

## EC Consultation on structural options to strengthen the EU Emissions Trading System

28 February 2013

Carbon Market Watch, a project by Nature Code, welcomes the opportunity to provide its views to the European Commission on the Consultation on structural options for the EU Emissions Trading System. While supporting the submission of the Climate Action Network Europe (CAN Europe), we would like to take the opportunity to provide more detailed comments on **Option e: Limit access to International credits** and recommend:

- 1. Eliminating access to international credits post-2020**
- 2. Implementing use restrictions for non-additional international credits pre-2020**

The EU's Emission Trading Scheme is the pillar of EU climate policy and the largest market for emission permits in the world. Currently, the EU ETS suffers from record low allowance prices, a massive oversupply and very low demand. The back-loading proposal is a first step towards tackling the demand supply imbalance. However, fundamental structural reform is needed to stabilize the EU ETS in the long run and to avoid undermining overall EU climate policy goals with an ineffective emissions trading scheme. This structural reform must include a full ban on offsets post-2020 as well as the implementation of use restrictions as soon as possible to increase the environmental integrity of credits used in the EU ETS. Allowing additional offsets post-2020 would directly undermine the structural measure of retiring a certain number of Phase III allowances permanently. These recommendations together with other structural measures outlined in the submission of CAN Europe would help to create the necessary scarcity in Phase IV. For details on these two recommendations, please see below.



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### Recommendation 1: Eliminating access to international credits in the post-2020 scenario

The use of Kyoto offset credits in the EU ETS was originally meant to be a cost containment tool to allow ETS operators to choose the most cost effective manner for greenhouse gas (GHG) abatement at company level. However, exceptional macro-economic developments and the fact that emissions have been substantially lower than the cap rendered the quantity limit of international credits in the period 2008 to 2020 too generous. This in turn has been a major driver for the build-up of the surplus. According to the recent European Commission report “The state of the European carbon market”, the use of international offsets in the EU ETS has almost doubled the oversupply in the period 2008-2011 and is estimated to amount to three quarters of the oversupply by 2020. Such oversupply undermines the EU ETS market and stifles mitigation action in Europe. Carbon Market Watch recommends eliminating access to international credits in the post-2020 scenario for the following reasons:

- 1. To encourage more ambitious domestic cuts towards decarbonizing Europe;**
- 2. To depart from offsetting as a zero sum game in order to stay below 2 degrees warming;**
- 3. To address the inherent quality concerns with Kyoto mechanisms that have remain unaddressed.**

- 1) Eliminating access to international credits would create more certainty on efforts that drive domestic abatement and can spur investment in low carbon technologies in EU industry. Currently, the very low EUA price<sup>1</sup> does not facilitate a low carbon path for European industry. In the long term, it is necessary to eliminate the use of international credits to encourage more ambitious domestic cuts, trigger more investment in low carbon technologies and enable EU industry to reach its de-carbonising goal of 80%-95% by 2050.
- 2) Since offsetting is a zero sum game, it cannot deliver the large long-term emission cuts required to stay below 2 degrees warming. Offsetting mechanisms such as the CDM and JI can therefore only serve as short to medium-term mitigation policy tools. In addition, a post-2020 climate treaty will also include commitments from developing countries. The risk of double counting of emission reductions that are sold as offsets is technically and politically difficult when both the host and buyer countries have reduction targets. Double counting is best avoided through financing and support measures (with strong MRV rules) that help poorer nations to develop on a low emission pathway without compromising the mitigation commitments of more developed nations.

<sup>1</sup> EUA Primary Market Auction, 4.29 Price €/tCO<sub>2</sub> as of 26/02/2013, European Energy Exchange  
<https://www.eex.com/en/Download/Market-Data/EU%20Emission%20Allowances%20-%20EEX>



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- 3) There have been serious quality concerns over the environmental integrity of certain project types in the Clean Development Mechanism (CDM) and Joint Implementation (JI). These issues primarily refer to the additionality of projects and are thoroughly discussed below. Since offsetting is a zero sum game (it does not lead to emission reductions per se, it only allows for the geographical displacement of emissions from one source while cutting emissions from another one) additionality is at the core of ensuring that offsetting does not lead to net global increases in emission levels. Non-additional credits also undermine the economic effectiveness of the CDM by artificially increasing supply with credits that do not represent actual emission reductions. Prices for CDM credits have already dropped precipitously and will likely remain very low if the projected oversupply is not addressed. Such low prices further exacerbate non-additionality problems because they inhibit truly additional projects.

Finally, allowing additional offsets post 2020 would directly undermine the structural measure of retiring a certain number of Phase III allowances permanently. In order to create the necessary scarcity in Phase IV, external international credits must be avoided.

### **Recommendation 2: Restricting non-additional international credits pre-2020**

The use of Kyoto offset credits undermines climate goals if they are from non-additional projects. Carbon Market Watch therefore strongly recommends restricting non-additional international credits in a pre-2020 scenario. Research<sup>2</sup> recently released under the CDM Policy Dialogue highlights that in the CDM important project types such as large-scale power supply and methane projects are unlikely to be additional. If such projects remain eligible in the CDM and the resulting credits are used for compliance, they could increase cumulative global GHG emissions by up to 3.6 Giga tonnes CO<sub>2</sub>e through 2020.

A Stockholm Environment Institute policy brief<sup>3</sup> finds that significant additionality concerns are related to large-scale (over 15 MW) hydropower and wind projects, natural gas and higher-efficiency coal as well as projects that generate electricity from waste gases in the iron and steel sector. Power projects currently amount to a quarter of all issued CERs. However, the projected source of CERs through 2020 shows that these projects will represent 70% of all issued CERs between 2013 and 2020. Of these, 90% represent large-scale power projects.

<sup>2</sup> Assessing the Impact of the CDM. Report Commissioned By The High-Level Panel On The CDM Policy Dialogue, July 2012  
[http://www.cdmpolicydialogue.org/research/1030\\_impact.pdf](http://www.cdmpolicydialogue.org/research/1030_impact.pdf)

<sup>3</sup> Transitioning Away from Large-Scale Power Projects: A simple and Effective Fix for the CDM?, Stockholm Environment Institute  
<http://www.sei-international.org/mediamanager/documents/Publications/Climate/sei-pb-2012-cdm-large-power-projects.pdf>



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Although the CDM Executive Board has the power to address these quality concerns, experience has shown that there is a lack of political will to address environmental integrity in a substantive way. Insufficient action at the supply level forces decisions on the buyer side to ensure the environmental integrity of the offsets used for compliance.

Quality concerns of offset credits also relate to social impact of offsetting projects. Two registered CDM projects, the Aguán Biogas Project in Honduras and the Barro Blanco Hydropower Project in Panama have been under public scrutiny because of allegations of human rights abuses on local communities. Yet, the CDM Executive Board has stated that it has no mandate to investigate human rights abuses. In response, a study by the European Parliament's Subcommittee on Human Rights<sup>4</sup> advises that the EU, as the major purchaser of CDM credits, should take these requirements into account to ban JI/CDM credits generated by projects that violate human rights from the EU ETS.

The threat of over-supply of international offsets pre-2020 combined with the serious quality concerns highlight the urgent need to change rules of allowing international credits pre-2020 into the EU. Lessons from the EU ETS with regards to offsetting have already been addressed by emerging emission trading schemes around the world. Switzerland is considering restricting the use of offset credits from large hydro projects and South Korea has completely banned the use of international offsets up to 2020.

Current prices at a record low provide a unique political window to implement offset restrictions. The use restrictions would increase the environmental integrity of credits used in the EU ETS. Moreover, regulation is needed to help market participants in their choice for carbon credits that uphold environmental and social integrity.

Putting in place use restrictions of international credits from non-additional projects and project types according to Article 11a (9) is a vital step to avoid that the EU ETS be undermined by substandard carbon credits that do not reduce emissions and increase global emissions if used in the EU ETS.

### Contact:

Eva Filzmoser - Director, Carbon Market Watch  
Tel: +32 2 335 3661 / Mob: +32 499 21 20 81  
Email: [eva.filzmoser@carbonmarketwatch.org](mailto:eva.filzmoser@carbonmarketwatch.org)

<sup>4</sup> Human Rights and Climate Change: EU Policy Options, Directorate General for External Policies, study requested by the European Parliament's Subcommittee on Human Rights  
<http://www.europarl.europa.eu/committees/fr/studiesdownload.html?languageDocument=EN&file=76255>

