AFEP

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AFEP opinion
on the report of the Commission released on 14 November 2012
"The state of the European carbon market in 2012"

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The French Association of Large Companies (AFEP) wishes to express its views in the context of the consultation opened by the Commission about its report called "The state of the European carbon market in 2012", released on November, 14th 2012, and presenting 6 options in order to raise the price of the EU ETS allowances.

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<u>1/ The current ETS system reflects a fall in greenhouse gas emissions, which is in line with its objective of reducing greenhouse gases emissions (GHG), but does not provide the medium to long-term visibility (2030 and beyond) required to stimulate investments</u>

AFEP is keen to point out that the European Commission designed the ETS Directive as an instrument based on regulating the **quantities** of allowances permitted, in order to ensure a regular reduction in the **level of** GHG in absolute terms over time. In so doing, its stated principle was that:

- allowance prices **should reflect supply of and demand for** allowances (no price fixing),
- emission reductions could come **either from operators improving specific emissions** (emissions per unit of production) via investments, **or from a fall in the level of production**. However, the Commission did not anticipate at the beginning of its project that activity levels would drop or decrease, which has led to the adoption of growth hypotheses which are too optimistic at this stage when it comes to calculating the volume of allowances.

Consequently, the current low allowance price does not mean that the ETS system "is not working". Quite the opposite. This low price simply reflects the fact that GHG emissions from the installations covered by the Directive have actually fallen, partly due to the economic crisis and partly to the efforts made by companies in order to reduce their emissions as a result of the ETS system and in view of improving their energy efficiency or their use of renewable energies**. The emissions reduction objective has, in fact, been met.**

However, it should be noted that, in the current period of reduced growth, the ETS system by itself cannot provide the stimulus for low carbon investments in the long term, i.e. beyond 2020, which is the year when the third ETS period ends. Indeed, there is a **high level of uncertainty** for investors concerning EU GHG reduction requirements **beyond the 2020 time horizon**, despite the tacit application of the Directive's annual linear reduction factor (-1.74 % per year) until 2025. This uncertainty is linked to the fact that **neither the path towards 2030 nor an objective for 2030 have yet been adopted explicitly** by the Member States.

The main question asked is therefore: should the EU ETS be adapted in order to stimulate medium and long term investments whatsoever be the current level of economic activity?

<u>2/ Companies recommend that medium to long-term visibility be provided (2030, 2040 up to 2050), since this alone can stimulate large scale low carbon emission investments across the EU</u>

To promote investments in low carbon emission technologies and processes in the medium to long term while maintaining and strengthening the competitiveness of the EU, it is essential to **launch now at EU level a high level group gathering representatives of Member States and all relevant stakeholders in order to define a cost-efficient pathway to reduce greenhouse gas emissions for 2030 and 2040**, in line with the energy production outlook and the EU competitiveness targets.

This high level group could take into account the **volume of allowances considered as a surplus at the end of 2020 in the process to establish the pathway towards 2030 and 2040**. This initiative should **enable a quick and significant rise of the allowance prices**, considering the banking provision between two periods as defined in the Directive, and support large scale low carbon emission investments across the EU.

Companies consider that such a medium and long term visibility should be based on European policies **integrating energy, climate change, research and development/innovation and competition issues**, shared by the Member States and the Commission through this high level group.

<u>3/ In this context, AFEP regrets that the Commission focused on 6 options which are not based on post 2020 measures and which are not subject to thorough impact assessment studies ; AFEP's points of view on those options are the following:</u>

- **Increasing the EU greenhouse gas (GHG) emission reduction target to 30 % by 2020:**
  - The EU must adhere to the conclusions of the December 2009 European Council – in which Heads of State or Governments reasserted the conditionality of any move to a 30 % reduction. These conclusions were reaffirmed in 2011 in the Roadmap for moving to a low–carbon economy in 2050 ("*This Communication does not suggest to set new 2020 targets, nor does it affect the EU's offer in the international negotiations to take on a 30% reduction target for 2020, if the conditions are right*").
  - Increasing the emission reduction target to -30 % by 2020 would widen the gap between the ambitious European policies already in place and the limited commitments of other developed countries.
  - A unilateral and unconditional move would not be effective in convincing our negotiating partners to step up their game, and would only result in hurting European companies' competitiveness.

- **Cancelling of emission allowances:**
  - Cancelling the emission allowances which have been back-loaded would be comparable to modifying the EU GHG target for the ETS sectors even though the rules applicable to this period have just been adopted and the period has just started.
  - The impact on European competitiveness of this measure should be carefully assessed;
  - For the post 2020 period, this measure does not bring the necessary price signal for investors.

- **Early revision of the linear reduction factor (1.74% per year):**
  - Every year from 2013 to 2020, emissions will have to decrease by 1.74 % compared to the previous year. The ETS Directive also lays down that the linear reduction factor would be maintained up to 2025 (Article 9). This represents a total reduction of 21 % for the ETS players in 2020 compared to 2005, and approximately a 38 % reduction by 2030, should this factor be maintained after 2025.
  - Modifying the linear reduction factor during the 2013-2020 period would create legal uncertainty for investors as it would mean that the ETS Directive is not a stable framework: it would therefore increase price volatility and discourage investments.

• **Extension of the scope of ETS to non-ETS sectors:**

- Non-ETS sectors (residential, agricultural, transport and waste management) are already covered by the Effort Sharing Decision. This Decision establishes binding annual GHG emission targets for Member States for the period 2013–2020. The inclusion of non-ETS sectors within ETS should be proposed by Member States and approved by the European Commission.
- In addition, a Commission proposal for a Directive on Energy Taxation supports a carbon taxation on energy products, which would apply to non ETS sectors. Such an instrument appears more appropriate for tackling emissions from non-ETS players, which are more scattered, and reaching a balanced effort sharing between ETS and non-ETS sectors. The European Commission should thus support the current ongoing negotiation on this text.

• **Limitation of international credits (CDMs):**

- The ETS Directive already prevents new projects coming from developing countries with the exception of least developed countries. Limiting the use of credits (CDMs) coming from projects already implemented would give a strong negative signal for all investors.
- Any further modification concerning the use of CDM credits should only be envisaged as part of a negotiation for the conclusion of a global agreement involving all major emitting States; implementing such a measure unilaterally would weaken EU diplomacy with respect to negotiation of this international agreement.
- Finally, it has to be reminded that CDMs have always been attractive tools for “non-carbon constrained” countries in order to integrate gradually carbon objectives in domestic policies; they should remain a diplomatic tool in order to convince new countries to join the global effort.

• **Carbon price control:**

- This option would go against current ETS system principles. The European Commission designed the ETS Directive as an instrument based on regulating the quantities of allowances permitted, in order to ensure a regular reduction in the level of greenhouse gas emissions (GHG) in absolute terms over time.

4/ AFEP considers that, provided medium and long term objectives are set for the EU ETS, provisions which are not mentioned in the Commission report should be examined, especially in regard to the expectations of the growing economies within the EU:

- **Integrating the variation of economic level for allowances:**

  - ***Introducing a reserve for growth:***
    - AFEP considers that if the back-loading Regulation was adopted, it would be useful to assess the economic impact of the case where the allowances, instead of being set aside, would feed in a reserve dedicated for growth, thus enabling companies to be able to cope at the lowest cost with a rise of their economic activity.
    - This reserve would be distinct from the new entrant reserve as it would be used in the case of growth without capacity change.

  - ***Integrating production levels of the preceding year in order to calculate the allowances of the on-going year:***
    - Companies also consider it would be interesting that the Commission assess the case of adapting the number of free allowances by calculating it based on the real level of activity of an installation, for example the production level of the preceding year.
    - This would enable to allocate more allowances for an installation with a higher level of production than expected, and reduce the allocation in the opposite case. In both

situations, the main driver for investments would be to reach the best practices in terms of emissions/unit of production existing in the same field of activity and would therefore avoid the current situation of the ETS where the production level is an adjustment factor.
    - It has to be reminded that some provisions favouring this approach have been adopted in the April 2011 Decision of the Commission defining transitory rules for the allocation of free allowances (cf. Articles 21,22 and 23) but they appear insufficient.

- **Enabling supply elasticity:**
  - Considering that the main issue to be solved is to know whether it is possible to create an ETS based on a "quantity" approach and also able to send an appropriate price signal, companies believe it would be necessary for the Commission to examine the feasibility of setting up an automated supply flexibility mechanism or an independent body whose aim would be to intervene on the EU ETS market.
  - The conditions of acceptance of such mechanisms should be carefully assessed by the Commission.

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Conclusion

AFEP recommends that medium to long-term predictability be provided (2030, 2040 up to 2050), since this provision could stimulate best low carbon emission investments across the EU.

Setting post-2020 reduction targets, while preserving the banking rules, would have a quick and significant effect on the current CO_2 price (economic operators anticipating future scarcity).

Supply elasticity requires to be brought in the system as long term planning demands some flexibility in the implementation phase. Ex post adjustments for free allowances would support this objective and foster the international competitiveness of the EU industries. This approach could also be relevant in order to address the expectations of the growing economies within the EU.

Furthermore, genuine and substantive R&D and innovation policies, integrated into energy and climate policies, are essential to boost low carbon solutions implemented in Europe, and to stimulate competitiveness and jobs in Europe.

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About AFEP:

The purpose of AFEP (French Association of Large Companies) is to present the views of large entreprises operating in France to the European Institutions and the French authorities, mainly with regard to the drafting of non-sectoral legislation (economy, finance, taxation, company law, financial information and markets, competition, intellectual property rights, consumer affairs, social regulations, employment legislation, environment, etc.).

AFEP represents more than 100 of the top companies operating in France. The French listed companies which belong to AFEP have more than 5,8 million employees and a combined turnover of over 1500 billion euros. Their market capitalisation in 2011 amounted to 800 billion euros.

As a genuine force for generating new proposals, AFEP is also a prime forum for contacts between member firms and public authorities, which do not hesitate to consult the Association when considering plans for reforms or regulations. Senior officials in the European Union and French administrations regularly take part in meetings organised at the head office of the Association, enabling direct and constructive dialogue to take place.

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