What carbon finance for what agreement to operate the Cancun's paradigm shift?

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Lessons from the ‘unachievement’ of the Kyoto Protocol

• a ‘mental map’ imprinted by the vision of a world Cap and Trade system with ***unique carbon prices*** throughout all sectors and countries with ***compensating transfers*** for the losers.

• this mental map ignores that significant carbon prices

- **hurt emerging economies over the short run** (higher share of energy expenditures in households budget and in production costs)
- do not prevent them to be **locked - in** carbon intensive growth patterns *(carbon prices alone can’t shift urban dynamics and the content of building and transportation infrastructures)*

• **‘fair’ compensating transfers** are hardly negotiable in a ‘burden sharing’ approach which comes to:

- raise the question *who picks the (very few) remains?*
- loose sight of the benefits of the cooperation

The meaning of the Cancun's « paradigm shift »

- From fair "burden sharing" to "equitable access to development"
- Nationally Appropriate Mitigation Action align with development objectives (Bali)
- The Global Climate Fund as a tool for this alignment under the common but differentiated responsibility principle
- « Green Growth » advocated as a new form of 'Marshall Plan' (low wave of infrastructure investment to achieve the LC transition

Climate Finance at risks of the distrust?

- What capital outlay for the Global Climate Fund?

- A context of ***’depression economics’, ‘public debts’*** and ***rebalancing of the world economic equilibrium*** can only:
  - exarcerbate the **‘donor fatigue’** in the Annex 1 countries
  - Reinforce the **social resistance** to carbon pricing (explicit or implicit)

- Limitations of current climate finance initiatives:
  - Clean Development Mechanism: ex post cash flows only
  - Low leverage ratios of low carbon Public Finance Mechanisms
  - Fragmentation

Turning the question upside/down

- **No debt bailout and lasting economic recovery w/o climate policy?**

- The question is **stupid if** you think that **climate finance** is doomed to remain a **marginal** department of global finance

- It is **dangerous** if you think that linking two sensitive issues is a **diplomatic non-starter**

- It is **not stupid if** you have in mind:
  - the induced investments generated by the 264-563 G$ of up front investment costs appraised by the WB for 2030 (2% of the world GDP)
  - The **paradox** of debt crisis in a context of huge amounts of world savings

- it is **unavoidable** if you have in mind that ignoring the short term constraints on economies also leads to a **diplomatic dead-end**

Why the non 'climate concerned' should be interested in climate policies

The world economy between 'instable growth' and 'depression economics'

- The paradoxical ***co-existence of large savings and private and public debts***
- ***« Saving glut »*** and ***« Buridan's Donkey »*** dilemma for industrial investors
- Risks of ***depression*** vs risks of **re-unleashing the 'commerce of promises'**
- ***Banking systems*** still ***fragile*** and under ***deleveraging*** process
- Tensions due to a « ***currency cold war*** »

Any new growth regime implies

- To redirect savings towards infrastructures and industry instead of speculation
- a more inward oriented industrialisation
- A more resilient financial and monetary order

Low carbon finance is a good candidate to contribute to sustainable economic recovery with …. less « ups and downs »

The agenda

- **Inject liquidity provided that it is used to fund low carbon investments**
- **Awake the Buridan's Donkey:** public guarantee to lower the risks of LCIs and enhance the low carbon entrepreneurs'solvency
- Make the **Banking System** interested in funding LCPs through facing their capital constraint and improve their risk-weighted assets (RWA)
- **Make institutional investors** interested in Carbon Based Financial Products to attract savings (instead of real estates and others …)
- Trigger a **wave of LCP in infrastructures**
  - Revitalizing the industrial fabric in OECD countries
  - **More inward-oriented growth** in emerging economies

Sketching a possible mechanism

1. **Its anchor :** an agreement, under UNFCCC on **a Social Value of Avoided Carbon Emissions** (SVC)
2. **Voluntaree commitments by governements** to back a quantity of **carbon assets** over a five years time period
3. Central banks open **drawing rights on these carbon assets** and accept as repayment **carbon certificates (CC)** to fund LCPs
4. **An Independent Supervisory Body**
   1. Negotiates with the governments the **NAMAs** to which these LCP should contribute to secure their development benefit
   2. Secures the **« statistical additionality »** of the project
5. After certification of the completion of the project: **asset swap** …. the CC are turned into carbon assets which appear on the balance sheet of the Central Banks (like gold), Banks or entreprises

An agreement on the Social Value of Carbon

1. **Surrogate of a « price signal »** to avoid the risk of fragmentation of climate finance

2. **↘ risk-adjusted perceived costs** of LCPs (= ↘ credit interest rate and leverage global **private savings**)

3. **Politically acceptable** in climate negotiations, this is a notional value, **not** a carbon price

Risk-adjusted costs of LCPs, a matter of total costs and not of only ‘incremental’ costs

Projects	**BAU**	**Low carbon**	
Up-front costs (planning and building phases)	100	100	
Excess up-front costs		10	-5
Operating costs	14	9	
Non carbon-related risks (technological, country, currency etc.)	10	20	-8
Carbon-related risk	2.5		-x
Risk-adjusted costs	**126.5**	**139**	**<126**

grant

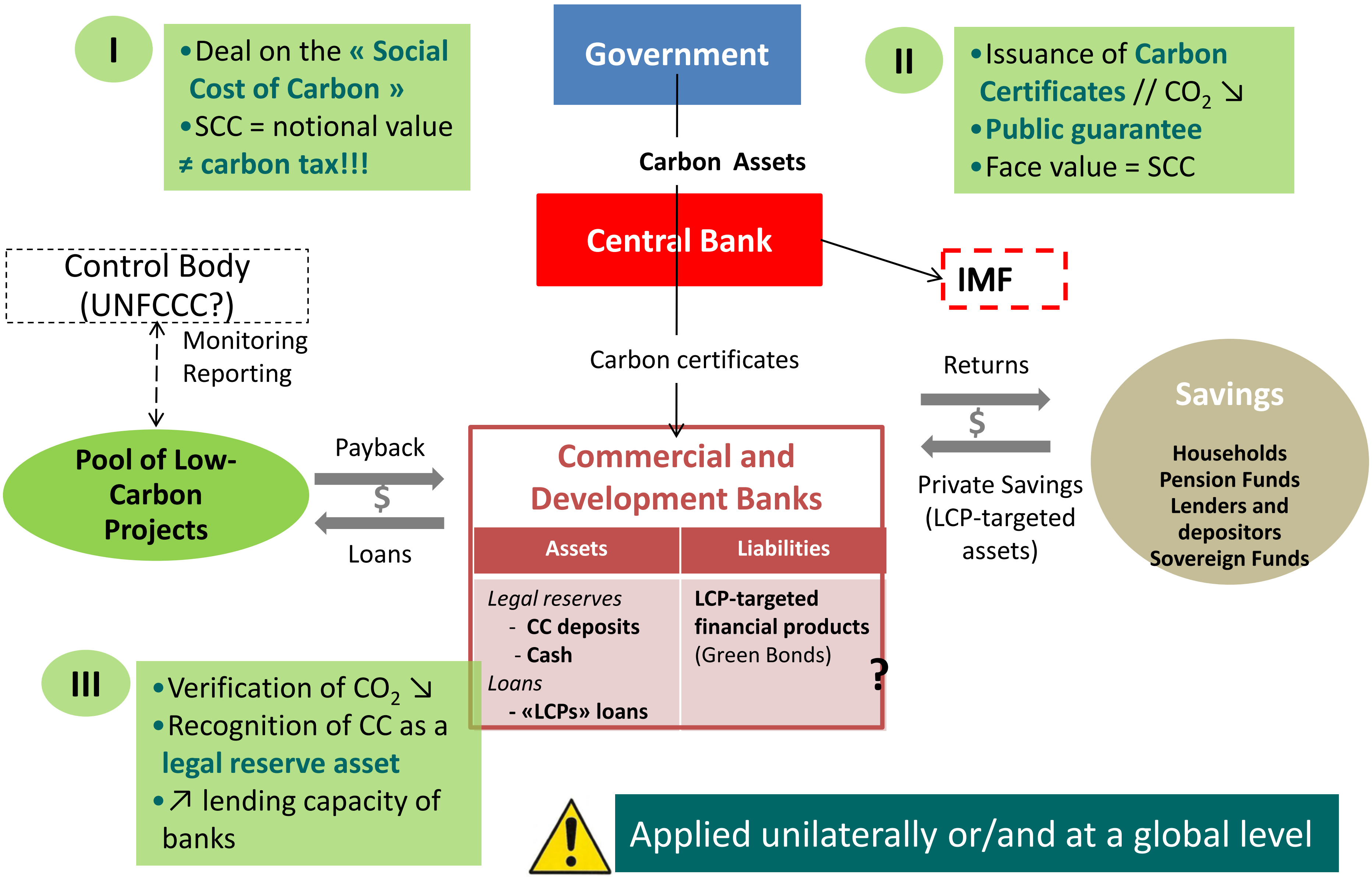
Public guarantee

Carbon tarding scheme *

Climate finance tools

* Carbon-related risk for the LCP depends on the tool used to make the carbon price happen: (i) in case of a carbon tax, the LCP avoid any carbon penalty, (ii) in case of a carbon trading scheme the risk gets even negative as the project would receive carbon revenues

A Climate-Friendly Financial Architecture

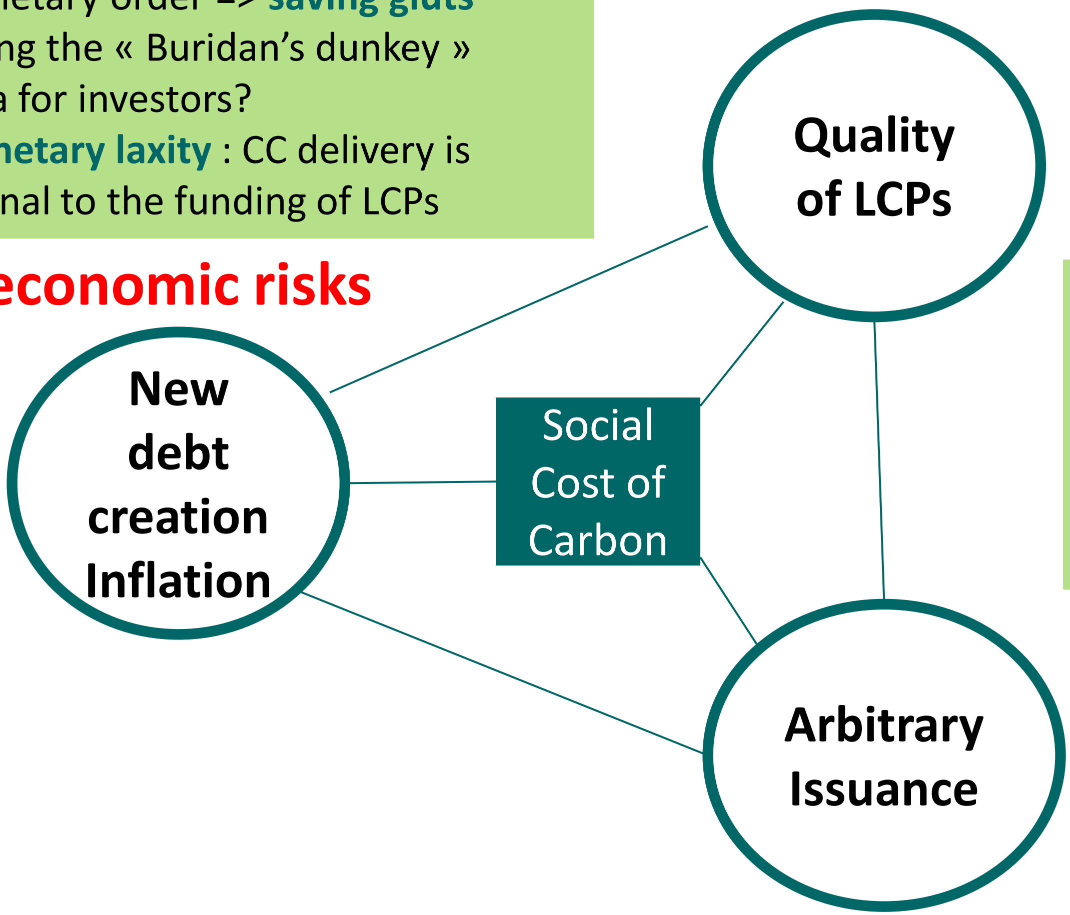


Adressing potential risks of the system

- Major imbalances of the global financial and monetary order => **saving gluts**
- Resolving the « Buridan's dunkey » dilemma for investors?
- **No monetary laxity** : CC delivery is conditional to the funding of LCPs

Macroeconomic risks

Environmental risk



- Taking stock of **CDM experience**
- From « project-based » additionality to **« statistical » additionality**

Regulation risk

Not a magic bullet ! A climate-friendly financial device to redirect part of (misused) savings toward a « green growth » recovery

Meeting the Common but Differentiated Responsibility Principle?

1. Carbon assets are created on a voluntaree basis countries under agreed upon rules
2. The geographical direction of the CCs and LCPs is not pre-determined
3. A net capital flow between Annex 1 and non Annex 1 countries has to be secured by a rule such as the distance between emissions and a ‘normative’ emissions trajectory compatible with the 2° objective
4. The drawing rights on the system has to be invert correlated to the distance between the announced pledges and this normative trajectory
5. A share of the carbon asset should be devoted to the provision of the capital of the Green Climate Fund

To sum up

1. A deal on the **« Social Cost of Carbon »**
2. **Money creation back on real wealth**
    - Avoided climate risks
    - Infrastructure investment
3. **No unleashed 'commerce of promises'** an no risk of 'speculative bubble' on carbon
4. A concrete way to secure « equitable access to development »
5. A respected **CBDP which can be progressively extented** to the most advanced of emerging economies
6. And a device palatable for 'non climate' concerned stakeholders

Elements for a brainstorming

- *Hourcade J.C., Perrissin Fabert B. Rozenberg J.* Venturing into uncharted financial waters: an essay, on climate-friendly finance, ***International Environmental Agreements*** (2012) 12:165–186, DOI 10.1007/s10784-012-9169-y

- *Aglietta M., Hourcade J.C.* Can Indebted Europe Afford Climate Policy? Can It Bail Out Its Debt, ***Intereconomics*** , 2012/3

- *Hourcade J.C., Shukla P.* Triggering the low carbon transition in the aftermath of the global financial crisis, ***Climate Policy*** **Volume 13*, Supplement 01*, 2013**

- ***And a side event next Thursday at 6 pm co-organized by the CIRED and the Caisse des Dépôts et Consignations***