The World Bank Submission on experiences and lessons learned from Joint Implementation for the possible design of mitigation mechanisms and on links and interactions with other tools

Introduction

The World Bank welcomes the opportunity to make a submission to the 11th Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP.11). This is in response to a call for inputs on experiences and lessons learned from Joint Implementation (JI) for the possible design of mitigation mechanisms and on links and interactions with other tools (Decision 7/CMP.11, Guidance on the implementation of Article 6 of the Kyoto Protocol).

This submission draws from insights and lessons derived from the World Bank carbon finance experience covering many different types of projects, programs and sectors over the past decade, including JI projects. It also builds on our previous submissions on revision of JI guidelines, the new market-based mechanism and the framework for various approaches. It is hoped that this will provide constructive input to Parties' deliberations. The World Bank would be pleased to elaborate further and contribute to this important work as needed.

The structure of this submission focuses on identifying those JI experiences and lessons learned relevant for the design of new international carbon market mechanisms. It is organized in three parts: Main conclusions, observations on experience with JI and lessons for designing new international market mechanisms.

Main conclusions

- Countries with mitigation objectives/targets typically aim to embed potential carbon market transactions into a broader mitigation strategy taking into account economic, political and compliance risk considerations. JI provides some – albeit rather limited – experience in this regard.
- JI had a slow uptake and most JI eligible countries hosted only a very few JI projects or no projects at all. This indicates the relevance of a pilot/early start phase when designing new market mechanisms. Different from Activities Implemented Jointly (AIJ) an early start phase would be stimulated by providing a prospect for emission reductions to be internationally recognized and used for compliance. Such a pilot/early start phase will also build needed institutional capacity, clarify how to embed potential carbon market transactions into a broader mitigation strategy on a national level (see above) and will contribute to building trust in carbon market transactions in a world where all Parties have a broad spectrum of different mitigation objectives.
- The JI experience revealed that many countries prefer to retain sovereignty by governing the JI themselves (JI Track 1), although some projects were also implemented under the internationally UNFCCC governed JI Track 2. Both Track 1 and Track 2 came under criticism as a result of their governance structures. Under Track 1 concerns were raised about the environmental integrity of some projects and under Track 2 there were issues with the efficiency of the procedures (i.e.,

cumbersome project cycle procedures and lack of standardization in baseline and monitoring methodologies) and with regulatory uncertainty. To prevent the New Mechanism(s) and approaches repeating the same mistakes it is recommended that new governance approaches are considered when designing New Mechanisms.

- JI benefited from the rather straightforward and solid accounting framework of the Kyoto Protocol (KP). New Mechanisms will not be able to use this Kyoto framework and are in need of new types of accounting given the broad spectrum of different mitigation objectives/contributions that Parties are to define in their Nationally Determined Contributions (NDCs).
- By definition JI has been limited to a project-by-project baseline and crediting approach. This limits the degree to which JI could inform the design of New Mechanisms that will not be limited to a project-by-project approach, and are expected to also include sectoral or policy driven and non-crediting approaches.
- Differentiated treatment of forestry and land use in relation to other sectors (such as energy, transport, waste etc.) and associated modalities have created dichotomy between forestry vis-à-vis other sectors (Removal Units, RMUs vs. Emission Reduction Units, ERUs). This was a major factor that limited the harnessing of land sector mitigation potential under JI. This experience needs to be taken into account when designing New Mechanisms.

Observations on experience with Joint Implementation

A first obvious observation is that the generation of ERUs has been very unevenly distributed. Russia and Ukraine represent 90% of global ERU issuance, nine Eastern European countries 7%, whereas seven Western European countries and New Zealand total just 3%[1].

The low uptake in countries that were not in a net seller's position of Assigned Amount Units (AAUs), the currency of the KP, had several reasons. One reason being the large density of low carbon policies, which creates complexity in baseline setting and accounting. Within the European Union, for example, the European Emissions Trading System and other climate policies limited JI opportunities. Some of the Western European countries developed elements of a national JI strategy/policy. For example, German JI rules exclude projects which benefit from public subsidies; French JI rules require that a share of achieved emission reductions remain in the country and account against the national target.

Second, most JI projects were implemented under JI Track 1 (national implementation). National implementation permitted national issuance of ERUs. It allowed countries full ownership of the mechanism's infrastructure and enabled them to best integrate JI into national institutional and administrative structures. However the JI guidelines failed to ensure sufficient assessment, monitoring and enforcement of national procedures in terms of their conformity with the JI guidelines. Additionally, national implementation did not systematically address the assessment of the quality of services

[1] Source: UNEP, January 1st, 2016.

provided by the Accredited Independent Entities (AIEs). As a consequence JI Track 1 suffered from a lack of transparency and issues of environmental integrity.

Implementation under Track 2 (under supervision by the Joint Implementation Supervisory Committee (JISC)), proved to be superior in terms of safeguarding environmental integrity but basically replicated the Clean Development Mechanism (CDM) approach including its shortcomings. These shortcomings consisted in a lack of professionalization of the executive board, an overcomplicated project cycle and limited standardization of baseline and monitoring methodologies.

Finally, despite greater flexibility provided by the JI guidelines in terms of allowing national circumstances to be accommodated, JI followed the CDM learning curve on methodologies, procedures and business models/project types and failed to contribute to innovation and learning. The CDM proved to be more innovative and in this sense "led" JI in this regard. In particular, despite more flexibility on land use projects, JI was not able to trigger much activity in this sector nor were new approaches developed. JI could not overcome CDM limitations such as high transaction costs and regulatory uncertainty due to imperfections in governance and inefficiencies in project cycle procedures and over-complex methodologies for baseline setting and MRV. There seem to be several reasons for these deficits, such as the concentration of most JI projects in essentially two countries capable of satisfying demand largely relying on the CDM model, the late start of JI, and a limited number of countries interested in hosting JI projects. A further reason is that for the national implementation (JI Track 1) there has been an increase in political risk due to uncertainty on evolving national implementation rules and procedures.

Lessons for designing new international market mechanisms

The Paris Agreement established a "New Mechanism for mitigation and sustainable development" (in the following it is referred to simply as the "New Mechanism") under UNFCCC governance and recognized voluntary cooperative approaches (VCAs) that can generate internationally transferable mitigation outcomes (ITMOs). Both the New Mechanism as well as potential VCAs will have to operate in an environment where all Parties to the Paris Agreement follow mitigation objectives defined in their respective Nationally Determined Contributions (NDCs). These mitigation objectives are expressed as economy wide targets for developed countries and include a broad variety of different metrics for most developing countries. International transfers of mitigation outcomes and emissions reductions will therefore have to happen in an environment of caps and other types of mitigation objectives. This makes the JI experience in principle relevant for both developing the modalities and procedures of the New Mechanism and the guidance on VCAs – although since JI generated only limited experience on international carbon crediting (and crediting only) within economies facing a carbon constraint for the reasons outlined above, this experience is not as rich as might it might have been. Still there are some conclusions to draw and lessons to learn.

Critical importance of accounting

The JI experience illustrates the critical importance of accounting. Under the KP rules ERUs are converted from AAUs ensuring that what the buyer receives is subtracted from the seller's account. This principle created the fundament of JI. Under the Paris Agreement, Parties agreed to develop a new approach to accounting to enable the international transfer of mitigation outcomes and emission reductions to comply with national NDCs. This new approach will need to take into account the different types of NDCs, i.e. the different metrics used to express mitigation contributions. The accounting framework of the KP provides a basis for budget style targets but does not cover other types of mitigation contributions.

Merit of an early start and a piloting phase

An important lesson from JI is the merit of an early start and a piloting phase. This is linked to another lesson on flexibility in national implementation. As mentioned above some testing and piloting of carbon crediting within economies under a carbon constraint happened under JI using national implementation. However this never reached a critical mass or sufficient diversification of host countries to enable emergence of international best practice knowledge or guidance. Early start and piloting is also desirable for another reason: having a carbon constraint increases compliance risk when engaging in transferring mitigation outcomes and emission reductions to another Party in a world of uncertainty on carbon market liquidity and regulatory environment. Early start and piloting can generate experience on national mitigation strategies, policies and management of the national mitigation potential, reveal the cost saving potential of international exchange of carbon assets, as well as build step-by-step the needed trust in selling and buying mitigation outcomes and emission reductions.

Useful insights on governance structures, project cycles and methodologies

On a more granular level, JI (and CDM) provide insights from their experiences with governance structures, project cycles and requirements on baseline methodologies and MRV. Building on the continuous learning and refinement experiences of the JI (and CDM) is clearly advantageous. The following trends in JI (CDM) regulation reflect lessons learnt and can inform New Mechanisms:

- Governance bodies are tending to move away from overseeing each project through a project-by-project assessment process and are focusing more and more on their core role of standard setting; Project cycles are becoming more efficient in standardizing validation requirements and – in perspective – merging, at least for some project categories, validation into verification. Similar trends can be observed for procedures on programmatic approaches.
- Baseline methodologies are moving further from project specific approaches. Standardized baselines are emerging which can cover whole sectors of economies and which include additionality requirements.
- Similar to standardization of baselines MRV requirements and procedures go through a process of simplification and standardization.

Merits on new innovative approaches non covered by JI

There are areas where JI (and CDM) do not provide any substantive experiences for designing and implementing VCAs and the New Mechanism. The project-based mechanisms of the KP do not allow for the generation of mitigation outcomes and emission reductions beyond a project-by-project level, such as mitigation activities implemented on a sectoral level, city level or policy driven activities. In particular in a context of carbon constraint economies set by the NDCs and in a process of increasing ambition over time, but also related to accounting requirements, these more aggregated approaches can have merits over project-by-project approaches. This once again confirms the significance of items one and two above, i.e. the importance of an accounting approach and a prompt start/piloting phase.

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