Political Economy of tradable permits – competitiveness, co-operation and market power

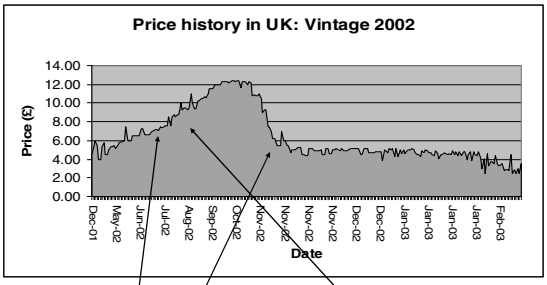
Shell Trading

Reminder: How does the market reduce emissions?

- An emission cap is established. If short, companies have a choice of:
  - Investing in new technology and capital stock to make emission reductions internally
  - Buying allowances in the market, or
- Companies MUST make this decision efficiently. It is essential to compare:
  - The cost of buying allowances, against
  - Marginal costs of abatement over time
- But investments may take several years. Hence we need prices for the future. This is called the "forward curve".
- The ONLY way emissions are reduced are from investment & implementation of new technologies.
- Hence a lack of liquidity and poor forward curve means inhibited and inefficient investment.

Shell Trading

Political economy of tradable permits – competitiveness, cooperation and market power



Market power

- Is it a problem if an entity holds sufficient quantity to influence price?
- Diversity is important but primarily to reduce marginal cost of abatement
- Price more deeply impacted by:
  - Buyers more motivated than sellers
  - Supply in early years from allocation not investment

Allocation

- Auctioning:

- open to spikes
- poor price discovery
- difficult to administrate

Baseline & credit / cap & trade

- Post-verification allocation very inefficient
- Buyers act before sellers can deliver supply
- No forward curve
- Inefficient investment