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# Discussion Paper

## The Political Economy of Renewable Energy

Why a political economy approach is essential in promoting market entry for renewables.

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# Introduction

Governments are becoming increasingly aware of the threat that climate change presents to social and economic progress and are realising that it must be given priority in poverty reduction and sustainable development strategies. A core area for institutional reform in the climate change agenda is the creation of incentives and accountability mechanisms that facilitate a transition from non-renewable and carbon intensive energy carriers to more renewable forms of energy.

Insights from on-going renewable energy reforms in a number of Asia Pacific countries are beginning to emerge, illustrating the opportunities and constraints for positive change in this sector. In most cases these reforms have emphasised solar, wind and wave power, biomass, and micro-hydro through small-scale schemes.

“A political economy approach can offer an understanding of systemic issues that influence the development of a sector.”

This discussion paper summarises findings from country-level political economy analyses (PEA) of recent renewable energy (RE)<sup>1</sup> projects in Malaysia and the Philippines. The projects are UNDP supported and financed by the Global Environment Facility (GEF). Two studies were carried between August and October, 2011, focusing on the Malaysia Building Integrated Photo-Voltaic Project (or MBIPV), and the Capacity Building to Remove Barriers to Renewable Energy Development Project (or CBRED) in the Philippines.

The paper suggests that while successful projects tend to consider wider influencing factors when promoting change within a sector, some RE interventions have tended to focus on narrower technical and management issues. A political economy approach can offer an

understanding of systemic issues that influence the development of a sector. This has implications for the design of future RE projects.

The purpose of this paper is to stimulate wider discussion of PEA within the context of UNDP's work in promoting low emission and climate resilient development pathways. It comes at a time of renewed focus on the need for increased access to all for modern, affordable and sustainable energy sources, as outlined in the UN Secretary General's new global initiative on Sustainable Energy for All (SEFA).

## Box 1: UNDP and Political Economy Analysis (PEA)

While work in this area is still relatively new in UNDP, findings from assessments undertaken in Cambodia, India, Indonesia, Iraq, Lebanon, Mongolia and the Occupied Palestinian Territories illustrate that a better understanding of the political environment would improve programme outcomes.

PEA is “concerned with the interaction of political and economic processes in a society: the distribution of power and wealth between different groups and individuals, and the processes that create, sustain, and transform these relationships over time”. The assumption is that by revealing the political, economic, social interests and incentives that promote or block pro-poor change, development practitioners can identify where the main obstacles lie and how to address them. Findings of a PEA can help to design better programmes that promote positive change, and identify where external assistance can make a difference.

PEA is intended to be applicable in all areas related to UNDP's work. In the context of renewable energy, discussions are currently taking place in headquarters to develop a joint Guidance Note on PEA for Energy and Environment. Given that initiatives in the Energy and Environment sector are not limited to a particular sector, but rely on coordination and collaboration with other ministers (Finance, Planning, and Sectors), PEA becomes even more relevant. This paper will be used as an input to these discussions.

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<sup>1</sup> Renewable Energy (RE) includes biomass, hydro, geothermal, solar, wind, ocean thermal, wave action and tidal action that does not lead to other environmental and social concerns.

## Political economy insights into renewable energy

In recent RE projects the barriers to harnessing resources have typically been seen as technical (i.e. the technology is not yet viable), economic (fossil fuels are still cheaper), and policy-based (governments do not have the right policy frameworks in place). Projects to support RE uptake tend to assume that government operates rationally and efficiently, expecting that improved capacity and technical know-how will help tackle blockages.

From this basis, interventions are typically designed around a fairly standard set of objectives that include helping to devise a policy basis and regulatory framework (eg. to encourage market entry for RE), capacity building assistance for a government agency or department, pilot initiatives and information provision for private sector entrepreneurs. This approach assumes that economic problems can be best addressed through regulated market-based approaches, such as Feed-in Tariffs (FITs) that enable RE producers to enjoy a higher tariff for a pre-defined period of time (see Box 2 below for detail).

Evaluations of RE projects tend to stress the achievement of technically defined outputs like training, pilot sites and policy development. These factors are important but ensuring that such outputs achieve concerted change depends on understanding the interests of different stakeholders and finding ways to bring them on board. These could include electricity utilities, regulators, and businesses with a stake in fossil fuel, local government, civil society organisations, key politicians and the public at large.

In reality apparent technical blockages in the RE sector are often highly politicised. For example removing fuel subsidies and raising electricity prices are unpopular with consumers, and businesses with an interest in fossil fuels exploit popular sentiment in order to stifle proposed policy change. Faced with such pressures, developing country governments sometimes struggle to implement rational policy. Projects based on experience in developed countries typically fail to address some of the unique challenges involved in policy change elsewhere.

Many different stakeholders with varied interests are critical partners in addressing climate change. Without the right incentives and shared interests, government is unlikely to take a strong lead, investment is unlikely to flow, and well-intended policies will not be implemented. In short, it is important to look beyond the RE sector in order to support RE development and market entry.

“... businesses with an interest in fossil fuels exploit popular sentiment in order to stifle policy change.”



UNDP/ Capacity Building to Remove Barriers to Renewable Energy Development Project (CBRED) - Philippines

## Key findings from country studies

RE case study reports from the Philippines and Malaysia were used alongside other material to inform this discussion note. Common points that emerged are summarised here. First, while the cost of RE is declining, it still has a long way to go before it can compete with coal or gas, particularly if subsidized and especially in countries like Malaysia which have their own fossil fuel reserves. Second, favourable policy frameworks are often not implemented in many countries even if they are created. Actual implementation is

achieved when the interests of important stakeholders are aligned, rather than when a policy is passed into law. Third, it follows from the above that neither market-based approaches nor state driven interventions will ‘necessarily’ be successful in supporting market entry for renewables. The main political and economic drivers relevant to RE adoption identified in the two case studies are as follows:

- *Fossil fuel interests still have a strong economic case (if the global impact of carbon emissions is not factored in).* Lack of support for RE is not only a matter of unjust protection of vested interests but also because fossil fuels are still cheaper and more flexible sources of energy. The economic case for RE is strengthening but still needs to be built over time.
- *There is little domestic demand pushing for climate change mitigation.* Outside small, affluent groups and RE industry lobbies, carbon emissions are not an issue of widespread public concern in the countries studied. In the Philippines and to an extent elsewhere, concern exists over adaptation to perceived increased risks from typhoons, but this does not translate into support for RE.
- *A strong desire for economic growth and energy security predominates.* Overriding concerns are for securing cheap and reliable energy sources. Government involvement in promoting economic growth and energy security does occasionally correspond with RE interests, especially in Malaysia through the promotion of ‘green technology’. However, care needs to be taken in interpreting this, as the country’s green technology policy is primarily focused on industrial promotion and does not necessarily reduce carbon emissions directly.
- *Government laws and regulations often contradict each other.* Action requires aligned incentives at many levels and across many agencies. This is hard to establish. Even high-level instruction may not be implemented locally given decentralised and often effectively autonomous local bodies, especially in the Philippines. Many examples exist of national policies that are never implemented.
- *Transparency and good governance remain challenges under market-led or state-led approaches.* Private sector involvement in energy provision from the early 1990s has been tainted with claims of collusion in Malaysia, the Philippines and Thailand. People are understandably concerned that the same practices will be repeated in the RE sector, even though it is a sector that is characterised by many smaller players rather than a few large energy utilities. .

“While politicians often promote RE in international forums, domestic policy making rarely gives it as much priority.”

## Good practices identified

The case studies also demonstrated some strong features of GEF financed RE projects that helped them respond to locally defined needs, including the following:

- *Flexibility and consultative processes.* It is important to avoid ‘identikit’ projects that are not designed through locally rooted and consultative processes. With little politically neutral technical space in most developing country settings, it is important that key project staff can read and respond to political context. Experienced national (government or otherwise) staff, on occasion working alongside internationals, are best placed to steer a path through what are often relatively opaque political waters. UNDP supported GEF financed projects are welcomed by governments for their flexibility, for supporting a lead role by the government who often shares costs, and for specialist technical support.
- *Multi-stakeholder approaches.* Building coalitions between different actors from various levels and agencies of government, commercial investors, and others appears to help galvanise wider support and political will for promoting RE, for example promoting implementation of feed-in tariffs in Malaysia. Multi-stakeholder approaches work by offering incentives and on occasion influencing many different organisations through politically aware and carefully devised interventions. At the same time there is probably more space to work with non-governmental bodies than is currently being achieved in many countries.

- *Technology approaches.* Narrow initiatives addressing a specific form of RE appear to be less effective than sectoral approaches. The steps needed to establish a supportive regulatory environment and bring key stakeholders on board typically apply across all forms of RE. Specific technologies and approaches like fitting photovoltaic solar panels onto new or existing buildings can act as initial entry points in order to enable projects to address sector-wide issues.

### **Box 2: Feed-in Tariffs: a Mixed Story**

A feed-in tariff (FiT) is a policy mechanism designed to accelerate investment in RE technologies by offering long-term contracts to RE producers who supply electricity to power utilities. FiTs have been successfully adopted mostly in developed countries and are regarded by many specialists as the best way to fund the extra costs of RE. However, assessing their application in Southeast Asia raises many challenging issues:

*It is rarely possible to establish a 'level playing field'.* Just as independent power producers in Malaysia and the Philippines have used close relationships and networks to secure favourable terms, so FiT processes are prone to collusion. Early players in the new renewable field in Malaysia have included very affluent and well-connected figures, while in the Philippines the country's flagship wind power project is promoted by a major political dynastic family.

*The user pays principle is hard to sell.* Expecting users to pay higher electricity bills is a brake on RE adoption in the Philippines (where electricity is already expensive and incomes are low) and in Malaysia (where the public is accustomed to subsidised prices). Exempting low-volume or low-income users may help reduce the impact on poor families but will not win over more influential middle-class consumers.

*Widespread residential FiT adoption is unlikely in developing countries.* Promoting photovoltaic panels for residential houses within a FiT regime may not be widely replicable in many developing countries: subsidies are too expensive for consumers or governments to be willing to cover; initial installation costs are too high and credit is less widely available; fewer people have suitable accommodation; managing the installation, permits, billing, and other aspects will be too cumbersome.

## **Implications for future renewable energy projects**

This paper introduces five discussion points for the design of future energy projects, as a contribution towards the broader debate on PEA in the context of renewable energy provision.

- *Keep aims realistic and long-term.* With tight budgets and limited incentives, most countries in Southeast Asia will remain only partially committed to RE. National economic plans in Malaysia, the Philippines and elsewhere typically envisage that RE will provide a rising yet small proportion of the overall future energy mix. Most government planners do not expect RE to provide enough cost-effective electricity to cope with rising demand, let alone to replace existing sources. The potential benefit of promoting RE needs to be seen from this perspective, comparing the value of initiatives with other mitigation benefits including cleaner fossil fuel technology and efficiency improvements. Unless wealthier countries (or markets) are able to offer major subsidies or carbon emissions incur a significant financial penalty, the economic and political barriers in many developing country environments will limit uptake, whether or not technical approaches like FiT are implemented.
- *Challenge any restrictive focus on RE.* It seems perverse to concentrate on RE and not to include other low emissions technologies (including hydropower and geothermal energy) in countries like the Philippines (and also Malaysia to a lesser extent), which have proven track records. While both hydropower and geothermal need careful management to avoid the associated social and environmental problems, they have more scope to produce significant medium-term increases in clean energy in many Asia-Pacific states. If pushed to reduce carbon emissions, many governments will press ahead with viable schemes and existing institutional arrangements rather than relying on unproven RE. In such cases, international agencies should engage to improve social and environmental impacts rather than avoiding the issue through fear of adverse publicity.

- *Avoid making the user pay where possible.* It is not a recipe for building public support for RE in price-sensitive economies, whether consumers are already burdened by high electricity costs (the Philippines) or accustomed to subsidised rates (Malaysia). Price rises are typically seen as evidence of uncaring government attitudes at best, and high-level corruption at worst. A more sanguine approach that recognises the difficulties involved in removing subsidies (including the possible adverse effect on poor families and small businesses) and considers other ways to fund FiT (for example levies on fossil fuel producers, central government support, or international concessionary financing) or alternative approaches to subsidising RE makes more sense. Changing existing subsidies so that they do not discriminate against RE also makes good sense, but is politically hard to achieve.
- *Build political support where possible and back 'champions'.* A need to build political support at many levels remains in the RE sector. Presidential commitments in international conferences may be sincere but implementing such sentiments is another matter, especially in decentralised systems of government like the Philippines but also in Malaysia, where many policies do not come to fruition given competing interests. Politicians or other high profile figures capable of influencing both policies and public opinion can be valuable advocates. Supporting NGOs and building public awareness is another important area given current low levels of concern over carbon emissions.
- *Assess the context carefully in project preparation:* This requires moving beyond the relatively narrow RE sector to understand: how energy policies are devised; the wider political and economic context of policy formation and implementation; a more nuanced analysis of barriers hindering RE adoption; what incentives critical actors at different levels respond to; and what realistic steps can be taken to address these factors. Many useful assessment tools exist such as stakeholder analysis, 'drivers of change' assessments, political economy analysis, and others. UNDP may also wish to change the composition of design teams responsible for conceptualizing RE interventions, reflecting the need for more contextual analysis.

### **Box 3: Conducting a Political Economy Analysis of Renewable Energy**

Conducting appropriate analysis early in the process of project or policy design can improve interventions. Approaches based on political economy analysis can be applied at the country level, or to specific sectors or issues, depending on need.

Political economy assessments and related approaches do not typically address project success or failure, concentrating instead on the wider context. Key skills and experience required to conduct the analysis include knowledge of RE in the country concerned and experience in drawing out key political or economic issues of direct relevance to current and future projects.

A combination of inside knowledge and external perspectives is often ideal in an assessment team. It is important to create some distance from proponents of RE whose own perspective may colour their view of those not supporting their aims.

Most assessments begin with available information on the RE field and on political trends in the country and sub-sector concerned. They then identify political issues (or drivers) before considering relevant interventions. The research that led to this discussion note assessed progress in Malaysia and the Philippines using GEF-funded projects as entry points, as follows:

- overview of issues and institutions in the climate change field with specific focus on RE;
- stakeholder analysis of key actors in the field;
- summary of key characteristics of the political economy of the country from existing literature including formal and informal political processes, key drivers of economic growth, how reforms are typically supported or blocked by different interests;
- review material and interview informants on the progress of a specific project;
- identify key themes relevant to the project;
- for each theme, explore stakeholder interests and institutional arrangements, considering the overall power structures at the appropriate level, resource availability and related incentives and commitment to environmental objectives; and
- draw conclusions from the emerging evidence base, leading to recommendations summarised in a report.

**Cover Photo:** *UNDP/Capacity Building to Remove Barriers to Renewable Energy Development Project (CBRED) - Philippines*

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