ICAP *Brief #2*

7 REASONS FOR EMISSIONS TRADING

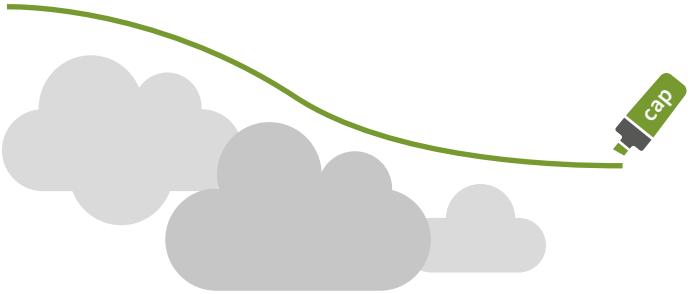
An emissions trading system (ETS) is a market-based policy used to regulate greenhouse gas (GHG) emissions. The government decides to limit emissions from one or more sectors of the economy over a given period and issues allowances according to this limit. Companies may be granted allowances for free, buy them from the government at auction, or trade them on the market. 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 emissions allowances, an ETS puts a clear price on carbon. This means that the costs to society caused by GHG emissions – such as negative effects on public health, damage 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.



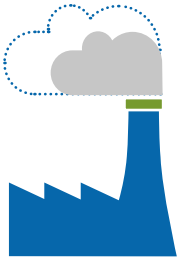


2. ETS creates a binding framework for emissions reductions

In an ETS the government sets a clear policy framework to limit or reduce emissions in covered sectors over time. In systems with an absolute cap, this means setting in advance a system-wide limit on emissions, determined by a fixed supply of allowances.[1] This provides strong certainty that the desired environmental outcome will be achieved and, when the cap declines over time, creates a predictable emissions reduction pathway for businesses and investors

3. Covered entities can choose how, when, and where to reduce emissions

An ETS offers covered entities an inherent level of flexibility regarding their compliance strategies. Depending on their technical, financial, and operational needs, covered entities can choose how best to comply. Options include: reducing their emissions; buying extra allowances from other participants or through auctions; making use of banked allowances; or using offset credits from certified projects.



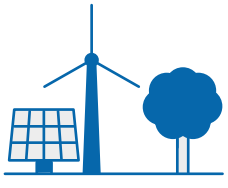
REDUCE EMISSIONS



BUY EXTRA ALLOWANCES



BANK ALLOWANCES



USE OFFSET CREDITS

1 Intensity-based ETSs impose a limit on the number of emissions per unit of output. The supply of allowances under the cap therefore depends on the level of economic activity. (see also ICAP ETS Brief #12).

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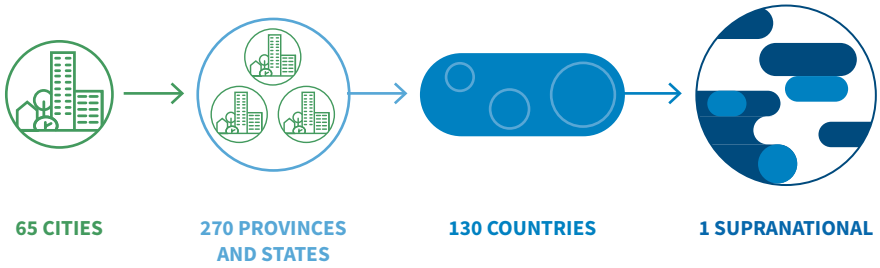
4. ETS fits a variety of economic and political contexts

An ETS 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 jurisdictions of various scales, including individual cities, states, provinces, countries, and regions, with the design of each system adapted to the jurisdiction's unique economic and governance profile.





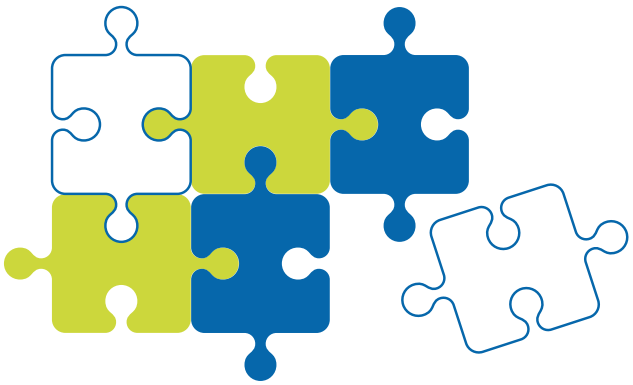
5. ETS can provide an additional source of revenue for the government

An ETS can raise funds through the auctioning of allowances. ETS revenues are gathered by the government and may be used for different purposes, including supporting climate action beyond the ETS, addressing the policy's impacts on vulnerable populations, or financing research and development into low carbon technologies (see also ICAP ETS Brief #6).

6. Emissions trading provides a range of additional co-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 can include cleaner air, improving resource efficiency, ensuring energy security, fostering technological innovation, and creating jobs.





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

'Linking' two or more systems creates a larger carbon market, which opens more (and potentially cheaper) options to reduce emissions. When systems are linked directly, allowances can be used interchangeably for compliance in both systems (see ICAP ETS Brief #4).

ABOUT THE INTERNATIONAL CARBON ACTION PARTNERSHIP: ICAP is an international forum for all levels of governments focusing on best practices in emissions trading. Its work centers on three main pillars: technical dialogue, knowledge sharing, and capacity building. For more information, see the **ICAP website** and its **ETS Map** and **Allowance Price Explorer** or follow us on **LinkedIn (International Carbon Action Partnership)**.