



**OECD GLOBAL FORUM ON SUSTAINABLE DEVELOPMENT:
EMISSIONS TRADING**

**CONCERTED ACTION ON TRADEABLE EMISSIONS
PERMITS COUNTRY FORUM**

**OECD Headquarters, Paris
17-18 March, 2003**

**The State of Development of National CDM Offices in
Central and South America**

by

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FOREWORD

This paper was prepared by Liana Morera, Olga Cabeza and Thomas Black-Arbeláez (Andean Center for Economics in the Environment) for the OECD Global Forum on Sustainable Development: Emissions Trading and Concerted Action on Tradeable Emissions Permits (CATEP) Country Forum, held at the OECD Headquarters in Paris on 17-18 March 2003. The aim of the Forum was to bring representatives from OECD and non-OECD country governments together with representatives from the research community, to identify and discuss key policy issues relating to greenhouse gas emissions trading and other project based mechanisms for GHG emission reduction, such as Joint Implementation and the Clean Development Mechanism. The Forum also aimed to promote dialogue between the various stakeholder groups, and discuss policy needs in the design and implementation of tradeable emissions schemes. Forum participants included representatives from OECD and non-OECD governments, as well as from the research community. Those from industry and other institutions involved with emissions trading, joint implementation and clean development mechanism projects such as the European Commission and the World Bank were also represented.

The OECD Global Forums are one of the two pillars of the new architecture of the Centre for Co-operation with Non-Members, agreed upon by the Committee on Co-operation with Non-Members. The Global Forum on Sustainable Development (GFSD) provides a mechanism for achieving the OECD Ministers' outreach objective and will complement other work on sustainable development. Within the organisational framework of OECD, the GFSD will aim to facilitate a constructive dialogue between non-member and OECD economies on key issues on the sustainable development agenda.

CATEP is a research network funded by DG Research of the European Commission, and co-ordinated by the Department of Environmental Studies, University College, Dublin.

The ideas expressed in the paper are those of the author and do not necessarily represent the views of the OECD or its Member Countries.

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1. INTRODUCTION

The Clean Development Mechanism (CDM) offers great potential to assist Annex B countries in meeting their emissions reduction commitments by increasing the supply of low-cost emissions mitigation projects, thereby reducing the international market price of emissions reduction credits and the national cost of compliance.

However, CDM project development is facing a series of barriers, which if not addressed, may constrain the effective supply of Certified Emission Reductions (CERs) into the international marketplace. Low CER prices coupled with high formulation and transactions costs make for weak benefit-cost ratios. Owners of potential projects perceive major institutional, regulatory and market risks. These conditions are compounded by a lack of capital in developing countries to appropriately formulate or to execute projects, both from the weaknesses of the capital markets and from the unfamiliarity of bankers with the CDM¹.

One of the requirements for developing countries to participate in the CDM established by the COP7 Marrakech Accords pertains to the designation of a national authority for the CDM. Specifically, this accord stipulates that a Non-Annex B country choosing to participate in the CDM must only do so voluntarily, and shall designate a national authority in charge of the mechanism, which shall be responsible of evaluating and granting national approval to the projects developed within said framework.

According to Article 12 of the Kyoto Protocol, projects to be carried out under the (CDM) must be “additional”, produce real and long term emissions reductions, have the consent of the participating Parties, and contribute to the sustainable development of the countries in which said projects are established.

If the expected supply of CERs from Latin America is to materialise, national CDM offices must come on line, operate effectively and approve projects. National approval, which forms part of the CDM project cycle established by the Convention, is an indispensable requisite so that the operational entities responsible for the external technical evaluation of a project may develop the validation report. This in turn, permits the project to be registered by the Executive Board as a CDM activity.

¹ For more information on these barriers see World Bank NSS Program, “Capacity Building for the Kyoto Protocol” Workshop Report sections 3 and 4. World Bank, March 2003

2. OBJECTIVES

The general objective of this study was to evaluate the institutional capacity of the Central and South American CDM offices, specifically to:

- Determine the current state of the national CDM offices with respect to the requirements and legal responsibilities established by the Convention, the Kyoto Protocol, the Marrakech Accords and the decisions taken by the CDM Executive Board;
- Evaluate their ability to support the efficient and effective development of the CDM potential in their countries; and
- Identify their main deficiencies and weaknesses and their immediate needs with respect to said obligations.

3. EVALUATION METHODOLOGY AND CRITERIA

To meet these objectives, the Andean Center for Economics in the Environment carried out the following main activities and analyses:

- i. A written survey of the CDM offices for preliminary gathering of information to determine the characteristics and provide a diagnosis of the National Offices²;
- ii. Direct interviews with the directors/coordinators of each one of the offices, to discuss key issues identified in their survey responses;
- iii. Examination of legal, operating and planning documents related to the undertakings of their offices and their development.

Thirteen national CDM authorities of the Latin American region were evaluated during the second semester of 2002. Information on the offices was gathered with respect to their constitution, organisational structure and functions, portfolio of CDM projects, financial sustainability, relationships with other entities, obstacles to their development, and strengths and weaknesses of the undertaking. Furthermore, we examined their charters, legal documents and relevant national norms, their regulations on procedures, and any other available information that would enable us to determine the current state of development of the offices.

² The information requested in the surveys is listed in Annex A.

Table 1. Countries that Participated in this Study

Argentina		Nicaragua
Bolivia	El Salvador	Panama
Colombia	Guatemala	Paraguay
Costa Rica	Honduras	Peru
Ecuador		Uruguay

Notes: Mexico, Venezuela and Chile were invited to participate, but stated that their governments had not yet established national CDM offices or responsibilities, and therefore could not respond to the survey or the interviews. Brazil initially stated it would participate, but the designated representative developed health problems impeding his participation.

4. RESULTS AND FINDINGS

The implementation of CDM offices is advancing rapidly throughout Latin America, demonstrating important political commitments and investments from the governments of these countries. The consolidation of the CDM by the COP7 Marrakesh Accords, the ratifications of the Protocol by the European Union, Japan, and Canada, and the effective demand for projects from the PCF and the Dutch CERUPT programs, have increased confidence regionally that the carbon markets will develop and the CDM will be viable, in both governments and productive sectors. Although the average number of approved projects per CDM office is still very low—2.7—the trend is clearly toward consolidation of physical space, qualified directors and personnel, regulations for project evaluation and approval, capacity building in key sectors, and promotion of project portfolios: continued development of the CDM offices should improve the rate of project approval in the short to medium term.

However, several issues have been identified by this report that may affect the development of the CDM offices, the number of projects approved, and the quality of the projects in the national portfolios. If these issues are not adequately addressed, the flow of projects into the carbon markets and the developmental benefits of CDM may remain low.

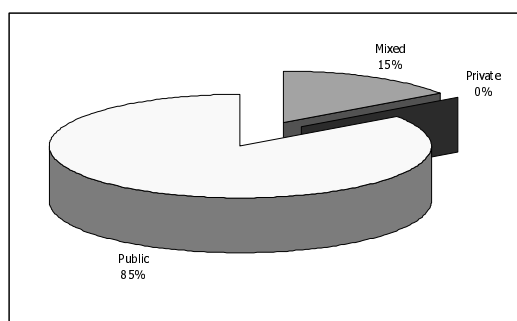
5. CURRENT STATE OF THE CDM OFFICES WITHIN THE FRAMEWORK OF THE MARRAKECH ACCORDS

All of the Latin American countries included in the survey have implemented or are preparing to implement their national CDM offices³. As expected, the stage of development is quite diverse among countries. Few offices have managed to consolidate criteria and procedures on evaluation and national approval, and to develop a qualified technical team with a broad knowledge on the Mechanism. The majority is still in the stage of redefining functions and activities in the light of the decisions and rules established by the Marrakesh Accords, due in part to the uncertainty and lack of defined rules for the CDM before COP7. This circumstance had lead in the past to limited institutional investments for the consolidation of technical personnel and for the definition of criteria and procedures on project evaluation and approval.

Some offices do not yet have a clear legal foundation that entitles them to confer the national approval required by Marrakesh. The evolution undergone by offices to adapt to the CDM requirements has not, in all cases, been accompanied by a development of appropriate legal frameworks to maintain and validate the activities. This situation may generate conflicts or competition with other institutions working on climate change which may consider themselves the national CDM authority.

Most of the national CDM authorities in Latin America are public entities created within governing institutions such as Ministries or Secretariats of the Environment and also have specific functions assigned to them concerning scientific climate change issues which go beyond the scope of the CDM. 15% have private participation in their Board and decision-making processes. Argentina, Bolivia, Colombia and El Salvador have established separate offices for CDM and for scientific climate change activities.

Figure 1. Public and Private Participation in CDM Offices



Although most of the offices have operating regulations that establish a specific administrative structure, in general these offices have been unable to fully fund their technical positions. They lack qualified permanent staff, or a sufficient number of personnel, to be able to meet minimum requirements.

³ See Table 2 for specific country information.

To carry out their activities, they sometimes receive the support of personnel from other related offices or departments and from external consultants, often counting on international cooperation for specialised support and project work, when available.

The scarce development of some offices creates uncertainty to developers and investors alike, and may increase delays and transactions costs associated with the projects. The inability to establish an office in Mexico, for example, is a clear hindrance to the development of the country's great CDM potential. The lack of clear rules and criteria and procedures for the evaluation of CDM projects, impedes a transparent and efficient process necessary to reduce the risks incurred by project formulators at this stage and may lead to demotivation in developing projects in some countries of the region.

6. PROJECT EVALUATION AND NATIONAL APPROVAL PROCESSES

The stage of development of criteria, processes and procedures to carry out the evaluation and national approval established by the Marrakech Accords varies considerably among the evaluated institutions. Although many of the offices surveyed are currently developing formal procedures, only five of the total surveyed (38%) have duly regulated evaluation and approval procedures and criteria.

These procedures vary according with the criteria established by the offices to evaluate and grant national approval: of note, 62% of the offices use the contribution of the projects to national sustainable development as their sole evaluation and approval criterion. Only four offices examine the submitted projects for compliance with UNFCCC CDM rules regarding baselines, additionality, and monitoring and verification protocols.

The evaluation and approval periods vary between offices. Evaluation periods average 17.3 workdays, but range between 10 and 50 days among offices. Once evaluated, the official approval process averages 4.5 days, ranging between 2 and 10 days, depending on the criteria analysed and the methods of evaluation that are applied.

Even though the majority of offices will only apply projects' contributions to sustainable development as the approval criteria, to date few have been able to define concrete methods to carry this out. This situation creates great uncertainty for project formulators and interested investors, and the delays may constitute an important transactional cost for the projects. Clearly, this is an area CDM offices are struggling with and need technical assistance in.

Most offices' approval processes will not assure that approved projects are additional, impose real emission reductions, and have adequate monitoring programs: they will leave those key issues to the Operational Entities (OEs) in the process of project validation. This leaves a serious question: if CDM offices choose not to approve baselines and additionality arguments, will the OEs be prepared to consistently evaluate the additionality and real greenhouse gas mitigation of nationally approved CDM projects to the Executive Board and the Parties of the UNFCCC?

Project approval processes may be affected by political disturbances. Given the institutional and budgetary dependence of these offices on their central governments, new political administrations can mean the imposition of new office directors and staff, resulting in disruption of approval processes and

project reviews. Two examples of such upheaval in CDM offices are Paraguay and Honduras, both of which have completely replaced directors and professional staff following political change⁴.

Table 2. CDM Project Evaluation and Approval

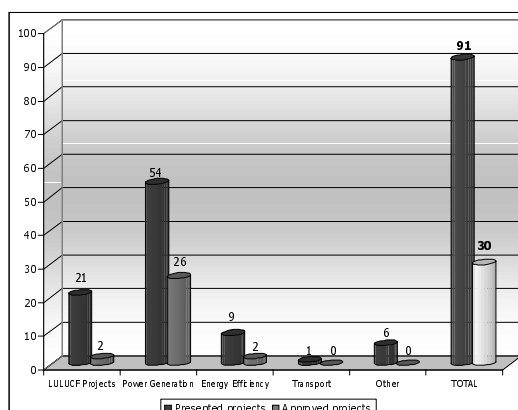
Country	Evaluation Processes Established	Approval Processes Established	CDM Project Evaluation and Approval	
			Examination of UNFCCC CDM Formulation Rules	CDM Rules Used as Criteria For Approval?
Argentina	Yes	Yes	Yes	No
Bolivia	No	Yes	No	-
Colombia	No	No	No	-
Costa Rica	Yes	Yes	Yes	Yes
Ecuador	No	No	No	-
El Salvador	No	No	Yes	Yes
Guatemala	No	No	Yes	Yes
Honduras	No	No	No	-
Nicaragua	No	No	Yes	Yes
Panama	Yes	Yes	No	-
Paraguay	Yes	Yes	No	-
Peru	Yes	Yes	No	-
Uruguay	No	No	No	-

7. PROJECT PORTFOLIO DEVELOPMENT

In general, the project flow is notably smaller than expected. Since the Marrakesh rules were established, the 13 Latin American CDM offices have on average received only 7 projects per office and approved only 2.3. Although this indicator varies among offices, it raises questions regarding the regions' ability to fulfill its emissions reduction potential and contribute to efficient carbon markets. Factors that limit the number of new initiatives are the lack of knowledge among sectors with CDM potential, the uncertainty and risks associated with the international and domestic regulatory frameworks, the current low price of CERs and the high costs of project formulation.

Currently, regional portfolios of approved projects consist mostly of power generation (87%). Future project potential might be determined by the high number of available projects in the areas of power generation, energy efficiency and forestry. The high degree of difficulty associated with the estimation of sectoral baselines for national or international interconnected power grids may limit approvable projects. The rate of increase in approved projects in the short to medium term will depend on CER prices and CDM formulation costs, increased formulation capacity in the CDM sectors, project quality and institutional consolidation.

⁴ This statement does not relate to the political or technical correctness of the changes, simply that these complete replacements resulted in disruptions of approval processes and other office responsibilities.

Figure 2. : Projects Presented and Approved in the Region, by Project Type

The resource and capacity constraints faced by the offices also will affect the quality of projects and portfolios. A recent study by the Andean Center carried out for the IADB, analysed 56 projects in 3 national portfolios in Central America and found that more than 90% of the projects have serious technical deficiencies and require further work in order to be approved by OEs and the Executive Board⁵.

8. OTHER ACTIVITIES PERFORMED

Most offices perform other functions related with the CDM. In order to achieve financial sustainability, some are gearing towards project formulation services. In some cases, this may lead to conflicts of interest: can the same entity formulate a project and then provide it national approval?

Marketing of the CDM opportunity and capacity building are key activities. Some also perform responsibilities that go beyond the scope of CDM and that pertain to other topics related with climate change such as adaptation and vulnerability, placing additional demands on professional staff.

⁵ *Inter-American Development Bank, Andean Center for Economics in the Environment: Evaluación del Potencial de los Países Centroamericanos para Participar en el MDL y el Mercado Internacional de Carbono: Un Análisis Técnico y Económico de 56 proyectos MDL. Washington, D.C., December 2002*

9. INDEFINITION OF PROPERTY RIGHTS

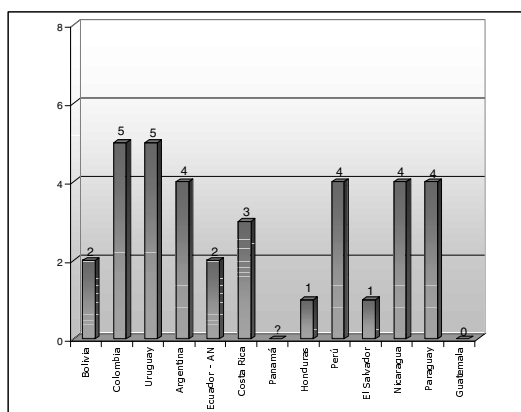
One area of potential risk identified by the study is the lack of a legal definition of the property rights for the CERS generated. This lack of clarity could lead to future rent-seeking struggles between developers, political interest groups and the State, when projects begin to produce important financial flows. 38% of the offices evaluated are now working to determine said property rights; this includes studies on legal frameworks, assistance during the negotiation of the CER purchase agreement, and the formulation of national laws.

In most cases, the national policy seems to be that the CERs will belong to the owners of the projects, although clear legal basis for this is lacking in most cases. The Bolivian government intends to establish joint ownership of CERs, that would fix a 50-50 distribution in cases where the State provides resources such as land, and a 10-90 distribution (10% for the State) in the case of projects on private property.⁶

10. FINANCIAL SUSTAINABILITY

Most offices identify the lack of financial resources as a chief limiting factor to operate adequately. Argentina has a well established office but lacks funds for capacity building and marketing, and has no approved projects yet.

Figure 3. Staff Assigned to Offices



⁶ Interview with Mr. Sergio Jáuregui, coordinator, Clean Development Office (Oficina de Desarrollo Limpio), Bolivia, December 2002.

CDM offices created within institutions such as Ministries or Secretariats can depend on resources from the national budget to finance operational costs, and obtain resources in-kind.

At present, all of the offices are looking for additional financing sources or developing financial strategies to procure the resources necessary for their operations in the longer run. Most charge for, or are studying the possibility of charging for, the rendering of their project evaluation and approval services, although the majority have not defined the cost of this service. This is particularly critical in the case of capacity building, identified by all the offices as a key activity for the development of their CDM potential. Capacity building in the CDM is highly specialised and costly, and there are insufficient funding sources to date to assist with this key start-up activity.

11. OTHER LIMITING FACTORS

Several other factors may limit the development of the offices. These include (a) constant political changes which impose frequent replacement of authorities, decision-makers and professionals; (b) the lack of financial alternatives to support the adequate formulation of CDM projects, and (c) the slowness and uncertainty in international negotiations related to the Convention and the Kyoto Protocol.

CONCLUSIONS

The implementation of CDM offices is advancing rapidly throughout Latin America, demonstrating important political commitments and investments from the governments of these countries. However, several issues may affect the region's ability to deploy its CDM potential, beginning with the state of development of National Designated Authorities. To date, the average number of approved projects is low: only 2.7 per country. The supply of approved projects from the developing world will depend on the efficiency and effectiveness of the development process in said offices.

In addition to the institutional issues, a series of factors will affect the supply of approvable projects. These include the low price of CERs in comparison with high costs of CDM formulation and transactions. At such low prices many desirable projects from renewable energy will not be feasible. Economic sectors with high CDM potential still do not recognise their CDM potential or perceive current risks as too great to take on. The other major constraint is the lack of available finance in developing countries to address the high costs of project formulation and implementation. If these issues are not adequately addressed, low levels of supply of CDM projects may affect the price of emissions reduction credits in the world carbon market, and the cost of compliance of Annex B countries. In order to fulfill the region's CDM potential, the issues and needs identified in this study have to be addressed by domestic and international policymakers.