

CLIMATE CHANGE,
CARBON MARKETS AND THE CDM:
A CALL TO ACTION

Executive Summary:
Recommendations of the High Level Panel
on the CDM Policy Dialogue





CDM Policy Dialogue

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The world faces an unprecedented triple threat on climate change – an unfortunate confluence of three corrosive trends:

- ▶ The Earth's climate system is on a precipice, with staggering impacts of climate change already felt around the world. From devastating droughts, floods and extreme storms to rapid ice melt, climate change is already here and about to get much worse.
- ▶ International climate action is falling far short of what the world needs to avoid potentially unmanageable consequences. Nations are doing only slightly more than half of what the world needs now.
- ▶ Global carbon markets – an important policy instrument that the international community has developed over the past decade to facilitate real-world emissions mitigation – are collapsing with potentially devastating consequences. This is particularly true of the world's largest carbon market designed specifically to link developed and developing countries, an instrument operated by the United Nations known as the Clean Development Mechanism (CDM).

To diffuse this triple threat, the international community must act quickly and decisively.

While not sufficient in themselves, well regulated carbon markets have proved essential to addressing climate change, and nations must as a high priority restore faith in global carbon markets generally and in the CDM specifically. Carbon markets enable nations to meet their mitigation targets in a flexible and cost-effective manner, by counting emission reductions regardless of where they occur. As such, carbon markets can both increase the cost-effectiveness of mitigation activities and also facilitate the adoption of more ambitious mitigation targets. Over the past decade, the CDM alone has helped nations mitigate approximately one billion tons of greenhouse gas emissions in a manner that realized US\$3.6 billion in savings for developed countries. Over this same period the CDM has mobilized more than US\$215 billion in investments in developing countries, thereby accelerating economic growth and poverty alleviation.

Global carbon markets have enabled many developing countries to better understand their own potential to

mitigate emissions in nationally appropriate ways. Favourable experiences with the CDM have enabled Brazil, China, Mexico, South Korea, and other major emerging nations to explore domestic carbon market systems. Although the CDM has been criticized for approving some projects with questionable environmental and sustainable development benefits, the CDM has improved markedly in recent years and its positive impact extends well beyond specific projects. The CDM has helped combat climate change by creating a global culture for action and by mobilizing the private sector through markets.

Unfortunately, the CDM is imperilled. Carbon prices in the CDM market have declined 70 % in the past year alone and are projected to fall further. Why? Mitigation targets are so modest that they no longer create strong incentives for private international investment and local action in developing nations. And many countries with mitigation targets have not linked the implementation of their targets to the use of the CDM. Policymakers and climate advocates alike increasingly question the continuing value of instruments like the CDM under these circumstances. Furthermore, governments, private investors, and financial institutions are losing confidence in the CDM market, a trend that is likely to accelerate in the absence of new solutions, weakening global carbon market technical capacity.

Some might not mourn the potential death of the CDM. After all, nations have begun work on a new generation of market instruments that hold perhaps greater long-run promise. Yet, new solutions will take years to design and make operational. For the balance of this decade the CDM is likely to remain the world's foremost – and possibly sole – means of gaining the benefits of a truly global carbon market. This means that a strong CDM is necessary to support the political consensus essential for future progress. A robust CDM, furthermore, is necessary to bring the benefits of carbon markets to developing countries now.

If nations permit the CDM market to disintegrate, the political consensus for truly global carbon markets may evaporate along with much of the world's developing country carbon market capacity. Developing countries and the private sector are unlikely to see sufficient benefits to justify aggressive emissions mitigation steps in those nations. The collapse of the CDM, in short, could seriously set back international climate cooperation, with potentially devastating consequences for all.



CDM Project: 1558: Ratchaburi Farms Biogas Project at SPM Farm, Thailand. The crystal clear benefit from CDM on a pig farm in Thailand

Asger Olesen

To avoid this self-inflicted wound, the international community must take four essential and mutually reinforcing actions as a matter of great urgency.

First, nations must **intervene forcefully to address the immediate crisis** and substantially increase their mitigation ambition. Not only would this reduce their own climate pollution but also it would create more demand for international carbon transactions, thereby accelerating progress elsewhere. They should also actively consider the establishment of one or more funds to purchase carbon credits and stabilize carbon prices in order to restore market confidence about future prices.

Second, the international community must **adapt the CDM to new political and market conditions** by enhancing its role. Perhaps the greatest contribution the CDM has made to date has been helping nations and stakeholders gain valuable experience with innovative climate solutions through hands-on practical action. To ensure it continues to perform as a priority this learning-by-doing function, the CDM should expand to include the latest potential policy tools, such as by: (i) testing sector-wide approaches that could mitigate emissions at scale, including by reducing emissions from deforestation; and (ii) assisting with the design of new financing instruments, including the Green Climate Fund. The CDM can also advance this leadership role by facilitating the widespread adoption of best practices and uniform technical standards, as well as by promoting appropriate international links across carbon markets worldwide.

Third, the CDM must **substantially reform its operating procedures** and greatly expand its assistance to participating countries to maximize its impact. The CDM has long struggled with a perception that it does not contribute enough to emissions mitigation and sustainable development. Though partly deserved, this perception is also somewhat out of date as the CDM has made significant improvements in recent years. Nevertheless, these negative perceptions and some continuing weaknesses threaten the credibility of the CDM and the long-term viability of global carbon markets. For this reason, the CDM needs to improve its standards and outcomes through fundamental reforms to its operating procedures. The CDM must also work harder to enable a broader number of countries to gain meaningful access to its benefits.

Fourth, the CDM must **strengthen and restructure its governance** to become a more accountable and efficient organization. Despite commendable recent progress, the CDM remains burdened by a perception that it is slow, opaque, unresponsive and politicized. To address any remaining shortcomings and improve its reputation, the CDM must strategically allocate responsibilities between its governing body and staff, enhance its openness, transparency and opportunities for stakeholder participation, create avenues to hear appeals and address grievances, and reduce costs and delays.

Well regulated global carbon markets can help to avoid the unacceptable risks of climate catastrophe.

They reduce costs and promote ambitious climate action around the world better than just about any other international climate policy developed so far. They have also demonstrated enormous potential to mobilize private-sector financing. Global carbon markets link developed and developing countries, providing them with joint incentives to tackle climate change.

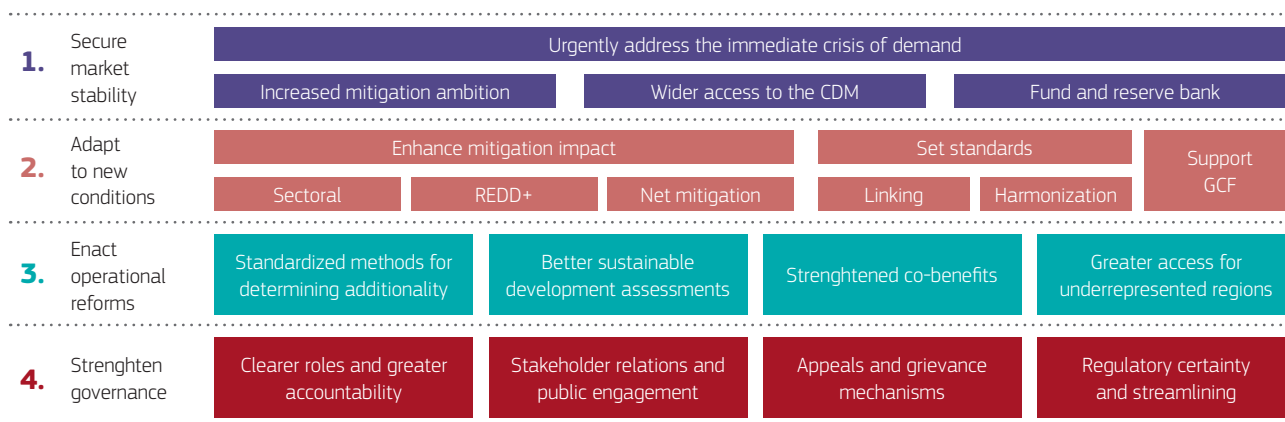
Despite many successes, the CDM – the world’s only truly global carbon market today – is collapsing for reasons outside its scope, and nations must intervene to avert this downfall. The CDM is an admittedly imperfect instrument and by the end of the decade promising new mechanisms may emerge. Yet the CDM is and will continue to be for some time the best means of promoting practical collaboration among developing nations, developed nations and the private sector, and for this reason it must be safeguarded. Strengthening and reforming the CDM is not an end in itself but a means to spur action and provide

an essential bridge to future solutions. This is why nations must reverse the continuing slide of the CDM market while modernizing the institution to carry out its vital role.

Based on these considerations, we have formulated a set of concrete recommendations to help address the short-term crisis in the carbon market and to lay the foundation for the effective operation of market mechanisms, including as appropriate the CDM, to contribute to addressing climate change. These recommendations are set out in full in the following sections, together with the stakeholder views expressed on the different topics, and our own research findings that underpin our recommendations.

The Panel urges that its recommendations be implemented fully and without delay, with a timetable agreed that will bring them into effect by the United Nations Climate Change Conference scheduled for December 2013.

Figure 1: Overview of recommendations



Recommendations:

The Panel recommends the following 51 actions across 12 areas to address the crisis in international carbon markets and to make the CDM fit for the future (the actors responsible for each recommendation are indicated in brackets at the end of each paragraph):

1. Urgently address the immediate crisis of demand

- 1.1 As a matter of urgency, increase mitigation ambition by strengthening the pledges that have been made under the United Nations Framework Convention on Climate Change and by adopting corresponding domestic policies and measures. What is important for the future of international carbon markets is that mitigation targets are tightened and taken seriously. **(National governments)**
- 1.2 Ensure access to the CDM as a tool to help national governments (and the emitters that they regulate) to achieve their mitigation targets in a cost-effective manner. The use of the CDM should not displace the focus on effective domestic mitigation actions. To unlock the full potential of the CDM, all countries should be enabled to use CERs, not only those with mitigation targets under the Kyoto Protocol. **(National governments, CDM Executive Board)**
- 1.3 Investigate the establishment of a new fund and/or enable existing or emerging funds to purchase and to cancel part of the current overhang of CERs. National governments could be invited to meet part of their commitments to international carbon finance through contributions to this fund. The CDM Executive Board could be authorized to use a portion of the financial reserves of the CDM to establish and commence the operations of this fund. **(National governments, CMP, CDM Executive Board)**
- 1.4 Consider the establishment of an institution to serve as a de facto reserve bank for CERs, charged with stabilizing the market. **(CMP, CDM Executive Board)**
- 1.5 Pending the restoration of realistic pricing in CER markets, care should be taken in expanding the supply of CERs without creating disincentives for project developers or investors. **(CDM Executive Board)**

2. Develop new approaches to enhance mitigation impact

- 2.1 Develop and test sectoral approaches within the CDM, while maintaining the availability of the current project-based approach. **(CDM Executive Board)**
- 2.2 Develop and test project-based and/or national/sub-national REDD+ programmes, while implementing appropriate controls to mitigate risks. **(CMP, CDM Executive Board)**
- 2.3 Develop and test approaches to achieve a net mitigation impact, on both buyer and seller sides, while avoiding disincentives for project developers and investors. **(CMP, CDM Executive Board)**
- 2.4 Stop registering new projects involving gases with comparatively low marginal costs of abatement (e.g. projects that reduce HFC-23 and projects that reduce N₂O from adipic acid plants), which have matured to the point of being ready to graduate from the CDM. Regulation may be needed to ensure the phase-out of these industrial gases. **(CMP, CDM Executive Board)**

3. Set robust standards to enable linking and harmonization

- 3.1 Identify and develop standards that anticipate the needs of emerging market-based mechanisms, particularly in the measurement, reporting, and verification of emission reductions and the tracking of mitigation outcomes. **(CDM Executive Board, UNFCCC Secretariat)**
- 3.2 Actively seek opportunities for collaboration with other market-based mechanisms, including those designed and implemented at the national level, around common functions such as standard-setting, accreditation, registration and issuance, capacity-building, and communication. **(CDM Executive Board, UNFCCC Secretariat)**
- 3.3 Ensure the comparability among the standards used across market-based mechanisms, both inside and outside the Convention, in order to minimize regulatory inconsistency, to safeguard environmental integrity, and to promote fungibility. **(National governments)**

3.4 Establish a common registry function that tracks mitigation outcomes effectively, so as to avoid double counting across different types of market-based mechanisms. **(National governments, UNFCCC Secretariat)**

3.5 Improve regulatory engagement and outreach efforts to regulators of emissions trading systems, including through the dissemination of lessons learned from the CDM. **(CDM Executive Board, UNFCCC Secretariat)**

4. Support the rapid implementation of the Green Climate Fund

4.1 Promote the use of CDM standards and methodologies in accounting for payments for verified results, so as to leverage the achievements, knowledge, and resources of the CDM. **(Green Climate Fund Board, CDM Executive Board)**

4.2 Apply the standards and methodologies developed under the CDM as a way to facilitate the implementation of mitigation activities supported by the Green Climate Fund. **(Green Climate Fund Board, CDM Executive Board)**

5. Implement standardized methods for assessing additionality

5.1 Increase the use of standardized approaches, such as performance benchmarks, in the assessment of additionality. These should be set conservatively to ensure additionality across a population of similar projects, and should account for technology- and context-specific factors, moving away from more subjective and unverifiable financial additionality tests. These changes should by no means lead to weakening of the additionality test as conducted today, and in fact may lead to questioning the continued inclusion of certain technologies in specific locations where they are likely to be the norm. A timetable should be set for implementing these changes. **(CDM Executive Board, UNFCCC Secretariat)**

5.2 Identify positive lists to simplify additionality assessments for project types and contexts where there is a low risk of non-additionality. **(CDM Executive Board, UNFCCC Secretariat)**

5.3 Ensure that the focus of incentives constantly shifts to the next generation of technologies, in order to drive technological change. In order to achieve this, standardized baselines and parameters must be

periodically reviewed according to the pace of technological progress. **(CDM Executive Board, UNFCCC Secretariat)**

6. Ensure that CDM projects help to achieve sustainable development

6.1 Assess the contribution of CDM projects to sustainable development in the project approval process in a transparent, inclusive, and objective manner. Where host countries do not have the capacity to do this and at their request, the CDM Executive Board could designate an appropriate and mutually acceptable independent authority to do so, and should also help national authorities to develop such capacity. **(Host countries, CDM Executive Board)**

6.2 Report, monitor, and verify sustainable development impacts in a more systematic and rigorous manner throughout the lifetime of a CDM project. Project participants should be required to declare, in their requests for registration and issuance, how a project assists the host country to achieve sustainable development in a manner that allows for comparison across projects. **(Host countries, CDM Executive Board, project participants)**

6.3 Enhance safeguards against negative sustainable development impacts. If a credible allegation is made that a project has negative impacts, it should be investigated by the host country and, if substantiated, result in corrective measures. Some negative impacts (e.g. the use of child labour) are non-negotiable reasons to reject a project. **(Host countries)**

6.4 Enable a host country to withdraw its approval of a CDM project if, following an objective and transparent assessment process, the project is proven to have a harmful impact on sustainable development. **(Host countries, CDM Executive Board)**

6.5 Provide increased support, including capacity-building and best-practice examples, to host countries that request it in order to perform the above functions. **(CDM Executive Board, UNFCCC Secretariat)**

7. Strengthen co-benefits and enhance the scope of energy technology

7.1 Encourage the increased development of projects with high co-benefits (e.g. household-level service projects), including through simplifying requirements, standardizing registration and issuance procedures,

and using positive lists. *(CDM Executive Board, UNFCCC Secretariat)*

- 7.2 Explore opportunities for cooperation with other international institutions and financial mechanisms in support of co-benefits generated by CDM projects. *(CDM Executive Board, UNFCCC Secretariat)*
- 7.3 Promote greater take-up of new energy technologies in the CDM, such as energy efficiency, renewable energy, and carbon dioxide capture and storage in geological formations. *(Host countries, CDM Executive Board)*
- 7.4 Stimulate collaborative technology development and local technology innovation. *(CDM Executive Board)*

8. Encourage greater access to the CDM for underrepresented regions

- 8.1 Prioritize the development of CDM projects in developing, non-high-income countries, with very few

projects that have issued CERs. *(CMP, CDM Executive Board, UNFCCC Secretariat)*

- 8.2 Enhance the accounting of suppressed demand for energy services, so as to increase the potential for participation in the CDM in low-income countries with currently low levels of emissions. *(CDM Executive Board)*
- 8.3 Accelerate the development of standardized parameters, including baselines, and simplified procedures for household-level services (e.g. electrification, water purification, sanitation, cooking) and public services (mass transport, lighting and municipal renewable energy programmes). *(CDM Executive Board, UNFCCC Secretariat)*
- 8.4 Introduce a new grant scheme and expand the existing loan scheme to further reduce financial barriers to the implementation of CDM projects. *(CDM Executive Board)*



0268: Lages Methane Avoidance Project, Brazil. Local community using machines to work in reforested areas. Lages project uses only forestry wood waste from reforested areas.

Julio Alberto Pavese

8.5 Mobilize finance towards the building of capacity for hosting CDM projects in underrepresented countries. **(International, regional, and national development banks)**

8.6 Share experiences and best practices, particularly within regions. **(Designated national authorities)**

9. Rethink existing governance arrangements

9.1 Reorient the CDM Executive Board towards policy and strategy issues, while delegating project-specific and technical decision-making to the UNFCCC Secretariat (including rulings on requests for registration and issuance). **(CDM Executive Board, UNFCCC Secretariat)**

9.2 Adopt an accountability framework to clarify and strengthen the relationship between the CDM Executive Board and the UNFCCC Secretariat. This framework should include a service level agreement with performance indicators for the UNFCCC Secretariat, as part of the annual Management Plan, and the CDM Executive Board should be responsible for performance management of the UNFCCC Secretariat in the discharge of these duties. This framework should also identify what the CDM Executive Board should do to facilitate and to enable the UNFCCC Secretariat to deliver on its mandate. **(CDM Executive Board, UNFCCC Secretariat)**

9.3 Develop and implement robust codes of conduct for all members of the CDM governance structure, including the CDM Executive Board and the UNFCCC Secretariat. These codes of conduct must include means for objectively assessing and addressing conflicts of interest. **(CDM Executive Board, UNFCCC Secretariat)**

9.4 Revise the criteria for the composition of the CDM Executive Board to reflect not only regional distribution, but also professional knowledge and experience (e.g. from carbon markets, economics, communication, legislation, governance, and working experience from other boards). Based on such revised criteria, a transparent process of selecting candidates, following a public call for nominations, should be undertaken by a selection committee. The committee would propose candidates to be appointed by national governments. **(National governments)**

9.5 Enforce term limits on membership of the CDM Executive Board, with terms as members and as alternate

members both taken into account. The suggested term limit is two three-year terms. After a combined six years of service, whether as a member or as an alternate member, a person should not be eligible to be nominated to the CDM Executive Board again. Care should be taken to ensure that the expiry date of terms is phased so that the CDM Executive Board has a mix of experienced and new members and retains institutional memory. **(National governments)**

9.6 Over the longer term, the CDM should evolve toward a more decentralized system of operation in which the issuance of CERs could be undertaken by certified national and regional authorities in accordance with guidelines by the CDM Executive Board. **(National governments, CMP)**

10. Improve stakeholder interactions and public engagement

10.1 Improve accessibility and respond to stakeholders properly and professionally, promptly answering complaints and queries. **(CDM Executive Board, UNFCCC Secretariat)**

10.2 Designate a contact person or “account manager” within the UNFCCC Secretariat for stakeholders in respect of individual cases, with the ability to provide technical clarifications and guidance. **(UNFCCC Secretariat)**

10.3 Adopt a strategic communications policy, including processes for responding to criticism and for enabling the dissemination of accurate and accessible information to a broad audience, to ensure the fair coverage of issues relating to the CDM. **(CDM Executive Board, UNFCCC Secretariat)**

10.4 Establish guidelines for adequate local consultation procedures to ensure local community stakeholders are properly notified and consulted on proposed project activities. **(CDM Executive Board, UNFCCC Secretariat)**

11. Establish independent mechanisms for appeals and grievances

11.1 Implement the appeals mechanism, which is currently being negotiated, for registration and issuance decisions. Both positive rulings (i.e. approvals) and negative rulings (i.e. rejections) should be appealable. Grounds for appeal should be limited to procedural and substantive issues related to the CDM modalities

and procedures. Provisions should disallow frivolous or vexatious appeals, require appeals to be filed within a reasonable and defined timeframe, and require appellants to satisfy admissibility criteria. Remedies should include confirming, remanding, reversing, and/or modifying the decision. The appellate body should be independent from the CDM Executive Board and operate according to a strict code of ethics and conduct. Members of the appellate body should be appointed by the CMP. **(CMP)**

- 11.2 Establish a grievance mechanism for local stakeholders to address environmental and social concerns and to facilitate the resolution of issues emerging after the registration of a project, while fully respecting national sovereignty and without impeding ongoing project operations. The mechanism should be established at the national level, but can be supported by existing CDM institutions if requested by a host country. **(Host countries)**

12. Promote regulatory certainty and streamlining

- 12.1 Designate a champion among the members of the CDM Executive Board to identify and propose

streamlining measures, to be supported by the UNFCCC Secretariat. **(CDM Executive Board, UNFCCC Secretariat)**

- 12.2 Pursue the digitization of content and the automation of workflows in order to facilitate transparency and consistency. **(UNFCCC Secretariat)**
- 12.3 Increase the use of standardized approaches and elements in validation and verification procedures. **(CDM Executive Board, UNFCCC Secretariat)**
- 12.4 Strengthen the training of, and communication with, designated operational entities in order to ensure a common understanding of rules and expectations of validation and verification results. Parallel training for project developers should also be provided. **(CDM Executive Board, UNFCCC Secretariat)**
- 12.5 Revise rules and procedures only at pre-defined points so as to guarantee a certain level of confidence and consistency in the application and interpretation of current rules, while avoiding retroactive application. **(CDM Executive Board, UNFCCC Secretariat)**

About the CDM Policy Dialogue:

The CDM Policy Dialogue was launched at the United Nations Climate Change Conference held in Durban, South Africa, in 2011 by the Chair of the CDM Executive Board and the Executive Secretary of the United Nations Framework Convention on Climate Change (UNFCCC). Its objective was to make recommendations on how best to position the CDM to respond to future challenges and opportunities and also on how to ensure the effectiveness of the CDM in contributing to future global climate action.

An independent High-Level Panel was formed to lead the CDM Policy Dialogue, consisting of 11 individuals reflecting a balance of expertise and regions. It commissioned a wide-ranging research programme addressing 22 topics across three main areas: the impact of the CDM to date;

the governance and operations of the CDM; and the future context in which the CDM could operate. It also organized a stakeholder consultation programme holding dozens of formal and informal meetings around the world.

The full report of the Panel contains an overview of information gathered from the Panel's research findings and stakeholder consultations, as well as its conclusions. It was presented at the 69th meeting of the CDM Executive Board (September 2012) and subsequently made public. The full report, as well as the research reports and the summaries of the stakeholder consultations, are available on the website of the CDM Policy Dialogue:

www.cdmpolicydialogue.org



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