



13 June 2007

FOURTH MEETING OF THE EUROPEAN CLIMATE CHANGE PROGRAMME (ECCP) ON THE EMISSION TRADING SCHEME (ETS) REVIEW – 14 AND 15 JUNE 2007

BUSINESSEUROPE COMMENTS ON JOINT IMPLEMENTATION (JI) AND CLEAN DEVELOPMENT MECHANISM (CDM)

1. Introduction

When nations agreed at Kyoto on the development of the flexible mechanisms, Clean Development Mechanism (CDM) and Joint Implementation (JI), these mechanisms were seen as essential to enable a cost-efficient climate change policy, for sustainable development and to promote the transfer of technology.

Almost ten years after the Kyoto protocol was agreed in 1997, understanding and acceptance of these mechanisms have improved. This has been confirmed by both developed and developing countries, e.g. at the 11th Conference of the Parties to the United Nations Convention on Climate Change (UNFCCC COP11, 2005). Furthermore, COP11 negotiations ensured more funding for the CDM Executive Board (CDM EB) as well as the election of the JI Supervisory Committee (JISC).

However, ongoing attention to the well functioning of CDM and JI mechanisms and market dynamics is needed. In this position paper BUSINESSEUROPE raises the need for further initiatives by governments, the EU Commission and the UNFCCC JI and CDM bodies to improve the functioning of the CDM and JI market.

It is urgent to improve the JI and CDM market as soon as possible, to ensure the necessary technology transfer and sustainable development as well as to assist in cost-efficient implementation of EU's climate change policy. The mechanisms can also play a major role in technology development both in developed and developing countries.

Improving the demand side as well as the supply side of the JI and CDM market will only happen if the EU Commission and Member States continue and strengthen the financial support of the JI and CDM mechanisms. However, allowing private companies to participate through unrestricted access to JI and CDM credits (ERUs¹ and CERs²) is also necessary. This will strengthen the demand side of the JI and CDM market. Hereby, European companies directly involved in JI or CDM project development will provide energy-efficient and low-carbon technologies for the specific JI and CDM projects, and European companies buying ERUs and CERs will provide the investment

¹ ERUs: Emission Reduction Units

² CERs: Certified Emission Reductions



funds for JI and CDM projects, provided that they have access to JI and CDM credits in their compliance with EU allocation plans post 2012.

The certainty issue is of specific importance. It is vital that companies continue to be involved in developing CDM and JI projects as 2012 approaches. As there is no clarity about the post-2012 agreement, uncertainty about the value of JI and CDM credits post-2012 is an issue of increasing concern. It is imperative to eliminate this uncertainty to avoid slowing down project activities towards 2012.

2. Barriers to further development of JI and CDM

BUSINESSEUROPE welcomes the initiatives taken at COP11 in 2005 and looks forward to full implementation of the decisions taken. However, many problems in the JI and CDM market need to be dealt with at UNFCCC, EU Commission and government level if JI and CDM are to make a significant contribution to the transfer of technologies, which is crucial to an environmentally and economically effective climate change policy.

In this context it is of crucial importance that the Commission and governments work to improve the functioning of the mechanisms; the CDM EB and JISC need to work efficiently and become able to handle not hundreds but thousands of projects each year in the near future, thereby increasing the supply of credits.

It is equally essential that the Commission and governments do not hinder European companies' participation in the funding of projects through purchase of ERUs and CERs, thereby enhancing the demand of credits. The limitation set by some Member States and the EU Commission in the national allocation plans of 2008-2012 sends the wrong signal to companies in the EU and to host countries in less developed countries.

BUSINESSEUROPE believes that a well functioning JI and CDM market can make it easier for a wider number of countries to engage in a global agreement, resulting from the benefits to developing countries of transferred technology and the benefits to developed countries from cost-effective emission reduction projects.

Both in the short and longer term the environmental and economic implications of a non-functioning CDM and JI market are too serious a problem to be neglected by governments. It needs to be resolved immediately.

BUSINESSEUROPE would like to see companies participating in the transfer of low-carbon and energy-efficient technologies through JI and CDM projects and buying credits from these projects. However, there are many uncertainties which prevent private companies from participating in the JI and CDM market. The observed barriers are:

- Need for capacity building within the UNFCCC bodies to enable the CDM EB and Methodology Panel to improve the speed and accuracy of the work carried out
- Uncertainty about how to obtain approved methodologies in the UNFCCC bodies of CDM EB and JISC



- Lack of communication between the UNFCCC bodies (especially CDM EB or the secretariat) and the project-makers and/or Designated Operational Entities (DOEs) as to why methods and/or projects were rejected
- Uncertainty about approval of projects in the country where the project is implemented and in the country where the credits are taken to
- Uncertainty about project development time
- Uncertainty about how many CERs and ERUs companies are allowed to use beyond 2012
- Unduly severe restrictions on how many CERs and ERUs companies are allowed to buy, to comply with the NAP 2008-2012
- Lack of commitment to make JI and CDM play a significant role in the EU ETS, as seen in the EU Commission's Communication *Limiting Global Climate Change to 2 Degrees Celsius* and as seen in the attitude of some Member States in their NAP 2008-2012.

As long as these numerous barriers exist, Europe-based companies will not be able to play the role they otherwise would be able to in the start-up of the CDM and JI market. And therefore part of the technology transfer demanded by developing countries, and needed to solve the climate change problem, will not be realised.

3. Recommendations

BUSINESSEUROPE calls upon EU governments and the EU Commission to remove the barriers. And for EU governments and the EU Commission to whole-heartedly support the JI and CDM market through more government funding and by facilitating companies' access to the JI and CDM market, as project makers as well as credit buyers.

An immediate action that BUSINESSEUROPE calls upon governments and the Commission to take, is to avoid setting narrow restrictions on companies' use of JI and CDM credits to comply with NAP 2008-2012 and beyond 2012.

Likewise BUSINESSEUROPE calls upon governments to fund the implementation of CDM and JI projects while eliminating these barriers of uncertainty, bringing down transaction costs to a reasonable level.

In this context, it is of specific interest for governments to eliminate risk by implementing projects in new areas, areas with no approved methodologies so far, thereby financing the development and the UN approval of "standards or prototypes" of projects based on new methodologies.

Through these actions which remove barriers, governments would also allow a significant inflow of CDM and JI credits; this will bring down the EUA (European Allowance) price and thereby reduce the direct and indirect cost impact of not having a



well functioning EU ETS as well as the impact of not having a well functioning CDM and JI market.

To address the barriers hindering sufficient supply of CDM and JI credits, many initiatives need to be taken by all countries in the COP/MOPs, initiatives which would improve the JI and CDM mechanisms:

- Governments need to raise more funding for the JISC which already in 2006-2007 does not have sufficient funds. Too few countries have made resources available for the JISC so far. There is a need for about USD 2 million of funding to meet the budget, some of this money has been pledged but not yet received by the UNFCCC. Pressure needs to be put on countries that have not paid their pledge.
- The JISC needs to be put in a position where it can avoid the problems that the CDM EB has had, and be able to work efficiently to approve already implemented/started JI projects and encourage implementation of more projects.
- There is a need to develop a solution to the further financing of the JISC, which, contrary to the CDM EB, is not developed.
- Though the CDM EB has been promised more funding, many countries have still not transferred funds. Pressure needs to be put on these countries.
- There is a need for an improved dialogue between project-makers and/or Designated Operational Entities (DOEs) and the CDM EB as well as the Methodology Panel in order for rejected projects to have precise information about what elements of the projects caused a rejection. Likewise, if the methodology panel rejects a method, there is a need to clarify the reasons for the rejection.

To address the barriers hindering sufficient supply as well as demand of JI and CDM credits, BUSINESSEUROPE calls upon the EU Commission and member states, in particular, to take a number of initiatives to improve the JI and CDM market:

- BUSINESSEUROPE encourages the Commission and Member states not to restrict companies' access to JI and CDM credits in NAP 2008-2012 and beyond.
- The EU Commission needs to address the EU Member States and encourage them to fund the JI/CDM in proportion to their needs for CDM and JI credits, e.g. in the NAP 2008-2012.
- Further attention needs to be paid to implementation of the International Transaction Log, which is crucial for the transfer of JI and CDM credits.
- The EU Commission needs to have greater focus on Russia and other JI countries. BUSINESSEUROPE advocates that the EU Commission takes further initiatives towards JI countries. EU assistance is needed to ensure that it is possible (according to criteria described in the Marrakech accords) for the UNFCCC to allow these countries, having a cap on their emissions, to apply the approval procedure of track 1 countries. This would make the approval procedure of JI projects administratively much easier and faster compared with track 2 procedures.
- The EU Commission is encouraged to ensure that the 27 Member States, when implementing the linking directive, do not increase the administrative burden by setting 27 different standards for approval, e.g. it should be ensured that Member States do not develop their own national documents in addition to the UNFCCC



documents (Project Design Document etc.). National documents create barriers and prevent a well functioning CDM and JI market from developing.

- When approving JI and CDM projects a particular problem is the lack of approved end-user methodologies. Many cost-efficient energy savings can be found in households, therefore BUSINESSEUROPE wishes to encourage governments to involve in end-user projects in order to develop these methodologies. This is also a way to involve non-EU ETS sectors in the carbon market.

Addressing the uncertainty issue, BUSINESSEUROPE encourages EU Member States to agree that, no matter what regime comes after 2012, projects already begun before a final decision on the post 2012 regime is taken, will be of value to the companies and governments involved in these projects also after 2012. This is necessary to prevent a situation where JI and CDM activities will stop as 2012 approaches.

In the appendix, BUSINESSEUROPE gives a more detailed explanation of the above concerns and recommendations.



Appendix

Cost efficiency is dependent on well functioning CDM and JI markets

As the EU approaches 2008-2012, the need for a cost-efficient way of reaching the Kyoto target becomes more and more urgent. Credits from Clean Development Mechanism (CERs) and Joint Implementation (ERUs) are essential if EU Member States are to reach their Kyoto target.

The urgency of the need to develop more projects is demonstrated by the recent evaluation on how far Member States are from their individual Kyoto target.

Whilst the EUA price within the EU has been very volatile, already today we see an impact on energy-intensive industries, due to an EUA price up to 28 euro per tonne of CO₂ in 2005. In 2008-2012 the constraints on EUAs will be more severe, as demonstrated by the forward price for EUAs in 2008 of between 15 and 18 euro at present. An adequate inflow of JI and CDM credits could bring down EUA prices and thereby reduce the indirect impact on energy-intensive industries due to higher electricity prices as well as reducing the direct impact of higher marginal costs due to high EUA prices within the EU ETS sectors.

The post-2012 regime is unknown. However, in the EU Communication *Winning the battle against global climate change* the cost implications of the EU moving on towards a 20 percent reduction is analysed. The EU Commission estimates the impact of a further EU reduction in GHG of 20 percent by 2025 compared with 1990 with no inflow of JI and CDM to be a reduction in GDP growth of 1.7% in 2025 and a CO₂ price of 90 euro per tonne. Inflow of JI and CDM would bring down the costs significantly.

With the observed distance to targets set for 2008-2012, more CDM and JI credits are important simply to keep down the costs of the EU's climate change policy and to limit a slowdown in EU economic growth.

Government involvement in buying CDM and JI credits also has the direct cost impact of reducing the pressure put on EU ETS sectors, since a higher inflow of CDM and JI credits makes room for free allocation of EUAs to industry, thereby reducing the competitive impact of the EU's climate change policy.

In conclusion, no matter whether we look at the present evidence of EUA prices or the impact assessment of the EU's climate change policy over shorter and longer periods, it is evident that there is an urgent need to make the JI and CDM market work.

Environmental effect and the need for a well functioning CDM and JI market

The impact on climate change is limited if global participation is not ensured. In such a global framework, technology transfer from developed to developing countries is a crucial element of an effective climate change policy.



GHG emissions divided by region in 2000 and 2050 (%)		
Region	2000	2050
Canada and USA	23	12
Enlarged EU	14	8
Russia and CIS	8	5
Oceania and Latin America	12	10
Africa and Middle East	12	23
Asia	31	42
Total	100	100

Source: Commission Communication, Feb. 2005, Winning the Battle Against Global Climate Change

Evidence indicates that, no matter what sort of "post 2012 climate change initiatives" nations agree upon, it is necessary to incorporate the ability to implement projects in countries outside the EU and transfer the technology to these countries in exchange for GHG credits. The numbers in the table above clearly demonstrate that the EU cannot combat climate change alone. Transfer of low-carbon and energy-efficient technology without restrictions and development of new technology is imperative.

A well functioning CDM and JI market before and after 2012 is an important tool to create incentives for technology transfer and sustainable development, and pave the way for new markets in less developed countries to deploy all existing and new low content or CO2 free technologies.

BUSINESSEUROPE believes that well functioning JI and CDM mechanisms can make it easier for a wider number of countries to engage in a global agreement, resulting from the benefits to developing countries of transferred technology and the benefits to developed countries from cost-effective emission reduction projects. Furthermore, technology development can be enhanced through the use of the mechanisms.

Evidence of the financial problems of CDM EB and JISC

Governments need to raise more funding for the JI Supervisory Committee (JISC) which already in 2006-2007 does not have sufficient funds. The JISC needs to be put in a position where it can avoid the problems that the CDM Executive Board (CDM EB) has had and to some extent still has. JISC must be able to work efficiently to approve already implemented/started JI projects and encourage more projects to be implemented well before 2012.

Too few countries have made resources available for this work so far. The budget for JI activities in 2006-2007 in the UNFCCC is USD 4,387,790. The current shortage is about USD 2,5 million. Of this, countries have pledged USD 1,3 million but only about USD 400,000 had been received by the UNFCCC by 29 August 2006. The outstanding USD 900,000 is mainly explained by Canada and the EU Commission who have not yet paid their pledges.



For the moment the CDM EB has been given more funds, and is expected to be self-financing by 2008. But there is a need to give attention to whether the CDM EB has actually received sufficient funding. Many countries that promised to fund the CDM EB in 2006 and 2007 have still not paid. The table below shows pledges and outstanding amounts as at November 2006.

Status of pledges to support 2006 CDM activities in the UN (USD)		
Country	Total pledge	Outstanding
Austria	128,717	0
Belgium	81,000	56,825
Canada	2,010,000	1,500,000
Denmark	212,000	106,000
EU	1,335,000	905,616
Estonia	5,000	0
Finland	40,000	0
France	236,000	(9,710)
Germany	1,000,000	0
Greece	30,000	30,000
Iceland	10,000	0
Ireland	49,250	0
Italy	1,000,000	500,000
Japan	1,000,000	-*
Luxembourg	20,000	(3,894)
Malta	5,800	800
Netherlands	284,652	0
Norway	760,000	(57,407)
Portugal	36,000	(2,163)
Slovenia	5,000	(1,356)
Spain	500,000	0
Sweden	140,000	0
UK	740,000	0
Total	9,628,419	3,099,241

* Pledges by Japan will be given to other CDM-related activities not to the CDM EB

(::) : countries have paid more than pledged

Source: UN November 2006

Concerning funding, it seems that many countries – though depending on buying credits to reach their Kyoto target – seem reluctant to provide the necessary funds for the basic work done by JISC and CDM EB.

BUSINESSEUROPE calls upon the EU governments to fund the JI/CDM in proportion to their needs for CDM and JI credits, e.g. in the NAP 2008-2012.

However, JI and CDM credits cannot play a role in reaching the commitments if the logistics to transfer the credits from one country to another is not in place. Developing the International Transaction Log (ITL) is therefore fundamental. Recently this task was contracted and hopefully the development of the ITL will take place smoothly and



on time. There is a need to ensure sufficient attention to this project where deadlines must be met.

BUSINESSEUROPE encourages the Commission and Member States to provide sufficient funds and attention to make JI, CDM and ITL work.

Improved administration of the CDM and JI bodies

BUSINESSEUROPE welcomes the fact that the additional funds agreed upon at COP11 have made it possible for the Clean Development Mechanism's Executive Board (CDM EB) to obtain increased support from the UNFCCC Secretariat and to function as an executive body.

It is now necessary to ensure thorough internal capacity building in the UNFCCC Secretariat so that the additional staff leads to higher speed and quality in the approval procedure of individual projects and to an improved dialogue between project-makers, DOEs and other competent stakeholders, and the CDM EB.

BUSINESSEUROPE wishes to emphasize the need for an improved dialogue between project-makers/DOEs and the CDM EB as well as the Methodology Panel in order for rejected projects to have precise information about the elements of the projects that caused a rejection. Likewise, if the Methodology Panel rejects a methodology, there is a need to clarify the reasons for the rejection.

BUSINESSEUROPE also wishes to emphasize the need for more funding to the JI Supervisory Committee (JISC). In order for countries that have started out early on JI projects to get these evaluated and approved, it is essential that the JISC is put in a financial position where it can work effectively.

Concerning methodologies, when JISC is assessing JI projects, BUSINESSEUROPE wishes to emphasise that these projects take place in countries having a Kyoto cap. JISC's concerns should therefore address the development of a baseline for the country and the development of a baseline for the project. This focus should ensure that the approval procedure in the JISC is made as fast as possible.

Finally, BUSINESSEUROPE is concerned about end-user-technologies. So far few projects have led to the approval of end-user methodologies. The household sector is a significant source of emissions and it is, therefore, important to make sure, that end-user technologies can be applied in JI and CDM projects. This is also a way to involve non-EU ETS sectors such as households in the carbon market.
