

European Climate Policy Research Seminars (ECPRS)

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Hype or Reality: Can the CDM trigger FDI?

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The Wishful Scenario 1

- ❖ Inherent in the CDM concept was the expectation that the Clean Development Mechanism might broaden the traditional economic determinants of foreign direct investment flows...
- ❖ That multinational companies (MNC) perceive new CDM-related business opportunities (such as the production of CERs by foreign affiliates (and their subsequent internal use or sale).



The Wishful Scenario 2

- ✚ The assumption was that production of CERs would also give the subsidiary or affiliate of a MNC a competitive advantage (e.g. energy efficiency improvements).



The Current Realities

- ❖ The CDM Portfolio update presented by Jane Ellis of OECD at the 2005 SB-meetings in Bonn offers causes for optimism and pessimism alike.
- ❖ On the positive side, CDM projects have increased to 5 registered CDM projects, 8 others are requested for registration by the CDM Executive Board of which 3 are under review and 110 CDM projects are under validation which could generate 16.9 Mt Co₂-eq.



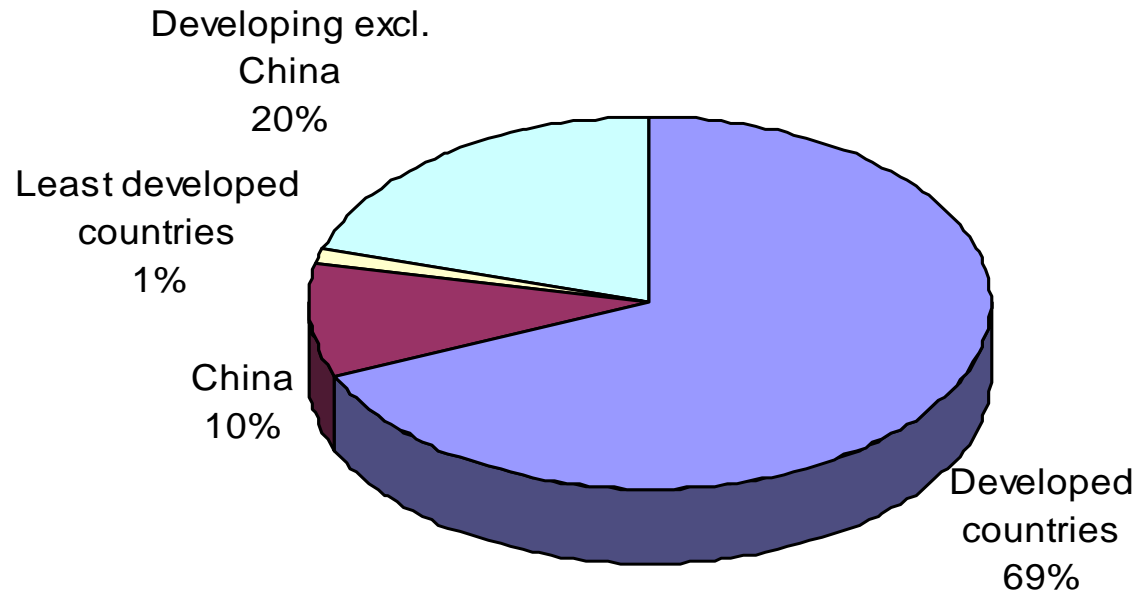
The current FDI realities

- While CDM is slowly emerging, the realities of FDI at global level should not be forgotten, they are..



FDI Inflows in Selected Regions in 2003

**FDI inflows in selected regions in 2003
(percentage of global FDI inflows)**





FDI Flows and CDM Market Potential 1

From a global perspective, current trends in FDI flows give some indication of the preferences of capital.

- ❖ One element in common with the CDM is the quality of the general business environment.
- ❖ But FDI flows do not necessarily reflect CDM market potential, for a number of reasons:



FDI Flows and CDM Market Potential 2

1. CDM demand comes from both governments and the private sector, which might have different motivations and preferences. And private sector demand is not all associated with TNCs that operate in developing markets.



FDI Flows and CDM Market Potential 3

2. Conversely, not all TNCs have an interest in Kyoto compliance instruments such as CERs from CDM projects and therefore might not have a compelling incentive to make the required additional investment in climate mitigation.
3. CDM transactions are predominantly in the form of CER trade, rather than equity investment in CDM projects, and not all equity investment in CDM projects will be in the form of direct FDI.



FDI Flows and CDM Market Potential 4

4. FDI might flow to sectors/economies that do not represent large CDM potential.

Vice versa India is expected to be a major supplier of CERs, but its inward FDI is low and non-equity FDI mainly flows to the telecom, IT and business services sectors, which do not have substantial CDM potential.



FDI Flows and CDM Market Potential 5

5. FDI flows to companies do not guarantee investments in climate change mitigation efforts that meet CDM criteria, although technologies that are transferred to developing countries in connection with FDI generally tend to be more modern and environmentally "cleaner" than what is locally available (OECD, 2002).
- ❏ Greenfield FDI may even increase absolute greenhouse gas emissions.



FDI Flows and CDM Market Potential 6

6. The necessary institutional prerequisites, specialized capacity and incentives to facilitate CDM investments and to keep transaction costs low...
...might be lacking in potential CDM host countries.



Implications and Need for Further Research 1

This paper suggests that the simplistic assumption that CDM financial flows will be correlated closely with FDI flows may not hold and warrants further analysis.

Further research is needed to determine how developing country entities can attract CDM investment or enhance their ability to export CERs. This will require more detailed analysis of:



Implications and Need for Further Research 2

1. the sources of demand (countries; government vs. private; sectors and their CDM preferences),
2. the dynamics of evolving carbon markets,
3. the different CDM transaction models (equity investment in CDM projects vs. *ex ante* CER purchase agreements vs. secondary market CER trades),
4. the national determinants of CDM financial flows, and
5. the possible links between trade flows, FDI and CDM.

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**Thank you for your
attention!**

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