

11th February 2011

Carbon Price Support consultation response

The Carbon Markets & Investors Association (CMIA), is an international trade association representing firms that finance, invest in, and provide enabling support to activities that reduce greenhouse gas emissions across five continents. CMIA's international membership accounts for an estimated 75 per cent of the global carbon market, valued at USD 130 billion.

CMIA was created to ensure that the progressive business voice is heard, and to promote market-friendly climate change policy. Our members provide highly-skilled jobs and add value to the economy through services to, and capital injections into, the growing global carbon market.

CMIA distinguishes itself from other trade associations by providing a unique for an industry grouping that solely represents organisations providing services to and investing in the environmental sector.

Our membership does not include any entities with compliance obligations under cap-and-trade schemes. This results in a unique and harmonious advocacy platform with emphasis on the environmental integrity of market mechanisms and climate change policies.

CMIA's membership comprises close to 60 companies including financial institutions, asset managers, investment and carbon funds, project developers, lawyers, accountants, verifiers, emissions brokers, and IT firms.

Summary

We have reviewed the HM Treasury consultation document 'Carbon price floor: support and certainty for low-carbon investment' dated December 2010. Our response to the specific questions posed in the document is set out below; however, we have first made a number of high-level comments regarding the proposals and their impact upon the carbon markets.

In general, the Carbon Markets and Investors Association (CMIA) is opposed to any instrument, tax or otherwise, that seeks to artificially manipulate the price of Emissions Union Allowances (EUAs) instead of leaving the price to be determined by the open market. Such an instrument, as the reformed Climate Change Levy (CCL) would be, would, and will, have an adverse effect on the carbon market for a number of key reasons.

Firstly, it will reduce the efficiency of the market. Secondly, it will reduce confidence in the EU Emissions Trading Scheme (ETS) as the primary mechanism for combating climate change within the EU. Thirdly, it may decrease certainty in market, as it will feed the suspicion that Member States will interfere in the market if it is not operating to their liking. Finally, it undermines the notion of the EU ETS being a single, uniform market.

CMIA does agree with the motives behind the proposal. In order to drive low-carbon investment in the UK, and in particular in the electricity sector, a stronger, more consistent, price signal is required.

We believe the solution to this should be found through developing the EU ETS, not through the introduction of new instruments. CMIA believes that reform of, and improvements to, the EU ETS, should be the UK Government's policy. In particular, increasing the 2020 emissions reduction target to 30%, with the resultant lowering of the EU-wide emissions cap, would likely raise free market EUA prices comfortably above the proposed price floor level whilst also reducing emissions across the EU.

Considering in detail the impact of the price floor on the EU ETS, we are concerned about the impact of the floor on the EUA demand-supply balance. It is our view that, if implemented, the price floor would reduce demand for EUAs in the UK, since a heightened EUA price would lead lower-emissions technologies to become economically viable. Similarly, emissions will be more likely to occur overseas as emissions will occur where they can be made at the lowest cost. Therefore, without amending the UK's National Allocation Plan (NAP) UK EUAs will simply flow to the EU carbon market, depressing the EUA price outside the UK. Regardless of the UK NAP position, an effect of this UK-only measure will be simply to shift emissions to other EU Member States.

In addition, we have concerns regarding the impact of the price floor on the UK's Assigned Amount Unit (AAU) holding. If the floor price has the desired impact, the UK's annual greenhouse gas emissions will be reduced. This will in turn free up a proportion of the UK's AAUs which it could in turn sell. The sale of AAUs would again mean that the UK's reduced emissions had simply been exported to whichever Member State purchased them.

CMIA response to consultation questions

Investment

- 3.A1 *What are your expectations about the carbon price in 2020 and 2030? And how important a factor will it be when considering investment in low-carbon generation?*

Based on Point Carbon estimates, we expect a carbon price in 2020 of €36.

The current and anticipated future price of carbon will be a factor when considering investment in low-carbon generation. However, we would expect energy commodity prices to continue to have a much larger impact on investment in low-carbon energy.

- 3.A2. *If investors have greater certainty in the future long-term price of carbon, would this increase investment in low-carbon electricity generation in the UK? If so, please explain why.*

Players in EU energy markets are used to dealing with the risks of price movements, and this has not, of itself, curtailed investment. Price movements are specifically useful as a signal. So price certainty/stability is not a good goal for its own sake.

However the carbon market is unique in as much as supply/demand is controlled by regulation not by economics.

If outcomes in terms of low carbon investment are not yet sufficiently high, then

A) Confidence in the long term certainty over the regulatory framework needs to be addressed, and hopefully will be by the forthcoming EU roadmap to 2050, and that determining the appropriate regulatory framework for the market to operate within, rather than price intervention in the market, is the proper role of government

B), If the overall average price level is deemed to be too low this can already be addressed within the current regulatory framework, by adopting a unilateral European move to a 30% emissions reduction target by 2020.

- 3.A3. *How much certainty would investors attribute to a carbon price support mechanism if it were delivered through the tax system?*

That depends on the country (commitment) since a tax risk is political. This depends on the price support mechanism rate determination chosen. However, of the three mechanisms chosen, the longest term of price

certainty is five years (the term of a Parliament). A price signal of this duration would not be sufficient to affect investor behaviour.

A further key general problem with attempting to indirectly address emissions via a tax rather than directly via the level of the EU ETS cap, is that whilst the cap will produce a predictable reduction in greenhouse gas emissions, which is after all the goal of EU and UK climate policy, a tax will produce a reliable income for the Government with no reliable environmental outcome.

In order to maintain public confidence it is crucial that efforts against climate change are seen as exactly that, rather than as revenue raising exercises. From this perspective a unilateral UK tax designed to interfere with the operation of the EU ETS and one that will potentially undermine the EUA price that mainland Europe faces would seem to be highly undesirable.

3.A4 *In addition to carbon price support, is further reform of the electricity market necessary to decarbonise the power sector in the UK?*

Yes, direct technology support (FIT) is more effective and could also be efficient if designed properly. The carbon floor price alone is unlikely to make large-scale deployment of low-carbon electricity generator technologies sufficiently viable and attractive. We would anticipate that further Government intervention would be required to create and maintain momentum in decarbonising the UK energy sector.

Carbon price support mechanism

4.E1: *How should the carbon price support rates be set in order to increase certainty for investors, in particular over the medium and long term?*

The carbon price increases the costs for the whole economy. In addition, it increases competition between thermal technologies (including nuclear) and not necessarily between renewables and thermal. The carbon price support rates should be linked to specific technologies and specific dates (for example £60/tonne for CCS by 2020). That would justify the cost increase for the economy and also deliver results in terms of low carbon technology adoption. In order to provide certainty, predictability of the price floor level must be as high as possible. Therefore, the rate escalator will increase certainty for the longest period (the length of a Parliament) out of the three options listed. However, none of the options proposed provide significant long term certainty. In order to do so, a clear long-term price target (e.g. a 2030 price target) needs to be announced by the Government.

4.E2: *Which mechanism, or alternative approach, would you most support and why?*

Directed technical change through FIT and improvement of the ETS. That would increase effectiveness (goals achievement) and efficiency (economy wide costs). Our preferred approach would be for the Government to pursue amendments to the EU ETS, in particular a reduction in the level of the cap for Phase 3. Of the options outlined in the consultation, we would most support a mechanism based upon the carbon market index, which would therefore ensure that trends in the carbon market, and the wider economy, are reflected in the rates. However, this would need to be paired with some form of signal of what the long term emissions cap is, in order for the Government to meet it's goal of providing certainty for investors.

Future price of carbon

4.F2: *What is the most appropriate carbon price for the UK to meet its emissions reduction targets in the power generation sector? How would this be affected by changes in the structure of the electricity market?*

This is the wrong question. The carbon price simply reflects the ease or difficulty with which the emissions cap is being met. If the government feels that insufficient abatement is being achieved through the EU ETS the solution is to tighten the cap, via for example the EU moving to a 30% cap.

A great benefit of the EU ETS is it does not discriminate between decarbonising the power sector vs other sectors of the economy. First priority must be to reduce greenhouse gas emissions overall by allowing economically rational behaviour to dictate where emissions reductions take place.

By allowing this, the cost of emissions reductions are minimised and therefore the ambition of the emissions reductions that society can economically afford is deepened. In order to further widen the range of abatement options available to the EU ETS, in addition to tightening the cap we would advocate the inclusion of new sectors into the EU ETS such as the transport sector.