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Long-term Finance: Enabling environments and policy frameworks related to climate finance

10th June, 2013, Bonn, Germany

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E3G – Third Generation Environmentalism

Recap of 2012 LTF Work Programme

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- Need to intensify efforts for *enhancing enabling environments* in many developing countries:
  - National policy, regulatory and governance frameworks have crucial role in reducing investment barriers and effective use of climate finance
  - International policies can reinforce and support efforts to enhance enabling environments by setting ambitious targets and norms, increasing transparency and information, and fostering learning
  - Need to continue to build and strengthen national systems and institutions, and to sustain investments in human, institutional and technical capacities to use finance more effectively.

Recap of 2012 LTF Work Programme

- Improve information of *climate-related financing needs* in developing countries
  - Methodologies refined and improved to assessing and costing mitigation and adaptation needs.
  - Need to improve the capacity of developing countries to conduct their own assessments in accordance with their development priorities

- Strengthen *tracking of climate finance* – both public and private:
  - How climate finance channelled and used – important for MRV of flows to developing countries and in evaluating its impact
  - Comprehensive approach towards transparency and consistency of information on support and climate finance flows
  - Assessing effectiveness needs to be supported by clear and transparent guidelines and criteria to assess the scale and scope
  - Also important for learning lessons and replicating successful and innovative practices

Climate Finance and Investment Challenges

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Investment Challenges:

- Requires shifting $26 trillion from high to low carbon energy investment globally
- Estimates of the financing needs of developing countries vary significantly – for mitigation some consider an additional $300 billion/year is required by 2020
- Planning under uncertainty of the costs of adaptation – need to integrate climate risks to make all investments in economic sectors and infrastructure resilient
- Ultimately need to redirect all public and private finance into low carbon and resilient options

Financial Challenges:

- **Requires upfront investments:** in efficiency, RES to displace long term fossil fuel purchases. Strains existing capacity of post crisis financial system
- **Managing Risk:** low carbon investment has higher political, technology, and policy risks. Investors amplify low carbon risk (downplay high carbon risk)
- **Integration:** regulatory reforms needed to integrate low carbon and climate resilience into on-going infrastructure investment in cities, water systems, industrial clusters, energy grids

Energy investment landscape is changing

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We are moving from a period of optimising the operation of existing energy assets

To a period of investment in asset replacement, decarbonisation, ICT innovation

Lower risk → Higher risk

And from investment in lower capex better understood assets with higher running costs

To investment in higher capex, less well tested assets with lower running costs

Barriers to Scaled-up Investment

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Policy and Regulatory Barriers

- Policy uncertainty and complexity
- Transaction costs (complying with policy/licensing/reporting etc)
- Land allocation, access and security of ownership
- Enforcement of policy and pricing incentives
- Existing subsidies and policy support for high carbon alternatives

Market and Technology Barriers

- Relatively high upfront cost of technology
- Human and operational risks (lack of trained people)
- Limitations of support infrastructure (e.g. grid infrastructure)
- Immature supply-chain and limited capacity of project developers
- Long term viability of many state utilities under question
- Lack of track record of particular technology/project

Financial Barriers

- Country risk: defaults or other factors leading to non-return of invested capital including inflation
- Currency risk: Exchange rate fluctuations making returns volatile.
- Deal flow: insufficient volume commercially attractive deals for diversified investment portfolios
- Complexity risks: difficulty evaluating multiple and overlapping risks

Policy and Institutional Responses Required for Effective Use of Climate Finance

Policies designed meet barriers and challenges to use climate finance for:

- Bridging upfront financing gaps
- Bridging incremental cost gap
- Catalysing for transformational change and innovation by removing specific risks and overcoming barriers

For adaptation climate finance also likely to be required for:

- Increasing scientific understanding of potential impacts and climate risks
- Strengthening cooperation and communication with policy-makers and other decision-makers, including data and user friendly risk-assessment tools for the private sector
- Integrating risk-management approaches within the planning process
- Policies and regulations that incentivise investment in resilience e.g. building codes

Range of public sector interventions can leverage the private sector

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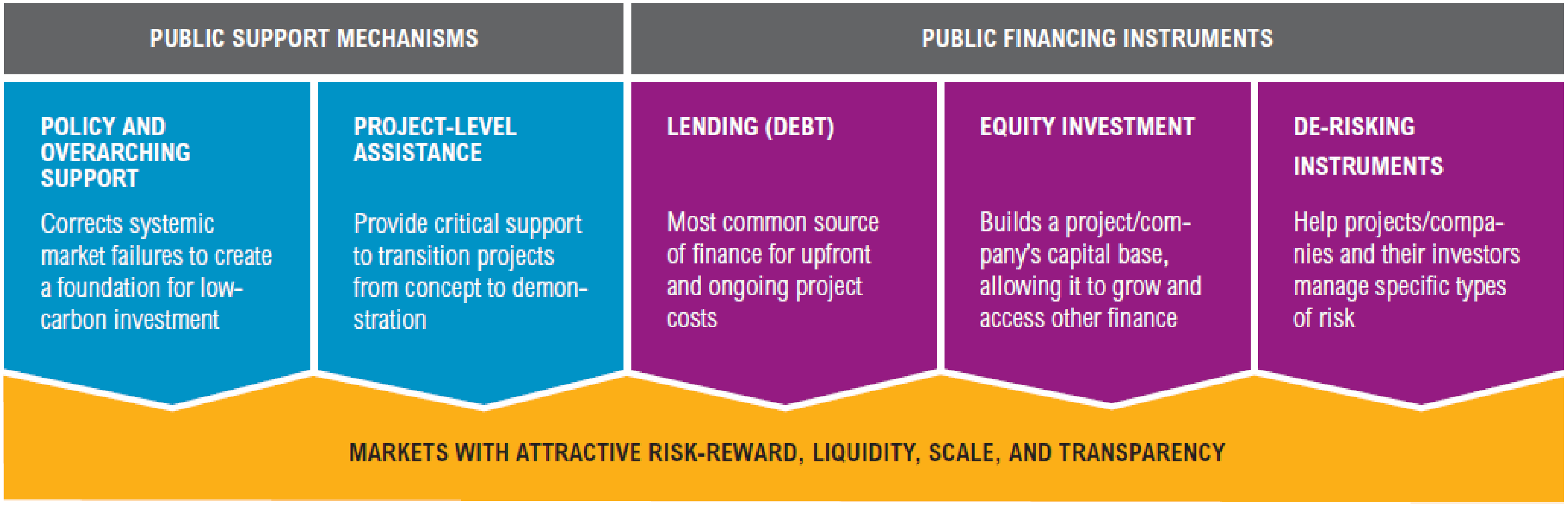

Source: WRI

Elements of effective enabling environments and policy frameworks for climate finance

- Governments leadership for creating conducive enabling environments for scaled-up investment
- Appropriate institutional arrangements to facilitate effective cross-Ministerial coordination
- A clear, long term and coherent policy and regulatory framework underpinned by rule of law – aim to align investment timescales and policy timescales
- Aligning price signals to incentivise deployment of low carbon/resilient investments (may require reform of existing subsidies)
- Need to foster and establish markets to capture benefits of green growth
- Capacity for designing, developing and implementing strategies, policies, regulatory frameworks and public financial incentives (including climate finance)
- Tracking of climate finance to enable directing finance to greatest potential impact or needs, and the transparency and accountability increases confidence of investors

Engagement of stakeholders is key to creating effective enabling environments and policy

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- Early engagement of stakeholders and dialogue – particularly private investors – necessary to increase transparency and buy-in to the new policy objectives

- Active approach towards engaging stakeholders to understand how different sources of finance can best meet national and/or sectoral objectives

- Identify and prioritise capacity needs – both institutional and for market development e.g. make data available for aggregators of small EE projects

- Design and implement policy instruments that share risks with private sector e.g. Feed-in-Tariffs

- Market enabling activities to increase project deal-flow e.g. data, tools and feasibility studies

Bridging Supply and Demand of Climate Finance

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International

•National Financing Strategies and Platforms that identify opportunities for use of climate finance to effectively mobilise and track public and private sources of finance

•Build capacity of national public policies and financial institutions – including National Development Banks and hosts of Green Funds to blend, direct and track climate finance

•Create deal flow: facilities to develop pipeline of financeable projects

National

Key Questions – defining the scope of the 2013 LTF?

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- Need to learn much more from existing use of climate finance – examples of successful cases from all countries?
- Climate finance involves new and complex issues for policy and market reform – need to understand what policies and instruments work best in different contexts?
- Identify where there may be particular challenges with implementation?
- Country leadership in designing strategies and plans that actively identify financing options – how to incentivise and reward these?
- How to ensure better and balanced attention on enabling environments for attracting adaptation finance and investment?
- How can tracking of climate finance be part of an effective enabling environment for climate finance?