Recent developments in the EU ETS – the world's largest operational carbon market

DG Climate Action
European Commission

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The EU ETS: basic facts and figures

Performance and recent developments

Reform of the EU ETS for the next decade

EU ETS: key facts and figures

ETS GHG reductions:
-21% by 2020
-43% by 2030

~ 40% of EU's GHG emissions

Phase 1: 2005-2007
Phase 2: 2008-2012
Phase 3: 2013-2020
Phase 4: 2021-2030
by default continuing in 10-year trading periods thereafter

€14 billion of auctioning revenue in 2018

CO_2, N_2O, PFCs

Annual cap for emissions (1.89 bn in 2018)

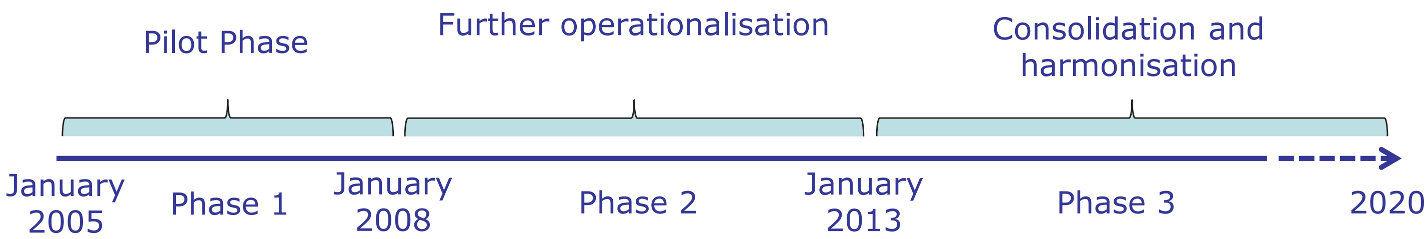
€49 billion value of annual trading

57% auctioning

Electricity sector: 100% auctioning in principle, optional free allocation for the modernization of the electricity sector in certain Member States

Manufacturing sector: up to 100% of benchmark for sectors at risk of carbon leakage, other decreasing from 80% in 2013 to 30% by 2020

EU ETS Timeline



Phase 4: 2021-2030

- rules established by the revised ETS Directive (March 2018)

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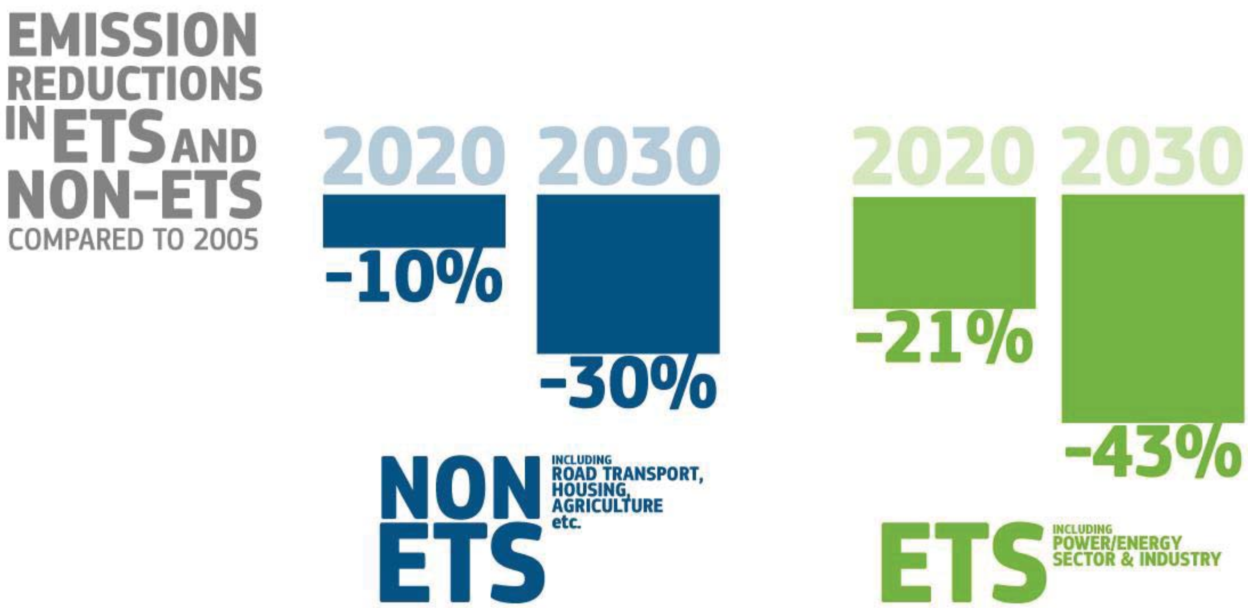
Domestic reductions in emissions from ETS and non-ETS sectors



The EU ETS successfully supports the EU's climate targets

2020 targets

- The EU **is on track to surpass its 2020 target of -20% GHG** emissions from 1990 levels
- A **mature and very liquid carbon market** has developed over the last decade
- ETS-covered installation **emissions fell by 8%** (by 14% in the power sector and 0.2% in industry) since the start of phase 3 in 2013
- At **least 50% of the revenues** from auctioning should be **spent by Member States on climate and energy** purposes (**~ 80%** spent on such purposes in 2013-2017)

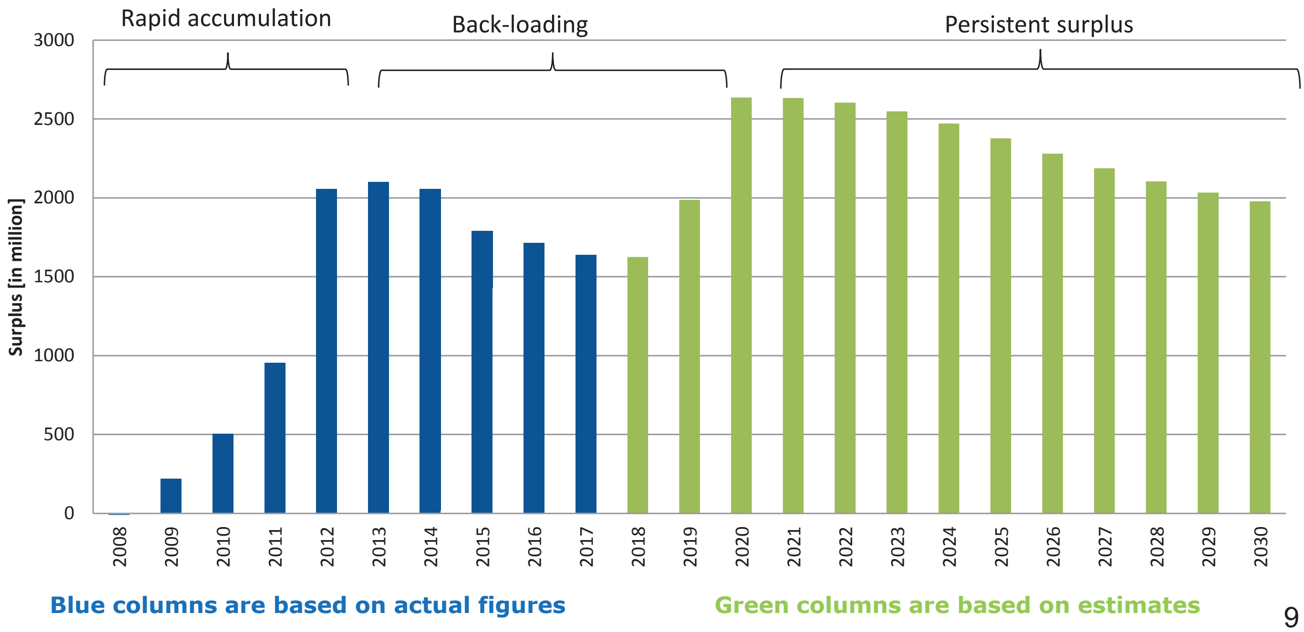
2030 targets

- To enable the ETS to reach the EU's 2030 GHG reduction targets, the EU revised its legislation to strengthen the system for phase 4 (2021- 2030)
- The revised ETS Directive **entered into force in April 2018**

… however there have been challenges

- While the ETS has successfully supported the EU's climate targets and a liquid market has developed, a weakened price signal has been its main challenge over the years
- Large imbalance between the supply and demand of allowances at the start of phase 3 => **a 2.1 billion surplus** of allowances by 2013
- Causes: **deep economic recession, large input of international credits** to offset emissions in the EU

Double-dip recession and the start of the structural reform debate



Effective measures to strengthen the market have been agreed and implemented in phase 3

Stability measures taken for the short and long term:

- **Short-term**: Back-loading of auction volumes (2014-2016)

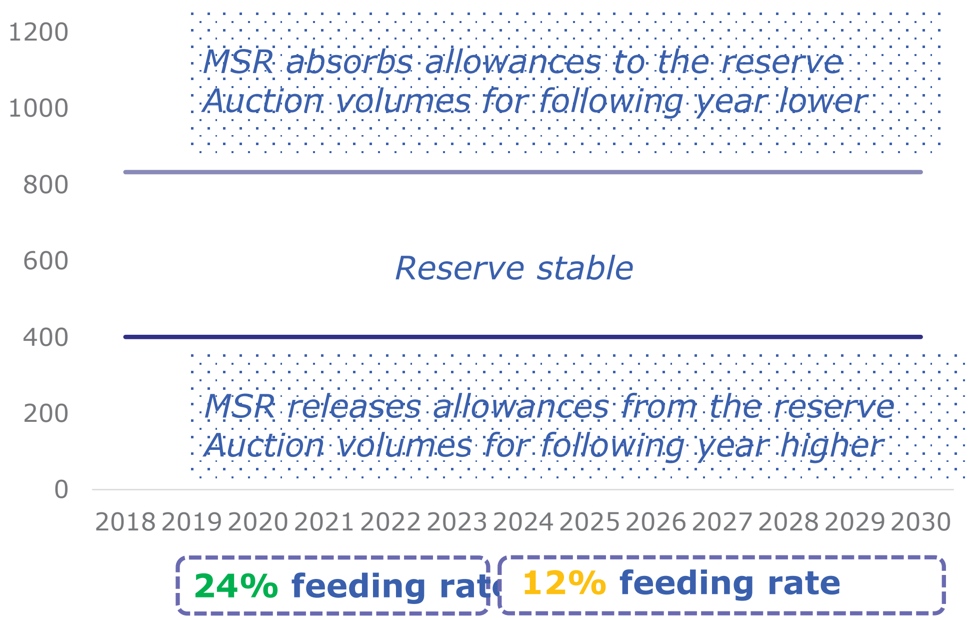
- **Long-term**: **Market Stability Reserve** (established in 2015, operational as of January 2019)

⇨ ***In 2017, surplus at 1.65 billion allowances, the lowest level since the start of phase 3***

Evolution of the carbon price

Source: ICE

EU ETS Market Stability Reserve



How does the Market Stability Reserve work?

- The reserve is **volume-based**: the size of the surplus of allowances determines whether allowances are added to or taken out of the market
- The reserve is **rule-based**: objective threshold automatically trigger a reserve-feed or release. No room for discretion based on political considerations
- The reserve is an integrated element of the EU ETS: no new actors or data gathering exercise is necessary
- First review in 2021, after that every 5 years

The need for market stability instruments in carbon markets

- Most ETSs around the world have a market stability mechanism in place
- In North-American and Asian markets these mechanisms are often price-based (e.g. auction reserve price, carbon price floor)
- The Market Stability Reserve is the EU's stability instrument and our experience is positive: it delivers the envisaged resilience and strengthened carbon price signal
- Stability instruments require close monitoring to ensure satisfactory performance in real-life markets

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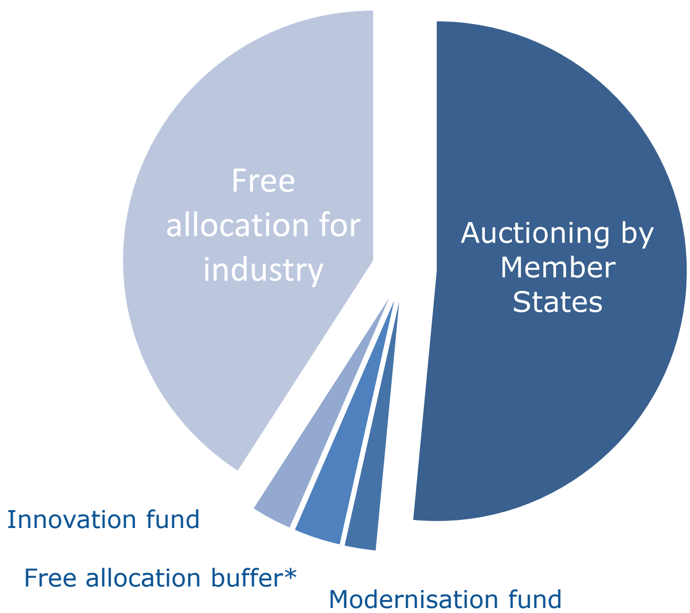
Structure of the EU ETS in Phase 4

- A **thorough revision of the EU ETS** was carried out between 2015 and 2017, with a view to lay down the framework for 'Phase 4' (2021-2030)
- The revision was concluded in November 2017 and new legislation **entered into force in April 2018**.
- The focus is now on implementing the new rules



** Allowances dedicated for auctioning that may be converted*

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Key issues in the political debate

EU ETS strengthening

Free allocation and carbon leakage

Low-carbon funds

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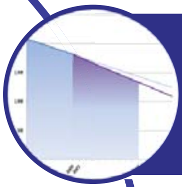
Free allocation and carbon leakage

- **Continued free allocation to industry as safeguard against the risk of carbon leakage**
- **Regularly updated benchmarks to preserve ambition level and reflect technological progress**
- **Closer alignment with production: allocations adjusted due to changes in production (> 15%)**
- **Possibility for a limited conversion of auction volume into free allocation ('buffer')**
- **Indirect cost compensation continued with enhanced reporting and transparency**

Strengthening of the EU ETS

Aim: strengthen the carbon price signal and effectively address surplus on EU carbon market



Steeper declining cap

Annual reduction 2013-2020: -1.74% (≈38 mt CO_2)

Annual reduction from 2021: -2.2% (≈48 mt CO_2)

Effectively addressing the surplus on the EU carbon market

Double the feeding rate of the Market Stability Reserve

Limit the validity of allowances in the reserve as of 2023

Review clause in the context of global stock-takes under the Paris Agreement

Low-carbon funds

Significant financial support for innovation and modernisation of energy systems available through the EU ETS

Innovation Fund

- At least 450 million allowances to support renewables and carbon capture and storage (CCS) as well as breakthrough technologies in industry in all Member States

Modernisation Fund

- At least 310 million allowances to support modernisation of energy systems and just transition in 10 lower income EU Member States
- No support to energy generation from solid fossil fuels

Conclusions

- **The EU ETS is the world's largest carbon market, in operation uninterruptedly since 2005**
- **The market is liquid and has realized substantial emission reductions**
- **Recent reforms have strengthened the EU ETS and made it more resilient to shocks**
- **Implementation work is ongoing to prepare for the Fourth Trading Period (2021-2030):**
  - Free allocation rules, carbon leakage, benchmarks
  - Low-carbon funding mechanisms

Thank you!

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