

Brussels, 23 January 2008

## **Questions and Answers on the Commission's proposal to revise the EU Emissions Trading System**

### **1) What is the aim of emissions trading?**

The aim of the EU Emissions Trading System (EU ETS) is to help EU Member States achieve their commitments to limit or reduce greenhouse gas emissions in a cost-effective way. Allowing participating companies to buy or sell emission allowances means that emission cuts can be achieved at least cost.

The EU ETS is the cornerstone of the EU's strategy for fighting climate change. It is the first international trading system for CO<sub>2</sub> emissions in the world and from the start of this year applies not only to the 27 EU Member States but also the other three members of the European Economic Area – Norway, Iceland and Liechtenstein. It currently covers over 10,000 installations in the energy and industrial sectors which are collectively responsible for close to half of the EU's emissions of CO<sub>2</sub> and 40% of its total greenhouse gas emissions. Discussions are under way on legislation to bring the aviation sector into the system from 2011 or 2012.

### **2) How does emissions trading work?**

The EU ETS is a 'cap and trade' system, that is to say it caps the overall level of emissions allowed but, within that limit, allows participants in the system to buy and sell allowances as they require. These allowances are the common trading 'currency' at the heart of the system. One allowance gives the holder the right to emit one tonne of CO<sub>2</sub>. The cap on the total number of allowances is what creates scarcity in the market.

At present, for each trading period under the scheme, Member States draw up national allocation plans (NAPs) which determine their total level of ETS emissions and how many emission allowances each installation in their country receives. At the end of each year installations must surrender allowances equivalent to their emissions. Companies that keep their emissions below the level of their allowances can sell their excess allowances. Those facing difficulty in keeping their emissions in line with their allowances have a choice between taking measures to reduce their own emissions - such as investing in more efficient technology or using less carbon-intensive energy sources - or buying the extra allowances they need on the market, or a combination of the two. Such choices are likely to be determined by relative costs. In this way, emissions are reduced wherever it is most cost-effective to do so.

### **3) How long has the EU ETS been operating?**

The EU ETS was launched on 1 January 2005. The first trading period ran for three years to the end of 2007 and was a 'learning by doing' phase to prepare for the crucial second trading period. The second trading period began on 1 January 2008 and runs for five years until the end of 2012. The importance of the second trading period stems from the fact that it coincides with the first commitment period of the Kyoto Protocol, during which the EU and other industrialised countries must meet their targets to limit or reduce greenhouse gas emissions. For the second trading period the Commission has capped national emissions from EU ETS sectors at an

average of around 6.5% below 2005 levels to help ensure that the EU as a whole, and Member States individually, deliver on their Kyoto commitments.

#### **4) What are the main lessons learned from experience so far?**

The EU ETS has put a price on carbon and proved that trading in greenhouse gas emissions works. The first trading period successfully established the free trading of emission allowances across the EU, put in place the necessary infrastructure and developed a dynamic carbon market. The environmental benefit of the first phase may be limited due to excessive allocation of allowances in some Member States and some sectors, due mainly to a reliance on emission projections before verified emissions data became available under the EU ETS. When the publication of verified emissions data for 2005 highlighted this over-allocation, the market reacted as would be expected by lowering the market price of allowances. The publication of verified emissions data has allowed the Commission to ensure that the cap on national allocations under the second phase is set at a level that results in real emission reductions.

Besides underlining the need for verified data, experience so far has shown that greater harmonisation within the EU ETS is imperative to ensure that the EU achieves its emissions reductions objectives at least cost and with minimal competitive distortions. The need for more harmonisation is clearest with respect to how the cap on overall emission allowances is set.

The first two trading periods also show that widely different national methods for allocating allowances to installations threatens fair competition in the internal market. Furthermore, greater harmonisation, clarification and refinement are needed with respect to the scope of the system, access to credits from emission-reduction projects outside the EU, the conditions for linking to emissions trading systems elsewhere and monitoring, verification and reporting requirements.

#### **5) What is the purpose of the current proposal?**

The proposal seeks to amend the Directive<sup>1</sup> which establishes the EU ETS. The goal is, for the period beyond 2012, to strengthen, expand and improve the functioning of the ETS as one of the most important and cost-effective tools for achieving the EU's target for reducing greenhouse gas emissions. This target, endorsed by the March 2007 European Council, calls for a reduction in EU emissions of at least 20% by 2020 compared with 1990 levels, and by 30% provided that other industrialised countries commit to comparable efforts in the framework of a global agreement to combat climate change post-2012. The decision to launch negotiations to draw up this agreement was taken at the December 2007 UN climate change conference in Bali and the negotiations are expected to start in March or April.

The proposal to revise the Directive balances the needs for economic efficiency and fairness between sectors and Member States, and will provide more predictability for industry. It sets out a predictable trend line for the emission reductions required by the sectors covered by the ETS. Increased harmonisation will make the system simpler and more transparent, increasing its attractiveness for other countries and regions to link up to it.

#### **6) What will happen now with the proposal?**

The proposal falls under the co-decision procedure, meaning that it must be approved by both the Council of the EU and the European Parliament to become

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<sup>1</sup> Established by Directive 2003/87/EC, as amended by Directive 2004/101/EC.

law. They are expected to begin discussing it soon. The Commission hopes that a final decision adopting the modifications to the Directive will be taken by 2009.

## **7) What are the main changes proposed to the ETS?**

The main changes are the following:

- There will be one EU-wide cap on the number of emission allowances instead of 27 national caps. The annual cap will decrease along a linear trend line, which will continue beyond the end of the third trading period (2013-2020).
- A much larger share of allowances will be auctioned instead of allocated free of charge.
- Harmonised rules governing free allocation will be introduced.
- Part of the rights to auction allowances will be redistributed from the Member States with high per capita income to those with low per capita income in order to strengthen the financial capacity of the latter to invest in climate friendly technologies
- A number of new industries (e.g. aluminium and ammonia producers) will be included in the ETS; so will two further gases (nitrous oxide and perfluorocarbons).
- Member States will be allowed to exclude small installations from the scope of the system, provided they are subject to equivalent emission reduction measures.

## **8) Will there still be national allocation plans?**

No. In their NAPs for the first (2005-2007) and the second (2008-2012) trading periods, Member States determined the total quantity of allowances to be issued – the cap – and how these would be allocated to the installations concerned. This approach has generated significant differences in allocation rules, creating an incentive for each Member State to favour its own industry, and has led to great complexity.

The Commission proposes to set a single EU-wide cap and to allocate allowances on the basis of fully harmonised rules. National allocation plans will therefore not be needed any more.

## **9) How will the emission cap in phase 3 be determined?**

The rules for calculating the EU-wide cap are set out in the proposal.

From 2013, the total number of allowances should decrease annually in a linear manner. The starting point of this line is the average total quantity of allowances (phase 2 cap) to be issued by Member States for the 2008-12 period, adjusted to reflect the broadened scope of the system from 2013. The linear factor by which the annual amount shall decrease is 1.74% in relation to the phase 2 cap.

The starting point for determining the linear factor of 1.74% is the 20% overall reduction of greenhouse gases compared to 1990, which is equivalent to a 14% reduction compared to 2005. However, a larger reduction is required of the EU ETS sector because it is cheaper to reduce emissions in the ETS sectors. The division that minimises overall reduction cost amounts to:

- a 21% reduction in EU ETS sector emissions compared to 2005 by 2020;
- a reduction of around 10% compared to 2005 for the sectors that are not covered by the EU ETS.

The 21% reduction in 2020 results in an ETS cap in 2020 of a maximum of 1720 million allowances and implies an average phase 3 cap (2013 to 2020) of some 1846 million allowances and a reduction of 11 % compared to the phase 2 cap.

All absolute figures indicated correspond to the coverage at the start of the second trading period and therefore do not take account of aviation, which will be added towards the end of the second trading period, or the other sectors that will be added in phase 3 (for more details see answer to Question 12).

### **10) How will the emission cap beyond phase 3 be determined?**

The linear factor of 1.74 % used to determine the phase 3 cap will continue to apply beyond the end of the trading period in 2020 and will determine the cap for the fourth trading period (2021 to 2028) and beyond. It may be reviewed by 2025 at the latest. In fact, significant emission reductions of 60%-80% compared to 1990 will be necessary by 2050, if we are to reach the strategic objective of limiting the global average temperature increase to not more than 2°C above pre-industrial levels.

### **11) An EU-wide cap on emission allowances will be determined for each individual year. Will this reduce flexibility for the installations concerned?**

No, flexibility for installations will not be reduced at all. In any year, the allowances to be distributed have to be issued by the competent authorities by 28 February. The last date for operators to surrender allowances is 30 April of the year following the year in which the emissions took place. So operators receive allowances for the current year before they have to surrender allowances to cover their emissions for the previous year. Allowances remain valid throughout the trading period and any surplus allowances can now be "banked" for use in subsequent trading periods. In this respect nothing will change.

The system will remain based on trading periods, but the third trading period will last eight years, from 2013 to 2020, as opposed to five years for the second phase from 2008 to 2012.

For the second trading period Member States generally decided to allocate equal total quantities of allowances for each year. The linear decrease each year from 2013 will correspond better to expected emissions trends over the period.

### **12) What are the annual ETS cap figures for the period 2013 to 2020?**

The annual cap figures are as follows:

<b>year</b>	<b>Mio t CO2</b>
<b>2013</b>	<b>1,974</b>
<b>2014</b>	<b>1,937</b>
<b>2015</b>	<b>1,901</b>
<b>2016</b>	<b>1,865</b>
<b>2017</b>	<b>1,829</b>
<b>2018</b>	<b>1,792</b>
<b>2019</b>	<b>1,756</b>
<b>2020</b>	<b>1,720</b>

These figures are based on the scope of the ETS as applicable in phase 2 (2008 to 2012), and the Commission's decisions on the national allocation plans for phase 2, amounting to 2083 million tonnes following the decision of the Court on the Slovak plan. These figures need to be adjusted for several reasons. Firstly, in line with the extensions of the scope in phase 2, provided that Member States substantiate and verify their emissions accruing from these extensions. Secondly, following the proposal of the Commission to extend the scope of the ETS as from

the third trading period. Thirdly, the figures do not take account of the inclusion of aviation, nor of emissions from Norway, Iceland and Liechtenstein.

### **13) Will allowances still be allocated for free?**

Yes, some will, but overall significantly less than is the case today.

While the great majority of allowances has been allocated free of charge to installations in the first and second trading periods, the Commission believes that auctioning of allowances should be the basic principle for allocation from the third phase onwards. This is because auctioning best ensures the efficiency, transparency and simplicity of the system and creates the greatest incentive for investments in a low-carbon economy. It best complies with the "polluter pays principle" and avoids giving windfall profits to certain sectors that have passed on the notional cost of allowances to their customers despite receiving them for free.

It is estimated that around 60% of the total number of allowances will be auctioned in 2013, and this proportion will increase in later years..

### **14) How is it proposed to allocate the allowances that will be handed out for free?**

It is proposed that allowances to be allocated for free should be distributed according to EU-wide rules which will be developed later under a committee procedure ("Comitology"). These rules will fully harmonise allocations and thus all firms across the EU with the same or similar activities will be subject to the same rules. The rules will ensure as far as possible that the allocation promotes carbon-efficient technologies. The rules may for instance specify that allocations are to be based on so-called benchmarks, e.g. a number of allowances per quantity of historical output. Such rules would reward operators that have taken early action to reduce greenhouse gases, would better reflect the polluter pays principle and would give stronger incentives to reduce emissions, as allocations would no longer depend on historical emissions. All allocations are to be determined before the start of the third trading period and no ex-post adjustments will be allowed.

### **15) Which installations are to receive a free allocation and which not, according to the proposal? How will negative impacts on competitiveness be avoided?**

Taking into account their ability to pass on the increased cost of emission allowances, full auctioning should be the rule from 2013 onwards for the power sector. There should also be full auctioning for carbon capture and storage as the incentive for this arises from the fact that allowances will not have to be surrendered for emissions which are stored.

In other sectors, allocations for free will be phased out progressively from 2013, resulting in no free allocation in 2020. However, an exception will be made for installations in sectors judged to be at significant risk of 'carbon leakage,' meaning that they could be forced by international competitive pressures to relocate production to countries outside the EU that did not impose comparable constraints on emissions. This would simply increase global emissions without any environmental benefit.

By 2010, the Commission will determine which sectors are concerned, taking into account the extent to which the sector concerned is able to pass on the cost of the required allowances in product prices without significant loss of market share to less carbon efficient installations outside the EU. In this respect, the Commission will assess among other things the cost of allowances compared to production cost and

the exposure to international competition. Installations in these sectors will receive up to 100% of their allowances for free.

Under an international agreement which ensures that competitors in other parts of the world bear a comparable cost, the risk of carbon leakage may well be negligible. Therefore, by 2011, the Commission will carry out an in-depth assessment of the situation of energy-intensive industry and the risk of carbon leakage, in the light of the outcome of the international negotiations and also taking into account any binding sectoral agreements that may have been concluded. The report will be accompanied by any proposals considered appropriate. These could potentially include maintaining or adjusting the proportion of allowances given free of charge to industrial installations that are particularly exposed to global competition or putting in place an effective carbon equalisation system to neutralise any distorting effects from imports, e.g. by including importers of the products concerned in the ETS.

#### **16) Who will organise the auctions and how will they be carried out?**

The Member States will carry out the auctions. The distribution of the auctioning rights to Member States will be largely based on historical emissions, but a part of the rights will be redistributed from richer Member States to poorer ones. This is in order to take account of the lower GDP per head and higher prospects for growth and emissions among the latter and to strengthen their financial capacity to invest in climate friendly technologies.

Any auctioning must respect the rules of the internal market and must therefore be open to any potential buyer under non-discriminatory conditions. The proposal provides a basis for adopting a Regulation (through the comitology procedure) that will provide the appropriate conditions for ensuring efficient, coordinated auctions without disturbing the allowance market.

#### **17) Which sectors and gases are covered by the new proposal?**

The ETS covers installations performing specified activities. Since the start it has covered, above certain capacity thresholds, power stations and other combustion plants, oil refineries, coke ovens, iron and steel plants and factories making cement, glass, lime, bricks, ceramics, pulp, paper and board.

So far the ETS covers only carbon dioxide emissions. The Commission now proposes to include additional sectors and greenhouse gases in Annex 1 of the Directive, which will extend the scope of the ETS. CO<sub>2</sub> from emissions from petrochemicals, ammonia and aluminium will be included, as will N<sub>2</sub>O emissions from the production of nitric, adipic and glyoxylic acid production and perfluorocarbons from the aluminium sector. The capture, transport and geological storage of all greenhouse gas emissions will also be covered.

#### **18) Will small installations be excluded from the scope?**

A large number of installations emitting relatively low amounts of CO<sub>2</sub> are currently covered by the ETS and concerns have been raised over the cost-effectiveness of their inclusion. The Commission therefore proposes to allow Member States to remove these installations from the ETS under certain conditions. The installations concerned are those with a rated thermal input below 25MW whose reported emissions were lower than 10 000 tonnes of CO<sub>2</sub> equivalent in each of the 3 years preceding the year of application. They may be excluded from the ETS only if measures are in place that will achieve an equivalent contribution to emission reductions. It is estimated that around 4,200 installations, accounting collectively for around 0.7% of total ETS emissions, could be opted out of the system under these provisions.

### **19) What is the impact of new sectors and gases on the total cap?**

It is estimated that the proposed extension of the scope, together with the possibility for Member States to exclude small installations, will lead to a net increase in coverage of around 6%, or up to 120 to 130 million tonnes of CO<sub>2</sub>-equivalent, compared with the current trading period (2008-2012).

### **20) How would emission allowances be allocated to new sectors and gases?**

The Commission proposes that they should be allocated through EU-wide rules, in the same way as for other industrial sectors already covered.

### **21) How many emission credits from third countries will be allowed?**

Under the EU ETS, Member States may allow their operators to use credits generated by emission-saving projects undertaken in third countries to cover their emissions in the same way as ETS allowances. These projects must be officially recognised under the Kyoto Protocol's Joint Implementation (JI) mechanism (covering projects carried out in countries with an emissions reduction target under the Protocol) or Clean Development Mechanism (CDM) (for projects undertaken in developing countries). Credits from JI projects are known as Emission Reduction Units (ERUs) while those from CDM projects are called Certified Emission Reductions (CERs).

The proposal sets out two scenarios for the use of such credits between 2013 and 2020. The first reflects only the EU's independent commitment to reduce its emissions to at least 20% below 1990 levels by 2020. The second increases this reduction in the context of a satisfactory global agreement to combat climate change post-2012.

**Based on a 20% emissions reduction**, i.e. before a satisfactory global agreement is reached, operators will be able to use credits given to them by their governments for the period 2008-2012 that they have not already used up. As the limit on these credits is generous it is expected that operators will be able to achieve more than one third of the emission reductions required between 2013 and 2020 through their use.

Only credits from project types which were accepted by all Member States during the 2008-12 period will be eligible for use, however. This restriction is needed to guarantee that JI/CDM credits are treated equally throughout the ETS. Without this rule the market for JI/CDM credits could be fragmented between credits accepted by all Member states and others accepted only by some.

To create greater flexibility, credits from new energy efficiency or renewable energy projects that promote sustainable development could be used in accordance with agreements concluded with third countries, provided that these new credits do not increase the overall number of credits available. Subject to the same restriction, CERs from new projects that started from 2013 onwards would be allowed from Least Developed Countries without the need to conclude an agreement with these countries. Again, only project types that were accepted by all Member States during the 2008-2012 period would be eligible.

**Based on a stricter emissions reduction in the context of a satisfactory international agreement**, the limit on the use of JI/CDM credits will be automatically increased up to half of the additional reduction effort. This means that if the annual cap under the EU ETS were reduced by e.g. 200 million tonnes following a global agreement (in order to achieve the more stringent reduction target for overall

emissions), the limit on the use of JI/CDM credits would be raised automatically by 100 million credits.

Credits additional to those left over from 2008-12 will be accepted only from projects in third countries that ratify the international agreement or from additional types of project approved by the Commission. The Commission will adopt measures to provide for the use of additional types of project credits and/or the use by such operators of other mechanisms created under the international agreement, as appropriate. These additional credits would help make the reduction target cheaper for the EU to meet.

## **22) Why will the use of JI/CDM credits by companies be restricted before an international agreement is reached?**

Prior to a satisfactory international agreement being reached, any increase in the use of JI/CDM credits after 2012 above those granted for 2008-2012 would reduce incentives for companies to invest in carbon-efficient technologies and thus risk undermining the achievement of sufficient domestic emission reductions to achieve the emissions and renewable energy targets for 2020.

## **23) Will it be possible to use credits from carbon 'sinks' like forests?**

No. The Commission has analysed the possibility of allowing credits from certain types of land use, land-use change and forestry ('LULUCF') projects which absorb carbon from the atmosphere. It has concluded that doing so could undermine the environmental integrity of the EU ETS, for the following reasons:

- LULUCF projects cannot physically deliver permanent emissions reductions. Insufficient solutions have been developed to deal with the uncertainties, non-permanence of carbon storage and potential emissions 'leakage' problems arising from such projects. The temporary and reversible nature of such activities would pose considerable risks in a company-based trading system and impose great liability risks on Member States.
- The inclusion of LULUCF projects in the ETS would require a quality of monitoring and reporting comparable to the monitoring and reporting of emissions from installations currently covered by the system. This is not available at present and is likely to incur costs which would substantially reduce the attractiveness of including such projects.
- The simplicity, transparency and predictability of the ETS would be considerably reduced. Moreover, the sheer quantity of potential credits entering the system could undermine the functioning of the carbon market unless their role were limited, in which case their potential benefits would become marginal.

The Commission believes that global deforestation could be better addressed through other instruments. For example, using part of the proceeds from auctioning allowances in the EU ETS could generate additional means to invest in LULUCF activities both inside and outside the EU, and may provide a model for future expansion.

## **24) Besides those already mentioned, are there other credits that could be used in the revised ETS?**

Yes. The Commission is proposing that projects in EU Member States which reduce greenhouse gas emissions not covered by the ETS could issue credits. These 'domestic offset credits' would need to be managed according to common EU provisions set up by the Commission in order to be tradable throughout the system. Such provisions will be adopted only for projects that cannot be realised through

inclusion in the ETS. The provisions will seek to ensure that domestic credits do not result in double-counting of emission reductions or impede other policy measures to reduce emissions not covered by the ETS, and that they are based on simple, easily administered rules.

**25) Does the review affect the unlimited banking of allowances from phase 2 to phase 3?**

No. The Directive foresees unlimited banking of phase 2 allowances into phase 3. This means that every allowance not surrendered or retired in the second trading period can be used at face value in phase 3. Technically, banking will be done by replacing the phase 2 allowances with phase 3 allowances. The phase 3 allowances issued as a result of banking will come on top of the phase 3 cap decided in the review. The Commission has not proposed any changes to this provision.

**26) What effect will the changes have on electricity prices?**

The reduction in the EU-wide quantity of allowances to be issued in the third trading period will increase scarcity in the allowance market and hence the price of allowances can be expected to increase. The price of electricity can be expected to increase correspondingly but, taking into account today's carbon prices, the rise is expected to be limited to 10 to 15% by 2020 compared with business as usual. Other factors such as oil and gas prices may have a much bigger impact.

The fact that electricity producers will no longer receive any allowances for free is not in itself expected to have a significant influence on electricity prices since generators are able to pass on a significant part of the cost of allowances to their customers, irrespective of whether they receive the allowances for free or not. The most important impact from ending free allocation to electricity generators is that it will eliminate windfall profits.

For consumers the total bill for households may not increase: this depends on the extent to which household energy efficiency measures succeed in reaching the target of 20% savings.

**27) Is there any guarantee that the price of allowances won't fall sharply during the third trading period?**

No price level can be guaranteed in a free market, but the proposal intends to make market conditions as predictable as possible and to minimise instability due to changes to the EU ETS. The sharp fall in the allowance price during the first trading period was due to over-allocation of allowances which could not be "banked" for use in the second trading period. For the second and subsequent trading periods, Member States are obliged to allow the banking of allowances from one period to the next and therefore the end of one trading period is not expected to have any impact on the price.

**28) Are there any provisions for linking the EU ETS to other emissions trading systems?**

Yes. One of the key means to reduce emissions more cost-effectively is to enhance and further develop the global carbon market. The Commission sees the EU ETS as an important building block for the development of a global network of emission trading systems. Linking other national or regional cap-and-trade emissions trading systems to the EU ETS can create a bigger market, potentially lowering the aggregate cost of reducing greenhouse gas emissions. The increased liquidity and reduced price volatility that this would entail would improve the functioning of

markets for emission allowances. This may lead to a global network of trading systems in which participants, including legal entities, can buy emission allowances to fulfil their respective reduction commitments.

While the current Directive allows for linking the EU ETS with other industrialised countries that have ratified the Kyoto Protocol, the Commission is proposing to extend this to include any country or administrative entity (such as a state or group of states under a federal system) which has established a cap-and-trade system whose design elements would not undermine the environmental integrity of the EU ETS. Where such systems cap absolute emissions, there would be mutual recognition of allowances issued by them and the EU ETS.

### **29) What is a Community registry and how does it work?**

Registries are standardised electronic databases ensuring the accurate accounting of the issuance, holding, transfer and cancellation of emission allowances. As a signatory to the Kyoto Protocol in its own right, the Community is also obliged to maintain a registry. This is the Community Registry, which is distinct from the registries of Member States. Allowances issued from 1 January 2013 onwards will be held in the Community registry instead of in national registries.

### **30) Will there be any changes to monitoring, reporting and verification requirements?**

The Commission intends to adopt a new Regulation (through the comitology procedure) governing the monitoring and reporting of emissions from the activities listed in Annex I of the Directive. A separate Regulation on the verification of emission reports and the accreditation of verifiers should specify conditions for accreditation, mutual recognition and cancellation of accreditation for verifiers, and for supervision and peer review as appropriate.

### **31) What provision will be made for new entrants into the market?**

Five percent of the total quantity of allowances will be put into a reserve for new installations or airlines that enter the system after 2013 ("new entrants"). The allocations from this reserve should mirror the allocations to corresponding existing installations.

Any allowances remaining in the reserve shall be distributed to Member States for auctioning. The distribution key is the same as the one for all other allowances to be auctioned.

### **32) How did the Commission take into account comments made by stakeholders?**

The Commission met extensively with a large number of stakeholders in the course of its review of the EU ETS. It has assessed their suggestions and in many cases reflected these in the proposal and its assessment of the proposal's economic impact.

### **33) What is the role of an international agreement and its potential impact on EU ETS?**

When an international agreement is reached, the Commission shall revise or repeal the EU-wide rules for allocation to provide that free allocation shall only take place where this is fully justified in the light of the international agreement.

The EU-wide quantity of allowances shall also be reduced at a rate corresponding to the increase in the level of reduction commitments. The relation between the reductions due in the EU ETS sectors as compared to the sectors outside the EU ETS remains the same.

For the effects on the use of credits from Joint Implementation and Clean Development Mechanism projects, please see the reply to question 21.

**34) In September, the Commission adopted the third package for the liberalisation of the internal energy market. Isn't there a contradiction between liberalisation, which should lower prices, and putting a price on carbon emissions through the ETS, which should raise them?**

No, there is no contradiction at all – to the contrary the better a competitive EU internal market for electricity works, the clearer and less distorted the necessary price signals from the EU ETS will be.

The overall objective of liberalisation has always been to render the supply of energy as efficient as possible and to eliminate undue monopoly profits. This may lead to lower energy prices, but it is not necessarily the case since energy prices are always a function of underlying supply costs.

The EU ETS identifies the price of carbon that is to be signalled to the economy. This can best be achieved, if electricity is supplied on a competitive market, where undue monopoly profits are eliminated.