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EU ETS and the EU citizens

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Abstract

The European Emissions Trading Scheme (EU ETS) is the largest cap-and-trade system in the world. It covers 40% of the EU's emissions. Because of its extendedness it serves as a role model for the most part of the world. Therefore, it is important to assess whether it is desirable for the Europeans. I will focus on the allocation of allowances as that is considered to be the crucial part in the literature. I will assess the allocation of allowances on the grounds of the principles of effectiveness and fair distribution of burdens. I find that the way as the allowances are allocated now is neither effective nor fair in terms of distribution. Consequently, it is not desirable for the EU citizens. In my thesis, first I introduce the topic of EU ETS, then I review the literature, after I proceed with my argumentation, and in the last chapter, I consider the objections to my argumentation.

Table of contents:

Introduction	p. 3
Chapter 1: Literature Review	p. 4
<i>Emissions Trading</i>	<i>p. 4</i>
<i>EU ETS</i>	<i>p. 7</i>
<i>Research aim</i>	<i>p. 9</i>
Chapter 2: Auctioning and Benchmarking	p. 10
<i>Auctions</i>	<i>p. 11</i>
<i>Benchmarking</i>	<i>p. 12</i>
Chapter 3: Objections	p. 16
<i>Auctions</i>	<i>p. 16</i>
<i>Benchmarking</i>	<i>p. 17</i>
Conclusion	p. 19

Introduction

Emissions trading is a common way to tackle the emission of greenhouse gasses. Emissions trading is often also referred to as a cap-and-trade system. The basic idea behind this system is that the issue of climate change can be tackled through the power of the market and following the logic of economics. In case of greenhouse gasses a cap is imposed on the total amount of greenhouse gasses that can be emitted. After, the allowances are allocated to the actors, who then can either use them or trade with them (Caney, 2010, p. 198). Similar system has been used also before in order to combat environmental problems. Allocation of quotas that can be traded has happened already in the case of fisheries, wetlands management, and industrial pollution policy. In case of climate change, a cap-and-trade system has been already implemented in the USA in relation to SO₂ emissions to deal with acid rains (Newel & Paterson, 2010, p. 96).

There is an important aspect that results from the market-based nature of the emissions trading. In a market economy the actors try to be economical, save money and find the cheapest solutions. As emissions trading is a market-based instrument the actors will seek out opportunities to reduce the emissions where it is the cheapest and most cost-efficient. That is why many actors find the emissions trading such a good response to the climate change (Newel & Paterson, 2010, pp. 96, 98).

The Emissions Trading Scheme (ETS) of the European Union is one of the main climate policies of the EU. It incorporates the around 40% of EU's emissions (European Commission, n. d.) Besides that, it is also the largest cap and trade system in the world. As a consequence, the European Union serves as a model for the rest of the world when it comes to emissions trading systems (Beck & Peter, 2020, p. 781; Dirix, Peeters & Sterckx, 2015, p. 703). It has been started in 2005 with the first, "learning by doing" phase and since then the European Union has introduced several other phases (Dirix et al., 2013, p. 371; Newel & Paterson, 2010, p. 101). As of 2021 we are at the phase 4.

My research on the EU ETS is relevant both from the academic and social perspective. First, the current academic literature lacks the normative assessment of the latest developments of the EU ETS. Namely, as it is a recent development, little literature can be found in regard of the

Phase 4 of the EU ETS. In general, cap-and-trade systems are regarded positively, as they let the market do the work. But by reviewing and evaluating the features of the EU ETS Phase 4 from a normative perspective I could provide a valuable contribution to the existing literature. Through the assessment of EU ETS Phase 4 I could establish whether the EU ETS is following a desirable path. Second, the European Union is often regarded as a model by the other parts of the world. Climate change is a challenge that probably all the countries want to overcome and in this aspect the EU through its emission trading system has particularly a leading role. Therefore, it is important to assess whether the scheme that serves as a model to other countries provides desirable outcome to the citizens of the entity that adopts it.

The research question that tries to investigate the fairness of the EU ETS is as follows: Is the current phase of EU ETS favourable to the people? The thesis statement on this research question is that the EU ETS Phase 4 does not favour the average citizens. In order to prove my point first I will review the literature, then I analyse some features of the EU ETS and finally, I review the objections to my arguments.

Chapter 1: Literature review

Emissions trading

In the literature there are debates about the emissions trading systems in general and about the EU ETS in specific. I will start with the overview of debates related to emissions trading and then move to the EU ETS. Spash (2010, p.169) introduces a broader structural issue in regard of the creation of cap-and-trade systems. He argues that when creating, and operating these schemes, the major power that shapes them is the interest of corporations and companies. The corporations affect and manipulate the emissions market with one goal. This goal is to achieve as much financial gain as possible and meanwhile they do not take into consideration neither the environmental nor the social consequences.

In the literature it often arises the question whether the idea of emissions trading is fair at all. According to the first argument the emissions trading leads to the commodification of the

environment. The issue with commodification is that humans treat the atmosphere as if it could be owned. According to Aldred (2012, pp. 342-344) by owning the atmosphere people are authorized to harm it as it is regarded as their private property, and this is a problem. However, Caney (2010, p. 204) rejects this kind of approach by stating that this argument mixes up the private property rights and the right to use. According to him emissions permits should be understood as a right to use a resource. He brings up the example of fishing permits to show the difference between the two interpretations. When purchasing a fishing permit, people do not purchase the river but the right to fish for a period.

Another issue that Aldred (2012, p. 350) introduces is that emissions trading contributes to people not fulfilling their duty to protect the environment. Through emissions trading some companies are doing the actual work to reduce the emissions and individuals do not participate. Spash (2010, p.169) adds that because of this people do not recognize that change is needed in human behavior, institutions and infrastructure. A similar critic is addressed by Newel and Paterson (2010, p. 98) who state that emissions trading is a way to avoid the domestic action in regard to climate change. However, Caney (2010, p. 211) claims that some duties such as the responsibility to lower emissions can be discharged by delegating it to others.

There are also debates about how the allowances should be allocated. This part is of a crucial significance. Caney (2010, pp. 213-214) introduces the allocation to countries based on population size. However, he finds that not convincing for several reasons. For example, per capita allocation does not take into consideration the differences between people's need; it is not concerned with the other climate change related benefits and burdens; or does not consider whether people have access to sustainable energy sources. However, Newel and Paterson (2010, p. 97) argue that being against per capita allocation means the support of the idea that some people have more rights to pollute than others, so some people have more entitlements to the global commons than others. According to them this would be unfair. Currently, the main ways to allocate emissions are grandfathering, benchmarking, and auctioning. These usually refer to firms. Grandfathering consists of freely allocated permits based on historical emissions. By benchmarking firms get free permits based on their output. Auctioning requires firms to buy permits from auctions (Wang & Zhou, 2020, p. 215).

In the academic literature there is some debate about which allocation method is the best. According to Wang and Zhou (2020, p. 217) grandfathering helps to maintain the competitiveness of firms. This happens because firms do not have to pay for the allowances, therefore they do not end up worse off than the firms in other countries where a cap-and-trade

system is not implemented. However, from another perspective of fairness grandfathering is questionable as those firms get more free permits that have contributed to the problem by polluting more. Another issue with grandfathering is that firms pass the costs on consumers despite they have received free permits (Wang & Zhou, 2020, p. 224). Caney (2010) and Dirix et al. (2013) evaluate grandfathering based on the principles of effectiveness and fair distribution of burdens. The first important aspect is the effectiveness of policies. A climate policy when implemented, has to work, otherwise it does not fulfil the criteria of justice. The reason is that climate change causes a wide-range of problems to people. One of the issues that arises due to climate change is the violation of human rights and these violations should be stopped somehow. A policy that aims to tackle climate change and, in this way, human right violations is just only in case if it works. Otherwise, it just contributes to the maintenance of human rights violations therefore it cannot be desirable (Caney, 2010, pp. 197, 199; Dirix et al., 2013, p. 371; Dirix, Peeters & Sterckx, 2015, pp. 702, 713). The second criterion is the fair distribution of burdens. This criterion entails that a climate policy should contribute to a just allocation of burdens that does not favor certain largely polluting industries. A policy distributes the burdens fairly if the costs will not fall disproportionately on those who are already worse-off. The authors mostly favor the polluter pays principle, which consists of holding responsible those who have caused the problem, so those who have polluted. Thus, polluting entities should bear the burdens (Caney, 2010, pp. 197, 199, 214-215; Dirix et al., 2013, pp. 371-372; Dirix, Peeters & Sterckx, 2015, pp. 702, 713-714). Based on the evaluation of Dirix et al. (2013, pp. 372-375) grandfathering violated the principle of effectiveness as it allows the delay of mitigation due to the overallocation of entitlements. It violates also the principle of fair distribution as grandfathering entails a benchmark that defines the entitlement to allowances, thus ignoring historical responsibility. Caney (2010, pp. 215, 219) finds grandfathering problematic only from the perspective of fair distribution of burdens, but his argumentation is very similar to the one presented by Dirix et al. (2013).

Benchmarking is a bit less discussed in the literature. However, some positive aspects of it are often highlighted. Benchmarking has the positive feature to reward the CO₂ efficient firm while CO₂ intensive firms are likely to receive fewer permits (Wang & Zhou, 2020, p. 218). Besides that, benchmarking is considered favorable from the perspective of distributional outcomes as well. An example of this is that in case of benchmarking the firms pass just a small portion of the costs to consumers contrarily to the other allocation methods (Wang and Zhou 2020, p. 224).

Auctioning is considered to be quite fair because firms buy permits themselves while simultaneously passing the costs to the consumers. Contrary to the grandfathering, where firms pass the costs to consumers even though receiving the permits for free, auctioning is therefore more desirable (Wang & Zhou, 2020, p. 224). Some scholars claim that auctioning fits the polluters pay principle as those have to pay for the emissions who actually emit or those who buy products from polluting industries (Caney, 2010, p. 214; Dirix et al., 2013, p. 372; Wang & Zhou, 2020, p. 218). Aldred (2012, p. 345) and Caney (2010, p. 214) present the idea that auction can be a just practice if the revenues from auctioning are spent in a fair way such as funding adaptation and sponsoring mitigation. Caney (2010) connects this claim to the upper mentioned principle of fair distribution of burdens. In this way polluters pay for the emissions and in the meantime, poor can be helped through the revenues. However, Wang and Zhou (2013, p. 218) disagree with this as they claim that the use of revenues from auctioning can be complicated and can lead to other fairness issues. Zetterberg et al. (2012, pp. 23, 26) claim that auctions are the best form of allocation from the perspective of efficiency, fairness, transparency and simplicity. They state that auction promote innovation because if innovations are widely adopted, the allowance prices will fall and this would not be the interest of big companies in case of grandfathering as they own a lot of allowances.

To sum up the part of emissions trading in general, authors discuss both the broader picture such as manipulation of the design or desirability in general of emissions trading, and they also get involved in more specific issues such as allocation.

EU ETS

Now I turn to the EU ETS specifically. As mentioned in the introduction, EU ETS was founded in 2005 and incorporates 40% of EU's emissions. The current one is the fourth phase and by now it incorporates the energy sector, manufacturing industries and aviation (European Commission, n.d.). In the current academic literature, the EU ETS is often criticized from a lot of different aspects. One of these is related to the EU and its entanglement with the big companies. Several authors bring up problematic aspects about the too close or seemingly too close ties between the EU and the big companies. Caney (2010, p. 216) and Dirix et al. (2013, p. 372) states that the first phase of EU ETS can be criticized in particular for favoring energy companies. The energy companies managed to make a lot of profit without contributing to the decrease of the emissions or if they reduced somewhat the emissions the degree was negligible.

According to Aldred (2012, p. 340) this was possible because energy companies have passed on to consumers the price of allowances even though they have got them for free through grandfathering. In relation to the controversies of the energy companies Caney (2010, p. 219) draws attention to the responsibility of the EU as it was the system that allowed to have such an unfair situation which brings huge benefits to the energy companies instead focusing on the energy need of the poor. Dirix et al. (2013, pp. 370, 372) draw the attention to the fact that the claim that the EU ETS often favors some entities is not only true in regard of the energy companies but also to high emitting countries, large companies that work in a carbon-intensive way, powerful interest groups and dominant stakeholders.

Another sector that is presented in several articles as a powerful entity is the aviation sector. The EU ETS was extended also to the flights (Beck & Kruse-Andersen, 2020, p. 781). However, this cannot be described as a very successful act because of several issues. First, as stated by Dirix, Peeter and Streckx (2015, p. 710) and Newel and Paterson (2010, pp. 103-104) the inclusion of the aviation sector has happened only in 2012, in the Phase 3 so they could continue the unregulated pollution until that point. The second aspect that is mentioned by Dirix, Peeter and Streckx (2015, p. 710) is that not all flights have been incorporated in the EU ETS. The intercontinental flights have been exempted from the obligation to join to the EU ETS. This has happened because of the interplay of different entities. Several actors opposed and protested against the extension of the EU ETS on aviation because that was against their interest, and as a result of this only a partial extension has succeeded. The opposition came both from countries and airlines. Such developments of the EU ETS in regard of the aviation have contributed to a less efficient functioning of the EU ETS. Also, the example of the aviation has shown that many factors hamper the implementation of policies related to the tackling of climate change. Inefficient functioning of the EU ETS is also caused by external factors such as pressure on behalf of the powerful entities, and the actions of these entities contribute to the unfair situation that has been present in the field of EU ETS.

In the EU ETS inequalities do not rise only in relation to companies or as the consequence of their activity. Inequalities do rise also in relation to states. Namely, in the context of the EU ETS the European Commission sets structures and expectations that harm some states. An example for that is what happened in the Phase 2. In Phase 2 the Commission refused to accept the Kyoto targets of the newly joined states from Eastern Europe, thus reducing the allowances that they could get. This action on behalf of the Commission was problematic as these newly joined states were not part of the EU's formal Kyoto target, therefore they should not have been

bound by that. Nevertheless, the argumentation of the European Commission to sustain its action was that such a huge number of extra allowances that would arise from the Kyoto targets of newly joined states would hamper the efficient working of the EU ETS (Newel & Paterson, 2010, pp. 102-103).

Inequalities between states may be present also in other ways. Brink, Vollebergh and van der Werf (2016, pp. 603, 604) draw the attention to an important aspect. They review different ways as the prices of the allowances can be modified and increased in order to make the EU ETS more effective. However, they mention also the different drawbacks of the situation when the price of the allowances is high. The authors claim that the price of the allowances affect the different member states differently. They state that a higher emission price has a larger negative impact on the economies of the new member states compared to the other member states. This happens because the ETS sectors make up larger part of new members' economies.

The criteria of effectiveness and fair distribution of burdens is used also in relation to the specific characteristics of EU ETS. One of the features that is also assessed is offsetting. Offsetting allows to entities to acquire more allowances if they invest in emissions-saving projects in the third world (Dirix et al., 2013, p. 374). According to Dirix et al. (2013, pp. 374-375) offsetting violates the principle of effectiveness as allows to overly polluting entities to pursue their practice. Offsetting fails to also satisfy the fair distribution as it helps to reinforce the monopoly powers and provides benefits to the emitters that are polluting a lot.

Research aim

The aim of this research is to evaluate the current situation of the EU ETS. I will assess whether the structural features of the EU ETS Phase 4 are allowing a fair functioning and if they are based on the principles earlier introduced in the literature review: effectiveness and fair distribution of burdens. I have chosen these criteria because these are commonly used criteria to evaluate climate policies. Besides that, it has been already used to evaluate the features of EU ETS in earlier phases. In my research I will establish whether the current system of EU ETS is built up in a way that favors the interest the European people.

Chapter 2: Auctions and Benchmarking

The aspect of the EU ETS that I will focus on in this thesis is how the allowances are distributed. It is important to deal with the issue of the distribution of allowances as it is described as a central question of emissions trading by several scholars. For instance, Zetterberg et al (2012, pp. 23-24) say that the issue of the distribution of allowances raises questions related to political feasibility, distributional effects and fairness. Wang and Zhou (2020, p. 215) emphasize the importance of the allocation by stating that the allocation methods are likely to have an effect on the cost-effectiveness of the carbon market. Aldred (2012, p. 340) claims that the allocation of permits has not been ideal and that there is relevant political obstacle to make the allocation more ideal. My argumentation shows through the example of EU ETS that these criticism of distribution of allowances are valid.

In order to assess the allocation rules within the EU ETS it is important to overview how it has changed and what is the method of allocation of allowances today, when we are in the Phase 4. In the first two phases of the EU ETS the dominant method of allocation of allowances was grandfathering (Aldred, 2012, p. 340; Dirix et al. 2013, p. 372; Wang & Zhou, 2020, p. 216; Zetterberg et al., 2012, p. 23). Since the third phase most of the allowances have been allocated by auctioning. In Phase 4 the estimated share of allowances to be auctioned is 57%. (European Parliament & Council, 2018, para. 8; ICAP, 2022, pp. 4, 5). The rest is allocated on the basis of benchmarks based on the regulation of the European Commission (European Commission n. d., European Commission, 2019/331, sections 1-4). Now that the allocation of allowances is done mostly by auctioning many would argue that the EU ETS has become better. As described in the literature review, revenues from auctions can be used to help the poor; those pay for the emissions who actually pollute; and less extra profit will be allowed to the firms compared to the other allocation methods (Aldred, 2012, p. 345; Caney, 2010, p. 214; Wang & Zhou, 2020, p. 224). However, in the following part I demonstrate that these are not the only aspects to take into consideration and that the current way of allocating the emissions raises issues in terms of effectiveness and fair distribution. Most of the arguments that favor the current allocation within the EU ETS (auctioning and benchmarking) over the other methods look at it only in isolation and do not investigate more comprehensively the whole structure. Therefore, they omit to consider the in-depth structural problems related to them. Behind the few superficially visible positive outcomes that the current allocation may show, there are injustices that arise from the structure of the system, and they make the current system undesirable. In the following part I

will show these structural deficiencies that lead to the conclusion that auctioning and benchmarking in the EU ETS does not favor the EU citizens. Both benchmarking and auctioning have several issues and the basis of all the problems that arise is that the wrong actors have too much influence on the process and benefit from it.

Auctions

The objections against the auctioning are related to the rich companies. Different reasons are present. The first reason is related to the origin of the wealth of rich firms. Economic activity is key to gain wealth and to become richer. However, several scholars have shown that the economic growth and the functioning of the economy has always required the consumption of energy. Throughout the past century energy has been created by burning fossil fuels. Therefore, the more someone has polluted the environment the more it has gained economic benefits (Moellendorf, 2022, pp. 77, 78, 80; Shue, 1993, p. 42). As a consequence, currently, those have more capabilities to purchase the allowances that have contributed to the arising of the climate change. Rich firms can purchase allowances and continue to pollute, and because of their economic power they impede smaller and poorer firms to access allowances. In this sense auctioning is similar to grandfathering as it depends on historical emissions. To the contrary, smaller and poorer firms are in a disadvantaged situation. Since there is a relation between pollution and wealth, the reason of being disadvantaged is that smaller firms did not pollute at all (because they are new for instance) or they have polluted to a smaller extent compared to the rich firms. Smaller and developing firms because of their more modest economic capacity cannot compete at the auctions against rich firms. Therefore, firms that have polluted historically and have already more resources can continue polluting and accumulating more wealth while those who did not contribute to climate change are worse off as they have less capability to purchase allowances. In this way auctions reinforce the monopoly powers as they can purchase the allowances and if someone needs allowances, they have to be purchased from those big firms. Thus, it contributes to inequalities. According to Dirix et al. (2013, p. 375) reinforcement of monopoly powers does not satisfy the criterion of fair distribution of burdens. The principle of fair distribution of burdens is harmed as rich firms can continue polluting and getting rich while other companies are deprived from this opportunity.

There is a second reason why auctioning favors unjustly the more powerful firms. Auctioning is a system that is influenced by the various features of the market. However, the characteristics

of a market can be distorted and manipulated by powerful market actors. There is empirical evidence that when allowances are auctioned powerful firms can manipulate the market. They even have the power to distort the price of the emission permits based on their interest. These actions have the capacity to decrease the efficiency of the emissions trading system (Wang & Zhou, 2020, pp. 215, 216). The distortion of the auctioning system not only harms the effectiveness of the system but contributes to the accumulation of wealth on behalf of the already rich and powerful firms. This happens since firms distort the market in a way that favors their economic interest, meanwhile they do not care about other factors such as environmental considerations.

The unequal distribution of wealth and the failure of assigning the desired price to the allowances has some consequences also to the larger population. Rich firms continue to contribute to the aggravating of climate change by accumulating even more wealth. The owners and main decisionmakers of the powerful firms do have the means to adapt to climate change induced by them. However, poor people are more exposed to the effects of climate change (Jamieson, 2010, pp. 269-270). Therefore, besides having less space for economic development, they will be also harmed more heavily by climate change. Shortly, through manipulating auctioning rich firms will not only gain more money but they will contribute to harming the poor who consequently will end up worse off in many different aspects. In this way both principles of effectiveness and fair distribution of burdens is harmed.

Benchmarking

The rules for free allocation of allowances are set up in the 2011 Benchmarking Decision of the European Commission. In phase 4 a revised version of it is in force. The decision was taken pursuant the directives of the European Parliament and the Council, however the final decision and the set up of the specific details were done by the European Commission (European Commission, 2011/278; European Commission, 2019/331; European Commission, n. d.). However, the idea that a supranational body creates the framework for the allocation of free allowances raises some issues. These issues at the end have a negative effect on the outcome from the perspective of effectiveness and fair distribution. The first aspect that justifies the concerns about giving the Commission the power to set the framework of the free allocation has to do with the power of firms and the extent to which the Commission is exposed to manipulation.

There is a lot of literature that discusses the relationship between the lobbyists and the European Commission. Some research presents that the Commission is addressed and manipulated by many interest groups (Klüver, Mahoney, Opper; 2015, pp. 482, 483, 486, 495). Others also state that the Commission is the crucial actor for lobbyists and interest groups who want to influence the decision-making in the EU. It is easier to lobby groups to effectively enforce their interest at the Commission than at the other bodies of the European Union. This happens because in the Commission the power is concentrated in the hand of fewer decision-makers compared to other EU bodies. As the power of the Commission has increased over time, the Commission has also become even more central to lobby groups (Gullberg, 2015, pp. 1534, 1541). Many of the authors presented in the literature review also show that the regulation of the EU ETS fits in this scheme, and it is often subject to successful lobbying.

The EU ETS regulation has favoured the interest of the powerful firms on many occasions. As I have presented in the literature review, some features of the EU ETS have been created on the pressure of rich companies so that the framework favours their economic goals and not the interest of the environment or society as a whole (Caney, 2010, pp. 216, 219; Dirix et al., 2013, pp. 370, 372). Therefore, delegating too much power to an authority that is likely to represent the interest of the rich polluting firms is problematic. By having the Commission as responsible to set the specific guidelines for benchmarking we risk that the free allowances will be distributed in an unfair way. As shown, lobby groups are able to manipulate the benchmarking rules in a way that favours them. This affects all of us. On one hand, it may lead to the exacerbation of climate change as firms do not care about the environment but the profit. On the other hand, it may lead to the accumulation of wealth by those who are polluting the most. According to Jamieson (2010, pp. 269, 270) the unfair distribution of resources has the consequence of exposing the poor people to the effects of climate change. Less resources can be used to the mitigation and adaptation, and to help the poor since the assets available get piled up by the rich. These people in need will also be in a more vulnerable situation than before. All of this can happen since firms are not interested in the implementation of effective climate policy but to make profit (Spash, 2010, p. 169). This is shown also in the case when firms got free allowances by grandfathering, but they still raised the prices and passed the costs of CO₂ emissions permits on the consumers (Wang & Zhou, 2020, p. 228). Letting so much room for influence to these firms in the regulation of such an important issue leads to distributional concerns and a questionable effectiveness.

The second issue with the role of the Commission to create the rules of benchmarking is the lack of incentive. The Commission is not incentivized to represent the interests of the people because of the democratic deficit of this institution. The Commission is often criticised for not having the democratic legitimacy to pursue its functions. In the literature it is often called the least legitimate and accountable European institution. The reason for this is that the members of the Commission are not directly elected by the European electorate (Murdoch, Connolly & Kassim, 2018, pp. 390, 392; Vesnic-Alujevic & Nacarino, 2012, p. 64). Without accountability by people there is no strong incentive to work for the people and to pursue policies that are taking into consideration the interests of the Europeans. I am not saying that it is completely impossible that without democratic accountability the Commission would pursue the interest of the people. However, the world is built on incentives. Word economy goes on because people get rewarded with money for working. People work hard because they get money for working hard. Incentives urge people to do a proper work. The reward of decision makers for their work is that they get re-elected. The Commission does not have the incentive to provide a fair system to the people because they are not accountable to them. If people are worse off that does not affect the Commission because they do not get elected by the people. Discontent among people because of the unfairness of a policy does not affect the position of the people working in the Commission. Because of this lack of accountability, they don't have the incentive to represent the interest of the people and make fair policies.

On the contrary, national governments are accountable to their citizens. In case if the government causes discontent, the electorate can change it to someone that is expected to be better. The same applies in case of climate change. The electorate should perceive whether the actions of the government benefit the majority or not. In case if the government goes against the interest of people in relation to climate change, then the electorate can express its discontent by changing the leaders. However, if the leaders are not accountable there are problems as the direction of policies cannot be changed, and more just policies cannot be adopted. This is exactly the case if the Commission has a disproportionately big role in deciding about the allocations of the free allowances. Caney (2010, p. 200) establishes some aspects that have to be taken into consideration in relation to climate change mitigation. One of these aspects is that the decision-making process must be fair and include all relevant agents. However, a decision-making is not fair if those who are affected by the decision cannot hold accountable those who are making the decision. In this way those in power can act irresponsibly and make decisions that are unfair. In this case it is the Commission that at the end creates the final framework for

benchmarking, and this is a body that does not have direct accountability to the people. Lack of accountability violates both the principle of effectiveness and fair distribution as conscientious citizens cannot change an eventually ineffective or distributionally unfair trend of the Commission.

A third argument against the European Commission having important role in the allocation of the allowances is related to the lack of knowledge. The European Union is a huge organisation with a population of 446 million and it includes 27 countries with several different regions (Eurostat, 2023). In such a huge organisation the European Commission may not be able to take into consideration the needs of all regions of the European Union. This might happen not because the Commission has bad intentions but because of the lack of knowledge and capacity. Considering the needs of all the 27 member states and also the different needs of the different regions within a country is not likely to happen. This is the case because the Commission is a supranational body far from most part of the EU. Therefore, it might have difficulties to hear the concerns of every entity living in the European Union. This situation is similar to the capability of driving a car. One might have a driving licence, but each type of car is different. When someone is used to driving an automatic car then when it comes to drive a manual one that might cause issues. Those who have always driven an automatic car are not used to how to deal with manual cars. They do not feel the challenges that those face who drive a manual car. They are not that much aware to what to pay attention, they do not have the routine with it. This applies also vice versa. Similar thing happens when someone drives only small cars and from that perspective has to understand the issues that a truck driver faces. Until that person has not experienced how is to drive a truck it is hard to imagine that he/she would have the real capacity to understand the challenges of that. Trying to explain to someone how to drive a truck and to what to be aware when driving a truck is difficult if the person that is explaining has experience only with small cars. This is the case when national delegations try to explain national peculiarities to the Commission or when national representatives share their needs in the Council and the Commission has to create policies based on that. The Commission does not have experience with all the regions of the EU. Therefore, they cannot understand the challenges and the needs of the people living there. Contrarily, national governments have more chance to know the necessities of their citizens as they are in the same country and closer to the people. They know what causes injustices and how the life of those who are subject to injustice can be changed the most easily. If the decision makers do not know the needs and the situation of the people that are affected by the decisions, then wrong policies might be formulated. The

Commission has already pursued similar practices. Newel and Paterson mention that (2010, pp.102-103) during Phase 2 the Commission did not consider the particularities of the newly joined Eastern European countries. Instead, the Commission forced these countries to revise downwards their plans. This happened because the Commission had a different, more supranational perspective and consequently it did not focus on the necessities of specific countries. Due to lack of knowledge about the specific situations a centralized supranational authority can contribute to distributional issues.

Chapter 3: Objections

There can be raised some objections against the arguments that I have put forward. In this section I will try to address these objections and show that my assessment of the EU ETS even if it may be subject to some changes, it is valid.

Auctions

My first argument states that those have more power to buy allowances that have polluted more. The concern that could be raised in case of this argument is excusable ignorance. This consist of the idea that polluters are not that responsible for the pollution if they did not know about the harmful effects of it. This is a common argument that is used to exempt polluting entities from the responsibilities. Usually, the benchmark date is 1990. In this year the Intergovernmental Panel on Climate Change (IPCC) published its first Assessment Report. Therefore, from this point on everyone should have known about the harmful consequences of the CO₂ emissions for sure (Moellendorf, 2022, p. 87). Because of the lack of knowledge until 1990 Jamieson (2010, pp. 272-273) and Tan (2023, p. 4) claim that historical emissions should be treated differently.

However, the problem with their perspective is that they talk about moral culpability. My issue with the firms that got rich through pollution is more practical. I am not arguing that they should be blamed and hold responsible for not knowing the consequences of their action. My claim is that there should not be developed a system that favours those who have polluted historically

more. Through auctioning those companies are favoured that have already more money. I acknowledge that firms that did not know about the effects of emissions do not have moral responsibility in that specific area therefore they should not be punished for that. However, I deem unfair towards the other firms that they did not pollute and now they have disadvantage because of the way the allocation of allowances is done. However, a system that would try to treat all the firms equal without allowing richer firms to get more allowances might lead to rich firms to have more costs. Nevertheless, this does not mean that rich firms are hold accountable for their historical emissions. According to Heyward (2021, p. 129) even though it is not right to hold firms liable for their historical emissions, it is not unfair to let them bear part of the costs today. Being not blameworthy does not automatically exclude a causally responsible agent from any moral response. Not knowing about something does not exempt people from later recognizing that they have done something wrong and therefore not to abuse of the beneficial situation that they have acquired through harming the society. Consequently, it is acceptable to create a system where rich firms are not advantaged.

Benchmarking

In the previous chapter I claimed that national governments should have more power in the EU ETS. I based my statement on the fact that they are democratically elected. This means that people can re-elect the decision-makers if they are satisfied with the situation or they can change the leaders if they are not satisfied. However, it can be claimed that elected politicians also represent a threat when it comes to the tackling of climate change. The concerns about re-election push politicians to deal with short term issues. The policies implemented by politicians will have effect quickly and make people's lives better in short run. This enables politicians to be re-elected. Nevertheless, in this way, long-run issues such as climate change are neglected as they are not immediate concerns for most of the voters (Boston, 2020, pp.1-2). Despite these concerns I do stand out for having decision-makers who are elected by the people even in the case of climate policy. People are smart enough to assess that what the elected leaders do is harmful for the community or not. People do have the capabilities to have a correct judgment of the situation. Democracy is based on this assumption, otherwise it would be nonsense to give the people the right to decide who leads the community. Thinking that the people are not capable to make the right decision, or the decision of people is bad, has some implications. Someone may consider the concerns about democracy and the human behaviour related to it too significant to allow people to decide about long-term questions. However, by doing so that

person rejects the whole idea of democracy, as in this way people would not have the chance to influence matters that also affect them.

A related argument that could undermine the idea of democratic accountability is developed by the rational choice theory. According to this reasoning making a rational choice means that people behave in a selfish way. In case of elections this means that when voting, people consider only their self-interest (Edlin, Gelman & Kaplan, 2007, pp. 293-294). In the context of climate change this means that the individual voters will not take into consideration the interests of the society as a whole or the consequences of climate change on the future generations. Instead, they will vote based on their own selfish interests, which often does not overlap with the creation of (fair) climate policies. However, this theoretical assumption in practice does not really hold. Contrarily to the assumptions of rational choice theory voters are not that much of a rational actor. Voters do not have such a strong consideration about their self-interest when they vote. Instead, people put lots of emphasis on what is a socially beneficial option when they cast their vote (Edlin, Gelman & Kaplan, 2007, p. 294). This factor also points to the direction of having a democratic supervision and accountability over those who create the policies in relation to climate change. The electorate is capable of electing and holding accountable the leaders so that they implement effective and distributionally fair climate policies. Nevertheless, the willingness of voters to be mindful of long-term issues does not mean that elected politicians will have them on the agenda. The evidence presented states only the openness on behalf of the electorate to vote altruistically. Therefore, if long-term issues are not on the agenda of parties, people cannot vote for that. Even though, based on the electorate's attitude I could suppose some pressure on the politicians to deal with long-term issues.

My claims in regard of benchmarking are mostly focused on the supranational and international nature of the European Commission. An objection to this can be the global feature of climate change. Climate change is a complex issue, the consequences of climate change are not limited to the responsible countries. Instead, the whole world is affected by them (Shue, 1993, p. 45). Therefore, it might be required to delegate the competences related to climate change mitigation to a supranational body. Dealing with the issue at an international level could help to enhance effectiveness of policies. An international set up gives the chance to share information and coordinate between actors. It can be a good "forum" to find an agreement (Hurds, 2021, pp. 31, 33). Besides that, the current world is globalised. The flow of information, people, and money goes on internationally (Jamieson 2010, pp. 275-276). This is even truer in case of the European Union. Therefore, I do not reject the idea of having international cooperation on the issue of

climate change. However, I sustain my critic in regard of the specific features of the current system. I do think that an international body could help to provide some benefits in relation to the EU ETS. The problem with the current way of functioning is that it is too much exposed to the manipulation of the lobbyists of companies. This issue is also related to the democratic deficit of the Commission. Another important matter is the presence of many country-specific or region-specific aspects. If too many tasks are delegated to an international body, it can omit to take into consideration these special features of the cooperating entities. Therefore, a European Commission that is more transparent and more accountable to the electorate and in charge of less tasks could favour a desirable functioning of the EU ETS. It could have an important role especially in the field of coordination. My claims about the ineffectiveness of the current EU ETS are supported also by empirical data. Even though recently we have experienced decrease in the emissions, the reductions are insufficient to reach the EU targets (European Environmental Agency, 2022/2023). Therefore, EU ETS can be considered ineffective as despite the relevant decrease in emissions, it is unlikely that the reduction targets will be met.

Conclusion

In my thesis I have assessed whether the current set up of the EU ETS is desirable to the EU citizens. Because of the limited space available and the particular importance of the allocation of allowances I have focused on this specific feature of the EU ETS. I have done my assessment by focusing on two criteria that are commonly used in the literature: effectiveness and fair distribution. I found that the current functioning of the EU ETS fails to satisfy these criteria. I have presented different arguments for the different allocation methods used in the EU ETS Phase 4. The issue with auctions is that due to their preceding pollution, those have the most ability to gain more allowances today who have contributed to the problem of climate change. These companies through their market power can also manipulate the EU ETS. These flawed features of auctioning contribute to an ineffective functioning of the EU ETS and to an unfair distributional outcome. In case of benchmarking the main problem is that the European Commission is the entity that creates the benchmarking rules. The first issue with this is that firms are able to manipulate the Commission. This is possible because this is the EU body that

is the most exposed to lobby activity. Another issue is the lack of democratic accountability of the Commission. This makes it even more exposed to the power of lobbyists. Besides that, it also enables the ongoing of undesired processes in regard of climate policy as people cannot interfere with the actions of the Commission. The third issue with the Commission having such a strong role is its lack of knowledge and capacity to understand the specific necessities of the different European regions. These features lead again to an ineffective and distributionally unfair EU ETS.

A strength of my research is that I have included considerations in regard of benchmarking and auctioning that usually are neglected and not taken into consideration. Therefore, I have provided a useful contribution not only in regard of EU ETS, but emissions trading in general. Another strength is the interdisciplinarity of my research as I have included approaches such as rational choice theory. A limitation of my research is that I could focus only on the allocation method. Therefore, as a recommendation for further research I would suggest assessing also other parts of the current EU ETS. Also, similar research could be done in relation to other cap-and-trade systems. Such research would be desired as this would allow comparison of the different systems. Through comparison we could find out which specific features are the most desirable to create a fair system.

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