The World Bank
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

1818 H Street N.W.
Washington, D.C. 20433
U.S.A.

(202) 473-1000
Cable Address: INTBAFRAD
Cable Address: INDEVAS

UNFCCC Secretariat
P.O. Box 260124
D-53153 Bonn
Germany

January 11, 2012

Subject: Inputs on the "The CDM policy dialogue" in response to the call for public inputs made at EB64

Dear Members of the Executive Board and UNFCCC Secretariat,

We welcome the opportunity to provide inputs on the "The Policy dialogue on the CDM". Our recommendations on the issues to be addressed in the dialogue are structured under the headings of 1) assessing the performance of the CDM, 2) Evaluating the experience with CDM regulation, 3) Discussing the CDM and the role of carbon crediting post 2012.

1. Assessing the performance of the CDM

In this part we suggest to analyze the performance – both achievements and challenges - of the CDM based on experience gained from the existing portfolio of CDM projects.
Developed through a „learning-by-doing" approach, the CDM has exceeded expectations, not only in terms of the number of projects, but also in terms of awareness (on climate change in general, as well as in identifying, assessing, implementing, monitoring and verifying greenhouse gas mitigation/sequestration activities in different sectors) and capacity building (in both public and private sectors) that it has generated. At the same time, concerns have been raised by different groups of stakeholders (e.g., overly conservative methodologies, disadvantaged project activities, prospects/incidence of free riding and the implications on overall GHG mitigation efforts and too high transaction costs associated with the mechanism which contribute to undermining the CDM and carbon finance impact, as well as leakage and concerns over the distribution of CDM projects across countries and sectors). These should be taken into consideration as the Panel assesses the performance of the CDM.
This analysis should cover the two dimensions of the CDM, i.e., as an instrument to achieve greenhouse gas (GHG) emissions reductions and to assist host countries in achieving sustainable development. As the CDM is a market-based instrument, the analysis should also consider economic and financial dimensions. Key to structuring such analytical work is the identification of

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appropriate performance indicators to feed into the overall assessment. In our view these indicators could include:

(a) CDM's contribution to emissions reductions:

- Assessment of the CDM's contribution to global GHG mitigation: The volume of issued (and expected to be issued) CERs relative to the quantified GHG emission reduction or limitation commitments of Annex B Parties.
- Estimate of actual GHG reduction performance taking into account potential risks: The overall volume of estimated actual emission reductions through the CDM as compared to the volume of CERs issued. This assessment may warrant consideration of potential over-crediting of actual emission reductions (e.g., given possible leakage) as well as under-crediting of actual emission reductions (e.g., given crediting periods shorter than project lifetimes, possible positive spill-over and/or overly conservative baselines and boundaries).
- Assessment of cost-effectiveness of mitigation through the CDM: The average price of a CER as compared with GHG mitigation costs for internal measures in Annex B Parties.
- Assessment and comparison of transaction costs associated with the CDM: The transaction cost of the CDM per CER issued compared with a similar measure for transactions costs of alternative instruments which involve public finance and regulatory policy (assuming a similar degree of rigor to ensure environmental integrity, e.g., to exclude free-riding and monitor achieved environmental performance).

(b) CDM's contribution towards assisting developing countries in achieving sustainable development:

- Assessment of sector/technology impact: The share of CDM projects (as well as emission reductions) in key sectors such as renewable energies, waste management, energy efficiency and transportation (compared to overall CDM portfolio and overall investments in low carbon technologies in developing countries).
- Assessment of geographic reach: The share of CDM projects (as well as emission reductions) in different countries and regions, including low income regions, countries and communities.
- Assessment of carbon finance impact: The amount of carbon finance (i.e., CER revenues) associated with CDM projects – in total and by key sector and country.
- Assessment of broader financial impact: The volume of underlying climate-friendly investments in developing countries leveraged by the CDM.
- Assessment of the structure of the underlying funding of CDM projects and assessment up to what degree the CDM catalyses private sector climate finance.
- Assessment of co-benefits: Scope and type of environmental and social co-benefits associated with CDM project activities.
- Assessment of impact in private sector: Indicators (and evidence) for the impact of the CDM on business practices and corporate decision making (e.g., in terms of taking into account emissions and emission reduction possibilities in investment decisions).

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- Indicators (and evidence) for the impact of the CDM on policy making in developing countries (e.g., in terms of gaining familiarity and confidence with market-based instruments to achieve environmental objectives and/or in terms of stimulating taking GHG emission considerations in policy decisions).
- Indicators (and evidence) for the capacity building brought about through the CDM in developing countries to address climate change.

2. Evaluating the experience with CDM regulation

The CDM has broken ground as the first market mechanism to be governed by a UN institution. Many experts and stakeholders have devoted their time, energy and expertise to contribute to its functioning and success. At the same time, the CDM regulatory bodies, the decision-making process and some decisions and guidance have also raised concerns (e.g., regarding the inherent practical difficulty of determining additionality of a project activity and verifying it objectively, the difficulty of counting on carbon finance to enhance bankability of a mitigation/sequetration project activity, and the perception of an insufficiently transparent and independent regulatory process) that need to be taken into account in the evaluation of the experience with CDM regulation. This evaluation should serve as critical input to inform and enable policy decisions on (i) improving/reforming the mechanism, (ii) defining the future scope of the CDM; and (iii) the way the CDM can be combined with other mechanisms and policy instruments. In our view this evaluation should include at least the following aspects:

- CDM governance structure (in terms of, e.g., roles of various actors and potential conflicts of interest, ensuring quality and environmental integrity; direct costs; timelines; and due process) and consideration of potential alternatives.
- Experience with the CDM project cycle (in terms of, e.g., ensuring quality and environmental integrity and transparency and predictability) and consideration of options for simplification.
- Experience with CDM methodologies (in terms of, e.g., ensuring quality and environmental integrity, transparency, ease of understanding and implementation, and consistency between different but similar project activities) and consideration of options for standardization.
- Experience with ensuring environmental integrity through project-specific additionality testing, consideration of conceptual alternatives.
- Experience with allowing prompt start project activities under the CDM. (Insights from this experience can potentially inform the consideration of early start for a new market mechanisms.)
- Regulatory and methodological challenges for project activities in underrepresented sectors such as transportation and forestry. Options to address them.
- Regulatory risk and implications for bankability of CDM revenues. Options to address them and to improve bankability of CDM revenues. This should be based both on a conceptual analysis as well as on an empirical study.

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- Regulation for forestry carbon credits and consideration of potential alternatives to temporary carbon credits.

3. Discussing the CDM and the role of carbon crediting post 2012

For the carbon market to continue and to efficiently and effectively contribute to meeting greenhouse gas mitigation objectives necessary to address climate change, there needs to be greater clarity on plans to use market instruments, and the CDM in particular. We suggest that the high-level policy dialogue also include a discussion on the role and potential contributions of the CDM in the climate policy at the international (UNFCCC) level, as well as at the regional and national levels. In this context we suggest to consider the following topics:

- Scenarios for the potential demand for carbon credits between 2012 and 2020, and beyond where possible. This can be based on the assumption of implementation of Parties' mitigation pledges under the UNFCCC as well as relevant domestic legislations.
- Possibilities and implications of scaling up the current CDM project-based approach to sectoral and/or policy-based crediting (i.e., beyond current eligible activities under projects and programmes of activities).
- Potential and implications for better integrating the CDM in domestic climate change and development policies (i.e., potential to address possible perverse incentives) and for blending CDM revenues with public finance.
- Role of the CDM operating alongside a potential new carbon crediting mechanism. Considerations to ensure environmental integrity and avoid any double counting.
- Link between the CDM and developing countries' mitigation pledges and objectives.
- Potential contribution of the CDM to the mobilization of international climate finance.
- Merit and possibility of a transparent and predictable review of CDM post-2012 to take stock and reflect any changes in circumstances.

We will be pleased to provide further information and clarifications at your request and would welcome the opportunity to further contribute to the CDM policy dialogue.

Yours sincerely

Klaus Oppermann
Team Leader Policy and Methodology
Carbon Finance Unit,The World Bank