

Cost Containment Mechanisms: Market Perspective

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Why have a market anyway.....

- ▶ An emissions markets is a policy tool that guides companies to allocate shareholder capital in the most efficient way possible in order to deliver on their individual emissions targets.
- ▶ The market is itself a core cost containment mechanism since it is the forward price curve that tells a company whether to make or buy. This drives capital to find the lowest cost abatement opportunity, regardless of which company is sitting on the best opportunities.
- ▶ And the bigger the market the lower the compliance costs. The wider the pool of possible abatement projects then the more opportunities there are to find low cost emission reductions, the marginal cost of abatement will be lower and the market price will be less.

But markets are dangerous. Why not price caps...

- ▶ Although price caps offer clarity on short-term compliance costs the disadvantages are severe:
 - ⊕ The introduction of a price cap sacrifices the basic environmental guarantee that underpins a cap and trade system. We can have a guaranteed emissions level or a guaranteed price level but not both. Price intervention in the form of a price cap compromises the emissions cap because it offers a buy out whereby companies can pay a fine rather than redeem an allowance against their physical emissions.
 - ⊕ A price cap limits the return on investment in emissions savings activity. In a regular free floating market higher allowance prices will incentivize the flow of capital into more advanced technologies, larger abatement projects and more innovation.
 - ⊕ Unilateral price caps in one jurisdiction create a major barrier to market linkage.

So what should we do...

- ▶ Extend the market domestically and internationally,
 - ⊕ Incorporate more gases and sectors: chemicals, transport, agriculture, CCS
 - ⊕ International linkage
 - ⊕ Expand methodologies to cover policy programs and technology benchmarks
 - ⊕ Incorporate forestry

- ▶ Ensure the efficiency of market institutions
 - ⊕ Establish long term clarity on targets and rules
 - ⊕ Get registries in place
 - ⊕ Don't mess about with auctions or new entrant reserves
 - ⊕ Ensure verification capacity of verifiers

- ▶ Governments (or a Global Central Carbon Bank) may participate in the market but should not “print allowances”.

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