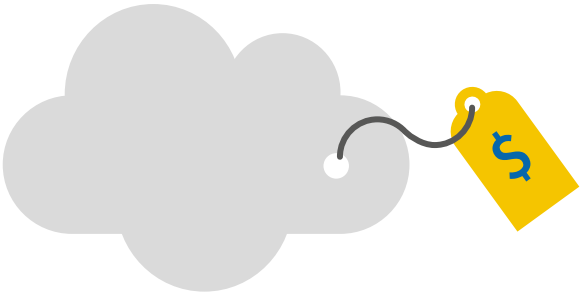
icap *Brief #2*

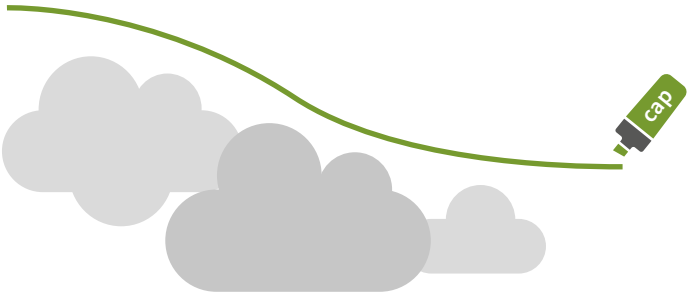
7 ARGUMENTS FOR EMISSIONS TRADING

An emissions trading system (ETS) is a market-based instrument that can be used to reduce greenhouse gas (GHG) emissions. It works on the principle of 'cap and trade'. The government imposes a limit (cap) on total emissions in one or more sectors of the economy. Companies in these sectors need to hold one permit for every ton of emissions they release. They may either receive or buy permits, and can trade them with other companies. This is the 'trade' part of 'cap and trade'. Currently, there are 20 ETSs operating across five continents, with major economies like China preparing to introduce a nationwide system. In 2020, roughly 14 % of global GHG emissions will be covered by ETS. But just what makes emissions trading such an attractive policy instrument?

1. ETS sets a clear price on carbon

By creating a market for GHG emission permits, an ETS puts a clear price on carbon. It means that the costs to society caused by GHG emissions – such as negative effects on public health, damages linked to extreme weather events or the impacts of climate change on natural ecosystems – are made visible and integrated into the price that people pay for their goods and services.





2. ETS puts a firm limit on emissions

In an ETS, the government sets a clear emissions target, capping the maximum amount of emissions that are allowed in selected sectors of the economy. This ensures that the desired environmental outcome will be reached. With a steadily declining cap, an ETS also delivers a predictable reduction pathway, which sends a long-term signal for businesses and investors.

3. Participating companies can choose how, when and where to reduce emissions

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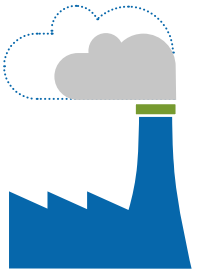
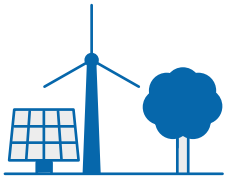


REDUCE THEIR EMISSIONS

BUY EXTRA PERMITS

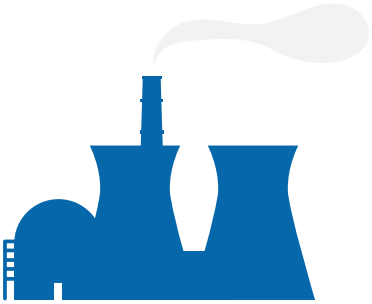
BANK PERMITS



USE OFFSET CREDITS

4. ETS fits a variety of economic and political contexts

Emissions trading can be tailored to suit a wide variety of economic and political contexts. There is no one-size-fits-all approach. Systems are currently operating in a range of jurisdictions covering individual cities, states, provinces, countries, and regions, with the design of each system adapted to their unique economic and governance profile.



5. ETS can provide an additional source of revenue for the government

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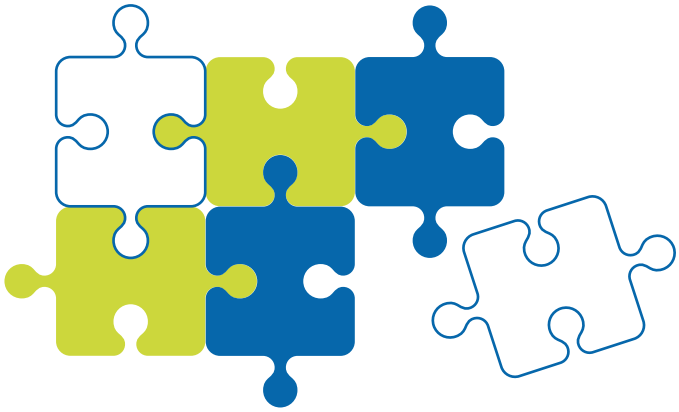
6. Emissions trading provides a range of additional benefits

While the primary goal of emissions trading is to reduce emissions, a well-designed ETS can deliver substantial environmental, economic and social co-benefits. These benefits can include cleaner air, improving resource efficiency, ensuring energy security, fostering technology innovation, and creating jobs.



7. ETS can be linked to create a bigger, more efficient carbon market

The 'linking' of two or more systems creates a larger carbon market, which opens up more (and potentially cheaper) emission reduction options. When systems are directly linked, permits can be used interchangeably for compliance in both systems (see also ICAP ETS Brief #4).