

PROJECT

Climate
Energy

Effects of emissions trading on electricity prices

The sharp rise of electricity prices across Germany in 2005, provoked dispute. The climb in prices was blamed, among other things, on the introduction of the European Union Greenhouse Gas Emission Trading Scheme (EU ETS). In Germany emissions allowances were allocated free of charge to all companies. However, the electricity producers decided to include the value of the allowances as opportunity costs when calculating their variable costs and when establishing prices for consumers. The survey deals with questions concerning the legal and economic legitimacy of this approach and how to avoid windfall profits for the electricity producers.

The EU ETS is a market-based instrument that is intended to contribute to an efficient mitigation of greenhouse gas emissions. In order to implement an emission trading scheme, emission allowances had to be distributed. One method of allocating allowances is to distribute them without charge to emitters for example based on historical emissions (grandfathering). Another method is make emitters pay for the allowances they receive, e.g. by auctioning certificates off to the highest bidder.

The survey analyses theoretically, how these allocation methods differ with respect to the quantity of emissions for which costs are internalised. In the framework of the analysis, various problems are identified such as windfall profits and undesirable incentives to invest in power plants damaging to the climate. Various alternative policy options are put forward and analysed in order to find solutions to these problems.

The [Project Report](#) [1] is available for download.

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Links

[1]

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