Policy Dialogue on Finance and Leveraging the Private Sector in Mitigation
December 7, 2010 – Cancun, Mexico

- Meeting Summary -

Moderators: Maas Goote (the Netherlands) and Ned Helme (CCAP)

➢ Overview and Main Conclusions

This fifth policy dialogue of 2010, hosted by the government of the Netherlands and the Center for Clean Air Policy (CCAP), was attended by participants from developed and developing countries as well as international organizations. The dialogue dealt with finance, leveraging private-sector investment, managing investment risk, and what is needed in a Cancun decision to ensure private-sector financing is leveraged by the new Green Climate Fund (GCF). Discussion focused on how developing countries can leverage private-sector finance for nationally appropriate mitigation actions (NAMAs) to supplement public-sector funding from developed countries. It also addressed the barriers to NAMA investment in developing countries and a specific discussion on what needed to be added to the Cancun text to encourage private-sector investment in supported mitigation actions.

This December dialogue contributed in part to the successful outcome of the Cancun COP, which resulted in the "Cancun Agreements." It served to create a "safe" space for participants to speak candidly on the controversial topic of a private-sector role in financing mitigation. The discussion helped move the debate forward and build trust between countries, given the informal, roundtable setting. Other major outcomes of the meeting include the following:

- There was good agreement on the need for a threshold decision out of Cancun that the private sector plays a key role in financing mitigation. This was accomplished in the language on private funding sources in the Cancun Agreements.
- It was apparent that one key task for Cancun was finding a balance between clear objectives for including the private sector and a more technical discussion of how to do so. The dialogue served as an impetus for this debate, the details of which will be clarified in future dialogues in 2011.
- It was also suggested that the design phase of the GCF could help Parties learn from a wide set of financing actions and pilot efforts in designing a "toolbox" of financial arrangements.

- **Leveraging the Private Sector**

The moderators opened the discussion by framing the private sector as part of the solution to climate change and not part of the problem. The private sector must be engaged as part of a joint effort; instead of just dialogue with the sector, it should play a role in the climate negotiations. A "toolbox" of financial arrangements/ideas in the negotiating text was advocated to serve as a foundation that countries can build on for including the private sector. This text/toolbox could be built upon in a "start-and-strengthen" approach after learning from initial experiences.

Mexico presented on a cement-sector NAMA it is developing with CCAP and with support from USAID through Abt Associates. This NAMA would replace conventional fossil fuels with municipal solid waste (MSW) in the cement industry to reduce both carbon dioxide and the solid waste problem in Mexico. Municipalities would collect MSW and pay cement companies to take it. Cement companies would receive financial assistance for constructing facilities that process this waste. Creating a public-private partnership (PPP) would ensure that cement companies purchase fuels and that they have a long-term supply of MSW. Mexico underlined the importance of mobilizing the private sector in the developing world, suggested that all stakeholders must have clear responsibilities, and highlighted predictability and reducing risk for the private sector as essential components for success. CCAP is also working with Mexico on a steel-sector NAMA and on monitoring, reporting, and verification (MRV).

The conversation was directed toward whether the negotiating text currently makes room for the private sector. One participant advocated an increased role of developing countries' national development banks (funds could be used to train finance officials) in climate investment with the GCF complementing these. As it is now, the text starts with multilateral development banks, (MDBs), leaving little room for national development banks (NDBs). Some participants felt these roles should not be overly defined in the text, and there was disagreement over whether a global climate change bank as part of the GCF would be a bureaucratic "nightmare" or necessary to fill holes where other banks are lacking. Participants were in agreement that the text as of that morning needed amendment to include a more explicit treatment of private-sector incentives. Ultimately, Parties agreed at the COP that funds for developing countries should come from a variety of sources, including leveraging private-sector involvement. Although the specific role of private-sector financing will be further specified in future dialogues and negotiating sessions, this session helped open the door to a discussion of details.

Participants suggested that focusing on co-benefits to municipalities and ministries, building trust, and learning from pilot examples will help improve private-sector involvement. Parties need to find a way to "crowd in" the private sector, and PPPs should be built into the negotiating text. Although changing the paradigm will take time, countries need to start using pilot projects to build confidence that private-sector involvement works and can be profitable. Several participants saw no contradiction between focusing on both small pilot projects and large-scale actions, and one emphasized the importance of "going slowly because we're in a hurry." While the Clean Development Mechanism (CDM) provided ex-post financing for projects, funds are now starting to provide larger sums of upfront money for countries to develop sector-based pilot NAMAs.

- **Managing Investment Risk**

Developing-country participants emphasized that private-sector investors in developing countries are particularly risk averse and support networks do not exist. This risk aversion, which takes precedence over possible opportunities in early stages, makes it difficult to mobilize the sector. Extrapolating the developed-country paradigm for incorporating the private sector will not work in developing countries. Instead, developing countries need to see a slow, step-by-step approach: on-the-ground experiences, pilot projects that show economic viability (pilots can be quite transformational), increasing involvement of governments, and then feeding into the negotiations. Understanding this developing-country model is crucial to negotiating private-sector involvement.

Germany presented on its new, privately-managed Global Carbon Partnership Fund (GCPF) as one instrument that manages country, political, currency, or other risks in developing-country investment. The revolving fund is expected to reach a 7:1 leverage ratio and is structured with three tranches: the junior, public-sector tranche covers the investment risk and the senior, private-sector tranche has the lowest risk (the mezzanine tranche is reserved for development banks). Because the private sector's risk is hedged, the fund attracts private-sector money and allows the fund to support private developing-country banks in giving credit to small and medium enterprises and households.

Participants responded that risk mitigation and even co-benefits are not enough; private investments must still be profitable (and renewable energy, for example, often is not). One reiterated that small, transformational pilots are useful, as developing countries "have a knack for copying good ideas." However, there was agreement that transformation means different things in different countries and a design phase that incorporates NDBs could be useful in learning from a wide set of actions. This phase would attempt to balance prescription and flexibility.

In discussing the tradeoffs of building an investment risk-reduction "toolbox" into the text on the GCF, participants felt that too many technical financial windows (insurance, grants, loans, etc.) would be unmanageable. It was suggested that the text should include these four terms: public-private partnerships, national financial institutions (public or private), international financial institutions, and complementary (to existing funds). However, participants agreed that the negotiating text would not likely get this prescriptive yet, and that flexibility to examine these options must be preserved. The dialogue nonetheless encouraged participants to think further "down the road" toward issues that will need to be addressed in 2011 during future dialogues and negotiations. Although many Parties are reluctant to mention PPPs or private-sector money, direct access and national finance are two areas in the text in which common ground and trust could be built. The key is creating a "race to the top" where financing drives real results.

Participants reached broad agreement that a balance must be struck between reducing risk and reducing emissions (most mitigation projects do not require 100% financing). Balance must also be found between over-prescriptive text and delaying technical decisions. Finding these balances were key tasks for Cancun. One suggestion was to include wording about objectives and put aside ideological and controversial questions. Although some issues belong in the design phase, some clarity is needed so decisions are not simply "kicked down the road." In the end, the Cancun Agreements left room for the private sector but did little to define details or a "toolbox" – tasks that will have to be taken up during discussions in 2011.

- **Next Steps**

The next policy dialogue will be held during the next UNFCCC negotiating session. The next CCAP Future Actions Dialogue (FAD) is scheduled to be held in May or June of 2011. CCAP is also launching a new regional dialogue program to begin with a Latin American dialogue from March 21 to 24 in Costa Rica.