

DFID/DSA Policy Forum, Monday 2 June 2008

Discussion Group 5 Summary Report:

Mitigation and new sources of development finance

Jim Watson and Tao Wang

Sussex Energy Group and Tyndall Centre

SPRU, University of Sussex

Session contact: w.j.watson@sussex.ac.uk

Note-Taker: Nina Bednarsek

The leaders of this group had the following questions prepared for two group sessions:

1. Does the concern to mitigate climate change provide innovative opportunities to fund development?
2. Will this result in development that is more sustainable at a local level? What are the implications for equity and justice?
3. How can we ensure that mitigation funding does not crowd out other funding?

The discussion groups generally agreed that climate change mitigation projects do provide innovative opportunities to fund development but there are lots of problems to overcome in implementing these.

There is not only the need for mitigation but also for adaptation and there is often a strong interaction between these two processes. New sources of development finance should thus also be directed to projects that aid processes of adaptation and mitigation.

Many discussions about mitigation, development and investment focus rightly on finance. In order for innovative opportunities to be created, governments have to have a very clear vision of the scale and timing of mitigation required – and translating this into incentives. It has been recognised that aid projects have failed in the past because of strings attached to funding, a lack of follow up and so on.

There are still fundamental questions about the efficiency of aid in helping to deploy more sustainable technologies – and what is the best way to mobilise finance in these developing countries. The members of both groups thought that traditional aid was not necessarily an effective way of achieving this. But if aid is going to be the predominant form of financing in the future, it should be better directed. An alternative approach is to create demand for low carbon investment through carbon market incentives - but the problem is how to achieve the transition to this. One basis for developing such incentives is the CDM (see below). At the moment the incentives for businesses to make low-carbon investments are too small.

Since the private sector will provide most of the investment funding, there should be more engagement of the private sector. However, if markets are not yet providing climate change mitigation investments on their own, it is the legitimate role of the government to provide the information, put the emphasis on education and create new incentives to ensure that money flows from investors. This is how the connection

between the private market and government policy should be developed so as to reduce the risks of investing in low carbon technologies. One example of this within developing countries is the Chinese government's renewable law in 2006. This has promoted the deployment of renewables by providing an additional incentive for wind power generators. In less developed countries, the challenges are greater since it is often the case that no similar incentives exist.

For developing countries this can be a long-term process where there is a need to develop indigenous capabilities in technologies so that these can be manufactured, operated and perhaps developed in these countries. For the least developed countries, this is particularly challenging. Finance is often needed for small-scale projects, which have to meet certain requirements, ideally with environmental and sustainability benefits. This could then facilitate development within the local communities where projects are based. A key issue here is transaction costs of small projects. This then raises a number of questions: to what extent are there barriers due to the ownership of intellectual property for low carbon technologies by developed country / multinational firms? How can indigenous capabilities be developed and what is the role of developed country governments and firms in facilitating this?

Clean Developmental Mechanism (CDM) was created to encourage investment in projects that reduce emissions in developing countries as an alternative to more expensive emission reductions in their own countries. Both discussion groups agreed that the CDM has been successful to some extent, incorporated a lot of projects and does channel the money from one (more developed) county to the other (less developed). But so far CDM had mixed impacts whereby CDM projects did not have enough funding or in lots of cases sustainability and technology transfer have not been paid enough attention. Sustainable development should be taken more into consideration especially since there is a strong linkage with the climate change. Barriers and transaction costs should be reduced – some participants argued that the 'additionality' criteria for CDM projects should be relaxed. Others supported suggestions that sectoral or programmatic approaches to CDM should be pursued.

There is, however, some risk that mitigation funding will crowd out money for other development priorities – or that there will be too much focus on some developing countries at the expense of others. Much of the funding could easily flow to support action within rapidly developing 'middle income' countries (e.g. China and India) and might therefore neglect opportunities in Sub-Saharan Africa. Despite the fact that the emissions in most African countries are very low, deforestation is a big issue and should not be overlooked. An additional problem for many of these countries in Africa is high investment risk which further hinders venture capital flow. It was suggested by several group members that there should be different approach within the CDM for these countries which takes better account of their circumstances.