



# Climate Finance Fundamentals

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## BRIEF 2

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### Evolving Global Climate Finance Architecture

Climate Finance is evolving fast, although a clear picture of the future global architecture has yet to emerge. Since 2008, the international community has established a new climate finance initiative at an average rate of one every two months. Today, 21 dedicated bilateral and multilateral public climate finance initiatives are in place, in addition to dozens of carbon funds and development initiatives with a climate change focus. This raises hope that additional funding will be made available to tackle climate change. However, more effort is required to enhance the mobilization, administration and disbursement of these funds. Also, current funding efforts remain largely uncoordinated and not part of a comprehensive global climate funding approach. The main actors dealing with these issues are several national governments, the World Bank, the UN and the Multilateral Development Banks and within some recipient countries, National Trust Funds. Among the likely political decisions to be taken in Cancun is the proposal of pooling resources, as well as centralizing governance, through the establishment of a Global Climate Fund, which holds potential to make climate finance more effective.

#### Climate Finance

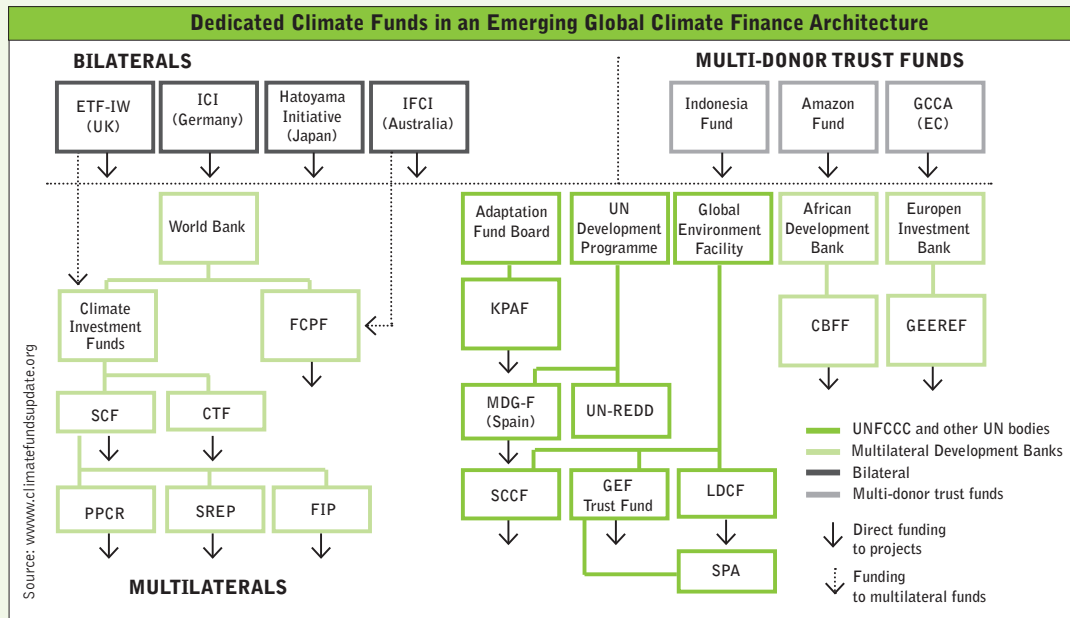
Climate finance is the term given to the financial resources that are being mobilised to mitigate climate change and allow developing countries adapt to climate change impacts. The raising of this new funding is justified for both political and scientific reasons. The bulk of the damage from climate change is likely to fall on the poor countries of the world despite the fact that they have had little responsibility for the problem. Developed countries, with less than 20 % of the world's population, are estimated to be responsible for 75 % of total historic emissions.

A reduction in annual global emissions of 17 billion tonnes by 2020 and 35 billion tonnes by 2030 is required to limit global mean temperature increase to 2°C above pre-industrial levels. In order to meet these targets there is need to raise new and additional finance at a global level. The 2009 Copenhagen Accord pledged funds of \$10 billion a year from 2010 to 2012, increasing to \$100 billion per year by 2020 to combat climate change in developing countries through mitigation and adaptation.

In response to this need for new finance there has been a proliferation of new funding initiatives over the past three years. The increasingly complex financial architecture has raised various governance issues that are currently under debate. A number of principles and criteria to be followed have emerged from the UNFCCC process, which can be categorized following the three main functions of resource mobilisation, resource administration, and resource disbursement, as described in Brief 1 of this series.

#### The Main Actors and Instruments on the Supply Side

The main actors dealing with these issues are developed country governments working through a number of bilateral initiatives, the World Bank through



Fund	Type	Administered by	Areas of focus	Date operational
Adaptation Fund under the Kyoto Protocol (KPAF)	Multilateral	Adaptation Fund Board	Adaptation	2009
Amazon Fund (Fundo Amazonia)	Multilateral	Brazilian Development Bank (BNDES)	Adaptation, Mitigation, REDD	2009
Clean Technology Fund (CTF)	Multilateral	The World Bank	Mitigation	2008
Congo Basin Forest Fund (CBFF)	Multilateral	African Development Bank	REDD	2008
Environmental Transformation Fund (ETF) – International Window	Bilateral	Government of the United Kingdom (channeled entirely through the World Bank, FCPF, and the CBFF)	Adaptation, Mitigation	2008
Forest Carbon Partnership Facility (FCPF)	Multilateral	The World Bank	REDD	2008
Forest Investment Program	Multilateral	The World Bank	REDD	2009
GEF Trust Fund – Climate Change focal area (GEF 4 <sup>th</sup> replenishment round)	Multilateral	The Global Environment Facility (GEF) -- completed	Adaptation, Mitigation	2006
GEF Trust Fund – Climate Change focal area (GEF 5 <sup>th</sup> replenishment round)	Multilateral	The Global Environment Facility (GEF)	Adaptation, Mitigation	2010
Global Climate Change Alliance (GCCA)	Multilateral	The European Commission	Adaptation, Mitigation, REDD	2008
Global Energy Efficiency and Renewable Energy Fund (GEEREF)	Multilateral	The European Commission	Mitigation	2008
Hatoyama Initiative (follow up to Cool Earth Initiative)	Bilateral	Government of Japan NOTE: this includes some private sector loans	Adaptation, Mitigation	2008
International Climate Initiative (ICI)	Bilateral	Government of Germany	Adaptation, Mitigation, REDD	2008
International Forest Carbon Initiative (IFCI)	Bilateral	Government of Australia	REDD	2007
Least Developed Countries Fund (LDCF)	Multilateral	The Global Environment Facility (GEF)	Adaptation	2002
MDG Achievement Fund – Environment and Climate Change thematic window	Multilateral	UNDP	Adaptation, Mitigation	2007
Pilot Program on Climate Resilience (PPCR)	Multilateral	The World Bank	Adaptation	2008
Scaling-Up Renewable Energy Program for Low Income Countries (SREP)	Multilateral	The World Bank	Mitigation	2009
Special Climate Change Fund (SCCF)	Multilateral	The Global Environment Facility (GEF)	Adaptation	2002
Strategic Climate Fund (SCF) -- umbrella fund, including SREP, PPCR, FIP	Multilateral	The World Bank	Adaptation, Mitigation, REDD	2008
Strategic Priority on Adaptation	Multilateral	The Global Environment Facility (GEF); completed	Adaptation	2004
UN-REDD Programme	Multilateral	UNDP	REDD	2008

its administration of the Climate Investment Funds (CIFs) and the Global Environmental Facility (GEF), and the Kyoto Protocol Adaptation Fund. Moreover, the role of the Multilateral Development Banks (MDBs) in scaling up climate finance is increasing.

■ **Bilateral initiatives** – governments with major initiatives to fund climate change projects in developing countries are Japan, Germany and Australia. Japan through the Hatoyama Initiative has been the largest contributor. Since 2008, it has disbursed \$5.3 billion, of which \$3.9 billion is public money from the government budget with the rest coming from private loans used for mitigation projects.

Germany, through the International Climate Initiative (ICI), is the second largest contributor working at the bilateral level, with a total amount disbursed since 2008 of \$270.9 million. This initiative receives funding from the sale of tradable emission certificates and provides financial support to international projects supporting climate change mitigation, adaptation, as well as biodiversity projects with climate relevance.

Australia is the third largest bilateral contributor so far. Through the International Forest Carbon Initiative it has disbursed \$66.1 million since 2007. This initiative aims to increase international forest carbon monitoring and accounting capacity to show how reducing emissions from deforestation can be included in a future international climate change framework. The two main recipient countries of this initiative are Indonesia and Papua New Guinea.

■ **Global Environmental Facility (GEF)** – The GEF was established in 1991 and therefore has the longest track record on environmental funding. It also serves as an operating entity of the financial mechanism under the UNFCCC and currently administers two funds under the guidance of the UNFCCC Conference of Parties supporting the development of adaptation plans and implementation of projects in developing countries via the Least Developed Countries Fund (LDCF) and the Special Climate Change Fund (SCCF).

Between 2006 and 2010, the GEF-4 (fourth replenishment) disbursed \$1.0 billion to climate change related projects. Country and project allocation is based upon complex criteria. The current Resource Allocation Framework (RAF) uses the logic that abatement costs will be lower in countries with higher GHG emissions than in countries with lower emissions. In this way countries with higher GHG emissions are prioritised in receiving climate finance. The GEF Secretariat has now proposed a new System for the Transparent Allocation of Re-

sources (STAR), which will replace RAF and enable direct access to finance.

■ **Multilateral Development Banks (MDBs)** – In the last five years climate finance has become a priority activity of all the MDBs. MDB mitigation financing is projected to increase from \$17 billion in 2009 to \$21 billion in 2012. The financing instruments of the MDBs are mainly loans, equity and concessional financing and, at a smaller scale, grants. About half of the MDBs' finance goes to the private sector. MDBs have extended significant technical support to their clients during the identification, preparation and implementation of climate change programs and projects. However, if mitigation activities appear to be well consolidated, many aspects of adaptation opportunities are still poorly understood, for example how to manage risks and the role of private investment streams in poor areas, and these remain extremely underfunded.

■ **Climate Investment Funds (CIFs) at the World Bank and the Kyoto Protocol Adaptation Fund** – Far less finance has been disbursed to-date through these new funding initiatives, which have been the delivery mechanisms of choice for several industrialized countries, including the UK and the United States. However, both initiatives have shed important light on how financial resources should be administered in a more transparent and accountable manner, which breaks from the traditional donor country-dominated governance structure of development funding initiatives. Furthermore, a more equitable representation of all stakeholders has been established, although there remain differences between the CIFs' and the AF's approach to increasing developing countries' voice in fund governance. For example, within the two CIFs' Trust Funds, the Clean Technology Fund (CTF) and the Strategic Climate Fund (SCF), decision-making is undertaken by trust fund committees, which have equal representation from both developed and developing countries. The Adaptation Fund Board is comprised of 16 members representing Parties to the Kyoto Protocol, taking into account fair and balanced representation of groups including the Small Island Developing States and the Least Developed Countries, but giving developing countries a slight majority.

■ **Measuring, Reporting and Verification (MRV)** – Resource disbursement should be harmonised to avoid overlapping or double counting with other initiatives. This can be achieved through the process of Measuring, Reporting and Verification (MRV). In the context of climate change negotiations, MRV of finance refers to the measurement of the amount of climate finance flows from developed to devel-

oping countries, the reporting of these flows to the international community and the verification of the accuracy of the reported data to ensure that commitments are fulfilled.

Furthermore, MRV can enable access for the most vulnerable. Climate finance should be distributed in an equitable manner, responding to the needs of all countries and taking into account the social and economic reality of the recipients within countries. This will require that vulnerable groups have access to credit, resources and technologies. It is also in line with the principle of national ownership as upheld by international donor agreements on aid effectiveness and reflected by the extent to which recipient countries exercise leadership over their climate change policies and strategies.

### The Main Actors on the Demand Side

■ **National Trust Funds** - Indonesia and Brazil, both countries vulnerable to climate change, have established national trust funds, which can serve as interesting models for other developing countries. The Indonesia Climate Change Trust Fund is designed to link the international architecture for climate change with national investment strategies. The ICCTF has recently been launched (September 2010) and it is likely to have two funding mechanisms. The first is an 'Innovation Fund', which will receive bilateral and multilateral non-refundable contributions. A 'Transformation Fund' may then be introduced to help mobilize investments towards a low carbon economic development path. Beyond national ownership, this initiative aims to be based on transparent and open governance and on local community empowerment.

Brazil, through the Amazon Fund, is aiming to raise donations for investments to prevent, monitor and combat deforestation. The Amazon Fund is owned and managed by Brazilian bodies, with restricted intervention from donors; therefore it is another example of respect of the national ownership principle. The Amazon Fund Guidance Committee (COFA) is a committee formed by the federal government, state governments and civil society. Each group has equal decision making power. However, lack of transparency in releasing information has been reported.

Furthermore, the difficulty in accessing the fund has been noted by local and grassroots organizations, as has the limited coherence between the fund objectives and national strategies.

### A Way Forward?

As has been shown, difficulties in respecting governance principles emerge from both fund-generating and recipient countries. Greater coherence in the international response is therefore necessary to make climate finance more robust in mobilising, administering and disbursing resources. Negotiations on the critical elements of a post-2012 climate finance regime are now focussing in particular on the establishment of a new Global Climate Fund, to be decided at COP 16 in Cancun. Over time the new Global Climate Fund could act as the dominant international channel for climate finance.

■ **Global Climate Fund** - The guiding principles of this innovative financial mechanism are:

- (i) Scale: At least half of existing public finance and all revenue from any new international instruments should be channeled through the new Fund.
- (ii) Legitimacy: Equitable representation of countries in governance bodies, transparency and country ownership should be respected.
- (iii) Effectiveness: Access to finance should be directly provided to developing countries, avoiding intermediaries and minimising transaction costs.

Beyond this, the next steps that are likely to be discussed in Cancun include the delivery on the non-binding finance pledges made by developed countries in Copenhagen. Ideally these political pledges would become legally binding as a formal COP decision. In order to do so countries should clarify what new sources of funds could contribute to this goal, particularly the amount of public finance.

The delivery of financial resources still needs to be enhanced, taking into account country ownership, effective use and allocation of resources to ensure that the money reaches the most vulnerable countries and communities.

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### References and useful link

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