E3G SUBMISSION FEBRUARY 2022

SUBMISSION REGARDING THE AIMS OF THE NEW COLLECTIVE QUANTIFIED GOAL ON CLIMATE FINANCE

This is E3G's response to the **call for submissions**, mandated under FCCC/PA/CMA/2021/L.17, Para. 17, of views on the objective of the new goal, with the deadline of February 15th.

Overview

In light of the objective of the new goal set out in FCCC/PA/CMA/ 2021/L.17, Para. 15, E3G submits that the new goal on climate finance must, by extension, aim to support mobilising trillions (USD, per annum) in financial flows in support of decarbonisation and other mitigation, adaptation and wider resilience, as well as addressing loss and damage by climate change – *and* that it should also address the necessity of making changes to the international financial architecture, based on new strategic frameworks, so it is fit to deliver Article 2 of the Paris Agreement and the aims of the Convention.

Achieving the objective of the new goal, i.e. the aims under Article 2.1, would necessarily require a historically unprecedented upscaling in climate finance flows, on the order of trillions – and would therefore necessitate significant and specific improvements to the international financial architecture, in terms of its institutions and its rules, both reforming existing architecture and establishing new architecture where appropriate. The new goal for climate finance mobilisation by developed countries must be established, with its elements and features and accompanying decisions, in the way that best supports the ambitious broader efforts toward, financing the aims of the Paris Agreement.

We thus submit that the new goal should reflect the following—explored below:

> The universal appetite to mobilise trillions

> Implications for international financial architecture:

- Architecture of public finance institutions
- Architecture for finance mobilisation, notably private finance
- Architecture for debt relief, sustainability, and fairness of access
- Architecture for the international tax regime

> Further considerations regarding the political economy of climate finance contributor countries

Background

In Glasgow, per FCCC/PA/CMA/2021/L.17, Para. 15, the CMA decided:

> *"… that the new collective quantified goal aims at contributing to* ***accelerating the achievement*** *of Article 2 of the Paris Agreement of holding the increase in the global average temperature to well below 2 °C above pre-industrial levels and* ***pursuing efforts to limit the temperature increase to 1.5 °C*** *above pre-industrial levels, recognizing that this would significantly reduce the risks and impacts of climate change; increasing the ability to adapt to the adverse impacts of climate change and* ***foster climate resilience and low greenhouse gas emissions development****, in a manner that does not threaten food production; and* ***making finance flows consistent*** *with a pathway towards low greenhouse gas emissions and climate-resilient development;"* [Emphasis added.]

To accelerate the achievement of Article 2 of the Paris Agreement, the finance under the new goal must therefore be transformative, a lever for shifting wider trillions required, while responding to immediate needs of developing countries.

The universal appetite to mobilise trillions

While Parties may differ on quantitative elements of the goal for collective finance mobilisation by developed countries for developing countries, and qualitative aspects of the trillions sought, Parties should agree on the need for efforts to mobilise trillions. However, without prejudice to its composition, Parties should agree that the new goal should support the aim to mobilise the trillions required, at scope and scale based on needs, as a starting point for deliberations.

At the Glasgow sessions, numerous Parties affirmed an appetite to work toward a mobilisation of climate finance flows on the order of trillions (USD) per annum. This included interventions by delegates as well as by Heads of State and Government. Notable examples included:

> The **United States, European Union, and United Kingdom issued a joint statement**[1] calling for a "new paradigm of climate finance—spanning both public and private sources—is required to mobilize the trillions needed to meet net-zero by 2050 and keep 1.5 degrees within reach", noting "[t]he world must mobilize and align the trillions of dollars in capital over the next three decades to meet net-zero by 2050, the majority of which will be needed in developing and emerging economies. Mobilizing capital at this scale requires a collaborative effort from all of us, including governments, the private sector, and development finance institutions, as well as better mechanisms to match finance and technical assistance with country projects, including through country partnerships."

> The position of **the Africa Group of Negotiators and the Like Minded Developing Countries**[2], who explicitly called for a headline collective mobilisation goal by developed countries of in the trillions per annum: "to mobilize jointly at least USD 1.3 trillion per year by 2030, of which 50% for mitigation and 50% for adaptation and a significant percentage on grant basis from a floor of USD 100 billion, taking into account the needs and priorities of developing countries outlined in the Updated NDCs", though other countries opposed such language for pre-empting deliberations.

> **Barbados called for an annual issuance of half a trillion USD**[3] ($500 billion) in Special Drawing Rights (SDRs) by the International Monetary Fund (IMF), for 20 years, to be put in a trust to finance the transition, noting the existential urgency for small island developing states, and the fact that $500bn is just 2% of the 25 trillion USD spent globally in economic recovery spending over the past 13 years.

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1 See: https://www.whitehouse.gov/briefing-room/statements-releases/2021/11/02/u-s-president-biden-european-commission-president-von-der-leyen-and-uk-prime-minister-johnson-announce-commitment-to-addressing-climate-crisis-through-infrastructure-development/

2 See: https://unfccc.int/sites/default/files/resource/3_11_21_%20Joint_CPR_New%20Goal.pdf

3 See: https://gisbarbados.gov.bb/blog/prime-minister-mottley-closing-of-gaps-required/#:~:text=Prime%20Minister%20Mottley%20said%20the,months%20to%20fight%20the%20pandemic.

Implications for international financial architecture

The current international financial architecture has demonstrated it is insufficient for the aim of mobilising trillions to deliver Article 2 of the Paris Agreement. Reflecting that reform of the international financial architecture is essential for delivery of the ultimate ambition of the new goal, the CMA's decisions regarding the goal must contain non-quantitative elements on a common agenda for reforms to the international financial architecture.

This perspective was also noted by Argentina-Uruguay-Brazil (ABU) in their submission on the new collective quantified goal:

> *"[T]rillions –not billions– are necessary to address the current financial gap. No one can do this alone. Parties and the financial and private sectors, among others, will be crucial to address the needs already quantified in many of our NDCs. But new funds and grants alone are not enough. In order to achieve the Paris Agreement goals we need to review and adjust the global financial architecture and developing countries must be involved in the redesigning process."*[4]

In this submission, E3G would like to highlight three specific areas of the international financial architecture necessitating action and reform, particularly by developed countries and major economies, in order to successfully deliver the aim of the new goal and achieve Article 2, with the trillions necessary:

1. Architecture of public finance institutions (including IFIs and DFIs)
2. Architecture to mobilise finance, notably private finance (e.g. platforms)
3. Architecture for debt relief, sustainability, and fairness of access
4. Architecture for the international tax regime

Architecture of public finance institutions

Mobilising trillions to achieve the objective of the new goal will necessitate replenishment, recapitalisation, and reform of the world's public finance institutions. This vision must include public finance institutions at all levels—local and subnational, national, regional, and global—and in particular public banks.

[4] See: "Argentina, Brazil and Uruguay (ABU) Proposal on the New collective quantified goal on climate finance". Dated November 3rd, 2021.

Much as sustainable development should be at the heart of climate action, the world's development finance institutions have an essential function in climate finance to play given their wider roles and influence.

Public finance institutions require various reforms to contribute maximally to the new goal. Firstly, their investments must aligned to become consistent with climate-resilient development and holding warming to 1.5C. Many public banks have initiated Paris alignment processes but there is considerable improvement to be made.[5] For example, continued public investments in non-1.5C-aligned fossil assets bear considerable financial risks for developing countries, and could be repurposed to support modern and affordable energy systems. Such processes should respect the principle of common but differentiated responsibility as well as the nationally determined nature of alignment processes for national institutions, while mainstreaming improved consideration of financial risks and other factors.

A second area of reform must be to ensure that public finance institutions are maximally effective in ushering wider financial flows to serve Article 2 of the Paris Agreement at scope and scale. Research indicates that, with specific changes to their policies, multilateral and bilateral finance institutions could be much more effective in mobilising the trillions of dollars held by savers in climate-aware institution investors.[6] In particular, this will necessitate engagement of different public finance actors with local, regional, and global capital markets, e.g. via the platforms explored in the following section, and more effective blending of finance to include use of guarantees.

However, even if public finance institutions conduct balance sheet optimisation while re-orienting their finance away from damaging activities and toward the most transformative and catalytic investments, they will require new and additional financial firepower. Broad recapitalisation and replenishment of public finance institutions will be required to mobilise the necessary trillions in wider flows, delivering a step change at the scope and order of magnitude and under the timeframes required for Article 2. In addition to recapitalising public banks, it will also be vital to replenish international climate funds providing climate finance on highly concessional terms or on a grant basis. The latter is especially needed for project origination and preparation.

[5] See: **https://www.e3g.org/matrix/**

[6] See: **https://www.e3g.org/publications/closing-the-trillion-dollar-gap-to-keep-1-5-degrees-within-reach/**

Architecture to mobilise finance, notably private finance

COP26 showed broad political support from Parties for new cooperation structures, but the working fora for cooperation on finance mobilisation at scale do not yet exist in a sustained form. Moreover, there is a large gap in analytical capacities for finance mobilisation – as the majority of the world's countries do not have costed NDC Investment Plans with financing strategies identifying how public resources or private capital will be mobilised.

Country-driven platforms for finance mobilisation, particularly at country level and regional level, represent a solution to these challenges – with the core function of convening different public finance actors with private financial actors and matchmaking around countries' project investment needs. Platforms would be endowed with analytical capacity to facilitate and address issues across the investment value chain, from project origination to deal-structuring. Delivering the trillions for Article 2 will require the proliferation and resourcing of such platforms.

Platforms have been championed in the development finance community for some years. A Reference Framework for effective country platforms was endorsed by the G20 in 2020.[7] The concept has also been supported by the private finance sector which sees finance mobilisation platforms as a critical mechanism for enabling blended finance at scale.[8] As noted by former central bank governor Mark Carney, in his capacity as chair of the Glasgow Financial Alliance for Net Zero (GFANZ), platforms for finance mobilisation have the potential to mobilize USD 1 trillion per annum of new private finance flows for climate action by the middle of the decade.[9]

In December 2022, G7 leaders endorsed the idea of establishing country-level platforms, echoing the decision by the G20. However, in reaffirming the G20 position, G7 leaders also decided that country platforms will need to be supplemented by regional platforms.[10] It is hoped that 2022 will see the G7, in partnership with the G20, resource and co-launch with developing countries a limited set of regional finance mobilization platforms that could serve as an interface between country-led efforts and regional capital markets.

[7] See: **http://www.mof.gov.cn/en/Cooperation/mulid/202011/P020201104581749367491.pdf**

[8] See: **https://assets.bbhub.io/company/sites/63/2021/11/Country-Platforms-Action-Plan.pdf**

[9] Ibid.

[10] See: **https://www.g7uk.org/g7-leaders-statement-partnership-for-infrastructure-and-investment/**

Architecture for debt relief, sustainability, and fairness of access

One dimension of the international financial architecture already in need of reform is that around international debt markets – specifically debt sustainability rules, systems for debt relief, and fairness of access to debt markets. With efforts to mobilise trillions in private investments, including by scaling up issuance of debt-based instruments such as green bonds, the need for such reforms is becoming even more acute than already it is.

The COVID-19 crisis has been highly damaging for developing countries, many of whom are facing balance of payment crises in servicing their sovereign debts. For this reason, the G20 instituted a Debt Service Suspension Initiative (DSSI), but this expired in 2021. The G20 aims to offer further debt relief via a "G20 Common Framework for debt treatment beyond the DSSI", but this has disappointed many, in part due to lack of a proper mechanism for engaging private creditors. The IMF, which has proposed reforms to this Common Framework, warns that unless debt restructurings are accelerated, some developing countries may see economic collapse.

Rules around debt sustainability must be reformed to ensure that limited fiscal space does not prevent countries from making essential climate-related investments. "Investing to save" must be better incentivized, particularly in macro-critical areas such as resilience and modern energy systems which will improve countries' fiscal positions in the long-term. As part of a broader international reform agenda, these considerations must be better reflected into guidelines on debt sustainability, notably at the IMF.

Lastly, developing countries' access to capital markets must be strengthened and put on fairer terms, particularly in relation to creditworthiness. Developing countries face much higher costs of capital relative to developed countries with similar credit ratings,[11] while independent experts have also critiqued the objectivity and methodologies of credit rating agencies. [12]

Architecture for the international tax regime

The decisions surrounding the new goal should also consider the necessary reforms to the international tax architecture as required to render it fit to

[11] See: https://www.uneca.org/sites/default/files/com/2021/speeches/HM-Intervention-Ghana.pdf

[12] See: **https://au.int/sites/default/files/documents/38809-doc-final_africa_scr_review-_mid_year_outlook_-_eng.pdf**

support the required fiscal commitments in green spending as well as official development assistance (ODA) and climate finance for developing countries. The recent G20 agreement, endorsing the OECD Inclusive Framework's (IF) proposal of a 15% global minimum tax rate and a redistribution of 25% of the largest companies' residual profits to market jurisdictions, offers the promise of improved political space for enlarged fiscal spending on matters such as climate finance.[13] Although most countries are generally agreed that this is a step in the right direction, some developing countries call for more ambitious and transformational reforms to international tax architecture.[14]

While shifting the trillions must entail a step change in the mobilisation of private capital, this will also necessitate historic expansions of fiscal commitments. As discussed, enhanced public finance support by developed countries will be needed both to recapitalize and replenish the public finance institutions providing essential climate finance, as well as to bring in institutional investors via provision of instruments such as guarantees, to reduce the cost of capital for developing countries.

While such reforms would need to be bold to support full delivery of Article 2, these reforms should also be mindful of the benefits offered by the current international architecture to the economies of many Small Island Developing States, who are especially vulnerable to climate change. Reforms to the international tax architecture should therefore accompanied by efforts to ensure alternative economic activities particularly as hubs in the international economic and financial architecture.

Reforms to the international tax architecture must also consider and manage the emergence of new efforts to expand the application of carbon pricing. This includes unilateral initiatives with strong cross-border impacts, notably Carbon Border Adjustments, which are being explored in the EU, Canada, UK and other jurisdictions, as well as initiatives that strive towards an international reference price on carbon, potentially via a so-called "climate club".. If such mechanisms are to be established, then proceeds from these mechanisms would present an opportunity to set dedicated shares to scale climate finance for developing countries – and, in light of common but differentiated responsibilities, an opportunity which must not be missed.

[13] See: **https://www.oecd.org/tax/international-community-strikes-a-ground-breaking-tax-deal-for-the-digital-age.htm**

[14] See: **https://www.southcentre.int/statement-july-2021/**

Further considerations regarding the political economy of climate finance contributor countries

The new collective quantified goal is likely to, and should, challenge conventional notions of political feasibility in developed countries, especially on budgetary feasibility. There already appears some convergence between major global private financial institutions[15] who are calling for a new collective quantified goal to establish a floor of $100bn in purely grant-equivalent terms, combined with a higher trillion-dollar mobilisation goal, echoing the position of developing countries such as India[16] regarding the historic $100bn goal agreed in 2009. Such a goal, in addition to the reforms to the financial architecture discussed previously, in addition, would not be straightforward to accomplish.

While necessary, meeting a significantly higher new collective quantified goal will be politically challenging for developed countries. In this context, it will be important to learn lessons based on the $100bn experience about navigating the political economy constraints these countries face. Among the developed countries, one particular challenge with delivery of the $100bn was establishing a common understanding of the respective contributions and fair burden-sharing – common frameworks such as expected contributions as percentages of GDP/GNI, even if informally agreed among donors, will be helpful.

Moreover, the experience of difficult debates in the legislatures over the national budgetary contributions to international climate finance reflects the need for building much stronger political mandates from the public and electorates in support of climate finance and Official Development Assistance (ODA). Such political mandates can only be built over sustained periods of time, and also arguably necessitate a public sense of satisfaction with public and social services offered domestically by national government spending.

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[15] See: **https://www.blackrock.com/corporate/literature/whitepaper/bii-the-big-emerging-question-2021.pdf**

[16] See: **https://archive.pib.gov.in/documents/rlink/2015/nov/p2015112901.pdf**

About E3G

E3G is an independent not-for-profit climate think tank with deep expertise in climate diplomacy and international climate politics, as well as sustainable finance, systemic financial reform, and the international financial architecture for climate and development.