Linking to action in developing countries

European Carbon Investors and Services

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Linking is key, but complex

- The linking provisions of the EU ETS constitute real money, guaranteed, for developing countries
- Consequently, the linking provisions of the ETS Review are perhaps the EU's biggest bargaining chip going into the post-2012 negotiations
- The EU needs to seize this opportunity to signal the desired evolution of the carbon market
- The US will be hard pressed to convince emerging economies that equivalent sums will be available from ODA
- The EU needs to balance three competing needs:
  - The imminent power supply crunch in key countries means that carbon finance should be available to lock in clean energy infrastructure in the EU
  - Technology leapfrogging is equally urgent in large emerging economies, particularly China, and requires co-financing by the EU and other industrialised countries
  - Cost effectiveness is still a political and economic necessity, particularly for sectors exposed to international competition

Project based CDM still matters

- As in all policy-driven markets, the EU needs to maintain confidence by providing certainty for existing investments and maintain deal flow while negotiations are ongoing – i.e. don't pull the plug!
- The EU's unilateral target (and progress in the US) has generated post-2012 activity in the CER market
- However, 'continuity' is still an issue:
  - The Review needs to agree to continued fungibility after 2012 for projects initiated before 2012
  - CDM/JI market needs visibility on banking for CERs and ERUs under the ETS, not just EUAs (2.5% limit under Marrakech)
- CDM provides de facto linking between schemes
- Even as carbon finance evolves, lower income countries may not have the capacity to deliver sectoral approaches and will continue to use project based CDM

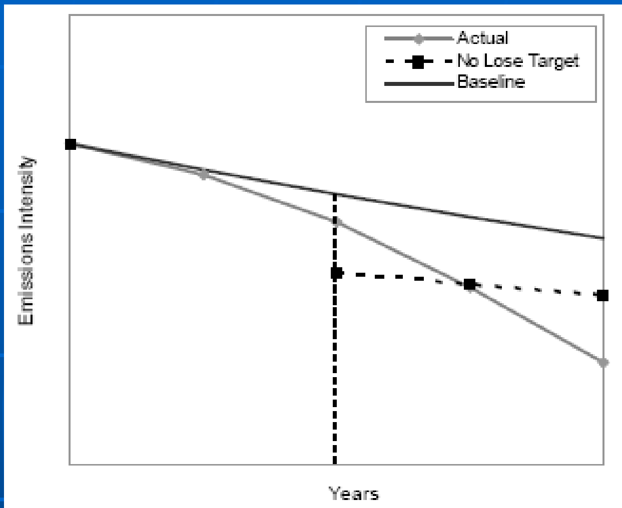
HFC-23

- These projects have provided exactly what the carbon market was designed to deliver: the lowest cost reductions
- However, there are questions regarding perverse incentives for ozone depleting substances from new HCFC-22 plant
- And, the high volumes of these credits are limiting opportunities for projects of higher sustainable development value and wider geographical distribution of the benefits of CDM
- Our position:
  - No eligibility for new plant (as defined by COP/MOP and CDM EB)
  - No fungibility with EUAs after the first crediting period for existing projects
  - Some mechanism (international or domestic, financial or regulatory) must be negotiated to ensure that incinerators are maintained

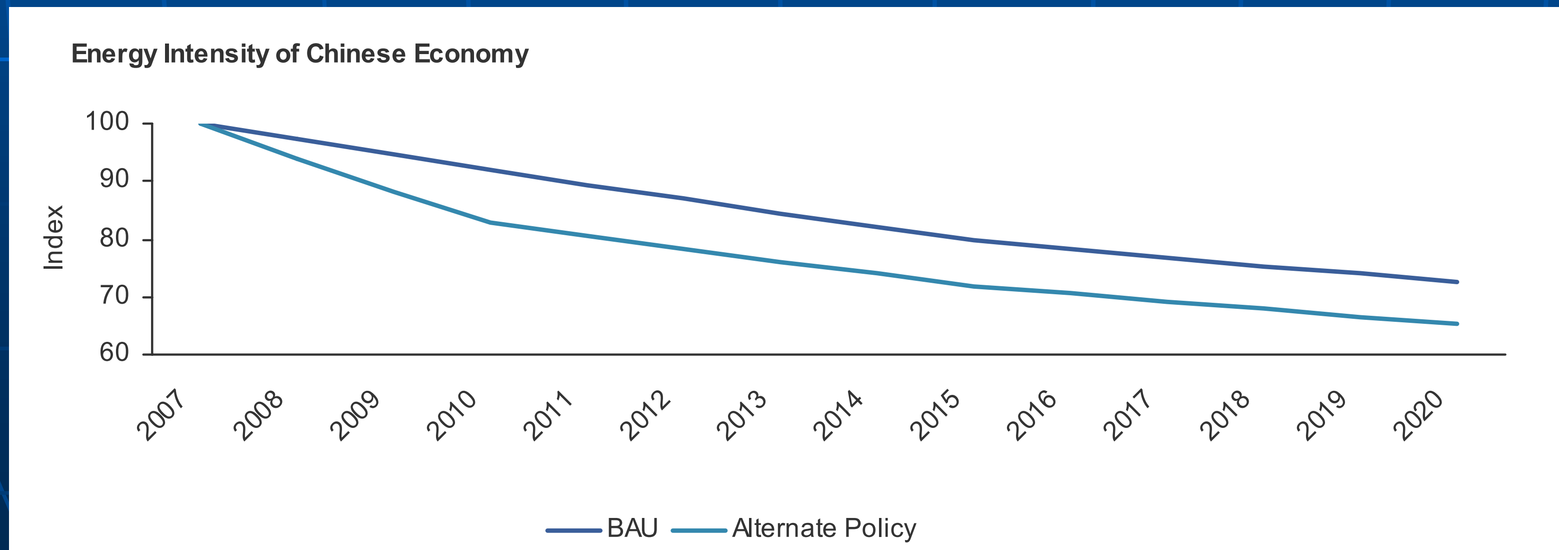
Post 2012 design principles

- CDM is a success story
- However, carbon finance will have to be bigger and bolder after 2012 and achieve the following:
  - Moving beyond 100% offset in order to achieve scale in emissions reductions by 2020
  - Supporting policy development in emerging economies to deliver co-benefits and move towards a level playing field
  - Incentivising energy efficiency
  - Reducing transactions costs for project developers
  - Overcoming the inherent challenges of a ‘baseline and credit’ approach i.e. how to guarantee additionality
  - Providing upfront capital for investment in low carbon infrastructure

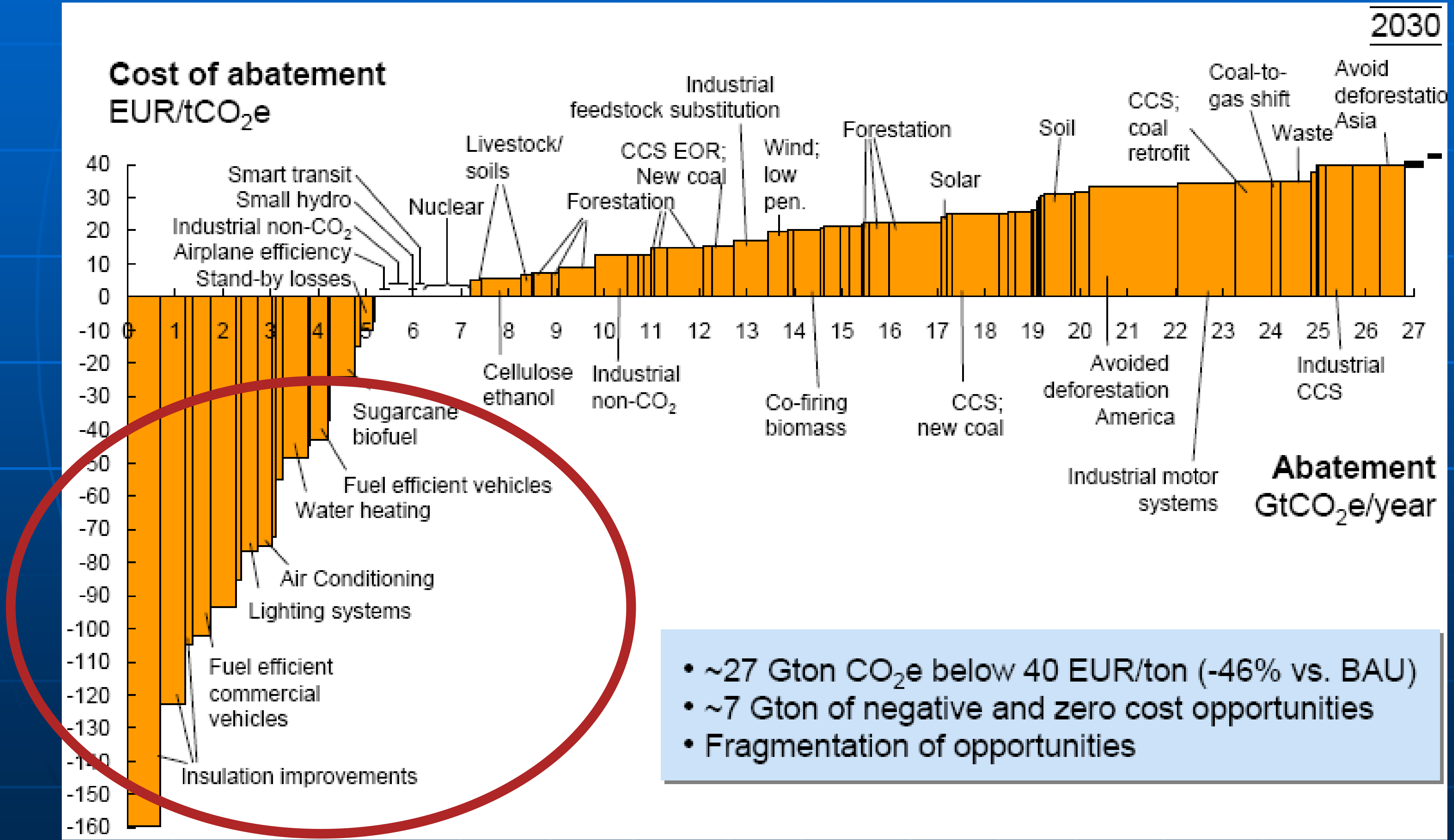
Moving beyond 100% offsetting



- Middle Income Countries need to be moving in this direction
- A number of countries have already indicated their interest in sectoral crediting and policy co-financing by their actions e.g. China and Mexico renewable energy policies
- We could signal, for example, that only this approach is acceptable from Middle Income Countries in sectors regulated by the ETS in the EU



Getting to energy efficiency



Some issues arise…

- The scale of financing available needs to overcome the loss of full financing (100% offsetting) on a project by project basis
- Data requirements are challenging and capacity constraints will also be significant (e.g. imagine modelling Chinese new entrants in the power sector)
- Additionality would become politically negotiated but need to maintain an element of third party verification
- A sectoral or policy based approach requires a more complex financial structure to deliver upfront financing e.g. use of sovereign guarantees
- We need to avoid the five-year process from agreement on targets to agreement on rules and the additional five-year implementation phase before projects really get going
- Clearly, pilot projects will be essential

Deciphering the 2020 targets

- The EU has agreed to a unilateral 20% reduction target ("at least") and a conditional 30% reduction target
- An international agreement should include sectoral crediting and policy co-financing, so this is what we should link to under the 30% scenario
- Abatement costs will have a smaller differential under this scenario but greater levels of linking will be:
  - required by the international deal, and
  - supported by the environmental integrity of the mechanisms
- What does this mean for supplementarity? Perhaps we will need mandatory participation, not optional participation up to a mandatory maximum
- If addressed sector-wide, deforestation could be tackled and it would not be low cost

Recommendations

- Provide continuity for existing projects
- Limit HFC-23 to projects' first crediting periods
- Use the ETS Review to signal how the carbon market must evolve to achieve climate change and development objectives
- Pilot new approaches, creating synergies with other types of financing
- Guarantee a significant amount of linking if international agreement is reached including new carbon finance mechanisms