

Development Dividend: Making the CDM Work for Developing Countries



SECOND MEETING OF THE DEVELOPMENT DIVIDEND TASK FORCE

10th December 2005

Hochelga 6, Hotel Queen Elizabeth, 900 Rene Levesque Boulevard West, Montreal

MEETING REPORT

WELCOME AND INTRODUCTION

John Drexhage, Director, Climate Change and Energy, IISD, opened the Second Meeting of the Development Dividend Task Force. In his opening comments, he welcomed participants and reported on the wrap up COP-11/MOP-1 negotiations. During the meeting John also emphasized the success of the Development Dividend project at the COP/MOP, as five separate side events addressed the issue.

John Drexhage noted that the aim of the Task Force Meeting was to review the outlines of the three research papers proposed and sent to the members prior to the meeting, and to examine/discuss issues of relevance arising in COP-11/MOP-1 that may require further research/investigation by the Task Force. He asked that the meeting begin with a review of the decisions from the conference and to then begin discussions around each of the papers.

COMMENTS ON COP-11/MOP-1 DECISIONS

The Task Force members participated in a discussion about the decisions arising from COP-11/MOP-1. The overall consensus by the Task Force was that the outcome was better than expected. Key areas of discussion included:

- The decisions (par 8) on comprehensive guidance to the CDM Executive Board (EB) from the COP/MOP - is viewed as having the potential to improve on the overall issues surrounding the strengthening of the CDM, especially focusing on the government structure, and enhancing the effectiveness and efficiency of project decisions and the quality of the work done by institutions. As an aside, the clear commitments from Annex 1 countries for funding through the next couple of years may help to solve the financial situation/deficit of the CDM EB adding to its improvement. Agreement on the share of proceeds from CERs will hopefully make the CDM EB a more self-financing body, lessening dependence on Annex 1 countries.
- The decisions related to additionality (par 25-28) - The request to the EB to review inputs addressing additionality was well received. The inclusion of information in the EB report on selection and approved approaches on baseline scenarios, and the

“tool for the demonstration and assessment of additionality” will help to address all project related issues but particularly the highly controversial issue of carbon capture and storage (CCS). At the next MOP in November, it is expected that the additionality track, and the CCS track will come together, along with the issue of social benefits to the CDM, which is in direct relation to the Development Dividend. It would be helpful to have a positive list of projects that are eligible, and did not use the additionality tools, especially projects that are automatically additional such as wind-power projects.

- Decisions on efforts to increase participation in the CDM (par 34, 36, 41) - This is viewed as key in the Development Dividend project, to improve the capacity of project participants to deliver project activities which enhance sustainable development (SD) benefits. Capacity building is regarded as lying outside the capabilities of the EB and perhaps even the COP/MOP, but could be a key role for the Task Force.
- The decision (par 20) that a local/regional/national policy or standard cannot be considered as a CDM project activity, but that project activities under a programme of activities can be registered as a single CDM project provided... - This is viewed as a step towards programmatic CDM which brings together the three concepts of sectoral, policy-based, and private sector-based initiatives. With respect to the Ghana CDM proposal, this decision implies that the mandatory energy efficiency standard is not a CDM project activity, but the replacement of Air Conditioners is. This decision attempts to avoid a government putting a policy in place and not implementing it. It also indicates that a program to support a policy would not be implemented by the government but a private sector or institution. It is understood that the implementation of energy efficiency policy measures, resulting in CDM activities can be presented as a package, as one project design document (PDD). Although this is a positive step for the CDM, a potential impediment is that a policy can be put in place and the implementation of the policy can be registered even if the activity for delivery is not known.
- The decision for the EB to develop a simplified methodology for calculating reductions for small-scale project activities that propose the switch from non-renewable to renewable biomass (par 29-30) - This decision could potentially inflict a delay in achieving project equity as many projects in Africa will be excluded. It may have been more appropriate to switch from non-renewable biomass to an alternative fuel. There is some confusion with this issue and the land-use, land-use change and forestry (LULUCF) issue, although fuel wood has been recognized as an energy issue, and not a LULUCF issue. The feeling is that there is no reason to continue with LULUCF projects unless the government helps to engage the private sector.

OVERRIDING ISSUES

Task Force participants discussed further areas of concern not necessarily addressed in the decisions, for example:

- Governance of the CDM EB - This could be considered a question of managing a private sector mechanism which may be challenging to the UN. The issue of independent governance could involve putting in place a CEO on the EB who would be open to dialogue with business. This issue has not yet matured as there is a lot of focus on the support structure of the EB which is important for strengthening purposes yet with respect to independence, the CEO question will have to be more seriously addressed in the future.
- Transportation and energy efficiency - This area has not been directly included in the COP-11/MOP-1 decisions, yet in the transport sector there exists weak monitoring systems overall. For example, it is crucial that the process of monitoring fuel sold and its actual use in engines be well established. The issue of double counting is also prevalent among these types of projects.
- Official Development Assistance (ODA) and the CDM - The potential exists for the CDM to grow so much post 2012, that it could outgrow ODA and move toward more responsiveness to business needs.
- Outstanding issues - it was felt by one participant that some of the main outstanding issues consist of:
 - The programmatic CDM approach bringing in projects of a different nature
 - Dealing with multiple actors for CERs
 - The monitoring of activities not all starting at the same time
 - Not necessarily knowing what types of activities will arise from programs
 - The possibility of having different types of activities within the same PDD

DISCUSSION ON THE DEVELOPMENT DIVIDEND RESEARCH PAPERS

At the First Meeting of the Development Dividend Task Force, areas identified for further research and analysis were: Defining the Development Dividend, Changing the Rules for a Development Dividend, and Financing the Development Dividend.

During the second meeting and in a presentation on the current outlines, Deborah Murphy highlighted six different areas that will need to be reassessed post COP-11/MOP-1. For example, removing “policy-based” CDM and changing “sectoral” to “programmatic”. Deborah’s presentation was cut short to allow for more discussion time. This presentation is attached.

The group participated in open dialogue on the current outlines. It was expressed that a clear overall objective of the three papers ought to be well defined and that it may be more effective to change, “papers” to “chapters” and amalgamate the research into one piece of work. Identified was the necessity to explicitly state the linkages between each paper/chapter and how they relate and can potentially affect one another.

DISCUSSION ON PAPER 1: DEFINING THE DEVELOPMENT DIVIDEND

At the previous meeting, the Task Force agreed on the necessity of defining the Development Dividend and the first paper outline was developed to clearly articulate

what is meant by “development dividend,” and to propose a framework for assessing its strength in specific CDM projects.

At this second meeting, the Task Force addressed additional factors to consider in Paper/Chapter 1:

- Clearly differentiate between the means of the work and the project goal before defining the Development Dividend and in its definition, be clear of its specific context to reduce Greenhouse Gas (GHG) reductions, and create SD, and that it is not a synonym of SD. In doing this SD must be clearly explained as well (the work done by the OECD on SD indicators should be reflected as well as other work such as the UNDP Millennium Development Goal (MDG) indicators).
- There are two areas which are underrepresented in the Development Dividend project and ought to be addressed: poverty and critical ecosystem degradation, particularly where carbon has a significant impact.
- More than one member of the Task Force felt that presenting a framework for developing countries to include the CDM in their larger development plans and goals and to link these with MDGs focusing not only on the environment but also financing and planning, would be useful.
- It is deemed important to address the issue of monitoring SD standards in the host country. Currently a letter stating that SD standards are being met at the end of the process is all that is required. Discussed further was that SD indicators is an area of work that has gone on for a long time but needs to be directly applied to the CDM.
- This paper should discuss risks in terms of, performance risk of the technology provider who will assume the technology risk, the carbon delivery risk, and the financial risk.
- When doing a Development Dividend assessment to find what works best, explore the background of project proponents, the economy, and society, etc. since this information is not included in the PDDs.

DISCUSSION ON PAPER 2: CHANGING THE RULES FOR A DEVELOPMENT DIVIDEND

Based on information gained at the First Task Force Meeting it was established that the second paper could focus on Changing the Rules for a Development Dividend. The idea for the research was to explore in depth some of the CDM rule changes suggested in the phase 1 report. These included sectoral and policy-based CDM, special treatment for small-scale projects, product-based crediting and an expanded scope for sinks under the CDM. Case studies and analysis was to highlight both the potential and the practical difficulties associated with each approach.

However, at this Task Force Meeting, it was agreed that rather than focusing on sectoral and policy-based CDM (although one member felt that an analysis of policy versus sectoral may not be necessary but a debate on the issues may help us with future

directions), the research should move toward programmatic CDM, not focus on small-scale projects, and potentially leave sinks aside.

Here is a short summary of the issues surrounding the second outline proposed.

- Aim to galvanize the private sector to participate in the CDM keeping in mind the purpose of allowing projects to compete on a commercial basis while achieving the Development Dividend.
- An alternative title could be, “Mechanisms for Supplying the Development Dividend”, or “Mechanisms for Supporting SD”.
- Implications that small-scale projects are linked with SD benefits and that other projects do not bring about as many benefits are to be avoided. The prevailing feeling among members is that it is important to express the importance of SD in all sized projects, project types, and contexts because every scale of project should be able to contribute to SD. Consider the idea of larger scale projects funded from government to government to ensure SD benefits at this size.
- It was suggested that the issue of carbon sinks is not suitable for this project because LULUCF projects are accompanied by another host of issues. At best, the sinks issue deserves a completely separate chapter or paper.
- This research can help to set an agenda building on the added value of this overall initiative by outlining where we will be in ten years from now and what can be done immediately, in the medium-term, and post-2012.
- In the three papers it appears that the focus has been on decisions of the COP and Programmatic CDM. With respect to the right niche for policies in the CDM, a potential would be revenue streams. This would branch the focus to looking forward, and not just as per the COP decisions.
- It is recommended to assess some DNA’s to find out how they’re going about their SD criteria because in theory, they’re following guidelines. Perhaps there is the potential for an analysis of the DNA which could ensure the Development Dividend.

DISCUSSION ON PAPER 3: FINANCING DEVELOPMENT DIVIDEND

At the First Meeting of the Development Dividend Task Force, the group provided support for a third paper, Financing the Development Dividend. This paper will explore the ways in which we might increase the available financing for CDM projects that yield a development dividend.

Discussions on the financial paper lead to the following highlights.

- Essential is a clear distinction between the market gaps, as the CDM is a market instrument moving into the commercial sphere. The capacity to understand it is weak on the side of financiers and on the side of developers, understanding the

financing barriers is also weak. For instance, it is a challenge for a development organization to recognize that what matters most is price.

- Give a thorough assessment of different financial providers and explore financial instruments keeping in mind that a good project to a financier isn't necessarily one with SD dividends. A characteristic of a good project is a positive cash flow during the life of the loan, which implies that the costs can be fully repaid. Recognize the issue of buyers wanting to associate their image with carbon, but not with SD standards.
- With the CDM, the big problem is underlying finance. Carbon finance is available but project finance is not. As well, the gap between classic finance and carbon finance should be addressed.
- The CDM can potentially act as a tool for attracting investment, especially in countries which are not typically attractive for foreign investment. Identify the challenges and constraints of the different financing arms such as multilateral institutions, bilateral financial institutions, expert credit agencies (ECAs) and local financiers (ECAs have a role to play but the constraint is that they function on national interests).
- Define and explain carbon risk on a more in-depth level than in the first research paper. The aim being to develop a carbon delivery guarantee. Required is a source of untied insurance in order to take the carbon delivery risk. The structuring of this is an obstacle as there is no natural party in place to take this on. This issue needs to be raised in the consciousness for policy-makers. (Carbon delivery is important but in small scale, it is not worth the risk. It would be helpful to build on this by identifying barriers of the suppliers of capital and developers considering grants, loans, and equity.)
- The research on finance needs to address primarily the, a) barriers separating financiers from CDM, b) barriers in regard to instruments, c) barriers from the perspective of financiers and project developers, and d) a need to establish a role for ODA.
- The use of ODA is a grey area and needs clarification and the best use of ODA needs to be identified. Mixed credit schemes are another way to use ODA as a financing package apart from using ODA for project preparation. (The Marrakech accords indicate that ODA is not acceptable to CDM projects or for buying CERs).
- With respect to addressing local banks, there is a role to be established for rural and community development banks especially in terms of using the money to leverage funding for CDM. The banking sector in developing countries is very weak and can only provide very short term loans. There is thus a need to strengthen the local banks.
- Define Development Dividend in a form that financiers can understand again, in this research paper. Most financial institutions look at the financial value of a project. It needs to be defined in a way that quantifies it. The ultimate result will be

a premium product or a product with a premium associated with it that has value to the financial sector /buyers. Consider the value that investors will put on the Development Dividend. Recognize that the private sector is accountable to their boards and there exists a lot of pressure on spending the sector leans towards the best cost deal with the lowest risk.

PARTNERSHIPS FOR RESEARCH

Deborah Murphy announced partnerships with southern research groups for developing the research papers/chapters which will be a tactic to contribute to the **influencing strategy to ensure that the findings of research are made available to a wide range of decision makers, such as the Executive Board, Southern partners, COP Parties, DNAs, buyers and sellers, and project developers.**

1. The first paper focusing on defining the Development Dividend will be undertaken by IISD; TERI (Preety Bhandari); and the Chinese Academy of Social Sciences, China (Xianli Zhu).
2. The second paper on reforming the CDM to bring about the Development Dividend will be completed by IISD, Winrock International, Costa Rica (Christiana Figueres); Federal University of Rio De Janeiro (Suzana Kahn Ribeiro) and Embrapa, Brazil (Andre Cau).
3. The third paper will be developed by IISD; International Financing Consulting (Diana Smallridge); SouthSouthNorth (Emily Tyler); and, ECM Centre (Tom Owino).

WORK PLAN AND NEXT STEPS

At the First Meeting of the Development Dividend Task Force, it was agreed that the Task Force should be viewed as a body that will investigate on-going and new issues related to the CDM over the longer-term. Effort will be made to ensure the continuation of the Task Force as long as the CDM proceeds, through the identification of timely and pertinent topics for further discussion and research.

Holding the second meeting immediately after COP-11/MOP-1 contributed to this intention. Insight was gained and the direction of the research influenced by the most recent negotiations and overriding issues of concern.

Revamped outlines of the papers/chapters based on discussions at this second meeting will be distributed to the members in mid-January and feedback will be obtained by the end of January. Drafts of the research will be complete by mid-March.

There will be two more Task Force meetings within the next 8 months. The Third Task Force Meeting will be held in Vancouver on the 27th and 28th of March during Globe, an

international trade show and conference on business an the environment, and will focus on:

- **Reviewing the research areas.**
- **Addressing feedback on the research to date.**
- **Next steps.**

The principle role of this secretariat until March 2006 will be to: 1) develop the research chapters with the southern partners identified; 2) adjust research according to feedback from the Task Force; 3) and work toward securing more funding and enhancing the longevity of the Task Force.

The Development Dividend Task Force
Second Meeting of the Development Dividend Task Force
10th December 2005

GOVERNMENTS

Canada	Sushma Gera (CDM EB/ Foreign Affairs Canada)*
Canada	Jane Rigby (Environment Canada)*
Canada	Jeanne-Marie Huddleston (Foreign Affairs Canada)*
Norway	Georg Borsting
Denmark	Frode Neergaard

MULTILATERAL INSTITUTIONS

UNDP	Brian Dawson
World Bank	Charles Cormier

BUSINESS/INDUSTRY

Winrock International	Christiana Figueres
Development Bank of Japan	Takao Aiba
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IETA	Andrei Marcu*
International Financing Consulting	Diana Smallridge
Natsource	Aline Ribas
Transalta	Don Wharton

NGOs AND RESEARCH INSTITUTES

Chinese Academy of Social Sciences	Xianli Zhu
ECM Centre	Tom Owino
EMBRAPA	Andre Cau
Hamburg Institute	Sonja Butzengeiger
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IDRC	Simon Carter
Federal University of Rio De Janeiro	Suzana Kahn Ribeiro
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SouthSouthNorth	Emily Tyler
TERI	Preety Bhandari
TERI	Mahesh Vipradas

IISD	John Drexhage
IISD	Aaron Cosby
IISD	Deborah Murphy
IISD	Michelle McLaren

**Not present at the Montreal meeting*

REGRETS

GOVERNMENT

Canada	Paul Samson (CIDA)
Columbia	Martha Patricia Castillo
India	R.K. Sethi
Japan	Hiroshi Yamagata

MULTILATERAL INSTITUTIONS

IFC	Allan Miller
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BUSINESS/INDUSTRY

BP	Chris Mottershead
Shell International	David Hone
TC+ES	Mark Trexler
Chicago Climate Exchange	Michael Walsh
IEA	Richard Baron
IPEICA	Tim Stileman
Alcan	David Hecnar

NGOs AND RESEARCH INSTITUTES

Centre for Clean Air Policy	Jake Schmidt
IDRC	Merle Faminow
WRI	Kevin Baumert
NRTEE	Alex Wood
Mitsubishi Research Institute Inc.	Kenichiro Yamaguchi