these with a view to encouraging Committee Members to vote in support of them. We also indicate where alternative compromise amendments might be welcome on certain issues.

We divide the amendments into three different categories and urge MEPs from the ENVI committee to support the following amendment within each category:

1. **Setting an ambitious new carbon budget:** Support amendments 211-214 as important first steps in bringing European ambition closer to what is required by the Paris Agreement which calls on all countries to pursue efforts to limit temperature rise to 1.5°C.
2. **Review the ETS cap in line with the Paris Agreement:** Support amendments 713-715 to improve the ETS cap and reduce free allocation in light of international circumstances.
3. **Cancellation of ETS allowances:** Support amendments 228, 232, 293, 369, 402, 669, 673-675, and 729 to remove excess allowances from the system and to correct for other national and EU policies.

INTRODUCTION

On December 8th 2016 MEPs from the Environment, Public Health and Food Safety Committee (ENVI) will vote on their official report on how to reform the EU Emissions Trading Scheme (ETS) for its 4th phase (2021-2030), building on the legislation proposed by the European Commission in July 2015.[1]

The effectiveness of the ETS has been severely hampered by weak reduction targets, excessively generous international offset provisions, and by the consequences of the economic crisis. Two previous interventions to fix the ETS, the back-loading decision and the Market Stability Reserve have proved inadequate: as this document goes to print the carbon price languishes at €6. That price is far too low to drive the investment Europe needs to cost-effectively reach its stated long-term climate goals.

The ENVI vote, then, is a key opportunity to repair the ETS. It is also an opportunity to further enhance Europe's climate ambition, bringing it more in line with the Paris Agreement which calls on all countries to reduce emissions to keep temperature rise well below 2°C and pursue efforts to limit it to 1.5°C. Together, the EU ETS and the EU Effort Sharing Regulation[2] define the EU's greenhouse gas budget for the period from 2021 to 2030. The smaller this budget is, the more Europe will reduce its greenhouse gases: the supply of ETS allowances would be decreased and raise the price that factories and power stations would have to pay for their greenhouse gas emissions.

The ENVI committee is the lead parliamentary committee on this file and its report will largely set the terms for the final plenary vote expected in February 2017. This vote follows on from opinions reached by the Development (DEVE) committee, and Industry committee (ITRE) earlier this year.

We review the three main categories of ambition-related amendments tabled in the ENVI committee in the sections which follow.

1. SETTING AN AMBITIOUS NEW CARBON BUDGET

The following amendments are vital as these can simultaneously improve environmental ambition, increase the carbon price, and strengthen the 2030 climate target.

The new emissions budget for the ETS is determined by two key elements: the initial starting level for the carbon budget and the rate of emissions reduction from that starting point. The Commission proposes that the ETS carbon budget for 2021-2030 should start from where the current ETS budget ends in 2020. They also propose that the rate of reductions should be roughly 48 million tonnes per year, as defined by a "Linear Reduction Factor" (LRF) of 2.2%.[3]

Several amendments have been tabled in the ENVI committee to lower the starting point of the cap and/or accelerate the rate of emission reductions compared with the Commission proposal. Both interventions lead to a smaller, and hence more ambitious carbon budget.

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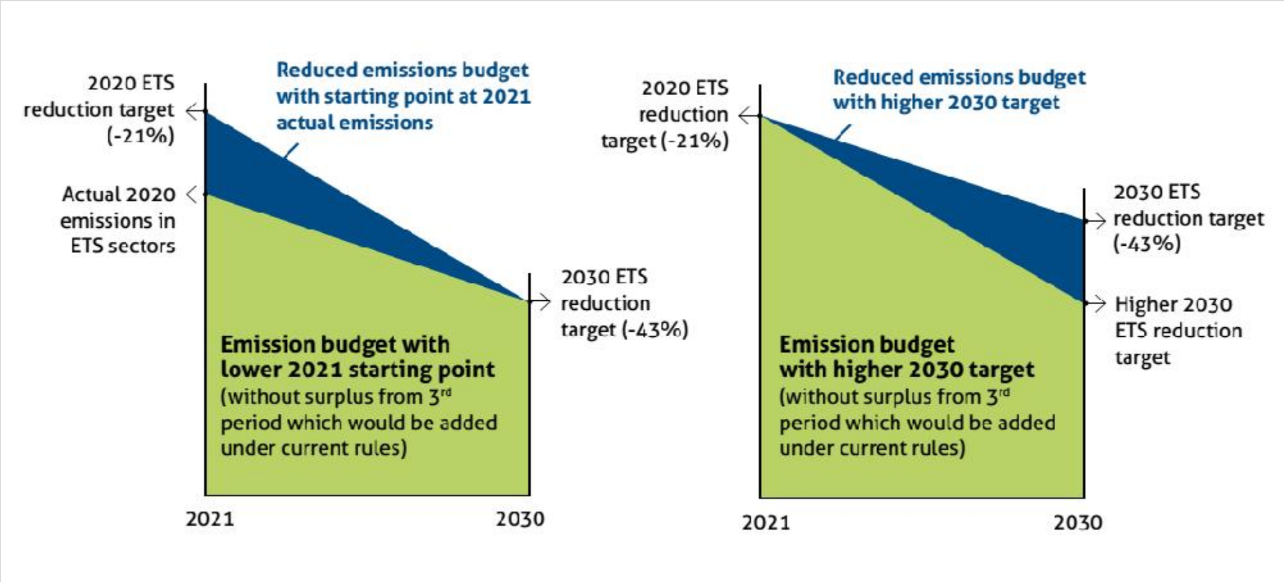
[1] http://ec.europa.eu/clima/policies/ets/revision/documentation_en.htm

[2] The EU ETS is a carbon market, limiting the emissions from Europe's power stations, factories and airline operators, while the EU ESR is a set of national carbon budgets limiting emissions from transport, heat and agriculture.

[3] The Linear Reduction Factor is expressed as a percentage of the average annual allowances issued in the Phase 2 cap, which was roughly 2,200 Mt.

Figure 1: Phase IV budget can be made more ambitious both by changing the starting point and by changing the Linear Reduction Factor



The most important and progressive of these amendments are summarised below, ranked in order of their estimated environmental ambition as measured by the volume of carbon they remove from the Phase IV cap. The implied LRF value and the impact on the EU's economy-wide target in 2030 is also given for reference. In many instances, each of these values is determined by future ETS emissions and therefore uncertain. Where this is the case we have used Member State emissions forecasts collated by the European Environment Agency.[4]

Table 1: ENVI amendments affecting the starting point or annual reductions of the ETS cap

Rank	AM #	Group	Description	Absolute annual reduction	Phase IV emissions saved[5]	2030 EU-wide target (vs 1990)[6]
#1	211	Greens/EFA (Rivasi)	4.2% LRF from 2021 starting from 2020 emissions (or from 2020 cap if lower).	73 Mt	2,220 Mt	-45.8%
#2	214	Greens/EFA (Eickhout)	2.8% LRF from 2021 starting from 2020 emissions (or from 2020 cap if lower). LRF is derived from Phase 2 cap.	62 Mt	1,617 Mt	-43.9%
#3	212	EFDD (Evi)	4% LRF from 2021 starting from 2016-2018 average	72 Mt	1,387 Mt	-44.3%

[4] Trends and Projections 2015. An updated set of figures for the ETS were published as this briefing was going to print.

[5] Range of values reflects the uncertainty over 2016-2018 emissions. We have used Member State WEM forecasts published by the EEA as an upper bound and Sandbag forecasts as a lower bound. In each instance, we have assumed that the proposed LRF refers to the current baseline (average Phase 2 allocations), though some ambiguity in the legal drafting could suggest that the LRF is fixed against the new emissions reference years, which would lead to more modest savings.

[6] Assumes changes in the LRF affect stationary installations only. If LRF affects aviation emissions the gains will be larger. In each instance, we have assumed that the LRF is fixed against current baseline values. See preceding footnote.

			emissions.			
#4	213	EPP (Pietikäinen)	3.3% LRF from 2021 starting from 2016-2018 average emissions.	60 Mt	691 Mt	-42.1%
#5	215	S&D (Schaldemose)	2.4% LRF from 2021 starting from 2018-2020 average emissions. LRF is derived from Phase 2 cap.	53 Mt	835 Mt	-41.8%
#6	216	ALDE (Gerbrandy)	2.4% LRF from 2021 starting from 2016-2018 average emissions. LRF is derived from Phase 2 cap.	53 Mt	309 Mt	-40.9%
#7	218	S&D (Dance)	2.2% from 2021 starting from 2018-2020 average emissions. LRF is derived from Phase 2 cap.	48 Mt	67 Mt	-40.1%
#7	219	EPP (Liese)	2.2% from 2021 starting from 2018-2020 average emissions. LRF is derived from Phase 2 cap.	48 Mt	67 Mt	-40.1%
#8	217	S&D (Guteland)	2.4% LRF from 2021.	58 Mt	242 Mt	-40.8%
#9	223	S&D (Paolucci)	Baseline of ETS cap corrected at the start of each phase to account for overlapping EU and national policies.	??	??	??
#9	224	EPP (Liese)	Baseline of ETS cap corrected at the start of each phase to account for overlapping EU and national policies.	??	??	??

Several groups have called for the starting point for the new budget to be set against *emissions* in the years just before the budget rather than *allowances* in 2020. ETS emissions are already lower than the allowance budget for 2020, and are expected to continue falling. Starting the new carbon budget where the old budget finishes, as the Commission's proposal suggests, therefore risks building oversupply and weak ambition into the new cap from the start.

Michèle Rivasi from the Greens has tabled the most ambitious amendment (211), but similarly ambitious amendments have been tabled by the Greens shadow rapporteur, Bas Eickhout (214) the EFDD shadow rapporteur, Eleanora Evi (212) and Sirpa Pietikäinen of the EPP (213). Each of these amendments call for an emissions-based starting level in combination with Linear Reduction Factors that would see the ETS cap fall to zero by 2050. While the Linear Reduction Factor on the face of these amendments looks quite different when expressed as a percentage, the absolute values are much more similar than these suggest. This is because some of the amendments with very high LRFs (i.e. higher than 3%) have redefined that reduction factor as a percentage of the new reference years used for the new starting point of the cap. This is different from calculating the LRF based on the average Phase 2 cap as is currently legislated.

However, the LRF is not the only factor which separates the ambition of these amendments. Amendments which seek to reset the starting point of the cap using later reference years are also more ambitious, because ETS emissions are expected to fall further over time, leading to an ETS cap which starts lower and is smaller overall. This is also what puts amendment 215 from Christel Schaldemose (S&D) ahead of amendment 216 from the ALDE shadow rapporteur, Gerben-Jan Gerbrandy despite both advancing a 2.4% LRF.

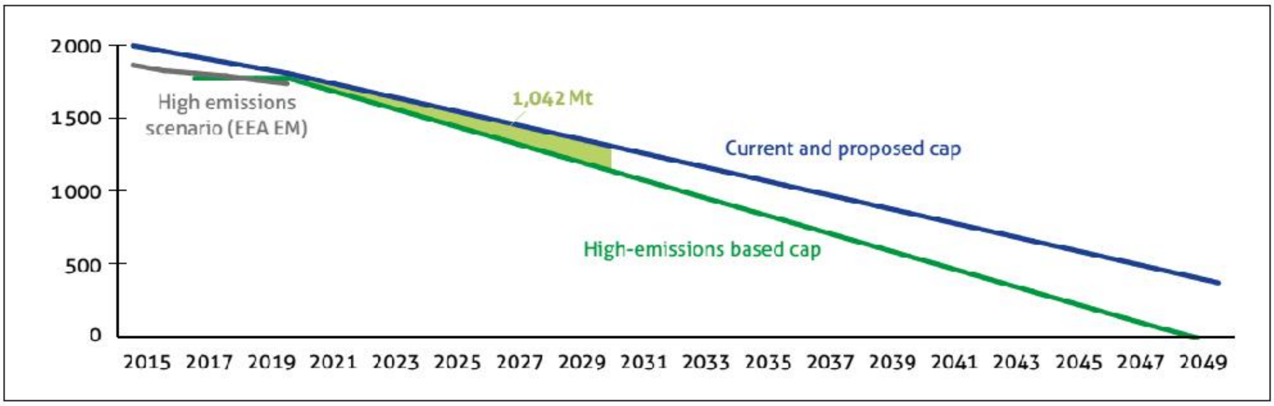
Seb Dance from S&D (218) and Peter Liese from EPP (219) have tabled similar amendments which maintain the current 2.2% LRF, but reset the start of the cap from 2018-2020. We have ranked amendment 217 from the S&D shadow rapporteur Jytte Guteland behind these, even though the impact on volumes appears larger at first glance. That is because her amendment will lead to smaller reductions than 218 and 219 if emissions fall faster than the Member State projections – which based on past experience seems quite likely.

Finally, we take note of two amendments from the Italian S&D delegation (223) and EPP member Peter Liese (224) which call for the level of the Phase IV cap to be reset to reflect overlapping policies. These amendments could also have a significant impact on the volume of Phase IV allowances, though precise numbers are difficult to predict at this stage.

CAN Europe recommends that ENVI MEPs support amendments 211-214, any of which would be a first and important step in bringing European climate action closer to what is required by the Paris temperature goals.

We also recommend the following compromise. While we fully support the principal of these amendments, which promote a steep trajectory and aim to rebase the Phase IV cap from the most current emissions data, we note that 2020 ETS emissions data is unlikely to be available before April 1st in 2021, a quarter of the way into the first year of the new trading period. We also note that there is a danger in setting the cap on the basis of emissions in any single year, when emissions that year could be unusually high or low because of aberrant weather patterns or fossil fuel prices. CAN Europe therefore recommends that average 2017-2019 emissions are optimum for defining the starting point of the Phase IV cap. Below we illustrate how a cap set on this basis would compare against the cap in the Commission proposal. We have plotted this alternative cap with a 2.8% LRF referring to the current baseline.

Figure 2: Change to the Phase IV ETS budget if starting point set against average 2017-2019 emissions and a 2.8% LRF is applied (Member State WEM emissions forecast).



With these parameters, the Linear Reduction Factor would decline by 62 Mt a year, the Phase IV cap would be reduced by 1,042 Million tonnes compared with the Commission proposal, the EU 2030 target would be

-42.9% all other things being held constant, and the stationary ETS cap would reach zero by 2049, however each of these impacts (except the absolute value of the Linear Reduction Factor) would be larger if emissions fell faster than the Member State forecasts used here.

Please see our briefing "A Fresh Start for the ETS" for further explanation about resetting the starting level of the cap, and to see some draft legal text for the compromise amendment described above.[7]

2. Review of the ETS cap in light of international circumstances

While it is important to set an ambitious ETS cap up front the EU also needs to install provisions in the EU ETS Directive to further increase environmental ambition of the cap in light of the UNFCCC facilitative dialogue and global stocktaking process agreed in Paris. As the latest UNEP Emissions Gap Report indicated, current pledges will lead us to a temperature rise of 3°C. In order to reach the 2°C limit, a further emission reduction of 25% is needed. Countries are therefore asked to revise and improve their Paris pledge. In order to ensure a smooth process, current and future EU legislation should provide the right tools to ensure any increase of the EU NDC (Nationally Determined Contribution) can be quickly integrated in the relevant pieces of legislation.

The most important and progressive amendments are summarised below.

Table 2: ENVI amendments concerning reviews of the cap relating to the UNFCCC process

Rank	AM #	Group	Description
#1	714	Greens/EFA (Eickhout)	Commission review the LRF, the level of free allocation and the need for additional policies within 6 months of the 2018 UNFCCC facilitative dialogue and each global stocktake.
#1	713	S&D (Guteland)	Commission review the 2.4% LRF and the level of free allocation and the need for additional policies within 6 months of the 2018 UNFCCC facilitative dialogue and each global stocktake, with a view to phasing out free allocation by end of Phase IV.
#2	715	EFDD (Evi)	Commission to prepare a report responding to UNFCCC facilitative dialogue in 2018 and subsequent five-yearly global stocktakes, with a view to increasing the LRF, and installing other GHG reduction policies.
#3	79	ECR (Duncan)	Commission shall prepare a report as part of the five-yearly UNFCCC stocktakes, and potentially issue new legislative proposal on that basis.
#3	712	EPP (Belet)	Commission shall prepare a report as part of the five-yearly UNFCCC stocktakes, and potentially issue new legislative proposal on that basis. First report after 2023.
#4	708	EPP (Liese)	Commission shall prepare a report as part of the five-yearly UNFCCC stocktakes, and potentially issue new legislative proposal on that basis. First report after 2023. The possibility of using third party offsets to be considered within the Commission report.

[7] http://www.caneurope.org/publications/reports-and-briefings/1223-can-europe-briefing-a-fresh-start-for-the-ets

The shadow rapporteurs from the Greens/EFA group, the S&D group and the EFDD group all take the 2018 facilitative dialogue as the appropriate first cue for the Commission to come forward with a report and a new legislative proposal. S&D and the Greens not only highlight reviews of the correction factor, and the need for additional policy, but also stress the need to decrease free allocation as international carbon pricing developments allow.

These amendments are significantly stronger than the proposal from the ECR rapporteur Ian Duncan in his draft report, which calls for regular reports to be conducted but only commencing with the global stocktakes starting in 2023. A similar amendment has been tabled by the EPP shadow, Ivo Belet, emphasising carbon leakage considerations, and another by EPP member, Peter Liese. We have ranked Liese's amendment behind the EPP group amendment because it entertains reintroducing international carbon offsets into the package as a route to increased ambition. We oppose the use of international offsets, as their environmental integrity has been proven to be very low and as they would weaken EU domestic mitigation efforts.

CAN Europe recommends that ENVI MEPs support amendment 713-715 to regularly improve the ambition of the ETS cap and strengthen carbon leakage rules in light of international developments starting from the UNFCCC facilitative dialogue in 2018.

3. Cancellation of ETS carbon allowances

By 2020, the ETS surplus will have grown to between 2.6 and 4.4 billion allowances.[8] Permanent cancellation of this surplus can be used to bring Europe back onto the least-cost path towards its climate goals.[9] Several amendments have been tabled to cancel carbon allowances in the scheme. This is an important means of tightening the ambition of the EU ETS independently of any change to the Linear Reduction Factor. Moreover, while setting an ambitious new cap and building in appropriate reviews are the primary means of guarding against oversupply in the *future*, cancellation is the most efficient way of addressing *historical* oversupply in Europe's carbon budgets. We summarise the most important amendments in the table below in the approximate order of their environmental ambition.

Table 3: ENVI amendments concerning cancellation of allowances

Rank	AM #	Group	Description
#1	669	Greens/EFA (Eickhout)	Electricity generators surrender two allowances for each tonne of CO_2 they emit.
#2	673	EFDD (Evi)	All allowances become invalid at the end of each trading period.
#3	293	Greens/EFA (Staes)	Any EUA auctions which do not clear €30 shall be cancelled.
#4	674	S&D (Guteland)	All allowances in the MSR cancelled at the end of each period.

[8] EC (2014), SWD(2014)17, Impact Assessment accompanying the Proposal for a Decision concerning the establishment of a market stability reserve (see http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52014SC0017&from=EN) UK government: 3.1 billion, (see https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/364992/UK_MSR_position_gov.uk.pdf); estimates by Sandbag: 4.4 billion, (see https://sandbag.org.uk/site_media/pdfs/reports/EU_on_track_for_30_cuts_by_2020_9Dec15.pdf)

[9] COM (2011): A Roadmap for moving to a competitive low carbon economy in 2050: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52011DC0112

#5	729	Greens/EFA (Eikchout)	The MSR can never hold allowances exceeding 50% of annual volume issued. Any excess beyond that ceiling is cancelled.
#6	675	Greens/EFA (Eikchout)	Allowances equivalent to the volume of offsets surrendered into ETS by 2020 are cancelled from the MSR.
#7	402	S&D (Schaldemose)	Any allowances remaining in NER at the end of Phase IV shall be cancelled.
#8	369	S&D (Guteland)	Any unissued allowances from the free allowances budget shall be cancelled at the end of Phase IV (if correction factor triggered best performers are exempted).
#9	228	S&D (Guteland)	Member States have the option to cancel any of their own auctionable allowances that are not in the MSR.
#10	232	EPP (Pietikäinen)	Member States have the option to cancel any of their own auctionable allowances that are not in the MSR.
#11	290	S&D (Guteland)	Member States may cancel allowances corresponding to emissions from power stations which closed early as the result of domestic policy or place them in the MSR.
#11	292,299	EPP (Belet)	Member States may cancel allowances corresponding to emissions from power stations which closed early as the result of domestic policy or place them in the MSR.
#12	291	GUE (Konečná)	Mandatory assignment of allowances to MSR by Member States corresponding to emissions from power stations which closed early as the result of domestic policy.
#13	24	ECR (Duncan)	Every 2 years, Member States may surrender a number of allowances to the MSR equal to the number of allowances connected to electricity capacity that has come offline in that period.
#14	25	ECR (Duncan)	Commission to report on the impact of overlapping EU climate and energy policies.

In terms of impacts on allowances volumes, the most environmentally ambitious amendment in this category is 669 from the Greens/EFA shadow Bas Eickhout. Obliging electricity generators to surrender two allowances each year instead of one would cancel massive volumes of ETS allowances. Power emissions accounted for 1,066 Mt of demand for allowances in 2016 and the annual demand for allowances would be doubled under this amendment.[10] This would be sufficient to soak up all the surplus in the system in a matter of a few years – even if the MSR did not exist. Moreover, these are allowances that would be cancelled directly from the market, not from the MSR, which would have a huge impact on the carbon price. The electricity sector has shown greater appetite for higher carbon prices than manufacturing sectors, and even faces sector specific carbon prices in some EU countries, such as the UK carbon floor price, which is currently fixed at £18 tonne, more than three times the current carbon price. Moreover, unlike unilateral carbon price floors, this proposal would reduce supply rather than leaving more allowances available for other sectors. CAN Europe supports the call for large-scale and rapid removal of

[10] Values obtained from Sandbag's EU ETS dashboard: http://sandbag-climate.github.io/EU_ETS_Dashboard.html

allowances implied by this amendment, but we note that a sunset clause or other caveats would need to be introduced to ensure such a measure would be feasible.

In second place, we have listed amendment 673 from the EFDD shadow, Eleanora Evi. She proposes to invalidate all allowances at the end of trading periods 3 and 4. This would wipe the slate clean in 2021 and 2031, cancelling all allowances in the system whether they are in the MSR or owned by companies. Indicatively, this would cancel between 2.6 and 4.4 billion allowances in 2021. [11] We support this amendment in ENVI because it reflects the drastic scale of intervention needed to repair the ETS, but we note that if it entered legislation in this precise form it could have some adverse effects on market functioning.[12]

In third place, we have listed amendment 293 from Greens/EFA MEPs Bart Staes and Michèle Rivasi. This places a €30 clearing price on EUA auctions from 2021, cancelling all allowances which do not reach this level. As this affects the supply of allowances on the market, it affects the price more directly and immediately than interventions which cancel allowances from the Market Stability Reserve described below, and could therefore make the ETS drive behaviour change faster than those amendments. With auctions accounting for 57% of the cap each year (e.g. 1,008 Mt in 2021 under the Commission proposal), and the Market Stability Reserve providing an additional bottleneck on supply, the €30 target price could be achieved relatively early in Phase IV. If adopted this would also have an immediate effect on the carbon price in Phase 3, as market participants would stop selling their allowances in anticipation of the higher receipts their EUAs could command once this measure takes effect.

Another powerful amendment (674) has been tabled by the S&D shadow Jytte Guteland which cancels all allowances in the Market Stability Reserve at the end of each period. The MSR continues to help regulate supply *within* periods but is reset to zero *between* periods. This is a very effective mechanism for correcting the legacy of past surpluses in the system, without adversely affecting market functioning, and would cancel around 2 billion allowances in 2020.

We follow this with two similar, but slightly more modest cancellation amendments tabled by Greens/EFA shadow Bas Eickhout. The first puts a ceiling on the allowances the MSR can hold equivalent to 50% of the cap, a limit which therefore gradually ratchets down over time as the cap declines. The second seeks to correct the MSR for offsets surrendered into the ETS up to 2020 and would cancel approximately 1.6 billion allowances.

Beneath these we list two S&D amendments which seek to cancel unused allowances at the end of Phase IV, unissued free allowances and unissued NER allowances respectively, ensuring that these are not repurposed for use in Phase V. While the volumes implied are unclear, these would affect the supply of allowances in circulation from 2031.

We then group an assortment of amendments together (290, 292,299, 291, 24, 25) which concern Member State's unilateral capacity to cancel their own allowances, or mechanisms to correct for reduced demand for carbon allowances owing to EU or national policy. In his draft report, the ECR rapporteur, Ian Duncan, proposed two amendments on this theme. An amendment which allows Member States to voluntarily submit allowances to the Market Stability Reserve to correct for power stations closed by national policy (24), and another which seeks to correct for overlapping EU policies (25). The first, however, is a voluntary

[11] European Commission Impact Assessment vs. Sandbag forecast.

[12] If adopted in this precise this would drive the carbon allowance price to zero until 2021, putting the ETS into hiatus and potentially harming some early movers into low-carbon technology. Moreover, preventing banking between trading period 4 and later periods might be disadvantageous once pre-2020 surpluses are addressed. This might also have the unintended effect of lowering the carbon allowance price in Phase 4, as more challenging future caps cannot impact the carbon allowance price in Phase 4.

measure and also only a temporary supply adjustment, and the second is simply a reporting obligation, with no explicit action following from it. Both the EPP shadow and the S&D shadow go further creating options for Member States to cancel allowances corresponding to the demand from closed power stations, as well as placing them in the MSR. However, all of the amendments in this subcategory face serious limitations.

- First, they severely limit the conditions under which Member States can cancel allowances, which they should be free to cancel under any conditions, not just when they have taken national measures which close power stations. No such conditions are imposed by amendments 228 and 223 tabled by Jytte Guteland and Sirpa Pietikäinen respectively.[13]
- Second, they make the supply correction voluntary. Amendment 291 by GUE shadow Kateřina Konečná makes the supply correction mandatory however she only directs allowances to MSR which significantly weakens her proposal.
- Third, they put the cost of correcting for national action at the feet of the Member States who have taken that action, which effectively punishes Member States for taking early action. If voluntary, the Member State will be discouraged from forfeiting additional revenues, and if mandatory the Member State will be discouraged from adopting national measures which close power stations.

We therefore propose the following compromise. A mandatory correction for national policies overseen by the Commission, which is permanent (i.e. cancellation) and which adjusts the allowances auctioned by all Member States, not just the Member State where the relevant national policies have been implemented. Action by any single Member State lowers the demand and lowers costs for all Member States, allowing the whole community to free-ride on their efforts. A correction to all Member State auctions should therefore be cost-neutral to national economies. A compromise amendment with similar effect was discussed in the final stages of the ITRE opinion, but ultimately discarded in favour of voluntary action. Moreover, this permanent, mandatory adjustment to supply for national policy, could also be extended to adjust for EU policy where this is seen to lower demand.

CAN Europe recommends that ENVI MEPs support amendments 228, 232, 293, 369, 402, 669, 673-675, and 729 to cancel excess allowances from the system and to correct for other national and EU policies.

CONCLUSION

The presence of several important amendments to the ETS Directive in the ENVI committee make the upcoming vote an important milestone to improve Europe's climate ambition and to make the ETS a more effective contributor to EU's climate efforts going forward. We urge ENVI members to support the ambitious amendments highlighted in this briefing.

[13] While Member States can already purchase and cancel allowances, as demonstrated by Sweden's recent national commitment, they are currently obliged to auction all of their allowances and not entitled to cancel them. While the effect on national budgets is the same, the political barriers are different: forfeited revenue opportunities are not visible in the less visible than national expenditure on EUAs.

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Climate Action Network (CAN) Europe is Europe's largest coalition working on climate and energy issues. With over 130 member organisations in more than 30 European countries - representing over 44 million citizens - CAN Europe works to prevent dangerous climate change and promote sustainable climate and energy policy in Europe.