AFRICAN DEVELOPMENT BANK GROUP

Meeting of the Committee of Finance Ministers and Central Bank Governors

FINANCING CLIMATE CHANGE: REVIEW AND FOLLOW UP TO COPENHAGEN

Cape Town, 21 February 2010

Summary

Climate change already imposes significant costs on Africa, primarily in the need to adapt across all sectors to a more hostile climate. Action to address these challenges should be fully integrated into development efforts. Africa contributes minimally to global warming, but can contribute to mitigation efforts by preserving its lakes and forests.

At the same time, there are growing pressures for countries to adopt a low carbon growth path, and for multilateral development banks to assess investment proposals accordingly. Given the very low levels of access to energy in Africa and the higher cost of low carbon options this will be a particular issue in Africa. But it also presents an opportunity to exploit Africa's comparative advantages.

The overriding question is finance. Expectations that new and additional assistance would be provided to meet the costs have not yet been met. Africa must therefore ensure that its case is heard, that adequate resources are made available, especially for adaptation. To ensure that Africa can benefit from any new resources, action should be taken to develop and implement national plans, and in so doing to identify specific investment opportunities.

Detail

Copenhagen Climate Conference

The Copenhagen Conference marked a two year negotiating process. The result was much less than firm comprehensive agreement for which many hoped, and the process will continue leading to a further meeting in Mexico at the end of 2010. The Accord reached is essentially a political document, but will serve as the guideline for further negotiations. It aims to keep the maximum increase in global temperatures to below 2 degrees Celsius. Most of the major emitters have submitted plans on how they propose to reduce their emissions, but these fall short of binding commitments, and are insufficient to achieve the desired trajectory. There are still major disagreements within and between countries on the respective efforts and on the measures of reporting and validation.

The accord recognizes the importance of adaptation, and of reducing emissions from deforestation and forest degradation (REDD). It agrees on the need to provide positive incentives to such actions through the immediate establishment of a mechanism to enable the mobilization of financial resources from developed countries, including for capacity building, technology development and transfer.

The Accord does not assign any responsibilities to countries to provide additional finance and contributions therefore remain, as now, voluntary. However it proposes the establishment of a high-level panel to develop proposal on how to significantly scale up long-term financing for mitigation and adaptation strategies in developing countries from public as well as private sources. It is to focus in particular on new and innovative long term sources of finance.

Adaptation

Understandably, climate related costs have generally been regarded as an add-on and treated separately, with debates on financing largely amongst Ministers of Environment rather than Finance, and efforts to engage Finance Ministers have not been successful. This has a number of disadvantages. At national level it can lead to competition between environmental and development needs; increased transaction costs; and a fractured approach to setting priorities and managing foreign currency inflows.

Wherever possible adaptation should be developed and implemented as part of existing sector strategies, programmatic rather than project based. For instance by making strategic choices that reflect water demand and supply; improving energy efficiency; climate proofing infrastructure and public health systems. Adaptation is essential to protect livelihoods and health. These costs must then be incorporated in medium term strategies and expenditure frameworks as part of overall macro-economic management.

Internationally it has meant that discussions on external resource requirements, priorities and programmes have underplayed adaptation because of the difficulties in demonstrating distinct incremental costs, and unproductive semantic debates about the distinction between development and adaptation. For the most part international climate funding for adaptation comes from conventional public expenditure and official development assistance.

In most respects adaptation is inextricably linked to, and largely indistinguishable from, development and should be treated as such. This is important for current debates and also the post-2012 climate regime. Much international attention has been focused on progress towards the MDGs and the external financing required (see for instance the Secretary General's report on progress in Africa, published in 2008). This will intensify in the run up to the UN High Level meeting this September, and as many of the donor commitments of additional resources were set in the period to 2010.

It is estimated that "climate proofing" will add some 40% to the costs of meeting the MDGs in Africa; this would require international financial assistance of some $100billion a year over the next decade – far higher than current levels. Whilst imposing new burdens, climate change also provides new incentives: for instance to the development of higher agricultural productivity through improved techniques, development of climate resilient fertilizers and seeds; more extensive and efficient irrigation, better water management; conservation of lakes and forests and sustainable use of their resources.

<u>Mitigation</u>

The imperatives of climate change will force all countries to seek a lower carbon development path, to rely less on fossil fuel sources. In the longer term a global carbon market should provide an incentive for countries, businesses and consumers to choose the lower carbon option. At present these low carbon options are typically more expensive than conventional energy sources. This presents a dilemma, particularly in Africa given the very low access to energy.

However, a lower carbon growth path offers opportunities for Africa to make use of its comparative advantages, such as forest resources; hydro and solar potential; to develop bio-energy, and improve land use. Targeted measures for both adaptation and mitigation could attract additional funding. The scope and value of such measures will differ according to country needs and circumstances. Early development of National Plans of Action will ensure that measures are properly integrated into development strategies and medium term economic frameworks, but will also provide solid evidence of financing opportunities.

Africa lacks access to energy both on and off grid. It has to invest in new generating capacity. Additional resources would offer scope to incentivize best practice, introduce new technology, develop institutional capability, and undertake the long term investment in cross border projects. The Pittsburgh communiqué recognizes that access to diverse, reliable, affordable and clean energy is critical for sustainable growth. The G20 committed to stimulate investment in clean energy, renewable and energy efficiency and to provide financial support for such projects in developing countries, and to facilitate the transfer of clean energy technology.

In some cases private sector finance would have an important role to play. But pending the development of new market based mechanisms, few sources now exist to meet the additional costs incurred, such as the Clean Technology Fund. (The G8 committed $6bn to the Climate Investment Funds managed at the World Bank – however it is not clear how much of this has been delivered, and there are no set asides for particular regions.)

There is already pressure on the Multilateral Development Banks to set targets to increase the investment in clean energy and to minimize carbon based projects. Proposals are circulating asking the MDBs to introduce a more rigorous assessment of coal fired generating plants. This would require MDBs to identify and appraise cost lower carbon options; to demonstrate that all reasonable measures to improve efficiency and to reduce demand have been identified; and that the best available technology would be used.

For projects in MICs it is suggested that any investment should be accompanied by a package of significant and measurable actions in the power sector that, in the aggregate, are intended to reduce its emissions by an amount equivalent to the emissions to be added by the proposed project. The MDB should either condition its support for the coal project on these actions, or finance complementary operations that do so.

<u>Financing</u>

Although estimates of cost vary, it is generally agreed that climate change will have a major impact on Africa with consequences across most sector, but for Africa concentrated in forestry, agriculture, and energy.. It will add to the development challenges already faced, and make Africa more vulnerable. Recent research (by the Grantham Institute for Climate Change at the London School of Economics) puts the costs of adaptation at some $13-$29 billion per annum by 2015, and the incremental costs of pursuing a low carbon growth strategy at $9-$12 billion a year by 2015. Costs of both adaptation and mitigation rise thereafter. These estimates of costs for Africa alone exceed the pledges made in Copenhagen to assist all developing countries.

Initial expectations, expressed in the Bali Action Plan prior to the Copenhagen Conference, were that future climate funding should be new and additional, and not diverted from existing development commitments. It should also be adequate, predictable and sustainable, although it was always recognized that official and concessional funding would not be enough and innovative means of financing, and private sector investment would need to be mobilised.

Climate funding initiatives, include the Clean Development Mechanism (CDM) established under the Kyoto protocol to promote low carbon projects and emission reductions, and the Climate Investment Funds administered by the World Bank. With the exception of the Adaptation Fund which is financed from a levy on CDM projects, all the funding is voluntary.

Transactions from the sale of emission credits from CDM have been $6-$7.5 billion in recent years, but African participation is under 3%. There are a number of barriers such as weak national capacity to develop CDM projects; complex procedures; limitations on eligible activities restrict scope for adaptation initiatives: and the comparatively small financial size of African projects.

The CDM however has a limited role when set against the size of the funding required. Looking beyond 2012 (when the Kyoto Protocol expires) there is potential for generating additional carbon based revenue. For instance, from: auctions of emissions allowances; levies and taxes on emissions; issue of bonds; or a new “Green Fund” financed by assessed contributions based on historical emissions, population and income. (The G77 and China proposed that developed countries should contribute 0.5% of GNP to cover both mitigation and adaptation for developing countries.)

Key principles for evaluating proposals are whether adequate resources would be obtained; how predictable and sustainable would be the flows; burden sharing; and additionality to existing development commitments. At the same time there has to be an appropriate balance between resources to support mitigation, promotion of new technology and adaptation. Any additional funding must be blended with development funding in a way that provides predictability, reliability, and links expenditure to results.

The proposed High Level Panel will be the focal point for discussions on the financing and governance of climate funds. In particular it will look at the mobilization of new and additional resources to reach the $30bn for 2010-2 in the Copenhagen Accord, and at larger sums thereafter. The expectation is that it will provide a menu of policy options and ease the way towards a legally binding agreement in due course.

The arrangements for the Panel and a supporting secretariat have not yet been finalized. However, it seems likely that there will be pressure for an interim report before the G8 Summit and for a meeting that Germany may call in mid-year. The final report should be available before the Mexico meeting in December.

Governance

Financing raises some complex technical issues, but the related issues of governance and implementation will also loom large. Any institutional framework arising from a global deal should promote equity, efficiency and mutual trust. It should avoid establishing yet more international institutions by using existing development channels wherever possible, and by respecting national and regional priorities.

Essentially the proposals fall into two groups: first for new institutional arrangements under the UNFCC Conference of Parties (COP), and those which would use existing institutions. Within the latter there are different views over the role, or primacy, to be given to the World Bank. Prime Minister Meles, speaking on behalf of African countries at Copenhagen, called for the creation of a short term fund, consistent with the commitments made, and said that the resources allocated to Africa should be managed by the AfDB. He also proposed that the long term financing should be channeled through the AfDB; this was endorsed by the 2010 AU Summit.

Conclusions

Climate change is increasing a public finance matter and should be integrated into debates about development strategies and financing at both national and international levels. As overall funding requirement will be much larger than the resources available, Africa will be competing with other regions for a limited pot.

Africa must engage pro-actively with the High Level Panel once it is established, to make sure that Africa's needs are taken into account, that adaptation and REDD are given due weight. Within the MDBs attention should be given to maintaining a proper balance between the needs of growth and of low carbon growth.

Efforts should be made to build up institutional capacity in order for African countries to be able to prepare National Action Plans, to develop and submit funding proposals to existing financial mechanisms such as the Clean Investment Funds, but also to demonstrate that new funding will be used effectively. Countries should therefore promote investment opportunities; establish the regulatory frameworks which will encourage private sector involvement, and promote energy efficiency.