

Berlin, 18.3.2013

Open letter on European emissions trading

Dear Chancellor Dr. Merkel,

Numerous German economists and social scientists are asking the Federal Government to dedicate more attention to the European emissions trading scheme. It is of fundamental economic importance to European climate policy and the German energy transition. In its current form, the European emission trading scheme is not able to fulfill its guidance and steering functions. Urgent action is needed:

Structural reforms of the emissions trading scheme are necessary to create long-term scarcity of allowances and thus an efficient framework for climate-friendly investments. This requires a clear timetable to design and implement the reforms.

Furthermore, as proposed by the EU Commission, it is necessary to postpone the auction of 0.9 billion allowances (backloading) in order to restore confidence in emissions trading and to gain time for the long-term, structural reform. Thus, the emissions trading for enterprises and international climate cooperation remain relevant.

Due to the urgency of a clear German position in Europe for a credible climate policy, we will address this letter also to the public. We are available for discussions.

Yours sincerely,

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Offener Brief zum europäischen Emissionshandel

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Strengthening the European emissions trading scheme

The emissions trading scheme has been implemented to limit the emissions of harmful greenhouse gases and create incentives for investment in low-emission technologies. The certificate price reflects not only the effectiveness and efficiency of emissions trading in achieving the emissions targets, but is also an important factor for business decisions, as it translates the longer-term emission reduction targets into a price relevant for companies. This concerns both the risks of investing in CO₂-intensive technologies and the benefits of innovations and investments in low-CO₂ strategies.

Current situation

In recent years, the price of CO₂ allowances decreased significantly and remains at a long-term low. This trend has been reinforced by the fact that a large surplus of emissions certificates has accumulated. The reasons are mainly a large influx of international emissions credits and unexpectedly high emissions reductions due to the economic crisis.

The influx of international emissions credits is greater than expected, as projects to avoid CO₂ emissions have been implemented much faster and more numerous than expected and demand for credits in other regions of the world is significantly lower than expected. By 2015, an additional supply of about 1.7 billion allowances could be available for emissions trading.

As a result of the economic crisis, about 130 million tons of CO₂ less were emitted annually as certificates were awarded since 2008. This resulted in a surplus of about 650 million allowances by the end of 2012. Moreover, 420 million allowances are auctioned at an early stage in the third trading period with- in Early Auctions and NER300 Reserve and contribute to an additional "front loading".

This surplus has led to a sharp drop in CO₂ prices. At the beginning of the third trading period, the price has fallen to less than five Euros. The economic crisis and influx of international certificates have further aggravating the situation on the European certificates market. Beyond these temporary effects, the low CO₂ price reflects misjudgments regarding the compatibility of the selected path towards emissions reduction with an emissions reduction target of 20% for 2020.

Urgent action needed

In political discussions, European climate policy is often reduced to an emission reduction target of 20% by 2020. This goal is expected to be reached with the current rules of emissions trading. The consistently low prices, however, show that the possibilities to avoid CO₂ emissions have been significantly underestimated. Therefore the trajectory to achieving the long-term emissions reduction target of 80 to 95% can and should be adjusted. To efficiently achieve the long-term goals, already today, investment decisions must consider climate-friendly and energy efficient technologies. Therefore, companies need clear and credible frameworks. The faster a reform of the emissions trading scheme is initiated, the earlier these frameworks are created.

If the necessary reforms are not carried out, the emissions price will remain on a low level in the long run. Member states would then be inclined to take alternative measures. For example, the UK has already introduced an additional CO₂ tax to ensure a minimum price that companies have to pay in total for CO₂ emissions. Such specific measures might, however, undermine the importance and effectiveness of emissions trading. Furthermore, additional uncertainty for businesses about the investment conditions can arise.

Worldwide, the falling price of CO₂ is monitored carefully. If the EU emissions trading scheme is weakened as a key instrument of European climate policy and politicians do not respond, Europe is in danger of losing its credibility in the international cooperation on climate protection. Currently, emissions trading schemes are introduced in several provinces in China, South Korea, Australia, New Zealand and California. Here, the EU emissions trading scheme is an important model, which, however, loses influence through a long-term, low CO₂ price.

International competitiveness

As the industrial sector continues to receive free allowances, the companies are not affected by a higher CO₂ price. For energy-intensive processes, the new EU aid rules further include a compensation for CO₂ price-related increases in electricity prices.

Necessary steps

Structural reforms of the EU emissions trading scheme are needed so that the CO₂ price sends the right signals in the future and thus creates better frameworks for climate-friendly investments. For the decision and implementation of such a reform, a clear timeline is necessary. However, it will take a few years until a structural reform has an impact on the certificate surplus. Therefore, an additional short-term measure is necessary, which, already today, sends the right signals.

The delay of the auction of 0.9 billion allowances (backloading), as proposed by the EU Commission, is urgently needed in order to create sufficient scarcity in the short term so that the European emissions trading scheme remains relevant for enterprises and international climate cooperation. However, since the additional amounts to be auctioned increase the surplus again at the end of the trading period, backloading works only as a supplement to a structural reform.