

Billions at stake in climate finance: four key lessons

How can we break through the impasse on the road to Copenhagen? As the climate talks stall over the size of emissions cuts and who pays for them, it is increasingly clear that funding will be key to breaking the deadlock. Guaranteeing adequate levels of climate finance will be a deal maker or breaker for the poorest nations as the December summit approaches. But on the brink of a new chapter in climate funding, with unprecedented flows at stake, donor countries need to learn from decades of aid experience – mistakes as well as successes. Failure to do this risks wasting a great opportunity to kickstart low-carbon, climate-resilient development for the world's poor.

Policy pointers

- **Developing countries need** stability in climate finance to plan for adaptation and to restructure their economies towards low-carbon pathways of development.
- **Governance structures** must be put in place to ensure the fair and effective dispersal of new forms of climate finance. These have to be transparent and perceived as legitimate by key stakeholders.
- **Independent evaluation** must be instituted from the start to ensure effectiveness and generate trust between contributors and recipients. This means building on the lessons of past overseas development assistance (ODA) and creating independent monitoring organisations.

The price of transition

Poor and developing countries face a big transition to low-carbon development pathways, and a major leap in addressing the adaptation gap. These transformations will not come cheap. Estimates of the yearly cost of funding adaptation to climate change have ranged from US\$8 billion to well over US\$100 billion by 2030. On the mitigation side, the figure is as high as US\$650 billion a year. A recent World Bank report put the total need at over US\$500 billion a year by 2030.¹ China and many countries in Africa have repeatedly called for wealthy nations to commit 0.5 to 1 per cent of their GDPs to climate finance, a sum that would add up to US\$200-400 billion transferred each year.

Raising enough predictable funding has proven difficult. The reason is that voluntary funds established under the Kyoto Protocol and the UN Framework Convention on Climate Change (UNFCCC) are grossly inadequate.

Over US\$18 billion has been pledged since 2002, but under a billion dollars has been disbursed.² Well over US\$6 billion has been pledged by a dozen wealthy nations to World Bank-administered Climate Investment Funds, but some of those funds will function as loans, and very little has been deposited to date. Many developing nations resist having the World Bank administering such funds, since they see it as serving donor interests, not theirs.

State of the funds

Many poorer nations fear that climate funding will displace other overseas development assistance (ODA), which is needed for basics such as schools, healthcare, food and safe drinking water. Climate finance under the Least Developed Countries Fund (LDCF) and the Adaptation Fund (AF), both overseen by the UN, have had very slow start-ups and have been beset by problems to do with their financing and governance.

What's different about climate aid?

There is consensus among developing countries that climate finance – whether for mitigation or adaptation – should not be equated with overseas development assistance (ODA, or simply 'aid'). The two are considered to be fundamentally different. Aid is perceived as about voluntary giving, under a

charity paradigm. Climate finance is an obligation under a legally binding global treaty (that is, the UN Framework Convention on Climate Change or UNFCCC) to enable the solution of a global problem in which the parties primarily responsible for causing the problem (the developed countries) owe financing to the others (the developing countries) to help them tackle the problem (both mitigation and adaptation).

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The LDCF is based on voluntary contributions and is managed entirely by the Global Environmental Facility (GEF), closely affiliated with the World Bank; while the AF has a much more representative governance

structure but has yet to disburse any funds – and hence is still untried in terms of performance.

Mitigating and adapting to climate change, and more immediately making progress on a global climate deal, clearly requires massive and reliable amounts of funding. The history of international cooperation on funding is, however, littered with noble promises and misguided efforts. If wealthier countries are to commit to these sums and developing countries are to believe them, they will have to address a series of issues which have been shown to have an impact on aid effectiveness.

The four lessons we need to learn

There are four simple lessons that can inform the current negotiations over climate funding. If properly done, major funding flows might provide a breakthrough in the climate negotiations. However, if it is done poorly or mismanaged, climate finance will almost certainly worsen global problems of inequality, corruption and distrust, and further weaken efforts to tackle the problem. Ignoring the past is the fastest way to climate ruin.

1. Climate finance must be adequate, predictable and appropriate. The history of foreign aid is a history of unmet promises. Recipient nations know this, so another promise is no progress. Climate finance must be adequate, predictable, enforceable and appropriate. There need to be binding ways to assure that promises are actually met, so an independent registry and monitoring agents will be needed.

Internationally collected funds such as carbon taxes, airline levies or levies on carbon trading (like the Adaptation Levy on transactions through the Clean Development Mechanism) potentially solve the problem of capture of funding by national treasuries. Conditionalities on who can receive climate funding and how to prioritise the 'most vulnerable' nations and 'most cost-effective projects' need to be acceptable to developing nations to secure their buy-in.

In exchange, transparency in the criteria for disbursing funds and tracing and evaluating their actual delivery and effectiveness will be crucial to ongoing political support for them. Future flows of climate finance to recipients will have to be related to current performance and a demonstrated ability to provide cuts in greenhouse gases and to contribute real social benefits. The flow of low-carbon technologies must also be rapidly increased so developing countries are not locked into high-carbon development pathways – and they must be delivered in an affordable and accessible manner to those countries.

Jargon buster

Adaptation Fund (AF): overseen by the UN, this is funded by the 2 per cent Adaptation Levy on Certified Emissions Reductions.*

Climate Investment Funds (CIFs): the Clean Technology Fund and the Strategic Climate Fund, funded by a series of developed countries and implemented by regional banks and the World Bank.

Certified Emissions Reductions (CERs): certificates issued under the Clean Development Mechanism* for projects which bring about greenhouse gas emissions reductions that would not otherwise have occurred.

Clean Development Mechanism (CDM): under the Kyoto Protocol,* the mechanism that allows industrialised nations to offset their emissions by promoting 'clean development' in poorer countries. These countries meet their emissions reduction targets by earning, trading or selling Certified

Emissions Reduction* credits. Established in 2006, the CDM has registered over 1000 projects.

Global Environmental Facility (GEF): an international body set up to provide financial support to developing countries to tackle issues such as biodiversity, climate change, international waters, land degradation, the ozone layer and persistent organic pollutants.

Kyoto Protocol: the international agreement, linked to the UN Framework Convention on Climate Change (UNFCCC), on industrialised countries' targets for cutting their greenhouse gas emissions. Signed in 1997, it came into effect in 2005.

Least Developed Countries Fund (LDCF): the fund established to support the 49 vulnerable, low-income Least Developed Countries (LDCs) that are signatories to the UNFCCC in preparing and implementing their National Adaptation Programmes of Action.



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Climate crises on the rise: a street in Dhaka, Bangladesh, during a 2004 flood

2. Climate funds must be fairly governed. Having money flowing is not enough: it is crucial for climate funds to be controlled by both ‘contributor’ and ‘recipient’ countries. Process and control is key – the people who sit on bodies like the AF board are crucial to their legitimacy. Who decides what projects receive funding? Who calls the shots in how it is raised and distributed?

The existing model of foreign aid, with donors deciding who gets the money and under what conditions, will not work for climate finance, where the buy-in of developing countries is essential if it is to succeed. Participants in negotiations need to feel their concerns have been recognised through meaningful participation. Efforts have to be made to overcome the severe imbalance in capabilities rich and poor nations bring to the climate negotiations, but far more are needed to build capacity and access to key decision-making arenas.

3. Old coordination problems between funding nations need to be solved. Currently, there are nearly 100 different national, international and private agencies providing different tranches of climate finance. Many are competing to be the global lead agency addressing the issue.

With funding fragmented, there is potential for duplication of efforts and contributors failing to agree

an appropriate division of labour among themselves. This creates confusion and increases transaction costs for recipient governments that are already strained. The 2005 Paris Declaration on Aid Effectiveness saw nations agree to coordinate more fully, and the 2008 Accra Agenda for Action proposed specific information mechanisms. Their calls needed to be heeded by climate negotiators.

Seventeen countries and foundations have now signed the International Aid Transparency Initiative (IATI); more will sign shortly and others will follow its standards. Ensuring reporting is more systematic is important. Building on this experience for future climate financing, efforts will need to be ramped up to address the lack of coordination and to build on contributors’ core strengths by region and policy area. There needs to be a coordinated strategy developed in a contributor-recipient summit – such as the one held in Monterrey, Mexico, in 2002 – which results in concrete new mechanisms for coordination.

This mechanism will determine who will lead work on mitigation, and which agencies will focus on which types of adaptations and in which regions and at what scale. Without this kind of coordination, there is a grave risk that all contributors will tend to seek out those areas with higher returns and to prioritise governments on the grounds of political expediency rather than where

need is most acute. Efforts to coordinate private sector finance with public financing will also be needed.

4. Accountability and independent evaluation are critical. Central to building trust and effectiveness are independent systems of accountability and evaluation, both of climate funding flows and the efforts on the ground that they fund. This is critical to the mutual accountability of both contributors and recipients and is a useful way to build trust and ownership, as well as to evaluate project effectiveness. For example, at which scale are interventions most effective? Which combinations of public and private finance provide the best results in the most efficient and equitable way? Which governance arrangements enable this to happen? Does mainstreaming of climate adaptation and mitigation into national development planning and poverty reduction plans work best? Is budget support most effective, or do some projects need to stand alone? Which agencies are most effective at addressing which financing needs?

Decades of experience in overseas development assistance suggest some unintended consequences are exceedingly likely. These need to be tracked and addressed. They include the capacity of small and

fragile governments to absorb new funding, and the displacement of existing revenue streams when new funding is provided. Evaluation should require concrete metrics, but not be driven by the gathering of statistics alone. Effectiveness will incorporate several dimensions, including financial accounting, environmental integrity and social benefits. This means assessing whether funding has actually improved local livelihoods and delivered sustainable development.

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This briefing represents the views of the authors and not necessarily those of their institutions.

Further reading & websites

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Notes

- ¹ World Bank. 2009. *Development and Climate Change.* World Development Report 2010. World Bank, Washington DC.
- ² Vidal, J. 20 February 2009. Rich nations failing to meet climate aid pledges. See www.guardian.co.uk/environment/2009/feb/20/climate-funds-developing-nations.



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