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Governing Clean Development: Bringing in the Politics

Why does governance matter?

***Whether* we are collectively able to bring about a transition to a low carbon energy future and *how* we might do so is first and foremost a question of politics. Institutions, policy-making processes and the nature of politics are central to societies' ability to set priorities, manage trade-offs and address conflicts in a prevailing context of inequality and uneven development.**

It may seem strange to some people that carbon markets, energy finance and carbon finance need governing. Aren't carbon markets meant to operate without government intervention and regulation? Doesn't finance seek out the best available investment opportunities without the help of governments?

The first thing to remember is that **all markets are based on politics and institutions**. Someone has to set them up, define the rules and procedures by which they will function and allocate property rights. How that is done has big implications for whom markets serve and how. As we have seen with the Clean Development Mechanism (CDM) to date, left to their own devices many investors will seek out the lowest cost abatement opportunities which often bring few sustainable development benefits. Rules have to be agreed about which sectors and methodologies are acceptable and which criteria have to be met to safeguard the credibility of a market which was set up as a way to reduce emissions.

Of course politics and institutions are not the only things that matter. The availability of finance and technology are also critical. But **we cannot escape the importance of questions of who governs finance and technology and on whose behalf**. Whether it is at the national, regional or global level, decisions about carbon finance and technology affect who has access to which energy (*whose energy needs count*) and on what terms (*who pays for it and how it is distributed*).

The Governance of Clean Development: CDM and Beyond

As discussion moves forward about reform of the Clean Development Mechanism and the need for new forms of regulation of carbon markets and climate finance, attention to governance issues has never been greater. But what do we know about the governance of clean development, about when, how and for whom it works?

This briefing highlights emerging insights from a research project on The Governance of Clean Development: CDM and Beyond. *It identifies a series of key issues that need to be addressed if governance is to be made to work for the climate and development.*

Governing markets

"Those who assume that the carbon market is purely a private market miss the point that the entire market is a creation of government policy. Moreover, it is important to realize that, to flourish, carbon markets need a strong regulator and approach to governance. This means, for example, that the emission reduction targets must be ratcheted down over time, rules about eligibility of carbon credits must be clear etc. Also, carbon markets need to work in concert with other policies and measures since not even the most ardent market proponents are under any illusion that markets alone will solve the problem".

Abyd Karmali, MD, Global Head of Carbon Markets, Merrill Lynch

How does governance matter?

Governance can refer to many things from '**good governance'** (transparency, accountability and the rule of law) to '**global governance'** (the role of international institutions) and **'private governance'** (the role of voluntary standards and forms of regulation by private actors). Each has a role to play in governing clean development and especially with respect to energy, but the links between them need to be better understood if we are to ensure that they both bring down greenhouse gas emissions and deliver sustainable development. Aspects of governance which are often crucial include the following:

• **Participation** or exclusion from decision-making: who sets priorities about energy and how? Who participates in consultations on CDM projects or around World Bank investments? This has a huge impact, for example on whether host communities are able to capture benefits from projects or on the sustainability of an energy path a country chooses.

• The existence of not of mechanisms of **accountability** for decisions taken. Who is answerable to whom and the means that exist for redress have a significant impact on the transparency and fairness of decisions on energy policy and carbon finance projects.

• **Transparency** of decision-making is crucial for trust and credibility. Trust that there are not conflicts of interest, as sometimes occur between those approving CDM projects and those promoting them; and credibility around the processes for establishing that additionality and sustainable development criteria have been adequately met. Unfortunately there are many cases of double-counting, dubious additionality and the operation of a revolving door between actors that are meant to be fully independent of one another.

• Questions of **institutional capacity** to handle carbon and energy finance and ensure it benefits the poor. Capacity to evaluate proposals for projects and to monitor their social and environmental performance are key to determining who gains and how.

• **Policy space** to assert and defend national development priorities in the face of pressure from international institutions. The power countries have to set the terms of their relationship with other governments, institutions and the private sector will shape decisively *who wins* in terms of access to energy or carbon finance and on *what terms*. Policy space can also refer to how much attention is given to competing domestic policy objectives. Tackling energy poverty through sustainable energy often gets squeezed out by more powerful

The importance of buy-in

Despite support from REEEP (the Renewable Energy and Energy Efficiency Partnership) to identify and overcome barriers to Argentina's vast renewable energy potential, a lack of government buy-in has meant that governance barriers have not been addressed. The Indian government, on the other hand, has set up a National Solar Mission and sought to promote the development and export of renewable energy technologies as a key growth strategy.

Whose voice counts?

Our research has found that many consultations over proposed CDM projects provide few opportunities for real engagement about the nature of the project or the way in which host communities might benefit or be affected. There are also indications that Clean Technology Investment Plans for the World Bank have so far had limited civil society engagement.

A question of capacity

Our research reveals that many governments, by their own admission, are not in a position to verify the claims made by project developers about the sustainable development benefits that CDM projects will bring. This represents an important governance gap that has to be addressed to ensure that CDM projects both reduce emissions and deliver social benefits.

actors and agendas around energy security or energy for industry.

- How key actors in the governance of clean development handle issues of **policy coherence.** Carbon finance is currently of negligible significance in shaping energy policy. Energy policy is profoundly shaped by policy in areas such as trade, industry and agriculture and the energy needs and political interests of those sectors. This means that the benefits of carbon finance for clean energy are often undermined by business as usual decision-making in other areas of energy policy.

- **Policy coordination** among departments with competing mandates and interests is not just an issue for governments. The growing number of international institutions and initiatives active in the area of clean development means issues of duplication and comparative advantage arise, and need to be resolved if funds are to be used in the most effective manner.

- The existence of **robust political coalitions** with an interest in clean energy. Many government ministries depend on and have close ties to energy interests that benefit from large subsidies and other forms of state support and are threatened by the prospect of scaling up investments in clean energy. Building change-oriented coalitions also needs to be balanced with efforts to challenge the power of sectoral interests attached to conventional forms of energy.

For whom does governance matter?

If carbon and energy finance is to realise its potential to tackle forms of (energy) poverty, which it must if it is to both engage developing countries and to facilitate the sorts of low carbon transitions that are required the world over, **it has to serve the needs of the poorest people**. This is true not only at national level, but also at the international level among institutions charged with tackling poverty. The World Bank's new Energy Strategy provides an important opportunity for the institution to define for itself a unique role in financing clean energy for the poor rather than seeking to compete with existing public and private funding streams for conventional forms of energy which are supported by other sources of finance. Identifying the needs of those people and ensuring their concerns are adequately represented and acted upon means **re-thinking the governance of clean development to become more inclusive, equitable and transparent**.

Policy space

While a country that is attractive for investors such as China has been able to use taxation to incentive investments in energy sectors where they are most wanted, many other countries cannot afford to impose conditions on investors. Common standards or minimal sustainable development requirements might provide greater guarantees that all countries are able to capture social benefits from carbon finance.

Addressing incoherence

In the absence of higher levels of coordination and coherence among international institutions, there is a real danger that efforts to de-carbonise economies and support clean energy are actively undermined by business as usual lending patterns of multilateral development banks and conventional investment strategies of private investors. If governments choose to, there are a suite of policy levers they can use to screen finance to ensure it supports low carbon development. The case of the World Bank loan to South Africa for the Medupi coal-fired power station highlights , however, the governance challenge of reconciling competing demands for responsiveness to recipient countries, accountability to civil society, and donor control over how funds are spent.

Addressing coordination challenges

There is a need for some rationalisation and refocusing of governance initiatives in the area of clean energy. Where a number of initiatives exist with similar policy objectives, such as with REN21, REEEP and IRENA, it makes sense to agree a division of labour by scale, region, technology or type of financing offered to ensure that they are complementary rather than overlapping.

Learning from the Past

There is a real danger with carbon finance, whether through the CDM, the World Bank or one of the many other initiatives in this area, that we fail to learn previous lessons about the governance of aid and finance. This suggests the importance of:

***Stable and predictable flows** of finance. This will be critical for restructuring economies towards low-carbon pathways of development.*

***Governance structures** that ensure the fair and effective dispersal of new forms of climate finance. These have to be transparent and perceived as legitimate by key stakeholders.*

***Independent evaluation** must be instituted from the start to ensure effectiveness and generate trust between contributors and recipients.*
This means building on the lessons of past overseas development assistance (ODA) and creating independent monitoring organisations.

***Capacity** to absorb, allocate, distribute and monitor funds needs to be enhanced or in some cases built.*

See *Billions at Stake in Climate Finance: Four Key Lessons* IIED Briefing. Download the PDF at **www.iied.org/pubs/display.php?o=17075IIED**

There is now a great deal of experience around the world in innovative ways of **involving citizens in deliberation and decision-making processes** where complex social choices regarding technology choices and developmental strategies are required. The potential of these tools and strategies urgently needs to be explored in the energy sector to ensure popular understanding and support for difficult policy choices between competing energy paths, each with very different consequences for energy poverty, energy security and climate change.

Getting governance right

There are clearly **many different ways of governing clean development and energy**. No one approach is appropriate or desirable for all countries with different governance systems and facing distinct energy challenges.

But if the starting point is reducing greenhouse gas emissions as fast as possible while delivering as many social benefits as possible, then governance, for all the reasons outlined here, is central. **Effective, capable, accountable and just institutions are the only ones that can provide the form of steering, conflict resolution and broad societal engagement that are necessary to delivering clean energy.**

What is currently lacking in many governments' policies is a **joined up, coherent** and **pro-active clean energy strategy**: one which aligns key policy goals (whether they be energy security, energy poverty or sustainable energy) with available sources of finance and political support. Some of these may come from projects of programmes conducted through the CDM. Many more may come from regional and multilateral development banks like the World Bank. Others still may seek to tap into one of the many public-private partnerships and initiatives which seek to reduce barriers to and enable finance for clean energy such as REEEP, REN21 and the Asia Pacific Partnership on Clean Development and Climate, for example.

Whether markets in carbon and carbon finance form part of responses to the multiple challenges of climate change, energy poverty and energy security will depend on how well they are governed, *by whom* and *for whom*. It is not an exaggeration to say, therefore, that **unless we get the governance right, clean development and clean energy will remain a distant prospect**.

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