

THE CASE FOR

TAPPING INTO OPPORTUNITIES FOR ENHANCED CARBON MARKET

1. COOPERATION

AN EMISSIONS cap-and-trade system is in theory one of the strongest policy tools available in the fight against climate change. While the cap guarantees the necessary emissions reductions, the trading dimension of the system instils economic value in the reductions cuts and ensures that they are achieved at the lowest possible cost as companies strive to optimise their costs.

The carbon price signal drives investment in abatement technologies and low-carbon innovation. Auctioning of carbon allowances generates revenue which in turn provides macroeconomic benefits and opportunities to further support the transition to a low-carbon economy.

Therefore, as countries implement their Nationally Determined Contributions (NDCs) under the Paris Agreement, a growing number of countries and sub-national jurisdictions are using or considering putting in place carbon markets in order to meet their mitigation commitments.

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Along with the EU – whose emissions trading system (ETS) extends to Norway, Iceland and Liechtenstein and will soon be linked to the Swiss ETS – South Korea, New Zealand, certain parts of the United States and Canada also have emissions trading systems in place, while China has embarked on scaling up from regional and municipal pilots to the national level. Others, such as Mexico, are considering introducing an ETS.

Designing and implementing a successful ETS is a challenging task that requires a number of important policy choices to be made. These choices depend on factors such as the size and scope of the system and the specific profile of the country or region, but also the political context and the broader regulatory environment.

Once an ETS is in place, its lasting success hinges on incorporating lessons learned in a timely manner and adapting the system to the relevant emissions targets. For these reasons, existing carbon markets continue to be reviewed and reinforced.

The EU has just recently agreed the framework for its ETS for the period until 2030 to help implement its headline target of a domestic 40% emission reduction by 2030 compared to 1990 levels. While the cap of the EU ETS will be adjusted to reflect the increased ambition in terms of emissions reductions, the main design choices that have characterised the system since 2013 will be maintained. Auctioning remains the principal way to bring allowances into circulation, complemented by free allocation based on updated

benchmarks reflecting the performance of the best 10% of installations covered by the EU ETS.

The Market Stability Reserve, designed to reduce the prevailing surplus of allowances in the EU's carbon market and avoid adverse interactions with other energy policies, will be substantially strengthened from 2019. Important new low-carbon funding mechanisms have also been agreed, to help further stimulate low-carbon innovation and support the modernisation of Europe's energy system.

The lessons learned from the implementation of the EU ETS so far have guided the decisions made in the recently-agreed revision. In particular the reinforced Market Stability Reserve will address the imbalance of supply and demand on the EU's carbon market and make auction supply more flexible.

Due to the growing number of carbon markets, their implementation and the review cycles some have already been through, there is an ever-increasing wealth of knowledge and experience in the design and implementation of emission trading systems, which is a valuable source of learning for policy-makers worldwide who are revising or planning to develop and implement carbon markets.

While the scope, policy and design choices may differ, key challenges are shared: How to ensure an effective and robust scheme? How to create a robust carbon price signal that drives emissions cuts and innovation? How to avoid adverse effects on industrial

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The Florence dialogue high-level meeting chaired by Jos Delbeke, at the European University Institute, September 2017.

Photo credit: Florence School of Regulation (EUI)

competitiveness and carbon leakage in the absence of a uniform global carbon price? How to ensure the most effective interaction with other policy instruments in order for the carbon price to incentivise investment in low carbon technologies?

Enabling continuous exchanges of experience and mutual learning will be a necessity for the further development and promotion of carbon markets as a climate policy tool, but also for the consideration of differences and commonalities between systems – paving the way for reinforced cooperation between carbon markets across the globe over time in the spirit of the Paris Agreement implementation.

PERSPECTIVES FOR CARBON MARKET COOPERATION

Last September, the European Commission, together with the European University Institute, organised a high-level carbon market workshop in

Florence, Italy, to enable such exchanges and create a process for further dialogue and cross-fertilisation of experiences.

Carbon market cooperation is sometimes reduced to formal linking of carbon markets. Yet while linking offers a number of benefits, reducing costs of emission reductions and increasing market liquidity, several conditions need to be met before markets can be linked in order to be able to capture the full potential of these linking procedures. In practice, these conditions may not always be easy to fulfil, taking into account political and economic considerations and differences between systems. Other forms of bilateral or multilateral cooperation and capacity-building deserve to be explored more thoroughly.

Building sustained support for emissions trading as a carbon pricing policy is essential, while the policy also needs to find its place in the wider policy framework.

At the same time, ensuring a long-term carbon price signal is critical to the lasting success of emissions trading.

Every jurisdiction with a carbon market in place has a story to tell and experiences to share. Creating a continuous process for learning and exchange would enrich perspectives, foster mutual understanding and the development of coherent and compatible solutions and best practices, which in the long term will enable strong links between carbon markets and potentially serve as a blueprint for others eager to establish their own market.

As part of global cooperation efforts in the fight against climate change, it is vital to create a forum for jurisdictions that have successfully set up emissions trading systems to share their knowledge and experience and build trust, in order to solve common problems, facilitate the sharing of ideas and encourage strategic actions towards the common goal of mitigating climate change. For this to happen, we need to create a space for exchange and give impetus to a process for enhanced carbon market cooperation that can grow over time. This would enable Parties to develop collectively low carbon emission strategies in a cost-effective manner.