New study highlights need for speedy reform of EU Emissions Trading System

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Delaying the introduction of a Market Stability Reserve (MSR) for the European Union Emissions Trading System (EU ETS) until 2021 risks undermining investment in clean technology, according to a new report published today (16 February) ahead of a vote in the European Parliament Environment Committee on the 24th of February.

A large surplus of allowances has accumulated in the EU ETS and because businesses face uncertainty, complexity and regulatory risk they cannot efficiently respond to this surplus. The report finds that the credibility and consistency of the carbon price is reduced for investors and reductions of greenhouse gas emissions are delayed.

The report by 12 international research institutions, convened by Climate Strategies, is based on economic models and laboratory experiments. It finds the EU Commission's proposal to retain surplus allowances in an MSR is an appropriate response to restore the consistency and credibility of the carbon price.

The European Commission last year proposed to introduce an MSR in 2021. However, a number of countries, including the United Kingdom and Germany, have argued that the reforms need to be made by 2017.

The authors find that the EU ETS will perform best if the MSR is implemented in 2017. In addition, the 900 million allowances that are currently held back for delayed auctioning need to be directly transferred into the reserve. The Market Stability Reserve can help the European Union to achieve its target of reducing greenhouse gas emissions by at least 40% compared with 1990 levels by 2030 at a lower cost.

The research was led by Professor Karsten Neuhoff at the German Institute for Economic Research (DIW Berlin), who said: "If the implementation of the Market Stability Reserve is delayed until 2021, we risk a lost decade for investments in modernization of energy intensive industries and the energy sector. All the models we ran indicate that the MSR should be introduced earlier than has been proposed. Bringing the start date forward to 2017 will significantly help the European Union stay on track with its efforts to switch to a low-carbon economy and reduce emissions."

Dr Luca Taschini, Research Fellow at the Grantham Research Institute on Climate Change and the Environment at London School of Economics and Political Science said: "Implementing the Market Stability Reserve in 2017 will help the European Union to meet its long-term emissions targets at a lower cost than would be the case if it is delayed until 2021. Starting earlier would make low-carbon investments across Europe more attractive."

The work was convened by the international researcher platform Climate Strategies and involved economic models and laboratory experiments by 12 institutions, including the German Institute for Economic Research (DIW Berlin), the Grantham Research Institute on Climate Change and the

Environment at London School of Economics and Political Science, the Climate Economics Chair of Paris-Dauphine University and Resources for the Future in Washington DC.

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Notes for editors

1. The full report available is available online: http://climatestrategies.org/publication/is-a-market-stability-reserve/

2. The research was supported with funding from the Stiftung Mercator, Mistra's Indigo Program, the United States Environmental Protection Agency and German Economic Ministry. Full list of participating institutions convened by Climate Strategies: , German Institute for Economic Research (DIW Berlin, project lead), Australian National University, Centre for European Economic Research, Climate Economics Chair of Paris-Dauphine University, Colorado School of Mines, London School of Economics and Political Sciences, Oxford University, Resources for the Future, University of Duisburg Essen, University of Michigan, University of Virginia and Zurich University of Applied Sciences. As well as computational analysis of the EU ETS, the study involved experiments with human subjects, a detailed assessment of the EU Transaction Log and interviews and workshops with market participants.

3. While currently not considered in the European debate, price based stability reserves, which have been implemented or proposed in Emissions Trading Schemes in North America and Asia, were also assessed. Evidence from the analysis suggests that price based stability reserves could also improve the functioning of the EU ETS. However, strong performance of a price based MSR requires accurate information on marginal abatement costs and a transparent political process for setting the price triggers.

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