



Towards a global carbon market

Risks of and prospects for linking the EU ETS to other carbon markets

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Our background

Carbon Market Watch (formally CDM Watch est. 2009) was established in 2012 to scrutinise carbon market mechanisms.

We work on 3 levels:

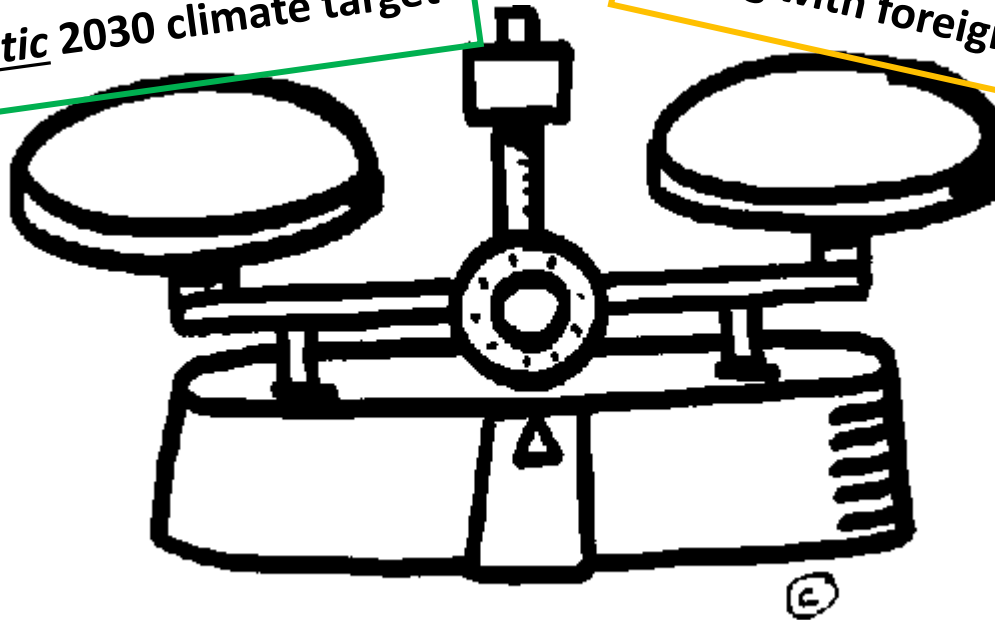
- International climate negotiations UNFCCC/ICAO – human rights in climate change, NAMAs
- EU climate policy – EU’s Emissions Trading System and Effort Sharing Decision
- Carbon Market Watch Network – over 800 members in 70 countries. Our civil society partners play an active role in shaping the carbon market debate.

The dilemma ...

\$50 million
mobilized by EU for
World Bank's PMR

EU's domestic 2030 climate target

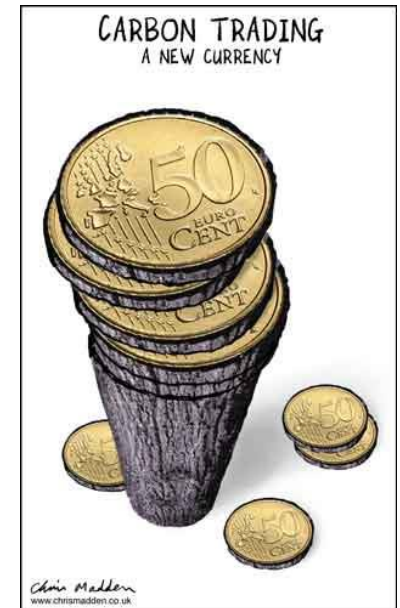
Linking with foreign carbon markets



Linking leads to an equal carbon price in both carbon markets

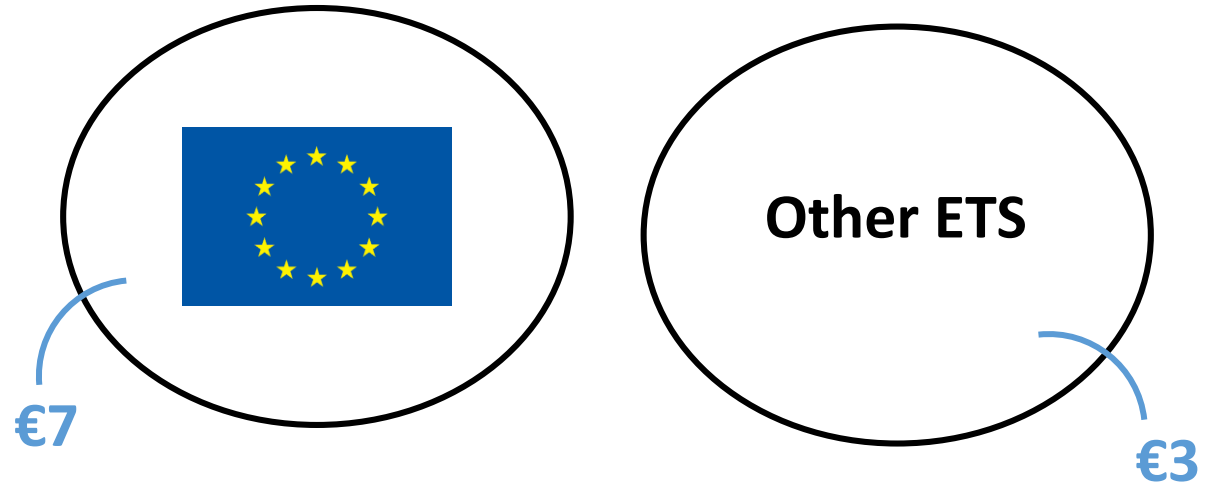
Three scenarios:

1. Linking the EU ETS to a **lower-cost** carbon market.
2. Linking the EU ETS to a **higher-cost** carbon market.
3. Linking the EU ETS to a **similar-cost** carbon market.

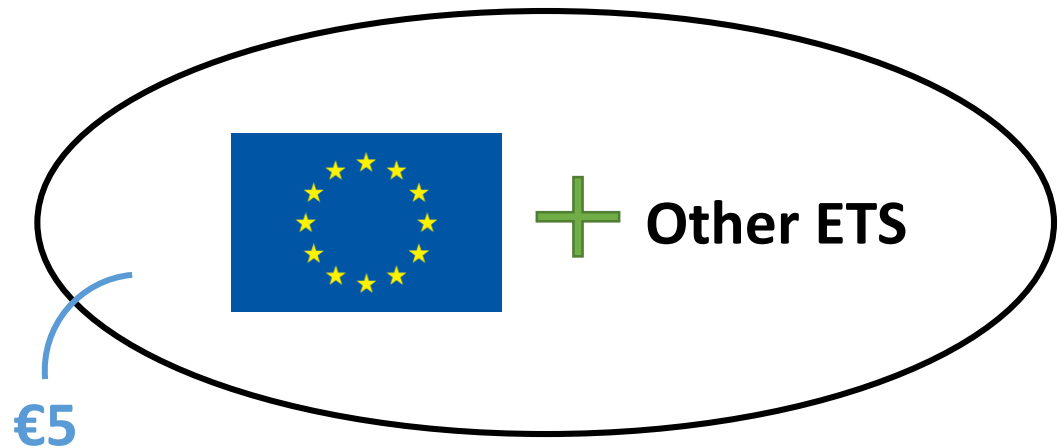


Linking the EU ETS to a lower-cost carbon market

Before linking:



After linking:



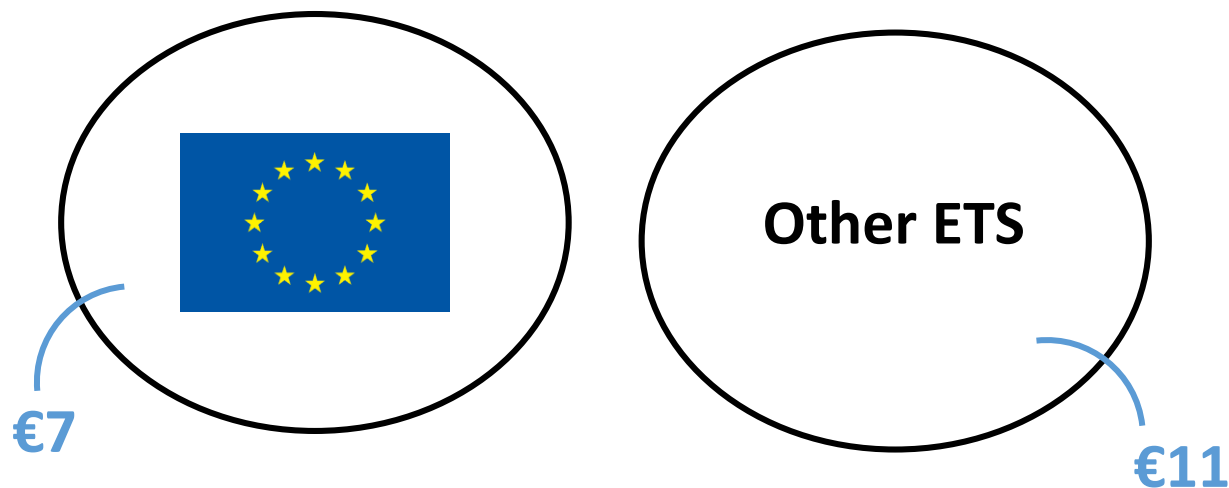
Linking the EU ETS to a lower-cost carbon market

Consequences compared to no linking:

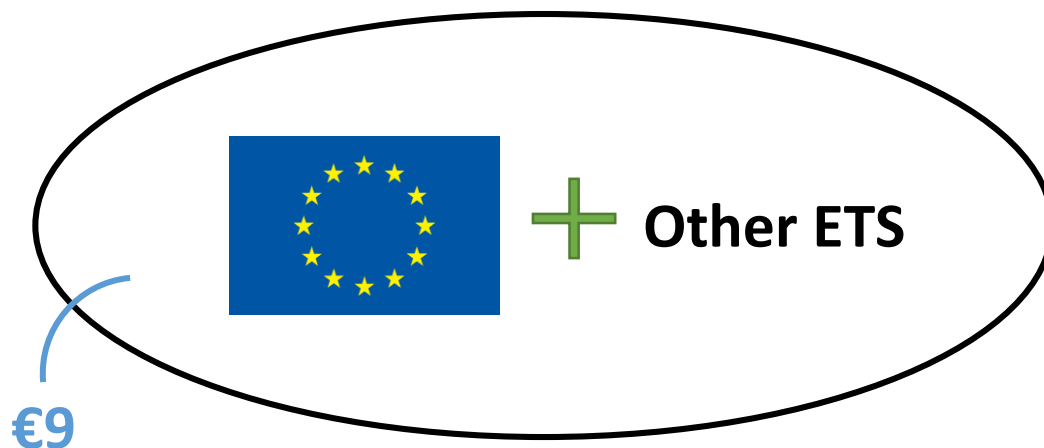
- **Increased emissions** in the EU.
- **Lower costs for EU companies** that can buy cheaper reductions abroad.
- **Loss of public funds:** lower auctioning revenues for EU governments.
- **Risk of less investments** and innovation in the EU.
- **Lower co-benefits** associated with mitigation, such as a reduction of local air-pollutants.

Linking the EU ETS to a higher-cost carbon market

Before linking:



After linking:



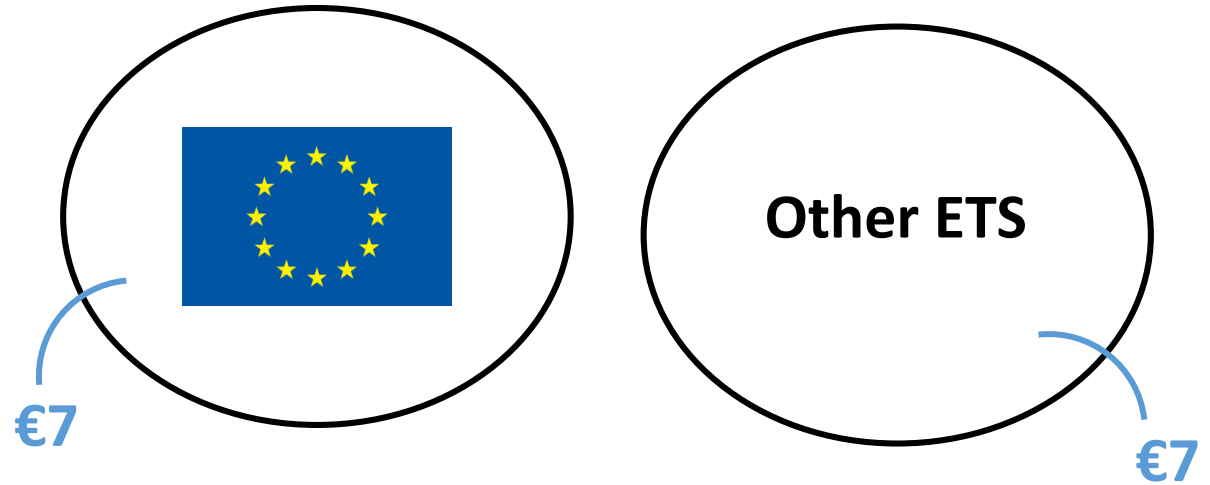
Linking the EU ETS to a higher-cost carbon market

Consequences compared to no linking:

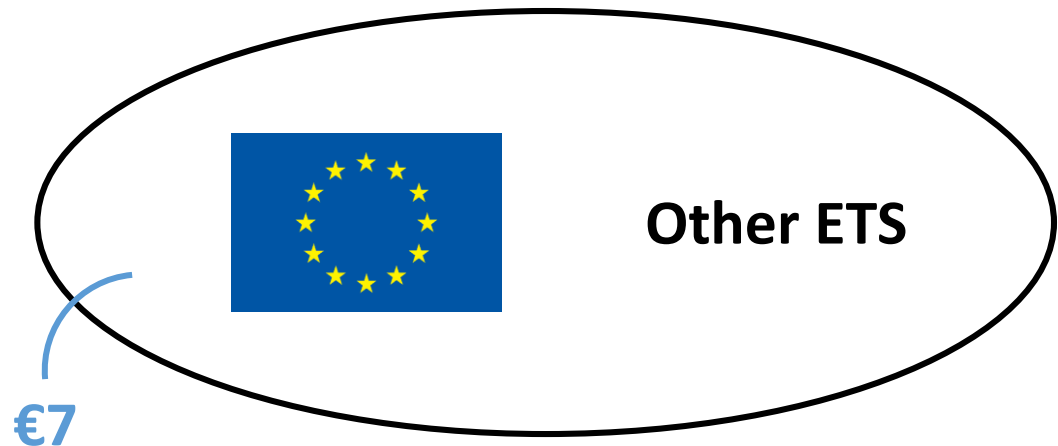
- **More emissions abatement** in the EU.
- **Higher costs for EU companies** that need to buy allowances due to the higher carbon price.
- **More public funds:** higher auctioning revenues for EU governments.
- **More investments** and innovation in the EU.
- **Higher co-benefits** associated with mitigation, such as a reduction of local air-pollutants.

Linking the EU ETS to a similar-cost carbon market

Before linking:



After linking:



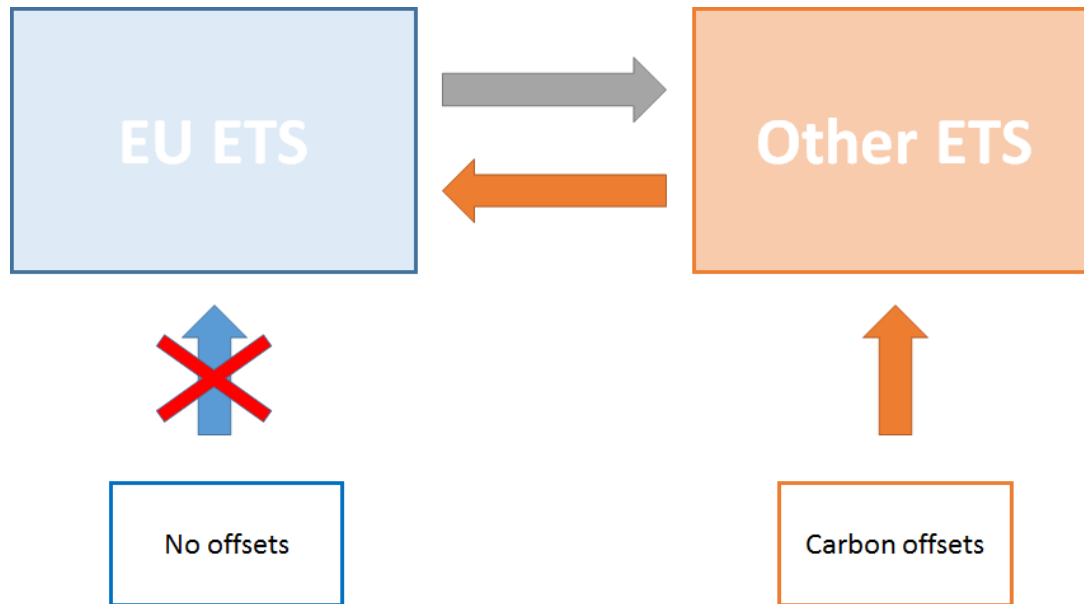
Linking the EU ETS to a similar-cost carbon market

Consequences compared to no linking:

- Not many? (increased liquidity)

Other consequences of ETS linking

- No control over carbon offsets.



- Uncertainty for price or supply controls.
- Reduced overall emissions abatement if systems have surplus allowances that would otherwise be retired or unused.

Critical design features for ETS linking

Three critical design features that have considerable impact on each system's climate policies after linking:

- 1. The stringency of the target**, because this determines the level of overall emissions abatement, and the amount of domestic investments, co-benefits and auctioning revenues.
- 2. The use of carbon offsets**, because after linking these offsets could enter the EU ETS through the backdoor.
- 3. The type of price or supply controls**, since after linking these price controls also apply to the EU ETS even though they were not introduced in the EU.

Comparison of carbon markets

Swiss ETS	Post-2020 stringency, use of international offsets unclear yet
Quebec-California ETS	There are price controls, California allows forestry offsets
Chinese ETS pilots	Chinese pilots have no absolute caps, allow forestry offsets, include price controls
South Korea ETS	South Korea will allow international offsets, has price controls
New Zealand ETS	New Zealand ETS has no cap, has 2-for-1 surrender obligation, has a price ceiling
Kazakhstan ETS	Kazakhstan ETS has low ambition, no clear price signal, little trades
US RGGI	US RGGI has low price, allows forestry offsets, has price controls

Lessons learnt from other carbon markets

- **Quebec-California ETS:** holding limits on the amount of surplus allowances that participants can bank for future use; complimentary measures to the ETS.
- **California ETS:** buyer-liability rules (entities are responsible if the offset project did not create meaningful emission savings)
- **US RGGI:** mechanism to reduce future caps for banked surplus allowances.



Lack of transparency and public participation

No public access to the negotiation mandate or other relative documents, hardly any information on the linking discussions made publicly available.

Impact of link with Swiss ETS small, but future talks to link the EU ETS to the other carbon markets could have far reaching implications for EU's climate policies.



Democratic control of ETS linking

Currently the European Parliament has no say during the linking negotiations and cannot gain access to crucial documents (e.g. the negotiation mandate).

Linking requires ongoing harmonization of climate standards in each jurisdiction, might make regulatory interventions more difficult.



Recommendations

- **A decision to link the EU ETS to other carbon markets needs to result in increased climate ambition in the EU**
- **The upcoming EU ETS revision should introduce public review of linking proposals**
- **The upcoming EU ETS revision should introduce safeguards for any decisions to link the EU ETS to other carbon markets, e.g. an assessment of the:**
 - Fair share of the climate ambition of the resp. jurisdiction
 - Inclusion of aircraft operators
 - Exclusion of international offsets
 - Existence of equivalent price and supply controls to the EU's MSR and a robust allowance allocation method
- **The lessons learnt from other carbon markets can be valuable for the EU ETS revision**

Read more...

