

Financing Climate Change

Surya Sethi

Principal Adviser Energy, Government of India

1. Ladies and Gentlemen, I thank ODI for affording me the opportunity to address you today. I am indeed honoured. In the next 25 minutes or so I will present five truths about Climate Finance and then briefly recount the current thinking on possible sources for such funds. And though no one understands India as well as the British, time permitting, I will close with a short infomercial on my country.

2. The first truth is that providing funds to support developing country actions that address Climate Change is fundamentally different from the voluntary aid paradigm. Under Article 4 of the UN Framework Convention on Climate Change, the developed world, including the US, assumed an obligation to provide “new”, “additional”, “adequate” and “predictable” resources to developing countries to fund the agreed incremental costs of mitigating Climate Change and adapting to Climate Change. This obligation of the developed countries is at the heart of the Common But Differentiated Responsibility principle enshrined in the Convention. Article 4.7 of the Convention captures the balance of commitments foreseen for developed and developing countries and I quote:

*“The extent to which developing country Parties will effectively implement their commitments under the Convention will depend on the effective implementation by developed country Parties of their commitments under the Convention related to financial resources and transfer of technology **and will take fully into account that economic and social development and poverty eradication are the first and overriding priorities of the developing country Parties.**” (Emphasis added).*

3. The commitment of the developed countries to provide “new”, “additional”, “adequate” and “predictable” financial resources to facilitate developing country actions on Climate Change was re-emphasized under paragraph 1(e) of the Bali Action Plan. Specific references to this commitment can also be found in respect of funding nationally appropriate mitigation actions by developing countries under paragraph 1(b)(ii) and, in respect of adaptation, under paragraph 1(c) of the Bali Action Plan.

4. There was considerable debate in Bali as to whether the objective of COP 15 at Copenhagen should be to produce an “agreement” on a new “framework”. The developed countries agreed that the Copenhagen “outcome” should be in the nature of “enhanced implementation” of the existing Framework Convention, respecting its “principles and provisions”. Under the Convention, the developed world’s commitment in respect of climate finance is legally binding and is distinctly different from voluntary aid or assistance under the donor-recipient platform that characterises ODA. Further, this commitment is in the nature of compensation under the polluter pays principle with strong overtones of ethical responsibility for the damage caused. This is not a donation or foreign aid. Hence, any reluctance to meet this commitment can hardly be called “donor fatigue”.

5. The second truth is that addressing Climate Change does require “New”, “Additional”, “Adequate” & “Predictable” Financial Resources. Adaptation, mitigation, and low carbon pathways impose incremental initial and lifetime costs. The World Bank estimates that climate proofing is already imposing an incremental cost of about 20% on development. The Convention accepts that development and eradication of poverty remain the “first and overriding priorities” for the developing world. Thus, it follows that if social and economic development is not to suffer and if the MDGs are to be met, the resources provided to the developing world

to address Climate Change should be “new” and “additional” to avoid diversion of existing official and private financial flows, from domestic and foreign sources, that currently fund development. Further, such resources should be “adequate” to pay for the full incremental initial and lifetime costs if development is not to suffer. And finally, unlike voluntary ODA and private flows, climate finance must be “predictable” if addressing Climate Change is not to be at the cost of development.

6. The third truth is that incremental costs of addressing Climate Change must be met primarily through resource transfers, grants, or concessional loans and this limits the role of private sector. To the extent that the initial and lifetime incremental costs of investment in adaptation, mitigation, and sustainable development are positive, they must be fully recompensed if economic and social development and poverty alleviation are not to suffer. Thus, resource transfers, grants or grant equivalent of soft loans must recompense the agreed incremental costs incurred by developing countries in meeting their obligations under the Convention. In capital constrained developing economies even the incremental up-front costs of win-win options would need to be funded but this funding could be done through debt that would be repaid out of the benefits that flow.

7. It is pointed out that the current range of instruments delivering official and private foreign and domestic financial resources will continue to fund the base costs of economic and social development. Indeed Article 11.5 of the Convention specifically refers to bilateral, regional and multilateral channels being sources for implementation of the Convention because the question of meeting incremental costs arises only if the base funding for required development is made available. The developed world is interpreting Article 11.5 to mean that their obligations under the Convention can be delivered through bilateral, regional and multilateral sources. For

this to be so, such resources have to be clearly additional to the level of flows from these sources under business-as-usual and, more importantly, they need to be in the nature of grants or resource transfers when funding agreed incremental costs of addressing Climate Change.

8. Developed countries often argue that private flows can predictably meet a significant part of the new and additional funding needed to address Climate Change. First, barring some philanthropic foundations, private capital does not typically bear incremental costs that yield no financial benefits. More importantly, I and several independent research institutes and NGOs have conclusively demonstrated that private funding can become a significant part of climate finance only under a cap and trade regime with hard caps backed by very deep emission reduction commitments, which could well exceed 100% of the current emissions of developed countries. In any event, the aftermath of the private sector's handling of simple mortgages, ladies and gentlemen, has made it difficult to tell what is private and what is not.

9. The fourth truth is that funding required to address Climate Change is several hundred times the currently available resources and Institutional capacity for climate finance remains limited. There are widely varying estimates of climate finance needs ranging from 40-50 billion dollars to a couple of hundred billion dollars per annum. The UNFCCC estimates a requirement of 0.3-0.5% of GDP which translates to about \$ 165 billion per annum at the lower end. The numbers rise with time and the upper bound is set by Lord Stern who now estimates the annual cost of addressing Climate Change as at least 2% of global GDP by 2050. This broad range of estimates merely reflects our very limited understanding of the science of Climate Change. We need to learn by doing and cannot wait to eliminate all uncertainty. All experts agree that the cost of addressing Climate Change will multiply if we fail to act immediately.

10. In contrast, the commitments made to various funds managed by GEF, the current financial mechanism of the Convention, total just US\$ 1.3 billion for the period 2007-10. The funds managed by GEF for adaptation total about 275 million dollars and since 2005 GEF has provided about 110 million dollars for adaptation projects. The Adaptation Fund to be built up from 2% of CDM flows is currently expected to yield about 100-300 million dollars by 2012. Tapping other flexibility instruments will, at best, add increments of similar magnitude.

11. To put the absence of funding and institutional capacity in perspective it is pointed out that the net disbursements of World Bank, the World's largest development institution, have ranged between negative 0.8 to negative 8.4 billion dollars between 2002 and 2008. Together with IDA the net disbursements over the same period have ranged between negative 2.9 billion to a positive 5.4 billion dollars. More importantly, the World Bank with its project based lending neither has the financial instruments to affect the massive resource transfers needed to address Climate Change nor the equitable governance structure considered essential for the financial mechanism under the Convention.

12. The fifth truth is that a new financial mechanism matching the governance structure foreseen under the Convention is needed to deliver the financial flows committed by the developed countries. The Convention is silent on the choice of an Institution to manage the available funds. However, Article 11.1 requires that the financial mechanism "shall function under the guidance of and be accountable to the COP, which shall decide on its policies, programme priorities and eligibility criteria". Further, Article 11.2 of the Convention states that the "financial mechanism shall have an equitable and balanced representation of all Parties within a

transparent system of governance”. While creating the Adaptation Fund the foregoing provisions were adhered to in full.

13. A “one country one vote” rule; a majority representation for developing countries on the Governing Body and the Executive Board, designated representation in these bodies from the Group of Least Developed Countries and the Alliance of Small Island States and possibility of direct access by recipients are other precedents of the Adaptation Fund that the proposed Financial Architecture must adopt. A professional secretariat and appropriate number of technical thematic assessment units duly supported by panels of experts and an oversight role by external and internal auditors are essential elements of the proposed Financial Architecture. The proposed Financial Architecture must ensure direct access by recipients through an in-country Climate Change Fund that meets required fiduciary standards and is capable of receiving funds from multiple sources and disbursing them through a number of windows covering specific approved activities. Such a structure will be demand driven with full involvement of actual recipients and will permit off budget funding. A transparent, efficient and competitive procurement regime and conditionalities limited to those warranted by prudent fiduciary norms and the MRV regime foreseen under the Bali Action Plan would characterize climate funding under the proposed Financial Architecture. A Trustee selected through open competitive bidding among reputed pre-qualified institutions would administer the funds.

14. Oxford Institute for Energy Studies has developed a Review Draft of such a financial mechanism, its architecture and its governance structure. I have contributed extensively to this Review Draft and will be happy to share the same if you so desire.

15. Let me now spend a minute on the current thinking on the potential sources of Climate Finance. Given the quantum of funding requirement and its nature that I highlighted, the role of public money will remain significant. An amount up to 0.5% of the GDP of the developed world may be mobilized through individual country assessments on the basis of historical responsibility for GHG concentration, current emission levels, current GDP etc. Developed countries may decide to raise these contributions from the private sector through carbon markets including proceeds from country specific or region specific auctioning of emission rights. Alternatively, domestic public funds may be earmarked from the budget or raised through carbon taxes, or levies on sectoral emissions or any other means considered feasible within the country's borders. Domestic public funds may be supplemented by public funds mobilised internationally through levies on international travel or marine haulage. Finally, commercial private sector investment could fund win-win options and voluntary contributions from private sources within the country could also contribute to meeting a country's assessed contribution.

16. And finally, a few words about my country. India is home to 17% of the World's population but accounts for less than 4% of the World's GHG emissions. India consumes about 3.6% of the World's commercial energy and its per capita energy consumption is 4% that of the US, 20% of the World average and about 28% that of China. Despite its rapid growth in recent years India has reduced the energy intensity of its GDP to less than half of what it used to be just a generation ago. India's energy intensity now is comparable to that of Germany and Japan. India's emission intensity has also been falling at a rate of about 5% per annum in recent years.

17. It is true that 2 or 3 Indians figure among the Forbes top 10 list, and yes some Indian companies are becoming global in their reach. However, it is

also true that some 600 million Indians live without electricity in the 21st century and some 700 million Indians still meet over 80% of their energy needs from some form of biomass. India, ladies and gentlemen, remains an acutely poor country and accounts for about a third (which incidentally is the largest share) of poor at any poverty threshold between \$ 1.25 and \$2 per day. India's poor at any threshold in this range outnumber the Sub Saharan poor by about 50% and the total number of Indians living below 2\$ a day matches the total population of the developed world. Stockholm Economic Institute analysed country responsibilities for Climate Change taking into account the life styles of the rich and income distribution into account. India's responsibility was still found to be only 0.3% compared to 36.4% for US, 22.6% for EU27 and 5.2% for China. Under our most likely scenario, India's per capita energy consumption in 2030 might equal China's per capita energy consumption in 2005 and reach about 70% of the World average in 2005! We are not hiding behind the poor ladies and gentlemen; we simply have a long way to go. The myth of Chindia is far overdone and one need not go beyond IEA's comparisons of the two countries to recognise this reality.

18. A recent World Bank study shows India's performance in low carbon sustainable growth as being unique among both developed and developing countries. Not only is India doing its fair share by promoting sustainable growth; it is also spending some 2.4% of its GDP on adapting to Climate Change that it did not cause. India recognizes that addressing the climate challenge is global responsibility and, as a responsible nation, India is carrying more than its fair share of the burden.

I thank you for your attention.