

# Discounting – a promising compromise

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**Axel Michaelowa**

Perspectives GmbH, Hamburg – Zurich

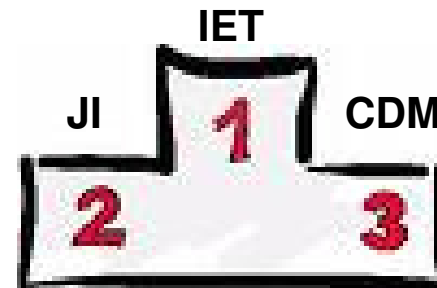


- **Lesson from the Kyoto Mechanisms: get the incentives right!**
- **Why the negotiators want new mechanisms**
- **Discounting by host countries – the benefits**
- **Outlook for Copenhagen**



## Expectations for the Kyoto Mechanisms

- Two **project-based** mechanism (CDM and JI)
- One **government-government** trade based mechanism (IET)



- **Expectations:**
  - **IET dominates numerically** due to high supply of hot air and **low transaction costs**
  - **JI will be attractive**, especially in **countries in transition**
  - **CDM will fail** as its rules are much too **cumbersome** and the **investment climate** in developing countries is **dismal**




## Lessons from the Kyoto Mechanisms

- **Results**
  - **CDM overwhelming numerical success** - 5000 projects, billions of CERs
  - **IET stalled** due to mistrust of buyers in government sellers. First transactions tainted with corruption
  - **Jl latecomer** due to late institutional decisionmaking and governmental ERU transfers
  - **Reason: Clear incentives for the private sector and limited government interference determine success**





## Shortcomings of the CDM

- **“Cat and mouse game”** between project developers and regulators 
- Significant share of **non-additional** projects
- **Vicious circle** of increased checks and increased workload of regulators
- Many projects with **limited contribution to sustainable development**
- Important project types **not mobilized** by CDM
- Host countries do not want to **“graduate”**



## Negotiators want to

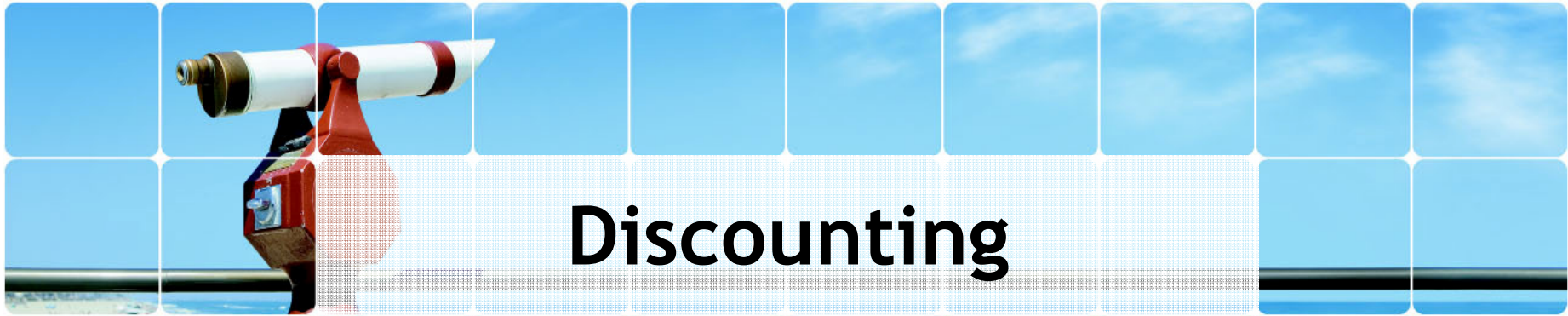
- **reduce transaction costs**
- **mobilize more private capital**
- **reduce complexity**
- **increase environmental integrity**
- **harness reductions in sectors not covered today**
- **Increase the scale (double if not triple)**
- **increase the fit with national circumstances**
- **make monitoring and verification easier**
- **reduce carbon leakage/get fair burden sharing**
- **provide incentives to graduate**





# Discounting

- 1 t CO<sub>2</sub> eq. reduction generates **0.x CERs**
- Differentiation according to **per capita emissions/per capita income** of host country
- **Advantages**
  - Allows to **keep the CDM** as proven mechanism
  - Improves environmental integrity of CDM on global level
  - CDM contributes to **global emissions reductions**
  - Improves **regional distribution**
  - Increases **political acceptability** of CDM in industrialized countries



# Discounting

- ... is proposed in the **Kerry-Boxer Senate bill**
  - 1 offset credit equals **0.8 t CO<sub>2</sub>** of domestic reduction
- ... is implicitly done when choosing **conservative default baseline emissions factors**
- ... should not be differentiated according to **project types** because the discount factors would essentially become **arbitrary**
  - **Sustainable development benefits?**
  - **Capturing rents from low-cost projects?**

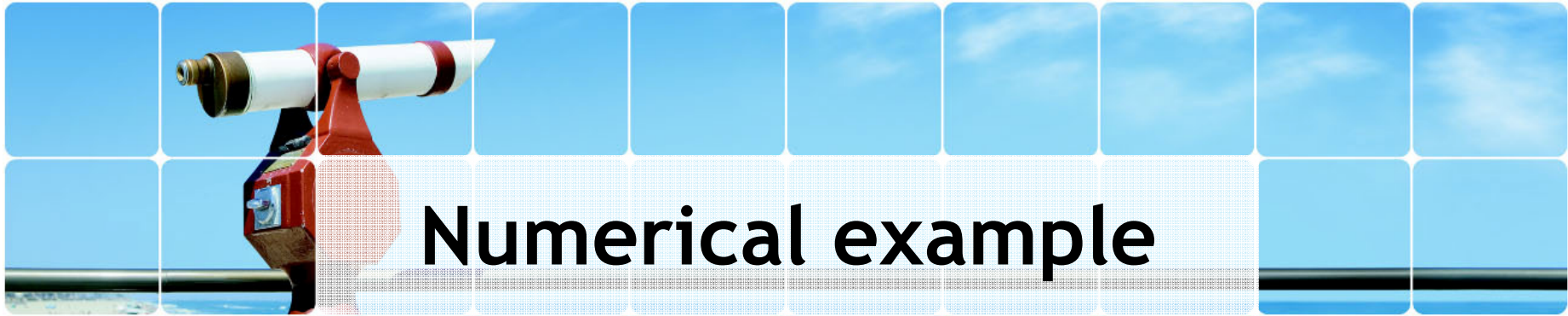




## Market effects

Effect	No import limits	Import limits
Mitigation mainly in	... <b>industrialized</b> countries	... <b>developing</b> countries
Mitigation costs	...increase	...increase somewhat
Costs are paid	...by CER users	...by CER users
Rents of CER sellers	...remain <b>stable</b>	... <b>increase</b> substantially
CDM market volume	...remains <b>stable</b>	... <b>increases</b>

Source: Schneider (2008)



# Numerical example

<b>Country</b>	<b>Development index (50% per capita GDP, 50% per capita emission)</b>	<b>CERs from 1 t CO<sub>2</sub> reduction</b>
<b>Qatar</b>	<b>7.6</b>	<b>0.07</b>
<b>Korea</b>	<b>2.3</b>	<b>0.22</b>
<b>China</b>	<b>0.8</b>	<b>0.63</b>

**Starting point of discounting: Development index 50% of world average**



- **Weaknesses** of sectoral mechanisms become more and more **clear**
- **Benefits** of discounting are increasingly recognized
- Optimal outcome would be **coexistence** of sectoral mechanisms and CDM according to the **free choice of host countries**
- Discounting makes the playing field even between sectoral mechanisms' **stringent baseline** and the CDM