Government of India Submission on

Financing Architecture for Meeting Financial Commitments Under The UNFCCC

Background & the Legal Basis

1. Addressing the impact of climate change and climate variability by raising adaptive capacity i.e. protecting people from climatic adversity; and avoiding the large scale world-wide climate hazards linked to anthropogenic activities i.e. protecting the climate from the production and consumption patterns of people by mitigating GHG emissions are the two major public goods challenges of our time. The current global architecture for delivering and financing these public goods is mandated under the multilaterally negotiated United Nations Framework Convention on Climate Change (UNFCCC).

2. Specifically with respect to financing, the framework provides for new, additional, adequate and predictable financing by developed country Parties to developing country Parties to implement the UNFCCC (hereafter the Convention). In this regard, Article 4.3 (provision of new and additional financial resources to meet the obligations of the developing country Parties under clause 12 paragraph 1 and to meet the agreed full incremental outlays, including for the transfer of technology, required by the developing country Parties for implementing measures included under Article 4.1); Article 4.4 (assistance to meet the costs of adaptation); and Article 4.5 (promotion, facilitation and financing of the transfer of, or access to, environmentally sound technologies and know-how) of the Convention, all lay down legally binding commitments on the part of developed country Parties to provide such financing. Article 4.8 (on funding for response measures especially in vulnerable developing country Parties); and Article 4.9 (on funding for least-developed countries) of the Convention also detail legally binding commitments of developed country Parties to provide funding to developing country Parties.

3. The foregoing commitments by developed country Parties are at the core of the balance of commitments between developed and developing country Parties as reflected in Article 4.7, which states that "The extent to which developing country Parties will effectively implement their commitments under the Convention will depend on the effective implementation by developed country Parties of their commitments under the Convention related to financial resources and transfer of technology and will take fully into account that economic and social development and poverty eradication are the first and overriding priorities of the developing country Parties". And precisely the same balance is captured under section 1b(ii) of the Bali Action Plan.

Additionality of Resources & Financing Instruments

4. The financial resources committed under the Convention cannot be new and additional if they merely divert any existing or likely resources, including

ODA and other net foreign inflows, available for economic and social development and poverty alleviation to developing country Parties.

5. Further, to the extent that the incremental lifetime costs of investment in adaptation and mitigation are positive, they would have to be fully recompensed if economic and social development and poverty alleviation are not to suffer. This is true for both private and official sources of such new and additional funding. Only a grant that results in a resource transfer can truly recompense such positive incremental costs[1] in full without impacting social and economic development and poverty alleviation – the recognized first priority of the developing country Parties under the Convention. As an example, carbon markets under CDM actually pay for such positive incremental costs in full and thereby preserve the socio-economic viability of the underlying investments despite the higher costs of mitigation. While incremental lifetime costs must only be funded through new and additional grants and resource transfers, the base costs of economic and social development can be funded by a range of current or new financial instruments offered by bilateral, multilateral or domestic/foreign market sources. And indeed Article 11.5 of the Convention specifically refers to such bilateral, regional and multilateral channels being sources for resources for implementation of the Convention. Instruments that fund these base costs can include traditional equity and loan investments, concessional loans, loan guarantees or other risk mitigation structures, and a range of funds for acquisition, development, deployment and diffusion of technologies.

Projected Funding Needs

6. The UNFCCC has estimated a requirement of US$ 200-210 billion in additional investment in 2030 to return GHG emissions to the current level. Further, additional investment needed worldwide for adaptation is estimated to be US$ 60-182 billion in 2030 by UNFCC, inclusive of an expenditure of US$ 28-67 billion in developing countries. Incremental investment needed by developing countries for adapting to projected impacts of climate change is estimated as US$ 10-40 billion per annum by the World Bank and Oxfam estimates this number to be US$ 50 billion per annum. The UNDP estimates that incremental investment needed for adaptation alone could amount to US$ 86 billion per annum by 2015. Not only do these numbers vary widely among themselves, they are a fraction of UNFCCC's own estimate that peg the incremental cost of addressing climate change at 0.3-0.5% of global GDP or Lord Stern's revised estimate of 2% of global GDP. At current levels of global GDP this range translates to US$ 165 billion to US$ 1.1 trillion.

7. The above broad range of estimates is not surprising for we are still struggling to fully understand the science of climate change. Hence, we need to learn by doing and not wait for elimination of all uncertainty because costs of impacts

[1] Incremental costs hereinafter refer to both the incremental investment cost and the incremental lifetime costs where applicable. Such incremental costs will need to be fully recompensed through resource transfers (typically under bilateral arrangements) or grants (typically multi-lateral arrangements) that effectively result in resource transfers to the developing countries.

from climate change will be a multiple of the estimates made if we fail to act immediately.

Funding Sources

8. Clearly the magnitude of funding needs is enormous compared to what is available under the current financial mechanism of the Convention. The funding committed to GEF, for various funds managed by it, is US$ 1.3 billion for the period 2007-10. The funds managed by GEF for adaptation total about US$ 275 million and since 2005 GEF has provided US$ 110 million for adaptation projects. The Adaptation Fund to be built up from 2% of CDM flows is expected to amount to US$ 100-500 million by 2012. Tapping other flexibility instruments will, at best, add increments of similar magnitude. The carbon markets have the potential for raising larger sums. However, this requires very deep emission reduction targets (potentially negative emission obligations for some developed country Parties) that are legally enforceable. And while carbon markets may be able to fund incremental costs of mitigation under certain scenarios, funding for incremental costs of adaptation would require resource transfers or grants.

9. It is stressed that the proposed funding sources cannot be voluntary providers of funds because voluntary contributions are not predictable and cannot service legal commitments under the Convention. Further, the commitments under the Convention to fund the incremental costs of addressing climate change cannot be treated as aid or assistance under a donor-recipient platform. Finally, as already stated, agreed incremental costs of combating climate must be funded with resource transfers or grants. Keeping these requirements in mind, the following funding sources are proposed (as stated above, the base costs would continue to be funded through normal channels in accordance with current practices):

a) Annual contributions equal to 0.5% of the total GDP of the developed world for funding full agreed incremental costs of adaptation and mitigation through resource transfers or grants. Individual country contributions may be decided multilaterally on the basis of historical responsibility for GHG concentration, current emission levels, per capita GDP etc. Each developed country Party or any grouping of developed country Parties would be free to decide the means for raising these contributions through country specific or region specific auctioning of emission rights, carbon taxes, and specific levies on sectoral emissions or any other means considered feasible within their borders.

b) Any levies on international travel or use of marine haulage that are negotiated under the Convention.

c) Any private sources of grant funding on a voluntary basis.

d) Any other grant funding or contributions on a voluntary basis.

Institutional Base/Governance of the Financial Architecture

10. Although the Convention is silent on the choice of an Institution to manage the funds made available, it is quite explicit in stating under Article 11.1 that the proposed financial mechanism "shall function under the guidance of and be accountable to the Conference of the Parties, which shall decide on its policies, programme priorities and eligibility criteria". Article 11.2 further states that the "financial mechanism shall have an equitable and balanced representation of all Parties within a transparent system of governance". While creating the Adaptation Fund (AF) the foregoing provisions were fully adhered to. At Nairobi the second meeting of the CMP actually decided that the AF should be under the 'authority' of the COP in addition to the requirement of 'being under the guidance and accountable to'. The Nairobi decision also adopted "a one country one vote" rule in relation to the operation of the AF and a majority representation for developing countries on the governing body (Decision 5/CMP.2.para 3). CMP.3 at Bali created the Adaptation Fund Board with a majority of members from developing countries and designated representatives from the two main recipient interest groups i.e. Group of Least Developed Countries and the Alliance of Small Island States. Moreover, it was decided that Parties should have direct access to the funds, and the involvement of the GEF and the World Bank in the running of the AF was reduced to an interim provision of secretariat and trustee services respectively. The AF structure succeeded in developing an equitable and balanced representation of all parties within a transparent system of governance as required under Article 11.2 of the Convention. The same is true for the Multilateral Fund under the Montreal Protocol.

11. Anything short of the above precedents would be a step backwards and, hence, the proposed financial architecture must be under the direct control of COP as detailed in paragraph 10. An Executive Board, with an equitable and balanced representation of all Parties, appointed by COP must manage the proposed financial architecture. A professional secretariat and appropriate technical committees that establish eligibility, evaluation and compliance criteria, in conformance with the Convention, would assist the Executive Board. Direct access to funding by developing country Parties and their involvement in every stage of the process, through the COP, will make the architecture demand driven. A Trustee selected through open competitive bidding among reputed and pre-qualified institutions would administer the funds.

12. It must be recognized that any funding that is pledged or becomes available outside the governance structure foreseen under the Convention and highlighted above, cannot be counted towards the fulfilment of the commitments made by developed country Parties under the Convention. The Convention would be undermined if parallel initiatives outside the governance structure foreseen by the Convention are considered towards fulfilment of commitments of developed country Parties under the Convention

Eligible Countries/Entities

13. Although establishing detailed and formal country eligibility criteria is outside the scope of this note, it is conceivable that differentiated criteria could be established for different developing country Parties or groups of developing Country Parties to match their differing needs and vulnerabilities. In general

all developing country Parties would be eligible with special emphasis being laid on the needs of Vulnerable States and Least Developed Countries. For eligible Parties, funds could be made available to national or sub-national governments, private entities within the eligible country or other private or national/sub-national entities (for example, holders of intellectual property rights).

Target Investments For Funding Support

14. The proposed financial architecture should target multiple sectors and support a range of activities that could include though not be limited to the following:

    a) Incremental costs of mitigation across all economic and social sectors.

    b) Incremental costs resulting from deployment and diffusion of commercially available low carbon technologies.

    c) Incremental costs of research and development of clean energy or low carbon technologies

    d) Incremental cost of building capacity and institutional framework in recipient countries.

    e) Full costs of preparing national communications and national action plans and implementation of the same.

    f) Full cost of technology patents and license fee for IPRs covering low carbon technologies.

    g) Full cost of adaptation to climate change.

Funding Verticals and Funding Criteria

15. Establishing various verticals along which funding could be made available under the proposed financial architecture or the various criteria that warrant funding is also beyond the scope of this note. Suffice it to say that the proposed financing architecture should be organized into functional windows to address specific requirements such as a Technology Acquisition and Technology Transfer Fund for available climate friendly technologies, a Venture Capital Fund for emerging climate technologies, Collaborative Climate Research Fund, Adaptation Fund etc. The financing architecture could integrate other funds operating under the Kyoto Protocol to avoid duplication. It might be argued that the proposed financial structure would be unwieldy and ineffective because of concentration of all activities under one umbrella. It is pointed out that the only unifying force is a common architecture of governance, funding and investment policies under the direct control of and accountable to COP. Each vertical will be operated and will grow independently under this common architecture.

16. The criteria established for funding specific investments would largely be linked to outcomes and shall not enforce co-financing from certain specified sources or harsh conditionalities that go beyond the objectives that address

climate impacts as laid down under the Convention. The assessment criteria could, among other measures, include the following:

a) Impact on adaptive capacity and mitigation beyond business as usual.

b) Adaptive capacity realized or emissions mitigated per unit of investment.

c) Conformity to a host country's national program.

d) Contribution to the host country's sustainable development objectives.

Ability to fund the base costs directly or through other sources subject to the proposed financial architecture providing grants or resource transfers to fund all agreed incremental costs related to addressing climate change.