

NAT/136
Greenhouse gas emission
allowance trading

Brussels, 29 May 2002

OPINION

of the

Economic and Social Committee

on the

**Proposal for a Directive of the European Parliament and of the Council
establishing a scheme for greenhouse gas emission allowance trading within the
Community**

and amending Council Directive 96/61/EC

COM(2001) 581 final - 2001/0245 (COD)

On 11 December 2001 the Council decided to consult the Economic and Social Committee, under Article 175 of the Treaty establishing the European Community, on the

Proposal for a Directive of the European Parliament and of the Council establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC
COM(2001) 581 final - 2001/0245 (COD).

The Section for Agriculture, Rural Development and the Environment, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 6 May 2002. The rapporteur was **Mr Gafo Fernández**.

At its 391st plenary session (meeting of 29 May 2002), the Economic and Social Committee adopted the following opinion by 93 votes to one, with four abstentions.

1. Introduction

1.1 In March 2000 the European Commission published a Green Paper on greenhouse gas emissions trading within the European Union. This Green Paper launched a far-reaching and open debate with the various stakeholders in European civil society, many of whose suggestions are included in this draft directive. The Committee also had the opportunity to issue an opinion on the Green Paper¹.

1.2 The scheme for greenhouse-gas emission allowance trading, together with the Joint Implementation Mechanism and Clean Development Mechanism of the Kyoto Protocol, are designed to reduce the cost and macroeconomic impact of implementing the Agreement and thereby facilitate compliance by the signatory states.

1.3 The Kyoto Protocol will not be legally binding until 2008. However, the European Commission has decided to bring forward the implementation of this mechanism at Community level to 2005, so as to have sufficient time to run it in and, if necessary, fine-tune it before it officially enters into force.

1.4 There are two reasons why a legislative system needs to be set up at Community level. Firstly, it will harness synergies to reduce costs overall; this would be much more difficult to achieve if the Member States were acting individually. Secondly, it will prevent the economic fragmentation of the emissions market and the Member States possibly drawing up national criteria that distort competition.

1.5 Central to the scheme are the concept of emission allowances, the greenhouse gases concerned, and the sectors and/or installations covered by the Directive.

¹ CES 1004/2000, OJ C 367 of 20.12.2000, p. 22

1.6 The emission allowance is the amount of greenhouse gases that an installation is authorised to emit into the atmosphere over a given period of time, as granted by the competent authority in the Member State.

1.7 With regard to the six greenhouse gases covered by the Kyoto Protocol, the Commission has decided that the scheme will initially cover CO₂ alone in order to simplify the initial implementation of this mechanism and owing to the difficulty of monitoring, at the moment, emissions of the remaining gases.

1.8 With regard to the sectors and installations covered by the Directive, Annex 1 lists them as energy activities (with a rated thermal input exceeding 20 MW), the production and processing of ferrous metals, the mineral industry, and the production of pulp and paper. CO₂ emissions from thermal installations exceeding 20 MW in sectors not mentioned in this Directive are, however, also covered by it.

1.9 The scheme is based on four key areas: (i) a national emissions allocation plan, (ii) a system of individual permits, (iii) a system for monitoring compliance, including the use of penalties, and (iv) a mechanism for emissions trading between the participating entities.

1.10 The national allocation plan will be drawn up for the initial period 2005-2008, and for each subsequent five-year period. For each period, each Member State will determine the total quantity of emission allowances to be allocated and the national allocation criteria. After 2008, the Commission will specify a harmonised method of allocation.

1.11 The granting of emission allowances begins with an application by the installation operator to the competent authority to be issued with an emissions permit based on the productive and technical parameters of the installation. The competent authority will issue an individual emissions permit, allocating emission allowances free of charge during the 2005-2008 period, and will stipulate emissions monitoring requirements and the operator's annual obligation to surrender a number of allowances, either their own or of a third party, equal to their total emissions during the preceding year.

1.12 In accordance with the guidelines for monitoring and reporting emissions adopted by the European Commission, the Member States, in cooperation with the competent authorities responsible for issuing permits, will ensure that operators comply with their emissions permits. Member States will be able to impose a penalty on operators who fail to submit for cancellation each year enough allowances to cover their actual emissions. These penalties will be lower in the 2005-2008 period.

1.13 The emissions trading scheme begins with a registry system established in each Member State, which will be standardised at Community level in the form of electronic databases. The European Commission will designate a Central Administrator to maintain an independent

transaction log. Transactions will be carried out on a commercial basis by the entities or persons specifically authorised in the Directive. The details of these transactions will be private.

1.14 At international level, the Community may also conclude agreements with third countries to provide for mutual recognition between the Community scheme and schemes in third countries.

1.15 Finally, the Commission may make a proposal by 2004 to extend the scope of this Directive to include other gases and activities and may submit a report by 2006 on the application of this Directive, accompanied by proposals as appropriate.

2. General comments

2.1 The Committee welcomes this Directive, as it is innovative (and may, therefore, be subject to fine-tuning, on the basis of experience gained in some European Union countries) and will help to achieve - at the lowest possible cost and with the lowest impact on the economy and employment in the European Union - the national commitments to reduce greenhouse gases provided for in the Kyoto Protocol, which also provides for direct emissions trading between Member States. The Committee has always given its unreserved support to the approval and ratification of this Protocol.

2.2 However, while the Committee shares the ultimate objective of this Directive, it does have a number of reservations concerning the proposal itself.

2.3 The first discrepancy is found in the subject matter of the Directive, as laid down in **Article 1**. The Committee does not agree with this. As stated in the Committee's opinion on the Green Paper on this subject, the purpose of this Directive should not be to "*promote reductions of greenhouse gas emissions in a cost-effective manner*" but "*to ensure that greenhouse gas emissions are reduced in a manner that is cost-effective and minimises the impact on competitiveness and overall employment in the European Union*".

2.4 Secondly, the Committee has a number of doubts concerning the coercive implementation of this Directive during the transitional period 2005-2008 (i.e. before the official entry into force of the Kyoto Protocol).

2.5 Thirdly, the Committee sees no justification for the exclusion of other greenhouse gases in the initial proposal or for the failure, as of 2008, to consider the other two flexibility mechanisms provided for in the Protocol.

2.6 The Committee also has reservations concerning the compatibility of this Directive with the functioning of the internal market and, in particular, the requirement that this system does not distort competition as a result of differing interpretations of the conditions governing emissions in each installation by the competent authorities in each country. Likewise, the Committee does not agree with the way its relation to the Directive on integrated pollution prevention and control (IPPC

Directive) is defined and, in general, the fact that emissions allowances are seen as a "burden" rather than as a "potential benefit" for companies making an additional effort to reduce emissions. Each of these aspects will be discussed with reference to the relevant article.

2.7 The Committee therefore proposes deleting the paragraph in **Article 2(2)** referring to Directive 96/61/EC.

2.8 In **Article 3** (Definitions), the Committee proposes the following changes:

2.8.1 "*Installation*": *A technical unit in a single location where one or more activities listed in Annex I are carried out.*

2.8.2 Replace "Person" by "*Operator*" and define as follows: "*Any natural or legal person who can demonstrate sufficient interest in participating in this system.*"

2.9 **Article 6.** Add the following: " An obligation to surrender allowances *or credits generated by Clean Development projects or Joint Implementation projects* equal to the total emissions..."

2.10 With regard to **Article 9** (National allocation plan), a number of Member States have developed their own methods for achieving national emissions objectives and thereby meet their obligations under the Kyoto Protocol. These alternative methods must be included in this Directive as flexibility mechanisms that help maintain the *acquis* achieved, providing that Member States can demonstrate that they are making the same effort as this Directive.

2.10.1 Installations in these countries compete mainly with enterprises outside the EU, which do not have to bear the burden of emission quota costs or taxes on emissions; thus the implementation of the directive would reduce the competitiveness of such firms.

2.11 The Committee therefore proposes completing **Article 9** as follows:

2.11.1 Add two new sub-paragraphs to paragraph 1:

- Six months before 1 January 2005 and 2008, and six months before each subsequent five-year period, the Member States shall notify the European Commission of installations that they intend to include in or exclude from the scope of this Directive. These installations must be clearly identified and precise reasons given.
- The Commission, in accordance with the general procedure applicable to the National Allocation Plans, may exclude such installations from the scope of this Directive, after verifying that:

- 1) as a result of national policies, including sector-specific or other voluntary agreements under public supervision, these installations make an effort to reduce their emissions in such a way as to achieve the same results as this Directive;
- 2) these installations are subject to the same monitoring and verification procedures provided for in Articles 14 and 15 for other installations covered by this Directive.

2.12 **Article 10:** Method of allocation

2.12.1 The Commission proposes allocating emission allowances in tonnes of CO₂, and thereby limits the use of other indicators. However, other measurement systems may be appropriate for some installations.

2.12.2 Two important examples are energy efficiency objectives and those based on "standard references" that are widely recognised and accepted as such. The proposal should therefore consider these alternatives and include them in Annex 3 as valid options for Member States within their overall strategy.

2.12.3 The proposal should also stipulate that a transitional period is needed following the entry into force of the Kyoto Protocol to assess the suitability of the method of allocation in each Member State and its compatibility with the internal market. This is necessary to verify the suitability of the mechanism and find a harmonised system at Community level that is compatible with the emission allowances mechanism provided for in the Protocol for all the signatory states.

2.13 The Committee therefore proposes the following:

2.13.1 **Article 10(1):** Replace with: *"Until the period beginning 1 January 2013..."*

2.13.2 **Article 10(2):** Replace with: *"In accordance with Article 26(2), the European Commission shall propose a harmonised method of allocation that shall be applied as of 1 January 2013 and which, in the event that a fee is charged for these allowances, must take account of energy taxes paid by companies to avoid double taxation".*

2.13.3 The Commission should also ensure that no damage is done to the internal market in the period up to 2013 and broadly speaking should, by means of the harmonised method of allocation, ensure a level playing field among Member States.

2.14 **Article 12(1):** Replace "persons" with *"operators"*.

2.15 **Article 13.** Validity of allowances. Paragraphs 2 and 3. Replace "persons" with *"operators"*.

2.16 **Article 16.** Penalties: The penalties provided for in this article must not under any circumstances be applied before the entry into force of the Kyoto Protocol's first commitment period

in 2008. At the same time, penalties must not exclude the subsequent surrender of credits. Until 2013, therefore, penalties can only have the symbolic value of forcing operators to develop the market in allowances, without the aforementioned penalties being seen as disproportionate. Furthermore, the reference to a "market price" is very vague owing to the fact that transactions between operators are confidential. The Committee therefore suggests the following:

2.16.1 Amend Article 16(1) as follows: "...The penalties provided for must be *effective and proportionate, in accordance with the provisions of paragraph 3, and may be applied following the entry into force of the Kyoto Protocol.*"

2.16.2 Amend the second part of paragraph 3 as follows: " The excess emissions penalty shall be EUR 50. Payment... ."

2.17 **Annex I:** In the paragraph referring to energy installations, replace "exceeding 20 MW" with "*exceeding 50 MW*". This will focus the Directive in the initial phase on those sectors or individual installations with the highest greenhouse gas emissions without affecting small plants such as large hospitals or other installations of a similar size. The exclusive reference to CO₂ also needs to be removed so that all greenhouse gases are covered. However, the Committee also believes that the aforementioned threshold of 50 MW could be revised in 2006 in the light of new electricity production or combined cycle technologies, as part of the review provided for in Article 26.

2.18 **Annex III:** The following changes are proposed:

2.18.1 In paragraph 4, remove the reference excluding electricity produced from renewable energy. This will allow renewable energy sources to be included with biomass, thereby improving their market penetration and increasing security of energy supply within the European Union.

2.18.2 Add the following to the end of point (3): "*In particular, consideration may be given to other methods of allocation used by the Member States, providing these are based on widely recognised "standard references" and achieve the same results as the methods proposed in this Directive.*"

2.18.3 In point (6), replace "new entrants" with "*new companies or new installations*" and complete the end of the paragraph as follows: "... Member State, *or the manner in which the increased capacity of existing installations shall be considered in such a way as not to discriminate against these new activities.*"

2.18.4 Include a new point (6a) as follows: "*The plan shall take account of the appropriate formulae to prevent the competitiveness of a given sector or installation being compromised disproportionately, as well as the methods used to ensure compatibility with the internal market.*"

2.19 Add the following to the end of the point (7): "*Likewise, when allocating individual allowances, consideration shall be given to efforts made by the installation concerned to reduce*

emissions since 1990, and to the real possibilities for the sector and individual installation concerned to make additional efforts to reduce emissions."

Brussels, 29 May 2002.

The President
of the
Economic and Social Committee

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of the
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Göke Frerichs

Patrick Venturini
