Submission by Global Forest Coalition (GFC) - Institute for Agriculture and Trade Policy (IATP) - Institute for Policy Studies (IPS) - Third World Network (TWN) - Tebtebba (Indigenous Peoples' International Centre for Policy Research and Education)

Also on behalf of Asian Indigenous Women's Network - [earth] - Friends of the Earth England, Wales and Northern Ireland - Friends of the Earth Malaysia - Sustainable Energy and Economy Network (SEEN)

New-market-based mechanism (SBSTA)

I. Introduction

Invited in paragraph 52 of Decision 1/CP.18, to submit our views, the above admitted observer organisations submit to the Parties for their consideration the following submission, which presents an overview of lessons learnt from existing markets, followed by information relevant to the possible elements of the mechanism to be considered in the work program, as outlined in para 51, Decision 1/CP.18.

It is worth recalling that the COP17 decision "defines" a new market-based mechanism – it does not "establish" one. No decision was taken at COP18 to establish such a mechanism, and a SBSTA work program has been established to elaborate modalities and procedures. Developments under this work program must take account of the full range of views on the NMM, and in particular lessons from existing markets, before a decision is taken on establishing one. Such a decision must only be taken in the context of a balanced package which sees significant progress on mitigation commitments, including commitments from developed countries to support mitigation action in developing country Parties.

This submission presents lessons from existing carbon markets (section III); evaluates current discussions and proposals under the NMM in the context of increasing ambition (section IV); and examines the implications for achieving both environmental integrity and equity under a New Market Mechanism (section V).

Given the urgent need to reduce emissions, the centrality of the markets discussion under the UNFCCC is distracting, dangerous and irrelevant at this critical moment. The key recommendation from this submission is to postpone this discussion until ambitious targets are agreed, with a framework to increase domestic action in developed countries and commitments to support mitigation action in developing countries.

There is also a need to fundamentally assess the effectiveness of carbon trading for delivering real, effective and additional emission reductions as compared to other policy instruments such as carbon taxes. Many eminent scientists and persons have expressed reservations about the effectiveness of carbon trading schemes, such as Dr. James Hansen, Prof. Jeffrey Sachs, George Soros, and others.

Recommendations:

- There is a need for clear provision of climate finance not dependent on carbon markets, to increase mitigation action in developing countries.

- Current requirements for ensuring permanence should not be weakened in an attempt to increase market liquidity.
- The NMM should not increase the financial and reporting obligations of developing countries, nor be double counted as both emission reductions and financial / technological assistance for developed countries.
- A thorough and objective evaluation of existing market mechanisms should be conducted before discussions on the NMM proceed.
- Parties should concentrate on ***increasing ambition*** for developed country parties (via domestic actions), ***guaranteeing commitments*** for supported NAMAs to increase developing country mitigation, and ***meeting existing obligations*** for climate finance under the Convention.
- Conservative accounting standards (including crediting thresholds, discounting and other methods) contravene the principles of the Convention by shifting the mitigation burden, as well as the costs for this burden, onto developing countries. Conservative accounting is therefore not a suitable mechanism to deal with the lack of environmental integrity in NMMs due to intractable problems with additionality and setting credible reference levels.

II. Background/context

The purpose of a NMM, as outlined in Decision 1/CP.16 and Decision 2/CP.17, is to promote cost-effectiveness in emission reductions and provide comparability in mitigation actions, ensuring a net decrease and/or avoidance of global greenhouse gas emissions and assisting developed country Parties to meet part of their mitigation targets, while ensuring supplementarity.

The work program under the SBSTA to elaborate modalities and procedures for the NMM ***must first take into account evidence from existing market mechanisms to determine the ability of market mechanisms to meet these stated objectives***, while also maintaining the principles of the Convention, including the principle of common but differentiated responsibilities (CBDR). This submission raises concerns that discussions and developments on the NMM to date indicate a likely failure to contribute to the ultimate objective of the Convention or to realize financial and technology transfers to developing countries if carbon markets are relied on to provide mitigation and financial support.

Whilst the term 'market-based mechanism' can refer to a variety of approaches, the NMM is being discussed as a carbon market approach. This submission therefore evaluates the NMM in the context of carbon markets, while alternative market and non-market approaches are explored in related submissions on the framework for various approaches (FVA) and non-market based approaches respectively.

Carbon markets have historically delivered little to no emission reductions (and have even been responsible for increases)[1] while promoting policy designs that prioritize fungibility of units over the environmental integrity of the system itself.

There are significant technical and scientific barriers to ensuring environmental integrity in a market-based mechanism, including establishing credible baselines to

[1] Corporate Observatory Europe, EUETS Failing on the third attempt, http://corporateeurope.org/news/eu-ets-failing-third-attempt; FERN: Trading Carbon – how it works and why it is controversial, http://www.fern.org/tradingcarbon; and Michaelowa and Purohit 2007; Schneider 2007; Lu□ttken 2012; in Bolscher (2012) Design options for sectoral carbon market mechanisms. Ecorys report for DG Climate Action, European Commission.

ensure emissions reductions to be real, additional and permanent. To address the issue of environmental integrity, developers of carbon trading methodologies in a number of forums are moving towards conservative accounting standards as a cost-effective solution. With conservative accounting, fewer (up to 80%) emission reduction units are credited than are actually measured to allow for uncertainty margins in the number of emission reductions actually achieved. The result of this 'conservative accounting', designed to increase confidence in the environmental integrity of carbon credits, is that this is achieved by significantly increasing costs to host countries, while decreasing income potential – the burden for environmental integrity is therefore borne by the developing countries. Developed countries achieve cheap offset credits to meet climate targets while continuing business as usual. It is imperative that this scenario does not eventuate under the NMM.

The implications for developing countries of the establishment of a NMM include:

- NMMs could offer very little in the way of financial or technological support for mitigation actions, because of the low value accredited to offsets generated through conservative accounting;
- NMMs could decrease ambition for developed countries;
- NMMs could risk the double counting of purchasing emissions reductions for compliance purposes (permits to pollute) as transfers of climate finance to developing countries.

The development of new markets, in a context where existing markets have failed to deliver finance or mitigation ambition, abdicates the commitments developed countries have made under the Convention to meet the full costs incurred of mitigation actions in developing countries (Article 4.3). The results of this approach are greater climate impacts and increased adaptation costs as environmental integrity concerns are discounted, rather than dealt with.

III. Lessons from existing market mechanisms

A thorough evaluation of existing carbon markets is needed before further discussion on reform of existing or development of new market mechanisms. In particular, this evaluation must include an investigation into end recipients of investment flows from existing market mechanisms, and total emissions reductions.[2]

Below we present a brief overview of analysis and lessons on the CDM, as the only global carbon market offset mechanism, and the EU ETS, as the world's largest carbon allowance/emissions trading scheme.

Lesson 1: Carbon market mechanisms are not effective tools for emissions abatement.

- There is growing consensus that 'cap and trade' programs are insufficient to reduce emissions on the scale needed, with insufficient incentives for energy technology innovation, and misplaced incentives for sectors with dispersed emission sources

[2] At COP17 in Durban, the CDM Policy Dialogue was established, and a high level panel formed to evaluate the CDM. In September 2012, the Panel recommended 51 actions across 12 areas to reform the CDM. The objective of the dialogue, however, was in ensuring the effectiveness and ongoing relevance of the CDM, and as such, the findings and recommendations do not bring the necessary objective information to draw lessons from existing mechanisms that would be relevant to taking decisions on the establishment of a new market mechanism.

(transport, forests, and agriculture).[3]

- In any 'cap and trade' mechanism it is the 'cap' (rather than the trade), which reduces emissions, with the EU ETS currently suffering from a massive surplus of allowances, in part due to the cap being set too high. The EU has failed to tighten its cap by raising its reduction target to 30 percent by 2020, and the effects of the recession, over-allocation of emissions allowances, and oversupply of inexpensive CDM credits mean a likely surplus that could reach up to 2.4 billion allowances between 2013 and 2020. A recent report to the European Commission found that sufficient demand was not present for a NMM.[4]
- Lack of policy certainty and EU post-2012 CDM credits limited to LDC purchases means significantly reduced confidence and investment in the CDM. Recurring price crashes (in both the CDM and EU ETS) have led to closing down of carbon trade desks, withdrawal of investment and calls from industry as well as environmentalists to close the ETS – calling it "a failed experiment".[5]

Lesson 2: Far from being cost effective, carbon trading has been a drain on public resources.

- Despite emissions trading and offsetting being proposed as "cost effective" mitigation tools, carbon markets have been shown to be many times more expensive than direct regulation. An analysis from Swiss bank UBS in 2011 found that the EU ETS had failed to deliver any real reductions in emissions while delivering windfall profits to energy companies, at a cost to the taxpayer estimated to reach 240 billion by 2020,[6] a staggering public cost in a time of economic crisis.
- The CDM, far from reducing abatement costs, has also created windfall profits, increasing costs many times over. One example of windfall profits comes from a CDM project in South Korea and Brazil to eliminate nitrous oxide, which generated $189 million in credits at a cost to the company of $15 million. Countless other examples abound.[7]

Lesson 3: Carbon markets are poor instruments to transfer finance to climate mitigation actions, and vulnerable countries.

- The CDM continues to be characterized by a highly asymmetrical distribution of resources, attracting investment where risk is lowest and return is highest. This is why more than 70 per cent of approved CDM projects can be found in only four countries, with only 2 percent of CDM projects located in Africa. Limited distribution of finance remains a very real risk under proposals for the NMM. From 1 January 2013, operators in the EU may only purchase CDM credits generated in LDCs,[8] in an attempt to resolve this distribution problem. However, circulating

[3] March 15, 2012. http://newscenter.lbl.gov/feature-stories/2012/03/15/cap-and-trade-programs-do-not-provide-sufficient-incentives/, see also The Carbon Trust (2008) 'Global carbon mechanisms: emerging lessons and implications.' Carbon Trust, UK.

[4] Design options for sectoral carbon market mechanisms. Ecorys report for DG Climate Action, European Commission. http://ec.europa.eu/clima/news/articles/news_2012111402_en.htm;

[5] See 'Time to scrap the ETS' http://scrap-the-euets.makenoise.org/; see also Point Carbon: EU CO2 scheme a "regulatory omnishambles", Barclays, 19 Nov 2012. www.pointcarbon.com

[6] UBS 2011

[7] For this and other examples see FERN (2010) Trading Carbon: How it works and why it is controversial, p74. http://www.fern.org/sites/fern.org/files/tradingcarbon_internet_FINAL.pdf 14

[8] Directive 2009/29/EC of the European Parliament and of the Council of 23 April 2009 amending Directive 2003/87/EC so as to improve and extend the greenhouse gas emission allowance trading scheme of the Community

credits from before 2013, the persistent lack of overall demand for credits in the EU ETS, and a consistently low carbon price, means LDCs are not likely to see any significant increase in CDM projects, and those they do see may require prohibitive upfront costs coupled with limited revenue from carbon markets.

- There is no direct link between the size of the carbon market (by value) and the investment available for actual emissions reduction activities. A vast majority of investment in emissions trading schemes such as the EU ETS is in derivatives (estimates range from 64-99%). In line with all commodity markets, only a fraction of the US$176 billion[9] invested in the carbon market is available to finance emissions reducing activities, with a very small proportion of that going to developing countries and projects on the ground.[10] New or expanded carbon markets will primarily increase trading volume, not financial flows to actual emission reduction activities.
- The development of new national and regional trading schemes (i.e., Australia, California) are often cited as an indication of future increased demand for offset credits in developing countries. In reality, even where new trading mechanisms are being developed, these are not necessarily going to generate resources for developing countries. Many trading schemes are concentrating on internal offset programs, with very low expectations to purchase international offsets. For example, in the California trading scheme, only approved offset projects located in the U.S. are currently allowed. Limited international forest offsets are being developed, but demand for these will remain extremely low.[11]

Lesson 4: Carbon markets 'lock-in' polluting technologies, delaying action on climate mitigation and increasing costs.

- Enabling industrialized countries to 'outsource' emission reductions 'locks-in' polluting technologies, by postponing investment decisions for cleaner energy. A significant proportion of fossil fuel-based energy generating capacity in industrialized countries is due to be replaced over the next 10-15 years. Investment decisions made now will determine the carbon intensity of energy generation for the next 40 years.[12] The policy framework must exclude offsets in the medium term (as noted in the Stern Review from 2008) to drive investment decisions and regulatory reform that can create technology innovations to reduce emissions at the scale and on the timeframe needed.

Lesson 5: Carbon markets are highly susceptible to fraud and therefore ill-suited for reliable climate finance.

- The EU ETS, to date the largest regional carbon market, has shown just how vulnerable carbon trading is to malpractice, fraud and cybercrime. There have been

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Text with EEA relevance**,** article 11a. http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:140:0063:01:EN:HTML

[9] Total carbon market value estimated in the World Bank's 'State and Trends of the Carbon Market 2012.'

[10] The exact proportion available to finance emissions reductions is unclear, due to the opaqueness of an increasingly complex carbon market, but some estimates put this at 2-3 percent of overall market value (see, *inter-alia*, The Munden Project (2011) REDD and Forest Carbon).

[11] REDD+ offsets will be limited in quantity, and supply will be limited to Chiapas in Mexico and Acre in Brazil.

[12] International Energy Agency, World Energy Outlook 2011; and The Guardian, 9 November 2011, 'World headed for irreversible climate change in 5 years, IEA warns.' http://www.guardian.co.uk/environment/2011/nov/09/fossil-fuel-infrastructure-climate-change

3 major fraud incidents involving the EU ETS in 5 years, ranging from carousel fraud,[13] recycling of credits already used for compliance,[14] to permits being stolen from national EU ETS registries and sold on, closing the virtual accounts on the EU ETS carbon 'spot market' for several weeks,[15] with yet another incident of cyber-theft surfacing early in 2013.[16]

- The Financial Services Authority (FSA) in the UK has again issued another public warning on its website with the reference "Find out why you should be careful about investing in the carbon credits market."[17]
- Given the scale of potential fraud in carbon markets, Interpol are considering expanding their mandate to cover criminality in the global carbon markets, with an Interpol Officer quoted as saying: "The carbon markets involve so many parties, so many new instruments and forms of vulnerability that we haven't been aware of before."[18] The cost to the taxpayer associated with fraud and organized crime is significant.

Lesson 6: Emissions from fossil and land based sources are not equivalent.

- The verifiability of emissions reductions from fossil fuel use is undermined by a process that falsely creates fungibility between credits generated in different sectors. Such a process also creates 'accounting loopholes' which justify increased emissions from fossil fuel use. Emissions from land-based sources, such as forests and soil are particularly prone to reversal, with fires, floods, drought and climate change itself increasing the risk that terrestrial carbon pools will release CO_2 rather than sequester it.[19] In addition, high levels of uncertainty in accounting for terrestrial emissions, with IPCC guidelines suggesting 60% for forestry and land-use change compared to 10% for electricity generation and industrial processes, make fungibility between forest and energy offsets unviable.[20]

IV. Increasing ambition (para 51(e))

The Doha decision requests the SBSTA to conduct a work program on the NMM, considering possible elements, which take the form of general principles. While there is much which remains undecided about the form and structure of a possible NMM, a key distinction in approaches under discussion is between sectoral (which could be either

[13] cyber criminals generated billions of Euros worth of revenue in value-added tax (VAT) from the trade in carbon permits across the EU and then disappeared before paying the VAT to the tax authorities.
[14] carbon offset credits already used by companies to cover emissions subject to the EU ETS target were swapped for Assigned Amount Units (AAUs) and then recycled into the carbon market because they fetched a higher price and were easier to sell than AAUs. Whilst technically legal under the Kyoto Protocol, the practice caused havoc in the EU's carbon markets because such recycled offset credits cannot be used a second time for compliance by companies in the EU ETS.

[15] Euractiv, 7 February 2011, EU spot carbon market reopens amidst safety fears. http://www.euractiv.com/climate-environment/eu-spot-carbon-market-reopens-am-news-501941

[16] UNs forest protection scheme at risk from organized crime, experts warn. The Guardian, % October 2009. http://www.soca.gov.uk/news/539-carbon-credit-thieves-jailed
[17] http://www.fsa.gov.uk/consumerinformation/scamsandswindles/investment_scams/carbon_credit
[18] Emile Lindemulder, a Criminal Intelligence Officer with Interpol quoted in 'Crime in the Carbon Markets,' Shapiro 2010. http://cironline.org/blog/post/crime-carbon-markets-803
[19] 18. Hopkins, F. et al. 2012. Warming accelerates decomposition of decades-old carbon in forest soils. Proceedings of the National Academy of Sciences of the United States of America (PNAS), May. Accessed at: http://www.pnas.org/ content/early/2012/06/07/1120603109.abstract.
[20] IPCC Guidelines for National Greenhouse Gas Inventories. Reporting Instructions

trading or crediting) and project-specific (CDM-type crediting) approaches. Scaling up to a sectoral approach has been presented as circumventing the problems of the project-based approach by allowing greater government involvement for regulation and emission reductions at scale, and avoiding the issue of emissions reduced in one area moving to another (leakage). Yet the 'additionality' requirement at the heart of environmental integrity (if the emission reductions that are awarded 'offset credits' are not additional, the atmosphere will see an increase in emissions) are not resolved by a transition from project-based to sectoral approaches – and risk being worsened, due to the scaling up to entire sectors of an economy and greater volumes of emissions reductions involved.

If developed in line with existing commitments under the Convention, a NMM would need to provide targeted support to ensure mitigation actions in developing countries, without displacing developed country obligations for ambitious emissions reductions domestically. The variety of approaches being described under the NMM can make it difficult to discern if these requirements would be met. In table 1 below, we summarize the different approaches, with particular consideration for environmental integrity and equity.[21]

[21] Note, the characteristics of different approaches are not mutually exclusive, (i.e., sectoral crediting could award credits on a BAU baseline set only on historical data, adjusted to account for national polices and external impacts (projected), or adjusted for a crediting threshold below the BAU baseline. The table only serves to explain the characteristics and differences between these approaches, and does not indicate any of this is or should be agreed under the NMM.

Approach	Characteristics	Reference level approach	Developing country considerations	Environmental Integrity considerations	Equity implications
Sectoral crediting	Credits issued ex-post, after emissions reductions across entire sector determined	BAU baseline established for sector (economy-wide, national or sub-national)	- Data reliability and availability a serious constraint to establishing sectoral baselines -Monitoring will require considerable data, costs and capacity - Incentives for aggregated emissions reductions achieved primarily through policy intervention	-Sub-national boundaries do not address national leakage -Sectors with dispersed emissions sources, such as building, transport and land-use sector make baseline setting and monitoring extremely difficult, and require approaches beyond carbon price to reduce emissions -Overall volume of offsets increased, with conservative accounting (discounting/buffers) suggested to alleviate environmental integrity concerns	-Risk of asymmetric dispersal as seen under CDM – only countries with technical capacity and low investment risk will attract market actors -Conservative accounting places burden for environmental integrity on host country, resulting in increased measuring and monitoring costs, with lower returns as amount of carbon credits compensated is discounted -Increases accounting flexibility and use of loopholes, thereby decreasing ambition for implementing countries.
Sectoral trading	Allowances issued ex-ante, to be traded among installations at completion of crediting period (ETS model)	Emissions cap established per sector – installations trade between those who are under or over the cap	- Substantial transaction costs, requiring extensive measurement and monitoring -Suited for sectors with large point sources (power and industry). Developing countries may have only few installations, making sectoral trading inappropriate -Substantial capacity constraints for developing countries to implement sectoral trading	-Due to larger scale of sectoral trading (than project-based), the risk of issuing non-additional credits, and thus allowing global emissions to increase, is much higher -Vulnerable to industry lobbying – in the EU ETS, the majority of allowances were given away rather than auctioned, resulting in windfall profits for utility companies passing non-existent costs to consumers	-Increases accounting flexibility and use of loopholes, thereby decreasing ambition for implementing countries.
Installation-based crediting	Credits issued ex-post to individual projects or installations, which show emission reductions relative to a baseline (CDM model)	BAU baseline established within defined project boundaries	-Private sector prefer project-specific investments which avoid government interaction -Low levels of finance generated due to lack of demand/low carbon price -Appropriate projects restricted to a handful of more industrialized developing countries	-Additionality cannot be proven; large proportion of projects considered non-additional -Leakage beyond project boundaries -Emissions justified through offset credits means likely overall increase in global GHG emissions	-Allows industrialized governments and companies to avoid meeting their emissions reduction obligations at source -Offsetting allows industrialized nations to count lowest cost abatement towards their own targets, increasing costs for developing countries left with higher cost projects
Crediting threshold	A crediting threshold, or incentive level, is established below the BAU baseline	Parties are awarded credits for emissions reductions below the crediting baseline, hence moving 'beyond offsetting'	Unsupported mitigation actions must be carried out to reach the crediting threshold, before parties are eligible for credits / international support	The gap between the BAU and crediting baseline partially compensates for environmental failings, but not possible to fully compensate for levels of uncertainty	Increased environmental integrity is at the cost of pushing additional burdens onto developing countries, equivalent to unsupported NAMAs
Intensity targets (for sectoral or installation-based crediting)	Targets are set per emission driver, such as unit of GDP; metric ton of product output	Minimize potential for over-crediting by factoring key emission drivers, such as production growth, into the baseline	Not possible to know future output / intensity of sectors, hence baseline setting is unreliable	Possible creation of perverse incentives to increase (or delay decreasing) output in order to increase credit generation in the future	

V. Environmental integrity, equity and common but differentiated responsibilities

The development of 'New Market Mechanisms' poses significant concerns for environmental integrity, equity and CBDR. Demands for high levels of environmental integrity and calls to move 'beyond offsetting' are translating into methodological proposals for conservative accounting, buffers to insure against leakage and reversals, and 'crediting baselines' to ensure mitigation action is taken before credits are awarded. This effectively transfers the ***burden of environmental integrity*** onto host countries, meaning developing countries have to commit to increased mitigation action with reduced credits for this action if they opt to voluntarily participate in market mechanisms. The potential for the new mechanism to develop in such a way that transfers onto developing countries the ***burden of mitigation action*** as well as financing this mitigation action, and the increased risk of ***double counting of finance and support,*** undermines the principle of equity and CBDR.

This section evaluates selected elements of the SBSTA work program on the NMM (Decision 1/CP.18, para 51), making recommendations to ensure the principles of the Convention are maintained, with increased ambition in developed countries, and mitigation action in developing countries pursuant to financial and technological support.

Voluntary participation - para 51 (b)

High transaction costs are a significant barrier to participation in a crediting system, where host countries or entities would receive the financial gains from the credits only long after the initial investment has been made. For those able to overcome the price barrier for participation, the lag time between investment and actual sale of credits risks an oversupply of credits and hence very low gains of participation in the system, with investment and transaction costs potentially outweighing financial return. Participation in a trading system also requires substantial upfront investment.

The principle of voluntary participation of Parties in the mechanism is undermined if there are not viable and concrete alternatives for financial and technological support for developing country mitigation actions. Furthermore, the option of 'voluntary' participation does not resolve the failure of carbon markets to reduce emissions, which will disproportionally affect vulnerable countries.

- *Recommendation* - There is a need for clear provision of climate finance not dependent on carbon markets.

Standards that deliver real, permanent, additional and verified mitigation outcomes, avoid double counting and achieve a net decrease and/or avoidance of greenhouse gas emissions - para 51 (c)

The delivery of real, permanent, additional and verified mitigation outcomes is complex in a market mechanism, due to an overriding necessity to create a fungible 'unit' which can be considered as comparable to emission reductions units from different sectors and different localities. This pursuit of fungibility distracts attention from what should be the central environmental priority of permanent and additional emissions reductions.

Permanence – risk of non-permanence (reversals) are dealt with in CDM sinks projects by issuing temporary credits, which must be replaced on expiration. The temporary nature of these credits provides a disincentive to buyers, resulting in insufficient project revenues. Some Parties believe new approaches should be designed to address non-permanence, such as the use of buffers or insurance, or reducing the time-frame to ensure permanence, All of these

'solutions' compromise the integrity of emissions reductions, and are done in order to provide fungibility while transferring liability and responsibility for permanence to host countries.

- *Recommendation* - Current requirements for ensuring permanence should not be weakened in an attempt to increase market liquidity.

Additionality – It is generally accepted that the counterfactual nature of additionality makes it impossible to prove with complete certainty, which means the 'zero-sum' nature of offsets is a best-case scenario – if they are not additional, offsets increase global emissions. For project-specific crediting, reviews of the CDM show high levels of non-additional projects.[22] For sectoral crediting, with aggregate accounting, additionality is widely believed to have been dealt with when a credible RL is set. This position ignores the fact that a lack of data in the majority of developing countries for many sectors means that it is not possible to set a RL with any degree of certainty, hence the additionality problem is not dealt with through a move to sectoral mechanisms.

Verification - High verification costs can be a barrier to participation of vulnerable countries. Discussions in REDD+, where some Parties are insisting that finance should be dependent on internationally verified credits, could set a dangerous precedent for support for mitigation action in developing countries being subject to international verification. Verification requirements should be in line with existing agreements under ICA, and follow IPCC definitions. In this case, verification is performed by countries and then checked by external reviewers (as opposed to independent international verification of developing country emissions reductions). Such credits would not be eligible for a trading mechanism, but insisting on higher standards of verification undermines national sovereignty and increases mitigation costs, without resulting in a net decrease in emissions (due to the intractable problem of additionality).

Avoidance of double-counting – There are three different types of double counting, all of which must be excluded if NMMs were to contribute to global emissions reductions. The first is the risk of units being credited in different mechanisms (such as the CDM and a NMM). While there is general agreement this should not occur, avoiding this is by no means simple. The second is an emissions reduction being counted by both the host country and buyer country. Despite analysis showing that this could lead to double counting of more than 1 billion tonnes of emissions reductions,[23] there is no agreement amongst Parties to exclude this type of double counting. The third type of double counting is when credits purchased to meet emissions reduction commitments are also counted by the buyer as fulfillment of financial obligations. Articles 4.3 and 4.7 of the Convention establish the commitments of developed countries to provide financial and technological support, and state that the obligations of developing countries to meet emission reduction commitments are dependent on this support.

- *Recommendation* - The NMM should not increase the financial and reporting

[22] See: Schiedner (2007) Is the CDM fulfilling its environmental and sustainable development objectives? An evaluation of the CDM and options for improvement. Berlin, Germany; and Michaelowa and Purohit 2007; Schneider 2007; Lu□ttken 2012; in Bolscher (2012) Design options for sectoral carbon market mechanisms. Ecorys report for DG Climate Action, European Commission.

[23] Eriksson et al (2011) The Implications of International Greenhouse Gas Offsets on Global Climate Mitigation. SEI Working Paper WP-US-1106

obligations of developing countries, nor be double counted as both emission reductions and financial / technological assistance for developed countries.

Net decrease - The concept of a net decrease in emissions reductions has yet to be defined, but implies that the NMM must go 'beyond offsetting' which is a zero-sum game, moving emissions from one location to another rather than decreasing them. A net decrease is assumed to have been achieved in a sectoral market mechanism by setting stringent baselines which are below BAU, discounting, or using short crediting periods with frequent review. These are elements of conservative accounting which is further discussed below. These narrow accounting measures, however, would likely be insufficient to achieve a 'net decrease' in global emissions[24] which would require the elimination of the first two types of double counting, as well as cancelling units – both politically and technically difficult to achieve.[25]

In summary, standards to ensure environmental integrity are either not possible in a market mechanism, or are achieved at the cost of shifting the burden for environmental integrity to developing countries. This is illustrated in developments such as weakening permanence rules to improve market liquidity, while discounting credits to account for uncertainty in emissions reductions. Host countries will need to invest a great deal of money to count and verify carbon to participate in a NMM, while conservative accounting methods, such as a discount rate or buffers, will reduce the eventual amount of carbon credits compensated to a fraction of the carbon measured. This transfers both the mitigation effort, as well as the financial burden for that effort to developing countries, making conservative accounting an explicitly inequitable approach to climate mitigation.

- *Recommendation* – Parties should concentrate on increasing ambition for developed country parties (via domestic actions), guaranteeing commitments for supported NAMAs to increase developing country mitigation, and meeting existing obligations for climate finance under the Convention.

Accurate MRV - para 51 (d)

Accuracy in measurement, reporting and verification of emission reductions varies significantly between sectors. As all carbon is measured by proxy, accuracy can be considered to be the wrong terminology in this context. What is desired is actually a reduction in uncertainties on emission reduction estimations. Levels of uncertainty for MRV in Annex I countries start at 10% for the coal sector and 40% for the land-use sector.[26] As this level of uncertainty is not sufficiently robust enough for financial trading platforms, methodologies to verify credits for carbon markets are developed with the objective of decreasing these levels of uncertainty, requiring substantial investments from host countries which are likely to dwarf financial returns at current carbon prices or without significant increases in mitigation ambition.

- *Recommendation* – Reducing uncertainty in MRV with the objective to trade emissions reductions comes at significant financial cost. Excluding international trading of emissions reductions would allow MRV in line with requirements under

[24] UNFCCC NMM Technical Paper, 24 August 2012. http://unfccc.int/resource/docs/2012/tp/04.pdf

[25] Kollmus et al (2013) New Climate mitigation Mechanisms: Stocktaking after Doha, http://www.infras.ch/e/news/displaynewsitem.php?id=4947

[26] IPCC Guidelines for National Greenhouse Gas Inventories. Reporting Instructions

national communications, building national capacity and allowing efforts to be directed at mitigation actions rather than overly focusing on MRV of these actions.

Conservative methods, ambitious RLs, crediting thresholds - para 51 (f)

Conservative and ambitious reference level - For all proposals for a new market mechanism, data availability for the sectors involved is a key prerequisite for a well-functioning system with a good baseline (reference level). In almost all developing countries, lack of data presents a major limiting factor to establishing credible baselines. There are differing opinions on whether reference levels should be an extrapolation of historical baselines, or adjusted to account for existing and planned policies and projected for future impacts. Lack of data and unpredictable events, as well as incorrect assumptions in projected reference levels means that reference levels frequently diverge from reality.

- *Recommendation* – The elaboration of a non-market based mechanism would allow countries to use simpler baseline and MRV parameters. These would be insufficiently accurate for a trading context, but which would be sufficient to adequately monitor and verify whether the emission reduction policy objective is met.

Crediting thresholds - In addition to conservative reference levels, many proposals currently on the table promote themselves as moving 'beyond offsetting' or achieving 'net emissions reductions' by introducing a crediting threshold which is well below a conservatively defined baseline. This requires developing country Parties to significantly alter their emissions compared to a claimed trajectory before any credits are issued, through a 'crediting baseline' or 'incentive level' below the BAU baseline. The gap between the BAU baseline and the start of crediting would partially compensate for the scheme's environmental failings, but at the cost of pushing additional burdens onto developing country Parties (which would be expected to meet the gap between the business as usual threshold and the crediting baseline with their own resources). The conservative adjustment introduced with a crediting threshold does not mitigate against the difficulty of setting credible baselines, and in practice requires domestically funded developing country mitigation action (termed 'own efforts' by the EU), before credits eligible for international support are produced.

Conservative accounting, through conservative reference levels, crediting thresholds, discounting or buffers, reduces the amount of finance that developing countries will see from a market mechanism, while increasing costs.

- *Recommendation* –Conservative accounting standards contravene the principles of the Convention by shifting the mitigation burden, as well as the costs for this burden, onto developing countries. Conservative accounting is therefore not a suitable mechanism to deal with the lack of environmental integrity in NMMs through intractable problems with additionality and setting credible reference levels.

Supplementarity - para 51 (h)

The principle of supplementarity, as defined under the Kyoto Protocol, aims to prevent that international offsetting mechanisms hinder domestic action in Annex I countries. Supplementarity is usually interpreted as the use of market mechanisms being in addition to developed country domestic action, represented as a portion of mitigation efforts to be achieved through international offsets. In addition to this, the principle of supplementary should consider the effect that market mechanisms have on reducing ambition by impacting on domestic regulation, with examples of the EUETS becoming an incentive not to

implement progressive energy efficiency policies or policies that would trigger a transition to low-carbon economies.[27]

Promotion of sustainable development - para 51 (j)

The CDM has been widely seen to have failed to deliver on its sustainable development objectives, for a variety of reasons. This is in spite of the fact that sustainability benefits were the first of the two goals listed for the CDM. By contrast, sustainability has not been a significant part of discussions on the NMM, and that the NMM should 'promote' sustainable development is at the end of a long list of other elements. To be effective, incentives for sustainable development are needed through budgetary support for ongoing national policy and regulatory reform which can increase national capacity and ownership of policies, rather than reliance on a narrow price signal.

Prompt start -para 51 (l)

Given the multiple challenges to the implementation of an NMM, and lack of demand for emission reduction credits, it is unclear why a prompt start would be needed. Instead, we recommend the opposite, and suggest that further discussions on the NMM are postponed until ambitious emissions reduction targets have been agreed.

VI. Conclusion

Market-based approaches in the form of carbon markets are an economically, environmentally and socially inefficient means to address climate change. The development of the new market-based mechanism is inappropriate and the development of non-market-based approaches should be accelerated. The key priority now for the UNFCCC negotiations is establishing top-down aggregate targets at a scale to avert catastrophic climate change. Developed country Parties should take the lead in increasing ambition (in line with their historical responsibilities) with mitigation action in developing countries being dependent on international support. Any discussion on New Market Mechanisms should be postponed before this has been achieved.

[27] The EU ETS has actively weakened policies such as the Energy Efficiency Directive, the Large Combustion Plant Directive and held back expanding implementation of e.g. feed-in tariff initiatives. See "Common Concerns to scrap the ETS" in http://scrap-the-euets.makenoise.org/common-concerns/