

Guest Commentary

Backloading yes, but don't stop fundamental reflections for post-2020

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In last week's edition, Jesse Scott developed Eurelectric's position in favor of the EU ETS back-load and more generally of the extension of the EU-ETS beyond 2020. Likely a majority of readers will agree with this backload but some of Ms Scott's arguments, relating to the benefit of a market-based approach in comparison to a tax system, have to be nuanced.

1) First of all, it is amazing that historically and without exception all market mechanisms relating to carbon emissions have progressively fallen to a carbon price nearly equal to zero : UK-ETS, EU-ETS (phase 1), CCX (Chicago), CER and ERU markets, RGGI, New South Wales, and now EU-ETS. This deserves a serious reflection, especially about the fundamentals of such systems. I am afraid that the key issue is that the carbon allowances are virtual commodities which are not supported by real assets. As soon as they are released, they create a windfall wealth which everybody (including fraudsters) tries to capture. This reminds me of the story of the assignats during the French revolution.

2) As stated by Ms Scott, the purpose of the ETS is to expose sectors to true costs of carbon. Most people will agree with such a statement. But there is today absolutely no guarantee that the market price which results from the EU-ETS will ever correspond to these costs. The deep fluctuation of the carbon price corroborates this concern.

3) There is also no guarantee that the carbon price prevailing in the EU ETS will be in harmony with the prices resulting from other mechanisms in the world.

4) There are no major differences between a system where the allowances are sold by auctions by the governments and a tax system.

5) There is no reason why the level of national carbon taxes could not be more or less harmonized between the European countries, in the same way as for VAT.

In the difficult situation of the EU-ETS, we cannot exclude tax systems which would have the main advantage of providing the governments with resources, in this period of budgetary diet. These resources are pivotal for financing the investments and the R&D effort required by the transition to a low-carbon economy. The failure of the mechanism aimed

at financing the carbon capture pilot projects in Europe is a severe lesson of the limits of the EU ETS as a financing tool.

I believe that European commission and governments should think about it twice, before deciding on the system to be implemented after 2020, which will be the great appointment in the climate saga. If, for any reason, a market mechanism remains deemed to be preferable for phase 4, I believe that such a system is only acceptable if two conditions are fulfilled:

a – A European carbon bank (or equivalent) is created for regulating the carbon price and maintaining it within the limits of a politically accepted 'snake'. These limits should be decided at the qualified majority of the states. Such an institution should be distinct from the European Commission in charge of administrating the system. Its creation would invigorate the confidence that operators can place in the allowances as financial assets.

b – At the international level, Europe should be more flexible and move towards a common position with President Obama. It is clear that a fully administrated system such as the Kyoto Protocol does not correspond to the vision of most nations, even of those which have accepted the urgency of climate challenge. We should accept that neither USA nor China will ever embark on such a system. On the other hand, nobody contests the 1992 U.N. climate convention, even if it has to be amended. We believe that a global system based on regional or national mechanisms could be efficient if smooth but sufficient links are developed between the various ETS which are emerging around the world. The link between EU-ETS and Australia's scheme is an illustration of this approach and the discussions around the future of the U.N.'s Clean Development Mechanism (CDM) are obviously important here. It is probably too late to have a full-fledged protocol ready for 2015, but a solemn declaration adopted during the Conference of the Parties to the UNFCCC would pave the way towards an historical convention.

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