EDC2020

SEVENTH FRAMEWORK PROGRAMME

Project funded under the Socio-economic Sciences and Humanities theme

The Challenge of Securing European Coherence on Climate Finance[1]

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1 Based on the working paper 'International climate finance: principles for European support to developing countries', available at: www.edc2020.eu
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Summary

The European Union places considerable emphasis on tackling climate change, both within Europe and internationally. Recognising that climate change is a global concern, much attention is focused on supporting developing countries. Europe has a long-standing relationship with developing countries through its programme of development cooperation and so is well placed to understand some of the challenges these countries face regarding the impacts of climate change. As the largest contributor of official development assistance, Europe has considerable experience in delivering substantial international public finance at scale and has sought, through the Paris Declaration on Aid Effectiveness and the Accra Agenda for Action, to improve the effectiveness of aid delivery. In a similar way, the EU needs to have a credible strategy for assisting developing countries cope with climate change.

Principles of climate finance under the UNFCCC

As new funding mechanisms to tackle climate change have developed, a number of principles have been proposed to assess their relative worth. However, little emphasis has yet been given to how these principles might fit together into a coherent over-arching framework. Table 1 proposes such a framework, which brings out two important points: first, it provides the elements of a working definition of what constitutes 'climate finance'; and, second the set of principles can be seen as a collection of mutually reinforcing, inter-dependent attributes of climate finance.

European initiatives for supporting international climate change actions

There has been a flurry of initiatives in recent years to develop new ways of channelling international climate finance. European Member States and the Commission have been very active experimenting with a number of novel approaches. In the short term, this has increased the fragmentation of international assistance contrary to the Paris Declaration on Aid Effectiveness, of which Europe is a strong proponent. Perhaps an

The commitment to provide new finance in support of climate change actions in developing countries was one of the few areas where tangible progress was made at the Copenhagen COP meeting. In light of this, securing a system that supports such flows is an immediate challenge for the international community. What should Europe's approach be to the provision of such finance? This policy brief examines several European initiatives against a number of principles set within the UNFCCC negotiations that are meant to guide the governance of climate finance. These initiatives display considerable diversity in approach and varying degrees of compliance with the proposed principles, limiting the overall coherence of the European response.

No. 7 . January 2011

Table 1. Principles and criteria for European support for actions on climate change in developing countries

Phases in delivery of funding	Principle	Criteria
Mobilisation – how funds are raised	The polluter pays	Financial contributions are relative to the quantity of emissions
	Respective capability	Financial contributions are relative to national wealth
	Additionality	Funds are more than existing aid commitments
	Adequacy	Funds generated are equal to the scale of the task of maintaining global temperature rise to below 2oC
	Predictability	Funding is known and secure over a multi-year funding cycle
Administration – how funds are managed	Transparency	Funding structure, financial data, board members, decision making processes and decisions are put in the public domain
	Accountability	Fund management reports to a recognised authority
	Equitable representation	There is broad representation of all stakeholders on the decision making of the fund
Disbursement – how funds are spent	National ownership	Recipient countries exercise leadership over their climate change policies and strategies
	Timeliness	Funding is delivered when required
	Appropriateness	The funding modality does not result in additional burdens for the recipient
	Access for the most vulnerable	Credit, resources and technologies are made available to vulnerable groups

optimal approach will emerge out of this diversity, but at the global level the number of initiatives appears to be increasing rather than diminishing. This has obvious cost implications at the point of delivery, where national capacity is often limited and not well placed to cope with the multiple administrative demands of different funding sources.

Table 2 lists five European initiatives that have generated considerable discussion and that represent a variety of approaches. An important over-riding consideration is to determine how Europe can best contribute to the global challenge, as climate change is a shared policy area, in which both the EC and the Member States have their own competences[3]. Member States can therefore choose to act unilaterally or through the European institutions and there is already experience of these two approaches being employed. A second issue concerns how climate change funds are channelled to the recipient. This encompasses not only the use of bilateral and/or multilateral systems, but also the way in which public finance might be blended with private funding.

Table 2. European Climate Change funding initiatives

Initiative	Instigator	Funding channel
GCCA	European Commission	Multilateral
GEEREF	European Commission	Public-private funds
GCFM	European Commission	International bond issue
ETF-IW	Member State (UK)	Multilateral
ICI	Member State (Germany)	Bilateral

European Commission initiatives

The Global Climate Change Alliance (GCCA) – this initiative has been described as ‘an EU answer to the development dimension of climate change’[4]. Yet, the EC has been unable to mobilise financial support for the Alliance from the Member States. Only two countries (Sweden and the Czech Republic) have made modest contributions, which clearly raises questions of whether this could be considered an adequate response, on its own, from the EU. The intention that the GCCA would become a ‘clearing house’ for European countries’ support to developing countries

3 Strob, S. (2008). European procedures and mechanisms to promote coherence of development cooperation and climate change policy. Planning the Global Climate Change Alliance.

4 European Commission (2008). *Implementation framework of the Global Climate Change Alliance*. Commission staff working document. SEC(2008) 2319. Brussels.

on climate change appears to have been too optimistic in this area of shared competency. (The availability of alternative multilateral channels perhaps explains the lack of uptake by some Member States.) With regard to fund disbursement, and the principle of supporting national ownership, the intent of the GCCA to use budget support arrangements should allow for larger volumes of financing to be disbursed without resulting in additional administrative burdens for the recipient country (and parallels the EU's commitments on aid delivery). However, this appears to be a medium-term goal at best: of the twelve countries where initial support programmes have been identified, funding will be channelled through budget support arrangements in only four. The transition from projects to more programmatic forms of support will likely be as challenging for climate change actions as it has proved for development cooperation.

The Global Energy Efficiency and Renewable Energy Fund (GEEREF) – is an innovative risk capital fund, managed by the European Investment Bank Group that aims to accelerate the transfer, development and deployment of environmentally sound technologies in developing countries. The advantage of its structure is that it provides equity, not debt. It therefore represents a very different approach to the GCCA: one that focuses on working with the private sector to deliver climate change mitigation technologies in developing countries. In response to the adequacy principle, the total amount of money expected to be mobilised by the GEEREF initiative may be as large as €1 billion, which if realised would make a substantial contribution to climate-related finance. However, this figure is based on securing a significant amount of leverage of private finance, which will depend on prevailing market conditions. The present low level of international investment could constitute a significant obstacle to the expected scaling-up of this fund, at least over the short-term.

The Global Climate Financing Mechanism (GCFM) – is yet another approach, which applies the idea of an 'International Finance Facility' (a tool that has been used to address urgent large-scale vaccination funding needs) to fund priority climate change actions. The EC has proposed this as a 'bridging initiative' to be used before the new international financial architecture is agreed upon through the UNFCCC negotiations[5]. Bonds would be issued on the international markets to raise funds by an appropriate financial institution, enabling the 'front-loading' of funding for immediate use. Repayment over a long period (e.g. 20 years) would likely be financed through revenue raised by EU Member States from the future auctioning of emission rights. Initially, the front-loaded finance would be provided by the private sector through the purchase of bonds, therefore representing finance that is additional to existing aid commitments. Although this has not received much favour to-date, it may re-surface as the need to identify sources of fast start finance becomes more pressing.

Member State initiatives

Several Member States have developed their own strategies towards securing new funding for climate change actions in developing countries. The UK and Germany, in particular, have been active in this regard. A key issue is whether or not these national initiatives complement the broader European strategy.

The Environmental Transformation Fund, International window (ETF-IW) – is an initiative of the UK government that focuses on poverty reduction, environmental protection and helping developing countries tackle climate change. In the course of its development, all ETF-IW funding has been allocated to three multilateral funds: the World Bank-administered Climate Investment Funds (CIFs), the Forest Carbon Partnership Facility (FCPF) and the Congo Basin Forest Fund (CBFF). It is noteworthy that considerable UK resources have gone into strengthening the CIF architecture administered through the World Bank, rather than aligning behind the European initiatives instigated by the European Commission. Civil society has found the transparency of these arrangements hard to follow at times, although the funding structure, financial data, board members and decision making processes are now all in the public domain and can be found on the World Bank's website. Because the funds are coming from general budgetary expenditure, the predictability of the financial flows are in question, as it is based on a voluntary budgetary contribution from the UK government, rather than from a source of finance that would automatically generate the funds.

5 European Commission (2009). *Towards a comprehensive climate change agreement in Copenhagen*. Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. COM (2009) 39 final. Brussels.

The International Climate Initiative (ICI) – This German initiative provides finance to international projects supporting climate change mitigation, adaptation and biodiversity projects with climate relevance. The key innovation of this national initiative lies in the way that funds are mobilised. ICI raises its funds from private companies (compliance buyers) under the framework of the European Union Emission Trading Scheme. In 2008, the German government began the auctioning of a percentage of its allowable emission permits to businesses. Of the amount raised, €120 million each year is earmarked for developing countries and countries in transition. This innovative approach to the mobilisation of funds means that the finance generated is additional to current ODA contributions (though it is unclear if it will be additional to ODA commitments). Given that the source of funding comes from the auctioning of domestic allowable emission permits, this should also be more predictable than voluntary contributions made through general budgetary expenditure, although it does depend on the auction price achieved. This initiative has demonstrated early success in providing climate finance in a timely manner. Using existing development cooperation channels, the ICI has been able to establish a pipeline of fundable projects quickly, finance these projects and move forward with implementation.

Coherence of approach?

This set of European initiatives shows a diversity of approach towards raising public finance and varying degrees of compliance with the proposed principles of climate finance. The quickest initiative has been the German ICI that has already supported a large number of projects on the ground in developing countries. As this has been a continuing, strong call from developing countries – to see timely action and the provision of additional finance – it would appear to be a model that other Member States could consider adopting, although this might be at the expense of an EC-coordinated approach. The challenge remains in defining the added value of the latter. The multilateral route may offer the possibility of greater scale, but this comes at the expense of delayed delivery, as experience with both the GCCA and the CIFs have shown.

A major challenge for Europe is whether a credible European strategy on international climate finance can be developed for the post-2012 period, with the case for collective action at the European level clearly laid out. It is clear that some key Member States are pursuing their own national interests over adopting a common European position. For example, the UK determined at an early stage to use the World Bank as the account manager for its national climate finance, with funding to be channelled through the multilateral development banks.

A key concern for Europe, and one where there appears to have been mixed experiences in the funding initiatives described in this paper, is the emphasis given to matching international financial resources with defined needs within developing countries, as identified through National Communications, NAPAs and now NAMAs. In this context, something can be learned from the earlier experience of the development cooperation relationship. Prior to the Paris Declaration on Aid Effectiveness, national ownership was a principle of engagement that donors at times ignored. What may be needed now is a similar 'Paris Declaration' for the provision of climate finance, whilst recognising the very different relationship that exists between North and South over climate change. The value of the Paris Declaration was that it drilled down, going beyond vague statements of principle to agree explicit criteria and indicators by which progress could be impartially monitored, and in so doing strengthened the coherence of international action.

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Consortium partners: European Association of Development Research and Training Institutes (EADI, Germany), Overseas Development Institute (ODI, United Kingdom), Institute of Development Studies (IDS, United Kingdom), German Development Institute (DIE, Germany), Fundación para las Relaciones Internacionales y el Diálogo Exterior (FRIDE, Spain), Society for International Development (SID, Netherlands).

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