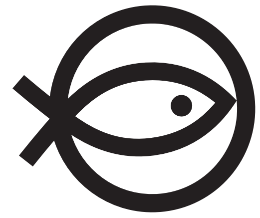
AN ANALYSIS OF THE POTENTIAL OF PRIVATE FINANCE as part of the agreement to mobilize 100 billion USD per year from 2020, for climate change



DanChurcAid 2012

WILL THE PRIVATE SECTOR PAY THE CLIMATE BILL?

Table of Content

Introduction ... 4
The cost of climate change in the developing world ... 4
Private finance ... 5
Criteria for analysis ... 6
Forms of private finance ... 7
Forms of private finance ... 7
Open market investments ... 7
Private finance leveraged by public finance ... 8
Philanthropy and CSR projects ... 9
Private finance reconsidered ... 10
Access for the Least Developed Countries ... 10
Access for adaptation ... 11
Political regulation in developing countries ... 12
Political regulation in developed countries ... 12
Leverage ... 13
Additionality ... 14
Likelihood of possible positive side-effects ... 14
Risk of possible negative side-effects ... 15
Analysis and conclusions ... 15
Recommendations ... 16
Abbreviations ... 18

Acknowledgements

This paper has been written by Jonas Wamsler and Mattias Söderberg, DanChurchAid.
DanChurchAid
Nørregade 15
1165 Denmark
www.dca.dk
No copyright. We encourage the use and spread of the paper and its contents and recommendations.

Will the private sector pay the climate bill?

An analysis of the potential of private finance as part of the agreement to mobilize 100 billion USD per year from 2020, for climate change

Abstract

Western governments foresee that private finance will constitute a big part of future international climate finance. This paper analyses the potential of private finance in relation to the commitment of developed countries to mobilise 100 billion USD per year from 2020.

The analysis concludes that while private finance may have a potential in general, it may be difficult to leverage big amounts within the frames of a long-term finance commitment. There is a need for clear frames for private finance to make sure that there is agreement about what kind of finance should be eligible for the long-term finance commitment.

Based on the analysis in the paper the following recommendations are made:

- Climate finance for Least Developed Countries (LDC) and other small and vulnerable countries should mainly come from public sources.
- The vast majority of adaptation finance should come from public sources.
- Private finance, counted as climate finance, should be complementary to existing investments.
- The effects on local development of private investments should always be considered and stakeholder consultations, including civil society actors, should be mandatory to ensure transparency and dialogue. Private finance, counted as climate finance, should always comply to the principle of "do no harm".
- Private finance should only be counted as climate finance if linked to national climate change strategies, such as Nationally Appropriate Mitigation Actions (NAMA) and National Adaptation Plans (NAP). This principle should also apply for initiatives to promote enabling environments. Activities to attract private investments in general should be supported through other initiatives.
- Private finance should be monitored to ensure that it is Measurable, Reportable and Verifiable (MRV).
- When the leverage factor is calculated, the location of the "end-bill" should be considered. An end-bill paid by public institutions in developing countries should not be eligible, while private payments of the end-bill may be eligible depending on the context. A pro-poor perspective should always be applied to ensure that those who have least responsibility for climate change are not the ones paying.

Introduction

Climate finance is one of the building blocks of the international climate negotiations. Agreements about implementation depend on progress in negotiations about finance, and thus difficulties to agree about finance affect progress in the overall talks.

When talking about climate finance, developed countries are increasing their emphasis on so-called private finance. However, there is still little, if any, agreement about the role, or even definition, of private finance. Private finance could have a huge potential, or minimal, depending on the perspective, and it is therefore important to consider the role of private finance more in detail. Will the private sector pay the climate bill?

The cost of climate change in the developing world

The effects of climate change, caused by global warming, are becoming more and more evident. Natural catastrophes such as flooding in Pakistan and Thailand and drought in Africa give an indication of the increasing need for adaptation to the effects of climate change. At the same time reports from IEA show how global emissions continue to increase and the need for urgent mitigation actions are apparent[1].

As noted in the Human Development Report 2011, there are serious concerns that increasing global temperatures will not only affect the climate but also severely affect development as a whole[2]. The necessary actions to combat climate change, both within adaptation and mitigation, have a price. For developing countries these costs come on top of the existing investments for development and actions to fulfil the Millennium Development Goals. However, to pay for a changing climate is hardly fair, for countries which have relatively small historical responsibility.

Industrialized countries have acknowledged their responsibility, and agreed to provide developing countries with new and additional, predictable and adequate funding to support enhanced action on mitigation. This includes substantial finance to reduce emissions from deforestation and forest degradation, adaptation, technology development and transfer and capacity-building. In the Cancun agreement the developed countries committed themselves to a goal of mobilizing 100 billion USD a year by 2020 to address the needs of developing countries[3].

McKinsey & Company estimate that the mitigation financing needed will be around 300 billion USD a year in 2020. Combined with adaptation costs of 75-100 billion USD a year, this will leave a funding gap in 2020 of 275-300 billion USD[4], to be covered by funds additional to the 100 billion USD promise. The World Bank defines the cost of adaptation as being additional to the cost of development[5], meaning that in addition to the expected cost of development, adaptation will cost 75-100 billion USD a year in the developing countries. These costs cover very specific actions that need to be completed to respond to the effects of the changing climate. Therefore it is essential that the funding is new and additional; if funding is taken from ODA, it cannot cover the adaptation cost estimated by the World Bank without leaving other development issues unfunded, which would contradict the responsibility of the industrialized countries. The estimated cost by 2020 is likely to increase, since it is based on a scenario where the global temperature does not rise above 2°C. However, considering the agreement from COP17 where global

[1] IEA, 2011, World Energy Outlook
[2] UNDP. 2011, Human Development Report
[3] UNFCCC, 2010, Cancun agreements
[4] World Bank, 2010,World Development Report
[5] World Bank, 2010, *"The economics of Adaptation to climate change, a synthesis Report"*

actions is likely to take place 2020 and beyond, a rise of 3,5°C[6] is more likely, which would lead to more dramatic effects leading to higher adaptation cost.

The IEA[7] highlights that hesitation in mitigation activities could raise the future cost, stating that "For every 1USD of investment in the power sector avoided before 2020, an additional 4.3 USD would need to be spent after 2020 to compensate for the higher emissions"[8].

Private finance

Various agreements emphasize that climate finance will come from a variety of sources, and for Western governments private finance is seen as a key source. In the light of the current financial crisis, public budgets are constrained and for these governments the goal of 100 billion USD per year in 2020 is only achievable if a portion of the funds comes from other sources than public budgets.

Apart from bringing non-public money, Western governments see private sector engagement in climate finance as an opportunity to promote technology cooperation and capacity building, as also agreed in the UN talks. However, developing countries have a different view. They are concerned about the big focus on private finance and call for limitation of its role, or total exclusion. From their perspective private finance may bring several risks, including lack of political influence.

Even if the current financial crisis has decreased the amount of foreign direct investments (FDI), the global inflow reached more than 1.200 billion USD in 2010. This was less than the peak year in 2007, with almost 2.000 billion USD, but it is still a major financial flow. While investments in industrialised countries have varied, following the financial crisis, the investment flow to developing countries as a whole has increased steadily for several years. In 2010 more than 570 billion USD came as FDI to developing

Agreements about climate finance

The agreements from Bali (COP13), Copenhagen (Copenhagen accord, COP15), and Cancun (COP16) outline several criteria for climate finance. Climate finance should be:

- **Mobilized by developed countries** – This is restated in various agreements, and referred to specifically in relation to the agreement to mobilize 100 billion USD in 2020.
- **Take into account the urgent and immediate needs of those who are particularly vulnerable to the adverse effects of climate change** – The focus on the most vulnerable refers to adaptation and not mitigation.
- **Balanced in allocation between adaptation and mitigation** – The agreement about balance refers to Fast Start Finance, to be implemented between 2010 and 2012. However, the need for climate finance will continue to increase for both mitigation and adaptation and therefore we believe this principle is valid also for long-term finance.
- **New and additional, predictable and adequate** – These concepts were agreed at COP13 but have been referred to in the negotiations about finance ever since. It is our interpretation that these concepts are also valid for long-term climate finance.
- **Address the needs of developing countries** – Climate finance should, according to the Cancun agreement, be used to pay for costs related to the needs of developing countries.

[6] IEA 2011: *World Energy Outlook 2011 Factsheet*
[7] IEA 2011: *World Energy Outlook 2011 Factsheet*
[8] IEA 2011: *World Energy Outlook 2011 Factsheet*

countries. This could be compared to the total ODA to developing countries the same year which reached 128 billion USD.

Private finance has one general characteristic, which is important to acknowledge in all initiatives. The driving force for private investments in general is the expected return and profit. Market based solutions will always have profit as the main priority, and possible effects on mitigation and adaptation will have a lower priority[9].

Criteria for analysis

While private finance is becoming a buzzword, and a focus of numerous discussions, meetings, conferences and negotiations, it is still a very vague concept, with many different meanings. With this paper we are trying to add to the understanding of private finance, and to identify some of the challenges which must be addressed if private finance is to become a source within internationally agreed climate finance.

The analysis will cover private finance in the form of investments in developing countries, and not internationally agreed market based mechanisms, and our interpretation of private finance is finance mobilized through corporate activities.

Private finance can be evaluated from many different perspectives, and the selection of criteria will have major effect on the result. To begin with, this paper analyses how private finance can contribute to the agreement about long term finance, to mobilize 100 billion USD per year in 2020. Private finance is likely to have an additional role to play for climate change related activities not funded through the 100 billion USD, especially in emerging economies.

In this paper we have chosen a number of criteria based on the actual decisions taken about climate finance, as well as a number of concerns based on the specific needs for the poorest developing countries. These criteria are the following:

Access for the Least Developed Countries (LDCs) – It is clear that the least developed countries should receive a considerable part of climate finance. The Cancun agreement emphasizes that the funding for adaptation should prioritize the most vulnerable developing countries, including the LDCs, the small island developing states and Africa[10]. Does private finance have a potential in relation to climate finance in the LDCs?

Access for adaptation – Adaptation is as important as mitigation[11], but still adaptation often gets less attention. Does private finance have potential in relation to adaptation?

Political regulation in developing countries – Developing countries are encouraged to develop plans for both mitigation and adaptation, and it is widely expected that climate finance will be used to support implementation of these plans. Are developing country governments able to regulate private finance?

Political regulation in developed countries – Without some kind of regulation or registration it will not be possible to measure, report and verify (MRV) private finance as part of climate finance. What kind of

[9] This is not necessarily the case for private charity and philanthropic activities. Such investments may be done with other types of objectives.
[10] UNFCCC, 2010, Cancun Agreement
[11] UNFCCC, 2010, Cancun Agreement

influence do developed countries have over private finance and can private finance be measurable, reportable and verifiable?

Additionality – Private investments are taking place all the time. However, private finance contributing to climate finance should be "additional" to existing investment flows. How can private finance become "additional"?

Likelihood of possible positive side-effects – FDIs have a range of possible positive side-effects, which are often part of the argument for engaging the private sector in climate finance. How can positive side-effects be ensured?

Risk of possible negative side-effects – There are also risks related to foreign direct investments. There are examples of land grabbing, human rights violations, tax-avoidance and negative effects on local markets. How can possible negative side effects be avoided?

Leveraging of private finance – One of the main arguments for including private finance in climate finance, is that a small amount of public finance can leverage a private finance so that the total financial flow increases. What is the potential of leveraging private finance?

Forms of private finance

Private finance flows to the developing countries in different ways. The major part of these funds flow through direct investments in the open market but developing countries also receive private finance supported by developed countries through official development aid (ODA) or other budgets. Private sector support through ODA takes the form of grants, loans, equity investments and guaranties. These options all have the form of FDIs, but they are to an extent influenced or regulated by political decisions. A considerable amount of private finance is also channeled through private funds as well as philanthropic initiatives and CSR related projects.

Below, six different forms of private finance divided into three categories are presented.

Forms of private finance

Open market investments

- Greenfield investments
- Mergers and acquisitions
- Equity investments

Private finance leveraged by public finance

- Loans
- Credits and guaranties
- Equity investments
- Grants

Private Funds and CSR projects

- Philanthropy

Open market investments

The most common form of private finance is the kind of private investments which are taking place without any form of public incentives or support. The private sector is becoming more and more transnational, and investments are made all over the world. Most Transnational Corporations are still

based in industrialised countries, but more and more companies based in developing countries are also investing abroad.

Greenfield investments

There are many kinds of private investment. What first comes to mind are probably companies establishing production and offices in other countries, so-called "Greenfield investments". These investments are often long-term, they include engagement at national level, and they are relatively "stable" in the sense that they are less likely to move.

Mergers and acquisitions

However, more common are mergers and acquisitions of companies already based in the countries. A merger, or acquisition, is as Greenfield investments often a long term investment and strong engagement at national or local level. When foreign companies acquire local companies in developing countries they are not only gaining company facilities and production capacity, but also local know-how, contacts and brand.

Equity investments

Equity investments, i.e. when foreign investors purchase stocks, bonds and shares in companies, constitute a big amount of global financial flows. This includes for example investments by pension funds and banks. Equity investments do not necessarily lead to engagement in the country, and this kind of private finance is often more unstable, as capital may be moved more easily if better profit can be obtained elsewhere.

Private finance leveraged by public finance

The objective for companies to invest is to make a profit. However, the potential profit of an investment should be seen in relation to the possible risk and additional costs. Many developing countries have difficulties to attract investments. In some cases political instability and weak public institutions may influence, another reason could be weak infrastructure, such as unreliable power supply, and in other countries lack of domestic capital and markets may influence. Prejudices and lack of information are also possible reasons. Even when climate investments in developing countries should be profitable, the investment may be made elsewhere, if the uncertainty is too big, or the possibility to increase profit is believed to be higher elsewhere.

In order to attract more private finance to desired sectors (mitigation and adaptation) in certain areas (developing countries) public finance can be used as incentives. Through different initiatives Western governments hope to leverage private finance in areas where investments otherwise would not have taken place. Below four different forms of public leveraging are presented.

Loans

According to the World Bank, the International Financial Institutions every year invest around 40 billion USD in operations that focus on the private sector in developing countries, a figure which to a large extent is made up of private sector loans[12]. The International financial institutions provide different types of loans many of them extended on terms substantially more generous than loans given on market conditions. This is called concessional loans, meaning that the institutions are willing to take on greater risks than commercial banks; the World Bank estimates that 20-40 per cent of the 40 billion USD is given on concessional terms[13].

[12] MIGA, 2011: *International Financial Institutions and development through the Private sector*
[13] [13] MIGA, 2011: *International Financial Institutions and development through the Private sector*

Loans to private companies are to be repaid and the amount of public finance will therefore be limited. However, this is also considered by companies and the loan-option may therefore have limited attraction if the potential for profit is limited.

Guaranties

Another way to encourage companies to make investments, which may be uncertain, is to give them guaranties, e.g. in the form of export credits. Export credits works as an insurance against many of the risks related to investments in foreign markets.

While export credits create security for companies they have also caused problems in some developing countries. If an investment fails, the authority giving the guarantee, usually developed country governments, take over possible requests from the company. However, these requests are in many cases redirected to the developing country government, adding to the foreign debt of the country[14].
Guaranties will increase the willingness of private investments in high risk projects. However, there must still be a realistic possibility for profit if companies are to engage.

Equity investments

A third form of public initiatives to leverage private finance is to make equity investments in private initiatives. In practice this form of private finance is the same as described above under "open market investments". The difference here is that the equity investment is made with public capital. Profit may still be a desirable outcome, but public institutions making equity investments may have other objectives, such as support of specific sectors or geographic locations.

Grants

A fourth public initiative is to give grants to companies, to encourage certain types of investments, or to supplement private investments to increase a desired effect. If private finance should be attracted to areas where the chance for profit is limited, grants, possibly in the form of public private partnerships, may be a good option.

Philanthropy and CSR projects

All private finance to developing countries is not linked to profit. There is also private finance flowing through CSR projects and allocations from private funds. These funds are more similar to development aid in their characteristic and they can take the form of financial support to

Cleaner water through improved sewage systems

The Danish National Advanced Technology Foundation invests public finance in research and development through public private partnerships. The initiatives are focused on development of new technologies, which can later be made ready for markets and sold by the private companies involved. One initiative is focused on development of cleaner water through improved sewage systems. Apart from the Foundation the initiative involves a company called Krüger A/S and the Technical University of Denmark, DTU.

There is a need for adaptation technologies, and many technologies are still to be developed or adjusted to the conditions in developing countries. The private sector has a lot of relevant and valuable expertise and would therefore be good to engage in public private partnerships to develop specific technologies. However, when a technology is ready for market introduction, companies will expect to get a return. To make the technology accessible in the poorest developing countries, public finance may be needed.

[14] Eurodad, 2011, Exporting goods or exporting debts

domestic initiatives in developing countries, or as concrete projects. Some initiatives may be linked to branding of the company, while others have a more philanthropic origin, with an aim to contribute to development.

It is difficult to categorise this kind of private finance as each initiative may be different. Some private funds may be used to leverage other financial contributions in bigger projects, while others are small initiatives directly linked to profit making production.

Private finance reconsidered

Below, the potential of private finance, as part of the developed country commitment to mobilize 100 billion USD per year in 2020, is analysed. The analysis builds on the eight criteria described above.

Access for the Least Developed Countries

By taking a closer look at the FDIs in developing countries it is clear that there are big differences between regions and countries. It should be acknowledged that private finance, and FDIs, have played an important role in the emerging economies, and that it may be an important factor to mobilise economic growth in certain sectors. The four BASIC countries (Brazil, South Africa, India and China) alone received foreign investments corresponding to more than 240 billion USD in 2010. However, poor countries, with limited markets and domestic capital, and relatively low levels of education, have difficulties to attract FDIs. The FDI inflow to Least Developed Countries (LDCs) in 2010 reached little more than 26 billion USD.

If a larger part of the 26 billion USD were allocated to climate related projects, it would be reasonable to expect that FDI flowing to the LDCs could play a major role in financing climate change related activities in the LDCs. However, this does not seem to be the case. In 2010 only 2.6 per cent of the Greenfield investments in the LDCs went to alternative and renewable energy.

When looking in detail at the FDIs flowing to the LDCs, it becomes clear that investments to a large degree are focused on the extractive businesses. More than 2/3 of the Greenfield investments flow to mining, extracting and processing coal, oil, gas, minerals and metals. Oil and natural gas alone make up 40 per cent of all Greenfield investments in the LDCs. This means that a few LDCs account for a big part of these investments and as an example Angola alone received an FDI inflow of almost 10 billion USD in 2010, while many other LDCs received less than 0.5 billion USD.

Current experiences of some of the main institutions supporting private investments in developing countries show that investments to a large extent target middle income countries rather than LDCs. IFC, which is the branch of the World Bank designed to focus on private sector investments in developing countries, made more than half of their investments in 2009 to just ten middle income countries[15], while the 80 IDA[16] (including the LDCs) countries shared the rest.

When export credits have been directed to the LDCs, it has often contributed to the debt burden of the developing world. A Eurodad report from 2011 showed that almost 80 per cent of poor countries debt to other governments was the result of export credits.[17]

[15] Friends of the Earth 2011: ”Leveraging private finance

[16] IDA referring to the countries eligible for the World Banks IDA loans, which mean that they have a max GNI per capita of 1,175 USD

[17] Eurodad 2011, Exporting goods or exporting debts

The World Banks PPI[18] database shows that from 1990 to 2003 only four per cent of the global investment in public private partnerships in infrastructure went to sub Saharan Africa[19].
Private investments will be made where profit is likely. Countries attracting many investments are therefore likely to continue to attract investments, while the poorer developing countries continue to have difficulties to attract investments even when there are public incentives.

If more investments are to be directed towards the LDCs, the private sector calls for a more enabling investment environment. Barriers like poor infrastructure, lack of banking services and problems relating to corruptions are often mentioned as reasons for why investments are not made in the LDCs. However, these concerns are related to the general development agenda and not specifically to the climate change agenda.

Access for adaptation

It is not easy to find reliable statistics about private investments in adaptation in developing countries. Many companies climate proof their investments, but these actions do not necessarily benefit the local community or the country. LDCs have developed National Adaptation Programme of Action (NAPA) to highlight their most urgent and immediate needs related to climate change adaptation. So far, there have been very few examples of private finance used for adaptation which is being linked to the NAPAs.
Based on the assumption that private investments are developed with an aim to create profit, the potential for adaptation activities might be limited. If user payment is used to ensure that private investments create a return, the adaptation measure may be limited to those who are able to pay. In general, the market for such initiatives in developing countries is limited. It would also be unfair to argue that poor people, who in many cases have contributed least to climate change, should be denied access to adaptation.

However, there are also areas where private investments are realistic. In Research and Development of new technologies, and adjustment of existing technologies, private finance may have a role to play. There might also be solutions where companies include adaptation as part of their investment to ensure higher profit. In such cases adaptation may also benefit the local community.

Local private investments in adaptation in Bhutan

The Pasakha area in Bhutan is a high risk area for flooding. The area is also an industrial zone and companies are engaging in adaptation activities to secure their production. However, investments are part of the public adaptation plans and are also beneficial for the local community. A Bhutanese application to the LDCF in 2012 includes 800.000 USD from these companies as co-finance, and will thus be part of a public private partnership.

Corporate production may also be affected by climate change, and companies may therefore also have incentives to invest in local adaptation. Initiatives such as the one in Bhutan can probably be encouraged through public incentives and public private partnerships. However, as mentioned in this paper it is also important to consider who will pay the end-bill. If the production is made for export, the end-bill is likely to be transferred to other countries, possibly developed countries. But if companies produce for local markets or public institutions, the bill will stay within the country.

[18] PPI stands for Private participation in infrastructure – a database produced by the Word Bank
[19] OECD, 2005, Investment for African Development: making it happen

It is difficult to find data experiences from leveraging private finance for adaptation. In 2010 IFU, did not invest in a single project that could be categorized as adaptation related, while they made eight mitigation related investments within wind and solar power and biogas.

The Climate Investment Funds of the World Bank (CIF) have had some success in the leveraging of private finance when it comes to mitigation, while leveraging from the private sector has been almost none existing in projects with focus on adaptation.

Political regulation in developing countries

All countries have rules for private sector investments. Some rules are national while others are linked to bilateral or international agreements. Western governments often argue that there is need for so-called "enabling environments" to improve the possibilities for investments in developing countries. Such enabling environments will in many cases include less political influence and decreased regulations for foreign investments.

Governments do have the possibility to favor investments in certain sectors. It can for example be done with tax incentives, improved infrastructure, and research capacity. However, to attract private investments from open markets to support implementation of a specific governmental plan (e.g. a NAMA or NAPA) might be difficult, without concrete financial incentives.
Private investments supported with public finance from developed countries do not have to be linked to agreements with the host government. On the contrary private investments receiving support, e.g. via public loans, may appear as open market investments, which thus are difficult for host governments to monitor.

Political drivers as incentive

Directives from the European Union have an influence on allocations of private finance. As an example the water framework directive of the EU set frames for water quality in the union. Investments are made in both Research and Development, and concrete activities, to fulfill the targets of the directive.

Political drivers can have positive effect on mobilization of private finance, both in developed and developing countries.

One important aspect related to political regulation in developing countries is the link to domestic plans for tackling climate change. As agreed in the UNFCCC talks developing countries should produce different plans for their actions. For example in the form of NAMAs, NAPAs and NAPs. However, without some kind of political influence in the host country it will be difficult to ensure that private finance is contributing to the fulfilment of these plans.

Political regulation in developed countries

The commitment to mobilize 100 billion USD by 2020 is a commitment from developed countries, not private companies. It is therefore possible to expect that developed countries will have some kind of influence related to private finance which would be counted as part of the 100 billion USD commitments.

A company investing in another country should comply with the laws of the country where the investment takes place. The country where the company is based has limited possibilities to intervene if investments are made on open markets. However, if public finance is used to leverage private finance, the public authority will also have a possibility to influence and monitor the investment.

When public money is given as loans, grants, equity investments or guaranties to the private sector, it is done because governments want to support a certain type of behaviour or geographic location. In the

case of climate finance, it is to motivate investors to invest in projects benefiting the climate, even though they would have a higher risk or a lower return than they would normally prefer.

Political regulation in developed countries is also necessary if private finance is to be measurable, reportable and verifiable (MRV). MRV is a key concept in the climate talks and developed countries call for MRV in relation to developing country mitigation action. Similarly, developed country finance should apply to MRV principles. Only if private finance is measured, it can be included in the long-term commitment to mobilise 100 billion USD per year in 2020. To enable MRV in private finance the amount of both private and public investment must be measured. However, as will be elaborated below about leverage, the end bill is also important to identify.

Leverage

The leverage factor is important as this is one of the key arguments for including private finance in climate finance. However, the leverage factor of different public initiatives is difficult to monitor, and also difficult to evaluate.

A high leverage factor indicates that a lot of private finance, additional to public finance, is leveraged. However, it is not always positive since it might indicate that a project is highly profitable and therefore not in need of public support.

The discussion about leverage, refers to finance additional to the public funds allocated from developed countries. However, one could also look at the leverage factor in relation to developing country finance. If investments are to be successful for the company they must also yield a profit. An investment in a developing country is therefore likely to give returns accumulated from domestic sources, which, depending on the type of investment may challenge the concept of leveraging. If the private investment receive payments from public budgets, in developing countries it means that the end bill for the action is paid by public funds in developing countries. This would contradict the Cancun agreement stating that developed countries should mobilize climate finance.

At the same time it should also be acknowledged that private finance, by its nature, is not linked to governments. In some developing countries, domestic private finance may be leveraged through developed country public finance, and in many cases private companies in developing countries, with local or foreign ownership, may be the ones paying the end-bill of foreign investments. However, taking the analysis one step further, the final cost for private investments may still go to the people living in the country. For mitigation actions, such as renewable energy supply, this may not be problematic. People will in most cases have to pay for energy, if it comes from a diesel generator or if it comes from a windmill. But for adaptation the situation is different.

Examples of leverage

The Danish IDFI, IFU, states that their investments have a leverage factor of about 8, but this include funds leveraged from other public finance institutions, such as the World Bank. The argument to use public funds for private sector initiatives is to leverage private funds which are additional to public ODA and the leverage factor of IFU is therefore likely to be considerably lower.

The GEEREF, a Public-Private-Partnership fund initiated by the European Commission, was expected to have a leverage factor of 3-10.

DFID estimates that their CP3 (Climate Public Private Partnership) will achieve a leverage factor of 1:9

The CIF, which give both grants and highly concessional loans, have a leverage factor around 1:3

Adaptation is a necessary action, imposed on developing countries even if people have not contributed with major emissions themselves.

The discussion about leverage is closely linked to MRV. When private finance is measured the end-bill must be monitored. In many cases it is likely to be sent to people, companies or public institutions in developing countries, but for initiatives related to export, the bill may end in developed countries.

Additionality

The concept of "new and additional" is mainly related to public finance. However, the concept is also just as relevant in the debate about private finance. In relation to ODA the basic logic behind "additionality" is to ensure that ODA commitments are not transformed to climate finance, thus undermining ODA and the work to reach the MDGs.

However, there is also a limited amount of private finance. The link to climate finance is relevant for many corporate sectors. These are sectors focused on renewable energy, energy efficiency, agriculture, communication, infrastructure, risk management etc. The amount of private finance in these sectors is already today invested somewhere. The idea to attract private finance to climate finance in developing countries is therefore likely to change the location of investments. If this change leads to closure of existing investments in developing countries, the investment will not be additional.

When monitoring private finance, it is also important to consider if investments are additional, or if they would have happened also without public leverage initiatives. Many mitigation projects in emerging economies are for example likely to be attractive for foreign investors, also without public regulations or engagement. And more and more companies are expected to initiate climate proofing of their activities, which may benefit local communities, also without public support. Anything else would decrease their long term possibilities for making profit.

If private climate finance is to be called new and additional, the investments made have to be investments that would not otherwise have occurred. This is an important aspect, since the current expectations to private investments are based on the patterns of already existing investments. Relabeling already existing investments so that they can be counted to the 100 billion, might help the developed countries to fulfil their promise, but it will not solve any of the climate related challenges faced by the developing world.

Likelihood of possible positive side-effects

The potential of private finance is to a large extent linked to desired and positive side effects. Many of these may be seen as obvious, such as increased tax income for the state and increased employment. However, documentation shows that positive side effects are not automatically linked to foreign investments, at least if necessary policy frameworks are not in place to support a positive development.

The likelihood of possible positive side-effects is not linked to a specific form of investments. However, if positive side effects are to be ensured, measures should also be taken to promote such a development. This can also be achieved through regulations linked to public finance used to leverage private finance. For example, PPPs can include components promoting technology cooperation and capacity building of local staff, and before public funds are given as investment loans, the effect of the investment on the local market can be analyzed.

Risk of possible negative side-effects
Unfortunately there are also possible negative side effects of private investments in developing countries. There are documented violations of workers' rights, initiatives to avoid paying taxes, land grabbing and pollution. To "do no harm" is an obvious criteria for most private engagement in developed countries. However, many developing countries lack regulations and effective implementation of legislation, which opens up for abuse and exploitation.

IFC, does not have the best CSR record. In 2009, 58 per cent of IFC investments in financial intermediaries ultimately funded projects that were accused of having high or medium social and environmental risk[20]. Public funded institutions do, however, have the possibility of creating sustainable frameworks for their private sector support.

Analysis and conclusions
Throughout this paper we have discussed different aspects of private finance in relation to climate finance. While many Western governments emphasis the opportunities with private finance, we have discovered several challenges and risk, which must be considered in the debate about private finance.

The criteria for climate finance, as described in the introduction of this paper, have been guiding for our analysis. Below the main conclusions are gathered.

Access for the Least Developed Countries (LDCs) – Does private finance have a potential in relation to climate finance in the LDCs?
Looking at the results of numerous past attempts, the initiatives to mobilize private finance for the LDCs have given limited effect. This does not mean that there is no effect, and many initiatives may be successful. However, in a bigger picture private finance, as part of the 100 billion USD target in 2020, does not seem to be the solution for LDCs.

Access for adaptation – Does private finance have potential in relation to adaptation?
The potential for private finance contributions to adaptation seems to be limited. The potential for profit is limited, and the leverage effect may be small, or even none-existing if the investment should be paid by domestic fees. However, as noted, there may also be potential in specific initiatives, e.g. in relation to climate proofing and research and development. Such initiatives are not likely to constitute a bigger part of adaptation finance, but still they can play an important role.

Political regulation in developing countries – Are developing country governments able to regulate private finance?
Developing countries do not necessarily have influence over private investments. The Cancun agreement states that long term finance should respond to the needs of developing countries, but there is no text saying who would identify these needs. However, it should be noted that the same agreement also identifies NAMAs and NAPs as key strategies for identifying needs related to mitigation and adaptation.

Political regulation in developed countries – What kind of influence do developed countries have over private finance and can private finance be measurable, reportable and verifiable?
Developed countries do not necessarily have influence over private investments, but if the private funds are leveraged with public funds, there should be a clear possibility to extend control. Still, the willingness to do so may differ as a lot of control, and restrictions, may limit the possibilities to attract private finance.

[20] Bretton Woords project, 2010

To monitor private finance is difficult. There are many transactions, many actors, and many aspects to consider. However, without monitoring it will not be possible to count private finance as part of the long term finance commitment. Developed countries must therefore execute some control.

Additionality - How can private finance become "additional"?
To evaluate if an investment is "additional" is difficult. Private finance is moveable and will seek possibilities for profit. If incentives make investments in mitigation and adaptation attractive it is likely to attract private capital, with a likely negative effect on other sectors. The concept of additionality is challenging, but important, and therefore further consideration is needed.

Likelihood of possible positive side-effects – How can positive side-effects be ensured?
The possibility to get positive side-effects from private finance is always present. However, it must be acknowledged that these positive effects should not be taken for granted, and thus not used as arguments in the debate.

Risk of possible negative side-effects – How can possible negative side effects be avoided?
Negative side effects are not desirable. Some of them can probably be avoided through use of political regulation in either developed or developing countries.

Leveraging of private finance – What is the potential of leveraging private finance?
The potential of leveraging private finance will differ a lot between different types of public finance support, different countries, and different sectors. For some mitigation actions the leverage factor may be high, while some adaptation activities will be impossible to fund with leveraged private finance. The important point is to consider the leverage factor carefully. It is especially important to clarify where the end-bill is paid, and if the investment in fact is paid by public funds in developing countries.

As described in the introduction of this paper, the focus has been on the potential of private finance as part of the 100 billion USD pledge, for climate finance in 2020. It should be noted that private finance has potential, and an important role to play in relation to development, but as we conclude below the potential is limited when we talk about the 100 billion USD. However, all estimations of future costs related to climate change indicate that 100 billion will be far from enough. There will be need for more money, and it is likely to come from a big variety of sources, including private finance.

Recommendations

Based on the analysis above a number of recommendations can be done. It is important to underline that these recommendations refer to the 100 billion USD commitments in 2020. Additional finance will be needed to enable necessary adaptation and mitigation. And additional finance will come from, as traditional ODA, foreign direct investments and, probably a major part, as allocations from public budgets in developing countries.

- Climate finance for LDCs and other small and vulnerable countries should mainly come from public sources.
- The vast majority of adaptation finance should come from public sources.
- Private finance, counted as climate finance, should be complementary to existing investments.
- The effects on local development of private investments should always be considered and stakeholder consultations, including civil society actors, should be mandatory to ensure

transparency and dialogue. Private finance, counted as climate finance, should always comply with the principle of "do no harm".

- Private finance should only be counted as climate finance if linked to national climate change strategies, such as NAMAs and NAPs. This principle should also apply for initiatives to promote enabling environments. Activities to attract private investments in general should be supported through other initiatives.
- Private finance should be monitored to ensure that it is Measurable, Reportable and Verifiable.
- When the leverage factor is calculated, the location of the "end-bill" should be considered. An end-bill paid by public institutions in developing countries should not be eligible, while private payments of the end-bill may be eligible depending on the context. A pro-poor perspective should always be applied to ensure that those who have least responsibility for climate change are not the ones paying.

Considering these recommendations it is not likely that private finance will constitute a major part of the 100 billion USD. However, private finance will still be an important financial source for climate change initiatives, especially in the bigger developing countries and in relation to mitigation, where it is easier to make marked based solutions.

Abbreviations

CIF	Climate Investment Funds
CP3	Climate Public Private Partnership (DFID program)
CSR	Corporate Social Responsibility
DFID	Department for International Development
FDI	Foreign Direct Investments
GEEREF	Global Energy Efficiency and Renewable Energy Fund
IDA	International Development Association
IDFI	International Development Finance Institution
IEA	International Energy Agency
IFC	International Finance Corporation
IFU	Danish Industrialisation Fund for Developing Countries
LDC	Least Developed Countries
LDCF	Least Developed Countries Fund
MDG	Millennium Development Goals
MRV	Measurable, Reportable and Verifiable
NAMA	Nationally Appropriate Mitigation Action
NAP	National Adaptation Plan
NAPA	National Adaptation Programmes of Action
ODA	Official Development Assistance
PPI	Private Participation in Infrastructure
PPP	Public Private Partnerships
UNFCCC	United Nations Framework Convention on Climate Change

DANCHURCHAID
NØRREGADE 15
1165 COPENHAGEN K
PHONE +45 3315 2800
DCA@DCA-DK

WWW.DANCHURCHAID.ORG