



INVESTING IN THE FUTURE:

Options for Climate Finance the U.S. Can Support

Secretary of State Hillary Clinton issued this breakthrough pledge at the Copenhagen Climate Summit: “The United States is prepared to work with other countries toward a goal of jointly mobilizing \$100 billion a year by 2020 to address the climate change needs of developing countries.” In the same speech, Secretary Clinton said financial support for the \$100 billion-a-year fund “will come from a wide variety of sources, public and private, bilateral and multilateral, including alternative sources of finance.”

For the time being, the Obama administration’s approach to climate finance relies on increasing budget appropriations to specific aid programs and leveraging private finance through export credit and development finance. These mechanisms alone, though, are not sufficient to meet the U.S. long-term climate finance commitment. Given the scale of the resources needed, all reasonable innovative finance mechanisms should be included in the discussion of options for mobilizing predictable public resources.

Secretary Clinton’s remarks at the Copenhagen summit indicated that the U.S. would be open to innovative financing options. But the current U.S. position on proposals under discussion in the UNFCCC ranges from ‘adamantly opposed’ to generally ‘unenthusiastic.’

In light of the U.S. Copenhagen commitment, a re-evaluation of those positions is imperative. Open dialogue with policy analysts from a wide range of stakeholders would help the administration arrive at a position that serves the interests of the U.S. and sets the stage for effective international cooperation on climate change.

Mechanisms that may be difficult to implement in the U.S. may be well suited to other countries’ national circumstances. The most constructive position for the U.S. in the international dialogue on climate finance would be to 1) entertain all proposals that may contribute to a global system of financing for low-carbon development, adaption to climate change and forest preservation, and 2) engage stakeholders at home to determine the best combination of approaches for meeting the U.S. commitment.

Any new source of climate finance brings with it certain political and technical challenges to implementation. This paper discusses five options and addresses the perceived challenges. All of these financing options could become viable in the U.S. and may contribute to an international system.

- CONTRIBUTING ORGANIZATIONS -

ACTIONAID • CARE, USA • GREENPEACE • INSTITUTE FOR POLICY STUDIES • NATURAL RESOURCES DEFENSE COUNCIL • OIL CHANGE INTERNATIONAL • OXFAM AMERICA • THE ALLIANCE FOR CLIMATE PROTECTION • UNION OF CONCERNED SCIENTISTS • WORLD WILDLIFE FUND

WWW.USCLIMATENETWORK.ORG

CONTACT: MATHEW TODARO, INTERNATIONAL POLICY DIRECTOR AT MTODARO@CLIMATENETWORK.ORG

- **SECTION 1: Redirection of Fossil Fuel Subsidies:** Building on the agreement at the G20 to remove fossil fuel subsidies, countries could further agree to redirect those subsidies towards clean energy, adaptation, and reducing deforestation. For years, fossil fuel subsidies have generated significant amounts of waste, drained national treasuries, and impeded the development of new markets in energy efficiency and renewables. Furthermore, as expressed by World Bank Managers in their recent letter to the Treasury Department regarding the issue of coal, the transfer of funds from subsidies to the development of clean technologies would serve to build trust between developed and developing countries and would be met with broad praise.
- **SECTION 2: International Aviation and Shipping Mechanisms:** This proposal would address emissions from these sectors -- which have been left uncovered by international agreements -- and also raise finance. During the past two years support for this concept has grown among countries, businesses and civil society. Multiple approaches have been proposed from a carbon tax or other levies on these fuels to sectoral cap-and-trade mechanisms that would set limits on pollution and require the purchase of allowances for emissions that exceed the cap. Under the latter approach, which has the broadest support, revenue from allowance purchases would be used for climate finance.
- **SECTION 3: Financial Transaction Tax (FTT):** This proposal would entail a very small levy on international financial transactions such as currency exchanges. It would take advantage of current sentiments in favor of regulating the financial sector and broad-based public campaigns for an FTT in several countries. This approach could be agreed to multilaterally and would be passed unilaterally by national legislatures.
- **SECTION 4: Special Drawing Rights (SDR):** International Monetary Fund (IMF)-issued Special Drawing Rights could be used to collateralize the Green Fund or converted into cash that would be used for climate purposes. In the collateralization proposal, existing developed country SDRs are used to underwrite private funds raised through the issuance of bonds while still being considered reserve assets by the IMF. In the cash conversion proposals, the interest fee for converting from Special Drawing Rights to cash would be covered by the developed countries, which would annually convert a set amount of their Special Drawing Rights.
- **SECTION 5: Setting Aside a Dedicated Portion of Emissions Allowances:** Under this concept, money would be raised by setting aside a small portion of emissions allowances and using the revenue from the sale of the allowances for international climate finance. This could be implemented either under a global system (such as the Kyoto-style country-based trading mechanism) or through an agreement to raise these funds domestically. Under the latter approach, countries would commit to setting aside a portion of the allowances under their domestic emissions trading system (as was included in the Waxman-Markey legislation) or to allocating a dedicated portion of revenues from domestic fees or taxes on greenhouse gas emissions for these purposes.

SECTION 1: SHIFTING FOSSIL FUEL SUBSIDIES TO INTERNATIONAL CLIMATE FINANCE

The recent announcements that G20 and Asia-Pacific Economic Cooperation (APEC) nations will phase out support for fossil fuels presents an opportunity to redirect substantial portions of those subsidies into international climate finance. The concept is simple. Stop funding the problem. Start funding the solution. This option for climate finance is clearly linked to greenhouse gas emissions causing global warming.

1. Potential Revenue

The amount of money currently spent on fossil fuels in Annex 1/OECD countries alone (between USD \$57 billion and at least USD \$100 billion annually) would cover a significant amount of what is needed for international climate finance. The elimination of the subsidies also would lead directly to greenhouse gas emission reductions in Annex 1/OECD countries.

In 2009, a report by the Environmental Law Institute found that shifting U.S. fossil fuel subsidies would generate at least USD \$10 billion dollars annually.¹ An additional USD \$4 billion in annual subsidies is flowing to fossil fuel interests from U.S. taxpayers via the U.S. Export-Import Bank, the Overseas Private Investment Corporation, the World Bank, and the regional development banks. These flows are technically “off budget,” but could be redirected by executive order and guidance from the U.S. Treasury. All of these subsidies meet the definition of subsidies established by the World Trade Organization (WTO) within the Agreement on Subsidies and Countervailing Measures (ASCM).²

Note that there is an additional USD \$300 billion to \$500 billion in Non Annex 1 subsidies to fossil fuels that exist mainly in consumer subsidies. While there are undeniable benefits to reducing these subsidies as well, this elimination should not be tied to climate finance, although it could be part of nationally appropriate mitigation actions (NAMAs). The need to sequence subsidy removal is discussed below.

2. Diplomatic Reasons to Continue Consideration

Internationally, the politics of ending fossil fuel subsidies are already intertwined with climate finance. Developing countries are legitimately concerned about access to energy for their people, and the removal of subsidies can be seen as a threat to this unless it is accompanied by increased climate finance. For example, nine World Bank directors representing 90 developing countries including the BASIC nations (Brazil, South Africa, India and China) recently stated that the U.S. Treasury’s guidance note on halting Bank support for coal “may have been acceptable if it had been accompanied by a U.S. commitment to provide such enabling finance and technology.” In the same letter, the directors noted the ongoing support for fossil fuels in the U.S. as a reason to continue providing that support internationally. This explicit linkage between ending subsidies and providing climate finance is important, particularly in light of the World Bank’s potential role as a key agency for climate finance.

3. Political Reasons to Continue Consideration

As the administration knows, there is tremendous bipartisan public support for reducing fossil fuel subsidies, particularly to “Big Oil.” In addition, as the controversy over a recent Export-Import Bank loan to Brazil for offshore drilling shows, continuing support for fossil fuel extraction abroad is a potential political liability. Linking subsidy removal with international climate finance is one of the most politically potent narratives for raising the necessary funding for climate finance. Finally, much of this finance can be accurately portrayed as building global markets for American clean energy technology and thus supporting green jobs and the clean energy economy.

4. How the U.S. Implements This Option

The president has already begun the process of subsidy removal (although not shifting) in his budget proposal by identifying almost USD \$4 billion annually in fossil fuel subsidies. This is a good start, but there is more that the administration can do immediately to build momentum and political pressure.

- The administration can lead by example by shifting fossil fuel subsidies that originate in the executive branch. This includes U.S. support for all the multilateral development banks via Treasury, the U.S. Export-Import Bank, the Overseas Private Investment Corporation, and other agencies that subsidize fossil fuels. Doing this unilaterally will establish stronger diplomatic relationships, while putting pressure on those in Congress who will defend fossil fuel interests.
- U.S. executive directors at Development Banks could be required to vote against any fossil fuel project (other than assistance with transition such as mine closure) that did not have as its sole purpose energy poverty alleviation or energy access for poor people and communities -- and where a full examination of all lower and zerocarbon alternatives had not been undertaken. If the World Bank is to have any credibility as an agency responsible for climate finance, it must stop supporting fossil fuel projects in all cases where the *sole* purpose of the project is not energy poverty alleviation.
- G20 nations could be encouraged to phaseout export credit and development bank support for fossil fuels.
- Subsidy shift could be part of an energy and climate bill in Congress, or advanced as stand-alone legislation. Subsidy removal could be pursued through the budget process. In the absence of a legislative linkage, it would require a separate initiative on climate finance.
- The president should establish an independent commission with multi-stakeholder representation to identify and quantify subsidies to the fossil fuel industry. While this initiative should not slow initial actions towards obvious subsidy removal, it will be important moving forward to have full transparency and accounting for fossil fuel subsidies.

5. Overcoming Perceived Obstacles to Implementation

Don't Reinvent the Definition

For subsidy shift to succeed, it's important that all parties agree to a common definition for fossil fuel subsidies. The G20 process has so far not produced agreement on this point. Therefore, we urge the United States to adopt and advocate for the WTO definition of subsidies as agreed within the Agreement on Subsidies and Countervailing Measures (ASCM). The ASCM provides a good basis for defining subsidies for fossil fuels. It has wide support -- the WTO has 153 members -- has been tried and tested through a rigorous negotiating process and is supported by extensive legal analysis and jurisprudence from the Dispute Settlement Body and the Appellate Body. As such, it has distinct advantages over any new definition, which would need to establish support, and be negotiated and tested through jurisprudence.

Sequencing is Key

The need to alleviate energy poverty and provide access to energy for the poor is perceived as an obstacle to phasing out fossil fuel subsidies globally. To complicate matters further, the removal of consumer subsidies in developing countries will, by definition, lead to higher gas prices in those countries. These two obstacles can be addressed by an agreement to a scheduled phase out of fossil fuels subsidies, with developed countries taking the lead, and directly linking fossil fuel subsidy removal to climate finance. Eliminating subsidies to fossil fuels on their own is not adequate to establish trust and build momentum towards a global transition to a clean energy economy. The removal must be sequenced and linked to climate finance. The most feasible solution would be an ongoing removal of fossil fuel subsidies, gradually decreasing the level of support, and differentiated in time and by country while increasing climate finance to developing countries based on their income level or vulnerability to climate impacts.

For example, Annex 1 countries could commit to phasing out energy subsidies completely within five to seven years, and that finance could in turn be redirected to climate finance. Middle-income developing countries could aim for 10 years, and low-income countries could target a 50 percent reduction within 10 years and a complete elimination in 15 years. This strategy offers benefits to all parties. Annex 1 countries would take a significant step forward in reducing their emissions, while also finding needed funding for climate finance. Non-Annex 1 countries would benefit from reduced exposure to the fluctuations in the oil market as well as financial and technology transfers for mitigation. In addition, subsidy phase out could become a central part of nationally appropriate mitigation actions.

Robust Consumer Protections Can Prevent Rising Gas Prices in the U.S.

Rising gas prices this summer will fuel industry and Congressional opposition to subsidy removal. Big Oil and their allies in the U.S. will cast subsidy removal as "new taxes" on the industry that will have to be passed on to consumers. Subsidy removal in the U.S. should be accompanied by robust consumer protections in the form of windfall profits taxes and anti-profiteering legislation. Dividend checks, potentially, that could be part of climate legislation could be used to counter concern. Finally, redirecting money from subsidizing the oil industry to building the global clean energy economy including the development of fuel-efficient vehicles, second generation biofuels, and other solutions will

help hold down consumer gasoline bills over time and is a politically palatable way to secure additional funds, even for international use.

Opposition in Congress Can Be Overcome

If subsidy removal and climate finance are separate initiatives, they both face steeper odds in Congress. In addition, the value of subsidies to the fossil fuel industry should be calculated based on revenue lost to the American taxpayer and the cost of the service provided on the market (price-gap).

Engage Experts

Producer subsidies are often in the form of tax credits. Specifically redirecting those credits to international climate funds poses some technical and accounting challenges. The administration can bring together the brightest minds in the business to design a budget proposal, legislation, or other policy option to accomplish this goal.

SECTION 2: GLOBAL SECTORAL MECHANISM FOR AVIATION AND SHIPPING EMISSIONS

This approach would address both emissions from these sectors (which have been left uncovered internationally and are growing at a rapid pace) and raise climate finance. In recent years, support for this approach has grown among governments, businesses and civil society. Among other benefits, it has the advantage of mobilizing global resources to tackle climate change from a system involving greenhouse gas emissions.

Multiple approaches have been proposed from a carbon tax or other levy on these fuels to sectoral cap-and-trade mechanisms. Under the sectoral cap-and-trade approach, which has the broadest support, a cap would be established for each sector and covered entities (airlines or marine transporters) would need to buy allowances for emissions through a dedicated auction. The sectoral mechanisms could be created by the United Nations Framework Convention on Climate Change (UNFCCC), by the respective international bodies that currently regulate these industries – the International Civil Aviation Organization (ICAO) and International Maritime Organization (IMO) – with direction from the UNFCCC on targets and timetables, or by domestic legislation regulating the emissions/revenues with international harmonization of the program. Another option is that the EU continues its aviation cap, the U.S. covers aviation under the cap, and specific revenues are dedicated (with some harmonization) towards an international investment fund.

Under variations of the concept, covered entities could purchase additional allowances from other capped sectors (i.e., the programs would be linked to other trading systems, such as the U.S. or EU Emissions Trading System (ETS)). Because aviation is a growth sector, linking these systems would likely generate demand for carbon allowances, thus strengthening the global carbon market.

A levy approach could be implemented as a carbon/fuel tax or a passenger/ticket tax. A carbon or fuel tax could be designed to address emissions (if the levy is set at an appropriate level) and also generate finance, while the purpose of a passenger or ticket tax would be solely to generate finance.

Revenue from auctioning allowances under the sectoral mechanisms or collected levies would be dedicated to helping developing countries adapt to the impacts of climate change, undertake actions to reduce emissions, and potentially offset negative economic impacts of the programs on local economies. In order to ensure that very small or poor nations that rely heavily on food imports and tourism revenue are not unduly harmed by this approach, an exception could be applied in those instances.

A global approach to these inherently global sectors makes good sense, but these would be the first common global caps or levies for any sectors. Without dedicating revenues to climate finance, it is not politically viable or fair. The use of revenues for this purpose is inseparable from the concept and vital to reaching a compromise between the need for a global approach and the importance of respecting ‘common but differentiated responsibilities’ for climate change.

1. Why Should This Option Be Considered?

Curbing Aviation and Shipping Emissions

All sectors, including international aviation and shipping, have a responsibility to act and to do so quickly to substantially reduce their greenhouse gas emissions. These sectors were entirely omitted from the Kyoto Protocol; this loophole should be closed. Aviation and shipping together constitute nearly 8% of global emissions and are growing fast. If they continue to grow unchecked and other emissions are reduced to the levels needed, these emissions would represent 50-85% of a 'safe' global carbon budget by 2050[A3]. If a sectoral cap or adequate carbon tax is combined with technological and operational improvements offers an effective means of reducing greenhouse gas (GHG) emissions from aviation and shipping. A recent U.S. Government Accountability Office (GAO) report analyzed these two approaches and found that both had merit.³ However, a passenger ticket levy likely would have no discernable effect on emissions.

Meeting 2020 Commitments Without Creating Competitiveness Issues

An international mechanism would allow these emissions to be addressed through a single cap for each industry, which would avoid competitiveness concerns by ensuring a level regulatory playing field. Traditional developing country opposition to a cap on these sectors would be mitigated by using revenues raised through the system for helping vulnerable developing countries in the fight against climate change. But even without the implementation of an international mechanism from day one, the prospect of revenues from a bunker cap/fee could create an incentive to both achieve a global emissions reduction from the sector and generate finance. By saying, "if there is an international mechanism along these lines we will dedicated X% of the revenues to international activities" you can create a strong voice within the developing countries to implement such an international mechanism. They will then argue for the global cap/fee in order to unlock the funding. This mechanism could contribute between USD \$19 billion and \$35 billion to climate financing by 2020. Based on projected emissions, the portion attributable to international aviation and shipping emissions originating in the U.S. would be between USD \$1.5 and 2.8 billion. The revenue from a levy would depend on whether all countries that have significant international aviation sectors participate and the scale of the levy.

Congressional Will Exists

The American Clean Energy and Security Act (ACES or Waxman-Markey) approved by the House of Representatives in June 2009 included an upstream cap on all aviation and shipping fuels – including those used for international trips. An international mechanism therefore would not impose an additional burden on U.S. carriers, but would promote a level playing field that brought other emissions from this sector under a similar emissions limit. Rather than allow an unclear 'spaghetti bowl' of international regimes develop, the U.S. can instead help ensure that a coherent international approach to global transport is created.

A U.S. Negotiating Lever

Some of the major developing countries have argued that the principle of ‘common but differentiated responsibilities’ (CBDR) should be applied to any international aviation and shipping measures, although they have not specified how it should be interpreted. At the same time, for many developing countries, the use of the transport sector to generate climate finance takes important steps in addressing their concerns. A global transport and finance approach supported by both developed countries and a number of developing countries, especially vulnerable countries, could be a platform for agreement. The current alternative is likely to be regional regulation that would cover all countries’ operators, but generate no finance. This is already developing into the default position, with operators of all nationalities to be covered when they fly to or from the European Union after 2012; a similar measure is envisaged for shipping post-2013. Under Waxman-Markey, a similar condition would exist in the U.S. through an upstream emissions cap.

Allies Support This Approach

The strongest champions of this concept were Norway, the EU, Australia and Canada (in that order). Japan indicated that it would not oppose this approach and Russia has been silent. The group of Least Developed Countries have signaled support, and a number of individual small island states have also supported it, although the formal Alliance of Small Island States (AOSIS) position does not go this far. There have been signs that opposition from OPEC countries is softening on condition that a portion of revenues be used for R&D within the sector. Interest is particularly strong from states such as Qatar, which is developing a program of algae biofuels for aircraft.

Industrial Support Exists

The Aviation Global Deal group, consisting of Air France/KLM, BAA, British Airways, Cathay Pacific, Virgin Atlantic, Virgin Blue, Qatar Airways, and LOT Polish Airlines support a similar proposal, including requirements that funds from the mechanism flow to international climate finance priorities such as adaptation.⁴ The national shipping associations of the United Kingdom, Norway, Sweden, Belgium and Australia recently published a detailed proposal for a global emissions trading scheme which supports the principle that all permits should be auctioned.⁵ A number of other national associations (in Denmark, Hong Kong, France and Germany) support a fuel levy approach.

2. How the U.S. Implements This Option

Congress could adopt a policy to allow the United States to participate in global sectoral approaches to reducing aviation and maritime emissions. This could be done in advance through provisions in a U.S. climate bill, which would help shape international discussions, or the U.S. emissions trading system could be modified in the future after completion of an international agreement. Congress could also adopt a set of guidelines to provide direction for international negotiations. This could be done either in advance for mechanisms to be developed in the future or to implement an international agreement. Congress could also adopt a set of negotiating guidelines to provide guidance for U.S. negotiations. Congress should make clear that to qualify or be implemented, a mechanism would need to meet clear criteria for effectiveness and equity, including the use of revenue generated for international climate finance.

Once an international system was in place, the U.S. system would need to ensure that emissions are not regulated twice. If an emissions cap or other relevant policy were put in place in the U.S., it would most likely be implemented “upstream” so that the system would cover all international aviation and shipping fuels (including those for international trips) at the refinery. Ensuring no double regulation could be accomplished in a number of ways. Rebates could be issued to airlines/ship operators for the cost of emissions allowances associated with fuel purchased in the United States but used for international trips. The U.S. and Europe could then link their trading markets with the international mechanism. Or emissions associated with international trips could be exempted from the U.S. cap, so long as they are covered by the international mechanisms and are implemented in a manner that meets the U.S. regulations.

3. Overcoming Perceived Obstacles to Implementation

Major Developing Countries Do Not Support Approach

As mentioned above, an approach supported by all developed countries and many vulnerable developing countries could provide the basis for agreement. The global transport regime and finance approach has clear benefits when the alternative is likely to be regional regulation that covers those countries’ operators, but generates no finance. Under such a scenario, the EU, U.S. and others (Australia) will move to regulate regionally (as is already happening) and the revenues will stay in country. Thus far this argument has not been successful because the United States has not supported these mechanisms. It is important to note that, unlike the UNFCCC, voting in the IMO is governed by regular rules and procedures, so the two or three biggest opponents (e.g., China and Saudi Arabia) could not block a majority vote to approve such a mechanism.

U.S. Aviation Industry Opposition

The Air Transport Association of America supports a global sectoral approach pursued through ICAO, but the industry does not yet support serious global emissions reductions. Currently, the Air Transport Association (ATA) seeks to avoid all mechanisms to reduce emission in their sector, including exemption from a U.S. climate bill (although they weren’t extremely active or successful in the House debate). However, if the U.S. passes a bill covering international flights (as the House-passed bill would) the U.S. Aviation industry should be more amenable to an international approach that would avoid a patchwork of different rules and regulations around the world. Also, unlike other airlines outside of the U.S., ATA does not support using revenues from an aviation mechanism for climate finance, but if the alternative was to have an international system with no harmonization, the industry will likely shift this positioning.

Congressional Resistance to International Tax

An emissions trading system in which permits are purchased for global warming pollution would not be considered a tax under U.S. or international law. Emissions trading systems have bipartisan support today and in the past (e.g. Hg, SO₂ ETs). The Chicago Convention (creating ICAO) is intended to limit bilateral taxes on aviation, but would not be inconsistent with a global approach (either a cap or tax) to these sectors. Further, a coherent global regime is preferable to a confusing overlap of regional regimes. The U.S. already applies a levy on aviation fuel. Generating revenue from a cap wouldn’t be disallowed under the Chicago Convention as it would be in an emissions based system (not fuel-based). Moreover,

if coverage under an international mechanism is treated as cause for a rebate or exemption from comparable U.S. regulation, this approach would be entirely consistent with existing U.S. constitutional and international trade law.

Additionally, in the case of maritime emissions, analysis has shown that the cost of emissions allowances as a fraction of the total cost of goods transported by ship is *de minimis*. The effect on consumers in the U.S. would be tiny.⁶

U.S. Administration Opposes Applying CBDR in ICAO and IMO

In the past, the U.S. government has argued that the principle of ‘common but differentiated responsibilities’ should not be applied to actions by ICAO and IMO. The application of CBDR that the U.S. has previously opposed involved exempting all developing country carriers from regulation simply due to their country of origin. A global approach to aviation and/or shipping would apply regardless of the country from which the trips originate. Instead, concerns around CBDR would be handled differently. Most important, resources raised should be directed towards adaptation and emissions reduction efforts in developing countries a way to address developing countries’ concerns. In addition, an exception for very small or poor nations that rely heavily on food imports and tourism revenue could be created, an exception that would reflect CBDR and that many parties endorse. Other CBDR proposals have called for “rebates” to address impacts on developing country economies from this approach. This could be another way to address developing economies are particularly affected by the approach.

Impact on U.S. Ports

A global mechanism to reduce emissions from shipping should have little if any effect on U.S. port traffic because it will be applied equally in all countries. If, on the other hand, maritime fuels are covered outside of an international system, there may be some concern about increased tankering in Mexico. This could be addressed through bilateral trade agreements with Mexico. The proposal discussed here, however, is for an international mechanism, which affects all countries equally and would have little-to-no impact on U.S. ports.

SECTION 3: GENERATING CLIMATE FINANCE THROUGH A FINANCIAL TRANSACTION TAX

A Financial Transaction Tax is an appealing source of public financing because it is scalable and predictable. The FTT is a very small tax that would be levied on all financial market transactions involving stocks, bonds, foreign exchange and derivatives (futures and options). This would include any financial transactions traded through stock exchanges, futures exchanges or any other facility established for the purpose of trading by financial market actors. Ordinary consumer transactions such as payments for goods, paychecks, ATM withdrawals and cross-border remittances would not be subject to the FTT, nor would short-term inter-bank lending and central bank operations.

The participation of all sectors of the economy will be needed to solve global warming. As the recession tightens budgets for global public goods, climate finance cannot be seen as taking dollars out of the hands of middle class American families. The FTT allows the financial sector, and in particular, the high flyers who engage in high-frequency stock-flipping and speculation, to contribute in a simple and equitable way to provide the resources needed to invest in the new energy economy and help the most vulnerable countries and communities adapt to the reality of climate change.

1. Why Should This Option Be Considered?

Finance Commitments Could Be Met While Providing Funding for Consumer Rebates and Green Jobs.

The Center for Economic and Policy Research estimates that a varied FTT (0.5% on stock trades; 0.01% on bond trades; 0.01% on swaps) would raise more than USD \$175 billion a year in the US alone, even assuming a 50% reduction in trading volume.⁷ The North-South Institute estimates that a levy of 0.005% on only currency transactions in dealer markets would yield approximately USD \$33 billion annually, assuming a 14.5% drop in trading. Of that total, USD \$28 billion would be raised in the U.S.⁸ Globally, an average tax of 0.05% on all financial transactions would generate an estimated USD \$400 billion per year. Many international advocates for an FTT have proposed that revenues be split equally between domestic and international needs, with the international portion divided equally between climate and global health programs. Under this scheme, an FTT could generate the USD \$100 billion per year in finance that governments have committed to spending to support developing country adaptation and mitigation.

As the Congress debates climate and energy legislation, it has become clear that shielding consumers from rising energy costs is an important policy goal. The FTT would provide the U.S. the ability to invest internationally in the global low carbon economy and still protect working families at home through green jobs creation. The tax could also be narrowly designed to target specific industries with greater responsibility for low carbon development and adaptation. This approach would raise less money but could also reduce political opposition. It could be designed to target specific types of transactions in the future, such as carbon derivatives transactions, helping curb speculation that could threaten the integrity of a carbon market.

FTT and Bank Taxes Are Complementary, Not Competitive

The bank tax proposed by President Obama is different in scope, purpose, and function from a financial transaction tax. The bank tax applies only to firms with more than USD \$50 billion in consolidated assets, which would include 50 banks, insurance companies, and large broker-dealers. An FTT covers a much wider range of financial activity, including hedge funds and other unregulated financial activities that are not in the top 50. The White House argues that a bank tax can raise USD \$90 billion over 10 years. A comprehensive FTT would raise more than \$100 billion per year in the US alone.

The bank tax is intended to get the big banks to pay us back for the bailout based on the level of the risk they expose themselves to. Some money could also be raised to capitalize an insurance fund that could be used to bail banks out in a future economic crisis. The FTT, on the other hand, generates billions of dollars, reducing the volume and spread of the most complex derivatives markets and increasing financial stability. The revenue raised would be allocated for public goods like adapting to climate change and creating green jobs in a low carbon economy – both at home and abroad.

Leaders Allied With U.S. Support FTTs for Climate and Development Financing

Japan's Foreign Minister Katsuya Okada favors the FTT, along with several European heads of state including French President Nicholas Sarkozy, German Chancellor Angela Merkel, and former U.K. Prime Minister Gordon Brown. Austria and Belgium have also expressed support for taxation of financial transactions. The EU Parliament recently passed a resolution to study the implementation of a regional FTT. An agreement by G8 countries to enact these taxes in a coordinated fashion would minimize competitiveness issues.

Not Difficult to Administer

The feasibility of administering a national financial transaction tax in the United States has already been established. The U.S. has a 0.0042% "fee" applied to transactions in all publicly traded securities and exchange traded futures and options (including the New York Stock Exchange and the American Stock Exchange) and other self-regulated financial organizations. Revenues from this tax are used to fund the Securities and Exchange Commission.⁹

Computerization of financial markets means transactions taxes can be easily collected at the point where deals are cleared and settled, making revenue collection relatively straight forward and inexpensive. Taxes on all transactions are collected by the exchanges where trading occurs between buyers and sellers. The banking sector has made collection of a tax on foreign exchange in particular far simpler over the last few years as it has worked to remove settlement risk from the system. The introduction of Real Time Gross Settlement (RTGS), the Continuous Linked Settlement (CLS) bank (which now settles 75 percent of all wholesale foreign currency trading worldwide), and the almost universal use of SWIFT messaging means that a simple electronic tag on existing settlement systems would automatically transfer the FTT to the relevant tax office. Taxes on "over-the-counter" financial transactions can be collected at the point of clearing or of settlement.¹⁰

Broad Coalition Support in the U.S.

A diverse range of U.S. groups have come together to advance a financial transaction tax, building off the growing momentum of “Robin Hood Tax” campaigns in the U.K., Italy, Canada and Australia. A key anchor of the U.S. campaign is Americans for Financial Reform, a coalition of more than 200 national, state, and local groups working to reform the financial industry in part through a financial transaction tax. Members of the coalition include consumer, civil rights, investor, retiree, community, religious, and business groups as well as Nobel Prize winning economists. They have engaged climate and global health groups in this effort and recently embraced the idea of using some of the proceeds of an FTT for climate finance. The campaign is supported by labor organizations like the AFL-CIO and the ITUC, Consumer Federation of America, and Campaign for America’s Future. The concept also enjoys the support of respected academics and economists like Nobel Prize winners Joseph Stiglitz and Paul Krugman, as well as Dani Rodrick and Jeffrey Sachs, and influential financiers such as George Soros, Warren Buffett, and John Bogle.

2. How the U.S. Implements This Option

Senator Tom Harkin (D-IA) and Representative Peter DeFazio (D-OR) have introduced bills that place a small transaction tax on trades of stocks, options and swaps. With a modest tax of 0.25% the bills propose to raise USD \$75 billion a year. According to the Center for Economic Policy and Research, the taxes proposed in these bills would return trading costs to 1980s levels. They effectively protect middle class investors by exempting individual retirement accounts, tax-benefited mutual funds, pension funds, and the first \$100,000 of individual stock trades per year.

Global health and climate groups are currently garnering support in the House and Senate for legislation that complements the DeFazio and Harkin bills to tax currency transactions at a rate of .005%, generating an estimated USD \$28 billion per year in the U.S. If, as currently proposed, the revenue were split equally between climate change and global health programs, the U.S. would raise approximately USD \$14 billion each year for international climate finance. The revenue raised would be designated to a climate trust fund or Global Green Climate Fund within the UNFCCC, much in the same way as revenue generated by the federal gas tax is directed to the Highway Trust Fund.

Like any other tax policy, a financial transaction tax is ultimately under the jurisdiction of the House Ways & Means and Senate Finance Committees. Speaker of the House Nancy Pelosi and Chairman of the House Financial Services Committee Barney Frank have indicated they would support an FTT if it were coordinated internationally.¹¹

3. Overcoming Perceived Obstacles to Implementation

Financial Sector Resistance

Powerful interests in the financial sector have been resistant to any regulation that is perceived to diminish their economic gains. However, the rates of taxation on financial transactions are intentionally set low enough – hundredths or thousandths of a percent – not to affect retail trading and everyday access to capital, but high enough to dissuade high volume transactions, particularly risky currency speculation by the biggest financial actors.¹² Hundreds of economists from around the world and renowned socially responsible investors like George Soros and Warren Buffet have supported a modest

financial transaction tax to raise trading costs back to the level of two or three decades ago in order to reduce the volume of speculation in financial markets and provide substantial revenue for public goods and deficit reduction.¹³

Congress Resists International Tax

This would not be an 'international tax.' Congress would have to approve the tax and the use of the revenues. Any government can introduce a tax on trades in its own currency wherever in the world they take place. In the case of the U.S. this would mean a tax on dollar transactions would be captured even if that trade happened between two traders in, for example, Johannesburg and London. This could be announced in the federal budget. As is the case with all taxes, an FTT would be legislated by Congress, approved by Senate Finance, and House Ways and Means Committees, collected and disbursed according to the letter of U.S. law. The FTT is not a tax imposed by an international regulatory body, international financial institution, or international agency. Revenue generated through a national financial transaction tax, however, could be directed to an international climate fund, such as a Global Green Climate Fund that is under the authority of the UNFCCC.

Safeguards for Competitiveness Can Be Enacted

Significant work has been done to develop FTTs to minimize perverse incentives that shift financial activity to areas with lower tax burdens.¹⁴ There are two cases at least in which it seems likely the tax could be applied to particular market segments without significant unintended distortions. First, a tax on stock exchanges alone has been implemented often and, with appropriate conditions and design, such as in the U.K., with success. Second, there are no close substitutes for foreign exchange trading as such, so it seems likely a tax could be applied successfully to the foreign exchange trading alone without causing significant distortions.

In addition to minimizing flight to exchanges outside the U.S., design measures and detailed implementation of an FTT can help ensure these costs are paid by those who can afford them. Some of the steps that complement an FTT include stimulating competition, tighter anti-trust legislation, controls on bonuses, exemptions and refunds built into the tax system, and differential rates of financial transaction taxation targeting those market sectors where the tax would have the most progressive incidence.¹⁵

Coordinate Internationally

A unilateral FTT in the U.S. could be a building block for an international system, as other countries join in. A first step to initiate international coordination would be a commitment from G8 (or G20) leaders to implement an FTT. To minimize perceived competition, G8 countries could coordinate the dates and timing of implementation and rates on an FTT.

Because different countries and regions face varying political constraints to enacting transaction taxes, one economist, Stephan Schulmeister of the Austrian Institute of Economic Research, has suggested that FTT implementation could take a phased approach. The first stage could be the implementation of a tax levied only on spot and derivatives transactions on organized exchanges in one or more major economies. A second stage would then include all over the counter transactions in a single currency,

followed by a tax on OTC transactions (spot and derivatives), in particular in the foreign exchange market. If an FTT on OTC assets were collected at the point of globally centralized clearing or settlement, it would apply to all agents regardless of where the dealing rooms are located or the trade is made. For example, the two dealers engaging in a foreign exchange transaction tend to be located in different countries, yet the transaction will be cleared by SWIFT and settled at CLS Bank. A general taxation of financial transactions in all major economies could be the final stage in the process of implementing an FTT.

SECTION 4: USING SPECIAL DRAWING RIGHTS FOR CLIMATE FINANCE

Special Drawing Rights (SDRs) are reserve assets issued by the International Monetary Fund (IMF) to member countries. Their value is based on a basket of four currencies - the U.S. dollar, the UK pound, the Euro, and the Japanese yen - and they are issued in proportion to IMF quotas, which are determined by each member country's relative weight in the global economy. Governments can use their SDRs to build its reserves or exchange them for cash. To date, four allocations of SDRs have taken place and there are 204 billion SDRs worth approximately \$320 billion U.S.¹⁶ Countries earn interest on any SDRs they hold in excess of their allocations, and pay interest on any SDR deficit in relation to their allocations.

There are various proposals for how SDRs could be used for climate finance, which broadly fall into two main categories --conversion of SDRs to hard currency to finance a fund or using SDRs as backing to raise private capital. The conversion proposals require developed countries to either give or lend their SDRs to a dedicated climate fund. For example, in December 2009 philanthropist George Soros put forward a proposal which would have developed countries lend \$100 billion worth of their SDRs from the 2009 allocation to a green climate fund. He proposed that the IMF's gold reserves could guarantee the interest payments and repayment of the principal. An IMF staff paper released in March 2010 exemplifies how SDRs can be used to raise private capital. The paper proposed using countries' reserve assets (including SDRs) to collateralize a Green Fund. The revenue raised from the sale of "green bonds" would be loaned to developing countries for mitigation projects. Unlike proposals that are based on the conversion of SDRs to hard currency, in this case countries' SDRs would not need to be 'cashed in' and would still be considered as reserve assets in the countries' possession.

Convert SDRs to Currency

Civil society groups have built on Soros' proposal, saying that in addition to using developed countries' SDRs from the 2009 allocation, the IMF should also make new and regular allocations of SDRs to be used for climate finance.¹⁷ In this scenario, the SDRs could be allocated to all IMF member countries, which would then transfer them to a multilateral climate fund. (If necessary, countries would convert the SDRs into cash before transferring them to a multilateral climate fund.) The interest charge on the SDRs would be paid by developed countries (through an appropriations process) or through IMF gold sales. Because the IMF's Articles of Agreement clearly contemplate the cancellation of SDRs, governments may collectively decide that the global climate crisis warrants taking the step of cancelling the interest charge on the SDRs, or even cancelling the SDRs themselves.¹⁸

Finally, another civil society proposal suggests a general allocation of SDRs in which developing countries would keep their SDRs in reserve form. This would free up fiscal space for developing countries to in turn draw on their reserves to be used for climate finance purposes. In this scenario, one could envision an agreement in which developing countries commit to use the extra fiscal space generated for financing climate activities and are expected to show exactly how that finance will be used so that it can be monitored. In this case, in order to avoid having the SDRs of developed countries sit idle, developed countries could donate their SDRs to a multilateral climate fund. Alternatively, countries could agree to do a targeted allocation of SDRs to climate vulnerable countries. This, however, would require an amendment to the IMF Articles of Agreement.

Use SDRs to Raise Private Capital

In March 2010, the International Monetary Fund released a Staff Position Note, “Financing the Response to Climate Change.”¹⁹ The report proposed the creation of a Green Fund that would issue “green bonds,” protected against the risk of default (or “collateralized”) by developed country SDRs. The IMF would still consider SDRs as reserve assets in the possession of the donating country that could be withdrawn should a country need to conduct currency operations. The fund could then provide financing in the form of loans for mitigation projects and grants for adaptation projects in developing countries. The proposal also raises the possibility of additional bond issuance in the early years of the fund to help provide fast track subsidy financing that would be repaid by developed countries at a later date. The staff note explicitly states that they are not proposing that the IMF would create, finance, or manage the Green Fund.

1. Why Should This Option Be Considered?

Not the “Silver Bullet” Solution, But A Part of the Financing Puzzle

At the December 2009 climate negotiations in Copenhagen, Secretary of State Clinton announced that the U.S. would help mobilize USD \$100 billion a year by 2020 for climate adaptation and mitigation in developing countries. This goal is now part of the Copenhagen Accord, and the U.S. must find a way to generate its fair share of the goal. (Much of civil society, including the U.S. Climate Action Network, believes that the total amount of money needed for adaptation and mitigation is actually closer to USD \$200 billion a year). The prospects of significant international funding in the current Senate bill are bleak, and appropriations for climate change simply are not likely to be reliable or substantial enough to constitute the “U.S. fair share” of the Copenhagen goal. Therefore, the U.S. should consider innovative ways to generate climate finance to meet – and hopefully exceed – this goal. The use of SDRs has the potential to contribute to the urgent funding needs for adaptation and mitigation. Because of this fact alone, it is an option that must be seriously considered.

An Efficient Use of Assets for Climate Finance During Times of Austerity

Developed countries’ SDRs from the 2009 allocation have been largely untouched. In the IMF’s proposal, SDRs used to collateralize the Green Fund are still considered reserve assets on country’s balance sheets. If a country needed to withdraw their SDRs for currency operations, they would be able to do so.

Furthermore, developed countries generally don’t need additional reserves and can raise funds on world markets at approximately the same cost as the SDR interest charge. In 2009, developed countries received SDR allocations as a consequence of a general allocation that was primarily meant to benefit developing countries. The redirection of excess reserve assets towards beneficial climate finance purposes is a justifiable use of these funds. Any interest charges incurred from the conversion of SDRs could be covered by developed countries or through IMF gold sales.

In the case of new allocations, even if developed countries did have to pay the interest rates for the conversion of SDRs to cash, with interest rates as they are now, at less than .5%, developed countries

would have to invest a relatively small amount in order to cover the costs of converting SDRs to hard currency.

Climate and Financial Crisis Integrally Linked.

Both the climate and financial crisis originated in developed countries but have had severe consequences on developing countries. As a result of falling currencies, decreased foreign investment, and lower trade, many developing countries have smaller reserves and have less money to spend on national development and climate related activities.²⁰ At the same time, some countries, such as Bangladesh, are beginning, out of necessity, to draw on their own national budgets to fund climate activities. In this context, climate change – in addition to the financial crisis—can be seen as having a draining effect on developing countries’ budgets and reserves and should help justify why SDRs should be used for climate finance.

2. How Would the U.S. Implement This Option?

The United States was allocated \$30.4 billion in SDRs (approximately US \$46.1 billion) in 2009. These funds are managed by the Treasury Department in the Exchange Stabilization Fund (ESF) and are governed by the Special Drawing Rights Act. The primary purpose of the ESF is for “stabilizing exchange rates.” However, according to section 3 of the Special Drawing Rights Act (22 U.S.C. 286o), it is also possible to invest “in obligations of the United States Government those amounts in the fund the Secretary of the Treasury, with the approval of the President, decides are not required at the time to carry out this section.” Therefore, if the president decides the ESF is not needed for stabilizing exchange rates, the ESF can then be used to lend SDRs for “a foreign entity or government of a foreign country.” Additionally, if SDRs are to be loaned for longer than six months in any 12-month period, the president must give Congress a written statement that explains the unique or emergency circumstances that require the loan or credit extends for longer than six months.²¹

Therefore, to use the U.S.’ SDRs from the 2009 allocation, the IMF board of governors would have to agree, first, that SDRs could be used for climate finance. The president must be willing to make the case before Congress in a written letter insisting that using SDRs for climate funding is essential. If the president were willing to submit this to Congress (approval is not needed), the Treasury Department could transfer its SDR funds. An amendment may need to be made to the two laws that govern use of SDRs, the SDR Act and the Gold Reserve Act.

In the case of the IMF proposal, US SDRs would be designated as part of a Green Fund, but also could be counted as U.S. reserve assets.

3. Overcoming Perceived Obstacles to Implementation

Just An IMF Loan

SDRs are not a loan in the traditional sense. There is no fixed repayment schedule for SDRs and there is no specified date of repayment. Additionally, there are no conditions attached to the use of SDRs. For example, Tanzania converted a portion of its SDRs and is now paying an annual interest charge of \$273,000. While the yearly charge of \$273,000 may be a burden on Tanzania, in the case of using SDRs for climate finance, this burden would not exist if developed countries agree to pay the interest on the SDRs. In this scenario, the interest charge paid for by developed countries would constitute part of their contribution to climate finance.

Can Only Be Used to Build Reserves

Although SDRs were not originally intended for financing purposes, it can also be argued that climate change represents an unprecedented crisis that may require SDRs to be used in a non-traditional way. In fact, Article 18.3 of the Articles of Agreement, “Unexpected Major Developments” states, “The Fund may change the rates or intervals of allocation or cancellation during the rest of a basic period or change the length of a basic period or start a new basic period, if at any time the Fund finds it desirable to do so because of unexpected major developments.” The current and anticipated future impacts of climate change should be seen as a “major development,” and one that was not anticipated at the time SDRs were devised. Additionally, the fact that the IMF Articles of Agreement do not specify how countries could use cash derived from the conversion of SDR should dispel the notion that SDRs can only be used to build reserves.

If political will does not exist to change the precedent for use of SDRs in this way, using SDRs for climate finance does not have to violate the principle of using SDRs to build reserves. As stated above, developing countries are faced with less revenue entering the country as a result of the financial crisis and a drain on national budgets because of the climate crisis. In light of this dual crisis, one can argue that additional SDRs are needed to build reserves of developing countries. In this case, one way around this would be for the IMF to issue a general allocation of SDRs, which would be used to boost reserves of countries. This would free up fiscal space for developing countries to in turn draw on their reserves to be used for climate finance purposes.

Alternatively, as suggested in the IMF Staff Position Note, SDRs could be mobilized in their reserve form to build the capital base of a fund. Such a scenario would keep SDRs in their reserve form and would not necessitate any interest payments.

Administration, Congressional Support

Although approval from Congress may not be needed, an informative letter from the President describing a transfer of funds from the U.S. to developing countries is sure to receive scrutiny. A European Climate Foundation report on the viability of SDRs for climate finance notes, “In a similar case following the Mexican crisis where President Clinton acted without Congress, Congress subsequently

passed legislation requiring the president to report to Congress about use of the ESF for ongoing assistance to Mexico.”²² However, assuming that President Obama was willing to file the initial notification with Congress, it’s likely that he would be willing to report back to Congress on how this the SDR funding was being spent. Because President Obama and his administration are invested in the Copenhagen Accord and the U.S. \$100 billion fund, it seems quite possible that the president would be willing to notify Congress.

Contrast of Special Drawing Rights Climate Finance Proposals

There are two contrasting sets of proposals for the use of IMF Special Drawing Rights (SDRs) for climate finance.

- The IMF staff note proposal envisions using existing developed country SDRs to collateralize a bond issuing green loan fund for mitigation projects. It also suggests using an additional issuance of bonds in the short term for subsidy resources that would later be paid back by developed country governments.
- A speech by George Soros at COP15, as well as proposals by Project Catalyst and ActionAid have suggested the active lending or donation of developed country SDRs to developing countries for climate finance.

	IMF staff position note	On-lending proposals (Project Catalyst, ActionAid, Soros COP15 speech)
SDRs lent out or cashed In	No. <i>The IMF staff position note proposes using existing developed country SDRs to collateralize bonds to be issued by a Green Fund. The bond proceeds would finance loans to developing countries’ governments for mitigation measures.</i>	Yes. <i>The Soros speech (SS) and Project Catalyst (PC) proposed the active lending of developed country SDRs. PC also envisions giving grants with the funds, compensated by investment revenue from using other parts of the fund. The ActionAid (AA) proposal requests that existing and future SDRs be converted to cash and given to a climate fund for developing countries.</i>
Issuance of new SDRs	No. <i>The IMF staff position note does not discuss the issuance of additional SDRs and aims to collateralize the fund with existing developed country reserve assets.</i>	Varies. <i>AA envisions the regular issuance of new SDRs for continuing climate finance. PC mentions that the proposal would be facilitated by new SDR allocations by the IMF after 2020 but does not emphasize it as critical to the proposal. The Soros COP15 speech does not mention new allocations.</i>
Use of IMF gold	None.	Yes. <i>SS and PC mention using IMF gold reserves as a possible way to pay the interest on the SDRs that are sold and as an ultimate backstop for the solvency of the fund. AA mention the use of IMF gold as one method of covering the interest payments on the SDRs that are converted to cash.</i>
Fund is self sustaining	Yes. <i>The SDRs are meant only to collateralize a loan fund financed by bonds and should be solvent for 30 years unless defaults exceed twice the expected rate of 5%.</i>	Varies. <i>SS and PC model the fund to be self-sustaining, albeit backed up by IMF gold. AA envisions the SDRs as being given to developing countries without expectation of being paid back.</i>
SDRs count as reserve	Yes. <i>Equity collateralizing the Green Fund could be structured to still be considered as reserve</i>	No.

assets	<i>assets.</i>	
Congressional action	Unclear. <i>The president can authorize the use of assets from the Exchange Stabilization Fund without Congressional approval for “unique and emergency circumstances.” However, Congress may need to authorize and/or appropriate funding depending on whether subsidy resources are required, whether the United States forgoes interest payments and how the Congressional Budget Office and Office of Management and Budget interpret the risk of losing U.S. SDRs.</i>	Likely. <i>Any proposal that requires amendment to the IMF Articles of Agreement would require Congressional action. New SDR issuances do not require Congressional approval unless they are over \$250 billion. However, if there was a new issuance of SDRs that were subsequently lent, given, or sold to other countries or entities with a significant risk of default or without the expectation of being paid back, this would require congressional authorization and appropriations.</i>
Changes in IMF Articles of Agreement	No.	Varies. <i>Any proposal that includes an irregular issuance of SDRs or the use of gold assets for interest payments would require a change in the IMF Articles of Agreement.</i>
IMF board action	Yes. <i>The IMF Executive Board would need to designate the Green Fund as a prescribed holder of SDRs, and may have to prescribe the use of SDRs as equity in the Green Fund if such operation is assessed not to fit within current prescribed uses of SDRs.</i>	Yes. <i>IMF board action is required for regular issuances of SDRs, irregular issuances, the use of gold assets or other activities envisioned under these proposals.</i>
Management of loan/grant fund	Not specified. <i>Explicitly states, “We are not proposing that the IMF itself would create, finance, or manage the Green Fund.” Also makes clear that how the resources would be disbursed to developing countries is a separate and important question which the note does not address. Resources could be channeled through existing climate funds or through some newly created entity.</i>	World Bank, UNFCCC or other. <i>PC proposes the funds be administered by the World Bank, multinational development bank, or a new facility. AA proposes the grants be turned over to a UNFCCC fund. SS does not specify.</i>
Expected return/default rate of loan fund	5% default rate. <i>The amount of reserve asset equity needed to collateralize the fund is calculated assuming a 5% +/- 1.5% default rate on mitigation loans. The return on loans is meant to service the bond issuance.</i>	4%-10% return or not specified. <i>PC models 4% return on concessional loans, 10% return on “green economy projects” and 5% return on safe cash investments while giving 50% of the funds as grants. AA does not specify. SS does not specify.</i>

SECTION 5: SETTING ASIDE A PORTION OF EMISSIONS ALLOWANCES FOR CLIMATE FINANCE

Emissions trading systems, whether at the national or the international level, offer an important avenue for generating climate finance that is connected directly to the source of emissions and therefore the cause of climate change. Using the proceeds from a pollution permit program to support achieving additional, cost-effective reductions and responding to climate change in developing countries makes sense as both a policy and political matter. Under such an approach, the link from finance to climate change is clear and direct. The ‘polluter-pays’ principle is one that has strong public and political support in the United States and elsewhere. In addition, emissions trading systems offer a key source of new, predictable, and substantial revenue streams that would not necessarily be subject to annual budgetary processes.

The concept of setting aside a portion of the revenue from an emissions trading system for climate finance purposes has been in play for some time. In international negotiations, discussions have most frequently been framed around Norway’s proposal to set aside a portion of assigned amount units or AAUs from the country allocation system set up under the Kyoto Protocol for Annex I countries. Depending on the amount of AAUs reserved for this purpose, the Norway approach, which sets aside 2% of international allowances, would generate approximately USD \$20 billion to \$30 billion annually for climate finance.

Another approach to this concept is for countries to set aside a defined portion of the allowances generated under their domestic emissions trading systems for these purposes. This approach would not depend on an international trading system as is currently in place under Kyoto, but would require countries to enshrine in their domestic law (and/or make an international commitment) to set aside a portion of allowances domestically. This approach has already been passed by the US House of Representatives.

This method of adapting the AAU concept was discussed in Copenhagen during the attempts to reach agreement around potential sources of climate finance. Similarly, Germany has set aside some domestic auction revenues for international finance.

1. How the U.S. Implements This Option

The U.S. could participate in either versions of this approach. The AAU option would require the U.S. to join a global, country-based emissions trading system with assigned amount units. The second option, based on setting aside a portion of allowances from a domestic ETS, could be implemented without regard to the design of an international regime. The Waxman-Markey bill passed by the House in June 2009 is compatible with this approach. It sets aside a portion of allowances (beginning at 7% and rising to 10% over time) for international adaptation, clean technology cooperation, and avoided deforestation. The Waxman-Markey approach provides for predictable finance (since it’s off budget), whereas setting aside revenue (rather than allowances) would require an appropriation. This precedent demonstrates that such an approach is politically viable in the United States.

¹ Environmental Law Institute, "Estimating U.S. Government Subsidies to Energy Sources: 2002-2008." September 2009. <www.elistore.org/Data/products/d19_07.pdf>

² International Institute for Sustainable Development, *The Global Subsidies Initiative*, "Defining Fossil-Fuel Subsidies for the G-20: Which Approach is Best?" March 2010. <www.globalsubsidies.org/files/assets/pb5_defining.pdf>

³ United States Government Accountability Office, *Report to Congressional Committees*, "Aviation and Climate Change." June 2009. <www.gao.gov/new.items/d09554.pdf>

⁴ Aviation Global Deal Group, "A Sectoral Approach to Addressing International Aviation Emissions." June 2009. <www.agdgroup.org/pdfs/090609_AGD_Discussion_Note_2.0.pdf>

⁵ Lazarowicz, Mark, "A global cap-and-trade system to reduce carbon emissions from international shipping," UK Prime Minister's Special Representative. 2009. <www.shippingandco2.org/CoS-GlobalCapAndTrade.pdf>

⁶ World Wildlife Fund, "International Shipping in a Post-2012 Climate Deal." December 2008. <www.wwf.dk/dk/Service/Bibliotek/Klima/Rapporter+mv./international+shipping+in+a+post-2012+climate+deal>

⁷ Baker, Dean, et al., "The Potential Revenue from Financial Transactions Taxes," Center for Economic and Policy Research and the Political Economy Research Institute, Issue Brief. December 2009. <www.cepr.net/documents/publications/ftt-revenue-2009-12.pdf>

⁸ Schmidt, Rodney, "The Currency Transaction Tax: Rate and Revenue Estimates," The North-South Institute, October 2007. See Abstract, also pp. 4-9. <www.nsi-ins.ca/english/research/completed/03.asp>

⁹ For more information on the Securities Exchange Act of 1934, see www.sec.gov/answers/sec31.htm

¹⁰ Schmidt, Rodney, "Notes on the Feasibility and Impact of a general Financial Transaction Tax," The North-South Institute, January 2010. <www.imf.org/external/np/exr/consult/2009/pdf/Comment84.pdf>

¹¹ Politico, "House Dems Consider Securities Transaction Tax." November 2009. <<http://dyn.politico.com/printstory.cfm?uuid=579214A8-18FE-70B2-A824AA42171BB189>> and <<http://dyn.politico.com/members/forums/thread.cfm?catid=18&subcatid=59&threadid=3261313>>

¹² Dietz, Miklos, Robert Reibestein, Cornelius Walter, "What's in store for Global Banking," McKinsey Quarterly, January 2008. <www.mckinseyquarterly.com/Whats_in_store_for_global_banking_2095>

¹³ "Economists' Letter to Congress," Formal Letter to Senators Reid, McConnell, Speaker Pelosi and Representative Boehner, November 2008. <www.cepr.net/documents/publications/Economists_letter_2008_11_19.pdf>

¹⁴ Schulmeister, S., Schratzenstaller, M., Picek, O., A General Financial Transaction Tax – Motives, Revenues, Feasibility and Effects, Study of the Austrian Institute of Economic Research (WIFO) commissioned by Ökosoziales Forum Österreich and co-financed by the Ministry of Finance and the Ministry of Economics and Labour. April 2008, <www.wifo.ac.at/www/jsp/index.jsp?fid=23923&id=31819&typeid=8&display_mode=2> See also Taskforce on Innovative International Financing for Health Systems, Working Group 2 Report: Raising and Channeling Funds. <www.internationalhealthpartnership.net/CMS_files/userfiles/090817%20WORKING_GROUP_2%281%29.pdf>;

Spahn, Bernd, P., "On the Feasibility of a Tax on Foreign Exchange Transactions," Report commissioned by the Federal Ministry for Economic Cooperation and Development. 2002. <www.wiwi.uni-frankfurt.de/profs/spahn/tobintax/Chapter0.pdf>;

Pollin, R., D. Baker & M. Schaberg, "Securities Transaction Taxes for U.S. Financial Markets." *Eastern Economic Journal*, 29/4/2003: pp.527-58. <http://college.holycross.edu/eej/Volume29/V29N4P527_558.pdf>;

Schulmeister, S., et al., "A General Financial Transaction Tax: Motives, Revenues, Feasibility and Effects," Austrian Institute of Economic Research. 2008. <[www.wifo.ac.at/www/servlet/www.upload.DownloadServlet/bdoc/S_2008_FINANCIAL_TRANSACTION_TAX_31819\\$.PDF](http://www.wifo.ac.at/www/servlet/www.upload.DownloadServlet/bdoc/S_2008_FINANCIAL_TRANSACTION_TAX_31819$.PDF)>

¹⁵ Schulmeister, S., Schratzenstaller, M., Picek, O., “A General Financial Transaction Tax – Motives, Revenues, Feasibility and Effects, Study of the Austrian Institute of Economic Research,” (WIFO) Commissioned by Ökosoziales Forum Österreich and co-financed by the Ministry of Finance and the Ministry of Economics and Labour. April 2008.
<www.wifo.ac.at/www/jsp/index.jsp?fid=23923&id=31819&typeid=8&display_mode=2>

¹⁶ Project Catalyst, “Climate Finance: Using SDRs to finance climate change mitigation and adaptation.” December 2009.
<www.projectcatalyst.info/images/2.%20Climate%20Finance/Publications/2.%20Briefing%20papers%20on%20climate%20finance/20091212%20Special%20Drawing%20Rights%20Briefing.pdf>

¹⁷ ActionAid, “Using Special Drawing Rights for Climate Finance.” February 2010.
<http://actionaidusa.org/assets/pdfs/climate_change/sdr_for_climate_finance.pdf?window_id=4>

¹⁸ International Monetary Fund, “Articles of Agreement of the International Monetary Fund, Article XVIII,”
<<http://www.imf.org/external/pubs/ft/aa/index.htm>>

¹⁹ Bredenkamp, Hugh, Catherine Pattillo, International Monetary Fund, “Financing the Response to Climate Change.” March 2010. <www.imf.org/external/pubs/ft/spn/2010/spn1006.pdf>

²⁰ International Monetary Fund, “The Implications of the Global Financial Crisis for Low-Income Countries,” March 2009.
<www.imf.org/external/pubs/ft/books/2009/globalfin/globalfin.pdf>

²¹ United States Code Service, Title 31, Subtitle IV, Chapter 53, Subchapter I, Section 5302 (31 USCS § 5302(b).)

²² European Climate Foundation, “Climate Finance: Using SDRs to Finance climate change mitigation and adaptation.” December 2009. <www.connectusfund.org/files/SDR%20Briefing%20paper.pdf>

For more details on international finance and other facets of the national and global campaign to cool the planet and heat up the clean energy economy see the USCAN Web site:

www.usclimatenetwork.org

