

## Carbon Market Watch feedback on the draft 2021 annual report of the independent emissions market advisory committee



Carbon Market Watch would like to hereby provide feedback on two crucial parts of the draft 2021 annual report: allowance banking and carbon offset. These two chapters correspond closely to our core expertise areas, and are critical elements that can undermine the functioning of an emissions trading mechanism.

The key conclusion of the draft report is clear: there is a lack of certainty that emissions will stay under the cap. The low quality of offsets and the significant amount of banked allowances that could re-enter the system at a later stage mean the cap is and will be met on paper, but likely not in reality.

The concerns raised by the draft report are valid and significant, and warrant further analysis and a policy response.

### ***Allowance banking***

As the draft report outlines: 321 million allowances have been banked by private entities. The draft report raises key concerns related to this issue. If the program is to be successful at reaching its stated climate targets these concerns need to be addressed.

The current oversupply in the market can lead to increasing emissions - going diametrically against the aims of the cap-and-trade program. As mentioned in the draft report, the amount banked is larger than what the cap-and-trade program is expected to deliver in terms of emission reductions, therefore these banked allowances raise the spectre of the cap-and-trade program actually not contributing to emission reductions, while compliance actors have actually followed the rules perfectly. This undermines trust in the system itself and its ability to push for long term and sustained decarbonisation of covered activities.

For the cap-and-trade program to be able to reach its 2030 targets, the oversupply needs to be tackled. The European Union has learned the hard way what the consequences of oversupply can be: prolonged low carbon prices, lack of incentives to decarbonise and low confidence in the market. The EU Emission Trading Scheme (ETS) has been amended to include a supply-control mechanism (the Market Stability Reserve - MSR) that has brought back confidence in the EU ETS. While the oversupply issue is by no means solved in the EU ETS, it has been at least partially addressed and carbon prices have risen significantly since the announcement of the MSR. An instrument to manage allowance supply seems needed in the Californian context as well to tackle the banked allowances, and the 274 million allowances held in reserve and cost containment accounts.

The cause of the oversupply is also clarified in the draft report: too low caps in the cap-and-trade program, and allowing offsets into the market.

The draft report includes an important conclusion: the oversupply in the market must be analysed, and the program caps need a comprehensive assessment. The draft report rightly states that the oversupply could also be due to companion policies pushing reducing emissions, however this warrants an assessment of how the caps could be made flexible to account for the potential successes of those companion policies.

### **Offsets**

The draft report raises some very important elements regarding offset use and quality. The peer-reviewed literature findings it mentioned should not be ignored, but rather be used to implement changes to the cap-and-trade program.

The draft report makes it clear that there are serious questions about the integrity of offsets due to inflated baselines. Calculating baselines based on regional averages is problematic as projects will tend to concentrate in sub-regions that have higher-than-average carbon content in their forest.

In addition, the worrying developments in how the buffer pool is at risk of failing to cover all reversals should raise alarms. Wildfires are on the rise, and the risk seems to not be properly reflected in the buffer pool calculations. This doesn't even go into the problem that the buffer is only meant to guarantee permanence for 100 years, whereas carbon will stay in the atmosphere for centuries to millennia. Even IF the buffer did work, there is still no equivalence between the offsets and continued emissions when it comes to permanence.

The zero-sum offsetting game also warrants assessment: does society still have the luxury to allow polluting industries to claim climate action by others? The IPCC AR5 makes it abundantly clear that all sectors of the economy need to decarbonise, and offsetting undermines those efforts. At the very least any offset unit brought into the WCI should lead to the deletion of a corresponding compliance unit (such as in Washington State where offsetting is done under the cap, rather than on top of it) - though ideally offsetting should be abolished.

We encourage a review of this system. Ideally, offsets should no longer be eligible, and the projects can be financed through revenues from allowance auctioning. This increases the degree of certainty with respect to total quantity emitted under the cap, and allows the cap-and-trade program to target specific areas and project types for funding.

### **About Carbon Market Watch**

Carbon Market Watch is a not-for-profit association with unique expertise in carbon pricing and a track record of policy work in international organisations and the European Union. Our strengths lie in evidence-based advocacy to improve climate policies, turning complex issues into comprehensible messages, and helping people understand and influence those policies.

Carbon Market Watch exists to ensure that carbon pricing and other climate policies cut pollution and drive a just transition towards zero-carbon societies. Given the urgency of halting the climate breakdown, we want market-based climate policies to fulfil their promise and be used in wise combination with regulatory and incentivising measures.