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## **IMPROVING THE FUNCTIONING OF THE EUROPEAN UNION EMISSION TRADING SCHEME**

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At the end of the first period of the EU ETS, there is a burning debate about the way the allowances have to be allocated. The initial allocation of rights is a tightly sensitive issue because it influences decisions of investment, and modernising and plant operation, especially when we are confronted to market failures: issues of information, incentives...

The aim of this paper is to find the adequate approach in order to remedies to these failures. To achieve that target, we propose to make a comparison between different NAP'S of the first period, to quantify the large difference in free allocation across countries.

First of all we will identify the deficiencies of each approach. For example using grandfathering based on historic emissions, encourages strategic behaviour to capture the rent and favour fossil fuel generation. Or making reserve for new entrants makes perverse incentives that reduce the efficiency of the EU ETS in reducing CO2 emissions.

The second step will consist on proposing other approach to circumvent those issues: Such as resorting to auctioning could support the transparency of the market by avoiding asymmetric information and strategic behaviour, it may encourage investment by recycling the revenues of that mechanism. We can also use uniform benchmark which consist on making a unique free allocation based on historic emissions and removing reserve for new entrant (which made the success of SO2 and Nox in the US)

Finally we will choose the approach that helps us, at the same time, to get, harmonised NAP'S and to circumvent the differences met in the first phase.

The EU ETS has an efficient market design, which may be undermined by the approach of the allocation. If we identify the problems we can improve the functioning of the system.

### **References**

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