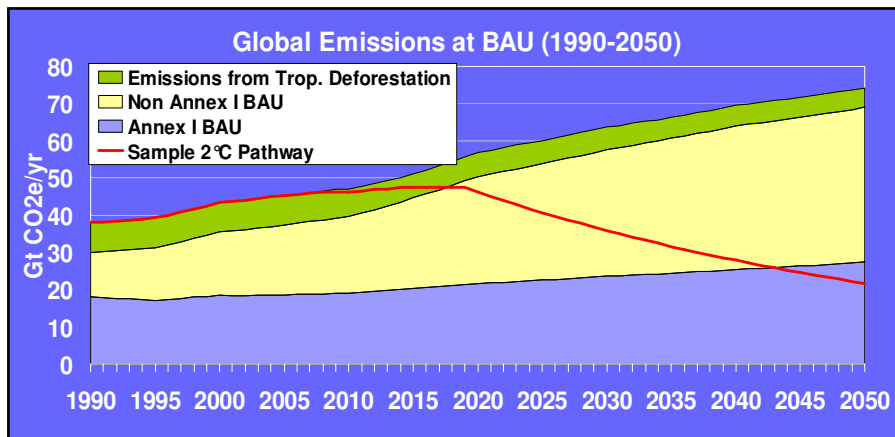




Making CDM Compatible with 2°C COP13/MOP3 Bali, December 3-14, 2007

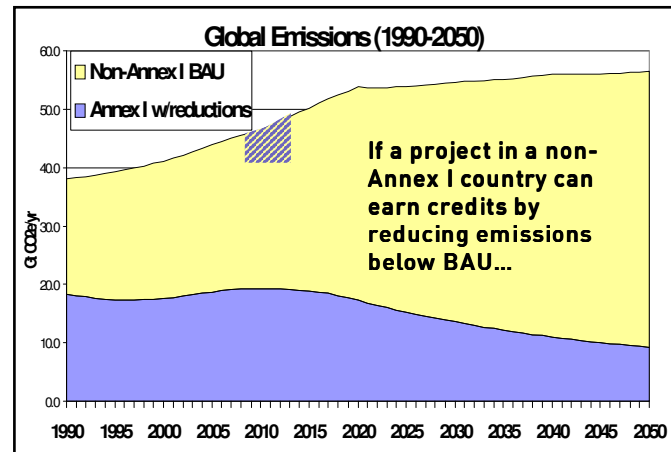
The Challenge: CDM and avoiding 2°C

To avoid 2°C of warming, global emissions must peak by 2020 at the latest and decline significantly by 2050. As a prerequisite, this will require deep reductions from Annex I countries. However, it is evident from the figure below that it will be nearly impossible to limit warming to 2°C if reductions were limited to industrialized countries. To avoid 2°C, modest net reductions from large emitting developing countries will have to start occurring in the not-so-distant future.

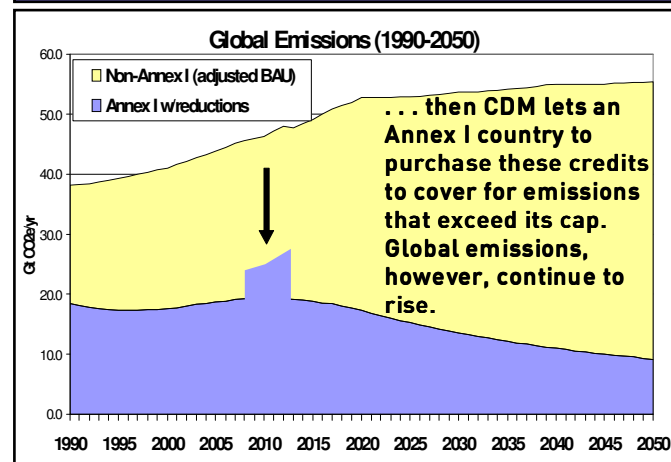


"Even if emissions from developed regions... could be reduced to zero in 2050, the rest of the world would still need to cut emissions by 40% from BAU to stabilise at 550 ppm CO₂e. For 450 ppm CO₂e, this rises to almost 80%" – Stern Review

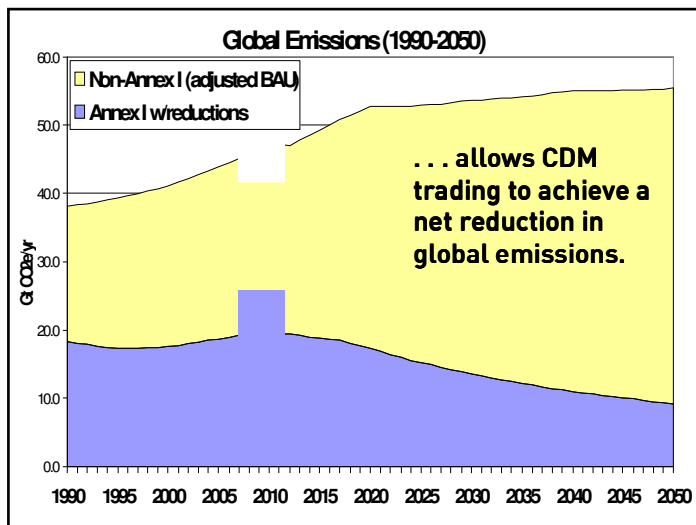
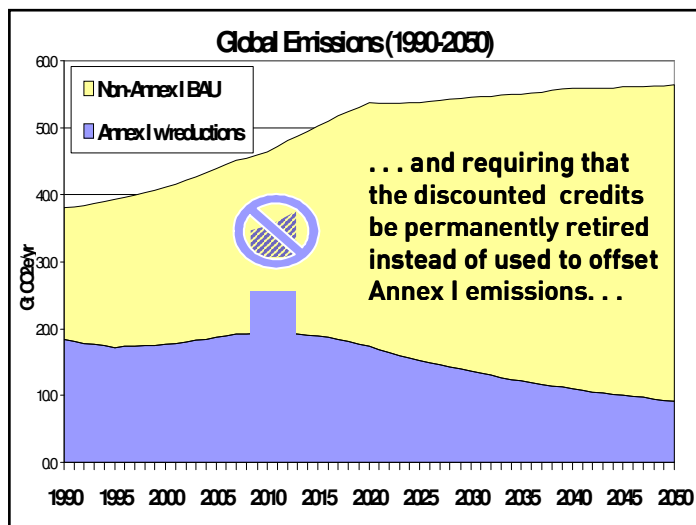
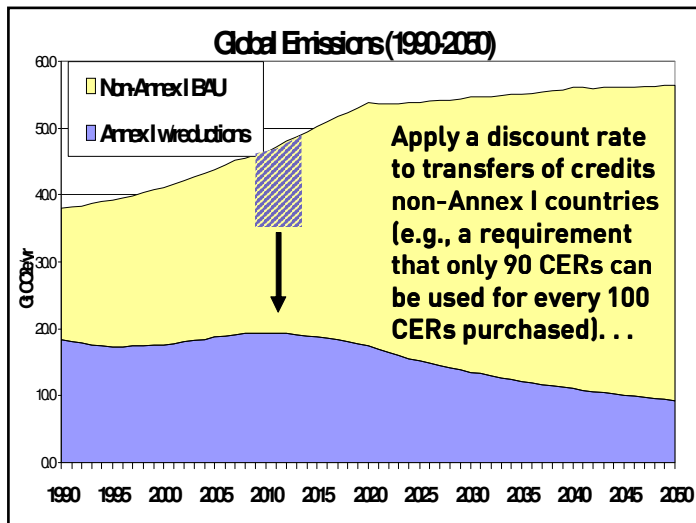
The CDM was designed to give Annex I countries access to low-cost abatement options while helping non-Annex I countries to achieve sustainable development through carbon market financing. While there is much debate about CDM's merits in delivering on those goals, it is also evident that in the post-2012 period the mechanism needs to be reformed so that it moves the world towards an emissions pathway that avoids 2°C of warming.



As the two figures on the right indicate, the CDM, as it is currently designed, shifts reductions from non-Annex I countries to Annex I countries to help the latter cover for emissions that exceed their cap. CDM, however, does not stop total emissions from continuing to rise. This will need to change if we are to achieve a peaking in global emissions in the near future.



A Solution: Discounting the CDM



A post-2012 framework that puts us on track to avoid 2°C of warming must provide a suite of new mechanisms that expands the carbon market and lead the world towards a peaking of global emissions. One part of that puzzle can be CDM discounting. Here's how it would work:

For example, an Annex I country can only use 90 out of every 100 CERs it purchases to meet that country's cap. *The remaining 10 CERs would be retired, representing a net reduction as a result of the transaction.* To discourage further use of the CDM by large emitting developing countries and to direct the mechanism towards poorer developing countries, the discounted percentage could be applied on a sliding scale, with higher discount rates for large emitting developing countries while CERs from poorer developing countries retain their full value.

Discounting can be applied on the supply side as well. The COP/MOP can provide guidance to the CDM Executive Board to withhold a percentage of the CERs from issuance. A large emitting developing country could also take the initiative to retire a portion of its CERs. In theory, *CER discounting would not impact prices if the discounted amount is balanced by a commensurate increase in the amount of CERs allowed to enter a trading system (i.e. EU-ETS).*

Discounting the CDM alone, however, would not avoid 2°C. Instead this proposal should be coupled with a sunset provision on CDM for large emitting developing countries as well as new carbon market incentives that will encourage such nations to more fully participate in the carbon market.