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Why an Emissions Trading System?

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Topics

- **Remarkable diversity of ETS systems**
- **Why Trading?**
- **What is a cap?**
- **Technical and political conditions**
- **Lessons learned**

A Remarkable Set of Examples

- Kyoto Protocol: The correct global vision
- EU ETS: The pioneer and multi-state prototype
- RGGI (Northeastern US states)
  - Truly volunteer multi-state effort (7 + 3 -1)
  - An auctioning path-breaker?
- New Zealand
  - Pioneering integration of land use into trading
  - No explicit cap; regulatory obligation, free NZUs & linkage
- California
  - Only clear legislative mandate in US
  - Revealing allocation and off-set debates
- Australia
  - Can agree on price and switch from tax to ET
- And one failure: US federal program
  - Good proposal, but bad politics (tactics and allocation)

Why Trading?

- The Grand Reasons
  - Ability to differentiate without sacrificing efficiency
  - Easier to propagate globally
- What are the alternatives?
  - Tax: For all the theoretical advocacy, rarely chosen
  - Default is always conventional regulation (“command & control”)
  - Subsidy a rising but fatally flawed contender
- Specifically,
  - EU ETS: Salvaging Kyoto after US withdrawal
  - RGGI: Building on NOx Program success
  - NZ: Full embrace of Kyoto logic; also ITQs
  - CA: Price of bipartisan support (Schwarzenegger)
  - Australia: The notable exception, but why not continue?
  - US (federal): Perceived presence of regulatory alternative detracted from political commitment

What is a cap?

- Classic formulation: The aggregate limit on emissions
  - Determines allowances to be distributed to firms
- Typically an absolute quantity, but not necessarily
  - Could be an intensity-based cap, adjusted for GDP
  - Given expected GDP, any cap implies an intensity target
  - Cap can vary by realized GDP to achieve given intensity
- NZ is interesting example of no explicit cap
  - Embedded in global system: NZUs and AAUs
- Offsets adjust local cap while preserving global effect
  - Also reduces cost…enabling tighter cap?
  - More importantly, propagates abatement & trading
  - Projects can be seen as mini-ETS's
  - Not clear than offset limits are needed; just integrity

Technical Conditions

- Measurement (aka MRV)
  - Trading and taxes presume fairly exact measurability
  - Variety of measurement techniques: upstream vs. downstream, material balance or emissions monitoring approaches; all feasible & used
  - Cost and administrative feasibility are main criteria
  - Key determinant of coverage and phasing
- Accounting and data handling capability
  - Closely related to measurement
  - Going beyond visual inspection of “command and control”
- Enforcement
  - Common to all alternatives, including standard regulation
  - Non-fuzzy, binary nature of surrender obligation should help
  - Basic governance capability; goes with development & emissions
- Institutional framework
  - “Market institutions” are not hard to develop

Political Conditions

- Perception of leadership
  - EU ETS, RGGI, Calif, and (possibly) NZ see selves as leaders in climate policy
  - Leadership rarely if ever invoked in failed US federal debate
- Maintaining broad bipartisan consensus
  - No partisan opposition in EU; only interest groups
  - Bipartisan collaboration in RGGI and California; & in earlier cap-&-trade
  - Notably lacking for CO2 at US federal level. But, Australia also?
- Providing expertise and education
  - Impressive stake-holder processes in EU, RGGI, and Calif
  - Committed expertise avoids political blunders
- Avoiding allocation battles
  - Largely avoided through delegation in EU ETS & RGGI
  - Important cause of disagreement & failure in US federal proposal
  - California is the exception

Lessons Learned

- Political feasibility is the big issue, not technical feasibility
  - Politics is local, depending on personalities, right moment, etc.
  - Technical conditions are necessary, but not sufficient
  - Educating stake-holders and building expertise prepares the way and promotes understanding
- Phasing in and trial periods seem order of the day
  - Phasing in usually dictated by measurement and politics
  - Trial or warm-up periods educate, work out problems, and build confidence
  - Relatively modest near-term ambition prevails; all that is required now
- Free allocation: Relax, everybody does it!
  - Free allocation compensates & facilitates political agreement on a cap
  - But no need to be a perpetuity; EU ETS got it about right
  - RGGI is the notable exception; but now a de facto tax
  - Objective is a price on carbon; not raising revenue

Thank you very much for your attention

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