

## EarthTrends Featured Topic: **Financing Carbon: Export Credit Agencies and Climate Change**

Source: *Transition from Fossil to Renewable Energy Systems: What Role for Export Credit Agencies?*

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During the 1990s, Export Credit Agency financing through loans, project guarantees, and investment insurance averaged \$80 – 100 billion per annum: roughly twice the levels of official development assistance during the same period. Export Credit Agencies of the world's leading industrialized (G8) countries have been the most important source of financing for energy intensive development activities during the 1990s. In fact, a substantial share of Export Credit Agency financing directed to developing countries is concentrated in sectors that have important implications for climate change such as power generation, oil and gas development, and energy intensive manufacturing.

Export Credit Agencies (ECAs) are financial institutions that promote exports and facilitate investments to overseas markets that are perceived as high risk. They cover or underwrite political and commercial risks to insure investments, and providing direct loans and equity (with favorable financing terms relative to those offered by commercial banks) to investors from their own home countries. For the period 1996-2001, Infrastructure accounted for the largest share of ECA-supported transactions (\$128 billion) followed by power sector projects (\$116 billion) and oil and gas developments (\$98 billion) (World Bank, 2001).

These are long term investments that will remain in place for the next 10 to 50 years, and are a cause for concern given their significance to greenhouse gas (GHG) emissions: electricity and heat production alone account for around 38% of global carbon emissions (Dubash, 2002). Oil and gas production also contributes to emissions of GHGs. Methane leaks from natural gas pipelines were estimated at 10-20 million tons of methane (CH<sub>4</sub>) a year, and natural gas flaring at oil wells for 202 million tons of carbon dioxide a year in the late 1980s. In addition, petroleum refining is a highly-energy intensive process that consumes both purchased energy (gas, electricity) and refining by-products. Overall, the energy sector is responsible for about three-quarters of humankind's carbon dioxide emissions, one-fifth of its methane, and a significant quantity of nitrous oxide (Environmental Chemistry, 2002). ECA financing is generally concentrated in 6 countries: Brazil, China, India, Indonesia, Mexico, the Philippines and Turkey; these countries are major contributors to global greenhouse gas emissions, and much of the investment in the power sector has gone to coal-fired and gas-fired plants.

Continued investment in the energy sector without consideration for the environmental impact of its development will increase global greenhouse gas emissions. Through their financing of fixed

capital, ECAs play an important role in the decisions that are made in the energy sector. ECAs are therefore in a position to contribute to improvements in the energy efficiency and intensity of developing country economies if they pay attention to the technological choices, fuel mixes and management practices of the projects that they finance. They are also in a position to play a standard setting role for financial institutions such as commercial banks and investment houses, and influence the behavior of their clients in an up-stream fashion.

### **Greening Export Credit Agency Financing**

The ability of Export Credit agencies to finance more sustainable projects is to some extent restricted by the international norms that govern their operation. Export Credit Agencies of the Organization for Economic Cooperation and Development (OECD) countries abide by the terms of the "Arrangement on Guidelines for Officially Supported Export Credits" which was established in 1978 to prevent ECAs from distorting capital markets and competing with commercial financial institutions. The Arrangement effectively limits the amount of subsidy that ECAs can grant to exporters, and links ECA terms to prevailing commercial rates for comparable services in order to control undercutting and competition amongst ECAs. The Arrangement also establishes parameters for combining official export credits

Top country destinations for ECA financing	
<b>Russia and Economies in Transition</b>	
Russia	\$2.1 billion, rehabilitation of refineries, oil fields and construction of pipelines
Poland	\$372 million, combined heat and power plant
Croatia	\$270 million, power plant
<b>Latin America and the Caribbean</b>	
Brazil	\$3.1 billion, gas pipeline, oil and gas field development and both hydro and gas-fired power plants
Mexico	\$2.7 billion, refineries, and power plants
Venezuela	\$565 million, LNG plant, and natural gas injection facility
<b>North Africa and the Middle East</b>	
Qatar	\$1 billion, new LNG plants and gas field development
Morocco	\$237 million, coal-fired power plant
Oman	\$200 million, LNG plant and pipeline
<b>Sub-Saharan Africa</b>	
Ghana	\$320 million, development of off-shore oil and gas fields
Chad	\$200 million, construction of oil pipeline
<b>South Asia</b>	
Pakistan	\$741 million, oil, coal and gas-fired power plants and oil refinery.
India	\$565 million, expansion of gas pipeline capacity and regasification plant
<b>East and South East Asia</b>	
Indonesia	\$3.1 billion, coal and other thermal power plants, plus LNG processing expansion and upgrade
Philippines	\$1.8 billion, gas fired, coal and geothermal power plants
China	\$1.3 billion, coal fired power plants
<b>Europe/Western Asia</b>	
Turkey	\$3.457 billion, construction of coal and gas fired power plants

Source: ProjectWare, 2002 (Note: only includes projects funded by the United States, Germany and Japan)

with official development assistance. Many governments choose to offer “tied aid”, which combines developmental aid grants with official export credits that requires the recipient to purchase equipment or goods from the donor country. Under the Arrangement, only low income countries are eligible to receive tied aid, and there is a minimum 35% grant component.

The Arrangement does, however, make some exceptions with regard to repayment periods for projects in particular sectors such as power plants, nuclear plants, ships and civil aircraft. A complementary agreement to the Arrangement, the *Ex-Ante Guidance for Tied Aid*, establishes that non-commercially viable projects qualify for the use of tied aid, and under this agreement tied aid can be used for renewable

energy and distributed power projects. The fact that tied aid can only be used in low income countries prevents ECAs from being able to finance renewable energy and distributed power projects in the emerging market economies where ECA power sector lending tends to be concentrated. The rules that govern ECAs therefore make it more difficult to “green” ECA finance for the energy sector.

The environmental and social impact of ECA financing has received increasing attention in recent years, and in 1999 the G8 heads of state agreed to negotiate common environmental guidelines for Export Credit Agencies, at the same time also agreeing to create a taskforce to study how to accelerate the development of renewable energy technologies. Four years later, however, the G8 countries have yet to reach consensus on a set of

environmental guidelines. There has been disagreement over what basis should be used for ECA environmental assessment standards, and what information ECAs should disclose to the public and affected communities about environmental impacts of their projects. Yet none of the environmental procedures or standards that were debated evaluates project impacts on greenhouse gas emissions or contributions to energy-efficiency improvements. There was also no discussion of reporting on project contribution to greenhouse gas emissions over time. Regardless of how the discussions on environmental standards are resolved, they are unlikely to produce tangible changes in lending to energy intensive sectors.

In 2001, the Renewable Energy Taskforce of the G8 recommended that ECAs extend the repayment periods for renewable energy projects to 12 - 15 years, making them exceptions to the standard terms of “the Arrangement” like nuclear plants, ships, civil aviation, or power plants. It also recommended that these ECA environmental guidelines include minimum standards for energy efficiency or carbon intensity, and common reporting methodologies to enable assessment of environmental impacts. To date, however, the G8 governments have largely ignored these recommendations.

## Reducing the Carbon Footprint of ECAs

In order to reduce the carbon footprint of ECA financing it is critical that ECAs disclose what projects are being supported in the energy sector, in enough detail to identify the power generation technologies being emphasized, the fuel mix being developed, and the planned production capacity, to allow a meaningful public dialogue

about the quality and direction of their financing portfolios. Portfolio targets can also be used to manage the environmental quality or risks of ECA exposures. It is also important that ECAs require or conduct a full cost assessment of energy and energy-intensive projects, identifying the full life-cycle cost of the project and identifying social and environmental externalities, in order to allow project developers to internalize these costs. In the long term, credible assessments of ECA contributions to a more

sustainable energy future will require systematic tracking of their progress in order to evaluate their impact. In particular, there must be a methodology to measure the emissions to be generated by project during its construction and development, and the emissions it is likely to displace or eliminate. Such a process will allow for more objective decision making and strategizing.

An ECA role in the transition to more sustainable energy requires more than good will, interest and positive action by the ECAs. Export credit

agencies respond to government directives and priorities from economy and finance ministries as well as foreign ministries responsible for international negotiations. Policymakers at the highest levels of these agencies must take up the issues of ECA reform. Just as important, environmental constituencies at domestic and international levels must engage in the ECA reform debate, and make improved environmental standards, particularly for climate change issues, a political priority.

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