



Joint Implementation Strategies for a Post-Kyoto World

Joint Implementation Action Group

Position Paper for the 14th COP/MOP in Poznan
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1. INTRODUCTION

In the post 2012 regime, the contribution of JI will be a crucial. This paper sets out the position of the Joint Implementation Action Group or (“JIAG”), a consortium of Joint Implementation (“JI”) practitioners which are currently developing JI projects representing more than 100 millions of tonnes of greenhouse gas emission reductions. It is essential that JI is strengthened to create incentives to reduce greenhouse gas (“GHG”) emission in a wide range of sectors, to maximize its potential as project finance mechanism, and to create incentives to reduce GHG emissions for a broad range of actors.

Joint Implementation deserves significantly more emphasis in international negotiations on mechanisms for tackling climate change. The purpose of this paper is to help policy-makers at the 14th Conference of Parties/Meeting of the Parties (“COP/MOP”) in Poznan understand the importance of JI and advice on practical solutions for best structuring the JI mechanism in the post-2012 period.

A JI-type mechanism has inherent advantages and can work in harmony with other emissions trading measures and market instruments. We will demonstrate some of the common fallacies and myths surrounding JI which have diminished the degree of international attention and priority of the mechanism. Finally, we outline the background against which a reformed JI would operate and the steps required to realize the full potential of the mechanism after 2012.

2. THE POWER OF JI

WHAT IT IS

JI is one of the three flexible mechanisms for emissions trading set out in the Kyoto Protocol. Like the Clean Development Mechanism (“CDM”) it is a mechanism for financing individual projects aimed at reducing GHG emissions, and functions similarly through the comparison of actual emissions from a project with a hypothetical baseline projected into the future.

JI is designed for use in Annex I countries with capped GHG emissions, unlike CDM, which is tailored to be used in non-Annex I countries bearing no obligations in terms of GHG limitation and reduction. Emission Reduction Units (“ERUs” – the trading currency of JI) are converted from a corresponding number of Assigned Amount Units (“AAUs”) and are hence created and used in an environment with capped emissions. This differs from the CDM, where projects result in the generation of Certified Emission Reductions (“CERs”) which can be used to off-set emissions in Annex I countries and thus stretch their emission caps. With the conversion into ERUs the original AAUs are cancelled from the

account of the project's host country thus preserving the total carbon trading currency balance in the GHG capped system. This means that all emissions reductions transacted under JI are underwritten by a legally-binding sovereign obligation attached to the assigned amount of each Kyoto party.

JI IS ESSENTIAL TO A CAP AND TRADE SYSTEM

A project-based mechanism linked to a cap-and-trade system opens up the possibility to achieve cost-efficient emission reductions in sectors and regions not covered by domestic emissions trading or other policy measures and also functions as a carbon price "safety-valve" (by allowing the inflow of cheaper credits into the cap-and-trade scheme). In the future, more and more countries and sectors are expected to commit to GHG limitation and reductions, and hence the role of JI will be gradually increasing over time while the role of CDM will be diminishing.

The importance of JI as a supplementary mechanism to national or international emission reductions cap-and-trade schemes is significant and can be summarised as follows:

- *JI helps to promote innovation.* Project based mechanisms are suitable for the discovery of new ways of reducing emissions: new, innovative methodologies can be developed and tested in a private and voluntary environment. As time is of essence in the challenge of reducing anthropogenic GHG emissions, it is essential to support mechanisms which promote innovation and technology deployment.
- *JI is not restricted in scope.* Project-based mechanisms are valuable tools to explore the emissions reduction potential of sectors and areas not generally targeted by emission trading schemes. Whereas a trading scheme is by definition limited in scope, a JI-like mechanism does not need to be. Even before regulators get round to creating rules for non-covered sectors, with the appropriate market incentives, JI can lead the way in cutting GHGs emissions, complementing reduction efforts taken in covered sectors and contributing to overall cost-efficiency of the system.
- *Project-based mechanisms emphasise positive incentives rather than penalties.* Trading schemes and standard-setting tend to be based on penalties in order to make non-compliance less rewarding. This creates a natural resistance and slows down implementation as traditional, conservative, industrial companies grapple with the new operating environment. In contrast, project-based mechanisms are seen as sources of funding which are attractive to business and entrepreneurs. This makes them politically popular and means more reductions can take place sooner. It creates an opportunity cost in principle on any GHG emissions released outside the boundaries of an emissions trading scheme.

THE ADVANTAGES OF JI

JI has a number of built-in design advantages that allow the mechanism to be simple while transparent which arise from being a project based mechanism within a capped environment:

- *Guaranteed environmental integrity makes JI sound.* Emission reductions achieved through JI are underwritten by AAUs, which makes environmental integrity of JI automatic and safeguarded not solely by the inherent characteristics of the project, but by the objective accuracy of the compliance mechanism – the national inventory and the size of the overall reduction commitment (provided the host country's assigned amount has been duly and fairly established to provide for the country's commitment to limit/reduce GHG emissions and not just for "hot air").

- *JI is localized and so more simple and nimble.* JI does not require a centralised body for the approval of methodologies and projects. As long as the country remains in compliance with established international requirements, it is free to adopt its own JI projects approval procedure as well as calculation, monitoring, and verification methods thus making the whole JI process simple. At the same time, an international mechanism similar to the current Track II, though further developed and improved, can provide a fall-back option where host countries do not qualify for the local verification of GHG emission reductions achieved by the JI projects or where they decide to defer the administration of the mechanism to the international level.

SMASHING THE MYTHS

The use and promotion of JI as a flexible mechanism to achieve reliable and cheap emissions reductions has been subject to several misplaced criticism and objections:

- *JI is not compatible with a cap-and-trade system.* While we appreciate the intention of some national governments and the EU Commission to create economy wide cap-and-trade schemes, it will be years if not decades before there is a full, leak-free coverage of emission trading schemes. In the meantime there will be plenty of uncapped sectors that can still contribute to overall GHG emission reductions. Some sectors, such as forestry and agriculture, are even intentionally left out by some regulators because they consider them not fit for inclusion in entity level emission trading. JI can help to overcome this problem through unlocking emission reduction potential in those sectors. JI coupled with the concept of “credit for early actions” can actually speed up reductions of GHGs outside the cap and trade scheme: ambiguity about whether or not a sector or GHG will be included in future cap-and-trade schemes (N₂O emissions for example) may lead some polluting industries to wait for their full allowance allocations before implementing emission reduction activities. Moreover, even in capped sectors many opportunities can be still found for JI, especially when it comes to indirect emissions not covered by the cap.
- *GIS is a more efficient mechanism than JI.* Green Investment Schemes (“GIS”) refer to schemes that link the transfer of AAUs to investments that reduce GHG emissions or have other environmental benefits. While much discussed among intergovernmental organizations, NGOs and academics, they have proven difficult to implement. Project-based mechanisms in contrast create direct economic interest at those entities where the actual reduction potential is and can be implemented without creating new and bureaucratic institutions and regulatory structures. This is a substantial advantage over GIS.
- *JI is an off-set mechanism.* JI is similar to the CDM in the sense that it is a mechanism that reduces GHG emissions below a project specific baseline. However, other than the CDM and offsetting practices in the non-regulated market, a transfer of an ERU from a JI project goes hand in hand with the cancellation of an AAU in the host country. This means that as long as the national inventory system is accurate and properly working, JI (other than the CDM) does not allow the emissions of more GHG within the agreed cap under which it is implemented. JI does not off-set additional emissions within a cap-and-trade regime, i.e. there is no increase in the size of the overall cap.

3. FRAMEWORK FOR JI AFTER 2012

BUILDING ON PREVIOUS EXPERIENCE

Ensuring Continuity. A post-Kyoto international framework should regulate the transfer of CDM to a JI mechanism for projects that have been approved as CDM project activities before 2012 but find

themselves in a country or sector which operates under an international emission reduction target after 2012. Such a conversion provision should provide the necessary regulation that reductions can be claimed until the end of the project crediting period. Such provision will also encourage non-Annex I governments to take upon themselves reduction targets while keeping the benefits of JI projects. To simplify transfer the crediting period of JI and CDM projects should be harmonized.

Preparing for the new players. The goal of the Copenhagen round of post-Kyoto negotiations is to get as many countries as possible to make economy or sector-wide binding commitments to reductions in GHG emissions. This means that the JI spectrum will increase considerably in terms of new participants among project developers and investors. Ultimately developing countries like China, India or Brazil are likely to join in. Thus it is vital to be ready with a robust project-based mechanism for these to deploy and with an ability to release the financing of emissions reductions at a scale that is wider and deeper than CDM.

Expanding the scope. (i) Domestic GHG abatement projects can complement cap-and-trade regimes to promote emission reductions outside of the cap-and-trade regime. Currently domestic (or “unilateral”) JI projects are not allowed as two Annex I Parties have to be involved in each JI project. The expansion of JI projects to domestic projects will provide a strong incentive to local investors to invest in reductions of GHG emissions. (ii) Effort could be deepened further by designing programmatic and sectoral JI schemes. In sectoral approaches a sector would get a specific emission reduction target, whether it is a specific or absolute target. A JI mechanism could complement a sectoral target by providing a further incentive to reduce emission reductions below the agreed sectoral target.

4. WHAT NEEDS TO BE DONE

In order to fully explore the potential of the JI in the post-2012 period and enhance its role as a supplementary and cost-efficient project-based tool working within a capped environment, the Joint Implementation Action Group has developed a series of concrete proposals for reform of the Joint Implementation mechanism. The proposals offer potential to significantly strengthen and enhance the mechanism and are summarized in the legal background paper attached as Appendix I to this policy paper. They address, among others,

- the harmonization of crediting under JI and CDM to a uniform 10 year crediting period to allow for a smooth graduation of projects from CDM to JI;
- the allocation of AAU allowances in support of transiting CDM projects;
- improvement of effectiveness and efficiency by promoting transparency and securing due process for project participants, converting the JISC in a permanent body and creating appeal and review process of JISC decisions;
- shifting focus on additionality and environmental integrity from a financial perspective to an environmental one;
- supporting the expansion of sectoral, programmatic and domestic JI.

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