The potential for referencing market mechanisms in INDCs
Information note

Background - INDCs

As the Paris session of the Conference of the Parties to the United Nations Framework Convention on Climate Change (UNFCCC) approaches, both developed and developing countries are in the process of formulating Nationally Determined Contributions (NDCs), which should form the basis of a Paris Agreement to curb global greenhouse gas (GHG) emissions . Parties were requested to submit “intended NDCs” (INDCs) to give climate negotiators a first indication of Parties’ willingness to engage in mitigation actions in the context of a Paris Agreement and evaluate the ambition of a future climate treaty. Many developing countries are still in the process of formulating their INDCs; their decisions on mitigation goals depend on what they consider politically, socially and economically feasible, and on the support they can expect to receive from developed countries. The more international assistance they receive, the more ambitious their climate targets may be.

At the time of writing, early September 2015, four African countries had submitted their INDCs and others are in advanced stages of developing them. The final INDC's are expected to be ready by the beginning of October to allow sufficient time for the UNFCCC Secretariat to publish a synthesis report by 1 November 2015 as requested by the Lima Call for Climate Action.

Understanding the Africa context with respect to INDCs, market mechanisms and CDM

When preparing INDC's, it is recommended that, among other things, Parties also indicate whether or not they intend to engage in international transfers of emissions units from international market mechanisms, because this can impact achievement of a Party’s target. Transferable emissions units include offset credits generated from GHG reduction projects under, for instance, the Clean Development Mechanism as well as emissions allowances from emissions trading programs. In this context, Parties could consider whether they plan to purchase units as a means of meeting emissions reduction targets or whether some of the emissions reductions will instead be sold as offsets to support compliance elsewhere (and not be counted towards their own targets).

In the context of getting access to climate finance, the inclusion of market mechanisms and CDM in a country's INDC and in the post-2020 international climate finance architecture can have a number of benefits for mitigation activities in countries in Africa:

- Access to a mature and well established tool - During its 10-year history, a first-of-its-kind approach to climate change mitigation under administration of the United Nations, the CDM has been able to raise 500 billion US$ in investment for over 7500 projects and 250 Programmes of Activities in 105 countries involving over 4500 organisations thereby avoiding over 1.5 billion tonnes of CO2 and delivering over 110000 MW of electricity (as at 2012). If all of these CERs would fetch a price of USD 10 (rough average in the period 2008-2012), then that would result in a climate finance value of USD 16 billion.
- To date carbon market mechanisms and CDM have been one of the most successful models to bring private sector finance on a large scale into development cooperation, where sourcing from public sources is limited.
- On the overall instrument level, carbon market mechanisms offer a good opportunity to directly access international financial support for Parties’ green growth strategies and facilitate access to finance/technology/capacity building. They supplement international sources of climate finance in a potentially simpler and more straightforward way than accessing climate finance from public funds. Market mechanisms can be more liquid and

The CDM toolbox

Beyond serving as a direct access to finance through markets, the CDM has additional distinct and clear benefits.

The CDM is the most recognised and referenced method for monitoring, verifying and reporting emission reductions (MRV). It can be argued that it is in the interest of African countries to push for as much standardization as possible when it comes to measuring emission reductions. The more it is possible to streamline the certified emission reduction process, the better because this will allow an easy switch from one climate finance mechanism to another when needed. Switching between certification systems for different bilateral donors and international reporting has the potential to create a significant additional burden to the system as a whole and importantly the host of the mitigation activity. Out of all the baseline-and-crediting systems, the CDM has been most tailored to the context of Africa, for instance by having available methodologies, positive lists and simplified rules for additionality. On top of that most African countries already have technical and institutional capacity for generating carbon credits using the CDM this is the foundation on which future work can be build.

In public sector climate finance the CDM can work as a disbursement vehicle of climate finance through results-based payments, with CERs being retired and therefore not reaching the market. The procedures for monitoring, reporting and verification of the CDM are readily available and highly regarded for their rigor and their international acceptance, coupled with significantly simplified methods for voluntarily cancelling CERs the CDM has become an important tool for supporting Results Based Finance approaches within the climate finance context, as piloted by the World Bank's Carbon Initiative for Development (Ci-DEV).

The CDM furthermore has been a strong contributor to the Adaptation Fund and will continue being so with every CER issued.

accessible for individual projects than funds, for instance once the CERs from a CDM project are issued, a carbon market transaction can be faster than accessing funds.
- The overhead costs involved in carbon market transactions can be in many cases lower than the overhead costs involved in accessing fund-based types of climate finance. This is because there are less fiduciary requirements involved in selling a carbon credit than to accessing climate finance through a climate fund.
- Within this context, the approval of CDM projects and the determination of their contribution to a country's sustainable development remains the sovereign responsibility of the host country and not of a third party financier.

Beyond access to finance the CDM possess an extensive technical toolbox available to support mitigation actions as highlighted in the information box above.

As further backdrop a number of middle income developing countries are considering market mechanisms such as emissions trading and offsetting, as an instrument to reduce emissions in a cost-effective way domestically. This can increase future demand for carbon credits or transferable emission units from mitigation activities in Africa.

Concerns about CDM and market mechanisms

In the past, African countries have expressed valid concerns on the benefits of market mechanisms for them. In considering project registration figures alone (figure 2) African countries have been unequally represented in global terms (2.8%) and have struggled to access finance through market mechanisms created under the Kyoto Protocol. Over the past years the CDM has undergone continuous reform in response to this situation with the aim of improving equitable distribution, particularly benefitting African and LDC countries, through such initiatives as the introduction of Programmes of Activities(PoAs), creation of Regional Collaboration Centres(RCCs), the CDM loan scheme, micro-scale additionality and standardized baselines.

As a result of these initiatives supporting extensive efforts from host countries and developers, in the past few years Africa has caught up in the development of CDM projects, this is particularity evident in global participation figures for Programmes of Activities (see

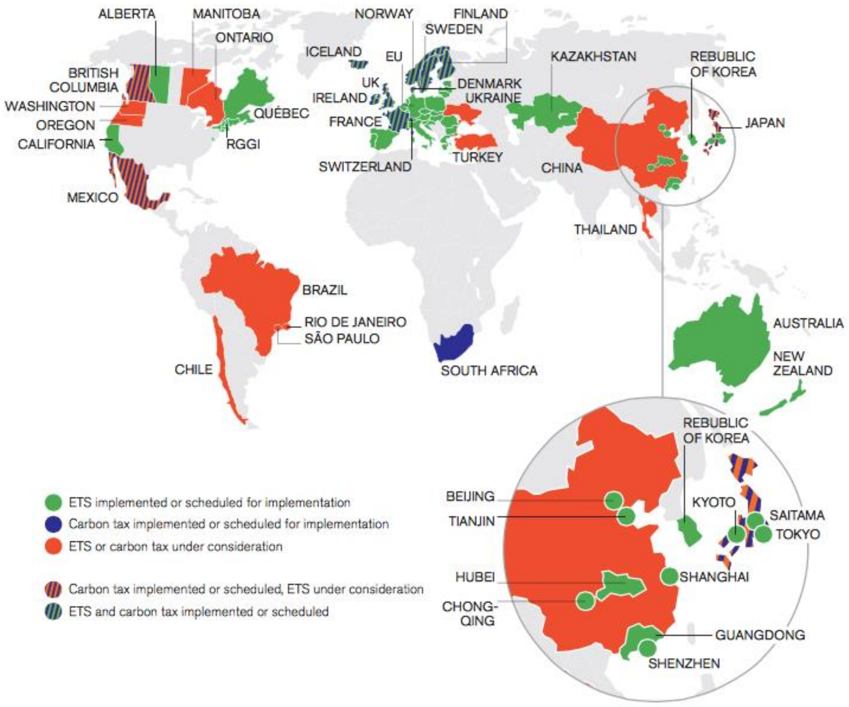

Figure 1: Emerging Carbon trading and pricing schemes (State and Trends of Carbon Pricing. World Bank (2014)

figure 2), the continent currently hosts 32% of PoAs. As one case study, carbon finance has proven quite effective in incentivising clean household energy projects that replace firewood collection, addressing a main driver of deforestation and forest degradation and therewith including emissions from the forestry and land use sector.

Despite the progress made and given the historical lack of equity in distribution of GHG emission reduction projects in the Africa region , the carbon market has not prioritised the carbon credits emanating from the CDM in Africa to create the demand that would incentivise further action. Furthermore, the forestry and land use sectors, among Africa's most relevant sectors targeted for emissions reduction, have not enjoyed sufficient support in terms of accessing financial revenue channels under the CDM. The upcoming conference in Paris creates an opportunity to revive the interest in market mechanisms and restore the demand – and hence the price or prioritisation – for African carbon credits

Potential for referencing market mechanisms in INDCs

Countries that consider market mechanisms and the CDM as instruments to realise their green growth strategies would do well to state this consideration explicitly in their INDCs. This is recommended for several reasons. Firstly it sends a strong signal in support of market mechanisms and the CDM to the Parties negotiating the new climate agreement in Paris. The position of market mechanisms, including the CDM, in the co-chairs' tool to the Geneva negotiating text is still being debated. Parties that intend to use market mechanisms and the CDM should make this very clear and the INDCs are the best place to do this. In addition to securing a position for markets in the Paris agreement, it sends a signal to industrialised countries that demand for carbon credits from Africa should be restored and prices recovered to a level that incentivises investments. Developed countries, particularly those that have already indicated the use of market mechanisms in their own INDCs or those that see markets as a vehicle for increasing the ambition in Paris are paying close attention to the reference to markets in developing countries INDCs.

Some developing countries have abstained from mentioning markets in their INDC even though they are in favour to use markets later. They have argued to have concerns on whether or not and in which form markets will form part of the Paris Agreement. This is a chicken and egg situation however. The more visible their potential in the INDCs, the greater the likelihood that they will be included. Another doubt which may prevent developing countries from including markets is that they interpret the use of markets as pertaining to the buyers only and not to the sellers.

Mentioning use of markets in the INDC gives a clear signal of intention to potential investors and technology providers in the international community that the country is open to use the market mechanism to meet its GHG mitigation goals. Moreover, in the African context, use of market mechanisms is an important door through which access to climate finance can assist in reducing poverty by improving the energy infrastructure and access to renewable energy thereby impacting the socio-economic context of the countries in the region as well as access to finance for off-grid rural electrification projects thereby reducing the use of non-renewable biomass and fossil fuels for cooking, heating and lighting and thereby impacting the health and welfare of people in the rural area, especially women and children.

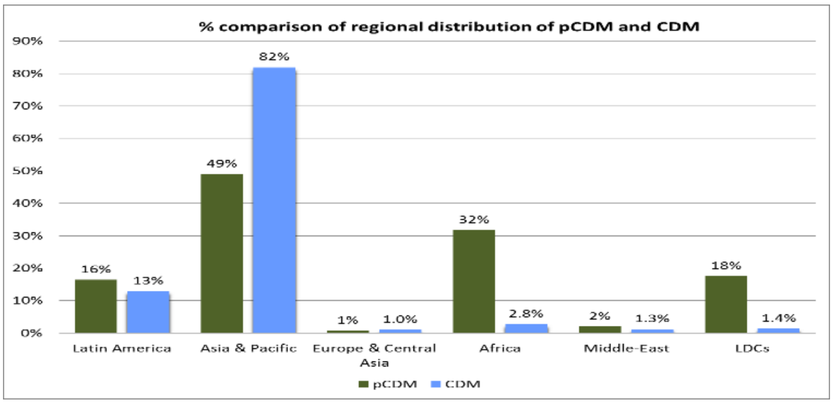

Figure 2: Percentage comparison of regional distribution of Programmatic CDM (pCDM) and Project CDM (CDM) initiatives per UNFCCC region Source: UNEP DTU (2015) UNEP Risoe CDM/JI Pipeline Analysis and Database. Available at: http://cdmpipeline.org/ [Accessed June 1, 2015

How a Party includes reference to markets and the CDM in its INDCs depends on various factors, including a Party's intention to pledge a mitigation contribution, the differentiation of this pledge between a part domestically financed and an additional part with international support, the main mitigation sectors and the Party's institutional setting. The minimalist solution lies in a simple positive reference to markets or CDM. Additionally, principles could be mentioned to which these markets should adhere such as contributing to the sustainable development of the host country, leading to real, verifiable and additional emission reductions and not result in double counting of emission reductions. The most sophisticated mentioning would detail in which sectors markets could help the country realise a greater emission reduction than what is achieved with the proposed measures thus far.

OUR OFFICES

Climate Focus
Sarphatikade 13,
1017 WV Amsterdam
The Netherlands

www.climatefocus.com

Carbon Africa
P.O. Box 14938-00800
Nairobi
Kenya

www.carbonafrica.co.ke