

Treatment of national and/or sectoral policies and regulations

Discussion Paper

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At its 16th meeting, the CDM EB adopted the following clarification for the treatment of policies and regulations:

EB 16 Report, Annex 3:

Clarifications on the treatment of national and/or sectoral policies and regulations (paragraph 45 (e) of the CDM Modalities and Procedures) in determining a baseline scenario

1. The Executive Board agreed to differentiate ways to address the following four (4) types of national and/or sectoral policies¹ in determining a baseline scenario:
 - (a) Type E+: Existing national and/or sectoral policies or regulations that create policy driven market distortions which give comparative advantages to more emissions-intensive technologies or fuels over less emissions-intensive technologies or fuels.
 - (b) Type E-: National and/or sectoral policies or regulations that give positive comparative advantages to less emissions-intensive technologies over more emissions-intensive technologies (e.g. public subsidies to promote the diffusion of renewable energy or to finance energy efficiency programs).
 - (c) Type L-: Sectoral mandatory regulations adopted by a local or national public authority motivated by the reduction of negative local environmental externalities and/or energy conservation and which would incidentally also reduce GHG emissions.
 - (d) Type L+: Sectoral mandatory regulations adopted by a local or national public authority motivated by the reduction of negative local environmental externalities and which incidentally prevent the adoption/diffusion of less GHG emitting technology.
2. Only “Type E+” national and/or sectoral policies or regulations that have been implemented before adoption of the Kyoto Protocol by the COP (decision 1/CP.3, 11 December 1997) shall be taken into account when developing a baseline scenario. If “Type E+” national and/or sectoral policies were implemented since the adoption of the Kyoto Protocol, the baseline scenario should refer to a hypothetical situation without the national and/or sectoral policies or regulations being in place.
3. “Type E-” national and/or sectoral policies or regulations that have been implemented since the adoption by the COP of the CDM M&P (decision 17/CP.7, 11 November 2001) may not be taken into account in developing a baseline scenario (i.e. the baseline scenario should refer to a hypothetical situation without the national and/or sectoral policies or regulations being in place).

(Note: The Executive Board noted that the Meth Panel is to continue to consider possible additional recommendations regarding national and/or sectoral policies or regulations of types L- and L+.)

¹ In this document the following terms are defined as: - Policies and regulations: are decided and published by local and/or national authorities of the host Party(ies). - Policy driven market distortions: are those that result from decisions taken by local or national public authorities of the host Party(ies).

The treatment of policies and measures is a decisive element in the overall CDM framework and even has the capacity to influence policymakers' behavior in host countries. We see the above clarification and ruling as a valuable first step towards sound policy guidance on the topic for which the CDM Executive Board has to be congratulated.

The critical issue is that the CDM should not discourage policymakers from adopting progressive policies and regulations leading to a reduction of GHG emissions in their own countries. This may be the case if the adoption of progressive regulations diminishes the host country's opportunity to benefit from the CDM on the grounds that all mandatory GHG reducing activities would happen anyway and could not be considered additional. Logically, it is indeed difficult to argue that activities mandated by law would be additional, as this would be defying the very nature of legislations. The more important consideration however seems to be the overall effect on the adoption of policies and measures in developing countries. As carbon prices rise and policymakers and project developers become more aware of the CDM opportunities, the CDM is likely to become a factor in the decision making process. With the way national policies and regulations are treated under the CDM, the CDM EB clearly has a choice between encouraging and discouraging host country lawmakers to adopt legislations and policies geared towards reducing GHG. Declaring projects required by law ineligible under the CDM results in a perverse incentive not to adopt tighter legislation. If, on the other hand, these activities can still result in certified emission reductions, the CDM can in fact sweeten the adoption of GHG controlling legislation. In view of the ultimate goal of the UNFCCC to combat climate change we believe that consideration of the long-term effect on domestic policies should be the overriding determinant.

In this context, the recent guidance passed by the CDM EB goes in the right direction and we would welcome further clarifications along the same lines. In particular, we like to encourage the CDM EB to consider the following aspects:

1. Treatment of "L+" and "L-" similar to "E+" and "E-"

The CDM EB makes the distinction in *regulations* which directly regulate environmental externalities and thereby affect the level of GHG (L+ and L-) and in *policies* which distort the market and give a competitive advantage to either GHG intensive or less GHG emitting activities (E+ and E-). Only for the latter, a decision has been taken. According to the EB's guidance, the baseline should be construed in a way that ignores higher emission levels which are due to distorting policies (E+) if these were implemented after adoption of the Kyoto Protocol. This makes sense as it prevents rewarding CDM host countries with "bad" policies with higher CDM credits than what project developers in these countries would have earned had these policies not been adopted. The CDM EB

also ruled that host countries that implemented “good” policies (E-) after adoption of the Marrakech Accords should in turn not be penalized with less CDM credits. Therefore, a hypothetical situation with non-existing policies and higher emission levels can be assumed when constructing the baseline.

We believe the CDM EB is showing good judgment in adopting the above guidance. What is as yet unclear is the treatment of L+ and L- regulations. When devising the guidance on regulations, we hope the CDM EB will stick to the same principle: not to reward “bad” regulations and to promote the adoption of “good” regulations. In concrete terms, we would suggest the following additional guidance:

4. “Type L-” sectoral mandatory regulations adopted by a local or national public authority that have been implemented since the adoption by the COP of the CDM M&P (decision 17/CP.7, 11 November 2001) may not be taken into account in developing a baseline scenario (i.e. the baseline scenario should refer to a hypothetical situation without the sectoral mandatory regulations being in place).

2. National Policies and Additionality

It is ambiguous from the guidance provided so far whether the permission to ignore policies adopted after Marrakech in the case of E- policies refers only to the way emission levels are being calculated or whether it includes the additionality test as well. We suggest the latter. For the same reason it makes sense to define baseline emissions under the assumption that the policy had not been passed, it makes sense to test for additionality under these conditions (e.g. consider the financial viability of the proposed CDM project if the subsidy for less emission intensive technologies was not paid). In both cases, host countries with good policies should not be penalized. We also suggest a similar interpretation for L- regulations.

3. Consistency with former guidance

It is clear that the general guidance already adopted on the treatment of national policies and regulations or potentially forthcoming guidance will not always be consistent with previous decisions, in particular methodological guidance already provided. Examples include the additionality tool according to which projects are non-additional if they are required by law, not taking into consideration when the legislation was passed. Furthermore, the consolidated LFG methodology requires to monitor forthcoming legislation and to adjust the baseline accordingly. If ever inconsistencies occur, we suggest the CDM EB will give preference to the general guidance.