Development of New Carbon Market Mechanisms: Lessons from CDM Experience

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Outline

• Background/History
• Essentials of a Market Mechanism
• Salient observations of the High-Level Panel
• Lessons learnt from CDM experience
• Characteristics and Essentials of a New CMM
Background/History

• Carbon Market mechanisms (CMM) before KP
  – US 1605 (b) SOx/NOx market trading system formed under the Acid rain program of Clean Air Act since 1995
• Kyoto Protocol (KP) CDM and JI → first international level CMMs that evolved during 2000-12
• Maximum experience gained on CDM as both buyer and seller population was large
• However, at the outset the mechanism architecture was non-existent
• Overall market regulator, the CMP - collection of signatories to the KP, provided the broad contours of the CMM
• The structure was developed by the regulator, the EB, through “Learning by Doing”
Implementation

- As the implementation began or “the rubber met the road” several scratches started showing up
- The EB made/elaborated the rules and the CMM got “perfected”[e.g. methodologies/tools/procedures]
- CDM is a rule-based mechanism had to undergo refinement and in the process it appeared to be undergoing frequent changes
- But the EB did not anytime allow the picture to go “out of the frame” provided by COP/MOP
- Many new modalities evolved during the implementation e.g. PoA, Standardized baselines
Essentials of any MM

• An internationally accepted requirement (the Convention) for Cap & Trade
• Rules of implementation (the KP)
• Presence of a regulator (EB)
• Coordinator / Manager of the scheme (Secretariat)
• Fairness and transparency in the playfield
• Permanence of the rules
• Sustained support from the buyers/sellers
Salient recommendations of the High-Level Panel on CDM Policy Dialogue

• CDM is imperiled due to modest size of mitigation targets and many Annex I countries do not use CDM credits to meet them
• International community must adapt the CDM to new political and market conditions
• CDM must substantially reform its operating procedures
• CDM must strengthen and restructure its governance to become more accountable and efficient
• Well regulated global carbon markets can help to avoid the unacceptable risks of climate catastrophe
Lessons learnt from CDM

• Due to inadequate performance of some DOEs the EB resorted to 100% check resulting in it becoming both rule setter and examiner
• Differences in interpretation by PPs DOEs and the Secretariat/EB
• Stringent and frequently revised rules
• Business realities and additionality rules diagonally opposite. Financial additionality sometimes overrode environmental additionality
• Too much conservative approach in some methodological standards – concept of materiality not accepted (effort vs. significance not recognized)
• Lack of market readiness in some (especially LDCs) ensured no/low uptake
• Ultimate collapse of market due to loss of support from buyers

However, CDM (and JI) have been excellent opportunities for groundtruthing of CMMs
Characteristics of a CMM

• Environmental integrity – eligibility and additionality criteria
• Prioritize options with lowest mitigation costs and minimal transaction costs
• CMM should lead to technology transfer and include capacity building
• Ideally it should have mechanism to measure the emission reductions achieved and allow course corrections
• Allow linkages to similar CMMs or “fungibility”
Essentials of a CMM

• An Apex body to make policies and peer review body (PRB) and Support structure to ensure implementation
• Agency for managing (MA) the CMM independent of and subordinate to the PRB and its support structure
• Well defined rules which take business realities in consideration during design
  – Any Change in the rules to have moratorium of [2] years
• Credits from LDCs may have higher weightage over developing countries with advances in markets
• Wideness of sectors including CCS/ REDD+
• Validators/verifiers to be appointed by MA to rule out contractual Conflict of Interest
Thank you,
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