Stabilising the Carbon Price
Overview of the Issues and Options

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ICAP-PMI Asia Pacific Training Course on Emissions Trading
Bangkok, 17 October 2023
1. (Why) should the carbon price be stabilised?
2. Different options to stabilise the carbon price
(Why) should the Carbon Price be stabilised?
(Why) does the carbon price need to be managed or stabilised?

Do you think it is desirable to have a high carbon price – or a low one?

To provide your answer:

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Should the carbon price be managed?

Yes, because…

• Investors need long-time certainty – but how far does the carbon market look into the future?

• Price spikes can create social and economic hardships – and political opposition

No, because…

• An ETS is not a tax – guarantees a certain emission level, not a certain price

• It is impossible to reliably determine the “right” C price

• Carbon price should be taken out of the political ballgame
Volatility of ETS prices: price slump in the 2010s

almost 10 years with a carbon price of less than 20 Euro

6 years with a carbon price < 10 Euro
Volatility of ETS prices: steep rise of C prices since 2017

- June 2017: EUR 5.15
- June 2019: EUR 24.41
  - + 373%
- February 2022: EUR 94.07
  - + 285%
What are the Options to manage the Carbon Price?
• In ETS auctions, allowances are not sold if the clearing price is below the price floor. Unsold allowances are retired – i.e. cap is reduced.
• Allowances can trade lower on the secondary market – but not for long.
• Only works if there is substantial auctioning
• Alternative: regulator buys back allowances if the market price falls below a given level.
• Similar but different concepts:
  • Auction reserve price (to avoid collusion & fraud)
  • Top-up fee / surrender charge (partial floor price)
• **Regulator commits to sell any number of allowances at a given price.** Logically, the market price cannot exceed this price level.

• **When the price ceiling is reached, the cap no longer constrains emissions effectively** – regulator prints as many allowances as needed to meet the demand.

• **Price floor and price ceiling can be combined to form a price corridor** (or price collar).
The EU solution: the MSR (market stability reserve)

- The Market Stability Reserve absorbs or releases allowances based on the size of the allowance surplus on the market.
- The reserve is volume-based: the size of the surplus of allowances determines whether allowances are added to or taken out of the market.
- The reserve is rule-based: thresholds automatically trigger reserve feed or release. No room for discretion based on political considerations.
- The reserve is an integral part of the EU ETS.
The Californian approach

- **Fixed and rising floor price** implemented as auction reserve price: unsold allowances go into the auction holding account, and auctioned later.

- **Allowance Price Containment Reserve**: certain share of allowances (< 10%) is placed in a cost containment reserve and can be bought at a fixed price (two tiers at 41 and 53 US$). Until now, prices have not reached this level.

- **Allowances in the reserve are part of the cap** – reserve is cap-neutral. Reserve will cushion price spikes, but will not set a hard ceiling.
Delegate price stability: a central bank for carbon?

- In the same way that Central Banks control inflation (and balance other economic objectives) – could a **carbon central bank** identify the “right” carbon price and adjust allowances in circulation accordingly?

- **Discretionary interventions:** carbon central bank is mandated to control auction amounts in order to lower or increase the supply of allowances, or to buy back allowances from the market.

- So far mostly a theoretical idea: Elements of this idea taken up in the **Korean Allocation Committee**, but with a quite limited mandate.
Good idea or bad idea?

Which price management approaches are sensible and practicable?

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Thanks! Any more Questions?

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Some takeaways / considerations

We cannot afford another decade without a strong enough carbon price. Carbon markets haven’t always anticipated long-run scarcity but seemed to be driven by short-medium term supply and demand factors. Price management can fix this and is therefore included in most ETS.

When it comes to linking carbon markets, price management is particularly tricky (as it is highly contagious).

Many countries and jurisdictions now have climate laws – often with emission targets / trajectories or carbon budgets, and often including review by expert councils. Could this lead to a renaissance of discretionary approaches?
How does the Market Stability Reserve work?

Each year, regulator establishes if there is a surplus of “allowances in circulation”

- If surplus > upper threshold, a defined share of allowances is not auctioned but instead flows to the MSR
- If surplus < lower threshold (scarcity), a defined number of allowances is released from the MSR
- As of 2023, if MSR > auction amount in the previous year, surplus allowances from the MSR will be retired

Upper threshold: 833 m EUA
Lower threshold: 400 m EUA

Total number of allowances in circulation

24% of surplus withheld from auction (after 2023: 12%)

200 m EUA released
Germany established a separate national ETS only for emissions from transport and buildings.

Started 1 January 2021 with a fixed price of 25 Euro per ton, rising to 55 Euro in 2025.

As of 2026, carbon price should fluctuate within a range of 55 to 65 Euro per ton.

Works like a tax – but it is an ETS (of sorts).