



POLICY BRIEF

Background Report on Long-term Climate Finance

There are different ways for developed countries to mobilize USD 100 billion per year for developing countries' climate actions by 2020.

The High Level Advisory Group on Climate Change Financing (AGF) convened in 2010 by United Nations Secretary-General Ban Ki-Moon found that meeting the commitment was 'challenging but feasible'. To evaluate how potential sources of international climate finance identified by the AGF have performed over the last five years, the German G7 Presidency commissioned a 'Background Report on Long-term Climate Finance' from CPI and CICERO. This policy brief summarizes its findings.

To date climate finance instruments or allocations have not developed in the way envisaged by the AGF. Most importantly, although the World Bank estimated that in 2014 governments raised more than USD15 billion from carbon taxes and emission trading scheme sales, carbon pricing has not translated into significant flows of international climate finance. Further, mechanisms that required additional measures to deliver climate finance and/or multilateral consensus have not yet materialised, including for international climate international aviation and shipping, removal of fossil fuel subsidies, and regional or global financial transaction taxes.

Six years down the road from COP 15 in Copenhagen there are more challenges and more opportunities. If combating climate change was already perceived as an enormous challenge in Copenhagen, it is even truer six years later. Impacts observed on local and global climates have increased and highly accurate forecasts and analysis on climate change effects have improved. Recent estimates of climate finance investments needed to reduce emissions to levels consistent with a 2 degree Celsius temperature rise are in the trillions of USD from now until 2050.

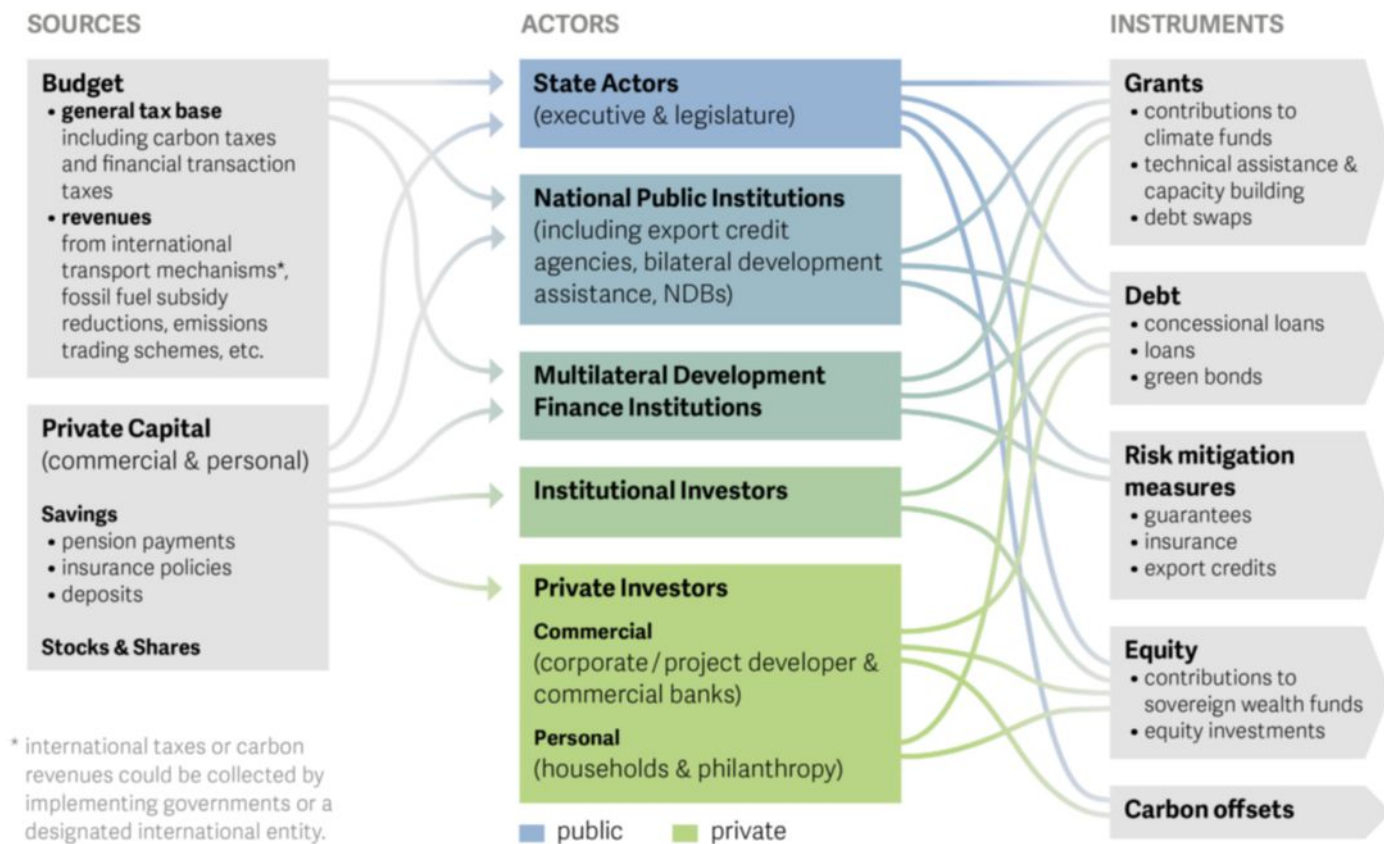
Even though some countries have faced considerable financial pressure and political opposition to dedicating resources to international climate action, global public climate finance has increased, and public budgets have proven to be the most reliable sources of domestic and international climate finance.

KEY RECOMMENDATIONS

- **Public policies and finance are key drivers.** Public budgets have proven to be the most reliable sources of domestic and international climate finance. More work is needed to understand how public finance and policies can be adjusted to maximise returns by encouraging deal flow, delivering value for money, increasing private sector participation, and facilitating effective results.
- **It will be essential to maximise private investment flows to achieve climate finance goals.** In addition to investment, private actors can bring expertise, innovation and efficiency. Experience shows that when enabling environments balance risk and returns over suitable time horizons, private investment flows. Work is needed to connect the financial and scientific communities, to clearly communicate climate risks and their potential implications for investors.
- **Building an optimized climate finance system will be impossible until fundamental tracking gaps are addressed,** particularly in respect of private investments. Work is needed to identify opportunities and strategies to support more ambitious mandates for public institutions, national and international, to gather and track data on private flows mobilized by public finance activities.

Climate-related bilateral overseas development assistance (ODA) contributions by developing countries have increased steadily over the past decade. They reached approximately USD 22 billion in 2013 while in the same year, a least of USD 32 billion of international public finance flowed from developed to developing countries.

The Climate Finance System



There are two principal sources of finance in the global climate finance system: public budgets and private capital. The centre column identifies the key actors whose decisions determine how public finance is delivered on the one hand, and how private capital is invested on the other. The right column shows main groups of instruments through which public actors channel finance to pay for public goods and services, close viability gaps (e.g. grants and loans), reduce costs and risks for private actors (e.g. insurance, guarantees), or into which public and private actors may invest (equity and debt).

In October 2015, a report by the [Organisation for Economic Co-operation and Development \(OECD\)](#) in collaboration with Climate Policy Initiative made preliminary and partial estimates that climate finance reached USD 62 billion in 2014 and USD 52 billion in 2013, equivalent to an annual average over the two years of USD 57 billion. While this latest report builds upon new and existing methodologies to provide a robust estimate for the first time, it is important to note that there is still no international agreement on what counts as climate finance, or on what should count toward the USD 100 billion goal.

Total global climate finance —both domestic and international, and public and private— rose to at least USD 391 billion in 2014 (CPI 2015). However, the value of global consumer subsidies that governments paid

to support fossil fuel consumption (USD 490 billion) was three to four times the value of public support for renewable energy in the power sector (USD 112 billion) plus biofuels (USD 23 billion) (IEA 2015).

Achieving the scale of investment needed requires a massive shift of capital from a high- to a low-carbon economy. Significant coordination and strong government leadership is necessary to align policies, pricing signals, and financial instruments to steer financial flows within and across borders towards a low-carbon and climate-resilient future.

In the last six years, some important opportunities have emerged across the global landscape that may help investors to achieve more value for money and encourage the reallocation of resources away from high-carbon, high climate risk investments.

Renewable energy costs have continued to fall, making some renewable technologies price-competitive with polluting alternatives. Oil prices too have dropped dramatically in the past year making fossil fuel sources less expensive, presenting a risk of backsliding if left unaddressed, and a once-in-a-generation opportunity for governments to level the carbon playing field by eliminating subsidies and pricing carbon without cost impacts to consumers.

The key findings of this report highlight where opportunities have emerged to better align the interests and interactions of public and private finance and actors in developed and developing countries, to deliver the USD 100 billion commitment as an early step toward transforming the global economy.

1. **Governments have a potent tool kit of policies, public institutions, and financial instruments that together can drive economic transformation at scale.** Government decisions can ensure these tools are deployed, even in variable political contexts, to balance costs and risks among different sources, actors and instruments. Public support has increased and proven to be reliable. Grant finance plays a catalytic role by supporting developing countries' efforts to establish the policies, frameworks, and institutional and technical capacities essential to shift public and private investments toward actions that tackle climate risks and build resilience.
2. **Private capital is the dominant global source of low-carbon and climate-resilient investment, but the full potential is still not realized as new financial systems and products to address credit, financial and liquidity risks still require improvement.** Outside of renewable energy finance, there are no precise quantitative estimates of global private investment that is helping to address climate change. Governments have the potential to close information gaps by requiring public institutions to collect and report information about private investments mobilized through public finance. Where private actors see opportunities to balance costs and risks, investment will follow. Mobilizing institutional investors and innovative new green financial products offer new avenues to scaling up climate finance. In 2013, institutional investors held an estimated USD 93 billion of assets in the OECD alone. Increasing awareness of exposure to climate risk across their portfolios, divestment campaigns and increased use of 'green' or climate-aligned investment products, e.g. non-fossil indices and green bonds, has also facilitated more proactive climate strategies by investors.
3. **Enabling environments that offer predictable regulatory and economic frameworks help investors to plan future investments, and to manage costs and risks.** A transformation of the global economy from a high-carbon, high climate risk system to a low-carbon and climate-resilient one requires the redirection of trillions of dollars of public and private finance. There are many examples of mitigation policies and economic instruments that have been used to set price signals, targets, and provide public support to drive low-carbon investments. Adaptation policies lag behind but mainstreaming climate-resilience across development plans and investment portfolios presents multiple opportunities to achieve co-benefits and better value for money.
4. **National and international public institutions can play a pivotal role mobilizing public resources effectively.** Multilateral Development Banks (MDBs) are key actors and have committed USD 21.6 and 24.7 billion (mostly debt finance) toward global climate finance each year from 2011-2013. Bilateral agencies and Development Finance Institutions are also key actors, contributing USD 26-27 billion in 2013. Bilateral agencies have a substantial role in supporting adaptation activities (almost 50% of their total contributions in 2013 were grants targeting adaptation). Bilateral DFIs and MDBs also mobilise substantial amounts of private finance including by providing risk coverage, concessional and non-concessional lending, technical assistance, as well as by managing and implementing projects for climate funds. The emergent Green Climate Fund could play a catalytic role ensuring vulnerable countries' needs are met, as well as realigning incentives and finding new ways to mainstream climate risk mitigation, building on lessons from DFIs, Export Credit Agencies and National Development Banks.

Download the full "Background Report on Long-term Climate Finance" from the G7 Website:

https://www.g7germany.de/Content/EN/Artikel/2015/06_en/g7-gipfel-dokumente_en.html



On behalf of:



Federal Ministry for the
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