

## **Response to the Commission's Proposal for 'A policy framework for climate and energy in the period from 2020 up to 2030'**

### **EXECUTIVE SUMMARY: 2030 PACKAGE - STEP IN THE RIGHT DIRECTION, BUT FAILS TO LEARN FROM 'PAST MISTAKES'**

The International Association of Oil and Gas Producers (OGP) supports a market-based and technology-neutral framework based on a single greenhouse gas emission (GHG) target for 2030, implemented through the EU Emissions Trading Scheme (ETS) and appropriate measures in the non-ETS sectors.

OGP welcomes that the Commission's 2030 Communication attempts to address all three objectives of the European energy and climate policy, namely security of supply, sustainability, competitiveness and affordability of energy. In this context, we appreciate:

- The Commission's Communication "*For a European Industrial Renaissance*".
- The effort to keep the EU ETS at the centre of the Union's climate and energy policy and by concentrating on a central emissions reduction target.

However, OGP is concerned about some aspects of the Commission's proposal:

- A new renewables target for 2030: when designing the 2030 framework, it is crucial that the unintended consequences of the 2020 package, such as the resulting distortion of the EU ETS due to overlapping support for renewable electricity, are avoided. The creation of a level-playing field among all energy technologies should be a priority, as part of an integrated and well-functioning internal energy market.
- While we agree with the Commission that security of supply for oil and natural gas is linked to diverse routes and sources, it should be noted that the term "energy independence" is misleading. Reduced import dependency is not a desirable goal in itself as it does not necessarily lead to lower energy prices or improved competitiveness.
- The Communication on 2030 policy framework is based on several narrow assumptions. For instance, it assumes that fossil fuel prices will only increase, which is highly uncertain. The example of the US shale gas revolution is relevant in this context.

#### **That is why we propose:**

1. Setting a realistic single 2030 GHG emission reduction target only, taking into account progress in international climate negotiations - the EU represented just over 10% of global CO<sub>2</sub> emissions in 2011 and according to the IEA New Policies Scenario, this share is expected to decline to less than 7% in 2035.
2. Maintaining the EU ETS as the central mechanism for CO<sub>2</sub> emission reductions for electricity and industrial sectors, and implementing cost-effective policies and measures for non-ETS sectors.
3. Completing the Internal Energy Market, phasing out production subsidies as soon as possible and supporting R&D.
4. Supporting substitution of coal with natural gas: it will not only lead to cost-effective reductions of CO<sub>2</sub> emissions but will contribute to improved air quality by reducing emissions of NO<sub>x</sub>, SO<sub>x</sub> and particulate matters.
5. When defining security of supply, encouraging and facilitating exploration and production of domestic oil and gas, and also taking into account imports of all raw materials, power generation equipment (wind, solar), as well as the variability of renewable energy sources.

## 1. Set a single greenhouse gas emission reduction target

The 20/20/20 climate and energy package contains complex and overlapping policies that, along with national implementing measures, have significantly increased both energy cost and investment uncertainty and have led to a greater market distortion. Therefore, OGP welcomes the Commission's attempt to reduce complexity and ensure greater cost-effectiveness for 2030. We believe though that this can be best achieved by establishing a **single GHG reduction target**. The ambition of the GHG target must be realistic and take into account sound science, progress at international climate negotiations and reflect existing and future commitments of the EU's major trading partners. Further unilateral action will have little or no impact on global emissions or on the 2°C objective, but could compromise future growth. Moreover, by imposing strict climate measures, global carbon emissions could increase as a result of carbon leakage. The EU 2030 target could be incorporated as part of a suitable binding international agreement.

The proposal for a **binding renewable energy target, even though only at the EU level, undermines the principle of technology neutrality** and potentially diverts Member States from applying the optimal and most cost-effective mix of low-carbon sources to meet the binding GHG reduction target. It also fails to take account of one of the main lessons from the 2020 climate and energy package: the overlap of the 20% renewables and energy efficiency targets with the GHG target has contributed to the distortion of the carbon price in the EU Emissions Trading System. This point is also raised by DG ECFIN's study "*Energy Economic Developments in Europe*," according to which the interaction of policies causes a decrease in the carbon price and an increase in carbon emissions.<sup>1</sup>

We, therefore, welcome the Commission's attempt to concentrate on an emissions reduction target and trust that this single focus will remain even after the review of the Energy Efficiency Directive. Energy savings have a role in contributing to reaching the EU climate and energy targets, but it should be pursued by alternative policy instruments such as standards for buildings and consumer products.

Finally, we also believe there is a need to clarify the proposed governance framework as it may undermine the simplicity of a single GHG target as a driver of reducing emissions.

## 2. Maintain the EU ETS as the central mechanism for CO<sub>2</sub> emission reductions

OGP maintains that an undistorted ETS is a means to achieve an environmental target cost-effectively. It should remain the central EU mechanism for CO<sub>2</sub> emissions reduction for electricity and heavy industrial sectors as it sets a single carbon price across countries and energy sources. The long-term nature of the EU ETS needs to be better understood (e.g. the current linear reduction factor leads to over a 70% reduction in the ETS cap by 2050 or a reduction of 85% were it to change to -2.2% from 2021). OGP re-affirms its view that the right approach is to clarify the long-term trajectory of the cap for Phase IV and beyond.

The establishment of the Market Stability Reserve (MSR) mechanism from 2021 onwards may offer a structured pathway for managing any potential imbalance between demand and supply of allowances that has built up in the system. Though it introduces an additional level of complexity, OGP acknowledges the fact that it is rule-based and should not require any further rule changes before the end of Phase IV. If it operates as designed, it acts as an objective control on the number of allowances in circulation. It might

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<sup>1</sup> European Commission, DG ECFIN, "*Energy Economic Developments in Europe*", January 2013, p. 75. In some Member States, this negative trend is mainly triggered by the growing use of coal in power generation, where cleaner natural gas is being displaced. Europe's coal consumption grew by 3.4% in 2012. CO<sub>2</sub> emissions from Ireland's coal-fired power plant increased by 27% in 2012. German emissions increased by 1.8% in 2012, with coal growing at 4.2%.  
(Source: <http://www.sciencedaily.com/releases/2013/11/131118193131.htm>)

present an opportunity to curtail future market intervention that increases political risk and undermines investment.

OGP also needs to be reassured, taking into account the elements of any future international agreement, that the provisions for carbon leakage in the ETS Directive will be extended beyond 2020 when qualifying installations will be receiving far fewer allowances than they do today.

Because the Impact Assessment is incomplete in analysing the consequences of the mechanism, OGP needs additional clarification (including use of Phase 3 emissions data) to properly consider the proposed MSR mechanism.

### **3. A subsidy-free, well-functioning Internal Energy Market needs to be created**

OGP strongly supports the completion of the Internal Energy Market, and agrees with the Commission that this is a key tool to promote all three objectives of the EU's climate and energy policy. The Internal Energy Market must be completed in accordance to the prescribed schedule to allow markets to deliver the most price efficient solution and to ensure greater security of supply. Once this goal is achieved, policymakers should secure and maintain fully integrated EU-28 gas and power markets.

We endorse the need to support R&D to bring promising low-carbon technologies, including Carbon Capture and Storage (CCS), to market. However, we also believe that all energy sources should be integrated into the market and allowed to compete under normal market conditions, without subsidies, as early as possible. If the EU wishes to have a well-functioning Internal Energy Market, then the timeline for subsidy phase-out needs to be accelerated closer than 2020. Production subsidies<sup>2</sup> for all fuels should be phased out. This way, cost-effective renewables would compete with conventional energy sources, while the carbon price would create a level playing field amongst low-carbon and other energy sources. To this end, OGP recognises the draft guidelines on State Aid for Environment and Energy as a first step towards exposing renewables to the market. OGP hopes that such an approach will be continued and further strengthened towards the 2030 framework.

### **4. Natural gas is a solution to reach the EU's climate & energy objectives**

Natural gas is a key energy source to reach the 2030 emissions reduction target and should not be discriminated against in the proposed framework. It is reliable, immediately available, can be indigenous and has lower air pollutant emissions than coal, such as SO<sub>x</sub>, NO<sub>x</sub> and particulate emissions.

We believe that a single overarching objective of reducing emissions, alongside creating a level-playing field for all technologies, would allow gas to support the three EU's energy and climate goals. Most importantly, the GHG emission target for 2030 could be achieved cost-effectively by mere switching from coal to gas: a combined cycle gas turbine emits less than 400g/kWh in comparison to a coal power plant at 850-1100g/kWh. Moreover, natural gas could be used in the transport sector, in particular to help the shipping industry to meet more stringent emissions targets. The 2030 package should also take into account that natural gas is valuable to counter-balance the variability of renewable energy sources.

Finally, natural gas from shale is potentially an opportunity for Member States to further diversify their supply sources, while stimulating growth and jobs. Shale gas in Europe has the potential to lead to

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<sup>2</sup> OGP does not accept the concept of tax reliefs as "subsidies" particularly when associated with tax regimes and rates significantly in excess of those levied on other industries. The deduction of business expenditures for tax purposes is a fundamental part of a normal tax regime.

a domestic production equivalent to 40% of the EU gas consumption. It could generate as many as 1.1 million jobs and boost growth by as much as 3.8 trillion euros by 2050. Further, it could also relatively reduce energy prices, a key element to support our energy intensive industry in competing on the global market.<sup>3</sup> Therefore, safe exploration for natural gas from shale should be encouraged in Europe.

## 5. Security of supply is also linked to RES variability

We agree with the Commission that security of supply for oil and natural gas is linked to diverse routes and sources. However, the notion of “energy independence” is misleading. The economic benefits (employment, technology development, tax and royalty revenues) of the indigenous production of oil and gas should not be underestimated either.

Reduced import dependency is not a desirable goal in itself as it does not necessarily lead to lower energy prices or improved competitiveness. Such arguments also undermine the efforts of the World Trade Organisation and existing and prospective Free Trade Agreements between the EU and third countries. Barriers to free trade and open investment in the energy sector ultimately raise prices, dampen economic growth and prosperity, and harm energy security by limiting the diversity of supplies.

Therefore, OGP recommends the EU policy makers employ a wider definition of “security of supply”, taking into account:

- The interdependency of energy sources, specifically the variability of renewables and flexibility of conventional sources.
- Imports of all raw materials (metals, rare earths) and power generation equipment (wind turbines, solar cells).

Free and indiscriminate access to fossil fuels in the global market is fundamental to maximising the EU’s energy security. For this reason, the EU should not support or introduce regulations which could have a negative impact on the EU’s access to energy resources (e.g. the current proposal to differentiate automotive fuels based on the feedstock of origin under art 7a of the Fuel Quality Directive). Additionally, free trade is linked to competitiveness and boosts trade-related employment which drives economic growth.

Furthermore, the assumption by EU policy makers, which underpins the EU’s energy and climate strategy, that fossil fuel prices will only increase is not necessarily correct. The Commission’s “*Energy prices and costs report*”, published alongside the Communication on 2030 climate and energy policy framework, acknowledges that “the surge in US shale gas (...) has driven prices down to historical lows”.<sup>4</sup> Taking the example of the US, this considerable fall in gas prices underlines the difficulty of projecting future prices and the dangers associated with making policy choices on forecasted prices.

*About OGP: Our membership spans the globe and accounts for more than half of the world’s oil output and about one third of global gas production. We foster cooperation in the area of health, safety and the environment, operations and engineering, and represent the industry before international organisations, such as the UN, IMO and the World Bank, as well as regional seas conventions, such as OSPAR, where we have observer status. OGP Europe in Brussels represents OGP members who are active in Europe at EU level.*

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<sup>3</sup> See [here](#) study on macroeconomic effects on European shale gas production by Poyry Management Consulting & Cambridge Econometrics.

<sup>4</sup> Commission Staff Working Document “*Energy prices and costs report*”, p. 168.



**ANNEX: OGP preliminary views on the EU ETS “Market Stability Reserve” mechanism  
*A draft Decision accompanying the 2030 Climate and Energy Package***

Background:

On 22<sup>nd</sup> January 2014, in the context of the 2030 Climate and Energy Package, the Commission published a draft Decision concerning the establishment and operation of a Market Stability Reserve (MSR) in the EU Emissions Trading System (EU ETS) from 2021. Its aim is to manage from 2008, on an objective basis, any potential imbalance between overall demand and supply of allowances in the ETS by way of a reserve.

OGP Position:

OGP maintains that an undistorted ETS is a means to achieve an environmental target cost-effectively. It should remain the central EU mechanism for CO<sub>2</sub> emissions reduction for electricity and heavy industrial sectors as it sets a single carbon price across countries and energy sources. The long-term nature of the EU ETS needs to be better understood (e.g. the current linear reduction factor leads to over a 70% reduction in the ETS cap by 2050 or a reduction of 85% were it to change to 2.2% from 2021). OGP re-affirms its view that the right approach is to clarify the long-term trajectory of the cap for Phase IV and beyond.

The establishment of the MSR mechanism from 2021 onwards may offer a structured pathway for managing any potential imbalance between demand and supply of allowances that has built up in the system. Though it introduces an additional level of complexity, OGP acknowledges the fact that it is rule-based and should not require any further rule changes before the end of Phase IV. If it operates as designed it acts as an objective control on the number of allowances in circulation. It might present an opportunity to curtail future market intervention that increases political risk and undermines investment.

OGP notes that the Impact Assessment (IA) for the MSR did not analyse the precise MSR mechanism that forms the basis of the draft MSR Decision: the analysis only ran as far as 2028 rather than to 2030 and beyond. Updating the analysis based on the 2013 verified emissions data once published would also help clarify the debate. In these circumstances it is difficult to form a clear picture of the proposal on incomplete analysis. OGP recommends these weaknesses are urgently addressed by the Commission.

OGP also needs to be reassured, taking into account the elements of any future international agreement, that the provisions for carbon leakage in the ETS Directive will be extended beyond 2020 when qualifying installations will be receiving far fewer allowances than they do today.

Because the Impact Assessment is incomplete in analysing the consequences of the mechanism, OGP needs additional clarification (including use of Phase 3 emissions data) to properly consider the proposed MSR mechanism.

OGP requests:

OGP would appreciate the Commission sharing its analysis of the impact of the actual MSR proposal and for this analysis to extend to 2030 and beyond, and include emissions data from EU ETS Phase 3 so we can gauge the full impact of the draft Decision, particularly if the linear reduction factor is eventually tightened from 1.74% to 2.2% in 2021. Any action taken must be the result of a full assessment of all of the dimensions and long-term nature of the proposal.

OGP also requests that any solution should avoid exacerbating carbon leakage.

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