



GREENPEACE



The EU Emissions Trading Scheme post 2012 – joint statement on key recommendations for improvements

July 2008

OVERVIEW

The EU Emissions Trading Scheme (EU ETS) is a key part of the EU's climate policy and the robust design of the scheme post 2012 will be critical for achieving 2020 and longer term emission reduction targets.

We therefore welcome the European Commission's intention, via proposals to amend the scheme released in January¹, to make the scheme more transparent, efficient and environmentally effective. In particular, the proposal to set the cap on total emissions at the EU level from the start of the third phase is a significant step forward from previous phases.

However, if it is to fulfil its potential as a fair and cost effective emission reduction mechanism which promotes investment in low carbon infrastructure within the EU, and also contributes appropriate financial support to the developing world, then other aspects of the proposed design of the scheme must be significantly improved. There are several design features which will be critical for ensuring this potential is achieved – including the level of the cap, access to project credits and pollution allowance allocation methodology. This statement focuses on these key design features.

The time to influence the political decisions taken in Europe with regards to the future of the EU ETS is now incredibly short with an agreement between Council and Parliament expected before the end of the year. It is critical that the UK Government, as a long term key advocate of the scheme, play a strong and leading role in ensuring that the EU ETS actually begins to deliver for the climate. As such we strongly urge the UK Government to take on board and act upon the recommendations outlined in this statement.

KEY RECOMMENDATIONS

1. Level of ambition – why Europe must move beyond the mindset of offsetting

We consider that the EU should adopt an economy-wide emission reduction target of at least 30% from the outset – with the effort for achieving this target split between the ETS and non-ETS sectors². Consideration should only be given to adopting a weaker target should an international climate agreement **not** be reached. Furthermore we believe that this target should be delivered within the boundaries of the EU – with further investment in developing countries provided on top of this. The reasons for this are set out over the page.

¹ http://ec.europa.eu/environment/climat/emission/pdf/com_2008_16_en.pdf

² With the EU ETS sectors continuing to deliver two-thirds of the effort as proposed by the European Commission.

To prevent catastrophic climate change we must keep the global average temperature rise as far as possible below 2 degrees centigrade above pre-industrial levels. To have a high chance of doing so, the 2007 IPCC Assessment³ report confirms that immediate and globally ambitious actions are required, and suggests that industrialized countries should take on domestic greenhouse gas reduction targets of **between 25% and 40% below 1990 levels by 2020⁴**. **Indeed, this was the range endorsed by all EU Member States at the international climate conference in Bali at the end of 2007.**

In terms of historic responsibility, industrialised nations have been a source of approximately three quarters of all CO₂ emissions from fossil fuels since 1850. Clearly industrialised nations such as those in the EU have a moral obligation, as well as the financial and technological means, to cut their emissions first and foremost - and in addition to this to provide significant support to developing countries in reducing emissions (including those from deforestation and forest degradation), and where possible adapting to the already inevitable impacts of climate change. Indeed, the level of climate change which the world is already locked into is imposing severe additional development challenges for people in low income countries – from food production, water and energy supply, through to impacts on health and tourism sectors.

Developing countries are also looking for the industrialised world to move first and show leadership. Demonstrating the achievability and viability of a low-carbon pathway, and of a serious political intent to deliver it, is vital to bring the developing world on board. In addition, the scale of required global cuts in CO₂ emissions means that there is no alternative to decarbonising Europe as quickly and completely as possible.

In order to meet these obligations therefore we consider that the overall EU Energy Package must be sufficiently ambitious to fulfil two distinct goals:

- it must put the EU on a low carbon trajectory which ensures that it plays its fair part in keeping the mean global temperature increase as far below two degrees centigrade as possible; and
- it must provide certainty that long term substantial financial support will be provided to developing countries to assist them in decarbonising their economies and where possible adapting to the impacts of climate change.

The current proposed economy-wide greenhouse gas emission reduction target of a 20% cut by 2020 – which allows a large proportion of the emission reduction to be met by the purchase of credits from Clean Development Mechanism (CDM) projects – will not ensure these goals are achieved. Fulfilling these two goals clearly requires the EU to **move beyond the mindset of merely offsetting** its own emissions.

In light of this we are calling for the EU to commit to:

- **an overall greenhouse gas emission reduction target of at least 30% below 1990 levels by 2020 to be achieved within the boundaries of the EU⁵; and**
- **to provide additional substantial funding* on top of this which should be invested in socially and environmentally robust adaptation and mitigation activities in developing**

³ IPCC : Intergovernmental Panel on climate change, the ca. 2500 scientists from 130 countries elaborating the world's most authoritative scientific review on climate change

⁴ Full working group III report, chapter 13, Page 776, <http://www.ipcc.ch/pdf/assessment-report/ar4/wg3/ar4-wg3-chapter13.pdf>. Clarification that the 25-40% reductions cited by the IPCC were for domestic emissions cuts can be found in the write up from a recent workshop held in the European Parliament where Dr Niklas Höhne (one of the lead authors of IPCC full working group III report, chapter 13) is noted as saying "According to the IPCC, GHG concentrations of 400-450 ppm CO₂e are required in order to achieve a 2-2.4°C target. Achieving this ppm concentration would require a reduction of -25% to -40% below 1990 levels in Annex I countries, and a reduction of -15% to -30% below the baseline in non-Annex I countries. These reduction figures exclude use of CDM (<http://www.europarl.europa.eu/activities/committees/studies/download.do?file=21435>).

⁵ For the EU ETS sectors this translates roughly into a 36/37% cut in emissions from 2005 levels.

countries⁶. These funds could flow via a variety of mechanisms e.g. via environmentally and socially robust market-based mechanisms and other financial instruments⁷.

* NOTE: Concrete figures are hard to determine but indicative levels of funding which reflect the EU's responsibility for current levels of climate change can be gleaned from the existing research on the potential cost of mitigation and adaptation. For example the UNFCCC's 2007 report on investment and financial flows estimates that by 2030 €69 billion will be required for mitigation in developing countries⁸. With the EU 27 responsible for approximately 30% of greenhouse gas emissions from industrialised countries in 1990, this implies that the EU should invest around **€21 billion per year on mitigation activities in developing countries**. There are various estimates as to the level of possible funding needed to address adaptation in developing countries. OXFAM for example estimate that it may cost around US\$50 billion per year, 30% of which equates to around **€11 billion as the EU's share of this⁹**.

2. The quality of credits from market mechanisms, such as the Clean Development Mechanism, must be assured

Crucial to the integrity of the Clean Development Mechanism (CDM) is that projects must be truly 'additional' (that they would not have happened in the absence of the mechanism) and that they contribute to sustainable development in the host country. However, there are significant concerns over whether the CDM is achieving these twin objectives. To highlight just two of the growing number of studies that have raised concerns over the lack of additionality:

- a recent report to WWF by the Öko-Institut concluded that approximately 20% of credits generated by CDM projects are likely to not be additional¹⁰. This is the equivalent of around 34 million tonnes of CO₂ per year; and
- an assessment by International Rivers found that the majority of hydropower projects in China applying for CDM registration (370 projects comprising 11.7 GW of power and 9.4% of total expected annual CDM credits worldwide) were mostly non-additional¹¹.

The sustainable development goal is also often overlooked with developing countries competing with each other to attract and host new projects at the expense of ensuring that they meet sustainability criteria. For example India sets rather ambitious criteria on paper but to date the government has failed to reject a single project put forward for approval. Furthermore, since the sustainability component of the CDM has no monetary value, no differentiation is made between projects that contribute to the development needs of a local community and those which do not.

In light of these concerns we consider that only external credits from CDM projects which meet the Gold Standard¹² accreditation and/or equivalent quality must be allowed

⁶ Again, with the EU ETS sectors taking on their fair share of this commitment.

⁷ This type of approach is supported by Dr Niklas Höhne one of the lead authors of IPCC full working group III report, chapter 13. In a recent paper Dr Höhne stated "An EU target that would be compatible with limiting climate change to 2°C would be to reduce emissions at least -30% below 1990 domestically plus to provide support for developing countries through CDM or other carbon mechanism at the order of magnitude of additional 10 percentage points" http://www.ecologic-events.de/cdm-workshop/documents/hoehne_briefing.pdf

⁸ Indeed this is report based on a scenario which would lead to more than 2 degrees centigrade warming. So mitigation costs to say below 2 degrees are likely to be significantly higher.

⁹ Other estimates: United Nations Development Programme Human Development report (2007) estimated that by 2015 costs of adaptation in developing countries could be approximately US\$86 billion per year.

¹⁰ Schneider L. 2007. "Is the CDM fulfilling its environmental objectives? An evaluation of the CDM and options for improvement" - a report prepared by the Öko-Institut for WWF

¹¹ Haya B. 2007. Letter to the members of the CDM Executive Board, RE: Concerns about the large number of Chinese hydropower projects currently undergoing CDM validation, October 12, 2007 (www.internationalrivers.org/en/china/china-other-projects/letter-cdm-executive-board-non-additional-chinese-hydros)

¹² The Gold Standard is an independent, transparent, internationally recognised benchmark for high quality carbon offset projects. It is restricted to renewable energy and end-use efficiency projects, requires projects to follow a conservative interpretation of the

to enter the EU ETS from 2013. And we maintain that access to credits should be in addition to, and not instead of a strong focus on domestic action which across the EU economy delivers at least a 30% cut in greenhouse gas emissions by 2020.

3. Auctioning – a fair and cost effective way to allocate pollution allowances

Within a trading scheme auctioning allowances is a key design feature which helps to ensure that the progression towards a low carbon economy takes place in the fairest and economically most efficient way. Auctioning of emission allowances includes the following benefits:

- It ensures the full cost of carbon is factored into investment decisions;
- It supports the ‘polluter pays’ principle;
- It avoids the accumulation of windfall profits to the most polluting sectors that can come about as a result of free allocation. For example, the power sector in many countries enjoyed spectacular windfall profits in the first phase of the EU ETS as it passed on the value of the allowances it was given for free to the price of power. In the UK alone it was estimated that this resulted in profits of £1.2-1.3 billion in 2005¹³. These profits are likely to continue in phase II. Indeed a recent report commissioned by WWF estimated that the profits to the German, British, Polish, Spanish and Italian power sector alone could be up to €71 billion by the end of the second phase (with the UK power sector reaping up to €15 billion of these profits)¹⁴; and
- It rewards the most efficient low carbon production.

The Commission have proposed that from 2013 the power sector will have to pay for all of its allowances. This is a very welcome move and it is critical that the European Parliament and the European Council do not weaken this key proposal.

The Commission have also proposed that energy intensive sectors and aviation receive 80% of their allowances for free in 2013 with this percentage declining every year to reach zero by 2020. Furthermore, it proposes to identify by end of June 2010 the energy intensive sectors and sub-sectors which may be at risk of re-locating outside the EU in the absence of a global climate change agreement. The Commission then plan to make appropriate proposals on how to support these sectors by June 2011. These proposals may include adjusting the proportion of allowances that are received for free.

We believe that only in the absence of a robust international agreement on climate change should the European Commission investigate possible measures to address the risk of relocation to specific energy intensive sub-sectors. In light of this we agree with the Commission’s proposal to wait until June 2011 before making suggestions regarding support measures. **However, in the meantime we strongly believe that the Commission should advocate 100% auctioning for all sectors from the start of 2013.**

In particular we see no reason why aviation should not be subject to full auctioning from the start of the third phase. This sector is clearly not at risk of relocation and research suggests it is also likely to reap windfall profits akin to those accrued by the power sector.

UNFCCC-additionality test and provides evidence by a UNFCCC-accredited independent third party that they are making a real contribution to sustainable development

¹³ Climate Change Bill final impact assessment <http://www.defra.gov.uk/environment/climatechange/uk/legislation/pdf/ccbill-ia-final.pdf>

¹⁴ EU ETS phase II – the potential and scale of windfall profits in the power sector (2008), by Point Carbon and summary by WWF can be found here http://www.panda.org/news_facts/newsroom/index.cfm?uNewsID=129962

Indeed a recent study undertaken on behalf of the UK Government concluded that a substantial level of auctioning would be needed to avoid such windfall profits¹⁵.

4. All revenues from the auctioning of pollution allowances should be spent on climate protection

Under the current proposal the Commission estimates that by 2020 revenues from auctioning could amount to €50 billion per year¹⁶. Indeed, the Carbon Trust estimate that the revenues from auctioning to the UK Government could be between €4 billion and €6 billion per year during the third phase¹⁷. These are new funds which could not have previously been anticipated before the inception of the EU ETS.

As stated earlier, the EU needs to offer substantial long term financial support to help developing countries reduce emissions and where possible adapt to the impacts of climate change. Revenue from auctioning provides a valuable source of new funding for these activities. However, even the current inadequate proposal by the Commission to allocate only 20% of the auctioning revenues to climate protection measures within and outside the EU has come under fire from European Finance Ministers who summarily rejected this in February this year¹⁸.

We recommend that all auctioning revenues should be used to fund climate mitigation and adaptation measures with at least 50% of the auctioning revenues going to assist developing countries, and the remaining revenues used within the EU.

Indeed the principle of using auction revenues to support climate adaptation and mitigation has recently also received support from the CBI who, in a joint letter with WWF to the Prime Minister, stated *“While we accept there may be some technical difficulties in ring-fencing the revenue, it should be perfectly possible to announce a similar investment in low carbon technologies and adaptation equivalent to the revenue raised by auctioning.”*¹⁹

5. EU (domestic) offset projects should continue to be excluded from the scheme

The Commission are proposing to allow credits from offset projects from sectors within Europe not covered by the EU ETS to enter the scheme. In our view this would be a serious setback to the scheme’s ability to influence emission reductions in the sectors covered by the scheme, and indeed across the EU as a whole²⁰.

The inclusion of domestic offsets was discussed during the negotiations of the Linking Directive. However, it was decided that for the first phase that only credits from Joint Implementation (JI) and CDM projects would be allowed. **We consider that domestic offset projects should continue to be excluded from the EU ETS for the following reasons:**

¹⁵ A study to estimate ticket price changes for aviation in the EU ETS: a report for Defra and DfT, November 2007

<http://www.defra.gov.uk/environment/climatechange/trading/eu/future/pdf/ticketprices-report.pdf>

¹⁶ “Boosting growth and jobs by meeting our climate change commitments” European Commission press release announcing the release of the climate and energy package, January 2008

<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/80&format=HTML&aged=1&language=EN&guiLanguage=en>

¹⁷ “Cutting carbon in Europe – the 2020 plans and the future of the EU ETS” Carbon Trust, 2008

¹⁸ http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ecofin/98717.pdf

¹⁹

[http://www.cbi.org.uk/ndbs/Press.nsf/38e2a44440c22db6802567300067301b/0b8e47289c37df4a8025743b00364155/\\$FILE/Joint%20letter%20on%20ETS%20to%20PM.pdf](http://www.cbi.org.uk/ndbs/Press.nsf/38e2a44440c22db6802567300067301b/0b8e47289c37df4a8025743b00364155/$FILE/Joint%20letter%20on%20ETS%20to%20PM.pdf)

²⁰ As the use of credits from offset projects does not actually reduce net greenhouse gas emissions - it merely allows the capped sectors to pollute above their cap.

- If there is significant greenhouse gas abatement potential in a sector (for example transport or Land use land use change and forestry) then arguably it should be governed by a separate policy and not be used to allow emissions from the EU ETS sectors to grow.
- Ad hoc development of projects is not a particularly effective way of tackling emissions from a sector. Indeed the inclusion of domestic offset projects may be used as an excuse to delay the implementation of a more focussed policy for a sector.
- Inclusion of domestic offsets may make it more complicated to determine the direct contribution of the EU ETS sectors to EU greenhouse gas emission reduction targets and to determine whether they are contributing their fair share or not.
- There is the risk of double counting of emissions reductions - both as a contribution to meeting the EU ETS cap, and towards achieving the effort sharing targets.

Access to project credits (be they from JI/CDM or domestic offset projects) could make it cheaper for ETS sectors to meet emissions caps. But crucially access to credits within a weak overall cap will disincentivise investment in clean technology within those sectors and slow down innovation. It could also help to “lock in” decisions on high-carbon infrastructure (of particular pertinence here for the power sector) which would have a significant impact on emissions from those sectors for many years to come. **Indeed, this is why we advocate that purchase of offset project credits should be additional to and not instead of a strong focus on domestic emission reductions.**

For future phases of the scheme the emphasis must be placed on reducing emissions from the ETS sectors rather than expanding their access to cheap emission credits from other sectors.