## Climate Finance Policy Brief No.1

# Where's the Money? The Status of Climate Finance Post-Copenhagen

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**Introduction**

When the dust settled after the near failure of the UNFCCC climate talks in Copenhagen, the issue of climate finance seemed strangely to have been one of the few areas, where despite all procedural and political misgivings, real progress was made. This is important, as finance is one of the most urgent issues that needs to be addressed in order to achieve a comprehensive post-Kyoto climate agreement.

In a last minute face-saving political effort by a small group of 28 countries who negotiated the text at the request of the Danish COP presidency, the "Copenhagen Accord" was created as a compromise document. However, it was neither endorsed nor voted on by the full Conference of Parties (COP) of the UNFCCC in Copenhagen; with the representatives of the 193 parties only "taking note". Thus, global climate change negotiations face political and possibly legal uncertainty going forward. Some fear that the UNFCCC process has been seriously undermined and its ability to rally the world to a global agreement cast in doubt. Among developing countries, distrust is growing over the possibility that an elite club of countries might attempt to wrestle control over climate talks permanently away from the 193-member body. These uncertainties and tensions play out as well in the area of climate finance. The "Copenhagen Accord" gives some clear promises and numbers for both short- and long-term financial support by wealthier countries for developing countries, especially the most vulnerable, to deal with climate change. It pledges US$10 billion per year from 2010-2012 with the promise to increase to US$100 billion per year starting in 2020. However, as the Accord is a nonbinding political agreement, many questions about if and how those commitments can be fulfilled are yet to be answered.

**A Bifurcation of the Global Climate Negotiation Process?**

Copenhagen revealed the possibility of a bifurcation of the global climate negotiation process. On one side, there is a relatively transparent multilateral process at the UNFCCC with its two working groups on long-term cooperative action (LCA) and further actions in the Kyoto Protocol (KP). Despite the strenuous and contentious negotiations at the COP15, many observers argue that progress was made in Copenhagen in these two working groups, whose reports to the full plenary should form the basis of the continuation of negotiations in the UNFCCC (Khor 2010). On the other side, the Copenhagen Accord was hammered out by a small group of UNFCCC parties in a less transparent two days of meetings on the sidelines of the COP, which for some smacked of the infamous "green room" proceedings at the WTO. Whether this bifurcation can be overcome, for example by inputting political commitments made in the Copenhagen Accord into a resumed UNFCCC negotiation process, has important implications for global commitments for climate change financing: the amounts as well as their nature and governance.

## The Copenhagen Accord and its Legal Ramifications

The Copenhagen Accord is a political statement, not a COP decision. In Copenhagen, it failed to clear the high hurdle of unanimous consensus of the delegates which would have been required for a formal decision. With several member countries openly objecting to the document in the final plenary, the delegates simply "took note" of the Accord, which allows UNFCCC parties to acknowledge its existence. However, it does not confer legal status on the document; in the text itself the words "legally binding" do not appear. Likewise, after confusion and worry among member states, particularly from developing countries, the departing Executive Secretary of the UNFCCC, Yvo de Boer, clarified on the UNFCCCC website: "Since the Conference of Parties neither adopted nor endorsed the Accord, but merely took note of it, its provisions do not have any legal standing within the UNFCCC process even if some Parties decide to associate with the Accord." (UNFCCC 2010a). By the end of -February, some 108 parties out of the 193 member countries of the UN have formally communicated their support for the Accord to the UNFCCC Secretariat (including all major emitting countries).

## Climate Finance References in the Copenhagen Accord: What Do They Mean?

The Copenhagen Accord devotes several paragraphs (Par. 8 to 10) to the issue of climate finance (UNFCCC 2009).

### *Short Term Financing*

Paragraph 8 calls for the provision of "scaled up, new and additional, predictable and adequate funding as well as improved access" to developing countries for mitigation, adaptation, REDD-plus, technology development and transfer and capacity building. Short-term finance "approaching" US$30 billion for 2010 to 2012 is to be used in equal parts for mitigation and adaptation, with preferred access for the adaptation monies going to least developed and small island states and Africa. It is significant that more definite language is not used for funding that is to be committed immediately. This money would have to be already identified in government spending plans, if it is not to be merely the recycling of existing pledges. The finance is to be committed through an unspecified number of channels (which could include bilateral aid and private investments), “including investments through international institutions”. While this latter reference does not exclude the existing funds under the UNFCCC managed by the Global Environment Facility (GEF), namely the Least Developed Countries Fund (LDCF) and the Special Climate Change Fund (SCCF), it may refer especially to the portfolio of Climate Investment Funds (CIFs) administered by the World Bank with CIF-funded programs to be implemented jointly with the regional Multilateral Development Banks (MDBs).

In Copenhagen, the World Bank and MDBs were heavily represented in a massive sales pitch to persuade the ministers and heads of states present to channel the promised fast track financing for adaptation and mitigation through the CIFs (particularly, since some of the funding included in the figure of US$30 billion over three years might have already been previously committed to them). The World Bank successfully garnered US$ 90 million in new pledges in Copenhagen to formally start a program which has thus far been dormant under the CIFs: the Scaling Up Renewable Energy Program in low-income countries (SREP). Technically, the CIFs are “sun-setted” until 2012, meaning their work is supposed to end as soon as a Post-Kyoto agreement and accompanying financial architecture is established by the UNFCCC. However, the COP could choose to extend the CIFs life-span, something that some large developed countries would certainly support (Marston 2010).

The WB and MDB involvement in climate finance is challenged on principle by many developing countries, who would like to see climate financing mechanisms consolidated under a Global Climate Fund with UNFCCC authority, as an earlier G77+China proposal demanded. Some of the criticisms revolve around the fear of unwanted conditionalities attached to monies channeled through the banks or the concern of high administrative fees taken out by the banks, as in the recent case where Bangladesh objected to receiving contributions from UK’s Multi Donor Trust Fund program via the World Bank (Adam/Vidal 2010). The Copenhagen Accord, at least for the short- to medium-term, cements the proliferation of climate financing instruments and with it a significant role for the development banks in the provision of climate funding. The UNFCCC’s Adaptation Fund (AF) which recently started its operations, has a designated funding source (a 2 percent levy on CDM projects) and thus does not rely exclusively on voluntary pledges like other existing multilateral climate funds, but in the short-term could need additional finance to ramp up its activities quickly. It is not clear if the AF would be one of the channels envisioned for the provision of the short-term US$30 billion over the next three years under the Copenhagen Accord.

*Long-Term Financing*

Paragraph 8 of the Copenhagen Accord also refers to mobilization of US$100 billion a year by 2020 to address the needs of developing countries. This is intended to come from a wide variety of sources, including international public as well as private contributions. This US$100 billion figure is at the lower end of a range of recent international climate finance estimates indicating that the needs might be far greater. The World Bank in its recent Word Development Report on climate change and development put the combined needs for adaption and mitigation per year by 2030 closer to US$275 billion (World Bank, 2010); whilst the international Climate Action Network (CAN) suggests that in public finance alone closer to US$195 billion would be required.

Moreover, the Copenhagen Accord refers to the long-term financing sum only as an aspirational goal, not a stated obligation. The language of the Accord likewise suggests that the provision of these funds could be made conditional on national mitigation activities deemed sufficiently ambitious by the developed countries ("in the context of meaningful mitigation actions"), especially by countries like China, Brazil or India, which as Non-Annex I countries do not have a mitigation obligation under the existing Kyoto Protocol. It hints further that the funding may be dependent on the monitoring and verification of those actions ("transparency on implementation"). Of course, the latter was hotly rejected by countries such as China and others as an infringement of their national sovereignty. In Copenhagen, some developed countries apparently even suggested that only developing country parties signing up to the Accord would be eligible to receive some of the money (Doane 2010; De Castro Muller 2009). Instead, many civil society advocates for a just climate deal and many developing country governments would argue that the provision of finances from industrialized countries to poorer countries is a matter of restitution for a climate debt and thus would reject any conditionalities placed on such a payment as a matter of principle.

One of the key questions for a post-Copenhagen debate about climate finance is how much of it will be 'new and additional'; how this term 'additional' should be defined; and where the money should come from. The Copenhagen Accord, while stating its intent to provide new funding, is sufficiently vague in referring to a "wide variety of sources" parties want to tap, such as "public and private, bilateral and multilateral, including alternative sources of finance" (Par.8). This was also the position of the European Commission immediately before the COP, where in their "European blueprint" they advocated that out of a nominal €100 billion required by 2020 to assist adaptation and mitigation actions in developing countries, international public finance would account for only €22 to 50 billion (or roughly US$28-63 billion), with the remaining finance being generated from the international carbon market and domestic finance in developing countries themselves (EC COM 2009).

While there is no doubt that private finance flows will be part of global climate finance commitments, serious questions remain around whether they should be counted as 'new and additional' funds. The inclusion of private sector funds could dilute any commitment by developed countries for public funding, since most public funds are said to "leverage" several times the original public sum in additional private investments. The World Bank claims that the US$3 billion allocated for the CIFs in 2009 leveraged an additional US$27 billion, some of it from the private sector (BWP 2010). This raises the question of how finance additionality should be defined. Would leveraged private investments be counted toward a country's climate financing contribution? Likewise, would the revenue of carbon trading be included, even though carbon credits bought from developing countries are offsets to developing country emissions and not "new and additional" emission-reductions – thus any finance resulting thereof shouldn't be assumed to be either? Then there is the suspicion that over-reliance on carbon-markets and maybe some future market-based climate finance instruments would not only hollow-out the collective commitment of developed countries, but be counterproductive. As some have argued, climate change, or more precisely, the emission of greenhouse gases is a major market failure (Stern 2006: 1). Tackling climate change should therefore not be entrusted to the irrationalities and potentially speculative exuberance of an emboldened global carbon market to any large degree.

Halting climate change is a global public good. A substantial core of the promised funds will have to be public monies, not only because markets will not necessarily finance all that which needs to be funded (one can safely assume that many urgently needed adaptation projects, especially in community-based, social development focused settings, will not be attractive to international private investors), but because Annex I parties' legal obligations under the UNFCCC cannot be taken over by private sector entities. Given the reality of tight national budgets in developed countries because of the global economic crisis and because of taxpayer pressure to spend public budgets domestically, many countries will be tempted to shift payment obligations around, as apparently the UK government is doing. In late January it was revealed that the UK's contribution of US$ 2.5 billion pledged in Copenhagen as part of the EU's € 7.2 billion package for short-term climate finance is entirely from its already announced development aid budget, with half of it previously allocated and at least a third of the money provided in form of repayable loans, f.ex. via the World Bank (Adam 2010). This seems to confirm the worst of developing countries' fears that fast-track climate finance instead of being new and additional to existing ODA may be recycled or diverted away from necessary foreign aid programs focusing on health, education, water supply or agriculture. It does not have to; other financing sources can be found. At its Pittsburgh Summit a few months before Copenhagen, the G20 even honed in on one potential one by pledging to reduce significantly and ultimately end climate-harming fossil fuel subsidies, effectively freeing those public expenditures for climate-resilient development and mitigation. For petroleum products alone, this year these subsidies will amount to close to one percent of global GDP or some US$740 billion, both in direct product subsidies and foregone taxation, according to a recent estimate by the IMF (Coady et. al. 2010).

The question of what is "new and additional" in climate finance nevertheless remains difficult to answer. No doubt, it can be unclear where development aid stops and climate finance starts, given for example that many adaptation projects aim to reduce vulnerabilities by promoting climate-resilient development. Even in the case of projects with an outright emission reduction focus it might be challenging to differentiate between renewable energy or energy conversion projects as purely development or mitigation-related. Currently, most donor countries decide themselves under existing OECD DAC rules, if they want to classify a project (and thus the funding for it) as climate-related (Timmons Roberts et. al. 2010). A broader international agreement on how to categorize and catalogue a project as being primarily climate or development focused is still missing.

The Copenhagen Accord's statements on climate finance also lack a reference to a financing baseline, a starting year or starting amount from which to reach the promised US$ 100 billion a year by 2020. Without the establishment of some sort of centralized global climate finance registry or reporting requirements to be overseen by the UNFCCC – which the Accord does not call for –it will be difficult to have transparent, comparable, verifiable and "measurable" accounting of whatever pledges (and how much of them) do eventually come in. Such measures will be particularly important over the decade from the start of the fast track finance this year to the much higher levels to be secured by 2020. It is noticeable that there is hardly any discussion as yet on the plausibility of this intended trajectory. Major challenges can be expected, as the proposed ratcheting up of international finance for developing countries is unprecedented. The clear danger is that those most in need will lose out as finance is directed towards large infrastructural programmes in middle income countries.

While a registry is not envisioned by the Copenhagen Accord, it stipulates the creation of a High Level Advisory Group under COP guidance to determine how revenue for the short-term and long-term climate financing goals of the Accord states can be fulfilled (Paragraph 9). In mid-February, the Advisory Group on Climate Change

Financing started its work. Co-chaired by UK's Prime Minister Gordon Brown and Ethiopia's Meles Zenawi, the panel has equal participation by developing and developed countries. The group has a ten-month mandate and is tasked with creating practical proposals to boost both short- and long-term financing for mitigation and adaptation strategies in developing countries, looking particularly at alternative sources of finance. A first report is expected for the UNFCCC meeting in Bonn this summer, the panel's final recommendations are to be communicated before Cancun (UN News Centre 2010).

*Alternative Sources of Financing*

The Copenhagen Accord – maybe because of the empty coffers of developed countries – places a lot of stock in referring to "alternative sources of finance" to create the financing needed. The Advisory group will most certainly look at the auctioning of emission allowances and cap-and-trade schemes as money-makers for fighting climate change. Other alternative climate finance proposals, some of which have been brought into the UNFCCC process through parties' submissions (UNFCCC 2008), include international levies and taxes, for example for air and maritime travel and transport. In the context of the global economic crisis, the suggestion for a financial transactions tax (FTT) has gained some political traction internationally with both governments and civil society. Likewise a recent suggestion was made to create additional Special Drawing Rights (SDRs), a global reserve currency managed by the International Monetary Fund (IMF), of up to US$100 billion in order to pay for mitigation and adaptation efforts in developing countries. This was first brought into play in Copenhagen by George Soros, then picked up and taken over by the IMF's Managing Director Dominique Strauss-Kahn during the Davos World Economic Forum. It could find support by developed and developing countries alike, given the right kind of rules and conditions for their use (ActionAid 2010). While the details of the latter proposal still have to be further developed – the IMF staff is said to be preparing some detailed paper on it – the IMF's intended entry into the emerging global climate finance architecture would strengthen the position of the multilateral development banks vis-à-vis the UNFCCC in the long-term management of substantial climate finance resources.

These alternative sources of finance would help secure that finance is 'additional' at least in terms of how the revenue is raised. Given these new forms of revenue, this could help ensure that the finance is additional to the delivery on current aid commitments.

It is for the management of a "significant portion" of such future climate finance sums that a new fund, the Copenhagen Green Climate Fund, is supposed to be established. The Copenhagen Accord envisions it as "an operating entity of the financial mechanism of the Convention" (Paragraph 10). The operation of the financial mechanism of the Convention is currently assigned exclusively to the Global Environment Facility (GEF), subject to a review by the COP every four years. The language of the Copenhagen Accord suggests that a Copenhagen Green Climate Fund would not replace the GEF, but function in addition to the GEF (which currently manages the severely underfunded LDCF and SCCF). Given donor countries' doubt about the ability of the GEF to scale-up project financing, and developing countries displeasure with the slowness of its funding release, it is unlikely that the GEF will house a future Copenhagen Green Climate Fund under its roof. How then might two UNFCCC funding institutions relate to and interact with each other? And how would the Adaptation Fund, established under the Kyoto Protocol and not the Convention, fit into such a scenario? What role would existing multilateral institutions (including the MDBs) play after the establishment of the Copenhagen Green Climate Fund? Would the Copenhagen Green Climate Fund – as a consolidated international fund top the hierarchy, with other existing funds acting as specialized operating or implementing entities? Or would the Copenhagen Green Climate Fund be in direct competition with already established funds for its share of the pledged climate finance pie?

All these questions are yet to be answered. Legally, one thing, seems to be clear: for the Copenhagen Green Climate Fund to operate under the Convention's Financial Mechanism, a formal COP decision, meaning the agreement of all parties, is needed. Such a consensus might come at the next COP in Cancun in December 2010, or later, if at all. Only then can money pledged under the Copenhagen Accord be distributed and managed by the Convention; otherwise, the money might still be committed, but without UNFCCC oversight and guidance (Werksman 2009).

**The LCA Working Group Report of Copenhagen: What Does it say on Climate Change Financing?**

With the international debate focused on the political commitments made in the Copenhagen Accord, the draft language on climate financing as reported by the Ad Hoc Working Group on Long-Term Cooperative Action under the Convention (AWGLCA) to the plenary in Copenhagen has received little attention. It is unclear, given the outcome of Copenhagen, if the LCA draft report will form the basis of further negotiations this year. Many have argued that because of the transparent and multilaterally inclusive way it was achieved, it should.

While many references to climate finance are still bracketed, meaning consensus still evades the UNFCCC parties[1], some important differences to the finance provisions in the Copenhagen Accord can be noted (UNFCCC 2010b). Chief among them is an insistence – without brackets – of new and additional public financing by developed country parties being the main source of funding through the UNFCCC financial mechanism (Par. 36), supplemented by private-sector financing and innovative sources of funding and allowing developing countries direct access to these funds, without the involvement of financial intermediaries. This is a critical point and one which is at variance with much thinking in developed countries. The working group report also mentions the need to "measure, report and verify" the financial support provided to developing countries (Par. 41). The draft decision on "Enhanced action on the provision of financial resources and investment" does not show agreement yet on the institutional arrangements needed to scale up climate financing. Both, the establishment of a Finance Board (Par.4) – which would oversee all funding arrangements under the UNFCCC as well as review modalities of operating entities such as the GEF – and the creation of a new Climate Fund or Climate Facility with specialized funding windows as an operating entity of the financial mechanism of the Convention (Par. 6-11) are possibilities to be further negotiated.

**Conclusion**

[1] The working group has yet to elaborate a long-term goal for financing – a figure the Copenhagen Accord already set. Likewise, a number for fast-tracking short-term finance for adaptation and mitigation is still missing in the negotiation draft.

Two months after Copenhagen, it remains unclear if the Copenhagen Accord will inform a resumed UNFCCC negotiating process, or whether it will effectively supersede the two UNFCCC working group reports from Copenhagen and serve itself as the basis for further international climate negotiations. The announced resignation of UNFCCC Executive Secretary Yvo de Boer by mid-year and the ongoing search for a successor might add to this conundrum. For climate change financing, this uncertainty has major consequences.

While the Copenhagen Accord for the first time has provided concrete numbers on the financial goals for short- and long-term financing of mitigation and adaptation action by developing countries, it did so as part of a political declaration of intent, not a legal COP decision. Likewise, the Copenhagen Green Climate Fund the Accord proposes might never see the light of day, at least not until a formal COP decision on its establishment. The earliest this can happen is at the COP16 in Cancun in December 2010. In the absence of a formal COP decision, funding pledges might well accumulate in the existing funds, particularly those administered by the World Bank.

The one concrete result of the Copenhagen Accord so far, the Advisory Group on Climate Change Financing has started its work and will submit its final recommendation in ten months time, immediately before the Cancun COP16 meeting. In the absence of guidance by the full membership of the UNFCCC , one might expect to hear less about the obligations of developed countries to provide new, additional and predictable financing to developing country parties that is measurable, verifiable and reportable, and more about innovative new financing sources and instruments, as well as the need to provide the right investment climate for private sector entities and security for global carbon markets, and to expand cap-and-trade schemes globally.

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## Climate Finance Policy Briefs

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