



Commodity Futures Trading Commission

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Speech

“The Most Important Thing”

Speech Commissioner Bart Chilton of the Commodity Futures Trading Commission before the Finance IQ, Second Carbon Trading Conference, New York, New York

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Introduction: Carbon & Economics

Thank you. It is a pleasure to be with you today and to be part of an event that is so important—important because we are dealing with the market potential of what is the most pressing issue of our time. In no uncertain terms, climate change is an epic, global issue.

Not long ago, making the business case that good environmental stewardship also made good economic sense was a tough argument to win. But not today: more and more people are seeing that we can turn what might have been considered economic drains into gains with great benefits. They see good environmental stewardship as a driver that can fuel the economic engine of our democracy.

Conversely, there is an economic price to not moving forward. Many U.S. companies are already losing business in Europe as their cross-Atlantic counterparts become leaner and more competitive in response to climate change. They need to comply with stricter regulations overseas if they want to be competitive and choose to sell products there. On top of that, the U.S. is missing out on the vast potential economic gains from emissions trading. The United States not being involved in climate change is actually hurting parts of the U.S. economy right now, today.

This audience has a particularly good insight on the situation. All of you here are examples that there is an understanding about the vast potential for economic growth in these emissions trading markets. You are pioneers in our collective green futures.

Horoscopes: The Most Important Thing

You have already received and shared a great amount of information during this conference. So, to avoid that saying, “It has all been said, but not everybody has said it.” I want to give you what I hope is a little different perspective and some new information.

Let's start with horoscopes. You haven't discussed that yet, have you?

For me, I like a quick and concise horoscope. Don't confuse me with too much deep thinking. Never mind too many extraneous facts. I prefer my horoscopes with no extra options, no frills attached. Tell me to take advantage of a business opportunity, stay away from strangers, show my affection to a loved one, or to be patient and I will be rewarded. Tell me my lucky numbers. I suppose I like my horoscopes rather more like fortune cookies.

Others, I know, are more indulgent in these matters. They will read several paragraphs from a more detailed horoscope and try to find the meaning in it. A while back, a friend was reading horoscopes from a popular purveyor of planetary punditry "Free Will Astrology." In it, there was a question that my friend read to me. I thought about that question for a while and finally said, "That's a great question." After a while longer, I repeated myself, "That is one great question."

So, I'll share it with you now. Here it is:

What is the most important thing you have never done? Again, what is the most important thing—the most important thing, you have never, emphasis on the word "never," done?

Take a bit to think. Isn't that a great question? Did anyone have an immediate response come to mind? That's a question you can ponder for a very long time, isn't it? I like that it makes you think, that it takes you immediately into a reflection of what you have done, what you may have missed, and what is still possible, what opportunities are waiting out there. It is just a great question. I hope you'll consider it and share it with others.

But, as I was thinking about that question, I moved beyond my own life and thought about the United States and about the world. What is the most important thing we have never done—never done, as a nation?

And you can see where I am going. It really comes down to addressing climate change. As a nation, we have tried to tackle health care. We have more to do, but we can't say we have never tried, so you have to rule that out as one of the things we have never done. Education? Been there, tried that. Going to the Moon? Done that. Going to Mars? Just did that one. (I know, it was un-manned.) I guess there are many other places we could space travel to, but before we leave this planet too far behind, let's focus on what is the most important thing we have never done . . . here on Earth.

Picking up the Slack: China and the U.S.

As I said, the answer has got to be—for a great many people—addressing climate change and global warming. We have not done that in the U.S., and I'll add an emphasis: we should.

Why should we? Well, I won't reiterate what others have said. This is an intelligent crowd and you already know the answers to that question. Suffice it to say, if we don't,

the planet is messed up forever. The damage will be irreversible in a few years if we don't respond. Pretty good reason, huh?

People like to say we should leave the planet a better place for our kids and grand children. Gosh, is that a tough bill to fill at this point in history. Global warming is a monumental world wide challenge like we have never encountered before.

There is a saying that change is made by those who participate. This is certainly true for climate change. It is fair to say that if not enough folks participate—I'm looking at you, the U.S. and China—we will fail. And since the United States and China are the largest contributors to global warming, they have an enormous responsibility to participate. It is unacceptable that China, the second-largest economy in the world, is not stepping up and participating in this global challenge. They argue that the responsibility rests with developed countries and as a developing economy they cannot commit to mandatory emissions reductions. However, the International Energy Agency (IEA) predicts that if China does nothing to reduce emissions, it could produce more carbon dioxide emissions during the next 25 years than all of the world's richest 26 countries combined. The cost of inaction will be much greater than the cost of action. How ironic is it that they host the Olympics where the entire world comes together, yet they won't participate on a critical issue that requires the entire world coming together. But, the U.S. response, "We won't do it because China isn't doing it," isn't much better. It reminds me more of a childhood squabble than a serious discussion about how to address this epic issue of our time. Thirty years from now, our kids and grandchildren will be the ones who determine if we, during this time, have left a legacy worth leaving. This is a global problem that demands a global response, especially from the world's two largest polluters.

Ready for Change

So, it is past time for the United States to pick up the slack and start getting serious about climate change. It is time to pass legislation that will set us on a straight and strong course for success. Those of you in this room already realize that. The markets realize it. In fact, the biggest increase in the Chicago Climate Exchange carbon market took place after Super Tuesday, February 5th. That is the date when 24 states had political contests—with 52% of all pledged Democratic Party delegates and 41% of the total Republican Party delegates at stake. That is the date when the field of presidential contenders shrank to three viable candidates. All three, Senators Clinton, Obama and McCain, support a mandatory cap and trade system. Within a short period of time thereafter, prices for the Carbon Financial Instrument traded on the Chicago Climate Exchange moved from the \$2.50-\$3.00 range to over \$7.00.

President Bush opposes cap and trade legislation, as you all know, and any president's opinion obviously matters a great deal. So, I am not convinced that legislation on this issue will become law immediately. But, I am convinced that change is coming next year. I would be surprised if in a year from now, legislation has not been approved by the Congress and supported by the next U.S. President.

And, when legislation does become law, we in government will have a really important job to do. It will be important both in terms of promulgating regulations to actually

implement the law, in as rapid a manner as possible, and then in monitoring these emission markets.

Establishing the actual credits and allowances under a new law would actually be done, presumably, under the auspices of the Environmental Protection Agency – with coordination among other federal agencies. The CFTC has the authority and responsibility to oversee derivative instruments that will be based upon the underlying emission allowances. Ensuring honest emission markets, for both futures and options contracts, would be the responsibility of the CFTC. We would perform the same types of oversight functions that we currently perform to guard against fraud, abuse and manipulation. We would work to ensure that these emission markets are viable tools for hedgers and for speculators.

When I say that we would do things like we do now for other commodities, that is not to say that emissions markets don't have unique characteristics. They do. For emissions, the underlying commodity is an allowance giving the holder the right to a specific action, as opposed to a physical commodity. Those who would be considered "Commercials" in these markets would hold the underlying commodity as part of a compliance strategy based on federal mandates. It is important to bear in mind that these markets are political constructs; in addition to market fundamentals, prices would be driven heavily by policy and regulatory issues. For example, "Deliverable Supply" would be determined administratively; the proper amount of allowances allocated for a given time period, method of allocation, and possibility of banking would all influence the functioning of markets. These are the kind of things we would keep in mind as regulators.

Super-Sized Markets

I was in Honk Kong earlier this year and spoke about the importance of addressing climate change and how the potential for emission markets was huge. I said that in 2006, worldwide futures grew by 31 percent, but that emissions markets grew by 131 percent. I knew at the time that there this was an understatement. Since then, I've been asking people in industry and in government about the scope of what these markets might be in the future. What I discovered is there are no official or concrete numbers. I also discovered that no matter how one looks at it, I dramatically underestimated the enormity of the potential.

I'll give you some sense of what we are talking about and what I think the potential is here.

We all know that the global market for carbon emissions has grown precipitously since its origins in the 1990's, and particularly in the last few years. In 2002, the World Bank estimated the volume of carbon emissions traded globally at 32 million metric tons with a value of approximately \$100 million. For 2008, these values are estimated to increase to a volume of 4.2 billion metric tons, and a total value of \$92 billion.

What does all that mean? It means that the market value of global carbon trades has experienced an average annual growth rate of about 312% since 2002! That is a cumulative increase of 92,000 percent! That's not conjecture, it is a hard number fact that this trading has gone from \$100 million to \$92 billion. As important is the fact that

what we are seeing is a policy value shift – a change in priorities for the world which is reflective of the seriousness of this issue.

All this growth has taken place while the world's historically largest emitter the United States, aside from the initiation of certain voluntary carbon markets, has sat on the sidelines and not truly tapped into its massive potential to participate in this space.

Actual Carbon Dioxide Emissions in the United States totaled approximately 6 billion tons in 2007, about three times greater than such emissions in the EU (2 billions tons of carbon emissions in 2007), where the most robust trading system and a largest portion of carbon emissions trading currently resides. Theoretically, if a mandatory, federal cap and trade system were to exist in the United States with the intent of reducing emissions to Kyoto levels (25% below 1990 levels by 2020), we could see a cap in 2009 or nearby years set slightly below the 6 billion tons of emissions I just referred to (depending on how comprehensive legislation is in terms of coverage).

Considering settlement prices for 2008 European Union Allowances (EUAs) trading this year on the European Climate Exchange between \$29 and \$42, and using a midrange value (\$35), that would imply over a \$200 billion cash value for carbon emissions here in the United States. And that is just to start out and without considering increased market volume through contract trading. The cash market would only grow in size as caps became tighter and allowances more valuable.

Taking this a step further, we observe generally that in developed markets, futures trading is conservatively 10 times the size of the cash market for many commodities and as can even be as great as 30 times that of the cash market for certain financial products. Even with the conservative assumption, this would imply a 2 trillion dollar futures market!

In terms of volume, a \$2 trillion market would be the equivalent of anywhere from 60 to 180 million contracts. To give you an idea of the magnitude of this, in 2007, Light Sweet Crude Oil traded on NYMEX saw a volume of about 120 million contracts. Natural Gas experienced an annual volume of 30 million contracts, and all metals combined on NYMEX, about 37 million. So, we are talking about a really incredible potential for emission markets. This could also increase with the possibility of the creation of project-based credits and international trade-ability.

Clearly, there are several variables and assumptions not factored into these conjectures about the ramifications of a U.S. cap and trade system, but I believe that the underlying message is crystal clear. The potential size and scope of a structured carbon emissions market in the U.S. is unequivocally vast. It is certainly possible that the emissions markets could overtake all other commodity markets at some point down the road.

Our Green Futures

So, we are all, everyone here and many people in this country and around the world, ready to take off on this exciting, but incredibly necessary, journey. We are literally going to help change the world, and you are all going to be a part of it. We are going to undertake the most important thing that we have never done.

Marshall McCloughan said, “You can’t move forward only using your rear view mirror.” As we get ready to take this ride, we can look at the existing derivatives markets. We can look at SO₂ and NO₂. We can look at the EU. We can examine our history, all in an effort to see what we need to do to ensure that we make as few detours as possible. But, I can tell you that most of us are ready to buckle up, look down the road, and drive into the future—to our collective green futures.

Thank you.