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**Establishing a National Authority (NA) for the Clean
Development Mechanism (CDM): The Costa Rican
Experience**

by

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FOREWORD

This paper was prepared by Paulo Manso (Costa Rican Office on Joint Implementation – OCIC) 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.

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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 challenge of climate change is now a global issue and part of the international agenda. The Kyoto Protocol (KP) and its provisions for flexible mechanisms have provided a framework for an effective and equitable global response. Among these instruments, the Clean Development Mechanism (CDM) using the market as its driven force has the potential to not only contribute to the ultimate objective of the UN Framework Convention on Climate Change (UNFCCC), but also encourage developing countries to move their economic growth under a less carbon-intensive development path.

A flexible mechanism such as the CDM, the surprise on the KP menu, has never been attempted before and it is a clear case where lessons can only be learned by doing and every mistake is a valuable lesson learned. One lesson already learned is that host countries that established national oversight entities during the pilot phase of Activities Implemented Jointly (AIJ) were remarkably more successful in accessing its benefits than countries that had not. Now, setting-up a National Authority (NA) is a compulsory requirement for all developing countries wishing to participate in the CDM.

The scope of this paper is to present a guide for those developing countries willing to develop its institutional capacity needed to participate in the CDM. Required framework conditions for CDM projects, roles of the NA in the CDM project cycle, possible structures of and tasks to be performed by the NA, steps in creating a NA and challenges of its institutionalisation, are considered from the perspective of a developing country.

2. FRAMEWORK FOR CDM PROJECTS

The CDM has been taking shape since the package of decisions of the seventh sessions of the Conference of the Parties to the UNFCCC (CoP7) known as the Marrakesh Accords, a 250 page interpretation of the KP, was agreed (November 2001). Many parties are already in the process of preparing CDM project activities and these project proposals must meet the demanding requirements of the CDM rules. However, some details such as guidelines for baseline and monitoring methodologies, in addition to definitions and procedures for afforestation and reforestation projects still remain to be clarified.

Key procedural requirements in developing projects include approval of the project by both the host and investor country, and definition of a baseline scenario, which quantifies the emissions level in the absence of the CDM project activity. Before the project can be officially registered as a CDM activity, the project design document (PDD) including the baseline have to be validated by an accredited third party known as the Operational Entity (OE), usually a private sector certification company. This includes a period of 30 days when the validator invites comments from stakeholders.

During the lifetime of the project, actual emission reductions are monitored following a pre-defined protocol, and verified by another OE. Based on these emission reductions, the United Nations CDM Executive Board, which is responsible for overseeing the CDM, will periodically issue Certified Emissions Reductions (CERs) as the tradable unit.

In addition, all projects must fulfil the substantive, administrative and institutional conditions valid in both the host and investor countries. The investor country might only be interested in purchasing CERs rather in actually investing in CDM projects. However, some investor countries programmes such as the CERUPT from the Dutch government or from multilateral organisations such as the World Bank's Prototype Carbon Fund (PCF), additional conditions for trading CERs must be fulfilled in addition to the CDM ground rules.

In general, CDM sits to attract foreign and promote local investment in projects that reduce greenhouse gases emissions and in addition promote sustainable development. In this vein, Costa Rica's CDM program is one of the elements in a strategy to obtain sustainable financing for the national development agenda. CDM has the potential to facilitate the transfer of clean technology and stimulate more cost-effective achievements through carbon marginal financing, and in this way, encourage sustainable development. Concomitantly, it provides a basis for an equitable cost sharing of the burden of climate change.

The CDM is often perceived as an instrument to provide added incentives for emission-reduction projects and afforestation-reforestation project activities in developing countries. However, the CDM market has not yet matured, and it is therefore difficult to judge exactly how financially attractive CDM projects are.

Furthermore, some critics have argued that CDM will never take off because the complex rules would put an excessive burden on the project developers. Indeed, the CDM's ability to generate carbon credits at acceptable transaction costs remains to be proven in practice.

Some developing countries can independently create the framework required for the CDM. This will not be the same, however, for others, in particular in Africa. Many of these countries lack the capacities required to prepare and implement CDM projects, and therefore, will need additional support for capacity building.

3. ROLE OF THE NATIONAL AUTHORITY IN THE PROJECT CYCLE

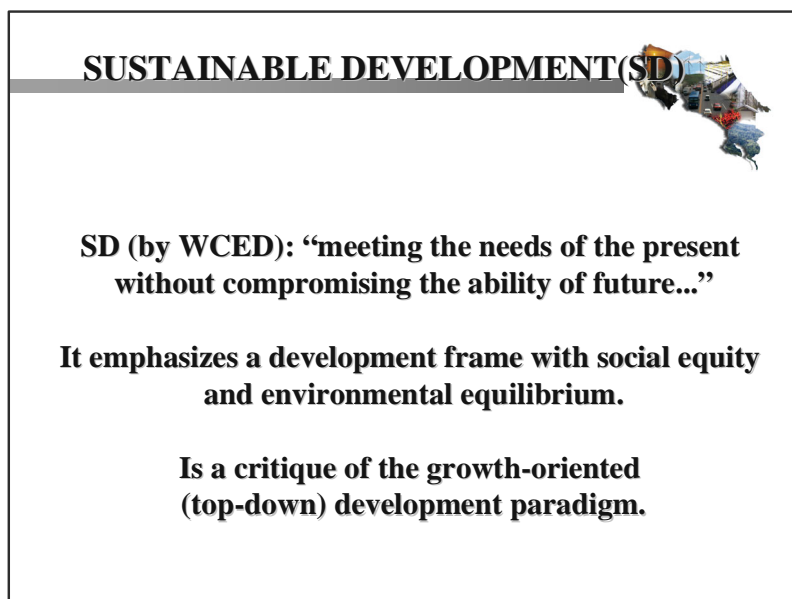
Under the Marrakesh Accord, the NA must ensure that the host country participates in a CDM project activity voluntarily. This condition also applies to all project participants. The NA must also confirm that a project contributes towards a country's sustainable development, in accordance with the standards set by the host country and whether projects will result in real, measurable and long-term benefits to mitigate the climate change.

The former is the centrepiece of the regulatory function of the NA, a compulsory requirement and an important aspect to increase the probability of approved projects being successfully validated and to reduce the perceived and real risks to local suppliers and buyers (of CERs) in implementing CDM projects.

It is advisable that the NA design and establish an evaluation procedure that adopt international eligibility criteria to secure the expected global benefits¹ and assess the contribution to sustainable development based on the framework of the CDM national strategy and local policies.

If the NA approves implementation, it must also ensure that the project environmental impact is adequately assessed.

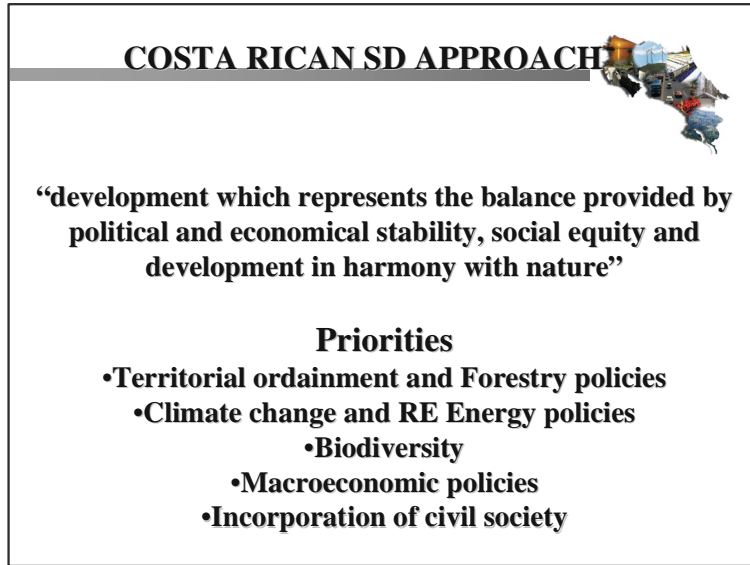
Figure 1: Sustainable Development



During the validation process, the NA shall make comments on the validator draft report and these comments must be taken into account and may have a significant impact on the validation process. Once the registration process has been completed and approval granted for the project, the NA can no longer intervene directly. However, it should regularly review verification reports to ensure that project implementation does actually contribute to a country’s sustainable development.

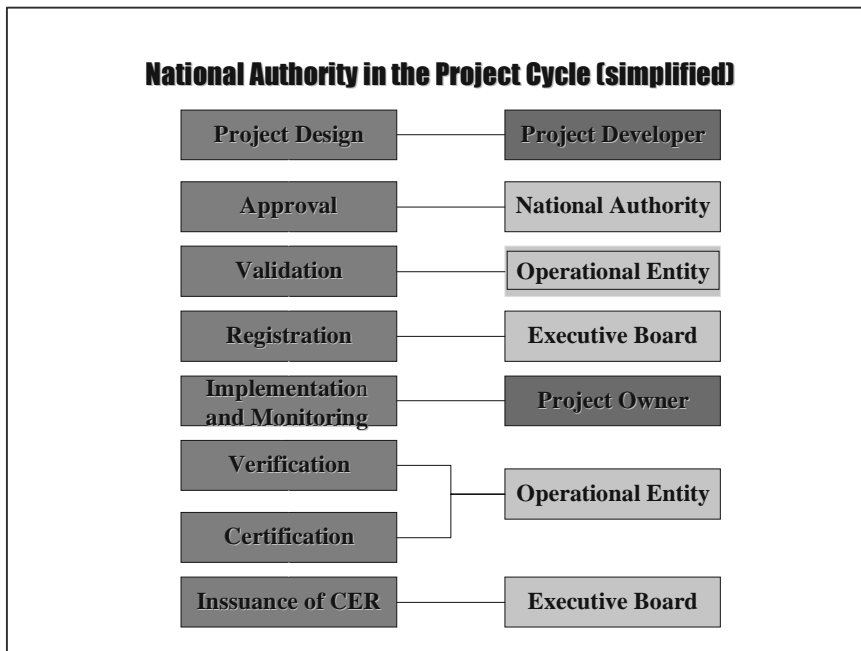
¹ Additionality criteria expressed in terms of real, measurable and long-term benefit related to the mitigation of climate change. Requires a baseline and the quantification of the impacts of the project activities on carbon stocks and flows. Externalities such as the managing of leakage and provisions for the management of other risks should be considered in addition to a monitoring protocol suitable to secure the long-term benefit related to the mitigation of climate change.

Figure 2: Costa Rican Sustainable Development Approach



Marketing is another important task to be performed by the NA. The entry into the CDM is likely to be highly competitive. The market has been diminished both by stringent requirements imposed by the Marrakesh Accords as well as by the exit of the United States from the KP. Only those projects deemed of high quality will compete in the emerging market. Therefore, a host country interested in being actively engaged in the carbon market needs an aggressive marketing strategy. It should take full advantage of international experiences, internal and external consultants that provide inputs for identification, formulation and development of proposals for potential CDM project activities, as well as multilateral banks acting as intermediaries for buyers in addition to brokers that bring potential buyers and CERs suppliers together.

Figure 3: National Authority in the Project Cycle (simplified)



Notes: Figure 3 outlines the basic tasks that the NA must carry out in the project cycle.

4. STRUCTURES OF NATIONAL AUTHORITY

There is no right approach to structure but rather a number of approaches are possible to respond to the needs and availability of resources in each individual developing country.

Some countries have attached the NA to the climate change office. The climate change office is a fully governmental entity responsible to report on national commitments under the UNFCCC. These offices are more scientific by nature and not business oriented. Under this structure the NA could be responsible for determining and drawing up CDM national policy and strategy, developing guidelines, processes and approval procedures for CDM, and dealing with comments and complaints.

On the other hand, some developing countries have attached their NA to governmental entities accountable to a CDM Board entrusted to the National Climate Change Committee. Usually these boards have no permanent staff. However, day-to-day tasks involved in preparing and processing CDM project activities could be carried outside of a state administration, to ensure greater and more rapid scope for action. A technical office or clearinghouse would carry out the following tasks on behalf of the NA entrusted to a CDM Board or any other governmental entity:

- Carrying out secretariat duties for the CDM Board;
- Serving as a focal point and provide support for investors/buyers;
- Promoting the CDM project approach;
- Providing potential projects for investors;
- Processing framework agreements with investors/buyers;
- Assessing statements made on environmental impact;
- Providing legal advice for investors/buyers;
- Coordinating with other official entities and authorities;
- Drawing up standardised baselines;
- Monitoring ongoing CDM projects;
- Conducting public relations work, updating the web, etc.

In general, the range of tasks should reflect the country's potential opportunities on the emerging market.

Figure 4: CDM Institutions

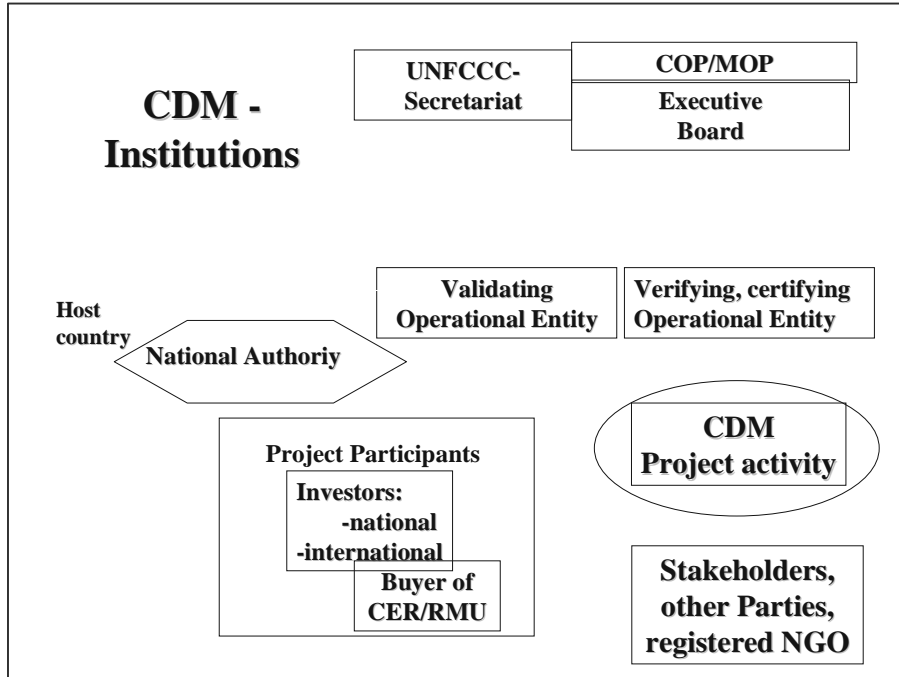
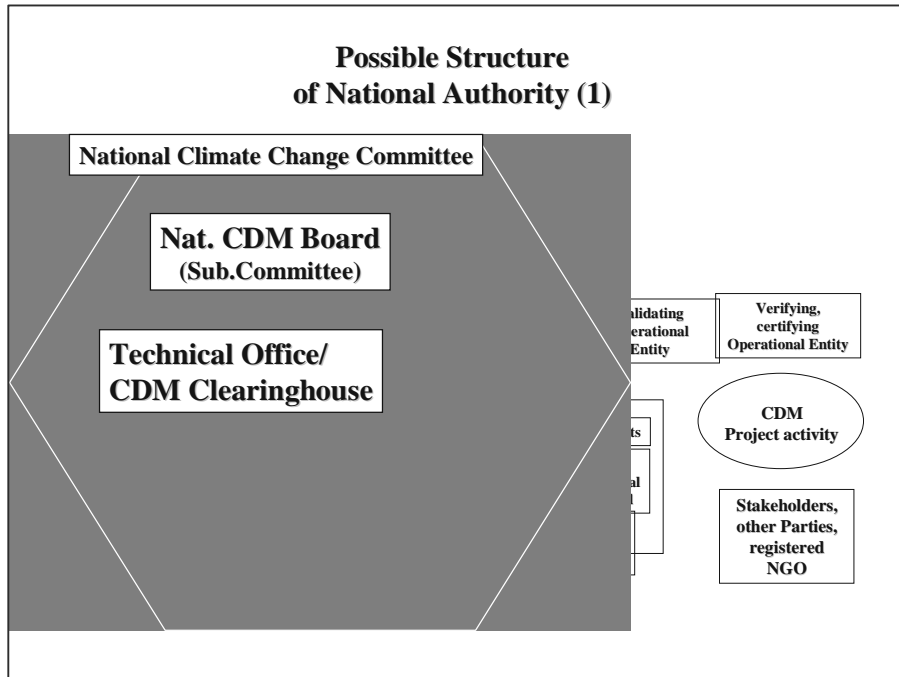


Figure 5: Possible Structure of National Authority (1)



5. COSTA RICAN EXPERIENCE

It is precisely the compatibility that exists between local development priorities and what can be called a responsible policy on climate change that climate change issues are addressed at its highest political level in Costa Rica. Under a two pronged approach such as implementing the Kyoto Protocol flexibility mechanisms (AIJ/CDM) and no regret policies and measures on mitigation, Costa Rica has inflected its greenhouse gases emissions curve during the last decade. Nevertheless, national emissions are expected to double during the next 15 years.

Costa Rica's experience with the UNFCCC flexibility mechanisms started in 1995 with the creation of a national Activities Implemented Jointly (AIJ) programme, envisioned and implemented by the Ministry of Environment and Energy (MINAE), the rector entity in climate change, as a new component of the national agenda on sustainable development. An agreement of cooperation was signed among public, private and NGO sectors for the development of the national AIJ programme.

The MINAE signed this initial agreement of cooperation with the Investment Board of Costa Rica (CINDE), a private entity specialising in the attraction of direct foreign investment, a forestry NGO (FUNDECOR) with recognised experience in sustainable development and the Association of Private Energy Producers (ACOPE).

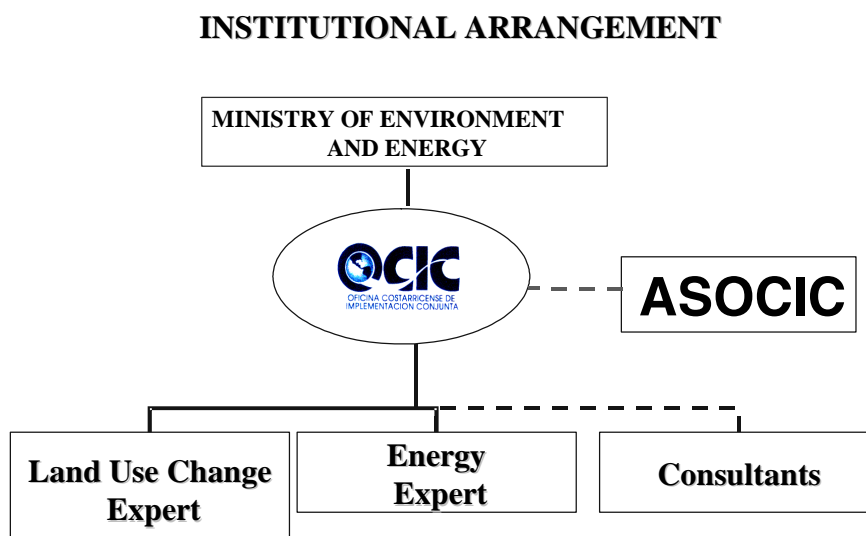
In 1996, the national AIJ programme was legally elevated to the rank of maximum deconcentration office of the MINAE. This decision taken by an executive decree allowed the programme to have an administrative office, the Costa Rican Office on Joint Implementation (OCIC) and also guaranteed all participating sectors a voice in policy development. Figure 6 illustrates the institutional arrangements put in place.

In 2002, Costa Rica ratified the Kyoto Protocol and underwent another transformation. To move toward sustainable financing, a private association of stakeholders was established, known as the Costa Rican Association of Joint Implementation (ASOCIC). Founding membership was offered to main national utilities from the public and private sectors, as well as the Forestry Chamber and other public and private forestry entities, comprising a total of 16 associates.

Under this structure, OCIC is a mixed institution with a political mandate from the MINAE and under administrative guidance of ASOCIC. This coordination is framed under a new cooperative agreement between MINAE and ASOCIC. This structure allows for financial sustainability and flexibility for OCIC, now the National Designated Authority (NDA) for the CDM.

At times when most countries were still trying to understand the main basic concepts of the CDM, OCIC forged ahead with effective institutional developments as well as innovative financial instruments.

Figure 6: Institutional Arrangement



6. STEPS IN CREATING A NATIONAL DESIGNATED AUTHORITY

Prior to creating a National Designated Authority (NDA), it is advisable to perform a quick assessment of the political and institutional feasibility of establishing a successful entity. The initial assessment should consider aspects of: political stability, since CDM projects consider long-term effects; potential institutional rivalries in climate change issues; level of intersectorial communication; technical expertise in project development and evaluation; general level of interest and understanding of the CDM, etc.

Once the initial assessment is accomplished indicating favourable conditions for the NA, the following steps provides a general framework for establishing a NDA:

Define its mission and objectives; from a development country perspective it must at a global level contribute to the ultimate objective of the Convention, and at the domestic level it should help meet national sustainable development goals.

Seek support of political entities such as Ministries of Environment, Energy, National Resources, etc; and establish a legal framework via Presidential or Ministerial Decree or any other legal instrument. This legal instrument shall contain justifications, authorities, objectives and organisational structure, financing functions and procedures that will be the platform for the development and sustainability of the NDA. Furthermore, the NDA should have the authority to grant export of emissions right (CERs).

A review of the national legislation is crucial. The legal framework of a host country will directly affect the success of the national authority. Depending upon the development priorities of the host country, some legislation might be compatible with CDM. As such with trade and investment in general, those host countries with most transparent rules and most streamlined procedures, will be in the best positions to compete for CDM resources. CDM projects will not only compete with each other but also with the other KP flexibility mechanisms.

National strategies for CDM should be based on local sustainable development objectives. It is important to identify national policies already established for social and economical development in areas related with climate change such as energy, land use change and forestry, industry, etc. These policies will ultimately have the greatest impact on national resources and the environment at the local level and on climate change at the global level. CDM is a real opportunity to channel resources towards projects that are most likely to further national development priorities.

Attaining broad stakeholder participation is one of the most challenging steps. Some countries have centralised programs within the central government institutional framework. Others have achieved active participation from all sectors of the society and different sectors of the economy. Including participation of the private sector encourages a less bureaucratic, more result-oriented and business-like approach. Private and public developers together or by themselves are the real actors and the driving force for the implementation of cost-effective mitigation options.

Funds will be crucial and the source of funds will depend on stakeholders' involvement. NDAs based on public funding may face funding constraints and one way to deal with is to broaden the sources of in-kind support from stakeholders for items such as the physical facilities for offices etc as well as logistic assistance such as financial and accounting management support from private or NGO entities. This will allow for more flexibility to the NDA. Operational costs for running a NA might also be financed via a small commission fee on CER trading.

All these elements are generic and there is no one best approach to establish a NDA. However the NDA shall have the capacity to act as an effective entity that will allow the host country to be competitive in this emerging market.

7. CHALLENGES OF THE INSTITUTIONAL ORGANISATION.

The nature of the NA varies widely in regard to legal structure, financial support and responsibilities. However, the identified main challenges of the institutional organisation are the following:

7.1 Awareness raising

It is clear that CDM can further national goals and at the same time these projects have ancillary benefits above climate change mitigation. In this regard, the most difficult aspect to handle is managing expectations. CDM is an instrument to finance only a certain subset of sustainable development initiatives and it is not the only one. In this regard, expectations should be kept in its realistic dimension.

7.2 Political will

It is evident that in those countries where climate change has been made a priority, progress is made more quickly. In this regard, long term planning, vision and political will, are critical to successful implementation of the NDA for the CDM.

7.3 Cross-sectorial coordination

Despite the fact that it is governments who have signed the UNFCCC and the KP, most of its implementation will be performed by private and public developers and most of the CDM benefits channeled to their projects. Therefore, it seems logical that stakeholders share the costs of a NA. The governmental leadership is vital in this regard.

7.4 Full-time champion

Having a leader who is responsible to make the NA will be very effective. Many people with little direct involvement will not be able to get the job done.

8. CONCLUSIONS

There is no cookie approach and each country has to decide on the particular form of its NA institutional development. Participation in CDM is a learning process in each country. At the beginning it is impossible for a newly formed NDA authority to exercise all relevant functions. Over time, the growing maturity of the market will allow the NDA to gradually assume additional responsibilities. In the mean time, capacity building and technical training can be provided by specialised agencies and funded by different sources of Official Development Aid (ODA).

In the specific case of Costa Rica, the reason for success has been a country driven effort with strong political support, in addition to a solid technical platform integrating local and global market-driven instruments with domestic sustainable development initiatives. The Costa Rican enriching experience on the UNFCCC flexibility mechanisms is a lesson to be shared among those developing countries willing to be part of the emerging market of CERs.

In achieving sustainable development under the CDM it seems to be less a factor of project design but more a result of the national capacity to establish and implement: policies and measures, a compatible legal framework and a supportive institutional capacity. However, in achieving the ultimate objective of the Convention under social equity and environmental integrity via the CDM, the global benefit shall by far, surmount the local environmental cost.

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