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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