Carbon Trading: Environment’s Tryst with Economics

Ved Prakash

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Over a decade ago, most countries joined an international treaty under the United Nations Framework Convention on Climate Change ("UNFCCC") to begin to consider reduction of global warming and finally after intense negotiations, the Kyoto Protocol was adopted at the third Conference of the Parties to the UNFCCC (COP 3) in Kyoto, Japan, on 11 December 1997 and finally comes into force on 16 February 2005. The first commitment period of the Kyoto Protocol expires in 2012. This requires developed countries to reduce their green house gases ("GHG") emissions below levels specified for each of them in the Treaty. These targets must be met within a five-year time frame between 2008 and 2012, and add up to a total cut in GHG emissions of at least 5% against the baseline of 1990. Review and enforcement of these commitments are carried out by United Nations-based bodies. In order to give Parties a certain degree of flexibility in meeting their emission reduction targets, the Protocol developed three innovative mechanisms - known as Emissions Trading, Joint Implementation and the Clean Development Mechanism ("CDM"). These so-called “market-based mechanisms” allow developed Parties to earn and trade emissions credits through projects implemented either in other developed countries or in developing countries, which they can use towards meeting their commitments.

Carbon Trading is an instance of “cap and trade” principle, where the developed countries implement projects in developing countries that reduce emissions and use the resulting Certified Emission Reductions (“CERs”) to meet their own targets. India acceded to the Kyoto Protocol on August 2002; pursuant to which National CDM Authority (“NCDMA”) (the designated national authority) was established. The mode of trade permissible in India is Clean Development Mechanism² (“CDM”). The approval for projects under CDM is termed as Host Country Approval (“HCA”), which is the pre requisite for the issue of CERs. Subject to satisfaction of NCDMA, HCA is given within 60 days of online filing of the Project Concept Note (“PCN”) and Project Design Document (“PDD”). Presently, the income from carbon trading is treated as “other income” by the companies. Recently, Institute of Chartered Accountants of India has announced coming up with new accounting standards which should clear the mist on this issue.

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¹ Ved Prakash, Advocate can be reached at vpkeshari@gmail.com
² Article 12- Kyoto Protocol - As India does not fall in Annex I, it does not have any emission reduction targets.