

Carbon EXPO

Allocations in the Carbon Market

Imtiaz Ahmad

Vice President Fixed Income

imtiaz.ahmad@morganstanley.com

The EU ETS: The core essence

- The EU ETS is a market created by politics and regulation and it is the political intent and robustness of the regulations underpinning the system that will determine the success or failure of the market
- Traders increase market efficiency and can act as a catalyst for the system to deliver its stated objectives whilst also reducing transaction costs for compliance players
- Market participants need to know that what they are actually trading is underpinned by sound foundations
- **Allocations provide the key foundations for enabling the policy objectives of emissions trading to deliver**

The EU ETS: Allocations

- The market needs to be designed with a net short of sufficient size so as to enable targets to be met
- Ensure collection of sufficient real / verified emissions data to base allocations on
- Phase 1 was 97Mt long in 2005
- Phase 2 estimated to be 150Mt short in 2008
- Phase 3 EU ETS likely to make greater use of auctioning
- Greater harmonization across the EU
- Length of allocation period may be extended

The EU ETS: Allocations

- Additional sectors likely to be added to EU ETS such as aviation, shipping and potentially other gases
 - What basis will be used for the allocations?
 - System should avoid repeat of Phase 1 and ensure accurate emissions data is taken for these sectors now
 - Carbon price needs to be taken into account in both day to day decisions and long run investments and for this allocation levels and basis are key
 - EU Commission to take on greater pan EU decisions on allocations rather than Member States?
 - Harmonization on issues such as new entrants and plant closures?
 - Allocations should focus on delivering reduction of emissions in an objective manner rather than national Member State politics and regional aid issues

The EU ETS Long term – why do allocations matter

- Investments need to be made into new power generation plants across the EU, new industrial plant and carbon abatement projects via the Kyoto flexible mechanisms system
- Project investments and plant investments need longer term certainty often requiring payback periods beyond 2012 meaning that longer term allocations are needed
- The long term policy objective and incentives that EU Commission and Member States wish to signal via allocations has scope to result in investment decisions that result in newer, more efficient and cleaner plants being built resulting in abatement in emissions of GHGs
- The EU ETS has not failed. Phase 2 allocations are much more robust and designed with policy intent of the achievement of Kyoto Protocol targets