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Key lessons learned on the CDM and its use in the EU ETS

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Ten years after the adoption of the Kyoto Protocol, the CDM has become an immense global market, having more than 1000 registered projects and a value of several billion Euros. In this regard, the CDM has been a great success in creating a global market for GHG emission reduction projects. The CDM has also had a great impact on the thinking of business and policy makers in developing countries and the awareness and understanding about clean technologies, emissions trading and future action on climate change both in the private and public sector. Moreover, the CDM has considerably changed GHG emissions of some gases and some sectors in developing countries.

However, the CDM has also been heavily criticised for not delivering on its environmental and sustainable development objectives and for its governance problems. In a report for WWF, Öko-Institut has assessed the contribution of the CDM to meeting its environmental and sustainable development objectives and provides recommendations for improving the mechanism, including regarding its use in the EU ETS.

The report revealed considerable quality problems in the CDM:

- **Poor performance of some DOEs.** Designated Operational Entities (DOEs) are independent entities that validate projects and verify emission reductions. They are responsible for ensuring that all rules established by the UNFCCC and the CDM Executive Board are followed. There are serious concerns about the performance of some DOEs. Spot checks by CDM Executive Board revealed serious shortcomings, such as non-conformities of the DOEs with regard to "competencies to perform validation and verification functions" and "compliance with CDM requirements". In some cases, DOEs have failed to check whether very simple requirements of the CDM are met, such as that the project started after 1 January 2000.
- **The additionality of many projects is questionable.** If a CDM project would also be implemented without the CDM, but nevertheless registered as a CDM project, the issuance of Certified Emission Reduction Units (CERs) results in an increase in global GHG emissions, since the emission reductions from the project would occur anyhow while the CERs allow entities in industrialized countries to increase their emissions. Therefore, the demonstration of additionality requires showing that a project would not be implemented without being registered as a CDM project. Our findings suggest that there are serious problems in the way in which additionality has been assessed. The additionality of a significant number of projects seems unlikely or questionable. Several other sources support this conclusion. For exam-

ple, in a Delphi survey by Öko-Institut, 71% of the participants agreed with the statement that “many CDM projects would also be implemented without registration under the CDM” and even 86% of the participants affirmed that “in many cases, carbon revenues are the icing on the cake, but are not decisive for the investment decision”.

- **Low contribution of the CDM to achieving sustainable development.** The CDM project portfolio is mainly determined by the economic attractiveness and potential and risk of the mitigation options. The host countries, which have to endorse that a project contributes to sustainable development, apparently do not prioritise projects with high sustainable development impacts. Several publications have evaluated the contribution of the CDM to sustainable development. They all arrive at a similar conclusion: the CDM does not sufficiently fulfil its objective of assisting host countries in achieving sustainable development.

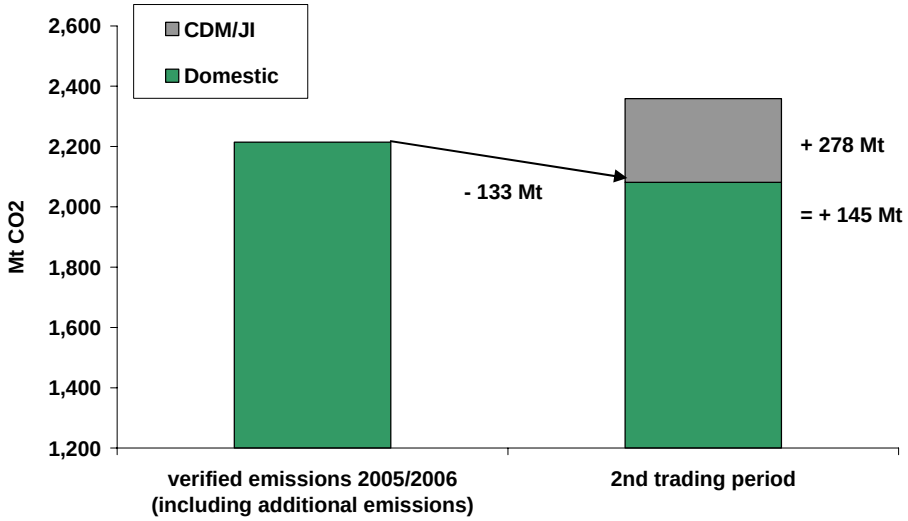
In conclusion, the environmental integrity of the CDM needs to be strengthened considerably. Since 2007, the CDM Executive Board has initiated action towards this end. The assessment of projects was considerably strengthened. As a result, the rate of rejected projects has increased from less than 1% in the early days to about 10% recently. In many cases, lack of additionality was a key reason for rejection. A Validation and Verification Manual for DOEs is under development.

Additional measures to improve the environmental integrity of the CDM should be envisaged: The assessment of additionality should be based on more transparent and objective criteria, such as ambitious benchmarks. The use of subjective barriers (e.g. “the own management is not willing to invest”) should be abandoned. DOEs should not be paid anymore by their clients but by the CDM Executive Board. DOEs should also be confronted with sanctions if they do not comply with rules. The retroactive crediting of projects, i.e. the crediting of projects which have started years ago (e.g. in 2001) but request carbon credits only years later, should stop, since in such cases it is not very convincing that the CDM was seriously considered in the investment decision.

These measures could help to ensure that emission reductions under the CDM are real, measurable and additional. However, even if improvements can be made to the CDM, it is important to note that the environmental integrity of offset mechanisms is likely to be lower compared to cap-and-trade systems, whatever the rules and design of the systems are. This is due to the large uncertainty associated with establishing additionality and determining baselines, which are by definition counter-factual and can never be determined with certainty.

Therefore, if the 2°C target of the EU should be met, we need to move beyond offsetting mechanisms in a longer term perspective – or we need much deeper cuts by developed countries than the envisaged 25-40% reduction by 2020. New instruments, such as sectoral crediting mechanisms, should be explored and the CDM should move beyond offsetting, e.g. by discounting emission reductions or using ambitious baselines below business as usual.

In the EU ETS, CDM and JI can be used extensively in the second trading period from 2008 – 2012. The use of CDM and JI is currently capped at 278 million tons per year. However, the annual cap for emission allowances is only about 133 million tons CO_2 lower than the verified emissions in 2005 and 2006. This enables installations to increase their 2005/2006 emissions by up to 145 million tons for the period of 2008 to 2012. As a result, the actual emissions in the EU ETS are likely to be higher during the 2008-2012 period than they were in 2005/2006 (see Figure below).



While the unlimited use of offset credits can result in theory (if such credits are based on real, additional and measurable emission reductions) in cost savings to achieve ambitious climate mitigation targets, there are several reasons for limiting the use of CDM and JI in the EU ETS: Firstly, an extensive use of offsets can result in a long-term lock to technologies that will jeopardise the achievement of ambitious emission reductions in the next decades. Secondly, there are considerable quality problems in the CDM. Even if these can (partly) be fixed, the environmental integrity of any baseline-credit-scheme is likely to be lower than for cap-and-trade-schemes, due to the intrinsic uncertainty in determining counter-factual baselines. Finally, to show leadership for the EU in international climate negotiations, it is important that the actual emissions in the EU do not increase but decrease over time.

WWF report by Öko-Institut: http://www.oeko.de/oekodoc/622/2007-162-en.pdf