

distribution of the adaptation funds. In addition, this option does not ensure that the countries most vulnerable to the adverse effects of climate change would be the recipients of these funds. Furthermore, placing such conditions on the allocation of funds may be highly contentious, particularly from the perspective of developing countries vulnerable to the impacts of climate change.

B. Establish a Fund to Help Developing Countries Defray Increases in the Marginal Cost of Mitigating GHGs that Could Occur through Hosting CDM Project. Many developing countries have expressed concern that project-based flexibility measures, such as CDM, will lower national GHG emissions in developing countries and thus lower their national baselines. Increasing marginal costs of emission control associated with these lower baselines, may raise the cost of control if and when developing nations commit to future emission reduction targets. To address this concern, the COP/MOP could establish a fund to help developing countries defray any increase in the marginal cost of mitigating GHGs that may have occurred with the implementation of CDM projects. For example, a record-keeping system could be established to track investments made in each host country, and future mitigation efforts in host countries could be partially financed by contributions from Annex I countries that have benefited from the cost savings associated with the CDM. Although this option may be attractive to developing countries, it will require Annex I countries to commit additional resources to support this fund. If Annex I investors in CDM projects are required to contribute to this fund, it will decrease the cost-effectiveness of purchasing CERs and may reduce private sector participation in the CDM. In addition, calculating the increase in the marginal cost of GHG mitigation in developing countries that could result from CDM project implementation would be analytically difficult. Because it involves creating a separate fund, this option may not be attractive to Canada.

C. Limit the Amount of CERs that can be Used by Annex I Countries to Meet their Emission Reduction Targets. A common concern among developing countries is project-based cooperative mechanisms, such as the CDM, may cause the burden of GHG mitigation to be inequitably distributed between Annex I and non-Annex I countries. The fear is that the presence of CDM opportunities may lead Annex I nations to neglect domestic opportunities for emission reductions. To address this concern, the COP/MOP could limit the total amount of CERs that could be purchased from a developing country through the CDM to a pre-determined percentage (e.g., 10% or 25%) of either developing country emissions or an industrialized country's annual emission reduction requirement. Although a similar option was considered at the Kyoto Conference, it was not included in the Protocol. While this option may partially alleviate some concerns regarding GHG mitigation burden-sharing, it does not fully address the fact that the CDM projects that are implemented may lead to increases in the marginal cost of GHG mitigation in developing countries. Furthermore, it may not be in Canada's best strategic interest to propose a limit on the amount of CERs that it could use through the CDM.

D. Establish a Capacity Enhancing Fund. Developing country concerns regarding project-based flexibility mechanisms often are tied to the notion that monitoring, verifying, and enforcing emission reduction activities can be extremely difficult and costly. These difficulties stem from the significant scientific uncertainties that surround baseline and project scenario GHG estimation, particularly for projects in the forestry and agricultural sectors. If developing countries undertake CDM projects without Annex I