Divide and Conquer[1]

By Ximena Aguirre Franco[2]

Last December, Mexico surprised the world by proposing to reduce its greenhouse gas (GHG) emissions to 50% below 2002 levels by 2050. This commitment was originally proposed – and accepted – under slightly different terms by German Chancellor Angela Merkel during the G8 meeting in Japan last year. But as the G8 agreement did not include specific targets, it will be difficult to enforce. And in April, Mexico's Ministry of the Environment and Natural Resources said that such a proposal is still subject to approval by Mexico's president and will depend on the technologies available and international funding1.

According to the Draft Special Program on Climate Change (the final version of which is under review), Mexico will introduce both a carbon tax and a cap-and-trade scheme, and there is a bill under review by Mexico's Federal Congress related to carbon taxes. The trading programme is envisaged to be in operation in 2011 with Mexico's National Commission of Electricity (CFE) and Central Lighting Company (CLC), both state-owned, as the sole participants. Private companies will be allowed to participate subsequently.

In its "Good Carbon Cap Legislation", Environmental Defense recommends that cap-and-trade schemes should not exclude any GHG emitter. According to the US-based NGO, Mexico's potential emissions trading programme may discourage additional emission reductions, which could be significant. However, according to Mexico's Third National Communication to the United Nations Framework Convention on Climate Change2, 61% of Mexico's total GHG emissions result from the generation of electricity, and CFE and CLC account for 45% of total energy sector emissions. Therefore, it is no coincidence that they are to be the market's first participants and only time will tell if Mexico's decision to limit participation is an error.

Although no further details are provided on how the cap-and-trade system will operate, speculation is that it will borrow from Pemex's internal carbon market, launched in June 2001. As a state-owned company, Mexico's petroleum giant created the programme at the government's behest, and Environmental Defense was employed to design the market, which covered Pemex's 25 largest carbon dioxide (CO2)-emitting facilities.

The short-term objective (known as the first phase) was to reduce Pemex's CO2 emissions by 1% by 2003, compared with 1999 levels, and the long-term goal (known as the second phase) for a 10% reduction by 2009. It is worth noting that during the first phase of operation, no actual payments were made for transactions; all transactions were virtual. The second phase would build on the experience gained during phase I, which ran from 2000-03, and would focus on developing Clean Development Mechanism (CDM) projects to reduce emissions and the virtual market would no longer be operational.

Under this cap-and-trade scheme, each participant was assigned a maximum CO2 cap for the 2000–03 period. Emission reductions achieved below the cap were marketed as permits, and

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each permit was equal to one tonne of CO2. Buyers and sellers entered bids and offers, as in other markets, thus establishing a market price. Trading was undertaken through a website administered by an internal Pemex unit, which also allowed for the trading of verified offsets from CDM projects in phase II. Similar to the Kyoto Protocol, participants that exceeded their caps could use offsets.

During the first phase, the total emission reductions achieved were 5.4 million tonnes of CO2, of which 82% was commercialised via Pemex's internal website. According to the company's 2007 GHG report, its internal CO2 market closed in 2005 with 224 CO2 market transactions having taken place, worth a virtual value of $20 million.

The report also states that, during the second phase, it is managing 19 CDM projects, and agreements have been signed to sell the emission reduction credits from four of the projects. Last year, the Mexican Congress approved legislation which allows for CDM profits to be reinvested by the government in new CDM projects. This action was welcomed as, without it, such profits would be part of the government's general income and thus could be used for any purpose, not necessarily those related to climate change. In this sense, if the pace is kept up, there will be a constant flow of money to be re-invested in CDM projects – there are 114 registered CDM projects in Mexico, or 7% of total registered projects, and a further 93 in the pipeline, according to UNEP Riso data.

Linkages with similarly-designed international carbon markets are key for the success of Mexico's domestic market – but such ties are yet to be secured. Negotiations are expected to start in the near future with the US, while Canada and Mexico have already created a climate change working group which, will make public its first working plan soon. At last year's G8 meeting, Canada agreed to reduce its emissions by 50% compared with 1990 emission levels by 2050 – or by 85% compared with current levels. This provides an incentive for a strong and effective relationship for CDM investment between both countries, drawing from the existing North American Free Trade Agreement relationship.

There is certainly "much ado about something" on climate change for developing countries. Mexico has good intentions, but is yet to turn its words into action. The trading scheme will only be effective if the government introduces caps for all GHG emitters, and not limited to state-owned companies, and effective sanctions are duly imposed for violating them. While Mexico's "divide and conquer" cap-and-trade approach makes sense based on numbers, it risks deterring private investors from undertaking projects which could play an important role in the GHG emission market and in achieving the government's intention.