Bridging the gap

Climate finance in the lead up to Doha COP 18

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Contents

Foreword

Over the past 12 months, since the Durban Platform was signed at the previous Conference of the Parties (COP) to the United Nations Framework Convention on Climate Change (UNFCCC), an interesting trend has been observed in the increasing participation of the private sector.

In June of this year, the UN Rio+20 Conference on Sustainable Development was recognized for its success at the business level. Corporations delivered a number of pledges that in some ways went further than governments have previously.

At the end of November, COP 18 will take place in Doha, Qatar, which will be noted for a number of reasons. The fact that the Middle East is playing host to one of the most well-known and prestigious international conferences on climate change shows at least a preliminary shift in mindset.

The region has been economically built on fossil fuels, so the reality of a sustainable future for the Gulf Cooperation Council's countries and surrounding economies is going to be a difficult one to achieve. However, this is a challenge the region's leadership is well aware of and they recognize the need to shift the focus of their economies to new, sustainable sources. It heralds a growing recognition of the potential damage of resource shortages, particularly in water, and the impending need to limit the effects of harmful climate change.

Business may not attend Doha in the record number that was seen in Rio. However, a few decisions should certainly be watched closely by the private sector. This includes the talks on the Clean Development Mechanism, the potential opportunities around the Green Climate Fund and the extension of the Kyoto Protocol.

On top of this, climate finance will be a much-discussed topic. The past year has again thrown up difficult fiscal challenges for the world's governments, and research economic forecasting consultancy, Oxford Economics, has done on our behalf has shown that the public funding gap for climate change is growing. In the worst-case scenario, the gap for climate change spending for the period 2012 to 2016 is likely to increase from US$45b to US$51b (compared with last year's estimate) and, in 2011, climate change spending fell in some of the world's most important economies. This proves that now is the critical time for the private sector to take a leading role in the foundation for a sustainable future.

I hope you enjoy this prelude of what is to come in Doha this November.

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Introduction

As the 18th Conference of the Parties (COP) to the United Nations Framework Convention on Climate Change (UNFCCC) approaches, it's timely to explore the potential impact of climate negotiations on business. Failure to achieve a much anticipated international agreement in Copenhagen in 2009, followed by slow progress at both the Cancun and Durban meetings, means that the focus is now predominantly on maintaining the credibility of the process.

In the last three years, negotiations have seemed to be on the brink of collapse, but a last minute agreement at the 2011 meeting in Durban on a new climate treaty provided a reprieve.[1] The Durban Platform for Enhanced Action calls for negotiations to be finalized by 2015 for a new international treaty, coming into force in 2020.

There are four central areas for negotiation:

- Ambition – target emissions reductions in any international agreement
- Legal form – the extension of the Kyoto Protocol and the legal structure of a new treaty
- Common but differentiated responsibilities – the importance of historical versus modern emissions and cost-burden sharing
- Implementation – the rules and institutions providing governance

Informal negotiations at September's UNFCCC Climate Conference Intercessional meeting in Bangkok were positive, but tension continues between the high ideals of climate action and domestic political pressures in times of economic austerity. No major breakthrough is expected at COP 18, and most agree that Doha will focus on issues of implementation. The best outcome would be agreement of a work program that will set out exactly how a new treaty in 2015 will be achieved.

1 This was despite a rejection of a new international climate treaty at the 2009 COP meeting in Copenhagen.
2 Most notably from Canada, which withdrew from the process.
3 For example, the US and OECD are pushing for a redefinition of a "developing economy" to ensure that major emitters are bound by legally binding reduction targets.
4 The AWG-LCA was established to conduct a comprehensive process to enable the full, effective and sustained implementation of the Convention through long-term cooperative action, now, up to and beyond 2012, in order to reach an agreed outcome to be presented to the COP for adoption.

What will Doha achieve?

There are some areas where we can expect to see action at Doha. Those that will have most impact on business are:

- Changes to the Clean Development Mechanism (CDM)
- Forward movement on the Green Climate Fund
- Extension of the Kyoto Protocol

Changes to the Clean Development Mechanism

The greatest potential lies in the work on changes to the CDM. Carbon capture and storage (CCS) has been included under the CDM and there is hope that movement toward the inclusion of credits under Reducing Emissions from Deforestation and Forest Degradation (REDD+) will be made at Doha. The High Level Panel on the CDM Policy Dialogue has proposed a series of actions to strengthen the failing international carbon markets. These include an increase in reduction pledges, a potential new fund allowing sovereign wealth funds and private investors to buy and cancel credits (easing oversupply), and phasing out HCF-23 and N20 credits (which have constituted half of all Certified Emissions Reductions credits so far). The Panel also proposed further work on the standardization of methodologies (benchmarking, reporting, monitoring and verification, assessing of additionality, etc.). It also said there was a need to increase governance, with increased accountability and regulatory certainty. This would not only enable links between the EU Emissions Trading System (ETS) and carbon trading schemes in California and Australia, but address key issues underlying much of the broader emissions reduction agreement.

Forward movement on the Green Climate Fund

Work has also started on the development of the Green Climate Fund, with regard to legal standing and accountability. Decisions about its powers need to be made, but have been delayed by concerns about the role of the private sector in driving the allocation of the much-needed funding. It is hoped that the launch of a new Standing Committee on Finance (which has already met), responsible for centralizing the work taking place in different areas of financing, will enable decisions to be made at Doha.

Extension of the Kyoto Protocol

Despite some objections, agreement was reached in Durban that the second commitment period of the Kyoto Protocol was to be extended to 2017 or possibly 2020.[2] This was a significant issue for the developing world, given the Protocol's central tenet of action on the basis of "common but differentiated responsibilities." Despite a lack of clarity on how surplus allowances are to be treated, an amendment to the Protocol is expected to be passed at Doha enabling the treaty to be extended by a further period from next year. Most importantly for business, this will preserve its infrastructure and accounting rules. The Ad Hoc Working Group on Further Commitments for Annex I Parties under the Kyoto Protocol (AWG-KP) has created an informal text, in order to facilitate agreement at COP 18.

Challenges

Agreement has been reached on a treaty affecting all nations, with "an agreed outcome with legal force," but the details have to be clarified.[3] At the same time, there are growing concerns that pushing back the date of an international climate treaty may result in too little action, too late.

The expected closure of the Ad Hoc Working Group on Long-Term Cooperative Action (AWG-LCA) in Doha could also prove politically difficult, as there is continuing debate about where responsibility for finance and scientific review should lie.[4] Historically, the negotiations have frequently become bogged down in procedural technicalities and it is to be hoped that this doesn't happen in Doha.

Current voluntary commitments fall short of the cuts required to limit global warming to a maximum of 2°C above pre-industrial times.[5] The United Nations Environment Programme (UNEP) has warned that existing pledges to cut greenhouse gas (GHG) emissions need to double by 2020 to limit warming to this level.[6] This is an economic as well as a climate requirement: the International Energy Association (IEA) estimates that for every US$1 of investment delayed until after 2020, a further US$4.30 would need to be spent to compensate for increased emissions.[7]

Disagreements about climate finance and equity, however, are the real sticking points that must be resolved if progress is to be made.[8] COP 17 saw agreement of the need to keep global temperature increase to 2°C or even 1.5°C, but no detail of how to do so in an effective, economic and fair way.[9]

5 UNEP, *The Emissions Gap Report*, 2010.
6 UNEP, ibid.
7 International Energy Agency, *World Energy Outlook*, 2011.
8 Focusing on historical and forward responsibility for emissions, burden sharing and equitable action between the developed and developing world.
9 UNFCCC, Agenda Item 15, *Establishment of an Ad Hoc Working Group on the Durban Platform for Enhanced Action*, 2011 (accessed via http://unfccc.int/resource/docs/2011/cop17/eng/l10.pdf). According to the Intergovernmental Panel on Climate Change (IPCC) Fourth Assessment report, emissions cuts of 80% by 2050 mean almost no chance of exceeding a 2°C increase in 2050 and only a small chance of reaching it by 2050.

A growing burden for climate finance?

One of the most challenging issues is the growing gap in commitments made on climate finance. US$100b in fast start finance has been pledged from the developed to the developing world, but continuing constraints within the global economy, combined with the growing cost of action, could see climate finance reprioritized. Longer-term finance is supposed to be ramped up to a level of US$100b a year by 2020, but it is increasingly difficult to define where and how such funding is to be found and directed.

Research from Oxford Economics, commissioned by Ernst & Young, shows that, in 10 key markets, there was a decrease in absolute expenditure on climate action in six countries (Germany, Spain, Italy, Japan, Australia and South Korea), little change in France and an increase in spending from the UK, US and South Africa in the 12 months from 2010 to 2011.[10] Table 1.1 shows 2011 government spend on climate change and the difference since 2010. Countries like Germany show that spending in this area has been a priority, with US$21b spent in 2011. The decreases from last year's figures may seem marginal, but they suggest that continuing austerity measures are having an impact on climate change spending. The real impact can be seen when these small increases are totaled over the next five years.

This clearer picture of the effect of reducing climate change spending can be seen in the funding gap that emerges in the 2012 to 2016 period. Oxford Economics examined two scenarios in their research. Under the first scenario, government spending was formulated according to historic rates (1990–2010) and the current constraints needed to reduce borrowing. Among the 10 economies in this baseline scenario, the cumulative funding gap is forecast to reach US$23.7b over the next five years — up from US$22.5b predicted in last year's study. This can be seen in Table 1.2 below. Breaking down the countries, the funding gap is set to be most pronounced in Spain, the UK and Italy. Spain is forecast to spend US$4.1b less on climate change by 2016, with the UK spending US$5b less and Italy US$3b less. Germany was the only country within the study that Oxford Economics expects to record faster growth in government spending than its historical average rate funding, through the use of fiscal policy in the medium term to reflate the economy. The US will see the biggest funding gap of US$5.6b, although this is due to the size of its economy and is relatively small when compared as a percentage of government spend (Chart 1.1).

Table 1.1: Summary of government spending on climate change in 2011

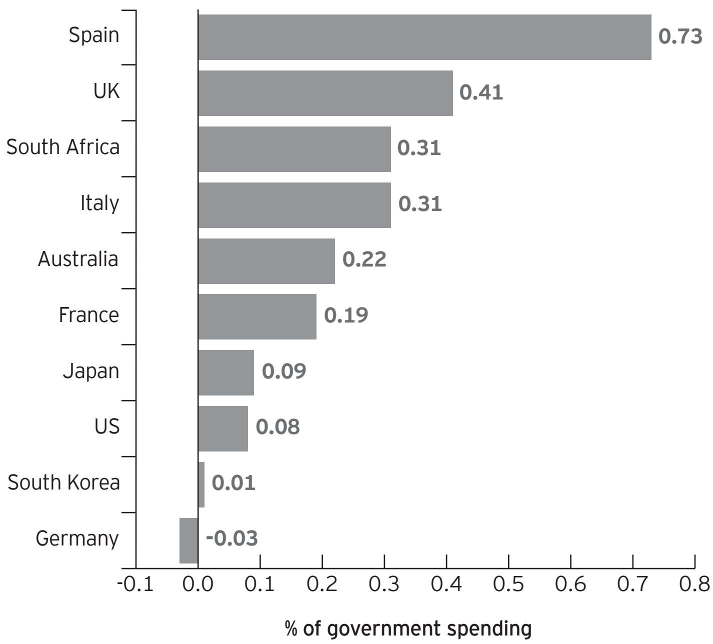
Countries	US$m at market exchange rates	% point change compared with 2010
Germany	21,719	-0.19
France	10,967	0.00
UK	6,871	0.05
Spain	4,194	-0.06
Italy	6,741	-0.03
Japan	13,761	-0.02
US	17,835	0.03
Australia	2,666	-0.12
South Africa	592	0.07
South Korea	2,350	-0.05

Table 1.2: Government funding gap on climate change between 2012-16 (US$m)

Countries	Total funding gap Scenario 1	Total funding gap Scenario 2
Germany	-438	7,909
France	2,707	7,362
UK	4,985	7,707
Spain	4,114	4,970
Italy	2,985	5,268
Japan	2,003	4,800
US	5,588	9,905
Australia	1,266	2,010
South Africa	466	641
South Korea	62	667
Total	23,738	51,239

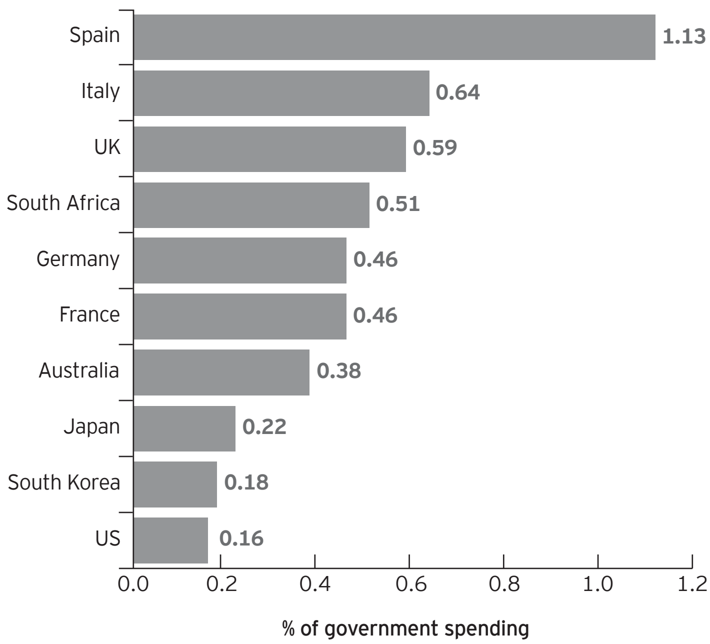
10 Research methodology can be found online at ey.com/sustainability.

Chart 1.1: Scenario 1 funding gaps



Source: Oxford Economics

Chart 1.2: Scenario 2 funding gaps



Source: Oxford Economics

The study also calculates the funding gap under a "worst-case" scenario, in which a number of countries exit from the Eurozone and multiple sovereign defaults trigger a renewed credit crunch in Europe, with activity depressed around the world as a result of trade and financial linkages. Under this outcome, Scenario 2, the cumulative funding gap widens ever further to a total of US$51b in aggregate, up from the predicted US$45b in 2010. In the event the Eurozone breaks up, Oxford Economics forecasts that the US would face the biggest climate change funding gap in absolute terms of US$9.9b. Germany, France and the UK would each face a gap of more than US$7b. During such an event, Oxford Economics predicted Germany's huge deficit would plunge the country into a deep recession, due to a sharp fall in external demand and associated effects on business and consumer confidence; thus the increase in its climate change gap. Charts 1.1 and 1.2 show the funding gaps in Scenario 1 and Scenario 2 as a percentage of government spending.

Governments in developed countries continue to grapple with the aftereffects of the global financial crisis. This funding gap only amplifies the need for financial innovation to unlock the capital markets and leverage private investment into the climate change space. To help tackle this, the public sector could, for example, underwrite the risk where private finance is contributed.

Qatar and the Middle East – how will hosting COP 18 influence the region?

One of the great hopes of COP 18 is the potential for engaging OPEC countries, traditionally skeptical of the UNFCCC, more deeply with the process. It is to take place in Doha, Qatar, in the heart of the oil producing world. Middle Eastern economies are developing rapidly and the region faces a number of sustainability challenges, especially in environmental and social terms.[11] The currently fragmented political and corporate response to sustainability has the potential to undermine competitive confidence in the region in both the private and public sectors.

Member states of the Gulf Cooperation Council, such as Bahrain, Kuwait, Oman, Qatar and the United Arab Emirates, are already showing an increasing focus on the role of cleantech and renewables as part of economic diversification, which includes cutting domestic oil use. Saudi Arabia, which has 20% of the world oil reserves and consumes about 800,000 barrels a day for domestic power consumption, is focusing on nuclear and solar as a means of generating alternative power in the region and freeing up more oil for export.[12, 13, 14]

In 2011, the country announced plans to pursue renewables in an effort to reduce its dependence on fossil fuels by half, investing at least US$100b into clean sources over the next 10 years.[15] On top of that, Middle East and North Africa is the world's driest region – water availability is only 1,200m^3 per person per year, compared with a global average of 7,000.[16]

A growing regional focus on the need for economic diversification and increased sustainability could provide a unique opportunity in the short to medium term.

11 Water scarcity; climate change; land degradation and desertification, air pollution, youth and female employment levels, labor conditions of migrant workers.
12 "Saudi Arabia Country Analysis Brief," *US Energy Information Administration*, http://www.eia.gov/countries/country-data.cfm?fips=SA, accessed 30 October 2012.
13 Kuick Research, *GCC Renewable Energy Sector Analysis*, August 2012.
14 A significant proportion of electricity is consumed in heating and cooling, a major issue for hot countries.
15 "Saudi Arabia Plans $109 Billion Boost for Solar Power," Bloomberg, http://www.bloomberg.com/news/2012-05-10/saudi-arabia-plans-109-billion-boost-for-solar-power.html , accessed 30 October 2012.
16 The Economist Intelligence Unit, *Sustainable Development in MENA*, September 2012.

What role is business playing and how is it affected by these negotiations?

New ways of managing resources, that can help the transition from current economic models to new economic models, need to be found. A lack of understanding of the most significant environmental and societal pressures on the bottom line over the short, medium or longer term could see losses incurred as a consequence of risks that should have been identified and managed. An awareness of the need for integrated reporting (economic, environmental and social) is growing. Implementing an integrated strategy can support the quantification of value from sustainable business activities not currently included in the balance sheet.

There are potential risks and opportunities that go hand in hand with UNFCCC decisions. There are discussions about creating a carbon fund that could see opportunities for both sovereign and private capital investment, and calls for an increase in national and voluntary emissions pledges. These could have a direct impact on the private sector and the cost of operations.

As negotiations continue, actions taken at a national level will remain vitally important, and action by industry has a significant role to play in helping to frame and develop approaches that support economic growth in a more sustainable way.

The mobilization of private and public capital for action is necessary for effective climate action and it is time for the private sector to engage more fully with the UNFCCC. That means that industry must develop an understanding of the policy process and how to advocate for change successfully. Perhaps the most important role for business today lies in helping to frame the institutions of a new treaty. In the same way as industry engaged with the UK Government in the development of its Green Investment Bank, industry should help to shape institutions that will be driving a shift toward low carbon mitigation and adaptation.

Engaging with the UNFCCC process is, however, about more than framing institutions; it's about supporting negotiations in moving the agreement forward. Growing awareness of the need to address environmental, economic and community matters is driving changes in corporate behavior. This knowledge, combined with private sector expertise, provides a useful knowledge pool for policy-makers. It is no longer about showcasing sustainability, but rather about the recognition that, if industry wants clear long-term policy frameworks, they need to engage with policy-makers. Industry frequently calls for policy certainty and stability in order to make long-term investment decisions, and there was disappointment when the only clear signal provided in Durban was that certainty would have to wait until 2015. It is now up to industry to provide support and pressure on policy-makers for a clear road map for action on climate change, at a national as well as an international level.

As negotiations continue, actions taken at a national level will remain vitally important, and action by industry has a significant role to play in helping to frame and develop approaches that support economic growth in a more sustainable way. Where the UNFCCC process can support action is in bringing countries together in implementing change while international negotiations are ongoing. The negotiations in Doha may provide a unique opportunity to encourage major oil and gas-producing states to gain understanding of the benefits of signing up to a low carbon agenda. The benefits of economic diversification and a wider integration of economic sustainability concerns in the international debate could help support the necessary political change.

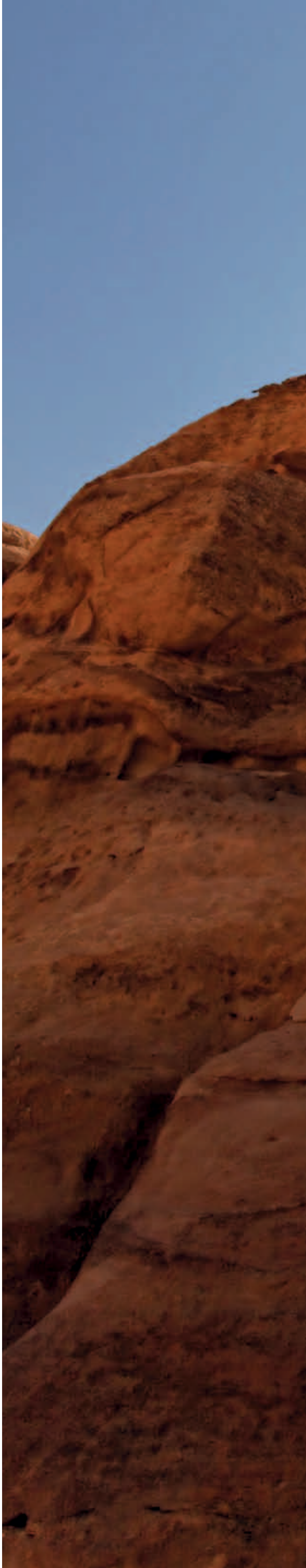
How to bridge the climate finance gap?

Climate negotiations, and the actions necessary to agree a global climate treaty, are a challenge to nation states in economic difficulty. Access to finance and economic growth, to energy and the impact of environmental crises (from flooding, drought and wildfires) are part of the complex, multilateral, transborder issues with which the international community is grappling.

Doha is not expected to provide a major breakthrough, but positive steps are being taken toward providing an effective framework for forward negotiations. Realistic negotiations on limited goals that are achievable; for example, with regard to cooperation on technology development and deployment, are to be hoped for.

The media frenzy prior to COP 16 in Copenhagen led to massive disappointment at its perceived failure. The wheels of international policy move slowly and, while there is appetite among some parties to see substantive ideas brought into negotiations, in many ways the best outcome to be achieved at Doha will be an agreement on a work program for how to achieve an international agreement by 2015. While this won't provide the certainty of policy environment that business requires in order to make long-term investment decisions, it will provide another indicator that fundamental changes in our economic environment are on their way.

While many had hoped for a global climate treaty to be in place by now, the current position provides a unique opportunity for the private sector to engage with the policy process. Perhaps it can use its knowledge of risk analysis and mitigation, its skill in leveraging and distributing finance, to help frame a more effective and wide-ranging global agreement.



Ernst & Young Climate Change and Sustainability Services

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