

# Development Dividend: Making the CDM Work for Developing Countries



## THIRD MEETING OF THE DEVELOPMENT DIVIDEND TASK FORCE

27<sup>th</sup> – 28<sup>th</sup> March 2006

Cortes Island Room, Fairmont Hotel Vancouver, 900 West Georgia Street, Vancouver,  
British Columbia

## MEETING REPORT

### March 27<sup>th</sup>

**WELCOME AND INTRODUCTION** - John Drexhage, Director, Climate Change and Energy, IISD  
Mr. Drexhage opened the Third Meeting of the Development Dividend Task Force. He welcomed participants and noted that the aims of the meeting were to review the three research chapters and the supporting background papers; to seek feedback and input from the Task Force on the three chapters; and to seek direction for a third phase of the Development Dividend project.

### **OVERVIEW OF CHAPTER ONE: *MEASURING AND DEFINING THE DEVELOPMENT***

***DIVIDEND*** - Aaron Cosby, Associate and Senior Advisor, IISD

Mr. Cosby provided an overview of the chapter and its purpose - to determine how to assess and measure the Development Dividend (DD). In his presentation, Aaron Cosby looked at recent developments in the CDM, considerations in measuring the DD, and a possible assessment tool. Questions raised by Mr. Cosby included: How do we achieve appropriate measurements? Is such a tool needed? Who would use the tool? And, are there enough existing tools?

### **Overview of Background Papers for Chapter One**

#### ***Promoting the Sustainable Development Contribution of CDM Projects – Actions in***

***China*** - Xianli Zhu, Research Centre for Sustainable Development, Chinese Academy of Social Sciences  
Ms. Zhu looked at initiatives by the Chinese government to promote the sustainable development (SD) contributions of CDM projects and the effects of such efforts. The paper outlines China's CDM regulations and requirements, such as the government levies on revenue of CER sales from HFC-23 destruction and N<sub>2</sub>O projects. These monies are being pooled in a National Clean Development Fund and are to be used for SD purposes. The Fund is not yet functioning as the rules remain undefined. Options for measuring the DD in CDM projects are also presented in the papers, including an analysis of existing SD measurement approaches. Ms. Zhu found that both advantages and disadvantages exist with each existing measurement approach, but that checklists and multi-criteria approaches may be the most suitable models for assessing the DD of CDM projects.

#### ***Clean Development Mechanism and Development Dividend: An empirical study from***

***India*** - Jagjeet Sareen, The Energy Resources Institute (TERI)

Mr. Sareen focused on the background of the CDM in India and the extent to which projects deliver SD benefits. An investigation of 25 registered CDM projects in India was used to assess SD contributions claimed in project design documents (PDDs). The 25 projects were all approved by India's DNA and therefore met India's SD criteria (social well being, economic well being, environmental well being, and technological well being). The projects were also considered in regards to India's Millennium Development Goals. It was found that many CDM projects in India have not made significant contributions to SD and that problems exist with geographical distribution, industrial energy efficiency, and a lack of social development objectives.

## DISCUSSION OF CHAPTER ONE:

The objective behind the DD project is to focus on finding a prominent place in the market for projects contributing to SD benefits, and not to exclude projects that do not provide a DD. The growing number of CDM projects at the registration and validation stage indicates that the market will change significantly in the next few years and it is important to keep this in mind and to reflect this in the research papers.

Although India does not have a tax/levy system on CERs, this approach is under consideration. There exists a potential difficulty in assuring that levies from CERs would go toward SD initiatives but if they did, this could imply a large DD on those projects contributing the most levies. It would be beneficial to address tax models and the potential for dividend benefits, especially if the expenditures on SD were ensured.

DNAs defining SD in the qualitative sense such as India run the risk of allowing almost any project to get approved. Consensus exists that a project's DD contribution cannot be measured by its PDD. Furthermore, project developers need SD criteria at the design and development stage of a project, rather than at the approval stage.

The need to define the Development Dividend and identify its place in the CDM market is a dynamic issue as is the need to determine the value and necessity for a tool or standard. Do we need to influence the price and make it marketable or influence policy rules to make it easier for these projects to receive approval?

Suggestions from the Task Force:

- An idea is to develop DNA guidelines for developing SD criteria although this has already been done to some extent.
- A thorough assessment of the existing tools building on efforts already carried out could help to identify gaps.
- It may not be a good idea to develop a tool because many currently exist. Furthermore, standards at a global level are quite unrealistic because SD criteria are considered an issue of national sovereignty. On the other hand if a very useful tool is developed, sensitive to different country needs, DNAs may use it, resulting in a *de facto* SD market standard.
- It is necessary to consider developing a model for post-2012 - look at the problems in the first commitment period and attempt to determine how these could be improved upon in the longer term, with SD as a key factor.
- A helpful tool would be a public database showcasing projects with high SD benefits that have been developed and implemented successfully in specific sectors.

## March 28<sup>th</sup>

### **OVERVIEW OF CHAPTER TWO: *OPTIONS FOR FOSTERING THE DEVELOPMENT DIVIDEND***

- Deborah Murphy, Associate, IISD

Ms. Murphy presented on chapter two, which explored potential alternatives for fostering the development dividend in CDM projects. To this end, Ms. Murphy sought solutions to the quality and quantity issues of the DD. In her research, she looked at the question of additionality and options for improving assessment methods to bring about DD. Programmatic CDM, small-scale projects, LULUCF projects and the regional distribution of CDM projects were also addressed. The paper concluded with an assessment of options to foster the development dividend in the short, medium and long term. Deborah Murphy went on to speak to a background paper submitted by EMPRAPA and IPAM, in their absence.

### **Overview of Background Papers for Chapter Two**

***Effectiveness of the Clean Development Mechanism within the Context of Forest Activities in Brazil: A Critical Analysis*** – Deborah Murphy for Andre Cau, Luciano Mattos and Paulo Moutinho

The authors of this paper conducted an analysis of the CDM in relation to LULUCF projects looking at both existing and potential activities to demonstrate the difficulties in implementing these types of projects. A project to avoid deforestation, PROAMBIENTE, was described. The program promotes sustainable forms of agriculture, forest management, watershed protection, fire prevention, biodiversity conservation, soil recuperation, and forest restoration. Compensation is provided to farmers who move toward more sustainable practices such as permanent agriculture. Such monies are transferred through an Agricultural Credit Fund, providing credit to agricultural investments, a Support Fund for technical assistance and the like, and an Environmental Fund for participating farmers investing in environmental protection. This program could benefit if avoided deforestation were allowed under the CDM.

***Programmatic CDM*** - Erik Haites, on behalf of Christiana Figueres

Mr. Haites emphasized that programmatic CDM involves a deliberate program of emission reductions, and can be implemented through multiple dispersed actions. As well, it involves only one executing agent as the program *is* the project activity. Programmatic CDM can broaden access to the CDM to include small businesses, households and transportation. This paper emphasized that programmatic CDM can enhance SD benefits but it requires further high quality methodologies and clarification on the COP/MOP decision. The paper concluded with recommendations that the CDM EB consider methodologies in a timely manner and that project developers work to submit high-quality methodologies to expedite the implementation of programs in the CDM.

***Opportunities and Constraints on Possible Options for Transport Sector CDM Projects - Brazilian Case Studies*** - Suzana Kahn Ribeiro, Federal University of Rio de Janeiro Transport Engineering Program

Ms. Ribeiro addressed the issue of transport as a key area to achieve carbon dioxide emission reductions. Her paper used a transportation case study to demonstrate how projects from this sector could be designed as programmatic CDM projects. Ms. Ribeiro illustrated some of the methodological difficulties related to developing a biodiesel CDM project in Brazil. She emphasized the potential for programmatic CDM to increase development dividends in the transportation sector.

**DISCUSSION OF CHAPTER TWO:**

Changing the rules for additionality could mean higher project approval rates but it would not necessarily guarantee an increased DD. The Task Force provided positive feedback regarding the option of combining the assessment of additionality with the baseline, and developing a positive list of technologies, sectors, and areas that could automatically be assumed to be additional. A suggestion was to look at the concept of adding sustainability to the definition of additionality.

There could be a need to address the definition of small-scale projects, which discriminates against certain project types. Defining small-scale projects in terms of capacity energy outputs instead of GHG reductions could be more appropriate because the various current definitions of maximum small project size can produce widely varying quantities of GHG reductions. As well, with renewables, the GHG reductions are often not predictable. It could be useful to develop a positive list of small-scale projects which are automatically considered additional. There may also be a need for a new category: micro projects.

If programmatic CDM turns out to be very complex, it may not open the door to more projects. It was noted that we cannot assume that all programmatic CDM projects lead to a DD.

The development of methodologies for LULUCF projects has been slow because of technical difficulties in calculating carbon stocks and flows. The discussion provided clarification on tCERs and ICERs, the issue of permanence and expiring credits, and their impact on investment. Attention needs to be given to secondary impacts of afforestation and reforestation (A/R) projects, e.g., the impact of fast-growing trees

in water scarce areas. It was noted that there would be little point in undertaking efforts to promote A/R projects in the short-term if the EU-ETS maintains its position not to include credits from LULUCF projects. There will be a very limited market for such projects in the first commitment period.

## **OVERVIEW OF CHAPTER THREE:**

### ***FINANCING THE DEVELOPMENT DIVIDEND*** - John Balint, International Financial Consulting Inc.

Mr. Balint presented on the third research chapter, which focused on potential ways to increase the available financing for CDM projects that yield a DD and the barriers to financing which exist in these projects. Key issues presented were market risk and future uncertainty, project costs (especially upfront costs for small-scale projects), and the undetermined value for SD benefits. Mr. Balint identified that some projects yielding SD benefits had characteristics that were inherently risky and unsuitable for financiers. His research further explored ways in which financing for CDM projects could encourage project stakeholders to include and/or enhance the DD. An option to develop a process that assesses, selects, and finances large and small projects having a proven DD was offered by Mr. Balint, and a pilot process carried-out in Africa was suggested as a means of learning more about this issue.

## **Overview of Case Studies for Chapter Three**

### ***Kuyasa Low Cost Housing Energy Upgrade Project; Bellville South Waste Disposal Site***

- Emily Tyler, SouthSouthNorth

Ms. Tyler provided information on two case studies. First, the Kuyasa Energy Upgrade Project is seeking financing for implementation which is proving difficult despite the project having been approved by the EB, being a Gold Standard Project, and securing 15 Euros per credit on the voluntary market. The second case study, the Bellville Landfill Gas Recovery, demonstrates the difficulties in securing financing in a landfill gas project, which is considered to generate better than average returns when compared with many other CDM projects. Both case studies reveal the need for technical expertise and appropriate institutional structures to secure financing. In particular, they demonstrate the barriers to financing CDM projects situated in local government (where there are potentially high DDs to be gained).

### ***Case Studies: Solar Technology for Electricity Provision and Vanilla/Jatropha Project***

– Tom Owino, ECM Centre, Kenya

Mr. Owino provided information on two Kenyan case studies, the Vanilla/Jatropha Project and Solar Technology for Electricity Provision, which both demonstrate the difficulties experienced by project developers in securing finance. He found that there was a need to educate project developers about how financiers evaluate projects and risk. He suggested that it is necessary to develop projects with SD benefits keeping in mind the requirements of the financier as well as the CER buyers. Mr. Owino noted that including SD in a project may actually increase the project risk profile and it might help to balance these risks with rewards.

## **DISCUSSION OF CHAPTER THREE:**

The case studies revealed lessons that could be put together for project developers to help them think like a financier. Project developers must understand that banks operate on the basis of getting the most in the shortest time, for the least amount of money. In this regard, developers may lose interest in the DD so there is a need for a financing and DD balance.

Buyers of credits have different motivations than financiers, and these motivations should be brought out in the discussion. For example, a buyer of credits is interested in certainty in the delivery of CERs.

An area for further exploration is the question of how SD provides a value added component in the market place. Emphasis was given to the importance of developing and making people aware of the right tools so that the market will take the lead – instead of forcing the market, there is a need to leverage it.

Two potential solutions are: a) attempt to monetize SD benefits, and b) improve the capacity of SD projects to participate in the broader market. However, if there is a reliance on the market for delivery of DD, an understanding of market fluctuations has to be kept in mind- there are no guarantees. The issue of the role and influence of VERs was also raised as a potential niche market.

There is a need to identify and understand the barriers that inhibit financing of projects with high DD benefits (e.g., size, type, or nature of the project). To this end, it might be beneficial to develop a list of potential projects in a country and rank the risk of those projects. Pooling carbon credits may lower the overall risk and increase financing while decreasing transaction time. In this case, a buyer may be willing to pay more for SD benefits. The development of a white list exhibiting a wide array of project options with different contributions to SD could also be useful.

All agreed that it significantly more attention is required for exploring opportunities to leverage CDM investments with ODA.

## **WRAP-UP AND NEXT STEPS**

The Task Force provided valuable input on the papers and research directions, with considerable debate taking place over the necessity of “measuring” the development dividend. Some felt it would not be possible to come up with a meaningful metric, while others expressed the need for some type of ranking to guide the decisions of buyers and investors while informing developers. The need to address the long-term in the papers was noted by the Task Force, as the CDM should be viewed as a long-term mechanism that will evolve as the market matures. The Task Force members noted the need to develop the next drafts of the paper as three chapters in one coherent piece of work, where strong linkages are made between the chapters.

It was felt that there is growing consensus on previously controversial areas under the CDM (e.g., the need to include avoided deforestation and a larger role for LULUCF projects; the need for a simplified process for additionality in certain sectors, perhaps over the longer term as lessons are learned). In line with this coalescing of issues, the role of the Task Force is evolving. While the Task Force was originally formed to investigate on-going and new issues related to the CDM over the longer-term, a future role may be to act as a sober pragmatist to help depoliticize issues and ensure future decisions further the two objectives of the CDM. This is consistent with the goal of the Development Dividend Project to bring about change by strategically informing the CDM debate with high-quality research and analysis, as well as providing relevant perspectives to stakeholders engaged in the CDM.

Work on Phase II will continue until the end of August 2006, and will include meetings with funders in Bonn, Germany in May 2006. The three research papers will be revised and developed into three chapters of a publication. Final versions of the chapters will be completed in July 2006, with the intent of publishing the chapters in August 2006 - in time to feed into COP/MOP-2 in 2006 and to influence intervening debates.

A third phase of the project is expected to begin in September 2006. Task Force members expressed interest in pursuing three possible areas of future work: programmatic CDM, options for post-2012 (with, perhaps, a focus on LULUCF projects) and financing. Proposals will be developed in these three areas and funding will be sought to support future Task Force meetings and project activities.

# Attachment A: The Development Dividend Task Force

## GOVERNMENTS

Canada	Sushma Gera (Foreign Affairs)
Canada	Jane Rigby (Environment Canada)*
Canada	Mariette Maillet (CIDA)*
Columbia	Martha Patricia Castillo*
India	R.K. Sethi*
Norway	Georg Børsting*
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## MULTILATERAL INSTITUTIONS

IFC	Alan Miller*
UNEP – Risoe Centre	Sami Kamel*
UNDP	Brian Dawson
World Bank	Mahua Acharya

## BUSINESS/INDUSTRY

BP	Chris Mottershead*
Chicago Climate Exchange	Michael Walsh*
Development Bank of Japan	Takao Aiba*
DNV	Einar Telnes*
IEA	Richard Baron*
IETA	Andrei Marcu (Ian Carter)
International Financial Consulting	Diana Smallridge (John Balint)
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TC+ES	Mark Trexler*
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## NGOS AND RESEARCH INSTITUTES

Centre for Clean Air Policy	Jake Schmidt*
Chinese Academy of Social Sciences	Xianli Zhu
Development in the Americas	Christiana Figueres (Erik Haites)
ECM Centre	Tom Owino
EMBRAPA	Luciano Mattos*
Federal University of Rio de Janeiro	Suzana Kahn Ribeiro
Hamburg Institute	Sonja Butzengeiger (Michael Dutschke)
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NRTEE	Alex Wood*
SouthSouthNorth	Emily Tyler
TERI	Preety Bhandari (Jagjeet Sareen)
WRI	Kevin Baumert*
IISD	John Drexhage
IISD	Aaron Cosbey
IISD	Deborah Murphy
IISD	Michelle McLaren

*\*Not present at the Vancouver Meeting. The names in parenthesis indicate where a substitute attended the meeting.*