Submission by Japan on Strategies and Approaches for Long-Term Finance (October 2013)

1. Executive Summary

Japan provided a total of $ 13.5 billion[1] of public finance to developing countries in the Fast Start Finance period 2010-2012. During the period, Japan mobilized $ 3.4 billion of private finance, $ 2.0 billion of which was mobilized by Japan Bank for International Cooperation (JBIC) and $ 1.3 billion of which was mobilized by Nippon Export and Investment Insurance (NEXI).

Japan is now working to mobilize climate finance, from a wide variety of public and private sources, to address the needs of developing countries. To achieve the goal of mobilizing jointly $ 100 billion per year by 2020, we believe that substantial scaling-up of private finance is indispensable.

As we design strategies and approaches for long-term finance, we conducted a research on barriers and possible solutions to scale up climate finance, especially private finance, through interviews with numerous private financial institutions, private companies and governmental institutions in Japan. As a result, it has become clear that lack of private investors' incentives for risk taking, and limited enabling environments in developing countries including hard and soft infrastructure are the main barriers for scaling up of private finance in climate change mitigation and adaptation. In addition, it has become clear that adaptation projects tend to generate relatively little financial return to private sector compared to mitigation projects.

To address these barriers and scale up climate finance substantially, Japan will make the most use of our development financial institutions and export credit agencies. In particular, Japan will continue to make use of public financial instruments provided by JBIC and NEXI on private company investments and also provide public assistance through JICA to improve enabling environments in developing countries. As for adaptation, Japan will strive to increase both public and private finance, utilizing the new scheme of concessional loan and the insurance mechanism of private companies.

[1] The total figure reported here reflects slight revisions to the figure we reported in COP18, which was the figure as of October, 2012.

2. Current situation

Japan has provided international climate finance in many areas both in mitigation and adaptation through the various channels, in order to address the needs of developing countries. Japan's provision amounts to a total of $ 13.5 billion of public finance and $ 3.4 billion of private finance in the Fast Start Finance period 2010-2012.

(1) Government agencies and institutions which are involved in providing or mobilizing international climate finance in Japan are as follows:

- Ministry of Foreign Affairs: [$ 9.7 billion]
  - Concessional Loan, Grant Aid, and Technical Cooperation provided through JICA, etc.
- Ministry of Finance: [$ 5.5 billion ($ 2.0 billion of which is private finance]
  - Co-financing with private financial institutions through JBIC
  - Contribution to multilateral funds such as Clean Investment Funds (CIF) and Global Environment Facility (GEF), etc.
- Ministry of Economy, Trade and Industry: [$ 1.5 billion ($ 1.3 billion of which is private finance)]
  - Private finance mobilized by NEXI's insurance, etc.
- Ministry of the Environment, Ministry of Agriculture, Forestry and Fisheries, and Ministry of Land, Infrastructure, Transport and Tourism: [$ 0.1 billion]
  - Feasibility studies in developing countries, etc.

(2) The areas in which private finance flows in the period are as follows:

- Energy efficiency: [$ 2.1 billion]
  - High energy efficient thermal power plant project in East Java, utilizing JBIC co-financing, etc.
- Renewable energy [$ 0.4 billion]
  - Renewable energy projects in Central America with Banco Centroamericano de Integración Económica, utilizing JBIC co-financing, etc.
- Forest [$ 2 million]
  - Forestation project in Viet Nam, utilizing Overseas Untied Loan Insurance by NEXI, etc.
- Others [$ 0.9 billion]

- Providing finance to DB Masdar Clean Tech Fund, L.P, etc.

3. Barriers

(1) Lack of private investors' incentives for risk taking

It has become clear that private financial institutions, such as banks, are highly limited in the amount of risk they can accept. They have the perspective that it is difficult to provide finance in developing countries whose credit ratings are low, unless recovery of funds is 100% guaranteed and the guarantee covers both country risks and credit risks. Private investors, such as trading companies, are also limited in the level of risk acceptance. They consider the volatility and low credibility of regulatory frameworks such as feed-in tariffs in developing countries as a significant disincentive to invest in renewable energy projects in these countries.

To address these barriers, it is indispensable to offer risk reduction instruments such as political risk insurance and guarantees, and to create enabling environments for investment in developing countries, such as strengthening regulatory frameworks and ensuring stable policy implementation.

(2) Limited enabling environments in developing countries, including hard and soft infrastructure

Private companies basically seek to invest in projects which deliver a financial return without receiving public assistance. On the other hand, they expect public sector to support creating enabling environments in developing countries such as building hard infrastructure like roads and developing soft infrastructure like policy and human resources, as a basis of securing a financial return. These include development of road infrastructure in the area surrounding power plants, electricity master plans which are required as a basis of power production business, human resources for capacity building of Meteorological Agency to provide the basic data necessary for weather related insurance.

(3) Securing a financial return in adaptation projects

There are numerous private companies which have sophisticated technologies to potentially contribute to adaptation in developing countries such as water resources management, disaster reduction and agriculture. But these companies regard securing a financial return and making profits as criteria for investment. Although some adaptation projects in developing countries are commercially viable, there are many projects which do not deliver a financial return. There are

relatively many projects which are still at the stage of feasibility studies to judge if they will be commercially viable in future.

4. Japan's Strategies and approaches for mobilizing climate finance

To address these barriers and scale up climate finance substantially, Japan will make the most use of public financial instruments on private company investments, and in a medium- and long-term perspective, support the creation of enabling environments and capacity-building in developing countries as a basis of mobilizing climate finance. In addition, Japan will strive to scale up both public and private finance for adaptation, utilizing the new scheme of concessional loan and the insurance mechanism of private companies. Furthermore, Japan will continue its contribution to mobilize private finance through multilateral channels, including contribution to the design of Green Climate Fund.

(1) Public financial instruments on private company investments

Japan will continue to utilize public financial instruments provided by JBIC, NEXI, and so on in order to scale up private finance substantially by mitigating risk and encouraging the participation of private companies in the field of climate change.

- JBIC co-financing and guarantees, including GREEN (Global action for Reconciling Economic growth and Environmental preservation), through which JBIC utilizes its untied facility (loans and guarantees) and supports projects with favorable impact on the preservation of the global environment.
- NEXI risk insurance, including Global Environment Insurance System, which offers a special option that insures 100% of country risks. (Normally, the insurance rate is 97.5%)

(2) Public assistance for the creation of enabling environments in developing countries including hard and soft infrastructure

Japan will continue to provide public assistance on hard and soft infrastructure in developing countries, including strengthening and stabilizing regulatory frameworks such as feed-in tariffs, developing human resources and related hard infrastructure. These efforts would help developing countries to attract private sector investments in both climate change mitigation and adaptation, by improving the investment environment.

- Concessional loan, Grant Aid, Technical Cooperation, and Private Sector Investment

Finance provided through JICA

(3) Scale-up of adaptation finance, both public and private

Japan will not only contribute to conducting feasibility studies on adaptation projects in developing countries funded by public finance, but also strive to scale up both public and private finance for adaptation, by utilizing the new scheme such as Stand-by Loan for disaster recovery and the new preferential terms for concessional loan (disaster prevention) and the insurance scheme of private companies.

- Stand-by Loan for disaster recovery ("Stand-by Emergency Credit for Urgent Recovery" (SECURE))
- Preferential terms for concessional loan (global environment problems and issues, disaster prevention and reduction)
- Weather related insurance provided by private companies

(4) Mobilizing private finance through multilateral channels

Multilateral channels play an important role through which public finance is delivered, by leveraging private investment through co-financing with the private sector and supporting developing countries in creating enabling environments to attract private investments.

Japan will continue to contribute to the institutional design of Green Climate Fund (GCF), which is expected to provide sufficient amount of finance for both mitigation and adaptation by mobilizing private finance. As we design the business model of GCF, we consider it important to analyze and verify the effectiveness of current multilateral climate funds such as CIF and GEF, which have a wealth of experiences in supporting developing countries.

- Contribution to the institutional design of GCF, including Private Sector Facility and readiness support

5. International approach on MRV and the definition of climate finance

In order to implement the above strategies and approaches, Japan believes that internationally coordinated approach is needed, which helps appropriately evaluate and track finance that virtually contributes to mitigation and adaptation in developing countries. With this in mind, Japan will continue to proactively contribute to the international dialogues in the following area.

- Creating transparent and efficient Measurement, Reporting and Verification (MRV) framework of climate finance flows, including climate finance effectiveness
- Work for defining climate finance
  - As for private climate finance, Japan is a member of OECD Research Collaborative and will continue to contribute to technical definitional discussion with our knowledge and experiences in mobilizing climate finance including Fast Start Finance.
  - To achieve the goal of long-term finance, we believe that the definition of climate finance should not be restrictive. In addition, we should be cautious so as not to create disincentive for private investments to develop new technologies and businesses in climate change fields. For example, we think the financial support on improving energy-efficiency in thermal power plants including coal power plants and in manufacturing processes including iron manufacturing, should be included in the definition of climate finance.

6. Other Issues

<International transport sector>

Since there has been no discussion or consensus within the UNFCCC on which industrial sectors might be identified as sources for long term finance, it is imbalanced if only the international transport sector is identified as a potential financial source. Imposing too much burden on the international transport sector is also inappropriate.

There has been significant progress at IMO and ICAO on measures to reduce GHG emissions in the international transport sector, such as the new energy efficiency regulation for international maritime as well as the decision of the global aspirational goals and a global market-based measure for international aviation. Therefore, the issues relevant to the GHG emissions reduction in the international maritime and aviation sectors should be continuously and exclusively considered at each UN specialized body, i.e. IMO and ICAO, which hold expertise of these sectors.