



SHIFTING THE CLIMATE FINANCE PARADIGM

NINE KEY CHALLENGES
FOR DEVELOPED COUNTRIES

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INTRODUCTION

International climate negotiations have advanced at a glacial pace in recent times, if at all. The area of climate finance has, however, bucked the trend. At the Copenhagen Conference of Parties (COP) in 2009, developed countries committed to part-funding the cost of adapting to the impacts of climate change and low carbon development in developing economies.¹

In the period from 2010 to 2012 *Fast Start Finance* began to flow and to have an impact. Funds were generally sourced from exchequers of developed economies, and transmitted *via* a variety of channels. This climate finance paradigm is now shifting. A transition from grants and loans provided from scarce exchequer resources to innovative instruments for leveraging private capital and mitigating investment risk is required. In the coming period climate finance will focus to a much greater extent on galvanising action and changing investment behaviour among private actors.

In this brief we explore the options and implications for developed countries within this changing climate finance paradigm. It is structured as follows:

- The first section outlines the **background policy context** for the climate finance debate;
- The second section explores the extent to which *Fast Start Finance* commitments have been met. It sets out some of the key challenges in making this assessment, as well as some of the problems faced by developed countries in what can be considered a “learning by doing” phase; and
- The final section identifies **nine key challenges** that developed countries face as they enter the new climate finance paradigm, and within the context of the difficulties encountered in the first period.

BACKGROUND

There is commonly acknowledged to be a global investment shortfall in two key areas: funding to mitigate greenhouse gas (GHG) emissions and keep climate change within safe levels; and funding to adapt to the negative impacts of climate change. Estimates of the scale of the global investment gap range from the enormous to the outrageous.² This is particularly the case in developing economies where the impacts of climate change will disproportionately be felt, and public and private funding to invest in low carbon technologies is lacking to a greater extent. At the COPs in Copenhagen (2009) and Cancún (2010), developed countries pledged jointly to provide to developing economies:

- US \$30bn in *Fast Start Finance* over the years 2010 to 2012; and
- US \$100bn a year by 2020 mobilised from a variety of sources.

A decision was also taken at Cancún to establish a Green Climate Fund (GCF). The objective of the fund is to channel new and predictable financial resources to developing countries to support mitigating GHGs and to adaptation to the impacts of climate change.

¹ When we refer to climate finance we take a narrow definition of the funding made available by developed countries for mitigation and adaptation to the impacts of climate change in developing countries. It should be noted that a broader definition is also possible, as the total finance available to tackle to advance low carbon growth and address the impacts of climate change.

² According to the Stern Review, the cost of mitigate the impacts of climate change could range from about US \$200bn to US \$1,000bn a year, while the International Energy Agency's Energy Technology Perspectives found that controlling emissions within safe limits would require an additional USD 36 trillion (35%) more in investments from today to 2050 than under a scenario where controlling emissions was not a priority.

FAST START FINANCE: LEARNING BY DOING

According to the submissions of developed countries,³ their commitments to provide *Fast Start Finance* would appear to have been fulfilled. Funding has either been:

- Channeled through investment funds and Multilateral Development Banks (MDBs) such as: the Climate Investment Funds⁴ (includes the Clean Technology Fund and the Strategic Climate Fund), the World Bank's Global Environmental Facility, the Forest Carbon Partnership Facility and Japan Bank of International Cooperation;⁵ or
- Channeled through bilateral or regional programs (e.g. the EU's Global Climate Change Alliance), generally overseen by developed countries' overseas development agencies (e.g. US Agency for International Development).

The largest three donors are the EU (and its Member States), the US and Japan. At the Doha COP in December 2012, the EU stated that it was on track to provide the full €7.2 billion it has pledged in *Fast Start Finance* for the period 2010-12;⁶ the United States claims to have provided US \$7.5 billion during the three-year period;⁷ while Japan claimed to have provided more than US \$13.2 billion as of February 2012.⁸ There are, however, several difficulties associated with evaluating these claims.

First, making sense of the available data and information is no easy task in the absence of a common reporting format. The Cancun and Durban COPs provided more detail and clarity on information to be included by developed countries in their biennial reports on provision of climate finance (and established a process of international assessment and review). Specifically, the agreements called for common reporting formats, and “methodologies for finance”, to be developed to “ensure that information provided is complete, comparable, transparent and accurate.” Many of the characteristics of the registry have yet to be determined and countries have not yet adopted a common reporting format for their *Fast Start Finance* commitments (the final reports are due in May 2013). Compiling information into a comprehensible form, which enables comparison between countries and assessment of accuracy and progress, therefore remains a complex and time-consuming process. It has required the efforts of independent parties⁹ combing through and compiling data from hundreds of documents.¹⁰

Second, the equivalences between funding can be difficult to determine in the absence or rules, guidelines or accounting conventions governing how different types of financial flows should be considered. The most obvious example is the difference between loans and grants, with the latter only estimated to have accounted for 43 per cent of total climate finance flows,¹¹ although within the EU the figure was 62 per cent.¹²

3 See: <http://www3.unfccc.int/pls/apex/f?p=116:8:1597202356291679>

4 The Climate Investment Funds comprises of several different programmes, and two distinct funds. They were designed by developed and developing countries, with the assistance of Multilateral Development Banks. The World Bank is the trustee of the largest of these funds, the Clean Technology Fund.

5 A summary of funding channeled through these sources for mitigation activities is available at: http://climatechange.worldbank.org/sites/default/files/MMF_2011_version_21.pdf

6 See: http://ec.europa.eu/clima/policies/finance/international/faststart/index_en.htm

7 See: <http://www.state.gov/e/oes/climate/faststart/index.htm>

8 See: http://www3.unfccc.int/pls/apex/www_flow_file_mgr.get_file?p_security_group_id=1090408772142046&p_flow_id=116&p_fname=JPN_FSF_2012.pdf, page 2.

9 See, for example: <http://www.faststartfinance.org/> (out of date) or <http://www.wri.org/publication/summary-of-developed-country-fast-start-climate-finance-pledges>

10 See: http://cdkn.org/2012/11/opinion-the-role-of-transparency-in-managing-climate-finance/?loclang=en_gb

11 Oxfam (2012) The climate finance cliff: An evaluation of Fast Start Finance and lessons for the future. Available: <http://www.oxfamamerica.org/publications/the-climate-finance-cliff>

12 See: http://ec.europa.eu/clima/policies/finance/international/faststart/index_en.htm

Loans must be repaid, and grants are thus, on the face of it, of greater value to developing countries. There is uncertainty in particular around how loans should be counted – should the cost to a developed country of funding a concessional loan, or the total nominal value of the loan be considered? The US, for example, included the full value of loans provided through export credit agencies; and France also counted the full value of loans given, which appeared to account for the majority of its *Fast Start Finance* contribution. Other countries planned to count only the cost of financing the loans to the exchequer, and not value of the final loan, but later reversed that position when they saw how other countries were planning to account for loans.¹³

Third, there is the question of how additional funds leveraged by public funding are to be counted. Multilateral Development Banks in particular have the ability to leverage additional contributions from the private sector, or from other countries, to scale up support. They therefore have the potential to be more valuable than direct contributions which are made bilaterally. Overall Oxfam estimated that 23 per cent of funding was channeled through these multilateral agencies.¹⁴ Additionally, “leverage ratios”¹⁵ are different across different agencies and funds. Again there are no rules determining how leveraged funds are counted. Countries such as Japan counted “leveraged” private finance of US \$4bn towards its *Fast Start Finance* total, whilst others did not count leveraged funds.¹⁶

Fourth, the Copenhagen Accord calls for finance provided by developed countries to be “new and additional” to existing commitments. There are differing interpretations of what these terms mean,¹⁷ unlike criteria for Official Development Assistance (ODA) which have been defined quite clearly. Development agencies, have argued that “new” suggests that finance should not include any commitments announced prior to Copenhagen, and, perhaps more controversially, that “additional” refers to finance beyond the long-standing promise to provide 0.7 per cent of Gross National Income (GNI) as Official Development Assistance (ODA) (although countries such as the US have never taken on this commitment). As argued in a study for the European Parliament¹⁸ and by the ODI¹⁹ differing definitions of additionality are possible, and it remains an essentially contested concept. The extent to which *Fast Start Finance* has met these criteria is therefore open to question, and can be difficult to determine in many cases. Oxfam estimates that between 27 and 43 per cent of *Fast Start Finance* appears to be new money – the rest was made up of money which had already been pledged before the Copenhagen conference; and that only 20 per cent can be considered additional to the 0.7 per cent target for ODA.

Countries are taking different approaches. Japan, for example, is counting US \$11bn that had already been announced under the Cool Earth Partnership well before Copenhagen. Australia claims its *Fast Start Finance* contribution is additional on the basis that it is drawn from a growing aid program. In cases where ODA is in decline, “additionality” is even more difficult to establish. For example, Ireland is expected to surpass its *Fast Start Finance* commitment with funding which is drawn largely from its overseas development agency, at a

¹³ Ibid

¹⁴ Ibid

¹⁵ Defined by Climate Policy Initiative as “...a set of instruments provided by a financial institution that encourage and catalyse other public and private investment by reducing investment risk or increasing project returns enough to attract private investors”. See: <http://climatepolicyinitiative.org/wp-content/uploads/2011/11/Effectiveness-of-Climate-Finance-Methodology.pdf>

¹⁶ Oxfam (2012) The climate finance cliff: An evaluation of Fast Start Finance and lessons for the future. Available: <http://www.oxfamamerica.org/publications/the-climate-finance-cliff>

¹⁷ See: <http://www.odi.org.uk/sites/odi.org.uk/files/odi-assets/publications-opinion-files/6032.pdf>

¹⁸ Knoke, Irene and Matthias Duwe 2012: Climate Change Financing: The Concept of Additionality in the Light of the Commission Proposal for a Development Cooperation Instrument (DCI) for 2014-2020, Brussels.

¹⁹ Brown, Jessica, Neil Bird, Liane Schalatek (2010); Climate finance additionality: emerging definitions and their implications; Heinrich Böll Foundation, Overseas Development Institute, Policy Brief, June 2010. <http://www.odi.org.uk/resources/docs/6032.pdf>

time that funding for the agency is being cut. Even within the EU, Member States remain reluctant to identify a common definition²⁰ and many have explicitly taken divergent approaches to defining additionality.²¹ The true “additionality” of funding and the extent to which other aid budgets are cannibalised is therefore almost impossible to determine. This is especially the case for adaptation funding, which is, in many respects, similar or identical to traditional overseas development aid.

Fifth, the effectiveness of finance has received little attention. Analysis has focused on whether absolute targets were met, rather than what impact financial flows were having. Ensuring money is well spent is perhaps vital for maintaining support for an international climate finance regime, yet there has been little thinking on what “success” would look like. One preliminary analysis by Climate Policy Initiative argued that funding should (among other criteria): support activities that have a powerful transformative or demonstration effect; ensure an effective balance between public and private capital; be used in a cost-effective manner; be nationally owned and aligned with local and national priorities; and be supported by strong “real-time” systems to measure progress, draw early lessons, and allow modification.²² Multilateral institutions assess the effectiveness of the programmes which they fund, although more could be done on agreeing common methodologies and practices.

A related issue is the extent to which funding has targeted the most vulnerable and needy: Least Developed Countries (LDCs) and Small Island Developing States (SIDS). Developed countries have committed to focus support on these countries, and in several cases finance is flowing to where it is most needed.²³ Several have channeled some *Fast Start Finance* through the Least Developed Countries Fund and the Adaptation Fund. But again, there are no rules and guidelines around which developing countries should be supported, and this is something which has been left for developed countries to determine on an arbitrary basis. There has been a tendency in some cases for bilateral flows to follow pre-existing linkages, rather than necessarily being made on the basis of greatest need. Furthermore, the complex of overlapping and sometimes uncoordinated international, multilateral and bilateral programmes which have overseen the transfer of funding, renders it all but impossible to establish the extent to which funding has been allocated equitably to recipient countries.

NINE KEY CHALLENGES

Challenges encountered in meeting and assessing compliance with *Fast Start Finance* commitments perhaps anticipate problems which will arise in the coming period, as developed countries face the far more complex challenge of “mobilising” US \$100 billion in climate finance annually by 2020.

Up to ten times the absolute annual level of finance will be required by 2020 compared to 2012 if commitments are to be met. Public funds which have been the focus of *Fast Start*

²⁰ Knoke, Irene and Matthias Duwe 2012: Climate Change Financing: The Concept of Additionality in the Light of the Commission Proposal for a Development Cooperation Instrument (DCI) for 2014-2020, Brussels.

²¹ An EU Accountability Report states that: “Some Member States aim for additionality related to climate related funding, while others include climate spending in their efforts to increase ODA. Three Member States define additionality as ODA over and above the UN ODA target of 0.7 % of GNI. One Member State states explicitly that fast-start financing is strictly additional to the aid budget and will not be reported as ODA. The most commonly used reference year is 2009, with some Member States using 2010. Some Member States finance climate efforts from outside the ODA budgets or through innovative sources. Some Member States use a combination of the definitions [...] and some have not yet decided on a definition of additionality.”

²² CPI (2011) Improving the Effectiveness of Climate Finance: Key Lessons, available: <http://climatepolicyinitiative.org/venice/files/2011/11/Improving-Effectiveness-of-Climate-Finance.pdf>

²³ See, for example, Japan’s commitments to SIDS and LDCs: [http://unfccc.int/files/cooperation_support/financial_mechanism/fast_start_finance/application/pdf/japan_fsf\(february_2012\).pdf](http://unfccc.int/files/cooperation_support/financial_mechanism/fast_start_finance/application/pdf/japan_fsf(february_2012).pdf), page 5.

Finance will not be sufficient to achieve this level of annual spend, particularly as many developed countries enter a period of deleveraging - the UN estimate that up to 85 per cent of funding will have to come from the private sector.²⁴ At the Doha COP in December 2012 it was not possible to agree a bridge connecting the *Fast Start Finance* period (which ended in 2012) to the 2020 commitment. The COP merely “encourages” developed countries to keep climate finance flows to at least the average level of their *Fast Start Finance* between 2013 and 2015. Some individual countries (such as the UK and Germany) made commitments to this effect, though they are in a minority.

Nor is there clarity around what sources of finance can be included to meet the 2020 commitment. It is clear, however, that private sector investment may be used. The Copenhagen Accord refers to “a wide variety of sources, public and private, bilateral and multilateral, including alternative sources of finance”. Everything from public funds, associated leveraged private investments, carbon offset market funds, multilateral development bank assistance, investment loan guarantees, concessional loans, foreign direct investment, institutional investor funding and equity investment should be on the table.

Nine key and interrelated challenges faced by developing countries within this context are as follows:

1. SCALING-UP

As noted, the current scale of financial flows is insufficient to meet commitments, nor has a blueprint or trajectory for scaling up financial transfers been outlined or agreed. Agreeing a pathway to meeting 2020 commitments is therefore a priority. This entails not only addressing the gross level of financial flows, but also the role that private finance will play. These issues can only be addressed by a concerted political process at international level.

2. CATALYSING PRIVATE SECTOR INVESTMENTS

It is clear that commitments cannot be met without galvanising investment from the private sector. Given the rapid scale-up in funding required, scarce exchequer resources should arguably be used in a more targeted manner. A much greater focus needs to rest on leveraging private sector funding, rather than fully funding investments from the public purse. Greater focus might therefore be placed on optimising “leverage ratios” associated with public funding. Partnerships between the public and private sectors might also focus on projects with transformative or demonstration effects - in the long term these are the types of projects that can catalyse long term and substantial transformation. Enhanced involvement of the private sector could also potentially be obtained through the more direct integration of private sector expertise in designing and implementing policies at national and international level, or through the development of a portfolio of bankable projects for adaptation and mitigation *via* the Green Climate Fund or other multilateral agencies. Best practice exchange programmes for engaging and leveraging private sector might also be engendered as part of the international political process.

3. DE-RISKING PRIVATE SECTOR INVESTMENT

Mitigating risk for the private sector is a key aspect to leveraging increased levels of private sector investment.²⁵ Low carbon and climate resilient investment proj

²⁴ United Nations Framework Convention on Climate Change. Source: United Nations Environment Programme Finance Initiative (2012) ‘Creating the “new normal”: Enabling the financial sector to work for sustainable development. Perspectives on financing sustainable development in the wake of Rio+20’. Discussion Paper. Châtelaine, Switzerland: UNEP FI.

²⁵ Brown, J, Jacobs, M (2011) ‘Leveraging private investment: the role of public sector climate finance’ ODI. Available at: <http://www.odi.org.uk/resources/details.asp?id=5701&title=climate-finance-privateinvestment-public-sector-climate-change>

ects in developing countries have typically been constrained by a range of factors, leading to high risk premiums being attached to these investments. Policy and regulatory uncertainty is a key factor. A weak, partial and changeable environmental policy backdrop and the lack of a uniform and sufficiently high carbon price distort the payback on clean versus polluting infrastructure projects. Other barriers to investment include lack of familiarity, limited information and knowledge, and limited expertise on green infrastructure. Options to “crowd in” private investment - many of which have been trialled in developed economies - include:

- Loan guarantees (from governments and public finance institutions) to underwrite loans to projects and protect the private investor against defaults;
- Policy insurance to cover investors in case of policy change;
- Seeding partial risk guarantee or other funds;
- Special Purpose Investment Vehicles which can partner development banks and private equity, and which can provide tailored and country-specific technical advice, as well as different forms of guarantees.

4. TARGETING INSTITUTIONAL INVESTORS²⁶

The enormous and increasing amount of funds under management by institutional investors²⁷ makes this a potentially key area to be targeted if 2020 commitments are to be met. According to HSBC less than 1 per cent of current bond issuances are “strongly aligned” with the climate economy,²⁸ so there is a great pool of investment capital available which is not being tapped. Institutional investors do not invest in individual projects, which tend to be financed in complex structures, but rather in aggregated investment classes, and for these to be attractive they generally need to have a low risk profile and a track record. Many renewable projects have attributes which suit the long-term investment horizons of these investors. There is no one-size-fits-all solution to attracting institutional investors, as they are as heterogeneous as potential recipient countries. Developed countries can generally help to “engineer investment grade offerings” through listening to and understanding the needs of institutional investors - such as those outlined by the Climate Bonds Initiative - and by engaging in de-risking initiatives, such as those outlined above. Promoting the establishment of Green Investment Banks in developing economies, or taking a leading role in sharing some of the risk of “lighthouse” or pioneering projects which can establish a track record for these investments in developing countries, could be particularly important.

5. MONITORING, REPORTING AND VERIFICATION

In order to ascertain if objectives are met within a much more complex and multifaceted climate finance paradigm, a far more comprehensive approach is required. Donors and Multilateral Development Banks are making efforts to improve tracking and reporting of flows of finance to developing countries, and an increasing body of evidence of best practice

²⁶ For a much more comprehensive analysis of the issues related to institutional investors, see: Kaminker, Ch., Stewart, F. (2012), “The Role of Institutional Investors in Financing Clean Energy”, OECD Working Papers on Finance, Insurance and Private Pensions, No.23, OECD Publishing. http://www.oecd.org/environment/WP_23_TheRoleOfInstitutionalInvestorsInFinancingCleanEnergy.pdf

²⁷ Investment in bonds has become increasingly popular following the economic crisis of 2008, and the Climate Bonds Initiative estimate that \$77 trillion is under management by various classes of institutional investor, see: <http://climatebonds.net/2013/02/9-useful-facts-bond-markets/>

²⁸ Kaminker, Ch., Stewart, F. (2012), “The Role of Institutional Investors in Financing Clean Energy”, OECD Working Papers on Finance, Insurance and Private Pensions, No.23, OECD Publishing. Available: http://www.oecd.org/environment/WP_23_TheRoleOfInstitutionalInvestorsInFinancingCleanEnergy.pdf

is emerging.²⁹ The Rio markers already provide an approximate way of quantifying public funding to address climate change. However, detailed, accurate, and comparable information on finance is lacking, and there are a number of gaps in the international reporting regime. Multilateral institutions, for example, are not required to report information to the UNFCCC, nor are there any agreed formats or conventions for how they might do so. Tracking private flows of finance remains particularly incomplete and highly challenging.³⁰ There is therefore considerable room for the development of more formalised definitions, guidelines, conventions and rules for private finance flows, how they should be counted to meet commitments, and how their net contribution is to be calculated. Furthermore, assessment of environmental integrity and effectiveness of flows is required through overhauled auditing and transparency systems and the development of best practice guidelines. This could lead have the additional benefit of more formalised recognition of the efforts of private actors.

6. GREATER FOCUS ON FINANCE FOR ADAPTATION

The Cancun Agreements require that *Fast Start Finance* be delivered “with a balanced allocation between adaptation and mitigation,” and that it includes forestry resources. In the climate finance debate, however, funding for adaptation and mitigation are generally lumped together towards the ultimate objective of meeting the *Fast Start Finance* and 2020 commitments. Oxfam estimate that only 21 per cent of *Fast Start Finance* went to adaptation.³¹

In reality mitigation and adaptation activities are qualitatively different enough to suggest far more differentiation between funding for these activities. Adaptation funding is very closely aligned to ODA, and is largely funded from public sources. Even within the changing climate finance paradigm private sector investment is less likely to play a role in adaptation because there is generally less opportunity to make a profit in areas such as drought relief, coastal protection, or crop failure. On the other hand, low carbon energy infrastructure investments can turn a profit and are generally far more likely to be attractive to the private sector. This pattern can be seen in the *Fast Start Finance* period. In the case of both Japan and the US, for example, overall, the majority of *Fast Start Finance* went to mitigation projects;³² the grant-based portion of their contributions, however, gives more balanced consideration to adaptation.

Because of this broad distinction, there may be a case for a greater differentiation between financing adaptation and mitigation, and perhaps a case for breaking down the US \$100 billion overall target accordingly. Clearer methodologies are also required for determining if ODA is “new and additional”, as discussed above.

Finally, many developed economies have development assistance partner countries, and these pre-existing linkages should be leveraged to encourage greater levels of private sector investment in recipient countries, in areas which are of interest to the private sector. On the other hand, climate finance needs to find its way

29 Buchner, B., Falconer, A., Hervé-Mignucci, M. and Trabacchi, C. (2012) *The Landscape of Climate Finance 2012*. San Francisco: Climate Policy Initiative.

30 Buchner, B; Brown J, and Corfee-Morlot, J (2011) *Monitoring and Tracking Long-term Finance to Support Climate Action*. OECD: Paris.

31 Oxfam (2012) *The climate finance cliff: An evaluation of Fast Start Finance and lessons for the future*. Available: <http://www.oxfamamerica.org/publications/the-climate-finance-cliff>

32 See: <http://www.wri.org/publication/summary-of-developed-country-fast-start-climate-finance-pledges>

to the most needy, and not just serve geopolitical priorities or the needs of the private sector in developed countries. Greater consideration needs to be given to balancing these objectives and it may perhaps be necessary to develop criteria to establish with greater clarity which recipient countries are deserving of funding.

7. DEFINING A ROLE FOR THE GREEN CLIMATE FUND (GCF)

The establishment of the GCF is an important development. However, the fund enters an already highly concentrated international architecture of bilateral and multilateral funding initiatives. While the GCF Board has been appointed, no funds have been committed, nor have any commitments been made to the ongoing early and adequate replenishment process. Questions around how much of the US \$100 billion by 2020 will be mobilised to pass through the GCF remain unanswered. There is a political challenge to overcome developed countries' reluctance to commit a significant share of their multilateral climate finance contributions to financing instruments under the UNFCCC framework.³³

A prominent or central role for the GCF within the world of climate finance could arguably help resolve some of the more intractable issues outlined above, such as: ensuring that funds are allocated equitably and efficiently between recipients; ensuring a fair balance between adaptation and mitigation; monitoring the effectiveness of various approaches; and evaluating and determining best practice. The GCF would also be in a position to develop country-specific expertise and knowledge in the most effective instruments in mitigating risk, thereby ensuring that funding commitments are optimised and transaction costs minimised.

There is perhaps a key strategic issue for the GCF and participant countries to resolve. Does the GCF see itself working in parallel to, or as a sort of umbrella for other funding initiatives in the area? Or if it is to present itself as a competitor to these existing initiatives? The former role would arguable represent a more significant contribution to the international climate finance regime, although a hybrid institution combining both functionalities is perhaps also possible.

8. CONDITIONALITY

Conditionality is an unpopular word when associated with ODA. Climate finance, however, has the potential to be highly beneficial for developing economies, and it can and should be used to encourage more fundamental changes in these countries. It can be used to enhance enabling environments in many developing countries, recognising that national policy, and regulatory and governance frameworks play a crucial role in reducing investment barriers and using climate finance effectively. International pressure can reinforce and support efforts to enhance enabling environments by setting ambitious targets and norms, increasing transparency and information, and fostering learning. For example, the removal of subsidies for fossil fuels would appear to be an important enabling factor for promoting low carbon development. Differentiated access to carbon finance could be used to encourage the necessary changes.

9. EXPLORING INNOVATIVE SOURCES OF FINANCE

There are several potentially innovative sources of funding which could be used to achieve commitments, many of which have been set out in an analysis by the

³³ Bird, N; Brown J and Schalatek L (2011) Design challenges for the Green Climate Fund, Heinrich Boll Stiftung & ODI.

UN. In each case there are difficulties to be resolved. The template for how these innovative sources could be mobilised is perhaps provided by the Clean Development Mechanism (CDM), where 2 per cent of certified emission reduction units issued for most Clean Development Mechanism projects go to the Adaptation Fund. The share of proceeds could be extended to joint implementation and international emissions trading schemes, and the rate could be raised.

In the case of the EU Emissions Trading Scheme Directive 2009/29/EC, 50 per cent of the revenue from auctioned permits can be used to fund global energy efficiency and renewables promotion, adaptation or avoided deforestation. This is therefore one promising area which merits further attention, particularly where other emissions trading schemes could ultimately converge with the EU's scheme. The disbursement of revenues, however, remains in the hands of EU Member States as a consequence of the legislative agreement, and, as with carbon tax revenues, some Member States will inevitably be opposed to any form of hypothecation. Yet there is some "willingness" to consider using the revenues from auctioning revenues for climate finance.³⁴ This is an option which may be more politically acceptable, for example, than the redirection of exchequer funds from within mainstream budgets. The low carbon price currently prevailing under this scheme, however, limits the scope to provide a significant revenue stream in the short to medium term.

The aviation and maritime industries are also expected to make some contribution to climate finance, with a UN report estimating that these industries could provide US \$2–3 billion per year for climate finance.³⁵ The International Civil Aviation Organisation (ICAO), however, has questioned why it should be singled out as a contributor of climate finance, and has argued that revenues from any instrument covering aviation (such as emissions trading) should be applied in the first instance to mitigating the environmental impact of aircraft engine emissions (rather than climate finance).³⁶

Other options which might also be explored further include an international financial transactions tax, revenues from implementing border taxes on imports of GHG-intensive products, or redeployment of fossil fuel subsidies in developed countries. All, however, would appear to face similar political barriers. Difficulties and challenges notwithstanding it is unlikely that the 2020 commitment can be met without harnessing some of these options for mobilising innovative and new sources of finance.

³⁴ See: European Council Conclusions, March 2011.

³⁵ http://www.un.org/wcm/webdav/site/climatechange/shared/Documents/AGF_reports/AGF_Final_Report.pdf

³⁶ See: http://www.icao.int/publications/journalsreports/2011/6603_en.pdf



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