European Climate Change Programme – WG Ships

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Background document:

Access to Reductions in Other Sectors – International Credits

The EU was first in recognising that efforts made outside its borders can stimulate private sector action. Market based mechanisms have the advantage of meeting emission reduction obligations at lower cost, as well as promoting the transfer of low-carbon technologies to developing countries. They also have the potential to raise significant climate finance towards mitigation and adaptation.

Under the Kyoto Protocol, industrialised countries can achieve part of their emission reduction commitments by using units acquired through its flexibility mechanisms. The Kyoto Protocol includes three flexibility mechanisms: International Emissions Trading; Joint Implementation (JI); and, the Clean Development Mechanism (CDM). Through the latter two mechanisms, Parties can achieve reductions by investing specifically in emission-saving projects in third countries. Hence, these two mechanisms are often referred to as the "project-based" mechanisms. Joint Implementation projects are undertaken in Annex I countries whereas CDM projects are undertaken in non-Annex I countries.

Largely thanks to demand from the EU ETS and from EU Member State Governments, the CDM has been a very successful mechanism with an estimated value of several billion dollars. Well over 2,000 projects have now been registered and several thousands more are in the pipeline waiting for registration. The CDM has helped reduce compliance costs for Annex I Parties, it has facilitated technology transfer to developing countries and has extended the carbon price signal far beyond the EU. CDM projects have contributed to enhancing the cost-effectiveness of mitigation actions in general and have been successful in engaging the private sector in project activities in developing countries.

As the largest purchaser of Kyoto credits in the world, to safeguard the integrity of its ETS, the EU has provided leadership in the UNFCCC process to reform the CDM in order to improve its environmental integrity, effectiveness, efficiency, regional distribution and contribution to sustainable development. The EU consistently seeks to improve the governance structures of the CDM Executive Board and has been a major advocate for the increased use of standardised approaches for a more objective and transparent baseline determination and assessment of additionality.

The EU has also used the provisions of the current EU ETS legislation to promote the reform of the CDM. It should be noted that in 2011 the EU Member States adopted certain restrictions on the use of credits from industrial gas projects. Further, the European Union legislation stipulates that in the absence of an international agreement, only credits from new projects in Least Developed Countries, and credits from existing projects in other countries can be used in the EU ETS. The EU legislation has provisions that enable bilateral or multilateral agreements between the EU and third countries which could provide credits from projects or other emission reducing activities.

Although the project based mechanisms have generally been a success, it should be noted that under the Kyoto Protocol their use is limited by the principle of supplementary. That is, the Kyoto Protocol requires that the majority of the mitigation action is not exported. In this way, the use of credits should not be unlimited. The EU legislation makes this principle concrete in that no more than 50% of absolute reductions below 2005 emission levels can be achieved through the use of international credits.

There is also an inherent design problem with the current project based mechanisms. Both JI and the CDM are pure offsetting mechanisms, where a tonne of greenhouse gas emissions reduced in a third country creates a right to emit a tonne of greenhouse gas at home i.e. not net reduction in emissions. The continuation of this system alone would make it impossible to scale up at the level necessary to stay within the 2 degrees Celsius objective encompassed in the 2010 UNFCCC Cancun Agreements.

The Clean Development Mechanism (CDM) will continue post-2012, but the European Union is calling for its reform to improve its environmental integrity, effectiveness, efficiency, and governance. The CDM is unevenly distributed across countries and the European Union believes that over time it should increasingly focus on least developed countries and providing financing for clean technology.

With all of these considerations in mind, the efficiencies created by out of sector reductions are undeniable. However, we should keep in mind that all credits are not equal. For instance, EU ETS allowances represent a legislative entitlement to emit greenhouse gases under the EU ETS. Further, CERs and ERUs, provided their environmental integrity is ensured, represent legislatively approved and verified reductions in greenhouse gas emissions. Contrary to EU allowances or other credits issued under EU legislation, and credits issued under the Kyoto Protocol, verified emission reductions (VERs) cannot guarantee legislatively approved regulatory standards including for additionality and robust baselines. These credits lack the credibility and reliability accruing from legislative approval that EU allowances and Kyoto Protocol credits have to undergo. For this reason, risks in terms of misuse, double counting and even fraud related to VERs are considerably higher compared to systems that are based on legislatively approved regulatory standards, international or EU laws and subject to the respective reporting, monitoring and verification rules.

Disclaimer

The purpose of this background paper is to indicate possible areas for discussion and assist participants with their preparation. This document should not be seen in any way to limit the scope of discussion or to exclude any relevant aspect. ECCP participants are requested to raise and address all relevant aspects. This document is not intended to indicate any preferences or views of the Commission.