

13 November 2008

ENGLISH ONLY

UNITED NATIONS FRAMEWORK CONVENTION ON CLIMATE CHANGE

**AD HOC WORKING GROUP ON FURTHER COMMITMENTS
FOR ANNEX I PARTIES UNDER THE KYOTO PROTOCOL**

Sixth session

Accra, 21–27 August 2008, and Poznan, 1–10 December 2008

Item 3 (a) of the provisional agenda

Analysis of means to reach emission reduction targets and identification

of ways to enhance their effectiveness and contribution to sustainable development

Emissions trading and the project-based mechanisms

**Further input in relation to possible improvements to emissions trading and
the project-based mechanisms under the Kyoto Protocol**

Submissions by Parties

1. The Ad Hoc Working Group on Further Commitments for Annex I Parties under the Kyoto Protocol, at the first part of its sixth session, invited Parties to submit to the secretariat, by 17 October 2008, further input in relation to possible improvements to emissions trading and the project-based mechanisms under the Kyoto Protocol, as contained in annexes I and II to its report on the first part of its sixth session (FCCC/KP/AWG/2008/5, paragraph 22).
2. The secretariat has received five such submissions. In accordance with the procedure for miscellaneous documents, these submissions are attached and reproduced* in the language in which they were received and without formal editing.
3. The secretariat has also received one submission from an accredited non-governmental organization. In line with established practice, the secretariat has posted this submission on the UNFCCC website at <http://unfccc.int/parties_and_observers/ngo/items/3689.php>.

* These submissions have been electronically imported in order to make them available on electronic systems, including the World Wide Web. The secretariat has made every effort to ensure the correct reproduction of the texts as submitted.

CONTENTS

	<i>Page</i>
1. FRANCE ON BEHALF OF THE EUROPEAN COMMUNITY AND ITS MEMBER STATES** 3 (Submission received 5 November 2008)	3
2. REPUBLIC OF KOREA 14 (Submission received 17 October 2008)	14
3. NEW ZEALAND 16 (Submission received 31 October 2008)	16
4. NORWAY 27 (Submission received 11 November 2008)	27
5. SRI LANKA 29 (Submission received 10 October 2008)	29

** This submission is supported by Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, Montenegro, Serbia and Turkey.

PAPER NO. 1: FRANCE ON BEHALF OF THE EUROPEAN COMMUNITY AND
ITS MEMBER STATES

This submission is supported by Bosnia and Herzegovina, Croatia, the Former Yugoslav Republic of Macedonia, Montenegro, Serbia and Turkey

Paris, 5 November 2008

**Subject: Analysis of means to reach emission reduction targets and identification of ways to enhance their effectiveness and contribution to sustainable development: emissions trading and the project-based mechanisms (AWG-KP)
Further input in relation to the elements on possible improvements to emissions trading and the project-based mechanisms under the Kyoto Protocol**

The EU welcomes the invitation by the AWG-KP to provide further input on possible improvements to emissions trading and the project-based mechanisms under the Kyoto Protocol. We hope this input will assist in further clarifying the proposals brought forward by various Parties and the key elements that need to be agreed by the AWG-KP in order to improve the carbon market mechanisms for the second commitment period. The elaboration of these improvements to the mechanisms and their implications for the ability of Annex I Parties to reach emission reduction targets, will require further work by the Parties in Poznan and beyond. This work will need to proceed in harmony with the AWG-LCA, to maximise synergies towards a global and comprehensive agreement in 2009. In particular, the impact on supply and demand of tradable units would need to be further quantified.

The input provided below builds on the EU submission of 14 February 2008 on means available to Annex I Parties to reach their emission reduction targets (as contained in FCCC/KP/AWG/2008/MISC.1) and further EU views and information provided during the AWG-KP sessions in Bangkok, Bonn and Accra.

The submission focuses on those elements contained in Annexes I and II of the Accra conclusions (FCCC/KP/AWG/2008/L.12), which the EU considers as the most important issues to further consider given their possible implications for the ability of Annex I Parties to achieve mitigation objectives.

Introduction

The carbon market offers a key means for Annex I Parties to meet mitigation objectives and to provide finance for the worldwide transition towards a low carbon economy. The EU wants to work with other Parties to build a liquid global carbon market with a broad coverage and deep emission cuts to create a robust carbon price signal as a key means to deliver cost-effective GHG emission reductions. This global carbon market should contribute towards achieving mitigation and development objectives by increasing the cost-effectiveness of action, by leveraging investments in lower-GHG emitting technologies and by transferring technology to developing countries.

To achieve this, we need action on three fronts:

- The current Kyoto mechanisms need to be improved to enhance their cost-effectiveness while maintaining and strengthening environmental integrity.
- Participation in existing mechanisms should be enhanced.
- New carbon market mechanisms should be introduced.

The carbon market needs to be significantly scaled up, while providing incentives for enhanced mitigation action by developing countries. This implies the need to increase the portfolio of instruments beyond those currently available, including through an enhanced CDM and new carbon market mechanisms that allow for a net contribution to mitigation and provide new means of participation in the market. These mechanisms may include emissions trading and crediting mechanisms applied on a sectoral basis. The scale of participation in the market will be highly relevant for the supply and demand of tradable units and thus will impact Annex I countries' ability to reach ambitious emission reduction targets.

The question of appropriate mitigation action by developing countries and how it is supported by finance and technology is the subject of ongoing discussions in the AWG-LCA. Participation in carbon market mechanisms could provide an incentive to enhanced mitigation action. Therefore the use of particular market mechanisms to support action in specific sectors and countries needs to be considered in the broader context of the discussions on mitigation action and support in the AWG-LCA. The outcome of this discussion is relevant to the AWG-KP as the level of participation of developing countries in new mechanisms and the CDM will be highly relevant for the scale of the market and thus impact Annex I countries' abilities to reach targets cost-effectively.

I. Views and information on elements contained in Annex I to the Accra conclusions (FCCC/KP/AWG/2008/L.12)

1. Clean Development Mechanism

a. Access to the CDM

Improve access to CDM project activities by specific host Parties (section I.K.)

Although the CDM rules themselves are rarely the only barrier to CDM investment in a specific country, higher levels of participation from regions currently under-represented in the CDM could be enhanced by treating these regions differently in the CDM, including by providing preferential terms of market access to smaller and less developed countries. Such preferential access should respect environmental integrity and must be weighed against impacts on market effectiveness and efficiency.

Options that could be considered by the AWG-KP are:

- promoting sectoral crediting mechanisms and programmatic CDM where feasible;
- improving the current rules of LULUCF, building on lessons learnt in implementing them;
- a differential treatment in respect of fees and levies.

Improving access by specific host Parties to the CDM further requires a coordinated approach between development and climate policy and a consideration of the future scope of the CDM in relation to enhanced mitigation action by developing countries.

The EU's views on ways and means to improve regional distribution of CDM project activities are further elaborated in the EU submission of 16 September 2008 on regional distribution prepared for the Article 9 review.

b. Sectoral crediting mechanisms (sections I.E and I.F)

Sectoral approaches to mitigation action may include new carbon market mechanisms on a sectoral basis. The EU notes that among all proposals, two types of sectoral approaches may be most relevant for discussion under the AWG-KP: baseline-and-credit approaches on a sectoral basis (*sectoral crediting mechanisms*), which this section focuses on; and emissions trading based on a sectoral emissions cap (*sectoral trading*), addressed in section 3 below.

Participation of developing countries in these sectoral mechanisms should reflect their nationally appropriate mitigation actions and the need, in particular for specific sectors in advanced developing countries, to enable their participation in mechanisms that allow for a net contribution to mitigation.

Sectoral crediting mechanisms include both sectoral CDM with a pre-established ambitious baseline and sectoral crediting against a previously established no-lose target. Both proposals are very similar in their approach. In both cases aggregate emission reductions in a specific sector within a country are credited against a sectoral reference level for emissions, either established on the basis of a baseline or an agreed no-lose target. In both cases, the reference level should reflect national circumstances and be set sufficiently below business-as-usual projections.

Sectoral crediting mechanisms may provide a cost-effective means for Annex I parties to achieve their emission reduction targets. At the same time, these mechanisms may provide incentives for enhanced mitigation action by developing countries and for recognising actions on a sectoral basis by developing countries in the carbon market.

Compared to the project-based CDM, sectoral crediting mechanisms with ambitious baselines or no-lose targets would:

- significantly scale up finance for mitigation action;
- significantly strengthen developing countries' engagement in systematic mitigation action which is truly transformative in nature;
- address the problems of additionality where based on an ambitious sectoral reference level;
- reduce potential emission leakage by capturing all sectoral emissions;
- reduce administrative costs to participants.

The EU recognises that the implementation and crediting of mitigation action on a sectoral basis would require support for policy and institutional design, in particular in relation to monitoring, reporting and verification.

General issues to be addressed when implementing sectoral crediting mechanisms in an environmentally sound manner include:

- **Sectoral boundaries and leakage:** in order to prevent emission leakage within the sector, the mechanism should cover all entities/emission sources in the sector. Provisions would also be needed to prevent leakage from the sector covered by the mechanism to other sectors not participating in sectoral crediting, and to address possible sectoral leakage between countries.
- **Monitoring, reporting and verification:** establishing a sectoral reference level and determining sectoral emission reductions is only viable in sectors that can apply a robust, reliable and transparent system for collecting and using data, especially for monitoring, reporting and verifying emission levels, business-as-usual projections and emission reductions. Capacity building is key to enable this.
- **Institutional issues:** rules governing the mechanism would need to be established by the CMP and operationalised by the CDM Executive Board or another governing body.
- **Incentives for private sector participation:** to activate investment flows from private entities in the sector and to ensure their participation in the mechanism, the coordinating entities would need to provide sufficient incentives for participation. The challenge for the coordinator is to provide incentives to individual entities/emission sources for the aggregate emission reductions in the sector. In some countries this may need to be complemented by an enabling framework providing up-front support, since the emission reduction credits would only be received ex-post.
- **Transition issues:** to avoid double counting, participating sectors would only be able to participate in one type of flexible mechanism.

Sectoral CDM (section I.E)

Sectoral CDM is a scaled-up form of the current CDM. Instead of crediting projects and programmes, sectoral CDM would provide a mechanism for crediting emission reductions covering all emission sources within a certain sector, with only one sectoral baseline. This baseline should be ambitious, meaning it should be clearly below business-as-usual projections, similar to establishing a no-lose target.

The EU recommends that the CMP consider establishing rules and guidelines that enable the CDM Executive Board, or another appropriate technical body under the authority of the CMP, to administer sectoral CDM. These rules shall include:

- **criteria for the determination of ambitious sectoral baselines, including the use of ambitious benchmarks;**
- **procedures for monitoring, reporting and verifying sectoral emission reductions;**
- **provisions to prevent double counting with other CDM activities.**

In addressing the issues above, the CMP should consider using relevant technical expertise, from both within and outside the CDM Executive Board and its support structures.

The CMP should consider further work on sectoral CDM in conjunction with the further work on sectoral no lose targets.

Sectoral crediting on the basis of no-lose targets (section I.F)

In the post-2012 period, some developing countries may take on a no-lose emissions target for specific sectors. Sectoral crediting based on no-lose targets would be a new carbon market mechanism where:

- Sectoral emission reductions are credited against a sectoral target (the no-lose target).
- The target is established as an agreed emission level below business-as-usual and reflects national circumstances.
- Reductions below the no-lose target generate credits for sale on the international carbon market by the host country government.
- The target is “no-lose” in the sense that there is no penalty if it is not achieved.

Thus, sectoral crediting on the basis of no-lose targets provides an option for national actions of developing countries to be credited and used to raise finance and support technology investment through the international carbon market.

The EU recommends that the CMP consider introducing sectoral crediting on the basis of no-lose targets as a new mechanism for the second commitment period. Upon introducing this mechanism, modalities and procedures shall be established pursuant to which, inter alia:

- **The level of the sectoral no-lose target(s) in each participating sector will be agreed.**
- **The sectoral no-lose target is an emission level for a given year or years, which is clearly below business-as-usual emission projections. It needs to take into account any registered CDM project activities affecting emissions in the sector to avoid double counting of emissions and must cover all emission sources within clearly defined national sector boundaries.**
- **Upon periodic reporting by the Party on its emissions covered by the no-lose target and on any emission leakage, and independent verification and/or expert review, credits shall be issued for emission reductions below the target.**
- **Verified credits could be traded internationally and used for compliance with emission reduction targets of Annex I Parties.**
- **Rules and guidelines shall be established on governance, including monitoring, reporting and verifying emission reductions and issuing emission reduction credits which ensure environmental integrity, taking into account existing reporting and review structures.**
- **The CMP may delegate parts of its tasks above to a technical body operating under its guidance.**

Introduce crediting on the basis of nationally appropriate mitigation actions (NAMA) (section I.G)

The EU acknowledges proposals such as the concept of crediting nationally appropriate mitigation action in developing countries and notes that there are significant methodological challenges, e.g. in quantifying emission reductions of individual policies and measures.

In this regard, the EU seeks further clarification especially on:

- How the crediting of NAMAs would stimulate enhanced mitigation by developing countries.
- Which part of developing country mitigation action should be credited.
- How to ensure that only the measurable, reportable and verifiable emission reductions that are a result of nationally appropriate mitigation actions are credited.
- How to ensure that only the emission reductions which are additional to what would otherwise have occurred are credited.
- How to ensure that only emission reductions that exceed agreed nationally appropriate domestic mitigation action are credited.
- Which rules and guidelines, including the institutional set-up, would be needed to operationalise the crediting of NAMAs.

c. Environmental integrity of the CDM

Enhancing the environmental integrity of the CDM is a key element to ensure the credibility of the mechanism. Different options exist to achieve this goal. Both sound multi-project baselines and multiplication factors, could be alternatively or complementarily used for this purpose.

Ensure environmental integrity and assess additionality through the development of standardized, multi-project baselines (section I.H)

Increased standardization in baseline setting may be a way to facilitate speedier development of new methodologies and CDM activities, thereby decreasing transaction costs for individual CDM projects. If set at an ambitious level, standardized baselines may also help to improve the environmental integrity of the CDM, by enhancing the conservativeness and objectivity of baseline setting. Ambitious baselines are a way to increase the CDM's contribution to global mitigation efforts and to increase the use of innovative technologies.

Development of standardized baselines in a top-down way could build on the experience with existing methodologies, specifically on the possibility currently set in the CDM modalities and procedures to choose benchmarks as a basis for baseline setting.

- In order to be able to set benchmarks, enhanced reporting of greenhouse gas emissions and underlying data in key sectors by host countries will be required.

The EU recommends that the CMP consider introducing the mandatory use of benchmarks for baseline setting for specific project types in the CDM.

- **In doing so, the CMP must draw on relevant technical expertise in determining for which project types this requirement would apply and which criteria should be used to set benchmarks.**
- **Criteria for benchmark setting include the top performing installations or processes in the relevant sector, based inter alia on the performance of key technologies that are beyond common practice and technology penetration rates.**
- **Benchmarks should reflect national circumstances and be periodically adjusted.**

Increased use of benchmarks for baseline setting may also be a way to simplify and improve the assessment of additionality. Project-by-project additionality tests may be replaced by more objective emission standard setting, if they ensure an overall high degree of environmental integrity.

The EU recommends that the CMP consider introducing the use of benchmarks for baseline setting in a CDM activity as a way to determine the additionality of that CDM activity for those project types where this approach ensures environmental integrity.

The criteria for benchmark setting referred to above should minimise the risk of non-additional projects being approved.

Introduce multiplication factors to increase or decrease the certified emission reductions issued for specific project activity types (section I.M)

The introduction of multiplication factors greater than one in crediting would mean that for environmental integrity to be delivered, provisions are needed to ensure that the total number of CERs issued is not higher than the aggregate quantity of emission reductions achieved. This, together with the need to determine criteria and multiplications factors for specific project types, would mean that a highly complex system would need to be introduced for the issuance of CERs, which seems difficult to realise.

However, the proposal for the introduction of multiplication factors less than one (i.e. discounting) has an appealing simplicity compared to other approaches and could serve to strengthen the environmental integrity of the CDM and/or its contribution to global mitigation efforts. It could be considered as an option for example:

- to increase the conservativeness of emission reduction estimates;
- to deal with unforeseen negative incentives resulting from CDM projects;
- as an alternative in situations where it is not feasible to establish ambitious baselines on the basis of benchmarks;
- to favour projects with high sustainable development benefits by introducing lower or no discount rates for these project types;
- to introduce a net contribution of CDM activities to global mitigation efforts.

The EU recommends that the CMP consider exploring how introducing discounting factors for the crediting of emission reductions from specific project types could contribute to strengthening the environmental integrity of the CDM, improving regional distribution and/or technology transfer.

d. Scope of the CDM

Include other land use, land-use change and forestry activities (possibly with a cap) (sections I.A and I.B)

The consideration of LULUCF activities other than afforestation and reforestation needs to be informed by the outcome of the methodological discussions on non-permanence, leakage,

measurements, definitions and other issues, taking place under AWG-KP 6 agenda-item 3(b), so as to ensure their environmental integrity. Similarly, discussions on the 1.b (iii) of the Bali Action Plan need to be reflected.

In the EU's view, a project-based mechanism such as the CDM would not be the appropriate means of addressing REDD. A new sectoral market or funding mechanism on a national basis should be explored to avoid leakage problems and to ensure global mitigation benefits.

Include carbon dioxide capture and storage (CCS) (section I.C)

The EU has already indicated its support in principle for inclusion of geological CCS in the CDM and has elaborated its views on various technical, methodological, legal and policy issues that need to be concluded to provide the necessary technical, economic and regulatory framework to ensure maximum environmental integrity and safety and with the objective of avoiding any seepage. The EU has proposed a pilot phase for the demonstration of CCS in developing countries through the CDM to facilitate learning by doing (EU views are contained in FCCC/SBSTA/2007/MISC.18/Add.1 and a further submission of 27 June 2008).

2. Joint Implementation

The EU continues to support Track 2 JI, particularly in relation to Parties that do not yet have the capacity to develop the institutional and legislative framework required for Track 1. We encourage Parties to develop institutional structures and procedures to enable their participation in Track 1.

Many of the proposed improvements in Annex I to the Accra conclusions concerning JI are similar to those made for the CDM. As JI is a project-based mechanism, indeed many parallels can be drawn with the CDM in terms of possible improvements, especially under the Track 2 procedure.

On the other hand there are also some fundamental differences between the two mechanisms that need to be taken into account when discussing possible improvements to JI. JI projects take place in an Annex I country that is covered by an economy-wide cap on emissions and ERUs are generated by converting existing AAUs. As such, all activities included in the national inventory could generate ERUs for sale on the carbon market. The only existing limitation is that Annex I Parties should refrain from using ERUs generated from nuclear facilities.

Within JI there is potentially more scope for flexibility and simplicity in procedures than in the CDM as there is no requirement for one international body for approval of methodologies and projects. However, this would lay more responsibility with the accredited independent entities who will have to be capable and responsible for evaluating and approving new approaches to baseline setting and monitoring (when the project is not using an approved CDM methodology or when it deviates from the CDM methodology). Additionally, JI host countries which are fulfilling the eligibility criteria for using Track 1 may adopt their own JI project approval procedures and monitoring and verification rules. They could simplify these procedures and introduce improvements, such as standardized baseline setting requirements and determination of additionality.

The EU recommends that the CMP consider possibilities to further standardize and simplify JI rules and procedures, while ensuring environmental integrity.

Where a Party become eligible to host JI projects, provisions need to be developed for the treatment of ongoing CDM activities to prevent double counting of emission reductions.

3. Emissions trading

The EU notes that there are three proposals in Annex I to the Accra conclusions related to emissions trading: introduce emissions trading based on sectoral targets, introduce emissions trading based on nationally appropriate mitigation actions and linking schemes between Annex I and non-Annex I Parties.

In the post-2012 period, some sectors in some developing countries may be suitable to implement emissions trading as a means to strengthen mitigation action in that sector and as a means to provide the necessary financing and technology to enable that mitigation action. The EU considers it is worthwhile for the AWG-KP to explore all options that enable the linking of these actions to international emissions trading, especially the proposals on introducing emissions trading based on sectoral targets and linking emissions trading schemes established on a voluntary basis in developing countries to international emissions trading.

In the view of the EU, at the core of the proposals to be discussed by the AWG-KP should be the linking of a national (sectoral) mechanism in developing countries to the global carbon market.

Participation in emissions trading would enable developing countries to make use of the most cost-effective means to reduce emissions and to involve the private sector. Linking of these sectoral emissions trading schemes to the global carbon market would allow financial support from the carbon market towards reaching the sectoral emissions targets. This would significantly scale up the carbon market while providing a cost-effective means for Annex I parties to achieve their emission reduction targets.

An advantage to participation in trading over participation in sectoral crediting mechanisms is that tradable units can be allocated ex-ante on the basis of a target applied to a sector. This means incentives can be provided to private entities in the sector to participate and reduce their emissions.

The EU recognises that the implementation of mitigation action on a sectoral basis would require support to policy and institutional design, in particular in relation to monitoring, reporting and verification. An international enabling framework may be set up to provide support for some countries beyond what would be required to apply sectoral crediting approaches.

Provisions for sectoral emissions trading in developing countries and its international recognition should be based on an internationally agreed target for the emission level within a certain sector. Sectoral trading should initially focus on sectors with high emissions, a high mitigation potential, large point sources and sufficient data availability. To be effective and environmentally sound, the level of the target should ensure sufficient scarcity of tradable units in the market, and robust

monitoring, verification and compliance provisions need to be in place. When determining sectoral targets, different national circumstances should be taken into account.

mechanism for the second commitment period, thereby giving a possibility for developing countries to participate in international emissions trading. Upon introducing this mechanism, modalities and procedures should be established, pursuant to which, inter alia:

- **The sectoral target is an agreed emission level for the participating sector for a given year or years which is below business-as-usual emission projections, takes into account any registered CDM project activities affecting emissions in the sector to avoid double counting of emissions and covers all emission sources within clearly defined sector boundaries.**
- **The sectoral target should be based upon the most recent available data.**
- **The CMP will establish rules and guidelines on monitoring, reporting and verifying sectoral emission levels, taking into account existing reporting and review structures.**
- **Emission units will be allocated on the basis of agreed sectoral targets. The CMP will establish rules on accurate accounting of these units.**
- **Parties may devolve emission units to private entities. Upon compliance of the countries involved with the rules and guidelines referred to above, emission units may be linked to the international carbon market and be made available for compliance purposes.**
- **The CMP may delegate parts of its tasks above to a technical body operating under its guidance.**

4. Cross-cutting issues

Relax or eliminate carry-over (banking) restrictions on Kyoto units (section IV.A)

Currently, carry-over restrictions only exist for CERs, ERUs and RMUs. In practice, these rules lead to preferential retirement, since there is no limit on the carry-over of AAUs. When surrendering units for compliance, Parties can surrender any CERs, ERUs and RMUs above their carry-over limit and bank the resulting AAUs to the next commitment period instead. However, the implementation of supplementarity provisions may in practice lead to restrictions in the amount of CERs and ERUs that can be surrendered and may lead to the situation that some of these units will be lost. The AWG-KP should discuss proposals for changes to carry-over restrictions from the second commitment period to subsequent periods.

The carry-over restrictions affecting the carry-over from the first commitment period to the second commitment period should not be changed. However, further analysis is needed on the possible surplus of AAUs or other units/credits from the period 2008-2012. This should be taken into account when considering the necessary scale of emission reductions to be achieved by developed countries in aggregate in order to ensure an effective carbon market and progress towards our 2°C objective.

Introduce borrowing of assigned amount from future commitment periods (section IV.C)

Proposals on borrowing of assigned amount need to consider:

- implications for compliance and compliance assessment;
- potential severe implications for compliance with targets in future commitment periods;

- perverse incentives to adopt lower targets in the future, because borrowed assigned amount that has been used to comply with earlier targets is taken into account when setting the targets.

Taking into account these risks, the EU does not support borrowing of assigned amount from future commitment periods.

Extend the share of proceeds (section IV.D)

The EU's views on the extension of the share of proceeds are elaborated in the EU submission of 16 September 2008 on the share of proceeds under the preparations for the Article 9 review.

The following considerations, *inter alia*, are key for the EU:

- An improved understanding of the financial needs and appropriate means and mechanisms for adaptation is required.
- Sourcing of finance for adaptation should not discourage mitigation efforts.
- A broad discussion under the AWG-LCA on financial issues that is guided by the principles of effectiveness, inclusiveness, fairness and sustainability and that is supportive of a global climate change regime will be required.
- A comprehensive treatment of the finance question will maximize the achievable benefits.

II. Views and information on elements contained in Annex II to the Accra conclusions

Annex II contains a number of proposals that are relevant to the functioning of the carbon market and that would need to be discussed by the AWG-KP at a later stage, since they are related to the future scope of and participation in the carbon market.

The EU has the following views on some elements of Annex II at this stage:

- **Governance**: this includes issues related to the institutional set-up and governance of the existing and new mechanisms. The EU's views on improvements needed in the current governance of the CDM and JI are elaborated in the EU submission of 16 September 2008 on institutional arrangements, governance, rules and procedures of the CDM and JI under the preparations for the Article 9 review. Some of these ideas may also be taken up by the AWG-KP for the second commitment period.
- **Commitment period reserve (CPR)**: with regard to the CPR, the EU is in favour of retaining a sufficiently high level to limit the risk of Parties' non-compliance through overselling.
- **Commitment, review and compliance periods**: it is possible to distinguish between the period for which a commitment is made, the period for review of commitments and the period for compliance assessment. With regards to the length of these periods, there is a need to balance long term certainty and flexibility for the market with the need for regular review and compliance assessment.

PAPER NO. 2: REPUBLIC OF KOREA

Republic of Korea

Subject: SECTORAL CDM

Proposal:

- To recognize carbon credits as an incentive for the improvement of carbon intensity in each sector. Improvement of carbon intensity can be measured using each Non-Annex I Party's level of carbon intensity in the year of 2012 as a baseline on the assumption that such credit would be given from 2013.
- To expand the scope of CDM so that sectoral CDM could be recognized.

Rationale:

- The sectoral approach can play an important role in mitigating GHG emissions of developing countries. However, it is not feasible to set certain global or international standards and impose them on developing countries. Thus, the sectoral approach has to be linked to the incentives for developing countries.
- Carbon credits could serve as an effective incentive for developing countries.
- Such credits can be measured by the improvement of carbon intensity in each sector.
- The baseline of carbon intensity to measure the improvement should be the carbon intensity of each sector of respective Non-Annex 1 Parties in the year of 2012 on the assumption that sectoral CDM will start in 2013.
- Such sectoral CDM approach will provide incentives for Non-Annex 1 Parties. It does not require international standards since it is based on the local carbon intensity of each country in 2012.

CER MULTIPLICATION FOR SUSTAINABILITY PROJECTS

Proposal:

- To reduce the multiplication of CERs based on GWP for HFC and N₂O and instead to multiply the CERs from the CDM projects with higher linkage with sustainability, such as those for improving energy efficiency and developing renewable energies.
- To stop the mechanical multiplication of CERs based on GWP and to apply the concept of sustainability to the multiplication of CERs from the CDM projects described above.
- To agree on establishing an expert group to review this issue by COP 15 and to start substantive discussions after COP 15.

Rationale:

- The mechanical application of GWP in issuing CERs is now giving huge perverse subsidies to the projects that do not make contributions for sustainability. Only a few companies that reduce HFC and N₂O make huge revenues, while many CDM projects which could have considerable positive impacts on sustainable development, such as those for improving energy efficiency and developing renewable energies, suffer from low rates of return and, in turn, end up with low investment.
- If we stop the multiplication of CERs from such CDM projects as for reducing GHGs with high GWP and, instead, start multiplying CERs from such CDM projects as for improving

- energy efficiency and developing renewable energies, then the investment for the CDM projects with high sustainability contributions will increase.
- Multiplying CERs for the CDM projects of strong sustainability can function as a mechanism to promote more environmentally sound CDM projects.
- If we multiply CERs from sustainability projects in a manner that total increase of CERs from sustainability projects does not exceed the total reduction of CERs from the reduced multiplication of the CERs from the projects that reduce the GHGs with high GWP, then we can still maintain environmental integrity.

CARBON CREDITS FOR NAMAs

Proposal:

- To expand the scope of CDM to recognize carbon credits for verifiable mitigations arising from the Nationally Appropriate Mitigation Actions (NAMAs) stipulated in paragraph 1(b)(ii) of Decision 1/CP.13, the Bali Action Plan.
- To agree on the principle of recognizing carbon credits by COP 15.
- To start discussions for the details of the criteria and scope of NAMA credit scheme after COP 15.

Rationale:

- It is necessary to provide appropriate incentives for Non-Annex 1 Parties to take Nationally Appropriate Mitigation Actions.
- It is also necessary to provide technology and financial resources in a measurable, reportable and verifiable manner to developing countries.
- It is also necessary to make sure that transfer of technology and financial resources be properly linked to the actual and verifiable mitigation in developing countries.
- The above-mentioned 3 issues could be resolved if carbon credits are recognized for verifiable mitigation arising from NAMAs.
- Not all mitigation from NAMAs would be verifiable and eligible for credits. Nevertheless, carbon credits for verifiable mitigation will function as a positive incentive for developing countries to initiate NAMAs.
- Carbon credits will function as a means for transferring technology and financial resources to developing countries since the revenue from the sales of carbon credit will enable developing countries to buy technology and mobilize funds necessary for initiating NAMAs.
- Carbon credits will be directly linked to the transfer of technology and financial resources with mitigation actions since it is given to the verifiable mitigation arising from NAMAs.
- Carbon credits will open the door for private sectors to engage in mitigation actions of developing countries, as is the case of unilateral CDM.
- Carbon credits will function as an efficient mechanism for technology and finance transfer and will link such transfers to actual mitigation actions in developing countries.

PAPER NO. 3: NEW ZEALAND

New Zealand Submission on Emissions Trading and the
Project Based Mechanisms

October 2008

New Zealand welcomes the opportunity to provide input in relation to options that have been tabled by Parties in the AWG-KP to improve emissions trading and the project based mechanisms.

Our submission addresses only a selected number of the elements contained in Annexes I and II of the paper FCCC/KP/AWG/2008/L.12

Summary

- New Zealand's ambition is to see the mechanisms further improved to provide the basis of an efficient global carbon market, enabling mitigation efforts to be as cost effective as possible while ensuring environmental integrity and contributing to sustainable development.
- New Zealand considers it important to address three important issues when looking at each proposal:
 - cost effectiveness;
 - administrative complexity;
 - potential for perverse outcomes: given its multiple objectives, this issue will be of particular relevance to looking at proposals to improve the CDM.

International Emissions Trading

- International trading of Kyoto unit types (AAUs, CERS, ERUs, RMUs) is fast developing, especially as more Parties begin to design and implement domestic/regional trading schemes.
- Discussion on the rules for trading in future commitment periods should seek to ensure that rules enable and not hinder the devolution of responsibilities to private sector entities.
- New Zealand supports proposals that would reduce the differentiation between unit types and thereby improve the efficient functioning of the global carbon market. Ensuring consistency in the treatment of carry over (banking) provisions for various unit types is in our view an important step towards this.
- As experience with trading develops it is our hope that Parties will have the confidence in the quality of all Kyoto unit types resulting in fewer restrictions to their use in domestic and regional trading schemes.

- Relaxing Commitment Period Reserve provisions could further aid the liquidity of the carbon market.

The Clean Development Mechanism

- New Zealand fully supports the CDM continuing to be available in future commitment periods.
- We support exploring improvements to the CDM, including those related to administrative integrity, greater efficiency, and the timely review of project applications. It will be important to keep in mind the need for environmental integrity of the CDM as well.
- We are mindful that mechanisms such as the CDM may be of diminishing significance in the future for major emitting developing economies as they transition towards nationally appropriate mitigation actions. The CDM may need to evolve, or further instruments be developed, to accommodate this.
- Based on the above, New Zealand is interested in the elements to differentiate the eligibility of Parties as a means towards transitioning some Parties towards nationally appropriate mitigation actions.
- Sectoral crediting mechanisms (sectoral CDM and sectoral “no lose” targets) may have a role to play under a future framework, however, ultimately some developing countries will need to move beyond offsetting and no-lose targets towards binding national and/or sectoral targets.
- Consequently, discussion of these elements needs to be closely aligned with discussion under the AWG-LCA.
- New Zealand does not consider that nuclear power projects are an appropriate activity under the CDM.
- Efforts to enhance equitable regional distribution of CDM projects should be focused on facilitating the uptake of projects in host countries through practical improvements. There should be no measures to explicitly direct in which countries or regions CDM projects take place, nor steps that would interfere in the efficient functioning of the carbon market.
- New Zealand recognises the importance of co-benefits, but we have reservations with suggested changes to include co-benefits as criteria for the registration of projects. In our view, the current design principle whereby the host country has the prerogative to evaluate the contribution of projects to sustainable development should be retained. This is because:
 - Host countries are best placed to evaluate co-benefits. It would be extremely difficult to develop a standardised measure for a third party to compare and evaluate co-benefits;

- It would be extremely difficult to decide which co-benefits to include and which to exclude;
 - Such decisions risk politicisation;
 - It would add to the administrative complexity of the CDM, including for host countries;
 - It could lead to unintended perverse outcomes
- New Zealand considers the CDM should be technology neutral. We have reservations about proposals to favour certain project activity types or technologies over others. Such proposals would likely add to the administrative complexity of the CDM and significantly detract from its cost effectiveness.

Specific Comments

Elements in Annex I

I Clean Development Mechanism

IC Include Carbon Capture and Storage.

1 New Zealand provisionally supports the inclusion of CCS in the CDM. This support is subject to a number of outstanding considerations outlined in New Zealand's Submission to the UNFCCC Secretariat in June 2008. New Zealand supports discussing this item both under the SBSTA and the AWG-KP

ID Include nuclear activities

2 New Zealand does not consider that nuclear power projects are an appropriate activity under the CDM.

- We do not consider that nuclear power is a sustainable energy source.
- We have longstanding concerns about safety, security, non-proliferation and waste management.
- Noting the purpose of the CDM to assist non Annex 1 parties in achieving sustainable development, we do not consider that nuclear power projects are an appropriate activity under the CDM.

3 Therefore New Zealand supports Option 1; and opposes Option 2 and the status quo option.

Elements:

I.E. Introduce sectoral clean development mechanism for emission reductions below a baseline defined at a sectoral level

I.F Introduce sectoral crediting of emission reductions below a previously established no-lose target

I.G Introduce crediting on the basis of nationally appropriate mitigation actions

III.A Introduce emissions trading based on sectoral targets

III.B Introduce emissions trading on the basis of nationally appropriate mitigation actions.

General comments:

4 The elements 1.E, 1.F 1.G, II A and III.B sit at various stages along a continuum of possible steps towards nationally appropriate mitigation actions from developing countries,

ranging from a continuation of the CDM as an offsetting mechanism at one extreme to more binding sectoral target models at the other. Considerably more detail is needed for these options to be able to distinguish between them and discuss their relative merits. In a number of cases they appear to be overlapping and the list could usefully be shortened.

- While New Zealand fully supports the CDM continuing to be available in future commitment periods, we are mindful that mechanisms such as the CDM may be of diminishing significance in the future for major emitting developing economies as they transition towards nationally appropriate mitigation actions. The CDM may need to evolve, or further instruments be developed, to accommodate this.
- Based on the above, while sectoral crediting mechanisms (such as sectoral CDM and sectoral no-lose targets) may have a role to play under a future framework, ultimately, some developing countries will need to move beyond offsetting and no-lose targets towards binding national/and or sectoral targets.
- For each of the elements, there would need to be robust MRV requirements (i.e. equivalent to Annex I and CDM accounting standards) to secure market confidence and environmental integrity. This should include provision to avoid double-counting of any continued project-CDM in that sector/country.
- Improvements will require rapid progress in building inventories and MRV capability in developing countries.
- New Zealand notes concerns raised about sectoral crediting mechanisms (including sectoral-CDM) in terms of their potential impact on the supply/demand balance of the global carbon market. It is very difficult to assess the impact before decisions are made in the AWG-LCA on shared vision and mitigation pillars.

5 In this context, each of these elements may have merit and New Zealand supports further consideration under the AWG-KP. This should be closely aligned with discussion under the AWG-LCA on mitigation and sectoral approaches using market mechanisms.

IJ Differentiate the eligibility of parties through the use of indicators

6 This element is potentially significant for the future role of the CDM as a flexible mechanism. In New Zealand's view it requires serious consideration, although we note that we have not fully developed our position on this. As noted above, New Zealand considers that the CDM should become a mechanism of diminishing significance for major emitting economies as they transition towards nationally appropriate mitigation actions. This proposal could potentially facilitate this.

7 In this context, discussion on defining the eligibility of Parties to use the CDM (as a host country) is closely linked to discussions on nationally appropriate mitigation actions from developing countries in the AWG-LCA.

IK Improve access by certain host parties (& Annex II IH Allocate proportions of demand to specific groups of host Parties to enhance their sustainable development)

8 Proposals to improve access by certain host parties to the CDM appear to be driven by concerns about the need to enhance the equitable and regional distribution of CDM projects.

9 New Zealand in its submission to the Secretariat on the 2nd Review of the Kyoto Protocol pursuant to its Article 9 has outlined our views on this subject. New Zealand considers that addressing this issue requires a careful and pragmatic assessment of why the distribution of CDM is unfolding as it is, and more critically, consideration as to whether the CDM is the best mechanism to assist LDCs in achieving their sustainable development objectives. This consideration should be made in light of discussions in the AWG-LCA addressing other financial mechanisms for adaptation, mitigation and technology transfer.

10 New Zealand notes the economic factors driving the current distribution of projects. These include: (i) that the private sector will gravitate towards low-risk, high-opportunity locations and projects;

and (ii) the distribution of potential emission reductions among non-Annex I Parties. These factors will play a key underlying role in determining how CDM projects are distributed. It is consistent with the intent of the CDM, which is to identify and encourage cost effective mitigation opportunities in non Annex I countries that these factors continue to shape investment decisions in the future.

11 We consider that efforts to enhance equitable regional distribution of CDM projects should be focused on facilitating the uptake of projects in host countries through practical improvements. There are in New Zealand's view a number of positive steps that can be explored further with the aim of encouraging a more equitable regional distribution of projects.

12 In this context we are supportive of looking at rule changes to facilitate the uptake of small scale project activities (the focus of element IK). For example, increasing the maximum size of small scale project activities for certain host Parties or reducing additionality requirements for such projects being implemented in certain host Parties. However, New Zealand would not support the proposal to exempt such projects from the requirement to demonstrate additionality.

13 There are also, in New Zealand's view, suggested rule changes that could be very detrimental to the cost effectiveness of the CDM as a market instrument. There should be no measures to explicitly direct in which countries or regions CDM projects take place, nor steps that would interfere in the efficient functioning of the carbon market. For example, it would be inappropriate to require the purchase of minimum quota of CERs from particular host Parties (as appears to be the intent of Annex II element IH). Such proposals would in New Zealand's view, be practically difficult to administer and enforce (in particular on private sector entities participating in the market), and significantly detract from the cost effectiveness of the CDM as a market mechanism. In this context such developments would be at odds with the least-cost principle articulated in the Principles (Article 3.3) of the Framework Convention, which state *"policies and measures to deal with climate change should be cost-effective so as to ensure global benefits at the lowest possible cost"*.

14 Finally we note that the proposal (Element IJ above) "to differentiate the eligibility of Parties to host CDM project activities" could potentially have a significant impact on the distribution of projects.

IL Include co- benefits as criteria for the registration of projects

15 The issue of co-benefits generated from CDM projects and how and if these should be further incentivised, is a complex subject that has been the subject of considerable literature¹ and discussion in international fora. It is a complex issue because at its core is an implicit tension between the CDM's stated objectives of reducing emissions at least on the one hand and contributing to sustainable development on the other. A number of papers show that projects that rank highly on cost-effectiveness criteria often score poorly against sustainability criteria and vice versa².

16 At one level it is an apparently straightforward argument that for two CDM projects that generate a similar number of emission reductions, a project that clearly generates more significant co-benefits should be favoured by market regulators. But this becomes a more complex argument if one considers the trade off between cost effectiveness and sustainability criteria.

17 New Zealand is of the view that the primary focus of the CDM as a mechanism should be its potential contribution to mitigating climate change. Co-benefits are important, but care should be taken not to refocus the CDM away from the challenge of emissions mitigation. Doing so may contribute to perverse outcomes.

18 In our view, the current design principle, whereby the host country has the prerogative to evaluate the contribution of projects to sustainable development, should be retained. This is because:

- Host countries are best placed to evaluate co-benefits. It would be extremely difficult to develop a standardised measure for a third party to compare and evaluate co-benefits;
- It would be extremely difficult to decide which co-benefits to include and which to exclude and there is significant risk of politicisation of this issue;
- It would add to the administrative complexity of the CDM, including for host countries;

19 Furthermore, there will inevitably be some potential for perverse outcomes when different criteria are being considered. For example, technology transfer is listed as an example of a co-benefit. However, research into technology transfer in the CDM has shown that technology transfer (originating from outside the host country) has occurred most with large scale non-CO₂ reduction projects (e.g. N₂O and HFC -23 destruction) wind energy and hydropower projects. Bioenergy and agricultural projects that generate other co-benefits have generally used local technology.³ Therefore placing greater emphasis on technology transfer may come at the expense of other co-benefits.

¹ Including a number of OECD publications, notably OECD (2000): Ancillary Benefits and Costs of Greenhouse Mitigation.

² For example, CICERO (2001) Working Paper 2001:07 Can the Clean Development Mechanism attain both cost effectiveness and sustainable development objectives.

³ De Coninck, H, Haake, F, Van der Linden, N (2007) Technology transfer in the Clean Development Mechanism. Climate Policy 7 (2007).

20 Finally while we have reservations with the proposal to require registration of co-benefits, this does not exclude the potential for the market to differentiate and reward projects that demonstrate significant co-benefits⁴.

21 In sum, while New Zealand acknowledges the importance and potential magnitude of co-benefits associated with CDM projects, New Zealand's has reservations about proposals to centralise the evaluation of such benefits on the grounds that:

- It could potentially dilute the focus on emissions mitigation
- It will add to administrative complexity CDM,
- It will detract from the cost effectiveness of the CDM
- It may be extremely difficult to evaluate and compare co-benefits in manner that would provide adequate information to market participants.

22 It could, however, be worth thinking about whether adding information about co-benefits on a voluntary basis might make some projects more attractive to companies pursuing a higher degree of corporate social responsibility.

23 New Zealand also notes that discussions in the AWG-LCA on financing for adaptation, mitigation and technology transfer are considering instruments that may prove more fruitful in addressing developing countries' needs.

IM Multiplication factors/specific project activity types

24 New Zealand has similar reservations with the proposal to increase or decrease CERS issued for specific project type activities as those discussed in relation to proposals to incentivise co-benefits. The rationale for this proposal identified in the technical paper is to alter the mix of projects activity types under the CDM. The reason to do this would be to favour certain activity types or technologies over others.

25 In New Zealand's view the CDM as a market mechanism should technology-neutral. Generally, the intent of a market based mechanism, such as the CDM is to allow the market to identify, within some constraints set by market regulators (e.g. rules determining eligible activities) least cost abatement or mitigation opportunities.

- We do not see a need to adapt the CDM to favour certain project activity types or technologies over others
- We have doubts about the feasibility of being able to agree to favoured project activity types at the multilateral level.
- If there were to be an agreement among parties that certain technologies should be favoured over others, it is not clear that CDM is the appropriate mechanism to do this. This proposal should be seen in light of broader discussions on other financing instruments in AWG-LCA

26 Such a proposal is likely to:

- add to the administrative complexity of the CDM
- reduce the cost effectiveness of the CDM
- become extremely politicized as parties to seek to incentivise technologies that are of national interest.

⁴ For example external organisations like the Gold Standard label provide the market with information that enables market participants to choose projects with a higher sustainable development component.

II Joint Implementation

27 Any proposal to include nuclear power activities in the JI would not be supported by New Zealand

III International Emissions Trading

28 As general comments

- New Zealand supports proposals that would reduce the differentiation between unit types and thereby improve the efficient functioning of the global carbon market. Ensuring consistency in the treatment of carry over (banking) provisions for various unit types is in our view an important step towards this.
- As Parties' experience with trading develops it is our hope that Parties will have confidence in the quality of all the Kyoto unit types, resulting in fewer restrictions to their use in domestic and regional trading schemes.
- Relaxing Commitment Period Reserve provisions could further aid the liquidity of the carbon market

29 See further comments on elements contained in Annex II of the document FCCC/KP/AWG/2008/L.12,

IV Cross-cutting Issues

IVA Relax or eliminate banking restrictions on Kyoto units

30 New Zealand would like to see the same treatment in terms of carry over rules for all Kyoto units (specifically AAUs, CERS, ERUs and RMUs): there should be no restriction on the carry over of these unit types to subsequent commitment periods. We note that this would contribute significantly to enhancing the equivalence amongst units types (element III B in Annex II, improve fungibility between unit types, and in doing so improve the functioning and efficiency of the international carbon market.

IVC Introduce borrowing of assigned amount from future commitment periods.

31 New Zealand does not yet have a firm position on borrowing but has reservations based on the potential implications for the environmental integrity of the Kyoto Protocol.

IVD Extend the share of proceeds

32 New Zealand supports the scaling up of adaptation funding for vulnerable countries, based on identified needs. This will require identification of adaptation needs, funding assistance required and the most effective models for distribution. Parties should first focus discussion on what needs to be accomplished through adaptation funding, rather than beginning with mechanisms for collecting funds. (We acknowledge that some Parties have made good progress in this regard through the development of National Adaptation Plans of Action.) Parties should consider the need, identified in the Bali Action Plan, for financing to be adequate, predictable and sustainable, and for it not to have perverse outcomes for markets. It is important to analyse all options together in order to decide on which option or mix of options will be most effective and efficient in meeting adaptation needs.

33 With this in mind, New Zealand considers that financing for adaptation, as a cross-cutting issue, is best dealt with in the AWG-LCA. This will help to ensure that the Bali Road Map delivers efficient and effective outcomes in a consistent and coherent manner, and that issues of equity and fairness between all Parties are appropriately considered.

34 New Zealand notes that the CDM adaptation levy was introduced to help provide a more equitable solution for CDM-eligible countries with low CDM uptake. The proposal to raise funds for adaptation by applying a levy to joint implementation or international emissions trading, with funds to be disbursed to parties uninvolved in either activity, is of a different nature and context.

35 If considering extending the share of proceeds to international emissions trading by means of a levy at issuance, Parties should reflect that because the number of units issued relates to a Party's AAU allocation, the share of funding for adaptation raised by the levy would mirror exactly the Party's emissions reductions target. New Zealand questions whether responsibility for adaptation funding should be distributed according to burden sharing criteria. A country's responsibility for adaptation may not be readily assessed by reference to its mitigation potential and other effort-sharing criteria.

36 New Zealand also notes that Parties use the flexible mechanisms to varying degrees, with some Parties trading internationally more than others. If the levy was a transaction levy rather than an issuance levy, extending the share of proceeds to international emissions trading would produce an unfair outcome as Parties that traded more in units would carry a greater burden of adaptation funding than Parties that chose to use regulatory or carbon charge responses. This could have a perverse outcome on the choice of climate change responses, and could result in less mitigation taking place. Any levy that applied on transactions of units would discourage trading activity and seriously detract from the efficiency of the carbon market.

37 Scaling up financing for adaptation should avoid generating perverse environmental outcomes. For example, activities leading to the generation of RMUs have positive mitigation outcomes and should not be taxed. The aim should be to encourage activities that will reduce GHGs, rather than disincentivise them. New Zealand also questions the need to levy both AAUs and ERUs, as this would lead to a double-levy on JI projects and reduce investment in emission reduction activities in Annex 1 Parties.

38 New Zealand opposes the consideration of any approaches that would encroach on national sovereignty and domestic policy choices. We would note there is significant variation in national circumstances and in the application of domestic emissions trading schemes, including in the coverage of gases. A levy on domestic emissions trading would not be acceptable to New Zealand.

39 Consideration should also be given to the fact that the flexible mechanisms may not offer a predictable and sustainable source of funds due to supply/demand and price uncertainty beyond 2012.

Elements from Annex II

I. Clean Development Mechanism

IG Allocate proportions of demand to project activity types that contribute more to the sustainable development of host Parties

40 See our previous comments on Annex I Elements IL and IM

IH Allocate proportions of demand to specific groups of host Parties to enhance their sustainable development

41 As described in our comments on Annex I Element IK, New Zealand's does not support measure to explicitly direct in which countries or regions CDM projects take place. This proposal would be practically difficult to administer and enforce and potentially significantly detract from the cost effectiveness of the CDM as a market mechanism.

IK Use global temperature potentials instead of global warming potentials

42 New Zealand is firmly of the view that for reasons of consistency, clarity and comparability, a common metric must be used for all measurements of greenhouse gas emissions. We are very supportive, however, of the continuing discussion of alternative metrics under the IPCC.

IL Include technology transfer as a criterion for the registration of project activities

43 See our previous comments on Annex I Elements IL

III. Emissions trading

A. Eliminate restrictions on the trading and use of certain Kyoto unit types under national and regional emissions trading schemes

44 In the interests of a more efficient and effective global carbon market New Zealand would like to see Parties applying fewer restrictions on the eligibility of different Kyoto unit types within their national and regional emissions trading schemes. At the same time we fully acknowledge the sovereign right of Parties to design domestic and regional trading schemes as they see appropriate to meet national circumstances and domestic policy objectives. As Parties experience with trading develops it is our hope that Parties will have sufficient confidence in the quality of all the Kyoto unit types to be able to apply fewer restrictions to their use in their domestic and regional trading schemes.

B. Enhance equivalence among Kyoto unit types

45 See our comments on eliminating carry over restrictions.

C. Reduce the commitment period reserve

46 The Commitment Period Reserve (CPR) is a mechanism designed to prevent over-selling by Parties. It requires a net buying Party such as New Zealand to hold 90% of its assigned amount in its registry at any point in time throughout the first commitment period. Parties such as New Zealand who have implemented, or are in the process of designing, Kyoto compatible domestic emission trading schemes, need to build this constraint into their domestic rules. In New Zealand's view, it is appropriate to re-address whether the level at which the CPR is currently set has any adverse effects on the efficiency of the international carbon market and domestic trading schemes.

47 The potential problems of the CPR being set at 90% emerge when designing a domestic trading scheme that devolves Kyoto units to private companies, landowners etc as is the case with the proposed NZ ETS. The NZ ETS also allows for selling/buying of units from/to the international market. An additional feature of the NZ ETS is that the allocation of units is not necessarily to those firms who have an obligation to surrender units (forestry sector are the prime example). In sum while the NZ ETS will be short overall in CP1 there will be many participants with units to sell. The ability to sell these units abroad is a key principle for the NZ ETS in order to ensure that prices on the domestic market align with those on the international market and liquid market conditions. In New Zealand there is some potential for CPR to be triggered in CP1.

48 New Zealand proposes a loosening of CPR provisions in future commitment periods in to provide Parties with some additional flexibility in designing domestic emissions trading schemes. At the same time we acknowledge the continued importance of the CPR as a safeguard mechanism against overselling. Therefore New Zealand proposes that:

CPR levels be lowered in subsequent commitment periods for Annex I parties that meet their commitments in the previous commitment period

49 For the above reasons, New Zealand would oppose any proposals to increase the CPR above current levels.

PAPER NO. 4: NORWAY

SUBMISSION FROM NORWAY

AWG-KP – Further input on possible improvements to emissions trading and the project-based mechanisms under the Kyoto Protocol

1. Norway welcomes the conclusions of AWGKP in Accra where Parties were invited to provide further input on proposals for improvements in emissions trading and the project-based mechanisms.
2. Norway reiterate that the AWGKP in Bangkok, 31. March to 4. April this year agreed that emissions trading and the project-based mechanisms under the Kyoto Protocol should continue to be available to Annex I Parties as means to meet their emission reduction targets and could be appropriately improved.
3. According to IPCC we need to see 25-40 percent emission reductions from Annex I-Parties in 2020 to avoid an increase in global mean temperature that exceeds two degrees Celsius. To increase the ability of Annex I Parties to reach such ambitious emission reduction targets the carbon market should be significantly scaled up. In addition to ambitious reductions by Annex-I Parties emissions in developing countries have to substantially deviate from projected baseline emissions within the next decades to achieve a two degree goal.
4. In such a context the present project based mechanisms will not be sufficient to achieve the necessary global emission reductions. This implies that middle income developing countries would need to move beyond the current CDM by net contributing to emission reductions by new type of mechanisms. Contributions from developing countries in the form of nationally appropriate mitigation actions are an issue for the AWGLCA. It is however important that consistency between discussions on these matters in the AWGKP and AWGLCA is ensured. New crediting mechanisms could evolve from existing flexibility mechanisms, but in our view new additional concepts must be developed.
5. We note that there are several proposals in Annex I to the Accra conclusions related to further exploring sector based approaches and mechanisms that can contribute nationally appropriate mitigation actions in a measurable, reportable and verifiable manner. These mechanisms needs to move beyond projected based mechanisms actively involving the receiving countries in setting policies as a minimum at a sectorial level.
6. We find it in particular interesting to further explore how sector based approaches might provide extended incentives for mitigation. In particular emissions trading could be a means for transferring resources from developed countries to developing countries through a possibility to receive and to surrender allowances, in the context of moving towards a low carbon economy. All Parties should be given the possibility to take part in an extended emissions trading market. It should be looked into how these countries could be prepared for the participation in such new mechanisms, by inter alia introducing capacity building programs to facilitate the measurement, reporting and verifying of emissions in specific sectors. For other mechanisms than emission trading it should in particular be looked into how to ensure that only additional emission reductions are credited, and that only reductions that exceed agreed nationally appropriate domestic mitigation actions should be credited.
7. On the current CDM we look with interest how regions, where today only a few projects are registered, could be motivated to increase their participation in the mechanisms. Thus we welcome further elaboration of options of programmatic CDM and differential treatment in respect of share of

proceeds for projects based in these regions. In this regard we also believe that improvements of the current rules for LULUCF in CDM could enhance equitable regional distribution of clean development mechanisms projects.

8. Regarding the proposals on carbon capture and storage in the CDM, Norway would underline the potential this technology offers to reduce CO₂ emissions by as much as 85-95% from fossil fuel power plants and this technology offers also a large potential for reductions in emissions from other industrial processes. There is ongoing work on the issue of carbon capture and storage in a number of different international fora, but we believe that efforts need to be intensified and that there is a need for specific global actions to give the impetus to early marked implementation, such as including carbon capture and storage in CDM, of this important technology at a global scale.

9. Under crosscutting issues there is a proposal to extend the share of proceeds to finance adaptation to emission trading and Joint Implementation. Norway definitely recognises the need for scaling up financing for adaptation needs and therefore the need for considering new innovative financial mechanisms. On this issue we would like to make reference to our proposal in the AWGLCA on international auctioning.

10. Norway is looking forward to discuss further the different proposals regarding improving the flexible mechanisms in Poznan in the AWGKP.

PAPER NO. 5: SRI LANKA

Analysis of means to reach emission reduction targets and identification of ways to enhance their effectiveness and contribution to sustainable development: emissions trading and the project-based mechanisms (AWG-KP)

Further input in relation of the elements on possible improvements to emissions trading and the project-based mechanisms under the Kyoto Protocol

- i. The Government of Sri Lanka is of the view that Kyoto Protocol should continue to be available to Annex I Parties. However in order to engage non Annex I Parties in a more equitably distributed manner, it is necessary to take steps to assist developing countries that have not engaged in CDM to a considerable extent, to develop projects.
- ii. More opportunities in the field of REDD projects will be highly appropriate.
- iii. More emphasis on transfer of technologies for CDM projects at accessible costs from Annex I countries to non Annex I countries would be benefited.
