

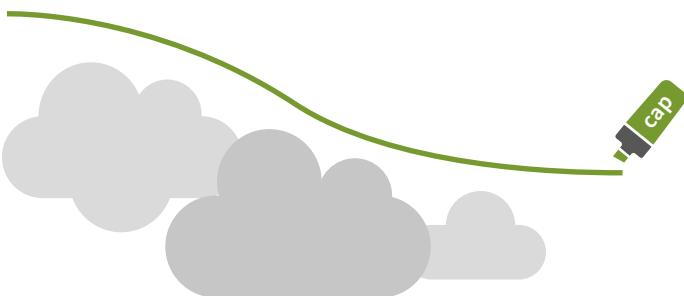
7 REASONS FOR EMISSIONS TRADING

An emissions trading system (ETS) is a market-based instrument that can be used to reduce greenhouse gas (GHG) emissions. The government determines a limit (cap) on total emissions in one or more sectors of the economy and issues allowances according to this limit. Companies in these sectors need to hold one allowance for every tonne of emissions they release. They may receive these allowances for free from the government or buy them in auctions organized by the government. Currently, there are 29 ETSs operating across five continents. 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, 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.

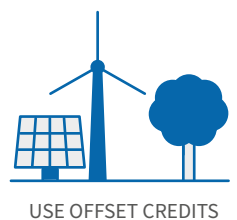
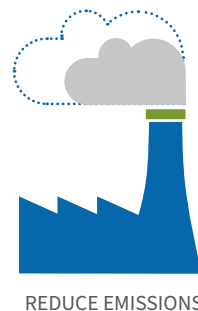


2. ETS puts a firm limit on emissions

In an ETS, the government sets a clear emissions target, capping the maximum amount of emissions¹ 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 provides a long-term signal for businesses and investors.

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

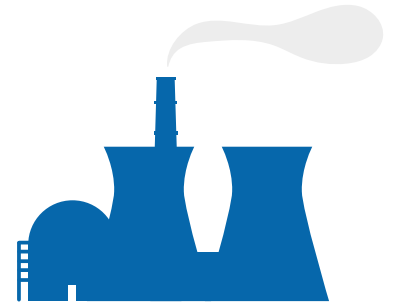
An ETS offers covered entities an inherent level of flexibility regarding their compliance strategies. Depending on their technical, financial, and operational needs, covered entities can choose how they wish to comply. Options typically include: reducing emissions in-house; buying extra allowances from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



¹ Intensity-based ETSs impose a limit on the maximum amount of emissions per unit of output. The cap therefore depends on the level of economic activity.

4. ETS fits a variety of economic and political contexts

ETSs 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 the implementing jurisdiction's unique economic and governance profile.

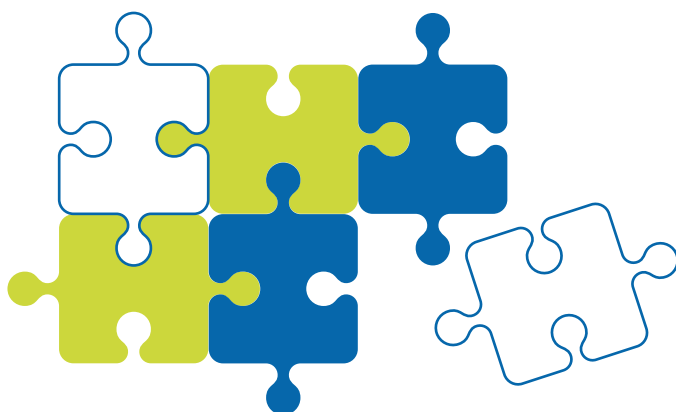
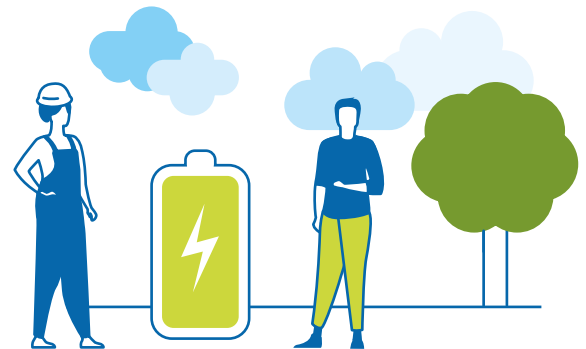


5. ETS can provide an additional source of revenue for the government

ETSs can generate revenues from auctioning allowances. These additional resources are typically collected by the government and can be used in several ways, including supporting climate action beyond the boundaries of the ETS, mitigating the distributional effects of carbon pricing for vulnerable groups, and financing research and development of low-emissions technologies.

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 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

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