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With a view to the Council (Environment) on 20 June 2016, delegations will find in the Annex a non-paper from Sweden.

ANNEX

SWEDEN

Swedish Government's views on the Commission's proposals to remove unallocated allowances from the Market Stability Reserve

The Market Stability Reserve (MSR) is an important step towards ensuring the short and long-term efficiency of the EU's Emissions Trading Scheme (EU ETS). The agreement reached between the Council and European Parliament in May 2015 included important provisions about how unallocated emissions allowances from the third trading period would be dealt with. Unallocated allowances from phase 3 shall be placed in the reserve in 2020. The Commission shall then review the EU ETS Directive in relation to those unallocated allowances and, *if appropriate*, submit a proposal to the European Parliament and to the Council.[1]

The Commission has proposed in its review of the EU ETS that the new entrants' reserve will be created with 250 million of unallocated allowances from the MSR. Furthermore, the Commission proposes that 50 million allowances are used to create the innovation fund.

Sweden is deeply concerned by the Commission's proposal to take unallocated emissions allowances from phase 3 from the MSR to create the new entrants reserve. Similarly, Sweden is concerned by the Commission's proposal to take 50 million allowances from the MSR to strengthen the Innovation Fund, unless all other elements of the MSR Agreement from 2015 are upheld. This agreement foresaw that unallocated allowances from phase 3 would be transferred into the MSR and did not mention using these unallocated allowances for other purposes such as the new entrants' reserve.

[1] See Article 1, paragraph 3 of the Decision (EU) 2015/1814 of the European Parliament and of the Council of 6 October 2015 concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading scheme and amending Directive 2003/87/EC:
”Allowances not allocated to installations pursuant to Article 10a(7) of Directive 2003/87/EC and allowances not allocated to installations because of the application of Article 10a(19) and (20) of that Directive shall be placed in the reserve in 2020. The Commission shall review Directive 2003/87/EC in relation to those unallocated allowances and, if appropriate, submit a proposal to the European Parliament and to the Council”.

There is a surplus of allowances of almost 2 billion allowances on the market at present. In order for the MSR to have the greatest effect, it is essential that all unallocated allowances from phase 3 remain in the MSR and will not be released onto the market during phase 4.

The Commission's impact assessment of the EU ETS review analysed a number of different policy options against the baseline of placing all unallocated allowances in the MSR. The Commission claims in its impact assessment that the risk of carbon leakage is lower if unallocated allowances from phase 3 are used to fill the new entrants' reserve as the allowances do not need to be taken from the pot of allowances for free allocation under phase 4.

If free allocation for installations not at risk of carbon leakage were removed as Sweden has argued, this would provide a significant number of extra allowances available in the free allocation pot for the new entrants' reserve. Sweden is also open to exploring other options for taking allowances from phase 4 to fill the new entrants' reserve.

Furthermore, the Commission's own impact assessment concludes that the functioning of the MSR would be impacted negatively if unallocated allowances from phase 3 were taken to fill the new entrants' reserve.

The Commission's impact assessment also analyses the use of unallocated allowances for innovation support. In the agreement between the Council and the European Parliament, the Commission's review would consider whether up to 50 million unallocated allowances should be used to supplement existing resources to promote projects under the Innovation Fund.

Sweden believes that there is no need to take an additional 50 million unallocated allowances from phase 3 to add to the Innovation Fund when the NER300 program has significant volumes of funds which have not been disbursed.

By removing unallocated allowances from phase 3 from the MSR, the Commission's proposal increases the total number of allowances available for use during phase 4. This step of increasing the total number of allowances available goes entirely against steps to reduce the total cap and the number of allowances available under the EU ETS.

It is essential for the short and long-term efficiency of the EU ETS that the MSR functions properly. The Commission's proposal risks significantly undermining the function of the MSR by removing unallocated allowances from phase 3 from the MSR for use during phase 4. Therefore, Sweden proposes that all unallocated allowances for phase 3 remain in the MSR. The allowances needed for innovation support and to create the new entrants' reserve should be taken from the pot for free allocation for phase 4 whilst all free allocation to sectors not at risk of carbon leakage should be phased out.