

STRATEGIC GUIDELINES FOR THE DESIGN AND IMPLEMENTATION OF DOMESTIC TRANSFERABLE PERMITS

EXECUTIVE SUMMARY

Tradable permits can be effective policy instruments for environmental management.

There has been increasing interest in tradable/transferable permits (TPs) as a cost-effective instrument for environmental management, both for pollution control and natural resource management. The OECD "Strategic Guidelines for the Design and Implementation of Domestic Transferable Permits" (2001) summarise the main issues to be considered by policy makers when designing and introducing a TP scheme. The Guidelines are based on the recent publication, *Domestic Transferable Permits for Environmental Management: Design and Implementation* (OECD, 2001), which provides systematic analysis and full discussion on the various approaches, challenges, conditions and potential solutions relating to the design and implementation of TPs at the national level.

TPs can be environmentally effective, economically efficient, flexible, and designed so as to limit unwanted distributive effects. They can guarantee *environmental performance* as they are based on setting of quantified limits on emissions or natural resource use. A TP scheme can achieve *economic efficiency* by minimising the overall cost of compliance by encouraging those firms that can abate pollution and/or conserve resources more cheaply to do so first, while allowing those with higher costs to opt for buying additional permits or allowances. A TP scheme also grants firms *greater flexibility* in the choice of means for achieving the environmental objectives. Depending on its design, a TP scheme can also *better control the distributive effects* of the policies, achieving desired income distribution or transfers among different groups.

There are four main families of tradable permits

There are four main families of TPs with distinct ways of adjusting for flexibility in governments' approaches to environmental policy. They include the following: (i) *quotas* (cap and trade or minimum limits and trade) – a quantified ceiling or floor assigned to firms for a given period, (ii) *credits* – acknowledgement at the end of the period of the achievement of an emission or abstraction level below the one which had been authorised for a given firm, (iii) *averaging* – the competent authority sets average limit values for an entire range of similar products manufactured by firms within the same industrial branch; and (iv) *transferable usage rights* – formally regulates access to resources that are freely available, or organising the regulation of the use of resources whose ownership is shared.

In designing a tradable permit system, a number of key variables and options should be considered.

There are many important variables to be considered when designing a TP system, but they can largely be categorised into three types, those related to (i) objectives and basic characteristics of the system, (ii) design options, and (iii) means of application.

The first type includes basic elements such as the physical basis of permits depending on the environmental objective of the TP system, and the coverage of participants. The second type relates to design options such as the method of initial permit allocation (i.e. administratively allocated or through auctioning), the degree of temporal and spatial flexibility (i.e. whether banking, borrowing, or bubbles are allowed), and how to organise the transfer or trade itself (bilateral or through a trading platform). The third type is concerned with the means of implementation, such as monitoring, verification, and enforcement of penalties in cases of non-compliance.

THE OECD ENVIRONMENT PROGRAMME

Policy-makers need to consider certain issues and constraints before implementing a tradable permit system.

There are a number of issues that policy-makers should keep in mind when deciding to opt for a TP scheme over other policy instruments, including;

- *Competitiveness* - TPs can have favourable impacts on competitiveness compared with regulatory approaches, but each case needs to be examined carefully, particularly the rules of initial permit allocation and fiscal redeployment, in order to determine the net impact on the competitiveness of firms.
- *Compatibility of the proposed TP system* with existing legal and institutional frameworks, regulatory regimes, and other instruments such as taxes or negotiated voluntary agreements.
- *Distributive effects* arising from the implicit sharing of property rights to the environment among the government, firms responsible for pollution and/or resource extraction, and residents of the concerned community.
- *Political and social acceptability* of the concept of the "right to pollute".

Designing and successfully launching a tradable permit system can require regulatory and institutional reform.

The process of designing and successfully launching a TP system requires political will and often improving or even overhauling the existing regulatory and institutional frameworks. Some of the key elements in regulatory and institutional reform to facilitate introduction of a TP system include the following:

- A shift from regulations focused on technology choice to formulation of physical limits, such as ambient air/water quality standards, that are more in line with environmental objectives and offer greater flexibility in the choice of means to achieve compliance.
- A shift from environmental standards expressed in terms of unit and concentration values to those expressed as absolute/mass values (ceiling or quotas by period).
- Assignment of responsibility for verifying policy implementation to independent administrative authorities whose long-term mission would be to ensure compliance with regulations and to develop transfer activity and fair transactions.

Based on an assessment of existing experiences, the Guidelines provide advice on the consideration of these and other key conditions in the design and implementation of domestic TP schemes.

To download the document **Strategic Guidelines for the Design and Implementation of Domestic Transferable Permits** [ENV/EPOC/GEEI(99)13/FINAL] for free, visit our website at <http://www.oecd.org/env/>.

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