

Discussion Paper



3 Essential “S”s of Climate Finance - Scope, Scale and Speed: A Reflection.

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Abstract

The call for urgent climate action is heard worldwide. The climate actions of developing countries would have to be supported by climate finance flows from developed to developing countries as mandated in the UNFCCC and its Paris Agreement. Yet the progress achieved is not quite satisfactory.

This paper examines analytically the scope, scale and speed required in climate finance. The climate finance requirements runs into trillions of Dollars. The commitments made by the developed countries for enhancement and support in relation to climate finance is not clearly translated into reality. The call for enhanced climate actions on the basis of scientific reports is laudable. However, the means to achieve the climate goals is not commensurate to the urgency shown, nor do we witness the seriousness required in the discourse on climate finance.

Equally important is the issue of reporting and tracking of climate finance. The Discussion Paper finds serious concerns with the various numbers reported. Definitions of climate change finance used in various reports were not consistent with the UNFCCC provisions. Methodologies used were also questionable.

This Paper attempts to identify the essential elements, step by step, for a robust and transparent accounting of climate finance flows from developed to developing countries. The global community displayed an unprecedented speed in ratifying the Paris Agreement. Meeting the climate finance obligations also deserves the same momentum. The Parties at CoP 24 in Katowice in December, 2018 need to address these important questions on climate finance.

Disclaimer

The views and analysis contained in this Discussion Paper do not necessarily reflect the views of the Government of India.

Foreword

In December 2015, at CoP 21 in Paris, India had strongly called for a robust system of measurement, reporting and verification of climate finance under the UNFCCC to ensure transparency and credibility. A call was also made to the developed world to fulfill their obligations on climate finance so that climate justice for developing countries and the future generations is delivered in light of the principles of the Convention and the Paris Agreement such as 'equity'.

The attached Discussion Paper prepared by Climate Change Finance Unit, Department of Economic Affairs, Ministry of Finance makes an analysis of the post Paris Agreement developments, the seriousness of discourse in the international climate finance arena and the scope, scale and speed needed in the ambit of climate finance. It also emphasizes that significant efforts are still to be seen in the mobilization of climate finance commitments from developed to developing countries.

While India will continue to play its constructive role at CoP 24 to UNFCCC at Katowice, I hope that this Reflection paper will be of utility to stakeholders during deliberations therein.

Secretary, Department of Economic Affairs

28 November, 2018

3 Essential "S"s of Climate Finance - Scope, Scale and Speed: A Reflection

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The worldwide call for stepping-up climate actions is louder than ever with the release of the recent IPCC 1.5°C report (IPCC, 2018). The Report has warned of a warmer Planet and called for unprecedented actions to address climate change. Global action on climate change is contingent on the delivery of timely and adequate finance. Considering this, the findings of the said report should, ideally, set in motion a serious discourse on the Scope, Scale and Speed of climate finance required to take climate actions effectively at the upcoming climate negotiations at Katowice, Poland in December, 2018. At this CoP, one of the major tasks before the Parties is finalizing the Paris Agreement Work Programme (PAWP), in which finance is a key component.

2. Since the inception of multilateral negotiations on climate change, finance played an important role as an enabling factor in ensuring collective efforts at addressing the global problem of climate change. United Nations Framework Convention on Climate Change (UNFCCC) (adopted in 1992) recognized the pivotal role finance plays in climate actions and mandates countries in Annex II (Industrialized countries) to provide financial resources including for the transfer of technology needed by the developing countries to take climate actions.

3. Though a quarter of a century has passed, climate finance discussions still lack a precise and adequate system of accounting modalities for financial resources. This lack of transparent rules leads to incomparable amounts being reported by countries applying their own discretion and judgment. How climate finance should be defined and accounted is still a matter of negotiations under the UNFCCC.

4. The present scope, scale and speed of climate finance are not only insufficient but not even being discussed properly. The objective of this booklet is to highlight these necessary three 'S's of climate finance that are essential for global cooperative action against climate change.

Scope

5. Climate finance should support both the adaptation and mitigation activities of the developing countries in accordance with the country needs and priorities. The Paris Agreement gives equal weightage to adaptation and mitigation.

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6. Under the UNFCCC, the intent and obligation of climate finance is unambiguous, that developed country Parties shall provide financial resources to developing countries. But what constitutes these financial resources for climate finance itself, its key elements, are only very broadly defined.

7. The definition and accounting of climate finance has been the centre of discussions under UNFCCC. Attainment of transparency with respect to defining and accounting climate finance in the global fora will represent one of the major achievements of the multilateral process on climate negotiations. The absence of robust accounting methods complicates the tracking of climate finance. Current guidelines agreed under the UNFCCC (Decision 2/CP.17) require Annex II Parties to report on climate finance both in their National Communications and in their Biennial Reports, to be respectively submitted every four and every two years to the UNFCCC Secretariat. Since 2012, Annex II Parties are required to report to the UNFCCC using a standard format known as the “common tabular format” (CTF) (Decision 19/CP.18). However, there is no required project-level reporting, so users of this information are largely unable to understand what is included in the summary information reported in the CTF tables. Overall, the UNFCCC guidelines leave extreme discretion to developed countries regarding climate finance accounting. Each developed country can decide what it counts as climate finance and why it is climate finance and whether it can be considered as “new and additional” (Romain Weikmans & J. Timmons Roberts, 2017).

8. So far, most developed countries have relied heavily – though not exclusively – on data collected using the OECD DAC Rio marker methodology to report to the UNFCCC Secretariat on their financial commitments towards developing countries. The end result is that the definition of climate finance in the UNFCCC has remained imprecise and incomplete. A lot of questions on climate finance and its definition still go unanswered/ambiguously answered. Does the phrase ‘funds provided’ be taken to mean actual funds or resource flows in terms of actual ‘disbursements’, and accounted for by both contributing and recipient countries? Similarly, how would private flows be counted — any private flows, or only those associated with some clearly defined climate objectives? How would flows from multilateral development banks (MDBs) be counted? Should attribution be done on the basis of shareholding or on the basis of preferential credit status accorded by the recipient countries?

9. Ideally, the contours/elements for ensuring clarity in international climate finance flows should include the following:

10. First, counting only public grants, unrequited equity and grant-equivalent values of loans only as climate flows. The fundamental reason for having the USD 100 billion a year climate finance commitment was to enable developing countries to undertake their costly climate actions. Loans may have a role, but only if they are

measured in their grant-equivalent terms. The principles behind and the measurement of grant-equivalency are very well understood in the economic and financial literature. Only when a loan offers an interest rate below the market rate, the grant equivalent can be calculated as equal to the difference between net present discounted values of the interest rate charged and the market rate.

11. Second, counting only such transfers of finance ex-post that are formalized in an entry in a book of accounts as specifically climate finance, and preferably earmarked as either mitigation or adaptation or cross cutting, by both the recipient and the source countries.

12. Third, the value of climate finance flows must be counted as actual disbursements of such finance crossing borders in a particular year and not as multi-year promises, pledges, and/or other indefinite commitments.

13. Fourth crucial element is how to treat private climate finance flows that are 'mobilized' or 'leveraged' in some form by the acts of public policies in source countries. 'Mobilized' or 'leveraged' finance would have a very precise meaning in terms of the public backing granted by the source countries to permit grant-equivalency.

14. Fifth crucial element of defining climate finance flows has to do with clearly defining what is meant by the terms 'new and additional' - which must begin by defining the starting value or baseline value of climate finance flows. The term 'new and additional' was meant to clearly mean that the climate finance flows would be 'new and additional' to other forms of ODA, and not just diverted from existing levels of ODA towards climate finance.

15. Developing countries in their discussions at the UNFCCC, continue to stress public grants and grant-equivalent public financing flows from developed countries as the predominant expected source, allowing for some flows of private capital backed formally by concessionary public flows and terms – and counted by their grant equivalent terms, and not by the face-value of such flows in the form of loans or other similar forms. On the other hand, developed countries increasingly saw private financial flows 'leveraged' or 'mobilized' by developed countries, and flows from international institutions such as the multilateral development banks, as the increasingly major source contributing to the USD 100 billion a year goal. This is problematic as it is difficult to define what constitutes mobilized finance, identify what the climate related component of private flows would be, as well as clearly attribute the source country for such flows.

16. Developed countries, however, continued to see the accounting of such flows to be the sole responsibility and determined by only the source countries,

whose varying definitions and accounting methodologies between one country and another, and by different types and sources of financing, obviously created further problems of accounting reliably for such flows.

17. As such, without clear and harmonized definition of climate finance and how much of the reported finance actually serve the climate finance priorities of the developing countries, it is difficult to arrive at any comprehensive assessment of the progress in the achievement of the climate finance commitments of the developed countries. The Nineteenth meeting of the Standing Committee on Finance (SCF) held in October 2018 developed the summary and recommendations on the 2018 Biennial Assessment and Overview of Climate Finance Flows (BA). It highlighted the needs of defining and clear understanding of climate finance in the technical report (Box 1).

Box 1: Highlights of the Summary and Recommendations by the Standing Committee on Finance on the 2018 Biennial Assessment and Overview of Climate Finance Flows.

- On a comparable basis, climate finance flows increased by 17 per cent in the period 2015–2016 compared with the period 2013–2014. High-bound climate finance estimates increased from USD 584 billion in 2014 to USD 680 billion in 2015 and to USD 681 billion in 2016. The growth seen in 2015 was largely driven by high levels of new private investment in renewable energy, which is the largest segment of the global total.
- Total amounts channeled through UNFCCC funds and multilateral climate funds in 2015 and 2016 were USD 1.4 billion and USD 2.4 billion, respectively. On the whole, this represents a decrease of approximately 13 per cent compared with the 2013–2014 biennium and can be accounted for by a reduction in the commitments made by the Climate Investment Funds, in line with changes in the climate finance landscape as the GCF only started to scale up operations in 2016.
- MDBs provided USD 23.4 billion and USD 25.5 billion in climate finance from their own resources to eligible recipient countries in 2015 and 2016, respectively.
- Collection and reporting of domestic climate-related finance is often not undertaken systematically, thereby limiting the availability of information. The most significant source of uncertainty relates to the geographic attribution of private finance data.
- When considering these flows in aggregate, support for mitigation remains greater than support for adaptation across all sources.

Scale

18. Let us look at the scale of financial resources required. At the outset, it is important to note that, climate finance is an obligation of the developed countries as a part of their historical responsibilities being the major contributors to the stock of greenhouse gases (GHG) in the atmosphere accumulated since the industrial revolution. The need for financial support for developing countries that have not contributed to the stock of GHG in the atmosphere but are suffering from adverse impacts of climate change is an essential pre-requisite.

19. Developing countries have myriad developmental challenges and climate change puts additional burden on the already scarce resources. The climate finance requirements of developing countries are likely to be enormous. Even preliminary estimates by simply summing the finance needs in NDCs with a conditional component, comes to around USD 4.4 trillion (Weischer et al., 2016).

20. While the existing focus of the support provided by the developed countries, as we would see later, has been on mitigation, a major portion of the total finance needs of the developing countries would be for adapting to the adverse impacts that climate change has on the people and property of these countries. A recent report by Oxfam (2018) illustrates the finance needs for coping with climate change as follows:

“Climate change is already a brutal reality for millions. In 2017, extreme weather events brought destruction across the world: hurricanes in the Caribbean caused over 200 deaths and total estimated losses of \$130bn; extreme monsoonal floods affected more than 43 million people in Eastern South Asia; and drought affected millions of people in East Africa. People in poorer countries are on average five times more likely than people in rich countries to be displaced by extreme weather events. Adaptation costs in developing countries are expected to be \$140- 300bn a year by 2025/30. By mid-century, the costs of climate change to developing countries are estimated to exceed \$1tn per year, even if global average temperature remains below 2°C.”

21. Time and again many studies have similarly espoused the need for trillions of Dollars, in new and additional financing for addressing climate change. It is time for the developed countries to wake up and take note of the huge challenge faced by the developing countries for mobilization and provision of financial resources.

Speed

22. Finally, we come to the speed of provision of climate finance. It is important that climate finance flows to the developing countries in a timely manner so that a global transition consistent with a pathway towards low greenhouse gas emissions and climate resilient development can be effected. Is the current speed adequate? We try to address this by answering the following two questions:

A) What is the commitment by developed countries on the table?

23. The much discussed quantitative commitment is the goal of USD 100 billion committed by developed countries at Copenhagen in 2009. However, this goal of USD 100 billion is a meagre amount in size in contrast to the actual needs assessed for developing countries in trillions of dollars. We have to be much more serious in this business. Climate finance targets need to be set high in order for climate justice to be delivered for poorer countries and future generation.

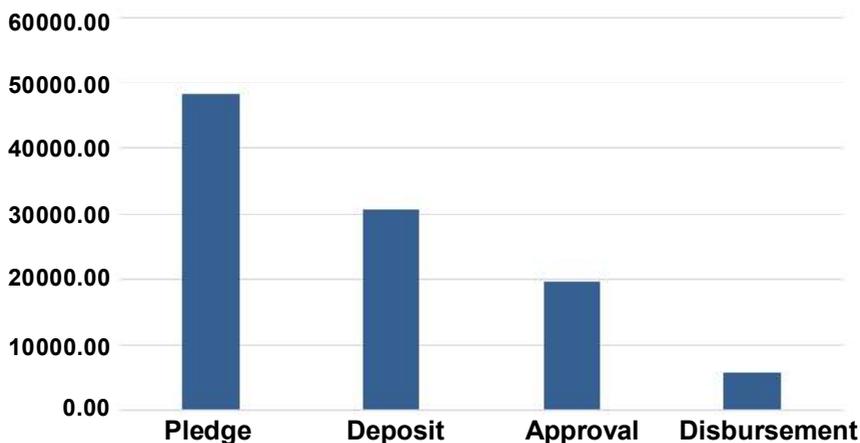
24. While the adoption and subsequent entry into force of historic Paris Agreement is hailed by many, developed countries failed to make any substantive finance pledges even at CoP-21. They agreed that a new collective goal for climate finance from the current floor of USD 100 billion per year will be set in 2025 only.

B) What has been the progress in climate finance delivery by developed countries?

25. In 2016, developed countries published a roadmap to USD 100 billion, which claimed that public climate finance levels had reached USD 41 billion per year in 2013-14. However, these claims have been contested by many. There are various issues in reporting-Credibility, Accuracy and Fairness in reporting.

26. A Government of India Discussion Paper in 2015 noted that only credible number is USD 2.2 billion in 2013-14, if we restrict to country disbursements of actual climate finance on a concessional basis. The 2017 numbers also tell a similar story (Figure 1). Only around 12 per cent of total pledges to multilateral climate funds have actually materialized into disbursements.

**Figure 1: Multilateral Climate Funds (USD Million)
(upto 2017)**



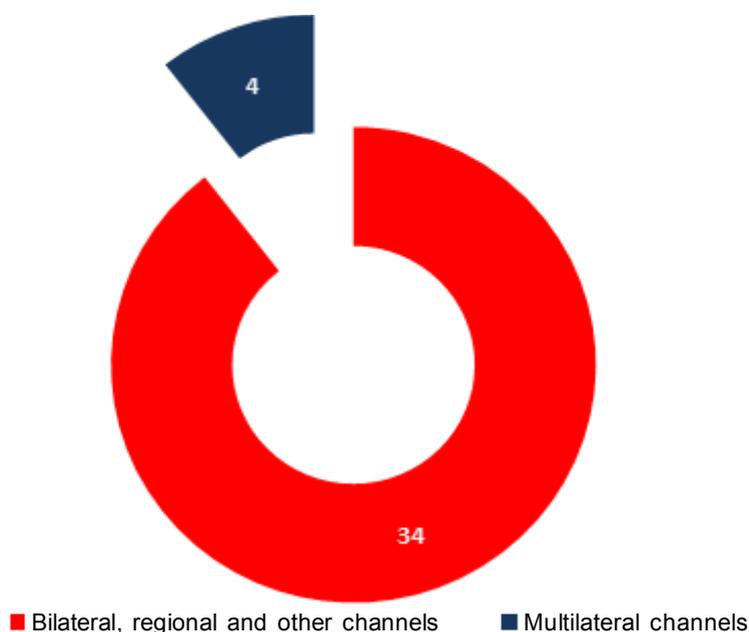
Source: Climate Funds Update (Nov. 2018)

27. Oxfam (2018) provides an assessment of USD 100 billion goal. What it states is that, the aggregated climate finance, estimated as net climate-specific assistance is far lower than the reported climate finance; new climate-specific assistance may be just USD16-21 billion. The value of loans is being over-reported. If the finance for development projects that only partially cover climate change were reported more accurately, annual bilateral flows of public climate finance could be between USD 10 billion and USD 15 billion lower than reported. Grant based assistance is too low and is rising too slowly; only an estimated USD 11-13 billion was given as grants per year, forming just 23-27 percent of the total, public climate finance amounted to 21 percent of total global official development assistance (ODA) budgets in 2015-16.

28. The recently released Summary Report of the Standing Committee on Finance (UNFCCC, 2018), has assessed the total climate finance flows based on the Biennial Assessment reports of the Annex II Parties. There are crucial gaps in relation to the methodologies used even in this Report due to the non-standardized information provided by different organizations, making meaningful comparisons difficult. While the self-reporting by the developed country Parties may suffer from the short-comings as mentioned earlier, it gives us an insight into the areas into which these funds have flowed and an idea of the pace of change. The total climate specific finance flows from Annex II Parties in 2016, according to this report, amounts to around USD 38 billion which is less than 40 per cent of the USD 100 billion target of climate finance. As the following chart shows, much of the flow of this finance (around 90 per cent) has been through bilateral, regional and other channels while only around 10 per cent of this was through multilateral funds (Figure 2). For example, the total pledges to the Green Climate Fund (GCF), the largest multilateral fund, is a meagre USD 10.3 billion. Further, most of the total climate finance has flown into mitigation. It needs to be noted that the growth in the reported climate specific finance actually slowed down from 24 per cent between 2014 and 2015 to 14 per cent between 2015 and 2016 (UNFCCC, 2018).

29. The various reported figures on climate finance have often led to serious questions and contributed to the 'trust deficit'. But all is not lost. Paris Agreement has provided an opportunity to agree on new rules of accounting and reporting framework on climate finance. The CoP 21 decision text calls for developing recommendations for modalities, procedures and guidelines to enhance the transparency of support provided in accordance with Article 9 of the Paris Agreement. This work is expected to improve the acceptability and integrity of the reported numbers.

Figure 2: Climate Finance to Developing Countries in 2016 as Reported by Annex II Parties (USD billion)



Source: Summary of Standing Committee of Finance Report (UNFCCC, 2018), based on Annex II Party Biennial Reports

Conclusion

30. The message is loud and clear – we need to establish more credible, accurate and verifiable numbers on the exact size of the climate finance flows from developed to developing countries. Modalities for accounting of financial resources cannot be at the discretion of a particular country. In order to have a transparent reporting of climate finance, the accounting framework has to be robust with concrete definitional requirements as explained above.

31. The developing countries will endeavour to do their best within their own domestic resources for their adaptation and mitigation actions, keeping in mind the imperatives of sustainable development and poverty eradication. The IPCC Reports and the Paris Agreement call for enhanced actions on both adaptation and mitigation. It is evident these efforts will not be sufficient in view of the long term climate goals. Paris Agreement and the NDC implementation will commence post 2020 and International public finance flows from developed to developing countries remain the critical enabler in ramping up these actions.

32. The global community displayed an unprecedented speed in ratifying the Paris Agreement. Meeting the climate finance obligations also deserves the same momentum. The Parties at CoP 24 in Katowice in December, 2018 need to address these important questions on climate finance, while finalizing the Paris Agreement Work Programme.

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