



New, Innovative Sources of Climate Finance Position

May 2015

Climate Action Network International (CAN-I) is the world's largest network of civil society organizations working together to promote government action to address the climate crisis, with more than 900 members in over 100 countries. www.climatenetwork.org

Summary

The gap between the need for adaptation and loss and damage finance and the current finance provided or committed is large and growing. It has been estimated that each year US\$150 billion will be needed for adaptation and loss and damage by 2025, even if warming is kept below 2 degrees. When compared with the currently provided sum of approximately \$20-23bn per year and the current warming trajectory of approximately 4 degrees, the scale of the challenge is clear. There is also a growing gap in mitigation finance. Finance for mitigation needs to increase urgently in order to keep warming below 1.5 degrees.

This briefing paper identifies a number of potential new sources of climate finance. Some of these “new” sources of finance have been under discussion for a number of years within the High Level Advisory Group on Finance, the Leading Group on Innovative Finance and others. They include a **Financial Transaction Tax (FTT)**, a **fossil fuel levy (or Carbon Majors Levy)**, **carbon pricing for international aviation and maritime, domestic or regional carbon pricing/carbon markets, and others**. If the political will is generated to fully realise these new sources of finance, they could fill the finance gap that exist.

CAN calls for all parties to work with urgency to bring these new sources of climate finance to fruition, building on work that has already been done and with an emphasis on implementation. Key next steps are outlined in section 4, in brief they are:

- **UNFCCC** - COP21 in Paris to agree to a 2 year work program to explore innovative sources of finance, with a mandate to meet substantial milestones by COP22 and completion of the work program by COP 23. An example text is contained in 4.1.
- **Financing for Sustainable Development (FFsD)** - At Addis Ababa in July, to commit to the continued scaling up and delivery of climate finance flows on top of existing aid with indicators more clearly defined, and specify key instruments to mobilise innovative sources of finance - especially those laid out in this paper.
- **PM Hollande's Innovative Finance Mission** - Make recommendations towards progress of the innovative sources of finance identified in this report.
- **IMO/ICAO** - Make clear progress on sector-wide global emissions reductions targets and implementation of levies and/or carbon pricing mechanisms.

- **Other fora - G20, G7, ADB, International Climate Finance Day** - Offer opportunities for governments and business to recognise the need to increase climate finance, and the potential for new and innovative sources of finance as described in this report, giving impetus to the UNFCCC, FFsD, IMO/ICAO and domestic and regional legislatures.

1. Scale of Need and Gap

Assuming warming is limited to 2°C the UNEP Adaptation Gap Report shows that the additional cost of adaptation and loss and damage for the LDCs alone is likely to be at least US\$50 billion/year by 2025/2030 and possibly double this value (US\$100 billion/year) by 2050. Costs for all developing countries have been estimated at US\$150 billion/year by 2025/2030 and US\$250 billion to US\$500 billion/year by 2050. If warming is higher, the cost of adaptation and loss and damage are likely to rise significantly. A 4°C pathway could potentially double adaptation cost and loss and damage by 2050.¹

Yet public adaptation finance (excluding domestic budgets) to developing countries was only a fraction of this need - estimated by some sources to be in the order of \$20-23bn per year² in 2012/13, only a small share of which is likely to be “new and additional”. The majority of finance for climate adaptation is being drawn from stagnating levels of aid (official development assistance), hence public finance for developing countries is not increasing in the light of the increasing challenges to development in the face of climate change impacts.

While costs for mitigation are decreasing in many areas, in particular through the expansion of renewable energies, there are also significant investment demands. If new sources would, for example, channel money directly into the Green Climate Fund, both adaptation and mitigation action would benefit.

It is clear that both additional public finance (budgetary commitments) as well as new and innovative sources of finance are needed.

2. New and innovative sources of finance: a definition

It is important to clear up any confusion about what is meant by “innovative” sources of finance and how they can contribute to overall climate finance. Innovative sources of finance should continue to be defined as new ways and mechanisms -- such as those laid out in this paper -- to generate additional and complementary resources for international climate finance and sustainable development.³ In recent years, many donor countries and blocs have begun referring to ‘innovative finance’ as a means to leverage finance, mostly in the forms of investments, from the private sector which are then counted and labelled as climate finance. Innovative finance does not - and should not - be exclusively set out to use existing and already scarce public resources to further leverage and incentivise private sector finance.

Innovative finance may play a role in both increasing finance to complement existing public flows and effectively internalise the social and environmental damage and costs incurred by state and non-state actors; for example, through the application of the FTT and the carbon majors levy. We also emphasize previous assertions made by both the Leading Group on Innovative Finance and the UNDP that innovative finance should add further predictability, quality and efficiency to flows of finance, particularly ODA.

3. Potential New and Innovative Sources

¹ UNEP Emissions Gap Report 2014, p26

² calculation based on 90% of \$23-26billion, of which 90% developing countries, as per Buchner et al 2014 in UNEP Emissions Gap Report 2014, p27

³<http://www.cidse.org/publication/content/publications/finance-and-development/sustainable-development-financing.html>

During 2010 significant work was undertaken on innovative sources of finance, including from the Leading Group on innovative finance and High Level Advisory Group on Climate Finance (AGF). New ideas have been explored since then in a range of fora, including the recent Africa Adaptation Gap Report 2, the IMO and ICAO. 2015 is the year to begin unlocking these ideas as the scale and interconnectedness of the climate, sustainable development and poverty reduction, disaster risk challenges become clear, and the need to generate large sums of additional resources is clearer than ever.

The UNEP estimates that between USD 26 billion & USD 115 billion could be raised by 2020 from just 3 innovative sources: auctioning of emission allowances (ETS); revenues from international transportation (Carbon Pricing); and a Financial Transaction Tax (FTT). Other opportunities include a proposal for a Global Fossil Fuel Extraction Levy (to be paid into the Warsaw International Mechanism for Loss & Damage) as well as shifting finance from dormant mechanisms. A short background on each is explored below.

3.1 Financial Transaction Tax (FTT)

A financial transaction tax - also known as a Robin Hood Tax - entails the placement of a miniscule levy on the trades of stocks, bonds and other financial instruments.

Eleven European countries are in the process of establishing a regional FTT, with the goal of having it operational by 2016. Recently French President Francois Hollande announced his initiative⁴ to organise a meeting of the 11 countries to reach an agreement at the earliest on committing FTT revenues to the Green Climate Fund (GCF) and a mechanism to implement this. This announcement shows that France has realised the importance of climate finance in reaching a global climate agreement in Paris at the end of this year. However, the details of this announcement still need to be specified and more importantly delivered. France and its European partners have to work with their other European partners to: 1) set a minimum amount of revenues that would be mobilised by the FTT, for example, EUR 35 billion per annum as proposed by the EU commission; 2) commit to earmark the majority of these revenues to international solidarity and the GCF, and; 3) set a deadline by the end of 2015 to finalise this process so that the FTT is implemented by 2016.

Other developed countries should also establish a comprehensive FTT and dedicate significant portions of revenues for international climate finance, including to the GCF.

3.2 International Aviation and Maritime Transport

Carbon pricing for the sectors of international aviation and maritime transport have been identified as potential sources of revenue for, inter alia, the following reasons:

- Fuels used for international transport are currently exempt from taxation, unlike domestic sectors;
- Emissions from these international sectors are not included in national emissions targets, and are the fastest growing emissions of any sector globally;
- Carbon pricing – levies or carbon markets – applied in a fair and equitable way can be effective ways to achieve emissions reductions in these sectors, as well as raising revenue that can be used for climate change adaptation and mitigation;
- These sectors can raise substantial revenue for climate finance - the AGF estimated that a carbon price of \$25 per tonne on international transport emissions could generate around \$30 billion in total revenue annually, of which over \$10 billion could be used for climate finance as a contribution from developed countries.

Market-based Measures (MBMs) – Carbon Pricing – have been under consideration in the International Maritime Organization (IMO) and International Civil Aviation Organization (ICAO) for well over a decade during which time very little progress has been made. The shipping industry itself, after supporting global

⁴ <http://www.euractiv.com/sections/development-policy/hollande-will-use-fft-fight-climate-change-311098>

MBMs as an alternative to a patchwork of regional measures, withdrew its support when it became clear that the EU would not proceed with implementation of strong regional measures. The environmental integrity of ICAO's proposal of carbon neutral growth after 2020, through a market-based mechanism, is in doubt. And efforts to use the MBM as a means of raising revenue are being resisted. Other types of MBMs including those that could generate revenue to be used for climate finance are still officially on the table, though receiving little attention.

Neither IMO nor ICAO have agreed to an emissions reduction target. Both sectors have argued that a carbon price will have little utility in controlling emissions, given the historically high fuel prices in recent years. The recent drop in fuel prices, however, undermines this argument and has already resulted in changing practices such as speeding up ships that result in lower efficiency and higher emissions.

The recent proposal from the Marshall Islands for the IMO to set a sector-wide international shipping emissions reductions target⁵ is welcome - and IMO member states should move to adopt and implement this quickly.

Given the slow pace and apparent lack of determination of the IMO and ICAO to take effective and timely action to control emissions from the respective sectors, it is essential that the UNFCCC retain a role in ensuring that these sectors make a fair contribution to global emissions reductions efforts, as well as to generating revenue to address the impacts of their emissions. The negotiations towards the Paris agreement and the high-level political attention should result in an additional push and high-level agreement for using these sources.

Appropriate mechanisms that can be the basis for differentiating between countries based on their level of development, capacities and responsibilities, while respecting the approaches and customary practices of these bodies have been proposed, and should be implemented.

In December 2008, at COP 14 in Poznan, Poland, the LDC Group submitted a proposal for an International Adaptation Passenger Levy (IAPAL) to levy a small passenger charge for international flights – differentiated with respect to the class of travel – to raise between \$8bn and \$10bn annually for adaptation in the first five years of operation, and considerably more in the longer term. Being international and dependent only on the evolution of the air travel demand – and not on bilateral replenishment – the funds raised were meant to be truly be new and additional, as well as significantly more predictable than traditional funding mechanisms.⁶

3.3 Fossil Fuel Levies

A global fossil fuel extraction levy (a “Carbon Majors Levy”) would provide a new source of finance and ensure that the fossil fuel industry pays for the climate loss and damage that their products are causing.

A proposal on how a Carbon Majors Levy could work was made in June 2014⁷ and uses recent science that attributes 63% of emissions in the atmosphere to 90 specific entities, known as the Carbon Majors - including investor and state owned entities such as Chevron, ExxonMobil, Saudi Aramco, BP, Gazprom, and Shell, and states such as the former USSR, China, Poland and Russia⁸. It is based on existing international law and precedents for such a scheme – including the oil spill regime (IOPC) where companies that ship oil pay a levy into an international mechanism that provides compensation in cases of oil spills.

⁵ http://www.marinelog.com/index.php?option=com_k2&view=item&id=9039:marshall-islands-calls-for-imo-action-on-ship-ghg-emissions&Itemid=227

⁶ International Air Passenger Adaptation Levy proposal made by the LDCs in 2008, see: http://www.eurocapacity.org/downloads/ecbi_Brief_-_IAPAL_13_Q&As.pdf

⁷ <http://climatejustice.org.au/issue/carbon-majors/>

⁸ The 2013 Carbon Majors Report has more recently been updated with the finding that emissions traced to the carbon fuels and cement produced by the 90 Carbon Major Entities through to 2013 total 939 GtCO₂, or 65% of all anthropogenic CO₂ since 1751. <http://www.climateaccountability.org/pdf/Media%20Outline%20Dec14.pdf>

Equity, or differentiation, can be incorporated via a process that would allow developing countries at a low level of development to “opt-out” by keeping the funds raised by the levy on fossil fuel extraction within their own budgets for climate change purposes⁹.

The fossil fuel extraction levy is a new idea within the UNFCCC negotiations, and could provide a new source of finance, with the co-benefit of placing a price on carbon. Initial estimates are that at a low level of \$2 per tonne of CO₂e the levy would raise approximately \$50 billion per year.

A related concept is the fossil fuel tax proposed by Ecuador to OPEC and within the UNFCCC. The “Daly-Correa tax”¹⁰ would impose a 3-5% tax on every barrel of oil exported to rich countries, potentially raising \$40-60 billion a year. This concept is contained within the current Geneva negotiating text¹¹.

An agreement at Paris to explore the concept of a fossil fuel extraction levy, with a mandate to the Standing Committee on Finance (or similar) would provide Parties with enough time to consider and implement the concept, to ensure that sufficient funding can be generated, e.g. for the International Mechanism for Loss & Damage.

3.4 Carbon pricing and carbon markets

Mechanisms to price carbon at national levels help internalise the cost of pollution and are central to many governments' efforts to reduce emissions. As a result of carbon pricing, such mechanisms raise revenues, which could play a significant role in raising finance for climate action, domestically for all countries, and internationally for those countries with greater capacity and responsibility.

The adoption of such mechanisms should be accompanied by agreed standards and rules for the use of the revenues they generate. The EU's Emissions Trading Scheme is a particular case in point, as it urges EU Member States to allocate 50% of revenues from the auctioning of emissions allowances for climate action, though this is not an obligation. In 2013, EU Member States used 87% of auction revenues amounting to EUR 3 billion for climate action, though the large majority of this was used domestically and it is unclear how much of this simply displaced other domestic budgetary sources. From the finance generated, less than EUR 500 million, or just 13%, of these revenues went to international climate finance, from just five EU Member States. This initiative should go further to support efforts to raise international climate finance and provide an example to other countries setting up carbon pricing mechanisms. However, it is worth noting that the unpredictability of carbon market auction revenues means that these should be conceived as part of a broader package of financing.

In July 2015, the European Commission is expected to present a proposal to reform the EU ETS for the period 2020-2030. This presents the EU and its Member States with a concrete opportunity to deliver additional international climate finance in two re-enforcing ways:

1. Member States should seek to establish an ETS International Climate Fund, which can be replenished by a percentage of total auctionable permits to be withheld at European level before permits are distributed to Member States. The Fund would channel revenues directly to the Green Climate Fund for mitigation and adaptation actions in developing countries. Depending on the percentage of allowances dedicated in this way, and dependent on the carbon price, climate finance contributions

⁹ <http://climatejustice.org.au/discussion-paper-opt-out-process/>

¹⁰ <http://www.theguardian.com/environment/2012/nov/21/oil-nations-carbon-tax-climate-talks> and <http://www.rtcc.org/2013/02/26/ecuador-finalising-opec-carbon-tax-plans/>

¹¹ <http://www.rtcc.org/2013/02/26/ecuador-finalising-opec-carbon-tax-plans/> para 128.1b.

generated by the EU carbon market could deliver between 1 to 6 bn a year additional to existing contributions to the Green Climate Fund¹².

2. Changing the current rules to stop giving emissions allowances for free to companies, hence generating billions in finance.

3.5 Other Mechanisms

The Sustainable Development Mechanism (SDM) unit in the UNFCCC secretariat has a large surplus of money (almost USD 150 million) as a result of the levy on Certified Emission Reduction (CERs) that goes to the UNFCCC secretariat. At least half of this could be directed to the Adaptation Fund.

Also, the proposed 2015 budget to focus on scaling up the CDM is USD 28 million. Either shifting this amount towards other goals or amending the current mandates to include capacity building initiatives on non-market based mechanism that currently have budgetary constraints, for example, capacity building for governments on NAMA implementation and design, will be of more beneficial use.

Other options that could be considered include Special Drawing Rights and Debt Conversion/ Debt-Climate Finance Swap. Exploration of all innovative finance options should ensure their implementation incorporates equity and fairness, they generate additional and complementary resources for international climate finance and sustainable development, and add further predictability, quality and efficiency to flows of finance.

4. Next steps in the UNFCCC, G7, G20, FFsD, IMO, ICAO etc

In order to build on the work already undertaken on new and innovative sources of finance, and to help meet the urgent scale-up of climate finance required, we recommend the following next steps.

4.1 UNFCCC

At COP21 in Paris, countries should agree a [1 or] 2 year work program to explore innovative sources of finance, with a mandate to report back and make recommendations to the COP at both COP 22 and COP 23 on how to implement new and innovative sources of finance.

Example text that should be agreed at Paris:

Acknowledging that alternative sources of finance have the potential to provide substantial new sources of finance, Parties agree to collectively work to identify and mobilise alternative sources of finance and identify and establish any new instruments required. Therefore Parties decide to launch a work program to be undertaken by the [SCF] [alternative body] to identify alternative sources of finance, with a view to mobilise alternative sources of finance in the soonest possible timeframe, with new and additional finance flowing from alternative sources by 2020. This work program will consider such sources as, inter alia:

- Consideration of a levy on fossil fuel extraction to provide financial support to the Warsaw International Mechanism for Loss and Damage;
- A tax on oil exports from developing to developed countries to be established; [from paragraph 53.1b]
- An international renewable energy and energy efficiency bond facility to be established; [from paragraph 53.1c]
- Parties encourage the International Civil Aviation Organization and the International Maritime Organization to develop a fair levy scheme to provide financial support for the Adaptation Fund. [from paragraph 47.5]
- Other sources as appropriate.

¹² source: forthcoming Oxfam research

The work program will ensure alternative sources are developed in such a way as to avoid incidence on countries at a low level of development. [based on paragraph 53.c]

The work program will consider the potential for alternative sources of finance to maximize co-benefits such as, inter alia, providing a price signal on carbon.

The [SCF][alternative body] will report to COP on progress of the work program, with a view to substantial milestones being met by COP 22 and the completion of the work program by COP 23.

4.2 Financing for Sustainable Development (FFsD)

The FFsD Conference in July should set an ambitious precedent for international commitments on sustainable development financing, and it should make a positive contribution to the UN climate negotiations taking place later in the year in Paris. It is crucial that the FFsD outcome advocates for strong integration of climate change objectives into overall sustainable development financing. The FFsD should also advocate for the continued scaling up and delivery of climate finance flows on top of existing aid that are consistent, predictable and measurable with more clearly defined indicators for meeting targets.

FFsD should include a commitment that both the level of climate finance support and the level of ODA net of climate finance will continue to increase. This should be pursued while ODA and all other flows of public finance become increasingly climate proof. Sending these signals on both overall financial flows and specific climate finance flows will be essential to meet the needs of developing countries.

The current Zero Draft for the Addis Ababa Accord highlights the need to mobilize support for innovative sources of finance (para 62). It points to some of the key instruments that we have laid out in this paper, including the expansion of countries participating in the financial transaction tax, carbon taxes and a tax on international transport fuels. Advancing efforts towards the operationalisation and implementation of these mechanisms should be strongly advocated for at both the national and international level. The FFsD is one of the first opportunities to do this and to anchor a strong political commitment to ensure more consistent flows of climate finance through innovative sources.

Countries should use the efforts of the FFsD negotiations to champion instruments for additional sustainable development and climate finance.

4.3 PM Hollande's Innovative Finance Mission

Pascal Canfin and Alain Grandjean, who have been commissioned by French Prime Minister Hollande to deliver a report on new and innovative sources of financing, should consider all of the innovative sources of finance identified in this report, and the proposed next steps identified here. We look forward to their recommendations being a valuable contribution to expediting the implementation of truly new and innovative sources of finance that will help fill the finance gap.

4.4 IMO/ICAO

ICAO need to amend their policy on taxation in the field of international transport to support the introduction of a global tax on international aviation. ICAO's model agreements should be amended and the exemption should be negotiated out of Air Service Agreements. This can begin with developed countries, with the EU taking the lead in amending its Energy Taxation Directive to introduce such taxation on an intra-EU level. States can also introduce departure taxation as an alternative means of raising finance from this sector, provided the funds are earmarked for climate finance.

ICAO's process for drafting a global market-based measure should also consider using the scheme to raise climate finance. This can be achieved through a fair levy on trading, as occurs with other market based measures, or through use of revenues from any allowance auctioning.

IMO has failed to set an emissions target, and emissions from the sector are expected to increase between 50% and 250% by 2050. The fall in oil prices will undermine efforts to rein in this increase. Along with other measures, such as improving the stringency of the Energy Efficiency Design Index, IMO and its parties must consider a levy or carbon pricing system for international shipping to encourage greater efficiencies in the sector and adopting the proposal from the Marshall Islands for a sector-wide global emissions reduction target.

4.5 Other fora - G20, G7, ADB, International Climate Finance Day

Other fora that offer opportunities for governments to recognise the need to increase climate finance, in particular for adaptation and loss and damage, and the potential in new and innovative sources of finance (as described above), and give clear signals to the UNFCCC, FFsD, IMO/ICAO and domestic and regional legislatures that such sources of finance should be implemented as soon as possible, include:

- G20 Finance Ministers Meeting in May
- G7 Finance Ministers Meeting in May
- ADB Asia-Europe Meeting (ASEM) Finance Ministers Meeting

At the **International Climate Finance Day** on 22 May business can play a role by encouraging governments to establish the regimes identified above and hence boost climate finance.