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.

![Diagram]

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
Parties, mechanism, and incentives, or 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:
• 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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