1. Introduction

The Kyoto Protocol to the United Nations Framework Convention on Climate Change (UNFCCC) relies heavily on the three flexibility mechanisms of Clean Development Mechanism (CDM), Joint Implementation (JI) and International Emissions Trading (IET) in order to facilitate the achievement of legally binding emission reduction targets of Annex 1 countries (industrialized countries and economies in transition). Despite the success of these market mechanisms (particularly, the CDM) in terms of expected emission reductions, there are several criticisms. The European Unions Emissions Trading Scheme (EU ETS) has faced problems such as a severe fall in the price of carbon resulting from an oversupply of EU emission allowances (EUAs), windfall profits from free allocation as well as those of fraud. The criticisms of CDM are primarily those of cumbersome project cycles, additionality concerns, insufficient sustainable development benefits, unequal geographical distribution of projects and the inability to promote change in developing country’s energy systems. Currently, the negotiations under the UNFCCC include discussions on improving the existing market mechanisms as well as creating New Market Mechanisms (NMMs). This knowledge package presents the history and the status of discussions on market mechanisms with a focus on NMMs under the UNFCCC. For information on non-market based approaches, please refer to "Non-market based approaches: Status of discussions under the UNFCCC".

2. NMMs under the Ad Hoc Working Group on Long-term Cooperative Action (AWG-LCA)

Formal discussions on the NMMs began during Conference of Parties (COP) 13 at Bali in 2007, which resulted in the Bali Action Plan[1] asking for "enhanced national/international action on mitigation of climate change, including, inter alia, consideration of: 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". The Ad Hoc Working Group on Long-term Cooperative Action (AWG-LCA), created with the aim of negotiating a new agreement that would fulfill the mandate established in the Bali Action Plan, thus took forward the issue of establishing new market mechanisms. Consequently, at the Durban climate summit of 2011 parties decided to establish a new market-based mechanism and to continue consideration of a framework for various approaches to promote and enhance the cost-effectiveness of mitigation actions[2]. Currently, there are two separate strands of negotiations on NMM – one of them is a bottom-up approach, known as the ‘Framework of Various approaches’ or the FVA (which also includes non-market mechanisms) and the other one is a top down approach which is a market based mechanism working under the COP[3]. Although unlikely, the negotiations on new market mechanisms are expected to the finalised at the COP to be held in Paris in November/December 2015.

One key goal of NMMs is to scale up mitigation actions in developing (and among them, emerging) economies. The idea is to move beyond project and programme level activities towards targeting broad sectors of the economy. A sectoral scope would provide more flexibility to parties to choose the mitigation policies and measures needed to achieve their sectoral targets and participate in the NMM[4].

The negotiations on NMMs however, continue to lack consensus across parties. For instance, the EU in its submission to the UNFCCC[5] in 2014 prefers that NMMs should encompass broad sectors of the economy and be implemented through crediting and trading. Crediting would imply, first defining a "crediting threshold" or a level of emissions below which reduction credits would be issued. The host country would then adopt policies and measures aimed at reducing the sector’s emissions below that crediting threshold. The reductions below the threshold would receive credits that can then be traded in the international carbon market. The country would not suffer any penalty if the threshold were not reached. Trading would imply setting a pre-defined emissions cap for the targeted sector and issuing the country with the respective emission allowances. The country would adopt policies and measures aimed at reducing the sectoral emissions below that cap. If the emissions are then below the cap, the country would be able to sell its remaining allowances in the international carbon market. If emissions exceed the cap, it would have to purchase units from the carbon market.

The views of the EU resonate well with those of the Alliance of Small Island States (AOSIS) and the Least Developed Countries (LDCs). Switzerland and South Korea support the option of NAMA/policy crediting - where the mitigation effects of different policies and actions outside the scope of projects (but not necessarily at the sectoral level) are credited3. Switzerland also intends to use NMMs to achieve their post 2020 targets as outlined in their recently submitted Intended Nationally Determined Contributions (INDCs)6.

An analysis of the submissions to the UNFCCC in the years 2013 and 2014 indicates that most parties are more in favour of crediting rather than trading. Japan prefers to have both - a project based and a sector-based framework coupled with a decentralized governance structure that would be established bilaterally by the investor and the host country. This is also known as Bilateral Offset Crediting Mechanism, and is being implemented by Japan already outside the UNFCCC umbrella. China, on the other hand, clearly prefers having a project-based crediting approach, which would then be equivalent to the existing CDM7. Other developing countries like India and Brazil have remained silent on the issue of NMMs although they are considering market mechanisms domestically.

Countries like Malaysia, Colombia and Saudi Arabia hold the view that developed countries will take the lowest-cost abatement opportunities in developing countries using NMMs8. Taking an extreme stand, Bolivia actively opposes functioning of any market-based approaches as a measure to combat climate change on several grounds. For instance, it states in its submission to the UNFCCC9 that the establishment of market mechanisms would transfer the responsibility of emission reduction from the shoulders of developed country parties to developing country parties and enmesh developing countries in an unstable market making them vulnerable to the effects of uncertainty in carbon prices. The discussions on various aspects of NMMs have continued with no particular outcome under the LCA and more recently under the Subsidiary Body for Scientific and Technological Advice (SBSTA).

3. Stumbling blocks for the negotiations on NMMs

Based on the progress of discussions on NMMs at the UNFCCC, it can be said that before agreeing on the establishment and functioning of NMMs, some challenges need to be addressed. These are as follows:

1. Low price of carbon/ no existing market for NMMs- The lack of an established market and the low price of carbon are the main obstacles for the progress of negotiations on NMMs. The EU ETS, having overallocated its EUAs, led to a substantial fall in the price of carbon. This oversupply of AAUs is likely to continue plaguing the carbon trading markets for a long time and will impact the proper functioning of NMMs to a great extent.
2. Responsibility of implementation of NMMs rest largely on the host countries - For some developing countries (especially LDCs), the requirements for the implementation of NMMs will be extremely cumbersome in light of their existing lack of resources and capacity10.
3. No agreement on NMMs under LCA combined with the fact that Kyoto 2 covers much less countries taking up binding commitments are likely to affect the negotiations on NMMs.

4. Current status of discussions on NMMs under the UNFCCC

As no new post-2012 agreement was decided upon, discussions on NMMs now continue under SBSTA and the Subsidiary Body for Implementation (SBI). Despite the ongoing negotiations, there is no real interest in progressing in them and views on NMMs by different parties continue to lack unanimity. Negotiations on NMMs remained stuck at the SBSTA and did not reach agreement at the COP held at Lima in 2014. Some parties like China and Brazil insisted that these should be taken up under the Ad Hoc Working Group on the Durban Platform for Enhanced Action (ADP), which is negotiating a new climate agreement for the post-2020 period. Others, however, have opposed, as they considered this would influence outcomes under the ADP and whether or not markets will be included in the new climate agreement. The current draft of the negotiation text, which is supposed to be the basis of the legal post-2020 agreement, touches upon the issue of NMMs. The negotiating draft text proposes that a centrally governed market mechanism will be established on the basis of existing market mechanisms and that proceeds from this market mechanism will cater to the adaptation needs of the most climate vulnerable. However, there is no consensus on the definition, design and rules of the NMMs. Therefore, it is difficult to predict whether a universal agreement on new market mechanisms will be reached at the COP 21 to be held in Paris.

Sources

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