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ECLAC

SIXTY YEARS WITH LATIN AMERICA AND THE CARIBBEAN

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Sumission

To: UNFCCC Secretariat
From: United Nations Economic Commission for Latin America and the Caribbean.
Subject: Second Review of the Kyoto Protocol pursuant to its Article 9.
Date: 7 March 2008

The third Conference of the Parties serving as the Meeting of the Parties to the Kyoto Protocol (CMP3) in the decision *Scope and content of the second review of the Kyoto Protocol pursuant to its Article 9* invited Parties and relevant organizations to submit their views on:

> *(a)Extending the share of proceeds to assist in meeting the costs of adaptation to joint implementation and emissions trading;*
>
> *(d) The scope, effectiveness and functioning of the flexibility mechanisms, including ways and means to enhance an equitable regional distribution of clean development mechanism projects*

We welcome this opportunity to submit our views on these two important issues which, in our view are key to increasing contributions to mitigation and to face adaptation costs in developing countries.

1.-On extending the shares of proceeds to emissions trading and joint implementation.

On this subject three considerations can be made.

a) There is no conceptual basis for limiting the Share of Proceeds to the CDM[1]. CDM and JI are both project based, but only the CDM is burdened with a Share of Proceeds. The fact that projects are developed under an emissions cap affects the risk of environmental underperformance of such projects but not to their economic nature and thus to their taxability. What distinguishes CDM, JI and ET instruments is that under JI and in ET producers and consumers of emission reductions come for developed countries. Ironically these two mechanisms are levy free. Countries that are responsible under the Convention and the Protocol of leading action reflecting their historical and actual responsibility for the effects of global warming are treated fiscally in more favourable terms than developing countries. This violates the polluter pays principle enshrined in the international climate regime.

b) The Protocol recognizes the responsibility of developed countries for climate change by allocating emissions reductions targets. By levying only CDM not only the cost of climate change externalities are being imposed on developing countries but also the cost of addressing adaptation. Players benefiting from the flexibility of the carbon market in developed countries (JI and ET) should pay their equal share in the

[1] It is explainable historically. In the context of a political negotiation where CDM appeared as a "concession" to allow participation of developing countries in a new source of income with the creation of an environmental services market. Its operation was very restricted and a levy was added, which at the time seemed a necessary cost to create the instrument.

effort of funding the externalities of climate change. The long time lag between present mitigation and future climate stabilization makes it impossible that by reducing present emissions in developed countries, adaptation costs in developing countries are avoided. The polluter pays principle comprises, in the case of climate change both elements, the cost of mitigation and the cost of adaptation.

c) Levying the Share of Proceeds from all three mechanisms will avoid market distortion and put all three instruments nominally on equal terms. Because of higher risk associated with projects in developing countries, the Share of Proceeds will disproportionally penalize the CDM. From this point of view, it should be discussed whether the Share of Proceeds for adaption for JI and ET should be set at an equal or higher level than the CDM Share of Proceeds.

The funds would not necessarily have to go to adaptation, but also to fund production of further mitigation efforts including Reducing Emissions from Degradation and Deforestation.

2.-On Effectiveness of the CDM: Reducing the cost of technology absorption by adopting a definition of technological additionality[2], based on level of uptake in regions.

The CDM has proven to be an insufficient tool to make a meaningful difference to energy production or consumption patterns in developing countries. There is thus a need to enhance its role as a proper incentive to trigger more substantial structural changes in the energy sector. The CDM's project by project procedures divert from the potential for change at a larger scale, trapping the mechanism in the detailed analysis of project circumstances and the concerns of proving financial additionality.

The effectiveness of CDM has to be enhanced and technology deployment scaled up. One way of doing so is to mandate the Executive Board to appraise certain technologies (and project types) as being additional in specific regions. This process would imply the establishment of a baseline of technological absorption for each of the technologies selected, preferably at a regional level, and the agreement on the level of uptake beyond which those technologies would not any longer be additional[3]. This way a set of technologies, like wind generation, biomass cogeneration, solar preheating of water, etc. could be agreed internationally to be accepted in certain regions as additional, at least for some time. The considerations and decisions of the Executive Board, supported on consultative processes, would be made public to increase their legitimacy and give certainty to the projects presented. Projects related to these technologies would see their preparation cost and risk, associated to uncertainty of approval, diminish. This would facilitate new initiatives and partnerships and create a creating a long term investment framework. The proof of project specific financial additionality would become obsolete. The CDM Executive Board (aided by research institutions) would monitor technologies absorption within the technological additionality area.

[2] The concept belongs to Ken Newcombe and was presented in a regional workshop in ECLAC in Santiago in September, 2005 in his capacity of Director of the World Bank Carbon Finance Business.

[3] In the case of renewable energies, Latin America and the Caribbean show levels of participation of close to 24 % of the total supply and has been relatively stagnant for the past 5 years (ECLAC 2005). Until their participation in supply were above a more significant level, for example 50%, they would still be considered additional. Other thresholds, such as whether the availability of the resource, like wind or sun, is above or below the mean should not only recomplicate the operation of this simplification.

The concern of creating value for projects that due to financial attractiveness would occur anyway is different from the concern of environmental integrity. The environmental gains will be obtained under this approach, and an individual project could have been carried out aside from the CDM, but the vast majority of projects will occur either at a larger scale, faster, or would have not occurred at all.

3.-On Scope and effectiveness of the CDM: Projects with a territorial base: monitoring historical consumption of fossil fuels in large city-type projects.

The EB of the CDM has made an important step in authorizing the development of Programs of Activities. These PoAs are however limited to a single project class applying the same approved methodology. This limitation is probably based on the concern that combining methodologies in one programme would result in an overly complex monitoring and verification framework.

One way of scaling programmatic approaches up and trigger emission reductions in areas that are currently left out of the CDM would be to monitor the energy input (upstream) of a project rather than the emissions downstream, which are particularly suited for large territorial units like cities in developing countries that could then launch rewarded climate change action plans. The consumption of fossil fuels directly or through electricity would establish an strong relation between the numerous actions within a territorial jurisdiction and their mitigation results creating thus a space for combined measures, whether technological, organizational or policy driven, that could result in reducing fossil fuel consumption, whether directly as liquids or gases, or indirectly as electricity supply. Projects could be scaled to more ambitious boundaries, including combinations of methodologies, some actions being more influential than others at different times, depending on changing opportunities.

This approach is more viable than previously for the following reasons:

- The IPCC has made important progress in establishing the relation between fossil fuel consumptions and emissions thus facilitating the use of emission factors for consumption (upstream) instead of actual emissions of CO2 (downstream) making monitoring inputs more reliable;
- The monitoring of energy consumption is a regular commercial practice. Municipalities or corporate entities have usually access to a long time series of information. Focusing on consumption (or precursors of emissions, in a more general formulation) can favor the combined effort of different levels of government and private actors to partner in modifying their patterns of consumption and of emissions opening the door for much larger scale projects.

The CMP should encourage the submission of proposals and views in order to examine this option and a process to address issues of concern as they arise.

Among some of the issues that have to be considered are the following.

The concept of financial additionality would not apply to this model since downstream financial incentives constitute a crucial part of the concept. In any case, financial additionality, should be eliminated from the CDM altogether, since it lacks environmental reason and purpose. Growth fluctuations in the economy will have an influence in this type of projects, if they involve large scales and multiple actors such as in the case of a city or province in a country. Therefore the baseline intensity of energy consumption vis a vis the local GDP should be clearly established in projects of this nature. Emissions leakage from relocation should be accounted for and the balance of emissions embodied in

trade must be also accounted for. To reduce the environmental risk of inaccuracies in statistical estimations of carbon imports and exports from the project, consideration should be given to the creation of a reserve or a discount scheme to compensate the estimations errors.

4.-On scope and effectiveness of the CDM.

A predictable space, as opposed to occasional opportunities, should be created in the CDM processes to examine innovative approaches, even if on a preliminary basis, and to encourage innovation. Policies in developing countries that pursue internalization costs and reduction of GHG, particularly in the case on new infrastructure investment should be given a space in CDM under a category on innovative approaches, to examine whether market mechanisms would turn them viable, and to examine their level of environmental integrity. Until now there has been no such space to explore future developments for the CDM on a regular, institutional basis. The present submission period is an example of the need of such spaces.