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A smart EU energy and climate change policy framework can be a source of jobs and growth in Europe

Response from the Confederation of British Industry (CBI) to the European Commission Green Paper on a 2030 framework for climate and energy policies

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Europe requires around a trillion euros[1] of investment in its energy system by 2020 to meet its long-term energy and climate change policy goals of ensuring competitiveness, securing energy supply, and tackling climate change. This challenge also represents a significant growth opportunity; while the European economy grew 1.5% in nominal terms between 2008-2011[2], total low-carbon sales in Europe grew 6.5%[3]. For the UK alone, the CBI has calculated that maximising the potential of green business could boost the economy by just under £20bn in 2014/15.[4]

However, the current European energy and climate change policy framework is not incentivising the necessary level of investment, nor is it sufficiently holistic in terms of working for all businesses, including those that are energy-intensive. As such, when designing its 2030 framework, the Commission should look to learn the lessons of the 20:20:20 climate and energy package and consider the improvements needed in order to maintain the competitiveness of European businesses and get this much-needed investment flowing into the European economy. The CBI has identified five key priorities for a 2030 policy framework:

- An ambitious and credible EU-wide emissions target is needed for 2030
- The EU ETS should continue to be the cornerstone of EU energy and climate change policy
- Support for businesses most at risk of carbon leakage must be at the heart of the package
- Completion of the EU Internal Energy Market must be a priority
- Europe must support the development and deployment of technologies to deliver energy and climate goals

[1] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=SPLIT_COM:2010:0677(01):FIN:EN:PDF
[2] Data Source: Eurostat/Haver Analytics
[3] Data Source: UK Department for Business Low-Carbon Environmental Goods and Services Data
[4] CBI (2012) *The Colour of Growth: Maximising the potential of green business.* http://www.cbi.org.uk/campaigns/maximising-the-potential-of-green-business/

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An ambitious and credible EU-wide emissions target is needed for 2030

In the CBI's 2012 policy brief *Targeting 2030: Giving the EU Emissions Trading System a long-term future*,[5] we identified that the absence of long-term certainty in EU energy and climate change policy is undermining investor confidence. We argued that setting a 2030 EU-wide emissions target is the most important step towards getting investment flowing, and that this should be solidified in European Council conclusions by 2014.

The CBI has been lobbying strongly for the EU to set a 2030 emissions target and urges the Commission to propose one along the following lines:

- **A single EU-wide emissions reduction target will drive investment across all technologies.** The best way to meet Europe's emissions goals and drive investment is through an ambitious and credible emissions reduction target and an effective EU ETS. An emissions-target only approach provides Member States with the flexibility to meet the target in the most efficient way for their national circumstances. For the UK, we have argued that this is best achieved through a balanced energy mix, including nuclear, renewables, gas and Carbon Capture and Storage (CCS). Renewable energy and energy efficiency targets should not be set as they are likely to unhelpfully overlap with emissions targets, potentially hampering the ability of the carbon market to select the lowest-cost options for reducing emissions. The UK is currently embarking on a major Electricity Market Reform programme[6] which recognises the importance of a transition towards technological neutrality, allowing the market to ensure the most cost-effective pathway towards meeting the UK's legally-binding climate goals.

- **This target should be set at 40%, with the potential to ratchet up in the event of an international agreement.** Business needs a solid framework against which to make investments in low-carbon technology, therefore a unilateral target should be set across the EU which provides long-term certainty. The path set out in the Commission's *Roadmap for moving to a competitive low-carbon economy in 2050,* and reconfirmed by the European Council in February 2011, provides Europe with a sensible objective; it envisages a 2050 emissions reduction goal for Europe of 80-95% below 1990 levels. As part of this, the Commission's pathway proposes an EU emissions reduction goal of 40% by 2030 as being on the cost-effective pathway to 2050. The CBI believes that a target for 2030 set at this level would help to build investor confidence. The EU should also consider increasing this target if a global deal is achieved, stretching to around 50%. Getting a global climate deal is a major priority for business and would put the world on a shared low-carbon pathway, aiding European competitiveness and building new markets for European businesses at the forefront of developing low-carbon solutions.

To give business confidence, the Commission must clearly cost how the target will be achieved across Europe and set out a fair burden share between EU Member States and across economic sectors. An ambitious and credible EU emissions target can only be economically and environmentally achieved if supported by a package of sensible measures which work for all business. The rest of this paper details the CBI's priorities in this regard.

The EU ETS should continue to be the cornerstone of EU energy and climate change policy

Emissions trading has the advantage of 'locking-in' emissions reductions once a cap has been set, guaranteeing the reductions will come from the lowest-cost options across the sectors covered, and providing the market with a long-term signal for low-carbon investment. A strong EU ETS will help deliver economic growth in Europe. The CBI has three main messages on reforming the EU ETS:

[5] CBI (2012) *Targeting 2012: Giving the Emissions Trading System a long-term future*. http://www.cbi.org.uk/media-centre/press-releases/2012/11/europe-must-agree-2030-carbon-target/

[6] https://www.gov.uk/government/policies/maintaining-uk-energy-security--2/supporting-pages/electricity-market-reform

- **Setting a Phase IV cap is the most important step towards getting the EU ETS working effectively.** While technically operating well, the EU ETS is not currently delivering on its potential to both reduce emissions and drive investment. This is because its short-term focus has allowed the recent European recession to have an exaggerated impact on the carbon market, threatening both long-term investment and the future of the EU ETS itself. Because the cap is currently only set to 2020, investors don't have the necessary visibility and certainty needed for investment despite the 1.74% annual linear reduction factor technically continuing into the future. This means that the market is struggling to incentivise investments to meet post-2020 emissions reductions as cheaply as possible.

  Getting long-term certainty back into the EU ETS is the most important step to restoring confidence in it, and hence getting investment flowing. For companies making major investments with long lead times, 2020 is very much in the 'rear view mirror'. An EU ETS cap for 2030 is required now, so that businesses can see beyond 2020 and follow the trajectory out to 2050. A 2030 cap should be set in-line with the overall EU emissions target for 2030 as set out above.

- **Structural EU ETS reform should be integrated into long-term policy proposals.** In its response to the Commission's Consultation on *The State of the European Carbon Market in 2012 (the 'Carbon Market Report')*, the CBI argued that 'structural' EU ETS reform must be clearly linked to the long-term as stand-alone short-term measures risk increasing uncertainty for businesses.

  It would therefore be sensible for the Commission to integrate structural reforms into its long-term policy proposals. Pursuing structural EU ETS reform alone risks 'putting the cart before the horse,' but in the context of setting a 2030 target it would make sense to consider what adjustments are needed to put the EU ETS on the correct trajectory towards meeting it. Out of the structural options previously proposed by the Commission, a one-off removal of allowances from the system and amending the linear reduction factor – the reduction in the amount of allowances available annually – in-line with a 2030 target, is likely to be the most sensible combination.

- **Any potential EU ETS flexibility mechanism needs further research.** Stakeholders have also been discussing whether structural reform of the EU ETS should include measures to make the system more flexible. It is argued that enabling the currently-fixed supply of allowances to respond to changes in demand as the economy fluctuates would increase the robustness of the system. The Australian ETS, for example, has a 5-year rolling cap within an overall emissions target to reflect economic circumstances.

  The CBI thinks that it is right to explore flexibility mechanisms. While the Commission should investigate a wide-range of options, it should adhere to some key principles. Firstly, any flexibility mechanism should be transparent and have clear rules to maintain certainty. A flexibility mechanism must also respect the nature of emissions trading which correctly holds that if policymakers design the correct market parameters – the supply of emissions allowances over time and the rules for surrendering and trading them – then the market will naturally deliver the appropriate carbon price to encourage investment. It is for policymakers to set the rules of the market and for the market to deliver the price.

Support for businesses most at-risk of carbon leakage must be at the heart of the package

A future EU energy and climate change policy framework will only be successful if it works for all businesses. This must include energy-intensive industries which make a direct and significant contribution to economic growth and are a crucial piece of a low-carbon future. For example, in the UK, manufacturing

industry employs over 2.5 million workers and contributes 9% of UK GDP annually,[7] producing products like the steel for wind turbines and chemicals for electric car batteries.

The EU's global partners are looking closely to see whether Europe can successfully integrate its energy-intensive industries into a smart policy framework to prevent carbon leakage. With the most developed carbon market in the world, Europe sets an example to fast-growing nations with proposed emissions trading systems like China and South-Korea. These places are unlikely to progress their plans unless emissions trading is clearly consistent with competitive industry.

The CBI has three main priorities on carbon leakage support from a 2030 package:

- **There must be a clear commitment to prevent carbon leakage post-2020.** As a core part of its proposals on a future EU energy and climate change package, the Commission must clearly commit to support those businesses most at-risk of carbon leakage throughout the length of the package. This should be done in an evidence-based way, reviewing the current support rules to ensure they are providing the necessary support. The Commission should:

    - **Seek to learn lessons from how other emissions trading systems are proposing to support energy-intensive industries.** The Australian system, for example, has a more flexible system of support than the EU ETS, basing free allocation on actual rather than past production.
    - **Support initiatives to develop global sectoral agreements.** DG Enterprise's work to develop a steel sector roadmap is a positive development. Using such initiatives to speed up global sectoral agreements would help to consider how to best treat whole sectors, rather than just how to treat sectors within the EU ETS.

- **Current direct carbon leakage support must be improved if measures are taken to increase the carbon price.** With pre-2020 EU ETS reform still on the table, businesses could be facing increased costs from a higher carbon price before 2020. It is therefore vital that the Commission supports the European economic recovery by ensuring that at-risk industries are supported from any increase in costs as a result of shorter-term measures to strengthen the EU ETS. This is especially important as many companies participating in the EU ETS are concerned that current support based on past rather than actual output may be inaccurate.

- **There should be a harmonised support scheme for indirect emissions costs.** There is a particular problem with supporting electro-intensive businesses that are not in the EU ETS itself but face the pass-through costs in their electricity bills. These businesses do not qualify for free allowances, relying on support from Member States governments, which must follow guidelines for compensation for indirect costs. This is uncertain as it requires State Aid approval and uneven as it depends on the will and capability of Member States. This undermines the European level playing field and leaves many businesses without adequate support. For example, while the UK has agreed to provide over £100m of support, it is still awaiting State Aid approval to go-ahead with its plans. Meanwhile many other Member States provide no support at all.

  With this in mind, as part of a 2030 package, the Commission should propose a new mechanism to support electro-intensive industries on a harmonised – EU-wide – basis. One option could be enabling these industries to be included in the EU ETS and designing a mechanism by which they can be allocated allowances as necessary. Permits which would otherwise have been auctioned by the EU or Member States could be given to electro-intensive industries, who could then sell them on. Making use

[7] UK Department for Business Manufacturing Sector Analysis

of the free allowance system should ensure that support is not taken directly from consumers' energy bills.

Completion of the EU Internal Energy Market must be a priority

Completing the EU Internal Energy Market is vital to drive competitiveness and growth in Europe. It could lead to a saving of up to €35bn per year in European electricity costs[8] and an increase in European GDP of 0.6-0.8% by 2020[9]. Greater grid interconnection between Member States will also help to foster the uptake of renewable energy right across Europe. The Commission must therefore ensure it makes completing the Internal Energy Market a key priority to support a smart future EU energy and climate change package.

At the same time, the Commission must realise that it is beneficial for Member States to retain flexibility in certain aspects of the Internal Energy Market to ensure it matches with national circumstances. Capacity mechanisms are an example of this, with a number of Member States – including the UK – currently designing them. The Commission will need to consider what role the EU should play in supporting capacity mechanisms, while not delaying those Member States already planning to introduce them.

Europe must support the development and deployment of technologies to deliver energy and climate goals

EU research and development policy must support new and innovative low-carbon technologies. This must include technologies needed to develop a balanced European energy mix such as unconventional gas and cutting-edge renewable energy as well as other vital low-carbon technologies like low-emissions vehicles and new energy efficiency measures. In addition, if Europe wants to meet future emissions targets, it must help develop the technologies required to assist the further decarbonisation of its energy-intensive sectors.

One area in which the EU can play a particularly strong role is in the commercialisation of Carbon Capture and Storage (CCS) technology. CCS will be vital for ensuring that Europe is able to exploit its indigenous reserves of fossil fuels and can also be a major export success story for Europe.

In the short-term, this means ensuring that the current NER300 Second Round prioritises CCS demonstration projects which received no funding in the First Round. Longer-term, it is positive that the Commission is consulting on how to incentivise CCS technology in Europe. The Commission should not forget that CCS also has significant potential to reduce industrial emissions; industrial CCS projects should be included in the Commission plans to demonstrate the technology.

The CBI is the UK's leading business organisation, speaking for some 240,000 businesses that together employ around a third of the private sector workforce. With offices across the UK as well as representation in Brussels, Washington, Beijing and Delhi the CBI communicates the British business voice around the world.

The CBI's policy positions on energy and climate change are steered by its Energy and Climate Change Board, a cross-sectoral group of 18 business leaders committed to tackling the UK's triple challenges of energy security, affordability and decarbonisation.

[8] http://ec.europa.eu/europe2020/pdf/compact_en.pdf
[9] http://ec.europa.eu/europe2020/pdf/energy_en.pdf