NEW 'MARKET MECHANISMS' – NO NEW FINANCE FOR FORESTS

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Acronyms

AOSIS	Alliance of Small Island States
BAU	business as usual
CDM	Clean Development Mechanism
CfRN	Coalition for Rainforest Nations
CMIA	Climate Markets and Investment Association
COP	Conference of the Parties
ETS	Emissions Trading Scheme
EU	European Union
FVA	Framework for Various Approaches
GFC	Global Forest Coalition
GHG	greenhouse gas
IPCC	Intergovernmental Panel on Climate Change
JI	Joint Implementation
LDCs	Least Developed Countries
MRV	measurement, reporting and verification
NAMA	Nationally Appropriate Mitigation Action
NGO	non-governmental organisation
NMM	New Market Mechanism
QELRO	Quantified Emission Limitation or Reduction Objective
REDD+	Reducing Emissions from Deforestation and Forest Degradation
SBSTA	Subsidiary Body for Scientific and Technological Advice
UNEP	United Nations Environment Programme
UNFCCC	United Nations Framework Convention on Climate Change
WGBU	German Global Advisory Council

Introduction

The establishment of new market mechanisms under the Convention has grown out of discussions under the Bali Action Plan (BAP) on various approaches to enhance the cost-efficiency of mitigation actions. New market mechanisms were 'considered' and 'defined' in the Cancun and Durban decisions, and a work programme on non-market approaches was established in the Doha decision.[1] Yet the establishment of new markets under the Convention, whether under the Framework for Various Approaches (FVA) or the New Market Mechanism (NMM) remains contentious. The Philippines have noted that the Convention is inherently a non-market approach, and the discussions around markets are about introducing market mechanisms under the Convention, which represents new responsibilities for developing country Parties.[2] For other Parties, such as the EU and Norway, progress on the FVA and NMM remains a key outcome for the Conference of the Parties (COP) 19 in Warsaw in November 2013.[3] At COP 18 in Doha, many Parties – including China, Brazil, India, South Africa, Ecuador, Bolivia, Grenada and Venezuela – were reluctant to move forward on the NMM, expressing concerns about defining the NMM when there is no agreement on what this is in practice.[4]

There is much opposition to the use of market mechanisms under the Convention, and little real-world evidence to substantiate the oft-repeated claim that carbon markets are the most cost-effective way to reduce emissions. The climate crisis has now reached what can be described as a 'planetary emergency', with GHG emissions increasing globally – recently crossing the 400ppm threshold – already well beyond levels considered safe for a stable climate system.[5] Current pledges are expected to lead us to a world of 4–6˚-C warming compared to pre-industrial temperatures, with catastrophic outcomes.[6]

In this context, it is hardly surprising that recent submissions on the FVA and the NMM have contained a range of views from Parties and observers, with many questioning the wisdom of pushing forward new markets in the face of lack of demand and the failure of existing markets.[7] Bolivia has called for a moratorium on the establishment of any new markets under the Convention, saying that carbon markets support the constitution of a new global right – the right to pollute – and contradict environmental integrity and the basic science of climate change.[8]

A broad coalition of NGOs concur with Bolivia, concluding in their submission that 'given the urgent need to reduce emissions, the centrality of the markets discussion under the UNFCCC is distracting, dangerous and irrelevant at this critical moment.'[9] This report gives an overview of developments around market mechanisms in the climate negotiations, and analyses the potential for effective mitigation and raising climate finance from these mechanisms, with a particular focus on forests.

CARBON MARKETS SUPPORT THE CONSTITUTION OF A NEW GLOBAL RIGHT – THE RIGHT TO POLLUTE...

1 Decision 1/CP.16 para 80 agrees to consider the establishment, at CP.17, of one or more market-based mechanisms. Decision 2/CP.17 para 83 defines, but does not establish, an NMM. Decision 1/CP.18 para's 44, 47 and 50 request SBSTA work programmes on the FVA, non-market approaches and the NMM respectively.

2 TWN Bonn News Update (3-14 June 2013) no 27. http://www.twn.my/title2/climate/bonn.news.11.htm

3 See Party submissions on FVA and NMM (25 march 2013) at: http://unfccc.int/documentation/submissions_from_parties/items/5901.php

4 Personal notes, 4 December 2012, contact group on FVA, COP 18.

5 See: 400ppm from 350.org http://400.350.org/#1

6 See: Kevin Anderson, Climate Change, going beyond dangerous – Brutal numbers and tenuous hope, in Development Dialogue September 2012 | What Next Volume III | Climate, Development and Equity. http://whatnext.org/resources/Publications/Volume-III/Single-articles/wnv3_andersson_144.pdf

7 See http://unfccc.int/documentation/submissions_from_parties/items/5901.php and http://unfccc.int/documentation/submissions_from_observers/items/7482.php for Party and observer submissions on markets (25 March 2013); and http://climatemarkets.org/blog/a-wake-for-carbon-offsets-but-will-lessons-be-learned-for-climate-finance.html for news on carbon markets and climate finance.

8 TWN Bonn News Update (3-14 June 2013) no 18. http://www.twn.my/title2/climate/bonn.news.11.htm

9 See NGO submission at http://unfccc.int/resource/docs/2013/smsn/ngo/338.pdf

Purpose and scope of the FVA

The work programme on the FVA aims to arrive at a decision in Warsaw, yet recent discussions at SBSTA 38 failed to resolve the purpose and scope of the FVA, with wide divergences. While some Parties see the FVA as a broad framework to guide market and non-market approaches under the Convention, others, including the European Union, Norway, Australia, the US and Japan see the FVA as a framework to create guidance for international aspects of domestic emissions trading systems, providing UN oversight for internationally traded units used for compliance under the Convention.[10]

The Alliance of Small Island States (AOSIS) have cautioned against the risk of market fragmentation in this context, saying that the FVA should be limited to a regulation and coordination mechanism to develop common accounting frameworks for markets under the Convention and under the Kyoto Protocol (KP), without providing oversight of markets developed outside the Convention. AOSIS says that this will lead to a fragmented and decentralized approach to the use of international offset units[11] – with each trading system adopting a different definition of what counts as 'a ton of carbon', it would be impossible to ensure the environmental integrity of such a scheme.[12]

Several developing countries, including the Philippines, Brazil, China, Tuvalu and Senegal on behalf of LDCs, have emphasised that it is important to focus on the purpose of the framework and the scope of the approaches to be included, before undertaking detailed work. [13] Saudi Arabia noted that this agenda item was introduced in the Bali Action Plan (BAP) to meet the objective of the Convention, meaning that the purpose of the FVA should be to enhance the implementation of the Convention. Malaysia and Bolivia suggest that the purpose should be to establish the criteria to assess the eligibility of approaches, not only focusing only on markets.[14]

By the end of SBSTA 38, there was still no agreement on the purpose and scope of the FVA. In the final negotiating session in Bonn, while the United States, Australia, the EU and others said they would like to adopt the text "in the spirit of compromise", and Norway emphasised the need to move forward, many countries felt that the questions presented in the draft conclusions for Warsaw prejudged the outcomes. Bolivia, Venezuela, the Philippines and Tuvalu felt there was a lack of balance in the text generally, emphasising the need to focus on purpose and scope, and not move ahead with prescriptive questions prematurely, calling for a more balanced debate between market and non-market approaches, and a clear understanding of how the purpose and scope of the FVA relates to raising ambition.[15]

...MANY COUNTRIES FELT THAT THE QUESTIONS PRESENTED IN THE DRAFT CONCLUSIONS FOR WARSAW PREJUDGED THE OUTCOMES.

10 TWN Bonn News Update (3-14 June 2013) no 18. http://www.twn.my/title2/climate/bonn.news.11.htm
11 TWN Bonn News Update (3-14 June 2013) no 18. http://www.twn.my/title2/climate/bonn.news.11.htm
12 See Oscar Reyes (2-13) A wake for carbon offsets. http://climatemarkets.org/blog/a-wake-for-carbon-offsets-but-will-lessons-be-learned-for-climate-finance.html
13 TWN Bonn News Update (3-14 June 2013) no 27. http://www.twn.my/title2/climate/bonn.news.11.htm
14 TWN Bonn News Update (3-14 June 2013) no 18. http://www.twn.my/title2/climate/bonn.news.11.htm
15 TWN Bonn News Update (3-14 June 2013) no 27. http://www.twn.my/title2/climate/bonn.news.11.htm

Purpose and structure of the NMM

The purpose of the NMM, as stated in the Cancun and Durban decisions, is to promote cost-effectiveness in emissions reductions and provide comparability in mitigation actions, ensuring a net decrease and/or avoidance of global greenhouse gas (GHG) emissions and assisting developed country Parties to meet part of their mitigation targets. The EU and Norway suggest that enhancing the cost-effectiveness of mitigation actions will lead to an increase in the overall level of ambition.[16]

In terms of structure of the NMM, Norway and the EU are closely aligned in their vision of an NMM as a centralised market operating under the authority of the COP, replacing the existing project-based mechanisms with a mechanism that covers broad sectors of developing country economies. In this context the EU reiterates support for the Least Developed Countries (LDCs) to participate in the Clean Development Mechanism (CDM), but states that countries with the necessary capacity should move towards participation in the NMM and ultimately in cap-and-trade systems.

Other countries, notably those moving ahead with their own domestic emissions trading schemes, such as Australia, New Zealand and the US, are supportive of a divergent approach, outlining a model for the NMM which makes it difficult to differentiate from the FVA. They envisage an NMM in which national and other emissions trading schemes can meet agreed 'guidelines', in order for credits from these systems to be eligible for international trading for compliance purposes against UNFCCC commitments. Other Parties wanting to minimise UN oversight and maximise flexibility include Saudi Arabia, Tunisia and Japan.

The Doha decision contains a list of agreed elements for the NMM,[17] including its operation under the authority of the COP; voluntary participation; the concept of a net decrease of greenhouse gas emissions; and avoiding double-counting. These guiding elements are open to a range of interpretations, raising new concerns such as the expansion of carbon markets to include forests and other land-based emissions (element d), and the concept of *net* reductions as a way of moving beyond offsetting (element c). These concerns are discussed in greater detail below in the context of forests and the NMM.

Sectoral trading and crediting

While diverging views mean that the form and structure of a possible NMM remain undecided, one key distinction in the approaches under discussion is between sectoral and project-specific approaches. The NMM is generally understood to go beyond the project-by-project approach used in the CDM and JI, and to 'scale up' to cover economy-wide sectors. The EU has made several submissions detailing sectoral crediting and trading systems, and suggests that for both, 'New Reduction Units' would be issued which Parties could use for compliance with emission reduction obligations under the Convention.[18] China, on the other hand, supports a project-based crediting mechanism, and argues that the NMM should not replace the market-based mechanisms under the KP.[19] AOSIS and CfRN advocate an approach that allows units generated from either sectoral or project-based mechanisms to be eligible for compliance purposes under the Convention and the second commitment period of the KP.[20]

The three main proposals currently on the table are sectoral crediting, sectoral trading, and project-based (or installation-based) crediting.

- **Sectoral crediting:** emissions reductions are generated and verified before credits are issued, meaning that credits are issued *ex-post*. The Norwegian submission stated that credit units would be issued only if the sector as a whole reduces emissions beyond the established crediting threshold. This creates problems for the

16 See Party submissions on FVA and NMM (25 march 2013) at: http://unfccc.int/documentation/submissions_from_parties/items/5901.php

17 Decision 1/CP.17 para 51: Elements of the SBSTA work programme on NMM: (a) Its operation under the guidance and authority of the Conference of the Parties; (b) The voluntary participation of Parties in the mechanism; (c) 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; (d) Requirements for the accurate measurement, reporting and verification of emission reductions, emission removals and/or avoided emissions; (e) Means to stimulate mitigation across broad segments of the economy, which are defined by the participating Parties and may be on a sectoral and/or project-specific basis; (f) Criteria, including the application of conservative methods, for the establishment, approval and periodic adjustment of ambitious reference levels (crediting thresholds and/or trading caps) and for the periodic issuance of units based on mitigation below a crediting threshold or based on a trading cap; (g) Criteria for the accurate and consistent recording and tracking of units.

18 See EU submission at: http://unfccc.int/files/documentation/submissions_from_parties/application/pdf/nmm_eu.pdf

19 See presentation from China at SBSTA workshop on NMM, Bonn, 19 May 2012: http://unfccc.int/files/bodies/awg-lca/application/pdf/20120518_china_2100.pdf

20 See submissions at: http://unfccc.int/documentation/submissions_from_parties/items/5901.php

private sector, which prefer to invest in individual installations rather than risk non-performance across an entire sector. The sectoral approach would reduce operating costs compared to a project-by-project CDM approach, but rules out many vulnerable countries and LDCs from having the capacity to participate in such a mechanism. A crediting approach also requires countries to invest in achieving verified emissions reductions before they can trade these for finance – another barrier to entry for poorer countries.

- **Sectoral trading:** allowances are issued *ex-ante*, to be traded among installations at completion of the crediting period (ETS model). An emissions cap is established per sector, with allowances traded between those who are under or over the cap. A trading scheme based on allowances, such as the EU ETS, is more efficient than a crediting mechanism, but it also requires significantly greater institutional capacity, both to enable effective enforcement, policing and monitoring of the scheme, and to distribute allowances via auctioning or other allocation methods. Developing countries face major capacity constraints in implementing sectoral trading, given that the EU has not managed to avoid the pitfalls of over-allocation, fraud and price collapse in its own ETS.[21] Norway has suggested that governance levels could vary between the crediting and trading tracks.[22]

- **Project-based crediting:** credits are issued *ex-post* to individual projects or installations, which show emissions reductions relative to a baseline which is established for defined project boundaries (the CDM model). This is the preferred approach for the private sector, with the Carbon Markets Investors Association (CMIA) stating that individual installations should be rewarded for compliance, to avoid the non-compliance of some installations affecting others.[23] Additionality and leakage have proved to be obstacles to achieving genuine emissions reductions under project-based approaches.

AOSIS and LDCs are calling for existing rules and eligibility criteria under the KP to be applied to any new markets under the Convention, stating that an international framework for market mechanisms already exists under the KP.[24] The Philippines has said that markets are outside of the Convention, and introducing elements from the KP flexible mechanisms into the Convention represents new responsibilities for developing countries, with several other Parties raising concerns during SBSTA 38 that the NMM should not shift the mitigation burden to developing countries.[25]

In the face of failing carbon markets and spiraling climate change, Bolivia has called for a moratorium on market mechanisms under the Convention. Conservation organisations such as WWF, usually supportive of a market-based approach to mitigation, have noted that the current low levels of ambition give little or no justification to establish an NMM or any other market-based approach, and they have warned that they will oppose the NMM if it repeats the failures of the existing carbon markets and broadens the already huge gap between the low pledges made, and the steep emissions reductions needed.[26] Many other Parties emphasised the need to establish linkages between the possibility of a NMM and an increase in Annex 1 mitigation ambition, and the need to review the collapse of the current carbon market, including China, India, Tuvalu, Saudi Arabia, Bolivia and Cuba.[27]

...THE CURRENT LOW LEVELS OF AMBITION GIVE LITTLE OR NO JUSTIFICATION TO ESTABLISH AN NMM...

21 EU ETS myth busting: Why it can't be reformed and shouldn't be replicated. April 2013, http://www.fern.org/EUETSmythbusting
22 See Norwegian NMM submission: http://unfccc.int/files/documentation/submissions_from_parties/application/pdf/nmm_norway.pdf
23 See CMIA NMM submission: http://unfccc.int/resource/docs/2013/smsn/ngo/336.pdf
24 TWN Bonn News Update (3-14 June 2013) no 18. http://www.twn.my/title2/climate/bonn.news.11.htm
25 TWN Bonn News Update (3-14 June 2013) no 27. http://www.twn.my/title2/climate/bonn.news.11.htm
26 See WWF NMM submission: http://unfccc.int/resource/docs/2013/smsn/ngo/342.pdf
27 TWN Bonn News Update (3-14 June 2013) no 18. http://www.twn.my/title2/climate/bonn.news.11.htm

Forests and the NMM

There is some convergence of discussion on forests and the NMM, with several submissions (CfRN, US, Indonesia) referring to REDD+ as one possible sector for piloting of the NMM. The wording of element (d) in the Doha decision on the NMM (see footnote 17), which refers to the MRV of emissions removals and avoided emissions as well as emissions reductions, also opens the NMM up to emissions from the land-use sector. This raises questions regarding the appropriateness of different sectors for emissions trading mechanisms.

The WWF submission states that some sectors are not appropriate for crediting; the CMIA submission points out that only developed economic sectors are eligible for credit issuance/trading, while a submission from the Global Forest Coalition (GFC) and others argues that sectors with dispersed emission sources are not appropriate for market mechanisms. This last point relates to lack of fungibility between terrestrial and fossil emissions. While some Parties argue that 'a ton is a ton' (CfRN submission), regardless of the emissions source and location, the idea that reductions in emissions from the land use sector can compensate for or 'offset' emissions in other sectors is scientifically flawed.[28]

The Coalition for Rainforest Nations (CfRN) have put forward an approach suggesting that the REDD+ mechanism should be defined as part of the NMM, with a pilot phase to be launched at COP19 in Warsaw. They propose that units generated from results-based actions for REDD+ could then be used by developed countries which are Party to the KP to meet their emissions reduction obligations (QELROs) under the second commitment period. The use of NMM units for compliance in the second period of the KP forms part of the Durban outcome,[29] although there has been long-standing resistance to forest credits being eligible for meeting commitments under the KP.

During negotiations at SBSTA 38 in Bonn, the EU noted that market approaches are not always the most cost effective measure, in particular for REDD+, while AOSIS said approaches which do not rely on offsets can allow countries to access finance up-front, and should be used where it is difficult to measure emissions accurately or data is unreliable, such as the forest sector.[30]

Fungibility

The need for full fungibility in emissions units is expressed in several submissions, in particular those from the private sector, but also from the CfRN. This refers to the ability to trade emissions reduction units from different sources and locations. Full fungibility does not currently exist in compliance carbon markets, with forest carbon credits in the CDM subject to strict permanence rules, and excluded from the EU ETS altogether over concerns relating to permanence, leakage and verification.[31]

The enthusiasm of some Parties to include forests in the NMM therefore raises concerns, given the particular problems of quantifying and trading carbon from terrestrial sources. Emissions from land-based sources such as forests and soil are particularly prone to reversal, with fires, drought and climate change itself increasing the risk that terrestrial carbon pools will release CO_2 rather than sequester it.[32] In addition, high levels of uncertainty remain in accounting for terrestrial emissions. For land based carbon sequestration, estimating and measuring uncertainties of 50% or more are common, meaning reductions in emissions are often indistinguishable from errors.[33]

The German Global Advisory Council (WGBU) has stated that, in the long run, fossil fuel emissions cannot be compensated for by the terrestrial biosphere, and has called for emissions from land-use change to be treated separately to emissions generated from fossil fuel combustion.[34] Due to the fundamental difference between carbon pools, if energy-related

28 Mackey et al (2013) Untangling the confusion around land carbon science and climate mitigation policy. Nature Climate Change 3 552-557

29 [1) Decision 1/CMP.7, Annex 3 (proposed amendments to the Kyoto Protocol) - Article 3, paragraph 12 bis allow any units from any mechanism established under the Convention to be used to meet Annex 1 Parties compliance targets under the Kyoto Protocol

30 TWN Bonn News Update (3-14 June 2013) no 18. http://www.twn.my/title2/climate/bonn.news.11.htm

31 See DG Climate Action, http://ec.europa.eu/clima/policies/forests/lulucf/index_en.htm

32 See: Cox et al (2000) Acceleration of global warming due to carbon-cycle feedbacks in a coupled climate model. *Nature* **408** 184-187; Fearnside P (2004) Are climate change impacts already affecting tropical forest biomass? *Global Environmental Change* **14** 299-302; Choat B, et al. (2012) Global convergence in the vulnerability of forests to drought. *Nature* doi:10.1038/nature11688; Friedlingstein P, et al. *(2006)* Climate–carbon cycle feedback analysis: Results from the C4MIP model intercomparison. *J. Climate* **19** 3337–3353, among others.

33 See Pelletier J, et al. (2011) Diagnosing the uncertainty and detectability of emission reductions for REDD+ under current capabilities: an example for Panama. *Environmental Research Letters* **6**

34 Members of the German Advisory Council on Global Change (WBGU), "Solving the climate dilemma: the budget approach. Special Report" (1 November 2008) http://www.wbgu.de/fileadmin/templates/dateien/veroeffentlichungen/sondergutachten/sn2009/wbgu_sn2009_en.pdf

emissions are offset against biological sinks (whether as avoided sources of emissions or sinks), this justifies the combustion of fossil fuels from permanent fossil fuel reservoirs, which have formed over geological periods. Equating permanent fossil fuel sinks with terrestrial sinks, and trading one for the other (permitting higher emissions from the combustion of fossil fuels) brings the risk that the carbon stored in terrestrial ecosystems is released again after only a few decades or centuries.[35]

Permanence

The risk of non-permanence (reversals) is dealt with in CDM forestry projects by issuing temporary credits, which must be replaced on expiration. The temporary nature of these credits provides a disincentive to buyers, resulting in insufficient project revenues. Some Parties (including Australia) are pushing for new approaches to address non-permanence which increase market liquidity, such as the use of buffers and insurance, or reducing the time-frame to ensure permanence. All of these 'solutions' compromise the integrity of emissions reductions, and are done in order to provide fungibility while transferring liability and responsibility for permanence to host countries.

Bolivia's submission on the NMM highlights the scientific and conceptual incongruity of emissions markets with the basic science of climate change, in particular the simplified approach of carbon markets which avoids the reality that different greenhouse gases have different global warming potentials.[36] Mackey et al point out that for land-based emissions reductions to compensate for the burning of fossil fuels, permenance would have to be guaranteed on a time-scale of 10,000 years and more.[37]

'Beyond offsets' – net emission reductions

Given the criticisms of the CDM, and the general recognition of the inability of offsetting to reduce emissions at the speed or scale required, central to discussions to scale up carbon markets, is the claim to move 'beyond offsetting'. The recent UNEP Emissions Gap report suggested that offsets contribute around 1.5 Gt CO_2e to the emissions gap.[38] In the 'beyond offsets' dialogue, the focus is on net emissions reductions and conservative accounting approaches such as crediting thresholds and discount factors, with the EU submission referring to the 'transition from pure offsetting to the generation of net mitigation benefits.'[39]

The concept of a net decrease in emissions has yet to be defined. A net decrease is assumed to have been achieved by setting 'crediting thresholds' which are below the business-as-usual (BAU) baseline, discounting, or other conservative accounting measures which reward less than the measured emission reductions. Conservative accounting alone, however, would likely be insufficient to achieve a

35 See also: Mackey et al (2013) Untangling the confusion around land carbon science and climate mitigation policy. *Nature Climate Change* **3** 552-557

36 See: http://unfccc.int/files/documentation/submissions_from_parties/application/pdf/nmm_bolivia.pdf

37 Mackey et al. (2013) Untangling the confusion around land carbon science and climate mitigation policy. *Nature Climate Change* **3** 552-557

38 UNEP (2012) The Emissions Gap report. http://www.unep.org/pdf/2012gapreport.pdf

39 See EU submission at: http://unfccc.int/files/documentation/submissions_from_parties/application/pdf/nmm_eu.pdf

...CONSERVATIVE ACCOUNTING...ALSO CARRIES THE DANGER OF TRANSFERRING THE MITIGATION BURDEN TO DEVELOPING COUNTRIES, WHILE SIMULTANEOUSLY REDUCING THE FINANCIAL SUPPORT FOR THESE COUNTRIES TO REDUCE EMISSIONS.

'net decrease' in global emissions,[40] given that it would also require the elimination of double-counting, as well as cancelling of units – recognised as politically and technically difficult to achieve.[41]

The concept of conservative accounting, as well as failing to achieve a net decrease in emissions and thereby go 'beyond offsetting', also carries the danger of transferring the mitigation burden to developing countries, while simultaneously reducing the financial support for these countries to reduce emissions.

Discounting

One of the purposes of conservative accounting is to increase confidence in the environmental integrity of carbon credits, by issuing fewer credits than were generated, thereby compensating for any inaccuracies in measurements, baseline setting, leakage or reversals. For example, if a project or action generates 100 tonnes of emissions reductions, but is only rewarded for 40 tonnes (a 60% discount factor), then the risk of overall emissions increasing is reduced. In this scenario, the burden for environmental integrity is borne by host countries that wish to participate in a market mechanism by decreasing income potential.

In order to circumvent this problem, the CfRN submission proposes that discount factors are applied at the point of use, rather than the source of emission reductions. Presumably this would mean that countries purchasing emission reduction units would need to purchase more units than they can actually use for compliance, rather than host countries being able to sell fewer units than they actually verified. In reality this would probably result in a lower price for purchased units, thereby having a similar on the income potential for host countries.

Crediting thresholds

The EU vision of the NMM, and of REDD+, includes a 'crediting threshold,' which is well below a conservatively defined baseline, as one way to achieve 'net emissions reductions'. This requires developing country Parties to significantly reduce their emissions compared to a BAU trajectory before any credits are issued, through a 'crediting baseline' or 'incentive level,' which is set below the BAU baseline. This is conceptually the same as unsupported NAMAs, and puts additional burdens on developing countries (which are expected to meet the gap between the business-as-usual threshold and the crediting baseline with their own resources). The conservative adjustment introduced with a crediting threshold does not mitigate against the difficulty of setting credible baselines, and in practice requires domestically funded developing country mitigation action (termed 'own efforts' by the EU) before credits eligible for international support are produced.

The EU introduced this concept during REDD+ negotiations in Doha, by proposing an incentive level below the (historic) baseline for emissions from deforestation. Many countries found this concept confusing, and rejected it as contrary to past agreements taken under the UNFCCC. The submission by GFC and others warns that conservative accounting standards contravene the principles of the Convention by shifting the mitigation burden, as well as the costs for this burden, on to developing countries.

40 UNFCCC NMM Technical Paper, 24 August 2012. http://unfccc.int/resource/docs/2012/tp/04.pdf

41 Kollmus et al. (2013) New climate mitigation mechanisms: stocktaking after Doha, http://www.infras.ch/e/news/displaynewsitem.php?id=4947

Failure of existing carbon markets

A large group of developing countries, including the African Group, China, the Philippines, India, Tuvalu, Saudi Arabia, Bolivia and Cuba have emphasised the need to learn from the current collapse of carbon markets to inform any discussion on new markets, and to understand the relationship between markets and ambition.[42] There is a need for a fundamental assessment of whether carbon trading can deliver real, effective and additional emissions reductions. Lessons from existing carbon markets show a failure in any significant reduction in emissions or generation of climate finance.

Since its inception the CDM has been subject to a host of criticisms, in particular for its failure to reduce emissions, and its failure to deliver on sustainable development objectives. The inability of CDM projects to prove additionality[43] has meant that the CDM, as an offsetting mechanism, has likely contributed to an increase in global GHG emissions – in the worst-case scenario estimated to be 3.6 Gt-CO_2eq cumulatively by 2020.[44] The move from project-based to sectoral approaches proposed in NMM discussions does not resolve, but risks worsening the potential for increased emissions, due to the greater volumes of emissions reductions involved when scaling up to entire sectors of an economy.

The WWF submission highlights a range of fundamental problems with the CDM, including but not limited to the lack of additionality, lack of sustainable development benefits, human rights violations, unequal regional distribution, lack of technology transfer, lack of cost effectiveness in some instances, perverse incentives and double counting. The submission from GFC et al. reiterates these issues with the CDM, and exposes further problems with the EU ETS, such as a vulnerability to fraud and oversupply of credits, leading to an estimated cost to the taxpayer of €242 billion by 2020. This sum, if invested directly in clean energy technology, could have achieved emissions reductions of 40% in the EU over that time.[45]

...VULNERABILITY TO FRAUD AND OVERSUPPLY OF CREDITS...

42 TWN Bonn News Update (3-14 June 2013) no 18. http://www.twn.my/title2/climate/bonn.news.11.htm

43 Additionality refers to the need for emissions reductions that are awarded 'offset credits' to be additional to what would have happened in the absence of the project (business as usual).

44 Randall Spalding-Fecher et al. (2013) *Assessing the Impact of the Clean Development Mechanism*. Report commissioned by the High-Level Panel on the CDM Policy Dialogue.

45 UBS analysis 2011

Conclusions and recommendations

Central to the use of carbon markets to reduce emissions is the idea that they deliver *real, permanent, additional* and *verified* mitigation outcomes. This briefing highlights the barriers to this, the most important of which is the attempt to create a 'fungible unit' which can be considered as comparable with emissions reduction units from different sectors, in particular between fossil and terrestrial emissions. The false assumption that reductions in emissions from the land use sector can offset or compensate for emissions from fossil fuels makes it impossible to achieve permanent and additional emissions reductions.

Introducing standards to ensure environmental integrity is either not possible in a market mechanism (in the case of non-fungibility for example), or is achieved at the cost of shifting the burden for environmental integrity to developing countries. Developments such as weakening permanence rules to improve market liquidity, while discounting credits to account for uncertainty in emissions reductions illustrate this point. Host countries will need to invest a great deal of money to measure and verify carbon to participate in REDD+ or an NMM, while conservative accounting methods, such as a discount rate or buffers, will reduce the eventual amount of carbon credits compensated to a fraction of the carbon measured. An NMM should not be used to introduce emissions reduction commitments, nor as a vehicle of financial and technical support to developing countries. All countries must work together for effective climate mitigation. This requires ambitious and steep targets from developed countries, with support for NAMAs and low carbon development in developing countries.

Recent analysis of the NMM has shown that the challenges for scaling up to a sectoral approach are formidable.[46] The expansion of markets will require substantial capacity-building in developing countries, with low carbon prices providing no guarantee of income. "Ultimately, carbon trading is a means to pre-empt and delay the structural changes necessary to address climate change. Instead of examining the fundamentals of an economic and political system, carbon trading adjusts the problem of climate change to fit and to benefit the polluters."[47]

CARBON TRADING... DELAYS THE STRUCTURAL CHANGES NECESSARY TO ADDRESS CLIMATE CHANGE

Recommendations

- **In the face of current lack of demand and oversupply of credits from existing market mechanisms until 2020, there should be no new markets under the Convention.**
- **The provision of long-term climate finance is critical for effective mitigation in developing countries. Relying on carbon markets to provide climate finance has already proven to be a failed experiment, risking temperature increases as emissions continue.**
- **Effectively addressing climate change will require a range of approaches – this is reflected in the discussions on non-market mechanisms, where many countries have suggested solutions such as fossil fuel subsidy reform, feed-in tariffs, technology and energy efficiency standards, the role of technology transfer and intellectual property rights (IPRs), and addressing unsustainable consumption patterns as elements of a non market-based approach.**[48]

46 See Kollmus et al (2013) 'New Climate mitigation Mechanisms: Stocktaking after Doha', http://www .infras.ch/e/news/displaynewsitem.php?id=4947 and 'Design options for sectoral carbon market mechanisms' (2013) Ecorys report for DG Climate Action, European Commission, http://ec.europa.eu/clima/news/articles/news_2012111402_en.htm

47 Tamra Gilbertson, Carbon Trade Watch, BBC World Service Interview, 17 April 2013, transcript available: http://www.redd-monitor.org/2013/07/18/australia-to-replace-carbon-tax-with-emissions-trading-scheme/#more-14209

48 TWN Bonn News Update (3-14 June 2013) no 18. http://www.twn.my/title2/climate/bonn.news.11.htm

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