Building blocks for a successful ETS

Insights from the EU perspective (and a bit beyond…)

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- How to achieve this?
  - Building blocks, iterative process
- Time dimension
  - What is needed when?

Straw poll:

Is the EU ETS successful?

When is an ETS successful?

- For example, opinions about whether the EU ETS is successful or not, vary widely
- In EU ETS review for Phase 4 revision (2015):
  - Objectives of EU ETS?
    - Short-term environmental objective: Emissions stay below the cap
    - Long-term environmental objective: Incentivise low-carbon development
    - Economic objectives: Establish functioning market, cost-effective reductions
  - Conditions: limit negative (side) effects
    - No **undue** distortion on competitiveness, limit carbon leakage, not punishing early action, etc.

How is that achieved?

- Short-term environmental objective: emissions below cap
  - Establish and communicate cap, obligations to participants
  - Issue allowances in line with cap
  - Track emissions robustly and timely
  - Enforce compliance
- Long-term environmental objective: low-carbon incentives
  - Sufficient carbon price level, i.e. ambitious cap
  - Limited flexibility provisions (credits, banking, borrowing)
  - Consistency with other policies affecting cap (e.g. RE policy, credit use) or price incentive (e.g. energy price controls)
  - Long-term certainty for participants on duration, clarity on timing evaluation, potential changes
  - Support for technology development, innovation

How is that achieved? – cont'd

- Economic objective: establish functioning market
  - Ensure demand and supply
  - Establish infrastructure (registry, trading platforms)
  - Ensure market access, liquidity
  - Establish market credibility: oversight, security
  - Limit market volatility, potential impact of major shocks
- Conditions: limit negative (side) effects
  - Competitiveness:
    - Use free allocation, carbon leakage provisions
    - Definition of scope, identification of participants
  - Early action: Use benchmarking

Timing: when what how?

- Experience and lessons learned from others' is useful to identify pitfalls, potential solutions
- But cannot (fully) replace learning by doing
  - Own context, own people, own experience
- ETS will evolve over time
  - Ideally, all data, capacities, institutions, consistent legislation, infrastructure in place, ambitious cap, auctioning, a global carbon price (no leakage), fully passed on, with resources for limiting negative side effects
  - In the real world: What is crucial to get right from the start, what can develop, improve over time?
- Iterations are needed also within one cycle
  - E.g. cap-setting, definition of scope, identification of installations, data gathering, revision of cap to reflect scope, installation data

Phasing in the EU ETS

Building block	Phase I	Phase II	Phase III	Phase IV
Cap	Tightening cap Identification of entities Banking, borrowing rules (no banking from pilot)	Tightening cap Harmonising scope Expanding scope Limitation of credit use	Expanding scope Top-down cap, cons with other policies Tightening cap Long-term trend cap	Tightening cap Long-term trend cap
Allocation	Developing allocation approaches, NAPs Data gathering grandfathering Avoiding competi-tiveness distortion	Improving data basis GF (Some) harmonising MS allocation approaches Avoiding competi-tiveness distortion	Harmonised allocation Harmonised NER rules Development of BMs Increased auctioning	Improving data basis BMs Updating BMs Limitation free allocation (carbon leakage)
MRVA	Development of EU MR rules Establishing institutions, responsibilities, legis-lation national level	Harmonisation MS MRVA approaches Development of EU VA rules Development of MRVA regulations	Increasing robustness Increasing harmoni-sation Reducing admin burden Increasing user friend-liness	Improving MRVA for BM-based allocation Establishing MRVA for Production change-based allocation
Market functioning	Establishment registry, Transaction log Market access, tran-sparency rules Definition of assets, accounting, tax issues	Strengthening market oversight Preventing fraud, theft	Price control mechanisms (backloading, MSR) Strengthening market oversight	Price floors (some MS)

Building blocks for a successful ETS

Building block	At start	Later
Cap	• Robust projections to understand effect of caps & flexibility provisions on carbon price & emissions • Understanding impact of banking & borrowing rules on market balance, timing of implementing measures • Consistent policy framework, reflected in cap level • Identification of all regulated entities, sources, emissions under the scope of the cap • Clear rules on banking, borrowing, validity of allowances	• Tightening of cap, reducing credit use • Widening of scope (+ corre-sponding cap adjustment) • Establishment of price control mechanisms (price floor, MSR) • Changing trading period length • Establishment of innovation incentives

Building blocks for success– Cont'd

Building block	At start	Later
Allocation	• Ensuring coverage of all comparable entities • Availability of data required for allocation, in line with MRVA rules, definitions & system boundaries • Clear allocation rules and timelines, including treatment of new entrants, transfers, closures • Timely allocation	• Increasing stringency of allocation • Development, application of benchmark-based allocation approach • Development, use of auctions

Building blocks – Cont'd

Building block	At start	Later
MRVA, com-pliance	• Clear MRVA rules, responsibilities, procedures, timelines, templates, incl. pre-approved MP • Legislation establishing mandates, obligations, sanctions • Sufficient capacity to ensure (timely) compliance, enforcement • Timelines consistent with allocation cycle • Availability of registry, accounts	• Strenghtening MRVA regime, reducing uncertainties, ensuring consistency • Ensuring 3rd party role in verification, availability necessary capacity • Reducing administrative costs • E-reporting
Market func-tioning	• Clear definition of characteristics, validity of tradeable assets • Clear rules, assuring access, preventing monopolies, preven-ting fraud and on who can trade • Establishment of regulating entity • Availability of trading platforms	• Increasing number & diversity of platforms • Development of more complex trading products, derivatives • Strengthening oversight and enforcement

Conclusions

- Experience from others' is useful but cannot (fully) replace (own) learning by doing
- Further lessons will be learned, each ETS will evolve over time
- Important to accommodate this learning in design and implementation choices
  - Learning phase, separate from subsequent phases => limited/no banking!
  - Allow for steps, iterations (also within one cycle) to ensure the right data are used for decision-making:
    - Legal basis for requiring data submission
    - Full installation level data set for cap-setting
    - Pre-approved monitoring plan for MRV

Conclusions – Cont'd

- The perfect can be the enemy of the good
  - Starting with grandfathering based on solid data may be better than a BM-based approach without a robust basis. First years can then be used to collect required data, develop BM approach
- First priority: elements with potentially significant, long-lasting impact:
  - Supply/demand balance, unequal treatment, system/market credibility
- Managing expectations is important
  - If rules and approaches are transitional, make this clear upfront to participants
  - 'Taking away' rights, assets later is more difficult if unexpected, unannounced

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