Opportunities and challenges created for JI and CDM by the EU ETS Directive

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Thomas Bernheim

Market-based instruments including EU ETS

European Commission

The ETS Directive as amended by the linking Directive

Aim

- The linking directive gives the opportunity to companies participating in the EU ETS to **use emission credits** generated through project activities eligible pursuant to Articles 6 (JI) and 12 (CDM) of the Kyoto Protocol **in order to fulfill their emission reduction obligations**.

- *"Member States* **MAY allow operators to use CERs and ERUs from project activities** *in the Community scheme up to a percentage of the allocation of allowances to each installation, to be specified by each Member State in its national allocation plan for that period"*.

Motivation for use of JI/CDM

Domestic

- **Increases cost-effective** by increasing market liquidity and diversity in marginal abatement costs
- **Reduces the market price** for carbon allowances in the EU ETS
- **Expands EU ETS market** by involving sectors and countries not covered by EU ETS in reduction efforts

External

- **Enhances the international climate process** by strengthening ties between parties and generating a global carbon price that stimulates investment in cleaner technologies
- **Enhances technology transfer** and sustainable development in hosting countries

Impact EU ETS on JI/CDM

- **EU ETS is a main driver for the global carbon market**
  - Currently involving 174 countries
  - Representing 91.7% of global population
  - Transactions valued at €22 billion in 2006 (with CDM €3.8 billion)
  - EU Member States investing upwards of €2.7 billion in JI/CDM
  - EU ETS generates potential demand of more than 1 billion ERU/CER (excl. government purchase)
- **EU ETS generates demand for JI/CDM that is**
  - **large (with tight NAP decisions)**
  - **quantifiable (with set JI/CDM usage limits)**
  - **long term (with the 20% target for 2020)**

Impact JI/CDM on EU ETS

- **Implies recognition of JI/CDM credits as equivalent to EUAs**
- **Need to safeguard environmental integrity of the EU ETS**

- Stimulate **global reductions** but ensure **sufficient domestic action** and co-benefits, and a carbon price stimulating technology innovations within the EU
  - *Quantitative safeguards: ensure **supplementarity to domestic action***
- Reduce **compliance costs** but **safeguard environmental integrity** of the EU ETS
  - *Quantitative/qualitative safeguards: **avoid double counting***
  - *Qualitative safeguards: ensure **strict application of additionallity rules***
  - *Qualitative safeguards: **prohibit nuclear, temporary credits and MS agree** only to approve **large hydroelectric projects** that observe criteria and guidelines of World Commission on Dams*

Double counting

Provisions for avoiding double counting

(1) Baselines for project activities should comply with *acquis communautaire*

(2) No ERUs or CER are allowed to be issued for reductions or limitations of GHG that take place in installations under EU ETS or impact emissions in these installations indirectly unless a **set-asides** is created in the NAP for all approved or planned JI/CDM projects taking place in ETS installations

Supplementarity

- Marrakech agreement: use of JI/CDM must be *supplemental* to domestic actions
- Linking directive: MS may allow operators to use JI/CDM credits up to a percentage of the allocation to each installation.
- Max limit on use of JI/CDM is based on the **level of effort a MS has to undertake to achieve its Kyoto target**:
  - A = distance Kyoto target - base year emissions
  - B = distance Kyoto target - greenhouse gas emissions in 2004
  - C = distance Kyoto target - projected emissions in 2010
- Limit (D) = (max A, B, C) / 2
- Annual average government purchase of Kyoto units are deducted
- Maximum allowed limit (in %) = (D / annual average cap) or 10 %

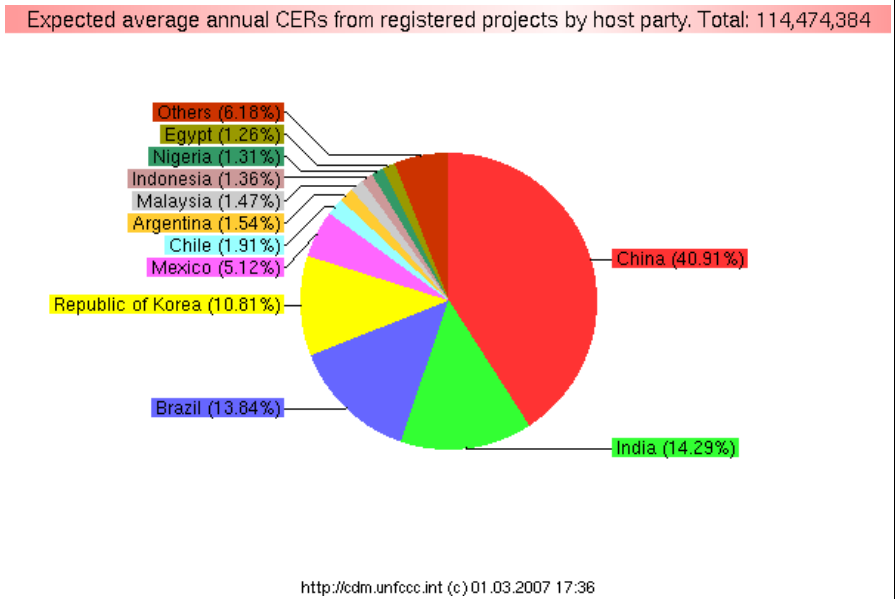
CDM current situation

	Annual Average CERs	Expected CERs until end of 2012
CDM project pipeline: > 1600 of which:	N/A	> 1,900,000,000
696 are registered	150,475,129	> 950,000,000
74 are requesting registration	9,181,902	> 50,000,000

Source: UNFCCC

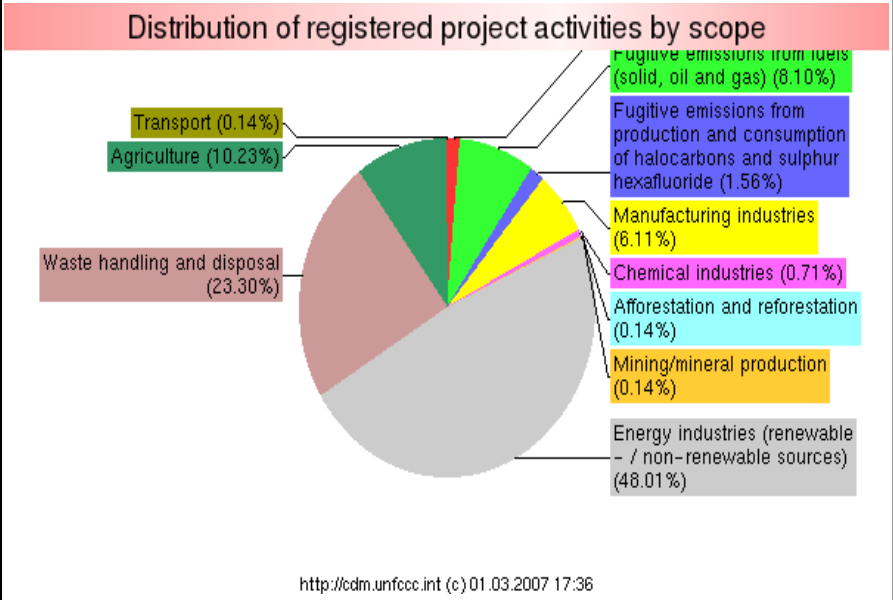
Characteristics of CDM market

Geographically skewed market



- 80% of CERs from 4 countries
  - 40% in China, 14 % in India , 13.54% in Brazil and 10% in Korea
- Very few in (sub Saharan) Africa

Sectorally skewed market



- 50% of all CDM projects relate to renewable energy
- 15 fluorinated greenhouse gas projects (8 in China, 4 in India, 1 in Mexico) account for one-third of expected emission reductions

Conclusions

New opportunities

- Before EU ETS there was limited demand for JI/CDM
- Now, with clear long-term policies on behalf of EU and Member States, more projects can be done, also after 2012
- Extending CDM may increase opportunities for cost-effective reductions
- CERs are cement for linking ETS to other systems

New challenges (questions for the debate)

- JI, CDM and other offsets will continue to play a role in revised EU ETS but **in what form is still unknown** (what happens in absence of global deal?)
- Use of extended (sectoral & policy) CDM will involve solving **governance**, **transition** (double counting) and **additionallity** issues
- Quantities and qualities of offsets used in the EU ETS may impact **internal price** but also the **sustainable development impacts** and the **opportunities for linking** to other ETS

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More info on EU climate policy: http://europa.eu.int/comm/environment/climat/home_en.htm

Background literature on EU ETS: http://www.claeys-casteels.com