

The case for an IRA (Independent Regulation Authority) : Governance Challenges of the EU-ETS

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1. The three levels of market regulation
2. Current proposals by the European Commission
3. The parallel with a central bank and the monetary policy
4. The mandate of an Independent Regulation Authority (IRA)

ANNEXES

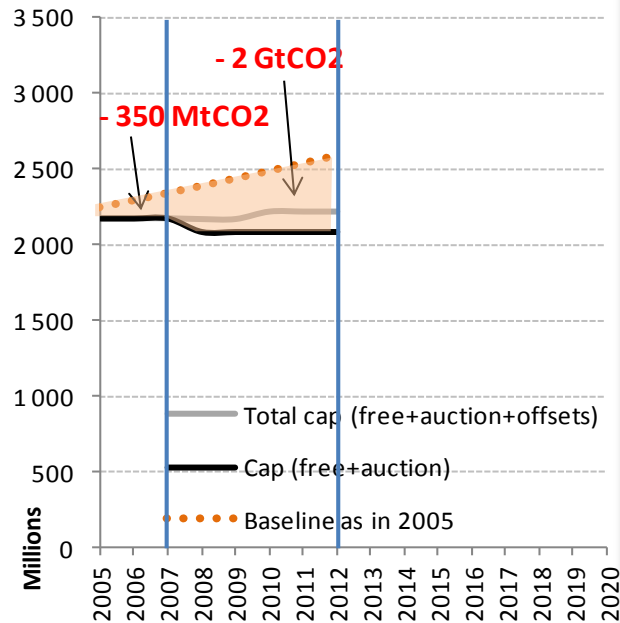
- **Security of market infrastructures** (registry, access to the market, detection of frauds ...) :
 - Major failures in 2009 and 2011 : VAT frauds and EUA thefts ;
 - New rules reduce the risk in the future but past failings have weakened market credibility in the public and among politicians.

- **Market oversight** to prevent the risk of market manipulations :
 - Adapting existing regulation on financial and energy markets ;
 - An innovative collaboration in France between both regulators ;
 - A major challenge : using all the market information.

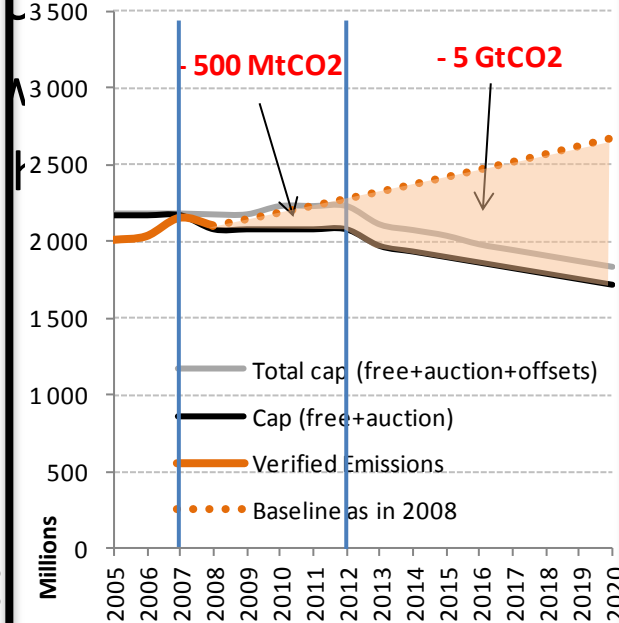
- **Interventions** of the public authority on the market :
 - Current propositions by the EU-Commission of back loading ;
 - Propositions for a new governance based on an Independent Regulation Authority (IRA)

Initial expectations and ex post observations

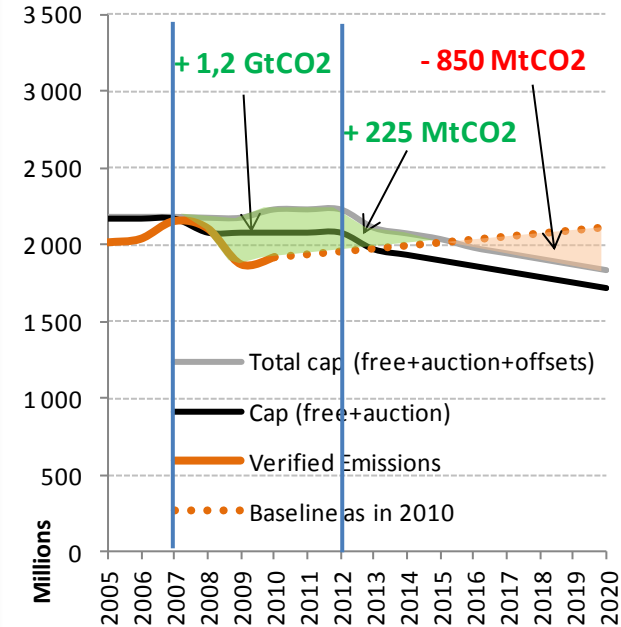
Beginning of 2005



Beginning of 2008



Beginning of 2012



Source: Trotignon (2012)

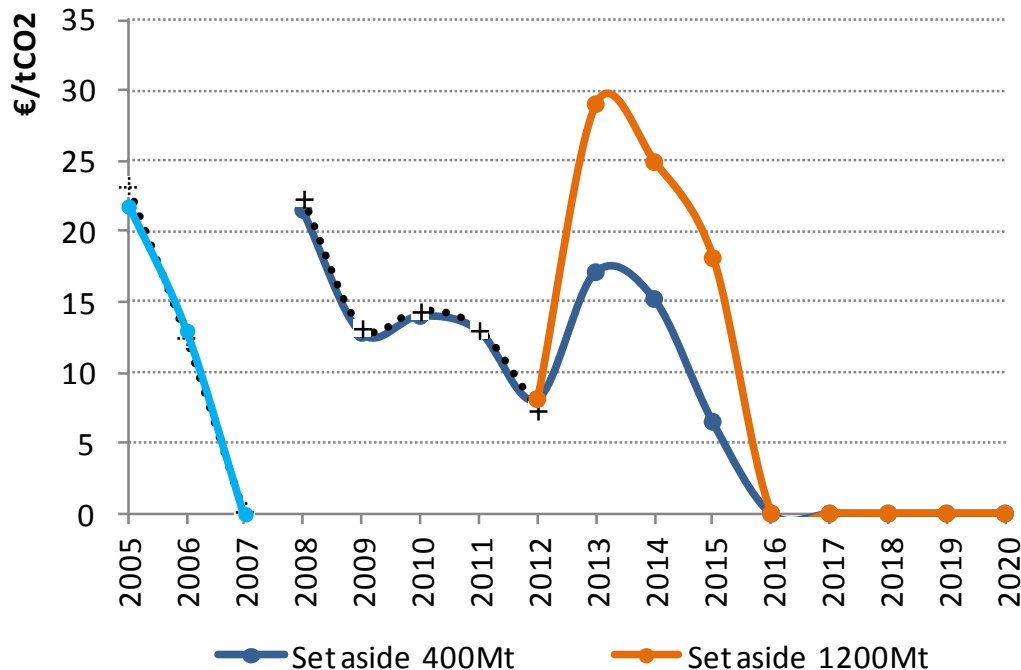
The current propositions by the EU Commission

- Past experience in changing provisions (the offsets case)
 - Qualitative restrictions as of April 2013 (decided in 2011)
 - Results: a surge in the use of this type of offsets
- Proposition of back loading in order to boost the market
 - Reducing auctioned amounts between 2013 and 2015
 - Adding these amounts to the auctions scheduled between 2016 and 2020
 - No change in the cap

Back loading: The risk of aggravating the lack of visibility

- Two set aside (back loading) scenarios, with no change to the current cap
- Effects on prices without any changes in market anticipations

**Back loading effect on carbon price:
two simulations with the ZEPHYR model**

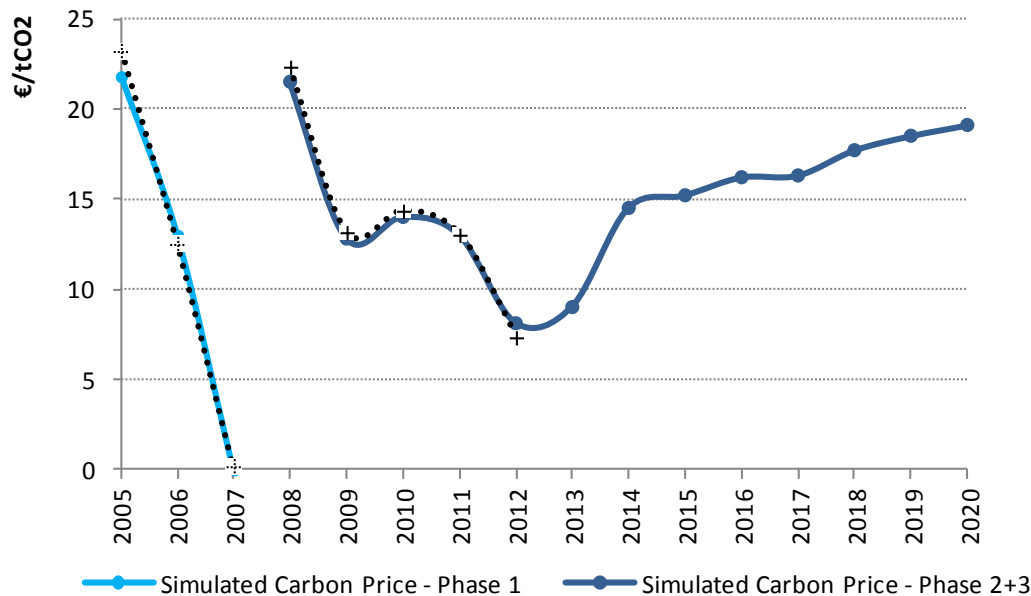


Source: Trotignon (2012)

Back loading: The risk of aggravating the lack of visibility

- “Set aside” of 900Mt changing into a “set away” in 2016

**Effect on the carbon price:
Backloading + reduction of the cap**



Source: Trotignon (2012)

- The ‘perfect game’ for the EU Commission ?
- In reality, it is risky because it plays with already unstable anticipations

The parallel with a central bank and the monetary policy

Three reasons to draw lessons from monetary policy :

- Technical similarities : EUA and CERs are “carbon moneys”
- Dynamic management of the supply help in reducing risks of market instability (especially with allocation through auctions)
- Integrating long term constrains (monetary stability ; climate policy goals) in the short term horizon of the decision by governments.

Short term and long term goals of the EU-ETS

- Short term goal : to reach abatement resulting from the cap at lowest costs
- Long term goal : investments required to engage the economy in a low carbon trajectory
- The function of the market : to reveal the price required to reach both of the targets (quantitative regulation)
- In a context of great uncertainty :
 - Current and future abatement costs
 - Economic conditions
 - Possible overlap with other policies

The parallel with a central bank and the monetary policy

	Monetary Market	Carbon Market
Final target	Long term monetary stability	Long term emissions reduction trajectory
Market oversight	Integrity and liquidity of transactions	Integrity and liquidity of transactions
Price instrument	Interest rates	Carbon prices
Quantitative regulation		
• Primary market	Supply of central money (M_0)	Allowances auctioning
• Secondary market	- Open Market (sell, buy and lend monetary assets) - Exchange rate	- Sell, buy, set aside carbon assets - Links with other markets (offsets, other cap & trades, ...)
Liquidity Crisis	Lender in last resort	Additional supply of borrowed allowances (or offsets)
Reporting	Reports to the Parliament ; market insight credibility	Reports to the Parliament ; market insight credibility

- No delegation on the ultimate goal : bringing emissions levels onto a path which mitigates climate change. In the EU : medium and long term targets (2020 ; 2050)
- Intermediate objective under the responsibility of IRA :
 - Making sure that the carbon price reflects short term and long term abatement goals
 - Avoiding market instability through dynamic management of supply
 - Adapting the cap in case of overlap with other policies tools and unexpected shocks
 - Linking with other markets (Offsets and Cap and Trades)
 - Public reporting to parliament and political authority

Thank you for your attention!

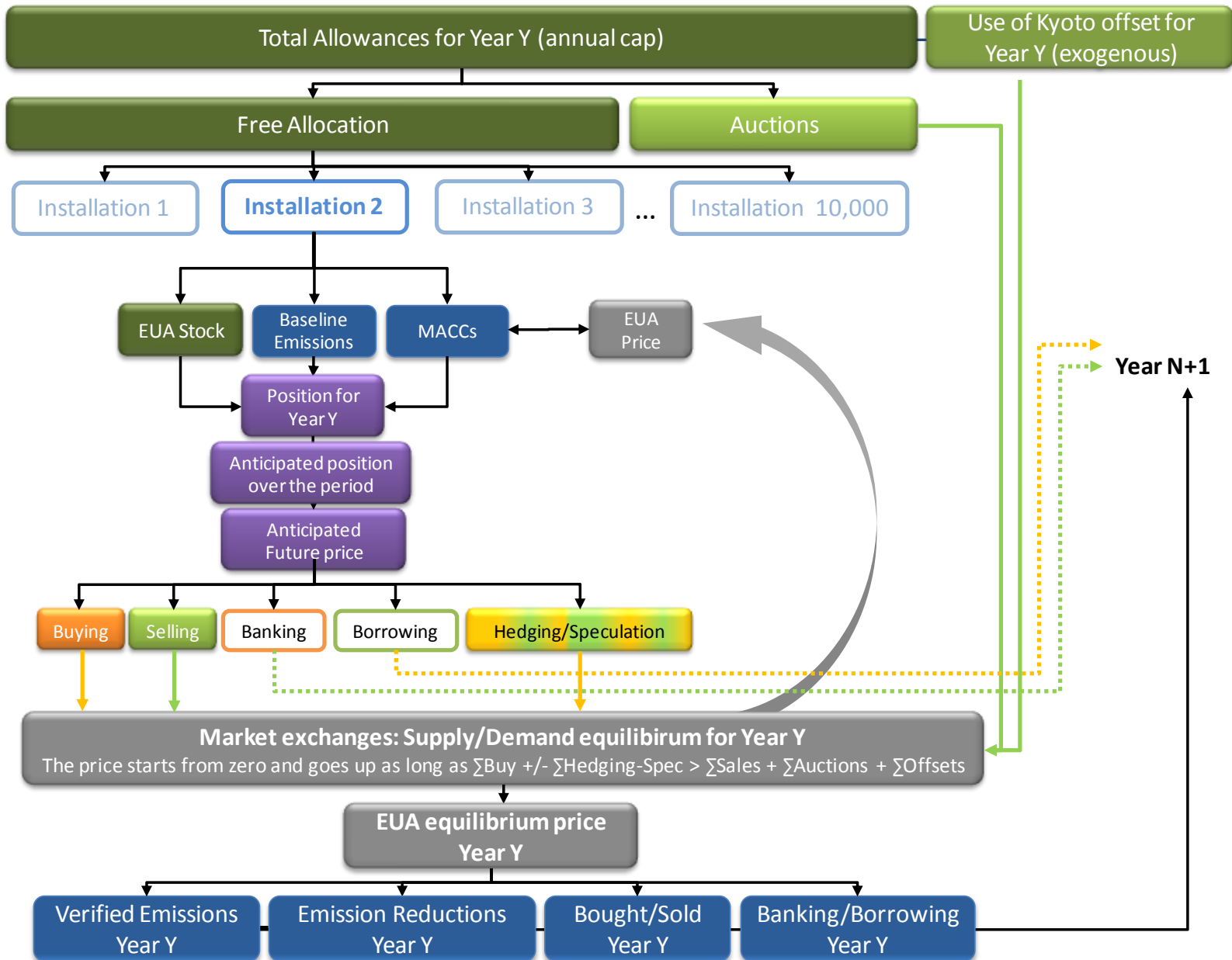
For more information, please refer to the paper :
'The EU-ETS : issues in the transition to Phase III', Cahiers de la
Chaire Economie du Climat, N°14, March 2012
And to the Raphaël Trotignon PHD thesis :
'In Search of the Carbon Price' (2012)

available on our website :

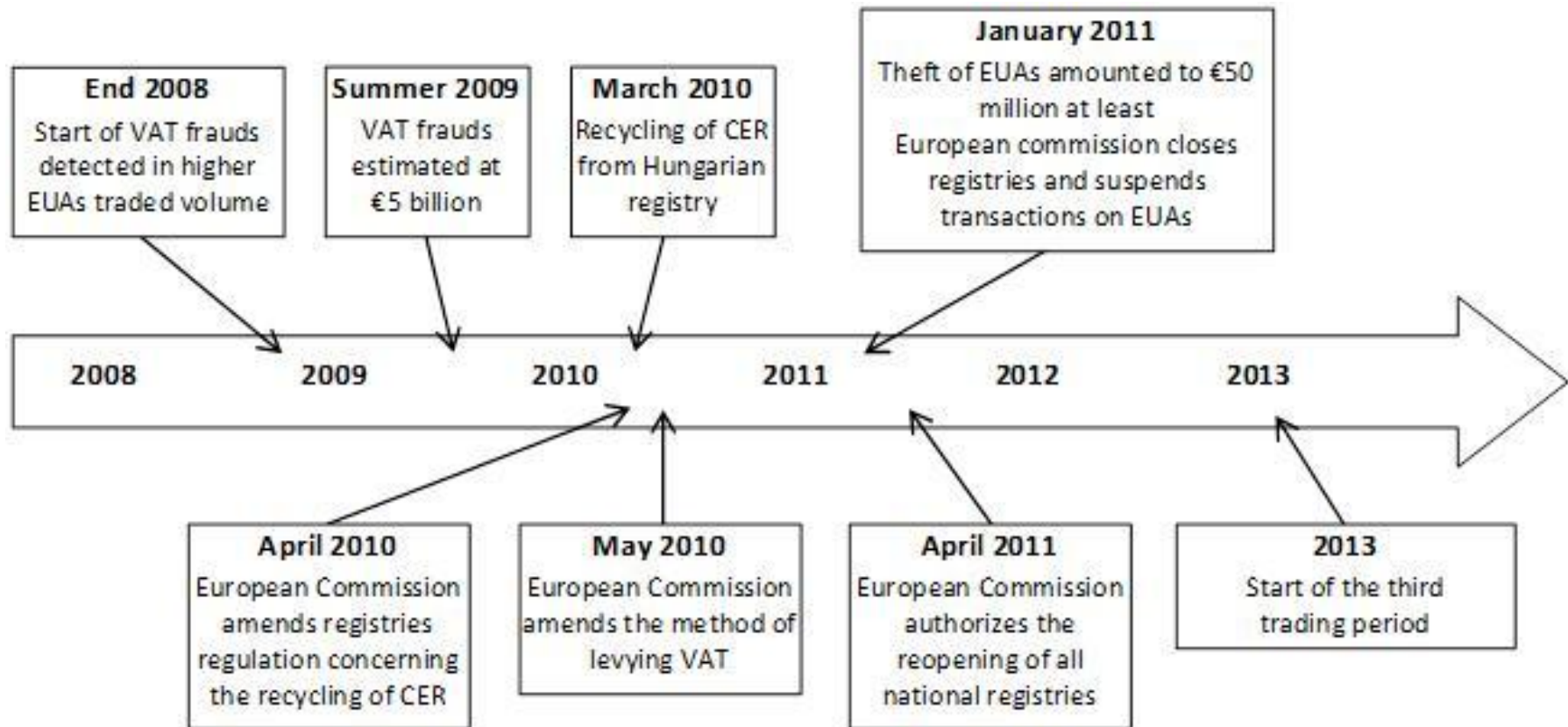
www.ChaireEconomieduClimat.org
www.climateeconomicsblog.blogspot.com

- ✓ Zephyr Model presentation
- ✓ Major Market failings
- ✓ The risk of instability on cap & trade markets
- ✓ The risk of overlap between policies

Annex : ZEPHYR-flex model presentation

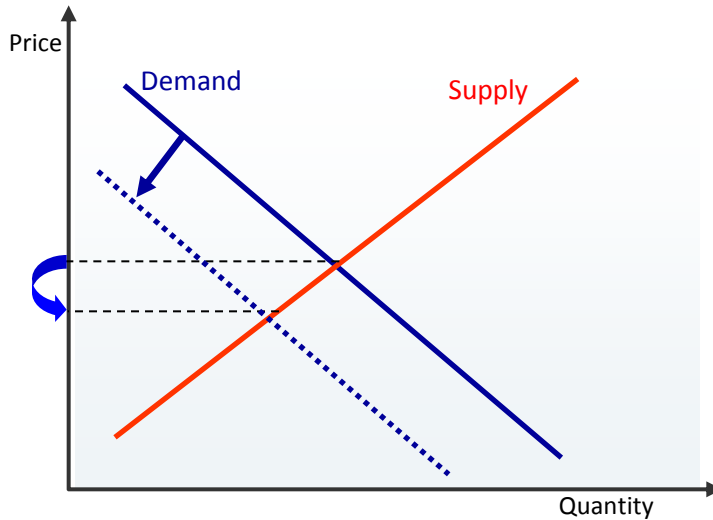


Source: Trotignon (2012)

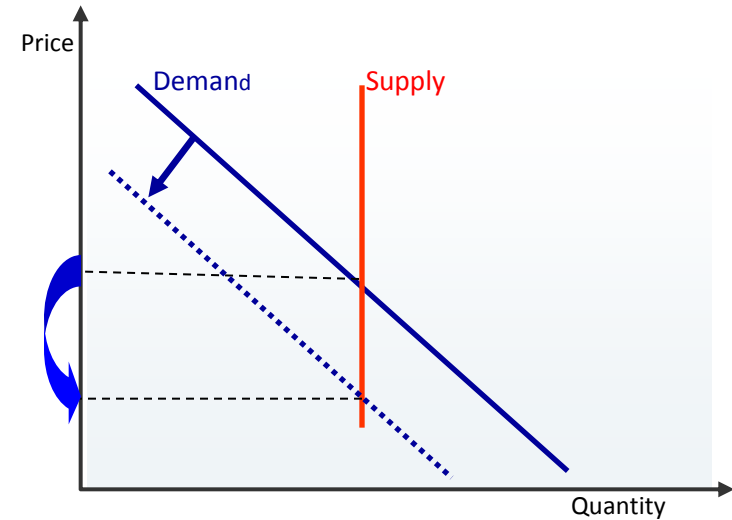


The risk of market instability on a cap & trade scheme

Demand change on a standard Market:



Demand change on a cap and trade market:



Managing the risk of overlap between policies

