Financing the Paris Commitments
The Urgent Need for Leadership

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Note: This discussion paper reflects research, analysis and proposals from its author(s). They have been invited to present their own findings, ideas and perspectives to inform and stimulate discussion independent of positions or viewpoints associated with Stanford University or its staff and leadership.
Abstract

Commitments to reducing greenhouse gases that 195 nations made in Paris are dependent on two contingencies. First, countries must identify the specific sectors where greenhouse gas reductions must be made. Even the United States has yet to identify precisely where it will achieve a third of its promised reductions. For the major developing countries, a greater portion of specific committed reductions is yet to be determined. The second contingency is financing. India, Brazil, Indonesia and South Africa made their Paris promises dependent on receiving sufficient foreign investment. Much of this investment will necessarily come from private sources. However, the significant new source of capital, and also potential leadership, is the Asian Development Bank. I urge the president to apply to join the bank America so recently lobbied its allies to spurn, to ask for a seat on the board, and to urge the bank to lead the efforts to help Asian and African countries build renewables on the scale of the plans they announced in Paris. Part of that leadership should be the mobilization of private capital paired with bank funds. Backed by China’s significant resources and recognizing the important role China played in making Paris a success, the expectation is reasonable that China’s impressive new institution will commit to making climate history.
Financing the Paris Commitments

People the world over cheered the news that 195 nations had seriously engaged the challenge of climate change in Paris and that most had committed to reducing their greenhouse gas emissions. Experts noted at the time that even if the commitments were to be achieved, they would not keep world temperatures below 2 degrees Celsius. In fact, estimates indicate the agreed-upon policies would likely accommodate twice the 2-degree target, considered the maximum that can be tolerated without catastrophic consequences of droughts and floods and violent storms. Preventing significant sea-level rise looks daunting under any practically plausible scenario.

Nevertheless, the Paris commitments are not the last word, nor were they intended to be. The most successful international environmental agreement of recent history, the Montreal Protocol to Protect the Ozone Layer, began with developed countries obligating to reduce by half their emissions from ozone-depleting substances. Just five years later, and with a better appreciation for replacement technology and ample substitutes, parties to the agreement scheduled full phaseout. The Paris agreements are similarly set to be reviewed in five years.

Paris commitments include both hard promises and aspirational objectives. Although the United States promised to reduce its greenhouse gas emissions 28 to 30 percent by 2030, fully one-third of the reductions are as yet unspecified. Even the United States has work to do to identify and then realize a major part of its commitment. For several developing countries, the identification of promised reductions and the means by which they will meet them is even more uncertain. So what the governments achieved in Paris, important as it was, will require sustained work to achieve.

A second caveat looms larger over the commitments, and that is the money necessary to achieve them: to build the new energy economy of renewable wind and solar, to make the grid improvements, to complete the efficiency investments that are implicit in the goals countries have set themselves. The most important pillars of the U.S. strategy for reducing greenhouse gas emissions are essentially assured of sufficient financing by the electric utility industry in the case of the Clean Power Rule for existing power plants and New Source Performance standards as applied to new coal-fired power plant proposals and by the automobile industry for the 54.5 mpg requirement for new autos manufactured starting in 2025. These rules are susceptible to political reconsideration, and thus the disposition of each presidential administration will need to be supportive. But if the regulations hold, one can be reasonably confident that at two-thirds of the commitment, reductions will be achieved.

The U.S. record regarding the commitments made at the international Conference of the Parties prior to the Paris meeting should inspire confidence. Although they receive little recognition, the greenhouse gas reductions promised by President Obama in Copenhagen are on their way to being met. The volumes of low-priced natural gas produced by the oil and gas industry created a lower cost fuel competitor for coal,
and one which also has the advantage of producing significantly less carbon dioxide. Thus, the displacement of coal pursued by the policies of the Obama Administration has been reinforced by the market. This experience is one critics of the oil industry might learn from; the industry has resources in technology, geology, engineering and subsurface characterization and exploration that may well lend themselves to a constructive role in addressing climate change.

If the prospects for the developed countries are at least directionally correct, in Europe where automobile efficiency requirements also are leading to reduced oil consumption, along with incentives to renewables for electricity, key developing countries face more daunting obstacles. Several of the major developing countries accounting for the most emissions growth now and in the future – India, Brazil, Indonesia and South Africa – made serious and respectable promises in Paris. They submitted ambitious plans to meet much of their expected growth in electricity demand with wind and solar energy installations. However, the gap between their goals and the identification of specific means to reach them is very large. And these are the countries where the greatest reductions must be made. According to the report, “Shaping Energy Transitions,” endorsed by some of the most-respected energy executives and authorities, the investment necessary to finance the construction of the massive new renewables promised is two trillion dollars over the next 15 years. And most of the plans put forward by developing countries explicitly state that keeping their commitments will be dependent on financing, most of which is assumed to be from foreign investment. Currently, the resources of international aid and lending institutions do not begin to approach the levels necessary to finance the needed energy transformation. Could private capital fill that role?

There are in the range of $70 trillion in capital invested in pension funds, endowments, hedge funds, private equity and similar institutions in the world. Such funds could be invested systematically in the new energy economies of the high-emission countries. Foreign direct investment dwarfs the annual transfers of funds from public institutions. However, recipient countries and their private sectors would have to design investment vehicles with characteristics not always offered in the developing world and with return prospects at a level that compensates for risks in a relatively new and growing industry in countries that, even though they may be growing, are also poor and the governance of which is distracted by more pressing concerns. Think of the political crisis in Brazil, the commodities downturn in South Africa, the endemic transparency challenges in Indonesia, the severe two-year drought in India. How much initiative will such countries mount to keep their Paris pledges? The initiative to design new incentives to secure private sector financial institutions will very likely have to come from the financial sector itself. Is that a realistic possibility?

The newly established Asian Infrastructure Bank (AIB) is one of the few new sources of capital mobilized to meet pressing demands in Asian countries. Its capital subscription, and even its membership, is still being added to. Some informed observers believe that the United States, which unsuccessfully lobbied its allies against joining, will eventually join the membership in hopes of influencing the AIB’s priorities and investment projects. One might foresee the bank’s carving out renewable energy as the object of a major portion of its investments. The AIB might also innovate new partnerships with private investment groups.
whereby the bank would offer one-third participation in various project commitments, much as the U.S. Overseas Private Investment Corporation has long done with private equity institutions. The potentially substantial financial resources available from Chinese reserves could change the renewables game in Asian countries. AIB has stated its intention to be open eventually to investing in Africa. However, the AIB CEO, in a dinner conversation with me in June in Beijing, said that he was not open to designating climate as a priority for AIB investment. He said that if renewable investments were proposed, the bank would consider them, and if the investments met standard investment criteria, they could be financed by the bank. But he ruled out a major funding priority aimed at helping countries realize their Paris commitments.

The challenge of financing the Paris commitments should be a major priority, especially of China, which along with the United States played such a critical collaborative role in making the Paris meeting successful. The burden is not simply one China need bear alone. Leadership on the part of governments and also private financial institutions will be required. The practice of waiting for developers to come forward and propose promising new projects will not meet the need in scale, timing and number of investments. One must ask for a different and more activist brand of leadership from private financiers, many unaccustomed to engaging in driving developers to initiate large projects, as from the development banks. Significant new funds must be found to scale up the installation of clean energy in order to realize fully the promises of Paris. But the Asian Infrastructure Bank, with its backing of China and with significant new multinational funding, is the major new player on the scene of world development, and its priorities remain to be determined. Asia and Africa, of course, need infrastructure, and the bank has been conceived as an important new source of funding for it, but the opportunity is to focus first on energy infrastructure. If the bank were to do so, it could lead the drive to make good on the Paris promises.

I recommend that the president make a priority to obtain commitments from public and private sources to finance renewable energy and energy efficiency. And I propose the president start by applying to join the Asian Infrastructure Bank, acquiring a place on the board, and pressing major investor and donor countries to make the achievement of the Paris commitments a major thrust of the bank’s investments. Many institutions will have to become engaged along with the AIB. But the partnership of the United States and China, together with an important well-capitalized new international funding institution, could accomplish several goals. It could ensure China remains engaged in reducing its own and other countries’ greenhouse gases; it could marshal very significant funds; and as both the biggest polluter and a developing country, it could use its vast capital reserves to set an example to other fast-growing developing countries. The U.S. president, by swallowing some pride and proposing to join the venture America tried to thwart, could make clear that the Paris commitments are worth a change of heart.