Consumers International

Policy position on climate change and emissions trading schemes

1. Background

In responding to citizen concern on climate change, governments around the world are regulating greenhouse gas (GHG) emission reductions. Governments have predominately chosen to do so by means of emissions trading, rather than carbon taxes and emissions trading schemes (ETS) are rolling out globally both at the country level, and at the international level under the Kyoto Protocol. Emissions trading schemes were designed to solve the problem of how to make emissions reductions affordable. Emissions trading schemes come in two forms:

1. Cap and trade emissions markets

Cap and trade systems are increasingly the policy of choice at both national and international levels to deal with emissions. A market is created to allow emissions to be traded through permits. Company X can buy permits from company Y allowing company X to create further emissions. At the same time a 'cap', or limit, is put on the number and size of permits on the market, which is gradually reduced with time. The intention then is that these schemes should work to reduce emissions over time.

2. Emissions offsetting

Offsetting is another type of trading scheme. Under these schemes, greenhouse gas emissions are 'made up for', or 'offset' by putting money into projects aimed at reducing emissions, such as building sustainable energy infrastructure.

In 2007, 65 million tonnes of greenhouse gases were traded internationally on voluntary carbon markets (largely representing carbon offsets), almost tripling the amount traded in 2006. The total value of the trades was $331m, an astounding 240% increase on 2006.[1]

ETS have received criticism for a variety of reasons, not least the inability of a scheme designed to address cost to impact on emissions levels. In addition to these fundamental problems, ETS are having a perverse effect on consumer action against climate change by preventing consumers' voluntary actions aimed at reducing climate change from being effective. The situation is made graver because in a significant number of cases, consumers are being misled as to the effects of their actions and are paying elevated prices based on this false impression.

In countries with national ETS, consumers electing to pay a premium for government accredited renewable energy do so because they are seeking to minimize their GHG emissions. Marketing by government and

[1] Hamilton, K. Sjardin, M. Marcello, T. & Xu, G *Forging a Frontier: State of the Voluntary Carbon Markets 2008*, New Carbon Finance, The Katoomba Groups Ecosystem Marketplace, 2008

industry pushes this perception. The perverse effect of ETS is that where a consumer makes this choice, the result is not a reduction in GHG emissions but simply a release of more carbon emissions permits onto the market.

The operation of the ETS means that, by purchasing renewable electricity the consumer has no effect on the overall pool of permits available (and thus carbon emitted), but simply reduces the number of permits the company producing the emissions intensive electricity is required to purchase and submit; this in turn drives down demand for permits and thus the price for permits in the carbon market. The number of permits is not reduced, it is the cost of the permits that is reduced. This means that more permits are now available to the remaining participants in the market at a cheaper price. Rather than reducing the number of permits available and thus carbon emitted, as the consumer intended, their action has merely resulted in cheaper permits, meaning the consumer has essentially subsidised the permits of the country's largest polluters.

In international schemes the outcome for consumers is the same. Again, consumers choosing to live more sustainably are unable to impact net GHG emissions in the desired way. In effect, consumers choosing to pay more to take action to reduce their emissions end up subsidising harmful emissions elsewhere. So a consumer may spend considerable amounts of money installing micro-renewable energy in their homes with the effect of enabling coal-fired power stations abroad to carry on with 'business as usual' and at a cheaper price.

2. National level ETS

Emissions trading schemes are being established as the primary regulatory mechanisms to reduce emissions. Many schemes or proposed schemes are devoid of complementary mechanisms to enable consumers to voluntarily engage in emissions reductions outside the mandatory scheme. This will result in consumers and organisations that are not required to participate in the scheme having little incentive to participate in emissions reductions activities.

An emissions trading scheme is driven through normal market mechanisms using a new 'carbon market'. Typically, a government will identify the largest polluters within the economy and require their participation within the scheme. All other members of that society have no mandatory responsibilities under the scheme. Those companies required to participate in the scheme are required to submit a 'permit' equivalent to a unit of CO2-e, for each unit of emissions that they produce in a given year. There are a finite number of units available for trading on a market, equal to the emissions reductions sought in that year. The higher the demand for permits the higher the price. Trading of permits allows the market to decide the price and the mechanisms by which they reduce emissions. As such, it is presented as rewarding those businesses that are able to reduce their emissions through efficiencies, conservation or new business models.

However, the flaw of an ETS, or 'cap and trade scheme' as it is otherwise known, is that there are a finite number of permits available on the market. The number of permits available in a given year does not change; instead it is the price per permit that changes. This effectively means the scheme sets both a cap and a floor to emissions reductions, and that emissions reductions over and above the cap cannot be

achieved. Often big polluters are required under pre-existing legislation to reduce emissions. ETS provides a loophole to this obligation by allowing them to pay their way out of it by buying pollution permits that have tended to be over-allocated in national as well as international schemes. Elsewhere, the tendency to set caps too high can result in governments effectively paying companies significant sums of money to 'limit' emissions to levels they had already achieved.

3. International/regional level ETS

If a national ETS fails to account for consumer action, consumers will become disengaged with domestic action and will seek quality forms of emissions abatement (carbon offsets) occurring abroad – essentially their actions can be said to be 'voluntary action leakage'. ETS aim to identify and abate carbon emissions at the cheapest possible price. Under the Kyoto Protocol where a target is not met domestically or where it is cheaper to purchase abatement internationally, it is possible for a country to invest in abatement projects occurring in developing nations through the accredited Clean Development Mechanism (CDM).

The aim of the CDM is to reduce the global cost of emissions abatement by supporting projects in developing countries that can be implemented at a cheaper cost to those in developed countries. The CDM may have an important role in providing consumers with confidence in purchasing emissions abatement abroad when they are unable or unwilling to participate in domestic emissions abatement. The strict regulations of the CDM can provide consumers with the assurance that they require to continue investing in emissions reductions by guaranteeing the success of the abatement.

The CDM was a controversial outcome of Kyoto negotiations. On the one hand, it can provide an incentive for developed nations to assist developing countries to build their economy using cleaner technologies – in this way it can be an important tool for development and poverty alleviation. On the other hand, it can result in developed economies reducing the amount of cheap abatement available to developing economies, which may affect their ability to participate in reducing emissions as they come into international negotiations such as those under the UNFCCC.

But from the consumer perspective the system is problematic. Within the context of voluntary action, there is a similar risk that consumers from developed countries may consume all the cheaper abatement opportunities, leaving consumers in developing economies with more expensive forms of abatement, essentially disempowering them from participating meaningfully in climate action. ETS can become a convenient way for developed countries to shirk emissions reductions responsibilities by shifting large proportions of emissions reductions to developing countries. This is directly in conflict with the accepted principal that developed countries must shoulder more responsibility that developed countries for climate change. The result is a non-transparent increase in carbon-intensive infrastructure in developed countries, undermining consumer mitigation efforts.

Regional ETS, such as that in the EU, have failed to result in significant emissions reductions because caps have been set too high and emissions permits over-allocated as the result of undue influence from the industry lobby. It is hard to see how this can be avoided at UN level, making ETS ineffectual in reducing overall emissions. From the point of view of allowing consumers to make voluntary shifts away from carbon-

intensive lifestyles, a carbon tax may be preferable to an ETS as there is no cap on emissions reductions, and thus all voluntary action will be accounted for. However, there are many arguments against a carbon tax, much of which is around equity, efficiency and the fact that a carbon tax cannot guarantee the level of emissions reductions.

4. Recommendations

Consumer organisations should

- Provide consumers with information on real impacts of voluntary actions as affected by ETS.
- Act as a watchdog for industry claims which may mislead consumers as to the results of their choices in products and services.
- Where national ETS are in place, lobby for complementary mechanisms to enable additionality of consumer voluntary action.
- Lobby for appropriate CPL on misleading advertising at a domestic level to ensure consumers are not encouraged to pay more for products and services that will not reduce total GHG emissions.

Businesses should

- Take all necessary steps to prepare for the necessary shift to a low-carbon economy.
- Refrain from lobbying for cap levels that would allow a 'business as usual' approach in practice.
- Engage with decision-makers to share innovative thinking genuinely aimed at reducing sectoral emissions.

Governments should

- Move away from ETS at both a national and international level.
- In developed countries, recognise that ETS are not designed to reduce emissions, by committing to reducing their own emissions to set targets, *excluding* offsetting.
- Where national ETS are in place, adjust the permits available under the ETS annually to account for voluntary actions, for example by establishing a voluntary market as a complementary mechanism.