

**Mr Angelos Pangratis
Deputy Head EC
Delegation
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Confidence through Compliance in Emissions Trading Markets

General Introduction

Ladies and Gentlemen, it is a great pleasure to be here today to have the opportunity - as a representative of the European Commission, one of the organisers of this event - to address you all at the opening of these two very interesting days.

Let me start by giving you a little bit of background on the EU climate change policy. The EU is fully committed to the Kyoto objectives and has already taken a number of initiatives on the basis of the EU Climate Change Program. Emissions trading is one of many instruments to meet our Kyoto obligations but however important not enough to achieve our objectives. Promotion of renewable energy, energy conservation, use of bio-fuels for transport, energy efficiency in buildings and appliances, technology development are other elements to help us reaching our targets.

These are important instruments, but more importantly, they are part of a policy at EU and at national level in our 25 Member States. This is supported by clear opinions and preferences of our citizens. When we look for example at the debate in the US on the hurricanes, they were not so much linked to climate change as similar events in Europe have been.

When we look at technological development, like in the US, the EU regards this as very important and key to tackle the climate change challenge, but it cannot be the only instrument and will not be sufficient to solve this huge problem. To date, there is no silver bullet in technology that will solve the climate problem and more technological advances by industry are needed. As policymakers we need to give the right policy signals and incentives to our partners in industry to create new technology. Without public policy initiatives it will not happen.

A few remarks on costs. Of course, it will cost our economies to transfer to a low carbon economy, our estimate is that it will cost around 0.5 % economic growth, which is not a very high price to pay in our view. The cost of non action will most likely be much higher. Moreover, new technologies and alternative sources will lead to benefits and savings, and possibly new markets. Therefore, if we talk about costs, we not only have to look at direct costs for companies, but have to keep avoided costs and the benefits for a more sustainable society and economic sectors in mind as well.

Emission Trading

Let me turn to emission trading. The workshop's title already clearly establishes the scope of our discussion.

Therefore, I will not recall here the basics of emissions trading that are well known to all of you. Nevertheless, I would like to set the overall context and focus on the two concepts of "confidence" and "compliance" that we will certainly explore in detail in the following panel discussions and working groups. Emission trading is very visible in society and can encourage the general public to be more involved in environmental policies than by a set of laws. It also creates more societal and environmental responsibility for companies and makes them realize that environmental friendly behaviour is an asset to companies.

The EU Emissions Trading Scheme is the flagship of European Union Climate Change policy and will help enable the EU to comply cost-effectively with its reduction target under the Kyoto Protocol. In putting in place the scheme the EU has broken new ground establishing the first truly international trading scheme and the biggest ever implemented.

The legislation establishing the EU emissions trading scheme does not contain any so-called "sunset" clause. Therefore, the scheme is a permanent feature of the EU's climate change programme and is not dependent on what happens in the international arena. The same applies for the rest of the EU's climate change programme: no brake will suddenly be applied at the end of 2012, the EU is in this for the long haul.

Our long-term vision is to establish an international carbon market. Linking together different national and regional emissions trading schemes will be the fundamental stepping stones toward achieving this vision. But to achieve this, emissions trading schemes must be compatible, and one of the most fundamental design elements that cannot be glossed over is the quality of the monitoring, reporting and verification systems. Without good quality monitoring, reporting and verification, an emissions trading scheme will be severely compromised and will not be able to link to another scheme.

Given the size of the EU emissions trading scheme, it is likely to be the nucleus for tomorrow's international carbon market. We believe that our monitoring and reporting guidelines took the best from all existing material and form a sound basis for the emissions trading market. However, there is always the challenge of implementation and enforcement, and always room for improvement and learning from others. Hence we find ourselves together today.

Both "confidence" and "compliance" elements that will be discussed in detail today are evidently interconnected and represent the basis of a successful market-related policy instrument such as Emissions Trading. A high level of compliance is a "prerequisite of investor confidence". Investors will not participate and the market will fail unless there is sufficient trust in governments enforcing the ground rules.

Emissions Trading opens up a new field of environmental instruments in Europe, covering new ground and new procedures. In order to be effective it requires a re-thinking and redefining of the role of regulators and regulated industrial activities.

A culture change has been activated recently in Europe. Environmental issues are also becoming financial issues whereby emissions reductions create **value** and extra emissions create **costs** on the balance sheet.

This is a major switch from the traditional “command and control” approach to environmental policy. Market efficiency, transparency, accountability are all becoming the building blocks of a new strategy under which regulators, business, market operators are all called to new responsibilities. Sound Monitoring, Reporting and Verification practices are then the indispensable tools to make it happen.

The main emissions trading schemes in the US and Europe:

In looking at how Emissions Trading operates in practice, the workshop will focus on the two existing systems: the US SO₂ and NO_x program and the EU CO₂ Emissions Trading Scheme.

It is fair to say that the development of the EU Emissions Trading Scheme is, to some extent, due to the positive experience of the US with emissions trading to combat air pollution. When such market-based instruments were discussed in the Kyoto Protocol negotiations - and actually proposed by the US - the EU had reservations. But our views have evolved.

Different regulatory cultures are behind American and European applications of emission trading. Duration and experiences are different too. In US you had the programs in place for several years. In Europe we started operationally only at the beginning of 2005. We consider it still a “work in progress” as we are learning everyday, but moving forward very quickly.

Nevertheless today is a unique opportunity to learn from each other and to highlight the positive aspects of how compliance is managed in each system.

The EU ETS experience

The EU ETS covers about half of Europe's CO₂ emissions. The value of the annual allocations that participating companies receive amounts to close to € 50 billion. Factory owners can trade these allowances. Those who can easily reduce emissions can sell the surplus allowances to those for whom reductions would be more expensive. In this way, cuts will be made where it is cheapest.

With the Emission Trading Scheme, the EU has created a new currency based on tonnes of CO₂ and a new market in emission allowances. Never before has the EU used a market-based instrument at such a scale to achieve an environmental goal. It is still early days, but the volume of traded allowances is steadily increasing and we have already seen trading days with allowances for more than 2 million tonnes of carbon dioxide changing hands.

Today, we recognise its crucial value in harnessing the creativity of the business sector, offering economic incentives to cut emissions, and in reducing compliance cost. Our Emissions Trading Scheme will reduce the cost of achieving our Kyoto target by about a third, saving the EU industry billions of Euros. We are convinced that such instruments must be at the core of a successful global long-term response to climate change.

With respect to monitoring CO₂ emissions, approximately 11,500 installations across the 25 EU Member States have begun to do so in order to surrender an equivalent number of allowances.

Verification of the monitored and reported emissions is essential to ensure realisation of the environmental objectives of the EU ETS. It also underpins the value and strength of the EU carbon allowance.

The first Monitoring, Reporting and Verification cycle will be finalised by 31st March next year. This 2006 deadline means just a little more than 100 working days are between us and the final deadline of the first verification exercise. The Commission is currently working with all the players involved: the Member States competent authorities, verifiers, industry sectors in order to facilitate a successful result.

Until recently ETS Monitoring Reporting & Verification has perhaps been overshadowed by other implementation issues. However, since 2004 a comprehensive set of guidelines for Monitoring and Reporting has been put in place. A revision process has already been established in order to increase cost efficiency.

On the Verification side the challenge is also the one of activating a process aimed at reinforcing a common and coordinated approach at EU level. It is clear that Emission Trading Verification is not an isolated process. On the contrary it is an element which is strongly linked with the compliance and enforcement of the EU Scheme.

The European Commission offers help and facilitation in terms of activating a series of activities and initiatives aimed at building-up a common approach to ETS Verification. Initiatives are taking place and practical instruments are being developed. These are the establishment of a "Verification Resource Centre", the setting-up of a network of Verification experts within the different Competent Authorities, the development of a common and comprehensive "Verification Reference Model". The Commission will then proceed next year with an internal evaluation of the completion of the Monitoring, Reporting and Verification cycle.

Conclusions

What can we expect from today and tomorrow's discussion?

As you will have understood from my remarks, the EU is about to enter the final phase of the first annual monitoring and verification cycle. One of the remarkable successes of emission trading schemes in the US is the high rate of compliance. We in Europe have been inspired by this success and it is one of the reasons that have convinced us to take the trading route despite our initial hesitations. We are keen to learn more about the US enforcement and compliance experience. And we are determined to replicate the impressive record in the EU ETS.

We are here to discuss, to listen, to compare the different challenges but also to define a set of best practices that can be beneficial for a successful implementation of the Emissions Trading instrument.

Strong enforcement mechanisms are critical to the success of trading schemes.

Understanding and taking proper action to strengthen compliance and enforcement in a market-based mechanism must be a priority for all policymakers involved in Emissions Trading.

In the case of greenhouse gases Emissions Trading a credible enforcement and compliance regime will make the market active and liquid, and carbon will have value. Choices will then be made which include taking into account carbon values in longer term investment decisions.

On a final note let me stress that 2006 will be a crucial year for the implementation of the EU Emissions Trading Scheme: 2006 will see 25 European governments deciding about the allocation of allowances for the years 2008 to 2012. By mid next year the Commission will produce and present a report taking stock about the implementation of the Scheme and outlining our view of what the EU ETS should look like after 2012. One of the objectives of the review is to assess how the scheme can be enlarged to other sectors and gases. As you will know, the aviation sector is likely to be next in line.

A successful completion of the first Monitoring, Reporting and Verification exercise will be the best evidence that the EU ETS is fully operational and it is here to stay for many years beyond 2012. As it has been shown in the recent Commission Communication on its future policies against climate change, the EU is convinced that market mechanisms, and emissions trading in the first place, must be at the core of a successful long-term response.

The entire world has shown enormous interest in the start of the EU ETS, as this scheme essentially marks the beginning of Europe's move to a low-carbon economy.

It is already now the world's largest carbon trading scheme. The EU ETS could become the nucleus from which an international carbon market can emerge that will greatly facilitate the global community to successfully and in a cost-effective way master the climate challenge.

The lessons from the design and implementation of the EU ETS are valuable for other countries working on or considering the use of emissions trading. We are keen to share our experience and this workshop is the best occasion to learn from each other and move forward.