PROJECT
DEVELOPER
FORUM

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From	gareth.phillips@pd-forum.net
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Page	1/5
Subject	**Call for public comments on the "Carbon Offsets Paper" launched by the National Treasury of the Republic of South Africa in April 2014**

Dear Mr Janoska,

The Project Developer Forum (PD Forum) commends the government of South Africa for its ambitious climate change policy and the consistent evolution and constant stakeholder engagement. We believe that the ambition and the broad consultation that is being shown will give South Africa the leverage to play an active role in promoting the progress of the international climate change negotiations to achieve the international cooperation that is required.

With this submission we respond to your invitation for comments on the *Carbon Offset Paper* as launched in April 2014, under consideration of the *National Climate Change White Paper,* as published in in 2011. Before entering into specific comments, we would like to commend the paper for i) giving consideration to the importance of market mechanisms, ii) mentioning the opportunities for combining different policy instruments and tools, iii) recognizing the need for sound Monitoring, Reporting and Verification procedures; and iv) emphasizing the importance of private sector engagement. Furthermore we appreciate that the documents outline important elements for further evolution, such as a) the possibility for the definition of sectoral carbon budgets, b) the establishment of a national offsetting scheme and c) the possibility to progress towards an ETS.

In this context, the Project Developer Forum is glad to provide comments which we believe are suited to support South Africa in implementing a sound and efficient carbon pricing scheme which will promote quantifiable and reportable early and increasing action, attract private sector engagement, innovation and jobs, and prepare the country for opportunities from enhanced international cooperation.

In the following section, we provide our response to some of the specific topics for comments as outlined in the Paper.

a) General design features of the carbon offset scheme

The PD Forum welcomes the developments in the South African tax and associated carbon offset scheme. Though the initial level of tax is relatively low when considering that only 40% of the applicable GHG emissions are covered, the offset component will translate this into a very effective incentive for investments with Measurable, Reportable and Verifiable GHG emission reductions. This element, together with the announced increases in tax level and coverage, provide a very clear signal not only to existing installations, but also for new investments that are of importance for South Africa’s economic growth. This is the kind of leadership which the fight against climate change needs and the proposals in this document illustrate how a transparent and efficient offsetting scheme can mitigate the economic impacts of the tax and lead to new investments and innovation in low carbon technologies.

The *Carbon Offset Paper* is intended to provide clarification as to "how firms" can reduce their carbon tax liability using carbon offsets (para 7). However, the paper is structured so that the clarification regarding "how" to develop eligible offsets for the South African carbon offsets scheme is somewhat lost amongst the discussion of why certain decisions relating to the design of the offset scheme have been made. Whilst clarification regarding the rationale behind the offset design is welcome and important for the public consultation process, it might be useful for the next version to prepare two separate documents so that one document outlines the clear procedures and requirements for firms who are considering using offsets and the other clarifies the rationale for the design.

Considering the proposal as presented, we note a number of potential benefits arising from them, as outlined below:

- A hybrid of tax and trading is easy to implement, but still offers a broad carbon price signal as the offsetting component provides a specific focus on the necessary clean economic expansion.
- A tax alone poses non manageable risk to fossil fuel investors, but no incentive to clean investors and thus hampers economic growth. Tax and offsetting together offers an effective hedging strategy which will promote clean expansion to balance portfolios.
- Early action from investors that developed and registered or validated projects is recognized.
- As soon as the terms for offsetting are clear and defined, there will be an effect of anticipation, leading to enhanced investment even before the tax obligation is effective.
- The scheme is designed to ensure efficient MRV of mitigation results even for new capacity.
- Cost / revenue recycling in the power sector would allow minimizing the increase of power costs.
- The scheme will attract investment, competition & innovation.
- It will also give political prestige for international negotiations and position in Lima 2014.
- The scheme will prepare the ground for a possible future ETS development and potential linking with other schemes under development internationally.

However, there are some issues around the general design of the offset scheme which we would like to bring to the Treasury's attention. The PD Forum would also like to highlight that Certified Emission Reductions were created under the CDM for transfer *between* jurisdictions, and specifically between Non-Annex 1 and Annex 1 Parties. An additionality test was introduced to prove that the project activity was not business as usual. We suggest that consideration is given to the Joint Implementation (JI) mechanism, as a means of developing projects with lower transaction costs than the CDM. JI was designed for transfer of units within entities who held a cap and has similar levels of rigour to the CDM in terms of calculating emission reductions and MRV. Under JI however, additionality is less critical as units are usually transferred within a jurisdiction or between jurisdictions with a cap and as such these units are backed by the national inventory. For this reason JI can offer a high degree of transparency, efficiency and solid MRV and environmental integrity without being subject to many of the complexities, costs and criticisms of the CDM.

That said, one of the in favour using the CDM for internal offsetting is that it offers and existing infrastructure and high credibility, and most importantly the opportunity to sell part of the offsets to international buyers. Such indirect linking of domestic and international demand can support some of the domestic mitigation costs and it could pave the way towards direct linking in the future. On the other hand the CDM still is a relatively expensive mechanism and therefore its reform or alternative options should be envisaged.
A first element of reform already mentioned by the *Carbon Offset Paper* is to pursue the development of sectoral mechanisms and given the strong domestic policy support for some mitigation measures, such as the REIPPP offer an interesting opportunity to promote such concepts. With such concepts, we believe that South Africa could be key driver for the reform of the CDM towards a more cost efficient and effective offset and MRV mechanism as needed by developing countries to support the development of their domestic carbon market infrastructure.

Beyond the reform of the CDM and considering the objective to develop Carbon Budgets for specific sectors as defined by the *National Climate Change White Paper,* Section 6.1.3., as published in in 2011, there remains the possibility to move towards a national Emission Trading Scheme, Given that high transaction costs under the CDM are mainly due to the demonstration of additionality, JI could offer an environmentally acceptable alternative, providing that a robust national inventory is developed.

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

The actual supply of carbon offsets is not clearly defined (para 16, 73, 79) since the potential will only be fully realized if the price signal provides sufficient incentive and there is also considerable uncertainty about the level of demand. This uncertainty of demand is not only related to the level of offsetting that will be used by entities covered by the domestic carbon tax, but also to a possible revival of international demand, which might be attracted by the fact that South Africa has established an ambitious domestic system. With full consideration of these uncertainties and given the importance of the offset mechanism to foster cost effective GHG mitigation and investments in clean infrastructure we recommend that eligibility criteria are clear, but not too restrictive in order to avoid that important and structural mitigation opportunities are lost. Furthermore we understand that the South African Treasury has effective measures to adjust its policies to the effective outcome. For example, in case the offsetting mechanism is very successful and offers abundant GHG mitigation at low cost, the coverage of the carbon tax or the share of offsetting allowed under the scheme could be expanded to ensure that this positive outcome is sustained. On the other hand, if international demand takes up a large share of the units and leading to a high demand and price, the coverage of the tax might be maintained at 40% for a longer time, while possibly the level of the tax might be adjusted to reflect the higher marginal abatement price.

In conclusion we believe that a sound monitoring of the progress of the offsetting policy is important to allow adequate adjustments over time, while it seems important to ensure that the option to develop GHG mitigation projects is accessible to a broad range of sectors and actors as this will reduce the cost of GHG mitigation and ensure innovation in all sectors of the economy.

Based on these considerations it might be of interest to define and signal that such flexibility of the design parameters of the carbon tax and the offset eligibility are being considered.

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

We offer the following comments on the eligibility criteria:

1. The justification for excluding all activities covered by the tax is due to both the observation that the offset scheme should not support activities with significant mitigation potential that can be achieved at negative costs (Para 56) and due to concerns about double counting. The first assumption regarding negative costs, does not appear rational, since it implies that the business as usual scenario is that the private sector will implement mitigation measures that make economic sense. However, it is clear that many profitable climate change mitigation activities do not occur even though a business could earn money from such investments. The reasons are primarily related to non-financial barriers. The criterion for defining a BAU scenario or baseline is therefore somewhat simplistic. Furthermore this paragraph appears to contradict para 65, in which the eligible project methodologies to define the BAU include sectors where mitigation costs will be negative e.g. Energy Efficiency. With regards to the issue of double counting, there are alternative design approaches which could address the issue of double counting which have not been explored in the paper
2. It is understood that the registering organization or accrediting organization will develop positive lists for specific project types in the following sectors - Energy and Energy efficiency, transport, agriculture, forestry and other land uses and waste. Project types that are included on the positive lists will be deemed automatically additional. The methodology or criteria for defining how projects will be included on this list however remains vague. More information on the approach for defining the positive list would be useful for both project developers and would help clarify understanding regarding the supply potential of eligible projects.

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

It is understood that in order to “kick start” the offset scheme, project developers may refer to methodologies for the eligible project types under the international offset standards defined by the CDM, Verified Carbon Standard (VCS), GS, Climate Community and biodiversity standard (CBS). It would be useful if the South African DNA defined in advance of the scheme which methodologies under these international standards are eligible. This would then remove the need for the DNA to “validate” projects for eligibility as indicated in para 91.

It is understood that ISO 14064 (1-3) a, ISO 14065 and ISO 14066 will be used as the standard for accrediting bodies/third party verifiers. It is however not clear if the CDM Validation and Verification standard will be applicable in the interim period. It is recommended that the South African government consider allowing the use of the CDM VVS in order to maximize the availability of auditing companies which will in turn ensure that transaction costs for their services are kept to a minimum as a result of competition.

Clarification regarding the timing and inclusion of stakeholder consultations would be useful. It is clear that a stakeholder consultation would occur at the time of verification, but it might also be useful to allow for stakeholder consultations via a web interface during the development of the positive list of project types deemed automatically additional, the approval of new methodologies and at the pre-screening of a project and/or at validation.

i) Other issues that might be of relevance.

In addition to the practical arguments above we would like to highlight some important opportunities to develop a regulation which can facilitate that the South African mitigation efforts are recognized by the international community, as well as to facilitate international cooperation and future linking of carbon pricing schemes:

a) The environmental effect of a pure carbon tax is difficult to quantify, especially because it focuses on existing infrastructure more than on new capacities. On the other hand, a developing country such as South Africa will need to focus on economic growth and creation of jobs and welfare and at the same time minimise the build-up of new GHG intensive infrastructure. Such a focus on a clean expansion and green growth can be achieved by allowing offsetting of existing GHG mitigations by emission reductions that stem from sustainable new production capacities. For such avoided GHG emissions, we believe that the Kyoto mechanisms are the most effective and reliable mechanisms for baseline setting as well as for MRV.

b) By using the Kyoto mechanisms as one of the key mechanisms, South Africa would ensure that the emission reductions generated are eligible according to the principles of the UNFCCC and thus are eligible in many other countries. In addition to promoting such indirect linking with the international community, which would facilitate sharing some of the domestic mitigation cost, we believe that South Africa has an important opportunity to catalyse the reform of the CDM towards an offsetting mechanism more suited to the demands of developing countries. Of special interest would be to catalyse the development of sectoral baselines and crediting approaches.

c) A further step could be to migrate from using the CDM towards using the Joint Implementation mechanism, an option which could be envisaged as the country develops is sectoral and national carbon budget approach and as soon as South Africa understands that it is feasible and adequate to convert its emission reduction objectives into firm national targets. Under such a scenario South Africa could develop a sound domestic offsetting mechanism which is aligned with UNFCCC principles and which generates tradable units with the highest level of environmental integrity.

In conclusion, we would like to reiterate that we believe the carbon tax and offset proposal, which is being developed by South Africa, is a highly differentiated and promising solution which we believe does not only contribute to the country’s international prestige, but may also be an inspiration for other countries. Given the importance of a coordinated progress by the international community, we encourage South Africa to continue its constructive way under close consultation with all stakeholders and in cooperation with other countries in order to ensure that the solutions that are being developed are comparable and allow as much international cooperation as possible.

Kind regards,

Gareth Phillips.

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