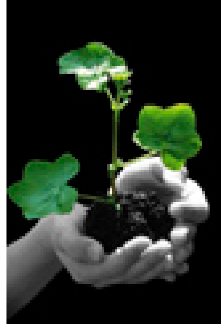

Understanding CDM

Martha Grossman throws light on the key features of CDM, its limitations and its impact on China post 2012.

THE CLEAN DEVELOPMENT Mechanism (CDM) is designed to assist developing countries by channelling funds and technologies that will build capacity and thereby contribute to a more sustainable approach to development. The mechanism is an element of the Kyoto Protocol to the United Nations Framework Convention on Climate Change (UNFCCC). The model helps developing countries gain knowledge and use the carbon abatement credits occurring from these CDM projects to meet their Kyoto emission reduction targets.

Under Kyoto, a CDM project must provide real, measurable and long-term benefits relating to the mitigation of climate change. It must produce a reduction in emissions that would not occur but for the particular project. Whilst a total of 76 developing countries participate in the scheme, China, India and Brazil host the majority of CDM projects.

China and India have both experienced exceptional growth in CDM projects since 2005 and China is now the world's largest CDM host. Approved Chinese CDM projects have been issued with 119,400,810 CERs (carbon credits), representing more than 40 per cent of the total issued globally by the UN to date. Perhaps one reason for China's fast progress has been the Chinese Government's ability to establish clear institutional structures (through the National Development Reform Commission), transparent CDM procedures and sound governance with clearer lines of responsibility for the smooth implementation of CDM projects on the ground.

Most notably, European countries with obligations under the EU's Emission Trading Scheme (EU ETS), which began in 2005 (Phase I), can use CERs to comply with the EU's cap and trade requirements. So far, the bulk of demand for CERs has come from the 27 Member States subject to EU carbon trading obligations. Aside from its usage within the EU ETS, there has also been a strong demand for CERs from industrialised countries, such as Japan, which are struggling to meet their Kyoto targets. In China, most of the media's attention has centred on CDM projects associated with energy efficiency improvements. For instance, in steel plants, waste heat capture and combined cycle power can be applied to reduce emissions and create CER credits. The largest such project is Jinan Steel/Camco International with expected 2.8m tonnes CO2 emission reductions.

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Achilles' Heel

Whilst CDM has been successful in terms of supporting the development of the European carbon market and other Annex I countries and investors, there are some concerns about its broader design and effectiveness to promote technology transfer and result in significant emissions reductions.

At present, the process has not included many emerging markets beyond China, India and Brazil. Africa's vast forestry and agricultural-based CDM potential, for instance, has been grossly overlooked. In this respect, it might be argued that as the CDM approach has matured, it has not fully aligned with the original spirit with which it was envisaged, that is, for underdeveloped countries to learn new carbon saving technologies from the developed world. Even in the largest CDM market, China, many experts would question the degree to which knowledge has been transferred, that the CDM structure has favoured the needs of developed country partners. There has also been a spate of criticism aimed at the CDM project approval and registration process, which has been marred by bureaucratic hurdles and extensive delays.

Aside from these concerns, most pressing is the realisation that the CDM market faces significant uncertainty once the Kyoto Protocol expires in 2012. The future of the CDM market depends primarily on international agreements post-Kyoto and the design of regional trading schemes in allowing the use of CERs for compliance (e.g. during Phase III of EU ETS).

A Bargaining Chip

There is no doubt that CDM and its role in future global agreements will be a major point of discussion in Copenhagen when world leaders assemble to take the Kyoto agreement to the next stage post-2012. However, how will changes to the ground rules for emerging markets during these rounds of negotiations impact China? It is likely that talks will place increasing pressure on China and India to adopt some form of binding emission-reduction targets (national or sectoral). The European Commission has already discussed the possibility of limiting the use of CERs within the EU ETS, if China and India refuse to take on such targets.

Therefore, CDM and its financial incentives to host countries may be used as a bargaining tool to ensure that China and India are more proactive in taking on targets in the future. The international re-engagement of the United States under President Obama and its determination to put in place domestic climate legislation also suggests positive signs for CDM success in Copenhagen. Let's not dismiss the critical need for the international community to take account of climate change as it works to resolve the wider impacts of the global financial crisis. In this context, although the CDM market might change, it is unlikely to go away. SBR

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