



# From Bonn to The Hague, Many Questions Remain

by Michael Toman and Jean-Charles Hourcade

---

Negotiators from around the world will meet next fall to try to find elusive common ground on the Kyoto Protocol. One key unresolved issue concerns how industrialized and developing countries will work together to reduce emissions.

---

With three years of international negotiations on climate policy set to culminate next fall, key questions remain. One of the most important aspects of the ongoing negotiations over implementation of the December 1997 Kyoto Protocol involves what rules should govern the use of the so-called “Clean Development Mechanism,” or CDM. In a nutshell, the CDM is designed to facilitate international financing of reductions of greenhouse gas emissions in developing countries, which do not have quantitative emissions targets under the Kyoto Protocol. Entities in developed countries that finance such reductions create “emissions credits” they can use to meet future obligations to control greenhouse gases or to sell to others.

The point of the CDM is to provide advantages to developing and developed countries. Developed countries would take advantage of cheaper opportunities to limit their net emissions than are available to them domestically. (Greenhouse gas reductions have the same long-term impact wherever they occur.) Developing countries would enjoy the economic and environmental benefits of investments made in their countries that reduce greenhouse gases—for example, upgrading the electricity generating system, or plant-

ing trees to trap some carbon dioxide (the principal greenhouse gas) while also arresting land degradation.

Under the Protocol, CDM projects and emissions credits were supposed to begin at the start of 2000. However, while international disagreements on the mechanism seem to be shrinking, agreement on how to implement the CDM is at least a year away.

## International Negotiations

At the Fifth Conference of the Parties to the Kyoto Protocol (COP-5), the fall 1999 round of international climate negotiations in Bonn, there was very little obvious progress on the practical details of the CDM. Among the industrialized countries, disagreements remain about the implementation of policies for greenhouse gas trading generally, and internal differences in views and interests among the developing countries implied a wait-and-see position for all.

However, beneath the surface, some real progress was made. The discussions in Bonn generally were much more businesslike than at the negotiations in Argentina a year before. Developing countries demonstrated an increased interest in the potential use of the CDM. Moreover, the technical and other sources of

dispute surrounding the CDM appear to be more clearly understood than a year ago, and there is some increase in shared understanding about what the CDM can do and how. For example, there is increased agreement about the valuable role of the private sector in identifying, financing, and operationalizing CDM.

By the time of the Sixth Conference of the Parties, currently slated to be held in late 2000, the international community is supposed to have reached agreement on how the CDM would work in practice. This means working out details on a number of issues, including who could initiate projects, how they would be financed, and how the emissions credits would be calculated and verified by some independent auditor. At a multinational experts' workshop on the CDM that we convened last fall, just a few weeks before COP-5, two days of frank but friendly discussion led us to conclude that the issues that follow are among the key concerns surrounding the CDM that negotiators must address over the next year.

### Credible Benefits for Developing Countries

In earlier discussions some developing countries expressed concern that they would be disadvantaged by the fact that CDM projects would allow the cheapest greenhouse gas reduction opportunities to be sold to the developed world. That concern has not entirely gone away, but it is now part of a more sophisticated and legitimate concern about how developing countries that host CDM projects can equitably share in the benefits. Developing countries recognize that, in principle, they will be able to exercise sovereign authority over CDM investments. The question is whether the CDM is designed to provide the greatest possible opportunities for mutually beneficial trade.

Some worry that opportunities for CDM investment will be unevenly distributed across developing countries, leaving those that are least developed at a particular disadvantage. The negotiation of the CDM

included a provision for taxing the proceeds of projects and redistributing the proceeds. However, at least some of this tax would be borne by host developing countries, not just by rich international investors.

Another way to address the issue of unevenly distributed benefits is to enhance prospects for investing in carbon dioxide sequestration projects, like reforestation, which could benefit the least developed countries. However, international negotiators remain at odds on how or even whether to count the effective greenhouse gas reductions from such projects. Doing this involves myriad technical complexities. If these complexities reduce eligibility for these investments, then some developing countries will lose their best opportunities for participating in the CDM.

Another concern is the extent to which developing countries can launch CDM projects on their own and the kinds of government-promoted projects that might be eligible, especially those chosen primarily on the basis of development objectives. For example, would infrastructure investments (like refurbishment of public facilities) that reduce energy use and carbon dioxide be eligible, or would the view be taken that the government was obligated to its citizens to do this anyway so the emis-

sion reductions were in some sense not "additional" to what would (or should) have occurred anyway? An even more formidable challenge is deciding whether financial payments from outside investors to encourage policy reforms like a reduction of existing energy price subsidies could be deemed eligible.

These kinds of issues underscore that concerns about the CDM cannot be divorced from the larger ongoing debate about foreign investment and financial assistance in developing countries. Developing countries have worried that the developed world would simply relabel existing foreign aid and call it support for the CDM, rather than providing new resources to help stimulate emissions limits. However, this issue is



fading somewhat in importance as direct assistance to developing countries is declining anyway and is being superseded by private investment. Foreign trade and investment are increasing worldwide, though some countries embrace it more warmly than others. Developing countries now seem more concerned with whether foreign private investment will serve their own needs in practice, given the relatively weak institutions for oversight in a number of developing countries.

### Environmental Integrity and Cost-Effectiveness

Another long-standing CDM debate has been over the integrity of the resulting credits. Because the reductions are measured against an inherently counterfactual baseline of what otherwise might have been, how can we be sure that we are not awarding “phantom” credits? A related question is how can we be sure that, whatever baseline is assigned, the proposed reductions from projects actually occur?

There are no perfect answers to these questions; the mechanism is inherently “leaky.” The degree of potential error from misspecifying the baseline before the fact, or awarding unearned credits after the fact, can be reduced by greater project-by-project scrutiny. But this level of scrutiny would greatly increase the costs to project participants and reduce the economic viability of projects, especially smaller-scale investments that may be of particular importance to the least developed countries.

One consequence of this would be to deprive developing countries of potential benefits they would have received, thereby limiting the opportunity for a large-scale technological transfer from industrialized to developing countries. Moreover, industrialized countries would have fewer opportunities to take advantage of the most cost-effective means of reducing emissions. By driving up the cost of abatement, this could reduce support for the Protocol in some industrialized countries.

There are a number of possible approaches for addressing these issues. They include establishing general versus project-specific baselines, perhaps with periodic revision of baseline rules according to known

rules; spot checking of project performance after the fact, with more rapid crediting for those participants that undertake more diligent oversight; and some form of shared liability between host country and any foreign investors for the failure of a project to produce the credits promised. A period of experimentation is needed to test out different approaches. It is important that international negotiators agree on some approaches and allow this experimentation to begin.

### Broader Policy Linkages

Finally, concerns were expressed in Bonn and in other venues about how the CDM relates to other aspects of the Kyoto Protocol. For example, the CDM is part of the larger debate over whether there should be limits on the use of this and other “flexibility mechanisms,” as espoused by the European Union and some developing countries, and opposed vigorously by the United States and some others. And some developing countries continue to worry that participation in the CDM now could prejudice their position in future negotiations about national greenhouse gas limits.

Without expressing a view here on the merits of these various points, we simply note again that under the Kyoto Protocol it was supposed to be possible to start accumulating CDM credits in 2000. While far from perfect, this mechanism does seem to have considerable promise for lowering industrialized countries’ compliance costs, providing tangible economic and environmental benefits to developing countries, and enhancing the international flow of climate-friendly technology in a way that could slow global emissions growth in the future. We therefore believe that progress on an implementing framework for the CDM is urgently needed, even while larger issues surrounding international climate policy are thrashed out. There is much to be gained from letting the experimentation begin.

Mike Toman is a senior fellow and director of the Climate Economics and Policy Program at RFF. Jean-Charles Hourcade is the research director of the Centre International de Recherche sur l’Environnement et le Développement (CIRED-CNRS), France.