CSE dossier

factsheet 3

THE (UN) CLEAN DEVELOPMENT MECHANISM

FOURTH SESSION OF THE CONFERENCE OF THE PARTIES TO THE UNITED NATIONS FRAMEWORK CONVENTION ON CLIMATE CHANGE

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"The Kyoto Protocol does not meet our requirement for developing country participation…Nevertheless, a major ***down payment*** *was made in the form of a provision, advanced by Brazil and backed by the United States, to establish a so called Clean Development Mechanism which* ***embraces the US backed concept of joint implementation with credit****."*[1]

— Stuart Eizenstat, US Undersecretary of State

The Kyoto Protocol provides that three mechanisms for industrialised countries to reduce their emissions – by buying emissions from other industrialised countries and developing countries. Therefore, the focus of all the big polluters is to buy as quickly and cheaply and to order their accounts to meet the Kyoto commitments. Dirty air will become the hottest commodity on the global market.

Just look at this mother of all deals. At the rate of US$ 20 per tonne of carbon, the US needs to spend only US$ 7.5 billion over the five year commitment period to buy all the emissions it needs to meet its commitment of reduction. This is assuming that it stabilises at its 1990 emission levels by 2008. If it would like to increase its

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emissions by 5 per cent over its 1990 emission levels by 2008, it will simply have to buy emissions worth a mere US$15 billion over a five year period. And, similarly if it increases its emissions by 10 per cent above 1990 levels, then it needs to spend US$ 22.5 billion to meet its targets.

The Clean Development Mechanism (CDM) is the only mechanism for North-South cooperation in the Kyoto Protocol. But how this mechanism suddenly emerged within the closed door meetings of the Kyoto Conference remains an enigma that nobody really seems to know outside the corridors of power. What Brazil had proposed was a mechanism called the Clean Development Fund as part of a comprehensive burden-sharing strategy that included penalties for industrialised countries which did not meet their emissions reduction targets. And the money in the fund was to be used to support developing countries to undertake climate change adaptation and mitigation measures.

But in Kyoto, both the name and substance of the Brazilian proposal got transformed into the Clean Development Mechanism, which is nothing but a form of Joint Implementation (JI) with credits, which developing countries have staunchly opposed till date.

Clean Development Mechanism (CDM) is as unclear as it is unclean. CDM, like JI, is based on the concept of project-based investment in developing countries in carbon-saving technologies by industrialised countries in which the credits for carbon savings will go to the investor countries. And these credits will be used by the investing country to meet its own emissions reduction targets. On the face of it, the proposal sounds interesting and it offers a few dollars to dollar-starved developing countries which makes their governments and their NGOs and other institutions see gold. But the proposal will not only threaten the future of the developing world but also the future of the Earth.

Clean Development Mechanism (CDM) is as unclear as it is unclean. CDM, is based on the concept of project-based investment in developing countries

Why is the Clean Development Mechanism so unclean?

1. The Kyoto Protocol itself says that the purpose of CDM is not to help the South but explicitly to "assist" industrialised countries (Annex 1 countries) to meet their commitment to reduce emissions. Therefore, it is designed to help the rich and not the poor. It is important to note that the Protocol sees no other role for developing countries in combating climate change other than helping Annex 1 countries to meet their commitments under the protocol.

2. Under CDM, industrialised countries which have commitments to curtail their emissions can invest in projects in developing countries and will in turn obtain certified emissions reduction units which they can use in their own balance sheet for gases that threaten to heat up the Earth. The only existing rationale for JI is the one articulated by the Norwegian government, which argues that cutting emissions in industrialised countries will be more expensive than cutting emissions in developing countries. This is because developing countries are using outdated technologies that are very energy-inefficient while developed countries are already using very energy efficient technologies. To cut carbon dioxide emissions it would be cheaper for industrialised countries to pay for slightly more efficient power stations in developing countries. And the saving in emissions as a result of the slightly more efficient power stations would be credited in the account of industrialised countries. Similarly, developing countries can be given money for planting trees to remove some carbon dioxide from the atmosphere because it would be cheaper to plant trees in developing countries as both land and labour are cheaper there.

3. The saving in emissions will have to be certified. This is a normal trading practice that allows the investor to get the best choice and promotes competition. The Executive Board of CDM will authorise certification agencies which will assess the internal compliance and reporting mechanisms of the country selling the emission reduction units. The rating firms — like investment rating companies — will rate the "compliance capability" of developing countries. This will force developing countries to compete with each other providing the rich North a cakewalk option*; "cheapest, most efficient"* portfolio of projects to invest in and take carbon credits.

4. The Kyoto Protocol says that CDM will assist in providing funding. This is a clear example of putting in a few words to cajole and confuse negotiators of the South. CDM is a clear market-based instrument. The North wants to buy what the South possesses and wants to pay as little as possible for it. It will invest in projects and will buy emission units. There is no additional aid or technology transfer that is promised.

5. The Kyoto Protocol also says that besides "assisting" the Annex 1 countries, CDM will promote "sustainable development" in the developing countries. These words are supposed to be a conjurer's trick, which transform this untouchable to make it the new savior. Magically, sustainable development is being sold as additional aid and technology transfer. For developing country negotiators CDM projects are seen as an additional financial mechanism for achieving sustainable

development. What is conveniently forgotten is the change in the terms of the trade. When the issue of additional aid and technology transfer was raised during the Rio negotiations, it was seen as a compensation for the pollution caused by the industrialised countries. The polluters had a liability not just a capability to pay. Additional aid and technology transfer was the terms of the agreement to repair the damage. Now, under CDM whatever money or technology is transferred it is done because the North is buying on the cheap emissions from developing countries. Each certified emission unit bought will increase the assigned amount of the buyer. And because the Kyoto Protocol provides that industrialised countries can bank their unused emissions, the South is literally transferring its future to the North. This is not aid, it is trade. The South should insist that sustainable development would mean that the terms of this trade are fair and just.

6. CDM will allow the participation of private and public entities. Therefore, not just governments but also multinational corporations can enter into deals with Southern corporations to buy and sell their emission units. This transnational business will require a framework of principles and rules for global fairplay.

7. A share of CDM proceeds will also be used to pay for the adaptation costs of developing countries. This provision literally amounts to taxing the poor to pay the poor. The Global Environment Facility, the financial mechanism of the Convention, does not fund adaptation measures or policies. This provision takes the responsibility of paying for adaptation costs from the realm of polluters' liability and turns it into a cooperative mechanism. And as the South will be paid for emission units and that also at the cheapest possible rates, there is no question of a surcharge for adaptation costs that is paid by the rich. Also, there is no provision in the other mechanisms, namely, Joint Implementation and Emissions Trading, to pay for adaptation costs.

The South must call this spade a spade and must develop its positions in full knowledge of its own costs and benefits. Southern governments must be clear that there will be a number of agencies — ranging from the World Bank to NGOs in the South — that will scramble for a piece of the brokerage or a percentage of the transactions costs and will persuade governments to accept CDM without delay.

CDM will cost the South the Earth

The key issue is the price. What price would the South be paid for its emission units? The very basis of CDM is that the North wants to buy these emissions as cheaply as possible. The US administration's calculations for its bill to meet the Kyoto commitments is "modest" simply because it plans to buy as much as 85 per cent of its emission units at the cheapest cost from the South and from Russia and Eastern European countries. Janet Yellen, chairperson of the White House's council of Economic Advisors recently reassured the commerce sub-committee on energy and power of the House of Representatives that the US government would do its best to keep the economic costs of cutting greenhouse gas emissions as low as possible.

She presented the following estimates: Whereas reducing greenhouse gases equivalent to one tonne of carbon through domestic action would be US$ 125 per tonne, the cost of doing the same through emission trading and JI with other industrialised countries like Russia would be US$ 30-50. In comparison, this cost would be as cheap as US$ 14-23 in developing countries. Greenhouse Gas Abatement studies conducted by the UN Environment Programme (UNEP) show that one tonne of carbon can be saved through an investment of only US$3 in coal washing, US$27 in afforestation, and US$221 in enhanced rail freight infrastructure in India. It is the cheapest end of these options that CDM will promote[2].

The desperation of the sellers is going to increase in this global market place. With its economy in shambles, Russia is talking about selling its emission credits for US$ 20 per tonne of carbon[1]. Given that Russia and Ukraine were given targets of stabilising at 1990 levels by 2010, and the fact that their current emissions are 20-30 per cent lower than those levels, their surplus is enough to meet the less than 6 per cent target of Annex 1 countries. *With the price of carbon per tonne pushed even lower in this surplus market, CDM can be used by industrialised countries to do evenless than their assigned amounts.*

And as the Kyoto Protocol allows industrialised countries to bank their unused assigned amount, the industrialised countries could become carbon rich by the next century.

The interest is to bargain for the "cheapest and most efficient deal". One approach to get the best deal will be to develop a portfolio of projects so that they can compete against each other, effectively leaving the buyer to pick and choose and arm twist for the best option. The World Bank's Prototype Carbon Fund that is expected to begin in early 1999 is an effort exactly in this direction. The Bank has received funding from a number of utility companies and Scandinavian governments to start developing a portfolio of projects from the South. The Bank expects to play the role of an "honest broker"

By accepting CDM developing countries will use up their cheap options for reducing emissions and not even get credits for it in the global balance sheet in this trade. But all that it is doing is that it is creating a mechanism whereby industrialised countries can get emissions reduction at the cheapest price possible.

It is vital for the South to understand the economic implications of CDM. It has to realise that the cheap option that it is offering the North today will be at a heavy cost to it in the future. Economists predict that the many carbon savings options that cost as little as US$ 10-25 per tonne of carbon currently could cost up to US$ 200-300 per tonne in the long term[4].

For an estimate of what it will cost developing countries in the future, one only has to look at the present costs of transition in the developed world. A forecast done by the Energy Information Administration of the US government shows the real costs the country would have to bear without the cheap CDM option. According to the study if the US were to take its commitments seriously then the impact on its economy would be substantial: Electricity prices would rise 20 per cent to 86 per cent by 2010; gasoline price would rise to US$1.39 – US$ 1.91 per gallon and coal prices would soar. Though the study has been sharply criticised by conservationists and officials, it is clear that one factor has made a substantial difference. The study does not "account for the lower costs that would result from the key feature of the Admistration's climate change policy: international emissions trading." This, say the critics of the study, would allow "the US to meet the treaty's targets largely by paying other countries to reduce their output of greenhouse gases"[5].

By accepting CDM developing countries will use up their cheap options for reducing emissions and not even get credits for it in the global balance sheet. And when the South has reached higher levels of energy efficiency and, therefore, the cost of curtailing emissions will be high domestically, the North will have no economic incentive to invest in these countries. And if global warming is still a threat — as it will definitely be because industrialised countries have taken precious little action domestically — then the pressure will mount on developing countries also to take the tough and expensive route. And by then the costs of cutting back on carbon dioxide emissions will be high even in developing countries. So what will be the form of international cooperation then?

The very basis of the CDM is that the North wants to buy emissions as cheaply as possible

CDM does not answer this question. *Worse, it allows the current generations of developing countries to sell off their cheaper emission control options today leaving future generations straddled with high cost options. Literally discounting the future.*

There has been little discussion on this issue or a demand to link the cost of emission reduction in the South to the cost of emission reduction in the North. In other words, to demand that the South be paid a "fair" price — which accounts for its present and future needs — for its emissions. Without this, CDM amounts to a global carbon scam and makes the sale of Manhattan for a few beads pale in comparison.

There is also the question of practicality. How will a country differentiate when a more energy efficient technology is being brought into a developing country to cut carbon dioxide emissions and when is it coming simply because foreign or domestic industrialists want to move towards better technology for competitive reasons. *After all, technological upgradation takes place all the time.* New cars have less carbon dioxide emissions per km than older ones. So will the foreign manufacturers of new cars in India take the credit for reducing carbon dioxide to their home countries?

Another concern is whether CDM will turn developing countries into technological guinea pigs for latest but untested technologies produced in the West.

CDM will cost us the Earth

There is yet another problem with CDM. Under the Protocol, industrialised country can even corner a large amount of emissions reduction credits from developing countries through CDM such that it meets more than its emission reduction targets. It would then even be allowed to bank these extra emissions for future use. In this way, that country would have siphoned off the advantages of the current cheap emissions reduction possibilities in developing countries for its own benefit for a long time to come. But how does this 'creative carbon accounting' help us to avoid global warming as industrialised countries would still be emitting large amounts of greenhouse gases?

CDM: An instrument for pulls and pressures?

At the Conference of Parties in November there will be tremendous efforts to win and wean developing countries to sell their emission, fast and as cheaply as possible.

The environment minister's conference in Tokyo has declared its intention to decide the mechanisms for CDM by the year 2000. There was no target set for any other instrument of the Protocol.

There is desperation in the air. Clearly the cheap price – below US$ 14-20 tonne of carbon emissions – will make it easy to buy the future. The last few months have seen a flurry of meetings on this com-

Every multi-lateral agency wants to indulge in emissions trading between countries

Brokers to the fore: UNEP vs UNDP vs World Bank vs UNCTAD

Every multilateral agency wants a foot in the door of this global carbon scam. Each agency is bidding to become the "legitimate" broker of developing country interests.

In Bonn in June, a new intergovernmental body proposed by UNEP did not go down well with some governments. UNEP's new Executive Director, Klaus Topfer proposed the establishment of an intergovernmental body on economic instruments for environmental conventions. Being new and eager to get on with the job and realising the tremendous opportunity for UNEP to enter this 21st century carbon trade, Tofper made a strong plea for the need to make connection between flexibility and minimising the economic repercussions. Topfer, who first proposed the idea at the UNEP Governing Council, wanted the Panel to initially work on the Clean Development Mechanism (CDM).

But no quicker was it proposed, it was also opposed. The Group of 77 and China, were the first to respond in writing that they did not support the initiative. According to them not only was IPCC already engaged in this work but also that UNEP in partnership with WMO is a host institution for IPCC. Therefore, rather than creating a new institution – which was also against the recommendations of the Earth Summit – UNEP should allocate "its already scarce resources to the efforts of the IPCC". Furthermore, they added, developing countries will not have the humanpower or resources to participate in the work of another intergovernmental body.

The European Union remained more guarded in its criticism. According to the EU, "if such a panel were established, they remained very doubtful that the CDM would be an appropriate issue for it to consider in its initial work." But it voiced its agreement with the G-77 and China in saying "the Conference of Parties (COP) to the FCCC is the body responsible for decisions on issues related to this convention." Therefore, UNEP would at best be a service agency for the COP and cannot take decisions on climate related issues.

But in the months after, UNEP has continued its efforts to take control of the CDM and is clearly marketing itself as the best agency to oversee this mechanism. It has teamed up with the Paris based International Energy Agency and is working through regional brokers to secure their place in the sun.

UNDP has been slow to get off the mark. But it is also eyeing the CDM and will push its competitive advantage of being in the business of development to the South. UNIDO which sees technology transfer as its still borne baby is also bidding for being the custodian of CDM.

The World Bank, on the other hand, has got its Carbon Prototype Fund – a portfolio based approach to do project investment in the South. The Fund will essentially be used to develop a set of bankable CDM and JI projects and then sell it to prospective investors. This would reduce the transaction costs, risks and more importantly, using the portfolio approach would make countries compete against each other. Securing the lowest cost options for the buyers. The Bank is callings its fund, "a model and not the model." The Bank is hoping to begin transaction business by early 1999 and project to do project business worth US$ 8 billion in trading under the Protocol in early years, going up to US$ 17 billion as CDM investments grow. The Bank sees a "large potential for leveraging investments in energy efficiency." And would provide its "brokerage" services on a bilateral basis to develop bankable projects. Till date, 13 companies and five governments have signed a MOU with the World Bank for projects in the electricity, gas and oil sectors and have committed US$ 120 million. The initial price of the carbon sale by the Bank is US$ 20 per tonne[8].

UNCTAD is keen to corner the emissions trading market. The agency sees its competitive advantage in being the first to "espouse the cause of emissions trading" and is gearing up with the rules and regulations to begin trading. As the mandate of the agency requires it to work with developing countries and as emissions trading is still not a mechanism for developing countries, the agency is ingeniously pushing for participation of these countries in this new mechanism.

So desperate are these new brokers that they are urging developing countries to agree that the present system of allocation of emissions rights is just and equitous. They suggest that the baseline should be taken as such and a cut on the projected emissions would be the country's entitlement. This can then be traded. These pragmatic UN officials brush discussion on the issue of equity or sustainability aside[9].

The turf battles for the lucrative carbon market are clearly on.

modity trade and the rules that are being set are clearly without conscience. UNEP is strongly bidding to become the grand broker in this dealing and wheeling and has been holding a series of meeting with the International Energy Agency on CDM. The emerging consensus on the rules of this earth game is as follows[4];

- Rules must be "simple";
- We must not wait for a perfect system but must get it started by 2000;

● Within the next two years, the following simple questions need to be resolved:

A. Guidelines for what kind of projects qualify. A very wide range of projects from ethanol, clean coal, repairing pipelines, *nuclear plants, dams,* demand side management and renewables is being put on the table. At the UNEP-IEA meet, the EU maintained that "only the best, most climate-friendly technologies should be under the CDM." There is also talk about projects leading to "sustainable development" in the South.

B. Mandate and composition of the CDM executive board with the consensus being that the CDM bureaucracy should be the "certifiers of certifiers". There is also the need for rules for validity and liability for the certified emissions units sold. The legal responsibility would need to be assigned in case the CDM project generates less emissions than promised. There is also talk about insurance for such a situation.

C. Determining roles of other agencies (a pointer to the turf battles ahead);

D. Defining baselines for CDM projects. Before each project, the 'baseline' or the previous amount of carbon emissions from the project area have to be established. This baseline is then used to say that emission reductions are "additional". There is now discussion about the issue of "leakages" in which a project could lower emissions but emissions in another part of the host country could increase. For instance, reforestation project in one location could be accompanied by greater deforestation elsewhere[7]. An important discussion also is if the baseline should be individual project based or sector based. That is, whether each project's additionality should be determined or whether there should be a baseline for each sector or each project activity. The latter clearly is in the interest of the buyers. In this way global baselines can be established for project activities – taking the least cost options. This would then force the carbon sellers to compete – cutting costs to meet the global baselines and lowering their prices of emission units further. Creating the perfect buyers market.

The favourite divide and rule strategy defines equity in the current CDM debate. How to set up regional quotas so that each country can participate in this perfidy on the Earth? And each developing country government can mortgage its people's future?

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