

Fourth Meeting of the Development Dividend Task Force and Launch of Phase III

**October 19-20, 2006
Room #2 Eigtved's Pakhus, Asiatisk Plads 2, 1448
Copenhagen, Denmark**

Meeting Report

October 19th

Welcome and overview of meeting

John Drexhage, Director, Climate Change and Energy, IISD, welcomed participants to the fourth Task Force meeting and launch of Phase III of the Development Dividend Project. Mr. Drexhage described the meeting organization and purpose, noting the objectives to: present outcomes of Phase II, including the prepublication of *Making Development Work in the CDM: Phase II of the Development Dividend Project*; consult the Task Force on Phase III; and discuss the proposed areas of work identifying directions and steps for moving forward.

Frode Neergaard, Danish Ministry of Foreign Affairs, welcomed participants to Copenhagen and the historic setting of Eigtved's Pakhus, Asiatisk Plads.

Summary of Chapter 1: *Defining and Measuring the Development Dividend*

Principal author of Chapter 1 and IISD Associate, Aaron Cosbey, presented the outcomes of *Defining and Measuring the Development Dividend*. Mr. Cosbey reviewed the methodology used in creating the framework to measure the development dividend (DD). He discussed the results of applying the framework to measure the strength of the DD in CDM projects, and provided conclusions and recommendations based on an analysis of the current roster of registered CDM projects.

The methodology used for the framework was a simple multi-criteria analysis (MCA), focusing on three dimensions: environment, social and economic. Criteria were weighted by the Development Dividend Task Force. Information from 215 project design documents (PDDs) from registered CDM projects were measured and analyzed using the framework. The framework was designed for the international policy community concerned about the ability of the CDM to deliver on its development promises.

Mr. Cosbey explained some limitations of the framework. For example, the framework assumes that sustainable development can be defined at the international level, and that those definitions will be appropriate in varying regional and national circumstances. This is untrue, but a necessary simplifying assumption. A second limitation is that the framework only evaluates potential benefits listed in the PDD - not actual benefits resulting from implementation of the project. The framework uses subjective scoring guidelines, and does not address scale well (a larger project may have more development dividends simply because it is a larger project). Although it compares project types, the framework does not consider national circumstances.

The analysis of the results of applying the framework revealed there is continued cause for concern with the DD in CDM projects. Few projects generated a high DD score and a high quantity of certified emission reduction credits (CERs). In general, small scale projects scored slightly higher than others, and programmatic CDM indicated a lot of promise particularly in the areas of energy efficiency and standards & labelling. Furthermore, inequitable distribution might not be as large a concern as previously thought- the skewed distribution of CDM investment is less so when deflated by GDP or population.

Mr. Cosbey recommended that in terms of rule changes for the CDM, there be discrimination in favour of high achieving projects (such as household energy efficiency and solar projects; or programmatic and small-scale projects). Recommendations for action at the national level consisted of encouragement for host countries to discriminate according to project type and other characteristics that are in line with national sustainable development priorities; or to negotiate add-on benefits to CDM projects.

Discussion on Chapter 1

Some key points raised by the Task Force were:

- It was agreed that if you look at CER distribution in terms of the potential for investment (GDP or population can both be used as proxies for this), regional inequity is not so high. For example, China has more investment opportunities than Bhutan, so we should expect to see more CDM projects there, even under an equitable distribution scenario. Thus the diagram illustrating the country distribution of CERs per dollar of GDP has a much flatter curve, indicating higher equitability, than the diagram simply showing CERs. An analysis of CERs per population generates a similarly flat curve. An analysis by greenhouse gas (GHG) emissions per country undertaken by a Task Force member indicated that China was [undersupplied] [under-supplying].
- Despite the analysis, the political nature of the CDM determines that regional inequity is a large concern for African nations; and Africa should not be ignored in the Development Dividend Project. Most African nations are not benefiting from the CDM; indicating a need for capacity building, incentives and other factors. If the issues involving the adaptation fund and LULUCF were to be resolved, the situation for Africa might be different. Yet Africa has the right to clean technology and technology transfer, and a mechanism is required for this.
- **NOTE:** After the discussions on the issue of regional inequality at the meeting, Mr. Cosbey used a regional framework for analysis. This analysis revealed that both Latin America & the Caribbean and Asia Pacific are vastly over-represented, at 46% and 33% respectively. Sub-Saharan Africa garners a mere 11%. But note that even so, it out-performs North Africa & the Middle East and Europe & Central Asia, which weigh in at 6% and 4% respectively. So, while a weighted CER count yields a much more equitable distribution on a country-by-country basis, a weighted regional analysis shows wide disparities. In large part this is due to the fact that the country-by-country analysis did not consider those countries that are non-Annex I Parties (and thus eligible hosts for CDM), but which do not have any CDM investment. A regional analysis does take such Parties into account, and in the end finds some cause for concern.
- If LULUCF were included in the exercise the results could be very different (there were no LULUCF projects registered at the time of the analysis).

Summary of Chapter 2: *Options for Fostering the Development Dividend*

Principal author of Chapter 2 and IISD Associate, Deborah Murphy, presented the outcomes of *Options for Fostering the Development Dividend*. In her research, Ms. Murphy explores in-depth some alternatives that could foster the DD in CDM projects emphasising solutions that could increase the amount of CERs delivering a strong DD. In considering alternatives, Ms. Murphy provided an analysis of additionality, programmatic CDM, small scale CDM projects, LULUCF projects and CDM investment in LDCs..

In each area, Ms. Murphy developed recommendations for short term actions to help foster the DD. These included the development of additionality tools based on environmental additionality; the timely approval of programmatic CDM methodologies and an analysis of opportunities presented through programmatic CDM, which could examine the 14 CDM projects with programmatic characteristics. Small-scale projects ought to be redefined to focus on environmental impacts and simplified approval procedures for small-scale projects are needed. The development and approval of methodologies for non-renewable biomass CDM projects should be encouraged and credits from sinks projects should be allowed under the EU-ETS.

Recommendations for medium to long term actions included building capacity to develop programmatic baselines and additionality tools. Additionality assessments using multi-project baselines based on benchmarks or performance standards should be introduced. A positive list of small scale projects/sectors that do not require an additionality test should be developed. An expanded definition of CDM LULUCF projects should include avoided deforestation, reducing forest degradation and improved agricultural practices. Efforts should be made to establish CDM fundamentals in LDCs to ensure they are sources of CERs post-2012.

Discussion on Chapter 2

Some key points raised by the Task Force were:

- Designated Operational Entities (DOEs) should consider the sustainable development benefits of projects in addition to the GHG emission reductions. Currently there is no focus on sustainable development in the verification process.
- The Meth Panel and the EB have taken an initial step to provide clarity for project proponents by developing a proposed definition of a “programme of activities”. This definition should be discussed in the paper.
- In terms of LULUCF, there are other options on the table that should be considered in the paper: the Brazilian proposal on avoided deforestation that examines a “positive incentive arrangement” that includes financial incentives for developing countries that voluntarily reduce their GHG emissions from deforestation; and the Costa Rica and Papua New Guinea proposal involves reducing emissions from deforestation in post-2012.
- A strong message regarding programmatic CDM should be put forward in the paper, as this is indicated as a promising area in Chapter 1. In the short-term, we need to encourage the submission of methodologies and timely approval of these methodologies on the part of the EB.
- Capacity building is more effective if it comes from the private sector rather than government. Awareness raising is needed but this loses effectiveness if there is no certainty post-2012. In considering a post-2012 regime, it is also important to recognize potential perverse incentives.
- It might be better to encourage Annex 1 governments to develop risk reduction schemes for LDCs, such as investment guarantee facilities, than suggest that public procurement programs be used to purchase CERs from LDCs. Another option to explore is support for unilateral projects (both in regard to LDCs and for programmatic CDM), with the intent of assisting governments unable to attract buyers at an early stage of the CDM project life cycle.
- **NOTE:** Ms. Murphy used input from the meeting as the basis for the final revisions of the paper. She added information about the merging of the baseline methodology and the demonstration of additionality; the Meth Panel and EB’s proposed definition of a “programme of activities”; recommended revisions to the definition of two of the categories for small scale projects; expanding the definition of LULUCF to include not only avoided deforestation but also reducing forest degradation and improved agricultural practices to increase carbon capture in agricultural soils; risk reduction schemes for LDCs and the potential of unilateral CDM to address the issue of low levels of CDM investment in LDCs.

Summary of Chapter 3: *Financing the Development Dividend*

Principal author of Chapter 3, John Balint, Green Capital Advisors, presented the outcomes of *Financing the Development Dividend*. The research explored ways to increase available financing for CDM projects that yield a DD and examined four CDM projects in Africa. The paper considered how such financing for CDM projects could be used to encourage project stakeholders to include and/or enhance the DD. Mr. Balint provided a review of finance support mechanisms, identified financing risks, discussed the financing challenge and suggested ways to increase available financing for DD projects.

When examining options for closing the CDM financing gap it is important to look at the needs of project proponents (demand-side). Mr. Balint found that project proponents seek more flexible, risk tolerant debt and equity sources; up-front purchases of carbon credits; both compliant and voluntary carbon credits; official development assistance (ODA) support and funding for sustainable development initiatives.

The discussion also included the needs and expectations of the sources of financing (supply-side). Mr. Balint stressed that good “bankable” projects are key. Credible, timely, cost-effective host country and EB approval processes would make projects with high DDs more appealing. As well, risk sharing would increase the likelihood of financing.

Mr. Balint offered some possible solutions including: building CDM capacity within host country governments to make better use of carbon finance for projects; linking projects with high sustainable development potential to national priorities and grant finance sources; and expanding roles and risk capacity of rural and community development banks to leverage financing. Furthermore, demystifying the financing process for local project developers in terms of potential carbon credit revenue streams is essential. Improvement in capacity building on small volume project commercialization in host countries would be beneficial. The development of a tool to screen the costs and benefits of developing projects with high sustainable development potential, and the development of risk mitigation financing instruments to enhance the attractiveness of projects with a high DD might help to influence financiers to engage in these projects.

Mr. Balint concluded that local development banks, IFIs and Annex I public sector programs need to take a leadership role in supporting projects with a high DD. This could include capacity building for local, small scale project proponents and local sources of financing. Voluntary carbon credit buyers could be a contributor if an internationally accepted standard for determining sustainable development benefits in projects was developed along with a registry system. Mr. Balint also mentioned that a credible method for determining the sustainable development benefits might be helpful as a risk mitigant.

Discussion on Chapter 3

Some key points raised by the Task Force were:

- Financing capacity in Africa, in particular, is very low. Recognition of what the CDM can bring is not well understood. It is not realistic to ask African countries to build capacity on the CDM when there is no certainty beyond 2012.
- The voluntary market is a huge untapped market and potentially could play a big role post-2012.
- CERs have to be generated before funding is received; indicating that another mechanism for financing is required to help get CDM projects started.
- Many host countries are not attractive for investment in these projects, and we have to ask what can realistically be done. A UNDP study found that 110 countries are not attractive for the CDM.
- Host countries need to identify and prioritize sustainable development criteria, strategies and projects because there are both national and regulatory risks in the CDM. Investors want certainty, and the CDM adds a layer of risk. Investors want to know that they will get re-paid, not whether or not there are sustainable development benefits; and buyers want to buy on delivery of credits, not before.
- If export credit agencies and banks could be convinced of sustainable development benefits, they may become a large source of financing for DD projects. Banks could be sold on the idea that investing in sustainable development actually reduces risks in some way. Undertaking a sustainable development risk analysis could offer insight into this claim. For example, is host country government support of projects a key component of project success? Are there lower risks associated with this project investment? The notion that sustainable development is a risk mitigating factor needs exploration.
- The use of ODA to finance the sustainable development component of a project should be further examined.

Overview of analytical research paper on the CDM in a Post-2012 regime

Deborah Murphy provided a presentation on the proposed direction of the analytical paper – the CDM in the post-2012 regime. The objective of the paper is to examine how the CDM might be incorporated in potentially promising future climate change regimes, and how to reconstruct the CDM in the absence of specific targets. Ms. Murphy indicated that the work would involve the identification of 3 to 5 promising post-2012 approaches, exploration of alternatives to the current shape of the CDM, examination of the scope and role of the CDM under the identified post-2012 regimes, analysis of the governance structures required to support the various options, and an exploration of options for increasing the Development Dividend.

Discussion of paper on the CDM in a Post-2012 regime

Some key points raised by the Task Force were:

- The exercise might use another term, such as “market-based mechanism for developing countries”, to allow the analysis to examine mechanisms that meet the goals of the current CDM, but are different from the current type of mechanism.
- Graduation from the CDM is an important consideration in any post-2012 regime and an issue that has not received adequate discussion because it is a political issue that governments do not want to raise. For example, are South Korea and Mexico going to be part of the CDM post-2012? Changes to the Annex-I and non-Annex-I lists would have implications for the CDM and should be addressed in the paper.
- The present system should be protected and there is a need for investments to have value post-2012. Options for bridging should be considered and a transition stage should be examined.
- The CDM could be a developing country offset mechanism if there is no compliance in the post-2012 regime. The paper could examine how to broaden the CDM infrastructure to have retail and voluntary aspects for such a regime.
- The analysis should examine a large number of post-2012 approaches and look for overlap and similarities between approaches (rather than narrowing the analysis to 3 to 5 approaches). The analysis should look at the goals of the CDM (sustainable development and affordable emission reductions) and come at it from two

directions: 1) the post-2012 approaches on the table, and 2) the various types of market mechanisms that might fulfill the objectives of the CDM (drawing on the broader environmental regulation literature).

October 20th

Welcome and overview of morning and review of previous day's discussions

John Drexhage welcomed participants back to the meeting and recapped the previous day's discussions. He provided an update of the UNFCCC process and outlined key issues in the lead up to Nairobi. Mr. Drexhage then introduced the topic of discussion, Phase III of the Development Dividend.

Discussion session – Development Dividend Phase III project directions

Aaron Cosbey launched discussion on Phase III with a short presentation on proposed options for moving forward. The objective of Phase III is to increase the DD in CDM projects focusing on both quality and quantity. He presented four options (in addition to the analytical research paper on post-2012):

- 1) Promotion of CDM projects with a high DD such as programmatic CDM - e.g., a case study of an existing project whereby IISD could potentially act as a project proponent or work in collaboration with project proponents to apply the Development Dividend Framework.
- 2) Policy analysis in support of CDM project types with high DD potential- e.g., analyzing EB decisions, methodologies pertaining to programmatic CDM, and creating a "guide to programmatic CDM".
- 3) Work at the national level – e.g., Influencing DNAs to adopt stringent sustainable development criteria, cataloguing best practices that promote the DD in national processes assessing the outcomes of the proposed add-on benefits and bringing DNAs together for discussion.
- 4) Work with financiers – e.g., making the case that sustainable development in the CDM lowers project risk, adapting the DD framework to serve as a tool for financiers to assess the sustainable development in CDM projects.

The Task Force offered the following input:

- 1) Promote desirable projects such as programmatic CDM through a case study of an existing project:
 - IISD is likely not well positioned to act as a project proponent. Working with project proponents to apply the tool to an existing project is a better fit.
 - The DD framework tool could be broadened and strengthened to test more than the DD, for example it could also look at risk profiles of CDM projects. These results could be brought to the financiers.
 - The tool could to be modified to allow for a more objective assessment. Rather than asking a group of experts (the Task Force) to weight the criteria, it could be weighted at the country level.
 - Areas of interest for continued work include transportation and LULUCF. For example, an acceptable process for gathering data on the rate of sequestration vs. emissions would be helpful, and there is a need methodologies for avoided deforestation and environmental services payment programs. Such work would be leading edge and would feed into the debate on avoided deforestation in the post-2012 regime. The transportation sector requires methodologies for ethanol projects.
 - Work with programmatic projects could be particularly valuable from the DD perspective – there is need to show that programmatic CDM projects have greater SD benefits
- 2) Provide policy analysis in support of desirable project types
 - Research is needed to strengthen the DD framework, and opportunities to link the work of IISD, UNEP-Risoe and UNDP in regard to measuring sustainable development in CDM project should be explored. One tool that is consistent may have greater resonance with financiers, developers and DNAs
- 3) Work at the national level to influence the DD in CDM projects
 - Sharing the DD framework at a DNA Forum could assist IISD in gathering input to improve the framework and ensuring that the framework meets the needs of host countries (e.g., experience has shown that very strict criteria can limit approval of CDM projects). IISD will need to identify opportunities to make presentations to DNAs, such as this forum established by the EB.
 - The applicability of the Development Dividend Framework in helping to link national climate change and sustainable development agendas could be explored.

- A review of sustainable development add-on's in CDM projects could provide useful information. For example, to what extent do project proponents report on these "add on's"; is there a way to monitor or verify that expected results have been achieved.
- 4) Work with financiers
- Work is needed to determine if sustainable development reduces financial/project risk. Does sustainable development make a difference to potential financing sources? Research is needed in this area as buyers have not indicated any interest in SD, and such a linkage needs to be proven or shown to be untrue
 - Explore opportunities to assist with the development of funds to invest in cleaner projects. For example, the Climate Fund in China is very similar to some of the work already taking place with Green Investment Schemes in Russia.
 - Work is needed to identify the demand side for the DD. Who are the potential investors? Work is needed to identify appropriate institutions that are motivated to support the DD. For example, it may be worth investigating groups of banks that take Corporate Social Responsibility (CSR) seriously – who and where are they? Do they provide an option for increased financing for DD projects?
 - Innovative funding options need further exploration, such as the establishment of a guarantee facility as a risk reduction measure for investments in LDCs, effective use of ODA, and support for unilateral CDM projects.

The Task Force indicated that the Development Dividend Project should continue to focus on improving the number of CDM projects with strong sustainable development contributions.

Wrap-up and Next Steps

IISD has taken the expert advice and input from the Task Force and defined and elaborated on the areas of work for Phase III. The main activities are:

1. To develop an analytical research paper on the Clean Development Mechanism (CDM) in the Post-2012 regime;
2. To undertake a case study with a programmatic CDM project in a non-Annex I country and apply the Development Dividend Framework;
3. To assist Designated National Authorities (DNAs) in establishing and enforcing effective criteria for sustainable development; and
4. To undertake further research into the financing of CDM projects with a high development dividend.

Concept papers for these four areas will be developed and forwarded to the Task Force for comment and input. IISD will work with Task Force members to identify potential sources of funding and launch the activities.

The Development Dividend Task Force
October 19th-20th, Copenhagen
Meeting Attendees (*Not present at the Copenhagen meeting)

Governments

Canada	Sushma Gera (CDM Executive Board/Foreign Affairs Canada)*
Canada	Jodi Brown (Environment Canada)*
Canada	Jeanne-Marie Huddleston (Foreign Affairs Canada)*
Columbia	Martha Patricia Castillo*
Denmark	Frode Neergaard
Denark	Torsten Malmndorf
India	R.K. Sethi*
Japan	Hiroshi Yamagata*
Norway	Georg Borsting*

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UNDP	Brian Dawson
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UNEP Risoe Centre	Sami Kamel
UNEP Risoe Centre	Karen Holm Olsen

Private Sector

Transalta	Don Wharton*
Green Capital Advisors	John Balint
Margaree Consultants Inc.	Erik Haites*
Natsource	Doug Russell*
IETA	Ian Carter*
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Chicago Climate Exchange	Michael Walsh*
Development Bank of Japan	Takao Aiba*
DNV	Einar Telnes
IETA	Andrei Marcu*
Natsource	Aline Ribas*
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NGOs and Research Institutes

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Hamburg Institute	Michael Dutschke*
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SouthSouthNorth	Emily Tyler
Development in the Americas	Christiana Figueres
ECM Centre	Tom Owino Oduol
Centre for Clean Air Policy	Jake Schmidt*
EMBRAPA	Luciano de Mattos
Hamburg Institute	Sonja Butzengeiger*
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