THE PEW ENVIRONMENT GROUP

COPENHAGEN 101: **CLIMATE FINANCE**

Financing for global responses to climate change will be a central component of negotiations at the 15th Conference of the Parties to the United Nations Framework Convention on Climate Change in Copenhagen. Climate finance is inextricably linked with the three other primary negotiating issues: mitigation, adaptation and technology cooperation.

Conference negotiators will attempt to bridge differences on the scale of financial resources needed, how best to mobilize these funds and what institutional arrangements should be employed to manage the financing of responses to climate change.

THE IMPORTANCE OF CLIMATE FINANCE

Under the climate change Convention, developed countries agreed to mobilize new and additional resources to help developing nations pay some of the costs associated with responding to global climate change. This understanding was reinforced in the Bali Action Plan adopted at the 2007 climate meeting in Indonesia that launched the current negotiating round, in which all countries are expected to undertake additional action to help prevent catastrophic climate change.

Global investment in mitigating and adapting to climate change is in the interest of all countries, including the United States. Investment in developing countries often yields the most cost-effective emissions reductions and creates shared economic opportunities for investors and recipients alike. Similarly, planning now for unavoidable climate change is cheaper and wiser than waiting for crises to flare and then responding. In short, climate finance can be seen as an opportunity to enhance economic prospects and global stability.

HOW MUCH FUNDING IS NEEDED?

The Convention has estimated that the finance and investment requirements of responding to climate change will be $100 billion to $150 billion in 2030.[1] Independent analyses by Project Catalyst[2] and the European Commission have estimated resource requirements at $100 billion to $200 billion annually by 2020. The World Bank has estimated that $75 billion to $100 billion per year from 2010 to 2050 will be needed for adaptation alone.[3]

WHY ARE THE FUNDS NEEDED?

Finance and investments are needed in three primary areas:

- **Mitigation.** Countries will work to reduce the impact of climate change by implementing low-carbon technologies which reduce greenhouse gas emissions and enhance carbon sinks such as solar, wind and bioenergy; carbon capture and storage; and deforestation and afforestation.
- **Adaptation.** Countries will adjust to the effects of climate change through capacity-building, development of risk assessments, early warning systems, and by building strong infrastructure, agriculture, water supply, health and coastal zones.
- **Technology.** Countries will research, develop and deploy low-carbon technologies and efficiency measures aimed at reducing carbon emissions.

WHAT ARE THE FUNDING SOURCES?

A significant portion of the necessary funding will come from each country's resources and current investment flows. However, international negotiators are also contemplating policy agreements that will generate new and additional public and private resources, particularly for adaptation. The financial resources needed to prevent and adapt to climate change are expected to come from a variety of sources including:

- **Voluntary Funding Mechanisms Under the Convention.** The Global Environment Facility is the primary financial mechanism under the climate change Convention. This financial organization allocates about $250 million a year, primarily for renewable energy and energy-efficiency projects. Voluntarily funded by member governments, global institutions and the private sector, the Global Environment Facility has invested $2.7 billion to date and leveraged another $17.2 billion in co-financing. It manages two Convention funds, the Special Climate Change Fund and the Least Developed Countries Fund, which have attracted $300 million in voluntary contributions for adaptation efforts by developing countries.[4] The United States contributed $80 million in fiscal 2009.[5]

- **Carbon Market Finance.** The Clean Development Mechanism, authorized under the Convention's Kyoto Protocol, is an example of carbon market finance. The mechanism allows firms in countries with binding international emissions-reduction goals to purchase offsets in developing countries. This mechanism has mobilized investments of $25 billion.[6]
- **The Adaptation Fund.** Convention parties created this fund to support adaptation efforts. The fund is financed by a 2 percent levy on transactions under the Clean Development Mechanism and is expected to generate approximately $150 million over the next year.[7] Depending on demand for and availability of certified projects (which is expected to be high), the mechanism's levy could generate $500 million to $5 billion annually by 2030.[8]
- **Allowance Auctions.** The auction of emissions allowances at the international or national level also holds the potential to generate substantial resources. For example, the American Clean Energy and Security Act (HR 2454), passed by the U.S. House of Representatives in June 2009, would allocate 7 percent of allowances for international deforestation, clean energy and technology cooperation efforts. The U.S. Environmental Protection Agency has estimated that these allocations, combined with the bill's offset provisions, could generate as much as $465 billion through 2030, or $23 billion a year.[9]
- **Bilateral and Multilateral Assistance.** Other vehicles for financing climate change actions by developing countries are bilateral and multilateral aid to individual countries along with aid sent to Convention funds described above. In its fiscal 2010 budget, the U.S. State Department requested $579 million for international climate change activities as part of its international affairs budget.[10]

With global climate finance resource requirements of $100 billion to $200 billion annually, it is clear that current financing arrangements fall far short of what is required. As a result, various proposals were put aside as part of the Copenhagen negotiating process in order to mobilize new and greater amounts of resources. Mexico has proposed a $10 billion annual green fund that would be financed through an assessment based on a country's gross domestic product, emissions and other factors. Norway has suggested an international auction for a portion of developed countries' shares of international emissions reduction commitments to generate predictable revenue for the mitigation, adaptation and technology needs of developing countries. In a shift in position, the United States indicated in October 2009 that it would accept the establishment of an independent climate fund, although it continues to maintain that support should be voluntary.[11]

KEY NEGOTIATING POSITIONS

At Copenhagen, negotiators will explore how much climate financing is needed and how it should be mobilized and governed.

Frustrated that financial promises by developed countries have not been fulfilled, developing nations are now pressing for significant, predictable new resource commitments from donor nations (over and above current official bilateral and multilateral development assistance). They want a predictable, sizable funding stream that is guaranteed by a set formula, not subject to the vagaries of voluntary national budget commitments. They also want a new, centralized financial mechanism under the auspices of the Conference of the Parties, where developing countries believe they have a more substantial presence (in contrast to multilateral development banks, which are perceived to be controlled by donors). Finally, developing countries have urged that the financial mechanism under the Climate Convention have three distinct funds—one each for mitigation, adaptation and technology.

Developed country parties do not favor the creation of more financial institutions, but rather agree that additional resources can and should be mobilized through the more coherent and efficient existing financial mechanisms under the Climate Convention (e.g., the Global Environment Facility and Adaptation Fund) and parallel multilateral and bilateral programs. Developed countries want to know that plans, programs and projects developed with donor funding are well conceived and likely to produce measurable, verifiable emissions reductions and adaptation improvements. Finally, developed countries are urging rapidly emerging countries such as China, India, Mexico and Brazil to contribute to the public pool of resources provided to the least-developed countries, including those most vulnerable to climatic change.

WHAT TO LOOK FOR IN COPENHAGEN

New Financial Commitments. The European Union has pledged to provide $3 billion to $22 billion annually by 2020 to finance climate change responses in developing countries dependant on the outcome in Copenhagen.[12] Will the United States and other developed countries make specific climate pledges or agree to new, predictable funding mechanisms?

Reform of the Clean Development Mechanism: Negotiators will attempt to streamline operations so that initiatives financed through the mechanism can be dramatically expanded. They will also consider whether projects to avoid deforestation, expand nuclear energy, and capture and store carbon are eligible under the mechanism.

A New Financial Architecture. Negotiators will decide whether a new financial entity, giving developing country parties a greater voice, will be established with the purpose of bringing greater coherence to the current array of financial institutions for climate measures.

The developed and developing nations will need to come together on monitoring, reporting and verifying developed nations' financial and technological contributions to developing nations. Negotiators will be working to bridge the differences in financial scale, and the world will be looking to the United States to offer significant estimated financial contributions.

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