

The EU Emissions Trading Scheme. Lessons from the first two phases.

Slovenski E-forum International Conference

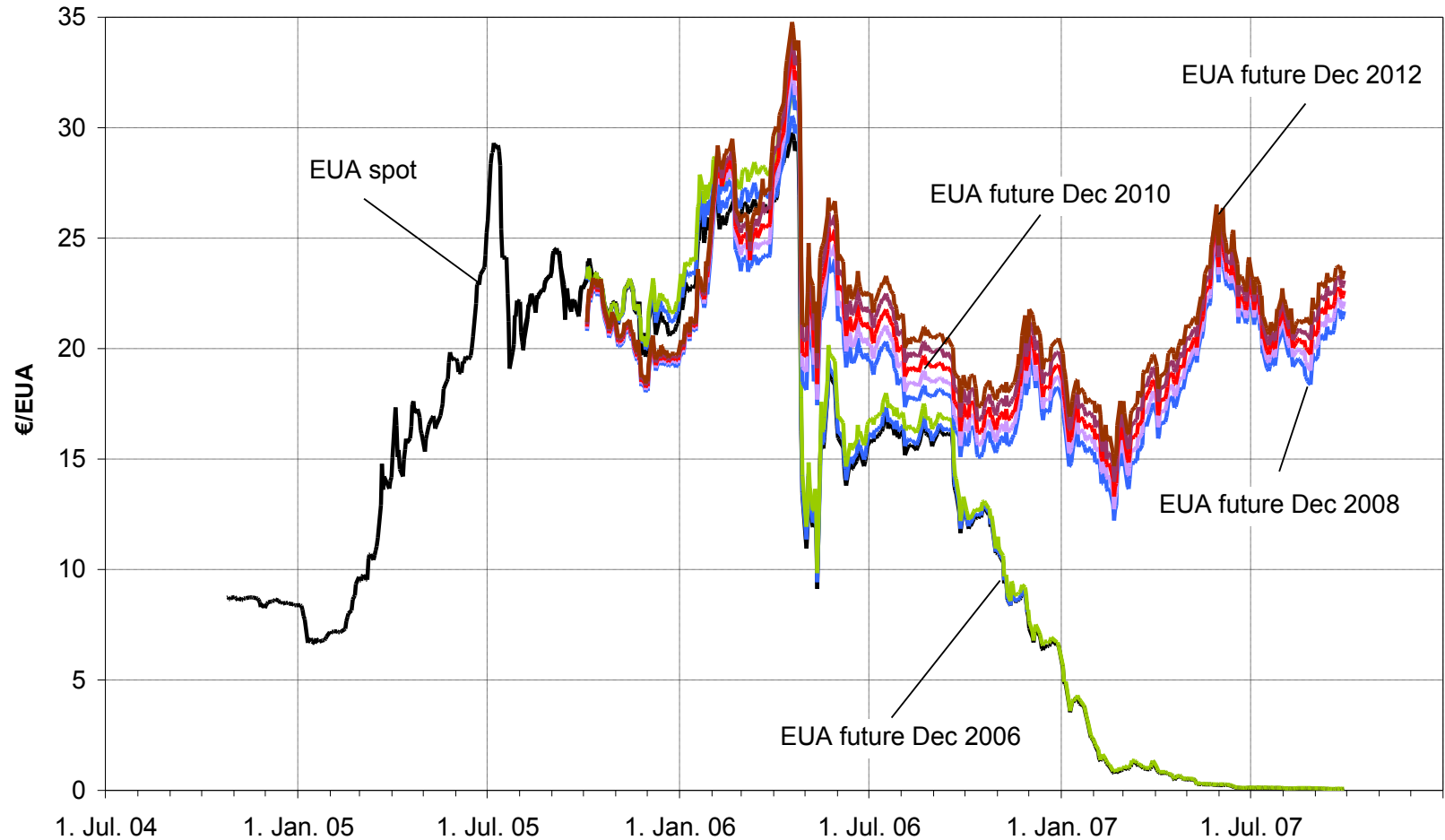
**The New EU Greenhouse Gasses Emission Trading Scheme.
Can it deliver what it promises?**

Ljubljana – 20 March 2008

Dr. Felix Chr. Matthes

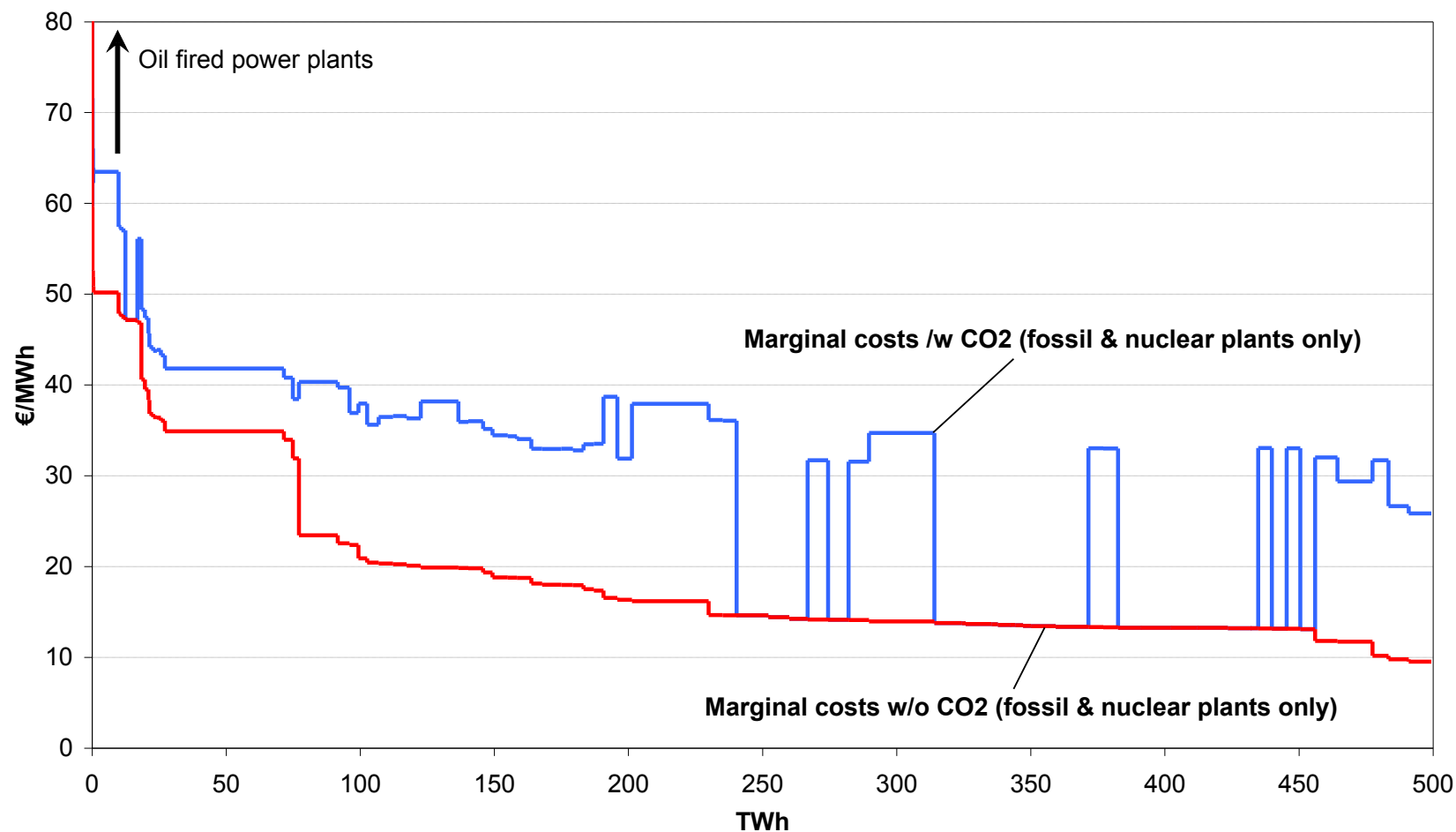
The EU Emissions Trading Scheme

The European allowances price



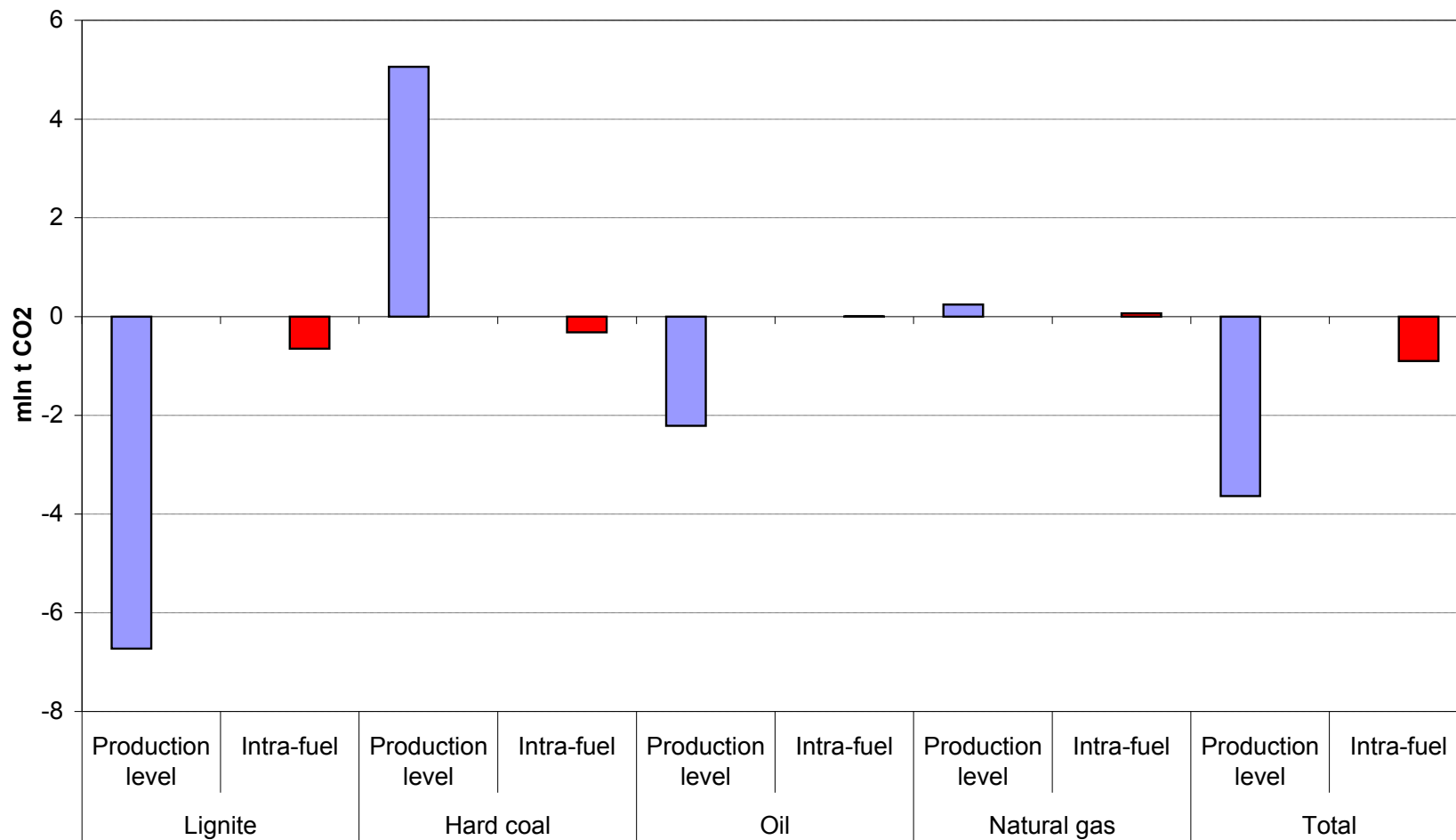
Modeling exercise /w and w/o CO2

A closer look to Germany (1)



Modeling exercise /w and w/o CO2

A closer look to Germany (2)

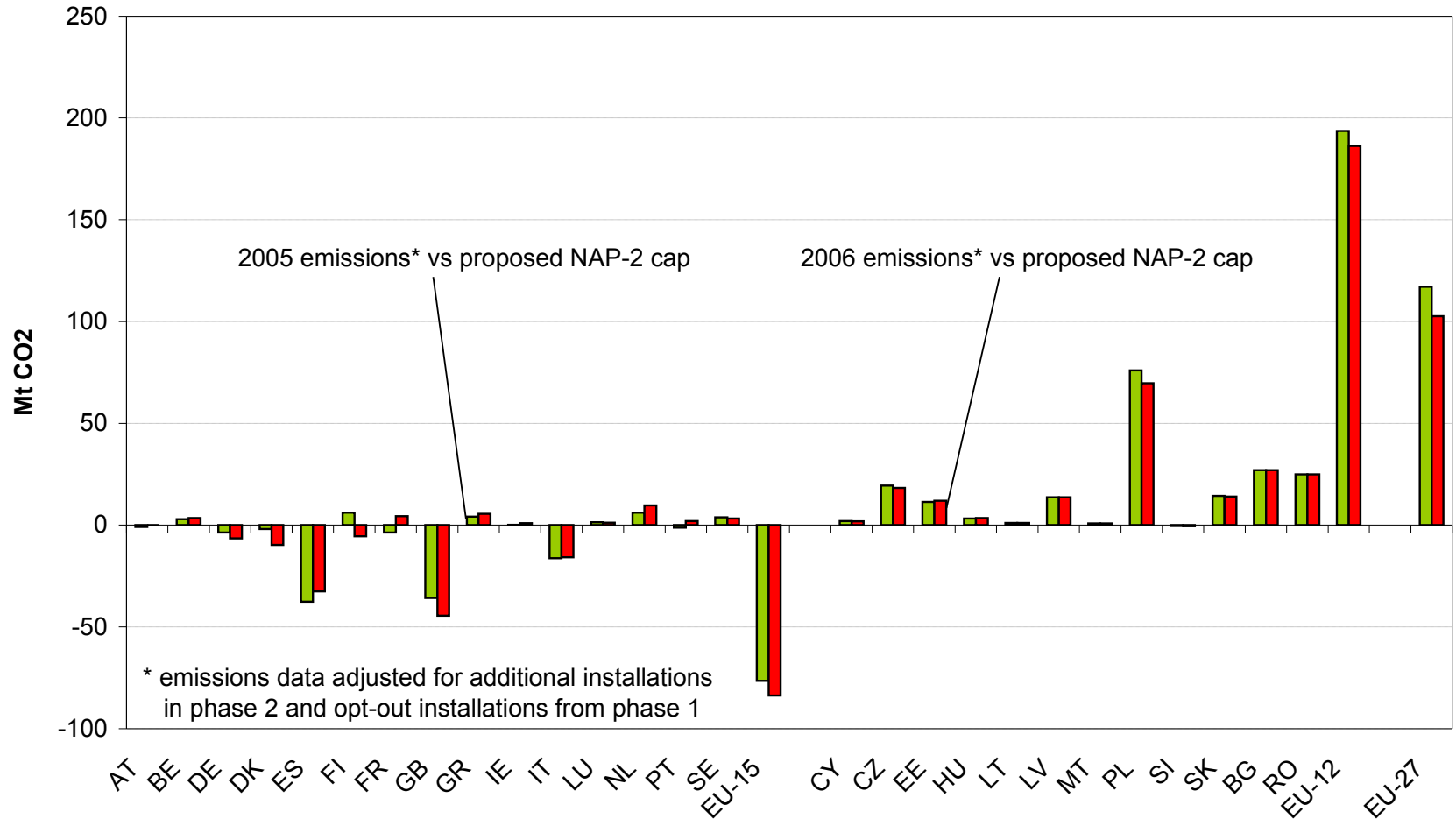


The EU Emissions Trading Scheme (Some) lessons learnt

- **The EU ETS worked**
 - significant allowance price for at least 18 months
 - an emerging secondary market
 - measurable effects regarding operation of installations
 - CO₂ emerged as a serious issue on the company level
- **The real world EU ETS is different from the textbook-style ETS**
 - strong interactions between allocation and cap setting, solving distributional problems by cap inflation (directly: cap, indirectly: replenishment of NER)
 - significant distortions of the CO₂ price signal
 - free allocation in an multi-period scheme (incumbents / new entrants)
 - new entrant allocation
 - updating
 - biased data / data uncertainties can be a major problem

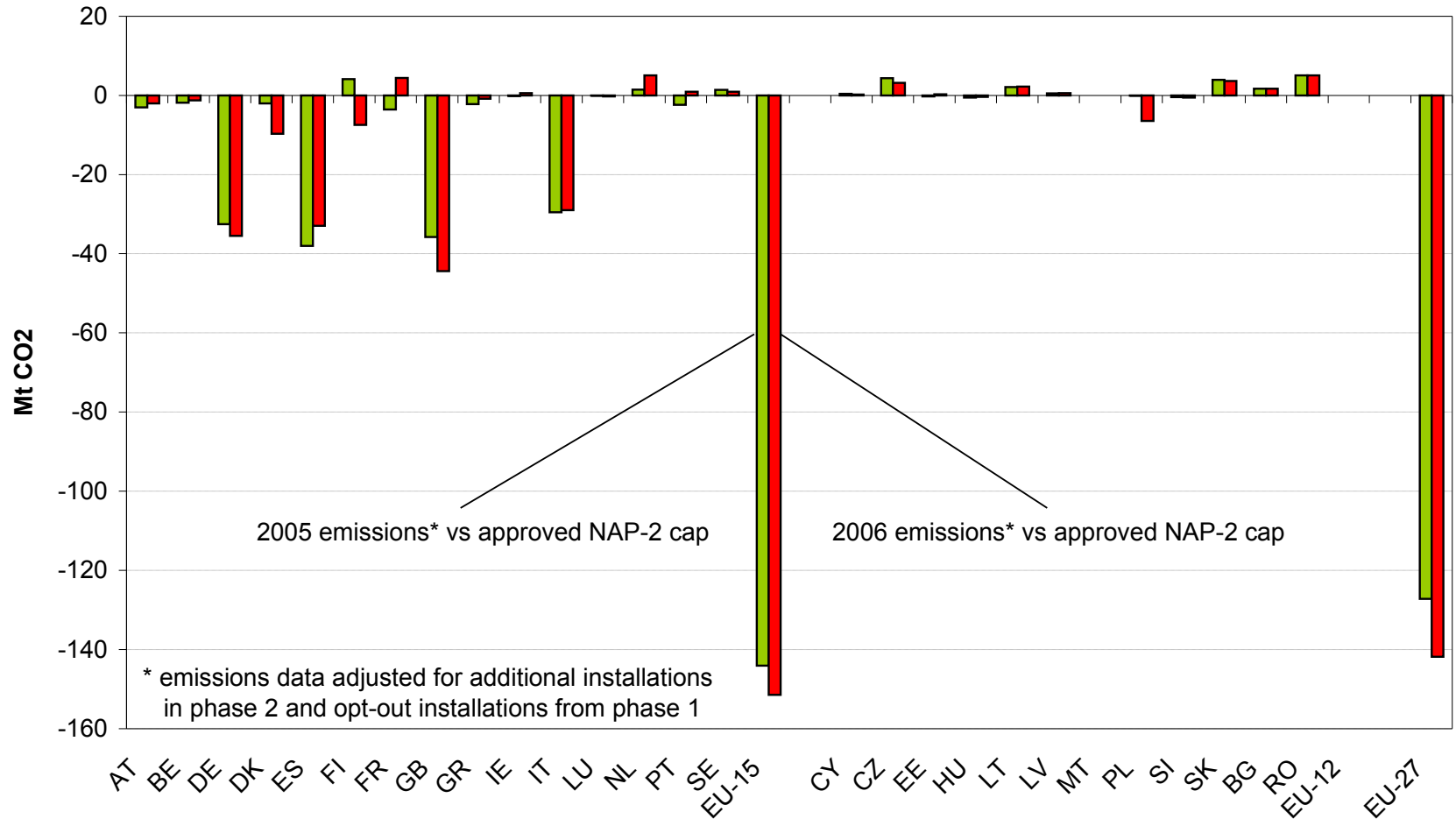
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Cap proposals from the MS for phase 2



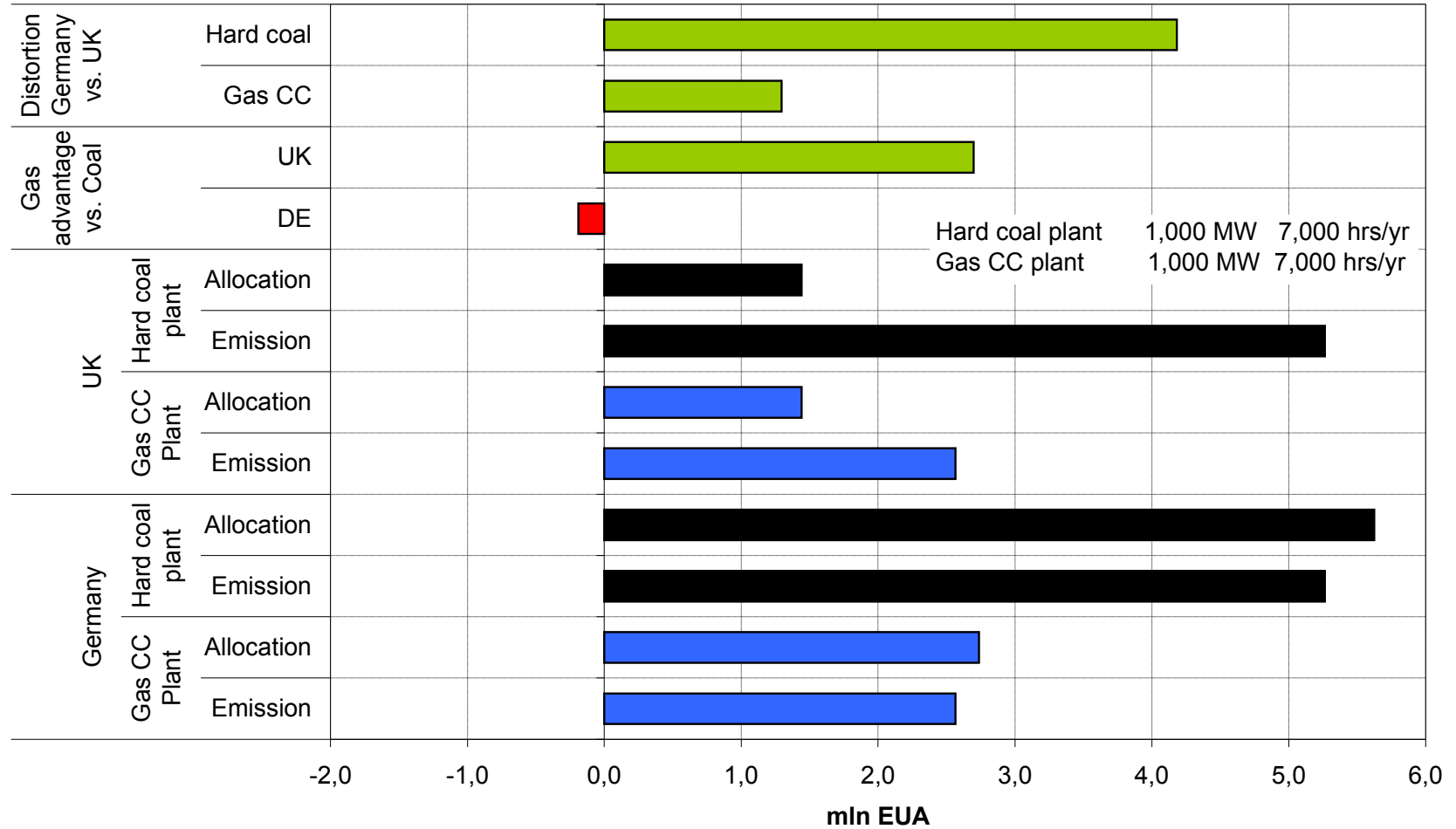
The EU Emissions trading scheme

Approved caps for phase 2



EU ETS new entrant allocation

Economic and competition distortions



The EU Emissions Trading Scheme

Windfall profits

- Most generators (in the liberalized market segments) passed through the opportunity costs of the allowances
- Rough assessment for phase 2
 - 70% free allocation for power generators @ 25 €/EUA
= 22 bn €/yr
 - Pass-through of 500 g CO₂/kWh (EU average)
 - Windfall profits for fossil power generation (1,778 TWh) = 13 bn €/yr @ 25 €/EUA
 - Windfall profits for nuclear & hydro power generation (1,282 TWh) = 16 bn €/yr @ 25 €/EUA
- The power sector is not the only one ...

The EU ETS

Key issues for the revision (1)

- **The cap**
 - **must be consistent to the overall targets**
 - **must reflect the effects from other policies and measures**
- **The cap setting process must be separated from the allocation process**
- **The EU-wide cap is a reality already in phase 2 (COM formula)**
- **The EU-wide cap is a necessity at least as a starting point**
- **The EU-wide cap must be assigned to the Member States**
 - **if this is necessary in the framework of the international climate regime (27 ‘non-ETS parties’ + ‘ETS party’)**
 - **if flexibility shall be provided to the Member States to tighten the cap**
 - **if EU-wide allocation provisions cannot be introduced**
 - **if the Member States cannot agree on alternative auction revenue sharing approaches**

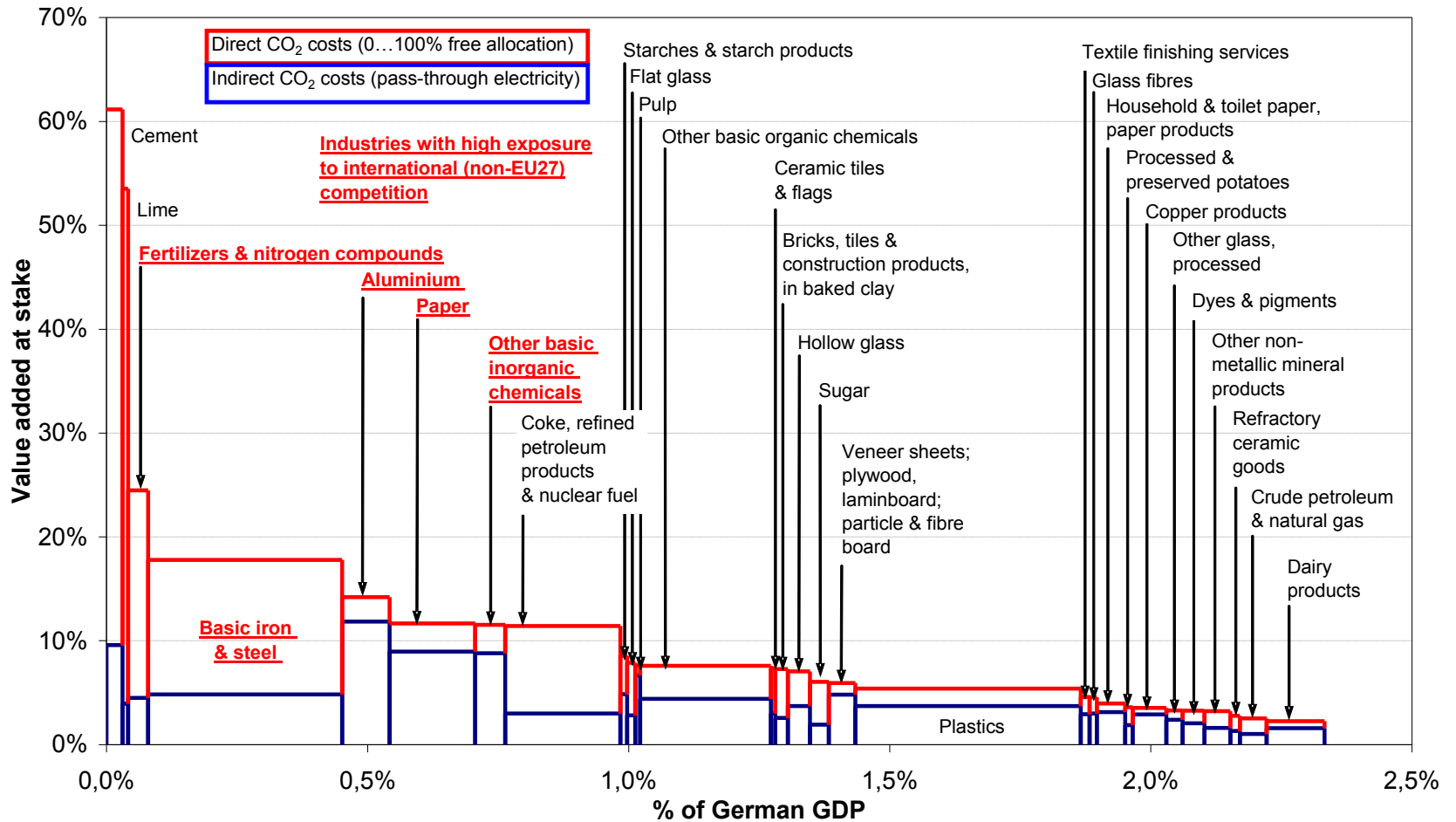
The EU ETS

Key issues for the revision (2)

- Allocation must maintain an undistorted CO2 price signal
 - Distortions from updating (& clones): base period updating, ex post adjustments, new entrant allocation
- Major role of auctioning
 - full auctioning for the power / energy sector as a bottom line
 - for all sectors where leakage problems cannot be proven
 - harmonization / coordination will be needed
 - ... and the challenge of redistribution
- Allocation could reflect potential leakage effects / distortions of international competition
 - if these effects can be proven for the relevant sectors
 - if allocation can remove these problems!
 - Direct/indirect CO2 costs
 - Border adjustments/sectoral commitments
 - Direct compensation

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CO2 cost & trade exposure



**Thank you
very much**

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