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## **UNICE position paper on the Clean Development Mechanism (CDM)**

### **The Importance of the CDM**

The CDM is, or should be, one of the key Kyoto mechanisms allowing those developed countries that have adopted greenhouse gas emissions targets to meet these targets at least cost, whilst simultaneously providing a financial incentive for developing countries to invest in sustainable development and carbon-efficient technology. Both these aspects of the CDM are of importance.

The Kyoto Protocol states that emissions should be reduced at least cost. The CDM is in principle an important means of accessing these least cost options as the lower efficiency of many carbon-based processes in developing countries should make it possible to reduce emissions far more cheaply in those countries.

The operation of the CDM is closely linked with the effectiveness of the emerging carbon market in Europe and in other countries with Kyoto commitments, in particular, in influencing the liquidity of such markets. The allowance price in the EU has risen from 6 euro/tonne in March to 30 euro in July 2005. A consequence has been an increase in EU power prices and erosion in the competitive position of European industry, especially in the energy-intensive industries. The availability of CDM and JI credits could be a positive factor in balancing supply and demand in the carbon market.

The lack of progress with the CDM work also undermines global cooperation on climate change. It creates problems for countries like Japan and Canada that are net buyers of such credits, as well as developing countries who have projects in the pipeline. This applies equally to the larger countries such as China, India and Brazil and many smaller developing countries. There is now a growing interest in the global carbon market as a way to foster cost effective climate projects. A non-functioning CDM will therefore also be an obstacle to future negotiations on post 2012 commitments for all countries.

### **The Vision for the CDM**

Governments must determine a vision for the future of the CDM. It is vital that the CDM is implemented effectively, on a large-scale and with a greater sense of urgency. Two pathways are possible, either of which will require different commitments and funding. These should enable the CDM and its Executive Board to be able to handle:

- Either, some hundreds of projects a year after 3 to 5 more years of slow progress, thereby having little real impact on either the global emissions or the

real transfer of technology and skills from industrial to developing countries. This could result in a loss of interest in the CDM, particularly within Business.

- Or, thousands of projects a year, many of them large-scale, with a real impact on global emissions in industry, energy and other sectors in developing countries. This development could influence the global carbon market and the future negotiations for post-2012.

UNICE strongly supports the latter course of action. Many companies within the EU stand ready to play an active role in a fully functioning CDM both through the development of projects and the purchase of credits. In order to create this situation UNICE recommends that the following issues must be addressed:

### **Lack of Core Funding**

The CDM was originally conceived as having a 'prompt start' whereby project credits (CERs) could be generated from 2000.

Unfortunately, the CDM experience has not been one of rapid development. An important reason for the slowness of the CDM Executive Board to establish a functioning system has been the lack of funding, and funding to establish basic administration and processes in particular. The insufficient funding reflects a lack of commitment from Governments. According to the CDM EB secretariat the gap in the Executive Board budget for 2005 was total USD 3.8 million in 2005 (EUR 2.6 million), of a total of USD 6.8 million (EUR 5.6 million). The income to date totals 3 million Euro. As a United Nations organisation the CDM EB cannot operate in deficit. It is, therefore, vital that further contributions are rapidly made available in order to allow work to progress.

It is difficult to rationalise the relatively large sums of money that Governments are committing to purchase credits from or to develop future CDM and JI projects, while allocating very little or no money to the CDM EB that has the responsibility for approving and making the rules so that CDM credits can be created. So far Governments from Annex I countries in the Kyoto Protocol have just put up EUR 3 million in the years 2002 to 2005 for the CDM EB, whereas they are willing to spend EUR 4,071 millions on projects to create the credits needed from now to 2012, (estimate from Point Carbon).

The paradox is that when the volume of credits through this system increases, the CDM EB will fund itself. It is also important to note that this money *has* to come from Governments; industry is not allowed to fund start-up of the CDM EB.

### **Staffing of the CDM Executive Board**

The Executive Board itself and its subsidiary organs consist of government appointees (almost all are civil servants) who serve on a part-time basis.

The Executive Board is supported by a secretariat that is reported to have only two permanent UNFCCC staff. Given the volume of work, it is not surprising that backlogs have formed in processing the applications for approval of new methodologies (which are fundamental to the baseline and credit system) and for the other actions required. While there may be other reasons as well that lead to these backlogs, it cannot help that so few staff are employed.

It is vital that the secretariat of the CDM EB should be strengthened with more resources in order to speed up operations. Members of the Board should be funded by the CDM process for their work in order for them to be able to devote more time and effort in this work. Today their salaries are paid by the Governments for which they work, and they often lack time for the work in the CDM EB. They also should be able to stay longer on the Board of the CDM EB, to enhance the knowledge base. It will also be important to have people that have real experience with industrial projects, both on the CDM EB and in other parts of the CDM system.

### **Management of the CDM Executive Board**

An improvement is needed in management of the CDM EB to make the system work better and more efficiently, although it must be acknowledged that this is also pioneering work not tried before on a global scale. Improvements are possible while keeping the high environmental standards required by the Parties to the Kyoto Protocol.

Two major criticisms of the operation of the CDM EB are the slowness in approving CDM methodologies and the lack of interaction with project participants and market players. Part of the reason for the former is that the CDM EB has undertaken detailed analysis of individual methodologies. Whilst this is commendable in evaluating the environmental benefits of projects, it has served to bring the process to a stop. It must be asked whether the role of the CDM EB is as a strategic body providing an overview of the direction of the CDM or as a technical body for methodology/project approval. With respect to the latter criticism, in some cases, the CDM EB has not consulted market players in order to understand the effect of changes that they (the CDM EB) have made in methodologies. This has resulted in some of the methodologies being unusable for the projects that proposed them, often because they did not fit to the circumstances of the host country. This lack of dialogue should be remedied.

UNICE believes that the CDM EB must act as a real board, focusing on the important and principle questions and refraining from the micromanagement of individual project proposals. A proper business plan that both expresses its goals, the resources required from Governments to meet these goals, and how it plans to do it is vital. We look forward to the management plan that has been promised as well as the improvement of the CDM Methodology panels operations and procedures to improve interaction with project proponents as well as validators.

## **Summary**

It is vital to EU Business and to EU Governments that both the CDM and JI are fully functioning as soon as possible. In order to make an impact on emissions of greenhouse gases, many thousands of projects will be needed. This will encourage both developed and developing countries to meet their commitments under the Kyoto Protocol and to open a dialogue concerning the period after 2012. The Kyoto Mechanisms are of strategic importance to the European Union in meeting its commitments under the Kyoto Protocol in a cost-effective manner and in the operation of its EU ETS. UNICE stands prepared to work with EU Governments and Institutions in their attempts to improve the current operation of the CDM and to facilitate a smooth start up of Joint Implementation.

