

CO2 Emission Allowances and Competition

Martin Pecina

Chairman

Office for the Protection of Competition

Czech Republic

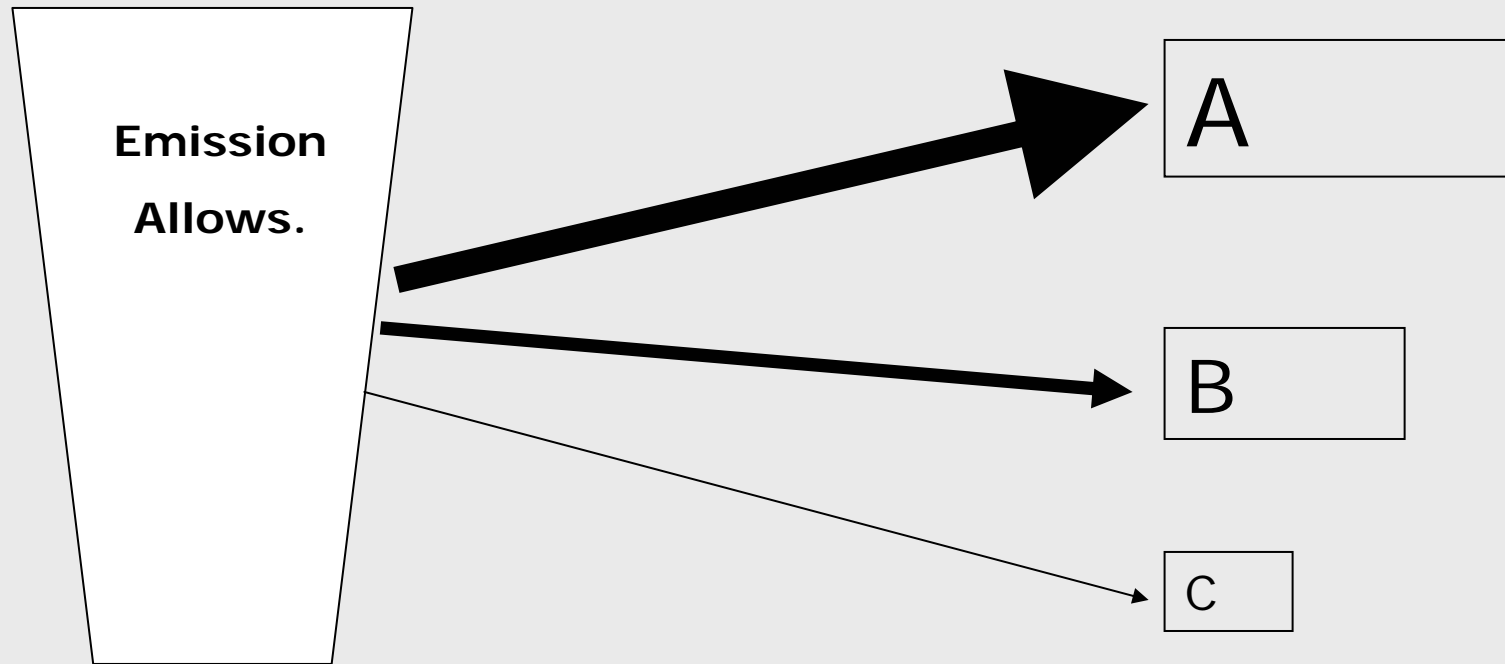
CO2 Emission System

- Set by Directive No. 2003/87/EC
- Key elements-National allocation plans implemented into national legislation
 - Setting the volume of emission allowances and the manner of their distribution
 - Key aspect for their drafting – data on historical emissions

Basic objective of the system

- Reducing the emissions of the greenhouse gases along with preserving economic growth and following the competition rules

The higher volume of emission greenhouse gases was produced by a company, the higher amount of allowances the company was given



At least 95% of the allowances were distributed free of charge

Unequal market conditions

- If a company, which received allowances free of charge, decides to sell them, the finances acquired in this way constitute *de facto* state aid and an unjustifiable competition advantage.



- Free allowances may, in the given system, result in distortion of fair competition.

Decision-making principle

Producers, who will likely produce emissions above the agreed limit, face the essential decision whether to:

- a) Reduce the emissions**
- or**
- b) Buy more allowances**

This decision-making is based especially on economic analysis.

Basic elements of economic analysis

- Production costs
- Sale price
- Price of emission allowances

A possible result of economic analysis

- Reduce production and sell the unused allowances



- However, this conclusion is not effective in terms of the emission reduction system

Costs of the emission allowances system

- First experience from Europe: the system is far more expensive than necessary for lowering the greenhouse gases emissions
- The system has impacted especially the electricity prices
- Hardly foreseeable effect of the system in next years increases uncertainty for investors

Impact on electricity prices

- Energy producing companies include the price of emission allowances into the price of electricity
- Problem: despite the fact that most of the allowances is free of charge, the energy producers charge their customers higher prices for the whole volume of their production, not only for the part for which they had to buy allowances
- The price of an allowance on the market is higher than its price, as the energy producers regulate the pressure on lowering the price of allowances and therefore also price of electricity
- Possible distortion of competition: In order to be able to behave in the described manner, energy companies may tend to concerted practices

Impact on consumers

- Price of electricity increased by the costs of emission allowances impacts negatively especially the lower-income households (which spend most of their income for energy).
- If the allowances were sold, they would constitute an additional income into the state budget (whose expenditures or incomes-taxes could be lowered).
 - E.g. Estimated impact in Ireland is 0.3-0.5 of GDP

Price of electricity in the Czech Republic

- Sector regulator (ERÚ) does not include the price of emission allowances into regulated prices
- Non-regulated prices – prices of power electricity are set by the market
- In the Czech Republic the price is set on the basis of an auction (condition of „virtual power plant“ set by the Office“) and by the price of electricity especially on German market along with cross-border interconnection capacity
- The wholesale market of electricity raised by app. 17% in the last auction (August 2006)

Impact on prices of non-energy producing companies

- The prices of industrial products face more global competition than the energy producers



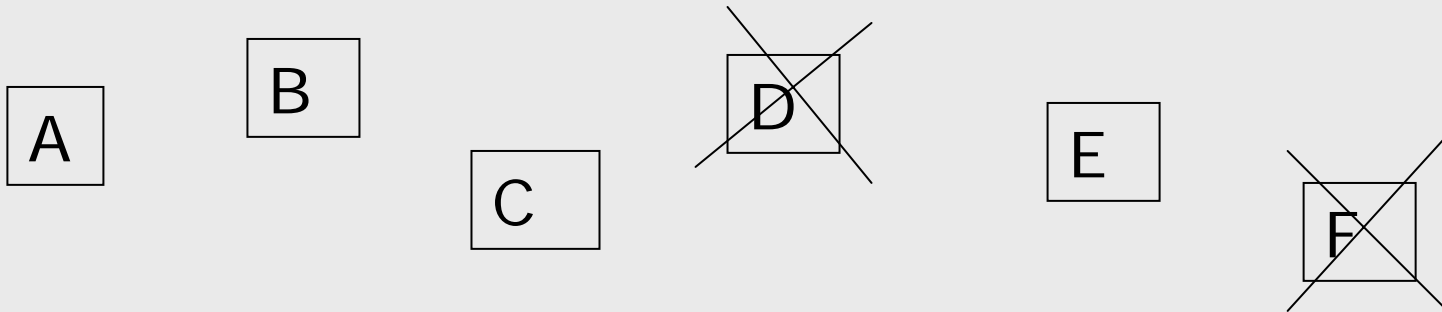
- It is much harder for them to project the prices of allowances into their production, contrary to energy producers

Problem related to reducing the emissions

- Situation on certain markets:
 - The system results in a situation, where some companies reduce their production and face the threat of leaving the market



- Danger of market concentration and reducing the quality of competition



Impact of the system on competition

Unequal conditions on the market and the danger of reduction in the number of competitors on the market



Distortion of competition



A conflict with the original aim



A different system is needed

**Celebration of the 15th
Anniversary of
the Czech Competition Law**

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