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Input to Policy Dialogue on the CDM

This is an attempt to define institutional factors informing policy choices and to suggest a priority of these institutional factors.

Until the present, the CDM landscape remains shaped by a succession of actor types. At first governmental funds, followed by new dedicated companies, then significant entries of banks or financial services, and recently the appearance and expansion of a few large and vertically integrated carbon investors (even a possibility of oligopolistic forces). These investors are pursuing portfolio strategies comprising first of all fossil fuel commodity concerns. This succession of actor types is itself path-dependent. Carbon markets are today quite segmented with each type of actors relating to their preferred actor type. The depth of the market does not yet transmit signals to all. The market segmentation is a function of the depth of the whole market.

Another institutional limit is the absence of countries but equally so the absence of whole sectors of the world economy, often by choice of leading corporations in these sectors. Insurance is a prominent actor, while power utilities and energy technology corporations are absent and seem likely to remain so.

In this context, market depth is a high priority policy objective. Market depths constrains the possibilities for pursuing policy. Policy that does not address market actors and their limits is not realistic.

Part of this barrier is a dichotomy of motives visible in all economic sectors, on one hand finance objectives, and on the other hand sustainability marketing objectives. The dichotomy originates in the last five years of carbon market evolution. This separation is a barrier for the private sector. In other words, carbon volume is a factor only for fuel and material input in production and not for the technology and business models used. Sustainability marketing objectives comprise product definition and offerings. Environmental concerns of consumers and customers are enhanced by the product but not by its production. Corporations do not invest in technology improvements and separate the price signals from carbon markets from their production choices. From the opposite side, the sustainability marketing efforts add choice for consumers but only as far as s/he can decide between alternative final products, thus limited to somewhat superficial aspects.

The dichotomy between finance objectives and marketing objectives adds to the segmentation among market actors. Vertically integrated carbon investors pursue only finance objectives, and dedicated companies create and expand types of carbon that is meaningful in marketing.

Deepening carbon markets in the current stage of market development could thus focus on each of these two faces, expanding volumes and certain qualities of "bulk carbon" for vertically integrated investors and, in parallel, expanding the customization of carbon for sustainability marketing. Neither of these two ambitions follows from an economic analysis of the market parameters and it is a separate interpretation of market development, dependent on an adequate observation of market actor types.

The segmentation of actor types and the dichotomy between finance and marketing objectives are currently powerful features of the market. There is a tendency to subsume these features under regional distribution of the CDM, LDCs and countries with less than 10 CDM projects, as if distribution and country representation were core aspects of market development.

I would like to propose a suitable label for this tendency - Westphalianism. The UNU has studied such tendencies and this label draws attention to the need to confront it. 'Westphalianism in CDM' appears to keep policy making from addressing the carbon market dynamics and disconnects the EB and the CDM secretariat from market actors. New market forces require time to establish metrologies, networks, alliances and interests so that the "spadework of commercial relations" uncovers efficiency potential.

A second appeal also concerns the realism of the policy dialogue. Since the 1950s, development assistance has experimented with many formats. Aid effectiveness is seen as a wide open challenge (as during the Busan conference), and recent innovations such as budget aid, pooling or results-based approaches have brought ambiguous results. Crucially for capacity development, CDM policy needs to draw lessons from development assistance. A suitable point of departure is the strength of institutional issues in development assistance, a realization that started after the Basic Needs orientation in the early 1980s. NGOs as much as governmental donors have learnt to accept the local arena of all developmental NGOs and of all governmental donors, and each such arena has an idiosyncratic dynamics that frequently undoes all efforts in planning or spending. The recent innovations in aid formats (since 2000) all address the strength of the local arena. The "aid chain" is one of the analytically productive concepts.

Capacity development for CDM can avoid many detours, especially by scrutinizing aid effectiveness. Two attempts to inform aid effectiveness might be revealing for CDM: "Drivers of Change" in DfID and "Problem Driven Governance and Political Economy Analysis" in the IBRD. These are typical and will appear in many more forms because they grapple precisely with the local arenas where aid happens.

For instance, a joint evaluation of a NAMA by other NAMA supporters is urgent. Joint evaluations of aid programmes have proven to be a source of learning for development assistance even so these have taken much time and effort to establish. Local competition for NAMAs and even more so in NAPAs might be a dominant barrier and only carefully crafted precautions against such local competition might make NAMAs and NAPAs attain certain impacts. In some contexts, the powerful legacy of development assistance against which NAMAs and NAPAs struggle make aid effectiveness lessons an unavoidable route to follow.

It should be an inspiration for CDM policy that joint evaluations have been particularly successful in water programmes and public health. Global public goods might be especially effective objects of joint evaluations. Finally, I would like to draw attention to a major focus of aid effectiveness efforts, a field known as 'impact evaluation' and its use of counterfactuals. Impact evaluations have brought genuine insights by creating counterfactuals that were assumed to be impossible. CDM methodologies' improvements are a potential driver for the direction of the CDM and with co-existing carbon schemes possibly increasingly so. Impact assessments for methodologies' improvements have not been addressed at all.

I hope these issues can enter the policy dialogue on the future of the CDM.

Sincerely