



**The impacts of climate change  
policies on industrial  
competitiveness**

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# **Fundamentals of the EU ETS scheme**

# EU ETS Structure

- The EU ETS started in January 2005 and includes the 27 countries of the European Union
- The EU ETS was designed with two phases. Phase 1 (2005–2007) was intended to be a trial period. Phase 2 (2008–2012) coincides with the Kyoto commitment period.
- The cap covers only carbon dioxide (CO<sub>2</sub>)
- More than 11,000 CO<sub>2</sub> emissions sources are covered by the cap, accounting for some 45 % of EU CO<sub>2</sub> emissions (iron and steel, cement, glass, and ceramics, pulp and paper, and energy, - electric power generation and refineries).
- Each country submitted a NAP for approval for Phase 1. The EC is in the process of finalizing NAPs for Phase 2

# EU ETS Structure

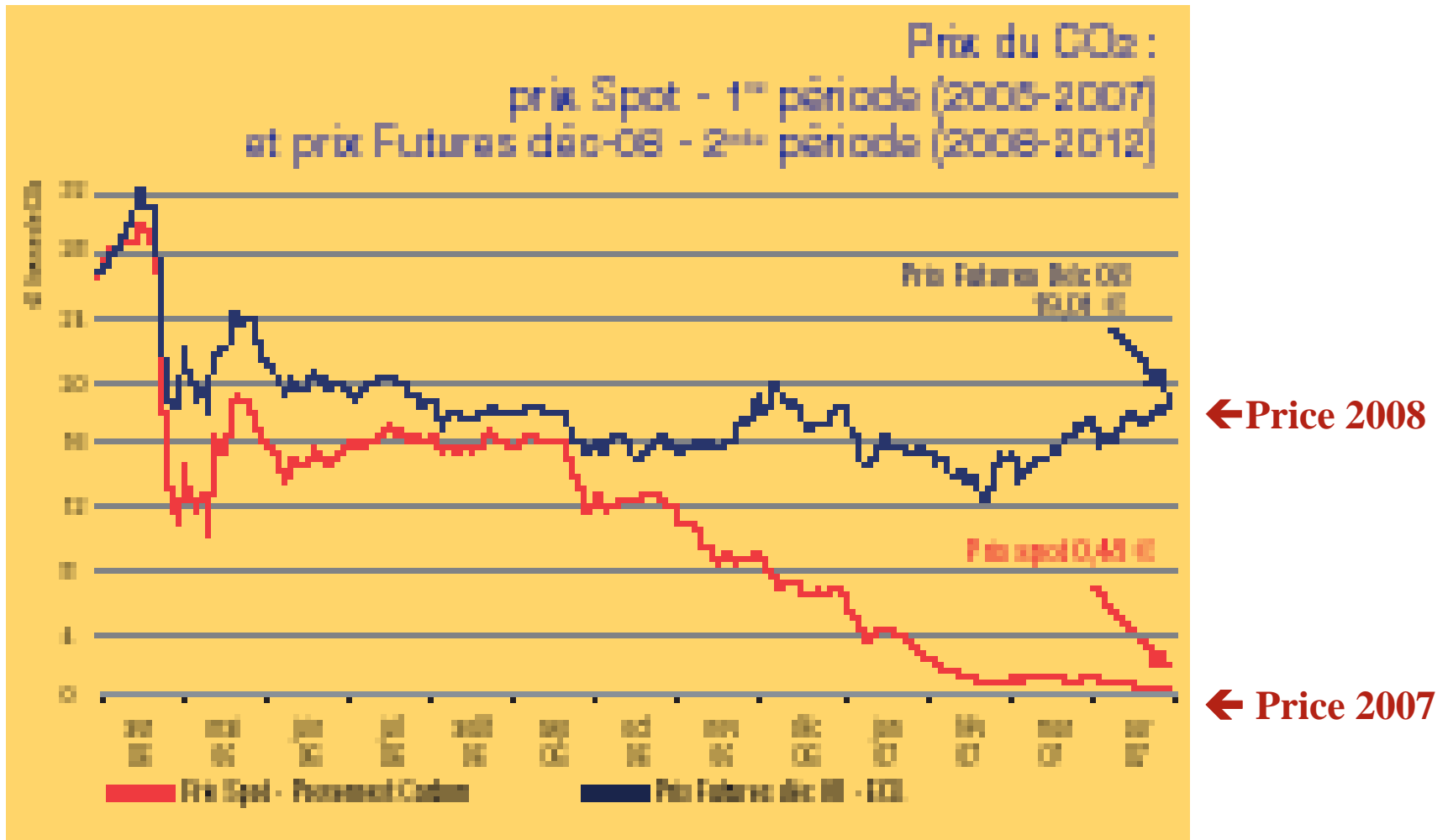
- EU ETS rules allowed countries to auction up to 5% of allowances, and 10% in the second period
- Emissions sources covered by the EU ETS may satisfy their commitments by surrendering allowances in an amount equal to their emissions or may supplement the EU-ETS allowances with JI (Joint Implementation) and CDM (Clean Development Mechanism) credits (generated by undertaking CO<sub>2</sub> reduction projects outside the European Union in accordance with Kyoto Protocol rules.)
- As a result, the price and availability of CDM credits will have bearing on the price of EU allowances.

# How the market behaved ?

- Early in Phase 1, most allowance trades were handled by brokers outside of formal exchanges
- In 2005 about 8 billion dollars of trades took place in the EU ETS. By end-2006; this is thought to have grown to 25–27 billion
- Prices June 11, 2007 (source : Point Carbon) :
  - o The current spot price is **€ 0.23**
  - o The 2008 forward price (Phase 2) is **€ 23.78**
  - o The 2009 forward price (Phase 2) is **€ 23.78**

# Spot and forward prices on the CO2 market

Source : CdC Mission Climat





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**Judging the facts – Right and Wrong ?**

# + RIGHT ?

**Setting the scene** : a mandatory cap-and-trade system based on absolute emissions levels determined in advance

**Simplicity** : an initially modest but effective constraint.

**A learning by doing approach** : setting an initial phase (caveat ?)

**Reducing the costs** : the principle of the system

**Monitoring emissions** : harmonised emissions monitoring and reporting requirements were set and the private sector was used for verifying greenhouse gas emissions.

**An inter state trading system and stringent penalties were set for non-compliance, to ensure environmental integrity** : a first in Europe for an environmental regulation and in the world for an environmental market

**Introduction of External Credits** : the « linking directive »

**A straight-forward and secure electronic allowance transfer and registry system set up**



## - WRONG ?

**A cap not fully aligned with other policies and measures** : The EU has chosen to apply the cap-and-trade approach to large stationary sources

**Length of the commitment periods and repeated, frequential cap-setting and allocation.** the EU ETS has been set up in discrete commitment or trading periods in which the cap for the next five (or x) years is decided along the way.

**New entrant and closure provisions** : free allowances from a new entrant set-aside which distort long-term investment decisions and create over-capacity (closure provisions not an incentive to retire old investments) + non harmonisation across EU

**Limits on Banking** : the carry-over of unused allowances from the 2005-07 period into the 2008-12 period is prohibited in almost all countries

**Reflecting the costs in the operations** : Inherent volatility of the carbon price due to imbalances of allocation between the industry and the power sector, and differences of behaviour between the two communities within this new market, led to a significant increase of the power prices



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**FINAL**

# Final Key Messages for EU ETS

- **Finding the right framework to undertake efforts towards long term reduction of greenhouse gas emissions at an affordable cost for the European economy**
- **ETS needs to be maintained but adapted to impact less heavily on operation now, and focus on influencing generators and clients long term investment choices towards carbon efficiency**
- **This needs reasonably low carbon prices in the short term, but clear predictable and stable economic signals in the longer term**
- **Give long term visibility to players on the evolution of constraints and rules of allocations : this is anticipated to include a gradual phase-out of free allocation to new assets, gradual phase-out of free allocation to incumbents at a pace consistent with economic life-time of existing assets. Also a gradual increase in auctioning**