



THE EUROPEAN WIND ENERGY ASSOCIATION

## EWEA Position on the Market Stability Reserve for the EU Emissions Trading System

- The Market Stability Reserve is a good first step to make the ETS resilient to future events that disturb the supply and demand balance;
- An early implementation of the Market Stability Reserve is required to reach a more significant carbon price before 2020, thereby providing a reliable and continuous price signal to investors;
- As the Market Stability Reserve is unable to reduce the surplus in the short-term, additional measures to reduce the surplus in the short-term are required to create scarcity in the market;
- Returning allowances from the reserve back to the carbon market should be strictly limited to the minimum necessary to retain liquidity in the market.

### Introduction

The European Wind Energy Association welcomes the legislative proposal to establish a Market Stability Reserve for the EU Emissions Trading System as a structural measure to address the imbalance between demand and supply in the ETS. A properly functioning Market Stability Reserve can make the ETS more resilient to events that disturb the supply-demand balance, including macro-economic shocks and a large inflow of international credits. The mechanism is a first step to create scarcity in the carbon market while at the same time ensuring predictability.

An ETS that would continue to operate for more than a decade with a surplus of around 2 billion allowances or more is not able to create a high and robust carbon price that would influence investment decisions. It is therefore important to create scarcity in the EU carbon market before the start of phase 4 in 2021. Therefore, EWEA is of the opinion that the Market Stability Reserve as proposed by the Commission requires improvements and needs to be implemented earlier than 2021. Moreover, with an expected oversupply of 2.6 billion allowances by 2020, EWEA strongly believes that the Market Stability Reserve needs to be complemented with additional measures to reduce the surplus of allowances.

### Early implementation

EWEA calls on European policy makers to support an early implementation of the Market Stability Reserve.<sup>1</sup> By advancing the implementation of the mechanism to 2016, the carbon price can reach a more significant level and stabilise before 2020. This is important for two reasons:

1. If a high carbon price is realized only after 2021, the ETS will have no impact on investment decisions in the power sector before then. The further the EU pushes a higher carbon price into the future, the further it delays a transition to a renewable power sector. In that scenario, polluting and inflexible power assets such as coal power plants will continue to be built and operated until after 2020, the EU could lose its technology leadership in renewables and become locked into high carbon assets.
2. An early implementation of the Market Stability Reserve is required to ensure a smooth development of prices and to synchronise the ETS with the tightening of the EU's overall carbon-reduction target for 2030. The reintroduction of the backloaded credits is likely to cause a collapse in the price in 2019/2020. This volatility should be prevented by reducing the surplus from 2017 onwards, thereby providing a reliable and continuous price signal that is in line with the EU's emission reduction objectives for 2030.

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<sup>1</sup> A similar call was made by the Environment ministers of the UK, Germany, Sweden and Denmark at the March Environment Council.

### **More significant interventions**

EWEA agrees with the Commission that a set of clear and pre-defined rules should provide the market with predictability concerning any changes to the supply of allowances. However, in order to reduce a surplus of allowances and restore the market balance faster, EWEA calls for more ambitious triggers that create more significant adjustments. For example, with the Commission's proposal for taking 12% of all allowances in circulation and with a surplus of 2.000 Mt, only 240 Mt. is taken into the reserve. As the Market Stability Reserve only takes small amounts of allowances out of an oversupplied carbon market, EWEA calls for a more ambitious mechanism and considerably higher percentages than 12%.

### **Pre-2021 retirement of surplus allowances**

EWEA believes it is key to create scarcity in the EU carbon market before the start of phase 4 in 2021. With an oversupply of 2.6 billion allowances in 2021- worth one year of ETS emissions - a post 2020 linear reduction adjustment will not start reducing the surplus significantly and increase carbon prices before 2025-2027. Backloading 900 million allowances will provide some short-term relief, but an estimated oversupply of 2.6 billion allowances will be back in 2020. While the Market Stability Reserve is needed to increase the resilience of the ETS, it will not be sufficient to reduce the surplus swiftly and create scarcity in the market in the short term. EWEA strongly believes that creating scarcity in the carbon market will only be possible with a mix of adjustments. The Market Stability Reserve is part of this mix, but is not enough. Therefore, EWEA deems additional measures, such as a permanent cancellation of surplus allowances or transferring a significant amount of allowances to the reserve before the start of phase 4, as crucial.

### **Limited release of allowances**

EWEA opposes the current provisions for returning allowances from the reserve to the carbon market as they go against the very idea of creating scarcity in the carbon market. The thresholds for upward adjustments as currently set by the Commission are too easily triggered and thereby are unlikely to fundamentally change traders' behaviour. Moreover, the ETS Directive already allows the Commission to increase auctions of allowances in the event of excessive price fluctuations. EWEA believes that returning allowances from the reserve back to the carbon market should be strictly limited to the minimum necessary to retain liquidity in the market. It therefore calls for additional barriers for a return of allowances, for example through a combination of more stringent volume and price thresholds.

### **Conclusion**

The ETS can only drive investments in new wind power capacity when it puts a significant price on the carbon externalities of fossil fuels. Scarcity in the ETS is required to make it effective and to provide a level playing field to renewable technologies by making coal and gas assets pay for the real costs of their GHG emissions. Therefore, EWEA calls on EU decision makers to agree on an early implemented ETS Market Stability Reserve in combination with additional measures to reduce the surplus before 2021. Anything else would be too little, too late.

### **For more information, please contact:**

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