GREEN FINANCE OBSERVATORY

9 RECOMMENDATIONS FOR THE COP26

One of the main negotiation topics at the COP26 this year will be the creation of a new carbon offset market named Sustainable Development Mechanism (SDM), and more specifically whether the double-counting of carbon credits, i.e. cheating, should be allowed. Of course, in diplomatic language, this is called neither cheating, nor double-counting but an issue of 'corresponding adjustment.'

This issue has been a sticky point during the past 2 COPs[1] and is expected by many to be resolved this year, given the tremendous financial interests at stake.

Many private lobbies are currently pushing to allow double counting under the fallacious argument that this may enable additional offset projects to be financed. It might be worth remembering here, that the original and overarching goal is to curb GHG emissions, not to increase offset projects that by definition do not aim at curbing emissions, but on the contrary to enable future emissions.

Since the SDM will also replace Kyoto's Clean Development Mechanism, whose track record is one of spectacular failure, there are a number of crucial lessons to be learnt for the design of the SDM, if we want to avoid wasting another decade.

Here are our 9 recommendations:

1. Ensure credible and binding measures to prioritize emission reductions over offsets
Talk is cheap: for all the talk about prioritising the reduction of emissions over offsetting, this is generally not backed by any credible measures. Reporting, transparency and guidance are not sufficient to achieve this goal. This could be achieved for example by setting up separate targets for emissions reductions and negative emission technologies (NETs) within net zero, and allowing the use of SDM credits only for the NET target.

2. No allowance for use in cap-and-trade schemes
As the bulk of the demand for Kyoto credits has historically come from the EU ETS when their use was allowed, there will likely be the temptation to allow SDM credits in the ETS, thereby once again removing or increasing the cap. This should be explicitly prohibited, as this would greatly undermine mitigation efforts.

[1] https://www.carbonbrief.org/in-depth-q-and-a-how-article-6-carbon-markets-could-make-or-break-the-paris-agreement

3. No forestry offsets
Forestry offsets have been shown to be far more problematic than others, due to incalculable additionality, documented cases of human rights abuses and risks of green land-grabbing. For all these reasons, they should be excluded from the SDM.

4. No Double counting
A nation selling offset credits should not be allowed to count those credits towards its own climate targets. If this were allowed to happen, it would result in those emissions reductions being counted twice, akin to cheating.
This issue of double counting - now renamed corresponding adjustment - is shockingly one of the main negotiation issues at the COP26, when we could expect this to be straightforward and more ambitious issues to be tackled.

5. Curb excessive speculation
Carbon markets have been plagued among other issues with excessive speculation, leading in turn to very high price volatility. This high price volatility means that it is impossible to observe any upward trend on prices, and that there is therefore no price signal, i.e., no incentive to change technology and behaviour.
This can and should be addressed through a clause introducing position limits (as already exists in commodities markets) and/or a ban on financial settlement.

6. Ensuring accountability and preventing carbon colonialism
In order to learn from the failures of Kyoto's flexibility mechanisms and to focus on the overarching goal of curbing emissions in developed countries, a mechanism should be put in place to mandate or at least strongly incentivize offset credit buyers to use credits from projects taking place on the same continent where they are located.

7. No carry-over of Kyoto credits in the SDM
The last-minute ratification by Jamaica and Nigeria of the "Doha amendment" in October 2020 meant that millions of carbon offset credits for the period 2013-2020 have just been issued to participating countries.[2] Allowing participating countries to use their stockpiles of unused CDM credits in the Sustainable Development Mechanism would mean ensuring the failure of the SDM right from the start: CDM credits have indeed been implicitly acknowledged by the market to have no additionality, judging by their price. In addition, allowing them would flood the market with credits and the carbon price would probably crash once more.

It is therefore essential in our view that the use of legacy credits from the CDM is banned or at the very least severely curtailed in the SDM, if it is to be a real market and not greenwashing.

8. Automatic cancellation of credits
Article 6.4 markets are required to ensure an “overall mitigation in global emissions.” This means they should ensure a net reduction in emissions, rather than just offsetting CO2

[2] https://carbon-pulse.com/110881/?utm_source=CP+Daily&utm_campaign=a7e6e70290-CPdaily02102020&utm_medium=email&utm_term=0_a9d8834f72-a7e6e70290-110288569

released in one country with savings elsewhere. Achieving this would require mandating the automatic cancellation of a portion of the credits being traded.

9. No SDM?

Ultimately, it is crucial to remember that there is no need for a sustainable development mechanism to achieve the Paris Agreement goals. The SDM is just a flexibility mechanism to lower the cost of mitigation, a legitimate objective, but that should not come at the cost of environmental integrity and weakening mitigation.

For all these reasons, no SDM is better than a bad SDM and we hope that the parties will not hesitate to reject an agreement that would fail to address the issues mentioned above.
