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Smokescreen Politics? Ratcheting Up EU Emissions Trading in 2017

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Abstract

The reform of the EU Emissions Trading System (ETS) adopted in November 2017 was surprisingly strong, given the previous opposition from central member-states like Poland and key stakeholders like the energy-intensive industries. The carbon price has also increased substantially since then. To explain why such major reform was possible, we present several findings with wider relevance. Importantly, all the actors pushing for a more ambitious reform benefitted from having a central, 'second-best' mechanism in place – the Market Stability Reserve – which could be further tightened. By focusing cancellation on allowances in the MSR and taking place only after 2023, policy entrepreneurs managed to make the distribution of costs obscure and diffuse, whereas the benefits (a probable higher carbon price and related greater auctioning revenues for member-states) were more specific and closer in time. That is what we call 'smokescreen politics'.

1. Introduction

The EU Emissions Trading System (ETS), covering almost half of the EU's greenhouse gas (GHG) emissions, has been hailed as the cornerstone and flagship of EU climate policy. However, recent years have proven troublesome, with a surplus of allowances and a carbon price too low to induce a low-carbon transition (Jevnaker & Wettestad, 2017; Dupont & Oberthür, 2015). The ETS has remained stubbornly on the agenda. The stringency of this climate instrument has been fiercely debated in the context of recovery from the financial crisis on the one hand, and political ambitions for decarbonization on the other. Making the ETS more stringent is now becoming increasingly feasible, in stark contrast to earlier years where even minor adjustments were hard-fought victories.

Agreement was finally reached on a structural fix for the massive surplus of ETS allowances in 2015, i.e. the adoption of the Market Stability Reserve (MSR): an automatic "market thermostat" to start functioning in 2019 (Wettestad & Jevnaker 2016). The scene was then seemingly set for discussions on other ETS issues than stringency: primarily carbon leakage provisions and a more technical "distribution of the bill." Fast-forward to November 2017, when surprisingly strong measures were adopted: chief among them a substantial tightening of the MSR in the period 2019 to 2023,) and a new capping of the surplus from 2023 on,

Given the strong previous opposition to such tightening from such central actors as Poland and the energy-intensive industries, and with the Brexit turbulence weakening the

traditionally carbon market leader the UK, this outcome seems puzzling. How did stringency re-emerge on the ETS reform agenda, and why were these stringency measures adopted? The carbon price more than tripled in 2018, jumping to around €20. Is the system finally working now? What are the prospects ahead? These are the key questions addressed in this article.

We put forward several findings with theoretical and practical relevance beyond EU climate policy studies, and partly beyond the EU: first, as to member-states, France assumed the leadership mantle, making Brexit and hesitant Germany less significant here. Although Brexit has been anticipated to weaken the push for ambitious, market-oriented climate policy, we find that UK's weakened position may be less detrimental to EU policy dynamics than easily expected. Further, the supporting roles of Sweden and the Netherlands remind us that also small member-states can be important EU policy-making, if they are armed with relevant knowledge and give the issue high priority. Second, beyond a constructive European Parliament, the Commission played an important offstage role in the decision-making process, demonstrating that it is more than merely a policy initiator.

Third, and with relevance beyond the EU, all the actors pushing for a more ambitious reform benefitted from having a central mechanism in place (the MSR) which could be further tightened: they could tinker with the status quo, instead of having to start from scratch. By focusing cancellation on allowances in the MSR (which by nature is not owned by anyone in particular) and only taking place from 2023 on, policy entrepreneurs in the EU institutions managed to make the distribution of costs fairly obscure and diffuse—whereas the benefits (a probable higher carbon price and related increased auctioning revenues for member-states) were more specific and closer in time. This is what we call 'smokescreen politics'.

In the next section we present the analytical framework for explaining how this outcome was possible. The third section provides a chronological overview of main developments during the years 2015–2018. In section four we then employ various analytical lenses. Section five presents a summary of key findings and a discussion of central prospects ahead.

2. Analytical framework: focus, explanatory lenses and method

After the MSR was adopted in the spring of 2015 it was expected that the subsequent overhaul of the ETS for 2030 would focus on free allowances and carbon leakage. Instead, post-MSR negotiations came again to focus much (but certainly not solely) on further tightening—resulting in a surprisingly strong outcome (see section 3). This change of the agenda of EU ETS decision-making for the 2021–2030 phase, leading up to a surprising tightening outcome, is what to be explained here.

By reviewing main theories and thinking about EU policy-making we can formulate expectations as to when and how an issue may re-emerge and make it onto the EU agenda. The literature on agenda-setting highlights the role of information, preferences, and institutions in explaining why issues are given attention. (Green-Pedersen & Walgrave, 2014). Information about real-world developments is important for something to become a political issue. However,, not all issues attract political attention. Political actors may fight for—or against—getting an issue on the agenda (Barach and Baratz, 1962) This also applies to the EU (Princen, 2007). , Political actors are embedded in political institutions: and the more venues and access points there are in a political system, the more opportunities are there for an issue to make it onto the agenda (Green-Pedersen & Walgrave, 2014, pp. 7–9). The EU's political system offers multiple access points, because policymaking takes place within three institutions: proposals are formulated by the European Commission (hereafter: Commission), and adopted by the European Parliament (hereafter: Parliament) and the Council.

In the EU, the agenda may be set from above in political institutions or from below via experts and working groups (Princen and Rhinard, 2006). The Commission has important agenda-setting powers as it has the task of formally launching legislative proposals (Pollack,1994). However, Council and Parliament may also push the Commission to put a proposal on the agenda, while interest groups may seek to influence the EU institutions - especially the Commission - in order for the latter to take their concerns onboard and include them in a policy process (Princen, 2007). For the issue of ETS tightening to re-emerge and win through in the policy-making process, we expect information about poor functioning of the ETS to make this more likely. However, this needs to be picked up by political actors, whose preferences must be compatible with re-adding this issue to the agenda.

Theories on EU policymaking offer differing views on the relative importance of these three institutions, as we will see. Moreover, studies have shown that the external environment—the international climate regime under the United Nations Framework Convention on Climate Change (UNFCCC) in particular—affects EU environmental policymaking. Actors seeking to place issues on the agenda for ETS reform may utilize external events. In the following, we first discuss three perspectives focusing different key actors, followed by two perspectives focusing more crosscutting factors (both internal and external to the EU), formulating propositions as to why further tightening again came to figure centrally on the agenda for ETS reform, winning through in the end.

Win for ambitious member-states seeking greater stringency?

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 of the EU (hereafter: 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 and 1998; see also Bickerton et al., 2015). Domestic preference-formation is influenced by elections and the interests of key domestic industries (Moravcsik ,1993, 1998).

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 in practice (Häge, 2013; Bickerton, et al., 2015). While majority-voting rules may give the more populous member-states greater influence, these can be halted by a blocking minority (at least four countries representing 35% of the EU population—a significantly higher threshold than the previous system, which member-states could request be used until March 2017).

New information—such as new voting rules in Council, and updates on ETS performance since the adoption of the MSR—is expected to influence member-state preferences. Those favoring a (more) stringent and ambitious ETS could have become emboldened by the new voting rules and disheartened by the ETS price crash in early 2016. While access to the Council is unlikely to have changed, the number of member-states required to form a blocking minority has been increased, raising the bar for blocking ambitious proposals. Our LIG-inspired proposition is then: *member-states favoring a tighter ETS utilized new information in order to place the stringency issue high on the ETS reform agenda, and new voting arrangements weakened the blocking ability of minority coalitions—together making the final outcome more ambitious than expected (P1).*

Supranational lenses: The Parliament again acting as a "policy greening" force?

Supranationalism and Multi-level 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 (Stone Sweet & Sandholz, 1998; Hooghe & Marks, 2001; Burns & Carter, 2011). Both institutions play a role in agenda-setting and policy framing—especially the Commission, given its responsibility for drafting legislative proposals. As for the Parliament, its powers have increased with each treaty change, and co-decisionmaking is now the default procedure. Both institutions also play a role in building broader networks and alliances.

A precondition for strong supranational influence and leadership is unity within and among supranational institutions on *specific* European solutions. This has been strengthened as "early agreements" have become commonplace, also within environmental policy (Delreux & Happaerts 2016, p. 103): EU institutions negotiate informally in trilogue meetings *before* the Council and Parliament formally adopt a final position, so as to avoid a costly conciliation process later. This ties intra- and inter-institutional negotiations together (Héritier & Reh, 2012, p. 1135). That there exist internal divisions in the Parliament is no secret: they can be exploited by the member-states, which remain the more powerful of the two, despite co-decision (Costello & Thomson, 2013). Unity within the Parliament is important in trilogue processes, for it to retain influence.

However, division are frequent among party groups in the Parliament. 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) tends to be more ambitious on climate-change policy than the Industry, Research, and Energy Committee (ITRE).

As we are examining the re-emergence of stringency that occurred *after* the Commission had launched a proposal for revising the ETS Directive in July 2015, it is natural to focus on the role of the Parliament. As co-decision makers, MEPs have broad scope for proposing amendments to proposed legislation, both during committee treatment and at the plenary reading. The Parliament is a relatively open institution characterized by fierce competition among lobbyists, who include consultants and lobby groups like the British Sandbag organization which have repeatedly put forward proposals on how to tighten the ETS, including a tightening of the MSR.

The rapporteur is an important gatekeeper for what gets included in the final report, as is the outcome of voting in the committee. As the ENVI committee is more oriented towards environmental considerations, our proposition here becomes: *Due to new information about tightening options, ENVI MEPs were able to place the stringency issue high on the ETS reform agenda, making the final outcome more ambitious than expected (P2).*

Non-state actors: industry also increasingly impatient?

Interest groups seek to lobby national governments and EU institutions. The literature on interest groups and stakeholders generally expects business to be more influential than diffuse interests like environmental organizations, due to technical expertise and better organization, and by being a key contributor to employment and value creation. Other things being equal, business unity will strengthen the position of business interests (see Rasmussen, 2015). 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). While process-tracing enables us to remain open to the possible impact of green groups, we expect business to play a more important 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, like stricter caps and greater use of auctioning (author). A higher carbon price raises the cost of fossil-fuel-based electricity, but such increases can generally be passed on to the consumer (Chernyavska & 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, the energy-intensive industries have been more reluctant and critical to the ETS. Electricity producers facing pressure to decarbonize due to various types of legislation (including renewables policy) could also push for a higher carbon price in order to increase the electricity price—to further stimulate investments in decarbonizing the power sector.

While business disunity would have reduced the overall influence of business, alliances may have been formed between those parts of the business community and policymakers that share a common view on ETS reform. If power producers continue to support ETS reform, this will aid proponents of ETS reform. If the reluctance of energy-intensive industries is dampened, for instance by continued access to free allowances, that will facilitate the adoption of reform. Hence, we propose that *increasing pressure from power producers concerned about investments in the electricity sector has contributed to placing the stringency issue high on the ETS reform agenda again and making the final outcome more ambitious than expected (P3).*

Institutional pathways, sequencing and feedback

The 2017 reforms were adopted against the backdrop of a regulatory history dating back to the late 1990s (author). Recent scholarship has drawn attention to institutional pathways, sequencing, and policy feedback to explain how such policymaking unfolds over time in several stages (see e.g. Bernstein and Hoffmann, 2018; Jacobs, 2011; Jordan & Matt, 2014; Moore, 2018; Pahle et al., 2018; Pierson, 2004; Rosenbloom et al, 2018). In such a perspective, the adoption of surprisingly ambitious reforms in 2017 can be understood as a response/feedback to unsuccessful previous efforts at reforming the ETS, building upon the institutional pathway created by the adoption of the MSR in 2015.

Pahle and colleagues (2017) draw attention to sequencing and how the initial adoption of a "second-best" instrument may form the basis for ratcheting up and adopting a more effective policy. This, they note, will require skilled policy entrepreneurship and the reduction of barriers, such as high technology costs; a complicated distribution of costs, for instance with specific costs and diffuse benefits (see Wilson, 1980); a complicated institutional and governance picture (for instance, governmental actors deficient in expertise/ capacity, and several institutional veto-points); and free-rider challenges emanating from lacking comparable action in key competing jurisdictions, As to costs and benefits, Downie (2017) and Bernstein and Hoffmann (2018: 201) point to the importance of specifying benefits of climate action in order to build coalitions of willing business actors. Also Rosenbloom et al. (2018: 14) draw attention to the very framing of policies as a key element of the mechanism of 'encouraging the emergence and development of supporting policy constituencies'. Jacobs (2011: 46) points to the need sometimes to obscure short-term costs and highlights benefits in order to get better policies adopted.

A key feature of the EU ETS reforms was a tightening of central MSR parameters. Hence our proposition here becomes: *By building on the institutional pathway created by the*

*establishment of the MSR in 2015, skillful policy entrepreneurs overcame the problem of complicated cost distribution or other obstacles to ratcheting up, resulting in a final outcome that was more ambitious than expected (*P4).

Global climate summits as focusing events

The international climate regime under the UNFCCC clearly affects EU policymaking (see Cass, 2005; Oberthür, 2006; Oberthür & Dupont, 2011; Falkner & Müller, eds., 2016). One central linking mechanism involves EU "entrepreneurs" who create 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). The Paris Agreement might have served as a focusing event that enabled the stringency issue to reappear on the agenda. After the Paris 2015 meeting and the adoption of the Paris Agreement, the targets and spirit of this agreement may have contributed to shifting the focus of the ETS reform process, with various EU stakeholders within and outside of the Brussels institutions using the Paris Agreement as a bargaining chip in the reform negotiations in order to further bolster the ambitiousness of the outcome. Hence, we propose that *the development of EU-external factors served as focusing events that contributed to placing the stringency issue high on the ETS reform agenda again, making the final outcome more ambitious than expected (P5).*

Method

We reconstruct the ETS 2030 reform events, using data from public records, position papers, media coverage, and several rounds of semi-structured interviews with policymakers, stakeholders, and close observers of EU policymaking (see list). Not least in order to assess the importance of institutional pathways and the ratcheting up that has taken place over time we draw on interviews conducted over a five year period. 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 enables the researcher to uncover causal mechanisms not foreseen by applied theories (see George and Bennett, 2005). While process-tracing has been criticized for not enabling generalizations beyond the case at hand, identifying key political mechanisms behind reforms of the *EU* ETS offers causal models relevant for research on ETS politics in other jurisdictions. We see the propositions as complementary ones, primarily helping us to zoom in and examine specific causal factors (whether actors or institutions) likely to have interacted to produce the final outcome.

3. Chronological overview, highlighting reform 2015-2017

The EU has moved from reform to reform without solving a fundamental problem: how to get its carbon market in balance? In this section we survey the roller-coaster ride of the EU ETs, with particular attention to developments that led up to the November 2017 outcome.

3.1. Background: Initiation and several rounds of reform

The EU ETS was adopted as a cornerstone of EU climate and energy policy in 2003, setting the main rules for the pilot phase 2005–2007 and second phase 2008–2012 (the Kyoto Protocol commitment phase). The ETS covers the power sector, many energy-intensive industries and EU-internal aviation, and now approximately half of the EU's GHG emissions (see literature overviews in Convery, 2009; Wettestad and Jevnaker, 2016, 2018).

The ETS initially adopted was a fairly decentralized system, with no common cap, and with considerable power over allocation processes and implementation of the system in member-states. During the pilot phase 2005–2007, states implemented the system differently, handing out allowances generously and for free, until the volatile carbon price hit rock bottom in 2007. When policymakers set about revising the system for its third phase (to run 2013–2020) it was clear that significant changes were required; thus, a far more harmonized, centralized and auctioning-based system was adopted in 2008 (Skjærseth and Wettestad, 2010).

As analyzed in several studies (e.g. Skovgaard, 2013; Grubb, Hourcade & Neuhoff, 2014; Wettestad, 2014), the financial crisis that hit Europe from late 2008 lowered both production as well as emissions. Allocation of ETS credits had been based on overly optimistic estimates of economic growth and thus of future demand; together with the use of Clean Development Mechanism credits (CDMs) and growth in renewables, this situation had resulted in the accumulation of a formidable surplus. The surplus was estimated to around 2 billion allowances, greatly surpassing the demand for allowances and leading to an overall low carbon price. In 2013, it dropped to €5—a far cry from the €30–40 level deemed necessary for sparking a low-carbon transition, and even further from the significantly higher levels considered necessary for a forceful push (Dupont & Oberthür, 2015).

But the worsening ETS crisis from 2011 onwards also called for responses at the EU level; in 2012, the Commission initiated a reform process with two main elements: "backloading" (postponing the auctioning of some allowances to 2019–2020); and structural reform, with six main options launched initially, including a discretionary price-management mechanism (Commission, 2012). The ETS crisis worsened in spring 2013, when the European Parliament voted against backloading. But the Parliament soon changed its mind and a governmental shift in Germany—leading to more vigorous support to ETS reform—altered the dynamics among the member-states. Domestically, Germany sought to introduce a coal levy resembling the UK price floor, a process which failed.

In early 2014, the Commission launched a proposal for introducing a Market Stability Reserve (MSR), a mechanism for automatically withdrawing or releasing allowances, depending upon the number of allowances in circulation and the size of the surplus. If the surplus was above 833 million, 12% would be withdrawn and put in the Reserve. If the surplus dropped below 400 million, then 100 million allowances would be released. After tough negotiations, the MSR was adopted in spring 2015 (to start functioning in 2019), with proposals for a revised ETS Directive for the 2021–2030 period tabled soon after (see Wettestad and Jevnaker, 2016; Marcu et al., 2016).

3.2.The post-MSR adoption blues

The MSR had been adopted through a separate decision, and the decisionmaking focus now shifted to the revision of the ETS Directive itself, preparing the ETS for the fourth trading period (2021–2030). Following the specific instructions from the October 2014 European Council conclusions, in July 2015 the Commission tabled a proposal. This included an updated 2030 cap, prolonged provisions for solidarity to low-income member-states, continuation of carbon leakage arrangements (with some revisions), and two new funds: an Innovation Fund to support industry decarbonization (450 million allowances) and a Modernisation Fund to assist the energy transition and move away from coal, especially in Eastern Europe (310 million allowances) (European Commission, 2015).

At this stage, it was expected that this revision process would deal mainly with free allowances and "the distribution of the bill," because the basic level of ambition had already

been settled via the European Council conclusions and the MSR decision (interviews, 2015). The carbon price climbed towards the €10 level, and a new optimism surrounded the ETS. In the Parliament the Environment Committee (ENVI) was set up as lead committee on the issue, while sharing competence with the Industry Committee (ITRE) on carbon leakage, transitional free allowances and issues concerning the Modernisation Fund. Ian Duncan from the Conservative ECR group was appointed Parliament Rapporteur for the ETS reform process. Meanwhile, The EU also contributed positively to landing the important Paris Agreement in December 2015, at the global climate summit hosted by France (see Dimitrov, 2016).

But 2016 saw the return of gloomy prospects. In the first months of 2016 the carbon price dropped from just above €8 to €5–6, settling at around €5. Price estimates for 2030 also dropped significantly. Price analysts struggled to understand the dynamics at work, finally settling on a combination of warm weather, low oil and gas prices, speculative selling, and the fact that traders had already factored in the coming MSR effect. The latter point indicated a fundamental lack of belief among industrial stakeholders in the MSR as an effective mechanism for dealing with the formidable surplus (Carbon Pulse 2016a; ENDS 2016a; Carbon Pulse 2016b).

Reacting to the low price, in March 2016 France proposed the introduction of a "price corridor" to the ETS, whereby allowances would be placed in the MSR if the carbon price proved to be too low, and released if too high (Carbon Pulse 2016c; 2016d). This was designed to avoid the spread of national measures like the UK carbon-price floor adopted back in 2011. The Environment Ministry in the key ETS country Germany responded by stating that it was open to discussion of further reform options, but that, rather than a price-based regulation (as proposed by France), it preferred to keep the quantitative-based approach (Carbon Pulse 2016e).

Rapporteur Ian Duncan delivered his ENVI draft report in late May, with proposals including a 'Linear Reduction Factor' (LRF) with a "minimum" 2.2% level (to be reviewed in 2023), an annual stocktaking by the Commission of other policies (such as RES and energy efficiency) undermining the ETS and subsequent cancellation of allowances, and 150 million additional allowances to the proposed 400 million Innovation Fund *(*International Environment Reporter 2016).

The Brexit vote in the June 23 referendum sent shock-waves also into the ETS. UK installations hold the second largest number of allowances in the ETS and the UK has traditionally been a key ETS policy entrepreneur, on several occasions advocating further tightening and development of the system. Although Brexit did not necessarily mean the UK would also be leaving the ETS, it was immediately clear that the British voice in the ETS reform discussions would be weakened (Carbon Pulse 2016f).

3.3. 'Tightening' climbs the agenda from mid-2016 on

A further signal of growing impatience with the ETS among some member-states came when Sweden announced the unilateral, yearly cancellation of a limited number of allowances (around seven million) in the end of June (ENDS 2016b; Carbon Pulse 2016g). In July the Commission put forward a specified Effort-Sharing proposal, with requirements and targets for reducing GHG emissions among the 28 member-states in non-ETS sectors (like transport, buildings, and agriculture). Both formal and informal links to the ETS reform process were indicated and included the possibility of additional cuts in the ETS sector to weigh up for fewer efforts in the non-ETS sector.

After the summer, the legislative process gained speed, and discussions in the Parliament were in the spotlight. By September, 729 amendments had been submitted by MEPs for the ETS process in the ENVI committee. These included proposals for a steeper LRF, many calling for "at least 2.4%" and even up to 4.2% (Carbon Pulse 2016h, i). ENVI was reported as severely split, with EPP basically supporting a 2.2% LRF, and S&D leaning towards an LRF increase to 2.4% (ENDS 2016c).

During the discussions, an additional important option surfaced: ICIS analysts suggested that the settings of the MSR could be altered, noting that "if the rate of which the MSR withdraws is doubled to 24% for its first three years (2019–21), prices would start to rise much sooner but then flatten out" (Carbon Pulse 2016j). This idea was also floated by other analysts such as Point Carbon (interviews, 2018).

As to the ETS reform discussion among member-states, at the Environment Council meeting in October, Sweden put forward several possible ETS tightening measures, including a firming up of the MSR, cancelling allowances above a set ceiling, and a somewhat steeper LRF than 2.2% (Carbon Pulse 2016k). The power-company federation EURELECTRIC joined the choir, calling for an MSR revamp in November and arguing for a doubling of the intake rate of the MSR to 24% until at least 2023 (Carbon Pulse 2016l). The Slovak Presidency expressed hope of reaching agreement on a common position on ETS reform by the end of the year (ENDS 2016d).

The MSR tightening option was now also included in discussions in the Parliament. ENVI Rapporteur Duncan noted, at a conference in London in mid-October, that he was targeting "a revamped MSR," as other options remained locked in political disagreement (Carbon Pulse 2016k). With discussions in the Parliament getting closer to finalization, the issues of further Linear Reduction Factor (LRF) tightening and, particularly, further tightening of the MSR mechanism moved to center-stage (interviews, 2017). Prior to the ENVI vote in December, it was clear that there were highly diverging views and positions on both these issues (and others)—basically with S&D, ALDE and the Greens in favor of both LRF and MSR tightening, and EPP and other conservatives far more skeptical (Carbon Pulse 2016m; Argus 2016).

Ahead of the December 15 vote, it was reported that an early compromise deal had been struck between ENVI coordinators from all political groups, including a deal on doubling of the MSR withdrawal rate. However, a steeper LRF was not included in this deal (ENDS 2016e; Carbon Pulse 2016n). The ENVI position that was adopted thus came as something of a surprise, as it also included a steeper LRF (2.4%). In addition to a doubling of the MSR withdrawal rate for four years (2019–1922), a long list of amendments was adopted, including the cancellation of 800 million allowances in 2021, and adding 200 million EUAs to the proposed Innovation Fund (up from 400 mill.), and adjustment of the criteria for the Modernisation Fund (Carbon Pulse 2016o)

Also in December, further ETS reform discussions took place among member-states, with the Slovakian presidency continuing the quest for a common ground and a possible common position. But these efforts proven futile. Eight member-states stood forth as vocal opponents of increasing the ETS ambitiousness at this stage: Bulgaria, Croatia, Greece, Hungary, Latvia, Lithuania, Poland, and Romania (ENDS 2016g).

Alongside ETS discussions, the Commission launched the Winter Package—"Clean Energy for all Europeans"—consisting of eight key proposals, including energy efficiency (a 30% target), renewable energy, the design of the electricity market, security of electricity supply and governance rules for the Energy Union. This launch marked the formal start of a second

parallel policymaking process with links to the ETS process (in addition to the Effort-Sharing process).

The first main event in 2017 was the plenary in the Parliament on February 15. The plenary position was adopted with a comfortable majority (379 in favor, 263 against, 57 abstentions), and generally supported the ENVI position—with some important exceptions: it opted to retain the European Commission's 2.2% annual Linear Reduction Factor, although opening for 2.4% in 2024 "at the earliest." Importantly, the key doubling of the annual MSR absorption rate to 24% was adopted. Furthermore, in line with ENVI positions, several amendments were adopted, including the proposed cancellation of 800 million allowances in 2021. The Parliament also wanted the Commission to issue an annual report on the interaction between the ETS and other policies (Carbon Pulse 2017a).

Two weeks later, the Council agreed on a common ETS reform position which proved generally more ambitious than that of the Parliament. Things were not to be easy, however. When the Council Presidency finally declared that a "general approach" had been achieved, Poland and the Netherlands protested, and the web-streaming cameras were turned off for 15 minutes for consultations behind closed doors. When the streaming resumed, the chairperson reiterated his original message: they had indeed achieved a final position with the necessary majority. 19 of the 28 ministers were in favor of the reform package (Carbon Pulse 2017b).

Like the European Parliament, the Council agreed to strengthen the MSR, and to remove twice as many allowances in the years 2019 to 2023 than when the MSR was originally adopted (up from 12% to 24%). The ministers also confirmed the annual emissions cap cut of 2.2%, approved by the European Council back in October 2014. A noteworthy element was the decision to further tighten the supply of emission credits by ensuring the ongoing cancellation of allowances in the MSR from 2024. If the number of allowances in the MSR should exceed the number of allowances auctioned the previous year, the difference would be cancelled. On this matter the Council was more ambitious than the European Parliament, which voted for a one-off, 800-million cancellation.

Observers noted that France, Sweden, and the Netherlands seemed to have formed a leadership coalition, in a situation where the traditional leader, the UK, was weakened by Brexit (but still part of the leadership coalition) and heavyweight Germany had flagged a more cautious position than in the process leading up to the adoption of the MSR. Not everyone was happy with the results. Jan Szyszko, Poland's Minister of the Environment, declared that his country felt cheated. Also Italy and Hungary expressed disapproval. But the Czech Republic and Estonia voted with the majority (ENDS 2017a; Sandbag 2017; EU Observer 2017a; Carbon Pulse 2017b; Euractiv 2017a).

Nine member-states voted against the plan (Bulgaria, Croatia, Cyprus, Hungary, Italy, Latvia, Lithuania, Poland, and Romania). Trilogue negotiations were expected to begin in spring or summer, with a final deal presented by autumn 2017.

3.4.Trilogue and finalization in 2017

Some rather quiet months for the ETS then followed. In May 2017, the carbon price was still below €5. Emmanuel Macron was elected president in France, having campaigned on the pledge to continue the French government's push for an EU ETS-wide price floor (Carbon Pulse 2017c, d). In late May, ETS reform talks between the institutions were postponed as Parliament Rapporteur Duncan failed to arrive: he was running for office in the upcoming UK elections; the elections in Malta also contributed to trilogue delays (ENDS 2017b; Carbon Pulse 2017e).

A new round of trilogue talks were held in the end of June, with Julie Girling replacing Ian Duncan as rapporteur and thus Parliament's main representative in the negotiations. The meeting failed to achieve a deal, and Malta passed on the EU Presidency to Estonia. However, according to Council representatives, a "triangle" of key issues had been identified: strengthening the ETS, including a doubled MSR uptake; preventing carbon leakage and the setting of benchmarks; and low carbon financing and support mechanisms (ENDS 2017c; Carbon Pulse 2017f).

Research published by Barclays Bank in mid-August noted that EU carbon prices could hit at least €15 euros by the early 2020s or even sooner, if legislators agreed to double the MSR intake rate. According to ICIS analysts, carbon prices could go even higher, as they claimed that current calculations had underestimated the aviation sector's probable need for allowances in the 2020s (Carbon Pulse 2017g, h).

The fourth trilogue meeting was held in Strasbourg in mid-September. Progress included a compromise to allow member-states to cancel allowances from their auction share voluntarily to correspond with the expected mitigation impacts of national measures in the power sector, like coal phase-outs. Furthermore, it was conditionally agreed that the doubling of the MSR withdrawal rate would last five years (that was the Council's position; the Parliament preferred four years). However, at least one more meeting was envisaged, to finalize the process (Carbon Pulse 2017i).

Elections in Germany in late September weakened the CDU and the position of Chancellor Merkel. Moreover, the Social Democratic Party's reluctance to form a new coalition government prolonged uncertainty about the country's political direction, also influencing positions on climate and energy policy (Euractiv 2017b).

Leaked Council preparatory notes in early October indicated a willingness to accommodate Polish demands to shield coal-fired power plants from higher prices in a reformed ETS—and hence unwillingness to accept the Parliament's proposal for a specific 450g emissions limit (ENDS 2017d; Euractiv 2017c). This was further confirmed in reports from a subsequent Coreper meeting, where member-state representatives endorsed an increase in the number of set-aside allowances that could be used under the Article 10c derogation —to 60%, up from the 40% agreed by EU leaders in October 2014 (Carbon Pulse 2017j).

However, ETS negotiators failed to achieve a final deal in October, at the fifth trilogue meeting, which lasted for more than 13 hours. Key remaining issues of disagreement included the nature of concessions to coal-intensive (mainly East European) member-states; and the size and purpose of various funds, the Modernisation Fund in particular (ENDS 2017e; Carbon Pulse 2017k). At a subsequent European Council meeting, Polish Prime Minister Beata Szydlo stated she would raise the issue of climate policy at the December EU leaders' summit if the ETS reform deal failed to compensate Poland adequately for the transition away from coal (Carbon Pulse 2017l).

On November 8/9, the final and sixth trilogue session was held—nine hours of marathon talks. Here is a summary of main decisions of particular relevance for the question of ambitiousness (see European Commission 2017; Carbon Pulse 2017m; ENDS 2017f; EU Observer 2017b;) :

- A 2.2% LRF. This meant an annual lowering of the cap by 48 million allowances (compared to 38 million under the 1.74% regime). The overall target was the 43% cut by 2030 agreed back in 2014.
- Doubled MSR intake from 2019 to 2023 (up from 12%, to 24%).

- Further tightening of the supply of emission credits by ensuring the ongoing cancelling of allowances in the MSR from 2023 (as put forward by the Council). If the number of allowances in the MSR exceeded the number of allowances auctioned the previous year, the difference would "no longer be valid" (i.e. cancelled: Article 2, 5a). According to Point Carbon, the combination of these two measures would remove 3.1 billion allowances from the market in the period 2019–2030 (Schjolset, 2017).
- Optional unilateral cancellation: allowing member-states to cancel allowances from their auction share voluntarily, to correspond with the expected mitigation impact of national measures in the power sector (e.g., coal phase-outs)—up to maximum average emissions from such closed installations in the five previous years (see Article 12, paragraph 4).
- An Innovation Fund with 450 million allowances, adopted basically as proposed by the Commission.
- A Modernisation Fund was adopted, not to finance coal-fired power plants (with some exceptions).
- Derogation, allowing continued free allocation to energy producers in qualified member-states.
- No provision for the use of international credits (such as CDM) in the 2021–2030 phase.

The political agreement was subsequently endorsed by Council and the European Parliament in early 2018. The outcome was indeed a classic EU compromise, and various aspects of it were hailed by key EU leaders and observers. Whereas the Commission and IETA welcomed the outcome and noted the positive link to the UN climate regime (European Commission 2017), others, like environmental NGOs and Green MEPs, were not convinced that this would help the transition towards decarbonization (Carbon Pulse 2017m; ENDS 2017f; Reuters 2017).

4.Analysis: why ETS reform has proven more ambitious than expected

The post-MSR ETS reform was expected to "distribute the bill," but it came to be dominated by the issue of possible further tightening of the system. In the end, a surprisingly ambitious outcome was adopted. How did this come about? A key determinant was the positions of the member-states.

Member-states: reluctants unable to block—but generously compensated

Here our proposition was that *member-states favoring a tighter ETS utilized new information in order to place the stringency issue high on the ETS reform agenda, making the final outcome more ambitious than expected*. Main findings here are, first, that "impatient" member-states did indeed utilize new information to place the stringency issue high on the agenda, whereas reluctant states proved unable to muster a blocking minority; and, second, these latter states were compensated in various ways.

As shown in the chronological overview offered above, growing impatience among many member-states could be noted. This was reflected in, *inter alia*, several national carbon-price bolstering initiatives: the price floor announced in France (but later withdrawn); the German (futile thus far) efforts to adopt measures to phase out coal; and the Swedish unilateral annual cancellation of some allowances. Following national debates on climate policy, member-states sought to upload domestic preferences by re-opening discussions at the EU level regarding ambitiousness—the stringency of the ETS in particular.

However, some important (non-)developments should be noted. First, unlike the dynamics leading up to the MSR adoption in 2015 where a key development had been ETS heavyweight Germany "coming off the fence" after the September 2013 elections, Germany now delayed in taking a strong, explicit position. When the position was clarified, it supported tightening but in a more low-key fashion, also emphasizing carbon leakage support. The September 2017 elections weakened Merkel's position and led to political uncertainty about government coalitions stealing energy and attention from the EU climate and energy processes.

Second, the voice of the most consistent ETS frontrunner and leader—the UK—was clearly weakened after the Brexit vote in June 2016. That is not to say that the UK has not participated in discussions and even flagged ambitious positions (see e,g. ENDS 2016f). But the Brits are on their way out, and their agenda has been filled with other matters than ETS tightening. Seen in combination with the German hesitation, this means that two of the key leaders in the process that had led up to the MSR in 2015 were now seriously weakened.

However, from 2016 on, new leaders emerged. France continued to communicate a strong and explicit ETS reform position also after the election of Emmanuel Macron in May 2016, flagging support to further tightening of the LRF and the MSR. The French leadership position has been bolstered by several factors: France is a traditional heavyweight in EU politics, holding many votes in the Council; its energy structure has been dominated by nuclear and some renewables, both of which benefit from higher carbon prices; and French ambitions of playing a leadership role also in European carbon markets politics have been strengthened after the election of Macron.

France has been joined by two states with long-standing green credentials in the EU: Sweden and the Netherlands (see e.g. Liefferink & Andersen 1998). Sweden had flagged its ambition of annual unilateral cancellation of some allowances in June 2016—and played an important role for the proposal to keep the surplus stable after 2023, at the February 2017 Council meeting (Interviews, 2018). The Netherlands had a strong state secretary for the environment, Sharon Dijksma, who was on her way out and did not need to worry about re-election (interviews, 2018). Also Luxembourg was active in getting the ambitious Council positions adopted. The role played by these countries show that small member-states can be important in EU policy processes, if they have relevant issue-specific expertise and high engagement (see Panke, 2010; Steinmetz & Wivel, 2010).

Moreover, this "coalition of the willing" was substantially strengthened by key Eastern states that defected from the blocking coalition, notably the Czech Republic (but also Estonia, Slovenia, and Slovakia). It should be noted that the Czech Republic had also defected in the process leading up to the MSR in 2014/15 (Wettestad and Jevnaker, 2016). Tellingly, the compromise proposal that won through at the February Council meeting, including a stable surplus after 2023, was called the "Czech proposal" (EU Observer 2017a; interviews 2018). Towards the end, nine countries voiced opposition to the proposal: Bulgaria, Croatia, Greece, Hungary, Italy, Latvia, Lithuania, Poland, and Romania. That was not enough to muster the votes necessary for a blocking minority.

However, these and other reluctant states were compensated quite generously. For Poland, the continuation of the 10c derogations and free allowances to the power sector was probably most important. As noted, the 60% figure is an increase from the 40% agreed by the European Council back in 2014. Several loosely worded conditions were attached, including that investments should "contribute to the diversification of their energy mix and sources of supply, the necessary restructuring, environmental upgrading and retrofitting of the infrastructure, or modernisation of the energy production" (Evans, 2017).

The second main compensatory element was the Modernisation Fund, introduced back at the European Council in 2014 to mollify Poland. Efforts to get an Emissions Performance Standard included failed. There is some "strict wording", but uncertainty prevails as to what this will mean in practice. It is stated that "no support from this fund shall be provided to energy generation facilities using fossil fuels." The derogations for Bulgaria and Romania were claimed to have been introduced "to isolate Poland" *(*EU Observer 2017b). These countries also ended up voting for the final deal. In fact, at the meeting of permanent representatives (COREPER) later in November, only Croatia voted against the deal, with Poland and Hungary abstaining (Vertis 2017).

Supranational lenses: the ambiguous role of the Parliament—and the Commission as "dark horse"

Here our main proposition was that *Due to new information, ENVI MEPs have succeeded in again placing the stringency issue high on the ETS reform agenda, making the final outcome more ambitious than expected.* Key findings are, first, that the Parliament was important in getting the stringency issue placed high on the agenda again, before the Council managed to up the stringency issue further. Second, divisions in the Parliament became apparent in its support also for carbon leakage provisions, widely seen as weakening the bite of the reforms. Third, an exclusively supranational focus on the Parliament is too narrow: the Commission played a skillful supporting role behind the scenes. Let us elaborate these findings in turn.

Discussions in the Parliament picked up speed in the autumn of 2016. It is striking to note the change of focus also here, although the initially key issues of free allowances and carbon leakage protection continued to figure centrally (and an important intra-dossier interaction developed). It was the question of further increase of the LRF that first entered the Parliament's agenda, and primarily in the lead Environment Committee. This was included in initial ideas circulated by Rapporteur Duncan in the spring of 2016. MSR tightening was put on the agenda in October, but did not become central until the final ENVI rounds in late November and December.

The ENVI outcome in December 2016 included a steeper LRF, a tighter MSR, and allowance cancellation in 2021. Furthermore, these proposals/measures were adopted with a solid majority (53 to 5), sending forceful signals to the plenary session. Thus, the ENVI Committee definitely contributed to shifting the focus of ETS reform to the ambitiousness issue—responding to the growing impatience among member-states and major industries and NGOs. Moreover, MEPs played a central role in the final trilogue hassles over the Modernisation Fund. Worried that the Fund could in practice allow the continuing dominance of coal in the power sector in Eastern Europe, they lobbied hard for an emissions performance standard of maximum 450g CO_2/kWh. That standard was not adopted, but wording was included to exclude support of fossil power, with an exception for district heating upgrades in Bulgaria and Romania. This was "a key issue," according to a well-informed source (interviews, 2018).

However, both the ENVI outcome in December 2016 and the plenary outcome in February 2017 contained long lists of proposed measures, many dealing with various aspects of carbon-leakage protection and compensation of industries for indirect trading costs. These issues were also emphasized in the final trilogue sessions (interviews, 2018). While making the system more ambitious, policymakers also made sure to shield industry.

What does this tell us about the "grand coalition" that had emerged after the 2014 elections, helping to make the 2015 MSR deal possible? A clearly more strained coalition was

reported back in 2016 (with the election of a new Parliamentary Leader further complicating matters) (see Carbon Pulse 2016m). So the somewhat ambiguous positions can be interpreted as a necessary internal compromise that gave something important to the dominant liberal-conservative EPP group, traditionally open to industry arguments (German not least)—and to the pro-environmental forces in the Parliament, with the Greens at the forefront. Moreover, UK MEPs (Duncan, later Girling) retained their rapporteur assignments despite the Brexit vote, and played important roles during the process.

Finally, we should note the skilled supporting role of the Commission: an exclusive supranational focus on the Parliament would be too narrow. Parliamentary Rapporteur Ian Duncan was central in introducing the idea of a double-intake MSR—but key Commission representatives also played important roles in introducing and pushing this idea (albeit discreetly, as confirmed by several Brussels insiders) (interviews, 2018). Actually, this discreet role of the Commission is probably more common than often acknowledged. The Commission was also represented in the final trilogue sessions, but the reports from these sessions are dominated by maneuvering by the Council Presidency, key member-states, and MEPs.

Non-governmental actors: impatient power sector; more satisfied energy-intensives; helpful consultants

Our point of departure here was that *increasing pressure from power producers concerned about investments in the electricity sector contributed to placing the stringency issue high on the ETS reform agenda again, making the final outcome more ambitious than expected.* Key findings are, first, that the power industry has upheld its pressure for a more stringent ETS— as expected. But opposition from the energy-intensive industry seems to have been less intense than, e.g., in the process leading up to the MSR. Second, and more surprising, we find that in addition to industry also the role of other non-governmental actors should be noted, particularly consultants and analysts like Point Carbon, ICIS and Sandbag. Let us elaborate on this.

Regarding the power industry, the main impression is one of continuing impatience. This industry contributed in several ways to the rallying around the MSR option in the process that led up to the MSR decision in 2015 (interviews, 2015; Wettestad and Jevnaker, 2016). Throughout 2016, the EURELECTRIC federation and various company alliances and coalitions argued for further ETS tightening. Some examples: in early June 30 energy companies (including EOn, Vattenfall and Vestas) sent a letter to the EU Council and the Parliament urging regulatory changes, to deliver more rapid reform (Carbon Pulse 2016p). In November the "Wake Up" coalition—formed in 2015 by 11 power companies including EDF, Fortum and CEZ—issued a statement that " the on-going revision is the last chance to salvage the ETS" (Wake Up Coalition 2016). In the same month, ten large utilities in the "Magritte" group issued a statement to EU policy-makers calling for a doubling of the MSR withdrawal rate and a tightening of the annual ETS cap up to 2.4%–2.6% (Carbon Pulse 2016q).[1]

Not unexpectedly, the energy-intensive industries focused mainly on carbon leakage issues, in line with earlier positioning. However, a letter in June 2016 from several industry associations, including the steel group EUROFER and cross-sectoral BusinessEurope, acknowledged that the power industry needed a "carbon price that provides a meaningful [low-carbon] signal" (Carbon Pulse 2016r). Hence, the split within industry between utilities and energy-intensives stands out as less serious than the case in the pre-MSR processes in 2013–2015. This is probably related to the significant attention given to various compensation

[1] 'Magritte' members are Centrica, CEZ, EDP, ENEL, ENGIE, Fortum, Gas Natural Fenosa, GasTerra, Iberdrola and Innogy.

mechanisms for energy-intensive industries, in the European Parliament and among member-states in the process all along, including the trilogue. This also includes a continuation of the possibility for member-states to establish specific mechanisms for compensating energy-intensive industries, in addition to the EU-level mechanisms.

Turning then to our second finding here, authors like Schjølset (2017) have highlighted the role played by consultants and analysts such as Point Carbon, ICIS and Sandbag in launching and feeding the idea of a double-intake MSR to member-states and MEPs. Our interviews confirm this to a certain extent, but interviewees also emphasized that these ratcheting up ideas were pushed by various actors, including the Commission. Be this as it may, we see that exclusive attention to industry is too narrow an approach to account fully for the role of non-governmental actors in ETS reform.

Institutional pathways, sequencing, and feedback: smokescreen politics

Here our main proposition was that *by building on the institutional pathway created by the establishment of the MSR in 2015, skillful policy entrepreneurs overcame the problem of complicated cost distribution or other obstacles to ratcheting up, resulting in a final outcome that was more ambitious than expected.* The empirical overview showed that the MSR tightening option came into focus in the fall of 2016, induced by not least the continuing low carbon price. As discussed above, information about this tightening option was fed into the process from several sources, including consultants and probably also the Commission. The cancellation element came in various forms, with the Parliament focusing on a one-off cancellation and the Council opting for the more dynamic MSR-centered mechanism that became the final outcome.

Why did the Council option win through? Here we find the line of thought put forward by Jordan and Matt (2014), Pahle et al. (2018) and others (see section 2) helpful, especially because it draws attention to the distribution of costs and benefits, as highlighted by Wilson (1980). The essential point to note here is that *by focusing cancellation on allowances in the MSR (which by nature is not owned by anyone in particular[1]) and with the actual cancellations not taking place until after 2023, policy entrepreneurs in the Council managed to make the distribution of costs fairly obscure and diffuse—whereas the benefits (a probable higher carbon price and increased auctioning revenues) were more specific and closer in time*. In comparison, a stepped up LRF would have targeted the total volume of allowances available for auctioning; have started already in 2021; and hence the question of who would pay the costs would become more transparent and somewhat closer in time. However, a one-off cancellation of 800 million MSR allowances in 2021 would also arguably have blurred costs and the distribution of them. But this was also somewhat closer in time than the model chosen and here a specific number provided a more transparent and focal point of opposition. Furthermore, old conflict lines as to one-off cancellations may easily have reoccurred. The even more complex and indirect model chosen is what we call "smokescreen politics"—and it contributed to ratcheting up the initially second-best MSR architecture; how much to be further researched.

Was this "smokescreen effect" deliberately designed? For instance Jordan and Matt (2014: 236) point to the complexity of modern policies and how this provides room for policy entrepreneurs to step in and influence target groups' perceptions about how they are affected by policies. It seems likely that the blurring of costs in this case featured in the deliberations of key Council negotiators. Experiences from several earlier failed attempts of adopting one-off set-asides/cancellations were well known. However, this is certainly a complex issue for further

[1] We are thankful to Brendan Moore for pointing out this aspect.

research, also dependent on when the central figures involved feel ready to reveal their motivations.

Interaction with the external environment: moderate help from the Paris Agreement

Here we proposed that *the development of EU-external factors has contributed to again placing the stringency issue high on the ETS reform agenda and making the final outcome more ambitious than expected.* Particularly the Paris 2015 meeting (widely regarded as a success) and the adoption of the Paris Agreement (PA) and the targets and spirit of this Agreement may have contributed to the shifting focus of the ETS reform process. . Various actors referred to it—member-states (France in particular), MEPs, and non-governmental actors; environmental organizations, of course, but also industries. For instance, in the letter sent by 30 energy companies in June 2016, it was explicitly pointed out that rapid reform also was important in order to bring the EU more quickly in line with the Paris Agreement (Carbon Pulse 2016p). In the processes in the Parliament, ENVI rapporteur Duncan on several occasions referred to the "imperative of the Paris Agreement" and how it had "changed the political landscape" (see Opinion 2016; Carbon Pulse 2016k). The "Paris factor" was also mentioned by S&D coordinator Guteland in her response to the ENVI outcome in December 2016 (Carbon Pulse 2016o).

This factor was also regularly mentioned in the ETS process throughout 2017. For instance after the Council meeting in February, Sweden's Isabella Lövin, Minister for International Development Cooperation and Climate declared: "we are really happy that the Council showed the ambition that we need if we are going to stick to the Paris target." CAN's Wendel Trio stated: "ministers recognised that the Paris Agreement requires scaling up emission cuts" (Euractiv 2017a). In October, the Parliament adopted a resolution ahead of COP 23 in Bonn, highlighting the importance of "implementing the [Paris] agreement through EU legislation, including swift adoption of […] the revision of the EU ETS Directive, as well as ratcheting up the EU's goals and policy instruments in a timely manner" (Parliament statement, reprinted in Euractiv 2017d). And after the trilogue outcome in November, some key policymakers and civil society representatives noted that this outcome would align the ETS better with the Paris Agreement, although several MEPs and ENGOs highlighted the remaining gap.

On the whole, our interviewees confirmed that this factor bolstered the change of focus in ETS reform and contributed positively to the final outcome (interviews, 2018). As such, the Paris Agreement served as a focusing event that was used to push for more ambitious ETS reform. But still, the "Paris card" cannot be put down as a key driving factor—but it may be more important in the years to come, as the regular review processes will provide windows of opportunity for further ratcheting up of ambitions. We return to that below.

5. Conclusions

How was this surprisingly strong reform possible? As noted in the analytical framework, the main explanations are complementary: there was a subtle interplay of factors involved.

First, as to member-states, France assumed the leadership, making Brexit-ridden UK and a more hesitant Germany less important here. The Brexit finding sheds light on the early effects of this process and indicates that it may prove less detrimental for EU policy dynamics than anticipated. Further, the supporting role of Sweden and the Netherlands shows that also

small member-states can play important roles in EU policy-making, especially when big countries like Germany are not involved.

Our analytical framework gave short shrift to cross-dossier policy interaction and linkage and the process tracing confirmed the modest importance of such interaction. But important intra-ETS dossier interaction should be noted, with a careful balancing of a 'triangle of issues' (i.e. stringency, competiveness and carbon leakage, and funds and compensation) (see Moore 2018 for more about this). Not least the Parliament contributed to striking a balance between environmental concerns and industrial competitiveness. The ENVI rapporteur served as the gatekeeper who took on the amendments that re-opened the formal discussions on stringency within the EU institutions. However, we should also acknowledge the important offstage role of the Commission in the decision-making process—the Commission is not merely a policy initiator.

Further, continued support from the power industry for ambitious reform, less reluctant energy-intensive industries, skillful consultants furnishing ideas for ratcheting up ideas, and the legitimating role of the Paris Agreement ("we need to get our house in order") all contributed to making ambitious reform possible.

Finally, all the actors pushing for a more ambitious reform stood to benefit from the status quo. In the MSR, they already had a central, 'second-best' mechanism in place which could be further tightened: no need to start from scratch. By focusing cancellation on allowances in the MSR (which by nature is not owned by anyone in particular) and with the actual cancellations not taking place until after 2023, policy entrepreneurs in the Council managed to make the distribution of costs fairly obscure and diffuse—whereas the benefits (a probable higher carbon price and increased auctioning revenues) were more specific and closer in time. This is a type of repeated interaction and iterative reforms we think is relevant also beyond the EU.

Was there one pivotal catalyzing event or factor that set this interplay in motion? Here we note the price drop in early 2016, which made clear the continued need for repair despite a structural fix (MSR), and a global climate agreement (Paris Agreement) put in place the year before.

What are main prospects ahead? Throughout 2018 we saw ally rising carbon price, hovering around €20 towards the end of the year. Although the driving factors are many, including some speculative buying, most analysts agree that the carbon price will continue to increase towards and into the 2020s. The MSR became operative in January 2019 and the capping of the surplus from 2023 on will mean significant cancellation of allowances at that point in time. In October 2018 investment bank Berenberg even published a forecast of a price spike in 2019 to €45 and further up to €65 in 2020 (Carbon Pulse 2018).. This will mean that the ETS can finally start functioning as initially intended, leading to fuel switches and stimulating the development of renewables and energy efficiency.

However, demand for allowances depends on a range of factors that are hard to predict, such as weather and oil prices. And the effects of other policies, like renewables, energy efficiency and air pollution (as highlighted by the power industry) are unclear. Efforts have been made to get this aspect included in the Governance Regulation framework , but with little success thus far. In our view, better management of policy interplay represents a key challenge for future EU climate and energy policy.

On the other hand, there are several upcoming processes which could lead to a further ratcheting-up of ETS stringency. The November 2017 reforms still leave a gap between the ETS and Paris requirements, as well as long-term EU ambitions like the 2050 goal of 80–95%

decarbonization. An MSR review is scheduled for 2021. However, as one interviewee pointed out, if the carbon price is above €20 by then,(which now seems very likely) the focus may be on compensation mechanisms to energy-intensive industries, not a further heightening of ambitions (interviews, 2018). The Paris Agreement provides for a global stocktaking in 2023. Several actors have noted this as a point to revisit, possibly increasing the LRF (now set to 2.2%).

Finally, analysts have cited the success and failure of China's ETS as the main possible game-changer ahead. We agree, but also see the further development of the EU carbon price as a key factor to watch. "Be careful about what you wish for, it may come true"—if the carbon price continues to rise, ETS discussions may change, and quite dramatically.

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