

СУЧАСНА СИСТЕМА МІЖНАРОДНОГО ПРАВА

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THE EUROPEAN EMISSIONS TRADING SCHEMES (EU ETS): SOME LEGAL PERSPECTIVES OF MARKET-BASED MECHANISMS

ЄВРОПЕЙСЬКА СИСТЕМА ТОРГІВЛІ ВИКИДАМИ (ЄСТВ): ДЕЯКІ ПРАВОВІ ПЕРСПЕКТИВИ РИНКОВИХ МЕХАНІЗМІВ

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Abstract. *In this article, the implementation of the Paris Agreement by the European Union, the current stage in the development of the climate policy of the European community in the fight against global warming in accordance with the European Green Deal, which was based on the strategy of achieving climate neutrality by 2030 by reducing greenhouse gas emissions by at least 55% to 2030 comparing with the level of 1990, are analyzed. The author researches some legal aspects of the implementation of the "Fit for 55" package of sectoral initiatives to the EU legislation, in particular the current phase of the EU Emission Trading Schemes (EU ETS), market mechanisms of interstate trading of certificates on emissions. The author draws special attention to the prospects of introducing EU's Carbon Border Adjustment Mechanism (CBAM) with the aim of determining a fair price for emissions during carbon-intensive production of goods that are imported into the EU, as well as stimulating cleaner industrial production in non-EU countries, and to related potential challenges and prospects for the development of climate diplomacy in order to achieve agreed compromises between the participants of the Paris Agreement in combating with global warming.*

Key words: *International Law, climate change, Paris Agreement, European Green Deal, Emission Trading Schemes, CBAM*

Анотація. *У цій статті аналізується імплементація Паризької угоди Європейським Союзом, сучасний етап розвитку кліматичної політики європейського співтовариства у боротьбі з глобальним потеплінням відповідно до Європейської зеленої угоди, в основу якої було покладено стратегію досягнення кліматичної нейтральності до 2030 року шляхом скорочення викидів парникових газів щонайменше на 55% до 2030 року порівняно з рівнем 1990 року. Автор розглядає деякі правові аспекти запровадження пакету галузевих законодавчих ініціатив "Fit for 55" до законодавства ЄС, зокрема поточної фази міжнародної системи торгівлі викидами EU ETS, ринкові механізми міждержавної торгівлі сертифікатами на викиди. Особливу увагу в статті приділяється перспективам запровадження механізму прикордонного коригування викидів вуглецю CBAM з метою визначення справедливої ціни на викиди під час виробництва вуглецевоємних товарів, які імпортують до ЄС, а також стимулювання чистішого промислового виробництва в країнах, що не входять до ЄС, зокрема*

пов'язані потенційні виклики і перспективи розвитку кліматичної дипломатії з метою досягнення узгоджених компромісів між учасниками Паризької угоди у боротьбі з глобальним потеплінням.

Ключові слова: *Міжнародне право, кліматичні зміни, Паризька угода, Європейський зелений курс, Схеми торгівлі квотами на викиди, CBAM.*

Introduction. The impacts of climate change are increasingly frequent and severe, and scientific warnings about the dangers of the current pathway have become stronger than ever (IEA 2023). Improving the legal mechanism for regulating of activities that have a negative impact on climate change within the framework of international legal cooperation is urgent for the parties of the Paris Agreement to achieve the global goal “to set the world on a clear path to keep 1.5°C within reach, to protect those impacted by climate change and to leave no one behind” (Paris Agreement, 2015). It was emphasized during COP28 that “the framework calls for regional and international cooperation, including for the first time asking to also look at the need to look at the transboundary nature of climate impacts” (COP28). The European Green Deal is the ambitious flagship policy towards a more sustainable future and can be considered like a major step forward in global climate change efforts and represents a significant and ambitious attempt to inspire other key actors to step up (Blaschke&Johns, 2021). Crucial role of finance has to play in delivering ambition due to such system like the European Emission Trading Schemes (EU ETS) for greenhouse gas emissions allowance trading and the EU’s Carbon Border Adjustment Mechanism (CBAM) to put a fair market price on the carbon emitted during the production of carbon intensive goods importing to the European Union.

The purpose of research is to analyze the current climate policy of the European Union, some legal aspects, prospects and challenges of the implementation of the European Green Deal to align with the Paris Agreement, the legislative package of sectoral initiatives "Fit for 55", in particular the current phase of the European Emission Trading Schemes (EU ETS) and EU’s Carbon Border Adjustment Mechanism (CBAM).

Recent literature review. The author draws on data from international organizations and research institutions that have conducted comprehensive global or regional studies of the prospects and challenges of implementing the European Green Deal in accordance with the Paris Agreement, the implementation of the “Fit for 55” package, in particular the reformed current phase of the European Emission Trading Schemes (EU ETS), and the legal prospects for the introduction of Carbon Border Adjustment Mechanism (CBAM). Among researchers who began to highlight this problem should be named Aleksandar Zaklan, Jakob Wachsmuth, Vicki Duscha, Sebastian Oberthür, Claire Dupont, Constantin Blaschke, Dietrich John and Julia.

Main research results. In order to prevent the danger of anthropogenic influence on the climate and stabilize the level of greenhouse gas concentrations, the UN Framework Convention on Climate Change was claimed in 1992, later the Kyoto Protocol was adopted in 1997, and in 2016 it was replaced by the Paris Agreement, in accordance with Article 2 of which the parties agreed to "keep global temperature increases below 2°C above pre-industrial levels and continue efforts to limit temperature increases to 1.5°C above pre-industrial levels" (Paris Agreement, 2015). The Paris Agreement became the basis for the possibility of providing support to countries that need additional financial and technical assistance to achieve global climate goals. The experience of countries' cooperation within the framework of the Kyoto Protocol was taken into account, and in accordance with the Paris Agreement, interstate trade in quotas was prohibited. At the same time, the Paris Agreement does not prescribe strict control mechanisms for the observance and fulfillment of contractual obligations, only a commission of international experts is given the right to check the information provided by countries regarding their achievements in reducing greenhouse gas emissions.

The current stage in the development of the EU's climate policy in accordance with the Paris Agreement is the implementation of the European Green Agreement (Communication...), which laid out the EU's strategy for combating climate change and achieving climate neutrality with an initial set of goals by 2030.

The European Commission has adopted a series of proposals to make the EU's climate, energy, transport and tax policies appropriate for decreasing of greenhouse gas emissions by at least 55%

by 2030 compared to level of 1990, as outlined in the European Green Deal (Communication...), and established in the European Climate Law (Regulation...).

As part of the European Green Deal and the European Climate Law, the EU has set the goal for achieving climate neutrality by 2050. It requires that the current levels of greenhouse gas emissions will be decreased significantly over the next decades. The EU's interim target for reducing emissions by 2030 was updated from 40% to at least 55% (EU Parliament). For this purpose, on July 14, 2021, the "Fit for 55" package was adopted, which by its nature is a package of sectoral legislative proposals and amendments to the current EU legislation on the reduction of net greenhouse gas emissions in order to provide a balanced basis for achieving the EU's interim climate goals by 2030 (Communication ...). The "Fit for 55" package includes legal acts in such important areas as the Emissions Trading System (EU ETS), regulation of the allocation of efforts to reduce emissions, land use and forestry (LULUCF), alternative fuel infrastructure, the Carbon Border Adjustment Mechanism (CBAM), social climate fund, green aviation fuel (RefuelEU) and greener shipping fuel (FuelEU Maritime), reducing methane emissions, CO₂ emission standards for cars and vans, energy taxation, renewable energy sources (RES), energy efficiency and energy efficiency of buildings (Communication ...).

The European Emissions Trading System (EU ETS) was created in 2005 and significantly reformed in the period 2013-2020 during its third phase (European Commission). EU ETS means the system for greenhouse gas emissions allowance trading within the Union in respect of activities listed in Annex I to Directive 2003/87/EC other than aviation activities (European Parliament and the Council, 2003). International Energy Agency indicates that "the experience from the EU ETS shows that interactions between benchmark design and pass-through of carbon (opportunity) costs need careful consideration and need to be followed over time as carbon prices varies" (IEA 2020).

The previous system of national limits was replaced by a single emission limit for the whole of the European Union, and an auction of allocation of allowances was introduced with new rules for allocation of allowances, which were still provided free of charge, were agreed, including 300 million reserve allowances for new entrants, to finance innovative renewable energy technologies, carbon capture and storage, also more sectors and gases were included. The EU ETS system operates in 28 EU member states, as well as in other countries like Iceland, Liechtenstein and Norway. Within the framework of the system, companies can buy and sell emission allowances, as well to use a limited number of international credits generated by emission reduction projects (Costantino, 2022).

According to International Energy Agency "an emissions trading system is generally embedded within higher-level greenhouse gas mitigation objectives, including those expressed within each country's nationally determined contribution (NDC) to the Paris Agreement on climate change and longterm mitigation strategies" (IEA 2020). There is an expert opinion that "ETS is not the only policy in Europe affecting GHG emissions, at the European level it forms a policy triad together with renewable energy and energy efficiency targets, while further policy initiatives occur at the national and even local level" (Zaklan, Wachsmuth & Duscha, 2021).

The package "Fit for 55" contains the Commission's proposal to amend Directive 2003/87/EC on the revision of ETS (2021-2030), including robust rules to eliminate the risk of carbon leakage, an annual reduction of the total emission quotas by 2.2% starting from 2021, the system of free allocation of quotas will be extended for another 10 years, as well as mechanisms for providing financial assistance to energy-intensive industrial sectors and the energy sector for the transition to a low-carbon economy, the established modernization fund will support investments to promote a just transition in carbon-dependent regions in 10 low-income Member States (European Commission...).

Such companies as energy suppliers, oil refineries and coal suppliers are eligible to participate in the Emissions Trading System, where they are able to buy and sell national emission certificates. There are two types of certificates at the EU markets: green certificates and emission certificates.

A green certificate can be considered the opposite to an emission certificate, while emission certificates such as EUA - EU Allowances impose costs on non-renewable production and set a maximum level of total emissions. Green certificates create additional income for renewable production and guarantee a minimum level of renewable production. The price of green certificates depends on deficit at the market. The price is higher when the green certificate scheme is driven by rigid governmental policy objectives. Certificates cannot be transferred between European markets,

unlike emissions certificates, so the overall market size is small. Markets of green certificates have fallen out of favor last years, and only a few European countries have still operated this mechanism, including Belgium, Sweden, Norway and Poland. Most of the markets have been organized at the national level, with the exception of Norway and Sweden, where there is a common market for environmental certificates called ElCert (Law on Elsertifikater, 2011). Most of trading is done due to such brokers as STX, Cleanworld, Evolution Markets and ACT or at the Green Power Hub platform. The price for Carbon Tax Rates inside of the EU is described below.

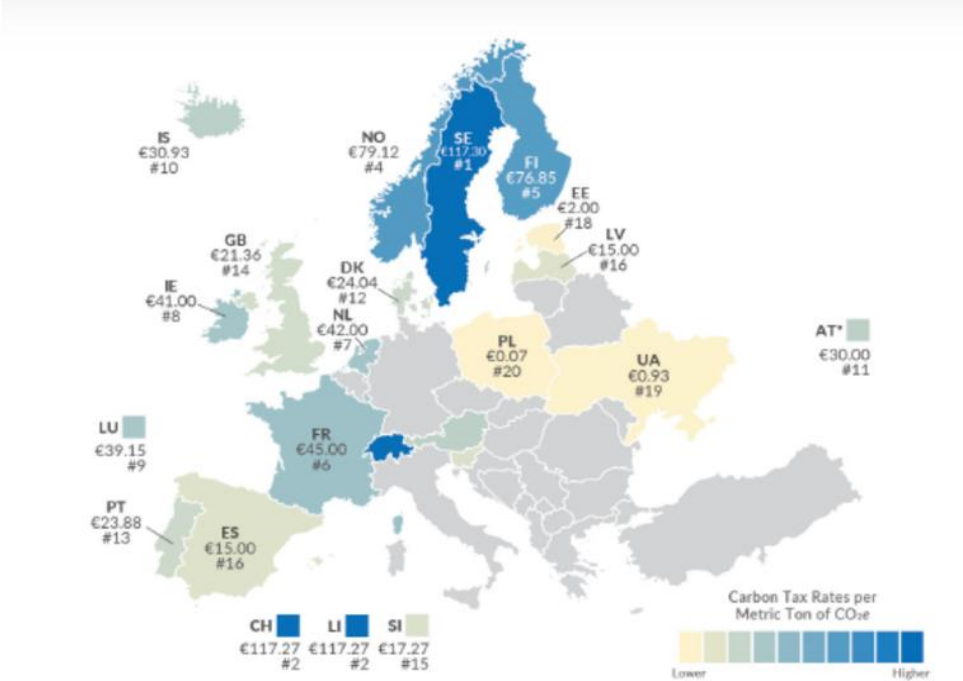


Fig.1. Carbon Tax Rates (Source: Tax Foundation, 2023)

Emission certificates fix the volume of emissions for which the financial responsibility is taken by supporting climate protection projects. One certificate corresponds to one ton of greenhouse gases. The amount of greenhouse gas emissions that are reduced or avoided by a climate project is calculated for the production of electricity from renewable energy sources by the amount of greenhouse gas emissions that are reduced or avoided as a result of the implementation of the climate project. The base scenario describes the volume of greenhouse gas emissions that would have been generated without the implementation of the climate project, the difference between baseline emissions and expected project emissions provides the expected reduction in emissions. Responsibility for CO₂ emissions from the production of products and services that cannot be further reduced can be assumed by purchasing emission certificates. Such repayment reliably confirms that the owner of the certificates has contributed to climate protection. The price of emission certificates at EU market during 2020-2023 is represented below.

The price of emissions allowances in the EU

Cost per tonne of carbon dioxide produced (€)



Source: Data provided by Montel; due to licensing this data is not available for download
EU Emissions Trading Scheme prices (December contract)

EMBER

Fig.2. The price of emission certificates in the period of 2020-2023
(Source: Montel, 2024)

For determining a fair price for emissions in the processes of the production of carbon intensive goods imported to the EU and stimulating cleaner industrial production in non-EU countries the EU Carbon Emissions Border Regulation Mechanism (CBAM) was introduced in the Regulation (EU) 2023/956, according to which “the EU ETS and the CBAM share a common objective of pricing greenhouse gas emissions embedded in the same sectors and goods through the use of specific allowances or certificates” (Regulation...). The step-by-step implementation of CBAM is consistent with the end of the free allocation of allowances under the EU Emissions Trading System (ETS) to support the decarbonization of EU industry.

At the transitional stage from October 1, 2023, CBAM has been applied to imports of iron, steel, aluminum, fertilizers, electricity and hydrogen, while oil and gas are not on the list. The purpose of the transition period is to collect information on embedded emissions to improve the methodology for the next period. The Regulation establishing a carbon border adjustment mechanism should apply to goods imported into the customs territory of the Union from third countries, except where their production has already been subject to the EU ETS through its application to third countries or territories or to a carbon pricing system that is fully linked with the EU ETS (Regulation (EU) 2023/956). The proposed rules require importers of goods to pay for CBAM certificates equivalent to the GHG emissions embedded within them, a discount is proposed for emissions covered by the GHG pricing mechanism in the country of origin (Report...2022). After January 1, 2026, importers will have to annually declare the number of goods imported into the EU in the previous year and their greenhouse gas emissions to receive an appropriate number of certificates to CBAM, the price of the certificates will be calculated depending on the weekly average auction price of EU ETS allowances expressed in Euro for tone of CO₂ emitted (European Commission, 2023). The phasing-out of free allocation under the EU ETS will take place in parallel with the phasing-in of CBAM in the period 2026-2034 (European Commission, 2023).

Communication from the Commission on the 12 of May, 2021 entitled Pathway to a Healthy Planet for All, EU Action Plan: 'Towards Zero Pollution for Air, Water and Soil' announced the promotion of appropriate tools and incentives to better implementation of the principle “polluter pays” and in such way to finalize the gradual abandonment of "free pollution", the corresponding principle is laid down in Article 191(2) of the Treaty on the Functioning of the European Union. (Communication...2021). The gradual termination of free allocation within the framework of the EU ETS is planned in parallel with the gradual implementation of CBAM during the period of 2026-2034 (Communication...2021). From this year the EU has expanded the scope of the European Emissions Trading System (EU ETS) by including the maritime sector (Safety4Sea, 2024). The EU ETS for maritime transport applies to all maritime transport with at least one call within the EU, covering 100% of emissions for transport between two EU ports and 50% for transport between EU ports and

non-EU ports (Directive 2023/959). It provides for a three-year phase-in period, increasing emissions from 40% in 2024 to 70% in 2025 and 100% in 2026, it applies to cargo and passenger ships with a gross capacity of more than 5,000 registered tons from 2024 and to seagoing vessels with a gross capacity of more than 5,000 registered tons from 2027 (Directive 2023/959).

Member States' auctioning revenues will increase as a result of the inclusion of maritime transport in the EU ETS (Directive 2023/959). It was specified that "Member States are encouraged to increase the use of EU ETS revenues pursuant to Article 10 (3) of Directive 2003/87/EC to contribute to the protection, restoration and better management of marine-based ecosystems, in particular marine protected areas" (European Parliament and the Council).

To stimulate cost-effective emission reductions in buildings, road transport and additional sectors, the new emissions trading system ETS 2 has been introduced for fuels combusted in these sectors and revenues from such auctioning of emission allowances will supply the new Social Climate Fund to address for climate and social actions in the EU with total ambition to mobilize together with the Member States' contributions 86.7 billion of Euro in the period from 2026 to 2032 (European Commission...). ETS 2 will be operated from 2027, the monitoring and reporting of emissions will be started in 2025 (European Commission...).

After the election of Joe Biden, the USA returned to the Paris Agreement. The Inflation Reduction Act of 2022 puts the USA on track to meet its 2030 Nationally Determined Contributions under the Paris Agreement with an estimated \$369 billion in climate investments over the next ten years (Public Law No. 117-169 (08/16/2022)). Providing such state subsidies to American companies violates WTO rules and makes this option infeasible for the EU (Sarah Jackson, Mary Helimich, 2022). Trade disputes over schemes to subsidize the decarbonisation of industry and transport will take place. The US does not apply CBAM.

China started the implementation phase of the national ETS in 2017 for limitation and reduction of CO₂ emissions in a cost-effective manner, that could become a major climate policy tool to help China realize its Nationally Determined Contribution to the Paris Agreement on climate change and its long-term low-carbon strategy, but the national ETS has covered only coal- and gas-fired power plants (IEA 2020). China has not applied CBAM.

Combating with climate change has become an issue of geopolitics. The relevant legal-institutional framework puts particular demands on EU coordination for coherence and unity in EU external climate policy (Oberthür & Dupont, 2021).

Conclusions. In the framework of the European Green Deal, the European Union announced the goal of achieving climate neutrality by 2050. In order to achieve global climate goals, the European Community reformed its emissions trading system (EU ETS) and established the general limitation of emissions for whole EU, as well as the introduction of an auction of allocation of quotas with new rules. Companies registered in the ETS obtain the right to buy and sell emission certificates, in such way the EU has introduced financial responsibility for production emissions that cannot be further reduced. There are emission certificates and green certificates in circulation on the EU markets. Green certificates have been losing popularity in recent years because their circulation is possible only within the boundaries of each individual EU country and, accordingly, their prices are determined by national markets. Green certificates have been currently in circulation only in the markets of Belgium, Sweden, Norway and Poland. Interstate trade in EU markets is only permitted by emission certificates. At the same time, it is obvious that the introduced additional financial responsibility of EU member economies should be shared with other partners. To implement the EU's intermediate goal of reducing emissions by 55% by 2030 through the implementation of the package of sectoral legislative proposals "Fit for 55", among which the new CBAM system was proposed, which, according to the legislators, should become a tool to reduce carbon leakage for importers who relocate production to countries with less strict climate policies

In fact, from 2026, the CBAM should act as an incentive for the EU's global trading partners to decarbonize their high-emission sectors, as well as a fair equalization of EU market requirements for both European producers physically located in and outside of Europe. CBAM will clearly affect the competitiveness of importers on EU markets. The governments of the countries of origin of imported goods to the EU markets will be forced to find an appropriate balance between national ambitions to achieve zero emissions and trade relations, appropriate strategies and procedures will

have to be worked out, adapted and agreed upon. Inevitable dissatisfaction of countries exporting carbon-intensive goods to the EU, there is a possibility to appeal the CBAM as a discriminatory trade barrier in the World Trade Organization. The synchronization of the EU and US markets is in question, since CBAM is not applied in the American legislation, at the same time subsidy schemes for the greening of industry are foreseen and consultations are currently ongoing regarding the provision of legislative opportunities for European countries to participate in subsidy schemes. At the same time, the EU considers CBAM exclusively as an environmental measure and it is doubtful whether the political will could appear to offer exemption from additional taxation or offer other concessions to third countries.

Climate policy has become part of global strategizing. The prospect of achieving global climate goals and the effectiveness of the fight against global warming depend on rationally developed and agreed solutions by the international community. Alone, Europe is not able to combat global warming.

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