



EUROPEAN PARLIAMENT

2014 - 2019

Committee on the Environment, Public Health and Food Safety

2014/0011(COD)

13.11.2014

*****I**

DRAFT REPORT

on the proposal for a decision of the European Parliament and of the Council
Establishment and operation of a market stability reserve for the Union
greenhouse gas emission trading scheme and amendment of Directive
2003/87/EC
(COM(2014)0020 – C8-0016/2014 – 2014/0011(COD))

Committee on the Environment, Public Health and Food Safety

Rapporteur: Ivo Belet

Symbols for procedures

- * Consultation procedure
- *** Consent procedure
- ***I Ordinary legislative procedure (first reading)
- ***II Ordinary legislative procedure (second reading)
- ***III Ordinary legislative procedure (third reading)

(The type of procedure depends on the legal basis proposed by the draft act.)

Amendments to a draft act

Amendments by Parliament set out in two columns

Deletions are indicated in ***bold italics*** in the left-hand column. Replacements are indicated in ***bold italics*** in both columns. New text is indicated in ***bold italics*** in the right-hand column.

The first and second lines of the header of each amendment identify the relevant part of the draft act under consideration. If an amendment pertains to an existing act that the draft act is seeking to amend, the amendment heading includes a third line identifying the existing act and a fourth line identifying the provision in that act that Parliament wishes to amend.

Amendments by Parliament in the form of a consolidated text

New text is highlighted in ***bold italics***. Deletions are indicated using either the ***■*** symbol or strikeout. Replacements are indicated by highlighting the new text in ***bold italics*** and by deleting or striking out the text that has been replaced.

By way of exception, purely technical changes made by the drafting departments in preparing the final text are not highlighted.

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DRAFT EUROPEAN PARLIAMENT LEGISLATIVE RESOLUTION

**on the proposal for a decision of the European Parliament and of the Council
Establishment and operation of a market stability reserve for the Union greenhouse gas
emission trading scheme and amendment of Directive 2003/87/EC
(COM(2014)0020 – C8-0016/2014 – 2014/0011(COD))**

(Ordinary legislative procedure: first reading)

The European Parliament,

- having regard to the Commission proposal to Parliament and the Council (COM 2014)0020),
 - having regard to Article 294(2) and Article 192(1) of the Treaty on the Functioning of the European Union, pursuant to which the Commission submitted the proposal to Parliament (C8-0016/2014),
 - having regard to Article 294(3) of the Treaty on the Functioning of the European Union,
 - having regard to the opinion of the European Economic and Social Committee of 4 June 2014,
 - having regard to the report of the Committee on the Environment, Public Health and Food Safety and the opinion of the Committee on Industry, Research and Energy (A8-0000/2014),
 - having regard to Rule 59 of its Rules of Procedure,
1. Adopts its position at first reading hereinafter set out;
 2. Calls on the Commission to refer the matter to Parliament again if it intends to amend its proposal substantially or replace it with another text;
 3. Instructs its President to forward its position to the Council, the Commission and the national parliaments.

Amendment 1

Proposal for a decision

Recital – (-1a) (new)

Text proposed by the Commission

Amendment

(-1a) The European Council Conclusions of 23 and 24 October 2014 on the 2030 Climate and Energy Policy Framework state that a well-functioning, reformed Emissions Trading System (ETS) with an instrument to stabilise the market will be the main European instrument to achieve the EU's greenhouse gas emissions reduction target.

Or. en

Amendment 2

Proposal for a decision

Recital 2

Text proposed by the Commission

Amendment

(2) The report from the Commission to the European Parliament and the Council on the state of the European carbon market in 2102¹ identified the need for measures in order to tackle structural supply-demand imbalances. The impact assessment on the 2030 climate and energy policy framework² indicates that this imbalance is expected to continue, and would not be sufficiently addressed by adapting the linear trajectory to a more stringent target

(2) The report from the Commission to the European Parliament and the Council on the state of the European carbon market in 2102³ identified the need for measures in order to tackle structural supply-demand imbalances. The impact assessment on the 2030 climate and energy policy framework⁴ indicates that this imbalance is expected to continue, and would not be sufficiently addressed by adapting the linear trajectory to a more stringent target

¹ COM(2012)652 final.

² Insert reference.

³ COM(2012)652 final.

⁴ Insert reference.

within this framework. A change in the linear factor only changes gradually the cap. Accordingly, the surplus would also only gradually decline, such that the market would have to continue to operate for more than a decade with a surplus of around 2 billion allowances or more. In order to address this problem and to make the European Emission Trading System more resilient to imbalances, a market stability reserve should be established. To ensure regulatory certainty as regards auction supply in phase 3 and allow for some lead-time adjusting to the introduction of the design change, the market stability reserve should be established as of phase 4 starting in 2021. In order to preserve a maximum degree of predictability, clear rules should be set for placing allowances into the reserve and releasing them from the reserve. Where the conditions are met, beginning in 2021, allowances corresponding to 12% of the number of allowances in circulation in year $x-2$ should be put into the reserve. A corresponding number of allowances should be released from the reserve when the total number of allowances in circulation is lower than 400 million.

within this framework. A change in the linear factor only changes gradually the cap. Accordingly, the surplus would also only gradually decline, such that the market would have to continue to operate for more than a decade with a surplus of around 2 billion allowances or more. In order to address this problem and to make the European Emission Trading System more resilient to *supply-demand* imbalances, *and thus to correct a design error in the system, so as to enable the ETS to function as an orderly market with stable and competitive prices, reflecting the true value of allowances*, a market stability reserve should be established. *This market stability reserve will also ensure synergy with other climate policies such as those on renewable energy and energy efficiency.* To ensure regulatory certainty as regards auction supply in phase 3 and allow for some lead-time adjusting to the introduction of the design change, the market stability reserve should be established as of phase 4 starting in 2021. In order to preserve a maximum degree of predictability, clear rules should be set for placing allowances into the reserve and releasing them from the reserve. Where the conditions are met, beginning in 2021, allowances corresponding to 12% of the number of allowances in circulation in year $x-1$ should be put into the reserve. A corresponding number of allowances should be released from the reserve when the total number of allowances in circulation is lower than 400 million.

Or. en

Amendment 3

Proposal for a decision Recital 3a (new)

Text proposed by the Commission

Amendment

(3a) In the light of the ETS reform that is envisaged by the introduction of the market stability reserve (MSR), and in particular, the reduction in the surplus of allowances, the auctioning of the allowances back-loaded to 2019 and 2020 in accordance with Commission Regulation (EU) No 176/2014,¹ would be counterproductive. Accordingly, the back-loaded allowances should be withheld and placed in the market stability reserve when it becomes operational.

¹ *Commission Regulation (EU) No 176/2014 of 25 February 2014 amending Regulation (EU) No 1031/2010 in particular to determine the volumes of greenhouse gas emission allowances to be auctioned in 2013-2020; OJ L 56, 26.2.2014, p.11.*

Or. en

Amendment 4

**Proposal for a decision
Recital 3b (new)**

Text proposed by the Commission

Amendment

(3b) The European Council Conclusions of 23 and 24 October 2014 on the 2030 Climate and Energy Policy Framework give clear guidance on the continuation of free allocations and carbon leakage provisions after 2020, stating that "the most efficient installations in the sectors at risk of losing international competitiveness should not face undue carbon costs leading to carbon leakage" and that "future allocations will ensure better alignment with changing production levels in different sectors" and

"at the same time, incentives for industry to innovate will be fully preserved and administrative complexity will not be increased." It is of paramount importance that the Commission reviews the functioning of Directive 2003/87/EC, in this respect.

Or. en

Amendment 5

Proposal for a decision Recital 4

Text proposed by the Commission

(4) The Commission should review the functioning of the market stability reserve in relation to its operation in the light of experience of its application. The review of the functioning of the market stability reserve should in particular consider whether the rules on placing allowances in the reserve are appropriate with regard to the aim pursued to tackle structural supply-demand imbalances.

Amendment

(4) The Commission should review the functioning of the market stability reserve in relation to its operation in the light of experience of its application. The review of the functioning of the market stability reserve should in particular consider whether the rules on placing *and releasing* allowances in *and from* the reserve are appropriate with regard to the aim pursued to tackle structural supply-demand imbalances. *To this end, a careful assesement of the impact of important demand drivers and of other environmental policies, and the monitoring of the ability of the market stability reserve to react to those, will be necessary in the context of the annual carbon market report.*

Or. en

Amendment 6

Proposal for a decision Article 1 – paragraph 1a (new)

Text proposed by the Commission

Amendment

(1a) The Commission shall ensure that the allowances back-loaded in accordance with Commission Regulation 176/2014 are placed in the market stability reserve as of 1 January 2021.

Or. en

Justification

Without altering the date of full operation of the market stability reserve, the purpose of this amendment, together with amendment 9, is to withhold the backloaded allowances in years 2019 and 2020 and place them directly into the reserve.

Amendment 7

Proposal for a decision Article 1 – paragraph 3

Text proposed by the Commission

Amendment

3. In each year beginning in 2021, a number of allowances equal to 12% of the total number of allowances in circulation in year x-2, as published in year x-1, shall be placed in the reserve, unless this number of allowances to be placed in the reserve would be less than 100 million.

3. In each year beginning in 2021, a number of allowances equal to 12% of the total number of allowances in circulation in year x-1, as published in May year x, shall be placed in the reserve, unless this number of allowances to be placed in the reserve would be less than 100 million.

Or. en

Justification

The two- year time lag will result in a rather slow response time, and should therefore be reduced to one year.

Amendment 8

Proposal for a decision Article 1 – paragraph 5a (new)

Text proposed by the Commission

Amendment

5(a) In any year, if the total number of allowances in the reserve in year x-1 is higher than 400 million, 30 million allowances shall be set aside and made available to support breakthrough innovation in low-carbon industrial technologies and processes. The selection and support criteria of Decision 2010/670/EU shall apply.

Or. en

Amendment 9

Proposal for a decision

Article 2 – paragraph 1 – point 3a (new)

Directive 2003/87/EC

Article 10 – paragraph 4 – subparagraph 1a (new)

Text proposed by the Commission

Amendment

3a. In Article 10, paragraph 4 the following subparagraph shall be inserted after the first subparagraph:

"Where the Commission has made such an adaptation, the allowances referred to in the first subparagraph shall be placed in the reserve referred to in Article 1(1) of Decision EU/XX/2015 2015 [insert number of this Decision when known], which shall become operational on 1 January 2021."

Or. en

Justification

Without altering the date of full operation of the market stability reserve, the purpose of this amendment, together with amendment 6, is to withhold the back-loaded allowances in years 2019 and 2020 and place them directly into the reserve.

Amendment 10

Proposal for a decision Article 2 a (new)

Text proposed by the Commission

Amendment

The following Article 2a (new) is inserted:

"Article 2 a (new)

Review of Directive 2003/87/EC

Within six months from the entry into force of this Decision [insert number of this Decision when known], the Commission shall review Directive 2003/87/EC, taking into account the conclusions of the European Council of 23 and 24 October 2014, in particular with regard to carbon leakage provisions and the continuation of free allocations, better reflecting changing production levels and incentivising the most efficient performance taking into account direct and indirect carbon costs, and if appropriate shall, in accordance with the ordinary legislative procedure, submit a proposal to the European Parliament and the Council."

Or. en

Amendment 11

Proposal for a decision Article 3

Text proposed by the Commission

Amendment

By 31 December 2026, the Commission shall on the basis of an analysis of the orderly functioning of the European carbon market review the market stability reserve and submit a proposal, where appropriate,

Within three years after the date of establishment of the market stability reserve, the Commission shall on the basis of an analysis of the orderly functioning of the European carbon market review the

to the European Parliament and to the Council. The review shall *pay particular attention to the percentage figure for the determination of the number of allowances to be placed into the reserve according to Article 1(3) and the numerical value of the threshold for the total number of allowances in circulation set by Article 1(4).*

market stability reserve and submit a proposal, where appropriate, to the European Parliament and to the Council. The review shall *include a detailed assessment of the impact of important demand drivers, including other environmental policies, and the monitoring of the impact of the market stability reserve in the context of the annual carbon market report. The review will pay particular attention to the extent to which the provisions in Article 1(3) and Article 1(4) of this Decision are appropriate with regard to the objective of tackling structural supply-demand imbalances. Where appropriate the Commission shall submit a proposal to the European Parliament and to the Council.*

Or. en

EXPLANATORY STATEMENT

Introduction

“A well-functioning, reformed Emission Trading System (ETS) with an instrument to stabilise the market in line with the Commission proposal will be the main European instrument to achieve this [greenhouse gas reduction] target.” European Council Conclusions, 23 October 2014.

On 22 January 2014, the Commission presented a proposal for a market stability reserve, together with a communication on the policy framework for climate and energy in the period from 2020 to 2030.

The aim of the Commission proposal is to make structural changes to the emissions trading system (ETS) in order to address the surplus of emission allowances, currently estimated at over 2 billion (which has been building up in the system since 2009 (during phase 2) and to rectify its shortcomings so that it achieves its purpose: “to promote reductions of greenhouse gas emissions in a cost-effective and economically efficient manner” (Article 1 of the ETS directive).

While the 2020 target for greenhouse gas emissions reductions is guaranteed by the overall emissions cap, the surplus of allowances is undermining the long-term cost-effectiveness of the scheme. The surplus therefore undermines the orderly functioning of the carbon market and crucially the carbon price, thus reducing incentives to invest in low carbon technologies. If the situation is not addressed, the cost of reducing GHG emission reductions will in future increase significantly.

The Commission proposal thus responds to calls made by the European Parliament "to adopt measures to correct the failings of the ETS and to allow it to function as originally envisaged"¹.

The market stability reserve (MSR) proposal would as such correct a structural shortcoming in the original construction of the ETS, which did not allow for flexibility in the supply of allowances to cater for changes to market conditions or to protect the ETS against unexpected and sudden demand shocks. As indicated in the Commission staff working document accompanying the proposal, the current imbalance arose because of a mismatch between the

¹ European Parliament resolution of 15 March 2012 on a Roadmap for moving to a competitive low carbon economy in 2050, P7_TA(2012)0086.

supply of emission allowances, which is fixed due to the nature of the EU ETS as a cap-and-trade system (and was decided in more favourable economic circumstances), and demand for them, which is flexible and impacted by economic cycles, fossil fuel prices, climate policies on renewable energy and energy efficiency and other drivers.

In light of this, your Rapporteur supports the Commission proposal to introduce a market stability reserve (MSR), on the basis that it is a structural reform which will introduce into the ETS Directive itself, rules which will govern fluctuations in the market and in particular the supply of allowances. It will avoid short-term discretionary interventions in the market and provide medium to long-term predictability and stability to industry.

Your Rapporteur believes that such a reform is necessary to maintain the ETS as the cornerstone of the EU's CO₂ reduction policy. Not doing so would take the ETS to the brink of collapse (without an investment incentive of the carbon price). This would lead to national initiatives taking over as the major policy instruments for CO₂ emissions reductions and thus a "renationalisation" of climate policy. It would cause fragmentation in the internal market, a complex patchwork of EU regulation and even a risk of carbon leakage within the EU.

Back-loaded allowances

Last year Parliament and Council amended the ETS Directive to enable the Commission to postpone the auctioning of 900 million emission allowances until the years 2019 and 2020. In February 2014, the Commission then adopted a Regulation to adapt the auctioning timetable for the third trading period of the ETS so that 300 and 600 million allowances were "back-loaded" to years 2019 and 2020 respectively.

As indicated above, the aim of this proposed reform of the ETS is to provide predictability and stability to the market. It would therefore be illogical if the back-loaded allowances were to come back onto the market in years 2019 and 2020 only to have them placed in the reserve again over time during the fourth trading period. This would cause unnecessary market distortion and would be inconsistent with the overall aim of reducing the surplus.

Also, as several stakeholders have pointed to the value of the back-loaded allowances in the light of improved carbon leakage provisions after 2020, such as ideas with regard to a more dynamic allocation (cfr infra), it seems unwise to re-inject these allowances onto the market.

Without altering the start date of operation of the market stability reserve, your rapporteur proposes to put the back-loaded allowances directly into the reserve.

Carbon leakage

While this proposal addresses problems regarding the oversupply of allowances for auctioning, it does not tackle the issues that exist with regard to the free allocation of allowances or the carbon leakage provisions.

Recently the current carbon leakage regime was continued until 2020. On 24 September 2014

the Environment, Public Health and Food Safety Committee of the Parliament supported the proposed Commission decision on determining the list of sectors deemed to be exposed to a significant risk of carbon leakage for the period 2015-2019. The assessment underlying that decision continued using an assumed allowance price of EUR 30, although the actual carbon price is considerably lower. This price assumption was however underpinned by the proposed establishment of a market stability reserve and of the 40% greenhouse gas emission reduction target for 2030.

The Commission impact assessment shows that the impact of the market stability reserve, even if it starts operating before 2020, would be limited. Allowances will most likely remain within the carbon price levels on which carbon leakage provisions for energy-intensive industry are based until 2020. With an average GDP growth (of 1,8%), market analysts expect a price of 30 euro only by 2027.

Your rapporteur acknowledges the need to give certainty to industry that they will remain protected against carbon leakage after 2020. It is therefore important to highlight the European Council Conclusions of 23 October 2014 that give industry the reassurance that "free allocation will not expire" and that "existing measures will continue after 2020 to prevent the risk of carbon leakage due to climate policy, as long as no comparable efforts are undertaken in other major economies, with the objective of providing appropriate levels of support for sectors at risk of losing international competitiveness".

The Commission has already started its consultations on proposals for post-2020 carbon leakage provisions, including improvements to the existing regime. These proposals are interlinked with the MSR are interlinked, but largely transcend the systemic error of market imbalances that is aimed to be fixed by the MSR.

Your rapporteur believes that further debate on improving the allocation of free allowances is certainly needed, in particular with regard to changing production levels and guarantees that the most efficient installations should not face undue carbon costs leading to carbon leakage. In line with the European Council's request to ensure a better alignment of allocations with changing production levels and in order not to prejudge or forestall future possibilities of a more dynamic allocation, your rapporteur proposes to put the back-loaded allowances in the MSR. Building upon the guidance of the European Council, the Commission should as soon as possible present its proposals for review of the ETS Directive, including improved carbon leakage provisions.

Investment incentives

Your Rapporteur would also support the allocation of a proportion of the allowances placed in the reserve to be used to invest in low carbon industrial technology and processes.

Operation of the market stability reserve

As regards the operation of the reserve itself, the Commission proposes that:

- allowances would be added to the reserve where the total surplus exceeds 883 million allowances (equivalent to 12% of the total number of allowances in circulation in the year x-2);
- 100 million allowances would be released from the reserve where the surplus is below 400 million allowances.

These parameters could be under- or over-adjusting the market situation if estimations about hedging are inaccurate. Also, more flexible parameters might be envisaged over time. There are demands for increasing the thresholds, whilst others advocate a slower release of allowances in the reserve. These concerns need to be addressed. Since there is still a substantial degree of uncertainty surrounding those issues, a well-timed review will be necessary.

With regard to the two- year time lag, your Rapporteur considers that the reference to year x-2 will result in a rather slow response time and so believes that the proposal should be amended to address this problem.