

COP29

Choosing Low-hanging Fruits Unfit for Purpose

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In a surprise first-day declaration from the Azerbaijani Presidency of this year's 29th Conference of Parties, a "deal" on the institution of carbon markets with clear rules with regard to ensuring assessment of claims and integrity of data relating to carbon emissions reduction, under the United Nations auspices, was announced. If implemented, this would help create credible carbon markets and allow carbon prices to ensure the realisation of the promises of decarbonisation implicit in the nationally determined contributions of different countries. But closer scrutiny suggests that neither is the deal an adequate and complete agreement nor is it likely to deliver on its objectives, making it perhaps a mere diversion from the really significant decisions that the summit must make, especially in areas like climate finance and fossil fuel use reduction.

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For a summit unlikely to yield anything of significance on its prime concern—identified as adequate flows of climate finance—the first day of the 29th Conference of the Parties (COP29) to the UN Framework Convention on Climate Change delivered a surprise. Even as negotiations had just about begun, the host Azerbaijan announced that a deal had been struck on one issue: the institution of carbon markets subject to the United Nations (UN) rules regarding emissions and carbon removals. Under the carbon markets scheme, countries with projects that reduce carbon emissions or sequester existing carbon in the atmosphere would earn "credits," each of which reflects one tonne of carbon dioxide (CO₂) emissions saved or removed. These credits can be traded in international markets: bought by entities wanting to compensate for emissions in excess of some target they are subject to, and sold by entities that earn domestic currency or foreign exchange revenues. The decision taken on day one sets the framework for identifying on a transparent basis the claim that carbon emissions have been prevented or removed and provides guidelines for the functioning of the markets in which these credits are quoted.

The popularity of the notion of carbon markets stems from two sources. It sets a price for carbon, being the price at which one unit of emissions is traded. Thereby, it allows the market to regulate emission levels. For example, if firms choose to continue emitting and buy their way out of penalties for not meeting targets through purchases of credits, the demand for and the prices of carbon credits would rise, making it uneconomic to adopt this strategy. At the other end,

countries which are in need of foreign exchange revenues can encourage new carbon-reducing activities and trade the credits they earn for scarce foreign currency. Since this delivers global benefits from reduced carbon in the atmosphere and helps countries strapped for foreign exchange earn much-needed foreign currency, carbon markets are seen as a win-win bet.

The problems with carbon markets as instruments of emission reduction are, however, manifold. The claims of carbon reduction or removal made were often exaggerated, leading to allegations of "greenwashing" to generate credits that can be traded and used to compensate for "actual" emissions. The credits claimed were also often not "additional," in the sense that the projects from which they were derived were in any case slated to be implemented, and the carbon "gains" were accounted for as part of the nationally determined contribution (NDC) of the country concerned. The latter also meant double counting of the emission reductions involved. Given these features, the Paris Agreement, while providing a role for carbon markets, stressed the need for monitoring and supervision to ensure integrity.

The Paris Agreement, in its Article 6, recognised the presence of voluntary cooperation involving the international transfer of mitigation outcomes to realise nationally determined contributions to carbon reduction. However, it noted the need for "integrity and transparency, including in governance," and "robust accounting to ensure, inter alia, the avoidance of double counting." So, it called for a "mechanism" to be established for the purpose, which was to be supervised by a designated body. It also stressed the need to "adopt rules, modalities and procedures for the mechanism."

Following this, a supervisory body was established as required, which in turn was mandated to spell out the required "methodologies" for assessing claims regarding emissions reduction or carbon removals, ensuring integrity and transparency, and making sure that the same carbon emission reduction

claims converted into credits and traded were also not included as part of the NDC of the country that was claiming those credits.

The deal that was announced and made much of on the first day was simply the endorsement by UN member countries of the recommendations made by the supervisory body in three areas. One was to place the mechanism within the UN system. The second was on the guidelines for the identification of projects that would be eligible to sell carbon credits and the approach to be adopted when estimating carbon mitigation effects. The third was to draw up guidelines of a similar nature for projects claiming to remove carbon from the atmosphere, or ensure “carbon capture and sequestration.”

The “deal” presented as an achievement has come under criticism from varied sources, essentially because the supervisory body established under Article 6.4 was expected to have a largely advisory role and to submit recommendations to

the Conference of Parties (COP) that was to discuss and debate the substance of those suggestions before arriving at an actual agreement. However, the supervisory body presented its suggestions in the form of a final agreement, to be merely endorsed by the Parties concerned, as happened on the first day of COP29. This does give the impression that the supervisory body was sidestepping due process and forcing the hands of the COP delegates, since no country would want to be seen as preventing the establishment of carbon markets with integrity.

But there is no guarantee that what the supervisory body has recommended would meet the notions of adequate transparency and integrity held by all nations. This is especially likely in the controversial area of carbon removal, which many see as a mere diversion from the more important task of mitigation through emission reduction. It does not help that the “deal” was pushed through in this questionable manner

under an Azerbaijani Presidency, since the country, like all fossil fuel exporters, has not been too keen on mitigation by reducing dependence on and “phasing out” or “phasing down” use of fossil fuels. They have preferred reducing net emissions and releasing carbon space through carbon removal measures.

One saving grace here is that the guidelines recommended by the supervisory body are still at the level of meta principles, and more detailed rules will have to be specified. So, the COP29 endorsement actually calls for the elaboration of standards, which is likely to be when disagreements could surface and the actual contours of any agreement be defined. But this means that the announcement of a deal amounting to an agreement was premature. The development was only one step forward on a journey that still has a way to go and might not even reach its intended destination.

Besides that, there is reason to believe that even when supervised and credible

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carbon markets are established, their functioning may not yield the intended result of emission reduction and generation of revenues for enhancing mitigation efforts or supporting adaptation or loss and damage compensation efforts. The difficulty in getting markets to work is illustrated by the experience with the European Union's Emissions Trading System (ETS), or its market for EU allowances (EUAs), which are permits that give the holder the right to emit one tonne of CO₂. The ETS is a "cap and trade" system, in which there is an aggregate ceiling on emissions generated by sectors covered under the scheme, which is intended to be lowered over time to realise emission reduction targets. Permitted emissions within this ceiling are distributed among sectors and producers. If any of them has a surplus of EUAs relative to needs, the unit can trade that permit for a price to others who can enhance their allowance.

In practice, the EUA market has not been able to deliver a carbon price that can help drive mitigation, because the price of EUAs has been volatile and in recent times been too low. This is largely because the need to ensure adequate supply of energy and other carbon intensive goods, especially when energy prices rose following the war in Ukraine, has forced the European Commission to distribute free allowances to producers of various goods and services. The result has been low prices for a long period. The commission has attempted to deal with this by creating a Market Stability Reserve (MSR), to be used to absorb EUAs from the market when supply is excessive and release them when supply is tight, in order to stabilise prices. But there has in recent times been chronic oversupply, resulting in extremely low prices for EUAs or carbon credits, defeating the purpose for which the trading system was created, which was to get carbon prices to levels that incentivise mitigation investments. Using the MSR to "adjust" the price, while unsuccessful, means that the carbon market has failed to do its job.

In the case of global carbon markets, there is similar uncertainty as to where the carbon price would settle. Credits

generated under the Kyoto Protocol were large in number, largely because of the lenient terms governing the process of claiming such credits. These lenient terms in turn meant that many of the gains in terms of emission reductions were illusory and the claims backing them unfounded. The excess supply of such credits has also meant that the price of those credits has been low, generating large demands from countries in which projects are subject to a ceiling on emissions that can be partly met with credits purchased at low cost from the market.

These experiences suggest that if at all global carbon markets, now under UN supervision, are to play their intended role, the standards regarding the kind of projects declared eligible and the assessment of claims of emissions reduction would have to be stringent. This would result in far fewer surplus credits being generated and delivered for trading in the market than would otherwise be the case. That would, in turn, take carbon prices to very high levels and reduce

demand from producers, who would seek other ways of avoiding the implicit high costs of mitigation. The corollary is that the billions of dollars that carbon credits are expected to generate for developing countries to pursue their mitigation and adaptation agendas as incorporated in their NDCs would not materialise. In sum, the market will not do what it is expected to do.

These problems would be confronted only when the standards are set following the recent "deal" and agreed to in a future COP, and the scheme implemented. That is likely to take a lot of time, and eventually turn out to be an exercise that does not deliver on its objectives.

In sum, the real issue is not the brake from appropriate procedure and process when announcing the COP29 deal, though that has adverse implications for the nature of negotiations on climate in general. The issue is that much is being made about an instrument that is unlikely to work, diverting attention from more direct measures of intervention to reduce carbon emissions.

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