



Fairness in Global Climate Change Finance

Summary

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Challenging ideas – Changing policy

It is now well established that action to avoid dangerous climate change must take place according to the principles of ‘responsibility and capability’, and the UN’s Framework Convention on Climate Change (UNFCCC) subscribes to this view. Morally and in political terms developed countries should lead global mitigation by making significant domestic emissions reductions. But in a world of limited finance, reductions arguably be undertaken wherever they can be made for the lowest cost.

Since emissions reductions in developed countries are insufficient to resolve the climate problem and are often more expensive to make than in developing countries, the principles of responsibility and capability might more productively be applied to the *financing* of global reductions: this would mean that the higher a country’s level of responsibility and capability, the greater its share of global climate finance. Technically, developed countries are already obliged to transfer finance to developing countries, under the UNFCCC, which states that ‘agreed full incremental’ costs in developing countries should be met by finance and technology from developed countries (Article 4.3).

Whether and how that obligation should be fulfilled is at the heart of the current international negotiations aimed at reaching a global post-2012 deal at Copenhagen in late 2009. It is fraught with difficulty, largely because of the size of the potential financial liabilities involved and the unpopularity that will arise from asking taxpayers and consumers to meet them.

Estimating costs

The various estimates of incremental mitigation costs are unsatisfactory. While being based in many cases on rigorous analysis, especially of mitigation opportunities in different countries, there is a high degree of uncertainty over future factors that will have a significant influence on costs. In particular the behaviour of governments, officials and populations is deeply unpredictable; ‘policy costs’ may prove significant and the most cost-effective route to decarbonisation may not always be the one taken.

Nevertheless, there is a convergence in the most recent cost estimations at around US\$100 billion to \$200 billion for developing world costs and around \$200 billion to \$400 billion for global costs by 2020–2030. Adaptation costs will add significantly to these sums and are now unavoidable. It is perhaps significant that developing countries in the UN negotiations have called for between \$200 billion and \$400 billion per annum.

A more pragmatic and responsive approach may be to base estimates of future financing of mitigation in developing countries on plans for Nationally Appropriate Mitigation Actions (NAMAs), verified by an international approval process accountable to UNFCCC signatories.

Financing proposals

The sums quoted above are several times larger than current climate change finance. The largest existing pool is the \$6.1 billion pledged in 2008 by ten developed countries to the World Bank’s Climate Investment Funds (CIFs). From where would greater sums of finance capable of meeting the needs estimated above be drawn?

1. Offsetting

To increase the flow of offset finance through the Kyoto Protocol’s Clean Development Mechanism (CDM), developed countries could relax any limits on the proportion of domestic reductions that can be offset by purchasing external credits or set more ambitious targets to drive a more aggressive offset market. The UNFCCC estimates that by 2020, offsetting could yield up to \$40.8 billion. But developing countries are unlikely to accept an increase in offsets as a sole or even majority source of finance for low-carbon development.

2. Leveraged or compulsory additional offsetting

For every tonne of CO₂ offset in developed countries, several could be reduced in a developing country at a price related to the market price of carbon. Governments in developed countries would first have to agree to binding emissions reduction targets and then to a corresponding ratio at which to leverage offsets. If they took on an emissions reduction target of 40 per cent below 1990 levels by 2020 and offset around half at a 2:1 ratio, this could yield \$130 billion per year. Such a mechanism would require developed countries either to accept deep domestic emissions reduction targets or to leverage offsets at higher ratios. It would replace rather than work within existing offset mechanisms.

3. Emissions Trading Scheme levies

There is currently a levy of 2 per cent on the sale of permits in the CDM, the proceeds of which go to the Adaptation Fund. The levy could raise \$200 to \$680 million annually in 2020. Bangladesh and Brazil have both proposed increases and at the UNFCCC COP 14 meeting in Poland, developing countries proposed that a CDM-type levy be applied to all emissions trading schemes. The proposal was blocked by developed countries.

4. Revenue from domestic permit auctions

Developed countries are increasingly auctioning permits to emit under cap-and-trade schemes up front, providing a revenue stream to governments. A proportion of these rents could be set aside to support developing country mitigation (and adaptation). If all Assigned Amount Units (AAUs) were subject to regimes in which they could be auctioned, then post-2012, upward of \$300 billion could be raised. Revenues from auctioning, however, are uncertain because the price paid by polluters depends on demand. Revenues are also captured by national treasuries and may not be used to fund low-carbon activities in developing countries.

5. Upstream auction revenue (AAU hold-back)

Norway has proposed that 2 per cent of AAUs are held back at the international level rather than being assigned to countries and are auctioned to raise money for an international fund. This would raise \$15-\$25 billion per year. Others have proposed that higher percentages of AAUs are held back. The principle stands a high chance of becoming part of the EU's negotiating offer for Copenhagen. However, holding back higher percentages of AAUs or setting a reserve price may be resisted by developed countries because costs would be passed on to their consumers while rents would be captured internationally. US Congress views international expropriation of finance as unconstitutional.

6. Crediting Nationally Appropriate Mitigation Actions (NAMAs)

The Republic of Korea has proposed a system of carbon credits for NAMAs to allow for actions to be taken early and financed up front against a future sale of carbon credits on the international market. The credits would be purchased by developed countries, where deeper reduction targets would be agreed. Its potential value would depend on the scope and effectiveness of NAMA plans and on the availability of developed country financing. Crediting NAMAs, however, might assist with the politics of a post-2012 agreement as it could help finance already planned low-carbon strategies in developing countries.

7. Global taxation

Switzerland has proposed a levy of \$2 per tonne at the national level in all countries with per capita levels above 1.5 tonnes, with countries retaining the funds depending on their level of development: 40 per cent in the case of developed countries and 85 per cent for the poorest. This would raise a predictable level of finance of \$48.5 billion per year of which \$18.4 billion would be deposited in an international fund. But the costs of a flat carbon levy would fall regressively.

8. Other levy-based proposals

Least developed countries (LDCs) have proposed an international levy on aviation which could raise between \$4 and \$10 billion annually and a levy on bunker fuels for aviation and shipping, which could raise between \$4 and \$15 billion. Brazil has hinted at a €100 billion climate fund involving a 10 per cent tax on revenues from the production and trading of oil and coal.

9. Non-climate-related funding sources

Other funding sources, such as increases in general overseas development assistance, a tax on currency transactions (Tobin Tax) or more broadly on financial transactions, revenue from untaxed income held offshore and the use of sovereign wealth funds, may all play a future role. For example, \$11.5 trillion of private assets currently held in offshore finance centres would yield \$225 billion annually if taxed at a conservative rate.

10. Frontloading finance

Frontloading finance using bonds raised against the guarantee of tax revenue in developed countries could leverage private sector finance into mitigation measures. Developing countries are understandably cautious but the European Commission has hinted at a proposition whereby developed countries guarantee lending for well-structured developing country projects and policies. This approach might also remove some of the short-term political pressure on developed country governments, whose contributions to global climate financing must otherwise be drawn from an increase in costs to today's taxpayers or consumers.

Building a North–South finance package

Within the current structure of the negotiations, agreed financing is likely to come primarily from Kyoto-type sources, especially while developed countries remain committed to putting in place and linking-up national or regional carbon markets. Therefore the choice is between different combinations or 'wedges' of measures that add up to an agreed sum. Measures such as the CDM and offset leveraging are incompatible (offset leveraging would replace the CDM). Others, such as AAU holdback, can be scaled up but appear politically less viable the larger they become.

Developed country governments face something of a Hobson's choice as the ultimate source of the financing is the same one: developed country populations. This may prove especially troublesome at a time of economic hardship. If the Kyoto-style approach continues to pervade, while a simpler approach of enhancing one mechanism may be preferable to a more complex collection of measures, it may prove politically more attractive to spread the cost across a number of measures.

Given the scale of financing required (and the likely unwillingness of taxpayers and consumers in developed countries to pay), *official* climate financing should also accommodate other financial flows, such as additional, climate-related overseas development assistance and the use of debt-based instruments such as frontloading.

There is also the equally politically charged discussion concerning the structure and mechanism by which the funding might be governed, allocated, channelled, monitored and verified. There are two choices. The first is a single World Climate Change Fund approach, as proposed by Mexico, to which all countries would contribute according to their level of cumulative emissions, population and ability to pay, but developing countries would be net recipients. It is supported by the European Commission but faces two political obstacles: it requires contributions from developing as well as developed countries, something the G77 has staunchly resisted, and developed countries are typically of the view that a new fund could be inefficient, wasteful and costly.

One possible alternative is a new international body to approve and verify developing country NAMAs and to monitor, report on and verify finance flows from developed countries. A body of this sort might build on the experience of the CDM board.

Allocating financial obligations

If developed countries are to fulfil their UNFCCC obligations and in a manner that is measurable, reportable and verifiable, sharing out financing commitments fairly and according to a clear, defensible methodology will be necessary. The concepts of 'responsibility' and 'capability' at the heart of the UNFCCC could form the basis of such an approach.

The Greenhouse Development Rights Framework (GDRs), an equity-based, burden-sharing proposal, is unique in that it quantifies 'responsibility' and 'capability'. GDRs allocates mitigation effort and adaptation cost according to a global responsibility and capability index (RCI). Responsibility is calculated by taking into account cumulative emissions per capita since 1990 and capability is measured as PPP-adjusted GDP per capita above an income threshold of \$7,500. The two indicators are combined with equal value to arrive at a single index which, while currently applied to emissions allocations, could be used to determine financial obligations. Such an index might be used in one or more of the following ways:

1. Global fund

The RCI can be used to calculate fair shares in a Mexican-style World Climate Change Fund. Using GDRs, in a \$250 billion per year global fund, the US's share would be \$82.7 billion in 2010; China's contribution would be \$13.75 billion; the EU15's share would be \$57.4 billion; while India's share would be \$1.3 billion. The dynamism of the RCI, taking into account changing shares of responsibility for the atmospheric stock of greenhouse gases and relative GDP growth, is an added advantage.

2. Article 4.3 (Annex II) fund

The RCI could also be used to distribute the financial burden around Kyoto Annex II countries only, were developing countries successful in negotiating the full implementation of the UNFCCC's Article 4. For a developing world financing fund of \$100 billion, the EU15 and the US are clearly liable for the lion's share: \$33.9 billion and \$47.7 billion respectively.

3. AAU auction or offset aggregator

The RCI could also be applied to a scaled up version of Norway's proposal to hold back developed countries' AAUs. Were an overall hold-back target of 10 per cent of AAUs agreed, rather than each country sacrificing a flat 10 per cent of its AAUs, each would be given a different proportion relative to its RCI ranking. Countries higher up the RCI would have more than 10 per cent held back and vice-versa. The RCI could also be applied to a leveraged offset to weight the degree of leveraging required according to the different RCI rankings of developed countries.

4. RCI as the basis for a global inventory

The politics of a financing system that relies heavily on a single mechanism may prove prohibitive not least because it would involve conspicuously large sums of finance flowing to developing countries from a handful of developed ones. A more eclectic, multi-channel approach to climate financing might be the quid-pro-quo for developed countries' fulfilment of agreed financing obligations, with a COP-accountable executive body to keep the finance-mitigation global balance sheet. An RCI could be used as the accounting methodology.

Conclusion

The costs of reducing global emissions are likely to be met (if they are met at all), for sound economic and inescapable political reasons, from a variety of different sources and via different mechanisms and channels; this may be especially true during a deep, global recession. Such an eclectic picture of global climate finance points to the need for an international arbiter of fairness and good practice: a formally mandated body that would set the standards for and verify mitigation actions, policies and plans, keep an inventory of developed–developing country financial flows, developed best practice, make policy recommendations, and report back to the Committee of the Parties to the UNFCCC.

Designing a climate finance regime that is demonstrably fair and based on clear indicators of equity can help both during this year’s negotiations and in post-Copenhagen domestic debates in developed and developing countries alike. An index of responsibility and capability of the type used in the Greenhouse Development Rights framework can provide a reference for observers and negotiators, a substantive basis for negotiation and a real-world methodology for sharing out agreed financial obligations.

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