

WHITE PAPER #1

One Planet Lab

Summit for a New Global Financing Pact, Paris, 22-23 June 2023

For solidarity contributions based on global flows

Supporting households vulnerable to climate extreme events and losses

This report reflects ideas and suggestions that have been debated in the group and led to a general consensus. Each suggestion does not necessarily constitute an endorsement of each member. The One Planet Lab is a space for world-renowned experts to reflect on little-explored issues and instruments, to ponder out of the box and feed the formal groups of the Summit with innovative ideas. It demonstrates that practical solutions are available to address the financing gap for adaptation and loss and damage in developing countries.

1. Context and diagnosis: why focusing on additional funding for adaptation and loss & damage?

Since the launch of the first COPs, **international financing for the ecological and climate transition in developing and emerging countries has intensified and increased in nominal terms**, mainly through three channels: i) public funds from OECD countries, either directly or *via* international organisations; ii) investments from private companies; and iii) financing from developing or emerging countries themselves, for the largest part. In 2020, global climate finance flows reached USD 632bn, of which nearly USD 83bn¹ came from developed countries to developing countries, bilaterally or multilaterally, compared to USD 52bn in 2013. **Despite this growth, funding remains largely insufficient and below commitments. To comply with the Paris Agreement objectives, annual financing flows in developing countries would need to be around USD 2,300bn annually** (OECD and IPCC).

In response to the scarcity of funding to achieve mitigation, adaptation, response to loss and damage associated with the adverse effects of climate change, development and ecological transition financing seem to be increasingly opposed to each other in multilateral forums. **International development financing is indeed also largely insufficient compared to the needs.** Nominal ODA has never been so high in the world (USD 204bn in 2022) but **the annual needs amount to nearly USD 2,000bn to reach the 2030 UN Sustainable Development Goals.** Other international crises, such as the war in Ukraine, are generating new financial needs that also compete with international development and green transition funding.

In addition to this diagnosis, this funding does not respond to the pressing need for vulnerable countries to face the already concrete and dramatic effects of climate change. Only 25% of global climate investment is directed to South Asia, Latin America and Africa, while human mortality from weather and

¹OECD (2022), Aggregate Trends of Climate Finance Provided and Mobilised by Developed Countries in 2013-2020

climate extreme events was 15 times higher in these regions, compared to regions with low vulnerability (IPCC). According to Centre for Global Development, just 5.37% of the USD\$50 billion that donors have put into climate funds administered by the World Bank have gone to the 10 most climate vulnerable economies. However, **reforms often target problems of middle and high-income developing countries, increasing the financing gap of low-income countries**, generally most affected by climate extreme events. In turn, “the greatest gains in wellbeing could come from **prioritizing climate risk reduction for low-income and marginalised communities, including people living in informal settlements**. Insufficient and misaligned finance is holding back progress.” (IPCC).

As concrete cases in point, a country like New Zealand, which has access to a developed insurance market and benefits from a high credit rating, has no difficulty in financing its adaptation or losses related to the recent hurricane. In contrast, Pakistan has only raised USD10bn in pledges and loans out of the USD16bn needed to finance uninsured flood damage, in a context of limited fiscal space because of a very high level of debt and interest payments. The same applies for Malawi after a recent devastating cyclone which damaged half of the country, with extremely low insurance coverage.

Therefore, developing countries affected by the dire consequences of climate change need additional financing for adaptation, and access to emergency funding to respond to loss and damage, as already highlighted in the report of the Independent High-Level Expert Group on Climate Finance² and the 6th report of the IPCC. In line with Paris Agreement, which reiterates the principle of equity and common but differentiated responsibilities and respective capabilities, additional financing has to come from all responsible stakeholders. However, several impediments are already known:

- i) **The mobilisation of private actors is difficult because such financing is not profitable**, contrary to most of the mitigation projects linked to clean energy generation or industrial upgrade.
- ii) **The increase in public financing from developed countries is not sufficient**. Indeed, international funds and bilateral aid remain limited and poorly focused: only 8 to 11% of the total tracked climate finance is dedicated to adaptation, loss and damage³, and most vulnerable countries, especially in Africa, are limitedly targeted. Disbursements for adaptation remaining very limited compared to mitigation projects⁴, notably due to low grant to loan ratios and rigid rules. While the transitional committee created at COP27 is working on identifying funding arrangements, including a fund, to respond to loss and damage, the uninsured losses in developing countries are expected to amount USD 200bn per year in 2030.
- iii) **Resource mobilisation by affected countries is too low**, due to limited fiscal instruments, tax cuts and tax evasion or the lack of access to liquidity, which leads to prioritization of debt interest payments over adaptation and rebuilding better after extreme shocks in a context of very scarce fiscal space and risk of sovereign default.
- iv) **Especially in low-income countries, local capacity to absorb and deploy external funds is limited**, due to the lack of depth and breadth of local SMEs and companies to originate, deploy and maintain

²Songwe V, Stern N, Bhattacharya A (2022) *Finance for climate action: Scaling up investment for climate and development*.

³Naran B, Connolly J, Rosane P, Wignarajah D, Wakaba E, Buchner B (2022) *Global Landscape of Climate Finance: A Decade of Data 2011-2020*.

⁴Atteridge A, Savidou G, Sadowski S, Gortana F, Meintrup L, and Dzebo A (2019) *Aid Atlas. Period 2002-2019*.

large infrastructure and adaptation projects, the difficulty for potential investors to assess the actual risk which often leads to overestimation and the lack of local expertise and technical skills to rebuild better after extreme events.

2. Rationale for solidarity contributions based on global flows against climate extreme events and losses

Ahead of COP 28 and to feed in the works of the June Summit for a New Financial Pact, the **One Planet Lab** was reactivated to work on an issue that has been little explored in the economic literature: **design innovative solutions to mobilize new sources of financing for adaptation and loss and damage.**

These solutions could feed into a two-tiered approach, dedicated to developing countries with reduced budgetary capacities. A first part of the amounts could be mobilised quickly for loss and damage (to reach speed to face extreme weather events and their adverse effects) and the other part could finance rebuilding and adaptation in the longer run (with a focus given to resilience and avoidance of repetition of crises). The group does not aim to design the governance of such a two-tiered approach, which could be discussed later in international negotiations, to determine the most efficient and transparent setting.

The **One Planet Lab** has studied ways of **putting to contribute global flows for global solidarity**, to create additional solidarity contributions on international and globalized flows. **Since taxation remains a sovereign right, and on account of exemptions to international taxations, actors — both consumers and producers — and goods involved in GHG emitting global flows are undertaxed, without sufficient incentives to reduce these growing flows or internalise negative externalities.** As an example, OECD Pillar 1 deal exempted extractive and fossil fuel companies from the global tax reallocation scheme and Pillar 2 exempted shipping companies from the minimal 15% global tax. Historic international conventions also lead to total exemptions of taxes on maritime and aviation fuels. **National unilateral taxation of global flows is hardly possible due to the very nature of these flows.** Circumventions, lobbies or difficulty to tax flows between jurisdictions hamper one-sided taxations, which calls for coordinated international action.

By suggesting the creation of solidarity contributions based on global flows, the One Planet Lab invites the involved stakeholders to participate at their level to global efforts towards a net-zero economy. Better than condemning globalization, the One Planet Lab acknowledges the necessity, in the short- to medium-term, **to make global flows contribute to the financing of adaptation and loss and damage.**

The contribution of global flows especially **makes sense to finance adaptation as well as loss & damage.** Since loss & damage and adaptation are **underfunded issues** where financing needs are supposed to spiral, it is **better to target new sources.** It also complements out current CBDR principle by including other actors, mainly from the private sector, to the Global efforts, in order to respond to the urgency. This contribution takes an effective pathway and **focuses on present and future issues, by targeting present and future flows.** It supplements expected schemes based on public and private institutions, and acts as a solidarity mechanism, so that current untaxed polluters — both consumers as well as producers — contribute for their emissions.

Several options are open to debate. This approach **focusing on global flows** has clear advantages:

- ! **It does not contradict the principle of fiscal sovereignty** and is therefore easier to implement than an international tax, while **putting to contribution globally traded goods, services and assets rather than focusing on the national capacity to raise taxes** on domestic individuals and companies ;
- ! **It targets carbon flows that are poorly and unevenly taxed**, in order to create an incentive for the companies concerned to reduce GHG and promote their contribution to reduce the impacts of climate change as responsible actors;
- ! **It has very limited inflationary effects** (and quasi none on consumers in developing and least developed economies), as it proposes either voluntary contributions (on over-rents) or very low rates of contribution (0,1% to 1% rates);
- ! **It includes an idea of fairness and proportionality**, as suggested contributions increase following the level of consumption and development.

The political advantage in mobilizing the flows of globalization for climate emergency response is also to create a sense of global solidarity across all humanity, with the basis for these contributions being detached from national borders and domestic taxpayers. It could, therefore, better mobilize global flows as well as economic added value stemming from large emerging countries to the benefit of the most vulnerable ones.

3. One Planet Lab suggestions and ideas for the June Summit

Seizing global flows that have the largest impact on GHG emissions is complex, as they rapidly moving and involving plenty of actors across long and scattered supply chains. In this context, **the One Planet Lab recognizes that producers and consumers at both ends of global carbon flows should be contributing**. By targeting the whole value chain, from the extraction of fossil fuels to the trade of carbonated goods, the majority of untaxed stakeholders that take part in the carbon use will participate in the financing of adaptation and loss & damage, and be incentivised to decarbonate.

! ***Putting to contribution the production of fossil fuels***

As a primary source of GHG emissions, the oil, gas and coal industries play a critical role in delivering on shared climate goals. Since the industrial revolution, only 100 extant fossil fuel producers have emitted 52% of global industrial GHG emissions⁵. However, the extraction and production industry of fossil fuels is a low financial contributor, in particular as we do not have a global carbon pricing mechanism. Exempted from the OECD Pillar 1 reallocation to market countries, fossil fuel industries are where budget erosion is the highest. It is estimated that between 2000 and 2015, the African Continent lost about USD 88bn due to capital flight and illicit financial flows, mainly from the oil and gas industries⁶. In the aftermath of the Russian attack on Ukraine, the growing pressure from public opinion is stressing among other things the windfall profits

⁵Griffin P (2017), *The Carbon Majors Database*. CDP

⁶UNCTAD (2020), *Tackling Illicit Financial Flows for Sustainable Development in Africa*

earned by some oil, gas and coal companies. In this context, several major oil, gas and coal companies have publicly indicated their ambition to better contribute to climate goals.

- **The One Planet Lab proposes the introduction of a solidarity contribution on fossil fuels production.** Ahead of COP28, it underlines the necessity to create a positive dynamic involving fossil fuel producers. It is in the industry's best interest to be encouraged to adapt its business model to the global energy transition. Several options could be followed. **The easiest would be a contribution charged for each ton of coal, barrel of oil or cubic meter of gas extracted at a level that would reflect on how much CO₂ is embedded in each ton of fossil fuel extracted.** A \$1 contribution per barrel of oil and a \$1 contribution per 100 m³ would respectively generate around USD 30 and 40 billion per year. To ensure a **sense of fairness and differentiation according to the level of development**, i) contribution collected from developed and high-income developing countries could be used to capitalise global funds to respond to Loss & Damages, while ii) administrations from developing low-income countries would commit to allocate these additional resources to national adaptation plans of loss & damage reserves. It should be clear that this measure is not a replacement for a national carbon pricing scheme and will positively contribute to greater fiscal revenues for developing and vulnerable countries, both directly and indirectly. To be effective and acceptable, it must go along with i) commitments to reduce fossil fuel subsidies as well as ii) consistency with existing import tax on fossil fuels that some countries already apply.
- **As an alternative, the introduction of tariffs on the exports of fossil fuels is suggested,** though the governance would be more difficult to create, it could possibly increase inflation, and consequently the solidarity would be less apparent.
- **A third option would be the creation of voluntary one-offs solidarity contributions from fossil fuel exporters and large State-owned companies,** calculated on the revenues/turn-over related to extractive activities. Though it relies on the goodwill of oil exporters and large companies, a simple 0.1% contribution on the 10 largest oil exporters (in terms of revenues) would immediately **levy USD 33 billion per year** which could be useful for example as a derisking lever.

! Putting to contribution the maritime transportation of goods

Despite accounting for 3% of greenhouse gas emissions, maritime transport is under-priced for its externalities on a global scale. According to the OECD, almost half of the emissions in the OECD and G20 are exempt from any form of contribution to carbon pricing, either directly (carbon tax or cap and trade) or indirectly (excise duties on fossil fuels such as fuel oil). The remaining emissions remain poorly taxed, with an average price of around €5/tCO₂ according to the OECD. At the same time, the sector benefits from favourable tax treatment on the revenues generated by these activities. International shipping companies benefit in many countries from a much more favourable profit tax regime, known as tonnage tax. In the context of the incoming renewal of the Strategy of the International Maritime Organization (IMO):

- **The One Planet Lab suggests, as a first best, the introduction of an international carbon tax or excise duty on international shipping activity and linked to carbon emissions.** It would be levied on international transport, at the point of filling the tanks, with a monitoring mechanism by the IMO. **By taxing the more than 1,000 MtCO₂ emitted annually by the sector, this global minimum tax could**

in the long run generate up to USD 100bn per year. Part of tax funds would be reallocated to sector decarbonation, as an incentive to adopt cleaner technologies, while another part would be directed to the financing of adaptation and loss and damage, following modalities and a ratio to be defined. To avoid any free-riding, eligibility to receive loss and damage support should be reserved to countries that implement the carbon contribution.

- **The One Planet Lab acknowledges that given the decision-making mechanisms at IMO, a second best could be to start with a regional agreement on this taxation** with a critical mass of willing countries that would then be sufficient to trigger a virtuous dynamic, and the current negotiations at the IMO is seen as an opportunity. To ensure a level playing field, a mechanism would have to be devised to deal with countries that do not apply the measure. Only countries that are party to the agreement would be allowed to benefit from the fund provided by this tax. At the same time, and in order to avoid double pricing, a linkage with the EU ETS or other national systems would be necessary

! *Putting to contribution the transportation of fossil fuels*

The maritime transportation of energy, mainly through tankers is not subject to taxation and is, therefore, not incentivised to shift its business model. There were 8,883 oil tankers worldwide in 2021, presenting high benefits while not contributing to the financing of global common goods.

- **The One Planet Lab suggests the introduction of a solidarity contribution on tankers, as a condition for access to insurance.** It would be a similar conceptual model to the one of the price cap imposed on Russian exported oil agreed by the G7. With a limited number of companies, this contribution has a high fiscal potential and could be easily implemented. The contribution should remain low, in order to avoid an increase in energy costs and affect the trade competitiveness of the countries from which the energy originates, which are often developing countries. Expected amount of additional resources will therefore remain limited.