

COP21 media briefing: what role for carbon markets?

December 2015

The twenty-first session of the Conference of the Parties (COP21) will take place from 30 November to 11 December 2015, in Paris, France, with the aim to flesh out a future Paris climate agreement to replace the Kyoto Protocol from 2020 onwards. One open question is the role carbon markets may play in fulfilling the climate pledge.

What's important in Paris?

Avoid double counting

Double counting occurs when a single emission reduction or removal credit is counted more than once towards emissions reductions targets. No provisions in the Paris agreement would allow emission reductions to be counted twice.

Ensure Supplementarity

In order to achieve the needed 2050 decarbonisation goal, all countries will need to ensure that they are developing in ways that contribute to decarbonisation and avoids lock-in to high carbon infrastructure and ways of doing things. For this reason, use of international emissions trading should only take place on top of planned ambitious domestic mitigation goals or actions.

Contain the dangers of hot air

Although the hot air units under the Kyoto Protocol (so called surplus AAUs) will become useless commodities after the second commitment period ends in 2020, several other types of hot air could severely undermine the environmental integrity of the Paris climate treaty, including surplus allowances from Emissions Trading Systems, non-additional carbon credits and non-permanent carbon offsets (sinks). To contain the dangers of such hot air in the Paris treaty, rules should be created to regulate the use of carbon markets so that only countries with adequate carbon budgets that do not allow for carry-over of hot air from the pre-2020 period are allowed to use international market mechanisms. At the same time, countries should move away from carbon offset credits towards the provision of financial support for climate actions in developing countries.

For more details about these recommendations, see our [new publications](#) on each of these issues as well as our [COP21 recommendations](#).

What we know about carbon markets

Since carbon markets make it cheaper to reduce emissions, some countries argue that they can take on higher targets if they use carbon markets. But to date this hope has been in vain: carbon markets have not led to higher commitments. On the contrary, mitigation commitments have been woefully inadequate: cap-and-trade systems have been severely oversupplied and offsetting mechanisms have been marred by insufficient environmental quality. The current pledges put us on track for around 3°C of warming, not the 1.5°C vulnerable countries are calling for, and not even the 2°C agreed by countries at the UN talks in Cancun in 2010.

For example, numerous reports have presented evidence that the Kyoto's offsetting mechanisms may have delivered much fewer emissions reductions than were sold. One study estimates that up to 70% of all offset credits issued from the Clean Development Mechanism (CDM) between 2013 and 2020 may not represent real emissions reductions. Another study finds that bogus carbon offsets issued under the Kyoto Protocols' Joint Implementation (JI) offsetting mechanism to date have increased global emissions by 600 million tonnes CO₂.

All in all, carbon markets have so far created an 11 gigatonne "Hot Air" loophole undermining the viability of the Kyoto Protocol international climate treaty. The carbon credits resulting from these carbon market design problems are called "Hot Air" because they do not represent real emission reductions.

This is a situation that cannot continue as the need to incentivise real additional climate action at Paris 2015 is of unparalleled importance in helping limit global warming below 1.5°C. A key consideration for the Paris treaty is therefore to incentivise real additional climate action while avoiding the build-up of bogus hot air credits.

The political reality about carbon markets globally

Only very few countries have outlined in their Intended Nationally Determined Contributions (INDCs) that they will use international trading as a means to help achieve their climate goals. From the industrialised countries, only Switzerland, New Zealand and to a certain extent Norway have indicated the use of markets under the Paris climate treaty. On the other hand, numerous developing countries have announced interest for an international carbon market to play a role in the future. Several countries, such as Albania, Barbados and Togo, suggest that they might continue to generate offset credits and others, such as Cabo Verde, Ghana, Mexico and Uganda plan to achieve their conditional pledges with the use of markets. Given this divergence between industrialised and developing countries on the role of international trading, the focus has shifted to providing finance for climate mitigation actions in developing countries without the generation of offset credits.

Despite the limited role of carbon markets contained in the INDCs of most industrialised economies, such as the EU and the US, the political reality regarding domestic carbon pricing schemes looks different: jurisdictions responsible for 40% of the global economy have already implemented carbon pricing mechanisms. Despite its domestic nationally determined mitigation commitment (NDMC), the EU is currently negotiating linking its Emissions Trading System with Switzerland with a view to a global carbon market at a later stage. China is currently fleshing out the rules to implement its national carbon market from 2017 onwards and in the Americas, carbon markets have also been linked in California and Quebec and could be expanded through linking to other regional emissions trading schemes, such as Ontario. These developments strongly suggest that we are moving away from one global carbon market under the UN Framework to a fragmented landscape with various national and regional carbon market initiatives.

The latest Bonn negotiations have significantly changed how carbon markets are being discussed. There was initially no mention of them in the draft treaty text going into the October session. However, about 5 pages of language proposals for carbon markets have been added by Parties. The latest draft treaty text indicates that international emissions trading will look very different after 2020 from the situation under the Kyoto Protocol. While under the Kyoto Protocol an international accounting system was set up, including an international carbon unit (Assigned Amount Units – AAUs) and a registry to track the trading of these units, such international oversight seems to be missing from the current draft treaty text.

What future for carbon trading?

The climate world post-2020 will look differently to what we were used to under the Kyoto Protocol. It has become clear that we need to reduce emissions more urgently than ever before. The previously prominent role of international carbon offsets for example cannot be sustained, as there is no room for offsetting anymore in the limited remaining global carbon budget. The focus has instead shifted to strong transformative climate action in each country to avoid a high-carbon lock-in. In addition to such emission reduction obligations there is, especially in industrialised countries, now an obligation to provide financial support for climate action in less capable countries. Climate mitigation action in the developing world therefore needs to be financed through climate finance with emission reductions to stay in the country of origin.

With no more role for carbon offsets, there is still a role to play for emissions trading as a means to potentially mitigate at lower cost, which would allow countries to adopt more ambitious climate commitments at the same costs. But while many countries and regions are shifting to emissions trading systems to implement their domestic climate obligations, the role for international emissions trading appears to be diminishing as countries instead focus on domestic mitigation to reap the associated co-benefits.