OPINION

A way forward on climate finance?

Smita Nakhooda

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Climate finance

The devastating impacts of climate change threaten to reverse progress in health, security and quality of life made in many developed and developing countries, with particularly severe implications for the poor. But public finance continues to subsidise and incentivise investments in business as usual approaches that will exacerbate the problem. Instead, we need to direct finance to re-orient the global economy around low carbon-climate compatible investment. In the immediate term, clarity on the international public finance that will be made available to support developing countries to take action would be a step in the right direction. Heads of state, ministers, business leaders and other luminaries have a busy schedule of meetings in 2014 aimed at eliciting commitments to act. The UN Secretary General will convene a Climate Summit, and another Ministerial Dialogue on climate finance is planned alongside COP 20 in Peru. But for these meetings to succeed, politicians in developed countries will first need to be convinced that climate finance is money well spent, and yielding global benefits. The international community will need to create a Green Climate Fund that can effectively deliver future finance to the interventions that will make the most difference. The overarching challenge, however, is to green global investment flows (from both developed and developing countries) as a whole so that they support sustainable development.

The climate is changing, with severe costs, but we're not doing a very good job of reducing emissions. These changes will have severe impacts on the poor, and threaten to reverse hard won development gains. The 5th report of the IPCC is clear that we need to pursue "aggressive" mitigation that results in 50% emission reductions by 2050 to avoid exceeding a 2 degree Celsius rise in global temperatures. ODI recently analysed the implications of climate-related disasters on poverty, and concluded that by 2030 more than 325 million poor people will live in the 49 most affected countries (Shepherd et al 2013). Yet the total spent on adaptation (US$ 5.7 billion) during the Fast Start Finance (FSF) period half what Germany spent (US$ 10.7 billion) was to respond to floods in the summer of 2013 (Nakhooda et al 2013a). The fact that climate change is resulting in irrevocable loss and damage has led to a process to develop institutional mechanisms to manage and respond to these losses under the UNFCCC.

Although spending on mitigation and adaptation activities is increasing, it is dwarfed by continued investment in business as usual. Indeed, most governments, including developed country governments, still actively subsidise the production and consumption of fossil fuels. These subsidies amounted to US $600 billion globally in 2012 and as much as US $90 billion in the OECD alone (Whitley 2013).

We need to scale up our investments in climate finance, and use it to complement good policy in both developed and developing countries. Much of this is needed in fast growing developing countries: additional investment needed in the energy sector alone may be as high as US$ 531 billion per year (IEA 2012). Public sector policy and incentives will be the keys to this redirection. Public

ODI
203 Blackfriars Road | London SE1 8NJ | UK
Tel: +44 (0)20 7922 0300 | Fax: +44 (0)20 7922 0399

Box 1: The Green Climate Fund

SOURCE: LIANE SCHALATEK AND SMITA NAKHOODA, CLIMATE FINANCE FUNDAMENTALS: THE GREEN CLIMATE FUND, ODI AND HBF: LONDON, 2013

The Green Climate Fund (GCF) is the most recent actor in the climate finance architecture. Over time it is supposed to be a channel for a substantial share of the US$ 100 billion that countries will mobilise by 2020. All countries have high expectations for the GCF, but competing visions have resulted in a slow design and operationalization process. For developed countries, it is important for the fund to have a strong focus on results, and to draw in private finance. For developing countries, it is important to have adequate commitments of public finance, and a country-driven approach that works through national institutions in support of national priorities.

The design of the GCF sought to respond to perceived inadequacies of existing multilateral funds such as the Global Environment Facility (GEF) and the Climate Investment Funds (CIFs). There is an opportunity for the GCF to be designed to fill important gaps highlighted during the Fast Start Finance period. It could provide much needed additional finance for institutional strengthening, policy reform and capacity building (including for the private sector). It could harness the implementation capacity of national and multilateral development banks to address particular policy and liquidity risks that impede private investment. An early focus in GCF operationalization has been on the need to support such activities, including through "readiness finance". It could address mitigation opportunities more expressly, ensuring that international finance fills gaps that domestic public resources or private actors cannot.

finance supports the implementation of emerging policy, and can address risks that deter climate compatible investment.

The international community has begun to tackle this challenge by setting targets for climate finance to support developing countries. Developed countries, who have contributed more to the accumulation of greenhouse gas (GHG) emissions, agreed to mobilise US$ 30 billion in fast start climate finance for developing countries between 2010 and 2012 under the UNFCCC. They would mobilise US$ 100 billion per year from public and private sources by 2020. Meeting these commitments should serve at least two purposes: first, it should build confidence in international agreements, if countries follow through on what they say they will. Second, it should help us achieve the goal of moving investment trajectories away from business as usual towards climate compatible development.

Countries self-report that they exceeded their targets, delivering US $35 billion. But recent ODI analysis of FSF, in partnership with the World Resources Institute and the Institute for Global Environmental Strategies (Japan), suggests we need to re-think the approach we have taken to meeting commitments (Nakhooda et al. 2013b).

Not all public finance is the same. Many different forms of public finance (including loans and non-concessional guarantees or finance) were used as part of FSF: indeed 48% were loans and only 80% was concessional. The fact that funding came from the public sector did not mean that it was cheap, or that it did not need to earn a return. The lion's share of funding went to mitigation, with about 15% for adaptation. 80% of adaptation finance was provided as grants, however.

Not all of this finance was new. Countries counted funding for programmes and projects with climate-related interventions that they were already supporting to meet these commitments.

Finance could have been better targeted: it did not always reach the biggest emitters or the most vulnerable. This results in part from an approach that built ongoing projects and programs to deliver finance during the FSF period, rather than directly responding to emission reduction opportunities and vulnerability to climate change through program design. Indeed, most climate finance was counted as official development assistance (ODA). So far, reliance on ODA for climate finance does not appear to have fundamentally changed its distribution. But, ODA has not been particularly focused on poor countries and people. There is now growing pressure for shrinking ODA budgets to target poverty reduction explicitly, and resistance to spending aid in wealthier emerging economies. These pressures are not consistent with the need for climate finance to also support emerging economies, particularly for mitigation in countries where emissions are growing fastest.

There is a need for clarity on the public sector contribution to medium- and long-term finance under the UNFCCC. Since the end of the FSF period, there has been significant uncertainty about future flows. Developing countries have emphasised the need to be able to predict how much support they are likely to get from the UNFCCC. Early investments were made in exploring potential sources of climate finance through a high level process led by the UN Secretary

Raise

Lesson from Fast Finance Experience

Not all of the finance provided was new. Some sources have proved unreliable: experiments with raising revenues through carbon markets have collapsed alongside the global price for carbon. In times of austerity, there is a need to strengthen political commitment to support developing countries to act on climate change.

Implication

We need to make progress on long-term finance trajectories, and the scope to raise additional sources of finance. While the Copenhagen Accord launched a process of concerted effort to explore new sources of finance, this agenda appears to have lost momentum in a context of austerity. The issues are as political as they are technical. But there are some obvious ways to free up resources, for example, by reforming fossil fuel subsidies. There are also clear links with the development agenda, and efforts to find innovative sources of finance to complement shrinking ODA budgets.

Steps to take

- Raise awareness amongst policy makers and their constituents in developed countries of the importance of international support for climate change, and the global benefits that can arise from its effective use
- Clarify developed country contributions to climate finance and options for scaling up, recognising that different forms of public and private finance have unique roles to play
- Analyse the political feasibility of additional sources including levies on fuels, transport and financial transactions in particular contributor country contexts, making links to efforts to raise innovative finance for development
- Scale back public investment in business as usual, particularly fossil fuel subsidies, incorporating climate risks and opportunities into investment choice

Target finance better

Lesson from Fast Finance Experience

Finance was weakly targeted to emissions and vulnerability. Mitigation finance was not strongly focused on countries where there was substantial potential for GHG emission reduction. Similarly, adaptation finance did not always expressly target vulnerability.

Implication

We need to focus mitigation finance on countries and interventions that can reduce emissions where they are growing the fastest, and target vulnerability. We need to seize opportunities to transition from high-carbon to low-carbon development trajectories. This will involve investing in clean energy, transport and more sustainable agriculture in ways that align with developmental needs and political priorities as well as financing more sustainable consumption. There is a particular need to increase the resilience of development to climate change, supporting risk reduction in developing countries.

Steps to take

- Focus on mitigation interventions that can significantly reduce GHG emissions in the context of recipient countries' climate change and development strategies. Negative environmental and social impacts need to be minimised. Avoid negative environmental impacts. Diverse public and private instruments can be used to this end
- Increase investment in adaptation, targeting vulnerability. These efforts should be linked to poverty and disaster risk reduction efforts.
- Prioritise support for institutions and strengthening policies and regulations, to implement emerging climate change strategies. International finance should complement and reinforce the substantial funding that developing countries are making with their own resources.
- Build a functional GCF that takes a pragmatic but ambitious approach, to fill gaps in the current architecture

Learn and improve

Lesson from Fast Finance Experience

Improved transparency on climate finance in both developed and developing countries will promote understanding of whether countries are meeting their commitments, and whether funding is being used effectively. Reporting on climate finance improved over the FSF period. But we need to understand whether we are succeeding in shifting global investments as a whole away from business as usual towards climate compatible solutions.

Implication

We need to know if we're succeeding in steering investment flows as a whole away from business as usual towards low carbon and climate resilient activities through the delivery of climate finance. To achieve this, we will need complete information on how climate finance has been spent and on wider investment trends, such as fossil fuel subsidies and investments in conventional energy sources. We will also need better tools and approaches to understand the impact of climate finance, and analysis of the experiences and achievements of programs supported. We will need to use this knowledge to convince policy makers and their constituents that this climate finance is having real results.

Steps to take

- The Standing Committee, through its assessment of climate finance flows, can provide an overview of climate finance in the context of wider investment flows, partnering with the climate finance research community.
- A collaborative work program on common approaches to monitoring and evaluation (particularly around GHG emissions and resilience, and impact on policies and institutions in recipient countries) could be established to take stock of emerging insights from fund evaluations to help us better understand and target climate finance, partnering with experts and think tanks who are engaged in research on the effectiveness of climate and development finance.
- Efforts to mobilise finance for sustainable development should support and respond to lessons from efforts to deliver climate finance effectively

THE CLIMATE FINANCE ROAD MAP

1992
UNFCCC Adopted

1994
GEF adopted as a financial mechanism of the UNFCCC

1995
Berlin Mandate to negotiate the Kyoto Protocol

2001
Establishment of Special Climate Change Fund and Least Developed Countries Fund, to focus on national adaptation programs of action in low income countries

2005
Kyoto Protocol adopted, including provisions for a Clean Development Mechanism and an Adaptation Fund financed through a levy on its sales

2006
Countries begin reporting climate related ODA against Rio Markers

2007
Bali Action Plan commits to developed countries to support nationally appropriate mitigation action in developing countries with finance, technology and capacity building

2008
World Bank administered Climate Investment Funds established, outside of the convention

Global financial crisis begins

2009
Copenhagen Accord signed: commitment to Fast Start Finance approaching US$30 billion between 2010 and 2012 and to mobilise $100 billion in public and private finance by 2020

G20 countries agree to phase out and rationalise fossil fuel subsidies

2010
UN Secretary General Advisory Group analyses sources of climate finance

UNFCCC COP agrees to create a Green Climate Fund and reiterates $100 billion commitment

2011
Transitional Committee design process results in adoption of Green Climate Fund Governing Instrument

Durban Platform on Enhanced Action adopted to result in a new agreement with legal force

Work Program on Long Term Finance proposed

2012
First Long Term Finance report released analysing finance needs, potential sources, and options to strengthen enabling environments

FSF period ends without clarity on mid-term finance, though Doha Gateway affirms commitment to $100 billion by 2020

Agreement to address "loss and damage" from climate change

2013
Work program on long term finance extended for a year to explore pathways to scale up

Ministerial Dialogue on Climate Finance to discuss options for scaling up, mobilisation, and strengthening effectiveness

2014
UN Secretary General to host Climate Summit

Peru hosts the 2014 COP

Second Ministerial Dialogue on Climate Finance

2015
France hosts the COP: new agreement on climate change "with legal force" to be agreed.

Successor to the Millennium Development Goals also to be agreed

2020
Developed countries mobilise US$ 100 billion from public and private sources

Close the gap between action and required emission reductions

General in 2010 (AGF 2010), with follow up work by the G20 informed by the World Bank Group and IMF, and a two year work program on Long Term Finance (UNFCCC 2013). But progress in realising new sources has been modest. One exception is Germany's effort to use revenues from emission auctioning to finance domestic and international climate activities through its national budget. This experience has reinforced the importance of using multiple sources to ensure predictability: revenues from carbon alone have been volatile and recently plummeted. Importantly, investment in climate change-related activities appears to have plateaued since the end of the FSF period. Indeed, dedicated concessional finance to address climate change may be declining: new pledges to multilateral climate funds in October 2013 were nearly 70% lower than they were in October 2012 (Nakhooda et al. 2013a).

The operationalization of the Green Climate Fund (GCF) is crucial in this context. Part of the reason we have seen a decline in funding through multilateral channels is because the fund is not yet operational. The design of the fund will need to win the trust of contributors and legitimacy with recipients (see Box 1). There is a long history of establishing financing mechanisms under the UNFCCC that have not raised significant resources, in part because they may not be perceived to be effective by contributors. The successful operationalization of the GCF is a critical test. A well-designed fund could help address some of the gaps revealed during the FSF period. It could help scale up finance for adaptation, address risks that impede scaled up investment in mitigation (including by engaging the private sector at diverse scales), and focus supporting institutions in developing countries to incorporate climate change into their investment and development planning processes, as well as helping them to harness and direct private investment into low carbon and climate resilient options.

Developed countries will need to indicate how much they are willing to contribute to the GCF in the near term. Without clarity on capitalisation, it will be impossible for the GCF to get to work. In turn, recipient countries will need to demonstrate that they will use this funding to achieve real and ambitious emission reductions and strengthen their resilience to climate change, consistent with their development needs. The GCF will need to do more than fund individual projects: it will need to engage diverse actors from the public, private and civil society sectors in pursuit of climate compatible development. To achieve this goal, it will need to build on, and indeed do better than, existing funds in delivering climate finance at scale in partnership with national stakeholders including government as well as the private sector, civil society, and local communities.

The type of funding makes a difference, and how it is delivered matters too. We need to focus on more than just how much money is committed in the near term. Contributor countries will need to clarify what sources of finance will be used, how they will raise this money, and the instruments they plan to use to spend it. Such information would help recipient countries understand what they can expect, and how they can make best possible use of available resources and finance (Nakhooda 2013, Bird et al 2013).

The UN Secretary General's Climate Summit in September and the Ministerial Dialogue on Climate Finance planned for COP 20 in December are two milestone forums where such clarity will be sought. It will take concerted effort at home, in capitals, to win political support for continued investment in the solutions to climate change. Developing countries are already making large investments that respond to climate change (Bird et al 2013). International finance will need to complement these investments, and help factor climate change into how domestic finance is spent. We will need to raise more finance, target it better, and focus on continuous improvement by learning about what works and why.

Beyond the US$ 100 billion

Finance will play an important role in securing a meaningful agreement on climate change in 2015 under the UNFCCC. Clarity on the public sector contribution to existing finance commitments, and operationalizing the GCF are crucial steps to this end. Countries will need to live up to their responsibilities under the convention: this is an important point of principle.

But ultimately, we will need to shift all forms of finance –both public and private, in and from both developed and developing countries– towards investments that provide long-term value by fostering low-carbon and resilient development. The climate finance challenge is inextricable from the wider challenges of financing sustainable global development. The silos that have emerged between the climate finance debates and efforts to mobilise finance for sustainable development are unhelpful, as both processes grapple with many common challenges.

The reality is that the clear lines of the UNFCCC between developed and developing countries do not reflect today's financial and economic circumstances. The countries with positive balances, and finance available that could potentially be invested in low-carbon development are not all developed countries. Countries such as China, and Gulf states such as Qatar and Saudi Arabia have substantial savings (IMF 2013). Several of the largest recipients of climate finance, however, for example Brazil, Mexico and Indonesia, have significant negative balances. Some developed countries such as Germany and Norway have positive balances, but not all do: others including the US and UK are negative. Many "developing" countries are investors in infrastructure and core assets in developed countries. Through their investment and finance, they can help shape the resilience and emission footprints of "developed" countries. For example, the Chinese Investment Corporation already holds shares in Thames Water, giving it a stake in the resilience of British water and sanitation systems. China invested as much as US$ 40 billion in renewable energy in other countries in 2013 (WRI 2013). Countries' economic circumstances and investment capabilities today are diverse and heterogeneous: they do not neatly fit broad categories of "developed" and "developing".

All countries, whether developed or developing, could commit a share of the public finance that they invest globally in low-carbon and climate resilient activities, while also scaling back public investment in high carbon activities. Both mitigation and adaptation are necessary to address climate change. Investments in mitigation can offer clear returns. Adaptation finance is imperative to reduce exposure to the costly risks that climate change poses. Both play crucial roles in providing financial security. But there is no optimal mix that applies to all countries equally: it depends on specific circumstances and, more importantly, on particular tolerance for risk.

Answering such questions through a global lens will need to become more central to our efforts to establish a post-2015 investment framework for climate compatible development. The sum total of public and private action in both developed and developing countries will need to add up to whatever climate compatible development costs, and keep us within 2 degrees.

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