Emission Reduction Projects within the Community

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Centre Borchette, Rue Froissart 36, 1040 Brussels

Terms of reference

Further extension of EUETS - desirability and feasibility of harmonised emission reduction projects

Necessity, desirability, feasibility

Experience with double counting issue.

Congratulations

To Caisse des Depots and French system for moving this issue forward

Criteria for Assessing Policy Instruments

1. Statically efficient (delivers outcomes at minimum cost);
2. Dynamically efficient (provides continuing incentives for innovation).

Both important for competitiveness

3. Environmental effectiveness (delivers net environmental gains)
4. Fair (less well off people are not disadvantaged);
5. Administratively politically viable - legal and agency infrastructure can be put in place, sufficient political support is forthcoming to both initiate and sustain the instrument in question.

1. **Static efficiency**

Higher transactions costs than EUETS

If total costs of projects come in below EUA prices, then statically efficient

Solution: Therefore only include activities not ‘includable’ in future EUETS?

EUA prices 2008-12: €13.90-18.80 per tonne of CO_2

Pricing and Risk

Risk Issue – who carries it – needs overt discussion.

Where sellers bear risk, EUA and Offset price should converge

2. **Dynamic Efficiency**

With additional supply, EUA price will be lower than without offsets.

Innovation in offset sectors encouraged

Innovation in traded sectors discouraged

Net effect?

Worst Case Scenario

Volume of supply from combination of CDM, JI and domestic offsets such that market implodes and allowance price asymptotically approaches zero.

Solution: Cap volume of supply from non trading sectors?

France - 10-15 million tonnes of CO_2 equiv per year of likely viable domestic offset projects in four sectors (agriculture and forestry, transport, buildings, industrial emissions not covered by quotas) This is 7.5-11.5 per cent of volume in EUETS

Price Elasticity of Supply?

Static and Dynamic Tradeoffs

Short term **trade-off** between static and dynamic efficiency.

CDM Example: ‘Chinese factories accused of exploiting Kyoto loophole’ - achieving major reductions in HFC gasses, where the equipment to reduce HFC gasses is cheap to install ($10-30 million per ftactory) and installations can then generate millions of CDM carbon credits (CERs) with no innovation incentive. This yields big dividends at minimal cost, but no innovation.

3. Environmental effectiveness

Key Issues

a. Baselines and the counterfactual, monitoring and enforcement

b. Scale and duration of opportunities.

Activist State role 1

The Caisse des Depots (2005) proposes that the State:

- Develop standardised methodologies (with relevant agency in charge of GHG inventories and Ecosecurities) to provide proof of additionality;
- Act as the guarantor of the integrity of procedures
- Help avoid double counting by ensuring compatibility with national inventory, and with compatibility of coverage (only sectors not now in EUETS and not already doing JI to be allowed – focus on diffuse emissions),

Activist State role 2

Develop protocols for small and medium sized operator so that:

Bundling is feasible, and

Transactions costs do not create such a wedge that individual projects are not viable.

Tenders will bring forward the portfolio, and projects should be ‘Kyoto compatible’, and compatible with other international schemes in the US and elsewhere

Question: Do all States have the capacity to deliver?

4. **Equity and fairness**

- Who wins and who loses?
- Depends on the portfolio.
- Large economies of both scope and scale in bringing forward, packaging and then delivering emission reductions via the offset mechanism.
- Unless State is proactively involved – as envisaged by CdP - the big guys will gain most
- There is an opportunity to help low income households and small farming, but it won't happen automatically.
- There are likely to be tradeoffs between efficiency, environmental effectiveness and equity.

5. **Administrative and political feasibility**

- Politics helps target groups not yet benefiting from trading, especially in the diffuse emissions area.
- The compatibility or otherwise of other policy instruments, e.g. CAP-related, and their likely impacts on GHG emissions, need to be part of the baseline process.

Future 1

Domestic offsets could deliver additional cost-effective abatement, but only if some conditions apply:

- Supply volume doesn’t overwhelm the market and push the price towards zero
- Real additionality is achieved, and seen to be achieved
- Transactions costs don’t create too large a wedge between other costs and allowance price.
- Dynamic efficiency is supported with complementary instruments.
- Considerable capacity and willingness for the State to get involved.

Future 2

- Confine domestic options to sectors which:

Are very unlikely to be included in EUETS

- Are not readily addressed by other policy instruments, such as taxation

Launch pilot scheme(s) (France?) to test viability under field conditions

Terms of reference revisited

Further extension of EUETS - desirability and feasibility of harmonised emission reduction projects?

If we proceed, **harmonisation** across MS (and otherlinked schemes) crucial

Desirable and Feasible if the pre-conditions noted earlier can be met

National Pilot will elucidate this issue, including double counting.