Various approaches, including opportunities for using markets, to enhance the cost effectiveness of, and to promote, mitigation actions

**Submission by the Centre for European Policy Studies**

**Background**

1. UNFCCC COP-17 in Durban decided to continue to develop various approaches to enhance the cost effectiveness of mitigation actions under the UNFCCC, and has asked the AWG-LCA to complete the work, and make recommendation on a number of issues, for adoption at COP 18 in Qatar.
2. The new approaches that are expected to emerge from these decisions form an important element in the architecture for a new climate regime.
3. The private sector can play, and should be incentivized to play, an important role, in meeting the UNFCCC objectives.
4. Overall, market approaches under the Kyoto Protocol during last number of years, especially via the CDM, have contributed to establishing climate change on the global agenda, and ensuring that the value of mitigation actions is now recognized around the world. During this period many lessons have emerged that can and should be applied towards the design and development of the instruments agreed under the Durban decisions.
5. Parties should continue to support and improve existing mechanisms, learn from them, and promote the development of new mechanisms.

**Why we need to move now**

6. **Science.** Scientific evidence points to the urgency of starting new, large-scale mitigation actions, with market mechanisms needed to catalyse new initiatives.
7. **Risk of fragmentation:** A number of new initiatives have been started and are being implemented independently in different jurisdictions, nationally or regionally. Delays in reaching an international agreement on a new way forward can only lead to fragmentation and away from the one price of carbon that is the most desirable outcome for minimizing societal cost of addressing climate change.
8. **Role of the multilateral system:** the UN has been the developer and regulator of this new market at a global level, and this has addressed many of the issues of legitimacy, coherence, accounting, avoidance of fragmentation, etc. Delays will diminish the credibility of using this platform for a global solution.
Durban Agreement & Issues for Consideration

9. At the Durban Climate Change Conference a number of key decisions were adopted, including:

10. Maintaining and building upon the existing flexibility mechanisms established under the Kyoto Protocol.

11. Acknowledging the role 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; and noting that Parties may, individually or jointly, develop and implement such approaches in accordance with their national circumstances.

12. Define a new market-based mechanism (NMM), operating under the guidance and authority of the Conference of the Parties, to enhance the cost-effectiveness of, and to promote, mitigation actions, bearing in mind different circumstances of developed and developing countries, and which, subject to conditions to be elaborated, may assist developed countries to meet part of their mitigation targets or commitments under the Convention.

13. This NMM is guided by decision 1/CP.16, paragraph 80:

   a. Ensuring voluntary participation of Parties, supported by the promotion of fair and equitable access for all Parties;

   b. Complementing other means of support for nationally appropriate mitigation actions by developing country Parties;

   c. Stimulating mitigation across broad segments of the economy;

   d. Safeguarding environmental integrity;

   e. Ensuring a net decrease and/or avoidance of global greenhouse gas emissions;

   f. Assisting developed country Parties to meet part of their mitigation targets, while ensuring that the use of such a mechanism or mechanisms is supplemental to domestic mitigation efforts;

   g. Ensuring good governance and robust market functioning and regulation;

14. Requesting the AWG-LCA to consider a framework for 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, must meet standards that deliver real, permanent, additional and verified mitigation outcomes, avoid double counting of effort, and achieve a net decrease and/or avoidance of greenhouse gas emissions;
15. This can be summarized as the COP tasking the AWG-LCA, leading to COP 18, to

a. Define the NMM, guided by the Cancun decision, by developing modalities and procedures (M&P)

b. Consider a Framework for new approaches, including the use of markets.

c. Both these tasks decisions leave a substantial amount of issues undefined, which will need to be address in the course of the work leading to COP 18 in Qatar.

16. Some of the main issues that we must highlight as needing to be addressed in submissions, as well as in the work leading to COP18, include

a. The relationship between the Framework and the NMM. The text refers to: “bearing in mind the differences between developed and developing countries”. This implies a certain level of flexibility and adaptability to be built into the NMM, and as such it implies moving away from CDM-type definition of a mechanism, as a tool that is applied the same way for all Parties.

b. NMM and Other Market Mechanisms under the Framework? Since the Durban text recognizes a NMM, without specifying what it is, it is a legitimate question to discuss whether Other Market Mechanism can emerge, bottom up, under the Framework and produce units that can be used for compliance with UNFCCC obligations.

c. What is the relationship between NAMAs and NMM? The NMM and NAMAs will be developed in the context of the new climate change regime to be defined under the Durban Platform. While in the KP the CDM was used to create reductions to be used as compliance units for Annex 1 countries obligations, in this new regime, developing countries will also want to use reductions and will want to ensure that the low-cost reductions are available for their own use, and not exported, leaving higher cost abatement cost actions for domestic use.

d. The scope of the Framework. It is clear that the various approaches (Other Market Mechanisms and non market) can be defined bottom-up, by using the potential Framework. The NMM is a top-down definition from the COP. The one issue that is unresolved, and needs to be addressed, is whether the NMM has also to comply with the Framework, or will be grandfathered outside the Framework. The same question needs to be addressed to the Kyoto Protocol flexibility mechanisms, if one takes into account the fact that units emanating from MNN, CDM and JI can be used for compliance with the SCP of the KP.

e. What are the standards that need top-down definition and what can be left to bottom-up implementation, as part of the NMM, and/or various approaches under the Framework?
f. **What is the role of the UNFCCC as a regulator,** in light of the fact that the UNFCCC is clearly mentioned in para referring to the NMM, but is not referred to in para were the Framework is mentioned.

g. **One single framework?** Various approaches can be a wide range of forms, some of them non-markets as well as markets that do not produce reduction units that are tradable. Is it realistic to attempt to create a Framework that will encompass all approaches?

h. **Carry over.** The relationship between the discussion on the Framework and the NMM, and that of the carry-over of units between the First and Second Commitment periods of the KP will be linked, given the fact that DEMAND/SCARCITY is a critical element of any market, and the rationale behind the creation of any new market mechanisms.

**NMM and NAMAs**

17. NAMAS are intended to allow the creativity of developing countries to find new and innovative solutions that are adapted to local realities and conditions. The key issues are how NAMAS are then accounted for, monitored, reported and verified, and critically, how they are financed.

18. NAMAs can be financed

   a. **Domestically**

   b. **Supported through funding,** such as bilaterally, or through instruments such as the Green Climate Fund

   c. **Through the carbon market,** by using market mechanisms that can produce units that can be used for compliance with UNFCCC obligations.

19. **Credits resulting from** some of the market-based NAMAs could be allowed by Parties for use in the international markets. Which market-based NAMAs are allowed by host Parties for use in international carbon markets is a matter of (the Host) Party choice.

20. Market based NAMAs may be adopted and implemented, on a voluntary basis by Parties, according to:

   a. The desire of Parties to make use of market mechanisms.

   b. Parties meeting agreed criteria that would qualify them to apply that particular type of NAMA.

   c. Parties may consider using low cost abatement cost NAMAS for domestic purposes and allowing high abatement cost NAMAS for trading in international markets.
NMM and Framework

21. The Durban decision is unclear in the relationship between NMM and “various approaches, including markets” that “can be individually or jointly be developed by developed by Parties
22. The assumption must be made that a number of market mechanisms could potentially emerge, that will all have fungible units
   a. CDM and JI, from the KP
   b. NMM, to be defined through its M&P by the AWG-LCA
   c. Other Market Mechanisms that will have to be within the Framework that is being considered
23. NMM is a top-down mechanism that will be defined by the COP. It is recognized in the Durban decision that it will have to accommodate “different circumstances between developed and developing countries”. Therefore we can see a set of core common elements/standards and elements to be defined locally that will be part of the M&P.
24. Other Market Mechanisms will be developed and defined bottom-up and will have to conform themselves to a Framework that include a set of standards/rules defined globally. At the same time the Framework also, must bear in mind the “different circumstances of developed and developing countries” – a balance of definition to be done locally
25. There is a parallelism between what is implied in the structure (core elements and local elements) of the NMM and the Other Market Mechanisms.
26. This can only resolved by ensuring that the NMM set of core standards become the core standards for ALL market mechanisms, be they the NMM, or Other Market Mechanisms that may emerge in the future.
27. Therefore, with respect to markets mechanisms, the “core standards” of the NMM will have to be de facto the Framework for other bottom up approaches, and also be compatible with what has been developed for CDM and JI.

New Market Mechanism

28. The NMM will be defined through its M&P, and will use the experience of the Kyoto mechanisms, CDM and JI. It will have to move into a direction that permits the creation of a NMM that will address some of the constraints of CDM and JI, which were derived from the mandate and definition of these mechanisms, especially as it relates to the fact that they

   a. Are a project-by-project approach
   b. Lack flexibility to adapt to local conditions
   c. Require significant overhead cost
   d. Are offset mechanisms and do not meet the criteria of producing net reductions
29. However, since some elements will be left to local conditions, this could result in challenges, especially as they relate to:
   a. **Environmental integrity.** Units resulting from these mechanisms, since they need to be adaptable to local circumstances, could be seen as not “identically” implemented from country to country, and may lead to concerns that “a ton is not a ton”
   b. **Market fragmentation and reduced market liquidity.** If there is questioning of their environmental value “how much CO2 equivalent is any particular unit worth? -- and in the absence of any “official stamp of approval”, the acceptability of these units outside the jurisdiction that has created them may not be universal and automatic.

30. **Top-down rules, bottom-up implementation.** A core set of rules/standards will have to be defined top-down and that will have to be observed by the NMM no matter where they are implemented. These standards will include
   a. **MRV rules.** Clear methodologies and standards must be set for MRV, which is essential to ensure that reductions from different sectors and jurisdictions represent a ton of CO2 reduction
   b. **Guidelines for setting baselines for BAU and crediting.** How baselines are defined will be critical to ensure that the “hot air” is not being generated. The BAU baseline and the crediting baseline will play an important role but there will have to be an element of local decision as to where crediting baselines is set, which will also influence the abatement costs that are allowed for use in international markets, and those that are used domestically.
   c. **Criteria for the use of NMM.** The existing mechanisms (JI and CDM), the NMM, as well as other market approaches and can take a number of forms – CDM “classic”, PoA, sectoral crediting, sectoral trading, economy wide cap-and-trade. Parties that wish to adopt any of these will have to meet certain criteria, same way that Parties must qualify to use mechanisms under the KP, including JI track1 and JI Track 2.
   d. **Accreditation rules for verifiers** will be active in crediting or trading environments. This will very much also be a capacity building exercise, given the large demands such schemes can put on limited expertise available in any jurisdiction.
   e. **Sustainable development.** NMM will have to produce emission reduction units that contribute to sustainable development (SD). SD definition was left totally as the prerogative of the Host country, in order to avoid interference with national priorities. However, the CDM has shown that buyers, Parties that purchase units, and what is more important, authorize the use of types of units for what is domestic compliance, and which contribute to international compliance (e.g. EU ETS) can take a strong view of what is acceptable as SD contribution. As criteria may change over time, this may lead to controversy. In order to avoid such developments, it may be useful to examine if a set of common guidelines can be arrived at for those units that are to be used in the international carbon markets. SD definition for national purposes will remain a national prerogative.
31. The NMM could be further elaborated:
   a. **Crediting approach.** Under such a mechanism, at the end of the period, emissions from a defined, broad, area of the economy (subsector defined regionally, one sector, multi-sector, etc.) are compared to an ex-ante defined baseline (crediting baselines which should be different, and more restrictive, than the BAU baseline). The quantity of emissions under the baseline or reference level will be credited. One issue that needs to be recognized is that under such an instrument financing comes at the end of the cycle and as such instruments to finance the reductions ex-ante, such as a multilateral guarantee, need to be put in place.
   b. **Trading approach.** Under such a mechanism, a baseline or reference level is defined (national, sectoral, subsectoral, etc.) ex-ante. The allowances issued can be sold in the global market for emission rights. If emissions at the end of the period are above the defined baseline or reference level, then that Party must purchase the equivalent number of emissions on the market. Flexibility should be provided to Parties on how they implement such an approach taking into account national circumstances. The risk of not meeting the environmental objectives is real and needs to be addressed – and a number of risk management instruments can be implemented (pooling, reserve, insurance, guarantees, etc.).

**Governance of the NMM & Framework**

32. The NMM and Framework will require a Regulatory Body whose role should be to:
   a. Develop, administer, and apply, the standards that the COP approves.
   b. Administer the new approaches that are created, including the NMM. This will provide for coordination, transparency and avoid duplication between market mechanisms.
   c. Ensure the continued integrity, good functioning, and evolution of the NMM, and any new approaches
   d. Provide guidelines for their implementation at the national level according to national circumstances.
   e. Define and recommend to the COP conversion factors to allow conversion from units resulting from different market mechanism, to tons of CO2 equivalent. This role is central if the Framework is ever to have a chance of succeeding.

**Voluntary Participation**

33. The use of the NMM, as well other approaches that may be developed, will be on a voluntary basis, as Parties could implement NMMs, as well as other approved approaches based on the international standards approved by the COP. Alternatively, Parties do not need to implement any market approach, be it CDM, NMM, etc.
Incentive for Business to Participate

34. Existing mechanisms, CDM and JI, in spite of many drawbacks for the business community, provide a clear path for participation of the private sector, including clear counterparts. Risk mitigation strategies can be developed and the role of the UNFCCC in transferring credits in the “right account” cannot and should not be minimized.

35. Development of new market mechanisms should ensure that these features are maintained, and that clear accountability and responsibility exists for the reductions, and the benefits that accrue from them, as well as for failure to deliver.

36. Failure to do so will result in these becoming a government-to-government tool.

(technology/source) Neutrality

37. Market based approaches will have to be defined by national priorities and circumstances.

38. The criteria for recognizing the credits produced by NMM/NAMAs/various approaches for use in the international market will have to start from the point of being technologically/source neutral.

39. However, the market will also have to face reality, in maintaining scarcity that is needed for any market to function.

40. As an option, different demand windows could be explored for different reduction sources.

Capacity Building

41. The current market KP market mechanisms, CDM and JI, have shown how important, and how laborious and time-consuming, building capacity for such activities can be.

42. Regional approaches, such as EU ETS, as well as private initiatives, such as the Cement Sustainability Initiative, have shown how complex it will be to collect on a systematic, transparent and trustworthy way such large quantities of data – and how critical it can be to the success of the operation of the mechanism.

43. As such, capacity building cannot be an afterthought, but an integral part of any plan that can realistically be implemented. Responsibility for capacity building cannot be left disperse, without clear accountability and responsibility. The risk is that NMM, as well as other approaches under the Framework, are implemented, but the knowledge and infrastructure are not there, resulting in poor functioning, and discrediting the concept.