Joint Agency Submission to the SEM Committee's Consultation Paper -

Bidding the Opportunity Cost of Carbon Allowances (SEM-08-005)

March 2008

The development agencies, Forfás, IDA Ireland and Enterprise Ireland, welcome the opportunity to provide inputs to the SEM Committee's consultation paper, *Bidding the Opportunity Cost of Carbon Allowances (SEM-08-005).*

Energy is a key input to enterprise production activities. Ireland's ability to continue attracting high levels of foreign direct investment and to provide a supportive environment for Irish industry generally will depend on its capacity to deliver a secure and sustainable energy supply at a competitive price.

Of increasing concern to business is the rising cost of electricity in Ireland relative to competitor countries. Industrial electricity prices in Ireland were the second highest of the EU-25 as of January 2007 and the rate of increase between January 2001 and January 2007 was almost twice that of EU-15[1]. The high price of electricity in Ireland has implications for all firms, particularly for energy sensitive ones in important sectors such as food, chemicals and engineering. Ireland must ensure that its energy costs do not further outstrip those of competitor countries.

One of the benefits of passing through the full cost of carbon to end users is to incentivise more efficient energy use. In a country where industrial electricity prices are currently 18.7 percent above the EU-15 average, (without the cost of carbon), it is hard to see an additional price signal having much impact on demand, especially for business users. Significant improvements have already been made by business. Between 1990 and 2006, the actual energy intensity of industry declined by 53 percent. This means that it takes approximately half the amount of energy in 2006 to generate a euro of value added than it did in 1990. Furthermore, there are now a range of global financial and business reasons for business to proactively pursue a strong environmental/green agenda.

We acknowledge that there are other reasons, aside from demand management, to pass through the full cost of carbon. These include incentivising generators to be more efficient and sending signals to investors to develop clean technologies and renewable energy sources. However, with generators benefiting from significant carbon credit allowances, the expected effects of the full pass through of the cost of carbon on the behaviour of electricity generators will largely be negated unless the issue of windfall gains is addressed.

By 2013, the windfall gains will end with the likely advent of 100 percent carbon allowance auctioning for electricity generators. This means any claw back will be a short to medium term measure in duration. However, as many of the initiatives committed to in the Energy White Paper to improve competition in the electricity market will take some time to come into effect, the development agencies are strongly of the view that this issue needs to be

[1] Forfás, Electricity Benchmarking Analysis and Policy Priorities, December 2007

addressed as a matter of urgency to show that Ireland is serious about tackling its very significant energy challenges.

The development agencies acknowledge the challenges involved in addressing this issue now that we have an all island market, which involves two jurisdictions. However, it is imperative that the issue is dealt with promptly to provide the regulatory certainty that is required for the effective functioning of the SEM and to ensure that businesses and consumers benefit from the free carbon allowances awarded to electricity generators under the Emissions Trading Scheme.

The development agencies would favour the claw back of the windfall gains from electricity generators and the redistribution back to all electricity consumers, including enterprise in a manner that supports national competitiveness and sustainability policy objectives. The redistribution of the windfall gains to customers should be done in a way that rewards certain behaviours, such as participation in SEI's energy efficiency initiatives.