

Singapore, January 20th 2011Subject: Inputs on CDM policy dialogue

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Nexus- Carbon for Development welcomes the opportunity to respond to the Executive Board's call for inputs on CDM policy dialogue. The CDM has evolved into a global mechanism with a wide range of stakeholders and perspectives. Nexus is a non-profit alliance of grassroots development organizations, working on disseminating technologies for the bottom of the pyramid¹. In this capacity we are pleased to present the perspective of development practitioners for the consideration of the CDM panel on policy dialogue.

The CDM possesses some unique characteristics which have the potential to deliver added value in terms of the effectiveness of development funding. In particular Nexus members would like to highlight the favorable comparison with alternative sources of funding.

- CERs are a long term funding stream enabling project developers to better plan for sustainable interventions.
- Finance under the CDM is independent from the objectives and requirements of donor organizations and can be better tailored to local needs.
- CDM is an internationally coherent attempt to address the market failure that means technologies are not developed to meet the needs of poorest communities.
- The CDM is an output based funding mechanism and the ongoing monitoring and verification drives efficiency and quality of interventions and reduces potential for corruption.
- The principle of national sovereignty to determine development goals is embedded in the CDM

This is especially pertinent because the CDM also faces increasing competition from alternative mitigation funding mechanisms, such as fast start finance (FSF) and, in the longer-term, \$100 bn of 'public and private' funding to be provided annually by 2020. It is our opinion that such funding, depending on how it is dispersed, may become something of a poisoned chalice, especially in LDCs, where it can be used to enrich those it is channeled through, rather than development of sustainable interventions.

Despite the recent progress on reducing barriers to participation in underrepresented countries, the potential of the CDM to deliver migration and sustainable development is undermined by existing

¹ Nexus is an alliance of pro-poor project developers whose shared vision is that the carbon market should tackle both climate change and poverty in a fair and transparent way. Its members are a global alliance of social ventures that acts as a peer-to-peer services platform, creating synergies and providing awareness raising, capacity building, carbon project documentation, and carbon asset management. It is a registered charity in Singapore since 2008.

shortcomings. From the perspective of the development community the principle short comings of the CDM are;

- A lack of reliable and long term pricing signals
- High transaction costs of registration and participation
- No incentive for projects with higher co-benefits
- Competition from the voluntary market.

The short comings listed above prevent development stakeholder from accessing climate finance through the CDM. Therefore, to ensure readiness and positioning of the CDM to meet post 2012 challenges the mechanism must be orientated towards creating an enabling environment for development projects. This can be done through addressing the present shortcomings.

- A lack of reliable and long term pricing signals

Nexus would support the view that parties need to send a strong signal regarding the future of the CDM. Existing signals indicate that the CDM will be positioned away from 'industrial' projects in economies in transition² and maintained in LDCs. Consequently initiating development focused project activities in non-LDC countries has become problematic. Measures should be taken to ensure projects activities in Low Income Areas (LIA) remain eligible. Similar to the positive list developed for additionality, a positive list of eligible project types could ring fence investments in 'development focused project activities.

Measures can be taken to provide greater confidence in the long term viability of the project activities. Whilst improvements made to the CDM have enhanced its flexibility, assurance is needed on the compatibility of project activities with future funding mechanisms. For example, investor could be reassured that CDM project activities, either standalone or PoA, be grandfathered into any funding dispersal mechanisms for mitigation activities, such as NAMA.

- High transaction costs of registration and participation

Transaction costs are frequently identified as a major barrier to project development. In particular, development practitioners are adversely affected by the high transaction costs and long lead in times associated with the certification process (because of their limited access to appropriate expertise and financial resources). Whilst recognizing achievements in this regard, the costs and time of registration and issuance must be reduced. In 2011 Nexus conducted a study on carbon finance transactions costs for household energy projects³. The principle findings of the study were that the highest costs were human resources and DOE costs, and that household energy projects, which accumulate scale over time, are likely to be loss making in the first two to three years. In order to participate in the CDM, organizations running these projects need access to appropriate financing instruments such as pre-finance or debt. For reasons outline below development practitioners are typically unable to take on these liabilities. Possible directions to address these issues are;

- Simplifying and streamlining the process to reduce human resource costs

Despite work on standardized baselines, the complexity of the CDM remains baffling to non-specialists. The study showed that the costs of hiring external expertise is a large component of the human resource cost. A future direction should be to examine options to allow 'non-specialists' to work on project development. Some examples of these options are the development of project specific tools. For example the, ERs Calculation Sheet developed by IGES and the 'CDM decision tool' developed by GERES.

² For example the recent EU directive that post 2012 credits will solely be sought from LDCs.

³ Study is available from nexus-c4d.org

- Improving the efficiency of DOE interventions

Increased dialogue between DOEs and project developers on common problems is the starting point for greater efficiency in DOEs interventions. Additional capacity building work on specific project types is recommended. For example, many auditors are trained in industrial processes and struggle to effectively audit development focused projects. The present performance evaluations of DOE do no analysis by project type. This, as well as greater transparency or guidance on recommended fee structures, would facilitate the process of selecting the right DOE and promote positive competition for services.

- Providing finance facilitating tools

Whilst transaction costs can be partly reduced, they cannot be avoided. Adequate and affordable finance is urgently needed to cover transaction costs until revenues start flowing in. Currently, most project developers enter into a forward contract with a down payment upon signature. This practice is seldom available to development practitioners because they usually do not have collateral, do not provide co finance and require too large a down payment. Whilst measures are being made to address this, through the project development fund, it is likely that the level of funds available will not be commensurate with the needs of development practitioners.

- No incentives for projects with higher co-benefits

Whilst recognition of national sovereignty is vital to maintaining the credibility of the CDM, as project activities increasingly move into under-represented countries the EB will need to ensure project development follows recognised best practices⁴. Improvements can be made at methodological and DNA level to facilitate the delivery of development benefits.

- Capacity building and additional resources for DNA to identify priority interventions and enable sufficient scrutiny of projects.
- Incorporate 'development criteria' into methodologies to ensure project development follows recognised best practices.
- DOE to be instructed to verify development benefits
 - Development criteria for monitoring development benefits for specific project types
 - Require project activities to monitor development impacts
 - Sustainable development benefits might be weighted in ER calculations or at least issuance contingent on demonstrating the project 'does no harm'.

Increasing the association with CERs as, not just a mitigation unit, but a metric for development outcomes will strengthened demand and price of credits and enhance the prestige of the CDM amongst the international community.

- Competition with the voluntary market

Project developers face a confusing set of choices when electing to develop a carbon finance project. Often development practitioners will elect to develop projects in the voluntary market. There are two main drivers for this;

- Methodologies in the voluntary markets for key development technologies, such as cooking stoves and biogas, have advantages over their CDM counterparts. For example, the biogas

⁴ An example of this would be improved cooking stove (ICS) projects. ICS projects have a long history of failure. Analysis of the reasons for the failure of so many programs has led to the emergence of accepted best practices in the development community. Best practices include avoidance of subsidies, ensuring technologies are appropriate for local cooking needs and constructed from local available skills and materials. It can be seen from the present pipeline that many projects in the CDM pipeline are in danger of repeating the mistakes of the past.

methodology in the Voluntary Gold Standard allows methane avoidance to be calculated, increasing the ERs available to project developers.

- Projects in the voluntary market can be credited retroactively. This is a big advantage for development projects which accumulate scale over time. Thus a successful pilot can be registered once the project risks have been addressed.
- Ongoing price resilience of voluntary market reflecting niche for projects with high sustainable development benefits

Without action to address the areas of competitive advantage of the voluntary market the CDM will not become the benchmark for a number of key project types with high relevance in underrepresented regions.

In summary, from the perspective of development practitioners, the CDM has some unique characteristics that improve the effectiveness of development finance. Existing signals show that at least some part of the present CDM will evolve into a mechanism focused on projects with high sustainable development co-benefits. Although there has been much work and progress in this regard, in order to fulfill this role more must be done to create an enabling environment for development stakeholders to participate. Addressing the shortcomings listed above will go some way towards creating this environment. On behalf of the Nexus membership I thank you for the opportunity to provide input and look forward to future consultations. Please do not hesitate to contact us for further information and/or discussion.

Yours Sincerely

A handwritten signature in black ink, appearing to read 'Sam B', with a long horizontal line extending to the right.

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On behalf of members of Nexus Carbon for Development