

What impact is the carbon market having on rural Welsh businesses?

Politicians from across the world are currently meeting in Glasgow at the COP26 conference to discuss climate change and collective actions to tackle it. One of the key areas of discussion will be the contentious Article 6 of the Paris Agreement which seeks to establish a global carbon offsetting market. (Chestney, 2021)

These talks, along with recent news features of Welsh farms being purchased for afforestation and carbon offsetting, has highlighted some of the impacts of the fast-developing carbon market.

This article delves into carbon markets and explores its impact on rural Welsh businesses.

What is the carbon market?

The carbon market is a mechanism where businesses can trade or purchase greenhouse gas reductions and rights to release greenhouse gas emissions. In Wales the market can be split into two distinct sections, the compliance market and the voluntary market. (Margaree, *Carbon Market*, 2007)

Compulsory Market

The compliance market refers to the market for trading carbon allowances allocated to businesses whose participation in emissions trading schemes is mandatory due to their energy intensive activities.

This is not a new concept and has been in practice for more than 15 years.

In 1997 the signing of the Kyoto Protocol committed countries across the globe to limiting and reducing greenhouse gas emissions (UNFCCC, 2021). Article 17 of this significant treaty set out the principles of carbon trading which would allow countries who had not used their allocated limit of greenhouse gas emissions to sell their “spare” carbon units to countries who had exceeded their limit.

These principles were adopted by the UK in 2002 when it became the first country to introduce a multi-industry Emissions Trading Scheme for businesses as a policy instrument to tackle global warming. (McAulay, 2005) The scheme was voluntary and recruited 32 businesses who committed to reducing their greenhouse gas emissions. Each business that registered received funding to support their commitments and participated in a cap and trade system which facilitated the purchasing and selling of their trade emissions allowances set under the scheme. (National Audit Office, 2004)

2005 saw the introduction of the European Union’s Emissions Trading Scheme (EU ETS). The mandatory scheme applied to four key energy intensive sectors; electricity generation, iron and steel, mineral processing and pulp and paper processing. (Carbon Trust, 2021) Each of the participants in the scheme was given an emissions allowance which it was able to trade with other participants in line with the principles set out in the Kyoto Protocol. The cap on emissions was then reduced over time so that overall emissions fall.

In addition to being able to trade “spare” emissions allowances, businesses were able to ensure they were compliant with their emissions cap by purchasing carbon offsetting units. These are also known as Certified Emissions Reductions (CERs), and are credits produced by emission-reducing projects that can be traded and sold under the Clean Development Mechanism element of the Kyoto Protocol. (UNFCCC, 2021). Though it should be noted that the trading of carbon offsets was excluded from the EU ETS from 2021. (Redshaw Advisors, 2021)

Following the UK’s exit from the EU in January 2021 the UK replaced the EU ETS with its own scheme, the UK Emissions Trading Scheme (UK ETS). The mechanism of the scheme closely follows those of the EU ETS, but with a tighter emissions cap and a higher fine for those exceeding their cap. The policy currently applies to energy intensive industries, aviation companies operating domestic flights and the power generation sector. As before, UK businesses that are regulated by the scheme are able to trade with other participants, though this is now limited to a UK market. The cap on emissions will reduce over time in line with the UK’s ambition to become net zero carbon by 2050. (UK Government, 2021) The first “auction” of the scheme, where businesses were able to trade their emissions allowances, was held in May 2021. (ICE, 2021)

Whilst carbon offsets are not currently permitted under the scheme (UK Government, 2021) the new strategy launched by UK Government that sets out the plan for how the UK will reach Net Zero Carbon by 2050 suggests that this is something that is being considered for future development of the UK ETS;

Working in partnership with the devolved administrations, we will aim to launch a call for evidence in the coming months exploring the role of the UK ETS as a potential long-term market for GGRs (Greenhouse Gas Removals), as part of our upcoming consultation on the UK ETS. (UK Government “Net Zero Strategy”, 2021, pg. 184)

Another example of a compulsory carbon market is the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) which came into play in May 2021. The scheme is in its pilot stage and currently requires aeroplane operators to monitor and report on their CO₂ emissions for the 2019 – 2020 period in order to provide a baseline for carbon neutral growth. From 2025 onwards the aviation sector is required to offset any emissions beyond this baseline level. (UK Government, 2021). This offsetting is done in a similar way as that mentioned above in the EU ETS via the purchase of CERs.

Voluntary Market

The voluntary carbon market attracts a variety of participants, from individuals looking to offset the emissions of their emission intensive activities (e.g. flying) to businesses looking to offset their emissions and become net zero carbon. This is fuelled by businesses aiming to meet the UK’s commitment to become Net Carbon Zero by 2050, and deliver on their net zero carbon pledges to engage with an increasingly environmentally aware customer base.

Similar to those being traded in the compulsory market, businesses are able to purchase carbon units from afforestation or carbon sequestration projects in order to offset their carbon emissions.

This area is booming and recent claims by Mark Carney suggest this market could be worth \$100bn a year by the end of the decade. (Financial Times, 2021)

Recent Savills research showed that prices for nature-based carbon offsets increased by 30% in 2019. (Savills, 2020)

Due to how fast this area is moving and the need for regulation to ensure quality standards are met in terms of carbon offsetting a taskforce has recently been established, the Scaling Voluntary Carbon Markets taskforce, to oversee this. (Financial Times, 2021)

What is the impact for Welsh businesses?

Business activities in Wales account for approximately 70% of the country's carbon emissions (this includes industry processes, business, power generation and agriculture), (Duffy, Hughes, Messenger, 2021) and therefore is a key area to focus decarbonisation efforts if the country is to mitigate the impact of climate change, overcome the biodiversity crisis and reach its ambitious target to reach Net Zero by 2050.

Welsh businesses that are mandated by UK ETS to participate in the cap and trade scheme, such as Tata Steel in Port Talbot and Valero in Pembrokeshire, account for 46% of Wales' total emissions, so it no surprise that Welsh Government was supportive of the establishing of the UK ETS which it says ensures a "polluter pays" principle on the journey to decarbonisation. (Welsh Government, 2021)

The scheme provides a clear incentive for businesses to work to reduce their carbon emissions, improve efficiency, increase innovation, and invest in low-carbon technologies. This will not only support Wales' ambition to become net zero carbon by 2050 but will also ensure long-term sustainability and competitiveness of large Welsh businesses.

Maintaining competitiveness was a key consideration in the consultation on the design of the scheme which has included mechanisms designed to manage extremes of carbon pricing to protect businesses against high costs and free allowances being allocated to some industrial installations to ensure they remain competitive.

The carbon market has however received widespread heavy criticism of recent. Greta Thunberg walked out of a meeting on voluntary carbon offsetting in COP26, urging those participating in the discussion to stop greenwashing. (Guardian, 2021)

Offsetting and carbon trading has also been labelled an attempt to avoid genuine emissions reductions by allowing corporations to purchase carbon offsets from other countries to facilitate their "business as usual". (The Green Party, 2021)

Molly Scott Cato, Green Party Finance and Economy Speaker, said;

“The ‘carbon credits’ that are traded will enable financiers to control the environments of other countries and profit from them without the citizens of those countries seeing any benefit. Communities who live from the land may be displaced to make space for the planting of trees to absorb the CO2 Bill Gates produces from his private jet. The very opposite of climate justice.” (The Green Party, 2021)

Whilst this quote relates to communities in the Global South it can be applied to rural Welsh communities with their rich heritage and history in agriculture and farming.

And this impact of carbon offsetting is very much being felt by the Welsh rural agricultural businesses. Over the past months there has been growing concern over large corporations outside of Wales, who are able to take advantage of Welsh Government grants for afforestation, purchasing Welsh farms for the purpose of carbon offsetting.

This causes a number of issues including local people being outbid by large corporations, the availability of agricultural land for local food production and domestic carbon offsetting, as well as the impact it will have on Welsh heritage and language by displacing communities.

This is an issue that has gained political attention. Jonathan Edwards, MP Carmarthen East and Dinefwr, raised recently in Westminster that several farms in Carmarthenshire have been purchased for the voluntary carbon offset market. (Garside, Wyn, *“UK Emissions Trading Scheme: Wales”* 2021)

Ben Lake, MP for Ceredigion, has also warned;

“Tackling climate change should not be an opportunity for large companies to greenwash their emissions while continuing to emit millions of tonnes of CO2. To be successful, tree planting projects must have local control, with rural communities working alongside the Welsh Government so that they benefit from this transition. We must not allow businesses to buy farms, allow rural communities and the Welsh language to be undermined for the sake of a greenwashed business-as-usual.” (The National, 2021)

The growth of the carbon market presents a number of opportunities for Welsh businesses.

Those participating in the compulsory market will be incentivised to invest in innovative and exciting solutions for decarbonisation. This will not only lead to advantages for the environment, but could also bring competitiveness, new efficiencies and provide the opportunity for Welsh businesses to be at the forefront of the growing green economy.

The use of carbon offsetting is a fast-developing area and it will be very interesting to see how the UK Government builds on the current policies for the UK ETS, CORSIA and the outcome of the new voluntary offsetting task force – but also how it proposed to regulate the area of carbon offsets and monitor the impact that is already being felt by rural agricultural businesses.

The developments in this area have the opportunity to see Welsh rural agricultural businesses taking a lead in carbon offsetting by harnessing the potential of their land for forestation and sequestration.

Though as discussed earlier, without stringent regulation it could blight rural Welsh communities by facilitating large corporate companies to purchase farmland, outbid local people and local businesses. The wider impact of this has the potential to create fragmented communities, affect Welsh heritage and Welsh language, and hugely impact on Wales' domestic food supply.

This is definitely a space to be watched.