# Breaking the Climate Finance Funding Deadlock

## Financing climate protection with the help of Special Drawing Rights

*A Proposal from the*

***World Future Council***

Head Office: Mexikoring 29 | 22297 Hamburg, Germany | Phone +49 40 3070914-0 | Fax +49 40 3070914-14
E-Mail: info@worldfuturecouncil.org | www.worldfuturecouncil.org

"Whatever a society can do, it can finance."

*John Maynard Keynes*

"Anyone can create money. The problem is getting it accepted."

*Hyman P. Minsky*

# Breaking the climate finance funding deadlock

## Introduction

The UNFCCC negotiations in Cancun in December 2010 resulted in a decision to establish a Green Climate Fund (GCF). Many are now looking to it as the solution to climate finance. But nothing has yet been paid into this fund, threatening to turn it into an "empty shell" (UNSG Ban Ki Moon). Indeed, there is "an 'ever-widening chasm' between what poorer countries need to adapt climate change and what wealthy countries are delivering". (FT. 17.11.11)

An effective policy to reduce climate change as far as still possible would require at least $ 100 billion a year, and it is not realistic to expect that this will come out of national budgets. Countries currently facing huge budget deficits find it politically very difficult to spend money on long-term climate related issues. An innovative solution is now needed to bridge the gap between the urgent financial requirements of less industrialised countries and the current political inability of rich countries to provide the required funding. The funding problem must therefore be solved at the international level. The only international organization that can create these necessary additional funds at once is the IMF.

The centerpiece of the WFC proposal is the innovative use of a financing tool that utilises the ability of the IMF to create new money in the shape of its own reserve currency: Special Drawing Rights (SDRs). Such new funding will not be inflationary if issued only against performance, i.e. to produce new goods and services with (mostly) unused productive capacities and unemployed labour.

The use and control of this new money could be coordinated by the Global Environment Facility, UNEP, UNDP or the new Green Climate Fund of the UNFCCC.

## Why new money?

At the COP 16 in Cancun $100 billion a year were pledged for climate finance. But where will this money come from? There are many proposals, like a Financial Transaction Tax and revenues from $CO_2$ emission trading and airline taxes. But all involve a redistribution of existing funds or expected cash flows. Every Dollar thus obtained must be paid by somebody else. Resistance and lobbying against such redistribution can be expected to be strong and the fulfilment of the pledge therefore very doubtful.

The key challenge is not a lack of liquidity in the international monetary system but a lack of funds for climate and energy projects that are immediately available. Therefore the World Future Council proposes using an existing mechanism to solve this new problem.

***Why the IMF? What are SDRs?***

Many measures which the IMF has implemented in the past decades have been controversial and are now seen as counter-productive. But the IMF was originally created to mitigate economic imbalances, making the world economy not only more stable but also fairer. The possibility of an international currency - "Bancor", as designed by Keynes – was already discussed at the founding of the IMF in 1944 in Bretton Woods. In 1969, with the introduction of Special Drawing Rights (SDRs) as an international reserve currency (or, to use IMF terms, an international reserve asset) this concept was revived. SDRs were reinvigorated in the 2009 financial crisis when the IMF was asked by its member governments to create new SDRs to the value of 250 billion Dollars. The strengthened role of SDRs in the international monetary system offers not only the possibility to finance climate change mitigation but also paves the way to a more stable and just global financial system.

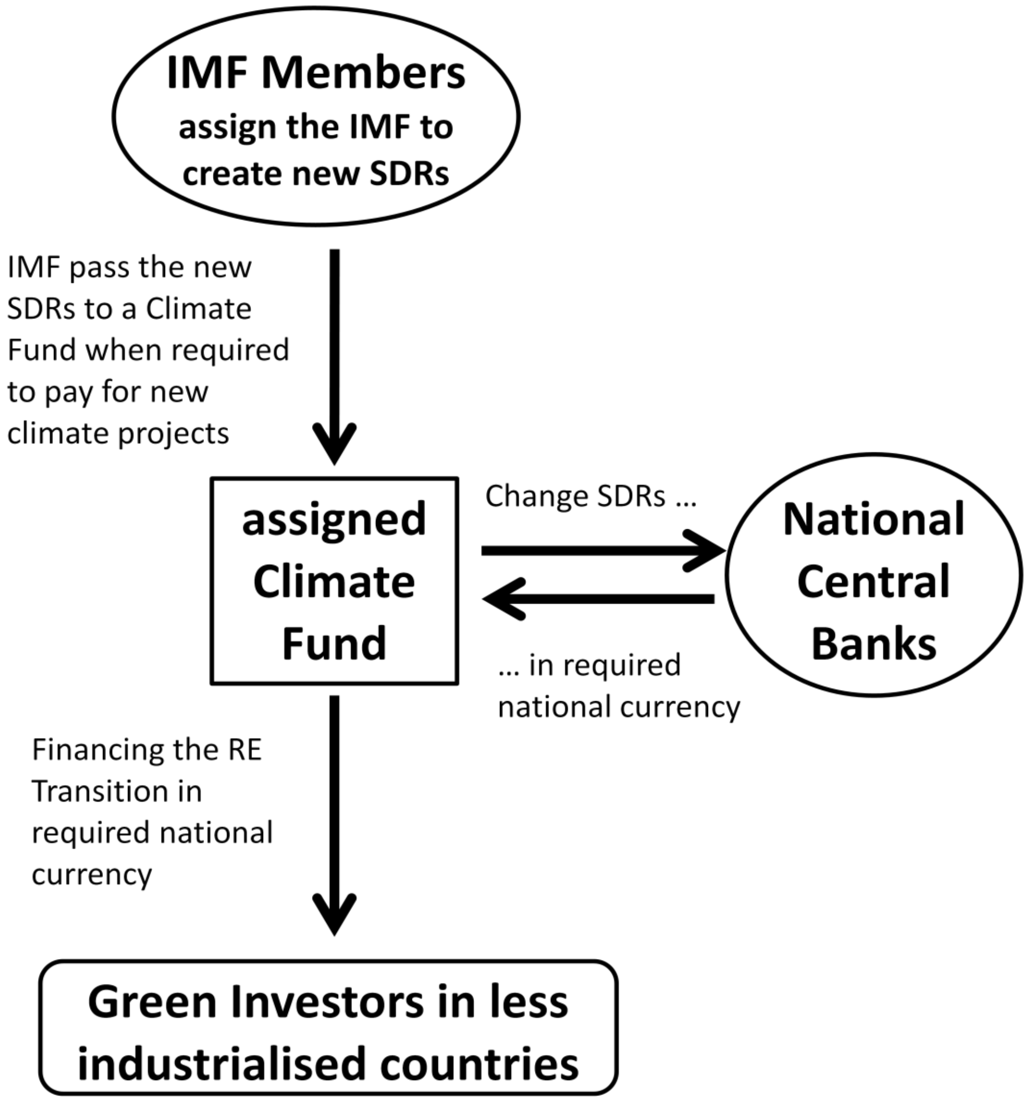
If governments can combat the financial crisis with newly created money, why can they not respond to the challenges of climate change in the same way?

## The proposed mechanism

The centrepiece of our proposal is the establishment of a financing tool that uses the ability of the IMF to create new international reserve money in the shape of SDRs to meet the needs of climate finance. The IMF member states can agree on the issuance of new SDRs to themselves (proportionate to their quota shares).

However, in our proposal member states could commit themselves in advance to putting the majority of these new SDRs at the disposal of an assigned new Climate Fund. A small portion (e.g. 10% – 20%) could be allocated to them to finance agreed national climate protection projects.

## Flows from new SDRs for green projects in less industrialised countries

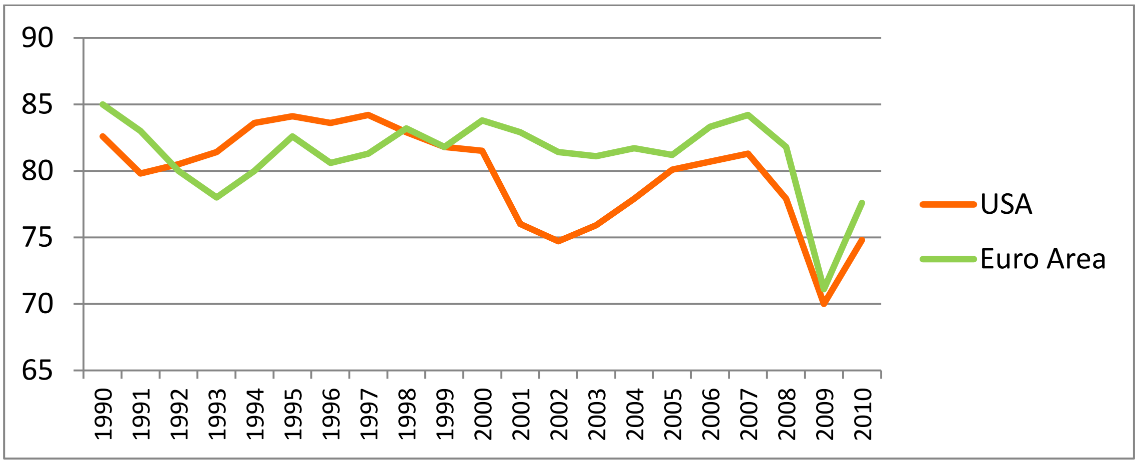



As SDRs are not currently a medium of payment, the **assigned Climate Fund** would change the newly obtained SDRs into the required national currencies at the respective central banks, when they are required to pay for agreed climate projects, e.g. renewable energy plants.

This exchange is based on existing agreements between the IMF and various member states as SDRs are accepted as part of national currency reserves. At that moment, the creation of new money in the currency of the IMF (SDRs) becomes a creation of new money in the equivalent national currencies. There is no excess money that potentially could finance new asset bubbles or other speculative activities. The rise in new money is equal to the rise in new production, and therefore there would be no inflationary impact from the monetary side.

There would also be no added indebtedness, as the new money is created interest-free. In the real economy an additional demand of $100 billion a year would not cause serious inflation, as global GDP is around $60 trillion and the average current utilization of industrial capacities is approximately only 80 percent (see ECB, Fed).[1]

**Capacity Utilization in the Euro Area and the USA (in percent)**




(Source: Fed, Statistical Release G.17; ECB, Monthly Bulletins)

*At the theoretical level it could also be shown that in a normal economic situation an additional demand would lead to higher production rather than higher prices.*

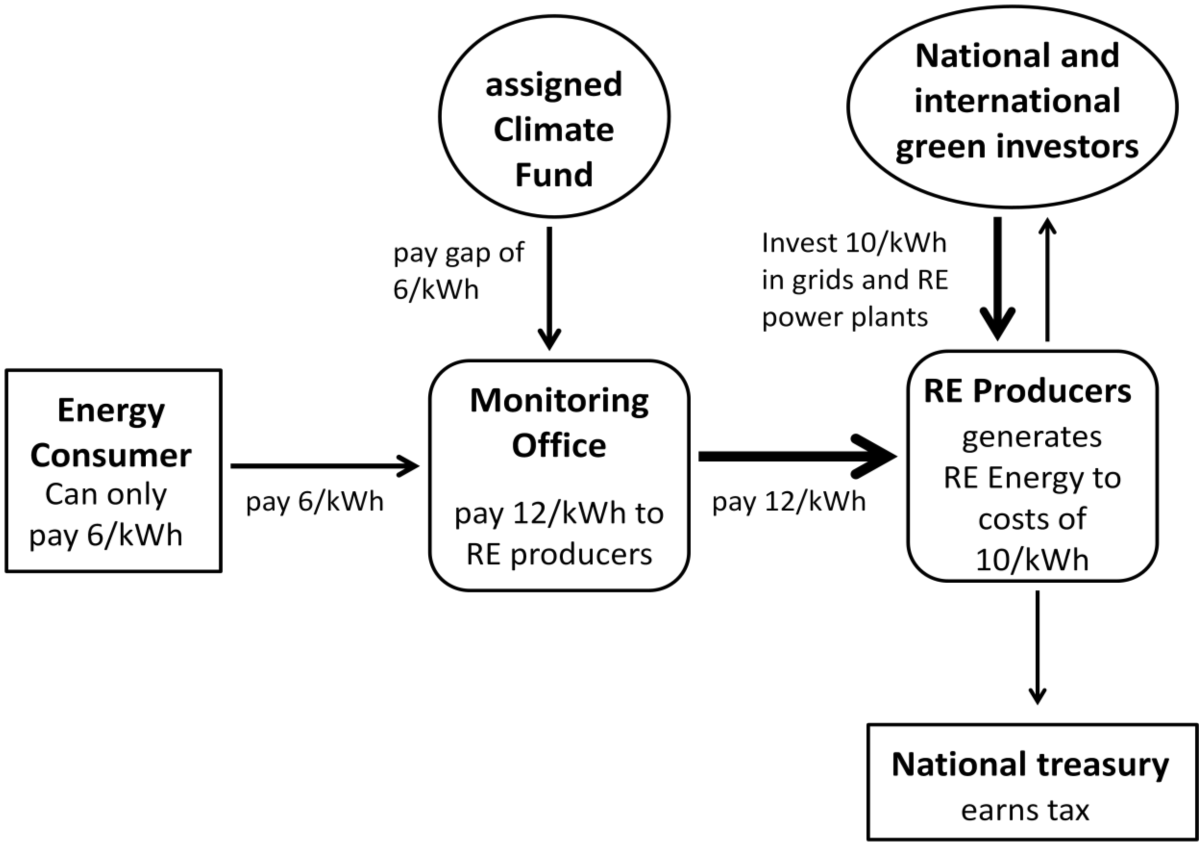
## The basic principle of this proposal is that the new money should be paid only against performance

The **assigned Climate Fund** should ensure that new economic value and new green jobs (new wages and new revenues) are created in the less industrialised countries by using the additional funds it receives by exchanging SDRs created and provided to it by the IMF only to pay directly for renewable energy infrastructure projects.

[1]"Idled capacity in the U.S. automobile industry is sufficient to produce all the wind turbines the world needs (for) a crash program to develop 3,000 gigawatts (3 million megawatts) of wind generating capacity by 2020, enough to satisfy 40 percent of world electricity needs." (Lester Brown , "PLAN B 4.0 -- Mobilizing to Save Civilization", pgs. 116-17, W.W. Norton & Co. , New York 2009)

One possibility to achieve this imperative is the financing of feed-in-tariffs (FITs), because money is only paid out if the energy is in fact produced. In this case the **assigned Climate Fund** pays out the gap between the price for energy that consumers in poor countries can afford to pay and the price that covers all costs (including a sufficient yield) of the private green investors.

## The financial flows using FITs (Prices are only exemplary)




## Who profits from the new SDRs and how?

Industrialised countries profit because the biggest part of the additional demand for renewable energy investment goods will come to them because that is where most industrial capacities are located. With this additional demand and production, new incomes, profits and taxes materialize. Less industrialised countries profit from renewable energy installations where the necessary infrastructure is build at no cost to them. The resulting income will increase domestic purchasing power. New local production and service are stimulated as well as increasing the tax base.

SDR financing of new climate projects in less industrialised countries will lead to a resource transfer from industrial countries. The advantage of the financing through new money is that the transfer of (mainly) previously unutilized productive capital does not require increasing indebtedness or lengthy prior redistribution disputes.

Also, commercial banks benefit because the necessary pre-financing of FIT-based projects opens up a new field of business. The private sector benefits because the resulting increased demand for new climate projects provides many new employment and production opportunities, and the IMF benefits from its enhanced role in providing climate finance.

Most of all, we all benefit from reduced climate threats and the increased renewable energy (RE) production which is otherwise lost. (See WFC study on the cost of unused RE potential.)

## Conclusion

The advantage of the WFC proposal can be summarized as follows: Resources of at least $100 billion a year would be immediately available. No country would be required to pay for this from its national budget or increased indebtedness. The new money would be equal to the rise in new production, and therefore there would be no excess money in the monetary system. Given the current under-utilization of global production capacities, no significant inflationary impulse is to be anticipated from the new demand. Over the longer term, it is to be expected that the industrial economies will respond to the increased demand for carbon-free investment goods with an expansion of their corresponding capacities such that excessive demand will not result. Less industrialised and industrialised countries will benefit from the new climate security investments made possible by the new financing mechanism.

## The World Future Council

The World Future Council brings the interests of future generations to the centre of policy making. Its up to 50 eminent members from around the globe have already successfully promoted change. The Council addresses challenges to our common future and provides decision makers with effective policy solutions. In-depth research underpins advocacy work for international agreements, regional policy frameworks and national lawmaking and thus produces practical and tangible results. In close collaboration with civil society actors, parliamentarians, governments, business and international organizations we identify future just policies around the globe. The results of this research is then feed into our advocacy work, supporting decision makers in implementing those policies.

The World Future Council is registered as a charitable foundation in Hamburg, Germany. Our work is made possible by support from private and institutional donors. For more information see our website: www.worldfuturecouncil.org

Contacts:

World Future Council
Head Office
Mexikoring 29
22297 Hamburg, Germany +49 (0) 40 3070914-0

UK Office, World Future Council
100 Pall Mall
London SW1Y 5NQ, UK
+44 (0) 20 7321 3812

Researcher Future Finance
Dr. Matthias Kroll
+49 (0) 40 3070914-25
matthias.kroll@worldfuturecouncil.org

Director Climate and Energy
Stefan Schurig
+49 (0) 40 3070914-27
stefan.schurig@worldfuturecouncil.org