SUBMISSION OF THE SOUTH CENTRE TO THE TRANSITION COMMITTEE TO DESIGN THE GREEN CLIMATE FUND

ON THE ISSUES OF WORKSTREAM 3 – OPERATIONAL MODALITIES

The following is a Submission of the South Centre, an inter-governmental organization comprising developing countries, and an Observer organisation of the UNFCCC, to the Transition Committee to Design the Green Climate Fund. This Submission is on the issues relating to Workstream 3 of the Committee, and broadly follows the themes of the workstream provided by the Co-Facilitators. The Centre may wish to revise this Submission in due course. The Centre will also make Submissions on other workstreams.
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1. Operational Modalities

The terms of reference for the Transition Committee include a consideration of **"**Methods to manage the large scale of financial resources from a number of sources and deliver through a variety of financial instruments, funding windows and access modalities, including direct access, with the objective of achieving a balanced allocation between adaptation and mitigation".

This involves the following issues: (1) the sources of funds, (2) its delivery to users, (3) the use of financial instruments; (4) thematic windows in the Fund, (5) access modalities including direct access and (6) the objective of balance between adaptation and mitigation.

Besides these issues, the Co Facilitators have also provided a list of other issues.

This submission will deal with selected issues in Workstream 3. Some other issues (including thematic windows, mechanisms to facilitate expert and technical advice, and mechanisms to facilitate stakeholder participation, which are in the Co-Facilitators' list) are dealt with in the Centre's submissions on other work-streams and can be referred to in those submissions.

2. Sources and Adequacy of finance

Raising financial resources of the scale necessary requires renewed commitment by Parties to implement their obligations under the Convention, as well as new and innovative thinking about how climate finance is raised and channeled:

- **Which countries are responsible for providing financial resources** under the Convention?
- How can parties ensure that contributions are **made in practice and not merely on paper** – i.e. that they are "**new and additional**"?

- To what extent is the scale of resources is adequate **how can the "financing gap" be closed** through existing and new sources of financing?

- What is the **role of the UNFCCC financial mechanism versus other channels** in providing financial resources to developing countries?

2.1 Contributions by developed countries

The Convention provides that "**developed country Parties and other developed Parties included in Annex II" shall provide financial resources** (Article 4.3) and states that "the extent to which developing country Parties will effectively implement their commitments under the Convention will depend on the effective implementation by developed country Parties of their commitments under the Convention related to financial resources and transfer of technology" (Article 4.7).

The **balance of commitments in the Convention reflects the principles of "equity and common but differentiated responsibilities and respective capabilities"** (Preamble and Articles 3.1 and 4.1). These, in turn, reflect a recognition that "the largest share of historical and current global emissions of greenhouse gases has originated in developed countries, that per capita emissions in developing countries are still relatively low and that the share of global emissions originating in developing countries will grow to meet their social and development needs" (Preamble).[1]

The Convention makes clear that the countries that are legally required to provide financial resources are those included in Annex II of the Convention (i.e. the "developed country Parties" excluding the countries that are undergoing the process of transition to a market economy). In **the Bali Action Plan, Parties agreed to launch a process to enable the "full, effective and sustained implementation of the Convention"**. Implementing the financing provisions of the Convention is a key component of this effort.

2.2 New and additional contributions

The Cancun decision (Para 97) decided that "in accordance with the relevant provisions of the Convention, scaled-up, new and additional, predictable and adequate funding shall be provided to developing country Parties, taking into account the urgent and immediate needs of developing countries that are particularly vulnerable to the adverse effects of climate change."

To enhance action on climate change, **financial contributions must occur in practice and not merely on paper**. They should not merely be a recycling of "old" financial pledges or contributions (i.e. they must be "new"). And they should not merely involve double counting of other commitments, including official development assistance (i.e. they must be "additional").

[1] Some developed countries, particularly the United States, argue that the world has changed since the Rio Earth Summit was held in 1992, that countries' capabilities have developed, and that the principle of common but differentiated responsibilities "expresses the notion of a continuum of responsibilities and capabilities among countries". As noted in the Convention, however, climate change is the result of historical emissions the majority of which originated in the developed countries. Moreover, according to the IEA, per capita emissions from fossil fuels in Annex I countries averaged over 11 tons in 2007, versus 2.7 tons in non-Annex I countries. And some developed countries, in particular the United States, have increased their emissions since 1992.

Reflecting this, the G77 and China had called for financial resources that are "new and additional financial resources, which is over and above ODA".[2]

Developing modalities for evaluating whether financing is new and additional is a priority.

To ensure financing of the level and kind required, and to satisfy the requirements of the Convention, **financial contributions should be evaluated against a set of relatively basic criteria**.

- **They should be "new"**. Developed countries should clearly identify how their financial contributions are over and above climate funds previously pledged or allocated. Where financial contributions are composed of new funds and funds that have been previously pledged or allocated, the component that is new should be clearly identified.

- **They should be "additional"**. Developed countries should clearly identify how their financial contributions are over and above agreed international ODA targets. Doing so is necessary to address the incentive merely to "re-label" existing budget-lines as "climate finance" (resulting in additional resources on paper, but not in practice), or to shift resources away from traditional development priorities such as health, sanitation and education (resulting in a reduction of resources for these priorities).

- **They should involve "the provision of financial resources"**. Developed countries should demonstrate their financial contributions are provided to developing countries from sources envisaged by the Convention (i.e. in Articles 4, 7 and 11). This does not include carbon markets which, by contrast, finance compliance by Annex I countries with their own mitigation commitments (i.e. Article 4.2 and the Kyoto Protocol), and are addressed under the CDM and do not constitute the provision of new and additional financial resources for implementation by developing countries of their commitments (i.e. under Article 4.1 etc).[3]

- **They should be provided on a "grant or concessional basis"**. Developing countries have stated that financial contributions should be principally in the form of grants. To the extent concessional finance is provided, only the grant or concessional element should be counted as new and additional (as is the historical practice of key donors).

As a first step or exercise towards enhanced transparency and accountability in the provision of financial resources, the developed countries should clarify in relation to their **proposed short-term financial contributions** (i.e. 2010-2012): 1) the proportion that was pledged before Copenhagen, and the proportion that was pledged as a result of discussions in Copenhagen, and

[2] UNFCCC, *G77 and China Proposal: Financial Mechanism for Meeting Financial Commitments under the Convention*, Accra, Ghana: United Nations, August 2008. http://unfccc.int/files/kyoto_protocol/application/pdf/g77_china_financing_1.pdf

[3] A clear firewall should be maintained between discussions of public funding to enable compliance by non-Annex I countries with their commitments (i.e. funding through the financial mechanism to enable developing countries to meet their commitments under Article 4.1 of the Convention) and market-related funding to enable compliance by Annex I countries with their mitigation targets (i.e. funding through the CDM and other market-based mechanisms to enable developed countries to meet their mitigation commitments under Article 4.1 of the Convention and the Kyoto Protocol). The purpose, nature and legal basis of these funds are distinct.

so is “new”; 2) the proportion that is over and above ODA commitments (both 0.7% GNI and current levels), and so is “additional”; 3) the proportion that is grant-based versus concessional; 4) the proportion of any concessional finance that is additional, and the proportion that are loans to be repaid; 5) the proportion that is for adaptation and mitigation; and 6) the proportion that is to be provided through the UNFCCC financial mechanism versus “other channels”. Based on this information, Parties can evaluate more accurately the extent to which financing is “new and additional” public financing for climate change in the terms established by the Convention.

In relation to their **proposed longer-term financial contributions** (i.e. 2017 or 2020), developed countries should additionally clarify the proportion they expect to “mobilize” from various sources including the following:

- **From developing countries versus developed countries**
- **From carbon markets** thereby funding compliance with their own mitigation commitments; and
- **From international public sources**. Of this, developed countries should clarify the extent to which they will supply these sources, and the extent to which they are proposing that developing countries contribute to these sources (e.g. through “innovative mechanisms”), thereby funding their own adaptation and mitigation.

On the basis of this information, **Parties can then have an informed discussion about the level of new and additional public financial resources that developed countries are actually proposing to provide** (i.e. the amount “available” in terms of Article 11.3(d)) as well as the aggregate level of financing that is “necessary” for the implementation of the Convention (i.e. in terms of the discussion of scale above) in order to determine whether proposed financing levels are adequate.

2.3 Adequate and predictable contributions

The Convention provides that the implementation of **financing commitments “shall take into account the need for adequacy and predictability in the flow of funds”** (Article 4.3). The Cancun decision also mentions “scaled-up, new and additional, predictable and adequate funding shall be provided.” The determination of what is “adequate” requires an evaluation of:

- **What funding is “necessary” for the implementation of the Convention?** What scale of financial resources is required to address the various *thematic areas* (i.e. adaptation etc), the *nature of costs* to be covered (i.e. full, incremental, etc), and the *level of costs* in light of intended actions and the objective of the Convention?
- **What funding is “available” for the implementation of the Convention?** What scale of financial resources is currently available or pledged? Of the amounts pledged, how much of this is genuinely new and additional?

- **How does “available” funding measure against the yardstick of what is “necessary”? In other words, is it “adequate”?** Where “available” funding meets or exceeds the level of what is “necessary” it can be said to be “adequate” for the purposes of the Convention. Where it does not, it can reasonably be characterized as “inadequate”. To the extent that there is a difference between what is “available” and what is “necessary”, Parties will need to discuss the means available to close the finance gap and to ensure that the flow of funds is adequate and predictable.

It seems clear that a **substantial financing gap currently exists**. The Bali Action Plan acknowledged this when it called for “enhanced action on the provision of financial resources and investment”. The Cancun decision agreed to “scaled-up” funding. As noted, even studies that fail to meet the basic standards of completeness, adequacy, equity or consistency (noted above) estimate the cost of climate change to be in the multiple hundreds of billions of dollars. More recent estimates of potential future climate-related damage are denominated in trillions.

Measured against any reasonable standard **the $100 billion per year that Annex I countries have pledged to “mobilize” by 2020 thus fails to meet the standard of adequacy**. The amount that would be “available” based on their pledges, in other words, falls substantially sort of any reasonable estimate of the level that is “necessary” for the implementation of the Convention.

The **finance gap is likely to be even larger** if the mobilizing of funds includes repackaging existing funds; double-counting ODA; counting the full value of loans requiring repayment as “additional” finance; conflating carbon-market finance designed to meet their own mitigation commitments with financing for developing countries; counting the full value of funding through “innovative mechanisms” to which developing countries contribute; and/or conflating financing provided by developed countries with financing they “mobilize” from public and private sources in developing countries.

The challenge for Parties is **how to raise the level of ambition on financing and close the financing gap**, to ensure that the aggregate level of new and additional resources measures up to the yardstick of funding that is necessary for the implementation of the Convention. **Achieving this requires a more accountable and transparent system** for securing and validating compliance by developed countries with their financial commitments and mobilizing funding from both traditional and innovative sources.

2.4 Assessed contributions and “innovative sources”

The **responsibility for meeting financial commitments under the Convention lies with the developed countries** listed in Annex II of the Convention. Recognition in the Bali Action Plan of the need for “enhanced action on the provision of financial resources” is recognition of the need for enhanced efforts to implement these commitments.

The Convention's provisions relating to adequacy and predictability of financing (Article 4.3), as well as the need for "appropriate burden sharing among the developed country Parties" (Article 4.3), point to the **need for a more systematic method for assessing and allocating the responsibility among the developed countries** to provide adequate and predictable, new and additional financial resources. Such a basis must provide greater transparency and accountability.

A more systematic method should address financing on at least three levels:

- **The scale of financing required in aggregate.** As noted, this relates to the total scale of financing necessary for the implementation of the Convention and **the need for agreement first on the aggregate scale of financing required, and a clear metric against which to benchmark this level**. One approach, proposed by the G77 and China, is to denominate the necessary level of financing as a proportion of the GDP of the Annex I countries. A similar approach has been adopted by the international community in relation to ODA, which has been set in a UN General Assembly resolution and confirmed in other international instruments as the equivalent of 0.7% of GNI. Another approach, reflected in the Cancun decision is to denominate it in a specific currency (e.g. US dollars). A third approach would be to use a basket of currencies. The approach proposed by the G77 and China offers the advantages of not favoring a particular currency or currencies, and of avoiding risks associated with inflation and currency devaluation.

- **The contribution of individual developed countries to the aggregate amount of financing**. Ensuring **"appropriate burden sharing among developed country Parties" can be assured through the development of a scale of assessed contributions**, similar to the practice elsewhere within the United Nations. The Montreal Protocol, for example, uses the UN scale as the basis for contributions to the Multilateral Fund. Such an approach improves (though does not ensure) that financial contributions are adequate and predictable. And it facilitates an equitable allocation of the responsibility for meeting financial commitments.

- **The role of "innovative sources" of financing in contributing to the aggregate amount.** This reflects discussions among Parties of ways to harness non-traditional sources of financing (see box). The use of innovative sources provides one means to circumvent the traditional budgetary constraints faced by developed country governments, and provides a means to help them meet their commitments. **Funds raised through "innovative sources" could, for instance, be attributed to developed countries to assist them to meet a proportion of their assessed contributions**. Some innovative sources – such as special drawing rights or SDRs – offer considerable promise (notably the GEF explicitly allows contributing Parties to denominate their contributions in SDRs).[4] Some other innovative sources – such as levies on international air or marine

[4] Global Environment Facility, Instrument for the Establishment of the Restructured Global Environment Facility (Annexing International Bank for Reconstruction and Development, Executive Directors' Resolution No. 2006-0008), p. 89 at par. 5. For further information on SDRs as a source of climate finance *see*, ActionAid, *What are Special Drawing Rights and how can they be used to finance climate adaptation and mitigation?* (June 2010) and ActionAid/TWN, *Fruit of the Crisis: Leveraging the Financial & Economic Crisis of 2008-2009 to Secure New Resources for Development and Reform of the Global Reserve System,* January 2010, and Climate Analytics, *Climate Finance: Using SDRs to finance climate change mitigation and adaptation,* Briefing Paper, December 2009

> transport – may risk shifting the burden of financing to developing countries in a manner that is unfair and otherwise inconsistent with the provisions of the Convention. The appropriateness of each "innovative source", and the appropriate relationship between these sources and the commitments of developed countries, will require careful consideration on a case-by-case basis.

The High-Level Advisory Group on Climate Chance Finance, which was established by the UN Secretary-General, examined issues regarding sources of climate finance. The group was mandated to "conduct a study on potential sources of revenue for the scaling up of new and additional resources from developed countries for financing actions in developing countries." The Group's November 2010 report concluded it is challenging but feasible to mobilise $100 billion a year by 2020 to address the needs of developing countries. The sources analysed by the group and the annual amounts that can be raised include auctioning of allowances in domestic emissions trading schemes ($2 to 70 billion); global offset levies ($1-15 billion); revenues from taxes on international aviation ($1-6 billion); taxes on maritime emissions (2-19 bil), carbon tax ($10 bil), removal of fossil subsidies ($3-8 bil), redirection of fossil royalties ($10 bil), financial transactions tax ($2-27 bil), direct budget contributions (reference was made to the proposal of assessed contributions of 0.5 to 1% of GNP, which is $200-400 bil), net flows of development banks ($11 bil), net carbon market offset flows (8-14 bil). Obviously this is only a listing of sources that have been examined, with amounts based on certain assumptions, and not a proposal by or accepted by governments.

An important issue not in the above list is the use of Special Drawing Rights (SDRs) for purposes of supporting developing countries for sustainable development activities. The G20 in its London Summit in 2009 agreed that the IMF would issue $250 billion of SDRs as a means of increasing liquidity to counter recessionary trends arising from the global financial crisis, and this was subsequently implemented at the IMF. As the issuance was to countries in accordance with the IMF quotas, developing countries obtained only a small share of the allocation. The G77 and China proposed that there be periodic issuance of SDRs to provide resources to developing countries in need of liquidity due to the financial crisis. Subsequently several countries, individuals and organisations have proposed the use of SDR issuance for various uses, including to fund climate change actions in developing countries. This should be considered further, especially in a period when government budgets in developed countries are coming under stress, affecting the ability or will to increase budgetary support to developing countries.

In the context of ongoing negotiations, Parties should seek to implement the accountable, transparent and principled approach envisaged in the Convention, in which the Conference of Parties and the operating entity of the financial mechanism establish arrangements for the "determination in a predictable and identifiable manner of the amount of funding necessary and available for the implementation of this Convention and the conditions under which that amount shall be periodically reviewed". Ultimately, **the provision of assessed contributions drawing on *both* traditional sources and "innovative sources" will be required as part of the major effort to scale up financial resources** in order to cope with the adverse effects of committed climate change, and to curb emissions by 2015 or 2020 and avoid further dangerous interference with the climate system.

2.5 Contributions through bilateral, regional and other multilateral channels

The Convention envisages the provision of financial resources for the implementation of the Convention through its financial mechanism established in Article 11 (see box). It also states:

> The developed country Parties may also provide and developing country Parties avail themselves of, financial resources related to the implementation of the Convention through bilateral, regional and other multilateral channels (Article 11.5).

The relationship between financial resources provided through the financial mechanism and its operating entities, and financial resources that "relate to the implementation of the Convention" through bilateral, regional and other multilateral sources, requires further consideration as part of a coherent architecture.

It is clear from the provisions of the Convention that **the principal means for providing climate finance is the Convention's financial mechanism**, with "other channels" providing resources "related to the implementation of the Convention". The Conference of Parties has addressed the appropriate relationship between the financial mechanism and activities outside the mechanism:

> Consistency should be sought and maintained between activities (including those related to funding) relevant to climate change undertaken outside the framework of the financial mechanism and the policies, programme priorities and eligibility criteria for activities as relevant, established by the Conference of the Parties. (Decision 11/CP.1)

How consistency is achieved in practice requires further consideration, and is addressed in the South Centre's submission on Workstream 2.

Article 11: Financial Mechanism

1. A mechanism for the provision of financial resources on a grant or concessional basis, including for the transfer of technology, is hereby defined. It shall function under the guidance of and be accountable to the Conference of the Parties, which shall decide on its policies, programme priorities and eligibility criteria related to this Convention. Its operation shall be entrusted to one or more existing international entities.

2. The financial mechanism shall have an equitable and balanced representation of all Parties within a transparent system of governance.

3. The Conference of the Parties and the entity or entities entrusted with the operation of the

financial mechanism shall agree upon arrangements to give effect to the above paragraphs, which shall include the following:

(a) Modalities to ensure that the funded projects to address climate change are in conformity with the policies, programme priorities and eligibility criteria established by the Conference of the Parties;

(b) Modalities by which a particular funding decision may be reconsidered in light of these policies, programme priorities and eligibility criteria;

(c) Provision by the entity or entities of regular reports to the Conference of the Parties on its funding operations, which is consistent with the requirement for accountability set out in paragraph 1 above; and

(d) Determination in a predictable and identifiable manner of the amount of funding necessary and available for the implementation of this Convention and the conditions under which that amount shall be periodically reviewed.

3. Delivery and Uses of Funds

Ensuring clarity about how financial resources will be accessed and applied in practice and the results they will achieve is a principal concern of donors and recipients alike. Ensuring the effective use of climate finance requires, among other things, streamlined procedures for accessing it, effective and accountable national institutions, and arrangements for engaging relevant stakeholders in the design and implementation of activities. Key issues to be addressed include:

- How to ensure **direct access to funds** while enabling the support of regional or multilateral agencies if developing countries so desire?
- What **categories of activities** should be covered (e.g. projects, programmes, plans)?
- Which **countries** are eligible for funding and how should needs be prioritized in practice?
- How should **other entities** be involved, including international, regional and non-governmental organizations?
- What **arrangements at the national level** can help to catalyze and support effective action?

3.1 Providing the option of Direct Access

Developing countries have identified the need for direct access to funds. Direct access has the following advantages: it streamlines the use of financial resources, improves efficiency and effectiveness, and circumvents the challenges that have arisen with the current system.

Among other things **this demand reflects many developing countries' experience with the GEF** and the challenges of accessing financial resources through the participation of "implementing agencies" such as the World Bank, regional development banks and various UN agencies. As early as 1996, the Conference of Parties adopted a decision:

> *Expressing concern* over the difficulties encountered by developing country Parties in receiving the necessary financial assistance from the Global Environment Facility owing to, *inter alia*, the application of the Global Environment Facility operational policies on eligibility criteria, disbursement, project cycle and approval, the application of its concept of incremental costs, and guidelines which impose considerable administrative and financial costs on developing country Parties[5]

Concerns have been repeated in subsequent decisions of the Conference of Parties. As recently as 2008, the Conference of Parties invited the GEF "to consider the views of, and any concerns expressed by, Parties regarding their current experiences with the Global Environment Facility and its implementing agencies in relation to the provision of financial support for the preparation of national communications from non-Annex I Parties…"[6]

In terms of institutional examples of direct access to funding, **the Adaptation Fund allows eligible Parties to submit their project proposals directly to the Adaptation Fund Board** and provides that implementing or executing entities chosen by governments that are able to implement the projects funded under the Adaptation Fund may also approach the Adaptation Fund Board directly (Decision 1/CMP.3). This approach offers host countries the flexibility to access funds directly, to use the services of a multilateral entity, or to nominate an appropriate regional or sub-regional entity to support them (the approach is discussed further below under "eligible entities").

3.2 Plans, programmes and projects eligible for funding

The Fund Instrument or subsequent guidelines will need to provide direction on coverage of the **plans, programmes and projects that are eligible for financial resources in each of the thematic areas** that are covered by the Fund.

In each thematic area, **eligibility criteria** will be required to provide clear guidance on the types of activities that are entitled to the provision of financial resources. These will need to be tailored to reflect:

[5] UNFCCC, *Guidance to the Global Environment Facility,* Decision 11/CP.2 1996

[6] UNFCCC, *Additional Guidance to the Global Environment Facility,* 7/CP.13, 2008 (The GEF's inadequate response to guidance issued by the Conference of Parties arises from a number of factors, including that it serves a range of Conventions under the authority of the GEF Council, rather than operating directly under the authority of the Conference of Parties. The GEF has recently sought to enhance access to financing. The extent to which it has addressed the concerns identified by developing countries in practice will need to be evaluated in further reviews of the financial mechanism.)

- **The specific thematic area.** The eligibility criteria for forest-related activities, for example, will differ from those for renewable energy, transportation or agriculture. Clear criteria tailored to each thematic area will help to target financing and facilitate access.
- **The scale of activity.** Within each thematic area, eligibility criteria will need to reflect requirements of activities at different levels (e.g. project, programmatic and national planning levels).

As is the case with other funds, enhanced financial resources through the GCF should enable **activities at a range of different levels** including:

- **Specific concrete projects.** Financial resources will be required to enable individual projects comprising a set of specific, concrete activities that are defined clearly in terms of their scope, timing and expected results.
- **Larger overarching programmatic initiatives.** Financial resources will be required to support the development of a program of specific investments and activities within a specific thematic area such as adaptation, forest management, renewable energy, transportation, agriculture and other relevant sectors.
- **Integrated national climate plans.** In many cases, financial resources will also be required to enable developing countries to strengthen their efforts at the cross-sectoral and national level to integrate climate change into relevant economic and social development planning.

A **streamlined approval process** will enable effective disbursement of financial resources. One key component is the distinction between small and large-scale activities, with simplified criteria and procedures for small-scale activities. Additionally, to streamline access funding approvals can be made by the mechanism on an intercessional basis, and communicated via mail or other media, as is the case with the Climate Investment Funds.

In practice, the capacity of developing countries to raise and programme financial resources will depend on effective national organization and planning. As a result, many developing countries have developed (or are in the process of developing) **comprehensive national initiatives** to address climate change with the support of new and additional financial resources. By setting clear national objectives, and defining specific projects and programmes for funding, these can improve the capacity of developing countries to access resources in practice.

3.3 Eligible countries

It is clear under the Convention that **all developing countries are eligible to receive financial resources.** Article 4.3 of the Convention refers to the provision of financial resources to "developing country Parties" without offering a distinction among developing countries as to their eligibility for financial resources.

Consequently, all developing countries are entitled to receive financial resources for the implementation of measures set out in Article 4.1 – including those relating to adaptation, mitigation (including forests), technology development and transfer, and capacity building – as well as for national communications in accordance with Article 12.1. In so far as activities are covered by these Articles, **any attempt to formally narrow the category of countries eligible for financing runs counter to the letter and spirit of the Convention** (e.g. through new language specifying a subset of countries). It also runs counter to the Bali Action Plan, which mandates negotiations to implement (not to alter) the Convention.

At the same time, the Convention calls for **consideration of the specific needs and concerns of countries in certain situations**. It states, for example, that developed countries "shall also assist the developing country Parties that are particularly vulnerable to the adverse effects of climate change in meeting costs of adaptation to those adverse effects" (Article 4.4). It calls for full consideration of actions necessary to meet the "specific needs and concerns" of countries in certain vulnerable situations (Article 4.8, see box). And it requires full account of the "specific needs and special situations" of the least developed countries (Article 4.9).

Striking a balance between these requirements – i.e. the rights of all developing countries and the needs of those in specific situations – is **best achieved at an operational level through Fund guidelines and other modalities**.[7] The Adaptation Fund Board, for instance, has discussed a range of practical ways to prioritize allocation if resources are not sufficient to meet demand. Responding at an operational (rather than legal) level reduces the risk of narrowing the rights of developing countries under the Convention, while enabling approaches that are tailored to the needs and concerns of countries in different thematic areas, as well as the needs and concerns of identified categories of countries (e.g. the LDCs).

Article 4.8 of the Convention

In the implementation of the commitments in this Article [4], the Parties shall give full consideration to what actions are necessary under the Convention, including actions related to funding, insurance and the transfer of technology, to meet the specific needs and concerns of developing country Parties arising from the adverse effects of climate change and/or the impact of the implementation of response measures, especially on:

(a) Small island countries;

(b) Countries with low-lying coastal areas;

(c) Countries with arid and semi-arid areas, forested areas and areas liable to forest

[7] The tendency to seek to formalize new categories of countries – such as a new "most vulnerable country" grouping – is difficult to reconcile either with the provisions of the Convention or with the collective long-term interest of developing countries. A better approach is to address the needs of developing countries through guidelines (e.g. on vulnerability) to be applied pragmatically at an operational level as has been the approach preferred under the Adaptation Fund.

decay;

(d) Countries with areas prone to natural disasters;

(e) Countries with areas liable to drought and desertification;

(f) Countries with areas of high urban atmospheric pollution;

(g) Countries with areas with fragile ecosystems, including mountainous ecosystems;

(h) Countries whose economies are highly dependent on income generated from the production, processing and export, and/or on consumption of fossil fuels and associated energy-intensive products; and

(i) Landlocked and transit countries.

Further, the Conference of the Parties may take actions, as appropriate, with respect to this paragraph.

3.4 Eligible entities

As well as defining the basis upon which countries are eligible for funding, the Fund Instrument or associated guidelines should define the **entities eligible to submit proposals and to receive, manage and spend financial resources**. Eligible entities will typically be national legal entities formally nominated by the Parties, but a range of options is possible:

- **Official national entities**. A government ministry or ministries will typically serve as the official national entity for the purposes of engaging with the Fund (i.e. submitting proposals, receiving financial resources, reporting etc). This may also extend to inter-ministerial commissions and government cooperation agencies, as is the case under the Adaptation Fund.[8]
- **Sub-regional or regional entities.** Under the Adaptation Fund, a group of Parties may also nominate sub-regional and regional entities as implementing entities.[9] Under the SCF, funds are allocated to multilateral development banks before being disbursed to countries on a regional basis.[10]
- **Multilateral implementing entities.** In a number of funds, multilateral agencies are empowered to seek financial resources on behalf of countries. In the case of the Adaptation Fund, for example, multilateral implementing entities must receive an endorsement from a government who selects their services for use.[11]
- **Non-government entities**. For certain thematic areas or categories of activities (e.g. small grants) approved non-government entities could be entitled to propose activities for financial support.

[8] Adaptation Fund Board, *Operational Policies and Guidelines for Parties to Access Resources from the Adaptation Fund*, p. 6, par. 26
[9] *Id.,* at par. 28
[10] Climate Investment Funds, *Governance Framework for the Strategic Climate Fund*, p. 14, par. 49 and 50
[11] *Id*.

In all cases, the principal entity – usually a national agency that is officially appointed – would need to be approved by the Fund Board and satisfy certain basic fiduciary standards agreed collectively. Ultimately, **the agreed entity will bear final responsibility** for the overall management of the financed activities and for compliance with relevant financial, monitoring and reporting responsibilities.

4. Distinguishing between Public and Private Sector Financing (including Carbon Markets)

Ensuring clarity about financial resources requires an effort to distinguish clearly between resources from public and private sources. It requires addressing the apparent tendency (intentional or otherwise) to conflate the two. This tendency is reflected, for example, in the language of the Cancun decision, which states that developed countries commit "to a goal of jointly mobilizing USD $100 billion a year by 2020 … from a wide variety of sources, public and private …"

Both public and private financing is required to address climate change. But their role is distinct and should remain so. **This distinction is particularly important when the proposed source of private finance is a "carbon market".** Public sources finance emission reductions for the *developing countries* (i.e. supports emissions reductions by and for them, and that are attributed to them). By contrast, **carbon markets finance emission reductions for the *developed countries*.** Carbon markets, by "offsetting" the developed countries' emissions (i.e. the reductions are attributed to the developed country and not the developing country where the actual reductions take place) actually enable *developed countries* to meet their emission reduction targets, and to do so where it is cost-effective to them (i.e. in developing countries).

It is thus desirable for Parties to clearly distinguish:

- The emission reductions that are to be attributed to the developing countries (e.g. via their NAMAs), and emission reductions that are to be attributed to the developed countries to meet their targets (e.g. via offsetting through the CDM);
- The nature and level of financing that is necessary and available to assist developing countries and their relationship to specific provisions of the Convention; and
- The adequacy of these in light of the provisions of the Convention, and the other elements of the negotiations, including elements of the shared vision (and associated distribution of the carbon budget) of which they are to be a part.

Doing so will improve transparency and enable a more accurate determination by Parties "in a predictable and identifiable manner of the amount of funding necessary and available for the implementation of [the] Convention" (as required by Article 11.3(d)).

5. Engaging with the Private Sector and Other Economic Players

One of the issues put forward in Workstream 3 is how to mobilize and leverage private sector finance. The larger issue is the framework for engaging with the private sector.

With regards to the private sector in developed countries, they should be welcomed to make contributions and donations to the Fund. This goes as well for philanthropic foundations established by corporations or their owners.

However, resources of the Fund should not be used for subsidizing corporations or financial institutions of developed countries, as the Fund is established to provide resources to developing countries. Thus, the types of subsidies and incentives provided by governments in developed countries to the private sector (such as subsidies for R and D, subsidies or bail-outs linked to production of climate-friendly motor vehicles, tax breaks, subsidies for renewable energy) should continue to be financed by developed countries, as also the subsidy or concessional element that may exist in provision of funding to financial institutions that provide loans or guarantee loans provided to developing countries.

In the WTO, developed country members are obliged to provide incentives to their enterprises and institutions to promote and encourage technology transfer to LDCs, under article 66.2 of the TRIPS Agreement. The developed countries are expected to meet this obligation through their own financial resources, and not through a fund in the WTO.

Another type of private financing that is frequently referred to is the payment by companies for offsetting in the carbon trade. As discussed in Section 4 this should not be counted as part of the developed countries' commitment in the UNFCCC.

The engagement with the private sector and other economic actors in developing countries is of paramount importance, since the Fund aims to provide resources that can transform the economies and societies of developing countries onto an environmentally sound path. The Fund should thus encourage governments in developing countries to make use of a variety of instruments to engage with the big companies, small and medium enterprises, the urban informal sector, and the rural farmers, to be involved with the national efforts for mitigation, adaptation, technology development, capacity building and institutional development.

A variety of financing instruments such as subsidies, tax breaks, cheaper loans, public investment in agricultural programmes, will have to be employed in order to incentivize the economic units of developing countries. The incremental cost to the private sector to make changes for mitigation or adaptation, and various types of the relevant public-sector expenditure in incentivizing the private economic units, may legitimately be financed through the Green Climate Fund.

Appropriate financial instruments would have to be used for different types of uses and users. For example:

- A private company being asked to switch from a heavy-emitting machine to a new low-carbon machine may have to be financed partly by concessional loan and partly by a grant component, for the incremental cost to it for discharging the remainder of the loan taken earlier for the first machine, and for taking a loan for the new machine;

- Small farmers who are advised to shift from agriculture practices that result in heavy Greenhouse Gas emissions to a climate-friendly practice may have to be subsidized by the government that provides the new tools, inputs and land use practice. The government in turn may have to be financed through a grant from the Green Climate Fund.

- Adaptation activities that do not yield a commercial return would have to be paid for by government, and this requires a grant-based allocation from the Green Climate Fund.

- The government, to promote the use of renewable energy, embarks on a feed-in tariff scheme which requires it to provide a subsidy to be given to the renewable energy producers who are paid at a rate higher than the rate charged to the users of the power they generate. The Green Climate Fund could consider financing the subsidy element in the feed-in tariff scheme.

The climate actions in developing countries, which the GCF aims to stimulate and support, will require a framework and set of arrangements with the private sector and the economic units in developing countries, with suitable instruments and financing scale. This would be part of the planning process in the developing countries, and the Fund should be pro-active in understanding, encouraging and supporting the process.

6. Maintaining a balance of rights and obligations

The Fund should in its principles and operations be cognizant of and be in accordance with the rights and obligations of Parties under the Convention. The Convention includes a **balanced set of rights and obligations that together reflect a package of commitments**. The importance of all provisions and principles of the Convention was reaffirmed by all Parties in the Bali Action Plan when they resolved to "urgently enhance implementation of the Convention" through a comprehensive process including a shared vision "in accordance with the provisions and principles of the Convention".

In this context, elements of the balance relating to finance include:

- **The categories of countries eligible for financial resources**: e.g. all "developing countries" relating to provision of financial resources for national communications and implementation of Article 4.1 (see Article 4.3), and technology transfer (Article 4.5);

"countries that are particularly vulnerable" for costs relating to adverse effects (see Article 4.4), etc;

- **The categories of costs to be covered**: e.g. national communications; implementation of measures in Article 4.1 (national programmes, technology transfer, forests and other sinks etc)(Article 4.3); costs of adapting to adverse effects (Article 4.4); technology (Article 4.5), etc; and
- **The level of financial resources to be provided**: e.g. "agreed full costs" and "agreed full incremental costs" (Article 4.3); the need for "determination in a predictable and identifiable manner the amount of funding necessary and available for the implementation of the Convention (Article 11.3(d)), etc.

In this regard, **efforts to alter rather than honor this balance of rights and obligations seems likely hamper rather than help the negotiations** – particularly in light of the concerns regarding implementation that led to agreement of the Bali Action Plan. Of particular concern are the efforts by some Parties to change the categories of countries eligible for financial resources – for example through the tendency to narrow existing categories of countries (e.g. from "particularly vulnerable" to "most vulnerable") or establish new categories of countries (e.g. "major emitters").

Doing so risks leaving so-called "major emitters" with inadequate resources for adaptation, or "most vulnerable countries" with inadequate resources for mitigation, or middle income countries – which fit neither category – with inadequate resources for either. It threatens to politicize discussions and increase the threat, recognized in the Bali Action Plan, that "delay in reducing emissions significantly constrains opportunities to achieve lower stabilization levels and increases the risk of more severe climate change impacts."

To the extent that **practical decisions need to be made about prioritizing financing, these are best undertaken through guidelines agreed by the fund Board, under the guidance of the COP, and not through attempts to formalize new country categories** – which seem likely to create further delay rather than unlock the cooperative efforts required to move discussions forward and enhance cooperative action in practice.