Vattenfall opinion paper on the EU ETS

2010-12-08

- **In order to enable a transition towards a low-carbon society, massive investments in new technologies for generation, transmission, distribution and end-use are needed. These will not be realized unless there is a reliable price signal supporting such a move.**

  - A transformation process can be created through many different policies. Those which imply a CO_2 price on the market are generally to be preferred since they serve to internalize the environmental cost of CO_2 emissions and create conditions for a cost-efficient achievement.

  - Emissions trading is one of the most prominent tools to create a firm and uniform price on CO_2 emissions, while at the same time allowing absolute emissions to be "capped" on a level that is consistent with the 2 °C target.

  - The formation of a CO_2 price can be a powerful tool, but without sufficient stability and predictability, reflecting the long lead times of investments in new power generation capacity, many important long-term options are at risk of being omitted. That could increase the societal costs considerably.

- **The adoption of the EU ETS directive has been one of the most important achievements in the EU's climate policy framework to this date.**

  - The EU ETS is one of the most *cost-efficient* and *reliable* tools available to reduce GHG emissions through real cross-sectoral participation. It is the world's most ambitious international response to combat the threats of climate change.

  - As a result of the amendments agreed in 2008, the EU has i*mproved the functioning* of the system in many aspects incl. increased transparency, more level playing field, stronger price signal and formulation of a long-term GHG emissions reduction trajectory.

  - For Vattenfall with an international reach and with competitors in many countries, the Community-wide dimension is very important, especially when it comes to achieving a level playing field in the internal market where energy, capital and CO_2 move without borders.

- **In addition to being the largest mandatory carbon market in the world, the EU ETS is also the backbone for the global demand of credits worldwide**

  - Through the link towards the two project-based flexible mechanisms in the Kyoto protocol (CDM and JI), the EU ETS has also *created incentives for GHG mitigation in developing countries* and *generated substantial financing* to climate protection.

  - As a result of the recognition of these offset credits also in other carbon markets around the world, there are already indirect linkages of schemes, which can be regarded as a step *towards a more global carbon market*.

- As one of the largest buyers of CDM credits in the world, Vattenfall has fully embraced the concept of global carbon markets. It is important that these activities are developed further in terms of e.g. the *environmental integrity* and the *effectiveness of approval procedures* in the future.

- Should the EU deem *new rules necessary to improve the functioning of the CDM, every effort should be made to address these issues at the UN level* in order to avoid a more fragmented carbon market and a situation where "doubtful" credits are still used by other parties and/or operators in the world.

- In order to preserve the confidence in investors on the carbon market, it is important that any restrictions on eligibility of certain offset credits are *not retroactively imposed* on projects already registered and/or approved.

➢ **The CO_2 price signal perceived by operators in the market could be further strengthened if the long-term targets are clearly formulated in legislation**

- First of all, it has to be recognized that *the EU ETS is designed to minimize the EU's costs* for achieving its international commitment. The market price of allowances typically reflects the objectives in climate policy as agreed by the politicians. An allowance price which reduces during a period with low demand should above all be perceived as an indication on a healthy functioning of the system, not as a problem.

- The primary task of politicians is to decide on the society's GHG reduction targets. To be consistent with the reasoning behind the establishment of a cap-and-trade system, *it must then be left to the market to determine the necessary CO_2 price level* on basis of fundamentals including the participants' CO_2 abatement options.

- In order to promote an efficient EU climate policy, it is important to find a *well-balanced sharing of the efforts to mitigate GHG emissions between the EU ETS sectors and non-ETS sectors*. This should be done through setting targets which induce equivalent marginal CO_2 abatement costs. In addition, it would be reasonable to ensure that also the non-ETS sectors are subject to a defined reduction trajectory beyond 2020. Inter-sectoral flexibility through e.g. domestic offsetting is another element that could serve to improve the cost-efficiency further.

- The climate targets currently endorsed by the EU and other Parties of the UNFCCC are clearly not consistent with the very deep GHG emission cuts which are required to meet the 2 °C target. Instead of trying to intervene the CO_2 price formation, the policy makers should *send trustworthy signals to market participants* about which long-term emission reductions must be achieved in the 2030, 2040 and 2050 perspectives.

- The CO_2 price signal experienced by participants on the EU ETS market can be further strengthened if long-term targets are clearly formulated in legislation. *Providing enhanced visibility about the future direction of the EU ETS is a key success factor* and even more important for igniting the transition than the precise CO_2 price level over the next couple of years leading up to a new global climate agreement.

- In order to preserve the EU ETS role, and its ability to integrate new technologies, other *support for e.g. renewable energy have to be used carefully and eventually be phased-out*. Otherwise there is a risk that the allowance price will be derogated and thus unable to reflect the real CO_2 price that would be needed to achieve the climate target cost-efficiently.

➢ **It is important to refrain from making "quick fixes" to a functioning system since that could turn out counter-productive and damage investments**

- If the EU ETS shall succeed in driving long-term investments and spur a technological development to achieve a truly low-carbon society, *the most important factor from a business perspective is predictability* in policies.

- When the political conditions are right for stepping up to a more ambitious long-term climate target, the EU has a very powerful tool at its disposal, in the form of the EU ETS. Pending a decision on a climate target formulated as a part of a global effort sharing to limit the temperature increase to 2 °C, the *policy makers should refrain from making artificial interventions to the formation of a CO_2 price set by the market*.

- Making quick fixes aimed to steer the allowance price during a transitional period characterized by e.g. insufficient climate targets, or a weak demand resulting from the recession, will only serve to *induce more uncertainty* and *worsen the investment conditions* also for low-carbon technologies.

- The various interventions to strengthen the transformation pressure in the EU ETS sectors discussed (e.g. EPS and CO_2 taxes excised on sources already subject to the emission cap) would be *highly counter-productive* since it reduce the allowance price further, weaken the ETS policy and destroy the uniform price signal which is required for a cost-efficient steering.