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NEW MARKET MECHANISMS – RISKS AND REALITY

A civil society analysis of the state of UN climate negotiations

The Durban conference failed to deliver Kyoto targets, but industrialised countries still pushed for new and expanded carbon market mechanisms. The planned workshop on new market mechanisms (NMM) should focus first on lessons from the clean development mechanism (CDM). Scaling up a failed mechanism will not work for the climate.

A new market mechanism?

The Durban LCA decision "defined" a new market mechanism, but this is now treated as being "established", despite these terms not carrying the same legal meaning.

The planned LCA workshops to elaborate modalities and procedures for a new market mechanism must take full account of lessons from existing market mechanisms (the CDM) and fully consider whether a NMM can solve all of these problems, or whether there are better and more direct routes to "least cost emission reductions."

Markets need targets

EU and the US submissions on modalities and procedures for a new market-based mechanism promote the use of offsets via a new market mechanism even before the lessons of the current emissions trading schemes and their pitfalls are understood.

The price of CDM credits has already collapsed. The main issue is the lack of ambition levels in the targets, yet instead of focusing on increasing ambition levels, developed countries are busy making proposals outlining how developing country parties can reduce emissions to be credited to the North.

These new proposals, from the EU and US in particular, describe how developing countries will set emissions reductions targets and only those who set these targets will participate in the NMMs. This is supposed to be an "incentive" for developing countries to take on targets, with the US stating that NMM 'could play an important role in future emission reduction efforts around the world.'

The US submission is explicit in assuming all NMMs to be offsets, despite the opposition of many parties to developed countries meeting their responsibilities through emission reduction activities in developing countries.

"Additionality" and environmental integrity

The premise of NMM is to 'scale-up' the failed attempt to reduce emissions under the CDM via a sectoral approach (ie: transport, energy, cement) with accounting and crediting at a national level. This is supposed to circumvent the problems of the project based approach by allowing greater government involvement including for regulation and emission reductions at scale, and avoiding the problem of emissions reduced in one area moving to another (leakage).

None of this gets around the existing problems at the heart of carbon trading however: if the emission reductions that are awarded 'offset credits' are not additional, the atmosphere will see an increase in emissions.

The 'additionality' problems of the CDM are not resolved by sectoral crediting – and risk being worsened by its extension to entire sectors of an economy. If sectoral baselines are designed as "intensity-based baselines", that risk is further amplified by the impossibility of knowing future output/intensity and thus the possible creation of perverse incentives to increase (or delay decreasing) output in order to increase credit generation in the future.

The proposals currently on the table attempt to allay these environmental integrity fears by promoting themselves as moving "beyond offsetting." They would require developing country Parties to significantly alter their emissions compared to a claimed trajectory before any credits are issued. The gap between the "business as usual" baseline and the start of crediting would partially compensate for the scheme's environmental failings, but at the cost of pushing additional burdens onto developing country Parties (which would be expected to meet the gap between the business as usual threshold and the crediting baseline with their own resources).

The move "beyond" offsetting does not indicate an approach to deal with any of the other key problems associated with the CDM, including its role in exacerbating land grabs, local environmental and social conflicts. In covering whole economic sectors instead of individual projects, sectoral crediting would increase the overall volume of carbon offsets generated; in fact, that is one of its main goals. This creates the potential for all emission reductions in developing countries above the crediting threshold to be used as offsets by developed countries. It could make finance and support for NAMAs conditional on verifying emission reductions.

There is also a significant risk that the NMM could result in "double-counting" against climate finance obligations. The NMM would be generating credits for developed countries' targets; the financial contribution cannot count toward climate finance obligations to support emissions reductions in developing countries.

Locking in polluting technologies

Another problem that remains unresolved in sectoral trading is the locking in of surplus emissions (via over-allocation, or

via reduced production in times of economic recession in industrialized countries), as well as the definition of sectoral boundaries, which could have a major impact on activities within the sector. How sectoral boundaries are set will determine the apparent emissions intensity of a sector, and excluding extraction, processing and transport emissions could make some technologies appear less greenhouse gas-intensive than they actually are (especially for hydropower), resulting in an inappropriate support of dirty technologies.

All of this is likely to lead to the lock-in of old and polluting technologies by incentivizing incremental improvements of existing technologies over transformational change. This risk of technological lock-in in developing countries' infrastructure for decades will make future emission decreases both harder and more costly to achieve.

Misplaced incentives

Sectoral approaches also suffer from a discrepancy in terms of which actors are targeted by the incentives of such approaches: while credits generated would be issued to national, supranational or regional governments - the actual implementation of emissions reductions would have to be performed by individual installations. Thus, the actors that would have to implement the reductions would not directly be incentivized. Uncertainties are therefore increased when credits are 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 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 to change behaviour within a political entity.

Supply, supply, supply, but no demand

Scaling up carbon markets in the absence of tough Annex I commitments would most likely collapse the price of offset credits. "New market mechanisms" were first tabled when the USA was planning a federal cap and trade market, which was expected to lead to an almost tenfold increase in demand for carbon offsets compared to current levels (where the majority of demand is from the EU ETS).

Following the failure to pass a US federal scheme in 2010, there have also been delays and a downscaling of expectations for emissions trading schemes in Canada, Japan and South Korea. The EU has not exercised the option to raise its reduction target to 30 percent by 2020, and the effects of the recession and over-allocation of emissions credits mean a likely surplus in emissions credits that could reach up to 2.4 billion allowances between 2013 and 2020.

Unregulated markets

In parallel to the development of a new mechanism, a work programme was agreed in Durban to discuss the means by which bilateral or unilateral market mechanisms could be counted towards emissions reduction targets under a new post-2020 climate regime.

According to the Government of Japan, one of its main proponents, this system would allow countries to 'design, establish and implement' their own trading schemes and count the results towards global targets as long as a few common principles or accounting norms were adhered to.

This forms part of a broader 'regime change' agenda in international climate negotiations, seeking to downgrade the role of the UN process in decision making offering a far more decentralised governance structure, which would instigate a 'race to the bottom' on environmental and social standards, and widen the risks of double-counting.

Forests and the NMM

The Durban Decision also included discussion of market-based approaches for financing REDD+. There was no agreement in Durban that carbon trading could be used to finance REDD+, only an agreement that 'appropriate' market based instruments could be developed, with a focus on learning lessons from pilot projects. Despite this, the US is suggesting REDD+ as a new market mechanisms, stating in their submission that REDD+ is the first large-scale sectoral approach to driving emission reductions, and Australia, NZ, Japan and others are also pushing for a carbon-trade approach to be established.

Sectoral approaches would require very detailed and accurate emissions data in the countries and sectors covered. Obtaining this data for forests is a major barrier to establishing a market based approach, and risks diverting current funding away from necessary governance reforms, including changes in policies and laws that could protect forests, to a technical focus on measuring carbon.

This is a huge distraction from the actions that are needed to save forests, and developing countries are at risk of investing heavily into cumbersome MRV systems at the expense of more direct policies and measures which could directly tackle the underlying causes to deforestation.

Early lessons from REDD+ 'pilot projects' which aim to verify credits to international standards shows that the process of MRVing carbon is complex, expensive and time-consuming, undermining core project benefits such as land tenure reform and community managed forests.

Conclusions

Planned workshops under the LCA to discuss NMM should focus first and foremost on lessons from the CDM. Scaling up a failed mechanism will not work for the climate.

Support for developing countries NAMAs should not be conditional on verified emission reductions, and these emission reductions should not be used to offset the obligations of wealthier countries, whether traded on financial markets or used directly for compliance purposes.

The IEA estimates that under BAU scenarios we are on track for a 6C temperature increase this century. Urgent emission reductions across all sectors of developed countries are needed without them seeking more loopholes and offsets. Financial support for developing country NAMAs does not mean those who provided the support can use those reductions for their own compliance purposes.