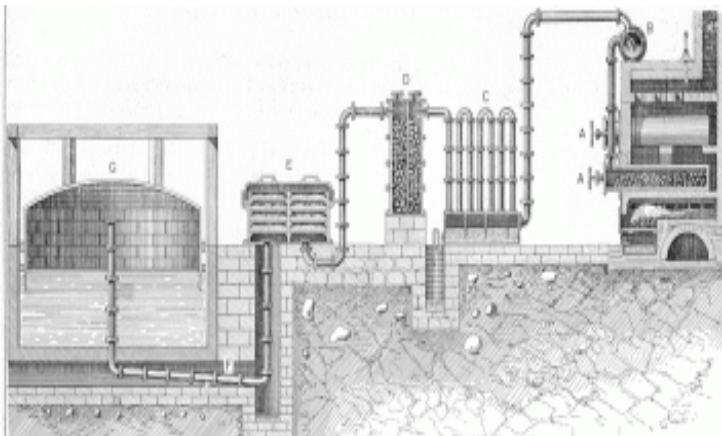


The ETS:

Improving the predictability of the scheme



Mark C. Lewis
Director
DB Commodities
Research



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DISCLOSURES AND ANALYST CERTIFICATIONS ARE LOCATED IN APPENDIX 1

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Contents

■ Why the timeframe should not be too short

- Reducing the vulnerability of the scheme to short-term supply shocks means making the timeframe more compatible with the investment cycle of the main industries covered by the ETS

■ Why the timeframe should not be too long

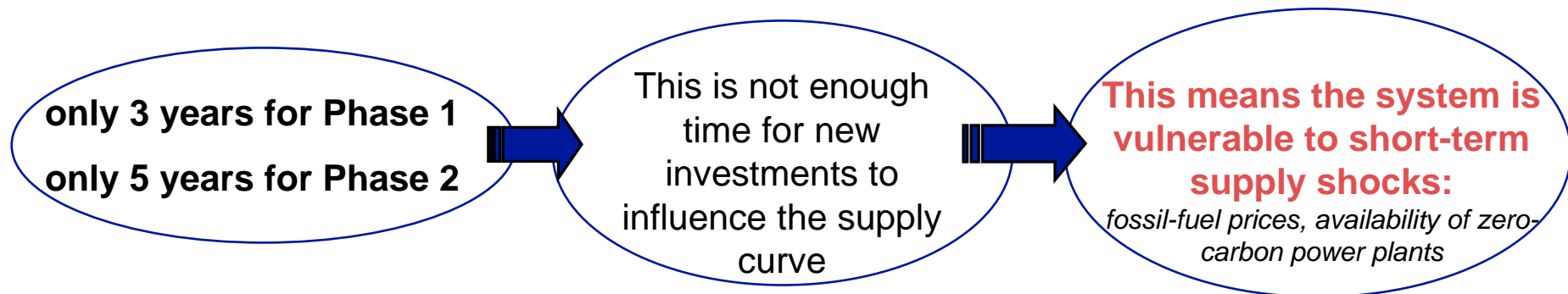
- Ensuring the timeframe incentivizes the correct investments for a carbon-constrained world means making the carbon price responsive from the very beginning of the compliance period

■ Greater frequency of disclosure would also improve predictability

■ Conclusion: the aim should be medium-term caps (8-10 years) within a long-term emissions trajectory (30-40 years)

Why the timeframe should not be too short ...

- The timeframe in Phase 1 (and Phase 2?) is too short



- A timeframe of 8-10 years is long enough to allow new investments to influence the supply curve

Where can the switching happen?

Breakdown of installed generation capacity in the EU-25, 2003* (MW)

Member state	Nuclear	Hydro	Wind	CCGT	OCGT	Hard coal	Lignite	Fuel oil	TOTAL
		/renewable							
Germany	21,400	9,895	17,936	1,000	18,500	30,500	22,200	5,100	126,531
France	63,400	25,110	950	0	5,734	15,748	0	5,438	116,380
UK	11,852	4,400	1,900	25,612	5,831	26,765	0	4,010	80,370
Italy	0	20,499	2,747	11,000	13,249	5,114	1,500	24,249	78,358
Spain	7,876	18,319	9,738	12,773	3,000	10,174	2,031	8,092	72,003
Sweden	9,441	16,143	2,010	0	1,384	1,730	0	2,653	33,361
Poland	0	2,192	73	0	0	22,077	7,357	0	31,699
Netherlands	449	37	1,228	1,228	11,299	4,678	0	1,675	20,965
Austria	0	11,729	142	0	3,463	1,552	0	955	17,842
Finland	2,671	2,994	2,209	0	3,509	4,825	0	439	16,647
Belgium	5,780	1,413	285	2,000	4,155	1,723	0	328	15,684
Czech Republic	2,760	2,135	11	600	170	2,909	7,420	0	16,005
Denmark	0	9	2,958	0	2,688	5,894	0	1,399	12,948
Portugal	0	4,512	571	1,200	1,275	2,891	0	1,205	11,654
Greece	0	3061	37	0	1,551	0	5,293	2,282	12,224
Slovakia	2,480	2,448	13	0	0	686	2,170	0	7,777
Hungary	1,755	48	28	0	1,286	1,110	1,664	2,707	8,598
Lithuania	2,367	916	0	0	0	800	1,301	400	5,784
Ireland	0	532	0	0	1,665	1,832	0	1,322	5,550
Slovenia	670	840	0	0	310	400	400	400	2,772
Estonia	0	3	0	0	600	1,000	700	234	2,537
Latvia	0	1,561	0	0	0	400	0	180	2,141
Luxembourg	0	1,129	21	0	0	451	0	0	1,601
Cyprus	0	0	0	0	0	988	0	0	988
Malta	0	0	0	0	0	577	0	0	577
TOTAL	132,210	129,596	43,057	55,785	79,670	144,824	51,988	62,865	700,995

* UK and Spanish figures are for year-end 2004

Source: Eurelectric, UK Government, Spanish Government, Deutsche Bank estimates



The maximum reasonable constrained schedule

Generation output and CO2 emissions in the EU-15, 2003 (TWh and M/T respectively)

Member state	Nuclear	Hydro	Wind/ Renewable	CCGT	OCGT	Hard coal	Lignite fuel	Fuel oil/ other	TOTAL NET GENERATION (TWh) (m/T)	CO2 Emissions
Germany	156.4	24.7	25	2.2	40.5	139.5	160.9	10.9	560.1	323
France	420.7	63.7	3.2	0	37.6	50.2	0	0	541.6	45
UK	82	2.3	7	120.1	24.4	131.3	0	8.3	375.2	175
Italy	0	43.7	10.5	66	58	26.9	5.3	69	279.4	128
Spain	59.3	43.1	15.1	42.5	61.1	53.5	5.3	26.5	251.4	91
Sweden	65.5	53	0.6	0	42.4	43.9	0	4.6	132.3	10
Netherlands	3.8	0.1	3.6	9.1	45	26	0	5.5	93.2	54
Austria	0	33.3	0.8	0	16.9	5.4	0	0.8	57.3	13
Finland	21.8	93	11.2	0	13.8	21.9	0	1.9	79.9	33
Belgium	45	13	1	6.1	16.4	9.8	0	0.9	80.5	23
Denmark	0	0	5.6	0	10.1	23.6	0	4.3	43.6	29
Portugal	0	15.8	1.1	7.4	7.3	12.6	0	1.9	46.1	18
Greece	0	2.5	0	0	5.4	0	33.8	7.2	49	53
Ireland	0	1.1	0.6	0	8.8	8.3	0	5.3	24.1	15
Luxembourg	0	3.3	0.1	0	0	0.1	0	0	3.5	0
TOTAL	854.5	297.1	85.3	253.4	260.8	513.6	205.4	147.3	2,617	1,010

Source: Eurelectric, European Commission Annual Greenhouse Gas Inventory (June 2005), EU-15 member-state governments, company data, Deutsche Bank estimates

Stylised generation output and CO2 emissions in the EU-15 (TWh and m/T respectively)

Member state	Nuclear	Hydro	Wind/ Renewable	CCGT	OCGT	Hard coal	Lignite fuel	Fuel oil/ other	TOTAL NET GENERATION (TWh)	CO2 Emissions (m/T)
Germany	156.4	24.7	25	2.2	89.1	183	68.1	10.9	559.5	281
France	451	63.7	3.2	0	135.6	37.2	0	0	568.9	40
UK	82	3	7	179.5	38.3	61.3	0	8.8	379.9	147
Italy	0	43.7	10.5	77.1	75.4	13.4	2.6	66.9	289.7	128
Spain	60.7	43.1	15.1	89.5	15.2	22.3	0	14.2	260.1	69
Sweden	70.3	53	0.6	0	72.7	2.7	0	3.5	136.9	9
Netherlands	3.8	0.1	3.6	10.5	45.5	25	0	5.5	94	55
Austria	0	33.3	0.8	0	18.8	5.4	0	0.8	59.2	14
Finland	22.3	93	11.2	0	138.3	18.6	0	1.9	77.2	30
Belgium	45.6	13	1	14.1	16.4	4.5	0	0.5	83.3	21
Denmark	0	0	5.6	0	136.6	23.6	0	4.3	47.2	31
Portugal	0	15.8	1.1	8.4	89.3	13	0	4.2	51.5	21
Greece	0	2.5	0	0	81.5	0	33.8	7.2	51.7	54
Ireland	0	1.1	0.6	0	10.4	8.3	0	5.3	25.6	16
Luxembourg	0	3.3	0.1	0	0	0.1	0	0	3.5	0
TOTAL	892.1	297.9	85.4	381.2	374.6	418.2	104.5	134.2	2688.2	916

Source: Eurelectric, European Commission Annual Greenhouse Gas Inventory (June 2005), EU-15 member-state governments, company data, Deutsche Bank estimates



How and where abatement can happen

	Nuclear	Hydro	Wind/ renewable	CCGT	OCGT	Hard coal	Lignite	Fuel oil
2003 actual	32.6	11.4	3.3	9.7	10.0	19.6	7.9	5.5
Stylised maximum constrained schedule	33.2	11.1	3.2	14.2	13.9	15.6	3.9	4.9

Source: Deutsche bank estimates

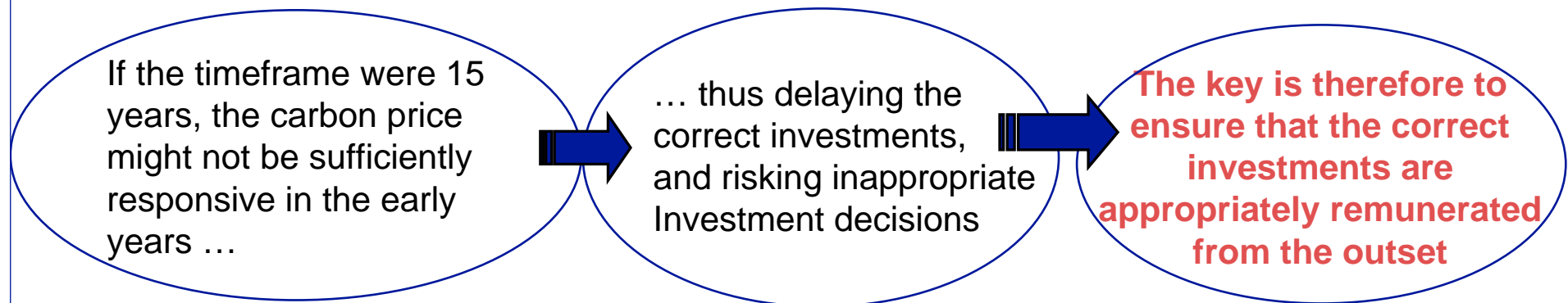
Reduction in CO2 emissions m/T		
Germany	41.3	
France	5.8	
UK	27.3	
Italy	0.2	
Spain	22.1	
Sweden	1.1	
Netherlands	0.1	
Austria	-1.0	
Finland	3.2	
Belgium	2.5	
Denmark	-1.9	
Portugal	-3.3	
Greece	-1.5	
Ireland	-1	
Luxembourg	0	
TOTAL	94.9	

CO2 emissions reduction under stylised schedule vs. 2003A level

Source: Deutsche bank estimates

Why the timeframe should not be too long ...

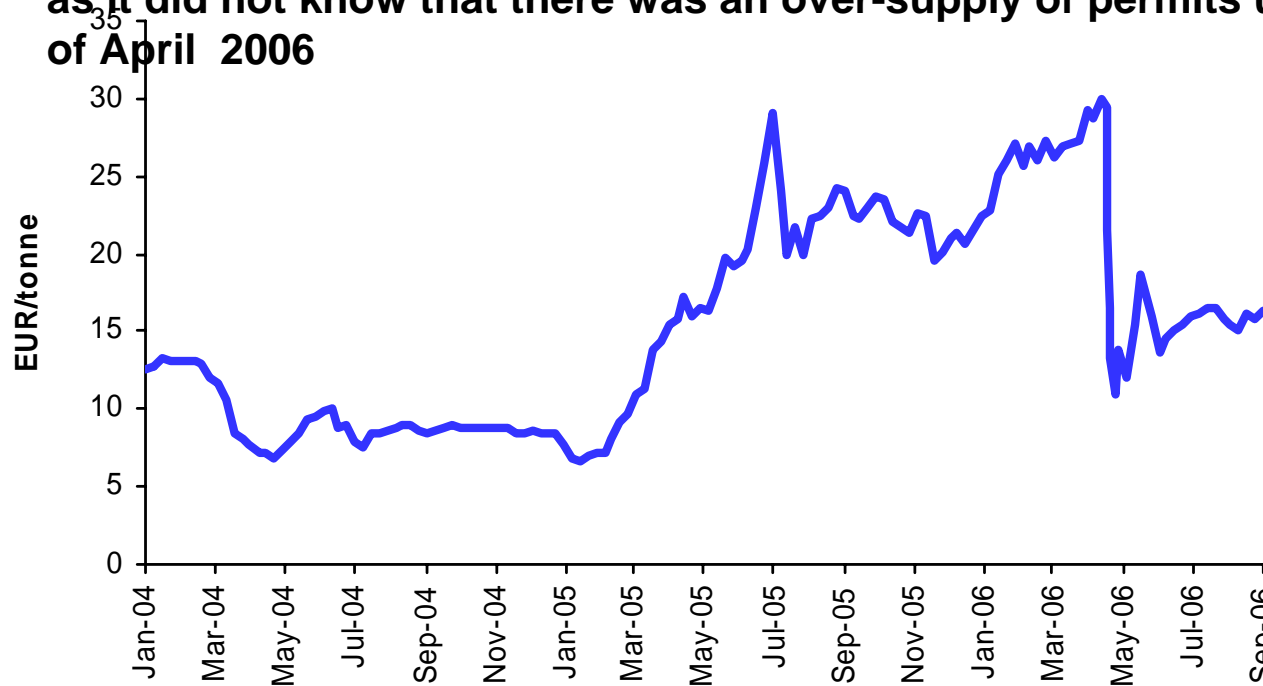
- If the timeframe were too long – say 12-15 years or longer – the carbon price might not be sufficiently responsive in the early years



- A timeframe of 8-10 years is short enough for the carbon price to be highly responsive from the outset in a way that rewards the right investments and penalizes the wrong ones from the beginning

Greater frequency of disclosure would also improve predictability ...

Over the first 17 months of Phase 1, the market was trading on a false premise as it did not know that there was an over-supply of permits until the end of April 2006



Source: Datastream

Conclusion: medium-term compliance periods within a long-term emissions trajectory is the rational policy

- A long-term cap set for 30-40 years would greatly reduce the incentive to change behaviour in the short term, as economic agents would hope for improved technology later in the period, or find other excuses to delay adaptation
- However, having a long-term **trajectory** (30-40 years) for the carbon cap with shorter-term **compliance periods** (8-10 years each) should ensure that the behaviour of the agents covered by the scheme take the long-term trajectory into account from the outset of the first compliance period
- Quarterly disclosure of emissions should be introduced as soon as possible

Appendix 1

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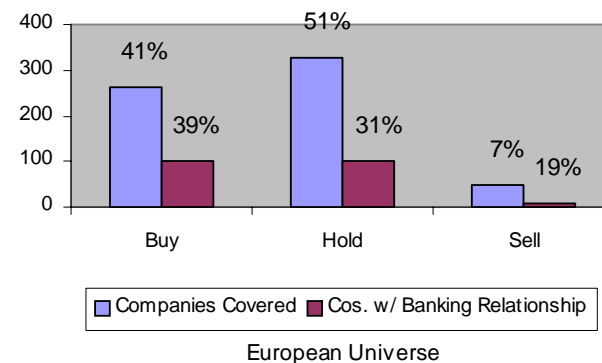
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