

A DANGEROUS OBSESSION

THE EVIDENCE AGAINST CARBON TRADING AND FOR REAL SOLUTIONS TO AVOID A CLIMATE CRUNCH

Urgent action is needed to bring down global greenhouse gas emissions and avoid catastrophic climate change. The report on which this summary is based evaluates whether carbon trading can deliver these emissions reductions quickly, strategically, and in a just and equitable way. It also looks at what alternative tools are available to governments.

The report finds that carbon trading is not delivering the urgent cuts in emissions needed to prevent catastrophic climate change, is failing to realise promised incentives for investment in new low-carbon technology, and is a dangerously unstrategic approach to making the transition to a low-carbon economy. Carbon trading schemes rely on offsetting, a controversial, ineffective and increasingly discredited mechanism. They also risk a repetition of the subprime mortgage crisis, and provide a smokescreen for rich developed countries' failure to provide developing countries with adequate support to tackle climate change.

Relying on carbon trading to tackle climate change is gambling with the future of billions of people.

A completely different, faster and more strategic approach is needed – one that relies on simple, direct and proven policy tools such as taxation, regulation and public investment. At the same time, governments must tackle the underlying drivers of uneven development which prevent developing countries from tackling climate change themselves, while promoting poverty reduction and sustainable development.



Friends of the Earth

ABOUT THIS SUMMARY

This is the Executive Summary of a report prepared by Friends of the Earth England, Wales and Northern Ireland for its Demand Climate *Change* campaign. The full report is being distributed to decision makers, media and campaigners ahead of the UN climate talks in Copenhagen in December 2009. For the full report, visit: http://www.foe.co.uk/resource/reports/dangerous_obsession.pdf

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Tackling greenhouse gas emissions to prevent dangerous climate change is one of the most pressing challenges facing humanity. The chance of keeping global average temperature increases below the critical¹ threshold is fast slipping away. It requires a peak and decline in global emissions by 2015. Rich developed countries are responsible for three quarters of emissions historically despite representing only 15 per cent of the world's population. They have a legal and moral obligation to make the biggest reductions and to provide finance and technology to developing countries to compensate for climate impacts and support clean development. But developed countries have largely failed to take sufficient action to reduce

greenhouse gas emissions or provide this much-needed finance to the developing world.

In this context carbon trading is increasingly being put forward as a tool for tackling climate change. Proponents of carbon trading argue that it helps to reduce emissions, and that it does this at the lowest cost, stimulates investment in low-carbon infrastructure and can help generate finance for developing countries to tackle climate change.

Friends of the Earth's report on which this summary is based evaluates **whether carbon trading can deliver the necessary emissions reductions quickly, strategically, and in a just and equitable way.** It also looks at what alternative tools are available to governments.



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- 1** G8 countries have agreed on the need to prevent global average temperature increase of 2 degrees Celsius over pre-industrial times. This would still threaten the existence of low-lying small island states. The Alliance of Small Island States (AOSIS) is calling on the global community to aim for a 1.5 degree target: <http://www.presstv.ir/detail.aspx?id=106831§ionid=3510212>.
- 2** Meeting Carbon Budgets – the need for a step change. Progress report to Parliament Committee on Climate Change October 2009, p70: <http://hmccc.s3.amazonaws.com/21667%20CCC%20Report%20AW%20WEB.pdf>.
- 3** See estimates on mitigation and adaptation finance from The Africa Group of Nations and the United Nations: Africa says poor need \$267 bln/yr in climate fight. Reuters, 20 April 2009: <http://www.reuters.com/article/latestCrisis/idUSLK631928>; and Fighting climate change: Human solidarity in a divided world, Human Development Report 2007/2008: <http://hdr.undp.org/en/reports/global/hdr2007-2008/>.
- 4** See reference 3.

CARBON TRADING

The basics

- Carbon trading is the buying and selling of an artificial commodity – the right to emit carbon dioxide.
- It is a market-based mechanism and is **an indirect tool for tackling emissions**, in contrast to more direct tools available to governments such as investment and regulation.
- Emissions trading schemes (ETSs) are **created by government regulation** with the following steps:
 1. An upper limit – or cap – is set on emissions from a sector or sectors of the economy.
 2. Businesses in those sectors are given or auctioned permits for a proportion of those emissions.
 3. Businesses that don't use all of their allowances can sell their surplus to others that exceed their allowance.
- All existing and planned ETSs allow for the inclusion of **offsetting**.
- A wider variety of actors including **banks and investment funds** are active in the carbon markets and there is increasing use of complex financial instruments known as **derivatives**.

The global carbon market

- ETSs are already operating or planned in 35 countries around the world.
- The European Union Emissions Trading Schemes (EU ETS) is the world's largest carbon trading market.
- The global carbon market has roughly doubled in size every year since 2005 and was worth US\$126 billion in 2008.
- It has been predicted to grow to a market value of US\$3.1 trillion per year by 2020.
- UK businesses are the biggest investors in carbon offset projects globally.
- The UK Government and the European Union are major proponents of carbon trading. They are pushing for the extension of the schemes to developing countries and the inclusion of new international carbon trading mechanisms in international climate negotiations.

PROBLEMS WITH CARBON TRADING

The report identifies six central problems with carbon trading, namely that it:

1. Is ineffective at driving emissions reductions.
2. Fails to drive technological innovation.
3. Leads to lock-in of high-carbon infrastructure.
4. Allows for, and relies on, offsetting.
5. Creates a risk of subprime carbon.
6. Provides a smokescreen for lack of action on climate finance by the developed world.

The report finds that:

1. Carbon trading fails to deliver necessary carbon cuts or technical innovation

Carbon trading is not achieving the emissions reductions promised, nor is it driving the major technological innovations that are needed to shift our economies to low-carbon pathways. The first phase of the EU ETS (2005-2007) has failed and Phase II (2008-2012) looks on course for a similarly dismal outcome. The perverse incentives created by the trading mechanism itself – particularly the focus on low-cost solutions – is further locking us in to high-carbon pathways. The UK's respected Committee on Climate Change recently confirmed this: "We cannot therefore be confident that the EU ETS will deliver the required low-carbon investments for decarbonisation of the traded sector through the 2020s. Given this risk, the Committee recommends that a range of options such as regulation and taxes for intervention in carbon and electricity markets should be seriously considered."²

2. Carbon trading relies on offsetting – a dangerous distraction

All existing and planned emissions trading schemes allow for the inclusion of offsetting and, to a great extent, rely on the ability of firms to purchase offset credits to escape their emissions cap by paying for reductions to take place elsewhere. Offsetting is profoundly unjust, fundamentally flawed and cannot be reformed. We need emissions cuts in both developed and developing countries in order to avoid catastrophic climate change. Offsetting projects frequently do not deliver emissions reductions at all, are sometimes worse than doing nothing, and lock developing countries into high-carbon development pathways with minimal social and environmental benefits and many detrimental local impacts.

3. Carbon trading risks a carbon subprime crash

The complexity of the carbon markets, and the involvement of financial speculators and complex financial products, carries a risk that carbon trading will develop into a speculative commodity bubble that could provoke a global financial failure similar in scale and nature to that brought about by the recent subprime mortgage crisis. Such a crisis would risk further undermining the effectiveness of trading as a tool for delivering cuts in emissions, and a far greater chance of catastrophic climate change if carbon trading is adopted as the primary tool for delivering emissions cuts globally.

4. Carbon market finance is a smokescreen for inaction

Carbon markets are failing to generate the finance that is urgently needed for developing-country mitigation and adaptation.³ What's more, developed countries are using the prospect of increased carbon market finance to hide from their commitments under the United Nations Framework Convention on Climate Change (UNFCCC) to provide new and additional sources of finance to developing countries. Carbon market finance is not "new and additional" finance as envisaged by the UNFCCC, as it comes from offsetting developed-country emissions cuts which should be additional. Counting it towards the financial commitments of developed countries is double counting.

5. Proposals to reform carbon trading are unrealistic

Powerful vested interests from industry and finance have exerted a significant influence over emissions trading schemes. Given these interests' historical impact and continued influence it is likely that the sweeping changes needed to emissions trading schemes to address these problems and increase their effectiveness would meet powerful resistance. Wholesale reform of carbon trading in the time available looks unrealistic.

6. Proposals to extend carbon trading are dangerous

It is implausible that a global cap and trade system could be established within the time available to avoid dangerous climate change, even if it could be agreed and made just, equitable and operationally effective. Pursuing carbon trading as a key tool for tackling climate change at the expense of more effective policy instruments is therefore a highly dangerous obsession.

7. The real driver behind the UK and EU agenda is economic interest

The UK and EU have invested significant time and resources developing their carbon trading scheme and therefore have a strong interest in making it work and seeing it expanded elsewhere. Industry and finance are key driving forces behind the European push to see carbon trading expanded globally.

Key recommendations:

The report supports a new approach to tackling climate change which relies on policy tools that are simple, direct, and proven to be effective. As highlighted by Lord Nicholas Stern, climate change is the greatest market failure the world has ever seen. Relying on indirect, untested and unproven mechanisms such as carbon trading to address this fundamental threat to humanity and the environment is high risk, irresponsible and dangerous.

The report makes three sets of recommendations covering emissions trading schemes, alternative tools for tackling emissions, and wider changes needed to address climate change in a just and equitable way:

1. Emissions trading

- **Halt expansion** of emissions trading schemes globally.
- **No linking** of emissions trading schemes.
- **Fundamental reforms** to existing schemes such as the EU ETS to close loopholes and ensure they are not subject to abuse and profiteering by industry and finance.
- **Focus government policy-making** and spending on the rapid deployment of the proposals set out below.

2. Developed-country emissions cuts – rapid deployment of simple, direct and proven policy tools

Developed-country governments must agree to emissions cuts of at least 40 per cent on 1990 levels by 2020, excluding offsetting, and adopt a huge transformational agenda to ensure that these cuts are delivered. This programme should comprise taxation, regulation and publicly-funded investment:

- **Taxation:** Increased use of hypothecated and escalating carbon taxes to drive behavioural change and

provide government revenue for low-carbon investment.

- **Standard setting and direct regulation:** A return to the use of proven, direct regulatory approaches to drive emissions reductions by heavily polluting industry, incorporating key lessons from the successes of the EU's Integrated Pollution Prevention and Control directive.
- **Public finance:** A major increase in public investment to address the climate crisis, prioritised in the research, development and deployment of renewable energy, improvements to energy efficiency in buildings, effective measures to tackle fuel poverty, and new public infrastructure, including sustainable transport. New carbon taxes and other innovative instruments such as a Tobin tax could provide new sources of funding for these investments, but it will also necessitate a reprioritisation of government spending and an end to perverse subsidies such as those to fossil fuels.

All policies should be underpinned by greater transparency and scrutiny in formulation and decision-making. All policies should also ensure a just transition for workers in affected industries and include actions to mitigate against any regressive impacts on low-income and other vulnerable groups.

3. Addressing global inequality and supporting low-carbon development in developing countries

Urgent action should be undertaken by developed countries to support climate mitigation and adaptation in developing countries and to address historic patterns of uneven and inappropriate development which prevent developing countries from tackling climate change and making progress on poverty reduction and sustainable development.

- **New and additional climate finance:** Developed countries must deliver on their commitment through the UNFCCC to pay the full incremental

costs of climate mitigation and adaptation in developing countries. This requires the urgent commitment and delivery of at least €200 billion in public funds per year⁴ by 2012 from developed countries. This finance must be delivered under the framework of the UNFCCC and ensure respect for human rights and a focus on social and environmental outcomes.

- **Technology transfer and intellectual property rights:** Supporting developing countries in making emissions cuts necessitates large-scale technology transfer of environmental goods and services. Current intellectual property rights stand in the way of this and must be tackled.

- **Stopping unfair trade and investment policies:** International trade and investment agreements are a driving force behind the growth of energy-intensive industries and also undermine development prospects in developing countries. A major refocusing of global trade and investment rules is needed.

- **Unconditional cancellation of illegitimate foreign debt:** Developing countries cannot be expected to pay for emissions reductions while paying US\$100 million per day in debt to the developed world. There must be 100 per cent cancellation of all unpayable and unjust debts, and US\$400 billion in immediate debt relief.

- **A new development paradigm:** Developed countries must stop promoting export-led development that contributes to climate change. Instead they must prioritise support for sustainable livelihoods and poverty reduction.

- **Addressing unsustainable consumption:** Rich countries use far more than their fair share of the world's resources. This is unsustainable and unjust. Rich countries must set targets to reduce their resource use and put in place plans to achieve them.

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Further reading:

Friends of the Earth: A Dangerous Distraction – why offsetting is failing the climate and people: the evidence. http://www.foe.co.uk/resource/briefing_notes/dangerous_distraction.pdf

Friends of the Earth is calling on people to demand a strong and fair global agreement to tackle climate change. Governments should:

1. Agree that developed countries must reduce their own emissions by at least 40 per cent by 2020, and reject all forms of offsetting, including proposals for new and expanded offsetting schemes.
2. Negotiate a new financial mechanism under the authority of the UN Framework Convention on Climate Change (UNFCCC) to ensure adequate financial flows of at least €200 billion per year by 2012 to developing countries to support their transition to low-carbon development and fulfil their adaptation needs.
3. Reject plans to introduce Reducing Emissions from Deforestation and Forest Degradation (REDD) offsets, and instead negotiate effective and fair policies that do not involve offsetting or plantations, and that recognise and enforce customary and territorial land rights of Indigenous Peoples and forest-dependent communities.

Friends of the Earth is:


- the UK's most influential national environmental campaigning organisation
- the most extensive environmental network in the world, with around 2 million supporters across five continents, and more than 77 national organisations worldwide
- a unique network of campaigning local groups, working in more than 230 communities throughout England, Wales and Northern Ireland
- dependent on individuals for over 90 per cent of its income.



**Friends of
the Earth**

Making life better for people by inspiring solutions to environmental problems

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