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Are capital flows from Europe climate proof?

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Introduction

The close of the negotiations for a new global climate treaty in Copenhagen is only weeks away. To keep the average global rise in temperature to 2 degrees Celsius as compared to pre-industrial levels, CO₂ levels should remain below 450 parts per million. This maximum level is required to avoid the most serious climate change impacts. In order to achieve this, global greenhouse gas (GHG) emissions must reach their peak soon, and fall by at least 80% worldwide by 2050 in comparison with 1990 levels.

At the same time, due to historic and current emissions, the climate is already changing and poor people in poor countries are suffering most from its impacts. Yearly, 325 million people are seriously affected by climate change². Following the *polluter pays* principle, industrial countries will need to pay part of the bill of poor countries to deal with these climatic changes³.

The European Union (EU) claims to take a leading role in the negotiations. In 2007, it has committed itself to a 20% cut in its GHG emissions below 1990 levels by 2020, and is ready to scale up this reduction to 30%. It has also set itself the target of increasing the share of renewables in energy use to 20% by 2020⁴. Furthermore it has committed itself to mainstreaming climate change in other policy areas, including its external policies. However, in the run-up to Copenhagen, the EU has received increasing critique that it is not living up to the expectations raised. It has made its commitments for more ambitious CO₂ reduction conditional to the outcome of Copenhagen, and refrains from committing to specific funding levels to assist developing countries in responding to the impacts of climate change⁵.

Meanwhile, as the climate negotiations unfold, key European financial institutions such as the European Investment Bank (EIB) and European Export Credit Agencies (ECAs) continue to support investments in developing countries in fossil fuels, large scale infrastructure and highly energy-intensive industries. Although they are public institutions, the EIB and ECAs thus back projects which undermine EU climate policies by stimulating GHG emissions and decreasing the adaptive capacity of the local population in countries that are highly sensitive to climate change. How can these capital flows from the EU be harmonised with its climate change ambitions?

2 Global Humanitarian Forum, The anatomy of a Silent Crisis. Human Impact Report Climate Change, Geneva, 2009, p.1 (ghfgeneva.org/Portals/0/pdfs/human_impact_report.pdf)

3 According to preliminary findings of a new global study from the World Bank the costs of adaptation to climate change in developing countries will be in the order of US\$75-100 billion per year for the period 2010 to 2050. See <http://beta.worldbank.org/climatechange/content/economics-adaptation-climate-change-study-homepage>

4 http://ec.europa.eu/environment/climat/climate_action.htm

5 The recent EU summit in Brussels did result in an acknowledgement of the need for an annual €100 billion towards climate mitigation and adaptation in developing countries, of which 22-50 billion should be paid by rich countries, and a commitment to contribute a 'fair share' of this amount. It failed however to put a clear figure on EU's contribution and internal conflict over the amounts to be taken on by Member States continued (NRC Handelsblad, 31 October 2009, Regeringsleiders akkoord over klimaat, http://www.nrc.nl/buitenland/artice2401578.ece/Regeringsleiders_akkoord_over_klimaat)

Climate change and sustainable development

An important question in the climate change debate is how to pursue objectives of economic development and climate policy at the same time. On the one hand, climate change is a serious threat to sustainable development with adverse impacts on water availability, food security, human health, etc. On the other hand, unsustainable development policies increase the vulnerability of ecosystems and people, hamper their ability to adapt to climate change, and may stimulate increases in GHG emissions.

The development path taken by developing countries in the world is a crucial factor in the expected future rise of GHG emissions. The 2008 World Energy Outlook report of the International Energy Agency (IEA), projects that 97% of the increase in world energy-related CO₂ emissions from 2006 to 2030, will come from poorer countries⁶. In fact, according to the IEA, if the current trend of increasing carbonisation of new energy sources in the developing world continues, the OECD (Organisation for Economic Cooperation and Development) nations could reduce their emissions to zero by 2030 and the planet would still overshoot irreversibly past the point of no return for climate disaster.

While it is essential that industrialized countries seriously reduce emissions, developing countries need to follow suit *and* need to reduce their vulnerability to the impacts of climate change already happening. A recent World Watch Institute report states that 'developing countries have the potential to "leapfrog" the carbon-intensive development path of the 20th century and go straight to the advanced energy systems that are possible today'⁷. While improved technology and high energy prices have created a favourable market for new energy systems, reaching a true economic tipping point will require innovative public policies and strong political leadership.

Climate change policies of the EIB

The EIB is one of the largest financial institutions in the world. In 2006 alone, the EIB approved loans totalling €53.4 billion worldwide, compared to the World Bank Group lending a total of €18.5 billion⁸. Since the 1970s, the EIB is increasingly providing loans to developing countries. The EIB lent €6.1 billion in developing countries in 2008⁹ and is expected to further increase its total lending volume by some 30% in the next few years.

The EIB announced in 2008 that long-term financing of investment aimed at combating climate change is one of its priorities¹⁰. In concrete terms, its commitment entails the EIB's participation in a number of global carbon funds and in the development of a carbon footprint methodology to assess its project portfolio. The carbon funds however mostly focus on developing the carbon market and supporting carbon credit generating projects, to help European countries and companies in the EU Emissions Trading Scheme to meet their emissions reduction targets under the Kyoto Protocol, thus off-setting domestic

⁶ International Energy Agency, 2008, *World Energy Outlook 2008*, Paris, OECD/IEA, <http://www.iea.org/weo/2008.asp>

⁷ World Watch Institute, *World Watch Report: Low Carbon Energy: A Roadmap*, 2009 <http://www.worldwatch.org/node/5945>

⁸ EIB Counterbalance, Basic facts about the European Investment Bank, http://www.counterbalance-eib.org/component/option.com_datsoqallery/Itemid,86/func_detail/id,71/

⁹ EIB, 2009

¹⁰ <http://www.eib.org/projects/events/klimaschutz-finanzieren.htm>. The EIB's approach to mainstreaming climate change in its investment portfolio is described in "The EIB Statement of Environmental and Social Principles and Standards" of 2009. (See http://www.eib.org/attachements/strategies/eib_statement_esps_en.pdf)

reductions. For 2009, the EIB planned to calculate the carbon footprint of 40 to 50 carbon-intensive projects under appraisal. The results of this calculation, however, have to be awaited as they will be published in 2010 at the earliest.

Climate change policies of ECAs

ECAs are public agencies that promote export by providing government-backed loans, guarantees and insurance to domestic private corporations that seek to do business overseas. ECAs are now the world's biggest class of public financial institutions, collectively exceeding in size the World Bank Group, and funding more private-sector projects in the developing world than any other class of financial institutions¹¹.

ECAs of the industrialised countries have agreed to common principles on environmental and social impacts of the activities they support¹². These so-called Common Approaches are voluntary guidelines and are to be operationalised at the national level. A key feature of the Common Approaches is that all applications for officially supported export credits for projects with a repayment term of two years or more should be screened on potentially adverse environmental impacts. Climate change or CO₂ emissions of guaranteed projects are however not mentioned in the Common Approaches. The only ECA to adopt a climate change policy as yet is the Export-Import Bank of the United States. While its recent Carbon Policy¹³ may not be very ambitious, it does mark a first step and provides an example for European ECAs to take climate change seriously.

Currently negotiations are ongoing at the OECD on a joint policy guidance for ECAs to integrate climate change considerations in their policies. There are serious dangers that these negotiations result in support of expensive technologies that aim for cleaning up fossil fuel based activities, without promoting necessary steps to advance energy conservation efforts. A precedent in this regard is the so-called Sector Understanding Renewable Energy and Water Sector Projects that was adopted at the OECD in 2006, and revised and further extended in June 2009. This Sector Understanding includes favourable terms for renewable energies. The agreement includes large dams as renewable energy. This is a highly contested issue, given that large dams are well known to have severe social and environmental impacts of their own, with research showing that they can directly contribute to climate change via the release of the greenhouse gas methane¹⁴.

EIB and European ECAs in practice

The EIB is the fifth largest international financier of coal-fired power plants over the last 15 years with a total investment of US\$ 2,511 million. The ECA support for European investments in coal-fired power plants taken together is about double this amount, with Germany leading¹⁵. This dwarfs the amount that has gone to mitigation of GHG emissions over the same period. Half of all new GHG-emitting industrial projects in developing countries have some form of ECA support.

¹¹ <http://www.eca-watch.org/>

¹² In alignment with the *Arrangement on Officially Supported Export Credits*, facilitated by the OECD, See for latest revision from February 2009: http://www.oecd.org/document/42/0,3343,en_2649_34171_40898090_1_1_1_1,00.html

¹³ See http://www.exim.gov/products/policies/environment/carbon_policy.pdf

¹⁴ <http://www.internationalrivers.org/node/1398>

¹⁵ Environmental Defense Fund, *Foreclosing the future; Coal, Climate and Public International Finance*, 2009, www.edf.org/documents/9593_coal-plants-report.pdf

A significant portion of EIB and ECA project financing in developing countries is concentrated in sectors that have important implications for climate change: transportation, infrastructure, aircraft sales, and energy-intensive manufacturing such as petrochemicals, pulp and paper, and iron and steel. A screening of the EIB projects in the pipeline in African, Caribbean and Pacific (ACP) countries shows that several of the proposed megaprojects with total costs above €100 million will be major contributors to increased GHG emissions. Middle-sized projects vary in climate impacts and inter alia include extension and refurbishing of transmission lines which potentially increases the use of electricity. Projects with positive impacts, such as wind farms, are relatively scarce and small.

The picture is partly different for the Asian and Latin American (ALA) countries, where the EIB has several projects under appraisal specifically aimed at mitigating climate change, including generation of renewable energy and energy efficiency measures. However, at the same time it is funding the production of Volkswagen cars in India and Argentina and wholesale stores in Vietnam.

The EIB claims that in the past year, it has provided loans worth €8 billion for financing of investment aimed at combating climate change, including €2 billion for renewable energies¹⁶. Renewable energy however, here again, includes disputed activities such as large hydropower and investments in biomass projects. The EIB is involved in controversial major hydropower projects like the Nam Theun-II dam in Laos, the Lesotho highlands water project and the Bujagali dam in Uganda. The Bujagali dam, for example, may not only contribute to climate change due to methane emissions, it will likely produce much less power than projected (contributing to higher electricity prices) due to climate changes in the region. Less rainfall combined with the need to feed hydropower plants with water lead to serious lower water levels in Lake Victoria and impact downstream Nile river flows, thereby challenging the conviction that large hydropower is the most viable energy alternative for Uganda¹⁷.

As for the European ECAs, Atradius Dutch State Business (DSB), the Dutch ECA, for example, has insured the total amount of €7.6 billion from 2002 to 2009. Among all the transactions Atradius DSB has supported, the construction and shipping industry sectors amount to 38% and 31% respectively¹⁸.

Most projects in the construction sector are dredging works in the Middle-East. Dredging for oil pipelines also comprises a significant portion of the portfolio¹⁹. In the shipping sector, Atradius DSB supported approximately 60 projects in the last 8 years. While more than 20 transactions were valued more than €10 million each, only 10 have been subjected to an environmental impact assessment (EIA). The remaining transactions relate to the defence sector, and therefore do not have their environmental impacts screened by Atradius DSB.

The construction/dredging sector and the shipping sector substantially contribute to the global emissions of GHG. The shipping sector pollutes far more than the

¹⁶ <http://www.eib.org/projects/events/klimaschutz-finanzieren.htm?lang=-en>, Entry of 5 June 2008

¹⁷ Case study by National Association for Professional Environmentalists (NAPE), The role of EIB and ECAs in Bujagali dam (Uganda) and Gibe III (Ethiopia), October 2009

¹⁸ Beleidsdoorlichting exportkredietverzekering en investeringsgaranties. Periode 2003-2007. Carnegie Consult. 2008. Overzicht van afgegeven polissen. Atradius DSB. Available at: <http://www.atradius.com/nl/dutchstatebusiness/overheid/afgegevenpolissen/>.

¹⁸ Shipping: The greening of the ocean waves.

¹⁹ Atradius polissen. Atradius DSB. Available at: <http://www.atradius.com/nl/dutchstatebusiness/overheid/afgegevenpolissen/>

aviation sector, reaching 4,5% of the global CO₂ emissions²⁰. One therefore may conclude that Atradius DSB's project portfolio seriously contributes to advancing greenhouse gas emissions, raising a challenge for this ECA to review its portfolio bearing climate change in mind.

Policy recommendations

A decisive reorientation of investments away from carbon intensive activities is necessary to avoid irreversible global warming trajectories. Political choices are needed for a new economic model, decoupling economic development from GHG emissions and redirecting public finance along climate friendly development paths.

In 2007 and 2009, the European Parliament²¹ and the G20²² respectively made clear statements to no longer use public money to support fossil fuel based development. As public institutions, the EIB and the European ECAs need to act upon these calls. They can play an important role in promoting the needed transition to a low carbon future. At the very least, their policies should be consistent with EU climate policies, to ensure policy coherence in the public sector. We urge the EIB and ECAs to elaborate policies on:

- Adoption of a transparent GHG accounting system;
An emission accounting system is crucial to compare the emissions with reduction targets and for a strategy to phase out public support for GHG emitting activities. The expected CO₂ emissions of all projects and aggregate data should be systematically documented and published as part of the EIB and ECAs annual reports.
- Phasing out of GHG emissions by setting clear reduction targets;
Clear reduction targets should be set for the short and long term. Investments in projects with large GHG emissions need to stop, while alternatives need strong support.
- Increased support to energy efficiency;
It is crucial to use public finance for scaling up investments in energy conservation measures. The EIB and ECAs should undertake specific efforts to make state of the art energy efficiency and conservation technologies available for application in developing countries
- Inclusion of climate change considerations in screening of projects;
Climate considerations should be included in environmental screening and assessment processes as part of the safeguard policies of the EIB and ECAs. Carbon footprints (now externalised social and environmental cost of carbon emissions) should be factored into project costs as a 'shadow' price, as part of cost-benefit analyses, to compare the investments with low-carbon alternatives. It should be guaranteed that project support does not increase

²⁰ Shipping: The greening of the ocean waves. Available at:

<http://www.telegraph.co.uk/earth/3347807/Shipping-The-greening-of-the-ocean-waves.html>.

²¹ In 2007 a resolution on trade and climate change of the European Parliament called on all EU governments to propose legislative instruments that force ECAs and EIB to take climate change considerations into account and to impose a moratorium on funding until sufficient data are available. (<http://www.europarl.europa.eu/sices/getDoc.do?pubRef=-//EP//TEXT+TA+P6+TA-2007-0576+0+DOC+XML+V0//EN&language+EN>)

²² Recently, in the statement resulting from its summit in Pittsburgh in September 2009, the leaders of the G20 agreed to phase out and rationalize inefficient fossil fuel subsidies over the medium term while providing targeted support for the poorest. They also committed to stimulate investment in clean energy, renewables, and energy efficiency and provide financial and technical support for such projects in developing countries. (http://www.g20.org/pub_communique.aspx)

vulnerabilities of people or sectors in host countries and thus decrease their adaptive capacity²³.

- Inclusion of climate change considerations in risk assessments; Risk assessments need to include screening whether climate change poses threats to the feasibility and performance of investments.
- Refraining from supporting projects that include elements of trading emission rights; Carbon markets pose serious threats to the integrity of emission reduction policies. Also the nature of CO₂ emission rights being a kind of derivatives poses threats to the stability of international financial markets. It is therefore essential not to promote the off-setting of emission reductions that rather should be realised domestically within the EU.

Role of Both ENDS

Both ENDS aims to put sustainability and the fight against poverty high on the agenda within the world of international funding. It closely monitors the policies and investments of large international financial institutions, such as the World Bank, regional development banks and the EIB, and supports Southern CSOs who see their local constituencies' livelihoods threatened by large scale projects financed by these financing institutions.

Both ENDS is an active member of Counter Balance, a newly formed European coalition of non-governmental organisations aimed at challenging the EIB. Both ENDS monitors the activities of the EIB by participating in research, analysis and lobby at a European and Dutch level, and plays a key role in the connection with organisations in the South. Both ENDS is also member of the international ECA-Watch network, which aims to reform the ECAs and reduce environmental and social impacts of ECA backed projects.

With regard to climate change, Both ENDS' focus lies on the support and up-scaling of local adaptation strategies, and contributing to the debates on the financing of effective climate policies, and the climate proofing of (development) policies and investments.

²³ For example investments in eucalyptus plantations which deprive people of their access to water resources, case study by GAMBA, *The role of EIB in the Veracel pulp mill in Brazil*, October 2009.