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Lessons from the European Emissions Trading Scheme

Summary by Jutta Kill, FERN

1. Over-allocation of permits due to intensive industry lobbying during the allocation process led to price collapse of ETS permit prices in April 2006 and few permit trades for compliance purposes[1]. Similar price collapse due to over-allocation has just been reported for the New South Wales emissions trading scheme.

   ► Lack of a stringent cap has undermined the emissions trading scheme. Slight tightening of the cap for the second phase of the ETS from 2008-2012 in the wake of the failure and price collapse during phase 1 has been offset by increasing the hole in the cap: across the board, companies are allowed to use significantly more offset credits from CDM and JI projects during phase 2 compared to phase 1 of the ETS. Several reports have shown that the shortfall of permits resulting from the tightening of the cap in phase 2 will be filled to 88%-100% by increased volume of offset credit influx into the ETS.

   “I believe switching from using coal to using gas in the summer time is enough for the ETS to meet its target. Alongside buying CERs, this will be enough so that no further internal abatement will be necessary,” Voorspools said." Kris Voorspools, analyst with Fortis Bank in Point Carbon 07.08.2007

2. Free allocation of emission permits has led to record windfall profits to energy utilities and some of the highest emitting industry sectors in the EU.

   ► 100% auctioning in the third phase[2] of the ETS increasingly considered as the

[1] Most trading in the ETS is currently not for compliance purposes but for secondary trading.
[2] Third phase commencing 2013

only remedy to salvage the ETS[3]. Capping emissions without 100% auctioning selects against immediate investment in long-term structural change. Short-term and uncertain price signals discourage structural change, cost-spreading discourages innovation.

"Germany's E.ON -- the world's biggest utility company -- has after a boardroom battle come out in favour of 100% auction of emission allowances after 2012." Jeremy Lovell, Climate fight brings mega profits to EU power firms. August 2007

3. Any influx of offset credits into the emissions trading scheme will undermine effectiveness due to risk of development of a 'lemons market' as a result of unverifiable quality of offset credits.

   ► this is of concern particularly given the increasing evidence that up to 1/3 of CDM projects [either already registered or in the process of CDM registration] are considered 'non-additional' by CDM experts.[4]

4. There is increasing acknowledgement, including from the private sector, that emissions trading will not provide the incentives and price signals required to trigger significant investments and R&D into zero-carbon and low-carbon technologies which is required to be able to achieve the emissions cuts required to avert climate chaos.

   ► see quotes below.

5. Increasing signs that more effective approaches to switch to zero-carbon economies are held back for fear of jeopardizing the EU's flagship Emissions Trading Scheme. A leaked UK government internal note for example reveals a deep concern that achieving the 20 per cent renewable energy target itself could present a "major risk" to the EU's emission trading scheme, for which London has become a major centre of exchange. Combined with the EU's drive to greater energy efficiency, increasing the share of renewable energy could cause a carbon price collapse and make the ETS "redundant", the note says.[5]

6. Effective and economically viable alternatives to cap-and-trade approaches include (1) a cap-and-auction approach under which the cap is reduced annually and will approach zero over mid-term & where auctioned permits are not traded; where a hole in the cap through an influx of carbon offset credits is not permitted and where (2) feed-in-laws ensure long-term minimum price guarantees for and unlimited uptake of renewable

[3] Recent Oko-Institute report "Auctioning in the EU-ETS" commissioned by WWF Germany; strongly-worded new report by UK-based business think-tank Open Europe on the present and future failure of the EU Emissions Trading Scheme now available at http://www.openeurope.org.uk/research/etsp2.pdf August 2007

[4] Articles and presentation at hearing in German parliament on 4 August 2007 by Axel Michaelowa, Perspectives GmbH, Switzerland

[5] 'Leaked note reveals UK's renewables angst'. ENDS Europe DAILY 2373, 15/08/07. ETS file

energy into the national grid. Such legislation has led to significant increases in renewable energy volumes in the national grid in Germany as well as a booming renewable energy industry, with creation of significant numbers of new employment, esp. in the wind energy and photovoltaic sector; where (3) subsidies promoting further use of fossil fuels are phased out and possibly re-directed towards R&D in the field of zero-carbon technologies, and where (4) energy efficiency potential, esp. in the housing and household appliances sectors is fully utilized. Market-based instruments to ensure incentives for best-practise have been proposed by among others, Driessen.

> "By 2015, the UK's electricity system will look remarkably similar regardless of assumptions on how the EU ETS plays out."
>
> IPA consultants

> The EU ETS "has not encouraged meaningful investment in carbon-reducing technologies."
>
> Tony Ward, Ernst & Young

> "Coal plants receive more allowances than eco-friendlier" fuels.
>
> Deutsche Bank Research, 6 March 2007

> "ETS has done nothing to curb emissions . . . is a highly regressive tax falling mostly on poor people . . . enhances the market power of generators. Have policy goals been achieved? Prices up, emissions up, profits up . . . so, not really."
>
> Peter Atherton, Citigroup Global Markets, January 2007

> "All generation-based utilities – winners.
> Coal and nuclear-based generators – biggest winners.
> Hedge funds and energy traders – even bigger winners.
> Losers . . . herm . . . Consumers!"
>
> Peter Atherton, Citigroup Global Markets, January 2007

> Emissions trading "would make money for some very large corporations, but don't believe for a minute that this charade would do much about global warming . . . old-fashioned rent-seeking . . . making money by gaming the regulatory process."
>
> *Wall Street Journal*, 3 March 2007

"European Commissioner for Energy gives damning verdict . . . 'A failure' . . ."
TV Channel 4 Evening News, London, lead story, 7 March 2007

The EU ETS "has not encouraged meaningful investment in carbon-reducing technologies."
Tony Ward, Ernst & Young, May 2006

►Windfall profits for European fossil fuel-intensive corporations

BP, Esso, Shell	US$ millions/year
RWE (Germany)	US$1 billion/year
Big six UK generators	US$1.2 billion/year
CEZ (Czech Rep.)	US$150 million/3 years

PRIVATIZATION OF Atmospheric WORLD CARBON DUMP BY THE EU EMISSIONS TRADING SCHEME	*Phase 1 gift to big business (MT CO2)*	*2005 emissions*	*Phase 2 approved gift to big business*	*Increase/ decrease in gift to big business*	*Gift = x% of "world carbon dump" (IPCC)*	*Yearly value of gift @ €30/t*	*Yearly value of gift @ €0.15/t*
Czech R	97.6	82.5	86.8	+5%	~1-2%	€2.6b	€13m
France	156.5	131.3	132.8	+1%	~1-3%	€4.0b	€20m
Germany	499	474	453.1	-4%	~5-9%	€13.6b	€70m
Netherlands	95.3	80.4	85.8	+7%	~1-2%	€2.6b	€13m
Poland	239.1	203.1	208.5	+3%	~2-4%	€6.3b	€31m
Spain	174.4	182.9	152.3	-17%	~2-3%	€4.6b	€23m
Sweden	22.9	19.3	22.8	+18%	<1%	€0.7b	€3m
UK	245.3	242.4	246.2	+2%	~3-5%	€7.4b	€37m
TOTAL EU	**1815.7**	**1672.5**	**1650.7**	**-1%**	**~17-34%**	**€49.52b**	**€248m**