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Lessons Learned in a Cap & Trade Environment

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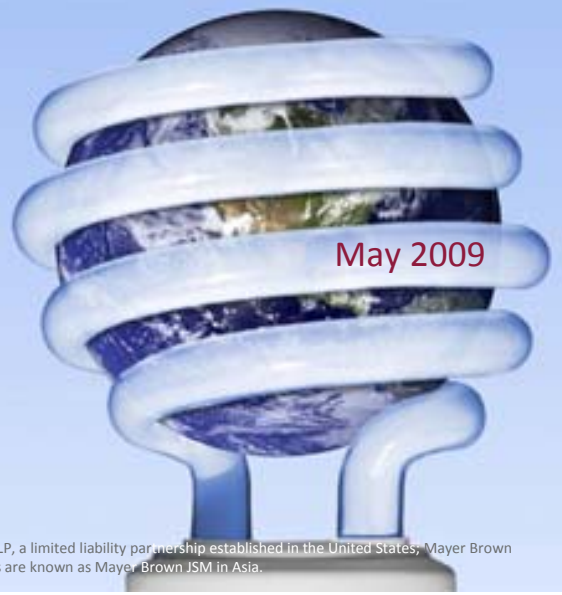

Presentation Outline

- Background: why cap & trade?
- Cap & trade and current climate change law
- The EU ETS: how does it work?
- The EU ETS: what design flaws have been identified?
- The EU ETS: how have they been fixed?
- What's next?

Background: Why cap & trade?

- Cap & trade
- Carbon tax
- Regulation

Background: Why cap & trade?

- Cap & trade v. carbon tax

How does cap & trade it into existing climate change law?

- Kyoto Protocol
- EU Emissions Trading Scheme ("EU ETS")

Cap & trade and existing climate change law

- Kyoto Protocol
  - UN Framework Convention on Climate Change ("UN FCC")
  - Binding greenhouse gas ("GHG") emissions reduction targets for Annex I countries

Cap & trade and Kyoto

- How to meet GHG targets
  - reduce your own emissions
  - trade emissions reductions
  - Clean Development Mechanism ("CDM")
  - Joint Implementation ("JI")
  - NB. "Supplementarity"

Cap & trade and Kyoto

- EU ETS
  - Began operation on 1 January 2005
  - Directive 2003/87 EC
  - Covers 45% of EU carbon dioxide emissions

The EU ETS: How does it work?

- Each Member State sets national cap on CO_2 emissions from participant sectors
- Power plus industrial plus aviation (from 2013)
- Divide allowances ("EUAs") to emit CO_2 equivalent to overall cap
- Importance of National Allocation Plans ("NAP")
- 3 Phases
  - Phase I (2005-2007)
  - Phase II (2008-2012)
  - Phase III (2013-2020)
- NAPs based on business as usual ("BAU")

The EU ETS: How does it work?

- EUAs allocated/auctioned by Member State to individual installations
- By 30 April each year operators surrender EUAs equivalent to actual emissions
- Compliance achieved through
  - emissions reductions
  - trading
  - CDM/JI credits

The EU ETS: Early design flaws

- Measures of success
  - Does it lead to emissions reductions?
  - Does it deliver a stable long-term price for carbon?
  - Does it promote low-carbon investment?
  - Is it fair?

The EU ETS: Perceived design flaws

- Does it lead to emissions reductions?
  - NAPs: “the race to the bottom”
  - The problem of “hot air”
  - The problem of “carbon leakage”
  - CDM: “additionality” issues/“exotic gases”
  - Impact of “banking” rules
  - Impact of recession

The EU ETS: Perceived design flaws

- Does it deliver a long-term stable price for carbon?
  - Impact of NAPs (Phase I and Phase II)
  - Price crash of 2006
  - Length of phases
  - Post-Kyoto issues
  - External impacts on price
  - Price floor issue

The EU ETS: Perceived design flaws

- Does it promote low carbon investment?
  - Phase I experience: windfall profits for power sector
  - Cannot deal with other structural issues
  - Offsets "justify" new fossil fuel generation
  - The problem of "carbon leakage"
  - The problem of "exotic gases"

The EU ETS: Perceived design flaws

- Is it fair?
  - The problem of “windfall” profits
  - Coverage issues
  - Allocation rules
  - Inadequate harmonisation
  - Fuel poverty issues
  - Competition issues
  - “Small emitters” and administrative burden

The EU ETS: How has the EU responded?

- Introduction of EU-wide cap in Phase III (cp. NAPs)
- Long-term EU carbon targets introduced
- Development of integrated energy and climate policy

The EU ETS: How has the EU responded?

- Increased level of auctioning
- Harmonised methods of allocation
- Limits on use of offset credits

The EU ETS: How has the EU responded?

- Extension to new sectors/gases
- New rules on “carbon leakage”
- Political commitment to partial “hypothecation” of auction revenues

The EU ETS: What are the outstanding issues?

- Limit on (and exemptions to) auctioning
- No price floor
- Hypothecation is not legally binding
- Questions about environmental integrity of offsets

The EU ETS: What are the outstanding issues?

- Inadequate restrictions on use of offsets?
- Criteria for establishing "carbon leakage" uncertain
- Impact of "banking"

The EU ETS: What next?

- Establishment of a global carbon market?
- Carbon trading moves downstream
- Conclusion