

A newsletter by **I4CE** INSTITUTE FOR CLIMATE ECONOMICS in partnership with



PARIS2015
CLIMATE CHANGE CONFERENCE
COP21-CMP11

Heading towards the 21st Conference of the Parties (COP21) to the United Nations Framework Convention on Climate Change (UNFCCC) to be held in Paris from 30th November to 11th December 2015, I4CE - Institute for Climate Economics, in partnership with ADEME, the French Environment and Energy Management Agency, attempts to shed some light on the challenges surrounding this Paris Climate Conference 2015. We will be exploring what can be expected from the post-2020 climate agreement in Paris. We will also be discussing some key success indicators of such an agreement. Over the course of six issues, ClimasCOPE will provide analysis related to carbon pricing, Climate Finance, greenhouse gas (GHG) emissions' accounting, the role of subnational actors, adaptation to climate change and the compatibility of government commitments with the scenario wherein global mean temperatures would rise by no more than 2°C.

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Editorial – Financing the low-carbon transition : the need for coherence between regulations and ambition

On a global level, for achieving the objectives of a low-carbon transition, the annual investment needs are measured in trillions of dollars per year. This amount may seem high, but in reality, it only represents a small percentage of total global current investment, and a few hundred billion dollars a year more than the cost of a "business-as-usual" scenario. Rather than increasing the volume of global investment, the main challenge is thus, to improve the distribution of funds to meet the needs of a low-carbon economy, rather than continuing with – or, in the case for developing countries, formulating – the existing high-carbon economic model.

States may steer the economy towards this new model, but it is neither within their capacity nor their power to finance it in its entirety. The private sector therefore has a vital role to play in terms of its capital contribution as well as its ability to effectuate investments. However, the private sector is not engaging in climate financing at a level and pace that is sufficient to keep warming below 2°C. This situation will improve if the regulatory, social and economic environments provide it with clear signals. The public sector must therefore encourage the private sector to act, only stepping in where necessary, while minimising the negative social impacts of transition such as fuel poverty, loss of jobs in high-carbon sectors, etc.

Private investors regularly call for a stable regulatory framework to reduce risks and limit obstacles to investment. In reality, there is a two-fold need: a clear future direction in the development of regulations, as well as coherence between sectoral policies affecting the climate¹.

At present, there is little or no coherence between policies. On the one hand, energy-climate policies set targets – sometimes even ambitious ones(!) – while on the other, incentives exist to extract and consume fossil fuels – more than US\$ 500bn in annual subsidies, for example. This contradiction blurs political signals and stands in the way of the private sector committing investment required to meet the 2°C target.

However, coherence does not mean uniformity. While the long-term signal is based on general principles, issues of financing differ according to the actors and sectors. Thus, there is no single choice of tools and policies and only a

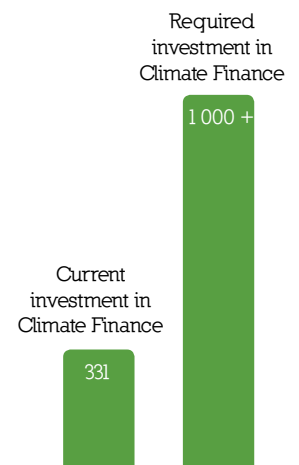
combination of instruments is conceivable. The establishment of financing tools will therefore address certain challenges, but not all. Support policies must be accompanied by regulatory and tax policy reform across all sectors – including the financial sector – to produce a coherent regulatory framework capable of achieving this transition.

The scale of the challenge involved in the transition to a low-carbon economy – and the risks of failure – mean it is not enough to simply tack on incentive systems operating in the margins. Such an approach will not bring about a sufficient reduction in investments supporting the high-carbon economic model. The transition instead requires policies as a whole to become systematically climate-friendly². Let us hope that the commitments and practices announced by private financial actors in September 2014 at the Climate Summit in New York are a sign that the sector is ready to evolve. The next step would be for the various financial-sector governance institutions to address these needs by incorporating climate objectives into their actions.

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² To apply it to the context of the financial sector, see the analysis framework based on intermediation and the supply and demand of finance in "Mainstreaming climate change in the financial sector and its governance", by CDC Climat and IDDRI, 2015.

The global current and required investment towards Climate Finance (billion USD\$ per year)



Source: Climate Policy Initiative 2014 and UNFCCC 2014

¹ The OECD calls this "policy alignment"

The Challenge – Finance will be the cornerstone of the Paris agreement

Discussions concerning finance in the context of the UNFCCC¹ – and therefore the anticipated Paris agreement – do not cover the world's investment requirements for the low-carbon transition, i.e. the trillions of dollars mentioned on p.1. They focus instead, on a budget of US\$10 billion and a target of US\$100 billion.

The *US\$10 billion* figure corresponds to the initial capitalisation of the Green Climate Fund (GCF) by governments at the end of 2014. This new financial institution, created in 2010, is governed jointly by developing countries and developed countries. Its main objective is to provide finance to help developing countries limit their greenhouse gas emissions – mitigation – and adapt to climate change – adaptation. The GCF is also responsible for funding these two types of actions equally. The Fund intends to engage its first disbursements from 2015 onwards.

Despite its usefulness to the work of the UNFCCC, the GCF will be insufficient to respond to the real financial challenge of the Paris agreement. At the Copenhagen Conference in 2009, and then in Cancun in 2010, developed countries committed to "mobilize" *US\$100 billion* per year in private and public climate funding for developing countries by 2020. However, with five years left for this deadline, the scope of flows included in this US\$100 billion still remains to be clarified and an agreement has not yet been reached, particularly between developed and developing countries, regarding the share of public financing. According to the UNFCCC's *Standing Committee on Finance*, between 2010 and 2012 – based on various scopes, some including private financing and others not – there were between US\$40 billion and US\$175 billion per year in financial transfers from developed countries to developing countries to finance climate initiatives. The effort required to reach the US\$100 billion commitment will therefore depend on the choice of scope and additional amounts involved.

Moreover, the issue of financing is vital to the signing of a climate agreement involving all countries in Paris in December 2015. Success will

largely depend on the confidence each country has in other countries' commitments. For developed countries, the US\$100 billion commitment therefore represents a first test of sincerity. It now seems clear that simply aggregating existing finance will be insufficient and that progress needs to be made in terms of credible additional efforts, starting with the public sector.

Due to budgetary constraints, developed countries are instead promoting an improvement in the leverage effect of public financing to attract more private capital. Part of the solution lies with development banks – whether national, bilateral or multilateral – which have long used their public resources to mobilize private financing. These banks also encourage better coordination of development aid with the Sustainable Development Objectives due to be ratified by the UN in September 2015.

To achieve this, a few years ago, these institutions began including the climate as a factor in investment decisions. At the Climate Finance forum held in Paris in March, institutions which are members of the International Development Finance Club (IDFC) and multilateral development banks committed to improving their practices by harmonising methods for monitoring climate financing and initiating the greening of their financing activities (see p.4).

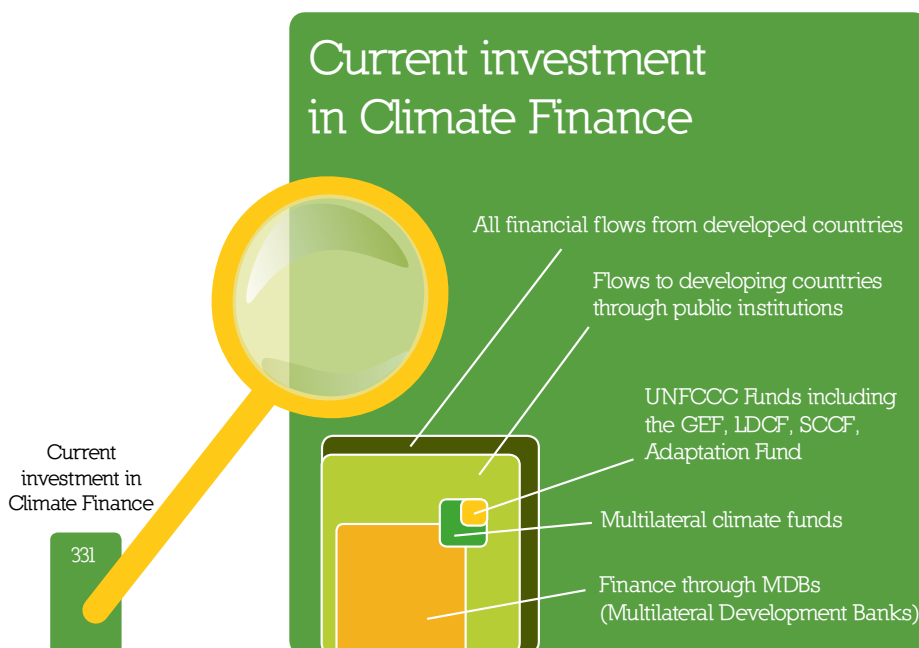
Find out more

- Green Climate Fund.
<http://www.gcfund.org>
- Report by the Standing Committee on Finance, 2014 .
http://unfccc.int/cooperation_and_support/financial_mechanism/standing_committee/items/8034.php

Despite this, along with export credit agencies, these institutions are experiencing increased pressure to end support for fossil fuels. This type of initiative – which is sometimes symbolic from a financial perspective – contributes to reinforcing systems' coherence. And part of the confidence required for a 2015 Paris Climate Agreement lies in this coherence, since it is at the heart of the role which finance must play !

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Breakdown of current Climate Finance investments (billion USD\$ per year)



Source: UNFCCC, Report by the Standing Committee on Finance, 2014

News

May Calendar

- 18-24 May. First Climate Finance Week in Paris: mobilizing private actors.
- 31 May. Deadline for the agreement on the draft text of the Paris Agreement.
- 4-14 June. Fifth part of the second session of the Ad Hoc Working Group on the Durban Platform in Bonn.

Latest national contributions (iNDC) submitted

United States, on 31st March with a GHG emissions reduction target (ERT) of 26% to 28% in 2025 relative to 2005 levels; **Russia** (ERT of 25 to 30% by 2030 relative to 1990 levels) and **Gabon** (ERT of at least 50% by 2030 relative to 2000 levels) on 1st April; **Liechtenstein** (ERT of 40% between 2021 and 2030 relative to 1990 levels) on 23rd April, **Andorra** (ERT of 37% by 2030 relative to a "business as usual" scenario) on 30th April and **Canada** (ERT of 30 % by 2030 relative to 2005 levels) on 15th May.

The Major Economies Forum – The need for an ambitious and credible agreement

On 19th and 20th April, the leading economic powers and major emitters met to discuss preparations for the Paris agreement. The main topics addressed were: the presentation of already-submitted and expected iNDCs in order to determine a timetable for iNDC submissions; the notion of the agreement's "accountability" in order to foster trust between countries, promote general participation; the level of the agreement's ambition which, depending on participants, cannot be based solely on iNDCs but should also involve the establishment of a long-term process to revise national contributions and ensure monitoring of their progress.

Encouraging private investment in Climate Finance

From 17th to 19th April, a session on scaling up Climate Finance was held, with the World Bank, the International Monetary Fund, finance and development ministers and private investors in attendance. The aim of these discussions was to provide solutions to make up for the shortfall in energy, infrastructure and land use investments needed to achieve the low-carbon transition. Participants emphasised the need to make Climate Finance more attractive using mechanisms such as carbon pricing, a gradual reduction in fossil energy subsidies and reform of financial regulations. Public-private partnerships, particularly those related to "clean investments" are seen as a key solution to mitigating the risks of climate change.

Promoting public-private partnerships in Climate Finance

On 17th April, G20 finance ministers and governors of central banks discussed solutions for reducing financial sector vulnerabilities through macroeconomic policy reform. In the context of climate financing, discussions focused on achieving favourable results in terms of adaptation, alternative energies and the role of financial institutions during a low-carbon transition. The G20's Financial Stability Board was put in charge of analyzing the impacts of climate change on the financial sector.

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Global investments

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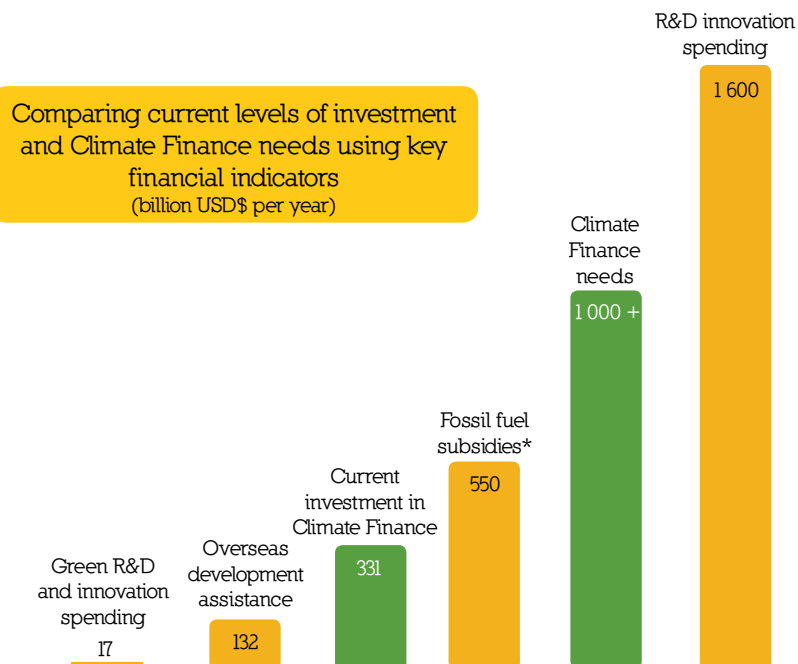
Indicators

Share of global emissions of countries that have submitted iNDCs



Source: I4CE - Institute for Climate Economics, May 2015

Comparing current levels of investment and Climate Finance needs using key financial indicators (billion USD\$ per year)



* The IMF recently calculated the true cost (fiscal costs and environmental losses included) of global energy subsidies: USD\$4,900 bn. in 2013 and an expected USD\$5,300 bn. in 2015

Source: IEA 2015, World Bank 2013, UNFCCC 2014, Climate Policy Initiative 2014 and OECD 2013.

Five initiatives for Climate Finance

UNEP inquiry into the design of a sustainable finance system

The United Nations Environment Programme (UNEP) has launched a "UNEP Inquiry" with the aim to "Better align the financial system with the resilience and the long-term success of the economy". This initiative identifies catalogues and examines policies, actions, regulatory innovations and mechanisms responding to this objective which have already been implemented by governments, central banks and regulatory authorities, as well as investors and private banks. The inquiry is also due to issue proposals and recommendations for political and regulatory reform of financial markets to support investments in the green economy.

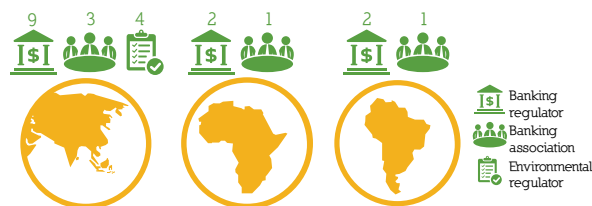
At the start of May, the Inquiry's Consultative Council met to examine progress made and to provide recommendations ahead of the publication of the final report in October 2015. The best practices identified by the Inquiry are in the process of being standardized to promote more widespread use. The study is currently focusing on practices of financial systems in South Africa, Bangladesh, Brazil, China, Colombia, India, Indonesia, Kenya, the United Kingdom and the United States of America.



Source: UNEP Inquiry, 2015

The Sustainable Banking Network

The Sustainable Banking Network (SBN) is a voluntary and informal group of banking and financial regulators set up in 2012 by the International Finance Corporation (IFC). The SBN's work involves defining innovative financial options and promoting climate-friendly investments. The SBN is run by regulators and banking associations exclusively from emerging or developing countries. Nine of its members have already or are in the process of drawing up sustainable financing guidelines.



Source: Sustainable Banking Network, 2015

Aligning policies for a transition to a low-carbon economy – Encouraging regulatory coherence

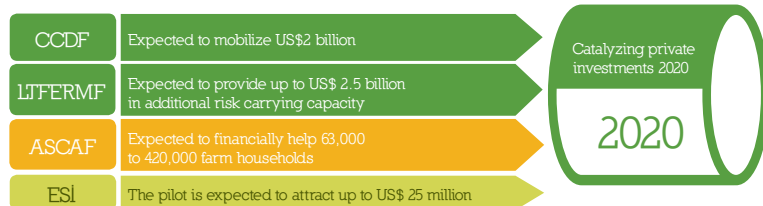


Source: APT, Draft paper, 2015

In June 2015, at the OECD (Organisation for Economic Cooperation and Development) Ministerial Council Meeting, the OECD, IEA (International Energy Agency), ITF (International Transport Forum) and NEA (Nuclear Energy Agency) will present a report arguing for the "alignment of policies for the transition towards a low carbon emission economy", in order to facilitate the adoption of international climate agreements. The report will examine the major areas of inconsistency between climate policies and all other policies, whether cross-sector (investment, taxation, innovation) or within key sectors in the low-carbon transition (energy, mobility, land use).

Four initiatives for boosting private financing by the Global Innovation Lab for Climate Finance

In April 2015, the Global Innovation Lab for Climate Finance, an initiative launched by eight countries¹ and representatives from the financial sector, announced four pilot projects aiming to overcome certain obstacles in order to attract private investment for mitigation or adaptation projects in developing countries. The objectives of these four projects, which have attracted US\$100 million in initial financing, are: to encourage the creation, financing and rapid refinancing of renewable energy projects (CCDF); to provide an insurance product covering the financial performance of energy efficiency projects (ESI); to strengthen farmers' technical capacities and give them access to financing for investments resilient to climate change (ASCAF); and to supply tools for managing exchange-rate and interest-rate risk for climate projects (LTFERM).



Source: Lab for Climate Finance, 2015

¹ United Kingdom, United States, Germany, Denmark, France, Japan, Netherlands and Norway

Common green investment practices from the International Development Finance Club (IDFC)



The International Development Finance Club (IDFC) is a group of 23 international, regional and national development banks. In March 2015, Club members agreed on the common definition of climate-friendly financial activities. A pilot group was also created to help establish a basis for common "green" practices in the run up to COP21. This involves adapting their practices to climate challenges, for example, by evaluating the impacts projects have on greenhouse gas emissions, by taking into account the vulnerability of projects to the effects of climate change or by integrating a carbon price into the economic assessment of investments.

I4CE – Institute for Climate Economics is a research institute on climate economics launched in September 2015, supported by *Caisse des Dépôts* and *Agence Française de Développement*. This think tank provides independent expertise and analysis on economic issues related to climate & energy policies in France, in Europe and throughout the world. The views and opinions do not engage the responsibility of ADEME.

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