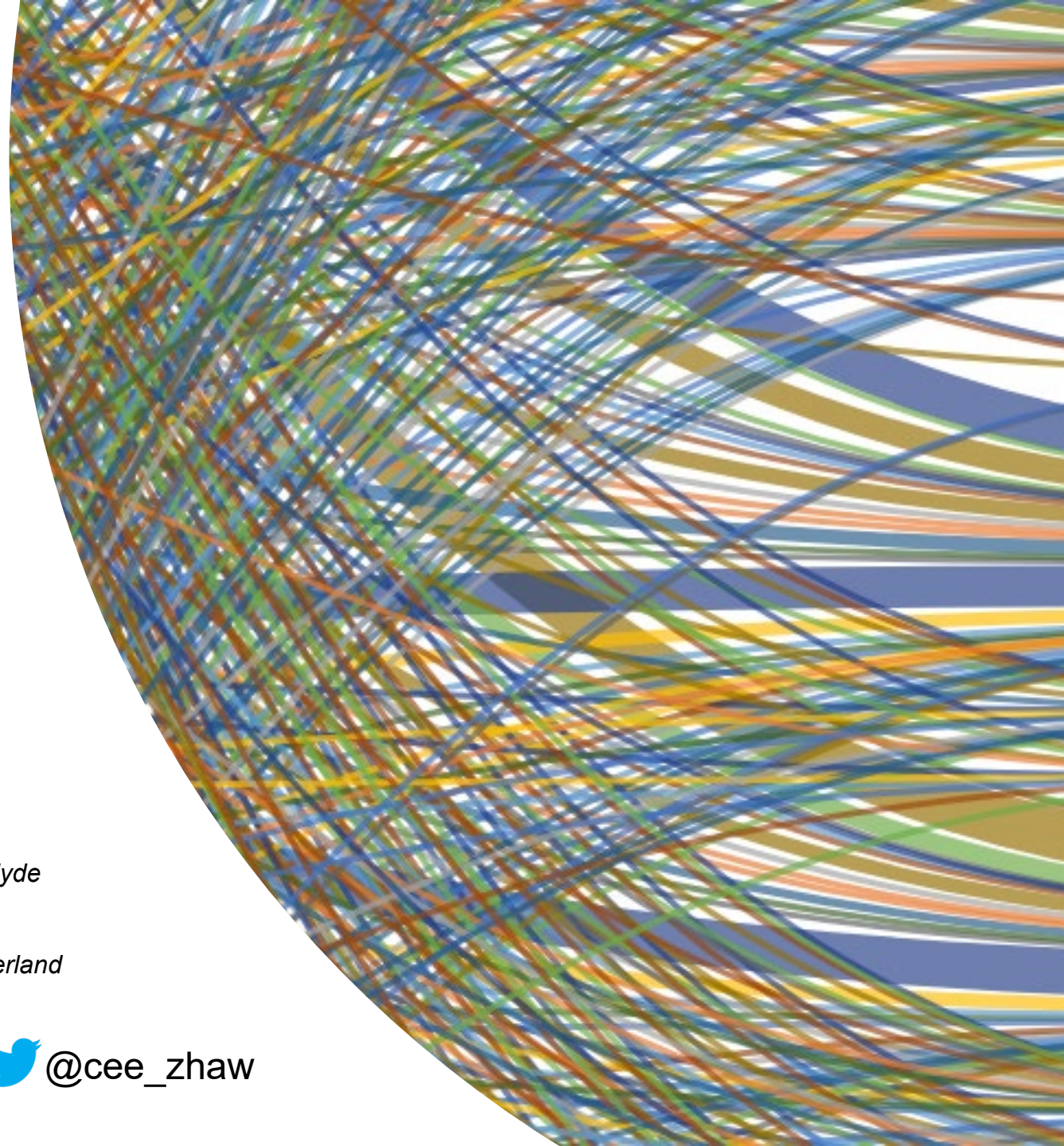
The Carbon Market Challenge: Preventing Abuse Through Effective Governance



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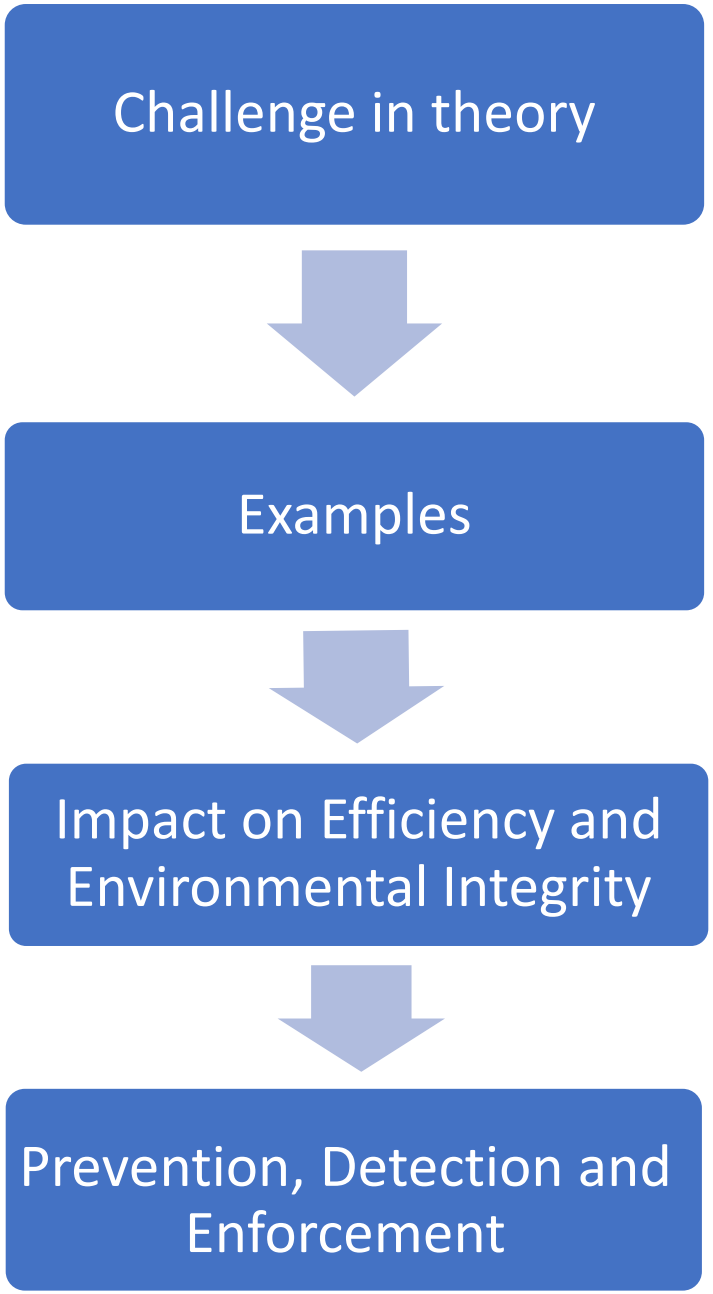
Overview Presentation

1. Multi-level and linked carbon markets
2. Lobbying efforts against cap-and-trade legislation
3. Risks related to Cap Stringency
4. Risks related to Overshooting the Cap
5. Risks of Fraud
6. Carbon markets in net-zero world



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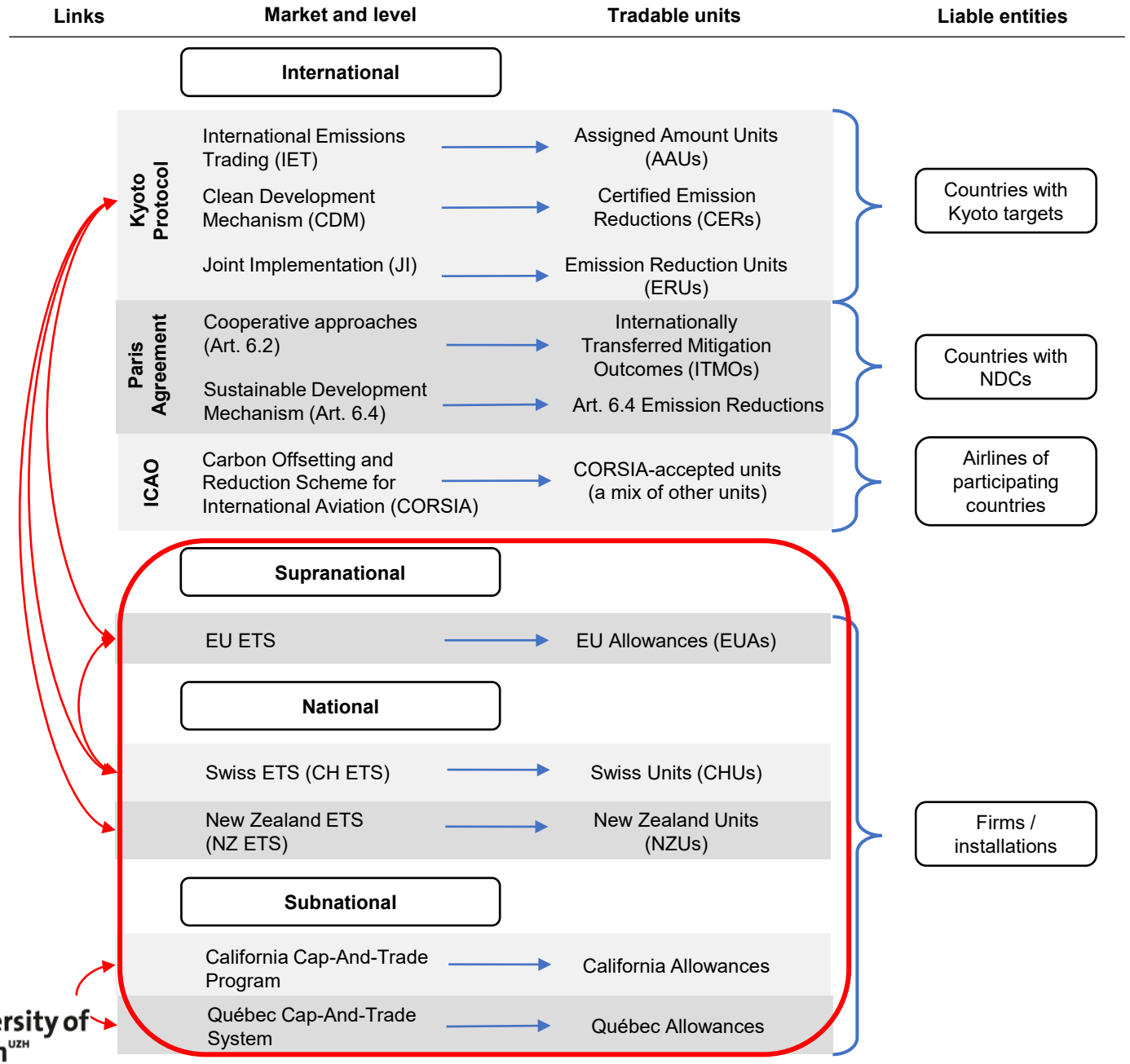
Overview of carbon markets

CHALLENGES:

- Many different markets on different levels with different tradable units:
  - International
  - Supranational
  - National
  - Subnational
- Different liable entities
- Linkages between markets and fungibility of units

RISKS OF ABUSES:

- Double counting due to missing oversight between the levels (Governance gaps!)



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Cap-and-Trade-Systems

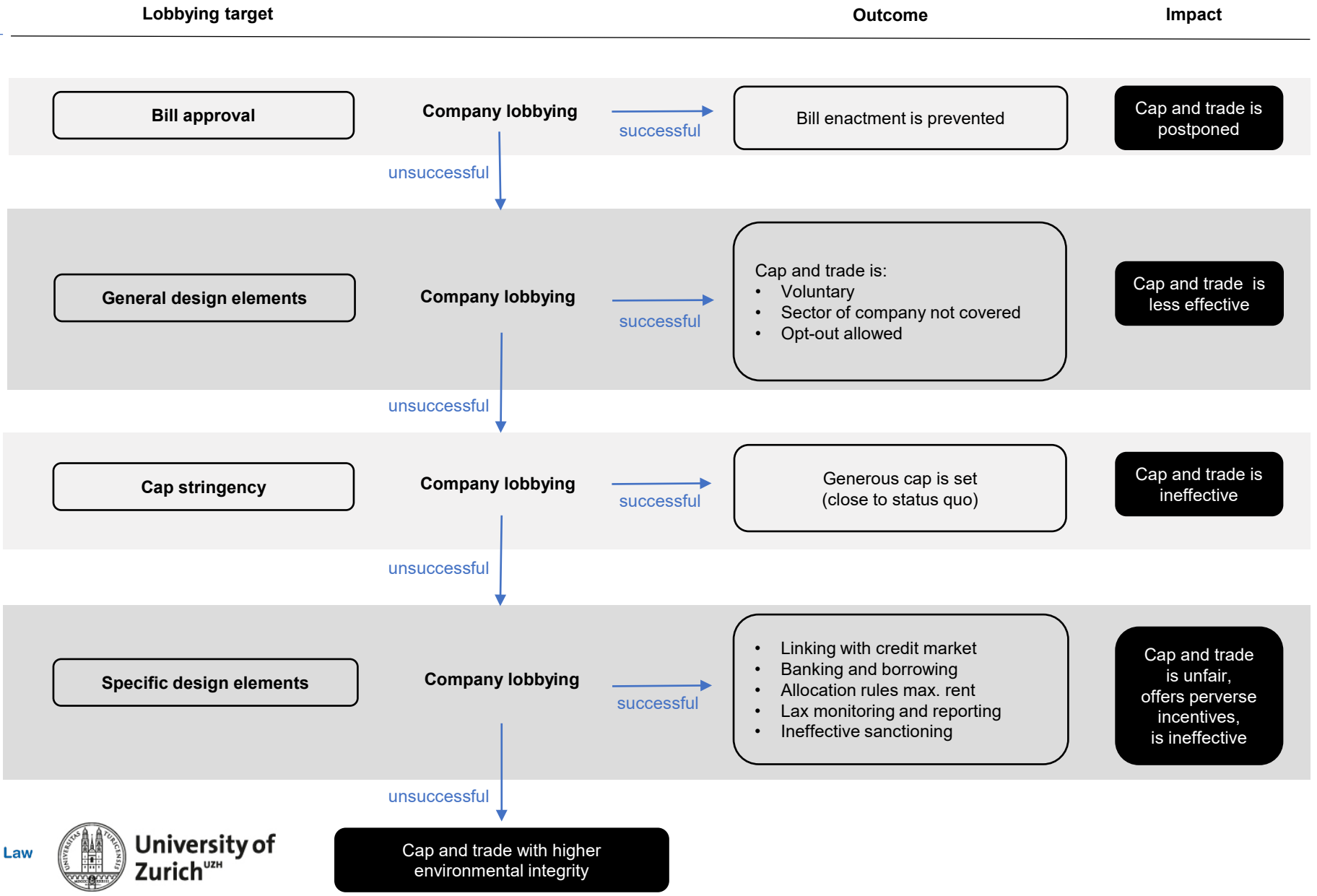
Lobbying for Allocation Rules:

Windfall profits
Free allocation to companies which can pass on the opportunity costs to consumers

Updating:
If future allocation is based on passed emissions the incentive is reduced to reduce emissions

Output based allocation:
Indirect subsidy and lowers costs of consumers which reduces change in beaviour

Possible Lobbying Efforts Against Cap-and Trade Legislation



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Risks related to Cap Stringency

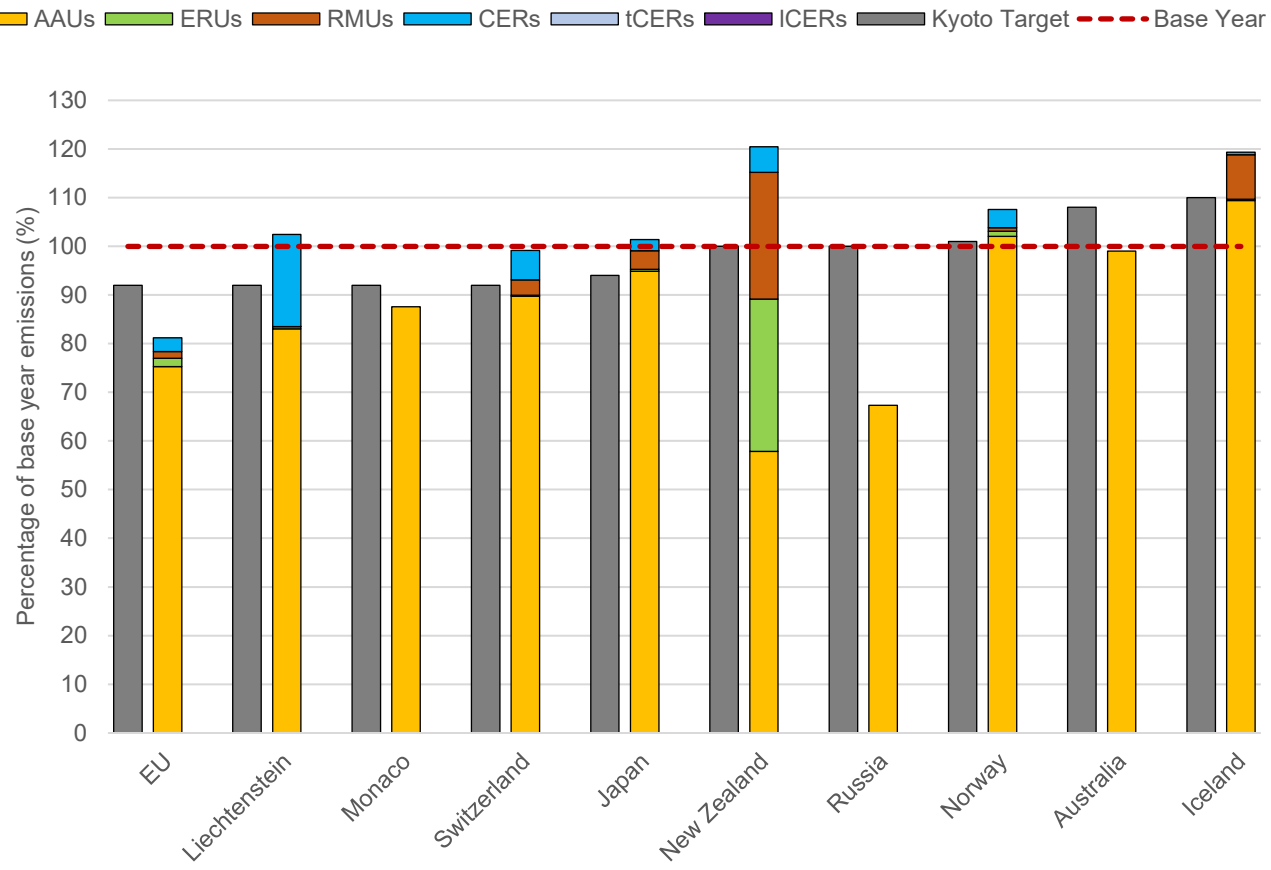
Overallocation Examples:
International / Kyoto Protocol:
1. Demand dropped as US not ratified and Canada left Supply high as economies in transition generous allocation (hot air)
2. Supplementarity requirement (Art. 6.1 d KP) was not defined and therefore not enforced (see Graph)
3. Parties not participating in 2nd Commitment Period failed to cancel remaining units

Supranational / EU Emissions Trading:
1. Demand dropped due to financial crises,
2. Cheap Kyoto Units supply (1500 Mio CERs/ERUs)
3. Complementary policies such as higher than expected renewables production due to renewable support policies
4. Surplus bankable in future periods

National / New Zealand ETS:
Linking to overallocated systems without limit (NZ link to KP units) will also reduce price of national system

Use of Offsets Under the Kyoto Protocol 1st Commitment Period

Source: Own Graph based on UNFCCC compliance data



New Zealand surrenders largest amount of ERUs in 1st Commitment Period

Risks related to Overshooting the Cap

Overshooting Definition:
Real aggregated emissions are higher than the cap set

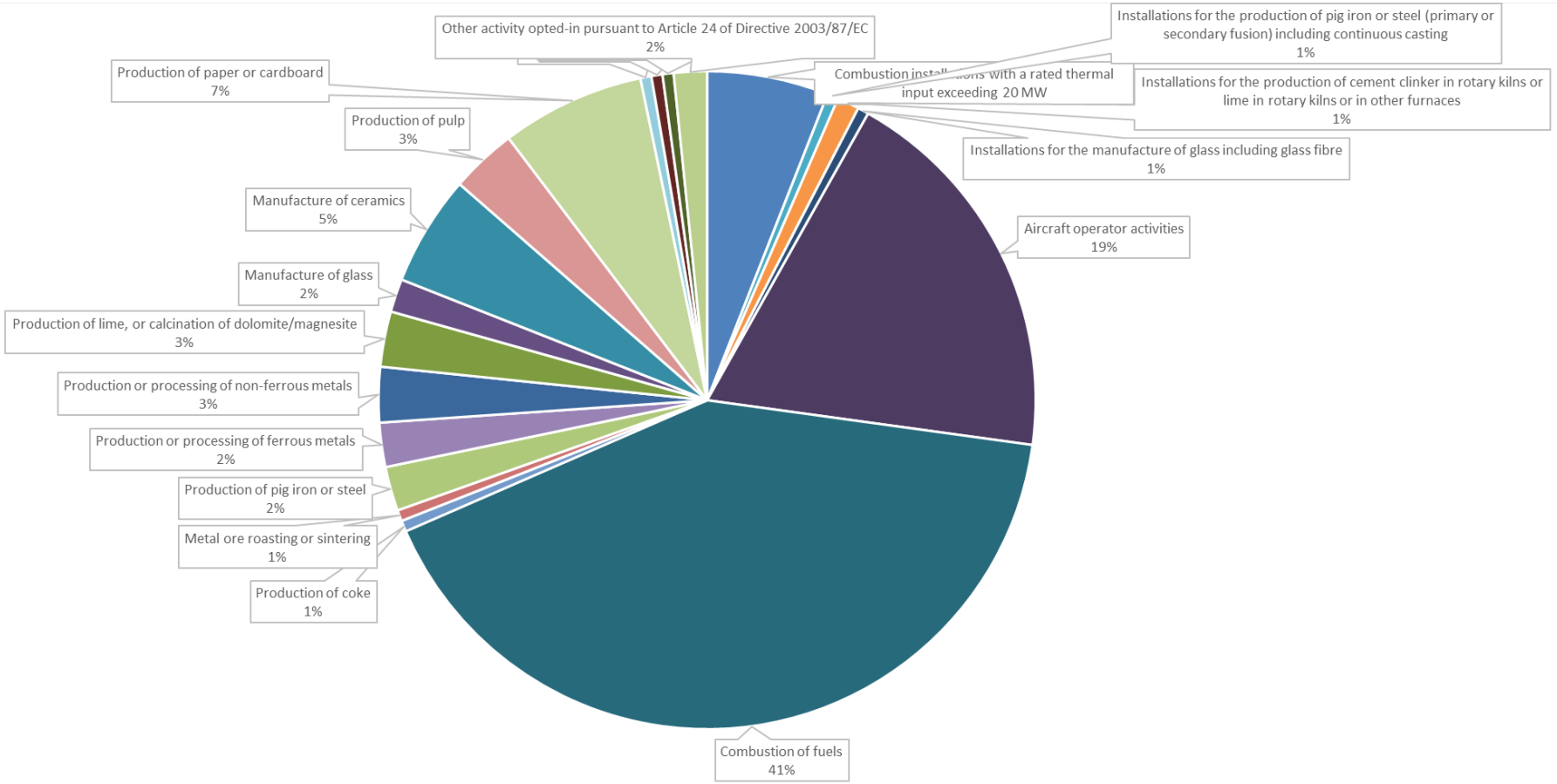
Risk of overshooting linked to **sanctioning** and **insolvency** rules:

1. Risk higher for ETS with sanctioning systems without make-good provisions (e.g. Korea)

2. Risk higher for insolvency rules without clear responsibilities how make-good is addressed in case of non-compliance (e.g. Germany)

Non-compliant entities in EU ETS in 2020

Source: Own Graph based on Compliance data 2020



In total 199 entities showed a compliance code of «B» wich means that the number of allowances surrendered by 30 April is lower than verified emissions

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Risks of Fraud

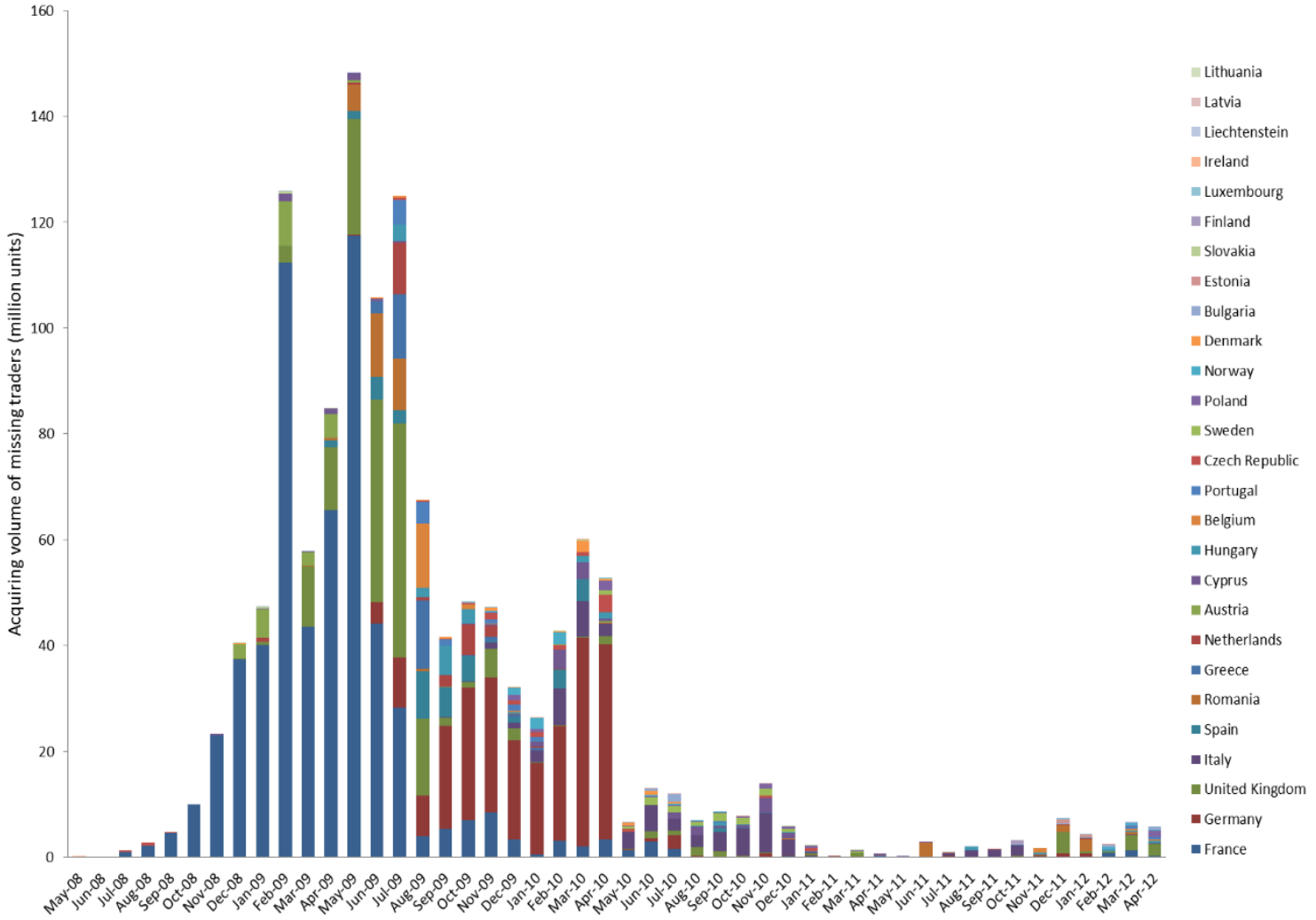
Value-added-tax (VAT) fraud in EU ETS: More than 5 Billion Euro losses in public funds accross several countries (mainly France, UK, Germany and Italy) see Graph

Money laundering to conceal the illicit source of money: Often conjointly with VAT fraud due to missing rigorous account opening processes.

Allowance Theft: Pishing and hacking attacks in 2010 and 2011 in Austrian, Czeck, Geek, Romanian and Italian registries. More than 2 Million allowances were stolen.

Development of VAT fraud in the EU ETS

Source: Wei 2016



Fraud started in France , moved to the UK and than to Germany. Italy was the latest country adjusting the VAT regulations

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Cap-and-Trade Systems in a Net-Zero World

Open questions:

Will there be a separate market for emissions removal units or will market be integrated?

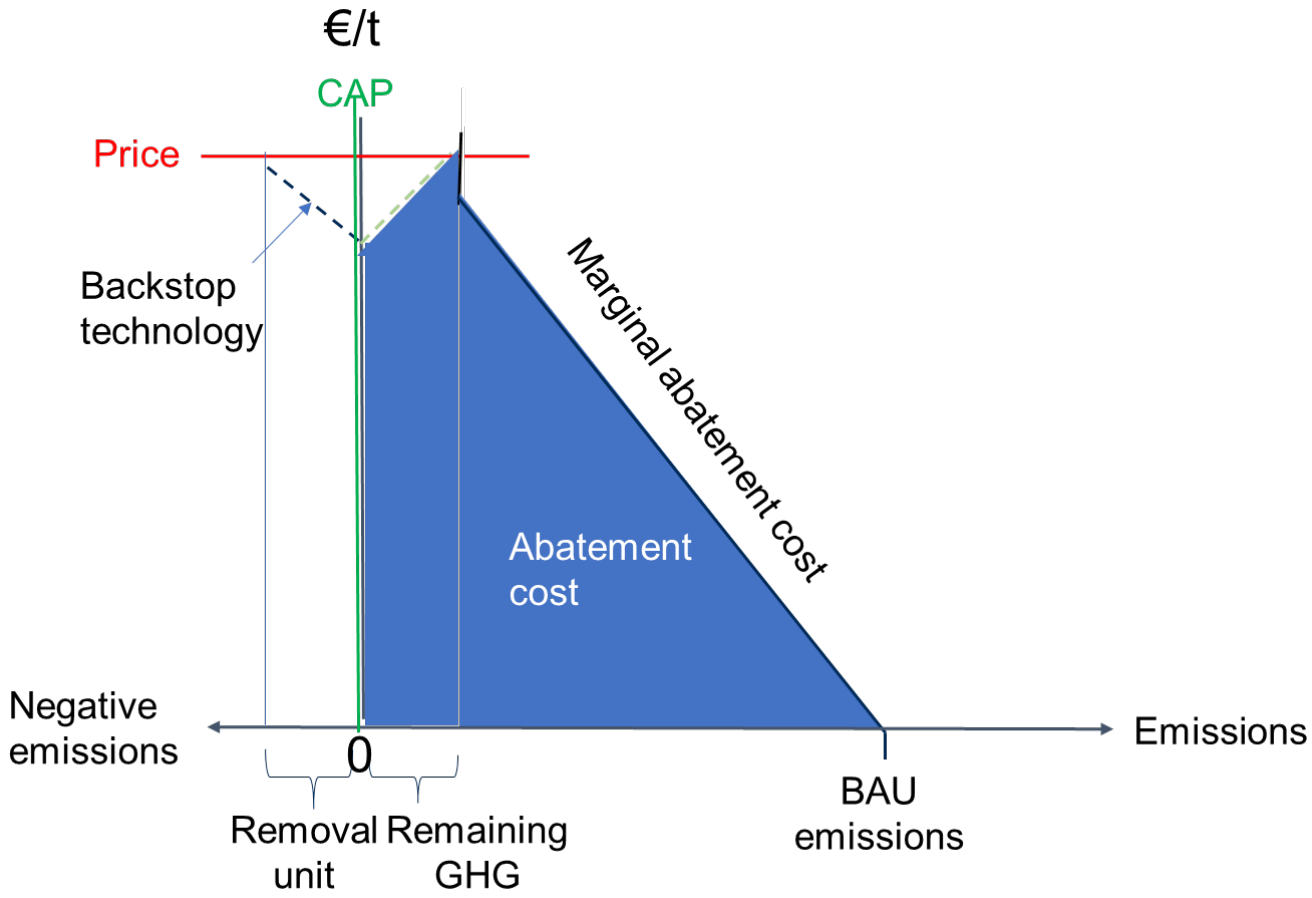
Will be there separate caps for emissions and removals?

Will there be qualitative and quantitative restrictions?

Who will be awarded the removal unit (capturer, transportation, storage provider)?

How will co-risks and co-benefits be addressed (land conflicts, food security, enhanced biodiveristy)?

A net-zero cap-and-trade system



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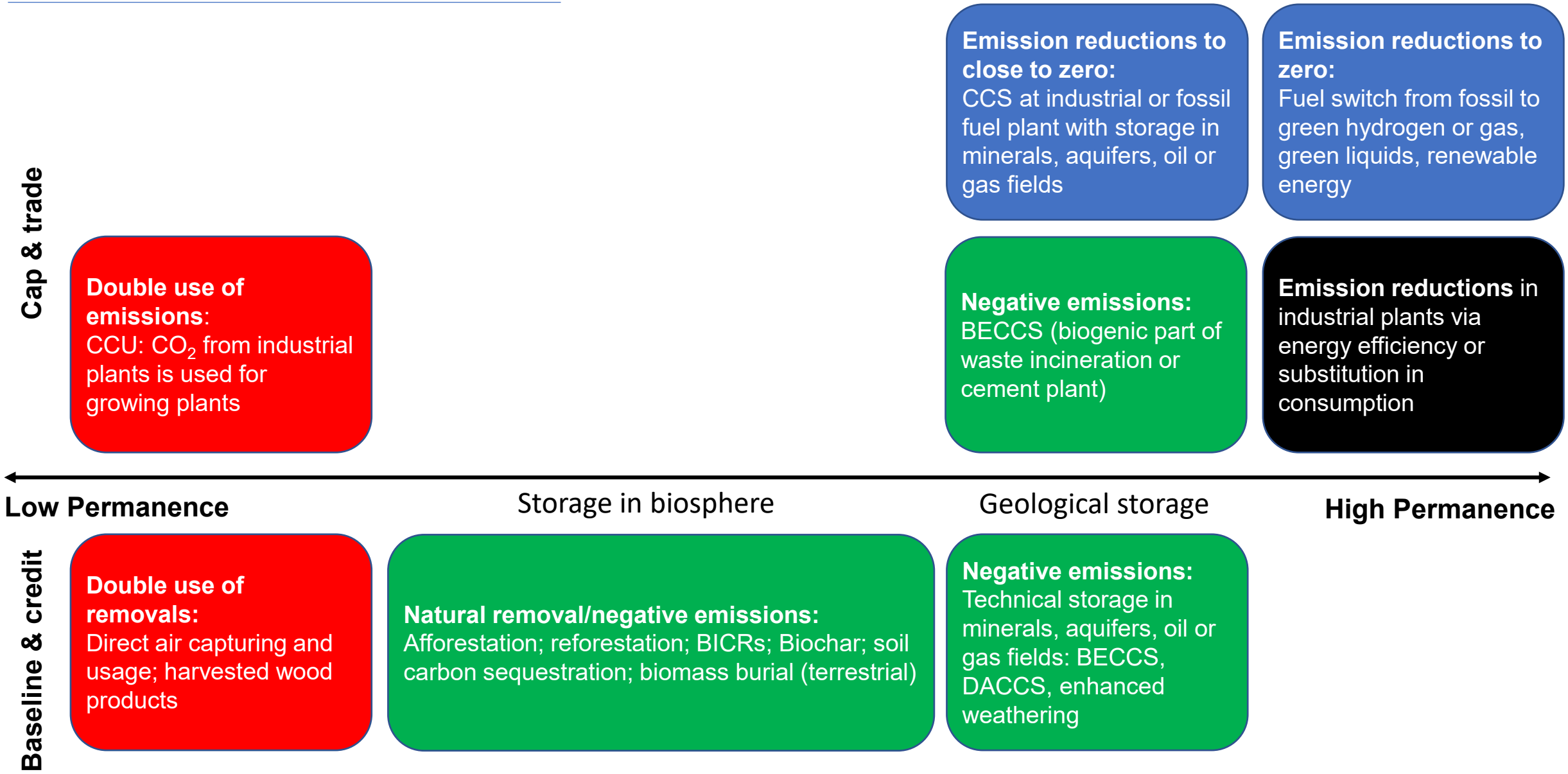
Reductions vs. Removals



PUBLICATIONS

Policy Brief I
The Carbon Market Challenge: Preventing Abuse Through Effective Governance

Policy Brief II
Carbon Markets in a Net-Zero World

Papers are available at www.snis.ch

Will be published soon
Open source

The Carbon Market Challenge: Preventing Abuse Through Effective Governance

Legal, Environmental and Economic Principles

Baseline-and-Credit-Systems:
Risks, Impacts, Examples,
Prevention, Detection and Enforcement

Cap-and-Trade:
Risks, Impacts, Examples,
Prevention, Detection and Enforcement

Lessons Learned
Future Challenges

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