



Submission to the AWG-LCA¹ Views on new market-based mechanisms

21 February 2011

Climate Action Network-International is a coalition of 550 environmental and development nongovernmental organizations worldwide committed to limiting human-induced climate change to ecologically sustainable levels

CAN welcomes the opportunity to respond to the invitation to present views on the establishment of new market-based mechanisms (decision -/CP.16, paragraphs 80-82).

CAN strongly believes that any new market-based mechanisms must take into account and build upon the lessons learned from the operation of existing market-based mechanisms during the first commitment period of the Kyoto Protocol to ensure the environmental integrity of any new mechanisms as well as the overall UNFCCC regime.

Safeguarding overall environmental integrity

1. Level of ambition: Recalling the current alarmingly low level of ambition expressed in most of the pledges made to date, CAN is concerned that the use of international market-based mechanisms could further weaken the impact of these commitments on the implementation of domestic emission reduction efforts. In particular, CAN believes that without raising the level of ambition to more than 40% emission reduction for Annex I parties compared to 1990 levels by 2020, with a majority of this reduction implemented domestically, there is no room – or indeed need – for the use of offsets by Annex I parties.² Furthermore, any new mechanisms must contribute to net global emission reductions.

2. Avoiding crediting business as usual reductions: One of the fundamental flaws that CAN and others have repeatedly pointed out with regards to the CDM is the crediting of “business as usual emission reductions”, i.e. reductions that would or could likely have happened even without the additional incentive provided by the mechanism. These non-additional credits jeopardize the overall environmental integrity of the mechanism and, therefore, the design of any new market-based mechanisms must ensure that business as usual emissions reductions cannot receive saleable credits.

3. Ruling out double-counting: Possible future market-based mechanisms have to make sure that there is no double-counting of the units traded. In particular, three different types of double-counting have to be ruled out. First, it has to be ensured that emission reductions that result in the issuance of credits for international trade are only counted towards the financial *or* emission reduction commitments of the purchaser; they may not be counted towards emission reduction pledges of the seller. Second, the international trade of emission reduction credits results in financial flows between the seller and the purchaser. The purchasers can count the emission reduction credit toward their own emission reduction commitment *or* the payment toward any financial commitments but not both. Third, during the transition from the current project-based mechanisms toward any new market-based mechanisms, it must be assured that any emission reductions implemented are only credited in one of these mechanisms and not both.

4. Safeguard environmental treaties, international obligations and sustainable development: Any new market-based mechanism has to ensure that the activities carried out within the scope of the mechanism contribute to the sustainable low-carbon development of the host country and honours all international obligations contained

1 Pursuant to decision -/CP.16, paragraph 82.

2 These views are further elaborated in our November 2009 position paper “The Role of International Offsets in Light of Current Annex I Emissions Reduction Targets and Climate Financing Commitments”, available at http://www.climatenetwork.org/sites/default/files/CAN_position_offsets_Nov09.pdf

in, inter alia the Convention on Biodiversity, the UN Declaration of the Rights of Indigenous Peoples, the Montreal Protocol, and the World Commission on Dams, and all other relevant existing treaties and conventions. For that reason, and to ensure consistency with the objective of sustainable development contained in Article 2 of the Convention, an activity cannot participate nor be part of any new market-based mechanisms if it has been found to have unacceptable social or environmental impacts (such as those contained in international obligations and internationally recognized safeguards referred to above).

5. Departure from project-based mechanisms: One of the lessons learned from the CDM is the impossibility of accurately assessing the additionality of emission reductions achieved by individual projects. CAN therefore believes it is necessary to move from project-based crediting to crediting based on larger segments of the economy of the host countries, with the possible exception of LDCs and sectors of the economy where these mechanisms are not appropriate.

6. Supplementarity of emission reductions: To further ensure that new market-based mechanisms do not undermine the environmental integrity of the UNFCCC regime, they must be supplementary to substantial domestic emission reductions in Annex I countries (and only be used there once the emission reduction ambitions of these countries have been elevated to an aggregate reduction target of more than 40% below 1990 levels by 2020). One of the lessons learned during the first commitment period of the Kyoto Protocol is that an exact interpretation of “supplemental” needs to be agreed by parties to ensure that flexible mechanisms are indeed supplemental to, as opposed to a replacement of, domestic emissions reductions in Annex I countries, which should be the main focus of these countries’ efforts. CAN expects developed countries to have achieved near-complete decarbonization of their economies by 2050, and use of off-set credits has the strong potential of locking in polluting infrastructure in those countries, rather than creating strong incentives for sustainable investment. Replacing polluting infrastructure will increase the cost of action to fulfil the obligations of Article 2 of the convention at least over the medium to long term. In addition, a carbon budget to 2050 that is compatible with a 1.5°C objective requires strong decarbonization action in developed countries *in addition to* developing countries following, with appropriate support, sustainable, low-carbon development pathways.

7. Share of proceeds: CAN believes that a share of proceeds levy should be applied to the trade of all units generated by any new market-based mechanisms, set at a non-distortionary, but nevertheless effective rate. Proceeds generated by this levy should flow through the UNFCCC’s Green Climate Fund.

8. Supplementarity to international support: The financial flows, technology transfers and capacity-building associated with tradable units generated by any new mechanisms must also be supplemental to the financing and technology promised by developed country parties to enable and support mitigation actions in developing countries pursuant to decision 1/CP.13 paragraph 1.b.ii³.

9. Low-hanging fruits: Any new market-based mechanisms must not lead to the deprivation of negative or low cost mitigation opportunities (“low-hanging fruits”) of developing countries by crediting such action for purchase by developed countries – such activities must be retained for developing country unilateral and MRV-supported domestic action.

Views regarding sectoral approaches

Decision -/CP.16 paragraph 80.c stipulates that new market-based mechanisms to be considered at COP17 ought to stimulate mitigation across “broad segments of the economy”. Since CAN believes that parties will likely consider sectoral approaches (sectoral crediting and/or sectoral trading) under this heading, we would like to offer our views and concerns regarding these approaches.

3 This requirement is closely related to the second type of double-counting described above in that credit generating mechanisms cannot replace the financial obligations of developed countries with respect to 1/CP.13, 1.b.ii.

In our view, if established, both types of sectoral approaches would have to entail setting a threshold well below BAU emissions projections in the host country. The reductions that are required to reduce actual emissions to that threshold would then be achieved by the developing country party in part unilaterally and in part with financial, technological and capacity-building support from developed countries. In sectoral crediting, any reductions *beyond* the threshold would generate credits after the end of a reporting period which could then be traded, while a failure to reach or exceed the emission reductions represented by the threshold would not result in any penalties (sectoral no-lose crediting). In the case of developing countries' voluntary participation in sectoral trading, allowances would be issued to host countries at the beginning of a reporting period, which can be traded internationally. If the actual emissions of the sector would exceed the amount of allowances still held at the end of a reporting period, further units would have to be purchased.

1. Getting the threshold right: CAN's most serious concern lies in the setting of the crediting/trading threshold. This threshold is crucial for the overall environmental integrity of any sectoral mechanisms. If this threshold is set too lenient, it would risk creating even more "hot air" emissions certificates. The threshold has to be set substantially below conservative BAU emissions projections. The experience with the first phase of the EU ETS (which can be considered a real world experiment with sectoral trading), in which an overly generous threshold led to over-allocation and near market collapse, should serve as a cautionary tale.

2. Including all relevant emissions in sector boundaries: In order to ensure that sectoral approaches accurately capture all emissions associated with the activities within a sector, sector boundaries have to be designed very carefully and with full transparency. For example, in the power sector, sector boundaries could either be designed to cover the emissions associated with operating power plants, and all other emissions associated with the activities of the sector, for example, emissions from extraction, processing, transport and disposal of fuels (e.g. for coal, gas, oil and nuclear plants), reservoir emissions of hydro power plants, or emissions associated with constructing and decommissioning of installations. Or, alternatively, it must be clear what emissions are covered, and rules established to ensure that emissions are accounted for correctly. Furthermore, sectoral boundaries must be continuously monitored with regards to their continuing appropriateness and possibly re-defined based on changing circumstances, for example to re-include emissions that were displaced outside of the sector (leakage) due to the definition of these boundaries.

3. Accuracy of emissions data: Accuracy of emissions data within the covered sectors is of crucial importance to sectoral approaches. Without sufficiently detailed data it will be impossible to make BAU emissions projections with any reasonable degree of certainty. Furthermore, the accurate assessment of actual emission in the sector (and thus the determination of how many, if any, credits can be issued) requires detailed and accurate emissions inventories. This problem could be overcome by initially limiting sectoral approaches to sectors with relatively few large point sources or sectors with the possibility of accurate upstream accounting for sectoral emissions. At the moment, probably only a few developing countries possess the necessary technical capacity and probably only for a limited number of industrial sectors. Significant capacity-building prior to implementation would be required.

4. Delay of mitigation action: Since sectoral approaches are based on BAU emission projections, there is an incentive to delay emission reduction actions in sectors that might be eligible for sectoral approaches in the future in order to keep BAU emissions high. Definitions and rules would need to be established to ensure this practice does not occur.