

Seminar of Governmental Experts (16-17 May 2005)

Supporting material* for the presentation by France on behalf of the European Community and its Member States

The investment challenge

1. The nature and scale of the challenge

Tackling climate change requires the diffusion of cleaner products and equipment. The stock of some products, such as household goods, and even cars, may be largely replaced over a couple of decades. That is not, however, the case for energy infrastructure, urban infrastructure, housing and transportation infrastructure. The long-lived nature of these investments means that equipment built now will still largely be around in the middle of the century and decisive for long-term emissions profiles. The right choices will facilitate the transition to a low carbon future. However, the choice of unsustainable or inefficient technologies, infrastructures, or technologies that are not compatible with future improvements, will lead either to stranded capital, or to “lock in” which will limit future options to tackle climate change.

Take the example of energy where major investment is needed over coming decades. The International Energy Agency has estimated that meeting global energy demand will require cumulative investment of around \$16 trillion by 2030, for production and distribution, about half in industrialised countries, half in emerging economies and other developing countries. About \$10 trillion is required for electricity.

The IEA has also produced in its World Energy Outlook 2004 a World Alternative Policy Scenario which foresees faster deployment of more efficient and cleaner energy technologies and lower greenhouse gas emission reductions. Although the pattern of investment in energy supply and end-use equipment is substantially different from in the reference scenario, the total investment required over the period does not differ much between the two scenarios. Financing that may, however, be difficult, especially in developing countries because end-users, who would have to invest more, will find it harder to secure financing than suppliers who would need to invest less. Note, however, that even the IEA's alternative scenario would result in major increases in CO₂ emissions by 2030. Keeping concentrations well below 550 CO₂ equivalents ppmv and aiming to keep temperature increases below 2°C requires further action.

Major long term investment is also underway in many other sectors, such as transport, infrastructure, housing. The challenge is to find ways to influence and to channel these decisions in the right direction over the coming 10-20 years, because the window of opportunity to avoid dangerous levels of climate change is narrow.

* this paper does not reflect a formal EU position but is intended as a contribution to the debate

- What choices within the UNFCCC can give the right incentives? How can we ensure that the necessary enabling framework is in place soon to support financing of long term investment compatible with a lower carbon future? What role does a broader participation play?
- How can climate change tools also support investment for development?

2. International actors

The international financial institutions have a role to play in directing investment decisions, through integration of climate change considerations into their appraisal processes, and their influence on bilateral and commercial practices. Some of these institutions have begun to take climate change considerations on board. At the International Conference for Renewable Energies renewables2004, IFIs like the World Bank, GEF, EIB or the EBRD have committed themselves to increase their portfolios for renewable energies and energy efficiency.

- What sort of actions should we, the international community, be asking the World Bank, the regional development banks, etc. to do to integrate climate further into their planning processes? What priorities should they follow?
- What is the possible role of the international trade regime, and the WTO?

3. How to influence private investment decisions

The real challenge is to influence private investment decisions since much of the investment will come from the private sector. Some of that will involve foreign direct investment, but for most investment the primary role will be local capital. Decisions on public investment at a national level will also be crucial.

A global carbon price is at the heart of creating the incentives needed to meet the investment challenge. The Kyoto protocol, including its flexible mechanisms, is already having an effect. In the EU, the European Trading System is making emissions trading a reality so that business can start to integrate climate policy into investment decisions. There is a link to the Kyoto Protocol project mechanisms (CDM already, JI from 2008) which provides a further innovative tool. But at the moment policy is only outlined for the next few years – that is not enough certainty for businesses for long term investments. The uncertainty over the future of the CDM after 2012 is already having an impact on the success of the mechanism. Current arrangements are inadequate given the scale of the investment challenge.

Of course, climate policy is only one among many drivers. If current high oil prices continue, that will also have an impact on investment decisions. A clearer framework for integrating climate considerations into investment decisions, including the integration of externalities in energy prices, could also help us to improve our management of possible future energy shocks to the benefit of both consumer and producer countries.

Improving the investment environment will help tackling climate change: for example, clearer and fairer rules, including on intellectual property rights, will help the diffusion of new technologies and drive development more generally. We should also consider the coherence of our policies in different fields, and consider how to involve actors outside the environment and climate community.

This seminar is the place for identifying the sort of questions we need to address and sharing some initial ideas for how we might respond.

- How can we work together to identify options that can better address these questions in all countries – annex I countries within the Kyoto Protocol, other annex I parties, and outside annex I, particularly in emerging economies?
- How can we build on and strengthen existing bases, in particular the Kyoto protocol and its flexible mechanisms, so as to provide the greater visibility and certainty needed to influence these globally crucial and urgent investment choices, particularly in sectors where there is a long period for capital stock turnover?
- How can we start to mainstream climate considerations in investment decisions in other policy areas and find synergies with development priorities?
- How can a global climate framework provide greater certainty and predictability to our decisions?