

# Submission to the inquiry by the House of Commons Select Committee on International Development on: UK aid for combating climate change

October 2018

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### **About this submission**

This written evidence was submitted on 28 September 2018 to the UK House of Commons Select Committee on International Development inquiry into 'UK aid for combating climate change'. The submission addresses four aspects of the inquiry.

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This policy paper is intended to inform decision-makers in the public, private and third sectors. It has been reviewed by at least two internal referees before publication. The views expressed in this paper represent those of the author and do not necessarily represent those of the host institutions or funders.

# Executive summary

In 2015 and 2016, Member States of the United Nations committed to a number of international agreements, including the 2030 Agenda for Sustainable Development (including the Sustainable Development Goals) and the Paris Agreement on climate change. Taken together, these agreements set the new global development agenda, and should place sustainability and climate action at the core of support for international development support. The actions undertaken in developing regions (South Asia, Southeast Asia and Africa) will be essential to the achievement of the goals of the Paris Agreement, or, if the goals are missed, will determine the ability to adapt to the consequences.

The current UK strategy for overseas aid places an emphasis on mobilising private sector investment to meet the developmental challenges faced by many countries. UK official development assistance (ODA) related to climate change is allocated through the International Climate Fund (ICF), and 80% of ICF funds are focussed on supporting the enabling environment for private sector investment in developing countries. This is either through finance made available directly to the private sector (private sector investment support), or support (usually multilateral) offered to public sector institutions that focus on supporting private sector investment (policy implementation support).

Support for the private sector in developing countries is essential to realising the Paris Agreement and the Sustainable Development Goals (SDGs), but there are two broad channels through which this can be enabled: firstly, through direct support and secondly, through creating the enabling environment for private sector investment. The funding for the second channel includes *policy design and development*, and *research*, constituting about 15% and 5% per annum of the total ICF spend, respectively.

The importance of the second channel can be seen in the experiences of a number of current programmes and projects. Many projects of the multilateral institutions or private sector investment funds report challenges in realising investment plans, or in the disbursement of finance. The problem they face is not the absence of opportunities: rather, it is often a lack of the availability of viable investment projects.

Some climate change impacts are already observable and further warming is now unavoidable. Therefore, mitigation and adaptation should be considered together and international development programmes designed, financed and allocated accordingly. The UK should take the lead by developing a robust screening process to determine a climate rationale for the allocation of *all* international development resources, not just those distributed through the ICF. It should involve a holistic, coherent approach to considering both the mitigation (reducing greenhouse gas emissions) and adaptation (long-term risk reduction) aspects of aid. The scale of the impacts of climate change, and the threats that they pose to achieving development, make such an approach essential.

Climate change has been identified as a priority area in the strategy of the CDC (the UK's private sector development finance institution) over the next five years. The CDC should be encouraged to rise to this commitment through developing an integrated and holistic climate change screening and evaluation process and policies for *all* investments. This is important both to signal UK commitment to climate action, but also to identify and mitigate risks from potential losses to which all CDC investments will be exposed in future because of climate change.

This process of climate screening of all international development resources (not just those related to climate change) should also be championed across institutions in which the UK is a shareholder, including bilateral and multilateral institutions. To demonstrate its commitment, the UK should prioritise this approach in UK-owned and controlled development institutions, including the ICF and CDC.

The UK can also lead by championing reforms to the mandates of the multilateral development banks (MDBs) and making available additional resources for climate action. This will demonstrate commitment to robust climate action and also a recommitment to the principles and institutions that represent multilateralism.

# Inquiry submission: UK aid for combating climate change

## What will the consequences be if the international development community fails to take action?

1. In 2015 and 2016, all Member States of the United Nations committed to a number of international agreements, including the 2030 Agenda for Sustainable Development (including the Sustainable Development Goals), the Paris Agreement on climate change, the Addis Ababa Action Agenda of the Third International Conference on Financing for Development, and the New Urban Agenda on sustainable urban development. Together, these agreements set the new global development agenda, with sustainability at its core.
2. To meet the goals of these agreements, the next two decades will be critical. In particular, three areas will determine what the future will look like. In the next 15 to 20 years, it is estimated that the world economy will double in size (if annual global growth is 3% on average). This growth will need the support of investment of approximately US\$5–6 trillion per annum (i.e. about US\$90 trillion between 2015 and 2030). Most of these investments will occur in cities; it is estimated that urban populations will double in the next 40 years. The shape and functioning of these cities will be determined by investment decisions and policies implemented now.<sup>1</sup> This growth and investment will be led by developing countries in Asia and Africa.
3. At the same time as these global structural changes are occurring, greenhouse gas emissions will have to decrease by approximately 30% by 2030 and reach 'net zero' (a balance between sources and sinks) by mid-century to limit global warming to no more than 1.5°C above pre-industrial levels, or during the second half of the 21st century to hold the increase in global temperature to well below 2°C. Meeting these targets requires immediate action at scale from all countries. The world can cut emissions a little more strongly earlier and a little less later, or vice versa, but the shape of feasible paths is similar. How this growth and development occurs will determine our ability to avoid climate change impacts.
4. Many of the impacts of climate change will be felt through changes in environmental factors, whether through inundation of previously inhabitable or productive areas due to sea level rise, more frequent and/or intense extreme weather events (e.g. rainfall, tropical cyclones, heatwaves, etc.), or a lack of water (causing extended droughts and desertification). These changes will affect all other developmental priorities, including potential destruction or damage of economic infrastructure (roads, water networks, communication networks and buildings), damage to social infrastructure (hospitals, schools), exposure of populations to new health hazards (disease), or risks to economic output (heat impacts causing a decrease in labour productivity, crop destruction or loss of capital investment).
5. In all cases, the poorest or most vulnerable people will be impacted hardest. High-carbon growth in the long run is fundamentally unsustainable: the consequences of climate change could be catastrophic and lead to a reversal in development gains or entrench poverty for those who are most vulnerable. However, because it is difficult to predict when and where the impacts will occur, *all* developmental actions and investments need to consider climate change, both mitigation and adaptation.
6. If the international development community fails to support climate-resilient development, developing countries could also miss out on the immense opportunities presented by strong

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<sup>1</sup> See New Climate Economy (2018) *Unlocking the inclusive growth story of the 21st century: Accelerating Climate Action in Urgent Times*. Available at: <https://newclimateeconomy.report/2018/>

action on climate change. These include unlocking large-scale investment in sustainable infrastructure in the short term, taking advantage of new markets, skills and technologies, improving the energy and water productivity of economies in the medium term, and avoiding economic drags associated with ecosystem degradation, or the health and pollution impacts on populations from fossil fuel-driven growth.<sup>2</sup>

## **What role can international development play in combating climate change?**

7. The actions undertaken in developing regions (South Asia, Southeast Asia and Africa) will be essential to the achievement of the goals of the Paris Agreement, or, if the goals are missed, they will determine the ability to adapt to the consequences. The actions implemented in the next decade will also determine the developmental trajectories or successes in meeting the Sustainable Development Goals (SDGs). All Member States of the United Nations have committed to these goals and it is imperative that any international development support reflects this commitment and places the goals at the heart of decisions.
8. While many international development institutions have been at the forefront of action on climate change, it is still too often seen as a separate development category when compared with those focussed on poverty alleviation, health, education or disaster support. This distinction is evident in the latest Economic Development Strategy published by the Department for International Development (DfID) in 2017. The strategy recognises the importance of climate action, but it only receives a brief mention under the sector priorities of 'agriculture' and 'infrastructure, energy and urban development', while 'extractive industries' including oil, gas and mining are highlighted as a priority sector for support, with no mention of climate change considerations.
9. International development strategies and support have to recognise that strong action on poverty alleviation, health, disaster support and climate change are interwoven and complementary. If these problems are not addressed together, and if climate change action is not placed at the centre of development decisions and support, the integrated nature of development as embodied in the SDGs risks being undervalued and underemphasised. It is possible that in supported countries unsustainable growth and development paths will be locked in, exacerbating other development challenges, or risking non-achievement of the SDGs.
10. For example, fossil fuel-based electricity generation technologies<sup>3</sup> enjoy continued support in developing regions. While projects of this nature will have developmental benefits in terms of energy security and job creation, they run the risk of locking in long-term unsustainable growth paths. These are also growth paths that have higher greenhouse gas emissions, which could expose these countries or regions to greater climate change impacts in future. Fossil fuel-based projects also have the potential to exacerbate more immediate environmental challenges, such as air pollution, that threaten to limit development and prosperity, particularly for the most vulnerable people.

## **Does the Government strike the right balance between adaptation and mitigation in its ODA spending?**

11. The current UK aid strategy places an emphasis on mobilising private sector investment to meet the developmental challenges faced by many countries. This framing is guided by DfID's Economic Development Strategy (2017), which also promotes 'climate smart' investments across the department's economic development work (see pg. 27). UK ODA related to climate change is currently allocated through the International Climate Fund (ICF). The two largest departments responsible for over 95% of ICF distributions since its inception are the Department for

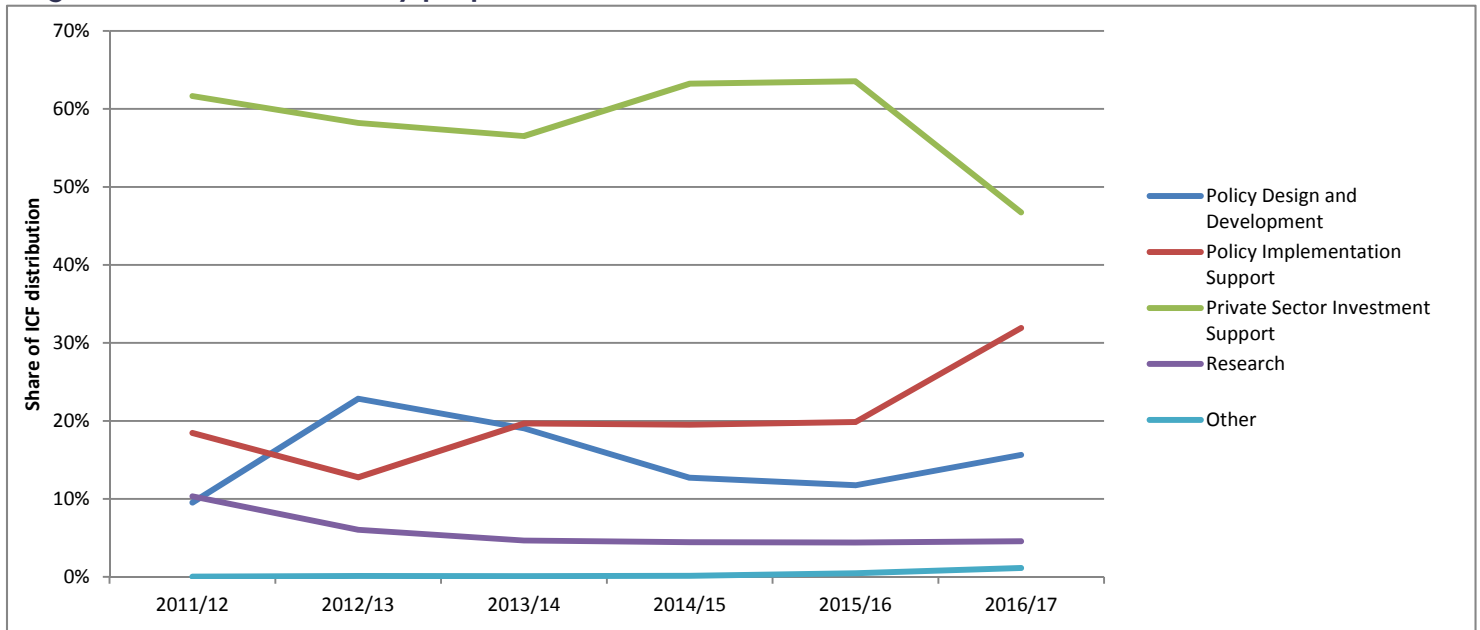
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<sup>2</sup> See New Climate Economy (2018) *Unlocking the inclusive growth story of the 21st century: Accelerating Climate Action in Urgent Times*. Available at: <https://newclimateeconomy.report/2018/>

<sup>3</sup> See: <https://www.cdcgroup.com/en/our-investments/investment/cecasl-power/>

12. In 2016, the ICF distributed around £1 billion, with a near-even split between projects tagged as 'adaptation' (35%), 'mitigation' (30%)<sup>4</sup> and 'cross-cutting' (35%). However, when the end purpose of funds is examined, alignment with the current ODA strategy can be seen (see Figure 1). Currently around 80% of ICF funds are focussed on supporting the enabling environment for private sector investment in developing countries. This is achieved either through finance made available directly to the private sector (private sector investment support), or support offered to public sector institutions (usually multilateral) that have a focus on supporting private sector investment (policy implementation support).

**Figure 1: ICF distribution by purpose**



Source: Author's analysis based on data obtained by Carbon Brief (2017)

Note: Categories have been defined by the author, and projects classified based on overall strategic intent or purpose of programme funded or institution receiving support.

13. The central role of private sector support is also evident in the top 10 recipients of ICF funding, which account for 48% of the distribution since 2011/12. Of these, six have received nearly £2 billion each, or 40% of total ICF distributions. These six recipients are predominantly multilateral institutions focussed on mobilising private sector investment through providing finance to riskier, early stage projects, including via the Climate Investment Funds (which are the largest recipient of ICF support to date).

14. The trend for private sector-specific support from the ICF is also projected to increase to 2022 as DfID provides increased capital injections to CDC, the UK's private sector development finance institution (DFI). Additional capital of between £600m in 2018/19 and £1.2bn in 2020/21 has been committed to the CDC by DfID. Currently 27% of total DfID capital contributions to the CDC have been allocated to the ICF;<sup>5</sup> if this same weighting were used to allocate the new contributions, this would mean additional ICF-related contributions to the CDC of £162m in 2018/19, rising to £324m in 2022. These would be the single biggest annual allocations of the ICF, and the largest total spend. All of this allocation would be focussed on investing directly in the private sector in the developing regions of Africa and South Asia.

<sup>4</sup> See: UK reporting to the European Union under Article 16 of the Greenhouse Gas Monitoring Mechanism Regulation: [http://cdr.eionet.europa.eu/gb/eu/mmr/art16\\_finance/envwbuhyg/Final\\_2017\\_UK\\_Article\\_16\\_MMR\\_return.xlsx/manage\\_document](http://cdr.eionet.europa.eu/gb/eu/mmr/art16_finance/envwbuhyg/Final_2017_UK_Article_16_MMR_return.xlsx/manage_document)

<sup>5</sup> Based on data provided to Carbon Brief (2017), available at: <https://docs.google.com/spreadsheets/d/1jOtXQf9AroiSsHnnMyV9m0KdQnIt5wnciL4ik6qg1A/edit>

15. It is recognised that support for the private sector in developing countries is essential to realising the Paris Agreement and the SDGs, and there are two broad channels through which this can be enabled. The first is the direct allocation of finance to private sector entities. This has been the primary channel for the ICF to date. The second is supporting public policymakers to develop and create an environment that enables investment through the development and implementation of credible, coherent, long-term policy signals that create markets and reduce investment risk. The aspects of ICF funding that support this second channel, *policy design and development*, and *research*, have received approximately 15% and 5% per annum of the total ICF spend respectively. These allocations have remained the same over the five years of operation of the ICF.
16. The importance of the second channel can be seen in the experiences of a number of current ICF-supported programmes or projects to support private investment. These programmes, whether managed by multilateral institutions<sup>6</sup> or private sector investment funds,<sup>7</sup> report challenges in realising investment plans, or in the disbursement of finance. The challenge they face is not the absence of opportunities, rather it is often a lack of availability of viable investment projects. While in some cases investment disbursement is reduced because of operational difficulties (for example in the case of the Green Climate Fund), in others it is due to the lack of viable projects in target countries. Where there are project opportunities, their investment viability is often reduced due to policy-related risk and lengthy delays associated with policy or regulatory processes, particularly for those projects that are classified as least developed and most in need of support.
17. As a result, the future allocation of ICF funding between different purposes should be considered more carefully. In particular, the levels of financial support for the development of policy and regulatory environments that enable investment should be scaled up. While it is more difficult to demonstrate the impact of these types of spend, the creation of a regulatory environment for mobilising private investment is essential to leverage the other components of ICF ODA, particularly those focussed on private sector investment being provided to the CDC. The CDC is not mandated to support policy development, and nor should it be, but to be effective it will require an enabling investment environment in countries where it invests, which UK ODA can support. This is particularly important in light of the need to implement and ramp up country-developed nationally determined contributions (NDCs) to the Paris Agreement. This process should be led by partner countries and funds should be distributed in line with UK safeguards and transparency requirements.

## Is it still appropriate to aim for targets or splits between adaptation and mitigation for ODA spending?

18. While current global reporting requirements for climate-related ODA emphasise the splits between mitigation and adaptation<sup>8</sup> finance, it is important to consider if this distinction is still relevant. In particular, the continued split for mitigation- or adaptation-specific finance is challenging due to the current emissions path and those pledged to in NDCs. Some climate change impacts are already observable and further warming is now unavoidable. Therefore, mitigation and adaptation should be considered together and support programmes designed, and finance allocated, accordingly.
19. For example, research by Conway et al. (2018)<sup>9</sup> finds that the majority of current and planned hydroelectric power stations in eastern and southern Africa will be located in the same rainfall

<sup>6</sup> See the 2017 Annual Review of the Green Climate Fund as an example: [http://iati.dfid.gov.uk/iati\\_documents/5750487.odt](http://iati.dfid.gov.uk/iati_documents/5750487.odt)

<sup>7</sup> For examples, see the 2017 Annual Review of the Climate Investment Funds (CIFs) ([http://iati.dfid.gov.uk/iati\\_documents/7997475.odt](http://iati.dfid.gov.uk/iati_documents/7997475.odt)), the 2017 annual review of the Climate Public Private Partnership Programme (CP3) ([http://iati.dfid.gov.uk/iati\\_documents/8182556.xlsx](http://iati.dfid.gov.uk/iati_documents/8182556.xlsx)) or the Annual Review of the Private Infrastructure Development Group, particularly related to Green Africa Power (GAP) ([http://iati.dfid.gov.uk/iati\\_documents/5521454.odt](http://iati.dfid.gov.uk/iati_documents/5521454.odt)).

<sup>8</sup> See OECD DAC Rio Markers for Climate Change, available at: [https://www.oecd.org/dac/environment-development/Revised%20climate%20marker%20handbook\\_FINAL.pdf](https://www.oecd.org/dac/environment-development/Revised%20climate%20marker%20handbook_FINAL.pdf)

<sup>9</sup> Conway D, Curran P, and Gannon KE (2018) *Climate risks to hydropower supply in eastern and southern Africa*. Policy Brief. Grantham Research Institute on Climate Change and the Environment. Available at: <http://www.lse.ac.uk/GranthamInstitute/publication/climate-risks-hydropower-supply-eastern-southern-africa/>

zones. These stations will therefore be exposed to the same future climatic fluctuations and potential effects of climate change. This will in turn influence their electricity generation capacity, and power shortages could have knock-on socioeconomic effects that would affect development in some of the most vulnerable countries in which UK aid is spent. Therefore, hydropower investments in these regions have to consider both their potential to mitigate emissions, but also include the design and implementation of strategies to adapt to future climate change impacts to support their effective functioning and energy security.

20. Other examples occur in sectors that receive significant international development support, such as investments in public transport systems that could mitigate emissions. These investments have to consider the potential impacts of climatic conditions on their future operation, such as temperature, rainfall or extreme events that could either alter the actual usability of the infrastructure or impact the economic sectors they aim to enable (such as agriculture or health), which in turn determine their economic viability or design.

## **How can the UK play an active role in leading the world on this issue?**

21. The UK has long played a vital and leading role in raising, allocating, managing and reporting development support, including on climate change. For the UK to further this role there are three main channels: (i) leading by example in the UK's domestic approach to climate change; (ii) maximising the impact of UK bilateral aid and climate finance commitments; and (iii) using the UK's influence on the board of multilateral financial institutions (e.g. the World Bank and regional development banks).
22. In terms of domestic action, the UK is a policy leader on climate governance and has successfully decoupled GDP growth (up 71% since 1990) and greenhouse gas emissions (down 42% over the same period). The UK was one of the first countries to pass a comprehensive framework law on climate change, the 2008 Climate Change Act. Its robust framework and evidence of success over the past 10 years provide the UK with the credibility needed to support the extension of these ideas and models around the world, as well as offering an example for other countries.
23. In terms of bilateral aid, the UK's commitment to maintain allocations of 0.7% of gross national income for international development support is a critical contribution and signal of intent. To take a further lead, the UK should work towards reducing the emphasis on dividing the allocation of finance between mitigation and adaptation. This split can unwittingly juxtapose these two aspects as if they are in competition for resources, when instead they should be considered and financed together to enable and support resilient development. Examples of where this distinction could be relaxed are in ODA channelled towards infrastructure (e.g. energy, water and transport), buildings (e.g. exposure to flood risks or energy efficiency), and agriculture. Prioritisation of projects or programmes to be supported should be led where possible by country or development partners, based on their identified developmental needs and an understanding of their risk exposures.
24. The UK should also take the lead through developing a robust screening process to determine a climate rationale for the allocation of all international development resources, not just those allocated through the ICF. This process would take a holistic, coherent approach to considering both the mitigation (reducing greenhouse gas emissions) and adaptation (long-term risk reduction) aspects of all international development programmes, investments and support. The scale of the impacts of climate change, and the threats that they pose to achieving, or potentially reversing, development require that this approach be followed.
25. This process of climate-screening all international development resources (not just those related to climate change) should also be championed across institutions in which the UK is a shareholder, including bilateral and multilateral institutions, such as the Climate Investment Funds, Private Sector Infrastructure Development Group (PIDG) and the Green Climate Fund (GCF). To demonstrate its commitment, the UK should prioritise this approach in UK-owned and -controlled development institutions, including the CDC.



26. In particular, due to the scale of ODA resource committed to the CDC over the next five years, that institution should be encouraged to develop a more integrated climate change strategy that goes beyond current commitments. Climate change has been identified as a priority area in the new CDC strategy, and thus it should be encouraged to rise to this commitment through developing holistic climate change screening and evaluation processes and policies for *all* projects in which it invests. This could be both through a combination of policies (for example, excluding all fossil fuel investments), and through a process that integrates climate change into investment decision-making (for example, applying a shadow price on carbon). A climate screening process is important because there will be large increases in the amount of UK ODA allocated to the CDC in the next five years, but also because it will help to mitigate risks from the potential losses to which all CDC investments will be exposed in the future because of climate change.
27. The third way in which the UK can lead is related to reforms to the mandates of the multilateral development banks (MDBs) and making additional resources available for climate action. The MDBs need to ramp up investment and this will require support from developed countries. Bhattacharya et al. (2016)<sup>10</sup> calculate that a one-time injection of US\$35bn, spread across development banks, combined with an increase in gearing ratios in line with commercial lenders, could enable a four-fold increase in lending from MDBs per annum, from US\$70bn to US\$200bn. If this one-time injection is combined with reforms to the mandates of the MDBs, with a focus on climate change-related investments and factoring in operational improvements, it could mobilise around US\$1 trillion per annum from private sectors sources, according to Bhattacharya et al. (ibid.).
28. The UK's experience, reputation for its international development work, and influence within MDBs places it in a unique position to promote this one-off injection and reforms so that the MDBs are more reflective of those they aim to support and make climate change a common thread in all decision-making. To lead the world the UK should actively advocate and support these changes. This will both demonstrate the UK's commitment to robust climate action and recommit the country to the principles and institutions that represent multilateralism.

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<sup>10</sup> Bhattacharya A, Meltzer JP, Oppenheim J, Qureshi Z and Stern N (2016) *Delivering on Sustainable Infrastructure for Better Development and Better Climate*. Available at: <https://www.brookings.edu/research/delivering-on-sustainable-infrastructure-for-better-development-and-better-climate/>