COMMENTARY

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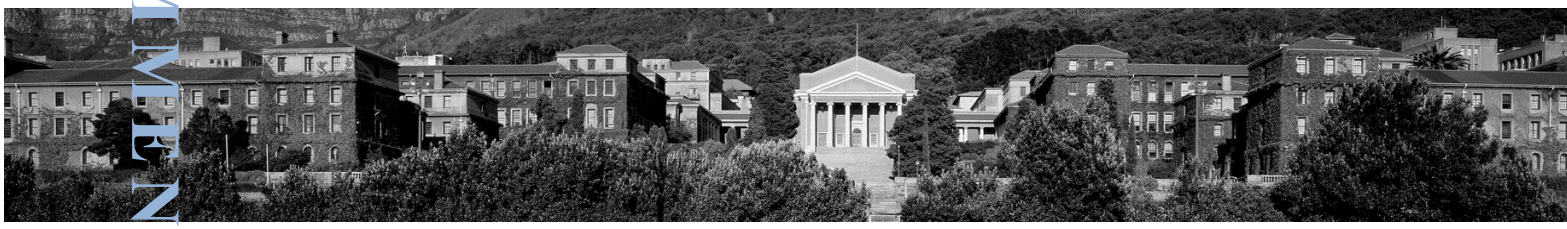

Comments on the *Carbon Offsets Paper* issued by National Treasury in April 2014

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Introduction

ERC welcomes the opportunity to provide comments on the Carbon Offsets Paper (National Treasury 2014).

As requested, the comments are organised in relation to themes identified in the paper.

a) General design features of the carbon-offset scheme as outlined in this paper

While this is not the paper on a full emittsions trading scheme (ETS) that had been indicated, comments are provided on the narrower focus of domestic offsets. The design is closely allied to Treasury's design of a carbon tax as set out in a policy paper (National Treasury 2013), with domestic carbon off-sets designed to reduce tax liability by up to 10%, for activities not covered by the tax. ERC has commented separately on the tax policy, and the present comments should be read together with those comments.[1]

The finding that carbon offset projects can generate significant local sustainable development benefits (p. 16) should be treated with caution. The experience with the CDM has been mixed, as assessed for example in (Ellis, Winkler, Morlot & Gagnon-Lebrun 2007). Market mechanisms generally favour low-cost reductions, and require clear policy guidance and / or financial incentives to deliver additional benefits.

b) Carbon-offset potential under the proposed carbon tax in South Africa

The estimates of demand for carbon off-sets appear to be based on simple methods, assuming total emissions and shares that might not be covered by a tax. We see no reference to the demand *at a given price*, be that a general carbon price, or assumed price of CERs; demand would presumably vary with price. It is also reasonable to expect that, since limited to domestic offsets, there would be relatively few large buyers. Hence a survey of demand from potential buyers (the major emitting firms in SA) might provide a more solid basis for estimating demand.

The assumptions for supply similarly rest on bold assumptions, for example 'roll-out multiplication factors' (Table 4).

Overall, our sense is that the estimates of demand and supply are not very certain; and hence Treasury's conclusion that supply should exceed demand may not be robust.

c) Eligibility criteria of carbon-offset projects under the carbon tax

The paper proposed that projects in the AFOLU and waste sectors be eligible for generating carbon offsets, since they are excluded from the first phase of the carbon tax.

For AFOLU, the paper does not appear to examine whether the potential for emission reductions could be achieved by a) the CDM, which does include afforestation and reforestation activities (contrary to para 19), but not deforestation; and in relation to the latter, b) investment in REDD+ projects – new provisions on Reducing Emissions from Deforestation and Forest Degradation in developing countries, under the UNFCCC. Domestic carbon offset projects should be examined against these alternative options – for the purposes of effective emission

[1] See http://www.erc.uct.ac.za/Research/publications/13ERC_Comments_Treasury_Carbon_Tax_Paper.pdf for comments on the carbon tax. It remains ERC's view that a simpler design of a tax above thresholds of absolute emissions, at the full nominal rate, with transitional assistance to energy-intensive and trade-exposed firms, provides for a better system.

reduction. If the sole purpose of carbon offsets is to reduce tax liability, then this mechanism is another (complex) feature of the carbon tax regime.

Listing of eligible and ineligible project types tends to raise discussion. Some overlap is seen on energy efficiency, and the determination of in/eligibility may be contested. Assuming listings go ahead, the exclusion of F-gases seems sensible.

d) Interim arrangements to operationalise issuance of carbon-offset credits by using existing international carbon-offset standards

Unless we missed others, the only reference to interim arrangements is in para 110. Given the complexity of setting up institutional structures (next point), this seems an option worth exploring not only as an interim measure.

e) General institutional arrangements to implement a domestic carbon-offset scheme

The paper does outline some of the institutional arrangemements that would be required. For a relatively small market (5-50 Mt CO_2-eq / year, if potential were correct) would need to replicated a wide range of institutions devleoped internationally, for a market of well over 1 billion CERs:

- The work of the CDM Executive Board, assisted by technical panels for baselines, methodologies; and small-scale projects, would have to be replicated by the DNA approving domestic methodologies
- A project cycle
- Verifiers would replicate designated operational entitities; which
- Would need to be accredited by additional bodies

Overall, the impression is that a large institutional effort is envisaged, duplicating existing international systems, for a relatively small market.

Given the above, we see a significant risk that a domestic carbon offset system would *increase* the transaction costs for relatively small projects in a small market.

f) The role, functions, capacity and location of the administrating entity of the scheme

If the scheme were to proceed, the DNA could play a central role. However, the current functions of the DNA were built around approval of projects, that were then examined – for baselines, monitoring, additionality, validation, verifiation, etc – by an international system. That suggest that extent to which the DNA's capacity would have to be enhanced will be considerable.

g) Development of a South African carbon offsets registry

The registry function is outlined, but the complexity of requirements in the International Transaction Log (ITL) may bear examination. Are there any examples of domesic registries in other countries? Some experience may have been developed in SA – at least for academic purposes – but it remains a question whether such a registry will robustly meet all the requiremnets.

h) Other issues that might be of relevance

The issue of additionality plagued the early development of the CDM, with debates being repeated *ad nauseam*. Any carbon offset system should draw the lessons learned on standardised *benchmarks* and well-developed tools for project additionality (ensuring that projects that would have been built anyway do not claim credit). The CDM methodologies provide standardised and internationally approved tools for these purposes, which should be utilised.

References

Ellis, J, Winkler, H, Morlot, J C & Gagnon-Lebrun, F 2007. CDM: Taking stock and looking forward. *Energy Policy* 35 (1): 15-28.

National Treasury 2013. Carbon tax policy paper: Reducing greenhouse gas emissions and facilitating the transition to a green economy. Policy paper for public comment, May 2013. Pretoria, Republic of South Africa. http://www.info.gov.za/view/DownloadFileAction?id=189311

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