MCC Press Release

Why a European Carbon Central Bank Authority could reduce political uncertainty and stabilize investors’ expectations on the EU ETS

November 6, 2014. Berlin. Establishing a European Carbon Central Bank is a possible pathway to tackle low political credibility of the European Emissions Trading Scheme (EU ETS) among investors. Delegation of power to an independent authority could also enhance the flexibility of the system. These were the key findings of the new study “Afters Monetary Policy, Climate Policy: Is Delegation the Key to EU ETS Reform?” lead by Godefroy Grosjean, guest researcher at the Mercator Research Institute on Global Commons and Climate Change (MCC). It is now published in the journal “Climate Policy”.

The new paper comes at a time when European climate policy is at a crossroads. Its centerpiece, the EU ETS, is currently under great scrutiny and likely to be reformed as a result of the collapse in EUA prices. At the same time, policymakers have agreed on the 2030 framework for energy and climate policies, which will influence the functioning of the EU ETS. Reform proposals such as a price corridor, sectorial expansion to transport and buildings as well as a reduction of free allocations of allowances have already been discussed by the MCC and others.

The new research maps current reform options in the context of the credibility problems found in long-term policy. Based on the experiences from monetary policy, it shows that if political uncertainty and lack of long-term commitment are the main drivers of the low price, delegation of authority could represent an appropriate option to alleviate the credibility problems that long-term policy has. It could also provide higher flexibility in response to unexpected economic and policy events. Another MCC study has just shown that market fundamentals account for at most 10 percent of the decline in prices but indicated that the price is significantly influenced by the uncertainty among investors about the realization of long-term climate targets.

“The independence of a carbon central bank might increase the credibility of the EU ETS, if it is introduced on a clear and transparent institutional framework and mandate,” says Godefroy, a researcher at the Potsdam Institute of Climate Impact Research and guest researcher at the MCC. “Its long term stability goals would make it harder for intervention based on short-term political consideration. Nevertheless, delegation to an independent body is unlikely to be a silver bullet due to institutional hurdles in creating such an agency.”

Major political barriers stand in the way of an authority like a carbon central bank. “Setting up an independent body with discretionary power requires a modification of the European Union treaties, which is
difficult in the current political context,” says MCC director Ottmar Edenhofer. “A carbon central bank would have to be supported by democratic legitimacy on the EU level.”

Despite the potential barriers, however, the idea of establishing an independent body has merit. “Climate policy is likely to be a work-in-progress in the coming decades due to the depth of uncertainty. Therefore, advancing the understanding of a carbon central bank is appealing because it might be an appropriate instrument to stabilize investor’s expectations even in the presence of further economic and policy shocks”, says MCC co-author Christian Flachsland.

About the MCC
The MCC explores sustainable management and the use of common goods such as global environmental systems and social infrastructures in the context of climate change. Six working groups conduct research on the topics of economic growth and development, resources and international trade, cities and infrastructure, governance and scientific policy advice. The MCC was jointly founded by the Mercator Foundation and the Potsdam Institute for Climate Impact Research (PIK).

References of the cited articles:
Grosjean, Godefroy; Acworth, William; Flachsland, Christian; Marschinski, Robert (2014): After Monetary Policy, Climate Policy: Is Delegation the Key to EU ETS Reform?, Climate Policy DOI: 10.1080/14693062.2014.965657

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