

To: The European Parliament and General Audiences

An International View on Decisions before the European Parliament on the ETS Post 2020

The European Emissions Trading System (ETS) faces a decisive moment. The European Parliament will soon hold a crucial vote to strengthen the original proposal of the European Commission for the ETS post 2020. As other regions are also enacting carbon pricing, we as leading researchers in these regions are writing to express support for the proposal package and our European research colleagues whose work has informed these developments.

There are two important dimensions to the decision before the Parliament. One aims to deal with the structural surplus that has rendered the ETS ineffective since the financial crisis. A strengthened emissions reduction factor, the potential cancelation of some of the current surplus and exercising the potential role of the market stability reserve more fully. The logic for these changes appear strongly evident.

The second is the proposal to ensure a full carbon price passes through to basic materials. In our countries and in subnational jurisdictions, where carbon pricing policies are steadily expanding, we are struggling to address the emissions from basic materials such as steel or cement, embodied in products like cars or buildings. Without this, the carbon price cannot provide sufficient incentive for new product design or innovation in production and use of basic materials.

In our jurisdictions, we have sought to advance a carbon price pass-through to basic materials but it is very difficult to achieve this objective. We also find that emissions-intensive and trade-exposed firms and sectors face particular challenges, whether for the ETS or carbon tax systems. The proposal before the Parliament addresses long run goals and provides a program element that enables more broader and comprehensive coverage, which eventually will need to become economy wide. This feature is an essential element of a policy framework to provide a market signal for climate friendly innovation and investment in basic materials sectors.

Primary production material is emission intensive and dominates industrial emissions. The current proposal envisages to achieve the objective of a full carbon price pass-through with the inclusion of imports of cement and other less trade intensive materials into the EU ETS, combined with a shift from free allocation to full auctioning of emission allowances to the respective producers. Ensuring that materials consumption faces the full cost of carbon is right in principle for it to work effectively and to be an approach that other regions could accept and follow. The level should be set at a 'best available technology benchmark' and in combination with full auctioning of allowances to European producers to avoid the risk of mixing climate policy with protectionism. This policy innovation will attract international attention and make more ambitious and comprehensive policy options possible in our own nations.

With the research network Climate Strategies, we have explored ways to achieve a full carbon price pass-through in our domestic trading systems. Based on positive experiences that we have gathered from the Korean and Chinese power sectors, we find that the political objective of a full

carbon price pass-through can also be achieved with inclusion of consumption of basic materials in the carbon pricing system. If the carbon price signal is muted for the value chain (as with free allocation of emission allowances for 'carbon leakage protection'), it is thus reinstated with a consumption charge at the carbon price and benchmark used for primary production (tonnes of CO₂ emissions/tonne of material). As the consumption charge is applied irrespective of production processes or if location trade related sensitivities are avoided, the approach has the potential for broader application with other materials.

(See <http://climatestrategies.org/projects/inclusion-of-consumption-in-emissions-trading/>)

It is now very well quantified and understood that production of basic materials compromises a large share of global greenhouse gas emissions and it is one of the most difficult emissions sources to address with a moderate carbon price. Therefore, it will be important that all countries implement policies that address both production and consumption of materials to achieve the international climate policy objectives agreed in Paris.

Sincerely,

[All writing in our personal capacities]

Dallas Burtraw

Darius Gaskins Senior Fellow
Resources for the Future (RFF)
Washington D.C., USA

Professor Frank Jotzo

Director Centre for Climate Economics & Policy
Australian National University
Canberra, Australia

Professor Jong-Soo Lim

Kwangwoon University
Seoul, South Korea

Professor Joyashree Roy

Coordinator Global Change Programme
Jadavpur University
Kolkata, India

Professor Harald Winkler

Director Energy Research Centre
University of Cape Town
South Africa

Professor Libu Wu

Director Center for Energy Economics and Strategy Studies
Fudan University
Shanghai, China