

The EU Emissions Trading Scheme

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What is the EU ETS?

- Part of EU implementation of Kyoto
 - Regardless of Russian ratification
- CO₂ cap-and-trade for large stationary sources (\approx 45% of emissions)
 - EU-wide trading (EU15 + 10 accession)
- Two-phase implementation
 - 2005-07: Preparatory period
 - 2008-12: First commitment period

Short History of the EU ETS

- 2000-03: Discussion and adoption of EU Directive by Commission and EU Parliament
- 2003-04: Linking Directive allows Clean Development Mechanism credits
- 2004: Each MS (member state) transposes directive and develops “National Allocation Plan” (NAP) for EC review and approval
- Jan 1, 2005: Program starts

Current Outlook

- 5 MS' submitted NAP's on schedule (Apr 1)
 - 20 submitted as of late August
- 8 NAP's approved in July 2004 (incl. UK & Germany)
 - Proceedings initiated against Italy & Greece
 - 2nd round of approvals in October 2004
- Likely partial ($n < 25$) start on Jan 1, 2005

Comments on Allocation (1)

- Always very controversial and it was here
 - Explicit assignment of rights to emit and associated scarcity rents
- EU experience further reinforces trend to free allocation of allowances
- Much of controversy related to implicit change in regulatory system
 - Inflexible but negotiable vs. flexible but non-negotiable

Comments on Allocation (2)

- EU system similar to US OTC NO_x allocation
 - Decentralized allocation by individual states but full trading among states
 - Differences in allocation have not affected markets or abatement in OTC NO_x program
- Main differences in allocation
 - Much more updating in US OTC NO_x program
 - But more new source/closed source provisions in EU NAPs

Observations

- Technically competent construction
- Triumph of “low-price realism”
 - Notwithstanding previous European rhetoric
 - Makes subsequent linkage easier
- Danger of a zero price, but unlikely
- Competitive effects will be minimal
- Markets have emerged and trading will occur

Some Problems

- No inter-period banking
 - 2008-12 cap lower than 2005-07 cap
 - Higher 2nd period price will have no influence on 1st period price
 - Bankable CDM credits will tend to mitigate
- Post-2012 requirements
 - No post-2012 cap; tied to Kyoto
 - Desirable to encourage > 8 yr investments
 - Hard to imagine cap disappearing; probably gets extended

Significance of the EU ETS

- 1st formal “hard” CO₂ cap-and-trade program
 - A significant precedent for others
- Linkage provisions provide means for accessing cheap abatement and connecting to other systems
- EU is creating an important “fait accompli” concerning the nature of a future global system