June 2024

UN Trade and Development submission in response to the *Call for evidence: information and data for the preparation of the sixth Biennial Assessment and Overview of Climate Finance Flows.*

Link: https://unfccc.int/sites/default/files/resource/Call_for_evidence_BA6.pdf

UN Trade and Development (UNCTAD) welcomes the opportunity to share information and data on the call for submissions for BA6 and would like to support The Standing Committee on Finance (SCF) by providing some considerations.

Financial instruments to address Loss and Damage

In November 2023, UNCTAD published the report *Taking responsibility: Towards a fit-for-purpose Loss and Damage Fund*, available here. The report reflects on several aspects of the Transitional Committee's mandate that have emerged during its activities in 2023 and offers a series of recommendations. It is structured around four chapters that are linked by a focus on tackling the systemic challenges that keep developing countries in crisis and out of climate-resilient development pathways.

The theme of global economic governance reform was reflected in the historic decision to establish funding arrangements for loss and damage. Decisions 2/CP.27 and 2/CMA.4 acknowledged not only the necessity of a new fund and financing arrangements, but also called on International Financial Institutions to consider their role in contributing to such arrangements, including new and innovative financing approaches.

The report includes a comparative analysis of the innovative sources of financing for Loss and Damage, starting from the assumption that the minimum volume of funding proposed to initially capitalize the LDF is $150 billion, rising to a suggested $300 billion by 2030, dependent on ongoing analysis of projected and recorded costs.[1] [2]

The report argues that **insurance mechanisms are an insufficient tool**, the first reason being the inherent degree of information asymmetry for LD, specifically moral hazard, as applied to the changes in behaviour that may or may not have been undertaken by the different parties involved in seeking to mitigate or adapt to current and potential future risks. The problem of accurate risk assessment remains unresolved: attempts to use 'objective' measures have been insensitive to the actual range of risks that manifest themselves for developing countries. For example, the World Bank's Pandemic Emergency Financing Facility was established to provide financing in the event of a pandemic striking developing countries, dependent on meeting strict criteria of 250 pandemic deaths in the claimant country and 20 in a neighbouring country. The rate of interest to investors was high, at 13 per cent, intended to compensate for the additional 'risks' of a payout being made. But when Ebola struck the Democratic Republic of Congo over 2018-20 killing 2,280 people,[3] the low numbers of deaths in neighbouring countries meant

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[1] Richards, J R et al. (2023). The Loss and Damage Finance Landscape. Heinrich Boell Stiftung : Washington, D.C. Available at https:// www.lossanddamagecollaboration.org / publication / the-loss-and-damage-finance-landscape

[2] Stamp Out Poverty (2018). The Climate Damage Tax : what it is and how it works, p.2. Available at https:// www.stampoutpoverty. org / live2019 / wp-content / uploads / 2019 / 06 / CDT_guide_web23.pdf (accessed 8 August 2023).

[3] BBC (25 June 2020). DR Congo's deadliest Ebola outbreak declared over. Available at https:// www.bbc.com / news / worldafrica-53179323 (accessed 8 August 2023).

Congo was unable to claim payments from the fund.[4] Furthermore, the notion of actuarially fair insurance is misaligned with the fundamental principles of loss and damage. Actuarially fair insurance is intended to generate an equal exchange – of different risk- and loss-aversions managed through the provision of an insurance market. But support for loss and damage is precisely not supposed to be an equal exchange in this sense. From the 1992 Rio Agreement onwards, the notion of CBDR has been a guiding principle, recognizing the indeed unequal allocations of responsibility for climate change (typically in developed countries) and impacts from climate change (typically in developing countries).

The report uses **five principles for assessing innovative sources of financing: fairness, dependability, feasibility, suitability and transparency.** Through this framework, it makes a quantitative and qualitative assessment of the options that are being discussed in the public fora, such as fossil fuel subsidy phase out; levies and taxes (maritime fuel levy, financial transaction tax, etc); windfall fossil fuel profits; redirect/reissue of Special Drawing Rights (SDRs); Official Development Assistance (ODA) increase.

Of the different options for innovative sources of finance for loss and damage, none are without their challenges, whether in distributional impacts, compliance with CBDR-RC or political feasibility. **Bilateral, public resources should form the basis of the LDF**, but ensuring a reliable and predictable replenishment is challenged by recent trends in development and climate finance. But these trends won't turn around without political will. At the same time, the discussion on innovative sources has allowed for consideration of how **greater multilateral coordination around fiscal policies** can not only raise revenue but offer second order benefits such as tackling inequality and reducing emissions-intensive activities. **It is crucial for developing countries to consider together which mechanisms offer the most promising way forward for their development trajectories: to raise revenue for climate-resilient development while avoiding regressive distributional impacts that put more pressure on the most marginalized populations**.

Article 2.1(c)

In December 2023, UNCTAD published the report *Making sense of Article 2.1(c): What role for private finance in achieving climate goals?*, available here. The report discusses the implementation of Article 2.1(c), and its complementarity with Article 9, with a particular focus on the private sector and the mobilisation of private capital towards low- GHG and climate-resilient development. It is crucial that Parties do not forget this obligation to the development dimension of climate goals when attempting to align financial flows with climate-related needs.

The scale of resources managed by private financial actors that are not flowing towards productive, development-enhancing, climate goals implies an additional urgency for Parties to consider ways to discipline private finance in line with Article 2.1(c). Inadequate accountability for the current net zero claims of such financial actors can fuel unrealistic expectations for mobilising private finance undermining the necessary scaling up of climate finance.

The report proposes recommendations to Parties on the key actions they can take to deliver the ambitions of Article 2.1(c) while upholding commitments on the basis of equity and the

[4] Jones O (2019). Pandemic bonds : designed to fail in Ebola. Nature. 572(7769) : 285

principle of common but differentiated responsibilities and respective capabilities in light of different national circumstances (CBDR-RC).

The report is structured around five chapters:

- **Section 1** summarises current challenges in the climate finance landscape and the relationship between Article 2.1(c) and Article 9. Aligning private finance with Article 2.1(c) will not solve the outstanding climate finance deficit, which requires scaled up public contributions. Even by conservative estimates, annual financing for climate goals is orders of magnitude too low. According to UNFCCC analysis, delivering less than half of developing countries' NDCs will cumulatively amount to around $6 trillion by 2030.[5] Before the pandemic, UNCTAD estimated that delivering both climate and development goals demanded closer to $2.5 trillion of annual financing – a number that will have surely risen thanks to ongoing economic shocks, inadequate financial support and delayed climate action. At the same time, advanced economies have not met their collective goal to deliver $100 billion in annual climate financing and have consistently failed to meet the 0.7 per cent Official Development Assistance target, while at times double-counting these financial flows and delivering most climate finance as debt. Bilateral financing in general has significantly slowed, while according to the UNFCCC, private finance mobilization has severely underperformed when compared to past predictions.[6] Rather than just relying on the voluntary and uncertain alignment of private finance to resource just transitions, developing countries need a significant increase of targeted public finance support to break the climate investment traps of chronically insufficient funding and develop publicly-owned, low-emissions infrastructure in countries where the private sector is currently unwilling to go. This implies a much bigger, upfront role for public finance support, whether from contributor countries or multilateral sources. This will be key to any hope of successfully mobilizing private sector capital as part of Article 2.1(c) implementation, particularly towards mitigation efforts and the energy transition.
- **Section 2** considers the misalignment of finance with Paris Agreement targets, using the example of the role of the banking sector in financing the fossil fuel industry.
- **Section 3** considers the realignment of private sector finance away from high-emissions industries and towards low-GHG and climate resilient investments through policy and regulatory measures. The report highlights that pro-active, market-shaping strategies are needed to align private finance with Article 2.1(c): measures to decarbonize private financial flows have so far resulted in piecemeal or voluntary commitments from major financial institutions and institutional investors in developed countries who also continue to be the biggest financiers of fossil fuels. There are also persistent issues with public policy approaches which focus only on market-led mechanisms such as risk-disclosure, carbon pricing, ESG frameworks and green taxonomies. These are designed to nudge investors out of high-emissions and into green investments, but since prospective profits not prices are, ultimately, what drives investment decisions, these efforts are not getting the impact the world needs as long as high emitting sectors are immensely profitable. The alternative to a market-led, 'derisking' strategy is a 'market-

[5] UNFCCC (2021). First Report on the Determination of the Needs of Developing Country Parties. Available at https://unfccc.int/topics/ climate-finance/workstreams/needs-report

[6] UNFCCC (2022). Report on progress towards achieving the goal of mobilizing jointly USD 100 billion per year to address the needs of developing countries in the context of meaningful mitigation actions and transparency on implementation. Available at https://unfccc.int/sites/default/files/resource/J0156_UNFCCC%20100BN%202022%20Report_Book_v3.2.pdf

shaping' role for public policy, underpinned by policy coordination across fiscal, industrial, trade and financial measures, involving robust regulatory mechanisms for disciplining financiers of high-emitting assets, and establishing a clear trajectory for capital allocation in alignment with green transition plans which in turn encourages an orderly transition by creating certainty for private sector actors.[7]

- **Section 4** explores the mobilisation of private capital towards low-emissions and climate-resilient development in developing countries, in relation to Article 9, discussing the barriers and opportunities to the just and equitable delivery of climate finance. Mobilising private finance for developing countries has not resulted from current attempts to align private finance with Article 2.1(c), whether depending on 'derisking' strategies or through disclosure frameworks and taxonomies that attempt to nudge the market towards green development. Therefore, bridging this investment gap will also require scaling up bilateral public contributions across mitigation, adaptation and loss and damage. Any role for private finance is likely to be concentrated in supporting and continuing the big push in mitigation ambition. Planning the energy transition, in particular, requires a clear path from NDCs to investment policy measures that address the specific challenges of promoting investment in the energy sector. Limited financial resources in developing countries coupled with a dependence on GHG-intensive activities necessitates the provision of increased levels of transition financing, to allow for a smooth and well-managed reallocation of labour and capital.
- **Section 5** concludes with key policy messages, including the necessity to move beyond piecemeal, ineffective tinkering to wider, systemic reforms in global economic governance to achieve the development dimension of Article 2.1(c).

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[7] Kedward K et al (2022). Aligning finance with the green transition: From a risk-based to an allocative green credit policy regime. UCL Institute for Innovation and Public Purpose, Working Paper Series (IIPP WP 2022-11). Available at https://www.ucl.ac.uk/bartlett/publicpurpose/wp2022-11.