Scheme for greenhouse gas emission allowance trading within the Community. EU Emissions Trading System (EU ETS) Directive

2001/0245(COD) - 14/11/2012 - Follow-up document

The Commission presented a report on the **state of the European carbon market in 2012**. The purpose of this first report is to analyse the functioning of the carbon market and to consider whether regulatory action is needed, as foreseen in the EU Emission Trading System (ETS) Directive. It also responds to the call of the European Parliament and the Council made on the Commission in the context of the Energy Efficiency Directive.

The ETS as a central pillar in European climate change policy: the report underlines that the EU ETS has created a functioning market infrastructure and a liquid market producing an EU wide carbon price signal. This has contributed to delivering real greenhouse gas (GHG) emissions reductions in line with the EU targets for 2020.

The implementation of the EU ETS has been accompanied by **a wealth of market and operational experience for governments and companies**. This experience fed into the major revision of the system's operational design, agreed in 2008 for application as of 2013, where the following fundamental changes will apply:

- an EU-wide cap on allowances, as opposed to 27 individual Member State caps, decreasing by 1.74% annually, up to and beyond 2020, providing much greater regulatory predictability and stability;
- auctioning as the default system of allocation in phase 3;
- harmonised rules for free allocation, based on performance benchmarks established prior to phase 3;
- stricter rules on the type of international credits that are allowed for use in the EU ETS.

Mismatch between supply and demand: the effects of the crisis compounded by a number of regulatory provisions related to the transition to Phase 3 have caused serious imbalances to emerge between supply and demand in the short term with potentially negative long-term repercussions.

By the end of 2011, **8 171 million allowances had been put into circulation and 549 million international credits had been used** for compliance, in total adding up to 8 720 million units that were available for compliance over the period 2008-2011. In contrast, verified emissions in the period 2008-2011 were only 7 765 million tonnes CO2-eq. Consequently, **by early 2012, a surplus of 955 million allowances had accumulated**.

If not addressed, these imbalances will profoundly affect the ability of the EU ETS to meet the ETS target in future phases in a cost-effective manner, when significantly more demanding domestic emission objectives than today would have to be reached.

The Commission therefore proposes **action on two fronts**:

1) Revision of the auctioning timetable as a short-term measure: in order to address the rapid increase of supply in the transition to phase 3, the Commission proposes to change the auctioning timetable and invites the Climate Change Committee to give an opinion on the draft amendment to the Auctioning Regulation before the end of the year in order to provide certainty for market participants.

To eliminate any legal uncertainty, Parliament and Council are invited to urgently adopt the proposed "mini-amendment" of the EU ETS Directive that would clarify expressly the relevant provision and would then allow the Commission to swiftly adopt an amendment to the Auctioning Regulation.

2) Options regarding structural measures: the Commission considers that structural measures should be discussed and explored with stakeholders without delay. These discussions can benefit from insights of the 2050 Low Carbon Economy and Energy Roadmaps. Changing the auctioning profile is only a short-term and temporary measure that would allow for a more stable phase 3 and more gradual build-up of the surplus. It would not be a solution that addresses the structural surplus. To do so would require **deploying a structural measure affecting more profoundly and permanently the balance between supply of and demand for allowances**.

To remedy the growing structural imbalance between supply and demand and to gather stakeholders' views, **six non-exhaustive options** for structuralmeasures have been put forward by the Commission:

- ***Option 1:*** increasing the EU GHG target to 30% in 2020;
- ***Option 2:*** withdrawing a number of allowances during phase 3;
- ***Option 3:*** early revision of the linear reduction factor (the total amount of allowances decreases by the linear factor of 1.74% annually, compared to the average annual total quantity for the period 2008-2012);
- ***Option 4:***extension of the scope of the EU ETS to other sectors;
- ***Option 5:*** limit access to international credits;
- ***Option 6:*** discretionary price management mechanisms.

Should the Commission decide to pursue any of these options, **all would require a legislative proposal by the Commission to the co-legislators, accompanied by a full impact assessment** in line with smart regulation principles.

While each option affects supply or demand, some options will require more time to analyse, decide upon and subsequently implement. Options also have different impacts on market certainty in the short term and the interaction with other policies such as renewables and energy efficiency will need to be further analysed.

The Commission welcomes stakeholders' views on structural options and will as the next step shortly launch a formal stakeholder consultation process.