A Policy Proposal Brief for Developing Countries:

EARLY ACTION TO CREATE PRE-2020 DOMESTIC CARBON MARKETS IN DEVELOPING COUNTRIES BASED ON INDC MIGITATION TARGETS.

INTRODUCTION

The Paris Agreement devotes four full pages to the topic of pre-2020 action, with a call in Section IV to "enhance ambition in the pre-2020 period in order to ensure the highest possible mitigation efforts under the Convention by all Parties"; it calls for Parties to "strengthen the existing technical examination process in the 2016-2020 period to accelerate the development and dissemination of policies and technologies with high mitigation potential". As noted by the South African delegation following the announcement of the Agreement, "***The closing of the pre-2020 ambition gap is essential, and the work of the COP in this regard must remain our focus***."

This is a conceptual proposal for EARLY ACTION based on a very simple regulatory signal to the markets. If appropriate entities consider the concept viable, this would require significant work in the regulatory design and specification for each interested Party.

This policy proposal seeks build on the call to early action pre-2020 in the Paris Agreement and to:

- utilize the unique opportunity presented by the recently consolidated INDC mitigation targets;
- send positive regulatory signals now to the domestic emitting sectors and firms in countries interested in early action:
- stimulate domestic demand, prices, and voluntary trading in the pre-2020 period of domestic credits from CDM, VCS, Gold Standard, and creditable NAMA. For example, we believe Colombia's national portfolio of approved POA/CDM projects could mitigate between 5 and 10 million tons per year, depending upon the price that is developed from the implementation of this EARLY ACTION proposal.

This is an extraordinarily simple concept based on the creation of inter-temporal demand from the INDC target, using banking of domestic NAMA / CDM / VCS /GS credits. The national INDC mitigation target consolidated in the Paris Agreement would be used to send positive regulatory signals that could jump-start voluntary trading now, using and banking **domestically produced** credits for future compliance in the post 2020 period. These domestic markets could begin now with a simple regulatory signal, at very low administrative cost, using existing institutions and procedures for registry and accounting.

PROPOSED TEXT: A SIMPLE REGULATION from the Ministry of Environment would include a text as follows:

"Under whatever mitigation policy and programs that (country name) may adopt for compliance for the 2020 UNFCCC agreement, the types of carbon credits that will be eligible for compliance will include NAMA credits, Certified Emission Reductions (CER) from the Clean Development Mechanism (CDM), among others, from domestically approved and registered emission reduction and forestry sequestration projects operating within the boundaries of (country name).

These credits will be bankable: eligible credits generated since December 31, 2012 can be banked and freely traded among interested parties until their use for compliance in the future. All credit transactions should report prices upon credit delivery in order to provide price information to the market. Once used for compliance, credits will be eliminated from the registry to prevent double counting.[1]"

KEY ELEMENTS AND BENEFITS OF THIS EARLY ACTION PROPOSAL

It builds upon earlier public efforts and private investments. For countries that have been working on the creation of domestic voluntary carbon markets, the INDC target represents a golden opportunity to activate and strengthen those markets now, in the 2015-2020 period. For example, in Colombia, the Fundación Natura and the Mercantile Exchange have been working diligently on the creation of a "voluntary trading platform for mitigation of greenhouse gases" with funding from GEF, with the IDB as an implementing agency. A positive regulatory signal regarding the compliance eligibility of credits from domestic projects, NAMA and POAs for post 2020 targets could jump-start trading on that platform as soon as the regulation is published.

Cost-effectiveness. On the margin, many of the most cost-effective, ready-to-implement, and well-monitored and verified options to advance mitigation are the already-registered CDM projects and POA in each developing country. Some countries may have cost effective creditable NAMAs ready to implement. This proposal allows the country to use the most cost effective mitigation options to build towards meeting their national targets, as a first market-oriented step.

Banking would explicitly be allowed: credits purchased in the pre-2020 period could be saved and used for compliance in the post 2020 period. Indeed, the INDC preparation guide that UNFCCC presents on their website makes several references to the constructive use of certified emission reductions from CDM, VCS and Gold Standard.

The UNFCCC director of carbon markets, Niclas Svenningsenn, recently supported the use of pre-2020 credits for post 2020 compliance[2]. The new domestic regulation should state that domestically produced credits are bankable and freely tradable until their use for compliance in 2020 and beyond.

Based on the INDC target and a simple regulatory signal, companies with high abatement costs could start buying domestically produced CERs and/or NAMA credits now. Early movers could move now to pick up available CERs/NAMA Credits in order to minimize the risk of higher prices later. Clearly, owners of registered / certified projects are willing and able to sell them under the right demand and price conditions. Voluntary trading would begin to see many more transactions. This is a key opportunity to ignite domestic demand and prices now. ERPAs at decent prices could then support investment needed to implement many currently stranded projects.

THE CLIMATE BENEFITS ARE CLEAR: mitigation would begin now, instead of waiting another five-seven years for the formal regulatory programs to be designed, negotiated and implemented. As the IPCC has always indicated, reductions today are more useful that the same reductions years later. UNEP's

[1] Voluntary Cancelation of CERs could be accumulated and used for future compliance as well. https://cdm.unfccc.int/Registry/index.html
[2] Bloomberg news, 2015/05/29, "UN Fosters Use of Pre-2020 Carbon Credits for Climate Plans"

2014 EMISIONS GAP report includes a series of technical and scientific reasons to support early action[3]. Delaying mitigation action and allowing higher emission levels in the near term:

a. means that faster and more costly emission reductions are required later to stay within the same carbon dioxide emissions budget.
b. causes lock-in of carbon intensive infrastructure; the lock-in effect applies to lost opportunities for energy efficiency.
c. can slow the transformation of the energy system.
d. leads to higher overall costs and economic challenges.
e. reduces societal choices.
f. leads to higher climate risks.
g. forgoes co-benefits which are important for adaptation and resilience.

Early Action and Trading Experience pre-2020 are needed to prepare for the Post 2020 period: Even the best trained and well-funded regulatory institutions in the world have had design and implementation problems in full scale implementation of major market based instruments.

For example, the EU ETS over-allocated allowances during their first two years, resulting in a price crash in April 2006, and suffered major price volatility during several years. There were registry security problems including hacking and credit theft. This proposal would provide valuable domestic trading experience at low cost and risk, which would help the country to plan and develop their permanent trading models and institutions before the 2020 period, allowing them to identify problems and address them before the formal UNFCCC compliance period begins.

A few years of experience in a simple domestic trading model such as this one, would provide a strong foundation for the implementation of the permanent market based policies being planned for 2020 and beyond. This inter-temporal demand could create many more transactions and contribute to **price formation** in the pre-2020 period that will be key for policy planning and implementation for the post-2020 period.

Like California's AB32 Cap and Trade program, a 2020 national mitigation regulatory structure in developing countries could include various compliance options, including in-house abatement, state-issued Allowances, complementary carbon credits from project based mitigation, a carbon tax, or possibly links to other trading systems. The California program provides a very useful model for the incorporation of Early Mover Offsets into the Cap and Trade Compliance Scheme; the core principles in developing country Early Action could build on the California model[4].

Signaling CDM CERs as eligible for future compliance is consistent with required UNFCCC MRV. A key component of the Paris Agreement is the requirement for rigorous and transparent MRV in the regulatory programs that stand to be developed to fulfill the INDC targets. However, new MRV systems are complex and expensive to plan, build and operate. The cost and complexity of new MRV systems must be carefully contemplated and planned by governments and regulated sectors.

Meanwhile, CDM projects all have MRV that were designed with UNFCCC methodologies and audited by UN –accredited auditors. As Christiana Figueres stated at COP20, *"I am very much a Clean Development*

[3] UNEP, THE EMISSIONS GAP REPORT 2014, Nov2014.
http://www.unep.org/publications/ebooks/emissionsgapreport2014/portals/50268/pdf/EGR2014_HIGHR
[4] California Early Actions Offsets Program
http://www.arb.ca.gov/cc/capandtrade/offsets/earlyaction/credits.htm

Mechanism (CDM) enthusiast, and my enthusiasm is not just because of the potential offsetting, or the market part of it, but because it is such a valuable tool in verifying mitigation".[5]

Signaling CDM CERs as eligible for future compliance is consistent with required baseline estimation. The UNFCCC will review very closely quantifications of baseline emissions by country, sectors, or whatever method a country chooses. UNFCCC will review carefully baseline approaches to ensure that the new national targets are real and not illusory. Meanwhile, CDM projects all have baselines that were prepared and audited using UNFCCC methodologies. CDM baselines are consistent with required baseline discipline for INDCs.

Once the permanent domestic compliance programs are implemented post 2020, the CDM baselines could be reduced by the amount of the new sectoral mitigation target. Reductions below that new baseline could continue to be sold in the domestic and/or international markets. Different options would be evaluated in different countries depending on policy priorities.

Signaling CDM CERs as eligible for future compliance is consistent with required accounting and registry requirements, and ensures no double-counting. In the pre-2020 period, CERs that are sold to other countries will count against the buyer country national commitments; CERs that are sold domestically will count towards domestic national commitments when used for compliance.

The UNFCCC CDM Registry issues CERs, documents trades, and eliminates credits from the country registry when used for compliance or when eliminated voluntarily. The CDM registry ensures accurate CERs accounting for all legal transactions. It maintains accounts for each Participant and each national Party, and monitors all transactions from issuance until the time of use of each CER for compliance or user-elimination. No double counting is allowed with the CDM.

The UNFCCC has established the system and will continue to operate it, as indicated in the Paris Agreement Decision on Guidance Relating to the CDM[6]. Developing countries can begin domestic voluntary trading on the UNFCCC registry foundation now, without incurring domestic administrative costs for new registries under the INDC. The same would occur for Gold Standard and VCS credits using the MARKIT registry.

Much needed confidence can be built with the emitting sectors. In many developing countries, producer associations are very aware of the national INDC targets; they are highly concerned about the cost of compliance and how this will affect their competitiveness. A time-proven measure to generate needed confidence in the productive sectors is the implementation of an EARLY MOVERS POLICY – using the INDC target to signal that the government will **respect the early mitigation investments**, those made prior to the INDC. The lists of private and public companies that invested early in mitigation through the CDM and similar programs include many of the best and most progressive companies in developing countries, the environmental leaders, the firms interested in carbon markets. It is important that the policy signals begin to ***build trust with this group of leaders***, by respecting their investments in mitigation projects and creating a cost-minimizing framework for compliance through domestic trading.

It could be uneconomic for a government to fail to signal that its domestically generated credits will be an eligible compliance option in the future. Administrative silence on this issue would create the risk

[5] http://www.ecosystemmarketplace.com/articles/christiana-figueres-close-personal-carbon-markets/
[6] Guidance Relating to the CDM: FCCC/KP/CMP/2015/L.4

that the CERs produced domestically would be exported to other countries which could meet their goals with these inexpensive options, leaving only more expensive options for domestic compliance accounting.

The Internationally Transferrable Mitigation Outcomes component of the Paris Agreement makes this an explicit possibility. Article 6 provides for international policy linkage, and is thereby exceptionally important for the successful exploitation of the foundation provided by the Paris Agreement. The necessary language for heterogeneous international policy linkage (not only international carbon markets, but international linkage of other national policy instruments) is included. Economically responsible governments would prefer to use these low cost options for domestic compliance and meeting their INDC targets in the most cost-effective way.

This proposal could result in significant compliance cost-savings for the country's economy: If indeed prices and compliance costs in the post-2020 period under formalized cap-and-trade (or other compliance programs) are significantly higher than the CER/VER/NamaCredit prices from voluntary trading in the pre-2020 period, then the purchase, accumulation and banking of these credits for National Compliance use at UNFCCC post 2020, could result in important cost savings for the country's economy, when compared to the case where all compliance investments would begin from zero in the post-2020 period.

Stalled mitigation project portfolios could be implemented with domestic demand, beginning the movement towards low carbon development now. If this proposal were to effectively jump start domestic demand and raise prices to significant levels (one would assume in the US$3-5-7 range) then many renewable energy, energy efficiency, clean transport, and land use change projects that have been formulated and registered under CDM /VCS /GS /NAMA, but are uneconomic without the additional carbon market value, could become economically viable. This has major implications for technology transfer, employment, collateral benefits and moving forward towards low carbon development.

The environmental and social co-benefits of implementing these portfolios early would be very important to developing country welfare. *Why wait until post 2020 to begin to obtain collateral benefits of mitigation, when this proposal could begin generating them now?* For example, improved domestic demand and prices would elevate the rates of return for projects and programs such as:

- Restoration of watersheds, biological corridors and key ecosystems with forestry carbon fixation, which are key to ecosystem-based adaptation in many tropical countries;
- Renewable energy projects that displace pending fossil fuel projects for industrial and electrical generation projects, with major local air quality benefits;
- Clean transport projects would produce major local air quality, noise, congestion and other local benefits.

Finally, and of great utility, the World Bank Partnership for Market Readiness has recently published a new comprehensive study that will be of great utility for designing and implementing this policy proposal, entitled: "OPTIONS TO USE EXISTING INTERNATIONAL OFFSET PROGRAMS IN A DOMESTIC CONTEXT"[7].

This new report includes guidelines on legal issues, regulatory options, and technical considerations that can help developing country policy makers to see how this type of system can be effectively and

[7] https://openknowledge.worldbank.org/handle/10986/22347

efficiently implemented in practice. Section 3.3, GateKeeping, is of particular interest to governments interested in controlling the environmental quality of offsets that would be eligible for compliance purposes. In this model, the international certification program remains responsible for oversight and enforcement of emissions reductions, verifications, credit issuance and registry functions, and the host government checks each project type to ensure that it complies with domestic environmental quality criteria. Currently, the EU, South African, Mexican and South Korean domestic offset programs use the GateKeeping scenario. Four scenarios are developed and reviewed.

COMMENTS FROM INTERNATIONAL POLICY EXPERTS

Several policy experts have reviewed the proposal and have given their comments and recommendations, as follows.

Policy Expert	Entity	Comment-Recommendation
Marcos Castro	World Bank PMR	This proposal would serve to create market readiness in the pre 2020 period. The PMR would welcome the opportunity to contribute to structuring this proposal for domestic implementation in countries that wish to move forward with it. Interestingly, the OECD has indicated that emissions pricing programs in countries seeking entry to that organization will be favorably viewed.
Dirk Forrister	IETA	The INDC process gives developing countries the flexibility to undertake a strategy like this –I think it is pretty innovative as a way of building some local liquidity during the pre-2020 period. Since it is a purely domestic play, it should be free of the "pre" and "post" 2020 accounting questions that could impact international deals. So I think it could be useful, as local companies should see the value of purchasing lower cost CERs now, instead of risking higher cost compliance in the future.
Einar Telnes	Government of Norway	I have a lot of affinity for the cost-benefit-argumentation. In my view, a key argument that could be emphasized further is the NEED for early actions in order to prevent the temp from rising much above 2 degrees. In that context the next 5 years are vital.
Marc Stuart	Founder, ECOSECURITIES	I think this is a pretty brilliant idea and I think it should be aggressively promoted. It makes a ton of sense for the many reasons delineated and is the first idea I've seen that would allow for genuine continuity in these markets.
David Antonoili	President, VCS	This is VERY interesting, and amazingly simple. The idea of establishing a simple regulation that sets out "Early Action" as laid out in the document is quite compelling, and really all it is doing is formalizing a market that will be based on perceptions regarding future caps. In other words, companies would enter the market based on the perception that they may have some sort of cap placed upon them in the future.
Walter Vergara	World Resources Institute	This is an excellent initiative and it dovetails extremely well with the actions that are required to move the LAC region toward zero carbon economies. Early action is pivotal to ensure the process starts without delay. Congratulations on a well thought concept and strategy.
Peter Kalas	Former Minister of Environment Czech Rep, Green Fund	I find this proposal highly interesting as it is based on existing market and administrative elements and has convincing rationale of using actively the transition time of the Paris Agreement prior to 2020. I think that we should now start mobilizing and support the earliest implementation of this policy for the Paris Agreement. The focus on the early carbon market activation and carbon price formation is the key.
Jan Karremans	Euroclima	Following the success of COP21 and the INDCs, finding clear and simple policies for Early Action in the pre-2020 period is of great importance for the climate and for low carbon development. This proposal is the first I have seen that is solid conceptually, applicable and useful for developing countries to make the transition to the highly structured polices that all countries will be preparing for the post 2020 period. It deserves serious consideration from developing country governments, multilateral agencies, development banks, and key actors.