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THE 10th EDITION

looking to the **future** of carbon markets

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THE DESIGN
Examining What Makes Climate Policy Tick

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THE TOOLS
Financing Low Carbon Development

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FRAGMENTED MARKETS WITH FRAGMENTED MRV PRACTICES – DOES IT MATTER?

'The carbon market' is a misnomer. There is not one market for carbon but a melting pot of national, regional and sectoral schemes. As a consequence, we have an 'alphabet soup' of diverse credits, generated by numerous markets, which have value to different organisations in various countries. Whilst there is international agreement on the need to first quantify and then reduce carbon emissions to mitigate climate change, there is no agreement on the best approach. And rightly so, as clearly, 'one size cannot fit all'. Individual nations and sectors must be able to implement the most appropriate and cost-effective ways to reduce their emissions, while securing economic growth.

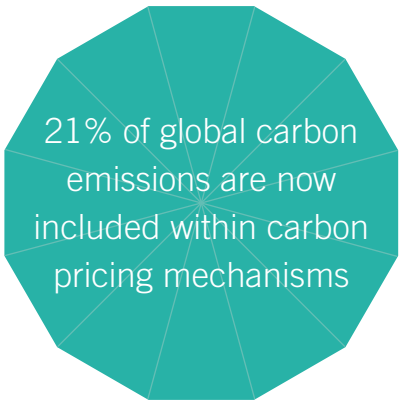
Thus these schemes do have distinctive and unique design features, but also common solutions to their challenges - not least relating to monitoring, reporting and verification (MRV). Scheme designs ultimately come down to political and strategic decisions, underpinned with technical priorities. Some commonality is necessary, and some degree of variance is inevitable, but much is not significant. This variance does however come with potential consequences, including cost burdens and barriers to trade, both of which represent potential risks to international competitiveness.

It is therefore the necessary commonalities and the consequences that should be the main focus of concern when designing new carbon market mechanisms, as these will potentially limit the possibility for future linkage across schemes and, in turn, the overall mitigation potential. Those differences that neither affect these consequences, nor detract from the quality of the data generated, can and should be accepted.

Through current collaborative approaches between parties, experiences are being shared and developments coordinated with sight on potential linkages down the line. Together with the UNFCCC's umbrella Framework for Various Approaches (FVA), there is hope for ensuring that these schemes, despite their differences, all deliver consistent and comparable mitigation outcomes that are real, permanent, additional and verified.

Since the fragmentation of the carbon market is well known, it is not necessary to detail the many market mechanisms, regulations and schemes in operation and currently under consideration. In total, 21% of global carbon emissions are now included within carbon pricing mechanisms and when emissions in China, Brazil, Chile and other emerging economies are covered, this could reach 50%.[1]

With mechanisms originating from different governments with differing priorities, it is clear to see how and why the carbon market has become so diverse and in turn why scheme design features, including those relating to MRV systems, can and have become so fragmented.



Whilst there is clearly a case for coordination of schemes to minimise variations and their consequences, it is necessary to recognise which elements require consistency and those which do not.

The primary decisions made by existing schemes - and those currently being considered by emerging economies designing new carbon market mechanisms - are political and strategic; they are not technical. The underlying decisions will be supported by science and technical principles, but at the outset, technical issues are not paramount.

The main aim of these initial political decisions within all schemes is to achieve cost effectiveness - achieving the desired mitigation target at the lowest possible cost. Achieving cost effectiveness requires a maximisation of trade opportunities across activity, geography and time. Therefore scheme design that maximises the sectoral, geographical and temporal boundaries is king.

Boundary considerations - and through these, the scheme's cost effectiveness

- will be further impacted by a number of factors including: the degree of environmental ambition; the overall aims for domestic emissions reduction versus global carbon trade; the acceptance or not of offsets; the sectors to be covered; allocation practices; carbon leakage avoidance and cost containment mechanisms. Clearly, decisions on these design elements will therefore have the greatest impact on the overall success of any scheme.

In this diverse market, it should be noted that the geographical boundaries and the benefits in relation to cost effectiveness of schemes can only be maximised by linking, enabling participants to take advantage of mitigation options on a global scale. Therefore, focusing on boundary considerations and cost effectiveness will help to minimise variations across schemes, minimise the resultant consequences, and help to facilitate linking.

Ultimately decisions of a more detailed technical nature, including those related to MRV, will need to be made. And again variations at this level are inevitable because sector unique features and existing standard practices come into play.

The essential considerations in relation to MRV are that the resultant data is consistent and comparable across schemes. Comparability is necessary for jurisdictions to consider linking and to avoid concerns over competitiveness and leakage. To achieve this, all schemes must ensure that the data is subject to independent MRV and that MRV principles are clearly defined to ensure transparency and completeness of the data whilst minimising uncertainty.

The differing methods to achieve that outcome are not significant. Different sectors will need to apply different monitoring approaches. Monitoring practices and the equipment required cannot be identical on land, in the air and at sea, for example. However, it can achieve comparable results. Similarly, standard practices that are regulatory accepted and therefore extensively applied and functioning well, must be factored into the MRV elements of carbon market mechanism design to ensure efficiency and reduce cost burdens for operators.

These specific areas of focus will bring consistency and comparability of scheme design, to help minimise variations across schemes and the resultant consequences, and enable opportunities for linking a global carbon market. And steps are already being taken to assist in achieving this.

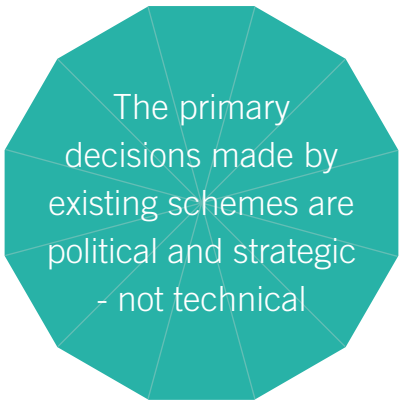
Regulators and stakeholders now have substantial knowledge and understanding gained from experience in designing and operating carbon markets and MRV systems. In addition, countries are coordinating with each other to learn from these experiences. For example, the EU is currently supporting China to develop new climate regulations, to initiate their national carbon trading scheme, and to procure a low carbon roadmap to 2015. Similarly, California and Australia have signed a memorandum of understanding (MOU) to share information and support building capacity to address climate change.

The governments of a number of countries are also advancing further than simply coordination to actively progressing the linking of their schemes: California and Quebec approved a link as of 1st January , 2014; the EU and Australia have announced intentions to fully link by 1st July, 2018; the Kazakh emissions trading scheme (ETS) is considering links with the EU and other countries; and Korea is designing key elements of its ETS in line with those of Europe in order to minimise any need to change for potential future linking opportunities.

In support of actions by individual countries are initiatives such as the World Bank's Partnership for Market Readiness (PMR). This is a global partnership of developed and developing countries that provides funding and technical assistance to support and facilitate the development of carbon market-based instruments in developing countries.

Finally, in recognition of the diversity of schemes within the carbon market, the need for a framework under which all can operate has been identified at UNFCCC level. The FVA is a general framework, which is currently under development and aims to provide an umbrella for emissions reductions approaches at national and regional levels or multilaterally, enabling individual mechanisms to be designed for local needs whilst meeting consistent standards. Discussions for how the FVA will work continue, but it is anticipated to provide a set of common principles against which all mechanisms must comply to ensure real, permanent, additional and verified mitigation, whilst avoiding double counting and ensuring a net decrease and/or avoidance of carbon emissions.

To effectively address the global problem



of climate change and minimise global average temperature rise to 2°C requires action from all sides. The momentum of mitigatory action should not be slowed by unwarranted concerns over the need for identical approaches.

Providing that the mechanisms and systems are sufficiently transparent to provide confidence in the accuracy and completeness of the data, and thus comparability across schemes, then the markets can be sufficiently assured that: real and permanent emission reductions are being achieved; that linkage can be pursued; that mitigation is maximised, and success achieved.

On the path to climate change mitigation strategies, this can only be a positive step.

(Endnotes)
[1] Mapping Carbon Pricing Initiatives – Development and Prospects. The World Bank, 2013

About the Author(s):

Madlen King is global head of climate change and sustainability for LRQA. LRQA is the world's leading independent provider of assessment services including certification, validation, verification and training across a broad spectrum of standards and schemes. LRQA is recognised by over 50 accreditation bodies and delivers services to clients in more than 120 countries. In the climate change and sustainability arena, LRQA's international services include the EU ETS, CDM, JI, ISO 14064, PAS 2050, corporate responsibility report verification, ISO 50001 and ISO 14001 as well as a range of regional and national standards and schemes. Madlen is involved in shaping the future of environmental policy through engagements with national governments, the European Commission, the European Co-operation for Accreditation, IETA and as vice president of the DIA. In addition, Madlen is a member of the Institute of Environmental Management & Assessment, is a Principal Environmental Auditor and is a Chartered Environmentalist. Madlen holds a Bachelor's (BSc) in Environmental Science and a Masters (MSc) in Environmental Management.

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