KfW Development Bank

››› Perspectives on Development Financing

No. 7, December 30, 2016

State of international climate policy following the Marrakech Climate Change Conference

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The Paris Agreement took effect on 4 November 2016 with ratification by 115 countries, which are responsible for over 55% of greenhouse gas emissions worldwide.

The most important elements of the Paris Climate Accord

- All countries, regardless of their level of development, undertake to contribute to climate protection and adopt measures to keep the global temperature increase "well below 2°C" above pre-industrial levels. A total of 0.9°C of warming has already occurred within this increase
- The aim is for global emissions to reach their peak as quickly as possible. Net global greenhouse gas emissions are intended to fall to zero in the second half of the century.
- The national climate policy plans presented by the individual countries (Nationally Determined Contributions, NDCs), which are to be updated every five years to increase ambition, are a key tool for putting the global goals into practice on a national level.
- The countries have pledged to shape their development in a manner compatible with the climate. As a result, global adaptation efforts are to be reviewed periodically.
- From 2020 onwards, industrialised countries are set to provide developing countries with USD 100 billion a year in climate action financing.
- Financing flows must be designed to be compatible with a path to climate-friendly and resilient development.
- Initial measures to implement and realise these goals were agreed at the COP22 climate conference in Marrakech in November 2016.

National contributions to target achievement

In contrast to the international climate change policy of the past, the approach of the Paris Agreement is not based on negotiated country objectives. Instead, it puts emphasis on all countries setting their own goals in the form of NDCs, with their high transparency of execution and the regular updating of these goals leading to effective international climate policy.

In line with the precautionary principle, the agreement seeks – via a target range of up to 1.5-2°C in warming – to take account of climate impacts and risks growing exponentially with the level of global warming, meaning that this ideally needs to be kept to a minimum within the bounds of technical possibility. On the other hand, the economic costs of climate protection increase with the percentage of reduction in emission levels. A global cost-benefit analysis of climate policy efforts, within the context of an economic optimum, is only scientifically possible with a large number of value-laden assumptions.

As a result, efficiently executing the highly ambitious Paris climate protection targets at the national level, fairly distributing climate policy costs and revenues, and rationally organising transformative technology policies all acquire particular importance for the future.

In the process, many countries and companies can be expected to push bold climate protection targets independently of specific governmental systems, as part of a broader investment and innovation agenda.

More climate protection…

The goals agreed in Paris entail requirements for global greenhouse gas emissions to be 40-70% below their 2010 level by 2050, and close to zero by 2100. Industrialised countries would have to implement even larger emissions reductions (at least 20-40% by 2030 and 70-90% by 2050) to allow developing countries to enjoy a certain amount of catch-up development. Even then, however, the necessary emissions reductions among developing countries remain bold. Indeed, reaching the 1.5°C target also mentioned in the Paris Agreement would probably require a global greenhouse gas emissions reduction of 85-95% by 2050. This makes it clear that implementing the global goals from the Paris accords will be politically, technologically and economically challenging.

…and more adaptation necessary

The expense of measures to adapt to climate change, which are negligible in relation to those for climate protection, is viewed as politically unsatisfactory by many developing countries. Supporting the poorest countries and small island nations in adapting to climate change is regarded as a core function of international climate financing.

Even if global warming is presumed to be limited to 2°C, the consequences of this climate change may still be severe locally. Adjustment to climate change therefore demands an approach differentiated by region and sector. Action is mainly intended to be undertaken in the water supply, agriculture, coastal zones, cities affected by flooding and heat waves, and sensitive ecosystems.

Responsibility for executing the necessary measures and the bulk of the costs will have to be borne by private households and companies as well as cities and other sub-national public sector structures. These actors are often unaware today that they are implementing climate change adaptation measures in their planning processes. Defining adequate output indicators often remains a challenge when implementing adaptation actions.

Loss and damage; climate risk insurance schemes

Residual damage that cannot be prevented through climate protection and adaptation to climate change is termed “loss and damage” in UN diplomatic jargon, being addressed as the “Warsaw Mechanism” in the climate negotiations. Climate risk insurance schemes – their premiums subsidised by international payments as needed – can make an important contribution to dealing with this residual damage. Germany is an important trend-setter in this area by launching its InsuResilience Initiative for increasing climate insurance coverage in the course of its G7 Presidency. KfW, for example, is making an investment in the African Risk Capacity (ARC) and the Climate Insurance Facility (CIF) within this context.

The rise of climate financing

The climate financing goal of USD 100 billion a year for climate projects in developing countries was agreed in binding form under international law in the Paris Accords for the period between 2020 and 2025. Applying the usual UN allocation formula, Germany is due to pay for around 10% of this.

According to the OECD, the public international climate financing approved by industrialised countries via bilateral and multilateral channels in 2014 amounted to USD 44 billion. The OECD recently estimated, based on information disclosed internationally, that this figure will rise to around USD 67 billion p.a. by 2020. The difference between this and the USD 100 billion threshold is intended to be covered through mobilising private climate change financing.

Among other elements, this assumed that German public climate financing would double from 2014 to 2020, as Chancellor Merkel committed at the Petersberg Climate Dialogue in May 2015. The German government's two-fold increase in its commitments is primarily related to the budget funds deployed by the Federal Government along with the grant element of KfW development loans.

The calculation system used as a basis for the figures above is based on the gross amounts committed without differentiating by financial instruments. Consequently, development and promotional loans from KfW Development Bank are directly counted towards the German public financial contribution. In 2015, KfW Development Bank accounted for EUR 5.3 billion in German public climate financing.

The Green Climate Fund (GCF) was created as a new instrument of the UN Framework Convention on Climate Change to internationally implement climate financing in developing countries. Capitalised with USD 10 billion, the GCF has started to finance climate protection and adaptation measures. Accredited entities (including KfW) assume responsibility in conjunction with the recipient governments for helping to provide the GCF with sustained added value in funding policy by means of potentially transformative project concepts.

Efficiently and effectively allocating funds is a challenge within the complex interplay between actors in international climate financing. In particular, restraining the concessionality level, minimising crowding-out effects in the private sector and recording the impact of promotion are growing in importance.

Implementation of climate policy goals

National climate plans – NDCs

Nationally Determined Contributions (NDCs) are climate policy plans created by countries, in which they publicly announce their self-defined goals to reduce greenhouse gas emissions and adapt to climate change. A total of 190 nations have submitted NDCs, which are the key tool for achieving the Paris Climate Agreement's objectives. NDCs will be a crucial point of reference in the future for designing development banks' climate protection measures. The German Climate Action Plan 2050 adopted in November 2016 breaks the EU climate plan down into sectoral targets and rafts of measures via a national emissions reduction pathway.

Support and subsidy policies for sectoral transformation

At the moment, the idea of internationally coordinating market-based approaches to carbon pricing at individual country level is being discussed by international forums. This would function as a cross-sectoral price signal for greenhouse gas emissions in the form of a tax, an emissions trading system or results-based sectoral policies, which would facilitate economically efficient target achievement without political selection of technology. The rollback of subsidies for electricity or fossil energy sources is another topic of discussion in this same context. Objectives for expanding renewable forms of energy, achieving energy efficiency or decommissioning fossil-fuel power plant complexes are alternative approaches to this. They can be applied within a mix of policies, but are also often accompanied by market-based approaches.

At present, climate action policy is particularly focused on the electricity, transport and construction sectors. Despite having comparable emissions and reduction potential, the manufacturing industry, waste disposal, forestry and agriculture currently receive less political attention for reasons including their greater complexity. In particular, the broader development of renewable forms of energy, electric personal mobility and the expansion of low-energy standards in new construction and existing buildings are being stepped up.

Focus areas for Financial Cooperation (FC)

In the last 10 years, FC has been strongly geared to measures with climate protection or adaptation as their primary or secondary aim, in close coordination with the relevant contracting entities (especially the Federal Ministry for Economic Cooperation and Development, Federal Ministry for the Environment, Nature Conservation, Building and Nuclear Safety and the EU). In the past few years, climate action projects of this type have represented around 55% of new commitments by KfW Development Bank each year. A realignment was therefore not necessary after COP21. In the years ahead, however, FC is likely to support even stronger transformative approaches (including by promoting the national reform agenda through policy based lending or co-financing of national investment plans) and the mobilisation of private investments (e.g. via guarantee instruments, structured funds, GET-FiT and PPP methods).

Implications for the financial sector…

In 2015, the issue of climate change was elevated by the G20 group of nations to the agenda of the Financial Stability Board (FSB) – an international body for supervising the global financial markets – on the initiative of figures including UK central bank governor Mark Carney. Important parts of the financial sector have since been making efforts to understand and take account of the financial risks and opportunities within business policy resulting from climate change and climate policy.

It is often evident that the climate impacts to be expected are small for the investment period of most investors compared with other investment risks. The discussion around a systematic overvaluation of companies in the fossil energy industry ("carbon bubble") has not yet resulted in a revaluation of this sector.

The financial sector is well aware of the risk of "stranded assets" due to policy shifts, though this is not limited to high-emissions sectors. An international divestment campaign against investments in coal power and technology from pension and government funds as well as insurance companies is making its first impacts.

KfW Development Bank has taken a low-emissions position early on with the direction of its portfolio focusing on climate change, for instance in the energy and transport sectors.

In line with the FSB's recommendations, in the course of considering scenarios, financial institutions would quantify risks related to climate change (policy) in the years ahead and would put these on a comparable basis with capital market risks and project risks.

Ensuring that finance flows are compatible with international climate targets (as is sometimes called for) cannot be fully operationalised on an institution-wide level for sectorally diversified financial institutions. The redirection of finance flows will therefore depend strongly on the willingness of governments to change the general sectoral conditions for climate-essential investments within their range of competence.

…and for the development banks

As a result of its strong starting point, its political mandate and its particular skills, KfW is entitled to a key position in bringing about the transformation outlined above, both in Germany and in many developing countries and emerging economies. This runs the gamut, including demonstrating and expanding new technologies while complying with high environmental and social standards, providing long-term financing and assuming additional costs and risks to mobilise private investments, and strengthening reform processes and general conditions.

In particular, development banks from industrialised and developing countries are to play a key role in this area via long-term financing packages with 15-20 year terms, assuming additional costs for especially innovative or efficient technologies, or covering national risks and structuring financing. They have a wide array of tools at their disposal in this process, ranging from grants, equity investments and guarantees to loans with different degrees of interest reduction (concessionality). By dealing with environmental and social standards in an exemplary fashion, they can help to improve national practices and ensure long-term acceptance of climate protection and adaptation approaches and technologies.

The International Development Finance Club (IDFC, http://www.idfc.org) co-funded by KfW in 2012, which presently encompasses 23 national and sub-regional development banks with a total of over USD 600 billion committed each year, is an important platform for exchange and cooperation between development banks from industrialised and developing countries.

Outlook

The following three areas of action will be especially relevant in the coming years:

a) Remodelling the worldwide energy system, in particular integrating a rapidly growing proportion of fluctuating renewable energy sources (wind and sun) into the grid and phasing out fossil fuel power plant capacity in the move to a continuously growing and reliable power supply.

b) Coordinated action (such as via the G7/G20 Agenda) towards worldwide carbon pricing, rolling back fossil energy subsidies and significantly increasing energy efficiency.

c) Sectoral definition of details and implementation of the NDCs with a view to the decarbonisation targets by 2030 in the G20 nations. This will create new approaches for loan-based sectoral reform programmes in some countries.

The UN climate process (UNFCCC) is assigned the important task of creating a credible and efficient system for transparency and comparability of national efforts around climate protection and climate action financing, helping to align the state of ambition and implementation on a global level (“global stocktake”).

To complement these major challenges, the COP23 climate conference, over which the island nation of Fiji will be presiding in Bonn, Germany in November 2017, will make the topics of island countries, adaptation and insurance schemes an area of focus.

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Photos

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