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CARBON EMISSIONS

Breaking News

Set-Aside: An Idea That Won't Go Away?

IETA has today circulated a draft Communication of the European Commission entitled *A Roadmap for Moving to a Low-Carbon Economy in 2050*. The document states that the over-supply of EUAs over Phase-2 of the EU-ETS could be compensated for by setting aside 500-800m EUAs from the Phase-3 cap, thus restoring the supply-demand balance envisaged when the Phase-3 cap was originally determined (the Commission made a very similar suggestion in its Communication of 26 May 2010).

Currently, we estimate that the ETS will have a Phase-2 EUA surplus of 405m, and that the total residual abatement requirement over the 11 years 2010-20 will be 378Mt, or 34Mt per year, such that EUA prices should be determined by the short-run marginal cost SRMC of fuel switching (see our report of 31 August 2010, *May You Live in Interesting Times*). As a result, we calculate that if a policy of setting aside 500-800m Phase-3 EUAs were ever to be implemented, this could increase the average residual abatement requirement by 45-73Mt p.a. over 2010-20, resulting in an average residual abatement requirement of 79-107Mt p.a. We think that under such a scenario, and other things being equal, the EUA price would be determined by the long-run marginal cost LRMC of fuel switching, because under such a scenario we estimate that new gas-fired generation capacity would have to be built.

We would emphasize that this is only a draft Communication and that setting aside 500-800m EUAs over 2013-20 is here mentioned only as an idea and not as a concrete policy proposal at this stage. Nonetheless, we think that the persistence of this idea shows a willingness on the Commission's part to consider ways of tightening the ETS cap over 2013-20, and we will be monitoring the ongoing discussion on this issue closely as events continue to unfold.

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