Konrad Adenauer Stiftung

CLIMATE REPORT 2017

PRIVATE SECTOR AND CLIMATE FINANCE IN THE G20 COUNTRIES

ABOUT THE REPORT

The G20 countries comprise two thirds of the global population as well as more than three quarters of the world's economic output, trade and CO_2 emissions. Climate change is on the G20 agenda as a central future issue, also as an economic and fiscal challenge because corresponding investments from the private sector are a prerequisite for the fulfilment of the Paris climate protection goals. Our latest Climate Report, which continues the series from 2007, 2011 and 2014, provides answers to the question of how far the private sector plays a role in climate financing in the G20 countries.

MEXICO

In 2015, Mexico was able to mobilise 2.3 billion US dollars for climate projects. However, only 32 percent of this sum came from Mexico itself. The bulk of the money came from multilateral sources such as the World Bank, bilateral cooperation agreements and other international financing mechanisms. These figures show that Mexico's efforts to reach its ambitious climate protection targets by 2030 are, to date, by no means sufficient. In addition to the optimisation of existing financing instruments and the implementation of planned tools, a massive mobilisation of private capital is needed above all.

Mexico is, together with Chile, Brazil and Argentina, the spearhead of solar energy in Latin America. Source: © renacal1, iStockPhoto

INTERNATIONAL CLIMATE PROTECTION COMMITMENTS

When it comes to proactively taking part in international climate protection efforts, Mexico is the flagship emerging market par excellence. Not only was it the first non-Annex-I country to join the ambitious reduction targets for 2050 voluntarily, but also in the run-up to the COP21 in Paris, Mexico attracted a lot of attention by presenting its Intended Nationally Determined Contribution (INDC) punctually and with an unexpectedly ambitious contribution: by 2030, the country would independently cut its greenhouse gas emissions by 22 percent against a business-as-usual scenario, without the support of the international climate protection regime. Should the Paris agreement lead to a more intensive multilateral climate protection cooperation, especially in the form of increased technology transfer and additional international financing, Mexico could even commit itself to an increased reduction target of 36 percent.

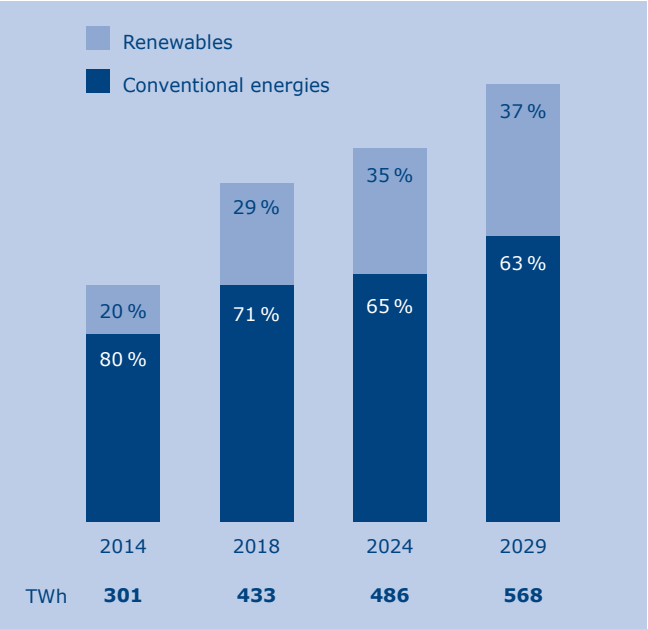
This means that the sectors with the highest share of CO_2 emissions in Mexico will face drastic adjustments. A government document on the subject, for example, states that Mexican industry, together with the energy sector, will use 43 percent of its electricity from "clean" sources of energy by 2030 and will have to increasingly include pollution-reducing technologies. In the transportation sector, among others, stricter environmental regulations and requirements for vehicles and industrial plants will be necessary. The expansion of the public transportation system and the advancement of investing in electricity-powered vehicles are also important. In addition, in the building construction sector, the construction of sustainable and energy-efficient buildings is to be promoted. At the same time, the INDC, with the involvement of the forestry sector, supports a rigorous deforestation stop.

For the Mexican government, it is also necessary to embed its commitment to combating climate change at a national level in a legal framework and to establish a broad set of instruments for the mobilisation of public, international and private funding.

LEGAL ANCHORING OF THE INDC

Over the past decade, Mexico has made considerable progress in regard to its climate protection policy. The most important milestone in Mexican climate policy is the 2012 General Climate Act. It includes general climate objectives, strategies and plans

PLANNED DEVELOPMENT OF MEXICO'S POWER GENERATION FROM RENEWABLE AND CONVENTIONAL ENERGY SOURCES



Source: El Economista

aimed at reducing the country's greenhouse gas emissions by 50 percent by 2050 compared to the year of 2000. In addition, the "clean" energies (nuclear energy and gas are both encompassed in this definition of the Mexican climate protection legislation) should contribute at least 35 percent to electricity generation by 2024. On this basis, the national climate strategy 10-20-40 was adopted in June 2013, which is a sort of a route planner with concrete measures for the next ten, twenty and forty years. In addition, the so-called "Climate Change Special Programme 2014-2018" went into effect in 2014, with 23 measures to reduce CO_2 emissions by more than 80 million tons compared with the business-as-usual scenario.

In addition to these main instruments of Mexican climate policy, countless structural reforms also underpin climate protection policies in the energy sector. In this context, the climate change law, which is aimed at regulating the sustainable use of energy and the reducing of CO_2 emissions in the electricity sector, is of particular significance. The National Renewable Energy Programme of 2015 is linked to the above-mentioned special programme and sets clear expansion targets for renewable energies.

INSTRUMENTS OF CLIMATE FINANCING

With regard to the provision of financial mechanisms to reduce CO_2 emissions, Mexico has caught up over recent years. This is also necessary if it wants to achieve its ambitious (unconditional) climate protection targets. According to estimates, the Mexican state will have to spend between 160 and 170 billion US dollars on this by 2030.

However, the implementation is still very cumbersome. The best example for this is the Mexican Climate Fund. It was set up in 2013 to pool all the funds made available by the government, the private sector and international donors for climate protection, and to distribute them among the various mitigation and adaptation programmes and measures. By 2016, however, the fund had received no contributions due to the lack of statutory regulations and coordination. A reform of the General Climate Act, which is currently being discussed, should provide a remedy. Still, with clearer regulations, small-volume emission reduction measures were supported with 1.35 million US dollars.

In addition to the Climate Fund, there is yet another national fund which could, however, spend significantly less money. The "Fund for Energy Exchange and Sustainable Energy Use" (FOTEASE) was able to implement 39 projects within six years, with a total budget of almost 9.1 million Mexican pesos (approx. 700,000 US dollars).

In addition, a carbon tax was introduced in 2014. This is intended to make large companies and consumers pay a higher price for fossil fuels and encourage a more economical use of non-renewable energy resources. The income resulting from this tax collection is to be used for concrete measures of (emission) reduction and the expansion of utilising renewable energies. However, compared with other countries, which also levied a tax burden on the use of fossil fuels, their implementation in Mexico has not produced the anticipated results. This can be attributed mainly to the very low tax rate set by the Mexican Treasury under the last tax reform. While the global average rate for such a fee is 20 to 30 US dollars per ton of CO_2, it is only five US dollars in Mexico. This means that only three percent of the fuel price is taxed, which equals an extra charge between five and 15 cents per litre of gasoline, diesel, heating oil, etc. Consequently, most companies prefer to pay this small extra charge instead of spending large investments on the more environmentally friendly and resource-saving conversion of their industrial facilities. A further weak point is that natural gas is excluded from this allocation because, according to the national climate protection legislation, it falls under the category of "clean" energy. The fact that from 2014 to 2015 the tax revenues decreased by a significant amount has a lot

to do with this. Mexico's natural gas-based power-generation has been growing during these years, in contrast to its power-generation based on petroleum. While in 2014 nearly 520 million US dollars flowed into the Federal coffers through this tax, in 2015 the amount decreased to only 410 million US dollars. It is also critical that so far, neither the purpose of the total tax revenue, nor the appropriate measures have been identified for which the funds could be used.

Another financial tool that the Mexican government wants to establish by 2018 is a renewable energy certification scheme. In this model of quotas, the state determines the ratio of renewable energies within the total energy consumption of the country and mandates electricity producers and suppliers to cover a certain (over time increasing) part of their electricity production or supply from renewable energy sources. The operators of renewable energy plants receive certificates for their electricity production, which they can also sell to other stakeholders in the energy market. Also worth mentioning is an emissions-trading pilot project with which the government is preparing the private sector for a planned, compulsory national emissions-trading starting in 2018.

Lastly, Mexico's government has also set the framework for the development of green bonds. By 2016, the National Development Bank of Mexico, *Nacional Financiera* (NAFIN), was able to issue bonds totalling 500 million US dollars. The capital of Mexico participated with 50 million. In 2018, the issuance of a "green" bond worth US six billion US dollars is expected for the construction of the new international airport.

PARTICIPATION OF THE PRIVATE SECTOR IN CLIMATE PROTECTION

The Mexican energy sector can refer to a significant financial contribution from private companies in regard to climate protection. The energy reform of 2013 made this possible. It opened the Mexican energy sector for foreign investors and liberalised the national electricity market in particular. Articles 25, 27 and 28 of the reform provide that companies in Mexico are allowed to produce and sell electricity. The previously firmly established monopoly of the Federal Electricity Commission (CFE) was thus dissolved and replaced by a freer wholesale market. At the same time, the reform creates incentives for the expansion of renewable energies: by 2050, 50 percent of electricity is to be generated by renewable sources of energy. Private companies wishing to participate in the Mexican electricity market may be required to produce or purchase their electricity from renewable energy sources. By means of state-regulated tenders and the subsequent auction of greenhouse gas certificates, the government has granted numerous concessions for foreign companies over the last two years. In the first power auction for renewable energies, 75 percent of the assigned electricity supply was solar power and 25 percent wind power projects. At the second power auction, 16 solar projects have been signed. By 2019, 34 companies will have invested 6.6 billion US dollars in renewable energy.

The other sectors, particularly the transportation sector, which should make a major contribution to climate protection due to their high emission quotas, have not yet managed to secure significant private financial resources. There is a lack of a secure legal framework and clear policy goals that would encourage potentially interested companies to inject significant financial means into emission-reducing projects.

State programmes designed to support sustainable energy projects or issue eco-loans for small and medium-sized enterprises are trying to increase the involvement of the private sector. How effective these programmes are, however, cannot be determined precisely because of the lack of instruments to ascertain transparency. This tackles a very fundamental problem with regard to the financing of climate protection projects in Mexico. Representatives from the public and private sectors agree that in order to fulfil the emissions reduction commitments it is important to make the actual effects of the numerous measures visible and to quantify them. This would create more confidence in Mexico's climate policy and also have the advantage, in the event there are negative results, to implement counter-measures. Additionally, a recurring argument by representatives of the private sector in the debate on the mobilisation of private climate finance is the need to promote a clear legal framework. Particular attention should be paid to the definition of ownership rights and to tax incentives.

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IMPRINT Publisher: Konrad-Adenauer-Stiftung e.V., European and International Cooperation Department, 10907 Berlin, Germany | Responsible: Jasper Eitze, Coordinator for Energy, Climate and Environmental Policy | Berlin, July 2017| www.kas.de