

EU Emissions Trading System Policy Case Studies



The EU Emissions Trading System (EU ETS) has been a core part of EU climate policy since it was established in 2005 and is the world's second largest carbon market.



Policy Type: Emissions Trading System

Key Features

The EU ETS covers more than 11,000 installations in 31 countries (including all 28 EU member states). The cap is determined in multi-annual phases (currently in Phase III). Market Stability Reserve will start operating in January 2019, which will automatically modify the volume of allowances when there is either a surplus or scarcity in allowances. GHG emission covered: CO₂, N₂O, and PCFs.

Sectors Covered

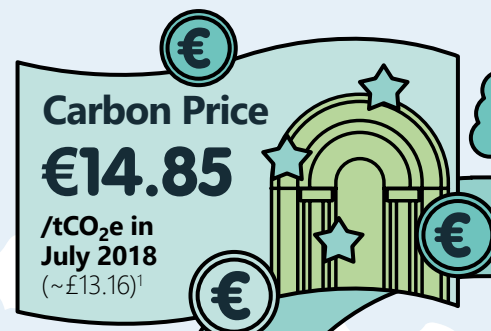
Power, Industry and some Aviation.

Sectors Not Covered

Agriculture, Forestry, Waste, Transport and Buildings.

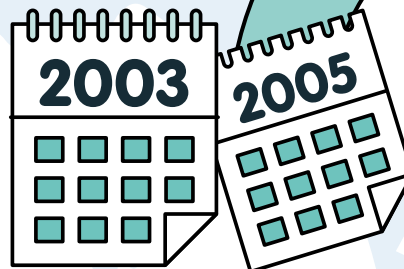
Emissions Covered

45%



Point of Regulation

Point of emissions. Mainly applied to large emitters, such as electricity generators and industrial entities.



Key Dates

The EU ETS was introduced via the EU ETS directive of 2003 (Directive 2003/87/EC) and established in 2005. The first phase ran from 2005 until 2007 followed by Phase II (2008-2012), and Phase III (2013-2020). Currently there are plans for Phase IV to run from 2021 to 2030.

¹ Exchange rate July 2018: 1 euro: £0.886339. Source: www.xe.com, accessed 02/07/2018.

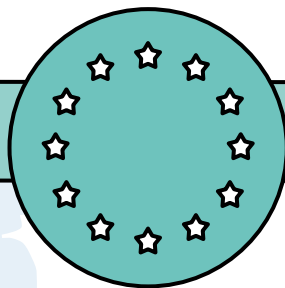
Introduction

The EU Emissions Trading System (EU ETS) was designed to create a multi-sector market-based approach to emission reduction in the EU. It has been progressively revised to harmonise the treatment of operators in different participating sectors and countries. The EU ETS operates in phases, with the emissions cap determined prior to each phase.

Policy makers have faced a number of challenges however, not least in how to maintain a strong decarbonisation incentive given the turbulent economic conditions of the last decade. In addition, concerns over the impacts of the carbon price on the competitiveness of industries have been a major

factor in the system design. Nonetheless, the EU ETS remains a strong model for decarbonisation policy and in the coming years it is planned to be further linked to other similar systems and international mechanisms for carbon reduction.

From the UK perspective, the EU ETS will remain important. The UK has confirmed it will stay in the EU ETS until at least the end of the current Phase (ending December 31, 2020) after which it could remain in the EU ETS or link to it. In either case, climate policies will continue to affect competing industries within the UK and the EU.



Key Findings

ETS Design

- The decision on which sectors to include was based on four criteria:
 1. The environmental impact of imposing a carbon price on the sector,
 2. The economic efficiency of reducing its emissions via a market-based approach,
 3. The administrative costs and feasibility of including the sector, and
 4. The existence or suitability of alternative decarbonisation policies for the sector.
- The concern about applying carbon costs to internationally competitive industries is that it could lead to products being made outside the carbon pricing region instead of within it, with no global reduction in emissions. This phenomenon is called carbon leakage. To avoid this, allowances are allocated for free to participants in certain sectors, based on their risk of carbon leakage such as carbon cost intensity and trade exposure.
- The method of free allocation of allowances to trade-exposed industries was designed so that they are subject to the full carbon price incentive to abate emissions.
- While the linking of two or more carbon markets can help decarbonisation targets be met at lower costs, key design aspects of these markets must be harmonised. The EU and Swiss authorities have agreed to link and have established the harmonisation of a set of design elements, including the means of protection of trade-exposed industries.
- A fixed cap can lead to an oversupply of allowances if there is an unforeseen economic downturn that reduces demand for emitting activities, for example the 2008 financial crisis. For the EU ETS, this resulted in several successive large drops in allowance price. To prevent this from happening again, the European Commission introduced the Market Stability Reserve that automatically modifies the volume of allowances within the market.



Definitions

Emissions Trading System

A cap on emissions is set and obligated parties are required to hold a permit for each tonne of emissions they emit. The cap determines the number of allowances available in the system, which can be traded between parties.

Point of Regulation

The point in a chain of emission producing activities at which a regulator places the obligation to comply with emission reduction policy. The point is defined relative to the point of emission, either up or downstream from this.