CLIMATE ACTION NETWORK EUROPE

NATIONAL ALLOCATION PLANS 2005-7: DO THEY DELIVER?

KEY LESSONS FOR PHASE II OF THE EU ETS

Summary for policy-makers

SUMMARY

This summary for policy-makers is based on a CAN-Europe report[1] evaluating the way the EU Emissions Trading System (ETS) has been implemented by Member States in the first trading period 2005-07. The report is based on input from environmental NGOs from across Europe, who analysed their respective National Allocation Plans (NAPs) on the basis of their benefit for the climate. It highlights concrete positive and negative examples against the original purpose of the system and the text of the directive establishing the ETS. The conclusions from the analysis in this report aim to inform the design of the next round of NAPs by recommending key improvements to ensure that the EU ETS delivers maximum benefits for the climate.

1. Emission limits set by Member States for the first phase were a major disappointment. To ensure maximum environmental benefit of the ETS and the overall success of the system as a whole, they need to be strengthened considerably. The Kyoto targets require ambitious caps with absolute reductions for the phase 2008-12.

2. The allocation rules need to implement the simple principle that is embodied by the ETS: more pollution equals higher cost. In the period 2005-7, many Member States have not implemented this principle well, and distorted the signal to favour more polluting technology. This can be corrected in the phase 2008-12, with member states making maximum use of product-based benchmarks and auctioning as priority mechanisms within the system and rules that give clear incentives for investment into reductions.

3. There was a significant lack of transparency in most Member States processes to determine their NAPs. This has resulted in questions on the validity and legitimacy of the crafting and data within the NAPs. Member States must open up the processes in the second phase, consult early with civil society and make all information publicly available to allow independent verification.

The assessment of the NAPs for 2005-07 involved the input of NGO experts from around the EU. Their specific knowledge on the respective national climate policy backgrounds and the actual experience of the NAP processes in individual Member States have added valuable insights to the report that a desk research exercise alone could not have produced. The evaluation of the main indicators has been based on consensus among the contributing experts and within the wider Climate Action Network Europe and can therefore claim to represent the view of a broad range of environmental groups.

[1] National Allocation Plans 2005-7: Do they deliver? Key lessons to Member States' for 2008-12; due April 2006

I. CO^2 CAP-AND-TRADE AS A KEY INSTRUMENT FOR EU EMISSIONS REDUCTIONS

The EU Emissions Trading System

The EU Emissions Trading System (ETS) commenced operation on 1st January 2005. It covers carbon dioxide (CO^2) emissions from large point sources in key industry sectors (incl. energy, paper, metal, cement). The EU ETS is the first mandatory international trading system for greenhouse gas emissions in the world, and regulates around 11,400 installations (owned by ca. 5,000 companies) across Europe. Together, they emit more than two billion tonnes of CO^2 every year - nearly half of the carbon emitted in the EU25. This makes the ETS the single most important instrument in the policy toolbox created at EU level to reduce emissions of climate change gases to meet the international obligations under the Kyoto Protocol until 2012 and beyond.

National allocation plans

While the ETS directive adopted in 2003[2] defines the architecture of the system, decisions on the limits set for the covered industry sectors and the rules that guide the distribution are in the hands of national governments. This information is communicated through National Allocation Plans (NAPs) formulated and submitted by each Member State for every trading period, which then undergo assessment by the European Commission. The first round of these plans was prepared in 2004 for the period 2005-07, largely regarded as a learning phase.

In 2006, EU Member State ministries need to send in their NAPs for the trading period 2008-12, which coincides with the Kyoto Protocol's 1st commitment period. These NAPs do not just concern the sectors covered by the ETS. To justify the emissions limits set for the ETS, Member States need to provide details on all sectors that contribute to national emissions and show how together these will allow compliance with the Kyoto targets.

Cost-effective reductions: making the ETS work for the climate

The decision to go for a market-based mechanism to reduce industrial CO^2 emissions in Europe was taken after a decade of long and controversial discussions over EU wide energy and CO^2 taxes. Without significant reductions from energy and manufacturing sectors, climate targets in the near-term and in the long-term will be unachievable. Analysis of reduction cost on a sectoral basis across the EU clearly identified energy and manufacturing sectors as the key areas in which the cheapest reductions could be made[3]. With the introduction of a trading mechanism, these cuts in industry can now be made in the most cost-efficient way, as the market

[2] 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

[3] Both the top-down and bottom-up analysis of sectoral emissions reductions can be found at http://europa.eu.int/comm/environment/enveco/climate_change/sectoral_objectives.htm

helps to identify the cheapest reductions to the benefit of all participants, compared to other regulatory instruments.

If the ETS is not used by EU Member States to facilitate such reductions, this will have serious implications for the cost of future emission cuts in Europe. With investments in the covered sectors being made for decades to come, the ETS needs to send the clear signal that cleaner technology and processes will be rewarded. Otherwise, Europe risks being locked further into a carbon-intensive infrastructure with high emissions and loses out on the significant innovation potential in this area. As a result, making the deeper cuts necessary in the future will become more expensive.

The international credibility of the EU as a leader on climate change is also at stake in the implementation of the ETS. Failure of political will to make the ETS work for the climate in the face of pressure from short-term financial interests could spell disaster for talks on the future of the of the UN regime on climate change after 2012. It will be impossible to convince major developing countries and key trading partners such as the United States and Japan that they should do what Europe has not proven to be feasible.

The implementation of the EU ETS by Member States for the period 2008-12 will determine the overall success of EU domestic climate policy to a large extent. The emission limits agreed in the NAPs will fix the contributions that these sectors can make towards national and Kyoto emission targets. These numbers cannot be changed afterwards. Member States should think long and hard what reductions they put into their National Allocation Plans.

II. ENVIRONMENTAL ASSESSMENT: KEY FINDINGS

What matters most for preventing dangerous climate change are absolute levels of greenhouse gas emissions, which in turn determine their respective concentration in the atmosphere. Based on this premise, the most critical environmental indicator for a working EU ETS is a system that ensures absolute reductions and continuously decreases total emissions levels over time. To this end, the design of the system should maximise the financial signal to businesses to invest into cleaner technology in the long run. Another critical issue for the implementation of a major policy instrument such as the EU ETS is transparency of the process to ensure that the important decisions involved in the NAPs are made on the grounds of justified criteria and verifiable data.

Accordingly, Climate Action Network Europe has measured the implementation of the ETS for 2005-07 against three main indicators:

1) the level of the emissions limits;

2) the environmental signal from the allocation rules;

3) the degree of transparency of NAP methodologies and adoption process.

Economic aspects are, of course, also an important concern, in particular for the companies affected by the system. As the EU ETS in theory is by default the least costly of instruments for a given amount of emissions reductions, this has not been assessed separately. The impact on companies, while potentially noticeable for some, is not a result of the ETS but of the underlying emissions reduction requirements for the European Union. Nevertheless, economic aspects have been taken into account where relevant within the other indicators.

1) THE LEVEL OF EMISSIONS LIMITS

The NGO assessment of the EU ETS emissions caps for 2005-07 concludes that the majority of them are not in line with their corresponding national climate change targets or energy strategies. Out of 25 countries, only two Member States (Germany and the United Kingdom) have asked the participating industry sectors to reduce their emissions over historic levels (based on the information provided for respective base years, mainly 2000-2002). All other Member States allow for increases (see data presented in Table 1).

Considering that around half of the EU25 countries are not on track to meet their Kyoto Protocol emission targets, such lax implementation of the ETS is a major disappointment and a worrying precedence for 2008-12. Most countries have not chosen a smooth transition for steeper cuts in the second phase. The EU ETS is the main means with which Member States can make controlled reductions in their national emissions through cuts by major emitting sectors. Failure to do so implies a stronger burden on other sectors such as transport and households to make reductions, although such cuts may be more expensive and instruments to achieve them politically difficult to agree.

Furthermore, it means that a stronger reliance on the purchase of external credits from the Kyoto system becomes likely, which

TABLE 1: COMPARISON OF ALLOCATION FOR THE ETS SECTOR IN 2005-07 AND RESPECTIVE BASE YEARS IN EU15 MEMBER STATES

Member State	Annual allocation for ETS sectors 2005-07, Mt CO_2	Annual emissions base year/period, ETS sectors, Mt CO_2	Difference annual allocation - base year/period, Mt CO_2	Relative difference annual allocation - base year/period
Austria	33,00	30,22	2,78	+ 9,2%
Belgium	62,93	61,04	1,90	+ 3,1%
Denmark	33,50	30,90	2,60	+ 8,4%
Finland	45,50	36,20	9,30	+ 25,7%
France	156,51	144,60	11,91	+ 8,2%
Germany	499,00	501,00	-2,00	- 0,4%
Greece	77,58	75,24	2,34	+ 3,1%
Ireland	22,32	20,88	1,44	+ 6,9%
Italy	232,50	224,00	8,50	+ 3,8%
Luxembourg	3,36	2,54	0,81	+ 32,0%
Netherlands	95,30	86,50	8,80	+ 10,2%
Portugal	38,17	36,60	1,57	+ 4,3%
Spain	174,43	154,86	19,57	+ 12,6%
Sweden	22,90	20,20	2,70	+ 13,4%
United Kingdom*	245,33	245,90	-0,57	-0,2%
EU 15	1742,34	1670,68	71,66	4,3%

Sources: National Allocation Plans, CAN-Europe members, own calculations

* Note: UK figures are based on the European Commission Decision C(2005) 1081 concerning the proposed amendment to the national allocation plan for the allocation of greenhouse gas emission allowances submitted by the United Kingdom in accordance with Directive 2003/87/EC of the European Parliament and of the Council, 12 April 2005.

is of questionable benefit to the world climate compared to absolute reductions in highly-industrialised Europe.

In those countries which do not need additional reductions to meet their Kyoto targets (for example most Central and Eastern European Member States), the emission cap set under the ETS is still of importance. Lack of constraint at the national level is no justification for over-allocation, which constitutes a rather direct subsidy to national industry. The European Commission made it clear in their assessment of the NAPs that in these cases allocations over realistic 'business as usual' requirements are not acceptable, and made the respective Member States cut their proposed total levels significantly.

Environmental NGOs also assessed the methodologies used for setting the emission caps, which in many cases revealed a lack of top-down orientation on the national Kyoto targets. The quality of projection figures and data sources used for this purpose was also questioned in a number of countries. In addition, many NGO experts called into doubt the reliability of assumptions on policies and measures for cuts in other sectors, which also need reporting in the NAPs and are part of the justification for the setting of the ETS limit.

2) THE ENVIRONMENTAL IMPACT OF THE ALLOCATION RULES

The fact that allowances are given on the basis of past emission levels and not, for example, auctioned, implies that the biggest polluters can receive the most allowances and that many additional rules are needed to guide the distribution of allowances to companies. This has made the system unnecessarily complex and a comparison between countries immensely difficult, leading to difficulty also for the companies affected.

Environmental NGOs analysed the choice of allocation mechanisms; rules for new entrants; cases of plant closure; impacts of early action; reduction potential and clean

technologies. The assessment paints a mixed picture. While good examples exist, which make the carbon price an important factor in future investment decisions, many Member States have, unfortunately, developed rules that are either not clearly rewarding of emission reductions or even give perverse incentives to continue investing in high-emission technology or running more polluting plants.

Regarding the allocation mechanism, most countries have relied on grandfathering, and unfortunately often used high emission base years or periods as a basis for allocation. Benchmarks have been used in some cases, especially for new entrants in the power sector, but with both bad (fuel-specific values) and good (state of the art gas plants as standard) examples. Only Denmark, Ireland, Hungary and Lithuania chose to make use of the possibility to auction up to 5% of the allowances.

Similarly, the individual allocation rules reveal positive and negative cases. The climate benefits lie in the details. Too many Member States will sell excess allowances from new entrant reserves; which will allow additional emissions and could create instability in the market if there are significant volumes. Early action and reduction potential and clean technology have not been taken into account specifically in all NAPs and could be used more. Examples exist of misguided implementation, creating for example hot air credits for business as usual investments in the past. Potential reduction measures such as biomass co-firing, for example, have been largely ignored.

3) TRANSPARENCY OF THE NAPS 2005-07

Transparency is crucial for public acceptance as well as for ensuring that the process makes use of the best available information, which may not always be available to government authorities. Unfortunately, NGOs identified major problems with the transparency of NAP development processes and the methodologies that were decided.

Regarding processes, only a few countries conducted two rounds of public consultations as demanded by the European Commission. Many also gave industry associations, privileged access and involved them from the start in discussions on the key elements. NGOs were often not invited and comments to consultations were mostly ignored, although similar questions had to be answered later when they came from the European Commission. This imbalance in the process has seriously impacted the NAPs to the detriment of its supposed environmental benefits.

Furthermore, various data sources employed in the NAPs were not accessible and therefore unverifiable. In particular, the use of sectoral projections on economic development and emissions provoked many questions, which remain unanswered. Other relevant policies and political objectives (such as renewable energy targets) were often ignored to justify higher emissions projections in a future scenario without the ETS or other reduction measures. In addition, the low capacity of some governments to monitor and verify industry data gives rise to doubts about their accuracy, especially since there are significant gaming incentives in a system based on free allocation.

III. RECOMMENDATIONS FOR THE TRADING PERIOD 2008-12

1. Ambitious emission caps for absolute reductions

The maximum emission ceilings set by Member States will decide the success of ETS in reducing emissions towards the respective national Kyoto targets. Member States need to set ambitious caps in the NAPs for 2008-12 that lead to absolute emissions reductions from the ETS sectors.

The Kyoto Protocol targets are only a first step and steeper cuts will be needed both globally and in the European Union. The EU Spring Council meeting in 2005 already indicated that pathways for developed countries of up to 30% reductions should be explored for 2020. This implies that all EU Member States will need to be making reductions in the future and should therefore develop methodologies that prepare for an ever more carbon-constrained future.

A) EMISSION CAPS AND METHODOLOGIES

- The NAPs for 2008-12 need to set caps that present reductions over the historic levels indicated in the NAPs for 2005-07 and the total ceilings for that period, whichever is lower.
- The NAPs need to spell out a credible national Kyoto Protocol implementation strategy that puts an emphasis on domestic emissions reductions.
- Sources of information and the methodology on the basis of which target-setting is being done must be transparent and data must be independently verified.
- Domestic emissions targets should be the number one criterion for the decision on the cap for industry sectors under the ETS. These can be Kyoto targets or the respective burden-sharing targets (for EU15). Where stronger national targets have been announced, those should be used as the guiding quantitative objective.
- The methodology should build on the target as the objective that informs the cap setting and, therefore, include an essential top-down element. Absolute national targets are the single most important driver for climate policy at present and these will only become stronger in the future.
- In no case may the absence of a Kyoto constraint serve as an excuse for handing out free emission allowances in excess of what a plant is likely to emit, which would be a direct subsidy. In the long run, after 2012, significant reductions over current levels of greenhouse gas emissions will be required in all EU member States.
- Post-2012: Rules to ensure continuous reductions in the level of the caps should be introduced at EU level. As a principle, this should be applied already at national level.

The guidance on preparation of National Allocation Plans 2008-124 issued by the European Commission in early 2006 indicates that those countries that still need to make reductions towards their Kyoto targets

[4] Communication from the Commission "Further guidance on allocation plans for the 2008 to 2012 trading period of the EU Emission Trading Scheme" Brussels, 22.12.2005, COM(2005) 703.

should cut the total amount of allowances in Phase II by 6% compared to the amount of allowances issued in Phase I. This is clearly insufficient. Seeing as the EU15 countries allowed emissions from the ETS sectors to rise by over 4% compared to the respective base years (see Table 1), which were often above average figures, a mere 6% reduction from this too high level is totally inadequate.

B) PROJECTIONS AND DATA

Projections are by their very nature wrought with uncertainties and should be used with great caution. The experience of the first phase shows that they can depend on the origin of the underlying data and are potentially subject to inflation. The independent and transparent nature of the information used to justify NAP decisions is vital for credible methodologies.

- In countries with a Kyoto constraint, the caps should not be guided by business as usual projections but be decided by the national reduction targets.
- Any business as usual or reference scenarios need to take into account existing and planned reduction policies and relevant political objectives such as renewable energy targets.
- High-emission reference cases should not provide an excuse for higher caps. Making assumptions about a future without carbon constraints is irrelevant in the face of the global challenge of climate change. Carbon constraints such as provided by the Kyoto targets are here to stay; the question is how they will be achieved - not if, and industrial sectors will need to make reductions.
- Post-2012: To meet steeper reduction targets with domestic emission reductions and to ensure predictability for businesses, it is crucial that future NAPs are based upon steady emissions reductions from an agreed fixed, historical baseline.

C) POLICIES IN OTHER SECTORS

The ETS represents only part of a package of measures adopted at EU level under the European Climate Change Program. It was designed to address particular sectors and needs other instruments to complement it for the emission sources not covered, such as transport, households and agriculture. At the national level, the introduction of the ETS also needs to be seen as part of a suite of policies. Developing a credible National Allocation Plan should serve as an overall Kyoto implementation exercise. If no credible policies for other sectors can be presented, the ETS sectors will have to accept a lower cap instead to ensure that the overall target is met.

- Ambitious reduction policies should be designed for all sectors of the economy.
- The introduction of the EU ETS should not lead to a weakening of the environmental objectives for participating sectors where these were already subject to regulation.
- Credible emission projections for all sectors need to be included in the NAP. The assumptions and data on which these projections rest must be transparent.
- Realistic but cautious quantitative assessments of the reduction impacts of policies for other sectors must be included in the NAPs.
- Efforts to extend other policy instruments such as CO^2 and energy taxes to activities and sectors not covered by the ETS should be stimulated by the development of the ETS. Seeing such similar efforts will also enhance overall acceptance of the ETS among its participants.

2. Allocation rules that give clear signals for clean technology

The mechanisms and rules governing the allocation to individual installations also play an important role for the signals that the participating companies receive regarding changes to their processes or future Investments. Especially in a system largely based on free allowances the allocation rules can influence considerably the extent to which companies integrate carbon emissions into their operations. Differentiation on the basis of emissions is key: more polluting installations should not receive the same treatment as cleaner ones.

A) ALLOCATION MECHANISM

The current reliance on the use of past emission levels, has created many problems and induces rent-seeking behaviour by many participants and is seen as unfair by others. It should be reduced as soon as possible, and changed to a maximum use of auctioning and product-specific benchmarking. Under the current circumstances, benchmarks constitute a useful second-best alternative to auctioning for those sectors and products for which establishing such benchmarks are feasible.

- Member States should make use of auctioning to the full extent to which it is possible under the directive (10% of the total volume of allowances for 2008-12).
- Rules for auctions must be transparent.
- The proceeds of any auctioning should be earmarked for specific purposes and not be used to fill gaps in state budgets.
- Benchmarks should be product-specific and measure carbon intensity.

- Benchmarks should be set on the basis of best available technique (BAT) standards for individual processes and not use the average performance of existing plants.
- Where grandfathering without benchmarking is unavoidable, correction factors must be used to differentiate between different kinds of technology, rewarding lower emissions.
- Allocation to individual installations for 2008-12 should be based on the same data as the allocations for 2005-07, preventing the possibility that a plant might have increased emissions during 2005 in order to be judged on the basis of the higher figures of those years. If base years are still being used after 2012, an update with more recent data should be considered.
- Harmonisation of the allocation rules across Europe is desirable to ensure that there is no downward pressure on the rules in any given country.
- Post-2012: in the future, the limit on auctioning needs to be lifted and this allocation mechanism should become the main means of distribution under the EU ETS.

B) NEW ENTRANTS

Special new entrant rules are only required in a system that is based on historical emissions. The best way of getting around the complex issues regarding new entrants would be to base the system on auctioning or have the installations buy their allowances on the market. As existing installations presently receive free emission allowances, new entrants need to be considered in relation to them. While it would be best in theory if new entrants would buy their allowances to make every emission count, this may give an incentive to keep older, more polluting plants in operation. Giving free allowances also to new entrants should provide an incentive for early replacement of existing installations (especially power plants) by new ones with lower emissions. Lower allocations to existing installations facilitate this.

- New entrant rules should reflect the principle that more pollution means fewer allowances.
- New entrants should be given allowances based on best available technology, product-specific benchmarks.
- New entrant reserves must be taken off the total emission ceiling for the ETS sector to ensure that they do not inflate the national total of emissions.
- In cases where a reserve may retain allowances at the end of a trading period, excess emission rights should be cancelled and not auctioned.
- Where countries allow for the transfer of allowances from closed installations, such new entrants should not receive free allowances in addition.

C) PLANT CLOSURE

Replacing old, polluting and inefficient plants by new and cleaner ones is one of desired outcomes of the EU ETS. The question of what should happen with allowances given to an operator in case an industrial plant would close its operations is a complex issue. In a system based on auctioning this does not arise, since operators will bid for fewer allowances or will immediately resell them if emissions go down due to low production levels. In the case of free allowances, plant owners have an incentive to keep inefficient plants running at low levels to sell excess allowances, which will then be used for emissions elsewhere with no reduction in the total.

- NAPs should define in concrete terms what constitutes plant closure of an installation.
- Plant closure rules should guard against gaming behaviour of plant operators to keep plants open simply for receiving free allowances from the state.
- Plant closure rules need to provide incentives to replace old plants, for example through limited transfer provisions.
- Plants that (partially) close their operations should be allowed to keep their allowances until the end of the current trading period but not beyond, to give an incentive to close down early within that period.

D) REDUCTION POTENTIAL

It is common sense that in a carbon constrained world it is good to know where reductions can be made most easily. Thorough scientific assessments of technological and economic reduction potential can provide very useful insights into what emission cuts can be achieved in which sector and at roughly what cost. Integrating this information into future NAPs could lower the overall cost of making reductions and facilitate steeper cuts. In the first trading period, most NAPs only made at best a half-hearted effort at incorporating the reduction potential into the sectoral differentiation in the NAP or the setting of the total cap.

- Information on reduction potentials for sectors and activities should be included in the NAPs systematically.

- Transparency is needed on how and what kind of information is being taken into account regarding technical and economic reduction potentials.
- In the power sector, the potential to switch fuels to biomass has largely been ignored and should be integrated thoroughly in all NAPs for 2008-12.

E) CLEAN TECHNOLOGY

In theory, support to clean technology is inherent in the EU ETS. However, in many cases allocation rules have so far not clearly given fewer allowances to cleaner plants. Furthermore, some technologies such as the cogeneration of heat and power (CHP) need particular consideration.

- NGOs support the promotion of using best available technique (BAT) standards as a reference for allocation.
- In the power and heat sector, allocation rules should ensure that the higher efficiency of CHP plants is being taken into account and that they are not disadvantaged compared to heat or power only plants.
- Transparency is required in the application of special provisions for clean technology in terms of the information and data on which these provisions are based.

3. Greater transparency of process and outcomes

If a major policy tool such as the EU ETS is to succeed, public acceptance is necessary. Moreover, expert input can help shape a better legislation. However, most Member States did not conduct their NAP development for 2005-07 in an open and transparent fashion.

- Member States need to disclose the data that underpins the essential decisions in the NAPs and allow independent verification to create trust in their integrity.
- Assumptions underlying sectoral and national projections need to be made public and their choice justified.
- The process for developing the NAPs for 2008-12 must be open to the public and involve civil society and industry in equal parts from the beginning.
- At least two separate rounds of public consultations should take place, both on the main elements of the NAP and on a draft version of it.
- Consultations must allow a time-frame for comments that is sufficient for extensive analysis of the documents involved and a critical response; this should be at least one month.
- The guidance on preparation of National Allocation Plans 2008-12 provides a basis for more transparent NAPs by requiring Member States to present a lot of key data in an overview format. The Member States are encouraged to follow the format thoroughly.

4. Limiting the use of external credits and assuring their quality

In the NAPs for 2008-12, Member States need to specify a quantitative limit on the volume of credits from the Kyoto project mechanisms, Joint Implementation (JI) and the Clean Development Mechanism (CDM). The possibility that companies may use these credits for compliance was not foreseen in the original ETS directive, but introduced subsequently through what became known as the "linking directive"[5] . According to Article 11a of the linking directive, a cap on external credits shall be indicated in the NAPs as "a percentage of the allocation of allowances to each installation".

The use of JI and CDM credits by companies under the ETS will be additional to what Member States are planning to acquire for their Kyoto target compliance. Current practice of CDM projects in particular has given rise to doubts over both the environmental benefits of such credits for the climate as well as for local communities. And sustainable development concerns have often been sidelined by the desire of potential buyers for large volumes of cheap credits. The ETS as an instrument to facilitate domestic emission cuts in Europe should use the credits with great caution, if at all.

- As a minimum, Member States should set installation-level caps on JI/CDM credits low enough to ensure domestic action in the EU continues to be the main means through which reductions are achieved, taking into account their own purchases of external credits.
- The cap on JI and CDM credits should be set at the installation level as specified by the linking directive and be monitored for each installation, not on a sectoral level or for all ETS sectors together.
- The cap on JI and CDM credits should apply on an annual basis, facilitating monitoring through the installation accounts in the national registries
- Only high-quality JI/CDM credits should be eligible for use by companies in the ETS.
- Responsible companies in the ETS should only use Gold Standard certified credits if they resort to external credits at all. Developers that do make an effort to demonstrate the environmental and social value of their projects can apply for the CDM Gold Standard label with little additional effort[6].

The Commission guidance document for 2008-12 NAPs suggests that Member States apply the limit collectively to all installations and for the whole trading period. This recommendation could maximise the total volume of JI/CDM credits, which is against the spirit of the quantitative limit agreed among all EU institutions in the linking directive. It would also favour big companies with many installations in more than one country to the detriment of smaller players, because it would work on a first come, first serve basis.

[5] Directive 2004/101/EC of the European Parliament and of the Council of 27 October 2004 amending Directive 2003/87/EC

[6] The Gold Standard label should also become available for JI projects in the future. For more information please consult the website http://www.cdmgoldstandard.org/

IV. OUTLOOK ON THE NAPS FOR 2008-12

The expectations for the next round of NAPs are high, because they count directly towards the Kyoto Protocol targets. The plans need to look at strategies to meet these targets, taking into account all sectors, not just those subject to the ETS. However, ambitious reduction targets from these sectors will be needed to ensure national targets are met. The rules should make sure that more pollution means higher cost, to give the right signals to participating companies.

Many Member States will face strong pressure from the affected **industry representatives** in this period. Much has been made of the economic impacts, as the carbon price rose to unexpected heights. In parallel, electricity consumers complained bitterly over a high surge in power prices. Both carbon and power prices are now being used to argue for a lax implementation of the ETS in phase 2, with no additional reductions.

The important political decision made on the desired maximum allowable level set in the NAP should be independent of arguments on the price of carbon and be guided by the climate change objectives behind them, Kyoto targets and beyond. The ETS is still maturing, more players start participating and potential sellers come to market, also influencing prices. Similarly, competitiveness arguments need very careful evaluation to assess their validity. Complaints about high power prices that target the ETS as the main driver for recent surges downplay other important factors such as fuel prices. In addition, they miss the fact that internalising the cost is not only part of a functioning market, it is also the inherent mechanism through which the ETS is meant to work: putting a price on carbon so that the production of goods that create such emissions becomes more expensive and there is an incentive to switch fuels or improve efficiency.

Without discarding the validity of economic implications for individual companies, these arguments should be seen as the political 'playing cards' that they are in most cases. Some business representatives still want to get rid of the system as a whole. **Member States** should, therefore, look twice at such claims and refrain from following their misleading logic. The private commercial interest of potential losers of the system must not drown out the significant gains that are to be had by implementing the ETS in the way it was intended. Low cost emission cuts, incentives to develop and invest in cleaner technology, save energy and make efficiency improvements - the potential economic benefits of the ETS for innovation are immense.

Expectations are high also regarding the role of the **European Commission** in the assessment of the 2008-12 NAPs. The Commission's assessment of the first round was thorough and strict, and the new guidance document sends a clear message to Member States that the next round will be even more rigorous. The Commission's task is not trivial. It will have to act as the safeguard of the environmental integrity and international credibility of the EU's climate policy.

The **environmental NGOs** that form the Climate Action Network Europe will also be monitoring the process closely, and are ready to engage constructively. These groups remain vigilant to cases where EU governments try to subvert the ETS purpose and abuse the system to the detriment of the environment. The environmental success of the EU ETS is too important.

ABOUT CAN – EUROPE

The Climate Action Network (CAN) is a worldwide network of over 365 Non-Governmental Organizations (NGOs) working to promote government, private sector and individual action to limit human-induced climate change to ecologically sustainable levels.[7]

CLIMATE ACTION NETWORK EUROPE

The vision of CAN is a world striving actively towards and achieving the protection of the global climate in a manner that promotes equity and social justice between peoples, sustainable development of all communities, and protection of the global environment.

Climate Action Network Europe (CAN-Europe) is the European node of the global CAN and is a registered non-profit organisation operating since 1989. At present, CAN-Europe has over 100 members, including many national groups from the international networks Friends of the Earth, Greenpeace and World Wide Fund for Nature.[8]

CAN-Europe provides a forum for NGOs to share ideas and expertise, strategies and information on climate change, promote actions and link these with wider efforts. CAN-Europe has been following the development of the EU Emission Trading System (ETS) since the first public discussions in 1999 and has been critically following the process ever since. CAN-Europe believes that ambitious implementation of the ETS will be critical to meeting emissions targets now and in the long-run lessons from the first period 2005-07 have been implemented at national level to see whether the system is fulfilling the purpose it was designed for.

[7] For more information about CAN-International visit http://www.climatenetwork.org

[8] Details on the member organisations of CAN-Europe and other regional nodes of CAN are available through the online CAN directory at http://www.climnet.org/members/criter.htm

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