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The evolution of emissions trading in the European Union – The role of policy networks, knowledge and policy entrepreneurs

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Abstract

This paper starts with a recapitulation of how emissions trading became a cornerstone of the European Union's climate policy. While a whole bouquet of reasons can be identified the major reasons why the EU Commission decided to pursue the establishment of an emissions trading scheme within the EU are: (1) the integration of international emissions trading into the Kyoto Protocol; (2) the failure of the 6th Conference of the Parties to the United Nations Framework Convention on Climate Change (UNFCCC) and the withdrawal of the United States from the Kyoto Protocol negotiations; and (3) the unsuccessful attempt to introduce an EU-wide CO_2-tax. Other reasons were the fact that emissions trading did not need unanimity in the European Council like the CO_2-tax; the economic efficiency of emissions trading which appealed not only to the Commission but also to industry and Member States; the danger of a fragmented carbon market as the United Kingdom and Denmark had already set up domestic emissions trading schemes that were incompatible; the incentive a European emissions trading scheme would be for the formation of a global carbon market; and the possibility to influence investment strategies of power companies towards a sustainable modernisation of the EU's power generation infrastructure.

Drawing upon these preconditions, this paper analyses the development of the European Union Emissions Trading Scheme (EU ETS). Based on the fact that the EU is embedded in a multi-level policy-making architecture which encourages the emergence of policy networks it is argued that the EU ETS has been shaped by an (informal) issue-specific policy network established by some staff members from DG Environment, including individuals knowledgeable on emissions trading – such as experts from consultancies, environmental NGOs and the business sector. It is argued that within this European policy network on emissions trading the European Emissions Trading Directive – as adopted on 13 October 2003 – has been negotiated and developed. It is concluded that the sharing of knowledge about this relatively new and largely unknown regulatory instrument and about design options for a potential European emissions trading scheme was the key momentum for the establishment and continuity of this policy network and that the ability of managing knowledge generation processes was the main factor to allow for a few staff members from DG Environment to play a dominant role as policy entrepreneurs in developing the European Emissions Trading Directive, even beyond their formal role of proposing the scheme as representatives from the EU Commission.

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Introduction

When in 1968 Canadian economist John H. Dales published his book *Pollution Property and Prices* (Dales, 1968), he might not have guessed the importance of his idea of emissions trading for today's climate policy. But since then, his idea has come a long way and the trading of greenhouse gas emissions has become a key policy instrument to tackle the problem of global climate change. On a global level, emissions trading *between governments* has been established as one of three flexible mechanisms in the framework of the Kyoto Protocol. On the national level, many industrialised countries – ratifiers as well as non-ratifiers of the Kyoto Protocol – have either introduced or are considering *company-based* emissions trading systems (cf. Schüle & Sterk, 2008; Sterk, Braun, Haug, Korytarova, & Scholten, 2006). And on the supranational level, the European Union established today's largest company-based greenhouse gas emissions trading scheme operating since January 2005. It encompasses about 11,500 installations from all its Member States, responsible for around a third of the EU's greenhouse gas emissions, and roughly 45% of the EU's CO_2 emissions (Vis, 2006, p. 48).

In order to reach the Community's emissions reduction commitment of minus 8% compared to 1990 agreed to in the Kyoto Protocol the European Commission proposed the establishment of a European Union Emissions Trading Scheme (EU ETS) in the framework of its Post-Kyoto Strategy in June 1998 (European Commission, 1998). The proposal was followed by a Green Paper in March 2000 (European Commission, 2000), a draft directive of the European Commission in October 2001 (European Commission, 2001a), and a binding EU framework directive – the European Emissions Trading Directive – on 13 October 2003 (European Commission, 2003a). After having been implemented by all EU Member States, the EU ETS finally went into effect on 1 January 2005 encompassing CO_2 emissions from combustion plants, oil refineries, coke ovens, iron and steel plants, and factories making cement, glass, lime, brick, ceramics, pulp and paper. By now emissions trading has developed into one of the EU's major instruments to combat climate change and both, the European Commission and the European Council have stated that they regard the EU ETS as an "essential instrument for achieving the medium- and long-term emission reductions that are necessary to stabilise greenhouse gas concentrations in the atmosphere" (European Commission, 2006, p. 2).

How does emissions trading work?

While emissions trading schemes differ from each other regarding the participants they cover – countries under the Kyoto Protocol; companies or users of industrial installations in the EU or any domestic scheme – the principle of the cap-and-trade market mechanism is the same. Participants are allocated a certain quantity of emission allowances in accordance with their historical emissions less a specified reduction commitment. Each emission allowance entitles the party in question to emit one tonne of carbon dioxide (or one tonne of CO_2 equivalent as in the Kyoto Protocol) within a specified period. At the end of this obligation period, the party must demonstrate that the extent of its emissions are covered by its emission allowances. Governments or companies may acquire additional emission allowances either by purchasing them from other market participants or by carrying over any remaining credit from one obligation period to the next. Those which emit more than their allowance have to make up the shortfall by acquiring the necessary allowances from other market participants.

Emissions trading gives market participants the flexibility to fulfil their reduction commitment either by their own efforts or through the purchase of additional reduction certificates, but in the latter case, since there is a fixed number of emission allowances within the system, other market participants have to achieve a correspondingly greater reduction. In terms of economic theory, emission allowance trading ensures that reductions are achieved where one tonne of carbon dioxide can be avoided most cost-effectively – assuming a 'perfect market' and 'complete information'. Emissions trading therefore minimizes the total cost to the economy of all avoidance measures.

The economic implications of emissions trading

From an economic point of view the establishment of an emissions trading scheme involves a major effort at shifting the "calculation mechanism" of market economies by putting a price on greenhouse gas emissions, and thus "internalising" the externality that they involve (MacKenzie, 2008). This means that emitting greenhouse gases becomes part of economic calculations as a direct or as an