The Commonwealth

Discussion Note

Commonwealth Finance Ministers Meeting 2016

Unlocking Climate Finance for Commonwealth Countries

Prepared by the Economic Policy Division, the Commonwealth Secretariat[1]

Summary

The world has committed to an ambitious climate action agenda, and colossal financial resources are required to deliver this action. Commonwealth developing countries are some of the most vulnerable to climate change in the world, and will bear a disproportionate burden of the harmful impacts. The Commonwealth Secretariat is working to support its developing-country membership to access climate finance and build low-carbon, climate-resilient countries through four channels: (1) advancing an ambitious global consensus to limit climate change and address its harmful impacts; (2) directly supporting member governments to improve their access to climate finance; (3) promoting initiatives to increase the quantity of finance for green investments; and (4) advancing financial instruments that build fiscal resilience to climatic shocks.

Ministers are encouraged to:

- provide continued support for current Commonwealth Secretariat climate-related action, as well as consider other areas where greater Commonwealth action would be valued; and
- share the practical challenges and opportunities they face to finance adaptation and mitigation investments.

The purpose of this paper is to provide an update of the Commonwealth Secretariat's climate-related initiatives.

1. Rationale for climate action

The world has committed to an ambitious climate action agenda. Targets have been set to reduce greenhouse gas emissions to safe levels, transition the global economy to a low-carbon path and build the resilience of vulnerable countries to climate change. According to the World Economic Forum, by 2020, approximately $5.7 trillion USD will need to be invested annually in green infrastructure to deliver on this demanding agenda: an amount considerably higher than the current level of climate finance.[2] A significant proportion of climate finance should be channelled to Commonwealth developing countries, as they are already suffering significant loss and damage associated with the adverse impacts of climate change, and – for some – such effects will threaten their very existence. Yet climate finance has not been flowing to those that most require support for adaptation and mitigation. For instance, between 2003 and 2016, Commonwealth small states received less than 5 per cent of all bilateral and multilateral climate finance flows.[3]

In 2013 the Commonwealth Secretariat established an Expert Group on Climate Finance to address this imbalance and set out a more strategic approach to the Commonwealth's work. Since then the Secretariat has scaled up its climate finance action, and is planning to maintain and extend this commitment in line with the Commonwealth Heads of Government Meeting (CHOGM) Climate Action Statement and the Secretary General's prioritisation of this agenda.

2. Commonwealth Secretariat initiatives

2.1 Global advocacy and consensus building

The Commonwealth has been calling for collective action on climate change since 1989. The initial agenda was articulated in the 1989 Langkawi Declaration on the environment. At CHOGM 2009, Heads of Government agreed to the Port of Spain Climate Change Consensus: The Commonwealth Climate Change Declaration. This declaration was circulated on the eve of COP15 in Copenhagen and had a decisive impact on it.

A similar approach was pursued for COP21, where Commonwealth leaders asserted their commitment to an ambitious agenda to limit the impacts of global climate change, as articulated in the CHOGM 2015 Commonwealth Leaders' Statement on Climate Action.[4] The Secretariat used the COP21 platform to advocate for the main principles of the CHOGM Climate Action Statement. The key messages from the statement were reflected in the Commonwealth Secretary-General's speech, which was submitted to the United Nations Framework Convention on Climate Change (UNFCCC) as part of the official opening.

In April 2016, the Commonwealth Secretary-General hosted a Commonwealth Dialogue on Climate Change. This dialogue reaffirmed the central role the Commonwealth will continue to play in addressing the existential threat of climate change now and into the future. The Commonwealth will hold a Conference on Climate Change in October 2016 to inform our planned climate change strategy.

2.2 Supporting member countries to access climate finance

The Commonwealth is currently taking practical action to enhance Commonwealth countries' access to climate finance through the Climate Finance Access Hub ('the Hub'). The Hub was a key recommendation of the 2013 Commonwealth Expert Group on Climate Finance, and its establishment was endorsed at the subsequent 2013 and 2015 CHOGMs. It seeks to strengthen the capacity of host countries/institutions to access climate finance at the national level and sustainably implement climate change actions. The Expert Group identified the complex and crowded climate finance landscape as one of the main bottlenecks in the way of scaling up climate finance for developing-country members. Since member countries often do not have the time and resources to navigate and optimise access to climate funds, the value of the Hub lies in the flexible deployment of climate finance advisers (national and regional) who are linked to a capacity development programme. It works to embed long-term capacity in member governments, using a programmatic approach, rather than project-based/short-term approaches. Linked to this is collaboration with a range of regional and national partners working in climate finance to ensure that the Hub complements other readiness initiatives. These partners have also reaffirmed the need for the Hub.

The Hub is currently being operationalised and will be hosted in Mauritius. The signing of the Hub's hosting agreement will take place in September 2016, by which stage the General Manager and first set of national advisers will be in place. The Secretariat has received 15 requests from member countries for national advisers.

The Commonwealth Secretariat and the governments of Australia and Mauritius are contributing resources for the initial implementation of the Hub until July 2017. Once fully operational, the programme will require an operational budget of approximately £4 million per annum over 4 years to support the placement of 24 national advisers, 6 regional advisers and the Hub headquarters in Mauritius including a knowledge management mechanism. The Commonwealth Secretariat is working to secure funding to scale up the programme. Both membership and alternative external resources are also being explored to potentially support full implementation.

Member countries are encouraged to consider providing additional financial contributions for the Climate Finance Access Hub to support its full operationalisation.

2.3 Increasing the quantity of finance for green investments

The Commonwealth Secretariat is actively supporting two initiatives that aim to increase financial resources available for green investments in Commonwealth small states and least developed countries (LDCs).

Commonwealth Green Finance Facility

The first is the Commonwealth Green Finance Facility (CGFF). Proposed at the CHOGM in 2015, the CGFF initiative is taking forward a mandate to explore options for mobilising private capital to finance small-scale green projects across the Commonwealth.[5] The Commonwealth Enterprise and Investment Council (CWEIC) and the Prince of Wales's International Sustainability Unit (ISU) have co-chaired the working group that has been established to develop the CGFF proposal and will present an update to ministers at the meeting.

The CGFF proposal outlines the strategic case for establishing a new facility, illustrating the financing gap for green private sector investments in Commonwealth small states and LDCs. It provides three mutually reinforcing options for Commonwealth action to address the financing gap, focusing on:

- increased advocacy to facilitate appropriate private sector financing solutions for small and vulnerable states;
- increased technical and capacity-building support to enable countries to more successfully access finance for green private sector projects; and
- new risk capital to directly finance green projects and leverage additional finance for these investments.

Multilateral Debt Swap for Climate Action

The second initiative is the Commonwealth's Multilateral Debt Swap for Climate Action. At previous Finance Ministers meetings, members have expressed concerns about the rapidly growing and unsustainably high debt burdens in many Commonwealth small states. Such countries are also often very vulnerable to the negative consequences of climate change and have limited fiscal space to respond. In response, the Commonwealth identified a solution to address both these concerns, in the form of a Multilateral Debt Swap for Climate Action. The debt swap mechanism aims to channel pledged climate finance to pay down the multilateral liabilities of indebted small states, in exchange for small states' commitments to invest saved resources in climate change projects. There is no guaranteed debt relief but it can be provided by climate finance providers, should they agree. The main benefit of the swap proposal is a ramp-up of investment in climate resilience projects and improved debt management through a reduction in foreign exchange risk by writing down multilateral debt usually contracted in foreign currency.

This year the UN Secretary-General, the World Bank, the United Nations Economic Commission for Latin America and the Caribbean (UNECLAC) and UNFCCC have all articulated their support for the Commonwealth's Multilateral Debt for Climate Action Swap and the concept is gaining more traction. We are collaborating with UNECLAC, through a newly established task force, to facilitate the roll-out of debt swaps. Furthermore, the Commonwealth is now working closely with the World Bank to pilot a variation[6] of the Commonwealth's debt swap in a member country.[7]

2.4 Advancing financial instruments that build fiscal resilience to climatic shocks

Evidence continues to show that climatic shocks can have devastating effects on small states and LDCs. As many member countries are particularly vulnerable to these shocks, the Commonwealth Secretariat has started a new programme of work to advance innovative financial instruments that build countries' fiscal resilience to these events. To date, the international shock-financing architecture has predominantly been skewed towards post-shock financial facilities. These have their value and are a crucial means for funding recovery initiatives in the aftermath of a disastrous hurricane, earthquake or drought. However, in the face of criticisms concerning the adequacy of support – in terms of the timeliness of disbursements, access to concessional finance for the most vulnerable countries and scale of support – international financial institutions (IFIs), the G7 and the G20 have turned their attention towards pre-shock financial instruments to deliver more effective disaster risk finance strategies. Such instruments include insurance products, contingent loans, index-linked securities/loans, and hedging and risk management instruments. The pre-shock financial architecture is complex and burgeoning, and considerable work is required to outline the financial implications for the adoption of particular financial instruments/ portfolios for countries.

To enhance disaster risk finance strategies, the Secretariat aims to provide technical guidance on the financial implications of adopting ex-ante financial instruments, either individually or as part of a disaster risk finance strategy, as well as technical advice to countries interested in implementing these ex-ante financial instruments. To date the Secretariat has focused on index-linked loans/securities which provide a stay on debt service payments immediately after a shock, and has been examining two operative examples: Agence Française de Développement's (AFD's) 'countercyclical loans' and Grenada's 'hurricane clauses'.[8] The Commonwealth Secretariat has presented this work at the Paris Club and is working closely with some IFIs on this issue. Relevant policy papers documenting these new innovations will be made available at the ministerial meeting.

Member countries are encouraged to provide a preliminary indication of their desire to work with the Secretariat to make greater use of ex-ante financial instruments to build fiscal resilience to climate shocks.

Notes

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2 The current level of climate finance invested in low-carbon and climate-resilient actions is estimated to be US$391 billion p.a. (Climate Policy Initiative 2015). From *Scaling up Green Finance in Commonwealth Countries: The Case for a Commonwealth Green Finance Facility*.

3 According to the Climate Funds Update website. http://www.climatefundsupdate.org/

4 The Paris Agreement sets an unambiguous goal to hold global temperature increase to 'well below 2°C' and for parties to pursue efforts to limit this to 1.5°C above pre-industrial levels. Commonwealth states communicated the need for greater ambition, with 52 out of 53 member countries committing to 1.5°C through the CHOGM 2015 *Commonwealth Leaders' Statement on Climate Action*.

5 The members articulated their support for the CGFF in the *Commonwealth Leaders' Statement on Climate Action*, 2015.

6 It focuses on bilateral rather than on multilateral debt.

7 Commonwealth Secretariat (2016), *Multilateral Debt Swap for Climate Change Adaptation and Mitigation Proposal: An Exposition of the Operational Features*, Discussion Paper 21, Travis Mitchell.

8 The AFD's 'countercyclical loans' provide the right to defer up to 10 semi-annual principal instalments (whether consecutive or not) upon the occurrence of a triggering event that is linked to a fall in commodity export earnings. The collection of hurricane clauses in Grenada's three debt-restructuring agreements in 2015 enable a stay on debt repayments or the option to fast-track debt restructuring in the event of a natural disaster.