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No new money – no deal!

HOW THE EU NEEDS TO REVISE ITS CLIMATE FINANCE POSITION TO REACH AN EQUITABLE AGREEMENT AT COP 15

It is positive that EU leaders –for the first time – have agreed on a climate finance position on October 30, 2009. The world has been waiting for the EU to act on this issue for many months. The adoption of a position only 5 weeks before COP 15 is not a second too soon.

For negotiations to progress to a successful outcome in Copenhagen, the world desperately needs strong developed country leadership to provide the sufficient resources to support developing countries to deal with climate change. As a historic climate champion, the EU is in a good position to lead, and the financial crisis presents the EU with an unprecedented opportunity to transform its economy. But the proposal adopted on October 30 will not be sufficient to provide the necessary leadership. Rather, the proposal signals that the EU is shying away from assuming its historical responsibility for climate change, and returning to business as usual. Faith-based development groups view this as unacceptable and inadequate.

Below is an analysis of the EU climate finance proposal from an equity and adequacy perspective. The proposal is evaluated against how well it can contribute to an agreement that avoids dangerous climate change without compromising the right of poor countries to development.

KEY ACTIONS: What the EU and other developed countries need to do before COP 15 to make their climate finance offer adequate and equitable

1. Revise all calculations underpinning EU positions that under-estimate mitigation and adaptation costs, & commit to an overall annual EU public finance contribution of at least €35 billion in 2013, rising to €45 billion in 2020

2. Fulfil the EU obligation to make long-term, post-2012 finance commitments at COP 15. Do not try to *replace* commitments to long-term finance with "fast-track" finance, however important the latter may also be.

3. Commit that all EU public climate finance will be new and additional to existing ODA commitments and offsets

4. Reject the idea that developing countries should contribute to international public climate finance, and reduce the expected amount of unsupported adaptation and mitigation to be done by developing countries themselves

5. Push for innovative climate finance mechanisms such as levies on aviation and shipping, and international auctioning of emission allowances, with safeguards which ensure the principle of 'common but differentiated responsibilities' is not undermined.

6. Push for a centralized, equitably governed fund under the authority of the UNFCCC as the main vehicle for climate finance under the post-2012 agreement

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1. Needs estimates are far from what recent science calls for

The EU estimate that €100 billion will be required by 2020 is based on old science. This is particularly true for adaptation costs, which are hugely underestimated, assumed to be only €10-24 billion in 2020, which is far below recent research estimates.

First of all, the EU figures build on a UNFCCC estimate[1] that since has been widely criticized for being inadequate. Specifically, a study by the International Institute for Environment and Development (IIED) reaches the conclusion that the UNFCCC figures are 2-3 times too low, as a result of excluding certain sectors or certain parts of sectors from the calculations.[2] Furthermore, a recent World Bank report also has reached the conclusion that adaptation costs will be significantly higher than the UNFCCC predicts.[3] The European Commission acknowledges that the UNFCCC figures have been criticized, but does not adjust its own figures to adjust to the higher needs estimates in such recent studies.

Second, the EC method for assessing costs for 2020 is highly questionable. The UNFCCC study which underpins the EU estimate assesses adaptation costs in developing countries to be €23-54 billion by 2030. The EC calculates costs for 2020 by linearly extrapolating the costs up to starting in 2012 going up to €23-54 billion in 2030, assuming that they are at €0 in 2012 (!). The EC thus does not acknowledge the fact that climate change is already having a huge impact, particularly on the poorest and most vulnerable countries and people.

If current climate impacts that are already being felt, as well as the calculations in recent scientific studies were taken into account, the cost estimate for adaptation in developing countries would be more than 2-3 times higher than the EU predicts.

Also the estimates of mitigation costs are under-estimated by the EU. The European Commission estimates that €71 billion will be required annually by 2020 to cover the additional costs of reducing emissions in developing countries, in the energy and industry sectors. The World Development Report reaches the conclusion that mitigations costs in developing countries will be $140-175 billion annually by 2030, with associated annual financing needs of $265-565.[4]

Another alarming gap in the EU position is the discrepancy between mitigation and finance proposals. The EU finance package is far from adequate taking into account the low level of ambition of developed country mitigation targets. The figures and cost estimates underlying the EU finance position are based on scenarios where developed countries as a whole decrease their emissions by 30% by 2020. If mitigation targets are lower, the costs of adaptation will rise significantly. In addition, if mitigation action is delayed into the future, the scale of finance required will increase as well. The European Commission estimates that if developed country targets remain at low levels, the need for public finance will increase to more then €120 billion annually.[5] However, this significantly higher figure is never mentioned by the EU in the negotiations.

The EU should urgently revise its finance position to take into account recent scientific reports on the costs of adaptation and mitigation in developing countries, and make sure that the EU proposals are adjusted upwards to take into account the low level of ambition of developed country mitigation targets.

[1] UNFCCC (2007). *Investment and Financial Flows to Address Climate Change.*
[2] IIED and Grantham Institute for Climate Change at Imperial College (2009): "Assessing the costs of adaptation to climate change: a review of the UNFCCC and other recent estimates"
[3] World Bank (2009), *The Economics of Adaptation to Climate Change.*
[4] World Development Report 2010 : Development & Climate Change; p. 259: "It is also important to distinguish between mitigation costs and incremental investment needs. Because many clean investments have high up-front capital costs, followed later by savings in operating costs, the incremental financing requirements tend to be higher than the lifetime costs reported in mitigation models."
[5] European Commission Communication, "Stepping up international climate finance: A European blueprint for the Copenhagen deal", September 2009

2. No concrete EU figure

The EU has for the first time put a number on the table for total global public finance needs, amounting to €22-50 billion annually by 2020. However, the EU still does not specify how much should be its own fair share of the total contribution. The European Commission has previously estimated that the EU should pay between €2-15 billion annually. The wide range is a result of different weightings for the criteria in the effort sharing formula, based on capability and responsibility. Considering that the European Council proposes a significant weighting on emissions – rather than capacity to pay – the EU contribution is likely to be at the lower end of the range.

CAN has estimated the total public finance needs for adaptation and mitigation to be at least €131 billion p.a. by 2020, of which the EU fair share would be approximately one third, i.e. at least €45 billion.[6],Based upon recent studies, this figure would need to be revised further and potentially be twice as high.

Asking developing countries to pay, based on current emissions as the EU position posits, does not take into account the historical responsibility of developed countries. Basing calculations on historical emissions rather than current emissions would justly increase the share that developed countries must pay, and the EU contribution would be much higher.

APRODEV, CIDSE & Caritas believe that the outcome of COP 15 must indicate clear commitments by developed countries to concrete financial contributions, on an annual basis, starting from 2010 but not limited to fast-track/near term finance. Failing to agree on concrete figures and revenue raising mechanisms for long-term commitments is likely to result in failure in Copenhagen, as developing countries will accept no less. The EU should present a unilateral offer before COP 15 to put pressure on other parties to also put concrete figures on the table.

3. Developing countries pay up to half of total €100 billion

It is positive that the EU finally has a position on climate finance, and is starting to discuss numbers and ranges for the international public finance required. Other developed countries should follow suit. However, developing countries still doubt whether the EU position will lead to any new money on the table. This is because the EU is asking developing countries themselves to pay for up to half of the estimated €100 billion required annually in developing countries to deal with climate change.[7]

The call on developing countries to pay can be criticized for several reasons.

First of all, the EU and other developed countries have fundamentally over-estimated the amount of 'own action' that can be done domestically in developing countries, without international public support. The Commission sees a very limited role for international public finance – covering only 10-20 % of additional costs of mitigation in the energy and industry sectors. In particular, a large share of mitigation costs is identified by the EU as 'long term low

[6] Already in 2013 there would be a significant need, estimated by CAN to be €110 billion (of which the EU should pay €35 billion).
[7] The EU divides the total €100 billion needs estimate into three sections: finance provided by developing countries themselves (20-40%), finance provided by carbon markets, and international public finance (€22-50 billion). Of the international public finance, developing countries should also contribute, based on an effort sharing formula based on capacity to pay and responsibility for emissions. The EU states a preference for a heavy weighting on emissions, which means that large developing countries such as China and India would have to pay significant amounts and that the EU's share would be significantly less. This means that developing countries would have to pay twice: through 'own actions' – up to €40 billion, as well as through contributions to international public finance – up to €10 billion – adding up to €50 billion annually

cost efficiency measures', to be paid by developing countries themselves. The European Commission's analysis, underpinning the EU climate finance position, also states that "A large part of the funding for adaptation can also come from private households and private firms as it is in their own economic interest"[8].

The EU's over-reliance on developing countries' own action does not take into account the political and economic reality of these countries. While developing countries are already taking significant amounts of own action, there is a limit to the action they are able to take without international support, due to a number of economic and political constraints. Although certain low-emissions and adaptation investments may be profitable in the very long term, developing country priorities are many times guided by what is feasible and profitable in the short term, climate change competing with other pressing needs such as basic health care and education.

Many of the measures the EU wants developing counties to undertake themselves are of the type that even industrialized countries have not managed to implement – due to bottlenecks, political & institutional barriers to implementation, upfront costs, short-term unprofitability, etc. The actual financing needs may consequently be more than two or three times higher than the actual mitigation cost.[9] Demanding developing countries to make up-front payments for investments that will not be profitable for several decades is not only unrealistic but also deeply unjust. Thus many of the developing country 'own actions' identified by the EU would in fact require additional international support.

Second, the idea that developing countries should contribute to international public financing through a 'global distribution key' does not take into account the right of poor countries to development or the historical responsibility of industrialized countries for climate change, and sends a very negative signal to the ongoing negotiations. The idea that developing countries should pay is also not in line with the UN Convention on Climate Change, which makes a clear distinction between developed and developing country financial obligations under its articles 4.3 and 4.4:

4.3 The developed country Parties and other developed Parties included in Annex II shall provide new and additional financial resources to meet the agreed full costs incurred by developing country Parties in complying with their obligations under Article 12, paragraph 1. They shall also provide such financial resources, including for the transfer of technology, needed by the developing country Parties to meet the agreed full incremental costs of implementing measures that are covered by paragraph 1 of this Article and that are agreed between a developing country Party and the international entity or entities referred to in Article 11, in accordance with that Article. The implementation of these commitments shall take into account the need for adequacy and predictability in the flow of funds and the importance of appropriate burden sharing among the developed country Parties.

4.4 The developed country Parties and other developed Parties included in Annex II shall also assist the developing country Parties that are particularly vulnerable to the adverse effects of climate change in meeting costs of adaptation to those adverse effects.

APRODEV,CIDSE and Caritas believe that abandoning one of the key equity principles underlying international cooperation on climate change, just a few weeks before an agreement needs to be reached, is not only unjust, but is also bad negotiating strategy and bound to fail.

4. No guarantee of additionality to ODA commitments

The EU Heads of State agreed on October 30 that climate financing should "not undermine or jeopardize the fight against poverty and continued progress towards the Millennium Development Goals". However, without a clear commitment that climate finance will be

[8] European Commission Communication, "Stepping up international climate finance: A European blueprint for the Copenhagen deal", September 2009
[9] World Development Report 2010: Development & Climate Change

additional to ODA commitments, the EU position is nothing but an empty promise, simply repackaging old money.

EU Development Ministers concluded on November 17 that climate change increases the costs of achieving the MDGs and poverty reduction efforts. When the goal of providing 0.7% of GNI was agreed in 1960, evidence of the impacts and damage climate change would cost developing countries was not included into this support. The cost of climate change will now add an additional burden to developing countries already struggling to meet their development needs. Climate proofing investments, new agricultural techniques, insurance mechanisms all impose additional costs onto traditional development funds. It is unjust to ask developing countries to pay for this additional cost which has been imposed on them by the historical fossil fuel-based growth of developed countries.

Whilst climate change action and development should be coherent in the planning and implementation, APRODEV, CIDSE & Caritas believe they should be financed from separate sources. If developed countries were to count climate finance towards their ODA target, they would be diverting money from development assistance and stepping back on their commitments to achieving the Millennium Development Goals. Poverty reduction is an essential foundation for reducing vulnerability to the impacts of climate change; subsequently both ODA and climate finance are crucial to ensure sustainable poverty reduction. Diverting ODA for climate change purposes would result in a finance gap to address these prior vulnerabilities. A recent study[10] suggests that this could increase adaptation costs significantly, meaning it makes economic sense to count it as additional to ODA targets.

The EU could provide significant momentum to the negotiations by speaking out in favour of additionality to ODA commitments, which is currently an option in the negotiating text and pushed strongly by developing countries.[11]

APRODEV, CIDSE & Caritas urge the EU to adopt a clear position to ensure that climate finance is new and additional, as agreed in the Bali Action Plan, in order not to undermine poverty eradication efforts. Diverting existing or already promised ODA to finance climate actions means less money for health, education and other development goals. Additionality must be clearly defined as new and additional to ODA commitments (0.7 % or above). Anything less would constitute a severe threat to development.

5. Carbon markets cannot replace public finance

Developed countries are proposing that a significant amount of low carbon development in developing countries will be delivered through the carbon markets. Whilst CIDSE, APRODEV & Caritas acknowledge the carbon markets will play a role in low carbon development, we are deeply concerned that poor people will not benefit from the current or proposals for reformed markets. Current and future options associated with carbon markets will only deliver partial emissions reductions in certain key sectors, but they will not encompass a comprehensive approach to sustainable low carbon development in developing countries, consequently significant other non-market support measures will be required, and developed countries under the UNFCCC are obligated to provide this support based on the polluter pays principle.

Public finance will be required to ensure a comprehensive approach to sustainable low carbon development and importantly to deliver equitable and just outcomes, focusing on enabling capacity building and ensuring a pro-poor approach.

[10] IIED and Grantham Institute for Climate Change at Imperial College (2009): "Assessing the costs of adaptation to climate change: a review of the UNFCCC and other recent estimates"

[11] One of many examples of developing countries raising additionality as a key principles for climate finance: African Group pushes for additionality at UNFCCC negotiations in Bonn, August 12 2009 http://www.iisd.ca/download/pdf/enb12425e.pdf

Whilst both public and private climate finance is needed, public finance has a special role to play:

i. Developed country *governments* are obliged to cover the full incremental costs of climate change in developing countries, as agreed in Art 4.3 of the UN Framework Convention on Climate Change in 1992.

ii. Private funds cannot be expected to meet the full *incremental* costs of climate action. Public funds are often required to leverage private finance and steer it in the right direction. For example, the private sector will not necessarily invest in building solar panels in developing countries if they see insufficient returns and if conventional fossil fuels turn out to be more profitable. A feed-in tariff, for example, could help leverage private sector investments, but would require public financing to cover the initial incremental costs.

iii. Public money is needed to ensure a more equitable outcome and steer money towards areas where market-based instruments are not sufficient/appropriate, for example in the Least Developed Countries (LDCs) and to the poorest and most vulnerable people and communities. As agreed in the UNFCCC Art 2, a key objective of the Convention is 'enabling economic development to proceed in a sustainable manner'. Art 3.4 further stipulates: 'parties have a right to, and should promote, sustainable development'.

iv. Many developing countries question the idea of 'no-regrets' action, i.e. the notion that certain emission reductions in developing countries would come without a cost. In fact, even these actions may need up-front financing to support initial capacity building, etc.

v. As long as the carbon market (via offsets) does not pay for more than the 40 % reduction by 2020 required by Annex 1 countries, ADDITIONAL public finance will be required to cover the 15-30 % BAU deviation required by developing countries. Public and private sources are thus not wholly interchangeable. Public finance will be required regardless of what carbon markets deliver (below 40% reduction) – because they are intended to pay for two separate emission reduction targets.

The EU should recognize that public finance cannot be replaced by carbon markets/private finance, and that public finance has a special role to play, both for adaptation and mitigation. Flexible mechanisms/offsetting should not be expanded with the current low level of ambition of developed country mitigation targets.

6. Support for global sources paves the way for bunkers and AAU auctioning

The European Council recognized on October 30 that contributions from "global sources" could play a role in the financial architecture resulting from a global climate change agreement. This recognition is positive and paves the way for innovative climate finance mechanisms such as auctioning of Assigned Amount Units (AAUs) on international level, and a financial mechanism based on emissions from shipping and aviation.

Innovative, global sources are key to ensure that any financial commitment made at COP 15 is realized. Also, the scale of need in long-term finance is very difficult to determine in a precise way. Innovative sources such as AAU auctioning have an important potential for scaling up resources over time.

The idea of auctioning AAUs on international level is based on the polluter pays principle, enshrined in the Convention. It also creates financial flows which are additional to ODA

commitments, delivering up to USD 69 billion per annum.[12] The proposal can also be amended in several ways to enhance its predictability and to embrace an automatic compliance mechanism.

The EU should make sure that agreement on the proposal to auction AAUs on international level becomes a key outcome of Copenhagen , The EU and other industrialized countries could move ahead with AAU auctioning under an amended Kyoto Protocol. The US would be required to contribute to a comparable level through the outcome of the LCA track.

The AAU auctioning proposal could possibly be combined with other innovative finance mechanisms such as levies on aviation and shipping. A "cap and trade" or levy regime on international aviation and shipping would serve the dual function of raising revenue and creating incentives to reduce emissions from these high-impact sectors – this could raise an estimated US$25-37 billion per annum.[13]

APRODEV , CIDSE & Caritas urge the EU to push for agreement on global sources of finance, including AAU auctioning and levies on aviation and shipping, as an outcome COP 15, as they could provide an important way to ensure that funding is additional and predictable.

7. Central pot of money needs to be expanded to a Global Climate Fund

APRODEV, CIDSE & Caritas view the current aid paradigm as inappropriate for climate finance. It entails a continued risk of 'donor darlings', i.e. donor countries choosing programs and projects based on their political priorities, rather than directing funds in a co-ordinated manner to where they are needed the most. Building an international climate finance architecture on a jungle of bilateral and multilateral channels also means that developing countries will have to continue to 'shop around' for financial support, with huge transaction costs, immense administrative burden and lack of effectiveness and efficiency as a result.

For these reasons, it is positive that the European Council Conclusions of 30th October do not exclude the possibility of a central pot of money under the UNFCCC. Such a central pot should be expanded to a centralized UN Climate Fund[14], as proposed by several other parties in the negotiations, both developed and developing countries. APRODEV, CIDSE & Caritas believe that such a fund would have clear added value, as it would be able to ensure the necessary coherence and co-ordination of funds, an equitable distribution of resources and allow developing countries to focus on climate actions rather than the process of shopping around amongst a multitude of donors for financial support.

The governance of the financial mechanism under the Convention has the ability to make or break a deal in Copenhagen. If the mechanism works, it will attract more support and funding and deliver results, but in order to work it needs to be politically palatable by all parties. Governance of the climate finance mechanism must fulfil certain key criteria to be acceptable to both developed and developing countries. These criteria include: efficiency, effectiveness, equitable governance, representation, transparency, accountability, subsidiarity and independent oversight. At current; there is no existing institution which can fulfil these criteria.

APRODEV, CIDSE & Caritas urge the EU to recognize that new institutions will need to be created as an outcome of COP 15. A new, centralized global climate change fund should be under the authority and guidance of the COP and provide the main vehicle for international climate finance.

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[12] http://www.climatenetwork.org/climate-change-basics/by-meeting-and-date/bonn-ii-june-2009/CANfinance_position-scale_and_sourcesFinal7June2009.pdf
[13] [13] Staff Working Paper accompanying Communication 'Stepping Up Climate Finance'. See http://ec.europa.eu/environment/climat/pdf/future_action/sec_2009_1172.pdf, last page
[14] APRODEV (2009): "The United Nations Climate Fund: An Equitable Financial Mechanism under the UNFCCC", Submission to the UNFCCC, http://unfccc.int/resource/docs/2009/smsn/ngo/161.pdf

8. **<u>Language on developing country mitigation actions is insufficiently linked to financial support</u>**

It is clear that reducing emissions in developed countries will not be enough. Emissions will have to be limited also in developing countries. However, one key issue from an equity point of view is who pays for the additional cost of reducing emissions in these countries. According to the Convention, the full agreed incremental cost of climate action in developing countries should be covered by international public finance.

To the extent that new and additional climate finance is provided, developing countries should commit to promoting low-emissions, sustainable development. Their supported actions, as well as the finance provided by developed countries, should be MRV'ed (monitored, reported and verified) on international level.

Proposals by developed countries calling for developing countries to produce ambitious mitigation strategies, without any guarantee of financial support, are not in line with the principle of "common but differentiated responsibilities". Rather, these proposals are a way for developed countries to escape their historical responsibility for climate change, and rather push the burden of reducing emissions onto poor countries.

The EU's proposal on Low-Carbon Development Strategies (LCDS), to be undertaken by developing countries, risk further widening the trust gap with developing countries, as they do not entail a clear link to financial support. The EU has vowed to improve its language and communication on LCDS, to avoid inciting developing countries' fears of financial support being tied to burdensome conditionalities. However, the EU new climate finance position fails to address these concerns.

CIDSE, APRODEV & Caritas urge the EU to state clearly that its proposals regarding developing countries commitments to mitigation actions are linked to the provision of MRV finance by industrialized countries, to cover both capacity building needs and the incremental cost of climate action.

9. **<u>Fast-track finance important but cannot replace long-term commitments</u>**

While it is positive that the European Council has put forward and supported previous proposals made by the EU on fast-track finance, APRODEV, CIDSE & Caritas insist that any fast-track finance offer made in Copenhagen by developed countries must be clearly new and additional, and not merely be re-packaging of ODA or already made commitments. It is also crucial that the near-term finance offer is not used as a cheap way to 'buy off' certain developing countries in the negotiations to accept inadequate mitigation commitments, but is closely linked to an ambitious, adequate, predictable and sustainable long-term finance offer, including mechanisms – without which there will be no agreement in Copenhagen.

It is also important that institutional arrangements to support near-term finance do not undermine or second-guess negotiations on a post-2012 architecture, whilst providing an necessary bridge between near- and medium term action so as to avoid any gaps in the provision of support to developing countries.

The EU should commit to at least a third of the estimated €7 billion required annually from 2010 to 2012 for fast-track finance needs, including capacity building and near-term adaptation and mitigation needs.