

Climate Finance Post-Copenhagen

The \$100bn questions

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Climate change is the single greatest threat to development – making the battle to overcome poverty ever harder and more expensive. Finance is urgently needed to help vulnerable communities adapt to a changing climate. Last year the World Bank estimated the costs of adaptation in poor countries were \$75–100bn per year if global warming was kept to 2°C.¹ The non-binding pledges from rich countries to cut emissions offered since Copenhagen would steer a course towards a catastrophic 4°C.²

Mitigating climate change is not only about how much rich countries cut their emissions, but also how they help developing countries curb theirs. Emerging economies and poorer countries must now pursue more expensive development paths than the ones rich countries followed. More money will be needed to meet the extra costs of clean development in developing countries.

Climate finance is about more than compensating developing countries for the costs imposed on them by a problem they did not create. It is an investment between rich and poor countries in a common future. Rich countries cannot only fight climate change at home and win.

In the current economic climate the sums required appear daunting, but they are well within the realms of possibility. It is entirely feasible for rich countries to raise hundreds of billions of dollars in public finance each year, through innovative mechanisms, without breaking the bank.

At Copenhagen, there was progress on finance, if limited. The Copenhagen Accord³ proposed the establishment of a 'Copenhagen Green Climate Fund' and included a loose pledge from rich countries to 'mobilise' \$100bn a year by 2020. That such vagueness can be considered a success indicates the extent of Copenhagen's disappointment. Nevertheless, in 2010, world governments have the opportunity to turn ambiguity into action by agreeing

- on a UN Green Fund that is fair, transparent, and accessible; and
- to bring a package of climate finance sources on-stream by 2013, worth at least \$100bn a year, to help poor people cope with climate change.

To rebuild trust between rich and poor nations and put the negotiations back on track towards a comprehensive deal, these issues must be

formally agreed under the UNFCCC at COP-16 in Mexico in December 2010.

The UN Secretary General has convened a High Level Advisory Group on Climate Financing (AGF)⁴ to provide recommendations ahead of the Mexico meeting on how the money can be raised. In this note, Oxfam raises the key questions that the AGF needs to tackle to ensure that sufficient and sustainable sources of finance are found.

Making progress in 2010

At least four critical questions about the \$100bn commitment must be urgently addressed:

- Is it enough?
- Is it new money?
- Is public or private money needed?
- Can grants or loans be used?

Oxfam estimates that to tackle climate change, poor countries will need at least \$200bn per year by 2020, in public finance over and above existing development aid targets. Here we set out the reasons why and explain how it can be done.

Is it enough?

One hundred billion dollars is not an insignificant figure, but tackling the costs of climate change in developing countries is likely to be at least twice as high.

Numerous estimates of the costs of mitigation and adaptation in poor countries range between \$110–275bn per year.⁵ But most estimates are based on warming higher than 2°C – which could mean the difference between life and death for poor people. Oxfam estimates that at least \$150bn per year should be made available by 2013, rising to at least \$200bn per year by 2020 (\$100bn for adaptation and \$100bn for mitigation).

These costs could be even higher. The inadequate emissions cuts rich countries have proposed under the Copenhagen Accord put the world on course for around 4°C of warming, and potentially even higher for regions like sub-Saharan Africa.⁶

To reach agreement on climate finance at COP-16, rich countries must establish sources of finance capable of scaling-up to meet the needs of poor countries. Aiming for \$100bn per year is a good start, but it must be the floor not the ceiling if a global climate catastrophe is to be avoided.

Is it new money?

Under the UNFCCC, Bali Action Plan, and Copenhagen Accord, rich countries are obliged to provide 'new and additional' financial resources to poor countries.⁷ The question is, 'additional to what?'

Many developed countries argue that their climate finance, including pledges made towards \$30bn of 'fast start' finance from 2010–2012,⁸ is new and additional if it comes on top of their current flows of Official Development Assistance (ODA). Nearly all will count their fast start pledges towards long-standing promises to increase ODA to the 0.7 per cent of GNI target first agreed in 1970. Many are re-announcing pledges that have been made before.

But climate finance is not aid. It is not an act of charity, or an expression of solidarity with poor countries, but a legal obligation under the UNFCCC. Meeting this responsibility with money that would otherwise have been available for health and education in poor countries is unjust. Worse still, doing so would reverse hard-won development gains of recent years. Climate change imposes new burdens on poor countries, and new resources are needed to tackle it.⁹

In 2010 rich countries must accept that climate finance must be new and additional to existing aid targets. New means of raising money outside of annual national aid budgets must be found. However rich countries raise the cash, there must be no more re-packaging of past promises with green ribbons.

Is public or private money needed?¹⁰

The Copenhagen Accord suggests that \$100bn should come from a mixture of public and private resources. Oxfam estimates that a minimum level of public finance of at least \$200bn per year for mitigation and adaptation by 2020 is needed to incentivise new private sector flows and to cover areas the private sector will not reach.

The need for public finance for adaptation

It is the world's poorest and most vulnerable people – on the front line of the climate crisis – that adaptation finance must reach.

This includes women farmers, responsible for 60–80 per cent of food production in most developing countries.¹¹ Climate change's most savage impact on humanity in the near future is likely to be the increase of hunger.¹² Women farmers are the first line of defence.

Only public finance can be sure to reach these women and other marginalised communities. The interventions needed – like planting mangroves, or developing small-scale irrigation systems – will not attract investment from the private sector, since they do not generate internal returns. But they are often the difference between life and death.

The private sector will invest in adaptation measures to protect its investments, while public regulation can help channel private investment to support local communities' adaptation efforts.

But rich country contributions under the UNFCCC for adaptation finance must be public money only – ensuring that those hit first and worst by a problem they did least to cause get the help they need.

The need for public finance for mitigation

Under the UNFCCC, developed countries are responsible for meeting 'the agreed full incremental costs'¹³ of essential mitigation action in developing countries.

Even if rich countries make sufficient emissions cuts at home, action must also be taken to control the growth in developing countries' emissions.¹⁴ Developing countries will incur incremental costs in doing so. These are the costs of investing in a more expensive wind farm instead of a cheaper coal-fired power plant – the extra costs of development in a carbon-constrained world.

By their very nature, these costs will not be met by the private sector alone searching for profits. The private sector will have to provide trillions in investments over the coming decades¹⁵ – to build wind farms and other low-carbon infrastructure – but a minimum level of public finance is needed to incentivise their action.

Public money is also needed to ensure pro-poor outcomes. Only public finance can direct investments in rural renewable energy systems that ensure that those outside the formal market economy, particularly women, benefit too. There is no justice in a global climate regime which assumes those with low energy use must remain forever thus.

Does the carbon market count?¹⁶

The UN Clean Development Mechanism (CDM) has been the largest source of mitigation investments in developing countries to date,¹⁷ and many developed countries seek to count these flows as climate finance contributions under a global deal. This despite the fact that the current low mitigation pledges of rich countries mean future carbon finance flows are projected at less than \$4bn per year;¹⁸ far short of the hundreds of billions needed.

But this carbon market finance is used to deliver emissions cuts counted towards the targets of developed countries – not the extra reductions needed in developing countries. Rich countries might like double counting, but the atmosphere does not.

Some rich countries claim instead that the profits earned by sellers of CDM offsets – the difference between the actual cost of abatement and the carbon market price – should be counted as a climate finance contribution. But these profits are captured by the private sector in poor countries – and even where it is taxed, as in China – there is no guarantee that the revenue will finance extra emissions cuts.

To count as a contribution under the UNFCCC, finance must be guaranteed to provide extra reductions beyond those counted as rich country cuts.

Can grants or loans be used?

The AGF may focus on the use of loans for climate finance. Oxfam sees no role for lending for adaptation and recommends strict limits and safeguards for lending for mitigation.

Use of loans for adaptation

There is a strong principled objection to the use of loans for adaptation. Since adaptation finance is not aid, but an obligation to help prevent damages in poor countries and people from the excess carbon emissions of rich countries, only a perverse logic could justify the use of loans. Offering a loan to help poor people adapt to climate change is like crashing into your neighbour's car, and then offering a loan to cover the damages.

In more practical terms, life-saving adaptation investments may be constrained if governments know they have to finance them through loans. As investments designed to reduce vulnerability (rather than boost productive capacity) there is a risk that adaptation expenditures may be first to face the axe when national budgets are trimmed. Because poor women and other vulnerable citizens will benefit most from these expenditures, using loans to finance adaptation will also increase – rather than reduce – the burden on these marginalised populations.

Use of loans for mitigation

Many vital mitigation investments require public grants, but for some projects in the energy sector, limited concessional lending may be an appropriate way to cover some developing country costs.

For measures that will not generate profits, like institutional capacity building, or where pro-poor outcomes must be safeguarded, like mitigation for agriculture or forestry, mitigation should be financed through grants. In the absence of adequate regulation, lending to finance agricultural abatement, for example, could be captured by large agri-businesses, forcing poor people from their land, or risk increasing the vulnerability of smallholder farmers, particularly women, if livelihood assets are depleted to repay loans.

Concessional lending may be an appropriate way to finance emissions savings in the energy sector. This is because the incremental costs of investing in renewable over fossil-fuel energy fall in the extra up-front capital expenditure required. Compared with a coal-fired power plant, a wind farm is expensive to build, but cheap to run.

By making it cheaper to borrow money to invest in a wind farm than in a coal power plant, investments in renewable energy become profitable.

Research shows that up to \$10bn per year of the costs to poor countries of clean energy investments could be covered by extending to them the preferential borrowing rates enjoyed by rich countries.¹⁹ To make further investments in the energy sector profitable, grants can be mixed with concessional loans to make credit lines more attractive compared with those available for fossil fuels.

However, there must be strict limits on the amount of mitigation finance that can be provided as loans. It is estimated that the energy sector should account for 68 per cent of total public mitigation costs over the next decade.²⁰ Oxfam estimates that no more than half these costs should be assumed to be appropriate for lending, meaning that no more than one-third of total mitigation finance should be provided as loans.

Setting this limit is necessary to ensure that sufficient mitigation finance for energy investments is available to countries who cannot sustain further debt, and to poor rural communities that do not currently have energy access. Developed countries must be the guarantors of all loans, and must not attach inappropriate economic or political conditions, which are not only illegitimate, but would undermine national planning for low-carbon economic transformation.

Critically, rich countries must only receive credit under the UNFCCC for the grant element of any concessional lending.²¹ Loans are not a free lunch – only their real value to poor countries should count.

In sum, public finance for adaptation should be provided entirely in the form of grants. For mitigation, strict limits should be agreed which ensure that at least two-thirds of public finance is provided through grants, with no more than one-third through concessional lending. In the case of concessional loans, only the grant element may be counted towards UNFCCC obligations.

Where should the money come from?

By COP-16 in Mexico, Parties must agree a roadmap to the scale of public financing from rich countries needed in poor countries for adaptation and mitigation. The sources of finance identified must meet certain key principles. They must be:

- reliable and predictable;
- scalable to meet needs; and
- equitable and grounded in responsibility for emissions and capability to pay.

Figure 1 illustrates one roadmap to long-term public climate finance that meets these principles within the parameters outlined above. It is not definitive,²² but does show that it is possible for rich countries to mobilize hundreds of billions of dollars in public finance each year

without breaking the bank. More detail on individual sources is contained in Box 1.

Box 1: Sources of climate finance

1. \$75bn / year as grants by 2013 from assessed contributions of developed countries

- Binding commitments according to responsibility (for historic emissions) and capability (to pay).
- This money could come from e.g. auctioning of emission allowances in domestic Emissions Trading Schemes, or from budgets currently used for subsidising fossil fuels.

2. \$100bn / year as grants by 2013 from developed countries' revenues from a global Financial Transactions Tax

- A micro tax averaging just 0.05% on certain financial transactions could raise \$400bn per year; 50% of the revenues could be used to address budget deficits, with 25% earmarked for international development, and 25% for climate finance.²³
- There is now significant interest across the G20 in new taxes on the banking sector to repay the costs of the economic recession, which can also pay for pressing global challenges.

3. \$16bn / year as concessional loans by 2012 from using Special Drawing Rights (SDRs) to issue 'green bonds'

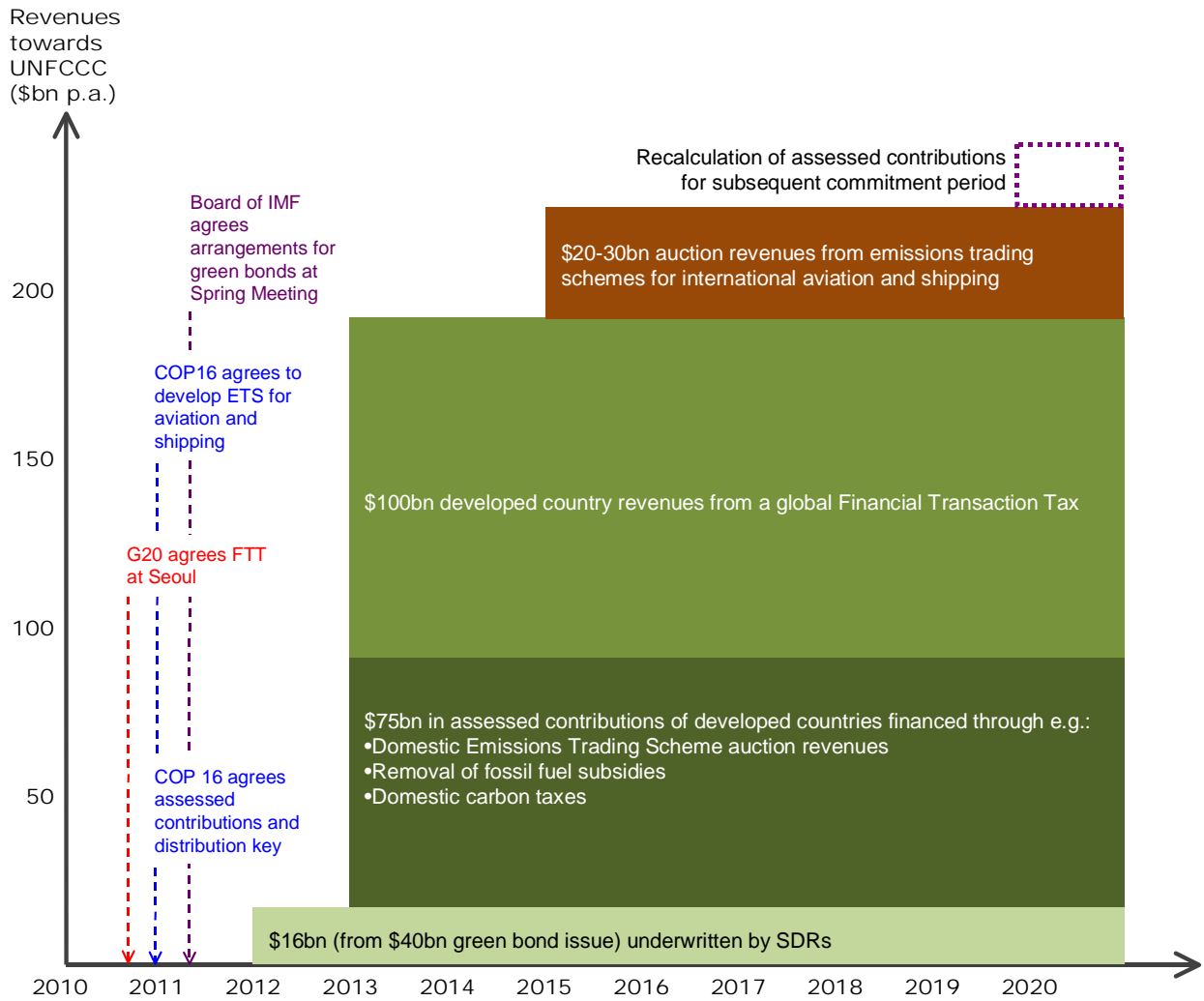
- SDRs are a reserve asset created by the IMF. Using \$120bn of developed country SDRs as capital, 'green bonds' could be issued, raising \$40bn per year to be directed as concessional loans for clean energy investments.
- Only the grant element of the loans – their real value to poor countries – should be counted under the UNFCCC (approximately \$16bn from a \$40bn principal²⁴).
- Much interest now exists in the use of SDRs for climate finance. A similar proposal was made in March 2010 in an IMF staff working paper.²⁵

4. \$20–30bn / year as grants by 2015 from emissions trading schemes for international aviation and shipping

- Emissions from these sectors are not currently capped, and are growing fast. Emissions trading schemes could both control the emissions of rich country ships and planes, and generate revenues for climate finance through the auctioning of emission allowances.²⁶
- Some progress was made towards a deal on international transport at Copenhagen. Political will is needed to seal a deal in 2010.

Oxfam believes that any roadmap on climate finance must be based on binding assessed contributions for rich countries, calculated according to their responsibility for emissions and capability to pay. On top of these contributions, rich countries should establish certain innovative means of raising finance, outside of their annual national budgets. Not all of these will start generating revenues immediately – so a substantial commitment in assessed contributions must be made up-front by 2013. If any innovative source fails to deliver projected revenues, assessed contributions will need to be increased to compensate.

Figure 1: Oxfam's proposal for long-term public climate finance



Recommendations

By COP-16 in Mexico in December 2010, Parties must agree a roadmap to long-term climate finance, which:

- Specifies and guarantees a minimum level of public finance, sufficient to meet needs in developing countries for mitigation and adaptation, likely to be at least \$200bn per year by 2020;
- Provides resources which are new and additional to existing targets for Official Development Assistance (ODA);
- Does not include financial flows generated through the offset carbon market;
- Specifies and guarantees a limit to the use of concessional loans to no more than one third of total public mitigation finance, and allows no use of concessional lending for adaptation;
- Counts only the grant element of loans to developing countries as a rich country contribution under the UNFCCC;
- Establishes a package of sources of finance from developed countries, which meet criteria of predictability, scalability and equity based on responsibility and capability.

Notes

- ¹ World Bank (2009) 'The Global Report of the Economics of Adaptation to Climate Change Study', Washington DC: World Bank.
- ² Oxfam International (2009) 'Climate Shame: Get back to the table: Initial analysis of the Copenhagen talks,' December 2009.
- ³ The Copenhagen Accord is the non-binding political agreement reached between a group of countries and 'noted', not endorsed, by the Conference of Parties to UNFCCC. UNFCCC, 'Draft decision -/CP15: Copenhagen Accord,' December 2009.
- ⁴ See <http://www.un.org/wcm/content/site/climatechange/pages/financeadvisorygroup>
- ⁵ Oxfam International (2009) 'Hang Together or Separately: How global co-operation is key to a fair and adequate climate deal at Copenhagen,' (figures updated to include World Bank 2009 estimate of costs of adaptation); and World Bank (2009) *World Development Report 2010: Development and Climate Change*.
- ⁶ J. Rogelj, *et al.*, 'Copenhagen Accord pledges are paltry,' *Nature*, April 2010; WWF International (2010) 'The Copenhagen Accord: A stepping stone?'; IPCC (2007) 'Climate Change 2007: The Physical Science Basis', chapter 11.
- ⁷ UNFCCC (1992) Art. 4.3; UNFCCC (2007) 'Decision 1/CP13: Bali Action Plan,' 2007, §1(e); Copenhagen Accord, §8.
- ⁸ In the Copenhagen Accord, developed countries also made a 'collective commitment... to provide new and additional resources... approaching USD 30 billion for the period 2010-2012 with balanced allocation between adaptation and mitigation.'
- ⁹ Oxfam International (2009) 'Beyond Aid: Ensuring adaptation to climate change works for the poor', September 2009.
- ¹⁰ Public finance is money derived from governments, or institutions acting on their behalf. This includes money from national budgets, and from innovative international sources designed to raise money on behalf of governments.
- ¹¹ Food and Agriculture Organization of the UN, 'FAO Focus: Women and Food Security,' see <http://www.fao.org/focus/e/women/sustin-e.htm>
- ¹² Oxfam International (2009) 'Suffering the Science: Climate change, people and poverty'.
- ¹³ UNFCCC, Art. 4, §3.
- ¹⁴ Oxfam International (2009) 'Hang Together or Separately', *op. cit.*, pp. 12–14.
- ¹⁵ International Energy Agency (2009) 'World Energy Outlook 2009,' November 2009.
- ¹⁶ The carbon market here refers to the flexibility mechanism established under the Kyoto Protocol to assist developed countries in meeting their emission reduction targets by purchasing credits through the Clean Development Mechanism (CDM) for reductions in developing countries which offset growth in their own emissions.
- ¹⁷ World Bank (2010) *World Development Report*, *op. cit.*, p.262.
- ¹⁸ Project Catalyst (2009) 'Scaling up Climate Finance,' September 2009, p.17.
- ¹⁹ *Ibid.*, p. 18.
- ²⁰ European Commission (2009) 'Towards a comprehensive climate change agreement in Copenhagen: Staff Working Document,' January 2009. Cost estimates are €48bn for energy and industry (not assuming the rent is captured); €18bn for REDD; €5bn for agriculture.
- ²¹ The OECD calculates that the grant element or 'grant equivalent' value of concessionary loans as the difference, in net present value terms, between the loan cash flows at the coupon rate, and a developing-country cost of capital of 10 per cent.
- ²² For example, it assumes a flat revenue profile for each source, rather than attempts to make proposals about how each may be scaled up over time.
- ²³ See <http://robinhoodtax.org.uk/>
- ²⁴ The grant element of a mixture of 15 and 20 year green bonds, with a coupon of 5 percent and repayment of principal at maturity is approximately 40 percent, following OECD–DAC guidelines (i.e. the difference between the net present value of the cash flows discounted first at the developing country cost of capital, assumed at 10 percent, and then at the coupon rate).
- ²⁵ IMF Staff Position Note, 'Financing the Response to Climate Change,' March 2010; see also ActionAid (2010) 'Using Special Drawing Rights for Climate Finance,' February 2010; G. Soros (2009) 'Using SDRs to Fight Climate Change,' speech at COP-15, December 2009.
- ²⁶ Oxfam International (2008) 'Turning Carbon into Gold: How the international community can finance climate change adaptation without breaking the bank', December 2008.

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