What role for offsetting in post-2012 climate policy?

Reactions to Sandbag report
European Parliament
29 November 2012

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Recap of EU regulatory framework (1)

- *Quantity limits*
  - **EU ETS in 2008-20: 50% of reduction effort 2008-2020 i.e. approx 1.7 billion tonnes**
  - **ESD: approx 700 million tonnes**
  - **If new international agreement increased use by up to 50% of the additional reduction effort**
- *Quality requirements*
  - **CDM projects registered prior to 2013**
  - **CDM projects registered after 2012 in LDCs**
  - **No ERUs after 2012 without new QELRCs**

European Commission

Recap of EU regulatory framework (2)

- *Exceptions*
  - **Provision to** restrict use **of specific credits from project types decided in CCC → industrial gas, LULUCF, nuclear**
  - **Provisions for** bi- or multilateral agreements **for supply of credits if no international agreement concluded by Dec 2009 → opening for NMM**
  - **Provisions for** Community projects
- *If there is an international agreement*
  - **only credits from projects in third countries that have ratified agreement**
  - **types of credits to be agreed**

Quantity aspects: recent CER/ERU market developments

- **Despite overhang in EU allowances steady increase in demand**
  - *Increasing spread with EU allowances incites arbitrage*
  - *Phase 3 use restrictions on industrial gas projects*
  - *ERUs: uncertainty about CP2*
  - *New sources of demand from Australia, aviation, later Korea, China*

	2008	2009	2010	2011	Total 2008-11
CER	82	78	114	177	451
ERU	0.05	3	20	75	98
Total	82	81	134	252	549

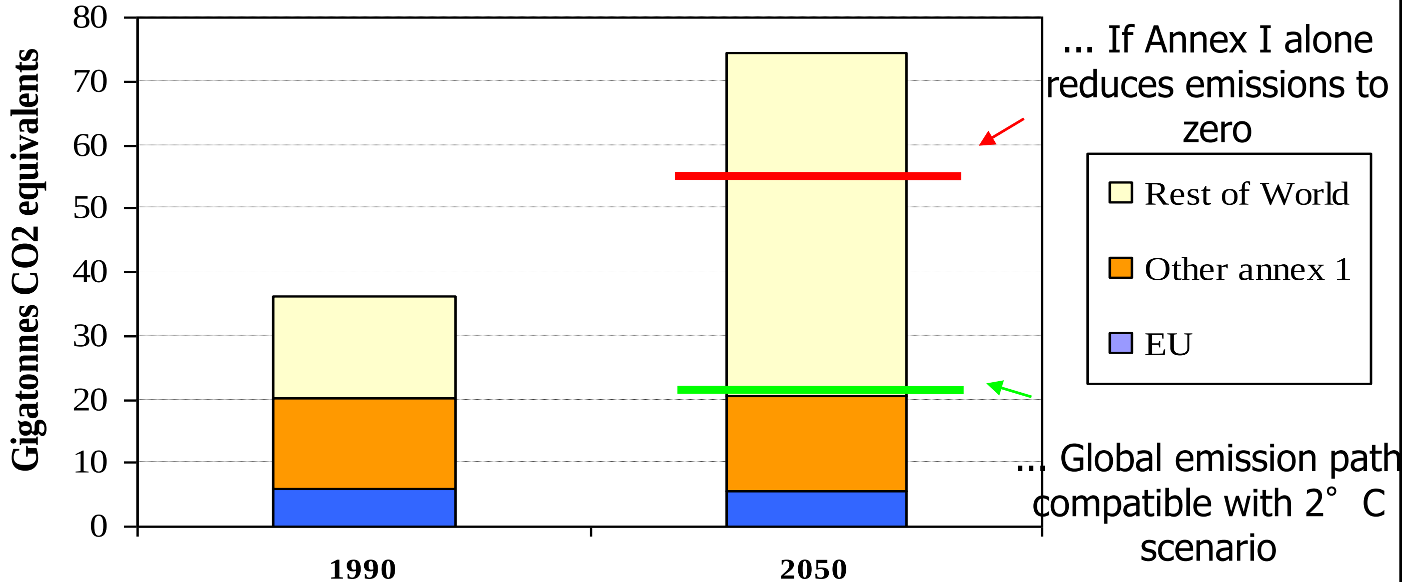
- **Even greater increase in supply**
  - *CDM: >5100 projects (49 PoAs), >1 Bln CERs, 7.6 bln CERs by 2020, $215 Bln investments, mainly China, India, South Korea, HFC, adip N2O*
  - *JI: 450 track 1, 49 track 2, 412m track 1 (292m in 2012!) and 19 m track 2, mainly Russia, Ukraine, HFC*
- **Prices below 1 euro**

How market developments affect the future role of offsets in EU

- International credits allowed in EU to contain compliance costs.
- Instead they have become major driver of the surplus. Without credits overhang would be 25% of expected amount
- Carbon market report (14/11/2012) proposes 6 options for structural reform for further investigation, one on restricting offset use:
  - **No or limited future access (phase 4) to credits:** would lower risk on major renewed surplus build up and create investment clarity on real domestic effort needed
  - **Flexibility could be allowed in times of demand shocks** (similar to Sandbag proposal)
  - **Balance against lower financial and technology flows to DCs**
  - **If international conditions are right and the cap is strengthened, see how offsets can again be use as cost containment.**

Reminder: offsetting alone cannot solve climate problem

Figure 1: Projected development of greenhouse gas emissions in different regions of the world



Source: Greenhouse gas reduction pathways in the UNFCCC process up to 2025, CNRS/LEPII-EPE, RIVM/MNP, ICCS-NTUA, CES-KUL (2003).

Community/domestic projects under art 24(a)

- *No priority*
  - **Limited potential (double counting, extended coverage in ETS or other binding legislation)**
  - **Moral hazard problem / inconsistent with move away from project-level crediting internationally**
  - **Administrative costs**
- *Hierarchy in the Directive*
  - **1st best harmonised extension of the scope of the EU ETS**
  - **2nd best – unilateral extension of the scope of the EU ETS**
  - **3rd best – Community offsets**
  - **obligation to consider 1st best route for activity with Community projects in the subsequent EU ETS review**

Quality aspects:
Recent CDM regulatory developments (1)

- **UNFCCC: Consecutive reforms in CDM**
  - More efficiency in the process: **enhanced Secretarial capacity, streamlining of registration and issuance procedures, PoA, …**
  - Geographical expansion: **loan scheme, top down development of standards and standardised baselines, DNA capacity building, …**
  - Improved objectivity: **improvement of additionality tools (FOIK, CP, investment analysis) and methodologies ('clean coal', HFC, etc.), development of sector-specific standardised baselines, …**
  - Enhanced transparency: **M&P for direct communication, online communication tools, co-benefits tool,…**

Recent CDM regulatory developments (2)

- **High level policy dialogue on the future of the CDM**
  - *Analysis of successes and challenges of 11 years of experience with CDM*
  - *Insists on urgent need to secure market stability, adapt to new conditions, enact operational reforms and strengthen governance*
- **Some of the more interesting proposals:**
  - *Call for further development of **sectoral approaches**, stimulate **net mitigations**, move to **standardised baselines**, use experience of CDM to **kick-start the Green Climate Fund**, and **ban HFC and adipic N2O***
- **More controversial proposals:**
  - *Purchase of CERs through Green Climate Fund*
  - *Reserve bank to manage the prices and stabilise markets*
  - *Kick-start REDD+ crediting*
- **Report should feed into 2013 review of modalities and procedures**

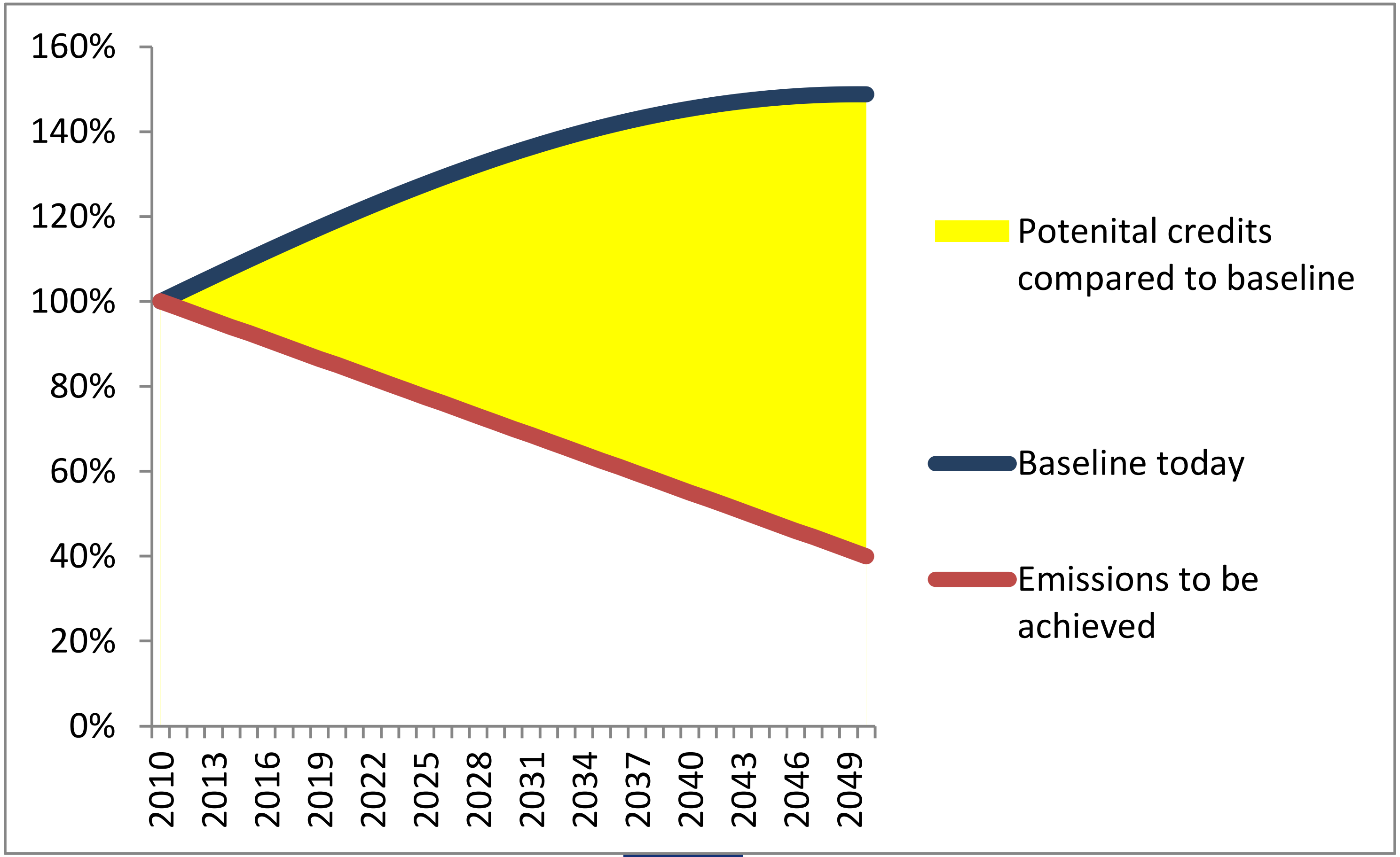
How these regulatory developments may affect the future role of CDM in EU

- Positive developments but fundamental design problems remain:
  - **Baseline setting and additionality testing remain inherently difficult and based on imperfect tools**
  - **Standardised baselines prone to methodological difficulties**
  - **Not designed to drive the structural transformation of industry (no net reductions, limited scalability)**
  - **Disincentives for national or sectoral CC policies remain**
- CDM remains second-best to New Market Mechanism and cap-and-trade
- Real question is whether CDM can evolve into precursor of NMM?

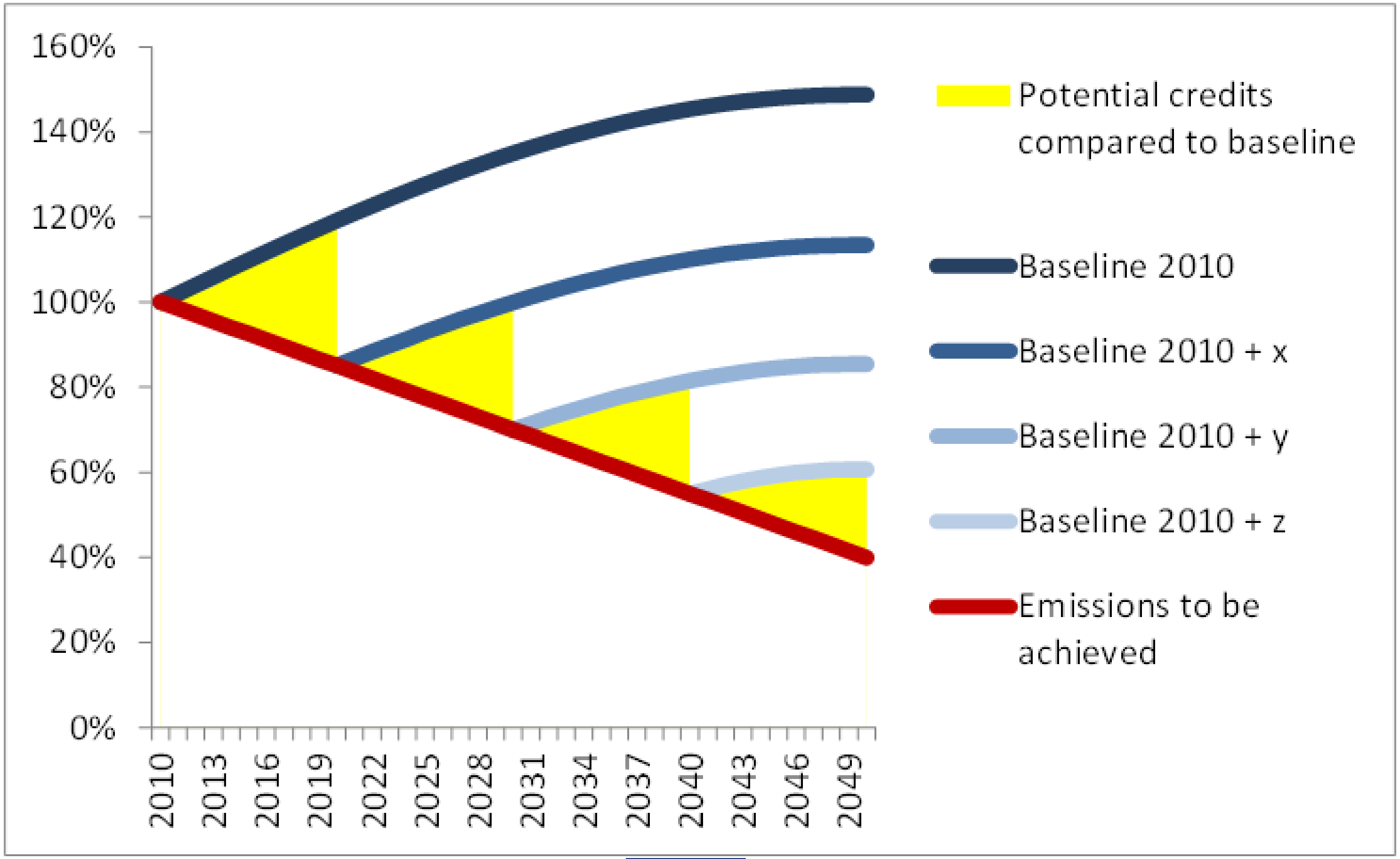
How these regulatory developments may affect the future role of JI in EU

- JI has problems of its own:
  - ***AAU overhang and lack of transparency, coherence and reliability of national procedures undermine trust in track 1 JI***
- JISC proposing revision of JI guidelines, merging of tracks and ways to deal with transition period from CP1 to CP2
- EU position:
  - ***JI should continue, open for continuation during transition period, possibly continue issuance and later deduct from AA***
  - ***Implement innovative approaches that lead to net reductions (standardised baselines and discounting)***
  - ***Single unified JI track implemented at host country with strong international oversight and accountability to CMP***
  - ***Compulsory standard setting, unified accreditation process, centralized issuance***
  - ***No ERUs from countries without new QELRC***

Crediting cannot be set using a static, indefinite baseline…



...but needs to recognise how infrastructure and technologies change over time



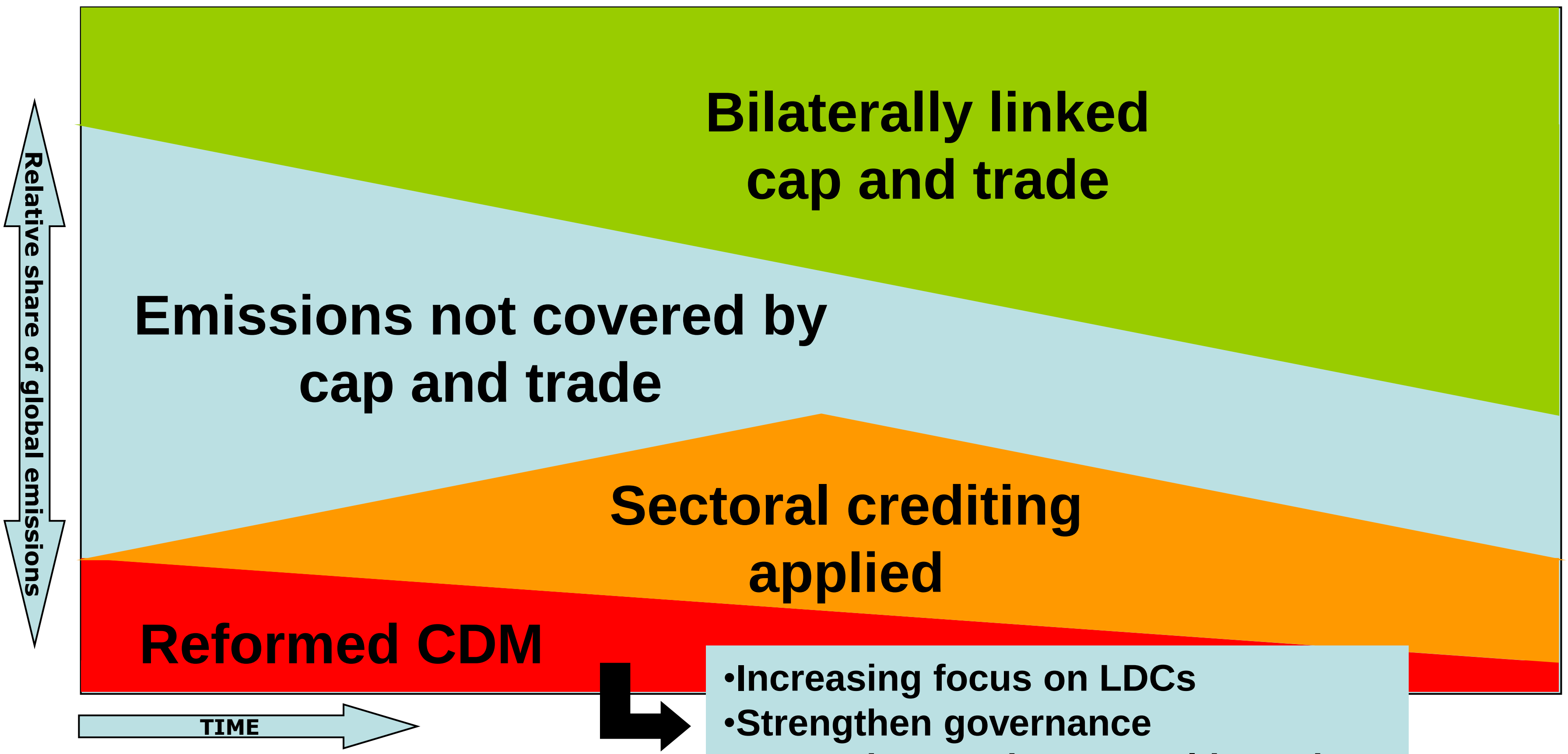
No additional use restrictions in the pipeline

- **Unilateral measures are second-best solution.**
- **Need to trust EB takes its responsibility seriously.**
- **'Clean Coal' projects**
  - *Revised methodology more robust and significantly limits the number of credits that can be earned*
  - *More essential than the choice of technology is to ensure that all emission reductions are real*
  - *No projects expected to be registered before end 2012*
- **Large hydro dam projects**
  - *2011 study revealed potential concerns with certain projects*
  - *But also recognised that local circumstances matter a lot for additionality and sustainable development impacts*
  - *COM expects the CDM Executive Board to continue working on improving the way additionality of these projects is tested.*
  - *EU requirements to assess hydro dam project according to WCD have improved independent reporting and verification of SD impacts*

International carbon market: EC vision for post-2012 remains unchanged

- Link compatible domestic cap-and-trade systems to develop an OECD-wide market
- New Market Mechanism for (advanced) DCs as a step towards cap-and-trade
- Reform and better focus CDM (focus on LDCs)
- EU remains strongly committed to the UNFCCC process
- First priority is progress with the New Market Mechanism in Doha.

Carbon Market Transition



- Increasing focus on LDCs
- Strengthen governance
- Strengthen environmental integrity

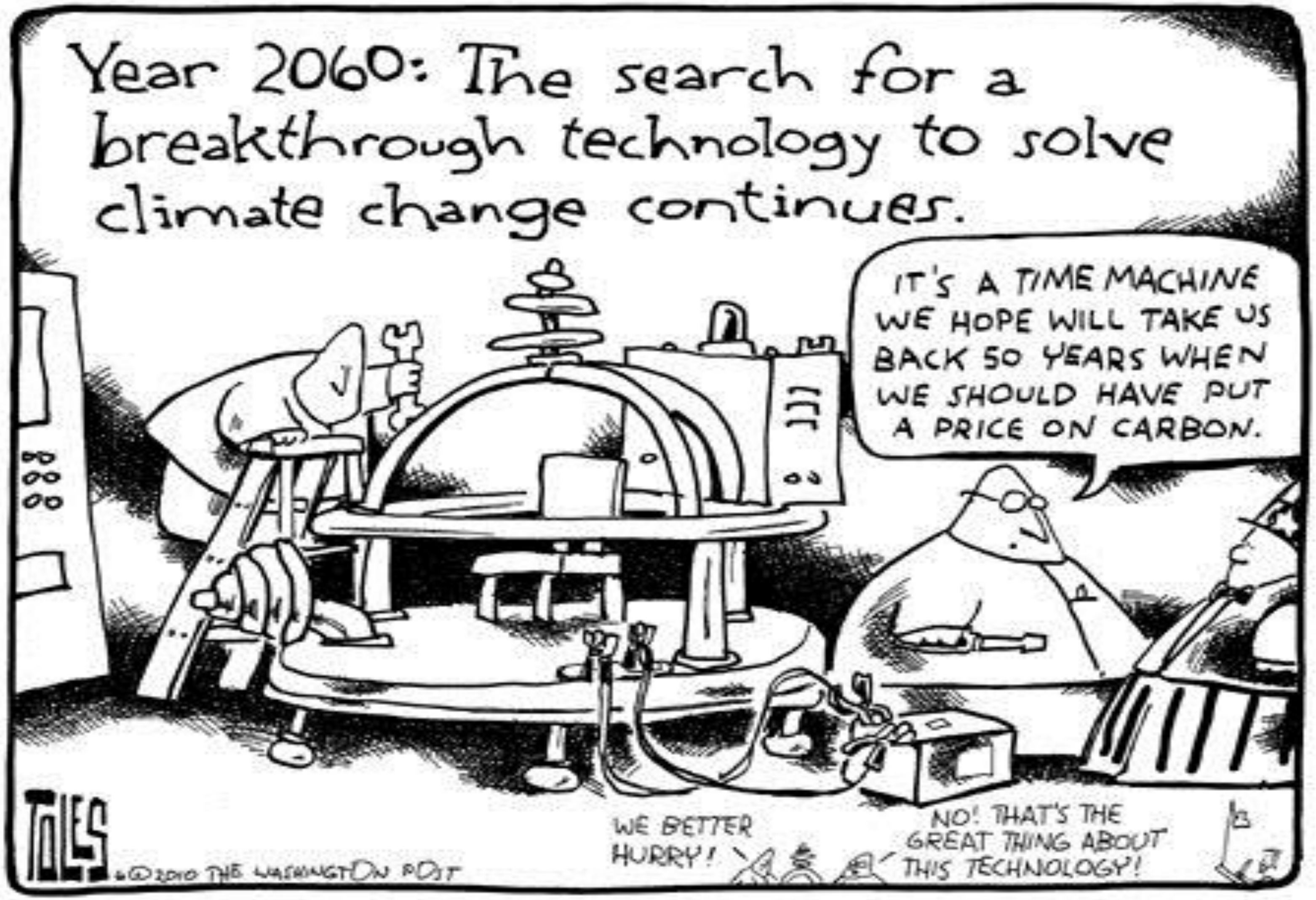
Means

Through UNFCCC supply-side where possible

Through (EU) demand-side where necessary

Concluding remarks

- *Expectations of what the carbon market is supposed to achieve is evolving.*
  - **CDM was designed as an instrument to reduce compliance costs in developed countries and contribute to SD in DCs**
  - **Now expect carbon markets to incentivise emission reductions and financial transfers at a far greater scale, and stimulating own action by DCs.**
- *The world is experiencing a shift in the nature of the carbon market, away from ex-post project-based offsets towards New Market Mechanism and cap-and-trade.*
  - **Cap-and-trade introduced in many countries**
  - **EU preparing to link with Australia and Switzerland**
  - **Outreach on ETS to many other countries and work with WB PMR to go beyond CDM**


Year 2060: The search for a breakthrough technology to solve climate change continues.
IT'S A TIME MACHINE WE HOPE WILL TAKE US BACK 50 YEARS WHEN WE SHOULD HAVE PUT A PRICE ON CARBON.
WE BETTER HURRY!
NO! THAT'S THE GREAT THING ABOUT THIS TECHNOLOGY!
TOLES
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