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20 June 2017

Dear Dr Cames and Dr Harthan,

I am writing regarding your report into the additionality of the CDM, recently released by the European Commission. We at IETA appreciate the time you put in to your analysis in a bid to improve the markets of the future. We would like to offer our initial thoughts on your study before we undertake a more detailed review.

We believe the CDM's benefits have far outweighed its shortcomings. It has steadily improved over time, gaining lessons from real world experience. As an innovative endeavour by the Parties to the Kyoto Protocol, it truly broke new ground by tapping the entrepreneurial spirit of developers, financiers and project hosts all around the world and mobilising them for climate action. It created new business fields in climate mitigation and carbon finance, and it spread the base of experience through partnerships all around the developing world. Its success is evident in the many successful projects that are still operating in many developing countries.

However, your study took little account of the positive attributes of the CDM. It did not investigate the "real world" of project development. Instead, it reviewed technical aspects and regulatory assumptions on which experts disagree. Then it jumped to the conclusion that there should be a limited role for offset crediting mechanisms in the future. This conclusion runs contrary to the cooperative spirit underpinning the Paris Agreement and the International Civil Aviation Organization's work on CORSIA for the aviation sector. Rather, we think that efforts should be made to create a mechanism that uses best practices, drawing from the lessons of the last two decades.

#### **IETA's perspective**

Crediting mechanisms form an integral part of the Paris Agreement, which we support. To date, it has been signed by 195 countries, and ratified by 148, and entered into force last year. The provisions in Article 6 of the Agreement allow countries to cooperate voluntarily on market-based approaches that help them achieve their Nationally Determined Contributions (NDCs) at a lower cost. The resulting economic efficiency can help them increase their ambition over time. For businesses that are serious about climate action, this is one of the most valuable aspects of the Agreement's architecture.

Ahead of the Paris talks in 2015, more than 90 countries indicated that they would seek access to an international carbon market to achieve their reduction goals. While the Paris Agreement



does not mention the CDM or carbon offsetting, Article 6.4 lays out the foundation for a new mechanism that can help countries (both developed and developing) reduce their emissions and promote sustainable development.

The Paris Agreement encourages countries to make progress towards economy-wide NDCs over time. But it recognises that many countries will need to start with project-based approaches as part of their contributions, which could be credited for market use through Article 6.4. In the ‘bottom-up world’ of emission reduction pledges, many countries can — and should — pursue carbon crediting to meet their initial contributions to the Paris Agreement. Hopefully, it will enable them to gain experience for even more comprehensive action in the future.

Importantly, last year ICAO reached a landmark deal to use offsetting as a tool to reduce global aviation emissions. They are now evaluating which types of units will be acceptable as offsets under the CORSIA programme. This marks a second example of the global acceptance and endorsement of crediting mechanisms, and it highlights the vital role they will play in the future.

In summary, we believe that utilising flexible mechanisms to reduce emissions at least cost is essential to driving the large-scale transition required to avoid dangerous climate change.

#### **Initial concerns about the report**

The report makes a broad policy recommendation to limit carbon crediting after 2020, due to the contention that additionality is difficult to guarantee. We believe this recommendation is poorly advised, for a variety of concerns stated below.

1. The study suffers from a flawed “desk review” approach, taking little input from the professional developers of the 7000+ CDM projects. It relied on the formulaic paperwork of the CDM process, citing old studies by research institutes or think-tanks, augmented by a handful of anecdotes from field research. The prior research cited often suffered the same shortcomings, often relied on desk researchers with little or no on-the-ground experience with project development. Some of those prior researchers showed signs of having an inherent philosophical bias against the mechanism.

If you had engaged in constructive dialogue with the wealth of experienced project developers, you would have learned about the many barriers to successful project implementation – and the challenges of overcoming conventional bias in favour of traditional energy sources. Contrary to the study’s blanket assertions that they might have “happened anyway”, real world experience is that many good projects in developing countries frequently get stalled or shelved because of a variety of practical barriers – even if they appear to be profitable on paper. The CDM motivation has frequently helped to overcome barriers and catalysed market-based action. Your study also missed assessing the views of the many stakeholders and communities whose lives have improved as a result of CDM project development.



2. The study mistakenly alleges that most energy-related projects are unlikely to be additional, because of the belief that the CDM revenues may have delivered an insufficient amount to the overall project financing. As you note, investment analysis was not intended to be the only determinant of additionality. This was because of an understanding that there are many significant challenges to implementation of clean energy projects in developing countries, where there are biases in favour of conventional practices that are often more relevant. Clean energy projects in developing countries involve careful alignment of multiple cost and benefit drivers. They do not “just happen anyway”.

This is not to say that the CDM’s approach to additionality of energy projects is perfect. We believe there is room for improvement. IETA has long advocated for moving away from hypothetical additionality tests and case-by-case assessments and towards the use of standardised baselines built on positive lists and performance benchmarks.

3. It is disappointing that your study offers few constructive solutions for the many developing countries, particularly in Africa, that have yet to take full advantage of crediting mechanisms such as the CDM. These countries have a severe need for the carbon finance that a crediting mechanism can bring. The UNFCCC, in 2014, estimated that every \$1 of public money invested in the CDM leveraged an average of \$10 of private sector investment. The CDM offered a way for these countries, with low levels of emissions, to attract investment and participate in the global response to climate change. Leveraging private investment is crucial for to make the low carbon transition required. Your report makes little mention of this important and ambitious challenge for Africa.

It also does not evaluate what the decline in CDM market activity has meant for project development, which has stalled considerably. By your own logic, the fact that many of the projects in the CDM pipeline, particularly in Africa, have stalled underscores their additionality. Admittedly, some CDM host countries have adopted domestic incentives that enabled some projects to survive, we hear of many that are stalled.

4. It is dangerous to provide broad policy recommendations on crediting mechanisms and carbon pricing as a whole based on the limited scope of your study. Your analysis focuses on a subset of just one of the several types of crediting mechanisms in use today. We think it inappropriate to draw conclusions for all systems based on that narrow review. Moreover, the CDM is a product of an old architecture (the Kyoto Protocol) that will no longer be in operation post-2020, as it will be replaced by the Paris Agreement. We think it inappropriate to generalise the applicability of your findings to the future mechanism because:

- You offered no evidence to support your allegations that the same concerns would apply to other standards in use in carbon markets (California, Québec, voluntary



markets), which were outside the scope of the study. In fact, your report notes that the use of standardised baselines and focus on non-CO2 mitigation actions may be preferred, which is exactly the focus of some of these other crediting mechanisms.

- Your concerns should not be applied to crediting mechanisms that have yet to be developed, including the crediting mechanisms under Article 6 of the Paris Agreement, or those that continue to evolve to meet current needs and reflect best practice. For instance, many of the voluntary crediting mechanisms continue to innovate and provide new solutions that could help pave the way for effective trading of emission reductions.
5. You overlook the governance, transparency and rigour surrounding the CDM – developed specifically to ensure that only genuine emission reductions are credited. This includes detailed public project scrutiny, a rigorous methodology development process, third-party auditing of the project’s design, and a different entity to audit the reductions claimed. These checks and balances are vital to the environmental integrity of the mechanism, yet are ignored by your analysis.
  6. You do not adequately consider the importance of offsetting for some industrial sectors, such as aviation, where there are very few technology options to help reduce emissions. Therefore, without the use of offsets, it is likely there would be no carbon reduction in these sectors, and their emissions would instead continue to grow. Calling for an abandonment of crediting mechanisms altogether defeats additional action that such sectors can contribute towards the climate mitigation challenge, which hopefully other sectors will follow.
  7. You underestimate the importance of the Paris Agreement in involving all nations in reducing emissions and its role in avoiding double counting. All countries will now have to make a determination about whether to allow the export of emission reductions, because such reductions will need to be reflected in the national accounts. This will add an extra dimension of scrutiny to the process, helping to ensure that traded emission reductions are real. Furthermore, offset mechanisms are a way to involve countries which otherwise could struggle to contribute to the global climate change response.
  8. There is a risk that reductions could be stranded, if there is no mechanism to recognise and monetise them, such as that which is proposed under Article 6.4 of the Paris Agreement. This paragraph is key to engaging with the private sector. There is broad consensus that private finance and investment is needed to meet climate change mitigation potential in the medium to long-term. Annual additional investment needs are estimated to be in the order of tens of billions of dollars yet the current sums available – which are largely via public funds such as the Green Climate Fund – are yet to meet this gap. Private sector actors can be more innovative than public investors, and



they can expand the available capital for climate action. Their involvement could bring the needed climate finance at a much quicker pace. Closing the door to future crediting mechanisms would stymie that flow.

Furthermore, it has been well documented that the inherent flexibility of markets allows for emissions to be cut further and faster – driven primarily by the private sector. A 2015 study by the New Climate Institute found that markets under the Kyoto Protocol “exploited cost-effective mitigation potential” and can be used to increase ambition. It also found that markets encouraged a level of private sector engagement that would have otherwise been absent.

Meanwhile, the World Bank’s State and Trends of Carbon Pricing 2016 report found that the cost of meeting 2030 NDCs is \$115 billion less with an international carbon market than without – and that if these savings were ploughed back into other mitigation efforts, a further 1.5 gigatonnes of CO<sub>2</sub>e could be reduced by 2030.

As we enter a new era of climate action, it is important to emphasise that the overall idea of crediting mechanisms to channel carbon finance towards mitigation opportunities outside organisational or government boundaries is still sound: the atmosphere does not differentiate between a tonne reduced in Russia and a tonne reduced in Brazil. It is economically efficient and environmentally critical to maximise abatement from low cost sources. In turn, this can help to overcome the primary barrier to pursuing higher levels of decarbonisation: cost.

Yours sincerely,

Dirk Forrister  
President & CEO