The role of market mechanisms in bridging the gap

UNEP's Emissions Gap Report 2021 finds that annual greenhouse gas emissions need to almost halve by 2030 to limit global warming to 1.5°C, but the updated Nationally Determined Contributions (NDCs) under the Paris Agreement are still insufficient. This factsheet looks at how market mechanisms can help to catch up on climate action.

Why are market mechanisms important?

Market mechanisms – including carbon tax, cap and trade, and voluntary transactions – can form an important component of larger strategies to achieve the long-term goals of the Paris Agreement. Markets can provide an opportunity for countries, companies and other actors to achieve their emission reduction goals at lower costs and enhance their ambition.

The number of countries that – in their new or updated NDCs – have indicated the planned or possible use of voluntary cooperative approaches, including carbon markets, has almost doubled compared to the previous NDCs.

International markets could facilitate a shift in capital investment toward selling regions. In this way they could bring positive impacts on local air quality, employment and other sustainability metrics. At COP26, nations will attempt to finalize the rulebook for trading emissions under Article 6 of the Paris Agreement.

What is the potential of market mechanisms?

There is already considerable experience in designing and implementing market mechanisms to control pollutants, including different forms of carbon markets. The current state of carbon markets is diverse. They include both voluntary and compliance-driven programs and are used both domestically and internationally to reduce emissions, with different types of allowances and credits and involvement of public and private sector entities as buyers and sellers.

Global studies estimate that, if all NDCs were transformed into tradable emissions abatement and all countries had economy-wide targets, around 4-5 GtCO2e could be traded per year in 2030.

If the savings from more cost-effective global implementation of NDCs were redeployed toward increased ambition, emissions reductions could be roughly doubled over the next decade for no added cost, compared to countries acting alone to implement their commitments.

How can market mechanisms deliver?

Carbon markets can deliver real emissions abatement and drive ambition, but only when rules are clearly defined, designed to ensure that transactions reflect actual reductions in emissions, and are supported by arrangements to track progress and provide transparency.

Current NDCs only partially contain economy wide quantitative targets, making it difficult to set-up a global market system that is rigorous. Clear rules and guidance for Article 6 need to be decided at COP26, in order to get a global market started and then gradually expand and improve as pledges evolve and experiences are gained.

For markets to play a strong role in the process towards net zero emissions, the coverage of sectors, gases, and economies must become increasingly inclusive, enabling markets to become comprehensive and more effective.

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