

Focus on the Global South makes a Submission on new market-based mechanisms on behalf of **admitted observer organizations** Corner House, ECONEXUS, Fairwatch Association, Gender CC – Women for Climate Justice and **non-admitted observer organizations** CDM Watch, Centre for Civil Society Environmental Justice Project, University of KwaZulu-Natal, South Africa, Ethiopian Society for Consumer Protection, Global Alliance for Incinerator Alternatives, Ibiza Ecologic (Spain), National Fisheries Solidarity Movement (India) and Sustainable Energy and Economy Network (IPS, USA).

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## **Submission to the UNFCCC AWG-LCA: Views on New Market-based Mechanism**

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Our organizations welcome the opportunity to respond to the invitation to present views on the establishment of new market-based mechanisms (decision -/CP.16, paragraphs 80 – 82). We believe that before starting to consider new market based mechanisms, as the AWG-LCA is tasked to do prior to the 17<sup>th</sup> session of the COP, a critical look should be taken at the performance of the market based mechanisms established under the UNFCCC so far. Thereafter, we present our concerns with sectoral approaches, as they appear to be gaining interest among parties.

### **Evaluation of the CDM**

In particular, the performance of the CDM has been extremely poor. In brief, since the CDM is designed as an offset mechanism it can, in an ideal scenario, only be a zero-sum game, resulting in a shift in emissions rather than a reduction in emissions. Thus, from the outset, the role that it can play in any effort to reduce greenhouse gas emissions is limited. Of course, in the less than ideal, real world scenario, the CDM has been further undermined by the non-additionality of many of the credits issued<sup>1</sup>, which has actually led to increased emissions.

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<sup>1</sup> The overall design flaws of the CDM, wherein crediting is based on a hypothetical and thus unknowable future, also make it impossible to precisely ascertain how many CDM credits are non-additional. However, studies estimate the non-additional portion to be quite substantial. Schneider (2007) estimated that 40% of CDM projects are non-additional, while Sutter and Parreño (2007) suggest that half of all projects are non-additional. This implies that the majority of CERs issued are fake (Haya, 2009).

Furthermore, the ability of developed country parties to purchase offset credits from outside of their collective cap has further reduced the need to start implementing transformational changes toward low-carbon societies in developed countries and has led to the continued reliance upon and lock-in of polluting technologies. Since the CDM takes a short term view, as most market-based instruments do, it only supports incremental improvements in developing countries instead of more transformational changes<sup>2</sup> and also locks in polluting technologies in developing countries as well.

In addition to these environmental concerns, the CDM has utterly failed to achieve much of its sustainable development objective. A number of CDM projects have been associated with inadequate stakeholder consultations as well as human rights abuses. Furthermore, the CDM's tendency to first focus on negative or low-cost abatement opportunities in developing countries, leads to higher costs that these countries have to bear when making their own mitigation contributions in the future.

The rationale for developing market-based mechanisms has been that they are claimed to be the most cost-effective way to reduce greenhouse emissions. Yet, there is a massive amount of regulation that is required to set up carbon trading mechanisms. It is not clear whether a carbon trading system is actually cost-effective. The full costs incurred by actors including governments (to set up the EU ETS) and the UNFCCC (to set up the CDM), private corporations, and individuals should be compared to other mechanisms such as feed-in tariffs or levies, which are also market-based instruments. Yet, since the negotiations focus primarily on trading mechanisms as regards the discussion of “ Various approaches, including opportunities for using markets, to enhance the cost-effectiveness of, and to promote, mitigation actions, bearing in mind different circumstances of developed and developing countries,” these market-based mechanisms that could be much more cost- and environmentally effective are not considered.

Applying the precautionary principle would mandate the exclusion of offsetting mechanisms until a climate agreement is reached that is able to reduce greenhouse gas emissions to a level that would have an extremely strong likelihood of limiting global warming to less than at least 2°C, if not 1.5°C. Policies that are much more effective than offsetting include the implementation of regulations that ban undesirable technologies, such as coal-fired or nuclear power plants; the support for publicly funded research and development; and subsidies for desirable activities. For example, investment in improving the infrastructure of mass public transit would likely result in much higher emissions reductions than an offsetting mechanism, but it would also require more support than “myopic” market-based approaches are able to offer.

### **Concerns with Baseline-and-credit Mechanisms**

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<sup>2</sup> The profit-seeking motive that is, by design, the main driver of market-based mechanisms, is likely to favour incremental, inexpensive improvement of polluting (but lucrative) activities over more substantial changes in the underlying activities. Examples from the CDM include providing support to coal-fired power plants rather than renewable energy or energy efficiency projects, as well as the flaring of landfill gases instead of supporting better waste management practices.

Based on our concerns with the performance of the CDM in its current form and general concerns about a baseline-and-credit mechanism, we would like to offer some additional views on sectoral approaches as they appear to be gaining interest among parties. In this context, paragraph 80.c of decision -/CP.16 (when referring to “broad segments of the economy” of host countries) can be interpreted as referring to sectoral approaches. Sectoral crediting approaches set a baseline for a specific sector in a host country that is below a projection of Business As Usual (BAU) emission levels in the future. Internationally tradable credits are issued for any emissions reductions that are below the baseline. This is known as a baseline-and-credit approach. By its very nature it is flawed, as it is impossible to accurately predict future emissions. There are a whole host of factors that affect economies and the incorporation of new technologies, which could either increase or decrease BAU. For example, the current recession has resulted in a drop in BAU. Yet, this drop in BAU does not reflect the implementation of cleaner technologies, suggesting that BAU will increase once the recession lifts. In such a case, credits awarded would be non-additional and thus would actually result in increased emissions.

Since sectoral crediting is likely to be much larger in scope than the current CDM, the risk of issuing non-additional credits and thus allowing global emissions to further increase is much larger as well. When designing sectoral baselines as intensity-based baselines, that risk is further amplified by the impossibility of knowing future output and the possible creation of perverse incentives to increase (or delay decreasing) output in order to increase credit generation. Another problem specific to sectoral approaches is the definition of sectoral boundaries, which could have a major impact on activities within the sector. For example, if sectoral boundaries for the power sector were defined in a way that did not include emissions associated with extraction, processing and transport of fuel (regardless of whether extracted locally or imported) for coal, oil, gas and nuclear power generation or the emissions associated with the flooding and maintaining of the reservoirs of large hydro generation, these activities would appear to be less greenhouse gas intensive than their actual complete lifecycle emissions, resulting in the inappropriate support of dirty technologies. This is also very likely to lead to the lock-in of old and polluting technologies (which, as discussed, is also a general concern with market based approaches) by incentivising incremental improvements of existing technologies over transformational change.

Furthermore, due to the inherent technology neutrality of sectoral approaches, such mechanisms would effectively provide subsidies to socially undesirable technologies, such as nuclear or fossil fuel based power generation (with or without CCS) or large hydro generation, as long as they represent a marginal improvement over currently employed technologies when they are only evaluated against their greenhouse gas emissions at the tailpipe. When other environmental and social concerns are taken into consideration, the balance may look very different. This would present an additional risk for such technology to be locked in to developing countries’ infrastructure for decades, making future emission decreases both harder and more costly to achieve.

Sectoral approaches also suffer from a discrepancy in terms of which actors are targeted by the incentives of such approaches: while credits generated under such approaches would be

issued to national, supranational or regional entities (such as developing country governments) the actual implementation of emissions reductions would have to be performed by individual installations. Thus, the actors which would have to implement the reductions would not directly be incentivised by these approaches. While the incentives created by the CDM in relation to private sector decisions are compromised by various uncertainties (in the registration and issuance processes, in the number of credits the developer will receive, and in the value of those credits), those uncertainties would be even greater as and when credits were generated on a sectoral scale. Before sectoral crediting yielded any credits, individual actors would need to put emission reduction efforts into place without knowing whether any credits would be issued (and thus revenues earned) as a result of the performance of to the entire sector. Second, given that the incentives of sectoral approaches are mainly targeted at governments (or similar regional, national or supranational entities), it is not clear that purely financial incentives are sufficient. While private companies are arguably incentivised by financial considerations, government decision-making typically involves a more complex set of factors, besides purely financial considerations. These uncertainties cast doubt on the effectiveness of incentives that would be provided through sectoral mechanisms.

Sectoral approaches, if established, would require very detailed and accurate emissions data in the countries and sectors covered. It is questionable whether any but a very few sectors in a very few developing countries would be currently able to provide such data. Data uncertainties further exacerbate the risk that sectoral approaches could result in the issuance of credits that do not represent actual emission reductions. Furthermore, this data requirement also means that it will be even harder for developing countries currently not able to participate in the CDM to participate in such schemes in the future, thus further skewing the geographical distribution of participation.

## **Conclusion**

To conclude, the precautionary principle and experience from the CDM together suggest that any baseline-and-credit based market mechanisms must be rejected unless – which is highly improbable - credible efforts are made to resolve the problems outlined above. In particular, sectoral crediting approaches risk elevating the problems observed with CDM to a much larger scale while also introducing additional new risks. Emissions trading among economies that are subjected to absolute caps can be allowed if accompanied by additional policy measures to address the shortcoming inherent in all market based mechanisms. The foremost mitigation objective of any future climate regime must be the support of the decarbonisation of developed countries' economies and support for low-carbon development of developing countries. Any mechanisms under such a regime, including any market based mechanisms, must be thoroughly scrutinised to assess whether they support rather than weaken or neutralise these main mitigation objectives.

## **References**

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