



PolicySolutions

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CDM Policy Dialog

Dear Mr Hession
Members of the CDM Executive Board
Members of the Panel for CDM Policy Dialogue

Policy Solutions welcomes the formation of the 12-member Panel to conduct the CDM Policy Dialogue and their terms of reference, as well as the opportunity to provide input on the issues to be addressed.

As a mechanism of the Kyoto Protocol, the CDM will invariably need to adapt to external forces, such as those that have led to a precipitous drop in CER prices, most notably the intention of countries to exit the Kyoto Protocol beyond 2012 and the impact of the financial crisis on energy use and demand for CERs in Europe. With limited demand, CER prices have fallen to all-time lows of under €4 in January 2012. This situation underscores **fundamental issues about the role of offsetting under the UNFCCC umbrella.**

Combined with high volatility, continued policy uncertainty and significant transaction costs – particularly for small-scale project activities with the greatest sustainable development benefits – the potential benefits for developers of primary CERs increasingly do not outweigh the risks. Under such circumstances, no commercial bank will lend to a CDM project activity that is not financially viable in its own right, meaning that the CDM is unlikely to spur development of investments that would not have happened in the absence of one of the worst-performing commodity markets over the past year. **The lower the CER price, the less credible are claims that private investments are additional and the less justification there is for offsetting as a climate mitigation policy.** This is a negative (external) feedback loop that is critical to the effectiveness of the mechanism.



Instead of moving toward a second commitment period under the Kyoto Protocol that would have included ambitious caps for major emitters as a basis for carbon markets from 1 January 2013, the international policy framework has evolved in a different direction. The predominant model is no longer “cap-and-trade with international offsetting,” but rather regional, national and sub-national commitments and actions, so far without non-compliance sanctions, coupled with offsetting (in some cases open to CERs, in others, not).

The continuance of the CDM thus should not be regarded as an end in itself; rather the CDM must demonstrate that it can evolve to “ensure the effectiveness of the mechanism in contributing to future global climate action”, as mentioned in the TOR. As stated by the Executive



Board, the report on the dialog process is expected to be relevant to the ongoing intergovernmental negotiations on the future international climate regime more broadly.

To support the work of the CDM Policy Dialog and the ongoing management of the CDM, the CDM Executive Board, therefore, should commission an **independent external outcome evaluation (IEOE)** of the effectiveness of the CDM in its present form. The evaluation should be based on clear Terms of Reference to facilitate the selection of a service provider through an open and international competitive bidding. The TOR should specify the objectives of the evaluation; its scope and focus; major evaluation questions; main tasks and methodology; deliverables (including evaluation report Table of Contents) and milestones; team composition and profile; and governance and organization for the IEOE.

It will be necessary for the Executive Board to lay the foundation for the outcome evaluation by preparing an evaluation plan, including:

- Developing a **logic model for the CDM** in its current form (i.e., a depiction of inputs, activities, outputs and (short-, intermediate and long-term) outcomes), keeping in mind the dual purpose of the CDM. On the mitigation side, the theory is that offsetting should lower overall mitigation cost and/or increase the level of ambition, but such impacts have yet to be rigorously documented for the CDM in the real world, in a context of volatile energy prices, economic crisis, and taking into account CDM-specific transaction costs and risks. Similarly, local sustainable development benefits have been documented for individual project activities, but a systematic framework for evaluation is lacking.
- Selecting performance indicators to assess progress towards outcomes;
- Specifying data sources and collection methods;
- Specifying data analysis methods.

The CDM Executive Board could delegate these tasks to the Panel and the exercise could draw on the independent evaluation expertise of the GEF and its implementing agencies, as well as of Parties to the UNFCCC and other stakeholders.

Such an independent evaluation, founded on a common understanding of the program logic underlying the CDM, would provide much needed perspective and insights to consider how the CDM (or an offsetting mechanism, more generally) might evolve going forward to remain relevant and deliver agreed outcomes. **If the CDM cannot do so more effectively than other policies and mechanisms, then the vast resources engaged by the CDM should be deployed elsewhere.** Mitigation is increasingly urgent, and we need to be asking ourselves resource optimization questions, for example: If the billions invested in CDM had instead been invested in assisting developing countries with implementing key NAMAs, such as reforming utility regulation, tariff design and incentives, or establishing robust regimes for mandatory minimum energy performance requirements and building codes, could a better outcome for the climate system have been achieved? Certainly, such measures have been among the most cost-effective in industrialized countries.

Thus it is **critical that the work of the Panel considers more than mere adjustments to the mechanism** within the framework of the CDM Modalities and Procedures handed down by the Parties and instead address fundamental questions, such as:



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- What is the program logic behind offsetting?
- Has the CDM been effective in achieving defined outcomes (independent external evaluation proposed above)? For which gases, sectors, countries?
- Under what conditions might international offsetting be most appropriate?
- Why have policymakers of emerging regional/domestic climate regimes not adopted/endorsed the CDM as an approved regime to deliver offsets?
- How can the lessons learned from the CDM inform new mechanisms, such as deploying resources under the Green Climate Fund?
- How can the human and institutional capacity that has been built under the CDM be most advantageously deployed going forward?

Whether the CDM can be effective in contributing to future global climate action is heavily dependent on how the mechanism relates to other policies and measures to address key emissions sources. As long as CER demand is tied to commitments under the Kyoto Protocol, the largest contribution the CDM can make may be to apply its lessons learned to inform the emerging post-2012 climate regime and to redeploy the limited human resources from CDM to NAMA and international cooperation efforts.

The CDM has no doubt raised awareness and increased capacity to develop, implement and monitor climate mitigation activities. The fundamental question seems to be how the human and institutional capacity that has been built under the CDM can best be deployed going forward. The answer may or may not be to continue the CDM as an international offset mechanism in its present form.

Sincerely

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