

## Romania in the ETS

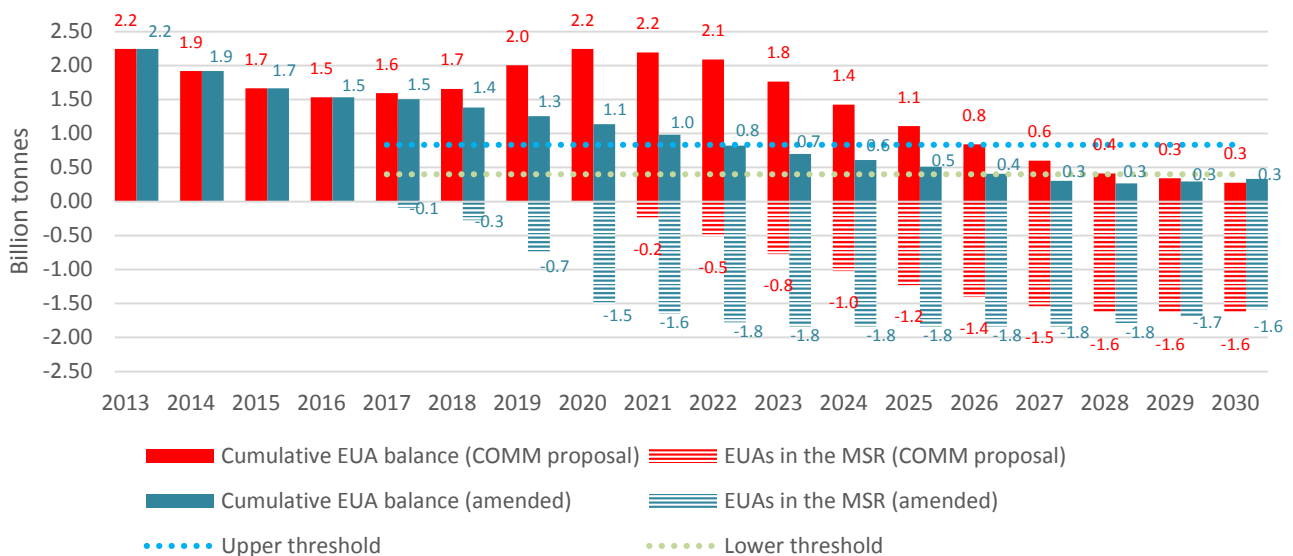
### Arguments for the introduction of a Market Stability Reserve

The Romanian government position on the Market Stability Reserve (MSR) proposal in the Council of Ministers is endangering vital reforms to ensure the EU's climate policy is economically effective. This position is very difficult to understand since Romania enjoys a very comfortable position in the ETS. Its EUA balance (free allowances plus auctionable allowances, minus verified emissions) in 2013 was more than 31.4 Mt, the second highest in the EU. **Of all EU countries Romanian manufacturers also held the highest level of accumulated surplus relative to its emissions (92%).**

With the current free allocation regime set to continue in Phase 4, such continuously accumulating balances will insulate Romanian manufacturing industries from any putative negative effects that an MSR might produce all the way to the late 2040s. If anything, rather than opposing an enhanced MSR, the Romanian government should welcome the additional source of revenue that a gradually improving carbon price will produce.

### Background

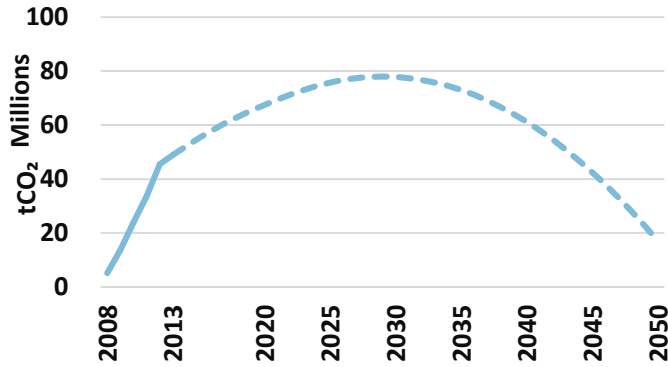
The EU's flagship instrument on climate, the Emissions Trading Scheme (ETS), finds itself already oversupplied by more than 2 billion allowances (EUAs) with more being added every day. We estimate that this already huge surplus (equivalent to one year's full emissions) could double by 2020 unless action is taken to redress the balance of supply and demand in the market. This lack of scarcity can lead to the undoing of emission cuts achieved so far, and is preventing the ETS from channelling the future investments of European businesses into low-carbon technologies.



**Figure 1: How an enhanced MSR could rein in ETS surpluses, using the Commission's emissions forecast (amended proposal starts the reserve in 2017 rather than 2021, and prevents the backlog and unused allowances from reaching the market)**

The oversupply of EUAs is the outcome of a situation where low market demand meets a supply that has been set inflexibly too high. The Council is debating a proposal by the Commission to introduce a Market Stability Reserve (MSR), which would constitute a transparent, rules-based and predictable mechanism to flexibly adjust supply by acting on auction volumes, so that such imbalances are avoided in the future.

## Manufacturing surpluses



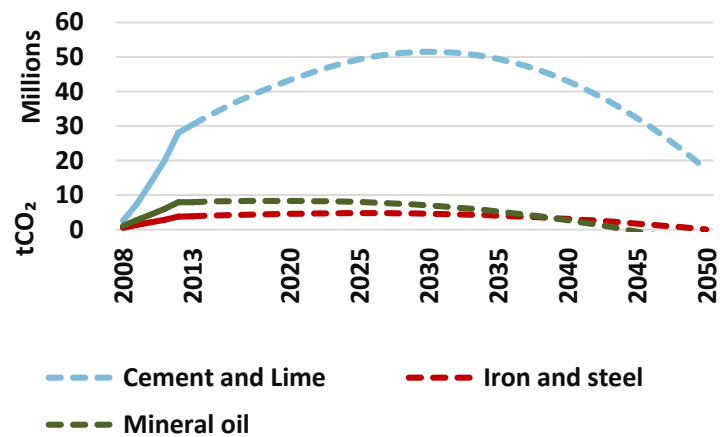
**Figure 2: Cumulative EUA balance for Romania's manufacturing sector until 2050.**

*(Emissions assumed stable at 2013 levels. Excludes aviation & combustion. LRF -2.2% post-2020. Historical offset use only. Surplus projections do not account for waste gas transfers between installations, as the data is not publicly available, meaning cumulative balances may be lower than shown).*

Romanian manufacturing installations are set to receive, under present policies, enough free EUAs to last them even past 2050 (Figure 2).<sup>i</sup> Because it will not need to purchase a single allowance before that date, the Romanian manufacturing sector will be completely insulated from any incentives to decarbonise – even though the EU has set itself the goal to cut its emissions 80-95% by that year!

Even when looking more closely to the country's three biggest ETS sectors, making up 85% of Romanian manufacturing emissions in 2013, one notices that structural surpluses last well into the 2040s, as can be seen from Figure 3. Moreover, 53% of Romania's manufacturing emissions are concentrated in just three multinationals in the

cement and lime sector, none of whom will face a cumulative shortage before the year 2045, as shown in Figure 4. It is economically rational for these companies to call for a strong MSR, because the market scarcity the MSR is set to induce would turn their respective surpluses into assets whose value would steadily increase over time. And indeed we see that many heavily oversupplied companies are supporters of ETS reform.



**Figure 3: Cumulative EUA balance for Romania's three manufacturing sectors with the largest emissions in 2013.**

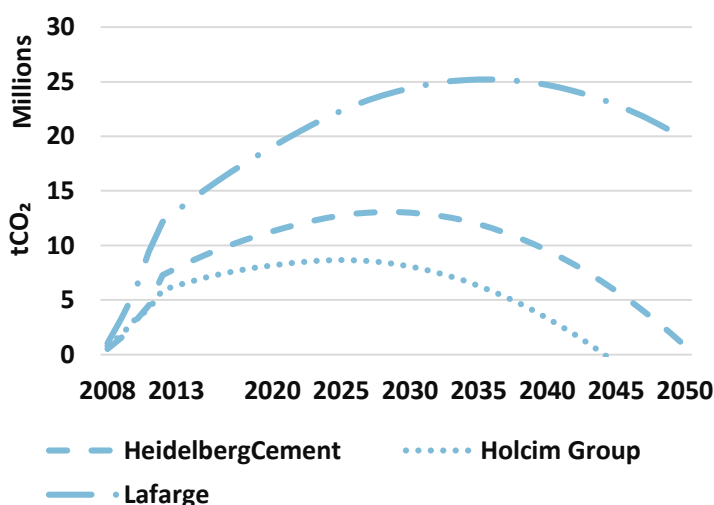
## Power surpluses

Unlike most countries covered by the ETS, Romania also continues to receive significant volumes of free EUAs also for its electricity production under Article 10c of the ETS Directive.

In fact, as shown in Figure 5, Romanian emissions from electricity generation have been steadily falling for a long time, which means that Romanian generators will be able to use Article 10c allowances to cover their entire

emissions for a period of nearly three full years. This, as shown in Table 1, is the second longest duration of any of the EU countries whom this measure is available to, making Romanian electricity consumers some of the best protected in the EU against the impact of the ETS on energy prices through indirect costs.

More importantly, while this long interval can partially be explained by the fact that electricity generation has fallen as a result of the economic crises of recent years, as shown in Figure electricity generation in Romania has in fact been steadily decarbonising since 2006, when inefficient Communist era thermal generation started being phased out, a new Romanian nuclear reactor came online, and renewable generation, especially wind, started receiving production subsidies. These trends are set to continue in the future.



**Figure 4: Projected cumulative balances for Romania's highest emitting cement companies in 2013**

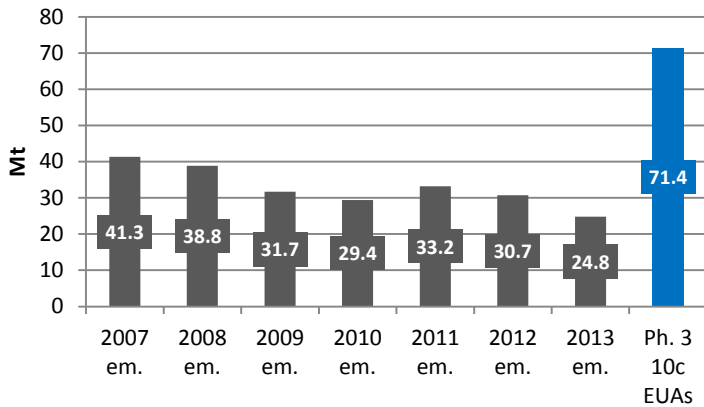


Figure 5: Scale of free allocation (under Article 10c) for Romanian electricity generation relative to historical emissions.

## Auction revenues

Over Phase 3 alone, once accounting for diminished auction volumes due to transfers to the power sector under Article 10c, and assuming uniform contributions to the backload, Romania can expect to auction around 324 million EUAs. Given current market expectations (the expected average yearly futures prices for EUAs listed on the Intercontinental Exchange) without any MSR the auctioning revenue would amount to around €2.4 billion.

However, with an MSR that starts in 2018 and that removes the backload and unused allowances, the modest increase in the carbon price would increase

auction revenues for the Romanian government to around €3.6 billion (Using price forecasts calculated by Thompson Reuters PointCarbon). **Thereby, by opposing a strong MSR, the Romanian government is forsaking the difference, a whopping €1.2 billion.**

## Conclusion

The decisions of the October 2014 Council ensure that post-2020 Romania will enjoy increased revenues due to a higher share of auctionable allowances, additional funds for the modernisation of its energy system from a dedicated reserve, as well as the continuation of the Article 10c regime protecting its electricity generators. Furthermore, even before 2020 a host of low interest loans are available to any Romanian manufacturing installations that wish to enhance their energy efficiency and thereby receive revenues from the sale of spare allowances.

This series of provisions give Romanian industry and consumers ample protections against starting the MSR early and placing the backloaded and unused allowances into the reserve. Given that implementing exactly these measures could also give the country **€1.2 billion** in extra revenues, this leaves Romania little justifiable reasons to oppose the best hope for effective reform of the EU's flagship instrument on climate policy.

Country	Duration	Rank
Bulgaria	2.1 years	Tie for 4 <sup>th</sup>
Cyprus	3.9 years	1 <sup>st</sup>
Czech Republic	2.1 years	Tie for 4 <sup>th</sup>
Estonia	1.5 years	6 <sup>th</sup>
Lithuania	1.4 years	7 <sup>th</sup>
Poland	2.5 years	3 <sup>rd</sup>
Romania	2.9 years	2 <sup>nd</sup>

Table 1: Duration which free EUAs will cover 100% of generators' emissions in countries making use of Article 10c provisions.

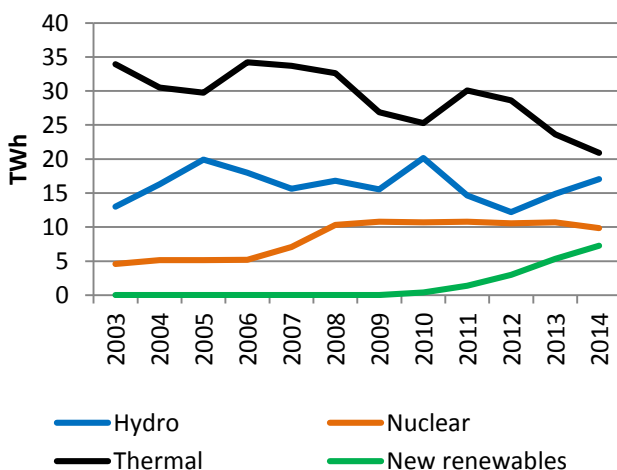


Figure 6: Time series of electricity generation in Romania by fuel source. (Source: ENTSO-E.)

<sup>i</sup> The EU transaction log currently does not share data on waste gas transfers. Some industrial installations transfer waste gases to combustion installations together with a corresponding amount of freely allocated allowances. Such allowance transfers can occur within companies or between companies and hence may reduce companies' overall allowance balances. Sandbag has been able to collect some data on allowance transfers from specific companies and industry bodies. However, without visibility of complete data it is not possible to calculate precise balances split by country, sector and company. Sandbag strongly urges the European Commission to enhance the transparency of the European Environment Agency's Data Viewer by making data on allowance transfers explicitly visible.