Policy and sectoral crediting – key opportunities and challenges

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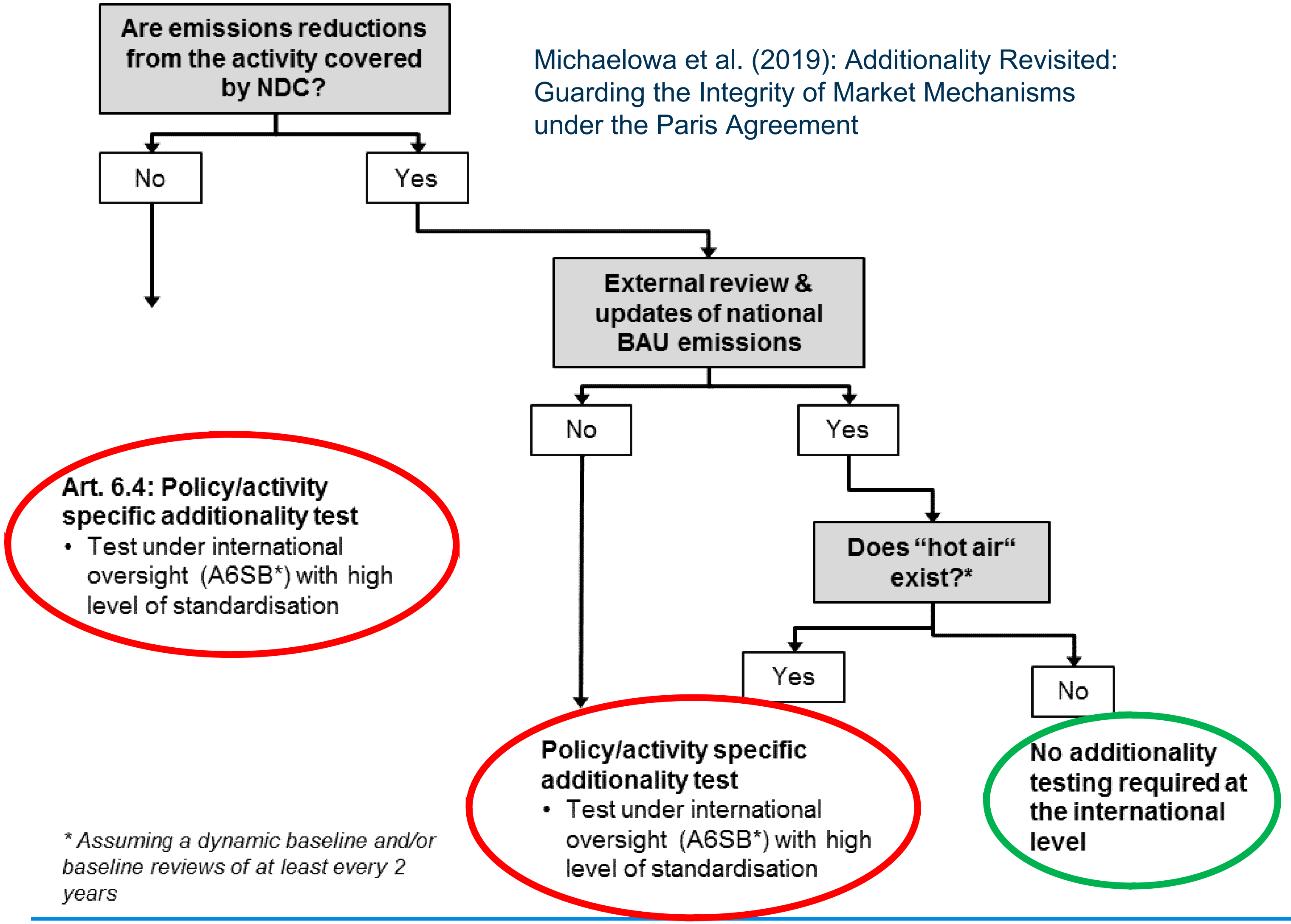
Zurich CMA Event "Can Policy Crediting deliver what its promises?", 29 April 2024

Key aspects of policy crediting

- In the Article 6 / Paris Agreement context, increasing interest in policy crediting to scale up mitigation activities
- Crediting of policy instruments is complex
  - Specific requirements for additionality determination, baseline setting and MRV
  - Carbon market principles to be applied only at policy instrument level, or also at activity level?
- Policies that systematically address barriers faced by individual activities
  - Monetary barriers: closing cost gap between mitigation and BAU technologies: *yes!*
  - Non-monetary barriers: removing barriers that prevent profitable activities: *no?*
- Creditable policy instruments
  - Mandates for deployment of low-carbon technologies/behaviours
  - Financial incentives to deploy low-carbon technologies/behaviours
  - Policies that eliminate prohibitions/prohibitive obstacles to mitigation activities (to correct previous bad governance)

Additionality determination: highest level (NDC)



Michaelowa et al. (2019): Additionality Revisited: Guarding the Integrity of Market Mechanisms under the Paris Agreement

** Assuming a dynamic baseline and/or baseline reviews of at least every 2 years*

Art. 6.4 rules (para 38) : “robust assessment that shows the activity would not have occurred in the absence of the incentives from the mechanism, taking into account all relevant national policies, including legislation, and representing mitigation that exceeds any mitigation that is required by law or regulation”

➢ **Determine how policy is incentivised by the mechanism**

Additionality determination: high level (costs)

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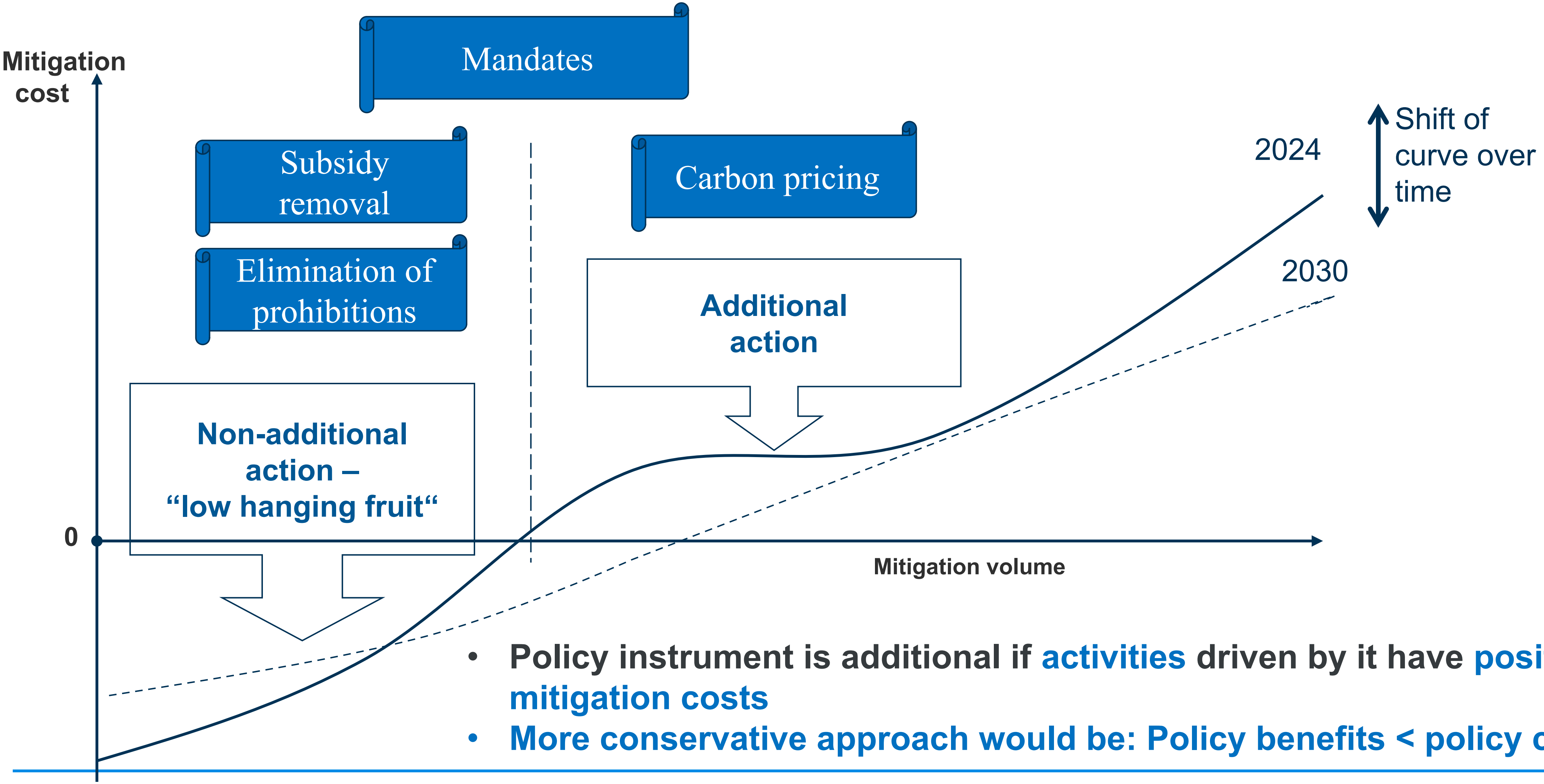


- Policy instrument is additional if activities driven by it have positive mitigation costs
- More conservative approach would be: Policy benefits < policy costs

Additionality determination: pragmatic level I

- Is the implementation of activities under the policy instrument dependent on very activity-specific characteristics?
    - If yes, separate additionality test is needed
- What additionality tests should be applied and in which manner?
    - Regulatory additionality: No re-packaging of existing policies
    - Financial additionality
        - Investment analysis to be applied at the level of policy as a whole for carbon pricing policy instruments
- Modelling-based baselines cannot capture additionality
- Sectoral crediting does not enable additionality testing and therefore is problematic
    - Further challenge: Credits are diluted by actors who increase their emissions

Additionality determination: pragmatic level II

For mandates → payback period threshold: 3 < [x] < 5 years

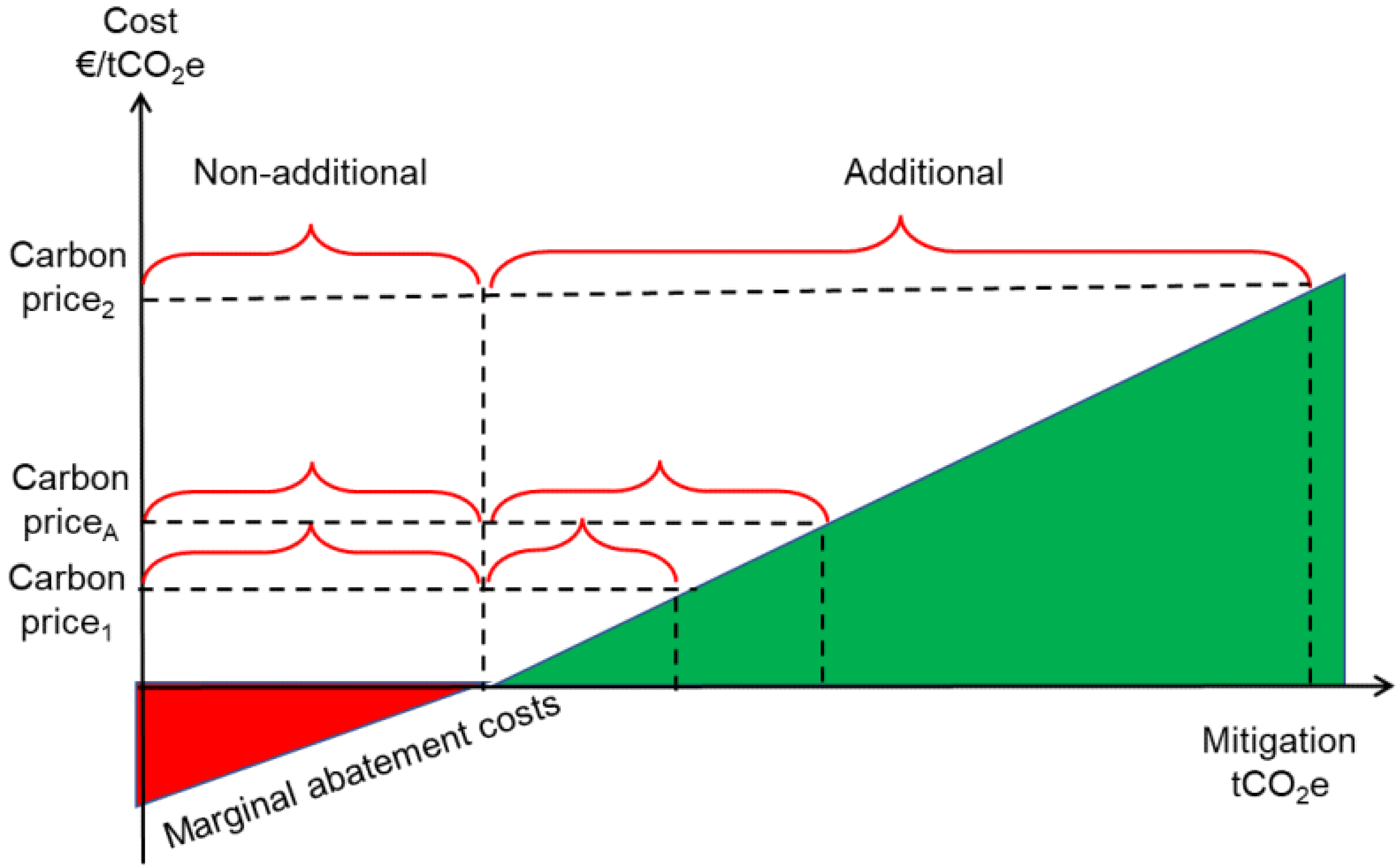
- Differentiated based on the host country's development stage

For financial incentives → carbon price threshold: 5 < [x] < 50 $/t CO_2e?

- Sum of costs >0 (see graph, price$_A$)
- Is the carbon price at a level that would be above carbon pricing implemented in similar countries under business-as-usual?

How to take into account non-monetary benefits (e.g. health benefits)?

- Barrier analysis should not be allowed if policy has significant net societal benefits



Key opportunities and challenges

- Opportunities for policy and sectoral crediting
  - Incentivize carbon pricing
    - Gold Standard excludes carbon pricing from its policy crediting methodology ….
  - Generate revenues to generate necessary conditions for activities that in a narrow sense seem not to be additional
    - Funding grid strengthening which is necessary for renewable electricity projects in many countries
- Challenges for policy and sectoral crediting
  - Narrow interpretation of "theory of change" without consideration of policy benefits
    - Benefits of fossil fuel subsidy reform or energy efficiency standards cannot be ignored!
  - Conservative baseline is no substitute for robust additionality test
  - Sectoral crediting is incompatible with traditional additionality testing
- Recommendations
  - Test sectoral crediting where carbon pricing covers a full sector
  - Do backcasting exercises for modelling-based baselines
  - Assess appropriate length of crediting periods in context of NDC updates

Thank you!

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