sandbag

Decoding the Deal

Explaining the Council agreement on Market Stability Reserve May 2015

About Sandbag

Sandbag is a UK-based not-for-profit think tank conducting research and campaigning for environmentally effective climate policies.

Our research focus includes reform of the EU Emissions Trading Scheme, the EU 2020 and 2030 climate & energy packages, Carbon Capture & Storage/Utilisation, and the phase-out of old coal in Europe. The International Centre for Climate Governance ranks us in the top twenty global climate think tanks.

For more information visit our website at www.sandbag.org.uk or email us at info@sandbag.org.uk

Summary: Council strikes deal for a stronger MSR with more allowances submitted by wealthier states

EU Member States struck a deal on Wednesday, April 29, 2015, to strengthen the Commission's proposal for a Market Stability Reserve (MSR). The Council agreed to bring forward the start date to January 2019 and to place hundreds of millions of backloaded and unallocated allowances directly into the reserve. A key element of the deal was an agreement that wealthier Member States would submit a higher proportion of allowances into the Market Stability Reserve over 2019-2030, alleviating the obligations of poorer countries and thereby increasing the auction revenue benefitting poorer states over this timeframe.

Sandbag calculates that some 1.5 billion allowances belonging to poorer Member States were shielded from the reserve in the Council agreement, but the actual level of compensation from wealthier states to poorer ones depends on how aggressively the Market Stability Reserve would eat into these particular allowances.

Against the Commission's low surplus forecast, this deal would require wealthier Member States to step in to provide 14 million allowances that would have otherwise been required of poorer states over 2019-2030. However, larger surpluses, as predicted by Sandbag, would trigger larger adjustments to supply, requiring wealthier nations to contribute as many as 260 million additional allowances on behalf of poorer ones over the same timeframe.

Total shielded volume 2019-2030 (Million EUAs)	**1,483.4**	
Emissions scenario	**Commission**	**Sandbag**
Contribution from wealthier MSs (Millions EUAs)	**14.2**	**260.2**

The environmental impact of the change in Council's position is considerable: by starting two years earlier than the Commission's proposal and channelling the backloaded and unallocated allowances into the reserve would remove between 1.9-2.2 billion allowances from Europe's vastly oversupplied carbon market already by 2020.

Three clusters of shielded allowances

Our estimate of 1.5 billion allowances to be shielded from the MSR's supply adjustments over the 2019-2030 period is made up of three separate clusters of allowances benefitting lower-income Member States: one cluster exists under the Phase 3 cap and consists of roughly 360 million outstanding solidarity & growth allowances, while two clusters exist under the post-2020 cap – one containing roughly 810 million new allowances for solidarity, growth & interconnections and a further one containing 310 million allowances meant for financing a modernisation fund for countries with particularly high investment needs.

The net additional contribution from wealthier Member States on behalf of poorer ones from each of these three categories is provided below, against both the Commission's and Sandbag's surplus forecast until 2030.

Shielded cluster	**Total (2019-2030)**		**Solidarity & growth (2019-2020)**		**Solidarity, growth & interconnections (2021-2030)**		**Modernisation (2021-2030)**	
Shielded volume (Millions of EUAs)	**1,483.4**		**361.3**		**812.1**		**310.1**	
Emissions scenario	**COMM**	**SB**	COMM	SB	COMM	SB	COMM	SB
Contribution from wealthier MSs (Millions of EUAs)	**14.2**	**260.2**	10.0	24.6	2.9	160.5	1.2	75.1

All three EUA clusters are made up entirely of auctioned allowances. Besides these three clusters, approximately 10.5 billion further allowances will be auctioned over the 2019-2030 period. However, none of these other allowances are shielded from the supply adjustments implemented by the MSR.

Net beneficiaries are also part-contributors

Under the Commission's forecast, of the total EUA volume that the reserve must absorb over the 2019-2030 period some 23 million would need to come from the three abovementioned clusters – yet the shielding prevents this from happening. Therefore, in order for the MSR to conduct the same supply adjustment as without the shielding, the shortfall will have to come from the unshielded category of allowances.

Since allowances in the unshielded category belong to all Member States, each State's auction pot will be proportionately affected by any changes to the auctioning schedule. Therefore, if the shortfall due to shielding must be corrected by channelling instead unshielded allowances into the reserve, all Member States must relinquish such allowances according to a predetermined distribution key – including poorer ones. However, because their contribution is significantly less than what they gain from shielding the abovementioned clusters, they are able to derive the net benefits mentioned in the previous section.

Concretely, under the Commission forecast, of the abovementioned 23 million EUAs, poorer Member States will have to shoulder 9 million. This allows them to achieve the net benefit of 14 million described earlier.

Total shielded volume 2019-2030 (Millions EUAs)	**1,483.4**	
Emissions scenario	**Commission**	**Sandbag**
Displaced MSR adjustments	**23.1**	**390.2**
Contribution from poorer MSs	**8.9**	**130.0**
Additional contribution from wealthier MSs	**14.2**	**260.2**

Under the Sandbag forecast, the displaced volumes and net benefits are much larger. This is because the MSR is set to absorb 12% of the surplus each year the market is oversupplied. The larger the surplus, the larger the volume channelled into the reserve, prompting the MSR to try to raid a larger volume from the shielded clusters. However, this shielding forces a larger volume to be instead channelled into the reserve from among unshielded allowances, implying a greater burden on both wealthier and poorer Member States.

Who benefits when

An additional complication is that the Member States who benefit from shielding these clusters are slightly different in each instance. While, as a general rule, there is a net loss of allowances to the MSR from wealthier member states and a corresponding gain to poorer ones, there are some notable exceptions. The beneficiaries of solidarity, growth & interconnection allowances in Phase 4 are countries with GDP per capita at or below 90% of the EU average (Baltics, Eastern Europe and Mediterranean – except Italy). The Phase 4 modernisation fund is reserved for a poorer subset of these, i.e. Member States with GDP per capita below 60% of the EU average (i.e. Baltics and Eastern Europe). Meanwhile the beneficiaries of Phase 3 solidarity & growth allowances are mixed – these also include some relatively prosperous countries, such as Sweden, Luxembourg and Italy.

A breakdown of beneficiaries under each cluster is provided below, as well as a list of excluded countries who will be net contributors when each cluster is shielded.

Country category	All periods (2019-2020)	Solidarity & growth (2019-2020)	Modernisation (2021-2030)	Solidarity, growth & interconnections (2021-2030)
Net beneficiaries	BG, CZ, EE, HU, LA, LT, PL, RO, SK	BE, BG, CY, CZ, EE, ES, HE, HU, IT, LA, LT, LU, MA, PL, PT, RO, SK, SI, SE	BG, CZ, EE, HR, HU, LA, LT, PL, RO, SK	BG, CY, CZ, EE, ES, HE, HR, HU, LA, LT, MA, PL, PT, RO, SK, SI
Net contributors	AU, DE, DK, FI, FR, IC, IE, LI, NL, NO, UK	AU, DK, FI, FR, DE, HR, IC, IE, LI, NL, NO, UK	AU, BE, CY, DE, DK, ES, FI, FR, HE, IC, IE, IT, LI, LU, MA, NL, NO, PT, SI, SE, UK	AU, BE, DK, FI, FR, DE, IC, IE, IT, LI, LU, NL, NO, SE, UK
Mixed	BE, CY, ES, HE, HR, IT, LU, MA, PT, SI, SE			

Until there is more clarity on how allowances will be divided under the Phase 4 modernisation and solidarity, growth & interconnections clusters, the net costs and benefits for individual Member States cannot be calculated. This is possible, however for Phase 3 solidarity & growth allowances. We provide a breakdown of the net cost or benefit to each Member State in the table below under both a Commission and Sandbag surplus forecast:

Country	Commission	Sandbag	Country	Commission	Sandbag
Austria	-0.25	-0.62	Latvia	0.09	0.21
Belgium	-0.05	-0.13	Liechtenstein	0.00	0.00
Bulgaria	1.11	2.71	Lithuania	0.15	0.37
Croatia	-0.07	-0.17	Luxembourg	0.00	-0.01
Cyprus	0.03	0.07	Malta	0.02	0.04
Czech Republic	1.12	2.75	Netherlands	-0.62	-1.51
Denmark	-0.23	-0.57	Norway	-0.13	-0.32
Estonia	0.28	0.68	Poland	3.88	9.51
Finland	-0.31	-0.77	Portugal	0.10	0.25
France	-1.00	-2.46	Romania	1.96	4.81
Germany	-3.75	-9.19	Slovakia	0.50	1.23
Greece	0.27	0.65	Slovenia	0.05	0.13
Hungary	0.29	0.72	Spain	0.19	0.46
Iceland	-0.01	-0.01	Sweden	-0.02	-0.05
Ireland	-0.17	-0.42	United Kingdom	-1.95	-4.79
Italy	-1.46	-3.58			

Table 1: Net gains and benefits from shielding the solidarity and growth cluster in 2019-2020 (Millions EUAs).

Conclusion

The deal brokered in Coreper on April 29th agreed a stronger market stability reserve in exchange for a slightly larger contribution into that reserve by wealthier Member States over 2019-2030. In Sandbag's view, a more robust market stability reserve helps the EU ETS deliver Europe's climate goals cost-effectively, so no redistribution of allowances is strictly necessary to justify its introduction. However, we welcome the advance in the Council's position in regards to an earlier state date, and the placement of unallocated allowances into the reserve in addition to the previous commitment to place backloaded allowances into the reserve.

The Coreper agreement has brought the Latvian presidency's trialogue mandate considerably closer to the position of the European Parliament. We hope that the two institutions, along with the Commission, can now move forward swiftly to agree a strong market stability reserve which starts as early as possible, and keeps a maximum volume of allowances off Europe's oversupplied carbon market in the near term.

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