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# EU ETS STABILITY MECHANISM NEEDS NEW DESIGN

*Grischa Perino (Universität Hamburg)*

*joint work with*

*Michael Pahle (PIK)*

*Fabian Pause (Stiftung Umweltenergierecht)*

*Simon Quemin (PIK & Paris-Dauphine University)*

*Hannah Scheuing (Stiftung Umweltenergierecht)*

*Maximilian Willner (Universität Hamburg)*

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# KEY POINTS

- Market Stability Reserve (MSR) is like an **autopilot** of the EU ETS
- It automatically responds to (expected) changes in market conditions
  - Total Number of Allowances in Circulation (TNAC)
- **Aims** of MSR:
  - Reduce demand-supply imbalances
  - Increase synergies with other climate and energy policies
  - Stimulate low-carbon investments

# KEY POINTS

- Root of the problem: **TNAC**
  - Inadequate measure of scarcity
  - Works well for past and present events
  - Systematically off for what lies ahead

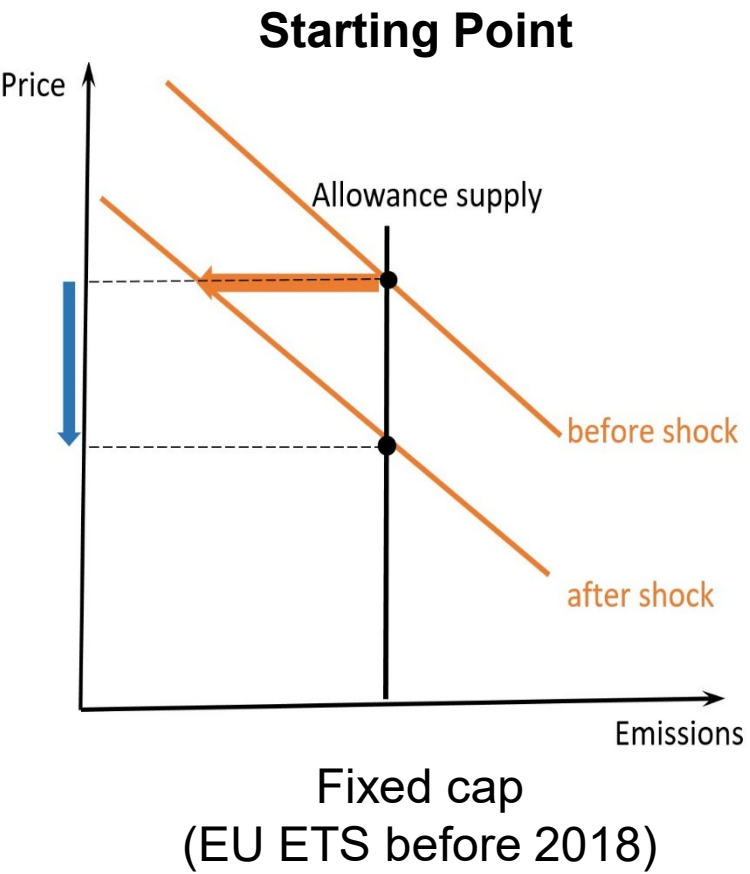
**Reality**



**What TNAC  
responds to**



# TNAC-based cap adjustment destabilizes EU ETS



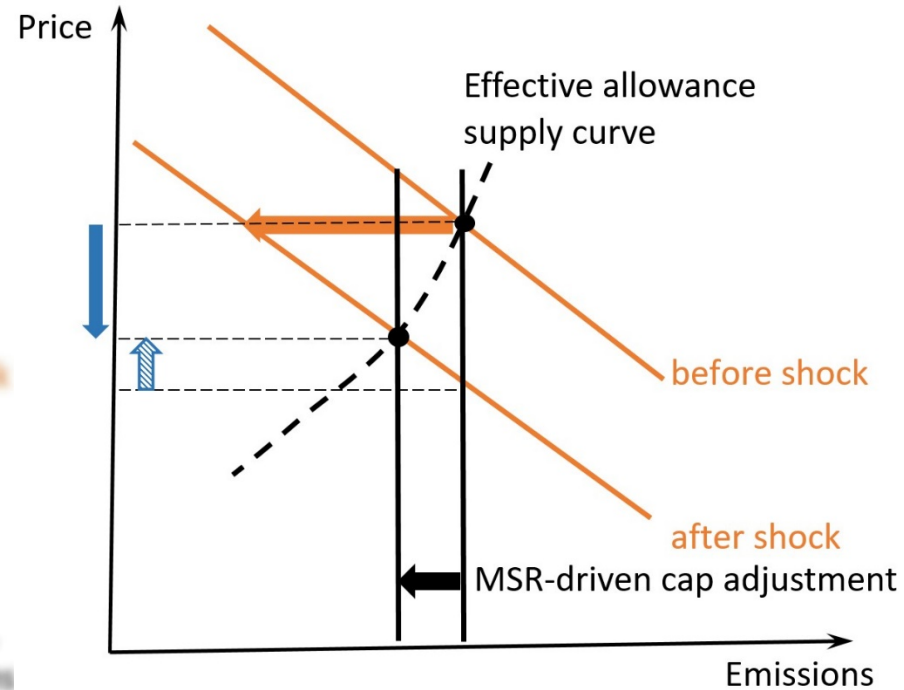
# TNAC-based cap adjustment destabilizes EU ETS

## Starting Point



Fixed cap  
(EU ETS before 2018)

## Aim



Stabilising Adjustment  
(MSR + current change)

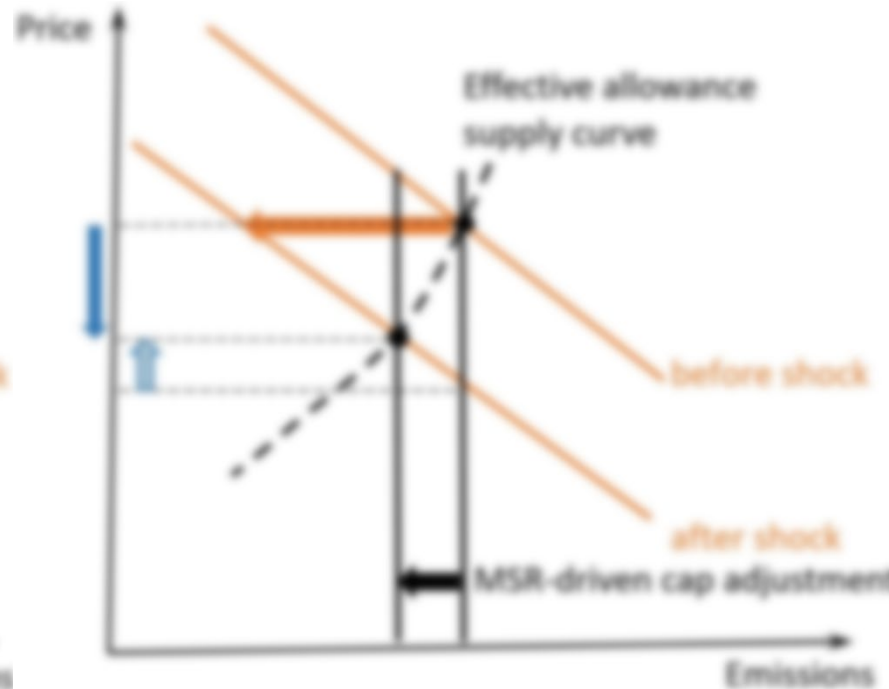
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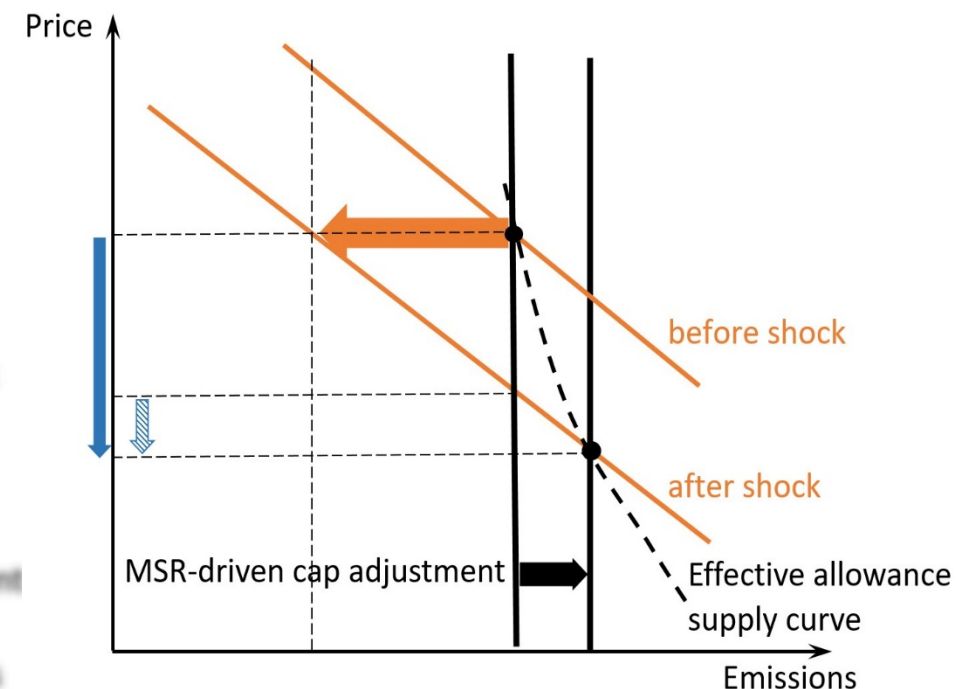
Fixed cap  
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## Aim



Stabilising Adjustment  
(MSR + current change)

## Risk



Destabilising Adjustment  
(MSR + anticipated change)

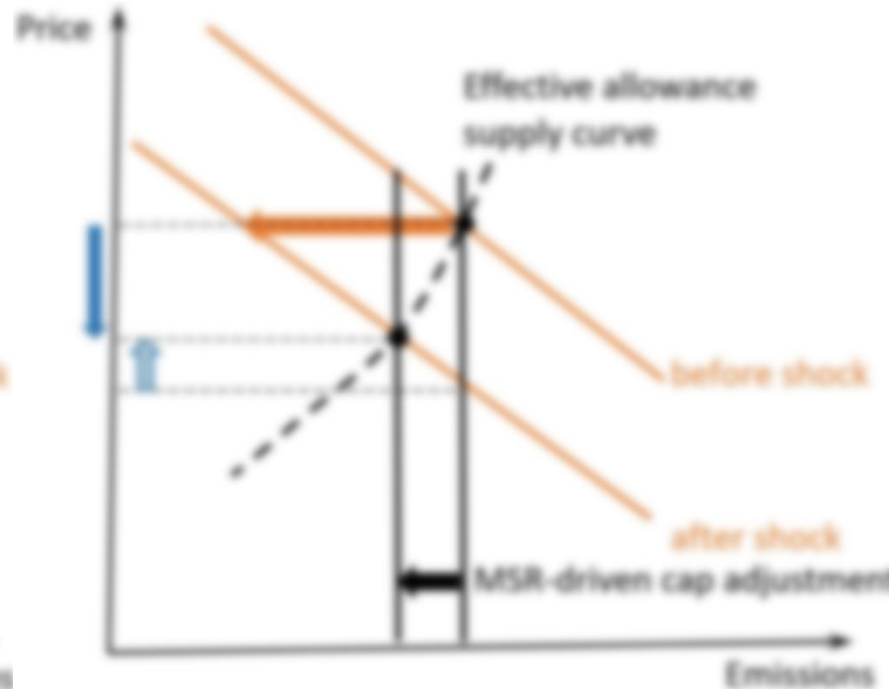
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Starting Point



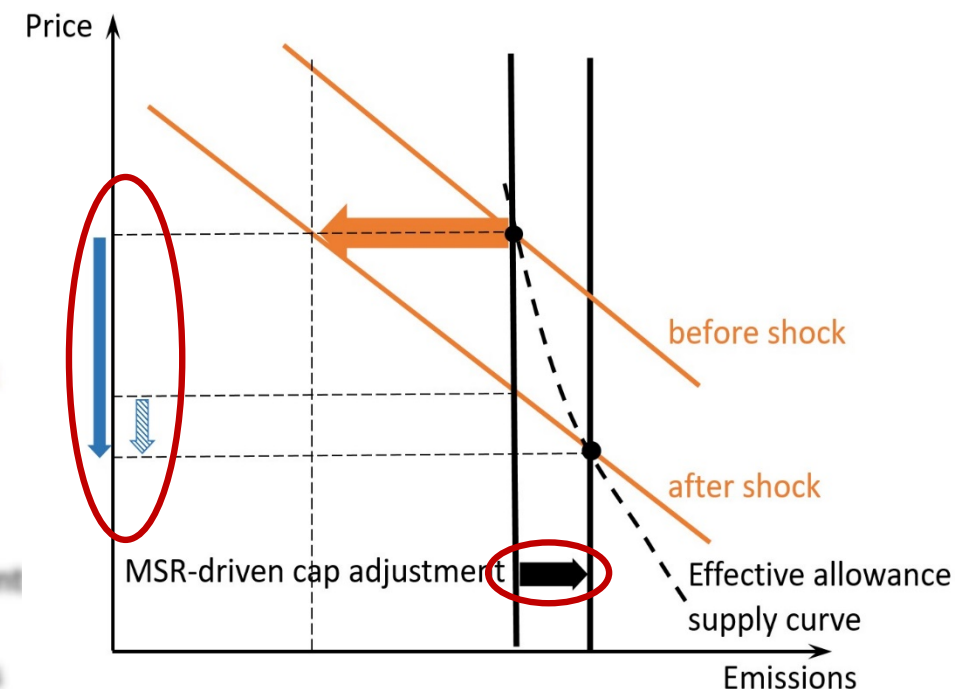
Fixed cap  
(EU ETS before 2018)

Aim



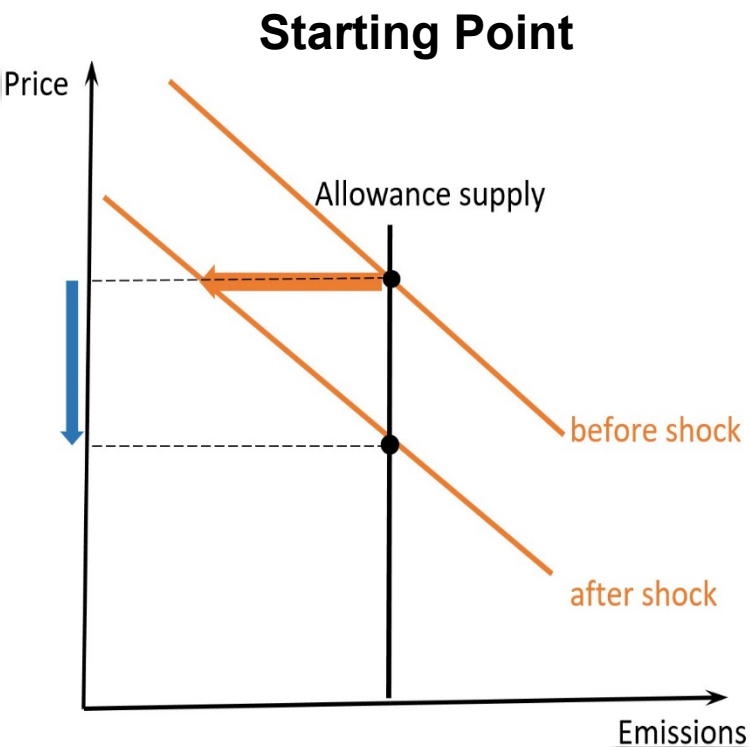
Stabilising Adjustment  
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Risk

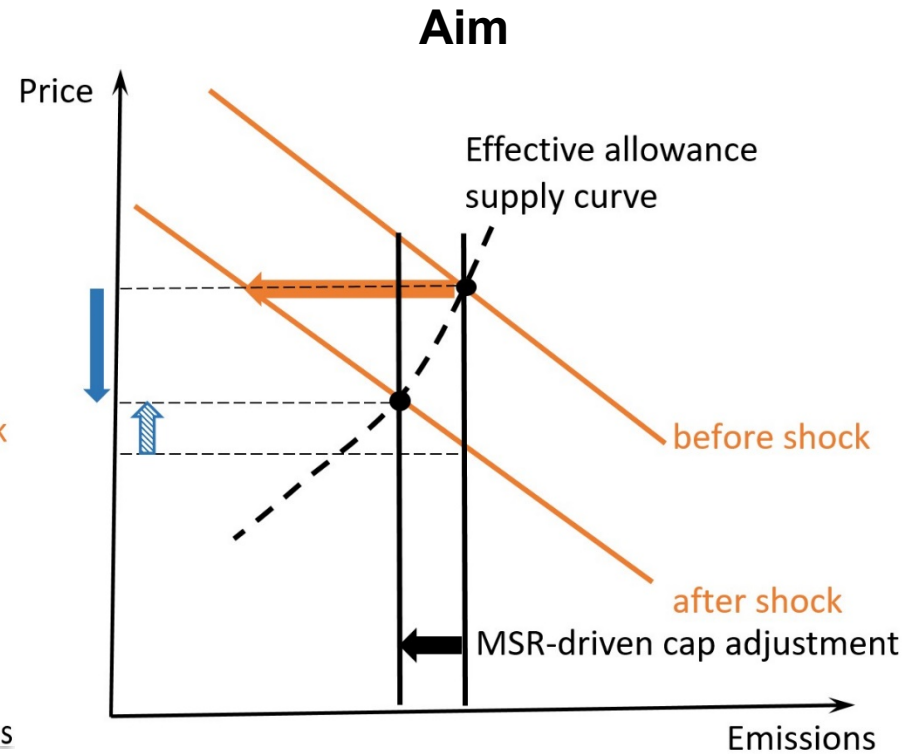


Destabilising Adjustment  
(MSR + anticipated change)

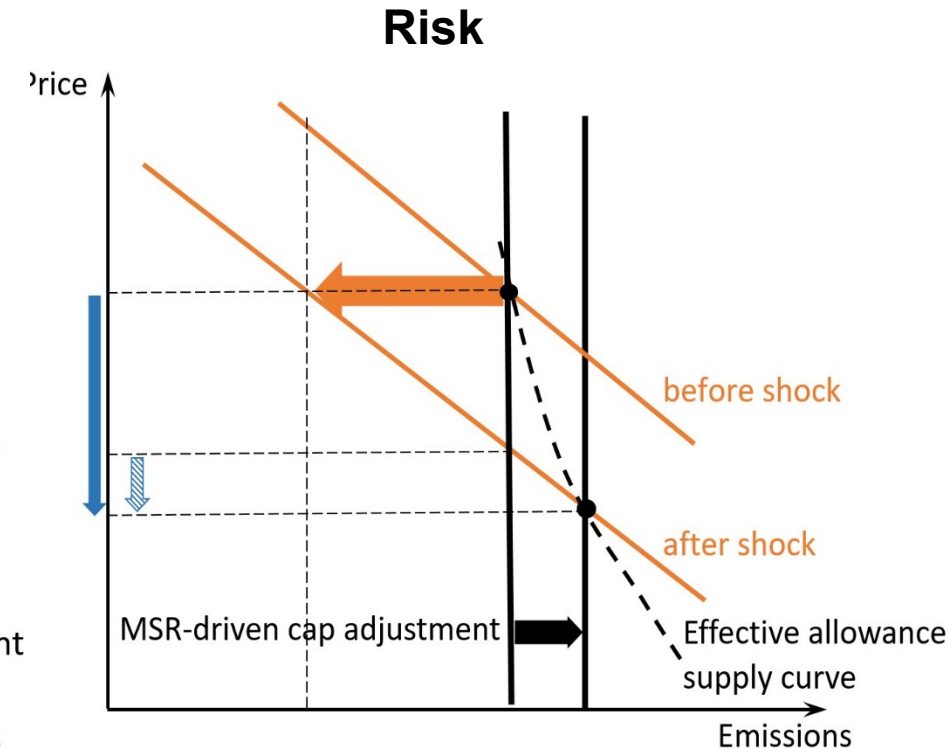
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Fixed cap  
(EU ETS before 2018)



Stabilising Adjustment  
(MSR + current change)



Destabilising Adjustment  
(MSR + anticipated change)



# KEY POINTS

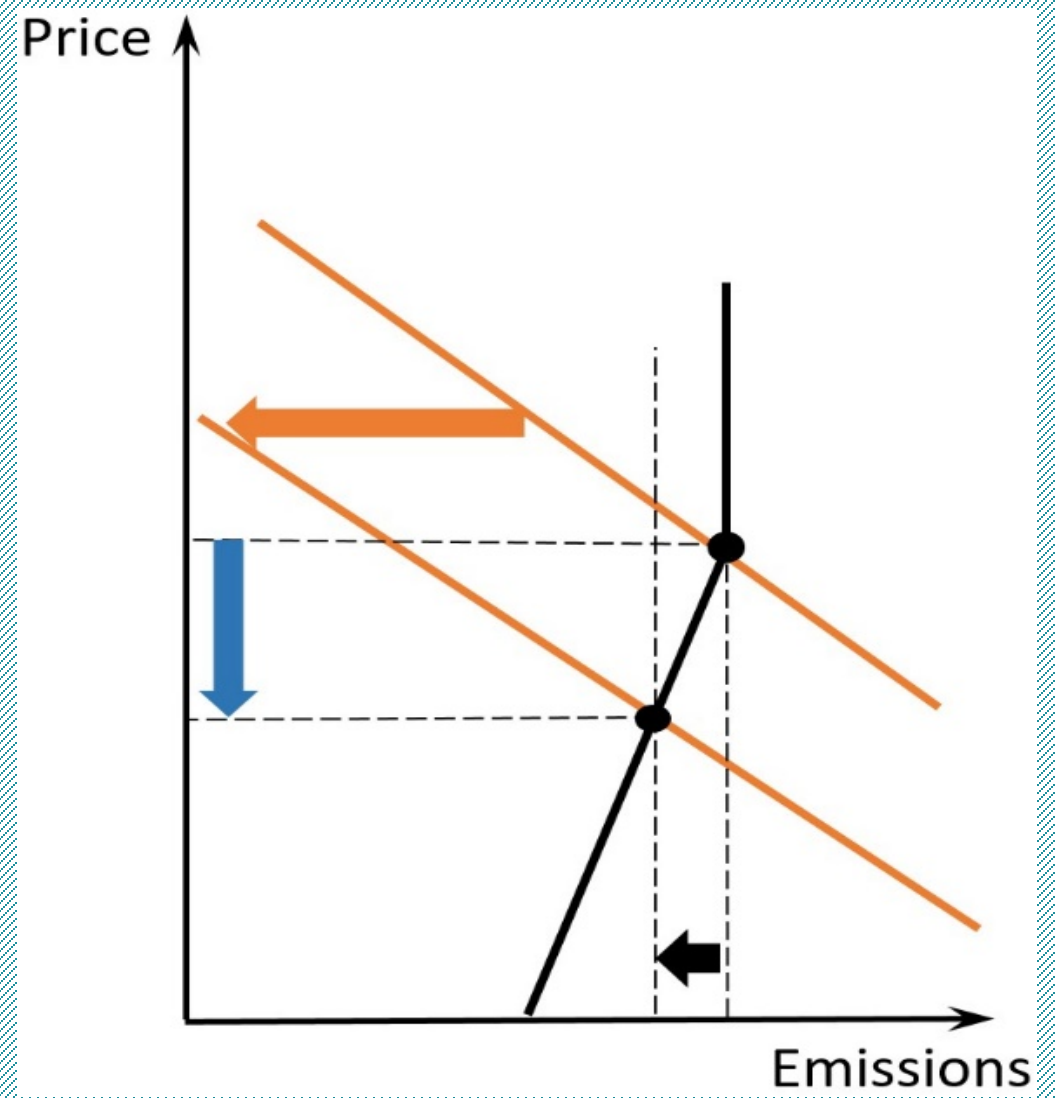
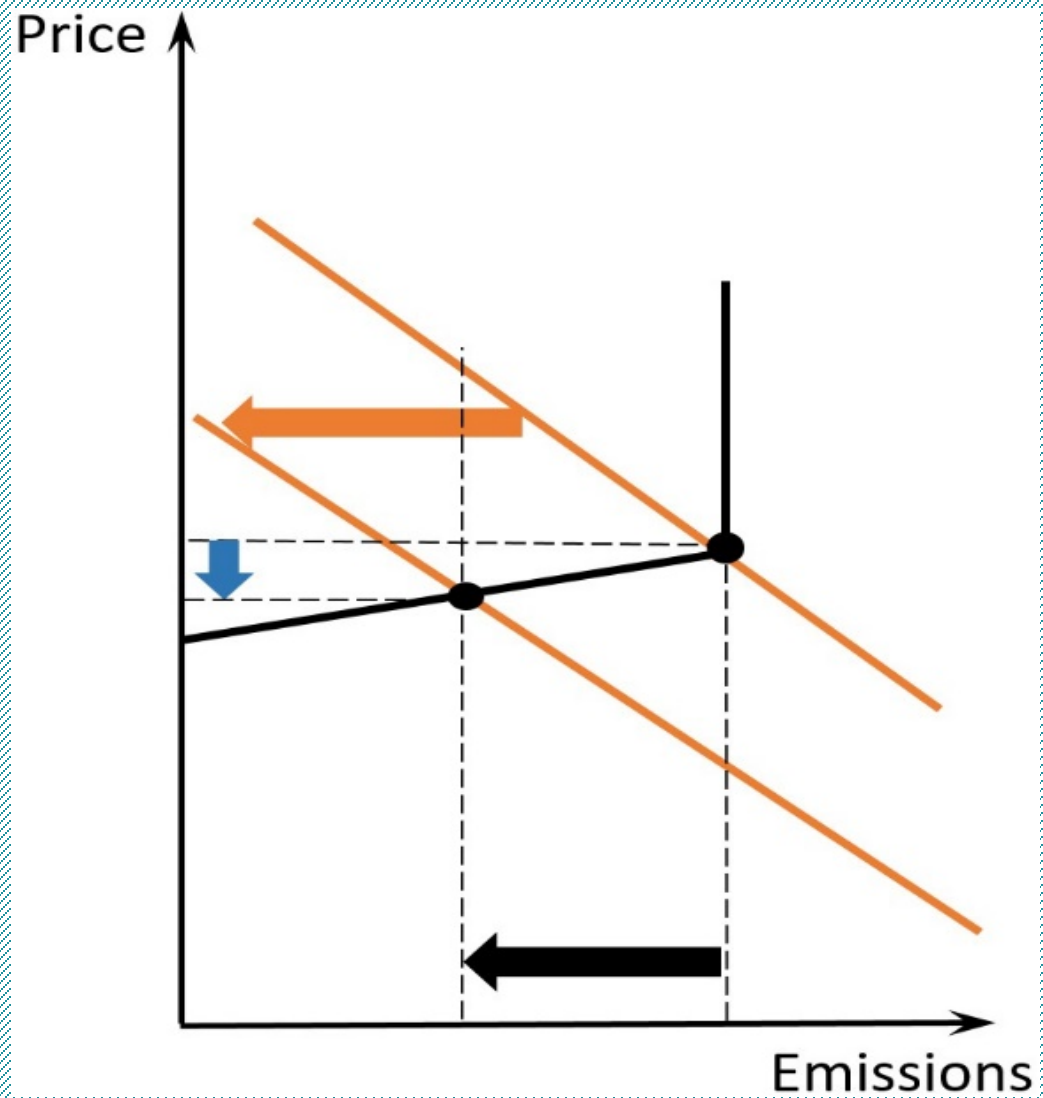
- Root of the problem: **TNAC**
  - Inadequate measure of scarcity
  - Works well for past and present events
  - Systematically off for what lies ahead
- Solution: Move to a **price-based quantity adjustment**
  - Gives back **control**
  - Better in achieving **targets**
  - Re-establishes **transparency**

Reality



What TNAC responds to





# Advantages: Price-based quantity adjustment

- \* **Price stability** increases

- \* Demand-supply imbalance kept in check (regardless of nature or timing of shock)
- \* Stronger investment signal
- \* Less need for hedging

- \* Guarantees (and controls) **climate effect of overlapping policies**

- \* Effects are **predictable**

# THANKS

Link to full paper: <http://uhh.de/cen-eu-ets>



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