

# Building blocks for a robust Sustainable Development Mechanism

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## **Executive Summary**

The Paris Agreement marks a new era for international climate action in general, and specifically for international carbon markets. Though the agreement does not mention markets per se, Article 6 paragraph 4 establishes what has become to be known as the Sustainable Development Mechanism (SDM) which builds on and shares some features of the Kyoto flexible mechanisms namely the Clean Development Mechanism (CDM) and Joint Implementation (JI).

The SDM however will need to function in a radically changed world from its Kyoto Protocol predecessors. Importantly, it must deliver an overall reduction in greenhouse gas emissions and promote sustainable development within the 2030 Agenda. Significantly, the SDM must function in a world where all countries have contributions towards the overall goal of limiting global warming to 1.5 degrees, decarbonisation by the latter half of the century, and the UN Sustainable Development Goals (SDGs) outlined in the 2030 Agenda.

The CDM experience in particular provides lessons for the design of the new SDM. However, contributing to these goals in the new context calls for a fundamentally new approach to the role of markets, not a copy paste exercise from existing practices. This notably means a shift away from offsetting towards results based finance and an integration of the SDGs, human rights, transparency and public consultation as core principles into the activities of the mechanism.

This policy brief offers recommendations for the design of a robust and effective Sustainable Development Mechanism.

## **Recommendations:**

- Increase overall ambition
- Abolish carbon offsetting for the Paris Agreement
- Design the SDM as a tool for results based climate finance

### **Sustainable development and environmental integrity**

- Define, monitor, report and verify real, measurable and long-term sustainable development and mitigation benefits
- Ensure environmental integrity, contribute to transformational change, and avoid perverse incentives that undermine ambition

### **Robust governance**

- Ensure effective public and local stakeholder participation
- Establish an institutional grievance process
- Establish a robust SDM oversight body
- Adapt, reform and build on beneficial existing CDM infrastructure

## A new carbon market era

Article 6 of the Paris Agreement established the Sustainable Development Mechanism (SDM) as a new carbon market instrument for the period after 2020. Its purpose is inter alia to replace the existing mechanisms under the Kyoto Protocol, the CDM and JI with a more effective climate tool. The chapeau of Article 6 sets out the overall purpose of the article including the SDM, namely that its provisions are established to promote: i) higher ambition ii) sustainable development and iii) environmental integrity.

The SDM will function in a radically changed world, where all Parties have commitments to contribute to the common objectives of limiting global warming to 1.5 degrees, de-carbonization by the second half of this century, and the Sustainable Development Goals laid out in the UN 2030 Agenda. Notably, under the Paris Agreement, all Parties can host SDM projects on a voluntary basis.

When elaborating the rules, modalities and procedures for this new mechanism, the experience with existing mechanisms, especially the CDM are of utmost importance. The Paris Agreement specifically invites Parties to build on the experience gained so far from the Kyoto mechanisms.

However, the SDM should not be a copy-paste exercise from the CDM. Rather, the SDM should be a new instrument that draws lessons from both the successes and mistakes of the CDM.

### Comparing SDM and CDM building blocks

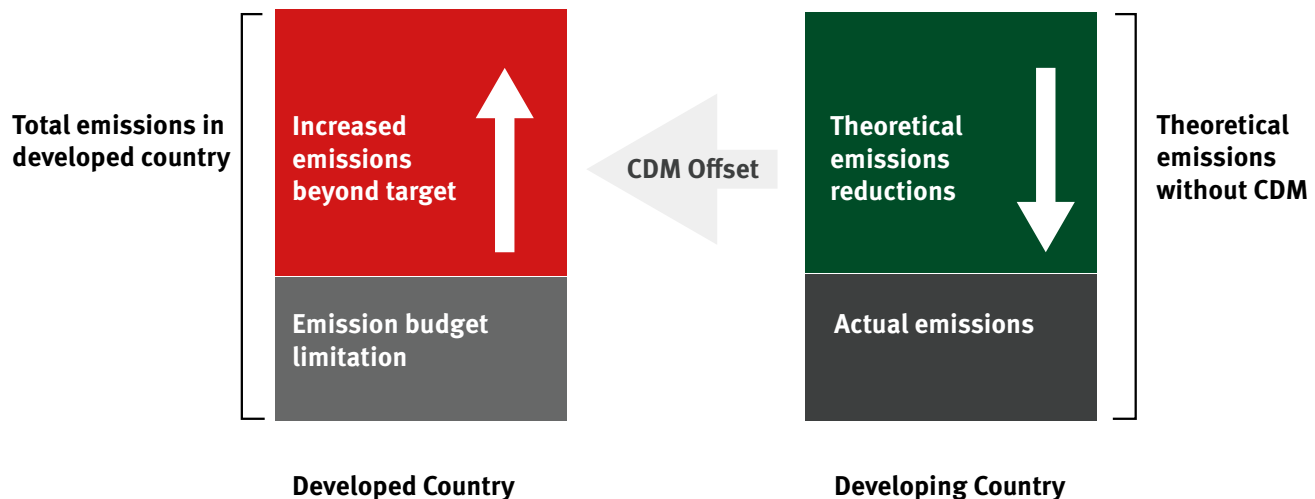
SDM	CDM
Must contribute to overall emission reductions/net mitigation	Established as a pure offsetting mechanism, shifting, not reducing, emissions
Must account for mitigation targets of all countries under the Paris Agreement, including their progression over time	Based on Kyoto Protocol where developing countries did not have a reduction target and did not take future climate commitments into account
Should promote ambition and encourage implementation of climate friendly policies	Created perverse incentives to continue business as usual practices and in some cases increase emissions beyond business as usual in order to be paid to reduce them
Must reflect and reinforce changing low emission technology and policy landscape	Credited many non-additional projects
Must contribute to real, measurable and long-term mitigation and sustainable development that contributes to overall shift away from fossil fuel lock in	Made questionable contribution to sustainable development, including a lock in of fossil fuels

### Not an offsetting tool

The SDM has the specific goal to ‘deliver an overall mitigation in global emissions’, meaning that using the SDM must lead to emissions reductions that would not have otherwise occurred, must not correspond to increased emissions elsewhere, and contribute to a ratchet of ambition over time. The role of offsetting and the danger of increasing overall emissions when offset credits are not real, additional, or measurable must be taken into consideration within the

context of the global carbon budget to limit global warming to below 1.5°C. Given the overall Paris framework and objectives, it becomes clear that offsetting is not an appropriate tool for the climate change challenge. Therefore, in contrast to the mechanisms established under the Kyoto Protocol, the SDM must not be an offsetting tool.

## Offsetting: No Overall Reduction



For more information, see Carbon Market Watch briefing: *Good bye Kyoto: Transitioning away from offsetting after 2020*

## A tool for results based finance

Results based finance is an approach that provides an estimation of the greenhouse gas mitigation benefit of a given amount of climate finance, which can be used towards climate finance pledges but does not correspond to increased emissions elsewhere. As part of the climate negotiations leading up to the Paris Agreement and at the Paris conference itself, many countries made climate finance pledges. The SDM should build on the results based finance approach to mobilize the private and public sectors for more climate action and provide an estimation of their mitigation impact.

Additionality, in that climate mitigation efforts are supported that would not otherwise have occurred is vital to guarantee environmental integrity in order to avoid an overall increase of greenhouse gas emissions in offsetting. Similarly, additionality is also critical for the effective and efficient use of climate finance. To function as an effective climate finance tool, the SDM must support measures that would otherwise not find funding – meaning that they go far beyond business as usual. The scope of eligible activities<sup>1</sup> should be restricted to project types that have a high likelihood of being additional.

Building on extensive research and analysis on this issue, the SDM must exclude technology and project types that have proven to have a low likelihood of additionality, including fossil fuel and large hydro projects. Projects or activities are likely to be additional if they are not required by law or regulation and are not common practice. Further, activities are likely to be additional if other potential (non-mitigation) benefits are not sufficient to carry it out anyway, and if the climate finance is the main or only revenue stream for the proposed activity. Conversely, activities are unlikely to be additional if they are legally required, if they are common practice or would in many cases be “business as usual”, if there are many compelling reasons to carry out the activity, or if other revenues make up a significant portion of the financing for the activity.

<sup>1</sup> COP decision 2015, para. 38

## **Environmental Integrity and Sustainable Development**

The Paris Agreement highlights an intrinsic relationship between climate change actions and sustainable development, underlining the close relation to the implementation of the SDGs and NDCs. The chapeau of Article 6 expands on this relationship and sets out the goals of not only higher ambition but also sustainable development and environmental integrity as mandates for the article including the SDM.

The importance of sustainable development is reiterated in the preamble, the overall purpose (Article 2), the long term goal (Article 4), in the chapeau of Article 6 and in the accompanying COP decision that welcomes the 2030 Agenda for Sustainable Development (SDGs). Adopted in 2015, the SDGs lay out goals applicable to all countries, developed and developing, for the period between 2016 and 2030. Those goals were adopted by all UN Members and explicitly recognize that the solutions to climate change and sustainable development are inherently connected and interdependent, and that calls for coordinated efforts to address both simultaneously. Moving away from the more singular approach to define sustainable development for each individual country, the SDGs provide a foundation for an international understanding for what sustainable development is.

In the context of Article 6 guaranteeing environmental integrity means that at a minimum, mitigation benefits must be real, measurable and long-term and that they must result in an overall mitigation of global emissions. A number of parties take a more holistic view of environmental integrity taking into considerations the impact of climate activities on air, water, soil, and biodiversity. This holistic understanding further implies a close relationship between environmental integrity and sustainable development.

### **REAL, MEASURABLE AND LONG-TERM SUSTAINABLE DEVELOPMENT BENEFITS**

The provisions for the SDM make it clear that reducing GHG emissions and contributing to sustainable development in line with the 2030 Agenda are equally important. This COP decision regarding the SDM specifies that the rules, modalities and procedures are to be adopted on the basis of real, measurable and long-term benefits.<sup>2</sup> This means that not only emission reductions, but also purported sustainable development benefits should be clearly defined, measured, reported and verified.

### **ENVIRONMENTAL INTEGRITY AND TRANSFORMATIONAL CHANGE**

Environmental integrity of the SDM must not only be real, measurable, verifiable, and additional but must also be understood in the context of the progression of NDCs over time towards the 1.5 degree goal and long term decarbonisation. This means that the SDM must promote more ambition and transformational change encouraging further climate friendly legislation. It must not function as a crediting system that create perverse incentives, such as improving the profitability of high-emitting activities or setting an unambitious target to be paid to overachieve it.

Therefore, the SDM must move far beyond small improvements from business as usual and push and encourage countries towards programmatic interventions with high mitigation potential on the economy wide or sector wide scale. The SDM could deliver long term emissions reductions by fundamentally transforming behavior patterns, sectors, markets, and investment practices. For example, the SDM could push for modal shifts in mobility such as internal combustion engines to other modes of transport.

## **Robust governance**

Robust governance is an important element to ensure the integrity of the SDM. To that end a number of key principles need to be established, notably i) provisions for local stakeholder consultation, ii) an institutional grievance process, iii) a supervisory board, iv) a robust infrastructure and v) sufficient public participation. While some important elements were left out and or never successfully implemented for the CDM, a number of CDM structures, processes and procedures could be adopted, reformed, and built upon for the new mechanism.

<sup>2</sup> Vgl. Olsen, K. H. (2017) *Learning from CDM SD tool experience for Article 6.4 in the Paris Agreement*.

## **LOCAL STAKEHOLDER CONSULTATION AND PUBLIC PARTICIPATION**

Stakeholder and broader public participation is critical to establishing effective institutions and achieving successful outcomes and avoiding or minimizing adverse impacts of development and climate measures. By taking into account stakeholder concerns and feedback in advance, parties and project developers can improve institutional and project design and outcomes, identify and control external risks, and establish a basis for future collaboration and partnerships.

When planning the design and implementation of activities, full and effective public participation including local stakeholder consultation should be ensured as they are crucial elements to avoiding harmful consequences of mitigation actions. Free, prior and informed consent of affected peoples and communities must be obtained before an activity is carried out.

## **INSTITUTIONAL GRIEVANCE PROCESS**

The Paris Agreement preamble calls on Parties to respect and promote human rights obligations when taking action to address climate change. A grievance mechanism is crucial to operationalize this human rights provision. It is also an essential tool to avoid conflict between stakeholders and project participants and address community-based grievances before disputes escalate.

For the integrity and credibility of mitigation projects it is furthermore essential that the project impacts are independently assessed and that the project planning is complied with in implementation. Finally, adequate response measures for affected peoples or communities need to be put in place to serve as a last appeal measure for when in the course of implementation activities deviate from approved planning.

## **SUPERVISORY BOARD AND MEMBERSHIP**

The SDM is to be “supervised by a body designated by the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement.”<sup>3</sup>

Given the complex economic data involved and the technical character of SDM projects, the selection criteria for Board members should focus both on technical expertise and national representation,<sup>4</sup> with members to be transparently nominated and selected. Board members should be independent and not associated with Parties’ negotiating delegations to avoid conflict of interest.

Civil society should have the opportunity to nominate Board members and be represented in the Board itself.

To guarantee the highest level of transparency, all meetings of the supervisory body should be open to the public. Observers should be able to participate in person or via video-conferencing in SDM Board meetings and be given the opportunity to directly engage with the Board and provide input to meeting agendas.

Moreover, all documentation related to the registration of activities of the mechanism should be made publicly available.

## **INFRASTRUCTURE**

The CDM built valuable capacity and institutional structures and processes, which the SDM could adapt, reform and build on for a successful start. Such institutions include Designated National Authorities (DNAs), Designated Operational Entities (DOEs) as well as panels and working groups.

<sup>3</sup> Paris Agreement, Art. 6(4)

<sup>4</sup> See also Streck (2007: 98); von Ungerer et al. (2009)

Existing DNAs authorized by a Party to participate in the mechanism should have a coordination role in demonstrating, recording and showcasing how SDM activities promote the country's sustainable development in line with the UN Sustainable Development Goals. Further, the DNA should reconcile activities carried out with the host country's policy context and international commitments.

DOEs could play a role in not only assessing emission reductions, but also sustainable development benefits. Once assessed, DOEs should also be held liable for the mitigation and sustainable development benefits they have assessed.

Existing CDM panels and working groups also hold valuable competences and expertise that the SDM can build on. However, civil society should have an extended role and be able to provide input to these groups' deliberations.

## **Conclusion**

To be relevant, it is important that the SDM furthers the goals of the Paris Agreement as a whole as well as the Article 6 provisions to further ambition, ensure environmental integrity and support sustainable development. The new mechanism must adapt to the new Paris landscape and not follow the CDM's offsetting precedence. Instead, the SDM should be used as a tool for results based finance. Like its predecessor, the SDM has a dual mandate as a climate policy tool and to promote sustainable development.

Correspondingly, it is not only the emission reduction benefits of the mechanism, but also any sustainable development benefits that must be monitored, reported and verified. In order to foster ambition and avoid perverse incentives, the SDM must promote transformational change and encourage further climate action and commitments in the host country. Outcomes can be optimized by proactively involving and soliciting input from civil society, the general public, and local stakeholders.

When problems occur, such as if implementation deviates from approved planning, the SDM must also be ready with a grievance mechanism. Oversight of the SDM should be technical and non-political and avoid conflicts of interest. This can be facilitated by an expanded role for civil society including in the nomination of board members. Deliberations should be open and transparent. But at the same time, various other CDM panels and working groups can be adopted, reformed and improved on to have a new role under the SDM.

The CDM provides a valuable basis on which to learn and improve, and some valuable infrastructure to adapt, however the SDM must not be a simple copy paste exercise from the CDM. A true new start is needed for the SDM to live up to its true potential to be fit for the purposes of the Paris Agreement and the ongoing climate change challenge.



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