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Finance and Investment from Developed to Developing Countries:

A Global Financial Architecture for Climate Change

The impact of climate change will be disastrous for both developed and developing countries, as well as the global ecology and economy. But the most disruptive impacts can still be mitigated if urgent action is taken to ensure a peak in greenhouse gas emissions and then a decline in global emissions before 2015. Although emissions are rising in some developing countries, industrialised countries have a higher historical responsibility for accumulated emissions. In addition, the fossil fuel resource-intense economic growth that has been the basis of these emissions provides them with a higher capacity to act.

A Global Financial Architecture for Climate Change (Global Financial Architecture) is needed to shift public and private finance and investment flows towards decoupling economic growth from increasing greenhouse gas emissions to a low carbon and climate resilient future (including both adaptation and compensation). The UNFCCC secretariat's Investment and Financial Flows report (2007) estimates that $133 billion a year in additional investment in developing countries will be needed in 2030 to increase climate resilience and contribute to their low carbon economic development. It should be noted that this estimate is based upon an unacceptably high stabilisation level of 500 ppm CO_2-eq[1] (and not taking into account the need for increased energy access in developing countries). To have a 50% probability of staying within a 2°C temperature increase, CO_2 concentrations should at least stay below 450 ppm CO_2-eq[2]. More ambitious action is therefore required that will be reflected in a higher overall cost. Failure to do this would lead to damage costing much more – at least 5% and perhaps more than 20% of global GDP[3].

Adaptation and Mitigation funding currently available to developing countries is well below the above figures and a decision on the basic elements of the Global Financial Architecture will need to be an essential part of the agreement for a Global Deal in Copenhagen (COP15).

Elements of global financial architecture for climate change

A Global Financial Architecture will need to include:

- carbon market instruments;
- additional public national funding;
- public international funding;
- re-directing development towards sustainable development;
- commercial funding; and
- private investment.

These approaches should be structured so that they are mutually reinforcing.

While the carbon market is essential, by itself it will not deliver the necessary shift in public and private investment. Public investment and additional approaches are necessary to shift private investment and provide services that the market cannot offer.

We discuss public funding in this paper. According to WWF research, an estimated $25 billion a year in international public funding for Adaptation and Mitigation in developing countries could be available during the first commitment period. This would come through CDM, actual and pledged funds within and outside the UNFCCC process. Even so, available public finance will need to be increased substantially to address climate change challenges.

In our view a Global Financial Architecture arrangement for public funding will consist of three main elements:

1. How to raise funds – mechanisms and who should pay
2. How to manage funds – an institutional arrangement and governance of funds
3. How to use funds – disbursement of funds and implementation

Principles to guide negotiations

Agreeing a set of basic principles contributes to negotiating an agreement by ensuring transparency and coherence. However, agreeing on those principles should not substitute an agreement on concrete mechanisms and institutions.

First, addressing global environmental issues requires interdependent consideration of social, economic and environmental matters between states at widely disparate stages of development and with widely different economic interests. General norms – i.e. principles – allow for a wider range of interpretations leading to facilitation of an agreement.

Second, the world's perception of the environmental crisis has developed very fast, and the necessity to find solutions is now very urgent. Principles are useful for responding to that necessity because states may agree more speedily on general standards, objectives and principles if they are flexible and adaptable. When that is the case they can overcome the difficulties involved in treaty negotiations and ratification, and provide a basis on which to elaborate more detailed rules.

Third, principles are particularly well suited to face the scientific uncertainty surrounding some environmental problems – not least climate change issues. States may be reluctant to act on environmental issues where specific effects are not easy to predict. Principles can adequately operate in a dynamic and evolutionary regulatory regime required to address the issue as the science evolves.

1 Raising Funds

Any financial architecture will have as its basis an instrument or set of instruments to mobilise financial resources. Already many proposals have been made not only within the UNFCCC process but also by actors outside the process. An evaluation of current proposals should take account of principles and criteria.

Principles and criteria

- *Leadership*[4]*:* An agreement to reduce greenhouse gas emissions should be comprehensive and include actions by developed and developing countries. However, the agreement should take into account that any action by a developing country is based upon action by developed countries to reduce their own emissions and provision of resources.

- *Adequacy:* The provision of financial resources by developed countries should be related to the objectively determined needs of developing countries for adaptation, mitigation and technology transfer in a 2°C scenario[5]. This does not apply to the provision of finance *per se*, but the relation to needs should be the basis of an agreement. This is especially so in the case for adaptation.

- *Predictability/effective – stable flow of resources[6]:* Financial flows will only contribute to long-term sustainable economic development and greenhouse gas reductions if countries and investors can anticipate finance being available. Investments are then made accordingly. It should be possible to get political support for such an instrument in the providing countries.

- *New and additional:* Funding agreed under the COP should be additional[7] to ODA[8/9] and reported to the COP so that it can be verified as contributing to the commitments under the Convention.

- *Polluter Pays:* the polluter pays for the reparation of damage[10]. Polluters should take responsibility for the external costs arising from their pollution. Internalisation is complete when polluters take responsibility for all costs arising from pollution. The COP should decide how the polluter is defined – either on the basis of existing categories or historical CO_2 emissions.

- *Effort Sharing:* Criteria should be developed for dividing financial contributions to a Global Financial Architecture. These should be based upon historical responsibility for emissions and the ability to pay, so that they count towards fulfilling the commitments under the Convention[11]. The COP should decide on when the historical responsibility commences, the threshold of CO_2 emissions for which polluters are held responsible, and the threshold of income after which parties are deemed able to contribute towards Global Financial Architecture financing.

- *Precautionary principle:* The level of financial means made available should reflect a mitigation scenario of staying below 2°C. But adaptation finance should take into account the possibility that global warming could increase above 2°C.

2 Institutional arrangements and Governance

The financial resources raised will have to be managed by one or more institution. The governance structure will be of the utmost importance because the financial flows will be substantial. Governance should be robust to ensure that decisions are made efficiently in order to implement the goals of the Convention without delay.

Principles and criteria

- *Representative:* Climate change is a common challenge in which there is no question of a donor-receiver relationship. The governance structure should comprise an equitable and balanced representation of both providers and recipients of funds[12].

- *Transparency:* Citizens and stakeholders should have access to detailed information about how they are being represented in the governing bodies, including those of funds. Furthermore, the activities and decisions of these bodies should be a matter of public record[13]. Government participation should not be restricted by a lack of human, technical or financial resources; instead, a budget should be set aside to facilitate participation of all relevant countries and stakeholders.

- *Accessible:* To achieve climate change stabilisation, developed and developing countries must rapidly redirect their economic development. Greenhouse gas emissions should peak and then start to decline well before 2020. Because the impact of climate change is already felt in some regions, the structure of a Global Financial Architecture and its procedures should allow efficient and timely access to funding both for low carbon development and adaptation[14].

- *Appropriate:* The conditions applied to the provision of funds should (a) reflect that the providers are those responsible for climate change; (b) take into account the possibility of earning interest from investments; and (c) take into account the social and economic reality of the recipients[15]. Funding for adaptation should take the form of grants because developed countries are the main cause of climate change, developing countries are bearing the major part of the costs, and adaptation investments are less likely to result in a viable financial return on investment.

- *Under authority and accountable to the COP*[16]*:* To strengthen and support the UN process, financial resources disbursed in fulfilment of developed countries' obligations under the UNFCCC should either be placed under the authority of the Conference of Parties, or related to it through clear accountability rules. With the exception of the Clean Development Mechanism, at present there is more public climate finance available outside the UNFCCC process than within it. This can result in competing centres of decision-making which can lead to decreasing efficiency and additional transaction costs. A decision on this issue is therefore of the utmost importance.

- *Effective:* Institutional support should reflect the stage of development of a given technology. Different stages need different ways of financial and technical support if they are to be effective. Organising different levels of support for technology development, transfer and dissemination should be considered.

3 Disbursement and spending

Finance spent through the Global Financial Architecture should directly contribute to achieving the goals of the Convention. A Global Financial Architecture agreement should therefore (a) create a framework for parties to maximise the positive impacts for the global community as well as the host countries; (b) coordinate their efforts so that they learn from each other; and (c) ensure that the financial benefits of investments are equitably distributed.

Principles and criteria

- *Sovereignty:* Finance should be based upon low carbon development plans and adaptation action plans developed by the respective countries themselves. Climate finance is the result of a global agreement to protect not only worldwide public goods, but also those impacted by global change. Action, however, is taken on national and regional levels. In the short term, already developed NAPAs can function as a basis for funding where those countries have them.

- *Equity:* fair distribution of funding[17]. Criteria should balance the need of countries impacted by climate change with their expected contribution to greenhouse gas reduction and their own financial capacity. The present division of Clean Development Mechanism benefits shows that financial instruments tend to benefit a small number of countries disproportionably if there are no criteria for distribution. Limiting international public finance access to a maximum percentage or amount should be considered.

- *Sustainable development*[18]*:* Investments should strengthen broader sustainable development goals, including those of economic and social welfare and environmental sustainability. They should also fully comply with international and national environmental legislation, commitments or frameworks.

- *Transparency:* All expenditure, implementation activities, reporting and lesson learning should be carried out in an open and transparent way. They should recognise UN resolutions and agreements on rights and be accountable to national parliaments. Projects and programmes should reflect international agreements on public participation and accountability, respect for human rights, and the rights of indigenous people.

Finance for mitigation

- *Effective:* Funding should prioritise low carbon development plans that lever the conditions for emissions reductions in the most cost-effective and coherent way. This is in order make sound climate technologies competitive in a domestic market[19]. Host countries should demonstrate that projects and programmes are most effective through (a) an assessment of what is needed; (b) what more could be done with more finance; and (c) the provision of integrated implementation plans before finance flows can be increased. Actions could include policy measures relating to sustainable development, carbon market instruments and regional or global technology action plans.

- *Measurable, verifiable and reportable:* Financial support is based upon positive activities of host countries and an agreed system or standards for reporting to the Conference of the Parties.

Finance for adaptation

- *Prioritise Least Developed Countries, Small Island Developing States and drought and flood prone African countries*[20]*:* Financial support for adaptation should differentiate between those that will be hit hardest and those that have contributed the least to climate change. The communities that will be hardest hit by climate change often do not have the means to protect themselves against its impacts and should therefore be prioritised.

- *Readiness / absorption:* A budget should be set aside to support those countries with limited resources, in order to develop the institutional infrastructure to execute plans, programmes and projects.

Download illustraions and additional materials from

http://www.panda.org/about_wwf/what_we_do/climate_change/publications/policy.cfm?uNewsID=150781

[1] http://unfccc.int/files/cooperation_and_support/financial_mechanism/application /pdf/vanvuuren.pdf, p. 15

[2] http://unfccc.int/files/cooperation_and_support/financial_mechanism/application /pdf/vanvuuren.pdf, p. 8

[3] http://www.hm-treasury.gov.uk/d/CLOSED_SHORT_executive_summary.pdf

[4] Principle 7 Rio Declaration

[5] UNFCCC art. 11.3 d
Bali Action Plan (BAP) art 1.e.i; art.4.7

[6] UNFCCC art. 11.3

[7] Bali Action Plan art 1(b) (i) and (ii)

[8] Existing finance should be climate smart

[9] UNFCCC art. 4.3

[10] WWF: Environmental Liability: 'Polluter Pays' Principle must be maintained, 25 June 2002
OECD fact sheet about EPR: http://www.oecd.org/document/53/0,3343,en_2649_34395_37284725_1_1_1_1,00.html

[11] United Nations Framework Convention on Climate Change
Living Planet Report, 2006, p. 25

[12] ibid

[13] UNFCC art. 11.2

[14] BAP art. 4.7

[15] BAP art. 4.7

[16] UNFCCC art. 11.1
Nairobi C/CMP.2 Principles agreed for Adaptation Fund

[17] Kyoto Protocol art 3.1
The principles of One Planet Living: "Promote equity and fair trading relationships to ensure the OPL community has a beneficial impact on other communities both locally and globally, notably disadvantaged communities."

[18] Idem
The principles of One Planet Living: "We need to sustainable ways to meet the basket of human needs: things like food, clothing, housing, energy, health, education, mobility, and leisure."

[19] WWF Position on the Clean Development Mechanism for COP/MOP1 16 November 2005
WWF Position Paper for the 22nd Session of the Subsidiary Bodies of the UN Framework Convention on Climate Change and the Seminar of Governmental Experts Bonn, 16-27 May 2005

[20] WWF Position paper: Priorities for Nairobi: Charting the Course for a Safe Climate post-2012, 7 Nov 2006