



Effective Enforcement and Compliance in the EU ETS: A View from the Financial Sector

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Rupert Edwards

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Introduction

- ☀ Compliance and Enforcement: the Achilles heel of International Environmental Law
- ☀ A prerequisite of investor confidence
- ☀ Particularly true in a market that is created by policy
- ☀ Markets can price policy risk as with any other risk
- ☀ But the rules must be credible or the investor community will not play or will heavily discount the price thus undermining policy goals

Agenda

- Enforcement and Compliance under Kyoto
- The Allocation Process: the first enforcement challenge
- Monitoring And Verification
- Conclusion

Enforcement and Compliance under Kyoto

- EU ETS is law without Kyoto
- But ratification and the strong compliance measures from Bonn and Marrakech Accords would help investors long-term confidence
- Some risk that Linking Directive could clash with these compliance mechanisms
- This adds to reasons why CDM/JI projects at a discount to EU ETS Allowance price
- ETS does not need Kyoto provided the political will remains

The Basic Compliance Machinery of ETS

- Basic enforcement and compliance machinery looks good
- Fine is punitive, criminal and still requires compliance!
- Affected industries will comply
- Registry for tracking allowances
- Allowances like a financial instrument rather than commodity. Therefore easy to trade

The Allocation Process

- Will Commission enforce the Directive and ensure that National Allocation Plans leave the market short?
- The Commission, Competition Authorities and ultimately the ECJ have the legal means
- Rules on ‘state aids’.
- Rules on ‘abuse of a dominant position’
- Long lead times might create market uncertainty
- Member states and Businesses have a vested interest in ensuring that their peers/competitors comply
- So do Green -leaning politicians and NGOs

Comparison of Emissions Trading and Monetary Union

- ⊛ Political Will as much as Law
- ⊛ ETS and EMU: Flagship policies where political will overcomes technical obstacles
- ⊛ NAPs must converge on best practice
- ⊛ The EU persuaded the markets that weaker credit economies macro had converged on Germany and France.
- ⊛ Moments of loss of confidence: the Danish no vote; a little fudging of Italian and Danish debt/GDP ratios.
- ⊛ But Monetary Union happened. Those who betted on it happening made money.
- ⊛ Those who bet on the ETS succeeding will make money if I am right that political will is there

Monitoring and verification

- ✪ The basis of volume data
- ✪ And of financial accounts
- ✪ And of financial community analytics
- ✪ Modelling of the marginal abatement costs of carbon reduction for different industrial sectors pointless if the data thought to be unreliable
- ✪ The financial community will note that auditors appear to be insisting on limited liability in relation to monitoring carbon
- ✪ For the power sector at least, there should be some correlation between verification numbers and other financial statements



Monitoring and Verification (part 2)

- There are some gaps in the accession country data
- But from the point of view of investors this is not so bad as long as EC insists on no “hot air”
- In reality the EU15 has a good history of monitoring and verification under UNFCCC
- The importance of transparency and public participation enshrined in treaties including Aarhus
- Confidence in the EU pollution register because of the involvement of civil groups

Conclusion

- If enforcement and compliance regime is credible the market will be active and liquid, and carbon will have value
- Decisions will then be made which include a layer of carbon value over longer investment horizons
- This will help lead us toward a low carbon economy