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The Paris Package: Setting the Finance Agenda for Climate Action

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Introduction

The year 2015 is crucial for global agreements that establish the trajectories and paradigms of development. The Millennium Development Goals (MDGs) are set to be replaced with the Sustainable Development Goals (SDGs) at the UN General Assembly in September and negotiations on a new global treaty on climate change will take place in Paris in December. The global climate and development processes intersect; therefore, the question of financing—how much, how and for what—should logically also intersect.

However, the Addis Ababa Action Agenda adopted at the UN Financing for Development (FFD) conference in July failed to yield concrete new proposals for additional funding that can be swiftly implemented to meet the world's multiple challenges.[1] Instead, the agenda once again stressed the need for countries to achieve the target of 0.7 percent of Gross National Income for Official Development Assistance and noted with concern the failure of many countries to do so till date.[2]

The failure of Addis means that finance has now become the proverbial elephant in the room. Just like in the classic fable on the blind people and the elephant, experts on development, climate and finance approach the elephant from their own perspectives by touching and feeling only its partial contours. None of them is able to comprehend the overall landscape of challenges and opportunities. Development experts are scared that climate finance will detract from available resources. Climate experts, meanwhile, obsess about finance going to "bad things like fossil fuels".

And finance experts worry that institutional interventions will lead to outcomes that are suboptimal from a market point of view. This brief is an attempt to remove the blindfold and lift the veil of disciplinary ignorance.

First, some facts: According to statistics published by Climate Policy Initiative, in 2013, global climate finance totalled $331 billion, $193 billion (58 percent) of which was from private sources and $137 billion (42 percent) from public sources.[3] The worrying statistic is that only about $34 billion of that flowed from developed to developing countries, a 20-percent reduction from the previous year.[4] It is estimated that 74 percent of climate finance is used in the country in which it originates, which highlights the limited flow of financial resources from developed countries to those most vulnerable to climate change. This is in sharp contrast to technology flows, where technology owners and providers aggressively seek international destinations. We have a concerted push to mainstream green solutions, without the necessary financial ecosystem to allow for global finance to follow technology in the new markets that it seeks.

At the 15th Conference of Parties to the UNFCCC held in Copenhagen in 2009, developed countries committed to jointly mobilise $100 billion dollars a year by 2020 from a "wide variety of sources, public and private, bilateral and multilateral, including alternative sources of finance". Given that currently there is a flow of roughly $30 billion as detailed above, this would mean a gap of $70 billion in climate finance for developing countries. Part of the gap could potentially be closed by the world's development finance institutions – multilateral, national, regional and bilateral – increasing their investments and the percentage of their investments that go towards climate finance investments. The rest will inevitably require what is called "blending". For example, investments made to green India's energy resource development will both increase sector productivity and reduce its carbon intensity. This would be true of most areas of infrastructure in countries undergoing a development transformation, were the finance, development and climate communities able to work together to smartly identify such blending opportunities. Then, and only then, will a harmonious and adequate climate finance response be possible.

There are two structural issues with climate finance besides the concerns over the levels of mobilisation. One is the heavy focus on mitigation activities. For example, in 2014, the Multilateral Development Banks committed $28 billion towards climate finance, representing 22 percent of their total financing activities.[5] Mitigation activities accounted for 82 percent of the $28 billion and 18 percent went towards adaptation projects.[6] The strong bias towards financing mitigation activities causes concerns as it ignores the imperatives of building resilience, capacities and capabilities that are already required in many parts of the world to respond to changing climate. Supporting adaptation to the impacts of climate change and pathways for climate-resilient development is a vital component of the climate change response for developing countries. Mitigation is important but so is adaptation; one cannot be said to take unquestionable priority over the other.

Secondly, over the next 15 years to 2030, it is estimated that the global economy will require an estimated $89 trillion in infrastructure investments across cities, energy, and land-use systems.[7] A further $4.1 trillion is also required for incremental investment in low-carbon transitions, to keep within the internationally agreed limit of a two-degree-Celsius temperature rise.[8] However, although the challenges of development and climate change are increasingly intertwined each passing day, it is crucial that financing climate action does not become a substitute for financial flow for development. Climate finance must be treated as 'additional finance'. It should not be conflated with Overseas Development Assistance even if there is an overlap in the sorts of development initiatives that eventually get supported.

While significant scope exists for developmental activities within the adaptation framework, there is concern that the SDGs could encourage fund transfers only if developing countries conform to a pre-set 'green' agenda. Attempts to paint climate financing with the same brush as developmental aid will undoubtedly cause strain in the relationship between the rich and the poor. Development finance must not be cannibalised by climate finance flows. Climate finance will be crippled if it seeks to work within an underdeveloped ecosystem and, in the long run, leapfrogging infrastructure investments and provision of basic services in order to implement the climate agenda will only prove futile. It is imperative that 20th century developmental exigencies are not compromised by the 21st century agenda. Both must be addressed together, with the balance of narrative always focusing on the side of ensuring lifeline access and services for all.

Innovative solutions and thought leadership are both required to break out of the current stalemate. There is, obviously, political convergence: the same group of world leaders will ultimately agree on the climate and development agenda. Yet even such convergence remains outside the banking conversation on prudential norms and monetary policies that impact the price and availability of money.

The 21st Conference of Parties (COP 21) scheduled for December this year in Paris offers the chance to change some of the worrying realities shaping the financing agenda currently; namely:

- Levels of finance for the huge scale of transformation required;
- Financing for adaptation and climate-resilient development;
- Finance for access to lifestyle and lifeline existence.

COP 21 therefore needs to have a Communiqué on finance. It must address the core question of how lifeline energy and developmental needs of the poor can be met whilst taking effective action on climate change. In a manner of speaking, it must strive to make the ambitions of New York sensitive to the aspirations of New Delhi. Therefore, it is important that long-term finance be mobilised and made accessible for both climate action and development priorities. Basel III should be re-written to facilitate green investments and improve financial flows to climate-related interventions in developing and emerging economies. Strong commitments and intent from developed countries to specifically provide resources to least developed countries to adapt to climate change and chart a path of sustainable development is also needed.

It is expected that the negotiations in Paris will proceed along well trammelled lines, bringing with it a history of silos, a bias towards incrementalism and politically fossilised divisions. This will not, by itself, serve the urgent need to shape a holistic and collective view on Climate and Development Finance. We need a leaders' initiative that marks a major aspirational and substantive thrust for an agreement on climate finance. This will not happen automatically as part of the “business as usual” COP21 process. What is needed is a **Paris Package** that defines the aspirational and practical contours needed to meet the climate-development finance challenge. To make this happen we propose that this package be announced by a collective of global leaders this December.

'Paris Package'

The 'Package' will be headlined by an aspirational communiqué by world leaders, a statement of decisions on administrative arrangements for 2015-2020 and the 'Intended Nationally Determined Contributions'. A key component of this communiqué would be the effective financing of climate action. This will send signals to financial institutions and private actors about the intention of countries to create a policy ecosystem and regulatory environment that is conducive to directing capital flows towards adaptation and mitigation efforts and towards 'de-risking' climate investment. The proposed Package has been divided into Critical Components and Significant Components, which collectively cover the range of policies required to positively transform development and climate action.

Critical Components

1. Developed countries need to reconfigure their institutions and regulations to free up investible capital in energy and infrastructure projects in emerging and developing countries.

2. Lifeline energy needs to be delivered at the lowest possible cost to the poor.

3. Financing institutions should not impose blanket restrictions on financing fossil fuel projects, or blanket portfolio limitations on financing for fossil fuel initiatives. This will perversely constrict the ability of developing and emerging economies to lower the carbon intensity, and increase the productivity, of their energy delivery systems, through investments in cleaner power plants.

4. It is critical that banking conversations are sensitive to requirements of climate and development. Barriers for investment by multilateral banks and private funds in 'cleaning

up' coal-based power production and energy efficiency projects should therefore be dismantled. Any moves to introduce sustainability criteria into Basel III should be effected only in the context of this re-write. Basel III norms have created disincentives for investment in infrastructure projects in developing countries, which are critical for long-term adaptation and development.

5. Flow of private capital for climate-compatible development is restricted by the perception of regulatory and market risks – the perceived risks are higher than the actual risks. Clear signals from global processes are needed to 'de-risk' climate finance.

6. Supporting adaptation should become a viable business proposition. Emphasis on the commercial value of adaptation projects is required for increasing private investments in adaptation activities. Creating successful demonstration models is critical for this. One of the reasons why a large proportion of private finance is diverted towards mitigation activities is that investors are aware of the returns on such investment. On adaptation however, such awareness is missing, leading to a significant funding gap. In this context, the UNFCCC must play a critical role and ensure the knowledge gap is narrowed. The multilateral development banks can contribute by taking the lead and partnering with organisations adept at identifying and implementing adaptation development projects. Once this is done and a market is created for adaptation projects, the private sector will crowd-in, as it has in traditional sectors.

Significant Components

1. Accreditation and administrative processes for accessing global financing, including the Green Climate Fund, need to be rationalised and simplified to allow easy access for developing countries.

2. Policies facilitating decentralised finance and low-cost micro-finance models would be necessary for adaptation and mitigation projects. There is an increasing number of technological innovations (such as solar home systems) which meet essential daily needs at the domestic level. These solutions do not need big infrastructure projects. Micro-finance institutions can play a key role in these areas.

3. The New Development Bank's potential for financing infrastructure and energy projects should be leveraged, especially for projects on clean and responsible coal technologies, carbon sequestration and climate-compatible infrastructures.

4. In the context of countries with lifeline energy and developmental needs, taxing consumption rather than carbon would be more effective. For instance, carbon taxes should be applied on consumption over and above the 'threshold consumption' or 'lifeline consumption' across all countries. Also, corporate carbon taxes should be introduced for carbon consumption by large corporations.

5. Central Regulators need to incentivise participation of the private sector in climate-compatible investments through backstop guarantees against risks for mitigation and adaptation projects. For instance, in emerging economies like India, the central bank has the authority to lay down guidelines whereby commercial banks can lend funds at lower interest rates to private enterprises which are looking to invest in green infrastructure. These interest rates can be benchmarked to actual performance of the private sector.

6. Continuity of carbon markets and setting of a floor price for carbon is important to give strong signals to the market to invest in carbon, especially for the developing and emerging economies. However, there is little clarity on an appropriate international arrangement for this. A renewed conversation is urgently needed.

7. Technology collaborations in the public sector should be facilitated by easing regulations, creating mechanisms to crowd-in private capital, and increasing the risk capacity of private enterprises. The proposed new UN-based Technology Facilitation Mechanism should focus on this objective. Public sector owned technologies should be efficiently deployed.

8. Innovative financial tools such as green climate bonds should be facilitated to reduce market and regulatory risks. Insurance tools should be integrated as a risk transfer mechanism.[9]

9. Impact investment infrastructures for long-term financing should be encouraged as they produce quantifiable social and environmental impact alongside a financial return.

Even before the negotiations, developed countries or the G7 group could signal, through an announcement, their serious intention to facilitate global climate actions (both adaptation and mitigation) through effective financing. If the Paris agreement were to be implemented from 1 January 2020, financial actions should not lag due to delays in the decision-making process and this issue, therefore, needs to be tackled in the next four years. The development and climate landscape is set to be shaped decisively in 2015. This opportunity to rethink and reconstruct the global financial architecture that will catalyse these global processes awaits us in Paris.

Disclaimer

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