Global Policy Coherence 2009

Governance | climate - finance - trade

"Policy Coherence Between the Climate Negotiations and the International Financial and Monetary Regimes"

The Perfect Storm I: Trade, Finance and Climate in 2009

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Thank you very much. I am pleased to be here to examine the question of policy coherence between the climate regime and the monetary and financial regimes.

What I would like to do is to pick up from where Derek[1] was going in his introduction. I am going to look at the issues of coherence as it relates to the negotiation of a post-2012 climate agreement and what is occurring in the monetary and financial arenas that may well impact these negotiations.

Let me try to characterize the kinds of tensions for government officials which can arise because of differences in approach between economic negotiations and climate negotiations. Developed country environmental negotiators, who are taking part in working out a post 2012 agreement, no doubt are getting certain messages from their frankly much more powerful colleagues in trade ministries, in finance ministries and in Treasuries. Likewise developing country environmental ministers are going to get similar messages from their also more powerful trade and finance people saying "Don't do anything that is going to upset our areas".

All of these messages can easily make it more difficult to negotiate a new effective climate agreement. The climate negotiators have to come to grips with an enormous breadth of issues in the Bali road map which one way or another overlap with trade arena and/or overlap the monetary arenas. But their domestic colleagues are strongly advising them to stay out of these economic matters.

The Indonesian Government recognized this interlinkage in the preparation of the Bali conference. They brought together for informal discussion following the Bali meeting for the very first time ministers of trade to discuss trade and climate. And they separately hosted the very first discussions of ministers of finance on economics and climate.

The question really is then how do we create the ambiance, the proper environment as it were, for doing some of what Ditte[2] was saying needed to be done. How do we create policies and adapt programs to permit meaningful coherence between different powerful international economic regimes and environmental negotiations.

My contribution today is to try to lay out some of the issues which are involved from the monetary and financial side and the climate negotiations side. If we can describe the difficulties well enough, then maybe we might be better able to pursue a solution and develop a coherent way forward.

This is not really an examination of just the World Bank or the International Monetary Fund. There are many institutions involved in global and regional monetary policy including regional development banks, bilateral financial agencies, the Basel organizations of central banks and bank regulatory authorities. It is not just the Bank and the Fund alone that set global monetary and financial policy, but they are central players in the story.

Given their importance, I want to bring you up to date on two developments in the World Bank Group. One

[1] Derek Osborn, Chairman, Sustainable Development Observatory, *European Economic and Social Committee* (EESC)

[2] Ditte Juul-Jørgensen, Head, Sustainable Development and SPS Issues Unit, DG TRADE, *European Commission*

is that the World Bank Group has been developing over the last months a "Strategic Framework on Climate Change and Development". In fact the public commentary period of the draft text ends today. The team developing the report anticipates submitting the text to the Executive Directors of the Bank and the Fund later this month. Then at the annual fall meeting in October, the authors will present the final text to the Ministers for approval[3].

This strategic framework document does give us an insight into what the World Bank Group which includes the Bank itself, the IMF, the Global Environment Facility (GEF), International Finance Corporation (IFC), and Multilateral Investment Guarantee Agency (MIGA) are viewing as the relationship between global monetary and financial policy and climate change. As a World Bank Group draft policy paper, it is a lengthy one; it is 70 pages.

I want to share two preliminary observations about the draft report itself. Basically it is an add-on document. It is additional and supplemental instructions to the existing programs of the World Bank Group. It also suggests new supplemental World Bank Group funding arrangements. Unfortunately unlike the bold title "Strategic Framework", it is not very strategic. It does not fundamentally change the financing activities of the World Bank, the Fund or other World Bank Group agencies.
The second observation that can be made about it is that the draft policy is looking forward to constructive outcome of the post-2012 negotiations and realizes that of necessary there will be additional financial activities required to implement the post-2012 agreement. Clearly the WBG wants to have a leading role in implementing those new financial activities. In some ways this policy report is their application to be the lead financial body that the World Bank Group believes will be set up under the new agreement, even though that agreement is still in such a preliminary phase that it has not been decided what its legal status will be.

To look clearly at the question of coherence, it may be helpful to step back and see what the Bali Agreement said on financial matters, which the draft Strategic Framework quoted at some length.

Governments in Bali committed themselves to four core pillars in the post 2012 agreement[4], each of which has a significant macro-economic component.

The first core pillar called for "Enhanced national/ international action on mitigation of climate change, including, inter alia, consideration of:

(1) Measurable, reportable and verifiable nationally appropriate mitigation commitments or actions, including quantified emission limitation and reduction objectives, by all developed country Parties, while ensuring the comparability of efforts among them, taking into account differences in their national circumstances;

(2) Nationally appropriate mitigation actions by developing country Parties in the context of sustainable development, supported and enabled by technology, financing and capacity-building, in a measurable, reportable and verifiable manner; ..."

The second pillar out of Bali sought "International cooperation to support urgent implementation of adaptation actions, including through:

(i) Financial needs assessments, ...integration of adaptation actions into sectoral and national planning, ...other ways to enable climate-resilient development and reduce vulnerability of all Parties...;

(ii) Risk management and risk reduction strategies, including risk sharing and transfer mechanisms such as insurance;
(iii) ...
(iv) Economic diversification to build resilience; ..."

In the financing area, the third Bali pillar sought to "Enhance action on technology development and transfer to support action on mitigation and adaptation, including, inter alia, consideration of:

(i) Effective mechanisms and enhanced means for the removal of obstacles to, and provision of financial and other incentives for, scaling up of the development and transfer of technology to developing country Parties in order to promote access to affordable environmentally sound technologies; ..."

And the fourth Bali pillar committed countries to "Enhanced action on the provision of financial resources and investment to support action on mitigation and adaptation and technology cooperation, including, inter alia, consideration of:

(i) Improved access to adequate, predictable and sustainable financial resources and financial and technical support, and the provision of new and additional resources,

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3 The final report entitled "Development and Climate Change: A Strategic Framework for the World Bank Group Report to the Development Committee" was approved by the Development Committee in October 2008

4 Bali Action Plan, UNFCCC conference, Bali, Indonesia, FCCC/CP/2007/6/Add.1*, Decision 1/CP.13

including official and concessional funding for developing country Parties;

(ii) ...

(iii) Innovative means of funding to assist developing country Parties that are particularly vulnerable to the adverse impacts of climate change in meeting the cost of adaptation;

(iv) ...

(v) Mobilization of public- and private-sector funding and investment, including facilitation of climate-friendly investment choices;

(vi) Financial and technical support for capacity-building in the assessment of the costs of adaptation in developing countries, in particular the most vulnerable ones, to aid in determining their financial needs"

That is the framework from the Bali side for the post 2012 negotiators.

Let me identify four ways, but there are others, that the global operations of the current monetary and financial regimes may have contradictory elements that impact on the development of a coherent and effective climate regime, based on the Bali Plan of Action.

REPORTING AND DOCUMENTATION OF CAPITAL FLOWS

In different sections, the Bali Plan of Action says that nation climate changes need to be "measurable, reportable, and verifiable". However nothing in the draft World Bank Group plan talks about climate-related measurement at all. Under the Basel II Framework for international capital standards[5] and IMF rules of the reporting of international financial flows, there is also nothing that says that there should be the measurement of financial flows should indicate climate change-related impacts. Nothing.

The draft World Bank Group study does report that the International Finance Corporations (IFC), the private sector arm of the World Bank, is reported to be looking at this question. However it is clear that the IFC's examination does not apply to other parts of the international financial system.

So developing countries finance ministers are being asked to continue a business-as-usual approach -- under Basel rules dealing with disclosure of bank finances, IMF rules on reporting international capital flows and the World Bank Group projected strategic framework. Yet under Bali commitments, governments represented by prime ministers, foreign affairs officials, and environment ministers have adopted language that says that there should be "measurable, reportable, and verifiable flows" of climate-related outcomes.

What can be done about this?

One can certainly look at a having a Basel Agreement III that incorporates a climate element to the bank capital reporting system and one can certainly look at the creation of new subcategories in the IMF capital flow accounts. These are routes to coherence. But they are not, with the exception of the IFC's study, on the table to my knowledge before Finance Ministers in Washington next month or before the Central Bankers in Basel.

PROJECT DEVELOPMENT DOCUMENTS

The World Bank, the major regional development banks (e.g. Asian Development Bank, African Development Bank, Inter-American Development Bank) and the sub-regional development banks are project-based institutions. Government agencies who seek grants, loans, guarantees, and other forms of financial support have to provide project by project documents as part of their application for resources. However the World Bank Group is not proposing to require greenhouse gas footprint forecasts as part of their project application. In fact the project papers at the World Bank Group and the regional development banks do not have a separate component for the climate-change assessments or for energy efficiency decision-making.

If you are then in the developing country ministry and are hearing from the Bank and you are hearing from your regional development bank that they don't need anything about potential greenhouse gas impacts in project documents, you are not about to commission extra background studies on the comparative benefits for climate-change of alternative scenarios to get that loan or grant. However your Environment Minister may well say that he/she wants to know how much greenhouse gas is going to be generated in order to meet any post-2012 national commitments. As a development grant official, you will have difficulties within your capitol between these two conflicting messages.

The relevance to the post-2012 negotiation process is that the officials from developing or transition countries that attend the negotiations in Poznan and Copenhagen needs to get a consistent message from the OECD partners in order to have effective support in her/his capitols to take on greenhouse gas caps or other economic constraints. Right now these senior country officials are getting mixed messages from global financial and aid system and the climate system.

What can be done about this?

5 http://www.bis.org/publ/bcbsca.htm

One can certainly look at having a mutually agreed component of the post-2012 agreement that lays out the format for a supplemental part of all multilateral and bilateral grant applications that demonstrates that a comparative climate change assessment has been done and utilized in the project application. One can also expect that the World Bank Group and the various regional development banks to incorporate now into their due diligence the likely climate-related impacts of a given project proposal.

EXISTING LOANS FROM THE WORLD BANK, THE LOANS AND GUARANTEES FROM THE IMF, THE REGIONAL DEVELOPMENT BANKS, AND FROM THE GLOBAL ENVIRONMENT FUND

Developing countries and the institutions of the international financial system have been signing agreements with ten, fifteen, twenty or longer year repayments periods, long before there was widespread recognition of the impacts of climate change. The loan agreements signed in the 1970s and 1980s before the adoption of the UNFCCC in 1992 and those loan guarantees that came into force in the 1990s before the Kyoto Protocol in 1997 contain repayment provisions that do not take into account the likely ecologically- induced economic changes in the next few decades. As you know, the IPPC's latest forecast considers that it is very reasonable to expect very extreme weather-induced changes in developing countries which will have significant economic affects.

These developing country governments are then likely to face budget policy choices to divert resources to deal with unexpected consequences of climate change within the repayment period of these pre-existing loans and guarantees. These governments may also in that same time period face economic policy choices of a humanitarian character to deal with internally or externally generated environmental refugees. In either case the current contractual arrangement is that if they don't pay their debts on the previously agreed schedule they risk loan default and cross defaults for failures for other loans besides the ones they are not paying. When financial officials of developing countries are placed in such uncomfortable situations, they are not likely to want to be supportive of their environmental ministry or foreign affairs ministry officials who are tasked to negotiated a post 2012 agreement that does not recognize the new climate-change related burdens of old debts.

And again, what can be done?

One can develop an agreement on waivers for the consequences of unexpected climate impacts or climate related humanitarian expenditures that may require delayed payments to international or bilateral financial institutions. These waivers could for instance, specify what procedures are needed for an temporary suspension of weather-related debt repayments, which international environment institutions can confirm the more long-term unanticipated weather-related induced changes to those in the original loan agreement and what types of restructuring in principal, interest, and other charges will be considered acceptable by the loan making institution and the loan recipient governments.

THE DEFINITION OF "ADAPTATION" INVESTMENTS

As I noted earlier, the Bali Plan of Action contains strong text on what Governments have agreed to do to adapt to the reality of climate change. Unfortunately the draft Strategic Framework takes a different view than Bali. The draft Strategic Framework makes quite clear that IDA, the soft loan window of the World Bank Group, considers that "adaptation is critical, but it should not be pursed as an end to itself", only as a means for development objections. The language becomes more explicit later in the text, when it is described as "adaptation is for climate resilient growth", that is adaptation for bank funding would be for areas that can recover from climate effects. Therefore low lying areas, small island economies, places where desertification is likely to increase are not in the scope of what will be covered by IDA under the draft Strategic Framework[6].

How can this kind of tension be resolved?

The World Bank Group, the Development Assistance Committee of the OECD, or the COP could develop an honest ten-year financial plan for how the international community will help address the realities of the consequences for small island countries, coastal countries, and other IDA designated countries.

These four areas –reporting of capital flows, project documents and their lack of greenhouse gas assessments and comparative climate change impacts, dealing with existing loans, unusual climate events, and the need for climate-induced waivers, and what IDA considers as the operational definition of "adaptation" – provide a window into the tensions created for the post- 2012 negotiators from both the North and South. In each area I have suggested various ways to reconciling these tensions.

Where do we need to go forward from here?

First I would say to those who might have some contact with government officials scheduled to attend the fall session of the Banks/Fund meetings that they are advised to say "no thank you" to this draft of

[6] These IDA re-definitions of adaptability were deleted from the final version of Strategic Framework that was submitted to the Annual Meeting

Strategic Framework on climate change because it has not grappled adequately with these questions.

Second I would say that we should take very seriously the expression “measurable, reportable, and verifiable”. The international community has to develop a coherent approach on these measurement terms that will be used by all institutions in the monetary arena, the trade arena, and the climate arena. Whether these words in the final Post-2012 agreement modify the commitments of particular regions and not others, somehow a reporting system needs to be created that addresses the monetary side of the reporting, the trade side of it and climate side of it so that we can have enhanced monetary and climate coherence.

Thank you.

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