JOINT MINISTERIAL STATEMENT ON THE MARKET STABILITY RESERVE

1. The EU Emissions Trading System (ETS) has enabled the EU to be a global leader in promoting the principle of emission trading internationally. However, the EU ETS also needs reform to ensure that it operates optimally.
2. Carbon pricing mechanisms, inspired in large part by our own EU ETS, are being rolled out across many parts of the world. Currently around 40 national and over 20 sub-national jurisdictions have already implemented or scheduled emissions trading schemes or other carbon pricing mechanisms such as a carbon dioxide tax. Most recently and notably, the seven ETS pilot schemes in China are a prelude to a national scheme covering the world's largest economy, something that we warmly welcome and encourage.
3. However, while the EU ETS is clearly a very cost-effective tool to decrease emissions of greenhouse gases, it is also suffering as a result of two critical issues that must be urgently addressed.

Two critical EU ETS issues that must be addressed:

4. First, unlike many other trading systems around the world, and unlike normal free markets, **the EU ETS market has no flexibility** within a phase to adjust supply in response to large changes in demand. This has meant that the market has been unable to cope with the huge surplus of over 2 billion allowances, which is still rising rapidly. In turn, we have seen a dramatic slump in the carbon price which is putting in jeopardy the ability of the EU ETS to act as the central tool for cost-effectively decarbonising the power and industrial sectors.
5. Second, **the return of backloaded and other allowances to the market at the end of phase III**, is widely predicted to cause substantial market turbulence, further undermining investor and wider confidence in the EU ETS.
6. Without a more stable and meaningful low carbon investment signal from the EU ETS, that engenders market confidence, we risk seeing critical low carbon investments delayed and the overall costs of decarbonisation rise unnecessarily in the future.

A Stronger MSR can ensure that the EU ETS delivers the low carbon investment we need at least cost:

7. We therefore warmly welcome the draft Market Stability Reserve (MSR) legislation. The MSR has the potential to provide a rules-based market mechanism to address both of these issues, and provide comfort to industry by allowing for the reintroduction of allowances under a demand shock. However, the legislation must be significantly strengthened in two key ways.
8. First, **we cannot wait until 2021 for the MSR to come into place**. By that time, the level of surplus in the EU ETS is likely to be significantly higher according to market analysts, with the resulting risk that critical low carbon investments needed this decade, are further postponed into the future, increasing decarbonisation costs and further undermining confidence in the system. **We therefore call for the MSR to start in 2017**.
9. Second, as currently drafted, the MSR does not fully address the problems resulting from the return of a very substantial number of allowances at the end of Phase III. **These allowances must either be put into the reserve or otherwise addressed to avoid damaging the credibility and stability of the EU ETS.**

10. To ensure MSR parameters are appropriate in an evolving carbon market whilst preserving certainty for the market, introduction of the MSR in 2017 must be at least accompanied by early review, so that any necessary adjustments needed to the MSR, including to the thresholds and rates, can be done quickly.
11. **We look forward to working with the Presidency, our Council colleagues and the European Parliament to secure a rapid agreement to the stronger MSR that Europe urgently needs. We stress the need for all sides to come together to seek an ambitious and pragmatic outcome that has majority support across the institutions.**

<u>Carbon Leakage & Sustainable Reindustrialisation:</u>

12. **Our governments take the potential risk of carbon leakage extremely seriously** – that is, the risk that a higher carbon price could in future be driving Energy Intensive Industries to relocate overseas. We are therefore fully supportive of the October European Council Conclusions that underline that carbon leakage prevention through the free allocation of allowances to industries at significant risk must continue in the EU ETS Phase IV from 2020 to 2030, as long as no comparable efforts are undertaken in major economies, and with better alignment with changing production levels in different sectors. Both direct and indirect carbon costs should be taken into account, in line with the EU state aid rules so as to ensure a level-playing field.
13. **We therefore call for the Commission to – following an adoption of a robust ambitious MSR - bring forward draft phase IV EU ETS legislation, including post-2020 carbon leakage proposals, within 6 months.**
14. **We believe that the current EU level carbon leakage prevention measures before 2020 are sufficient.** Governments are due to issue over 6 billion free allowances to industry between 2013 and 2020. We note that the existing EU carbon leakage protection measures in place up to 2020 are based on an assumed carbon price of €30/ tonne, well above the current carbon price, and that no independent market analyst has projected an EU ETS price above €30/ tonne before 2020, even with a much strengthened MSR.
15. **We note that there are many factors that determine the competitiveness of industry, and the price of energy, with the carbon price being one very small contributor.** We note the findings in the IEA's 2013 World Energy Outlook that the EU carbon price is not driving the divergence between US and EU energy prices in recent years. We also note that multiple studies have found no evidence to date of relocation of production to third countries due to the EU ETS.
16. **We underline our determination to ensure that European industry remains competitive, innovative and sustainable in the short-, medium- and long-term,** and our desire to work closely with industry in this endeavour. We note the new opportunities to do so through, for example, Horzion2020, the NER400 and the building of an Energy Union with an ambitious and forward looking climate change policy.

Signed by:-

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