CUTS International GENEVA

Note

Climate Finance

Where are the UNFCC parties at and where they should aim to go to better support LDCs & developing countries?

By Leslie Debornes

Summary

This note will focus on the state of climate finance in the UNFCCC framework, before and after the Paris agreement, then looking at the challenges of current public climate finance as well as presenting possible alternatives and opportunities. This paper will be concluded with some recommendations to climate negotiators going to COP22, especially developing countries and LDCs negotiators (including EAC representatives).

Introduction

As countries have started negotiating on the implementation of the Paris Universal Climate Agreement, to be able to achieve the long-term goal of keeping the increase in global average temperature to well below 2°C above pre-industrial levels, certain countries will need to be supported. Climate change is a challenge affecting every country on the planet. However, it is clear that many of them are more vulnerable when facing its negative effects. Many developing and Least Developed Countries (LDCs) lack the domestic resources to support projects and innovations that would, for example, help stave off agricultural disasters or ease the transition to a clean energy economy. Financial, technical, and other type of support to countries whose economies are developing or in transition is crucial to helping them address the adaptation and mitigation issues acknowledged in the Convention.[1]

This paper will focus on climate finance, and especially public climate finance, that is allocated to developing countries and LDCs. Before going into an analysis of climate finance and its challenges, it is critical to define this concept. According to the Global Landscape of Climate Finance report, climate finance encompasses "all primary private and public financial investment flows that specifically target low-carbon or climate-resilient development". According to United Nations Framework Convention on Climate Change (UNFCCC), "Climate finance refers to local, national or transnational financing, which may be drawn from public, private and alternative sources of financing. Climate finance is critical to addressing climate change because large-scale investments are required to significantly reduce emissions, notably in sectors that emit large quantities of greenhouse gases. Climate finance is equally important for adaptation, for which significant financial resources will be similarly required to allow countries to adapt to the adverse effects and reduce the impacts of climate change"[2]. There is no internationally agreed definition of "climate finance", which constitutes a major barrier to understanding the magnitude of climate finance and the barriers to climate finance investments.

The global climate finance system is a complex continuum of relationships and transactions, driven by public finance, policy and incentives on the one side, and the need to balance risks and returns on the other.[3]

Public actors including governments, bilateral aid agencies, Climate Funds, multilateral, bilateral and national Development Finance Institutions (DFIs) drive the global climate finance system by reducing the costs and risks of climate investments, strengthening knowledge and technical capacity, and building the track record needed to enhance confidence in such investments.[4]

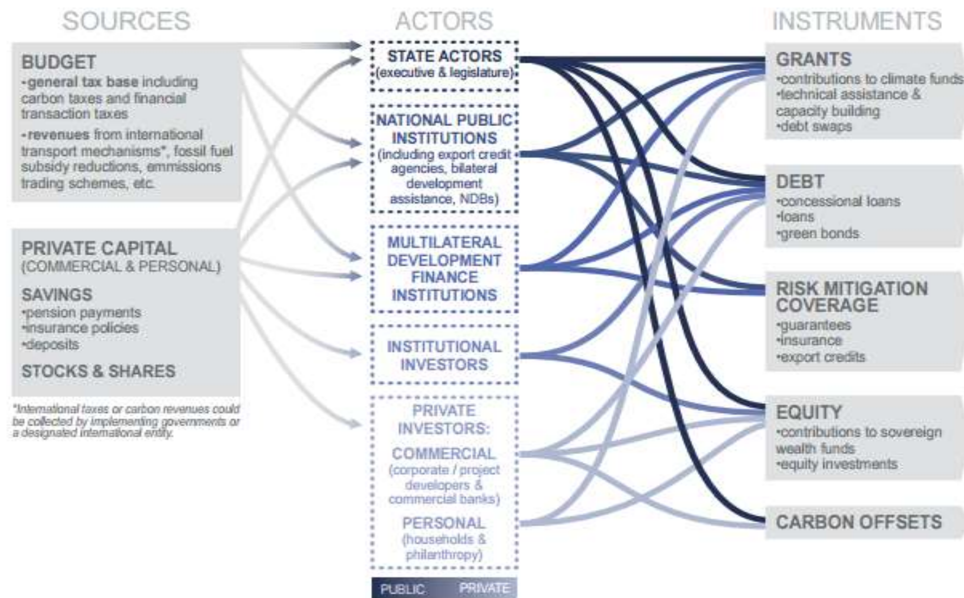
[1] http://unfccc.int/cooperation_and_support/items/2664.php

[2] http://unfccc.int/focus/climate_finance/items/7001.php

[3] http://voxeu.org/sites/default/files/file/buchner%20and%20wilkinson.pdf

[4] http://climatepolicyinitiative.org/wp-content/uploads/2015/11/Global-Landscape-of-Climate-Finance-2015.pdf

Figure 1. The Climate Finance System



Source: CPI and Cicero (2015).

According to the Global landscape of climate finance report (2015), public climate finance is on the rise, with contributions by governments and intermediaries reaching at least USD 148 billion (range of USD 144–152 billion) in 2014, an 8% increase from 2013 levels, and a 10% rise from 2012. Public actors are increasingly recognizing the benefits of climate action for achieving their goals, and that managing climate change is in their national economic interest.[5]

Figure 2. The evolution of total public and private finance, 2012-2014, in USD billion

Source: CPI analysis.

This paper will present the state of climate finance in the UNFCCC framework, before and after the Paris agreement, then looking at the challenges of current public climate finance as well as presenting possible alternatives and opportunities. This paper will be concluded with some recommendations to climate negotiators going to COP22, especially developing countries and LDCs negotiators (including EAC representatives).

Climate Finance in the UNFCCC Framework: State of Play & Challenges

Climate Finance within the UNFCCC & Kyoto Protocol

The UNFCCC and the Kyoto Protocol recognized that all countries are not equal when facing climate change, which is why they foresee financial assistance from Parties with

[5] http://climatepolicyinitiative.org/wp-content/uploads/2015/11/Global-Landscape-of-Climate-Finance-2015.pdf

more resources to those less endowed and more vulnerable. Developed country Parties (Annex II Parties) shall provide financial resources to assist developing country Parties in implementing the Convention. To facilitate this, the Convention established a Financial Mechanism to provide funds to developing country Parties.

The Convention, under its Article 11, states that the operation of the Financial Mechanism is entrusted to one or more existing international entities. The operation of the Financial Mechanism is partly entrusted to the Global Environment Facility (GEF).

ARTICLE 11: MECHANISM

1. A MECHANISM FOR THE PROVISION OF FINANCIAL RESOURCES ON A GRANT OR CONCESSIONAL BASIS, INCLUDING FOR THE TRANSFER OF TECHNOLOGY, IS HEREBY DEFINED. IT SHALL FUNCTION UNDER THE GUIDANCE OF AND BE ACCOUNTABLE TO THE CONFERENCE OF THE PARTIES, WHICH SHALL DECIDE ON ITS POLICIES, PROGRAMME PRIORITIES AND ELIGIBILITY CRITERIA RELATED TO THIS CONVENTION. ITS OPERATION SHALL BE ENTRUSTED TO ONE OR MORE EXISTING INTERNATIONAL ENTITIES.

2. THE FINANCIAL MECHANISM SHALL HAVE AN EQUITABLE AND BALANCED REPRESENTATION OF ALL PARTIES WITHIN A TRANSPARENT SYSTEM OF GOVERNANCE. […]

5. THE DEVELOPED COUNTRY PARTIES MAY ALSO PROVIDE AND DEVELOPING COUNTRY PARTIES AVAIL THEMSELVES OF, FINANCIAL RESOURCES RELATED TO THE IMPLEMENTATION OF THE CONVENTION THROUGH BILATERAL, REGIONAL AND OTHER MULTILATERAL CHANNELS.

United Nations Framework Convention On Climate Change, 1992
https://www.unfccc.int/files/essential_background/background_publications_htmlpdf/application/pdf/conveng.pdf

At COP17, Parties decided to designate the Green Climate Fund (GCF) as another operating entity of the Financial Mechanism of the Convention. The Financial Mechanism is accountable to the COP, which decides on its climate change policies, programme priorities and eligibility criteria for funding.[6]

In addition to providing guidance to the GEF, Parties have established other special funds, such as the Special Climate Change Fund (SCCF), the Least Developed Countries Fund (LDCF), and the Adaptation Fund (AF) under the Kyoto Protocol.[7]

By far the largest of climate funding sources is the Clean Development Mechanism (CDM). Authorized by the Kyoto Protocol and launched in 2001, the CDM grew slowly at first but reached an annual volume of $8.4 billion by 2007.[8] It allows emission-reduction projects in developing countries to earn certified emission reduction (CER) credits. These CERs can be traded and sold, and used by industrialized countries to a meet a part of their emission reduction targets under the Kyoto Protocol. The mechanism stimulates sustainable development and emission reductions, while giving industrialized countries some flexibility in how they meet their emission reduction limitation targets.

The CDM is the main source of income for the UNFCCC AF, which was established to finance adaptation projects and programmes in developing country Parties to the Kyoto Protocol that are particularly vulnerable to the

[6] https://www.unfccc.int/cooperation_and_support/financial_mechanism/items/2807.php
[7] Ibid.
[8] http://g24.org/wp-content/uploads/2016/01/57-1.pdf

adverse effects of climate change.[9]

- *An eye on some challenges*

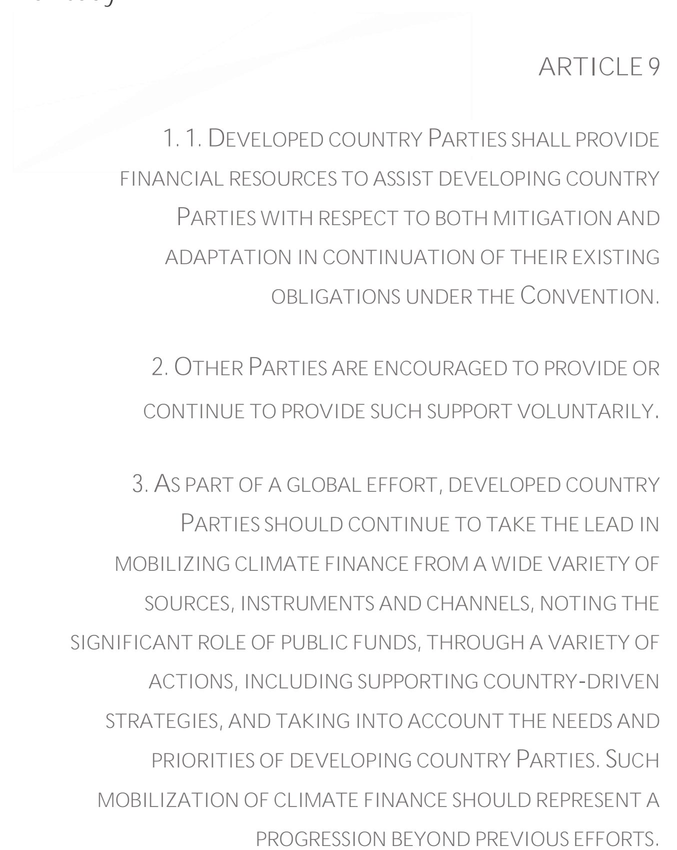
The CDM faced one major challenge: its relatively small volume of transactions. This can be explained by several factors: (i) the relatively lax Kyoto targets, (ii) the refusal of the United States to participate, (iii) the bureaucratic complexity of the CDM process, with lengthy, case-specific analyses required for each transaction. It takes an average of 300 days for a project to complete the CDM regulatory process, with transaction costs as high as $500,000 per project.[10]

CDM is not only limited in total size; in practice, it has been narrowly focused on a few countries and activities. China alone has issued almost half (more than 46 per cent) of the certified emission reductions (CERs) under CDM; China, India, the Republic of Korea and Brazil together have issued more than 90 per cent of the total.[11]

An analysis of the GEF adaptation funds found that they are not adequate to the task of responding to developing countries' needs, owing both to the complexity of the funds and to incomplete implementation of UNFCCC guidance. Improvements in both communications and organizational structure are needed in order for multilateral adaptation funding to serve the needs of the affected countries.[12]

Paris Agreement: A Turning Point on Climate Finance?

During the last COP in Paris (COP21), climate finance was one of the critical points to be agreed upon to ensure that the ambitious goals set by the Parties would be reached, and that, in doing so, developing countries and LDCs would be supported when undertaking adaptation and mitigation actions. The negotiations resulted in Article 9 of the Paris Agreement, and were even materialized by some commitments by some country members already.



ARTICLE 9

1. 1. DEVELOPED COUNTRY PARTIES SHALL PROVIDE FINANCIAL RESOURCES TO ASSIST DEVELOPING COUNTRY PARTIES WITH RESPECT TO BOTH MITIGATION AND ADAPTATION IN CONTINUATION OF THEIR EXISTING OBLIGATIONS UNDER THE CONVENTION.

2. OTHER PARTIES ARE ENCOURAGED TO PROVIDE OR CONTINUE TO PROVIDE SUCH SUPPORT VOLUNTARILY.

3. AS PART OF A GLOBAL EFFORT, DEVELOPED COUNTRY PARTIES SHOULD CONTINUE TO TAKE THE LEAD IN MOBILIZING CLIMATE FINANCE FROM A WIDE VARIETY OF SOURCES, INSTRUMENTS AND CHANNELS, NOTING THE SIGNIFICANT ROLE OF PUBLIC FUNDS, THROUGH A VARIETY OF ACTIONS, INCLUDING SUPPORTING COUNTRY-DRIVEN STRATEGIES, AND TAKING INTO ACCOUNT THE NEEDS AND PRIORITIES OF DEVELOPING COUNTRY PARTIES. SUCH MOBILIZATION OF CLIMATE FINANCE SHOULD REPRESENT A PROGRESSION BEYOND PREVIOUS EFFORTS.

UNFCCC Paris Agreement, 2015
http://unfccc.int/files/essential_background/convention/application/pdf/english_paris_agreement.pdf

The Overseas Development Institute estimates that the public finance offered by developed countries in Paris will result in at least $18.8 billion per year by 2020. In addition, Japan aims

[9] https://cdm.unfccc.int/about/index.html
[10] http://g24.org/wp-content/uploads/2016/01/57-1.pdf
[11] http://unctad.org/en/Docs/gdsmdpg2420094_en.pdf
[12] http://unctad.org/en/Docs/gdsmdpg2420094_en.pdf

to mobilize $10bn per year in public and private finance by 2020. Moreover, new pledges to climate funds, including the AF, LDC Fund, and the GCF, added up to more than $1.5bn.[13]

The Agreement encourages other countries, i.e. developing countries, to provide support on a voluntary basis. A number of them have already elected to contribute climate finance, with nine making contributions to the GCF. Already, Brazil's Ex-President Dilma Rousseff said the country was considering contributing climate finance, joining other emerging economies like China, which pledged to provide $3.1 billion over three years.[14]

Moreover, countries agreed that, along with the GCF, the AF created under the Kyoto Protocol could play a role in implementing the Paris Agreement. The Fund has been particularly valued by developing countries since it allows national institutions to access finance directly, without going through an international entity.[15]

Lastly, the Paris Agreement marks a step forward in reporting and improving transparency of finance, which is essential to ensure accountability and avoid "double-counting." Developed countries committed to continue reporting every two years on finance they have provided and mobilized, but also to start reporting on public funding they intend to provide in following years. The Agreement also encourages developing countries to report on finance received, as well as their needs. This can help improve tracking of funding commitments and set the level of ambition for future climate finance goals.[16]

- *An eye on some challenges*

A challenge that is constantly mentioned in the research and advocacy papers concerning the Paris Agreement is the fact that the agreement is not legally binding. Which means on finance support that it will mainly be based on voluntary contributions from parties. Creating funds and monitoring them is a good step forward, making commitments showcase political will, however a critical question remains unanswered: "Will the developed countries will deliver on the US$100 billion per year by 2020 to help poorer countries to mitigate and adapt to climate change?".

Moreover, in the hypothesis of funding reaching US$100 billion per year by 2020, it will not be enough to ensure sustainable development, tackling climate through both adaptation and mitigation actions. Parties will have to take action on monitoring of the funds' allocation, evaluation of projects funded through climate finance, etc. Many critical means of implementation are still to be agreed upon, and parties, both public and private, should not take a step back after the ambitious goals set in Paris.

Another and final challenge to be mentioned is the tendency of relying on private sector commitments that has been quite noticeable in the last years. Private companies and organizations are more and more prominent in UNFCCC negotiations, especially since Paris. Shift of financing from traditional to green economy / development is critical, and private

[13] https://www.odi.org/comment/10201-climate-finance-agreed-paris-cop21
[14] http://www.wri.org/blog/2015/12/what-does-paris-agreement-do-finance
[15] http://www.wri.org/blog/2015/12/what-does-paris-agreement-do-finance
[16] Ibid

sector players will have a strong role to play. However, public finance institutions, such as the Green Climate Fund, due to their pool experience and toolsets should not be forgotten. They can pay for goods and services that private actors cannot or will not pay for, and which can help investors manage risks. The GCF could play a catalytic role in ensuring that vulnerable countries' needs are met, particularly where national development bank-type institutions do not exist, by helping to realign incentives and find new ways to mainstream climate risk mitigation.[17]

Possible Alternatives to Leverage Climate Finance for Developing countries & LDCs

Many researchers and climate experts have been working on potential alternatives to be implemented to leverage the amount of climate finance, to allow for more funding of climate adaptation and mitigation projects, more support of developing countries and LDCs in fighting climate change adverse effects. Some of these alternatives are quickly presented below:

1. International transport has been seen as an attractive source of potential climate finance as it is not currently subject to emissions reduction measures, and lies outside the national boundaries of emissions accounting systems. The AGF estimated these could generate around $10 billion in climate finance per year by 2020. However, securing an international agreement on that issue is the main barrier to implementation.[18]

2. Expanding the global carbon market could be of potential benefits for developing countries and LDCs. The size of a global carbon market could be enormous: a worldwide cap of 30 Gt CO2-e, trading at US$20 per ton, would imply a total value of carbon allowances of US$600 billion per year. Not all of that amount, of course, would flow to developing countries.[19]

It could be done through expanding and linking the growing number of emissions trading schemes around the world to promote cost-effective reductions in emissions and to bring forward action in developing countries: strong targets in rich countries could drive flows amounting to tens of billions of dollars each year to support the transition to low-carbon development paths.[20]

3. Appetite for levying an international financial transactions tax may have stirred following the public bailout of many private banking institutions following the 2008 financial crisis. However, concerns about market distortions and deeply entrenched national positions mean such an instrument is unlikely to be implanted on a global scale.[21]

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[17] http://voxeu.org/sites/default/files/file/buchner%20and%20wilkinson.pdf

[18] Ibid

[19] http://g24.org/wp-content/uploads/2016/01/Financing-for-Climate.pdf

[20] http://www.wwf.se/source.php/1169158/Stern%20Summary_of_Conclusions.pdf

[21] http://voxeu.org/sites/default/files/file/buchner%20and%20wilkinson.pdf

4. Strengthening the green bond market to ensure more funds are allocated to finance environmental technology and projects. The green bond market has never stop growing since its initiation in 2008. A green bond, like a regular bond, accesses financial markets to raise capital. However, the proceeds of a green bond are dedicated to specifically finance "green" initiatives, such as renewable energy or energy efficiency. A total of 98% of green bonds come from institutions in the developed world, specifically the UK, US and Europe. Investors consist of institutional investors such as pension funds and insurance companies that are familiar with setting aside allocations for investment-grade bonds from these issuers. Further issuance of green bonds, especially by sovereigns in developing countries, including major emerging economies, could unlock cross-border climate finance. [22] However, when strengthening green bond markets, some issues will need to be handled to safeguard their credibility and sustainability:

Impact: How can the issuer demonstrate and, if possible, quantify the positive impact of the green bond, and how can an investor measure impact consistently across portfolios?

Additionality: How can the issuer ensure that the proceeds are indeed used for the declared "green" purpose and that the new green bond is not just a rebranded normal bond that would have been issued anyway?

Verification: Is there any third party monitoring and verifying that the purpose of the green bond has been met? [23]

The 2009 World Economic and Social Survey Recommendations & Suggestions

To finance climate investments in developing countries on the necessary scale, new measures and institutions will be needed. These might include:

- *A global clean energy fund, established outside the existing multilateral financing organizations;*
- *A global feed-in tariff, guaranteeing fixed purchase prices to producers of renewable energy in developing countries;*
- *A reformed and streamlined CDM, which by some estimates could mobilize more than $40 billion annually;*
- *Separate forest-related financing mechanisms, to address the potential for both mitigation and adaptation in the forest sector; and*
- *A global research, development, and deployment fund, along with measures to accelerate technology transfer.*

Source : http://g24.org/wp-content/uploads/2016/01/57-1.pdf

Another option to leverage climate finance would be to look at the lessons learnt from development finance to improve the effectiveness of international financial support. Scaling up international public climate finance is essential, but once available these funds will have to be accessed, managed and used effectively. A key goal is to ensure that the principles of effective development co-operation apply to international public climate finance:

1) Ownership by developing countries

2) A focus on results

[22] http://voxeu.org/sites/default/files/file/buchner%20and%20wilkinson.pdf

[23] https://www.weforum.org/agenda/2014/09/three-ways-clean-green-bonds

3) Inclusive development partnerships

4) Transparency and accountability to one another.[24]

Recommendations to Climate Negotiators going to COP22: Take a Step Forward on Climate Finance

Climate finance is one of the critical means of implementation of Paris Agreement that will be discussed during COP22 negotiations. Climate finance is for many years a challenging matter comprising public and private actors and policies. Some advancements have been made since Kyoto, some alternatives have been proposed, and in Paris, through the Agreement itself and other actions/commitments, many parties seem to have understood the central role of climate finance in adapting and mitigating climate change effects.

EAC Climate Negotiators, along with developing countries and LDCs negotiators, should aim at scaling up climate finance flows and shift public and private investments to support green growth. Commitments made by developed and some developing countries should be respected, and EAC negotiators should push for concrete actions on that front.

Being proactive, EAC negotiators should make sure climate finance flows are tracked adequately, especially the flows to and in developing countries to build trust through transparency and accountability. Monitoring of climate finance will happen every 5 years, through the NDCs' review (i.e. finance will be part of it). The tools and details of this monitoring will be critical points to be negotiated. The process should remain transparent, flexible and inclusive, making sure every progress and abnormality are recorded.

As the AF has been a very valuable tool for developing countries and LDCs to access climate finance, the Fund's functioning and communication system should possibly be reinforced and reorganized to allow for more funds to be transferred to the national stakeholders of those countries, allowing them to fully implement adaptation activities planned in their NDCs at the earliest.

Ambitious goals have been fixed in Paris, to ensure emissions' reduction, the CDM should also be redesigned/reinforced (i.e. reducing bureaucratic burden of the actual process) to allow for more developing countries and LDCs to participate in CERs' activities.

Based on some of the alternatives presented above, EAC Climate Negotiators might want to advocate for expanding global carbon market and strengthening the green bond market, two already existing mechanisms, that if improved/leveraged can potentially bring more benefits to developing countries and LDCs.

At national level, EAC Climate Negotiators should strengthen domestic policy frameworks in support of low-carbon and climate resilient infrastructure investments, eliminating subsidies for fossil fuels and creating support and incentives for renewables. Facilitating climate finance is not an objective that should be pursued at multilateral level only.

[24] http://www.oecd.org/environment/cc/Financing-climate-change-action-policy-perspectives.pdf

CUTS International, Geneva

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