

Post-Kyoto Strategies for the IDB

A Report Based on the Proceedings of

**The Forum: A REGIONAL APPROACH TO THE KYOTO CHALLENGE:
THE ROLE OF THE IDB**

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Executive Summary

The Kyoto Protocol, adopted in December 1997, represents a historic landmark in the global climate change negotiations. It not only establishes binding emission reductions for developed countries, but also creates mechanisms that should enable these countries to achieve their reductions in a cost-effective manner while supporting the sustainable development of developing countries.

The Clean Development Mechanism (CDM), one of the three cooperation mechanisms provided under the Kyoto Protocol for the reduction of greenhouse gases, is the only mechanism in which developing nations can participate. Unlike the other two mechanisms (Emission Trading and Joint Implementation), the CDM is not just an emission reduction instrument, but is also established to assist developing countries achieve sustainable development. When operational, the CDM is likely to induce additional capital flows and accelerate the transfer of technologies. Whether this mechanism can succeed in achieving its ambitious goals will depend mostly on yet unresolved issues related to its design and function.

While it is expected that some progress will be made on the rules, procedures and governance issues at the next Conference of the Parties (COP IV) in Buenos Aires, Argentina (November 1998), the full implementation of the CDM may take several more years. It is currently anticipated that a fully operational CDM will require one or more institutions to carry out a set of different functions. The role that International Financial Institutions (IFIs) and United Nations Agencies can play in establishing and implementing the CDM could potentially be significant.

The support, however, that international organizations can provide to developing countries for combating climate change is not necessarily restricted to the CDM. As already mentioned, the CDM is the only mechanism in which developing countries can participate for emission reductions, but it is still a voluntary mechanism. As is the case with developed countries, developing countries are committed to develop, update, and publish national inventories of greenhouse gas emissions and to develop measures to mitigate climate change. This implies that any international organization exploring how best its member countries could combat climate change, should consider options beyond just the CDM.

Forum: “A Regional Approach to the Kyoto Challenge: the Role of the IDB”

Over sixty Latin American, Caribbean and U.S. government, nonprofit, business, and academic leaders participated, along with representatives of international and regional organizations and IDB staff, in the Forum: “A Regional Approach to the Kyoto Challenge: The Role of the Inter-American Development Bank,” which convened September 29-30, 1998 at IDB headquarters in Washington, DC. This report summarizes the results and discussions of this one-and-a-half-day event.

During the first session, several presentations provided background information on aspects related to the CDM, such as the provisions of the Kyoto Protocol and the ongoing international negotiations. Also, the climate change activities of other multilateral organizations and their role

in regards to the CDM was discussed. Moreover, presentations were made on how the private sector views the investment opportunities in Latin America through the CDM.

During the second session, discussions were organized around four Round Tables following a background presentation on IDB's current activities (primarily in regards to energy and forestry) and related programs, such as the Sustainable Markets for Sustainable Energy Program. Participants in the four Round Tables represented views from: (i) academia; (ii) regional, bilateral institutions and NGOs; (iii) the private sector; and, (iv) official representatives from Latin American and Caribbean countries.

In the final session, Nancy Birdsall, Special Advisor to the President and former Executive Vice-President of the IDB, and Waldemar Wirsig, Manager of the Sustainable Development Department, presented a detailed summary of the lessons and conclusions of the meeting.

Considerations and Conclusions

- All participants underlined that climate change is a technically complicated issue compounded by political difficulties and suspicions. Due to the fact that the climate change debate is constantly evolving, not only at the scientific and technical levels, but also at the political level, it is difficult to determine a possible role for an institution such as the IDB. Therefore, any action of the IDB should be dependent on the evolution of the international negotiations and the requirements of its member countries.
- In determining its role, the IDB should concentrate and focus on its strengths. The IDB is a special institution: it is 50% owned by its borrowing member countries and 50% by non-borrowing member countries. Because of its structure, the IDB has a unique regional expertise that allows it to clearly understand and articulate regional concerns. Due to the mutual trust and willingness to work together, the IDB can work effectively in close partnership with the countries of the region. Furthermore, the IDB has been an active player in sectors relevant to climate change, notably the energy and forestry sectors, and has extensive experience in capacity building at the regional level. Finally, the IDB, over the last few years, has been working directly with the private sector in financing investment projects.
- The IDB, however, needs to recognize its limited operational capacity. Consequently, every action undertaken by the IDB entails a high opportunity cost, making it vital to determine which actions will have the most developmental impact on the borrowing member countries and could be replicated successfully.

Educating the IDB

- In light of the above considerations, it was noted that the IDB should not actively participate in international discussions on the design and structure of the CDM. Instead, it should concentrate on providing support for its borrowing member countries in the preparation of their own national positions, and if possible, facilitate a regional consensus building. The IDB could, however, play a broker role in a dialogue with its borrowing member countries.

- The participants agreed that as a first step, the IDB should continue to educate itself in climate change issues in general and the CDM in particular. Such an educational process would also assist the IDB to prepare for the great challenges that will arise from the implementation of the Protocol. In addition, it was agreed that it would be useful for the IDB to attend the next Conference of the Parties and to disseminate the proceedings of this Forum.

Strategy on Climate Change

- The IDB should seriously consider the preparation of a broader IDB Strategy on Climate Change. This strategy should be based on the IDB's comparative advantage, and build upon existing strategies, policies, and programs in such areas as energy, infrastructure development, clean technology, coastal marine resources, forestry and rural development. Moreover, the strategy should also avoid unnecessary duplications with other institutions
- An IDB Strategy on Climate Change could address the main action areas proposed by the participants at the Forum: (i) capacity building and technical support; (ii) information networks; and, (iii) risk reduction for private sector investment. The strategy could also encourage and emphasize the use of market mechanisms by all countries as a preferred option when confronting climate change issues.

Capacity building and technical support

Recognizing that, in accordance with the Climate Change Convention, most resources are to come from developed countries, the participants suggested the IDB could make resources available for national capacity building initiatives. The suggested lines of activities include the following areas to support the borrowing member countries:

- Prepare for future climate change negotiations;
- Develop and/or strengthen national institutions such as national or regional CDM offices;
- Foster local discussion and participation of different actors such as the private sector, economic authorities and academia in the area of climate change;
- Develop internal trading regimes.

Other suggested capacity building areas, which are more technical or project related, include support to:

- Finance studies in mitigation, adaptation, and determination of baselines, as well as studies on the possible national benefits of the CDM;
- Assist its borrowing member countries prepare national studies and GHG inventories;
- Provide project preparation funds for specific projects, especially in small and poor countries, and funds for the identification of projects to be financed through the CDM as well as for the pre-feasibility studies for CDM projects.

Information Networks

Participants noted that there is a lack of information collection, analysis and dissemination in the region. This includes possible projects financeable through the CDM, technologies and methods that can reduce GHG (for example through energy efficiency measures, renewable energies,

etc.), and information about activities and initiatives of other countries. The participants suggested that the IDB could play a key role in facilitating the transfer of information and knowledge, thus reducing the existing gap between technology and knowledge.

For both areas (capacity building and information networks), the IDB could consider using the following instruments:

- Include climate change issues in the programming dialogues between the IDB and its borrowing member countries. As a result, the finance and economic ministers would become more involved in the climate change discussion, facilitating a better understanding of the importance of the possible economic implications of climate change.
- Include the issue of climate change as one of the topics in the “Research Network” that already exists at the IDB (Office of the Chief Economist) as a way to foster research and dialogue at the national level with the economic and financial sectors.
- Work with the “Research Network” to further develop and study necessary data on critical areas such as the determination of baselines.
- Continue the role as facilitator of national and regional meetings, such as the recent meeting of the Working Group on the Implementation of the Clean Development Mechanism of the Forum on Ministers of the Environment, held in Lima last May.
- Create partnerships with interested donor countries in a similar way as the World Bank did with Switzerland and Norway.
- Strengthen the Sustainable Markets for Sustainable Energy Program.

Facilitate Private Sector Investment

The participants suggested that the IDB could play a facilitating role to catalyze private sector transactions such as by providing guarantees on compliance to reduce risks.

Also discussed was the fact that the IDB not only has the expertise, but the mechanisms as well, to facilitate certified emission reduction transactions between the private sector and host countries. The IDB could also serve as a matchmaker between investors and host countries and act as a clearinghouse for CDM projects—facilitating an equitable regional distribution of projects.

In the preparation of the strategy, the IDB’s Private Sector Department or the Inter-American Investment Corporation could explore the conditions for the private sector participation in the market. Also, the Multilateral Investment Fund (MIF) could explore operations to prepare the necessary regulatory regimes at the national level.

The Road Ahead for the IDB

This Forum provided a useful and rich dialogue that shed light on the possible role for the IDB in climate change mitigation. The IDB is confident that it could be in a position to start work on the suggested strategy but hopes to continue to make wide use of this type of consultations and dialogue during its elaboration.

Introduction

Over sixty Latin American, Caribbean and U.S. government, nonprofit, business, and academic leaders participated, with representatives of international and regional organizations and IDB staff, in the Forum: “A Regional Approach to the Kyoto Challenge: The Role of the Inter-American Development Bank,” which convened September 29-30, 1998 at IDB headquarters in Washington, DC. Various IDB staff, including several Executive Directors also attended the Forum. This report summarizes the results and discussions of this one-and-a-half-day event. The report includes a short introduction followed by brief discussions of the major issues debated during the Forum’s three sessions: (i) the background presentations; (ii) a series of four Round Tables on “Helping the IDB to Determine its Role in Supporting the Countries in the Challenges Faced by Climate Change;” and, (iii) a final wrap up and conclusion session.

The Forum began with introductory remarks by President Iglesias, who provided the general guidelines for the discussion. Mr. Iglesias indicated that the main objective of the Forum was to receive information, ideas, and suggestions regarding the role the IDB could play in supporting its member borrowing countries to meet the Mandates of the Climate Change Convention and the Kyoto Protocol. In particular, the Forum should focus on utilizing the IDB’s comparative advantage to help the countries benefit from the opportunities opened up by the CDM. Mr. Iglesias acknowledged that negotiations on the remaining issues of the CDM could take a long time because of the complexities of the issues involved and their political implications. Therefore, this is an ongoing process where many issues remain unsolved and the complexity makes it difficult to define a possible role for the IDB.

The IDB has always been interested in assisting with the environmental issues affecting the countries of the region as well as supporting their sustainable development. Mr. Iglesias remarked that while it is true that the most abundant instrument available to the IDB is money, but the question arises: yes money, but money for what? One of the most useful instruments available to the IDB is its capacity to convene many parties around important issues. The IDB can introduce the subject in its dialogue with its member countries and can also initiate important actions in the traditional activities of the IDB in such areas as energy and forestry. Furthermore, the IDB could channel technical cooperation resources from donors towards pilot activities such as its Sustainable Markets for Sustainable Energy Program. But, what else could the IDB do, taking into account its comparative advantages and limitations? Mr. Iglesias concluded the presentation by making specific requests to government, private sector, academics, NGOs, donors and international organizations about what the IDB could do to address issues related to its own competence.

Session 1: Background Presentations

I. From Kyoto to Buenos Aires and Beyond

Moderator: Nancy Birdsall, Carnegie Endowment for International Peace/Special Advisor to the President of the IDB

What are the main issues to be confronted in the next Conference of the Parties in Buenos Aires? What is expected to be accomplished? What is the road ahead?

Mr. Tahar Hadj-Sadok, Coordinator Science and Technology Program, UNFCCC Secretariat

Mr. Tahar Hadj-Sadok presented background information on the Kyoto Protocol and identified possible opportunities for IDB action. The core of the Protocol is the adoption of legally binding emissions reduction commitments for the developed nations. The reduction commitments agreed in Kyoto range from 0% to 8%, but included the possibility for Norway, Iceland and Australia to actually increase their emissions. However, overall the reduction commitments will be 5.2% below the levels of 1990 during the commitment period (2008-2012). These reductions are estimated to be 25% to 29% lower compared with the business-as-usual scenario. The Kyoto Protocol includes an agreement on a number of instruments to facilitate the achievement of these targets. These so-called flexibility mechanisms include emissions trading (Art. 17), and two mechanisms based on projects: Joint Implementation (Art. 6), which includes projects among Annex B parties only, and the Clean Development Mechanism (Art. 12), for projects between developed and developing country parties.

The CDM is the only mechanism that involves the participation of developing country parties. The design and development of the CDM is set to begin at the next Conference of the Parties (COP) in Argentina. The CDM will be governed by the COP to the Protocol and will have an Executive Board. The Certified Emission Reductions (CERs) have to be real, long-term and measurable, and they should not occur in the absence of the project. In addition, part of the proceeds should be used to cover costs of adaptation for the most vulnerable developing countries. Moreover, crediting can start as early as January 1, 2000.

Mr. Tahar Hadj-Sadok also mentioned some possible roles for the IDB:

- Implementing and funding projects which includes the identification, development, and preparation of projects.
- Certifying emission reductions—that is, to act as an operational entity.
- Adaptation activities—as the CDM generates funds for adaptation, the IDB could manage an adaptation fund. It is expected that these funds would be transferred to the most vulnerable countries in the form of projects.
- Capacity building, training, and information dissemination.
- Improving the distribution of benefits from the participation in the CDM among the countries of the region (e.g. matchmaking, clearinghouse, etc.).

Institutions required for the implementation of the Kyoto Protocol and the role of organizations in facilitating the implementation of the CDM

Mr. Ned Helme, Director, Center for Clean Air Policy

Mr. Ned Helme, Executive Director of the Center for Clean Air Policy addressed the purpose of the CDM, the institutions necessary to implement it—both at the international and national levels, and identified some potential roles for international financial institutions (IFIs).

According to Mr. Helme, the following functions must be undertaken at the international level: certification of eligible activities, additionality and baseline settings, quantification and certification of emission reduction units. Other more controversial international functions can be pricing those emission reduction units, arranging funding as necessary, tracking trades, and protecting vulnerable players. Functions that must be performed at the national level include monitoring and verification of baselines, emissions and emission reductions; determination of additionality; determination of non-CO₂ benefits; registration of third-party certifiers; and the development of national, sectoral baselines. At the project level there is a necessity to learn the rules for baselines, additionality, quantifying reductions, host country approval, learning how to identify project opportunities, assess technological options, quantify costs and benefits of low-carbon-GHG project options, and negotiate carbon credit contracts.

Regarding the potential roles for IFIs, Mr. Helme proposed the following areas: participate in the design of CDM institutions; provide research to countries to determine the value of participation; serve as an operating entity for the CDM; build national capacity; develop projects; and, act as a broker. In conclusion, Mr. Helme considers that IFIs could be most effective in representing regional interests, helping countries establish the proper infrastructure and eventually contributing to projects.

Global financial mechanisms for a regional approach to the Kyoto challenge in the Americas

Dr. Graciela Chichilnisky, Columbia University

The paper presented by Professor Chichilnisky proposes that new global mechanisms can help the developing countries face the challenge of industrializing rapidly without causing global damage to the atmosphere and biodiversity. The key to solving this dilemma is to cut the link between economic progress and carbon emissions by adopting new forms of energy to reduce the use of fossil fuels, by using cleaner technologies with fewer emissions, and developing new products and technologies that do not use resources intensively. This can be accomplished through the “knowledge revolution,” which means changing from a resource-intensive to a knowledge-intensive development process. To facilitate this change, there is an urgent need to use new financial mechanisms. Regional banks such as the IDB “can play a pivotal role in the global negotiations, charting a new course of industrialization that will create a path to sustainable development in the region and globally.”

Under this new form of industrialization, the private sector plays a key role as the main source of technological innovation. Innovative and non-traditional self-funding mechanisms need to support the technology transfer and to create knowledge-based industries and products, which requires international cooperation. The Program on Information and Resources of Columbia University, in collaboration with UNIDO and UNDP, have proposed an approach involving new financial instruments such as securities backed by environmental assets which can attract financial resources from global capital markets. The IDB can offer credit enhancement for the securities that are sold in the capital markets to fund the transfer of technologies and the development of cleaner products in the region. In order to attract funding from the private sector, these new financial instruments require a free market approach and active participation and control in their regulation by all nations, especially the developing countries.

II. What is Expected from a Regional Approach to Climate Change?

Moderator: Mr. José Maria Cartas, Alternate Argentina Executive Director, IDB

What Are Other Multilaterals Doing?

Mr. Charles Feinstein, Chief, Global Climate Change Unit, World Bank

Charles Feinstein, Chief of the Global Climate Change Unit of the World Bank presented the work his institution is undertaking in the area of Climate Change. The World Bank accepts the objections of developing countries to abide by Annex B targets at this point in time, and considers it imperative that the industrialized countries take the lead in reducing GHG emissions.

The World Bank's clients have significant potential to pursue lower-carbon energy paths while achieving goals for economic development and ensuring local and regional environmental protection. The World Bank is trying to capture the available "win-win" or "no regret" opportunities, which include the implementation of macroeconomic and structural reforms in the short and medium term at the country level. The Bank will continue to fund a variety of energy sources, including fossil fuels, but will do so by promoting clean and efficient use of those sources. Since 1993, the World Bank has adopted policies on energy efficiency and energy reform, leading to an actual portfolio with many more win-win loans.

With respect to the Agenda to address Climate Change, the World Bank takes its guidance from the Convention. It actively supports client countries in building capacity and undertaking investments, and it helps to mobilize more funds and other financial resources to meet the additional costs that the climate-friendly options impose.

The World Bank's Agenda include many elements:

- Integrate climate change in sectoral dialogue and in the development planning process.
- Integrate climate change externalities, including impacts or vulnerability in the Bank's Economic and Sector Work and Country Assistance Strategies as appropriate.
- Identify climate friendly options in the project cycle early on.

- Mainstream renewable energy policy in the energy and environment sector dialogues with clients.
- Identify climate-friendly options in the World Bank Group portfolio through rigorous GHG accounting at the investment level.
- Promote market transformation mechanisms to facilitate market entry of renewable energy and energy efficient technologies.
- Invest GEF Climate Change Resources.
- Implement World Bank-GEF Renewables Strategic Partnership to leverage expanded investment in renewable energy.
- Help develop Carbon Offsets Markets by demonstrating potential of market mechanisms through the Activities Implemented Jointly Program, and by promoting an efficient and equitable carbon offsets market through the creation of new financial institutions. For example, the World Bank developed a Prototype Carbon Fund (PCF) with the idea that this Fund will supply high quality offsets at a competitive price, and to ensure that buyers and sellers of offsets receive a fair share of the value added. The PCF will be presented for approval to the Board of Directors after Buenos Aires, but in the meantime there is an active pipeline of projects under development.

Ms. Alicia Bárcena, Special Technical Advisor UNDP

Alicia Bárcena explained that many of the on-going UNDP projects are supportive—both directly and indirectly, with the efforts to mitigate GHG emissions. UNDP is strongly compromised with sustainable development, based on the understanding of the principle of common but differentiated responsibilities. UNDP is in the process of understanding the debate and in improving its own internal education.

UNDP has three vehicles for action: (i) global programs; (ii) work at the regional level; and, (iii) the most important—country programs. The instruments the Agency can utilize are:

- Technical assistance and capacity building
- Project preparation and development
- GEF implementing agency

As a GEF implementing agency, UNDP/GEF have already devoted US\$ 260 million to the climate change portfolio. In addition, UNDP has leveraged US\$ 200 million of co-financing. Those funds have been used to support the developing countries on the preparation of their national communications and their greenhouse gas inventories; to support capacity building and the exchange of experts within the region; and, to support political dialogue among the different countries of the region by financing together with UNEP and the IDB, discussions of the Forum of Ministers of the Environment of Latin America and the Caribbean on the Clean Development Mechanism.

Mrs. Bárcena expressed the need to find areas that require special attention and to act in a coordinated way with other institutions. These areas of action can include: (i) the continuation of the preparation of GHG inventories in the Latin American and Caribbean countries; (ii) the identification of projects that qualify for the CDM, and are socially, environmentally and

economically feasible; and, (iii) the creation of internal financial capacities in the countries of the region.

In addition, in January 1998, the UNDP Executive Committee created a Task Force on Climate Change to provide advice on the role of the UNDP in regards to climate change. The Group concluded that a climate change program should be initiated to provide a strategic and unified approach to climate change in the Post-Kyoto period and beyond.

Arsenio Rodriguez, UNEP

UNEP support the countries of the region on the issue of climate change in three ways:

1. By promoting a political dialogue, mainly through the Forum of Ministers of the Environment of Latin America and the Caribbean in collaboration with UNDP and the IDB.
2. By promoting a more efficient use of energy.
3. Evaluating and monitoring the situation of the greenhouse gases as one of the implementing agencies of the GEF and in close collaboration with the World Bank.

III. The View from the Private Sector

How competitive is the LAC Region to attract private investment through the CDM?

Mr. John Palmisano, ENRON Corporation

Mr. Palmisano prepared a presentation on private sector views regarding CDM investment in Latin America. The private sector is interested in Latin America because of relatively high investment opportunities compared to other regions of the world. The region also has a competitive power sector where a rapid process of privatization is under way. Moreover, the projected growth in electricity demand will open more commercial opportunities. In addition, relatively low project risks and low barriers to entry facilitate a friendly economic climate in Latin America.

Mr. Palmisano suggests that that the CDM projects must contain certain attributes to be of interest to the private sector. For example, CDM projects must connect to existing or proposed commercial opportunities and must be put into a commercial context (risk adjusted return on capital, etc.), but these activities must not add substantial costs to the development of a project. Furthermore, the selling price of the CDM reductions will be critical.

The main concerns of the private sector regarding the CDM include the absence of demand, the bilateralism versus multilateralism idea, the “NGO-ization of the CDM” and the methods to protect investments against future devaluation. In order to reduce these concerns, Mr. Palmisano proposed a “right path” following incremental and positive steps which include institutions based on bilateral actions with international oversight, clear and enforceable liability rules, a focus on energy related projects, and the maintenance of the environment integrity of the system.

Trading Opportunities for the Latin American countries

Mr. Roger Brown, INTESA, Venezuela

In the opinion of Mr. Brown, the CDM will shift economic diversity in Latin America. The countries of the region will have a more active role in their own destiny, and tremendous opportunities will be created. According to Mr. Brown, there is a conflict between public and private viewpoints: public sector is responsible to its citizens, whereas private sector has to respond to its shareholders and is interested in the sustainability of industries. Private sector has the financial resources but it also should have the responsibility to protect the environment and to contribute to the entire process.

The third aspect Mr. Brown addressed was the technology contribution, including the technologies to create a market and to facilitate trading. Costa Rica, Chile, Venezuela are all interested in moving forward. The public sector wants to regulate before trading begins but the private sector wants to start now because they have responsibility to their shareholders. Technology is available to start transactions in any country. Thus, any nation or group of nations that want to implement trading can do so now.

Finally, Mr. Brown addressed the question about knowledge. He considers the international community to be in a learning process and there is a necessity to put the available information in the middle of that process. From that knowledge base we will be able to make educated decisions.

Recommendations for IDB action:

- Take a balanced view (philosophy of the mean) and consider both private and public desires in trying to move these issues forward.
- Facilitate trading, invest in projects from both a public and private view.
- Invest in technologies, especially in trading technologies.

Session II: Helping the IDB Determine its Role in Supporting the Countries in the Challenges Faced by Climate Change

Mr. Walter Arensberg, Chief of the Environment Division, Sustainable Development Department, IDB

Mr. Arensberg provided a short introduction to the activities and the instruments available to the IDB to support its borrowing countries.

The issue of climate change represents a great challenge for the IDB. The objective is to do something that is responsive to the client countries needs, and something that is practical. The discussion on the round tables will explore concrete options for the IDB to be analyzed between now and Buenos Aires, and choose something that makes sense for both the IDB and the countries of the region after the Fourth Conference of the Parties next November.

The IDB is a relatively small bank compared to the World Bank. It has a capitalization of around US\$ 100 billion and lends around US\$ 6 to 7 billion a year, of which US\$ 850 million is in the area of environment. The IDB's main instrument is public sector lending, which emerges from bilateral dialogue with the countries and their desired strategies. In addition, the IDB also has concessional funds available for specific purposes, either in the form of technical cooperations or trust funds from member countries. Unfortunately, the amount of concessional funding is diminishing. The third window the IDB has available is the private sector window, which was recently created to lend directly to the private sector to finance infrastructure projects without sovereign guarantees. The two other windows are the Inter-American Investment Corporation (IIC) and the Multilateral Investment Fund (MIF), which was created to promote private sector activity in member countries through grants and equity.

Finally, one of the key features of the IDB is that it can work in close partnership with the countries of the region, due to their mutual confidence and their willingness to work together.

Mr. Jaime Millán, Principal Energy Economist, IDB

Mr. Millán presented an overview of the region's energy sector identifying the transportation sector as the main culprit for GHG emissions and discussed the relative clean nature of the power sector. Later, he described the main comparative advantages and limitations of the IDB in supporting its borrowing countries in the area of climate change, and gave a short description of the Sustainable Markets for Sustainable Energy Program of the IDB; a key tool to mainstreaming sustainable energy lending in the IDB. Finally, Mr. Millán presented the highlights of the IDB's new Energy Strategy, pending approval of the Board of Directors, and gave a short summary of IDB's activities in the forestry sector.

According to Mr. Millán, the main advantages the IDB has to support its member borrowing countries in facing their climate change challenges are: (1) the truly multilateral nature of the institution; (2) its capacity to manage trust funds from donor members; (3) its active role as a partner in the development of the energy sector in the region; and, (4) its experience in building capacity at the regional level. Nevertheless, the IDB has several constraints such as its limited operational capacity and the competition from other key areas of high priority, which place a high opportunity cost for its involvement in climate change related work.

Round Table Discussions

Round Table Discussion 1: What does Academia think the IDB could do?

Leader: Dr. Michael Toman, Resources for the Future, U.S.A

The discussion on this round table focused on two specific issues the IDB should concentrate on. The first one is related to knowledge. More specifically, on how to improve the climate change knowledge for the countries of the region, and increase the knowledge about technologies available for combating the threat of climate change. The participants stressed the need to have the same knowledge base for developed and developing countries.

Professor Choucri of MIT proposed two instruments to facilitate the transmission of that knowledge:

1. IDB could make a serious effort to reduce the technology gap. Both the gaps between knowledge information technology that is about to reach the market place and knowledge about the information in policy sectors. This can be referred to as the “technology-policy gap.” IDB can also engage or support technology briefings in non- scientific language (science vs. policy world).
2. Strengthen the regional use of information networks. The information technology is already in place in the region but a need exists to facilitate its transmission, especially in making transmission mechanisms more effective for governments and civil society.

Dr. Tester from MIT noted that in the area of knowledge, universities have an important role to play by collaborating with Latin American institutions to create leaders and should also play a more active role in promoting energy and environmental innovations. Other participants noted that universities could make partnerships with the IDB to facilitate the transition to a more sustainable development process through education and training.

The second area of discussion of the Round Table was on the need for the IDB to support national studies and to finance research at the national level in the following areas:

- Potential projects at the national level that can be financed through the CDM.
- Project selection criteria, which fulfill both efficiency and economic development criteria.
- Identification of technologies which would provide suitable incentives in Latin America.
- Identification of present legislation, which may obstruct CDM projects or impede their development, and to propose alternatives.
- Identification of regulations, which may actually encourage increases in GHG emissions.
- Identification of potential national benefits that may come with CDM projects.

Santiago Montenegro, from the Universidad de los Andes in Bogotá, suggested that the IDB could help countries in the region to reduce transaction costs, investment barriers, and inherent project risks in the CDM.

Oswaldo Girardín, from Fundación Bariloche in Argentina, mentioned the important role the IDB could play in supporting capacity building and providing training at the national level.

Round Table Discussion 2: What do Regional Organizations, NGOs and Donors think the IDB could do?

Leader: Mr. Larry Harrington, Alternate U.S. Executive Director, IDB

The participants at this round table agreed that initiatives such as the Sustainable Market for Sustainable Energy Program in place at the IDB have to incorporate incentives, and be replicated if possible. There is a space for common action between the different organizations that work at the regional level, as Luiz da Fonseca mentioned.

Jeff Seabright from the USAID considers that the IDB has an important role to play. Nonetheless, the functions it can assume will depend in large part on the degree of centralization of the CDM. In his opinion, the IDB's role as a lending institution with or without the Kyoto mechanisms can influence the quality of infrastructure investment in the region. The IDB can play the function of matchmaker for projects or it can serve as a factoring agent of credits. It can monetize those carbon credits and put more liquidity into the market.

Many participants felt the IDB could play an important role by providing direct financial support for specific projects, especially in poorer countries, or can assist small countries of the region to compete in the same conditions as the bigger countries for CDM projects.

Brett Orlando from IUCN mentioned the need to develop the institutional infrastructure to implement CDM projects in Latin America. There is an enormous need in the region for capacity building in the areas of analysis of adaptation and vulnerabilities. Jeff Brocaw from USAID reminded the participants that the IDB also has expertise in the forestry area, and given the mixed situation regarding opportunities for CDM in the region, this area should be given a high priority.

The IDB can play a key role by contributing to the reduction of a significant implementation gap that exists in the region. Jacob Scherrs, from NRDC, considers that there is a lot of activity already in developing countries in the area of climate change, but that this information needs to be disseminated. In this area, some participants suggested that the IDB should use its convening power and the strength of the new information technologies to create a permanent Forum on the Internet. Nancy Kete, from WRI, considers that an important area for greening the mainstream flows exists.

Round Table Discussion 3: What the Private Sector thinks the IDB could do?

Leader: Mr. Roberto Vellutini, Private Sector Department, IDB

The participants at this round table focused on three main areas of action for the IDB including capacity building, information collection and dissemination, and reduction of transaction costs for private sector participants in the CDM. The private sector considers that the CDM represents a large opportunity to do business, though some of the risks involved on financing projects through the CDM are important, but that the IDB can assist in mitigating them considerably.

David South suggested that the IDB could help create a comparative advantage for countries of the region to supply Certified Emission Reduction (CER) Units when the demand is unleashed. This could be accomplished by providing support to capacity building efforts in order to facilitate knowledge based at the national and regional levels, to create a more general and consistent knowledge of the CDM and to understand the merits and processes involved in the CDM. It is essential to involve the various stakeholders from the different sectors at the national level and to avoid limiting the dialogue within the environmental sector alone. A more business-

oriented vision is required in order for countries to benefit from the possibilities of this capital inflow, as well as from the new technologies.

Luis Fernando Alarcón proposed that the IDB should incorporate the issue of climate change as one of the topics on the Agenda in the dialogue between the IDB and its borrowing countries. Latin America is a leading region in the Climate Change negotiations, particularly in regards to the CDM, so it is important to help the countries of the region to maintain and increase that leadership especially when the CDM begins. Also, Mr. Alarcón supported the idea of creating CDM offices or project areas to reduce transaction costs and noted that it is important to clarify the issue of credit sharing between the public and private sector.

In the area of risk reduction, the IDB can play a role on securitization of CO₂ reductions within its loan portfolio and can help reduce some of the transaction costs. It can also assist in reducing the transaction costs by facilitating clear and transparent CDM regimes and policies within the region. The IDB can help reduce the risks by using the mechanisms already in place at the IDB, such as through the Private Sector window or the Inter-American Investment Corporation.

The panel leader Roberto Vellutini, speaking from the point of view of the Private Sector Department of the IDB, made some suggestions for the IDB's participation. At the general level, some aspects of the climate change issue could be characterized as public goods, so there is a natural role or niche for the IDB's actions that includes collection analysis and dissemination of information on climate change. The IDB can also help on the establishment of policies and regimes for its borrowing countries in such a way that they can take advantage of the CDM. There also exists the possibility that some projects of risky technologies could be financed through the Private Sector window. These types of projects present a trade-off for the IDB. From the policy side, these projects are good and desirable, but difficult to finance because they involve a new, untested product with only a limited guarantee from the supplier. Therefore, there is a trade-off between the public interest versus the credit aspects. Providing information on the technologies can minimize this trade-off, which is one role for the IDB. Another possibility is developing public-private partnerships. The Private Sector window of the IDB is willing to take on certain risks, but the public sector can mitigate these risks by forming agreements or providing some guarantees, thus making the whole project economically and financially feasible.

In regards to information, the IDB can assist in the gathering of information on projects related to GHG emission reductions, or it can work on a database of new technologies, acting like some kind of information broker.

Michael Marvin, supported by other participants, suggested that the IDB should not concentrate only on the CDM or the Kyoto Protocol, but to take a more holistic approach by concentrating on environmental sustainability. The CDM has not yet even started and there is already an enormous amount of pressure on this mechanism, so let it move forward first.

Finally, Nancy Birdsall raised the question of whether or not it is useful for the IDB to work in the specific details of the CDM, given the general lack of optimism on seeing a CDM regime emerge soon. Maybe this is a possible role for far into the future.

Round Table Discussion 4: What the Region thinks the IDB could do?

Leader: Ms. Vivian Blanlot, Consultant, former Chilean Environment Secretary

Participants at this Round Table agreed on a couple of possible areas where the IDB could play a useful role in helping borrowing member countries face the climate change issue. The first area is capacity building. The second is in the provision of financial and technical assistance to undertake studies, to prepare their national inventories on greenhouse gases, and to protect vulnerable players so that the benefits of the CDM are distributed evenly among the different countries.

Due to the present state of uncertainty regarding the rules and guidelines for the CDM and the period of time required to clarify the issues, participants did not anticipate any other role for the IDB. Most participants in this Round Table agreed that the IDB does not have any role to play as an operational entity of the CDM, except for the general roles mentioned above.

Participants also agreed that any technical assistance should be demand driven (i.e. as an answer to specific countries' requests). Assistance should focus on providing help to evaluate potential projects to be financed through the CDM, to estimate the long-term economic and social impacts of the projects and their costs, to finance studies on additionality, and to understand the division of responsibilities between the investors and the host countries.

Ms. Evelyn Bravo from Venezuela strongly rejected including any conditioning on IDB loans based on climate change considerations. She also pointed out the need for additionality of any IDB funds provided to finance climate change studies or projects (i.e. these funds should not affect the amount available for other priorities). Ms. Bravo also suggested that IDB could undertake or finance studies on the economic and social impacts of the application of the Kyoto Protocol, especially in countries highly dependent on fossil fuel exports. Finally, the representative of Venezuela recommended that the IDB focus should not be limited to the CDM, but should also help in monitoring the correct application of the Protocol, especially in the issues of technology and financial resource transfer as well as in the mitigation of the adverse effects of climate change in the region.

Mr. Rene Castro from Costa Rica identified three potential areas for IDB to choose its role. These areas are related to three requirements for CDM implementation: (i) national authorities; (ii) the Executive Board; and, (iii) the trading regimes for the exchange of CERs. In the first area, the IDB could play an important role facilitating capacity building and providing support to estimate abatement costs at the national level. Mr. Castro agreed that the IDB is already playing an important role in the second area by facilitating, together with UNEP and UNDP, technical meetings of the Forum of Ministers of the Environment of Latin America and the Caribbean to discuss the issues concerning the CDM implementation. Finally, the former Costa Rican Energy and Natural Resources Minister believes the IDB has several options in the third area. It could play a role as a broker, factoring credits, acting as a clearinghouse, helping the poorest countries of the region, or it could play a more risky role by helping to jumpstart the market through the purchase of carbon futures.

Final Remarks

Nancy Birdsall's Conclusions

Background pieces:

- Climate change is a technically complicated issue that is compounded by political complications and suspicions. In the past, there have been some win-win trades but much of the gains have gone to the OECD countries rather than to the less developed countries.
- IDB is a special institution since it is 50% owned by borrowers and 50% owned by non-borrowers. The IDB can play a possible role as a broker, not in the transactions per se but in the larger conversation between countries, especially as a liaison between the OECD countries and borrowing countries in the region.
- The CDM market will most likely be developed through private agents. IDB has a comparative advantage in private market transactions since it has already been working with the private sector and has developed instruments to facilitate its work with the private sector.
- Latin America is a special region and has the opportunity to assume a leadership role in this issue because it has the most competent macroeconomic management and is already undergoing a privatization process.

Roles of the IDB:

- The IDB should develop a strategy in a systematic way, which should build on the IDB's comparative advantage and should take into account what all the other institutions are doing. That strategy should be discussed in draft form with key stakeholders including private sector players so as to ensure their input and buy-in.

What should go into the strategy:

- *Capacity building.* Capacity building for domestic regimes that use market mechanisms. The IDB should work to help countries build capacity to manage their own internal trading regimes. In order to conduct trades there is an inherent need for certification and enforcement. The IDB already does similar work through our regular institutional building and strengthening. IDB could provide training or financing to prepare countries to participate in the climate change negotiations.
- *Market mechanisms.* The IDB is full of economists and the dialogue with countries tends to be with finance and economic ministers in each country. Therefore, encourage, through a policy position, the use of market mechanisms in all the countries.
- *Information dissemination.* Information and data should be used so countries can evaluate the value of their own participation. This is critical to the baseline question. It is essential to ensure that the baseline is set in a manner that recognizes the equity issue. The IDB does not have to generate this data but rather, it should find ways to finance countries and institutions that develop this kind of information. This type of activity should be included in the IDB loans. The IDB Chief Economist could sponsor the *Red de Centros* to study this kind of information in order to help countries be prepared. This could also incorporate the use of regional technical cooperation.
- *Other areas.* Should the IDB work to catalyze private sector transactions through guarantees? IDB can be used as a vehicle to connect to the private sector. For example, MIF funds could be used by both public and private sectors to prepare the regulatory regimes at

the national level. A key question remains as to whether the IDB should assist in shaping the CDM or should the IDB simply provide support for each of these countries so each country is capable of preparing its own position?