The EU’s emissions trading scheme: progress so far

A recent report has assessed the first two years’ of operation of the European Union’s emissions trading scheme (ETS). Its implications for business and whether it has lived up to its promise as a cost-effective tool for reducing greenhouse gases were examined.

The ETS is a central instrument for implementing the 1997 Kyoto Protocol and is the world’s first cross-border emissions trading system used to tackle emissions of greenhouse gases (GHG). Launched in 2005, the scheme covers almost 11,500 installations responsible for emitting about 45 per cent of the total CO₂ in the EU. It aims to reduce GHG emissions by 20 per cent by 2030 compared with 1990 levels. The first phase, from 2005-2007, is currently being reviewed. The second phase runs from 2008-2012.

The report, from a Centre for European Policy Studies (CEPS) researcher, indicates that the cap-and-trade model of the ETS has advantages over using taxation or voluntary agreements to curb GHG emissions. It allows the most cost-effective ways for the reduction of emissions to be factored into business strategies, improving long-term predictability. It also minimises distortions to competition among industries in the EU by imposing an EU-wide carbon price. In addition, it offers environmental benefits by capping overall emissions levels.

Compromises made in adopting the ETS included allocating free allowances and leaving the process of allocation to the discretion of member states. During the first phase, teething problems included the short time allowed for adoption of the scheme, volatility in the carbon price and an increasing gap between gas and coal prices, which drove power plants to burn more coal, increasing emissions to a higher than expected level. In addition, small installations faced high administrative burdens. There was also an absence of verified baseline data on emissions, prior to 2005.

Fundamental issues that currently need to be addressed include constraining the inflated projections of emissions and centralising the allowance of emissions. A key point for assessing the success of the ETS is how far it encourages installations to make long-term investment decisions on new low-carbon technologies. Current allocation periods provide certainty for only three, and then five years. These are much shorter periods than normally associated with investment cycles.

Other concerns include allowing energy producers to pass on increased power prices while benefiting from ‘free’ allocations, resulting in windfall profits. There are also fears of non-EU producers being given a competitive advantage in energy-intensive industries such as aluminum.

It was suggested the current review should look at issues of complexity, distortions to competition and investment incentives. Member states would like more consistency on setting caps at the EU level and sector level. The report recommends using EU-wide benchmarks, such as output measurements and activity rates, as well as promoting predictability for investment purposes by mapping out future allocation rules.

1 For more information on ETS see: http://ec.europa.eu/environment/climat/emission/review_en.htm
2 http://ec.europa.eu/environment/climat/emission/linking_en.htm
3 CEPS: www.ceps.eu


Contact: Christian.Egenhofer@ceps.eu

Theme(s): Climate change & energy