At issue: Is the Bank's carbon markets approach an effective way to address climate change?

The World Bank's involvement in the carbon market is under hot debate: Janet Redman from the Institute for Policy Studies opposes its approach while Jon Sohn, from Climate Change Capital argues that there is a role for the Bank to play.

Janet Redman, Sustainable Energy and Economy Network, Institute for Policy Studies

When the World Bank entered the carbon market with the launch of the Prototype Carbon Fund in 1999, it claimed the aim was to temporarily catalyse private investment in clean, renewable energy to help stem climate-altering greenhouse gas (GHG) emissions; and prepare least developed country governments to benefit from the carbon market. Nine years and $2 billion later, the Bank is brokering a rapidly expanding carbon trading portfolio that enriches dirty industry and does little to help the 1.6 billion people living in energy poverty.

At the heart of the Bank's role in the carbon market is a serious conflict of interests - the Bank is making a commission from trying to solve a problem that it helped create, and continues to exacerbate. Between 2005 and 2007, the World Bank Group financed more than $1.5 billion worth of GHG emitting oil, gas and coal projects, despite calls from its own Extractive Industries Review (2001-2004) to get out of oil and coal lending by 2008.

At the same time, the Bank is allegedly charging an estimated 13 per cent overhead for administering its ten carbon funds. Assuming a portfolio of $2 billion, this amounts to $260 million in 'overhead costs'; a figure equivalent to one half of the funding needed to open the Adaptation Fund, a fund proposed to help poor countries deal with the damaging effects of global warming adopted at the UN climate talks in Bali in December.

As part of a market-based system, carbon finance is supposed to be guided by the 'invisible hand' to the most efficient solution to climate change. This means prioritising projects that reduce the largest volume of emissions for the least money. In reality, the Bank is channeling over $1 billion to the most polluting industries - manufacturers of industrial chemicals, coal-fired power plants, steel, cement and aluminium factories - in the global south, making them slightly more efficient and more profitable in the process.

In some cases, such as with ozone-depleting hydro fluoro carbons (HFCs), carbon credits command a higher price than the original product. Thus, the Bank finds itself in the compromising position of providing perverse incentives to both produce and destroy one of the planet's most powerful greenhouse gases. For instance it directed $10 million in carbon finance to a Chinese mining company for capturing some of the methane released during coal mining. The waste methane was "recycled" to produce a free power source at the operation site. In similar examples, the power generated has been sold back to electricity grids, providing a new income stream. These companies are under no obligation to invest the revenue in clean energy. In fact, they can use the money to expand operations, release more GHG, and sell more carbon credits for reducing it.

Despite promises at the outset to the contrary, by the end of 2007 only five per cent of the World Bank's entire carbon market activities were in wind, solar and small hydropower generation. And only one fund, the Community Development Carbon Fund, focussed funding on local sustainable energy projects. If the World Bank is going to be a major player in fighting climate change it should start by ending its own fossil fuel funding. After that, public and private finance should be directed to existing clean, renewable technologies that promote local control of energy development and consumption.

Jon Sohn, Climate Change Capital

Carbon markets are based on the concept that GHG reductions are the same in Boston or Beijing so long as reductions occur. The largest carbon market is designed to supplement domestic actions to reduce emissions under the Kyoto Protocol. To date, the main corporate and sovereign market players have been from the EU and Japan. The World Bank originally filled a void between the policy theory of carbon finance and real markets of commercial scale that we see today. Notably, it was the Bank, rather than the IFC, that facilitated a market through bilateral transactions with individual projects, challenging many internal assumptions about the Bank's role with the private sector.

The Bank first established the "learning by doing" Prototype Carbon Fund (PCF). Initially, the Bank indicated it would focus on renewables with the PCF, but that portfolio has diversified and more funds have followed. Their approach resulted in innovative projects but also, unsurprisingly given the bilateral commercial nature of Clean Development Mechanism (CDM) projects, raised public concerns regarding sustainability of some investments. In initiating the funds - normally the domain of private equity or hedge fund managers - and seeking to balance commercial demands with its mission of poverty alleviation, the Bank faced challenges. The precise volume of carbon credits produced remains to be seen, and concerns have been raised by some donor countries. However, benchmarked against a commercial bank's project finance portfolio, the Bank has obtained a degree of success regarding sustainability.

Bank funds face governance and 'additionality' concerns. Additionality requires that the project underlying the offset would not have occurred otherwise. Some stakeholders perceive a conflict of interest if the Bank "sets the rules" of the carbon market and then profits from those rules. The reality is nuanced. The Bank has no right to establish additionality rules. It experiments and takes risks, but it is a disservice to the United Nations' CDM's Methodology Board (the CDM's decision-making body) to suggest subservience to the Bank. If the Methodology Board finds a project is not "additional," there is nothing the Bank can do. There is great potential in this aspect of international law if the Methodology Board is strengthened and professionalised. Donors can also ensure that the governance of Bank carbon funds leads to accountable decision-making.

Differentiation from the private sector is a challenge. Compare the Bank with a carbon boutique: Climate Change Capital (CCC) is a leading investment bank specialising in commercial opportunities created by a low carbon economy. CCC has a number of different investment vehicles, the largest being its carbon finance funds - investing in projects that result in certified emission reductions. CCC could not mobilise fund money to engage with projects at as early a stage as the Bank. The PCF provided commercial testing that CCC and other specialists could follow and scale-up. As more private sector actors emerge, the Bank will need to innovate to be necessary. It is endeavouring to do this with the launch of the Carbon Partnership Facility. The Bank may help develop new approaches that move beyond the one-size-fits-all approach of the CDM, including avoided deforestation, sectoral crediting and policy co-financing that leads to integration of carbon value into long-term national policy decisions. The Bank can leverage its technical assistance programmes and country assistance strategies to achieve this goal.

Janet: The idea that emissions reductions everywhere are equivalent ignores the fact that projects are carried out in particular political and economic contexts. For the families that live next to the Bisasar Road Landfill in Durban, South Africa - kept open by additional funding provided through carbon finance despite community documentation of severe health impacts - not all emissions reductions are created equal. The fact is, carbon trading doesn't reduce global emissions. In the best-case scenario it holds growth of emissions levels to zero, but that scenario isn't realistic when offsets are exported to countries with no emissions ceilings and little environmental oversight.

And while the UN is ultimately in control of the fate of Kyoto Protocol mechanisms like the CDM, it depends on outside institutions like the Bank to develop the reductions methodologies that it approves for private investors. But the World Bank is not constrained by CDM approval. As of November 2007, only a third of the active projects in the Bank's carbon finance portfolio were registered with the CDM. Far from having nothing to do with the other two thirds of the portfolio, the Bank has moved ahead on projects without CDM designation. The precise volume of carbon credits produced by these projects, as well as how much buyers are spending per ton of carbon dioxide equivalent is kept confidential as part of the business agreements.

Mandatory caps on green house gas emissions with declining targets over time are critical

Instead of piggybacking on Bank research and development in the developing world, capital from industrialised countries should be directed toward building a low carbon economy at home, where the majority of the world's annual greenhouse gas emissions are generated - or toward renewable energy in the developing world.

Jon: Mandatory caps on GHG emissions with declining targets over time are the critical factor to reduce emissions. For instance, the new EU Emissions Trading Scheme phase 3 design elements require that emissions in 2020 will be 21 per cent below 2005 reported emissions. Imported credits are a limited tool to help meet those mandatory targets supplementing domestic actions. There are other important policy carrots and sticks that can help climate mitigation including both ambitious renewable and energy efficiency targets for the EU. CCC's renewable and private equity funds capitalise on such policies in Europe.

The climate change Convention recognises the principle of common but differentiated responsibilities among industrialised and developing countries. Yet climate change is a global problem and emission reductions must occur wherever possible as the Convention and Bali roadmap also recognise. Bank funds can play a role in incremental cost challenges in client countries. Private capital must address the problem globally not just "at home."

Any global path towards a low-carbon economy will undoubtedly present difficult trade-offs and environmental justice issues. Bank funds should set positive international standards with the UN role continuing. In that vein, the UNFCCC website for the Durban example indicates that no NGO stakeholder comments were submitted during the UNFCCC's 30-day public comment period mandated by international law: a missed opportunity to support community concerns at the international level. Nonetheless, carbon market actors that manage trade-offs and gain local community support for investments will lower risk and enhance reputation. Additionally, many GHG reduction projects can have co-benefits in the form of reducing local criteria pollutants such as sulfur oxides, nitrogen oxides and particulates.

Janet: The agreement reached in Bali is evidence that developing countries are, for the most part, ready and willing to reduce their emissions. However, implicit in the principle of "common but differentiated responsibilities" contained in the roadmap is the idea that industrialised countries must help pay their historical 'carbon debt' by transferring clean, renewable technology to developing countries. And while local campaigns in developing countries like the one fighting the Durban landfill can rarely access the small openings offered by international institutions for public participation, they have sparked a global movement for climate justice demanding a fair transition to a low-carbon economy that does not trade off safe, healthy communities for foreign investment.

Establishing mandatory caps with declining targets over time is inarguably the most critical step in reducing emissions. Absolutely. But a carbon trading system by definition acts like a leak in that cap by letting countries cheat every time they purchase pollution credits from a developing country that has no caps. The global total isn't being ratcheted down, in Boston or Beijing.

If the World Bank is truly going to be a player in reducing GHG emissions, it should be helping lower transaction costs for investments in clean, renewable energy in the global south, not energy intensive industry. Let's prioritise the other tools available besides trading like subsidy shifts, debt cancellation, border carbon adjustments whose revenue reverts to the country of origin for clean energy development, or a carbon debit mechanism that keeps track of the climate footprint of investments managed by the World Bank, with the debit being charged to the investors and invested in clean energy and adaptation to climate change in the poorest countries.

Jon: Emissions trading and the use of alternative compliance mechanisms are established tools to achieve emissions reductions at a lowest cost. To assert that the use of market mechanisms to achieve environmental goals is uniformly cheating takes a narrow and pessimistic view of our global challenge: taking carbon out of the earth's atmosphere.

It is true that financing emissions reductions through the CDM in countries without a cap does not provide additional reductions beyond the agreed cap; CDM is designed to meet the caps of industrialised countries more cost-effectively while accelerating and scaling up technology diffusion globally. However, there are proposals for CDM reform that involve setting progressive baselines that would result in greater net contribution to the atmosphere, i.e. by moving beyond 1:1 offsetting. CCC supports these proposals as a desirable evolution in carbon finance for developing countries that have the technical capacity (e.g. data gathering and monitoring) to deploy these more advanced policy tools but are not yet ready to take on hard caps.

The Bank can help by piloting work to reduce GHG emissions at the sector level in partnership with interested client countries. Many Bank clients are interested in carbon finance and in addressing climate change in their economic development strategies. Without question a good deal of this interest comes in the context of developing renewable energy capacity. Yet most agree it also requires an economy-wide approach. As prioritised by the Bali roadmap, innovative ideas with respect to technology transfer are also a key issue to address. Given the long-term nature of our challenge, we will need as many arrows in our quivers as possible to ensure global emissions are reduced to necessary levels.

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Hamlyn House, Macdonald Road, London N19 5PG, UK
Tel +44 (0)20 **7561 7610**
info@brettonwoodsproject.org
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