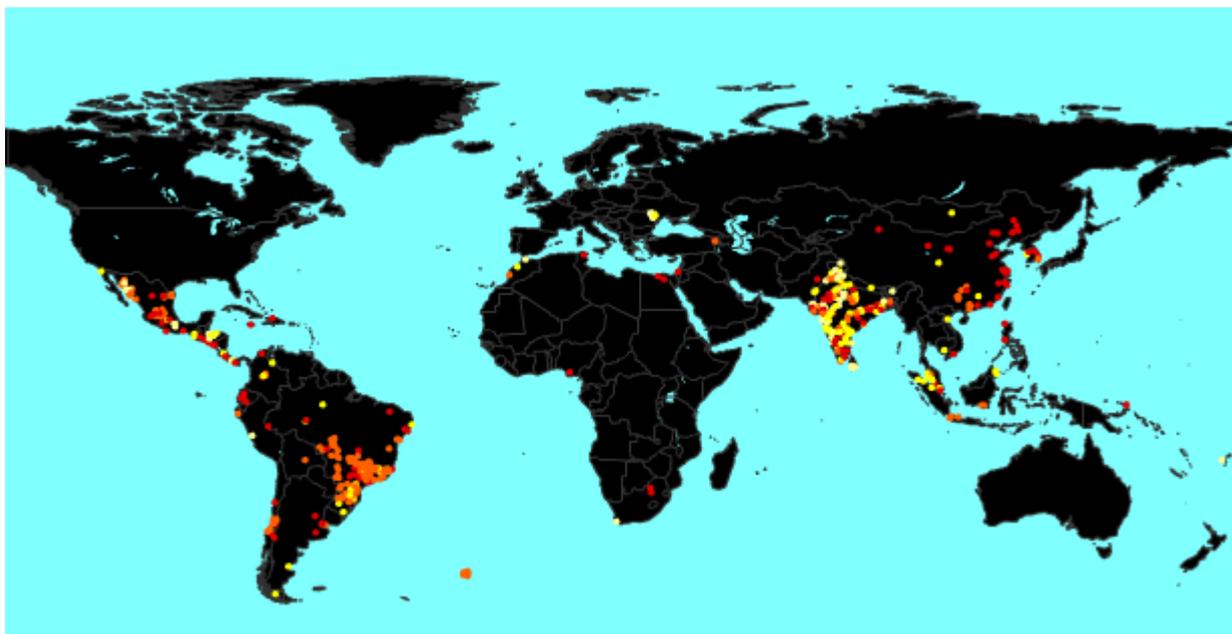


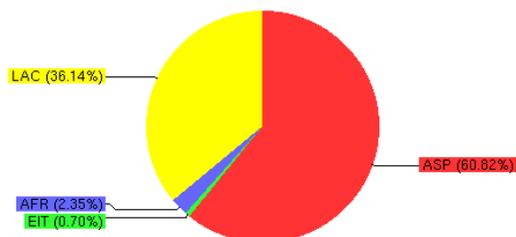
Equitable distribution of clean development mechanism project activities - Analysis of submissions

Background

The picture and graphs below, showing the distribution of CDM project activities, indicate by themselves that the regional and sub-regional distribution is unbalanced.

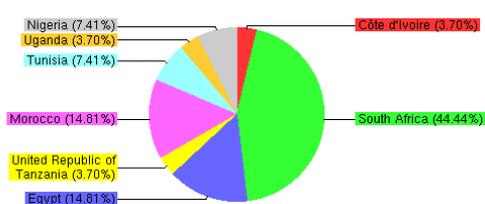


Region Projects Statistics. Total 1151



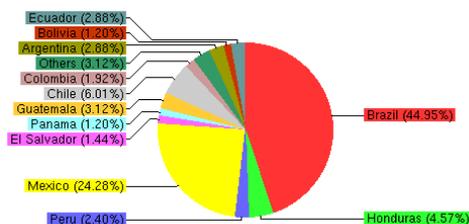
<http://cdm.unfccc.int> (c) 13.09.2006 14:08

Region AFR. Country Projects Statistics. Total 27



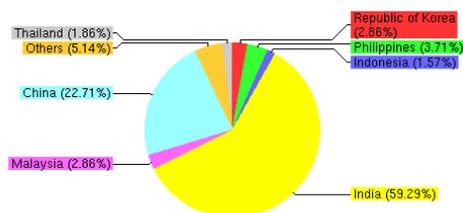
<http://cdm.unfccc.int> (c) 13.09.2006 14:12

Region LAC. Country Projects Statistics. Total 416



<http://cdm.unfccc.int> (c) 13.09.2006 14:13

Region ASP. Country Projects Statistics. Total 700



<http://cdm.unfccc.int> (c) 13.09.2006 14:15



Source: CDM Statistics (public and internal information) <http://cdm.unfccc.int/Statistics>

COP/MOP 1 requested Parties to submit to the secretariat their views on systematic or systemic barriers to the equitable distribution of clean development mechanism (CDM) project activities and options to address these barriers, for consideration by COP/MOP 2. COP/MOP 1 also requested the Board to report on options to address these issues. The Board, subsequently, opened a public call for inputs and requested the secretariat to prepare an analysis of the submissions received from Parties and in response to its own call for public input.

Summary

All submissions agreed that there were barriers to the (increased) participation of Small Island Developing States (SIDS), Least Developed Countries (LDCs) and Sub-Sahara African countries and a number of options were proposed and are summarized below. Two of the main obstacles for these countries relate to financial issues: a need for increased financial resources to assist in building requisite capacity and for innovative means of project financing/risk management.

In addition, thought might be given to increase flows of ODA that combines technical assistance/capacity building for the initial stages of the CDM (i.e. helping to identify and develop documentation in the initial stages). The enabling and capacity development role of such funding for CDM projects should be recognized and accepted; however, a clear statement supporting such efforts should be made by the COP/MOP.

All proposed recommendations aim at enhancing players and structures in ways to optimize the use of CDM within the existing patterns of investment and other financial flows. To change fundamentally the direction of that funding, measures will need to be taken to alter those patterns.

Recommendations from Parties and Public

The following sections summarize the main recommendations arising from the submissions:

(a) Structural and institutional issues

Public sector

- governments in NAI countries to encourage/develop an enabling environment and framework for clean investment and sustainable development with stable fiscal and regulatory regimes and reforms in the energy sector
- governments to facilitate and public institutions to contribute to a more even distribution of CDM activities
- mainstream CC/CDM options and incentives in long-term country and sector development plans (NAI countries)
- governments and capacity support should avoid complex and unnecessary administrations with lengthy and expensive procedures
- link public and private regulatory and incentive systems
- undertake Technology Needs Assessments (TNAs)

Private sector

- increase access by project hosts to (low-rate) capital and financing (innovative options) and gain acceptance by national financial institutions of carbon finance and related instruments as valid 'currency' (collateral) for national financial institutions
- encourage the emergence of risk mitigation and insurance instruments
- find/encourage a few national CDM champions (motivated individuals)
- develop a more active, well-established and vigorous formal private sector in NAI countries;

**(b) Capacity issues***Public sector*

- establish/enhance DNA capacity

Private sector

- increase funding/budgets for technical assistance/capacity building to include theoretical and practical hands-on training that assists in identification and development of CDM projects through creating a critical mass of people and CDM expertise in host countries
- better procedures for emission inventories and baseline data
- more information and tools on the CDM
- involve voluntary organizations and NGOs;

(c) CDM process issues*General*

- give a clear signal that the CDM will continue in one form or another after 2012
- implement programmatic CDM; aggregating small project activities would unlock energy efficiency potential and enhance the impact on sustainable development
- reduce additionality parameters (in specific cases); e.g. certain project types, in certain countries, and for a certain period of time should be considered additional
- remove disparities in the rules and procedures
- use the DNA forum to exchange information and expand their facilities
- explore synergies between the work of other UNFCCC expert groups

Constraints or variations on the CDM?

- either introduce distortions to promote CDM projects in particular countries and/or define additional mechanisms that are more likely to deal with equitable distribution and sustainable development; i.e. there might be “additional opportunities (or incentives) under the Kyoto Protocol processes”, two suggestions for the latter are
 - ‘equitable’ valued quotas or ‘per capita allocation’ for NAI countries leading to tradable “Carbon Emission Reduction Permits” (CERPs)
 - Carbon Emission Reduction Obligations (CEROs) for Annex I countries

Methodologies

- develop simplified versions of some data-intensive methodologies which could be applied in particular conditions e.g. many methodologies are too complex for LDCs, requiring data that is not available and deviation requests are prohibitive due to costs/process for such countries’ PPs. Consider how a methodology could be applied under more challenging conditions
- develop methodologies for household and very small project activities

(d) Other options

- some sectors (oil and gas) well-suited for large reductions but face technical challenges
- link CDM into national considerations of energy supply and security (involve other line ministries)
- unilateral CDM projects should be given more support
- include all eligible GHG mitigating and sequestration activities
- develop (NAI) continent-wide emissions trading systems.
- NAI countries/regions/sub-regions could think of ways that they can be pro-active in the CDM market
- stimulate buying from high risk countries by developing portfolios.



(Further analysis is provided in **Attachment A**)



Attachment A: Equitable distribution of clean development mechanism project activities

I. Introduction

A. Mandate

1. By its Decision 7/CMP.1 (paragraph 32), COP/MOP 1 requested Parties to submit to the secretariat, by 31 May 2006, their views on systematic or systemic barriers to the equitable distribution of clean development mechanism (CDM) project activities and options to address these barriers, for consideration by COP/MOP 2. Such submissions from Parties are contained in document FCCC/KP/CMP/2006/MISC 1. By its Decision 7/CMP.1 (paragraph 33), COP/MOP 1 requested the Board to report to it at its second session information on systematic or systemic barriers to the equitable regional and subregional distribution of clean development mechanism project activities, and options to address these issues.
2. The Board, at its twenty-third meeting, took note of the decision of the COP/MOP with regard to regional distribution of CDM project activities and agreed, in light of this decision, to open a public call for inputs through the UNFCCC CDM website starting 1 March 2006 and ending 21 April 2006. Submissions received were planned to be considered at the twenty-fourth meeting of the Board.
3. At its twenty-fifth meeting, the Board agreed to postpone the further consideration of this issue to its twenty-sixth meeting in order to consider the submissions by Parties, which were not yet made available, with a view to prepare its recommendation on regional distribution to COP/MOP 2. The Board further requested the secretariat to prepare an analysis of the submissions received from Parties and submissions in response to its own call for public input on that issue for consideration of the Board at its twenty-sixth meeting.

B. Scope of the note

4. This note, in response to the request from the Board at its 25th session, incorporates the inputs requested by COP/MOP 1 (in section II) and those responding to the call for public inputs by the EB (in section III). In preparing the note, the secretariat has reviewed the submissions and summarized the main points, for ease of comparison, under the categories of ‘barriers’ and ‘options’, with each category covering ‘structural and institutional issues’; ‘capacity issues’; and ‘CDM process issues’. A number of ‘other options’ were suggested by the public that do not fit into these three categories.
5. As background, the Board may wish to consider the following facts. At the time of writing, there are 299 registered CDM projects and another 861 at the validation stage, however, the projects come from only 52 countries with the largest share being in the Asia-Pacific region (148 registered/704 validation), followed by Latin America and the Caribbean (141 registered/421 validation), Africa (5 registered/27 validation) and countries with economies in transition (5 registered/8 validation). The current situation confirms that a few countries (Brazil, Chile, China, India and Mexico) account for the majority (currently 72%) of registered projects indicating that there are regional as well intra-regional imbalances.



II. Response from Parties

6. The following is a summary of the four submissions from Parties (Austria on behalf of the European Community and its Member States¹, Morocco, Pakistan and Uzbekistan)².

A. Barriers

7. When considering the current inequitable distribution of CDM projects one must keep in mind that the CDM is a voluntary market-based mechanism and that private sector investment activities will naturally gravitate to countries and projects where transaction costs and investment risks are low and opportunities are high.

8. The submissions by Parties highlighted several barriers, many of which are widely acknowledged as hindering effective involvement in the CDM; one Party highlighted that some of these barriers require longer-term attention by a range of actors suggesting that not all necessarily require support under the Convention. The barriers are summarized below under three areas:

(a) Structural and institutional issues that, while not being specific CDM problem areas, will affect the identification and development of CDM projects, determination of their baseline emissions and emissions factors, as well as their monitoring and verification

- weak institutional and administrative capacity
- fragmentary strategies and policies relevant to and supportive of CDM requirements
- poor, unavailable or unreliable public information
- lack of a stable legal and financial framework for foreign investment
- absence of financing possibilities;

(b) Capacity issues

- absence of CDM-specific experience and capacity for project preparation
- low level of industrial development and energy production
- accessible projects are often only in forestry, bioenergy or are small scale
- lack of awareness of potential and benefits of the CDM;

(c) CDM process issues

- minimum CDM requirements that, for an NAI country, may not have been met (NB: currently only 88 NAI countries have established their DNAs)
- the processes are too complex for the available expertise in-country
- lack of approved methodologies and baseline data for certain sectors of particular interest to small countries
- CER prices are too low.

B. Options

9. The Parties suggested options that might be considered when addressing the barriers they had identified. They are summarized following the same grouping as above:

(a) Structural and institutional issues

- the NAI countries could prepare long-term development policies and plans that factor the CDM in

¹ Supported by Bulgaria, Romania, Bosnia and Herzegovina, Croatia, Serbia and the former Yugoslav Republic of Macedonia

² The full texts of the submissions are available in document FCCC/KP/CMP/2006/MISC.1.



- Technology Needs Assessments (TNAs) could be undertaken and innovative options for financing the results of TNAs determined
- in general, an enabling environment and framework for clean investment and sustainable development could be created. However, this should mostly be tackled in the broader context of promoting economic and social development by other relevant fora (e.g. International Financial Institutions, the Commission on Sustainable Development (CSD), international public and private investment institutions, ODA and development institutions);

(b) Capacity issues

- technical assistance should be given to countries entering the CDM late to help them build the required capacity
- national experts should be given both theoretical and practical, hands-on, training in the different aspects of the CDM project cycle (in particular on: possible barriers to CDM project elaboration and ways of overcoming them; selection of appropriate CDM projects; problems of small-scale projects; benefits from participating). Training could be arranged at the regional level
- a budget should be made available for capacity building assistance (as above), especially for LDC countries that could be derived from a tax on CERs. Assistance should include helping to establish DNAs and development of a first batch of projects;

(c) CDM process issues

While some amelioration of potential entry-level barriers have already been achieved (e.g. simplified methodologies, modalities and procedures for small-scale CDM projects; various financial incentives, such as free registration and a reduced rate of the share of the proceeds for smaller projects; bundling of projects to reduce transaction costs) the Parties expressed that more could be done by:

- accelerating the process to operationalize programmatic CDM
- reducing the additionality parameters for a certain period for currently disadvantaged countries, below a certain threshold, especially in the area of renewable energy
- removing disparities in the rules and procedures between the CDM and JI in the area of AandR
- using the DNA forum to share good practices and lessons learned
- exploring possible synergies between the ongoing work of the expert groups under the UNFCCC (EGTT, LEG, CGE) and that of the CDM Executive Board and facilitating an exchange of views (focus on opportunities for creating an enabling environment for clean investment and sustainable development).

10. In addition, it was suggested that there might be the possibility to identify “additional opportunities (or incentives) under the Kyoto Protocol processes”. In those cases where it would still be difficult for a non-Annex I (NAI) country to actively participate in the CDM, the Adaptation Fund would provide a means of indirectly benefiting from it.

III. Response from the public

11. In response to the call for public inputs by the Board at its twenty-third meeting, five inputs were received³.

³ The World Bank, Oxford Climate Policy, AOSIS, Centre for Social Justice (India) and Aaditya Energy Foundation (India). The full texts of these submissions are available on the secretariat web site at http://cdm.unfccc.int/public_inputs/reg_distri.



A. Barriers

12. The public submissions also highlighted that CDM projects are distributed through market mechanisms. They stated that private sector buyers focus on low risk CDM projects in low risk countries, that investors will always seek projects providing the greatest returns on their investments, and that the varying state of economic development in individual host countries will have different levels of attractiveness for them as they will largely follow trends in foreign direct investment.
13. For comparison, the same headings have been used to summarize the inputs from the public:
- (a) **Structural and institutional issues**
- lack of enabling investment environment due to weak capital markets, prevailing risk ratings and state of economic development making investment less attractive
 - difficulties in financing the underlying projects which might be the foundation for a CDM project activity. For instance, many LDCs need to increase electricity generation to meet demand and promote development. They could develop renewable energy sources, but often have no access to investment at market conditions
 - the energy economy of many NAI countries is weak with low emissions/levels of fossil fuel use and thus few opportunities to reduce greenhouse gases from fossil fuels. This places them at a distinct disadvantage
 - lack of market opportunities due to weak public institutions
 - poor security
 - distorted incentives
 - NAI public and private sector entities have insufficient incentive to experiment with international regulatory mechanisms
 - multilateral and bilateral support has moved from CDM project financing to activities linked to purchasing CERs;
- (b) **Capacity issues**
- need to build capacity of various organizations (small scale industries, government agencies, individual experts, NGOs) through technical assistance, workshops and meetings
 - capacity of the public sector to establish DNAs (lack of understanding of requirements) and to support CDM projects is not yet available in many LDCs (and may not be worth building in countries with more urgent needs and priorities and only limited CDM potential)
 - lack of sufficient personnel and of IT equipment restrict participation
 - capacity of project sponsors to learn about and utilize the CDM is limited (often not worth building for just one single, perhaps small CDM project)
 - also, the private/local service sector, that could support project sponsors and the CDM, is not mature in many LDCs, which makes it more difficult for project developers to access the carbon market
 - lack of more broad-based awareness (currently, knowledge is limited to a few persons in an NAI country);
- (c) **CDM process issues**
- LDCs, in particular in Africa, are systematically put at a disadvantage by the modalities for the CDM and the approved CDM methodologies due to their level of economic development (they use insignificant amounts of fossil fuels and have low data reliability)



- rural areas have not been sufficiently explored for CDM projects. These will, aggregated, be on much larger scale than for the industrial sector
- small projects, which are typically found in LDCs, face proportionally higher transaction costs
- there are methodological barriers to private sector investment in CDM Projects
- rather restrictive guidance on bundling of small-scale project activities and the size limit of such bundles
- models for cooperation and sharing of ‘CDM resources’ between host countries do not yet exist and are not supported by the CDM modalities and procedures; cross-border projects face additional procedural uncertainties and methodological difficulties
- the (low) economies of scale of some Parties deter them from a unilateral approach
- the relationship (acceptability) of ODA and GEF grants to the CDM project cycle is still unclear
- the window of opportunity to benefit from the CDM in the first commitment period is rapidly closing.

B. Options

14. The public inputs also suggested options that might be considered when addressing the barriers they had identified. They are summarized following the same grouping as above:

(a) Structural and institutional issues

- encourage/develop an enabling investment climate with stable fiscal and regulatory regimes, better access to capital and financing
- find/encourage a few national CDM champions (motivated individuals in government or the private sector)
- encourage/develop a more active, well-established formal private sector that is able to handle a complex regulatory environment and that vigorously pursues CDM opportunities and benefits from learning by doing
- undertake reforms in the energy sector
- governments can facilitate agreements that satisfy national sustainable development objectives between multilateral funding agencies and the private sector
- public institutions can contribute to a more even distribution of CDM activities
- avoid creating complex and unnecessary administrations with lengthy and expensive procedures
- integrate GHG mitigation options and related incentives, in particular the CDM, into longer-term country and sector development plans
- include CDM project activities in facilitation, risk mitigation and insurance instruments;

(b) Capacity issues

- assist the private sector with the identification and development of CDM projects (buyer governments could fund such capacity building and/or support it through a programme of dedicated purchases from supported countries). Experience shows that hands-on training combined with long-term market incentives works best. Such capacity building should help create a critical mass of people and CDM expertise in host countries
- define relevant and efficient procedures with better emission inventories and baseline data



- assist the establishment of DNA capacity; could be regional cooperation and outsourcing of CDM-related administrative tasks or multilateral organizations could take on a service-provider role for certain countries
- many projects in LDCs can only be undertaken with ODA support. A combination of CDM with other sources of financial assistance (i.e. combining CDM with ODA to fill funding gaps) can help developing countries to undertake CDM projects and meet their long-term sustainable development objectives. The enabling and capacity development roles of such funding for CDM projects should be recognized and accepted and the possible impact on additionality should be clarified
- make more information about the workings of the CDM available by, *inter alia*, providing tools on CD-ROMs
- in general, examine the CDM in its current form and identify what changes and activities may be required to assist SIDS (LDCs in general) and improve their participation in the CDM
- involve voluntary organizations and NGOs more;

(c) CDM process issues

One submission was concerned that the CDM is becoming ‘elitist’ while another thought that the only way to address the issues of sustainable development and equity in the CDM would be to either introduce constraints on the mechanism (although this was not a preferred option, the author stating that the system should not be distorted to promote CDM projects in particular countries) and/or define additional mechanisms that are more likely to deal with these issues. The ideas presented for the latter approach fit into the suggestion from one Party that there might be “*additional opportunities (or incentives) under the Kyoto Protocol processes*” for instance

- ‘equitable’ valued quotas or ‘per capita allocation’ leading to tradable “Carbon Emission Reduction Permits” (CERPs), whereby the lowest emitting countries would also get a share. The sale of surplus CERPs could be earmarked for sustainable development purposes. To avoid additional transaction costs, such a scheme would require that a minimum demand could be guaranteed
- industrialised countries could take on Carbon Emission Reduction Obligations (CEROs), as part of their emission reduction commitments, to provide for a minimum demand for CERs from these countries, without imposing an unfair burden.

Another group of suggested CDM process-related options falls under methodologies

- many approved methodologies were not developed to cope with the more complex conditions and mitigation opportunities in LDCs and may require data that is not available. While combining elements from approved methodologies may help, CDM regulatory bodies find it difficult to overrule or deviate from them. Therefore, assessment of methodologies by the CDM Executive Board and its panels and working groups should always consider how a methodology would be applied under the more challenging conditions of LDCs, how it would affect access to CDM projects, and which remedies could be included in the methodology
- modalities and methodologies for household and very small project activities should be developed further
- it would be helpful to develop simplified versions of some data-intensive methodologies, for instance through providing standard baseline and default factors for typical situations in LDCs; in some cases these methodologies can be a significant barrier for LDCs, that may not have the information and expertise that is required to apply them. The expertise that is available in some development organizations could be used to



systematically screen approved methodologies and identify alternatives that better reflect the reality in LDCs;

15. Other options suggested were

- LDCs often have mitigation opportunities in energy efficiency, specifically through setting energy efficiency standards, which hardly exist in Africa. While standards and policies have been excluded as eligible CDM projects, programmes of activities are eligible. Aggregating small project activities under programmatic CDM would unlock this potential and enhance the impact on sustainable development
- to realize significant emission reductions, large scale projects will be required and the oil and gas sector is well-suited to achieve large reductions. However, these types of projects currently face technical challenges (e.g. defining baselines, determining additionality, political acceptability)
- unilateral CDM projects should be supported to improve geographical distribution
- a portfolio approach would stimulate buying from high risk countries
- certain project types, in certain countries, and for a certain period of time should be considered additional
- make all GHG mitigating and sequestration activities eligible to benefit from the CDM including energy efficiency at household level and in transport as well as measures to reduce or replace biomass use from non-sustainable sources
- link public and private regulatory and incentive systems
- develop (NAI) continent-wide emissions trading systems that include NAPs and burden sharing agreements.

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