

The EU ETS: Perspectives for US Climate Policy

A. Denny Ellerman

Massachusetts Institute of Technology
Mission Climat, Caisse des Dépôts

7th INFRADAY Conference
Berlin, Germany
October 10, 2008



Massachusetts Institute of Technology

Agenda

- **What did the EU ETS accomplish?**
- **Positive lessons**
- **Negative lessons**
- **US Policy Outlook**



A Technical Success

- A mechanism in place to limit GHG emissions to whatever level desired
- Supporting regulatory infrastructure is developed and functioning well
- A market with ample trading has created the only unified price in the EU
- Conditions for *efficient* abatement exist

Despite Great Odds

- A new and unfamiliar regulatory instrument
- Little experience and some hostility to emissions trading
- Extremely rushed implementation
- Very poor data on installations and ETS emissions

A Political Success

- Triumph of Community institutions despite decentralized structure
- Successfully played on strong public support and self-identification as an environmental leader
- Now a source of considerable pride with no thought of its disappearance



Results

- Modest but measurable abatement in the trial period
- CO₂ price is being integrated into operational & investment decisions
- Worldwide impact on project development
- No transforming technological innovation



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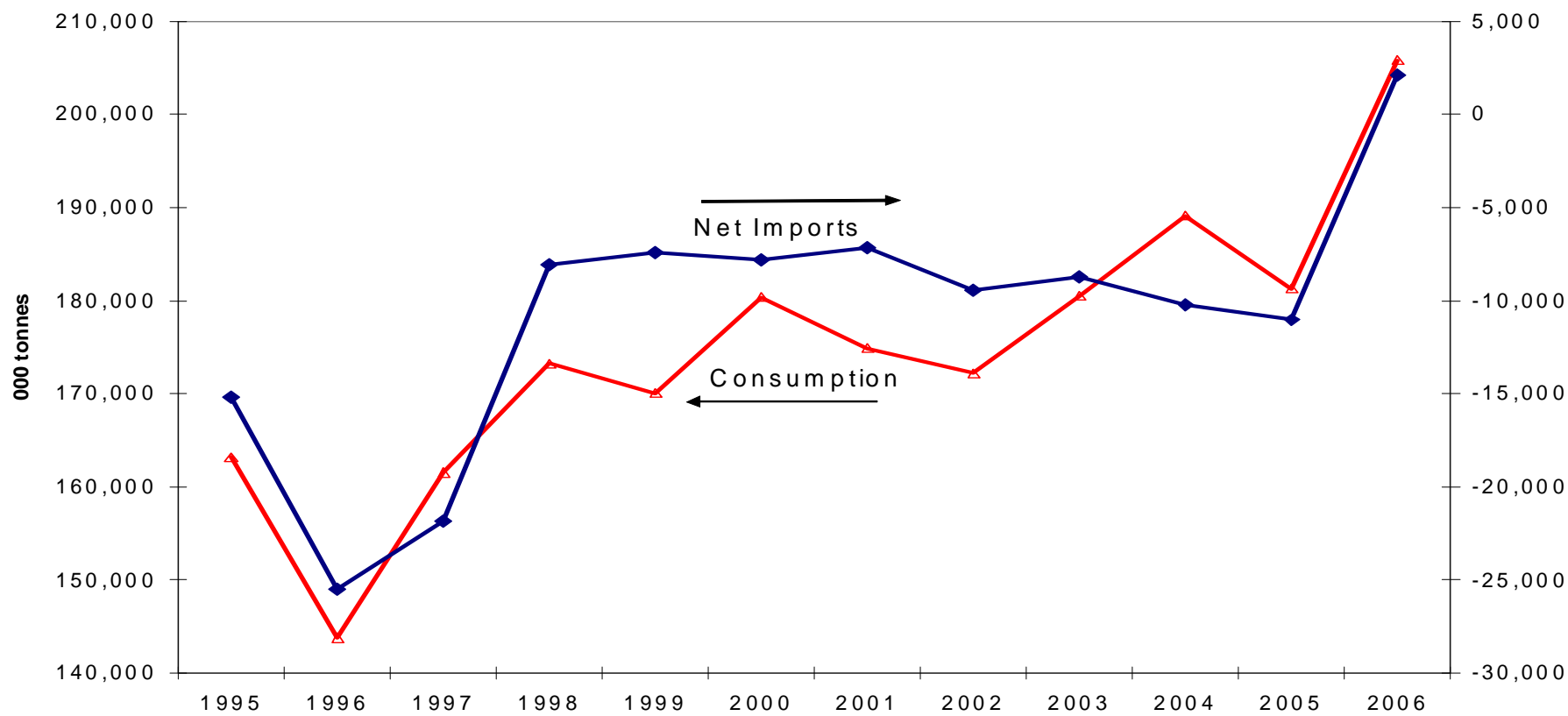


Economic Impact Is Imperceptible

- No visible macro-economic effect
 - De-industrialization of Europe??
- Energy-intensive sectors more at risk
 - Here too little effect, so far
- Why? CO₂ is but one price among many
 - All others as important now as before
 - True for investment, also?



Crude Steel Imports, EU25

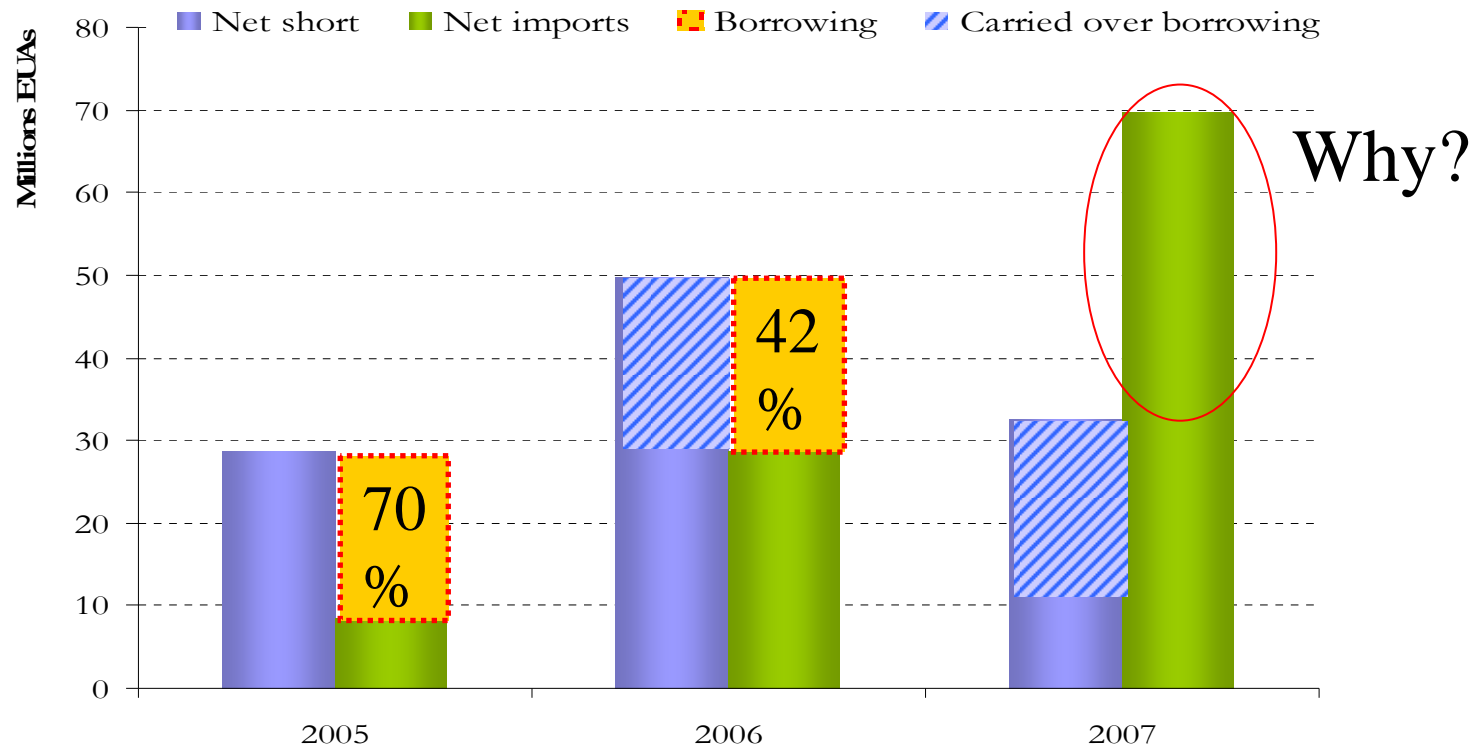


Borrowing Works without Abuse

- EU ETS is only cap-and-trade system with unrestricted year-ahead borrowing
- An alternative compliance option that was used significantly in 2005-06
- All paid back in 2007
- Redistributed demand is a useful way
- An alternative to a price cap in US



Evidence of Borrowing in the UK



Recap on Borrowing

- 3000 short installations in 2005 & 2006
 - 475 show evidence of borrowing (16%)
- Short positions of 409 Mt in 2005-06
 - At least 63 Mt borrowed (15%)
- Only foreign EUAs can be observed; no doubt domestic EUAs as well
- Perhaps as much of 30% of short positions covered by borrowing



Multinational Systems can be created

- EU is not the United States of Europe
 - Member States are sovereign nations
- Successfully bridged very large gaps in economic circumstance, institutional preparedness, and commitment to climate policy
- EU club benefits explain adherence as well as vital role of Commission
- What could replace this on a world scale?



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Coverage

- Good reasons for partial coverage in EU
 - But expansion is proving difficult
 - Complicated by point of regulatory obligation
 - Partial \Rightarrow downstream
 - Comprehensive \Rightarrow upstream
 - The link to free allocation
 - US system should be comprehensive
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Allocation

- Was free allocation a mistake?
 - Political practicalities and existing use
 - Unleashing the revenue-seekers
 - Windfall profits? What did you expect?
- Trade-impact as a basis for allocation
 - Over-allocation and auction exemption
- But a useful evolution to more auctioning



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Pres. Bush is not the Problem

- Next president will be favorably disposed
 - Pres. Clinton was too
 - Serious discussion under way
 - Action to date is disappointing
 - Revealing lack of consensus and of willingness to compromise
 - Will climate change be the real priority of the new president?
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The EU ETS Effect

- US action depends on finding resolution to internal differences
- Remarkable attention being given to the EU ETS by all in US debate
- This example counts for more than anything else said or done by Europe
- One of many important issues engaging the EU-US relationship

