

Backloading: Vote to support the EU's only harmonised and cost-effective climate policy instrument

Business association IETA recommends supporting backloading to allow future discussions on improving the efficiency of the EU's Emissions Trading System



IETA supports the ETS as the cornerstone of the EU's climate policy. It has achieved emission reductions at a low cost. It has successfully created an EU-wide, robust infrastructure and processes to (i) monitor, report, and verify emissions, (ii) track, auction and transfer emission allowances, and (iii) manage and transparently ensure compliance of installations. It has raised awareness of the cost of carbon emissions and the value of investments aimed at emissions reductions.

But despite these achievements, the system is facing challenges, which require structural changes. **However reforms take time, and before structural measures are introduced, the backloading proposal is the only one that would address the current problem of imbalance between supply and demand.**

Backloading is an anticipated and justified intervention in the scheme. The economic crisis has reflected the design flaws of the system, which does not adjust to changes in external circumstances due to a fixed supply. The EU carbon market is the only major commodity market where supply does not reflect the level of demand

The text is a simple legal clarification of the Commission's power to change the timing of auction of allowances. Previous changes to the timing of auctions have already taken place. The EU should have the possibility to temporarily address the over-supply situation by ensuring more auctioned allowances do not enter the market.

Quick Facts: Why the EU ETS is the EU's best climate policy instrument

Business-friendly instrument: The targets and the linear reduction of the total cap provide predictability to businesses

Cost-efficient instrument: The pre-agreed total cap of allowances ensures the achievement of an environmental goal. Within that cap, businesses are given the flexibility to achieve emission reductions at least possible cost

Maintains the EU's internal market: The EU-wide dimension of the EU ETS ensures the same rules apply across all Member States, thereby preventing unnecessary costly adaptations that national measures cause.

Alternatives would be both costly and less efficient: Alternatives such as taxes would be more costly without guaranteeing the achievement of an environmental goal, or command and control regulations would remove any flexibility for businesses

A supportive vote on the backloading proposal represents a vote of confidence in the EU ETS and against the emergence of patchy national measures, which risk undermining the EU's internal market

Why backloading should be supported

- Represents a change in the timing of auctions of allowances and not a change in the total cap (any change in market fundamentals would require a separate review forming part of the discussions on structural measures)
- Procedural matter: the text on the table provides legal-clarification only
- Parliament twice requested the Commission to address the current oversupply of allowances – which is what is now being proposed.
- The backloading proposal would affect auctioned allowances only – no impact for free allowances for sectors at risk of carbon leakage
- Very low and volatile prices are reflecting this imbalance. Failed auctions are also reflecting a problem of proper ETS functioning
- Market fundamentals and design of the ETS are not affected by this proposal – anything more than a one-off change in the timing of auctions during Phase 3 would need to be dealt with as part of the structural reform

Impacts – what would be the consequences of supporting the proposal in the plenary vote?

- Supporting backloading would send a strong political signal that would reinforce confidence in the market and in the EU ETS
- Start of trilogue negotiations with Council, which would allow the debate to move on and for informed discussions to focus on structural reform of the scheme
- Little impact on prices is expected if the proposal is adopted as backloading has already been priced-in by market operators. Conversely a rejection of the proposal would lead to a price collapse, which risks undermining the credibility of the scheme for years and puts into question future viable reform
- With third countries watching the EU and how it will overcome the current challenges, support for a one-off intervention to change the timing of auction of allowances would send a strong political signal both to EU operators but also to third countries developing cap-and-trade systems.



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What is at stake?

Chart 1: EUA spot prices 2011-2013



Source: Data taken from Point Carbon

The prices of EUAs are much lower compared to the 30€/tonne originally foreseen. The imbalance between supply and demand is reflected by these low prices, and the high volatility, which puts in evidence that **the market no longer trades on market fundamentals but on expectations that backloading will take place**, since it was announced in the debate on the Energy Efficiency Directive.

What is at stake without backloading is the risk of seeing a system that is undermined, and which loses its relevance as the main climate instrument. The EU ETS risks being replaced by the emergence of national measures which would be more costly and less effective.

Backloading would buy time to agree on reforms, which would help make the scheme more predictable

Allowing a change in the timing of auction of allowances once between 2013 and 2020 is an important proposal that would ensure the scheme remains the most relevant climate policy instrument of the EU. It would also enable an informed debate to take place on structural measures that could be introduced to address the current imbalance between supply and demand. **It would also ensure that future ad hoc interventions in the system are avoided. Failure to adopt the backloading proposal risks increasing the risk of unforeseen regulatory interventions in the system to deal with problems of oversupply.** Market operators would prefer to see the backloading proposal adopted as a one-off intervention, in order to then focus the debate on long-term considerations. Should backloading not be adopted, we risk seeing an increasing number of national policies emerge that would seriously undermine the EU's internal energy market.

IETA defends a market-based mechanism to reduce emissions in the most cost-effective way

There is no contradiction between supporting a market-based-mechanism to achieve emission reductions, and supporting the backloading proposal. As it currently stands, the text would allow a change in the timing of auction of allowances to take place only once during Phase 3 of the EU ETS. It is therefore an exceptional measure to deal with the current problem of oversupply. It is also closely linked to discussions on future structural reform of the scheme.

One proposal put forward by IETA as part of these debates on long-term considerations, is the concept of introducing a flexible supply mechanism. Such a mechanism would be based on a pre-defined formula, based on the quantity of allowances, above which surplus allowances would enter into a reserve, or conversely be released in times of economic growth. Having an informed debate on structural measures could ensure interventions are not at the discretion of the regulator as soon as economic circumstances change, but are based on a clear, transparent and pre-defined formula, which is clear and transparent and included in the legislation.

Structural reform of the EU ETS, which is dependent on a successful vote on the backloading proposal, is necessary to ensure the scheme's past achievements are maintained and to ensure it continues to deliver emission reductions cost-effectively in the future.

If this opportunity to provide an effective political signal in the ST is lost, the structure, liquidity, and relevance of the EU carbon market will be put at significant risk.

Key market operators will have little choice but to reduce their exposure to the carbon market or leave it altogether.

CONTACT INFORMATION

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