BU Global Development Policy Center

Climate Finance & International Investment Agreements

Rachel D. Thrasher

Researcher, Global Economic Governance Initiative

bu.edu/gdp

@GDP_Center

ICEF Plenary Session: Background

- Economic activity in emerging market and developing economies (EMDEs) currently contribute to approximately two-thirds of greenhouse gas emissions
- Their efforts to transition their energy industry and their manufacturing industries from high to low-carbon alternatives is “indispensable”.
- BUT many of these countries are burdened with excessive debt, making public finance further limited.
- Thus, some of the climate finance needed for the energy transition will have to come from the private sector

Need for Climate Finance

- Experts predict at least $1.4 trillion per year will be needed in **domestic financing** from EMDEs (excluding China) by 2025 (Songwe, Stern and Bhattacharya 2022).
- Domestic financing alone is still not sufficient, as researchers have estimated an additional $1 trillion per year is needed in external finance by 2030 – from developed country pledges, development banks and private lenders and investors (Songwe, Stern and Bhattacharya 2022).
- Others estimate that in order to reach the scale of investment required for global economic transformation, we will need $2-5.7 trillion annually.
- Where does this money come from?
  - "Existing development finance mechanisms, tax revenues from high-income countries and multilateral financing".
  - BUT there are hard limits on the amount of public funds – and excessive debt burdens for EMDEs make that more challenging still.

Songwe, Stern and Bhattacharya 2022; ICEF 2024 "Innovative Finance" Session Draft 2024

Goals of Climate Finance

And this session

- To fund appropriate mitigation, adaptation, and resilience interventions, and
- To finance a portfolio of policies and projects that benefit the Global South in implementing decarbonization.

Goal of this session: to explore innovative financing methods, green innovation, decarbonization, linking finance to innovation, among other things

Global Development Policy Center

Paris Agreement Article 2.1(c)

Paris Agreement Article 2.1(c) lays out the individual responsibility of governments to

"mak[e] finance flows consistent with a pathway toward ***low GHG emissions*** and ***climate resilient development***."

BUT recent research shows that investment agreements, as they are currently written and interpreted, undermine both the pathway toward low GHG emissions *and* toward climate resilient development.

Tienhaara et al., 2022a; Tienhaara et al. 2022b

Network of IIAs

Characteristics of the Network

- ~2500 international investment agreements in force
  - Some standalone bilateral investment treaties
  - Some exist as chapters within larger free trade agreements
- ~1800 of these contain investor-state dispute settlement (ISDS)
- ISDS → private investors may bring claims against national governments in international arbitration fora, outside the courts of the host state

Alschner, Elsig and Polanco 2021; UNCTAD 2016

IIAs and Financial Flows

Two mechanisms for impact

- Quasi-political risk insurance
- ISDS awards: Climate-negative flows to fossil fuel firms

IIAs as political risk insurance

How are IIAs like insurance?

- (i) covered risks are identified;
- (ii) occurrences of the risk generate an entitlement to compensation;
- (iii) there are mechanisms to obtain binding decisions over whether there was an occurrence and the amount of loss; and
- (iv) further mechanisms are available to compel payment of the amount awarded.

OECD 2024

IIAs as political risk insurance

How to estimate the value?

- Multilateral Investment Guarantee Agency (MIGA) has indicated that its fees for investment guarantees average approximately one percent of the insured amount per year.
- Average MIGA rate of 1%: investors seeking coverage for claims at issue in ISDS would need to pay substantial annual amounts:
    - USD 7 million/year for coverage sufficient for a possible average ISDS claim of approximately USD 700M;
    - USD 20 million/year for coverage sufficient for a possible USD 2 billion claim;

This is essentially free money for fossil fuel firms.

OECD 2024

ISDS Awards to Fossil Fuel firms

ISDS statistics

- Consistent average: ⅓ are won by investors and ⅓ are won by states, and ⅓ are settled.
  - 80 percent of claimants are investors from high-income countries and
  - 72 percent of defendant states are developing countries.

- On average, ISDS cases result in additional finance flowing out of developing states and toward developed country investors, ***especially fossil fuel investors*****.**

- **Fossil fuel firms have been awarded some of the largest awards in ISDS cases, "account[ing] for 8 of the 10 largest awards" under ISDS cases**

Moehlecke and Wellhausen 2022; OECD 2024

Relevant treaty provisions

Two-provisions; outsized impact

- 32% of claims* invoke direct or "indirect" expropriation
- 46% of claims invoke unfair or inequitable treatment

Author's estimate; drawn from italaw and UNCTAD 2024.

Note that the claims included in this statistic are those that (1) involve fossil fuels or climate-adjacent policies, (2) were decided or otherwise concluded in 2023 or 2024, and (3) where the treaty provision alleged to be violated in the claim is known.

Risks of ISDS Cases

How ISDS can slow down climate action and climate resilience

If fossil fuel firms are able to bring cases like this (and win), it could significantly slow down the flow of finance toward climate-positive economic activities.

The risks are big:

- To cancel all oil and gas projects without a final investment decision, the risks range from 60-234 bn
- To cancel, additionally, oil and gas projects under development, add 32-106 bn
- Total, the risks could amount to $340 bn
- And the risk increases every year that these projects are not shut down.

The experience is much worse for EMDEs, because more than two-thirds of that risk resides in low- and middle-income countries, including those highly vulnerable to climate change.

Tienhaara et al., 2022a; Tienhaara et al. 2022b

Three pathways forward

To ensure climate finance is available for climate

1) Fossil fuel carve out
2) Climate policy carve out
3) Coordinated withdrawal from IIAs

OECD 2024, Tienhaara et al., 2022a; Tienhaara et al., 2022b

Three pathways forward

To ensure climate finance is available for climate

- Fossil fuel carve out
    - Wholesale – fossil fuel investments and investors are no longer "covered investments"
    - Whole ISDS carve out – fossil fuel investments and investors may not bring ISDS claims
    - Partial ISDS carve out, limited remedies – fossil fuel investments and investors may only bring select types of claims (e.g., direct expropriation)

OECD 2024, Tienhaara et al., 2022a; Tienhaara et al., 2022b

Three pathways forward

To ensure climate finance is available for climate

- Climate policy carve out
  - Positive carve out – climate policies are protected government activity that is not subject to challenge under the treaty
  - Negative carve out – a climate rationale is a recognized exception to the treaty commitments

OECD 2023

Three pathways forward

To ensure climate finance is available for climate

Coordinated withdrawal from IIAs (abolitionist approach)

Examples:

- Intra-EU ISDS found inconsistent with EU law
- South Africa withdrawal from BITs
- Ecuador, Bolivia, South Africa, Indonesia and India

Public Citizen 2018

Three pathways forward

To ensure climate finance is available for climate

Main concerns with Abolitionist Approach

- Don’t IIAs incentivize investment?
  - Research shows no consistent correlation (Vandevelde 2005; Pohl 2018; Reiter and Bellak 2020).
- Don’t we want to incentivize green investment? Don’t we want to crowd in private investment?
  - Given the above, IIAs are not the way to do that.
- Haven’t renewable energy companies been active users of ISDS?
  - Statistic outlier: Only in one specific context, most of them relate to Spainand neighboring countries during the Financial Crisis

Three pathways forward

To ensure climate finance is available for climate

1) Fossil fuel carve out
2) Climate policy carve out
3) Coordinated withdrawal from IIAs

Colors:

- BU Red: #CC0000
- BU Black: #2D2926
- GDPC Navy: #002D72
- GDPC Light Blue: #98B6E4

White logo

Black logo

BU Global Development Policy Center

Typeface:

- Sans Serif (Open Sans, Calibri)

Remember:

- BU Branding guidelines require the logo to have equal spacing on all sides.

1. Point #1
2. Point #2
3. Point #3
4. Point #4