Domestic Emissions Trading Schemes: Readiness Preparation and Challenges for Implementation

Partnership for Market Readiness (PMR)
1\textsuperscript{st} Partnership Assembly Meeting (PA1)

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Barcelona, May 31, 2011
Lesson #1: Setting-up market based instruments is a learning process

- **Phase 1**: Preparation
  Identify the role of ETS in the policy mix and interactions with other policies, analyze the options carefully (accepting that phantasy of the market will be greater than the phantasy of the designers)

- **Phase 2**: Early Implementation (Piloting)
  Try it in practice (avoid long-term poisoning of the scheme from failures in the early phase)

- **Phase 3**: Acceptance (piloting -> broad implementation)
  Allow regulators, regulated entities and third parties to learn to live with the scheme

- **Phase 4**: Large-scale impacts (broad implementation)
  Bring the scheme to its full potential, implement a design which reflects policy interactions extremely carefully

* special relevance for market readiness measures
** extremely high relevance for market readiness measures
Lesson #2: Different dimensions of learning should be addressed with a balanced approach

<table>
<thead>
<tr>
<th>ETS</th>
<th>Legislator/Regulator</th>
<th>Regulated entities</th>
<th>Third parties (service providers, NGOs et al.)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ETS</strong></td>
<td><strong>Capacity/Basic skills</strong></td>
<td>Phase 1**</td>
<td>(Phase 1**)</td>
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<td></td>
<td><strong>Experience</strong></td>
<td>Phase 1**+2**</td>
<td>Phase 2**</td>
</tr>
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<td></td>
<td><strong>Acceptance</strong></td>
<td>Phase 1**+2**</td>
<td>Phase 2**+3*</td>
</tr>
<tr>
<td><strong>ETS</strong></td>
<td><strong>Infrastructure (legal, services, technical)</strong></td>
<td>Phase 1**+2**</td>
<td>Phase 2**+3*</td>
</tr>
<tr>
<td>+ „RoP/RoM“</td>
<td><strong>Policy mix, Policy interactions</strong></td>
<td>Phase 1**+3**+4</td>
<td>Phase 3**+4</td>
</tr>
</tbody>
</table>
Lesson #3: It is about quantity controls, it is about high quality and trusted data

- A market-based instrument for an immaterial commodity (emission allowance) must be based on high-quality and accountable data
  - Markets should trust in the data
  - Third party verification of data and transparency are key
- Time consistency is more important than precision (at least in the beginning)
- Clear guidelines are necessary for monitoring as well as for verification (including accreditation)
  - Monitoring and reporting provisions are important
  - Procedures and institutional arrangements are key
- Data issues should be addressed parallel to the design phase
- Memo item: The data issue is a key determinant for the definition of the scope of the scheme
Lesson #4: Cap-setting and allocation are two sides of the coin

• **Cap setting is key for the scheme**
  - Cap creates the primary price signal
  - Clear procedures (and institutional arrangements) are important (‘Chinese walls’ between cap-setting & allocation)
  - Interactions with other policies and measures must be reflected

• **Allocation is the key challenge for the scheme**
  - Highly controversial (because it is also a distributional issue)
  - It is not only about distribution, allocation is essential for incentives (price signal)
    - distributional effects between incumbents (‘early action’) and incentives
    - distributional effects & incentives for incumbents vs. new entrants
Lesson #5: Finding the right balance between flexibility and simplicity

• Complexity and flexibility should be limited as much as possible
  – Regulated entities ask for special provisions and flexibility, this leads to complexity
  – Complexity mostly decreases transparency
  – Complexity incentivizes gaming

• Designing schemes with reduced complexity requires courage and experience as well as broad stakeholder involvement (… and some Enlightenment at least)
Lesson #6: Other technicalities matter and should be addressed early

- There are important technicalities beyond the narrow framework of the scheme which should be addressed at an early stage (to ease the phase-in for the regulated entities and to avoid crime and fraud)
  - Many legal issues
    - Permitting and allocation
    - Compliance and enforcement
    - Taxation (VAT ...)
    - Liabilities
  - Accounting issues
  - Market oversight issues
  - Market transparency issues (publication strategies ...)
- Respective stakeholders should be brought in early
Lesson #7: The position of ETS within the policy mix is to be defined

• The role of economic instruments
  – which can trigger cost-effective decentral decision-making based on relative prices
    • Fair comparison is needed: real world taxes vs. real world ETS
    • flexibility to an changing (economic) environment and to other policies
      – for those sectors which are sensitive to prices
• The role and evolution of market-based instruments
  – price signals created by markets
    – robust and non-distorted price signals for regulated entities
• The interaction of ETS with other policies and measures must be carefully analyzed and balanced
Climate policy = ETS & more

\[ T \cdot (I^2+C) \cdot I \cdot m (F,L, P) + s(B,P,T) + (I_i+M_i) \]

**Linking**

- International initiatives & markets

**Allocation**

- Remove specific barriers*
- Strengthen specific players*
- Support specific technologies*

**Auction revenue spending**

- Fair & liquid market with manifold players

**Scarcity**

- Innovation
- Internalization
- Capacities

* Evaluate, modify & eliminate specific policies, if necessary
Lesson #7: EU ETS is a central pillar of an comprehensive & ambitious policy mix

- Matured/competitive potentials:
  - Carbon pricing: ETS for large large point sources, taxes for diffuse sources
  - (Exceptions: large uncertainties on quantities)

- Locked potentials
  - Regulation, incentives
  - complementary to carbon pricing (ETS, etc)

- Innovation-intensive potentials:
  - Regulations, incentives, infrastructure roll-out
  - complementary to carbon pricing (ETS, etc)

- Infrastructur-related potentials:
  - Infrastructure planning, risk and uncertainty management with appropriate lead-times, targeted incentives and regulatory framework for respective demand and supply options
Lesson #7: Interaction of policies must be reflected carefully

- Emission reductions from EU ETS
- Emission reductions from other policies and measures to support power production from renewable energy sources

<table>
<thead>
<tr>
<th>Year</th>
<th>Emissions (bn t CO₂)</th>
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<tbody>
<tr>
<td>2005</td>
<td></td>
</tr>
<tr>
<td>2020</td>
<td></td>
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<tr>
<td>1/3</td>
<td></td>
</tr>
<tr>
<td>1/2</td>
<td></td>
</tr>
<tr>
<td>2/3</td>
<td></td>
</tr>
<tr>
<td>Multilateral target</td>
<td>1/3, 1/2, 2/3</td>
</tr>
<tr>
<td>Unilateral target</td>
<td>2020 EU ETS cap</td>
</tr>
</tbody>
</table>

Electricity in additional renewables in 2020 through other support schemes

Öko-Institut 2010
Thank you very much

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