THE ETS INTERNATIONAL CLIMATE ACTION RESERVE

THE EU'S EMISSION TRADING SCHEME AS A SOURCE OF INTERNATIONAL CLIMATE FINANCE

CLIMATE FINANCE: A LEVER FOR INTERNATIONAL CLIMATE ACTION

Climate finance, both pre-2020 and post-2020, will be a central issue at the Paris climate change conference. The Copenhagen climate finance commitment from developed countries to deliver $100bn per year by 2020 has triggered some increases in climate finance, but developed countries are struggling to meet their commitments without taking resources from existing aid budgets. Governments are increasingly looking for the private sector to step in, however this does not fill the growing needs for publicly-financed actions, especially for adaptation, but also for mitigation in less-developed markets.

In addition to addressing how developed countries will meet the $100bn commitment by 2020, the Paris climate deal will also need to demonstrate how financial support will continue beyond 2020. Developing countries rightly ask for greater transparency, reliability and predictability of financial support to enable them to enhance the ambition of their climate action. At the same time, developed countries often state that budgetary processes only allow commitments for one or two years. The Green Climate Fund is particularly important as it will be playing an increasingly central role in channelling climate finance. Pledges made last year amounting to some $10 billion have been a welcome step; yet, going forward, the Green Climate Fund should increasingly be replenished in automatic ways, to supplement multi-annual replenishment processes that depend on political will and hamper longer term predictability.

AN EU ETS INTERNATIONAL CLIMATE ACTION RESERVE

The EU Emission Trading Scheme (ETS) will be revised starting in 2015 in line with the agreements reached by EU leaders on the EU 2030 Climate and Energy Package and the EU ambition to reduce carbon emissions by at least 40% in 2030. This revision offers a unique opportunity to increase transparency and predictability of climate finance from the EU and its Member States by establishing a mechanism that automatically directs a portion of the ETS revenues as additional international climate finance.

The ETS revision needs to include substantial changes to turn it into an effective mitigation and financing instrument, including the permanent cancellation of the large surplus of allowances and a move towards full auctioning of all allowances. The EU ETS currently grants generous exemptions to large industries. About €10 billion are annually diverted from taxpayers to the EU's largest polluters. Instead this revenue should be used to finance climate protection in Europe and abroad.

Oxfam commissioned the Institute of European Studies (IES) to assess the feasibility of technical options for revenue-raising from the EU ETS. The study found that the greatest predictability would be gained in the case of a new **ETS International Climate Action Reserve**, following the examples of the New Entrants Reserve 400 (NER400) and the Modernisation Fund.

Political agreement has already been reached that the revised EU ETS will include two EU level funds, one to support innovation in industry (NER400) and one to compensate poorer EU states for the cost of modernising their energy infrastructure (Modernisation Fund). The proposed international climate finance reserve could follow the precedence of these two funds, and support developing countries with the costs they face due to climate change.

OPERATIONALISATION OF THE RESERVE

- After 2020, a fixed percentage of the EU emissions allowances (EUAs) destined for auctioning would be put into the reserve before the remainder is allocated to Member States. Auctioning revenues at national level, in accordance with current legislation, should also be spent on supporting climate action– both domestically and internationally.
- EUAs held in the reserve would be auctioned by the EIB in coherence with the overall auctioning schedule.
- Revenues resulting from auctioning EUAs would be channelled to the Green Climate Fund or to other bi- or multilateral partners of the EU and its Member States in implementing their commitments under the UNFCCC[1].

SUBSTANTIAL AND PREDICTABLE FINANCE FOR THE GREEN CLIMATE FUND

Establishing this reserve would greatly enhance the long-term visibility and predictability of a sizeable proportion of overall climate finance from the EU and its Member States. Especially in combination with the Market Stability Reserve that will avoid high price volatility of EUAs, the reserve would allow for a predictable revenue stream for international climate finance purposes such as the Green Climate Fund.

- The IES research estimates that with the introduction of a 10% reserve for international climate solidarity**, €34.88 billion could be raised over the period 2021-2030**, with an estimated average carbon price of €22.5 per EUA in the period 2021-2030. This would result in on average, over **€3 billion per year for the Green Climate Fund.**
- A 5 % reserve would raise on average €1.7bn a year, and a 2% reserve would raise on average €0.7 bn a year.

ATTRIBUTION TO MEMBER STATES

The IES study suggests that the same effort sharing formula that is applied on the overall allowances distribution[2] could be applied to the international solidarity reserve. This could lead to low or even zero 'contribution' by Member States with low GDP per capita (i.e. 'contribute' relatively less to the reserve); and a proportionally higher 'contribution' by richer Member States. Member States would be able to report the flows from the reserve as

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1 As an alternative option, permits held in the reserve could be transferred directly to the Green Climate Fund, leaving the monetisation in the hands of the GCF (following the example of the Adaptation Fund that monetises the 2% of CDM credits it receives from CDM projects once issued). This option would currently not be in conformity with the resource mobilisation modalities of the GCF as the GCF board has decided that for the time being, contributions to the fund would be either grants, concessional loans or paid-in capital contributions, although other forms and sources could be explored in the future. Arguably, accepting EUAs as contributions could be considered here.

2 Based on the proportion of historical verified emissions and adjusted by a GDP per capita rebalancing mechanism.

supplementary to their own budgetary climate finance contributions, applying the effort sharing key.

POLITICAL RELEVANCE TO THE NEGOTIATIONS

The EU needs a successful international climate deal to help move forward with its own climate and energy ambitions and decarbonisation strategy. To get a successful climate deal, the EU needs to stand with the most vulnerable countries and prioritise its alliance with them. For these countries, climate finance - particularly for adaptation – is crucial, and they need guarantees that there are clear provisions to ensure that post 2020, climate finance will still be available at increased levels. The ETS international climate finance fund is a way in which climate finance guarantees can be given, solidarity can be built and allies can be supported.

The reserve as proposed would give a clear unequivocal signal to developing countries that the EU is ready to make supplementary financial commitments to support developing countries, independent from changes in political priorities at Member State level as well as from short-termism and ad-hoc commitments inherent in annual budgetary cycles. As pressure to deliver on climate finance, particularly for the post 2020 period, is certain to gain momentum in the run up to the Paris climate deal, the ETS international climate solidarity reserve is an idea whose time has come and which will increase the likelihood of a successful Paris climate deal.

CALENDAR

Legislative proposal on the EU ETS revision:

- July: Commission publishes legislative proposal on revised ETS
- October: (tbc) European Parliament report on Commission's proposal
- 2016: Council position possibly only after Paris agreement, though political agreement could be made earlier if politically important

Other relevant processes:

- Financing for Development (FFD)
  FAC Development Ministers, EU position on FFD (26 May)
  UN Financing for Development Conference, Addis, Ethiopia (13-16 July)
- "Towards a new international climate agreement in Paris": European Parliament Own Initiative Report
  Draft report for consideration: 16 June
  Deadline for amendments: 17 June
  Adoption in ENVI: 22-23 September
  Vote in Plenary: October (tbc)
- EU council preparations for COP
  Informal EU environmental ministers meeting on climate finance, July (date tbc)
  Informal ECOFIN meeting on climate finance, September (date tbc)
  ECOFIN on climate finance, October (date tbc)
  EU council position on COP21, November

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