

News & Views

Links to third parties depend on political will

As long as third parties have ratified the Kyoto Protocol, **Peter Vis** at the European Commission believes that creating a link to the EU ETS should not pose too many problems. - Once schemes are up and running, it should not be particularly difficult to establish links, as long as both sides are comfortable with the environmental robustness of the other. The mechanics of reaching bilateral agreements might take some time, but the difficulties should not be over-emphasised. It will happen if there's the political will, Vis told Point Carbon.

However, Vis emphasises that the list of potential third parties is not too long. - Let's say that the EU scheme will potentially include about 30 countries of Annex B of the Kyoto Protocol – the present 15 plus 12 candidate countries, including Romania and Bulgaria, who could be expected to have joined the EU by 2008 – plus the three non-EU EEA countries Norway, Iceland and Liechtenstein. Excluding the US, that leaves only seven other Annex B Parties. Linking could be with countries like Japan, Canada, New Zealand - and, of course - with Russia if Russia puts in place an environmentally sound entity-based emissions trading scheme.

The time aspect of linking depends upon from when these other Parties have entity emissions trading schemes up and running, according to Vis.

Formal links low priority?

- By 2008 domestic trading programs that are linked to the Kyoto mechanisms, probably all programs, will be linked with each other through the mechanisms. I don't see a big advantage in having direct links over indirect links via the Kyoto mechanisms, said **Erik Haites**, Margaree Consultants. - The EU and other countries that have operational programs prior to 2008 will be busy sorting out the operational problems and making adjustments in preparation for the commitment period. I expect that negotiating formal links will be a low priority prior to 2008, since indirect links will happen automatically in 2008. Norway, due to its close economic links with the EU may be the only country interested in formal links with the EU program, he stated.

He believes that a link between the EU ETS and Canada will never really become an issue. - The work of the Domestic Emissions Trading Working Group assumed that emissions trading would begin on 1 January 2008. The process of negotiating emission reduction covenants with industry is just starting. It is not clear whether those negotiations will lead to an earlier start. Assuming a 1 January 2008 start, the Canadian and EU systems will be linked by the Kyoto mechanisms, rather than by mutual acceptance of the respective domestic allowances.

Technicalities could be a hindrance for Norway

A Norwegian emissions trading system will be established in 2005, at the same time as the EU ETS, and it is widely anticipated in both camps that there will be some link between the two. However, there are difficult operational issues to be solved first, according to **Asbjørn Torvanger** at Cicero.

- Assuming that the EU Parliament will not make radical changes to the EU ETS, the Norwegian scheme will be broader than its EU counterpart, as it includes all six greenhouse gases. Furthermore, different sectors are included in the two systems. Norwegian companies may buy quotas freely from the EU, but can only sell its CO₂ quotas. That may lead to a differentiation of the Norwegian market, as well as create significant transaction costs which will reduce interest, he pointed out. - As establishing a link between the two is probably more important to Norway, this issue will have to be solved there, he added.

- On a general basis, though, getting access to the EU ETS should be attractive to Norwegian companies, perhaps particularly to the smaller ones fearing that one or two major actors may dominate the Norwegian market and manipulate prices. That will be unlikely with interaction with the EU ETS, Torvanger told Point Carbon.

ViewPoint: EU ETS – views from the outside

The proposed EU Directive on emissions trading scheme has the potential for providing substantial emissions reductions at low costs. Its political significance can hardly be underestimated: it sets the direction for the future of international climate change cooperation. It comes as no surprise that the Directive is controversial within the EU (everything involving money is). However, also outside the EU, reactions have been mixed.

The proposed directive provides an opening for countries outside the EU to link up with the scheme. To link, a 'third country' will have to show that it has established a credible domestic trading scheme. It will also need the approval of its national allocation plan by the EU Commission. For political and economic reasons, prior to 2008 none of the major actors like Japan, Canada and Russia seem likely to opt for this. Rather, they have tended to be sceptical to the scheme, fearing its economic consequences.

Analysis being carried out by Point Carbon indicates that a EU scheme working in isolation in the post-2008 period could come at a cost for major "Kyoto buyers" like Japan and Canada. In both countries, the private sector has opposed emissions trading out of fears for high costs. To some extent such fears are legitimate, since carbon prices could increase substantially under a scenario with an isolationistic and enlarged EU. However, the most profound reactions to the EU scheme have so far come from Russia. Russia has seen its expected revenues from sales of excess allowances dwindle as a consequence of the US withdrawal from Kyoto. The EU scheme, which could further reduce demand for surplus allowances, has not been applauded.

It can be argued that although expected revenues from sales of allowances have declined, Russia is still set to be the main beneficiary of the Kyoto Protocol. Moreover, the Protocol was never about giving Russia money. Nevertheless, the planned EU scheme is one of the reasons why the Russian ratification process is moving forward at a piecemeal pace, and that Russian parliamentarians are looking out for a better deal.

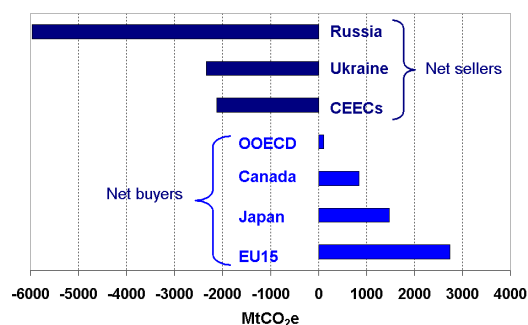
This does of course not imply that the EU should not pave the road for other to follow. However, it illustrates the fact that leading the world to more ambitious and truly global agreements requires a clear understanding of the fact that what you do internally will also have consequences for what you can achieve outside EU.

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GHG Emissions (MtCO₂e)

	1990	2000	1990-2000
EU15	4216	4068	-3,5%
Canada	607	726	20%
Russia*	3040	1926	-36%
Japan	1247	1386	11%
CEECs	1076	741	-31%
OOECD	181	188	3,6%

Sources: UNFCCC, *Point Carbon estimates (CEECs=Central and Eastern European Countries; OOEC=Iceland, Liechtenstein, Monaco, New Zealand, Norway and Switzerland)



Gap between Kyoto targets and emission projections in the 1st commitment period 2008-2012

Point taken

A link between the EU ETS and Russia is likely to be achieved only after Russia has ratified the Kyoto Protocol, but even then there are difficult factors to overcome, believes **Anna Korppoo** at Imperial College London. - Internal EU opposition to allowing Russian surplus AAUs into the EU ETS could create problems. However, allowing ERUs in is more likely, she told Point Carbon. - Access for ERUs to the EU ETS might have to be considered as a political carrot by the EU if the Russian ratification process is not proceeding soon. If only ERUs and not AAUs were allowed into the EU ETS, however, the Russian potential to sell is not really an issue. Implementing JI projects in Russia has been very difficult so far, which indicates significantly smaller amount of Russian ERUs appearing to the market than would potentially be for sale, she said.

The Japanese government seems to not study the market linkage option, according to **Naoki Matsuo** at Climate Experts. - There are two approaches to link the fragmented markets; policy-driven and market-driven. I believe that a market-driven linkage through CERs is a possible solution, as the CERs may be the common currency to link the markets. The important factor is how many CERs are to be provided into the market through CDM projects. One hurdle is the lack of proper and timely incentives to implement CERs, especially for Japanese stakeholders, who are the biggest demanders, he said. Japan is scheduled to have a comprehensive policy review in 2004, and it may install some sort of emissions trading domestically.

- I would expect companies from third parties to look at getting into what will apparently be the most liquid emissions trading system, ie. the European one, **Marc Stuart** at EcoSecurities told Point Carbon. - There is no reason transferable credits under the Kyoto Protocol should not flow between the various systems, and the EU ETS will most likely become the corner stone of the emerging markets, he said. Stuart doubts the benefits to third party companies in the first EU commitment period, 2005 to 2007, but sees a potential from 2008 and onwards. - The liquidity of the EU ETS would seem to be a tremendous incentive for Canadian and Japanese companies to establish a link, and in my view it is quite realistic that political and corporate forces will marshal to make it happen.