EU ETS Compliance forum – notes for keynote speech

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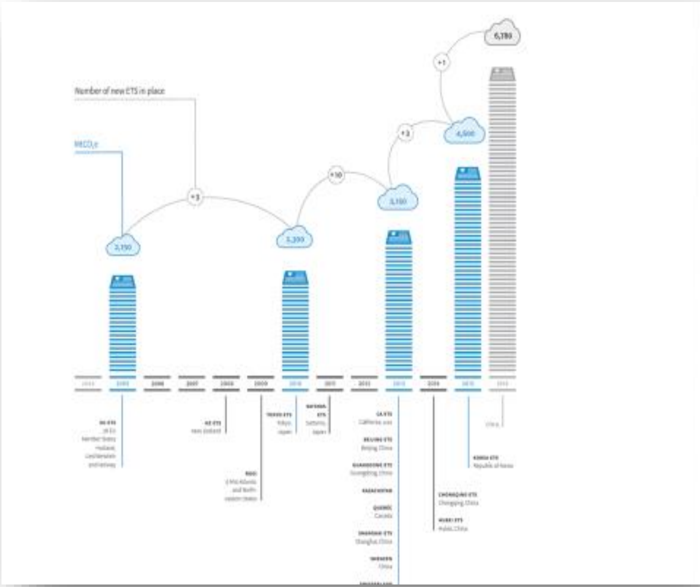
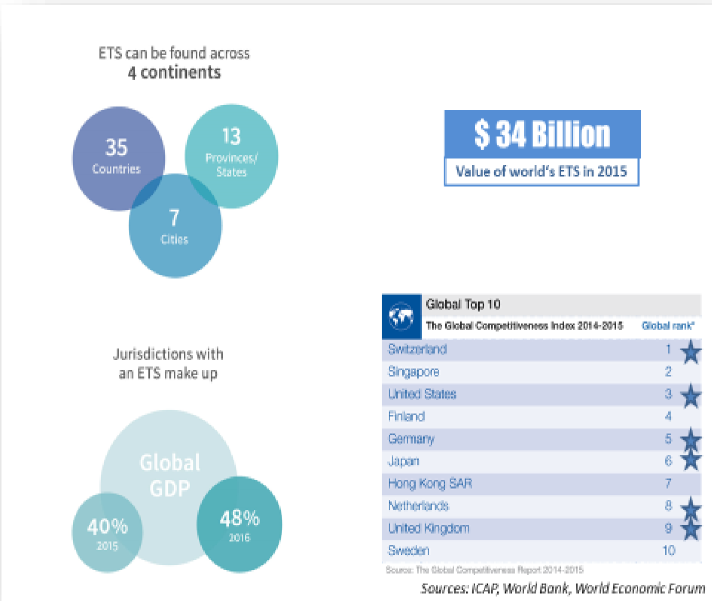
Celebrating a decade of EU ETS:

- somewhat unexpected emergence of the instrument early in the last decade,
- EU pioneering the instrument for GHG,
- laying a lot of the foundations that other ETS are now building upon
- Sound MRV and compliance rules as a cornerstone



Trend curve on ETS worldwide in 2015:

- EU: with the approval of the MSR a basis has been laid for a robust carbon price signal in the EU ETS in the longer term. EUA prices have reflected this, increasing in value by about 25% over the course of the last 12 months.
- But also worldwide, the trend curve on ETS is encouraging:
  - We now have 17 ETS operating worldwide
  - Level of implementation varies from city to subnational to country and supranational level; and design adapted to individual circumstances
  - Value of the world's ETS at 34 billion USD in 2015
  - And the latest figure from the World Economic Forum in September: there is no evidence that carbon pricing harms the economy: six out of the ten world's most competitive economies (all of which in Europe) do carbon pricing



What have been the milestones in 2015 in other ETS around the globe?

- Korea has launched its ambitious system in January, bringing the world's currently second largest carbon market on stream.
  - Korea has carefully prepared the ETS launch with the cap-no-trade Target Management System, which has provided it with robust MRV data of which to base the allocation plan, and has set an ambitious cap which is in line with its 2020 emissions target
  - Nonetheless, some aspects of the current discussion in Korea – especially industry opposition to allocation, resulting in a multitude of lawsuits – should be quite recognizable to those involved in the early days of the EU ETS and it is encouraging to see – and I will come back to this aspect of the usefulness of international exchange and dialogue – that Korean policy-makers are able to benefit from European experiences in this regard.

- The year's second highlight also comes from Asia: with President Xi Jinping's announcement that China is to launch its national ETS in 2017 and an explicit reference to it in China's INDC, there is now a commitment at the highest political level that the world's biggest emitter will implement this policy instrument within the next two years.
  - China's system would be the world's biggest, covering about 3-4 Gt of CO_2e
  - The design is currently still under development, but there may be some similarities to the multi-level nature present in the early phases of the EU-ETS – for instance concerning allocation plans developed at the provincial and approved at the national level. The Chinese National Development and Reform Commission is currently working hard on developing the legal & MRV frameworks, as well as allocation rules, and other design aspects.
  - There are also indications that lessons are being learned from other systems. A price stability reserve may be built into the design from the very start, and NDRC seems open to allow for a secondary market and derivate products to operate from the beginning, unlike in most Chinese ETS pilots.
  - A key question is the transition of the ETS pilots that have built up a lot of valuable capacity and experience into the national system. At this stage, it appears that there might be a 'plus' logic - pilots can cover additional sectors or set lower thresholds than the national system
  - Of course this venture presents an enormous challenge – from obtaining robust MRV data to establishing a functioning, liquid market. But the overall trend is encouraging: NDRC is

strongly committed to making the policy work, and is supported by various international actors that assist with building up capacity and expertise.

- Good news in terms of market-based climate action – also from North America.
  - The joint carbon market of California and Québec is nearing the end of its compliance period with very positive results.
  - The expansion of the market to cover fuel distribution – and the resulting coverage of the system to 85% has gone very smoothly.
  - Moreover, the system looks set to grow further as Ontario has indicated its intention to set up a system and link it to CQ-QC by 2018.
  - The other momentum comes from Washington D.C. President Obama's Clean Power Plan that looks set to provide important momentum to the proliferation of cap-and-trade across North America.

- Looking at these developments, there clearly is good news both for what we might term 1st generation ETS and for the 2nd and 3rd generation ETS:
  - the first generation ETS have matured and proven that ambitious reform is possible (look at the MSR, or the RGGI reform in 2014 that led to almost halving the RGGI cap).
  - And second generation and third generation systems have taken on board learnings from those older systems (for instance with regard to a need for a price/quantity management mechanism from the start), and in addition adapted the ETS to fit their individual circumstances (e.g. coverage of indirect emissions in Korea, floor and ceiling prices in California-Québec).
  - This and the strong interest from other countries and jurisdictions around the globe in ETS (e.g. in Mexico, Chile, Thailand, Vietnam, Turkey, just to name a few) gives reason for optimism that ETS as a policy instrument will continue to grow both in robustness and importance as a key instrument in the fight against climate change.

What to expect from Paris in terms of markets?

- We are three weeks away from the Paris summit that is to provide a framework for global climate action post-2020.
- Carbon markets is of course only one of many aspects being negotiated, but Parties views' have differed significantly as to how and whether to make an explicit reference to market elements in the Paris Agreement.
- The INDCs submitted to date reflect this divide. The synthesis report by the UNFCCC released on 30 October reports that about half of those submitted to date

indicated that they intend to use market-based mechanisms, though the references differ in specificity and scope.

- Some Parties – e.g. New Zealand, Switzerland, Korea – have indicated that they intend to use international credits to meet part of the mitigation commitments but overall it appears that more Parties would be interest in offering some kind of credits than there might be demand post-2020. But of course it is early days, and neither negotiations nor the development of a post-2020 climate architecture are concluded in any way.
- With regard to a reference to markets in the Paris agreement, the latest negotiating session that took place in Bonn in October seems to have brought some progress. Unlike the Co-Chair draft which was largely silent on markets, the current text makes explicit reference to the possibility for countries to cooperate on markets and to 'internationally transferred mitigation outcomes', as well as to a sustainable development mechanism. Also wording on avoiding double-counting and the need for strong accounting frameworks. Remains to be seen what Paris brings, but this is encouraging.

But what the negotiations also show is that larger carbon markets will develop largely bottom-up, through linking of systems

- This is an issue at the core of ICAP's mission and one we have been closely examining in our technical dialogue among ICAP members, representing 31 members and 4 observers from four continents, over the past two years.

- Among ICAP members there is a consensus that linking will be an important discussion as emissions trading proliferate worldwide. Its benefits – in terms of cost-efficiency, market liquidity, but also political cooperation and symbolism – can be very significant. At the same time, linking is also challenging. It implies a loss of sovereignty over one's own system, and potentially being open to adjust ETS design elements that have emerged from carefully struck political compromise packages domestically. It also implies accepting resource transfers across the systems as well as a potential loss of domestic abatement.
- Ultimately our members feel that a fundamental precondition for linking to occur is political will and a strong basis of mutual trust in the integrity of the other's system. California and Québec underline that their linking marriage, building upon a long-standing cooperation in the context of the Western Climate Initiative, is a happy one and that they are keen to extend their family over time.
- At the same time, there is agreement that discussions in a context like ICAP that allow for a frank exchange about concepts and pathways towards linking, compatibility of different ETS designs and potential options for bridging these differences.

- Something that we have been looking at more closely in the ICAP context, mainly because there was not much prior work /knowledge on this is the option of restricted linking, implying that unit flows might be initially restricted, for instance through quotas, exchange rates or mutual discount rates, potentially with a view to arriving at a fuller link over time. To stick with the analogy above, this would amount to 'moving in' rather than 'getting married'. Restricting linking would not deliver the same benefits as full linking, but would provide linking partners with some safety net compared to the potential impacts of full linking. So far, there are no empirical cases for such restricted linking, to be seen if this is an option that eventually gains traction in reality. But important to continue discussion on linking and potential models for it, as a global carbon market remains an attractive long term vision.

Hope that my speech has convincingly conveyed three key messages:

- Trend curve for ETS is positive; carbon pricing systems are maturing and proliferating.
- The Paris COP has the potential to send a further positive signal for carbon markets worldwide.
- Linking ETS is the only viable pathways towards larger, more robust trading systems.

And for all three dimensions, whether domestic ETS, transfers of mitigation outcomes under an international climate architecture, or the smooth functioning of bilaterally linked markets, sound MRV, compliance and enforcement systems are at the root of an environmentally effective, legitimate policy instrument. Wishing the conference participants of this 6th EU ETS Compliance Forum much success with their deliberations!