



The Central Role of Financing in the Paris Agreement and Opportunities for National Development Banks



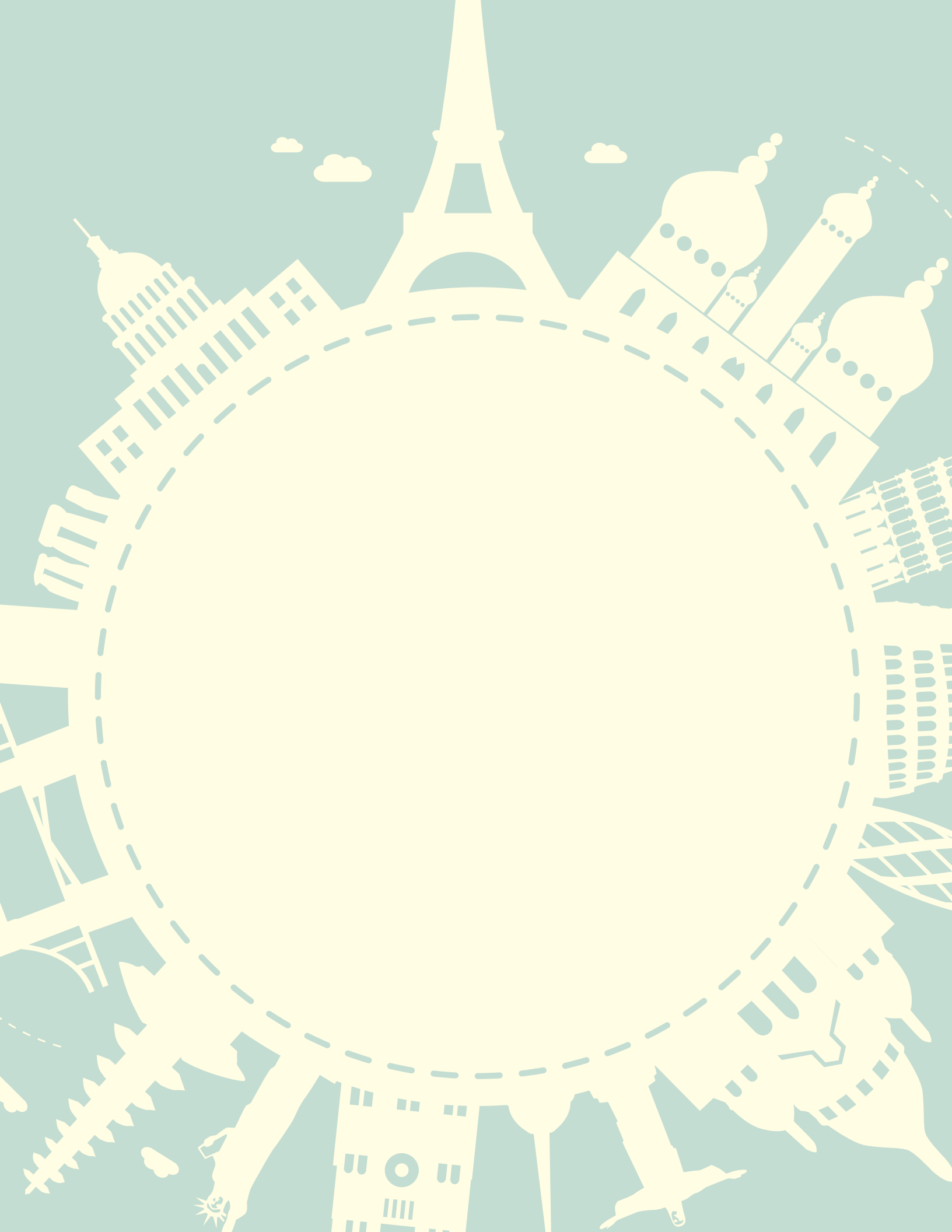
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The recently adopted Paris Agreement implements a transformation and innovation process in the world economy to mitigate climate change and attenuate its impact. The financial institutions, in particular the national development banks, will play a critical role in the implementation of the Agreement, making it possible for countries to comply with their national contributions through vast investment processes, to benefit from the opportunities created by the economic transformations, to access climate financing for adaptation and mitigation and to be able to moderate climatic risks, among them also those associated to the emerging risks of stranded assets through full substitution of fossil fuels in the global energy systems.

THE AGREEMENT

Financing has had a decisive role in the construction of the consensus leading to the Paris Agreement, adopted by 195 countries on December 12, 2015.

That Agreement, which constitutes a milestone of climatic diplomacy, represents a concerted response from the international community –primarily based on cooperation– to tackle climate change. It fosters the willingness to engage on the Parties to the Agreement, instead of in the power to apply sanctions to those who do not comply.

The Agreement seems to point out –unequivocally– the end of the era of fossil fuels.

"The Paris Agreement is a historical milestone of international efforts in the fight against climate change. The agreement is both ambitious and just. ...

"The IDB collaborated with Latin American and Caribbean countries to reach this milestone. We are now ready to increase our financial and technical support to help them to implement the agreement and to make an effort in limiting the increases in global temperatures to less than 1.5°C".

*Luis Alberto Moreno
President of the Inter-American Development Bank
December 14, 2015*



Strictly speaking, what is commonly called the Paris Agreement encompasses three different elements:

- The Paris Agreement itself, which is structured as an Annex of the text of the adopted decisions, is legally binding, constitutes the core of what was negotiated, and contains stable and lasting elements for climatic action which must remain without substantive changes as a result of what was jointly negotiated.
- The decision of the Conference of the Parties¹ Includes the draft decision, through which it is decided to approve the Agreement, and then other decisions which include related important aspects, among others, the Intended Nationally Determined Contributions (INDCs), mitigation, adaptation, financing, and losses and damages, which was preferred not to include in the body of the Agreement; the decisions are designed to ensure that the Agreement can be effectively and transparently implemented.
- An Agenda for Action. An agenda of solutions and commitments complementary to the formal agreements adopted at the COP 21, that resulted in a vast number of commitments for action with a view to reduce emissions and increase adaptive capacity, which were made public by countries, regions, cities, institutional investors and companies.

The Ambition

In order to achieve its objectives, the Agreement proposes on the one hand "to ensure that global greenhouse gas emissions reach their highest point as soon as possible" while "striking a balance" between those emissions and the absorption by sinks in the second half of the century. In practice this means that net emissions associated with human activities must be zero.

The Agreement also establishes as an objective maintaining the increase of global mean temperature much lower than 2°C with respect to preindustrial levels, but at the same time recommends "continuing the efforts to limit that increase of temperature at 1.5° C, that is, toward an even more ambitious mitigation objective.

At the same time, the Agreement is clearly aimed at implementation: all countries commit to carrying out actions to reduce greenhouse gas emissions (mitigation) and to improve the resiliency of national societies (adaptation) through the presentation of Intended Nationally Determined Contributions (INDC).

In order for those contributions to materialize, it is necessary to ensure political consistency, make financial resources available, involve economic and social actors, develop of new financial instruments, and strengthen local institutions to ensure that the proposed contributions make their impact where it is more effective and necessary.

In this regard, the Agreement establishes some provisions and essential elements to periodically increase the ambition of the countries in the action, particularly regarding mitigation:

- The countries must update the actions they intend to carry out every five years, and each updating should be at least as robust as the previous one, that is, the proposed action must be incremental and progressive. In fact, countries may already present an up-to-date contribution when they forward the agreement ratification instrument (See the figure on the Road Map of the Paris Agreement).
- A country may adjust its contribution to increase the ambition level at any time.

1. Published by the UNFCCC as document FCCC/CP/2015/L.9/Rev. 1 and cited here in its Spanish version.



THE ROLE OF CLIMATE FINANCING

Financing has been essential in achieving the necessary consensus to adopt the Paris Agreement, since developing countries have understood that it is necessary to ensure the provision of financial resources that are in line with their needs, which constitutes the indispensable counterpart of the efforts –particularly mitigation– that they must carry out.

With regard to climate financing, the Agreement explicitly frames the obligations of the countries on climate and includes three key elements for this:

- At the institutional level. The Green Climate Fund (GCF) and the Global Environment Facility (GEF), which are the entities in charge of the operation of the Financial Mechanism of the Convention, will also serve as financial mechanism of the Agreement. These institutions will then have the responsibility for allocating the incremental financial resources channeled for climate financing from the effectiveness of the Agreement.²
- Public financing. Public financing plays a critical role, especially in the actions aimed at improving resiliency and adaptation, and also in enabling leveraging and mobilizing resources from other sources, in particular funds from the private sector. Hence it is important that the Agreement has established that "in the supply of a higher level of financial resources a balance should be sought between adaptation and mitigation" (Art. 9.4 PA) and that "The Parties that are developed countries shall communicate biennially... the projected levels of public financial resources that they will be provided to the Parties that are developing countries, when these are known." (Art. 9.5 PA), with a view to ensuring, in this manner, greater predictability of the financial resources that are made available.
- Collective financing goals. The Decisions issue a very strong signal on this matter, indicating the need to expand financial support to ensure the transition toward low carbon and climate-resilient economies. Furthermore, the Conference of the Parties may establish, in the future, financial contribution goals for the Parties, in particular for developed countries, a function generally opposed previously by these countries. Thus the text establishes that "it was decided... that developed countries have the intention of maintaining their current quantified collective mobilization objective until 2025... ; before 2025, the Conference of the Parties serving as the meeting of the Parties in the Paris Agreement (CRA) will establish a new quantified collective objective that will amount to at least to 100,000 million dollars per year, taking into account the needs and priorities of the developing countries; (Para. 54 Dec. -/CP.21).

2. In the case of the Global Environment Facility (GEF) is the management of resources made by the Least Developed Countries Fund and the Special Climate Change Fund, which are managed by the GEF, are also included.



The Agreement, in its Art. 2.1.c, also expresses an innovative purpose, consisting in aligning the financial flows with low carbon global development. That article establishes that it is necessary "to increase the financial flows at a compatible level with a trajectory that leads to a climate-resilient development and with low greenhouse gas emissions," thus recognizing once again the central role of financing in modifying the global trajectory of emissions and it sends a powerful signal to governments, public and private financial institutions and, in general, to the economic agents to rethink from now on the rationale behind investment decision-making.

Furthermore, in the decisions to make the agreement effective, the approved text recognizes the importance of adequate and predictable financial resources, including results-based payments, as appropriate, for the application of policy approaches and positive incentives designed to reduce the emissions due to deforestation and forest degradation and to promote the conservation function, sustainable forest management, and the increase of forest carbon stocks (REDD+). This is another very important subject for Latin America and the Caribbean, where the conflict between food security and the need to produce agricultural goods for export versus the impetus to deforestation processes that the former imply, should find approach mechanisms in which the introduction of results-based payment, within the framework of REDD+ actions, can contribute to resolve.

A central feature of the Agreement is, strictly speaking, that its ultimate value resides in the quality of its implementation and there is where climate financing plays a critical role. The provisions contained therein will accelerate and expand the availability of financial resources for climate action, in a context in which multiple initiatives are already in place to expand the magnitude and scope of the financing.

Thus, the large financial institutions have committed to increase the scale of their financing and of investments in renewable energies, transportation, and low-emissions agriculture, resilient infrastructure, and innovative technologies, and the issuance of green bonds has grown formidably and the development of new financial instruments to reduce the risk profile of the investments, even as the investment costs of low-carbon technological options decrease.

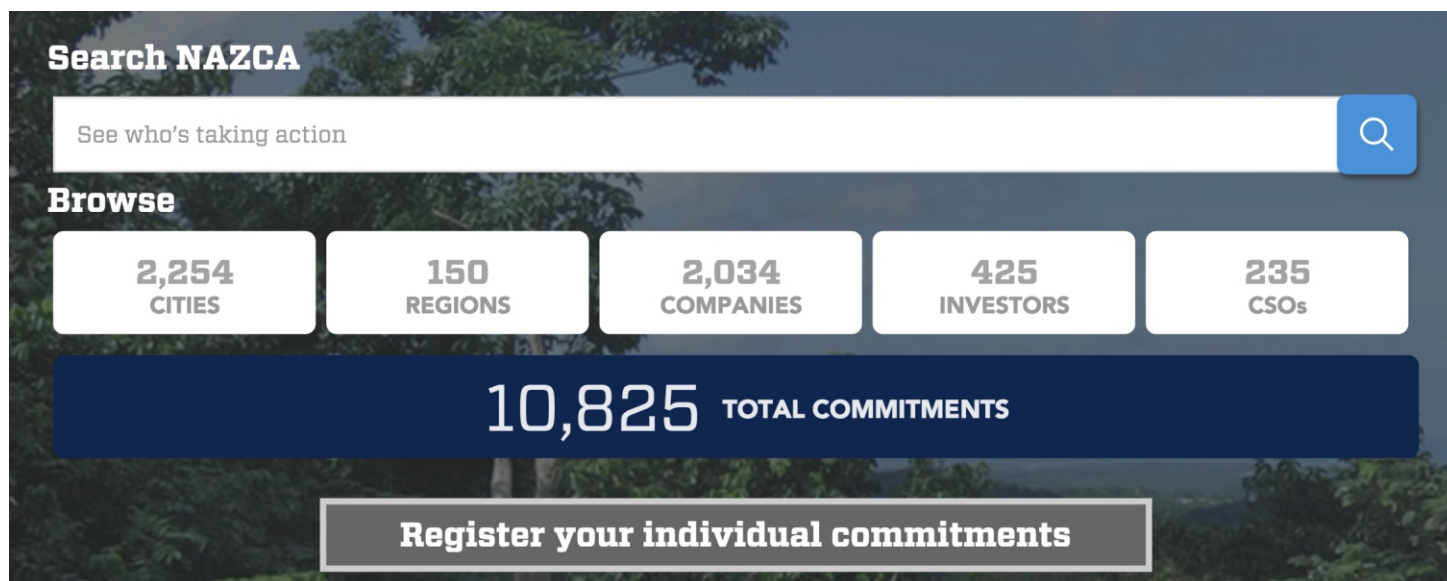
Furthermore, some estimates indicate that, for example, international public financing originating in developed countries could increase up to some \$18.8 billion dollars per year by 2020.

The Agreement should then give an irreversible impetus to processes designed to convert current investment flows to green investments and reduce the financing still available today bound for intensive carbon investments.

The latter, on the other hand, is already beginning to occur each time with greater strength, as shown by the decisions of the so-called "Portfolio Decarbonization Coalition," whose members manage some \$600 billion in assets, and have committed to divest in high-intensity carbon assets, as well as those of some 500 institutions involved in the Campaign for Divestment in Fossil Fuels, that total some \$3.4 trillion in assets.



Furthermore, the Nazca Climate Action Portal (Non-State Actor Zone for Climate Action. NAZCA) launched during the COP 20 in Lima records the climate response commitments of non-state actors: companies, cities, regions, and investors.



Thus an international collective effort has been implemented in Paris that should lead to the decarbonization of the 'global economy in the long run. That means initiating radical transformation processes in the energy systems and in the production processes, as well as gradually modifying the current consumption patterns of goods and services.

Then, the Agreement, in practice, is going to manage the initial transition to a low-carbon economy. By giving sense and direction to the deployed transformation process, the economic actors can now perceive with greater clarity that it makes sense to be part of the transformation, instead of remaining stranded in the 20th century economy, primarily sustained in wasteful consumption of fossil fuels.



THE INTERNATIONAL FINANCIAL SYSTEM AND CLIMATE CHANGE

Furthermore, the international financial system has begun to consider climate change as one of the central issues for the future of the financial sector. For the financial institutions, the Agreement makes it necessary to reevaluate the loans portfolios, develop strategies to cope with climate change, evaluate the climate risks for all assets whose investment they are willing to finance, monitor the greenhouse gas emissions resulting from their own banking operations, and generally, to recognize and internalize the climate dimension as one of the new conditions in which financial businesses develop today.

In addition, from the perspective of the investors, from now on it will be reasonable to ask companies about their strategy to reach a level of net emissions equal to zero in the future. That approach will encourage the deployment of capital from high-risk, non-sustainable fossil investments to investments that include the climatic risk. It will also make it possible for investors to benefit from the opportunities generated with the transition toward low-carbon development pathways.

The role of the national development banks

The national development banks could have a double responsibility in this matter. On the one hand, they should help facilitate the emission reduction efforts (mitigation), by promoting investment in sectors that were formerly considered higher risk and that today, under the Paris Agreement, are beginning to be essential to national development aimed at a carbon-neutral economy: energy efficiency, non-conventional renewable energies, intelligent agriculture, innovation in infrastructures and in urban development modalities, new transportation modes, new materials, innovation in processes, technologies for fuels storage, etc.

But, in addition, this resource allocation process to sectors and transforming activities, with the growing participation of the national commercial banks, should be accompanied by careful scrutiny of the climatic risk inherent in new investments.

And in this the national development banks also have a key role, exploring the nature of the risks, but also possible synergies between mitigation and adaptation, developing and applying methodologies for the treatment of risks in evaluation processes, and creating new financial instruments to be able to mitigate risks in the loans granted.

Furthermore, since the Paris Agreement places emphasis on guaranteeing climate financing resources for the future implementation of the nationally determined contributions (NDCs)³, and this instrument constitutes a central vehicle in the fulfillment of the commitments made by the countries in Paris, the national development banks should also play a key role in promoting and facilitating access to climate financing and in the combined assignment of those resources –and others from different origins– within the framework of a broad transformation and innovation process that will require the full participation of all social and economic actors.

3. The ex-ante expected and intended nationally determined contributions (INDCs), once the Agreement has been signed by each country, will become Nationally Determined Contributions (NDC).



The expected contributions at the national level

Indeed, 31 countries from Latin America and the Caribbean presented before or during the COP 21 their intended nationally determined contributions (INDCs) to be taken into account in the Paris Agreement. Thus, in order to comply with those contributions they should then carry out mitigation actions –while almost all the countries of the region also specify adaptation actions in their INDCs– and to this end they will need access to climate financing resources, mobilize lines of financing from the national financial system, including the commercial banks, and channel investments that frequently imply the adoption of new technologies and processes or even include the incursion into new business sectors and economic activities.⁴

The contributions presented by the LAC countries have significantly varied characteristics, because at the time they sent their INDCs the countries could provide the information they considered appropriate, including the reference point, or base year, horizon, scope, the assumptions included, whether the contributions could be achieved with own resources (unconditional) or with climate financing (conditional to access to financing), whether adaptation actions were included, whether they were ambitious and if they intended to achieve transformations.

If we examine the range of emissions reduction expected by the countries of the region when adding, where applicable, the presented unconditional contributions to the conditionals –if any– this is highly heterogeneous and is between 15% (Honduras and Trinidad and Tobago) with respect to the emissions corresponding to a baseline to 2030 scenario, and 44% in the case of Barbados (which does not specify the conditional or unconditional nature of its contribution), with a very significant 36% observed in the case of Mexico due to its relative weight in regional emissions. It should be highlighted that Ecuador presents total reductions resulting exclusively from the energy sector of up to 46%. Although the contribution is expressed in relation to the intensity of emissions from its GDP, Uruguay's INDC should also be highlighted, which foresees a total (conditional and unconditional) reduction of 40% from its energy intensity by 2030. In any case the proposed contributions include very significant reductions in numerous cases and that implies an intense investments effort that needs to move away from traditional financing schemes.

It is observed that most of the INDCs analyzed are aimed at more than one sector, with the energy sector having the highest prevalence, which is explicitly mentioned or included in the “all sectors” formula in all the INDCs presented in the region. It should also be emphasized that energy is understood as the sector with the greatest impact and potential for emissions reduction by the countries of the region that have presented their INDC. Nevertheless, at least ten of the INDCs indicate that their contributions will be carried out on all the sectors of their economy. As indicated, the rest of the contributions show various combinations of references to the energy sector with others, such as transportation, agriculture, waste and industry, in that order of frequency, but without large variations. (See synthesis table on LAC's INDCs).

Another noteworthy issue is that more than 50% (12/22) of the countries that presented quantified contributions, have foreseen a combination of conditional and unconditional reductions, while 8 countries (36%) presented exclusively conditional contributions and only 4 (18%) presented only unconditional contributions. This confirms the importance assigned to climate finance in the region and the potential role of the national development banks both in access to financing and in the realization of the nationally determined contributions.

4. It should be recalled that the Lima Call for Climate Action establishes that the information that must be provided by the Parties that communicate their intended nationally determined contributions may include, among other things and as appropriate, quantifiable information on the reference point (indicating a base year, as applicable), the terms and/or periods of application, the scope and coverage, the planning processes, the assumptions, and the methodological approaches including those designed to estimate and record the emissions and, where applicable, the anthropogenic absorptions of greenhouse gases.



The resurgence of market mechanisms

It should also be noted that the Agreement devotes a complete article addressing the so-called cooperative approaches to voluntary participation, establishing a mechanism to promote mitigation of greenhouse gas emissions and to support sustainable development. This concerns Article 6, which encompasses several concepts: cooperative approaches, transfer of the mitigation results, a mechanism to contribute to the mitigation and to sustainable development, and a framework for approaches not based on the market.

In essence it establishes a new credit mechanism based on voluntary cooperation, which provides the possibility of transferring the results of mitigation activities –although it goes much further– that will require efforts to develop the technical details starting right away.

The introduction of the possibility of utilizing the international transfer of the mitigation results to comply with the nationally determined contributions brings to the table the consideration of market mechanisms to fulfill the contributions to which the countries involved committed in their presentations before and during the COP 21, and also implies a new space for the generation of resources for climatic action and sustainable development, as well as an opportunity to combine cash flows from the financing and income from the transfer of mitigation results.

The principles on which the new market mechanism included in Art. 6 will rest include environmental integrity, transparency, avoiding double accounting, verification and certification, supervision and others that will be elaborated in the coming years.

Furthermore, Art. 6 refers to the notion of mitigation results that seems to suggest a largely broader scope than that of a project activity in the Clean Development Mechanism, which could include for example, program of activities, sectoral approaches, and bilateral instruments schemes and new innovative mechanisms.

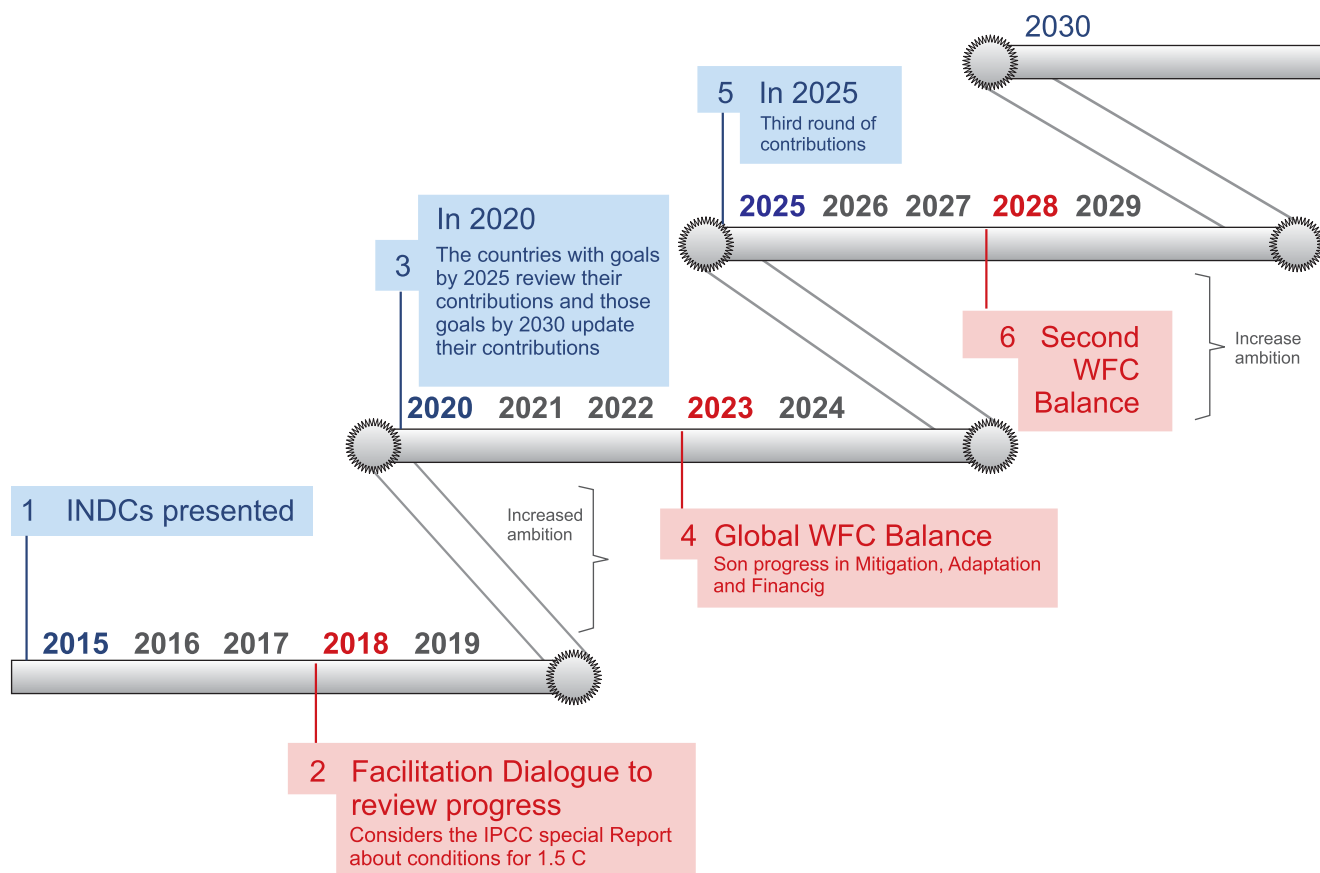
Although some countries seem to have explicitly rejected export of credits based on mitigation activities, others have included that possibility in their INDCs as a means to comply with their contributions.

Although the rules for the operation of a mechanism of that type should be established in the coming years, before the effectiveness of the Paris Agreement, it will be possible to take advantage of the vast experience achieved among others through the Clean Development Mechanism and the Joint Implementation and others, linked to the emissions trading systems, such as the Emissions Trading Scheme of the European Union.

At the same time, the aforementioned Art. 6 also considers the importance of having approaches not related to the market, such as those proposed, for example, by Bolivia; integrated, holistic, and balanced approaches that help the countries to comply with their nationally determined contributions, within the context of sustainable development and poverty eradication.



ROAD MAP OF THE PARIS AGREEMENT



WFC: Conference of the Parties as Meeting of the Paris Agreement.

Figure adapted from the material of the Carbon Brief, "[Timeline: The Paris Agreement Ratchet Mechanism](#)"



Synthesis of INDCs Presented by Latin American and Caribbean

Country	Emissions	Type of goal	Base Year	Horizon Year	Reduction		Adaptation
					Unconditional	Conditional	
Antigua and Barbuda	1.14	Actions			Yes		Yes
Belize	14.59	Actions					To be defined
Bolivia	136.47	Actions					Yes
Cuba	34.79	Actions					Yes
El Salvador	13.07	Actions					Yes
Guyana	7.64	Actions					Yes
Suriname	8.63	Actions					Yes
Argentina	405.03	BAU		2030	15%	15%	Yes
Colombia	199.68	BAU		2030	20%	10%	Yes
Ecuador	138.16	BAU		2030	20.4% to 25%	17.1% to 20.8%	Yes
Guatemala	39.27	BAU		2030	11.20%	11.40%	Yes
Haiti	7.91	BAU		2030	5%	26%	Yes
Honduras	47.7	BAU		2030		15%	Yes
Jamaica	9.59	BAU		2030	7.80%	2.2%	Yes
Mexico	748.91	BAU		2030	22%	14%	Yes
Paraguay	110.98	BAU		2030	10%	10%	Yes
Peru	159.1	BAU		2030	20%	10%	Yes
Saint Kitts and Nevis	0.34	BAU		2030		35%	Yes
Saint Lucia	1.14	BAU		2030	23%		Yes
St Vincent & the Grenadines	0.32	BAU		2025	22%		Yes
Bahamas	4.17	BAU		2030		30%	Yes
Trinidad and Tobago	40.4	BAU		2030		15%	Yes
Venezuela	396.74	BAU		2030		20%	Yes
Barbados	3.35	BAU and base year	2008	2030	44% vs BAU		Yes
Uruguay	14.76	Intensity		2030		25%	Yes
Chile	93.74	Intensity vs Base Year	2007	2030	30%	5%-15%	Yes
Costa Rica	4.97	Fixed Emissions Limit		2030	9.374 ktCO ₂ e, imply 44% vs BAU		Yes
Brazil	1823.15	vs base year	2005	2025	37%		Yes
Dominica	0.32	vs base year	2014	2030		45%	Yes
Dominican Republic	31.18	vs base year	2010	2030		25%	Yes
Granada	1.94	vs base year	2010	2030	30%	10%	Yes



RESOURCES

Institutional

- [United Nations Framework Convention on Climate Change \(UNFCCC\)](#).
- [INDC Portal](#).
- [REDO+, UNFCCC](#).

Science

- [Inter-Governmental Panel on Climate Change \(IPCC\). Fifth Evaluation Report](#).

The Negotiation

- [UNFCCC, Text of the Paris Agreement, December 12, 2015](#)
- [UN News Centre, COP21: UN chief hails new climate change agreement as 'monumental triumph', Dec. 12, 2015](#).
- [United Nations, Secretary General](#).
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- [France Diplomatie. COP21 The Paris Agreement in four key points, an historic step for the climate](#).

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- [Robert Stavins, Paris Agreement - A Good Foundation for Meaningful Progress, Resources for the Future, Dec. 14, 2015](#)
- [Teresa Ribera, IDDRI](#).
- [Daniel Bodansky, Reflections on the Paris Conference, Opinio Juris, Dec. 17, 2015](#).
- [Harald Winkler, ERC, UCT. Paris Agreement: After climbing a great hill, many more to climb](#).

Climate Financing and International Financial System

- [Green Climate Fund](#).
- [Green Climate Fund. Beyond Paris: GCF Looks Ahead](#).
- [Green Climate Fund: Launching of the Green Climate Fund in Durban](#).
- [Finance Portal, UNFCCC](#).
- [UNEP Finance Initiative \(UNEP FI\)](#).
- [Inter-American Development Bank](#).
- [World Bank](#).
- [Financial Stability Board](#).

Agenda for Action

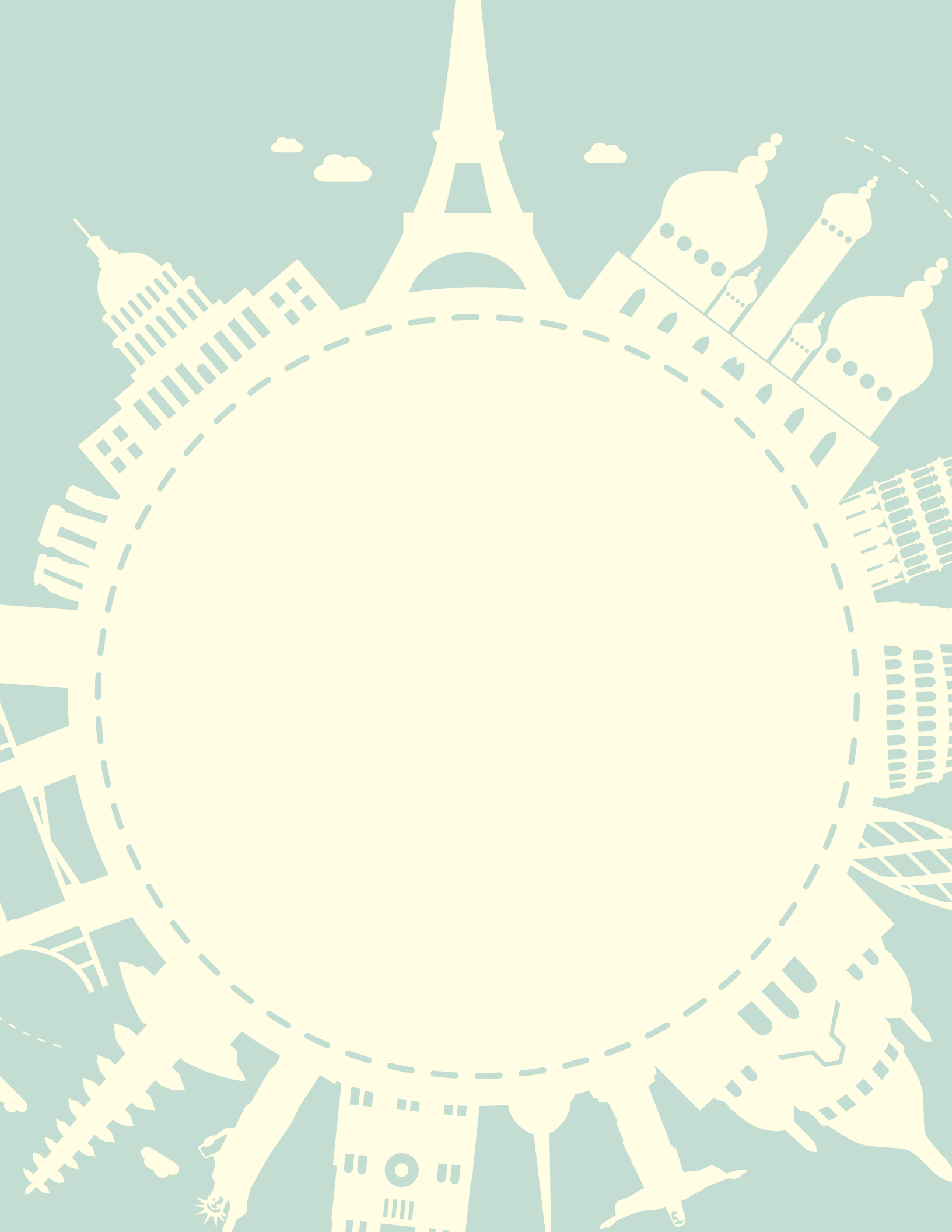
- [The Nazca Climate Action Portal](#).

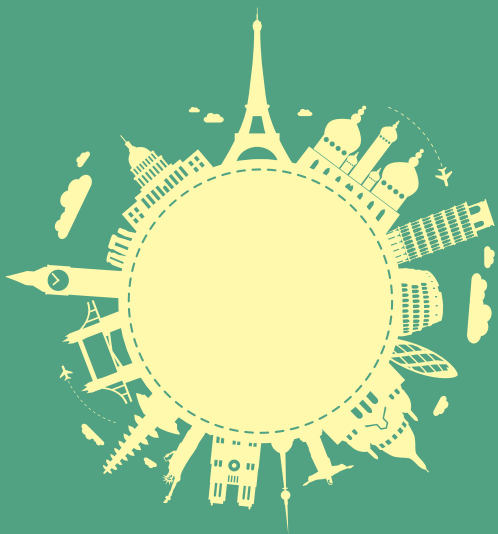
Carbon Markets

- [Andrei Marcu: Carbon Market Provisions in the Paris Agreement \(Article 6\). January 26, 2015](#)
- [Anthony Mansell, What role for carbon markets in the 2015 climate agreement? Biores, Volume 9, Number 1](#)
- [Rebecca Pearse, After Paris: Where Now for Carbon Pricing? Inside Story, Dec. 21, 2015](#)

Information regarding Development Banks

- [ALIDE - Latin American Association of Financial Institutions for Development](#)
- [Green Finance \(IDB\)](#)





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IDB Contact

Maria Netto | mnetto@iadb.org • Jose Juan Gomes | joseg@iadb.org



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