Financing Policies for Climate Change Mitigation in Indonesia

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The world has moved beyond the conventional view that economic development goals are incompatible with environmental objectives. Now we all know, that if left unchecked and unaddressed, climate change represents a serious threat to both the environment and our economic well-being. On the other hand, as a developing country, Indonesia's response to global climate change must be consistent with its development and poverty reduction objectives, while environmental policies need to be in line with economic goals and should be applied using sound economic principles.

Climate change is an issue of high priority for Indonesia. The country is highly vulnerable to climate change, and also emitting significant greenhouse gases primarily from land-use change and forestry. Therefore Indonesia is committed to making a significant contribution to limit global greenhouse gas emissions, and also to helping make a global climate change agreement possible.

This commitment is reflected in the target to reduce emissions by 26% by year 2020 compared to business as usual scenario with the country's own resources, and it could be up to 41% with international support. These goals were announced by Indonesia's President S.B. Yudhoyono at the G20 Summit in Pittsburg, 3 months before and repeated at the COP15 in Copenhagen, which makes Indonesia among the first developing countries voluntarily setting such a high emission reduction commitment, even though it is not mandated by the international climate convention.

Although the 26 to 41% targets are quite a big challenge, but it is achievable, and in a way it could complements the country's development and economic reform objectives, and supports Indonesia's transition to a long-term low carbon development path.
Based on the study of Indonesia's National Council on Climate Change in 2009, technically Indonesia has the potentials and opportunities to reduce GHG emissions up to 84% from the projected BAU scenario in 2020. However, making those opportunities into real practice will be very costly for our limited development budget, and it also faced other constraints in its implementation, such as technological readiness, large-scale up front financing, and other problems related to social and behavioral changes.

Indonesia's emissions profile is dominated by the land-use change and forestry sector. The emissions from deforestation, forest degradation and peat land fires are estimated to account for 60% to 80% of the country's 2005 datasets. The other sources of GHG emissions are from the power sector and manufacturing industries, and also transportation. Energy use in Indonesia is still far below the per capita global average, and even further below energy consumption levels in the developed countries. But as Indonesia's economy grows, energy emissions from fossil fuels are also growing very fast, especially with the growing share of energy supplied by high carbon coal. Waste and agricultural rice are also contributing to Indonesia's emissions, but not as significant as peat-land forests, land use, power, transport and manufacturing industries.

Policies for climate change mitigation

The challenge for the Indonesian policy makers is how to design and implement policies and instruments to achieve 26% emissions reduction target in a way that is consistent with pro- growth, pro-poor, and pro-job development objectives. Meeting these complex challenges will require more innovative ways of combining policy mix and instruments, as well as a fair and equitable transition from the current inefficient and wasteful policy settings.

It is a tall order, but currently the government of Indonesia has started to apply 5 policy instruments, namely : (1) programming and budget allocation policy, (2) climate change financing policy ; (3) financial & fiscal policy, (4) energy & carbon pricing strategy ; and (5) regulatory & institutional frameworks .

- **Programming & Budget Allocation Policy :**

For the Medium Term Development Plan (2008-2012) and starting with the Annual Development Plan for this year (2010) the government of Indonesia has made budget allocation policy to finance sectoral and regional development programs which are in line with the expected emission reductions from each contributing sector. The higher the emission reduction target is set for a certain sector, the bigger budget allocation will be given to that sector. Budget allocation priority is also given to the sectors and development programs which are contributing significant climate mitigation and adaptation impacts .

- **Climate Change Financing Policy** :

According to the NEEDS national study for Indonesia, there are a number of existing and potential sources for climate financing , which include public and private sources.
In addition to public funds from government budget, financing climate mitigation in Indonesia are also making use of international funds made available by bilateral and multi-lateral donor agencies in the forms of grants, loans and technical assistance.

The government of Indonesia has received loans in the forms of *development program loan*, as well as *climate change policy loan*, such as jointly financed by Japan and France since 2008 and will soon be increased with participation of the World Bank and other donor agencies in the future. Such an important development and/or policy loan is channeled through and managed by the Ministry of Finance, and usually become part of the government budget. The objective of this loan is to support the government's efforts to develop policy and systems for a lower carbon, more resilient growth path of Indonesia's current and future development. This could benefit Indonesia in coping with cross sectoral & institutional issues and in improving governance, forest management, energy efficiency and security in the short and medium term.

There are also *project loan*, such as for geothermal project which is given to and managed by Public Enterprise and the private sector. There are also *seed funds* and *two-step soft loan* for environmentally friendly projects such the one supported by KfW (Germany), as well as loan by and for *private investments* related to low carbon development.

Grants from international development partners usually are channeled directly to the sectoral agencies who are implementing the programs or projects. However, recently there are urgent needs to pool all grants and other aids or assistance for climate change related programs, to be coordinated by and channeled through the newly established "*Indonesia Climate Change Trust Fund (ICCTF)*". The ICCTF supports access to finance from public funds and international sources for both mitigation and adaptation efforts. It also supports investments for most vulnerable areas and communities.

In addition to ICCTF, the government of Indonesia recently also establish "*Indonesia Green Investment Fund (IGIF)*" by the Ministry of Finance under its Government Investment Unit. The main purpose of IGIF is to leverage private and market based sources of funding for low emissions development programs/projects. It is designed to provide coordination to private funding to match the large-scale capital.

Both the ICCTF and IGIF are basically a new type of mechanism or facility for financing climate change or development programs in Indonesia. It has also tried to adopt a new model or structure of governance for its initial operation so that the climate funds could start hitting the ground. Therefore the government is now busy making all necessary efforts to improve their legal basis, its governance and funding performance.

In this context, and also in relation to the climate change policy loan, the government of Indonesia is in the process of reviewing all mechanisms and facilities for climate change to be governed under "one roof" or "one stop service". Currently there are several *steering committees* are being formed and some are already in operation for different loans and programs but mostly have the same objectives of reducing emission or for low carbon development, and yet somehow they are not related or well coordinated with one another. There are also issues of how to manage effectively the possible different windows of climate funds, such as for mitigation, adaptation, REDD, technology development, etc. Due to its importance and critical role, this national trust fund for climate change model needs further assessment as well as support from all parties in terms of its operation, governance, effectiveness and impacts for development and the environment.

- **Economic & Fiscal Policies**

The Ministry of Finance's "Green Paper on Economic & Fiscal Policy Strategies for Climate Change in Indonesia" presents Indonesia's conceptual strategies that can guide longer term policy reform for climate change mitigation. It also sets out strategies to access international financing and canvassing the need for policy reform and institutional development. The policy strategies include strategy for the energy sector, for the land-use and forestry sector, for international carbon finance, and strategy for institutional development.

On the energy sector, works towards the implementation of a carbon tax/levy on fossil fuel combustion is being processed, in parallel with removal over time of energy subsidies. This will be coupled with policy to access international carbon markets, for instance, by negotiating a "no lose" target with appropriate parameters. It will be followed by introducing incentives for energy efficiency and deployment of low emissions technology, exemplified by a specific geothermal policy strategy.

For the land-use and forestry sector, support and incentives will be given for carbon abatement measures through the inter-governmental fiscal transfer system, working towards the creation of a Regional Incentive Mechanism for climate change.

Policies to attract international carbon finance include support the creation of a new, broad-based carbon market mechanisms such as sectoral targets and crediting. Also support for new and additional sources of international public financing, as well as ensuring adequate returns for Indonesia's emissions reductions.

In an increasingly carbon-constraint world, there is likely to an expansion of both private market and public finance to support climate change mitigation in developing countries. If suitable mechanisms are put in place internationally and domestically, Indonesia could be a major recipient of such finance. Currently, Indonesia accounts for less than 2% of the Clean Development Mechanims (CDM) market, but might and will be able to attain at least 10% of such larger future carbon finance flows, based on its share of emissions.

Attracting carbon finance inflows is not an end in itself for Indonesia. Rather, it can assist Indonesia prepare for a low carbon development in the future. For that purpose, Indonesia needs to continue engaging actively with international forums in the UNFCCC as well as G20.
Indonesia believes that there is a role for both public and private carbon finance. Public finance is particularly important in the short term, before private markets are fully functional. Public finance should be used to support public awareness, capacity building, institutional reform, and up front financing of mitigation initiatives.

Private carbon markets, driven by demand from developed countries' emissions trading schemes, could provide the mainstay of carbon finance in the medium term, probably after 2012. More broadly based carbon finance mechanisms, such as sectoral "no lose" targets and crediting, can assist Indonesia to benefit from this global development.

- **Energy & Carbon Pricing Policy**

The Green Paper issued by the Indonesian Ministry of Finance presents strategies that can guide longer term policy reform for climate change mitigation, including a move towards pricing of carbon emissions. It sets out concrete pricing policy options for geothermal, and for creating abatement incentives for regional governments, especially to reduce emissions from land-use and forestry. Introducing carbon pricing is necessary in the medium to long-term development of the country to achieve emissions reductions at least cost.

The mainstay of efficient reform of the energy sector, for instance, should be to ensure that price signals are transmitted accurately through the market. This amounts to ensuring that implicit and explicit subsidies do not distort relative prices and induce "wrong" investment or consumptions decisions. Efficient mechanisms for the economy to reduce carbon emissions are to remove energy subsidies over time and to introduce a price for carbon emissions.

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