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Finance for the Paris Climate Compact

The role of earmarked (sub-) national contributions

Summary

In December 2015, negotiators will converge on Paris to forge a new international climate change agreement for 2020 and beyond. This Policy Brief is about one of the preconditions for a success at Paris: a breakthrough on climate finance, or, to be more precise, on how earmarked (sub-) national contributions to support developing countries could be part of the 'Paris Climate Compact' proposed in the recent report on Mobilizing Climate Finance commissioned by the French Presidency.

This Policy Brief is based on an OCP/ecbi Think Piece by Benito Müller entitled 'The Paris Predictability Problem: What to do about climate finance for the 2020 climate agreement?', originally published in May 2015.

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I. The Issue

Anyone involved in the debate on international climate finance will be familiar with references to funding being *'new', 'additional', 'adequate'*, or *'predictable'*. It is therefore not surprising that these terms appear in Section F (Finance) of the draft negotiating text adopted in February 2015 at the Geneva UN climate negotiating session.[1] What may be of interest, however, is their relative distribution, illustrated in Figure 1. Although no hard conclusions can be drawn from such rudimentary evidence, it can reasonably be interpreted as indicating the paramount importance of ***funding predictability***, particularly to developing countries, and that the current multilateral funding regime fails to provide it. Indeed, this interpretation is supported in May 2015 at the Berlin ministerial *Petersberg Climate Dialogue*, where 'many Ministers stressed that better predictability of public finance ... would be necessary to foster an upwards spiral of ambition on means of implementation and mitigation.'[2]

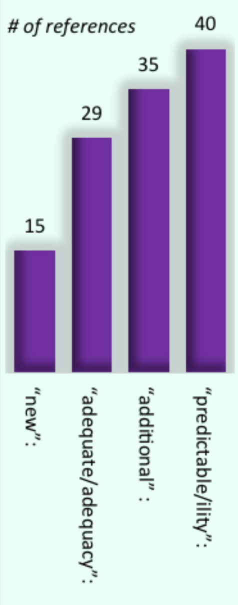

Figure 1. Section F (Finance) of the Geneva Text

This raises two questions: (i) Why is predictability important? (ii) What is the problem affecting the predictability of current multilateral climate finance for developing countries? To start with the latter, one needs to keep in mind that the finance at issue here relates to budgetary contributions – in other words, contributions determined solely by the budgeting processes of the contributor Party. These budgeting processes are notoriously complex, highly political, and very often dependent on individual personalities. Moreover, there is what has been referred to as the 'domestic revenue problem', that is the fact that domestic requirements as a rule prevail over foreign needs in budgeting discussions. This is why developing countries tend to associate the (un-) predictability of such budgetary contributions with an unpalatable measure of political caprice.

Autor:

Benito Müller, Director of the European Capacity Building Initiative (ecbi); Managing Director, Oxford Climate Policy; Convener International Climate Policy Research, Environmental Change Institute, University of Oxford; Member of Climate Strategies benito.mueller@philosophy.ox.ac.uk

Editor of the series: Charlotte Streck

Box 1. Laudato Si' (Pope's Encyclical)

The warming caused by huge consumption on the part of some rich countries has repercussions on the poorest areas of the world, especially Africa, where a rise in temperature, together with drought, has proved devastating for farming. [§ 51]

The developed countries ought to help pay this debt by significantly limiting their consumption of non-renewable energy and by assisting poorer countries to support policies and programmes of sustainable development. The poorest areas and countries are less capable of adopting new models for reducing environmental impact because they lack the wherewithal to develop the necessary processes and to cover their costs. We must continue to be aware that, regarding climate change, there are ***differentiated responsibilities****.*[§ 52]

Concerning the question of why predictability is important, there are really two answers. Firstly, actions to address climate change often require longer-term support and cannot be planned or implemented without a sufficient degree of funding predictability.

Yet, secondly, predictability – or rather enhancing the predictability of (public sector) funding for developing countries – could also be of key importance for the Paris Agreement. The fact is that there will be no success in Paris without an agreement on financial support for developing countries. In the past, there has been the option of setting up a new fund or mechanism (Financial Mechanism, Adaptation Fund, Least Developed Countries (LDC) Fund, Special Climate Change Fund, Green Climate Fund) but this is no longer a viable option for Paris.

At the moment, inspired by the Copenhagen US$100 billion figure, the focus appears to be on numbers – long-term funding goals and pathways of how to get there. If it were possible to agree on such figures/pathways and if there were sufficient certainty that the targets would/could be kept, then predictability would be reasonably assured. However, it is unlikely that this will be possible in the context of budgetary contributions, which is why for Paris to be a success, predictability (of public sector funding) needs to be enhanced by other means. But how?

II. 'Le mieux': International Innovative Finance

Plan A: Earmarking international revenue sources

Arguably the most effective way to overcome the domestic revenue problem is to avoid national budgets in the first place. The CDM adaptation levy (earmarked for the Adaptation Fund) is a good example of how this can be done. Money, in the form of CDM credits, is taken directly from project developers and given to the Adaptation Fund to be monetized in the carbon market. National governments are not involved at all, and the proceeds are completely 'automatic' and as such, in principle, fairly predictable.

The best way to address the predictability problem in the context of the climate negotiations would hence be to strengthen the adaptation levy by extending it not only to the other Kyoto Protocol mechanisms,[3] but also to ***any new market mechanism*** under the Paris Agreement, especially if it were to involve some form of international auctioning of emissions permits (ideally with some price floor). International innovative instruments related to climate change are also being discussed in other fora, most notably at the International Civil Aviation Organization (ICAO)[4] and International Maritime Organization (IMO)[5] in the context of reducing international aviation and maritime emissions. They, too, could be harnessed to generate predictable climate finance for developing countries.

The distinguishing feature of these international

Table 1: Aviation taxes and their use in selected developed countries – indicative figures.

Source: Lockley and Chambwera (2011) and GCF Pledge tracker

	Domestic		*International*		*Total raised*	*Use*	*GCF IRM* pledge*
	Economy	*Premium*	*Economy*	*Premium*			
UK (2011)	$20	$40	$98-123	$196-280	**$3 bn**	Government revenue	**$1.2 bn*****
USA (2005)	7.5% of fare	7.5% of fare	$14.50	$14.50	**$16 bn****	Aviation infrastructure, security etc.	**$3 bn**

* Initial Resource Mobilisation
** Aggregate of all federal aviation taxes, not just those listed.
*** Capital and grant

innovative finance instruments is that they are ***collected by an international body***, thus, by definition, avoiding the problems associated with national budgetary contributions. This is why they would clearly provide the best way of enhancing predictability. However, such international levies are still anathema to many national treasuries, which makes it unlikely that any of them would be established in time for Paris. So what to do instead?

III. 'Le bien': Earmarking of Domestic Sources

Plan B: Earmarking at the national level

On 23 June 2015, the French Presidency published a report commisioned in February by the President of the French Republic on Mobilizing Climate Finance[6] which, covering *the financial instruments identified more than a decade ago as 'innovative' (financial transaction tax, carbon market auctions revenues, etc.)* while also looking *at the means of finding 'innovative' ways of using existing tools in the 'toolboxes' of both private and public actors to scale-up financial flows for the low-carbon economy.*[7]

The scope of the report is linked to the current UN climate negotiations in the run up to Paris. However, the core of its proposals, according to the authors, falls, strictly speaking, outside of the scope of these negotiations. *Nevertheless, they serve to support the 'Compact' or the 'Alliance' for climate that will be reached in Paris: this will include the formal UNFCCC agreement, as well as commitments made by public and private actors outside of the agreement itself.*[8]

Among the concrete instruments considered by the Presidency Report is the ***Financial Transaction Tax*** (EU FTT) proposed by the European Commission, which is to be collected domestically by the participating EU member states[9] and hence is not 'international' in the above-mentioned sense.

The fact that the revenue from this tax, estimated at €37 billion per year (US$41 billion), is presently earmarked for development aid, fighting epidemics, and climate change demonstrates that even though treasuries often do not consider it to be best fiscal practice, they are still willing to earmark domestic revenue streams under certain circumstances. Moreover, the proposed EU FTT is by no means alone in this respect. In the UK, for example, earmarking precedents include the Climate Change Levy initially used to fund a number of energy efficiency initiatives such as The Carbon Trust, and the Renewables Obligation, under which payments for shortfalls are earmarked to be paid back to suppliers. Other UK examples are, as in most countries, the National Lottery and, most significantly, the National Insurance scheme, where contributions are held 'off budget' (i.e. separate from the national budget) in the National Insurance Fund.

While not all countries may wish to introduce an FTT, there is absolutely no reason why they could not earmark (part of) another domestic revenue source to be used for supporting climate change measures in developing countries, particularly if the source is related to the earmarked purpose. A good example of this has been described in Peter Lockley and Muyeye Chambwera's 2011 Oxford Energy and Environment Brief entitled 'Solidarity Levies on Air Travel: The case for a ready-made innovative stream of finance in support of the current international climate negotiations' (Table 1). The UK Air Passenger Duty, for example, raises annually more than double the sum that the UK pledged for the multi-year Initial Resource Mobilization of the GCF. Given this and the above-mentioned precedents, it should be in the realm of the politically possible to redefine at least part of this duty as an 'Air Passenger Solidarity Charge' earmarked for, say, the GCF.

Plan C. Earmarking at the sub-national level

If, as in the case of the US and Canada, national-level instruments are unlikely, the solution may be ***sub-national public sector contributions***.[10] As it happens, some state and provincial governments in the US and Canada have very progressive views on climate change.

For example, on 29 April 2015, California's Governor, Jerry Brown, issued an Executive Order which not only establishes a new interim statewide greenhouse gas emission reduction target to reduce greenhouse gas emissions to 40 percent below 1990 levels by 2030, but also specifically addresses the need for climate adaptation, directing the state government to incorporate climate change impacts into state legislation and to identify what actions the state can take to reduce the risks posed by climate change. Moreover, California already engages in subnational support to developing country governments.[11]

Quebec is also noteworthy in this context, not only because climate change measures have overwhelming cross-partisan political support, but also because Quebec has a long-standing tradition of engaging in international relations. For one, it is convinced of the need to work together with governments engaged in the fight against climate change.[12] Quebec is also special as a sub-national government in having a Ministry for International Relations, and it seems reasonable to think that solidarity with the poorest and most vulnerable countries in their fight against the adverse impacts of climate change, as demanded in the Pope's latest Encyclical (Box 1), fits very well with Quebec's stated intention 'to contribute tangibly, in its own way, to the progress and advancement of developing countries.'[13]

It thus stands to reason there might be sufficient political will in California and Quebec to use a small share of the proceeds from their ***joint auctions of allowances for their emission trading schemes*** as a solidarity charge for the poorest and most vulnerable countries, say through the UNFCCC Least Developed Country Fund (LDCF), which is chronically under-funded and is in danger of being closed down due to insufficient resources.[14] Indeed, given that both are in the Western Climate Initiative (WCI) as well as in the International Carbon Action Partnership[15] (ICAP), 'Plan C' could ultimately well develop into a 'Plan WCI', or even a 'Plan ICAP', which would make any first move in this direction a genuinely historic event of global significance.

IV. A 'Development Gold Standard' for climate finance

The finance breakthrough required for a Paris success will not come in the form of a new fund, or the adoption of a new global finance target/pathway. It may not even be part of the international climate negotiations. If anything, it may be that a significant number of developed country governments, national or sub-national, decide to contribute to the Paris Climate Compact[16] by adopting domestic instruments that ***enhance the predictability/automaticity of their support*** by the ***earmarking of certain innovative domestic funding sources*** for the support of climate change efforts in particularly vulnerable developing countries.

The current proposal for a ***Financial Transaction Tax*** by 11 EU member states is clearly very important for a success in Paris.[17] However, other national and, indeed, sub-national developed country governments can also play a significant part towards that breakthrough. The most straightforward way of doing this would be to follow the CDM share of proceeds for adaptation – which 'was crucial in building sufficient G77 support for the CDM'[18] – by setting aside ***two percent of the revenue of carbon instruments*** (emission trading schemes, carbon taxes) in solidarity with the poorest and most vulnerable countries, thereby establishing a voluntary '***Development Gold Standard*** for such instruments.

This idea of using a share of ***(sub-) national auctioning revenues as a source of funding for the LDCF*** was first presented at the ecbi Bonn Seminar[19] on 7 June 2015, during the June 2015 ADP session in Bonn, Germany, and discussed extensively with government and non-government stakeholders during the negotiations. It generated some very positive feedback and considerable interest, not only from LDCs (Box 2), but also among potential contributors, both at the national and sub-national level, indicating that the time for the idea may finally be ripe. In short, the finance breakthrough required for a Paris success is possible, but it is not necessarily in the hands of the UN climate negotiators. It is in the hands of governments, at all levels, who need to weigh very carefully their desire to adhere to theoretical best fiscal practice against the very pragmatic need to have a success in Paris. Moreover, in this case, *le mieux* need not be *l'ennemi du bien*, as Voltaire contended – the good can be a stepping stone to the better, if not to the best. *En route*, it can even provide the finance breakthrough needed for success in Paris.

Box 2. Endorsements

The funding situation of the LDCF is indeed precarious and needs to be addressed as a matter of urgency. In addition to ensuring adequate public funds for the continuation of the LDCF, I agree that we need to identify other predictable sources of funding for the Fund, such as funds that could be obtained from setting aside a share of the proceeds from auctioning of emission permits. Indeed, I think the idea of including sub-national sources in this context would be a historic game changer in this context and should be strongly supported as a new 'gold standard' for emissions trading schemes.

Giza Gaspar Martins (Republica de Angola)
Chair of the Least Developed Countries Group (2015)

Le financement prévisible du Fonds pour les PMA a été un problème depuis sa création en 2001 pour soutenir les besoins immédiats et urgents des pays les moins avancés. Au cours des dernières années, la situation est devenue critique. La demande pour les ressources du Fonds pour les PMA dépasse considérablement les fonds disponibles pour les nouvelles approbations: à la date d'avril 2015, les fonds disponibles pour de nouvelles approbations de financement s'élevaient à 12 millions de dollars; tandis que les 26 projets ayant été techniquement approuvés constituent une demande totale de financement de 200 millions de dollars. Voilà pourquoi je soutiens pleinement l'idée d'utiliser une part des recettes provenant des systèmes d'échange d'émissions nationales et sous-nationales comme proposé dans le document, notamment dans le cadre de l'appui sous-national pour le Programme d'action de Lima-Paris

Tosi Mpanu-Mpanu (République démocratique du Congo)
Président désigné (2016) du Groupe des pays les moins avancés

Endnotes

[1] The eighth part of the second session of the Ad-hoc Working Group on the Durban Platform, or 'ADP.2-8'.
[2] Co-chairs summary, Petersberg Climate Dialogue VI.
[3] International Emissions Trading, Joint Implementation.
[4] See, for example the presentation on 'Market-Based Measures' by the ICAO Environment, Air Transport Bureau at the *Global Aviation Dialogues* (GLADs) *on Market-Based Measures to address Climate Change*, Nairobi 14 April 2015.
[5] For example the Norwegian proposal regarding the Prevention of Air Pollution from Ships: Elements of a possible market-based CO_2 emission reduction scheme (IMO MEPC 60/4/55 29 January 2010). Another interesting, well-developed example is the International Maritime Emission Reduction Scheme (IMERS).
[6] Pascal Canfin and Alain Grandjean, *Mobilizing Climate Finance: A roadmap to finance a low-carbon economy*, 18 June 2015, http://fr.slideshare.net/mobile/lesechos2/canfin-grandjean-final-18062015
[7] Canfin and Granjean 2015, p. 10.
[8] *Ibid.*
[9] 'Taxation will take place in the Member State in the territory of which the establishment of a financial institution is located, on condition that this institution is party to the transaction, acting either for its own account or for the account of another person, or is acting in the name of a party to the transaction.'[Proposal for a COUNCIL DIRECTIVE on a common system of financial transaction tax and amending Directive 2008/7/EC]
[10] Note that that there are precedents for contributions by sub-national governments to multilateral funds. The Belgian contribution to the Initial Resource Mobilization of the GCF, for example, was made up not only from the Federal budget, but also from the budgets of the Walloon and Brussels Regions.
[11] Memorandum of Understanding on Environmental Cooperation between The State of Acre of the Federative Republic of Brazil, the State of Chiapas of The United Mexican States, and the State of California of the United States of America
[12] See: 'Québec: A leader in the fight against climate change!' Ministry for Sustainable Development, the Environment and Climate change, Quebec.
[13] Quebec Ministry of International Relations and Francophonie, "Québec and solidarity", http://www.mrif.gouv.qc.ca/en/solidarite-internationale/quebec-et-la-solidarite/portrait
[14] See, for example, Megan Rowling, *Climate change projects in poorest nations lose out in battle for funds*, Thomson Reuters Foundation, 18 June 2015.
[15] ICAP is an international forum for governments and public authorities that have implemented or are planning to implement emissions trading systems with 30 full members, including 11 EU Member States and the European Commission, as well as 11 US States and 4 Canadian Provinces.
[16] The Compact for climate that, according to Canfin and Grandjean (2015), will 'will include the formal UNFCCC agreement, as well as commitments made by public and private actors outside of the agreement itself.'
[17] France has repeatedly announced its willingness to earmark a significant portion of the revenues of a FTT for climate at the international level. The ongoing negotiations on such a tax among 11 Member States of the European Union is a key element in assisting, notably France, the mobilization of additional public funding for climate in order to fulfill the '$ 100 billion of Copenhagen' commitment. To this end, this report concludes that at least € 10 billion in revenues from the TTF will be needed in 2020 among the 11 Member States. Negotiations must conclude no later than September in order to optimize its potential contribution to the success of the CoP21.[Canfin and Granjean 2015, p. 16]
[18] Michael Grubb, Christiaan Vrolink and Duncan Brack, The Kyoto Protocol: a Guide and Assessment, London: RIIA 1999, p.133.
[19] The forthcoming Seminar Report will be available on the ecbi Publications Catalogue.

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Climate Strategies
40 Bermondsey Street
London SE1 3UD
United Kingdom
info@climatestrategies.org

Companies House Number 05796323.
Climate Strategies
www.climatestrategies.org

@climatestrat climate-strategies climatestrategies