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Background paper – Session II

Defining a Climate Finance Toolbox for Effective Climate Action

22-23 July 2015, Luxembourg

From November 30th to December 11th, 2015 195 State Parties will meet at the 21st Conference of Parties (COP21), under the United Nations Framework Convention on Climate Change, in Paris, to finalize and adopt an international agreement expected to set the scene for effective action against climate change in the post-Kyoto period. Scientific evidence has never been stronger on the anthropogenic causes of climate change. Urgent and determined action around the globe is needed to maintain the rise of temperature below 2°C in comparison to the pre-industrial period and to prevent irreversible harm to human and natural systems. To that effect large scale efforts are necessary, on the one hand, to reduce greenhouse gas emissions significantly and, on the other hand, to adapt to the already unavoidable effects of climate change.

During the ongoing international negotiations in preparation of the COP21 in Paris, an appropriate answer to **the question of climate finance** has been identified as one of the crucial elements for the success of the process and the adoption of a fair, ambitious, dynamic, legally binding, global agreement. While the potential benefits of a transition from fossil fueled modes of production and lifestyles to low-carbon economies and eventually "green growth" and subsequent job creation are well recognized, innovative and effective ways to meet the substantial financial needs that such a transition requires, are yet to be defined.

Furthermore, in light of the principle of common but differentiated responsibilities and respective capacities, **expectations of important financial flows from industrialized countries to developing countries**, to support the development of climate compatible and resilient development pathways, have become a central issue of the discussion. Parallel negotiations on a new Paris agreement, on the one side, and on Financing for Development (FfD) to culminate during the International Conference on FfD, in Addis Ababa in July, linked to the adoption of a new set of Sustainable Development Goals (SDG) in New York in September, on the other side, have prompted apprehensions of decreasing levels of Official Development Assistance (ODA), if public funding were to be shifted towards financing climate action.

Also, on the background of a slow recovery of industrialized countries from the economic crisis, it has become even more obvious that the enormous financing needs for both climate action and the poverty eradication agenda cannot be met by public funding alone. It is imperative to identify smart ways to **use public funding with the highest possible leverage on likeminded**

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private sector funding sources, willing to join the governments in effective climate action, not least because a successful transition to low carbon economies worldwide holds the promise of significant economic opportunities.

In this respect, the sheer number of existing finance mechanisms (over 50 multilateral funds, some 60 carbon markets and dozens of climate investment funds globally) calls in itself for serious efforts in coordination, ownership and accountability. The extent of the challenge becomes apparent in comparing recent global figures spent on climate finance – 331 billion dollars in 2014[1] – to the estimated 5 trillion dollars additional investment needed for clean energy up to 2020[2]. The 2014 Biannual Report of the UNFCCC Standing Committee on Finance (SCF) estimated that from 2010 to 2012, finance flows from developed to developing countries ranged from $40 to $175 billion per year. This included annual flows of $35 to $50 billion through public institutions and $5 to $125 billion of private finance. In light of these facts, it is encouraging to hear **calls for an international climate finance toolbox** to provide adequate financial responses and instruments to a widely diversified set of financing needs for effective reductions in greenhouse gas emissions and for adaptation to the effects of climate change.

Efforts in mitigation and adaptation need different means and instruments of financing according to the place and time they must be produced in. Financial support to the Pacific island development state of Kiribati to protect its population against rising sea levels, for example, will have to come from different sources and in a different form than investments in renewable energy infrastructures to improve the energy mix in industrialized countries or in emerging economies. Adaptation activities, with lower potential for private investments, will call for higher levels of **public and/or concessional funding**. Investments in profit generating infrastructures for the production of renewable energy have the potential to attract **private sector funding** on commercial terms. The financial and political risk level of a given project and the relative prospect of financial return for the investor, coupled to environmental and /or social impact, help to define which type of financing or blend of financial resources are best suited for specific climate actions. In this respect it is encouraging to note that an increasing number of governments, including in development countries, have been putting in place policies that are managing to mobilize private investment for renewables.

The **climate finance toolbox** that we need, could include government grants to risk mitigating guarantees and insurance schemes, green bonds and climate investment funds to impact investment. Financial flows from public sources could be used to provide enabling legal and regulatory environments and to leverage increased private sector funding. Public interventions must aim at crowding in private sector investment and not crowding it out. It will take project financing as well as investments to seize the economic opportunities that lie in the transition from fossil fueled economies to low carbon and climate friendly modes of production and

[1] Climate Policy Initiative
[2] International Energy Agency (IEA)

lifestyles. Putting a credible price on carbon emissions – i.a. through effective emissions trading systems – would of course be very helpful in that respect.

On this background, it is encouraging to observe the **growth of socially responsible investment and impact investing**, combining reasonable financial return with well documented social and/or environmental impact to the benefit of individuals and their communities. Opportunities flowing from the availability of new, non-traditional sources of financing should be further explored, while keeping in mind that high levels of harmful subsidies for fossil fuel production remain an impediment to all low carbon investment. Determined action on both fronts should help to reduce the complexity of the transition processes from fossil fueled economies towards safer, low carbon, circular economies. In this context, the proposals from the Canfin-Grandjean report[3], commissioned by President François Hollande, in so far that they call i.a. for a more intensive use of financial tools with a high leverage potential, like guarantees, subordinate debt and credit enhancement schemes, as well as for stronger investment flows into economically viable renewable energy infrastructures are welcome.

In 2009 developed countries committed to mobilize jointly 100 billion dollars per year by 2020 to address the needs of developing countries for climate action. This amount is to come from a wide variety of sources: public and private, bilateral and multilateral, including alternative sources of finance. A significant portion of this amount should flow through the Green Climate Fund (GCF). Other relevant funds of the UNFCCC process include: the Special Climate Change Fund (SCCF) and the Least Developed Countries Fund (LDCF), the Adaptation Fund (AF), and the Global Environment Facility (GEF). With regard to the newly established GCF, so far out of a total of 10.2 billion dollars in committed contributions, EU member states have pledged 4.75 billion dollars. The GCF Board is expected to approve a first set of projects in its November meeting. A transparent operational set-up for swift and effective implementation of a country-driven project pipeline should allow the GCF to raise further capital to deliver on its mandate.

At their recent meeting in Elmau (Germany), **G7 leaders have reaffirmed their commitment to the Copenhagen Accord to mobilizing jointly USD 100 billion a year by 2020** from a wide variety of sources, both public and private, to be channeled through the Green Climate Fund and other multilateral funds. It is also their declared intention to increase by up to 400 million the number of people in the most vulnerable developing countries who have **access to direct or indirect insurance coverage** against the negative impact of climate change related hazards by 2020 and support the development of early warning systems in the most vulnerable countries. Furthermore G7 members aim at accelerating **access to renewable energy in Africa** and developing countries in other regions with a view to reducing energy poverty through mobilizing substantial financial resources from private investors, development finance institutions and multilateral development banks. This objective is widely shared with the African Union, with the United Nations Environment Program (UNEP), as well as with the incoming French presidency of the COP21.

[3] Mobiliser les financements pour le climat - Une feuille de route pour financer une économie décarbonée

Session II - Climate Finance

During **Luxembourg's EU Council Presidency** in the second semester of 2015, Ministers for the Environment and Ministers of Finance will discuss the topic of climate finance in their informal meetings and during their formal Council sessions respectively. In this context it will be important to elaborate a credible financial offer to complement the EU's Intended Nationally Determined Contributions (INDC).

At the Informal Meeting of EU Ministers for the Environment on 22-23 July, 2015, the topic of climate finance is being addressed on the basis of keynote presentations by three eminent actors in this field:

- **Mrs. Hela Cheikhrouhou**, Executive Director of the Green Climate Fund (GCF), will brief ministers on the institutional set-up and governance of the GCF, its level of capitalisation, the accreditation process for partner entities, its project pipeline and the calendar according to which the GCF should become operational. She will also relay expectations brought to the GCF by the authorities of developing countries.
- **Mr. Jonathan Taylor**, Vice-President for Environment and Climate Action at the European Investment Bank (EIB), will present EIB's view on challenges to scale up investments for low carbon and climate resilient growth. He will also speak about EIB's overall financing for climate action and the Bank's innovative climate finance products.
- **Mr. Achim Steiner**, Executive Director of the United Nations Environment Program (UNEP), will speak on ways and means to better align international financial systems and the world's need for sustainable development, ahead and in view of the COP21, notably on the basis of a recent UNEP Inquiry report.

Questions for discussion

1. In order to draw a credible pathway to mobilize 100 billion dollars on a yearly basis by 2020 for the support for adaptation and mitigation activities in developing countries, the following questions need to be answered:
   a. What type of incentives and financial instruments are needed to leverage indispensable private sector money with limited amounts of public funding?
   b. What kind of methodology can be applied to credibly account for private sector funding that is genuinely targeted at effective climate change action?
2. Can Ministers agree to the pertinence of the concept of a Climate Finance Toolbox to address the financial needs of effective climate action? – What types of financial tools that are already in use nationally, can be identified to populate the Climate Finance Toolbox? –
3. In view of the latest progress in the preparation of EU's position for Paris with regard to the the mobilisation of climate finance, what are the national decision making processes to make public funding for climate action more predictable? – What efforts are needed to better align national sectoral and finance policies for that purpose? - How do Member States prepare nationally to collectively live up to the commitment of developed countries of mobilizing 100 billion dollars per year as of 2020 for climate action in developing countries?
4. Are the perspectives of economic opportunities and green growth related job creation that are inherent to the transition from fossil fuels to renewable energies, perceived as such throughout national governments? – If not, what could help to raise the level of awareness in that regard?