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Design elements for new market mechanisms

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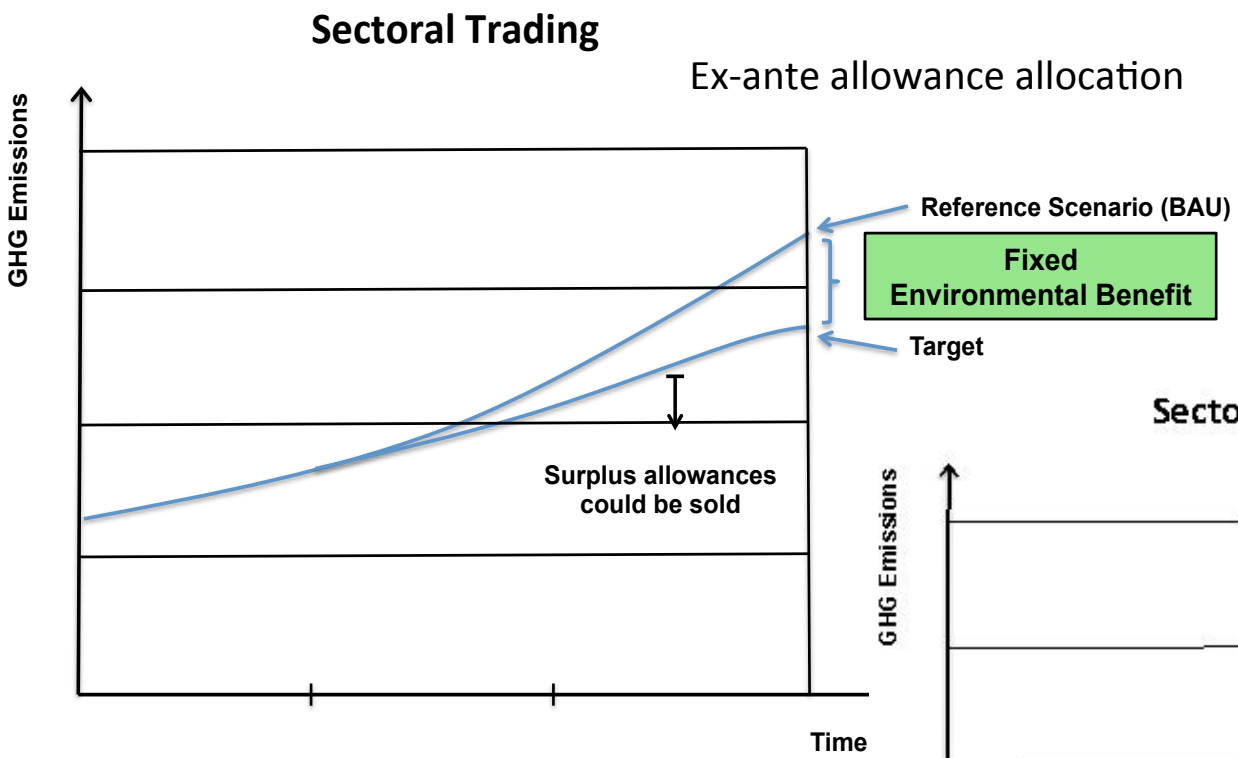
Key design elements

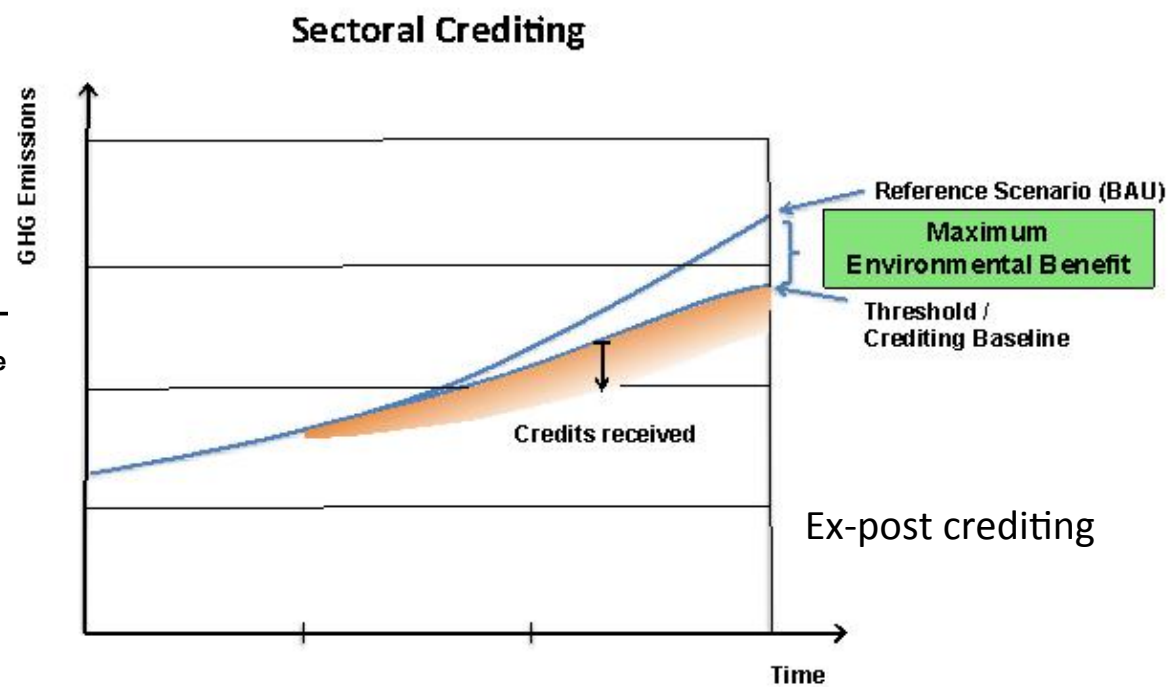
Design element	Sub design elements
Crediting or trading	
Coverage of the mechanism	Sector/activity boundaries Types of GHGs to cover Upstream versus downstream coverage
Sector target or crediting threshold	Nature of target/threshold Method for setting target/threshold Interaction with other policies and measures
Operational/incentive framework	Operation/incentives at government/ installation level Methodology for allocating trading units Currency used Temporal flexibility
Requirements for data collection and MRV	
Compliance framework and penalties	
Government institutions and accounting framework	National governance International governance
Ways of managing the transition from CDM to new market mechanisms	
Finance of the system	

Assessment criteria

#	Assessment criteria
1	Environmental effectiveness
2	Environmental integrity/MRV robustness
3	Administrative feasibility, including transaction costs
4	Political feasibility
5	Economic efficiency
6	Private sector participation/potential to mobilize private capital
7	Potential impacts on competitiveness
8	Preparedness for evolution towards domestic cap-and-trade system
9	Low risk of perverse outcomes

Trading and crediting





Nature of the sector target or crediting threshold: options

- **Absolute emission baselines**: the crediting baseline or trading target is set at an absolute level of GHG emissions for the sector.
- **Indexed baselines**: the emission level is set at a function of one or several economic or physical variables, such as GDP, tonne of output etc.
- **Technology diffusion baselines**: the crediting threshold is defined at a certain level of technology diffusion, e.g. MW installed capacity, production or production share for renewable electricity.

Nature of the sector target or crediting threshold: assessment

	Pros	Cons
Absolute emissions baseline	Allows crediting of all measures to reduce GHG emissions in the sector Applicable also in more diverse sectors Simplicity	
Indexed baseline	Lower uncertainty in establishing the threshold Political acceptance	More difficult to apply in sectors with diverse products and services More complex to implement Incentive to increase outputs
Technology diffusion baseline	Aligns with interests in particular technologies	Focus and scope rather narrow Difficult to define

Operation/incentives of the scheme

International handling of credits / emission units	Government receives credits/allowances					F) Installations receive credits
National implementation	A) Government Regulation	B) Government Incentives	C) Installation-level crediting	D) Binding installation targets	E) Installation targets plus PAMs	

- Incentives under installation level crediting
- Transaction cost
- Option D and E, and C and F to a lesser extent, contribute to evolution to cap-and-trade

International governance

a) Approval of national schemes:
   - Option 1: Approval by new regulatory body on its own
   - Option 2: Approval by COP based on assessment by new regulatory body

b) Composition of new regulatory body:
   - Option 1: CDM EB model
   - Option 2: Full-time professionals

Approval of national schemes assessment

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	Approval by new regulatory body on its own	Approval by COP based on assessment by new regulatory body
Pros	▪ Depoliticises process ▪ Faster decisions	▪ Higher political legitimacy, setting targets or thresholds a very political question
Cons	▪ Can a technical body tell a government whether its threshold is robust enough?	▪ Politics may trump objective facts ▪ Slower decisions, only possible once a year

Composition of new regulatory body: assessment

	CDM EB model	Full-time professional body
Pros	▪ Established model, higher political acceptability ▪ Lower costs	▪ Probably more apolitical ▪ Members can be real experts
Cons	▪ EB members often political appointees rather than experts ▪ EB discussions can be politicised	▪ Higher costs ▪ Probably less politically feasible