





CHAPTER 2:

THE EMERGING GLOBAL CARBON MARKET

An efficient global market for greenhouse gas emission reductions is expected to make compliance with emission reduction targets more achievable at a manageable cost and helps to reduce the risk of climate impacts on developing countries and the poor.

It is important to leverage private and public capital for climate change mitigation. Involving diverse public and private stakeholders in combating climate change is essential to a sustained long-term program to reduce atmospheric concentrations of greenhouse gases. This requires mobilization of predominantly private capital on an unprecedented scale to tackle a global environmental problem. This can be achieved through the development of efficient markets for achieving and trading emission reductions. The Kyoto Protocol gives that opportunity. It provides the context for the establishment of the Italian Carbon Fund which is designed to provide a source of funding for emission reduction projects in developing countries and economies in transition.

Carbon emission reductions can be a powerful tool for development. The carbon market offers an opportunity to channel private capital to clean technologies in developing countries and economies in transition and to make their development more sustainable. Moreover it will be difficult for these countries to reduce the emissions intensity of their economic activity over the longer term without

increased foreign investment in cleaner technologies and more energy efficient infrastructure.

Given the difference in emission abatement costs between OECD and poorer countries, it may be surprising that the supply response from developing countries and economies in transition has been limited. Only about 200 million tons of carbon dioxide equivalent has been traded since the Kyoto Protocol's inception in 1996, with international prices ranging from only pennies a ton to about US\$10. These prices are only a fraction of the cost of abatement in the more energy-efficient Annex I countries, which range from about \$15 to well over \$100 a ton.²

Partly due to uncertainties related to the Kyoto Protocol's entry into force, and lack of clarity about market rules, the private sector—particularly in Europe—has been reluctant to enter the market for structuring projects that originate emission reductions under the Clean Development Mechanism and Joint Implementation.

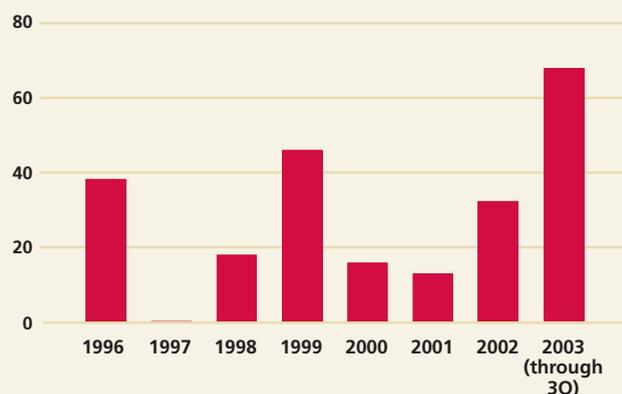
Market research suggests that rather than directly purchasing from project sponsors in smaller developing countries, private sector carbon

² *State and Trends of the Carbon Market(s)*, December 2003.

STATE AND TRENDS OF THE CARBON MARKET(S), DECEMBER 2003

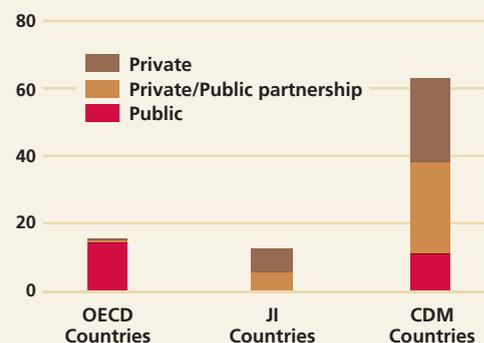
Market Volume Has Increased

Estimated Volumes of Project-based Transactions (million tCO₂e)



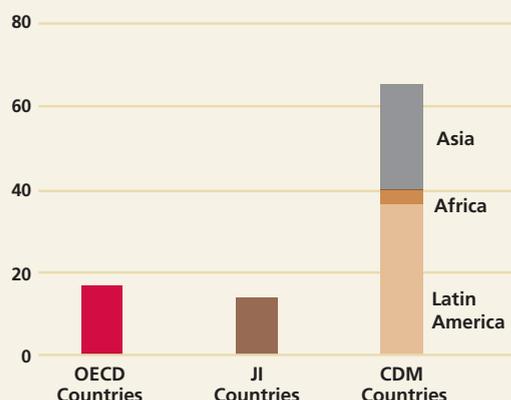
Private Sector Flows Remain Mostly within OECD

by Volume of Project-based Transactions (million tCO₂e)



Carbon Finance Flows 2002-03

Volume Of Emission Reduction Projects (million tCO₂e)



buyers are more likely to purchase emission reductions either through large projects in India, Indonesia and Latin America or through public/private partnerships such as the Prototype Carbon Fund, where risks and transaction costs can be managed across a large project portfolio.³ Small developing countries, Africa and the poorer areas of developing countries which generally tend to receive less foreign direct investment,⁴ therefore also appear to be at risk of not receiving any significant carbon investment.

In 2002, contracts for over 32 million tons of carbon dioxide equivalent (tCO₂e) were concluded; nearly 60 million tCO₂e were transacted in 2003. These are a significant increase over the approximate volume of 12 million tCO₂e traded in 2001.

Carbon Finance Flows

Early carbon projects tended to take place in industrialized countries, but the share of developing countries in the overall market for project-based transactions has been rising steadily, and appears to have reached more than 80% in the past two years.⁵

The Marrakesh Accords appear to have provided more certainty to emission reduction purchases in developing countries.

Over 2002 and 2003, 44% of the private sector's independent carbon asset volume acquisitions have come from developing countries. Of that, a majority of reductions have come from larger projects in Latin America and to a lesser degree Asia, while very small volumes were associated with projects in the poorer regions of Asia and Africa.⁶ Over the next several years, a much greater percentage of emission reductions is likely to come from projects in India and China.

³ Market Analysis contained in *State and Trends of the Carbon Market(s)*, December 2003. Available at <http://www.prototypecarbonfund.org> in the PCFPlus/Research section

⁴ PCFPlus/Research section *Global Development Finance Online 2003*, World Bank, 2003

⁵ *State and Trends of the Carbon Market(s)*, December 2003. Available at <http://www.prototypecarbonfund.org> in the PCFplus/Research section

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