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The functioning and socio-economic impacts of the EU Emission Trading System: updated evidence and insights

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Abstract

For decades, environmental degradation has been the focus of public opinion, academia, research centers, and institutions. This attention is motivated by increasing awareness of the severe ecological and socio-economic problems caused by climate change. The European Union is one of the most active jurisdictions in addressing these problems, having implemented several measures over the last two decades.

One of the pillars of the European climate policy framework is the EU Emissions Trading System (ETS). In this paper, we investigate the development of that system, as well as its current structure and functioning. In addition to providing an overview of the EU ETS and the new EU ETS 2, we analysed the potential socio-economic impacts of these mechanisms. This is particularly important for EU ETS 2, which will create an emissions market for sectors such as buildings, transport, and small business emitters, where price increases may have a more significant regressive effect.

To study whether this is the case we examine three countries, France, Italy, and Hungary. Through a literature and scenario review, we find that negative effects are expected for vulnerable households in these countries. Recycling carbon market revenues to support vulnerable households can mitigate the adverse effects of EU ETS 2, and the EU's establishment of the Social Climate Fund (SCF) goes in this direction.

Further recommendations to make carbon markets more effective and fairer concern using revenues for low-carbon investments, focusing on carbon removal technologies.

Strengthening international cooperation with non-EU jurisdictions should be promoted to ensure that the system works well by linking the existing carbon markets.

By properly using ETSs, an increasing number of countries may hopefully move towards rapid decarbonisation and, at the same time, achieve a truly just transition in the coming years.



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