

# Review of the EU ETS and its Future Development

Comment by

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# Part I: General Overview of the Current Situation

## 3 remarkable features

- **Why emissions trading was chosen**
- **How fast**
- **Decentralisation**

# Why Emissions Trading?

**Europeans do not like emissions trading because it is a licence to pollute (*European Commission in the mid-1990s*)**

# 1. Why the ETS was chosen

## Economic

- Cost-effectiveness from *macro*-perspective
- Long-term predictability
- Flexibility for industry
- Environmental certainty

## EU-specific

- Internal-market compatibility
- General tendency towards EU target setting

## Political

- Large stakeholder support

**ETS is instrument by default. All other instruments failed!**

## **2. Extraordinary commitment by EU member states**

# ETS was adopted in record time

- Average conclusion of “co-decision” agreement in 18 months
- ETS was adopted between Oct. 01 and July 2003 (18/19 months)
- No conciliation
- Linking Directive was fast-tracked
- REACH took more than 3 years

Total co-decisions	1 <sup>st</sup> reading (fast-track) agreement	2 <sup>nd</sup> reading agreement	Conciliation
403 Approx. 80 p.a.	28%	50%	22%

# Implementation was rushed

- **late allocation plans & bottlenecks in infrastructure**
- **need to adapt national laws / enlargement**
- **Political and regulatory uncertainty: e.g. UK, Germany**
- **lack of capacity, resources and experience**
- **absence of International Transaction Log**
- **Difficulties with compliance system**

### **3. High level of decentralisation, in fact cross-border (“multilateral”) scheme**

# Natural cycle of EU “law-making”

**Phase 1: Denial** Member states can do it alone; no EU action needed

*Timing:* Development of national schemes: DK, UK, Norway, Germany

**Phase 2: EU or internal market benefit is identified**

*Timing:* Green Paper; EU ETS Proposal

**Phase 3: Maximum decentralisation** (Member states to keep control)

*Timing:* NAPS I

**Phase 4: Gradual re-centralisation or re-balancing**

*Timing:* 2006/7 Review

- 1. Strong commitment in EU and member states**
- 2. EU ETS is “only possible” consensus on emissions trading and climate change**
- 3. EU ETS is a true cross-border scheme (not directly applicable to nation states) and possible template (?) for international scheme**

# Part II:

## Challenges for Review

1. Investment
2. Sector coverage
3. Linking

## Investment

- 1. Short-term allocation periods of 5 years are disconnected with investment cycles spanning up to 30, 40 or more years. Call for longer allocation period.**
- 2. Long-term allocation could lock the EU into an unsustainable capital stock that could result in stranded investment (← uncertainty)**

## Investment (2)

1. **Key is predictability (on different levels):**
  1. **That ETS continues**
  2. **That (allocation) rules remain stable**
  3. **Predictability for allocation**
    - a) **knowing allocation far ahead**
    - b) **length of allocation period**

## Investment – some proposals

- 1. Allocation roadmap (by Commission, EP and Member states), setting out harmonisation steps**
- 2. Updating of allocation based on 10 year old data (→allocation is known 10 years ahead)**
- 3. 3 X ten years**
- 4. Compliance factor regime**
- 5. Specifically auctioning of a small quantity of the current cap of allowances of vintages year up to 30 to generate forward price that can be used to analyse investment decisions.**

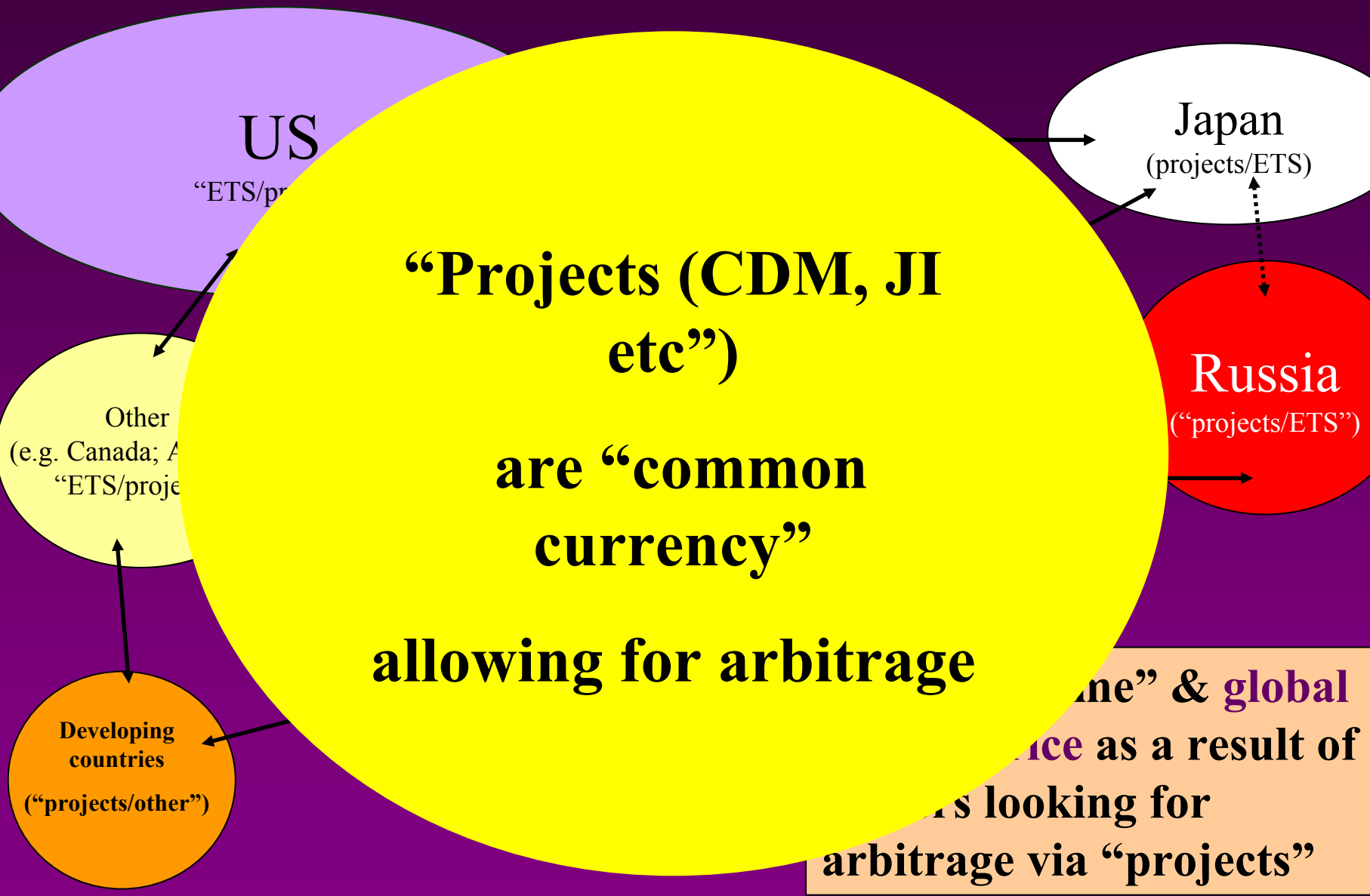
## Sector coverage or how many sectors?

1. **Original: large stationary sources: industry and power**  
→ similar abatement cost (*other sectors subject to other policies*)
2. **Expansion to transport and other sectors minimises the costs to society**
3. **But distributional impacts due to different “willingness to pay”** → increases of allowance price

**Need for striking a balance  
between  
economic efficiency or balance of interests in  
society**

# Linking

- 1. Linking of ET schemes – even if very different design options, e.g. banking, sector coverage, opt-ins/opt-outs - is possible through technical fixes.**
- 2. Such fixes can generally reduce efficiency through transaction costs, market segmentation, perverse effects or distortions. → efficiency may become questionable**
- 3. Distributional impacts are crucial – convergence of allowance prices is precondition for linking**
- 4. Condition for convergence of prices are “projects” or “off-**





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