

Carbon Market Update No. 2

Is time running out for the Clean Development Mechanism to mitigate climate change?

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The climate change mitigation community has not been idle waiting for the KP to go into effect. Almost all CDM procedures are already in place, and the first dozen projects have already been “registered” under the CDM. However, many potential CDM projects have been delayed for a variety of reasons.

CDM projects typically require agreement among several entities from different countries, making the decision making process slow and complicated. Official approval of potential CDM projects requires institutions in both host (developing) countries as well as Annex 1 (industrialized) countries. In many countries these institutions are not yet fully developed. Moreover, a market mechanism such as the CDM is not entirely compatible with public bidding and other requirements when projects involve public entities such as local governments. Such procedures can add considerable costs and delays to project sponsors making potential mitigation projects less attractive.

Where a project involves significant technology transfer, and there are many different technology providers, decision making for potential beneficiary companies in developing countries can become complicated.

Even when technology choices and engineering issues have been resolved, CDM project development takes about two to three years. Some of the reasons are a consequence of the CDM cycle. For instance, each CDM project must be based on approved baseline and monitoring methodologies and this has become the largest bottle neck in the process. While many methodologies have been approved, the scope of such methodologies is often very restricted so that many potential projects cannot proceed until new methodologies are approved.

Getting off to a slow start in a new field — emissions trading to mitigate climate — would not itself be a major problem except for two constraints.

In the first place, the same factors that delayed KP ratification also have prevented any global climate change agreements beyond 2012. Thus, while many mitigation activities would continue to reduce emissions for many years in the future, and the CDM allows for a crediting period of up to 21 years, there is currently no market for emissions reductions to be accrued beyond 2012. The most cost-effective CDM projects — and with the largest potential contribution to climate change mitigation— often generate little benefits to project sponsors besides carbon credits. These projects have to recover their expenses through a revenue stream that exists only for a few years.

Secondly, according to the 1999 Marrakech Accords —setting forth the rules of the CDM— any mitigation activities started after January 1, 2000 and before November 18, 2004 can only claim credits if they can be registered prior to year-end 2005. Because of the delays associated with the CDM approval process, a great deal of “legitimate” carbon credits may not be available to project sponsors.

As a result of these two circumstances, CDM projects would appear to be less attractive to potential project sponsors, as well as fail to demonstrate the enormous potential of this market mechanism to mitigate climate change at low cost. Without this message, countries may be discouraged from making future climate change mitigation commitments, and the earth’s climate will be the loser.

The main solutions are in the hands of the Parties to the Climate Change Convention: to consider eliminating or postponing the December 2005 deadline and to establish the framework beyond 2012. The CDM Executive Board will have to continue its efforts to streamline procedures for smoother registration of projects. And potential sponsors will have to start projects as soon as possible in order to make sure the projects are viable under current conditions.