IETA
INTERNATIONAL EMISSIONS TRADING ASSOCIATION

February 6, 2009

Ad Hoc Working Group on Long-term Cooperative Action
UNFCCC Secretariat
Martin Luther King Strasse 8
P.O.Box 260124
D-53153
Germany

Dear Mr. Machado,

IETA welcomes the opportunity to respond to the call for input from Parties and observers laid out in the 2009 Work Programme of the AWG-LCA, which was agreed at COP 14 in Poznan. IETA would like to take this opportunity to point out some areas of convergence in the ideas and proposals of Parties that we believe should serve as the focus for negotiations as the Parties move forward.

1. *First,* it is clear from the views expressed in the assembly document that there is a great deal of interest in **the use of markets to enhance the cost-effectiveness of, and to promote, mitigation actions**. IETA encourages such interest, as we believe that emissions trading has the ability to deliver effective environmental policy outcomes at a far lower cost than command and control or tax-based approaches. IETA advocates broad-based cap-and-trade systems with unrestricted domestic and international trading, as well as the wide-ranging use of offsets to allow effective discovery of a price for carbon. Robust markets with a sizable number of available offsets act as a powerful incentive to minimize overall social costs, and enable the private sector to invest resources in the most efficient and effective manner in order to protect the climate.

   Our support for international cap-and-trade systems includes forming linkages where possible. Moving to a global price, and a global GHG market, is one of IETA's fundamental goals. Linking to create a larger GHG market improves the efficiency of emissions trading for two fundamental reasons. Firstly, a larger market is inherently more efficient, liquid, and competitive. Secondly, a larger market provides a broader pool and greater variety of abatement costs in which to discover opportunities for low-cost abatement. Globally, linking allows more GHG abatement to occur with the same level of social resources, or conversely the increased efficiency can reduce the social costs of a given carbon constraint.

   We agree with Parties when they note that the market is critical for mobilizing capital and technology transfer to the scale needed to achieve the ultimate objective of the convention. We would add that the market-given ability to flexibly achieve a target, at a lower cost to society, is key to gaining the domestic political backing necessary to ratify an international treaty in many countries. For that reason, if the International Community is truly committed to meeting the challenge of climate change and coming to agreement in Copenhagen, the Parties should re-focus on the market as one of the key vehicles for financing mitigation through the private sector in developed and developing countries.

To function effectively, however, markets require coherent scientific, political, and technological timelines. At present, there is little consistency between these timelines, and in some areas there is serious conflict. In addition, markets require a supply/demand balance that incentivizes technological development, demonstration, and diffusion at the scale required by science. IETA urges the Parties to focus on these two facts when designing a framework for the new climate change agreement.

2. *Second*, **on the need for a long-term global goal**, it is clear to IETA that the Parties are generally in agreement that there is a need for a long-term global goal punctuated by credible medium-term goals established in 2012. IETA heartily agrees and would like to go farther. In order to provide for longer-term investment horizons, IETA believes that carbon pricing needs to become embedded into capital asset planning, since research and development, breakeven/payback periods and relevant forecasting can take several years to realize. For this to occur, certainty and predictability for the future must be assured by the Parties. Such assurance can come in several forms, such as fixed medium- and long-term targets, a pledge that the international regime will continue to operate, and the legislation of rolling commitment periods. In the long-term, investment in new and low-carbon technologies will not be possible without certainty regarding long-term goals and the potential for private sector returns on long-standing investments.

3. *Third,* **concerning incentivizing mitigation in developing countries,** IETA agrees with statements made by many Parties when they say that scale-up of market-based activities within developing countries and implementing carbon market-related domestic policies prepare those countries for full integration into the global carbon market at some point in the future. Indeed, IETA believes that the strategic use of the carbon markets is the most effective way to motivate communities and businesses towards lowering emissions. The CDM has been a very successful pioneer in this regard, stimulating an emission reduction industry in many developing countries where there was previously very little attention paid to the atmospheric effects of industrial activity.

4. *Fourth,* **on contributions by different groups of countries**, IETA recognizes that many Parties propose a move to some form of differentiation among Parties, in variance with the current Annex I/non-Annex I distinction. These proposals are based on an increased scientific understanding of the levels of mitigation required by developed and developing countries and the changing social and economic situation in the world.

   If some form of differentiation is agreed by the Parties, IETA believes that the Parties should strongly focus on the use of market-based mechanisms to incentivize reductions in that setting, and that any new mechanisms should be fully integrated with the global carbon market whenever possible. In other words, credits earned via any of the proposed approaches should be fully fungible with AAUs, CERs and ERUs.

   Moreover, IETA urges the Parties to ensure that the mechanisms designed mobilize *private* capital and do not simply enable government-based trading. The IPCC, UNFCCC secretariat, and International Energy Agency have all consistently emphasized the very significant role that the private sector must play in generating investment in emissions reductions if the Parties are to realize the ultimate goal of the Convention and its Protocol. IETA does not believe that the creation of new mechanisms that simply allow credits to be generated, bought, and sold by governments will incentivize emission reductions at the scale and speed required.

Finally, IETA believes that the understanding that private capital must play a critical role in addressing climate change means that the Parties must work closely with the private sector when designing new market-based mechanisms or else risk that those mechanisms prove ineffective and underutilized. IETA is concerned that much discussion of the "carbon markets" is taking place today without consideration of or interaction with those entities that form it. IETA urges the Parties to reverse that trend, and is very eager to actively collaborate with the Parties on the design of new mechanisms.

5. *Fifth,* **on the creation of new flexible mechanisms,** IETA understand that many new market-based mechanisms have been proposed by the Parties as a method of incentivizing mitigation action in developing countries. Examples include the establishment of sectoral or economy-wide "no-lose" targets, where credits would be issued for over-achievement of the target, or crediting on the basis of nationally appropriate mitigation actions. IETA is interested in such ideas but would like to make three points in relation to them:

   First, IETA believes that while the development and implementation of future mechanisms must build on the experiences gained in the operation of the CDM and JI, the Parties should not shy away from the creation of institutional arrangements that vary significantly from them. Indeed, IETA believes that new market-based mechanisms could conceivably entail the implementation of innovative financial and regulatory regimes that, where appropriate, go far beyond the current UN mechanisms and might even contain non-UN based elements. A purely illustrative example is a mechanism entailing a non-UN external regulatory board comprised of public and private participants.

   Second, IETA would like to emphasize that much work is yet to be done on how to bring the proposals conceived so far to a level of development that explains crucial details concerning timelines, data availability and collection, and market design. In particular, there seems to be no proposal explaining how economic entities will be able to generate and trade emission reduction credits within the mechanisms proposed. Going forward, such work must also include a serious consideration for the potential effects that the possibly large number of credits generated by such mechanisms could have on the global market price for carbon. IETA is doing work internally on these issues and looks forward to working with the Parties and other stakeholders to further develop proposals that incentivize private capital to meet the UNFCCC's environmental objectives.

   Finally, IETA understands the opinion expressed by some Parties that "a carbon market should be more than an offset market" and has taken interest in some of the ideas for crediting only below low-cost or "win-win" solutions, or only after significant "nationally-appropriate mitigation actions" have been undertaken by host countries. In our initial analysis, however, IETA foresees that some of the ideas espoused by the Parties could, in practice, cause significant confusion and uncertainty in the market, especially in situations where the private sector must wait for significant government action before their opportunities to reap benefits from emission reductions begin. Such 'waiting around' would be devastating to a market dependent on secure private sector investment and the existence of businesses whose main revenue-generating activity is facilitating emission reduction. IETA looks forward to providing more input on these ideas as they take shape and as the negotiations proceed.

6. *Sixth,* **concerning the nature of differentiation,** if it is to take place, IETA highly urges the Parties to clearly define the criteria/parameters upon which such differentiation will be based, and to leave no doubt as to the nature and extent of the contribution provided for in

the agreement. Such clarity is necessary if the private sector is to have the maximum lead-time in preparing for any requirements or market opportunities that result from such changes. Actors in the carbon market today are struggling to stay in business as a consequence of the high level of market uncertainty resulting from the lack of an international agreement post-2012. Only indication of future commitments and design of forthcoming mechanisms in the near future can prevent a substantial loss in the capacity and expertise of carbon market businesses that have been built-up over the past 10 years.

7. *Seventh,* **on the extension, scale-up, review and improvement of the current market-based mechanisms**, IETA feels strongly that regardless of any moves to differentiate among developing country Parties post-2012, the operation of the existing flexible mechanisms should continue. Indeed, reform and expansion of the flexible mechanisms is crucial for an effective post-2012 framework, as the these mechanisms will allow developing countries that do not graduate to a new form of commitment the chance to enhance their sustainable development and build emission reduction capacity. Offsets generated through the CDM will also continue to assist Annex I countries in the achievement of their compliance commitment under the new international agreement.

IETA also strongly believes that problems with existing mechanisms should be addressed within the UNFCCC negotiation process rather than uni- or bi-laterally by major country buyers. Adding uni- or bi-lateral qualitative or quantitative restrictions to the CDM only adds uncertainty and confusion into the market. IETA applauds the success of the CDM to date and believes that its environmental integrity is strong. IETA also believes, however, that the CDM requires reform so that activities can be scaled-up, geographical distribution enhanced, and environmental integrity assured beyond doubt. As IETA has stated many times, the necessary reform will require significant changes to the CDM's governance and management system, but we are confident that once reform is implemented, the emission reductions incentivized by the CDM can be increased exponentially and expanded into under-utilized host countries and new project types. IETA has made significant and detailed proposals for the reform of the CDM, and we will continue to expand upon our work in this regard and engage with the CDM Executive Board and the Parties whenever possible to advance these proposals.

8. *Eighth,* **on what needs to be measured, reported and verified,** IETA believes that all commitments under the convention and associated actions, by developed and developing country Parties, should entail measurement, reporting, and verification. Moreover, it is IETA's view that MRV systems should be established in all major sectors of developed and some developing countries in order to ease the move to market-based emission reduction approaches in developing countries. Such monitoring shall be based upon the 2006 IPCC Guidelines and ISO 14064, which must be accompanied by guidance to enable detailed and consistent MRV at the appropriate sector level. Furthermore, to enable such emission reductions to be included in emission trading markets, those sectors/Parties must commit to MRV on a scheduled annual basis, given the appropriate provision of funding and capacity building assistance. After all, reduction actions need to be measured, reported, and verified in order to be credited in the market. As some Parties have noted, such verification and emissions inventories will build confidence among Parties as well as ensure that the COP has adequate information to assess progress against the objectives of the Convention.

9. *Ninth,* **on the stimulation of technology development, diffusion, and transfer,** IETA believes that establishing a global price on carbon emissions and allowing unhindered access to offsets for up-capped sectors and countries is the most effective move that the Parties could make to enhance investments in clean technology development and diffusion, in developed and developing countries alike. IETA need only point to the success of the CDM in technology transfer, analysed and documented in a recent study commissioned by the UNFCCC, in order to exemplify the ability of market-based mechanisms to facilitate the transfer of clean technology. Any new market-based mechanisms, such as no-lose targets with crediting, would certainly scale-up such transfers to developing countries dramatically as long as they ensured incentives for developed and developing country private sector actors to take part. The expansion and improvement of programmatic CDM or a move towards the use of standardized baselines and/or positive lists for the determination of additionality in 'regula' CDM would have a similar positive effect on technology transfer and diffusion, albeit at a smaller scale.

That being said, IETA is also aware that there are some technologies that require more than the carbon market price to bridge the gap to economic competitiveness. For those technologies the development of a market needs to be accompanied by other policies, measures, and instruments. IETA urges governments to consider innovative funding arrangements for such technologies, such as the use of domestic auction revenues to support the demonstration of critical technologies like Carbon Capture and Sequestration. IETA is also interested in the possibility of the development of an international mechanism for technology development or transfer that could lead to credits for participation. We look forward to engaging with the Parties on this idea more in the coming months.

10. *Tenth,* **on policy approaches and policy incentives on issues relating to reducing emissions from deforestation and degradation in developing countries; and the role of conservation, sustainable management of forests and enhancement of forest carbon stocks in developing countries**, IETA believes that market mechanisms have enormous potential to act as an effective means to promote the large-scale investment required to reduce emissions from deforestation, forest degradation and land-use change in developing countries. For this reason, IETA advocates the use of market-based mechanisms that create carbon credits that are fully fungible with AAUs, CERs, ERUs, etc. to the greatest extent possible and looks forward to contributing to the discussion on the design and implementation of such mechanisms in these areas as the negotiations move forward.

    It is clear to IETA, however, that the sustainable management of forests and the enhancement of forest carbon stocks require long-term investment and the application of modern techniques and management skills. IETA believes that in order to develop a market capable of generating such long-term private sector investment the required legal and regulatory infrastructure must be established in host countries, particularly as to land ownership and enforcement of forest conservation deeds. IETA is aware of some truly innovative approaches to the establishment of regulatory infrastructure for land management that have already been developed in some countries, such as Brazil, and are proving successful. IETA believes that these approaches should be enhanced further and shared with other countries. We also recommend that public sector funds be made available to developing countries in the period from 2009 to 2013 to facilitate the diffusion of such infrastructure, examine the specific local and regional barriers, and establish the systems and resources to enable developing countries to fully participate and benefit from the carbon market and to attract private sector investment in forestry and sustainable land use.

Each of the issues covered above represents a real challenge for the AWG-LCA and for the negotiations, which IETA hopes very much can be concluded in Copenhagen. The paragraphs above are necessarily general but there is an urgent need now to become specific, and to deal with real-world examples rather than high-flown principles. Each of the issues needs to be examined from the perspective of the financial sector, if there is to be any chance of the substantial private sector investment and contribution that the Parties, the UNFCCC Secretariat and other stakeholders are all looking for. IETA's members have helped turn the CDM into a major success. They are very keen, and very well placed, to ensure that the expansion of the CDM and the design of possible additional instruments, is effective and attracts maximum private interest. We will be working on the AWG-LCA's agenda throughout 2009 and hope that we will be able to engage with you in doing so.

Sincerely,

Henry Derwent

President, IETA