



A handwritten signature in blue ink that reads "Dirk Forrister". The signature is fluid and cursive, written in a professional style.

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## THE RISE, REACH AND POWER OF A GLOBAL MARKET

Professionals in carbon markets see great strength in the Paris Agreement's ambitions. Its power is grounded not so much in the amount of reductions delivered in initial national mitigation plans, but in the strength that will grow from the foundations established for future cooperation.

Paris offers the promise of meeting the climate challenge through new markets that rise up, reach out and empower an economic and energy transformation – one that is revolutionary. The Agreement's market provisions are based on sound economic fundamentals.

The challenge of limiting warming to 2° Celsius – or better – requires action at a scale we have never seen. It must transform our energy and manufacturing systems, combined with large amounts of carbon storage in forests and underground.

### SOLID ECONOMIC FOUNDATIONS

The fundamental economics are simple: climate change is one of those challenges that is best met together. Acting in isolation often costs more and accomplishes less. This reality derives from the fact that emissions reduction and sequestration opportunities are not spread evenly across the earth. In some places, action costs more than in other places. That's why the need for cooperative linkages is an essential element for the long term success of the Paris Agreement.

Linked markets help reduce costs for participating industries – and their national economies. The World Bank estimates that linkages between global pricing systems could save 30% by 2030 and 50% by 2050. These economic gains accrue to both high- and low-cost systems when cooperation occurs, because compliance costs are levelised. The modest economic transfers are worth the cost to business, because both sides meet their obligations more cost-effectively.

Linked markets also reduce the risk of emissions "leakage" from one place to another. This is a major concern of industries covered by carbon pricing systems: they fear that when they reduce emissions to comply with their obligations, the environmental benefit is lost (or "leaks") if competitors in uncovered jurisdictions bear no carbon price. They worry that the cost advantage enables the competitor to increase production and grow their emissions.

Linked markets reduce this risk in two ways: first, by requiring similar levels of stringency before markets are linked; and second, by giving covered industries

access to the same market pricing. That's the beauty of Article 6 – it offers Parties the choice of creating and participating in a linked system to take advantage of these attributes.

### THE PARIS SURPRISE

For many businesses, Article 6 emerged as the last-minute surprise of the Paris Agreement. They knew that the hangover from the financial crisis left many Parties skeptical of reliance on markets. At the same time, they understood that it was an essential element for enabling the transition to occur in an economically efficient manner. They hoped for a sentence, a phrase, even a couple of words, that would assure the availability of market-based approaches. Instead, they got a full article devoted to cooperation through markets.

This was a testament to years of hard work from market negotiators, who finally responded to a strong call for carbon pricing policies from CEOs and presidents, NGOs and Nobel laureates - even Al Gore and Leonardo di Caprio!

## FOR MANY BUSINESSES, ARTICLE 6 EMERGED AS THE LAST-MINUTE SURPRISE OF THE PARIS AGREEMENT.

Article 6 holds true potential for change. It can inspire countries to erect strong national market based systems that can link with others. Markets rooted in national (or sub-national) law provide stability to the system, which inspires business confidence. It is not a requirement to participate but instead – because the provision begins with the notion of voluntary cooperation – a freedom to choose the path that works best.

### THE RISE OF NEW MARKETS

If nations take the 2°C challenge seriously, then we will see a steady rise of new carbon markets throughout the coming decade. Korea's national emissions trading system started last year. And next year, China's plans for a national market will nearly double the amount of global emissions subject to carbon pricing.

China could inspire others in Asia to step up their own plans for national markets. Already, a number of other Asian countries are investigating market options, as well as jurisdictions across North America, Latin America and Africa.

The International Civil Aviation Organization will launch a new global market-based mechanism for the aviation sector, starting in 2020. This sector offers to bring carbon market experience to a number of leading countries.

### REACHING OUT

For this “rising up” of new markets to stand the test of time, nations will need to reach out to partners to forge links between markets. This is where the real economic efficiency lies. When markets are linked and transfers are enabled, both the sender and receiver benefit – as does the planet. Linkages can embolden national ambitions and create a pathway to a 2°C level of climate protection.

We see the first examples appearing on the horizon: Ontario is poised to join the California-Quebec carbon market. Mexico has signed a Memorandum of Understanding with California and with Ontario and Quebec to explore market linkages. The Pacific Alliance countries (Chile, Peru, Colombia and Mexico) announced their intent to explore a common carbon market. In Asia, early discussions convened by the Asia Society Policy Institute explored how market linkages might emerge with China, Korea and Japan .

### BACK TO FUNDAMENTALS

The foundations for cooperation begin with good accounting. That's why Article 6 aims to set guidelines early so that nations can develop policies that properly account for results. This focus on results is an imperative for nations to have confidence in the Agreement. The basic accounting requirements should apply to both market and non-market approaches so that the public understands what is actually being accomplished.

Good accounting promotes confidence all around. Honest reporting of imports and exports offers transparency to nations and their industries, and it gives the public assurance that progress is being made. Nations should report according to a standard format that sums up the amounts transferred by jurisdiction. If both sender and receiver report accurately, then an outside observer should be able to see that the amounts match up.

Countries are empowered under Article 6 to give consent to transfers, so they have a clear channel for tracking amounts sent and received. The accounts should show corresponding adjustments from each party to a transfer. This approach is analogous to the double entry bookkeeping system that is standard in most businesses.

### LAUNCHING A NEW EMISSIONS MITIGATION MECHANISM

Article 6 outlines a new emissions mitigation mechanism to promote sustainable development. This mechanism could become a valuable tool. It could ease market access for developing countries by offering central

infrastructure for issuance of emission mitigation units. This mechanism can draw upon the CDM and JI experiences of the past – but it should be upgraded to modern standards to assure highest credibility.

The Article 6 mechanism can be read narrowly or broadly. Its maximum strength could be attained with a reading that innovates on the past and builds infrastructure for the future.

An innovation in this mechanism could be to enhance its transfer function by tapping the power of a centralized UNFCCC registry system. This could, for example, serve those interested in both allowance trading systems or baseline-and-credit (or project crediting) systems. While large jurisdictions, like the EU, the US and China, are large enough to operate their own registries, others might see value in tapping into a central UN registry – especially if it has transfer functions to other major registries.

The mechanism could extend further to offer unbundled components that nations could use in establishing their own systems. For example, the mechanism could offer a fully integrated crediting system as well as a set of tools:

- Defined units of measure;
- Standardized baselines;
- Compliance standards and procedures;
- Verification procedures – and licensing systems for verifiers;
- Issuance procedures;
- Registry services;
- Market oversight procedures.

For a small or developing country interested in becoming “market-ready”, the use of such common elements could accelerate its ability to link to others in the future.

To realize the promise of Paris, the provisions of Article 6 must be elaborated soon, so that nations can know how to use the tools it provides. They can inspire new markets to rise up, encourage partners to reach out through linkages – and power a new wave of entrepreneurial climate action that will breathe life into the words of the Paris Agreement.