

# International Network for Environmental Compliance and Enforcement, Angelos Pangratis

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Confidence through Compliance in Emissions Trading Markets: A Workshop to Identify Linkage Issues, Promote Effectiveness, and Emphasize the Importance of Achieving High Rates of Compliance in Emissions Trading Systems

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## 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 organizers 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. 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 policy is widely supported by public opinion. It is interesting to note the differences that occasionally might exist on the two sides of the Atlantic. When we look for example at the debates in the US on the hurricanes, they were not so much linked to climate change or at least to climate changes linked to human activity. Natural disasters in Europe (floods, forest fires, etc.) regularly generate wide public debate about global warming.

The EU, like the US, regards technological development as very important in order to tackle the climate change challenge on the medium and long term. However, to date, there is no "silver bullet technology" that will solve the climate problem in the short term. As policymakers we need to give the right policy signals and encouragements to our industrial partners to invent new technology and successfully implement it. Without adequate public policy

initiatives this will not happen.

A few remarks on costs. Of course, there will be a cost to our economies in order to be transformed into "low carbon" economies. 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 energy sources will lead to benefits and savings, and possibly to new markets. Therefore, if we talk about costs, we not only have to take into consideration direct costs for companies, but also to take account of savings and the benefits from a more sustainable society and direct longer term benefits for new sectors of economic activity.

## 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 will certainly be analyzed in detail in the following panel discussions and working groups. Emission trading is very visible in society and can increase overall awareness and encourage the general public to be more involved in environmental policies. It also creates more societal and environmental responsibility for companies and makes them realize that environmental friendly behavior is an asset to them.

The EU Emissions Trading Scheme is the European Union's flagship of Climate Change policy that will enable the EU to comply, cost-effectively, with each commitments within 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 by 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 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 eventually link to another similar scheme that might emerge.

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 they form a sound basis for the emissions trading market. However, implementation and enforcement remain great challenges and there is 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 redefining of the role of regulators and regulated industrial activities.

Europe is undergoing an important cultural change: environmental issues become financial issues, emissions reductions create value and extra emissions create costs. This is a major shift 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, businesses, market operators are all called to assume new responsibilities. 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 SO<sub>2</sub> (Sulfur Dioxide) and NO<sub>x</sub> (Nitrogen Oxide) program and the EU CO<sub>2</sub> Emissions Trading Scheme.

It is fair to say that the development of the EU Emissions Trading Scheme is, to some extent, due to the previous positive experience of the US with the above mentioned emissions trading. 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 CO<sub>2</sub> emissions. The value of the annual allocations that participating companies received amounts nearly € 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 CO<sub>2</sub> 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 recognize 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 CO<sub>2</sub> emissions, approximately 11,500 installations across the 25 EU Member States are now participating in the scheme.

Verification of the monitored and reported emissions is essential to achieve the environmental objectives of the EU's ETS. It also underpins the value of the EU carbon allowance.

The first Monitoring, Reporting and Verification cycle will be finalized by 31st March next year 2006. This deadline means that 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, experts and industries in order to reach a successful result.

Until recently ETS Monitoring Reporting and 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 the cost efficiency of the system.

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?

I would propose three main objectives: First, develop a better understanding of shared experiences of both sides of the Atlantic. Second, start the process of definition of a set of best practices on the basis of the accumulated experience. And, thirdly formulate appropriate policy responses to the challenges of building "confidence" through "compliance" in Emission Trading markets.