



Carbon Markets in the Post Paris World

Carbon Market Watch Briefing
November 2016



Key Recommendations

Ambition

- Initiate a work program on how best to achieve overall mitigation, exploring cancellation, discounting, conservative baselines and credit period curtailment for various mechanisms.

Environmental Integrity

- Account for all transfers, both via Cooperative Approaches and the SDM, with a rigorous transparent accounting framework tied to NDC demonstration and compliance.
- Define a mitigation outcome as an ex-post emission reduction in overall emissions as demonstrated by recent inventories or as tied to a concrete mitigation activity.
- Limit eligible reductions for transfer (ITMOs) via Cooperative Approaches to the difference between current emissions and the average of the last three of a party's inventories.
- Exclude technologies with a low likelihood of additionality via a negative list.
- Develop conservative, updated, standardized baselines based on sectoral benchmarks appropriate to the local context of the mitigation activity including national policies and relevant NDC action.
- Limit and review crediting periods to account for the working life of technologies and changes in additionality due to technological progress through time.
- Exclude activities for which global leakage cannot be measured and temporary sinks, such as REDD and forestry credits, from eligibility under the SDM.

Governance

- Establish a UNFCCC body to oversee accounting of international transfers including for targets outside of NDCs such as international civil aviation.
- Shift the contractual relationship with DOEs from activity proponents to the SDM supervisory board, to be financed by fees raised from activity proponent fees.
- Invite nominations from civil society for membership in the body designated by the CMA to supervise the mechanism to foster impartiality.
- Hold stakeholder consultations for the elaboration of the SDM, make future meetings of the SDM supervisory body open to observers and the public, and publish documentation for all activities carried out under the SDM.

Sustainable Development and Human Rights

- Dedicate a share of proceeds from all international transfers of mitigation outcomes to help vulnerable developing countries adapt to climate change.
- Earmark proceeds from the transfer of ITMOs via Cooperative Approaches for climate change measures like a Green Investment Scheme that advance selling countries towards reaching Sustainable Development Goals.
- Require public and private entities participating in the SDM to monitor and report activity co-benefits towards the achievement of the UN Sustainable Development Goals and how they apply relevant human rights law.
- Require local stakeholder consultations in a manner that protects the right to full and effective participation of affected peoples and communities for activities conducted under the mechanism.
- Establish robust environmental and social safeguards in line with international best practice for multilateral climate finance institutions.
- Establish an institutional grievance process at the UN level to provide a means of recourse for people and communities affected by the projects with the power to revoke activity letters of approval.

Introduction

The Paris Agreement represents a new era for international climate action, including for international carbon markets. Humans have emitted so much into the atmosphere that even if compensated, very little can still be emitted to limit serious consequences of climate change. 2°C of warming would have very negative effects, which is why it is important to swiftly work towards the Paris goal of the 1.5°C limit. If carbon markets are to help work towards this goal, they must work to rapidly increase ambition and guarantee high environmental integrity.

The Paris Agreement's Article 6 on international cooperation and markets, was vague enough to offer something to everyone. The chapeau in the first paragraph sets the overall scene and lays out the general provisions of higher ambition, sustainable development and environmental integrity. Parties wanting less international oversight negotiated for their efforts to be "recognized" and that such efforts be "consistent with" multilateral "guidance" when engaging in cooperative approaches. Parties looking for a multilateral approach got a "mechanism to contribute to the mitigation of greenhouse gas (GHG) emissions and support sustainable development", in short the Sustainable Development Mechanism (SDM), as an heir to the Clean Development Mechanism (CDM) and Joint Implementation (JI). Parties resistant to a commoditized approach got recognition of the importance of non-market approaches and a "framework for non-market approaches to sustainable development".

Now the task is to interpret the vague language in the article and the corresponding COP decision. This will not be easy as the diverging viewpoints have not suddenly converged about what the Article as a whole should do or what the various bits actually mean. Further, the elaboration of each provision is almost certainly co-dependent on progress made in the others.

This briefing provides a starting point to interpret what Cooperative Approaches and the Sustainable Development Mechanism are, how they differ, and where the pitfalls lie in moving forward. It also highlights recommendations on how they could play a constructive role in global climate action while fostering sustainable development and protecting human rights.

Cooperative Approaches

Directly after Article 6's chapeau's overall trinity of goals: higher ambition towards 1.5°C and decarbonization, sustainable development, and environmental integrity, the second paragraph on cooperative approaches introduces the new term "internationally transferred mitigation outcomes" (ITMOs), as a backing element for international carbon markets. The language goes on to specify that when parties engage in Cooperative Approaches, that they do so in a manner consistent with multilateral guidance ensuring environmental integrity, applying robust accounting, and in promoting sustainable development. The corresponding COP decision para 37 calls for the Subsidiary Body for Scientific and Technological Advice (SBSTA) to develop such guidance, which will need to improve on existing practice and experience for the new challenges of the post Paris landscape.

Define an ITMO as an actual reduction over and above an NDC

Under the Paris Agreement, an ITMO could conceivably be the result of a baseline and credit system, or tradable units or allowances under an overall limit – such as under a cap and trade system or an NDC, or both. The SDM was clearly

established as a crediting mechanism to succeed the CDM and JI with public and private entity participation that carry out specific mitigation activities that lead to mitigation outcomes in a host country; Cooperative Approaches on the other hand represent transfers of mitigation outcomes between countries on the national level.

One of the major problems with the Kyoto Protocol was the unambitious targets of many countries far above business as usual emission levels, referred to as “hot air”. When traded, hot air allows countries buying hot air to increase their emissions without any real mitigation action elsewhere. This increases global GHG emissions beyond an alternative case where no trading would have occurred and may contribute to locking in higher emissions in the buying country]. Today, many NDCs are not ambitious enough with trajectories likely creating hot air. Simply creating a budget under an NDCs does not constitute a “mitigation outcome” or reduction.

A distinguishing characteristic of a mitigation outcome should therefore be that they represent actual mitigation effort and be measured ex-post, as opposed to future reductions, in clear GHG terms either based on recent downward emission trajectories as demonstrated by inventories, or when tied to a specific SDM activity. Trading future, ex-ante, reductions would seriously risk undermining future the Paris Agreement.

To transfer mitigation outcomes with Cooperative Approaches, eligible reductions should be limited to any surplus reductions left over after a party has reduced emissions at the end of a compliance cycle compared to the average of the previous three inventories.

Recommendations:

- Define a mitigation outcome as an ex-post emission reduction in overall emissions as demonstrated by recent inventories or as tied to a concrete mitigation activity.
- Limit eligible reductions for transfer (ITMOs) via Cooperative Approaches to difference between current emission levels and the average of the last three of a party’s inventories.

Robust accounting to avoid double counting

Robust accounting is as essential to environmental integrity as the avoidance of hot air. COP decision paragraph 37 specifically calls for guidance for Cooperative Approaches to “ensure that double counting is avoided on the basis of a corresponding adjustment by Parties for both anthropogenic emissions by sources and removals by sinks”. This necessitates a second step after inventory compilation to account for transfers in order to demonstrate achievement and compliance of NDCs, which now take a variety of forms. Such accounting is specifically mentioned for Cooperative Approaches, but should also be applied to SDM transfers, including to targets outside NDCs such as for international civil aviation for a global, holistic harmonized accounting system.

Recommendations:

- Establish a UNFCCC body to oversee accounting of international transfers including for targets outside of NDCs such as international civil aviation.
- Account for all transfers, both via Cooperative Approaches and the SDM, with a rigorous transparent accounting framework tied to NDC demonstration and compliance.

Promoting sustainable development

Where engaging in Cooperative Approaches involving ITMOs, parties are further required to promote sustainable development. Although Cooperative Approaches are not associated to specific mitigation activities which may have sustainable development co-benefits, a share of proceeds from the ITMOs should be used to support sustainable development namely to help with the cost of adaptation and build resilience to the adverse effects of climate change. Further, the practice of Green Investment Schemes (GIS), established as funds to finance climate measures with proceeds from AAU sales, can be built upon to finance climate friendly activities that advance countries towards sustainable development goals.

Recommendations:

- Dedicate a share of proceeds from the international transfer of mitigation outcomes to help vulnerable developing countries adapt to climate change.
- Earmark proceeds from the transfer of mitigation outcomes (ITMOs) via Cooperative Approaches for climate change measures like a Green Investment Scheme that advance selling countries towards reaching Sustainable Development Goals.

A Mechanism for Sustainable Development (SDM)

The Paris Agreement established a new ‘mechanism to contribute to the mitigation of greenhouse gas emissions and support sustainable development’, to succeed the Kyoto Protocol’s Clean Development Mechanism (CDM) and Joint Implementation (JI). The new mechanism shares the overall Article 6 chapeau with cooperative approaches and the non-market provision including the ambition, environmental integrity, and sustainable development trinity. However, it contrasts with cooperative approaches in a number of ways, notably with strong centralized oversight directly under multilateral supervision and authority.

The Paris Agreement gave the SDM a number of CDM and JI features, including the CDM’s share of proceeds provision for administrative costs and adaptation financing. The agreement’s wording suggests that all countries will be able to generate and use units towards their NDCs, a combination of elements of the CDM and JI. While both mechanisms have the goal to allow for higher ambition in their mitigation actions, the SDM adds the more specific goal to “deliver an overall mitigation in global emissions”.

It is an open question to how multilateral “supervision” designated for the SDM will deliver “an overall mitigation in global emissions”, what is meant by “mitigation activities” beyond projects, and how it will define sustainable development and protect human rights. Rules will also need to be established for transparent and robust governance for the new body designated to supervise the operation of the mechanism.

Going beyond pure offsetting to promote ambition

To contribute to the overall 1.5°C and long term decarbonisation goals of the Paris Agreement, the agreement called for the SDM to deliver “an overall mitigation in global emissions”. This moves away from a pure zero sum, net neutral offsetting logic towards net mitigation, a significant departure and bold move for more climate action. Overall mitigation

can notably be achieved through cancellation and discounting, or for specific activities, conservative baselines and/or shortened crediting periods. SBSTA should carry out further work on how best achieve this for the SDM.

Recommendation:

Initiate a work program on how best to achieve overall mitigation, exploring cancellation, discounting, conservative baselines and credit period curtailment for various mechanisms.

Ensuring environmental integrity in the SDM

For the SDM to have high environmental integrity, parties must learn from both the mistakes and in some cases, the reforms implemented under the CDM and other market mechanisms. Emission reduction activities under the SDM must therefore be real and verifiable, additional, and permanent. They must also not “leak”, or be counted multiple times towards a mitigation goal, including non NDC goals such as targets for international emissions including aviation. COP decision paragraph 38 on the SDM specifies a number of these features by calling for the modalities and procedures to be developed on the basis of “real, measurable, and long term benefits”; “reductions in emissions that are additional to any that would otherwise occur”; and that “verification and certification... by designated operational entities”.

Real and Verifiable: A credit must be real and verifiable in that it must be tied to an actual measure that has been undertaken, as opposed to sold as a meaningless piece of paper or serial number. For supposed measures that may be taken on the other side of the world, this calls for a system resilient to fraud. Some measures may reduce emissions, but are hard to measure. Reductions must therefore be verifiable. This means that the process for measuring, reporting, verifying, and evaluating (MRVE) measures and future emissions must be highly robust and be checked by an independent, impartial third party. The insure impartiality, the direct relationship between activity proponents and DOEs should be abolished. Instead, the SDM supervisory body should contract with DOEs, with fees raised from activity proponents.

Recommendation:

- Shift the contractual relationship with DOEs from activity proponents to the SDM supervisory board, to be financed by fees raised from activity proponent fees.

Additionality: The CDM and JI have shown that testing for additionality – comparing against a counterfactual reality that will not occur – is complicated, controversial, subjective and has likely resulted in the approval of many non-additional projects. This is one of the most important aspects that the SDM must improve on. With technological progress and the changing costs of different options to reduce emissions, what may or may not happen in the future is a moving target. What may have once been declared to be additional may no longer be additional in a few years. Technologies that are clearly non-additional should be excluded from the SDM from the start, using a negative list. Further, crediting baselines should be conservative, updated, based on sectoral standardized benchmarks that take national policies into account. Further crediting periods should be limited and regularly reviewed to account for technological progress through time in different contexts.

Recommendations:

- Exclude technologies with a low likelihood of additionality via a negative list.
- Develop conservative, updated, standardized baselines based on sectoral benchmarks appropriate to the local context of the mitigation activity including national policies and relevant NDC action.
- Limit and review crediting periods to account for the working life of technologies and changes in additionality due to technological progress through time.

Leakage and Permanence: Measures implemented under the SDM to reduce emissions should also not ‘leak’ or lead to increased emissions elsewhere. This is a notable problem with efforts to reduce deforestation. Beef, soy, palm oil, and wood products cause more than half the world’s deforestation in tropical countries. Global supply chains for these commodities means that if they are not sourced in one country because of forest protection measures, they will come from another leading to deforestation elsewhere, and no overall reduction in deforestation or emissions.

SDM measures undertaken to generate reduction units must also be permanent and not be able to re-release stored emissions later in the future, otherwise the measure was futile and has allowed additional emissions in the meantime. This is an issue with carbon temporarily stored in plants and with carbon capture and sequestration (CCS). Plants may be cut down, they may burn up, or just rot and decay. If carbon from CCS is not well ‘sequestered’ it can also be re-released.

Recommendation:

- Exclude activities for which global leakage cannot be measured and temporary sinks, such as REDD and forestry credits, from eligibility under the SDM.

Robust governance for the SDM

The SDM is to be “supervised by a body designated by the COP serving as the meeting of the Parties to the Paris Agreement” (CMA). Here, rules will also need to be established for transparent and robust governance. As the supervisory body should serve a technical scientific function, it should be as transparent and depoliticised as possible. This was a further problem with the CDM Executive Board that should be improved with the Paris Agreement.

Recommendations:

- Invite nominations from civil society for membership in the body designated by the CMA to supervise the mechanism to foster impartiality.
- Hold stakeholder consultations for the elaboration of the SDM, make future meetings of the SDM supervisory body open to observers and the public, and publish documentation for all activities carried out under the SDM.

Supporting sustainable development and human rights

Climate change action, sustainable development, and human rights are all part of the same package and feature prominently in the preamble. Reiterated again in the Article 6 chapeau and the specific paragraph establishing the SDM, parties have made it clear that sustainable development is a prominent defining feature of the mechanism. Although the CDM also had such a goal, the lack of a defining framework and patchwork of interpretation led to highly variable results, at worst detrimental to human and ecological wellbeing.

In 2015, parties not only negotiated the Paris Agreement, but also set new [Sustainable Development Goals](#) (SDGs) applicable to all countries. Climate action is one of these goals, as are human rights issues such as reduced inequalities; peace, justice, and strong institutions; good health and well-being; quality education; and gender equality. The pursuit of climate action can have many sustainable development co-benefits and should not undermine others. It is important that in elaborating how the SDM works, parties improve on and learn from the CDM's mistakes and take advantage of the new global SDG framework to interpret what sustainable development is when implementing mitigation activities. Public and private entities participating in the SDM should report on their contributions to the SDGs appropriate to the local country context. Buyers of units from the SDM should express a preference for and give priority supporting activities with sustainable development co benefits.

Recommendations:

- Require public and private entities participating in the SDM to monitor and report activity co-benefits towards the achievement of the UN Sustainable Development Goals and how they apply relevant human rights law.

Similarly, the SDM must fundamentally improve on the CDM and should have a rights based approach with effective stakeholder consultation. Many multilateral institutions active in climate finance on the ground have now adopted clear social and environmental safeguards, a practice the CDM has not caught up with. Social and environmental safeguards are a major aspect lacking in the CDM that should be a key improvement in establishing the SDM. For instances where implementation varies from proposals and causes negative consequences, it is important that affected people have an avenue for redress through an international grievance mechanism.

Recommendations:

- Require local stakeholder consultations in a manner that protects the right to full and effective participation of affected peoples and communities for activities conducted under the mechanism.
- Establish robust environmental and social safeguards in line with international best practice for multilateral climate finance institutions.
- Establish an institutional grievance process at the UN level to provide a means of recourse for people and communities affected by the projects with the power to revoke activity letters of approval.

Contact Information:

Aki Kachi – International Policy Director

Aki.kachi@carbonmarketwatch.org

Kelsey Perlman – Policy Officer, Aviation and Land Use

Kelsey.perlman@carbonmarketwatch.org

Juliane Voigt – Policy Officer, Sustainable Development

Juliane.voigt@carbonmarketwatch.org



This project action has received funding from the European Commission through a LIFE grant. The content of this section reflects only the author's view. The Commission is not responsible for any use that may be made of the information it contains.

