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THE FUTURE OF THE EU EMISSIONS TRADING SYSTEM

by Erika Lennon*

Slightly more than a year after ratifying the Kyoto Protocol in October 2003, the European Commission established the European Union Emissions Trading System (“EU-ETS”), a cap-and-trade system, to help implement its goals under the Kyoto Protocol.¹ Now, as the reporting period for the Kyoto Protocol begins, the European Union (“EU”) is looking beyond 2012 and creating plans for the future.

The EU-ETS has completed its first phase (2005–2007) and is currently beginning its second phase (2008–2012). In these first two phases, the EU-ETS was limited to installations in certain industries, namely energy activities, production and processing of ferrous metals, activities involving pulp and paper production, and carbon dioxide emissions.² Additionally, the structure of the EU-ETS centered on allocations through National Allocation Plans (“NAPs”)³ and the predominantly free distribution of allowances.⁴ Each country submitted a NAP laying out its number of allowances and its allocation plan, then at the end of the year each country reported its emissions and could sell any leftover allowances.⁵ Thus, these initial EU-ETS phases establish the system, but are limited in scope.

As the “cornerstone for the EU’s strategy for fighting climate change,” the EU-ETS must be continued and strengthened.⁶ To establish a proposal for phase three, the Commission used three guiding objectives: to fully exploit the potential of the EU-ETS to the EU’s overall greenhouse gas reduction commitments; to refine and improve the EU-ETS based on experience; and to contribute to the transformation of Europe into a “low greenhouse-gas-emitting economy” and to create incentives for low carbon investment decisions by “reinforcing a clear . . . and long term carbon price signal.”⁷

The Commission issued a draft proposal on January 23, 2008 that included an overview of the provisions and specific language to amend the EU-ETS directive.⁸ This draft proposal acknowledges the EU commitment to reduce greenhouse gas emissions by at least twenty percent below 1990 levels by 2020.⁹ The new proposal tries to create a more harmonized system to exploit the benefits of emissions trading and facilitate linking the EU-ETS with other emissions trading systems that may emerge while avoiding distortions in the market.¹⁰ In addition to increased harmonization, the proposal includes new industry sectors and new gases, which will allow for new investments and new abatement opportunities, hopefully leading to increased efficiency.¹¹ The expansion of the EU-ETS to include more industries and gases other than carbon dioxide is a key provision in the fight against climate change.¹² It is estimated that there will be six percent increase in coverage—about 120 to 130 million tonnes of CO₂-equivalent when compared to phase two and will cover almost half of Europe’s emissions.¹³

Another key part of the proposal is the shift from individual country NAPs to a Community-wide quantity of allowances.¹⁴ The initial Community-wide cap will base the number of allowances on the average total number of allowances issued by Member States during phase two.¹⁵ Additionally, it will create greater harmonization across countries by standardizing allocation rules, which will help prevent countries from having NAPs that favor certain industries.¹⁶ Further, the draft proposal calls for a decrease in allowances yearly from 2013 to 2020 so as to reduce overall emissions in a cost-effective way.¹⁷ Reducing allowances yearly will not only help the EU meet its emissions reduction goals, but do so in a way that avoids instability and uncertainty.

The new draft proposal calls for the auctioning of allowances, which is distinguishable from the initial phases of the EU-ETS, when most of the allowances were given away for free.¹⁸ The draft calls for the full auctioning of allowances in the power sector, but for the free allocation of allowances in other sectors of industry initially, with a program to eliminate all free allocations by 2020.¹⁹ It is proposed that the power sector, due to its inclusion in the current EU-ETS scheme, have auctioned allocations, whereas other industries are given some free allowances to help adjust to the emissions trading system. Moreover, the draft proposal recognizes that some industries could suffer from “carbon leakage” due to international competition, thus it allows consideration of this factor in assessing whether to auction off or freely distribute allowances.²⁰ Further, a portion of the proceeds from the auctioned allowances will go to programs designed to fight climate change and to adapt to its inevitable effects.²¹

As the international community works towards a post-Kyoto agreement, the EU has put forth a new plan to fight climate change with a focus on expanding and refining the EU-ETS. The proposed changes in the EU-ETS show the steps the EU is taking to fight climate change in the upcoming decade. By expanding and harmonizing the EU-ETS, the proposal looks to the post-Kyoto world and the changes to come. 

Endnotes:

¹ Council Directive 2003/87/EC, preamble, para. 4, art. 1, 2003 O.J. (L 275) (EC), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32003L0087:EN:HTML> (last visited Feb. 15, 2008) [hereinafter EU-ETS Directive].

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² EU-ETS Directive, *id.* annex I.

³ EU-ETS Directive, *id.* art. 9.

⁴ EU-ETS Directive, *id.* art. 10.

⁵ EU-ETS Directive, *supra* note 1, art. 9; Questions and Answers on the Commission's Proposal to Revise the EU Emissions Trading System, ques. 2, Memo/08/35 (Jan. 23, 2008), *available at* <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/08/35&format=HTML&aged=0&language=EN&guiLanguage=en> (last visited Mar. 1, 2008) [hereinafter EU-ETS Questions and Answers].

⁶ EU-ETS Questions and Answers, *supra* note 5, ques. 1.

⁷ *Commission Proposal for a Directive of the European Parliament and of the Council Amending Directive 2003/87EC so as to Improve and Extend the Greenhouse Gas Emission Allowance Trading System of the Community*, 2008/0013 (COD) (Jan. 23, 2008), *available at* http://ec.europa.eu/environment/climat/emission/pdf/ets_revision_proposal.pdf (last visited Jan. 27, 2008) [hereinafter Proposal EU-ETS].

⁸ Proposal EU-ETS, *supra* note 7.

⁹ Proposal EU-ETS, *supra* note 7, at 13.

¹⁰ Proposal EU-ETS, *supra* note 7, at 13.

¹¹ Proposal EU-ETS, *supra* note 7, at 13.

¹² Proposal EU-ETS, *supra* note 7, at 34-36.

¹³ EU-ETS Questions and Answers, *supra* note 5, ques. 19; Mark Scott, *Giant Steps for Carbon Trading in Europe*, Bus. Wk., Jan. 23, 2008, *available at* http://www.businessweek.com/globalbiz/content/jan2008/gb20080123_051988.htm (last visited Feb. 9, 2008).

¹⁴ Proposal EU-ETS, *supra* note 7, at 14, 21.

¹⁵ Proposal EU-ETS, *supra* note 7, at 21; EU-ETS Questions and Answers, *supra* note 5, ques. 9.

¹⁶ *See* EU-ETS Questions and Answers, *supra* note 5, ques. 8.

¹⁷ Proposal EU-ETS, *supra* note 7, at 14.

¹⁸ Proposal EU-ETS, *supra* note 7, at 22.

¹⁹ Proposal EU-ETS, *supra* note 7, at 15-16.

²⁰ Proposal EU-ETS, *supra* note 7, at 16.

²¹ Proposal EU-ETS, *supra* note 7, at 15.
