oxford climate policy

ecbi

The Paris Predictability Problem

WHAT TO DO ABOUT CLIMATE FINANCE FOR THE 2020 CLIMATE AGREEMENT?

Think Piece[1]

May 2015

Benito Müller[2]

In December, negotiators will converge on Paris to forge a new international climate change agreement for 2020 and beyond. This think piece is about one of the preconditions for a success at Paris: a breakthrough on climate finance, or, to be more precise, on how developing countries will be supported in their efforts to combat climate change and its adverse effects.

I. The Issue

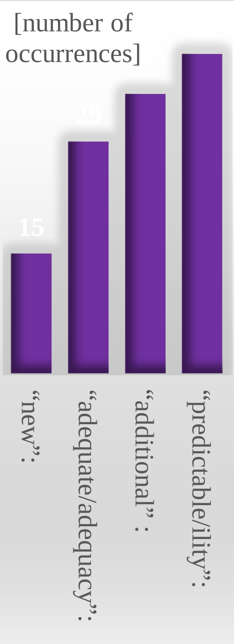


Figure 1. Section F (Finance) of the Geneva Text

Anyone involved in the debate on international climate finance will be familiar with the following funding attributes: ‘*new*’, ‘*additional*’, ‘*adequate*’, and ‘*predictable*’. It is not surprising that these terms appear in Section F (Finance) of the draft negotiating text adopted a few weeks ago in Geneva at the most recent UN climate negotiating session.[3] What is more interesting, however, is their relative distribution, illustrated in Figure 1.

While no hard conclusions can be drawn from such rudimentary evidence, it is not unreasonable to interpret it as indicating that ***funding predictability*** is of paramount importance, particularly to developing countries, and that the current multilateral funding regime fails to provide it.

Assuming this is the case 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, domestic requirements as a

---

[1] OCP is a lead member of the European Capacity Building Initiative (ecbi). This submission is OCP’s sole responsibility and does not necessarily reflect the views of all ecbi members.

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

[3] The eighth part of the second session of the Ad-hoc Working Group on the Durban Platform, or ‘ADP.2-8’.

rule prevail over foreign needs in budgeting discussions.[4] This is why developing countries tend to associate the (un-) predictability of such budgetary contributions with an unpalatable measure of political caprice.

Concerning the question of why predictability is important, there are really two answers. In a first instance, 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 a significant finance package. In the past, there has been the option of setting up a new fund or mechanism (Financial Mechanism, Adaptation Fund, LDC Fund, Special Climate Change Fund, Green Climate Fund) but most people will have realized that this is no longer a viable option for Paris: we have all the Funds and Mechanisms we need!

At the moment, inspired by the Copenhagen $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 very unlikely that this will be possible if we are talking about budgetary contributions, which is why for Paris to be a success, we need to seek to enhance predictability (of public sector funding) by other means. But how?

II. 'Le mieux': International Innovative Finance

Plan A: Earmarking international revenue sources

There are a number of ways in which funding predictability could be enhanced. The most effective way of overcoming the domestic revenue problem is to avoid national budgets in the first place. The CDM adaptation levy (earmarked for the Adaptation Fund) is a very 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 budgets, or for that matter Treasuries, are not involved. As such, these funds are without any doubt 'additional', in the sense of 'not displacing ODA'. They are also fairly predictable, even if one may not always like the predictions, as witnessed by the collapse of the CDM adaptation levy.

By far the most direct way of addressing the predictability problem would hence be to strengthen the adaptation levy by extending it to the other Kyoto Protocol mechanisms, and to any new market mechanism under the Paris Agreement, especially if it were to involve some form of international auctioning of emissions permits.

A number of other 'international innovative finance' instruments have also been under discussion in this context. There is, for one, the International Adaptation Passenger Levy (IAPAL), proposed in December 2008 at COP 14 by the LDC Group. Under this proposal, a small passenger charge would be levied on international flights − differentiated with respect to the class of travel − to raise between $8 bn and $10 bn annually for adaptation in the first five years of operation, and considerably more in the longer term. Since the levy was to be internationally collected and dependent only on the evolution of air travel demand, the funds raised would be truly new and additional, as well as significantly more predictable than traditional funding mechanisms.

[4] See, for example, the discussion of the 'domestic revenue problem' in 'International Adaptation Finance: The Need for an Innovative and Strategic Approach'.

Other (mostly carbon market-based) instruments have been discussed and some have even been considered by the International Civil Aviation Organization (ICAO)[5] and International Maritime Organization (IMO)[6] in the context of reducing international aviation and maritime emissions. There has been an extensive and fruitful discussion on how these instruments could be harmonized with the UNFCCC Principle of Common but Differentiated Responsibilities and Respective Capabilities. However, however little progress seems to be expected in either forum (see Box 1).

The distinguishing feature of these innovative finance instruments is that, like the CDM adaptation levy, they are (meant to be) 'international' in the sense of being collected directly by an international body, thus by definition avoiding the problems associated with budgetary contributions, which is why they would provide the best way of enhancing predictability. The problem is that such international levies are regarded as anathema by many national treasuries, which is why it is highly unlikely that any of them would be established in time for Paris. So what to do?

Box 1: Status Quo at ICAO and IMO

The triennial Assembly of the ICAO in 2013 failed to agree a global Market Based Mechanism (MBM) for international aviation. Subsequently, under pressure from other countries, Europe has severely constrained its legislation for an Emission Trading Scheme in aviation to cover only flights within the European Union.

There was no discussion at all on the topic of an MBM for international shipping at the IMO environment sessions in 2014, nor had there been during its previous session in 2013 when the topic had been postponed to 'a future' session.

The outlook for a global MBM for international aviation and maritime transport continues to be unclear, even though both industries would clearly prefer a global approach rather than a patchwork of regional legislations.

The next Assembly of the ICAO, in 2016, is to decide on a scheme capable of being implemented from 2020 (but what the decision would be, and whether the scheme would be effective, if decided, no one knows). At the IMO, it is not clear when the topic may progress any further, even though workable MBM proposals (including how to reconcile various positions and address disproportionate impacts on certain countries) have already been tabled and assessed.

Source: www.imers.org/content/cop20-lima

---

[5] 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.

[6] 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).

III. 'Le bien': Earmarking of Domestic Sources

Plan B: Earmarking at the national level

Not all innovative finance instruments currently under discussion are 'international' in this sense. The Financial Transaction Tax (EU FTT) proposed by the European Commission (Box 2), for example, is to be collected domestically by the participating EU member states.[7]

Box 2. The EU Financial Transaction Tax

The EU FTT, initially to be introduced by 1 January 2014 (later postponed to 1 January 2016), is to cover financial transactions between financial institutions; it will charge 0.1% against the exchange of shares and bonds and 0.01% across derivative contracts, if just one of the financial institutions resides in a member state of the EU FTT. The proposal was approved by the European Parliament in July 2013, and must now be unanimously approved by the 11 initial participating states before coming into force.

The fact that the revenue from this tax, estimated at €37 billion per year ($41 bn), 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 Consolidated Fund) in the National Insurance Fund.

Why Earmarking?

Earmarking each and every revenue stream would clearly make budgeting more difficult, if not impossible. But there is a variety of circumstances where it can be useful and appropriate (see To Earmark or Not to Earmark?). In particular, it can be used to reduce the potential effects of the political risks described earlier in the context of budgetary contributions.

Unlike budgetary contributions – which are, by and large, politically determined – contributions based on earmarked sources of revenue are co-determined by political and other, usually market-based, parameters. The ***share*** of the source that is being earmarked will usually be politically determined, but the ***magnitude*** of the contribution also depends on the overall size of the revenue in question. Thus, the decision on what share of the EU FTT should be used for climate change is political, but the actual contributions resulting from this decision also depend on the relevant financial markets.

To be clear, political decisions are not necessarily less predictable than markets. Indeed, if one is involved in the relevant decision-making processes – particularly as a powerful player – one might well prefer a purely political process. The problem from the vantage point of the developing country recipients is that they typically have very little, if any, say in the political processes that determine the relevant contributions. This is why, for them, market-based uncertainties will be more palatable than

[7] '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]

those arising from the relevant political (developed country) processes: from the outside, markets appear more predictable than individuals.

Obviously things can go wrong, even if the market is the only determinant, as the fate of the CDM adaptation levy has shown, but from the vantage point of 'outsider' recipients, earmarked contributions are preferable to those determined purely by political 'insiders'.

Alternative Instruments

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).

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**	Gov't 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**

* Aggregate of all federal aviation taxes, not just those listed.

** Capital and grant

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.

In the US context, even though aviation revenue is already earmarked, such a change of purpose is unlikely because it would presumably require Federal legislation (such as an amendment to the Airport and Airway Trust Fund or the Passenger Facility Charge Program legislation), which in the current political climate on Capitol Hill would not be easy, to say the least. So what could be done?

Plan C: Earmarking at the sub-national level

If national-level instruments are unlikely, one could consider sub-national public sector contributions.[8] As it happens, at sub-national level, some governments in the US have very progressive views on climate change. On 29 April 2015, for example, California's Governor Jerry Brown issued an Executive Order (B-30-15) which not only establishes '*a new interim state-wide greenhouse gas emission reduction target to reduce greenhouse gas emissions to 40 percent below 1990 levels by 2030* […] *in order to ensure California meets its target of reducing greenhouse gas emissions to 80 percent below 1990 levels by 2050*', but also specifically addresses the need for climate adaptation, directing

[8] 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.

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.

Accordingly, it would not seem too farfetched to think that in California, at least, there could be sufficient political will to earmark some share of, say, California's aviation revenue as a solidarity charge for the poorest and most vulnerable countries. This could then be used as a contribution to the UNFCCC Least Developed Country Fund, which is chronically under-funded and in danger of being closed down due to insufficient resources (see Box 3).

Box 3. The Least Developed countries Fund: Status Quo

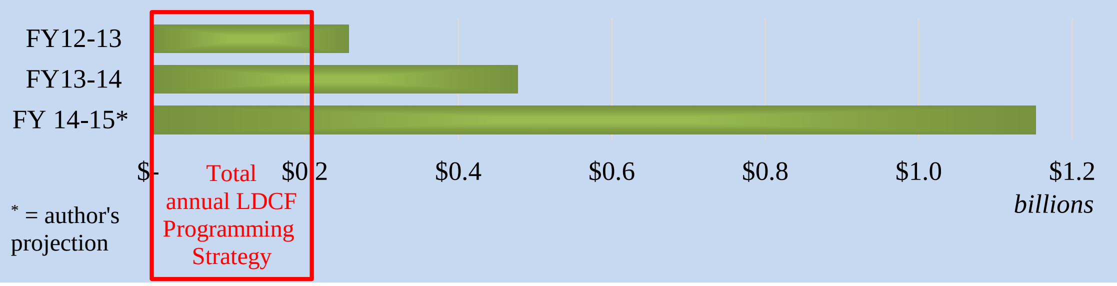
Having been established more than a decade ago to address the urgent and immediate needs of Least Developed Countries (LDCs) especially vulnerable to the impacts of climate change, the Least Developed Countries Fund (LDCF) still struggles to obtain adequate and predictable funding. The Global Environment Facility, as operating entity of the LDCF, has been far from able to program LDCF resources at the level of around $200 million per year, as proposed in the Programming Strategy for the LDCF. Moreover, in the near term, demand for LDCF resources considerably exceeds the funds available for new approvals.
As at 27 April 2015, funds available for new funding approvals amounted to $11.96 million; whereas 25 full-sized projects (FSP) and one medium-sized project (MSP) had been technically cleared for a total funding demand of $198.96 million. In addition, another 12 project proposals, requesting a total of $75.20 million, had been endorsed by countries' operational focal points and formally submitted for review by the Secretariat.

Source: Progress Report on the Least Developed Countries Fund and the Special Climate Change Fund (GEF/LDCF.SCCF.18/03), 8 May 2015.

Alternatively, California could decide to use part of the revenue from ***auctioning allowances for its emission trading scheme***. Over the last couple of years this revenue has been steadily increasing (see Figure 2) to a level where it might well be politically feasible to use part of it to cover a significant share of the $200 million per annum considered to be the strategic resource requirement of the LDCF (Box 3).

Moreover, in light of the fact that California is working closely with British Columbia, Ontario, Quebec, and Manitoba through the Western Climate Initiative to 'develop harmonized cap and trade programs that will deliver cost-effective emission reductions'[9] and the recent California-Quebec joint auctions, it stands to reason that 'Plan C' could well be extended to also become a 'Plan Canada'. Moreover, the sub-national collaboration in providing support for developing countries could extend to other sources, such as carbon and indeed fuel taxes.[10]

Figure 2. Total Auction Proceeds in the California Greenhouse Gas Reduction Fund (GGRF)



[9] Source: Background Information: www.arb.ca.gov/cc/capandtrade/capandtrade.htm.

[10] The 2010 British Columbia carbon and fuel tax revenue was US$ 0.7bn and 1.2bn respectively, while California earned $3.2bn in fuel taxes alone.[http://www2.oecd.org/ecoinst/queries/Default.aspx]

IV. Conclusion

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 negotiations. If anything, it may be that a significant number of developed country governments, national or sub-national, adopt domestic instruments that ***enhance the perceived predictability of their support*** – the ***earmarking of certain innovative domestic funding*** for the support of climate change efforts in particularly vulnerable developing countries being chief among such instruments.

This is why the current proposal for an ***EU Financial Transaction Tax is of paramount importance*** for a genuine success in Paris, something which the French Presidency and indeed the President of the French Republic are clearly keenly aware of (see Box 4). However, this does not mean that other national and sub-national developed country governments could not also provide financial contributions with this sort of enhanced perceived predictability. If the idea of a financial transaction tax is anathema, they could earmark a share of, say, their aviation-related and/or domestic emission trading revenue for the purpose. And if that is also unacceptable, then there is always the (sub-) national lottery as *ultima rati*o: no one can deny that supporting particularly the poorest and most vulnerable countries in their fight for survival against climate change impacts is a good cause, and why should lotteries only support good causes at home?

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, or rather their treasuries, 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 4. Hollande will 'use FTT to fight climate change'

The question of where to allocate the proceeds of the tax has come back to the forefront, with Hollande announcing his wish to see the revenue in its entirety spent on the fight against climate change.

This tax 'should be used in the service of the climate, to fight against climate change', the French head of state said.

'Many emerging countries are not prepared to sign an agreement on the climate at the end of the year' because they cannot afford the necessary investment. 'We have to find 100 billion dollars for the Green Climate Fund. So part, if not all of the Financial Transaction Tax should be used for the benefit of the Green Climate Fund', he said.

This presidential U-turn is not without political motivation. Paris will host the COP 21 in December 2015, hosting representatives from 194 countries, who will try to agree on a plan for reducing CO_2 emissions from 2020 and keeping the global temperature rise below 2 °C by 2100. One of the indispensable conditions of this ambitious agreement is that richer countries should help to finance this enormous project in the developing world.

Source: www.euractiv.com 8 January 2015