HEINRICH BÖLL STIFTUNG
INTERNATIONAL POLITICS

G20 *Themes #7*

Green finance and climate finance

1. What do "Green Finance" and "Climate Finance" mean?

The G20 uses the term "Green Finance" as a broad umbrella term that refers to the major shift in financial flows required to support projects that benefit the environment and society by reducing pollution or tackling climate change. For this shift to occur, all actors, such as private banks, insurers, investors, and governments, must have strong incentives to refrain from making traditional business-as-usual investments. It also entails greening the financial sector through the practices of due diligence and risk management to ensure that green projects, or projects generally, do not harm the environment.

"Climate finance" is a subset of green finance, and in a narrower sense of the term, refers primarily to public finance that promotes multilateral efforts to combat climate change through the UN Framework Convention on Climate Change (UNFCCC). In addition to UNFCCC, there is increasing recognition of an emerging normative framework for climate finance.[1] Under the UNFCCC, developed country parties have an obligation to provide financing "from a variety of sources" to developing countries for that purpose. The 2015 Paris Agreement on Climate Change anchors an earlier pledge (made by the 2009 UNFCCC Conference of Parties (COP)) by developed countries to raise USD 100 billion per year; indeed, this is established as the "floor" from which climate finance should be up-scaled post-2020. The Paris Agreement states that financial flows generally must be made "consistent with a pathway towards low greenhouse gas emissions and climate-resilient development." To this end, the public sector increasingly looks to the private sector to leverage its limited financial resources.

2. What are the stated G20 goals and commitments in relation to "Green Finance" and "Climate Finance"?

Green Finance: The Chinese Presidency of the G20 established the Green Finance Study Group (GFSG), following the successful two-year work program by the UN Environment Program (UNEP) and an influential report, "The Financial System We Need: Aligning the Financial System with Sustainable Development". The G20 endorsed the GFSG's Synthesis Report, which recommended a series of voluntary actions around: (1) provision of strategic economic and environmental policy for green investment; (2) principles for green finance; (3) learning networks for capacity building; (4) support for green bond markets and facilitation for cross-border investment in green bonds; (5) knowledge sharing on environmental and financial risk; and (6) improvement in the measurement of green finance activities and impacts. The 2016 G20 Communiqué underscores many of these points.

Climate Finance: The G20 established its Climate Finance Study Group (CFSG) in 2012. The CFSG explicitly operates on the principles, provisions and objectives of the UNFCCC, and recognizes the importance of country ownership. It primarily compares ways in which G20 countries promote public sector

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climate finance so that they can voluntarily take up good practices. In 2016, this Group studied and reported on efficient and transparent provision and mobilization of climate finance[2]; and on mainstreaming climate change considerations into development assistance and climate finance programs[3]. The G20 endorsed these two CFSG reports, which do not contain hard commitments or goals.

The most recent Chinese G20 Presidency sent a strong signal in support of the Paris Agreement, issuing the G20 Presidency's Statement on Climate Change, and taking on a number of voluntary energy initiatives, such as energy access, renewable energy and energy efficiency.[4]

3. Have the G20 goals and commitments in relation to "Green Finance" and "Climate Finance" been fulfilled? What are the challenges?

Overall: To date, no hard commitments or tangible initiatives emerged from either of the Study Groups, though in fairness to the GFSG, it is only a year old and what will come of the recommendations in the Synthesis Report remains to be seen. As noted below, some areas of green finance and climate finance overlap in confusing ways, in part because G20's terms of reference for the two Study Groups lack clarity.

Green Finance Challenges: The GFSG Synthesis Report identified a range of general and specific challenges: (1) inadequate internalization of environmental externalities[5]; (2) maturity mismatches (inadequate supply of long-term funding relative to the demand for funding by long-term projects); (3) lack of green finance definitions; (4) information asymmetries (between investors and recipients of investments); and (5) capacity constraints.

Asymmetry of information constrains efforts to green financial institutions, and is rightly identified by the GFSG as a key challenge in the context of green finance and risk management, even though the issues involved are climate change-related. Because one-third of the world's financial assets are invested in fossil fuel producers and users, individual financial institutions and the financial system itself are vulnerable to future climate policies. This creates a "transition risk" or the risk that the transition away from use of fossil fuels may pose to financial institutions and the stability of the entire financial system. The Task Force on Climate-related Financial Disclosures has started to develop voluntary, consistent climate-related financial risk disclosure measures for use by companies in providing information to investors, lenders, insurers, and other stakeholders. The initiative is led by the Financial Stability Board, a club of rich countries (including members of the G20) and relevant international organizations and bodies, concerned with the stability of the global financial system. This initiative is a welcome development but needs strong support by G20 financial regulators to make meaningful impacts on the markets.

These green finance challenges, especially internalizing externalities, exist as a result of decades of lack of awareness and political will on the part of central banks and regulators, who are captured by the fossil fuel lobby. For central banks, there is scope for exercising leadership in this area, and some countries have done so, as exemplified by China with its Green Credit Guidelines, even though such actions could raise questions about central bank independence. Regulators have largely neglected to regulate or guide banks and investors on best practices. To date, no international organization has a complete grasp of these issues.

Climate Finance Challenges: Overall, there are many pressing challenges, including adequacy and reliability of financial pledges to meet the 2 (or 1.5) degree commitment under the Paris Agreement, adequacy of amounts directed to adaptation, and coordination of various financial flows toward climate-resilient investments. Compared to the magnitude of these challenges, the G20's work on climate finance appears to lack long-term vision or ambition. The CFSG also seems to suffer from lack of internal participation and coordination. Most recently, the CFSG, chaired by Brazil and France, was unable to even collect adequate information from G20 member countries on the questions posed in its June 2016 document, "Promoting efficient and transparent provision and mobilization of climate finance to enhance ambition of mitigation and adaptation actions."

There is a significant coordination issue among climate funds, multilateral development banks and bilateral assistance. The CFSG's most recent work on Mainstreaming Climate Change Considerations into Development Assistance and Climate Finance Programs does not go far enough to ensure the coordination needed to maximize sustainable development and climate co-benefits. Multilateral development banks lack the leadership to shift their portfolios more decisively from fossil fuels to renewables as well as the comprehensive principles and assessment tools to enable a holistic assessment of climate impacts and climate co-benefits. In addition, while the G20 focuses on the public finance dimension of climate finance, a significant coordination challenge exists with much desired leveraging of private sector participation in climate finance.

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In their provision of climate finance, governments should employ criteria for leveraging private investment. For instance, any failure by private investors to internalize externalities means failure to price or tax the cost of carbon pollution (for example, according to the Rio de Janeiro «polluter-pays» principle). The investment management firm, Blackrock, and many other financial actors believe putting a price on carbon will help scale up climate investments. Some 40 countries and more than 20 jurisdictions already use carbon pricing mechanisms. However, civil society organizations (CSOs) argue that carbon pricing should be considered a transitionary measure – see Section 5 below – and that a carbon price establishes other externalities and unintended outcomes.

4. What is the desired future direction of the G20 with respect to "green finance" and "climate finance"?

Overall: In order to carry through with the stated objectives and findings of the GFSG and CFSG, the G20 should prioritize green and low carbon development in each of its work streams. As a matter of priority, sending such policy signals to G20's work on infrastructure investment would enhance the G20's policy coherence. Without mainstreaming sustainability and green/climate content in the infrastructure investment work stream, the G20 not only fails to demonstrate its credibility in this area, but it also raises questions about its very commitment to support the Paris Agreement.

In terms of the challenges described in Section 3 above, some are addressed by various international organizations, but organizations such as the World Bank Group have a long way to go in terms of greening their own portfolios. The G20 countries, as significant shareholders of these institutions, are in a position to exercise their leverage to ensure a level playing field and consistency of approaches by various actors. Given the overlapping challenges shared by green finance and climate finance – for example, the lack of universally accepted definitions – the G20 should also promote consistency and complementarity of the two approaches.

Furthermore, in view of the overlapping nature of green finance and climate finance, the G20 should revisit the terms of reference of the two Study Groups, in order to avoid creating similar work areas with potentially different results, and confusing stakeholders. This task should be carried out with a view to instilling a sense of urgency and ambition in the CFSG in particular.

Green Finance: The wider issues around the financial system reforms that the G20 must undertake to protect the world from another devastating financial crisis should be taken up by the G20 central bankers and finance ministers. Meanwhile the GFSG should move toward promoting the implementation of its recommendations.

Climate Finance: If the CFSG wants to provide adequate support to the UNFCCC, it should ensure the participation of all G20 members in meeting the requirements of the UNFCCC rules, including national ownership and mandatory developed-country led provision of resources to meet the challenges of climate change.

Furthermore, the G20 should continue to encourage all developed countries to abide by the Paris Agreement. Specifically, the Agreement requires that "developed country Parties shall provide transparent and consistent information on support for developing country Parties provided and mobilized through public interventions biennially in accordance with the modalities, procedures and guidelines to be adopted by the Conference of the Parties." (Article 9, para. 7.) In addition, the G20 should ensure that trade agreements and intellectual property rules support the mandate of the Technology Mechanism as designated by the Paris Agreement: "A technology framework is hereby established to provide overarching guidance to the work of the Technology Mechanism in promoting and facilitating enhanced action on technology development and transfer in order to support the implementation of this Agreement." (Article 10, para 4.)

5. What do business and civil society groups expect from the G20 on "green finance" and "climate finance"?

Business 20 (B20) on green finance: Businesses welcome the manner in which green finance can blaze a new path for global economic growth. Specifically, they expect the G20 to facilitate the development of green financing and investment markets by:

- Designing incentives for, and lowering financial costs of, green investments
- Establishing green standards and encouraging disclosure and reporting on the impact of investments
- Building institutional capacity and knowledge through a G20 international platform
- Encouraging or rewarding financial institutions that take actions to measure climate, environmental, and social risks

Civil 20 (C20) on green finance: CSOs are critical of the voluntary nature of GFSG recommendations. In addition, CSOs highlight new dimensions of risk management that pertain to both green finance and climate finance, namely the climate-risk disclosure of financial investments (described above in Section 3).

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C20 on climate finance: CSOs have taken the G20 to task for their lack of commitment for a significant scaling-up of climate finance post-2020, and a clear time-table to reach the pledge of at least $100 billion **per year** by 2020. CSOs urge the G20 to speak out in favor of meeting climate finance pledges and to act on another 2009 pledge made at the U.S. G20 Summit in Pittsburgh to eliminate all fossil fuel subsidies. CSOs also warn that carbon pricing should be a transitional strategy, since it lacks the power to ensure a decisive shift to low- or no-carbon alternatives and, in the absence of supports, could put an undue burden on low-income people (instead of de-incentivizing the highest commercial polluters for which a carbon tax might be more appropriate). Furthermore, such pricing should take into account the cost of carbon to society as a whole, and not just for major economic actors. The Chinese G20 Summit Communiqué and G20 Energy Ministers' Communiqué call for diversification of energy sources and strongly endorse an expansion in the use of natural gas. Therefore, UNFCCC leadership on this issue is crucial.

[1] See for example: https://www.odi.org/sites/odi.org.uk/files/resource-documents/11018.pdf

[2] Report of Climate Finance Study Group, June 2016, Promoting efficient and transparent provision and mobilization of climate finance to enhance ambition of mitigation and adaptation actions, available at: http://g20.org/English/Documents/Current/201608/P020160815356793288948.pdf

[3] Report of Climate Finance Study Group, June 2016, G20 Outlook On Mainstreaming Climate Change Considerations into Development Assistance and Climate Finance Programs, available at: http://g20.org/English/Documents/Current/201608/P020160815355719634016.pdf

[4] G20 Voluntary Collaboration Action Plan on Energy Access; the G20 Voluntary Action Plan on Renewable Energy; and the G20 Energy Efficiency Leading Program issued by the G20 Energy Ministers and mentioned in paragraph 23 of the Chinese Leaders' Communiqué: http://www.g20.utoronto.ca/2016/160905-communique.html

[5] Environmental externalities refer to the economic concept of uncompensated environmental effects of production and consumption that affect consumer utility and enterprise cost outside the market mechanism. As a consequence of negative externalities, private costs of production tend to be lower than its "social" cost. It is the aim of the "polluter/user-pays" principle to prompt households and enterprises to internalize externalities in their plans and budgets. (Source: OECD)

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Author: Motoko Aizawa (motoko.aizawa@ihrb.org)

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Contact: Simone Zühr, zuehr@boell.de