

The EU ETS: Dead End or Path to the Future?

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FEEM-IEFE Joint Seminar Series

November 17, 2011

Motivation

- Path to the Future?
 - Trading system offers best hope for global regime
 - Kyoto Protocol embodied this vision and hope
 - EU ETS provides cornerstone for such a system
- Or Alternatively, a Dead-end?
 - US partner-system unlikely for a decade (at least)
 - EU ETS widely seen as failing (and by Europeans!)
 - Could it be abandoned in favor of more visible actions?

Main Features of the EU ETS

- A classic cap-and-trade system
 - But highly decentralized implementation
- Covering electric utilities & industry
 - Aviation will be added in 2012
- Sequential multi-year periods with declining cap
 - 2005-07; 2008-12; 2013-20; -1.74% annually post-2020
- Offsets allowed up to 13% of emissions
 - Only from Kyoto CDM and JI mechanisms

Achievements of EU ETS

- A price on carbon about 7% of global GHG emissions
 - Modest reductions so far; but pervasive signal for abatement, investment, and innovation
- Mechanism in place for effecting further limitation of GHG emissions as desired
 - More than anyone else has done
- Shown feasibility of multi-national system
- Path-breaking changes in allocation

The EU as a Microcosm of the World?

- Sovereignty
 - Member states are sovereign nations
 - EU decision-making and Directives
 - A very weak federal structure
- Heterogeneity
 - Economic circumstances: per capita income
 - Market institutions and experience
 - Commitment to climate policy varies widely
- E-W divide similar to global N-S divide

The EU ETS as an EU Institution

- Full participation despite differences
 - But not needed globally
- The only uniform price in the EU
 - Assures least cost abatement
- Successful amendment to correct for initial problems; demonstrated ability to adapt
 - Continually tighter cap
 - Redistribution of cost burden
- This is what is needed globally

Is All Well with the EU ETS?

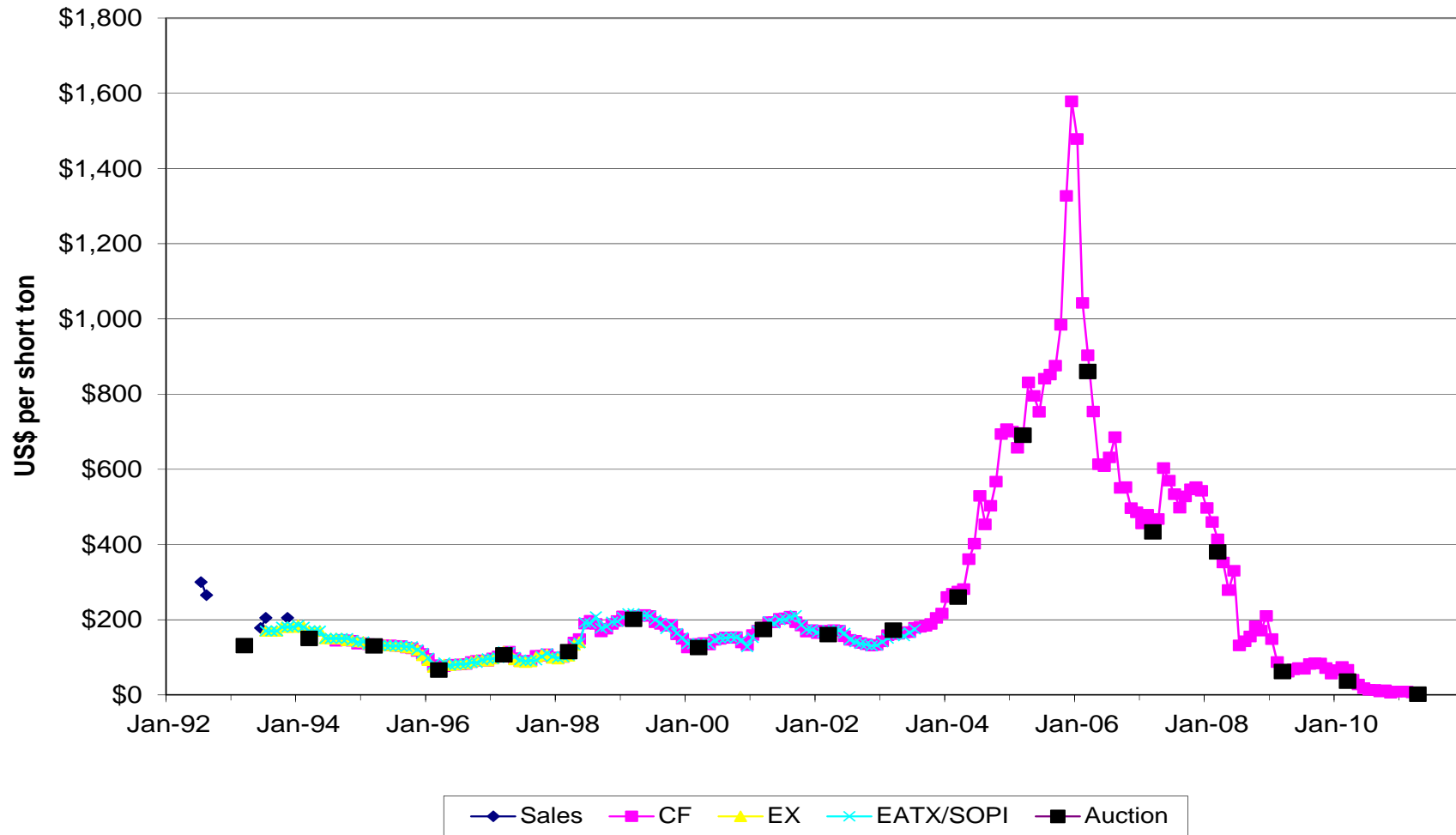
- A persistent ETS malaise within Europe
 - Proud of the achievement, esp. to outsiders
 - But, pervasive feeling that it does not do enough
- Voiced as: “The price is too low.” ... But why?
 - Is the cap too loose?
 - The recession has reduced demand
 - Is something else suppressing demand?
- Could other climate policies be the problem?
- Perhaps also, impatience, lack of visibility?

Problems?

Not What You Hear About

- Not VAT fraud, phishing, CER recycling, registry hacking, or price volatility
- The real problem: EUA price suppression
 - Other climate policies are the cause
- RE incentives overlap & reduce demand
 - Not a trivial amount; 10X price effect in Germany
- What effect on longer term investment & innovation?

US SO₂ Trading: Harbinger of the Future?



The Sad Fate of US SO₂ Trading

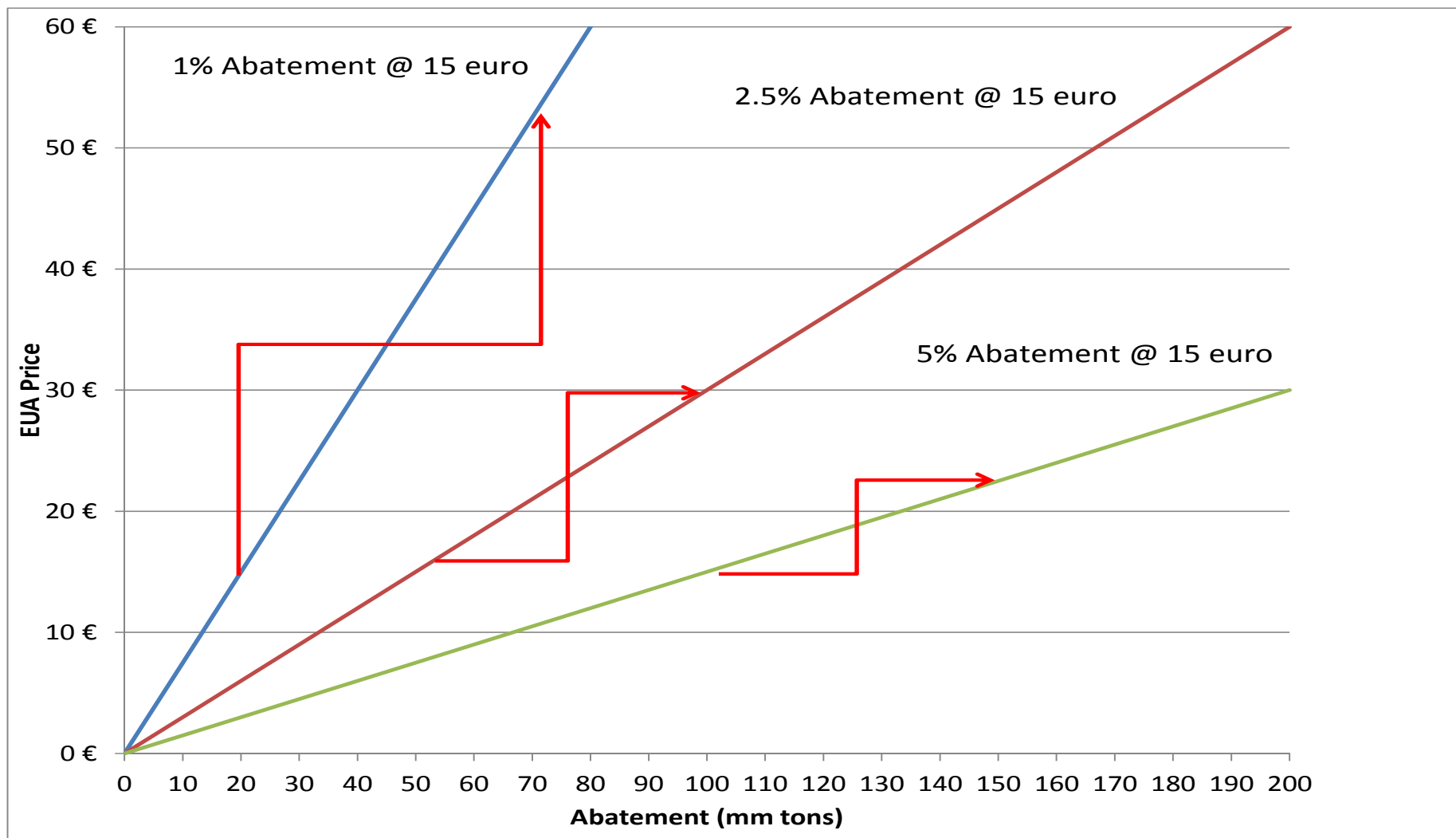
- Initially, reducing acid rain precursor emissions
- Then, fine particulates and a brilliant regulatory solution: tighten the cap (CAIR)
- But, the underlying (1970s) legislation requires that source-receptor relationships be taken into account; and a judge so rules.
- Now, a cap with overlapping (more constraining) conventional, prescriptive regulation
- Government fiat can destroy as well as construct

RE and ETS Effects

German Electricity Sector Simulation

	2008		2009		2010	
	Units	%	Units	%	Units	%
RE Injections (TWh)	72	11%	74	12%	80	12%
Displaced Generation (TWh)						
Coal	-31	-17%	-34	-20%	-32	-18%
Natural Gas	-35	-33%	-27	-28%	-40	-36%
ETS Effects (TWh)						
Coal	-7	-4%	-7	-4%	-10	-6%
Natural Gas	7	7%	7	7%	10	9%
Emission Effects (mm tons)						
RE Injections	-49	-14%	-51	-15%	-53	-15%
EUA Price	-4	-1.1%	-4	-1.1%	-5	-1.5%
Counterfactual Emissions	355		340		349	
RE demand suppression	45	13%	47	14%	48	14%

Illustrative Price Effect of Overlapping Instruments



What's Wrong With This?

- It is significantly more costly
- Can government direction (subsidy & mandate) be as effective as price?
 - Do we know (or command) the future?
 - Could RE policy be subject to capture?
- Will it replicate globally as well?
- Is GHG reduction the primary objective, or an ancillary benefit?

Final Remarks

- The EU ETS is a success & still the path to the future for a global regime
- But it will not be if it becomes the casualty of a misguided industrial-cum-climate policy
- Need more attention to interaction of instruments, clearer thinking on the objective, and how best to engage the rest of the world