

EFET statement on EU greenhouse gas policy and draft emissions trading directive

February 2003

The trading of carbon dioxide emission allowances should represent an economically efficient means of meeting EU reduction targets. Economic efficiency will be optimised by achieving equivalence in initial obligations between emitting companies in different Member States. The draft directive agreed by the Council of Environment Ministers is to be welcomed in principle. The Commission guidelines envisaged on the issuance and trading of allowances should facilitate greater harmonization in due course. However, the directive would tolerate extended national opt-out periods and possibly indefinite industry pooling arrangements. This means that sufficient certainty as to obligations of individual companies may remain absent in a significant part of the internal energy market in the future. Only a certain and truly harmonized legal framework for issuing and enforcing allowances will underpin the liquidity required for the creation of a successful and durable pan-European market in traded carbon emissions.

Background

The European Federation of Energy Traders (EFET) supports the development of competitive markets in electricity and gas. EFET has initiated both practical standardisation projects and new policy ideas, which will help foster liberalisation and facilitate the functioning of wholesale markets.

EFET members also recognise the importance of environmental measures, as part of the development of an internal market in electricity. We support the European Union's efforts to move towards more sustainable means of power production and patterns of consumption. Both a reduction of CO₂ emissions, as part of the means to meet the EU's challenging Kyoto target, and an increase in the use of renewable sources for electricity production have a role to play.

EFET has followed the debate about the European Commission's proposal for a directive, establishing a framework for greenhouse gas emissions trading within the European Community, especially in relation to the design of the market and the instruments. We welcome the Council of Ministers' political agreement on this subject in December 2002. Nonetheless, we remain dubious about the chances of the directive, as drafted, leading to a really liquid and transparent pan-European traded market in greenhouse gas emission allowances within the next ten years.

Achieving a successful and durable market in traded emission allowances

The overall EU objective must be to maximise the chances of Member States achieving their CO₂ reduction allocations cost-effectively. A natural next step beyond national reduction quotas is for Member States to set sectoral targets, involving promises by different branches of industry to contribute to the total reduction. Although most governments are reconciled to such target setting, including for electricity generation, some baulk at imposing real obligations on individual enterprises. EFET believes only real corporate obligations, duly enforced where necessary, can underpin the confidence needed for a liquid and transparent market in emission allowances to evolve.

To put the analysis a different way, regardless of the allocation method of allowances for a particular enterprise in a particular sector (from “grandfathering”, through benchmarking, to auctioning), allowances must later have the potential to become the basis for truly market-based instruments. And any successful market-based instrument is founded first and foremost on the legal certainty of one counter-party that it will prevail, if it seeks to enforce the corresponding contractual obligations against the other. In the case of emission allowances, such certainty can ultimately only be derived from confidence that the entity promising to reduce its emissions would suffer a penalty, if it does not do so.

It follows that the latitude allowed to Member States by the proposed directive to:

- Opt out of mandatory trading schemes till 2007, and
- Organise longer term pooling of allowances for individual emitting companies in the same industry sector nationally

may well result in a diminished number of potential trading parties across Europe.

EFET will be further studying the draft Council text of the directive, with a view to recommending possible amendments to members of the European Parliament. EFET also looks forward to full engagement with the European Commission in the process of elaborating guidelines under the directive. These guidelines will be crucial in mitigating the negative effect of any nationally unharmonised trading schemes continuing into the future.