



Banking on carbon markets

Why the European Investment Bank got it wrong
in the fight against climate change



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Written by Joseph Zacune
for Counter Balance
zacune@gmail.com

Edited by Antonio Tricarico,
CRBM/Counter Balance

Graphic design: Carlo Dojmi di
Delupis

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CRBM - Campagna per la Riforma della Banca Mondiale

Via Tommaso da Celano 15
Roma (Italy)
tel. +39.06.7826855
Fax. +39.06.7858100
web: www.crbm.org
email: info@crbm.org

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Counter Balance

26 Rue d'Edimbourg
1050 Brussels, Belgium
tel. + 32(0)2 893 08 61
info@counterbalance-eib.org
www.counterbalance-eib.org

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Summary

The European Investment Bank (EIB) has established carbon funds, facilities and instruments to shore up the EU's reliance on carbon markets as a solution to combat the climate crisis. Acting as facilitator to extend this core policy of the EU, the Bank is focusing its efforts particularly on ensuring that carbon trading is the centerpiece of the EU's compliance with Kyoto Protocol targets and the delivery of climate finance.

However, the continuation of the Kyoto Protocol is in serious doubt beyond 2012, so the bank is urgently trying to create investor confidence in uncertain future carbon markets. Critically, these policies do nothing to reduce emissions and they continue to allow business-as-usual pollution in Europe and frequently have negative social impacts in 'transition countries' and the global South.

Furthermore, the EIB is supporting the expansion of carbon markets as a means to tackle the climate change in spite of financial instability and volatility associated with the creation of the "carbon" commodity and related financial markets. This approach poses a major threat to fragile economies and impoverished communities. This 'financialised' approach undermines the urgent need for state intervention including the provision of public funds to address the current climate crisis (Gerebizza, 2011).

The EIB has so far pledged EUR 589 million for its carbon funds but there is a major lack of transparency regarding the EIB's investment in specific offset projects, as well as consultancy and other services it may provide to strengthen carbon markets. However, its support of fossil fuel-related sectors in order to generate carbon credits highlights a systematic bankrolling of polluting industries.

Instead of supporting communities affected by pollution or engaging in sustainable practices, the bank is helping corporations that are engaging in fossil fuel extraction to earn carbon offset credits through projects that purportedly make their activities less destructive. Companies investing in controversial dam projects, monoculture tree plantations and now forest carbon trading are also being



European Investment Bank building, Luxembourg

catered for by the EIB. Despite its confidence in carbon markets and catalytic role in

their continuation, the EIB is dependent upon external consultants to actually manage these funds and seems to lack the relevant in-house expertise.

Yet instead of propping up carbon markets, the EIB could play a role in transforming public infrastructure to curb emissions in Europe.

The EIB has so far pledged EUR 589 million for its carbon funds but there is a major lack of transparency regarding the EIB's investment in specific offset projects

1. Introduction to carbon trading

Carbon trading systems comprise of emissions trading and offsetting. Emissions trading is the buying and selling of the right to emit greenhouse gas pollution. An emissions trading scheme establishes a limit or 'cap' on emissions from sectors such as energy, pulp and paper, steel and cement manufacturing.

Under the Kyoto Protocol, 37 industrialised countries, including those in the European Union, are mandated to reduce their emissions on average of 5.2% per cent below 1990 levels by 2008-2012. EU Member States use the EU Emissions Trading Scheme (ETS) as a tool to meet these obligations¹.

Carbon-intensive industries in the EU contribute to achieving the Kyoto reduction targets, through the EU ETS. A portion of each member state's Kyoto Protocol permits to pollute are passed on to companies, and all emissions by the industries covered by the EU ETS must be covered by a permit (or a carbon offset, see below). The mechanism is flexible as companies can trade these permits between themselves by selling off surplus permits if they find it easier than other companies to reduce their emissions (FERN, 2010).

1.1 Offsetting

Emissions trading schemes are undermined by loopholes as offset provisions allow the purchase of the right to pollute from industries and projects in countries that are outside of this scheme. Purchasing offset credits allows the industries covered by the EU ETS to release emissions over and above the cap whilst still claiming to stay within the cap.

Offsetting is an integral part of all carbon trading schemes including the EU ETS, which is by far the largest carbon market in the world, accounting for around three-quarters of traded carbon, and it sets an overall legal limit on emission reductions from over 11,000 power stations

and factories operating in 30 countries² that account for nearly half of the EU's emissions (Carbon Trade Watch & CEO, 2011).

This offsetting escape hatch allows business-as-usual pollution by industrialised (Annex 1)³ countries that claim to reduce equivalent emissions by funding projects, most often in developing countries (FoE, 2009). Although the EU ETS was originally operating outside of the UN Framework Convention on Climate Change (UNFCCC), the 2004 'Linking Directive' allows Kyoto flexible mechanism credits from carbon offset projects to count towards national emission caps, as agreed by EU Member States. The limit of offsets is variable in EU countries: companies in the UK used offsets for 8 per cent of emission cuts whilst companies in Spain and Germany used 21 and 22 per cent of offset credits respectively to cover emissions over and above the EU ETS cap (IGES, 2010).

As highlighted by Carbon Trade Watch, "new EU ETS rules will allow power producers in the UK and Germany (currently the largest buyers of emissions permits), as well as companies operating in Spain and Italy (which allowed vast quantities of offsets in phase 2 in 2008-2012) to buy more than 50 per cent of their "reductions" in the form of offsets." (Reyes, 2010)

The main carbon trading mechanism under the Kyoto Protocol is the Clean Development Mechanism (CDM) and it has 3,211 registered projects in developing countries.⁴ As Lex de Jonge, former Chair of the CDM Executive Board, stated: "[T]he CDM, at its best, is a zero sum game, because its credits are used to offset reduction obligations of Annex 1 [rich industrialised] countries." (Jonge, 2009).

Evidence suggests that the CDM has actually increased rather than reduced greenhouse gas emissions (Carbon Trade Watch, 2011c).

2 The EU27 plus Norway, Iceland and Lichtenstein. Negotiations are underway for Switzerland to join the scheme, see European Council (2010) "EU to link its greenhouse gas emissions trading system with Switzerland" 20 December 2010, http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/

3 There are 41 Annex 1 countries including the European Union (EU-15), Members States that joined before 1996. They include industrialised countries and transition economies: Australia, Austria, Belarus, Belgium, Bulgaria, Canada, Croatia, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Monaco, Netherlands, New Zealand, Norway, Poland, Portugal, Romania, Russian Federation, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey, Ukraine, United Kingdom, United States of America

4 <http://cdmpipeline.org/overview.htm>

1 See European Commission website about the EU ETS http://ec.europa.eu/clima/policies/ets/index_en.htm

Although the CDM has an explicit mandate to promote sustainable development⁵, it has well-documented negative social and environmental impacts on the ground (Gilbertson & Reyes, 2009; CDM Watch, 2011, Focus on the Global South, 2010).

The creation of the CDM was highly controversial. In 2001, after the US withdrew from the Kyoto Protocol, the EU, which had been previously quite critical of trading mechanisms to be allowed under the protocol, did a policy U-turn and supported the extensive use of carbon trading. In the same year, the CDM and other trading mechanisms were adopted despite the fact that they were riddled with loopholes that allowed Annex 1 countries to cancel out the small emissions cuts that were enshrined in the Protocol (Lohmann, 2006).

The smaller, accompanying offset mechanism is Joint Implementation (JI) that covers projects in economies in transition i.e. Russia, Central and Eastern Europe. These projects take place between two countries that have reduction targets under the Kyoto Protocol: one finances a project in the other country in return for offset credits (Carbon Trade Watch, 2009). JI projects initially had a substantial impact, but decreased in importance after the implementation of EU ETS: Many JI projects take place at factories also covered by the EU ETS. If they sell offset credits and count their reductions towards their EUETS target, the same reduction would be counted twice. To avoid this double counting of the same reduction, EUETS permits are cancelled, if a JI project sells offset credits. This has reduced the interest in JI projects.

There are primary and secondary carbon markets. In the primary carbon market, a project would sell offset credits to buyers who then receive the credit to pollute. However, the secondary market is increasing in size. It consists of purely financial transactions and speculation, with permits and credits being traded as financial products many times over before they eventually reach a company and cover emissions from that sector. The fact that these pollution permits and offset credits are not being traded directly but generate financial derivative products from their presumed underlying value is cause for concern in

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terms of market volatility and instability, and also raises the question about what such trading, which does not lead to any additional emission savings, contributes to the climate objectives of the scheme (FoE US, 2009).

Yet despite the lack of credibility surrounding carbon markets, the EIB is a major driver of the investment of financial resources that are being channelled into uncertain future carbon markets. Unstable carbon markets, low carbon prices and failing climate talks have not yet slowed the push for new carbon markets (Reyes, 2011b). The EIB counters this by claiming that carbon markets deliver on climate finance obligations⁶.

However, only a small fraction of carbon finance is actually received by developing countries through carbon markets, and instead profits are being reaped by corporations and the financial sector. Although global carbon markets have been valued at over \$100 billion in the last few years, only 0.5% percent of the money in the EU ETS and CDM market has actually gone to offset projects in developing countries, with rest going to carbon traders, brokers, verifiers, project developers and so on (FoE EWNI, 2011).

1.2 Forest carbon offsets

There are attempts to include forest offsets in carbon markets on an international scale. Reducing Emissions from Deforestation and Degradation (REDD) was formally proposed by pro-carbon market tropical rainforest countries Papua New Guinea and Costa Rica at the UN climate talks in Montreal in 2005 (see FoEI 2008 for further information).

A global REDD financing mechanism is yet to be agreed. However, many governments are supporting proposals for funding through forest carbon trading. This could lead to the effective privatisation of swaths of developing country forests, in order to generate and deliver carbon offsets for rich industrialised countries' emission reduction targets.

⁵ However, host countries of CDM projects have no criteria or mandatory tests for their approval.

⁶ The European Investment Bank and carbon finance. Fact-sheet, available at: http://www.eib.org/attachments/thematic/carbon_finance_en.pdf



There is also a major risk that REDD will reward those engaging in deforestation activities, such as dirty energy and logging companies, at the expense of those who are not involved in such activities and have already made efforts to care for their environment. Worse still, there is already evidence that companies are continuing their damaging activities elsewhere, using their engagement in REDD to greenwash their corporate image (FoEI, 2010).

There is also a threat that REDD will be used to finance monoculture tree plantations. Yet plantations are not the same as forests: they store less than 20% of the amount of carbon and only a fraction of the biodiversity of old growth forests (Palin et al, 1999, for CGIAR). The inclusion of plantations therefore raises the alarming prospect that REDD funds could be used for projects that increase emissions: old growth forests could be cut down and sold for profit, and then replaced with plantations funded through REDD. REDD-financed plantations may be cultivated on fertile agricultural land, with serious impacts on access to food.

REDD projects are already being established across the global South in preparation for a UNFCCC agreement

There are attempts to include forest offsets in carbon markets on an international scale. Reducing Emissions from Deforestation and Degradation (REDD) was formally proposed by pro-carbon market tropical rainforest countries Papua New Guinea and Costa Rica

on REDD. They are also emerging outside UN processes, through bilateral agreements between countries, voluntary carbon markets, sub-national carbon trading schemes and interim agreements (see FoEI 2010 for more information).

The World Bank's Forest Carbon Partnership Facility (FCPF) is designed to support countries' preparations for REDD, including through the development of pilot REDD projects (see FCPF section on FoEI 2010 report). The EIB is also investing in forest carbon offsets ahead of any UN agreement (see section 3.7). There is a risk that these proposals will be widened beyond forests to include GM crops, biochar and soils as greenhouse gas sequestration projects (African Biodiversity Network et al. 2011).

1.3 Additionality

Several contradictions, intrinsic to the creation and functioning of carbon markets, as described above, illustrate that at best offsetting does nothing to reduce emissions, and in fact it often results in increased emissions due to the spurious nature of many offset projects in particular large hydro, forest offsets and gas destroying projects (see EIA, 2010 & 2010b; International Rivers, 2008 etc).

Projects are supposed to be additional, which refers to the added benefit the project brings in terms of emissions reduction as compared with a business-as-usual scenario.

It is an inherently unreliable concept because it is based on a hypothetical future amount of emissions, and the project manager is supposed to demonstrate that planned emissions reductions could not be implemented in the absence of CDM funding

(see FERN, 2010). Dam projects also have to prove that they would be additional under the CDM i.e. that they would not have been built without financial support from carbon offsets. In practice, this requirement has been frequently manipulated (see International Rivers, 2008).

1.4 Hot air

Industrialised countries with emission targets under the Kyoto Protocol, particularly from Central and Eastern Europe, have easily met their emission reduction targets due to their dramatic decline in energy-intensive industries during the transformation from command economies af-

ter 1990. Yet the Kyoto Protocol, signed in 1997, awarded permits to pollute based on emission levels in 1990. This has led to a huge surplus in pollution permits known as 'hot air' that could be sold. In order to partially attempt to compensate for this, Green Investment Schemes (GIS) have been created to facilitate donor countries' investment in environmental projects with the profits from sales of pollution permits.

1.5 Voluntary markets

The EU ETS and the CDM and JI are part of the 'compliance' market i.e. they are directly linked to emission reduction obligations of the Kyoto Protocol. The much smaller, unregulated voluntary carbon market is independent of government targets and policies and allows companies, NGOs and individuals to invest in offset projects, often to compensate for their carbon footprint. Credits have been generated in offset initiatives such as 'avoided deforestation' projects linked to voluntary carbon markets since the early 1990s (EcoSecurities, 2007).

1.6 Post-2012 uncertainties

With the first commitment period of the Kyoto Protocol (2008-2012) soon coming to an end and with disagreements characterising the UN climate negotiations in general, the prospects for a global, compliance carbon market in the post-2012 period remain unclear. A national carbon trading scheme that would link to the global carbon market has been shelved in the US. And there is uncertainty surrounding so-called emerging economies that are developing carbon trading mechanisms (Reyes, 2011). Furthermore, the EU ETS continues to be dogged by ineffectiveness.

1.7 Critiques of carbon trading

Carbon trading has been criticised for inherent structural flaws, which undermine its ability to reduce emissions and drive technological innovation. Instead, it has resulted in the lock-in of high carbon infrastructure, business-as-usual or even increasing emissions due to offsetting and the risk of "subprime carbon", that is the risk related to the creation of the largest derivatives markets in the world based on a brand new and untested "virtual" commodity, carbon, in a context of ineffective financial regulatory regime (see Gilbertson & Reyes, 2009, FoE EWNI, 2009b; FoE US, 2009; FERN, 2010). Furthermore, carbon markets have proven to be highly susceptible to fraud, including through value-added tax (VAT) fraud in the EU ETS. VAT

or 'carousel' fraud involves the rapid shifting of large volumes of European Union Allowances (EAUs, units traded in the ETS) from country to country in order to generate short-term finance from the delay in making VAT payments, or failure to pass on to tax authorities the VAT rate collected by the seller of the carbon permits (Reyes, 2010).

Offsets undermine the UNFCCC, which demands that rich industrialised countries meet their obligations to reduce their emissions and provide climate finance to developing countries (see articles 4.2, 4.5, 4.7 in UNFCCC, 1992). In 2010, of the US\$144 billion carbon market, only US\$3,370 million went to project developers (and only a fraction of that will go to communities who host projects) (FERN, 2010).

Climate science shows that we are rapidly approaching catastrophic climate change. Recent analysis on carbon budgets, i.e. the just allocation of remaining atmospheric space for greenhouse gas emissions, highlights that in order to remain within a two degree temperature rise threshold (which is still highly dangerous), the USA has to reduce its emissions by 95% by 2030 and the EU by 80% (from 1990 levels), as part of a global carbon budget. Emissions from countries like China would need to peak within the next five years and then fall (FoE EWNI, 2010b).

Since offsets represent, at best, no cuts in emissions and considering that there is very little atmospheric space left, many progressive NGOs, Indigenous Peoples organisations and social movements view carbon trading and offsetting as a dangerous distraction from climate action (Via Campesina, 2010; FoE EWNI, 2009b & 2009c; IEN, 2011).

2. Carbon Markets Actors in the EU

The EU has gone from being skeptical about carbon markets to being a frontrunner in their growth, which has in turn influenced EU institutions' approach to carbon trading (Lohmann, 2006). From 2000, European industrial vested interests have increased their efforts to erode opposition to unfettered carbon trading and the EU ETS came into force with broad backing from NGOs in 2005 (Lohmann, 2006).

2.1 The role of the European Union

The European Commission states that the EU ETS is "a cornerstone of the European Union's policy to combat climate change and its key tool for reducing industrial greenhouse gas emissions cost-effectively." (EC, 2011c). The EU ETS is the largest carbon market in the world and given that it is linked to the Kyoto Protocol flexible mechanisms (namely the Clean Development Mechanism, the Joint Implementation and the Emission Trading), EU Member States want to ensure that there is a smooth transition in the post-2012 period.

The first phase of the ETS (2005 to 2007) was strongly criticised for handing out a surplus of permits to pollute, European Union Allowances (EUAs), resulting in a failure to reduce emissions and the eventual collapse of the price of carbon. The second phase of EU ETS (2008-2012), which coincided with and was linked to the first commitment period of the Kyoto Protocol, was supposed to rectify these initial problems but failed to do so as a surplus of emission permits was once again issued, with the surplus growing with the prolonged economic downturn in the wake of the 2008 financial crisis (in fact GDP and CO₂ emission growth rate are usually directly linked in a linear manner); reductions achieved as a result of this economic downturn have shown to not indicate a structural change in EU energy infrastructure as emissions began to rise again by over 3.5 per cent in 2010, compared to 2009 levels (EC, 2011) as economic output rose in 2010. Globally, emission increases are taking place despite the global economic recession. According to the International Energy Agency (IEA), energy-related CO₂ emissions were the highest in history in 2010 (International Energy Agency, 2011). Carbon markets are doing nothing to halt this rise.

Due to the over-allocation of permits for European companies to continue to pollute, the EU ETS has failed by its own standards to tackle climate change. There is a surplus of around 970 million of these permits from the second phase of the scheme (2008-2012), which can be used in the third phase, meaning that on aggregate, polluters need to take no action domestically until 2017 (Carbon Trade Watch & CEO, 2011).

In this context, the commitment to purchase carbon credits has been seen as crucially important by the EIB (and its co-investors) to provide certainty of a carbon offset market beyond 2012 and to boost confidence for offset project developers who could potentially profit from post-2012 offset credits (Conning, 2009).

2.2 EU corporate lobby

The European industrial lobby is highly influential, particularly in Brussels, and many of these same companies are subsidised by the EU ETS by being allowed to use 1.6 billion offset credits in its second and third phases, primarily in relation to the UN's Clean Development Mechanism. For instance, power companies are set to gain EUR 71 billion in windfall revenues during the second phase (Carbon Trade Watch & Corporate Europe Observatory, 2011).

In particular, power companies got permits for free and then today calculate pass-through costs on electricity based on permit price, but buy and use cheaper offset credits and hold on to permits for use in phase III when power companies will have to purchase permits at auction.

In addition, even though EU ETS permits will be auctioned in the third phase rather than another free hand-out of permits, there will be still major subsidies to industry as corporate lobbying has resulted in free permits which could amount to EUR 7 billion annually. Energy companies successfully lobbied for an estimated EUR 4.8 billion in subsidies of EU ETS auction revenues to be returned to the industry for carbon capture and storage (CCS), with a smaller amount for "clean" energy, that includes controversial agrofuels (Carbon Trade Watch & CEO, 2011).

Lobbying by the International Emissions Trading Association (IETA), the chemical company, Cefic and power producers like Enel-Endesa has ensured that companies can retain offset credits from offset project types banned for use from 2012 for later use until at least April 2013 (Carbon Trade Watch & CEO, 2011).

2.3 The role of the World Bank

The World Bank is the primary financial institution that has pioneered the development of carbon markets, with currently 200 WB staff dedicated to carbon markets.⁷ Carbon finance lies at the centre of its core global lending program, and its Carbon Finance Unit (CFU) manages 12 Carbon funds and facilities, totaling more than US\$2.5 billion (See FoEI, 2011). EU Member States and other donors back its aggressive support of a post-2012 global carbon market despite the uncertainty surrounding the extension of the Kyoto Protocol.

Whilst the World Bank has been the front-running impetus behind the growth of carbon markets globally, the European Investment Bank (EIB) – along with the European Bank for Reconstruction and Development (EBRD) – have been catching up fast, and play a complementary role in the push for the extension of carbon markets after 2012.

2.4 EIB's role in carbon finance

The EIB carbon funds are set up to play facilitating and catalysing roles in the carbon market. The bank states that: "EIB-sponsored carbon funds have all been designed to extend market capacity and complement rather than replace private sector participants in the carbon market. EIB carbon funds also seek to anticipate market developments and promote confidence in regulatory developments, in particular for the period beyond 2012 and the Kyoto Protocol." (EIB, 2009d).

Their main tasks are:

- linking the sellers and buyers of the carbon credits while minimising their risks from the transactions
- providing financial liquidity to the carbon market
- providing finance for investment for offset projects
- enabling the participation of companies in the market
- supporting EU Members States to meet their emission reduction obligations through offsetting.

These funds aim to maximise the profits of investors and catalyse support for carbon finance in specific sectors, countries and regions on behalf EU Member States. The EIB, in a similar vein to the World Bank, helps establish a framework of support for existing carbon trading initiatives and the creation of expanded international carbon markets. The Bank attracts and facilitates investment and smoothes the way for company engagement. Through this practical assistance, the EIB is essentially propping up carbon markets.

By signing Emissions Reduction Purchase Agreement (ERPAs) for projects, the developers convert their carbon credit into bankable revenue stream (Conning, 2009). All carbon funds sponsored by the EIB are managed by a team (either public or private), consisting of a carbon adviser and a portfolio manager, the combination of which allows complementarities between a carbon finance specialist and specialist(s) on administrative, compliance, monitoring, and reporting aspects. The guidelines given to the funds are that each one should respect the EIB environmental and social guidelines and each has its own specific financial guidelines depending on its region and sector targets. Additionally, the EIB is a member of each fund's supervisory committee.

Given that each fund's investor is either an EU ETS compliance buyer or EIB and other public agencies partnering with the fund's investors, developers are ensured that each credit which they will deliver to the fund will be purchased by the fund at the agreed price in the purchasing agreement (ERPA) (Cusworth & Balenciaga, 2011).

Risk reduction of carbon credits for the post-2012 period is key. Simon Brooks, Vice President of the European Investment Bank (EIB), emphasised risk reduction as the EIB's Post 2012 Carbon Credit Fund's key contribution: "Our key aim in launching this fund was to facilitate project business after 2012 by offering a solution to the main issues facing project developers: the timely coming into effect and the potential shape of a post-2012 agreement, income levels from future carbon credit revenues, and the availability and reliability of buyers for ERPAs signed in advance. The Fund offers solutions to all these problems." (Conning, 2009).

As shown below, the EIB in fact outsources significant management of its carbon funds to external consultants, bringing into questions why the Bank is playing such a central role in carbon trading when it lacks in-house expertise to engage in what it offers to Member States governments.

⁷ <http://www.redd-monitor.org/2011/09/28/president-yudhoyono-promises-to-dedicate-the-next-three-years-to-protecting-indonesias-forests/>

3. EIB's carbon funds and facilities

The EIB has six main carbon funds:

- The Multilateral Carbon Credit Fund (MCCF)⁸
- Carbon Fund for Europe (CFE)⁹
- Post 2012 Carbon Credit Fund (P2012)¹⁰
- The EIB-KfW Carbon Programme¹¹
- The EIB-KfW Carbon Programme II¹²
- Fonds Capital Carbone Maroc (FCCM)¹³

The six funds have pledged EUR 589 million to purchase pre-2013 and post-2012 project carbon credits. 65 per cent of that amount has been committed by EU compliance buyers (governments, ETS companies and intermediaries investing on behalf of such compliance buyers) while 20% came from European Development Financial Institutions and Agencies. The rest of the commitments are born by EIB's own balance sheet (Cusworth, 2011).

To date, 60 per cent out of EUR 589 million has been engaged in 82 purchasing contracts with sellers for deliveries spread over 2008 to 2021. The carbon credits are sold through forward contracts that are settled (disbursed) against delivery, no advance payments are made (a common practice in both the trade in CDM and voluntary offset credits). Given that each delivery necessitates verification from the UNFCCC bodies, and noting that none of EIB funds was engaged in industrial gas credits which constitute the majority of credits delivered from 2008 to 2010, less than 5 per cent of the amount engaged has been disbursed by the six funds as of December 2010. Around 30 per cent has been registered by UNFCCC but credits have not yet been issued by the UNFCCC, while the rest is following its registration process¹⁴ (Cusworth & Balenciaga, 2011).

8 http://www.eib.org/attachments/strategies/carbon_credit_fund_en.pdf

9 <http://www.eib.org/attachments/thematic/CFE.pdf>

10 <http://www.eib.org/attachments/post-2012-ccf.pdf>

11 http://www.eib.org/attachments/thematic/eib_kfw_carbon_programme_en.pdf

12 http://www.eib.org/attachments/thematic/eib_kfw_carbon_programme_ii_en.pdf

13 http://www.eib.org/attachments/thematic/fonds_capital_carbone_maroc.pdf

14 The CDM process cycle can be divided into seven stages: preparing the Project Design Document (PDD); getting approval from each country involved; validation and the 30 day public comment period; registration by the CDM Executive Board Monitoring emission reductions; verification, certification and issuance of emission reduction credits; renewal of the crediting period (see CDM Watch, 2010)

3.1 Multilateral Carbon Credit Fund (MCCF)

Joint initiative between EIB and EBRD

Launched: 2006

Fund capital: EUR 208.5 million

Member State participants: Finland, Belgium (Flanders), Ireland, Luxembourg, Spain and Sweden

Corporate participants: Zeroemissions (Spain), CEZ (Czech Republic), Endesa (Spain), Gas Natural (Spain) and PPC (Greece)

Offset project host countries: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Russia, Kazakhstan, Serbia, Kyrgyz Republic, Latvia, Lithuania, FYR Macedonia, Moldova, Mongolia, Montenegro, Poland, Romania, Slovak Republic, Slovenia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan¹⁵.

Carbon managers: Royal Haskoning¹⁶, Greenstream Network¹⁷, ICF Consulting¹⁸

The Multilateral Carbon Credit Fund (MCCF) was established by the EIB and the European Bank for Reconstruction and Development (EBRD) and is specifically aimed at countries from Central Europe to Central Asia. It is subscribed with commitments of EUR 208.5 million, spread between a project fund and a green fund¹⁹ (EIB, 2011).

Project types include:

- Energy efficiency in industry and larger projects in the residential sector (double glazing, insulation)
- Renewable energy such as wind, hydro, biogas (from landfills/ wastewater) and biomass
- Avoidance of venting/ flaring from gas exploration, transport and distribution and petro-chemical plants
- Fuel-switching from carbon intensive (coal, mazut, oil shale) to less carbon intensive fuels such as natural gas
- Sequestration of greenhouse gases (forestry)

15 Countries are divided into three zones, each of them has an assigned Carbon Manager – private company with carbon market experience that develops, negotiates, signs and monitors carbon credit transactions: West: EU + Croatia – Haskoning (NL), North-East: RUS, UA, BY - Greenstream Network (Finland), South-East: the rest - ICF International (UK)

16 www.royalhaskoning.com

17 www.greenstream.net

18 www.icfi.com

19 The Green Fund is much smaller than the Carbon Fund and comprises of Green Investment Scheme (GIS) for country to country investments.

Project examples

IF Cement, Ukraine. Joint Implementation

This project is run by Ukrainian-owned cement producers and a major regional employer that is generating carbon credits by employing efficiency measures at their plant, including: the installation of high-efficiency dust collectors and the introduction of water recycling. The project also supports the 'Energy strategy of Ukraine until 2030' which aims to reduce emissions of sulphur oxides and nitric oxides.

Gas-flaring at Eastern Siberia oil field, Yarakta. Joint Implementation

In the first of such type of transactions in Russia, carbon credits are being generated by utilising gas which would otherwise be flared at an oilfield in Eastern Siberia. The credits were agreed to be purchased through the MCCF in 2009 (EIB, 2009). The gas, which is flared and is set to be re-utilised under this scheme is a by-product of oil extraction. The carbon credits will be bought from Irkutsk Oil's subsidiary, UstKutNefteGas (UKNG). UKNG submitted this gas flaring reduction project proposal to the Joint Implementation Supervisory Committee in order to secure funds to process the gas instead of flaring it (JI PDD, 2010). The project includes the construction of a 30 km gas pipeline, two compressor stations, a gas re-injection well, gas storage facilities and additional power generation. This process claims that it allows some 95 per cent of the total volume of Associate Petroleum Gas (APG) produced over the whole life of the field to be re-used, resulting in significant reductions of greenhouse gas emissions (EIB, 2009). The crediting period starts on 1 July 2011 and lasts one and half years until 31 December 2012 (BVS, 2010).



While the Russian Federation is the host, Spain, Netherlands and Switzerland are involved in order to receive offset credits (JI PDD, 2010). This transaction was negotiated for the MCCF by Green-Stream Network Plc., which acts as a carbon manager for the MCCF in Russia.

CDM hydropower, Armenia – purchasing carbon credits from ten small hydropower plants have been bundled into a single project under the Clean Development Mechanism (CDM) framework.

OÜ Nelja Energia wind farms, Estonia and Lithuania – purchasing carbon credits generated via the Joint Implementation (JI) mechanism from wind farms managed by the Estonian investor, OÜ Nelja Energia, wholly-owned by Fre-energy AS. In June 2009 the EBRD provided a EUR 19 million equity investment in Fre-energy, to help support the development of OÜ Nelja Energia's wind farm projects.

The Fund participants are private and public companies, and EBRD and EIB shareholder countries. The companies purchase carbon credits from emissions reduction projects financed by the EIB or EBRD to meet their mandatory or voluntary greenhouse gas (GHG) emissions reduction targets. Eligible projects are financed by the EIB and/or EBRD. The money to purchase the carbon credits generated by these projects is provided by MCCF investors. As shown above, these investors are six EU governments and five EU ETS corporates (neither the EIB nor EBRD have invested in MCCF) (Cusworth & Balenciaga, 2011b).

The MCCF was developed for project-based carbon credits using an intermediate structure involving three independent, private sector companies acting as "carbon managers". While the MCCF Secretariat carry out supervision, the negotiation, contracting and monitoring of carbon offset transactions are outsourced to these independent consultants, each of them covering a specific region. Furthermore, although the carbon managers negotiate the Emission Reduction Purchase Agreements (ERPAs) with the selling project companies, the actual contracting is carried out through Stichting CPI²⁰. Carbon offset credits are only sourced from projects that received financing from the EIB and/or EBRD.

Incentives for engagement in MCCF carbon projects

The EIB encourages participation by sellers of carbon credits by offering prices for carbon credits that reflect market and project risks and payment up to 50% of carbon finance upfront in hard currency. In certain cases, there is an option to acquire post 2012 carbon credits. Since the EIB rely on consultants, they promote these services as a means to minimise the workload of the project owner including through consultants developing and submitting Project Idea Notes (PINs), Project Design Documents (PDDs) and negotiation of Emission Reduction Purchase Agreement (ERPAs).

Investor confidence is further bolstered with the reassurance of carbon finance expertise in project appraisal and risk mitigation by these two major European financial institutions.

²⁰ Stichting Carbon Purchase Intermediary (CPI) is a special purpose vehicle created to acquire carbon credits for MCCF participants

3.2 Carbon Fund for Europe

Joint initiative between EIB and World Bank

Launched: 2007

Fund volume: EUR 50 million

Member State participants: Fondo Portugues de Carbono, Portugal, Ireland, Luxembourg, Belgium (Flemish Region)

Corporate participants: Statkraft (energy company), Norway

Offset project host countries: Czech Republic, Egypt, Jordan, Malaysia, Nigeria, Russia, Thailand

Carbon manager: World Bank

The Carbon Fund for Europe (CFE) was launched in May 2007, when it was fully funded by the above participants. The CFE is designed to help European countries meet their commitments to their Kyoto Protocol targets through the CDM and JI, which are compatible with the EU ETS. The CFE is a trust fund established by the World Bank, in cooperation with the European Investment Bank (EIB). The Fund will purchase carbon credits through the Kyoto mechanisms for climate-related investment projects from either bank's portfolio as well as self-standing projects.

While the World Bank brings its expertise and experience of the carbon market to the CFE, the EIB brings its knowledge of the European economy and its large project pipeline in developing countries. Through the CFE, the two institutions spur on private sector development in the carbon market. These offsets generated from their projects can be used against obligations under Kyoto or for other regulated or voluntary greenhouse gas emissions reduction regimes.

The CFE gives preference to projects with relatively short lead times in order to maximise the generation of credits that could be used up to 2012. The Fund may also purchase carbon credits generated by a project beyond 2012, up to a limit of 40%.

Project types include:

- Renewable energy such as wind, hydro, solar, fuel switch from fossil to biofuel
- Energy Efficiency in buildings and industriesMethane recovery from landfill or wastewater treatment
- Recovery of natural gas otherwise flared

Project examples



Gas flaring reduction project for JI from the Komso-molskoye oil field in Yamal-Nenets, Russia that is operated by Rosneft-Purneftegaz (World Bank, 2011c). The

World Bank states that 7,221,456 tonnes of CO₂ equivalent will be reduced (World Bank, 2011d). An Emission Reduction Purchase Agreement (ERPA) was signed with the World Bank in 2008.

Denmark has invested in this project for credits to be generated between 1 January 2010 to 31 December 2012. This project is designed to treat and transport gas through a new pipeline and then to sell it to Gazprom (UNFCCC, 2011).

The Project Design Document recognises the severe negative impacts from gas flaring as well as the economic costs from this wastage amounting to US \$13 billion annually, despite the national target to use 95 per cent of associated gas from oil extraction (JI PDD, 2006).

3.3 Post-2012 Carbon Fund

Launched: 2008

Fund volume: EUR 125 million

Investors: Caisse des Dépôts, Instituto de Crédito Oficial, KfW Bankengruppe, Nordic Investment Bank

Carbon managers: Conning Asset Management (Europe) Limited²¹ (Investment Manager) and First Climate (Investment Adviser)²²

The aim of this Fund is to support carbon offset project developers to lock in their future carbon credit revenues now (EIB, 2009b). The Post 2012 Carbon Credit Fund supports offsets projects by giving value to their post-2012 emissions reduction and offering purchase of these post-2012 offsets at attractive prices. Existing carbon offset projects are driven by the demands related to industrialised country obligations for emissions reduction under the Kyoto Protocol in the first commitment period, 2008-12.

An international policy regime for emissions reduction and the carbon market after 2012 has yet to be defined: consequently, as 2012 approaches it remains difficult for new projects to attract investors amidst this uncertainty. Therefore, the EIB and its partners, including the World

²¹ www.conning.com

²² www.firstclimate.com

Bank, are attempting to instil confidence and shoulder the risk of investments in projects associated with a post-2012 carbon market.

The EUR 125 million available to invest in carbon credits is earmarked exclusively for purchasing Kyoto-compliant carbon credits generated under the CDM and JI after 2012, potentially up to 2020. The Fund is set to sell on the carbon credits if and when the shape of the post-2012 carbon market regime emerges.

Simon Brooks, Vice President of the European Investment Bank (EIB), has emphasised risk reduction as the Fund's key contribution:

"Our key aim in launching this fund was to facilitate project business after 2012 by offering a solution to the main issues facing project developers: the timely coming into effect and the potential shape of a post-2012 agreement, income levels from future carbon credit revenues, and the availability and reliability of buyers for ERPAs signed in advance. The Fund offers solutions to all these problems... it guarantees to purchase CERs [Certified Emission Reductions] based on current Kyoto regulations, irrespective of any potential changes to the framework in the future and independent of whether an agreement has been reached in time or not." (EIB, 2009)

The EIB fails to clarify about what strategy it will adopt if there is no post-2012 regime in place due to failed climate negotiations. COP 17 in December 2011 is the last chance for a global climate regime to be put in place, without a gap as the first period of the Kyoto Protocol ends. Despite the potential failure of the climate talks, the drop in carbon credit prices and volatility of markets, and despite the wide recognition, including among market participants, that project-based offset mechanisms are not suitable to trigger structural change in energy-infrastructure, either at scale or speed needed to prevent runaway climate change, the EU, EIB and World Bank have not stopped supporting new project-based carbon market mechanisms (Reyes, 2011b).

3.4 EIB-KfW Carbon Programme I & II

EIB-KfW Carbon Programme I

Joint initiative between EIB and KfW (Kreditanstalt für Wiederaufbau)

Launched: 2008

Fund volume: EUR 100 million

Carbon manager: KfW (Kreditanstalt für Wiederaufbau)²³

²³ <http://www.kfw.de>

For the first tranche the recipients of these emission credits are primarily European small and medium-sized enterprises (SMEs) that do not wish to purchase certificates directly from a project developer but have to fulfil their commitments under the second phase of the EU ETS. The Carbon Programme supports the development of the ETS and the overall carbon offset markets by providing liquidity and assuming certain risks (EIB, 2009).

Project types for the first tranche:

- Renewable Energy
- Landfill gas
- Coal mine methane, coal bed methane
- Fuel switch
- Energy Efficiency
- Carbon Capture and Storage (CCS)
- Land use, land use change and forestry

EIB-KfW Carbon Programme II

Launched: 2009

Fund volume: EUR 100 million

Carbon manager: KfW (Kreditanstalt für Wiederaufbau)²⁴

This mechanism is designed to create the opportunity for selling and purchasing of offset credits under the CDM and JI, but also for credits to be regulated under their post-2012 successor(s) for delivery up to 2020. Offset projects are prioritised in Least Developed Countries (LDCs). Usually the offset credits will already be purchased before project completion directly from the local project companies on the name and account of KfW (KfW, 2011).

Project types:

- Small energy efficiency
- Renewable projects (landfill gas and coal mine methane)
- Fuel switching in LDCs

Project examples:

- Hunan Taoyuan Hui renxi Hydropower Project, China: 20 MW²⁵ large hydro, operational from July 2008
Swiss Atmoguard credit buyer (KfW, 2008)
- Chiller Energy Efficiency Programme, India
- Biogas Support programme, Nepal
- Chiller Energy Efficiency Programme, Philippines
- Solar Water Heating, South Africa
- Boiler Modernisation, Poland

²⁴ <http://www.kfw.de>

²⁵ Civil society organisations often define large hydropower as being above 15 MW capacity

3.5 Fonds Capital Carbone Maroc (FCCM)

Launched: 2009

Fund Volume: MAD 300 million (EUR 26 million)

Investors: Groupe Caisse de Dépôt et de Gestion, Caisse des Dépôts et Consignations

Carbon managers: Accès Capital Atlantique S.A. (ACASA)²⁶

The EUR 26 million Fonds Capital Carbone Maroc (FCCM) is dedicated to carbon finance in Morocco. The first carbon fund to be set up in Francophone Africa, its remit is to help Moroccan promoters carry out projects proposed under the Kyoto CDM by acquiring their carbon credits over the period 2008-2017.

Areas covered by FCCM:

- Renewable energy
- Energy efficiency
- Waste management
- Afforestation and reforestation

Project examples:

Essaouira wind power project (60 MW) in Cap Sim, Morocco. France and Switzerland are involved parties (UNFCCC, 2011b).

A consortium of European banks and French carbon trader Orbeo have reportedly agreed to buy 2 million U.N.-backed carbon offsets up to 2018 from a Moroccan wind farm project, near Tangiers. The project was developed by Morocco's Office National de l'Electricite (ONE) and UK-based clean energy project developer Camco. It is also connected to the Post 2012 Carbon Fund as credits are to be purchased up to 2018 (Reuters, 2010).

3.6 New Entrants' Reserve (NER) auction fund (NER300)

The New Entrants' Reserve (NER) is a financing instrument managed jointly by the EIB, EC and Member States. It is nicknamed NER300 because Article 10(a) 8 of the revised Emissions Trading Directive 2009/29/EC contains the provision to set aside 300 million permits to pollute in the New Entrants' Reserve of the EU ETS for subsidising installations of innovative renewable energy technology and carbon capture and storage (CCS) (EU Directive, 2009).

The allowances will be sold on the carbon market and the money raised – which could be as much as 4.5 billion EUR if each allowance is sold for 15 EUR – will be made available to projects as they operate (see www.ner300.com). In terms of the geographical spread of the projects, concentrated solar power (CSP) proposals are to be found in the Mediterranean, with over half of these proposals from Cyprus. Geothermal projects have been proposed in central Europe and ocean-related proposals come from countries with access to the Atlantic. Northern European countries dominated the proposals for bioenergy projects (NER300, 2011).

Yet again the EIB's role is dependent upon external consultants, in this case due to the lack of in-house expertise to evaluate the proposals for CCS and renewable energy projects (NER300, 2010). In July 2011, the process began to select carbon exchanges and clearing banks for the monetisation of the 300 million pollution permits for phase 3 of the EU ETS (EIB, 2011).

3.7 Forest carbon offsets

Besides the six carbon funds detailed above, the EIB has recently got active also within newly established and still pilot forest carbon funds. In May 2011, Christopher Knowles, Head of Climate Change and Environment at the EIB stated that he hopes its support for a €250 million climate fund will spur European investments in Reduced Emissions from Deforestation and Degradation (REDD) projects (Point Carbon, 2011). He added that the bank was willing to make a significant investment in forest carbon, despite the fact that the EU has excluded carbon credits from forestry projects in the EU ETS until at least 2020 (Point Carbon, 2011).

In particular, the European Investment Bank is considering a €20 million investment in the €200 million Althelia fund – planning to back up to 25 projects in next three years - and the fund managers are committed to ensure all Althelia's REDD investments are developed in such a way as to be eligible for any future international REDD mechanism or regional mandatory markets, such as in California²⁷.

²⁶ www.acasa.ma

²⁷ <http://www.carbon-financeonline.com/index.cfm?section=global&action=view&id=14051&linkref=cnews>

3.7.1 Althelia fund

The EIB announced it would be a “cornerstone investor” in the new Althelia Climate Fund, whose objective is to invest in forest carbon and REDD projects through forward purchase agreements and to issue tradable offset credits. The projects, which will be designed according to programmes such as the Verified Carbon Standard (VCS) and UN REDD, are to be located in Africa and Latin America (EIB, 2011e).

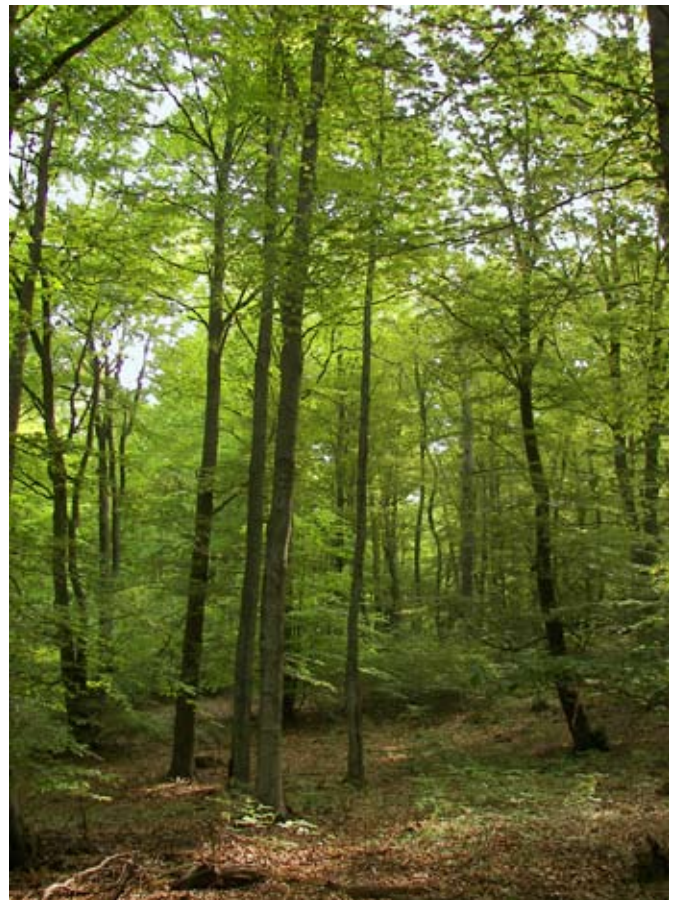
The rationale behind the forestry investment is to give confidence to financial institutions in the private sector to invest in forest carbon in a similar vein to its support of CDM projects, particularly since investors are sceptical of forest carbon offsets and are not willing to take on the associated risk (Point Carbon, 2011). As previously outlined, no agreement has been made to include forests into compliance carbon markets but the EIB is also interested in piloting the forest offset projects for the voluntary market to begin with.

Furthermore, the EIB – along with the World Bank and Asia Development Bank – is reportedly issuing a first-of-its-kind ‘rainforest bond’ which would repay investors based on returns from the ecosystem services provided by the area of rainforest. Bank of America Merrill Lynch (BoAML) is structuring the transaction, which has been under development since 2010. There is an estimated \$10 billion in bonds being issued to date, much of which has come from multilaterals banks (Carbon Finance, 2011).

The bond “would see institutional investors receive returns for monetised ecosystem services including REDD+ credits”, referring to credits awarded to projects that reduce emissions from deforestation and forest degradation, and with the ‘plus’ denoting conservation, sustainable forest management and enhancing carbon stocks (Carbon Finance, 2011). This could result in land grabbing for the privatisation of forests, industrial biofuels, monoculture tree plantations, GM crops and biochar projects.

3.8 EIB’s other climate funds

In 2010, in accordance with its role as the main long-term financial institution of the EU, the EIB pledged almost EUR 21 billion for climate finance, which comprised of 29% of its overall annual financing. The majority of these funds, EUR 19 billion, were earmarked within the EU. In countries outside the EU, the EIB financed EUR 2 billion for climate related activities in 2010.



According to the European Commission (EC), this amount is likely to increase further until 2013 due to the agreed increase in the Energy Sustainability Facility from EUR 3 to 4.5 billion and the Commission’s proposal to allocate an additional EUR 2 billion until 2013 across different regions for EIB financed climate projects (EC, 2011e:40-44).

Photo by Willow, Wikipedia (Creative Commons Attribution-Share Alike 2.5 Generic license)

The EIB acts a catalyst for investment in climate-related technology with partner institutions within and outside the EU (EIB, 2011d). Broadly speaking, the EIB, other Multilateral Development Banks (MDBs) and larger bilateral Development Financial Institutions (DFIs) have been stepping up their programmes and facilities in the area of climate investments over the last years (EC, 2011e: 40-41).

As Europe’s main financial institution, the Bank spurs investment by coalescing a large variety of institutions, stakeholders and financial partners for climate-related investments, blending grants and loans. Furthermore,

the Bank is collaborating with governments, companies and International Financial Institutions to jointly provide finance for mitigation and adaptation initiatives.

As part of its twin approach to consider mitigation and adaptation measures, the EIB states its support for:

- Energy efficiency and renewable energy investments;
 - Investments to accelerate the development and dissemination of low-carbon technologies and processes in all sectors (i.e. long-term R&D, early-stage commercialisation and demonstration; clean transport; carbon capture and storage);
 - Afforestation and sustainable forest management, the multifunctional benefits of which include both climate change mitigation and adaptation;
 - Lending that fosters resilience in sectors which are particularly vulnerable to climate change and to governments and local authorities that need to adapt to climate change (i.e. flood control and drought management measures in the water sector);
 - Technical assistance initiatives in a wide range of areas for project development and implementation;
 - Development of carbon markets²⁸ (EIB, 2011g).
- Some of these activities such as the investment in forestry and energy efficiency including CCS could help to bolster its lending practices to carbon finance projects that generate offset credits from the very same sectors.

Furthermore, the EIB's expertise in risk-sharing in its broader climate finance portfolio could be soon applied to its role in the development of carbon markets. With carbon markets expanding with a complex array of investors and intermediaries being involved, banks like the EIB are taking on some of the risk to help stave off concerns about volatile markets from carbon offset buyers (Lohmann, 2010).

This could lead to the creation of new speculative bubbles, commodity price swings and other hazardous impacts from which governments cannot shield their citizens in our globalised world economy.

²⁸ <http://www.eib.org/projects/topics/environment/climate-action/carbon-finance/index.htm>

3.8.1 Risk-sharing facilities

There is an increasing range of EIB financial facilities to fund renewable energy or low-carbon projects such as the Risk-Sharing Finance Facility (RSFF), which provides investment for research, development demonstration and innovation that face greater risk and more difficulties to seek funding.

The EIB has also widened its range of financing facilities to include sub-investment grade risk where appropriate by making use of resources from an instrument called the Structured Finance Facility (SFF). The SFF can be applied to help finance renewable energies or other types of priority energy projects, such as trans-European energy networks (TENs). 21 of the 30 priority projects are rail schemes, but road, port and airport schemes are also included, despite their potential high-carbon footprint. According to the EIB website, the Commission has an additional priority list of TEN-Energy projects (TEN-E) comprising of a total of 10 electricity and natural gas transportation schemes, ranging from small cross-border power links to transcontinental gas pipelines²⁹.

The Bank's risk-sharing finance is characterised by a mix of grants and loans as well as technical support, most often involving partnerships with the European Commission or national authorities (EIB, 2011g).

²⁹ For more information on the TENs project, see <http://www.eib.org/projects/topics/tens/financing-of-ten-projects/index.htm>

4. In whose interest?

As highlighted, the EU has shifted towards strongly being in favour of carbon markets and has spurred their growth, which in turn has influenced EU institutions' approach to carbon trading, including the EIB who aligns its mission with the objectives of EU Member States and the EC.

Over the last decade, robust Member State support, corporate lobbying by European industrial vested interests and weak civil society opposition has allowed the EU ETS to come into force and it has now been established as the centerpiece of the EU's climate policy, despite its dramatic failures to reduce greenhouse gas emissions. Its failure has been characterised by its free handouts of permits to major polluters (Carbon Trade Watch & Corporate Europe Observatory, 2011).

Even those engaging in these financial mechanisms have conceded how they have been unable to meet their own criteria. As Peter Atherton (2007) of Citigroup conceded, "ETS has done nothing to curb emissions... [and] is a highly regressive tax falling mostly on poor people."

Asking whether policy goals were achieved, he answered:

"Prices up, emissions up, profits up... so, not really. Who wins and loses? 'All generation-based utilities – winners. Coal and nuclear-based generators – biggest winners. Hedge funds and energy traders – even bigger winners. Losers... ahem... Consumers!'" (Bond, 2009).

Today, the EU ETS is the largest carbon market in the world and the EIB has adopted the EU position to try and guarantee a smooth transition for the continued reliance on carbon markets in the post-2012 period.

According to the European Commission: "For projects with commercial potential, EU funds can be used in partnership with the private and banking sectors, particularly via the European Investment Bank (EIB), in order to help overcome market imperfections in the financing of projects and activities of strategic interest to the EU and its citizens." (EC, 2011d:75).

Indeed since the EIB is owned by EU Member States it has

to serve public interest through its financing activities. In 2010, lending for climate action reached EUR 20.5 billion, or almost 30% of all its lending and it claims that "green growth" is a core objective (EIB, 2010). The EIB appears to use a very broad definition of climate finance that, for instance, makes no clear distinction between grants and loans and risks including projects and operations of its portfolio which might turn out to be not so low carbon and transformative as expected.

Yet is the EIB genuinely supporting public interest by supporting low-carbon growth and adaptation? Can the EIB's approach to climate finance be classified as genuine climate action? How do the bank's priorities to bolster corporate and national governmental approaches to climate change tally with EU citizens' needs in the climate crisis? And what is the development impact of such EIB investments and initiatives?

4.1 National interest

The EIB's role in carbon finance, including its funds that spur on the EU ETS and carbon offsets, allows EU Member States to avoid real cuts in emissions and the provision of appropriate, public finance for adaptation and mitigation measures in developing countries. After seven years, the EU ETS has not managed to cut emissions significantly despite all of its promises and increasing public awareness of the dangers of catastrophic climate change (Schiller, 2011).

The EIB has focused its resources on playing a catalytic role to spur on the expansion of carbon markets despite persistent concerns over a post-2012 agreement at the UNFCCC, and the questions over effectiveness of the third phase (2013-2020) of the EU ETS (Conning, 2009).

This serves the interests of EU Member States that insist in UN climate negotiations that carbon market mechanisms, including the CDM, are necessary for them to be able to meet emission reduction targets through the continuation of the EU ETS (TWN, 2011). As raised previously, there is a surplus of around 970 million of these allowances (that are 970 million of metric tonnes of carbon dioxide equivalent) from the second phase of the scheme (2008-2012), which can be used in the third phase, resulting in the fact that polluters do not need to take any

domestic climate action until 2017 (Carbon Trade Watch & CEO, 2011).

Promoting the expansion of carbon market, opens up developing countries and poor communities to the vagaries of financial markets (Gerebizza, 2011). This also undermines alternative approaches that could generate finance from the taxation of financial transactions and the shift in public subsidies away from fossil fuels and military expenditure.

Furthermore, the EIB's carbon finance, allows EU member states to dodge their climate finance commitments by allowing them to claim that this support takes place through the EIB that generates finance through the banking system and private investors, thus minimising direct financial support from governments.

This fits squarely with EU national governments' rejection of proposals to match every Euro from EU funds with equivalent state contributions, and a lack of funding being forthcoming for climate finance for developing countries. EU countries were accused of offering loans instead of grants and creative accounting to make climate pledges appear new and additional at the climate talks in Cancun in December 2010 (Guardian, 2010).

To illustrate further, Central and Eastern European Member States in particular have expressed concerns about the burden of climate finance schemes on their state coffers. They are attempting to delegate financial and technological support for developing countries to the private sector instead of harnessing their own resources. A further financial incentive for these countries to champion carbon markets is the allowance of these countries to host three CCS and renewables projects in the EU ETS, rather than the maximum of two originally proposed by the Commission (EurActiv, 2010), thus potentially benefiting more from a reflow of some allowance auction revenues in the third implementation phase of the Kyoto Protocol.

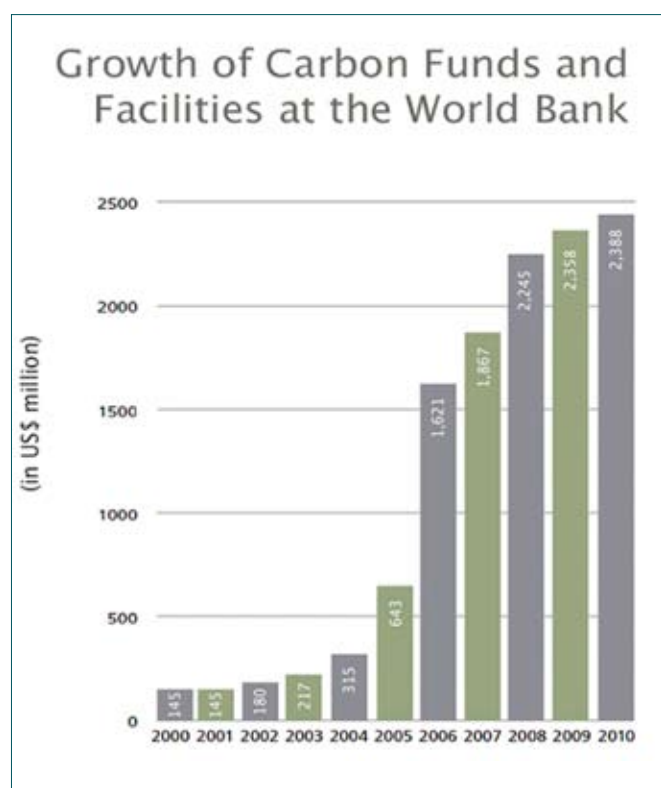
4.2 International Financial Institutions' (IFIs) interest

The EIB is following a similar pattern to its partner, the World Bank, which pioneered its image rebranding to one of green, climate bank. Carbon trading provides a smokescreen to allow IFIs such as the World Bank and EIB to continue fossil fuel lending by claiming these negative climate impacts are being offset through their carbon finance portfolios.

The CDM has already approved projects for methane capture from coalmines and 'supercritical' coal fired power stations, and it is preparing to accept Carbon Capture and Storage (CCS). Gas flaring reduction projects are included within the JI and CDM pipelines (African Biodiversity Network et al., 2011; World Bank, 2007).

This comes against a backdrop of widespread criticism for failed IFI economic policy prescriptions, fossil fuel lending and the marginalisation of local communities as well as the increased public concern over the role of banks and financial sector in the current economic crisis (IPS, 2008; FoE US, 2011).

Beyond the image rebranding to allow continued fossil fuel lending, carbon trading is profitable for IFIs and provides them with a new source of income. The World Bank's portfolio totals more than EUR 1.7 billion (US \$2.5 billion) and the EIB's is EUR 589 million (World Bank, 2010; Cusworth & Balenciaga, 2011). Furthermore, there will be further capital investment through EC grants linked to EIB funding.



The World Bank focus on facilitating carbon finance investment conforms to that of the EIB including the priority focus on the continuation of the CDM in the

post-2012 period. This has to be put in the context of their efforts being weakened by the breakdown of carbon trade schemes in Japan, Australia, the US and South Korea as well as scandals surrounding VAT fraud and the ban of EU ETS carbon offsets related to CDM industrial gas projects from 2013 (World Bank, 2011).

However, hope for carbon markets is still being pursued through an expanded CDM and a new REDD mechanism – with or without a Kyoto Protocol – in order to support industrialised countries meeting their quantified emissions reduction objectives. Furthermore, the establishment of the Green Climate Fund at the UN climate talks in Cancun – with the World Bank named as initial trustee and a formal agreement for the mobilisation of \$100 billion – opens the door for the World Bank to leverage carbon finance (World Bank, 2011).

The EIB already collaborates directly with the World Bank in the Carbon Fund for Europe and has followed its lead as a pioneer of market mechanisms being the key solution to fossil fuel lending and concomitant climate change.

4.3 Corporate interest

More and more corporate investors and intermediaries are cashing in on carbon markets. Among the largest buyers of UN offset credits today are financial-sector speculators, Wall Street or City of London financial firms such as Goldman Sachs, Barclays Capital, Deutsche Bank, BNP Paribas Fortis, Citigroup and JP Morgan Chase. This is not surprising when you consider that in the first half of 2008, 99 per cent of carbon market transactions were in derivatives (Lohmann, 2010).

What is more visibly apparent with regard to the EIB's carbon funds is the dominant role played by corporate consultants who manage these funds and pro-carbon trading lobbies operating in Brussels.

The EIB's operations are reliant on consultants including the carbon managers of their funds. For MCCF, the

carbon managers are, Royal Haskoning³⁰, Greenstream Network³¹, and ICF Consulting³². For FCCM, the carbon manager is Accès Capital Atlantique³³. For the Post-2012 Fund, the portfolio manager and the carbon adviser are Conning Asset Management³⁴ and First Climate³⁵ respectively. For the two EIB-KfW funds, the manager is KfW while the World Bank manages CFE.

If this outsourcing indicates the bank's ability to manage these funds, it highlights that the expertise is evidently lacking internally. Why has the Bank opted to initiate these funds that are highly profitable for consultant managers but are removed from its own areas of expertise? Why are funds directed towards consultants who are able to profit from policies that do not even constitute genuine climate action?

It should be recalled that there are over 15,000 professional lobbyists that operate in Brussels, a large majority representing business interests and not subjected to ethical and transparency rules (Alter-EU, 2011). A key lobbying group that strives to influence European and global carbon markets is the International Emissions Trading Association (IETA) – a group of 176 transnational financial, law, energy and manufacturing corporations including Goldman Sachs, Morgan Stanley, Deutsche Bank, Citigroup, Chevron, ConocoPhillips, Shell, Total, Petrobras, Endesa, Mitsubishi, Duke Energy, Standard (Lohmann, 2010).

This undue influence from powerful lobbyists undoubtedly shapes EU political processes and institutions, including the EIB, towards gearing their policies to serve the interests of corporate-dominated sectors.

Corporate polluters have effectively been subsidised with billions of Euros through the over-allocation of ETS permits. This amounted to a surplus of around 970 million of permits to pollute worth EUR 6.5 billion during the second phase of the scheme (2008-2012) (Carbon Trade Watch & Corporate Europe Observatory, 2011). This not only allows polluters to profit from EU climate policies rather than been held to account for damaging

What is more visibly apparent with regard to the EIB's carbon funds is the dominant role played by corporate consultants who manage these funds and pro-carbon trading lobbies operating in Brussels

30 www.royalhaskoning.com

31 www.greenstream.net

32 www.icfi.com

33 www.acasa.ma

34 www.conning.com

35 www.firstclimate.com

activities but chemical, iron and steel corporate lobbyists are also attempting to weaken EU emissions reduction targets. Mitigation actions have been so severely undermined by the ETS that EU Member States need not take climate action domestically until 2017 (Carbon Trade Watch & CEO, 2011).

4.4 CDM and JI offset projects: reversing the polluter pays principle

Despite the EIB propping up carbon markets through the CDM and JI, the bank does not keep or disclose a full list of supported projects, the volumes of finance involved or the fees it and the consultants involved charge for managing these funds. The EIB also do not disclose a record of funds disbursed in order to protect commercial confidentiality of their partners in the funds, and of the sellers of carbon to the funds, which the EIB claim might be compromised by the release of information that allowed the price paid to be deduced, as outlined in Section 5.2.3 in their Transparency Policy³⁶ (Cusworth & Balenciaga, 2011). However, their carbon funds often refer to the sectors that they support through the CDM and JI, and on occasion there are reference to specific projects. CDM and JI registered projects end up rewarding those companies engaging in destructive practices such as dam developers, chemical and fossil fuel companies, which earn offset credits by cleaning up these practices to a given extent.

As Larry Lohmann has pointed out: “In the global South, only those companies with the resources to exploit a complex UN regulatory system are capable of producing carbon offset commodities for sale through the Kyoto Protocol carbon market.” (Lohmann, 2010).

Moreover this project-based approach is not capable of triggering the transformational energy infrastructure change that is needed to stay well within the EU’s two-degrees maximum global warming objective (which however cannot be considered ‘safe’ in terms of catastrophic climate impacts). Beyond subsidising corporations carrying out destructive practices, diverting finance and preventing real climate action, these projects allow profits to be generated from policies that have resolutely failed to prevent irreversible climate change since they allow polluting activities to continue unabated in Europe (FoE, 2009; Focus on the Global South, 2010). Therefore, the EIB is spurring

carbon intensive patterns in developed countries that buy CDM credits to dodge their obligations. Furthermore, the carbon market involves financial speculation and it is very difficult to prove the link between emissions reduced and the price paid. By running carbon funds, the EIB supports profit-led carbon finance that is based on imperfect rules. As shown, its carbon funds have very little to do with environmental protection or transition to low-carbon energy infrastructure per se but in actual fact constitute rent-seeking. This diverts spending on a just transition towards sustainable energy infrastructure.

4.4.1 Gas flaring

Under the MCCC, the EIB supports projects that avoid gas flaring. Yet campaigners have argued that this practice has caused severe social and environmental harm, and government intervention should end it and subsequently compensate the affected communities rather than rewarding oil companies with carbon credits under Kyoto mechanisms (Carbon Trade Watch, 2006).

In 2009, the EIB and EBRD’s first venture in Russia was to generate carbon credits under the JI mechanism by utilising gas that would be flared at Yakarta, an oilfield in Eastern Siberia, involving Irkutsk Oil. The carbon credits beneficiary is Irkutsk Oil’s subsidiary, UstKutNefteGas (UKNG).

Additionally, under the Carbon Fund for Europe, carbon credits are being generated for JI from the Komsomolskoye oil field that is operated by Rosneft-Purneftegaz. Currently some gas is captured for a processing plant and the rest is flared as this saves on infrastructural costs, but causes severe environmental damage (World Bank, 2011c). An Emissions Reduction Purchase Agreement



Photo © Luca Tommasini, (“Oil for nothing” documentary)

36 <http://www.eib.org/about/publications/eib-transparency-policy.htm>

(ERPA) has been signed under the Fund in order to establish a gas flaring reduction carbon offset project. Rosneft, which is currently undergoing privatisation, has faced strong criticism for polluting activities including oil spills. Its activities on Sakhalin Island have destroyed the livelihoods of Indigenous Peoples and fisherfolk (Business & Human Rights Resource Centre, 2011; Guardian, 2011). Russia is the single largest source of gas flaring in the world but the government is not enforcing the utilisation of associated flared petroleum gas until 2012 (Irkutsk, 2009). Currently, gas flaring restrictions vary from region to region as the federal Mineral Resource Act, which sets standard license terms, does not require the condition on associated gas flaring and usage to be included in the oil production license or license agreement (World Bank, 2011e). Civil society has expressed concerns over extractive development in the fragile Siberian habitat and land used by Indigenous Peoples, where UKNG is operating (BIC, 2009).

In Nigeria in 1984, the government declared gas flaring illegal but it continues to be standard practice by Shell and other oil companies despite their promises to end this damaging practice (FoEI, 2011). Various deadlines have been imposed by the government and the current deadline is December 2012 (Business & Human Rights Resource Centre, 2011b). Shell and other companies could potentially receive Clean Development Mechanism (CDM) licenses to reduce gas flaring. The Italian company, Eni, which is 30% owned by the state, is already benefiting from CDM license to reduce gas flaring at the controversial Kwale-Okpai project in Nigeria, where local communities denounce continuation of gas flaring and human rights violations despite the reported emission reductions³⁷. The company aims to secure emissions reduction credits through the CDM, by reducing its gas flaring activities in the Congo (Heinrich Boll Foundation, 2009).

4.4.2 Fossil fuel switching

Under the MCCF, carbon credits are being generated from initiatives that switch from coal, mazut³⁸ and shale oil to natural gas. Again, such moves towards cleaner energy should be introduced without companies being able to claim carbon offset rewards. Furthermore, in the case of natural gas, fossil fuel companies in the US are being

scrutinised as there are increasing concerns over the chemicals used in the process of extraction (FT, 2010). Natural gas is an inherently dirty source of energy, as highlighted in recent research by the US Environmental Protection Agency (EPA, 2011). It is also a fossil fuel and hence, its use at an industrial scale will have to be curtailed along with oil and coal if EU emissions are to be cut by some 90% by mid-century.

4.4.3 Landfill gas

The EIB supply finance for landfill gas projects under its carbon fund portfolio, which represents around 12% of its overall carbon finance (Cusworth 2011). Waste to energy offset projects have been condemned as the demand to fuel power plants can increase flows of rubbish, which cause emissions, in order to generate offset credits. The profits from these credits have allowed destructive businesses to expand their operations that cause further pollution and displacement (See case studies in Focus on the Global South, 2010). Further, local waste-picker communities acting to reduce waste and sustain livelihoods are often sidelined by CDM projects (Gaia, 2010).

4.4.4 Dams

While the EIB has pulled out of the Gibe 3 Dam in Ethiopia in 2010, it has funded large hydropower such as the Ruzizi hydropower project in Rwanda, the Bujagali dam in Uganda and Hunan Taoyuan Hui renxi Hydropower Project in China. The Hunan Taoyuan Hui renxi Hydropower Project is set to generate offsets through the CDM project and is being supported by the EIB-KfW Carbon Programme.

Initially, large hydro was not traded in the EU ETS because many Member States did not accept it due to controversy and only accepted hydro offset credits in compliance with the World Commission on Dams (WCD) recommendations. However, these guidelines have been violated, and hence EU law has been breached under the CDM (International Rivers, 2008; FoEI 2011).

Large dams are highly controversial as they have caused the displacement of 40–80 million people, impoverishing most of them in the process (World Commission on Dams, 2000; Bosshard, 2003; World Bank, 2011b). According to John Briscoe, the World Bank's former senior water advisor, "Big dams account for 10 percent of our portfolio but 95 percent of our headaches." (Bosshard, 2003).

37 The reality behind EU 'energy security, 2011. <http://bankwatch.org/sites/default/files/energy-security-nigeria.pdf>

38 Mazut is a heavy, low quality fuel oil.

Furthermore, dams are a source of greenhouse gases, especially in the tropics. Scientific studies have shown that decomposing organic matter in reservoirs caused by dams has resulted in significant emissions of the greenhouse gases methane, nitrous oxide and carbon dioxide (International Rivers, 2008). Methane emissions from dams currently account for at least 4% of the total global warming impact of human activities, and constitute the largest single source of anthropogenic methane (Lima, 2007).

Dams that have been considered and/ or approved as offset projects under the Clean Development Mechanism (CDM) have had negative health, social and environmental impacts. Moreover, dam breaks in China have killed approximately 300,000 people in China and their development has led to the violent repression of local communities (International Rivers, 2007 & 2008b; Bosshard, 2011).

Further, there is a major issue of dams failing to be additional i.e. that they would not have been built with carbon finance to reduce emissions from a business-as-usual scenario (in the case of dams this scenario implies dams replacing other forms of dirtier energy as the CDM classifies hydropower as clean renewable energy). To illustrate, more than a third of the hydropower approved by the Clean Development Mechanism's Executive Board was already completed at the time of registration and almost all were already under construction (International Rivers, 2007).

4.4.5 Land grabbing for monoculture tree plantations

Carbon offset credits are set to be increasingly generated from broader trading in ecosystem services (biodiversity, soil, water etc). Under the CDM, land is being set aside and communities are being forcefully removed in order to make way for monoculture tree plantations.

In Uganda, communities have been displaced from the Namwasa forest by the police and military to make way for large-scale tree planting by the UK-based New Forests Company (NFC) (allAfrica, 2010). In 2008, the EIB proposed to lend EUR 4.65 million to finance a NFC Forestry Project to plant fast-growing eucalyptus and pine trees in order to generate CDM offset credits (EIB, 2008). Luwun-ga and Namwasa plantations in Uganda are spotlighted in an EIB annual report that boasts of its green credentials (EIB, 2010b). Meanwhile, NFC is taking over more land in Uganda and elsewhere in Africa for plantations and wood

products industries (RDB, 2011; IGHE, 2011).

The Consultative Groups on International Agricultural Research (CGIAR) highlights how plantations at best store 20% of intact old growth forests, and their expansion has degraded fertile land and destroyed local livelihoods (FoEI, 2008b; Gilbertson & Reyes, 2009).

4.4.6 New land grab threats

The EIB is set to establish a EUR 250 million climate fund to encourage European investments in Reduced Emissions from Deforestation and Degradation (REDD) projects (Point Carbon, 2011).

Friends of the Earth International along with other social movements and NGOs have been warning that REDD policies are set to unleash a global land grab (FoEI, 2008). Oil and energy companies are already profiting from offset projects in the voluntary market and there is a major risk that a global REDD deal for compliance markets could be pushed through at the UN climate talks in Durban, this December (FoEI, 2010; Shapiro, 2010; see www.redd-monitor.org for up-to-date information). Privatising swathes of forests to allow for continued pollution in the North provides lucrative businesses opportunity and a smokescreen for inaction. As the Chief Executive of American Electric Power stated forthrightly in October 2009, if anyone claims that the "only reason American Electric Power wants to [invest in a forest offset project in Bolivia] is because it doesn't want to shut down its coal plants, my answer is, 'You bet, because our coal plants serve our customers very cost-effectively.'" (Lohmann, 2010).

According to the EIB, "Carbon forestry is under consideration but given the lack of clear directions from international negotiations and also with regard to terms of methodologies/ verification/ reporting, EIB is still assessing the best way to participate in this market." (Cusworth, 2011).

There is a risk of widespread land grabbing through the CDM for projects that require large, unpopulated areas of land such as industrial tree plantations and biofuels in Africa. There are proposals on the table at the UNFCCC to widen the range of projects that are eligible for CDM funding and this includes GM crops, biochar and soils as greenhouse gas sequestration projects (African Biodiversity Network et al. 2011).

Conclusions: Public interest and genuine alternatives

An increasing body of evidence and on-the-ground testimonies illustrates that addressing the ecological crisis through carbon markets will fan the flames of climate change. In particular, offsets mechanisms, such as the Clean Development Mechanism, can hardly be reformed because they intrinsically justify inaction in terms of real emission reductions by European and other developed countries bearing an historical responsibility for climate change.

Avoiding these market mechanisms and implementing a series of sustainable interventionist measures could tackle instead climate change structurally in order to make a rapid, just transition towards economic and environmentally just societies. Governments must act immediately to put in place economic reforms to instigate a shift in fossil fuel-based industrial, agricultural and transport policies that protect workers and communities. Both alternative financial resources and alternative public policies to the approach based on carbon-markets development exist and should be pursued soon.

Regarding energy infrastructure, savings can be made in the construction of energy –efficient buildings since they account for 40 per cent of energy use in most countries (IEA, 2008). Around 60 per cent of oil is consumed in transport and should therefore be targeted for energy-saving measures also. Another important measure would be global feed-in tariff programme with the investment of US \$100 billion per year over 15 years, which would make appropriate, renewable energy affordable (FoE, 2010).

Spending priorities should be shifted in light of climate change. Redirecting national budgetary military spending would free up resources to allow climate action plans to be put into practice rapidly. Global military spending reached EUR 1.1 trillion in 2010 and the Iraq war alone has cost over EUR 2000 billion (SIPRI, 2011), Stiglitz & Bilmes, 2008). The EU's military expenditure totaled EUR 197 billion (US \$285 billion) in 2010 (SIPRI, 2011b).

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Photo © Elena Gerebizza/CRBM

In addition, governments are financing high carbon infrastructure and the annual global fossil fuel subsidies amount to EUR 487 billion (IEA, OPEC, OECD, World Bank, 2010). The World Bank's coal financing totaled EUR 3 billion for 2010 (FoEI, 2011).

Land use is another major source of anthropogenic emissions. Forestry and sustainable agricultural policies could reduce emissions with measures such as a shift in the EU Common Agricultural Policy to benefit small farmers rather than industrial and fossil-fuel based agricultural production.

More potential government-led initiatives include innovative taxes that could also redress inequality and poverty. An international Financial Transaction Tax (FTT) that would generate revenue from cross-border financial transactions could create hundreds of billions of Euros in government revenue per year (see

www.robintax.org.uk). More generally, mobilising domestic resources is key to give long-term sustainability to climate mitigation and adaptation actions, through taxation and innovative fiscal policies, in order not to generate problems and long-term dependency from international financing as it happened with the aid system in the last decades, with limited results. For instance clamping down on tax avoidance in Europe could save EUR 236-266 billion (FoE EWNI, 2010).

5.1 Time to get onto the right path in the fight against climate change: An urgent need to refocus action within the EU and exit carbon finance

As the largest European public financial institution, the European Investment Bank could and should play a key role in supporting a just transition within European countries, at a time of serious budget constraints all over the EU. Investing with publicly managed resources in actions promoting a truly and democratic low-carbon transition would help making real emission reductions within the EU and make the European commitments on climate change credible and effective at international level.

Therefore the EIB should stop supporting carbon funds and exit the carbon finance business, while reorienting dramatically its large and existing portfolio toward interventions bringing an added value in a European low carbon transition. This would start by phasing out support for fossil fuel projects and reassess all carbon footprint of EIB portfolio in order to strategically change the interventions of the Bank in the energy, transport and industrial sector in Europe. In this regard a careful analysis is needed about the systemic use by the EIB of intermediated lending through different types of financial intermediaries, such as large banks and private equity funds, whose carbon record is often unknown or questionable.

At the same time the EIB should review its overall involvement in climate finance as regards its lending to non-EU countries, and in particular developing countries. The lack of internal capacity to perform proper development due diligence, as emerged in the last years (Counter Balance, 2010), and the systemic outsourcing of the management of its carbon and climate funds to external consultants and managers, as detailed in this report, proves that the

EIB is not the better equipped and skilled institution for the European Union to scale up its funding for climate mitigation and adaptation action.

The additional commitment in this regard of 2 billion Euro for three years, agreed in 2011 by the European Parliament and the European Commission on top of all existing resources available to the EIB for implementing its lending mandate outside the EU, is highly questionable. To date it is not clear at all how the Bank intends to use these resources and according to which “climate” strategy, given its structural lack of internal expertise and capacity. This has been recently proven once more in the case of the reforestation project carried out by New Forests Company in Uganda with EIB support and related generation of carbon offsets credit³⁹. Even though the project is defined as “environmental” by the Bank, it damages local communities and their environment and will not help solving the climate crisis. On this basis it is highly likely that once again additional resources for climate action will be primarily used to prop up carbon markets. Therefore this commitment should be urgently reviewed and possibly eliminate in the definition of the new EIB external lending mandate for the 2013-2020 period.

The EIB should stop supporting carbon funds and exit the carbon finance business, while reorienting dramatically its large and existing portfolio toward interventions bringing an added value in a European low carbon transition

At the same time the European Union should prioritize the financial support in developing countries for adaptation through the existing UN Adaptation Fund, and restate its support for the establishment of a Green Climate Fund under the United Nations Framework Convention on Climate Change, to be managed in a democratic and transparent way by institutions and agencies independent from IFIs and other financiers, such as the World Bank and the European Investment Bank. This

request should be carefully taken into account in the context of the upcoming debate at European level of the reset of the institutional financing architecture for the overall European External Action.

39 Oxfam International, The New Forests Company and its Uganda plantations. 22 September 2011, Matt Grainger and Kate Geary, <http://www.oxfamnovib.nl/Redactie/Downloads/Rapporten/cs-new-forest-company-uganda-plantations-220911-en.pdf>

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