

Editorial

While many see the UN Climate Change Conference in Durban as a climate policy success, there are still no signs of any ambitious climate change mitigation targets on the horizon. The carbon markets have reacted accordingly, with prices hovering at the lowest levels ever. Nonetheless, the decision on the second Kyoto commitment period secures the continued existence of the CDM and JI mechanisms. Durban also saw the introduction of a new market-based instrument, although its structure and design are admittedly extremely vague.

Apart from analysing the conference outcome, this issue looks at the establishment of a new foundation aimed at accelerating use of PoAs. It also spotlights the challenges currently faced by designated national authorities (DNAs) in host countries. And in a detailed analysis, the JIKO team proposes a solution to the difficult issue of carry over AAUs into the second Kyoto commitment period.

I wish you an interesting and informative read.

Christof Arens

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JIKO Report

Durban Takes CDM Reform Further and Establishes New Market-based Mechanism

Negotiations on the flexible mechanisms: An in-depth look at the outcome

The Climate Change Conference in Durban brought the international climate regime a decisive step further. With regard to the flexible Kyoto mechanisms and the development of new market-based instruments, the successes achieved were relatively small. Among other things, the introduction of a new market-based mechanism was agreed in principle, but its design and structure will take some time to work out. JIKO Info looks at the negotiation process and its outcome.

The Durban conference made several basic decisions on the Clean Development Mechanism and took the reform process further with regard to specific elements. One fundamental step involves the adoption of rules for the approval of CCS projects. In this project activity, carbon dioxide is extracted from exhaust gases and compressed in underground storage depots.

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The Post-Durban Carbon Market: Lack of Demand Despite Improved Conditions

by Dr. Silke Karcher, BMU

Was Durban a breakthrough or a well-sold extra round with no real outcome? When it comes to the carbon market, there are grounds for optimism. At the same time, the lack of demand fuels doubts as to which new projects and ideas will actually be implemented: in terms of the conditions and the further development of market-based approaches, the outcome in South Africa was a clear step in the right direction. However, although it seems likely that the lack of demand will be remedied in the future, this will only serve the market indirectly.

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Knihiko Shimada, facilitator of the CDM negotiations, endorses a passage of text. Photo: Courtesy of IISD/ENB.

The CMP in Durban decided on the key prerequisites for projects using this contested technology: host countries must, among other things, provide proof that they have set up the legal framework for introducing CCS, including processes for location selection and accident prevention. In addition, they must accept risk liability for the duration of the crediting period plus 20 years; alternatively, liability can be covered by investors. During this time, five percent of the CERs generated must be kept in reserve to cover the risk of CO₂ seepage.

After years of debate and contrary to the recommendation of the CDM Executive Board, the CMP decided to introduce the concept of materiality for CER issuance. This means that during the verification process, minor errors and deviations will not result in a review of a request for CER issuance. In the decision, the following thresholds for over-estimating certificate issuance are established:

- 0.5 percent for projects > 0.5 million t CO₂-eq p.a.
- 1 percent for projects between 0.3 and 0.5 million
- 2 for all projects below 0.3 million
- 5 percent for small-scale projects
- 10 percent for micro-projects

The rules on remedying inequitable regional distribution of CDM projects were further expanded in some areas. For example, simplification of the additionality test was expanded to energy efficiency and renewable energy projects in areas with no access to the electricity grid. The methodologies are also to be further simplified for these areas. Management of the loan scheme for projects in countries that have been under-represented in the CDM so far was assigned to the UN Office for Project Services (UNOPS).

Currently disadvantaged host countries are also to receive support with regard to standardised baseli-

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nes (SBLs): the designated national authorities (DNAs) in least developed countries (LDCs), small island states and African states will receive financial support from the Executive Board in the development of and in submitting SBL proposals. Funding will also be provided for identifying and submitting proposals for microscale renewable energy technologies that are automatically defined as additional.

It did not prove possible to push through an overall reassessment of additionality testing, as called for by the EU. The EU had expressed considerable doubts about the additionality of certain project types such as power plant construction and infrastructure activities like Bus Rapid Transit projects because it is highly unlikely that the CDM would be the deciding factor for an investment decision. In the end, the negotiators agreed that the EB should "consider approaches to improve additionality testing for projects in the private and public sectors". Moreover, the CMP reached no agreement on the issue of the appeals process; the EB is requested to submit its draft, revised if necessary, at the next CMP.

Joint Implementation: Mechanism preserved, reform on hold

The JI debate centred primarily on the future of the mechanism. Following the overall agreement on a second Kyoto commitment period, the survival of JI seems safe in principle. In addition, the climate change conference in Cancun had decided to subject the rules for JI to a thorough review in 2012. The JI Supervisory Committee (JISC) had proposed a fundamental reform a year ago: this would include combining both JI tracks into a single track for the post-2012 period. The result would be a single standard for emissions calculation and verification, and reduce both transaction costs and knowledge barriers.

A further issue takes in the conditions under which existing JI projects can receive credits in the second commitment period. The JISC had recommended continuing issuance in the second commitment period based on the assigned amount units (AAUs) from the first commitment period. This proposal

was supported by Russia, the Ukraine and Belarus, although it attracted criticism from the EU and others because it impacts on how excess AAUs are dealt with in former CIS states.

These issues were, however, not addressed in detail in the concluding decision. Rather, they were integrated into the overall review of the JI rules. The CMP merely acknowledged the JISC proposals and invited Parties and observers to submit their views on JI reform to the UNFCCC by April 16. The Secretariat is to prepare a synthesis report from these by 31 July. The JISC will include the submissions in its further discussions and, in time for the next climate change conference, develop drafts for reforms and rules for the transition into the second commitment period. The CMP in Qatar is then to use these as a basis for revising the JI rules.

The sheer existence of the JISC had been in limbo in the last few years, because the relatively few projects in Track 2 do not generate anywhere near enough in fees to finance it. The Conference in Cancun thus introduced fees for Track 1, which stabilised the financial situation of the JISC. The Secretariat expects that the new fees will provide financial security for the coming years.

New market-based mechanism agreed

The debate on the introduction of new market-based mechanisms was both intense and controversial. While the EU again called for the creation of sectoral mechanisms, many developing countries remained sceptical. They fear that sectoral mechanisms will place them on a slippery slope which will ultimately lead to binding emission reduction targets. In the end, negotiators agreed that a new market-based mechanism would be introduced. Its rules were deferred to the next COP, however. One thing that is clear is that the instrument will not be a true offsetting mechanism because it was agreed that the measures taken must lead to net emission reductions.

In addition, the negotiators agreed to a working programme to assess whether and what form the bottom-up introduction of market-based mechanisms by individual Parties can be recognised. These

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mechanisms must also meet environmental standards.

NAMAs: little progress, dynamic pipeline

Last year, many developing countries took steps to give Nationally Appropriate Mitigation Actions (NAMAs) much clearer structures by developing proposals for NAMAs using bottom-up learning processes. Nonetheless, the NAMA model remains extremely broad-based and was not addressed in any great depth in Durban.

As documented in the Copenhagen Accord of 2009, the invitation still stands for developing countries to submit details of their NAMAs to the UNFCCC Secretariat if they have not already done so. Developing countries are also called upon to further specify the information they have submitted, for example as regards the methodologies, sectors and gases involved, and the support needed in conducting NAMAs. All the respective information should be consolidated into a single document and published on the UNFCCC website.

One key NAMA-related decision made in Durban was the development of a NAMA register in the form of a dynamic, web-based platform. The register is a voluntary instrument which allows developing countries to demonstrate their unilateral emis-

sion reduction activities. They can also use the register to publish activities for which they seek support from funders. The UNFCCC Secretariat has until May 2012 to develop a prototype. The final product must be ready in time for COP 18.

Some industrialised countries favoured a standardised format for NAMA reporting. This was, however, rejected by various developing countries to avoid excluding certain activities and to minimise reporting obligations. Instead, a non-binding list of aspects was agreed which must be adhered to when reporting NAMAs for which international support is sought, for example concerning the type of emission reduction activity, the timeline for implementation, the costs and type of support, and the expected reductions.

A further important decision made in Durban involved the basis for measuring, reporting and verification (MRV) of self-implemented and supported NAMAs in developing countries. As agreed in Cancun, developing countries are required to submit biennial update reports on their emissions inventories and reduction activities, and also on the assistance they received and still need in conducting their NAMAs. These must be submitted as independent reports or as an annex to the four-year national communications (NatComs), and must contain additional information on the type of



Successful re-establishment. The EU regained its pioneer role at the climate change talks.

Photo: Courtesy of IISD/ENB.

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reduction activities, the methodologies used, key targets and steps taken to achieve them, implementation progress and information on international market-based mechanisms. The reports must be submitted to the UNFCCC Secretariat in an electronic form which has yet to be specified. The decisions made in Durban also allow significant flexibility in reporting for least developed countries (LDCs) and small island developing states (SIDS).

Conclusion and Outlook

The CDM of the near future will be restricted to LDCs. The EU has made it unmistakably clear that the Durban decision will not lead to change in the approval rules for CER imports into the EU Emissions Trading Scheme (ETS). Thus, the small improvements for LDCs and under-represented host countries are a step in the right direction, and especially the support to be offered concerning standardised baselines. To accelerate use of the CDM in LDCs, there is however a lack of seed funding for PoAs (see the article on the PoA Foundation in this issue). The introduction of default values and a tightening of the sampling procedure would promote use of the PoA instrument. Last but not least, all these developments are being halted by the ongoing poor demand.

In this light, the decisions regarding CCS are not worth the paper they are written on. It remains highly questionable whether project sites with CCS-suitable geological storage locations nearby can actually be found in LDCs. These sites must also have industrial facilities or power plants of sufficient capacity to make investment in CCS technology feasible.

As for JI, everything remains open. While the agreement on a second Kyoto commitment period has likely secured the future of the mechanism in principle, the JISC, by proposing to merge the two tracks, has essentially proposed a fundamental reform upon which the states must now act. From an environmental integrity perspective, it would make sense to replace what up to now has been an extremely non-transparent Track 1 with a new system with stricter rules.

While the negotiations on new market-based mechanisms made good progress on paper, modalities and procedures are to be agreed by the end of 2012. However, this process took four years with the CDM. Also, the larger emerging economies in particular still have considerable reservations regarding the new mechanisms. Their substance is a central issue when it comes to the matter of environmental integrity. If, as required by the EU, the new mechanisms are to operate at sectoral level, the baselines must be set using sectoral projections that by their very nature are subject to uncertainty. Added to this comes the poor data quality in most developing countries. This raises the question as to who is expected to buy the hoped-for large numbers of emissions certificates generated by new mechanisms. With the current weak emission reduction targets, the CDM is more than able to meet any demand. Many market observers agree that one thing the carbon market does not need is an additional source of certificates.

With regard to NAMAs, only a few details made it into the international framework. But that aside, the development of the NAMA pipeline continues apace. In the Durban side events, several new NAMA proposals were presented. However, now that the NAMA concept has been developed, it remains unclear to what extent funding is available in industrialised countries. It would not be the first time that the industrialised countries promote the development of models but are unable to make funding available to assist their implementation. 2012 could thus be the acid test for NAMAs.

Finally, in the development of NAMAs and the new market-based mechanisms, it is important not to forget an important detail: the Bali Roadmap states that NAMA and CDM activities must take place within the context of sustainable development. Following the unsatisfactory results with the CDM, when developing a new instrument the need for a fully transparent and satisfactory system is key. Yet it must make sustainable development in the host country its utmost priority.

CHAWSt/TWe/FMe

Further information:
All Durban conference decisions are linked to from the JIKO portal:
www.jiko-bmu.de/1090

JIKO Analysis

The Post-Durban Carbon Market: Lack of Demand Despite Improved Conditions

Continued from p. 1



Dr. Silke Karcher, is Head of EU Affairs and Bilateral Cooperation on Environment and Energy at the German Environment Ministry.

No demand: The glass is half empty

The key issue for the carbon market is policy-driven demand. Without this there is no carbon market and, as expected, Durban provided no solution for this problem. Demand remains uncertain. A spirit of optimism, which the market – and the international climate regime – could well do with, will not be seen for the time being. Nonetheless, the conference in South Africa did produce some carefully optimistic signals:

- On the whole, the results from Durban are a sign that the international climate regime has a future.
- The decision to continue the Kyoto Protocol with existing and new market-based mechanisms is a clear indication that the global carbon market will continue.
- The message from Durban also underpins existing and newly developing regional emissions trading schemes and thus their potential to generate demand from offset projects, including in the international market:
 - ⇒ The most important regional market so far is the EU Emissions Trading Scheme (ETS). Given the outcome from Durban and the historical low in emissions trading prices, the question of raising the 2020 emissions reduction target from 20 percent to 30 percent becomes more pressing. All eyes are now on the Danish EU presidency. Initial signals are expected from the Environmental Council some time in March. A 30 percent target, and even a lesser decision on, say, a 25 percent target for the EU only or a set-aside for crisis-related excess EAUs, would boost demand.
 - ⇒ Other regional stakeholders should find encouragement in the path set out in Durban regarding an international climate change agreement. These include the US state of California, Australia, New Zealand,

China, Korea, Ukraine and countries that are still in the early stages in considering the merits of setting up their own emissions trading schemes, such as Brazil.

There is thus no hard and fast solution to improving demand. Nonetheless, there is much talk on developments and initiatives in this direction to ensure demand does not dry up in the medium term.

Committed to market-based mechanisms: The glass is half full

With regard to conditions for the carbon market, the decisions reached in Durban are a significant step forward in many respects.

Institutions

A key success is the decision on a second commitment period under the Kyoto Protocol. This secures the legal framework for the Kyoto institutions and the continued use of the flexible mechanisms.

CDM

This applies especially to the CDM, which can now be continued under a secure legal framework. This is vital because up to now, and presumably for the foreseeable future, the CDM is the prime mechanism used in the carbon market. And it is also vital that the CDM reforms have been given a new breath of life. The decision on Further Guidance states among other things the improvement of the rules for PoAs, the development of suppressed demand methodologies, and of standardised baselines. Support is to be stepped up for countries underrepresented in the CDM.

In addition, the Executive Board has begun the so-called policy dialogue on the CDM. Issues such as the direction and depth of the CDM's management will be decisive. Appointments to the dialogue group purposely target people with no in-

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Rahmenbedingungen

BMU study on the development of PoA-based NAMAs
www.jiko-bmu.de/1039

Text of the Kyoto Working Group:
http://unfccc.int/files/meetings/durban_nov_2011/decisions/application/pdf/awgkp_outcome.pdf

involvement in the CDM to ensure an external view. The challenge is to link the latter into a debate that is both scientifically founded and considers experience gained so far.

Against this backdrop, the potential of PoAs can be discussed in detail, and a bridge can be built between the CDM and new market-based mechanisms, and also to NAMAs. The experience and theoretical assumptions arising from projects conducted by the German Environment ministry to support the development and distribution of PoAs can serve these purposes.

New market-based mechanisms (NMMs)

The EU objective of introducing new market-based mechanisms has been achieved. The AWG-LCA decision defines a new market-based mechanism. It also launches a working programme with submissions and their evaluation, plus a series of workshops. In addition, NMMs are operationalised in the supplementary proposals on the Kyoto Protocol text in the Annex to the Decision on Extending the Kyoto Protocol. Certificates from such mechanisms are to be made tradable in order to meet emission reduction targets, for example by Annex I States.

To secure a future for NNM, pilot projects are needed which should not be allowed to be decoupled from the need for compatibility with the UN process. States with strong international climate change programmes and also the EU as a potential source of demand are called upon in this respect.

Joint Implementation

The legal framework for JI is basically secured, as is that for the CDM. The continuation of JI depends, however, on the availability of AAUs. COP18 is expected to provide clarity on this issue. The question of targets and especially the management of excess AAUs from the first commitment period will be one of the key tasks in implementing the Durban decisions. Balancing the extremely diverse interests will not be easy, to put it mildly, cf. the article on AAU carry-over elsewhere in this issue.

REDD

Up to now, and with the exception of the voluntary sector, no market-based mechanisms have been developed for reducing emissions from deforestation and forest degradation (REDD). This is

Which world power is ahead on climate change? Todd Stern, US Special Envoy for Climate Change, and Xie Zhenhua, Head of the Chinese delegation and Deputy Director of the National Development and Reform Commission (NDRC) in Charge of Climate and Energy Conservation.

Photo: Courtesy of IISD/ENB.



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Indaba the Ice-breaker: Under the leadership of Maite Nkoana-Mashabane, South Africa's Minister for Foreign Affairs, the South African COP Presidency hosted a number of informal gatherings that give delegates a chance to talk about key issues and help foster negotiations.

Photo: Courtesy of IISD/ENB.



mainly due to the huge difficulties in reliable calculation. This is a big problem and one that should not be under-estimated in the future. At the same time, smart introduction of market-based mechanisms or components thereof can help provide urgently needed funds, including in the REDD sector.

Market-based components are envisaged in the LCA decision on REDD: The COP "can develop them". It is important to rise to the challenge of developing a market-based mechanism (or a mechanism comprising market components) which meets REDD needs by drawing on experience gained with the CDM while keeping a keen eye on other conditions in the REDD sector. REDD is too important for its market-based financing option to be passed up without thorough investigation. But it is also too complex to allow simple transfer of models using existing emissions reduction technology.

Combinations of market-based and results-based or convergence between the two could bring new opportunities. Models are thinkable which, depending on the results under consideration, use a currency other than a tonne of carbon.

Conclusion

The Durban outcome has given new momentum to the climate change negotiations. This will benefit the carbon market. All the Durban decisions additionally show – if to varying degrees – a common recognition that market-based approaches can and must make a key contribution. It is also clear that the existing mechanisms must be improved and that the development of new approaches is just in its infancy. There is much to do, especially for those with valuable experience gained in the early stages of CDM and JI, the first-ever project-based, market-based mechanisms.

Durban Raises Hopes for Binding Climate Change Agreement

General climate change policy decisions made in South Africa

The Climate Change Conference in Durban ended in the early hours of the morning on 11 December 2011, breaking all previous duration records. From a realpolitik standpoint, the conference outcome is far more positive than many people expected. The parties agreed on a second Kyoto Protocol commitment period and on a roadmap for a new, comprehensive climate change agreement. Progress was also made in implementing the Cancun Agreements.

At the start of the negotiations, the US and especially China and India were against commencing talks on a binding agreement. The EU, however, was successful in initiating an alliance between the small island states, least developed countries and some progressive Latin American countries, which helped overcome resistance. A new Ad Hoc Working Group on the Durban Platform for Enhanced Action is to draft a new agreement by 2015. In return, the EU declared its willingness to agree to a second Kyoto commitment period. The actual targets and the length of the second period are to be agreed by the end of 2012; talk is of five or eight years.

The EU and its coalition partners have thus managed to re-open the door to a binding agreement which seemed to have been closed after the Copenhagen conference. However, the new agreement will only go into effect from 2020. Until then, the non-binding pledges from Copenhagen and Cancun will apply. These are clearly too weak when compared to what would be needed to reach the 2°C goal. While it was agreed that talks would begin in 2012 on how to achieve this ambitious target, it appears unlikely that countries will actually adopt tougher targets. One possible

exception is the EU, but even here the idea of introducing stricter targets meets with considerable opposition.

With regard to the CDM, it must be remembered that from an EU standpoint, these agreements do not meet the definition of an international post-2012 agreement as set out in the EU Emissions Trading Directive and the effort sharing decision. Thus, no change can be expected to the rules which say that certificates from new projects registered after 2012 may only be used in the EU Emissions Trading Scheme if the projects are conducted in least developed countries.

Apart from these advancements in fundamental issues, progress was also made at working level on issues concerning transparency, financing, technology, adaptation and deforestation.

Further information:

EU information on the ETS post 2012:
http://ec.europa.eu/clima/news/articles/news_2012011101_en.htm

See also the Wuppertal Institute's in-depth report on the Durban conference:
www.wupperinst.org/cop

JIKO Report

Finance PoAs, Develop the Carbon Market

German Environment Ministry establishes Foundation for the Future of the Carbon Market

On behalf of the German Environment Ministry, the KfW Bank has launched a new Foundation for the Future of the Carbon Market. Its function is to assist emissions reduction in developing countries by promoting the use of programmatic CDM activities (Programmes of Activities, or PoAs). The Foundation's aims thus go significantly beyond serving as a mere financing facility.

By establishing the new PoA Foundation, the German Environment Ministry rounds off its activities in practical application and further development of the programmatic CDM. Since launching the PoA Support Centre, the KfW Bank has taken up and promoted a large number of worthwhile initiatives for PoA use. Funding provided by the PoA Support Centre covers a range of activities, from consultation and advice, to the development of project documentation (PINs and PDDs), to validation at programme level and particularly as regards methodologies.

The PoA Foundation will make a strategic contribution to developing the carbon market as part of the instrument mix needed in the international climate regime. Given the risks and the uncertainty regarding the transition period until a detailed climate change agreement enters into force, there is much to do in terms of structuring. By supporting suitable PoA activities, it is hoped that the Foundation will provide stimulus for national climate change policy in host countries and foster the integration of carbon market projects. The Foundation's capital of €10 million is provided by the German Environment Ministry as part of its International Climate Change Initiative. Right now, the Foundation is seeking cooperation opportunities with other finance partners. Active funding provision is planned for the second quarter 2012.

Early promotion on the part of the PoA Support Centre provides an excellent basis on which the Foundation can build the support it gives. If found suitable, promising programmes which are already registered can receive start-up funding from the Foundation. Detailed guidelines on the provision of start-up funding are currently being developed. The Foundation's articles set out clearly defined targets and responsibilities.

One of the key prerequisites for providing start-up funding is that the PoAs must be viable, fund themselves through the sale of the certificates they generate, and reimburse the start-up

For more about the PoA Support Centre:
www.kfw.de/carbon-fund

Reduce emissions, prevent deforestation, replace open fires. PoAs to introduce efficient cookers have many benefits.
 Photo: atmosfair / RWE Pressebild



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funding they receive. The Foundation cannot promote programmes which fail to demonstrate such market maturity. The same applies to the PoA Support Centre, which is structured to support programmes which in all probability will hold their own in the market.

The German Environment Ministry sets great store by the fact that the PoAs it funds must be suited to replication. By demonstrating their feasibility, they show that any obstacles can be overcome. Funding will thus target PoAs which despite their CDM-based viability have not been implemented or which were only implemented under exceptional circumstances.

As is usually the case with PoAs, the focus will be placed on small-scale emission reductions which require a high degree of organisation in under-represented sectors. This brings attention to another of the Foundation's objectives which will play a role in programme selection: linking PoAs to the development of national climate change policy in host countries.

The Foundation thus takes account of the PoA to NAMAs strategy jointly developed by Southpole and KfW for the German Environment Ministry's CDM/JI Initiative. This could be used as a basis on which PoAs could serve as a catalyst in both 'top down' and 'bottom up' strategies. There has, however, been no agreement on whether, when and to what extent this might be achieved.

A desire to link the carbon market mechanisms to NAMA development has been expressed by many host countries. Nonetheless, it must be admitted that the benchmark for implementing PoA-based NAMAs, say with regard to national climate change policy in the host countries, has been set extremely high. Whether it can be reached or if projects can simply cruise below it, depends not only on how international climate change negotiations progress, but on the mobilisation of additional demand on the carbon market in the meantime.

One problem that stands in the way of achieving this goal is that the EU has determined that CERs from projects started after 2012 must be generated in least developed countries. It is not the prioritisation of LDCs that is the problem, but the financing options and the emission reduction potential in those countries. With regard to financing, a combination of supported NAMAs and the issue of clear accountability of emission reductions must be looked at more closely. And with regard to emission reduction potential, progress is needed in the methodological rules on 'suppressed demand' in LDCs.

The Foundation wants to promote programmes that foster ideas on such strategic considerations. These are vital in sparking activity for national climate change policies which will integrate the carbon market opportunities arising from host countries' strategic planning.

Against this backdrop, the Foundation will cooperate with third parties at organisational level and on individual programmes. This could include external funding, joint funding of start-up activities, early purchase of certificates once the start-up funding runs out, and cooperation in operative implementation of PoAs.

TF

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JIKO Analysis

CDM Reform and Developing Countries

Opportunities for Designated National Authorities (DNAs) in Host Countries

by Malin Ahlberg, German Emissions Trading Authority



Malin Ahlberg,

an environmental engineer, has been working with the German Emissions Trading Authority (DEHSt) for several years. Her work covers the assessment of CDM and JI projects under Germany's Project-based Mechanisms Act (ProMechG) and further development of the flexible mechanisms at international level. Before joining DEHSt, she worked for three years for a Swedish environmental consultancy.

Since the UN Climate Change Conference in Cancun in 2010, the CDM Executive Board (EB) has taken considerable steps to further standardise the CDM. In particular, it has assigned a more active role to the designated national authorities (DNAs). Whether the reforms will improve regional distribution of projects depends not just on overall demand on the carbon market, but primarily on how host countries support domestic development of the CDM. With the introduction of requirements on standardised baselines and the new rules on Programmes of Activities (PoAs), the DNAs can take on more responsibility and have more scope in project design.

For the determination of standardised baselines (SBLs), in 2011 the EB approved the guidelines for project proposals and a working plan for the implementation and improvement of the guidelines. This makes it possible for Parties, project participants and industry organisations to submit SBLs to the EB via their DNA. The EB then follows a predetermined participation process to decide whether the SBL should be adopted. In the negotiations on the related procedures, the developing countries stressed the need to keep the costs involved in submitting SBLs to a minimum. This has been taken into account in two ways. Firstly, submission of SBL proposals to the EB is free of charge. Secondly, the costs involved in qualitative assessment of the SBL by a Designated Operational Entity (DOE) may be borne by the UNFCCC if the SBL is submitted by a country with less than 10 registered projects. This provides an incentive for countries not yet or only marginally involved in the CDM to make use of SBLs. They will then find it easier to conduct projects.

If the EB approves certain SBLs, it is up to the host country to decide whether an SBL must be used for a specific project in that country. As a result, the DNA must decide the scope in which the SBL may be used. If, for example, a host country allows a higher baseline for individual projects even though an SBL has already been set for the sector involved, it weakens the environmental integrity of the SBL.

To a limited extent, and in relation to PoAs, the DNAs also have a responsibility to ensure the integrity of the CDM and to bring the EB's attention to any misuse of the programme and to any wilful deception. Apart from these new qualitative responsibilities, CDM reform gives DNAs greater opportunity to create the conditions needed to attract investors to provide funding for CDM projects. Three areas of action can be identified in this regard:

- **Support project development:**

DNAs should propose technologies¹ which are automatically defined as additional, actively support project developers in collecting data for SBL definition, and establish contact with potential, trustworthy coordinating/managing entities (CMEs). In this way, they boost a host country's attractiveness for CDM activities.

- **Transparent proposal process:**

For PoAs and projects which use an SBL, host countries should offer efficient and transparent proposal procedures. Thus, it is not acceptable for a host country to require project developers to obtain separate approval for each individual project activity (CPA) within a PoA. And in terms of environmental integrity,

¹ EB 63 Annex 23: „Guidelines for Demonstrating Additionality of Microscale Project Activities“

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Climate change pushes sustainable development. With increased demand for CERs from projects conducted in LDCs, African DNAs are facing a heavier workload. The picture shows a project on efficient lighting in Rwanda. Photo: © Adam Bacher / www.nuruenergy.com.

it is not necessary because the additionality of the CPA can be ensured via the eligibility criteria. When it comes to the approval process for projects which use a recognised SBL, a simplified procedure should be implemented to accelerate project development.

- **Further development of standards and guidelines:**

As CDM stakeholders, the DNAs have the opportunity to submit specialist input to the EB and thus to ensure that these standards also take in country-specific conditions.

tries with a chance of success under the CDM are those that create good investment conditions and can score relatively high in good governance ratings. As a result, these countries are more likely to be favourably considered for additional instruments and especially in providing financing through carbon funds, giving them very good opportunities to make the best possible use of the CDM in implementing their national climate change strategies.

Despite these improvements, the current rather poor demand for CERs on the carbon market (certificates are currently being sold for €4) means that after 2012, the only least developed coun-

JIKO Analysis **The AAU Problem**

Set-aside and limitation: Preventing a domino effect in international climate change talks

The issue of carrying over excess assigned amount units (AAUs) into the post-2012 period has burdened the climate change talks under the Kyoto Protocol for a long time (see box). It cannot be ruled out that this might have a domino effect on the post-2020 talks. In Durban, it was decided that a decision on transferring surplus AAUs will be taken at this year's conference in Doha. The implications of AAU transfer are to be assessed in May at the sessions of the UNFCCC Subsidiary Bodies in Bonn. However, the problem stretches much further than pure transfer. JIKO Info looks at the issues involved and offers a possible solution.

The vast majority of surplus AAUs are shared between Russia with 5.9 billion, the Ukraine with 2.8 billion, and the EU with 2.4 billion. The number of surplus AAUs expected to be carried over is estimated at 11 billion, or 11GtCO₂eq. This is well over half the voluntary 2020 reduction targets set by the industrialised countries, which on a nominal basis amount to a combined total of 18Gt. The AAU surplus thus has potential to call

the success of climate change policy for the second Kyoto commitment period into question. Of course, the new reduction targets for Russia and the Ukraine must be above their respective AAU surpluses. The affected EU states face less of a problem if effective internal effort sharing is assumed.

This article takes an in-depth look at emissions data for Ukraine in relation to the AAU problem. Ukraine's 2020 emissions reduction target of 20 percent based on the Kyoto Protocol's base year 1990 would appear appropriate when compared with the EU target of 20 percent which is also based on 1990 levels. The most recent inventory from Ukraine, dated 6 January 2012, shows that the country's emissions are currently 59.9 percent below 1990 levels. Thus, a reduction target of 20 percent for Ukraine would have disastrous effects, both in terms of international emissions trading under article 17 of the Kyoto Protocol and also for Joint Implementation projects.

Background: AAU Carry Over

One of the biggest loopholes in the Kyoto Protocol is 'hot air'. This refers to the surplus assigned amount units (AAUs) allocated to economies in transition in Central and Eastern Europe prior to the start of the first commitment period under the Kyoto Protocol. In numerous instances, these countries' AAUs far exceed their emissions without them having to conduct any reduction measures. For example, Russia's and Ukraine's Kyoto targets are set at emission levels from 1990. With the economic breakdown in the 1990s, Russia's emissions dropped by around 30 percent compared to 1990, while in Ukraine the drop was as much as 60 percent. Under the Kyoto Protocol, these surpluses may be carried over into the next commitment period, thus reducing even further the need to cut emissions

in the future. The emission reduction targets agreed to by Russia and Ukraine would actually generate additional surpluses: while Russia has announced a 2020 emissions reduction target of between 15 and 25 percent below 1990 levels, Ukraine is aiming for 20 percent. With these targets, emissions in both countries can rise significantly in the future even without the need to carry over surplus AAUs from the first commitment period. A similar effect occurs in the current economic crisis in all KP Annex B states. The EU currently faces the challenge of devising climate change policy to neutralise over-allocations under the EU Emissions Trading Scheme (ETS) and through effort sharing.

¹ Assuming continuation of the „Annual compilation and accounting reports for Annex B Parties under the Kyoto Protocol for 2011“

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AAU greening for new projects only, no double counting

Green Investment Schemes (GISs) can be used to avoid criticism regarding trading of surplus AAUs which are not the result of specific emission reduction efforts. These link trading of surplus AAUs with new emission reduction activities which are financed from the sale of surplus AAUs. There is, however, no legal framework for these GISs at international level. It thus remains unclear whether the principle of one carbon credit equalling one metric tonne of carbon dioxide equivalent will be upheld on the investment side or whether more certificates will be circulated than actual reductions achieved. At the same time, a solution must be found to the problem of new emission reduction measures generating new emissions allowances.

Continue the JI second track and make it more ambitious

There is also a risk regarding Joint Implementation projects. While in JI second track, issuance of emission reduction units (ERUs) is monitored internationally by the Joint Implementation Supervisory Committee (JISC), the host countries are able to conduct JI first track projects at their own discretion. The monitoring function of the designated national authority (DNA) in Ukraine and other states with surplus AAUs is obviously structurally weak, because the transfer and submission of ERUs from the national emissions inventory does not impair the national emissions reduction target on account of the country's large AAU surplus. Maintaining JI first track in the second Kyoto Protocol commitment period thus poses an additional problem when it comes to ensuring environmental integrity.

Projected development of greenhouse gas emissions and emission reduction units in Ukraine

	Relative reduction	Absolute GHG emissions [t CO ₂ eq]	Surplus AAUs
Base year 1990	---	933 283	---
2008	53,7 %	432 179	501 104
2009	59,9 %	374 120	559 163
2010/11/12 (estimated ¹)	57,1 %	1 200 000 (400 000 p.a.)	1 599 849 (533283 p.a.)
Surplus CP1	---	---	2 660 116
CP2 AAU pledges ²	20 %	746 626 (base year 1990)	350 000
CP2 AAUs total/8 years	20 %	5 973 008	2 800 000
CP2 burden from surplus AAUs in total	---	---	5 460 009

All figures without LULUCF and rounded off.

1) Estimate based on assumption that crisis-driven drop in emissions will be partially corrected in subsequent economic upswing. GHG emissions in Germany thus rose by 2.7 percent in 2010 but are still four percent below pre-crisis levels.

2) All other data based on the existing pledges made by Ukraine and rounded figures for estimated CP1 surplus

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Hot air or climate change mitigation? The potential for emission reduction activities in Central-Eastern Europe is huge. The possibilities are many, but so are the obstacles. Photo: Kandis/photocase.com

Surplus carry over must be strictly limited

The main problem of over-allocation of national emissions allowances stems from the fact that the old ERUs from the first commitment period can be carried over into the subsequent period. In the case of Ukraine, this means that the unused AAUs from CP1 must be added to the almost 40 per cent over-allocation in the second commitment period (CP2). According to current expectations, Ukraine was probably able to save some 2.66 billion AAUs in the five years that constituted CP1.

The risks highlighted using the example of Ukraine apply in a similar way for Russia. The result would be an extremely weak overall outcome from the combined CP2 reduction targets for all industrialised nations. This would put considerable pressure on the international climate change talks on a comprehensive climate change agreement for the period beyond 2020 just agreed in Durban. The big emerging economies are only willing to commit to more climate change mitigation efforts if the industrialised countries

actually put their pledges into action. This could result in a domino effect.

Solving the AAU problem

To ensure that climate change policy under the Kyoto Protocol is not reduced to the absurd, a new consensus is needed among the industrialised countries. A key principle should be the recognition of new and additional emission reductions in all industrialised countries in the second commitment period regardless of the emission reductions actually achieved. Looked at from a purely technical standpoint, this would ideally mean completely doing away with carrying over CP1 AAUs. The differing capabilities of the industrialised countries would be evident in their adoption of new emission reduction commitments.

Most countries see waiving their high surplus AAUs from CP1 as a huge economic loss. However, the non-existent demand for AAUs in a CP2 is a convincing argument to the contrary. The

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value of surplus AAUs from CP1 could plummet to zero. Viewed realistically, this could make it much easier to forfeit a large stock of surplus AAUs. This view can serve to support negotiations. There are, in principle, several solutions to the AAU problem:

- **Carrying over AAUs from CP1**

Transferring AAUs from CP1 into CP2 is out of the question. Waiving of the remaining emission reduction units (ERUs) should be subject to a one-off compensation rule for the transition period which is linked to further investment in climate change mitigation. The compensation rule could involve carrying over a limited number of AAUs (see below).

- **Base level for emission reductions in CP2**

The historical base year of 1990 is indispensable to long-term monitoring of achieved emission reductions. To determine the level for a second commitment period, the base year can no longer be used for many countries as shown in the example of Ukraine. Instead, the emission reductions achieved in CP1 could serve as a new reference level.

- **Additionality of ERUs from Joint Implementation**

The use of ERUs from new Joint Implementation projects must be based on the additionality of the achieved emission reductions. Given the low incentive to exercise the monitoring function of the designated national authorities (DNAs) in host countries, monitoring must be ensured by means of UN structures, meaning the Joint Implementation Supervisory Committee (JISC). JI first track should thus be abolished because it is not transparent.

Limited AAU carry over

Direct provision of additional funds for carbon financing with the group of industrialised countries under the Kyoto Protocol is unrealistic. The following looks at the effects that limited AAU carry over could have on the beneficiary countries. Two levels must be considered. Firstly, national emis-

sion reduction units could be used to incentivise climate change mitigation investment. Secondly, AAUs could be used to secure a more ambitious reduction target.

Particularly as regards the EU, a comparable reduction achievement could be used as a reference. With its 20 percent reduction target, the EU agrees to an additional commitment for CP1 of 12 percent or in the 30 percent scenarios to 22 percent by 2020. Distributed over the eight years between 2012 and 2020, this results in annual reductions of 1.5 percent or 2.75 percent. Looked at realistically, the average reductions for the period 2008 to 2012 would have to be used as a base reference. This would then result in a minimum requirement of less than 0.5 per annum with the 20 percent target, and of 1.5 percent if the 30 percent target is adopted.

Projecting these additional annual emission reductions of 1.5 percent onto Ukraine, with the 30 percent target the country would be required to achieve an additional 12 percent cut in emissions compared with 1990 levels. Overall, Ukraine would then achieve reductions of 72 percent compared with 1990 levels by 2020, while the EU would have achieved 30 percent. It is evident that based on these calculations, no common denominator can be found. This is another good reason why the role of the Kyoto Protocol's base year must be put into perspective when setting new reduction targets.

Additional emission reductions in Ukraine: Domestic activities and climate change cooperation

Due to a lack of sufficient analyses and data, a fictitious scenario must be used to show that the above-mentioned issues require further thought and clarification. These scenarios assume that Ukraine has great emission reduction potential but lacks the necessary financing power, technology and expertise. Adoption of a target similar to the EU in the 30 percent scenario can thus only be considered as a climate change cooperation initiative.

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Sealing leaks. Methane leaks in vast quantities from out-of-date gas pipeline compressor stations. With use of the right instruments, vast quantities of greenhouse gas emissions could be avoided in the Russian and Ukrainian pipeline grid.

Photo: Wuppertal Institute.



Against this backdrop, it is assumed that Ukraine can achieve 50 percent of its 12 percent reduction target by 2020 by means of domestic activities. The remaining six percent would be addressed by using cooperative mechanisms like Joint Implementation. The portion to be achieved through domestic activities could involve instruments like standardised baselines at sectoral level, limiting the number of tradable certificates and restricting the crediting period as per the discussion on the new market-based mechanisms. As a result, Ukraine would achieve domestic reductions of six percent plus x. This would rise to an overall 12 percent at the end of the crediting period.

There is, however, the risk that the incentive effect of emissions trading will not occur due to the lack of demand for certificates or too low a price being asked for them. Thus, to ensure it achieves a reduction target of this magnitude, Ukraine could have its surplus AAUs from CP1 recognised as a kind of national compliance reserve.

Under the scenario, with the fictitious target of 12 percent, emission reductions in Ukraine during the period 2013 to 2020 would achieve 112 million t CO₂eq by 2020. Linear distribution over the eight-year phase results in annual emission reductions of 1.5 percent or 14 million t CO₂eq. Of these, Ukraine should achieve 56 million t CO₂eq under its own steam by 2020, while the remaining six percent must be achieved by means of financing incentives using cooperative mechanisms. For CP2, cumulative emission reductions of 504 million t CO₂eq would result, of which 252 million t CO₂eq must be achieved using JI. The option of achieving the domestic component in the JI sector must be further analysed and taken up at a later date.

Assuming the crediting period is shortened to seven years, the JI projects would have to generate an adequate amount with which to fund reduction activities by selling some 252 million certificates. At certificate prices of €8 to €12, these would cost between €2 and €3 million. This

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might seem high, but it covers neither the total initial investment nor the costs of domestic climate change activities. With a certificate price/overall investment ratio of an average 1:10, the overall costs of Ukrainian and cooperation measures would amount to somewhere in the region of €40 to €60 billion for the commitment period. These are the costs Ukraine could expect if it is to achieve similar emission reductions to the EU.

Raising the target in the least industrialised countries is thus linked to raising the targets in highly industrialised countries. With the right climate change targets, the advanced countries could serve as an engine of investment in sustainable development. The reverse situation would not work, however. Whether this can be realistically achieved is something negotiators are required to answer when the AAU problem will again be up for debate at the Subsidiary Bodies sessions in May.

To secure this additional reduction target of six percent, up to 252 million surplus AAUs must be set aside as a Domestic Compliance Reserve. Given the extent to which JI projects will be implemented, the reserve will go unused.

Solving the AAU problem

The rules governing the approval of AAU carry over comprise one of the central issues in solving the problem. Another is how the Domestic Compliance Reserve should be organised. When may reserve AAUs be offered to incentivise investment? How will the CP2 AAUs freed up by follow-on measures be set aside to prevent double issuance of certificates for one and the same reduction effort?

The following options may be considered if the use of carried AAUs serves solely as an incentive for new climate change investment and to secure tougher reduction targets:

Option 1: One percent carry over rule

The one percent carry over rule suggested by

South Africa results in an extremely limited carry over volume which is not enough to incentivise affected countries to adopt tighter targets. With 2.66 billion surplus AAUs and the one percent carry over rule, Ukraine could carry over only about 26 million AAUs. This covers about 10 percent of the 252 million AAUs mentioned above.

Option 2: Similar carry over limits for CERs and ERUs

Looking at the carry over rules for the CDM and JI project-based mechanisms, surplus AAUs could be subjected to a similar-level limitations, with 2.5 percent of the surplus or 66 million t CO₂eq being carried over to CP2. If the 2.5 percent is applied to allocated AAUs, the volume carried over would amount to 116 million. This does not meet the 252 million AAUs required above.

Option 3: Carry over 50 percent of the new effective reduction target

In this light, the question arises as to whether an additionally agreed reduction target should be pushed for in Ukraine, up to a maximum equal to the amount to be achieved domestically (supplementarity rule). Carrying over the 252 million AAUs needed in the scenario outlined above would require set-aside of some 2,408 million AAUs.

Core issues

The third option heavily relies on two things:

- That the cooperation framework containing a supplementary reduction target is matched by appropriate demand from other industrialised countries. The general balance between supply and demand must be taken into account in agreements on the second commitment period.
- That Ukraine is willing to recognise the AAUs for what they are worth and agree to further effective emission reductions in the second commitment period and from 2020.

Outlook

Western industrialised nations must also tighten their emission reduction targets in order to create demand for JI certificates from Eastern Europe and Russia. The offer that would be made to Ukraine based on the ideas outlined above must also be made to Russia and to EU member states in Central and Eastern Europe.

This could provide the solution to the AAU problem. It calls for greater international cooperation between industrialised states, the success of which is vital in reaching a climate change agreement for the period beyond 2020. This is the only way to prevent the post-2020 negotiations having negative repercussions or producing a domino effect.

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Glossary / Abbreviations

All CDM/JI-specific terms and abbreviations are explained in detail in a glossary on the JIKO website at www.jiko-bmu.de/459

Impressum

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Subscription:

*JIKO Info is distributed in electronic
form only. Entry into the subscription
list is free of charge.*

Internet Address for subscription:

www.jiko-bmu.de

Translation:

Stocks & Stocks, Bonn

Layout:

www.SelbachDesign.de

JIKO Info

*covers current developments in the
policy field project-based mechanisms
in Germany and worldwide. The
newsletter is published as part of the
project JIKO at the Wuppertal Insti-
tute for Climate, Environment and
Energy (see www.wupperinst.org/jiko).
The editorial staff works independ-
ently from the JI-coordination unit
at the German Ministry of the
Environment.*

*JIKO Info is published quarterly
and on special occasions.*