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# New Finance for Climate Change and the Environment

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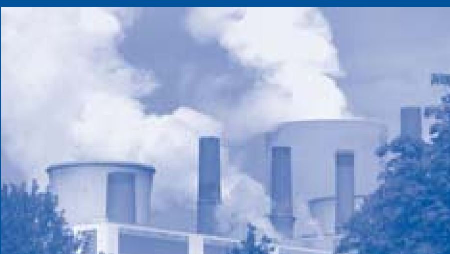

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As always, responsibility for the content of this report rests with the authors alone. In particular, no responsibility for the opinions here expressed should be attributed to WWF or the Heinrich Böll Foundation.

## LIST OF ABBREVIATIONS

| | |
|---|---|
| AfDB | African Development Bank |
| ADB | Asian Development Bank |
| AFB | Adaptation Fund Board |
| BioCF | BioCarbon Fund (of the WB) |
| CDM | Clean Development Mechanism |
| CEIF | Clean Energy Investment Framework |
| CERs | certified emission reductions |
| CIF | Climate Investment Fund |
| COPs | Conference of the Parties |
| CTF | Clean Technology Fund (one of the WB's Climate Investment Funds) |
| DAC | Development Assistance Committee |
| DEFRA | Department for Environment, Food and Rural Affairs |
| DfID | Department for International Development of the UK |
| DG | Directorate General |
| EBRD | European Bank for Reconstruction and Development |
| EC | European Commission |
| ENRTP | Environment and Natural Resources Thematic Programme |
| ETS | Emission Trading Scheme |
| EU | European Union |
| ETF-IW | Environmental Transformation Fund – International Window (UK) |
| FAO | Food and Agriculture Organization of the United Nations |
| FCPF | Forest Carbon Partnership Fund (WB) |
| GCCA | Global Climate Change Alliance (of the EC) |
| GEF | Global Environment Facility |
| GHG | greenhouse gas |
| GIFC | Global Initiative on Forest and Climate (of the Australian Government) |
| IADB | Inter-American Development Bank |
| IBRD | International Bank for Reconstruction and Development |
| IDA | International Development Association |
| IFAD | International Fund for Agricultural Development |
| IFC | International Finance Corporation |
| LDC | Least Developed Country |
| LDCF | Least Developed Country Fund |
| MDBs | Multilateral Development Banks |
| MDG | Millennium Development Goals |
| NAPA | National Adaptation Programmes of Action |
| NGO | nongovernmental organization |

| | |
|---|---|
| ODI | Overseas Development Institute (London, UK) |
| ODA | official development assistance |
| OECD | Organisation for Economic Co-operation and Development |
| POP | Persistent Organic Pollutant |
| PPCR | Pilot Program for Climate Resilience (under the SCF) |
| RAF | Resource Allocation Framework (of the GEF) |
| REDD | reducing emissions from deforestation and forest degradation |
| SCCF | Special Climate Change Fund |
| SCF | Strategic Climate Fund (of the WB) |
| SFM | sustainable forest management |
| SIDS | Small Island Development State |
| TFA | Tropical Forest Account (of the GEF) |
| UN | United Nations |
| UNCBD | United Nations Convention on Biological Diversity |
| UNCCD | United Nations Convention to Combat Desertification |
| UNDP | United Nations Development Programme |
| UNEP | United Nations Environment Programme |
| UNFCCC | United Nations Framework Convention on Climate Change |
| UNIDO | United Nations Industrial Development Organization |
| WB | World Bank |

## PRESENTATION

The world has moved beyond simple acknowledgement that climate change and environmental degradation pose significant risks to humanity and the planet's ecosystems. In recognition of the increased vulnerability of billions of people, mostly in the developing world, Northern donors have pledged billions of dollars in new financial commitments. Those funds are to be delivered through no fewer than a dozen new environmental funding mechanisms seeking to mitigate these risks and to help the most vulnerable to adapt to coming societal and environmental changes.

As we have watched these funds and financial mechanisms take form over the past year, it has become apparent that the new funds are not yet articulated in an overarching strategic framework. Nor have many of the funds' sponsors articulated how they would comply with an agreed set of principles regarding effectiveness, equity and fairness, and efficiency between the global North and South. For example, while the intent may exist, there is no uniform call that the disbursed funds must be part of and integrated into an overall development strategy articulated by participating countries. Country ownership, harmonization of donor activities, and mutual accountability of all partners have not been established as foundational principles of the funds. And methods to reduce transaction costs for recipients, improve donor-recipient dialogue and in-country effectiveness have not been articulated.

It is hard to escape the impression that, in the rush to do good, the governments, and in particular donor governments, have risked overlooking many of the hard learned lessons and best practices that have been adopted for other development and environment purposes. This is profoundly troubling. The environment and vulnerable people depending on environmental goods and services for their livelihoods are in dire need of an overarching strategy framework to help guide, prioritize and harmonize the various mechanisms for funding environment and climate change. In equal measure, it is imperative that the funds ensure coherence with other dimensions of sustainable development and comply with accepted international principles on aid effectiveness. At the very time when the international community needs to bring together the disparate elements, institutions, conventions and agreements in a strategic framework, donor governments seem to have opted for a disjointed approach that encourages fragmentation of the global response, much to the detriment of effectiveness and efficiency.

WWF and the Böll Foundation strongly embrace the provision of new financial resources to address the urgent challenges of climate change, environmental degradation and their impact on vulnerable people. By commissioning this paper, *New Finance for Climate Change and Environment*, it is our hope that we can help clarify major recent developments in environmental and climate finance while contributing to a productive global dialogue about the opportunities and challenges offered by those new financial commitments. We hope that the research will broaden public understanding of and engagement in the global discourse about the more than one dozen new funds and their interplay with existing financial mechanisms. Together, we also plan to sponsor a number of public seminars and consultations in both northern and southern capitals to encourage active involvement of stakeholders and concerned parties in shaping the final institutional architecture for environment finance.

We would like to point out several factors that shaped the final outputs of this study. It was our original hope that the research would provide information and reveal a consistent set of patterns that might suggest ways of harmonizing and building mutually supportive relations among the new and existing funds. Such information and patterns, we hoped, would facilitate a dialogue among many stakeholders from which a more coherent, integrated architecture would emerge. We also hoped that

this analysis would reveal how new financial commitments would also address some of the underlying questions of moral obligation and fairness between the North and South which, in turn, could guide overall financial commitments under a future post-Kyoto climate agreement. That aspiration has been frustrated by several factors, not the least of which is the fact that many of the new funds exist only as general statements of commitment. Yet to be defined for many funds are the real levels of financial commitment, operational strategies, implementation modalities, funding priorities as well as a host of specific operational guidelines. As a consequence, suggesting a coherent architectural blueprint must await another day. Moreover, the study has necessarily focused on existing funding mechanisms, notably the Global Environment Facility and the World Bank, that are already and are likely to remain central architectural pillars.

A second consideration that has shaped the study is that, up to the present, many of the actual decision making processes regarding the new funds have unfolded in northern, donor countries with comparatively limited influence of developing country governments and institutions. As a consequence, many of the complex political issues that have shaped development of other financial mechanisms, such as the Montreal Protocol Multilateral Fund, the Global Environment Facility and, most recently, the UNFCCC's Adaptation Fund, have not yet come fully into play. Among the long-standing issues that set the political background we would include: What constitutes "new and additional" funding as opposed traditional overseas development assistance? What are the "common but differentiated responsibilities" between north and south? What are the fairness and equity considerations that must underlie financial flows? Public discussion about the funds in developing countries has risen steadily in past months, including submission of specific proposals regarding the structure and operation global funding mechanisms. While the study recognizes these underlying political issues and growing contributions and perspectives from developing countries, it is not able to offer a comprehensive analysis of how such considerations have shaped the emerging architecture.

We are deeply grateful to Gareth Porter and colleagues from the Overseas Development Institute (Neil Bird, Leo Peskett, Nanki Naur) for their persistence in ferreting out information from the many government offices and for their willingness to take on board and integrate into their analysis constantly changing updates about the funds. While we recognize that much of the information provided herein may change, we believe that their framework and analysis provide a sound foundation to track and respond to new developments as they unfold in coming months.

For WWF and the Heinrich Böll Foundation,

| | |
|---|---|
| David Reed | Barbara Unmüßig |
| Director | Co-President |
| WWF, Macroeconomics Program Office | Heinrich Böll Foundation |

## EXECUTIVE SUMMARY

Fourteen international funding initiatives have been announced over the past 18 months, all of which are aimed at addressing global environmental issues. This sudden proliferation of funds is unprecedented and warrants examination. Clearly, the need to respond to the threat of climate change has become an increasingly important international policy concern, particularly as it has become evident that those most likely to be affected soonest and most severely are the poorest people living in developing countries.

This paper begins by describing the existing architecture with regard to international funding for environmental actions, focusing on two pre-eminent institutions within this architecture: the Global Environment Facility (GEF) and the World Bank. In many respects, the current situation is tending to move the locus for strategy development and funding decisions for climate-related international investments away from the former and toward the latter. One reason for this shift is the limited impact that the existing system has had in addressing climate change issues, and more broadly, its limited success in channeling sufficient funding to address major environmental concerns such as tropical deforestation. The present system has so far failed to deliver transformational change for the global environment.

The desire to achieve more immediate impacts is a major driving force behind the donor countries' interest in creating new funding mechanisms, as first signaled at the 2005 G-8 Summit meeting in Gleneagles – and likely to be repeated at the 2008 G-8 meeting in Hokkaido Toyako. The document reviews eight new bilateral funds and six multilateral funds established to address the challenges related to climate change. Each of these new funding initiatives is described, focusing on three characteristics: (i) stated objectives; (ii) means of financing and disbursement; and (iii) aspects of fund governance. This latter aspect is a key concern, taking into account the considerable sensitivity associated with the way funds will be controlled and disbursed.

All of the funds aim to help developing countries address the challenges associated with a changing climate. Yet, in most cases, there appears to have been only limited involvement of potential recipient countries in the design of these funds. At the same time, most of the funds have a limited time horizon, with no commitments being made beyond 2012, the anticipated date for entry into effect of a post-Kyoto agreement. This short timescale is significant because it provides an opportunity for "piloting" new approaches rather than establishing any new long-term architecture for global environmental funding. There is therefore an important window of opportunity in which to try out new approaches and methods to secure the necessary financing for actions that respond to a changing climate around the world. Much will depend on how the various key players manage this development phase. Complementarity and synergy among the various initiatives needs to be secured within the United Nations Framework Convention on Climate Change (UNFCCC) framework, underpinned by an understanding between those funding these initiatives and the national governments in countries where activities will be undertaken.

Three new World Bank–managed funds signal an institutional ambition to respond to this challenge. All three funds, however, mirror similar funding schemes managed by the GEF and therefore raise the prospect of duplication of effort. The situation is further complicated by the involvement of bilateral funds in each of these three key areas: supporting low carbon technologies, pursuing climate change adaptation efforts and reducing emissions from deforestation and forest degradation. For example, leveraging finance to encourage the adoption of low carbon technologies is an objective of a number of the funds reviewed. Although there are obvious differences between the activities of the proposed

World Bank Clean Technology Fund (CTF) and the GEF's existing funding for the elimination of barriers to energy-efficient and renewable technologies, it is clear that there is substantial overlap between them as well. For example, activities that are supported by the CTF, as well as the GEF, are providing: (i) positive incentives for the demonstration of low carbon development and mitigation of greenhouse gas emissions through the public and private sectors; (ii) the diffusion and transfer of clean technologies by funding low carbon programs and projects that are embedded in national plans and strategies to accelerate their implementation; and (iii) promoting realization of environmental and social co-benefits thus demonstrating the potential for low carbon technologies to contribute to sustainable development and the achievement of the Millennium Development Goals. Furthermore, the channeling of funding by donor countries through the CTF might be at the expense of funding the GEF's climate-related priorities and might have the effect of significantly reducing World Bank participation in the GEF.

As to the future of the GEF, much will depend on how it reacts to this new financial landscape. Responding to new opportunities, however, will require some changes in the organization.

Policy coherence is also badly needed among the new funds and between the globally agreed priorities on climate change and relevant national policy frameworks. The level of alignment with country systems is not yet clear, although much can be learned from the experience with development funding and the implementation of the Paris Declaration on Aid Effectiveness. A significant level of flexibility is needed in these international funds to ensure that their areas of intervention are consistent with nationally defined priorities.

The early stage of development of these new funds means that some questions can only be raised, rather than answered. Whether the pledged financial resources will be additional to existing official development assistance (ODA) commitments is one issue about which civil society has expressed active concern, but as yet, no clear response has been provided.

The international community is therefore clearly at a crossroads with regard to establishing a harmonized financing approach. The proliferation of new funds and funding mechanisms over the past year coupled with the deployment of those funds through certain institutions, notably the World Bank, is bringing about incremental, yet fundamental, change in the existing architecture for global environmental finance. This apparently ad hoc approach in responding to mounting environmental problems has generated real and potential competition among agencies that could lead to less efficient distribution and use of funds.

There are frequent reports that other European governments are preparing to launch additional funds related to climate. Given the already considerable confusion among recently announced funds, these new funding entrants will certainly intensify the lack of cohesion and dysfunction among this patchwork quilt of funding mechanisms. To date, there has been no effort to harmonize the new funds and their respective approaches into a coherent system. As a consequence, international agencies have launched into the quickly changing institutional dynamics seeking to maximize their respective institutional interests, rather than seeking the greatest global benefit. Clearly, out of such a competition, winners and losers will emerge, and without a harmonized financial architecture, the benefits for the global environment will remain suboptimal.

In this context, three clear conclusions stand out:

- First, every major institution involved in this restructuring of the global financial architecture will undergo fundamental change. Donors must broaden the mandate and strengthen the institutional arrangements of the GEF as the financial mechanism of the UNFCCC, or the facility will be relegated to an insignificant status in the international environmental sphere. The World Bank must dramatically reform its governance systems, its transparency and its internal incentives to meet the international environmental norms that have evolved over the past decades. The many agencies of the United Nations development system must likewise shed their bureaucratic legacies to become more responsive, flexible contributors in response to emerging problems. Changes such as these are inevitable in the coming months and years.

- Second, the dynamics surrounding these new entrants in the international financial architecture have been limited to interactions among donor countries and to Northern stakeholders since they are not negotiated within the framework of the UNFCCC. This is attributable, to a certain degree, to the lack of information about the proliferation of funds and the potential consequences of this multiplicity of funding mechanisms. Moreover, for lack of a timely policy vehicle or institutional mechanism, voices of the global South seldom have been forcefully heard in the early stages of the public debate. This can be expected to change in the coming months and, as these voices emerge more strongly, public dynamics will undergo considerable change and additional institutional reforms in the emerging architecture will become certain.

- Third, an overarching process of harmonization is urgently needed. To the degree that individual donors feel that the uniqueness of their funding mechanisms can be protected and rendered operational, the need for harmonization can be ignored for the time being. However, as the publicly announced funds are translated from statements of commitment into operational terms that include geographic priorities, funding processes and qualifying criteria, the overlaps, redundancies, competing views and lack of synergies will become increasingly apparent. A harmonization process initiated sooner rather than later, and supported within the UNFCCC framework, will deliver benefits to donors and recipients alike and significantly increase their combined benefits for the global environment and human enterprise.

# 1. INTRODUCTION

In 2007, the proposed architecture for financing global environmental actions saw rapid change. With climate change arriving center stage of the international policy agenda, an unprecedented 14 new funding initiatives were announced. This sudden proliferation of global environmental funds is not intended to replace the existing funds administered by the Global Environment Facility (GEF) on behalf of the United Nations Framework Convention on Climate Change (UNFCCC).[1] Nevertheless, it represents a major challenge to the existing system and raises a series of questions about the future architecture of global environmental finance – especially what role and functions the GEF should play in that structure. One key concern revolves around the question of how funding to address climate change will be spent – and, more important, who will make those decisions. The history of the system of global environmental finance is one of conflict and compromise over those issues. This present stage of development of the international funding system poses questions about renegotiating some of those compromises.

This paper describes recent developments and trends in global environmental finance. Its aim is to—

- map out the new environmental funds in terms of their objectives, funding and institutional arrangements;
- identify factors that seem to be shaping the development of these funds;
- provide an initial analysis of the potential for duplication, complementarity or synergy between or among new funds and between new funds and existing funds; and
- critically examine the dynamics between the GEF and the Multilateral Development Banks (MDBs) and their changing roles as the central institutions in financing measures for global environmental benefit, particularly with regard to climate.

The paper focuses on new funds developed within the public sector (and largely with public money) rather than private sector initiatives. These include multilateral funds administered through the MDBs and United Nations (UN) organizations, the UN climate convention, the GEF and bilateral funds from donor governments.

[1] The GEF is the financial mechanism of the UNFCCC.

## 2. EXISTING ARCHITECTURE OF GLOBAL ENVIRONMENTAL FUNDS

Existing sources of global environmental finance include national government spending, national private sector spending, foreign direct investment, international debt and official development assistance (ODA). Globally, the private sector constitutes the largest share of investment and financial flows needed to address climate change, at approximately 86 percent of all such flows (UNFCCC, 2007). In stark contrast, ODA funds are currently less than 1 percent of global investment (UNFCCC, 2007). However, these funds target poor, aid-receiving countries and provide considerable resources for those most vulnerable to climate change.

ODA includes several funding streams to channel finances to developing countries to help them address environmental issues.[2] These include—

- the financial mechanism of the Rio Conventions, specifically the GEF;
- the MDBs, including the World Bank, Asian Development Bank and so on; and
- bilateral ODA.

This section describes these three elements and briefly reviews their strengths and weaknesses.

### 2.1 The Global Environment Facility

The GEF is at the center of the existing system of financing programs and projects to protect the global environment. The *GEF Instrument* states that "the GEF . . . shall operate for the purpose of providing new and additional grant and concessional funding to meet the agreed incremental costs of measures to achieve agreed global environmental benefits in the GEF focal areas." It has provided primarily grants and to a lesser extent concessional funding to recipient countries for projects and programs that have the explicit purpose of protecting the global environment in six focal areas: climate change (mitigation and adaptation), biodiversity, international waters, persistent organic pollutants, ozone depletion and land degradation (desertification and deforestation). It works with 10 multilateral agencies: the World Bank, United Nations Development Programmes (UNDP), United Nations Environment Program (UNEP), International Fund for Agricultural Development (IFAD), Food and Agriculture Organization of the United Nations (FAO), United Nations Industrial Development Organization (UNIDO) and four regional development banks (Inter-American Development Bank [IADB], African Development Bank [AfDB], Asian Development Bank [ADB] and European Bank for Reconstruction and Development [EBRD]) (GEF, 2008a). These agencies collaborate with eligible countries to develop, submit and implement projects and programs in line with the GEF strategy and overall GEF policies. Projects and programs are approved by the GEF Council, which is made up of both recipient countries and donor countries (GEF, 2007a).[3]

The GEF is the officially designated financial mechanism for four Rio conventions (United Nations Convention on Biological Diversity [UNCBD], UNFCCC, the Stockholm Convention and United Nations Convention to Combat Desertification [UNCCD]). It achieved this status, however, only after a period of intense debate between donor and developing countries. When it was first established as a pilot in 1991, it was an initiative of donor countries that were primarily concerned with avoiding the fragmentation of funding to address global environmental concerns. It is widely believed that a primary motivation was to keep control of the funds out of the hands of developing country majorities. Thus

[2] This paper does not include an analysis of the UN environment-related agencies.

the GEF was established as a trust fund administered by the World Bank. The donor countries insisted on giving control over project planning and financing decisions to the World Bank, in which they held most of the votes on the governing board.

Initially, the GEF was strongly opposed by the Group of 77 developing countries on the grounds that it had been set up without consulting them and that the World Bank was an instrument that primarily served the interests of industrial countries. The developing countries demanded a governing structure based on the UN model of full equality for all participants, with decisions made by a simple majority. After three years of hard negotiations, the two groups of countries reached agreement on a system of governance in which both a 60 percent majority of members of the government body with one vote per state and a 60 percent majority of states making contributions was necessary to take a decision. The governance system also included a Participants' Assembly with universal membership that would meet every four years.

Since then, the Conference of the Parties (COPs) of the climate (UNFCCC) and biodiversity (UNCBD) conventions have continually renewed the status of the GEF as their funding mechanism. Two other conventions have also agreed to make the GEF their funding mechanism: (i) the Stockholm Convention on Persistent Organic Pollutants (POPs), at its first meeting of the COP, adopted the GEF as its interim financial mechanism; and (ii) the UNCCD, in 2003, also designated the GEF as a financial mechanism. As the financial mechanism for the UNFCCC, UNCBD and POPs, the GEF is obliged to respond to the guidance of these conventions, including the programming of funds in the respective GEF focal areas relevant to each convention.

The UNFCCC decided in 2001 to establish a Special Climate Change Fund (SCCF) and a Least Developed Country Fund (LDCF) to finance projects relating to climate change adaptation, technology transfer and capacity building in the various sectors, including energy, transport, industry, agriculture, forestry and waste management, as well as in economic diversification. The GEF was directed to be the manager for the LDCF and SCCF, which became operational in 2002. Funding for the SCCF was raised by voluntary contributions beyond regular GEF replenishment from 13 contributing participants (Canada, Denmark, Finland, Germany, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom). The plan for the SCCF's initial five-year period was endorsed by the GEF Council in November 2004. In 2007, the GEF was named interim secretariat for the Kyoto Protocol Adaptation Fund.

### 2.2 Multilateral Development Banks

MDBs are key actors in the global system of financing for protecting the world's ecosystems, both as participants in the GEF and as stand-alone financing institutions. As commercial lending institutions, they dispose of funds on a much larger scale than the GEF. At the same time, they have made public commitments to support global environmental objectives and have restructured their operations significantly to enhance their role in financing to benefit the global environment.

The World Bank has played a major role in financing measures to achieve global environmental objectives, but that role has been linked in the past to the GEF. As one of the GEF's three initial Implementing Agencies, the Bank has been the largest multilateral partner of the Fund. Since the end of the GEF Pilot Phase in 1991, the World Bank has provided more than $4.8 billion of the Bank's own funds to cofinance GEF-supported projects and has mobilized more than $13.8 billion in cofinancing from other donors (Gorman, n.d.).

The Bank's partnership with the GEF has been the key to mobilizing additional resources for renewable energy and energy-efficiency investments through public-private partnerships. One such

partnership was the Renewable Energy and Energy Efficiency Fund, which was the first International Finance Corporation (IFC) investment fund exclusively designed to finance sustainable energy investments. The World Bank–GEF Strategic Partnership for Renewable Energy, established in 1999, shifted GEF programming for renewable energy from a single-project approach to large-scale, long-term renewable energy programs.

The World Bank Group (including the International Bank for Reconstruction and Development [IBRD], International Development Association [IDA] and IFC) has also moved over the past decade toward asserting a larger role in financing projects related to climate change outside the framework of the GEF and the UNFCCC. One strand of that role is its lending for renewable energy and energy efficiency. The share of Bank lending for those two climate-friendly segments in its total energy lending portfolio more than doubled between 1994 and 2006 and had reached 40 percent of the total by 2007 (World Bank, 2007).

The World Bank's independent role in climate-related funding developed further in response to the 2005 G-8 Gleneagles Summit in Scotland, where the G-8 countries asked the Bank to produce a road map for accelerating clean energy investments in developing countries in cooperation with the other MDBs. The Bank produced the Clean Energy Investment Framework (CEIF), which identifies the scale of investments needed (i) to increase access to energy, particularly in Sub-Saharan Africa, (ii) to accelerate the transition to a low carbon economy and (iii) to support adaptation to climate change.

The CEIF thus established a series of niches for the World Bank in funding related to climate change that also responded to its interests as a commercial bank for the development of new areas of business, including what the Bank calls "climate-proofing" development projects, which it estimates will require a few billion U.S. dollars annually. A Bank paper on climate change has predicted that it would have to increase IDA funding by 6 percent to 21 percent annually just to maintain the same net level of benefits to recipient countries, compared to a scenario without climate change (Mani, 2007).

The World Bank has been the leader in facilitating the development of carbon finance – the purchase of greenhouse gas (GHG) emission reductions in conjunction with the Clean Development Mechanism (CDM) of the UNFCCC's Kyoto Protocol. The Bank established the prototype carbon fund in 1999, and its group of carbon funds has now grown to 10 and is worth more than $2 billion. Most of these funds were established with money provided by European states that had purchased carbon reductions carried out in the developing world (World Bank, 2008a).

Other MDBs have also increased their climate-related lending significantly in recent years. The ADB launched an initiative in 2005 to encourage more attention to energy savings, under which it committed to expanding investments in energy-efficiency projects to $1 billion annually. The ADB also approved the Carbon Market Initiative in 2006 to help developers and sponsors prepare projects eligible for Certified Emission Reductions (CERs) of GHGs under the CDM. The Asia Pacific Carbon Fund established by the ADB provides up-front funding against the purchase of an estimated 25 percent to 50 percent of future carbon credits expected from such CDM projects.

## 2.3 Strengths of the existing system

*Embodiment of a global bargain*

The GEF represents a hard-won bargain between donor and developing countries over priorities, programming strategies and specific project and program choices. Although neither group of states has been entirely happy with the result, it is nevertheless recognized that its structure, as well as its operational principles, are the result of a continued balancing act between the interests of both sets of countries. GEF programming involves a reconciliation of the interests and views of the participants of the Rio conventions, including both the host and recipient countries (Porter, Clemencon, Ofosu-Amaah and Philips, 1998). Any other institutional model would likely bring renewed confrontation between donor and recipient states over control of the funding for global environmental concerns.

*Synergies between grant assistance and concessional lending*

A central element in the GEF's structure and operations is that it combines the impact of grant assistance with concessional lending provided by the World Bank and other multilateral banks, such as the regional development banks and IFAD. The synergy between the two has been achieved by linking bank loans with GEF grants, thus making investments (e.g., in forest conservation or clean technology) more attractive to recipient countries.

*GEF coordinates bilateral and multilateral efforts*

The GEF has been a mechanism that catalyzes the coordination between bilateral and multilateral agencies with regard to sharing knowledge of project pipelines in each country and focal area, as well as at the strategic level of policy and programming. Although duplication of effort by World Bank and UNDP was a serious problem at the beginning of the GEF's operational phase in 1994, joint pipeline reviews by all agencies reduced that problem. The GEF also offers the framework for broader consultation and cooperation among multilateral agencies on strategic approaches to programming in or across focal areas. For example, the GEF Focal Area Task Forces bring together GEF Secretariat specialists and representatives of the GEF agencies to discuss the strategic and effective allocation of GEF resources. This mechanism for coordination does not eliminate the tendency toward competition among the GEF agencies, but it does harness their common interest in using GEF funds to reduce threats to the global environment.

Another advantage of the GEF is that the GEF Council offers the opportunity for donor country representatives to meet every six months to discuss policy and strategy for using their contributions to fund measures that address global environmental concerns. The Council meetings have provided opportunities for wider consultations among donors, recipient countries, multilateral agencies and the nongovernmental organization (NGO) community.

## 2.4 Weaknesses of the existing system

*Low level of funding by donor countries*

A critical problem of the existing system, in which the GEF has been the central institution, is that the donor countries on which the GEF has depended for its funds never intended for it to cover all the financing needed to achieve the objectives of the global environmental conventions in question. Rather, it was intended to be a catalyst for measures to address global environmental problems.

Despite the fact that the GEF was designated as the financial mechanism for the climate and biodiversity conventions, the funding provided by donor countries was never at the level required to produce significant progress in reversing the threats to climate stability and biodiversity conservation. Over the entire 18 years of its operation, total funding allocated to the GEF has provided $7.4 billion in grants to support more than 1,950 projects. By 2007, the GEF's climate change portfolio had grown to include more than $2.2 billion in grants for projects with a total value of nearly $14 billion when cofinancing (a considerable amount of it provided by the private sector) is included. But it is now clear that the initial assumption underlying GEF – that relatively small amounts of grant financing, when combined with projects financed by other multilateral partners, could leverage transformational change, for example, in energy markets in the developing world – was flawed.

China has used GEF climate projects strategically to pilot approaches that it can then apply more widely using its own resources when they prove successful (UNDP, Office of Evaluation, 2008). GEF's China Renewable Energy Scale-Up Project is its most ambitious effort at stimulating a transformational change in the power sector. Some $140 million in GEF grants within a total package of $400 million (including World Bank loans) will support implementation of a national policy to establish a mandated share of electricity consumption to come from renewable sources over a 10- to 12-year period. However, the World Bank (2006) warned that this initiative and others aimed at achieving market transformation in China would require a minimum of $250 million to $300 million *per year* over 10 years – two or three times more than is now being provided by GEF and the World Bank combined – to achieve "significant and sustained market penetration of energy efficiency and renewable energy technologies" in China.

In the area of biodiversity and forest loss, the difficulty of achieving a measurable impact without a significantly larger scale of GEF resources is even greater. Conventional projects involving protected area schemes – even when accompanied by efforts to deal with local community-based driving forces – have not had the desired effect in slowing the commercial driving forces behind deforestation in areas with the greatest forest losses. Achieving that objective would require more ambitious concepts backed by much greater commitments of grant financing.

### *Lack of strategic approach to climate change*

The origins and evolution of the GEF reflected an approach that seemed to assume that the give and take among various interests would produce approaches that could foster transformation of energy markets over time. The result was that it has lacked a strategic focus on how to bring about much faster transformation, particularly in energy use. Thus, until recently, the GEF adhered to an approach in which an interest to influence the major GHG-emitting countries' systems of energy use was balanced by a project-by-project method of allocating funds. In September 2005, the GEF Council adopted the Resource Allocation Framework (RAF), a system for allocating GEF resources to recipient countries. Resources are allocated to countries based on each country's potential to generate global environmental benefits and the country's capacity, policies and practices to successfully implement GEF projects. Implementation began in July 2006 and applies to resources for financing biodiversity and climate change projects through the fourth replenishment of the GEF. The allocations determined by the RAF use a combination of a GEF Benefits Index and a GEF Performance Index (GEF, 2005). The GEF Benefits Index for climate change seeks to measure the potential benefits that can be realized from climate change mitigation activities in a country. The approach reflects the objectives of the GEF climate change operational programs to address long-term priorities to mitigate climate change. No consideration, however, was given to the role of forests in mitigation and adaptation. Ninety-five percent of the pledged funds to the Climate Change focal area were allocated to individual countries. Only 5 percent, or $50 million, were set aside for regional and global programs. Hence, the complexity of the RAF and the related distribution of climate funds

have made a strategic approach to addressing the challenges associated with climate change at a global level rather difficult.

Due to the fact that the Global Benefits Index for climate change does not reflect the role of forests in climates, related funding constraints triggered the development of an incentive mechanism, the Tropical Forest Account (TFA), which rewards tropical forest countries with additional resources if they direct their country's RAF resources to projects addressing sustainable forest management (SFM). The TFA is capitalized by a portion of the global and regional resources in biodiversity and climate change and some resources from the land degradation focal area. Through this approach, the GEF is trying to strengthen the role of forests in its mitigation strategy.

The GEF has long recognized that it needs to mobilize the investment resources of the private sector on behalf of global environmental benefit, particularly with regard to investments in low-carbon technology. The GEF Council has discussed the matter repeatedly and issued a series of decisions. Two studies were prepared in 2006 to advance a new private sector strategy that would collaborate with the private sector (GEF, 2006a and 2006b). New proposals, including one for a new fund to be focused solely on collaboration with the private sector, were presented to the Council in June 2007. Successful collaboration with the private sector, however, may require a degree of experience and commitment that the GEF cannot achieve in a short time with its existing structure and commitment to collaboration with governments. The length and uncertainties inherent in the GEF project cycle also rule out the participation of a wide range of businesses in GEF projects. And the GEF Secretariat and most of the GEF agencies lack the long-established relationships with investors and manufacturers that are a necessary basis for forging the kind of collaboration needed.

In June 2008, the chief executive officer of the GEF, Monique Barbut, presented an approach to the GEF Council to shift from single-project interventions toward a more programmatic approach, to focus the limited funding resources of the GEF-4 on the highest priority issues and to achieve a synergistic impact by linking projects together (GEF 2008). All focal areas, including climate change and biodiversity, are now supportive of programmatic initiatives to promote a more strategic approach to climate change, including sustainable forest management.

### *Conflict of interest of the MDBs in energy lending*

Even though the World Bank's recent expanded role in climate-related funding represents a substantial evolution from the Bank's role in past decades, the Bank retains some of the characteristics that have made its operations part of the problem: internal Bank incentives encourage lending large amounts of money quickly and generate a strong bias toward large-scale, capital-intensive projects with predictable rates of return. Those needs have led to a dominant emphasis in the Bank's energy lending portfolio on conventional power sector loans, which accelerate the threat of global climate change rather than reduce it. In 2005, the Bank loaned more than $2.5 billion for conventional power projects (i.e., fossil fuel development and large dams), whereas it used only $109 million in IBRD and IDA funds for renewable energy and energy-efficiency projects (FOE, 2005). That continued a long-established pattern of failing to consider climate change in its lending to the energy and mining sectors. During the previous five years (2000–04), 84 percent of World Bank Group lending in those two sectors gave no consideration to climate change (Nakhooda, Sohn and Baumert, 2005).

The Bank needs to break its dependency on conventional power lending by channeling more resources for renewable energy and energy-efficiency projects. The responsible course of action for the Bank is to ensure that there is a sound analysis of all energy options for a country, to finance from

its own resources the economically viable yet environmentally sustainable investment options, and to mobilize additional resources where available.

*Slowness of GEF project initiation*

One problem with the GEF's role has been a project approval process that is far too long and complex. When Monique Barbut became GEF executive director in late 2006, she found a lapse of an average of 66 months between entry of a concept into the pipeline and project initiation. That is long enough for major changes to occur in the recipient country that could have a serious impact on the project's success. It also discourages participation in many proposed GEF projects by private sector entities.

In June 2007, the GEF Council approved a revised project cycle (GEF, 2007a), which has enabled the GEF to reduce the lapse time between the presentation of a project idea and its implementation to an average of 22 months by introducing expedited and simplified procedures. Furthermore, the number of work programs for Council approval have been increased from four to twelve annually. With this increase, significantly more projects can be processed compared to the old project cycle.

The relatively complex structure of the GEF itself, involving an independent secretariat, GEF agencies and a council that must approve the inclusion of projects in the work program, as well as the final project proposal, makes it difficult to further simplify the project cycle so that it is comparable to those of the multilateral lenders.

# 3. THE EMERGENCE OF NEW ENVIRONMENTAL FUNDS

## 3.1 Driving forces behind the new funds

*Increased political understanding of climate change in donor countries*

Global environmental issues and particularly climate change are now high on the political agendas in many northern and some southern countries (especially the Small Island Development States [SIDS]). Related to this, there are indications of direct links between climate change concerns and voting preferences in northern countries. In the United Kingdom, the Local Government Association (LGA) recently found that 62 percent of respondents in a survey were more likely to vote for a candidate with policies to tackle climate change (LGA, 2008). Climate change and energy have also become major themes of party policies, and media coverage of the issue has increased significantly in the United States and the United Kingdom as well as in other European countries (Boykoff, 2007).

*Desire to achieve more immediate impacts*

Despite recent efforts to move toward a results-based management system, donor governments are aware that the existing system has not produced visible progress. In searching for a new approach to climate funding, they have sought options that can be organized quickly and demonstrate a more dramatic impact on reducing GHGs. The idea of promoting low carbon technologies, which surfaced at the G-8 Summit at Gleneagles, met both of these criteria.

*Desire to mobilize private sector resources*

Another factor driving the creation of new funds has been the growing interest to mobilize private sector resources for global environmental benefit. One way to mobilize these resources has been to facilitate markets for environmental services (e.g., carbon and water, among other services that can now be priced and traded). The global market for carbon emissions reductions increased in value to an estimated $30 billion in 2006, three times greater than in 2005 (Capoor and Ambrosi, 2007). It is expected that the volume of carbon trading transactions will continue to increase as more countries that have ratified the Kyoto Protocol look for cost-efficient ways to meet their commitments. Donors have been supporting the carbon market actively (e.g., through "pump-priming" carbon markets in prototype carbon facilities such as the BioCarbon Fund [BioCF]). At the same time, the World Bank has rapidly built up its own carbon market funds – the Forest Carbon Partnership Fund (FCPF).

*World Bank's need for new energy market niches*

In the late 1990s, the World Bank was strongly wedded to its fossil fuel lending portfolio, and it had adopted a policy that explicitly ruled out rejecting any loan on the basis of its impact on the global environment. The Operational Policy Committee had recommended that it use a shadow carbon price to determine at what point alternatives to a conventional fossil fuel loan should be considered (Porter et al., 1998). But by 2005, its interests regarding energy loans had begun to shift. The Bank was already motivated to assert a more active role in clean energy loans outside the context of the GEF. By 2005, when G-8 leaders gave their encouragement for the World Bank to play a lead role with regard to climate-friendly technology, it had already seen its core markets for loans in the conventional power sector decline by more than 40 percent since the early to mid-1990s – a loss of nearly $1.3 billion on average annually for the 2000–04 period as compared with the annual average during the 1990–94 period (World Bank, 2007).

It was not until 2004 that the Bank's private sector arm, the IFC, started to identify clean energy opportunities within its own investments in a search for ways to expand its renewable energy and energy-efficiency business. After the new system of tracking those opportunities was found to be successful, the World Bank itself began to apply a similar method of building up its own lending for clean energy (World Bank, 2007). The Bank's need for new energy lending niches coincided with the donor government's desire for a new vehicle to speed up climate-friendly technology to create a new alliance.

*Preference for programmatic over project-based funding modalities*

In the case of adaptation, the way that finances are delivered is a possible driver for donor decisions on how to channel funding through multilateral routes. For example, the UK's Department for International Development (DfID) is keen to pilot a programmatic approach through integration into national plans. None of the UN special funds (or the Adaptation Fund) are presently structured in a programmatic way. Perhaps in response to this situation, DfID is planning to channel funds through the Strategic Climate Fund of the World Bank, which would allow for programmatic options (HMG, 2008).[4]

*Are there differences in these drivers between the bilaterals and the multilaterals?*

Whether finances for the environment are channeled through bilateral or multilateral pathways depends on a range of factors. Historically, different bilateral donors show a large variation in the levels of aid distributed through multilateral channels. Belgium and New Zealand, for example, put most (more than 90 percent) of their aid through multilaterals in the 1990s, whereas Japan and Denmark put a small proportion through this system (less than 30 percent) (Hicks et al., 2008). In some cases this is partly due to differences in the size of the donors, with smaller donors that have a lower capacity to manage funds opting for multilaterals and larger donors opting for bilateral channels. But it also relates to factors such as how seriously countries perceive environmental treaties (Hicks et al., 2008). Interestingly, the choice of multilateral agency (between loan- and grant-based providers) appears to depend on technical experience, number of years in existence and multilaterals in which they have greater voting shares (Hicks et al., 2008).

Of key interest to this study is whether the weaknesses of the current multilateral system or the overlaps and potential competition in their aims has contributed to the emergence of the bilateral funds. The research has found little evidence to indicate that this is the case. Some interviewees from bilateral donors did mention concerns about the international system (acknowledging, for example, the competition between GEF and the World Bank funds), implying that it could be part of the rationale to establish bilateral funds. But some of the bilateral funds (Australia, Japan, Norway and the United Kingdom) are considering channeling finance through multilateral means. As mentioned above, this is occurring in the broader context of increasing proportions of aid being channeled through the multilaterals. It is therefore hard to reach a strong conclusion on drivers in this case.

## 3.2 The new bilateral funds

This section provides details of the new bilateral funds that aim to address the international funding gap for climate change. Most of these funds are not yet operational, however, and so their final structure and operational practices cannot be stated with complete certainty. Information about each of these funds was collated from web searches, literature reviews and key informant interviews during April 2008. Because most of the funds remain under development, not all of the presently available

documentation is consistent, and this may have led to some errors and discrepancies in the description of the funds.

Four European countries, together with the European Union[5] Australia and Japan have made recent commitments to provide new financing to assist international measures to tackle climate change. Most funds are aimed at supporting developing countries and hence have a close relationship with development assistance. The following initiatives have been reviewed:

- The Global Climate Change Alliance (GCCA) of the European Commission
- The International Window of the Environmental Transformation Fund (ETF-IW) of the United Kingdom
- The Spanish Millennium Development Goals (MDG) Fund
- The Japanese Cool Earth Partnership
- The German International Climate Initiative
- The Norwegian Agency for Development Cooperation (NORAD) Rainforest Initiative
- The Australian Global Initiative on Forests and Climate (GIFC)
- The German Life Web Initiative[6]

Not all of these initiatives are similar in intent, however. They all aim to address climate change adaptation and mitigation by providing direct or indirect financial support for such activities, but only a few have wider ambitions to facilitate the coordination and negotiation between donors and potential recipient countries in the lead up to a new post-2012 climate agreement.

Three key characteristics have been selected to explore the similarities and differences among the funds:

- the funds' stated objectives;
- their means of financing and disbursement; and
- aspects of fund governance, in terms of how the funds have been established.

### *Objectives*

All the initiatives reviewed have multiple objectives (see table 1) that add climate change mitigation and adaptation measures to existing concerns of biodiversity conservation and poverty reduction. By doing so, they broaden the scope of "environmental concerns," making any definition of what constitutes environmental funding increasingly problematic. This furthers the existing lack of clarity over the relationship between climate change adaptation and development (WRI, 2008). The combination of these objectives within the same funds, however, may help to fill existing gaps in funding critical adaptation activities in developing countries.

*The European Commission's GCCA* will address mitigation, adaptation and poverty reduction via a proposed partnership with developing countries that will include the provision of both technical and financial assistance. In addition, it aims to provide an informal forum that will facilitate negotiations for a post-2012 climate agreement. The GCCA also plans to add value by acting as a clearinghouse mechanism to coordinate the international adaptation initiatives of EU member states.

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[5] The European Union and its Commission are treated as a bilateral source.

[6] The change in government in Australia since the announcement of this initiative has delayed implementation while it is re-considered by the present government. The initiative may be developed under a new name.

*The UK's ETF-IW* has two kinds of objectives. The first process objectives relate to transforming how finances are delivered. These include facilitating moves toward additional finance provided in a programmatic way; avoiding aid proliferation and ensuring coherence; and piloting models that will feed into the UNFCCC negotiation process and the Kyoto Adaptation Fund. The second set are thematic objectives that include supporting poverty reduction, providing environmental protection and tackling climate change in developing countries by addressing unsustainable deforestation, access to clean energy and activities that support adaptation. Most of the finance available under this initiative will be channeled through the World Bank's Climate Investment Funds (CIF) Facility, although early support to the Congo Basin Conservation Fund has been provided to address uncontrolled deforestation in that region.

*The Spanish MDG Fund*, which includes a thematic window on Environment and Climate Change, will support efforts to reduce vulnerability to climate change and poverty reduction. The fund will support (i) interventions that improve environmental management and service delivery at the local and national level, (ii) activities that will increase access to new financing mechanisms and (iii) efforts to enhance adaptive capacities.

*The Japanese Cool Earth Partnership* has three priorities: (i) establishing a post-Kyoto framework that will ensure the participation of all emitters and aim at fair and equitable emission targets; (ii) strengthening international environmental cooperation, under which Japan will provide assistance to help developing countries achieve emissions reductions and to support adaptation in countries suffering from severe climate change impacts; and (iii) supporting innovation that will focus on the development of innovative technology and a shift to a low carbon society.

*The German International Climate Initiative* has three objectives: (i) supporting sustainable energy systems, adaptation and biodiversity projects related to climate change; (ii) ensuring that investments will trigger private investments at a greater magnitude; and (iii) ensuring that financed projects will strategically support the post-2012 climate change negotiations. For this purpose, it will also support multilateral activities and funds focusing on adaptation and forest management.

*The Norwegian NORAD Rainforest Initiative* is not a fund as such, but a pledge of earmarked funding to be allocated through the national budget. It will support the conservation of rainforests by promoting large-scale forest protection and the development of forest-based carbon management. More general measures will include support for adaptation and promoting clean energy in Africa.

### *Forests and Biodiversity*

Two of the eight funding initiatives, the GIFC and the Life Web Initiative (partly financed via the Climate Change and Biodiversity window of the German International Climate Initiative), focus solely on forests and biodiversity.

*The Australian GIFC* aims at facilitating global action to address emissions from deforestation by providing incentives to developing countries to reduce deforestation. Its specific objectives include reducing forest destruction, increasing forest plantation cover and supporting SFM practices.

*The German Life Web Initiative* aims to support the creation and management of new and existing protected areas by creating a global partnership to support the UNCBD Programme of Work on Protected Areas. Specifically, a clearinghouse mechanism will be established that will guide donors to country needs.

### Table 1: Fund objectives

| Details | Name of Initiative | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **Global Climate Change Alliance of the European Commission** | **International Window of the Environmental Transformation Fund of the United Kingdom** | **Japanese Cool Earth Partnership** | **German International Climate Initiative** | **German Life Web Initiative** | **Australian Global Initiative on Forest and Climate** | **Norwegian NORAD Rainforest Initiative** | **Spanish MDG Fund (Thematic window on Environment and Climate Change)** |
| **Objectives** | 1. To foster effective dialogue and cooperation on climate change between the European Union and the poorest countries.<br>2. To facilitate the integration of climate change concerns into poverty reduction plans at local and national levels.<br><br>Technical and financial support will be provided for the following:<br>• Adaptation<br>• Mitigation<br>• Deforestation<br>• Disaster Risk Reduction<br>• Integrating Climate Change into Poverty Reduction | 1. To increase support for developing countries in adapting to the impacts of unavoidable climate change.<br>2. To support mitigation, in particular through helping developing countries toward being part of the transition to a global low-carbon economy, including through the promotion of clean energy.<br>3. To support the tackling of unsustainable deforestation. | 1. To assist adaptation to climate change.<br>2. To improve access to clean energy.<br>3. To assist the mitigation of climate change. | 1. To support sustainable energy systems, adaptation and biodiversity projects related to climate change.<br>2. To ensure that investments will trigger private investments at a greater magnitude.<br>3. To ensure that financed projects will strategically support the post-2012 climate change negotiations. For this purpose, it will also support multilateral activities and funds focusing on adaptation and forest management. | To support the implementation of the UNCBD Programme of Work on Protected Areas (PAs). This will achieved as follows:<br>• Partnerships will be enhanced via a clearinghouse mechanism guiding donors about partners' needs.<br>• matching funds and cofinancing will be provided for the creation of new PAs and improved management of existing PAs. | To facilitate global action to address emissions from deforestation.<br>Objectives include—<br>• reducing deforestation and forest degradation;<br>• increasing new forest planting; and<br>• promoting sustainable forest management practices. | 1. To support adaptation measures and clean energy in Africa.<br>2. To assist climate-related research, technical cooperation and private sector development.<br>3. To support new multilateral climate change and clean energy initiatives. | 1. To reduce poverty and vulnerability by supporting interventions that improve environmental management and service delivery at the national and local level.<br>2. To increase access to new finance.<br>3. To enhance adaptation capacity. |

*Financing and disbursement*

Two of the initiatives, Germany's International Climate Initiative and the EC's GCCA, intend to use innovative means to mobilize finance. The International Climate Initiative plans to raise money from the European Union Emission Trading Scheme (EU ETS). This will involve the German government selling 10 percent of the country's allowable emission permits to businesses and then using approximately 30 percent of the revenue earned from this sale to finance climate change–related projects. Similarly, the GCCA is looking into the potential of using earmarked auctioned revenues from the EU ETS. It is also considering using a mechanism similar to the International Finance Facility for Immunisation[7] as a means to mobilize and disburse larger sums of money in the form of grant aid to support climate change adaptation.

The sources of funding for Japan's Cool Earth Partnership are diverse and include government ODA funds, private funds and support from the Japanese Bank for International Cooperation. The remaining funds will be resourced directly from the national budget of each country, although how this finance will be classified is not clear at present for all the funds. It seems that most financing will come from the development rather than from the environment budget.

*Type of funding*

Grant funding dominates the smaller bilateral initiatives, although the two larger funds (the Cool Earth Partnership and the ETF-IW) are being planned mostly as concessional loans. The ETF-IW funding has been allocated by the UK's Ministry of Finance as a capital expenditure, which restricts this finance to being made available on a loan basis. This in turn will likely influence the choice of potential recipient countries, as the United Kingdom has a number of bilateral agreements not to increase the debt burden of some its poorest partner countries. However, the interest element of the fund can be treated as grant assistance, as has happened with the initial allocation to the Congo Basin Conservation Fund.

The Cool Earth Partnership will provide $2 billion as grant aid and technical assistance to support adaptation activities, whereas the bulk of the fund ($8 billion) will be made available as concessional loans to support mitigation activities. The GCCA is looking into providing grant aid, disbursed via projects or program-based support at the national level (raising the possibility of using budget support arrangements). Similar arrangements are being explored for the Spanish MDG Fund. The types of funding under the GIFC, the International Climate Initiative and the German Life Web Initiative are all still to be determined.

*Amount and period of finance*

Table 2 summarizes the estimated level of funding for each of these bilateral initiatives. The total nominal amount of dedicated finance is somewhat less than $3 billion per year, which represent a small percentage of the expected needs of developing countries. For example, an estimated $14 billion in additional investment is needed for adaptation in the forestry, fisheries and agricultural sectors alone by 2030 (UNFCCC, 2007).

All the funds have a limited time horizon, with no commitments made beyond the 2012 date for negotiations on a post-Kyoto agreement. This is significant, as this short timescale is indicative

[7] The central aim of the International Finance Facility for Immunisation is to help save more children's lives and to do so faster by investing the majority of resources up front – that is, "frontloading" – to ensure reliable and predictable funding flows. See iff-immunisation.org/index.html.

more of a piloting phase rather than any new long-term architecture of global environmental funding. The experience gained through disbursing these funds, however, will provide much valuable experience on how to channel global funds to tackle climate change in developing countries over the long term.

**Table 2: Estimated level of funding from bilateral initiatives**

| Fund | Currency | Total amount | U.S. dollar equivalent[a] | Period | Nominal annual level | Comments |
|---|---|---|---|---|---|---|
| Japanese Cool Earth Partnership | USD | 10 billion | 10 billion | 2008–12 | 2 billion | |
| ETF-IW of the United Kingdom | GBP | 800 million | 1,593 million | 2008–10 | 531 million | |
| Norwegian NORAD Rainforest Fund | USD | 560 million | 560 million | 2008–12 | 112 million | |
| Spanish MDG Fund | Euro | 90 million | 143 million | 2008–11 | 36 million | |
| GCCA of the European Commission | Euro | 50 million | 79 million | 2008–10 | 26 million | Refers to earmarked commitment from the ENRTP; additional funding may be forthcoming |
| German International Climate Initiative | Euro | 400 million per year | 634 million per year | Uncertain | 184 million (international component) | 30% of this funding will be used to finance climate change projects |
| Australian GIFC | AUD | 200 million | 188 million | Uncertain | Uncertain | |
| Total Bilateral Funding | | | | | Less than 3 billion | |

*Note:* AUD = Australian dollar; ENRTP = Environment and Natural Resources Thematic Programme; GBP = British pound; USD = U.S. dollar.

a. Valued at exchange rates available on April 22, 2008.

## Targeting of funds

All the initiatives have stated geographical preferences or donor identified criteria (e.g. the conservation of forest ecosystems). The loan-based aid disbursal of the ETF-IW will tilt financing toward middle-income countries. In contrast, the GCCA has the stated intention of focusing on poor developing countries, particularly LDCs (Least Developed Countries) and SIDS. The NORAD Fund is likely to focus on the Congo Basin, the Amazon and southeast Asia, while the GIFC will support regional initiatives in southeast Asia (Indonesia) and the Pacific (Papua New Guinea). Access to funding under the GIFC is expected to be further subject to the achievement of preestablished sustainability criteria such as agreed-on reductions in

deforestation rates. The Spanish MDG Fund provides funding to 59 countries identified by the Spanish Master Plan for International Cooperation. The Cool Earth Partnership will be based on individual bilateral agreements with partner countries that have committed to developing a low carbon economy.

*Fund governance*

The way in which these initiatives have been established will likely influence their impact on climate change measures in developing countries. One important aspect associated with the design phase, in which all the funds have been engaged, is the involvement of potential recipient countries. As table 3 shows, there appears to have been limited efforts so far to include the perspective of such countries in design considerations (e.g., about national absorptive capacity issues). Fund development seems to have taken place largely as an internal exercise within each of the donor governments. This is also reflected in the limited coordination that is apparent between the funds.

Two initiatives stand out, however, as having taken a more inclusive route. First, the German Life Web Initiative will be put to the COP 9 meeting of the UNCBD for approval and hence involve developing countries in deciding on the design phase; and second, the Spanish MDG Fund has been established as a joint initiative with the UNDP and thus links its funding into the multilateral channels of the United Nations.

The remaining funds appear to have taken a more insular approach. For example, the EU's GCCA has been driven by the Directorate General (DG) Development of the European Commission, working with the environment and climate change committees of the European Parliament on the wider issues concerning the role of the EU in international climate change negotiations. The international element of the ETF is jointly managed by DfID and DEFRA (the UK's Department for Environment, Food and Rural Affairs) and has been closely related to the World Bank CIFs, of which the United Kingdom has been a lead partner. Negotiations concerning the development of these multilateral funds have been criticized by civil society representations as lacking transparency and the involvement of potential recipients (Third World Network, 2008), although these processes have opened up to civil society to some extent recently. For example, in May 2008, during a two-day meeting in Potsdam, Germany, representatives of 40 developing and industrialized countries reached an agreement to create two international climate investment funds (the Clean Technology Fund and the Strategic Climate Fund) that will provide innovative financing for developing countries to pursue cleaner development paths and protect themselves from the impacts of climate change. These funds (CIFs) will be administered by the World Bank.

The GIFC was originally developed by the then Australian minister of environment, who toured several countries to gather support for the initiative during 2007. He secured agreement with the United States in April 2007 to work together to advance priority projects to improve forest management and reduce global deforestation. With the change in government, however, the initiative has progressed more slowly than originally anticipated, although the present Australian prime minister highlighted the GIFC at a recently held progressive governance summit in the United Kingdom.

The Cool Earth Partnership was announced by the prime minister of Japan and is being coordinated by the Japanese Ministry of Foreign Affairs. This is seen as a bilateral initiative and so will interact with partner countries via normal bilateral channels. However, the volume of funding is so large that it may divert attention away from multilateral processes, in particular the UNFCCC.

### Table 3: Potential recipient country involvement in fund design

| Name of Initiative | Potential recipient country involvement |
| --- | --- |
| **Global Climate Change Alliance of the European Commission** | • Joint initiative between DGs Development, Environment and External relations of the European Commission<br>• Potential recipients not involved in design or initiation phases<br>• Stakeholders invited to development dialogue forum<br>• Development assistance strategies with partner countries (NAPAs an option; regional forums and partnerships) |
| **The International Window of the Environmental Transformation Fund of the United Kingdom** | • Joint DEFRA-DfID initiative of the UK government; details remain unclear<br>• Potential recipients involved in design stage though consultation processes<br>• DfID proposes that recipients will be involved by deciding how funds under the CIF will be used, what partners they will work with to implement activities<br>• Recipient countries to develop adaptation plans and budgets and DfID proposes budget support as a means of implementation |
| **Japanese Cool Earth Partnership** | • Announced by Japanese prime minister, with the Ministry of Foreign Affairs coordinating development and governed by ministerial committee<br>• Involvement of potential recipient countries though normal bilateral channels |
| **German International Climate Initiative** | • Led by the Ministry of Environment (BMU), although the Ministry of International Cooperation is likely to be involved<br>• GTZ and KfW will be responsible for planning and implementation<br>• Recipient countries will be involved in the development and implementation of projects and through normal bilateral cooperation channels |
| **German Life Web Initiative** | • To be under CBD structure, with the Initiative to be presented and approved/disapproved at CBD COP 9 in May 2008<br>• Funding and Partnership will respond to country identified needs |
| **Australian Global Initiative on Forests and Climate** | • Planning and Delivery to be coordinated by Departments of Environment, Forestry and Foreign Affairs (including AusAid).<br>• Involvement of potential recipient countries though normal bilateral channels |
| **Norwegian NORAD Rainforest Initiative** | • Initiative currently under the Ministry of Environment |
| **Spanish Millennium Development Goals Fund (Thematic window on Environment and Climate Change)** | • Initiative agreed between the Spanish government and the UNDP |
| *Note:* BMU = Ministriy of the Environment; CBD = Convention on Biodiversity; CIF = Climate Investment Fund; COP = Conference of the Parties; DEFRA = Department for Environment, Food and Rural Affairs; DfID = Department for International Development; DG = Directorate General; GTZ = German Technical Cooperation; KfW = KfW Development Bank; NAPA = National Adaptation Programmes of Action; UNDP = United Nations Development Programme. | |

## 3.3 The new multilateral funds

Six new multilateral funds have been announced since 2007:

- The World Bank Forest Carbon Partnership Fund (FCPF)
- The GEF Tropical Forest Account (TFA)
- The World Bank Clean Technology Fund (CTF)
- The GEF-IFC Earth Fund
- The World Bank Strategic Climate Fund (SCF) and Pilot Program for Climate Resilience (PPCR)
- The Kyoto Protocol Adaptation Fund

### *Objectives, means, rationale and eligibility*

*The World Bank FCPF* has the dual objective of (i) preparing selected countries to participate in a future large-scale system of payments for verifiably reducing emissions from deforestation and degradation (REDD) and (ii) actually signing contracts with a separate group of countries for such verified emissions reductions in return for remuneration. It will therefore have two distinct parts: (i) a Readiness Mechanism to assist a group of 20 countries in building the capacity to participate in such agreements and (ii) a Carbon Finance Mechanism or Carbon Fund, which will negotiate contracts with a smaller group of countries and provide payment for the verified reductions in emissions.

There is no geographic focus for the FCPF. All borrowing member countries of the IBRD or IDA that are located in subtropical or tropical areas are eligible. However, priority will be given to countries with substantial forest areas and forest carbon stocks and to those that have forests that are important for the livelihoods of forest dwellers and indigenous peoples. The participants committee will select countries to participate based on the submission of a Readiness Plan Idea Note in accordance with technical criteria. It appears that the FCPF will give higher priority to countries that can best demonstrate how the system could work rather than countries that have the largest forest area and forest carbon stocks. Funding will be channeled, for example, through the SCF.

*The GEF TFA* is a financial incentive mechanism associated with the existing GEF Sustainable Forest Management Program, aimed at motivating tropical forest countries to invest country resources allocated through the RAF to projects dealing with SFM. The GEF views tropical forests as having benefits for (i) mitigating climate change, (ii) protecting biodiversity and livelihoods and (iii) providing environmental services for the millions of people who live in and depend on these forests. The ultimate aim of the additional funding from the TFA is to focus more investments in three GEF focal areas (climate change, biodiversity and land degradation) and on forests in regions where biodiversity and carbon stocks are high and forest conversion is taking place at a high rate.

The existing GEF system for allocating resources to all eligible countries in the SFM Program, the RAF, does not take into account the Land Use, Land Use Change and Forestry aspect of GHGs and the actions necessary to mitigate them. Hence, the rationale for the TFA is to provide a mechanism that was needed to fill the gap in the existing toolbox of GEF incentives to intensify the focus on reducing deforestation. The initial targets for the TFA are the three regions with large intact tropical forests: Amazonia, the Congo Basin and Papua New Guinea/Indonesia.

Each of these regions has more than 8 million hectares of broadleaf forest and is believed to be more than 70 percent intact. The target regions include 17 countries, which are home to 54 percent of tropical forest cover and 68 percent of tropical forest carbon.

The TFA creates an investment framework for a portion of the GEF global resources in biodiversity, climate and land degradation, and will foster convergence of investments in high tropical forest cover regions. It will reinforce the RAF system while keeping its integrity. In financial terms, the TFA will lead immediately to an augmentation of funding for SFM within the target region by up to $60 million. It also provides a real possibility of attracting additional donors.

The objective of the *World Bank CTF* is to accelerate the transformation to low carbon economies by financing the more rapid deployment of low carbon technologies and sector strategies. Such development, in turn, is aimed at bringing cost-effective reductions in the growth of GHGs. The aim is to put entire economic sectors and sub-sectors, such as the cement industry in China, on low carbon growth trajectories that will prevent large carbon emissions compared with the non-CTF intervention scenario. The primary rationale for the CTF is to mitigate the financing gap, which the Bank estimates at $100 billion annually. A secondary rationale is to provide mitigation efforts that are more "transformational" both within each sector and in overall development terms than have been in the past.

The CTF will use a blend of financial instruments, including grants, concessional loans and guarantees, to make investing in low carbon technologies more attractive to both public and private sector investors in the developing countries. It will also be a collaborative effort between the World Bank and other MDBs, through an investments plan for each country of operation prepared under the leadership of the country government. Upon the CTF trust fund committee's review of the investment plan and endorsement of the pipeline of projects and programs and the notional resource envelope required, the countries will proceed with project preparation. Prior to MDB appraisal, the project will be circulated to the trust fund committee for approval of use of CTF co-financing. Final project approval would be made by each MDB's own board. Access to CTF funding will be on the basis of: (i) ODA eligibility (according to Organisation for Economic Co-operation and Development/ Development Assistance Committee [OECD/DAC] guidelines); and (ii) an active MDB country program. There is no geographic scope or priority for accessing finances under the CTF.

The objective of the *GEF-IFC Earth Fund*, a partnership between the GEF and the IFC, is to leverage private sector funding to stimulate more innovative and cost-effective solutions in developing countries to the threats of climate, biodiversity loss and land degradation. It will emphasize new technologies that are yet to be commercially developed to address specific environmental problems (and therefore complement the CTF). The Earth Fund will rely on the IFC's ability to engage the private sector in order to encourage venture capital to make early-stage investments, using a wide array of financial instruments, including grants, soft loans and equity participation, as well as inducement prizes, to reward environmental innovation.
The main rationale for the Earth Fund appears to be that GEF efforts to engage the private sector under existing forms has not produced adequate results, and therefore a new, more flexible form of partnership with private sector entities, and particularly venture capitalists, is needed. The target of the fund is to work primarily with private investors and entrepreneurs, so it appears that there will be no country-related eligibility requirements.

The objective of the *The World Bank Strategic Climate Fund (SCF) (World Bank, 2008c)* is relatively broad and will address a host of issues. These issues include: (i) promoting

international cooperation on climate change and support progress towards the future of the climate change regime; (ii) providing experience and lessons in responding to the challenge of climate change through learning-by-doing; (iii) promoting and channel new and additional financing for addressing climate change through targeted programs to be established as part of the Strategic Climate Fund or through separate funds like the Clean Technology Fund or other funds addressing climate change, such as the Forest Carbon Partnership Fund; utilize the skills and capabilities of the MDBs to raise and deliver concessional climate financing at a significant scale to unleash the potential of the public and private sectors to achieve meaningful reductions of carbon emissions and greater climate resilience; (iv) providing incentives for scaled-up action and transformational action (both mitigation and adaptation) and for solutions to the climate change challenge and poverty reduction in developing countries, consistent with poverty reduction and sustainable development strategies that are robust to climate change; (v) providing incentives to maintain, restore and enhance carbon-rich natural ecosystems to prevent these carbon sinks from becoming sources of increased emissions, and to enhance all the services they provide, including climate resilience or adaptive capacity, and thereby support sustainable development; (vi) complementing other multilateral financial mechanisms, such as the GEF and the Adaptation Fund, and bilateral sources of financing and seek cofinancing where appropriate; and (vii) maximizing co-benefits of sustainable development, particularly in relation to the conservation of biodiversity, natural resources ecosystem services and ecological processes.

The SCF "will make available a range of financing, credit enhancement and risk management tools such as loans, credits, guarantees, grants and other support, targeted to the needs of developing countries. This strategic response will be implemented by the MDBs and other partners and will focus on accelerating and scaling up transformational low carbon and climate resilient investments while at the same time promoting sustainable development and poverty reduction."

*The World Bank Pilot Program for Climate Resilience (PPCR*) under the SCF "is designed to provide programmatic finance for country-led national climate resilient national development plans. The PPCR aims to provide transformational and scaled-up support for both the development and implementation of such plans. Furthermore, its purpose is to provide lessons over the next few years that might be taken up by countries, the development community, and the future climate change regime, including the Adaptation Fund. This experience will be gained through scaled-up interventions covering the full range of sectors and sources of financing, and with sufficient resources to move quickly from planning to action. The PPCR will build upon National Adaptation Programs of Action (NAPAs), will be implemented in a manner consistent with the Paris Declaration of Aid Effectiveness, and will complement the existing adaptation funds which continue to serve essential roles in tackling climate change."

The PPRC is intended to demonstrate a sector development risk management approach to climate adaptation. It will show how climate risk and resilience can be integrated into core development planning, so that the lessons learned can be applied in designing national adaptation programs. It will select 5–10 countries from those eligible for MDB concessional funding for scaled-up support to integrate climate resilience into development planning and budgets. The countries will be chosen on the basis of the advice of an Experts Group, but would expect to include at least one SIDS. The PPCR will support in-depth studies of particular sectors to determine how development planning needs to be revamped to take into account anticipated climate impacts.

The rationale for the PPCR is that the greatest need of the most vulnerable countries in coping with climate change is not specific projects but a rethinking of their development strategies at the sector level. Hence, priority will be given to highly vulnerable LDC eligible for MDB concessional funds, including the SIDS among them. Final selection of pilot countries will be the decision of the PPCR-Sub Committee, based on advice of the Experts Group. The impacts of climate change, according to this rationale, will be so pervasive in most developing countries that their needs for adaptation transcend the level of project. Country selection will be based on (i) transparent vulnerability criteria; (ii) preparedness to move to a strategic approach in integrating climate resilience into development; and (iii) country distribution across regions and types of hazards.

*The Kyoto Protocol Adaptation Fund* was established under the Kyoto Protocol to assist developing countries, which are particularly vulnerable to the adverse effects of climate change, meet their costs of adaptation. An innovative mechanism has been designed to use the proceeds from the system of CERs set up under the CDM. The Fund will operate on the principle of funding the full adaptation cost of projects and programs to address the adverse effects of climate change (in contrast to the adaptation funds already managed by the GEF, which fund only part of the total costs of projects). The funding will cover projects at the national, regional and community levels, and will reflect the priorities and needs of the country submitting the proposal. A board with a developing countries majority will make decisions on which adaptation projects to fund. All developing country parties to the Kyoto Protocol of the UNFCCC will be eligible to receive funding for climate adaptation projects, although the emphasis on vulnerability may give higher priority to certain categories of states.

*Funding details*

The World Bank FCPF

- amount of total funding: $165 million: $92 million for the Readiness Fund; $75 million for Carbon Fund
- target level: $300 million, of which $100 million would be for Readiness Fund, $200 million for the Carbon Fund
- type of funding: grants
- sources of funds: Austria, Denmark, Finland, France, Norway, Switzerland, the United Kingdom and the Nature Conservancy (The United Kingdom and Germany have contributed to both the Readiness Fund and the Carbon Fund; the Nature Conservancy has contributed only to the Carbon Fund; the other six countries have contributed only to the Readiness Fund. Minimum contribution to participate is $5 million for both governments and private sector entities.)
- period covered by funding: 2008–12

GEF TFA

- amount of total funding: initially $60 million
- type of funding: grants
- source of funds: GEF Global and Regional Exclusion funds ($30 million from the biodiversity focal area, $10 million from the climate change focal area and $20 million from the land degradation focal area); GEF intends to attract additional funding from donors
- duration of funding: GEF-4 (until June 2010)

The World Bank CTF

- amount of funding: still highly uncertain (The Bush administration has pledged some $2 billion but, according to congressional sources, there is uncertainty what amount, if any, will be approved in FY09 or thereafter. The United Kingdom has pledged part of the 800 million pounds (US$1.56 billion) committed to “environmental transformation” last year. Japan has indicated up to $1.2 billion for the CTF. A number of other donors have expressed interest in contributing.
- types of funding—
  - concessional financing in the near to medium term to meet investment needs to support rapid deployment of low-carbon technologies;
  - concessional financing at scale, blended with MDB financing, as well as bilateral and other sources of finance, to provide incentives for low carbon development;
  - a range of financial products to leverage greater private sector investments; and
  - financial instruments integrated into existing aid architecture for development finance and policy dialogue.
- sources of funding: United Kingdom and Japan; uncertainty prevails regarding contributions from the United States and other donors.
- duration of funding: 2008 to at least 2012 (It is proposed that the CTF would be reviewed after 2012 in light of the deliberations on a post-2012 climate change agreement, The agreed sunset clause for the CTF reads as follows: “Recognizing that the establishment of the trust fund is not to prejudice the on-going UNFCCC deliberations regarding the future of the climate change regime, including its financial architecture, the CTF will take necessary steps to conclude its operations once a new financial architecture is effective. Specifically, the Trustee will not enter into any new agreement with donors for

contributions to the trust fund once the agreement is effective. The Trust Fund Committee will decide the date on which it will cease making allocations from the outstanding balance of the Trust Fund."

GEF-IFC Earth Fund

- amount of funding: target amount is at least $200 million
- type of funding: grants and concessional loans
- sources of funding: GEF has allocated $50 million from its global and regional funds from the RAF and hopes to obtain at least $150 million in co-financing from private sector entities
- duration of funding: the Fund will begin operating in June 2008; there is no end date

World Bank SCF and its PPCR

- amount of PPCR funding: target for funding is $0.5 billion to $1 billion
- type of funding: grant and/or highly concessional financing; grant resources will be available to provide support for technical assistance and institutional adjustment
- sources of funding: World Bank hoped to interest donor countries in supporting the fund, but no pledges from donor countries have been reported
- duration of funding: The sunset clause for the SCF reads as follows: "Recognizing that the establishment of the trust fund is not to prejudice the on-going UNFCCC deliberations regarding the future of the climate change regime, including its financial architecture, the SCF will take necessary steps to conclude its operations once a new financial architecture is effective. Specifically, the Trustee will not enter into any new agreement with donors for contributions to the trust fund once the agreement is effective. The Trust Fund Committee will decide the date on which it will cease making allocations from the outstanding balance of the Trust Fund. Notwithstanding the above paragraph, if the outcome of the UNFCCC negotiations so indicates, the Trust Fund Committee, with the consent of the Trustee, may take necessary steps to continue the operations of the SCF, with modifications as appropriate." As far as the PPCR is concerned, it will provide financing only in the short term. Recipient countries will be identified, and the first phase of funding to prepare climate-resilient development plans will occur, primarily during 2008–2009. The Sub-Committee will not approve any new PPCR financing for activities after calendar year 2012.

Kyoto Protocol Adaptation Fund

- amount of funding: unknown (The level of funding that will be available to the Adaptation Fund is not yet known, because it will depend on the demand and price of emissions reductions on the carbon market. It is anticipated that there will be enough money in the fund for three or four years. The World Bank estimated in 2006 that by 2012 the amount could be anywhere from $100 million to $500 million. The GEF's calculations suggest that at least $600 million will be available by the end of 2012, given the current CER market development.)
- type of funding: grant assistance
- source of funding: a 2 percent levy on the emission permits (the CERs) generated by emission reductions projects under the Kyoto Protocol's CDM (The 2 percent share of the CERs generated by the projects will be levied by the CDM executive board and monetized and disbursed by the Adaptation Fund.)
- duration of funding: no definite start date has been decided; duration will be indefinite

### Table 4: Estimated level of funding from multilateral initiatives

| Fund | Total amount (US$) | Type of funding | Period | Source of funds | Comments |
|---|---|---|---|---|---|
| FCPF (WB) | 165 million, of which<br>91 million: Readiness Fund<br>74 million: Carbon Fund | Grants | 2008–12 | The United Kingdom and Germany have contributed to both the Readiness Fund and the Carbon Fund; the Nature Conservancy only to the Carbon Fund; six other countries only to the Readiness Fund. | Minimum contribution to participate is $5 million for both governments and private sector entities. |
| TFA (GEF) | 60 million | Grants | 2008–10 | GEF Global and Regional Exclusion funds ($30 million from the biodiversity allocation, $10 million from the climate change allocation) and $20 million from the land degradation focal area. | |
| CTF (WB) | Uncertain | Concessional financing, blended with MDB financing, as well as bilateral and other sources of finance | 2008–12 | UK and Japan. Uncertainty prevails regarding contributions from the United States and other donors. | |
| Earth Fund (GEF-IFC) | 200 million | Grants, concessional loans and innovative funding tools | 2008–**[?]** | GEF has allocated $50 million and hopes to obtain 150 million in cofinancing from private sector entities | Innovative funding tools include venture capital, prizes, and other tools that reward innovation. |
| SCF and its PPCR | Up to 1 billion | Grants and highly concessional loans | 2008–12 (PPCR) | PPCR: World Bank hopes to interest donor countries in supporting the fund, but no pledges have been reported | |
| Kyoto Adaptation Fund | Not known | Grants | No start date announced | A 2 percent levy on the emission permits generated under the Kyoto Protocol's Clean Development Mechanism | The exact level of funding is not yet known, because it will depend on the demand and price of emissions reductions on the carbon market. |
| Total Multilateral Funding | Less than 2 billion | | | | |

*Note:* CTF = Clean Technology Fund; FCPF = Forest Carbon Partnership Fund; GEF = Global Environment Facility; IFC = International Finance Corporation; MDB = Multilateral Development Bank; PPCR = Pilot Program for Climate Resilience; TFA = Tropical Forest Account; WB = World Bank.

### *Governance*

*Forest Carbon Partnership Facility (FCPF):* Policy and project decisions will be made by a Participants Committee, to include all public and private entities that have made a minimum contribution. The initial proposal is that the committee will have 12 members representing governments to be divided equally between REDD country members and donor country members. REDD country participants will elect representatives to the board, with each country participant getting one vote. Donors and private sector buyers will elect their representatives to the Committee; each will have one vote for each million dollars of contribution. Decisions by the board would be by majority if no consensus is reached. International organizations, NGOs and noncontributing private sector entities will be invited to participate in meetings as observers. The World Bank will be trustee and provide secretariat services through its Facilities Management Unit.

*GEF TFA:* Decisions on the use of resources under the TFA will be made under the overall GEF governance mechanism.

*The World Bank CTF:* The CTF will be governed by a Trust Fund Committee, which would include the following:

- eight representatives from donor countries or groups of such countries to the CTF identified through a consultation among such donors, and eight representatives from eligible recipient countries or groups of such countries identified through a consultation among interested recipient countries; provided, however, (i) if there are less than eight donor countries contributing to the CTF during the first year of the CTF operations, potential donor countries, identified through a consultation among the donor and potential donor countries, may serve as representatives from donor countries, and (ii) if there are less than eight donor countries contributing to the CTF in the subsequent years, the number of donor country representatives and recipient country representatives, respectively, shall be reduced to equal the number of actual donors contributing to the CTF. Representatives will serve for two-year terms, except that they may serve for a one-year term for the first year of the CTF operations and terms will be staggered so not all representatives are replaced each year. Representatives may be reappointed;
- the recipient country concerned, which, whenever the Trust Fund Committee considers an investment plan for a country or a program or project to be financed by the fund, will be invited to participate in the Trust Fund Committee during its deliberations on the work program, program or project;
- a senior representative of the World Bank, recognizing the role of the World Bank as the overall coordinator of the CIF partnership; and
- a representative of the MDB partners to be identified by the MDB Committee and chosen on the basis of rotation among the MDBs.

Members of the MDB Committee and the Trustee may attend the Trust Fund Committee as observers.

To ensure good linkages with key partners so as to promote the efficient use of resources and complementarity with other sources of financing, the Trust Fund Committee will invite to its meetings the GEF as an observer. A representative of the UN will be invited as an observer at Trust Fund Committee meetings for which broad strategic discussions are included on the agenda. Representatives of other institutions with a mandate to promote investments in clean technology to address climate change may also be invited as observers at Trust Fund Committee meetings. Recognizing the special areas of competence of the observers, the Trust

Fund Committee will invite observers to engage in an active dialogue. The Trust Fund Committee will elect two co-chairs from among its members for the duration of the meeting. One co-chair will be a representative of a recipient country and the other co-chair will be a representative of a donor country.

*The GEF-IFC Earth Fund:* The fund generally will be governed by GEF trust fund rules. Since the Fund deals with private sector entities, some modifications will be introduced, for example, some changes in GEF rules will be necessary for decision making on projects, because approval by the GEF focal point of any country in which a project is located would not be acceptable to IFC or potential private sector participants.

*The World Bank SCF and its PPCR:* The Trust Fund Committee for the SCF will consist of—

- eight representatives from donor countries to the SCF identified through a consultation among such donors, and eight representatives from eligible recipient countries identified through a consultation among interested recipient countries; provided; however, (i) if there are less than eight donor countries contributing to the SCF during the first year of the SCF operations, potential donor countries, identified through a consultation among the donor and potential donor countries, may serve as representatives from donor countries, and (ii) if there are less than eight donor countries contributing to the SCF in the subsequent years, the number of donor country representatives and recipient country representatives, respectively, shall be reduced to equal the number of actual donors contributing to the SFC. Representatives will serve for two-year terms, except that they will serve for one-year terms for the first year of the SCF operations. Representatives may be reappointed;
- a senior representative of the World Bank, recognizing the role of the World Bank as the overall coordinator of the CIF partnership; and
- a representative of the MDB partners to be identified by the MDB Committee and chosen on the basis of rotation among the MDBs.

Members of the MDB Committee and the Trustee may attend the Trust Fund Committee as observers. Any additional member of any Sub-Committee may be invited to attend the Trust Fund Committee as an observer.

To ensure good linkages with key partners so as to promote the efficient use of resources and complementarity with other sources of financing, the Trust Fund Committee will invite as observers representatives of GEF, UNDP, UNEP, and the UNFCCC. The Trust Fund Committee may also invite representatives of other organizations with a mandate to address climate change. Civil society will also be invited to identify a representative to observe the Trust Fund Committee. Recognizing the special areas of competence of the observers, the Trust Fund Committee will invite observers to engage in an active dialogue.

The Trust Fund Committee will have two co-chairs. One co-chair will be elected from among the country members of the Trust Fund Committee for the duration of the meeting, alternating from one meeting to another between recipient and donor representatives. The other co-chair will be the World Bank Vice President for the Sustainable Development Network.

Consensus is a procedure for adopting a decision when no participant in the decision-making process blocks a proposed decision. For the purposes of the SCF, consensus does not necessarily imply unanimity. A dissenting decision maker, who does not wish to block a decision, may state an objection by attaching a statement or note to the decision. If consensus is not possible, then a proposed decision will be postponed or withdrawn.

*Kyoto Protocol Adaptation Fund:* The Fund is governed by the Adaptation Fund Board (AFB), chosen for a two-year term and including 16 members representing parties to the Kyoto Protocol, as follows:

- two representatives from each of the five United Nations regional groups;
- one representative of the SIDS;
- one representative of the LDC parties;
- two other representatives from the parties included in Annex I to the Convention (Annex I Parties); and
- two other representatives from the parties not included in Annex I to the Convention (non-Annex I Parties).

Decisions of the AFB will be taken by consensus, but if no consensus can be reached, decisions will be taken by a two-thirds majority of the members present at the meeting on the basis of one member, one vote.

The governance arrangements for the new multilateral funds fall into three categories (see table 5). If the Earth Fund is set aside, it probably will not have an external board to make decisions on policy and projects. The FCPF clearly favors donors by allowing for the World Bank formula of voting power depending on contribution and decisions based on a simple majority. The Kyoto Protocol Adaptation Fund, on the other hand, clearly favors developing countries by allocating a large majority of the seats to those countries, while making decisions subject to a two-thirds majority. In the middle are the PPCR and CTF, with a consensus-based system, which makes a balance of representatives irrelevant, and the TFA, which relies on the existing system of double veto for donors and developing countries.

### Table 5: Governance mechanisms in new multilateral funds

| Fund | Governing board membership | Decision-making method |
|---|---|---|
| FCPF | 6 representatives of REDD countries; 6 representatives of donors and buyers. Each REDD country receives one vote, each donor or buyer gets one vote per million dollars contributed | Simple majority of votes |
| GEF TFA | Under GEF trust fund rules: 14 developed country representatives, 16 developing country representatives and 2 representatives from countries in Central Asia and Europe and the former Soviet Union with one vote per country | If there is no consensus, decisions are made by a combination of a 60% majority of total number of participants *and* a 60% majority of total contributions |
| CTF | 8 representatives each from developed and developing countries; a WB Senior Representative;a representative from the MDBs; a country representative when decision is made on a country investment plan | Consensus; no votes |
| Earth Fund | Under GEF trust fund rules: 14 developed country representatives, 16 developing country representatives and 2 representatives from countries in Central Asia and Europe and the former Soviet Union with one vote per country | If there is no consensus, decisions are made by a combination of a 60% majority of total number of participants *and* a 60% majority of total contributions |
| SCF and its PPCR | 8 representatives each from developed and developing countries, a WB Senior Representative, a representative from the MDBs | Consensus; no votes |
| Kyoto Adaptation Fund | 10 representatives of developing countries, 4 of industrial countries and 2 of Eastern Europe | Decisions made by two-thirds majority |

*Note:* CTF = Clean Technology Fund; FCPF = Forest Carbon Partnership Fund; GEF = Global Environment Facility; PPCR = Pilot Program for Climate Resilience; REDD = reducing emissions from deforestation and forest degradation; TFA = Tropical Forest Account.

### 3.4 Duplication, complementarity and synergy among fund activities

Is there potential duplication of activities among these new funds or among the new and existing funds? Or are these funds complementary or even synergistic in relation to one another and the existing funds? The following analysis of the interactions of new and existing funds covers three categories of funds: those that aim to support (i) low carbon technologies, (ii) adaptation and (iii) REDD (reducing emissions from deforestation and degradation).

*Low carbon technologies*

Leveraging finance to encourage the adoption of low carbon technologies is an objective of many of the funds reviewed. So, is the CTF going to do what the GEF was set up to do and has, in fact, been doing? The GEF has been engaged in funding projects aimed at “buying down” the cost of climate-friendly technologies for many years by offering a blend of grant and to a lesser extent concessional financing for promising renewable technologies. It also has a system in place to evaluate the kinds of projects contemplated by the CTF under its existing climate change focal area. This suggests that the CTF might overlap, and likely compete with, the existing operations of the GEF in the climate focal area.

In terms of the types of technologies supported, the GEF has focused its climate-related investments primarily on projects aimed at promoting renewable energy technologies that are not yet proven. The CTF, on the other hand, would fund technologies that are already proven, with the ambitious aim of scaling up the adoption of such technologies by buying down the costs of investments in lower carbon technologies than what otherwise would have been chosen in those countries’ industrial sectors. But the GEF also serves a second major niche in promoting clean technology that is much closer to what is being suggested for the CTF – that is, its portfolio of more than 30 projects for technology upgrading and adoption and diffusion of energy-efficient technologies in the industrial sector. Indeed, this industrial energy-efficiency portfolio has been implemented by the World Bank and the IFC. Rather than focusing on specific technologies or even a specific industry, it has supported the development of market and financing mechanisms, such as the energy service companies that support and stimulate investments in energy-efficient technologies. GEF projects have promoted energy-efficient equipment, such as boilers, motors and pumps, and even cogeneration of power (Miller, 2007). These appear to be exactly the kinds of investments that the CTF is aimed at promoting. It would be surprising if the CTF was not contemplating using some of the same mechanisms for “buying down” the costs of the some of the same types of technologies in a range of sectors.

The CTF is therefore likely to be doing the same things that the Bank has done in the past as a GEF agency. By creating the CTF, the Bank will have diminished incentive to continue its engagement with the GEF, because it will be funded directly by bilateral donors rather than through the GEF. Rather than creating synergy, therefore, the new arrangement will likely have the effect of undermining an existing GEF supported program that appears to have been reasonably successful.

The differentiation between the two approaches with regard to geographic focus does not appear to be clear-cut. It encourages the highest-emitting countries in the developing world to adopt a low carbon path by offering concessional loans as well as by financing the blend of concessional loans and grants. Through that approach it will provide the necessary incentives for the appropriate technological shifts to take place at the sector level. It also contemplates levering policy dialogue at the sector level with grant financing. The result should be that entire sectors shift to low carbon paths, thus preventing large carbon emissions compared with the

scenario envisioned before the CTF intervention. The GEF RAF for the climate change focal area uses a Global Benefits Index that, in the end, also concentrates most of its climate change resources on the highest-emitting countries.

The approach used by CTF to promote the adoption of climate-friendly technologies may also be differentiated from that of the GEF by virtue of the bigger role to be played in the CTF by IFC, which has long experience in collaborating with the private sector. The IFC's obvious advantage in working with the private sector is what led the GEF to develop a partnership with IFC through the Earth Fund.

Although there are obviously differences between the proposed CTF activities and the GEF's existing funding for the elimination of barriers to energy-efficient and renewable technologies, it is clear that there is a substantial overlap between them as well. Furthermore, the channeling of funding by donor countries through the CTF not only might be at the expense of funding the GEF's climate-related funding, but also will have the effect of dramatically reducing World Bank participation in the GEF.

### *Adaptation*

In the area of funding for climate adaptation, there appears to be an obvious overlap, at least with regard to objective, among the proposed new World Bank PPCR under the SCF framework, the Kyoto Protocol's Adaptation Fund and the existing funds to support adaptation by developing countries managed by and under the GEF. These overlaps include the fund for "Piloting an Operational Approach to Adaptation" within the GEF's climate change focal area, the LDCF and the SCCF.

In addition, activities carried out under the GCCA, the Cool Earth Partnership and the Spanish MDG Fund include mainstreaming of climate into development as a means of adaptation. The GCCA will focus on integrating adaptation plans into poverty reduction and development strategies. It plans to help develop the institutional capacity in LDCs and SIDS for mainstreaming and will focus on climate-proofing EU-funded programs and projects. The Spanish MDG Fund also plans to support mainstreaming environmental issues in national and subnational policy, planning and investment frameworks. The Cool Earth Partnership will support the mainstreaming of adaptation measures in the formulation of development plans and support measures that facilitate coordination between sectors. This points to a situation of funding overlap and complexity with, as yet, little sign of effective coordination.

Both donor countries and developing countries have been particularly critical of the PPCR with regard to its relationship to the Adaptation Fund. At the Paris donors' meeting in April 2008, some donors suggested that the PPCR should be revised to avoid such duplication. Similar concerns were expressed at the climate negotiations in Bangkok in April 2008, where the Philippines (for the G77), China and India all expressed concerns about the PPCR undermining the Adaptation Fund. The World Bank has denied any intention of competing with the Adaptation Fund and has promised to work with the UNFCCC Secretariat to ensure that they are not competitive in any way. It has even announced that the chairman of the Adaptation Fund will be on the oversight committee that governs the PPCR. As a further sign of collaborative working, the World Bank and the GEF have agreed to a set of operational principles by which each party recognizes that the other has important but different roles to play in funding adaptation.

Perhaps the biggest difference between the PPCR and the GEF funds is in the types of activities they will support. The PPCR will pilot approaches to mainstreaming climate change into development planning through sector strategies, whereas the GEF will support adaptation projects. Both approaches are prominent in the climate change literature and both have their advantages and disadvantages (e.g., see Klein et al.). Mainstreaming approaches may align better with other development processes such as poverty reduction strategies, but they may make it harder to disaggregate finance for adaptation activities compared with normal development activities. It may also be more difficult to see visible results in the short term.

The PPCR is a pilot fund, which the Bank has pledged will not “prejudice the ongoing UNFCCC deliberations regarding the future of the climate change regime, including its financial architecture.” The Bank has therefore promised that the SCF will “take the necessary steps to conclude its operations once a new financial architecture is effective.” Specifically, the Bank says it “will not enter into any new agreement with donors for contributions to the trust fund once the agreement is effective. The Trust Fund Committee will decide the date on which it will cease making allocations from the outstanding balance of the Trust Fund.” The SCF sunset clause finishes by saying that “if the outcome of the UNFCCC negotiations so indicates, the Trust Fund Committee, with the consent of the Trustee, may take necessary steps to continue the operations of the SCF, with modifications as appropriate.” World Bank officials have said, however, that their aim after the conclusion of the PPCR’s work is to increase funding for IDA’s mainstreaming of adaptation and to provide lessons for IDA and the Adaptation Fund.

The Adaptation Fund is to be funded from a 2 percent share of the revenues from the market for CERs under the CDM system set up by the UNFCCC. However, there are substantial uncertainties about how much funding the market will generate, because it will depend on both the size of the market and on prices. The variation is partly due to uncertainties in the future of carbon markets and size of future emissions caps, which are currently being negotiated in the Bali Road Map process up to December 2009. Estimates vary widely, from a few hundred million dollars to nearly a billion dollars by 2012, which would make expected funding for the Adaptation Fund comparable to the funding anticipated by the PPCR.

The uncertainties associated with the market leaves open the possibility that the Adaptation Fund would seek funds from donors for adaptation as well. If this happens, there will be competition between the Adaptation Fund, the existing GEF-managed adaptation funds and the PPCR or a successor organization that plans to continue the same kind of work for some of the same bilateral donors’ support. The LDCF and SCCF are already supported by overlapping groups of donors: the LDCF by 17 (Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland and United Kingdom) and SCCF by 13 (Canada, Denmark, Finland, Germany, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom).

The anticipated problem posed by the interaction of the PPCR with existing adaptation funds, therefore, is not that they are doing the same thing, but that they might compete for funding from the same donors under the same rubric. The question, therefore, is whether donors are prepared to increase their funding for adaptation to support two different approaches or will support the new approach at the expense of the old one.

### *Reducing emissions from deforestation and forest degradation*

The new political urgency surrounding the threat of climate change has given rise to a multiplicity of new funds – both bilateral and multilateral – to reduce the contribution that deforestation makes to global carbon emissions. The multilateral funds already announced for targeting deforestation in relation to climate change include (i) the World Bank's FCPF and (ii) the GEF's TFA. In addition to these multilateral funds, three bilateral funds – the Australian Government's GIFC, the Norwegian Government's Rainforest Fund and the UK's ETF – are all focused in part or in whole on reducing the contribution of deforestation to carbon emissions causing climate change. The bilateral funds have not advanced unique solutions for the contribution to carbon emissions from deforestation but appear to be oriented toward contributing to one or more of the multilateral funds dealing with the problem. The Australian GIFC, Norwegian Rainforest Fund and UK ETF have indicated their intention of channeling at least some of their resources on deforestation through the World Bank's FCPF.

However, the FCPF and the GEF TFA have adopted different approaches to the problem of reducing deforestation rates. The FCPF is clearly oriented toward future markets for CERs. One of it two major programs, called the Readiness Mechanism, is aimed at helping a small group of countries prepare to enter the CER market by providing technical assistance for the preparation of national REDD strategies, establishing reference scenarios for emissions reductions from those sources and establishing monitoring systems for such reductions. The other program, the Carbon Finance Mechanism – also called the Carbon Fund – will pilot incentive payments for REDD policies and measures in a select group of countries in accordance with actual contracts with buyers.

The GEF Sustainable Forest Management Program's TFA, adopted by GEF Council in November 2007, is intended to focus GEF forest investments on the tropical forest regions and countries with the highest carbon stocks and biodiversity. Thus, the GEF is committed to focusing its limited resources on investments in Amazonia, the Congo Basin and Papua New Guinea/Indonesia, which together account for 68 percent of the world's tropical forest carbon and 43 percent of all the world's plants as endemic species. At present, however, it is not intending to use carbon markets as a strategy to influence the rate of deforestation.

Although the FCPF gives priority to countries with substantial forest area and forest carbon stocks, it does not appear to anticipate focusing on the tropical forest countries, which are the largest sources of carbon emission from deforestation and land degradation. Rather, as a program for piloting, it is more concerned with working in countries that could best demonstrate how the system could work.

The majority of the bilateral funds that aim at supporting reduced deforestation will work in the Congo Basin, the Amazon and southeast Asia. For example, the small part of the ETF that is allocated for bilateral funding is currently providing support to the Congo Basin Rainforest Fund. The GIFC has made commitments to supporting activities in Indonesia and Papua New Guinea. The Spanish MDG Fund is supporting projects in Colombia and Ecuador and the NORAD Rainforest Fund is in contact with the Brazilian government. Some of the emerging funds also specifically target LDCs and SIDS. Although no specific details on the REDD window of the GCCA are available, it seems reasonable to assume that it will focus on African, Caribbean and Pacific countries in line with the EU's aid priorities. These facts appear to indicate a rather haphazard selection of country targeting based on existing donor priorities and initiatives (though it must be noted that most of the bilateral funds have not yet advanced to the stage where decisions about allocations to specific measures in specific countries have been made).

The GEF, if it continues to be independent of the carbon market, could capitalize on these differences and complement the approach of preparing countries to participate in the carbon market by focusing on capacity building measures and enabling countries to engage in the carbon market with cabon benefits derived from GEF supported interventions. However, the World Bank is also carrying out readiness activities that aim to help developing countries prepare for reduced deforestation investments. Funding from donors in this area (which is not raised through carbon markets themselves) could be in direct competition with the sourcing of funds for GEF activities on deforestation.

In addition, the bilateral initiatives (e.g., parts of the GCCA and GIFC) could reduce funding channeled through either the GEF or the World Bank. For example, the GCCA plans to expand such programs such as the forest law enforcement, governance and trade initiative of the European Union and the development of new laws against illegal international trade in timber and forest products as a way to address deforestation. The GIFC also plans to support the establishment of effective regulatory and law enforcement arrangements (including the prevention of illegal logging) to protect forests. How well integrated such efforts will be at the national level remains to be seen.

# 4. TOWARD A MORE COHERENT SYSTEM OF FUNDING

The creation of these 14 new global environment funds (and the likelihood of further bilateral initiatives), coupled with donor country willingness to channel a considerable portion of their new resources into the World Bank, raises questions about the future of the whole system of global environmental finance. Do the trends highlighted in the preceding sections portend a fundamental shift in the existing system of global environmental funding, one in which a World Bank–centered multilateral institutional arrangement replaces the GEF as the locus of strategy and funding decisions for climate change?

Major donor countries appeared to signal their readiness to move in that direction at the 2005 climate-centered G-8 Summit at Gleneagles, when the heads of state said the World Bank should "take a lead role in creating a new framework for clean energy and development, including investment and financing." Whether the donors had already consciously made the MDBs the primary channel for climate-related funding, or had not thought through the full consequence of decisions regarding the shift in the locus of global environmental financing, is not clear. Regardless, the Bank has acted as though it has a mandate from donors to act as the lead institution with regard to funding activities for climate mitigation – including reduced deforestation – and adaptation. Not surprisingly, GEF senior management has interpreted recent developments as a clear indication that their institution, which was intended to be the unique focus for global environmental funding, is being marginalized by the donor community.

## 4.1 Major requirements of a new system of global environmental finance

This section examines the question of the appropriate roles of the World Bank and other MDBs, the GEF and bilateral funders in the future architecture of global environmental funding in light of four different needs in regard to that architecture:

- the need to scale up efforts and to act with greater urgency;
- the need for policy coherence;
- the need for independent coordination; and
- the need for North-South accord in carrying out measures for global environmental benefit.

### *Need for scaling up with urgency*

There is need to quickly upscale successful technologies and good practices to significantly reduce the carbon footprint at the national and global scales. Considerations of time and dimension clearly favored the World Bank and other MDBs over the GEF. The Bank has demonstrated an ability to respond quickly to new opportunities by creating three new funds (the FCPF, CTF and SCF, including the PPRC and additional subsidiary funds). The GEF, on the other hand, has been constrained by a deliberately complex management arrangement, including a cumbersome approval process. Furthermore, the GEF's sometimes fractious Council has not been able to act swiftly to innovate in response to new circumstances and opportunities. For example, this management arrangement has been a major contributing factor to its failure until now to recognize the need for and adopt a policy toward carbon markets.

The World Bank is accustomed to moving billions of investment dollars annually, and its culture has long put a premium on large volume investments. Thus, in a sense, scaling up comes

"naturally" to the World Bank, whereas the GEF would need to make major organizational adjustments to scale up technology-related operations. Moreover, the GEF has been forced by its limited replenishment funding to find ways to stretch its funds, so it would need some shift in institutional arrangements to manage a fund for promoting clean technology that is an order of magnitude larger than the similar program it has managed in the past. The Bank was thus prepared to undertake the mission that the donors had in mind immediately, while GEF would not have been able to undertake the kind of urgent scaling-up without major internal adjustments. It was also recognized that climate action needs to be better integrated into the development dialogue and lending programs of the MDBs, than would be possible through the GEF alone.

### *Policy coherence on financing climate change mitigation and adaptation*

The lack of policy coherence on financing climate change at the national and global level is a reflection of a lack of overall policy on how to address the complexity of the issue itself. In making decisions on funding projects to reduce GHG emissions and adapt to climate change, it is vital that the system of global environmental finance acts on coherent policy guidance.

As of now, is not clear that the CTF is designed to push for the lowest carbon alternatives available in each case. The World Bank has not been able to provide a clear definition of what it means by "clean energy," and the ambiguity surrounding that concept represents a serious lack of policy coherence. There is a danger, in fact, that the CTF will simply fund incremental improvements in technology rather than anything close to the lowest carbon alternative, despite one of the investment criterion is "significant" GHG emissions savings, which will be the basis for prioritizing investments.

Bank officials have referred to "clean coal" technologies, for example, as following within the ambit of the new fund. But these are technologies that the World Bank and its private sector arm, the IFC, are already funding through its normal lending terms and that require less concessional terms than projects that are the lowest carbon alternative. Bank staff have suggested that such projects are indeed contemplated by stating that the starting point for determining what may be financed is the "business as usual" path. The implication is that anything that reduces emissions from that baseline would be eligible for funding by the CTF.

The danger of an unclear policy to guide investment on "clean technology" is that funds will not be invested to maximize reductions in GHGs but will become a compromise between that aim and the financial interests of the World Bank and other MDBs. When compared with the GEF's policy guidance from a combination of the UNFCCC and from the GEF Council, it appears that the new system will represent a serious retrogression in this regard.

Policy coherence is needed between the new global and bilateral funds and national systems in recipient countries. The level of *alignment* with country systems is not yet clear, as many of the initiatives are still in a development stage. It is likely that the GCCA will use country systems to disburse funding. The use of general budget support, channeled via the Ministry of Finance (with the involvement of the Ministries of Development and Environment) is one delivery mechanism currently under review (see box 1) and the GCCA recognizes it as being a potentially better way to deal with large volumes of funding.

The level of *harmonization* between the different initiatives cannot be determined at this stage. It is clear that initiatives have been donor-driven and talks between various initiatives have followed. Currently, the GCCA and the CIFs are in initial stages of dialogue over the

complementary geographic focus of their initiatives. The GCCA, the CIFs, the GIFC, the Cool Earth Partnership and NORAD Rainforest Initiatives are also consulting with other donors to gather support for their respective initiatives. The Spanish-UNDP hopes to ensure harmonization via a bottom-up structure. This Fund relies on resident coordinators to ensure that proposed activities are not duplicating initiatives financed by other funds. The GCCA also makes specific reference to its role as a clearinghouse mechanism that will ensure coordination among EU member states. It also refers to the Code of Conduct promoting "division of labor" to ensure effective aid delivery.

**Box 1: The potential for new aid delivery mechanisms to strengthen environmental spending**

Current levels of public funding for environment-related actions are clearly inadequate in many developing countries. This is reflected in the apparent limited attention given to the environment within national development strategies and within the daily practice of the public administration. With the advent of climate change and the likelihood of more severe environmental hazards arising from climatic variations, it has become increasingly important to find effective ways of addressing these concerns. International assistance, and the modality by which it is delivered, can make a significant contribution to improved national environmental governance and management.

General Budget Support (GBS) is seen as the aid modality that is most inherently aligned to national policies and systems. Its increased use holds the promise of addressing the problem of financing environmental objectives in a more creative way. Budget support can provide substantially increased and highly flexible funding for public sector budgets, through mechanisms that are low in transaction costs, serve to strengthen national financial management and accountability systems and give the beneficiary country a high degree of control over the use of the resources. This control is exercised through the democratic institutions normally in charge of the budget process, thus promoting country ownership of, and responsibility for, the development process. However, it is important to note that budget support is only a feasible option in countries with reasonably sound public financial management systems and low fiduciary risk. Also, budget support offers no guarantees that environmental objectives will be prioritized if they are not already part of government's policy priorities.

***Reference:*** Lawson and Bird, 2008.

Overall, there is still little clarity on how the implementation of these new funds will preserve (let alone strengthen) current donor harmonization and alignment efforts at the country level. There will need to be a significant level of flexibility in the definition of these international vertical funds to ensure that their areas of intervention are consistent with nationally defined priorities and that the management of the funds is absorbed by country systems. Harmonization will need to be pursued both internationally and in-country and will need to go beyond climate-related interventions.

### *Need for independent coordination*

To assure donors that financial resources are being applied in the most effective way possible to maximize impacts on climate change and other global environmental threats, independence and coordination are needed between the agency that is seeking funding for its own projects and the agency that reviews project or program proposals.

The GEF model has the distinct advantage of providing an independent staff and competitive proposals for project funding within an agreed global strategic framework approved by donor and recipient countries. It seems likely, however, that the decision-making process on the Trust Fund Committee or the SCF Subcommittee and the FCPF Participants' Committee will be driven by understandings among the MDBs themselves about how to divide the money. A notable feature of the governance arrangements for the CTF and PPRC is that either the World Bank or the other MDB representative could force a non-consensus and hence the postponement or withdrawal of the decision, which creates a powerful incentive for deals among them. That incentive structure will have the effect of encouraging each bureaucracy to bargain to maximize its share of the funding, thus eliminating any real possibility of outside review and control over how the money is spent. The GEF model also represents a system for coordination of GEF agency strategies and project pipelines by a neutral party. This advantage, too, will be lost in the system now being created. It thus represents a significant loss compared with the existing system in terms of the ability to distribute and allocate resources to appropriate agencies based on their comparative advantages as they address the complex challenge of climate change.

*Need for north-south accord*

Past decades of international cooperation on global environmental issues has demonstrated how important a north-south accord is for the harmonization of the competing interests of donor and recipient countries.

The new funds created by the World Bank will have significant implications for the north-south accord on funding, in which the GEF, as the financial mechanism for the UNFCCC, represents an imperfect and uneasy compromise between donor and developing country power over funding decisions. A central feature of the developing country position has been that decision making should be based on the principle of one country, one vote, rather than on the amount of money contributed, which is the principle governing World Bank decision making. In addition, the World Bank funds were developed outside the UNFCCC framework and hence subjected to limited negotiations between the North and South.

In this regard, the World Bank's CTF, SCF and FCPF all represent a distinct step back from the GEF compromise. In the FCPF governance structure, the World Bank has reintroduced the idea of the vote of those providing capital depending on the size of contribution. The CTF and SCF governance arrangements give unprecedented power over programming and project decisions to the World Bank and other MDBs. Those features of the new system are almost certain to create a new level of north-south political discord over the funding for global environment at an historic juncture, when the world can ill afford it. In the clause on decision making of the CTF and the SCF, it is stated that "decision-making will be made by consensus of the voting members of the Trust Fund Committee. Consensus is a procedure for adopting a decision when no participant in the decision-making process blocks a proposed decision. For the purposes of the SCF, consensus does not necessarily imply unanimity. A dissenting decision maker, who does not wish to block a decision, may state an objection by attaching a statement or note to the decision. If consensus is not possible, then a proposed decision will be postponed or withdrawn."

## 4.2 The future of the GEF

This brief assessment of how the emerging system of global environmental finance – at least for climate-related issues – suggests that there is no easy fix for the problem of constructing a system that meets all the major requirements.

Although the World Bank and other MDBs are better positioned to scale up financing to reduce greenhouse emissions rapidly compared with the GEF, the World Bank also has some major limitations as the potential centerpiece of a new system of global environmental finance. Among those is the fact that the new funds are not within the UNFCCC and its governance structure, as well as institutional biases brought about by the World Bank's status as a commercial bank. Furthermore, giving the World Bank and other MDBs the primary role in climate funding would tilt the balance between developing countries and the donor-MDB combination subtly, but decisively, toward the latter. This shift would threaten a tenuous compromise and promise a costly new north-south struggle just as the period of long-term cooperation on climate change is about to begin.

The GEF, as a network organization, has obvious weaknesses but, nevertheless, does have some characteristics that are crucial to a coherent and effective architecture for global environmental finance. To maximize the effectiveness of the emerging system of global environmental finance, it should have a central, rather than peripheral, role. Although donors have tended to be pessimistic about its future, the GEF, within its mandate, could be strengthened by a series of reforms over the next few years so that it could undertake, for example, a scaled-up program on clean technology, adaptation and perhaps even carbon markets that would have more resources behind it and greater impact than its present climate and SFM portfolios.

A quick list of key GEF weaknesses that need to be remedied would include (i) some provisions in the GEF Instrument that represent obstacles to obtaining funding outside the regular replenishments, (ii) its slowness to respond to new opportunities such as carbon markets and (iii) its project cycle, which was reformed but still has to show the desired impact in terms of shorter approval periods. Each of these obstacles to the GEF becoming a more dynamic funding institution in the area of climate change, including SFM, could be fixed if the political will were present to do so.

Perhaps the single most strategic issue on which reform is needed is the power given to the GEF Council under the present GEF charter to vote on each individual project. That power has slowed the pace of adaptation to climate needs and may need to be reconsidered. A more streamlined approach, under which the Council would approve "envelopes" of funding for an MDB to give it flexibility on decisions regarding individual projects but subject to clear policy guidelines provided in a programming document, would give the GEF a big advantage in being able to move larger sums of money for strategic programs on climate change.

The shift in the role of the GEF Council would immediately help accomplish a second needed additional reform: the simplification and shortening of its project approval cycle. By having the Council approve packages of projects at once, it should be possible to reduce the time required for final project approval by many months. That could also make collaboration with the GEF more attractive to private enterprises that have hitherto found its years-long project cycle forbidding.

The adoption of a system of approval of funding by envelopes rather than by individual projects would free up the GEF Council to focus on strategic issues confronting the GEF. That change, in turn, could make the GEF much more flexible and innovative in responding to emerging environmental challenges, reshaping GEF priorities and promoting innovative approaches with its partner agencies. One of the strategic challenges for the GEF Council is to make a much more compelling case for the synergies between its function of providing global environmental benefits and overcoming the obstacles to development posed by environmental threats, particularly by climate change.

The GEF also needs to be more innovative in working with donors to create new specialized funds. GEF Replenishments happen every four years and must be run through the office of a Vice-President of the World Bank and in effect are a joint operation between the GEF and the Bank. The amount of pledged resources is distributed by focal area as a result of the replenishment negotiation process. Contributions to the GEF trust fund outside the replenishment process and/or earmarked by the donor for a specific purpose have turned out to be problematic since the GEF instrument does not foresee such scenarios. Hence, any effort by the GEF to set up additional trust funds to receive funds for a specific purpose must be approved by the Bank and would be a lengthy process at best. That legal requirement is to a large extent responsible for the GEF's lack of flexibility in opening new windows for funding that could attract donor interest.

As to the future of the GEF, it can be concluded that much will depend on how it reacts to this new financial landscape. Responding to new opportunities will require some changes in the organization and likely will include the following:

- revising the GEF mandate to ensure that its function of providing global environmental benefits is more intimately linked to sustainable development challenges that are besetting developing countries as climate impacts intensify;
- reshaping GEF priorities to respond to emerging environmental challenges and promote innovative implementation approaches with its partner agencies;
- reviewing a host of institutional arrangements, including broadening mechanisms for channeling financial resources into GEF programs, creating new funds as requested by donor and client countries and assessing the relative merits of having the World Bank, or another agency, serve as the GEF's trustee; and
- strengthening the recently established public-private partnership window to significantly reduce the bureaucratic constraints encountered in such activities initiated under GEF-4, including separate governance arrangements with private sector partners.

Thus far, donors have shown no real interest in any alternative to the revision of the system implicit in the proliferation of new funds. But the needs of the system for coherence and effectiveness demand a serious consideration of a reform of the existing system in preparing for the post-2012 phase of international cooperation on climate change.

### 4.3 Other issues regarding the new funds

*Will resources be additional to existing ODA commitments?*

Among other key concerns raised since the appearance of the new funds is the question of whether the resources provided to the new funds by bilateral donors will be additional to existing ODA commitments. Diversion of ODA relating to climate change activities has been a focus of intense civil society concern (e.g., Oxfam, 2007). It has also been concluded from analyses of the financial requirements for adapting to climate change that additional finance will be required above and beyond existing ODA for developing countries to adapt to climate change (Stern, 2006). However, in mid-2007, Oxfam found that in almost all cases climate-related finance was being counted as part of existing assistance, with only the Netherlands explicitly committing to providing climate-related finance in addition to the 0.7 percent of national income as aid. This is occurring in a context in which total net ODA from DAC donors has fallen in real terms since 2002–05 with preliminary figures for 2007 indicating that it had declined by 8.4 percent in real terms compared with 2006.

Interviewees were generally aware of this issue, and some publicly available documentation[8] mentions the relationship to ODA, but it is still unclear how donor agencies will ensure that aid diversion does not occur as a result of these new funds. Climate-related finances will need to be classified and reported separately from developmental aid transfers.

The research also raised a series of wider issues in this context:

- The difficulties of disaggregating the costs for adaptation activities from normal development activities may make the aid diversion issue prominent in the adaptation funding area.
- The greater ease of classifying finance for specific adaptation projects as additional, compared with finance for climate-proofing development interventions, may contribute to further divisions between these two approaches and result in a tendency toward more project-based approaches.
- The shift in fund management from ministries of development to ministries of environment (e.g., as in Norway and Germany) may make distinctions easier, but this depends on how the funds are classified. For example, in Norway funds are still classified as ODA even though they are under the Ministry of Environment.
- The innovative financial mechanisms relating to climate investments (such as air travel adaptation levies and carbon trading auctions and levies) that are being considered by some donors may help to raise additional funds that are more clearly separated from ODA.

*Will the new funds undermine the authority of the Multilateral Environmental Agreements?*

The initiatives vary in their degree of alignment with the existing structures established under the Multilateral Environmental Agreements. For instance, the ETF has been deliberately created by the British government to transform the ability of the World Bank to address global environment issues, notably climate-related challenges, and purposefully excluded direct contributions to the GEF. This shift has given rise to concerns among recipient countries

[8] For example, the response letter from DfID to the Development Environment Group, April 2008, regarding the ETF.

regarding the creation of a new architecture for climate-related international finance that is parallel to the UN-driven architecture. The UN's financial mechanism (until now, the GEF) has been subject to the overall guidance established by the COPs to the climate change, biodiversity and desertification treaties

This move reflects two quite different starting points to the debate over financing climate change actions. The first is rooted in the longstanding relationship between donors and recipients, involving the transfer of financial resources between the north and south as part of the development process. The second represents a new global response to human-induced GHGs, which have been generated mostly in the industrial north. Under this latter approach, countries should respond to the challenges of climate change by applying the principle of "common but differentiated responsibility." In cases in which countries in the south are unable to meet present financing needs for adaptation and mitigation, northern countries can be expected to assist, but not through a classic donor-recipient relationship. However, traditional donor countries seem to be characterizing their international funding for climate change as part of developmental spending.

Particularly with regard to adaptation spending, it has proved difficult to determine where "developmental spending" ends and "climate adaptation" spending begins. Under these circumstances, and certainly for funds that have the co-benefit objective of poverty reduction (which is stated in half of the national initiatives), the likely effect on multilateral environmental governance is one that diminishes the UNFCCC as the sole center of negotiation for international finance.

On the other hand, the Spanish MDG Fund aims at supporting existing multilateral channels with its support of the One UN Reform[9] program and its use of the UNDP to guide and deliver its international cooperation. One step removed, the European GCCA aims at complementing and supporting the UNFCCC, the Kyoto Protocol and the Nairobi Framework. To do so, it intends to set up a forum and a fund (outside the UN system) that will support ongoing activities like the UNFCCC negotiations and the implementation of the GEF-funded National Adaptation Programmes of Action (NAPAs). It will also potentially facilitate coordination (in alignment with the UN process) by serving as a clearinghouse mechanism for European initiatives.

### *Are developing countries and civil society being consulted?*

With respect to *ownership*, few of the initiatives have involved recipient countries in the inception phase or have been consulted by partner countries. The second and third consultations on the ETF (and the CIFs) have included developing countries, and a web consultation was launched as a result of requests from civil society. Finally, in May 2008, during a two-day meeting in Potsdam, Germany, representatives of 40 developing and industrialized countries reached an agreement to create the two World Bank administered international climate investment funds, the CTF and SCF, that will provide innovative financing for developing countries to pursue cleaner development paths and protect themselves from the impacts of climate change. The GCCA, driven by the DG Development in the European Commission, was opened for consultation at the Lisbon Development Days, at a Bali side-event and through an NGO consultation event in March 2008. The Cool Earth Partnership was announced by the Japanese prime minister and its design is based only on consultations with like-minded donors

[9] The objective of the One UN Reform program is to ensure faster and more effective development operations and accelerate progress to achieve the MDGs by establishing a consolidated UN country presence, with one program, one budgetary framework and an enhanced role of the UN Resident Coordinator.

and inputs from a Japanese select committee. The GIFC was presented by the Australian government and is currently under review with like-minded partners and recipient countries, such as the ministries of environment and forests in Indonesia, much to the exclusion of NGOs.

It is likely that some of the initiatives will facilitate greater developing country ownership in the implementation phase because country policies and strategies will be strengthened and supported. For instance, the GCCA and the Pilot Programme for Climate Resilience (under the CIF) will potentially finance the implementation of NAPAs. Similarly, the Spanish UNDP fund and CIF, make a specific reference to their adherence to the Paris Declaration on Aid Effectiveness.[10] On the other hand, the imposition of specific conditionality clauses in some cases is likely to undermine nationally identified priorities. For instance, access to GIFC and Cool Earth Partnership financing is likely to be determined by achievement of predetermined indicators.

On the whole, this study concludes that the new bilateral funds have so far made insufficient efforts to promote domestic ownership. Global environmental funds' governance and priority setting remain largely driven by the interests of north-based development agencies. This problem further underlines the need for donor countries to reconsider the decisions that are now leading to a de facto reconstruction of the system of global environmental finance.

[10] See oecd.org/dataoecd/11/41/34428351.pdf.

## 5. CONCLUSION

The international community is at a crossroads with regard to the system of financing for the global environment. The proliferation of new funds and funding mechanisms over the past year is bringing about major changes in the roles of different funding institutions. Specifically, they have the effect of shifting funds for climate change as well as deforestation from the GEF to the World Bank. More important, it may consign the GEF to a peripheral role in the system, while making the World Bank and other MDBs the central institutions for financing climate change.

As we have argued in this paper, this would be an unfortunate result of a development that was clearly motivated by a desire to accelerate the transformation of energy and technology markets and thus achieve much greater reductions in GHGs.

Donor countries correctly recognized that the World Bank must be more active and effective than it has been in that effort, and hoped to exploit its potential to scale up investments in climate-friendly technologies. They were understandably pessimistic about the ability of the GEF to undertake that role, despite the fact that the Bank had developed its role in energy-efficiency technology promotion because of its partnership with the GEF. The donor countries believed that the urgency of the situation demanded a fundamental change.

We agree that the existing system of global environmental financing needs to be fundamentally changed, but that general statement does not go far enough. The changes that are needed cannot be achieved simply by shifting funds for climate and deforestation from the GEF to the World Bank, because both institutions need to make some fundamental changes in the way they operate, and they need to collaborate even more closely than in the past.

The GEF should not be allowed to recede into a relatively minor role in the system, because of the distinct benefits it offers: a framework for collaboration among disparate multilateral institutions and between donor and developing countries; a secretariat that is free of commercial and bureaucratic considerations in reviewing approaches to funding the global environment; and a source of scientifically based policy guidance for maximizing global environmental benefit from investments. These valuable assets should be integrated fully into the new system.

However, the GEF cannot continue to operate in the same way that it has in the past. It must be more adaptable, flexible and innovative, and that means shedding the legal and institutional rigidities that have constrained it. The reforms required to make the GEF much more effective would be far reaching and would demand a high level of political commitment to changes on the part of both the donor and recipient countries. But with that political commitment, the GEF would be capable of scaling up and meeting the new challenges in addressing climate change effectively.

The World Bank has obvious strengths that should be more fully exploited for global environmental benefit: its ability to mainstream global environmental concerns into to the broader development process and to think in terms of whole sectors and economies, its strong analytical capabilities, its private sector arm and its ability to manage large programs. But it also needs to change the way it operates. It is still in a transition from the model of a commercial bank, which must look at its investments in terms of rates of return, to becoming an institution mandated to fully mainstream environmental externalities by embracing a longer-term vision and methods.

During that transition, the World Bank, like other MDBs, needs to have an independent source of policy guidance in regard to the targeting of investments in climate-friendly technologies. The aim would be to ensure that the Bank better considers the trade-offs between commercial and environmental considerations while becoming independent of commercial conditions imposed by the donors.

The Bank has gone a long way toward that aim, in large part because of its association with the GEF. The legacy of that association is both the staff trained and motivated to create and carry out projects for global environmental benefit and an institutional commitment to global environmental objectives. The synergies that have been created by the Bank's participation in the GEF must continue rather than begin to wane, as appears to be the trend envisioned by the new World Bank funds and the enthusiasm of donors for them.

An overarching aim during the next period of development of the architecture of global environmental finance should therefore be to construct a stronger partnership between the GEF and the World Bank, one based on a reformed and more agile GEF.

Furthermore, a process of harmonization among the new bilateral funds is urgently needed. As the publicly announced funds are translated from statements of commitment into operational terms that include geographic priorities, funding processes and qualifying criteria, the overlaps, redundancies, competing views and lack of synergies will become increasingly apparent. A harmonization process, initiated sooner rather than later, will deliver benefits to donors and recipients alike and significantly increase their combined benefits for the global environment and human enterprise.

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