Maintaining best practice in ETS design and implementation: Updating the ETS Handbook

Stuart Evans
Senior Engagement Manager
Vivid Economics

pmr | PARTNERSHIP FOR MARKET READINESS

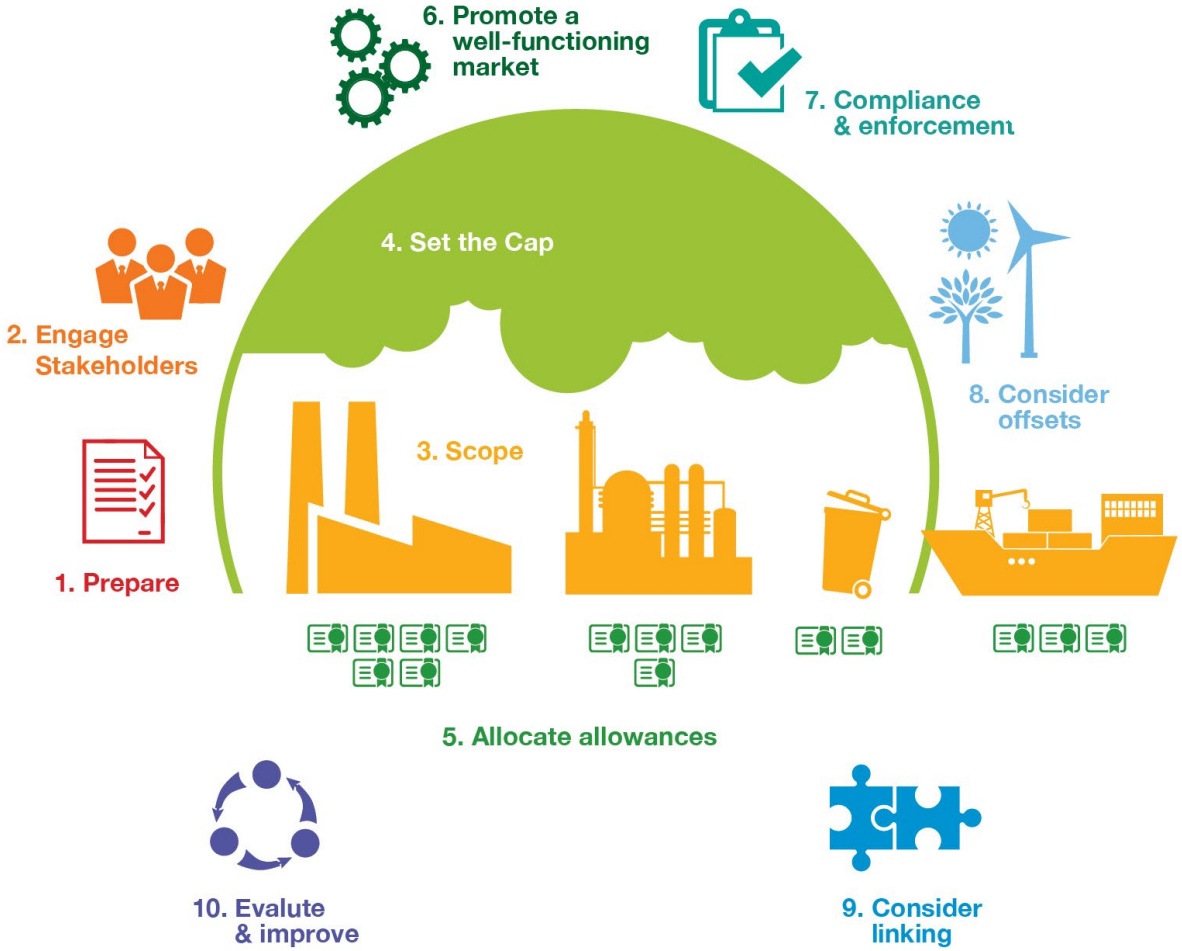
icap International Carbon Action Partnership

Why emissions trading?

- A quarter of global greenhouse gas (GHG) emissions are being covered by a carbon price, with emissions trading playing an increasingly important role.
- ETSs are a key tool in driving the economy wide transformations required to reduce emissions and meet climate targets, channeling capital flows, mobilizing knowledge, and tapping the creativity of entrepreneurs.
- ETS design needs to be appropriate to its context. This handbook is intended to help decision makers, policy practitioners, and stakeholders achieve this goal.

pmr | PARTNERSHIP FOR MARKET READINESS
icap International Carbon Action Partnership

ETS design in 10 steps



pmr | PARTNERSHIP FOR MARKET READINESS

icap International Carbon Action Partnership

Rationale for update

- New insights, approaches, and designs have proliferated since the original 2016 guide:
  - ETSs in China, Germany, the UK, Massachusetts and Nova Scotia, pilot ETS in Mexico
  - Learnings and refinements in existing ETS (California, Québec, the EU and New Zealand)
  - Linking of EU and Swiss ETS, Virginia and New Jersey join RGGI
  - Development of ETSs in Colombia, Ukraine and Indonesia
  - Consideration of ETSs across the world, such as Brazil and Japan
- Better understanding of how ETSs operate and what makes successful design

New developments in managing carbon leakage

Benchmarking

- The globally preferred method of allocation
- Avoids the incentive and leakage risk issues associated with grandparenting
- Output based allocation has been particularly successful due to its flexibility

Border adjustments

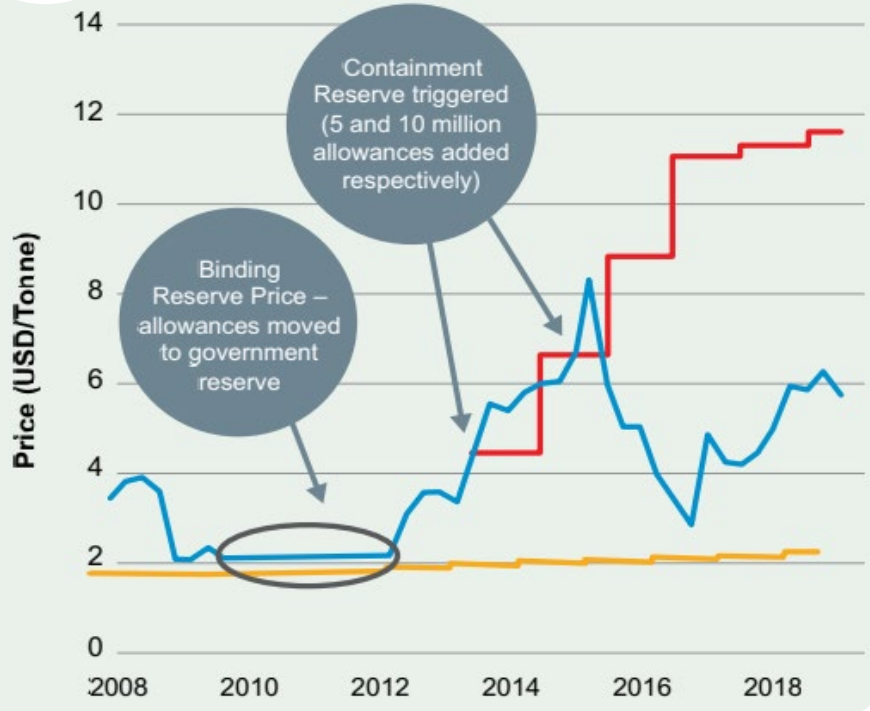
- Implementation of border adjustments being considered by multiple jurisdictions
- Potential to reduce carbon leakage risk and increase participation of hard to abate sectors
- Would allow for increased auctioning and revenue

Price or supply adjustment measures (PSAMs)

PSAMs in ETS

- Now common practice for ETSs to use PSAMs
- Persistently high or low prices will be inconsistent with longer-term decarbonisation
- PSAMs help to achieve a predictable and effective market
- Majority of PSAMs are rules based, with most using price triggers

RGGI PSAM example



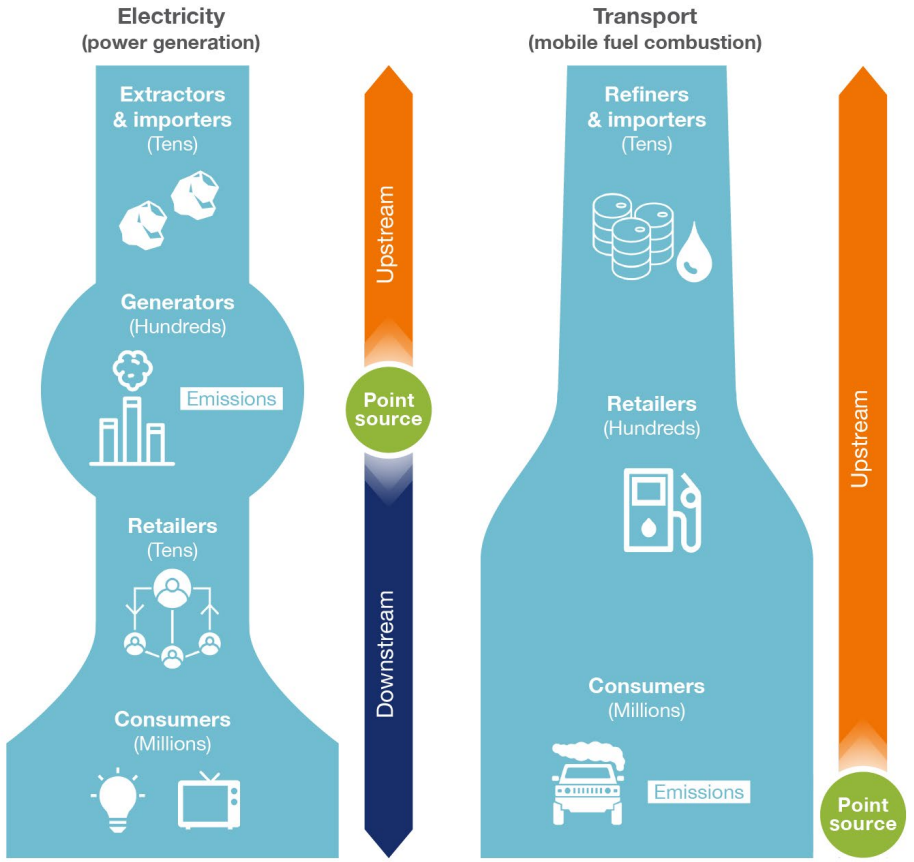
pmr PARTNERSHIP FOR MARKET READINESS

icap International Carbon Action Partnership

Expanding ETS to new sectors

Extended coverage

- Nearly universal coverage on sectors like power and industry
- Considerations of inclusion of sectors like waste and transport
- New sectors may need different:
  - Regulation point in the supply chain
  - GHG coverage
  - Participation thresholds



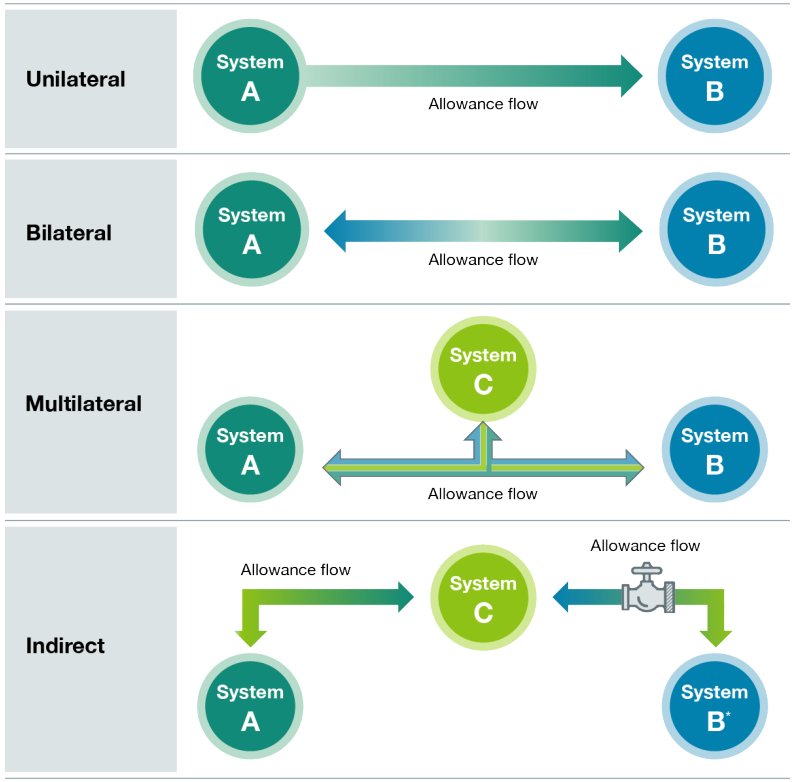
pmr PARTNERSHIP FOR MARKET READINESS

icap International Carbon Action Partnership

Expanding cooperation via linking

Linking

- Linking has an important role to play in expanding the coverage of ETS in future
- Developments in the literature and experience suggest there is more flexibility than first thought
- Coordination on key areas may be sufficient for linking to occur

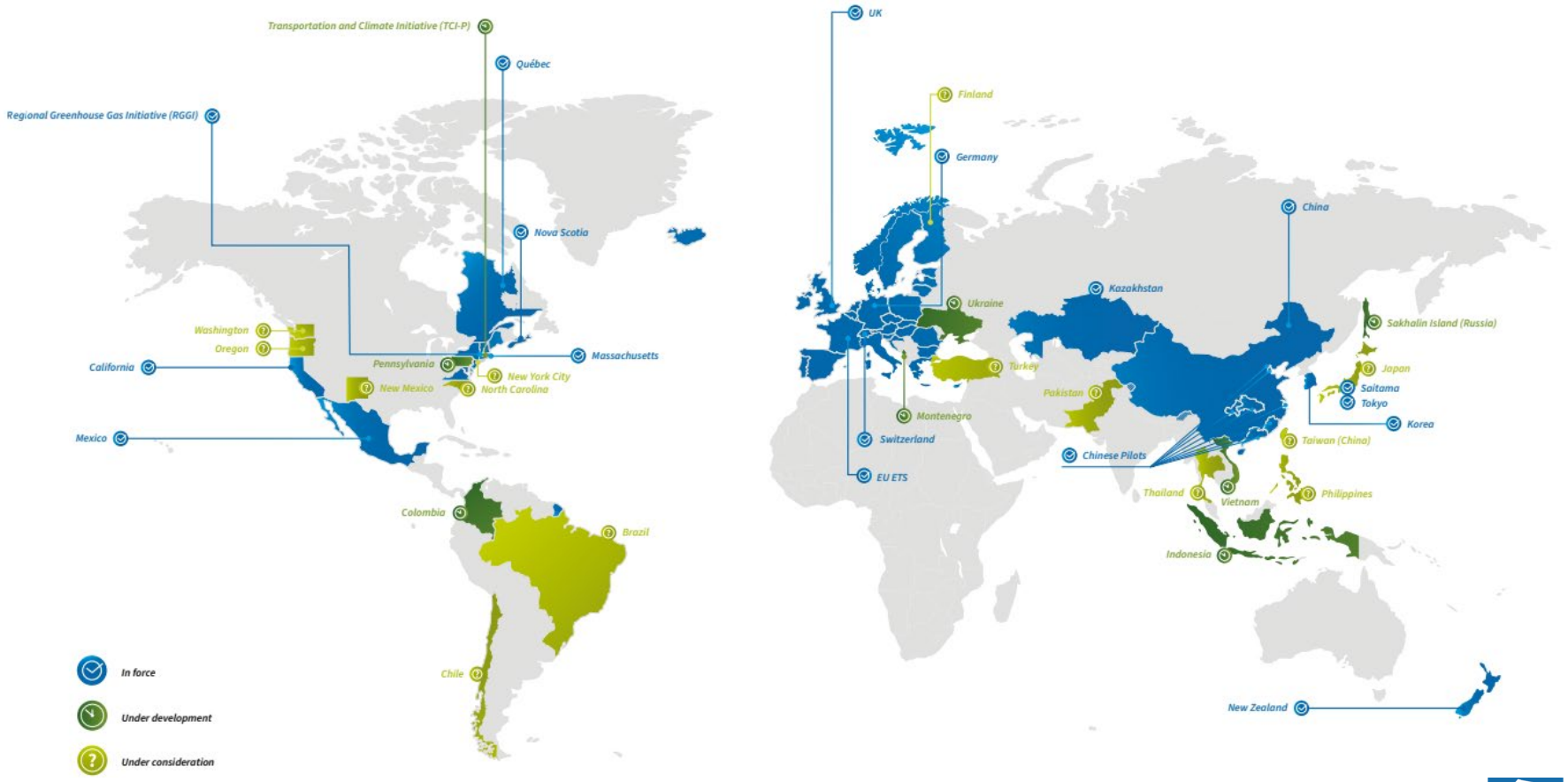


*The valve illustrates qualitative and/or quantitative restrictions imposed by System B on allowance inflows from System C. This is illustrative and without loss of generality because restrictions can be imposed in any type of linkage and in multiple systems simultaneously.

pmr | PARTNERSHIP FOR MARKET READINESS

icap International Carbon Action Partnership

Learnings from existing systems should inform future ETS design



pmr | PARTNERSHIP FOR MARKET READINESS

icap International Carbon Action Partnership