



The EU Emission Trading Scheme And Renewable Energy Support Mechanisms Workshop

EU ETS – one year of experience and outlook

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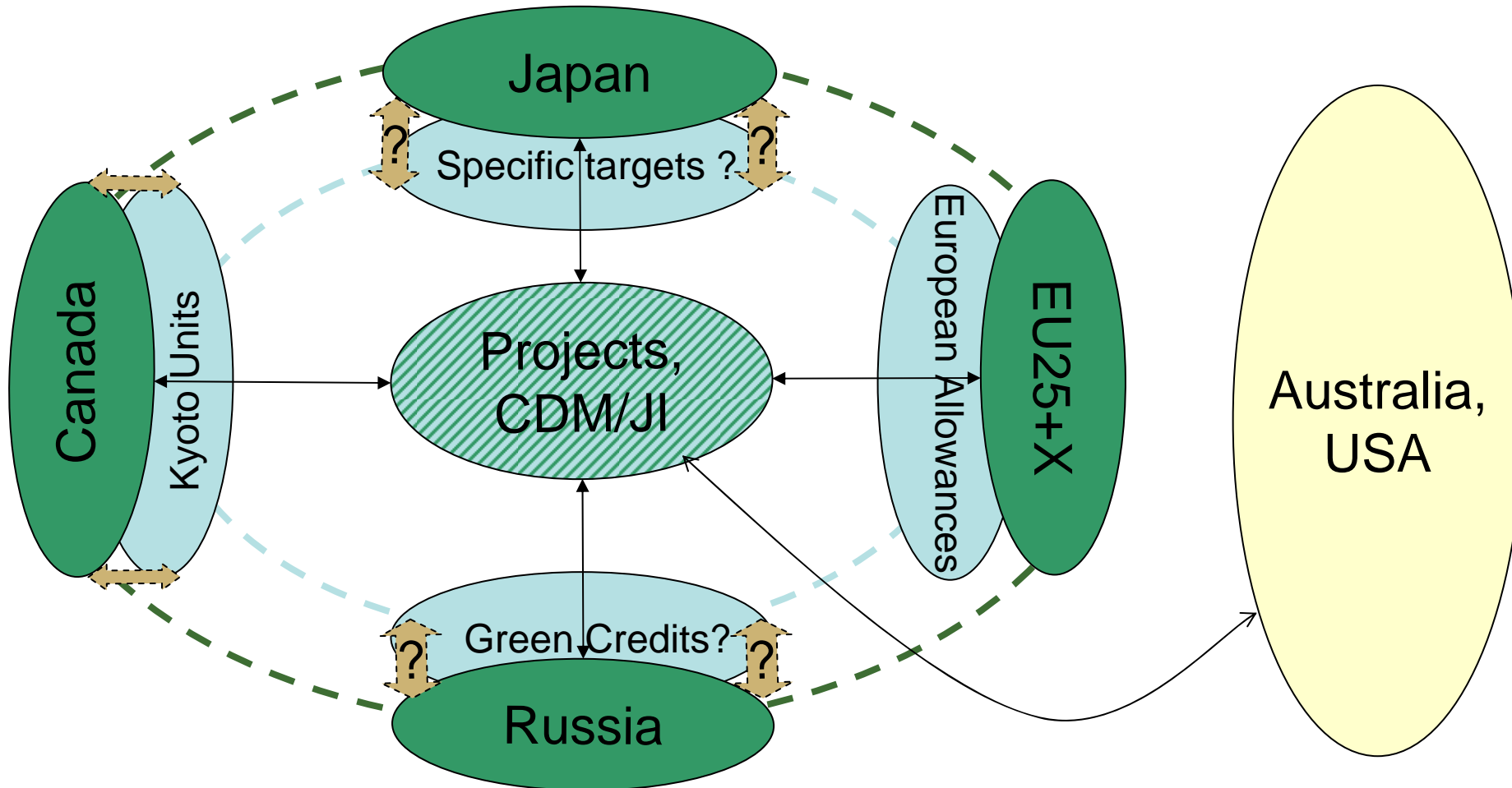
Highlights in 2005

- The EU ETS started on 1st January 2005
- The Kyoto Protocol entered into force
- First CERs were issued
- Exchanges for GHG trading started operating
- COP/MOP 1 in Montreal consolidates the flexible market mechanisms
- The JI Supervisory Committee created.
- International agreement to continue negotiations for post 2012.



Global GHG Market

- Kyoto Party-Level
- Entity-Level
- Non-Kyoto Party





The Emissions Trading Directive

- A national zero game
- Allocation defines scarcity in relation to Kyoto targets
- Allocation is relevant for all sectors
- EU Directive is a mix of “shall” and “may” provisions
- Leaves leeway to member states



The EU ETS – “learning by doing”

- World’s largest emission trading scheme: nucleus from which an international market can emerge
- Will contribute towards fulfilment of the Kyoto Protocol
- Least cost solution which incentivises energy efficiency and innovation of clean technologies
- EUAs a common currency throughout Europe
- Commission scrutiny has turned out to be crucial to ensure scarcity
- Learning by doing – market functioning issues still to be resolved
- Governments take time to comply (e.g. NAPs)



Market response - 2005

- Volumes increase as trading is picking up fast:
 - Traded volumes in EU allowances via brokered-OTC transactions were 8.44 Mt CO₂ in 2004, versus 306.68 Mt CO₂ traded volumes in 2005 (including exchanges).
- Prices Fundamentals:
 - allowances should be lower than business as usual driving efficiency in the use of energy (stringency of the target)
 - Banking and borrowing between the two national allocation periods
 - Issuance of CERs as equivalent to EUAs



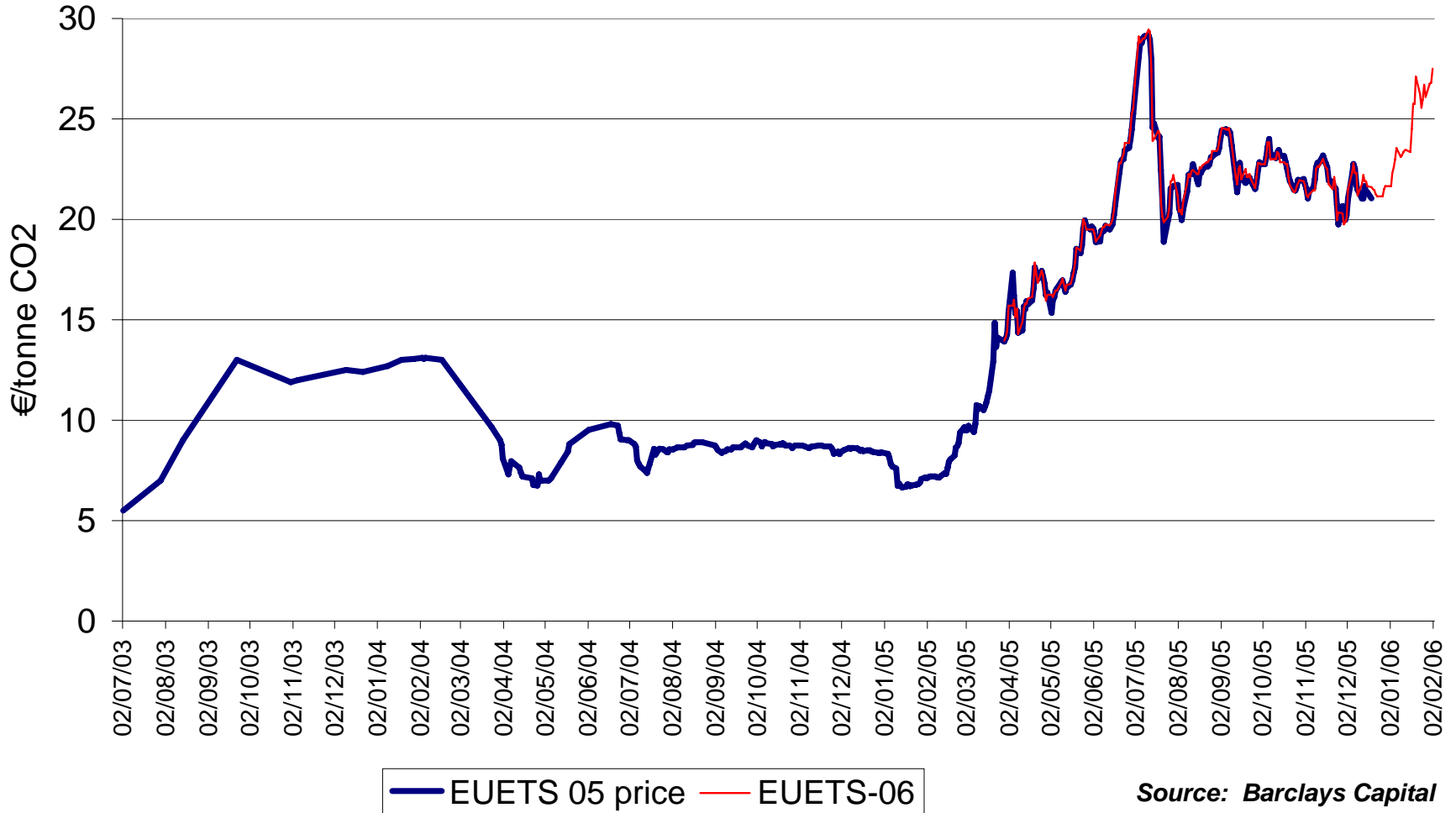
Key drivers in prices for EUAs versus CERs

- EUAs
 - Relative fuel prices: a relative high gas price encourages the use of coal, driving demand for CO₂ allowances.
 - Weather: a cold winter will trigger more demand for energy and hence CO₂.
 - Economic growth: Demand will increase with economic activity.
- CER/EUAs price differences due to
 - Very different delivery risks
 - EUAs are a guaranteed compliance tool
 - CER national percentage caps
 - CER contracts can run to 2012 (EUAs only until April 2008 first allocation period)



Historical Prices

Historical Carbon Allowance Prices



Source: Barclays Capital



What makes the success of the EU ETS

- Liquidity (+/-)
- Price transparency (+/-)
- Low transaction costs (+)
- Registries (+ ITL) (+/-)
- Implementation of the M&R guidelines (-)
- Tapping into reduction opportunities through the use of CDM and JI (-)
- Linking with other trading schemes in Annex 1 states (-)



Next steps in 2006

- Speeding up of the legislative process: Linking Directive only implemented by 7 EU Member States
- Registries need to be on-line to bring along more market players
- Monitoring, Reporting and Verification – implementation and harmonisation
- The CDM process still needs further streamlining to allow early transfer to CERs (ITL, EB)
- JI Supervisory Committee to function



A snap shot on 2008-2012

- To meet their Kyoto targets EU states are likely to
 - reduce the amount of EU allowances distributed to the trading sector (by 6 %) and increase their GHG purchases to cover shortfalls in their Kyoto targets.

Areas for change, in particular:

- Expansion of the scheme to other gases and sectors primarily relevant for post 2012 but earlier implementation regarding aviation possible.
- Allocation rules to be harmonised



Conclusion

- The EU ETS is learning by doing
- The trading sector will see more pressure towards Kyoto targets
- Market functioning issues need to be solved
- CDM and JI to provide for liquidity in the market but infrastructure needs to be in place



For more information

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