GUEST COMMENTARY - Linking carbon markets through project mechanisms: The need for common protocols

By Alexander Rau, Principal, Climate Wedge Ltd.

With momentum building towards mandatory carbon constraints in the US, and prospects for a harmonised, top-down international framework for carbon still bleak, project mechanisms will likely play an increasingly prominent role in linking together an emerging network of post-Kyoto carbon markets.

The past few years have demonstrated the success of markets for project-based emissions reductions (i.e. carbon credits), both in terms of long-term viability and investment opportunity as well as actual climatic benefit. Recently the combined pipelines of the CDM/JI mechanisms of the Kyoto Protocol passed the billion tonne mark, and significant amounts of private capital have been motivated to finance emission reduction projects well in advance of actual compliance obligations.

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As policy-makers debate the critical design elements of future emissions trading systems in North America and internationally, the bottom-up consensus from many of those active in the current markets is that regional systems are more likely to link indirectly rather than directly through the exchange of allowances. Heterogeneity in the design of different markets (safety valves, varying strictness and methods of allocation, etc.) would likely lead to politically unpalatable one-way flows of allowances and thus abatement.

By contrast, there is no inherent reason why the protocols governing emissions reduction instruments created at the project level should vary as dramatically from region to region. Linking through acceptance of common project mechanisms therefore has a more realistic chance of building a networked global market and carbon currency, which will facilitate the deployment of capital to where emissions can be reduced most efficiently.

Broadly speaking, such a project-based linking scenario could happen in one of three ways.

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Domestic trading schemes could fully accept existing project mechanisms such as the CDM, deferring to the parameters of those mechanisms and accepting only registered credits. This is arguably the easiest approach, as it ties together existing infrastructure and minimises administrative load. However, current restrictions and imperfections in the CDM process suggest this will remain an incomplete solution without significant modifications or the creation of other mechanisms to cover non-Kyoto countries and project types not feasible under CDM.

The second approach would be an acceptance of common frameworks for project-based reductions. This allows the flexibility for different regulatory systems to determine their own boundary conditions (e.g. on project types or geographies), while maintaining a coherent set of methodologies and certification procedures. In the absence of a single crediting authority, it would remain to be seen whether the linkage would occur through the instrument, or just through the multiple offtake markets a project can serve. This seems to be the intended direction of the international credits provision of the new Lieberman-McCain bill.

The final, and least desirable, scenario is that each region reinvents the wheel on project mechanisms and protocols, and we all pray for certain instances of overlap (with due respect, the RGGI approach).

Due to the wealth of experience and intelligence built up over the past few years in the international project markets, the core elements of project mechanisms are now largely understood. In particular, the CDM has generated a large set of methodologies that have been road-tested with billions of dollars of capital across hundreds of project types, and a group of experienced verifiers. This should serve as the basis for a common framework on project mechanisms for a post-Kyoto carbon regime.

By ensuring consistency in standards and criteria used in certifying emissions reduction credits, project mechanisms will continue to scale and deliver meaningful greenhouse gas reductions while linking together trading systems. And since project mechanisms provide natural boundaries around which to measure, verify, and document reductions, they will facilitate early action to reduce emissions even ahead of final consensus on legislation.

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