Ecologic Institute
Science and Policy for a Sustainable World

Stabilising the Carbon Price

Overview of the Issues and Options

Benjamin Görlach, Ecologic Institute

ICAP-PMI Asia Pacific Training Course on Emissions Trading
Bangkok, 17 October 2023

Table of Contents

(Why) should the Carbon Price be stabilised?

© Miredi– source Fotolia.com

(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:

Click on the link in the chat,
scan the QR code with your phone or
head to **menti.com** and enter the code **6796 0963**

Should the carbon price be managed?

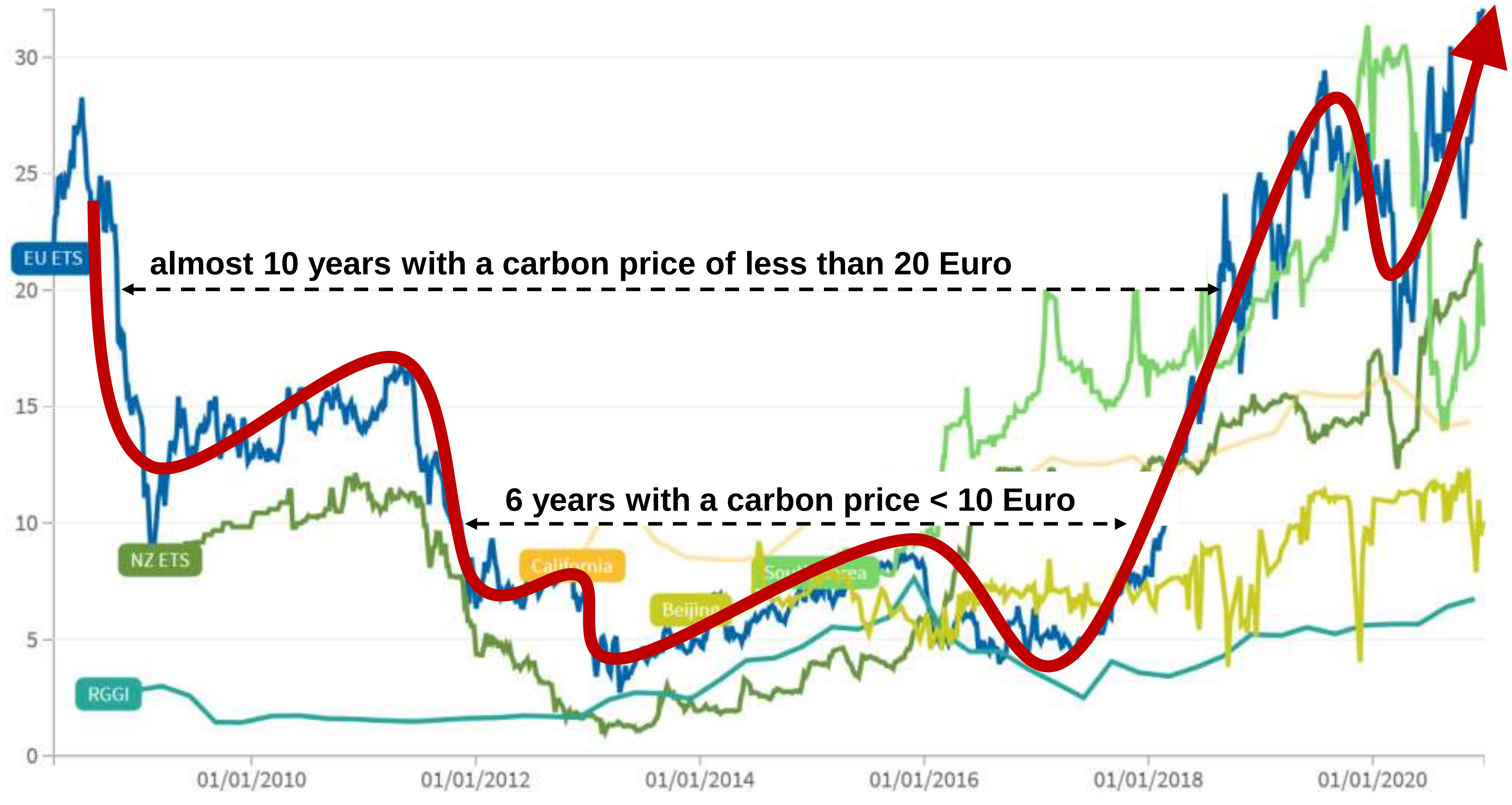
Yes, because…

- **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



Volatility of ETS prices: steep rise of C prices since 2017

What are the Options to manage the Carbon Price?

Genuine price floor

- 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)

Genuine price ceiling

- **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?

To provide your answer:

Scan the QR code with your phone or
head to **menti.com** and enter the code **6796 0963**

Thanks! Any more Questions?

Benjamin Görlach

benjamin.goerlach@ecologic.eu

Ecologic Institute

Pfalzburger Str. 43/44
10717 Berlin
Germany

Tel. +49 (30) 86880-0

ecologic.eu

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.

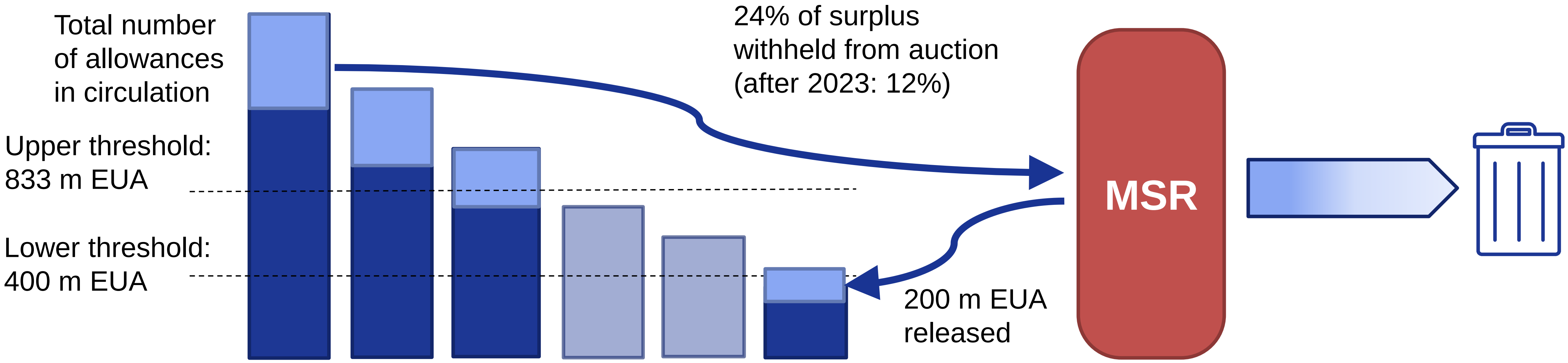
When it comes to **linking carbon markets**, price management is particularly tricky (as it is highly contagious)

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**



The German solution

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).