

such as the CDM and thus the indirect costs imposed by the CDM must be kept to a minimum to ensure wider participation. If the Carbon Fund option is selected, the investor's confidence in the mechanism will depend upon the credibility of the fund manager chosen.

**Issue #9: How might the CDM provide incentives for developing countries to engage in climate change mitigation activities?**

**Issue:** Throughout the policy discussions leading up to the Kyoto Protocol, developing country governments and NGOs raised concerns about the equity and efficiency of AIJ, and the extent to which these activities will provide benefits to host countries in the form of new capital and technologies. In addition, many developing countries have demonstrated reservation when encouraged to consider committing to emission reduction targets, citing the UNFCCC recognition that developing country emissions must increase as they pursue essential national development programs. Although some developing countries have expressed their general support for AIJ, this support is often tied to the condition that developing countries' input and perspectives be seriously addressed when designing the mechanisms that will replace the AIJ pilot phase.

Since emissions from developing nations are rapidly increasing, developing country participation in the CDM could play a significant role in helping to achieve climate change mitigation goals. Thus Canada will need to consider options for designing the CDM to encourage developing country participation in climate change mitigation activities. Several options to do so are considered below.

**Options:**

**A. Use the Share of Proceeds for Administrative Expenses and Assistance with Adverse Impacts as an Incentive Mechanism for Climate Change Mitigation.** Under this option, the CDM could allocate the share of proceeds, which will be used to "cover administrative expenses as well as to assist developing country Parties that are particularly vulnerable to the adverse effects of climate change to meet the needs of adaptation," to developing countries based on their willingness to participate in climate change mitigation activities. For example, the CDM could offer such funds under the agreement that recipients host CDM projects or undertake other measures to reduce GHG emissions. The advantage to this option is that it would allow the CDM to encourage policies and measures that generate substantial emission reductions, but are not easily measured or verified and, thus, may not be captured through standard CDM projects or other cooperative mechanisms. For example, the CDM could offer funds to developing country governments in exchange for agreements that they undertake energy efficiency upgrades at their facilities, or implement policies to reduce emissions in the transportation sector. Since estimating the amount of emission reductions associated with these measures is highly uncertain, the amount of CDM credits generated by these actions would not be subject to the same rigorous quantification and verification criteria required of CDM projects.

The disadvantage of this option is that, like many non-regulatory programs such as voluntary programs or tax credits, it would be difficult to ensure that government activities are in addition to actions that would have been undertaken in the absence of the