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*G-20 Experts Group on Climate Change Finance*

## **Policy Paper 3: Governance & Delivery of Public Finance**

### **Background**

MEF Leaders, at their July meeting in L'Aquila, Italy, agreed on a number of first principles regarding the financial aspects of future international cooperation on climate change. Specifically,

“...The expertise of existing institutions should be drawn upon, and such institutions should work in an inclusive way and should be made more responsive to developing country needs. ...The governance of mechanisms disbursing funds should be transparent, fair, effective, efficient, and reflect balanced representation. Accountability in the use of resources should be ensured. An arrangement to match diverse funding needs and resources should be created, and utilize where appropriate, public and private expertise. We agreed to further consider proposals for the establishment of international funding arrangements, including the proposal by Mexico for a Green Fund.”

They also called on G-20 finance ministers to further these efforts by taking-up climate finance issues and reporting back to them at the G-20 Pittsburgh Summit this fall.

This paper will seek to move the discussion forward on issues relating specifically to the governance and delivery of public finance. This paper will examine a number of focused questions in order to better understand the underlying issues, to make recommendations where possible on how best to resolve these issues or, where there is not broad agreement, to present options that could be discussed by the Finance Ministers at the September ministerial.

### **Summary to be considered by G20 Countries**

- **The system should be operational by 2012 reliable, accountable, credible, effective and efficient;**
- **It should be country led and owned and delivery should be consistent with national development priorities and strategies;**
- **The system will need to scale up finance; streamline/simplify the procedures; build trust and develop mutual accountability; including through sound management of funds;**
- **Governance should be equitable and representative;**

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- **Climate Finance should be coordinated at the national and international levels and integrated with development finance to ensure maximisation of results;**
- **Existing Institutions should be reformed where necessary and new institutions should only be set up where a clear gap exists.**
- **We recognise the existence and utility of different channels for efficiency, swift operationalisation and flexibility but rationalisation will be necessary.**
- **Finance should be delivered consistent with agreements under the UN negotiations, and delivered against country owned strategies and planning, consistent with national development priorities,**
- **Such finance should be accountable;**
- **The international community should provide support for the development of these national strategies and planning;**
- **These strategies should be reviewed at the international level by representative institution/s according to agreed criteria;**
- **Regarding technical aspects, there may be a need to consider, inter alia, the option of technical thematic bodies in a limited number of areas to assess specific aspects of these strategies according to agreed criteria; or other options; including relying on one body supported by experts. The bodies referred to above could be existing institutions reformed to deliver finance against proposed strategies and actions;**
- **At the international level mitigation and adaptation would need to be addressed differently recognising their different roles, but at the same time synergies should be maximised;**
- **A new body may be needed to co-ordinate the currently fragmented climate funds, facilitate the matching between actions and finance and provide robust MRV for mitigation and finance actions.**

## **Introduction**

The current institutional arrangements for climate financing under the Convention (and the Kyoto Protocol) are fragmented and not designed to handle the disbursement of finance at the scale and pace needed post 2012. An ambitious deal at Copenhagen will need a climate financing architecture, which is capable of delivering at pace and at scale consistent with developing countries own priorities and which ensures effective financial management. The governance of climate finance must reflect the fact that climate change is a global challenge. Representation must be balanced and shared between developed and developing countries

**The paper is focused on three main issues: (1) key principles and core functions that we need the future architecture to deliver; (2) key functions and division of responsibilities, i.e. which functions should be delivered at the national and**

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international level, and (3) options for scaling up delivery of public financing and how can we ensure that funding is allocated against national priorities in an efficient and effective way.

## 1. Key principles and core functions of the future architecture

- a) Operational by 2012: The current financial architecture for climate change should be reformed in order to face the challenge but the future architecture should be in place and functioning at the start of the next commitment period. It must be ready to deliver at pace and at scale. It should build on existing institutions, reformed where necessary. In this respect, we should use the lessons learnt from existing funds and institutions such as the Global Environment Facility (GEF), the Multilateral Development Banks and notably the Climate Investment Funds (CIFs), and the UN actors. The system should build on the experiences of thirty years of development finance, both good and bad, be consistent with the Paris Principles on aid effectiveness and ensure minimal transaction costs.
- b) Improved effectiveness and efficiency: For all Parties, there is a need to ensure our common objectives are reached for both mitigation and adaptation. For adaptation the poorest should be prioritized whereas for mitigation the most relevant lowest cost options should be prioritized, consistent with national development priorities, own action and any commitments made under the UNFCCC.
- c) Country-led / country-owned: Planning should be consistent with national development priorities and goals in order to ensure that climate finance is delivered in a coherent manner and consistent with the wider national priorities of the recipient country. Finance should be delivered against national development strategies, the strategies could either be separate for mitigation and adaptation or a country may wish to develop an overarching plan. Either way, at least the mitigation elements would be reviewed at international level against criteria agreed by developed and developing countries. In this context, these strategies and planning would be the basis for the delivery of finance and should coordinate finance at the country level. Climate finance delivered against these plans should be counted towards a country's financial commitments under the UNFCCC.

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- d) Mainstream and integrate Climate Finance into development planning in particular at the national level: Climate finance should be integrated into a country's core development planning and integrated with development finance, in order to maximise results, and to make the most effective use of existing processes and systems at the national and international level and minimize redundancy and/or inconsistency. It should be clear that this is distinct from the question of sources and the principle of 'additionality'.
- e) Scaled up financing: Existing project based mechanisms for delivering climate finance are often fragmented and impacts localised. We need to shift towards more programmatic financing, in order to help developing countries transform their economies (in particular some sectors) and societies, with delivery at pace and at scale according to national strategies.
- f) Streamlined and simplified access to finance: We need to streamline procedures for accessing finance and in particular to simplify access to resources where appropriate.
- g) Build trust: Mutual accountability between contributors and recipients is necessary. This should be accomplished through appropriate measuring, reporting and verification (MRV) of both action and support for mitigation, and monitoring and evaluation for adaptation, building trust and transparency. Such activities should be according to agreed criteria and consistent with national systems and processes.
- h) The system should be reliable, accountable and credible and in this regard, sound management of funds should be ensured, in particular through financial standards and auditing. National budgetary rules and fiscal constraints of both developed and developing countries should be respected.
- i) Equitable governance and representation: Governance must be shared and representation balanced between developed and developing countries.
- j) Need to ensure coordination at the national and international levels.

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## 2. Key Functions and Division of responsibilities

### a) What functions do we need post 2012

The key functions identified are the following:

- (i) *Setting objectives*: i.e. a) international policy / guidance; b) national planning; c) assessment of needs; d) setting of the level of ambition;
- (ii) *Mobilization and management of finance*, i.e. generation of resources and trustee function;
- (iii) *Allocation and delivery of finance*, i.e. matching of finance with needs through inter alia gross allocation to themes (e.g. adaptation, mitigation, forestry); allocation to regional / global priorities; and allocation to countries or institutions) and supporting developing countries to implement their national plans;
- (iv) *Monitoring and evaluation*, i.e. a) MRV of support, emissions reductions and actions for mitigation; and b) monitoring and evaluation of support and actions for adaptation;
- (v) *Encourage coordination, articulation and harmonisation*.

This section focuses in particular on the two functions, which should be more carefully addressed by the future architecture. These are ensuring coordination and coherence at the national and international levels and matching finance with activities or credible national strategies.

### b) Which functions are to be addressed in the future architecture? What is appropriate for national and international levels?

The future climate financing architecture needs to be able to deliver functions in a number of key areas. However, even before defining these, it is necessary to clarify which functions would need to be centralised (international level) or decentralised (country level or institutional / thematic level).

The functions that need to be centralised are those which will ensure coherence of actions with the goals of the Convention and with the level of ambition of the agreement, the one facilitating the matching between actions and finance, information sharing, and

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the establishment of common standards and where incentives may be misaligned without them.

The future architecture should usefully make a clear distinction between (i) the political and strategic aspects to be settled at the international level, (ii) MRV of finance and actions which would need to be addressed both at the national and international levels; (iii) responsibility for operational activities, should be undertaken by individual countries and multilateral institutions, reformed where appropriate, encouraging country ownership as far as possible.

Taking into account this concern, some options for the future architecture are detailed below.

### **3. Options for scaling up delivery of public financing and how can we ensure that funding is allocated against national priorities in an efficient and effective way.**

a) A need to mobilize finance - The question of scale

Depending of the assessment of needs and the level of ambition of the agreement, finance will be generated at an agreed scale. This is dealt with in a separate paper.

b) The existing situation – A multitude of channels

Existing institutions and funds financing climate change are numerous. However, they all have different characteristics and experience we can build on:

- the Global Environment Facility;
- the Least Developed Country Fund;
- the Special Climate Change Fund;
- the Adaptation Fund;
- the Multilateral Development Banks;
- the Climate Investment Funds administered by the World Bank;
- the UN agencies;
- regional and bilateral actors.

c) The future - How to scale up public funding, using and reforming existing mechanisms?

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There are multiple funding vehicles for climate change in the current system, including both bilateral and multilateral. These are fragmented, and usually project focused. In considering the shift from the current architecture in the future one, we need to consider three questions:

## *I. Do we want to keep all these structures in the future architecture?*

The current structure is not totally fixed and could evolve : The GEF is an operating entity of the Financial Mechanism of the UNFCCC on an 'interim basis'; the Adaptation Fund is directly related to the Kyoto Protocol; the Climate Investment Funds have a sunset clause, etc. All the current structures could therefore potentially cease to play a role in climate financing post 2012. However, the reality is that they are unlikely to disappear. We should look to rationalise and reform what we already have, as necessary, to make them more responsive and effective and to ensure they work better. There are some benefits to building on existing institutions:

- a) Transaction costs - Experience with the Adaptation Fund shows that setting up new funds is both time consuming and expensive. Building on existing institutions would mean the new architecture can be established quickly and efficiently and can draw on their experience;
- b) Flexibility / choice - Recipients and contributors need to have the flexibility to choose which channels of finance they want to receive and deliver funding. Contributors will want to use the systems, which they trust to deliver finance most effectively with appropriate fiduciary controls. Providing an element of choice, giving contributors and recipients more flexibility, should make it possible to leverage greater resources;
- c) Coordination - Where possible we should look to rationalize so as to reduce transaction costs. Only a limited number of institutions would be able to deliver at the pace and scale required. We should aim to ensure that they work to their comparative advantages and focus on the functions they are best placed to deliver. Where several actors work in a particular field, we would need to ensure greater coordination so as to avoid duplication of effort.

## *II. How to make the best use of them?*

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Different funds have different strengths; in the landscape of multiple funds, boards should seek to specialise in those areas of strengths. The future architecture should build on the comparative advantages of the different funds/institutions. In particular, development actors have a strong role to play, as both mitigation and adaptation to climate change are integral parts of sustainable development (all effort, including for climate purposes, must be seen as part of an overall program to promote growth and reduce poverty). The future architecture will also have to make distinctions between strategic decision making and guidance, coordination and harmonisation, operational activities, (e.g. capacity building, policy support, technical assistance, programs and investment projects) the secretariat role, fund management, (e.g. concessional financing and grants activities, advice role (technical, strategic), monitoring and evaluation competencies and audit functions.

The comparative advantage of funds should be identified. Funds should be reformed as necessary and new institutions only set up where gaps arise. Reform should ensure consolidation, re-enforcement and focus on recognised competencies and avoid overlaps. Such reforms of existing funds should be based on the principles described in Part 1.

Last, to ensure the efficiency of the global action, coordination will be necessary at the international level and at the national level to ensure coherence and rationalisation.

### *III. Is there a need for new institutions?*

The potential of existing institutions should be carefully assessed before considering the creation of new bodies. Coordination will be necessary and we see a potential case for a coordinating body, potential functions and elements of this will be dealt with later in the paper.

#### d) What does the future architecture look like?

##### *1) At the National level - Country led and owned low carbon climate resilient planning processes and strategies*

Contributors will want to be confident that the financial support they are providing is being used efficiently and effectively and recipients need to access finance at pace and scale to transform their economies to a low carbon, climate resilient base, whilst

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meeting their development goals. Mitigation and adaptation may be subject to slightly different processes due to the different nature of commitments and of the issues, but where possible the synergies between the two should be maximised.

The best basis for coordination at national level is a country-owned development strategies and plans. Such strategies and plans will reinforce efficiency and be a base for coordinating the support of various actors (private and public, domestic and international) in particular at the national level. The important factor is that these strategies and planning ensure that finance is delivered against countries own priorities according to their national processes and their preferred institutions, according to their respective advantages. Countries may therefore choose to develop one low carbon climate resilient strategy consistent their own national circumstances and priorities or they may choose to have a number of plans/ strategies including a low carbon strategy and a strategy for integrating adaptation into development plans.

These strategies should be developed with the support of the international community and include all of the relevant stakeholders at national level. Countries should decide what national structures they want to use to develop and coordinate implementation of these strategies. These strategies should be based on existing national development plans, take into account national specificities and priorities (they would then allow for different starting points, means and evolution). These plans could in particular define supportable actions, notably regarding planning, capacity building and policy reforms, technology piloting, technology deployment and transformation or forestry. Public finance should also help strengthen policy and institutional frameworks in key sectors that might be interested in sectoral approaches to carbon finance. Finance could then be coordinated at the national level in support of countries own planning and priorities.

Finance delivered against these strategies/ plans would then be consistent with the principles and aims of the UNFCCC agreement and should count towards contributing countries' financial commitments under the UNFCCC.

**For mitigation**, potential beneficiary-countries agreed to “*undertake transparent nationally appropriate mitigation actions, subject to applicable measurement, reporting, and verification, and prepare low-carbon growth plans*” (cf MEF declaration). The element of national strategies, which looks at mitigation should demonstrate what portion of deviation from business as usual would be self funded and what portion they would expect to be funded by international action. They should also identify any

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expected carbon market flows and country level MRV procedures consistent with national practices and procedures.

**Adaptation** should be integrated into all areas of planning and budgets. This will be necessary in both developed and developing countries if we are to ensure that our economies can address the challenges brought by a changing climate. Monitoring and evaluation will be needed for adaptation, consistent with existing processes and systems.

**Capacity building support and specific technical assistance should be provided** to help potential beneficiary-countries developing such national strategies, and in particular to integrate adaptation in all policies and planning. Existing institutions may be able to provide this function, reformed as necessary.

*2) At the international level - a High-level body could co-ordinate the currently fragmented climate funds facilitate the matching between actions and finance and provide robust MRV for mitigation and finance actions.*

*It could be supported either by one body supported by expert groups or technical thematic bodies, which could be existing funds or institutions reformed to deliver finance against low carbon climate resilient strategies and planning processes.*

We need to design a process that uses national planning and strategies based on developing countries own priorities as a pathway to access support. As indicated earlier, the recipient country would be responsible for formulating the national strategy and planning in consultation with all major stakeholders. However, before any international public funding is released, some degree of international assessment / endorsement would be required, at least for mitigation and in accordance with criteria agreed by developed and developing countries.

The process needs appropriate mechanisms to assess and endorse national strategies appropriately consistent with existing and agreed processes - this would need in particular to include (i) a technical review and (ii) robust MRV processes for mitigation actions and MR for adaptation actions and for financial contributions.

i) The technical review (based on agreed criteria), could be carried out by an international body supported by experts, or by technical thematic bodies or at the

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national level<sup>1</sup>. The different sections of the strategy/ different plans, for example adaptation and mitigation may need to be reviewed/addressed by experts in specific areas. This could be taken forward by having a limited number of thematic bodies, or experts on each area reporting to one body. The agreed criteria would be different for mitigation and adaptation. For adaptation priority should be given to the poorest and most vulnerable.

This process should be based on reformed existing institutions and all thematic bodies or experts groups would report annually on spend and progress.

(ii) Representative governance will be central to ensuring a MRV process consistent with developed and developing countries requirements. We would want to introduce a strong MRV process for mitigation support and MR for adaptation support so as to enable contributors / institutions to demonstrate that they have financed elements of agreed strategies.

Following the review of the plans/ strategies (working with recipient countries to improve them if necessary) and their endorsement under an agreed process countries could use the plan to approach funding entities and bilateral donors for climate support, ensuring that finance is co-ordinated at the national level. Funding may be released on the basis of eligibility criteria. Finance delivered against this process via national plans should be counted towards convention commitments.

### 3) Overarching Coordination – High Level Coordinating Body

Coordination will also be needed at both the national and the international levels. At the national level coordination should be based on country led and owned national strategies or plans, using national level structures of the country's choice. At the international level these plans would be reviewed by specific body/bodies as set out in the previous section. There will also be a need for coordination across the area of climate change, to ensure coherence and to deliver some central functions.

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<sup>1</sup> This international body/technical thematic bodies (one for each of the main climate areas, e.g. technology, forestry, adaptation), should be existing institutions, reformed to ensure they can deliver finance against national plans and have balanced representation of developed and developing countries

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In this respect, there may be a need for a new body/mechanism to address all or part of these functions. Key to the success of the body will be its ability to ensure co-ordination and coherence whilst minimizing politicisation of decision-making and its ability to facilitate the matching. This body could be under the guidance of the COP.

This high level mechanism/body could, for example:

- interpret guidance from the COP on priorities for mitigation and for adaptation, to facilitate the direction of finance to where it is needed most, in an efficient manner;
- ensure maximum coordination and prioritisation of finance to thematic areas according to need and could make proposals/recommendations on the gross allocation of resources between themes/building blocks (e.g. technology, forestry, adaptation, capacity building), or on allocations to institutions or even on regional objectives;
- facilitate the matching between the finance and the needs, recognizing in particular the sources and channels of funding and identifying the needs, building on countries assessments;
- It could also advise recipient countries on accessing external support through public and private sector finance channels;
- oversee MRV of mitigation actions, outcomes and support (incl. through international co-operation initiatives), monitoring and evaluation of adaptation actions and financial support;
- hold a transparent registry of national strategies or plans, depending on the agreement under the UNFCCC, (once reviewed by the international body or a thematic body) and finance delivered against these strategies and plans (it may consider also international cooperation initiatives). The Body could then report on an annual basis to the Parties on financial and mitigation commitments, and delivery of results;
- compile information and reporting periodically on the success of funding efforts;
- facilitate coordination between actors inside and outside the Convention (multilaterals, bilaterals, private sector);
- encourage synergies with other multilateral intergovernmental agreements (on desertification, biodiversity, water, etc).

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There might also be a need to consider if this high level body should manage finance, either if donors were to choose to put finance directly into the Body or if some funds were generated by a Copenhagen agreement.

## Role of the COP

The finance architecture should be called upon to deliver results and implement the framework of agreements under the UNFCCC. The COP should in particular set the broad policy framework and the level of ambition. However care must be taken to make a strong distinction between political guidance and implementation.