Ratcheting Up Carbon Trade: The Politics of Reforming EU Emissions Trading

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Abstract

The EU's emissions trading system (ETS) covers almost half of its greenhouse gas emissions and has been hailed as the cornerstone and flagship of EU climate policy. In spring 2013, however, the ETS was in severe crisis, with a huge surplus of allowances and a sagging carbon price. Even a formally simple measure to change the timing of auctioning was initially rejected by the European Parliament. Two years later, a much more important, quantity-focused "market thermostat" (the market stability reserve) was adopted, and proposals for a complete ETS overhaul were put on the table. This article examines how it was possible to turn the flagship around so quickly, providing insights into the mechanisms for gradually rendering emissions trading systems more effective. Crucial changes at the EU and national levels are identified, chief among them changes in Germany and in the European Parliament. Furthermore, the quantity-based tightening mechanism discussed could be of relevance for carbon markets outside Europe.

The EU emissions trading system (ETS) covers almost half of the EU's greenhouse gas (GHG) emissions and has been hailed as the cornerstone and flagship of EU climate policy. The twenty-eight countries of the EU (EU28) comprise the world's third-largest GHG emitter, responsible for about 10 percent of global emissions. With the EU ETS, launched in 2005, the EU has become an international frontrunner in the use of carbon trading.

However, starting in 2010 the ETS found itself in severe crisis, with a surplus of allowances and a sagging carbon price. A low price would weaken the incentives for decarbonization, but changing the design of the instrument was highly politically controversial. In spring 2013 the European Parliament rejected even a seemingly simple measure to change the timing of auctioning off emission

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allowances (the "backloading" proposal). However, only two years later, a far more complex and important measure—the market stability reserve (MSR)—was adopted, and proposals for a further ETS overhaul were launched. The MSR serves as a market thermostat, automatically adjusting the quantity and supply of allowances (hence, indirectly, the carbon price). Given the high controversy and the need for broad agreement in EU policy-making, how was it possible to turn the flagship around so quickly?

This article investigates how the well-established but struggling ETS was significantly improved, even in a time of economic crisis. By examining five causal propositions grounded in established political science theories about the roles of main actors and the central shaping forces of EU policy, we identify crucial changes at the national and EU levels, notably in Germany and in the European Parliament. Although the quantity-based tightening approach that was adopted has clear EU-internal roots, some of its features are relevant for other systems as well.

Our analysis has ramifications beyond the EU. Carbon trading has spread across the globe (Wettestad and Gulbrandsen 2015), and about half of the world's countries have pledged to reduce emissions through carbon trading under the 2015 Paris Agreement (ICAP 2016). Existing but not yet operational emissions trading systems must be tightened over time to ensure that emissions are actually reduced. While such improvement is possible, it is neither automatic nor easy. Scholars have discussed the performance of emissions trading systems and the lessons gained from experience with various design elements (Aldy and Stavins 2012; Ellerman et al. 2016; Newell et al. 2013; Schmalensee and Stavins 2015; van Asselt 2014). This literature is valuable, shedding light on the politics behind design choices and ETS emergence, but it has paid less systematic attention to reform processes (for exceptions, see Skjærseth and Wettestad 2010; Wettestad 2014). Sharp criticisms of the effectiveness of existing emissions trading systems (e.g., Pearse and Böhm 2015) have made understanding reform a key challenge. Examining the actual processes through which an emissions trading system has been tightened (or tightening at least has been attempted) can offer insights into the mechanisms for gradually rendering this policy instrument more effective.

Analytical Framework

How was it possible to improve the ETS significantly over just a few years? Somehow, the EU went from a situation of no agreement—not just on how to reform the ETS, but also as to whether such reform was necessary at all—to the adoption of legislation that substantially altered the design of the ETS.

Revising EU legislation requires the support of the main EU institutions, with proposals being formulated by the European Commission (hereafter, simply the Commission) and adopted by the European Parliament (hereafter, Parliament) and the Council of Ministers (hereafter, the Council). Theories on EU

policy-making offer differing views on the relative importance of these three, as we will show. Moreover, studies have shown that the external environment—the international climate regime under the auspices of the United Nations Framework Convention on Climate Change (UNFCCC) in particular—affects EU environmental policy-making. Any analysis seeking to explain the politics driving ETS reform in the EU must take into account the various actors and arenas involved in EU policy-making. In the following sections, we elaborate on these perspectives and formulate propositions as to why ETS reform became possible.

Changed Positions and Integrative Bargaining Among Member States?

Liberal intergovernmentalism (LIG) sees the EU as an international organization serving the governments of its member states. Member states are represented by ministers in the Council and by prime ministers or presidents in the European Council. Changes in EU policies can be traced back to the interests and positions of the member states (Moravcsik 1993; Moravcsik 1998; see also Bickerton et al. 2015). Domestic preference formation is shaped by elections and the interests of key domestic industries (Moravcsik 1993; Moravcsik 1998). Integrative bargaining among governments can also drive change. The room for agreement can be expanded by offering concessions and special treatment to reluctant parties, within the issue-area in question or in another issue-area (see, e.g., Sebenius 1983).

Qualified-majority voting has become the formal decision-making procedure within the Council on most issues (unanimity is still required within the European Council), but considerable effort goes into finding compromises, and consensus decisions remain prevalent (Bickerton et al. 2015; Häge 2013). The shadow cast by majority-voting rules may give the more populous member states greater influence, although these can be halted by a blocking minority. Since the Lisbon Treaty, a blocking minority must consist of at least four countries representing 35 percent of the EU population, while the previous system required blocking countries to hold a minimum of ninety-three votes—a rule that member states could request be used until March 2017).

Our LIG-inspired proposition is that ETS reform became possible due to support from member states, with changes in member-state positions being expected to follow from domestic shifts or integrative bargaining deals.

The Commission Back on the Offensive and a Less-Split Parliament?

Supranationalism and multilevel governance theories depict the Commission and the European Parliament as having developed their own institutional interests and the ability to utilize gaps in member-state control over European integration, thereby influencing EU outcomes (Burns and Carter 2011; Hooghe and Marks 2001; Stone Sweet and Sandholtz 1998). Moreover, both institutions play a role in agenda-setting and policy framing. This applies particularly to

the Commission, given its responsibility for drafting legislative proposals. As for the Parliament, its powers have increased with each treaty change, and co-decision is now the default procedure. Both institutions also play a role in building broader networks and alliances (Boasson and Wettestad 2013). A precondition for strong supranational influence and leadership is unity within and among supranational institutions on *specific* European solutions. This unity has been strengthened as "early agreements" have become commonplace, including for environmental policy (Delreux and Happaerts 2016, 103): EU institutions negotiate informally in tripartite ("trilogue") meetings *before* the Council and Parliament formally make final decisions, so as to avoid a costly conciliation process later. This ties intra- and interinstitutional negotiations together (Héritier and Reh 2012, 1135). That internal divisions exist in the Parliament is no secret; they can be exploited by the member states, which remain powerful despite co-decision (Costello and Thomson 2013). Unity within the Parliament in any matters subject to trilogue processes is important for that body to retain its influence.

Internal divisions also occur frequently within the Commission (Hartlapp et al. 2014). Specifically, the Directorate-General for Climate Action (hereafter, DG Clima) has often disagreed with the directorates-general responsible for industrial or energy policy (DG Enterprise and DG Energy; Skjærseth and Wettestad 2008; Skjærseth and Wettestad 2010; Skovgaard 2013). Divisions also exist among the party groups in the Parliament, each encompassing a wide range of opinions. The two largest groups are the center-right European People's Party (EPP) and the center-left Progressive Alliance of Socialists and Democrats (S&D). Divergence is also evident among the standing committees in Parliament, where the Environment, Public Health, and Food Safety Committee (ENVI) has usually been more ambitious on climate-change policy than the Industry, Research, and Energy Committee (ITRE).

Following the launch of the Carbon Market Report in 2012, the Commission increasingly stood out as an actor whose key reform proposals all experienced significant opposition. That makes the subsequent launch of new and more popular proposals the most likely change mechanism for us to explore here: ETS reform became possible because the Commission regained the initiative by launching reforms that were less antagonizing internally and vis-à-vis other EU institutions and stakeholders. The May 2014 elections may also have changed the composition and internal political dynamics of the Parliament, including regarding ETS dynamics. Thus, we propose that ETS reform became possible due to support from the European Parliament, which was less split after the 2014 election.

Business Unity or Two Camps?

Interest groups seek to lobby member states and EU institutions. The literature on interest groups generally sees the business community as being more

influential than diffuse interests (like environmental organizations), due to its technical expertise and better organization, as well as its key contributions to employment and value creation. Other things being equal, business unity will strengthen the position of business interests (see Rasmussen 2015 for an overview). Earlier analyses of EU ETS politics have not identified environmental organizations as key actors, finding the rather technical character of emissions trading less amenable to activist campaigning (Skjærseth and Wettestad 2008; Wettestad 2014). While process-tracing enables us to remain open to the possible impact of green groups, we expect business to play a bigger role. The key target groups of the ETS are energy producers and energy-intensive industries, but unity across these business groups has been sporadic at best. Power producers have generally been positive to the ETS and to further development of its design, such as stricter caps and greater use of auctioning. A higher carbon price raises the cost of fossil-fuel-based electricity, but such increases can largely be passed on to consumers (Chernyavs'ka and Gullì 2008). That option is less viable for energy-intensive industries, whose competitors on the global market may be subject to less stringent environmental regulations. Therefore, energy-intensive industries have been more critical of the ETS.

While business disunity would have reduced the overall influence of business, alliances may have been formed between those parts of the business community and the policy-makers that share a common view on ETS reform. If power producers continued to support ETS reform, this would aid proponents of ETS reform. If the reluctance of energy-intensive industries were dampened —for instance, by continued access to free allowances—that would also facilitate the adoption of reform. Hence, we propose that ETS reform became possible due to differing positions of businesses and a lack of united business opposition.

A Pull from the EU-External Context?

The international climate regime under the auspices of the UNFCCC clearly affects EU policy-making (see Cass 2005; Falkner and Müller 2014; Oberthür 2006; Oberthür and Dupont 2011). One central linking mechanism involves EU "entrepreneurs" creating political windows of opportunity by tactically referring to central processes in the external environment. For instance, the need to bring a strengthened ETS to the negotiating table at the 2009 Copenhagen climate summit expanded the window for Commission entrepreneurs seeking a reformed ETS (Boasson and Wettestad 2013). As the Paris 2015 meeting drew nearer, ETS reform entrepreneurs may have been able to use the need for a strengthened ETS as a negotiating card on the international scene, to strengthen their hand in the internal EU policy process; thus, ETS reform became possible due to the development of EU-external factors that provided backing for EU entrepreneurs.

Method

We reconstructed the events leading up to ETS reform, using data from public records, position papers, media coverage, and semistructured interviews with policy-makers, stakeholders, and close observers of EU policy-making (listed at the end). Process-tracing provides strong evidence of whether or not a hypothesized cause was indeed what brought about the outcome (thus reducing the risk of spurious conclusions) and also enables us to uncover causal mechanisms not foreseen by applied theories (see George and Bennett 2005). Although process-tracing has been criticized for not enabling generalizations beyond the case at hand, identifying key political mechanisms behind ETS reform offers causal models that are relevant for research on ETS politics in other jurisdictions.

From Turmoil to Market Thermostat

In 2008, a wide-ranging reform of the EU ETS was decided, making it significantly more centralized. However, the unfolding economic crisis in Europe revealed that ETS allocations had been based on overly optimistic estimates for economic growth. In parallel, market players sought to rid themselves of credits from the Clean Development Mechanism that were about to become void, and the Commission rescheduled allowance auctions ahead of time ("front-loading") to ease the transition from phase 2 to phase 3 (European Commission 2012b). Demand and prices for ETS allowances plummeted, so a significant surplus was building up.

2012–2013: The Turmoil of Backloading

The surplus grew to 900 million allowances and was expected to reach 1.4 billion by the end of 2012. The Commission was split on ETS reform, with DG Clima in favor and DG Enterprise questioning the need for intervening in the ETS market at all (Point Carbon 2012). The Commission proposed delaying auctioning of some allowances ("backloading") until the end of the third trading phase to deal with the imbalance, and that the decision be taken within a committee of member-state representatives, in a process known as "comitology" (European Commission 2012b). The plans had been heavily criticized in prior informal talks, so the Commission tabled a parallel legislative proposal to clarify that it could backload via comitology (European Commission 2012a).

BusinessEurope and energy-intensive companies were against backloading, while power companies supported it—if it was followed by structural reform (Brussels interviews, 2015). In November, the Commission published its options for structural reform: raising the 2020 target, retiring allowances ("set-aside"), early revision of the linear reduction factor, extending the ETS to new sectors, and either adding further restrictions on the use of Clean

Development Mechanism credits to comply with ETS obligations or introducing a discretionary price-management mechanism (European Commission 2012c).

Within the Parliament, preliminary discussions revealed substantial opposition to ETS intervention, particularly from the EPP (ENDS Europe 2013a). The committees were also divided, with the ITRE committee opposing backloading (EP 2013b) and the lead ENVI committee conditionally supporting it (EP 2013a). The dossier moved to a plenary vote, accompanied by a proposal to reject backloading. In April, a narrow majority (334 to 315) supported the latter proposal (EP 2013c). Although several party groups were split, S&D basically supported backloading, while the EPP was more skeptical (EurActiv 2013). The plenary vote dealt a serious blow to the ETS reform process: the allowance price fell to an all-time low of €2.75, with grim prognoses of ETS collapse (see, e.g., *The Economist* 2013). However, the legislative dossier returned to ENVI, where a looser compromise proposal was developed. Surprisingly, when that proposal was put to plenary vote in July, a majority of the members (MEPs) voted in favor of the earlier ENVI proposal that was previously rejected (344 to 311; EP 2013c).

Officially, the member states wanted more time before adopting a Council position, but it was reported that an undecided Germany was blocking the process (Brussels interviews, 2015; ENDS Europe 2013b). The German government was divided and postponed the issue until after the upcoming federal elections. Germany's Ministry of Economy had strong ties to—and was heavily lobbied by—energy-intensive industries that feared not so much backloading itself as opening the door to additional ETS reforms (Berlin interviews, 2015). The Ministry was headed by a business-friendly liberal party (FDP) and saw backloading as an unnecessary market intervention. Meanwhile, the Ministry of the Environment (headed by a conservative) supported backloading (Berlin and Brussels interviews, 2015).

The September 2013 elections kept the conservatives (CDU/CSU) in power, but now in coalition with the Social Democrats (SPD). The new coalition agreed on supporting backloading, but also agreed that allowances should not be permanently removed from the market (Berlin interviews, 2015). The SPD gained leadership of both the Ministry of Environment and the Ministry of Economy. Responsibility for renewable energy was transferred from the former to the latter ministry, where two new energy policy departments were heavily staffed with personnel from the Ministry of Environment (Berlin interviews, 2015).

In November 2013, member states agreed to start trilogue negotiations, where the Council—along with the Commission and Parliament—adopted backloading, as was foreshadowed by Parliament's July decision. The proposal was endorsed by Parliament (385 to 284) (EP 2013c) and the Council, with Poland dissenting (Council of the European Union 2013, 48). With legal clarification ensured, backloading was adopted in comitology (European Commission 2014a).

2014–2015: Toward a Stability Reserve and Beyond

Alongside a framework for a climate and energy policy for 2030, the Commission proposed an MSR in January 2014. The MSR was a structural reform targeting a surplus of 2 billion allowances (expected to grow to 2.6 billion by 2020). It would regulate the supply of allowances from 2021 onward by automatically setting aside—or releasing—allowances, depending on the number of allowances in circulation: if more than 833 million allowances were on the market, 12 percent could be withdrawn annually and placed in the reserve, while less than 400 million in circulation would trigger an annual release of 100 million allowances (European Commission 2014b). While loosely linked to one of the structural reform options (the discretionary price-management mechanism) previously presented by the Commission, the MSR had developed as a distinct option through consultations with stakeholders and experts in 2013 (Brussels interviews, 2015; European Commission 2014b).

Energy-intensive industries voiced their opposition (EurActiv 2014), whereas supportive power producers wanted the MSR to start earlier, with backloaded allowances being placed directly into it rather than released to the market before 2020 (ENDS Europe 2014b). The environmental ministers of Denmark, Germany, Sweden, and the UK called for the MSR to start before 2021, while their colleagues from Bulgaria, the Czech Republic, Hungary, Poland, Romania, and Slovakia wanted additional assessments and clarifications (Bloomberg 2014a).

Talks in Parliament were postponed until after the upcoming May elections, after which the EPP remained the largest grouping, followed by S&D. The elections also brought in over a hundred new far-right and far-left MEPs not affiliated with the major political party groups, triggering speculations about unpredictability and hurdles for environmental legislation, in particular (ENDS Europe 2014a). The two largest party groups sought closer cooperation (a "grand coalition") to retain influence over Parliament's position (Brussels interviews, 2015).

In June, Germany announced its support for the MSR, wanting a 2017 start and a direct placement of backloaded allowances into the MSR (Bloomberg 2014b). The UK soon followed suit (UK 2014). At the following meeting of the European Council, member states unanimously adopted a 2030 package: reduce "domestic" emissions by "at least" 40 percent compared to 1990, and the ETS with an MSR as the main instrument (European Council 2014). The climate target entailed a 43-percent cut (as compared to 2005) for the ETS sectors, and a higher annual linear reduction factor (2.2 percent from 2021 onward). Industries exposed to carbon leakage would remain shielded, and an innovation fund would also support low-carbon innovation in industrial sectors. Because Central and Eastern European member states tend to have lower GDP and high shares of coal in their energy mix, solidarity provisions for low-income member states were added: these included solidarity allowances, an opt-in for

free allocation to their power industry, and a modernization fund (European Council 2014).

While the MSR was thus unanimously supported, discussions continued on its details. Within Parliament, ITRE failed to deliver an opinion in January 2015, because what was on the table was deemed too far-reaching by some MEPs, but insufficient by others. A few weeks later, however, ENVI backed a compromise deal struck among the largest parliamentary party groups (EP 2015), including making the MSR operational beginning December 31, 2018; placing the backloaded allowances (900 million) *and* previously unallocated allowances (750 million spare allowances put aside for new or growing factories, or that were returned due to closures) directly into the MSR; and setting up a fund to support "breakthrough industrial innovation" based on unallocated allowances (300 million) in the period 2018–2025.

Meanwhile, member-state divisions centered on the MSR start date and the fate of backloaded allowances. In March, member states discussed a proposal similar to the ENVI position, but they shifted the start date to 2021—as initially proposed by the Commission—due to a blocking minority of Poland backed by Bulgaria, Croatia, the Czech Republic, Cyprus, Hungary, Lithuania, and Romania. Most of this group also opposed placing the backloaded allowances into the MSR, but the Czech Republic and Lithuania defected, enabling the Council to align itself with the Parliament on the fate of the backloaded allowances (ENDS Europe 2015a; ENDS Europe 2015b). This proposal featured a 2021 start date, backloaded allowances in the MSR, and shielding solidarity allowances from the MSR. With a Council position, talks with other EU institutions could begin.

At the first trilogue meeting, the member states, Commission, and Parliament reached consensus on putting backloaded allowances in the MSR, but a second meeting was scheduled due to a number of outstanding issues (EU 2015): the start date (Parliament wanted December 2018; the Council, 2021), the fate of the unallocated allowances (the Parliament wanted transfer to the MSR, and the Council wanted the issue postponed until the revision of the ETS directive), and the industrial innovation fund (proposed by Parliament, opposed by the Council). Member states resumed their internal negotiations. By the end of April, the member states had adopted a new negotiation position after "very tough discussions" (ENDS Europe 2015c), featuring a January 2019 start date and unallocated allowances placed in the MSR as a first step. Poland—alongside Bulgaria, Croatia, Cyprus, Hungary, and Romania—was overruled in the final rounds: the departure of the Czech Republic and Lithuania prevented the opposed group from blocking the earlier MSR start (Carbon Pulse 2015a; Carbon Pulse 2015b). The Czechs explained that they had shifted position because the solidarity allowances would be shielded from the MSR (EurActiv 2015).

At the ensuing trilogue meeting in May a deal was clinched, despite Bulgaria, Croatia, Hungary, Poland, and Romania reiterating their opposition to an early MSR start (Council of the European Union 2015); the deal included

a December 2018 start date, backloaded and unallocated allowances being placed in the MSR, keeping the solidarity allowances outside the MSR until the end of 2025, and a Commission statement to consider the use of the unallocated allowances.

The MSR had been adopted through a separate decision. The Commission now turned to updating the ETS directive in line with the member-state instructions (see European Council 2014). The new elements consisted mainly of additional details on carbon-leakage provisions and on two funds. Following up on the final MSR discussions, the Commission proposed putting some of the unallocated allowances into the innovation fund, to be used before 2021 (European Commission 2015).

Analysis: ETS Reform Examined Through Five Propositions[1]

Key Member States Get Off the Fence; Concessions Are Given

Was member-state support decisive for ETS reform? Did domestic shifts or integrative bargaining change the member-state positions? Elections in Germany kept the backloading discussion from being resolved; then, the elections in autumn 2013 brought a change of government and an about-face. Germany had initially been an undecided "fence-sitter" with regard to backloading, due to internal divisions, with the Ministry of Environment being in favor and the Ministry of Economy being opposed (Berlin and Brussels interviews, 2015).

However, the new coalition government came out in support of backloading. Soon, strong agreement emerged among member states in favor of adopting backloading. A few countries had remained officially undecided, awaiting Germany's move: this indicates a bandwagon effect, with previously undecided and opposed countries joining Germany once it got off the fence. As the most populous member state, Germany is a political heavyweight in the EU; it is also the biggest holder of allowances in the ETS. Policy-making went ahead despite the opposition of Poland, whose stable position can be traced back to the national level (Wettestad and Jevnaker 2016).

The German shift was also necessary for getting the MSR adopted. After the elections, Germany's Ministry of Economy and (now also) Energy was reorganized in a way that lessened German opposition to ETS reform: the industry department—a major ally of energy-intensive industries—was weakened relative to the new energy departments, which were staffed by personnel from the Ministry of Environment (Berlin interviews, 2015). With greater agreement between these key ministries as regards ETS reform, Germany came out in support of the MSR. However, that alone was not enough to swing the EU member-state vote.

The number of opposed or undecided states was higher with the MSR than on the backloading issue. Integrative bargaining was the key to winning them

1. For a more comprehensive discussion of these propositions, see Wettestad and Jevnaker (2016).

over. The initiation of a broader climate-policy development process in the European Council (the 2030 package) in 2014 allowed for compensation and side payments that won over the undecided—but also reluctant—member states. The continuation of solidarity provisions and the establishment of new funds reassured the Central and Eastern European member states. Including the MSR in the European Council conclusions relied on support from all member states, due to the unanimity requirement. However, the broad menu of issues up for discussion enabled a compromise deal, and all member states supported the introduction of the MSR.

Nevertheless, the details of the MSR remained subject to Council negotiations, particularly the start date and the fate of backloaded allowances (and later, of unallocated ones). Consensus was not achieved, but a qualified majority was sufficient to get a supportive Council position on ETS reform. A coalition of member states that wanted the MSR to start earlier and to include backloaded allowances managed to disrupt the blocking minority through concessions that persuaded the Czech Republic and Lithuania. Removing these two was actually more than enough to dismantle the blocking minority (the opposing coalition held precisely ninety-three votes, so defection by a single small country would have sufficed). While policy-making in the Council is held to be consensual (Bickerton et al. 2015), we found that majority decision-making does play a role, although as negotiations under the shadow of the vote rather than an actual vote.

To sum up, member-state support was indeed necessary for ETS reform. Member-state positions changed in response to domestic shifts and integrative bargaining. While a change in position of a major member state can trigger bandwagoning, changes in smaller member states might prove just enough to tip the balance between proponents and opponents.

From Contentious to Depoliticized Commission Proposals

Did the Commission regain the initiative on ETS reform by launching less controversial proposals? The Commission was divided on backloading, and its proposal faced political opposition. Moreover, it was not on firm political ground, since it was seen as overstepping its boundaries. Facing internal criticism as well as from the Parliament, the Commission had to backtrack by initiating a separate legislative track on backloading that ran parallel to the comitology discussion.

Launching the MSR option shifted the debate on ETS reform. The Commission proved more adept at maneuvering in the field and at anticipating member-state preferences when developing the MSR, which was a much more feasible proposal. The MSR was less controversial—within the Commission, as well as among energy-intensive industries, member states, and MEPs. Much of this can be credited to the features of the proposal—it was fairly technical, "depoliticized," long-term, and flexible. Crucially, it did not delegate substantial

new powers to the Commission. As such, the MSR follows the new intergovernmentalist pattern of European coordination without delegation (Bickerton et al. 2015). Moreover, time had passed, and crisis awareness had probably grown on all sides, also within the Commission.

Consequently, the Commission regained the initiative on ETS reform by maneuvering deftly among the differing positions held by various actors. This sheds additional light on the more general *form* of the MSR process, which was less heated than was the case with backloading.

From Division to Grand Coalition in the Parliament

Did the 2014 elections reduce divisions within the Parliament in a way that facilitated its support of ETS reform? Feeling excluded by the Commission's attempt to backload via comitology (where Parliament has less say), the Parliament wanted to influence ETS reform. MEPs welcomed the launch of a legislative track on backloading but were initially divided. Beyond a porous left-right division between party groups on backloading as a market intervention, there were conflicting positions in the ENVI and ITRE committees. The debate went to the plenary, where the wide range of opinions made it harder to unite on the content of ETS reform: the process became messy. Through a cross-party compromise deal, MEPs eventually rallied around a supportive position on backloading. The specter of ETS collapse contributed to bringing MEPs onboard: an irrelevant ETS might trigger a renationalization of climate policy, in turn reducing the number of issues on which the Parliament could co-legislate.

Cross-party coordination was better on the MSR. The entry of more extreme and radical parties and MEPs after the May 2014 elections forced the established party groups to coordinate closely to retain control over legislative dossiers, spurring a grand coalition between the EPP and the S&D. ENVI was clearly leading the discussions on ETS reform now, since ITRE had not managed to agree on a position on the MSR. Nevertheless, the ENVI liaison (rapporteur in EU jargon) coordinated with MEPs from ITRE when negotiating within the ENVI committee, which facilitated broader support when the MSR did come before the plenary.

Thus, the Parliament's wish to influence ETS reform was an important motive behind cross-party cooperation even prior to the elections, but the grand coalition formed thereafter improved this coordination. The MSR was adopted by early agreement through trilogue negotiations, where member states could exploit divisions within the Parliament to gain leverage (Costello and Thomson 2013). But the grand coalition reduced the possibilities for such maneuvering—as the process of MSR adoption revealed.

Although it was characterized as a "green champion" in the 1990s (Burns and Carter 2011), the Parliament had increasingly favored business interests (Burns et al. 2013; Rasmussen 2012; Rasmussen 2015). Parliament was split on backloading, but its subsequent push for fast-tracking the MSR shows that

concerns about environmental protection had not been entirely abandoned. Finally, rather than a Parliament whose internal divisions could be exploited by member states to restrict change (Costello and Thomson 2013), here a united Parliament provided additional backing for member states seeking more ambitious ETS reform.

Split Businesses but Tactical Play

Did differing positions among businesses, and thus the lack of a united business opposition, make ETS reform possible? There was a consistent split within the business community: the power industry was positive—albeit not enthusiastic—to backloading, whereas energy-intensive industries were negative, due to concerns dating back to the initiation of the ETS. The energy-intensives were critical of any policy measures that would not also apply to their competitors outside the EU. We find a similar pattern on the MSR: power companies like ENEL and Fortum were early advocates (Brussels interviews, 2015; Fortum 2013), whereas energy-intensive industries were skeptical, feeling that EU policymakers did not accord sufficient weight to their fears of carbon leakage in a time of severe economic crisis (Berlin and Brussels interviews, 2015).

Business interests were not decisive in the adoption of backloading: due to dynamics within the Council and Parliament, this came despite the strong opposition from energy-intensives. In contrast, business was more involved and achieved larger concessions on the MSR. Power companies had been feeding the Commission with analyses of this type of instrument. After having lost the battle on backloading and the argument against market intervention, the energy-intensives realized that they could not prevent the MSR from being introduced, not least given Germany's support. They therefore shifted their tactics, focusing instead on securing concessions and side payments.

Several proposals put forward by member states and MEPs catered to the interests of energy-intensive industries. The European Council adopted several elements to reassure energy-intensive industries, including an innovation fund to support the latter's low-carbon efforts and continued free carbon allowances to industries at risk of carbon leakage after 2020.

Summing up, business did not offer a united front against ETS reform, but the split did not keep business interests from putting their mark on the overall changes to the ETS. The power industry continued its general support for reform, contributing important ideas and support toward rallying around the MSR option. The energy-intensive industries, recognizing that they could not prevent ETS reform, undertook a tactical retreat while cashing in on their opposition to the MSR. This helped them secure side payments such as the innovation fund, as well as promises for subsequent negotiations on carbon leakage rules for the 2021–2030 phase. This is in line with Meckling's (2015) proposition that opposed businesses turn to minimizing compliance costs if they cannot prevent a measure from being introduced.

Little International Pull, but Ready for Paris

Did international climate developments offer support for the proponents of ETS reform? After 2009, ETS reform entrepreneurs could not cite the need to reform the ETS as a means to strengthen the EU's hand in global negotiations, as they had done in 2008. Global climate negotiations were progressing slowly, and the Paris summit was still years away. Brussels insiders emphasized that the global pull had weakened significantly (Brussels interviews, 2015).

From 2013 onward, this dynamic gradually changed. Preparations for a new climate-and-energy policy package got underway in the spring of 2013, being cast as necessary to underpin the EU's negotiating position at the 2015 UNFCCC summit in Paris. Once on the agenda, the 2030 package facilitated concessions and side payments to member states and industries that opposed ETS reform, thereby removing hurdles. However, the EU's interest in assuming international climate leadership seemed to figure less prominently—and certainly in a different way—in the run-up to Paris than in 2008. With meager economic development after the financial crisis, and parts of Southern Europe still struggling, the EU was increasingly concerned with economic competitiveness and vulnerability, becoming more inward-looking (Fischer and Geden 2015). Nevertheless, a failed ETS would have dealt a significant blow to the EU's prestige in international climate-change politics (Brussels interviews, 2015).

Thus, the low hopes for achieving a binding climate agreement in Paris meant a clearly weaker pull from the external context than in 2008, although it was not entirely absent.

Conclusions

The history of ETS reform shows that tightening a well-established but struggling ETS is hard, but possible, even in times of economic crisis. The process of negotiating the turnaround took a heavy load—but in the end, both backloading and the market stability reform were adopted. This had required designing the reform to be politically feasible, garnering broad support from policy-makers, and having the business community partly in support of reform. First, the Commission's proposal needed to anticipate criticisms from important players with conflicting views, rather than to overtly challenge them. The different responses to backloading than to the MSR show how the right preparation can facilitate a more constructive process. Second, a combination of domestic shifts and integrative bargaining was crucial for garnering sufficient support among member states in the Council. A change in the position of a major member state (Germany) triggered bandwagoning; other member states needed to be brought on board through side payments and concessions. Meanwhile, coalition-building among MEPs was fostered by both a shared motivation for sustaining the influence of the European Parliament and a grand coalition after the 2014 election. Third, although business was split, with energy-intensive

industries being strongly opposed to reform (and in the process, obtaining concessions), the power industry continued its general support for reform, contributing ideas and support for rallying around the MSR option.

Carbon markets outside Europe might well need subsequent adjustment, and the pioneering EU ETS offers insights into how a well-established carbon market could be adjusted—despite the challenging context of high controversy and multiple decision-making arenas. We highlight two lessons for other carbon markets: First, take conflicting views on the ETS in question into account when developing proposals. The feasibility of carbon market reform is a function of how well it matches the views of actors within the relevant political system. The automatic, quantity-based MSR was well aligned with most EU players. The MSR did not involve direct political intervention in the carbon price (interference was indirect, via the amount of allowances), a feature that could be relevant for other political contexts characterized by high opposition to political intervention in the carbon market. Second, assess the sizes and types of the coalitions and majorities that will be necessary to get reforms adopted. This should include examination of the motivations behind the various positions: what is upholding the opposition, or why does someone remain undecided? Could governmental or nongovernmental actors be enticed onboard by means of concessions and side payments, thereby increasing the size of the overall coalition? Because tightening an ETS might entail multiple rounds of reform, comfortable majorities might prove preferable to slim ones.

Returning to the EU ETS, what does the recent reform entail for the future of this system? The immediate MSR effect was an increased carbon price. But 2016 saw the return of a gloomy outlook: the carbon price settled at around €5, with long-term projections far below the level needed to incentivize a low-carbon transition. This has spurred interest in national bolstering measures, such as further carbon price floors (as in France) or unilateral allowance cancellation (as in Sweden). While the reform process surrounding the EU ETS was originally intended to move on to carbon leakage provisions (especially to free allowances for the post-2020 trading phase), the issue of further ETS tightening returned to the negotiating table, including adjustments of the MSR.

In parallel, the Brexit referendum entails the departure of an important supporter of a strong European carbon price. While the UK might wish to remain part of the ETS, this remains subject to negotiations, but even so, the UK voice will inevitably be weaker in future efforts to strengthen the ETS. Will this weaken the coalition of countries seeking a more ambitious ETS? No permanent group of member states has been openly opposed to tightening the ETS, and opposition has come mostly from relatively small member states. Moreover, new voting rules in the Council from March 2017 will make it harder to establish a blocking minority: an opposing coalition must then be joined by other big member states besides Poland. Thus, Brexit may not dramatically change the final policy-making balance. At the time of writing, negotiations among the Parliament, the Council, and the Commission on revision of the ETS directive were expected to be finalized in 2017.

In conclusion, adoption of the MSR has kept the EU's climate-policy flagship from sinking, but it is far from thriving. Important polishing and maintenance work remains, because further tightening will be necessary for the ETS to function as a significant driver of low-carbon transition. The EU ETS is now at a crossroads, and neither revitalization (probably through a beefed-up MSR) nor retraction accompanied by further blossoming of national compensatory measures can be ruled out.

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