DET KONGELIGE
MILJØVERNDEPARTEMENT

Stavros Dimas
EU Commissioner for the Environment

Your ref | Our ref | Date 29 JUN 2007

Review of the European Emissions Trading Scheme

Dear Mr. Dimas,

I refer to the process under way to review the European Emissions Trading scheme for the periods post 2012, and the general invitation to provide input before July 2007. From the Norwegian side, we have appreciated the efforts made by the Commission to set up process, as well as taking part in some of the undertakings so far.

Norway also submitted its input in an attempt to influence the shaping of the Directive before it was first established. The messages from this years' IPCC Report has underlined the need to develop the trading scheme to be an even more powerful vehicle to change emissions patterns both in the European countries themselves, as well as outside Europe and in particular in developing countries through the link to the Kyoto mechanisms.

<u>Assessment of the national allocation plans</u>
Norway would like to stress the importance of the Commission's assessment of the Member States' national allocation plans, and is of the opinion that the Commission should use a strict approach to ensure that the total amount of allowances issued in the EU ETS is as low as possible.

<u>Extension of scope</u>
Norway welcomes the intention to broaden the scope of the Directive, including the Commission's proposal to extend it to the aviation sector. However, we believe the

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scope could and should be extended even further. One obvious candidate is the transport sector, which would for practical purposes necessitate an "upstream" obligation to surrender allowances under the scheme.

Carbon capture and storage (CCS) is another prime candidate, especially related to installations already included in the scheme – notably fossil based power production. Norway has called for financial and other incentives to encourage the deployment of CCS, and finds that recognition of non-emitted CO_2 in emission trading can be one such incentive. We recognize that there are only a limited number of projects feasible in this time-period, though, but would nevertheless like to point to the IPCC Report on the huge potential for emissions reductions from a wide application of this technology. Norway intends to opt in CCS facilities in 2008-2012, the first will be in operation from 2010. Norway participates in the working group on carbon dioxide capture and geological storage (CCS) under the European Climate Program, and looks forward to work with EU countries and the Commission to find appropriate ways to do this. Developing appropriate monitoring and reporting guidelines (MRG) for CCS should be a priority issue.

Norway would also argue that a greater part of the industry sector could be included, also emissions of non-CO_2 gases. We intend to opt in emissions (of N_2O and CO_2) from fertilizer production in 2008-2012, and we are considering further opt-ins of industry. Due to an understanding with the industry we already have in place strict rules on monitoring and reporting of emissions of CO_2 from sectors such as production of aluminium, ferro alloy and silicon carbide.

<u>Allocation of allowances</u>
Norway believes that allowances in principle should be sold/auctioned. This will force the installations to face the full costs of their activities. We do not expect to be bound by the Directive's Article 10 and have proposed an allocation regime for 2008-2012 with a limited amount of allowances allocated for free. In light of the need to develop a low carbon future, as emphasised by the findings of the IPCC Report, sale should be the only allocation principle post 2012.

An efficient emissions trading scheme requires that all polluters face the same marginal cost of pollution. If no tradable allowances are granted under market price, the uniform market price on allowances will represent the marginal costs of pollution for the installations being subject to the trade system.

In the emissions trading scheme, an emission allowance is equivalent to an intangible asset. All allowances, received free of charge or bought, have an equal market price. The financial benefit of allowances granted under market price, is therefore independent of the company's emissions ("expected needs").

The emissions of an undertaking will as such depend on the internalisation of the pollution costs (and the marginal cost to pollution). If an operator expects that the granting of allowances free of charge in a *next* trading period will depend on the factual emissions of that the individual installation in a *present* period, the granting system may influence his behaviour in that present period. This will be the case if the expected granting of allowances is based on so-called "expected needs", updated historical emissions figures or any function of future production capacity (or likewise), notably BAT. In these cases, reduced/increased emissions due to lower/increased production or reduced/increased capacity, may lead to lower granting of allowances free of charge in the next period. Thus, the single market price on allowances will no longer be the internalised costs on emissions and the marginal costs to pollution will vary between the installations. Global emissions will still be determined by the cap (total supply of allowances granted or sold), but the allocation of the emission reductions to meet the cap will be far from cost efficient.

The possible inefficiency will be even worse if the operators expect that the granting of aid as regards competitors operating in the same product market, e.g. the energy market, will favour technologies with higher emissions rates compared to those with lower emissions, e.g. coal fired power plants compared to gas fired power plants and other energy technologies technology with smaller emissions.

Thus, it should be signalled as early as possible that there will be no granting of allowances free of charge in the next period or, alternatively, that allowances will be granted free of charge only to a very limited extent. This will ensure that new entrants take (fully) into account the expected long-term market prices of allowances when they decide what to produce and which technology to choose.

The overall size of the global CO_2 reduction needed underlines the importance of having a cost efficient system avoiding unnecessary costs.

<u>Linking the EU ETS to other schemes</u>
The Commission should assess the possibilities for linking the EU ETS to similar schemes in other countries, for instance emerging trading schemes in the USA, Japan, Australia and New Zealand. The wider the geographical scope, the more efficient the EU ETS may become as an instrument for cost-efficient greenhouse gas emission reductions.

<u>Third party verification</u>
During the first trading period the Norwegian Pollution Control Authority, supported by the Norwegian Metrology Service, has verified emission reports from installations covered by the trading scheme in Norway. Due to limited number of Norwegian installations and the fact that the Pollution Control Authority already inspects these installations we have seen this as an efficient verifying process fulfilling high quality

standards. The EU ETS should therefore maintain an option as the directive stands today for the Authorities to verify emissions covered by the scheme.

Yours sincerely,

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for Inger Glad Stokland
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for Lene Lyngby
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