A Cornucopia of Bad Ideas

Climate Finance for Loss and Damage in the Leadup to COP28

Robert Lyman 7/2/23

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CLIMATE FINANCE FOR LOSS AND DAMAGE IN THE LEADUP TO COP28

EXECUTIVE SUMMARY

At the last Conference of the Parties to the Framework Convention on Climate Change held in Egypt in 2022 (“COP27”), the Parties decided to establish a fund for responding to “loss and damage”. The concept of “loss and damage” is, in principle, the basis upon which the wealthier countries should now pay compensation in various forms for historic emissions. COP27 established a transitional committee to work on “operationalizing” a new loss and damage fund, which is to be approved and adopted at COP28. COP 28 will be held in Dubai in November and December this year.

A Summit for a New Global Financing Pact, held in Paris, France on June 22 and 23, 2023, under the chairmanship of French President Emmanuel Macron discussed how to create new sources of funding for loss and damages. At the conference end, there was no significant progress to report on these subjects, a result that sends an early signal of what probably will happen at COP28.

However, the discussions examined several new mechanisms for extracting money from the wealthier countries like Canada. These included:

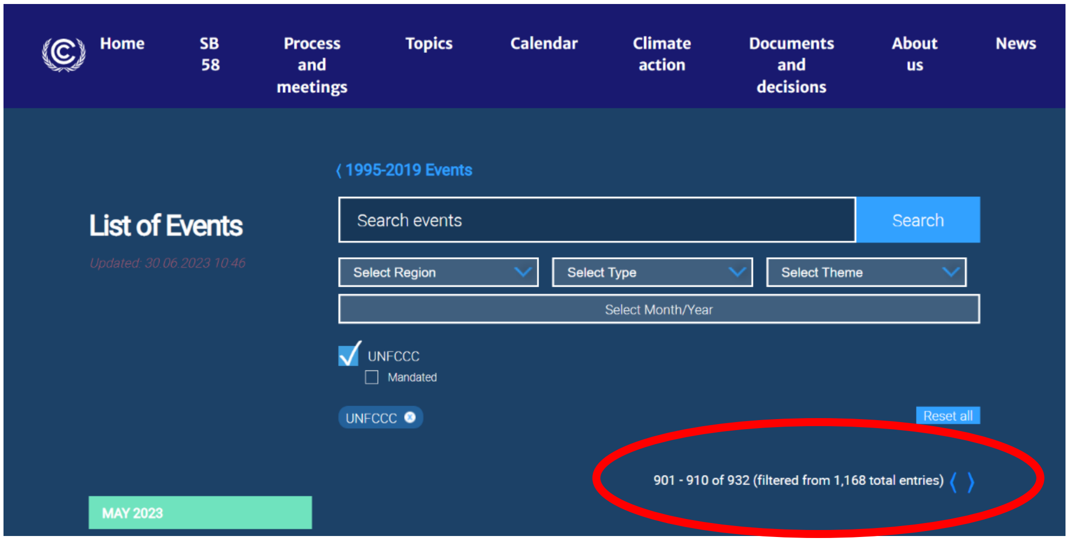
- A fossil fuel extraction levy, a global tax on all oil, gas, and coal producers.
- An air passenger ticket levy, a tax on every international and domestic passenger trip
- A levy on all international shipping based on each ship’s consumption of heavy fuel oil
- A tax on oil and gas industry “windfall profits” resulting from sudden increases in world prices
- A financial transaction tax on all financial instruments such as bonds, stocks, options, derivatives, and currency exchanges
- A stock buyback tax, imposed when a company purchases its shares of its own stock on the public market
- A special tax on “wealthy individuals”

The discussion of financial mechanisms is taking place in the context of what appears to be irreconcilable positions on the part of the “Annex II” countries (i.e., the mostly OECD countries identified as able to pay) and the rest. One group keeps raising the ante in terms of the amounts demanded and the other grudgingly agrees to discuss such funding “in principle” while refusing in practice to go beyond what the publics in the OECD countries find tolerable.

It seems inevitable that COP28 will fail to make significant progress in resolving the financing issues. For that, the people in the OECD countries should be very grateful.

CLIMATE FINANCE FOR LOSS AND DAMAGE IN THE LEAD-UP TO COP28

At the last Conference of the Parties to the Framework Convention on Climate Change held in Egypt in 2022 ("COP27"), the Parties decided to establish a fund for responding to "loss and damage". "Loss and damage" are the code words for the economic damages that the developing countries of the world have allegedly incurred as a result of the historic emissions of greenhouse gases (GHG) by the industrialized countries since the 18th century. The concept of "loss and damage" is, in principle, the basis upon which the wealthier countries should now pay compensation in various forms. COP27 established a transitional committee to work on "operationalizing" a new loss and damage fund, which is to be approved and adopted at COP28. COP 28 will be held in Dubai in November and December this year.



Over 1,000 meetings will take place around the world in advance of COP28. https://unfccc.int/calendar/events-list?unfccc=true

Several UN sub-committees have been working on how to operationalize the fund, but the most important and high-profile event was the holding of a Summit for a New Global Financing Pact, held in Paris, France on June 22 and 23, 2023, under the chairmanship of French President Emmanuel Macron. The summit included discussions on a large number of topics, but with a heavy emphasis on new approaches to funding by the World Bank and International Monetary Fund to “convert poor countries’ debts into financing for projects aimed at mitigating the consequences of global climate change”. This mysterious language appears to refer to ways that lenders might grant developing countries forgiveness of their debts (incurred to fund economic development) in return for their increased expenditures on climate mitigation.

Another prominent topic was how to create new sources of funding for loss and damages. At conference end, there was no significant progress to report on these subjects, a result that sends an early signal of what probably will happen at COP28.

The Summit’s failure to reach agreement, however, does not mean that discussions lacked imagination and novelty. Fueled by analyses provided by the Institute for Sustainable Development and International Relations (IDDRI) and the International Centre for Climate Change and Development (ICCCAD), the discussions examined several new mechanisms for extracting money from the wealthier countries like Canada.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THE FOSSIL FUEL EXTRACTION LEVY

The fossil fuel extraction levy would be a global tax imposed on oil, gas, and coal producers. It would be charged on each energy source at a level that would reflect how much carbon dioxide is embedded in each tonne of fossil fuel extracted. If applied at a global rate of US $6 per tonne in all jurisdictions, it allegedly could raise US$150 billion per year. Imposition of this levy would require agreement by consensus under the auspices of the UNFCCC agreement and then the Contracting Parties would have to adopt national laws and other measures to collect the revenues and authorize payment directly to the loss and damage fund. In other words, there is no way this levy will be implemented.

THE AIR PASSENGER/TICKET LEVY

The air passenger ticket levy, as implied, would be a purchase tax on passenger airline tickets. It would not be based on GHG emissions but on the simple act of flying by air. It could be varied depending on the class of customers or to increase the levy for frequent fliers. In 2014, the Group of Least Developed Countries proposed such a levy at a flat rate of US$5 per economy passenger and US$10 per business passenger, which they thought could raise between US $8 billion and US $10 billion annually. France already has such a tax. This proposal is likely to be strongly opposed not only by the airlines but by the entire travel industry and the countries whose economies are heavily based on tourism.

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INTERNATIONAL MARITIME ORGANIZATION (IMO) GHG LEVY

The Marshall and Solomon Islands has proposed imposition of a mandatory levy on international shipping. Each ship would be required to pay an amount determined by its GHG emissions, calculated on the basis of its consumption of heavy fuel oil. The IMO has already approved a GHG emissions reduction strategy with a target of reducing emissions by at least 50% by 2050 compared to their 2008 level. This strategy is due to be updated in July 2023 when proposals to introduce a levy will be discussed. Studies of this idea by the World Bank indicate that in a scenario of full decarbonization by 2050, revenues from a US $100 per tonne of carbon dioxide equivalent levy could total between $US 1 trillion and $2 trillion, or US $60 billion per year. Such a levy would be imposed on ship owners, but the costs would probably be borne by the companies whose goods are shipped and, ultimately, by consumers. It would drive up inflation worldwide.

TAX ON WINDFALL FOSSIL FUELS PROFITS

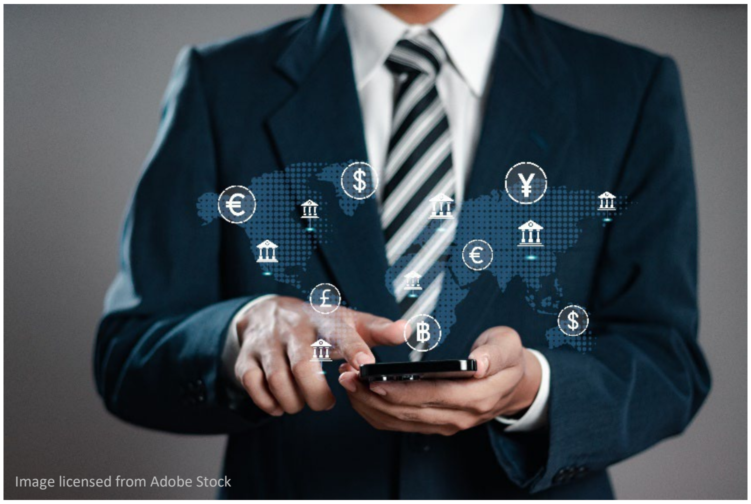
A "windfall" profits tax would be levied on "unforeseen large profits obtained thanks to special economic conditions", which can be regarded as excessive or unfairly obtained. It would pose quite a problem defining when windfalls happen and for how long. No less a person than UN Secretary Antonio Guterres has called for introduction of such a tax, although not specifically to donate to the loss and damages fund. The United Kingdom has already imposed a windfall profits tax on oil and gas companies.

Proponents of windfall profits taxes see them largely as an opportunity to make a short term "tax grab" that will raise revenues that governments can then spend of the projects and causes that they favour. They treat as inconsequential the impacts of such taxes on the incentives that companies have to invest and on the subsequent reduction in supply of the goods the taxed companies produce. As is the case with most corporate taxes, their ultimate impact is usually to raise the prices of the goods that consumers buy. Of course, in the case of climate campaigners, increasing the prices of oil and gas is part of the reason for implementing such taxes.

The proponents of such taxes seem to have no sense of irony, and they would undoubtedly object to anyone proposing special rebates of taxes paid by companies due to special adverse economic conditions that no one could have predicted.

FINANCIAL TRANSACTION TAX

A financial transaction tax (FTT) is a levy put on financial instruments and contracts such as bonds, stocks, options, and derivatives. It can also apply to monetary transactions, in particular foreign currency exchange. The daily volume of such transactions runs into the hundreds of millions, if not billions, so the potential for revenue is enormous.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The United States already imposes a financial transaction tax to fund the Securities and Exchange Commission, at the rate of 0.0042%, and the European Union has long debated the imposition of similar levies. In 2010, the UN High-Level Advisory Group on Climate Financing ("AGF") considered the option of using revenues from an FTT. Since then (naturally), all climate NGOs have been strongly advocating for imposing FTTs to generate additional climate finance. AGF estimated in 2012 that FTTs could raise between US$7 billion and $16 billion per year. The US Congressional Budget Office (CBO) estimated that, with the FTT rate set at 0.1% that was proposed by the Democrats in 2020, it could generate on average US$77.7 billion per year. The CBO report is worth quoting:

"A disadvantage of the option is that the tax would discourage all short-term trading, not just speculation—including some transactions by well-informed traders and transactions that stabilize markets. Empirical evidence suggests that, on balance, a transaction tax could make asset prices less stable: In particular, a number of studies have concluded that higher transaction costs lead to more, rather than less, volatility in prices. (However, much of

that evidence is from studies conducted before the rise of high-frequency trading programs, which now account for a significant share of trading in the stock market.)

The tax could also have a number of negative effects on the economy stemming from its effects on asset prices and the frequency of trading. Traders and investors would seek to recoup the cost of trading by raising the return they require on financial assets, thereby lowering the value of those assets. However, because the tax would be small relative to the returns that investors with long-term horizons could earn, the effect on asset prices would be partly mitigated when traders and investors reduced the frequency of their trading, which would have a trade-off in terms of lowering liquidity and reducing the amount of information reflected in prices. Consequently, investment could decline (leaving aside the positive effects of higher tax revenues lowering federal borrowing and thus increasing the funds available for investment) because of the following: the increase in the cost of issuing debt and equity securities that would be subject to the tax and the potential negative effects on derivatives trading that could make it more difficult to efficiently distribute risk in the economy. The cost to the Treasury of issuing federal debt would increase (again, leaving aside the effects of deficit reduction) because of the increase in trading costs and the reduction in liquidity. Household wealth would decline with the reduction in asset prices, which would lower consumption.

In addition, traders would have an incentive to reduce the tax they must pay either by developing alternative instruments not subject to the tax or by moving their trading out of the country (although offshore trades by U.S. taxpayers would be taxed). Such effects would be mitigated if other countries enacted financial transaction taxes; currently, many members of the European Union are considering implementing such a tax."

OTHER TAXES

There is growing interest on the part of the climate "community" in applying a tax on stock buybacks, on introducing a wealth tax, introducing new taxes or tax incentives on "high carbon/green savings" schemes and pension products and requiring banks to adjust their lending rates based on the perceived "sustainability" of the investment.

The US Inflation Reduction Act in fact introduced a stock buyback tax at the rate of 1%, without specifying the uses of the revenues so raised. The buyback tax works when a company purchases shares of its own stock on the public market; it is a share repurchase. The tax is expected to raise about $74 billion for the next ten years.

A wealth tax would allegedly be imposed on only the assets owned by the very wealthiest people in the world. The IMF has recently called for the introduction of wealth taxes. As of 2021, five countries (Columbia, France, Norway, Spain and Switzerland) have wealth taxes in place. Once implemented it would be easy to revise the definition of who is "wealthy".

COMMENTS

In the lead-up to COP28, there will be many more discussions concerning how to raise the funds that would be required to meet the "loss and damage" compensation objective, and the two other forms of climate-related funding that received considerable attention at COP27. These were the demands for much elevated funding of climate mitigation and for climate adaptation. The numbers change with every meeting but the Group of 99 countries demanded at least US $1.7 trillion per year for mitigation over the period 2025 to 2030, about $600 billion per year for adaptation and an unspecified but essentially limitless amount for loss and damage.

The discussion of financial mechanisms is thus taking place in the context of what appears to be irreconcilable positions on the part of the “Annex II” countries (i.e., the mostly OECD countries identified as able to pay) and the rest. One group keeps raising the ante in terms of the amounts demanded and the other grudgingly agrees to discuss such funding “in principle” while refusing in practice to go beyond what the publics in the OECD countries find tolerable.

The mainstream media gives virtually no coverage to this bizarre stand-off, preferring instead to acquiesce in the claims that immense funding is justified to “save the planet” and that the wealthier countries must honour their commitments to pay. The only real commitments to date are to provide up to $100 billion per year in climate aid and that target, it appears, will only be reached this year.

It seems inevitable that COP28 will fail to make significant progress in resolving the financing issues. For that, the people in the OECD countries should be very grateful.

ABOUT THE AUTHOR

Robert Lyman is an economist with 27 years' experience as an analyst, policy advisor and manager in the Canadian federal government, primarily in the areas of energy, transportation, and environmental policy. He was also a diplomat for 10 years. Subsequently he has worked as a private consultant conducting policy research and analysis on energy and transportation issues as a principal for Entrans Policy Research Group. He is a frequent contributor of articles and reports for Friends of Science, a Calgary-based independent organization concerned about climate change-related issues. He resides in Ottawa, Canada. Full bio.

ABOUT FRIENDS OF SCIENCE SOCIETY

Friends of Science Society is an independent group of earth, atmospheric and solar scientists, engineers, and citizens that is celebrating its 21st year of offering climate science insights. After a thorough review of a broad spectrum of literature on climate change, Friends of Science Society has concluded that the sun is the main driver of climate change, not carbon dioxide (CO_2).
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