

Dynamic Allocation

Carbon Expo 2015 - Frederic DINGUIRARD



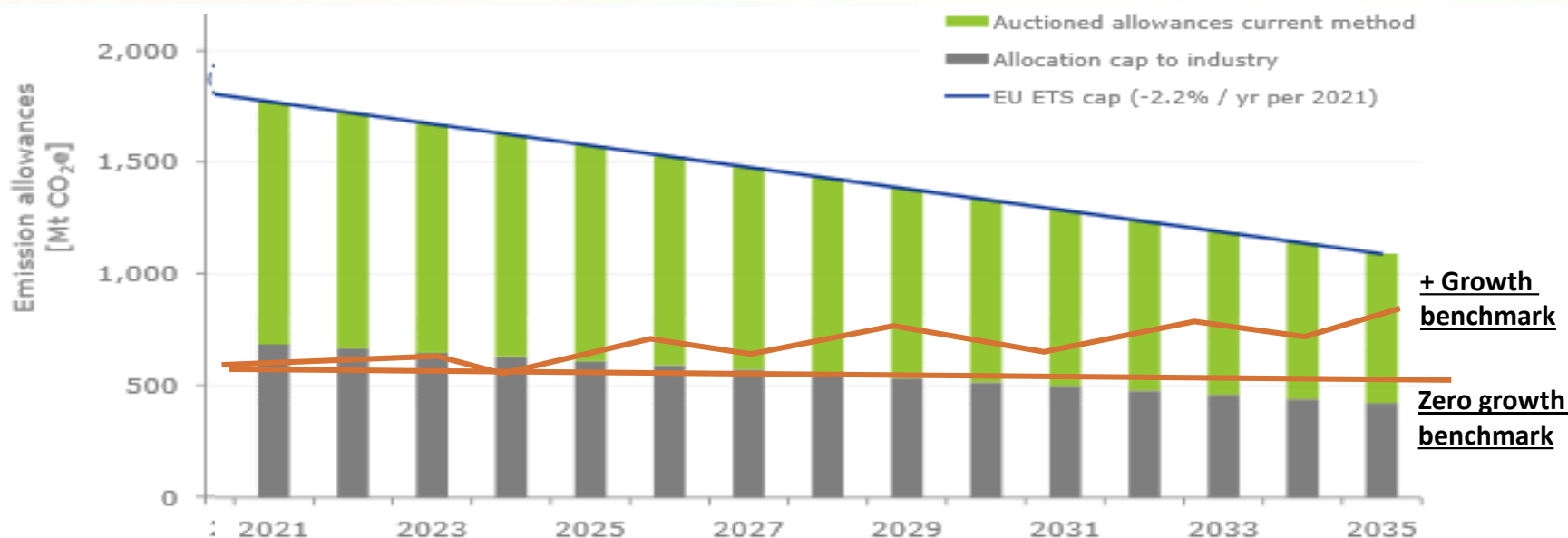
www.theshiftproject.org

Dynamic allocation: background



- **Dynamic allocation is part of an ETS reform package related to the competitiveness issue**
 - **Abolition of the Cross Sectoral Reduction Factor**
 - **« fit to size » allocation reserve = security of allowances supply in the long term**
 - **« realistic » 10% best performers benchmark-based emissions levels**
- **Industrials used to receive massive subsidies through grandfathered free allowances**
 - 1. Why would private sectors decline subsidies?**
 - 2. Who wins, who loses : Member States revenues, Power Sector, Tax payers ?**
 - 3. What are the environmental and economic consequences of a dynamic allocation reform package?**
 - 4. What would be the new shape of the EU ETS?**

Dynamic allocation: financial opportunity and risk reduction for EII and Industry



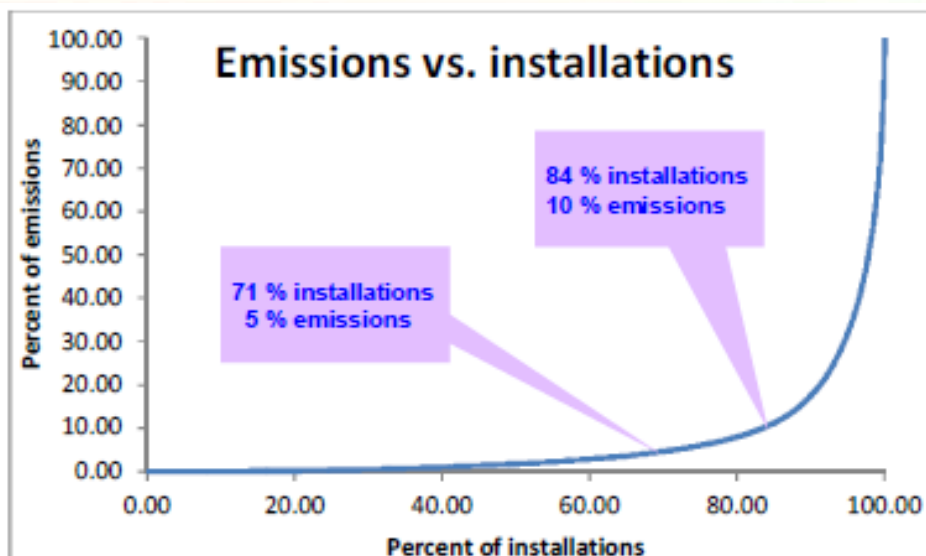
Sources : [Ecofys](#) and Author

The proposal for a dynamic allocation is a positive signal for the ETS long term credibility: EII & Industrials anticipate long term scarcity and react proposing the ETS to act as a carbon performance standard

Compared to former massive subsidies through grandfathered free allocations, in the long term dynamic allocation + abolition of the cross-sectoral factor will:

- Remove the risk of insufficient allowances supply
- Lead ETS compliance cost to zero for the biggest companies in EII/Industry

Benchmark: Business as Usual for a few big groups?



Source : CEPS, 2015

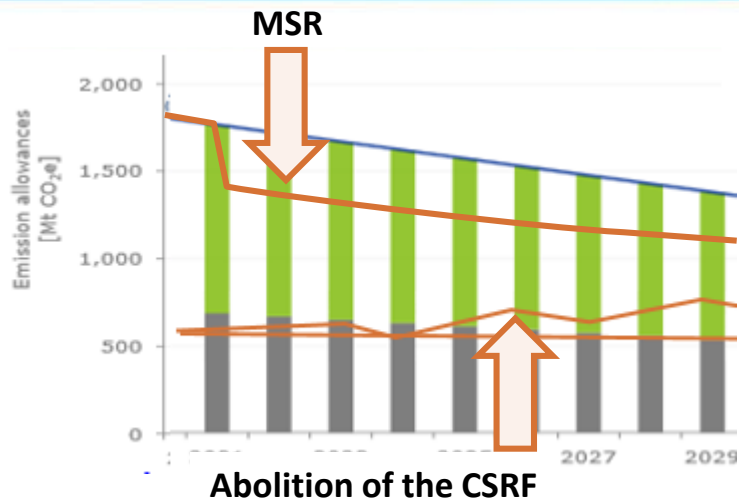
- 90% Verified Emissions by 16% install^o
- 16% install^o = approx. 1760 installations from ~200 sub-sectors → a few tenth install^o in each of the most emitting sectors?
- How many groups are “effective beneficial owners” of install^o emitting 90% of their sectors’ emissions?

Benchmarks will be defined based on the 10% lowest intensity installations covered by the EU ETS.

Considering the highly unequal size distribution of installations, there is a risk that very few major companies controlling tenth of installations and emitting approx. 90% GHG emissions of their sub-sector will receive a “business as usual” benchmark (Aluminium, Cement, Steel)

→ Smaller companies could face competitive distortions within the EU.

Dynamic allocation squeezes allowances availability for the energy sector and increases costs for Member States (



Direct Double-Squeeze: Energeticians will face tighter scarcity

- Less allowances auctioned from the MSR effects
- Less allowances auctioned as a consequence of the end of the CSRF and of dynamic allocations
- Less allowances to be auctioned due to the “fit to size” reserve of allowances for industry and EII

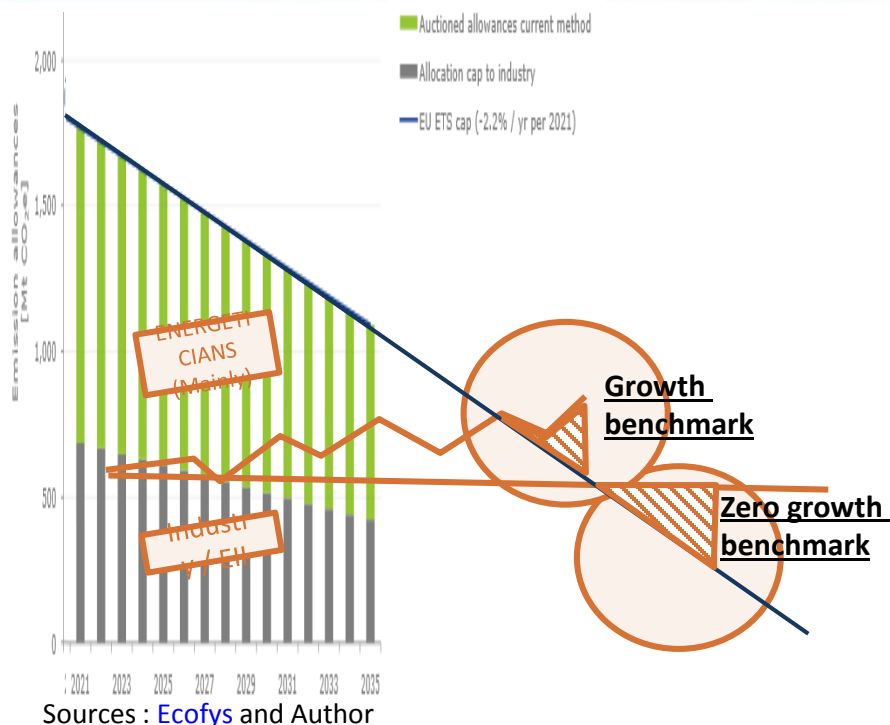
Auction Prices expected to increase

- Increased Carbon Cost on energy to be passed-through to wholesales buyers including EII
- Increased amount of state aid compensation for indirect carbon costs.

- Energeticians want to avoid a triple-squeeze: they want EII to receive cash from Member States and not allowances, to compensate indirect carbon costs.
- Tax Payers will finally pay for increased indirect carbon costs. Will it be sufficient to decarbonize the energy sector? A quantitative assessment is required.

How to cope with benchmark higher than ETS cap in the long term?

How to decarbonize EII and Industries, postponing their mitigation efforts? Who will pay the bill?



IN THE LONG TERM, THE BENCHMARK WILL COMPETE WITH THE CAP

⇒ Will the ETS be withdrawn (cf. Canada) or will EII and Industries anticipate and decarbonize “on time” ???

HOW TO INCENTIVIZE EII&INDUSTRY DECARBONIZATION BELOW BENCHMARKS?

- Competitiveness requires decarbonisation to be performed at industrial and EII level BUT at someone else expense...
- Dynamic allocation will postpone EII and industrial mitigation efforts

⇒ Who will pay the bill? Will they reduce their emissions on time to achieve 2030 and 2050 climate ambitions?

Communication and promotion regarding dynamic allocation



INDUSTRIALS AND EII:

- Set the focus on “dynamic allocation”, bypassing the removal of the CSRF which is absolutely key
- They do also bypass the squeeze on allowances to be auctioned
- Set the focus on technical calculations and figures, at risk of blurring the big picture
- Set the focus on “the end of an unfair subsidy” while, in fact, it is about long term profit and security of supply

ENERGETICIANS:

- Express concern on the squeeze in allowances auctioned. Security of allowances supply “backing” their 3 years anticipated energy sales is key.

MARKET INTERMEDIARIES:

- Involved in hedging for electricity sold up to 3 years in advance, they could face higher demand for options and other derivatives ensuring long term physical delivery

PROSPECTS: what do we propose



Further assess dynamic allocation: quantitative long term impacts, bearing in mind a key question: will it – and when- decarbonize the energy sector through allowances scarcity?

Our proposal below is compatible with dynamic allocation:

- The risk of carbon leakages has been assessed by the EC based on 30€/Ton. This price is the reason why some receive free allocation.**
- An Auction Reserve Price starting at 30 €/Ton would subsequently legitimate current free allocations, and create rewarding paybacks for low carbon investments in the industry.**
- EU Domestic Projects would provide EII and industrials with cheaper compliance costs (cheaper as compared to 30 €/Ton, increasing). Complementing free allocations, this would lead industrials to contribute earlier to cc mitigation.**