

UK Position on the EU Emissions Trading Scheme

1 The Stern Review of the economics of climate change confirms that climate change is a global problem needing a multilateral solution, and that we must act now in response. The Review points to the need for a carbon price signal across countries and sectors to ensure that emission reductions are delivered in the most cost-effective way. The UK Government set out its own priorities in the EU ETS Vision statement in October 2006,¹ which followed the Stern Review, and this annex builds on that initial statement.

2 Emissions trading is the UK's carbon price instrument of choice and a key component in a comprehensive UK policy framework to effectively mitigate climate change. Emissions trading ensures that the emissions from the sectors regulated are capped, but it allows emissions reductions to occur where they cost the least, thereby minimising economic impacts and maximising flexibility for industry.

3 The EU, with a strong lead from the UK, has built on the Kyoto Protocol to take the world's most significant step in establishing a carbon price by establishing the EU Emissions Trading Scheme. The scheme already covers approximately half of the UK and EU's carbon dioxide emissions, including emissions from electricity production and major industrial sectors. EU Heads of Government recently re-affirmed their commitment to the scheme, with the Spring Council "... *[underlining] the central role that emissions trading must play in the EU's long-term goals to reduce GHG emissions, and [stressing] the importance of the review by the Commission of the EU Emissions Trading Scheme in delivering an improved EU ETS that provides a market-based, cost-effective means to deliver emissions reductions at minimum cost – including as regards energy-intensive industries – and to make a major contribution to the EU's overall targets*".²

4 But emissions trading will not achieve its full potential to reduce emissions at least cost unless we get the design of the scheme right. It is crucial that we learn the lessons from the first Phase, which was always intended as a learning by doing phase. In particular, it is clear from the price of allowances in Phase I of ETS that there was a generous allocation of allowances in that Phase. Indications are that the market believes that the allocation for Phase II is much tighter, as shown by the higher price for Phase II allowances, and that it will lead to significant reductions from business as usual emissions. For the future, the UK believes that the EU ETS should:

- set safe, predictable and affordable limits on emissions, which tighten over time. The European Council meeting of Heads of Government in Spring 2007 committed to a 30% reduction in emissions below 1990 levels, in conjunction with other countries (and by 20% in any event). This was a

¹ Available on HMT website at http://www.hm-treasury.gov.uk/media/7E3/FC/foi_gore_2.pdf

² See page 23 Brussels European Council Presidency Conclusions, 2 May 2007 http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/93135.pdf



major step forward, and gives a clear signal about the direction of travel, and the firm commitment that the future will be carbon-constrained;

- be improved such that it is more efficient with fewer distortions. We need to move towards more auctioning of allowances, and to increase transparency. This may be easier to achieve with a more centralised cap setting process;
- cover the right emitters. We welcome the progress on the inclusion of aviation, and urge the EU to consider whether sectors that are not currently in the EU ETS should be brought in, including surface transport. The inclusion of other greenhouse gases should also be considered. We need to look carefully at whether small emitters can be excluded where they face a disproportionate regulatory burden, but where a sector is not suitable for inclusion in the EU ETS, it should face a carbon price through some other route; and
- form the hub of a global carbon market. Stern makes it clear that a global market is essential. Designed correctly, the EU ETS can become the basis of a global carbon market, delivering the emissions reductions necessary to stabilise the concentration of greenhouse gases at a level to avoid the most serious impacts of climate change. Properly constructed links between the EU ETS, the Joint Implementation (JI) and Clean Development Mechanisms (CDM), and other markets where possible, will make the carbon market deeper and more liquid. We welcome the fact that the ETS Directive provides for continued recognition of JI and CDM credits in the EU ETS post 2012, though we must ensure that such mechanisms deliver real emissions reductions. The UK is working with other countries and states to promote emissions trading, to share the lessons of existing schemes and to develop compatibility for possible future links. This year's review of the ETS Directive will provide an opportunity to remove some of the legal obstacles to linking with regional and non-Kyoto schemes.

5 We are working, using robust evidence and analysis, to build a widely shared UK and EU consensus on emissions trading and the actions necessary to strengthen the EU ETS (set out above). This will build on the strong commitment to emissions trading from all EU Heads of Government at the 2007 Spring Council. A key tool in building this consensus is the UK Manifesto on the EU ETS³, which was launched in March 2007. This showed that Government, business and NGOs agree on the basic principles for emissions trading as an effective way to deliver emissions reductions. The priorities identified in the manifesto are:

- a predictable trajectory for the level of emissions reduction required;
- exposing all of business, eventually, to a carbon price. We will look to deliver this taking into account concerns about competitiveness of EU industry, where industry in other countries does not face a carbon price;

³ Available on the DEFRA website at <http://www.defra.gov.uk/environment/climatechange/trading/eu/pdf/manifesto-uk.pdf>

- use of JI/CDM and a global market;
- harmonisation. Business wants a level playing field in Europe, to avoid distortions in the Internal Market. The UK will work within Europe to deliver this, which will help to make the market more transparent and efficient; and
- carefully managed expansion. Eventually the whole economy must face a cost for carbon.

6 We will also consider how best to give the necessary confidence in the long-term direction of the scheme; we will look to make early decisions on emissions caps, and at how to signal the direction of EU emissions reductions much further into the future. We will also continue to press the Commission to produce a legislative proposal as soon as possible. To ensure that we have the detailed views of UK industry to feed into the Commission's thinking, we launched an issues paper⁴ in March 2007, asking for views on a range of questions about the future structure of the scheme.

7 This long-term confidence will be helped by the welcome commitment at Spring Council to a 2020 emissions target. This shows that Governments are aware of and responding to the need for long-term signals about emissions. In the UK, the draft Climate Change Bill has proposed to set in statute emission budgets for the UK three carbon budget periods (each of five years) ahead. We need to consider how the UK's EU ETS cap will be made consistent with both the EU's overall commitment, and the UK's domestic policy goals.

