ETS- Emission Trading Systems

Emission Trading Systems (ETS) are market-based mechanisms designed to reduce greenhouse gas (GHG) emissions. The concept is rooted in the idea that putting a price on carbon can incentivize businesses and industries to reduce their emissions more efficiently. Here's an explanation of how Emission Trading Systems typically work:

1. **Cap and Trade:** ETS operates on the principle of "cap and trade." A government or regulatory body sets an overall cap on the total amount of certain greenhouse gases that can be emitted within its jurisdiction. This cap is typically set to decline over time, reflecting the government's commitment to reducing overall emissions.
2. **Allowances:** Under the cap, the government issues a certain number of emission allowances, with each allowance representing the right to emit a specific amount of greenhouse gases. These allowances can be allocated to industries, power plants, or other entities covered by the system.
3. **Trading:** Entities subject to the ETS can buy or sell allowances among themselves. If a company can reduce its emissions at a lower cost than its allocated allowances, it can sell its surplus allowances to other companies that may find it more expensive to cut their emissions.
4. **Compliance:** At the end of a specified period (such as a year), covered entities must surrender allowances equal to their actual emissions. If a company has reduced its emissions, it may have surplus allowances that it can keep for future use or sell on the market.
5. **Penalties:** Entities that exceed their allocated allowances and do not have enough surplus must buy additional allowances on the market or face penalties. This creates a financial incentive for companies to reduce emissions below their allocated levels.
6. **Market Dynamics:** The trading of allowances creates a market price for carbon, which reflects the supply and demand for emissions rights. This price signal encourages companies to invest in cleaner technologies and processes to reduce their carbon footprint.

ETS can operate at different scales, from regional systems to national or even international ones. The European Union Emissions Trading System (EU ETS) is one of the most prominent examples, covering multiple member states and a variety of industries. The goal of ETS is to provide a cost-effective approach to achieving emission reductions, promoting innovation, and helping countries and regions meet their climate targets.

ETS reform under the EU Green Deal

To align the emissions trading system with the higher emission reduction targets of the European Green Deal, the EU agreed in December 2022 on an update of the scheme, cutting industry emissions by 62% by 2030.

What are the reforms?

Compared to the original proposal by the Commission, MEPs wanted more ambitious goals. The changes following the deal between Parliament and EU governments include:

- Further decreasing the number of annual allowances available until 2030 to cut emissions 62% by 2030, one percentage point more than the Commission proposal (61%).
- Increased financing for innovative technologies and to modernise the energy system via an Innovation Fund and a Modernisation Fund. A share of revenues from the new trading system will be allocated to the Social Climate Fund, which aims to support households and businesses affected by energy poverty.

- The phasing out of free allowances to industry by 2034, while the EU's Carbon Border Adjustment Mechanism will simultaneously be phased in and fully operational by 2034. The mechanism would apply a carbon price to imported goods from less ambitious countries and prevent companies moving production to a country with less stringent greenhouse gas emission rules.
- Extension of the scheme to include maritime transport
- The inclusion of emissions from municipal waste incineration installations from 2024.
- The creation of a separate emissions trading system (ETS II) for buildings and road transport as of 2027. ETS II could be postponed until 2028 to protect citizens, if energy prices are exceptionally high and a new price stability mechanism will be set up to ensure that if the price of an allowance in ETS II rises above €45, 20 million additional allowances will be released.
- The revision of the Emissions Trading System for aviation aims to phase out free allowances to the aviation sector by 2026 and to promote the use of sustainable aviation fuels.

All revenues from the Emissions Trading System will be used exclusively for climate-related activities[1].

1 https://www.europarl.europa.eu/news/en/headlines/society/20170213STO62208/the-eu-emissions-trading-scheme-ets-and-its-reform-in-brief?at_campaign=20234-Green&at_medium=Google_Ads&at_platform=Search&at_creation=DSA&at_goal=TR_G&at_audience=&at_topic=Emissions&gclid=CjwKCAiA9dGqBhAqEiwAmRpTCz3eHLXnXMDs1LRyF2HLt2gR2tlQNinnoey5DXZe7agI8hiR3bvV2hoCUXYQAvD_BwE