Options for implementing a minimum price in the EU ETS

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Overview

• What is the problem with the EU ETS?

• What are the options for implementing a minimum price?

• How are the revenues currently distributed?

• What are the options to feed the Euro budget?
EU ETS: Reason for concern

- Persistently low EUA price might lead to „hockey stick“ price curve
- Escalating price will induce future downward adjustment of the cap
- Concern over self-fulfilling prophecy & strategic gaming of the system

EUA minimum price

Level of price floor

- Available EU modeling indicates **20-40€/t** in 2020, rising over time (Knopf et al. 2013)
- Stern-Stiglitz Commission global
  - 40-80$/t by 2020
  - 50-100$/t by 2030
Options for implementing a minimum price

Edenhofer et al. (2017)
Allocation mode of allowances over time

- Large share of **free allocation**
- All revenues from auctioning are distributed to MS with fixed **grandfathering rule**.
- Additional **transfer mechanisms** adjust MS’ share for **buy-in** and ‘**green**’ incentives.
Thought experiment: EU implements minimum price in line with price projection

European Commission 2013
Hypothetical revenues under such a minimum price scenario

- **Substantial** but **temporally limited** value generated.
- Danger of **adverse incentive** with declining values: raise quantity (=
  relax cap) instead of price to sustain value base.

Dorsch et al. (2017)
Options to generate revenues from minimum price to feed the Euro budget

1. Implement an auction reserve price and change the allocation rule

2. Implement (flexible) CO$_2$ support rate at EU-level
Option 1: Change the allocation rule

- Implement auction reserve price
- A minimum price of 30€ would increase volume of revenues from 5.3 bn€ by additional 21 bn€

1a) Decrease free allocation ➞ conflict with Industry

1b) Decrease MS share ➞ conflict with Member States
Option 2: Implement CO₂ support rate at EU-level

- Implement a (flexible) price support, similar to UK. De facto this is a European CO₂-tax
- Revenues would go to the Euro budget.
Summary

- The EU ETS needs a minimum price. There are different options of how to implement a minimum price.

- ETS minimum price could feed the Euro budget:
  - Either change the allocation rule. Problem: this was a difficult compromise between Member States;
  - Or implement a UK-style price support. Problem: this would be perceived as a tax.

- Problem with linking ETS minimum price to Euro budget:
  - This would probably undermine the acceptance of the Member States to agree on a minimum price.
  - The tax-base is not stable. A substantial but temporally limited value is generated.

- Better: establish stable tax base, e.g. with land value tax
Further reading

Decarbonization and EU ETS Reform: Introducing a price floor to drive low-carbon investments

Policy Paper
