The European Trading Scheme: Overlap with complementary policies

Fabien Roques

13th IEA-IETA-EPRI Annual Workshop on Greenhouse Gas Emission Trading
Putting climate policy into practice
Paris, 11 September 2013

Agenda

- ETS has turned into a residual market that compounds policy and regulatory uncertainty from complementary policies
- Quantifying the effect of complementary policies: EU ETS allowance demand destruction by type
- Research directions for a supply management mechanism dealing with complementary policies

The ETS has turned into a “residual” market

- **Key issue: the supply of allowances (the cap) is fixed in advance, but the demand is modified by any subsequent change in the parameters used to define the baseline.**

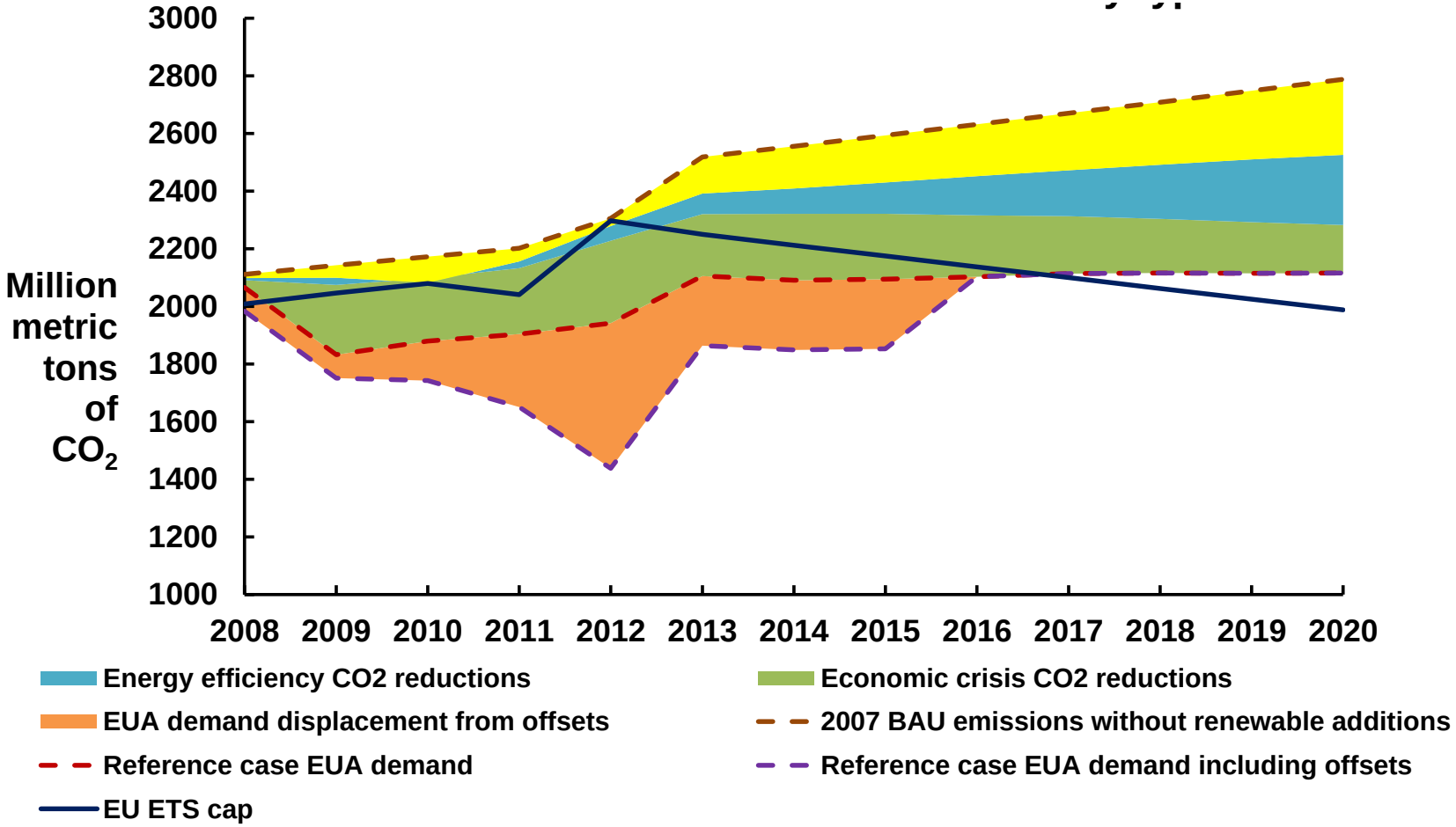
- **The key parameters supporting the baseline projection of emissions are:**
  - Economic growth and structural evolution of the economy
  - Technological progress – e.g. rate of production efficiency improvement by sector
  - Complementary environmental and energy efficiency policies

- **These complementary policies are largely determined by national governments**
  - Policies in support of renewables have been the prime drivers of power sector investments and carbon abatement over the past decade in Europe;
  - Emissions standards for local pollutants under the Large Combustion Plant Directive will drive more than 30 GW of coal and oil plants retirements by 2015 – more to come with the IED…

⇒ **The ETS supply / demand balance depends on changes to and effectiveness of complementary policies.**

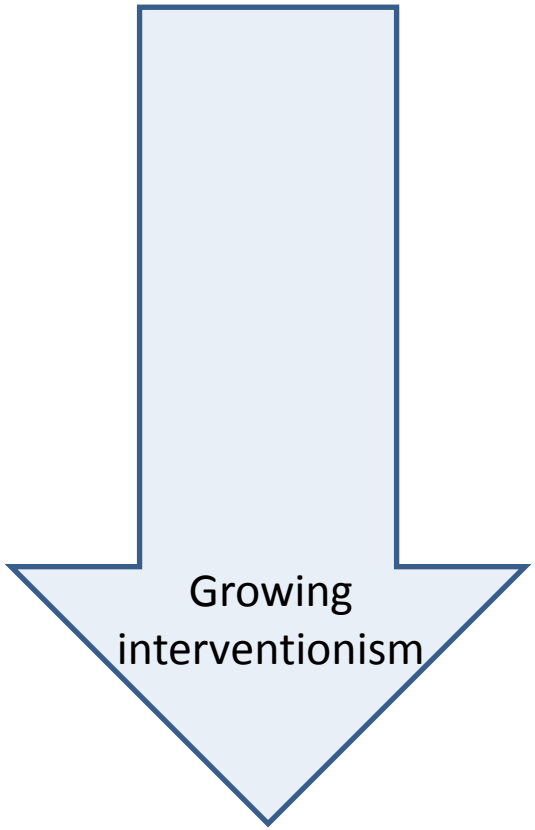
⇒ **The ETS market compounds policy and regulatory uncertainties associated with these complementary policies.**

Quantifying the effect of complementary policies: EU ETS allowance demand destruction by type



Source: IHS CERA

Guiding principles for a supply management mechanism dealing with complimentary policies

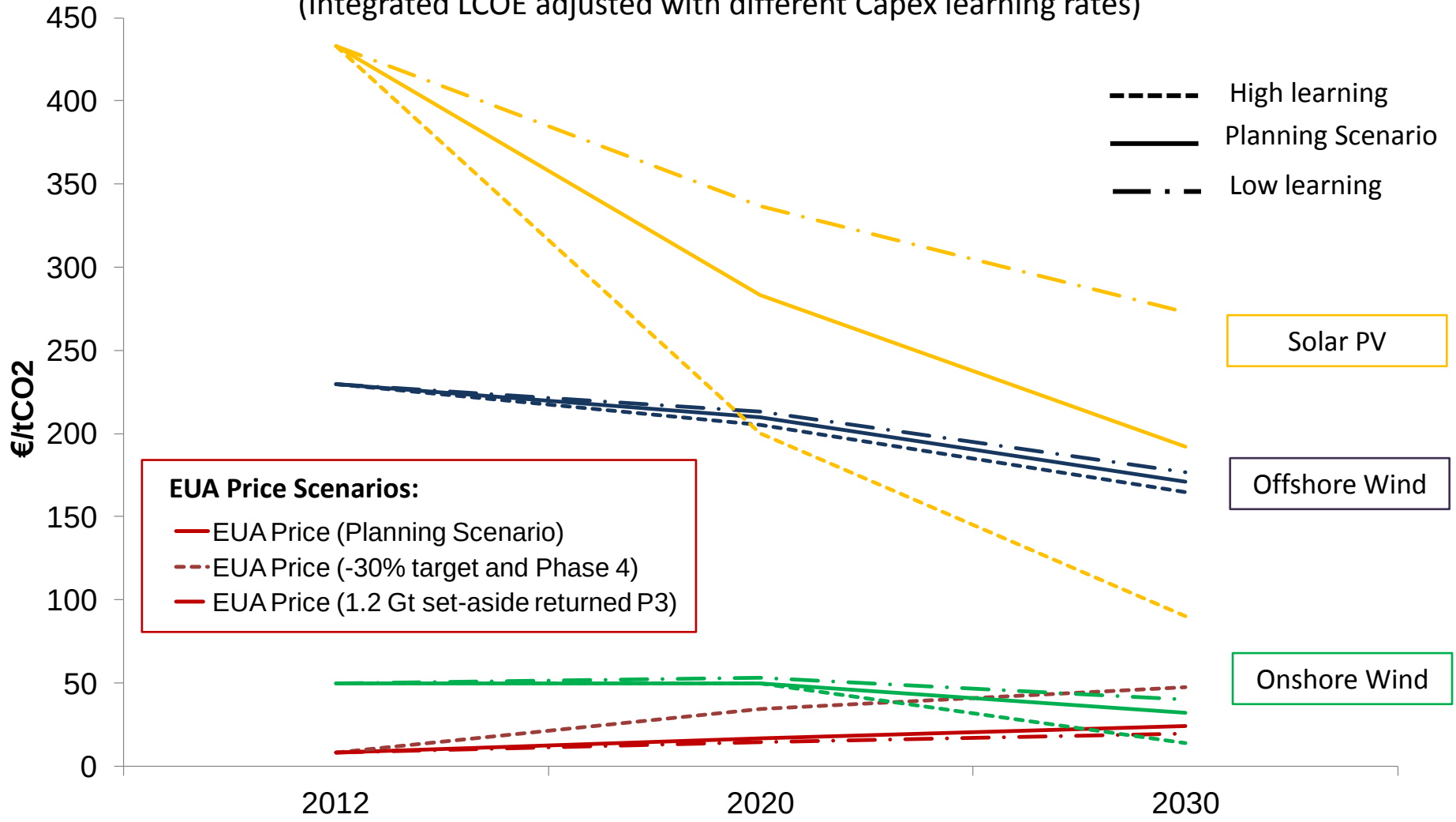


- Linkage of REN support policies by computing implied implicit carbon abattement cost?
- Encourage designs of REN support policies that lead to a predictable /controllable capacity deployment and therefore of carbon abatement (e.g. volume caps)
- Compute as part of *ex ante* impact assessment of national complimentary policies the equivalent carbon abatement compared to the baseline
- *Ex post* adjustment of the ETS cap in a predictable and automatic way to compensate for changes compared to the baseline emission forecast (e.g. mandatory nuclear plant closures, or change in support for renewables).

Carbon Abatement Costs of RES – Implicit and Explicit Carbon Prices

Outlook for EUA Prices and EU27 Integrated Carbon Abatement Cost for Wind

(Integrated LCOE adjusted with different Capex learning rates)



Source: IHS CERA

Conclusion: Key messages

- The EU ETS has turned into a residual market that compounds regulatory and policy uncertainty stemming from complimentary policies.

- Key objective of structural reform of ETS should be to address the overlap with complimentary policies through a predictable and automatic supply management mechanism.

- Two caveats:
  - Mechanism for supply management should not be used to address all ETS issues: e.g. inconsistency with EC climate targets, definition of phase 4, etc.
  - Mechanism for supply management should not be used to address issues with complimentary policies: lack of consistency (stop and go approaches), unsustainable cost burden, etc..

Thank you for your attention

Fabien Roques
froques@compasslexecon.com
+33 1 53 05 36 29 direct
+33 7 88 37 15 01 mobile