

7. LEVERAGE PRIVATE SECTOR FINANCE (ACTION AREA 4)

103. **The Private Sector Role.** Generating 86 percent of global investments, the private sector has a vital role in the global economic transformation towards development in a climate constrained world.¹⁶ The UNFCCC study estimates that the private sector should provide 80 percent of mitigation finance and a significant share of adaptation financing. In developing countries, the private sector has already contributed to 78 percent and 77 percent of total investments in renewable energy and energy efficiency, respectively.

104. There are several generic barriers to private investment in many developing and transition economies. These include riskier business environment, smaller transaction size and thus higher financing costs, and the lack of credit worthy project sponsors. In addition, barriers specific to climate financing include higher financial costs, the absence of a clear, durable, consistent, and sufficient price of carbon, uncertainties with respect to the eligibility and definition of credits from carbon avoidance projects, and lack of awareness on climate risks together with overwhelming uncertainties of investing in unfamiliar technologies.

105. **The WBG Role and Priorities.** The WBG will address some of the constraints to a more significant participation of the private sector through a collective effort of its different institutions. First, it will continue its core support to improve an overall investment climate and capacity of the public sector to channel private sector resources through policy dialogue, technical assistance and lending. Second, the WBG will intensify its work in supporting enabling regulatory and investment environment for renewable energy and energy efficiency. To support such investments, developing and transition countries need incentives and have to level the playing field for the private and public sectors (see Box 21). Third, it will make further contributions towards developing mature, efficient, and accessible carbon markets, as described in Action Area 3. Recognizing that an ability to attract any private investment flows is necessary for a country to start attracting climate friendly investment flows, the Strategic Framework reinforces the importance of IFC's increasing focus on facilitating private sector investments to Africa and developing frontier markets.

106. In addition, the WBG will continue developing innovative applications of WBG instruments largely aimed at financing private sector pro-development investments that utilize available sources of concessional climate finance to reduce financial and other barriers to climate investments. These will include:

- *Packaging IFC or IBRD instruments with frontloading mechanisms against anticipated carbon revenues, and leveraging GEF or CIF (private window) resources to cover the incremental cost of climate investment.* The IFC and WB already have significant experience, often with the help of the GEF, in using small initial subsidies and extending credit lines to SMEs through financial intermediaries to help energy efficiency and renewable energy programs mature and become self-sustaining. More recently, the WBG has been exploring several frontloading mechanisms such as encouraging lending against anticipated carbon revenue streams that IFC is starting to lead on. IFC is further considering monetization transactions where it will provide loans against future carbon revenues with recourse only to

¹⁶ UNFCCC, 2007.

the off-take agreements. IFC is also looking to expand the structures of its quasi equity loans (C-loans) to include upside returns from carbon credits beyond 2012. Financial packages utilizing new instruments, such as the CIF and CPF, will allow extending support to investments with climate benefits at a larger scale.

Box 20: Investment Climate Assessment for Renewable Energy in India

In India, the Ministry of New and Renewable Energy (MNRE) set a guideline tariff for purchase of power by utilities from renewable generators that lapsed in 2004. Since then, state governments/regulators have stepped in to set purchase prices as well as renewable quotas. As a consequence, the incentives for renewables today depend on the accuracy of the regulators' estimation of the costs, and the future energy market within which renewables will have to compete has become more uncertain. While the Electricity Act 2003 provides a framework for the introduction of wholesale competition and open access, the details of the design of the market structures and rules are not defined and will be important for the viability of the renewable energy projects. Furthermore, with the introduction of competition, existing mechanisms for encouraging renewables, such as quotas and regulation of purchase prices may require modification of their scope or may become less applicable.

What is now required is an environment policy that takes account of costs, benefits and barriers to renewable energy in a consistent manner and creates the appropriate investment climate for renewable technologies. This calls for the regulatory and wider policy framework to adequately take account of prevailing knowledge on costs and institutional requirements for renewable energy and seek to reduce barriers and increase incentives where appropriate. Accordingly, the main objective of this study is to allow policy makers to take full account of the considerable information available on costs and other aspects of different renewable energy technologies to deliver coherent policy in this area, while facilitating involvement from a wide set of important stakeholders in the policymaking process. The study will comprise the development of a number of scenarios for government policy objectives ranging from low renewable targets to high renewable targets, according to the 11th Five Year Plan and other policy pronouncements. For each target, policy mechanisms will be set out that would help meet this range of targets in key Indian states.

Source: The WBG

- *Using IFC, MIGA, and IBRD guarantee instruments more effectively* would enable local financial institutions to offer financing at sufficient maturities for clean energy and other climate friendly investments. MIGA, which provides guarantees against noncommercial risks, is scaling up its portfolio of private sector investments into renewable energy and energy efficient projects in developing countries, with the current pipeline of over US\$ 600,000, and plans to increase the pipeline considerably in FY09-10 (see Box 21).
- *Addressing the needs of underserved clients, such as municipalities and small and medium-sized enterprises, through sub-national application of financial products.* Some of the most cost-effective opportunities for mitigation and adaptation co-benefits are located in such entities, even if the proposed investment is not driven by climate objectives. Yet, these entities may have limited borrowing capacity and may not be able to secure the central government guarantee required for MDB financing. Efforts to serve these clients could involve sub-national lending plus technical assistance with the goal of improving the creditworthiness of these entities to enable future borrowing on commercial terms. The Bank is currently piloting sub-national application of financial tools for entities which cannot access sovereign guarantee, with 10 loans planned for FY09. At least three of these projects will have climate co-benefits. Continuing with this instrument, given that the pilot is successful, will increase opportunities for supporting climate friendly development investments.

Box 21: MIGA's Support to Private Sector Climate-friendly Engagement

Through its non-commercial risk guarantees, WBG's Multilateral Investment Guarantee Agency (MIGA) has facilitated private sector engagement in greener infrastructure projects which builds renewable energy capacity, encourage resource conservation and distribution efficiency, improve sanitation, and off-set greenhouse gas emissions. Since FY90, MIGA has provided more than US\$ 2 billion in guarantees for 59 green infrastructure projects in all regions of the world. As part of environmental due diligence, MIGA's teams are also assessing the robustness to climate risks of prospective projects involving water management, such as mining and hydropower, and in particular, how these could manage likely changes in local hydrology as projected by climate models.

MIGA developed an innovative instrument to mitigate a series of risks to carbon finance project performance, including host country political risk such as administrative/regulatory decisions by the government that may affect projects' operations, expropriation, withdrawal from the Kyoto Protocol, and inability of auditors to enter the project site due to politically motivated violence. In FY06, MIGA thus provided US\$ 1.8 million in guarantees for a landfill gas flaring project in San Salvador. MIGA's guarantee helped the investor raise funds from the carbon market and assures the company of reimbursement in the event that a harmful political event puts a stop to operations. MIGA's infrastructure team is working with the World Bank to explore ways to apply this guarantee structure to similar projects.

MIGA is formulating its approach to climate change in the context of developing its three-year Strategic Directions document (FY09). Efforts are focused on scaling up operations in the field of renewable energy and clean energy. The current pipeline of the applications is of US\$ 600 million, with about US\$ 280 million of projects expected to close in FY09. One of the priorities for FY09-FY10 is to develop a pipeline of new applications for renewable and energy efficient projects. Working in collaboration with the WB staff, MIGA has identified new leads and opportunities that include:

- New hydropower development in Ethiopia
- Large hydro and mini-hydro projects in Turkey
- Hydropower IPP in Albania
- Multiple geothermal projects in Indonesia
- Geothermal projects in Kenya and Djibouti
- Wind farms in Ethiopia and Pakistan
- New large hydro developments in Lao
- New transmission projects in Latin America
- Coal/diesel replacement projects in Asia

Going forward, MIGA will further incorporate climate change concerns into its relevant activities, accelerate business development building on existing clients and targeting new players (including South-South investors), develop new products to address political and regulatory risks associated with climate change mitigation, and intensify awareness raising and capacity building around MIGA's products that could be used to support climate friendly projects.

Source: www.miga.org/climatechange

107. **Other WBG activities.** The WBG, led by IFC, will further work to build awareness of the private sector on climate change driven risks to investment and on business opportunities related to mitigation and adaptation. IFC has initiated several technical assistance-focused activities toward meeting its goal of at least doubling its clean energy investments over the next three fiscal years. In addition to growing its cleaner production program, IFC is testing the potential for using clean energy as a business development strategy, such as, using information on clean energy opportunities to suggest nontraditional sectors dominated by private business (that is, construction) in which IFC could focus its lending efforts (see Box 22). IFC will also increase its efforts to build the private sector's knowledge and capacity in other sectors – including forestry and transport – towards economically attractive low carbon projects. On the adaptation side, it is important to offer state-of-the-art tools and methodologies to help private sector clients consider the long-term impacts of climate change on investments (see Chapter 9).

Box 22: Clean Energy as a Business Development Strategy at IFC

Studies by the International Energy Agency, McKinsey Consultants, and many other experts consistently show large opportunities for profitable investments in measures to improve energy efficiency and reduce greenhouse gas emissions. These opportunities are especially large in some of the largest and most rapidly growing developing nations such as China and India, both of which have many power plants, factories, and buildings that are substantially below energy efficiency international standards. IFC has initiated a pilot study in China to test whether some of these readily identifiable inefficient industries might be the basis for a targeted lending program. This is in contrast to established programs which rely on finding incremental improvements within traditional investment sectors – e.g., adding a waste heat recovery component to an investment in a cement manufacturer. If successful, the pilot will point to sectors where IFC is not currently engaged but where its lending can contribute significantly to both development and greenhouse gas reduction.

Source: IFC

108. Finally, as a market facilitator sharing knowledge and experiences of diverse players, the WBG will convene public and private actors to dialogue on financing climate change-related activities, e.g., on incentives to stimulate investments in clean technology and climate resilient technology and further rely on PPPs. This will be undertaken in collaboration with other MDBs, IFIs, and the UNFCCC Secretariat.