Submission to the UNFCCC

Sharm el-Sheikh dialogue between Parties, relevant organizations and stakeholders to exchange views on and enhance understanding of the scope of Article 2, paragraph 1(c), of the Paris Agreement and its complementarity with Article 9 of the Paris Agreement

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This joint submission by the Centre for Science and Environment (CSE) and ODI Global proposes issues for consideration at meetings under the SeS Dialogue in 2025. Further, to provide substance for discussion it summarises insights gathered during an online consultation held jointly by CSE and ODI Global in September 2024 (see Appendix). The consultation brought together diverse stakeholders to discuss the way forward regarding Article 2.1c implementation.

1 Proposed issues to be addressed in 2025

The proposed issues below serve to motivate discussions required to advance shared understanding and accountability beyond best practice sharing.

- Which topics and issues do you see as most relevant and helpful to be discussed in the context of the workshops in 2025?
    - On reforming harmful incentives - How can incentives for polluting activities be systematically changed so that finance flows can shift from polluting to climate consistent activities?
    - On unintended consequences - What are the implications for developing country financial systems and stakeholders, and how can the alignment of flows be facilitated to minimize negative impacts on them?

- Which stakeholders do you see as most relevant to participate in and contribute to the workshops in 2025?
    - The workshops must include governmental and non-governmental stakeholders involved in the real economy. Governmental stakeholders must include representatives of Central Banks, Ministries of Finance and regulators. Non-governmental stakeholders must include investors, commercial banks and credit rating agencies. Involvement of intergovernmental entities such as the Financial Stability Board will also be beneficial to the process.
- Which other processes should we take into account in our work in 2025?
  A non-exhaustive list would include:
    - Within the UNFCCC:
        - The Baku to Belém (B2B) Roadmap: At COP29, Parties agreed to contribute at least $300bn per year for developing countries, and call on all actors to enable the scale up of financing to developing countries to at least $1.3tn per year. Parties asked the Azeri and Brazilian Presidencies to prepare a Baku to Belém Roadmap focused on the $1.3tn, by COP30. The roadmap and 2.1c implementation are distinct but reduced ambiguity on scope and accounting regarding the roadmap will be needed to avoid conflating the two.
        - The Global Goal on Adaptation and the adaptation roadmap need finance for their implementation. Those two tracks also tie into issues of just transition and its finance. Whether these two processes reflect potential linkages with the scope of Art 2.1c and the SeS dialogue could be considered.
        - NDCs submission and GST cycle: NDCs 3.0 are due in 2025, with the next GST in 2028. The role of NDCs and GST for progressing Art 2.1c implementation could be considered.
    - Outside the UNFCCC:
        - The 4th International Conference on Financing for Development (FFD4) and G20 processes both address topics that intersect with the scope of Art 2.1c. Discussions in those fora could usefully inform the SeS dialogue this year.

The answers provided above draw on a workshop jointly organised by CSE and ODI Global in 2024. Below is a brief synthesis of this online consultation.

Appendix 1: Summary of CSE-ODI Global online Consultation – What is the role of Article 2.1c in advancing climate action?

Summary Document of the online consultation by the Centre for Science and Environment and ODI hosted on September 30, 2024

Introduction and context

On 30th September 2024, CSE and ODI held an online consultation to facilitate a conversation between groups of experts representing private finance initiatives and actors, public finance institutions, multilateral development banks (MDBs), think tanks, campaign and advocacy organisations, and climate negotiators.

The consultation aimed to create a space for nuanced discussions and for decoding the key challenges and opportunities of Article 2, paragraph 1(c) of the Paris Agreement. Specifically, Article 2.1c aims at enhancing the implementation of the UNFCCC and responding to the global climate crisis, in the context of sustainable development, by *"Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate- resilient development."*

The online consultation was oriented around three questions, with presentations from CSE, UNCTAD and ODI that can be found on the event webpage.

1. How is Article 2.1c interpreted by different actors at present?
2. What guardrails are needed to ensure that all countries take equitable action towards Article 2.1c?
3. What are the short-term and long-term actions needed for progressing on Article 2.1c in the UNFCCC Context?

The consultation was held under Chatham House rules. As such, this summary note identifies but does not attribute to individuals key messages arising from the consultation. Where names are mentioned, individuals have consented to being mentioned.

Key discussion points from the workshop

1. The urgency of climate action necessitates the coming together of financial actors

- In her welcome address, Sunita Narain, CSE's Director-General, emphasised that as climate impacts get more severe, the carbon budget window for the world closes, and we continue to have huge developmental needs across the world, conversations between different stakeholders are critical and that finance and financial actors are front and centre of this conversation.

2. Significant fears remain that the Article 2.1c agenda will act in opposition to developing country interests

- Building on a recent publication[1] CSE emphasised that while there has been growing consensus on the need for action at the intersection of finance and climate change, there remain different interpretations of what this means and how Article 2.1c interacts with the obligation for developed countries to provide climate finance for developing countries to adapt and mitigate climate change.
- There remain fears that developed countries' support for system-wide transformation of economies and financial actors through Article 2.1c dilute such obligations, or that measures taken in developed countries to redirect finance flows to climate action will be misaligned with developing countries' substantial and growing needs.

3. The breadth of actors and actions and disagreements of what Article 2.1c entails must not prevent action

- It was highlighted by participants that action is underway by public and private actors. While investments continue to be made, underinvestment is being seen into productive capacity for adaptation and mitigation actions.
- Even though clean energy finance is growing, the current state of finance continues to be unevenly distributed towards fossil fuels. Some actors and financial system actors are seeing skyrocketing profits. Delaying progress on this agenda is not valuable.

4. No-one size fits all countries, but finance will not move on its own: multi-layered cooperation is critical

- The diverging characteristics of countries, their market structures and starting points were all emphasised by participants.
- Article 2.1c is situated within Article 2, wherein the preamble highlights that sustainable development and poverty eradication have to be taken into account when responding to climate change. Sustainable, climate-resilient and low emission development is where action should start – the focus should not be on climate mitigation alone. Further, Article 2.2. also refers to CBDR-RC in the light of different national circumstances. The emerging question is therefore, how finance can be shifted towards climate-resilient and low emission development pathways – scaling adaptation and mitigation action – while avoiding a too restrictive uniform approach?
- Piecemeal efforts to transition the financial system must not leave developing countries behind, such that they are unable to access finance from developed country investors, and are locked out of industrialization.
- For many countries, the big question is how to transition away from fossil fuels for which investment is still flowing and revenues are being raised. Different countries and different economies will need various pathways towards achieving Article 2.1c, including comprehensive regulatory systems and incentives for actors to transition in a just and equitable manner.

[1] What do we mean by Paris alignment of finance flows? Decoding Article 2.1(c) of the Paris Agreement, CSE, 2024
https://www.cseindia.org/what-do-we-mean-by-paris-alignment-of-finance-flows-decoding-article-2-1-c-of-the-paris-agreement--12379

- The speed necessary to transition remains an open question for operationalising Article 2.1c, while participants further noted that there is a role for Article 2.1c at all scales, from financial inclusion to international financial regulation. Where finance remains inaccessible, (innovative) financial instruments and incentives cannot be applied.

5. The incentives for polluting activities must be systemically changed to change investment flows

- The participants highlighted that profits, not prices, drive investment measures. For example, while carbon prices nudge investors in incremental ways, market shaping measures are needed to drive real change.
- Private finance actors are restrained by regulatory frameworks and rather than focusing solely on taxonomies, the profit capabilities of high carbon industries must be changed, particularly in developed economies. Money is flowing to high carbon activities since subsidies and incentives keep driving it there.

6. Action being taken must result in real economy change, suggesting the need to link Article 2.1c with Nationally Determined Contributions (NDCs) and other national planning processes

- It was also emphasised that the finance sector does have a huge incentive to push for a transition in global economic systems and reorient finance to consider climate change. There is a lot of investor movement on physical risks. However, without real economy action, climate change is not being addressed.
- There remains a lack of alignment between NDCs, NAPs and investor expectations. It was suggested that there could be more alignment such that country plans and (multilateral) processes better engage with real economy actors, as well as investors and financial institutions. Collaboration with governments is one such option, particularly for adaptation where planning is often at sub-national and city levels.
- In particular, a lack of ambition in fossil fuel transition plans was identified by participants, with developed countries often having plans to utilise fossil fuels until 2050.

7. The cost of inaction is high, but transition remains costly, and there remains an important role for public finance and support, including technology transfer

- The transition and its financing is particularly important for developing countries that are seeking to meet growing energy demands, reduce emissions and grow their economy at the same time. The absence of technology and finance will make that transition difficult and as such, the link to climate finance needs was reiterated by participants.
- This needs to be coupled with appropriate expectations about what can be mobilised domestically and from private sources. This consideration extended into the impact of the wider multilateral financing system, where it was noted that reduction of unsustainable sovereign debt burdens in some developing countries can further enable a global mobilisation of resources.

8. A balance between global coordination and national sovereignty needs to be found in Article 2.1c implementation

- Participants emphasised that developing countries have a right to development and should not unduly suffer from the actions of developed (and other) countries.
- There remains skepticism around Article 2.1c as it is difficult to achieve a global goal in a highly unequal world.
- Participants emphasised examples of knock on impacts of action, for example, shifting credit ratings for countries moving away from fossil fuels.
- The derisking agenda and market-led approaches to Article 2.1c will require coordination across trade, fiscal and industrial policy at the domestic level and there remains a need to consider what constitutes a feasible rate of change that respects national sovereignty, while addressing cross-border and international implications of actions taken.

9. Accountability is important at national level and international level, with leadership shown by developed countries

- Participants noted that accountability is increasingly possible at national level, even if not yet mandated in the UNFCCC system for Article 2.1c actions. Businesses are starting to rethink their role in climate action, while governments will need to help redefine profitability to align private-sector goals with sustainability.
- There is a need for regulation over voluntary actions, as market incentives often do not align with the urgency of climate change, and a stronger public-private collaboration will enhance accountability.
- Proactive market-shaping strategies are necessary rather than market-led initiatives alone.
- As signatories to the Paris Agreement, governments must lead in these questions of accountability and climate-consistency of finance flows.
- Multilaterally, the question of financial system reform has already emerged. Current problems cannot be solved by old solutions: credit ratings will need to be looked at, while MDBs continue to re-evaluate their lending and investments. Global economic governance requires wider systemic reforms.

10. There are opportunities to learn from progress made to date and to debate the best way forward

- The consultation reiterated the ongoing Sharm el-Sheikh dialogues for discussions on Article 2.1c and its complementarity to Article 9, in addition to UNFCCC publications such as the biennial assessment and overview of climate finance flows by the Standing Committee on Finance, as points of reference in the UNFCCC process.
- It also highlighted the role of different institutions and actors including the G20, the World Bank and the International Monetary Fund in advancing crucial discussions around Article 2.1c. There is a lot to be learnt from ongoing initiatives, including the MDB Paris alignment process.

11. The multilateral climate change system is the best ‘soft regulator’ available for the Article 2.1c agenda but solving new problems with an old (financial architecture) regime may be challenging

- It will be important to balance the reality of the global financial system with the principles of the Paris Agreement and its pursuit of the Convention. Uncoordinated national-level approaches may not be desirable, while a global system of standards, taxonomies and frameworks may not adequately reflect CBDR-RC, in the light of different national circumstances.
- The multilateral climate change process has yet to find the balance between global coordination and domestic sovereignty, though should continue to try.

Relevant Publications

We have further listed below the co-hosts' relevant publications:

1. What do we mean by Paris Alignment of finance flows? Decoding Article 2.1(c) of the Paris Agreement by CSE
2. Putting climate-resilient development at the heart of equitable implementation of Article 2, paragraph 1(c) of the Paris Agreement: Could it scale adaptation finance? By ODI
3. Case studies of country actions to make finance flows climate consistent by ODI and partners

Appendix 2: List of participating organisations

1. Alliance for Financial Inclusion
2. Alliance of Small Island States (AOSIS)
3. Asian Development Bank
4. Asian Investor Group on Climate Change
5. Atlantic Council
6. AVIVA Investors
7. Centre for Science and Environment
8. Climate Emergency Collaboration Group
9. Climate Finance Group for Latin America and the Caribbean (GFLAC)
10. Climate Policy Initiative India
11. European Investment Bank
12. Federal Office of the Environment, Switzerland
13. Germanwatch
14. Imal Initiative for Climate and Development
15. Institutional Investors Group on Climate Change
16. International Development Research Centre
17. London School of Economics
18. Ministry of Finance, India
19. ODI
20. Recourse
21. Rocky Mountain Institute
22. South South North
23. Third World Network
24. UN Trade and Development
25. World Benchmarking Alliance