



Help or hindrance? Reforming offsetting rules in European Climate policy

Report launch held at the European Parliament on Thursday 29th November 2012.

*This event was kindly hosted by Linda McAvan MEP (S&D),
Peter Liese MEP (EPP) & Bas Eickhout MEP (Greens/EFA)*

Event agenda:

- Introduction: **Linda McAvan MEP**
- Overview of Sandbag's report: **Baroness Worthington**
- Assessing the current quality of CDM/JI offsets: **Lambert Schneider**
- Future developments in offsetting: **Thomas Bernheim**
- Closing remarks: **Peter Liese MEP**
- Event ends

The event began with a brief introduction from **Ms Linda McAvan MEP**, who made reference to the frequency of debates being held in the shadow of the UNFCCC's 18th conference of the parties (COP) being held in Doha, Qatar. Beyond the diplomatic talks, businesses fear the current state of the EU emissions trading scheme (ETS) and it is interesting how many rely on the expectation of the carbon price. She explicitly warned that the carbon market in Europe faced a number of hurdles, and these will require an array of solutions if we are to continue tackling climate change.

Baroness Worthington, Director of Sandbag Climate Campaign

Baroness Worthington firstly set about introducing *Sandbag's* latest report on offsetting – Help or Hindrance? Offsetting in the EU ETS. The report, based on interlinked data from both the EU ETS and United Nations Framework Convention on Climate Change (UNFCCC), shows how offsets are being used in the EU ETS, detailing both the kind and origin of credits, as well as the countries and companies that are using them to meet their emissions reduction obligations.

To provide some context for the report, Baroness Worthington spoke of an approach to climate change in which many things were yet to be decided. The role of the carbon market continues to require shoring up, a problem the discussion in Doha intends to address with the possibility of a Kyoto Project '2'. However there is also a debate within the Europe itself about issues of vast oversupply and under-demand which plague the Emissions Trading Scheme (EU ETS). The problem of oversupply lies within the sudden reduction in emissions, largely as a result of the economic downturn. And now, as *Sandbag* recently discovered, according to 2011 data the EU has already achieved its 2020 target (currently 20.7%¹ below 1990 levels) with another 9 years to go. Some have argued the economy is still in recession and will bounce back, thus restoring previous expectations, however last year the economy *did* indeed return to growth and emissions continued to fall².

It is important to note that due to these rigid caps, we have a flood of offsets entering the ETS which are nigh on destroying the carbon price because there is no provision for choking off supply. The window for reform to the third phase is extremely tight and arguably beyond us, nevertheless this should not stifle calls for change to the Directive.

¹ <http://www.sandbag.org.uk/blog/2012/nov/1/two-more-nails-20-coffin/>

² EU emissions in 2011 emissions were 2.5% below 2010. <http://www.eea.europa.eu/highlights/european-union2019s-total-greenhouse-emissions>

The study also revealed there was absolutely no shortage of emissions abatement. To date some 5,000 CDM projects have been registered, representing 7.6bn CERs (Certified Emission Reductions) in the pipeline up to 2020. The EU ETS has an offsetting budget of 1.6bn credits. Already 555m of these have been surrendered, leaving EU demand at roughly 1bn. The result of all these credits chasing such little demand is low prices. Furthermore, the EU banning of industrial gas credits has driven a rush to offload credits which will no longer be eligible for use in the scheme as of the 1st May 2012.

The EU ETS Directive stipulates that offsetting should be supplemental to our own domestic action, but as it stands offsets are replacing domestic action, at a time when there is a large over supply of EU allowances (EUAs). This begs the question whether we need these additional measures at all. Coupled with the fact that offsetting levels are calculated on the basis of allowance allocation, rather than the variance in actual emissions, we are left with a broken system. It may create a guaranteed market for the project developer, but for Europe, it means that offsetting fails as a price containment mechanism. There is also the issue of 'genuine' additionality of credits from the likes of hydro and coal fire projects, with the latter defying basic common-sense regardless of volume. Offsetting is at best a zero sum game, but if non-additional credits are used there is a real danger it becomes a negative for the environmental integrity of the EU ETS.

Baroness Worthington concluded with a call to increase ambition in the EU ETS at a time when the carbon price makes it so inexpensive. *Sandbag's* report lays out five key recommendations, with an aim to restore balance and faith in a grossly misregulated system.

Lambert Schneider, Carbon Market Expert

Speaking in a personal capacity, Mr Schneider sought to grant a research perspective on the quality of CDM and JI offsets. The initial worry goes back to the price of offsets, having seen a 90% drop in what is now effectively a "dead market". This crash can be attributed to two simple explanations: lack of demand and oversupply. The consequences look to include a lack of project development in what will become a highly unattractive venture for business. Low prices equate to 'business-as-usual' emissions as opposed to 'additional' emission reduction – the CDM will provide so little income it will fail to impact profitability. As a result the quality of the CDM project portfolio may decrease, with some projects ceasing operation altogether.

Mr Schneider went on to specifically address the quality of CDM offsets, of which there were four factors: additionality, over/under-crediting, sustainable development benefits and windfall profits. Additionality appeared to attract most criticism due to development in its application ranging from slow to non-existent. Rules continue to remain subjective, with too much ease in manipulation of investment analyses to assume future prices.

Substantial reforms have been demanded of the CDM via the CDM Policy Dialogue, whose recent recommendations remain pertinent to the task ahead. Most important is to standardise additionality tests with more objective ways to test the feasibility of projects. Other areas to consider are increased sustainability benefits, a rethink over government arrangements, better access to underrepresented regions (i.e. LDCs), improved stakeholders interactions as well as enhanced mitigation impacts. The latter could move CDMs beyond the offsetting mechanism it currently provides. The JI offsetting mechanism has had its own problems, largely born out of a small number of 'Track 1' countries (i.e. Russia, Ukraine) exchanging a surplus of AAUs (Assigned Amount Units) classed as "hot air" for JI project credits.

Mr Schneider focused on a number of key areas the CDM should look to be heading in. Calls for reform should be heeded, particularly regarding improvements to the methodology for HFC-23 abatement, as well as sustainability tools. That said, there has still been insufficient action on additionality and governance. The period 2013-2020 brings high integrity risks for specific project types (i.e. power generation, waste heat recovery) but more importantly, the CDM as a whole needs to avoid overlap with new, emerging ETSs from countries such as China or risk 'double-counting' offsets. Limiting purchase to high quality project types would be ideal but not particularly straight forward – this would require careful analysis, time to implement as well as a definition behind 'high quality'.

Thomas Bernheim, Policy Officer for DG CLIMA at the European Commission

After providing an initial overview of the current EU ETS regulatory framework, Mr Bernheim echoed comments made by previous speakers regarding the crisis of supply and demand within the EU ETS. This stems from the relative irrelevance of the applied instruments, which were originally created with a much broader international appeal. The Commission's recent carbon market report proposed six options for strengthening the EU ETS, one of which

addressed the use of offsetting – the focus was on flexibility, with potential reforms including the ability to restrict future access to offsetting and sanctions altering availability according to EU ETS prices, as also recommended in *Sandbag's* report. However, he stressed that offsetting alone is unable to solve the climate change problem.

The Commission's vision for post-2012 remains unchanged, with priority resting upon the talks in Doha and any progress that can be made under the New Market Mechanism and emerging ETs. However, expectations of what the carbon market is supposed to achieve is evolving under a CDM originally designed for application in developed countries. There is now an expectation for carbon markets to incentivise emission reductions and financial transfers at a far greater scale, perhaps shifting away base line and credit project-based offsets and towards New Market Mechanisms and ETs.

Mr Peter Liese MEP concluded the session by recalling his initial scepticism towards the CDM. Although the European Parliament happily embraced the mechanism, it was now time to admit they had gone too far, with issues of fraud and misuse coming to mind. He thus welcomed a more limited scope and questioned the share of responsibility currently taken by developing countries. Mr Liese went on to explain a number of aspects of the European carbon market demand structural change, of which the CDM and JI form a key aspect. He encouraged the European Commission to go further in its recommendations for reform, or else the price of carbon could crash even further and endanger the EU ETS itself.

REPORT and PRESS RELEASE



Sandbag Climate Campaign: Help or Hindrance? Offsetting in the EU ETS
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