

Consultation on structural options to strengthen the EU Emissions Trading System

A EURELECTRIC response



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▶ Growth, added-value, efficiency

Environmental Leadership

▶ Commitment, innovation, pro-activeness

Social Responsibility

▶ Transparency, ethics, accountability

Consultation on structural options to strengthen the EU Emissions Trading System

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EURELECTRIC response¹

The Commission has invited comments on the structural options and views reflected in the report on *The State of the European Carbon Market in 2012*.

1. Key messages

EURELECTRIC is strongly committed to the EU ETS as the best means to achieve the European Council goal of an economy-wide 80-95% reduction in EU greenhouse gas emissions by 2050 within an integrated EU internal energy market. We consider the ETS to be the best instrument to drive investments in carbon reduction because it is technology neutral, because carbon markets are the cost-effective way to drive investment choice in CO₂ reduction, and because the ETS is fully compatible with the internal energy market. Looking at today's landscape of hundreds of different climate-related policies across 27 Member States, EURELECTRIC sees a serious risk that a non-ETS approach to decarbonisation will not only distort, but also fragment, the internal energy market, undoing 20 years of work on harmonisation.

EURELECTRIC welcomes the carbon market report as a first step toward improving the ETS and restoring its credibility as a key driver policy. But we strongly regret that the structural options outlined in the report are not explicitly linked to a clear process of decisions on a post-2020 climate and energy framework. In order that the EU power sector can continue to deliver reliable, affordable and sustainable electricity to the European economy, EURELECTRIC looks to the European Commission to urgently bring forward a coherent top-down package of proposals which:

- Establish an ambitious, firm, long-term, economy-wide greenhouse gas reduction target for 2030 up to 2050, in line with the European Council goal;
- Establish the contribution to CO₂ reduction to be made by the ETS sectors by 2030;
- Establish the ETS as the main policy instrument for driving investment choice in CO₂ reduction, including for mature renewables and energy efficiency technologies;
- On this basis, revise the ETS annual linear reduction factor;
- And in light of these decisions, if necessary makes use of the option to retire a number of EUAs in phase 3 in order to speedily implement the new linear factor.

As previously stated in our October 2012 response to the Commission consultation on the auction time profile (back-loading), EURELECTRIC believes that the ETS can and should be the key driver policy for carbon reduction in an EU 2030 climate and energy package. EURELECTRIC also believes that a rebalancing of supply and demand in ETS is needed in order

¹ The Polish member association PKEE does not adhere to the views expressed in this paper.

for the carbon price to remain integral to business operations and investment decisions, through to 2020 and beyond.

EURELECTRIC has therefore assessed the six structural options outlined in the carbon market report in relation to two objectives:

- Securing the long-term role of the ETS as the key driver policy for carbon reduction in an EU 2030 climate and energy package;
- Maintaining the credibility of the ETS in the short-term before 2020.

On this basis, EURELECTRIC gives highest priority to option (c) for an early revision of the annual linear reduction factor in line with a 2030 target. We envisage that a revised linear factor coming into effect before 2020 would need to be increased in the range of 2.3% dependent on the economy-wide greenhouse gas emissions reduction goals and burden sharing between the ETS and non-ETS sectors. Option (b) to retire EUAs in phase 3 is seen as subsidiary to option (c) because it does not provide a long-term signal, but recognising that revision of the linear factor cannot take effect immediately, some EURELECTRIC members consider that a retirement is necessary to re-establish market confidence in a relatively short time. EURELECTRIC members agree that any retirement in phase 3 should be integrated into a subsequent revision of the linear factor in order to bring the retirement into alignment with the 2030 target.

EURELECTRIC also firmly favours option (d) for the extension of the scope of the ETS to other sectors because this is consistent with the goal of cost-effective economy-wide carbon reductions and the completion of the harmonised internal energy market. We take note that both Australia and California include additional sectors in their carbon markets, and we call on the Commission to undertake a detailed assessment of the feasibility of extending the scope of the ETS for phase 4.

In order to relieve the pressure of the ETS surplus while these structural options are under discussion, EURELECTRIC meanwhile supports a phase 3 back-loading which can signal to the carbon market – and also to international observers – that the EU is committed to a long-term strategy of driving carbon reduction through a strong ETS.

2. General comments on the carbon market report

EURELECTRIC broadly concurs with the Commission in its analysis of the current structural surplus in the ETS, noting that the carbon market is the only known market where there is no supply reaction to falling demand. We are also in agreement that this situation today has important implications for the EU's post-2020 policy framework, and for the development of an international carbon market.

EURELECTRIC is committed to the ETS as the best instrument to drive investments in carbon reduction because it is technology neutral, cost-effective and fully compatible with the internal energy market. In calling for a whole-economy 2030 target and for a cost-effective market approach, EURELECTRIC strongly agrees with the Commission's statement that the

ETS will need to play an increased role in the transition to a low-carbon economy by 2050. We also remind EU decision-makers that at the time of the decision in 2000 to establish the ETS they emphasised that “a Community approach is needed to ensure competition is not distorted within the internal market” and that uncoordinated action would have significantly higher costs.² With energy and climate policies today trending national through the operation of hundreds of different renewables support schemes, debates on national capacity mechanisms, the UK carbon floor price, and the Netherlands coal tax, and several additional discussions on creating national carbon taxes, EURELECTRIC sees a serious risk that a non-ETS approach to decarbonisation will not only distort, but also fragment, the internal energy market.

With international negotiations in the UNFCCC proceeding slowly, showing the world that the EU remains committed to a long-term strategy of driving carbon reduction through a strong ETS is crucial to securing a global level playing field in climate action. EURELECTRIC warmly welcomes the recent decisions in Australia, New Zealand, South Korea and China to establish domestic carbon markets on the model of the ETS, as well as the on-going preparations for linking the Australian and EU markets. Together with the EU, robust carbon markets in California, the north-east USA Regional Greenhouse Gas Initiative, Australia, New Zealand, South Korea and China can help to reduce emissions in around 40% of the world economy.

3. The role of the ETS in a 2030 package

While welcoming the carbon market report as a step in the right direction, EURELECTRIC nonetheless remains deeply concerned about design flaws in the current 20/20/20 package and the slow pace of current EU decision processes which will shape a future 2030 package.

Policy overlaps between the instruments in the 20/20/20 package have resulted in the energy efficiency target and support schemes for renewables creating an *implicit* carbon price which competes with the *explicit* EUA price in the ETS. As has been recognised by both the European Parliament and the Council, this competition reduces the price of EUAs, undermining the ETS as a market tool and encouraging additional emissions elsewhere. Meanwhile the hundreds of support schemes are causing abatement costs to rise substantially, at the expense of customers and taxpayers. This problem has the potential ultimately to destroy the competitive electricity market.

Rather than perpetuate this problem, EURELECTRIC believes that the ETS must be the key driver policy for carbon reduction beyond 2020, including for driving the expansion of mature renewables and energy efficiency technologies through a carbon price signal. EURELECTRIC

² COM(2000)87. The green paper states also that “The development of emissions trading within the Community, while making an important contribution to the protection of the environment by limiting emissions, must nevertheless avoid creating barriers to trade, restrictions to the right of establishment of companies and distortions of competition which would damage the internal market. Emissions trading should therefore form part of a coherent framework of common and co-ordinated policies and measures for reducing greenhouse gas emissions and implementing the Kyoto commitments. Furthermore, in developing an emissions trading scheme within the Community that respects the rules of fair competition within the internal market, the Community will also help avoid possible incompatibilities with multilateral agreements on trade.”

further proposes that the use of a common CO2 metric to measure the delivery of all the emissions reductions from the ETS, renewables and savings in primary energy, would facilitate cost transparency and greater coherence between climate-related policy instruments – and therefore the delivery of EU climate objectives at affordable prices. We call on the Commission to undertake work to develop a common CO2 metric.

Looking ahead, the electricity sector sees additional confusion from the current EU policy processes on roadmaps and climate targets, the implementation of the Energy Efficiency Directive, the report on the Renewables Directive, and the debate on ETS back-loading and structural measures. These processes are located in different parts of the EU institutions, working to different and non-aligned timetables. EURELECTRIC therefore welcomes the Commission's intention to prepare a 2030 framework paper, while still calling for a single, coherent and finite process of EU decisions which links together agreement on a whole-economy 2030 target, on the ETS phases 3 and 4, the future of renewables and energy efficiency beyond 2020, and the internal energy market. We are anxious that this process is moving slowly, and we urge that it should be substantially completed during the current Commission mandate. If decisions are not taken now, we foresee that a new Commission working with a new Parliament from 2015 is unlikely to agree the necessary measures before 2017 at the earliest – far too late to save the ETS and far too late to enable our sector to decide on investments for the years beyond 2020. Our sector mainly invests big and long-term, and for us 2020 is tomorrow.

4. Comments on the six structural options

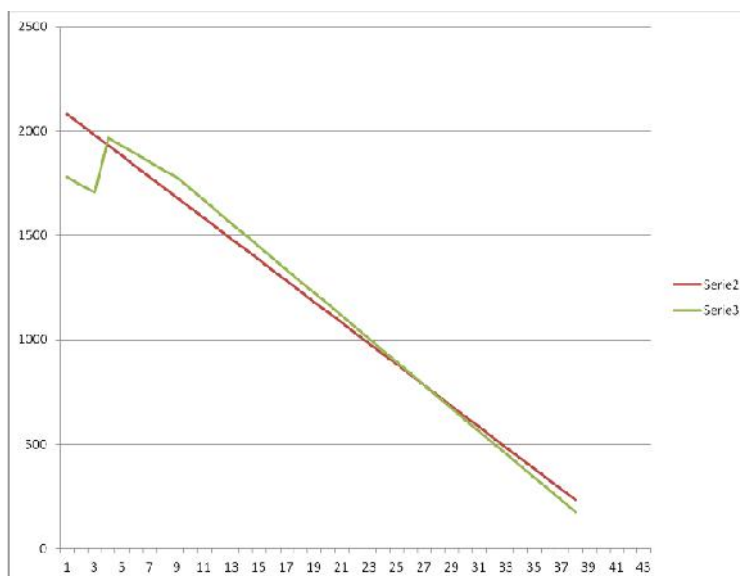
The carbon market report offers six options (a-f). EURELECTRIC has focused its assessment on options (b) for retirement, (c) on the linear factor and (d) on expanding the scope of the ETS. We note that option (a) would be implemented through either options (b) or (c), and that option (e) may be better considered in 2015 in light of the outcome of the UNFCCC Durban process toward an international agreement. Regarding option (f) for introducing a discretionary price management mechanism, EURELECTRIC shares the concern that this “would alter the very nature of the current ETS being a quantity-based market instrument [so that] the carbon price may become primarily a product of administrative and political decisions (or expectations about them), rather than the interplay of market supply and demand.” In our view the ETS is an instrument based on volume not on price, and any proposal on such a mechanism would need to be based on rigorous analysis and would need to apply a strong principle of transparency and predictability. In light of decisions on the 2030 target and cap we could be open to discuss an option for a mechanism to smooth supply volume over time.

EURELECTRIC gives top priority to option (c) for an early revision of the annual linear reduction factor in line with a 2030 target. The revision of the current 1.74% linear factor is necessary in order to meet the EU goal, and early revision has the clear merit of providing a stable long-term framework. EURELECTRIC's recommendation on the % for the new linear factor would depend on having clarity on the 2030 target and on the role of international

offsets into phase 4, however we can provisionally envisage a revision in the range of [2.25%–2.3%] taking effect before 2020, dependent on the economy-wide greenhouse gas emissions reduction goals and burden sharing between the ETS and non-ETS sectors, and we recognise that a later revision would require a steeper linear factor in order to reach the same target. We also emphasise that revising the linear factor will not by itself solve the problem of the ETS surplus without an accompanying resolution of the problem of policy overlap, so that the deployment of mature renewables and energy efficiency is driven by the carbon price.

In EURELECTRIC’s view option (b) for a retirement of EUAs in phase 3 has both advantages and disadvantages. We see option (b) as clearly subsidiary to option (c) but also closely linked: the case for option (b) depends on when the revised linear factor can come into effect. Certainly a one-off retirement of EUAs would be an insufficient measure on its own, because it does not provide the necessary long-term signal; on the other hand option (b) can have a speedy impact, re-establishing market confidence in a relatively short time, which may not be possible using option (c) alone. Some members would therefore favour a short-term retirement in order to quickly rebalance supply and demand. EURELECTRIC members agree, however, that any retirement in phase 3 should be integrated into a subsequent revision of the linear factor in order to bring the retirement into alignment with the 2030 target: in other words, we look at option (b) only as means to implement option (c). We note that a retirement would affect only auctioned EUAs, not free allocations, thereby maintaining the regulatory stability of the wider legislative ETS framework for phase 3.

Figure 1 shows an indicative scenario for combining options (b) and (c). The red line shows a 2.3% linear reduction from 2013, while the green line shows a retirement of 900m EUAs in phase 3 in combination with a 1.74% linear factor until 2020 and a linear factor of 2.53% from 2020 onwards.



Finally, EURELECTRIC agrees with the Commission that option (d) to extend the scope of the ETS to other sectors is “consistent with potential energy system changes such as the increased use of electricity, gas and biomass in all energy related sectors in the transition toward a low-carbon economy by 2050”. Although this option is not a short-term solution for the ETS today, it is EURELECTRIC’s preferred long-term plan for phase 4 beyond 2020. We call

on the Commission to undertake a full analysis of the feasibility of extending the sectoral scope of the ETS to e.g. transport and heating, taking note that both the Californian (from 2015) and the Australian carbon markets have a wider sectoral coverage than the ETS. EURELECTRIC also puts on record that we see a fundamental contradiction between the goal of cost-effective whole-economy decarbonisation and any division of the current ETS into separate sectoral schemes. In order to achieve the cost-optimising benefits of a market it is crucial that a consistent CO₂ price signal should apply throughout the economy, enabling the efficient distribution of assets. Where they are necessary, differentiated sector burdens are already included within the ETS through the mechanism of free allocations.

While it is recognised that changes to ETS phase 3 can only be slight revisions, future legislation for phase 4 could clarify that the objectives of the ETS encompass delivering the EU's CO₂ objective at least cost and driving the investments in low-carbon needed to sustain those emission reductions.

5. Potential cost and economic impacts of structural measures

In order to succeed in limiting climate change, decarbonisation needs to take place throughout the whole economy – not just in the power sector. In this way, EURELECTRIC notes that the purpose of the ETS is to expose both our sector and other sectors to true costs of carbon so that businesses invest in low-carbon innovation, and so that Europe develops next generation technologies.

Concerning compliance and administrative costs, EURELECTRIC's primary worry is not the impact of adjustments to the ETS, but rather the expense of a non-ETS policy approach. The administration of 1000s of different subsidy rates is already today costing €100s of millions per year.

EURELECTRIC supports a strong ETS because we see this as the best way to provide affordable, reliable, and sustainable electricity to the EU economy. We remind the Commission that it is not the ETS, but rather taxes and the burden of expensive renewables subsidy policies that are today causing electricity costs to rise, and that current renewables subsidies deliver emissions reductions at several times the cost of the same reductions if they were delivered through the ETS. This has a damaging impact on the whole economy because these costs affect all businesses and all residents. Meanwhile on-going policy uncertainty due to a weak ETS and the lack of a target beyond 2020 means that the European electricity sector is un-investable, and our sector is experiencing its own problem of global competition: instead of investing to replace old power generation and grids in Europe, EU-based electric utilities are becoming international and are investing elsewhere in the world. A stronger ETS can help to solve both of these problems.



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