

Emissions Trading

Brief Overview & Update

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Cap and Trade Basics (The Very Basics)

- **Cap and Trade**
 - **No specific technology requirement**
 - **No specific emission rate limit**
 - **No emission reduction requirement**
 - **No specific emission tonnage limit**
- **Affected sources must retire allowances equal to their total emissions**
- **If you cannot afford allowances/offsets, you cannot emit – if you cannot emit, you cannot operate**
- **Seems simple at first, but challenging political issues to address, particularly regarding allocation**
- **Domestic offset opportunities are typically limited**

Cap and Trade Basics (The Basic Elements)

- **The Cap**
 - Establishes a tonnage of cap for emissions for defined regulated sectors (demand)
- **The Allowances**
 - Establish permits to emit
 - At the end of the compliance period, each regulated entity must hold allowances equal to its actual emissions
- **The Trade**
 - Entities can purchase or sell allowances as part of their compliance strategy
- **The Underlying Principles**
 - High cost-of-control entities can purchase allowances
 - Low cost-of-control entities will abate
 - No entity pays more than the market price for allowances, in order to comply
 - Total cost is minimized

Cap and Trade Basics (The Compliance Basics)

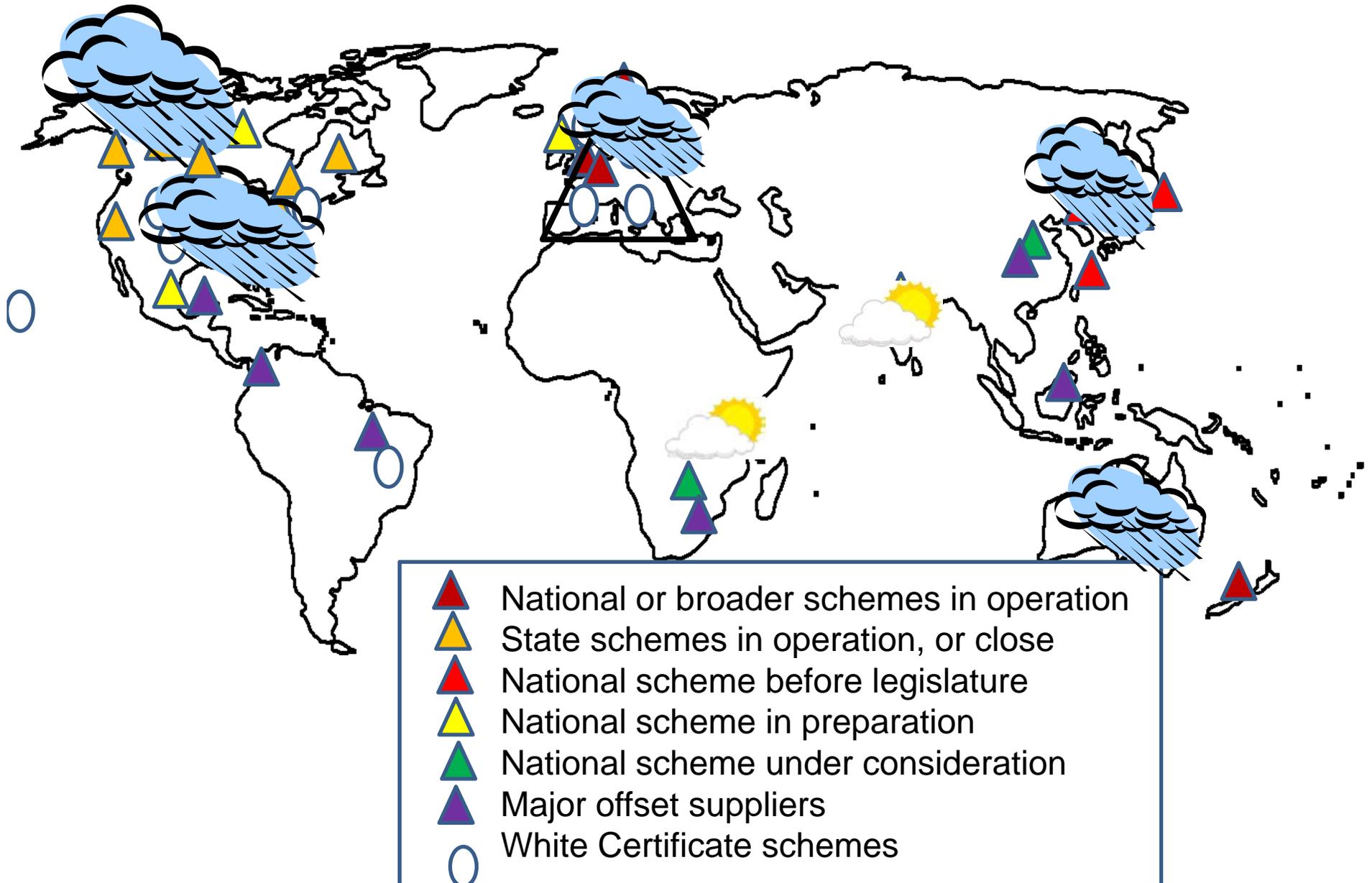
- **Compliance with cap and trade is an economic judgment**
 - **Given the available compliance options, what direct reductions can be made at a \$/tCO₂e cost below the market price?**
- **In theory, entities apply the lower cost compliance options (\$/tCO₂e), then purchase allowances/offsets to satisfy the remaining obligation**
 - **Entity identifies available emissions reduction options – internal abatement, energy efficiency, conservation – and understands the overall cost impacts associated with those options.**
 - **Entity must have an accurate view of the future allowance market to compare.**

What is the purpose of a cap and trade system?

Some unavoidable truths

1. The purpose is to deliver a proportion of a national absolute emissions reduction target, at least economic cost
 - *“not so much an emissions reduction measure as a way of ensuring that a given level of emissions reduction is met efficiently”*
2. In the case of absolute targets (rather than intensity-based) it implies subordinating the achievement of economic growth to a climate goal, in order to allow economic growth to continue in the future – but flexible implementation of the target can minimize the impact on growth
3. Carbon has never been paid for in the past, and now it must be. This inevitably causes some economic dislocation
4. Cost increases hurt, and by doing so motivate change. The system is intended to change outputs, not reflect them

Stormy Weather: The Current Trading World



Final Thoughts on Emissions Trading

- Today the ETS landscape is a good news, bad news story...
- Some OECD countries are slowing down in the face of fierce political opposition
- However, objections are in fact to doing ANYTHING significant on climate change – not to emissions trading as an instrument.
- Emissions trading remains a key weapon in the policy mix to achieve emissions reduction, but a uniform global scheme is a long way off
- A lot of action taking place at the sub-national level
- Some larger developing countries are considering experimenting with forms of sectoral trading



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