Carbon Market Watch

NEWSLETTER

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SCRUTINISING CARBON MARKETS

Courtesy of adopt a negotiator

Dear friends,

Carbon markets are in the dumps and policy makers and market participants alike are scrambling to come to their rescue. The Carbon Expo in Barcelona just came to a close and the next intercessional UNFCCC conference of this year starts in Bonn on 3 June. This year's Carbon Expo praised carbon markets as *"a fundamental tool to expediently spur economy-wide abatement activities and steer finance towards low carbon technologies"*. But the reality is that demand for carbon market units is at an all-time low. Current prices are looming at around 0.4 Euro for Clean Development Mechanism (CDM) offset credits and at around 4 Euros for European allowances. Prices are too low to finance low carbon technologies. On the contrary, in the absence of more stringent climate targets, fossil fuel use continues unabated, the emissions reductions due to the economic downturn are unsustainable and the public's and private sector's confidence in market mechanisms is waning.

The upcoming UNFCCC intercessional gives Parties another opportunity raise their mitigation pledges and to address the current oversupply of offset credits from both the CDM and Joint Implementation (JI). This oversupply is in no small part due to the lack of sufficient quality restriction which has led to hundreds of millions of offsets being issued that have limited or no environmental integrity. This year Parties get a chance to improve the quality of both programs, as they are scheduled to revise both the rules that govern the CDM and JI. Countries will also continue to discuss whether and how new carbon markets and their units should be approved both under the Framework for Various Approaches (FVA) and through the New Market Mechanism (NMM).

2013 is also crunch-time to draw up a deal to address emissions from aviation. The Assembly of the International Civil Aviation Organisation (ICAO) will be held in September 2013. There countries are supposed to agree on a framework for market-based measures to address international aviation emissions and on the feasibility of a global MBM. But the measures on the table are too weak to address emissions from aviation sufficiently and it is far from certain that countries will come to any agreement.

In Europe, the quest to prop up depressed $CO2$ prices in the European Union's Emissions Trading Scheme (EU ETS) is continuing. After the narrow rejection of the back-loading proposal in April, the European Parliament is expected to have a second vote in July. In this newsletter we also give an overview of the other main EU climate policy: the lesser known Effort Sharing Decision (ESD), which covers almost all sectors not included in the EU-ETS. These ESD sectors are responsible for 60% of the EU's greenhouse gas emissions, yet current reduction goals in the ESD are weak and instead of taking advantage of the huge reduction potential in these sectors, EU countries will have to do little until 2020.

Finally, Carbon Market Watch is in China to closely follow developments around the expected launch of 7 regional pilot emissions trading systems in the coming months. Stay tuned!

Happy reading!

The Carbon Market Watch Team

Carbon Market Watch @ Work

Press Releases

- Press Release: New offset credit data shows record use of dubious carbon credits; Norway backs away from wind and hydro offset credits (08.05.13)
- Press statement: International organizations welcome World Bank Ombudsman´s initiative to scrutinize investment project in Bajo Aguán, Honduras (05.03.13)

Publications

- ПОЯСНЕНИЕ ПРИНЯТЫХ В ДОХЕ РЕШЕНИЙ О ИЗБЫТКЕ ЕДИНИЦ КИОТСКОГО ПРОТОКОЛА. (20.05.13)
- Guest Commentary Umwelt Aktuell: Das Spiel mit Emissionsgutschriften in Europa: verspielt? (21.05.13)
- Fact sheet for Bread for the World "International aviation - Addressing Emissions while Respecting Equity Issues", (30.04.13)
- Watch This! NGO Voices on Carbon Markets #5 (27. 03.13) PDF (ENGLISH) PDF (HINDI)

Blog from China

- **Post #1:** Carbon Market Watch joins in partnership with Chinese NGO Green Zhejiang (23.05.13)

Media

- ARTE - Documentary: De l'argent propre avec de l'air pollué / Profite mit der schmutziger Luft (14.05.13)

Open Letter

- Open Letters to Airlines: Protect the integrity of the EU ETS; Abstain from using offset credits from HFC-23 and adipic acid projects (12.04.13)

Submissions to calls for inputs

- Submission to call for input: CDM Executive Board 73rd Meeting Agenda (21.05.13)
- Submission of Views to the Review of the Modalities and Procedures of the Clean Development Mechanism (26.03.13)
- Submission on Views regarding Human Rights in the Revision of the CDM Modalities and Procedures (26.03.13)
- Submission of Views on the Framework for Various Approaches and the New Market Mechanism (26.03.13)

Carbon Market Watch @ UNFCCC SB38

3–14 June 2013 in Bonn, Germany

Carbon Market Watch Recommendations for SB-38

UNFCCC Workshop on the review of CDM modalities and procedures

Saturday and Sunday 8–9 June 2013

The UNFCCC workshop on the review of the CDM modalities and procedures aims to facilitate the progress of Parties on the review of the CDM modalities and procedures.

Side Event: An Equitable Solution to Curb Aviation Emissions

Friday 7 June 2013, 16:45–18:15

This event bring together voices from the global south and north to discuss a future global deal that respects equity and avoids false solutions such as large scale offsetting.

Presented by: Bread for the World (BfdW) with contributions from Nature Code - Carbon Market Watch.

Side event: Embedding the CDM Infrastructure in FVA and NMM

Monday, 10 June 2013, 16:45–18:15

The event will present views on similarities of the flexible mechanisms of the Kyoto Protocol and the recent developments around FVA and NMM.

Presented by: Designated Operational Entities and Independent Entities Association (DIA) with contributions from Nature Code – Carbon Market Watch

Side event: Human Rights Protections in the CDM

Monday, 10 June 2013, 18:30–20:00
This event discusses the numerous concerns have been raised about human rights abuses associated with CDM projects. To protect the rights of affected communities, the CDM must establish institutional safeguards that effectively prevent social and environmental harms, and promote sustainable development. *Presented by: Center for International Environmental Law (CIEL) with contributions from Nature Code – Carbon Market Watch.*

List of all UNFCCC workshops and events at the SBI 38 session 2013

List of all side events at UNFCCC Bonn Climate Change Conference in Bonn June 2013

Reforming the CDM: Mission Impossible?

At the upcoming intercessional conference starting on 3 June in Germany, Parties will discuss revisions to the rules that govern the CDM. We highlight the most important issues that need to be addressed in order to strengthen the environmental and social integrity of the CDM.

Courtesy of carthageMartin/flickr

This year Parties will revise the rules that govern the Clean Development Mechanism (CDM), the so called "modalities and procedures" (M&P). The revisions are to be finalized in Warsaw, Poland at COP-19 by the end of this year. At the upcoming intercessional in Bonn Parties will discuss changes both during the negotiations and at a separate workshop. Parties and admitted observer organizations have already submitted their views and suggestions to the UNFCCC earlier this year in response to a public consultation (see box).

Submission on CDM M&P revisions

- Submission by Carbon Market Watch, summarized below
- Submissions by Parties
- Submissions by observer organizations
- Recommendations from the CDM Executive Board

The CDM is in a precarious situation, as demand for its Certified Emissions Reductions (CERs) is very low and is projected to remain low until 2020, if Parties do not increase their mitigation pledges. Because of the lack in demand and the oversupply, prices have dropped over 90% in the last year and a half and are now at around 40 Euro cents. This also impacts the quality of offsets. At such low prices, it is safe to say that it is not possible to implement new projects that are additional.

Parties have made different suggestions on how this supply demand imbalance could be addressed. Demand could be increased, some suggest, by allowing all countries to use CERs for compliance with their mitigation pledges, by encouraging the use of CERs in the aviation and shipping sector (see article on aviation) or by buying up large numbers of offset credits through the Green Climate Fund (GCF). The significant over-supply of carbon credits is in no small part due to lenient rules, in particular rules on additionality. Therefore, Carbon Market Watch believes that such large scale "rescue" purchases of offset credits are counter-productive. Especially if the purchases involve buying up the large number of offset credits that are from projects with questionable environmental integrity. Instead using up scarce climate finance to purchase substandard carbon credits, Carbon Market Watch believes that the supply-demand imbalance needs to be addressed by countries raising their mitigation targets and by the CDM reform dramatically improving the social and environmental integrity of the CDM. The CDM can only have a viable future if it is fundamentally reformed. It remains to be seen if there is the political willing ness to do so.

The following is a summary of Carbon Market Watch's key recommendations for the upcoming intercessional conference in Bonn. For detailed information about these recommendations, see our Carbon Market Watch recommendations for SB38, May 2013.

FUNDAMENTALLY REFORM ADDITIONALITY REQUIREMENTS

- **Additionality criteria must be strengthened and require, for example, that the impact of CER revenues on the economic attractiveness of a proposed CDM project activity is considered.**
- **Eligible CDM project types should be limited to the ones that have a high likelihood of being additional. Exclude those project types with low likelihood of additionality. (e.g. large greenfield infrastructure projects).**
- **Project types where baselines and additionality are intrinsically difficult to determine (e.g. because of signal-to noise ratio issues) should be excluded.**

CHANGE RULES (E+/E-) TO AVOID PERVERSE INCENTIVES ON OTHER GHG POLICIES

- **E- policies should be considered when setting the baseline. This would lead to more conservative baselines while the risk of perverse incentives is likely to be low for most sectors.**
- **E+ policies that have considerable impact on GHG emissions and which have high risks for perverse incentives, such as fossil fuel subsidies, should not be included in the baseline, irrespective of when they were adopted.**

ENSURE THAT ALL CDM PROJECTS UPHOLD HUMAN RIGHTS

- **All project activities registered, or seeking registration, under the CDM must be undertaken in a manner that respect human rights.**
- **Project activities must be suspended if they are found not to meet human rights obligations and standards until the relevant concerns have been fully addressed.**

IMPROVE THE CDM'S CONTRIBUTION TO SUSTAINABLE DEVELOPMENT

- **A minimum global standard for CDM projects on sustainability and "no harm" requirements should be defined.**
- **Mandatory requirements for monitoring, reporting, and verification of sustainability benefits during the entire project cycle should be established.**
- **Project types that support technologies or practices with high GHG emissions and that are associated with other high environmental and social costs (e.g. projects that support the extraction and use of coal) should be excluded from the CDM.**

STRENGTHENED CIVIL SOCIETY PARTICIPATION IN THE CDM PROCESS

- **The requirements for stakeholder involvement should be strengthened and clarified.**
- **A communication channel for case specific matters and a grievance mechanism to address the social and environmental impacts of specific CDM projects should be established.**

SET-UP A GRIEVANCE MECHANISM

- **The appeals procedure must be implemented swiftly and provide for broad legal standing;**
- **Complementary grievance mechanism should be established to address the social and environmental impacts of CDM projects during implementation of CDM project activity, e.g. when sustainable development co-benefit criteria are not realised as described in the PDD and to consider and address concerns about human rights impacts of a CDM project raised by or on behalf of individuals or communities.**

IMPROVE THE CONSTITUTION AND CONDUCT OF THE CDM EXECUTIVE BOARD AND SUPPORTING BODIES

- **Robust codes of conduct should be implemented for all members of the CDM governance structure, including the CDM Executive Board, working groups or teams assisting the Board, and members of the UNFCCC Secretariat.**
- **Nominations from representatives with vested interest in the CDM should be prohibited in order to prevent potential conflicts of interests.**
- **Quota rules on the composition of the Board should be established to ensure that members from environmental and academic organisations are represented.**
- **Term limits for Board member should be such that board members are limited to serve a maximum of two terms of two or three years.**

Joint Implementation reforms: too little too late?

In Doha Parties decided that the two JI tracks should be merged. However, all further decisions about JI were delegated to be discussed at the upcoming meeting in Bonn in June 2013. Below is a short summary of essential reform requirements needed.

JI Mazurskie Landfill Gas Project in Poland, Courtey of Mihai Brasoveanu

JI is currently divided into two "tracks". Under Track 2 an international board – the Joint Implementation Supervisory Committee (JISC) – approves JI projects and issuance of credits. Under Track 1, it is the host Parties that approve projects and issuance of credits (ERUs). Over 95% of JI offsets have been issued under track 1, with very limited transparency. Countries such as Ukraine and Russia have been issuing millions of JI credits with virtually no integrity or climate benefits (see JI article in our last Newsletter). In Doha[1] Parties decided that the two JI tracks should be merged. They also decided to establish common overarching guiding principles, including *"clear, transparent and objective requirements to ensure that projects are additional to what would otherwise occur"*.

All further decisions about JI were delegated to the Subsidiary Body for Implementation (SBI) and will be discussed at the upcoming meeting in Bonn in June 2013. Despite the poor quality of JI offsets they are used extensively. In 2012, companies covered in the EU-ETS for the first time used more JI offsets (over 284 million, representing 58%) than CDM offsets. In order to prevent JI offset credits to further undermine climate targets a number of essential revisions are necessary. Below we summarize the most important issues that will be discussed at the upcoming intercessional conference in Bonn. For our detailed recommendations to reform the JI see Carbon Market Watch recommendations for SB38, May 2013.

TREATMENT OF JI PROJECTS DURING THE INTERIM PERIOD

Current rules should stay in place which means that issuance of ERUs for emissions reductions after 2012 will only be possible once the new AAUs have been issued.

REQUIRE REVIEW PROCEDURE AT REGISTRATION STAGE

A review procedure by the governing body should be included at the stage of validation or registration.

REQUIRE STRONG CRITERIA AND REVIEW PROCEDURES FOR BASELINE AND ADDITIONALITY DETERMINATION

Such criteria have to be strengthened by, inter alia, including prior consideration requirements and requiring a review and approval of baselines and positive lists by the international governing body.

IMPLEMENT PROCEDURES TO RENEW CREDITING PERIOD

A procedure for the renewal of the crediting period for projects registered in the first commitment period must require that the baseline scenario and additionality claims of each project are re-established.

Framework for Various Approaches and New Market-based Mechanism Quo Vadis?

In Bonn, countries will continue negotiating if and how new carbon markets and their units should be approved both under the Framework for Various Approaches (FVA) and through the New Market Mechanism (NMM). We highlight some of the most pertinent issues that are still to be resolved.

At COP 18 in Doha, Parties did not get very far in agreeing on the details for establishing a new market mechanism (NMM) and a Framework for Various Approaches (FVA). The Doha decision includes establishing a work programme under the Subsidiary Body for Scientific and Technological Advice (SBSTA) for the FVA and the NMM. The FVA work program is supposed to:

1 The decision text can be downloaded here.

- address the purpose of the framework,
- develop the scope of approaches to be included under the framework (e.g. market based and/or non-market based);
- develop a set of criteria and procedures to ensure the environmental integrity;
- develop technical specifications to avoid double counting and
- agree on the institutional arrangements for the framework.

The Doha decision text on the NMM is slightly more detailed than that on the FVA and includes a number of important elements, such as:

- Operation under the guidance and authority of the COP;
- Standards that deliver real, permanent, additional, and verified mitigation outcomes, avoid double counting of effort and achieve a net decrease and/or avoidance of greenhouse gas emissions;
- Requirements for the accurate measurement, reporting and verification of emission reductions, emission removals and/or avoided emissions;
- Criteria for the accurate and consistent recording and tracking of units;
- Supplementarity;
- The promotion of sustainable development;

Below we summarize of Carbon Market Watch's key recommendations to help ensure the environmental integrity of new markets eligible under the UNFCCC. For detailed information about these recommendations, see our Carbon Market Watch recommendations for SB38, May 2013.

ENSURE ROBUST GOVERNANCE STRUCTURE

- **Appoint a UN body as a standards-setting organization and have all unit approved by this international body.**
- **Fully account credits through a rigorous, robust and transparent common accounting framework.**
- **Ensure that the appeals procedure is swiftly implemented and provides for broad legal standing.**

AVOID DOUBLE COUNTING

- **Use a common international transaction tracking mechanism for all offsets counted towards pledge attainment, with assignment of unique serial numbers to each ton transacted or registered;**
- **Establish clear and specific rules regarding the complementary relationship between CDM, NMM and other regional trading mechanisms;**
- **Establish rules to ensure that offsets are only counted by the buyer and not by the seller**
- **Ensure that financial flows are only counted once**

SECURE NET ATMOSPHERIC BENEFITS

Adopt accounting rules for FVA and NMM that clarify and ensure that under both mechanisms, a net atmospheric benefit has to be achieved.

UPHOLD HUMAN RIGHTS

All project activities registered or seeking registration under the CDM must be undertaken in a manner that respect human rights

DELIVER SUSTAINABLE DEVELOPMENT BENEFITS

Defining a minimum global standard on sustainability and "no harm" requirements that each CDM project has to meet.

Crunch-time for aviation emissions

At this year's ICAO Assembly in September 2013, Parties are supposed to agree on a Framework for market-based measures (MBMs) to address international aviation emissions and on the feasibility of a global MBM. But countries are far from agreeing how such MBMs should look like. The current preferred option is to simply use offsets to meet emissions reduction obligations. This will do little to incentivize airlines to do their share in helping fight global warming.

Courtesy of andreas.christen/flickr

Flying is bad for the climate: Jet fuel emissions account for 5% of global GHG emissions. On top of that other air travel impacts, such as contrails and cirrus clouds also lead to significant warming.[2] Aviation may therefore currently be responsible for up to

2 For more information, see: http://www.co2offsetresearch.org/aviation/AviationImpacts.html

14% of man-made climate change.[3] Most worryingly, air traffic emissions are rapidly rising. Left unmitigated, international aviation and shipping emissions could take up about 30% of the 2° degree Celsius global emissions budget by 2050. The aviation sector must reduce its emissions if we are to achieve the 2° degree Celsius goal.

Aviation and Equity

For all other GHG emissions the UNFCCC distinguishes between rich and poor countries: The concept of *Common but Differentiated Responsibilities and Respective Capabilities* (CBDRRC) says that developed nations have a historical responsibility and more capacity to tackle climate change and should thus take the lead in reducing and financing emissions reduction. However, the aviation sector is relatively young and developed and developing nations are already competing on an equal footing. Furthermore, aviation users from all countries no matter which country they come from cannot be considered poor but rather are middle or high income earners. This makes the equity argument in the aviation sector very difficult and suggests that all airlines should be treated equally.

Negotiating at a snail's pace

In 1996, discussions of how to allocate aviation emissions started under the UNFCCC. In 1997, the responsibility to reduce aviation emissions was given to the UN's International Civil Aviation Organization (ICAO) to develop a climate protection mechanism for its sector. Until now it has failed to do so: Neither countries nor companies have to currently account for their aviation and shipping emissions.

EU acts and retracts

In 2010, ICAO agreed to an aspirational goal of carbon-neutral growth by 2020. However, such voluntary actions will not suffice. This is why the EU tried to include all inter-European and international flights arriving to and flying from the EU into its EU ETS. But the EU's decision prompted very strong reaction, in particular from China, India and the US. The EU was accused that its unilateral approach would spark a trade war and infringe on national sovereignty.

After months of tense negotiations and lawsuits the EU introduced the so called 'stop the clock' exemption which temporarily halts the inclusion of intercontinental flights in the EU ETS for one year. Only flights within the EU still have to comply with the EU-ETS. The EU "stop the clock" is set to expire and the original EU legislation that requires all airlines to pay for their emissions will automatically enter into force as of January 2014. This is unless the EU decides that ICAOs actions are sufficient and that the inclusion of flights in the EU-ETS is therefore no longer necessary.

Options to reduce aviation emissions

At this year's ICAO Assembly in September 2013, countries are supposed to agree on a Framework for market-based measures (MBMs) which could serve as an umbrella for national, regional or sectoral initiatives to address international aviation emissions. Countries are also discussing the feasibility of one global MBM. But countries are far from agreeing how such a global MBM should look like. ICAO has narrowed its options to three approaches:

- a global cap-and-trade scheme
- mandatory offsetting with revenue generation which may be used for additional climate finance
- mandatory offsetting without revenue generation

Both the emission reduction goal and the measures how the cap can be met will determine if the aviation sector will have to reduce its own emissions. Of the option on the table, only a cap-and-trade scheme with a stringent cap and a limit on the use of offsets could achieve this. However, 100% offsetting will not lead to emission reductions in the sector itself, even if the cap was to be stringent.

Given ICAO's track record of 'aspirational goals' there is a genuine lack of trust that ICAO can deliver a binding agreement that would require the aviation sector to reduce its emissions. A so called 'coalition of the unwilling' headed by USA together with countries like India and China is fervently opposed to commit to a binding agreement to reduce emissions and questions the need for a market based measure.

The International Air Transport Association (IATA), a trade association representing the airline industry, recently declared that they prefer a 100% offsetting option. This position is likely to be supported by a majority of ICAO negotiating States.

The troubles with offsets

Offsetting is not a long term solution because it does not lead to emissions reductions in the aviation sector itself but merely compensates these emissions throughout investment in reduction projects elsewhere. Since offsetting delays mitigation action in the aviation sector itself, it cannot deliver the large long-term emission cuts required to mitigate aviation sector's emissions and projected growth in air-traffic. To make things worse, if the offsets are of low quality, climate impacts actually get worse. It is still unclear what types of offset credits would be approved

3 Lee et al. (2009) 'Aviation and global climate in the 21st century'. Atmospheric Environment

for such an aviation MBM. There are the two offset mechanisms under the Kyoto Protocol: the CDM and Joint Implementation (JI). Both of these mechanisms have come under sharp criticism for the lack of quality of their offsets.

Offset credits are also produced outside the UNFCCC, without international regulatory oversight. These include voluntary offset programs (e.g. Verified Carbon Standard), national offset programs (e.g. Australia's Carbon Farming Initiative), bilateral offset mechanisms (e.g. Japans' Bilateral Offset Credit Mechanism). Offsets from these programs have been scrutinized even less. We know little about their quality but it would be naïve to assume that they are generally of higher quality than CDM and JI credits.

If ICAO decides on a MBM, demand for offsets from the aviation sector could be in the hundreds of millions. Putting in place quality restrictions for such offsets would be absolutely vital.

CARBON MARKET WATCH RECOMMENDS:

- CDM: **Quality restrictions should be placed on CDM offset credits to ensure high environmental and social quality, for example, industrial gas and large scale power projects should be excluded.**
- Joint Implementation: **JI has been repeatedly criticized for a severe lack of quality control. 95% of all ERUs issued to date are issued by host countries without any international oversight. Offset credits from JI should not be eligible under an ICAO scheme.**
- New Market Mechanism (NMM): **A new offsetting mechanism was approved in 2011 and is being developed under the UNFCCC framework. It will likely take many years until emission reduction units will be issued under this new mechanism. NMM credits should only be eligible under an ICAO scheme if they are verified to be real, permanent and additional.**
- Voluntary offset programs: **Because of the lack of international quality oversight, offsets from the voluntary market should not be eligible for compliance.**
- Allowances from cap-and-trade systems: **Emission permits could also be acquired in the form of allowances from cap-and-trade schemes. Cap-and-trade systems only lead to emissions reductions if there is a scarcity of allowances. Surplus allowances from over-supplied schemes such as the EU-ETS should not be eligible under an ICAO scheme.**

In order to ensure that we stay below 2 degrees warming, the aviation sector needs to set a meaningful cap that leads to actual emission reductions in the sector itself. The use of offsets has to be restricted and eligible offset types have to be limited to those that have high environmental and social integrity.

The EU ETS back-loading hurdle

The quest to prop up depressed CO2 prices in the European Union's Emissions Trading Scheme (EU ETS) is continuing. After the narrow rejection of the back-loading proposal in April, the European Parliament is expected to have a second vote in July. Meanwhile, the scheme continues to be oversupplied by an estimated 2 billion allowances. Allowance prices are at a record low and raised concerns over the effectiveness of the scheme in reducing emissions and de-carbonising European industry.

The EU-ETS is ailing, and so far EU politicians have not come to its rescue. Already over-allocated in some sector, the EU-ETS has become severely oversupplied after the economic down turn which has led to a decrease in production and with it a decrease in GHG emissions. The current oversupply is estimated to be about 2 billion allowances. In 2008, EU allowances were traded at around 30 euros. Currently the price is between 3 and 4 euros.

The back-loading proposal initiated by the European Commission in July 2012 suggested delaying the auctioning of around 900 million EU allowances in order to prop up depressed prices and breathe air into the ailing EU-ETS. The held back allowances may have been reintroduced into the market at a later point. But the proposal was voted down in April 2013, raising even more doubts whether health can be injected in the EU ETS.

Energy intensive industries lobbied hard to have back-loading rejected. Many conservative EU Parliamentarians voted against "back-loading" following the neoliberal belief[4] that policy interference contradicts the logic of a free market system. They argued that once the EU's economy will be back on a growth trajectory, the allowance price will respond to that and increase.

After the rejection, nine EU Member States including France, UK and Germany succeeded in having a vote rescheduled for June in the European Parliament's Environment Committee. The full plenary assembly of the European Parliament is expected to vote again in July. But it is unclear if another vote on the pro-

4 Neoliberalism is a political philosophy whose advocates support economic liberalization, free trade and open markets, privatization, deregulation, and decreasing the size of the public sector while increasing the role of the private sector in modern society.

posal this summer will result in a different outcome. These nine Member States also urged the Commission to deliver a proposal for long term structural reforms to the EU ETS by end of 2013 at the latest.

The argument that regulating and adjusting the EU-ETS would somehow disturb the natural developments of an unregulated "free" market is a fallacy. The EU-ETS is market that was created purely by government policies with the aim to put a price on GHG emissions. All good policy making requires adjustments to ensure that the policy's operationalization fulfill the intended policy goals.

Back-loading is a first step into a deeper EU ETS reform that must deal with the overall stability and effectiveness of the scheme. It is estimated that back-loading could bring prices back up to at around 8 euros. Without deep structural reforms, the back-loading proposal will do little to improve the scheme long term. On the other hand if back-loading is rejected, it is difficult to see how deeper structural reforms intended to further stabilize the market will find political support.

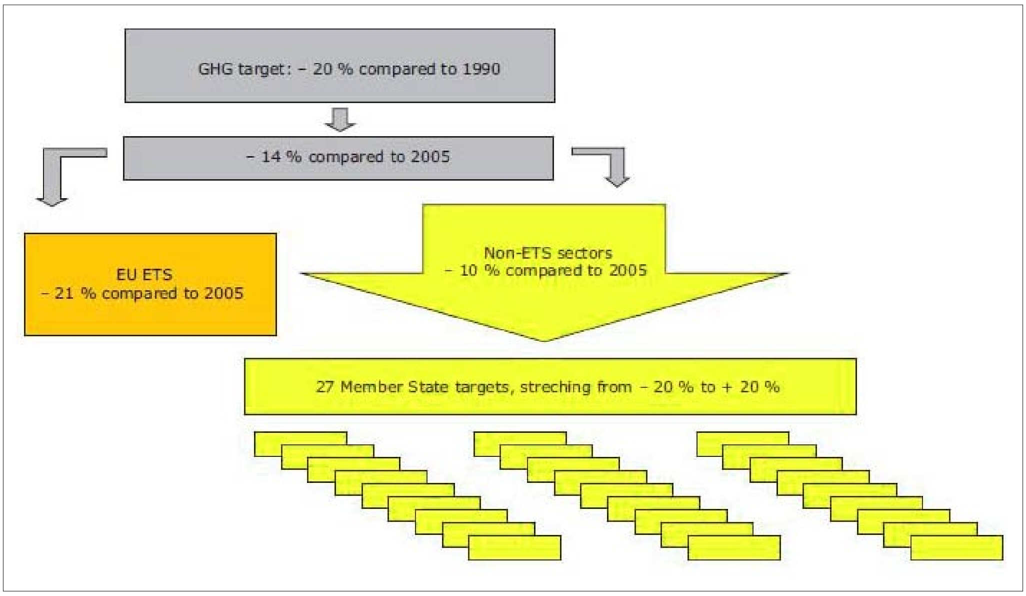
The EU's Effort Sharing Decision

Joint article by **Carbon Market Watch and** ClientEarth

The EU's Effort Sharing Decision (ESD) covers all sectors not included in the EU-ETS, except international shipping, aviation and LULUCF. These ESD sectors are responsible for 60% of the EU's greenhouse gas emissions, yet current reduction goals in the ESD are very weak and can be met mostly through the use of offsets. Clearly the ESD needs to be scrutinized and strengthened, if the EU wants to do its fair share to stay below 2 degrees warming. Together with a group of NGOs, Carbon Market Watch and ClientEarth will be taking a closer look at the ESD over the coming year.

The EU's 20% greenhouse gas (GHG) reduction target[5] for 2020 is implemented through the EU's Emission Trading Scheme (EU-ETS) and the Effort Sharing Decision (ESD). Under the ESD, EU Member States have taken on binding annual targets for reducing their GHG emissions from the sectors not covered by the EU ETS, such as housing, agriculture, waste and transport (excluding aviation). These sectors account for almost 60% of the EU's total emissions. The graph 1 illustrates the break down between the two policies.

Graph 1: EU Policies for 20% GHG reduction target



Source: EEA Report No 6/2012[6]

How the ESD works

The overall EU target under the ESD is a 10% emission reduction in 2020 compared to 2005 levels. Each Member State has an individual ESD target determined according to its economic capacity. Member States receive an annual allocation of Effort Sharing allowances as a mechanism to ensure annual compliance and steer a downwards trajectory to 2020. Targets range from a 20 % reduction for the richest Member States to a 20 % increase for poorer ones in 2020 compared with 2005 levels. Less wealthy countries are allowed emission increases in these sectors to account for their higher economic growth which is likely to be accompanied by higher emissions. Graph 2 shows the ESD reduction targets for all 27 EU member states.

These targets are currently too weak – a combination of low ambition further compounded by the economic crisis. To illustrate this low ambition, we are projected to overachieve the -10% Effort Sharing reduction target by an additional 8% by 2020 at EU

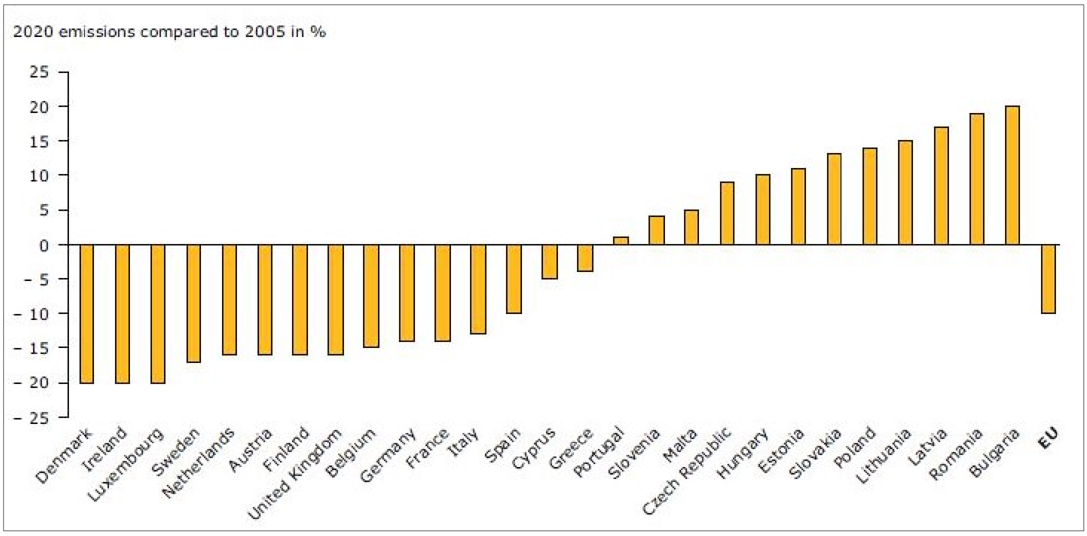
5 below 1990 emission levels

6 Greenhouse gas emission trends and projections in Europe 2012. Tracking progress towards Kyoto and 2020 targets. EEA Report No 6/2012. ISSN 1725-9177

level The emission reduction potential in the ESD sectors is much higher than the current 10% reduction targets. Studies demonstrate significant cost-effective additional reductions could be achieved by 2020.[7]

Graph: Effort Sharing Targets for 2020 relative to 2005 emissions levels

Source: EEA Report No 6/2012[7]



Offsets in the ESD

Similarly to the EU-ETS, the ESD 2020 targets can be partially met with CDM and JI credits. The use of offset credits is so generous and ESD targets so weak that overall, EU Member States are projected to accumulate a significant oversupply of ESD allowances and international offsets.

The use of international credits in the ESD is limited to 3% of each Member State's allowances in 2005. Although this number sounds low, it means that two thirds of the overall emission reductions required by 2020 under the ESD can be met through the use of international credits. Up to 750 Mt JI/CDM credits could be used during the period from 2013 to 2020.

Furthermore, the ESD allows an EU Member State to transfer part of its unused international credits entitlement to another Member State. In other words, the buyer country can use these entitlements to purchase further international credits above the 3% limit.

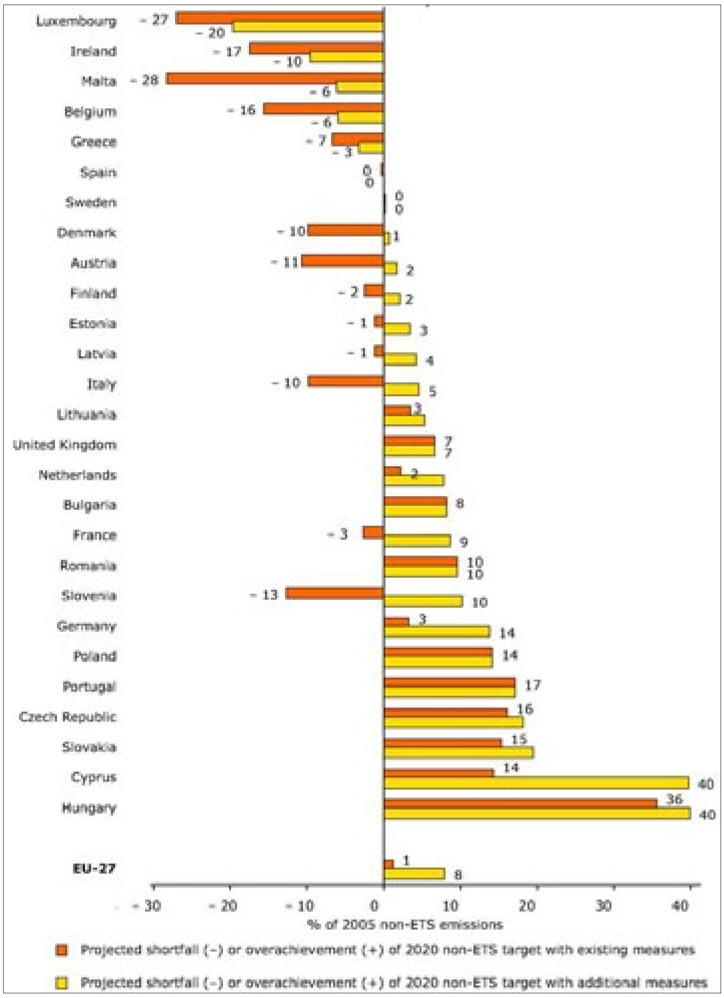
The ESD also allows Member States to carry over surplus allowances in a given year to subsequent years. Member States can also sell their allowances to other Member States during 2013-2019.

Combined with the low ESD targets for most Member States, these offset and carry over rules mean that little or no additional domestic action will have to be taken by EU Member States to meet their ESD 2020 goals. Graph 3 on the next page illustrates that only six countries are projected to have a shortfall of credits. Most of these are small countries: Luxemburg, Ireland, Malta, Belgium, Greece and Spain.

Quality of offsets

As in the EU-ETS, the quality of offset credits is particularly important, since offsets that do not represent real and additional emissions reductions further undermine the already weak targets. However, while the EU-ETS is governed at the European level, the decision on what types of offsets are allowed in the ESD is taken at Member State level. International credits from industrial gas projects that destroy HFC-23 and N2O (from adipic acid projects) are prohibited in the EU ETS from May 2013. Yet, only 18 Member States have declared that they will not use such credits towards their ESD targets. Concerns about quality do not only relate to credits from industrial gas projects but to all credits from non-additional projects such as for example coal power projects.

7 Next Phase of the European Climate Change Programme : Analysis of Member States actions to implement the Effort Sharing Decision and options for further community-wide measures (contract DG ENV C.5/SER/2009/0037)
Behavioural Climate Change Mitigation Options and Their Appropriate Inclusion in Quantitative Longer Term Policy Scenarios (DG Climate Action contract 070307/2010/576075/SER/A4)
Potentials and costs for mitigation of non-CO2 greenhouse gas emissions in the European Union unitl 2030, Results (DG Climate Action contract 07.030700/2009/545854/SER/C5)



Graph 3: Projected overachievement and shortfalls in ESD sectors
Source: EEA, 2012

The ESD 2020 and beyond

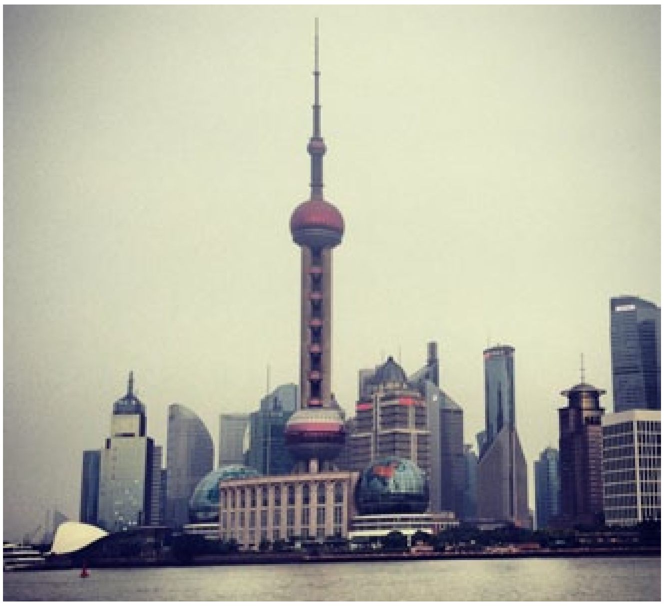
A legal framework will be needed post 2020 if we are to have economy wide, binding EU targets. However, the future of the ESD beyond 2020 is still unclear. In its current form the ESD enshrines low ambition and does not do enough to drive investment. However, if it were improved, it could be a powerful driver of emissions reductions and also help decrease Member States' strong reliance on costly energy imports. After all, 25 out of 27 Member States are net energy importers. Measures to reduce non-ETS emissions also come with clear benefits for citizens - energy efficiency in building retrofits help shield consumers from rising energy bills, and cleaner transport will reduce illness and premature deaths associated with air pollution. Measures in the ESD sectors also have the potential to create 350,000 to 450,000 net additional jobs in the EU by 2030.[8]

8 http://www.europeanclimate.org/index.php/en/news/111-an-economic-assessment-of-low-carbon-vehicles

But these and other benefits will only be realized if we have a strong, economy wide regulatory framework for climate change beyond 2020. As the instrument that gives effect to economy wide GHG targets and determines the 'equitable' target split between EU states, the Effort-Sharing Decision holds the key to a political agreement on a climate and energy framework for 2030. It will need to continue beyond 2020 to ensure that Member States have some flexibility in their choice of national mitigation policies mix, while taking into account differing national circumstances and capacity. It will require reform to in order to become a tool to drive investment in a wide range of sectors, and unlock the climate benefits that are currently being neglected in the shadow of the ETS.

China's Pilot Emissions Trading Systems

Carbon Market Watch is currently in China to follow developments around the expected launch of 7 regional pilot emissions trading systems. We give a first overview about the state of play of the 7 pilots.



Shanghai, Courtesy Diego Martinez

China's emissions have more than doubled over the last decade. It now contributes about 30% of global greenhouse (GHG) gases and has per capita CO2 emissions that are almost as high as the ones in the European Union[9].

9 http://ec.europa.eu/dgs/jrc/index.cfm?id=1410&dt_code=NWS&obj_id=15150&ori=RSS

China is taking climate actions on many levels. It has made a voluntary pledge under the UNFCCC to lower CO2 per unit of GDP by 40-45% in 2020 compared to 2005 levels. It further committed to increase the share of non-fossil fuels in primary energy consumption to around 15% by 2020 and to increase forest coverage by 40 million hectares and forest stock volume by 1.3 billion cubic meters by 2020 from 2005 levels.

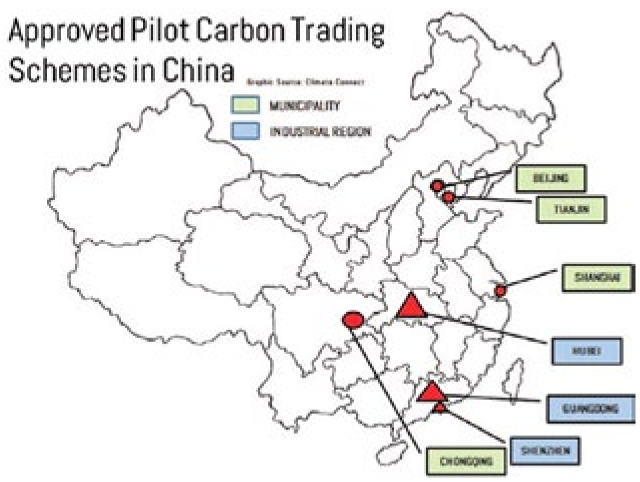
Towards a national Emissions Trading Scheme

China's 12th Five Year Plan (2011-2015) lays out plans to "gradually develop a carbon trading market". Recently, some sources[10] have indicated that the National Development and Reform Commission (NDRC), which manages the implementation of climate policy in China, may propose an absolute emissions cap for China for the next Five Year Plan from 2016 - 2020.

China's 12th Five Year Plan lays out plans to "gradually develop a carbon trading market". China is currently implementing seven pilot emissions trading systems (ETS) which are expected to serve as testing ground for a national ETS to be implemented after 2016. The seven ETS could eventually regulate between 0.8 -1 billion tonnes of CO2. If those trading schemes were to be linked they could becoming the second largest cap-and-trade programme aside from the EU-ETS (which is about twice as big).

China has announced it will allow for policy interventions, such as price control mechanisms to ensure stable market conditions and to potentially avoid some of the difficulties that have marred the EU-ETS.

China's Pilot Schemes



Source: SEI, 2012

10 http://www.21cbh.com/HTML/2013-5-20/3NNDE3XzY4ODM3Nw.html

In October 2011, the NDRC designated 4 municipalities (Beijing, Chongqing, Shanghai and Tianjin), 2 provinces (Guangdong and Hubei) and the special economic zone of Shenzhen City as regions for ETS pilots. All except two have already adopted their implementation plans and are expected to start their ETS in the course of 2013. The emission caps for these scemes are not yet known.

Shenzhen and Shanghai will launch operations in June 2013. Given that both cities have few heavy industries, their ETS will also cover medium and small emitters commercial sectors such as airports, hotels and financial service providers. Shanghai's ETS will also include its domestic aviation sector in its ETS.[11]

The table on the next page summarizes some of the features of the seven ETS pilots.

Chinese domestic offsets (CCERs)

All ETS pilots are expected to allow the use of Chinese Certified Emissions Reductions (CCERs) offsets. These offsets will be issued under a voluntary, government-administered Chinese offset program that is based on the CDM. The table above outlines likely provisions of CCERs in all seven ETS pilots. Demand for CCERs could be as high as 100 million per year by 2015.

The CCER program is currently being developed. China is the largest CDM host country in the world with more than 3600 projects registered and more than 800 million CDM offsets issued to date.[12] CCER program rules will likely be similar to those of the CDM. The NDRC is expected to act as the ruling body, similar to the CDM Executive Board. The methodologies will be based on CDM methodologies and possibly include some simplifications.[13]

It is too early to comment the ETS pilots or the CCER programme. It is for example unclear how China will address potential double counting issues. These could be partially avoided by focusing on non-CO2 projects in sectors that are not covered by any ETS. The CCER programme so far does not seem to limit project types to those that have more certain environmental integrity, such as for example coal-power projects. Carbon Market Watch will continue to observe the Chinese efforts to establish market-based mechanisms.

11 ICAP MAP http://icapcarbonaction.com/index.php?option=com_wrapper&view=wrapper&Itemid=147

12 http://www.cdmpipeline.org

13 http://cdm.ccchina.gov.cn/nDetail.aspx?newsId=39507&TId=20

Table 1: Summary of features of Chinese ETS pilots (2013-2015)[14]

	Municipalities				**Special economic zone**	**Provinces**	
Region	**Beijing**	**Chongqing**	**Shanghai**	**Tianjin**	**Shenzhen**	**Guangdong**	**Hubei**
Emissions covered	50%	n.a.	50%	60%	40%	42-50%	35%
Adopted implementation plans	yes	no	yes	yes	yes	yes	no
Planned launch	Second half of 2013	Late 2013	June/July 2013	Second half of 2013	18 June 2013	September 2013	August 2013
Companies trading emissions	420-600	n.a.	197	120	635	830	n.a.
Limitation on use of offsets of compliance obligation	10%	5-10%	10%	10%	n.a.	10%	10-15% (unofficial)
likely types of offset credits	CCERs	CCERs with possible inclusion of forestry credits	CCERs with possible limitation on types and origin	CCERs	CCERs from western China	CCERs and Guangdong forestry CERs	CCERs and Hubei CERs incl. forestry

14 Offset information taken from Presentation by Duan Maosheng from Tsinghua University, China / CDM Executive Board at the ETS Conference in Berlin 11 April 2013

CARBON MARKET WATCH

Carbon Market Watch was launched in November 2012 to expand the work of CDM Watch to areas beyond the CDM. Carbon Market Watch provides an independent perspective on carbon market developments and advocates for stronger environmental and social integrity. Carbon Market Watch is based in Brussels, Belgium.

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CARBON MARKET WATCH NETWORK

The **Carbon Market Watch Network** (formerly the CDM Watch Network) connects NGOs and academics from the global North and South to share information and concerns about CDM projects and policies. Its purpose is to strengthen the voice of civil society in the CDM and carbon market developments. Carbon Market Watch Network!

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