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## BETTER THAN NOTHING... BUT SO MANY 'BUTS'



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Investors are increasingly aware of climate risks and appreciate that fossil fuel companies are major emitters. Primary responses have been shareholder engagement or divestment. These actions impact fossil fuel companies, with

pressures to halt extraction and associated investment risks intensifying.

Future policy and technology developments could cost extractors an estimated \$34trn of revenue. Changing investment policies may make fossil reserves unusable, leaving present market valuations misjudged. Some argue that fossil fuel assets are increasingly uncompetitive, and their market share dropped from 29% of the S&P in 1980 to 5.3% by 2019.

One response from fossil fuel firms has been investment in carbon-offsetting measures. Royal Dutch Shell plans a \$300m reforestation scheme, planting more than five million trees, among other initiatives. Although it sounds impressive, climate-aware investors remain cautious. Is this a genuine attempt to address problems, or about retaining societal legitimacy to continue their activities? Some think that such offsetting omits crucial details. This article explores why.

### What is carbon offsetting?

Offsetting schemes absorb atmospheric CO<sub>2</sub> or reduce existing emissions. Unavoidable emissions can be offset to 'neutralise' them. However, quality varies and the CO<sub>2</sub> amounts involved can be hard to estimate. Better projects avoid double counting and include verification and registration. Other issues include the permanence of removed carbon storage, and whether unintended consequences cause emissions elsewhere.

Are Shell's impressive-sounding plans enough? The \$300m investment forms part of a plan to reduce its net carbon footprint by 2%-3% over three years, leaving an enormous gap to fill, as it must cover all 'scopes' of emissions from Shell's activities. Not just direct company sources, or energy use, but also indirect emissions, including customers' use of oil and gas. Carbon-neutral extraction of fossil fuels makes no sense.

### Offsetting problems

Reducing net emissions is essential. However, climate scientists can be wary of overreliance on offset schemes. Halving emissions of 1,000 tonnes generates a 500-tonne offset, but still emits 500 tonnes. Atmospheric removal may sound preferable, making tree-planting schemes appear promising. However, estimating CO<sub>2</sub> absorption from reforestation can be challenging. Reducing emitted gases in the first place may prove more reliable.

Additional offsetting can help – perhaps 100 tonnes of emissions compensated by 200 tonnes of offsets. For air travel, at least twice the emissions should be offset to allow for the climate impact from high-altitude CO<sub>2</sub> emissions. But carbon storage must be permanent on geological timescales. Extensive reforestation schemes could create monocultures. Apart from fire, the carbon stored in low-biodiversity forests is vulnerable to disease or pests. Humans cannot recreate the rich diversity of ancient forest ecosystems; it is better to leave them in place. Leakage is also a concern – for example, a project that halts forest clearance emissions might shift deforestation elsewhere.



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Another problem is that a project's carbon value could be (double) counted towards both purchased commercial offsets and national Paris Agreement pledges. Apart from CO<sub>2</sub>, gases, such as methane and nitrous oxide contribute to warming but estimating their equivalent climate impact is not straightforward

If significant offsetting volume is required, capacity may be insufficient to meet demand. Consequences could include a shortfall or the creation of substandard schemes. Bulk offsetting might also create an impression that everything is under control, reducing motivation to adopt low-carbon technologies, so that business carries on as usual.

Given the difficulties, although carried out in good faith, offsetting may prove insufficient. A precautionary principle suggests it is wiser to avoid emissions in the first place. Prevention is better than cure – particularly considering the significant uncertainties and the appalling consequences of failure.

#### Offsetting guidelines

The dangers of unchecked emissions and challenges outlined above suggest the following guidelines for carbon offsetting:

- First – reduce emissions as much as possible
- Thereafter, use offsetting to absorb residual emissions

Other requirements include:

- Ensure offsets are additional and avoid double counting
- Offset by more than the estimated emissions
- Ensure carbon removal is permanent

While lower-carbon technologies are developed and implemented, offsetting may also help mitigate emissions.

#### How should investors react?

Fossil fuel extraction firms' offset schemes are better than nothing. But although sounding impressive, they fall short of climate requirements. Offsets do not 'solve' global warming. Fossil fuel firms may primarily be addressing the social stigma from the harm they have caused. Offsetting should only be used while firms act decisively to reduce emissions.

Carbon offset programmes are no substitute for moves towards low-carbon technologies. Sustainable investors should adopt robust policies to ensure that fossil fuel companies understand this message.

The science is clear – to prevent dangerous climate change, rapid, decisive steps to reduce emissions are essential. Much of the public understands this message, although the finance sector has been slower to adjust. Professional investors should listen – early movement could reap reputational benefits.

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