

EOSG

Note to Mr. Nambiar

Note to the Secretary-General re: Wall Street Journal Article

Attached please find a note to the Secretary-General on the article about which the SG inquired this morning.

RO

Robert Orr
11 July 2008

| <u>DCDC</u> | <u>CDC</u> | <u>SG</u> |
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| Recommended Action: | For SG's approval <input type="checkbox"/> | Approved <input type="checkbox"/> |
| SG's attention | For SG's attention <input checked="" type="checkbox"/> | Noted <input type="checkbox"/> |
| Date: 14/07/08 | For SG's information <input type="checkbox"/> | Seen <input type="checkbox"/> |
| Comment (if applicable): | For SG's signature <input type="checkbox"/> | Signed <input type="checkbox"/> |
| 7h | Date: 14.07.08 | Date: _____ |
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Note to the Secretary-General

(Through Mr. Orr) 

Wall Street Journal article, entitled "UN Warming Program Draws Fire".

This note is to respond to your request of this morning, following your reading of the article in the Wall Street Journal, entitled "UN Warming Program Draws Fire".

Below you will find a few key responses to that article. However, in preparing this note, I realized that it needs to be **complemented by a thorough briefing on the Clean Development Mechanism (CDM) as a whole**. We will prepare such a briefing for you after your return.

This article is one of many critical articles that recently appeared in the press about the CDM – **especially in the USA**. Many of these can be traced back to a single source of analysis in California. This is happening after a year of very positive messages about the CDM world wide. Sustainable Development impact and "additionality" are the typical content/focus of the articles. They play recently an important role in US politics for a number of reasons, including:

- The discussion of use of offsets (i.e., CDM, one of the flexible mechanisms of the Kyoto Protocol) versus national action,
- competition over different offset schemes;

The article has a **number of factual errors about what the CDM is, and what it is not**.

CDM is not a subsidy scheme. The use of the **word subsidy is misleading**. It is a market **where people pay for offsets**.

The CDM is **not a scheme where public funds are distributed**. It is a market that is regulated by a scheme which is placed under the UN by governments. It regulates a market by **defining methods to determine, monitor, calculate and verify emission reduction offsets**, based on ideas generated by the market actors, reviewed by public (peers, competitors, governments can comment), hired experts in the respective field, and a group of experts before it is approved by the Executive Board of the CDM, which operates under the guidance of all Governments, Party to the Kyoto Protocol.

Without doubt there are many other market-based mechanisms that may work in the future, for now, the **CDM is the best available for the following reasons**:

1. It is an **innovative mechanism**, never done before, part of a global response developed under UN auspices with strong involvement from the private sector;
2. The mechanism is **still very young** and under close scrutiny by users, public and the governments that a part of the Kyoto Protocol;
3. It is a **thorough and participatory mechanism** that has established a standard;
4. It is **transparent and receptive to be able to learn and improve** (both through input processes to the regulating body – the CDM Executive Board - and through the Conference of the Parties - CMP) .
5. Once an activity meets the current standard it is additional and can produce the offset for a limited time – the granting of **additionality is not unlimited**. New knowledge or circumstances can have the activity disqualify.

It is not at all surprising that: "A United Nations program designed to combat global warming has started doing something no one expected: It is subsidizing fossil-fuel power plants that spew millions of tons of greenhouse gases into the atmosphere annually."

The CDM is designed to identify and use any opportunity to reduce emissions. Only nuclear is excluded and for forests, CDM activities are limited presently to afforestation and deforestation. It is not a renewable energy subsidy programme, nor is it a scheme that directs investment in sustainable development projects. On the other hand it is also not designed to prevent such investment and should lead to assisting developing countries in achieving sustainable development and thus the ultimate objective of the convention.

The CDM provides for the possibility that activities qualify which continue to emit greenhouse gases – such as a coal or gas-based power plant. However, less GHGs are emitted than those that would have been in the absence of the CDM project. The operation of the CDM activity reflects a choice to implement a measure or a different type of technology to produce the same output. This choice and the resulting emission offsets are third party verified to follow an approved method, which has been approved in accordance with the highest available process standard.

However it is important to note and acknowledge that CDM is an infant/toddler and that the global community is constantly reviewing the exact methods available to both make them less complex /costly and/or make them reflect the additionality of the implemented activity better.



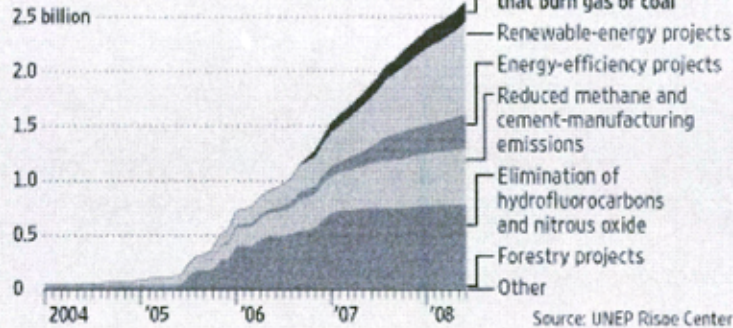
Janos Pasztor
July 11, 2008

cc. Mr. Vijay Nambiar
Mr. Kim Won-soo

Generating 'Carbon Credits'

Credits derived from fossil-fuel-burning plants are rising rapidly. Total carbon credits from developing-world projects if the United Nations approves all that have applied:

Number of credits available through 2012



U.N. Warming Program Draws Fire

Fund Designed to Spur Renewable Energy Subsidizes Gas Plants

By JEFFREY BALL

July 11, 2008

A United Nations program designed to combat global warming has started doing something no one expected: It is subsidizing fossil-fuel power plants that spew millions of tons of greenhouse gases into the atmosphere annually.

In the past year or so, 13 big plants in India and China that burn natural gas have won the U.N.'s blessing as aids in the fight against climate change. As a result, owners of the plants earn millions of dollars a year from a U.N. program intended to spur construction of solar panels, wind turbines and other renewable-energy projects.

This unforeseen turn is fanning new doubts about the environmental efficacy of the U.N.'s "carbon trading" program — the most ambitious effort yet to curb emissions of carbon dioxide and other greenhouse gases where they're rising the fastest, in the developing world.

Concern about the program is spreading to the U.S. Doubts about the validity of some pollution-cutting projects in the developing world were one factor in the Senate's rejection last month of a bill that would have capped U.S. greenhouse-gas emissions.

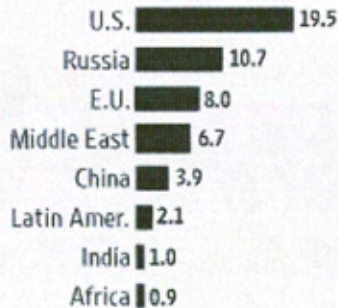
The U.N. is now venturing further onto controversial turf. In recent months it has opened the door to subsidizing new coal-burning plants. Advocates argue that modern, cleaner-burning fossil-fuel technology is expensive, and without help paying for it, owners would build old-style plants that pollute more.

U.N. officials strongly defend their approach. For more than a year, they have been taking a harder line in judging proposed emission-cutting projects of all stripes, they

Emissions Face-Off

Developing countries generally emit less greenhouse gas per person than the U.S. and Europe—one reason they argue for burning more coal and gas.

Metric tons of energy-related CO₂ emissions per capita, 2005



Source: International Energy Agency

point out. And since the world is widely expected to continue to get most of its energy from fossil fuels for decades, U.N. officials say it's entirely appropriate for the program to subsidize plants that burn that fuel more cleanly.

"Some of the countries in this world are endowed with fossil fuels," says Rajesh K. Sethi, an Indian government official who is chairman of the U.N. board that polices the subsidy program. "It is in the world's best interest that they use it as efficiently as possible."

Critics say the U.N. program is straying from its purpose of promoting renewable-energy projects. "Coal is, like, climate enemy No. 1," says Michael Wara, a Stanford University lecturer who has published several papers criticizing the U.N. program. For every unit of power it produces, burning coal

generates more greenhouse gas than burning natural gas.

Mr. Wara argues that India and China are already building more-efficient plants anyway, since doing so makes economic sense at a time of rising energy prices. Using the U.N. program to subsidize these plants wastes money that could be used for other clean-energy projects.

Despite growing talk of shifting away from fossil-fuel use, none of the world's big countries want to have to pay for that to happen. That strain was on display this week, as diplomats met in Japan to try to cobble together a more-forceful international agreement to curb emissions of greenhouse gases.

On Tuesday, leaders of the Group of Eight industrialized nations set a goal of cutting emissions 50% by 2050, but made it nonbinding and didn't detail how they would meet it. On Wednesday, representatives of developing countries such as India and China declined to endorse even that loose target, saying it would hit their economies too hard.

Among the coal plants seeking subsidies under the U.N. program is a \$4 billion behemoth currently under construction in the western Indian state of Gujarat. When it is finished in 2012, it will be one of the biggest coal-fired plants in the world.

The developer, Indian electricity producer Tata Power Co., is seeking about \$36 million a year in subsidies, arguing that the alternative would have been to build a cheaper, less-efficient power plant.

The U.N. hasn't yet officially considered Tata Power's application, but the proposal has powerful backers. Among them: The World Bank Group's International Finance Corp. and the Asian Development Bank, each of which has loaned Tata Power \$450 million to fund the plant.

“Let’s be honest with ourselves,” says Darius Lilaoonwala, senior manager of the International Finance Corp.’s power department. “These countries are going to need fossil-fueled electricity just like the U.S. and Europe. So let’s encourage them to do the most-efficient technology possible.”

“Of course, if you build a coal factory, it’s not good for the environment,” adds Tsukasa Maekawa of the Asian Development Bank. But countries that have a lot of coal are going to burn it, he says, so helping them finance more-efficient plants makes sense.

Fundamental Principle

One of the fundamental principles of the U.N. initiative, **called the Clean Development Mechanism, is that it should subsidize pollution-cutting projects only if they would otherwise be too expensive to build.** The Tata Power plant, however, will be built whether or not it gets the U.N. program’s financial aid. The power plant “has to go on. We’ve already started the project,” says Prasad Menon, Tata Power’s managing director.

In addition, the Indian government essentially required the plant to use high-efficiency technology. Mr. Menon argues the project should still receive the U.N. subsidies because “it’s a good move for the West to encourage India to move in this direction.”

This tension has dogged the international global-warming campaign since its inception. Under a 1997 treaty, the Kyoto Protocol, most industrialized countries other than the U.S. agreed to cap their greenhouse-gas emissions. They then required heavily polluting companies within their borders to cut their emissions over time.

Developing countries didn’t accept emission caps, arguing that stunting their economic growth to cope with a century’s worth of pollution from the developed world would be unfair. As a compromise, the treaty created the Clean Development Mechanism, which aims to chip away at developing-world emissions one project at a time.

Under the U.N. program, companies in wealthy nations can meet their environmental obligations at home by financing pollution-cutting projects in the developing world. Companies in the developing world get cash, while the companies in the West get “carbon credits” — permission slips to continue coughing out their own carbon dioxide and other greenhouse gases. The system is designed to curb world-wide emissions at the lowest possible cost.

But the system works only if the developing-world projects actually cut emissions. If projects such as coal- and gas-fired plants India and China would have been built even without financial aid, then the U.N. program isn’t actually cutting emissions.

The U.N. has the job of assessing the environmental validity of developing-world projects that seek subsidies. But **gauging whether a proposal actually cuts emissions is tricky.** The U.N. board must make **two judgment calls: whether the project would reduce**

the country's emissions below what they otherwise would be, and whether the project would have been built even without the U.N. subsidy.

It's a "hypothetical thing," says José Domingos Gonzalez Miguez, a Brazilian government official on the U.N. board. "This is the problem."

Every month or two, the board's 20 members fly to Bonn, Germany. There, in a U.N. high-rise, they meet for several days, poring over proposed projects. The meetings are posted on the Internet and watched by investors with big money riding on the decisions.

The U.N. program was created to encourage renewable-energy projects. But in May 2006 the board approved the concept of letting gas-fired power plants sell carbon credits. A stream of gas-fired plants began applying.

Three of the biggest plants sit near each other in the east China province of Zhejiang, near Shanghai. Construction on all three had begun before the U.N. board's decision.

The owners of the three plants argued in their U.N. applications that the cheapest way for them to generate electricity would have been to build coal-burning plants. But because they had built more-efficient gas-fired plants, they argued, they deserved permission to sell a carbon credit for every extra ton of carbon dioxide that, according to their calculations, their plants would have emitted had they been built to burn coal.

Together, the three plants were seeking permission to sell 2.7 million carbon credits each year. A credit represents permission to emit one ton of carbon dioxide a year. Given that such credits from developing countries are now selling for about \$13 apiece, U.N. approval would translate into about \$35.1 million a year for the owners of the three plants combined.

The value of carbon credits from projects in the developing world was \$7.4 billion last year, up 28% from 2006, according to the World Bank. Based on projects that have applied so far to sell carbon credits through 2012, when the Kyoto treaty's emission caps expire, fossil-fueled power plants account for only about 7% of the market, according to U.N. figures. But their share has been growing rapidly.

The architects of the U.N. program hoped it would spark a renewable-energy revolution, inducing a shift away from fossil fuels and toward everything from the sun to the wind to animal waste. In fact, renewable energy accounts for only about one-third of the carbon credits proposed to be issued through 2012, according to U.N. figures.

The owners of the three Chinese gas-fired plants worked with a broker that specializes in organizing carbon-credit projects. That firm, in turn, had hired a Norwegian auditing company, Det Norske Veritas, to certify that the plants' in-house emissions calculations were accurate. (The U.N. board authorizes auditors to do this kind of work on its behalf.)

In early 2007, Det Norske Veritas recommended all three projects to the U.N. board.

Today, Michael Lehmann, technical director for climate-change services at Det Norske Veritas, says he still believes the three Chinese power plants audited by his firm properly qualified for subsidies under the existing rules. But dozens of gas-fired plants in China are now rushing to snag carbon-credit revenue. That suggests the system “doesn’t seem to be right any longer,” he says — it’s unrealistic to think that none of them would be financially viable without the subsidies, particularly since so many are already built and running.

Mr. Sethi, the U.N. board chairman, says each of the plants the board has approved complies with the rules as they exist. “Each project is seen on its own merits,” he says, declining to say whether he thinks the higher-level diplomats who made that policy should change it. “We are simply the implementing tool,” he says of the board he heads.

Officials of the companies that own the three Chinese gas-fired plants defend their applications, saying they comply with the program’s rules. “Gas is within [the] terms,” says Li Jian, who works in the production technology department of one of the power companies, Zhejiang Guohua Yuyao Fuel Gas Power Generation Co. “So we got approved.”

The three plants’ applications were still pending before the U.N. board when, in early 2007, two coal-fired plants applied for permission to sell carbon credits. That prompted several months of testy debate among members of the U.N. board, who were conscious of how politically controversial the idea was.

Board members from developing countries that don’t burn a lot of coal argued against approving the coal-fired plants. Mr. Miguez, the board member from Brazil, said it violated the U.N. program’s intent.

“This would create loopholes,” he said. “We are here as the board of the Clean Development Mechanism. And I think we should stress the word ‘clean.’”

But members from countries that stood to gain from the proposal supported it. They included members from Canada and Japan — both industrialized countries that accepted emission caps under the Kyoto treaty, and which therefore were hunting for cheap carbon credits to buy. Also supporting the applications from the coal plants were board members from India and China, two developing countries for whom domestic coal is a cheap energy source.

The proposal would “be of very great use in countries like India and China,” Mr. Sethi, the board member from India, told his colleagues during one of the meetings that was broadcast online.

Board Approval

The board approved the coal proposal in September 2007, after adding provisions phasing out the rule over time and reducing the number of carbon credits any coal-fired plant could sell.

A few months later, the board approved the three Chinese gas-fired power plants' applications to sell carbon credits. And Tata Power formally asked the board to approve the sale of carbon credits from the massive coal-fired plant the company was developing in Gujarat.

Tata says the plant will emit an average of 26.7 million tons of carbon dioxide annually during its first decade of operation. That's 2.8 million fewer tons than the plant would discharge if it used the less-efficient coal-fired technology prevalent in India today, it says. So Tata is asking the U.N. to let it sell 2.8 million carbon credits annually. That would be worth about \$36 million at current market prices.

The Tata plant has its roots in an electrification push by the Indian government. The government had rolled out plans in early 2006 for about a half-dozen huge coal-fired power plants. Dubbed by the government the "ultra mega" plants, they would each be able to produce a sizable 4,000 megawatts of electricity.

Tata Power's application to sell carbon credits is being reviewed by Det Norske Veritas, the auditing firm. The firm's Mr. Lehmann says he has his doubts about Tata's bid. "Look at the facts," he says. "The project has received funding. It's part of the policy of the government to implement this type of project," he says. Whether the plant needs carbon-market money "is really questionable." Mr. Lehmann says that the auditing firm is still looking into the project and hasn't yet made its recommendation.

In May, a second Indian coal-fired plant applied for U.N. permission to sell carbon credits.

—Kersten Zhang and Gao Sen contributed to this article.