ROYAL NORWEGIAN MINISTRY
OF THE ENVIRONMENT

The Minister

European Commision
Commissioner Connie HEDEGAARD
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Structural options to strengthen the EU Emissions Trading System

Reference is made to the report from the Commission regarding the state of the European carbon market in 2012 (COM(2012) 652 final), and the structural options to strenghten the EU Emissions Trading System (EU ETS).

Participation in the EU ETS is an important part also of Norwegian climate policy. It is important that the system is well-functioning. For an emission trading system to work it is important that the rules are robust and predictable for all market participants in a long term perspective. Uncertainty on the policy framework and lack of confidence in the market may distort the industries' long-term investment decisions.

Lower emissions than expected, mainly due to the low economic activity, have led to much lower demand for allowances than previously expected and consequently lower prices. In general lower allowances prices in period with unexpected low economic activity should be seen as part of the ordinary functioning of the carbon market. ETS is designed to be an instrument where a predefined cap determines the emissions outcome and where the demand for allowances determines the market price for allowances. Having chosen this instrument, the threshold for interfering with the system should be high.

However, the Commission's report illustrates that without new measures we may expect a large surplus of allowances to last throughout Phase 3 of the EU ETS. The very low expected future prices could weaken the incentives to develop new and more climate friendly technologies. A strong long term price signal for all market actors is important to ensure that investments in the near future are consistent with moving towards a low carbon economy.

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In this exceptional situation Norway therefore appreciates the initiatives from the European Commission on measures to reduce the surplus of European allowances and thereby increasing the price level. We firmly believe that structural measures have to be implemented to obtain higher allowance prices. Higher prices could increase the overall confidence in the carbon market, and would support the credibility of the Emission Trading System as a suitable climate policy instrument.

Thus, the very low price level should be addressed in a proper manner as soon as possible. Norway prefers that the surplus is reduced through retirement of allowances and possibly followed by an early revision of the annual linear reduction factor.

Below I will comment more specifically on the options B-E, identified in the Commission's report.

B: Retiring a number of allowances in phase 3

Norway would support retiring permanently a number of allowances in phase 3. This would be an effective measure to reduce the surplus of allowances with immediate effect.

Retiring a number of allowances will have implications for both industries and states, but given the considerable amount of free allowances allocated, the consequences for most ETS installations will be limited. The impact on the proceeds from reduced sales of EUAs will most likely be small. It is even possible that the proceeds will increase if a fair number of allowances are retired.

C: Early revision of the annual linear reduction factor

A reduction of the EU ETS cap by an early revision of the linear reduction factor (C) could give more or less the same effect on the long term price level as alternative B. The actual price effect would depend on the number allowances retired in alternative B compared to the reduced number of allowance to be issued in the long run in alternative C. The main difference between option B and C is that C would affect the legal framework after 2020. Furthermore alternative C could affect the allocation of free allowances. Alternative B followed by alternative C, could also be seen as a two-staged process towards strengthening the trading system.

The decision process linked to an early revision of the linear reduction factor (C) could be more slow than the process linked to retirement of allowances (B). If so, the uncertainty in the market as to whether structural measure would be taken or not, will prevail for a longer time in the case of option C. On the other hand, an adoption of a revised annual reduction factor could create more confidence in the market as a robust decision that will not be reversed in case of high carbon prices. As indicated above, Norway emphasizes the importance of predictable framework conditions for firms' long term investment decisions, and that the perspectives for revisions should be at least until 2030.

D: Extension of the scope of the EU ETS to other sectors
In principle Norway supports the extension of the scope of the EU ETS to other sectors. Including new sectors would be an important development of the European carbon market. By widening the ETS, a larger part of the necessary emission reductions could take place in a cost effective manner. Inclusion of new sectors should be designed so that the incentives for emission reductions and technology development are not weakened.

However, we see an extension of the ETS as a separate issue that should be considered independently of the question related to the existing low price level. Norway does not see alternative D as the most relevant option to reduce the surplus and increase the allowances prices .

Depending on the cap foreseen for new sectors, increasing the number of sectors could increase the demand for allowances more than the supply and accordingly increase the price. At the same time, the regulatory framework for sectors already participating in the ETS could be maintained. However, several issues would need to be addressed and analysed. It may also be difficult to predict the effect on the price level of a larger expansion of the ETS, i.e. to include the transport sector. On the other hand, as pointed out by the Commission, including sectors less influenced by economic cycles may reduce price fluctuations.

E: Limit Access to international credits
Norway would not support further restrictions on the access to international credits (E). International crediting mechanisms is a vital element in establishing a broader international price on carbon and the maintenance of this marked is important. Norway believes that an effective way to reduce emissions on a global scale in line with the two degree target is to set a broad international price on carbon. Interaction between emissions trading systems and access to international credits is an effective way to ensure cost effectiveness of mitigation actions between different countries, regions and sectors.

According to the report of the High-Level Panel on the CDM Policy Dialogue (Climate Change, Carbon Markets and the CDM), the CDM, as a development mechanism, has been important for the transfer of climate finance, technologies and capacity building from developed to developing countries during the past 10 years. Further restrictions on the use of the CDM in the EU ETS could prevent developing countries in deriving the advantages from CDMs development benefits.

Yours sincerely,

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