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EFET Press Statement

Emissions trading and the price of wholesale electricity: let the market work

The Member States of the European Union have made binding commitments to reduce carbon dioxide emissions as part of their climate change policy. They have mutually undertaken national reduction targets and soon will be individually and collectively bound by the provisions of a duly ratified Kyoto Protocol (following the positive vote of the Russian Dumas last week). To help achieve the individual and national reduction targets the European Union last year adopted an Emissions Trading scheme.ⁱ

The obligations upon producers of electricity to limit their carbon emissions, consequent upon current and future national allocation plans, will inevitably have an impact on the price of power in wholesale markets, and thus indirectly on energy consumers. EFET believes, that trading of emission allowances constitutes the best method by which to achieve cost-effective emissions reductions. Trading can send short term and long-term generation signals and eventually encourage investment in low-carbon technologies.

We agree with Eurelectricⁱⁱ that carbon emissions trading and wholesale electricity markets should be allowed to function without undue regulatory or political interference. Distortive measures - such as wholesale price caps or artificially removing the carbon cost from electricity markets – would interfere with the operation of the wholesale market, diminish liquidity and ultimately remove the incentive to shut old plant and invest in appropriate technology.

A well-designed emissions trading system best meets the requirements of cost minimization, reduction target delivery and market compatibility. A single market price for carbon throughout the EU should ensure emissions reductions are made where the cost is the lowest, although the precise impact of the cap-and-trade system on the cost-structure of energy at national and sector level will still depend on national targets and national allowance regimes (both initial for 2005-7 and subsequent).

Footnotes

ⁱ The European Commission is still finalizing its approval of the national allocation plans (NAPs) for emissions rights drawn up by EU Member States under the terms of the Emissions Trading Directive. The Directive, adopted in mid-2003, provides for a cap-and-trade system, which requires industries to reduce their CO₂ emissions to those corresponding with issued or purchased allowances. Emissions allowances may be traded between those companies enjoying an historical surplus of issued allowances or able apply

new technologies most economically and those needing to purchase allowances. Electricity generators' obligations and needs are expected to account for some 60% of trading in the scheme.

ⁱⁱ Report published June 2004.

The Eurelectric report records that, through ratification of the Kyoto Protocol and the Burden Sharing Agreement on climate change action, the EU and its Member States have agreed to ambitious targets for reductions in greenhouse gas emissions. Obligations related to these targets will lead to a price being put on carbon and hence bring about an increase in the cost of energy. That would happen, according to the report, irrespective of the mechanism used, whether it is a command-and-control approach, carbon taxes or emissions trading.

The report underlines that emissions trading will be one among many factors - including fuel prices, the supply/demand balance, capital cost and regulation - influencing electricity markets and prices. Emissions trading may contribute to higher electricity prices as a consequence of internalisation of the carbon cost. However, as emissions trading increases the marginal cost of high-carbon generation, sending the market a signal to run less carbon-intensive power generation, it will encourage investments in low-carbon technologies and energy efficiency on the demand side. Both of these trends will help to achieve the desired policy objectives agreed by the Kyoto signatories.

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