

Policy Perspective

Clean Development Mechanism (CDM)

Indian Youth Delegation



Background

Climate Change is bringing us closer to our greatest fear- death. Many of us are changing our lifestyles – from micro changes like closing taps and saving water to macro decisions insuring ourselves against climate related disasters. It has rightly been pointed out that the costs of inaction are too high. But what are we really doing about it? Rather, what are our governments doing about it? CDM (Clean Development Mechanism) is simply one of the mechanisms by which we are able to reduce our emissions, help sustainably develop an area, transfer technology free of cost and also gain revenue by earning carbon credits.

Officially CDM is laid out in Article 12 of the Kyoto Protocol. The rules governing it were finalized in 2003 and are contained in the “Modalities and procedures for a clean development mechanism” in the Marrakech Accords, the decisions of the CDM Executive Board (EB) and subsequent decisions of the Conference of the Parties (COP). It gained momentum in 2005 after the entry into force of the Kyoto Protocol. Before the Protocol entered into force, investors considered this a key risk factor. The initial years of operation yielded fewer CDM credits than supporters had hoped for, as Parties did not provide sufficient funding to the EB. This led to the establishment of the Adaptation Fund to finance concrete adaptation projects and programmes in developing countries that are Parties to the Kyoto Protocol. The Fund is to be financed with a share of proceeds from clean development mechanism (CDM) project activities and receive funds from other sources.

CDM allows industrialised countries like UK, Germany etc. with a green house gas (GHG) reduction commitment (called Annex 1 countries) to invest in projects that reduce emissions in developing countries (such as India, Bangladesh) etc. as an alternative to more expensive emission reductions in their own countries.

Example (Figures are hypothetical):

A company in Brazil (a non Annex I country) switches from coal power to biomass. The CDM board certifies that by doing this the company has reduced Carbon dioxide emissions by 100,000 tonnes per year. It is issued with 100,000 CER's (Certified Emission Reductions). Under the Kyoto Protocol, the United Kingdom (an Annex I country) has to reduce its green house gas emissions by 1 million tonnes of carbon dioxide each year. If it purchases the 100,000 CER's from the Brazilian company, this target reduces from 1 million tonnes/year to 900,000 tonnes per year making the goal easier to achieve.

These projects would reduce CO₂ emissions by over 2.5 billion tons until the end of 2012. However, the previous adoption rate suggests that only a fraction of these projects will be certified (see below).

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The majority of CERs issued so far have been from HFC destruction projects. However, there are only a limited number of such project sites globally, of which most if not all have already been converted into projects. The fastest-growing project types are renewable energy and energy efficiency.

* Assumption: All activities deliver simultaneously their expected annual average emission reductions

** Assumption: No renewal of crediting periods

	Annual Average CERs*	Expected CERs until end of 2012**
CDM project pipeline: > 4200 of which:	N/A	> 2,900,000,000
--- 1243 are registered	233,479,091	> 1,350,000,000
--- 134 are requesting registration	19,032,917	> 70,000,000

India's Response

In accordance with the Indian government submission to the UNFCCC on the 24th of October 2008 we have the following response:

- The current global architecture for delivering and financing these public goods is mandated under the multilaterally negotiated United Nations Framework Convention on Climate Change (UNFCCC).
- The incremental lifetime costs of investment in adaptation and mitigation are positive, they would have to be fully recompensed if economic and social development and poverty alleviation are not to suffer. This is true for both private and official sources of such new and additional funding. Only a grant that results in a resource transfer can truly recompense such positive incremental costs in full without impacting social and economic development and poverty alleviation – the recognized first priority of the developing country Parties under the Convention. As an example, carbon markets under CDM actually pay for such positive incremental costs in full and thereby preserve the socio-economic viability of the underlying investments despite the higher costs of mitigation. While incremental lifetime costs must only be funded through new and additional grants and resource transfers, the base costs of economic and social development can be funded by a range of current or new financial instruments offered by bilateral, multilateral or domestic/foreign market sources.

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- And while carbon markets may be able to fund incremental costs of mitigation under certain scenarios, funding for incremental costs of adaptation would require resource transfers or grants.
- Each developed country Party or any grouping of developed country Parties would be free to decide the means for raising these contributions through country specific or region specific auctioning of emission rights, carbon taxes, and specific levies on sectoral emissions or any other means considered feasible within their borders.
- The carbon markets have the potential for raising larger sums. However, this requires very deep emission reduction targets (potentially negative emission obligations for some developed country Parties) that are legally enforceable.

Indian Youth Delegation Position

We second the government stance but we also believe that since we are the second highest CDM project registered country we aren't leading in making a change and are not exploring the potential we possess. We feel we have a larger responsibility.

CDM constitutes an incentive for reducing GHG emissions. Although the following points need to be given due attention:

- Sufficient technology transfer has not taken place.
- The environmental integrity of the Protocol is doubted since the CDM does not create additional emission reductions, but moves emission reductions to developing countries in exchange for carbon credits that increase the emission quotas agreed in Kyoto for Annex B countries.
- It is feared that the sustainable development focus of projects, which is left to the judgment of host countries, may direct the CDM towards the 'lowest bidder' in environmental or social terms.
- The heart of the African continent therefore seems to have been largely forgotten by the CDM. Of the first 165 projects validated and registered by the CDM executive board, only four were situated in Africa, only 2% represent sub-Saharan Africa (4% of credits), with 0.3% situated in Nigeria and 1% in South Africa (3% and 1% of credits respectively).
- Over 600 projects have been initiated from India but only 30 % of those initiated have managed to get registered under the UNFCCC. Hence we need to streamline the CDM process in India.
- The CDM EB has a lot of subjectivity in the system especially regarding measuring additionality and other project frameworks which are vague and often lead to the rejection of methodologies as a whole.
- CDM despite promising to involve the SMEs has not been able to assist their development.

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Despite the problems that we currently face in the CDM regarding its environmental integrity and sustainable development objectives, the CDM has had a great impact:

- On the thinking of business and policy makers in developing countries which have mainstreamed climate change in their business.
- On the awareness and understanding about clean technologies
- On emission trading and future action for climate change both in the private and public sector.
- CDM has considerably changed GHG emissions paths in some sectors in developing countries. For example, it is likely that by 2010, there will be no adipic acid and nitric acid plants or major landfills that have not installed GHG abatement technologies.

In this regard, the CDM can be considered a success by introducing climate change as an issue to key stakeholders in developing countries. If the problems of the CDM regarding its environmental integrity and sustainable development objectives are properly addressed, the CDM will continue to be an important instrument in combating climate change.

Recommendations

International

- Regressively reducing the percentage of emissions a country can reduce through buying credits in other countries. It should be regressively reducing every year.
- Also since the African continent remains largely forgotten, it should be essential that after every 10 projects, the country has to invest in Sub Saharan African region CDM projects.

OR

- With the increase in the percentage contribution to CDM as a whole as a country, the percentage of participation in sub Saharan projects should increase in the same proportion.
- Better functioning of the EB

National

- Small & Medium Enterprises (SMEs) should be given adequate attention

CDM despite of promising to involve the SMEs has not been able to assist their development. This can be done in the following ways:

1. Programmatic CDM launched by national level agencies would benefit the SMEs by reducing barriers in availing CDM benefits.

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2. They can be clubbed with bigger CDM projects and hence with the transfer of technologies the whole project will fund itself including the SMEs.
 3. The CDM EB must formulate policies to encourage SME centric projects after a particular region has contributed a stated number of projects.
 4. Simplify SME standards in the supply chain.
- The Technical Applicability and Possibility of DOEs:
 - India does not have a DOE established to its name and neither does it have its own India-specific benchmarks. The Indian based benchmark would make the carbon prices more transparent and remove uncertainties relating to long term investment in CDM projects. Also, none of the CDM projects registered so far have involved technology transfer free of cost. This is one of the major objectives to set up the CDM mechanism but it did not live up to its word.
 - Bundling agencies at National and State levels which lowers transaction costs.
 - CDM revenue could be recycled by the public authorities in the form of premiums to promoters, for example as part of a labeling program that would make it easier to apply standards that are currently disregarded.

Future of CDM

There is great level of uncertainty regarding the position of the Kyoto Protocol once the agreement comes to end in 2012. Will the agreement follow through? If so, what will be the new emission reduction targets? How will all this affect the CDM mechanism?

Volume projections for the carbon market indicate an annual demand of 200 to 640 MtCO₂ of credits for the CDM for the 2008-2012 period. The evolution of the market beyond this point will depend on the outcome of discussions on future commitment periods, which will condition the value of credits after 2012. Most cases it might act as a disincentive to set up a CDM project itself. This price currently remains low, at around 25 dollars per ton of CO₂. This limits the appeal of the mechanism, since in addition to transaction costs that cannot be reduced, projects must deal with the costs inherent in the learning and start-up phase of such a mechanism. We can only hope that the talks at BONN and the summit in Copenhagen in 2009 will provide for the applicability of CDM after 2012 which will influence present buying and investment decisions and will assure the CDM benefits in future.

Also the ICAI (Institute of Chartered Accountants of India) is going to be coming up with the accounting standards of the carbon credits accrued from these CDM projects and also the tax structure for the income accrued from the sale of the credits. If heavily taxed, this might change the face of CDM in India. Project coordinators are keeping their fingers crossed and hope that the tax does not affect the incentive to set up CDM projects in India.