



Advocates for International Development
Lawyers Eradicating Poverty

CLEAN DEVELOPMENT MECHANISM

CDM AND DEVELOPMENT

Peter Zaman and Delyth Hughes,
Clifford Chance LLP

Type: Legal Guide

Published: 27 February 2012

Last Updated:

Keywords: Clean Development
Mechanism, Development

This document provides general information and comments on the subject matter covered and is not a comprehensive treatment of the subject. It is not intended to provide legal advice. With respect to the subject matter, viewers should not rely on this information, but seek specific legal advice before taking any legal action

Any opinions expressed in this document are those of the author and do not necessarily reflect the position and/or opinions of A4ID

© Advocates for International Development 2012

CDM and development

The third part of this guide outlines some of the arguments put forward for the CDM as both good and bad for development, and then goes on to look at what the future might hold for the CDM.

The CDM is considered by many to be a useful tool for development, both in terms of helping those lesser developed countries to achieve economic, industrial and sustainable growth and in terms of encouraging the expansion and awareness of international climate change. The CDM facilitates such development in the following ways:

- (a) First, the CDM enables a transfer of wealth from developed countries to developing countries. Whilst the price of CERs fluctuates they have, in the past, exceeded 20 Euros per credit. This price is driven by international demand for CERs as units which are eligible for compliance within various trading schemes and by speculative positions taken by traders based on this demand. The price per CER paid to a developing country operator (i.e. the primary market price) will typically be lower than the price per CER on exchange or over-the-counter between entities in developed countries (i.e. the secondary market price), but it will still constitute significant value over the duration of a project. Some countries (e.g. China) have established floor prices for CERs sold from projects in their countries as a condition for granting the requisite approval of their project.
- (b) Second, the CDM facilitates the transfer of clean technology from developed countries to developing countries. The EB approves the methodologies, which are primarily developed by Annex B Countries, for reducing greenhouse gas emissions resulting from various industrial processes. The technology used to implement these methodologies is then introduced to the relevant industrial sectors in developing countries via CDM projects. By gaining exposure to and familiarity with such technology, developing countries will become better equipped to implement clean technology as their industry expands.
- (c) Third, it is hoped that the CDM will encourage developing countries to eventually accept binding emission reduction commitments under a successor agreement to the Protocol. The CDM creates awareness of the technological means by which lower emissions can be achieved. This awareness can help raise the industrial standards that emitters in developing countries are expected, and eventually required, to meet. It is anticipated that, if developing countries gain such awareness without the burden of research and development costs, they may be less resistant to emission targets that could otherwise threaten their continued economic growth. Whilst it is confirmed that a second commitment period under the Protocol will begin in 2013, the developing countries do not have emission reduction targets under it. Therefore, it is hoped that both developing and

developed nations will sign up to a new binding international agreement, where they both share binding commitments to reduce their emissions by 2015, likely to have effect from 2020 onwards.

Criticism

Despite the many advantages of the CDM, it is still subject to criticism from those who question its effectiveness in enabling international development.

First, it is unclear whether the CDM is solely responsible for the reduction of emissions, or whether such reductions would have been achieved despite its existence (i.e. the "business as usual concept"). It is argued by some that many of the product methodologies rely on technology which is just as advanced as that which is already in common industrial use in developing nations. Whilst the application of such technology to the reduction of emissions may be novel, it is arguable that the technological knowledge would still have been transferred in the absence of the CDM. Much of the confusion has arisen over the interpretation of the "additionality" requirement and whether it means "would emissions be greater but for the CDM project?" or "would the emission reductions be achieved but for the CDM project?". Indeed, some project operators have been reported as confirming that they would have implemented the emission reduction technology regardless of CDM investment, but were nevertheless happy to accept the windfall profits from registering the project and selling CERs.

Second is the 'low-hanging fruit' argument. It is often argued that certain project operators may be intentionally increasing their emissions in order to give themselves more room to cut emissions and, therefore, to increase their own profits. The potential for such manoeuvres is greatest in respect of industrial gases which are easily and regularly generated, often as a by-product, and have extremely high CO₂e. Investors receive CERs for destroying these gases which, in itself, is a relatively cheap process. Reductions of these industrial gases are often regarded as the 'low hanging fruit' of the CDM due to such low implementation costs and high reduction yields. Critics claim that, rather than using the CDM and the prospect of earning CERs as an incentive to destroy these gases, it would be cheaper to simply give money to the factories to install the necessary equipment to destroy the gas. Consequently, an unscrupulous project operator could be rewarded with an enormous volume of CERs for very little effort or expense.

Third, the process of developing a CDM project can be slow and cumbersome. Several years can pass from the time when a project is conceived to the time when a project begins to generate CERs and the uncertainty of the outcome means that the system favours those with the economic capacity to absorb the risk of a failure to have the project registered.

Fourth, investment through the CDM remains concentrated in certain developing countries (in particular, China and India) which have the capacity to generate more CERs due to their relatively advanced industrial development. Industrial processes

that emit large volumes of greenhouse gases lend themselves most readily to the application of CDM project methodologies. Also, because of their large emissions volumes, projects based on these processes generate large volumes of CERs, which makes such projects quite profitable. In contrast, countries that do not have much heavy industry or commercial agricultural production, as in sub-Saharan Africa, receive little CDM investment because the profit potential is much greater elsewhere. Although the EB has attempted to address this disparity by providing limited incentives for investing in CDM projects in the least developed countries (see paragraph 6.5), for example by waiving certain fees which are normally charged upon issuance of CERs, these are deemed by some to be insufficient to provide an equalising commercial incentive. The disparity between developing nations is only likely to increase when the least developed of them progress in terms of industry and agribusiness.

Finally, despite recommendations to implement a formal appeals procedure for use by the various stakeholders in the CDM process, no such procedure has been put in place. It is suggested that the stakeholders should have much greater involvement in the validations process of CDM projects and that there should be clear rules and guidelines in place in order for stakeholders to address their concerns. Current rules governing stakeholder consultation are criticised for being 'ill-defined, poorly regulated and badly documented', leading to criticisms that the CDM is ill-equipped to actually help developing countries to develop.

The future of the CDM

Confirmation at the 2011 climate change conference in Durban that a second commitment period under the Protocol will begin in 2013 has secured the future of the CDM for at least five years, until 2017, and possibly until 2020. At the same conference, some key decisions which will govern the future of the CDM were also made.

As mentioned above, it was decided that CCS Projects can earn carbon offsets under the CDM, although project developers must put 5% of the CERs which they earn into a reserve account in the CDM registry. The aim of this decision is to encourage even further investment in developing countries by opening up even greater opportunities for CDM projects. However, given the current uncertainty in the market regarding CER prices, critics suggest that the introduction of CCS Projects at this time will have little impact on investment in developing nations in the near future.

In response to some of the criticisms of the CDM being too bureaucratic, pedantic and un-commercial, delegates at the climate change conference also decided that the concept of 'materiality' is to be applied across the CDM so that certain projects can earn CERs even where data may be missing. Five different thresholds have been implemented in order to govern the materiality concept so that, at one end of the scale, microscale projects can receive credits where only 90% of the data is

available and, at the other, CDM projects applying for more than 500,000 CERs are permitted only to have up to 0.5% of data missing.