Innovative and Fair Sources of Finance for a New Loss and Damage Funding Arrangement

Alana M. Carlson with Olivia Hanks and Lindsey Fielder Cook

The decision at COP27, titled *Funding arrangements for responding to loss and damage associated with the adverse effects of climate change, including a focus on addressing loss and damage,* is a historical achievement which commits Parties to channeling funds to loss and damage (L&D). It acknowledges "the urgent and immediate need for new, additional, predictable and adequate financial resources."[1] This is significant for outlining the principles for where L&D funds should be sourced as well as for concretely establishing that L&D must be financially addressed in addition to mitigation and adaptation.

People of faith worldwide are increasingly calling for action on L&D because it is what our common humanity demands of us. The lives of so many – including those not yet born – depend on us acting with courage and compassion now. We cannot simply avert our gaze.

From Pakistan to the Pacific, from the Horn of Africa to the Arctic, the climate crisis is bringing devastation to communities, primarily those who least bear responsibility for causing it. We grieve for the people who have already lost their lives or their lands to climate breakdown. We welcome this COP27 decision to commit to funding arrangements for responding to Loss and Damage, because our global community – in particular the countries with the greatest historical responsibility for greenhouse gas emissions – has a duty to provide security and relief to the hundreds of millions of people affected by climate impacts. Funding to address loss and damage (L&D) is essential if climate-vulnerable countries are to plan, respond, and rebuild.

This paper briefly outlines some possible sources of finance for L&D. We recognize that developed country leadership is morally and legally grounded in the Paris Agreement, including Article 9.3,[2] as well is reaffirmed by the latest decision at COP27 on funding arrangements for Loss and Damage.[3]

We offer this paper in a spirit of constructive discussion. We do not endorse any specific solution but start from the Polluter Pays principle in addition to those outlined above. Additionally, we recognize, as noted in Article 2 of the decision which decides to establish new funding arrangements, that L&D finance must be channeled to those most vulnerable to the climate crisis.[4]

Fossil Fuel Tax (FFT)/Climate Damages Tax (CDT)

A FFT/CDT is a charge on the extraction of all fossil fuels (FFs) calculated at a consistent rate globally based on how much CO2e is embedded within the fuel.[5] Fossil fuel CO2 emissions represented 2/3s of total global greenhouse gas emissions in 2020, while between 2020 and 2021, CO2 emissions from FFs grew by 5%.[6] Continued, let alone increased use of FFs jeopardizes chances for a safer limit on global temperature rise and greatly intensifies L&D. António Guterres, the UN Secretary-General, has called "on all developed economies to tax the windfall profits of fossil fuel companies" and to direct the funds "to countries suffering loss and damage caused by the climate crisis.[7] In 2021, the top twenty-five oil and gas companies earned $205 billion in profits.[8] A CDT, rather than only a windfall tax, would provide an ongoing source of finance for L&D during the transition away from fossil fuels.

Redirecting Fossil Fuel (FF) Subsidies

As part of a two-year rise in spending, in 2021, more than $525 billion was explicitly spent by states on fossil fuel subsidies.[9] In 2020, the IMF reported that explicit and implicit FF subsidies globally totaled $5.9 trillion.[10] Economists widely oppose energy subsidies because of their high fiscal costs, distortionary impacts on resource utilization, and tendency to further entrench income inequality.[11] Energy subsidy reform can be a highly cost-effective means of reducing greenhouse gas emissions.[12] Continued subsidization of FFs is "a roadblock to a more sustainable future."[13] With high confidence, the IPCC has found that "removing fossil fuel subsidies would reduce emissions, improve public revenue, and macroeconomic performance, and yield other environmental and sustainable development benefits." [14] Removal of FF subsidies can reduce emissions as much as 6.4% by 2025 compared to business as usual.[15] Removal of FF subsidies is in line with a human rights based approach given that the negative impacts of FF extraction and use are most acutely felt by the most vulnerable communities while the richest receive the most monetary benefits.[16] Finance spent on FF subsidies could be shifted to supporting those experiencing L&D, thereby providing significant funding while reducing GHG emissions.

Debt Relief

Debt cancellation is the fastest way to free up financial resources for L&D. Many Global South (GS) countries are curtailed from responding to mounting climate costs as every year they must commit substantial sums of government reserves to pay creditors every year. The IMF estimates that 41 countries in the GS are currently unable or at high risk of failing to pay their debts.[17] 108 of the 116 GS countries increased their public debt during the COVID-19 and half are now currently in a debt crisis.[18] Immediate, austerity free debt alleviation would allow vulnerable GS countries to free up domestic funds to be used for addressing L&D and to mitigate against future losses. Positive examples of debt for climate and nature swaps are also being researched. Additional benefits from debt alleviation include enhanced debt sustainability and stronger GS economies.[19] While this is one way for the Global North to begin to meet its moral obligations to those most affected by the climate crisis, debt alleviation alone is not sufficient, and must be considered alongside other forms of finance for loss and damage.

International Air Travel Adaptation Levy (IATAL)

A modest fee on all international air passengers of $5-25 (depending on class of travel) has the potential to raise $10 – 100 billion annually.[20,21] By 2040, international air travel is forecast to annually increase by 5.1-5.6%.[22,23] As air travel continues to increase, so will its GHG emissions. By 2050, up to 1747.2 Mt of CO2 will be emitted annually by flights, of which +70% will be international.[24] It is both ethical and practical to consider an IATAL as one means of redressing the negative environmental impacts this mode of travel has. International air travel is a relatively inelastic industry and numerous studies have found that LDCs and SIDS that have large tourism sectors would not see a reduction in visitors because of such a small fee.[25,26,27] Universal application of this levy would mean airline competitiveness is not impacted while L&D is funded in an "effective, efficient and equitable" manner.[28]

Financial Transaction Tax (FTT)

The UN High Level Advisory Group on Climate Change Financing identified a FTT as "a new and additional source which could raise significant revenues."[29] Present financial markets are characterized by excessive price volatility, in part, due to speculative trading which contributes to artificially high fossil fuel prices and discourages short-term investment in renewable energy.[30] A FTT of 0.1% has the potential to stabilize prices, thereby reducing the global incidence of financial crashes by 5% and increase long term investment returns by 0.05% above the tax.[31] Additional benefits of a general FTT are: it does not discriminate against specific types of markets; it is an activity rather than place-based tax which addresses modern tax payer residence identification concerns; and its enormous tax base means a very low rate would have considerable receipts.[32] The revenues of a FTT could then be directed towards L&D.

<u>Special Drawing Rights (SDRs)</u>

Maintained by the International Monetary Fund (IMF), SDRs are units of account which can augment a country's reserves. The IMF allocates SDRs based on a member's quotas, therefore high-income countries proportionally receive the most.[33] In 2021, the IMF allocated $650 billion equivalent in SDRs, of which $275 billion went to emerging markets and just $21 billion was received by low-income countries.[34] High-income countries which have historically contributed the most to the climate crisis could channel their SDR allocations to low-income members. SDRs can be exchanged for currency which can then be directly channeled into loss and damage finance.[35] Last year the G7 "encourage[d] the IMF to work quickly with all relevant countries to explore a menu of options for channeling SDRs to…enable greener, more robust, recoveries in the most affected countries, supporting the poorest and most vulnerable countries in tackling these urgent challenges."[36]

<u>Military Funds for Loss and Damage Finance</u>

Finance for L&D could be raised through shifting spending on away from weapons that kill, and into transformative climate action, and financial support to stabilize and rebuild communities devastated by climate change. . In 2021, world military expenditure surpassed $2 trillion for the first time[37] while all global public climate finance (of which only $17.9 billion was grants) was just an estimated $83.3 billion the year before.[38] States should reduce their overall military spending and instead shift funds to help build real security and citizen safety through funding mitigation, adaptation, and L&D. UN Secretary-General António has previously told the UN Security Council that climate change is a "crisis multiplier," noting that the greatest impacts are where "fragility and conflict have weakened coping mechanisms."[39] Additionally, with high confidence, IPCC findings show that regions and people experience higher levels of vulnerability to climatic hazards when violent conflict is present.[40] Shifting military funds to L&D is therefore important for sustaining peace and redressing the environmental harm of conflict.

In the spirit of engaging in discussion with readers, please share any comments you may have on this working paper by email with Alana M. Carlson at amcarlson@quno.ch with the subject line "Working Paper Comments."

---

[1] UNFCCC. *Funding arrangements for responding to loss and damage associated with the adverse effects of climate change, including a focus on address loss and damage (Decision -/CP.27 -/CMA.4).* UNFCCC, 20 November 2022. https://unfccc.int/sites/default/files/resource/cma4_auv_8f.pdf

[2] UNFCCC. *Report of the Conference of the Parties on the its twenty-first session, held in Paris from 30 November to 13 December 2015 (1/CP.21).* UNFCCC, 29 January 2016. https://unfccc.int/resource/docs/2015/cop21/eng/10a01.pdf

[3] UNFCCC. *Funding arrangements for responding to loss and damage. (Decision -/CP.27 -/CMA.4).* UNFCCC, 20 November 2022. https://unfccc.int/sites/default/files/resource/cma4_auv_8f.pdf

[4] *Ibid.*

[5] Richards, Julie-Anne, David Hillman, and Laurey Boughey. "The Climate Damages Tax: A guides to what it is and how it works." Stamp Out Poverty, December 2018. https://www.stampoutpoverty.org/live2019/wp-content/uploads/2019/06/CDT_guide_web23.pdf

[6] United Nations Environment Programme. *Emissions Gap Report 2022: The Closing Window- Climate crisis calls for rapid transformation of societies.* UNEP, 2022. https://www.unep.org/emissions-gap-report-2022.

[7] Guterres, António "Secretary-General's Address to the General Assembly Secretary-General," United Nations (United Nations, September 20, 2022), https://www.un.org/sg/en/content/sg/speeches/2022-09-20/secretary-generals-address-the-general-assembly.

[8] Accountable US. "Exploitation: Oil Giants Set Record Profits While Taking Advantage of Inflation and the Crisis in Ukraine—The American People Pay the Price." Accountable US, March 2022.

[9] International Energy Agency, "World Energy Outlook 2022," IEA (International Energy Agency, October 2022), https://www.iea.org/reports/world-energy-outlook-2022.

[10] Parry, Ian, Simon Black, and Nate Vernon. *Still Not Getting Energy Prices Right: A Global and Country Update of Fossil Fuel Subsidies, WP/21/236,* International Monetary fund, 24 September 2021.

[11] Fedelino, A., Basdevant, O., Basile, G., and Tchaidze, R.," If Not Now, When? Energy Price Reform in Arab Countries." IMF Policy Papers. International Monetary Fund. 2017.

[12] IMF, "Fiscal Policies for Paris Climate Strategies—From Principle to Practice." IMF (International Monetary Fund, Policy Paper No. 19/010, 1 May 2019), https://www.imf.org/en/Publications/Policy-Papers/Issues/2019/05/01/Fiscal-Policies-for-Paris-Climate-Strategies-from-Principle-to-Practice-46826. and Stiglitz, J.E., and Stern, N, "Report of the High-Level Commission on Carbon Prices." World Bank. 2017.

[13] International Energy Agency, "World Energy Outlook 2022," IEA (IEA, Oct. 2022)

[14] eds. Shukla, P.R., J. Skea, R. Slade et al. "Summary for Policymakers." In: *Climate Change 2022: Mitigation of Climate Change. Contribution of Working Group III to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change*. Cambridge University Press, Cambridge, UK and New York, NY, USA

[15] GSI, "Raising Ambition Through Fossil Fuel Subsidy Reform: Greenhouse Gas Emissions Results Modelling from 26 Countries." International Institute for Sustainable Development. 2019.

[16] Arze del Granada, Javier, David Coady, and Robert Gillingham. "The Unequal Benefits of Fuel Subsidies: A Review of Evidence for Developing Countries." IMF WP/10/202, 2010.

[17] Guillaume Chabert, Martin Cerisola, and Dalia Hakura, "Restructuring Debt of Poorer Nations Requires More Efficient Coordination," IMF (International Monetary Fund, April 7, 2022), https://www.imf.org/en/Blogs/Articles/2022/04/07/restructuring-debt-of-poorer-nations-requires-more-efficient-coordination.

[18] Woolfenden, Tess, and Dr. Sindra Sharma Khushal. "The debt and climate crises: Why climate justice must include debt justice." CAN Network, October 2022.

[19] Dennis Shen, Thibault Vasse, and Giacomo Barisone, "Announcements," Scope Ratings -- European Rating Agency (Bloomberg, September 3, 2020), https://www.scoperatings.com/.

[20] "Financing Options for Loss and Damage: a Review and Roadmap," Climate and Development Lab, Brown University, International Centre for Climate Change and Development, 2016.

[21] UN Special Rapporteur on Human Rights and Environment, *Report of the Special Rapporteur on the Issue of Human Rights Obligations relating to the Enjoyment of a Safe, Clean, Healthy and Sustainable Environment*, July 15, 2020, UN Doc. A/74/161.

[22] Fleming, Gregg G., and Urs Ziegler, "ICAO Environmental Report: Environmental Trends in Aviation to 2050." International Civil Aviation Organization, 2016

[23] Abeysinghe, Achala and Muyeye Chambwera, "International Air Passenger Adaptation Levy: PCCB/ecbi Seminar on Innovative Sources for Multilateral Climate Finance, COP24, Katowice." European Capacity Building Initiative, 8 December 2018.

[24] Fleming and Ziegler, "Environmental Trends in Aviation to 2050." ICAO, 2016.

[25] Hepburn, C., and Müller, B. "International air travel and greenhouse gas emissions: A proposal for an adaptation levy." *The World Economy*, v.33, 2010, p.830-849.

[26] L. Pentelow and D. Scott. 2010. "The Implications of Climate Change Mitigation Policy and Oil Price Volatility for Tourism Arrivals to the Caribbean." *Tourism and Hospitality Planning & Development*, 7:3, 2010, 301-315

[27] Chambwera, M., Evans D. N., and Loga, D. 2012. "The International Air Passenger Adaptation Levy: Opportunity or risk for least developed countries?" Int'l Institute for Environment and Development, 2012.

[28] UN Special Rapporteur on Human Rights and Environment, *Report of Obligations relating to the Enjoyment of a Safe, Clean, Healthy and Sustainable Environment*, 2020, UN Doc. A/74/161.

[29] UN. "Report of the High-level Group on Climate Change Financing." United Nations, 5 November 2010. https://www.cbd.int/financial/interdevinno/un-climate-report.pdf

[30] Melodia, Lauren and Kristina Karlsson, "Energy Price Stability: The Peril of Fossil Fuels and the Promise of Renewables." Roosevelt Institute, May 2022

[31] Griffith-Jones, Stephany, and Avinash Persaud, "Financial Transaction Taxes," Initiative for Policy Dialogue, Columbia University, 2012 and De Long, J. Bradford, A. Scleifer, L.H. Summers, and R. Waldman. "Positive feedback investment strategies and destabilizing rational speculation," Journal of Finance, June 1990.

[32] Griffith-Jones and Persaud, "Financial Transaction Taxes," Columbia University, 2012

[33] IMF, "Special Drawing Rights (SDR)," IMF (International Monetary Fund, July 29, 2022), https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/14/51/Special-Drawing-Right-SDR.

[34] IMF, "Crisis Upon Crisis: IMF Annual Report 2022" (International Monetary Fund, August 1, 2022), https://www.imf.org/external/pubs/ft/ar/2022/in-focus/a-more-equitable-recovery/.

[35] Action Aid. "Using Special Drawing Rights for Climate Finance." Act Alliance, February 2010, and Roberts J Timmons et al., "Financing Options for Loss and Damage: a Review and Roadmap," Climate and Development Lab, Brown University, International Centre for Climate Change and Development, 2016.

[36] U.S Department of Treasury, "G7 Finance Ministers & Central Bank Governors Communiqué," U.S. Department of the Treasury (The Department of Treasury, June 9, 2021), https://home.treasury.gov/news/press-releases/jy0215.

[37] Lucie Beraud-Sudreau et al., "Trends in World Military Expenditure, 2021," Stockholm International Peace Research Institute (Stockholm International Peace Research Institute, April 2022) https://www.sipri.org/publications/2022/sipri-fact-sheets/trends-world-military-expenditure-2021.

[38] OECD, *Aggregate trends of Climate Finance Provided and Mobilised by Developed Countries in 2013-2020.* OECD, 2022, https://www.oecd.org/climate-change/finance-usd-100-billion-goals.

[39] Press Release Security Council, "Climate Change 'Biggest Threat Modern Humans Have Ever Faced', World-Renowned Naturalist Tells Security Council, Calls for Greater Global Cooperation | UN Press," United Nations (United Nations, February 23, 2022), https://press.un.org/en/2021/sc14445.doc.htm.

[40] IPCC, eds. H. -O Portner, D.C Roberts, E.S. Poloczanska, K. Mintenbeck, M. Tignor, A. Alegria, M. Craig, S. Langsdorf, S. Loschke, V. Moller, A. Okem. "Summary for Policymakers. In: *Climate Change 2022: Impacts, Adaptation and Vulnerability.* Contribution of Working Group II to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change. Cambridge University Press, Cambridge, UK and New York, NY, USA, doi: 10.1017/978100932584401