



Elements of CDM reform

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Axel Michaelowa, Sonja Butzengeiger
Hamburg Institute of International Economics, Germany
a-michaelowa@hwwa.de, butzengeiger@hwwi.org

1. Introduction: the surprising success of the CDM

In contrast to many forecasts of analysts in the aftermath of the Marrakech Accords, the CDM has been surprisingly effective both regarding institutional and quantitative aspects. An international body of rules with an unprecedented transparency and independent control has been implemented relatively consistently and to date, 179 projects estimating a CER volume of 341 million until 2012¹ have been made public on the UNFCCC website. In the months June and July 2005 alone, more than 150 million estimated CERs have been added. Also surprising is the high share of small-scale projects in project submissions (45%).

While the CDM thus can be seen as a clear success, there are several critical issues that prevent an even faster development being necessary to mobilize the CER volume needed to close the Kyoto gap². Therefore, calls for reform of the CDM procedures have been made by several governments³, business, but also research institutions⁴. We give an overview of the major problems and some possible approaches to solve them.

2. Perceived and real current problems with CDM

1. Slow registration of projects

While the CDM Executive Board (EB) exists for almost four years now, only in late 2004 the first project was registered. Currently 12 registered projects compare with 167 projects submitted for public comments under validation. A project developer typically needs to calculate 1.5-2 years for project registration in case a new baseline methodology has to be developed. Reasons hereof are not only long-lasting approval procedures by the EB and its Meth Panel, but also difficulties in getting host country approval or in raising the finance to pay registration fees (particularly in the case of unilateral projects).

2. High transaction costs

Development of a CDM project from the idea to the issuance of CERs is a costly endeavour. For “regular scale” projects with an approved methodology, up-front costs

¹ Only projects using approved baseline and monitoring methodologies; the number would be near 400 million if projects with submitted methodologies would be included.

² Estimated at around 3 billion t CO₂ eq. for the first commitment period.

³ e.g. Canada, India, Japan

⁴ International Institute for sustainable development, IISD

for PDD, validation, registration usually amount to 25,000-60,000 €⁵ plus verification costs during the project. This especially places a burden for small projects, but also for small and medium sized project developers.

3. Difficult determination of additionality, high rejection rate of methodologies

From the start of CDM-negotiations, there was an intensive debate how to determine whether projects are “business-as-usual” or are “additional”. This led to a relatively vague wording in the Marrakech Accords. The subsequent interpretation by the EB has been strict which led to protests from business and some Parties. The EB’s *consolidated additionality test* that consists of an investment analysis and a barrier test, today is widely used. However, some steps require a thorough effort of data collection⁶, and there is still space for gaming. From the business perspective, the additionality debate is major hassle.

Moreover, there are continuously high rejection rates of submitted new methodologies and no learning effect visible. Some project types have had much higher rejection rates than average, particularly energy efficiency, forestry and transport.

4. Lack of certainty about post-2012 CERs

While CERs can accrue for 21 years, the future of the international climate regime after 2012 is uncertain. Thus market prices of post-2012 CERs are very low and few buyers willing to contract post-2012 vintages. This has a strong impact on projects with long gestation times and high capital costs such as hydropower. If the CDM wants to contribute in bending the emissions path of developing countries downwards, these long-term projects have to be encouraged.

5. Contribution to sustainable development, equitable distribution of projects

The CDM has the twin aim of cost-effective greenhouse gas reduction for developing countries and of promoting sustainable development in the developing countries. While the former aim seems to be increasingly achieved, achievement of the second aim is debatable.

A few, end-of-pipe project types currently take the lion’s share of CER generation – as e.g. reduction of industrial gases (HFC and N₂O) and methane avoidance especially from landfills. Such projects do not create many jobs and also do not contribute directly to community development unless a part of the CER revenues is spent for this purpose as done in one HFC reduction project in India. Renewable energy is represented through a large number of projects, but usually with relatively low CER volumes per project. Energy efficiency and transport suffer from the lack of approved methodologies and difficulties of organising many different stakeholders.

Also, it might be argued that an equal geographical distribution of CDM projects is necessary – which clearly is not the case.

6. Insufficient Annex I incentives for private investors

For many years, there was no direct incentive to private companies to buy CERs, substantial CER acquisitions were only done by governments or multilateral funds. This has changed recently with the EU Linking Directive that allows the use of CERs in the EU emissions trading scheme. However, the transposition of the Linking Directive into member state law is slow.

⁵ Without EB administration fee.

⁶ E.g. on current practice in the host country

3. Proposed solutions

In the following, we highlight some potential solutions to be discussed:

3.1 Shortening of approval periods

- 3.1.1 Strict timelines for international bodies (need to secure sufficient personal capacities)
- 3.1.2 Shortening of pre-registration period
- 3.1.3 Accelerated development of consolidated methodologies

3.2 Reduction of transaction costs

- 3.2.1 Decision on administration fee and cross-subsidization of small projects
- 3.2.2 Allowing bundling for unlimited sizes
- 3.2.3 Centralized database for baseline data
- 3.2.4 Sectoral CDM
- 3.2.5 Streamlined but environmentally integer additionality determination

3.3 Long-term CDM-security (planning certainty)

- 3.3.1 Constructive Post-2012 negotiations need not only additional commitments by current Annex-B countries, but also clear commitments by recently industrialised countries and major emitters from the developing world.
- 3.3.2 Difficulty to merge intensity targets with CDM-concept
- 3.3.3 Unilateral declaration of post-2012 CER validity

3.4 Crediting of CERs against domestic climate policy instruments

3.5 Concentration of capacity building in low income countries with high emissions

3.6 Higher adaptation levy for low-development benefit projects

3.7 Financially supported development of methodologies for energy efficiency and transport