

What Should the US Learn from the EU ETS?

A. Denny Ellerman
MIT

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Evaluation from a Different Perspective

- **Not concerned with ETS Review, or how to improve the existing system**
 - Depends a lot on specific EU circumstances
 - In fact, a multinational system
- **Serious debate on C&T beginning in the US**
 - Surprising amount of attention to EU ETS
- **What does the EU ETS teach the US (or others) to do and not to do?**

Lesson #1: A carbon price won't “wreck” the economy

- **An exaggerated argument, but effective**
- **The EU economy has thrived and even equaled (!) US performance since 2005**
- **Could dodgy US sub-prime mortgages have more effect than a CO₂ price?**
- **Good EU economic performance also not due to the carbon price; just one of many**
- **At last, a quiet and compelling example from Europe**

Lesson #2: Adopt a long horizon with banking and borrowing

- **Repeated, sequential trading period is largest defect in EU ETS**
 - **Disincentive to investment or a politically helpful ambiguity?**
- **Alternative is long-horizon, pre-specified caps with review**
 - **Difference is in the presumption**
- **No evidence of abuse of borrowing in ETS**
 - **A radical innovation in emissions trading**

Lesson #3: A Safety Valve May be Warranted!

- **Initial prices can exceed expectations**
 - **Seen also in US OTC/NO_x Budget Program**
 - **In both cases, due to regulatory uncertainty, inexperience, and institutional features**
- **Perhaps a transitional, phase-in feature?**
 - **Motivation more political than economic**
 - **Lack of confidence/experience in GHG abatement**
- **Can long horizons and borrowing be a substitute?**

Lesson #4: Make sure installation-level data is available

- **A big problem in ETS NAP1 exercise**
- **Free allocation to incumbents assumes good installation-level data**
 - **All existing systems have high initial levels of free allocation**
- **Good cap-setting also assumes good data on covered sectors**
 - **Probably bigger problem in NAP1**

Lesson #5: Upstream MRV for small sources

- **EU ETS uses an upstream MRV method applied downstream**
 - **It works, but high transaction cost for small sources**
 - **Also justifies less rigorous MRV “tier”**
- **If EU ETS expands coverage, it will be forced to upstream MRV**
- **For US system with transport or res/com sectors, go upstream from start**

Some More Problematic Lessons?

- **New entrant and closure provisions**
 - Ubiquitous in EU ETS but rare in US
 - But present in Bingaman & Lieberman bills
- **BTA provisions**
 - Presumption of “deep then broad” or simply an option (that may not be used)?
- **Auction/free allocation split and evolution**
 - High initial & phased-out free allocation observed in principle and practice in EU
 - But much higher initial level than proposed in US

More generally...

- **It works**
- **It is not a big thing economically, and**
- **It can't be ignored in thinking about global architecture**
 - **A fact on the ground diplomatically**
 - **The “motor” of the world carbon market**
 - **Engaging China & India in a global trading regime**