

To whom it may concern
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Market Based Measure for the Aviation Sector

Project Developer Forum position paper

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Introduction

The Project Developer Forum (PDF) have been following the process underway to facilitate the development of Market Based Measure (MBM) to be used by the aviation industry towards its target of carbon neutral growth by the year of 2020. As this process achieves its critical stage in the month lead up by the 39th ICAO Assembly in Q4 2016, PDF believes that they can contribute with significant technical expertise and market experience to the development of a robust and workable mechanism that can be adopted by ICAO and set the aviation sector on their pathway.

PDF have set out in this note what it sees as the critical issues for the design of the MBM and the considerations that can determine the success of the process. In particular it has highlighted the opportunities for the use of emission credits from the Clean Development Mechanism (CDM) to meet many of its core objectives.

1. Carbon market context

Carbon markets have successfully been functioning at scale for approximately 10 years with the largest market the EU ETS having reached this landmark in 2015. The record of existing markets has been characterised by mixing success during this period with the reduction in emissions offset by over allocation of permits in the EU ETS, wild swings in prices and a drying up of investment in the project credit market. Despite these hurdles there remain new schemes underway and many under development and with the benefit of experience there seems likely to be a new wave of market based measures introduced or reformed over the next 5 years. This optimism is fuelled by the following observations:

- a. CDM in wider context of carbon markets: globally new market schemes are developed such as in Mexico, Kazakhstan, Turkey, South Africa, South Korea etc. allowing the use

of at least domestic CERs for the compliance purposes. As a lesson learnt it may be considered for the ICAO MBM not to allocate allowances to airlines based on complex and difficult allocation rules (especially in the light of missing data for all airlines globally) but to establish regular auctioning to allow for finding a price for carbon. To take the common but differentiated responsibilities into account subsidies for airlines in developing countries could be defined that can be financed by the auctioning revenues. Moreover, there needs to be reasonable de-minimis rules or thresholds for small emitters.

- b. Price evolution and outlook: the CER price has dropped dramatically after 2012 due to vanishing demand, but recently while the market is still consolidating a weak increase has been observed giving hope for middle term recovery. So, there is reason to expect that with a new push caused by a major player like ICAO prices may climb to levels that encourages new investments while the abatements costs will still be affordable for aviation industry. Indeed, ICAO can take advantage from the current situation by building upon an existing instrument and benefiting from the current low price level. Building a new scheme will spur price peaks in the beginning because new capacities have to be established before a mature market can evolve.
- c. Wider political context: as climate change is becoming more and more a reality and even politicians cannot deny any longer its existence regulations and limitations will increase and may threaten the aviation sector by burdening it with unforeseeable additional costs that very probably will be much higher than a price on carbon properly determined by free market forces.

2. Critical features in the design of the Market Based Measure for aviation

This report is focused on those features that came with the emissions market's experience to date, as listed below:

- a. Environmental integrity in any credits used: In addition to robust auditing of airline emissions, any emission reduction credit used must conform to the highest level of environmental integrity in order to stand up to the inevitable scrutiny from environmental NGOs, journalists and governments.
It is necessary that such credits are able to be proven to be additional and have a suitable and **transparent** system of monitoring and 3rd party verification.
In the light of the ongoing discussion about "true" additionality it should be considered if contentious financial additionality may be replaced by sectoral or technological benchmarks that allow an undoubted determination of eligible projects.
- b. A robust and transparent accounting and MRV system for credits and allowances: The systems requires a robust registry system that is sufficiently transparent to avoid any risk of double counting or double claiming. This also means that the projects need to have sufficient accounting structure so that each emission reduction is **permanent** and therefore removed from the national inventory of the relevant host country.
- c. With decisions to be made around the MBM in the year after the successful COP21 in Paris it is essential that any adopted MBM is easily able to be **co-ordinated with emission reduction targets on a country or regional basis that are adopted through the UNFCCC**. This ensures an alignment and co-ordination in actions and mechanisms.

- d. A system that contains sufficient flexibility to avoid high compliance costs: With the airline industry emissions growing at a very high rate (international emissions are projected to be 70% higher in 2020 than 2005 globally despite the achievement of an increased efficiency of 2% per annum), the MBM needs to ensure that there is sufficient availability of offsets in order to allow industry to both expand and meet its commitment to carbon neutral growth by 2020. In particular it needs to ensure that there is a low risk of spikes in price due to a shortage of supply of any offsets.
- e. Allows incorporation into other carbon markets: Linking is viewed as a key component to enhance the economic efficiency and reduce the cost of reducing emissions. This is important from a political standpoint and also allows the ICAO system to benefit from the lessons learnt in the 15 years of carbon market activity to date.
- f. Allows the reward for early action prior to 2020: With such high emission growth rates, any MBM needs to ensure that steps taken prior to 2020 are encouraged. This will provide a natural learning phase for pro-active participants in the market place and may offer very cost effective opportunities for reductions.

3. **Benefits of using the CDM infrastructure for the offset component of the ICAO MBM.**

As these issues are debated over the next months before an ICAO decision, it is evident how a focus on using emission credits from the CDM is beneficial. While it is undergoing and under constant reform, it now has a 12 year track record of generating **independent, credible and verifiable** emissions reductions internationally. Without the demand drivers from the EU and elsewhere, it has become characterised by over-supply, investment has now reached a very low level and the majority of participants have now left the market. This however also provides an opportunity for ICAO.

The core reasons for using the CDM as the exclusive provider of emission credits are set out below:

- a. Established environmental integrity: Over 12 years the CDM has established a robust mechanism for the approval and verification of project and program based credits. It has maintained a system that is transparent, has a strong body of expertise to provide validation and verification services and has an established governance structure. Critically for an organisation like ICAO, the CDM has also the legitimacy of the UN through the UNFCCC. The UNFCCC has made significant progress in its attempts to allow the mechanism to scale up with the introduction of standardised baselines and more programmatic activity.
- b. Robust registry and accounting system: The UNFCCC has a very established process for the approval and issuance of credits and a **proven registry** system that ensures the traceability of credits and avoids the risk of double counting. The host country Letter of Approval process provides a key safeguard that effectively allocates any emission reduction to the national inventory of a specific country. This ensures that any credits used by the aviation sector can easily be deducted from the relevant host countries inventory!
- c. Interaction with wider emission reduction efforts: Use of credits from the CDM will ensure that the MBM is as closely linked as possible to the UN process. It also ensures

that it will be linked up to the widest amount of other schemes. Beyond the EU, CERs are more likely to be used in emerging schemes.

- d. Available volumes: Crucially there is a wide base of projects and credits that can be used within the ICAO MBM. While a large number of projects have stopped verifying credits as a result of low demand and prices in the market there remain more than 7500 registered projects with the potential to generate around 1 billion t of tradable units **annually**. Even if industrial gases would be excluded still 800 Mt will be in the pipeline every year. Considering currently estimated growth rates in the aviation sector it is clear that no unbearable burdens need to be worried about, even with an average issuance success rate of 80% as in the past 10 years. With most projects having three 7 year crediting periods the base of existing projects can generate large volumes of credits into the 2020s. The state of the CDM provides an available, cost effective method for industry participants to take early action, engage with the market and grow a broad understanding of emission markets.

The mechanism provides opportunity for new projects to be developed. These large potential volumes could mean a cost containment mechanism for the MBM in its early years that will ensure growth is not immediately curtailed by compliance with emission targets.

4. Summary

PDF strongly believes that there is excellent complementarity between the objectives of ICAO with its MBM and what can be provided by the CDM. The CDM is a well-established mechanism that has proven it can supply more than sufficient emission reduction since the past ten years. It delivers transparent, stringent, environmental integer and permanent emission reductions and provides the necessary infrastructure for MRV as soon as ICAO decides to make use of this infrastructure without the need to waste time for reinventing the wheel. Moreover, the CDM is a recognised UN mechanism that easily can make a transition to the Article 6 – mechanism as per the Paris Agreement. Furthermore, aviation industry will avoid the risks associated with double counting as the CDM already has the **only** UN controlled and supervised registry including a working process (LoA) and infrastructure (DNA) for the recognition of emission reductions by a country. Moreover, airlines can decide to support sustainable emission reductions in their home base or where ever they think it is appropriate and use this activity for their CSR process.



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