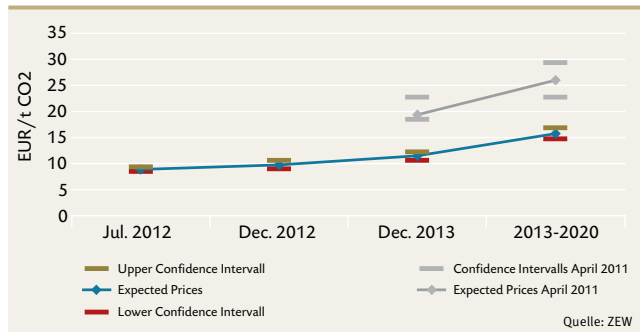


## The Clean Development Mechanism revisited

### Subdued EUA Price Expectations

After the steep drop in prices of the EU Emission Allowances (EUAs) last year, the current price expectations are subdued. Experts forecast that until July 2012 the price for EUAs will be below EUR 10 in a range of EUR 8.50 to 9.40 on average. In the medium term, a slight recovery is expected at best: Price expectations range on average from EUR 9.00 to 10.70 by the end of 2012 and from EUR 10.70 to 12.30 by the end of 2013. For the third trading period, experts predict an average price level of EUR 14.80 to 16.90. Current price expectations are clearly lower than those of spring 2011. The majority of respondents state that the reason for this is mainly the negative economic outlook for Europe.

#### Expected EUA Prices



### EUA-sCER Spread: Expectations Decline

Just like the EUA price expectations, the expectations for the prospective spread between EUA and secondary Certified Emission Reductions (sCERs) have dropped considerably compared to the expectations in the first half of 2011. The surveyed emission trading experts expect that until the end of July 2012 the level of the spread will range on average from EUR 2.70 to 3.50. Currently, the spread amounts to about EUR 3.00. By the end of 2012, a spread of EUR 3.00 to 4.40 is expected on average. A further increase of the spread is expected for the third trading period, ranging from EUR 3.70 to 5.30 on average, whereas for 2013, a stagnation of the spread is estimated.

#### Expected EUA-sCER Spread



### Regions and Types of CDM and JI Projects

During the climate summit in Durban, the conference parties settled on the development of a global climate agreement until 2015 that shall entry into force in 2020. A second commitment period of the Kyoto Protocol for the time after 2013 is indeed likely, but the final decision on the topic will be made during the next conference of parties. Compared with the current commitment period, some bold changes are expected: Japan, Canada and Russia, three major potential demanders for emission credits, have already rejected any further participation. This is also reflected in the subdued expectations of the experts concerning the medium-term development of demand for CERs. On the supply side, the majority of survey participants expects an increase of new CDM projects in the planning stage from 2013 onwards. From an investor's point of view, least developed countries are considered as most promising CDM regions. This is often explained by the assured use of

the credits for compliance in the EU ETS. While the experts see by far the greatest potential for new projects in Africa, a mainly declining development for new CDM projects in China and India is expected. For the rest of the Asian states a positive trend in the project activities is expected. For Latin America, the experts assume that the development will stay constant, except for Brazil, where a decline of the project activities is expected compared to the status quo. Regarding the JI activities, the experts expect a decline in all eligible regions. The strongest growth is seen in new projects particularly in the field of renewable energies (photovoltaic conversion, solar thermal energy, wind power and biomass). Increasing demand is also expected in projects on measures to improving efficiency on the demand side as well as in the fields of transport and afforestation or reforestation. However, stagnation in the fields of fuel switching and water power is expected.

## Special Topic: Evaluating the Clean Development Mechanism – A Critical Survey

The Clean Development Mechanism (CDM), a key component of the Kyoto Protocol, plays an important role in reducing emissions in developing countries and emerging economies. Aside from the objective to avoid greenhouse gases at least costs, a technology transfer that promotes sustainable and ecological development in the host countries is intended. Within the framework of the CO<sub>2</sub> Barometer, the emission trading experts surveyed gave their estimates on the strengths and weaknesses of the CDM. 65% of the experts state that the objective of cost-efficient greenhouse gas abatement is achieved, while 17% consider the CDM as a failure in this respect. Furthermore, around two thirds of the experts think that the CDM contributed decisively to raise awareness in developing countries regarding climate change. 56% of the experts rate the promotion of a sustainable development by CDM induced financial flows as successful, whereas 19% rate the mechanism as unsuccessful in this regard.

A less clear picture emerges from the estimation concerning the ecological effectiveness of the instrument: Although, 46% of the questioned see the CDM here successful as well 31% of the experts are undecided, and 23% consider the objective was not achieved. The responses show a similar pattern regarding the question whether the CDM contributes to a sustainable development by transferring low car-

bon technologies. 48% of the experts agree to this statement, whereas 31% are undecided, and 23% of the respondents think the aim was not achieved. The current method of determining emission baselines is often criticized in literature and by the media as it leads to adverse incentives and therefore lowers potentials of national environmental policy. Around 60% of the respondents share this opinion and see it as a major problem in the administrative structure of the CDM. The emissions trading experts state that a major conceptual problem is that additionality of emissions reductions is not sufficiently guaranteed. 61% think there is a greater need for action, 18% are undecided, and 21% of the respondents do not consider lacking additionality as a problem. With regard to the hypothesis that the current design of the CDM favors the concentration of projects in transition countries such as China, a less clear picture emerges. Although, 45% of the experts share this opinion, 24% are undecided, and around 31% think the opposite. Only about one third of the respondents (34%) think that aspects of fairness and distribution are neglected in the current CDM, 40% do not see such problems, however. The possible neglect of ecological and social sustainability of CDM induced projects is not seen as a problem. Especially large scale projects that interfere with the local ecosystem and communities are often criticized for not ensuring

sustainability. Furthermore, spatial restrictions of the financial and the technological transformation effect are not ranked as a serious problem.

In addition to the evaluation of the general design of the CDM, the respondents were asked to provide an assessment of the efficiency of the administration of the CDM. The results show that particularly the duration of the administrative process is perceived most critically: Almost 90% rate this as a serious problem. 61% of the emission trading experts surveyed criticize the transparency of the administrative processes.

The estimates regarding the process costs are also quite clear: 71% of the respondents see the transaction costs that arise within the framework of a CDM project as a serious problem. The results of the evaluation of the Designated Operational Entities (DOEs) and the Designated National Authorities (DNAs) are less clear. About 50% consider the lack of objectivity of the DOEs as problematic, whereas almost 27% are of the opposite opinion, and around 23% of the experts adopt none of both positions. The DNAs are accused of lacking objectivity by about 40% of the respondents, while 30% are undecided or see it as uncritical, respectively. Furthermore, the majority of experts (73%) thinks that the time period between the development of the initial concept for a CDM project and the phase of the CER generation is too long.

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### About the KfW/ZEW CO<sub>2</sub> Barometer

The KfW/ZEW CO<sub>2</sub> Barometer is a cooperative project of the KfW Bankengruppe and the Centre for European Economic Research (ZEW). With the KfW/ZEW CO<sub>2</sub> Barometer, carbon market experts are surveyed biannually on the development of price expectations and on issues which will determine the shape of the future carbon market.

The publications of the KfW/ZEW CO<sub>2</sub> Panel are available on: [www.zew.eu/co2panel](http://www.zew.eu/co2panel)

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