Content

What are Market and Non-Market Mechanisms?.

What are market mechanisms?

When countries set a limit, or cap, on greenhouse gas emissions, they create something of value: the right to emit. What happens if we apply market principles and rules? The countries or companies that reduce emissions below their cap have something to sell, an unused right to emit, measured in tonnes of CO2 equivalent. Countries and companies that don't meet their target can buy these one-tonne units to make up the shortfall. This is called emissions trading, or cap and trade. The net effect on the atmosphere is the same, provided measurements are accurate – i.e. each unit represents a true one-tonne reduction below the cap – and each unit is used only once. This requires clear rules and transparency.

There are a number of benefits to emissions trading. Flexibility is an important one. Companies can better plan their capital investments and climate action in the medium and long term, knowing that in some years they can buy units to help meet their reduction targets. In other years they might have units to sell. This is another benefit of emissions trading – it creates a monetary incentive to reduce emissions.

English

The Kyoto Protocol created three such "market mechanisms". The first, emissions trading (/international-emissions-trading), as described above, has led to a growing number of emissions markets in countries around the world. Perhaps the best known is the European Union Emissions Trading System (EUETS). The other two market mechanisms are project-based: the Clean Development Mechanism (/process-and-meetings/the-kyoto-protocol/mechanisms-under-the-kyoto-protocol/the-clean-development-mechanism) (CDM) and joint implementation (/process/the-kyoto-protocol/mechanisms/joint-implementation) (JI). Projects under CDM and JI don't earn units by reducing emissions below a set cap. They earn units by reducing emissions below "business-as-usual" – the emissions that would occur without the project. Just like emissions trading, for such mechanisms to work a tonne reduction must represent a real tonne. This means that the calculation of the "business-as-usual" emissions must be based on good information, for example of past emissions, and accurate measurement of the emissions once the project is implemented. The project earns the difference between the two – the business-as-usual emissions and the post-project emissions, again, measured in tonnes of CO2 equivalent.

The units have a name. Under the CDM, the units are called certified emission reductions (CERs). Under JI they're called emission reduction units (ERUs). Companies under the EUETS could use CERs and JI units to cover a part of their obligations. Likewise, countries with an emission reduction obligation under the Kyoto Protocol could use the units to cover a part of that obligation. The incentive thus created led to registration of more than 8000 projects in 111 developing countries eager to earn saleable CERs – spurring everything from wind power projects, to bus rapid transit schemes, to projects that spread the use of more efficient cook stoves. Likewise, JI incentivized projects, not in developing countries but in countries with an emission reduction commitment under the Kyoto Protocol.

Market and non-market based approaches in the Paris Agreement

Parties negotiating the Paris Climate Change Agreement decided they liked the benefits of countries cooperating to reduce emissions, like they can do under a market-based system. Under the Paris Agreement, cooperation should promote greater ambition (in terms of mitigation of emissions and adaptation to the effects of climate change), it should foster sustainable development and it should encourage broad participation in climate action from the private and public sectors. Parties also recognized that there are other ways to cooperate on climate action, and approaches other than market-based approaches.

Parties expressed all of this in Article 6 of the Paris Agreement, they recognizedthe possibility of cooperative implementation (/process/the-paris-agreement/cooperative-implementation) among Parties and agreed to create a new market mechanism, that should be built drawing on the lessons from what went before, such as the CDM and JI. They also agreed to create a framework for non-market approaches mechanism. Just as the details of the new market mechanism need to be hammered out, Parties need to agree on how their new framework of non-market approaches mechanism will function. Until they decide otherwise, the non-market approaches mechanism can be anything and everything, provided it's not market-based. It's a broad basket, but based on what Parties have expressed since Paris, the non-market approaches mechanism will focus on cooperation on climate policy, it could include fiscal measures, such as putting a price on carbon or applying taxes to discourage emissions.