Prepared Remarks for the ETS Compliance Forum

By Dirk Forrister
President & CEO, IETA
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Introduction

Good morning. It is a real pleasure to join you today to introduce two days of discussions on EU ETS.

As a representative of business, we view your work as pivotal to carbon markets - because at the end of the day, it is compliance that gives economic value to the market. Without it, nobody would take obligations seriously. No emissions reductions would occur, and no costs would be borne. There would be no need for a market. So we appreciate what you do- and that's why I'm happy to join you today.

As noted in my bio, I am the President and CEO of the International Emissions Trading Association – and I hope you know us. We are a professional industry group that promotes emissions trading as the preferred approach to reducing greenhouse gas emissions. We advocate. We analyze. We solve problems. And we share best practices amongst industry participants in all of the world's operating carbon markets.

The landscape of carbon markets is continually changing. We are anticipating growing interest in market-based approaches in the run up to the Paris negotiations in 2015. I know that you're working in this forum on some very detailed compliance issues. But I've been asked to put your work in a broader context of the European and global efforts to put a price on carbon.

I will focus on three main themes:

1. What is business looking for in the EU ETS reforms;
2. How Europe's policy is shaping up against a global backdrop of the Lima and Paris negotiations; and
3. Why does any of this matter for the Compliance Community represented here.

I. Business needs ETS reforms

Carbon markets are at an inflection point in many jurisdictions. They are poised to take on greater importance as the global community aims to live within an emissions limit that prevents global warming above 2 degrees C.

Right now, we don't know for certain how serious the sum of national efforts will be in Paris next year.

- But as of two weeks ago, we have a strong signal from the European Council that the EU ETS will be expected to deliver more than its share of an EU goal of reducing emissions by 40% by 2030 (with 43% for the ETS sectors).

- This domestic target is roughly in line with the 80% reduction that Europe seeks for 2050 – the lower end of the 80 – 95% range.

- IETA welcomed this news – because it offered a clearer pathway for business planning.

The Council's announcement also clarified other parts of the 2030 Climate and Energy package – with targets set at 27% for renewables and efficiency, although not binding on Member States.

- We were encouraged that a binding carbon target emerged even stronger as the centerpiece of European policy. This was a positive step, because it will reduce the policy overlap that has obscured the true carbon price – and contributed to the excess supply in the current ETS.

- While we support renewables and efficiency – we prefer market-based approaches for encouraging these technologies.

We were pleased to see Council support for reforming the ETS with a stability mechanism.

- We did not come to this view lightly – because of our deeply held convictions against market intervention. But we recognized that there were problems.

- First, the long term pricing signal wasn't likely to prompt investment in green infrastructure – which could mean that Europe would lose ground in its efforts to modernize its energy infrastructure.

- Second, no one expected the crisis – so the ETS and other markets were likely to attract intervention at some level. The situation was too severe for policymakers to ignore – and if an EU-wide solution did not emerge, we would be forced to deal with piecemeal fixes at Member State level – which was an even worse prospect.

This view led IETA to support the "backloading" policy, so long as it was coupled with meaningful 2030 targets and market reforms. We knew that backloading alone would simply push the problem forward in time – so a real, enduring solution was essential.

We worked hard over the past two years on reform options – evaluating all of the Commissions proposals, ranging from no action to cancellation to pricing floors and reserves. In the end, we supported a Market Stability Reserve as a preferred approach for addressing the market imbalance – and making the ETS more flexible to adapt to changes in demand.

It also has the virtue of providing a better result for taxpayers during auctions – since the public resource of allowances will be sold in a wiser fashion. Rather than flooding an already oversupplied market with more auctions – it provides a tool for adjusting the flow to assure good value in the auction results. This could be good for programs that rely on the auction proceeds for funding – like the NER 300.

IETA is now working with Members of the European Parliament to broaden the support for the MSR – and the 2030 package. We are also encouraging a possible early start for the MSR – and (more importantly) moving the back-loaded allowances into the reserve rather than returning them to market in 2019-2020 (as scheduled), only to remove them again in 2021 onward. Our analysis shows that if it waits to start until 2021, we will see a hugely volatile end of the decade – and this seems like a train-wreck worth avoiding.

II. <u>The ETS in Global Context – How is Europe Positioned for Paris?</u>

With the recent Council conclusions, Europe is relatively well positioned for next year's Paris Summit. It has a 2030 goal that is clear and ambitious – in line with an honorable share of global responsibility for 2050.

Thankfully, Europe isn't going it alone. All other major economies are making plans to announce their "Intended Nationally Determined Contributions" – or INDCs – in early 2015.

Let's look at a couple of the major players:

- In the US, President Obama has a significant program to strengthen automobile efficiency standards as well as a regulatory program to lower power plant emissions. That power plant program offers states the flexibility to adopt emissions trading markets to achieve compliance – and we expect several states will follow the lead of California and the Northeastern states involved in RGGI. Many observers expect that if the power plant program survives the inevitable court challenges – then EPA will make similar moves to control emissions from other industrial sectors, based on size… eight industries make up the lion's share of the remaining emissions.

- In China, the Vice Premier announced that the country was accelerating work on a national ETS as part of his remarks to the UN Climate Summit in New York in September. Seven pilot ETSs are now operational – though in market terms, there is room for more innovation and growth. IETA's Business Partnership for Market Readiness took a Mission of 23 experts to Shenzhen and Guandong last week – and we were impressed with how far these programs have come in their first year, given how "brand new" the concept is in China. Our Chinese counterparts are already looking for signs of how the pilots may form broader regional hubs in a national market.

- Mexico launched an initial step at carbon pricing, with a modest carbon tax that allows use of a limited amount of Mexican offsets for cost containment.

- South Africa plans a similar program next year – but with a stiffer level of tax.

- Chile also plans a carbon tax – but with no offsets. It is part of a broader tax reform program that addresses other pollutants and seeks major shifts away from coal.

- Korea plans an ETS – so companies are getting ready for their first compliance year in 2015.

- Kazakhstan has also announced an ETS – but it is working through some growing pains of setting good MRV standards.

A number of other jurisdictions – Brazil, India and others - are working with the World Bank's Partnership for Market Readiness on their own carbon pricing programs.

Given this movement across the globe, it should not be surprising that the World Bank, IETA and a number of other business organizations produced a Joint Statement on Carbon Pricing – which was launched at the UN Climate Summit in New York about 6 weeks ago. Over 73 governments and 1000 companies signed the statement. It called for greater collaboration in developing and implementing carbon pricing programs.

In New York, we saw heads of state like President Hollande and Chancellor Merkel voice strong support for having a carbon pricing element to the Paris agreement. We also saw corporate CEOs from companies like GDF Suez in Europe and Sinopec from China emphasize the same thing. Mark and I co-chaired an ICAP-IETA Forum with environmental ministers from Germany, Norway and Korea and officials from US States and Canadian provinces – all sharing experiences in carbon pricing as a cornerstone of their climate action plans.

But as compliance professionals, you know that the details matter for markets. And when UN negotiators met two weeks ago in Bonn, there was little focus on markets – and mostly just verbal thumb-twiddling, if there is such a thing. Maybe its because they know the contours of the agreement – but they won't be ready to negotiate the details until next year, when INDCs are more clear.

When the time is ripe, it will be important for leadership to emerge in the negotiations on the market architecture. Right now, its hard to see who will lead. Maybe it is just posturing – but nobody wants to seem like they need markets, because they fear that other negotiators would require them to pay a price for it. The scary thing is that in the future architecture, EVERYBODY needs market architecture. China needs it. The US needs it. Brazil, Mexico and Korea need it. And most of all, Europe needs it.

Maybe we've grown over-reliant on Europe as a voice of expertise on markets in recent years. Europe's current view is that it will enjoy the benefits of the ETS, but has emphasized that its INDC is "domestic." In other words, it can use trading inside the EU-28 – but it does not plan to extend its reach to assist other countries in their compliance... at least, not in achieving the 40% target for 2030.

- Will Europe consider strengthening the target?
- Will Europe explore market connections in a more favorable forum than the UN FCCC?
- Will the future of market linkages be formed bilaterally instead of through a set of UN tools?

IETA would like to see a more engaged EU on markets at future negotiations. Its time to start getting serious about what should go into the negotiating texts.

- Its also time for Europe to extend an olive branch to the many jurisdictions interested in using project-based offsets for some parts of their economies.
- By taking a domestic-only target, Europe has little to offer to the many developing countries that should be allies of the EU in building market infrastructure. Europe could lead by offering a path to linkage for developing countries – either through ETSs or offsets or hybrids.

- We're convinced that if we're to reach the 80 – 95% reductions by 2050, Europe will need to be part of a global market network that taps the most cost effective reductions – wherever they are.

IETA's vision is to create a Paris agreement that can stand the test of time – perhaps laying the basic policy foundation for the next 20 – 30 years. After all, the Kyoto Protocol will be the basic governance document for the 1997 – 2020 period – some 23 years.

IETA wants a fairly basic structure. We envision a simple, clean accounting system at UN level – and a set of market infrastructure tools, like standardized emissions benchmarks, MRV protocols and registries – to accelerate the uptake (and encourage the harmonization) of high-quality market approaches around the world. Building custom-made systems has its place – but the overall system will work better with harmonized elements.

This year, IETA commissioned a research team led by Rob Stavins at Harvard's Project on Climate Agreements. We asked them to review what minimum elements of architecture are needed in the Paris Agreement to unleash the power of markets in a "bottom up" world of national and subnational programs. This research will be published later this month, along with IETA's "Straw Proposal" of sample treaty text. You'll find both documents on our website.

III. <u>Why does any of this matter for the Compliance Community?</u>

I wanted to provide this context for your work together. You've been entrusted with operating the largest carbon mitigation program in the world. It has been through struggles – and it is poised to grow stronger.

It's also important to think about the possible connections between markets in the post-Paris world. Europe still offers a compelling model – though some nations are more intrigued with the California-Quebec linkage. Who did Mexico sign a cooperative agreement with? Governor Brown. Who did Shenzhen sign a cooperative agreement with? Governor Brown.

Any connections to markets in the future will need to ensure solid compliance, which is where you come in.

- First, you can help ensure that the MRV experiences in Europe are shared with other jurisdictions that are interested in building markets – which I know many of you already do through ICAP and various EU capacity building programs.

- Second, you can help us think through how nationally-driven compliance can evolve into a globally connected network of markets fit for the long haul. IETA is always eager to exchange views and learn from others, especially policy professionals.

Conclusion

I wanted to set out this broader context before you delve into the "nitty gritty" of compliance topics for this event. Because the nitty gritty matters – because it keeps the system operating with integrity. And its important, because others are following your lead. I hope this context helps energize your conversations – and encourages you to keep the ETS moving forward.

Thank you again for the hard work that you do in making the ETS work – and I wish you a good conference.