

Cap-setting: EU-wide versus national caps

Harmonised cap-setting procedures:
the advantages and drawbacks of
up-front or NAP-based cap-setting

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Overview

- The mandate for the group on cap-setting
- Experience from NAP1 and NAP2
- NAP-based cap-setting: features, advantages and drawbacks
- Up-front cap-setting: features, advantages and drawbacks
- Conclusions

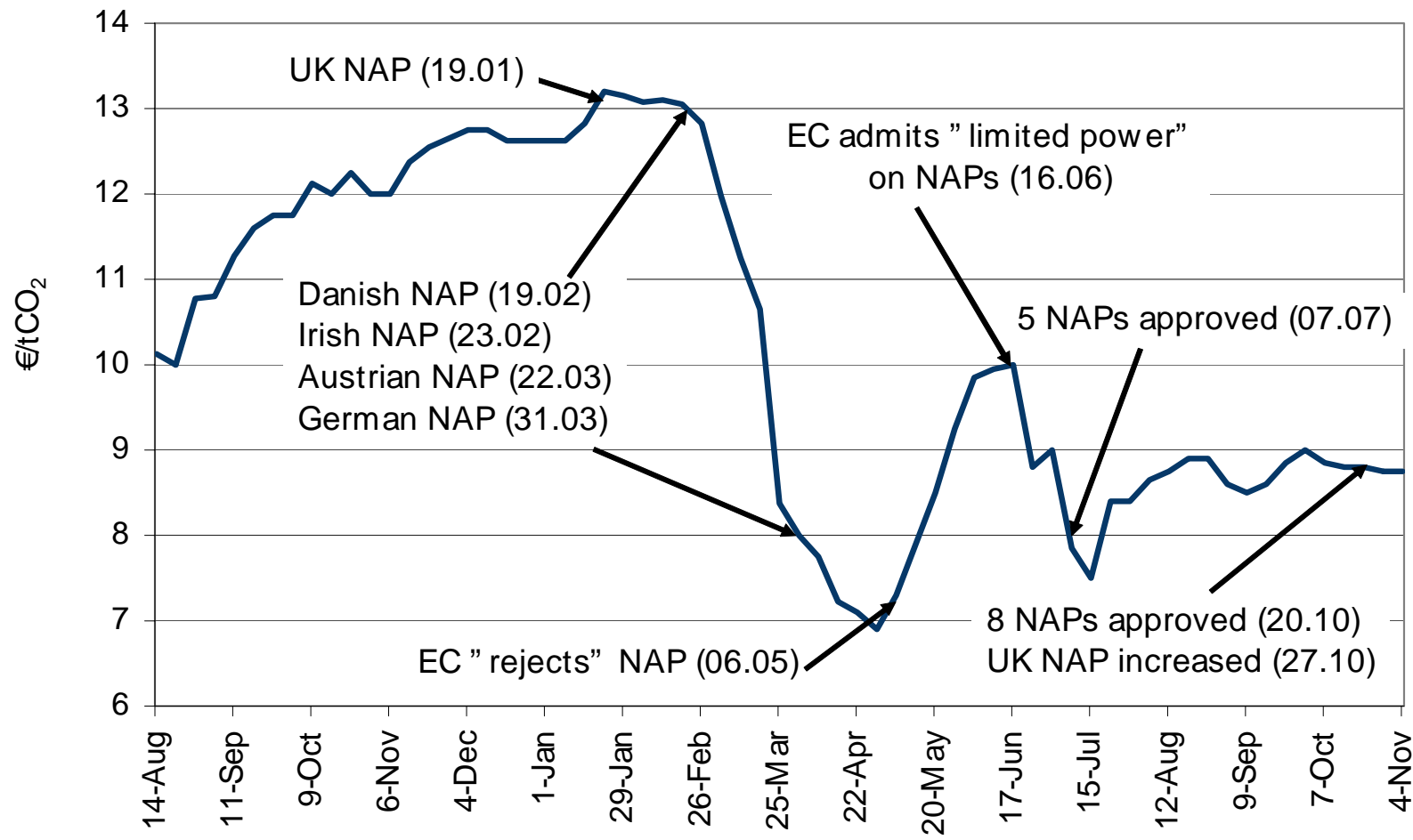
The mandate on cap-setting

- Explore the option of a single EU-wide cap and that of separate caps after 2012 determined by each Member State.
- **For the option of a single EU-wide cap:** explore alternative means to set this cap.
- **For the option of separate national caps:** explore the advantages and drawbacks of deciding them up-front in the Directive or setting these caps through national allocation plans.
- In order to increase **predictability**: explore whether the cap should be set for a longer period (e.g. 10 or 15 years) or whether a permanent structure, calculation, or elements of a calculation, should be developed for the cap with periodic allocation decisions at installation level.

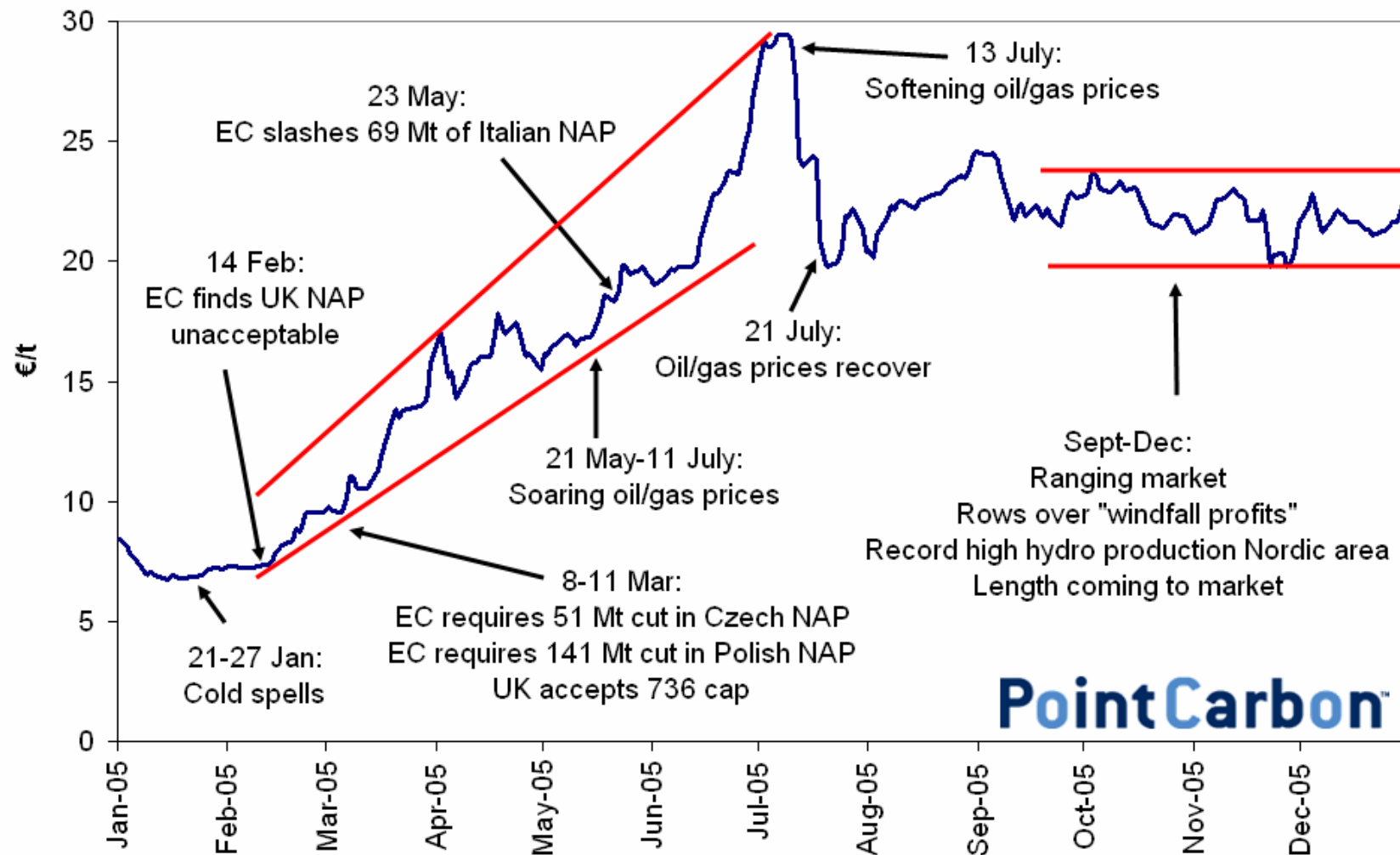
Experience from NAP1 and NAP2

- Burden on MS to draw up NAP, including determination of cap
- Long process for Commission's assessment (15 months in NAP1, about 1 year in NAP2 between first NAP notification and last decision)
- Significant volatility through regulatory announcements by MS and Commission, especially in NAP1 (see slides for illustration)
- Distortion of competition between MS trading sectors (see further slide) and, as a potential indirect consequence, also within sectors

Regulatory influence on NAP1 prices in 2004 (source: Point Carbon)

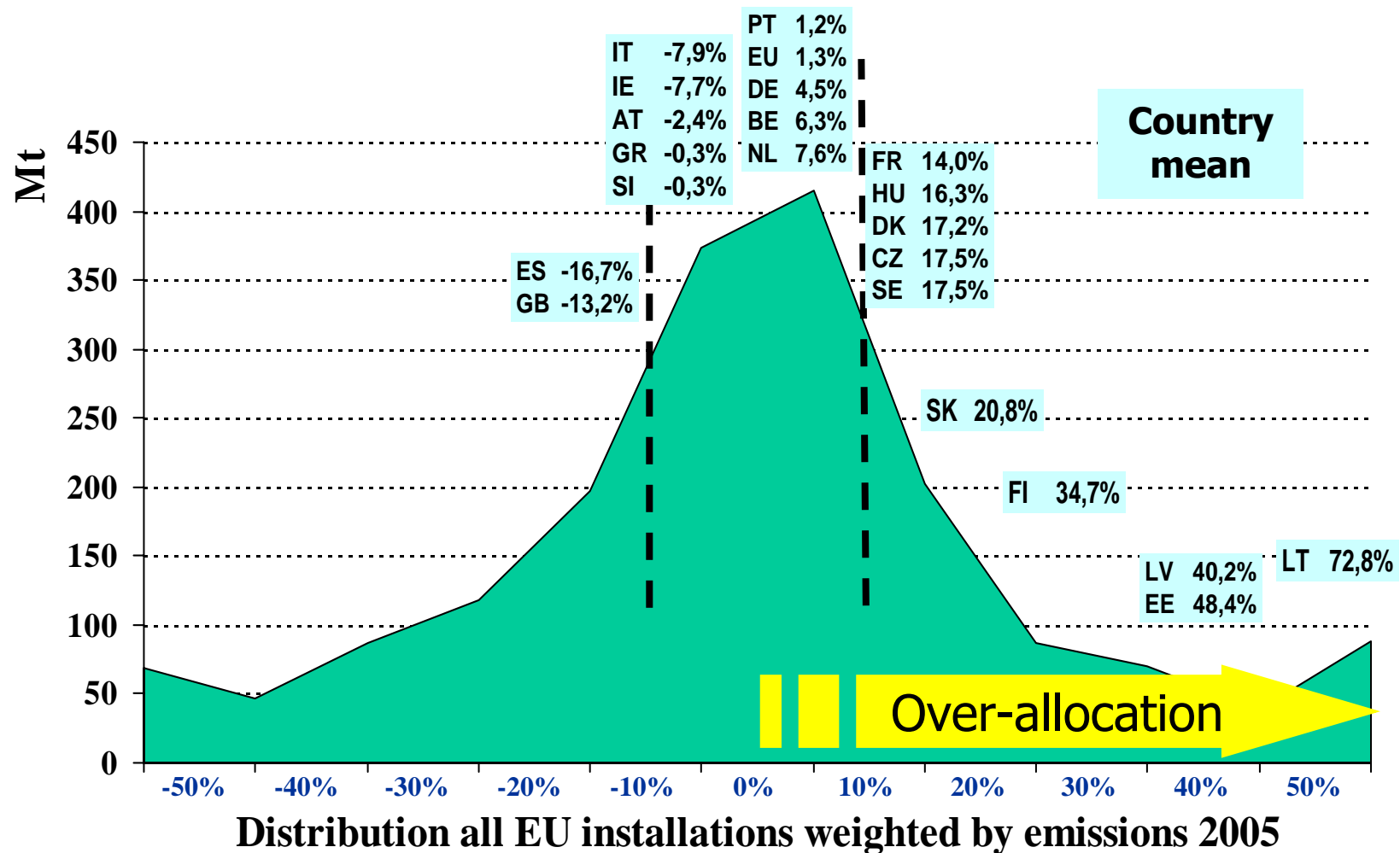


Regulatory influence on NAP1 prices in 2005, interlinkage with fundamentals (source: Point Carbon)



Cap-setting NAP1 (2005-7) in relation to 2005 verified emissions

All sectors



NAP-based cap-setting: features

- Concept of current Directive, applied in the first (2005-07) and the second (2008-12) trading phases
- Process led by Member States
- Starting point for NAP1/NAP2: (path towards) national Kyoto / burden sharing commitment must be achieved
- Each MS has large discretion in determining the distribution of the reduction burden between the EU ETS-sector and the non-EU ETS sector

NAP-based cap-setting: Advantages

- Each MS can fine-tune cap for its own EU ETS sector based on specific characteristics of national socio-economic situation
- National authorities generally know „their“ installations better and are „closer“ to them

NAP-based cap-setting: Drawbacks

- Level of ambition for caps of each EU ETS-sector is different
- This leads subsequently to a different level of ambition for sector and individual allocations
- Resulting difference in cap for EU ETS-sector leads to distortions of competition and a perception of unfairness (see experience from NAP1). This occurs mainly with free allocation but also in the case of auctioning (transfer of resources to less ambitious MS).

Up-front cap-setting: features

- Would mean modification of current system
- Distribution of the reduction burden between the EU ETS-sectors and the non-EU ETS sectors would be dealt with in a harmonised manner across Member States
- Up-front cap-setting possible via separate national caps or an EU-wide cap

Up-front cap-setting: Architectural options

- Common procedures with different degrees of harmonisation in future Directive, e.g.:
 - rules on determining the distribution of the reduction burden between the trading and the non-trading sectors
 - rules providing for methodologies for calculating the trading sector cap (conceptual or formula-based)
- Advanced form of harmonisation in case of separate national caps: concrete figures are enshrined in future Directive, in relative or absolute terms
- EU-wide cap as the most advanced form of harmonisation

Up-front cap-setting: Advantages

- Level of ambition for caps of each EU ETS-sector could be more comparable
- Less distortions of competition possible
- Can improve overall transparency, simplicity and fairness through a potentially more equal treatment
- Increases predictability and reduces volatility of allowances prices
- Reduces importance of Commission decision in ensuring fair treatment
- Speeds up decision-making by national authorities and Commission's assessment once operational and straight-forward rules have been agreed

Up-front cap-setting: Drawbacks

- Less tailor-made: Specific situation of EU ETS sector in each Member State might become a less important factor for the overall size of the cap (less relevant in case of auctioning)
- Less flexibility and margin of discretion for Member State authorities

Conclusions

- More harmonisation of cap-setting procedures can reduce regulatory uncertainty and can improve predictability for operators and the market
- More harmonised approach can reduce distortions of competition and of the Internal Market and can increase fairness