

CSE dossier



factsheet 4

FLEXIBLE MECHANISMS

Can you sell what is not yours?

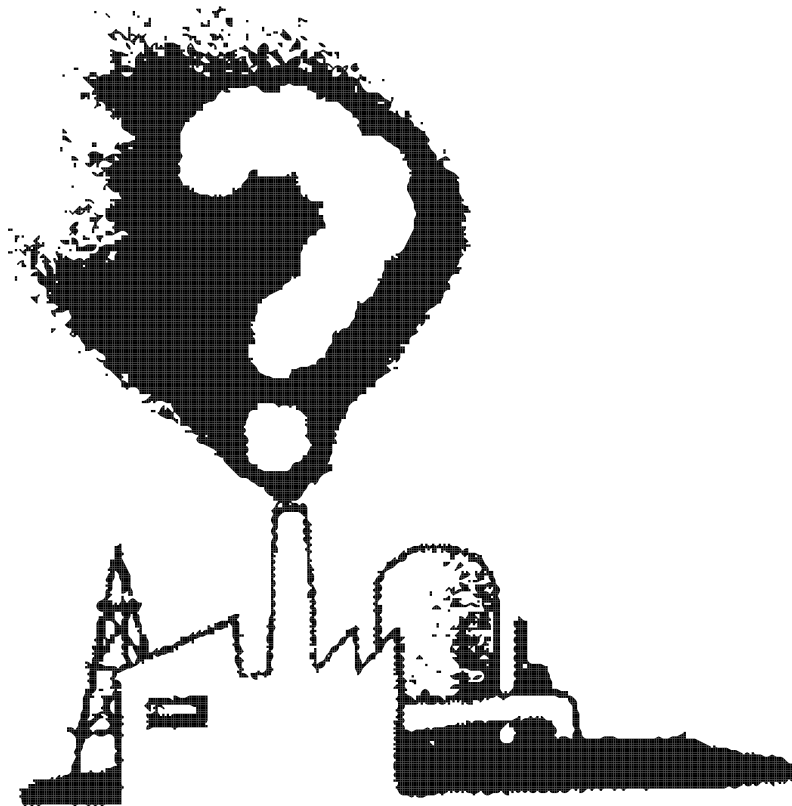
FOURTH
SESSION
OF
THE
CONFERENCE
OF
THE
PARTIES
TO
THE
UNITED
NATIONS
FRAMEWORK
CONVENTION
ON
CLIMATE
CHANGE

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Who does the atmosphere belong to? Can you trade emissions without allocation of rights and entitlements of each country to the atmosphere. The industrialised North seems to think so. And it thinks that the Kyoto Protocol has given them the sanction to appropriate

this global common and to sell and buy emissions without property rights.

In the Kyoto Protocol, article 17 on Emission Trading was a midnight entry that got drafted in at the last minute of negotiations in Kyoto. When developing countries raised objections at the inclusion of this mechanism without

the discussion on the issue of entitlements, it was agreed that this issue would be part of the work plan for the future. The Kyoto Protocol, in its article on Emission Trading, says that the “relevant principles, modalities, rules and guidelines, in particular for verification, reporting and accountability of emission trading, has to be worked out.” It is now essential that governments define these principles in a manner that is both equitable and sustainable.

Under the Kyoto Protocol, emission trading is a mechanism for trading between Annex 1 parties — between industrialised countries. But, as the trading requires the creation of trade rules to a global resource, it is essential that all countries participate in the rule-making exercise. For the development of rules on trading, it is also essential that all mechanisms of the Kyoto Protocol are considered together.

MANAGING GLOBAL COMMONS

Environmental experience from across the world with regards the management of common property like water, forests or fisheries shows clearly that the following elements are prerequisites of sustainable management;

a. Security of rights over common property: For instance, in the case of forest management it is clear that the rights of communities to common land must be clearly enunciated. Without this security of usage rights, forests are overused and destroyed — what economists call the “tragedy of the commons”.

b. Equity in the distribution of the common resource: This is essential as the community will respect the common rules of governance only if they are fair and equitable. Common resources demand consensus and most importantly demand discipline in the use of the property. Therefore, the equal distribution of rights is a prerequisite for common property management.

The atmosphere is also a common global resource. The management of this resource demands the cooperation of all countries and all people. For any agreement on the management of this resource to be effective, the community of member states must have clearly enunciated rights that must be equitable and just. *Without equity, agreement on climate cannot be ecologically effective.*

DISTRIBUTING THE ATMOSPHERE

The tragedy of the atmospheric common has been the lack of rights to the ecological space. As a result, countries have borrowed or drawn heavily and without control. They have emitted greenhouse gases far in excess of what the Earth can withstand. This was because they could emit without limits or quotas and were “free riding” on this natural capi-

tal. What has been called the “natural debt” of the North as against the financial debt of the South. The climate convention has to curtail the use of emissions and this can only be done through the creation of rights and entitlements of each nation to the atmosphere so that future responsibilities are clearly demarcated. This allocation of the common space has to be done on the basis of historical, present and future contributions of each nation to the global warming crisis.

Entitlements will also provide the basis for trading emissions. It is important to recognise that currently, without this allocation of rights, trading emissions cannot work. The world cannot set up a trading system of carbon without the clear enunciation of rights and entitlements of each nation. Otherwise industrialised nations will be selling what is not theirs to sell in the first place. This would be unethical trade practice. But also, it would be completely unsustainable as it would not allow each country to an equal responsibility of the global common. This strategy would not lead to long-term change and would not meet the ultimate objective of the convention.

What is equal to the North?

The question of who has been or will be responsible for global warming has been repeatedly raised both by industrialised countries and by developing countries. The picture on this, as far as available studies go, complicated. It is as follows:

- If past and current emissions are taken into account, then industrialised countries are largely responsible for the greenhouse gas emissions. Therefore, it is argued that industrialised countries must take the lead in cutting greenhouse gas emissions.
- But with economies of developing countries growing rapidly, their future emissions will become very high. Industrialised countries argue what is the point of our cutting emissions, if the developing countries are going to increase their emissions. So when should developing countries take on responsibility to cut down their greenhouse gas emissions?
- According to the Intergovernmental Panel on Climate Change (IPCC), a body of scientists from across the world, sponsored by the United Nations, the annual emissions of developing countries will equal that of industrialised countries in 2037. But others point out that on a per capita comparison these emissions will still be lopsided in favour of industrialised countries. Some 20 per cent of the world’s population will still be responsible for 50 per cent of the greenhouse gas emissions.
- A Brazilian study meanwhile says that if industrialised past emissions are taken into account, that is,

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Non Aligned Movement votes for equity

The heads of government of the Movement of Non-Aligned Countries met in Durban, South Africa in early September 1998, to address crucial global issues affecting their peoples with the view to agreeing to a set of actions in the promotion of peace, security and development, conducive to a new system of international relations based on the principles of justice, equality and democracy.

The final document, under Environment and Development, addresses climate change.³

Paragraph 342

The Heads of State welcomed the Kyoto Protocol on legally binding commitments for the parties to the Framework Convention on Climate Change to reduce their emission of Greenhouse Gases as contained in Annex B of the Kyoto Protocol. They called on the developed countries to undertake urgent and effective steps to implement these commitments through domestic action. Emission trading for implementation of such commitments can only commence after issues relating to the principles, modalities etc. of such trading, *including the initial allocations of emission entitlement on an equitable basis to all countries has been agreed upon by the Parties to the Framework Convention on Climate*

Change. They categorically rejected all attempts by some developed countries to link their ratification of the Kyoto Protocol with the question of participation by developing countries in the reduction of GHG emissions. They also called for immediate measures to provide the developing countries with necessary financial resources and clean technology to enable them to meet their existing commitments under the Framework convention on Climate Change, including inter alia, inventorisation of national emissions and dissemination of knowledge of climate change.

Paragraph 343

The Heads of State or Government urged developed countries to implement effective measures, to cope with their commitments in terms of the reduction of emissions of greenhouse gases in their own territories and highlighted the need to avoid the so-called 'flexibility mechanisms' of the Kyoto Protocol enabling those countries to elude the fulfilment of their commitments. In this connection, the launching of the Clean Development Mechanism, established in terms of the Kyoto Protocol, could bring about risk and opportunities for the sustainable development of developing countries that must be adequately addressed.

emissions from the start of the Industrial Revolution, then the emissions of developing countries will catch up with those of industrialised countries only in the early 22nd century.

● The Washington-based World Resources Institute (WRI), however, argues that as a greenhouse gas like carbon dioxide stays for only about one hundred years in the atmosphere, some of the emissions from the early part of the Industrial Revolution would have gone out of the atmosphere. Therefore, if decay rates of greenhouse gases are factored in, then developing country emissions will catch up with industrialised country emissions, even if historical emissions are taken into account, by the latter part of the 21st century.

● But when will per capita emissions of developing country emissions and industrialised countries become equal? Probably not even in the 22nd century, says an expert of the WRI. But that is partly because developing country population is increasing.

It is very clear that sharing responsibility and distributing the cap on greenhouse gas emissions is not going to be an easy task for governments, especially governments in democratic countries from the developing world whose leaders must assure the people that combating global warming will not disrupt their fledgling economies but also ensure future ecological and economic rights of their people. Therefore, discussions of the numerous matters that the KP, hurriedly put together in the wee hours of the last day in Kyoto in 1997, left undecided are going

to be critical for finding an ecologically effective and yet just and equitable solution for combating global warming, are going to be very important for the future of the world.

G-77 POSITION AND FOLLOW UP

The G-77 has taken cognisance of the issue of entitlements. In the Position Paper of the Group of 77 and China on the Mechanism of the Kyoto Protocol presented to the contact group on mechanisms in the meeting in Bonn, the group categorically stated the need for emission rights and entitlements. It said, " In respect of emission trading, the Group of 77 and China had stated that until the question of emission rights and entitlements is addressed equitably, it would not be possible to have emission trading. The question of legal and equitable basis of entitlements continues to occupy a central position."¹

The draft conclusions of the Chairmen on mechanisms to the meeting in Bonn also notes that the issues for work programme for Article 17 — emission trading between Annex 1 parties requires the following;²

1. Basis of rights and entitlements of Annex 1 parties for trading emissions;
2. Determination and creation of such rights and entitlements
3. Supplimentarity to domestic action for the purpose of meeting quantified emission limitation and reduction commitments under Article 3.
4. Conformity with the principle of equity in the

The world cannot set up a trading system of carbon without the clear enunciation of rights and entitlements of each nation. Otherwise industrialised nations will be selling what is not theirs to sell in the first place

convention.

5. Real and verifiable reduction of GHG emissions.
6. Elements of principles, modalities, rules and guidelines for any trading in emissions.
7. Elaboration of principles, modalities, rules and guidelines, including the funding of adaptation.
8. Matters related to verification, reporting and accountability.
9. Whether any commonality with other mechanisms.

The items have to be elaborated before trading takes place. But it is important to note that there has been little effort by anyone — including by multilateral agencies — to take on board the G-77 concerns. The frantic activity to define trading rules does not include the examination or even consideration of these issues. UNCTAD, which has the specific mandate for working on developing country concerns and is busy launching itself as the supranational emissions trading incorporated, treats this issue with a galling contempt. And as a result there has been no work by inter-agencies who are keen on brokering a deal to elaborate these principles of entitlements. But political commitment has been on the rise. The heads of government of the Non Aligned Movement who met in Durban in September strongly endorsed this principle (see box). And the European Parliament has in a 10 to 1 ruling also come out in support of the principle of contraction and convergence which would call for global equity in the sharing of the resource. The stage is now set for Buenos Aires.

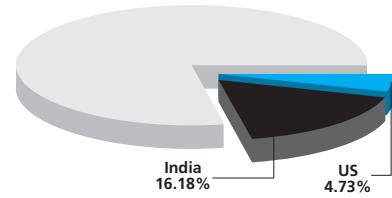
THE POLITICS OF THE BASE YEAR

Under the Kyoto Protocol, industrialised countries have ingeniously allocated the right to trade emissions amongst themselves without the assignment of entitlements on the basis of equity. The simple formulation adopted by the Protocol is that countries take a percentage reduction on its current emissions. The Kyoto Protocol has turned 'compliance' into an intense numbers game. In the Kyoto game anything that helps to increase the emissions in the base year, especially because of activities that have since ceased or reduced immediately gives the country a head start. And then, emissions trading, joint implementation and CDM further provide opportunities to borrow 'emissions reduction' from other countries where emissions reduction is already taking place because of a slowing down to the economy or from those countries where reducing emissions is cheaper in the short run. This sets a precedent that will lead to more greenhouse gas emissions and will force each country to fiddle with their carbon budget.

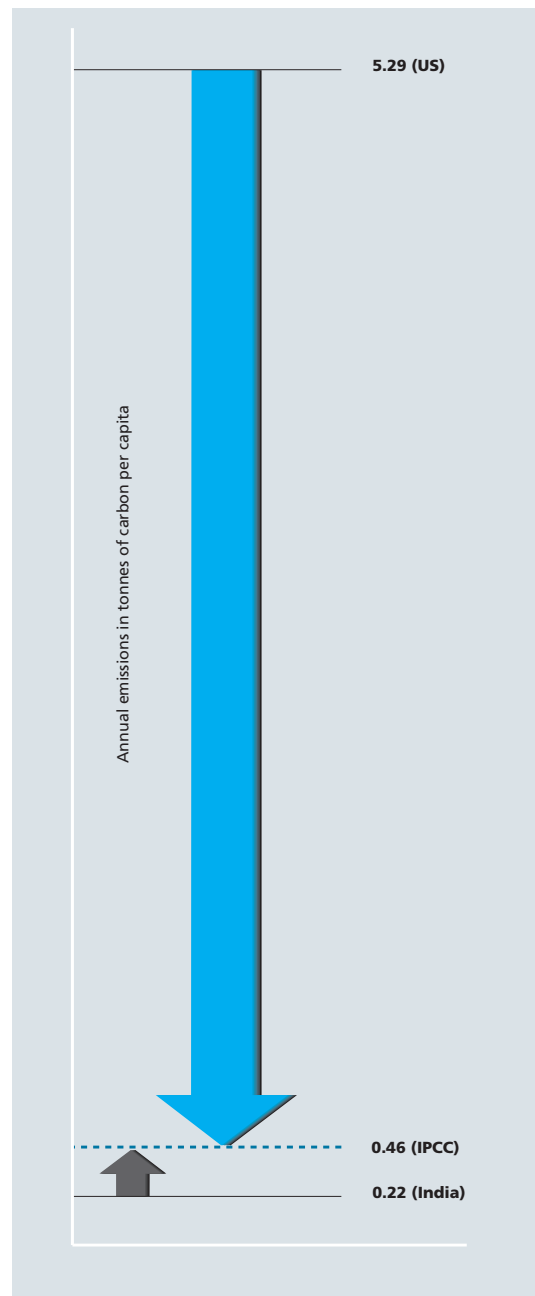
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More for less

Almost four times the population of the US lives in India



But if 0.46 tonnes of carbon are assumed to be an ideal per capita emission limit (according to IPCC estimates), India can still emit more. But the US has to come down drastically



Note: These figures are only for carbon dioxide emissions from fossil fuel burning, gas flaring and cement production

Source: Oak Ridge National Laboratory, USA

EU: will it or won't it

In climate negotiations, the EU has backtracked more often than it has been on track. The EU strategy seems to be to flex its muscles mainly in response to its domestic environmental constituency. But on each issue it finally, after much fanfare, gives in using US obduracy as its favorite excuse. During the run up to the signing of the climate convention at the Rio Summit, it made noises about the need for a carbon tax. But gave in quickly citing US pressure. During the many months leading to the Kyoto Protocol, the EU talked loudly and boldly about the need to cut emissions drastically – by 15 per cent of 1990 levels and no loopholes of being able to buy the future. But gave in. Post Kyoto, the EU had taken the high morale ground saying that it was important to curtail emission domestically. In June, presenting its position to the joint meeting of the subsidiary bodies to the convention, EU had strongly argued for the need of a cap on how the amount emissions that could be bought. In September there was a move to go back on this commitment. The draft resolution of the European Parliament in a complete turnaround said that was needed was “maximum degree of flexibility, including joint implementation and trading in emission rights consistent with the proper monitoring, reporting and enforcement of the global cap on emissions.” It then took the might of the articulate environmental community in Europe to reverse this damage. The final resolution of the European Parliament stresses the need for “an

agreement to have a quantitative ceiling on the use of flexibility mechanisms that will ensure that the majority of emission reduction to be met domestically.”¹¹ Ritt Bjerregaard, EU environment commissioner has however said that caps are not needed. And British environment minister Michael Meacher who had made a publicised speech to the GLOBE parliamentarians calling for a ceiling of 50 per cent in the use of flexible emissions seems to be having cold feet¹⁰. Reportedly only four EU countries are now supporting the 50 per cent target; Denmark, Germany, Luxembourg and Austria. The European environment council has now come up with an “innovative” approach to appease all sides. The draft council conclusions on climate change adopted at the EU ministerial council meeting in early October discuss three “options”. The paper reaffirms the “concrete ceiling on the use of flexible mechanisms has to be defined in order to ensure that those mechanisms do not undermine domestic actions.” But now it gives a menu of options on the ceiling. Option one, define as 50 per cent of the emission targets. Second, to use quantitative or qualitative criteria, involving early domestic actions to demonstrate progress. And, third option is to define the ceiling as a percentage of the emissions in 1990 or 1995.¹²

The chipping away has begun. It now remains to be seen if the EU will remain true to its position or will go back on its principles, once again.

The Kyoto Protocol provides a perverse incentive to polluters. The baseline method cannot be accepted as the principle for allocating atmospheric space

Take the case of Australia. In 1990, 30 per cent of the country's emissions were from deforestation alone. These emissions were controlled subsequently, but by winning the right to count any improvement from 1990 as its national credit, Australia can actually increase its emissions by 8 per cent. Given that these emissions are still present in the atmosphere and will cause global warming this is a death gift indeed.

If this innovative climate accounting is accepted as the method of calculating each nation's targets then it virtually rewards the big polluters and lets them appropriate the common space. In fact, this method would suggest that developing countries should be allowed to expand their emissions before they accept a percentage cut. Therefore, for developing countries, which will enter the same numbers game sooner or later, the baseline will be very important. ***The Kyoto Protocol, therefore, provides a perverse incentive to polluters. The baseline method cannot be accepted as the principle for allocating atmospheric space.***

Caps: how much change should be done at home?

Should industrialised countries be forced to bring about domestic reduction in emission levels? How much change should take place domestically? Or

can they meet their reduction targets by purchasing all their emission units from developing countries and ailing economies of industrialised countries. This is one of the most contentious debates of this new “commodified” atmospheric trade. Interestingly the European Union had initially taken a hard line on the issue of caps — arguing that the net transfers (or non domestic action) should not be greater than the amount of emissions reduced domestically. But under pressure from the US, Norway and its hot air surplus neighbours in Eastern Europe, it has now begun to backtrack. “Rules to police the instruments are needed not caps” says Ritt Bjerregaard, the EU commissioner for the environment speaking at the environment ministers conference in Tokyo⁴. But at the same meeting she is also reported as saying “flexibility must never become a back door through which rich countries can get away by paying other countries instead of doing their homework.”⁵ European NGOs want their governments to take action at home. They insist on a cap — with emission trading, joint implementation and CDM contributing not more than 30 per cent of the developed country target by the first commitment period. And that CDM should only contribute 3 per cent of the developed country reduction target and should be confined to renewable technologies and demand side management.⁶

The Kyoto Protocol is understandably “vague” about the issue. Article 17 of the Protocol that deals with emission trading says that reductions achieved through emissions trading would have to be “supplemental to domestic actions”. The Protocol, in the article on CDM, says that industrialised may use the certified emission reduction units to contribute to compliance “with part of” their emission reduction targets. The issue is “what is supplemental or how much is enough for something to be a part of something?” Is the US proposal cut emissions domestically by only 15 per cent “supplemental”? Or its decision to purchase 80 per cent of its emissions at the cheapest price through CDM a “part of” its emission reductions commitments?

The US and Norway have consistently argued against any move to put a “ceiling on what they can trade.” The most favoured blackmail is to say that this will “encourage” ratification of the Protocol. The second favourite is the bribe to developing countries saying that a ceiling will “limit the number of projects in developing countries”.

EMISSION TRADING: free but not fair

The currently discussed principles for emission trading are can be described as lead free but not fair. But there is desperation about getting the trade going. At the preparatory meeting in Bonn in June, annoyed with the G-77 and China for having asked for time to consider issues in the trading regime, the US delegation — which has dilly dallied on every climate related issue thundered “The United States wants to move from paper to action. The time for thinking is over”.

There are three negotiating blocks in climate:

- a. The JUSCANNZ block, led by US comprises of Australia, Canada, Iceland, Japan, New Zealand, Norway. This group has been at the forefront of demanding developing country participation is now joined by the Russian Federation that has a lot of “hot air” to sell. **This is the Free Raiders Group.**
- b. The EU block stands together. Its most important climate ploy is to allow its countries to “bubble together” — that is EU countries can meet their target in aggregate. **This is the Free Bubbles Group.**
- c. The G-77 and China are the third block. These countries do not have commitments to curtail their emissions but they are required to “assist” the industrialised meet their targets by selling carbon units. The Clean Development Mechanism has been designed to get their cooperation. This Group will face increasing division in the future as some of its members would like to “sell” quickly and cheaply while the going is good, while other members would like to see the establishment of an equitable

regime for trading. **This is the “(Not) For Sale Group”.**

A review of the positions of these three groups shows important differences between the Free Raiders and Free Bubbles groups and then are differences that both these groups have with the (Not) For Sale Group^{7,8,9}

Between the first two, the main differences are as follows;

a. *Caps on non-domestic trading.* The Kyoto Protocol says that in the case of joint implementation and emission trading the acquisition of emission reduction units will be “supplemental to domestic action”. In the case of the Clean Development Mechanism, it says that industrialised countries may use the certified emission reduction units to contribute to compliance “with part of” their emission reduction targets. The Free Raiders want no caps on what it will achieve domestically or through international trade. It would like to be able to buy the “cheapest” option and minimise its domestic economic costs. The EU position on this issue is, as yet, to emphasise “supplementarity”. It believes that “domestic action should provide the main means of achieving commitments and calls for a “concrete ceiling on the use of all the flexibility mechanisms to be defined

b. *How free and unregulated should the trading in atmosphere be?* There are important differences and similarity in the approach of these two blocks on making the atmosphere a free and open traded commodity.

c) *Who will be allowed to trade?* Both agree on that trading should be done by “legal entities, including private parties”. JUSCANNZ defines the “legal entities” as including private individuals, companies, societies (which could include environmental and other non-governmental organisations), industry groups and brokers.

ix) *Who will be responsible for the “legal entities”.* EU holds the Parties — the country — responsible for compliance and not the legal entity. JUSCANNZ is not specific about this.

x) *What will be traded?* JUSCANNZ calls it ‘Assigned Amount Units’ (AAUs) — which would represent a tradeable form of the ‘assigned amount’ of Annex 1. AAUs would have a unique serial number that identifies the country of origin and the relevant commitment period. The EU calls them, Parts of Assigned Amount (PAA) units.

xi) *What is the measure of this unit?* The JUSCANNZ want “no differentiation of the units on the basis of data certainty for gases or sources.” Both want unit to be denominated in CO (2) equivalent. The Global Warming Potentials (GWPs) would be

The US and Norway have consistently argued against any move to put a “ceiling on what they can trade”

used as the appropriate conversion to convert non CO(2) gases into CO(2) equivalent.

xii) *Institutional arrangements for trading:* JUSCANNZ does not want to establish a new international forum/institution for trading. It would like a system to record ownership and transfers of these AAUs at the national level. It would even give two countries the privilege of merging (or consolidating) their national recording systems into one system. It would therefore, see the world as one big free market and that countries are even operate mergers if needed. It would like cartels to operate with freedom. And at the end of the commitment period — which gives no room for ensuring compliance during the trading period — the Party will finalise its emission inventory and submit a report to the 'designated authority.'

The EU sees a greater role a global institution; it would want the UNFCCC secretariat to be responsible for recording and reporting trade. It would even want Parties to give prior notification to UNFCCC of their intention to transfer or acquire units, above a specified amount.

xiii) *But as far as non-compliance is concerned,* both have proposed a weak, toothless system. JUSCANNZ, of course, does not even use the word penalty.

What is property right of the buyer and seller. This is the issue of key concern to the G-77 and China. But this is one issue on which there is com-

plete unity among the superheated powers. They would not want to discuss emission rights. For them, the issue has been settled. They can trade their assigned amounts. And would like to do so as freely — not fairly — as possible.

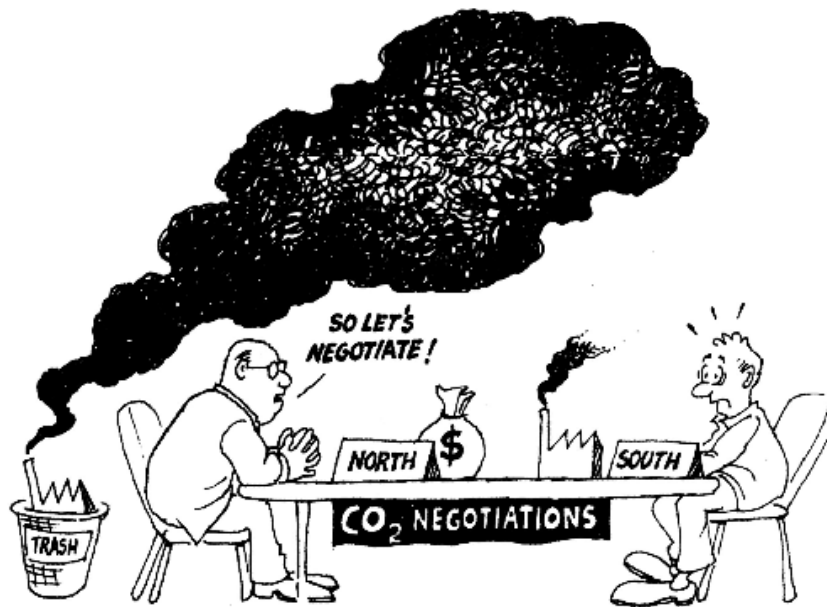
TOWARDS A 'PRINCIPLED' EMISSION TRADING SYSTEM

The principles of emission trading which have to be elaborated at Buenos Aires must be built upon the equitable principle of equal per capita entitlements for all people on earth. The world must accept some common maximum per capita emission for each country in order to deal with global warming. We cannot have a world in which some countries have to freeze their carbon dioxide emissions at one level and other countries at another level. This would mean freezing global inequality. A convergence principle towards a just and sustainable norm can be the only rational principle in such a situation. This would be globally just and in conformity with the principles of the Framework Convention on Climate Change. Per capita entitlements would also be the best approach to meet the "ultimate objective" of the convention, that is to curtail greenhouse gas emissions. Rather than the 'creative accounting strategy' of the Kyoto Protocol. Trading therefore must be built on equitable emissions entitlement. *Trading cannot be carried out for economic efficiency. It must also promote ecological efficiency and social justice.*

The world must accept some common maximum per capita emission for each country in order to deal with global warming. We cannot have a world in which countries have to freeze their carbon dioxide emissions at different levels

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- 2 UNFCCC 1998, Mechanisms, Draft Conclusions by the Chairmen, FCCC/SB/1998/CRP.2/ June 12, Bonn, *mimeo*
- 3 1998, Final Communiqué adopted at the NAM Heads of State Conference, Durban, September 1998
- 4 1998, EU environment commissioner: rules instead of ceilings in Joint Implementation Quarterly, September 1998
- 5 1998, Climate change – groups respond to Kyoto Protocol in Bridges weekly trade news digest, vol 2, number 37
- 6 Stephan Singer 1998, Cantalk

- 7 1998, Non paper on Principles, Modalities, Rules and Guidelines for an international emission trading regime, Australia, Canada, Iceland, Japan, New Zealand, Norway, Russian Federation and the United States of America, June 3, Bonn
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- 9 1998, Position paper of G-77 and China at the third meeting of the joint SBI/SBSTA contact group on the mechanisms of the Kyoto Protocol, June 11, Bonn
- 10 1998, European Parliament Resolution on climate change
- 11 Andrew Warren 1998, Cantalk October 5, *mimeo*
- 12 Kyodo Newswire 1998, EU drafts 3 ways to limit flexible emission cut systems, October 5



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 be carried out
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