A tropical discussion

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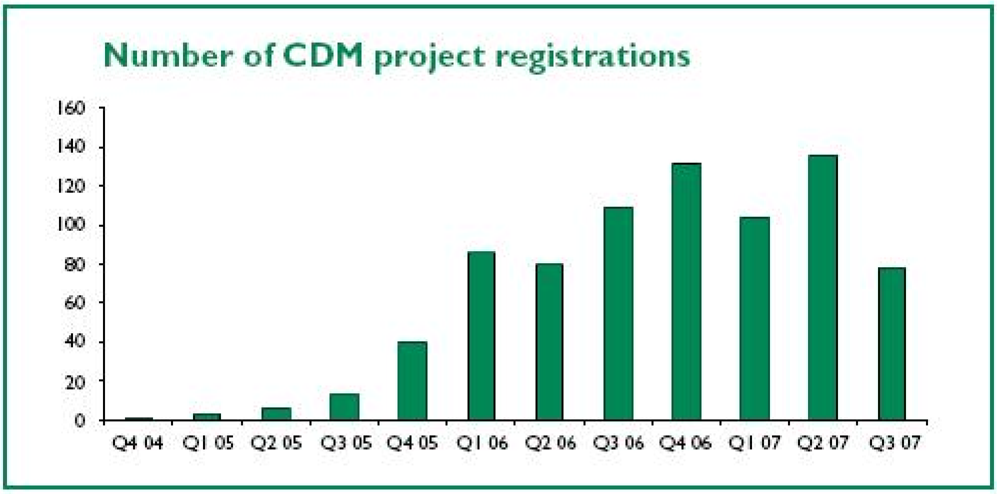
The Bali climate talks will address some long-standing carbon market controversies and discuss measures that could expand the market. Christopher Cundy reports

At the UN climate change conference in Bali this December, most attention will be focused on progress towards agreeing a new international agreement for when the Kyoto Protocol ends in 2012. But, while negotiators are under pressure to come away from the conference with a 'roadmap' for a post-2012 agreement, important discussions and decisions elsewhere are expected to have a nearer-term impact on the carbon market.

Of particular concern, given the recent downgradings of forecasts of likely supply of certified emission reductions (CERs), is the Clean Development Mechanism (CDM) Executive Board's report to the conference. In recent weeks, market participants have highlighted a slowing in the rate of CDM project registrations (see chart below) and a sharp increase in project proposals sent for review, rising from 10% in May to 50% in October.



"This takes up capacity at Designated Operational Entities, it creates insecurity and delays, and this is definitely not a sustainable situation. If we continue along these lines, it will be impossible meet the Kyoto targets," says Martin Enderlin, director of government and regulatory affairs at EcoSecurities, a leading developer of greenhouse gas emission reduction projects, which has been hit hard by the slowdown (see EcoSecurities' woes prompt CER rethink).

"[The conference parties] won't change the existing set up, but they could give a mandate to the board to consider other organisational forms," he says.

A long-running controversy within the CDM has been whether to include HFC23 destruction plants that began operating after 2004. HFC23 is a highly potent GHG created during the manufacture of the refrigerant gas HCFC22. Its destruction yields huge profits, in terms of carbon finance, and some argue these projects provide few sustainability benefits to host countries.

The issue appears on the agenda again at Bali and some are hopeful that a decision may be reached. At the September meeting of the Montreal Protocol, which sets controls on ozone-destroying gases, parties agreed to accelerate the complete phase-out of HCFCs, to 2020 for industrialised countries and 2030 for developing nations. Nonetheless, China is pushing hard for crediting of new projects.

Axel Michaelowa, Zurich-based partner at emissions trading consultancy Perspectives, says he could imagine a trade-off deal within Kyoto to allow new HFC23 plants to be credited. “I would be cautiously optimistic that new capacity could be integrated in some way,” he says, noting that there may be strings attached. For instance, the quantity of carbon credits generated could be restricted to a level that finances little more than the purchase of capital equipment.

Reducing emissions from deforestation (RED) will be one of the key issues discussed at Bali. The loss of forests is estimated to account for up to 25% of global greenhouse gas (GHG) emissions and the issue pertinent to Indonesia, ranked as the world’s third largest emitter of GHGs, mainly due to deforestation, according to a recent UN report.

Many of the side events at the conference will address the subject, and the World Bank is preparing to launch its Forest Carbon Partnership Facility at the conference, a prototype fund that will develop capacity in RED and buy emission reductions (see World Bank approves new carbon funds).

Charlotte Streck, a director at Dutch environmental consultancy Climate Focus, says RED is “one of the few areas where we have a tangible chance of getting something out of Bali”. While RED will likely form part of a post-2012 regime, and is unlikely to be pulled into the CDM, action will begin well before 2012. Streck says there is a strong desire among negotiators to agree a mandate that allows for ‘prompt start’, or piloting, of RED projects and gives reassurance that carbon credits will have a value in future.

The role of the carbon market in addressing RED is still uncertain. “We don’t know yet what these credits will look like, or the baseline, or where demand will come from,” says Anna Lehmann of 3C, a consultancy based near Frankfurt. A sticking point could be Brazil, a major forestry nation, which says RED should not be linked to markets. But Streck at Climate Focus notes that market demand for forestry credits already exists, particularly in the US.

A long-delayed CDM decision that could be resolved at Bali is the eligibility of non-renewable biomass projects. A methodology has been approved by the CDM’s Executive Board, but is awaiting approval by the parties to the Kyoto Protocol. A favourable decision will open the CDM to projects such as those that replace open fires with small wood-burning stoves. This will help expand the CDM to least developed countries, especially in Africa, where many such projects have been generating carbon credits for the voluntary markets.

On carbon capture and storage (CCS), seen by industrialised nations as an essential technology to reduce the emissions from fossil fuelled electricity generation, discussions will continue. Many observers question whether it is realistic to include CCS in the CDM, since the technology is largely unproven and rather expensive – it would need carbon prices upwards of €50 ($74) a tonne to provide an adequate incentive, and these levels are unlikely to be reached in the first Kyoto period.

Nonetheless, there is an urgent need to begin piloting this technology, as the plants will take several years to get in the ground and fossil fuels will continue to provide much of the world's energy for years to come. "I could imagine trying to get a separate fund going, or trying to find another avenue for financing," says EcoSecurities' Enderlin.