Guidelines for a Sectoral Sustainable Development Mechanism in the Post-2020 Climate Regime

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OVERVIEW

We propose a set of guidelines for a Sustainable Development Mechanism (SDM), a new market-based mechanism under Article 6 of the Paris Agreement. We propose that a new SDM should adopt a sectoral approach for facilitating the international transfer of mitigation outcomes. We suggest ways in which a new sectoral SDM can create a robust, credible market for tradeable carbon offsets, building upon the lessons of the project-based Clean Development Mechanism (CDM) and active sectoral-based crediting mechanisms in several domestic contexts.[1]

LESSONS FROM THE CDM EXPERIENCE

The CDM provides nearly a decade of experience with global governance of carbon offsets. It is imperative to capitalize on this experience in creating a post-2020 carbon offset mechanism. There are several factors that will influence the success of a future carbon offset mechanism that achieves the mitigation and sustainable development objectives of the Paris Agreement, most importantly, transparency, governance, and accounting.

Governance of the CDM was coordinated by the CDM Executive Board (EB) with support from participating countries' Designated National Authorities (DNAs) and accredited independent auditors, Designated Operational Entities (DOEs). The oversight provided by the CDM EB has largely been seen as successful. The national governance functions of the DNAs, on the other hand, has been gradually eroded[2] and has allowed for gaming of the system, wherein DNAs have been given undue authority in setting criteria for additionality and project selection.[3]

The environmental integrity of the CDM rests on the additionality of approved credits. There is now a wide range of evidence that suggests the additionality of CDM projects was severely limited[4,5] and potentially constrained by the project-based nature of the CDM's additionality review.[6,7] Compounding matters, the project-based additionality review of the CDM was limited in its transparency while its onerous requirements significantly increased transaction costs.[8,9] Although the CDM implemented a system to track transfers of certified emission reductions (CERs), moving forward, tracking the use of CDM credits may pose a threat to the environmental performance of the Paris Agreement if host countries and financing countries of CDM projects move to double-claim their past CDM activity.[10] Host countries and financing countries of CDM projects should work quickly to resolve how to handle existing CDM projects with the aim to discontinue crediting under these projects as soon as possible.

THE SECTORAL APPROACH

In contrast to the project-based approach of the CDM, a sectoral approach evaluates aggregate emission reductions relative to a single sector-wide baseline. A sectoral approach to the SDM would have several benefits. First, a sectoral approach would allow for greater flexibility in modes of investment, as activities complementary to direct mitigation, such as investment in infrastructure and capacity building, could be supported. Second, a sectoral approach would expand the range of mitigation options available, increasing the scale of possible emissions reductions. Finally, a sectoral approach would lower overall transaction costs, as analysis of additionality would be done once at the sector level and specific investments would not require detailed approval based on project-level additionality.

MAKING A SECTORAL APPROACH WORK

Moving toward an international sectoral approach to carbon offsets will require confronting several significant challenges, many of which have not yet been encountered in experience with the Kyoto mechanisms. Here we present a set of proposals for how a sectoral SDM could be implemented in a gradual manner that creates opportunities for learning without significant risk to the environmental integrity of the Paris Agreement.

Scope:

- Host countries for SDM activity should be limited to the Least Developed Countries (LDCs). Explicit rules should be adopted to expand host-country status to other developing counties based on the criteria of per-capita income, investment capacity, and mitigation opportunity. The shift to limit CER eligibility in the EU ETS to only LDC host countries signifies the political importance of limiting host country participation to the countries where sustainable development co-benefits are likely to be greatest.
- Beginning implementation of the SDM with a relatively small number of host countries will allow for more gradual adoption of governance norms before host country status expands. The CDM experience demonstrates the perils of inappropriately locking in practices while moving too quickly.

Governance:

- The CDM EB provides a useful international governance structure that should be maintained in governing the SDM[2]. However, participation rules for the executive board should be reformed to strengthen conflict of interest protection. Current CDM EB members should be retained to facilitate the transfer of key learnings from the CDM, but participation on the new executive board should also be expanded. A share of transactions under the SDM should be used to support building the technical capacity of the board.
- The new SDM executive board should establish an oversight committee to maintain transparency within the board and ultimately lower the possibility of gaming international carbon markets.
- Established CDM DNAs in host countries should be maintained under the SDM. This would help to lower political costs of transitioning to the SDM, increasing political feasibility. DNAs should also seek to engage domestic central banks to facilitate governance while maintaining national sovereignty.

Defining Sectoral Baselines:

- The new SDM executive board should adopt standardized methodologies for setting sectoral baselines. These methods should be adopted by the executive board with country input from all Parties to the UNFCCC, but the process to determine methodologies should be driven from the top.
- Sectoral baselines should be defined in terms of absolute emissions (rather than a technology baseline or a baseline indexed to economic variables). Absolute emissions baselines guarantee a certain level of overall environmental performance and are less likely to depend on external conditions.
- Baseline and crediting methods should avoid exemptions to provide the highest level of environmental integrity.

Emissions Accounting:

- A sectoral SDM poses significant challenges for emissions accounting. The accounting regime that will emerge under the Paris Agreement will need to grapple with the challenge of avoiding double counting of emission reductions between countries financing and hosting SDM activity. One feasible approach would be to establish multiple baselines that avoid double counting host country mitigation activities under Nationally Determined Commitments as activity under the SDM.
- Tracking emissions and emissions reductions credited in a domestic sector will require national and international registries of emissions and internationally transferred mitigation outcomes.

Reevaluation:

- The SDM should be established initially with clearly defined goals over short (approximately 5-year) timelines. The SDM executive board should establish regular evaluation timelines to allow for reflection and adjustments.
- Country-level sector baselines should be reevaluated regularly on the basis of emissions reductions and sustainable development.

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 A full paper discussing the ideas in this brief will be available soon. Please contact gabechan@umn.edu for a copy.