Limiting Climate Change: Who is going to pay?

by Richard Stewart & Benedict Kingsbury

Here in Copenhagen, agreeing on some principles of climate finance, at least in very basic form, is at last becoming a priority. Last week, after announcing EU money for a climate change fast start fund, German Chancellor Angela Merkel **acknowledged** that developing countries would only enter into a climate agreement if sufficient money was committed by developed countries: “This is the biggest headache to me.”

And last Thursday, billionaire George Soros **proposed** using IMF Special Drawing Rights to leverage over $100bn for mitigation and adaptation in developing countries, with the investments eventually to be recouped by the IMF. This has the attraction that the SDRs are already there - they do not require transfers from taxpayer funds. But this proposal for a fairly radical shift in what the IMF does has not attracted much attention at the COP.

All agree a final political declaration will depend on the developed countries putting some public money on the table. Where the developed governments are starting to make commitments is to the fast start fund, which will fund projects (clean adaptation, clean technology and avoided deforestation projects) immediately and through 2012, when the potential successor to Kyoto would begin. The EU has now pledged €7.2 billion over those three years, although a portion of this is existing promises or will be reallocated from aid budgets, rather than new funding. The US and others expect to provide similar funds too.

But while symbolically important (and potentially a stepping stone to further commitments), the amounts now being discussed by developed country governments are nowhere near what is likely needed to limit warming to 2°C, nor are they commitments that will last beyond 2012. The **UN** and other **respected independent sources** estimate that €55-80 billion in additional international financing is needed annually over the period 2012- 2020 to curb emissions in developing countries, and an additional €10-20 billion annually for adaptation, for a total of €65-100 billion annually.

Much of the needed finance—perhaps €50-70 billion annually—will have to come from public sources, including bilateral ODA, domestic emissions allowance auctions, World Bank and other multilateral programs, and international levies on marine and aviation sectors and perhaps a tax on international financial transactions.

Private finance would have to supply the balance: €15-30 billion annually. It will largely be generated through the international carbon markets, in which regulated entities in developed countries purchase emissions reduction credits from verified reducers in developing countries. Up to this point in the negotiations, developing countries had been very hesitant to include private finance in the funding mix. However, the AWG-LCA Chair’s most recent **draft text** includes recognition that private finance should play some role (and that part of the text is not in square brackets). This is a significant and important shift because AWG-LCA (Ad Hoc Working Group on Long-term Cooperative Action) is where most of the negotiating is happening right now.

There is very little detail yet in the negotiating texts on the institutions necessary to coordinate, deliver, and govern these funds, or on MRV arrangements for donors (which currently seem

unlikely to be very robust). Some vital topics, such as finance leveraging, are not even on the table.

Leveraging—achieving more reductions per unit of finance than would be achieved through awarding one credit for every unit of emissions reduction (e.g. for every tonne or carbon equivalent)—is essential if the available funds are ever to be scaled up to the necessary levels of finance to adequately curb emissions without blocking low-carbon development.

Leveraging of public financing can take a number of forms: low-interest loan guarantees or concessionary debt in which loans for low-carbon growth are given to developing countries below commercial rates; developed country funds could be used as collateral to secure developing country loans; provision of investment insurance or export credit provided by domestic or international public agencies, to minimize risk for private investors in developing country mitigation projects; or arrangements to catalyze technology transfers, which may include domestic tax or fiscal incentives to developed country manufacturers/patent holders.

In the case of private funding, leveraging might take new forms. Two likely techniques are:

1. Intermediary carbon banks would purchase reductions in developing countries at prices approximating the marginal costs of producing them. The banks would then sell the reductions at the market price that credit offsets command in developed countries—quite often a large spread—with the difference used to purchase additional reductions for the benefit of the climate system, or development goals.

2. Credit Discounting would require, for example, that 1.25 offset credits have to be surrendered to offset 1 unit of domestic emissions by regulated sources. This mechanism is found in the Waxman-Markey bill that passed the U.S. House.

But as we said above leveraging options, including arrangements that use public and private funds to leverage each other, are not on the table for serious discussion in Copenhagen. Unfortunately, that discussion is dominated by the issue of the magnitude of financing, but some basic approaches to MRV and climate finance institutions are being negotiated. We will write tomorrow on institutions that might overcome the basic lack of trust most developing countries feel in the prospects that adequate finance will actually flow to their domestic mitigation projects or programs.

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One Response

The problem of instituting a system of carbon credits without setting firm emissions limits on developing states seems to be that much of the "savings" that are produced by trading credits will be purely hypothetical. For example, with regards to the first scenario proposed above, what would stop investors in developing countries from creating GHG-emitting businesses purely for the purpose of shutting them down and selling those credits? Similarly, if carbon credits become prohibitively expensive in developed countries (as they seem designed to do), what would stop manufacturers in those countries from dissolving those operations and reforming in a developing country? It seems that we must find a way to convince developing countries to agree to stricter limits on their GHG emissions, even if that cooperation must be bought with greater amounts of financial and technical assistance from developed countires.

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