WWF South Africa's response to the Carbon Offset Discussion Paper published by National Treasury

Summary of WWF-SA's position

WWF South Africa (WWF-SA) finds the concept of commodification of public goods problematic, and would prefer to avoid such a process wherever possible. This necessarily includes the development of carbon offsets. Carbon offsets have been promoted as an important part of the solution to the climate crisis because of their economic and environmental efficiency and their potential to deliver sustainability co-benefits through technology transfer and capacity building. WWF-SA believes that offsets are a complement to (and not a substitute for) the traditional environmental impact mitigation hierarchy of *avoid, minimise, mitigate*. Although different meanings are ascribed to the terms used here, WWF SA understands minimise to mean designing a project in such a way as to reduce harm, and *mitigate* to mean alleviating the residual harm, to the extent possible. Offset is thus interpreted as an activity to compensate for residual, unavoidable harm.

For this reason, WWF-SA believes that offsets must have a phase out period. A cut-off date needs to be built into the offset system, after which the blanket provision of offsets is curtailed. For a carbon offset system to be credible, it must meet essential quality criteria such as permanence (offset delivers the reductions it stated) and leakage (the emission reduction in one area doesn't cause an increase in emissions somewhere else), tight rules, audit capacity, and registry for projects with transparency between buyers and sellers.

In principle, for a carbon offset scheme to work, the carbon price must not be so low that it disincentivises mitigation effort. However, within the current carbon tax price structure proposed in South Africa, there is an insufficiently strong tax incentive initially to either reduce emissions or to purchase offsets. WWF-SA also urges that implications of a floor price be modelled in relation to market development of offsets and the setting of different floor prices be considered for different types of projects because the size, complexity and cost effectiveness of projects varies per project type.

Finally, WWF-SA believes that an offset scheme should include thresholds of social and economic benefit so as to ensure strong and real sustainable development benefits such as provide cheaper and healthier energy, jobs and incomes, and/or ecosystem conservation and restoration.

a) General design features of the carbon offset scheme

1. **Basic stance:** WWF-SA finds the concept of commodification of public goods problematic, and would prefer to avoid such a process wherever possible. This necessarily includes the development of carbon offsets. However, we acknowledge the value of a flexibility mechanism as a means of preventing unnecessary economic shock for companies during a transition period, and believe that the carbon offset margin of 5 – 10% fills such a role. Furthermore, the WWF-SA recognises that an offset mechanism is an essential final step in a mitigation hierarchy, to enable the reduction of impacts that cannot be avoided or reduced through efficiency improvements or clean energy generation.

2. **Proposal of cut-off date for offsets:** With this in mind, WWF-SA would recommend a cut-off date built into the offset system, after which the blanket provision of offsets is curtailed. Subsequent to this cut-off date, it would still be feasible for certain tax-liable entities to apply for offsets if they demonstrate both a determined attempt to reduce carbon emissions

and the inability to reduce further. Under such a circumstance, we would propose that the current process emissions allowance is transitioned to an offset allowance. This would enable the possibility for sequestration of carbon where emissions are unavoidable, whilst ensuring that the price is determined by a flexible market mechanism. In addition, the consequent removal of a "free-ride" will further disincentivize highly-emitting industries and promote the development of alternatives.

3. **Mandatory reporting:** Under the proposed offsets scheme and the carbon tax as it stands, there is significantly more rigour applied to the measurement and monitoring of carbon offsets than there is to the emission of carbon dioxide from industry. Whilst this level of rigour is welcomed, since it prevents falsification of sequestration claims, we strongly support mandatory reporting of emissions from all large-scale emitters with a similar level of rigour. Whilst there has been discussion of the requirement for emissions reductions, WWF-SA strongly urges that i) a simplified tool to determine whether a company meets the minimum reporting criteria be developed as soon as possible; and ii) that guidelines for rigorous carbon emissions reporting be made available for both qualifying companies and independent auditors.

4. **AFOLU:** The exclusion of AFOLU from the carbon tax in the first phase makes it feasible for landowners and developers to undertake sector specific offsets in this period. However, generation of carbon benefits through activities endorsed in Appendix C (specifically ARR, REDD+ and improved land management) is unlikely to provide returns on investment within the specified five-year window. If these sectors become tax-liable in the next phase, they will become ineligible for offsetting activities, so whilst the activities may reduce their tax liability, they will nevertheless likely incur a loss. This uncertainty will hinder investment in the key target areas that are specifically identified as priorities for multiple-benefit carbon-offset project development. It therefore suggested that the Treasury provide clarity around the inclusion (or otherwise) of agriculture and other land uses in terms of carbon tax eligibility within the next phase of the carbon tax.

5. **Multinationals:** it is understood from the offsets document that multinational organisations will be held to the same conditions as local companies, and they will be liable for scope 1 emissions generated within the borders of South Africa. Has consideration been given to the reduced tax obligations of certain such companies?

6. **Carbon offsetting principles:** In general the WWF-SA agrees with the principles as laid out in the offset discussion paper. However, it is not clear that the offset paper fully considers the impact of some of these principles, as highlighted below.
   - "Real: Delivered GHG emission offsets originate within tangible physical objects with proof that they have occurred ***or will occur at a specific point in time***." [Comment: The forward selling of *ex-ante* credits has proven to be highly problematic. The overall success rate of CDM projects is 14%, and by 2007 the total credit issuance was only 76% of the initial forecast. For new projects in South Africa there is no reason to assume the rate will be significantly higher. Including *ex-ante* credits in the national offset market could undermine the success of the carbon tax. WWF-SA therefore strongly advises that the last clause be excluded from this, and that forward-selling of credits not be allowed within the offset regulations.]
   - "Enforceability: Offsets delivered by the project should be backed by legal instruments that recognise the validity of the offsets created, provide for transparency of the MRV system and ensure exclusive ownership." [Comment: where carbon projects are linked to land use (avoided deforestation, improved land management and afforestation) there is potential for conflict regarding this

enforceability. Legal standards surrounding the ownership of carbon rights in communal or state land, or where the project implementer may not be the owner of the land have not yet been developed.]

- "Additionality: GHG emissions reduction that the project delivers is additional if they would not have occurred under a "business-as-usual" scenario." [Comment: This is the most essential component for viable carbon projects, without which offsets can potentially undermine the development of a green economy. WWF SA supports the use of best-practice additionality assessments from international standards, and we hope to see these same stringent tools used should a local standard be developed.]
- "Permanence: GHG emissions reduction delivered by the project are permanent and unlikely to be reversed. Additional guarantees can be built in so that reversals will be compensated." [Comment: AFOLU projects are necessarily highly unlikely to provide permanent sequestration without long-term modification of the usage rights on the land as well as substantive protection mechanisms. The CDM addresses this non-permanence issue by creating temporary CERs that are only valid for the crediting period, and the VCS does the same for the contractual project period. Upon expiry, such credits must be replaced with either permanent CERS or new tCERs. Without this provision, the efficacy of offsets is threatened.
  - As such, any credits transferred to the national offsets programme must have their expiry dates maintained intact. Any such credits retired against a tax-liable entity must also include a required replacement date, after which point they must either be replaced or the tax is payable.
  - In addition, the VCS retains a buffer of credits from each project to address non-permanence issues – this role is best suited to an entity with a large pool of available credits, and whilst it might be a challenge to replicate through a national registry, it is strongly encouraged. This buffer is not counted towards the total emissions of the project or the standard
  - The EU-ETS specifically excludes temporary credits from their programme as a means of reducing risk. This might be considered within the South African context.]

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

7. WWF-SA appreciates that there is some range within the estimates provided in the offsets discussion paper, but we feel that the paper overestimates the simplicity of bringing carbon projects to market. The total supply is unlikely to meet the estimates in the offset paper in the first phase of the carbon tax due partly to the high cost, complexity and skills requirements for such projects under the specified standards.

8. In addition, the uncertainty with respect to AFOLU project potential (see paragraph 4) may drive developers (and risk-averse investors) to other models, reducing the total offset generation capacity detailed in the document. Finally, the high multiple-benefit potential of AFOLU projects will be lost, undermining to some extent the argument put forward for the use of offsets.

9. On the other hand, it appears that with the current carbon tax price structure, there is an insufficiently strong tax incentive initially to either reduce emissions or to purchase offsets. Consequently it does not seem likely that all companies will look to capitalise on their offset potential, at least in the first phase of the carbon tax. The current models assume a high rate of uptake from tax-exposed sectors, but our discussions with such entities indicate that this may not be the case.

10. This uncertainty may have implications with regards to the management of the carbon offset market. With all projects required to register exclusively with a national registry, there is potential for an oversupply of credits in the national marketplace. Since these will be embargoed from international trade, the effective carbon price may undermine energy efficiency activities in non-regulated sectors as players opt to purchase credits rather than undertake more expensive efficiency measures. This in turn undermines the mitigation hierarchy, reducing the overall effectiveness of a transition to a green economy.

c) Eligibility criteria of carbon offset standards under the proposed carbon tax in South Africa

11. The carbon standards selected present a sufficient level of rigour in the methodological structures and the additionality criteria, and WWF-SA supports the use of international best standards in this regard.

12. Nevertheless, WWF-SA supports the stated focus on carbon offset projects that provide a sustainable development angle, particularly those which enable the conservation and restoration of key biodiversity and water areas whilst providing measurable carbon sequestration benefits.

13. A concern arises over the fact that the current structure does not allow industries to claim credits for their scope 2 emissions[1] Scope 2 emissions are not part of the taxable activities in such companies, but the current proviso limits the ability to address their scope 2 emissions using carbon credit investment to undertake (for instance) renewable options such as photovoltaic or wind installations. Since these activities are also specifically excluded from the 12L Energy Efficiency tax incentive, this means that carbon tax-liable companies are less able to reduce their scope 2 emissions than other companies. In the case that a tax-liable company does invest in small-scale renewables, it would still not obtain a reduction in its carbon tax liability. In effect, this exclusion reduces the potential impact of the carbon tax by limiting the potential for small-scale captive power generation in carbon tax-liable companies.

    WWF-SA therefore strongly recommends that **either** an incentive for captive renewable power generation is provided from the carbon tax revenue (since this is specifically excluded in the current energy efficiency tax incentive), **or** offset credits be allowed for scope 2 emissions, even if these are only claimable against the same entity's scope 1 emissions up to the current limit.

14. It must also be noted that the exclusion of projects benefitting from other government incentives is likely to render many potential AFOLU and biomass-energy projects non-viable, inasmuch as the current EPWP Land User Incentive is typically essential for such projects to undertake large-scale activities on marginal land. If this clause is specifically referring to the Energy Efficiency Tax Incentive or the REIPPP (as implied later in the section) it should specify such.

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

[1] National Treasury Carbon Offsets Paper, Paragraph 55: "*…only entities not liable for the carbon tax will be permitted to implement emission-reduction projects and sell carbon offset credits to entities liable to the carbon tax.*"

15. In the absence of a fully-developed local standard, the onus of additional registration for projects (first through an international standard, and then through the local registry system) may well undermine the viability of even large-scale projects. WWF-SA strongly suggests that all interim administrative structures (prior to local standard development) be as simple and low-cost as possible. The proposal to include voluntary standards but to require a second validation from the DNA is unnecessarily complicated and onerous on project developers. A more viable option would be to approve selected methodologies within said standards that meet national eligibility criteria, and to trust in the independent audit process carried out by the standard and the certified third-party auditors to ensure that the necessary criteria are met. For CDM methodologies, the DNA should nevertheless retain the oversight role specified (corresponding to the role played by standards bodies under the voluntary standards).

e) General Institutional arrangements to implement a domestic carbon offset scheme

16. A concern with respect to the use of such standards rests on the lack of local expertise to audit them. At present there is one listed designated operational entity (DoE) in South Africa which is capable of auditing some (but not all) the project scopes detailed in Annex C. Whilst the SABS, SANAS and CSIR are proposed as suitable institutions, at present all the endorsed standards required DoEs that are registered either with the standard or with the ISO. Such registration, in addition to requiring highly specific skills, is costly and onerous. This skills shortage is unlikely to be addressed in the short term, and must necessarily be filled from an international pool. To a large extent, this reduces the sustainable development potential of such investments.

17. WWF-SA supports the development of a streamlined domestic carbon standard to simplify the process of project establishment. By reducing the international third-party requirements associated with the current DoE, it is feasible that a larger portion of the finance raised from carbon offsets will be directed into sustainable development and green economy targets, rather than channelled into a series of skilled intermediaries.

18. To this end, government must invest quickly in ensuring that the necessary skills are in place for the proposed medium-term domestic carbon scheme.

19. Nevertheless, WWF-SA must caution that the carbon market must not be seen as an objective in itself. A large carbon market runs the risk of undermining the effectiveness of a carbon tax, especially if it attains a size and lobbying status sufficient to entrench or increase the portion of allowable offsets under the tax. By retaining a small administrating entity, endorsing specific standards and methodologies, and limiting the size of the carbon market, government would be able to ensure that carbon offsets retain their position as the final step in the mitigation hierarchy.

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

20. The WWF-SA supports the use of the DNA to administer a domestic carbon offset scheme. Nevertheless, it will require significant additional capacity if it is to fulfil an administrative and oversight role for the significantly increased market size. We would caution that requiring the DNA to fulfil too many of the functions already addressed by the selected standards and independent auditors is likely to lead to reduced functionality of the overall scheme. The role of the DNA should be as a regulator of appropriate methodologies, a

reviewer of independent audits and project validations, and a gatekeeper for credit inclusion in the registry.

g) Development of a South African carbon offsets registry

21. International registries already fulfil this need for the specified standards, and to some extent include all the specified standards. Allowing credits to be traded through these registries (which also track country of origin and project methodology) would provide more flexibility for the local developers in the case of an international price boom, whilst still enabling local purchasers to obtain the credits. The DNA could endorse specific activities and methodologies within the selected standards as mentioned in paragraph 15, and require that purchasers provide certificates of retirement from the selected registries, specifying both the place of origin and the project methodology. This flexibility will encourage the broader development of offset activities within South Africa, and provide a certification schema for retirement of credits. It also reduces the overhead.

22. Nevertheless, in the medium term, development of a local registry would be preferable, inasmuch as an entity would be required to manage credits developed through a domestic carbon offset programme. Internationally, the carbon trading platform and registry are integrated as a single unit; in the South African example, this role could be filled by the JSE.

h) Development of a carbon trading platform

23. The WWF-SA supports the use of the JSE as a trading platform, since it has displayed much of the competence and fiscal responsibility required to maintain such a market.

i) Other issues of relevance

24. One thing that has been lacking in the Treasury reports to date has been case studies for specific example companies. Whilst the economic modelling has been conducted on a macro-level, a clear understanding of how this might operate on a case-by-case basis is hard to assess. The specific example of carbon tax, offset and rebate options (with costings) for one or two named entities that have disclosed emissions under the Carbon Disclosure Project might better illustrate how real companies are likely to respond to the tax.

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