Proposal by the LMDC on Definition of Climate Finance for the consideration of the Standing Committee on Finance

This submission is made by Bolivia on behalf of LMDC pursuant to Decision-8a/CP.26, para 12(LTF), Decision-8b/CP.26-para 6, 7 and 8(SCF), in the 26th session of the UNFCCC Conference of the Parties (COP). Para 7 of the decision requires the Standing Committee of Finance to continue its work on definitions of climate finance, considering the submissions received from Parties on this matter, with a view to providing input for consideration by the Conference of the Parties at its twenty-seventh session (November 2022).

Background

The commitments under the UNFCCC (hereinafter 'the Convention') and its Paris Agreement hinge on the principles of equity and common but differentiated responsibilities and respective capabilities (CBDR RC). The Convention and its Paris Agreement accept that climate change is a global phenomenon requiring collective efforts of all countries. The differentiation comes from the fact that the contribution to the problem of greenhouse gas (GHG) emissions has not been equal i.e., developed countries have been primarily responsible for the stock of carbon in the atmosphere. They also have greater capabilities to remedy the situation. The multilateral agreements, therefore, established the hierarchy in the responsibility across countries with the onus on the developed countries to provide the financial resources and technology and to enable the developing countries in their climate action.

The UNFCCC refers to climate finance as local, national, or transnational financing—drawn from public, private and alternative sources of financing—that seeks to support mitigation and adaptation actions that will address climate change. It also states that by the principle of "common but differentiated responsibility and respective capabilities" set out in the Convention, developed country Parties are to provide financial resources to assist developing country Parties in implementing the objectives of the Convention.

However, developed countries have started diluted the provision by not conforming to the principles and provisions of the Convention.

There is an urgent need to discuss different issues related to finance, such as the nature of the financial resource—whether the resource is new and additional or a mere reassignment of ODA to climate action projects; whether it is loan or grant; the period for which it would be provided; and the need for balance between mitigation and adaptation. These elements or characteristics of climate finance are laid out quite lucidly in the Convention and its Paris Agreement and must be the basis of the definition of climate finance. This is critical because the absence of a multilaterally agreed definition of climate finance has impacted the ability to track and assess the resource.

At present, there are different estimates of the extent to which the mobilization target has been achieved. The fourth Biennial Assessment of the Standing Committee of Finance presented an updated overview and trends in climate finance flows until 2018. The assessment mentioned that the total public financial support reported by Annex II Parties in October 2020 amounted to USD 45.4 billion in 2017 and USD 51.8 billion in 2018. This needs to be juxtaposed with the OECD estimates of USD78.3 billion in 2018 and USD79.6 billion in 2019. On the other hand, Oxfam (Climate Change Shadow report, 2020) estimated climate finance at $59.5bn per year in 2017–18, however, the climate-specific net assistance was estimated to be only USD$19-22.5 billion. Consequently, there is a need for greater clarity on the elements that should go into estimating climate finance.

The lack of an agreed operational definition for climate finance has resulted in uneven reporting by developed countries of their climate finance contributions under the UNFCCC, for example, through their biennial reports. It has also resulted in inconsistency in reporting by developing countries concerning climate finance needed and received. And finally, given that there is no institutionalized process within the UNFCCC to compare and match the flows reported by the developed countries with what the developing countries have received, there is no clarity of the extent to which the climate finance commitments under the UNFCCC and under the Paris Agreement are being met and whether these address the needs of developing countries.

To remedy this situation, a clear and operational definition of climate finance is needed. Such a definition should be consistent with the provisions of the UNFCCC and its Paris Agreement.

Principles enshrined in the UNFCCC and its Paris Agreement—A discussion of the relevant provisions with the view to derive the elements of climate finance.

The UNFCCC mandated the developed countries to take the lead in combating climate change with the responsibility to provide financial resources to the developing countries to meet the full cost and the incremental cost of climate action. Finance provisions under the Convention and its Paris Agreement are based on the principles of equity and common but differentiated responsibilities and respective capabilities; transparency, adequacy, and precautionary approach. The concept of "climate finance" as a financial resource that flows from developed to developing country Parties is founded on the provisions of Articles 4.3, 4.4, and 4.5 of the UNFCCC and is supported by Articles 9.1 and 9.3 of the Paris Agreement. These provisions require "the developed country Parties and other developed Parties included in Annex II" of the UNFCCC to provide financial resources to developing country Parties to cover the latter's costs with respect to reporting on their climate change actions, implementation of mitigation and adaptation actions, financing of technology development and transfer. In implementing their obligations to provide climate finance under Art. 4.3, 4.4, 4.5, 4.8, 4.9 of the UNFCCC and the relevant Articles 9.1, 9.3, 9.4, 9.5, and 9.7 of the Paris Agreement, the Annex II developed country Parties are required to:

- Provide "new and additional financial resources" to meet the (a) "agreed full costs" of meeting the developing country obligations under article 12(1) and (b) "agreed full incremental costs" of climate actions covered by article 4.1, including costs of transfer of technology (Article 4.3)

- Ensure that the financial resources provided to support developing countries with respect to their reporting and implementation of climate change actions under the UNFCCC are "new and additional" (Art. 4.3, first and second sentences).

- "Take into account the need for adequacy and predictability in the flow of funds and the importance of appropriate burden sharing among the developed country Parties" (Article 4.3, third sentence).

- "Give full consideration to what actions are necessary under the Convention, including actions related to funding, insurance and the transfer of technology, to meet the specific needs and concerns of developing country Parties arising from the adverse effects of climate change and/or the impact of the implementation of response measures" (Art. 4.8). Article 9.3 of the Paris Agreement requires the developed countries to support country-driven strategies and consider the needs and priorities of developing country Parties. It also goes on to state that such mobilization of climate finance should represent a progression beyond previous efforts.

- "Take full account of the specific needs and special situations of the Least Developed Countries in their actions with regard to funding and transfer of technology" (Art. 4.9). Article 9.4 of the Paris Agreement also mandates that the provision of scaled-up financial resources should aim to achieve a balance between adaptation and mitigation, taking into account country-driven strategies, and the priorities and needs of developing country Parties, especially those that are particularly vulnerable to the adverse effects of climate change and have significant capacity constraints, such as the Least Developed Countries and Small Island Developing States, considering the need for public and grant-based resources for adaptation.

On transparency, Article 12.3 of the Convention requires the developed countries to "incorporate details of measures taken in accordance with Article 4, paragraphs 3, 4 and 5" in their national communications– i.e. Annex II developed country Parties are required to report on their provision of climate finance to developing country Parties as a mandatory element in their national communications and other reports under the Convention, including the biennial reports (and now in the biennial transparency reports under the Paris Agreement).

Additionally, Art. 11.1 of the UNFCCC envisions that the developed country Parties would provide the financial resources pursuant to Art. 4.3, 4.4, and 4.5 through the Convention's Financial Mechanism "on a grant or concessional basis."

The provision of climate finance from developed to developing country Parties is integral to the balance of commitments between these Parties under the UNFCCC, as clearly indicated by Art. 4.7 of the UNFCCC 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."

These obligations of Annex II developed country Parties under Art. 4.3, 4.4, and 4.5 of the UNFCCC to support developing country Parties with respect to climate change action reporting, implementation of climate change actions, adaptation costs, and technology development and transfer continue under the Paris Agreement. The provisions in the Convention are complemented by the various provisions relating to climate finance actions and reporting by Annex II developed countries under the Paris Agreement, such as Art. 7.13, 9.1, 9.3, 9.4, 9.5, 9.7, 10.6, 13.4, 13.9, and 13.15.

Elements of climate finance assistance provided by the developed countries

Stemming from the provisions mentioned above, Climate finance provided by the developed countries must include the following elements:

a. These resources must be ***new and additional***. This implies that the resources for climate action should be over and above the existing provision for development projects. The Convention and the Paris Agreement recognize that developing countries need resources for their development and poverty eradication. Therefore, reallocation of resources from development projects to climate actions would hit the very tenets of the Convention and Paris Agreement. The developing countries are therefore seeking transparency on whether the resources mobilized by the developed countries are new and additional or these have merely been reallocated away from other development projects.

b. ***Climate specificity*** in the provision of climate finance is important. Resources need to be earmarked for climate action and should not be incidental flows. Climate specificity will also enable developing countries to seek higher allocation for adaptation.

c. Resources for climate action can be channelized through ***public or private sector sources, prioritizing public sources and grants***. Even in the context of financing by developed countries the resources could well be provided from public finance or through private companies. Given the responsibility placed on the developed countries to take the lead in providing resources and in keeping with the commitment under the Convention and the Paris Agreement, climate finance could be an unencumbered grant by the developed country or a concessional loan or guarantees provided by the developed countries to promote private companies to finance climate action in developing countries. This could also include the cost incurred by the developed countries in encouraging their private companies to take on adaptation action in a developing country. In the case of loans, it is important to ensure that the time horizon for loans and the rate of interest charged should be preferably similar to the International Development Association (IDA) loan. Also, Special Drawing Rights (SDR) modality can be used to support financial needs for climate action of developing countries.

d. ***Greater transparency and details of such flows are required***. At present this information is not being made available. Article 9.5 and 9.7 of the Paris Agreement which relates to ex-ante communication on resources to be provided and the ex-post information on resources mobilized through public intervention need to be implemented effectively.

e. It is important that actual ***climate finance flows*** and not just the mobilization by a developed country be considered while determining the extent of support provided by the developed countries. The extent of actual flows will determine the magnitude of climate action that can be taken. Mobilization or even promises to provide alone does not translate to actual flows. Therefore, there is a need for greater transparency on the actual flows. This is supported by Article 9.7 of the Paris Agreement.

Broad features of the Operational Definition of Climate Finance

From the UNFCCC and Paris Agreement treaty provisions discussed above as well as the reporting guidelines for the national communications, the biennial reports, and the biennial transparency reports, the key elements that should be considered for purposes of defining "climate finance" are as follows:

1. The Parties that are to provide financial resources are "developed country Parties and other developed Parties included in Annex II" (UNFCCC: Art. 4.3, 4.4 and 4.5 and Paris Agreement: Art. 9.1).
2. The provision of such financial resources is mandatory due to the word "Shall" in the treaty provisions.
3. The obligation is to "provide" such financial resources, i.e., in its ordinary meaning and context, this term should be understood as "to supply or to make available for use".
4. The object to be provided are "financial resources", and "prioritizing public financial resources" – i.e., in its ordinary meaning and context, "financial resources" would mean the supply of money that is provided or made available, including money from the public treasury as well as money that may have been raised or leveraged from other sources, on a "grant or concessional basis".
5. These financial resources are to be "new and additional" (as per the UNFCCC) and any "mobilization of climate finance should represent a progression beyond previous efforts" and be "scaled-up" (as per the Paris Agreement)
6. Any "mobilization of climate finance should represent a progression beyond previous efforts" and be "scaled-up" (as per the Paris Agreement).
7. The recipients of the financial resources are "developing country Parties".
8. The financial resources are provided for the following purposes:
   - Support developing country Parties in reporting on their climate change actions under the UNFCCC and its Paris Agreement, including reporting on the implementation of their Nationally Determined Contributions (NDCs)
   - Support developing country Parties in implementing "mitigation and adaptation" actions under the UNFCCC and its Paris Agreement, such as those included in their NDCs as well as actions by developing country Parties to address loss and damage.
   - Support "technology development and transfer" to, "capacity building" in, and "cross-cutting" support for, developing country Parties.

LMDC's Proposed Operational Definition of Climate Finance under the UNFCCC and its Paris Agreement

Considering the key elements above, and in view of the lack of an agreed definition of climate finance, an operational definition of "climate finance" that is <u>fully consistent with the relevant provisions of the UNFCCC and its Paris Agreement</u> would be as follows:

1. Climate Finance is the new and additional funding provided by Annex II/ developed countries to non-Annex-II/developing countries to meet:
   (a) the agreed full costs of the obligations of non-Annex-II/developing countries under Article 12.1 of the Convention as well as Article 13.14 of the PA; and
   (b) the agreed full incremental costs, of meeting the obligations of non-Annex-II/ developing countries as detailed in Article 4.1 of the Convention as well as their nationally determined contributions as set out in Articles 3 and 9.1 of the PA

   More specifically, such agreed incremental costs relate to defined actions/projects/programs undertaken or outlays proposed/incurred, by non-Annex-II/developing countries, towards mitigation, adaptation, technology transfer, capacity building, addressing adverse impacts or damage caused by climate change, loss incurred as a result of response measures that address climate change, and any transition to defined low emission pathway/(s) and climate resilient development. Such incremental costs must also include cost of insurance and the cost of raising and servicing the funds provided by Annex-II/developed countries.

2. It must prioritize public financial resources, on a grant or concessional basis, from developed country Parties and other developed Parties included in Annex II of the UNFCCC to developing country Parties only. These resources shall represent a progression from previous efforts and would be used for the purposes of:
    a) supporting developing country Parties in reporting on their climate change actions under the UNFCCC and its Paris Agreement, including reporting on the implementation of their NDCs;
    b) supporting developing country Parties in implementing mitigation and adaptation actions under the UNFCCC and its Paris Agreement, particularly those included in their NDCs as well as actions to address loss and damage;
    c) supporting technology development and transfer, capacity building, and cross-cutting support, to the developing country Parties concerning (a) and/or (b) above.

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