

Reflection on National and Unilateral Measures in the EU

January 2017

This reflection note is meant to further the work that IETA members started last year with the release of the IETA paper on Overlapping Policies with the EU ETS, available [here](#). In the context of the previous paper we outlined the belief that greater transparency is needed on the impact of such overlapping and conflicting policies.

At the same time, we also believe that the policy-making debate would benefit from a clear distinction between overlapping (or complementary) policies, i.e. policies that, while pursuing other objectives, have an impact on the EU ETS, and conflicting policies, i.e. policies that pursue the same objectives as the EU ETS and, as such, create a direct conflict.

IETA members are of the opinion that the EU ETS should remain the central pillar for reducing GHG emissions cost-effectively as it:

- Has the function of ensuring long-term decarbonisation of ETS sectors by allowing price discovery through market dynamics,
- Ensures that the most cost-effective abatement options are developed,
- Provides flexibility to businesses about investment timing,
- Guarantees an environmental objective,
- As an EU-wide system minimises intra-EU distortions and enables linking with other jurisdictions.

In light of these considerations, IETA members are concerned that certain measures implemented, or seriously considered, at the European Level and/or by Member States in a unilateral manner could undermine the cost-effectiveness of the EU ETS in reducing GHG emissions.

In a recent report¹, the World Bank points out that “[overlapping] policies [while motivated by other legitimate objectives] represent an implicit carbon cost, which can far exceed the level of the explicit carbon price and increase the overall social cost of reducing emissions”. Further to this point, as estimated by some studies ([here](#)), the ETS has the lowest cost per ton of CO₂ abated compared to other types of regulation and as such should be the preferred option to decarbonise the economy in the most cost-effective way. The ETS avoids the unnecessary economic burden to society associated with other types of regulation.

Moreover, in the aforementioned [Paper on Overlapping Policies](#), IETA estimated that the impact of overlapping policies at the EU level, such as the current Energy Efficiency Directive and the Renewable Energy Directive will lead to a substantial reduction in demand for ETS allowances until 2020. Additional policies such as national and unilateral measures also overlap with the EU ETS and cause reduced demand for ETS allowances. The aggregated impacts in 2020 could rise to over 1 Billion ton of CO₂.

¹ State and Trends of Carbon Pricing 2016

National and Unilateral Measures

There are national policies that overlap and/or conflict with the price signal and with supply and demand balance of the EU ETS. One of the reasons of such overlap arises from Member States setting national targets, covering ETS sectors, that are beyond the EU targets. While there might be domestic reasons for such a decision, it is important to acknowledge that these policies will have a significant impact on the supply and demand in the EU ETS, the functioning of the EU ETS and efforts on decarbonisation across Europe. Such policies also encourage a fragmented approach to EU climate action that, in turn, creates intra-EU distortions.

In light of these considerations, national policies that might potentially overlap and/or conflict with the EU ETS should be avoided and as a minimum be subject to an analysis of their impact on the system, in terms of potential additional emission reductions they might create and the timing of these, the intra-EU distortions they might cause, and in terms of potential additional costs for achieving such reductions compared to what would have been the case with the EU ETS only.

Greater transparency is needed on whether such policies contribute to turning the EU ETS into a residual policy instrument as emission reductions in the ETS sectors would be achieved not through a well-functioning ETS, but as a consequence of other national policies and regulations, associated with higher costs per tonne of CO₂e abated (which derive from multiple binding targets in parallel of the GHG emission reduction one).

Recommendations

IETA's main recommendation is to avoid policy overlap as a matter of principle as it inhibits the market effectiveness of the EU ETS. Emissions trading has the lowest cost per tonne of CO₂e abated compared to other types of regulation. As such, it should be the preferred option to decarbonise the economy in the most cost-effective way.

If, despite these considerations, national and unilateral measures are introduced, **certain policy coordination measures could ensure that certain inefficient effects on the EU ETS are predictable and minimised:**

- Full transparency should be provided ex ante and ex post on the delivery of emission reductions and their timing, as well as the CO₂e abatement costs associated with these measures, as a way to inform the policy making discussion;
- Gradual impact of national measures: Introduction of other policies should be done with sufficient notice to allow the market to naturally and automatically adjust;
- Clear governance: Efforts to ensure greater EU-coordination of national measures can help minimise the level of overlap with the EU ETS and help minimise costs.

Therefore, **we recommend conducting a General Review, every five years from 2021, of all policies that lead to emission reductions in the ETS sectors, in order to quantify the expected reductions, the timing of these reductions and the extra cost per tonne of CO₂e abated compared to the EU ETS; as a way to inform the policy making discussion and to evaluate the consequences of such policies on the EU ETS.**

If, in light of this General Review, additional measures have been shown to be introduced within an ETS Phase, which cause a material impact on the ETS, then **a discussion is required, to assess whether the cap of the ETS should be adjusted going forward.**

IETA believes that the cap of the EU ETS should be set at the beginning of each Phase, to signal the overall target level of scarcity. **There should be no changes to the cap 'within' a Phase (i.e. ex post).**

IETA recommends that the ETS Directive itself spell out the process of the General Review so as to inform greater policy coordination and harmonisation at the start of a new Phase, i.e. when the cap of the EU ETS is being set.