Various Sources of Contribution to Mobilize Climate Finance and Costs Estimates

Sanjay Vashist

Climate Action Network South Asia

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What is Climate Finance

- **Climate Finance**:
  - Developing country understanding: commonly understood as **finance** for undertaking adaptation and mitigation actions in developing countries.
  - Developed country literature**: investments** in projects and programs that contribute to reducing or avoiding greenhouse gas emissions (GHGs) and reducing the vulnerability of goods and persons to the effects of climate change.

Understanding the Finance Needs - *development*

- Addressing climate change calls for developing countries pursuing development that is <u>low carbon</u> and <u>climate resilient.</u>
- Developing countries requires investments for development needs: e.g.
  - in generating energy like power plants; in creating rail and road infrastructure and public transport system; for education and health infrastructure; for irrigation and agriculture inputs for food production
- Investment for development (baseline)
  - Public sources: (national government budgets; loans from other country governments; loans from international development finance institutes (world bank, ADB, etc)).
  - Private sources: (Individual savings through sale of bonds by governments; private sector, national and international, equity; Loans from financial institutions)

Understanding the Finance Needs - *Climate*

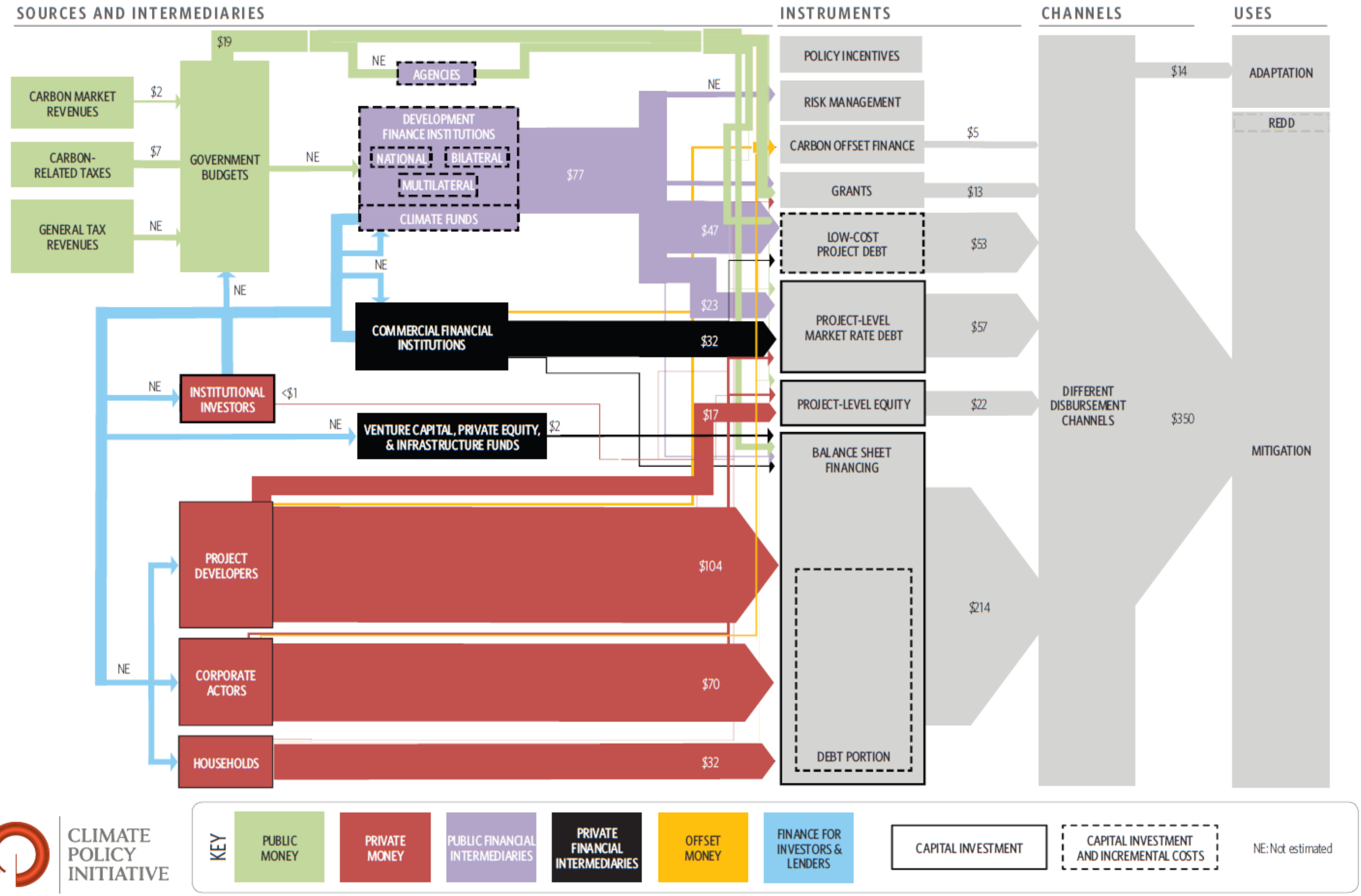
- Investments for climate resilient low carbon development
  - Implies the investment in development through options that increase countries resilience to and mitigates climate change.
  - This may require additional investments for <u>the same level</u> of development
  - <u>*Thus developing country challenge two fold:*</u>
    - financial resources for investments required for baseline development
    - additional/incremental financial resource to use climate resilient and low carbon options to achieve at least same level of development

Climate finance reported = base investment + additional/incremental investment

The Climate Finance Flows Diagram 2012

The Climate Finance Flows Diagram 2012, also known as the 'spaghetti' diagram, illustrates the landscape of climate finance flows along their life cycle for the latest year available, mostly 2011. The width of the arrows in the diagram represents the relative size of the flows.

*Notes: Figures are indicative estimates of annual flows for the latest year available, 2010 or 2011 (variable according to the data source). Flows are expressed in USD billions and rounded to produce whole numbers. Estimates spanning multiple years are adjusted to produce annual-equivalent estimates. Where ranges of estimates are available, the mid-point is presented. The diagram distinguishes between 'incremental costs,' that is, financial resources that cover the price difference between a cheaper, more polluting options and costlier, climate-friendly ones and do not need to be paid back — and 'capital investment,' which are tangible investments in mitigation or adaptation projects that need to be paid back. Categories not representing capital investment, or a mix of capital investment and incremental costs, are incremental costs only. The group of National Finance Institutions includes Sub-regional entities. Most data presented relates to commitments in a given year due to limited availability of disbursement data.



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Understanding Climate Finance

- In discussing climate finance – clarity important – whether total investment or incremental/additional investment
- Diagram gives the total climate finance investment flows covering: public sources, private sources and intermediaries.
- Public finance
  - sources: carbon markets, carbon taxes and government budgets
  - Intermediaries: agencies, bilateral, multilateral climate funds
  - Type of finance: policy incentives (e.g., feed in tariff), grants, concessional loans, guarantees to cover risks of investments.
  - International entities (such as export-important banks) sources from public monies provide market loans.

Understanding Climate Finance

- Private finance – comes from different sources but is primarily is in form of loan or equity – or forms that have a claim and have to paid back.
- Sources of private finance:
  - household savings – channelled through banks, bonds (government and private companies), mutual funds, etc – as a source of loan to finance investments.
  - Company reserves – earnings retained by various commercial organization – extended as loan or equity
  - Company raised market equity – e.g. floating of primary shares in market that individuals or companies subscribe to.

Understanding Climate Finance

- Private finance from both national and international sources. Foreign sources include:
  - Foreign Institutional Investors – who invest in financial markets and include – international mutual funds, pension funds, hedge funds, insurances firms, etc.
  - Foreign Direct Investment – investment in productive assets, i.e., setting up a factory or a business (this could be a major source for mitigation projects).
  - International loans – Multilateral, bilateral, International Monetary fund, Export credit, Commercial borrowing; Non-resident citizens, etc.

Summary

- Developing countries need foreign investments to increase rate of growth, as domestic savings are not sufficient
- Adding climate change goals increases the need for climate finance that is adequate and predictable

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Sources of Innovative Finance

An example – a solidarity levy on airline tickets to support medicines, diagnostics and prevention for HIV/AIDS, Malaria and Tuberculosis in developing countries. Established in 2006 by the governments of Brazil, Chile, France, Norway and the United Kingdom

Options for Innovative Climate Finance

- Three broad categories of innovative finance:
  - Carbon markets - auctioning of allowances, levy on trade of offset mechanisms (levy on CERs) etc.
  - Taxing GHG emissions: taxing GHG emissions or GHG-emitting activities: international aviation and international maritime emissions; taxing fossil fuels or reducing subsidies to fossil fuels; etc.
  - Other measures: taxing international finance transactions; creation of special drawing rights; etc.
- Criteria used for evaluations
  - Political feasibility
  - scale of finance raised
  - Administrative challenge of managing the source
  - Distortion on existing patterns of activities – primarily will it lead to losses in some countries and gains to others
  - Universality

Sources of finance: individual sources

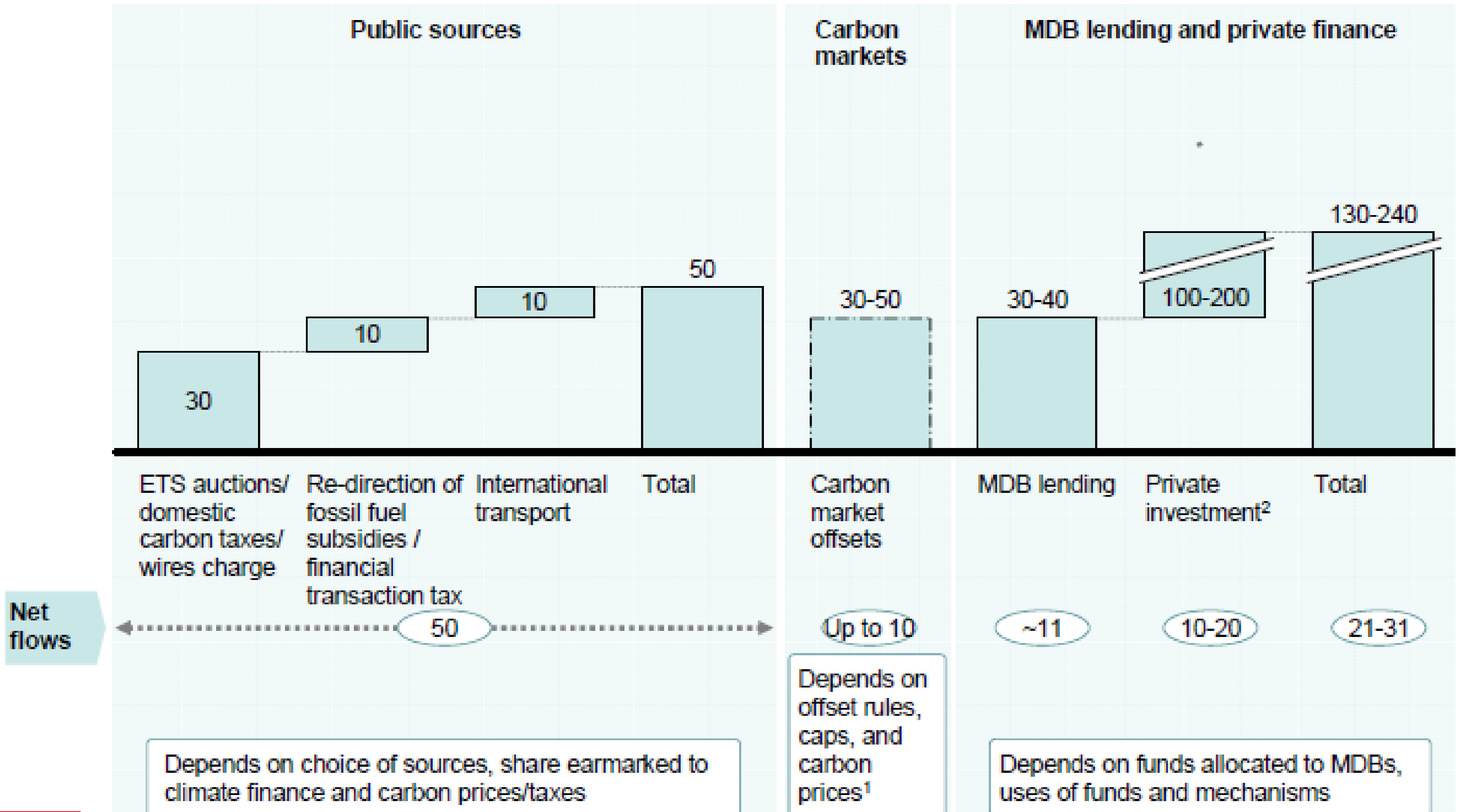
$bn, 2020, per year

Sources			Low carbon price ($15/t)	Medium carbon price ($25/t)	High carbon price ($50/t)
Public sources	1 Carbon market revenues	AAU/ETS	2–8	8–38 (25-50)*	14–70
		Offset levies	0–1	1–5	3–15
	2 International transport	Maritime	2–6	4–9	8–19
		Aviation	1–2	2–3	3–6
	3 Carbon-related revenues	Carbon tax	~$10 bn for tax of $1/tonne CO_2e		
		Wires charge	~$5 bn for tax of $1/tonne CO_2e or a charge of $0.0004/kWh		
		Subsidies	~$3-8 bn (4-12)*		
		Royalties	~$10 bn		
	4 Financial transaction tax		~$2-27 bn		
	5 Direct budget contribution		No clear guidance; estimates from current fast start funding of $10 bn per year to G77 proposal of 0.5-1% of GDP equivalent to $200-400 bn to		
Development bank instruments	6 MDB contribution		$30-40 bn for each $10 bn paid – in capital		
Carbon market finance	7 Carbon market offsets		8–12	38–50	150
Private capital	8 Public/private leverage		for medium carbon price around $200bn		

** Estimates in parenthesis are from World Bank (2011). Mobilizing Climate Finance. Washington DC*
Note: The figures in this table refer to the flows available for international climate finance using AGF and World Bank assumptions. A substantial amount of revenues, not accounted for in this table, would be retained in national budgets. For example, the AGF assumes that 90% of auction revenues and 50- 75% of travel would be retained domestically

Approximately $50bn could be raised from public sources with a carbon price of $20-25

$bn, 2020, per year



1 Not counted towards financing needs as carbon finance increases needs proportionally
2 International private finance; excludes domestic private finance
SOURCE: AGF report

Conclusion

- Countries and Region need to be self sufficient on Climate Finance
- Many options available in South Asia to raise funds based on equity principles
- Private finance is more of investment and thus should be seen in similar context
- Funds needs to be mobilised for long terms planning and towards comprehensive development.

Innovating with finance from government budgets

- International Financial Facility model (IFF)
  - Facility created to finance immunization as part of meeting the millennium development goal (MDG)
  - Financed by long term commitments by donors to repay the finances raised through bonds in international market
  - Enables raising of upfront money, with low annual paybacks spread over many years.
  - Bonds worth X raised in say first five year. Subscribes to bond paid an annual interest and partial payback on principle after, say, 3 years over a period of 10 years. So annual repayment is annuity amount plus interest.
  - The annuity amount and interest is paid by funds from donors. Thus donors pay a smaller amount which enables raising significant resources upfront.
  - IFFIm raised US$ 3.6 billion in first five years - **six times** the donor funds received into the IFFIm account over the same period. The donors (governments of the United Kingdom, France, Italy, Norway, Australia, Spain, The Netherlands, Sweden and South Africa) have pledged US$ 6.3 billion in donor contributions over 23 years.