

## **GREEN PAPER ON GREENHOUSE GAS EMISSIONS TRADING WITHIN THE EUROPEAN UNION**

### **SUMMARY OF SUBMISSIONS**

#### **PART 1: NON-GOVERNMENTAL SUBMISSIONS**

##### **General**

There was a virtually unanimous welcome for the Green Paper, and the consultation process that it entailed. Market-based approaches in general were given overwhelming support, with the marked exception of energy taxes that were widely opposed by industry. While open to emissions trading as an instrument, submissions from business and their Associations generally expressed a preference for voluntary agreements.

The submissions received are very substantially in favour of using emissions trading as an instrument to combat climate change (e.g. “welcomes the Commission initiative seeking to establish a European system of emissions trading ...”). This is true of business and NGO submissions, as well as those of governments. The formulae that receives the most support is for a “framework” to be established at European level, while still allowing some flexibility for Member States to respond to national circumstances. Some submissions are opposed to emissions trading *at entity level*. However, a few others consider that insufficient elaboration is given in the Green Paper for them to take a position. A very few representatives of small businesses expressed strong dislike and opposition to emissions trading.

The economic argumentation in favour of emissions trading seems to have been well understood by businesses (e.g. “trading ... should be designed to ensure that the environmental commitments made by the Member States are fulfilled at lowest economic cost, thereby preserving the competitiveness of European industries”).

Furthermore, if there is going to be emissions trading, the large majority of submissions – with one or two exceptions – argued in favour of it being regulated to some extent at Community level, while leaving scope for adaptation to national circumstances.

Given the considerable number of submissions, and the diversity of the views expressed within them, it is difficult to “distil” any over-riding conclusions of a very specific kind. Beyond the basic favouring of trading as an instrument, there are few areas of consensus among the opinions expressed.

The biggest conceptual controversy concerns the merits of the partial downstream approach, as advocated in the Green Paper, and an “upstream approach” favoured by some submissions. Several, especially among the NGO submissions, would favour an upstream approach, arguing for its greater simplicity. However, little regard has been given to similarity with energy taxation, that business submissions were clearly opposed to.

There was still generally some confusion between the emissions trading that is foreseen by the Kyoto Protocol, and emissions trading at entity level within the European Union. Many references were made to the project mechanisms of JI and CDM, although these UN mechanisms were not the focus of the Green Paper. Furthermore, domestic “project-mechanism” offsets were advocated by some. Another point in terms of concept was that the Green Paper concentrated on process emissions exclusively, and credits for actions not directly related to process emissions should be foreseen.

## **NGOs**

NGOs, not surprisingly, argue in favour of robust environmental effectiveness, requiring strict targets, monitoring, verification and compliance functions (that should be exercised at Community level). They generally favour the auctioning of allowances as a method of initial allocation, and can only envisage trading with absolute targets for participating entities, as well as strong compliance. However, one argues that the method of allocation of allowances can be left to Member States.

## **Business**

Business submissions were united in not wanting an emissions trading system to place European businesses at a competitive disadvantage. They were also concerned that industry should not bear an unreasonable burden in relation to other sectors (e. g. transport, households), for which other policies and measures should be developed. Concerns were expressed many times by industry about the “incoherence” and inequalities of the “Burden Sharing Agreement”<sup>1</sup>. Several companies gave explicit support for an EU-wide emissions trading scheme (one argued, however, that the Commission should not “force-fit” emissions trading into existing policies and measures).

Businesses, unsurprisingly, argue in favour of their own business interests, in spite of rationalising their points of view more tactfully. The nuclear industry, as well as some others, wants the power generators – including nuclear generators - covered by a mandatory European system, and one wants allocation by benchmarking to allow carbon free generators to be allocated allowances as well. The predominately coal and lignite based generators argued in favour of historical grandfathering. Market intermediaries argued for sufficient liquidity and market depth, and those companies who provide verification services argued in favour of strong verification roles. Such self-interest is not in the least surprising, nor is any criticism intended in pointing this out.

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<sup>1</sup> The agreement between Member States sharing out the EU’s overall 8% emission reduction figure, recorded in the Council Conclusions of 16 June 1998.

Generally speaking, industry well understood the potential distortions of competition if 15 different emissions trading systems were allowed to develop unfettered. Some agreed with the energy intensive sectors approach of the Green Paper as a practical first step. Industry was fairly united in wanting as wide a coverage as possible, both in terms of sectors and in terms of greenhouse gases. However, one submission recognised that the inclusion of other greenhouse gases “must only be permitted when no doubt exists as to the accuracy and reliability of this monitoring”. The definition of sectors was identified as problematic in a number of submissions. Also, some preferred that definition of sectors to be covered by emissions trading should be left to Member States. Some also thought that entities falling below any size thresholds could and should be allowed to join emissions trading. Industry, with only very few exceptions, preferred grandfathering as a method of allocation.

Businesses argued in favour of a high degree of harmonisation of the method of allocation of allowances, although some argue for a combination of different methodologies. Some expressed the opinion that Member States should be left to decide the level and nature of caps both on individual companies and for the trading sectors as a whole. This was justified in terms of the burden sharing being different for each Member State, each having its own national climate change programme (an argument that some use to justify that the Community should confine itself to co-ordinating national schemes). A strongly held opinion expressed in a number of submissions was that there should be commonality in terms of sectoral coverage. In the same spirit of wanting to avoid distortions of competition, some submissions specifically argued against “opting-in” or “opting-out”, on the grounds that such options would give rise to undue complication. On the other hand, others argued in favour of the autonomy that such flexibility would give, even if in some cases it was considered more appropriate that individual entities have the option rather than the Member States.

If industry is to be covered by emissions trading, then it is generally felt that they should be exempt for other policies and measures (certainly taxes and possibly technical standards). Furthermore, some submissions argued that participation in emissions trading should be voluntary.

Some submissions did not believe that the Integrated Pollution Prevention and Control (IPPC) and Large Combustion Plant (LCP) Directives were the best place to start in terms of defining the sectoral coverage of emissions trading. The majority opinion, however, was to acknowledge the appropriateness of starting with the coverage of these Directives, while allowing for the inclusion of additional sources not within the scope of the IPPC Directive. However, one submission expressed the view that “emissions trading should replace regulation, not complement it”.

Some Industry Associations are explicitly in favour of a high degree of European harmonisation. A few express great reserve towards a Community role in emissions trading, while admitting the need for the Community to ensure that national schemes within the EU can trade with each other.

On a positive note, industry well understands that markets require robust monitoring and compliance, or the incentives to trade are undermined. However, submissions that argue in favour of co-ordinating national schemes rather than having an EU-wide scheme argue against an alignment of monitoring and compliance provisions. Some conclude that existing compliance provisions within the Community “either allow too

many possibilities of political interference or are too lengthy”: a suitable system of sanctions should therefore be created.

Some submissions show a high level of understanding, whereas others showed a poor understanding of trading, and how trading would fit into the overall implementation strategy. The argument was made in one submission from an industry association that emissions trading should be built up from the basis of national schemes, that should be progressively complemented at Community level, as well as arguing in favour of a “baseline and credit” approach to emissions trading.

Many submissions from business are naturally concerned about competitiveness, but made little distinction between the impacts on competitiveness of emissions trading as opposed to the impact on competitiveness of any policies and measures to address climate change.

Several submissions expressed a preference for the inclusion of relative targets, without necessarily explaining how these would interact with the absolute targets for Member States under the Kyoto Protocol. Several companies and Associations equate absolute caps with a cap-on-growth, notwithstanding that trading would enable allowances to be bought on the market, and so allow for expanding industries.

The issue of similar compliance and sanctions throughout the EU was generally supported where it was mentioned at all. The rationale for this is made in terms of potential distortions of competition. However, others argue that “during the learning process, no penalties should be imposed for non-compliance”. This statement begs the question why any company would pay to buy allowances if there are no sanctions for over-emitting?

The representatives of forest owners deplored the fact that the Green Paper omitted to encompass sinks within a European trading system. Support for sequestration projects is also given by others.

## PART 2: GOVERNMENTAL SUBMISSIONS

**EUROPEAN PARLIAMENT:** The **European Parliament** was largely supportive of the initiative for an emissions trading system to be introduced at Community level as part of a wide-ranging strategy on climate change. The potential economic benefits of the involvement of entities in emissions trading were underlined. According to the **Parliament**, the Green Paper should not have confined itself to examining a “downstream” system, especially in the context of rising emissions from the transport sector in particular. However, it agrees with the Commission’s suggestion that the LCP and IPPC Directives constitute a good place to start in defining the coverage of emissions trading. The **Parliament** also expressed its opinion that allocation methodologies should reflect the “polluter pays” principle, and that auctioning allowances might distort competition less. However, the allocation of allowances to individual companies should remain at Member State level, subject to the Commission playing a more active watchdog role to ensure compliance with competition and state aid rules. Finally, the **Parliament**, as well as the **Committee of Regions** emphasised how important a robust system of tracking and enforcement was, as well as minimum standards of monitoring, reporting and verification procedures.

**ECONOMIC & SOCIAL COMMITTEE + COMMITTEE OF THE REGIONS:** Apart from favouring a Regulation as the legal instrument of choice, the **Economic and Social Committee** favours a grandfathering of allocations on the basis of benchmarking and voluntary participation in trading. The **Committee of Regions** favours wider sectoral scope for emissions trading, including the transport sector.

**AUSTRIA:** The sectoral coverage proposed in the Green Paper can be supported as a starting point, although other sectors should be eligible for inclusion if they can satisfy the monitoring criteria. Austria supports the creation of an EU-wide trading system, and places particular emphasis on harmonising the initial allocation of emission rights, as well as the greatest possible agreement on sector-specific emission targets. Austria considers that an EU system should be compatible with national and Kyoto Protocol trading systems, and that the creation of an EU scheme would not affect the distribution of competence between the EC and the Member States.

Austria’s preference is for an EU-wide system, and considers there to be a pressing need for the harmonisation of framework conditions, including taxes and other requirements, to avoid distortions of competition. It should be ensured that a certain minimum number of sectors are treated in the same way in all participating Member States. In terms of allocation methods, it is of central importance to ensure competition is preserved. For this, the harmonisation of framework conditions in all Member States is desirable. These framework conditions include taxes and requirements, as well as the setting of standards for energy efficiency and best practice.

The Austrian Ministry of Environment (that made additional comments) favours auctioning as a method of allocation. Ideally, agreement should be reached at

European level on auctioning as the preferred allocation method. Emissions trading should suppose absolute targets rather than relative (the latter, if used, needing to be converted to absolute emissions). Relative targets may be used, but in such case, trading should be “ex post” if and when absolute reductions are achieved.

**BELGIUM:** Belgium does not want discussions on emissions trading to continue forever. “The best will be the enemy of the good”. Feasibility of implementation is crucial. The Commission is encouraged to rapidly declare its intentions, including in respect of other policies and measures that are to feature as part of the overall strategy. The Community should start emissions trading sooner than 2005. While Belgium acknowledges the economic rationale for including a maximum number of sectors, it is more feasible to adopt the approach of the Green Paper and start with a limited number of key industrial sectors (representing a substantial proportion of emissions). The Commission should establish a specific list based on a combination of sectors drawn from the relevant annexes of the IPPC and LCP Directives. Emissions trading should build on procedures and institutions foreseen in the IPPC Directive. Belgium favours a harmonised Community system of emissions trading, with all the important variables determined at Community level, if possible by Regulation rather than Directive (so as to avoid differences of transposition). A harmonised European emissions trading is particularly important for “smaller” Member States that do not have within their frontiers sufficient critical mass. If opting-out is allowed, as part of a deal to allow agreement, it should be subject to equivalent effort through other policies and measures, and a temporary derogation from the Community system. Amounts of allowances allocated and allocation methodologies should be agreed at European level to prevent the distortion of competition within the internal market. Monitoring, reporting, verification and compliance should all be harmonised at EC level.

**DENMARK:** Denmark supports the Commission’s interest in emissions trading. It agrees that we should start early and develop the system gradually in the light of experience. “There is every reason to move forward carefully by starting with a limited system containing few and well defined sources”. It supports starting with CO<sub>2</sub> within the energy production and energy intensive sectors. “Especially the liberalisation of the electricity sector in the EU necessitates a united and harmonised regulation of CO<sub>2</sub> emissions, so that increased competition and trade with electricity contributes to both economic and environmental efficiency”. Protection of the internal market is best secured by a common agreement with similar terms on emissions trading within the Community. The total amount of allowances within the individual Member States must be agreed at Community level, although Member States must not be prevented from securing a higher level of environmental protection. Denmark favours the auctioning of allowances, as well as the use of absolute targets rather than relative targets. “There will no doubt be need for common rules or guidelines ... in regards to setting minimum financial penalties”.

**FINLAND:** Finland expresses support for emissions trading generally, but that further work and analysis should be undertaken on several issues. Opinions are rather qualified, using the excuse that the Green Paper’s analysis does not go very far. The Green Paper is criticised for “scant and unsystematic consideration given to the allocation of emissions allowances”. However, it is clearly acknowledged that “There would seem to be an obvious need for a Community emissions trading scheme, especially from the economic point of view”. Allocation is felt to be the most important question. “Fair treatment of companies in different Member States requires

the same rules to be applied when allocating allowances”. Few other clear statements are made, except that the sectoral coverage proposed in the Green Paper offers a “useful starting point”.

**FRANCE:** The French submission raises more questions than it answers, and considers several aspects that warrant further consideration. In particular, reflecting an issue of concern to France in the context of the Kyoto Protocol, the submission criticises the Green Paper for not addressing the organisation of the market of emissions trading, and, in particular, the issue of creating exchanges where trades can be carried out in a “transparent” and “efficient” manner. International competitiveness is a key sector for defining the scope. Preference for “as harmonised a system as possible for energy intensive industries”, although later the submission argues a preference for opting-out – on condition that MS demonstrate equivalent effort through alternative measures. France favours a Community approach to allocation to individual companies based on benchmarking. A harmonisation of minimum compliance sanctions is desirable, but that compliance should be an issue for Member States to implement.

**IRELAND:** Ireland states that “The development of a Community-wide pilot scheme is a necessary prelude to full international emissions trading and it is intended that Ireland will actively participate in the development and implementation of the scheme”. Ireland would like the possibility of including more sectors than those listed in the Green Paper – conditional upon them being satisfactorily monitored. It also favours some choice as to whether to participate in a “voluntary scheme”. Ireland argues that allocation is a matter for Member States, not the Community. “Burden sharing” having been decided, it is now for Member States to decide on the policy-mix, and the stringency of those policies, in meeting their target. The Commission should provide detailed guidelines on the allocations to individual firms. On compliance, apart from underlining the need for strong and verifiable compliance, Ireland argues that “There is a role for the European Union in ensuring that Member States are in compliance, and that individual States do not gain competitive advantage through non-compliance”.

**ITALY:** The Italian submission states that the IPPC and LCP Directives are a good place to start in defining the sectoral coverage of emissions trading. Italy supports, furthermore, that participation be limited to those for whom reliable monitoring and control procedures can be applied. Preference is expressed for a comprehensive yet simple system, rather than the complexities of “opting-out” subject to the proviso that equivalent policies and measures be applied to the sectors excluded from trading. The Italian submission states that “It is desirable to avoid the creation of a certain number of national markets, as this could generate quite substantial distortions”. The Italians oppose the idea that the total amount allocated to the trading sectors be agreed at Community level, but they argue in favour of the amounts for individual sectors within each Member States being agreed at Community level to avoid distortion of competition. They argue for co-ordination in the method of allocation to similar sectors in different Member States. Finally, the frequency and method of controls should be co-ordinated at Community level. The standardisation of monitoring and control systems set up by Member States should be guaranteed by an organisation at Community level.

**NETHERLANDS:** The Dutch Government’s submission advocates that particular consideration should be given to the “exposed sectors” of the economy, that is to say,

those sectors most exposed to international competition, and whose competitiveness is crucial in global markets. The Netherlands favours an early start to emissions trading with a view to “learning-by-doing”. The Commission should establish as soon as possible a number of framework principles. This is needed to stop developments in different Member States from diverging further. The approach to trading recommended by the Netherlands is the “baseline and credit” method, where companies trade around a hypothetical baseline that has been negotiated with Government. The Commission should ensure that EU competition law prevails. The Commission should also provide a central registry of trades, establish standards of certification for credits generated under the system and for the monitoring of emissions. Finally, the Commission should ensure that there are no conflicts with existing or future Community legislation.

On coverage, the Netherlands believes that emissions trading should start with the most energy-intensive sectors. There is no need for a perfectly level-playing field within the EU. The Burden Sharing Agreement was the levelling that was needed. From hereon, it is for Member States to decide on their policies for reaching their targets. “The internal market is difficult to reconcile with a flexible system”. The inclusion of additional sectors should be allowed. Member States should be allowed to fix the stringency of targets and determine the method of allocation. There should be a common EU-system for the “exposed sectors”, but such arguments would not hold for “sheltered sectors”, where “harmonisation arguments” were much weaker. Strong monitoring capability is needed to ensure that policies and measures, as well as emissions trading, are functioning well and are delivering the expected benefits.

**SWEDEN:** Sweden agrees with the Commission that in the short-run it is more realistic to include only CO<sub>2</sub> in an emissions trading scheme. However, Sweden favours broad sectoral coverage, and finds considerable merit in an “upstream” trading system, recommending that this option be further considered. An “upstream” system would cover emissions from the transport and household sectors. In any case, Sweden favours as wide coverage as possible, for reasons of economic efficiency. In a similar way, Sweden believes that auctioning is the most efficient way of distributing credits. The same method of allocation should be applied for all entities if there is to be a “level-playing field”. The existing Community monitoring mechanism “does not seem to be the ideal instrument since it primarily uses a top-down approach to monitor emissions and it is difficult to get information on an individual plant basis”. Sweden also argues that “it is paramount that the same sanctions apply to all Member States”.

**UK:** The UK welcomed the Commission’s promotion of emissions trading within the Community. “There is clearly a Community dimension to emissions trading, particularly in relation to the need to protect the integrity of the Single Market”. The idea that there should be some core sectors is accepted (that can be extended by the Member States subject to satisfactory monitoring capability), and that guidelines were needed on how targets should be set and allowances allocated. The Community framework “should not be too prescriptive”, and should not constrain Member States’ ability to meet their Kyoto commitments in a way that reflects national circumstances. The UK favours the “opting-in”/“opting-out” scenario. The UK explicitly says that wide coverage throughout the Community need not necessarily come from a common scheme, but “could also be achieved through a system of co-ordinated national schemes”. It considers that more should have been said in the Green Paper on maintaining compatibility with emissions trading under the Kyoto Protocol.

Therefore, any Community framework should be seen as a stepping stone towards the full international emissions trading system. The IPPC/LCP Directives are considered a good place to start in defining sectoral coverage, but some adaptations would be warranted. Targets should not be fixed at EC level (“Looking across the Member States, it is clear that there are very different starting points and scope for reductions behind the burden sharing arrangements. This would need to be recognised by any Community framework”). Somewhat in contrast to the Dutch argumentation, the UK argues that “Member States should not be allowed to systematically favour with less effort those sectors most open to international competition”. Finally, there would be no need to mandate particular allocation methodologies: the Commission will be able to vet allocations according to state aid rules on a case-by-case basis, although revised state aid guidelines would be warranted.

**Scottish Environment Agency:** Prefers all sectors to be able to join. Favours a common scheme throughout the EU as opposed to multiple fragmented schemes. Favours common allocation. Uniform standards of enforcement, monitoring and infringement procedures are “essential”.

**Norway:** Norway, as a member-country of the EEA, welcomes the Green Paper as a “very constructive and interesting contribution to developing emissions trading...”. Norway is thinking of introducing its own emissions trading scheme, and recognises the need for close co-operation with developments within the Community. The Green Paper envisages “a fairly narrow system” both in respect of sectors and gases. Norway rather favours the widest possible coverage. In particular, they would favour Member States being able to include additional sectors. Expanded state aid guidelines on the allocation of allowances is considered necessary. Maintaining full compatibility with emissions trading under the Kyoto Protocol, when that starts in 2008, is also considered to be particularly important.

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