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IETA POLICY BRIEF:

Market Provisions for the Paris 2015 Climate Agreement

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Background

The Paris Climate Agreement ("Agreement") will likely be a compact, foundational document, similar in length and scope to the UN Framework Convention on Climate Change (UNFCCC) or the Kyoto Protocol. There will not be much 'space' available in the document to provide detailed instructions and mandates on the use of market-based emission reduction policies. Instead, the operational details will likely be developed in UN Decisions.

The Paris Summit occurs at an interesting juncture: over 40 Parties have either implemented or are developing carbon-pricing policies at national or sub-national levels. In an ideal scenario, the Agreement would provide detailed guidance to those Parties (and others) on how their respective carbon pricing policies can be used in national contributions. Even better, it could include language that encourages Parties to cooperate with one another by linking their systems to enable transfers of emissions reductions between companies covered by their national programs. Transfers and linkages would produce better economic performance, helping ensure industrial competitiveness. Linkages can also enable greater net emissions reductions than if Parties attempt to achieve their targets individually.

Considering these factors, IETA conducted a thought-exercise, drawing on insights from research led by the Harvard Project on Climate Agreements. In 2014, IETA and several Parties considered the essential market provisions for the Paris Agreement. This process concluded that the **Agreement should include a unified international transfer system**, which Parties and private entities might use to trade emission units between jurisdictions. Parties would report units transferred or received as part of their national contributions. This structure would govern all trades of international units in a single authority, operating more smoothly and transparently than an "anything goes" model.

Fundamental Design Considerations

In order for Parties to achieve their goal of limiting global warming to 2°C, flexible market-based arrangements will be needed to assure cost effectiveness and guard against severe economic disruptions in the future. While there is broad authority for cooperative action in the UNFCCC, it offers no specific compliance structure or elaboration of how Parties should develop, account for and report on cooperative actions. **The Paris Agreement must enable high-quality, reliable carbon markets to be available to promote emission reduction contributions that are cost-effective and ambitious**.

Established research[1] also shows that linkage of emissions trading and carbon-pricing policies will reduce long-term abatement costs and help build support for an international climate agreement. The Agreement should anticipate that national systems will evolve over time, and it should enable national mitigation pathways that utilize both emissions trading

[1] See Stavins and Ranson 'Post Durban Climate Policy Architecture Based on Linkage of Cap and Trade Systems" (2012) here.

and project-based flexibility mechanisms[2]. To build confidence in national systems and to position them for easy linking in the future, it should advance a set of common infrastructure tools that will engender more harmonization amongst systems. Finally, the Agreement should provide incentives for early action – particularly in the pre-2020 period – to increase the likelihood of meeting the 2°C temperature objective.

Key Elements

Five key policy elements are necessary to support robust contributions from Parties interested in using market instruments. These elements are described below, followed by a "Straw Proposal" of texts for consideration by Parties in Appendixes 1 and 2.

1. A **unified international transfer system**, which Parties may use to transfer portions of their defined national contributions to one or more other Parties for compliance with the Agreement. This provision would support national systems that devolve emissions mitigation responsibility to private sector firms. This provision would govern all trades of international units in a single authority.

2. Transfers would be tracked in a reliable **international registry system**. This should include a centralized UN registry for use by interested Parties as well as an interconnection function for independent national or international registries. It should be made available for potential for use by both national and subnational institutions that may devolve mitigation responsibilities to private sector entities. It may also be useful to buttress this system with the existing international transaction log (ITL) or a comparable system, expanded to cover a wider range of units.

3. Total transfers and receipts would be **recorded in national reports** to the UNFCCC, which implies that robust reporting requirements should be elaborated. Standardized accounting and reporting provisions are essential to establish systemic integrity, including to safeguard against "double-counts" or "counterfeit" credits entering the transfer system.

4. A **unified project crediting mechanism** should draw together the array of crediting systems under negotiation in the CDM, JI, New Market Mechanism and REDD+ crediting systems. This mechanism should make high-quality project-based reductions broadly available for Parties' use in their national contributions. The Agreement should accelerate work on firm deadlines to produce detailed guidelines, modalities and procedures for this facility to assist in enabling early action.

5. **Market infrastructure should be made available** through the UNFCCC Secretariat in order for Parties to enhance their capability of participating in offset transfer mechanisms or emissions trading systems, including tools to enable, register and track international transfers. Operational details for these tools should be elaborated in future COP Decisions.

[2] Small and medium-sized countries should be encouraged to make initial Contributions though a project-based mechanism, given that they may need additional time and capacity building before they are able to implement or participate in a national emissions trading systems (ETS). This provision of the Agreement could also support Parties who intend to use hybrid systems that involve emissions trading and project based crediting.

Appendix 1

IETA Straw Proposal: Market Provisions for the Paris Agreement

Preamble inserts

1. Recalling Article 4 paragraph 2(A)(B) of the Convention that Parties may implement such policies and measures jointly with other Parties and may assist other Parties in contributing to the achievement of the objective of the Convention;

2. Urging Parties to utilize the benefits of interconnected systems, founded on quality standards and transparent accounting, to enable the scaling up of policies and measures to meet the magnitude of the climate challenge.

Cooperation between Parties in realizing their Contributions

1. Parties may voluntarily cooperate in achieving their mitigation contributions, which may improve cost effectiveness and bolster ambition.

2. A unified international transfer system is hereby established.

    a. A Party, through public/and or private entities, may transfer portions of its defined national contribution to one or more other Parties through carbon units of its choice.

    b. Transfers and receipts of units shall be accounted for and recorded in equivalent carbon reduction terms in the international transaction log, or equivalent system, to assure integrity.

    c. Transfers and receipts shall be included in national reports as contributions delivered by the receiving Party and as transfers from the transferring Party.

3. The Conference of the Parties shall at its [22nd] Session elaborate modalities and procedures for the operation of the unified international transfer system, including rules, modalities, measurement and verification standards, and reporting arrangements.

Appendix 2

IETA Straw Proposal: Market Provisions for COP Decision

I. Preamble inserts

1. Encouraged by progress under the Kyoto Protocol of cooperative approaches to emissions mitigation, including through Joint Implementation, the Clean Development Mechanism and emissions trading;

2. Recognizing the economic benefits of greater cooperation in mitigation, as highlighted in IPCC's Reports.

II. Unified International Flexibility Mechanisms

1. A unified project-based flexibility mechanism, comprised of the Clean Development Mechanism and Joint Implementation, is hereby established.

    a. The unified project-based flexibility mechanism will produce "international compliance units" (ICUs) acceptable for use by Parties in the unified transfer system.

    b. The baselines and methodologies of the CDM and JI will be merged into a single set of technical standards for use in the unified project-based flexibility mechanism.

    c. The process and governance for operating the unified project based flexibility mechanism will be agreed at the 22nd Session of the Conference of the Parties.

2. A unified mechanism for Reduced Emissions from Forest Deforestation and Degradation (REDD-plus) is hereby established.

    a. The unified mechanism for REDD-plus will issue "international REDD-plus units" (IRUs) that are available for use by parties in the unified international transfer mechanism.

    b. The Conference of the Parties shall at its 22nd Session elaborate modalities and procedures for the operation of the unified REDD-plus mechanism.

3. Parties may use ICUs and IRUs according to [Section II of the Straw Proposal of the Market Provisions for the Paris Agreement]. In addition --

    a. No ICU or IRU may be used for compliance by more than one Party.

    b. Parties may use ICUs or IRUs on a unilateral basis for that Party's contribution, provided no other Party is reporting it for compliance.

Early Action

1. Parties may use CERs, ERUs, ICUs, and IRUs as part of early contributions in the pre-2020 period, and such units may be banked for future use in national Contributions. Parties may devolve the ability to use or bank such units to private firms.

Market Infrastructure

1. Parties may access standardized components of market infrastructure made available through the UNFCCC Secretariat to implement emissions trading systems.

2. Standardized components of market infrastructure for emissions trading systems shall include-

    a. Monitoring and verification protocols for key sectors;
    b. Standardized emission performance benchmarks for key sectors;
    c. Standardized issuance procedures;
    d. A unified international registry;
    e. An issuance system for use in allocating units and/or establishing ownership of emission reduction units;
    f. A standardized reporting template for transfers and receipts; and
    g. An accreditation system for independent verifiers.

3. At a Party's request, the UNFCCC shall convene an expert panel to review its proposed use of the market infrastructure for emissions trading systems or similar carbon pricing policy. The panel shall provide a Market Structure Report indicating how the use of the components compares to use of similar components by other Parties.

4. At its 22nd session, the Conference of the Parties shall approve a Work Plan for the completion by 2017 of the listed standardized components of market infrastructure.

For more information, or to receive additional information from IETA on these policy areas, please contact Jeff Swartz, Director, International Policy: swartz@ieta.org

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