International Centre for Trade and Sustainable Development
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CLIMATE CHANGE FINANCING

Meeting the challenges that climate change poses to both developed and developing countries will require enormous and costly structural changes. Securing new and effective financing for climate change adaptation and mitigation is critical to any global agreement reached in Copenhagen, and in most countries, meeting the costs and absorbing external financing will require major fiscal reordering. These changes, which would be difficult and costly for any country to undertake, pose particular challenges to developing countries.

Precisely because climate change is caused by emissions from a broad spectrum of economic activities, efforts to address it will impact the way goods and services are produced and traded around the globe. Furthermore, the inevitable impacts of a changing climate imply vast social and ecological implications, especially in the most vulnerable areas of the world like the least developed countries (LDCs) and the small islands developing states (SIDS). For these countries, effective and predictable sources of funding are fundamental to helping their economies such as to mitigate climate change while adapting to impacts or, in the worst of cases, responding to disasters.

Estimates of the total global costs of mitigating greenhouse gas emissions and adapting to the changing climate vary widely from source to source, yet all of the figures are head-spinning. According to the 2009 World Development Report published this month, between US$ 140 billion and US$175 billion will be needed annually to help developing countries implement the mitigation measures that would be needed to prevent the world from warming more than 2°C. Notably, up-front investments will need to be even greater, as the economic savings associated with energy efficiency and the use of renewable energy sources only appear over time. McKinsey & Company, the global consulting firm, estimates that an extra US$ 563 billion above and beyond business-as-usual investments will be needed to jump-start the process (McKinsey 2009).

Current financing for both mitigation and adaptation falls far short of such estimates, amounting to less than 5 percent of the projected requirements. But political promises from developed countries in recent weeks indicate that the tide may be shifting. Aside from individual country statements, the G8 and the G20 have stressed that financing for climate change is a top priority.

Financing top of the agenda for the Copenhagen outcome

This past week, heads of state and government at the APEC Summit backed the Danish Prime Minister, Lars Løkke Rasmussen, in signalling that Copenhagen will produce a 'political agreement' in lieu of the legally binding treaty that was originally expected, with a possible treaty emerging after continued negotiations (see related story, this issue). With the two largest emitters and a solid regional block leaning in this direction, any major variation of this scenario is highly unlikely. However, US President Barack Obama was quick to clarify this week that the Copenhagen meeting should result in an "accord that covers all of the issues in the negotiations and one that has immediate operational effect." The question remains: what will Copenhagen produce, and how far can the outcome go to set the objectives of the forthcoming treaty?

Two issues have emerged as top priorities in the talks: financing and mitigation. The two topics are deeply linked. Stronger mitigation will both avert climate impacts and reduce the costs of adaptation, but, at the same time, greater mitigation measures will require greater funding. Mitigating emissions is particularly complicated for countries that are concurrently struggling with basic development needs such as access to water, health care, education, and civil strife. The same goes for adaptation costs in such countries.

Sourcing financial support

Identifying sources of financing has been one focus of the climate negotiations. Countries recognise that

developed countries will need to provide new and additional financial resources, but they continue to disagree over how such sources can be made reliable and sufficient. Many developing countries assert that financing for climate change - and especially for adaptation - should come primarily from the public sector. But most rich countries counter that public monies should only be used to leverage the much greater levels of financing that are available in the private sector.

Officials also continue to debate whether climate financing should be bundled into overseas development assistance (ODA) or kept strictly separate. Proponents of the former stress the efficiency of using existing institutions and the apparent overlap of objectives and activities. Opponents assert that the intermingling of ODA and climate funds will result in less per-country financing for each objective, that current institutions already struggle to deliver finance effectively, and that ODA decision-making is an inherently unbalanced process.

According to the OECD, the total volume of private investment flows that aim to mitigate greenhouse gas emissions is between six and ten times larger than the amount of public money devoted to the same cause. Further exploration of how to catalyse foreign direct investment (FDI) to help finance the climate fight is critical. According to the OECD, FDI to developing countries amounted to US$ 259 billion between 2003 and 2005. However, 54 percent of those funds were directed to activities that are not relevant for climate change mitigation. Likewise, less than a quarter of bilateral overseas development assistance commitments between 2003 and 2007 were directed to mitigation-relevant activities in developing countries.

In addition to the broad discussion on where the funding will come from, the climate financing negotiations are also considering proposals on a variety of issues, including a possible uniform global levy on CO_2 emissions (LDCs would be exempted); levies on international aviation and maritime transport, except for journeys from or to LDCs; how to use the proceeds generated by the Clean Development Mechanism and emissions trading; and possible external debt swap/relief for sustainable development in developing countries. These proposals are under discussion and will require substantial time for refinement and agreement.

Maximising opportunities for resilience

Another potential source of funding - and one that has not received much attention in the global climate talks - is the WTO's Aid for Trade initiative. Aid for Trade is a development assistance approach that has emerged from the WTO's Doha Round of trade negotiations. The initiative is intended to help developing countries take advantage of trade opportunities while strengthening their ability to fight for their interests in trade negotiations. It includes measures such as trade negotiation capacity building, infrastructure and marketing development, and ultimately is intended to help build economic resilience, particularly in LDCs and small and vulnerable economies. Notably, these countries, along with Small Island Developing States, are at the greatest risk for climate change impacts and require the greatest and swiftest adaptation support.

Because Aid for Trade and climate change financing address many of the same objectives, the two instruments could be conceived and implemented in a coherent and supportive manner. Specifically, climate change adaptation objectives could be targeted in two major Aid for Trade sub-categories: economic infrastructure and building productive capacity. Within economic infrastructure, adaptation projects could play a major role in transport and storage, as well as in energy supply and generation. Within building productive capacity, the agriculture and fisheries industries represent key sectors that are relevant from the perspective of economic resilience and climate change.

In this sense, officials could bolster climate financing by streamlining it with 'Aid for Trade' activities that are ongoing in many developing countries.

Governing finance

Another key issue in the current discussions is how financing will be governed. Among other questions, officials are debating the institutional structures for delivery and the question of direct access for recipient countries. The negotiations have already narrowed options significantly, but differences remain over many of the details of what a financial architecture for climate change should look like. One key discussion relates to the monitoring of funds, referred to as "monitoring, reporting, and verifying" or MRV. The question cuts both ways, as some parties wish to create a system that increases certainty about the delivery of adequate funds from

developed countries, while others wish to ensure that whoever uses those funds will be held accountable.

Key issues and concerns for SIDS, LDCs, and Small and Vulnerable Economies

Constructing and strengthening institutional capacities in LDCs will also be fundamental to addressing pressing climate challenges. LDCs like Malawi and Tanzania are currently struggling to fill critical posts and create effective financial mechanisms to support their climate efforts. Moreover, National Adaptation Plans of Action (NAPAs) and their implications in both countries are not well understood at the regional and local levels, and the two countries' national budgets seem to neglect to provide any funds for climate change.

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