



**DEVELOPMENT CO-OPERATION DIRECTORATE  
DEVELOPMENT ASSISTANCE COMMITTEE**

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**ODA ELIGIBILITY ISSUES FOR EXPENDITURES UNDER THE CLEAN DEVELOPMENT  
MECHANISM (CDM)**

**PROPOSAL BY THE CHAIR**

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## ODA ELIGIBILITY ISSUES FOR EXPENDITURES UNDER THE CLEAN DEVELOPMENT MECHANISM (CDM)

### PROPOSAL BY THE CHAIR

#### I. Background

1. The CDM is one of the flexibility mechanisms of the Kyoto Protocol. It is designed to foster sustainable development in recipient countries in line with the ultimate objective of the Protocol *and* to assist donors<sup>1</sup> in achieving compliance with their quantified emission limitation and reduction commitments. CDM projects are activities undertaken in developing countries<sup>2</sup> that will reduce emissions of greenhouse gases below an agreed baseline of emissions that would have occurred without the project.

2. A CDM project will generate emission reductions (called Certified Emission Reductions or CERs) that may be transferred (in part or in full) to the industrialised country that has supported the project financially, thereby helping it to meet its Kyoto emissions targets. CERs may arise either from emission-reducing (e.g. renewable energy) or from carbon capture activities (e.g. forestry). It is expected that CERs will be tradeable.

3. The DAC Network on Environment and Development Co-operation (ENVIRONET) has been collaborating with the DAC Working Party on Statistics (WP/STAT) to examine whether and how expenditures on the Clean Development Mechanism (CDM) projects could be reportable as official development assistance (ODA)<sup>3</sup>. This work led to the formulation of a number of options, ranging from no reporting to unrestricted ODA reporting of concessional public expenditures on CDM projects as ODA, with several middle-ground options also available.

4. The DAC Senior Level Meeting discussed this matter at its last meeting on 10-11 December 2003. Some Members expressed the view that public expenditures for activities under the CDM should not be counted as ODA because the resulting CERs benefit the donor. Others suggested such activities should be reportable as ODA without restriction, since the main objective of the CDM is to foster sustainable development in the partner country.

5. It was recognised that a consensus of either of these two extreme positions (full reporting of CDM as ODA or no reporting of CDM as ODA) would be very hard to achieve. Guided by the Chair, the meeting agreed to examine the feasibility of a compromise solution. The “Friends of the ENVIRONET chair” was requested to further explore possibilities for such a compromise, taking account of practical feasibility and statistical integrity [DCD/DAC/M(2003)11].

6. The proposals below build on the results of this work by the “Friends of the ENVIRONET Chair”, which has drawn on the expertise of Members of the DAC ENVIRONET and DAC WP/STAT as well as representatives of the OECD Environment Directorate and the Secretariat of the UN Framework Convention on Climate Change (UNFCCC). The DAC High Level Meeting is invited to agree to proceed on the basis of this approach.

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<sup>1</sup> Strictly-speaking: Parties included in Annex I of UNFCCC, which includes OECD Members and non-OECD Members.

<sup>2</sup> Strictly-speaking: Parties not included in Annex I of UNFCCC. This includes developing countries and also some countries in transition..

<sup>3</sup> See Annex 1 for an explanation of the terms ODA and CERs.

## II. Proposals for DAC consideration

### a) *Marrakesh agreement*

7. At its Meeting in Marrakesh, Morocco, in 2001 the Conference of the Parties to the UNFCCC agreed on modalities and procedures for a Clean Development Mechanism. In particular, it was agreed “that public funding for clean development mechanism projects from parties in Annex 1 is not to result in the diversion of official development assistance and is to be separate from and not counted towards the financial obligations of Parties included in Annex I”.

8. **The DAC should explicitly confirm its commitment to the Marrakesh agreement, which will underpin any decision its takes with respect to the ODA-CDM issue.**

9. In this connection, the UNFCCC Secretariat has informed the DAC Secretariat that, according to its understanding, the CDM Board, at the time of considering a proposed a CDM project that includes ODA financing, would seek an affirmation (project by project) from the donor that public financing does not result in the diversion of ODA. Moreover, it is the host Party's prerogative to confirm whether a clean development mechanism project activity assists it in achieving sustainable development. Thus, the recipient country will need to approve each project, including the source of financing.

### b) *Key principles underlying ODA*

10. “ODA” measures donor effort net of any returns to the donor from ODA expenditure. Such returns include loan repayments, recoveries on unspent grants and proceeds from equity sales. In line with this principle, CERs resulting from ODA-financed CDM projects should be considered as a return to the donor and give rise to a deduction from ODA flows. Conversely, if instead of receiving CERs, a donor has agreed with the host country not to receive any of the generated CERs, or if the project does not generate CERs (e.g a capacity development activity), no deduction would be necessary.

11. **The DAC should agree that the value of any CERs received in connection with an ODA-financed CDM project should lead to a deduction of the equivalent value from ODA. The DAC should also rule out the possibility of counting as ODA funds used to purchase CERs.**

### c) *Practical feasibility, statistical integrity and transparency of ODA reporting*

12. There are a number of ways of translating the above into actual statistical practice. The “Friends of the ENVIRONET Chair” has accordingly examined several possible methodologies from the perspective of practicality, statistical integrity and transparency of ODA reporting. Based on this analysis, the proposed approach is for donors to report as a receipt against ODA the value of the CERs received, irrespective of whether the CERs are sold or retained. This deduction should take place at the time of receipt of these CERs. Issues relating to the reference price to be used for the valuation of the CERs remain to be resolved.

13. **The DAC should agree to the principle of reporting as a receipt against ODA the value of the CERs received, irrespective of whether the CERs are sold or retained by the donor.**

### III. Next steps

14. Formulating a practical approach to ODA reporting in line with the consideration principles outlined above will require further clarification of some technical issues. These include the reference price for valuing CERs and how to deal with co-financing of projects. As some projects that might earn donors CERs may already be being funded by ODA, agreement on reference prices would be required by February 2005, in line with the statistical reporting cycle.

15. In addition, the continued uncertainties as to how the CDM regime will unfold call for a flexible approach, allowing for testing and subsequent refinements as appropriate.

16. **The DAC should request that ENVIRONET and WP/STAT continue to work to clarify remaining unresolved practical issues and formulate a practical approach in time for the next reporting cycle. This approach should be subjected to review within 3 years, i.e. no later than end 2007.**