Notes from the field

Governments as referees for low-carbon development

María José Gutiérrez
e: mjgutierrezm@gmail.com
The University of Oxford, MSc Environmental Change and Management

This briefing is one of eight produced by Masters Students in receipt of CDKN Masters Award Funding and published on the CDKN Website. The Briefings can be found at www.cdkn.org.

Key Messages

- A case study from Costa Rica shows that financial incentive mechanisms to reduce greenhouse gas emissions are feasible and can be greatly enhanced by strategic alliances.
- Governments need to be referees and coordinators to promote the fair and inclusive involvement of different stakeholders from the outset.
- Government policy and regulation to steer action at an early stage can embed good practice and ensure the integrity of actions and achievements over the longer term.

National efforts to reduce carbon emissions are increasing as a result of initiatives by governments and other actors in the public and private sectors. But evidence suggests that governments may be lagging behind, while the private sector forges ahead. Insufficient government policy and regulation does not prevent early action, but it does result in the rise of ad-hoc and decentralised sets of standards for emissions accounting, carbon neutrality labelling and the use of certification. This could undermine later government efforts to enforce regulation, and reduces confidence that the actions already being undertaken by the private and public sector have environmental integrity, such as declaring carbon neutrality, product labelling or producing carbon credits from reforestation and avoided deforestation.

Rather than attempting to block early action, governments must encourage it, acting as referees and coordinators to bring stakeholders on board, monitor the fairness, relevance and appropriateness of the standards being set, and facilitate collaboration to build a low-carbon economy.

In Costa Rica, for example, the Government has issued a standard to certify carbon neutrality as a result of early action from the public and private sectors and the need for regulation. This Policy Brief reviews a plan by the Banco Popular – one of Costa Rica’s early actors – to introduce an innovative mechanism to encourage emissions reductions, drawing lessons for a future government leadership role to enhance potential results.

The emissions trading landscape

The need to shift to a more sustainable model of development is widely acknowledged, with climate change seen by some as an example of the free market failing to account adequately for the impacts of human behaviour. Emission trading is, at present, the most common solution to this problem and is a useful tool to help countries meet emission reduction targets set under the Kyoto Protocol. However, as we approach the deadline for these targets, and in the absence of any international agreement on future targets, the landscape of emission trading is changing. King suggests that "[t]he lack of a truly international agreement on climate change is driving the creation of a wide variety of mandatory and voluntary programmes […] around the globe" (King, 2011, p.17).

The recent progress of the Clean Development Mechanism (CDM), the best-established international emissions trading tool to date, has encouraged emerging parallel initiatives at national levels, with developing countries using market-based approaches to achieve set mitigation targets. Figueres (2011) comments that, although these efforts are valuable, there are risks of growing differences in accounting and methods given the absence of regulation and a normalised structure between countries or states, which could undermine the aggregated global results.

Box 1. Costa Rica: part of the Latin America 'laboratory' for low-carbon lessons

Carbon productivity is a measure of carbon emissions per unit of GDP – a measure of how 'clean' a country's development is. Latin American countries have among the best carbon productivity values worldwide and are "showing unprecedented willingness to experiment with low-carbon growth models" (Araya 2011, p.3). They represent an interesting 'laboratory' from which we can draw some important lessons.

Costa Rica is a useful case study because:

- a national carbon market is emerging in response to the carbon neutrality goal set by the government for 2021
- the limited applicability of existing methodologies and restricted resources require creative new approaches
- it is a developing country with high carbon productivity
- different stakeholders wish to promote low carbon activities.

Costa Rica has the best carbon productivity value in Latin America after Uruguay – close to that of the United Kingdom. Yet it has failed to participate in international framework emission trading schemes, partly as a result of the high standards, costs and scale of the process.

Many opportunities for emissions reductions remain unexploited. For example, Costa Rica's transport sector contributes 63.5% of its emissions (Camacho, 2011), yet only 0.4% of expected Certified Emission Reductions until 2012 can be attributed to this sector (UNEP, 2011). There is therefore, a need for the national Government to play a more active role in stimulating carbon market development.

A lack of policy does not prevent action

Costa Rica's interest in low-carbon development has been made explicit by government policy-makers in both written statements and public speeches. However, while there are some efforts towards implementation, there is a lack of clear guidance for action in both the public and private sectors. Despite great potential, many opportunities for emissions reductions remain unexploited (Box 1).

The director of the Climate Change division within the Ministry of Environment, Energy and Telecommunications, William Alpízar, has stressed the need for national climate change policy to drive behavioural change, and to provide a solid basis for legislation at multiple levels (Alpízar, 2011). Current initiatives, for example in businesses, would benefit from support from policy-makers, with the Government playing a more active role in facilitating the transition to a low-carbon development model.

If the national targets of carbon neutrality and the implementation of a Climate Change National Strategy set by the Government are to be met, stakeholders such as industrialists, transport service providers, agribusiness constituencies and financial entities must have a clear role to achieve success. Clarity on roles will also help to avoid duplication of efforts and inconsistency between sectors and make it easier to absorb tasks from players unfit to manage them adequately. Several businesses, mainly in the private sector, want to become carbon neutral. Indeed, some have already declared themselves carbon neutral without adhering to any nationally accepted standard or measurement.

Policy-makers have shown their intention to address these issues through control tools, a registry of initiatives and advances, and legislation. However, failure to match these intentions with urgent action will make it harder and more expensive to correct embedded practices at a later stage, and to assure the integrity of the actions already taken. Early action is both a challenge and an opportunity for governments, as there is strong involvement from private and public sector actors in shaping the climate action regulatory scheme – those that are the scheme's current or future users. For example, verification companies are eager for governmental institutions to define requirements for their accreditation process under an emerging national carbon neutrality scheme. While their involvement aids the progress of the definition process, it can also represent a conflict of interests, as those to be regulated influence the regulation scheme itself.

The Government of Costa Rica does see the need to regulate. A national standard to certify carbon neutrality (INTE 12-01-06:2011) has now been established, setting guidelines and requirements for a Management System to Demonstrate Carbon Neutrality (C-Neutrality), based on current international standards such as ISO 16064 and the GHG (greenhouse gas) Protocol. This is a welcome first step, but does not negate the need for a defined structure to accompany it.

Box 2. Innovation by the Banco Popular in Costa Rica

Costa Rica's Banco Popular is a development bank that aims to contribute to the country's environmental goals. It is the country's second biggest in terms of assets and the most accessible to all socio-economic classes. In July 2010 the bank released a green credit line that offers better terms for environmentally friendly investments. Like many businesses, it also wants to be carbon neutral.

The bank plans to account for the emissions reductions resulting from these green investments to produce carbon credits. These would, first, offset the bank's remaining emissions after internal mitigation actions. Second, excess carbon credits could be sold for additional revenue. Third, the bank would then use these revenues to improve green credit terms.

An evaluation of 13 possible Banco Popular projects calculated their potential revenue from carbon credits and the reduction of the monthly fee the client would pay for a loan to execute the project. The evaluation confirmed the feasibility of carbon credit generation through this mechanism (Gutiérrez, 2011). There is potential for emission reductions beyond the bank's own offsetting needs, as well as interest from businesses wanting to neutralise their operations through purchasing these credits. However, the revenue from the carbon credits would be insufficient to reduce loan fees significantly. In all 13 cases, the contribution would not amount to even 10% of the monthly fee. The revenue generated would probably be better used by the bank to improve client services and technical capacity.

Successful implementation of the mechanism would, however, generate more than financial benefits: "…a differentiated interest rate is an educational element for the consumer and is also an element that pinches the companies to produce highly energy-efficient things because people will buy them with better rates" (Polimeni, 2011). The mechanism has great potential to encourage behavioural change for low-carbon lifestyles, from individuals to companies, as it allows the incorporation of small-scale actions into carbon markets and acts as a trigger for the emerging national market.

Lessons from the Banco Popular initiative

Costa Rica's Banco Popular plans to develop an accounting mechanism to promote low-carbon investments and produce carbon credits from existing small-scale actions (Box 2). This is an example where the actions of an influential stakeholder could incentivise emissions reductions at a fairly large scale and encourage emerging national carbon markets. While the general public and clean-technology providers support the concept of mainstreaming cleaner technologies, they need financial incentives and/or financial credit with favourable terms. An evaluation of the proposed Banco Popular mechanism finds that, although it is feasible to provide some financial support for clean development initiatives, "the bank can only go so far by itself" (Li, 2011).

The Banco Popular is unusual in that its public nature, coupled with a strong focus on socio-economic development and environmental goals, allows it to sacrifice profit to offer more favourable terms for green loans. These loans act as an incentive for borrowers to invest in low carbon activities and are independent of the bank's commitment to offset its own emissions internally.

The additional mechanism being proposed to offset emissions and produce carbon credits is likely to be effective, as it builds on what already exists. An analysis of the bank's plans (Box 2) finds that the mechanism would indeed be feasible and could create benefits beyond the financial sphere. However, the mechanism's financial capabilities are limited and need to be enhanced and broadened through the participation of other stakeholders and the formation of key alliances.

These potential alliances include the donation of funds from global institutions interested in supporting the initiative financially, thereby allowing it to function properly with adequate human and other resources dedicated to the project. Alliances could also emerge from independently profitable schemes such as that proposed with an electricity distribution company (CNFL), which involves the payment of more efficient appliances through the savings they themselves generate.

The analysis of the Banco Popular plan also shows the heavy responsibilities that often fall on those who are first to act. Because the Government has not set the rules of the game (the policy and regulations), players such as the Banco Popular must create their own rules, balancing cost-effectiveness with the need to set standards rigorous enough to be accepted by future regulations. While the bank faces some practical challenges and additional costs in going ahead without defined formal rules, the many benefits include: an enhanced public image; a head start on the competition; a chance to adopt the most convenient rules; and developing key alliances to stimulate future changes and profits.

Interesting models can be developed if space is provided for collaborative creativity. For example, the bigger investments that are more likely to be made by wealthier groups could help to cover the higher transaction costs of smaller developments. Another possibility would be to encourage competition between private companies for emission reduction innovations, with a financial reward in exchange for rights over the carbon credits produced. The bank could also offer loans for electric vehicles with tax breaks from the Government, if emission reductions are properly documented.

In short, creativity is essential, and the bank and other participants should explore opportunities that are not always obvious. The very process of designing and negotiating creative methods and incentive mechanisms for emissions reductions could generate unknown benefits.

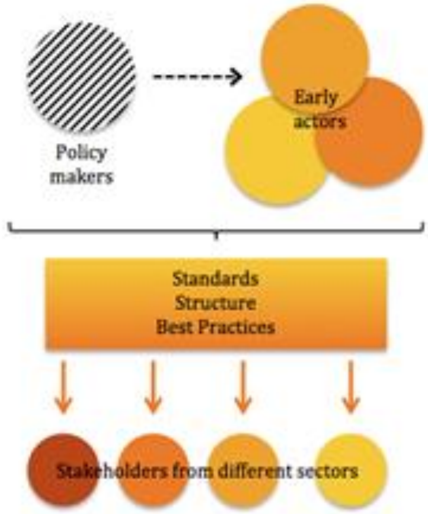
Governments need to referee and coordinate efforts

Government investment in tackling environmental issues, in this case ensuring that the necessary institutions are in place to incentivise and regulate emissions reductions, can be difficult to justify. Actions are often delayed, as they have been in Costa Rica, by competing political priorities. Nevertheless, governments and their policy-makers have a crucial role to play in the long and difficult process required to create an enabling environment for behavioural change.

In Costa Rica, government action on low-carbon development to date has included the issuance of a national standard to certify carbon neutrality, an implementation plan for the national climate change strategy, support for sustainable construction and, most recently, the announcement of a basic incentive mechanism to support good environmental practices, such as the reduction of carbon emissions, that focuses on awards rather than financial benefits. In the face of early action from businesses, the Government needs to take on a more pro-active role as referee and coordinator (Figure 1).

As referees, governments can identify bad practices at the early stages, balance the interests of different actors, safeguard the well-being of all stakeholders that will be affected, and impose sanctions and disincentives for inappropriate behaviour. As coordinators they can promote alliances and collaborative action, and oversee the national portfolio of emerging initiatives to identify duplication or gaps, thereby maximising positive results.

Figure 1. The referee and coordinator role of policy-makers



Governments can facilitate low-carbon development by reducing the transaction costs that fall on early actors. Government support does not always mean finance. As Andrei Bourrouet Vargas, Costa Rica's Vice Minister of Energy and the Environment has stressed: "there is a very important and sensible balance that must be established between the income through taxes for the country […], and the means set to stimulate" (Bourrouet, 2011). A leadership role that brings the right stakeholders together for creative solutions can have great value. The referee position filled specifically by the Government reflects the ability of this actor to see the bigger picture.

Policy-makers have several elements to consider and congruence is critical. They need to ensure that all sectors are accounted for in the rules that are set, including those who were not early actors, and that they are all encouraged to participate. Innovative ideas will struggle to develop if standards vary significantly between the different institutions involved. In the case of the Banco Popular, for example, the proposed mechanism may not fit with the regulations imposed by the General Superintendence of Financial Entities.

There are doubts as to whether Costa Rica's goal to become carbon neutral by 2021 can be accomplished, and this uncertainty – valid or not – is a challenge to the involvement of a significant number of actors and the mainstreaming of low-carbon action. Policy-makers need to build confidence among stakeholders by demonstrating, through collaborative action, that they are committed to achieving this goal and are willing to give it their full support.

The need for companies to reduce the carbon footprint of their operations is gaining increasing recognition worldwide, and is also influencing the behaviour of consumers. Structured action at an early stage will guide and encourage a much-needed shift towards a low-carbon economy. Governments need to get these processes right, to help companies prepare for future market conditions and future national or international standards.

Recommendations

Policy-makers should encourage the participation of strategic actors such as the Banco Popular in emerging national-scale efforts for low-carbon development. Their role in promoting equitable and sustainable development, beyond a purely financial agenda, assures an important balance in the overall impacts of emissions reduction mechanisms. When designing national policies and regulatory frameworks, it is important to:

- **allow different stakeholders to lead and participate** in the design of policy and regulations
- **seek congruence among sectors and ensure their involvement** to encourage collaborative and inclusive action and avoid political tensions
- **recognise the importance and feasibility of innovative mechanisms** and solutions and create the enabling conditions for implementation
- **prioritise the setting of general guidelines** at an early stage to avoid the embedding of wrong practices, recognising the resources it would take to correct these at a later stage
- **learn from the successes and limitations of existing mechanisms and frameworks**, adapting them to suit particular contexts, and building on innovative ideas for creative action
- demonstrate confidence in and **commitment to national goals and targets**, and inspire this confidence in other stakeholders through collaborative action
- maintain a **healthy balance between the need to support new and innovative efforts, and the government's fundamental responsibility** in the regulation of practices to ensure that they meet social and environmental standards and objectives

Acknowledgements

CDKN and María would like to thank Adam Harvey, JPMorgan ClimateCare for acting as a mentor and host for this MSc research.

References and further reading

Alpízar, W. (2011). Interview on the mechanism and the country's climate change strategy with the director of the Climate Change Direction of the Costa Rican Government.

Araya, M. (2011). The Squeezed Middle: Why Latin America Matters in Climate Politics | Intercambio Climático. *Intercambio Climático: Latin American Perspectives on Climate Change*. Available at: http://www.intercambioclimatico.com/en/2011/04/13/the-squeezed-middle-why-latin-america-matters-in-climate-politics/ [Accessed August 23, 2011].

Beaurain, F. (2010). PoA. Developng CDM Programmes of Activities, A Guidebook.

Bourrouet, A. (2011). Interview on the mechanism and the country's planned directions with the Viceminister of Energy and the Environment, Costa Rica.

Camacho, A.C. (2011). Bicentenario con aire ambiental. *El aire necesita un respiro. Avances, debilidades y retos hacia la carbono neutralidad*, pp.28-43.

Echeverri, A. (2011). Interview on the mechanism and the interest of Costa Ricans on clean technologies (electric cars).

Figueres, C. (2011). Opening Ceremony. Carbon Expo 2011. Barcelona, Spain.

Gutiérrez, M.J. (2011). *The potential role of a development bank in Costa Rica's emerging carbon market: an exploratory evaluation of an innovative emission reduction accounting mechanism*. MSc. Environmental Change and Management Dissertation. University of Oxford.

King, M. (2011). A tonne of trouble. *Carbon finance. News & Analysis of Market Solutions to Climate Change*, 8(4), pp.16-17.

Li, J.C., 2011. Interview with the Environmental Programme Coordinator of the Banco Popular.

Polimeni, J. (2011). Interview on the idea for the mechanism, the national context and other benefits.

U.S. Energy Information Administration (2009). International Energy Statistics. *Independent Statistics and Analysis*. Available at: http://www.eia.gov/cfapps/ipdbproject/iedindex3.cfm?tid=90&pid=44&aid=8&cid=regions&syid=2009&eyid=2009&unit=MMTCD [Accessed August 24, 2011].

UNEP (2011). *CDM Pipeline Overview*, Capacity Development for the CDM (CD4CDM). Available at: http://cd4cdm.org/ [Accessed August 4, 2011].

United Nations Statistics Division (2009). Indicators on income and economic activity. Available at: http://unstats.un.org/unsd/demographic/products/socind/inc-eco.htm [Accessed August 24, 2011].