Market Mechanism Positions on the Way to Paris

Elements of the debate on market mechanisms and their influence on the Paris Agreement

Input paper based on the first work package of the Research Project "Analyse der Wechselwirkungen zwischen Neuen Marktmechanismen und Emissionshandelssystemen" (FKZ 3714 41 506 0)

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On behalf of the German Umweltbundesamt (UBA)

February 2016

INPUT PAPER

Introduction

The Paris Agreement is hailed as an amazing diplomatic success and a major step forward for global climate policy both in general and specifically with respect to the development of carbon market mechanisms under Article 6. Such a strong anchor for market mechanisms in the multilateral agreement was not a foregone conclusion and previous negotiations on the Framework for Various Approaches (FVA), the New Market Mechanism (NMM) as well as in the Durban Platform for Enhanced Action (ADP), had made little progress on the multilateral level since the Parties asked the SBSTA to elaborate modalities and procedures for the new market mechanism in Doha. At the same time, various countries and notably the World Bank have made considerable efforts to foster carbon markets initiatives, promoting further work on market development from the bottom up. With the strong anchoring language of Article 6 in the agreement, market promotors now need to strategically take stock of the situation, the compromises made, the extent to which parties' positions have changed, and how the various bottom-up initiatives fit together in order to effectively influence carbon market developments through 2020 and thereafter. To this end, we track some of the main elements of the debate on market mechanisms to form a basis to understand, analyse, and foster a discussion on the Paris compromise of Article 6 and what it means for the future of carbon markets.

The status of market mechanisms in the negotiations before Paris

For the period after the expiry of the (first) commitment period of the Kyoto Protocol after 2012, negotiating a global successor and anchoring a strong role for markets has been an arduous process filled with fits and starts, before a stalemate prevailed over the past few years:

- The COP 13 Bali Action Plan established the Ad-Hoc working group on Long-Term Cooperative Action under the Convention (AWG-LCA) as a subsidiary body for GHG mitigation actions to work on "various approaches, including opportunities for using markets, to enhance the cost-effectiveness of, and to promote, mitigation actions" (UNFCCC/CP/2007/6/Add.1).
- At COP 16 in Cancun, Parties decided "to consider the establishment (…) of one or more market-based mechanisms to enhance the cost-effectiveness of, and to promote, mitigation actions" (UNFCCC/CP/2010/7/Add.1).
- The COP 17 Durban Decisions emphasized that "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". A New Market Mechanism was also defined "operating under the guidance of and authority of the COP to enhance the cost effectiveness, and to promote, mitigation actions" (UNFCCC/CP/2011/9/Add. 1).
- At COP 18 in Doha, Parties requested the Subsidiary Body for Scientific and Technological Advice (SBSTA) to conduct a work programme drawing on the work of the AWG-LCA to elaborate a framework for such (various) approaches, to conduct a work programme to elaborate non-market-based approaches, as well as to elaborate modalities and procedures for the new market mechanism defined in Durban (UNFCCC/CP/2012/8/Add.1).

Between Doha and Paris, no substantive progress had been made in the elaboration of a work programme for either a Framework for Various Approaches or a New Market Mechanism in the SBSTA. The role of markets was still uncertain in the future Paris Agreement and Parties were reluctant to continue on their elaboration in SBSTA without a clearer market reference in the future agreement to show how it would be used. At the same time, various countries blocked discussions on markets in the ADP, for example in the ADP2-7 in Lima in

2014[1], when Algeria for the Arab Group and China said sections on market and non-market approaches could prejudge discussions under the SBs[2]. This had led to a stalemate in the subsidiary bodies[3] pending progress and references to markets in the Paris Agreement.

Positions on markets going into Paris

A reflection of the previous negotiations, there was a broad spectrum of views on including market provisions in the Paris Agreement. The conflicting positions led few major interested parties to expect a compromise, possibly meaning that markets would be left out of the agreement. A plurality of Parties agreed that market and non-market based mechanisms should be eligible for use to fulfil Intended Nationally Determined Contributions (INDCs) goals, but there was no consensus on the exact formulation of market provisions and the extent to which markets should be centrally overseen and accounted for.

The EU, the EIG and Norway were and are the strongest market advocates for the development of a mechanism with strict rules to be developed under the auspices of the UNFCCC. The EU placed particular importance on language clarifying what double counting means when it comes to transfers; and the inclusion of an “own contribution” related to issues of moving beyond offsetting (a position supported by AOSIS). Further, the EU called for mentioning aviation and maritime emissions as part of Article 6. The Umbrella group, notably the US, Japan, and New Zealand, are also important advocates for markets, but see the UNFCCC as having more of an advisory and perhaps at most a coordinating role across a number of mechanisms. Umbrella members put an emphasis on bilateral initiatives, hold that they do not need “permission” to use markets to fulfil their contributions/commitments, and resist a strong multilaterally controlled accounting framework. New Zealand was perhaps the strongest market advocate and decided to coordinate a ministerial declaration on carbon markets[4] as a potential substitute for an expected lack of political signal in the Agreement itself. Concerns of what various double counting provisions could mean for the necessity of ratification of the Agreement, the US especially resisted prescriptive language on double counting.

AILAC supports a more centralized approach to multilateral oversight but is not an avid advocate and has applauded that many Annex 1 countries intend to fulfil their commitments without the use of international markets. AOSIS members were largely open or neutral with regard to provisions for markets in the Paris Agreements, although they clearly have a preference for centralized oversight in the design and use of any such mechanisms with the SIDS (the membership of which overlaps significantly with AOSIS) call for any mechanism to move beyond pure offsetting and for such a mechanism to help raise funds for adaptation in countries worst affected by climate change.

ALBA has consistently opposed to the use of markets in the Paris Agreement, and although other groups do not always exactly support ALBA’s views, similar opposition often comes from the Arab Group, various African Group members, Russia and China. The Like Minded Group is not necessarily united on the issue of markets, but members (a mix of various AL-

[1] International Institute for Sustainable Development - IISD (2014). Market and Non-Market Mechanisms Under the Convention. Earth Negotiations Bulletin 14 December 2014. Pg. 25

[2] IISD (2014). Ad Hoc Working Group on the Durban Platform for Enhanced Action. Earth Negotiations Bulletin 14 December 2014. Pg. 38.

[3] SBSTA 42 also failed to reach any conclusions. See IISD (2015). Subsidiary Body for Scientific and Technological Advice. Earth Negotiations Bulletin 14 June 2015. Pg. 21

[4] The declaration can be found here: https://www.mfe.govt.nz/sites/default/files/media/Ministerial-Declaration-on-Carbon-Markets.pdf

BA, BASIC, Arab Group, African Group Members and others) are generally at least sceptical if not hostile to markets. Specifically, Bolivia's main focus was on a framework for non-market mechanisms, while Venezuela and the Arab Group aimed to block any decision on markets whatsoever.

BASIC countries, while to some extent open to market mechanisms, were not generally advocates for their inclusion in the Paris agreement and have expressed the view that non-market based approaches should be on equal standing with a market mechanism. Brazil stressed that a mechanism in the Paris Agreement must be based on top-down accounting rules separate from NDCs with a focus on a successor to the CDM. Further, Brazil was intent on excluding forestry from markets and flatly against bilateral and voluntary emissions trading schemes, and was rather an advocate for an Economic Mechanism (EM) under the PA as a complementary tool, comprised of general guidelines related to an enhanced CDM (CDM+) while resisting any inclusion of an "own contribution" under such a mechanism. South Africa, while not otherwise a strong advocate for markets in general, called for including a sustainable development aspect under any new mechanism (resisted by EU and the US).

LDC's are generally not as critical as ALBA and the Arab Group, but are also generally not strong advocates. Though the LDCs note that while most action must be achieved domestically[5], markets could sometimes be used and that any market mechanism must ensure LDC access and have direct international verification and oversight.[6] The African Group and LDCs (which overlap with each other) also called for a share of proceeds to go to LDCs and adaptation, although notably Senegal joined New Zealand in its Ministerial Declaration. The Least Developed Countries (LDCs) in their submission in 2013[7] was cautious of a NMM: 'full implications of the introduction of a NMM must be properly considered before its establishment'.

The Coalition of Rainforest Nations led by Panama called for a clear inclusion for forestry and sinks and resisted Brazils positioning.

Using markets at home: the role of markets in INDCs

Parallel to the multilateral level and erstwhile stalemate, there has been and is a great deal of momentum when it comes to markets in a primarily domestic context and such developments are not necessarily consistent with countries' international negotiating positions. A survey of the role of such mechanisms in INDCs further illustrates that advocacy for the inclusion of markets does not necessarily correspond with the actual use of markets – either domestically on the national level or internationally.

While Norway, the EIG, and New Zealand all are strong advocates for the use of markets, use markets at home, and intend to use international markets in the post 2020 period; the EU and the USA which are also both advocates for provisions for market use internationally, do not intend to use international markets to meet their INDC targets after 2020. Several countries intend to use or are open to participating in international markets although they do not use emissions trading programs at home. These include Japan, many LDC's and many African Group members. ALBA group members neither intend to use international markets nor intend to use market based approaches domestically. AILAC members are divided with

[5] IISD (2014). ADP 2-4 Summary. Earth Negotiations Bulletin. 17 March 2014. Pg. 11

[6] IISD (2014). ADP 2-4 Summary. Earth Negotiations Bulletin. 17 March 2014. Pg. 11

[7] IISD (2014). ADP 2-4 Summary. Earth Negotiations Bulletin. 17 March 2014. Pg. 11

some participating and exploring markets internationally and domestically and some neither using markets internationally or domestically.

Based on an analysis of the 129 INDCs submitted by 5 November 2015, 62 Parties are planning to use international market mechanisms while 20 are considering their use.[8] While the number (86 out of 129) is quite high, most are aspirant sellers in the carbon market and are mostly low-income countries who have limited experience with existing market mechanisms.

Only thirteen Parties explicitly consider buying units: Canada, Costa Rica, Japan, Liechtenstein, Mexico, Moldova, Monaco, New Zealand, San Marino, Singapore, Switzerland, South Korea and Turkey; most of these potential buyers are not significant emitters. None of the seven largest global emitters intend to use international markets to fulfil their INDCs, which means that at present, there is no significant prospective demand for an international market mechanism. Of those who may use international market mechanisms, most do not specify what mechanism(s) they intend to use.

Many countries are working on market based approaches to climate change mitigation. Many countries would be interested in being a source of units to be sold internationally, and while several countries have expressed the intention or have reserved the option to use markets in reaching their declared INDC goals, they do not account for a large share of global emissions. The use of markets internally or willingness to participate in a potential future market mechanism is not necessarily reflected in these countries' negotiating positions in the UNFCCC.

Complementing efforts: promoting markets through diverse initiatives

For countries interested in using and promoting markets, there are several initiatives parallel and perhaps complementing the international negotiations and a great deal of effort and resources being invested in fostering market development in various countries. In many cases, these initiatives seek to complement the international climate governance structure in developing both cap-and-trade / emission trading programs, baseline and credit programs, and offset approaches increasingly tied to a carbon tax. Notable initiatives include those of the World Bank (Partnership for Market Readiness (PMR), Networked Carbon Markets), the International Carbon Action Partnership (ICAP), and the G7 Carbon Markets Platform. These initiatives have provided multiple high level opportunities to discuss the role of markets in the future even if there had been no concrete proposal on markets in the Agreement.

In terms of concrete country impact, resources invested, as well as process duration, the PMR is likely the most influential initiative to date promoting a broad agenda of market based instruments. The PMR supports emerging economies and developing states in their efforts to develop and pilot various carbon pricing mechanisms, e.g. domestic emissions trading systems (ETS), scaled-up crediting mechanisms, or carbon taxes. Large-scale support is provided in the form of grant funding and technical assistance. For example, China has been allocated $8 million to design and prepare a national ETS, including for work on cap setting, allocation, MRV, mechanisms for price containment, market oversight, and a legal frame-

[8] Submitted INDCs are available online at http://www4.unfccc.int/submissions/INDC/Submission%20Pages/submissions.aspx for a further summary see Obergassel and Gornik (2015) http://www.carbon-mechanisms.de/fileadmin/media/dokumente/publikationen/PB-INDCs-Markets-UPDATE_fin.pdf

work. South Africa has been allocated $5 million to refine design features of the proposed carbon tax and complementary offset mechanism, as well as strengthen MRV capacity.[9]

Other initiatives such as ICAP (focusing on linking ETS) offer a discussion platform and capacity developments approaches in a mutual learning context but is narrower in scope and focus on more specific issues. Several other recent initiatives (Networked Carbon Markets, Carbon Pricing Leadership Initiative, the G7 Carbon Markets Platform) aim to provide additional fora or capacities to discuss recent developments such as the discussion on carbon pricing.

The Paris Compromise

The inclusion of the provisions establishing the framework for market-based approaches in the text of the Paris Agreement was possible thanks to several major developments in the negotiation process, notably based on the joint Brazilian-EU proposal released well into the COP 21 on 8 December, which then became the basis for further negotiations and compromise.[10] The final Article 6 lays out a number of provisions cooperative approaches involving internationally transferred mitigation outcomes (6.2); and a centralized mechanism (6.4) for transferring emissions reductions developed within the UNFCCC. The compromise bridged the various positions on the centralised coordinating role of the COP/CMA (Conference of the Parties serving as the Meeting of the Parties to the Agreement), a move beyond pure offsetting, conditions for sustainable development, that trading be voluntary and subject to mutual agreement of Parties, forestry, sustainable development, a provision of the proceeds on trading, and as well as a number of others negotiated in bilateral meetings and informal informals. Further, Article 6 places a framework for non-market mechanisms on equal footing with (market) mechanisms and cooperative approaches

It was significant that the compromise came out of a joint proposal between Brazil and the EU, representing two different negotiating groups with different interests. Brazil's concerns' of subnational trading occurring without national government approval and that forestry not be included in trading was addressed by the provision that trading be "voluntary and authorized by participating Parties", while forestry is not explicitly mentioned in Article 6, rather only "sinks" in decision 37. For cooperative approaches, the final draft "promotes" sustainable development (as per South Africa), but does not "require" it as a criteria (as per the Umbrella Group). Further, such cooperative approaches "shall apply" robust accounting (as per EU, EIG); "consistent" with guidance under the CMA (but could allow for cooperative approaches if guidance is not provided). The EU got its wanted provisions on own contribution in the provision "to contribute to the reduction of emission levels in the host Party" and net mitigation in the provision "to deliver an overall mitigation in global emissions". LDC's have their "share of the proceeds" for "[assistance] to developing country Parties that are particularly vulnerable.

A further success was the ability to include the negotiating positions of the countries that were either cautious about (e.g. AILAC, Russia) or consistently opposed to (ALBA, Arab Group members, some African Group members and the Like Minded Group) the use of market-based mechanisms. The proponents of the non-market approaches (most importantly Bolivia) were willing to relent on their opposition to markets as long as market approaches were clearly voluntary and Non-Market Approaches were given equal footing.

[9] Partnership for Market Readiness (2015), Summary of Implementing Country Participants' PMR Activities, November 2, 2015, p. 2, 4.

[10] European Commission, DG CLIMA (2015), EU and Brazil agree ground breaking proposal on carbon markets at Paris climate talks http://ec.europa.eu/clima/news/articles/news_2015120804_en.htm

Post Paris, through 2020 and thereafter

The development of multilateral UNFCCC rules, modalities, and procedures for Article 6 of the Paris Agreement will advance in a highly dynamic field parallel to, and interacting with, domestic and international initiatives on various levels and notably a framework for non-market approaches. While according to current INDC's there is a lack of significant demand, provisions to ratchet up ambition in five year cycles and successful, and robust elaboration on Article 6, combined with strategic support of bottom up efforts may yet potentially have the potential to provide the building blocks for a global carbon market after 2020. Still, a number of important issues and questions need to be addressed including: What conflicts are left for future negotiations? What will future mechanisms actually look like? What exactly should Article 6 accomplish? What should be done with existing flexible instruments? What are the next priorities to be tackled next, what later, by when? This workshop welcomes your views on these questions, many others, and how to interpret the various provisions of Article 6 in order to contribute to these future developments with robust accounting and environmental integrity.

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