The Clean Development Mechanism – Preliminary Findings of a Survey on Stakeholders' Engagement and Motivations

-Gudrun Benecke, Lars Friberg, Miriam Schröder-

UNFCCC COP 12/MOP 2
6.-17.11.2006, Nairobi

Abstract

As part of a research project of the University of Potsdam on emerging climate partnerships within the Clean Development Mechanism (CDM), a survey on stakeholders' engagement was conducted during August-October 2006. The preliminary findings presented in this paper allow for the conclusions that:

- The CDM is a buyers' market dominated by the demand of big European power companies that are mainly driven by compliance motives.
- A diversification of the CDM market has been observed with regard to the increase of intermediary actors and transaction modes.
- Recently, a secondary market has emerged with the entry of the finance and banking sector.

From a market-based perspective the CDM can be characterised as:

- a still emerging, maturing and nascent market of varying stability where experiences and transactions are just manifesting
- a diversifying market into distinct primary and secondary segments, actors and instruments
- a policy dependent market in which legal and regulatory decisions play a major role.
-

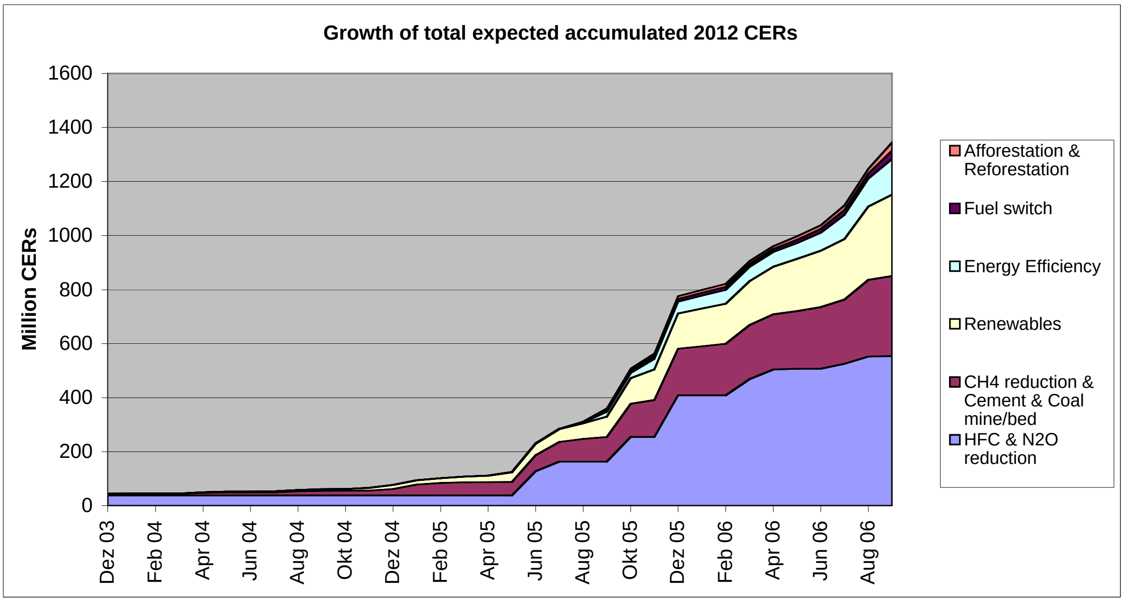
Due to the significance the CDM has gained for compliance and also investment issues for the various stakeholders, it might be assumed that the future of this Kyoto instrument is not only dependent on post 2012 decisions but that it might also influence international negotiations on the post 2012 regime.

The Clean Development Mechanism – Preliminary Findings of a Survey on Stakeholders' Engagement and Motivations

-Gudrun Benecke, Lars Friberg, Miriam Schröder-

I) Introduction to the survey

As an input for the debate about the future of the Clean Development Mechanism (CDM), this survey sets out to draw lessons-learnt from experiences made by various stakeholders from the demand side of the emerging carbon market. The carbon market is emerging from the infant pre-ratification phase and market analysts acknowledge its swift initiation, its boosting trade volume and its increasingly diverse set of actors. The Clean Development Mechanism (CDM) as a flexible mechanism is starting to prove its worth as an functioning policy tool to reduce greenhouse gas (GHG) emissions at high cost-efficiency. The expected number of certified emission reductions (CERs) has surpassed the benchmark of one billion tCO_2e and is projected to rise further. However, the mechanism has so far been less successful to live up to its second goal of supporting sustainable development.



Source: UNEP Risoe Centre, CDM Pipeline 20.10.06

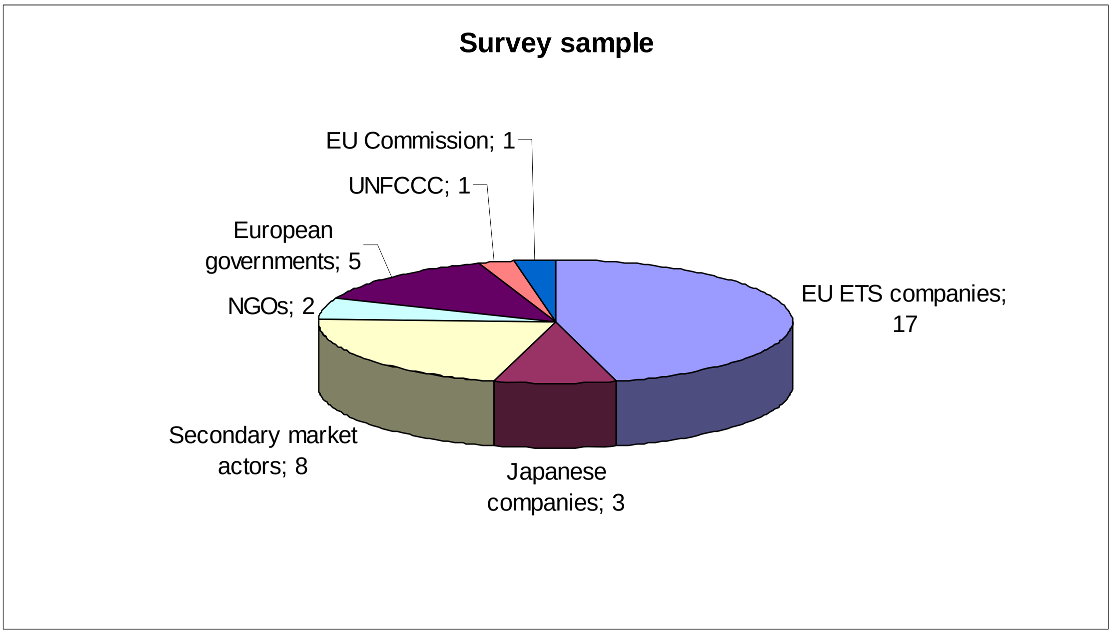
This survey will take a closer look at the engagement, strategies and motivations of various stakeholders in the carbon market. Exploring the experiences of this diverse set of actors covering governments, companies, project developers and many more intermediaries, we analysise the experience made so far with CDM and present some of the suggestions made by these market actors on how the CDM could be improved in the light of the post-2012 debates.

The following *research questions* were used as a guideline for the survey:

1. What kind of experiences have buyers on the carbon market made with CDM?
2. What strengths and weaknesses of the CDM do carbon market actors identify? What modifications for the CDM do they suggest?
3. What role do carbon market actors see for the CDM in the post-2012 period?

II) Methodological Approach

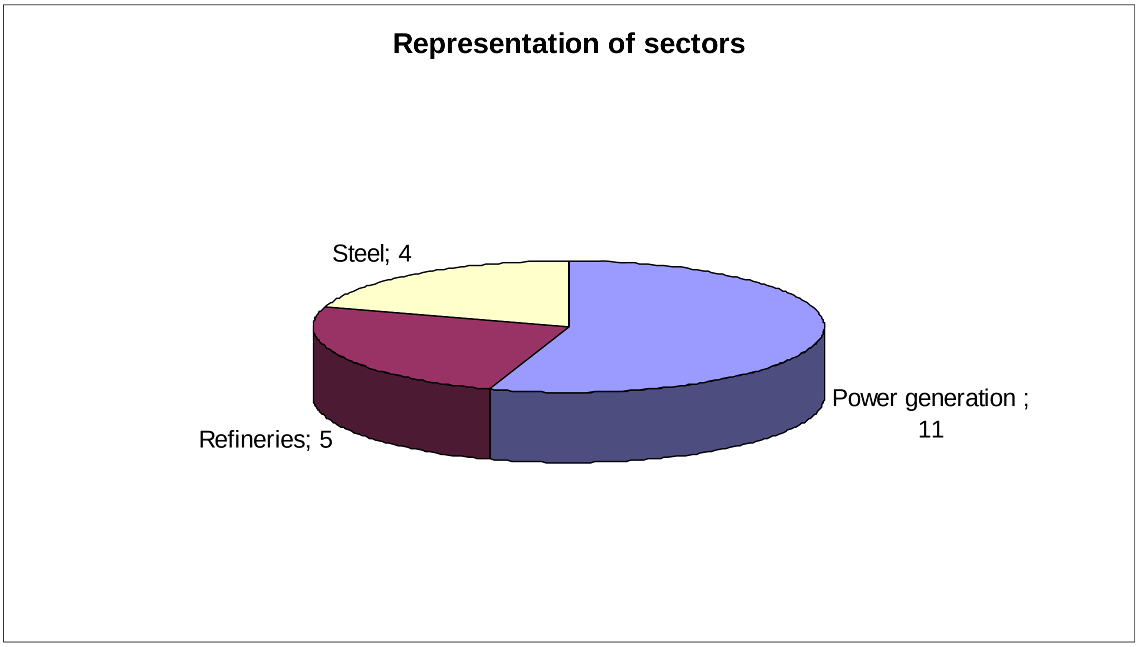
Conducted as part of a research project at Potsdam University[1], the survey consists of telephone-based and personal interviews with 36 stakeholders within the CDM market. The selection of interviewees was based on their perceived importance to the market. For example, among companies with reduction obligations under the European Emission Trading System (EU ETS), the companies with the largest installations within their country's National Allocation Plan (NAP) were approached for an interview. The interviews were conducted during August – October 2006 either in person or via the telephone using a semi-structured interview guideline. Japanese companies were included in the survey despite different framework conditions due to their relevance to the carbon market and in order to get a business perspective from a different angle. In favour of honest and frank answers the interviews were conducted under the Chatham House Rule so no attribution to specific firms will be made in this text.



[1] Please find further information on the research project at the last pages of this paper.

III) Stakeholder Analysis of CDM Engagement

The majority of the interviewed companies are from the power generation sector, five refineries and three steel producers were included as well. Two of the electricity companies and one steel producer are from Japan. They will be analysed separately as they face different framework conditions than European compliance companies.



Companies with large reduction obligations under the EU ETS

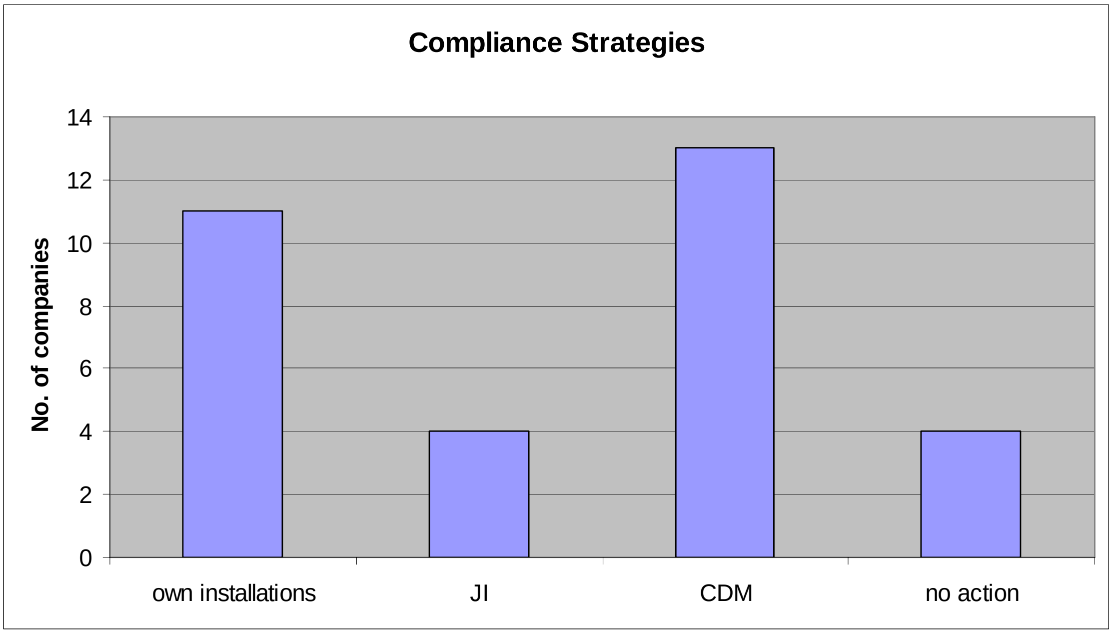
Compliance strategies

Some 12.000 European installations are covered by the EU ETS. Depending on their national allocation plans (NAPs), they face different GHG reduction obligations, which influence their motivation to become active in the carbon market. Apart from buying European Allowances on the market, three main options exist for these companies to comply with the targets set by the EU ETS:

1. Investment in own installations by reducing fossil fuel consumption and increasing energy efficiency
2. Investment in Joint Implementation (JI) projects, and
3. Investment in Clean Development (CDM) projects.

The compliance strategy of companies differs according to their potential to reduce emissions further in their own domestic installations, the percentage given in their NAP that allows for use of flexible mechanisms, their interest in expanding business to either Eastern Europe or developing countries, and last but not least their overall risk and return strategy. Out of the 15 interviewed European companies, 10 companies are investing in their own installations, 4 are interested in JI projects, 12 have chosen and one refinery plant plans to become engaged in the CDM market as buyers of CERs (Certified Emission Reductions). Only one Austrian and two Swedish companies do not plan to become active as their “NAP allocation was sufficient” and so that no need for additional permits arises. Some Danish companies display some gambling strategies not getting started with CDM in order to signal to the government that they are not prepared for any future strict emission reduction targets of their NAP.

CDM stakeholders such as government bodies, NGOs and non-compliance private actor confirm that most prominently larger companies mainly in the power sector and steel and chemicals industries with transnational outreach are engaged in the CDM. Remarkably missing so far are smaller and medium sized companies as these are not affected by emission reduction obligations and/or inexperienced with international operations.

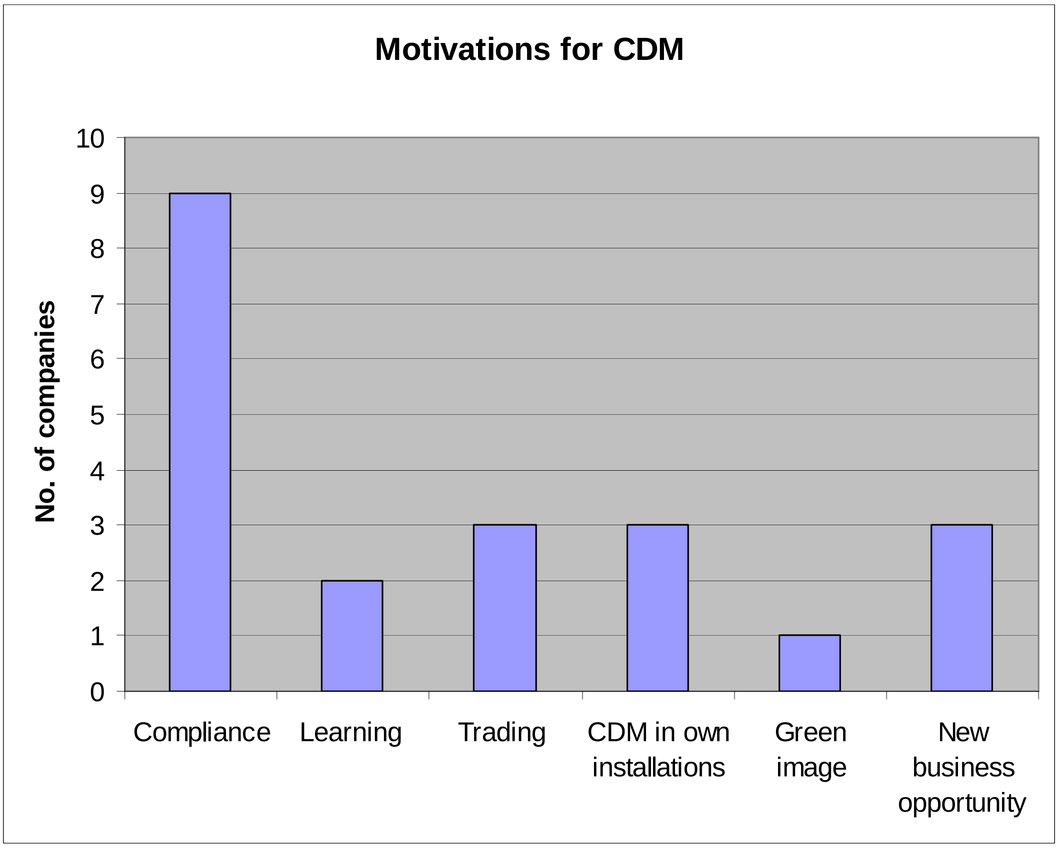


Motivations for CDM engagement

In our study we defined *engagement in CDM* as buying CERs directly from project developers and/or indirectly on the secondary market and/or initiating own CDM projects for CER generation. Although all companies interviewed have obligations under the EU ETS, only 8 out of 12 companies gave “compliance with the EU ETS” as a major reason for their engagement in CDM. Some companies – interestingly only refineries – stated to have been active in CDM right from the beginning in order to accumulate knowledge and to learn from early activities. Refineries and a steel producer engaged by initiating their own CDM projects - with their daughter companies in the developing country being the project partner. In one case, this led to the situation where the company opposed the EU ETS obligations for its European installations while welcoming the market demand for their new GHG reduction technology developed by them for CDM projects.

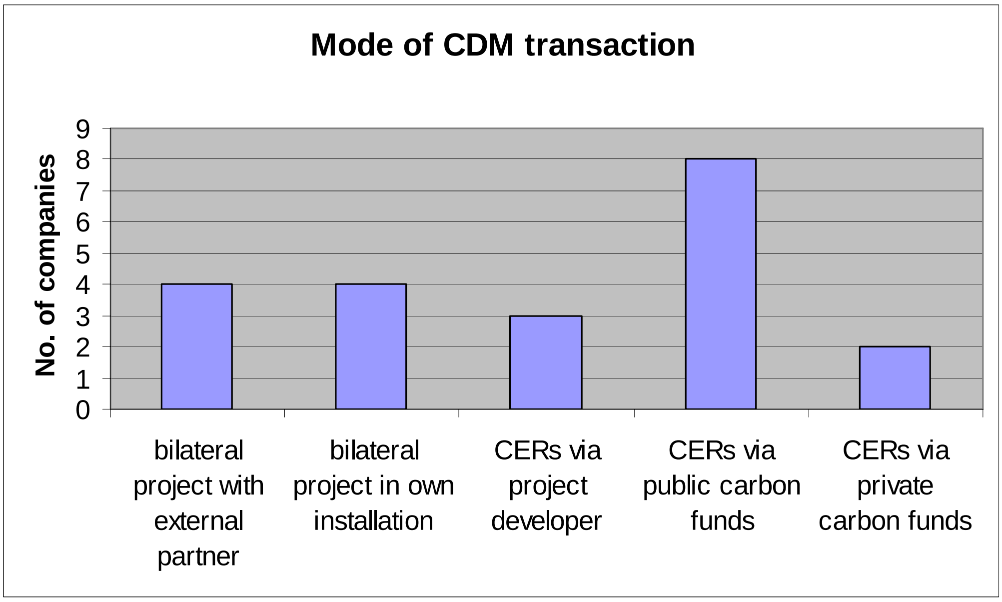
Interviews with other stakeholders confirm that apart from making profit, seizing opportunities to explore and access new markets, the possibility of learning experiences due to an anticipated continuation or extension of emission trading and the CDM are key motives for companies’ CDM interest. Yet, one company also gave “attaining a green image” as a rationale – but only amongst others and clearly determining that large-scale CDM projects on HFC23 are for profit while the small scale projects on renewable energy in poor and rural areas such as the Himalayans are for Public Relations. NGOs interviewed confirm that ‘green image’ rationales supposedly do not play a predominant role as this is too expensive compared to cheaper ‘green’ PR alternatives due to potential NGO criticism. Trading for themselves or for third parties was also given as a motivation for companies’ actions on the CDM market.

Other CDM stakeholders agreed that as the CDM market is maturing, motives have turned towards investment objectives, speculation and trading notice.
One more point of interest is that some companies stated that they wished to increase their use of CDM for EU ETS compliance if only the NAP of their country would allow them to do so.



Specification of CDM engagement

Companies are taking different approaches to the use of CDM as a possible compliance mode. While the majority of companies (which includes all power generating companies) go for funds to obtain CERs, two of the refineries only generate CERs by projects in their own installations. Only a very limited number – three companies – conduct CDM projects with external partners thus allowing for the possibility of financial and technological transfer to companies from developing countries.



Buying strategies

Companies have given the following factors as shaping their buying strategies for CER in general:

- Risk mitigation by obtaining diversified portfolio (given 4 times),
- Window of opportunity (given 2 times)
- Cost-efficiency
- Reputation and image of seller
- Using best available technology for green image
- Learning opportunity

The decision whether to initiate own CDM projects or to obtain CERs on the secondary market seems to depend partly on the risk aversiveness of the companies. The companies actively involved in bilateral projects gave "taking a front runner position" as one explanation for initiating own CDM projects, besides factors such as existing business contacts. However, the main reason for initiating a CDM project bilaterally is the comparatively cheap price of the CERs from high volume CDM projects. The following statement of an energy company representative provides a general viewpoint among business actors:

> "CO_2 is only one new upside. The project has to be feasible in other aspects as well… the possibility of turning a project into a CDM project is a minor decision-making factor, it has to be profitable on its own…Transaction costs are o.k. since most projects are large scale".

Another power generating company has even developed its own price assessment tool to calculate the benchmark of profitability for CDM project engagement. In contrast to own CDM projects, the clear advantage of carbon funds is seen in their potential to diversify risk by a mixed project portfolio so that its members could buy "risk free" and "ready-made" CERs. Buying CERs on the secondary market seems to be a convenient means for smaller companies with little knowledge about CDM and little time to invest in this "non-core business". This applies especially to public carbon funds, which were preferred due to their experiences and good contacts in the CDM host countries. Most of the interviewed companies bought CERs from either the World Bank Prototype Carbon Fund or the German KfW Climate Fund, but some also were clients of some of the following: Umbrella Carbon Fund, Danish Carbon

Fund, Spanish Carbon Fund, Italian Carbon Fund; European Carbon Fund, and the Community Development Carbon Fund.

Types of CDM projects

Besides the volume and price of CERs generated, companies do not seem to have a clear preference for project types. Almost half of the interviewed companies prefer a mixed project portfolio (in most cases via funds). Other project types conducted included: HFC, methane, landfill, flaring of industrial gases, hydro, renewable energies and energy efficiency.

Companies with large reduction obligations in Japan

The three interviewed Japanese companies (two electricity and one steel company) take a similar approach to reduce GHG reductions: all of them reduce GHG in their home installations, all of them engage in CDM activities and all of them are at least members of the Japan Carbon Fund. Their motivation is also clear: instead of compliance needs by a legally binding ETS, Japanese companies act voluntarily to reduce GHG emissions. They do so for two reasons: to live up to the pledge made to the Japanese society and in order to avoid a carbon tax. The latter would be implemented by the Japanese government if voluntary reduction agreements were not met. Means of compliance cover the same range of activities European companies undertake (with the exception of JI): bilateral CDM project development; membership in public and private carbon funds; and investment in own installations. In sharp contrast to the low profile of European companies when it comes to the use of nuclear energy, one of the Japanese companies does not hesitate to proclaim that the replacement of fossil fuel plants by nuclear power plants will make up the bulk of its reduction efforts at home.

Non-compliance private actors

This category comprises all private or semi-private actors that are engaged in the CDM not primarily for compliance reasons. These range from finance institutions and investment banks; public, semi-public and private funds, secondary market actors, i.e. traders; to consultancies and service providers such as Designated Operational Entities (DOEs).

Climate Change Strategies

All the interviewed state that mainstreaming of climate change activities within their entities starting from the mid-1990s, which is made explicit in climate change strategies and/or the integration of a sustainability focus into Corporate Social Responsibility departments. More concrete activities are for example setting up green investment schemes and internal carbon neutral policies. For many of the interviewed, operational activities related to climate change have been part of their core business anyway.

CDM Engagement

Due to the variety of actors comprised in this category, their specific activities within the CDM are distinguished as follows:

- Own investment activities in carbon funds; e.g. finance institutions
- Provision of advisory services to public or private funds on investment decisions for CDM projects or assistance in the development of CDM projects; e.g. consultancies
- From own project development to the acquisition of own portfolios; e.g. investment banks, funds

- Trading with future certificates; e.g. banks, traders, hedge funds
- Validation, verification and certification of CDM projects; e.g. DOEs

Buying Strategies

Analysing this CDM engagement, some main trends related to buying strategies emerge:

- Concerning the project types or the CERs acquired from CDM project activities, it is evident that the actors are open to CERs or projects of all sectors except for those not accepted under the EU ETS, e.g. forestry. Technical feasibility of the projects, the standardisation of the methodologies applied, project risks such as country risks due to administrative hurdles, the legal framework and political stability determine project investments.
- Regional or country foci or biases in the selection of project activities or CER acquisition also do not play a predominant role and are no trading issue. As for investment activities in CDM projects, location decisions are made according to country risk assessments that typically look at financing security. However, project investment or CER buying decisions are biased only if service providers or institutions have already existing networks or affiliations in certain countries.
- Generally speaking, decisions to invest in a CDM project or to acquire CERs from project activities are made based on strategic considerations such as risk spreading, diversification of the portfolio, closeness to existing/core business activities, investment security and expected financial return. Remarkably, portfolio structure and composition as well as planning and investment decisions are only to a limited extent transparent to the demand-side.

Motivations for CDM Engagement

Among the interviewed a relatively strong agreement exists concerning motivations and rationales for their engagement in the CDM:

- The first and nearly always mentioned reason to be an active player in the CDM market is to make use of an early mover advantage. Pioneering the market despite insecurities, risks and uncertainties also regarding its future, the underlying objective is to become market leaders in their fields of activities.
- In many cases, the actors interviewed also possess some strategic advantage due to similarities between CDM activities and their core business. Furthermore, foreign affiliations and client or partner networks abroad facilitate decisions to engage in the CDM. Particularly for private finance institutions, demands for CERs by compliance companies that constitute their main clients provide incentives for CDM engagement.
- As for public-interest related actors, e.g. semi-public carbon funds, CDM engagement is part of their business concept. The objectives are thus to promote the CDM, to assist creating a market, to instil some trust in its functioning, all of which are inspired by a political will.
- Only for a limited number of interviewed and specifically for renowned enterprises in the finance sector, engagement in the CDM is founded on image and Public Relations rationales.

State and supra-state actors

This survey concentrates mainly on the European level and thus focuses on the engagement of different European government and supra state institutions. This includes the highest political arenas of the UNFCCC as well as the European Union.

CDM Engagement

Within the different EU nation states examined, responsibilities for CDM issues are generally divided between the respective Designated National Authorities (DNAs), the Ministries of Environment, and the Ministries of Technical Cooperation.
Depending on the political impetus and assignment, the respective ministries exercise different functions with regard to the CDM.
In summary:

- Ministries of Environment, Economics, Technical Cooperation: Activities to support and promote the CDM within the member states in order to facilitate the process and the market development in general. This also involves institutional support to entities within the member states.
- DNAs: Adopting concrete tasks within the CDM process as internationally agreed upon and supervised by the EB. These comprise the observation and registry of the nation state's industry emissions, the monitoring of the CDM and CDM project approval.
- Ministries of Technical Cooperation: Assistance such as institutional support and capacity building to host countries.
- Ministries of Environment: Setting up and overseeing the implementation of buying programmes or CDM tenders as the strongest form of engagement. Negotiating Memoranda of Understandings (MoUs) with host countries.

CDM Strategies

According to these analyses, the CDM engagement strategies are differentiated into:

- 'Indirect engagement', which subsumes the three fields of assistance activities, e.g. support to DNA set up and capacity building in home and host countries; political coordination, e.g. within the nation state, between the host countries, on EU and international arenas; and business support or lobby activities. Observations reveal that states such as Germany, the UK, and Sweden fall into this category since they are for various reasons on track to meet their emission reduction targets without using CDM for their national obligation.
- 'Direct engagement', which implies the elaboration of a CER buying strategy and/or the establishment of a CDM tender. Particularly the latter is often designed according to political criteria and thus favours certain project types, e.g. energy efficiency and renewables, or host countries, e.g. India. Nation states such as Belgium (federal and state levels), Italy, Spain and the Netherlands use this option being generally short of meeting their national obligations.

Motivations for CDM Engagement

Motivations, objectives and reasons for engaging in the CDM usually are a mixture of:

- High policy decisions on nation state level that are often guided by distinct political interests. These comprise objectives to steer domestic companies towards certain technologies and thus to influence technological and economic developments within the respective member states.
- The decision for 'direct' or 'indirect' engagement within the CDM hinges on the willingness and feasibility to use tax payers' money in order to pay off domestic industry pollution. Depending on industrial lobby activities and the feasibility for domestic firms to cut down emissions, this constitutes a political decision for or against national burden sharing in order to meet international compliance obligations.

Non-governmental organisations

Generally speaking, the CDM constitutes such a specialised and technical field of activity that NGO engagement compared to other climate issue areas is not very high. Depending on the level of analysis, international, national and local non-governmental organisations or groups are distinguished. In the context of this survey, the focus has so far been on NGO engagement within the European Union.

Climate Change Engagement

The NGOs interviewed cover a broad range of issues within the thematic fields of climate, energy, environment and also development. Their focus of work concern local, nation state or EU levels although lobbying, research and advisory activities related to international and North-South related issues are also part of their campaigns. Strong interactions and relations with local civil society groups exist and feed into their work, yet, business and politicians at local or national level also constitute the main focal points for dialogue and lobby activities. Topics picked up for campaign work at the local level mainly concern environmental and climate issues that directly affect the population, e.g. impacts of transport.

CDM Engagement

What needs to be emphasised is that there is no one 'NGO voice' as the CDM touches many sensitive issues such as forests, North South equity as well as different views on the role of market based approaches such as CDM to tackle climate change.
At the local, project level within host countries NGOs have the option and are sometimes encouraged to participate with feed back in the CDM approval process. According to observations made by service providers, initially quite active local involvement is decreasing due to the enhanced professionalism of project development and the local employment and economic benefits that often outweigh potential social or environmental concerns.
Although European NGOs are to a large extent not directly involved in the CDM project cycle, they actively work on framework conditions. In this sense, they elaborate clear positions on the current design of the CDM and related to the post 2012 debate. In some cases, they are actively lobbying government and business and have often been involved in the design of the national CDM tenders.

CDM Position

Instead of a strategy, European NGOs rather have positions on CDM. They agree that CDM if used should concentrate on energy efficiency and renewable energy projects in order to provide at least some sustainability benefits. Yet CDM in its present form is looked at with slight hesitations since NGOs demand for stricter targets for industry to reduce GHG emission in their European installations.

IV) Characterisation of the CDM as a ‚Market'

In the following, assessments by stakeholders engaged in the CDM describing their operative environment, i.e. the CDM, will be analysed. From their perceptions on the CDM, conclusions can be drawn regarding the extent to which the CDM is perceived as a functioning market.

<u>Holistic market characterisation</u>
The CDM market is differentiated into a primary market that is project-related with a long-term orientation and into a secondary market that relates to trading with options and futures on project-generated CERs. This segment has just recently emerged during the last half year and is characterised by its short-term and fast nature, the small number of actors involved and thus a lack of liquidity. Interviewees describe the CDM market as highly complex, technical and fluid, which thus allows only specialised actors to engage in it. Due to its high complexity, regulatory and legal issues are more than in other markets considered highly relevant.

<u>Stability</u>
Characteristic features of the primary market, which most of the interviewed refer to, are its lack of stability due to a high number of entries. Generally speaking, the CDM is considered a pilot still working on a trial and error basis, which has yet shown that it works but constitutes a niche rather than a commercial market. Factors that contribute to certain instability apart from the infant state of the CDM are the emergence of secondary market transactions that still lack price transparency.

<u>Certainty</u>
Stakeholders to a large extent agree on the position that the CDM market is somewhat uncertain since it is more policy dependent than any other market due to its enshrinement in the Kyoto Protocol. However, due to the uncertain political and pricing decisions after 2012 a growing insecurity amongst market participants is recognised. Factors that add to this uncertainty are fears of market distortions resulting from the EU burden sharing and NAP II decisions as well as the additionality criteria relating to the CDM projects.

<u>Market Entry</u>
Particularly companies, representing the buyer, i.e. demand, side in the CDM market agree on the characterisation of the CDM as a 'jungle'. This is because the CDM provides opportunities for successful early movers for large profits but at large risks. Thus, companies emphasise the importance of being among the first movers in the market.

<u>Market Evolution</u>
Over the last years market actors have gathered a growing expertise in financing and trading with CERs. This relates to the emergence of new market actors, e.g. local banks, DOEs, even leading to certain saturation in distinct segments, as well as new market instruments provided by banks and stock exchanges. It is highlighted that the CDM market is still immature and unbalanced. In one way, this is due to the high demand for carbon offsets that has by far not been met by the supply side. In another way, this refers to the inequity of distribution regarding the CDM projects.

V) Identified strengths and weaknesses of the CDM by survey participants

Perceived strengths of the CDM

The following section summarizes the strengths and weaknesses of the CDM as perceived by the interviewed stakeholders.

Cost efficiency
Through the CDM reduction potential in developing countries that would otherwise not have been thought of is being sourced for credits. As CERs are cheaper than EUAs they are of interest for companies. Worth noting is that they are also accompanied with higher risk, ranging from project specific risk factors to currency risks, failure in CDM registration process, and CERs delivery. CDM creates an additional supply of credits that add to the overall amount available to companies in the EU ETS system, lowering the cost of compliance. Some European countries find that the CDM lower their total cost for Kyoto, thus allowing them to reduce the reduction efforts they need to impose on domestic sectors.

Flexibility
Many of the interviewed companies regard engagement in CDM as an important way to hedge their carbon risk. By adding the CDM option to their compliance tool box they increase their flexibility. The flexibility aspect seems to be a more important driver for some actors than the lower price on CERs compared to EUAs.

Banking
CDM creates a security valve for European compliance companies into the second EU ETS period 2008-2012 as they can chose to use their CERs either in the present or in the second commitment period, an option not available for the EUAs in the pilot phase as banking of EUAs is not allowed. This increases companies' flexibility and reduces their exposure to EUA price fluctuation risk.

Transfer of capital and technology
A few survey participants highlights the role that CDM has in facilitating technology transfer and increasing foreign direct investments into developing countries. It is stressed that the technology has to be suitable to the local context and that it is as much a matter of transferring human capital skills and management systems as transfer of technology hardware.

Increased liquidity and understanding of the Carbon market
Several survey participants point to the key role the CDM has played for the emerging carbon market. Bringing in substantial amount of capital,. CDM together with the emission trading system is building interest and increased understanding of the logic of value to carbon reductions in the mainstream finance community. The awareness increases that beyond being a risk carbon needs to be managed and that carbon reductions can also be a profitable asset.

UN involvement
The fact that the CDM is developed and supervised by the UN increases the confidence, credibility and transparency of the system.

Developing Country involvement
Some participants highlight that CDM is one of the few tangible outcomes of the Kyoto Protocol in developing countries and that CDM is playing an important role in fostering their interest in a continuation of the climate regime.

Perceived weaknesses of the CDM

Bureaucracy of the CDM in general and of the Executive Board in particular
By far the most common complaint of the CDM is that the system is overly bureaucratic. The lengthy process of registration, verification and approval is seen as too slow, arbitrary and developed without an understanding of how business work. Micro management of petty details by the Executive Board creating a bottleneck slowing down the process is another common complaint. All this process friction drives up the transaction costs of doing CDM projects, and the complexity and time lag creates a high threshold for new entrants.

Additionality
The methodology of financial additionality is another common topic of complaint from business actors engaging in project development. It is seen as difficult and subjective in its application. One participant developing renewable energy projects said that CDM is no more than the cherry on top of the cream of profitability and not driving the development of new projects.

Sustainable Development
The sustainable development goal of CDM is controversial. NGOs criticize some CDM projects for failing to contribute to local sustainable development. On the other side of the spectrum one business participant and one government civil servant in the survey argue for a delinking of CDM from sustainable development as it is too subjective and arduous to measure.

Regional distribution of CDM projects
When looking at the regional distribution of CDM projects one fact stands out, so far only a handful of the over 1000 proposed projects are situated in the least developing countries or in Sub-Saharan Africa.

Role of host countries
A sensitive issue is the role of host governments. Some Designated National Authorities were reported to overstep their role as outlined in the Marrakech accords ranging from excessively arduous filing procedures to extracting dinners and gifts to more serious forms of abuse of power bordering on corruption. Project developers are in a vulnerable situation, given that there are no international procedures for oversight of the national authorities' management of the approval process the risk of abuse of the CDM is real.

International Transaction Log
The fact that the International Transaction Log (ITL) for a transparent record of CERs changing hands is not operational and risk delays was mentioned by several actors as an unnecessary source of additional uncertainty linked to the CDM.

Weak and distorted demand
As the demand for CERs is to a large part driven by EU ETS allocations and by countries Kyoto obligation there is a need for policy makers to create a 'short' market. Companies favour the market based mechanisms but demand that they are implemented fairly. So far this has not happened as was shown by the overgenerous allocation in most European countries in the first round of national allocations that distorts and weakens demand for CERs.

Post 2012 uncertainty
The fact that the future shape, form and very existence of a continued climate regime beyond the first commitment period of the Kyoto Protocol is today unknown is mentioned by most survey participants as a fundamental problem.

Too small to make difference
Some of our survey participants point out that if the goal is to guide large, rapidly industrialising countries towards a path of low carbon economic development the CDM in its current form as a small, project based mechanism will not be able to have a perceivable impact.

Short time horizon

Linked to issue of post 2012 uncertainty is the complaint that the time horizon of the CDM is too short in comparison to normal business investment cycles for companies considering retrofitting or new investments in low carbon technologies.

Suggested improvements of the CDM

The vast majority of survey participants call for more streamlined, professional, less bureaucratic procedures governing the CDM. Different actors mention the following:

- Get the International Transaction Log operational,
- Consolidate more methodologies,
- Develop a positive list of approved project types that automatically fulfil additionality criteria,
- Ensure certainty for the validity of post-2012 CDM projects,
- Scrap the percentage cap of use of CERs in EU ETS,
- Include Carbon Capture and Storage projects in CDM,
- Set up additionality benchmarks,
- Develop forms for inclusion of programmatic, sectoral and policy CDMs,

It should be pointed out that many of these suggestions were made by business actors who also have a financial interest in reforms that lower the turnover time for projects and decrease transaction costs. Before a wholesale adoption of these proposals takes place, careful examination of the risk of detrimental effects to the environmental integrity of the CDM should be undertaken.

The future of CDM, post 2012

The CDM as a market based solution with its strong focus on cost efficiency and flexibility is attractive to business facing reduction compliance. Despite being ten years after negotiations on the rules for the CDM began it is still early days for the implementation phase of the CDM. Most commentators seem to agree that the CDM has proven itself as a functioning mechanism for cost effective GHG reductions in developing countries, less so when it comes to deliver sustainable development to local communities.

With the CDM, companies have a broader range of emission reduction options that lowers the price of reductions even if far from all choose to use it. For the future, our survey participants seem to be in broad agreement that despite the problems highlighted the CDM or "*brothers or sisters of the CDM*" are needed, building on the lessons learned will be a corner stone in a future climate regime. Common views are that there is a need for a more ambitious, scaled up mechanism that can cover sustainable policies and measures, whole sectors or programmes. When asked for details of such a future flexible mechanism our survey participants are still rather vague on what they envision as the better solution. This absence of clear ideas among stakeholders is worrisome given the limited time scope for such ideas to evolve from 'straw man' suggestions to fully fledged proposals ready to gain wider acceptance in time for the official post-2012 climate negotiations.

“Climate Partnerships in Newly Industrializing Countries”

-Research Project -

The research project focuses on the role of the private sector in the area of climate protection. The research project’s objectives are to generate empirical and theory-based knowledge on:

(1) *Conditions* under which partnerships between business and other actors emerge and how these are constituted in the framework of the CDM: What are the roles and interests of the diverse participating actors? What constitutes their motivation to engage in this new mechanism?

(2) Institutional *impacts* these partnerships exert under the CDM framework: Do they contribute to establishing new and efficient governance structures in the area of environmental policy in newly industrialised countries in the short and in the longer term? What effects do partnerships have on governance structures outside their thematic field? Do they ultimately contribute to sustainable development?

Both strands of academic debates on emerging modes of global environmental governance as well as on domestic political and governance repercussions are empirically investigated in the context of three country case studies in Brazil, China and India.
Until 2009, our combined findings will be made available and provide valuable inputs to policy-makers, companies, and scientist in the field of climate change as well as to the interested public.

The research project **“Climate Partnerships in Newly Industrializing Countries”** is part of the Research Center SFB 700 Governance in Areas of Limited Statehood which investigates diverse forms of governance in areas of authority, security, welfare and environmental problems. Operational since 2006 and financed by the German Research Foundation (DFG), the Research Center involves the Freie Universität Berlin, the University of Potsdam, the European University Institute, the Hertie School of Governance, the German Institute for International and Security Affairs (SWP), and the Social Science Research Centre Berlin (WZB).

Contact us:

Research Project D3

Alfried-Krupp-Haus Berlin
Binger Strasse 40
D-14197 Berlin
www.sfb-governance.de

Project Manager:
Prof. Dr. Harald Fuhr
Chair of International Politics, University of Potsdam
E-mail: hfuhr@uni-potsdam.de

Assistant Project Manager:
Dr. Markus Lederer
E-mail: lederer@uni-potsdam.de

Case Study India:
Gudrun Benecke
E-mail: gbenecke@uni-potsdam.de
Phone: +49.30.838.58.522

Case Study Brazil:
Lars Friberg
E-mail: friberg@uni-potsdam.de
Phone: +49.30.838.58.523

Case study China:
Miriam Schroeder
E-mail: miriams@uni-potsdam.de
Phone: +49.30.838.58.524