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Green Investment Schemes as a Way of Promoting Environmentally-Sound Cooperation among Russia, Canada, Japan and Other Nations under the Kyoto Protocol

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Green Investment Schemes as a Way of Promoting Environmentally-Sound Cooperation among Russia, Canada, Japan and Other Nations under the Kyoto Protocol

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Executive summary

A Green Investment Scheme (GIS) is a way to use revenues from greenhouse gas emissions quota trading under the Kyoto Protocol (KP), for environmentally-related purposes. The main original proponents of a Russian GIS originally were international NGOs, Russian ecologists, and the governments of the EU, Canada and Japan. After the withdrawal of the U.S. from the Kyoto Protocol, Russia lost the main potential buyer of its quotas, but at the same time acquired an effective power of veto over the KP's entry into force. In these new circumstances, the GIS has become a powerful and environmentally-sound argument in favour of Russian participation in the Protocol. The GIS idea is officially supported by progressive Russian officials.

The GIS could finance activities ranging from capacity building to large emissions reduction projects. We analyzed two approaches to GIS design: a program approach, where a number of smaller projects are bundled together; and a project approach, where each project is treated individually. We also considered two types of benefits of GIS: quantifiable and non-quantifiable. The former relates to strict verification of GIS projects, while the latter allows investors to decide on financing of other activities—capacity building, for example—with the aim of obtaining quantifiable results in future.

The approaches and expectations of Canada, the EU and Japan are briefly discussed and recommendations for a robust GIS and necessary Russian institutional arrangements are made. These recommendations will be useful for the preparation of bilateral agreements in the near future. Although potential investors may consider not only quantifiable projects, but also non-quantifiable ones, it is expected that they will focus primarily on energy projects with strict verification, which do not require any changes in Russian legislation for their implementation.

Currently the proposed creation of a GIS provides a strong argument for Russian ratification of the KP, because it clearly demonstrates the possible co-benefits of its implementation in Russia. The GIS was developed for the Russian context, but it could also be applied in other countries with transitional economies.

Introduction: grassroots reasons for the GIS initiative

Climate change caused by anthropogenic emissions of greenhouse gases (GHG) is the most serious and rapidly growing global environmental problem of the 21st century. Anthropogenic GHG emissions are closely linked to combustion of fossil fuels, which is the engine of the global economy. Therefore, the negotiations over relevant international agreements on climate issues have required major efforts of all involved parties and have faced considerable complications and delays.

This was the reason why countries were only able to negotiate a *framework agreement*—the UN Framework Convention on Climate Change (UNFCCC)—in 1992, and then spent five years agreeing to the *binding emission limitation and reduction targets* of the Kyoto Protocol (KP) adopted in 1997. The KP provides for a new approach to dealing with global environmental problems—the emissions trading (ET) concept inscribed in Article 17. It took another four years to develop the rules for emissions trading, and it was only with the Marrakech Accords of the Seventh UNFCCC Conference of the Parties in 2001 that international details of this new instrument were specified, with regional, multilateral, bilateral and domestic implementation details left to be developed independently, based on UNFCCC guidelines. Thus the Marrakech Accords have allowed *more detailed domestic and regional studies, e.g., the GIS*, to start.

The Green Investment Scheme (GIS), which evolved during these debates, is based on the idea of using revenues from Kyoto emissions trading (sales of special Assigned Amount Units [AAUs] specified by the Marrakech Accords) exclusively for projects and activities that provide environmental benefits. Implementation of a GIS in Russia is based on the premise that the country will have surplus AAUs for sale, i.e., its GHG emissions will be below 1990 levels during the first commitment period, as specified in the Kyoto GHG emissions reduction targets. This is confirmed by the available GHG emissions scenarios, and the volume of potential surplus Russian AAUs is estimated to be in the range of 1,000–2,500 MMt (million metric tonnes) of CO₂-equivalent during the five years of the first KP commitment period (2008–2012).²

Therefore, there is likely to be a large amount of unused AAUs and a potentially significant source of income, which could simultaneously help reduce global GHG emissions and solve domestic ecological problems.

There have been three groups that have made proposals on the GIS initiative:

- First, in early 1998, immediately after the adoption of the Kyoto Protocol, international environmental groups, including World Wide Fund for Nature (WWF), Greenpeace, Friends of the Earth and others, noted that unused *free or cheap Russian AAUs could undermine domestic emissions reduction measures in developed countries*. They coined the term “hot air” to refer to this loophole in the Kyoto Protocol and launched a campaign to close it. This led to the search for compromises and adoption of limits (caps) on emissions trading, which had to be based on environmentally-sound criteria.³
- Second, in 1998–1999, in response to global concerns, Russian non-governmental organizations developed a common position on this problem, in response to global concerns. They argued against unrestricted emissions trading because there would be no real environmental benefits and insisted that there were no safeguards against illegal use of the trading mechanism in the absence of a *solid institutional structure under international control and monitoring*.⁴
- Finally, in the spring of 2001, the GIS idea resurfaced once more. With the withdrawal of the

U.S. from the Kyoto Protocol, and the effective power of veto that this gave Russia over the Protocol’s entry into force the situation had changed dramatically. Without the U.S., Russia had no chance of selling huge amounts of AAUs because of the limited demand from other countries. While the Protocol’s entry into force now depends upon Russia, the country no longer has a significant economic incentive for ratification, as was previously the case. Therefore, the EU, Japan and Canada have been looking for new incentives, acceptable to the environmental community and the public that will ensure Russian participation in the KP.⁵

The views of the three groups mentioned above coincide with the interests of many Russian government officials and Russia’s largest energy company RAO EES (Unified Energy Systems of Russia). Russian officials have now realized that the unlimited and unconditional sale of Russian AAUs to raise money for the Russian federal budget will not benefit their ministries and agencies because the money will not be earmarked for the projects, measures and needs of these bodies.⁶

RAO EES has a monopoly on Russian energy production, controlling about 360 large power plants. The Russian government has 51 per cent of the shares in the company, which is headed by a well-known and powerful politician—the former Russian Prime Minister Mr. Chubais. RAO EES has established a Carbon Energy Facility to attract additional investments in the company’s energy projects by using the KP’s flexibility mechanisms. However, the Carbon Energy Facility failed to obtain the status of an official government agency and so could not initiate AAU trading on behalf of the Russian Federation, as its founders envisioned. Thus, RAO EES was not interested in emissions trading *per se* if all the income from trades was forwarded directly to the federal budget. The managers of the Carbon Energy Facility wanted to use GHG emissions trading as a means of implementing RAO EES’s investment projects. The representatives of RAO EES played important roles in international negotiations and even participated in the official Russian delegation. At the same time, several Russian non-governmental organizations, such as WWF-Russia and the Centre for Project Preparation and Implementation (CPPI) actively advocated the idea of “recycling” revenues from emissions trading by using them to finance environmentally-sound

projects. Their arguments were largely accepted by the Russian delegation.

As a result of these developments, the Russian Federation put forward the idea of carbon revenue recycling (conditional emissions trading) at the Sixth Conference of the Parties (COP) to the FCCC in The Hague in November 2000. Representatives of European delegations and NGOs welcomed this initiative and the EU officially approved the idea at the concluding session of the COP in Bonn in July 2001.⁷ Since then, further development of this idea has ensued. Around the same time, the Climate Strategies Network of European research institutions was formed and its members decided to launch a collaborative study on the Green Investment Scheme. This research had to be implemented in close cooperation with a key official Russian agency—the Ministry of Energy—as well as with Russian NGOs, including WWF-Russia and CPPI, which agreed to contribute to the work. The Royal Institute of International Affairs (RIIA) played a leading role and RIIA employees, Professor Michael Grubb and visiting analyst Anna Korppoo, organized research activities and analyzed overall results.

The number of participants in GIS research grew to include not only European organizations (Fridtjof Nansen Institute; U.K. Foreign and Commonwealth Office; German Ministry for the Environment, Nature Conservation and Nuclear Safety; Finnish Ministries of Environment, Trade and Industry, and Foreign Affairs; Dutch Ministry for Economic Affairs; Directorate of Transport and Energy of the European Commission; Swedish Ministry of Industry, Trade and Employment; and the Centre for European Policy Studies in Brussels), but also other industrialized country partners (Environment Canada; the International Institute for Sustainable Development [IISD]; and the Japan Central Research Institute of Electric Power Industry). Thus the GIS issue evolved from being an issue of Russian-European cooperation to a question of the level of overall global trading in Russia's surplus GHG emissions quotas.

Active research began in mid-2001, and in April 2002 a final report was published. At that time, the Russian Ministry of Energy and Climate Strategies in collaboration with the Dutch Ministry for Economic Affairs, Environment Canada, WWF Russia and Shell International Gas Ltd., organized a workshop on the GIS in Moscow.⁸ This workshop covered the research results on a broad spectrum of issues associated with

implementation of the KP by the Russian Federation. The next conference on GIS is planned for the near future to continue developments and utilize GIS findings to argue for Russian ratification of the KP.⁹

This article is based on the findings of this report and the workshop, focusing on the problem of ratification of the KP by the Russian Federation. *If Russia fails to ratify the Protocol, the efforts of the international community to limit GHG emissions would be seriously undermined.*

The goals and principal features of the Green Investment Scheme

The original goal of the GIS was to create a mechanism for deploying the proceeds from emissions trading to environmentally-sound ends. At the design stage it was important to demonstrate the feasibility of implementing such a scheme within the current Russian legal system, without major changes to Russian legislation.

The intention of the GIS designers has been to demonstrate the potential benefits of participation in emissions trading for all the involved parties, businesses and members of State Duma, thereby creating enhanced conditions for ratification of the KP.

The researchers began with a clean slate. Environmental objectives and the basic design features of GIS had to be developed and it was unclear whether, and how, GIS should differ substantively from Joint Implementation (JI). *Understanding the relationship between the GIS and JI and the differences between them is a key starting point for discussing the GIS.*¹⁰ There are two factors that inhibit the widespread use of JI and that explain the need for the GIS:

- The first is the overall purpose of GIS—to facilitate environmental improvements using the revenues from emissions trading. JI already has inherent features designed to ensure environmental and/or emissions reduction effectiveness internationally and domestically. Trading Russia's surplus AAUs would allow an increase in other countries' emissions without corresponding environmental improvements in Russia. Therefore, the so-called "ecologization" of JI projects is a secondary task for the GIS *and the modification of AAU trade is the primary goal.*
- The second issue concerns the *difficulty of proving the additionality of many projects in Russia.* It

is extremely hard to advance a credible definition of baseline emissions in a transitional and rapidly-changing economy or to define business-as-usual emissions at a given facility. Often a project which would have been otherwise considered business-as-usual in Western Europe requires considerable additional financial outlays and implementation efforts in Russia. Even commercially-viable projects are not implemented because of investment risks in Russia. If all risks (or adequate insurance) were accounted for, such a project would be rendered unprofitable. Not only would granting JI status to such projects secure additional foreign investment but also international control would reduce commercial risks. But while the commercial attractiveness of such projects for potential investors would be greater, the magnitude of these combined features is often impossible to quantify with any accuracy.

There is not yet enough experience with JI in Russia to assess its viability in the country, and the experiences of other countries (the Baltic States and Eastern Europe) can not be readily transferred because of the differing institutional conditions and investment risks. Thus, excessive reliance on JI mechanisms as part of the GIS would be a risky strategy. Perhaps at some later stage, when the basic GIS mechanism is in place, it will be possible to use JI for some projects carried out under the umbrella of GIS, but currently it is reasonable to limit the GIS to investment of the revenue from the transfer of AAUs.

Thus the first feature of GIS is its broader scope than JI. The GIS should be primarily based on AAU transfers, and may include not only investment projects but also capacity building and other measures with environmental benefits.

A second key issue is the *origin of AAUs used*¹¹ and *whether receipt of AAU trading revenues should be restricted to GHG emissions reduction projects*. The issue that remains is how AAU use can be controlled when the source of surplus AAUs is unknown. AAUs used for additional project financing usually do not have a history, and there is no way of telling whether they were produced by real emission reduction activities or from the closure of unprofitable business or military facilities. One way of overcoming this would be to impose more stringent conditions. For example, require that AAUs used for financing should be generated by certain types of project, e.g., energy saving

measures. This, though, would require additional certification of AAUs (i.e., a type of domestic verification of emission reduction at an enterprise from 1990 to 2008).

This is more environmentally strict and, therefore, more appealing to international environmental groups because it solves the “hot air” problem. If AAUs are a result of emission reduction measures or projects, its cost can not be very low. It means that the offer of Russian AAUs does not dramatically undermine reasons for domestic measures in other countries, i.e., certification of origin of AAUs would provide some safeguards against the dampening effects of emission trading with Russia on domestic emission reductions in other industrialized countries.

There is a possibility that some Annex I countries considering the international trade of AAUs will require certification of AAU origin. These requirements on external AAUs might be adopted by the EU, Canada, Norway and Japan in order to protect domestic AAU producers. It is unclear how strict these requirements will actually be, but in order to avoid the cancellation of future transfers of Russian AAUs, a strict certification of AAU origin policy should be established and followed.

It is important that the certification (verification) of past emission reductions could be considered as a criterion for Russian companies that would like to participate in GIS. Only companies with transparent records of production and good management (i.e., relatively effective fuel use in the past) can meet the requirement. It is a serious barrier for companies based on non-transparent or semi-legal business or newly-established companies, which usually do not follow appropriate ecological criteria in Russia, and it would be better to avoid participation of such companies in the GIS.

Nevertheless, not restricting the source of AAUs may still seem more attractive simply because it is more likely to ensure the positive influence of the GIS on ratification and would simplify the GIS operations. In this scenario, all Russian participants would only need to obtain a one-time permit to use a specified amount of Russian AAUs rather than having to apply each time for certification of AAUs. Therefore, this option is more attractive for Russian business people and for their lobby in the State Duma.

Thus, the second principal feature of GIS is targeted use of proceeds from emissions trading, which would require tracing the origin of traded emission quotas.

Main features of the two types of GIS

Quantifiable results (revenues from emissions trading to be spent only on GHG emissions reduction projects)	Non-quantifiable results (ET revenues being channelled for capacity-building, social, educational and general environmental purposes)
Clear results of GIS performance	Important for development of Russian system of project monitoring, verification, reporting and compliance
Quantitative criteria of GIS effectiveness	Useful for social programs, which help to gain public support for ratification of KP
Guarantee against non-targeted use of funds	Russian officials are interested because they need extra budgetary financing sources for “non-productive” components of Federal programs
Facilitates market access for new technologies	

GIS design options

At the initial design stage, many options were considered for the GIS. However, having assessed the reaction of Russian officials and business people after the GIS workshop in Moscow in April 2002, we decided to limit our consideration to two types and two approaches to the GIS.¹²

The two types of GIS considered here are: (1) quantifiable—for which emission reductions can be estimated, and (2) non-quantifiable. The first type will be an important policy instrument with relatively strict verification and additionality requirements. The second type allows investors to determine the degree of “greenness” of a proposed measure, using qualitative variables, e.g., capacity building, with the goal of obtaining quantifiable results in future.

The first type of GIS seems to be simpler and more straightforward; this is why it may be reasonable to start with a purely quantifiable approach. However, the second type is very important if one wants to gain wide public support for the GIS as a whole, especially in the context of its potential influence on ratification of the Kyoto Protocol by the Russian Federation. For example, one can envisage a GIS which requires a certain percentage of ET profits to be spent on vaccinating the local population against encephalitis (the encephalitis tick is predicted to spread over large areas of Russia, if average temperatures increase). This scheme would ensure wide public support for the Kyoto Protocol, increasing its chances of passing relatively unhindered through the State Duma (especially before the forthcoming elections at the end of 2003).¹³

Without the development of a non-quantifiable GIS it will be difficult to obtain support from Russian government officials, and the leverage of the GIS in favour of ratification of the Kyoto Protocol would be seriously undermined. This does not necessarily imply that all Russia’s partners (the EU, Canada, Japan and others) should develop a broad spectrum of non-quantifiable measures. Rather, the “division of labour” principle should be used: the comparative advantages and specific conditions of each country should be taken into account. In any case, quantifiable activities, i.e., GHG emission reduction projects, should receive the major share of financial resources.

Program approach vs. project approach

It is also possible to take two approaches to implementation: a “program approach” where a number of smaller projects are bundled together; and a “project approach,” where each project is treated individually. The first approach gives priority to small and simple projects such as energy efficiency, fuel switching, renewable energy and improvement of gas and heat networks. The second approach favours large projects, which require longer planning horizons and thus may be more complex to implement.

The program approach does not establish direct links between buyers of Russian AAUs and actual emission reduction projects to be financed in Russia. The project approach, conversely, involves buyers directly in project implementation.

The first approach may be seen as an extension of emissions trading. A foreign company purchases Russian AAUs in the international emissions trading

market to offset its own emissions and the Russian government uses the money to invest in efficiency improvements or pollution abatement measures. In this way, the GIS can become a source of funds for government programs and can build upon existing (and under-financed) Russian energy efficiency programs.

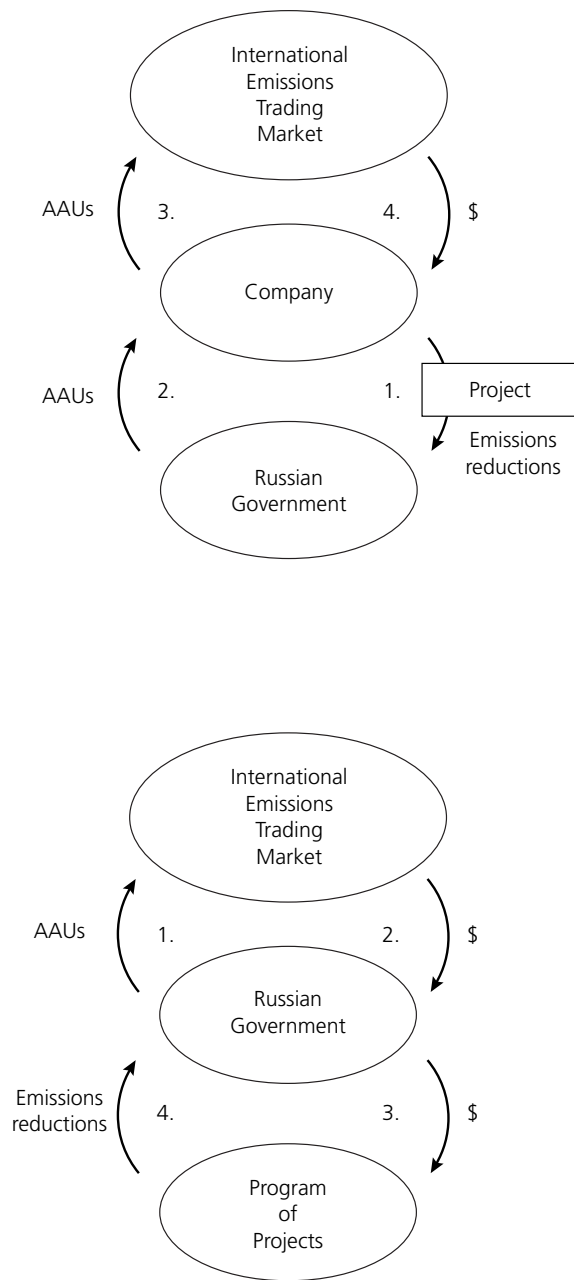


Figure 1. Program approach to GIS¹⁴

Project approach to GIS

The general opinion of the experts consulted was that a fund should be established that provides continuing financing for government programs. Currently, the government is still opposed to any new funds. This is a result of very unsuccessful work with Russian funds in the past, when a lot of money was not properly used. Public opinion also tends to view the creation of such funds as a form of money laundering after well-known failures of public investment funds during the Perestroika years. However, after a few years of stable economic development, the government could change the policy and a fund may be established. There are programs currently in place that indicate an *ad hoc* approach could be recommended now. In this context, experience and lessons learned by an international or foreign program can be used. In particular, ERUPT¹⁵ has experience in operating in Eastern Europe without a full set of legal provisions and even without ratification of the Kyoto Protocol by a host country.

Therefore, it is advisable to take a program approach in direct collaboration with an international or foreign program.

It usually takes considerable time to launch a new federal program in the Russian Federation; therefore, we recommend building GIS on existing programs, such as the “Energy Efficient Economy” program, which involves three pilot regions: Arkhangelsk, Astrakhan and Kaliningrad. In this context, Kaliningrad is closely linked to the EU, while Arkhangelsk may be recommended for Canadian investors as a large forestry and pulp and paper region.

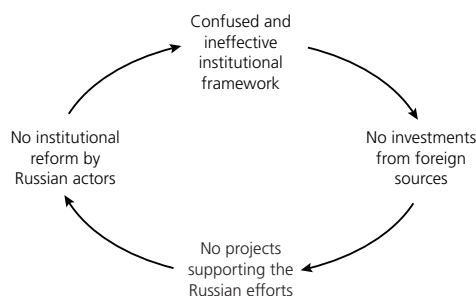
The project approach has similarities to Joint Implementation, and it is more attractive to large private Russian companies that wish to conduct AAU trades as independently from the government as possible. In this case, the buyer of AAUs is directly involved in preparation and development of large projects. RAO EES is known to support this approach and the company’s support is essential for the ratification of the Kyoto Protocol by the Russian Federation.

Therefore, both program and project approaches are important and do not have to be mutually exclusive. It would be appropriate to have the two approaches working in tandem.

Institutional problems concerning the operation of the GIS

Institutional problems that plague the government—poor cooperation among ministries, conflicts of interests between regional and federal authorities, between ministries and large companies—were described in the Climate Strategy Report issued in April 2002. The figure taken from this report (below) depicts the “vicious circle” of well-known institutional problems.¹⁶ In the present study, we focus only on several key relevant points that have surfaced recently.

Figure 2. The vicious circle of climate-related investments in Russia



1. The first issue is that GIS is not a part of the Kyoto Protocol: it is a separate agreement. This means that GIS need not include all GHG sources and sinks listed in the Protocol, nor work under all its mechanisms and provisions. *Therefore, a set of internal regulations will be necessary to ensure a robust and credible GIS. One possibility could be to limit GIS to just one sector of the economy at first. A good sector to start with is the energy sector (energy and heat production, transportation and consumption).*¹⁷ Control over project implementation in this case should be delegated to the Russian Ministry of Energy. To avoid monopoly bias in project selection, we recommend the organization of a tender for projects under the auspices of the Ministry of Economic Development and Trade.
2. There are *four groups of potential participants* in GIS: Russian and foreign governments and Russian and foreign private companies. However, *not all of them need to be simultaneously involved in GIS*. All groups may be involved, but at different stages of the GIS' development. Governments are needed to establish GIS proce-

dures, and they may have a supportive role if the private sector chooses to take the lead in the implementation of GIS projects. The minimum requirement is cooperation among Russian and foreign actors (governments and private companies). Private companies should be involved in GIS gradually, through successive steps. The procedures for participation in the GIS should be clear, widely-publicized and straightforward to implement.

3. The GIS may be packaged into bilateral agreements between Russia and the EU, Canada, Japan, and possibly several other countries (Norway, New Zealand, etc.). It is very important to keep changes in Russian legislation to a reasonable minimum, if they cannot be avoided altogether. We recommend constructing the GIS in such a way that would only require the issuance of a Russian government decree (at least for the first two to three years). At a later stage, when the GIS is fully operational, the corresponding law should be drafted and passed through the Russian Parliament.
4. *Distribution of quotas among regions and ministries within Russia should be avoided as much as possible.* Such bargaining would suspend any practical activities for many years. We recommend allocating a small fraction of the available carbon quotas (e.g., 100 MMt of CO₂-equivalent) during the pilot phase. This allocation might involve two or three ministries and three to five big companies (most likely including RAO EES).
5. It is important to limit operational expenses as a certain percentage of GIS funds, and provide minimal coverage of risks (or specify project insurance). Otherwise, administrative costs will grow indefinitely and inadequate insurance will discourage potential investors and undermine the very idea of GIS.

The potential value for other countries with transitional economies

The benefits and design options of the Russian GIS may be applicable in other countries, for instance in Ukraine, Belarus, Bulgaria, Romania, Croatia and other Eastern and Central European countries that are not going to become EU members in the near future. (EU members already share environmental and eco-

conomic policies which cover at least part of the tasks of the GIS). Ukraine, being the closest neighbour of Russia, is going to ratify the Kyoto Protocol at the European Conference of Environmental Ministers to be held in May 2003 in Kiev. It is likely that Ukrainian companies will have the same problems with AAU trading as their Russian colleagues. Therefore, lessons learned during the development of the Russian GIS should be applied in other countries with transitional economies.

While the main priority for establishing a GIS in Russia is to promote the country's ratification of the KP, fortunately this is not the case for other countries where it is possible to construct GIS in a less-hurried and more creative atmosphere. Similarly, other conditions apply that need to be taken into account.

First, Russia relies heavily on oil and gas combustion. Other transition economies, which are not very rich in fossil fuels, may better focus on renewables, where the basic pre-conditions exist.

Second, renewable energy could be combined with decentralization of the energy sector. This is especially profitable if natural gas or local renewables are used. However, such energy sources are usually not very large and, therefore, a *program approach is to be recommended* at the outset. The institutional conditions in most of these countries are also much better than in Russia, and there are more capacity building options than in Russia. Therefore, a focus on quantifiable projects is recommended.

Kazakhstan will be in a very favourable position if it joins Annex 1 and begins AAU trading. The conditions in Kazakhstan are somewhat different from other EITS, however, and here an approach focussing on a few large projects and non-quantifiable GIS may be more appropriate. Currently, there are only preliminary ideas where climate strategies, in collaboration with local NGOs and the WWF, expand GIS studies to Kazakhstan and Ukraine. Representatives of these countries and local NGOs have been invited to the GIS Conference in Moscow¹⁸ to discuss the idea and identify the most appropriate topics.

Approaches and expectations of Canada, the EU and Japan

These issues were described in the GIS report of April 2002;¹⁹ here we present brief summaries of this report.

Canada

The majority of stakeholders certainly prefer a GIS to unrestricted AAU trading. Priority is given to project-specific investments, as opposed to the program approach. In this regard, the Canadian position is close to that of EU; the Canadians want to enlarge the scope of GIS and include GHG emission reduction activities outside the energy sector, e.g., agricultural and forestry sinks. Monitoring and verification of GIS investments are also top priorities.

While there is no specific preference for the type of agreement (unilateral, bilateral or other), most observers tend to opt for bilateral agreements because they are easier to negotiate: it would be difficult to align Japanese, European and Canadian priorities, so it might be less complex to develop a set of bilateral agreements instead.

The Canadian government responded to concerns about the use of "hot air" with a formal indication that it is only going to use "green" AAUs. The intention of the government is to avoid accusations of being involved in simple money transfers from one country to another.

The Canadian-Russian Working Group on climate problems was established in the middle of 2002. However, not much work has happened yet, because the group is considering too broad a range of issues. Three sub-groups and three directions are planned: 1) GHG inventory, 2) land-use change and forestry activities, and 3) emissions trading. There is the intention to focus the group (or at least sub-group #3) on the development of GIS concept and to draft a bilateral agreement as soon as possible. Currently, however, the nomination of Russian co-chairs of sub-groups is a problem because there is no consensus among Russian agencies. The Russian co-chair of the Working Group, Mr. Bedritsky, Head of Russian Hydrometeorological Service (Roshydromet), made a proposal where all Russian co-chairs of sub-groups would be from Roshydromet only. While others, in particular the Ministry of Energy, strictly oppose speaking especially about the sub-group on trading and GIS.

There is evident interest in project-based GIS and projects that involve Canadian companies or expertise, in particular projects in natural gas sector, forestry and biomass energy. There is also an intention of ultimately bringing a portion of the revenues from trading with Russia (Canada being a major AAU buyer)

back to Canada in order to mitigate domestic opposition to Canadian money transfers.

European Union

The EU is interested in the GIS for two reasons: (1) the development of the GIS would enhance its relations with Russia, especially in the context of the EU-Russia energy dialogue which provides guarantees of a sustainable supply of Russian gas to Europe; and (2) the GIS is seen as a way of using and managing the Kyoto Protocol emissions trading and JI projects.²⁰ The history of UNFCCC negotiations shows that the EU has paid a lot of attention to “environmental integrity” while trying to limit the participation of some countries in international emissions trading. Therefore, the EU is unlikely to buy Russian AAUs without guarantees of the environmental integrity of such transactions.

The EU highlights the primacy of internal measures by EU members, while second-order priority is given to cooperation with Central and Eastern European countries which are going to join the EU in near future. The proposed EU-wide emissions trading system is internally-focused, though it obviously does not preclude EU members from buying Russian or other “external” AAUs. Moreover, the EU trading system covers only the largest emitters, which account for only about half of the total GHG emissions of EU. Therefore, the GIS may potentially help other companies to fulfill their emissions reduction obligations by purchasing Russian AAUs.

The EU is likely to favour a GIS that allows additional investments in projects in countries with transition economies, including Russia. Indeed, several EU members, e.g., the Netherlands and Sweden have begun pilot JI-style programs to support projects, demonstrate practical feasibility and ultimately facilitate ratification of the KP by the Russian Federation. The GIS could complement these initiatives.

Japan

Japan is the largest potential buyer of Russian AAUs. Japan wants to control spending of revenues from AAUs transactions so that funds are not misused or wasted. There is also a strong preference for using carbon funds for social or environmental purposes. However, potential buyers disagree on the details of verification criteria. Some want a project approach similar to JI with strict monitoring and additionality requirements. Others do not see any need to incorporate con-

cepts that may complicate the GIS and waste revenues that should be used only for their designated purposes.

Conclusion: how to cooperate with Russia to use GIS most effectively

1. Above all, failure to ratify the Kyoto Protocol by the Russian Federation would block all global Kyoto processes. Therefore, *facilitation of the ratification is a top short-term priority. GIS should practically demonstrate feasibility of good environmental results available for all countries, and first of all, for Russia.*
2. The analysis of current JI-style systems of the World Bank (Prototype Carbon Fund), the Netherlands’ ERUPT, wide JI-style Sweden activities in Northwest Russia and similar activities of other countries showed that GIS should be *focused only on emissions trading under Article 17 of the Kyoto Protocol.* Further broadening of the GIS’s scope can impede practical development of these JI-style initiatives. It is also important to provide more support to the project approach to GIS, because many Russian officials would be glad to see only a program approach with non-quantifiable results. Moreover, demonstration of good performance of the GIS is essential for ratification of the Kyoto Protocol.
3. It would be reasonable to accelerate development of *bilateral GIS agreements with Russia, while trying to avoid, or minimize, any changes in Russian legislation, required for implementation of these agreements.*
4. We recommend focusing GIS activities around energy projects and the Russian Ministry of Energy—the most practically robust Russian agency. We support the intention of this ministry to conduct a pilot phase of emission trading, that is, to allocate a portion of Russian AAU budget (say, 100 MMt of CO₂-equivalent) for international trading under the GIS mechanism.
5. If the first phase of development and practical implementation of GIS proves to be successful, the matter of Russian GHG legislation will become the main point and potential barrier for wide-scale use of GIS. The needed changes in Russian legislation should be carefully investigated and a fraction of proceeds from trades under the GIS should be directed for legal issues.

Endnotes

- 1 This article was specially prepared in February 2003 for the Climate Change Compendium <http://www.cckn.net/compendium> designed by the International Institute for Sustainable Development, Canada.
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- 2 Government of the Russian Federation, 2002; Government of the Russian Federation, 2003; Mastepanov *et al.* 2000.
- 3 Koch and Michaelowa, 1999.
- 4 Evans *et al.*, 2001
- 5 Climate Strategies, 2002; Kokorin, 2003b.
- 6 Mastepanov *et al.*, 2000.
- 7 Climate Strategy, 2002.
- 8 Climate Strategy, 2002.
- 9 International Conference on GIS is planned in Moscow at April 9–10, 2003, more information can be obtained from Anna Korppoo (Climate Strategies) a.korppoo@imperial.ac.uk or Alexey Kokorin (WWF Russia) akokorin@wwf.ru.
- 10 Egenhofer and Legged, 2002; Evans *et al.*, 2001.
- 11 Koch and Michaelowa, 1999; Korppoo *et al.*, 2001.
- 12 Climate Strategy, 2002.
- 13 Kokorin, 2002; Kokorin, 2003a.
- 14 Climate Strategy, 2002.
- 15 ERUPT is a Dutch government initiative; a good example of the program approach is ERUPT's Czech Republic biomass fuel project, which bundled together 28 separate sub-projects, see details at <http://www.carboncredits.nl>
- 16 Fridtjof Nansen, 2001; Korppoo, 2002; Climate Strategy, 2002; Government of the Russian Federation, 2002.
- 17 Mastepanov *et al.*, 2000.
- 18 International Conference on GIS is planned in Moscow at April 9–10, 2003, more information can be obtained from Anna Korppoo (Climate Strategies) a.korppoo@imperial.ac.uk or Alexey Kokorin (WWF Russia) akokorin@wwf.ru.
- 19 Climate Strategy, 2002; Government of Canada, 2002.
- 20 Khristenko, 2002.

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