

**Promoting a Paradigm Shift: Investing in Truly Additional Climate Mitigation
Submission to the Board of the Green Climate Fund**

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The goal of the Green Climate Fund (GCF) is to promote a paradigm shift towards low-emission and climate-resilient development pathways by providing support to developing countries to limit or reduce their greenhouse gas (GHG) emissions.¹ Any investment that leads to a paradigm shift and is truly transformative would need to be additional.² If non-additional projects are approved through the GCF, this would not only undermine the GCF's ability to promote real and verifiable emissions reductions, but it would also mean that it would have failed to leverage private financing, since money would have been invested in such projects anyway. If the GCF is to meet its mandate while maximizing its private sector leverage, **it must ensure that it has strong additionality tools and procedures in place that exclude business-as-usual projects.** While there are many issues that the GCF will need to resolve, this briefing aims at highlighting the need to build on the lessons learned, especially when considering a project-based additionality approach.

Current climate finance mechanisms have failed to exclude non-additional projects

Years of practical experience with the Clean Development Mechanism (CDM) – which has the most developed additionality procedures among carbon finance schemes and is currently the major climate finance channel directly targeting the private sector – have shown that private sector funding through the CDM often does not lead to the expected sustainable development and reduced emissions outcomes, nor to a multiplier effect in kick-starting clean energy investment.³ Instead, private sector funding through the CDM has been poorly invested as a result of the inclusion of projects that are non-additional both financially and in terms of emissions. Additionality has also been a challenge for other climate finance mechanisms such as the Global Environment Facility (GEF) and loans by multilateral development banks when estimating the amount of investments that they have leveraged.⁴

The demonstration of additionality is a controversial issue and has been debated in international climate negotiations and in the literature since the establishment of the CDM.⁵ The fundamental problem is that the question of whether a project would also be implemented without the CDM is hypothetical: it can never be proven with absolute certainty. As a result, many CDM participants have tried to and succeeded in gaming the system.⁶

¹ Governing Instrument for the Green Climate Fund, paragraph 2.

http://gcfund.net/fileadmin/00_customer/documents/pdf/GCF-governing_instrument-120521-block-LY.pdf

² Financial additionality is defined as an economically non-viable project becoming viable as a direct result of climate finance. Environmental additionality is when the emissions from a project are lower than the baseline.

³ Stadelmann, M., Castor, P. and Michaelowa, A. (2011). "Is there a leverage paradox in climate finance?" *Climate Strategies*. <http://www.climatestrategies.org/component/reports/category/71/324.html>

⁴ *Ibid.*

⁵ Schneider, L. (2009). "Assessing the additionality of CDM projects: practical experiences and lessons learned," *Climate Policy*, 9(3). <http://www.tandfonline.com/doi/abs/10.3763/cpol.2008.0533>

⁶ See for example:

(1) Cames, M., Anger, N., Böhringer, C., Harthan, R., and Schneider, L. (2007). "Long-term Projects of CDM and JI," Report to the Federal Environmental Agency of Germany, Dessau, Germany.

If the GCF chooses to adopt additionality tools, its ability to develop transparent and objective procedures will be critical for it to maximize its impact and maintain its environmental integrity. However, by the very flawed nature of the additionality concept, as mentioned above, the GCF would not be able to avoid all non-additional projects, and like the CDM, a number of “free-riding” projects will likely enter the pipeline. **This makes it critical for the GCF to clearly determine what it means by a paradigm shift, in order for only truly transformative and sustainable projects – i.e. those that are community-driven, climate-resilient, decentralized, pro-poor, and low impact – benefit from the GCF’s limited resources.**

Drastically improve current additionality practices

The CDM’s additionality rules have long been criticized as ineffective. The number of non-additional projects in the CDM has been estimated to be between 40-70%.⁷ In particular, large-scale power supply projects, which are expected to generate the majority of CDM credits going forward, have a higher probability of being non-additional and could thus increase cumulative GHG emissions by over a gigaton of CO₂e through 2020.⁸ Three types of analyses, listed below, that are used to demonstrate financial and environmental additionality must be drastically improved:

Investment Analysis

The investment analysis is used to show that a project is not financially viable without additional funding available through the sale of carbon credits. Studies of specific projects have shown that the quality of how an investment analysis is applied varies greatly.⁹ The majority of projects that use the investment analysis derive the financial benchmarks from internal company information rather than external sources, as is required by the additionality tool. Figures used in the investment analysis are also not always reported correctly. For instance, the way project developers calculate the required internal rate of return ranges considerably, even among projects of the same type within the same country. In addition, government subsidies and tariffs are often ignored in the calculations. For instance, a study of Indian and Chinese CDM projects found that three Indian wind projects ignored lucrative tax breaks in their Project Design Documents (PDDs), while hydropower developers in China understated the amount of power their projects would generate.¹⁰

Barrier Analysis

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- (2) McCully, P. (2008), “The great carbon offset swindle: How carbon credits are gutting the Kyoto Protocol, and why they must be scrapped.” *Bad Deal for the Planet: Why Carbon Offsets Aren’t Working and How to Create a Fair Global Climate Accord*. International Rivers. <http://www.internationalrivers.org/node/3975>
 - (3) Haya, B. (2007), *Failed Mechanism: How the CDM is Subsidizing Hydro Developers and Harming the Kyoto Protocol*, International Rivers. <http://www.internationalrivers.org/node/3993>
 - (4) “WikiLeaks Cable Highlights High Level CDM Scam in India,” International Rivers, 20 September 2011. <http://www.internationalrivers.org/node/1102>

⁷ “CDM Watch Recommendations on the Reform of the CDM,” Carbon Market Watch, 28 November 2011.

http://carbonmarketwatch.org/wp-content/uploads/2012/02/CDM-Watch-recommendation-for-CMP-decisions_2811201.pdf

⁸ Lazarus, M., Erickson, P., and Spalding-Fecher, R. (2012) “Transitioning away from large-scale power projects: A simple and effective fix for the CDM?” Stockholm Environment Institute. <http://www.sei-international.org/publications?pid=2204>

⁹ Schneider (2009)

¹⁰ Michaelowa, A. (2007) “Experience in Evaluation of PDDs, Validation and Verification Reports.” Presentation at Austrian JI/CDM workshop. Vienna, 26 January. Also see Michaelowa, A. and Purohit, P. (2007): “Can Indian CDM project developers outwit the CDM Executive Board?” *Climate Strategies*. <http://www.internationalrivers.org/files/attached-files/additionality-cdm-india-cs-version9-07.pdf>

The barrier analysis requires demonstration that barriers exist that would prevent the proposed project from being carried out if the project activity is not registered as a CDM activity. A systematic evaluation of 93 registered CDM projects found that the barrier analysis is highly subjective and difficult to validate in an objective and transparent manner.¹¹ 43% of the analyzed projects applying the barrier analysis provided no explanation as to why the identified barriers would prevent the proposed project activity. In some cases the barriers were not credible, were subjective, or bore little relation to the project activity. The study also showed that the PDD auditors (known as Designated Operational Entities, or DOEs) also played a significant role in promoting non-additional projects, because the majority of DOEs examined failed to transparently and comprehensively assess each barrier.

Common Practice Analysis

The common practice analysis requires an assessment of the extent to which a proposed project type has already been deployed in the relevant sector and region. Its main weakness is that it does not clearly define when a project activity should be regarded as common practice. As a result, the common practice test has allowed a number of large, non-additional and common power supply projects to receive CERs, which has contributed to the current oversupply of credits. For instance, a 2011 assessment of hydropower projects in the CDM¹² found that by allowing the boundaries of the assessment to be defined narrowly, and “essentially distinct” to be defined broadly, practically any project can be shown to not be common practice.

The GCF should not be overly dependent on leveraging factors

One cannot assume that the more funds that are leveraged by a finance mechanism, the greater the impact will be on GHG emissions reductions. In the case of the CDM, for instance, a recent study showed that the CDM has quite a low leverage factor (i.e. the efficiency in leveraging funds) – that of 3-4.5 on average.¹³ The study looked at 232 CDM projects and 370 GEF projects and failed to find a correlation between leverage ratios and mitigation efficiency. In the case of the CDM, researchers even found evidence of a paradox in which projects with lower leverage ratios achieved better results than those with higher leverage ratios. CDM solar projects for instance have a high leverage factor, but this reduces their likelihood of being additional because the amount of CDM financing is unlikely to be enough to actually mobilize the bulk of financing that is needed for such projects.

Avoid directly linking the GCF with the CDM

The CDM High-Level Panel recommended in its final report that the GCF could subsume some of the current oversupply of CDM credits.¹⁴ It also called for the promotion of “CDM standards and methodologies in accounting for payments for verified results, so as to leverage the achievements, knowledge, and resources of the CDM” and to directly “apply the standards and methodologies developed under the CDM as a way to facilitate the implementation of mitigation activities supported by

¹¹ Schnedier, L. (2007) “Is the CDM fulfilling its environmental and sustainable development objectives? An evaluation of the CDM and options for improvement.” Öko-Institut.

http://www.oeko.de/publications/reports_studies/dok/659.php?id=&dokid=622&anzeige=det&itit

¹² Haya, B. and Parekh, P. (2011). “Hydropower in the CDM: Examining Additionality and Criteria for Sustainability.” Energy and Resources Group, UC Berkeley. http://erg.berkeley.edu/working_paper/2011/Haya%20Parekh-2011-Hydropower%20in%20the%20CDM.pdf

¹³ Stadelmann, Castor and Michaelowa (2011)

¹⁴ Ibid, p. 25.

the Green Climate Fund.”¹⁵ The GCF should avoid any linkages with the CDM such as through an investment in bailing out the CDM from its current demand/supply disaster. In addition, it should learn from the mistakes of the CDM; rather than adopting a broken system of procedures and dealing with the downstream consequences, **it should instead clearly define at an early stage what types of projects and programs would truly lead to a paradigm shift.**

Summary of recommendations

The GCF must first clearly determine what it means by a paradigm shift, in order that only truly transformative and sustainable projects benefit from the GCF’s resources. In order to do so, it should consider the following:

- Support programs and projects that promote decentralized, pro-poor, climate-resilient, low-impact and community-driven adaptation and mitigation projects rather than single large-scale, business-as-usual power supply projects. Exclude project types with a low likelihood of additionality (e.g large infrastructure projects).
- Financial and environmental additionality must be clearly demonstrated for any private investment or private sector projects under consideration for GCF support. This should occur during initial evaluation stages prior to any approval of GCF support.
- Additionality assessments should include objective approaches to demonstrating additionality:
 - Barriers that are highly subjective, such as general references to risks or company-specific barriers should not be used to demonstrate additionality.
 - Make the investment analysis mandatory for all projects.
 - Exclude projects on which the GCF has no meaningful impact.
 - Instead of assessing the specific motivation of a project developer, as this is highly subjective and difficult to validate, the GCF should assess the market environment and current practice regarding the proposed project type.
- Ensure that any project auditors are assigned by the GCF Board rather than by project developers to avoid conflicts of interest.
- Private investments must adhere to rigorous standards of transparency and accountability.
- Exclude CDM projects from GCF financing.
- The GCF should avoid using leveraged funds as a major indicator of success for climate mitigation as it is likely that projects with high leverage factors are also non-additional.

Developing a fund that would finance non-additional projects would undermine the mitigation goals and the credibility of the GCF. It is vital that the GCF learn from the mistakes of the CDM, develop additionality rules that effectively exclude free-riders, and promote projects that offer a fundamental shift towards a sustainable, low-carbon future.

Contact:

Katy Yan
Climate campaigner
katy@internationalrivers.org

Zachary Hurwitz
Policy Program Coordinator
zachary@internationalrivers.org

¹⁵ CDM High-Level Panel Final Report, 2012, p. 6 <http://www.cdmpolicydialogue.org/report/rpt110912.pdf>