Growing fruits?

Carbon Finance in Climate Policy: Policies To Expand CER Supply

Jose Alberto Garibaldi
Energeia, Mexico / Defra, UK.
Stabilisation of CO2 at 550 ppm implies a temperature increase of between 2 and 5°C.

A 1.5 degree increase implies Caribbean coral collapse, and further hurricane increases.

A 2.5 degree implies Amazonian collapse.

And 550 ppm is very likely to be too little – need to think in terms of 500 ppm – and we are now at 370 ppm.

**Different Interests**

**US / UNFCCC based:** Technology; finance?

**Europe / Kyoto based:** Targets, but not against technology targets. Nervous interest in buying. G8 summit as a tenous consensus around action and finance.

**LAC / Carbon finance, adaptation?** How to finance climate change?
Main Arguments

Carbon finance is part of a larger climate change agenda

• An Opportunity: The world will invest 16 trillion in new energy infrastructure between now and 2030, 2 trillion more to reduce carbon. LAC likely to require 0.6 trillion in clean energy plus massive adaptation insurance/mechanisms

• A Problem: Climate change will be a major regional problem in the next decades; a policy framework to face it can help adapt, increase carbon relevance, and expand CER supply.

• A Changing Role: Current CDM focused on projects within existing infrastructure; 10 15 framework will not be effective; but programmatic approaches could if combining policy, finance, and technology introduction could help offset domestic sustainable development and transition costs.

• An Agenda: Take advantage of parallel financial and political tracks to influence the discussion agenda and help finance the transition. Climate needs to move into the economic development agenda.
Work Plan

Present some regional impacts

Examine scale of challenge and barriers for investment through examples

Present analysis of how to link finance, policy and technology through programmatic approaches

Suggest links with evolving international discussion on finance

Suggest an agenda for action
Regional Challenges and opportunities

The region:

• does not make over average world emission or stocks contributions
• has great carbon potential

CO₂ Stock 1900-2002 per region
(Total stock and total CO₂/ha. for '99)
But is already suffering more frequent and intense El Nino Impacts...
Rapid retreat of glaciers in the Cordillera Blanca, Peru

Broggi Glacier terminus elevation

The Cordillera Blanca glacier cover has decreased by over 15% since the 1970s

Sources: Peru National Communication to the UNFCCC, 2001; UNEP/GRID-Europe.
Sources Needs Checking
Increasingly frequent and severe hurricanes...
And potentially massive agricultural changes.
While not all countries are the same...

There are significant differences in size, source, and composition.
The region is likely to face massive economic impacts...

Increases in frequency and intensity of El Niño event.

**ENSO**

1982 – 83 : 12% of the Peruvian GDP, 8.5% agriculture production 40% fishing reduction.
1996 –97 : Total costs 15,480 million dollars; Andean region lost 7,545 US$ million (95% of Bolivia’s 1997 GDP, or 32% Venezuela’s exports). Ecuador lost 14% of GDP.

Increase in severity of Hurricane Season

2004, losses of US$ 7.55 billion. Hurricane Ivan destroyed Grenada and the Cayman Islands (200% GDP damage), Frances heavy damage to Cuba (US$ 1.5 billion in losses).
2005 Wilma destroyed significant Cancun’s tourism infrastructure; Stan hit Southeastern Mexico and Central America

**Glacier loss multipliers**

Lima located in one of the most arid deserts; with 80% hydro energy generation

Source: Geo Andino UNEP, Mexico 2004, and CAF, Costos del Niño en la Región Andina, 2000, Caracas; CEPAL 2005. Disaster Costs in LAC
INCREASED RAINFALLS

INCREASED TEMPERATURES

SEA LEVEL RISE

Health
- Climate related mortality
- Infectious diseases
- Respiratory diseases

Water
- Water provision
- Water quality
- Increased competence for water access

Coastal Areas
- Coastal erosion
- Lowlands erosion
- Protection infrastructure cost

Forests
- Forest composition
- Geographic distribution
- Health & productivity

Agriculture
- Agriculture production
- Water demand

Habitat loss
Biodiversity affected
Glaciers, permanently frozen soils and snow covered soils diminished

Acute need to quantify impacts!
A view from the bridge

There is a large adaptation agenda which must be pursued for its own sake. My comments simply point to the fact that if seen from an overall macro perspective, it would make sense for the countries in the region to:

- Maximize carbon revenue through policies tailored to both expand potential CER production and support climate resilience
- Use carbon revenue within a framework that allows leveraging additional resources
- Diminish investment risk to liberate resources and facilitate infrastructure replacement to offset in as much as it is possible climate change impacts.

This supposes countries in the region want to act to face climate change, and implies massive policy intervention.

It also suggests the problem is not environmental or sectorial, but economic.

How to expand supply?
To grow with less carbon, while adapting…!

A new development pattern is needed

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP per capita, 1999</th>
<th>Kg CO₂/Ha.</th>
<th>Emissions intensity, 1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU</td>
<td>(5.2, 4.7)</td>
<td></td>
<td></td>
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<tr>
<td>Australia</td>
<td>(4.3, 3.8)</td>
<td></td>
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<tr>
<td>Singapur</td>
<td>(3.4, 3.1)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kuwait</td>
<td>(6.2, 1.8)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ex URSS</td>
<td>(2.0, 0.7)</td>
<td>(2.6, 1.0)</td>
<td></td>
</tr>
<tr>
<td>Russia</td>
<td>(1.9, 0.7)</td>
<td>(1.3, 0.8)</td>
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<tr>
<td>Libia</td>
<td></td>
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<tr>
<td>Venezuela</td>
<td>(1.1, 1.2)</td>
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<td>Malasia</td>
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<tr>
<td>Saudi Arabia</td>
<td>(2.7, 1.5)</td>
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<td>Japón</td>
<td>(2.3, 3.5)</td>
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<td>Corea</td>
<td>(2.2, 2.3)</td>
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<tr>
<td>Italia</td>
<td>(1.9, 3.2)</td>
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<td>Suecia</td>
<td>(1.4, 3.3)</td>
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<tr>
<td>Alemania</td>
<td>(2.6, 3.4)</td>
<td>(2.6, 3.4)</td>
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<td>China</td>
<td>(0.6, 0.5)</td>
<td>(0.9, 0.2)</td>
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<tr>
<td>Irak</td>
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<td>(0.9, 0.1)</td>
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<tr>
<td>Indonesia</td>
<td>(0.3, 0.4)</td>
<td>(0.5, 1.1)</td>
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<td>Brasil</td>
<td>(0.5, 1.1)</td>
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<tr>
<td>Nigeria</td>
<td>(0.1, 0.1)</td>
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</tr>
</tbody>
</table>

A thought experiment – Imagine a step change

Key sector

• 5% of its GDP, 8% of its exports, 40% fiscal income.

22% Underconsuming Energy

• 22% less electricity (184 vs 235 TWh) for an economy of its size, and 46% less on a per capita basis (1,832 vs. 3,379 KWh).

• Income distribution improvements? energy consumption and CO2 per capita and absolute emissions increases = 9.8 to 28.3%.

Not particularly dirty: World average KWh/CO2

• 85% PES supported by hydrocarbons,
• Fifth within OECD, below US (579 grams per KWh generated, vs. 581 grams per KWh of Mexico 2002).

Assume a policy maker would seek major changes under current Mexican policy conditions.

Employ a proxy of recent (1990 – 2002) emission performance trends in different regions (e.g. OECD Europe, OECD, and worldwide emission average growth rate limits as examples

Thus, CO2 emission reductions would be calculated within existing Mexican policy scenarios and frameworks,

We will assume -against experience- that the portfolio of policy measures currently planned would effectively be implemented.
Modelling

Stringent goal

- Zero growth rate in the 2005 – 2015 period in total emissions derived from fuel combustion (approaches the 0.05% OCDE Europe countries annual emissions 1990 – 2002 period).

Intermediate goal

- Emissions have an annual growth rate of 1% (near the 1.08% OECD annual average rate in the same period).

Minimum Goal

- International average scenario would assume a maximum annual growth of 1.2%, close to the 1.27% worldwide observed for 1990-2002.
### Baselines and Goals

<table>
<thead>
<tr>
<th>Electricity gross generation GWh</th>
<th>Electric sector Emissions (mton CO₂)</th>
<th>Total Emissions (mton CO₂)</th>
<th>Emissions per capita (ton CO₂-inhab)</th>
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<td>339,827</td>
<td>194,803</td>
<td>616,438</td>
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<td>339,827</td>
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<td>improvement in income distribution in low growth scenario</td>
<td>310,508</td>
<td>177,996</td>
<td>563,253</td>
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<td>improvement in income distribution in medium growth scenario</td>
<td>310,508</td>
<td>177,996</td>
<td>563,253</td>
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<td>• No income distribution improvements:</td>
<td>From 4,235 to 86,726 thousands of tons between 2005 and 2015,</td>
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<td>• Income distribution improvements</td>
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<tr>
<td>• Income distribution improvements,</td>
<td>From 4,235 to 221,509 thousands tons.</td>
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</table>
## Reduction Programs

Main Impacts:
- Energy Efficiency
- Renewable Energy
- Fuel Switching

<table>
<thead>
<tr>
<th>Year</th>
<th>Hydro</th>
<th>Wind</th>
<th>Geo thermal</th>
<th>Solar &amp; wind small scale</th>
<th>Savings &amp; efficiency</th>
<th>Fuel switching</th>
<th>Co generation</th>
<th>Other</th>
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<td>2005</td>
<td>2,967</td>
<td>0</td>
<td>0</td>
<td>25</td>
<td>15,556</td>
<td>2,514</td>
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<td>2,967</td>
<td>320</td>
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<td>38</td>
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<td>654</td>
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<td>5,341</td>
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<td>0</td>
<td>51</td>
<td>18,348</td>
<td>8,672</td>
<td>654</td>
<td>0</td>
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<td>320</td>
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<td>76</td>
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<td>14,869</td>
<td>654</td>
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<td>2010</td>
<td>10,497</td>
<td>640</td>
<td>697</td>
<td>89</td>
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<td>16,247</td>
<td>960</td>
<td>697</td>
<td>108</td>
<td>24,595</td>
<td>22,245</td>
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<td>960</td>
<td>697</td>
<td>127</td>
<td>26,269</td>
<td>24,518</td>
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<td>2013</td>
<td>25,293</td>
<td>1,280</td>
<td>697</td>
<td>146</td>
<td>28,114</td>
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<td>1,280</td>
<td>697</td>
<td>165</td>
<td>30,113</td>
<td>19,110</td>
<td>1,266</td>
<td>2,490</td>
<td>84,246</td>
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<td>2015</td>
<td>31,502</td>
<td>1,280</td>
<td>697</td>
<td>184</td>
<td>32,285</td>
<td>21,061</td>
<td>1,266</td>
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<td>93,256</td>
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<tr>
<td>Total</td>
<td>157,606</td>
<td>7,680</td>
<td>4,182</td>
<td>1,072</td>
<td>256,347</td>
<td>178,778</td>
<td>10,066</td>
<td>17,431</td>
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<td>Scenario</td>
<td>Result goals-policies (mton CO₂)</td>
<td>Cover goals?</td>
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<td>E1</td>
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</tbody>
</table>

The graph shows the deviation from cover goals for each scenario, with E12 showing the greatest deviation.
A gap

Need to expand policy base, add incentives, and integrate with sustainable development.

State cannot do it alone.

There is a gap…

Private sector is interested in low risk and quick returns
There are risk and barriers:

**Industrial Processes**
- Business commitment increasing, but sectorial info scarce
- Limited by methodological and carbon protocol availability

**Forestry**
- Methodological and knowledge limitations
- Limited supply under current conditions.
- Land tenure and project organization issues

**Energy**
- Regulatory barriers (transmission, interconnection, capacity)
- Role of sectorial organs

**Urban**
- Inventory and information gaps
- Land fill opportunities and use
- Limited local developers knowledge
And low Hanging fruits as well

There are low hanging fruits which can be taken advantage relatively straightforward in energy, urban processes and forestry:

• “Boutique” CDM, with High impact and great GHG impact (Methano, CFC)
• Working within a rather limited policy and financial set.

Current LAC Portfolio
How to expand opportunities?

Crucial to expand and take advantage of opportunities to financed adaptation and take advantage of cobenefits (i.e. change our policy environment).

The market on its own will not create sustainable development.
A new public policy generation

CDM expansion is as much a policy and financial issue as an information and capacity building exercise

**Information and Capacity**
- Información de inventarios, potenciales, y oportunidades
- Coordinación con los gremios y gobiernos locales
- Desarrollo de tecnología

**Policy and Regulatory**
- Regulación (interconexiones, transmisión, capacidad)
- Coordinación de política fiscal y tributaria
- Estandares, disclosure

**Financial**
- Combinación dinero privado, público, multilateral
- Carbono como garantía financiera
- Vinculo a mercados de carbon
- Fondos de apoyo, Bursatilización
A new role for Carbon Finance?

Can carbon finance help diminish political adjustment costs?

Co-benefits & synergies; new financial mechanisms

Introduction

Implementation

Decreases through scale

Increasing tariff/subsidy

Cost/
Price

= stairs cost + knowledge

= political adjustment cost
How to act? Montreal

Context: Do policies move the baseline?
(Context: Ghana AC standard; EB16,22)

Why is this important?
Countries would have to choose between passing policies or approving CDM projects: a perverse incentive.

But more to the point: Is there a role for government action with climate Change mitigation and CDM in Developing Countries?

What was decided?
Policies are not CDM:

However:
Project activities, under programs, can be single CDM, provided methodological consideration observed.

There is a role for Government action…!
Is Montreal Enough? No

**Policies**
Governmental Function – General Environment

No CDM possible: not all policies result in CDM project activity

**Programs**
Governments / Private Parties –

- Specific incentives for policy goal
- Agent(s) involved in coordination, promotion, barrier removal.
- Program playing facilitating role for private, multilateral or GEF finance

Not always CDM possible: not all programs directly generate CDM project activity; however, can always form a single PDD as a single CDM project, including proj.act.

**Project Activity**
Private Parties / Public Sector

- In all cases, source of direct emission reductions
- Carbon finance operating incentive, complementary role
- CERs contractually assigned

CDM can include single methodology (e.g. in EE projects), or several (e.g. wind, landfill, and small hydro in different areas, but with similar incentives

Additionality considered not solely at the project level, but rather assessed within program context.
## An example…

### Policies

Energy Sectorial Program 1000MWs New renewable goals 2001

Law Initiative for Renewable Energy 2006

### Programs

<table>
<thead>
<tr>
<th>Incentives?</th>
<th>Agents?</th>
<th>Can generate CERs?</th>
</tr>
</thead>
</table>
| Interconnection, Transmission and Capacity Incentives, intermittent sources (2001-6)  
  - Green fund with GEF support 2003  
  - Accelerated depreciation for new projects (2005)  
  - Fossil fuel tax to support green fund (TBD) | Led by Ministry of Energy  
  - Program playing facilitating role for private, multilateral or GEF finance | Can be presented with a single PDD as a single CDM project.  
  Would require different methodologies for category  
  CERs generated by project activities within each categories |

### Projects

<table>
<thead>
<tr>
<th>Activities?</th>
<th>CERs?</th>
<th>Additionality?</th>
</tr>
</thead>
</table>
| Wind (85 MWs wind initially, 105 MWs subsequently)  
  Non electric applications, etc. | Go into the fund for marginal replenishment | In the context of the program (Law explicitly states objectives)  
  Methodologies assess projects in each category |
Mexico’s Green Fund

Large-scale renewable energy development project (WB-GEF: US$70M)

Based on California incentive scheme

Subsidy source, leveraging additional US$500M in private investment

Competitive, performance-based 5-year subsidy

Rationale: Reduce costs and increase renewable energy value recognition: need for subsidy expected to eventually disappear

First stage focused on wind; second stage includes other sources

Resulting Carbon finance feed into fund

Status

Project document contemplates support for renewable energy exports.

Currently developing bidding and carbon financed components; expected to run 2006.
Has this approach been successful?

Mexico

1999 – 2 MWs wind, no projects

2001 – 68MWs in projects

2006 – 84 already being built, 400+ already being built

Wouldn’t it make sense to start examining how to make sustainable policy goals and combining them with carbon finance to help increase needed investment?

But, NB. Do not stop the small to pursue the large!
New technologies – Biofuels, Brazil

• A New motorization concept, original from manufacturer, building upon long term Brazilian biofuel experience
• Allows use of hydrated ethanol (E100), gasoline or any blend, automatically adapting to the fuel
• Free consumer choice of fuel
• Vehicular hardware change to control emissions
• Booming sales:
  • 38,000 (2003) to around 400,000 (2004)
  • Already 24% of total car sales
• Soon will dominate market
Sub - Regional Approaches – Andean Integration

Andean Community of Nations mandate on Energy

- Electric and gas interconnections
- Promotion of Renewable energy

- In the power sector, electric interconnections imply approx 2/3 less emissions than gas interconnections (due to high hydro potential and content)

- Gas deployment can be linked to other secondary uses (transport, etc.) with higher carbon displacement and lower GHG production.
An Energy Policy Opportunity

The region’s countries tend to subsidize dirtier and unavailable fuels.

Could programmatic approaches help phase out subsidies?
A Transition fueled by specific programs

Are sectorial goals worthwhile?
Who would execute them?
Can the region develop policy matrixes for different income level / economy sizes
Which policy mixes are more effective for specific sectors (energy, waste, transport, forestry)
How to integrate multilateral and private financial packages be integrated with policy and carbon finance?
Where interest diverge but also where do they coincide with annex 1 countries
What is required to insure a favourable Kyoto regime remains post 2012

As efficiency levels increase, it is more costly to make reductions
Differences in relative efficiencies make it worthwhile to engage in trading
GLENEAGLES PROCESS – Complement Carbon Finance

What was the focus? Clarity on fundamental

- A statement on the science
- A package of measures
- Forward-looking engagement between G8 and the developing world, through global and regional institutions
- ...not post-2012 architecture or other UNFCCC business

What was achieved? A place on top of the table

- Greater clarity on the science
- Firmer agreement from all G8 on human causes and need for urgency
- Linking climate and development needs
- New global workstreams deploying global institutions to help tech transfer
- Business engagement worldwide
- Setting aside false dichotomy between technology/Kyoto
- A place at the top table

A Plan of Action – Technology and Finance

- To use less energy, and cleaner sources
- Developing countries – G5 statement and the “new paradigm”
- The International Energy Agency and The World Bank with key roles in taking the work forward; regionally, development institutions and banks: role for IDB
- Work will be taken forward through future Presidencies: Russia, Germany, Japan; Mexico has agreed hosting following up, CEPAL (ECLAC) already playing a role.
Regional Action so far

• **Preparatory Meetings** - Steering Committee (August 15)
• **ECLAC regional meeting** Mainstreaming Climate Change policies: Towards a Lower Carbon economies (CEPAL, September 13 - 14).
  • opportunities in Public Transport, Waste Management, Lightning, Energy Efficiency, Cogeneration, Fuel switching
  • Acute need to align policy for the long term; long term Climate Regime crucial
• Presentation of Results of the Conference at Iberoamerican network on National Designated Authorities
• Presentation and discussion in Caracas Environmental Ministers Summit.

Current

• IDB consultation of investment framework
• Meeting on Finance and CDM, Mexico City

Next Steps

• Annual IDB Meeting
• WB board presentation
• Spring Wb meeting of financial framework
Where do we go from here?

Carbon Finance has played marginal promotion role in large energy sector decisions

- Scale: Need to go beyond small project by project basis to large sectoral flexible mechanism in several areas.

- Volume: Large scale transactions focusing on introduction of new technologies within sectors

- Incentives: Investment Funds, Improved project finance, technology access. Access to large term finance to address long term problem

- Complementarity: Strategic partnerships combining new sources of finance, policy frameworks, and carbon finance to achieve goals
  
  Baseline is not the proposed policy, rather it is the past performance: evaluation of additionallity would require examine what have sectors done and what can they do.

  Baseline Is not moved by introduction of new policies

Expansion to other sectors: Cement, Steel, Transport, Forestry.
## Elements for an agenda

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<tr>
<th>Countries</th>
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<tr>
<td>Identify opportunities, priorities</td>
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<tr>
<td>Combine carbon finance with policy goals</td>
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<td>Engage MFI, Private sector.</td>
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<th>Financial Institutions</th>
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<td>WB/ IDB / CAF/ Others</td>
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<th>Financial Framework</th>
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<td>Instruments and diagnostic</td>
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<tr>
<td>Complementarities with CF, CDM (and GEF?)</td>
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<tr>
<td>Mobilizing private sector resources</td>
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<td>Engage in country and regional dialogue</td>
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<th>Regional institutions as pivots and support</th>
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<td>OLADE / CEPAL / others as fit</td>
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<tr>
<td>Can play central role on analyzing macro impacts, policy areas for programmatic action, potential for large scale mitigation, and cobenefits and synergies</td>
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<td>IDB / CAF / WB / others as fit</td>
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<td>Financing and assessing financial and institutional capacity as well as above</td>
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<td>UNEP / UNDP / WB / others as fit</td>
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<td>Linkages between mitigation, adaptation and overall development.</td>
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<td>Private Parties as developers and policy entrepreneurs</td>
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<td>Identify opportunities</td>
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<td>Support bundling of finance, policy, technology</td>
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What sectors could be in such a Regional Agenda?

• Increased Efficiency in GHG sectors
• Shifts in resource base / fuel mix
• Gas introduction assessments
• Renewable energy
• Transport and urban corridors
• Housing and built environment
• Solid and water waste management; landfills
• Rural electrification, access to energy
• Forestry? An urgent need
Summing up

- CDM can operate as a catalyst for policy and regulatory action, and this in turn, for further investment:
  1. Incentive for policy coordination towards lower carbon deployment
  2. Related to access to other finance sources (linkages with EU – ETS, Gleneagles / World Bank dialogue)
  3. An expanded view of project boundaries, baselines and goals; can operate either within current rules or an improved CDM

- This implies
  1. First Things first: a significantly enhanced capacity within the Executive Board
  2. Last but not least: a new role for the MFI, regional banks and research institutions:
     - How to link carbon finance with the underlying project finance, and the expansion of project finance
     - What is the performance of a sector and the potential, effective impact of policies.
     - What is additional in that context
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