EU Emissions Trading Scheme
Energy, Environment & Competitiveness

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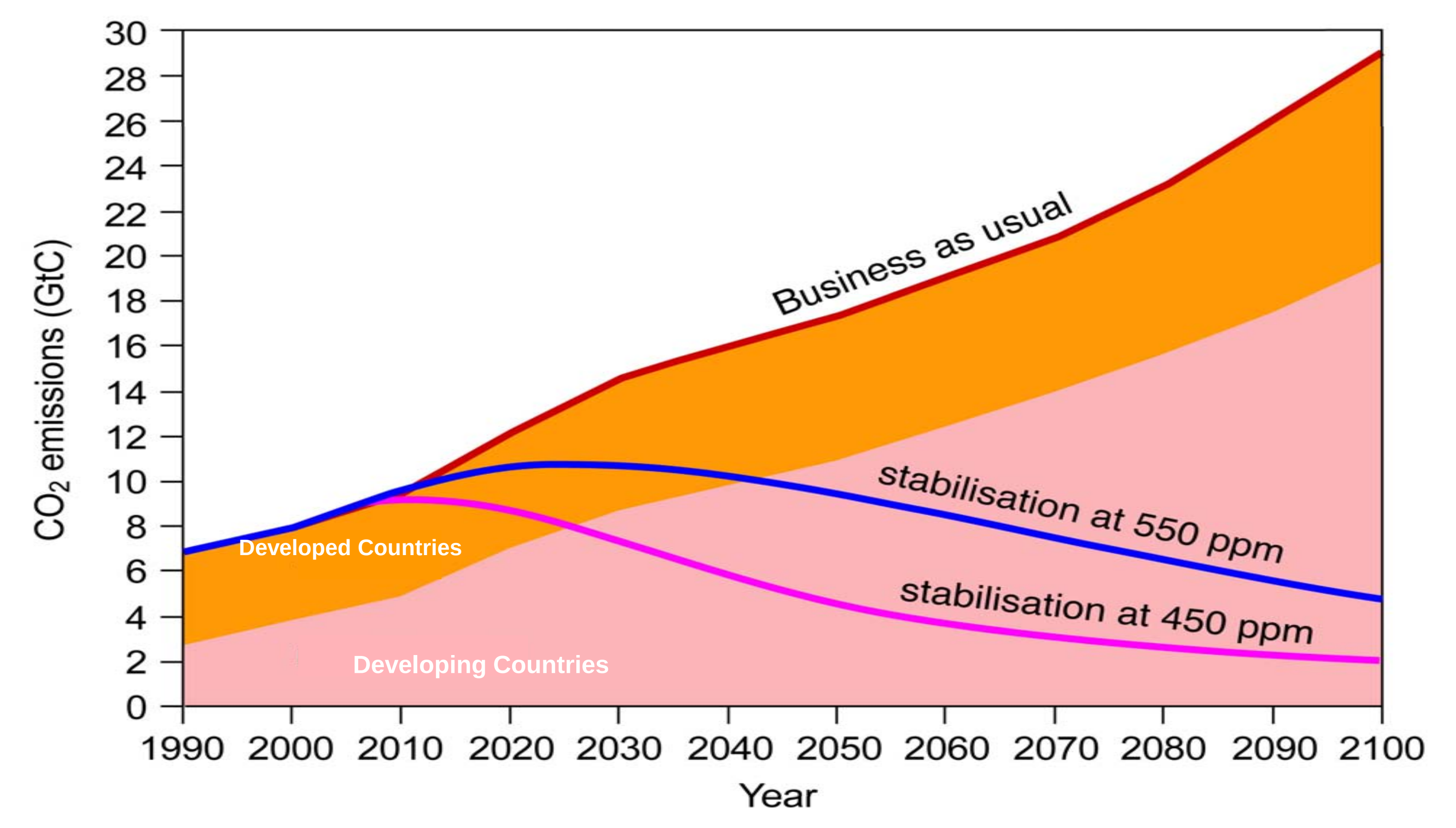
3 May 2007

Department for Environment Food and Rural Affairs

The challenge of stabilisation



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UK Vision for EU-ETS

- **Setting safe, stable and affordable emissions limits**
  - EU commitment to reduce emissions by 30% by 2020
  - EU commitment to reduce emissions by 60% by 2050
  - Commit to ensuring scarcity in EU ETS.
- **Building a global carbon market**
  - Cover more sectors and gases
  - Links to other cap and trade schemes
  - EU business to invest in emission reduction via CDM
- **Improving efficiency** through further technical changes
  - Length of trading periods
  - No anti-competitive distortions
  - More auctioning of allowances

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The UK's own ambition – the Climate Change Bill

- Enshrine in statute the Govt's target to reduce CO_2 by 60% by 2050
- Set up independent Carbon Committee to work with Govt to reduce emissions
- Have enabling powers to put in place new emissions reductions measures
- Improved monitoring and reporting arrangements

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UK Manifesto – drafted by Industry, NGOs and government

- EU ETS works and can be improved
- Clarity of post 2012 level of ambition and cap trajectory
- JI/CDM credits to be valid post 2012 and clarity on balance of effort between domestic and global action
- Minimising market distortion and increase transparency
- Harmonisation of implementation
- Expansion of scheme to be managed carefully and well signalled to maintain carbon market
- Linking to other schemes

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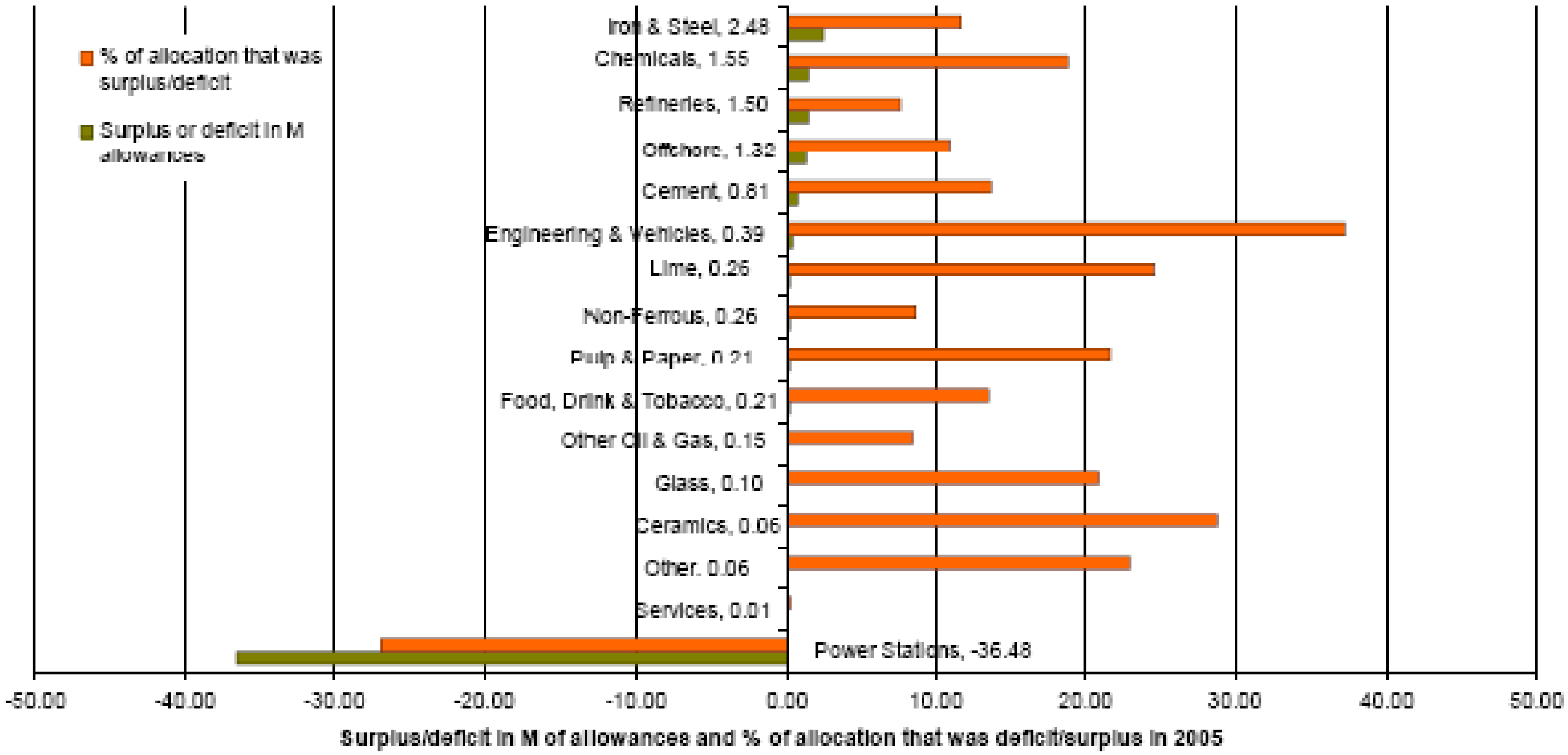
EU ETS - What happened in UK in 2005/6

UK Sector Allowance Surplus/Deficit - 2005

Figure 5. Sector surpluses, $MtCO_2$ and percentage of the total allocation to the sector



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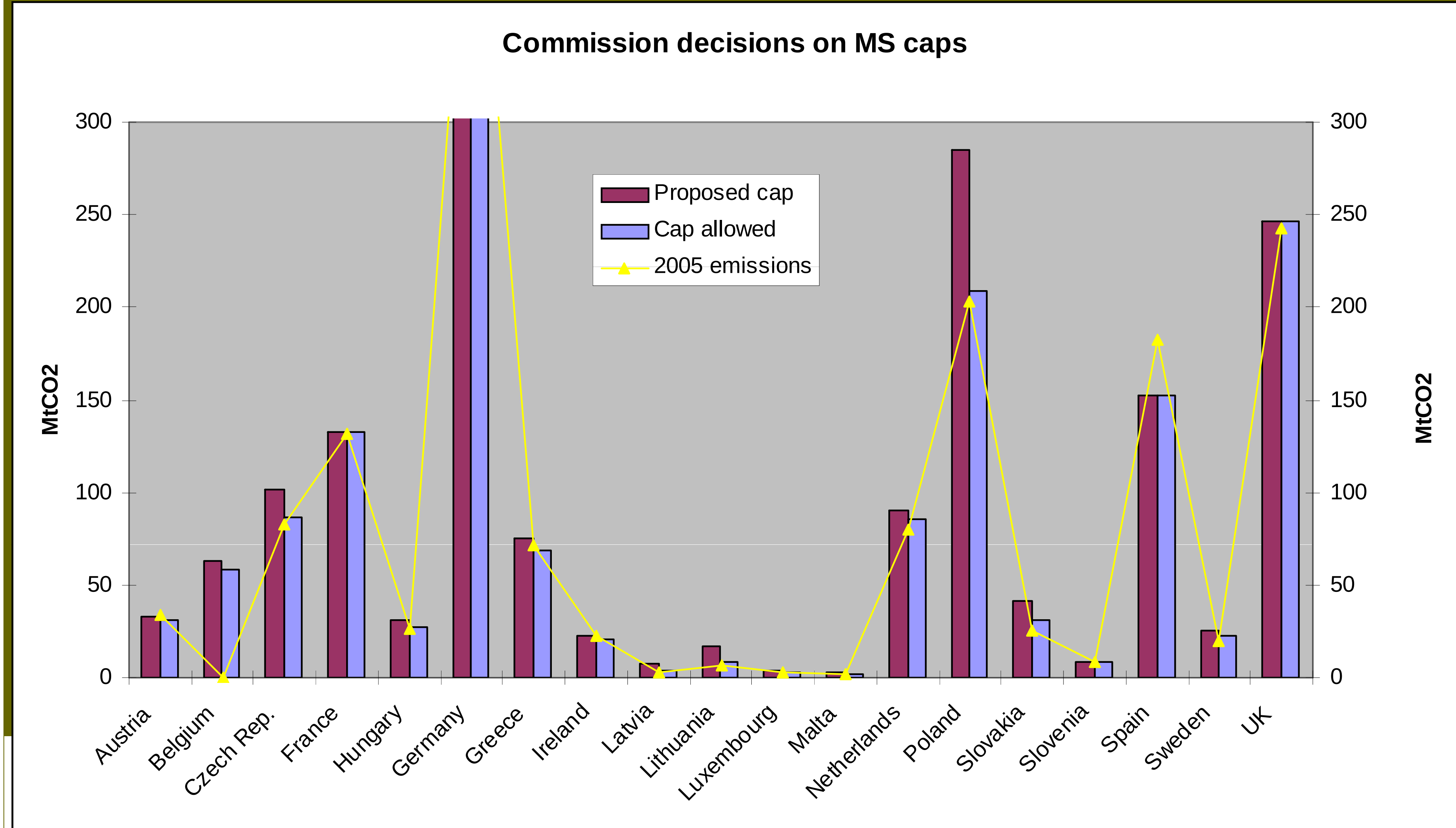
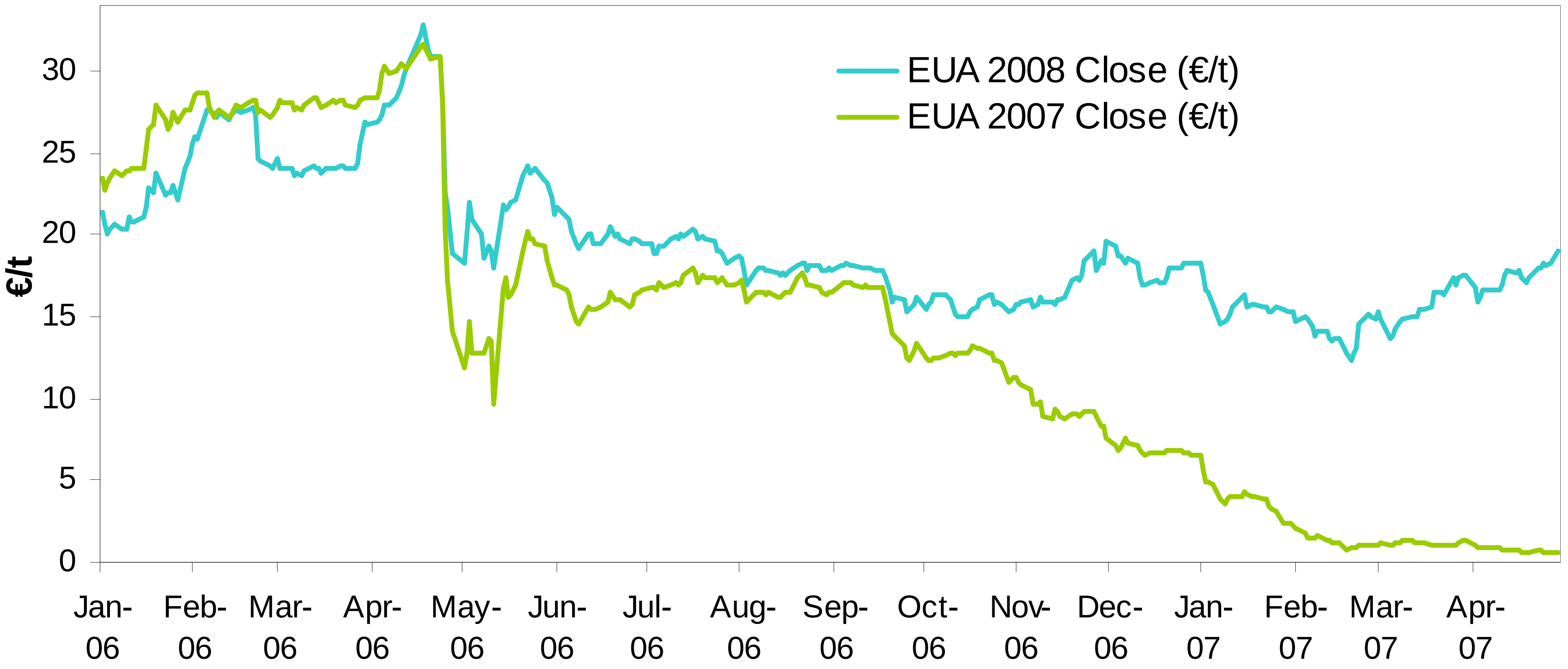
Phase II decisions



Market thinks Phase II looks better



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What lessons should we draw for Review?

- Need real scarcity
- More harmonisation of scope and rules
- Need to address competitive distortions – more auctioning
- Need good data as a basis for NAPs and their assessment

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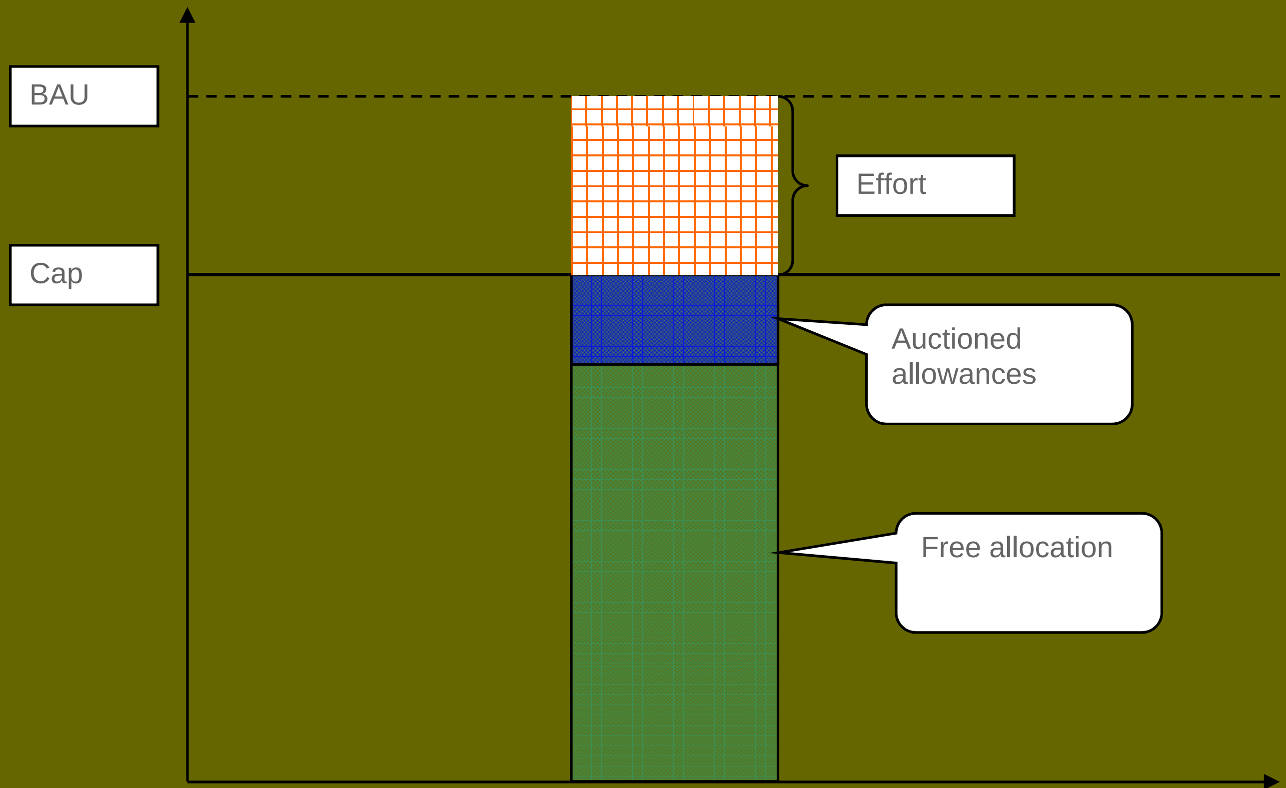
Environment vs Competitiveness?



Competitiveness & the EU ETS -the story so far

Studies to date suggest:

- competitiveness concerns have been over played.
- most sectors benefit in the short run (phase I& II) because of the level of free allocation.

But analysis is difficult and based on certain assumptions:

- Key factors like cost pass through have to be assumed as gathering evidence is difficult, especially given the limited data availability .
- Sector level results may mask sub sector impacts.
- Studies provide little insight into the distributional consequences of the scheme.

Going Forward - key questions about allocation methodology

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UK further analysis for the ETS Review

Led by UK Office of Climate Change: additional studies include

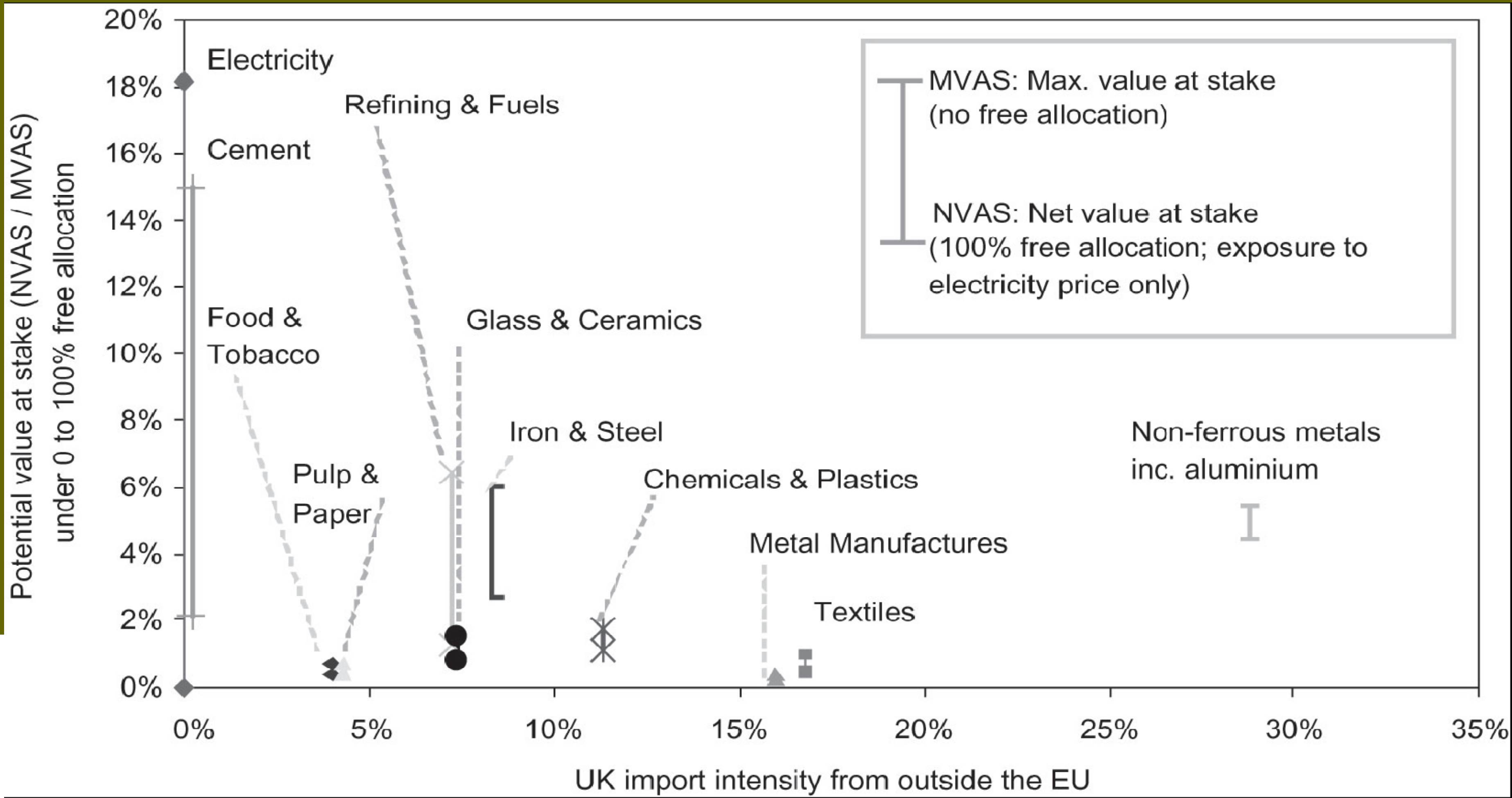
- Climate Strategies – detailed assessment of key sectors and UK competitiveness issues
- Oxford Economics – macro model of European economy, impacts of carbon price impacts on ETS sectors.
- ENTEC – cap setting option modelling

Emerging Findings

- Better to to tie the Cap tied to overall target (ie 20%/30% reduction rather than bottom up).
- Sectoral split based on projections/abatement potential or benchmark could result in significant redistribution from PII – so difficult to agree amongst MS?
- However, a sectoral split would reduce competitive distortions between MS, which in some cases may be considerable.

Health warning – not UK policy - yet to be finalised

Impact of non EU Competition on ETS sectors



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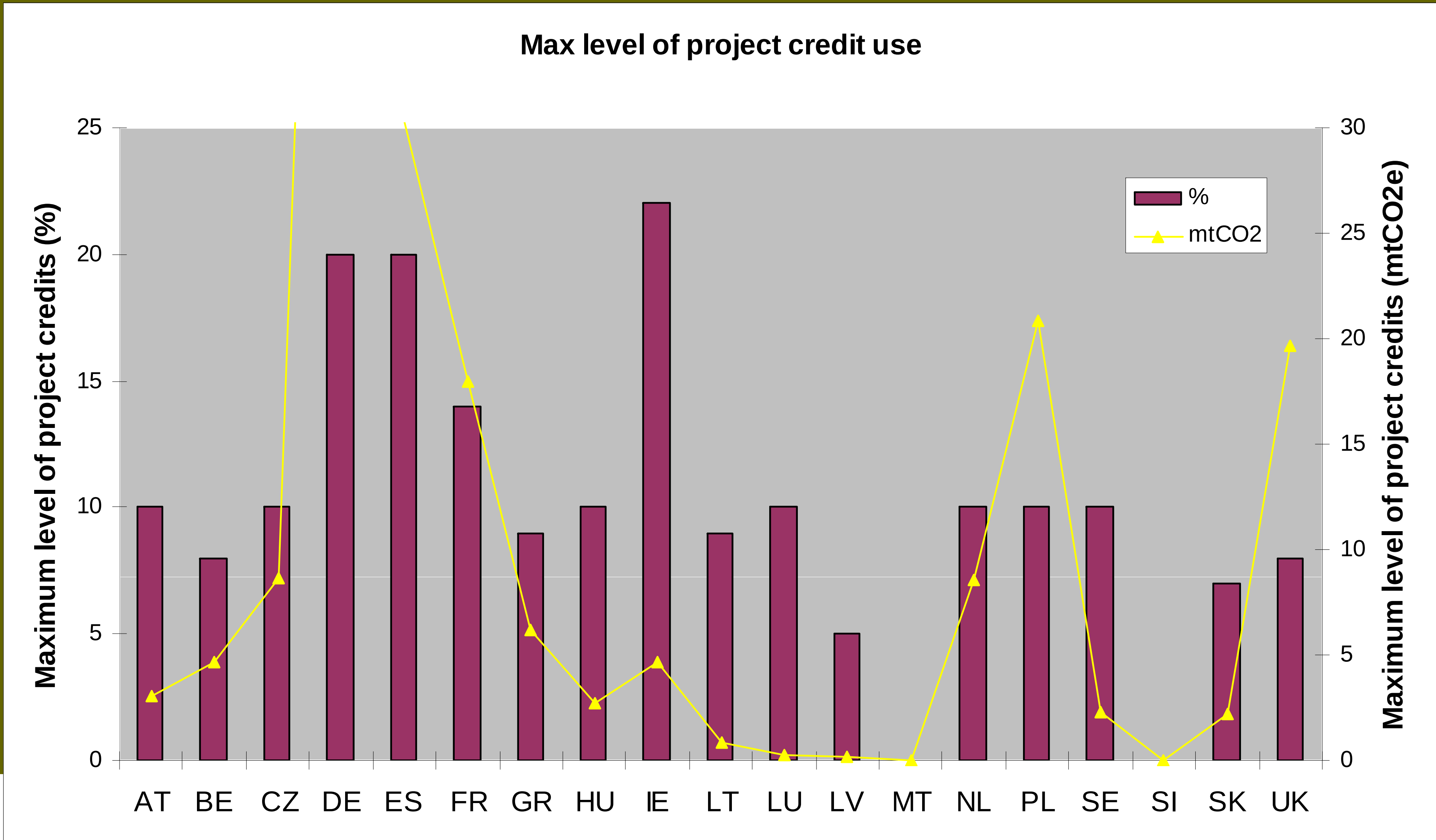
Kyoto Credits in EU ETS



EU ETS Competitiveness Issues Going Forward

- Central versus sectoral caps – extra versus intra competition
- Level of ambition/effort to 2020 and beyond
- Level of auctioning – evidence emerging that most ETS sectors **can** pass through cost of allowances **without** significant leakage
- Supplementarity & limitations on Kyoto credits within the EU ETS

But ……..

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Competitiveness - wider issues going forward.

EU ETS is but one – albeit principal – mechanism

Other policies going forward:

- Technology policy
- R&D – on technology
- Spend on renewabales - reducing the long run costs of the most viable technologies
- Carbon Capture and Storage
- Nuclear
- Skills – science and environmental science may be key.
- Planning issues
- Maintaining flexibility in the economies of Europe
- Expanding the scheme and linking

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Further information:

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