WWF for a living planet

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WWF analysis of NAPs for ETS Phase 2:

Weak caps, little auctioning, flexmex overdose

The European Directive 2003/87/EC forms the basis for the European Emissions Trading Scheme (EU ETS). Under this Directive, the European countries are required to present to the European Commission their National Allocation Plans (NAPs) for Phase 2 of the EU ETS by 30 June 2006. Phase 2 will run from 2008 to 2012, and as of 27 July, only five countries (Estonia, Germany, Poland, Lithuania and Ireland) have submitted their NAPs to the Commission. Nine others (the UK, Belgium, Bulgaria, France, Latvia, Netherlands, Portugal, Spain and Italy) have made their NAPs available for inter-ministerial or public consultation – an essential step before submission of the plan to the Commission. The Commission will take the decision on whether or not to accept a NAP within three months of its submission, with all final decisions taken before 31 December 2006. Late publication and submission of NAPs not only constitute a breach of the law. It also greatly limits the ability of industries falling under the scheme to prepare well in advance.

The NAPs that are already available do not bring heartening news. Cap levels, or number of emission allowances, of most NAPs lack ambition, providing little incentive to reduce emissions. In terms of allocation, most countries have refused to use auctioning of emission allowances up to the 10% allowed by the ETS Directive, failing to put the "polluter pays principle" into practice. Instead of focusing on increasing energy efficiency and pushing technological innovations at home, many countries encourage the import of credits from Clean Development Mechanism (CDM) and Joint Implementation (JI) projects (also known as flexible mechanisms), transferring the responsibility of tackling climate change from the industrialized nations in the EU to developing countries abroad.

WWF has analyzed the NAPs from some of the biggest emitting countries in the EU: the UK, Germany, Italy, Spain and Poland. Together, they are responsible for nearly three-quarters of the greenhouse gas emissions in the European Union.

Among these countries, Italy's and Spain's draft NAPs are the most ambitious. They propose big cuts in the cap. It is absolutely essential that such ambition remains intact until after the public consultation process and survives into the final draft.

In terms of cap, Italy's and Spain's draft NAPs could serve as a role models for countries in the process of producing or finalizing their draft NAPs. In this respect, Poland, Germany and the UK need to tighten their caps further. In addition to this, Germany, Italy, Spain and Poland need to substantially increase the number of emissions allocated by auctioning. The Spanish NAP already proposes a significant cut in the cap. However, Spain, as well as Poland, needs to drastically reduce the amount of credits allowed to be imported from flexible mechanisms. The following is a quick assessment of the NAPs of Germany, Italy, Spain, Poland and the UK:

Weak caps and little incentive to cut CO_2

The cap level is the main driver that determines how effective the trading scheme will be in reducing carbon dioxide (CO_2) emissions. A weak cap means that there is only little incentive for the CO_2 emission reductions we urgently need in order to tackle climate change. In its guidelines, the Commission has suggested that the cap levels of Phase 2 should be on average 6% lower than those of Phase 1. This is more lenient than the ca. 9% advocated by WWF and Climate Action Network (CAN) Europe.

However, among the five countries analysed, few meet even the 6% reduction suggested by the Commission. UK's cap has reduced by 2.9% and Germany's by 3.4%, while Poland's cap has dramatically increased by almost 17%. Such very modest reductions and huge increases get even more disappointing, if we take into account the massive over-allocation, which was revealed by the publication of CITL data in May 2006. The data showed that installations in many countries emitted much less than what they were allocated in the NAPs for Phase 1. Very ambitious caps in Phase 2 should be the logical result, but only a minority of countries seems to go down that road. The cap levels of Italy and Spain – for example – are more ambitious. The caps of these countries are up to 15% below those of the first phase. It is absolutely essential that such ambition becomes the norm for other NAPs. At the same time it is important that the Commission will insist on accordance with its guidance and the Directive, and rejects NAPs that are not in line with Kyoto or national targets or the potentials Member States have to reduce emissions.

Little or no auctioning - Polluters don't pay

Another environmentally important mechanism in the EU ETS is the auctioning of allowances, rather than giving them to the installations free of charge. Putting the "polluter pays principle" into effect properly, auctioning has the potential to simplify the scheme, to force emission reductions and to reduce "windfall" profits. Revenues from auctioning can be used for climate protection measures or to push clean and efficient energy in developing countries, and partially for redistribution among ETS participants that are most exposed to international competition.
According to the Commission guidance, Member States have the option to allocate up to 10% of their emission allowances by auctioning in Phase 2 of the scheme. However, few countries are planning to auction part of the allowances, and most at a level much lower than 10%. Germany, Italy and Spain are not planning any auctioning. Only 1% auctioning is planned in Poland. In this respect, the UK is the most ambitious country, with a plan to auction up to 7% of its allowances.

Flexmex overdose – Ignoring our responsibility

Instead of achieving all its emission reductions at home, industry can also decide to buy carbon credits delivered by projects in developing countries through the CDM or in industrialised countries (mostly transition economies in Eastern Europe) through the JI. CDM and JI projects use various technologies (e.g. renewable energies, energy efficiency, end-of-pipe reduction of industrial gases) to reduce emissions compared to a baseline.
Importing credits from CDM and JI projects could make it cheaper for industry in the EU to reduce emissions and spur on more emissions reductions. However, buying cheap credits from overseas could also disincentivise investment in clean technology development in the EU, slow down innovation and divert attention from the need to reduce emissions domestically. WWF and CAN Europe advocate that credits from CDM and JI projects should be limited to a maximum of 3% of the allocations for each installation. In addition, projects entering into the ETS also need to conform to the «gold standard» label, which ensures environmental and social performance of a project.
However, NAPs for Phase 2 are disappointing in this respect. NAPs usually don't specify any social or environmental standards that need to be observed by eligible CDM / JI projects. In the UK, Italy and Germany, credits from CDM / JI projects are allowed to make up around 10% of allocations. Poland allows 25% of its annual emissions to be covered by project credits. The most extreme case is Spain – it allows up to 50% of its annual emissions to be purchased from CDM / JI projects.

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WWF evaluation of NAPs for Phase 2 of the EU ETS

Key: Fulfilled ☺; Satisfactory 😐; Unsatisfactory ☹

Country	Evolution of the cap from the NAP for Phase 1[1] to the NAP for Phase 2 (in $MtCO_2$ / year)	Caps in line with Kyoto - downward trend	Allocation of emission allowances by auctioning	How the cap was decided	% of allowances allowed to be covered by credit imports from flexible mechanisms	Caps fixed according to the ETS Directive for submission to the Commission by 30 June 2006
Germany	☹ Phase 1 cap: 499 Phase 2 cap: 482 Reduction of 3.4% WWF advocated for a reduction of 5.2%	☹ Kyoto commitment fulfilled, but cap will not even be able to deliver emission reductions committed to by industry under voluntary agreements.[2]	☹ No auctioning	😐 Based on distance to Kyoto target approach[3]. However, distribution of reduction obligations between traded and non-trading sectors is inappropriate (only small burden for traded sectors). Measures for non-trading sectors unlikely to deliver.	☹ Up to 12% of allocations for each installation	☺ Draft NAP released in April 2006
Italy	☺ Phase 1 cap: 223 Phase 2 cap: 194 Reduction of 13% WWF advocated for this level of reduction	☺ In line with Kyoto commitment	☹ No auctioning	☺ Based on distance to Kyoto target approach	☹ Up to 10% of total cap	☹ NAP consultations started with 2 weeks delay in July 2006
Poland	☹ Phase 1 cap[4]: 239 Phase 2 cap: 280 Increase of 17.2% WWF advocated for a reduction of 6.3%	😐 Kyoto commitment fulfilled but projected trend in emissions is upward	☹ 1% of total cap (may change)	☹ Based on projections for production in each sector & GDP growth, assuming that both will lead to energy efficiency. Growth, not reduction in emissions is planned.	☹ Up to 25% of total cap	☺ Draft NAP released in May 2006

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Spain	☺ Phase 1 cap[5]: 182 Phase 2 cap: 153 Reduction of 16% WWF advocated for a slightly higher level of reduction	😐 Almost in line with Kyoto commitment, a slightly bigger reduction would be needed to be fully in line with Kyoto.	☹ No auctioning	☹ The cap was decided according to the Kyoto commitment. The distribution of allowances among installations, however, favours dirty coal power plants.	☹ Up to 50% of allocations for each installation	☹ Draft NAP released in July 2006
UK	☹ Phase 1 cap[6]: 245 Phase 2 cap: 238 Reduction of 2.9% WWF advocated for a reduction of 9.4%	☺ / ☹ Kyoto commitment fulfilled, but UK government's target not met.[7]	😐 7% of total cap, to be taken from power generator allocations	☹ Reduction from Business As Usual scenario.	😐 Up to 8% of total cap	☹ UK missed 30 June deadline - however, overall cap was announced on 29 June.

[1] Basis for NAP 1 cap figure unless stated otherwise: CITL data, including new entrants reserve and auctioning, http://ec.europa.eu/environment/climat/emission/pdf/citl_pr.pdf
[2] In two voluntary agreements with the government in 2000 and 2002, the German industry committed itself to voluntary emissions reductions of up to 45 $MtCO_2$ by 2012 compared to 1998 levels
[3] Under the distance to target approach, the cap is set at a level that reflects a predefined emission target, e.g., the country's Kyoto target. The cap is defined from a percentile reduction on a fixed historic baseline, e.g. X% on 1990 levels.
[4] Basis for cap figure in Polish NAP 1: European Commission Press Release "Rapid" (Reference: IP/05/269; Date: 08/03/2005)
[5] The initial cap figure for the NAP 1 in Spain was about 160 $MtCO_2$. Following amendments to the number of installations, the methodology and the format of the data table this was increased by 14.2 $MtCO_2$, making a total of about 175 $MtCO_2$. Following further changes - triggered by the European Commission - the Spanish cap for Phase 1 increased to 182 $MtCO_2$. For details see Real Decreto 777/2006, published in the Boletin General del Estado, 24 June 2006
[6] Basis for this cap figure (incl. new entrants reserve) is the approved UK NAP 1: http://www.defra.gov.uk/environment/climatechange/trading/eu/nap/pdf/0505nap.pdf
[7] Under Kyoto, the UK is legally required to reduce greenhouse gas emissions by 12.5% below 1990 levels between 2008 and 2012. The UK government has committed to deeper reductions which go beyond its Kyoto commitment. It has committed to reducing emissions by 2010 to 20% below 1990 levels.