



# IETA’s Views on International Credits in the EU

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## Contents

|   |   |
|---|---|
| Introduction .....  | 1 |
| A long-term approach for the EU’s climate & energy policies.....            | 3 |
| Principles.....   | 4 |
| What quality criteria should be considered for international credits? ..... | 4 |
| Why is flexibility to link with other markets important? .....              | 5 |
| IETA’s proposal .....   | 7 |
| Conclusion: encouraging global action.....                                  | 8 |

## Introduction

The European Commission’s proposal for a 2030 Climate and Energy policy would restrict emission reductions to domestic activities, closing the door to international credits and flexible international market mechanisms. More recently, the European Council concluded that Europe’s 2030 climate target of “at least 40%” should be met domestically. Some leaders have suggested that if a higher target is needed, then international credits may be needed to keep costs in check.

Europe’s long term goal is to reduce emissions by 80-95% from 1990 levels by 2050. While its proposed target for 2030 is in line with the lower end of this range, it is not yet clear how the longer term targets beyond 2030 will be met. IETA believes that the ETS will need robust international linkages if it is to attain its longer term goals cost-effectively.

Europe’s use of flexibility mechanisms such as the Clean Development Mechanism (CDM) was extremely successful in encouraging interest in carbon market solutions around the world. China, South Korea, Chile, Mexico, and Brazil are now exploring



carbon market mechanisms. The CDM has mobilised at least \$138bn<sup>1</sup> for mitigation projects and stimulated the development of significant capacity in climate finance, technology and skills transfer, and sustainable development.

It is important to note that all existing and proposed emissions trading systems around the world have provisions for the use of offsets: California, Québec, Alberta, Regional Greenhouse Gas Initiative (RGGI), China, South Korea, Switzerland, and Kazakhstan all allow for the use of offsets in their respective systems, either now or in the post 2020 period.

At present, we recognise that it is difficult to square the near-term need for market stabilisation with the long-term need for market linkages. Some analysts project that the EU ETS will face a surplus of over 2 billion emission allowances by 2020. Addressing this challenge is one of the European Commission's priorities for reforming the EU ETS. While the ETS is meeting its annual emissions targets, many market participants are concerned that it does not send an effective long-term investment signal.

IETA member companies believe the current supply-demand imbalance in the EU ETS needs to be resolved in order to restore the political credibility of the EU ETS as the central policy instrument to drive cost-effective emission reductions and low-carbon investment in Europe. If the ETS is not improved, we are concerned that individual Member States may be tempted to impose their own market interventions that could further erode the system's effectiveness.

Various options are under consideration to address the oversupply challenge, such as:

- setting a more stringent cap on the ETS;
- establishing a higher GHG target for the EU as a whole towards 2030; and
- creating a Market Stability Reserve (MSR).

**IETA supports reforms of the ETS, but we also envision a future where the EU will benefit from linkages to international carbon markets and high quality offsets.** International credits are a small part of the current oversupply in the EU ETS. IETA believes prohibiting their use post-2020 will halt important compliance options available to participants, as well as reduce the EU's important contribution to sustainable development in Least Developed Countries (LDCs) that the private sector makes via this mechanism.

This paper describes how IETA would approach the question of international offsets in Europe – and what should emerge in the EU's 2030 climate and energy legislation.

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<sup>1</sup> According to the UNFCCC's Executive Board on the CDM's annual report 2014 ([here](#))



## A long-term approach for the EU's climate & energy policies

IETA wants legislation as soon as possible to set a 2030 EU-wide GHG target, with a corresponding cap for the EU ETS and an effective plan for international market linkages.

IETA believes that allowing the use of international credits is in the EU's long-term interest, because it can broaden the impact of the ETS by offering market access for high-quality trading systems and carbon offsets. It is a classic "win-win" strategy, since it encourages global participation and lowers compliance costs for European companies.

Linkages offer a broader systemic benefit. The Intergovernmental Panel on Climate Change (IPCC)'s [Synthesis Report](#) notes that a single global carbon price is a leading element of the cost-effective benchmark scenario. **Simply banning international credits removes a flexible and cost-effective tool that compliance entities need in order to reduce emissions in the period 2020-2030. Moreover, a ban would mean the EU is less willing to engage in global carbon market solutions, which is difficult at a time when we need global linkages and heightened cooperation to address the global climate challenge.**

IETA members believe that the EU should reconsider how to allow the use of international credits as compliance units in the EU post-2020, as well as define the type of essential criteria that would need to be met for those international credits to be eligible. Such an approach would enable the EU to garner the maximum support for a strong agreement in Paris in 2015.

### **In short, the use of international credits in the EU post-2020 should:**

- ensure environmental integrity and additionality; and
- encourage faster progress to fight against climate change in various jurisdictions by using market access to the EU ETS as an incentive.

In considering how to structure this element of EU policy, we recognise that it must operate within well-defined parameters:

- Allowing an uncontrolled flow of credits is not a sustainable solution for an ETS, because it may not drive sufficient investment in abatement strategies within the covered sectors. We have seen from the past that focusing primarily on quantitative restrictions can lead to distribution problems about who gets access



to credits and about the extent to which different developing countries benefit. **We would recommend clear and strict criteria that would define the quality of international credits and place percentage limits on the total number that could be used in the EU ETS.**

- It is also of utmost importance for other countries and regions to **work towards viable international markets that would create demand for international credits from other jurisdictions**, to avoid a situation whereby the EU would be the sole source of demand for international credits.

## Principles

The role of credits within the EU ETS should satisfy the following principles:

- **Integrity** - International credits, which will be recognised under the post-2020 international climate agreement, should represent real, permanent and additional reductions, and be subject to robust monitoring, reporting and verification (MRV). It is therefore essential to ensure common and consistent MRV processes. One tonne of reductions located outside of the EU should equal at least one tonne of reductions within the EU. Clear quality criteria need to be agreed at the UN level from the outset, to allow individual and sectoral projects to develop once they meet minimum criteria set by the UNFCCC.
- **Scarcity** - The use of international credits should not put into question the principle of having scarcity in the EU ETS and ensuring a meaningful price signal for low-carbon investment.
- **Regulatory stability** - The scope in which international credits should be allowed (volume and type) should be defined as early as possible. This offers market participants visibility on what to expect in terms of market dynamics, and it helps to avoid a sudden inflow or outflow of credits when rules get modified.
- **Cost Effectiveness** - They can ensure a cost-effective means to decarbonise the global economy. Fully-functional and well-implemented emissions trading linkages will accelerate low-carbon investment at the scale needed to hold the average global temperature increase to 2°C.

## What quality criteria should be considered for international credits?

International credits need to represent real, permanent and additional emission reductions that are measurable, independently verified and represent a substantial contribution to emission reductions. The EU needs clear quality criteria for international credits to be recognised, both by the EU's member states for effort-sharing decisions



and for compliance under the EU ETS. A common approach would help avoid any uncertainty concerning the environmental integrity of such credits.

Criteria on the type of international credits could include the following:

- **Country type:** The partner country should be making proactive efforts to reduce its emissions/emissions intensity.
- **Clear additionality:** Offset projects should meet a clear additionality standard set by determining an appropriate sectoral benchmark for the country or region. Projects with clean technologies that abate significant levels of GHG emissions should flourish as a result.
- **Credibility:** UN-issued credits could be recognised, to ensure that qualitative criteria are guaranteed. Specific credit types, such as REDD+ or other credits meeting predefined quality criteria, could be encouraged by European Member States in their purchasing programmes.
- **Net mitigation contribution:** The extent to which a project counts against a host country's efforts to reducing their domestic emissions should be clearly established, to assure that there is no double counting. Net mitigation could be set by project type and/or by country type.

## Why is flexibility to link with other markets important?

Assuming that measures will be put in place to address the imbalance between supply and demand of allowances in the EU ETS, IETA believes it is important for the EU and the 2015 Agreement to be flexible in both supply-side and demand-side in light of the 2050 goals, without undermining the basic principle of cap-and-trade systems to operate under a firm cap.

**International market flexibility is important for four primary reasons:**

### 1. Cost-effectiveness

- Emissions credits can help lower compliance costs and ensure the carbon markets remain the central policy instrument. If implemented effectively, carbon markets limit total emissions but allow industry and governments flexibility to adopt the lowest cost abatement options to meet their targets. Cutting off market access to systems outside the EU removes a source of lower-cost abatement options and would likely raise compliance costs for European industry and governments.
- As emissions reduction targets grow more stringent over time, there will be shortage of allowances in the EU ETS that will grow tighter over time. European



businesses will need access to international markets to decarbonise cost-effectively and maintain international competitiveness. As costs of abatement differ from country to country over time, access to international market mechanisms and linking to ETSs outside the EU ETS cap can reduce overall costs to industry and governments alike.

- By allowing flows of credits in and out of the system, the long-term emission reduction targets for both the EU and international Parties will be able to be met by all sectors cost-effectively.

## **2. Efficient Market Functionality**

- Flexibility in the system also allows for greater market liquidity and scarcity—two fundamental aspects of carbon market design that will lead to low-carbon investment.
- We anticipate that the EU’s goals for 2030 and 2050 will create significant scarcity over time.
- Flexibility in the system allows participants to make strategic choices about their route to compliance as well as ensuring their abatement options for global greenhouse gases are more efficiently and cost-effectively abated using modern techniques and technologies.

## **3. International Cooperation and Global Partnerships**

- International efforts and cooperation in climate change mitigation are needed if we are to remain below 2°C. Focusing emission reductions only in the EU will not be sufficient to achieve the necessary emission reductions needed globally.
- Providing access to the EU ETS will incentivise advanced, emerging, and developing economies alike to meet climate mitigation goals using market mechanisms, improving the cost-effectiveness and quality of their systems. Parties hosting projects for which credits will be issued will see the benefits of market-based measures to reduce emissions.
- The use of CDM expanded Europe’s cooperation with many developing countries and prompted the growth of expertise within their business communities. It also created export opportunities for European technology<sup>2</sup>.
- Offsets are important not only in environmental terms, but also in providing improved prospects for linking of ETSs in the future. They provide a safety valve for each system and each system can implement the filters it feels are necessary for its domestic ETS, according to predefined criteria.

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<sup>2</sup> According to the UNFCCC, between 30% and 60% of the CDM projects involve technology transfers – see [here](#)



- Linking the EU ETS with similar trading programmes outside of Europe and/or allowing the use of international credits enables companies to capture a wider range of mitigation opportunities to keep costs down and reduce the risk of carbon ‘leakage’ through Europe and onto another jurisdiction without a robust carbon price.

#### 4. Global Climate Agreement in 2015 in Paris

- This year, global attention has turned to the Paris negotiations on an International Climate Agreement. Europe has an opportunity to signal its interest in working with other interested countries to build market architecture for the future that enables Parties to meet their ambition at lowest cost. It should avoid a singular focus on domestic actions, given the imperative for global cooperation.
- The rules in the Paris Agreement should provide effective bottom-up linkage provisions that encourage countries to achieve any or a specified share of their national targets through the use of international credits.

### IETA’s proposal

First, we acknowledge that there is a challenge in balancing the EU ETS’s design and objectives regarding the need to address the current oversupply in the market whilst recognising the potential benefits of international credits. However, the EU’s long-term decarbonisation goal of reducing emissions by 80-95% by 2050 compared to 1990 levels will require massive investment. **Leaving the door open to the use of offsets for meeting future targets will be an important cost-containment option to meet the EU’s long-term targets. Therefore, it is critical to establish the policy in the 2030 package, so that it can be built upon in the decades that follow.**

IETA believes that strict quality criteria need to apply to all credits that enter into the EU, either for compliance use in the EU ETS or for meeting national effort-sharing targets. In addition, a limit on the total use of international credits also needs to be set at the European level, to determine what total quantity of offsets will enter the European market.

In today’s context, we see the role of offsets in the EU in the following areas:

- They should be available for use by installations covered by the EU ETS, if there is support by EU Member States to go beyond the agreed 40% GHG emission reduction target by 2030 compared to 1990 levels.



- They should be available for use by governments for reaching the goals in the non-ETS sector (i.e. under the Effort Sharing Decision). Governments could simply define the criteria when publishing their tenders.
  - However, IETA members believe that international credits in non-ETS sectors should complement, rather than replace, domestic action to reduce emission, thus respecting Europe's complementarity policy.
  - Member states could use a portion of the revenues raised through auctioning to purchase high-quality offsets. This would create an opportunity to keep the system of offsets alive by creating a source of demand, without impacting the level of supply of allowances in the EU ETS.
- Offsets could provide an additional economic safety valve to the MSR. Once the MSR is empty or once allowances in circulation in the EU ETS have fallen below the lower threshold, offsets could become a valuable means of cost containment. However, in such a situation, the credits used should meet strict quality standards that would have been defined at the EU level, and measures need to be put in place to ensure double-counting does not occur.
- Offsets should be available for use by airline operators as part of the future ICAO market-based-mechanism.

In summary, the use of international credits in the EU ETS has represented major investment of the private sector in encouraging developing countries to reduce emissions. Instead of focusing solely on the use of public money for such a purpose through the GCF and the World Bank, the private sector can play its part through the development of emission reduction projects in third countries and use of the international credits they produce.

## **Conclusion: encouraging global action**

In light of the negotiations to reach an International Climate Agreement, the EU may want to consider allowing the use of credits from outside its own jurisdictions, to encourage other Parties to put in place emission reduction projects and sign up to an International Agreement on Climate.

IETA believes linking cap-and-trade systems is essential for ensuring cost-effective emission reductions at the scale needed to meet the global climate challenge. Carbon market architecture, whether designed at the national or international (UNFCCC) level, will help facilitate linkage of carbon pricing policies. One essential piece of architecture needed to build a global carbon market is the ability to link national emissions registries. The International Transaction Log (ITL) built out of the Kyoto Protocol could be



upgraded and expanded to assist in the process. However, we are also open to the prospect of a different tracking arrangement that assures the system's integrity.

Moreover, in light of the EU Member States' pledges towards international development, a discussion could take place to assess whether government purchasing of high-quality international credits could be considered as a form of Overseas Development Aid.

As stated in the Linking Directive, investment in projects outside the EU will assist the development of advanced environmentally sound technologies and assist developing countries in achieving their sustainable development goals. We note the particular benefits foreseen in the Directive to allow operators to use CERs and ERUs resulting from land use, land use change and forestry project activities in the Community system.

We believe these important considerations fall outside the scope of this paper and will be analysed by IETA members on a separate occasion.

## **IETA - Climate Challenges, Market Solutions**

24, Rue Merle d'Aubigné  
Geneva, 1207, Switzerland  
Tel: +41 (22) 737 0500

Boite 27  
Rue de la Loi 235  
Brussels, 1040, Belgium  
Tel: +32 (0)22 30 11 60  
Reg. 0889.072.702

1001 Pennsylvania Ave. NW,  
Suite 7451  
Washington, DC 20004, USA  
Tel: +1 470 222 43 82

3rd Floor - 350 Adelaide  
Street West,  
Toronto, Ontario  
M5V 1R8  
Canada  
Tel: +1.647.727.4960