

CDM in China: Taking a Proactive and Sustainable Approach

On 1-2 July 2004, the Chinese Government (in cooperation with the World Bank and the governments of Germany and Switzerland) hosted an international conference in Beijing on CDM implementation in China.¹ The event marked the conclusion of the China CDM Study and provided an opportunity for 250 Chinese and international experts to discuss the main results and recommendations of the China CDM Study² and the challenges faced by China to implement a proactive CDM strategy.

Proactive CDM policy

Chinese authorities and other participants expressed their firm belief that the CDM would play an important role in future global efforts to mitigate climate change. China and other developing countries thus intend to seek to integrate the CDM into future agreements beyond 2012 and to promote and expand carbon markets. Policy remarks by the Chairman and Members of the China National Climate Change Coordination Committee, as well as a panel dedicated to a discussion of 'Challenges and Opportunities for China CDM' demonstrated that China regards the CDM as an important instrument to enable developing countries to fulfill their 'common, but differentiated responsibility' under the UNFCCC to reduce their GHG emissions, while at the same time addressing local sustainable development challenges.

To realize the promise of the CDM, however, carbon markets must expand significantly, which is only possible if the USA, Australia and other countries eventually participate. Without the Kyoto Protocol in force, the value of CERs is largely dependent on demand from companies participating in the EU ETS, which is therefore crucial to carbon market development.

The conviction that the CDM is a 'win-win' proposition and that carbon markets will expand in the future, coupled with the planned implementation of the EU ETS on 1 January 2005, provided sufficient foundation for the Government of China to adopt a proactive policy towards the CDM, consistent with recommendations in the China CDM Study.

Wholly Chinese

Statements made by officials confirmed that the Chinese Government has fully embraced a 'proactive and sustainable' approach to the CDM and that the

Conference marked a turning point from study to implementation. The CDM interim management measures (see below) that went into effect on 1 July of this year represent a crucial first step.

Sun Cuihua (Division Director, National Coordination Committee on Climate Change, NDRC) provided an overview of the "Interim Measures for the Management of CDM Project Activities" in China, including general rules, admission requirements, institutional arrangements, project approval procedures, and several other miscellaneous items. Two provisions raised particular concerns among foreign participants and potential investors and intermediaries, namely:

- the requirement that the project developer shall be a wholly Chinese or Chinese-holding enterprise, and
- the plan to regulate the sharing of benefits between the project developer and the Chinese Government (with the benefits to be owned solely by the project developer prior to the determination).

The Chinese authorities believe that greater consideration of these important issues is needed and that final decisions should be based on practical experience.

Additionality paradox

Conference participants benefited from a lively panel discussion dedicated to "Industrial Sector Views on Barriers to and Incentives for CDM", as well as the active participation of many representatives of private enterprises throughout the Conference. Participants highlighted a lack of market demand (which is linked to continuing international and Annex I domestic regulatory uncertainty and a lack of political will for some major players to participate) – as well as complex/uncertain rules, high transaction costs (in particular, with respect to small-scale projects) and a lack of up-front funds for project

development – as serious barriers to active engagement of the private sector in the CDM.

Many Chinese players, as well as the China CDM Study, pointed out that current global 'market prices' (< US\$ 5/tCO₂-eq.) are simply too low to cover the full incremental costs of implementing many types of CDM projects and that the CDM therefore can only facilitate additional climate mitigation in combination with other incentives. Despite the significant mitigation cost savings that the CDM can represent for some investors, it is unlikely that the CER demand side will be willing to share these savings with host countries, given the availability of EU emission allowances at € 7-8/tCO₂-eq.

Enterprises in China also mentioned the 'paradox of additionality' (i.e., the fact that at low CER prices, projects that are clearly additional are not viable, as the CDM does little to raise IRR to levels required for host government and financial institution approval) and the need to clarify how CDM approval procedures can be integrated into existing domestic approval processes.

Spotlight on the power sector

Despite the critical importance of the power sector for China's future development and its dominant impact on Chinese GHG emissions (approximately 40%), the sector was prominent in its absence, which reflects their reservations about the CDM due to a range of factors. Increasing power shortages, which threaten China's economic development, for example, have led to a frantic pace of power plant construction. As a result, the CDM has not been considered a priority by the power sector, but Conference participants noted the strategic significance of this sector and the need to give immediate consideration to means of leveraging the CDM to contribute to a more sustainable energy supply. Engaging the power sector is also a prerequisite for developing standardized, regional baselines, which would help lower transaction costs. It was generally agreed that both aspects require government leadership.

For further information, please contact:

*LU Xuedu
Ministry of Science & Technology
luxd@mail.most.gov.cn*

*Jostein Nygard
The World Bank
jnygard@worldbank.org*

1 Key elements and documents of the conference are available from lnweb18.worldbank.org/eap/eap.nsf (both in Chinese and in English).

2 The second, revised edition (including the full workshop report) is available from: www.worldbank.org.cn/English/Publications/publications.asp. A Chinese edition is under preparation.