



## EU Emissions Trading System (EU ETS) – Summary Guide

### 1. What is the EU ETS?

The EU Emissions Trading System is the world's first and largest carbon market, launched in 2005. It is the EU's main tool for reducing greenhouse gas emissions by making pollution more expensive for companies.

It operates on a “cap-and-trade” principle:

- The EU sets a cap on the total amount of CO<sub>2</sub> and other greenhouse gases that can be emitted by companies in certain sectors.
- Companies receive or buy emission allowances (permits to emit CO<sub>2</sub>). One allowance equals one tonne of CO<sub>2</sub>.
- Companies can trade allowances. If they reduce their emissions, they can sell extra allowances to others.

### 2. Why Does the EU ETS Exist?

The ETS helps the EU reach its climate targets by making it more expensive to pollute and financially rewarding to reduce emissions.

It is part of the EU's broader goals:

- Reduce emissions by at least 55% by 2030 (vs. 1990 levels).
- Achieve climate neutrality by 2050.

### 3. Who is Affected?

As of 2024, The EU ETS applies in all EU Member States, the European Free Trade Association countries (Iceland, Liechtenstein and Norway) as well as Northern Ireland for electricity generation.

#### Covered sectors:

- Power and heat generation
- Energy-intensive industries (steel, cement, chemicals, etc.)
- Commercial aviation within the European Economic Area
- Maritime transport

By 2027, a new system (ETS II) will cover fuel used in road transport and buildings.

### 4. How Does It Work?

- The EU sets a cap on total emissions.
- Allowances are distributed through auctions and free allocations.





- The cap shrinks each year to cut emissions over time.
- Companies report emissions annually and must surrender enough allowances to match their emissions.
- If they emit more than their allowances, they pay fines and must make up the difference.

## 5. Trading and Pricing

- Allowances can be bought and sold on carbon markets (like energy exchanges).
- High prices encourage companies to innovate and invest in clean technologies.

## 6. Free Allowances and Carbon Leakage

To protect industries at risk of carbon leakage (moving production outside the EU), some companies receive free allowances.

These are gradually being phased out by 2034, especially with the introduction of CBAM (Carbon Border Adjustment Mechanism), which applies a carbon price to imports.

## 7. Revenues and Use of Funds

- EU ETS generates **billions of euros per year** through auctioning.
- Funds are used by EU countries for **climate action**, including:
  - Innovation and modernization funds
  - Renewable energy
  - Energy efficiency
  - Social Climate Fund (from ETS II)

## 8. Monitoring and Compliance

- Companies must monitor, report, and verify emissions annually.
- Non-compliance leads to fines of €100 per excess tonne of CO<sub>2</sub>, plus the obligation to make up for the shortfall.

