CDM Policy Dialogue: Input from the International Emissions Trading Association

The International Emissions Trading Association (IETA) welcomes the initiative taken by the Executive Board of the Clean Development Mechanism to establish a High-Level Panel for the CDM Policy Dialogue (Panel) and its invitation to submit views from stakeholders and other organizations.

Introduction

IETA is a non-profit business organization created in June 1999 to develop a functional international framework for emissions trading that results in real and verifiable greenhouse gas emission reductions, while balancing economic efficiency with environmental integrity and social equity. Its membership includes more than 155 international companies from OECD and non-OECD countries, across the carbon trading cycle.

IETA and its members have been actively involved in the CDM since the launch of this innovative market-based mechanism over a decade ago, engaging in all aspects of the CDM from the design and improvement of the mechanism's rules and governance to the creation and evolution of the carbon markets, and the development and financing of real CDM projects. Thus, IETA represents a unique cross section of CDM market actors and offers an access point to a wealth of diverse, broad and deep information and experience in the CDM and other emissions markets around the world.

From IETA's point of view, this Dialogue offers a valuable and timely opportunity:

- To study the CDM's evolution over the past 14 years from a few paragraphs in the Kyoto Protocol to a fully functional multi-billion-dollar business, and;
- To explore the accumulated capacity, insights and lessons for further improvement of the CDM to increase its efficiency and broaden and diversify its scope, and for the development of new climate financial flows, including new market-based mechanisms to complement CDM.

Throughout the Dialogue, IETA would like to be able to share with the Panel our members' diverse experience with the CDM, and to discuss the general principles that guide development of further market mechanisms as well as options for addressing some of the CDM's current shortcomings. Some key observations and messages are highlighted in this input, but the Panel should also take account of the

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CDM-related publications and submissions IETA has provided to the UNFCCC throughout the years (see Annex I), which contain many points that are still valid.

CDM in 2012: Looking back and preparing for the future

To date, the CDM has proved remarkably effective in delivering investment to low-carbon projects, enhancing the deployment of clean technologies [especially in China, India and Brazil]. The CDM has also pioneered the indirect linking of national, regional and UN carbon market schemes by creating a global economic incentive and internationally recognized currency for greenhouse gas emission reductions.

However, it must be noted that the CDM's track record in supporting projects is not equally successful across all developing countries. While IETA commends the CDM for having already undergone a tremendous transformation from an untested concept to a fully functional system, we strongly believe that the CDM must continue to evolve in order to operate effectively with the dynamic and diverse national priorities and circumstances of current CDM host countries and sectors to deliver low-carbon investment, sustainable development and technology transfer.

To avoid the worst impacts of climate change, the global community must mobilize additional finance of at least the Copenhagen figure USD 100 billion annually by 2020 for strengthened mitigation and adaptation. Although it is clear that the CDM in its current form cannot leverage the finance of that scale, the experience, institutions and capacity accumulated by the CDM offer a solid foundation for the development of a new, coherent international climate finance framework and for the contribution of a substantial portion of the additional finance needed. Such a framework should be developed holistically to allow the CDM to evolve and co-exist with other climate finance instruments and mechanisms. Most importantly, a reformed CDM would need to be scaled-up, even if new and different mechanisms are created.

The CDM mechanism itself can serve – and already serves – as a platform for developing and testing important new approaches, such as standardized baselines and Programmes of Activities (PoAs). The CDM should continue in countries and sectors most in need of its benefits, as the CDM is still the only functional and tested internationally recognized mechanism for incentivizing low-carbon investments in developing countries.

Structure of IETA's initial input

At this initial stage, IETA would like to draw attention to three issues to be addressed in the Dialogue:

1. The Dialogue’s scope and approach
2. Achievements, challenges, lessons and opportunities of the CDM
3. The process and next steps of the Dialogue

1. The Dialogue’s scope and approach

The CDM’s merits, shortcomings and opportunities should be examined in light of the objectives of the CDM and global climate policy. The overall objective of market mechanisms is to have a global carbon market with a strong, stable and robust carbon price that can drive the necessary low-carbon investments and support sustainable development in the host country. Such markets will need to be driven first by governments, and we need policy-makers to stimulate much more demand for carbon credits than we currently see today. Once sufficient ambition is in place, market mechanisms have the ability to incentivize public and private investments in low-carbon activities that meet relevant criteria. We hope that the Dialogue distinguishes and recognizes the difference between issues that are fundamental in the CDM’s design and those outside the CDM’s control, such as the policy struggles of the global climate regime, overall global economic circumstances, and the consequent current low levels of carbon prices.

To obtain a balanced and comprehensive view of the merits, shortcomings, challenges, opportunities and lessons of the CDM, the Dialogue needs to be both broad and deep. The investigation should consider variation across time, location and technology as well as perspectives spanning from individual projects to carbon businesses, stakeholders, national and UN governance. Similarly, the Dialogue needs to collect material broadly and deeply by inviting views and experiences from all relevant stakeholders, encouraging such stakeholders to provide evidence to substantiate their views on the CDM, and independently collecting and triangulating material to evaluate perceived and measured experiences and views on the CDM’s impacts, achievements and shortcomings.

Many of the CDM’s achievements, challenges and lessons are in the details. The Dialogue should take a close look into the core of the CDM experience, namely the CDM project cycle that all projects go through in order to generate CERs. To obtain a comprehensive view on what CDM is about and how it functions, the Panel will need to familiarize themselves with various themes and details related to the project cycle and CDM criteria.

The CDM has, and should continue to have a key role in: building capacity and expertise to identify and realize mitigation potential; developing methodologies and (programmatic, standardized) approaches; and broadening the reach of incentives for mitigation action by serving as a link between various schemes to incentivize mitigation action and by covering sectors and/or countries that are not covered by cap-and-trade systems or other climate policy instruments.

IETA encourages the Dialogue to also look at and examine other offset mechanisms and standards, such as the Gold Standard, the Verified Carbon Standard and the Climate Action Reserve to learn from their experiences and different approaches to the establishment of environmental integrity and the creation of units that can be used with confidence in emissions trading.

2. Critical analysis of achievements, challenges, lessons and opportunities

Inspired by UNFCCC Executive Secretary Christiana Figueres's introduction at the launch of the Dialogue in Durban, IETA presents a brief critical assessment of CDM from the perspectives of:

- Private sector utilization
- Infrastructure and governance
- Mobilization of funding
- Transition and evolution

To ensure that the CDM can fulfill its sustainable development objective, it is necessary to consider how a reformed CDM or any new market mechanisms could target its support. This may require distinguishing between the circumstances of emerging economies, other developing countries and Least Developed Countries (LDCs) and/or sectors, as well as making sure that CDM projects will reduce global greenhouse gas emissions in absolute terms. We understand that there will be a policy menu in each country and the CDM will be part of that menu to be used based on national circumstances and qualifications. The governing bodies of the UNFCCC will have to recognize this during any transition period to a changed CDM and will need to ensure that CDM is integrated with JI and new mechanisms under the Convention.

To function efficiently, a reformed CDM and any new market mechanisms should do what it can to avoid regional or national distortions, e.g. arising from unilateral bans on credits from CDM-projects in certain countries or certain types of projects as a result of lack of confidence in the environmental integrity of methodologies and governance; it should aim to keep administrative arrangements as transparent and efficient as possible whilst maintaining adequate quality control to safeguard the scheme's integrity.

Private sector utilisation

Achievements in private sector utilization

- The World Bank has reminded us that even during the financial crisis, low carbon finance and investment recovered growing by 30% to $243 billion in 2010.
- Parties can continue to actualize private sector contributions through an international agreement that includes decisions that: sustain existing and establish new market mechanisms, set ambitious emission reduction targets needed to send clear price signals to investors and create policy incentives to facilitate the diffusion of existing low-carbon technologies.
- Given the scale of private capital required and existing technologies available to address the challenge of climate change for mitigation and adaptation, it is important that Parties understand the full range of positive contributions that business can provide to assist countries in meeting their national low-carbon goals.

Challenges in private sector utilization

- Uncertainty is intrinsic to the CDM and its learning-by-doing dynamics-as well uncertainty of broader post-2012 climate policy and related CERs-have made the CDM a challenging business for private sector participation, rendering the risk-reward ratio unacceptable to some private sector actors
- A market-mechanism is dependent on business for its success. The CDM has offered too little engagement with private sector; this must be corrected.
- Private sector investors must be convinced there will be a market for the CERs: confidence can be increased by clear decisions at the UNFCCC and within Parties about the level of emissions reduction ambition, as well as a continued political goodwill towards the CDM

Key messages on private sector utilization

- The private sector can mobilize considerable amounts of finance for mitigation activities as long as the risk-reward ratio is acceptable and a sufficient timeline that justifies the required capacity building.
- The public sector can play an important role in supporting capacity building and shouldering some of the bigger risks.
- The CDM can serve as a model for engaging private sector in identifying, developing, implementing and financing mitigation action and for leveraging significant financing for mitigation and adaptation.
- There is a need to develop the CDM as part of a wider climate finance framework as the CDM cannot mobilize finance of the required scale on its own.

- The CDM should not be removed or downgraded until something truly better and tested emerges, i.e. not for several years. Even then, the CDM can co-exist with new approaches and play a role in certain countries, sectors and technologies.
- We welcome the CDM Dialogue's high-level panel as a good step forward in increasing engagement with the private sector, but the Panel should consider, as a priority, how continued and effective private sector engagement could be achieved. IETA would be happy to offer further thoughts on the specific support that emitters, financial institutions, clean technology companies and carbon project developers could offer during the Dialogue and beyond.

Infrastructure and governance

Achievements in infrastructure and governance

- The CDM has been instrumental in achieving a new level of engagement and communication between the UN system and the private sector and civil society, and it has introduced many important elements of national systems, such as participation rights, due process and transparency into the UN context.
- The CDM has undergone a tremendous learning experience and accumulated knowledge for 14 years and has built up a functional, multi-billion-dollar market-based scheme within the UN system which is self-financed, based on largely untested models arising from new developments in environmental economics.
- The CDM has developed nearly 200 active methodologies and dozens of methodological tools as well as established an internationally accepted standard for measuring, reporting and verifying (MRV) emission reductions.

Challenges in infrastructure and governance

- Learning-by-doing necessarily involves ongoing changes, which is a major challenge for project developers who face long lead times in project design and development.
- The CDM is still lacking an appeals process that would protect the rights of CDM actors and the separation of executive, legislative and quasi-judicial powers. This adversely affects the willingness of key private businesses to

participate, and increases transaction costs as potential risks have to be hedged

Key messages on infrastructure and governance

- Although the CDM can already serve as a model for communication and engagement with the private sector and civil society, the mechanism would benefit from further improvements in stakeholder engagement, for example by providing more reaction time for public inputs, making publicly available the material relating to CDM EB's decision-making and organizing interactive workshops with relevant stakeholders before making far-reaching decisions. Such improvements would make the mechanism more stable and transparent and thus more attractive for investors and project developers.
- Dynamic schemes such as the CDM may impose great risks on, and thus discourage, early action unless ongoing projects are sufficiently safeguarded against changes.
- In principle, all technologies that can contribute to the reduction of GHG-emissions should be accepted. If Governments consider that other controls are necessary to incentivize or reflect domestic political concerns they should take the necessary steps relating to the aspect of the technology that concerns them, rather than attempting to deny the possibility of GHG reductions from the methodology at global level. In terms of not yet commercially-available technologies a reformed CDM or new market mechanism also needs to be sufficiently flexible to apply or adapt to new abatement technologies.
- A future CDM cannot continue with a project-by-project approval. This will make the process too slow and will also discourage smaller-scale projects that could play an important part in expanding energy access in developing countries. The CDM's approach to project-specific additionality testing is not feasible for scaled-up approaches.
- Distinguishing between developing countries (emerging, LDCs and others) may make it easier to deal with this issue. The CDM is already exploring innovative approaches to additionality testing, and should continue to do so.
- Standardization of a single-projects approval procedure needs to be further developed. Positive steps have been made through the work on standardized baselines and this work should continue.

Mobilisation of funding

Achievements in mobilization of funding

- The CDM has mobilized $140 billion of new funding for low-carbon activities, typically leveraging 5-20 euros of investment with each CDM Euro.
- The CDM is currently the only mechanism offering private investors in developing countries direct access to international carbon markets to fund mitigation activities.
- The CDM is a self-financing mechanism which also currently provides the single most reliable source of funding for adaptation within the UNFCCC.

Challenges in mobilization of funding

- The CDM alone cannot deliver the funding needed but can be an important case for further leveraging public-private finance.
- Many CDM projects need upfront funding whereas the CDM's risks have, in most cases, undermined the developer's ability to secure upfront funding against future CER revenue.
- The uncertainty of future eligibility of CDM project types increases CDM-related risks and reduces the interest in investing in the mechanism and the underlying mitigation activities

Key messages in mobilization of funding

- Even relatively small amounts of CER revenue can mobilize large amounts of further private finance for mitigation, if there is direct access and clear rules for accessing the financing.
- Risks and delays will limit this effect whereas public funding can be used to enhance this leverage effect, e.g. through risk sharing and provision of up-front payments.
- In the future, the CDM and new market mechanisms must be scaled-up significantly in order to deliver the needed global emission reductions to avoid the worst effects of climate change.
- The CDM needs to be developed in a holistic manner to complement and reinforce other forms of climate finance.
- The CDM's role in creating a stream of income should be incorporated into work streams addressing climate finance and funding of National Appropriate Mitigation Actions (NAMAs); and should be incorporated into the Monitoring Reporting and Verification (MRV) of funding and financing of NAMAs. This will help both policy-makers and businesses take a more

holistic view of the opportunities and risks of investment in developing countries, and enabling better public and private strategies to manage them. In particular, combining CDM credits with sources of climate funding and financing from the Green Climate Fund, World Bank and Multilateral Banks' climate financing and bilateral funding can reduce private investor risk and significantly enhance the scale of mitigation actions in developing countries

The evolution of the CDM and new market mechanisms

Achievements in the evolution of the CDM and new market mechanisms

- The CDM has evolved from a purely project-based mechanism to a mitigation toolkit that encompasses broader programmatic and standardized approaches to match the diverse circumstances of current CDM host countries.

Challenges in the evolution of the CDM and new market mechanisms

- The evolution of the CDM needs to be supported by ambitious long-term climate policy goals and sufficient demand to absorb the increased supply of credits that a reformed, scaled-up CDM could deliver. Without new demand, new approaches will not be implemented and the mitigation potential offered by the CDM's evolution would be missed and/or postponed.
- A reformed CDM requires special expertise which needs to be maintained and nurtured if the CDM and new mechanisms are to be developed and implemented efficiently.
- CDM host countries are introducing NAMAs, some of which are to be financed unilaterally, some with international climate finance and some via markets. While representing important progress, NAMAs complicate the determination of crediting baselines for CDM projects. What is needed is a clear policy signal to clarify the circumstances of continued use of CDM-based credits, as new NAMAs become a reality.

Key messages in the evolution of the CDM and new market mechanisms

- It is important to recognize the value of the CDM's ability to continue uninterrupted work to develop and improve market mechanisms independent of timelines related to new market mechanisms. The Panel should ensure that CDM's experience, capacity and lessons can be fully utilized in the development and smooth evolution of new mechanisms to avoid unnecessary delays.

- The CDM and any new market mechanism must fit under the umbrella of a single framework; this design work is currently ongoing in parallel in the CDM and other contexts under the Kyoto Protocol and the UNFCCC and careful coordination and holistic approaches are critical in developing a single coherent, functional and efficient framework rather than multiple regulatory systems and markets
- The CDM has been a powerful instrument for developing processes and standards, setting up institutions, building capacity and enhancing dialogue between different actors engaged in mitigation activities.
- The CDM can co-exist with new market mechanisms and it will continue to be a relevant instrument for identifying and incentivizing cost-effective mitigation action in a broad range of contexts and countries, wherever sectors are not covered by cap-and-trade and/or gaps exist in other climate policy instruments
- To complement and reinforce other forms of climate finance, CDM needs to be developed in a holistic and coordinated manner vis-à-vis other climate finance instruments and mechanisms such as the Green Climate Fund and other international support for NAMAs.
- The CDM is already serving as a valuable platform for the development and piloting of new approaches, e.g. standardized baselines and Programmes of Activities, which represent natural evolution of the CDM and offer a smooth transition into new mechanisms. Many elements (e.g. standardized baselines, PoAs) that are likely to form the basis of any new mechanisms are already being developed under the CDM.
- A reformed CDM or new market based mechanism could be more directly linked to the funding of NAMAs, e.g. by developing NAMA-crediting for NAMAs which are listed in the NAMA registry in order to receive public/private sector support.
- The High-level Panel is encouraged to consider submissions on new market mechanisms in response to requests by COP 16 and COP 17, and decide how to assess them with respect to a reformed CDM to limit further distortion of the carbon market(s).

3. Process and next steps of the Dialogue

- IETA asks the Panel to make an agenda, work and resource plan, stakeholder outreach and engagement process and information on transparency, participation publicly available
- IETA highlights the need for a process where there is an opportunity to make substantive written input followed by presentations and discuss on stakeholder input
- IETA suggests a webinar immediately following first Dialogue meeting or a meeting with industry associations back-to-back with the first meeting of the Panel
- IETA suggests monthly updates or a consistently updated website demonstrating the progress of the Dialogue
- IETA requests that events and workshops be open to stakeholders; striking a balance between wide representation and encouraging genuine dialogue and sharing of information and experience
- IETA invites the Panel to discuss ways to best explore the extensive experience of IETA's members in the Dialogue, and asks the panel to get in touch as early on as possible to allow sufficient time for this valuable process
- IETA requests the panel to invite IETA and its members to relevant events during the Dialogue
- IETA invites the Panel to look through the extensive material developed by IETA over the years on CDM, most notably its CDM report delivered prior to COP each year (see Annex I)

Annex: List of CDM-relevant IETA submissions (2009-2011)

Please click on the title below to download the relevant publication/submission; it will link you to a web-based platform to download the relevant document.

Publication Date	**Title**
November 27, 2011	IETA Memorandum on the Continuation of the CDM
November 27, 2011	IETA CDM paper 2011
March 29, 2011	Submission to SBI on the Development of an Appeals Mechanism for the CDM
March 29, 2011	Submission to SBSTA on the Incorporation of Materiality into the CDM
March 18, 2011	Response to the CDM EB Call for Input on Direct Communication
March 18, 2011	Response to the CDM EB Call for Input on Future Work on PoAs
February 21, 2011	UNFCCC Submission on CCS as CDM Project Activities
February 21, 2011	Response to the AWG-LCA Call for Input Regarding New Market-Based Mechanisms
January 12, 2011	Response to EB58 Call for Input on Draft Revised "Guidelines on the Assessment of Investment Analysis"
January 12, 2011	Response to EB58 Call for Input on Three Draft Baseline Tools
October 15, 2010	Response to EB56 Call for Input on Materiality and Level of Assurance in the CDM
October 8, 2010	Response to EB56 Call for Input on CERs in the CDM
September 2, 2010	Letter to CDM EB Regarding Timing of Release of Market-Sensitive Data
September 2, 2010	Letter to the CDM Executive Board Regarding Challenges in Effectively Managing Significant Policy Issues
September 1, 2010	Letter to UNFCCC on the Role of the Private Sector

August 27, 2010	Response to the Call for Input on Focus Areas for Future Practitioner Workshops for CDM Stakeholders
April 23, 2010	Response to EB53 Call for Input on Appeals Mechanism
February 6, 2009	IETA Input to AWG-LCA
February 6, 2009	Ad Hoc Working Group on Further Commitments for Annex I Parties to the Kyoto Protocol