The European Union's Emissions Trading System in Perspective

PEW CENTER ON Global CLIMATE CHANGE

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Overview

- An Up-front Conclusion
- Key Features of the EU ETS
- Distinguishing Conditions
- Controversies and Problems
- Lessons for the U.S. debate

Our Conclusion

- A technical and political success
  - Not perfect, of course, but most criticism based on misunderstanding of goals, conditions, or basic design decisions
  - More than any other nation has done to control GHG emissions
- What has it achieved?
  - A price on CO_2 that affects business decisions
  - A mechanism for long-term control of GHG emissions
  - Abatement in line with modest initial ambition

Description of the EU ETS

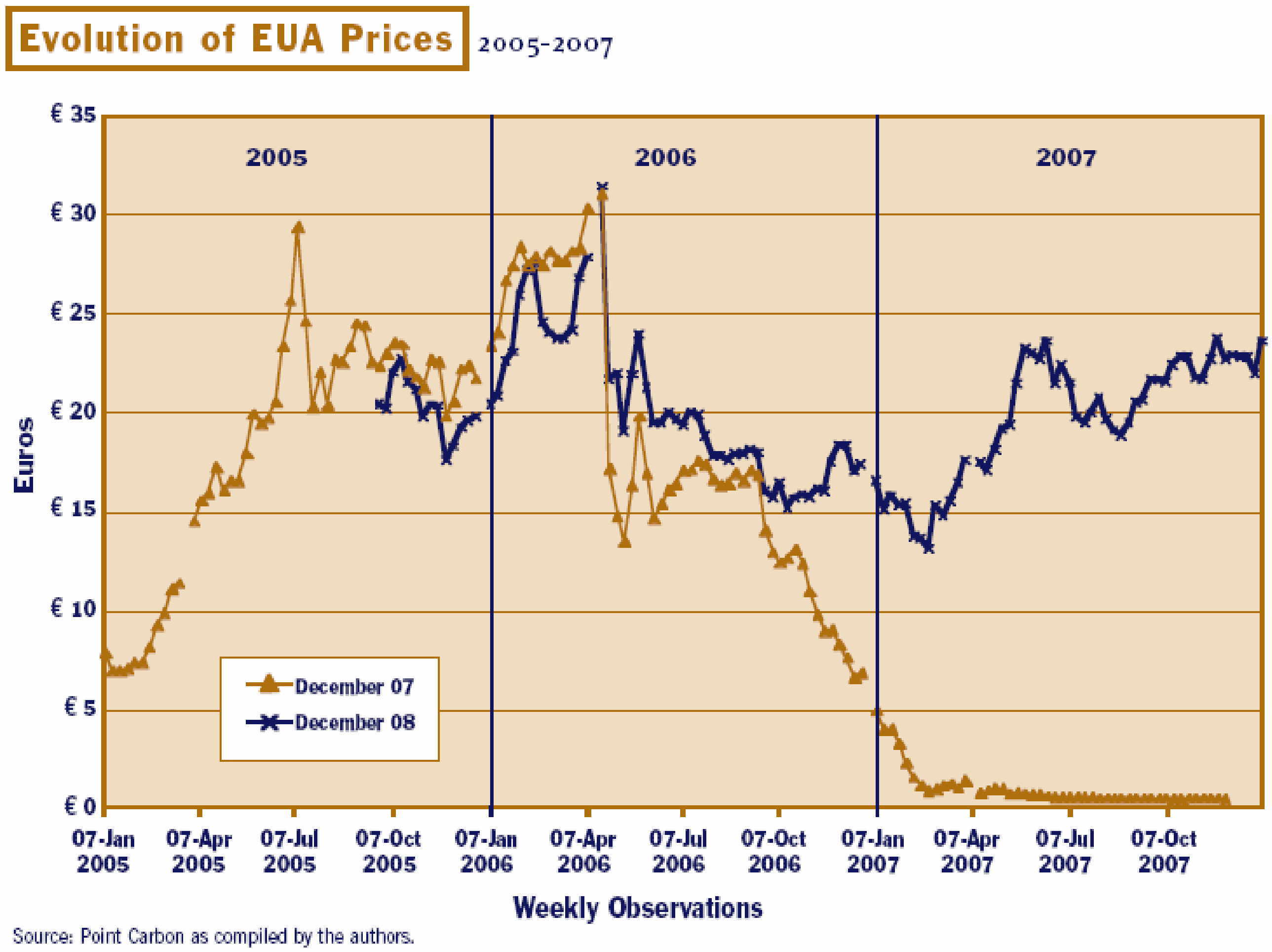
- Classic cap-and-trade system but decentralized structure
- Partial coverage: CO_2 only for power and industrial sectors
- Sequential trading periods: 2005-07, 2008-12, etc.
- CDM/JI credits allowed up to specified limit
- Complete intra-period banking <u>and borrowing</u>
- Allocation primarily by “grandfathering”
- Changes proposed and under consideration

Distinguishing Conditions

- Decentralized implementation
  - Caps and allocations proposed by Member States subject to guidance & approval by the center
  - Similar structure for registries, reporting, enforcement
  - Reflects political reality of the EU
- Highly compressed time schedule
  - Result of decision to implement a trial period
  - Compounded data problems in cap setting & allocations

Design & Information Matter

- Much commented price evolution
- Causes:
  - Poor data
  - Inter-period banking constraint
  - 2008 price notably less erratic



Controversies and Problems

- The big controversies
  - “Windfall profits”
  - Auctioning vs. free allocation
  - “Over-allocation”
- Problems
  - Partial coverage
  - Repeated, sequential periods
  - New entrant & closure provisions

Specific Design Lessons

- Take the time to get the data right
- Provide long horizons with banking and borrowing
  - No evidence of abuse of borrowing in EU ETS
- Be Comprehensive from the Beginning
- Allocation will be more contentious than for SO_2
  - And made more so by partial electricity sector reform
- Downstream monitoring and reporting by small sources is costly

Broad Lessons

- Economic impact is imperceptible
  - European economy has not been “wrecked”
  - No evidence of carbon leakage through trade
  - Adjustments in operations and investment
  - One price among many, all of which matter
- Unexpected abatement & non-directed outcomes
- Multinational systems can be constructed
  - Includes 27 sovereign nations plus Norway
  - EU ETS bridges wide divergence in institutional experience and per capita income

For More Information

www.pewclimate.org