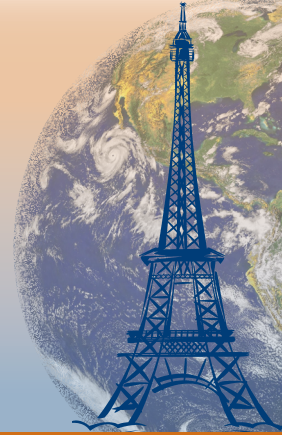


Aid and Climate Finance



Homi Kharas

Senior Fellow and Deputy Director, Global Economy and Development, Brookings Institution


In 2009, the Copenhagen Accord was the first effort to spell out the financial implications of a global effort to reduce carbon emissions. Although not a legally binding document, delegates from all countries attending the COP15 meeting agreed to “take note” of the accord. Developed countries made three financial commitments as a result:

1. to provide \$30 billion for mitigation and adaptation financing for the period 2010-2012;
2. to mobilize \$100 billion per year by 2020; and
3. to make such funding new and additional, and sourced from public and private, bilateral and multilateral institutions.

Currently, there is no guidance on what should be expected from donors in terms of climate finance until the 2020 reference provided by the Copenhagen Accord (as opposed to the 2010-2012 goal). Now, at the COP21 in Paris, the major issues are likely to be how to define and set targets for “new and additional” climate finance; how to monitor the flows of official bilateral and multilateral finance—as well as “catalyzed” or leveraged private finance—in order to achieve the \$100 billion in promised new financing; and how to allocate across countries the portion of climate finance associated with official development assistance, taking into account both climate mitigation priorities and development objectives (especially poverty reduction).

‘New and additional’

From 2010 to 2012, developed countries reported about \$35 billion in fast start finance (FSF) to the UNFCCC. Such climate finance is self-reported by countries to the UNFCCC with a varied level of detail. But compared with official development assistance (ODA), climate finance has less information on specific projects (some data is reported only at the aggregate level), on disbursements (as opposed to commitments), on instrumentality and financing terms, and on recipients and implementing channels. A significant fraction of climate finance is in the form of ODA (an estimated 80 percent for the fast start financing period of 2010-2012), and is identified by “Rio markers,” where donors indicate whether a project has a “principal” or “significant” objective of climate mitigation, or adaptation or both.



Among major donors, only Germany has identified a new revenue source for climate support (from carbon markets) and has specified 2009 as the benchmark year from which to count additionality.

There was an increase in climate-related ODA in the 2010-2012 period, with the amounts recorded by most large donors more than doubling compared to 2009. However, the aggregate volume of aid, including finance-related, did not rise; in constant prices, ODA commitments from DAC donors peaked in 2009 and modestly declined until 2012. Further, a very large increase in climate-related aid was recorded for 2010, the first year of the fast start financing commitment. Since then, flows have stabilized or declined. Taken together, these data suggest that little of the FSF was actually *additional*. Rather, it appears to be associated with a labeling of many development projects as climate-related. In fact, climate-related aid accounted for 20 percent of total country programmable aid in 2013, compared to 9 percent in 2009.

At the project level, it is clear that climate finance is being mainstreamed into development cooperation, with individual examples clearly showing the extensive overlap between development and climate objectives. Japan has tagged its support of metro systems in Delhi, Kolkata, Bangalore, and Ho Chi Minh City as also having climate mitigation purposes. USAID has included dam projects in Pakistan that provide irrigation and power generation services. The United Kingdom counts its support to the Consultative Group for International Agricultural Research to address climate-related threats to food security as part of its climate finance.

Donors have, however, agreed to establish a Green Climate Fund (GCF), with an initial commitment of \$10 billion. As a new mechanism for allocating climate finance, with a new governance structure and a clear balance between climate mitigation and climate adaptation financing, the GCF can be considered genuinely new. Donors have also supported the preparation of Nationally Appropriate Mitigation Action plans and many renewable energy projects. These, too, are clearly additional to what might have been expected as development programs in the absence of climate change.

Measuring climate finance

Although the bulk of FSF was provided by donors in the form of ODA, it is anticipated that this will not be the case for the stepped-up financing that has been promised for 2020 and thereafter. For middle-income countries in particular, there is considerable scope to expand the contribution of multilateral development banks and other official development financing institutions. These entities can both provide low-cost long-term debt financing, needed to make the renewables more cost-effective, for example, as well as risk mitigation, through guarantees and insurance, to leverage private finance.

The issue is that while there are longstanding statistical methodologies and definitions for reporting on ODA, no such methods have been developed for multilateral agencies, bilateral export credit agencies, or the co-financing by private firms of associated climate-related projects. Statistical issues include the need to avoid double-counting (especially when multiple agencies co-finance the same

project), the need to break out the proportion of multilateral finance attributable to developed countries, the definition of “mobilized” or associated private finance (is there a causal relationship involved in co-financing?), the choice between committed funds and disbursed funds, and even the definition of climate finance (for example, there is an ongoing debate as to whether high efficiency coal-fired power generation should be counted or not).

The difficulties involved in measurement are clearly highlighted by the UNFCCC Standing Committee on Finance that concluded that on average between \$40 billion to \$175 billion per year of climate finance was mobilized in the period 2010-2012, of which \$35 billion to \$50 billion was from public sources and \$5 billion to \$125 billion were from private sources. More recently, the OECD has estimated flows of \$52 billion in 2013 and \$62 billion in 2014, with the increase largely attributed to multilateral development bank-funded projects.

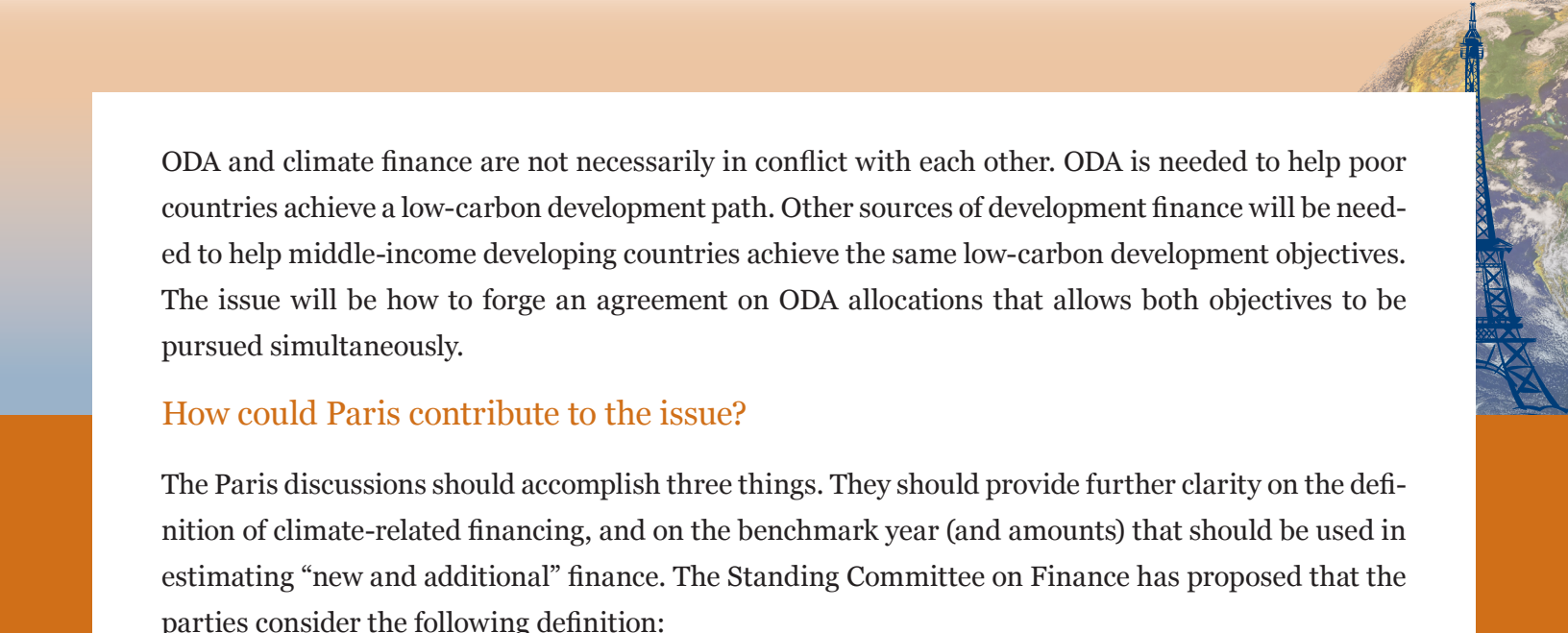
Flows from multilateral banks are set to increase. The World Bank Group, for example, has promised to increase its climate financing from \$10.3 billion today to \$16 billion by 2020. And it hopes to leverage an additional \$13 billion more from others in support of these projects. As such flows expand, the need for transparency, standardization, and accountability in reporting will grow.

The cross-country allocation of climate-related ODA and other finance

Most private finance for climate is currently oriented towards upper-middle-income countries. Multilateral bank climate-related financing is also geared towards middle-income countries. One issue that arises is therefore about the distribution of climate-finance among developing countries. The concern is that low-income countries may not receive the support they require. To the extent that low-income countries are also more vulnerable to climate change than others, they may also receive less than they deserve.

Currently, it appears that a significant fraction of climate-related ODA is a substitute for other development projects and programs. In multilateral development banks, for example, the formula for allocating aid across countries does not take vulnerability to climate change into account. For bilateral aid programs, there is a concern that a shift toward climate finance might also entail a shift toward allocating more aid to middle-income countries. In the absence of significantly higher aid volumes, this could even imply a reduction in ODA for some low-income countries.

This concern is underscored by the history of the allocation of FSF. None of the top 10 recipients of FSF are currently low-income countries. None are on the U.N. list of least-developed countries (LDCs). Only Kenya and South Africa are in sub-Saharan Africa. Yet countries in these categories are priorities for donors committed to poverty reduction. If the allocation of climate finance follows the allocation of FSF, and if the share of climate-finance in ODA continues to rise, then low-income, African and “LDC” countries could see a reduction in their ODA instead of the hoped-for increase as promised in the Addis Ababa Action Accord.



ODA and climate finance are not necessarily in conflict with each other. ODA is needed to help poor countries achieve a low-carbon development path. Other sources of development finance will be needed to help middle-income developing countries achieve the same low-carbon development objectives. The issue will be how to forge an agreement on ODA allocations that allows both objectives to be pursued simultaneously.

How could Paris contribute to the issue?


The Paris discussions should accomplish three things. They should provide further clarity on the definition of climate-related financing, and on the benchmark year (and amounts) that should be used in estimating “new and additional” finance. The Standing Committee on Finance has proposed that the parties consider the following definition:

Climate finance aims at reducing emissions, and enhancing sinks of greenhouse gases, and aims at reducing vulnerability of, and maintaining and increasing the resilience of, human and ecological systems to negative climate change impacts.

However, even this definition will need elaboration. For example, the dispute over high-efficiency coal plants referenced earlier could be interpreted to fit this definition (these do reduce emissions compared to current practices), but it could also be argued that such plants do not reduce emissions to levels consistent with what is necessary for only a 2 degree Celsius rise in temperatures. Thus, ongoing technical deliberations over definitions will be needed.

In addition, discussions in Paris should establish clear goals and targets for climate-related finance, starting from now, moving through the current 2020 benchmark, and forward to 2030 or beyond. Such targets will need to be monitored through agreed-upon mechanisms and methodologies. Currently, there are differences in approach among donors in moving from reporting to the OECD’s Development Assistance Committee using Rio markers at the project level, and reporting to the UN-FCCC. Multilateral banks have started to develop a harmonized system of reporting and are working with the International Development Finance Club to agree on measurement practices. The approach to measuring “mobilized” private flows also needs to be formalized and implemented. Ideally, there should be a common platform for aggregating all such flows from the myriad climate finance providers; where this platform should be located and who has the competence to organize it in the most effective way remains an open question.

Finally, the Paris discussions should establish principles for the allocation of various types of climate finance, particularly with regard to the use of aid-related climate finance in middle-income countries, and the share that should be provided to low-income or vulnerable countries. Partly, such principles could be based on the national needs and priorities that emerge out of developing countries’ own plans for low-carbon development pathways.



Developing countries will argue in Paris that climate finance should be largely based on additional ODA. Partly this is because ODA is an intergovernmental flow that is most easily monitored and verified, and partly this is because the high grant element of ODA would provide partial compensation for the climate-related damage that has been created through developed-country emissions. Developed countries, on the other hand, will be looking to the future, arguing that the most important objective will be to provide adequate, low-cost, long-term capital to make low-carbon investments financially attractive. Balancing these viewpoints will help determine how climate finance will be allocated in future.

What can we expect to see after Paris?

Following Paris, we can expect to see continued technical work on refining the measurement of climate-related finance. Debates will inevitably continue as to how to define “mobilization” of private capital. For example, if a country reforms its energy sector policy framework through the support of developed countries (or a multilateral institution), and this then “causes” additional private investment in the sector, should the investments count? Conversely, if a private investment was likely to happen anyway, but an official agency decides to offer a guarantee as a sweetener, should this be counted as additional finance being “mobilized”? While such debates may appear arcane, the definitions provide the incentive structure for how official agencies will behave, and therefore have real consequences.

We should, nevertheless, see considerable, rapid improvement in the transparency and accountability, by agency, of climate-related finance.

We can also expect to see continued debate over the mechanisms through which climate finance should be channeled. The preference of the developing countries is to use the newly established Green Climate Fund, partly because it promises to allocate financing equally to mitigation and adaptation, and partly because it could use countries’ own financing needs as the basis for disbursements. Developed countries may encourage greater use of the multilateral development banks with proven track records but that would need to scale up their ability to lead public-private partnerships in infrastructure projects.

In both cases, an upsurge in private investment in climate-related projects is expected. Given the relatively stable and long-term returns from infrastructure investments, and the low long-term real interest rates prevailing in capital markets in developed countries, there are significant financial incentives for private investors to participate in infrastructure projects in developing countries. If public money is added to the available blend of funds, and the right recipe of technical assistance, risk-mitigation, and dialogue platforms to build trust is found, there could be a tipping point of an exponential rise in project finance. If such a tipping point can be reached, Paris will have been a successful meeting for climate finance.