



Parliament of the United Kingdom  
House of Commons of the United Kingdom of Great Britain and Northern  
Ireland  
Commons Select Committee  
Energy and Climate Change Committee  
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London  
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**The Select Committee on Energy and Climate Change's  
Inquiry on linking emissions trading systems**

**Written evidence submitted by the  
International Emissions Trading Association (IETA)**

April 21, 2014

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## 1. Executive Summary

- IETA supports linking emissions trading systems (ETSs) with one another. By widening the geographic scope across national borders, linking enables companies to capture a wider range of mitigation opportunities to keep costs down.
- There is wide scope to link current and future ETSs. The steps national governments and sub-national governments take to harmonise their respective programmes could bolster the potential to meet challenging emissions reduction goals in the years ahead.
- At the **international level**, negotiations on a “framework for various approaches” (FVA) and a “new market mechanism” (NMM) afford a valuable opportunity to use international institutions to assist in linking markets - and to deliver the economic benefits broader market coverage brings.
- The European Union’s Linking Directive allows for the EU ETS to link with any country or administrative entity (such as a province, state or group of states in a federal system) if the country or sub-national region has a compatible ETS with an absolute cap on its emissions. As more emissions trading schemes develop globally in the period up to and after 2020, it is critical that business and European governments encourage other countries to design compatible systems that will ease the path to potential linkage with the EU ETS in the future.
- Experience and analysis from the recent **California-Quebec ETS linkage** not only shows that linkage is technically possible, but that it also has the potential to reduce overall combined costs, increase liquidity, and assuage concerns about market manipulation.
- IETA believes that the UK should encourage its partners in the European community to agree on a 2030 GHG reduction target that allows for ETS linkages with other countries and regions in the future, in line with the UK’s position of supporting a 50% GHG target for 2030 with the use of international credits.

IETA commends the Select Committee on Energy and Climate Change’s leadership in addressing important climate issues and enabling the UK to move forward to a low-carbon economic future. We applaud the Committee for opening this inquiry on linking emissions trading systems, as it comes at a critical time for both Europe and the international community. As Europe moves forward with its policies on energy and climate change for the 2020 to 2030 period, negotiators from around the world will advance the elements for next year’s post-2020 climate change agreement to be adopted in Paris. Since Europe’s energy and climate change policies must take account of actions set by its main trading partners and regional neighbours, it is essential that these two policy debates begin to converge this year.



## 2. About IETA

IETA<sup>1</sup> is a Switzerland-registered not-for-profit entity dedicated to the objectives of the United Nations Framework Convention on Climate Change and ultimately climate protection. It was created in June 1999 to establish a functional international framework for trading in greenhouse gas emission reductions. Today, IETA is the leading voice of the business community on the subject of carbon markets.

Since 2000, IETA has remained committed to its vision of a global greenhouse gas market. IETA's 130+ member companies include some of the world's leading corporations, including global leaders in oil, electricity, cement, aluminum, chemical, and other industrial sectors; as well as leading firms in the data verification and certification, brokering and trading, legal, finance, and consulting industries.

IETA continually promotes the establishment of effective market-based trading systems for greenhouse gas emissions by businesses that are demonstrably fair, open, efficient, accountable and consistent across national boundaries; and to maintaining societal equity and environmental integrity while establishing these systems.

A critical element in IETA's work remains the linking of trading regimes among the world's advanced economies, and its significance for the GHG market. IETA supports linking emissions trading systems (ETSs) with one another. By widening the geographic scope across national borders, linking enables companies to capture a wider range of mitigation opportunities to keep costs down.

As emissions trading schemes develop globally, IETA advocates for compatible systems that hold the potential of linking in the future. To this end, IETA has facilitated thought leadership on linking through its original research over the years. In 2001, IETA commissioned Erik Haites (Margaree Consultants) and Fiona Mullins (Environmental Resources Management) to write the first comprehensive report on linking<sup>2</sup>. In 2007, in preparation for COP 13 in Bali, IETA commissioned Judson Jaffe (formerly Vice President of the Analysis Group) and Dr. Robert Stavins (Harvard University) to conduct further in-depth academic research on linking<sup>3</sup>. Since this report, IETA has continued to view linking as a critical component of creating a consistent, fair and cost-effective international framework for reducing greenhouse gases.

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<sup>1</sup> <http://www.ieta.org>

<sup>2</sup> [https://ieta.memberclicks.net/assets/Reports/ietalinking\\_haites%20mullins\\_2001.pdf](https://ieta.memberclicks.net/assets/Reports/ietalinking_haites%20mullins_2001.pdf)

<sup>3</sup> [https://ieta.memberclicks.net/assets/Reports/ieta\\_linking%20report\\_jaffe%20stavins\\_2007.pdf](https://ieta.memberclicks.net/assets/Reports/ieta_linking%20report_jaffe%20stavins_2007.pdf)



We are pleased to submit written evidence to the Energy and Climate Change Committee's inquiry on linking emissions trading systems. **In the comments that follow, we answer each item listed in the terms of reference posted on the Select Committee's inquiry webpage<sup>4</sup>.**

### **3. How far advanced are the existing ETSs around the world and how many more systems are likely to be fully operational by the end of the decade?**

Many ETSs have been in operation for several years and are now into their second or third compliance phases. The most mature markets are as follows:

A) The **European Union ETS (EU ETS)**, entered into force in 2005, and is now in its 3<sup>rd</sup> compliance phase until 2020. Phase 1 of the EU ETS ran from 2005-07, Phase II from 2008-12, and Phase III began on Jan. 1 2013. The fourth Phase will run from 2021-28; the EU's 2009 Climate and Energy package addressed the years up to 2028. The EU ETS is a cap-and-trade system with an absolute and declining cap on greenhouse gas emissions.

B) The **Norway ETS**, which is designed to be compatible with the EU ETS, and began in 2005. Like the EU ETS, the Norwegian ETS is split into three phases: Phase I (2005-07), Phase II (2008-12), and Phase III (2013-20).

C) The **Switzerland ETS** started in 2008, and is now in its second compliance phase. The Switzerland ETS is a cap-and-trade system with an absolute cap on greenhouse gas emissions.

D) The **New Zealand ETS**, started in 2008, is a cap-and-trade system with an absolute cap on greenhouse gas emissions.

E) The **Alberta Specified Gas Emitters Regulation (SGER)**, an emissions intensity based cap which has been legislatively enforced since 2007.

F) The **Regional Greenhouse Gas Initiative (RGGI)**, a cooperative cap-and-trade effort among nine Northeastern and Mid-Atlantic American States, which began in 2009 and is now in its second compliance period, and;

G) The **California and Quebec ETSs**, which formally linked their respective programmes in January 2014 and are both in their first compliance period. Similar to the EU ETS, these programmes are cap-and-trade systems with an absolute cap on greenhouse gas emissions.

In 2013, carbon markets continued to advance across the globe. While traded volumes in traditional European and Kyoto markets declined as a result of the economic slowdown, new markets in **California, Quebec** and **China** began to trade – albeit with low volumes and cautious participants. Even more markets are poised to launch, from other Chinese ETS pilot markets to **Kazakhstan** and **South Korea**.

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<sup>4</sup> <http://www.parliament.uk/business/committees/committees-a-z/commons-select/energy-and-climate-change-committee/news/linking-emissions-trading-systems-tor/>



Last year, many market participants expected the first major links to emerge between the EU ETS and the Australian market. After Australia's elections in September 2013, this prospect grew more uncertain with the Australian government's pledge to abolish the current pricing programme. The new Australian government is setting the stage for change, but the process is incomplete.

**China** is working diligently to design its national carbon market with a view to future links with others. It enjoys collaborative working relationships with Europe, RGGI and California, all aimed at harmonising designs while preserving domestic priorities. Chinese leaders aim to get their national market up and running before engaging in formal links – but they intend to design it to be “linking-ready” for the future.

In January 2014, North America, witnessed its first cross border carbon market at the state/provincial level when **California** and **Quebec** formally linked their carbon markets—a major breakthrough for the development of carbon markets worldwide.

Listed below is a reference table which includes all existing ETSs as well as those under development. There is a column for 'timeline', which refers to the compliance period for the ETS, a second column for 'target', which refers to the overall emissions reduction policy target, and a third column for 'coverage', which refers to types of facilities or economic sectors that are included in the ETS.

	Timeline	Target	Coverage
EU	2005-20 (legislated until 2028)	20% below 1990 level by 2020	11,500 factories or installations. 43% of total emissions
Alberta	2007- present	Annual intensity reduction of 12% below baseline	All industrial facilities
New Zealand	2008-20	10-20% below 1990 level by 2020	Forestry (2008), energy, fuel & industrial sources



			(2010), waste & synthetics (2013)
RGGI	2009-20	2.5% yearly reduction; cap falling to 15% below 2014 level by 2020	Power sector
California	2013-20	Reach 1990 level by 2020	Energy, industrial sources (2013), oil & gas (2015). Covers 85% of total emissions
Quebec	2013-20	20% below 1990 level by 2020	Energy, industrial sources (2013), oil & gas (2015); Reaches 85% of total emissions
Australia <sup>5</sup>	2013-20	5% below 2000 level by 2020	Energy, industrial process, commercial transport; 60% of total emissions
China (PRC)	2013-20	Carbon intensity reduction of 40-50% by 2020	Differs between pilots; national system yet to be determined

<sup>5</sup> Australia's government is seeking to repeal the Carbon Pricing Mechanism; full details of its planned Direct Action Plan are yet to be released. The information in this table is based on the CPM as currently legislated.



Kazakhstan	2013-20	7% below 1990 level by 2020	Oil & gas, power, mining & metals, chemicals, others being considered
Switzerland	2013-20	20% below 1990 level by 2020 (higher target conditional)	950 facilities across multiple sectors
Tokyo	2013-19	25% below 2000 level by 2020	1,400 facilities with 20% of total emissions
South Korea	2015-26	30% below BAU by 2020	490 facilities, covering 60 % of total emissions

IETA has produced a series of ETS ‘case studies,’ in partnership with the Environmental Defense Fund. These case studies available on IETA’s website<sup>6</sup> provide an overview of the unique features in each programme, and a snapshot of the market oversight and regulatory context.

#### **4. What scope is there to link current and future emissions trading systems? Are there any examples of trading systems which have already been linked and, if so, what lessons can be learnt for the future?**

There is wide scope to link current and future ETSs. The steps national governments and sub-national governments take to harmonise their respective ETSs could bolster the potential to meet challenging emissions reduction goals in the years ahead.

At the **international level**, negotiations on a “framework for various approaches” (FVA) and a “new market mechanism” (NMM) afford a valuable opportunity to use international institutions to assist in linking markets - and to deliver the economic benefits broader market coverage brings.

Within the design of the Kyoto Protocol, the unit of account that provided the links for trading emissions amongst developed countries is the Assigned Amount Unit (AAU). It establishes the need for trade and creates supply and demand through the allocation of units against national

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<sup>6</sup> <http://www.ieta.org/worldscarbonmarkets>



targets relative to actual emissions. This gives the AAU economic value, which in turn generates demand for other units such as Certified Emissions Reductions (CERs) under the Clean Development Mechanism (CDM).

Under the Paris 2015 Agreement, there will need to be another unit of account or ‘carrier’ that establishes the need for trade of emission reduction units. The **FVA**, established at the international level, should serve as the carrier for linked carbon markets. The FVA should act as a basic framework with a broad, flexible scope that provides structure to emerging carbon markets.

The European Union Directive on the **EU ETS** allows for the EU ETS to link with any country or administrative entity (such as a province, state, or group of states in a federal system) with the requirement that the country or sub-national region have a compatible ETS with an absolute cap on its emissions. Prior to the outcome of the Australian national election in September 2013, officials from the European Commission and the Australian government announced plans to link their respective greenhouse gas emissions trading systems (ETS) in a two-stage process from 2015, allowing their emissions units to become fungible across the two programmes. After Prime Minister Abbott took office, Australia ended discussions with the European Union on linking its carbon market as it has drawn up plans to move away from an ETS and towards a policy of ‘Direct Action.’

The proposed linkage between the EU and Australia was meant to be a step towards a common market for emissions units in two of the world’s largest carbon markets. The emissions covered by Australia’s ETS are comparable to those in Germany, the nation with the largest emissions in the EU ETS. The schedule for implementing the linkage between the EU ETS and Australia’s Carbon Pricing Mechanism (CPM) entails a two-stage process. The first stage was scheduled to commence on July 1 2015 with a “one-way” link, whereby covered entities in Australia would have been able to surrender European Union Allowances (EUAs) to fulfill up to 50% of their compliance obligations under the CPM.

The linkage was expected to become “two-way” beginning on 1 July 2018, when EU entities could surrender Australian Emission Units (AEUs) to fulfill their liabilities. This implied that from 1 July 2018, EUAs and AEUs would have become fully fungible between the programmes and create a single market for allowances. While the proposed EU-Australia ETS link aimed to serve as a template for proposed links in other jurisdictions, the experience also shows that emissions trading systems are subject to political changes and priorities.

**California and Quebec** formally linked their respective greenhouse gas cap-and-trade programmes on 1 January 2014, meaning that tradable units – allowances and offsets – from either jurisdiction can be used in both California and Quebec to meet compliance obligations by covered entities. This important milestone was achieved after several years of regional



cooperation and preparation. Government officials from both Quebec and California, along with a multitude of stakeholders, worked to design individual – yet highly similar and centralised – cap-and-trade programmes for each jurisdiction under the umbrella of the Western Climate Initiative (WCI). The intent in developing the programmes together was to enable linkage of the markets. Thus, the policy design was highly harmonised and complementary from the outset. That said, officials needed to address key issues in the actual linking agreement.

As of April 2014, California and Quebec continue to hold separate quarterly allowance auctions, each following a sealed-bid, single-round, uniform price (lowest winning bid) format). However, via WCI Inc. infrastructure, the two jurisdictions are in the process of preparing for joint auctions by August 2014. Once allowance auctions are joined, Quebec and California entities will bid on a combined pool of allowances, and receive bundles comprised of both California Carbon Allowances (CCAs) and Quebec Carbon Allowances (QCA).

The longer term hope (aside from the immediate cost-saving and liquidity gains) is that a California-Quebec link can become a model for other jurisdictions to follow, while encouraging neighbouring North American jurisdictions to join the nascent market. IETA continues to provide technical and convening support to ensure the long-term success of North America's first-ever, cross-border compliance carbon market.

The **EU and Switzerland** entered into negotiations in late 2011 with the goal of linking their respective emission trading systems. The two jurisdictions are in an ongoing round of formal negotiations on how to best align their respective policies, but very few technical details have emerged as a result of these negotiations thus far.

For more information on the California, Quebec or Swiss ETS, please refer to the IETA-Environmental Defense Fund 'Worlds Carbon Markets Case Studies'. These case studies<sup>7</sup> provide an overview of the unique features in each programme, and a snapshot of the market oversight and regulatory context.

For updated information and analyses on ETS experiences and lessons learned, including the California-Quebec experience, please refer to the World Bank's Partnership for Market Readiness Technical Note, published in March 2014<sup>8</sup>.

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<sup>7</sup> <http://www.ieta.org/worldscarbonmarkets>

<sup>8</sup> [https://www.thepmr.org/system/files/documents/TN\\_PMR\\_Linking\\_Draft\\_FINAL.pdf](https://www.thepmr.org/system/files/documents/TN_PMR_Linking_Draft_FINAL.pdf)



## 5. What are the potential benefits and disbenefits of linking emissions trading systems?

The benefits of linking ETSs largely outweigh the costs and challenges. Fully-functional and well-implemented linkages will accelerate clean energy investment at the scale needed to hold the average global temperature increase to 2°C. Carbon market linkages stabilise carbon prices, increase liquidity in the carbon market, allow for cost efficiencies in emission reduction activities to be identified beyond borders, and assist in the implementation of an international framework for climate action.

Experience and analysis from the recent California-Quebec experience shows that linkage has the potential to reduce overall combined costs, increase liquidity and assuage concerns about market manipulation. The linkage of the California and Quebec systems shows that it is technically possible to link carbon markets from different jurisdictions, and there is now a template for other jurisdictions to potentially follow.

It is important to also note that proper implementation of a linked market is required to avoid negation of the benefits. In order for a linked market to fully realise these potential benefits, IETA engaged in detailed and technical consultations with California and Quebec officials, recommending that two main prerequisites must be satisfied. Our first consideration, and top priority, for ensuring that linking would yield benefits to market participants was to **harmonise auctions and compliance requirements. Monitoring, reporting and verification (MRV) standards must also be consistent** enough so that purchasers of allowances can be assured California and Quebec allowances represent the same quantity of reductions—that “a tonne is a tonne”. Without this basic level of consistency, fungibility would likely not be established between California and Quebec allowances and trading (and emissions reductions) will be stunted. As it stands now, having taken the necessary steps to harmonise, California and Quebec allowances are fully fungible for compliance in either jurisdiction by ETS participants.

Regarding auctions, IETA’s view is that linked carbon markets should also hold joint auctions, if possible. Compared to a separate, but coordinated, auction, joint auctions have the potential to create more liquidity and better achieve economies of scale. However, without a minimum level of critical policy harmonisation, IETA cautioned California and Quebec regulators against rushing a joint auction. Generally, IETA identifies the following auction features that linked carbon market participants should prioritise in its linking efforts: exchange rates and auction denominations (if a link transcends jurisdictions with different currencies), price floors and floor growth rates, and timing of reserve auctions. Additionally, IETA recommends harmonising annual compliance obligations and the timing of compliance deadlines.

Second, in harmonising differences between California’s and Quebec’s policies, IETA urged that a set of policies that would maximise compliance flexibility and market liquidity should be



chosen. IETA urged that the harmonisation of policies should not come at the expense of compliance flexibility, and should be addressed on a case-by-case basis.

## **6. What are the main challenges to linking emissions trading systems and what are the consequences of failing to address them adequately? Specifically:**

### **A) How can differing levels of ambition in terms of emissions caps in different systems best be managed?**

IETA believes that a stepwise approach to building a global carbon market is the most feasible for systems to be linked with variations in ambition. Through an arrangement that allows linkage between emission reduction approaches, countries can utilise existing market approaches, such as the CDM or NAMA (Nationally Appropriate Mitigation Actions) crediting systems to establish future supply and demand for carbon pricing units. This approach will ensure environmental performance, enhance economic growth and avoid competitive distortions.

In the UNFCCC process, the topic of linkages is under debate as part of the Framework for Various Approaches (or “FVA”). This policy concept would allow Parties to decide whether to include a national, sub-national or sectoral level approach in multilateral participation in developing a global carbon market. In order to do so, the FVA would encourage Parties to accept a fixed carbon emissions budget for a given future period in the form of tradable international allowances (an FVA unit, or “FVU”). These budgets could arise from the goals of specific policies or programs as a contribution to the global effort. The budgets would be fixed (i.e. absolute), irrespective of the nature of the mitigation program operating within the economy. By fixing an appropriate emissions budget for the approach, the Party would assure environmental integrity.

### **B) How can systems between countries at different stages of economic development be harmonised?**

From a business perspective, a 2015 Climate Agreement that facilitates the further development of market-based instruments and allows linking of those that already exist must be attractive to all key actors: developing countries, developed countries, and investors. The design will have an important impact on the ability of a linked emissions trading system to achieve this.

Harmonisation may begin by providing assistance and tools to developing countries to build the capacity necessary for market implementation, particularly in the area of monitoring,



reporting and verification (MRV). MRV poses the first fundamental building block in the development of emissions trading/carbon market infrastructure. Similarly, the UN could make available common tools to help harmonise new trading programmes. These tools could include standardised sectoral benchmarks, a common registry, an international transaction log, banking and borrowing models, and a set of model trading rules.

### **C) How can national priorities and particularities best be catered for?**

The California and Quebec linking example has shown that both jurisdictions have kept some of their own design elements (e.g. individual registries and market regulators) as a result of pre-existing legislative arrangements. In this example, California and Quebec had to show policy flexibility in order for their ETSs to eventually fully link rather than develop harmonised rules 'from scratch.' While it is important to recognise national priorities and particularities in the development of and linking of ETSs, the overall policy goal of a linked ETS is to expand the size and efficiency of an ETS. Therefore, some national priorities will likely have to be left out during the formation of a linked ETS. An example of this could be if one jurisdiction has imposed a carbon price floor and the others have not yet done so, or if one jurisdiction has a higher threshold for the use of offsets than another. In each of these examples, regulators must show flexibility and compromise in order for linking to eventually occur. In the case of California and Quebec, some of the original ETS legislation from each ETS remains, however both jurisdictions have arranged for a single approach to offsets, auctions, and MRV.

### **7. How can the adoption of consistent design features between emissions trading systems be encouraged? (e.g. monitoring reporting and verification rules; compliance and enforcement mechanisms; limits on the use of international offset credits; banking and borrowing rules; and price interventions, such as price floors and ceilings.)**

Much work is being done through the World Bank's Partnership for Market Readiness (PMR) to ensure that design features between emissions trading systems are consistent and similar when new jurisdictions decide to adopt an ETS. However, more work can be done to encourage that different systems emerge with similar design features. One critical aspect of this is on monitoring, reporting and verification (**MRV**) rules; there simply aren't enough practitioners in the field working on ensuring that MRV follows similar metrics across the wide range of economies that now have legislation in place to enforce MRV for emissions. This is of concern, because without similar MRV rules at the outset of an ETS, it becomes much harder for that particular system to link with another in the future. IETA is exploring options to help



address this issue by working with academia and expert organisations that practice MRV—but we encourage governments to look more deeply into this issue.

It is also essential that ETS registries provide a level of confidence and assurance to private sector actors, a role that the Assigned Amount Unit (AAU) and the International Transaction Log (ITL) plays under the Kyoto Protocol. In an internationally-linked carbon market, the ITL could be re-designed in such a way that it would also allow for unit tracking between different national and subnational mechanisms. This would help reduce the risk of double counting of emissions in a domestic ETS and an internationally-linked ETS and ensure that the overall system worked efficiently. Offsets, banking and borrowing rules, as well as price intervention mechanisms, should also be consistent in a linked ETS.

The California-Quebec example showed that individual working-level groups may be instrumental in order to identify the challenges for these rules to be consistent across all ETSs in a linked market. An offsets working group, as well as registry and trading working groups, were created in order to understand the differences in design between California and Quebec's respective ETS. These working groups helped narrow down the policy design differences between the two ETSs, as well as chart a way forward for the policy designs to eventually consolidate into one overarching regulatory framework. It is important for such working groups to address these issues, as experts could be called in to assist as well as stakeholder interviews with market participants on how to ensure policy consistency in a linked ETS.

## **8. What are the essential common features of linked emissions trading systems? Do these include common definition of emissions? Do linked systems have to cover emissions from the same sources and have the same banking and time periods? How can the rules of linked systems be renegotiated in the event of unexpected events?**

There are several common features of linked ETSs. Three of the most common are:

**Carbon Allowance Registries:** Before linked ETSs enter into force, carbon allowance registries need to be aligned. This takes time and political effort. IETA believes a simple and direct process should be put in place for entities in one jurisdiction to open registry accounts in the other jurisdiction. Once an entity has gone through the various requirements to open an account in one particular jurisdiction, a simplified process should exist for that same entity to open an account in the other jurisdiction.



**Banking/Borrowing:** In general, linked systems should operate with the same banking and borrowing rules in order for market participants to understand market rules and regulations most efficiently. Furthermore, emissions trading transaction costs would be higher in a linked ETS with individual banking and/or borrowing rules.

**Allowances/Offsets:** Linked ETSs should operate only with the same tradable units in order for the market to function properly. If a linked ETS could not use the same tradable unit for whatever reason, an exchange rate mechanism or some form of transfer mechanism would be needed in order for unit fungibility to occur in each ETS.

## **9. What should be the respective roles of intergovernmental organisations (e.g. UNFCCC), nation states and businesses in enabling emissions trading systems to be linked?**

For nation states, ETS linkages will only operate effectively if there is a recognition that the governments in each linked market can operate effectively together. One prudent example of this is RGGI in the northeastern United States.

RGGI is composed of individual, state-level CO<sub>2</sub> ETSs that allow allowance trading between one another. To assist states in establishing similar programmes, RGGI states created a Model Rule first published in 2006. Subsequently, and in accordance with this Model Rule, each state established its own cap-and-trade programme that: 1) set limits on in-state CO<sub>2</sub> emissions from electric power plants; 2) issued CO<sub>2</sub> allowances; and 3) established state participation in regional CO<sub>2</sub> allowance auctions.

Further to this, each state in RGGI (there are currently nine states in the programme) must also sign a Memorandum of Understanding (MOU) which outlined a comprehensive 2012 review of RGGI. The MOU requires that this review address the following issues: the environmental success of RGGI; the impact of RGGI on electricity price and system reliability; and, whether to consider any additional reductions. Lastly, the MOU calls for an evaluation of offsets including price, availability and environmental integrity. RGGI completed its programme review with the release of an updated Model Rule on February 7 2013.

The RGGI system shows that jurisdictions still seek autonomy of their respective ETS despite them being in a network of similar markets, whilst also seeking a greater 'core' rulemaking process that looks after the reliability and efficient functioning of the ETS network as a whole.

Participating jurisdictions in a linked international ETS will certainly be dependent on a review of each participant's carbon budget submission. IETA has proposed that this review should be conducted by an oversight body. Any such body, while having a critical role to play in providing



guidance and recommendations on the operations and regulation of an internationally-linked carbon market, will need to fit the realities of international governance, where nations will retain much of their existing authority over capital flows and broader trade policies. The oversight body could either fall under the UNFCCC, or be independent of the UNFCCC (i.e. a Board elected by countries participating in the market ensuring a balance of representation from developed and developing countries).

Businesses can also play an important role in enabling ETSs to be linked by supporting international guidelines and rulemaking processes for a linked ETS, and then swiftly adapting compliance plans for their business units. Business can also assist with numerous operational elements, from helping develop MRV standards, registries, sectoral benchmarks and trading infrastructure (exchanges, model contracts, etc).

Business also has a role in advocating high quality systems. For example, the experience of the migration of the EU ETS Union Registry in 2012 showed that European business and industry was largely supportive of a single European ETS registry versus 28 different registries for each EU member state, since it improved the overall system integrity.

## **10. What is the UK Government doing to encourage or facilitate linking of emissions trading systems? Could it do more? If so, what could it do?**

Internationally, the UK is a contributing country to the World Bank's Partnership for Market Readiness, a grant-based financing initiative which promotes the growth of carbon pricing and market mechanisms in over 16 'implementing countries'<sup>9</sup> representing economies in transition and under development. This initiative is extremely important in promoting the growth of carbon pricing policies and market mechanisms around the world, and the UK has taken an active role in its development. The PMR also promotes the approach of ETS linkages amongst PMR participating countries and has developed a work programme to facilitate this. We would encourage the UK government to continue to participate in the PMR and to enhance its participation where feasible.

In the EU, the UK should also continue to be an active voice within the European Community for linking the EU ETS with other systems as they arise.

Current proposals for the EU's 2030 GHG reduction target call for a 40% reduction in domestic emissions. We applaud Europe's leadership in this arena, but we believe Europe will miss the opportunity to build stronger linkages with the international community by focusing solely on domestic emission reductions—something the UK has long advocated for in the UNFCCC

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<sup>9</sup> <http://www.thepmr.org/content/participants>



negotiations. Europe should send a clear signal of its commitment to lead the development of an international policy framework for emissions trading across national borders, as the US and China will undoubtedly be focused on their own domestic policies until the end of the decade. ETS linkages not only control costs, but also encourage broad international participation in emissions mitigation to reduce the potential for “leakage” of carbon emitting activities to other jurisdictions.

IETA believes that the UK should encourage its partners in the European community to agree on a 2030 GHG reduction target that is flexible and allows for ETS linkages with other countries and regions in the future, in line with the UK’s own position of supporting a 50% GHG target for 2030 with the use of international credits, as well as a domestic target to be reached within this overall goal. The 2030 target needs to be robust enough to take into consideration the fact that many more countries will advance ETS legislation and implement such policies in the decade ahead—linking those policies with the EU ETS will allow European industry to meet GHG reduction targets more cost efficiently and quickly.

## **11. To what extent could progress on linking emissions trading systems help facilitate a global climate deal at international climate negotiations?**

The recently published IPCC WGIII report, *Mitigation of Climate Change*<sup>10</sup>, shows that governments need to work together and link efforts to fight climate change – including improving the use of carbon markets. Effective ETSs reduce the need for other policies to incentivise low-carbon investment, as stated in the report. Governments have an opportunity in the lead-up to the Paris 2015 Agreement to foster carbon market linkages that can reduce costs for their industries while pursuing low-carbon growth.

To conclude our testimony to this Committee’s inquiry, we would like to highlight four key reasons why we urge the UK, and Europe, to strongly encourage international market engagement through linked emissions trading policies.

**1. Cost-effectiveness** - Carbon markets limit total emissions but allow industry flexibility to adopt the least cost abatement options to meet their targets. Cutting off a source of low-cost abatement options by not recognising the use of international offsets would raise costs for European industry. Linking the EU ETS with similar programmes outside of Europe will lower compliance costs for European industry and reduce the risk of carbon ‘leakage’ through Europe and onto another jurisdiction without a robust carbon price.

**2. International Leadership** – Europe’s use of flexibility mechanisms, such as the Clean Development Mechanism (CDM), has been extremely successful in encouraging interest in

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<sup>10</sup> <http://mitigation2014.org/>



carbon market solutions around the world. China, South Korea, Chile, Mexico, and Brazil are now exploring carbon market mechanisms. The CDM has mobilised at least \$400bn for mitigation projects and stimulated the development of significant capacity in climate finance, technology and skills transfer, and sustainable development. It created export opportunities for European technology. This tool is important not only in environmental terms, but also in providing improved prospects for linking of emissions trading systems in the future.

**3. Political signal ahead of the 2015 climate agreement** – Next year, global attention will turn to the Paris negotiations on an international climate agreement. Europe has an opportunity to signal its interest in working with other interested countries to build market architecture for the future that enables Parties to meet their ambition at lowest cost. It should avoid a singular focus on domestic actions, given the imperative for global cooperation.

**4. Preparing for the Future** – As targets grow more stringent over time, there will be a shortage of allowances in the EU ETS, and European businesses will need greater access to international markets to decarbonise cost-effectively. As costs of control differ from country to country over time, access to international market mechanisms and linked ETSs can reduce overall costs to industry and governments alike.

To conclude, industry wants to avoid a patchwork quilt of a system, because it adds complexity and increases costs. That's the beauty of a globally linked market-based system: it's simple, cheaper and more effective. Linking emissions trading systems will help facilitate a global climate deal as they will represent concrete examples of international climate architecture to price and reduce greenhouse gas emissions.

**IEA expresses its sincere gratitude to the Select Committee on Energy and Climate Change its leadership and for opening this inquiry. We thank the Committee for the opportunity to provide our written testimony on linked emissions trading systems, and stand ready to offer additional testimony at the Committee's request.**