The Foundation for Science and Technology

Dinner Discussion 2nd April 2008

Can carbon trading contribute to meeting carbon emission targets?

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It's a pleasure to be here tonight. The answer to the question, "Can carbon trading contribute to meeting carbon emission targets?" is yes. I'm going to keep my talk somewhat general compared to the next two presentations that will delve much more into the specifics of the carbon market and try and give you a perspective of where the UK government is coming from.

The UK government and World Bank perspectives are almost identical and are consistent with many of the conclusions in the Fourth Assessment Report of the Inter-governmental Panel on Climate Change.

Carbon trading is essential for a cost-effective transition to a low carbon economy, where we need to exploit and strengthen all of the mechanisms within the Kyoto Protocol. In particular, we need to use emissions trading for Parties with targets and timetables and a strengthened Clean Development Mechanism (CDM) for developing counties in a post-2012 agreement.

There is a need to strengthen the carbon market post-2012 by capping emissions and link the different trading systems (national, European and global). For example, at the moment the European trading system is not adequately linked to the international system under the UNFCC. A European trading system will have to be consistent with, and embedded in a global framework. The World Bank's Clean Energy investment framework could play, in the intermediate period of the next four or so years until we get to a post-Kyoto world, a very important role. The World Bank's clean energy investment framework has three pillars: access to energy in developing countries that have no access to modern energy; mitigation of greenhouse gas emissions; adaptation to climate change. The elements of the clean energy investment framework can be valuable in the next few years in helping to create an appropriate market.

There is a need to recognise that the carbon market - whether it's emissions trading or the Clean Development Mechanism - must be consistent with national priorities and must be consistent with sustainable development. These mechanisms provide an opportunity to increase financial flows quite significantly and are an opportunity for the transfer of clean technologies.

The formal markets that are being established could and should be complemented by a voluntary market, but the voluntary market needs to have strict criteria and standards. The challenge to the private sector is to develop with a system that is as least as rigorous as that under the Kyoto Protocol. It needs to be self-regulating but with independent verification and certification.

A voluntary market, especially in the next few years, can promote activities that are not eligible under the Kyoto Protocol, such as avoided deforestation. A voluntary market can start to develop sectoral and programmatic approaches – again activities not eligible under the Kyoto Protocol . A question is whether the scale of financing available in the voluntary market is commensurate with these types of activities.

The financing model for the CDM needs to be re-thought. One of the weaknesses of the current CDM is that the approved projects earn an annual revenue stream for reducing carbon emissions after validation and independent certification. The problem with such financing is that there is no up-front financing for a project, so there is a limitation to the scale and the types of projects that can be implemented. Hence, there needs to be a rethinking of how we finance low carbon projects.

A robust carbon market will be absolutely essential to deliver the private financing and initiative on the scale that's needed to deliver a low carbon economy. We need to redirect existing investments of potentially hundreds of millions to hundreds of billions of dollars per year. However, the market will not work on it's own. It will need complimentary and supplementary policies and financing to be effective, e.g., additional financing for future technologies will be needed.

While there are currently many technologies that can be used to cost-effectively transition towards a low-carbon economy it's evident that we need both public and private sector investments in R&D for future commercially viable technologies. The immediate priority is to commercialise low-carbon technologies that are currently pre-commercial e.g., carbon-captured storage, future generation biofuels, electric cars etc.

There is a need for a policy environment which ensures a carbon price that will stimulate the transition to a low-carbon economy. There is a need for policies at the national, European and global level, with the key being a post-2012 long-term, global, equitable, regulatory framework with intermediate targets, involving all major emitters. An agreement that is only Kyoto plus five years will not send the right signal to the market, not induce the private sector to invest in the next generation of technologies and would not develop a robust carbon market.

The market needs to be much broader than it is currently. It needs to be broader with the participation of most countries and certainly all major emitters. It needs to involve all sectors, which it does not do today. We need to develop an approach to aviation and maritime emissions, within an international framework and we need to include avoided deforestation. One of the major weaknesses of the Kyoto Protocol is how we intellectually dealt with land-use and land-use change and forestry, and in particular it was a mistake not to include avoided deforestation. While we have to recognise there are important issues such as baselines, leakage, and permanence, all of those are technologically quite manageable. It probably means that avoided deforestation cannot be addressed at the project level, but will need to addressed at the national level with national baselines to minimise leakage.

There is a need to deepen the market, balancing demand and supply. In the last few years the European trading system never quite got that equation right with the price collapsing when it was recognised that there were far more permits than there was a desire to buy those carbon permits.

We need to ensure that there are much tougher targets in developed countries, and over time include developing countries in order to broaden the market. The market needs to be long, therefore we need a long-term global framework, 30 to 50 years, not five years beyond Kyoto, with intermediate targets. Without a long market we will never have a robust carbon system and will stimulate the right investments.

As we transition to a post-2012 regime, there will be need to manage change in a way that will not disrupt the current carbon market. We need continuity. We need to maintain and evolve the existing system and protect the current pipeline of investments, providing greater use of emissions trading within and beyond the developed countries which are currently trading. There is a need to assess whether we have the right instruments, especially if there were an agreement of sectoral targets rather than national emission targets.

All of this has to be debated within the framework of a post-2012 agreement. Fundamentally the current carbon trading system is sound but the greatest weaknesses at the moment are that there are no post-2012 obligations.

We need to move away from small-scale project-based offsetting. The World Bank's carbon funds have provided a wonderful learning opportunity but the transaction costs for the smaller projects are unacceptably high. We've learnt a lot of how to do project-based trading but we need to go to scale. We need to be sectoral at the country scale, e.g. whole energy or transportation systems, and we need to be much more programmatic addressing energy efficiency and deforestation through policy changes.

The CDM is a good mechanism, but it needs to evolve and there is room for significant improvement. There are a number of questions that need to be answered, e.g.,   the degree to which the projects under the clean development mechanism today are truly additional to what would of happened anyway. Have we got the methodologies for the baseline right? Is the Board that oversees the CDM effective and efficient? Should the CDM have a professional Board? Should it have fulltime professionals or should it be national delegates?   Are we happy with the pace of progress and the quality of implementation?   Can we streamline some of the procedures for CDM projects because the current rules appear unnecessarily complex and bureaucratic? Can we formalise the decision-making process? At the moment there is a request by some governments to have a more rules-based approach, while others argue strongly against this. Some would argue there is a lack of transparency and the decision-making process is not as rational as it should be.

The UK as well as the European Union recognise the need to strengthen support and structures, such as a strengthened secretariat, which is already underway It's much stronger today than it was three years ago, but it still needs to be much more transparent in the decision-making process.

There is a need for a more experienced Board, strengthened by a good secretariat. The current Board has been reluctant to deliver consistent and comprehensive standards and guidelines which are going to be essential as we move forward. There have also been more and more reviews by the Board of individual projects which seems inconsistent with the growing number of projects. We need a much more strategic Board and a different way of effectively reviewing the projects.

In summary, carbon trading is absolutely essential to any future regime to mitigate greenhouse gas emissions and transition to a low carbon economy. It will provide a cost effective way of stimulating finance from the Private Sector which will be absolutely essential. However, in order to have a robust carbon market we need a long-term regulatory framework with intermediate targets involving all major emitters. The CDM needs to become much more programmatic and sectoral and we need the Board for the CDM much more effective.

Thank you.