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In the Market for Climate Change Action:

Market mechanisms and the achievement of global emission reductions

An IISD Commentary

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Commentary

The 2007 analysis by the UN Framework Convention on Climate Change, *Investment and Financial Flows to Address Climate Change,* puts the total additional annual funding required to return greenhouse gas emissions to 2005 levels at between US$200 billion and US$210 billion in 2030. With numbers like this on the table, it's unsurprising that financing remains one of the most contentious issues in the international negotiations.

Resolution of the question "Who pays, and how much?" will be a major determinant of any future agreement.

Financing is particularly necessary in least developed countries that are often most vulnerable to the negative impacts of climate change, while at the same time the least historically responsible for it. Global needs will only increase in the coming years.

The provision of public funding via government and international organizations is one side of the financing coin, and a fundamental one at that. But the role that the international market plays in creating both the space and incentives for emission reductions is a second important component. Undoubtedly, given the increasingly interconnected nature of our international economy and the critical need for increased action on climate change, market mechanisms will remain a key piece of the climate change puzzle.

In Canada we simply do not have the ability to meet even the most modest of emission-reduction goals without the use of international offsets and market mechanisms. With Kyoto, the use of mechanisms under the International Emissions Trading system became something of a contentious issue in this country. The mechanism theoretically allowed a high-emitting country like ours to meet its commitments by simply purchasing excess credits from Russia, for example, which had a massive amount of surplus emission credits available because of its moderate target and struggling economy.

Canada made it clear that it would not make any "hot air" purchases from Russia or any other countries. But Copenhagen offers us the opportunity to move beyond Kyoto. Discussions of new mechanisms are about much more than hot air.

Canada is now the only Organisation for Economic Co-operation and Development (OECD) country that does not support or participate in international offsetting to meet domestic reduction commitments. A change in Canada's position on this could help rebuild its badly tarnished reputation. Such a move would have a potential double dividend in that it would show a real commitment to developing countries while working to meet our own reduction commitments in a meaningful way, with international offsets as part of the equation.

This is not to say that market mechanisms will be a silver bullet for Canada—or any other country, for that matter. Issues of access and transaction costs within existing mechanisms under Kyoto have led some to question the effectiveness of the Clean Development Mechanism and joint implementation.

New mechanisms under a future agreement will require robust processes to ensure the environmental integrity of both projects and crediting. When designed and implemented in the right way, market mechanisms have the real potential to sensitize all countries to clean energy opportunities and meaningful action toward low-carbon development.

Mechanisms that recognize nationally appropriate mitigation actions can improve on quality, quantity and regional distribution far above and beyond Clean Development Mechanism and joint implementation projects. A well-functioning system could ensure that revenue generated through the sale of emission permits is not misused and instead is spent on projects that will provide long-term benefits at the local, national and international level.

International offsets provide a cost-effective option in reaching emission-reduction commitments. Mitigation investments in developing countries are often more cost-effective, and larger emission reductions can be generated per dollar of investment within developed countries than with domestic reductions. Particularly in a country like Canada, the economic viability of mitigation actions is the priority. The positive role of mechanisms in the promotion and diffusion of green technologies, the advancement of energy efficiency, and the encouragement of conservation could be seen as positive spinoffs.

These positive spinoffs are key opportunities to move development in a truly sustainable direction. There are countless ways for countries to set their own commitments and actions while allowing market mechanisms to provide the parameters for economically efficient means by which to achieve a desired environmental goal.

A robust framework for market mechanisms within a future agreement could set the groundwork for a much broader shift in how development takes place at the most fundamental levels.

All countries around the world need to give particular attention to more creative avenues through which to engage the international market to their advantage in meeting national commitments. But the complexity of the market system must not be underestimated.

The international carbon market is a mosaic of markets, which includes allowance-based markets from both international and domestic emission-trading regimes, credit-based markets related to project-based mechanisms, and voluntary and subnational trading schemes. All of these interconnected avenues need to be considered and utilized under a new regime.

Although Copenhagen will not produce the robust legal framework once hoped for, momentum toward reaching agreement in the near future must be maintained. When it comes to deciding who pays and how, we know this is a daunting task, to say the least. If approached as one (albeit large) piece of the complex climate change puzzle, market mechanisms are sure to play an important role in providing broader international engagement as we continue to search for innovative ways to address climate change, and as we fundamentally rethink our development priorities.