Future of Carbon Market – Presentation Report

The two main carbon markets currently are - the EU emission trading scheme (EU-ETS) compliance market and the two offset mechanism Clean Development Mechanism (CDM) and Joint Implementation (JI). The developing countries participate in the carbon market through the offset mechanisms. Currently EU and Japan are the two main buyers of emission reductions from CDM and JI, EU being the biggest buyer. The total value of the global carbon market stalled at$142 billion after five years of robust growth, one reason being lack of post-2012 regulatory clarity.

The Kyoto Protocol ends in 2012. Formal negotiations have been going on for a successor treaty but no success as yet. Under the current regulations imports of CERs for compliance in EU ETS III (2013-2020) will be allowed from CDM projects registered during Kyoto Protocol from developing/LDC countries and project registered 2013 onwards ONLY from LDCs. However there is a feeling among a number of parties (countries)that despite its successes, as a project based system—and one that in practice covers so far a limited number of project types—the CDM is simply not designed to drive the structural transformation of industry in developing countries that the transition to a low-carbon economy requires. Hence talks on new market mechanisms that may feature in the successor treaty are being discussed to scale up emission reductions to meet the target of global warming below 2°C.

The Cancun Conference delivered positive decisions to improve the CDM. Inaddition, the Ad Hoc Working Group on Further Commitments for Annex I Parties under the KyotoProtocol (AWG-KP) has tried to clarify some of the considerations related to a possible gap betweenthe first and subsequent commitment periods. Nevertheless, the current uncertainties surrounding a post-2012 international agreement have left Europe alone to absorb the supply of project-based CERs in the post-2012 environment.

A number of market mechanisms are currently being discussed for the post 2012 treaty. Some of them are discussed below:

Reformed CDM

The major area of improvement and reform of theCDM is arguably the introduction of standardized baselines and monitoring methodologies. This is aimed at maintaining environmental integrity, but reducing transaction costs, enhancing transparencyand predictability, and facilitating access tounderrepresented project types and regions. Reducing the complexity and thus increasing the coverage of Programme of Activities (PoA)[1] is also an area needing significant reform. The CDM Executive Board has recently taken some steps in this directon.

NAMA

The NAMA concept was created in the Bali Action Plan (2007) at COP13 to denote [voluntary] mitigation actions by developing countries after 2012. The Cancun Conference formally recognized developing countries' Nationally Appropriate Mitigation Actions (NAMAs), which were pledged after the Copenhagen Conference.

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[1] A programme of activities (PoA) is a voluntary coordinated action by a private or public entity which coordinates and implements any policy/measure or stated goal (i.e. incentive schemes and voluntary programmes), which leads to anthropogenic GHG emission reductions or net anthropogenic greenhouse gas removals by sinks that are additional to any that would occur in the absence of the PoA, via an unlimited number of CDM programme activities (CPAs)

*"*Nationally appropriate *mitigation actions' by developing country Parties in the context of sustainable development, supported and enabled by technology, financing and capacity building, in a measurable, reportable and verifiable manner."*

In the context of sustainable development, developing countries agreed to undertake NAMAs aimed at reducing emissions relative to business-as-usual emissions in 2020—contingent upon the provision of finance, technology, and capacity building provided by developed countries. A registry is to be established under the UNFCCC to record NAMAs seeking international support and to facilitate matching of finance, technology, and capacity-building support to these actions.

NAMAs can basically be categorized as follows:

- Unilateral NAMAs: mitigation actions independently funded and carried out by developing countries.
- Supported NAMAs: climate protection measures in developing countries, supported by technical assistance and/or direct funding for climate protection from Annex I countries of the Kyoto Protocol ("directly" supported NAMAs).
- Credited NAMAs: climate protection measures in developing countries, that generate certified emission reduction credits (credits) to be sold on the international carbon market (e.g. sectoral measures).

Sectoral Crediting Mechanism (SCM)

EU and other Parties have been advocating the creation of new and more ambitious sectoral mechanisms that make it possible to tap into far greater emissions-saving potentials and provide more revenue for financing reductions in developing countries. Because only actions that go beyond a previously defined threshold or target are credited, this would ensure net benefits to the atmosphere.

The coverage of a SCM relates to the developing country that adopts the program as well as thesectors that are included. Coverage also involves determinations of the specific entities withinthe covered sectors and whether there is potential differentiation within sectors (e.g., new versusexisting facilities). Under SCM the crediting baseline will be set tighter than BAU projections to help ensure that credited reductions are truly "additional" and to provide a net environmental gain from its use . Various methods could be used to determine a relevant crediting baseline, including the development of average intensity targets based upon current or future technologies or statistical projections from historical information on emissions intensities.

Reducing Emissions from Deforestation and Forest Degradation (REDD+)

A significant development was achieved at the Cancun Conference (COP 16). For the first time, the importance of stemming the loss of tropical forests for mitigating global climate change with financial support from the industrialized world was enshrined in an international agreement. The Kyoto Protocol's Clean Development Mechanism has only allowed incentive payments to be made for afforestation and reforestation in developing countries, and only at the level of projects. With COP 16 decision, entire jurisdictions (including countries themselves) could receive incentives, subject to verification that emissions have been reduced against a reference level. REDD+ extends REDD by including sustainable forest management, conservation of forests, and enhancement of carbon sinks.

Even though the magnitude of finances required for REDD+ calls for the involvement of the private sector, the role of markets in mobilizing funding for REDD+ still needs to be discussed under the UNFCCC. It is clearly agreed that Phase I (national strategies and capacity building) and Phase II (implementation of strategies and investment in demonstration activities) will be financed through additional public bilateral or existing multilateral assistance, such as under Norway's
International Climate and Forest Initiative, the Forest Carbon Partnership Facility (FCPF), the REDD+ Partnership, or the UN-REDD Programme

Post 2012 Funds

Multilaterals and Government agencies have introduced post 2012 funds to purchase and trade carbon credits generated in the post Kyoto period, potentially up to 2022. By assuming the inherent regulatory risk, the funds will give a clear signal to the market and its partner's confidence in the development of a post Kyoto regime while directly supporting environmental projects.

Green Climate Fund

The Cancun Agreements formalized the commitment made by developed countries in Copenhagento mobilize $100 billion a year by 2020 to support concrete mitigation actions by developing countries that are implemented in a transparent way. The Cancun Conference decided to establish a "Green Climate Fund." The Green Climate Fund and the expansion of green lending through international financial institutions will provide additional long term financial support for developing countries. The fund would be raised from a mix of public and private sources.

The Fund will be governed by the Green Climate Board, comprising 24 members as well as alternatemembers, with an equal number of members from developing and developed country Parties. The WorldBank will serve as the interim trustee of the Green Climate Fund.

Bilateral Mechanism

Japan government has been promoting the use of bilateral mechanism. Under this mechanism the developed country will provide technology and fund to the developing country in return for emission reductions credits generated from the project.