EXECUTIVE SUMMARY

CLIMATE FINANCE

A tool-kit for assessing climate **mitigation** and **adaptation** funding mechanisms

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Executive summary

This report supersedes *Assessing the Alternatives: Financing climate change mitigation and adaptation in developing countries* (Stephen Spratt, 2009), which established a methodology for assessing and comparing various potential funding mechanisms. The aim of this paper is to apply this analysis to today's situation, helping us to better understand the changing landscape of climate finance and suggest a portfolio of mechanisms which would move us closer to the level of financing required to meet mitigation and adaptation costs in developing countries.

The global climate is changing, fast. This is the direct result of human activity. It is broadly accepted that we need to restrict global temperature increases to as far below 2°C as possible if we are to avoid triggering runaway, irreversible and catastrophic climate change. This means urgently decarbonising our global economy.

Whatever else happens, we will need to adapt to the climate change that is already 'in the system'. Moreover, the tragic fact is that those who stand to lose most through the effects of climate change have little or no responsibility for creating it: it is the cumulative impact of industrial activity in the developed world that has largely created this problem, and it is these developed countries, therefore, that need to shoulder the burden of dealing with it.

The need to rapidly and urgently reduce CO_2 emissions also means that, particularly for larger developing economies, fossil-fuelled development is not a viable long-term option. To ensure that their development is genuinely sustainable, countries need to embark upon a low-carbon path. Unlike their developed country counterparts, who grew their economies generating energy at low cost and without particular environmental consideration, the responsible trajectory now asked of developing countries will require significantly greater investment, and potentially higher energy costs. As with adaptation, there is therefore a degree of moral obligation for developed countries to finance this process, since it is their previous actions that have made it a necessity. As well as this obligation, there is practical necessity. Developing countries simply do not have the capacity to address poverty and human development while simultaneously adapting to and mitigating climate change.

In this paper we consider briefly the framework required for mitigation, looking at both a global cap on emissions and a carbon tax. We then examine the merits of nine proposals for how mitigation and adaptation in developing countries could be financed:

1 **China + G-77** – direct budget contribution of between 0.5% and 1% GDP of developed countries.

2 **General Carbon Tax** – applying a levy of $1 per ton of CO_2 emissions in all developed countries.

3 **Taxing carbon emissions from shipping** – a $25 price per ton of CO_2 emitted from the international maritime sector.

4 **Taxing carbon emissions from aviation** – a $25 price per ton of CO_2 emitted from international air travel.

5 **Financial Transaction Tax (FTT)** – with particular focus on the taxing of currency transactions.

6 **Redirecting fossil fuel subsidies** – phasing out subsidies to free up substantial amounts of public funds to be redirected to climate finance.

7 **Special Drawing Rights (SDRs)** – reserve assets created by the IMF that could be converted into hard currency or used to mobilise private capital.

8 **The International auctioning of national carbon emission permits (or 'assigned amount units' – AAUs)**

9 **Auctioning of domestic revenue permits: the EU Emission Trading Scheme (ETS)** – governments auction a proportion of their emissions' allowances to the private sector as a means to raise revenue.

To assess the relative merits of each proposal, our first step is to locate the proposals on two spectrums:

- **INTERNATIONAL** → **DOMESTIC**
- **DIVERSE** → **CONCENTRATED**

In respect of the first spectrum, it is suggested that there is distinct advantage if a mechanism is broadly **international** in form thus avoiding the 'domestic revenue' problem noted by Müller (2008), where money intended for international purposes gets directed to national budgets. This problem is even more relevant in the context of the current economic crisis as governments are under strong pressure from their electorates to spend revenue domestically rather than abroad.

In respect of the second spectrum, it is suggested that a considerable advantage accrues if a mechanism is **diverse** in its 'incidence'. That is, that the burden of payment of revenue is not concentrated on one particular group, and thus potentially subject to lobbying for repeal, but more economically spread out. Proposals that are more 'international' and 'diverse' are therefore assessed more favourably than those that are 'domestic' and 'concentrated'.

Following this stage, the proposals are then assessed against two sets of criteria and indicative scores assigned. The sets of criteria are divided into first-order (deemed essential) and second-order (deemed desirable).

In identifying the appropriate criteria we draw on the considerable work that has been carried out in this area by official agencies, NGOs and policy-makers.

The first-order criteria are:

- **SUFFICIENCY** – where the funds generated are substantial enough to be part of a 'portfolio' of mechanisms which could collectively raise a significant proportion of the annual $100 billion estimated requirement for mitigation and adaptation.
- **PREDICTABILITY** – where funds are generated in as stable and predictable a way as possible.
- **EQUITY** – where contributions reflect both historical responsibility and capacity to pay.
- **ADDITIONALITY** – where funds are 'new and additional' to existing aid commitments.
- **VERIFIABILITY** – where funds are collected and disbursed in a transparent and verifiable manner.

Second-order:

- **EFFICIENCY** – where as much economic efficiency as possible should be achieved, but not to the extent that it conflicts with the first-order criteria, particularly that of equity.

- **EASE OF IMPLEMENTATION** – where mechanisms that can be readily implemented are preferred, all other things being equal.
- **CO-BENEFITS** – where proposals are preferred that have positive developmental or environmental impacts.

Although we conclude this assessment with a recommendation based on these criteria, it should be emphasised that the primary role of this paper is to establish clear principles and criteria upon which current and future proposals can be assessed. Our intention is to develop a way of thinking about the issues inherent to climate change financing. We undertake this by assessing the prospective mechanisms on three occasions through different lenses. A broad scoring system is introduced to differentiate the financing instruments. We conclude with a suggestion of a cluster of mechanisms that could generate $72.5 billion annually to finance mitigation and adaptation measures in developing countries. Notably, the financial transaction tax stands out amongst the other mechanisms in terms of the quantity of revenue that could be generated. This $72.5 billion would go a long way to meeting the $100 billion per year in transfers from developed countries, committed to at COP-15 (Copenhagen).

The full report by Dr Stephen Spratt and Christina Ashford is available at:
www.stampoutpoverty.org/?lid=10939

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