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Design challenges for the Green Climate Fund

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Introduction

One of the achievements of the UNFCCC negotiations in Cancun was the decision to establish a Green Climate Fund (GCF). The details of this initiative were described in the outcome of the work of the Ad Hoc Working Group on long-term Cooperative Action (AWG-LCA). Many are looking to the establishment of this fund as the solution to adequately and appropriately address climate finance, with statements like 'Green Fund to dominate global climate finance' (Murray, 2010) and '$100 Billion Green Climate Fund Agreed Upon' (Redbaiter, 2010). Others caution that ambitious steps need to be taken to avoid the 'Green Fund' turning out to be an 'Empty Fund' whose function is limited to attaining the buy-in of developing countries into a binding international climate policy regime. Having been mentioned first in the Copenhagen Accord of December 2009, the intent is now to secure the design of the fund over the period March to November 2011. Approval to start up the fund is then expected at the seventeenth session of the UNFCCC in Durban, South Africa.

The design of the GCF has to address a large number of concerns, the details of which remain unresolved within the negotiations. Issues relating to what role it will play in providing sustainable finance at scale; how it will fit into the existing development assistance and climate financing architecture; how it will allocate finance to developing countries; and how finance will be delivered effectively, all remain to be clarified. This represents an ambitious agenda and much progress will need to be made quickly if a working proposal is to be put to the delegates at the next COP meeting.

This paper offers an early contribution to the debate by highlighting some of the more pressing design issues and describing the implications of these features. We assess the Fund according to the following three core functions:

Governance: how the funds will be managed
Sourcing: how funds will be raised – who will pay and how
Disbursement: how funds will be delivered and distributed

Issues of design: Fund Governance

The text in the Cancun Agreement on the Green Climate Fund is primarily focused on the governance of the Fund. The following important design features of the Fund are noted:

- The Fund will be accountable to and under the guidance of the Conference of the Parties, to support projects, programmes, policies and other activities in developing country Parties using thematic funding windows;
- The Fund will be governed by a Board of 24 members comprising an equal number of members from developing and developed countries; like the Adaptation Fund Board, it will guarantee representation by regional groupings as well as seats for representatives of small island

developing States (SIDS) and least developed countries (LDCs), the two country groups most severely impacted by climate change;

- The World Bank is to be invited to serve as the interim Trustee, to be reviewed three years after the start-up of the Fund;
- The Fund will be supported by an independent Secretariat;
- The Fund will be designed by a Transitional Committee of experts, of which the majority are to come from developing countries, with two members each from SIDS and LDCs.

In addition, it is proposed to establish a Standing Committee under the Conference of the Parties (COP) to assist the COP in exercising its functions with respect to the financial mechanism of the Convention, although the roles and functions of this committee remain undefined in the Cancun text.

The Fund 'accountable to and under the guidance' of the COP

The LCA text decided that the Green Climate Fund will be 'accountable to and functions under the guidance of the Conference of the Parties' (Para. 102)[1]. One of the debates surrounding the different proposals for the governance of the GCF has been whether the Fund should be 'accountable to and under the guidance' or whether it should also be 'under the authority' of the COP. The majority of developed countries that have a position on this issue argue that the relationship between the future executive board of the Fund and the COP should be modelled on the COP's relationship with the Global Environmental Facility (GEF), which is one in which the GEF is 'accountable to and under the guidance of the COP'. The G77+China position has been that the Fund should be modelled after the relationship between the Adaptation Fund Board and the CMP (the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol − the governing body of the Kyoto Protocol), which asserts that the board is accountable to, under the guidance of, *and* under the authority of the CMP. While it appears that consensus has been reached with agreed language on 'accountable' and 'guidance' in the LCA text for the Fund, it is important to understand what this language implies.

The distinction between 'accountability and guidance' and 'accountability, guidance, and authority' has been explained by Muller (2009). While there is no formally agreed definition of what 'under authority' means, Muller argues that its definition is implied in the Bali Adaptation Fund Decision (CMP.3/1) where the AF Board is stipulated to be under the authority of the CMP. By contrasting this definition with the relationship between the COP and the GEF (accountability and guidance only), Muller infers two key features of what 'under the authority' is implied to mean: that the COP has the authority (a) to select ('hire and fire') the members of the Board, and (b) to approve general rules and guidelines proposed by Board. The COP does not have this power over the GEF and, given the agreed language in the LCA text, nor will the COP have this power over the GCF. This may be a sign that Parties have found sufficient levels of trust and agreement in the proposed design of the GCF Board, which will have equal representation between developed and developing countries.

World Bank as Interim Trustee

The role of the World Bank in the Fund's structure has been and remains a contentious issue. The Cancun Agreements confirm the World Bank as an Interim Trustee, subject to a review by the Parties after three years. (There is some scepticism that, once established as trustee, any review would subsequently recommend an institutional shift.) A number of developing countries have argued

[1] This paragraph number (and following similar references) are from the Outcome of the work of the Ad Hoc Working Group on long-term Cooperative Action under the Convention

against the role of the World Bank in fund management as the Bank is seen to reflect the interests of wealthy countries, which hold greater decision-making power by virtue of their financial contributions to the Bank (Pickering, 2010). Some critical observers have also alleged a conflict of interest by the Bank, since it operates a portfolio of Climate Investment Funds (CIFs), which could continue to compete with the GCF for developed country budgetary contributions. The current role of the Bank as agreed in the LCA text seems to be mainly one of financial administration: the Bank will play no official role in fund design, management, or decision making. Nevertheless, it is likely that World Bank experts may be seconded to the Transitional Committee that will design the GCF and recommend operational procedures, project selection criteria, performance standards or safeguard measures for adoption by the COP 17 (Para. 111). The text also leaves the option open for the trustee to 'commingle' assets of the GCF for 'investment purposes' with assets the World Bank maintains itself, such as those under the CIFs (Para. 105). However, the Bank will be wholly accountable to the Fund Board and will administer the assets of the Fund only for the purpose of, and in accordance with the relevant decisions of the Board. Considering the hoped-for scale of finance that may pass through this fund, it is a critical concern that the Board has confidence in whoever undertakes the financial administration role for the GCF.

The Transitional Committee

The design of the GCF will be the responsibility of a transitional committee, working to the terms of reference set out in Annex III of the LCA text. Twenty five members out of the proposed 40 member committee will come from developing countries, and will include specific representation from the developing country regions and most vulnerable countries (the SIDS and the LDCs). This developing country majority should help to engender broad confidence in the design proposals.

Bringing together such a large group within such a short timeframe will likely be a challenge for the Executive Secretary of the UNFCCC Secretariat, bearing in mind that committee members must have 'the necessary experience and skills, notably in the area of finance and climate change'. The LCA text explicitly suggests seconding staff from relevant United Nations agencies, international financial institutions and multilateral development banks, along with the Secretariat and the Global Environment Facility, to the Transitional Committee (Para. 111). The decision to have a group of experts in a set of meetings (which will be open to observers) work out the design of the GCF – not finance ministers as requested initially by the United States – will go a long way to ensure broad support of Parties for the new Fund. Nevertheless, it will be a challenge to ensure the effective and transparent involvement of all these stakeholders, and also those, such as civil society, which the text does not formally acknowledge. Learning from existing best practice should be sought. In this regard, the model of the Adaptation Fund's way of doing business is instructive. The AF's website provides a portal for all interested parties to access comprehensive and timely information on fund development, which is something the transitional committee could copy to demonstrate its commitment to high standards of transparency and accountability.

The terms of reference for the transitional committee are quite comprehensive. The expert members will have to tackle questions such as funding windows and access modalities, the independent evaluation of the Fund's performance, what kind of environmental and social safeguards should be applied to funding disbursement, and how to set up mechanisms for stakeholder input and participation. Crucially important will be whether the committee members choose to define the term stakeholders in narrow or broad terms and if they allow for active participation by outside observers. Especially with respect to civil society participation it would be desirable to improve upon what some consider as the current low standards of existing climate funds in order to increase transparency, accountability and public acceptance of the GCF's important work.

Among the design issues that the transitional committee will have to address is the question of what sort of 'balance' will be set between funding for mitigation and adaptation, as called for in the terms of reference for the design of the GCF. The transitional committee will likely be asked to provide clarity on what 'balance' means within the LCA text – it is notable that since the expression first appeared in the Copenhagen Accord it was not more precisely defined in Cancun. With present funding by existing dedicated climate funds[2] overwhelming tilted towards supporting mitigation actions, there is likely to be a strong expectation that adaptation should receive a significant portion of support from the GCF. Some allocation formula is called for to give confidence that the subsequent funding decisions on this important issue are rule-based. This also applies to the allocation of funding between countries. In order to secure a framework for the equitable allocation of climate finance there would need to be some international formula for fund disbursement between countries. Whatever is determined, there should be a stronger, coherent framework for country funding that supersedes the present 'first mover' advantage that appears to be in place in accessing finance from some funds.

The Standing Committee

The proposed Standing Committee to be established under the COP will help the COP exercise its functions regarding the financial mechanism of the Convention (which will include the Green Climate Fund). The Committee is specifically tasked to help the COP improve 'coherence and coordination in the delivery of climate change financing, rationalisation of the financial mechanism, mobilization of financial resources and measurement, reporting and verification of support provided to developing country Parties.' While the roles and functions of the Standing Committee are to be defined further, the Committee will clearly need to have a wide array of expertise in order to help the COP with these issues.

The text on the Standing Committee appears to be a 'place-holder' for addressing some of the tougher issues later on. This is particularly true where the text notes the need for the Committee to assist in 'mobilization of financial resources' and 'improve coherence, coordination in delivery, and rationalization' of the financial mechanism. At present, it is unclear what sort of power and authority this new Standing Committee will have in terms of executing some of these important roles.

On coherence/coordination/rationalization, questions need to be answered around how this new Fund is going to interact with or relate to established funds, such as the Adaptation Fund and the Climate Investment Funds, whether there will be a hierarchy which gives the GCF supervision or an advisory role over existing funds inside and outside the UNFCCC framework and how overlaps are to be avoided. The formation of the GCF is being viewed by many as a way to simplify the intricate network of multilateral and bilateral funding mechanisms and bilateral agreements, largely through traditional channels for development aid, that currently provide support for developing countries addressing climate change (Murray, 2010). However, expectations should be tempered, as it is unlikely the establishment of this Fund will significantly change 'business as usual' in terms of the complex international climate finance support structure, at least in the short term.

Issues of design: Fund Mobilisation

The LCA text on the GCF hardly raises the question of how finance will flow into the fund. However, the context in which the fund has been proposed is one that acknowledges the joint developed country Parties commitment, first recorded in the 2009 Copenhagen Accord, to mobilise USD 100 billion per year by 2020 to address the needs of developing countries. While confirming the financial

[2] Source: www.climatefundsupdate.org

pledges from Copenhagen, Parties in Cancun failed to establish a time-table for scaling up from the yearly USD 10 billion until 2012 in Fast Start Finance to the long-term finance global commitment. Besides the GCF, other channels for the disbursement of climate finance exist. How much of the USD 100 billion by 2020 will be mobilised to pass through the GCF – and how much of presumably smaller yearly sums between 2012 and 2020 – is therefore an important issue for the transitional committee to consider.

Fortunately, the committee will not be starting from scratch. There is the work of the High-Level Advisory Group on Climate Change Financing (AGF) that was tasked with identifying the potential sources of finance to achieve the USD 100 billion goal. The report of the Advisory Group, which was issued immediately before the Cancun COP meeting, concluded that the goal was 'challenging but feasible'. The AGF acknowledged that raising such a level of international finance will likely require funding to come from a range of sources, including public finance, development bank instruments, carbon markets and private capital. (It is noteworthy that the TORs for the design of the GCF also refer to 'financial resources from a number of sources'.) However, whilst acknowledging there was a potential complementary role to be played by each of these four types of finance, there was no unity of view within the AGF on the balance to be struck between public and private finance. This remains a contentious and highly political issue that Cancun left unresolved, with Parties taking only 'note' of the AGF report. It is conceivable that political fora outside of the UNFCCC such as the G20 or the Major Emitters Forum will discuss the issue of sourcing. The absence of a political mandate or a resolution of this question could hamper the work of the transitional committee, especially since the prospect of this issue being resolved over the next twelve months would appear to be slight. Likely to be significant, if not uncontested, will be the role played by the multilateral development banks in providing specific expertise and support on this issue. These banks have long been engaged with the challenge of bringing together public and private finance to secure maximum leverage of public investments and many observers expect them to be able to offer some important insights.

Another major design issue concerns how to create the right incentives to encourage countries to participate in the new fund. The GCF is being created within an already extensive – and many would argue, over-populated – international architecture of bilateral and multilateral funding initiatives. If anything, this architecture continues to become ever more complex. For example, at the same time as the GCF is being established, there is an initiative underway to create an Africa Green Fund, to be administered by the African Development Bank. This proposed regional fund would appear to parallel the objectives of the GCF – and what is being proposed for Africa could be replicated by similar regional funds elsewhere. The Standing Committee will have to address this issue urgently to avoid undue fragmentation of effort and advise the UNFCCC – as well as recipient and contributor countries - as to what international architecture, and division of labour, best provides the necessary coherence and coordination in the delivery of climate change financing. Many early proponents for a global climate fund, such as the now proposed GCF, had expected such an institution to play the role of a 'fund of funds' or overarching umbrella over existing funding instruments that could then have taken on a role of funding windows. However, the Cancun language does not give any indication that such an ambition is to be pursued for the GCF, but rather that it is understood to be co-existing, as 'an operating entity of the financial mechanism' (not 'the' sole operating entity) with other funds inside and outside the UNFCCC context.

The LCA text offers very little guidance with regard to the role of the GCF, except to say that '*a significant share of new multilateral funding for adaptation should flow through the Green Climate Fund'.* This clause contains a number of possible limitations that could be seen to constrain the ambition of the fund. With this as the only guiding Convention text it is difficult to see how the fund will attract significant levels of funding without further innovation to draw the attraction of contributing countries. The experience of the Adaptation Fund in its attempts to raise funding from

national budgetary contributions is a salutary reminder of how difficult this may prove to be in practice, especially in the absence of an automated financing source such as the CDM levy, which provides most of the funding for the Adaptation Fund. There is a clear political challenge to overcome industrialized countries' reluctance to commit a significant share of their multilateral climate finance contributions to financing instruments under the UNFCCC framework. The transitional committee will need to give considerable thought to this matter if the Fund is to secure the necessary early financial support for its planned investments.

Issues of design: Fund Disbursement

The LCA text is also silent on fund disbursement, with one exception. This is the reference in the terms of reference for the design of the fund to funding windows and access modalities including 'direct access'. Direct access has become a prominent, new arrangement in climate finance delivery, whereby the recipient country is able to access financial resources directly from a fund, or can assign an implementing entity of its own choosing. This is in contrast to where funding is channelled through a third party implementing agency, usually a multilateral organization that is selected by the fund administrators (Brown, Bird and Schalatek, 2010). Direct access has been operationalised by the Kyoto Protocol Adaptation Fund through the accreditation of national implementing entities (NIEs). It is seen by many commentators as an important development to secure greater national ownership over funded activities, whilst maintaining high fiduciary standards and minimising transaction costs. However, establishing this new arrangement is taking time, with only three NIEs accredited by the AF Board to-date. Nevertheless, the fact that direct access has been highlighted within the TORs of the GCF is an important signal that this new institutional arrangement, instigated by the Adaptation Fund, has broad support within the international community and that the GCF has the ability to move beyond a traditional donor-recipient country relationship in the disbursement of multilateral climate financing.

Climate finance can take a variety of forms: it can be provided as grants, concessional loans, equity investments or through guarantees. Whilst the general presumption is that climate finance in support of adaptation actions in developing countries should be provided on grant terms, this does not apply equally to the funding of mitigation actions, although many observers have argued that at least in poorer developing countries mitigation finance should come likewise in the form of grants. It will therefore be important for the GCF to secure a good match between the type of finance and the objects of financing, whilst having sufficient funding to provide necessary grant financing, and this will be influenced by both country and project profiles. Potentially separate grant and loan windows could be created for different types of themes, sectors and countries. A better understanding of the role that private sector finance can play in the most vulnerable countries is also needed, as well as a more explicit acknowledgement of the central role of public funding for required climate investments that might not attract private capital, particularly in dealing with marginalized groups. Existing development banks, with their mission of poverty reduction, are well placed to provide some of this necessary expertise, as they have experience of working with all these different financial instruments in the context of development finance.

As stated earlier in the paper, achieving an equitable allocation of funding between countries will be a major challenge for the GCF. Going beyond general principles to ensure that finance reaches the most vulnerable countries (among the least developed countries, small island developing states and Africa) will prove difficult. In order to secure such a framework for the equitable allocation of climate finance there would ideally be an internationally agreed formula for fund disbursement between individual countries.

Finally on fund disbursement, this initiative would be well advised to be guided by the experience of development finance, both its successes and shortcomings. As the terms of reference for the design

of the GCF demands, the 'application of environmental and social safeguards' needs to be guaranteed in funding disbursement decisions, with many lessons to be learned from World Bank and other multilateral development bank practise. One of the major lessons of aid effectiveness is the recognition that national ownership over the development process is paramount. This suggests that one-off project interventions supported by external finance that are not embedded within some national priority setting process are unlikely to succeed. In fact, by working outside of national systems some development projects have tended to undermine national systems, or at least not taken advantage of the opportunity to improve them. This realisation has led international development agencies to move towards programmatic forms of support, with external finance underpinning national sector programmes that display coherence in terms of policy, strategy, budgeting and coordination.

Much the same argument applies to the delivery of climate finance – the challenge for the GCF will be to move beyond an approach that works through project interventions to supporting national programmes at scale. Each national government, together with the country's civil society and its private sector, has to decide the priorities of national climate investments. The partial expression of such national needs already exist in National Adaptation Programmes of Action, soon to be complemented by Nationally Appropriate Mitigation Actions (NAMAs) and national climate change strategies. The COP agreement on a new registry of developing country NAMAs provides an opportunity to match GCF funding for mitigation with developing countries' emission reduction needs and coordinate existing and new financing channels in a systematic way.

Conclusions

The next twelve months will be a testing time as the transitional committee grapple with the task of designing the Green Climate Fund. Much can be learned from previous relevant initiatives, such as the Kyoto Protocol Adaptation Fund and the Climate Investment Funds. However, the scale of the task should not be under-estimated. Among the more pressing design features that need to be addressed are:

First, the committee should give equal attention to the three sequential phases of fund mobilisation, fund governance and fund disbursement. The LCA text has focused on aspects of fund governance, but the challenges facing the establishment of the GCF may be more to do with how funds are raised and spent rather than the governance arrangements of the fund and its internal management and administration.

Second, the transitional committee, which is a temporary mechanism, needs to develop strong, early links with the Standing Committee on finance, which will be a permanent institution under the UNFCCC COP. The importance of this should not be under-played as some of the major challenges facing the future development of the Fund need to be addressed by the Standing Committee. There will be sequencing issues that need to be well managed if the transitional committee is to report on time to the COP meeting in Durban.

Third, the committee should clarify at an early stage its thematic and geographic ambition for the fund. The GCF will provide additional support for climate change actions in developing countries, but it is unlikely to replace existing funds. So, the challenge will be for the Fund to innovate and complement existing initiatives, within an appropriate division of labour, rather than seek to replace them. In terms of country allocation the GCF could establish best practice by determining an explicit and equitable rule-based approach to funding that would see the most vulnerable countries being targeted.

Finally, the Fund will have to address issues of implementing capacity and the establishment of a pipeline of fundable programmes and projects within the most vulnerable countries. This might

entail a funding window specifically on capacity building and support for institution building in recipient countries (such as for the national trust funds in Bangladesh or Indonesia), so that funds can be effectively absorbed.

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