Programmatic CDM feedback to Executive Board

After one year of existence of guidelines for Programmes of Activities it seems obvious that the new instrument has not been embraced by the market. The four PoAs so far submitted (as recorded by the CDM pipeline published by UNEP/Risoe), is insignificant compared to the high expectations to the initiative, not least due to the assumed higher sustainability qualities of activities addressed through the PCDM (this term will be used in the following for "Programmatic CDM").

The following feedback is reflecting the experience recorded in China since 2006, where a research programme, funded by the Danish Government, was initiated under the National Reform and Development Commission and carried out by a research team consisting of UNEP/Risoe and China Academy of Social Sciences. This project has now been terminated and a follow-up has been initiated by the British Embassy in Beijing to extract the experience from the initial project with a view to improving the framework conditions for PCDM in general, and with the particular purpose to look at ways in which the Chinese experience can help the least developed countries, particularly in Africa, to take advantage of an improved PCDM framework.

The Executive Board's call for PCDM stakeholder input published on the official UNFCCC website is a welcome occasion for the team contracted by the British Embassy to submit formally the problem areas for PCDM as identified in China over the past two years. It is our hope that it can be a platform and a first step in continued dialogue on the modalities for PCDM, so that this may feed into the process of developing a Chinese strategy for supporting future PCDM activities in African LDCs. We therefore invite the Executive Board to further exchanges of views in this respect and assure you of our dedication to make PCDM an efficient and valuable addition to the traditional CDM.

Dr. Pan Jiahua*
Professor
China Academy of Social Sciences
Beijing

Dr. Søren E. Lütken**
Chief Representative
Caspervandertakconsulting
Beijing

*team leader for the Programmatic CDM research project funded by the Danish government
**former programme manager at the Danish Embassy in Beijing for the Programmatic CDM research programme

Specific response to the Executive Board's invitation for public inputs during the period from 6 August to 3 September 2008, 24:00 GMT.

The following can be regarded as a consolidation of experiences recorded in China concerning the implementation and promotion of programmatic CDM during the period from June 1st 2007 to August 31st 2008. The issues raised in the following are all believed to work against the original intentions for the establishment of Programmes of Activities encompassing the promotion of small scale activities beyond the reach of traditional CDM and with significant sustainable development perspectives. Such activities would be assumed in particular to be relevant and supportive in least developed country contexts.

A review and pursuant addressing by the Executive Board of the following points would be helpful for improving the implementation and manageability of PCDM:

Validation

1) For the validation of PCDM projects the experience recorded in China since 2007, after the announcement of the guidelines for the Programmes of Activity, concurs with evaluations published from several sources on the internet. Obviously, the most contentious regulatory requirement for PCDM is the liability issue for the Designated Operational Entities. A DOE that adds a CPA to a PoA is 100% liable for this decision. At any point in time after the inclusion of a CPA in a PoA, it can be challenged by a member of the Executive Board. The Board then decides whether the activity should be excluded ex post. In such a case, the independent entity has to provide Certified Emission Reductions (CERs) to cover all CERs issued so far for the excluded CPA. This is a stronger liability than the one in place for standard CDM projects and is transferring additional risks to the independent entities, given that a challenge by the EB could come many years after the inclusion of a CPA in a PoA. These liabilities are reflected in the price for validation services, which has been quoted at 50,000 € plus. If administrative costs for PCDM turn out four times higher than normal it will be a significant obstacle for smaller programmes, not least because the time lag between the validation and the delivery of significant amounts of PCERs will be longer due to the only gradual inclusion of emission reduction activities. The up-front financing demand, therefore, is higher. Moreover, it seems to be very difficult to find validators willing to even provide a quotation for doing the validation, which is a show-stopper for PCDM altogether.

Methodological issues

2) On methodology application there are other concerns. A PoA has to be revalidated every time its baseline methodology is revised. Given the very high frequency of methodology revisions for conventional CDM projects, this could lead to a significant workload for PoA coordinators, validators and the CDM Executive Board. More problematic in that regard, however, will be the resulting higher level of risk affiliated to ERPAs. Methodology revisions may reduce the amount of CERs supplied through the programme and thus result in a shortage of compliance credits for the buyer. Such risk will be reflected in lower prices on the CERs. So while higher price demands could be justified by higher sustainability qualities of PCDM this will be countered by higher risk levels. Prices so far seen do not compete with traditional good quality CDM projects that still demand prices higher than PCDM.

3) Furthermore, the use of methodologies for PoAs is limited to one single CDM methodology. Such a regulation is stricter than the regulation for individual CDM projects – many registered projects use two methodologies in the same Project Design Document to encompass all elements of emissions reduction. This means that several project categories currently developed under the CDM will not be eligible for PoAs, because they use more than one single CDM methodology. Or, more likely, as the reduction of emissions from Programmes is actually higher than that accounted for (due to the exclusion of the part of reduction not covered by the one single methodology) the investment cost per generated CER will be higher than in normal CDM. This will challenge the viability of some PCDM activities. An example of this, where PCDM has a high degree of relevance, is small-scale biomass-to-energy projects where two methodologies normally are used for traditional CDM, one to cover the avoided methane generation, and one to cover the replacement of power delivered, captive or to the grid. For PCDM projects only one of the two sources can be included, which leaves PCDM at a disadvantage compared to the traditional CDM.

4) PCDM, as it stands, rests upon the employment of existing methodologies. No specific PCDM methodologies are developed and required. However, the application of small scale CDM project methodologies to PCDM leads to many concerns. Small scale projects methodologies are simple, but not very robust and the results can be highly uncertain. Due to the scale of a PCDM project, this uncertainty is amplified. DOEs and PCER buyers in addition to project developers will have to bear high risks resulting from such less robust and highly uncertain small scale project methodologies. The development and application of PCDM specific methodologies are required to eliminate these uncertainties and to promote healthy market development of PCDM projects. Without such specific methodologies, PCDM is affiliated with (much) greater uncertainties than traditional CDM projects.

5) Once a PoA is proposed and submitted, a geographical region is delineated. Then an issue may arise: the coordinator may not have the capacity for development of CPAs while another PoA coordinator may wish to take part of the CPA components for a new PoA. In this case, there will be overlapping of two PoAs. Current regulation excludes such competition among PoA coordinators and the development of PoA and inclusion of CPA may be delayed. If geographical overlapping is not allowed, it will promote monopoly and low efficiency of PoA implementation.

Market concerns

6) Programmatic CDM could potentially bring on board a lot of projects that are "out of the game" in the present setting. The present market recordings show that there could be significant influx of CERs from a number of sources. The most significant interest is related to energy saving equipment for industrial applications and lighting. Such projects have strong industrial stakeholders with advanced technology to reduce electric power consumption in productive installations. Such projects have significant advantages in terms of administrative capacity and technical and technological solidity compared to the weaker administrative structures in remote, rural areas that would be relevant for programmes based on indigenous, small scale, low-tech installations (e.g. in household) with high sustainability qualities. Thus, there may also be a competition among PCDM activities that would generally favour the less development/sustainability promoting and more industrial scale activities. Taking the above cost and risk elements into consideration this will still place the sustainability promoting activities in the lowest end of the scale of attraction for compliance buyers of CERs.

7) PCDM must be viewed in a broader market context. The potential generation of CERs is assumed to be significant. As there seems to be an oversupply of CERs in the market already, also for a future climate regime, it should be considered that additional generation of CERs from PCDM may lead to a downward trend in CER prices. This will be damaging for the CDM as a whole, but given the high transaction costs for PCDM it may be particularly damaging to the PCDM itself. Due to risk considerations following the above PCERs are unlikely to compete with traditional CERs in a low-price regime, and buyers may even avoid the PCERs altogether – or only include them as an exotic showcase in the overall portfolio. The Chinese Designated National Authority has already taken the consequence of this scenario by disallowing PCDM in China despite a significant market demand and interest in establishing such projects, particularly from the industrial sector. If the market factor is not included in the considerations for PCDM, this new instrument may end up becoming its own worst enemy, while at the same time challenging the foundation for traditional CDM projects through significant price decreases.

Beijing, 2nd September 2008
Dr. Pan Jiahua/Dr. Søren E. Lütken