FAQ on carbon credits and climate mitigation

Carbon credits have played a role in climate mitigation for many years as an instrument for offsetting climate-damaging greenhouse gas emissions in one place by greenhouse gas reduction measures in another place. Specific mitigation projects receive one carbon credit for each tonne of CO_2 they reduce, which they can sell to entities interested in offsetting their emissions. However, the climate impact of the carbon credits, the quality of the projects funded and therefore the actual emission reductions achieved can vary considerably.

This FAQ provides information on the challenges and quality differences in the use of carbon credits, the limits of carbon offsetting and new ways of financing climate action.

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1 Who can use carbon credits?

Carbon credits can be used voluntarily by various stakeholders. Private individuals can offset greenhouse gas emissions caused by their own behaviour by purchasing carbon credits or make a contribution to climate mitigation. Organisations and companies set themselves zero-emission targets and use credits to offset a share of their emissions or to finance climate mitigation measures elsewhere.

In addition, emission allowances are being used as climate policy instruments, such as in the European Emissions Trading System or by countries to achieve part of their climate targets abroad. This FAQ relates to the voluntary carbon market, i.e. the voluntary use of carbon credits.

2 What types of carbon offsets are available?

2.1 Carbon credits from mitigation projects

The revenue from the sale of carbon offsets is used to finance and implement a specific climate mitigation project. For this purpose, mitigation projects must first register with the carbon crediting programmes. These programmes specify the requirements for mitigation projects and the issuance of carbon credits. Independent experts check whether a project fulfils the requirements of the carbon crediting programme. After successful verification and registration, the emission reductions must be measured and calculated according to the set methods. A credit is then issued for each tonne of CO_2 mitigated. Carbon credits can be traded in electronic registers and sold to intermediaries or final customers. Once the credits have been used, they are deleted from the register. There is a large variety of climate mitigation projects, carbon crediting programmes and sellers of carbon credits. The characteristics of these credits and their actual climate impact can vary considerably (see question 5 on the quality of carbon credits).

2.2 Allowances from emission trading systems

Under emissions trading systems, a cap is set on the maximum volume of greenhouse gas emissions permitted for a group of emitters, such as electricity producers and industry. A credit is issued for each ton of CO_2 allowed under this cap. The emitters are allocated allowances or must purchase them from the government and demonstrate that they have an allowance for each tonne of their greenhouse gas emissions. Emission trading systems are designed to achieve climate targets as cost-effectively as possible. This is because those who can avoid greenhouse gases more cheaply can reduce their emissions more and sell surplus credits to others for whom reducing emissions would be more costly.

Emission trading systems were not designed for voluntary carbon offsetting; however, nonparticipating companies and organisations or private individuals can also buy and cancel allowances. This reduces the supply of credits and therefore also the total emissions. This is because the purchase of these allowances indirectly increases the cap of the emissions trading system.

A study conducted by Adelphi and Oeko-Institut has analysed the advantages and disadvantages of retiring allowances from the European Union Emissions Trading System (EU ETS) compared to using offsets from mitigation projects. In principle, allowances from emissions trading systems guarantee greater certainty that emissions will actually be reduced. In practice, however, a climate impact is only achieved if the total emissions permitted under the emission trading system are not set too high. In addition, some emission trading systems have instruments for stabilising allowance

prices. Under certain circumstances, these can result in the cancellation of an allowance only reducing the maximum total emissions by less than one tonne of CO_2 .

Further sources of information

<u>Oeko-Institut's blog post 'Voluntary carbon offsetting - credits, allowances or both?</u> (in German only)

Study 'Voluntary offsetting: credits and allowances' by Oeko-Institut and Adelphi (2021)

The following organisations offer EU ETS allowances for offsetting: <u>www.compensators.org</u>, <u>www.50zero.eu</u>, <u>ck.wisenederland.nl</u>, <u>www.fortomorrow.eu</u>

3 What are the limits of carbon offsetting?

Carbon offsetting is a concept in which individuals or organisations voluntarily offset their own emissions by purchasing and retiring carbon credits.

In the view of Oeko-Institut, carbon offsetting only makes sense if the emissions to be offset really cannot be avoided. It should therefore first be checked whether the processes and personal behaviour can be changed in such a way that the climate-damaging greenhouse gases are not released into the atmosphere in the first place. Private individuals, for example, can travel short distances by train instead of by plane, use green electricity, and drive less, among other things.

Overall, there is considerable uncertainty as to the extent to which the purchase of a carbon credit actually leads to a reduction of one tonne of CO_2 elsewhere (on the quality of carbon credits, see also question 5).

But even beyond that, carbon offsetting has its limits. After all, to achieve the objectives of the Paris Agreement, global GHG emissions must be reduced to net zero in the decades ahead. This means that every avoidable emission anywhere in the world actually needs to be avoided by the emitters themselves. The concept of carbon offsetting can therefore only flank the path to a net-zero society. Further measures must be taken to drive forward the necessary transformation towards a GHG-neutral way of life and economy. The emissions that remain in a net-zero world and are difficult to avoid must be neutralised by removing CO_2 from the atmosphere, e.g. by capturing and permanently storing CO_2 from biomass (BECCS).

For these reasons, Oeko-Institut, along with many other actors, is in favour of dispensing with offsetting and making instead **climate contributions** (also known as contribution claims) to take responsibility for the damage that emissions cause to society. This means, for example, that companies fund emission reductions outside their value chain without claiming compensation or neutralisation of their emissions.

3.1 How exactly do climate contributions work?

In contrast to the concept of carbon offsetting, whereby the actors claim that their emissions are offset by the purchase and retirement of carbon credits, in the concept of climate contributions the actors assume social responsibility for the negative impacts of their currently unavoidable emissions without claiming compensation.

The amount of a climate contribution is determined by the actors themselves by multiplying the quantity of their emissions by a carbon price they set themselves. In order to determine an appropriate price, they can use various metrics as a guide. These can be, for example, the climate

costs of GHG emissions which, for 2023, the German Environment Agency sets at EUR 250 per tonne of CO_2 emitted. Another possible metric is the carbon price that would actually be required to achieve the temperature goals of the Paris Agreement. The Intergovernmental Panel on Climate Change (IPCC) sets this at USD 90 to 220 per tonne of CO_2 for the period up to 2030. The prices of emission trading systems like the EU ETS can also serve as a guide.

The contribution calculated in this way provides actors with a budget for financing climate mitigation activities. It can be made by purchasing carbon credits from mitigation projects, or through the startup financing of mitigation innovations and breakthrough technologies whose abatement costs per tonne of CO_2 are still very high today.

Further sources of information

Short Briefing 'Fit for Paris. Replaying Kyoto-style CO₂ offsetting: how companies should finance additional climate mitigation' by WWF Germany (2022)

<u>Guideline 'A Guide to Implementing the Contribution Claim Model' by Development and Climate</u> <u>Alliance and Wuppertal Institute (2024)</u> (in German only)

<u>'A Guide to Climate Contributions - taking responsibility for emissions without offsetting' by</u> <u>NewClimate Institute (2023)</u>

4 What is important for the quality of carbon credits?

In cooperation with the World Wildlife Fund for Nature (WWF-US) and the Environmental Defense Fund (EDF), Oeko-Institut has founded the Carbon Credit Quality Initiative (CCQI), which sets criteria for high-quality carbon credits. The following aspects are particularly important for the quality of credits from climate mitigation projects: additionality, surplus of credits from old projects, robust quantification and permanence of emission reductions, avoidance of double counting, promotion of the transformation to a zero-emission society, good institutional structures and processes, and other environmental impacts and social aspects.

Further sources of information

Website of the Carbon Credit Quality Initiative

Short paper 'What makes a high-quality carbon credit?' by Oeko-Institut, EDF and WWF-US

CCQI methodology for the assessment of carbon credits

4.1 Additionality

Additionality means that the mitigation activity is only made possible by the revenues of carbon credits and would not have taken place in their absence. If the project would have been implemented anyway, it does not lead to additional climate mitigation and thus cannot offset any emissions. Whether a project is really additional is not always easy to check. The decisive factor is whether the project is already financially viable without carbon credits and would therefore be realised in the absence of the financial incentive provided by the credits or whether the project is to be implemented based on existing policy instruments like subsidy programmes. Various studies have found that the additionality of many mitigation projects is questionable. However, there are also projects for which additionality is very likely.

Further sources of information

Repository of Articles on Offset Quality of Berkeley University

Journal paper in Nature Communications "Systematic assessment of the achieved emission reductions of carbon crediting projects", co-authored by Lambert Schneider from Oeko-Institut (2024)

Study 'How additional is the Clean Development Mechanism?' by Oeko-Institut for the EU Commission (2016)

Study 'Has Joint Implementation reduced GHG emissions? Lessons learned for the design of carbon market mechanisms' by the Stockholm Environment Institute with the participation of Lambert Schneider (2015)

4.2 Old projects

Under the largest carbon crediting mechanism – the Clean Development Mechanism (CDM) of the Kyoto Protocol – there is a very large surplus of credits from old projects, for which there is a comparatively low demand. The surplus is so large that the credits are sold at very low prices. In most cases, however, the mitigation projects continue regardless of whether they can still sell their credits. This is because the activities often generate other revenue, e.g. from the feed-in of electricity from wind turbines. Continued operation is therefore more profitable than shutting them down. The purchase of credits from such CDM projects does not lead to more climate protection and is therefore not recommended. However, some CDM projects rely on current revenues from offset credits. This applies, for example, to the avoidance of nitrous oxide gas in nitric acid production or the use of more efficient stoves for cooking with wood. These projects are worth supporting.

Further sources of information

Study 'Vulnerability of CDM Projects for Discontinuation of Mitigation Activities - Assessment of Project Vulnerability and Options to Support Continued Mitigation' by Oeko-Institut and NewClimate Institute on behalf of the German Environment Agency (2017)

Article in the journal Nature Climate Change 'Robust eligibility criteria essential for new global scheme to offset aviation emissions' in which Lambert Schneider participated (2019)

4.3 Robust quantification of emission reductions

To ensure that every carbon credit is linked to a ton of avoided CO_2 , it is important that the emission reductions are not overestimated. They must be estimated conservatively because there are considerable uncertainties in quantifying them. One particular challenge is estimating the reference scenario, i.e. how many emissions would have occurred without the project. With avoided deforestation projects, for example, it is very uncertain how the forest would have developed without the project.

Further sources of information

Repository of Articles on Offset Quality of Berkeley University

Study in the Science journal 'Action needed to make carbon offsets from forest conservation work for climate change mitigation' (2023)

4.4 Avoidance of double counting

Double counting occurs when a single greenhouse gas emission reduction is counted twice in achieving mitigation targets or offsetting. Double counting is a significant risk with voluntary carbon offsetting, especially from 2021. This is because the Paris Agreement, under which almost all countries have climate targets, has since taken effect. If emission reductions from mitigation projects are sold in a country, there is a risk that not only the person who purchases the offset credit will be credited with the reductions, but also the country in which the project is implemented. The country can prove lower emissions when reporting on the fulfilment of its climate target, which could result in the country having to make fewer mitigation efforts to achieve its targets.

With a view to the voluntary carbon market, there is intense debate as to whether double counting in the context of NDCs poses a significant integrity risk. The Gold Standard, for example, maintains that such double counting must be avoided, whereas Verra believes this is unnecessary as long as it is transparent that the emission reductions are used by both the buyer of the carbon credit and the host country to achieve its NDCs.

Such double counting can be avoided by countries subtracting the emission reduction achieved through the project when reporting on the fulfilment of their climate targets under the Paris Agreement. To do this, the government of the country in question must authorise the project for international emissions trading under Article 6 of the Paris Agreement and make so-called 'corresponding adjustments' when reporting on fulfilment of its climate target, i.e by adjusting their emissions balance. In order to avoid double counting and use the credits to offset emissions, it is necessary to record them by making such 'corresponding adjustments' in the future.

Further sources of information

Article in the journal Science 'Double counting and the Paris Agreement rulebook' with the participation of Lambert Schneider (2019)

Study 'Future role for voluntary carbon markets in the Paris era' by NewClimate Institute for the German Environment Agency with the participation of Lambert Schneider (2020)

<u>Blog post "Glasgow delivers rules for international carbon markets - How good or bad are they?" by</u> <u>Oeko-Institut (2021)</u> (in German only)

Guideline 'Avoiding double counting and supporting host countries in the voluntary market' and the study 'Article 6 of the Paris Agreement and the voluntary market for greenhouse gas offsetting' by Development and Climate Alliance (2021) (in German only)

4.5 Permanence of emission reductions

Some project types, such as forest and peatland projects, carry the risk that the stored carbon is later released. For example, if a forest is planted and a fire later destroys it, the CO_2 that was absorbed is released back into the atmosphere (see question 6 on nature-based solutions). Most carbon crediting programmes address this risk through a sort of insurance: all projects must pay a portion of their credits into a fund (also known as a 'pooled buffer reserve'). If the carbon stored in a project is released again, the harm to the climate is compensated by cancelling the credits in the fund. How well this approach works depends largely on how well resourced the fund is, how broadly the risks are distributed, and the length of time for which the possible release of CO_2 back into the atmosphere is checked. Some carbon crediting programmes also use temporary credits or make a standard subtraction when quantifying emission reductions. A few carbon crediting programmes take no measures at all to ensure the permanence of emission reductions.

In Oeko-Institut's view, projects with a significant risk that the reductions will not be permanent should not be used to offset CO_2 emissions from fossil fuels. Even if credits are used for other purposes, carbon crediting programmes that have a fund to compensate any damage to the environment and ensure that CO_2 sequestration is checked over a long time (for at least 100 years) should be used wherever possible.

4.6 Promoting transformation to a net-zero emissions society

The Paris Agreement aims to ensure that people no longer produce any greenhouse gases in the second half of this century. The emission of CO_2 and the absorption of CO_2 from the atmosphere should therefore be balanced. As the global carbon capacity of technical sinks that have not yet been developed (e.g. direct air capture of CO_2) and natural sinks (such as forests, oceans, peatlands or other forms of land use) is only limited, they should be used to neutralise emissions that are hard to abate. This means that all technologically avoidable GHG emissions must actually be avoided in order to achieve the net-zero emissions target of the Paris Agreement. The transformation to a zero-emissions society requires a profound change in our economic activity and huge investments in future technologies. To achieve this, investments in long-lived technologies that continue to produce greenhouse gases must also be avoided. It is therefore important not to promote projects that continue to use fossil fuels such as efficient coal-fired power plants or new gas-fired power plants. Rather, climate mitigation projects need to be chosen which promote future technologies that avoid greenhouse gas emissions as fully as possible such as innovative renewable energy technologies.

4.7 Good institutional structures and processes

Carbon crediting programmes differ significantly in terms of their structures and processes – for example, in terms of how the public is involved in developing rules and approving projects, or how certifiers are accredited and vetted. Programmes with transparent and participatory structures and processes can better ensure that the latest scientific evidence is taken into account when developing the rules and that there are robust compliance mechanisms.

4.8 Environmental impact and social aspects

In addition to the climate protection effect, it is important that mitigation projects do not have negative social or environmental impacts; if possible, they should have positive impacts beyond climate mitigation. In this context, the type of project and how the carbon crediting programmes check potential negative impacts are very important. For example, projects such as efficient stoves for cooking with wood that improve the living conditions of rural households in developing countries often have comparatively high social benefits. Some programmes, such as the Gold Standard or Verra's Climate, Community & Biodiversity Standards, establish specific requirements with respect to other environmental impacts and social aspects.

Further sources of information

Study 'Ensuring safeguards and assessing sustainable development impacts in the voluntary carbon market' by Oeko-Institut (2022)

Study 'Assessing the transparency and integrity of benefit sharing arrangements related to voluntary carbon market projects' by Oeko-Institut (2023)

5 Where can I find out about the quality of carbon credits?

Oeko-Institut, the World Wildlife Fund for Nature USA (WWF-US) and the Environmental Defense Fund (EDF) have launched the <u>Carbon Credit Quality Initiative</u> (CCQI) to provide actors with better information on the quality of carbon credits from mitigation projects. An online tool allows users to check detailed information on potential quality risks of different types of credits. This allows them to independently assess individual projects for these risks before making a purchase decision, and to better distinguish between good and poor quality. An improved information base should improve the overall quality of traded credits in the medium term.

The initiative is primarily aimed at well-informed buyers and carbon crediting programmes. All assessments are publicly available. Detailed assessment forms can be downloaded from the CCQI website.

The CCQI currently covers around 80 per cent of the carbon credit types traded. This comprises 15 frequently used project types and includes the five largest carbon crediting programmes: the ACR, the Clean Development Mechanism (CDM), the Climate Action Reserve, the Gold Standard and the Verified Carbon Standard.

Oeko-Institut does not assess individual projects in the voluntary carbon market, nor does it make recommendations for specific project types. Anyone interested in a quality assessment of individual mitigation projects can turn to specialised rating agencies. These work in a similar way to the rating agencies for the financial market, which assess the creditworthiness of countries, companies and financial products. A rating is created for an individual mitigation project based on quality criteria. While the assessment of individual projects is subject to a fee, these agencies also offer summarised reports on individual project types, which are available free of charge. Moreover, the Berkeley Carbon Trading Project has identified specific clean cooking projects of high quality.

Further sources of information

Website and assessment tool of the Carbon Credit Quality Initiative of Environmental Defense Fund, World Wildlife Fund (WWF-US) and Oeko-Institut

CCQI factsheets on the quality risks of selected types of carbon credits

Overview of CCQI's quality assessments in the journal Carbon Mechanisms Review (pp.58-66)

Rating agencies: BeZero, Calyx Global, MSCI Carbon Markets, Renoster and Sylvera.

Berkeley Carbon Trading Project with information on clean cookstove projects of high quality

5.1 Examples of differences in the quality of carbon credits

The analyses conducted by CCQI show that all carbon credit types examined are associated with considerable quality risks. Credits or carbon crediting programmes often perform well in some areas, but poorly in others:

- For example, the Gold Standard performs best when it comes to ensuring that projects have no negative social impact.
- The Climate Action Reserve performs best in ensuring long-term carbon storage in forestry projects.

The results also differ considerably between project types:

- For example, the quantification methods used to calculate the climate impact of efficient cookstove projects have significant shortcomings. There is a risk that these emission reductions are often overestimated, which in concrete terms means that one credit represents significantly less than one tonne of CO₂. Furthermore, there is no guarantee that the carbon stored in forests as a result of the projects will not be released back into the atmosphere at a later date. However, the projects often have a high social benefit.
- For renewable energy projects particularly photovoltaics and onshore wind power there is an
 increased risk of non-additionality. This means that these types of projects are likely to be
 profitable even without the additional incentive of revenue from carbon credits and would therefore
 have been implemented anyway. Biogas plants or landfill gas projects, in contrast, often only
 become profitable as a result of the carbon credits; in this case, the revenue from the sale of
 credits makes a real difference.

Further sources of information

Website of the Carbon Credit Quality Initiative (CCQI)

Website and 'Carbon Offset Guide' of the Stockholm Environment Institute (SEI) and the Greenhouse Gas Management Institute (GHGMI)

<u>Guide 'Voluntary CO₂ offsetting through climate protection projects' by the German Environment</u> <u>Agency (2018)</u>

5.2 Is there an international consensus on what constitutes high-quality carbon credits?

There is a growing consensus that the quality of carbon credits on offer today is not always sufficient. On the initiative of former Bank of England Governor Mark Carney, the <u>Integrity Council for the Voluntary Carbon Market (ICVCM)</u> was founded in 2021. The ICVCM aims to establish a globally accepted standard for high-quality carbon credits. In addition to carbon crediting programmes and large institutional buyers of carbon credits, many independent researchers and civil society organisations are involved in the ICVCM. Oeko-Institut has also been actively involved in the ICVCM as a founding member. Lambert Schneider was Co-Chair of the ICVCM Expert Panel from 2021 to 2023 and then a member until 2024.

The ICVCM has introduced the so-called Core Carbon Principles (CCPs), which, like the CCQI, define criteria for good quality. In addition, an assessment framework has been developed that can be used to determine whether certain types of carbon credits fulfil the CCPs. Working groups set up by the ICVCM are currently undertaking this assessment for common combinations of project types and carbon crediting programmes.

From Oeko-Institut's perspective, the CCPs constitute an important step forward in creating an international minimum standard for good quality. In some areas, however, the CCPs are significantly less stringent than those of the <u>Carbon Credit Quality Initiative (CCQI)</u>. For example, the ICVCM assessment framework only requires a review of permanence for at least 40 years. This is significantly less than the 100 years already required by some major carbon crediting programmes. Whether the ICVCM will succeed in improving overall quality in the carbon market depends on how strict the ICVCM is in checking the compliance of certain types of carbon credits with the CCPs and whether it actually does not issue a CCP label for credit types with high quality risks.

Further sources of information

The ICVCM Core Carbon Principles

Assessment of the NGO Carbon Market Watch on the robustness of the ICVCM Core Carbon <u>Principles</u>

Study 'Analysis of the ICVCM's core carbon principles and assessment framework' by Perspectives Climate Group (2024)

6 What role can carbon credits from 'nature-based solutions' play in climate action?

Forests serve the climate and biodiversity in significant ways: they store climate-damaging CO_2 and produce oxygen, provide habitats for plants and animals, filter water and prevent soil erosion. The protection of forests in particular and their long-term ecological use therefore contribute directly to climate mitigation and biodiversity conservation. Peatlands and soils can also store CO_2 and thus contribute to climate protection as so-called sinks. Emissions from drained peatlands alone, which are often used for agriculture, account for around seven percent of Germany's GHG emissions. Rewetting peatlands and increasing their capacity to store greenhouse gases therefore usefully contribute to climate protection.

The international climate negotiations at COP26 in Glasgow in 2021 emphasised the importance of 'nature-based solutions' for global climate mitigation. These are locally appropriate, adaptive actions to protect, sustainably manage or restore ecosystems.

However, carbon dioxide is not always permanently stored in soils and forests. When practices change, soils are ploughed or trees are destroyed by storms or fires, the greenhouse gases are released back into the atmosphere. Carbon is also only temporarily 'parked' in many wood products; if these are burnt later, for example, the CO_2 is released again. Such temporary storage is counted against long-term CO_2 emissions when carbon credits are used for offsetting – the balance, however, does not add up.

In addition, Oeko-Institut's researchers critically assess the global mitigation potential of naturebased solutions for forests, farmland, grasslands, terrestrial and coastal wetlands and settlements. A study commissioned by the German Environment Agency concludes that the potentials specified in scientific research probably overestimate the realistic potential of nature-based solutions for climate mitigation. For this reason, these activities should not be allowed as options for offsetting fossil CO_2 emissions. Nevertheless, despite all the uncertainties, these projects should continue to be promoted and implemented as they have a number of benefits for people and the environment in addition to their mitigation effects.

Further sources of information

Study 'Nature-based solutions and global climate protection' by Oeko-Institut (2022)

Infographic 'Nature-based solutions'

Study 'The potential of blue carbon for global climate mitigation' by Oeko-Institut (2024)

Infographic 'Coastal systems and blue carbon storage'

Blog post 'CCQI scores for IFM projects point to substantial integrity risks' by Oeko-Institut (2024)

<u>Study 'Crediting Forest-related Mitigation under International Carbon Market Mechanisms' by</u> Lambert Schneider and NewClimate Institute (2018)

6.1 EU Carbon Removal Certification Framework (CRCF)

In 2022, the European Commission presented the EU Carbon Removal Certification Framework (CRCF) – a proposal to certify the removal of CO_2 from the atmosphere, including through naturebased solutions, and the related issue of carbon credits.

A study conducted by Oeko-Institut analyses the proposed EU certification framework for carbon removal. In their analysis, the researchers note that the proposal contains no explicit rules on the eligible uses of the removal units – one of the most significant regulatory issues of carbon certification. The permanent and long-term storage of CO_2 also remains vague and without clear specifications for potential operators of carbon removal projects. As the permanent storage of CO_2 in soils, forests, etc. is associated with major uncertainties, the experts believe that carbon credits should explicitly not be used to count towards emission reduction obligations. However, operators could use carbon credits to make financial contributions to climate mitigation without counting these towards their own emission reduction targets (see question 3.1 on how contribution claims work).

Further sources of information

Study 'Certification of Carbon Dioxide Removals. Evaluation of the Commission Proposal' by Oeko-Institut (2023)

<u>Blog post 'Where to put the CO₂?' by Anke Herold (Executive Director of Oeko-Institut) (2023)</u> (in German only)

Study 'QU.A.L.ITY soil carbon removals? Assessing the EU Framework for Carbon Removal Certification from a climate-friendly soil management perspective' by Ecologic Institute and Oeko-Institut (2023)

7 Contact at Oeko-Institut

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