Jumping on the emissions bandwagon

Liz Bossley highlights the findings of a new CEAG report*, published by the City of London Corporation, which provides a template for local government schemes to tackle climate change, based on European emissions allowances (EUAs) and set within the context of a retail emissions sector.

On 29 June 2006 UK Environment Secretary David Milliband said: ‘Every sector of society has to play its part in combating climate change, as every part of society will be affected by its impact. That means that government, businesses and individuals have to take action and work together.’ This new report by the Consilience Energy Advisory Group (CEAG), entitled Emissions Trading and the City of London, will help achieve Milliband’s objective.

While the Kyoto Protocol and the European Union Emissions Trading Scheme (EU ETS) aim to reduce greenhouse gas emissions by countries and by big industrial installations, a mechanism is needed to help national, regional and local authorities to devise their own environmental policies to be implemented by them at the household level.

CEAG suggests that the most efficient way of doing this is to use a compliance instrument that is already traded internationally, rather than by re-inventing the wheel each time a new ‘green’ policy is considered. It takes the most widely traded international emissions instrument – the EUA (European emissions allowances) – and demonstrates how regional or local government authorities can use it to reward households who comply with an environmental policy and penalise those who do not.

Up to now each new environmental scheme has invented its own different ‘compliance’ instrument – such as Renewable Obligation Certificates, Levy Exemption Certificates, OSPAR Oil in Produced Water Certificates – which has led to confusion, lack of comparability and an increasing administrative burden on those who have to comply.

Each precise policy for involving the public in the fight against climate change would be up to the authority concerned to decide for itself, depending on local circumstances. However, an authority might, for example, decide that it wants to reward new or refurbished buildings for being energy efficient. When granting planning permission, the building inspector could grant an annual EUA penalty or reward to the building, which can be collected or deducted each year through the building rates. Or, an old building may be given an EUA reward for installing double-glazing. This reward could be collected by the building owner when the new windows are purchased and installed. Or, as another example, old polluting cars could be penalised by paying an EUA ‘fine’ if they fail to pass national or local authority environmental standards when their owners apply for an annual MOT certificate.

A new environmental currency

An EUA represents the right to emit one tonne of carbon dioxide equivalent. EUAs are created by the 25 European Union (EU) Member States under their National Allocation Plans to comply with the terms of the European Emissions Directive. EU countries can only create as many allowances as the European Commission (EC) will permit to ensure that Europe meets its commitments under the Kyoto Protocol.

This does not mean that a local authority has to become a voluntary participant in the EU ETS to use the EUA. Once they have been created by an EU Member State, anyone can use EUAs for any legitimate purpose. The best analogy would be that local governments do not get involved in central government monetary policy, but it does routinely use national currency for its own purposes. In the same way that it would open a bank account to handle financial transactions in its national currency, local government authorities can open an emissions registry ‘person holding account’ to handle EUA transactions.

The EUA is only an instrument of compliance that can be applied to any environmental scheme, but the scheme itself has to be workable. A workable scheme needs a methodology for measuring, monitoring and evaluating the environmental parameters targeted for improvement. These issues will determine the mechanical construction of the policy. Once constructed, the use of the EUA to implement the policy will improve its efficiency and comparability with other environmental choices.

Each EUA can be traded many times over by individuals, companies, installations and countries. If installation and big companies who have to comply with the EU ETS need to buy allowances they will bid up the price. They will also be able to convert Kyoto-based allowances to satisfy their needs. So there is no danger of running out of EUAs, even if they are used as a compliance instrument by lots of different regulatory authorities around the world.

Retail emissions

The use of the EUA for compliance with local government environmental policies would create a need for EUAs at the household level. National or local...
authorities could licence emissions retailers who could buy or sell EUAs direct to the public in rewards from the policy or to pay penalties arising from it. To obtain a licence the retailer would be required to interface with the local authority monitoring, measurement and compliance database. Such a database is a prerequisite of any environmental policy, regardless of the chosen instrument of compliance.

Likely retailers are the types of companies who are already involved in various types of public retail markets and who are already active in the wholesale emissions market. For example:  
- utility companies supplying gas, electricity, water or telephone services;  
- banks;  
- companies who sell petrol to the public;  
- national supermarket chains;  
- household and car insurance companies.

The retailers would earn a retail margin, the same as they would in any retail market. The licensing authority could place limits on this margin, but the more retailers who are licensed the more competition there would be to offer the best prices to the person in the street. These retailers can also offer voluntary schemes based on EUAs to the public, who may wish to purchase and ‘retire’ (ie cancel) a number of EUAs to cover any of their own emissions that are not covered by mandatory government schemes.

Individuals could find the best emissions prices by shopping around in the same way as they do when they are buying and selling currency before going on holiday. Any savvy holidaymaker will check out if the travel agent charges more or less commission than a bank or a bureau de change and will compare their rates of exchange. The same would apply to EUAs – individuals would look for the retailer posting the lowest commission and the best EUA ‘sell’ and ‘buy’ prices.

As a purely mechanical matter individuals would not receive a tangible EUA ‘certificate’ to either exchange for cash with a retailer or pay to the local authority in compliance with the local government environmental scheme. An EUA, as created by the EU ETS, is an electronic instrument held in a registry account and is never seen in the form of a paper certificate. The individual would instead receive a penalty or reward notification from the local authority containing an individual household reference number identifier. It is this notification that would form the basis of a transaction between an individual and an emissions retailer. The retailer buys the EUAs rewards for cash at its EUA posted purchase price or sells the EUAs to the individual who will pay the retailer’s posted sales price. The retailer will complete the transaction by recording it online through its computer interface with local government software, specifying the individual household’s reference number identifier on the notification letter. A hard copy receipt could be issued by the retailer to the individual.

The use of the EUA as a standardised compliance instrument for green policies would have an invaluable educational and behavioural impact on companies and on the public. It would involve the wider public directly as consumers in the financial consequences of their environmental choices. It would be easier to compare the costs and benefits of a range of different environmental choices at the international, national, regional and local level if all environmental penalties and rewards were expressed in the same way, ie in terms of EUAs.

Additionally, by linking local schemes into the international effort, a local authority could be sure its own citizens were being treated fairly compared with citizens in other countries. If the international effort to arrest climate change is half-hearted, the price of EUAs will increase and the rewards from local EUA-based policies will be greater.

And if Mr Schwarzenegger is listening out in California, it could easily work there too!

*To obtain a free copy of the CEAGICorporation of London report, entitled Emissions Trading and the City of London, contact CEAG on t: +44 (0)207 928 1222 or e: sarenasteeds@ceag.org