



The EU as Climate Change Leader?

The Kyoto Protocol and the EU Emissions Trading Scheme

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Climate Focus

1. Introduction

- Ever since the United States announced their decision not to ratify the Kyoto Protocol, the European Union (EU) found itself the role of the alleged international climate leader. When the US withdrew from the Kyoto process, the EU found itself with a half negotiated set of implementation guidelines for the Kyoto Protocol and a treaty which had a long time to go before it would enter into force. However, under EU leadership the international community managed to formulate a consensus on the so-called 2001 Marrakesh Accords, and persistent EU support for the Protocol paid off when the Russian Federation ratified the Protocol.
- The Kyoto Protocol entered into force on February 16, 2005. If much energy has been used to come to this point, even more is needed to comply with the Protocol's obligations and commitments. In parallel the negotiations on the 'second commitment period' or the "post-Kyoto" regime officially started at the occasion of the 11. Session of the Conference of the Parties ("CoP") to the UNFCCC which coincided with the 1. Meeting of the Parties to the Kyoto Protocol and was held in December 2005 in Montreal. While the US is unlikely to actively assume a leadership role in the next years, it is the EU which has to show whether it can live up to the challenge to help formulating a sustainable, fair and effective international climate change policy.



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- The European Community (EC) and its Member States have adopted an impressive set of policy instruments designed to curb greenhouse gas (GHG) emissions in the territory of the EU. The creation of a community wide emission allowance trading scheme is one of the most innovative of such instruments. However, while a few Member States (notably the UK and Germany) have a fair chance to meet their emission reduction targets, set both under the Kyoto Protocol and the EU Burden Sharing Agreement, most are behind schedule and a number (such as the Netherlands, Spain, and Italy) are a long way behind. Progress in the implementation of national policy measures is slow; emissions of certain sectors, such as transport, are steadily increasing throughout the Community, and energy supply and generation still largely relies on the, often inefficient, use of fossil fuels.

2. The UNFCCC and the Kyoto Protocol: Background

- The ‘United Nations Framework Convention on Climate Change’ (UNFCCC)¹ was adopted on May 9, 1992 at UN headquarters, New York and opened for signature at the Earth Summit in Rio de Janeiro in June 1992. Three months after the 50th ratification document had been submitted, the Convention entered into force on March 21, 1994.
- At the occasion of the third session of the CoP to the UNFCCC, which took place in Kyoto, Japan, in December 1997, the Kyoto Protocol (the Protocol) was adopted. Under this landmark treaty, the industrialized Parties to the UNFCCC are submitted to legally binding targets (countries listed in Annex I to the treaty) to reduce GHG emission in 2008-2012. According to the treaty, Parties will have to cut their emissions by an average of 5.2 percent from 1990 levels.²

¹ United Nations Framework Convention on Climate Change, 31 I.L.M. 849 (1992), May 29, 1992.

² This number includes the US and Australia, countries which have made it clear that they would not ratify the Kyoto Protocol.



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- To achieve their Kyoto targets, countries have to rely mainly on domestic action. However, among the most innovative features of the Kyoto Protocol are the so-called ‘flexible mechanisms’ under which the Parties may achieve some portion of the required emission reductions beyond their own borders through the use of a variety of economic instruments. As the global climate system benefits from reductions in greenhouse gas emissions wherever they occur, making reductions in developing countries and countries with economies in transition as part of a national strategy of industrialized countries (which of course also includes the implementation of national mitigation policies) will make the costs of reaching emission reductions targets cheaper.
- Through the flexible mechanisms the Protocol foresees the creation of markets for GHG emission reductions through project-based emission crediting or emission trading. Two of these instruments are available only to countries with qualified targets: Joint Implementation (JI) set forth in Article 6 and International Emission Trading set forth in Article 17 of the Kyoto Protocol. In addition, the Kyoto mechanisms also include in Article 12 a Clean Development Mechanism (CDM), which aims to enhance co-operation among industrialized and developing countries to achieve sustainable development and reduce emissions.
- UNFCCC and Kyoto Protocol are setting a robust framework for international climate policy. The UNFCCC serves as broad discussion platform which enjoys almost universal support and ensure the involvement of the US and other non-Kyoto Parties. The Kyoto Protocol in the meanwhile ensures that the necessary infrastructure for further climate mitigation efforts is being established. Whether through international inventories, registries or the design of an international emission trading scheme, the Kyoto Protocol is crucial not only for achieving emission reductions but for setting the scene of any other future climate treaty. The flexible mechanisms play an important role in this process, forging partnerships between developing and industrialized countries, the private and the public sector.



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3. The EU as Negotiator

- The EU is an important player in the formulation of international environmental law. The EC and its Member States are actively participating in international processes and are parties to numerous multilateral environmental agreements. The specific nature of the EU as well as the allocation of competence and responsibilities between the EU, the EC, and the Member States raises a number of legal and political questions which merit further analysis.
- Generally, the legislator competent to adopt internal rules, is also authorized to represent the EC externally. Such competence includes the authority to enter into treaties and bind the EC and its Member States in the area of its competence. This means that where the EC has the competence to adopt legal instruments, such as in the area of environmental policy, such competence includes the competence to act in the context of international environmental negotiations.
- During the negotiations of the UNFCCC and the Kyoto Protocol Member States coordinated their negotiating position and a climate change strategy began to emerge. The European Commission failed in its attempt to be given a mandate to coordinate the EU position, and progress in developing a coherent negotiation position largely depended (and still depends) on the country holding the EU Presidency. However, the influence of the Commission that has had a consistently pro-active attitude towards the issue cannot be underestimated; it has played a key role in the development and adoption of new policy instruments.
- The UNFCCC and the Kyoto Protocol fall under so-called ‘mixed agreements’ due to their cross-cutting character. Generally, these agreements concern rights and obligations which relate to the Community on one hand, to the Member States on



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the other. Both the UNFCCC and the Kyoto Protocol have been ratified by the EC and the Member States.

- Soon after the adoption of the Kyoto Protocol, in June 1998, the European Council had reached an agreement on the targets of its Member States under a “Burden Sharing Agreement”, which adjusted the national targets under the Kyoto Protocol within a common European “bubble”. This burden sharing agreement as legally binding agreement under Community law has allocated the Kyoto targets among the member states and made the obligation binding long before the Protocol entered into force.

4. In a Nutshell: EU Position in International Climate Change Negotiations

- It was as early as 1988 that the European Commission first officially recognized the need for a legislative response to the increasingly disturbing phenomenon of the greenhouse effect. In October 1990, the European Council agreed that it was willing to take actions aimed at reaching stabilization of the total CO₂ emissions of the Community by 2000 at 1990 levels, assuming that “other leading countries undertook similar commitments”.³ The commitments in this declaration formed the main basis for the European position in the negotiations leading to the 1992 UNFCCC.
- Throughout the 1990s the EU claimed “environmental” leadership in the international negotiations process which led to the adoption of the UNFCCC and the Kyoto Protocol. This leadership found its expression in the commitment to hard targets and increased commitments of industrialized countries. For reasons of environmental integrity the EU opposed the idea of international emissions trading much supported by the US negotiators. Somehow paradoxically, it pushed at the same time for the possibility of meeting commitments jointly between a group of

³ See reference and quote in the recitals of Decision 93/389/EEC (OJ L 167, 9.7.93, 31-33).



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countries. Throughout the process, the EU as a whole (although not supported by all member states) also showed reluctance and skepticism towards increased flexibility through the use of the Kyoto mechanisms, CDM, JI and International Emissions Trading.

- The environmental and political ambitions of the EU in the international process were not always matched by diplomatic skill or a sense of realistic solutions. The EU is also plagued by a chronically complicated coordination process among its Member States. A common position, once found, can hardly be altered, and leaves little room for negotiations with third parties. It is also important to note that the EU position for the longest time was dominated by a small number of well-prepared member states.

5. The EU Emission Trading Scheme

- The Community has developed a broad suite of domestic “policies and measures” to meet its Kyoto target. In 2001, the EC formulated a package of twelve priority measures, including the establishment of an emission trading scheme, a combined heat and power (CHP) directive, a regulatory framework for fluorinated gases, and an action plan for the implementation of these measures. Since then, the EC has developed a number of measures. Such measures include the adoption of a Directive promoting CHP,⁴ of an indicative target for the share of renewables in the

⁴ Directive 2004/8/EC of the European Parliament and of the Council of 11 February 2004 on the promotion of cogeneration based on a useful heat demand in the internal energy market and amending Directive 92/42/EEC, Official Journal L 052 , 21/02/2004 P. 0050 –0060.



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generation of power is 22%,⁵ or of a Directive establishing a community wide European Emission Allowance Trading Scheme (EU ETS).⁶

- The European Parliament approved in its second reading on July 2, 2003 the establishment of an EU ETS. The objective of this scheme is to reduce the emissions of greenhouse gases in an efficient and cost-effective manner. As the EU ETS has been adopted in the legal format of a Directive, each member state has to transpose the Directive into national law. The EU ETS therefore consists of 25 emission allowance trading schemes, which are linked to each other. Allowances are tradable and fungible among the member states.
- The EU ETS is mandatory for all sectors listed in the annex of the Directive: combustion installations with a rated thermal input exceeding 20MW, mineral oil refineries, coke ovens, production and processing of ferrous metals, mineral industry (cement clinker, glass and ceramic bricks) and pulp, paper and board activities. Starting 2005 all operators of covered installations had to hold a national EU ETS permit which establishes the quantity of emission each installation is allowed to emit. Permit holders received a matching amount of allocations each year. They will have to surrender each year the national regulator a number of Allowances equal to the total emissions from their installations during the preceding calendar year. Allowances can be traded in the marketplace and transferred between accounts via an internet based registry system with electronic accounts.
- The objective of the EU ETS is to give flexibility to industry to identify the most cost-efficient GHG abatement possibilities. The effectiveness of the scheme depends

⁵ Directive 2001/77/EC of the European Parliament and of the Council of 27 September 2001 on the promotion of electricity produced for renewable energy sources in the internal electricity market, 27.10.2001; OJ L 283/33, 2001.

⁶ Directive 2003/87/EC of the European Parliament and of the Council, of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC.



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largely on the allocation of allowances from the national governments to the covered installations. The scheme is based on 5-years periods with a pilot period covering the years 2005-2007. At the time of writing, Member States are in the process of drawing up the National Allocation Plans for the second allocation period (2008-12). An analysis shows that the national allocation plans of the pilot period were generally very generous which will limit the emission reductions achieve through the scheme. It will be interesting to see whether governments and operators have learned to get used to the scheme, that the second allocation of allowances will be more stringent, thereby bringing the EC closer to its Kyoto target.

- The scope of the Directive initially did not link the EU ETS to emission credits under the Kyoto Protocol. It therefore did not allow Emission Reductions Units or Certified Emission Reductions generated by JI or CDM projects respectively imported into the EU to be converted into EU Allowances. To remedy this, the EU has adopted a Directive to amend the EU ETS to link the scheme to emission reduction units that comply with the Kyoto Protocol.⁷

6. Experiences with the EU ETS in Operation

- Despite some flaws in the design, the EU ETS can be regarded as a success: Studies show that the scheme leads to the pricing in of GHG emissions in the production of energy and goods. It also influences investment decisions and has created an internationally used reference price of GHG emissions. It has also created an unprecedented public awareness of the subject of global climate change.
- Concerns with respect to the scheme relate to the short allocation periods and the missing investment security, distortions in competition, the need for harmonization of the allocation, and windfall profits of the power sector.

⁷ Directive 2004/101/EC of the European Parliament and of the Council of 27 October 2004 amending Directive 2003/87/EC establishing a scheme for greenhouse gas emission allowance trading within the Community, in respect of the Kyoto Protocol's project mechanisms.



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- The EU ETS has boosted the demand for CDM and JI credits. Prices for credits from CDM and JI projects have more than doubled since the establishment of the scheme. The private sector is pushing in the CDM markets which actively involve developing countries in the compliance mechanisms of the Kyoto Protocol. The Kyoto mechanisms are set to channel billions of Euros in emissions limiting projects in developing countries and those with economies in transition.

7. Concluding Remarks: The EU as Climate Change Leader

- The EU has been an active participant in international climate change negotiations. While the EU acted as “environmental leader” throughout the UNFCCC/Kyoto Protocol process, pushing for more stringent targets, it has assumed political leadership only after the US pulled out of the Kyoto Protocol.
- While it is certainly true that the EU has been on the forefront of negotiating climate change commitments, the Union’s claim to act as guardian of the environment is not always reflected in negotiation positions.
- Whether the EU can live up to the task of a real leader of the process will depend on its ability to find positions acceptable for a broad number of countries; it will depend on its diplomatic skills, its flexibility, creativity and sense for the possible. A condition for such leadership role is an increased efficiency in the internal decision making.
- It is not clear whether the EC will be able to meet the joint target of the Community. The EU will not achieve the Kyoto target with the measures in place at that time, however, it has the potential of exceeding the target if it implements all additional policies and measures it is planning to implement.



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- One of the most ambitious measures to curb GHG emissions in the EU, is the recently adopted EU ETS. The emissions allowance trading scheme covers sectors responsible for 40% of the Community's emissions. Whether the scheme will lead to real and measurable reductions in the EU, will depend on the allocation of allowances from national governments to the covered installations. The allocations for the years 2005-2007 seem to be too generous to tap industry's emission reduction potential sufficiently.
- With insufficient emission reduction in the EU, governments as well as the private sector will have to make use of the Kyoto flexible mechanisms, CDM, JI and International Emissions Trading to meet the Community target. It is therefore likely that the EU, which initially opposed the including of the mechanisms in the text of the Kyoto Protocol, will be the greatest user and beneficiary of the flexibility provided.

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