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# The Reformed Financial Mechanism of the UNFCCC

Part II

## The Question of Oversight Post Copenhagen Synthesis Report

Benito Müller

with contributions by

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OIES EV 52  
April 2010

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ISBN: 978-1-907555-09-1

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#### **Acknowledgments:**

This work has been made possible through funding support from **Climate Strategies**. Climate Strategies is an international organisation that convenes networks of leading academic experts around specific climate change policy challenges. From this it offers rigorous, independent research to governments and the full range of stakeholders, in Europe and beyond.



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The authors would also like to express their thanks to all the people who have helped with their insightful feedback in putting together this paper.

This OIES Background Paper is the follow-up to the Report by Benito Müller and Luis Gomez-Echeverri, *The Reformed Financial Mechanism – Part I: Architecture and Governance*, Oxford Institute for Energy Studies Background Paper, EV45, April 2009.

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# I. Introduction

## A. Background

This Synthesis Report presents the key results of the second phase of a major analytic project on a reform of the Financial Mechanism of the UN Framework Convention on Climate Change (UNFCCC).<sup>i</sup> It synthesizes four OIES Energy and Environment Papers,<sup>ii</sup> and (updated versions) of four preliminary policy briefs by the lead author of this Report, published in the run up to the recent Copenhagen Climate Conference.<sup>iii</sup>

The success of the current international climate change negotiations crucially depends on how much finance is going to be made available to support developing country climate change activities, and it is unlikely that adequate financing will be forthcoming in the absence of an acceptable governance framework. The overall aim of the Reformed Financial Mechanism (RFM) project is to provide such a framework.

The work undertaken for this Report had its roots in an ongoing informal dialogue between UNFCCC negotiators facilitated by the lead author. In the course of this dialogue, it became apparent that a number of key issues in the management of international climate finance were in need of further analysis. Firstly there was the role of *political oversight* by the UNFCCC Conference of Parties (COP) in particular. Other areas identified as being in need of further elaboration were *independent oversight* in general, and of auditing, in particular, and *public oversight* in the sense of oversight by civil society stakeholders. Finally, there was the issue of *oversight of financial commitments* under

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<sup>i</sup> The results of the first phase of the project were published in Benito Müller and Luis Gomez-Echeverri, *The Reformed Financial Mechanism of the UNFCCC. Part I: Architecture and Governance*, Oxford Institute for Energy Studies Background Paper EV45, April 2009.

<sup>ii</sup> [1] *The Reformed Financial Mechanism of the UNFCCC: Promoting Transparency & Accountability*, by Luis Gomez-Echeverri.  
[2] *The Reformed Financial Mechanism of the UNFCCC: Renegotiating the role of civil society in the governance of climate finance*, by Anju Sharma.  
*The Reformed Financial Mechanism of the UNFCCC: Public Oversight*, by Benito Müller and Achala Chandani, with contributions by Dane P. Rook.

<sup>iii</sup> [1] *Is There Room for Compromise? The debate on institutional arrangements for climate finance* (October 2009);  
[2] *'Under the Authority of the COP'?* (October 2009);  
[3] *Procrustes' Bed & Ockham's Razor: The debate on existing institutions in climate finance* (November 2009);  
[4] *The Time is Right! Devolution of funding decisions to designated national/regional climate change funding entities* (November 2009);  
[5] *On the Need to Certify: Oversight of compliance with financial commitments under the UN Framework Convention on Climate Change* (December 2009).

the UNFCCC. The second phase of the RFM project was hence aimed at generating recommendations on:

- 1) ***How to design decision making*** (processes and remits) for the UNFCCC COP and RFM executive body so as to ensure sufficient political oversight and buy-in, without the danger of over-politicized micro-management of the RFM financial flows.
- 2) ***How to ensure proper stakeholder representation***, in particular, how to design the selection of stakeholder representatives, and how to design their role in the decision-making process.
- 3) ***How to design independent oversight*** (audit, monitoring, and evaluation) procedures within the framework of existing legal arrangements which will provide sufficient safeguards against malpractice both at the international and the national level.
- 4) ***How to oversee financial flows*** to ensure compliance with financial commitments

## B. Structure of the Report

Having given a short overview of the background to this Report, the remainder of the Introduction sketches specific dimensions along which the various proposed facets of the Reformed Financial Mechanism should be analysed and evaluated. An analytical framework is developed for conceptualizing and assessing the respective advantages and demerits of certain purposes and design features of the RFM. An outline of the core attributes and processes that must be considered is used to craft a candidate structure which addresses historic, contemporary, and prospective concerns relating to the design and function of the RFM. This introductory chapter also contextualizes the political, socio-ethical, and financial climates in which the RFM must currently take form. These specific considerations effectively circumscribe the realistic constraints under which any solution must be crafted, and extend helpful definition to both the objectives that must be met, and to the current trajectory by which such aims are presently being approached. Further, the remainder of this chapter serves to delineate the existing resources (both financial and institutional) and predominant perspectives that might register in the ultimate identity of the RFM. The foundations developed here serve to inform and guide the remaining chapters of the report, which deal with the oversight provisions necessary to properly steer and manage the RFM.

The subsequent chapters concern the various components of oversight in refashioning a system of decisional checks and balances that will ensure effectiveness, fairness, efficiency, accountability, and transparency in all processes of the Financial Mechanism. Separately, these strands of oversight involve political, independent, compliance, and public oversight features. These are addressed in separate, successive sections of the report and are briefly described in the following.

## **1. POLITICAL OVERSIGHT – CHAPTERS II & III**

These two chapters jointly explore means by which sufficient political oversight and buy-in can be attained without introducing the jeopardy of over-bureaucratization or inappropriately politicized management structures to the RFM. These chapters collectively examine two integral concerns of balancing equity, effectiveness, and efficiency in political oversight:

- *Distribution of decisional power*: within which bodies should certain elements of decision-making reside?
- *Disbursement of central funds*: what should constitute the bases for allocation and distribution of funds, and how can productive use of these funds toward stipulated objectives be gauged?

Chapters II and III examine these considerations from the separate vantage points of national-level, and multilateral cases studies respectively, and extract key analogous and direct considerations for reformation of the UNFCCC Financial Mechanism. Chapter II emphasizes examination of the horizontal balance of power (along the spectrum of legislative versus executive body authority) in budgetary decision-making and foundations of allocation processes for funds (with especial consideration of the utility and validity of formulaic prescriptions). This chapter draws on the case examples of China, India, Switzerland, and the USA to paint illustrative evidence for application to the RFM.

Chapter III addresses issues of representativeness of structure, vertical balance of power in decision-making (the degree of devolution to more localized bodies), and the relative successes and failures of various disbursement methodologies. These elements are investigated in case-based studies of the Kyoto Protocol Adaptation Fund, Global Environmental Facility, World Bank International Development Association, Global Fund to Fight AIDS, Tuberculosis, and Malaria, and the Montreal Protocol Multilateral Fund. Findings from these various cases are consequently synthesized into structured recommendations for the RFM. Chapter III also discusses the problem of administrative size and the derivative case for devolution of decisional processes. Finally, the chapter concludes with a dissection of the significance of the phrase ‘under the authority of’ and relates its implications for the governance and accountability of the RFM.

## **2. INDEPENDENT OVERSIGHT – CHAPTER IV**

This chapter delves into questions regarding transparency and accountability in the operations of the RFM. Much concern has been voiced on whether the Financial Mechanism can create a system through which to ensure that allocated resources are used effectively and efficiently for greater impact. Moreover, whether countries have the capacity to ensure that the resources are channelled to the intended purposes and used productively minimizing or eliminating the possibility of malpractice. This chapter explores various existing practices and approaches to auditing, monitoring and evaluation as possible lessons for the Reformed Financial Mechanism. Chapter IV highlights the

necessary elements for the construction of an independent process that relies on both internal and external provisions for fostering greater confidence in, and reliability of, oversight systems for the RFM, and it draws on case studies of networks, standards, and best and present practices centered on nine separate illustrative examples at both national and multilateral levels. Chapter IV offers relevant transferrable guidance for the reform of the UNFCCC Financial Mechanism, including treatment of the menu of choice and paths available, and critical obstacles to implementation.

### **3. COMPLIANCE OVERSIGHT – CHAPTER V**

Chapter V handles the issue of certifying compliance with financial obligations of Parties. It briefly examines the question of what should be counted as contributions towards climate finance, and considers the channels through which such funds may flow. Existing financial certification systems such as those employed for ODA and the Montreal Protocol’s Multilateral Fund are examined. The chapter assesses the best fit of institutional arrangements that facilitate a parameterized and transparent certification process that will foster confidence among both contributors and implementers.

### **4. PUBLIC OVERSIGHT – CHAPTER VI**

Chapter VI addresses the issue of how to open up channels of communication between the grassroots communities affected by both climate change and climate finance, and the decision-making structures of the RFM. It considers elements that have hampered such communication in past models of civil society engagement, and proposes a structure that will allow civil society to have a more active and integrated stake in the success of the RFM. It further shows how a bottom-up, well resourced and sufficiently empowered role for civil society participants is necessary to the success of the RFM, as previous efforts, which merely developed routes for consultation with such groups, proved ineffective at weaving local experience and expertise into fully-tailored solutions.

### **5. CASE STUDY DISCLAIMER**

Some of the Chapters of this Report draw on and highlight some lessons learned from case studies undertaken in the course of the work underlying it. The choice of these lessons was not aimed at providing a complete and balanced evaluation of the institutions and systems in question, but rather to highlight certain key features and lessons which are of importance to the design of the governance and disbursement regime of the RFM. In other words, the nature of the lessons chosen is not (necessarily) representative of the overall quality or performance of the institutions and systems in question.

## C. The Reformed Financial Mechanism<sup>i</sup>

### 1. THE ANALYTIC FRAMEWORK

#### *TWO KEY PURPOSES FOR AN INTERNATIONAL REGIME: DISTRIBUTIVE JUSTICE AND THEMATIC BALANCE*

While there is general consensus that the existing institutional arrangements for financing climate change activities in developing countries are not fit for purpose, there is less agreement on what that ‘purpose’ is meant to be. According to the table compiled by the UNFCCC Secretariat at the end of the third 2009 Bonn session,<sup>1</sup> there is a common understanding that the financial system should provide *financial resources to further enhance the full, effective and sustained implementation of the UNFCCC and fulfilment of the Bali action plan*, and that there is a *need to provide scaled-up, new, additional, predictable and sustainable financial resources, which would be derived from multiple sources*, in compliance with the *principle of equity and common but differentiated responsibilities*. ‘Equity’ appears in the Secretariat text only under *Principles to guide generation of resources*. However, it stands to reason that distributive justice is an issue not only in the context of shouldering the burden of contributions, but also in sharing the revenue.

*Distributive Justice*: Official Development Assistance (ODA) traditionally neither involves obligations to pay, nor entitlements to receive. The issue of *distributive justice* – of contributing and/or receiving a ‘fair share’ – strictly speaking *does not apply*: if ‘donors’ think they pay over the odds, then they are free to pay less, and if ‘recipients’ feel hard done by, then that is not a matter of injustice but bad luck.

In contrast, payments for climate change activities – particularly in the case of adaptation and response to climate impacts – are a matter of *restitution*. Hence there are both obligations to pay and entitlements to receive, which implies that equity, in the sense of either *shouldering a fair share of the payment burden*, or of *receiving a fair share of the revenue*, is an issue. The fact that the focus of the debate has so far almost exclusively been on the former (e.g. the Mexican and Swiss proposals) does not mean that the question of how to distribute climate finance equitably can be ignored. On the contrary, it has to be seen as one of the key challenges for any climate finance regime.

*Thematic Balance*. Climate finance involves a number of different themes (mitigation, adaptation, technology transfer, etc.), and the issue of ‘thematic balance’ relates to whether *each of these themes receives an appropriate share of the revenue*. Given the nature of climate finance, the decision on how this balance is to be achieved must involve not only contributors but also recipients.

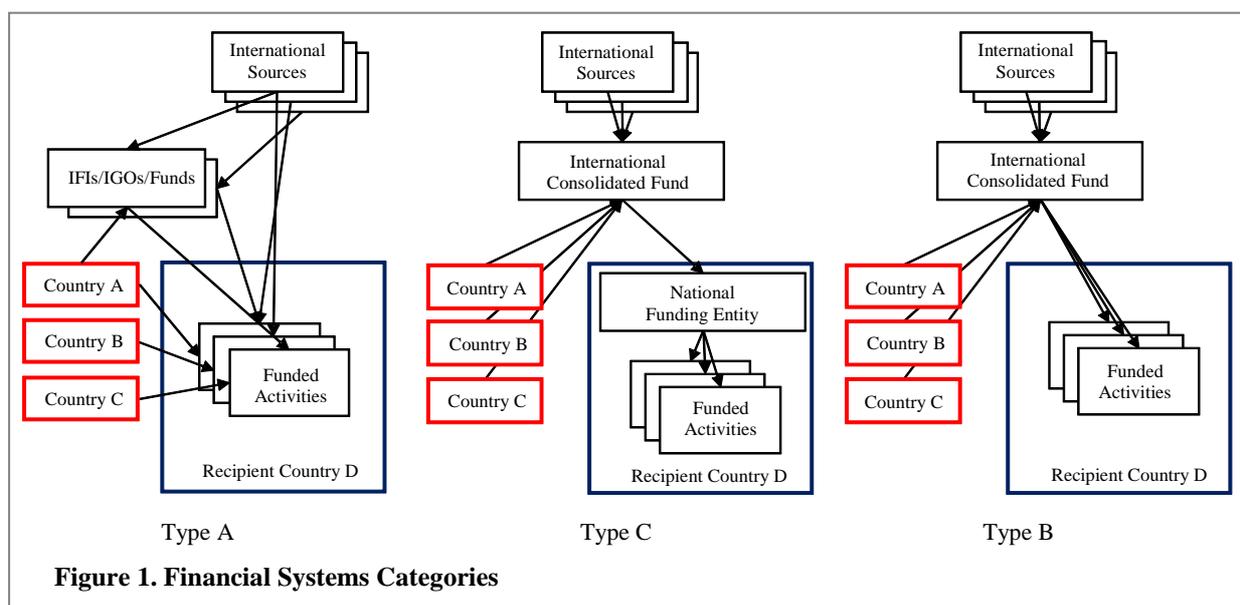
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<sup>i</sup> This section is based on Benito Müller, *Is There Room for Compromise? The debate on institutional arrangements for climate finance*, Oxford Energy and Environment Comment, October 2009, and on Benito Müller, *Procrustes’ Bed & Ockham’s Razor: The debate on existing institutions in climate finance*, Oxford Energy and Environment Comment, November 2009, both available at: [www.oxfordclimatepolicy.org/publications/mueller.shtml](http://www.oxfordclimatepolicy.org/publications/mueller.shtml).

### THREE DESCRIPTIVE DIMENSIONS

To discuss the different proposals in a coherent and comparable manner, it is useful to introduce three descriptive dimensions as categorizing tools, the distinctions between them being (i) *fragmented* or *consolidated*, (ii) *centralized* or *decentralized*, and (iii) *devolved* or *retained*.

The distinction between ‘fragmented’ and ‘consolidated’ refers to funding flows, and in particular the degree to which funding sources are channelled into intermediate collective ‘pots’ to be disbursed as lump sums to recipients, or directly used to fund their activities. The other two categorizations are about decision making, that is, whether or not funding decisions are taken by a central body, and whether they are devolved to the recipients or not.



All three of these dimensions are a matter of *degrees*, that is to say, financial systems can be more or less centralized/decentralized, etc. They are also *independent* in that they could occur in all combinations. Indeed, even though the concepts of ‘consolidation’ and ‘centralization’ are often used interchangeably, they are clearly distinct, in that one could have a completely fragmented system that is nonetheless completely centralized, say through a ‘coordinating’ body with powers to decide who has to pay whom.

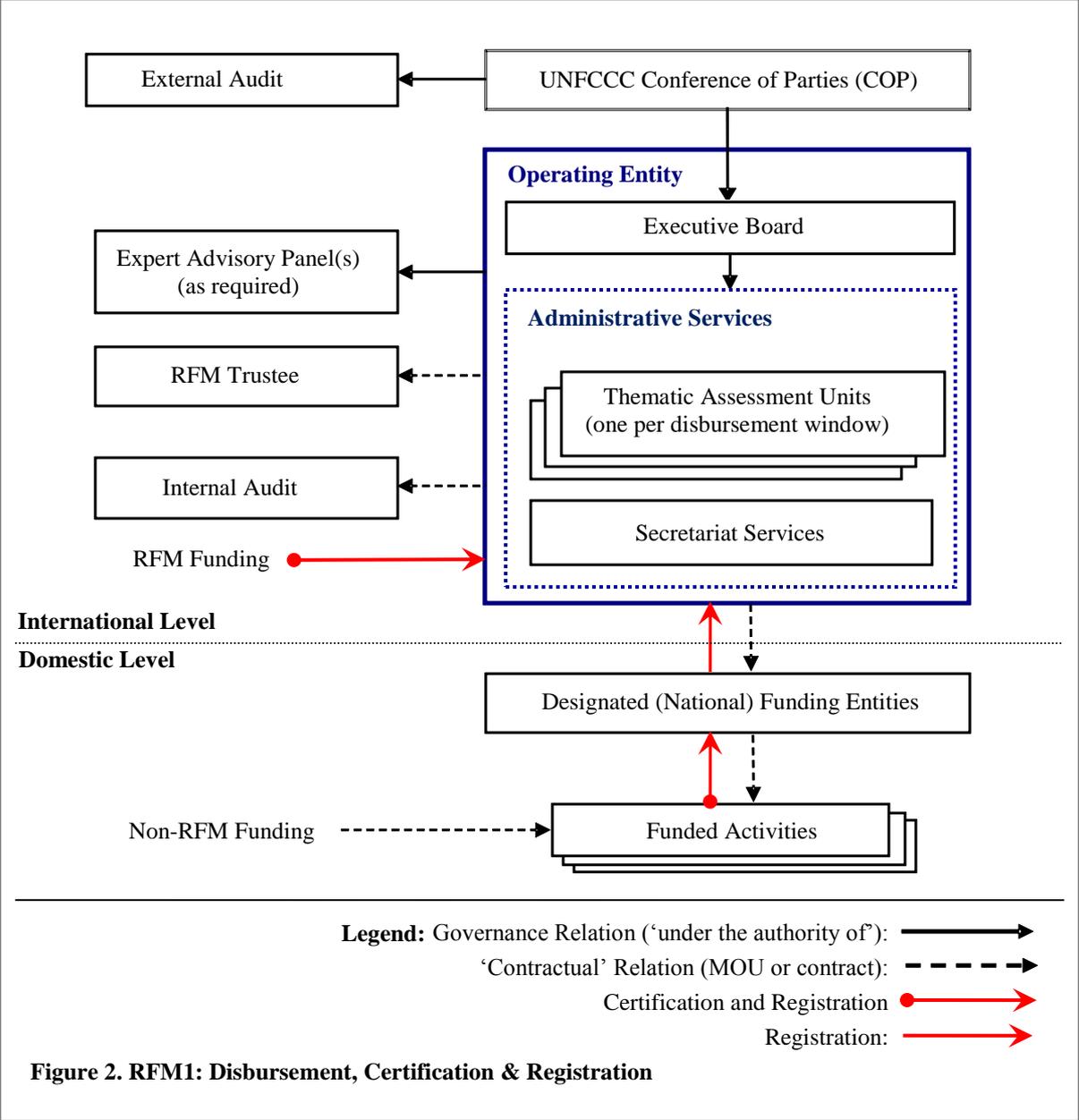
Figure 1 contains graphical representations of three specific combinations which have actually been put forward. Type A represents the current *fragmented, decentralized, and retained* system of climate change finance, meant to be enhanced through ‘high level coordination’ as put forward by the Climate Registry proposal (described below). Type B corresponds to the *consolidated, centralized, and retained* system put forward in the original G77+China submission,<sup>2</sup> while Type C represents the *consolidated, decentralized, and devolved* system of the Reformed Financial Mechanism (described below), the AWG-LCA<sup>3</sup> language introduced by India, and the UK Compact model.

**2. THE REFORMED FINANCIAL MECHANISM – MARK I**

At the heart of the original RFM proposal<sup>4</sup> (RFM1) is the idea of *consolidating* funding streams at the international and national level and of *decentralized* funding decisions through *devolution* to the recipient countries.

*KEY INSTITUTIONAL FEATURES*

Internationally, the institutional structure of RFM1 is constituted by an *Executive Board* which, together with a small number of *administrative units* (Thematic Assessment and Secretarial Units), provides the *operating entity* of the RFM1 (see Figure 2). Other functions, such as internal and external audits and evaluations, as well as that of trustee for the consolidated RFM fund, are to be outsourced.



Nationally, funding is to be consolidated in *Designated Funding Entities* (DFEs), with transparent governance and representation from all key national and sub-national government agencies as well as civil society. There are already a number of such climate change national funds and mechanisms (e.g. in Bangladesh, Indonesia, Brazil/Amazon) which could serve as templates for the envisaged DFEs. Under the RFM, *funding decisions* – i.e. decisions on (country) *priorities*, and *approvals of projects and programmes* – are taken in-country by the DFEs.

The RFM1 Operating Entity, in turn, does *not* fund in this sense, but *disburses* (‘channels’) revenue to the DFEs to enable their funding activities. The key point is that the RFM proposes a *genuine devolution of funding decisions*, and not just some half-way measure, as is the case of the NAPA (‘National Adaptation Programme of Action’) process, where such entities were merely given the right to make plans, but not to decide what is to be funded.

In the Climate Registry model, *eligibility for funding* depends on *certification of national strategic plans* by the international thematic Boards. This is decidedly *not* the case for country disbursements under the RFM; not only because this would unnecessarily duplicate work already undertaken at the national level, but also because it is very unlikely that any country – developing or developed! – would actually agree to having nationally approved plans or strategies submitted to such a procedure. This would touch at the very core of national sovereignty.

*GOVERNANCE.* The RFM1 Executive Board (EB) is *accountable to* and *under the authority and guidance of the COP*. Being ‘under the authority’ in this context simply means that the *COP (s)elects the EB members* (i.e., has the authority to ‘hire and fire’).

Following standard domestic practice, there is to be a well-defined *separation of powers* between the COP and the EB, in the sense that the COP delegates certain operational powers to the EB. Apart from the right to select the EB members, other powers retained by the COP are: (i) the power of setting *RFM revenue levels* (ii) approving *thematic disbursement criteria* (iii) approving *certification criteria* (see below) and (iv) approving overall *revenue allocation to themes*.

The tasks to be delegated to the EB are: (i) operational management of the disbursement entity, (ii) oversight over any other operating entity of the RFM, (iii) preparation of *proposals for thematic disbursement criteria* and regular *thematic budgets*, both for approval by the COP

*CERTIFICATION AND REGISTRATION.* As mentioned above, the COP is to approve criteria on what payments *are to count against compliance* with financial commitments under the UNFCCC. These criteria will be operationalized in a system of certification and registration under the RFM. As illustrated in Figure 2, contribution to the RFM consolidated fund will be certified and registered by the RFM secretariat. Other payments – if permitted by the certification criteria – will be *certified and registered in-country by the Designated Funding Entities*. The key here is that payments are to be counted (certified and registered) *at the recipient end*.

*BUDGETING AND DISBURSEMENT.* ‘Disbursement’, as used here, is not to be confused with ‘funding’. The latter, as emphasized above, refers to the traditional activities involved in the selection and approval of projects, programmes, and other ‘on the ground’ activities. ‘Disbursement’, by contrast, is taken to refer to the allocation of funds to the Designated Funding Entities by the RFM on the basis of theme-specific disbursement criteria, and the amount of revenue allocated for the relevant budget period to the respective themes. Disbursement criteria will vary from theme to theme. For example:

- *Mitigation disbursements* could be on made on a performance basis, with a flat up-front country component:  $x$  million +  $y$  million for the MRV<sup>i</sup> reduction in the previous period.
- *Adaptation disbursements* should be carried out through a very simple disbursement formula, e.g. a flat country component + a component proportional to the number of poor inhabitants.

The Budgeting Process will involve the *preparation of an overall budget* – based on general needs assessments carried out by the different thematic assessment units – to be presented to COP. This information provides the COP with the means to decide on the overall revenue level, as well as the theme allocations. Once these decisions are taken, the EB takes over and carries out the disbursements as prescribed in the relevant criteria, within the constraints given by the COP budget decisions.

### 3. CALLS FOR COORDINATION AND THE CLIMATE REGISTRY PROPOSAL

As mentioned earlier, the current debate on climate change finance is characterized by a divide not only on ‘who is to pay how much’ and ‘who receives for what purpose’, but also on how these flows are to be managed, i.e. on the issue of *institutional arrangements*. There is a broad recognition that the current system is not fit to manage the required financial transfers, but opinion on how this is to be remedied roughly divides into two camps:<sup>ii</sup>

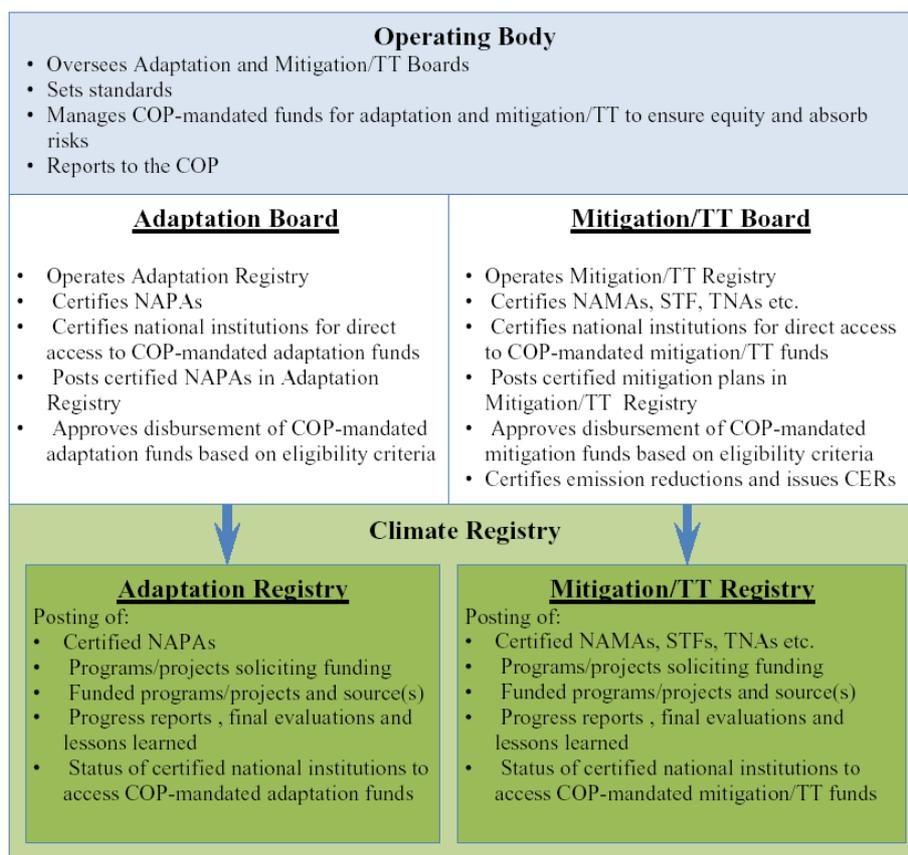
**The ‘Coordination Camp’.** At one end of the spectrum, there are those (mostly from developed countries) who believe that what is needed is *enhanced coordination* through *existing institutions* (possibly reformed to become *fit for purpose*). This side rejects both the need for new institutions and for consolidating funding streams.

**The ‘Consolidation Camp’.** At the other end of the spectrum, there are those (mainly from developing countries) who believe that coordination through existing institutions will not remedy current shortcomings, and instead call for reform of the *consolidation of funding* under the UNFCCC financial mechanism, to be managed by a *new operating entity*.

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<sup>i</sup> Measurable, Reportable and Verifiable, as referred to in paragraph 1.b.ii of the Bali Action Plan.

<sup>ii</sup> This polarized characterization is not exhaustive: there are a number of intermediate positions that can and have been put forward.



**Box 1. The Climate Registry Model**

Source: Reed *et al.*, 2009

In his Statement<sup>5</sup> to the United Nations Summit on Climate Change, the Japanese Prime Minister Yukio Hatoyama called for establishing *an international system ... under the auspices of the UN climate change regime. This system should facilitate one-stop provision of information on and matching of available bilateral and multilateral financing, while securing transparency and effective utilization of assistance.*

Japan, in other words, is firmly in the ‘Coordination Camp’. Is there room for a mutually acceptable compromise between these two world views? Before we can address this question, it is important to clarify what types of institutional arrangements are associated with the two camps. Given that the original idea of a Reformed Financial Mechanism (RFM1) clearly falls in the consolidation camp, what is needed for the present purposes is a somewhat clearer idea of how a coordination approach is meant to work. Probably the best worked out proposal of how such a ‘one-stop information exchange and matchmaking’ system would operate is the *Climate Registry Model* proposed in Reed *et al.*, (2009).<sup>6</sup>

In that model, an *Adaptation Board* and a *Mitigation/Technology Transfer (TT) Board* are to operate an *Adaptation Registry* and a *Mitigation/TT Registry*, respectively. An *Operating Body*, in turn, is meant (i) to oversee these two Boards, (ii) to set standards, (iii) to manage COP-mandated funds and (iv), to report to the COP (Table 1).

To avoid creation of new institutions, Parties could consider using the recently created Adaptation Fund Board to serve as the Adaptation Board. In equal measure, Parties could consider reforming the Clean Development Mechanism Executive Board or reforming the GEF [Global Environment Facility] to become the Mitigation/TT Board.

The [overall] function of the Climate Registry is to expedite, through the public pooling and sharing of information, the **matching of needs** of country governments and the **availability** of financial resources and products offered by financing institutions. ...the Climate Registry serves as an international **bulletin board** that lists developing country programs and projects.

Countries are meant to provide their national objectives, needs, and financing requests, framed at national level and through national adaptation, mitigation, and technology transfer plans such as NAMAs,<sup>i</sup> NAPAs, Technology Needs Assessments (TNAs), and Low Carbon Action Plans (LCAP). In addition:

- The statements of national strategic plans to address climate change must be **certified** to be in compliance with standards set by the COP or its designated body **so that these plans become eligible for financing**. The intention behind this requirement is to provide *assurances to investors that MRV, fiduciary and transparency standards are embedded in investment packages*.
- The plans then enter into the public registry domain where all interested parties, public or private, can enter into discussion or negotiation with the hosting country regarding the terms of financing.
- Through this **pooling and posting of information process**, the Climate Registry serves as an **international bulletin board** that lists developing country programmes and projects as integral parts of national climate strategies.
- Once alignment between a developing country's needs and contributing country/private investor financial resources has been established, the Registry will also function as a monitoring tool which displays the progress of the implementation of the agreement between the country and a funding source.
- One of the key problems for this sort of information exchange and matchmaking regime is delivery on the above-mentioned issues of **distributive justice** and **thematic balance**. Short of equipping the Operating Body with the power to order who has to pay for what, it is unlikely that this sort of system can deliver on these key requirements. Indeed, the Climate Registry model itself acknowledges as much by giving the Operating Body the function of managing *the COP-mandated funds ... to ensure equity in the access of all developing countries to financial resources to support adaptation and mitigation programs. This is a critical function because, without an equalizing distributional mechanism, past experience has demonstrated that financial resources will flow to the largest, most sophisticated developing countries.*

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<sup>i</sup> Nationally Appropriate Mitigation Action (cf. §1.b.ii of the Bali Action Plan)

#### 4. THE REFORMED FINANCIAL MECHANISM – MARK II

In the run-up to (and since) Copenhagen, the Reformed Financial Mechanism proposal has been adapted, not only to take into account what happened in the finance negotiations under the AWG-LCA, but also to accommodate certain specialist needs that were not sufficiently reflected in the original proposal – such as the need for continued international funding with consolidated funds, in addition to the core disbursement function. This has led to the following second generation (Mark II) proposal for a Reformed Financial Mechanism (‘RFM2’)

##### *THE COPENHAGEN DRAFT LCA DECISION ON FINANCE<sup>i</sup>*

The *Copenhagen Accord* – henceforth, ‘the Accord’ – was drafted by a group of *Friends of the Chair*, consisting of around two dozen heads of state and government and other heads of delegations, convened by the prime minister of the host country during the high-level segment concluding the Copenhagen conference. The Accord was tabled for adoption by the COP in the early hours of the last day. Ultimately, the COP did not adopt the Accord but merely noted its existence.

The Accord consists of 12 paragraphs concerning mitigation, finance, technology transfer, and adaptation, with a clear focus on mitigation and finance. The issue of finance is treated in a number of places in the Accord. The key language, however, is to be found in three consecutive paragraphs, creating a *Copenhagen Green Climate Fund*, a *High-level Panel* on potential sources of revenue, and ‘*collective*’ commitments to provide fast-start funding of (on average) \$10 billion annually for 2010–12, and a 2020 target of \$100 billion annually.

The lack of any concrete proposals on levels of finance has been a major impediment in the recent climate change negotiations, in this case under the AWG-LCA. Regardless of whether the figures are deemed adequate, the fact that they have now been tabled should help to unblock the negotiations, provided that they are followed up with an acceptable concrete scheme of how these funds are to be raised.

This could be facilitated by the envisaged High-level Panel, but unfortunately it could equally be undermined by it, if the procedural lessons from Copenhagen are not learned. There is, however, a grave danger that the Panel could be (mis-) used as an alternative negotiating forum, undermining the AWG-LCA finance negotiations instead of providing useful input for them.

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<sup>i</sup> For more on the Copenhagen Accord, and on its role in the future negotiations, see Benito Müller, *Copenhagen 2009: Failure or final wake-up call for our leaders?*, Oxford Institute for Energy Studies, February 2010.

Another potential problem with the finance text of the Accord is the fact that, according to the US delegation,<sup>i</sup> the *Copenhagen Green Climate Fund* (CGCF) was *inspired by ideas that had been put forward this year by Mexico*. It is well known that the key element of the Mexican proposal for a Green Fund is a very controversial burden-sharing scheme involving contributions from all Parties (except LDCs).

The proposal of a CGCF raises further important questions. Is it meant to manage the fast-start money? Given the experience of the time it has taken to set up the World Bank Clean Investment Funds (CIFs) and the Kyoto Protocol Adaptation Fund, this would be very curious indeed. If, however, it is intended to manage the mentioned *significant portion* of the medium term funding,<sup>ii</sup> the question that arises is: how does it relate to the *Climate Fund/Facility* that is to be established according to the draft AWG-LCA finance decision?<sup>7</sup>

#### *THE CONTINUED NEED FOR INTERNATIONAL FUNDING*

As originally conceived, the RFM was purely a disbursement mechanism. While the bulk of the RFM2 transactions are (ultimately) still meant to be carried out through ‘money-in-money-out’ disbursements to Designated Funding Units, it has to be acknowledged that there will still be a need for international funding in the more traditional sense, such as currently developed under the Adaptation Fund.

- One reason for this is that *not all funding purposes lend themselves naturally to be devolved* to the country level. While mitigation and adaptation *per se* would seem to be prime candidates for such devolutions, funding decisions for certain types of capacity building and technology transfer activities might be better kept at the international level.
- Even with respect to the prime candidates, it will be necessary to retain a more traditional international funding capacity for quite some time: it will take time before all countries will be able to participate in the devolved disbursement regime.

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<sup>i</sup> 19 December 2009, COP resumed 9<sup>th</sup> Meeting, 06:25.

<sup>ii</sup> *A significant portion of such funding should flow through the Copenhagen Green Climate Fund.* [CA: §8]  
*We decide that the Copenhagen Green Climate Fund shall be established as an operating entity of the financial mechanism of the Convention.* [CA: §10]



Furthermore, in light of the continued need for international funding (as opposed to disbursement), the RFM2 also envisages *further operating entities* which, in contrast to the Climate Facility, are to be involved in the international funding of activities. The exact number of these additional operating entities will depend on a number of factors. From a purely organizational perspective, it would probably be best to use just one such funding entity. However, as there are two ‘existing entities’ that currently have the status of being *an operating entity* under the current international climate change regime – the *Adaptation Fund Board* (AFB) under the authority of the COP/MOP,<sup>i</sup> and the *Global Environment Facility* (GEF) under the guidance of the COP – it might therefore make political sense to retain them under an Extended Reformed Financial Mechanism (RFM2) as *Adaptation Funding Entity* and *Mitigation Funding Entity*, respectively.<sup>ii</sup>

#### *CONSOLIDATION AND COORDINATION: THE GRAND RFM2 COMPROMISE?*

*Guidance, Authority, and Oversight.* In the case of the AFB this may not be too controversial, but a great deal of resistance to having the GEF involved in any capacity (even when ‘reformed’) is likely to come from developing countries, which – as the Adaptation Fund negotiations have clearly shown – have been less than happy about the manner in which the GEF has operated, particularly in its implementation of COP guidance. However, part of the problem with the GEF and COP guidance seems to be systemic, in that the COP itself is not the sort of institution which is well-suited to carry out any oversight, and guidance without proper oversight tends to be ignored. It is for this reason that in the RFM2 model, the COP is meant to delegate oversight and guidance of operating entities to the Finance Board, which will meet more than just once a year, and hence be in a better position to follow up its guidance on a regular basis.

*Coordination under the RFM2.* In the light of the institutional suggestions put forward for the Climate Registry ‘enhanced coordination’ model (see above), the proposed institutional architecture of the RFM2 model will fit perfectly with the Climate Registry ideas, with the Finance Board performing the role of the ‘Operating Body’, and the two other operating entities taking on the role of the two Boards, operating the two thematic registries.

*The Role of other Existing Institutions.* The RFM2 proposal might take care of two of the ‘existing entities’ – the Adaptation Fund Board and the (suitably reformed) GEF – as additional *operating*

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<sup>i</sup> Conference of the Parties serving as Meeting of the Parties to the Kyoto Protocol

<sup>ii</sup> This comes out of the idea that they would also cover funding for technology transfer and capacity building in their themes.

*entities*. This still leaves out other multilateral institutions which the Coordination Camp would like to involve, such as UNEP, UNDP, and the Multilateral Development Banks. These institutions can take on the role of *implementing entities* – although with direct access, this will no longer be the exclusive route to access funding. Moreover, there will be a need for *trustees*, and it stands to reason that most of these other existing entities, when fit for purpose, should not have to worry about participating in competitive tenders for performing these functions.

The question of ‘existing versus new institutions’ is sufficiently important to warrant a closer look, but before, there is another key point that needs to be raised which will determine the viability of the proposed compromise.

## 5. RAISING THE NECESSARY REVENUE

The compromise put forward in the preceding section will fail, if the consolidated disbursement arm is treated as just another placebo fund to buy in developing countries during a crucial phase of the negotiations, but is subsequently to be essentially left empty. Establishing the institutional infrastructure will not be sufficient. There will have to be agreement that a significant share of (national/international) public sector finance will be channelled through the RFM, so that the mechanism stands a fair chance of proving itself.

The problem is that to prove itself in ensuring the fairness and thematic balance of the overall financial regime, and to show that it is more efficient than the traditional fragmented funding model, the proposed extended RFM will require a significant amount of (consolidated) revenue. Developed country treasuries are unlikely to provide funds if they lack faith in the mechanism. This potential Catch 22 can be overcome by following the example of the Adaptation Fund: by using innovative financial instruments to raise sufficient funds. There are a number of proposals for such instruments on the table (in the AWG-LCA negotiations text):

- the LDC Group proposal of an *International Air Passenger Adaptation Levy* (IAPAL);
- the Norwegian proposal of a *set aside reserve of emission allowances* to be auctioned internationally (akin to the monetization of the share of CERs set aside for the Adaptation Fund);
- the Indian proposal of a *levy on international financial market transactions*.

The advantage of these instruments is that they do not involve transfers of funds from the domestic consolidated funds (budgets). There are also ways in which direct competition with budget items can be avoided, even for revenue collected domestically: for instance, by declaring certain (new) revenue sources, such as carbon permit auctioning, ‘off-budget’ so they can be earmarked without infringement of general budgeting principles.<sup>8</sup>

The envisaged RFM compromise will not only have to contain an agreement on the relevant institutional arrangements, but also on a significant level of revenue for the (consolidated arm of the) RFM to be (i) supplied by innovative international finance instruments and assessed contributions, and (ii) reviewed together with the overall financial commitments of developed countries.

Once the mechanism has a chance to show it can work, it is likely to become the vehicle of choice, like the Montreal Protocol Multilateral Fund, where most Parties choose to channel their full commitment through the fund, even though they are entitled to spend up to 20 percent of their commitments bilaterally.

## 6. EXISTING INSTITUTIONS

In the debate over institutional arrangements for international climate finance, a powerful, mostly Northern, school of thought contends that one should not create new institutions but only make use of existing ones. What is the basis of this contention?

### *'EXISTING INSTITUTIONS'*

The term 'existing institutions' has become an euphemism for the World Bank's Climate Investment Funds (CIFs), the Global Environment Facility (GEF), and the regional Multilateral Development Banks (MDBs) in the current debate on institutions for climate change finance in the post-2012 period. Curiously, the Kyoto Protocol Adaptation Fund (AF) is usually not included even though it has as much legitimacy to carry this epithet as, say, the CIFs. Indeed, it is widely held among the advocates of the 'No-New-Institutions' school that all UN/UNFCCC institutions are inefficient and opaque, in contrast to other existing multilateral (i.e. Bretton Woods) institutions. Does this view hold up to closer scrutiny?

Take the oft-cited fact that the AF has not actually funded any activities to date. Is this really a sign of UN inefficiency? Given that the counterpart of the AF at the World Bank, the Pilot Programme for Climate Resilience (PPCR), is not envisaged to disburse any funding before the end of 2010, two and a half years after its creation (July 2008), the AF – which will issue a first call for projects at COP 15, exactly two years after its formal creation at COP 13 in Bali – seems to compare quite favourably.

As to the question of transparency and good governance in general, it turns out that some of the traditional 'existing institutions' are not necessarily the shining examples they are often portrayed to be by the No-New-Institutions school. Take the case of the World Bank Group. A recent high-level report on the modernization of the Group's governance,<sup>9</sup> commissioned by World Bank President Robert Zoellick and chaired by former Mexican President Ernesto Zedillo, has revealed some *important shortcomings in three areas of the Group's governance: strategy formulation, voice and*

*participation, and accountability. The report contends that [c]urrent mechanisms for strategy formulation [of the World Bank] are not adequate for setting priorities and guiding operations. Mission creep is endemic, weakening accountability for results and increasing the risk that resources will be misallocated or spread too thin, undermining the institution's effectiveness. The Group's decision-making process is widely seen as too exclusive, offering many member countries too little voice and too few opportunities for participation. Insufficient institutional accountability for results weakens the World Bank's effectiveness and legitimacy. And certain conventions and practices have contributed to the perception that the institution is accountable and responsive only to a handful of shareholders at best. These weaknesses spring in large measure from the fact that the World Bank's governance—forged in the 1940s—has not kept up with historical change and today is not adequate to deal with global problems that require forward-looking, flexible, inclusive, and legitimate multilateral institutions.<sup>10</sup>*

In the present context, it has to be pointed out that there are aspects of CIF governance – such as the North-South balance on the governing bodies – that, for the Bank, are a step forward and in the direction of the Zedillo Report recommendations, even though they were only brought about by considerable outside pressure.<sup>11</sup> Other recommendations, such as the need for a more equal voting system, have not fared so well: in creating the CIFs, it was decided to simply abolish voting altogether.

As to transparency, the CIFs do have a policy of publishing documents on their website, although the speed of publication is not always as one might wish. Six months after being presented to the PPCR Sub-Committee, the report by the PPCR Expert Group on the criteria for pilot country selection had still not been published.

There is no doubt that the AF could, and should, learn certain governance lessons from the CIF experiment, not least as regards civil society participation. By and large, however, the AF need not fear a comparison with respect to the Zedillo Report recommendations.

To sum up, the argument here is *not* that institutions under the UNFCCC – such as the Kyoto Protocol Adaptation Fund – are perfect or better than other ‘existing institutions,’ but merely that some prevalent stereotypes to the contrary are misguided and based on prejudice, not fact.

#### *METHODOLOGICAL APPROACHES*

The question of how to construct an institutional architecture for international climate finance has been approached from a number of methodological vantage points, even within the No-New-Institutions school.

Some seem to take as starting point a *set of existing institutions* which they think should be given a role, more often than not because they stand a better chance of controlling them.<sup>i</sup> They then proceed to stretch the functions and governance of the climate finance regime across the *Procrustes' bed*<sup>12</sup> of these existing institutions. The result – as in the legend – is unlikely to be viable.

A more promising route has been to start with an *analysis of the functions and purposes* of the envisaged regime and then to see whether there are existing institutions that can perform those functions. In doing so, one should indeed apply a methodological principle known as *Ockham's razor*<sup>13</sup> which can be used to favour existing institutions by rejecting the introduction of unnecessary new entities. If an existing entity is fit for purpose, then a new one is not needed. However, this does not mean that one can dispense with creating new institutions altogether (nor incidentally, that all existing ones should have a role!). Existing institutions should not be given precedence simply because they exist, but only if *they are genuinely fit for purpose*.

#### WHAT PURPOSE?

Many in the No-New-Institutions school believe that previous experience in climate finance makes existing institutions automatically more 'fit for purpose' than new ones. However, this depends on the purpose. The Reformed Financial Mechanism (RFM) proposal<sup>14</sup> (Figure 3), for example, envisages two distinct types of financial transactions. There would be the traditional international funding activities as undertaken by existing institutions (evaluation and approval of projects and programmes). But there would also be a *disbursement of funds* to in-country *designated funding entities* according to some (performance or formula-based) macro-criteria. While it might be useful to have some technical experience in delivering the international funding, the key to the success of such disbursements lies in political buy-in, not technical or procedural expertise.

The question therefore is: can existing institutions be made fit for these purposes, and would they be able and willing to undergo such a reform? As I have argued elsewhere, such a reform might be possible for the purpose of international funding (despite the less than encouraging track record), but not for operating the disbursement function, which I believe requires the operating entity to be 'under the authority of the COP'. Given that it will be impossible to adequately scale-up the financial flows to developing countries effectively without a significant devolution of funding decisions to them, it is clear that it will be equally impossible to have an international financial regime which is fit for

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<sup>i</sup> Indeed, the difference in control seems to be the main reason why the Adaptation Fund is generally not included in the list of 'existing institutions'.

purpose without the introduction of a new entity to oversee international funding and to operate the required in-country disbursements.

#### *CONCLUSIONS AND THE WAY FORWARD*

Existing institutions have no automatic right to be involved simply because they exist. It is important to be clear about what purpose the institutions will be required to serve, before deciding whether the existing ones are fit for purpose. The mere prospect of reform is not sufficient to justify their involvement.

Experience has shown that *clarity on functional and governance arrangements* is the key to any fruitful discussion on institutional issues. In June 2006 – after six months of acrimonious exchanges about the desirability of the GEF as operating entity for the Adaptation Fund (AF) – the negotiations on operationalizing the AF were close to a breakdown, and expectations for a decision in Nairobi in December (CMP.2) were extremely low. The process was only salvaged at Nairobi because an implicit understanding had been reached between the G77+China and the EU *not to mention any existing institutions*, but instead to focus on the substance of the institutional architecture and governance. Without this, there would not have been a Nairobi decision on the AF (CMP.2/1) and the debate on whether the GEF should be the operational entity or not, would probably still be raging.<sup>15</sup>

Given the limited negotiation time, the only successful way forward is to focus once more on the functional and governance structure of international climate finance in general, the UNFCCC financial mechanism in particular, and to postpone any discussion referring to existing institutions to post-Copenhagen. The aim of Copenhagen must be to design a functional and governance architecture that is sufficiently specific to allow existing institutions to reform themselves and to *present themselves as fit for purpose* when the time comes to make the relevant institutional arrangements. Given the experience with institutional reforms in and outside the ‘existing institutions’, the watchword has to be ‘prudence’; and it is clearly more prudent to assign functions on the basis of proven reforms rather than on promises to reform.

#### **7. THE ROLE OF NATIONAL FUNDS AND INSTITUTIONS**

There is consensus that current financial arrangements are not suitable for the task, even under the present conditions of a relatively small amount of funding being available for developing country actions on climate change. With the envisaged increase in resources, the new regime would need to carefully explore the options for funding and disbursement (allocation). While it is clear that decisions on disbursement need to be taken centrally under the authority of the COP, the management of funds, and the decisions on funding, should be made close to the place of the actions that are being funded.

Shifting the management of funds and the responsibility of funding to the national level would have several advantages. In addition to the important enhancing aspects of ownership and a more conducive environment for alignment to national priorities, other advantages are equally important, such as the possibility for enhancing synergies among sectors and between mitigation, adaptation, and REDD (Reduced Emissions from Deforestation and Degradation).

Shifting the responsibility of management of funding to the national level brings other challenges that need to be addressed. There is general agreement about the weak institutional capacities of many developing countries. Climate change programmes, whether in the areas of mitigation, adaptation, or REDD are complex, and require skills that are scarce in most developing countries. These skills are needed urgently. The assignment of greater responsibilities, coupled with intensive capacity development programmes to address these weaknesses, would reap attractive co-benefits of having developing countries more fully engaged, managing their own funds and programmes, and building their capacities in the process.

There are a few national institutions already in place which other countries can use as models, building on the lessons learned and following their best practices. Some common principles are emerging as minimum requirements for these institutions to be credible. In addition to being able to carry out the complex and specific functions on climate change, they need to be equitable, efficient, and effective. Their governance must have credibility with, and be accountable to, the general public, and for this reason, it needs to be fair, transparent, and fully open to oversight and scrutiny.

Here follows an illustrative (not comprehensive) list of the types of functions that local institutions would need to perform, to coordinate, or to ensure the completion of, as part of their responsibilities in managing funds and disbursements of climate change funds at the national level:<sup>i</sup>

- ***Alignment with national policies.*** In addition to fiduciary responsibilities and performance assessment, the national institutions would also be responsible for coordinating the task of aligning policies and programme priorities for mitigation, adaptation, and REDD in the country, with actions to be funded on the ground.
- ***Financial support.*** Helping to mobilize resources, leveraging investments, and preparing up-to-date information to keep financiers and stakeholders informed at all times.
- ***Standards Setting.*** In addition to the standards needed for exercising their fiduciary responsibilities, national institutions would also be responsible for helping to fine-tune the

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<sup>i</sup> Adapted from Meridian Institute Report: REDD+ Institutional Options Report: Developing an efficient, effective, and equitable Institutional Framework for REDD+ under the UNFCCC, September 2009.

eligibility criteria of the Financial Mechanism to the national conditions, and to set sustainable development standards.

- ***Certification of Results.*** Based on their expert assessment, this function includes ensuring the quality of the implementing actors involved, and of the results of the actions performed. The MRV function would be included here. The institutions would need to verify that the funded programmes deliver adequate emissions reduction, adaptation needs, and REDD reference levels.
- ***Accountability.*** In addition to being accountable for their own actions and responsibilities, national institutions would also be responsible for ensuring that the various implementing partners are also accountable, and can be held responsible for their actions under their funded programmes and projects.

The National Funding Entities of the proposed Reformed Financial Mechanism will have to address the issue of how best to perform these different functions.

## II. Political Oversight: National Case Studies

‘Political oversight’, to be discussed in this and the next chapter, refers to the relationship between the Conference of Parties (COP) as the supreme body of the UNFCCC, and the proposed executive body (Executive or Finance Board) of the Financial Mechanism of the UNFCCC. The issue, in particular, is which of the two bodies is to take what decisions with respect to the central disbursement arm of the RFM, and whether there are any precedents of how disbursement might be carried out.

### A. The Balance of Budgeting Powers

#### 1. INTRODUCTION

The issue to be addressed in this section is the role of, and relations between, executive and legislative branches of government in allocating central funds. In particular, the aim is to get an idea about the (horizontal) *balance of budgeting power* between the executive and legislative branches of national government, i.e. the right to introduce/modify budget line items.

The aim is to see whether there are any clear preferences as to this balance of power, which could be carried over into the RFM context if one were to see the Administration of the Reformed Financial Mechanism as the executive branch, and the Conference of Parties as having the function of a legislative branch.

#### 2. THE CASE STUDIES

This section draws insights and conclusions of a much longer background study.<sup>1</sup> To avoid misunderstandings, please read the ‘Case Study Disclaimer’ in Chapter 1.

##### CHINA

The Chinese central budgeting process involves the *National People’s Congress* (NCP) as national parliament, the *State Council* (Cabinet), the *Ministry of Finance* (MOF), and a number of specialized government agencies on the side of the national executive branch.

The central budgeting process has two steps ‘up’, and two steps ‘down’. In the first step up, central government agencies and ministries prepare initial spending proposals, which are submitted to the MOF. In the first step down, the MOF carries out a preliminary review of these initial proposals, and submits a draft consolidated budget to the State Council. The State Council, based on this

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<sup>1</sup> Benito Müller and Achala Chandani, *The Reformed Financial Mechanism – Political Oversight*, OIES, forthcoming.

information, then sets budget ceilings, which are then communicated to the relevant central government agencies and ministries.

Based on these approved ceilings, the agencies and ministries then begin the second step ‘up’ by drafting detailed budgets for their organizations. They are again submitted to the MOF which consolidates them and prepares a summary budget for review and approval by the State Council. Once the State Council has approved the summary budget, it is submitted to the legislative branch (the NCP) for review and approval. The second and final step down begins with NCP approval of these broad budget lines. The MOF assigns disaggregated budget allocations to the central government agencies which, in turn, assign more detailed budget allocations to their subordinate spending units.

The key point in this procedure, concerning the balance of power of budgeting decision making power, is that it is *clearly in favour of the executive branch*. While the legislative branch does have some say in the budgeting process, it is only with respect to broad budget categories, and only after these were already approved by the State Council, which makes dissent by the legislative branch rather unlikely.

#### *INDIA*

The Finance Ministry is responsible for preparing the central budget (‘Annual Financial Statement’) which is carried out in consultation with the line ministries, the Planning Commission, and relevant interest groups. Any requests for expenditures from the central government Consolidated Fund must be passed by the lower House of Parliament (Lok Sabha). Initial estimates (Demands for Grants) are followed by *Detailed Demands for Grants* for each Ministry with detailed breakdowns of the budget relating to entities budgeted above a threshold of Rs 1 million.

After the presentation of the budget, the Lok Sabha debates the budget. In order for the executive to carry out the budgeted expenditures (and, for that matter the budgeted taxation) the Lok Sabha has to pass authorizing legislation (the ‘annual appropriations’ and the Finance Act respectively). Importantly, the Lok Sabha cannot increase the requests for funds by the executive, nor can it authorize new expenditures. The legislation is forwarded for comment to the upper house of parliament and signed into law by the President of the Republic.

Thus the balance of budgeting power – in the sense of being able to introduce and amend budget line items – *is with the executive branch*. This is not to say that the legislative branch has no say in the process. It can seek amendments to the budgets by the executive, and, failing that can reject the budget as a whole. This, in turn, would generally force the government to seek a vote of confidence, clearly not a welcome prospect for any government, but the right to introduce and modify budget line items remains the sole prerogative of the executive branch.

#### *SWITZERLAND*

The Swiss budgeting process is initiated by the heads of the seven Federal Departments, who

collectively form the Federal Council (the governing body of the executive branch). They put together a draft budget for review by the *Finance Committees* of both the houses of parliament. After the review, the budget bill is submitted to both houses. If there are extreme differences between the two chambers, Parliament has the option to send the budget back to the executive branch to be re-submitted.

The Swiss Parliament has the right to amend, introduce, and cancel any line item in the budget, but is unable to the overall expenditure (except for the ceiling on the overall expenditures). The balance of budgeting power, in the sense used here, is therefore *clearly with the legislative branch*. Having said this, both branches of government are subject to a rather uncommon constraint, in that nearly all changes in taxation have to be voted on by the population. Hence budgetary debates between the different branches of government tend to focus on the expenditure side.

#### *UNITED STATES*

The executive branch is responsible for drafting the annual spending budget, which is presented to the legislative branch in the form of the *President's Financial Proposal*. All other fiscal competencies are with the legislative branch (the US Congress), although the executive does have some indirect influence by the fact that the President has the right to veto (enacting) legislation.

Congress passes a *Budget Resolution* which sets overall levels on spending, providing the framework for the different appropriations committees to prepare spending legislation, such as appropriations bills. The executive can reject an appropriations bill (by way of a Presidential veto), but only as a whole, and not of selected parts. The balance of budgeting power is hence clearly with the legislative branch.

### **3. CONCLUSIONS**

*HORIZONTAL BALANCE.* There is no general pattern (in the four case studies) as to who holds the (horizontal) balance of budgeting powers at the national level. In two of the countries (China and India), it was the executive branch that had priority in 'micro managing' the budget. In the other two (Switzerland and the US), it was clearly the legislative branch. In other words, it is not really possible to draw any conclusions as regards who should be in charge of micromanaging the budget in the RFM proposal, the Finance Board (representing the executive of the RFM) or the COP (representing the RFM legislative branch). Having said this, it is curious that the respective preferences concerning the relation between the COP and some executive body of the Financial Mechanism seem to be precisely the opposite of their national realities.

*VERTICAL BALANCE.* While our case studies have not revealed a clear pattern in respect of the *horizontal* balance of budgeting power, they have revealed some interesting insights relating to the *vertical* balance of budgeting power between the national/central government and sub-national/local governments.

The most interesting example in this context is that of China (see case study in the subsequent section on Distribution of Central Funds). Over the last 40 years, China has tried out a number of extreme options of managing fiscal relations between the central government and the regions, ranging from initial central planning model, to an extremely decentralized model which meant that the central government was no longer able to play the role of fiscal equalizer. At present, the trend seems to be a return towards a system with a significant central budget to be shared between the regions, but with rule-based allocations, and devolution of spending decisions to the local level.

## B. Distribution of Central Funds

### 1. WORLD BANK COMPARATIVE ANALYSIS OF FISCAL TRANSFER MECHANISMS

The issue of (re-) distributing central funds – resources, mostly collected as tax revenue by national governments – to sub-national entities (states, provinces, territories, or generally ‘regions’) has been at the heart of domestic fiscal policy since time immemorial. One of its more recent centre-stage appearances has been on the occasion of the last fundamental reform of the Chinese fiscal system in 1994. An important paper written in that context was Jun Ma’s comparative country analysis of *Intergovernmental Fiscal Transfer*.<sup>16</sup>

*JUN MA (1997)*. Ma’s paper provides an overview of the fiscal transfer mechanisms in nine major industrial and developing countries,<sup>1</sup> with special reference to the design of transfers that are meant to overcome certain fiscal disparities between regions (‘equalization transfers.’).

The paper advocates a formula-based (equalization) transfer approach which would have at least three advantages over so-called ‘discretionary’ systems, namely

- (1) *It bases the evaluation of each region’s entitlement largely on objective variables, thus avoiding excessive bargaining and lobbying by the sub-national governments. As a result, it increases the fairness of the distribution outcome.*
- (2) *A formula-based system, if properly designed, can eliminate the disincentive inherent in many discretionary systems that encourage low tax efforts and over-spending of the sub-national governments.*
- (3) *Most important, a formula-based equalization system provides an effective means to address regional disparity issues.*[p.47]

As regards ‘effectiveness’, the paper – citing Anwar Shah<sup>17</sup> – puts forward the following four criteria:

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<sup>i</sup> The United States, Canada, the United Kingdom, Australia, Germany, Japan, Korea, India, and Indonesia

- (a) **Revenue adequacy:** the sub-national authorities should have sufficient resources, with the transfers, to undertake the designated responsibilities.
- (b) **Local tax effort and expenditure control:** ensuring sufficient tax efforts by local authorities. Formulas should not encourage fiscal deficits.
- (c) **Equity:** transfer should vary directly with local fiscal needs and inversely with local fiscal capacity.
- (d) **Transparency and stability:** the formulas should be announced and each locality should be able to forecast its own total revenue (including transfers) in order to prepare its budget. And the formulas should be stable for at least a few years (3-5 years) to allow long-term planning at the local level.[p.3]

In light of the special character of climate change finance – as captured by the principle of common but differentiated responsibilities and respective capabilities in the UN Framework Convention on Climate Change – it is not self-evident to what extent these criteria would be applicable without suitable adaptation. Payments by developed countries for climate change activities in developing countries are different in character to domestic fiscal equalization payments. At the same time, there seem to be sufficient similarities to justify an interpretation of these findings, in the context of setting up a disbursement regime for consolidated international climate change finance.

In other words, Ma's arguments – listed above as (1), (2), and (3) – for the superiority of formula-based transfers over purely discretionary arrangements seem to hold equally for the disbursement of (*ex ante*) internationally consolidated funds for climate change activities in developing countries. And the same seems to hold true of Shah's four criteria of effective payments.

*TRANSFER FORMULAE.* As to the (equalization transfer) formulae themselves, Ma distinguishes four types:

- (i) formulae that consider both fiscal capacities and needs of the recipients,
- (ii) formulae that only consider fiscal capacities,
- (iii) formulae that are based on some 'needs' indicators,
- (iv) a simple per capita allocation.

**Fiscal Gap Transfers** are meant to fill any fiscal gap between (reasonable) fiscal needs and (normative) fiscal capacities of the regions. The total funding available is transferred in proportion to the fiscal gaps.

**Fiscal Capacity (Equalization) Transfers** assume that the total (sub-national) tax revenue *should* be distributed in proportion to the total population of the sub-national entities in question. The transfers are to make up the difference for those who fall below that normative level (generally, those that are above this level will not have to transfer funds to the central government). Fiscal needs are not taken into consideration.

**Fiscal Needs Transfers** are meant to cover (a proportion of) the fiscal needs of sub-national entities. A region’s fiscal needs are calculated as the sum of the fiscal needs of the different relevant sectors (e.g. education, health, transportation, telecommunications, social welfare, police, fire, environmental protection). Each of these sectoral needs is calculated as the number of units that receive the service from the sector in question, multiplied by the national average unit cost for providing that service, and adjusted to local circumstances by an ‘adjustment index’.

For example, the fiscal need for education is calculated by multiplying the number of children of school age by the national cost of education per school child and a weighted average of wage, rental cost, student disability, and poverty indices.

Fiscal needs, in other words, are calculated as ‘reasonable’ costs given the regional circumstances and national averages. The total amount available is transferred in proportion to the needs. Fiscal capacities are not taken into account

**Simple Per Capita Transfers** are transfers where the available amount of funding is shared in proportion to the share in the relevant ‘eligible’ population, e.g. the share of people below a certain income. As Ma points out, this sort of transfer cannot actually fully equalize fiscal capacity,<sup>i</sup> but that is immaterial in the present context, as it clearly cannot be the aim of a disbursement regime to equalize fiscal capacities in the world.

*SUMMARY.* Ma’s paper is focused on the provision of **central government grants**, conditional or unconditional. **Conditional grants** – either matching or non-matching – are tied to a certain purpose, whereas **unconditional grants** can take *the form of a general revenue-sharing. The formulas used to allocate the equalization transfers to sub-national government are the central element of this grant system, and are subject to intense debate both academically and in practice.*[p.4] While this is the main focus of Ma’s paper, it is important to keep in mind that a formula-based approach is not the only possible alternative to what he refers to as discretionary allocation.

One alternative is the possibility of **performance based disbursement**. While this is not common in fiscal transfers, it is nonetheless important in the context of climate change finance, and will be discussed in Chapter 3.

The formulae used in Ma (1997) are based on a basic template, namely

$$u \times c \times a, \text{ where}$$

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<sup>i</sup> *Equal per capita transfer cannot fully equalize but can mitigate regional disparity in fiscal capacity. To see this, suppose there are only two regions, region A and region B, with per capita tax revenues of \$1000 and \$2000 respectively. An equal per capita transfer of \$1000 reduces the ratio of region B’s per capita tax revenue to that of region A from 2 to 3/2. But unless the per capita transfer is infinity, the ratio is always less than one (full equalization).*[Ma (1997):36]

$u$  = *number of relevant units in the region*,  $c$  = *national unit average* (contribution or cost), and  $a$  = *regional adjustment factor*.

Ma's typology is based on a differentiation with regard to (increasing) information needs. While there are parameters – in the needs assessment – that do not involve people as relevant units, the simplest formula in Ma's typology is the per capita one. Clearly, informational simplicity cannot be the (sole) reason for this, given that an equal distribution among the regions would not be more complex. The reason for choosing a per capita allocation in this context would have to be the assumption that ultimately the relevant units for fiscal purposes – *the ultimate contributors and beneficiaries* – are not regions, not enterprises, but *individuals*.

## 2. THE CASE STUDIES

This section draws some insights and conclusions of a much longer background study.<sup>18</sup> To avoid misunderstandings, please read the 'Case Study Disclaimer' in Chapter 1.

### CHINA

The situation in China, with regard to disbursement of central funds to sub-national entities, is of particular interest in the present context as it has varied extremely over the last decades. During China's centrally planned period, funding decisions were more or less retained at the central level, all the revenue was collected by the central government, which also decided in detail how it was to be spent at all levels.

*The pre-reform fiscal regime resulted in an equal fiscal capacity among regions, but the sub-national governments had no incentives and with low efficiency to develop their local economies because of lacking of enough fiscal autonomy, which became one of the start points of the economic reform.*<sup>19</sup>

In the 1980s, China began a process of *fiscal decentralization*, allowing sub-national governments ('regions') to have more say in how to finance their needs, and gradually build up their accountability. The tools employed were a variety of *contracting methods*, and the basic idea was to apportion revenue and expenditure between the central and regional authorities, while holding the latter responsible for their own profits and losses. Intergovernmental transfers fluctuated, indeed the central government became dependent on revenue transfers from better-off provinces, which in turn could negotiate better contracting terms than less well-off ones. This led to a marked increase in economic and fiscal disparities between the regions, which was seen as a threat to the unity of the country, and led to a fundamental fiscal reform in 1994, which replaced the contracting system with more progressive fiscal transfer methods.

However, there seems to be a widely held agreement that the system, as it stands, has thus far not been able to genuinely address these disparities. Further reforms are recommended, key among them – from the perspective of this report:

- (i) Delegation of legislative powers regarding fiscal issues in accordance with the *principle of subsidiarity*;
- (ii) Reform of the transfer payment system with the objective of creating equal access to public services across the country through *rule-based transfers* ('objective criteria').

#### INDIA

Like China, India was for some time governed by a central planning system, although not to the same degree. India, however, has had a formula-based intergovernmental transfer system for some time.

The Indian fiscal transfer system follows two routes. On the one hand there are the statutory transfers based on a formula determined by the Indian Finance Commission, on the other there is the non-statutory Normal Central Assistance carried out under the so-called *Gadgil Formula*.

The Finance Commission is tasked with *redressing the vertical imbalances* between the taxation powers and expenditure responsibilities of the Centre and the States respectively, and *equalization of all public services across the States*. The formula currently used for this purpose takes into account population size, income distance, area, tax effort, and fiscal discipline, but is weighted predominantly (75 per cent) in favour of the first two, i.e. *essentially in favour of the number of poor people*.

Initially, the *Normal Central Assistance* by the central government to State plans/budgets was allocated without reference to an allocation formula. Responding to a general demand for an *objective* and *transparent* allocation of Central Assistance, the *Gadgil formula* was adopted during the Fourth Five Year Plan (1969–74). The Gadgil formula, in its current form, uses two types of parameters. On the one hand, there are parameters which can be justified in terms of needs, namely size of population, poverty (relative per capita income), and special needs/problems. On the other, there are performance related indicators which are used as incentives. What is striking is that the needs-based parameters far outweigh the performance ones (92.5 : 7.5), and that the lion's share (60 per cent) is an egalitarian per capita allocation.

#### SWITZERLAND

Switzerland has a long-standing *fiscal equalization system*. Financially weak states (cantons) receive unconditional payments to equalize financial strengths ('*resource levelling*') and financial needs ('*burden compensation*') between the cantons. The former is based on an index involving the taxable income of individual taxpayers, earnings from taxable assets of individual taxpayers, and the taxable profit of firms. These factors are all relative to the population size, all on a *per capita* basis. Resource levelling in Switzerland is purely aimed at *wealth redistribution* and clearly separated from other objectives, such as burden compensation which, in turn, takes into account two kinds of financial needs:

- *Geographic cost compensation* takes account the higher expenses incurred by mountainous cantons.

- **Socio-demographic cost compensation** reflects additional expenses incurred by urban agglomerations with a disproportionate share of high public expenditure population groups.

The key lesson from the Swiss experience is that it is possible and desirable to clearly separate wealth distribution from burden compensation.

#### UNITED STATES

In the US, Federal budget spending falls roughly into two categories: **discretionary spending** (at the discretion of the annual appropriations procedure) and **mandatory/direct spending**, mostly (but not all) used to fund **entitlement programmes** such as social security, Medicare, and Medicaid. Most of the beneficiaries entitled to such funds are individuals. There is, however, one programme where the beneficiaries are bodies: under the Drinking Water State Revolving Fund, the Federal Government is transferring Federal resources to **in-state infrastructure funding accounts** from which assistance is made available to public water systems.

Following a country-wide needs assessment, each eligible State receives a share in proportion to its need. However, each eligible State is **guaranteed an egalitarian 1 percent** of the available funding up-front. The funding of projects by the State authorities from the funds thus received, in turn, uses a prioritization based on the relevant legislation.

The US system illustrates the need for a minimum egalitarian component.

### 3. CONCLUSIONS

Disbursements, in the sense used here, are (lump sum) payments to national climate change funding entities.

One of the main prerequisites for such an international disbursement scheme to function is for it to be regarded as **distributionally fair**.<sup>i</sup> Following Aristotle,<sup>ii</sup> this is the case if the disbursements are **proportional** to certain parameters. In those cases where it makes sense to measure some form of deliverables – such as emission reductions – it is possible to have **performance-based** disbursements (i.e. in proportion to the delivered quantities). In those where it does not make sense – such as payments for adaptation – the disbursement should be **rule-based**.

In either case, it would be advisable to follow the above-mentioned American example (Section 2), and introduce a **flat per country component** in the distribution, in addition to these (performance

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<sup>i</sup> Strictly speaking, the issue is not so much fairness, but (excessive) unfairness. Parties need not regard the scheme as fair to others, but as not unacceptably unfair to themselves.

<sup>ii</sup> According to this Aristotelian view of distributive justice, agents are entitled to different amounts if they differ in some relevant parameter, and an allocation is fair or just only if it is carried out in proportion to this parameter. The idea being, so Aristotle, that ‘What is just then is what is proportional, and what is unjust is what violates the proportion’.[Aristotle *Nicomachean Ethics*: Bk V: Ch.3.]

or rule-based) proportional disbursements.<sup>i</sup>

*Needs.* Performance based (proportional) disbursements are discussed in Chapter III. As to rule-based ones, let us consider the case of *adaptation finance*. Using Jung Ma's classification of rule-based fiscal transfers (Section 1), adaptation finance disbursements could be based on *needs assessments*. Following Ma, this could mean establishing *adaptation funding needs* of countries in terms of sectoral assessments, which in turn would take the form of *identifying a unit for the assessment* in the relevant sector (e.g. a metre of sea-defences), multiply the *number of such units* relevant to the country by a 'reasonable' unit cost and a local adjustment parameter. To put it in somewhat more formal notation, the sectoral financial *need*  $n$  for adaptation of country  $i$  in sector  $k$  is given by the formula

$$n_i^k = u_i^k \times c^k \times a_i^k, \text{ where}$$

$u_i^k$  = number of units in country  $i$  relevant for adaptation in sector  $k$ ;  $c^k$  = agreed 'reasonable' average cost for providing one of these units;  $a_i^k$  = adjustment factor (based on a separate formula) for these costs in country  $i$ .

The proportionality parameter in such a purely needs-based disbursement methodology – i.e. the country's total financial *Need* for adaptation – is then given by the sum of the relevant sectoral needs:

$$N_i = \sum_k n_i^k$$

*Capability.* Following Ma's typology, disbursements of adaptation finance could also involve some measure of capability, but it is not straightforward, as in the case of fiscal capacity, to define what a country's 'capability to pay for adaptation measures' might be. However, there is another way of taking capabilities into account which, while it might be less sophisticated, is probably more appropriate, namely to use capability as a *priority criteria*: disbursements are prioritized, and first priority is given to those countries which are below a certain general economic capability level, for example defined in terms of per capita GDP. In that way there is no need to estimate 'financial capabilities' of countries.

*Base Formula.* Ma's typology indeed can be taken one step further in the direction of simplicity, namely by adapting what he refers to as 'Simple Per Capita Transfers'. The idea is to use the size of a relevant population – for example the number of 'poor' inhabitants, i.e. living below subsistence level – as the simplest form of rule-based *proportionality parameter* for adaptation finance:

$$N_i^* = \text{number of poor people in country } i.$$

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<sup>i</sup> Note that the flat per country method can actually also be regarded as a proportionality allocation, where the proportionality is simply the proportion each country has in the total number of eligible countries.

In short, the simplest formula for disbursing adaptation finance would be in proportion to the number of poor people (in addition to the above-mentioned flat per country component). Country  $i$ 's allocation under this form of basic adaptation finance disbursement would be:

$$A_i^* = F/n + (T - F) \cdot p_i/p,$$

with  $T$  = the total of available funds,  $n$  = the number of eligible countries,  $F/n$  = the flat per country amount, and  $p_i/p$  = country  $i$ 's share of poor people in the eligible countries.

*Different Prioritization Methods.* The basic formula introduced in the preceding paragraph is, of course, purely needs based. If one were to include a capability component, it would probably be best to use some form of **prioritization**. There are at least two ways in which this could be achieved.

One could opt for an **absolute priority regime**, under which all priority needs would have to be met before any needs of non-priority countries could be addressed. Alternatively, priority countries could have a **dedicated funding window**, only accessible to them. The remainder of the funds would be disbursed to all (eligible) countries according to the chosen formula.

## III. Political Oversight: Multilateral Case Studies

### A. The Case Studies

This section draws some insights and conclusions of a much longer background study.<sup>i</sup> To avoid misunderstandings, please read the ‘Case Study Disclaimer’ in Chapter 1.

#### 1. THE KYOTO PROTOCOL ADAPTATION FUND

##### *BACKGROUND*

The Adaptation Fund (AF) has been established by the Parties to the Kyoto Protocol to finance concrete adaptation projects and programmes in developing countries which are Protocol Parties. The AF is financed from a share of proceeds of the Clean Development Mechanism (CDM) project activities, and other sources of funding. The share of proceeds amounts to 2 per cent of Certified Emission Reductions (CERs) issued for CDM project activities. The AF was launched in 2001 at the 7th Conference of the Parties (COP) to the UNFCCC in Marrakech, Morocco. The Fund became operational when its key documents were adopted at COP 14 in Poznan, Poland. Recently, the Adaptation Fund Board sent out an invitation to all developing country Parties of the Kyoto Protocol, to nominate National Implementing Entities. During its ninth meeting held in March 2010, the Board decided to accredit the first three Implementing Entities to manage grants from the Adaptation Fund, and to start financing concrete climate change adaptation projects. By accrediting its first *National Implementing Entity* (the Senegalese Centre de Suivi Ecologique), the Board also took the final step in operationalizing ‘*direct access*’ to its funds, without having to go via multilateral implementing agencies. Also, the Board issued call to parties to submit project proposals in April 2010.<sup>ii</sup>

##### *DEVELOPING COUNTRY GOVERNANCE OWNERSHIP*

The governance structure of the AF has been internationally acknowledged as being ground breaking, not least because of the representation of the interests of developing countries – which are most affected by climate change impacts. The Adaptation Fund Board (AFB) was established to supervise and manage the AF, *under the authority and guidance* of the Conference of the Parties serving as the

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<sup>i</sup> Benito Müller and Achala Chandani, *The Reformed Financial Mechanism – Political Oversight*, OIES, forthcoming.

<sup>ii</sup> ‘The Adaptation Fund Operationalizes Direct Access and Issues Call for Proposals by the Parties’. Available at: <http://afboard.org/pressreleases.html>.

Meeting of the Parties to the Kyoto Protocol (CMP). It is fully accountable to the CMP, which will decide on its overall policies in line with relevant decisions.

The composition of the AFB grants a majority of representation to developing countries. Among the 16 members, two represent each of the five UN regional groups, one represents Small Island Developing States (SIDS), one represents the Least Developed Countries (LDCs), two represent the Annex 1 (developed) countries, and two represent the non-Annex I (developing) countries. This composition imparts ownership of decision-making to those nations which stand to receive the funds, and thus helps to align AF objectives with implementation. At the same time, Board decisions are generally taken by consensus among all members. Only if all efforts to reach a consensus have been exhausted will a two-thirds majority of members be able to decide through a vote.

#### *DIRECT AND FLEXIBLE ACCESS TO FUNDS*

The principle of *direct access* is a cornerstone in the provision of funds<sup>i</sup> by the AF. It aims to simplify and accelerate the process by which resources for adaptation flow to developing countries. Direct access means that implementing entities at the country level, after having gone through an accreditation process, can access funds directly from the AF for approved projects and programmes. Eligible Parties may submit proposals either directly through their nominated National Implementing Entity (NIE), or use the services of Multilateral Implementing Entities (MIE). NIEs are national legal entities nominated by Parties which are recognized by the Board as meeting the fiduciary standards established by the Board. The NIEs will bear full responsibility for the overall management of the projects and programmes financed by the AF, and will bear all financial, monitoring, and reporting responsibilities. If an NIE is accredited as meeting the fiduciary standards of the AF, then it will also be entitled to receive funds directly from the AF. If an NIE is not accredited, then the funding will have to flow through an MIE. MIEs are those Multilateral Institutions and Regional Banks which meet the fiduciary standards provided by the Board. Thus, the AF allows a more focused process to nations best equipped to handle fund disbursements directly, yet offers assistive intermediation (through MIEs) to those less suited. This arrangement grants flexibility to nations, and through international fiduciary standards for NIEs, to hold accountable those nations which receive funds.

The direct, flexible access path established under the AF stands as one of the most lucid exemplars of devolution of decision-making in international fund structuring to date. By allowing national-level implementation through selection of the NIE disbursement route, the AF eschews the

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<sup>i</sup> Jan Cedergren, 'The Adaptation Fund – where is it heading?', <http://climate-l.org/2009/10/26/guest-article-25-the-adaptation-fund-where-is-it-heading/> accessed 07/03/10.

more traditional model of bureaucratized implementation by multilateral entities at the international scale. This devolution not only stimulates efficiency through the streamlining of the disbursement process (thereby reducing the resources siphoned off for implementation at the international level), but also constitutes national ownership of initiatives, by removing much bureaucratic interference in the decisional process. Still, this model could be improved, and the current manifestation of the AF stands as a halfway house to full devolution of decisional ownership and operation: in the present AF model, funding decisions are still taken at the international level.

The RFM takes this a step further, to facilitate a process that is more fully situated at the country level, where funding, decisional processes, and implementation functions all reside within national-level institutions.

#### *LACK OF CONCRETE FORMULA FOR FUND DISBURSEMENT*

The current prioritization formula for selecting projects is somewhat problematic, due to a lack of explicit clarity and objectivity. While the direct access feature had been intended to expedite the disbursement process, such disbursements will be troubled by the need for project compliance with certain criteria that are difficult to measure empirically. These criteria include parameters such as the level of vulnerability, the level of urgency and risks arising from delay, maximization of applicable co-benefits, and existent adaptive capacity to adverse effects of climate change. While theoretically sound attributes for consideration, such metrics prove difficult to quantify and assess, and involve value judgments in prioritization. The RFM should learn from the difficulties faced by the AF, and other funds which have not elected more concrete funding criteria in establishing their disbursement mechanisms. The AF example specifically illuminates the need for readily-measurable and objective metrics for disbursements.

#### *RELIANCE ON OPERATIONAL SUPPORT FROM COMPETITORS*

In the course of the negotiations in Bali that led to the establishment of the Adaptation Fund (CMP3, 2007), there was a deep North-South divide concerning the issue of whether the Global Environment Facility (GEF) should be the operating entity of the AF. In the end, the developing country view prevailed, with the creation of the Adaptation Fund Board as AF operating entity, although with the GEF providing secretariat services (and the World Bank as trustee) on an interim basis.

The marriage between the AFB and its service providers was arranged and, at least from a developing country perspective, was not based on 'love at first sight'. Accordingly it took some time before a satisfactory *modus vivendi* was established. One of the key problems was a lack of trust, which was not helped by the fact that there were some obvious potential conflicts of interest, due to the use of outside institutions. For example, the Memorandum of Understanding between the AF and the World Bank concerning the Bank's trusteeship for the AF was drafted by the Bank, and vetted by

lawyers of the AFB secretariat provider, the GEF. The fact that all GEF personnel are World Bank employees clearly meant that there was a potential conflict of interest. It thus is not surprising that there were initially occasions when the AFB Chair approached the UNFCCC Secretariat for independent legal advice.

While the trust between the AFB and its service providers has improved at the working level, there remains a problem of potential conflict of interest at the strategic level. Indeed, if anything this potential has increased over time, not least because the Trustee (the World Bank) has become a key competitor through its Climate Investment Funds. The secretariat service provider (GEF) has been a competitor from the outset, and the conflict of interest situation is unlikely to be resolved, particularly since the GEF management is proposing to take over a business model similar to the AF direct access model. It is difficult to see how such a situation could arise in the private sector – how a company could outsource its core administrative and financial function to its competitors. This should give food for thought for the RFM.

#### *AUTOMATIC FUNDING MECHANISM*

Finally, the AF's sourcing merits an exposition. The AF relies on a share of proceeds from the monetization of CERs from CDM projects as its primary funding source. This financing mechanism stands readily-important in constructing a RFM, as it redresses many of the fundraising woes that plague other multilateral facilities. Firstly, it removes (at least partially) pressures upon decision-making agents to make choices based on the priorities of contributing nations rather than on the needs of recipient nations. Facilities reliant upon voluntary contributions and replenishments are ultimately beholden to nations and bodies which supply such funds. Through downplaying the voluntary nature of fund provision, implementing bodies are freed to pursue projects that are more driven by impact than by political motivations and considerations. Secondly, such funding strategies are often able to create a more predictable and reliable source of funding, than those relying on the whims of voluntary contributions. Thus budgets and allocations can be planned more concretely into the future. One proposed programme that extends the more mandatory payment principle – the International Air Passenger Adaptation Levy (IAPAL) – would incorporate a nominal fee into all international air travel that would be used for adaptation funding. Such programmes are advantageous, in that they closely embody the Polluter Pays Principle. Whereas current voluntary funding schemes must sort out the messy philosophical problems of past and future responsibility determinations, programmes such as IAPAL clearly make those individuals who are currently polluting, accountable for payments to affected parties. The RFM would thus do well to adopt the AF's approach of an automatic financing mechanism.

## 2. GLOBAL ENVIRONMENTAL FACILITY TRUST FUND

Established in 1994, the GEF Trust Fund is the common funding resource of the Global Environment Facility (GEF). The GEF Trust Fund supports six focal areas: climate change; biodiversity; international waters; protection of the ozone layer; persistent organic pollutants (POPs); and land degradation. GEF Trust Fund assistance takes the form of projects conducted by the GEF Implementing Agencies (UNEP, UNDP, World Bank). Since 1999, the GEF has expanded opportunities for so-called ‘Executing Agencies’ – in particular Regional Development Banks (RDBs) – to implement projects.<sup>i</sup> The objective of the climate change focal area of the fund is to help developing countries and economies in transition to contribute to the overall objective of the UNFCCC. The projects support measures that minimize climate change damage by reducing the risk, or the adverse effects, of climate change. The GEF allocated in excess of US\$ 956 million in 2009 and US\$ 2.55 billion to climate change projects since the start of the GEF Trust Fund (all four replenishment periods).<sup>ii</sup>

### *PROBLEMATIC DISBURSEMENT FORMULA*

The key lesson for the design of the RFM governance and disbursement, from the experience with the GEF Trust Fund, concerns the method of determining resource allocations, the GEF **Resource Allocation Framework** (RAF). The RAF has been strongly criticized by many developing countries and civil society groups<sup>iii</sup> and could be controversial in implementation.<sup>iv</sup> The RAF involves two indices aimed at measuring countries’ performance. One relates to the potential of generating global environmental benefits in a particular focal area (GEF Benefits Index – GBI), and the other to capacity, policies, and practices relevant to a successful implementation of GEF projects and programmes (GEF Performance Index – GPI). A number of flaws exist in usage of these indicators.

**Performance Index.** The use of the GPI index –particularly one largely (70 per cent) based on the World Bank Country Policy Institution Assessment Indicator (CPIA, see below) – favours (i) the existence of supportive policies; and (ii) the capacity to implement and enforce policies’ in areas that

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<sup>i</sup> Other regional agencies include ADB, AFDB, ABRD, FAO, IADB, IFAD, UNIDO. See [http://www.gefcountrysupport.org/report\\_detail.cfm?projectId=140](http://www.gefcountrysupport.org/report_detail.cfm?projectId=140).

<sup>ii</sup> GEF Trust Fund, Climate Change Focal Area, [www.climatefundupdate.org/listing/gef-trust-fund](http://www.climatefundupdate.org/listing/gef-trust-fund).

<sup>iii</sup> Zoe Young, ‘The Politics of GEF’, *Eco*, Volume 15, Issue 7, 28 March, 2006.

<sup>iv</sup> See Fourth review of the financial mechanism, Revised draft conclusions, FCCC/SBI/2009/L.15/Rev.1. According to the conclusions, ‘COP 15 Decision GEF’s move towards country level programming has increased country ownership to some extent, but the current resource allocation modalities need improvement’

are at best tangential to the climate change problem.<sup>i</sup> Moreover, it is by no means self-evident that there is sufficient ground to reward countries with climate change payments, depending on the performance indicators assessed in the CPIA, particularly if climate change payments are restitutions, and hence a matter of entitlement.

The *GEF Climate Change Index* – defined as the product of a country’s carbon dioxide emissions in 2000, and a ‘Carbon Intensity Adjustment Factor’ (CIAF) – in essence rewards large, fast growing emitters. Consequently, almost two-thirds of the climate change money allocated to individual countries goes to the ten largest recipients (among them three OECD countries) and only one per cent to the LDC members on the list.<sup>ii</sup> In other words, a large number of countries were essentially left with no benefits at all.

Moreover, Müller (2007) argued that the reasoning behind the way the index was formed, namely that it maximizes the impact of resources spent on mitigation on the grounds that ‘in general, countries with larger emissions have lower abatement costs, which increase less rapidly with abatement than those in countries with smaller emissions’ was simply not tenable. If anything, he argued, the efficiency of GEF funding in terms of global environmental impact could really only be measured against marginal abatement cost curves, and could not be captured by simple parameters.

The Scientific and Technical Advisory Panel (STAP) formally commented on the Mid-Term Review of the RAF in Dec 2008, and noted, in a first instance, that its expertise is on the Global Environment Benefit Index (GBI), thus automatically excluding from review the controversial use of the GEF Performance Index. The STAP came to the conclusion that:

- a. *The RAF indices have not been subject to sufficient scientific scrutiny to conclude that they can be used to assess potential Global Environmental Benefits (GEBs); and*
- b. *The design and rules of the RAF should be simplified, and need to be verified and independently supported.*<sup>iii</sup>

The Technical Report concurred with the above-mentioned result that, theoretically, the GBI – reflecting upon carbon mitigation potential at the country level – would need to be based on marginal abatement cost (MAC) curves for the GEF recipient countries.

Thus, the GEF’s approach to quantified assessments should prove a useful warning in design of

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<sup>i</sup> Air pollution, water pollution, solid and hazardous waste, ecosystem conservation and biodiversity protection, marine and coastal resources, freshwater resources, and commercial natural resources.

<sup>ii</sup> See: Benito Müller, *Nairobi 2006: Trust and the Future of Adaptation Funding*, Oxford: Oxford Institute for Energy Studies, EV 38, January 2007:p.5.

<sup>iii</sup> See STAP response to the Mid Term Review of the Resource Allocation Framework at [http://stapgef.unep.org/docs/Guidance/STAP\\_MTR\\_RAF.pdf](http://stapgef.unep.org/docs/Guidance/STAP_MTR_RAF.pdf)

the RFM. Proper justification and research should be granted for the formula(e) ultimately employed, and approaches should be vetted by external experts prior to implementation. Furthermore, caution should be exercised, in order to prevent a mismatch of objectives of the facility and outcomes precipitated. As the case of the RAF grimly demonstrates, poorly-conceived formulae can encourage perverse outcomes which deviate from the intended results. Therefore, it is advised that the process for devising the RFM disbursement formula be made visible to all stakeholders and that active feedback and critique be encouraged, to reach a prescription which is both scientifically sound and politically acceptable.

### **3. WORLD BANK INTERNATIONAL DEVELOPMENT ASSOCIATION (IDA)**

The International Development Association (IDA) was established in 1960. IDA provides concessional loans and grants for programmes that are intended to boost economic growth and to improve living conditions in poor countries. Repayments are stretched over 35 to 40 years, including a 10-year grace period. IDA also provides grants to countries at risk of debt distress. In 2009 the IDA allocated US\$ 11.2 billion.

As in the case of the GEF Trust Fund, the key lesson to be learned from IDA in the context of this chapter concerns its resource allocation methodology. The IDA has adopted a formulaic approach to determining the allocation of funding. This formula gauges a prospective recipient's performance in implementing policies that promote economic growth and poverty reduction. This is assessed by the Country Policy and Institutional Assessment (CPIA).

The CPIA is meant to assess simultaneously a nation's *past* performance in economic management, structural policy, social inclusivity and equity, and public sector management and institutions. However, despite delineating an assortment of variables to be considered in determining the relative performance of each of these metrics, the selected weights have no justified backing. Moreover, most of these factors prove difficult to determine empirically, which means that the CPIA effectively constitutes a 'black box' in determining fund allocations.<sup>i</sup>

As concerns the design of the RFM, the IDA resource allocation methodology can only serve as a cautionary tale on the problems of opacity and alchemy of procedural determination. The IDA's approach does little to foster confidence in the application of funds. Its approach to assessment and disbursements is pretend scientific and opaque. The lesson for the design of the RFM has to be to

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<sup>i</sup> For a more detailed analysis of IDA resource allocation methodology, see Benito Müller and Achala Chandani, *The Reformed Financial Mechanism – Political Oversight*, OIES, forthcoming.

employ the guiding principles of transparency of procedure, and clarity and justification of disbursement methods, in order to avoid the position of the IDA.

#### **4. THE GLOBAL FUND TO FIGHT AIDS, TUBERCULOSIS, AND MALARIA**

##### *BACKGROUND*

The Global Fund to Fight AIDS, Tuberculosis, and Malaria (GF) was created in 2002 and functions as an independent, performance-linked financing body dedicated to combating the pandemics of AIDS, Tuberculosis, and Malaria worldwide. The GF seeks to channel grants to specific public health initiatives, developed through collaborations of all concerned stakeholders, to counter the impacts of these three diseases. The GF relies on voluntary contributions to fund its grants. Public sector entities constitute the bulk of contributions, with that supplied by governments dominating the contributor roster. The GF is founded on principles of transparency, with all project documentation, transcripts of proceedings, and budgetary figures posted to its website. In 2009 the GF allocated more than US\$2.8 billion.

##### *'DIAGONAL' METHOD PROMOTING BOTH CAPACITY-BUILDING AND PURSUIT OF SPECIFIC OBJECTIVES*

The GF approach to redressing public health concerns has been considered novel approach, not because of its 'diagonal' methodology. Traditional assistance models either gravitate toward the horizontal (systemic capacity-building) or vertical (targeting of specific problems). By contrast, the GF has adopted an amalgamated methodology that emphasizes specific objectives, yet requires that projects and programmes addressing them be rooted in systemic and infrastructure improvements.

The perceptible benefits to such an approach are multi-faceted, and address the shortcomings of traditional, separate methods. Horizontal approaches typically suffer from difficulties of progress assessment, whereas vertical methods generally stand wanting, due to capacity limitations.<sup>20</sup> The diagonal approach of the GF can measure results and progress toward predetermined goals, while stimulating capacity expansion in systems and institutions that generates co-benefits and builds self-support capabilities. The requirements for performance demonstration differentiates the GF from many other aid-providers, in that it requires both *ex ante* and continued proof of implementation for continued funding provision. The country-level development of objectives and indicators theoretically ensures that performance milestones will reflect situation-specific considerations and attributes, and make for more reasonable assessments.

It should be noted, however, that the diagonal approach requires a soft touch, and a dynamic application procedure that can make calibrations to balance horizontal and vertical objectives. Critics of the diagonal model of the GF have cited the inherent skew of results toward fulfilment of vertical objectives over horizontal capacity-building.<sup>21</sup> However, their claims appear somewhat misguided,

particularly given the differing timescales over which the separate impacts of vertical and horizontal initiatives are likely to emerge.

Vertical objectives, which are more identifiable and measurable, will almost certainly become visible in advance of broader systemic changes. Specific to the GF's aims, it has been posited that AIDS, tuberculosis, and malaria receive levels of aid which are disproportionate to those for other ailments, and thus in effect create imbalances in national health systems. While such may be the case temporarily, these skews have shown themselves to be transitory, as institutional knowledge, capacity, and resources exhibit spill-over effects to other areas of medicine and healthcare systems at the national level after only brief delays.

The advantage of this tack is that it creates measurable corrections to specific problems, and thereby attracts subsequent additional funding. In the case of the GF, such funding has expanded sizably since the Fund's inception, largely as a consequence of the visible performance of its initiatives. The added upside of the diagonal approach is that, through reinforcement of horizontal capacity-building, the observed results in specific vertical arenas become more durable and self-supporting over time.

#### *LEAN STRUCTURE DEVOLVES DECISION-MAKING WHILE ENHANCING REPRESENTATIVENESS*

The success of the GF's diagonal model seems to hold many translatable elements for the RFM. Robust adaptation to the ravages of climate change and environmental degradation necessarily involves capacity-enhancement measures for systems and institutions within affected nations. For the sake of accountability, however, contributing nations will be most cooperative and supportive if measurable action is taken. Therefore, the hybridized approach of diagonal programme design seems a sensible carryover from the GF to RFM structuring.

The GF governance model is renowned for both its 'lean' cost<sup>i</sup> and staffing structures<sup>ii</sup>, as well as its transparency.<sup>22</sup> Critical to the achievement of these distinctions is the GF's reliance on '**country ownership**' of projects, and its requirement of **performance-based funding provision**. The GF does not engage in project planning or implementation, but involves itself solely with project screening (through its Technical Review Panel – TRP) and fundraising and administrative activities (through its Secretariat). The TRP evaluates project proposals strictly on the basis of technical merit, and then offers its recommendations to the GF Board, which issues final approvals of disbursements.

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<sup>i</sup> Administrative costs, which are defined to include Secretariat expenses and fee payments to Local Fund Agents for oversight activities, total approximately 5 per cent of expenditures and have been completely offset throughout the Global Fund's history by income generated from investment undertakings (source: Global Fund website, accessed 22/2/2010).

<sup>ii</sup> See also *The Problem of Administrative Size* in the concluding section of this Chapter.

The GF Board is comprised of 20 voting members and six *ex officio* members without voting rights. Composition of the Board is prescribed by the Global Fund's bylaws with the aim of promoting a varied perspective. The Board includes a broad representation from donor and recipient governments, NGOs, and private sector interests.

The GF relies on an external system of devolved operating entities for project development and execution capacity. This is advantageous both in terms of efficiency and effectiveness. With respect to the former, all the administrative costs of fund operations are covered through returns on fund investments, and thus the level of administrative cost relative to capacity is 'sustainable'. With regards to effectiveness, the GF's insistence on a decentralized model for implementation of localized initiatives has been commended for being the most appropriate means of building automatic consideration for regional, cultural, and other context-specific factors into project design in combating disease.<sup>23i</sup> This is achieved by way of the integrated and representative decisional structure at the country level that the GF has fostered.

The *Country Coordinating Mechanisms* (CCMs) serve as the intersections between GF financing and implementation of proposals by national-level implementers. In line with its mission to build systemic capacity in the solutions which it finances, the GF has stipulated that the CCMs must include broad representation of stakeholder perspective. In realization of the fact that representation should be tailored to particular circumstances, the GF only has the stipulation that CCMs must be comprised of at ***least 40 per cent non-governmental representation***. While this seemingly extends considerable latitude to recipient nations to determine the composition of their respective CCMs, the GF Secretariat in practice has been quite demanding in its requirements for representativeness. Such forethought in relation to representation stands at the heart of the GF's lean operating model, however, as it effectively enriches communications among shareholders, and improves the likelihood of projects and programmes meeting their performance targets.

#### *UNCLEAR AND SHIFTING INFORMATIONAL DEMANDS ONEROUS FOR DEVELOPING NATIONS*

While projects and programmes introduced under the GF have generally achieved successful implementation, they have occasionally met with difficulty during the inception phases. Primarily, the GF might be hindered through not having clearly-defined informational requirements for project proposals. While it is recognized that evaluations should be dynamic, some applicant parties have expressed concerns that determination of the precise criteria upon which proposals are evaluated are not clearly divulged, despite the rather transparent approval processes. Such difficulties can derail

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<sup>i</sup> See: Berwick, D. (2002), 'A learning world for the Global Fund', *British Medical Journal*, 325, 55–6 Available at: [www.ncbi.nlm.nih.gov/pmc/articles/PMC1123621/?log%24=activity](http://www.ncbi.nlm.nih.gov/pmc/articles/PMC1123621/?log%24=activity)

proposals wholesale, and could probably be easily circumvented through more clearly delineated evaluation requirements. Perhaps the best approach for implementation of this might be a formulaic approach to assessment, with clear stipulation of relevant consideration factors for disbursements.

## **5. THE MONTREAL PROTOCOL MULTILATERAL FUND**

### *BACKGROUND*

The Multilateral Fund (MLF) was established under Article 10 of the Montreal Protocol with a legal personality in order to assist developing countries to meet their obligations under the Protocol to reduce the emission of Ozone Depleting Substances (ODS). The MLF began its operations in 1991. Funds are contributed to the MLF from ‘industrialized’ (non-Article 5) nations. These contributions are assessed according to the UN scale of assessment. The MLF has gone through seven replenishment cycles, and in 2009 allocated US\$ 150 million in funds.

### *PERFORMANCE-TIED, FLEXIBLE FUNDING WITH INDEPENDENT RESULTS VERIFICATION*

Funds to recipients are disbursed on an annual basis, and are contingent upon achievement of determined target levels of reduction. These reductions must be independently verified, and thus represent a performance-based determinant of disbursement allocation. Such facets are critical to creating the trust of contributors that funds will be appropriately deployed. Further, they create incentives for implementing nations to utilize monies appropriately and in a timely fashion. In addition, recipients may reallocate approved funds as deemed appropriate, lending an element of flexibility and expanded decisional capacity to the role of fund recipients. This reshuffling potential does allow for some expansion of choice capabilities amongst recipient nations.

### *IMPLEMENTATION THROUGH A LAYER OF MULTILATERAL IMPLEMENTING AGENCIES*

Much authority, however, remains effectively vested in the Implementing Agencies, which are mostly international multilateral organizations. While the Executive Board of the MLF approves national strategies and projects, it is the multilateral Implementing Agencies that are charged with the responsibility of disbursing funds at the national level, thus creating implementation authority for these Agencies. The necessity that projects and programmes be implemented by the UNDP, UNEP, UNIDO, World Bank, or a small number of bilateral agencies, promotes inefficiency and decision-making divorced from the environments in which initiatives are enacted. This delocalization of authority inherently fails to cultivate trust, and stands to misunderstand the specific facets of problems that are best addressed through devolved decisional mechanisms. Further, the choice of Implementation Agency is not clear-cut, as some overlap exists between many of the bodies. Battles for jurisdiction therefore both impede the implementation process and tend to bias programme design *ex ante* in order to justify housing of responsibility within a particular Implementing Agency. The

RFM should seek to avoid this unnecessarily frustrating and inefficient layer of bureaucracy, through devolution of authority to national agents, rather than international-level bodies.

#### *ASSESSED CONTRIBUTION SYSTEM FOR REPLENISHMENTS*

Despite the difficulties derived from the involvement of the Implementing Agencies, the MLF has enjoyed considerable cooperation from contributing nations in its funding efforts. The MLF operates with a replenishment mechanism by way of *assessed contributions* based on the UN scale. Replenishments are taken on a three-year cycle, and developed nations have maintained a comparatively high rate of payment, in excess of 95 per cent. The fact that the MLF replenishment process has enjoyed such a high rate of participation reflects the sound construction of its replenishment mechanism. A periodic replenishment cycle with a firmly prescribed basis for assessed contributions may therefore be recommended in the design of the RFM.

## **B. Conclusions**

The aim of this section is, in the first instance, to synthesize some of the key lessons from the case studies discussed in Chapter III for the design of the RFM. Having done so, the section then presents two short pieces published by the lead author in the run-up to Copenhagen concerning:

- (i) why the time is ripe for a devolution of funding decisions to the recipient countries, and
- (ii) the issue of what it means to be ‘under the authority of the COP’.

Both these issues are obviously of relevance to the topics discussed in this Chapter.

### **1. GENERAL LESSONS LEARNED**

The case studies of multilateral financial institutions carried out for the Müller and Chandani background paper have brought to light aspects to be replicated and pitfalls to be avoided in the design of the RFM. Indeed, the case studies revealed a number guidelines for design of the RFM:

- *ownership* of decision-making authority by recipient nations,
- concrete and *simple disbursement methodology*, where possible, based on performance,
- *equitable* use of funds reflecting the diagonal approach.

With respect to ownership, those facilities that failed to empower recipient nations with the appropriate decisional authority exhibited failings of confidence (on the parts of both contributors and recipients) and performance. In particular, proper and effective ownership can be observed to be facilitated through:

- broad and equitable representation of stakeholder perspectives,
- autonomy and devolution of decision-making,
- lean and non-bureaucratic administrative and operational structures.

Those institutions that facilitate inclusivity of, and communication between, all relevant stakeholders enjoy more solid support from both contributors and recipients. Further, such diversity of perspectives better acknowledged context-specific concerns which could not have been detected *ex ante* by less-encompassing participation. Devolution of decision-making, minimally encumbered by external institutional pressures, permits the formulation of programmes and projects that are better calibrated to local settings, and addresses concerns of those affected more effectively. Lean, non-bureaucratized structures further facilitate the devolution of decision-making and expedient disbursement of funds by housing more processes and choices with those who stand to benefit most from the proper design and implementation of strategies. This aligns objectives and benefits more neatly than would the top-down decisional structure of bureaucratic facilities.

Facilities that employ opaque, subjective, or poorly-justified disbursement methodologies seem to inspire the least confidence among stakeholders. Facilities with performance-linked disbursements seem to enjoy higher replenishment rates. This is why a concrete and simple disbursement methodology which is either formulaic or, if feasible, performance-based would probably be most appropriate for the RFM.

## 2. THE CASE FOR DEVOLUTION OF FUNDING DECISIONS<sup>i</sup>

### *THE ISSUES*

At the heart of any financial architecture debate is the question: ***who decides who gets how much and for what purpose?*** In the context of climate finance for developing countries, this can be interpreted at a macro- and a micro-level. The macro decision is about how much each country gets, and for what specialized theme.<sup>ii</sup> The micro decision is about approving the specific activities to be funded. As it is useful to distinguish the two, this Comment uses the term ‘*financing*’ for the macro-level decisions and ‘*funding*’ for micro-level ones.<sup>iii</sup> Whereas *financing* in the climate change context is mainly an issue of distributive justice between countries<sup>iv</sup> and of thematic balance,<sup>v</sup> *funding* is more about

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<sup>i</sup> This section is based on an *Oxford Energy and Environment Comment* under the title: ‘The Time is Right! Devolution of funding decisions to designated national/regional climate change funding entities’, originally published by the lead author in November 2009.

<sup>ii</sup> Climate change ‘themes’, such as mitigation, adaptation, technology transfer, and capacity building.

<sup>iii</sup> In other words, ‘funding decisions’ are meant to be the sort of decisions typically involved in approving and managing activities (projects/programmes).

<sup>iv</sup> In other words, ‘funding decisions’ are meant to be the sort of decisions typically involved in approving and managing activities (projects/programmes).

<sup>v</sup> Ensuring that there is not an inordinate imbalance in financing between the themes.

appropriateness, effectiveness, accountability, and efficiency.

This Comment discusses the need to *devolve funding decisions to national* (or, if more appropriate, regional) *designated funding entities*. It is about the rationale for devolving funding decisions to the recipients, as well as the need for joined-up decision-making at the recipient end.

The most straightforward argument in favour of devolving funding decisions to the recipient countries is based on the fact that the amount of (public sector) money required is in the upper tens of billions of €/\$, and that the final processing – i.e. the evaluation and approval of projects/programmes etc. – of this amount of funding will require *many thousands of people*. It would be immensely inefficient to build or bolster the necessary infrastructure for taking these decisions at the international level, irrespective of whether the decisions are taken by one central (new) entity or a handful of existing ones. Indeed, given the prevailing pay scales, the tax payers in contributing countries might also reject the idea of hiring yet more civil servants at home if the job can be done much more cost-effectively in the recipient countries. In short, there is a *transaction cost argument* against retaining funding decisions either at the bilateral or multilateral payer end which, given the total size of the transactions becomes compelling. However, it is by no means the only argument for the devolution of funding decisions.

#### *AUTONOMOUS DEVELOPMENT FUNDS*

The idea of devolving decision-making related to international funding down to national hubs is by no means new. Over a decade ago, a similar idea was put forward by two civil society organizations in the context of ODA. It is illuminating to review the benefits which were put forward by these organizations.

The Swedish Dag Hammarskjöld Foundation and the African Association for Public Administration and Management proposed the idea of African *Autonomous Development Funds* (ADF) in 1995. The model envisaged a public but politically independent institution, catering for both government and civil society. ADFs were meant to be *funding, not implementing, entities* with a national scope, aggregating finance from a variety of sources. The ADFs were proposed in response to the following concerns and conclusions:

- The delivery mode and a relationship of trust are *a critical variable[s] in determining the effectiveness of foreign aid*.
- Donors need to give up the idea *that the more control they have over the preparation of a given project the more likely it is that the project will yield positive results*. What is needed is *a modification of this process so that donor coordination takes place in response to the demands of recipient institutions*.
- [D]evelopment funding must be available *not only at the central level of government but also at lower levels*. *The central control of decision-making, information flow and resource allocation*

*can be broken if local institutions, including local government, are able to enhance their financial autonomy vis-à-vis central government.*

Established as national institutions with a specific sectoral mandate, the ADFs were meant to dispense money within the context of national policy to organizations applying for their resources on a competitive basis. They were to be run by boards of trustees, including representatives of government, donors, and civil society. To secure their operational autonomy, the ADFs were to have their own capital base, raised from external donor sources as well as domestically through donations and fund-raising activities. The overall aim of the ADFs was *to encourage greater innovativeness and effectiveness in the use of development resources*, by complementing existing transfer mechanisms (such as *direct resource transfer to governments or non-governmental organizations*).

The idea of ADFs failed to generate the necessary support and interest, with the last major workshop on the topic held in Tanzania in February 1997.<sup>i</sup>

#### *THE PROBLEM OF ADMINISTRATIVE SIZE*

It is not surprising that there should be a correlation between annual ‘throughput’ –the amount of money collected and allocated per annum – and the number of people providing secretariat services: higher through-put requires more people for processing. What is surprising is that judging from the situation at two of the institutions examined in the course of the case studies discussed earlier, the relationship would appear to be almost linear, over a considerable variation of throughput.

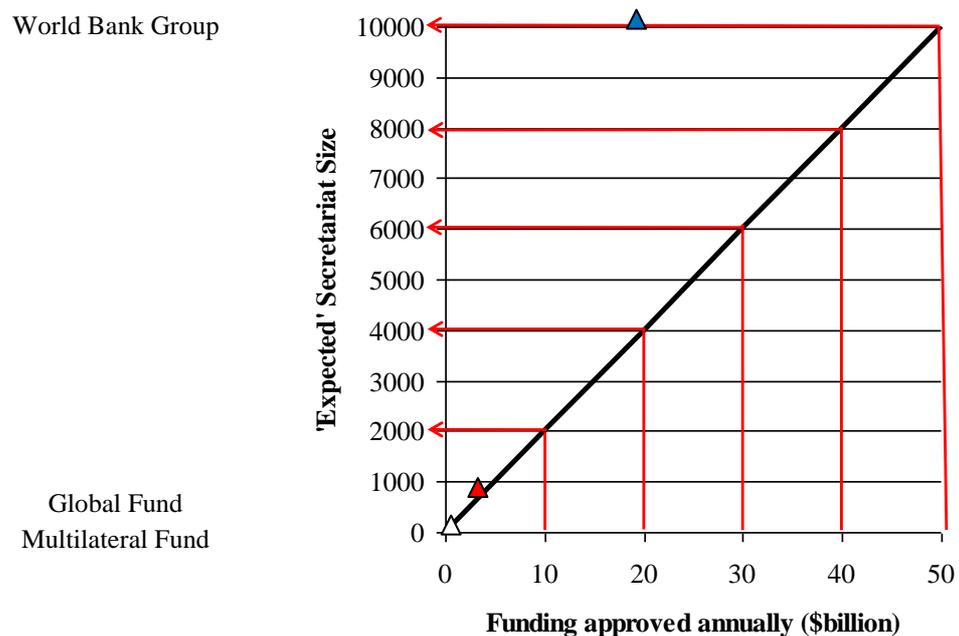
The Montreal Protocol *Multilateral Fund*, with its relatively modest average annual throughput of \$150m, on the one hand, employs 28 people in its Secretariat, which leads to a figure of **0.19** people per \$million annual throughput. The *Global Fund*, with its order of magnitude larger annual throughput of \$2,754.9 m, on the other hand employs 568 people in its Secretariat, leading to an average of **0.21** people/\$m. Naturally, it would take many more data points to establish a proper correlation, but it is remarkable that the figure of how many administrative positions it takes to service a given amount of throughput is as constant. And for the sake of argument, it is not implausible just to assume a linear relationship, particularly since the two cases suggest that this would lead to a conservative estimate of required administrative personnel for larger throughput figures.<sup>ii</sup>

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<sup>i</sup> A ‘Donor Seminar’ which was to follow that meeting never materialized because the participating four African country teams ‘encountered considerable problems’ in formulating their proposals.

<sup>ii</sup> The World Bank Group, for example, has a throughput of around \$20 bn (IBRD \$10.5bn, IDA \$9.2bn in 2008, Operational Summary, WB Annual Report 2008) and roughly 10k personnel (<http://go.worldbank.org/B6U4HPNDS0>), leading to a personnel throughput intensity of roughly 0.5 people per \$million.

Using an average figure of 0.2 administrative position needed for processing \$1 million of projects and programmes *per annum*, it becomes clear that if one is indeed thinking of tens of \$ billions to be processed, one will need *thousands of new administrative* positions. And there is no doubt that there really little appetite to create these positions at the international level, be it at the World Bank or under the UNFCCC. And given that the public in developed countries is unlikely to be enthusiastic of having these positions set up under their national administrations, *devolution of funding decision and project administration to the recipient countries becomes the only practicable solution*, particularly given the savings in personnel costs that this option offers over the other two.



**Figure 4. Estimated Administration Sizes**

#### *THE EMERGENCE OF NATIONAL CLIMATE CHANGE TRUST FUNDS*

Over the past decade, times have clearly changed. While the idea of national funding entities was initially proposed by some enlightened Civil Society Organization (CSOs), they are now emerging as government-backed realities on the ground, in the context of climate change funding and finance. Bangladesh and Indonesia, for example, have put forward plans for establishing such national trust funds.

In September 2008, the Government of Bangladesh (GOB) launched its *Climate Change Strategy and Action Plan (CCSAP)*. To scale up financing to meet the needs of this Strategy, GOB is now establishing a national *Multi-Donor Trust Fund for Climate Change (MDTF)*. The MDTF is designed to be a ‘one-stop’ mechanism for large scale climate change funding in Bangladesh. The benefits of having such a mechanism are seen to be *high-level coordination, elimination of overlaps, donor harmonization, flexibility in fund management, transparency, and the possibility of attracting additional funds from both local and external sources.*

The MDTF is to have two windows: an *on-budget window* for funding public sector projects ('budget support'); and, an *off-budget window* for funding projects from civil society. All projects funded through the MDTF will be rigorously reviewed, to ensure consistency with the priorities laid out in the CCSAP. (For more on the institutional arrangements of the MDTF, see Müller and Echeverri 2009,<sup>24</sup> Section 7.2)

The Government of Indonesia (GOI) is currently developing a 20 year *Climate Change Sectoral Roadmap* (CCSR), and is in the process of establishing a dedicated funding vehicle known as *Indonesia Climate Change Trust Fund* (ICCTF) to address the emerging and immediate needs of CCSR programme investments. The ICCTF is designed to link the international architecture for climate change with national investment strategies, with the aim of becoming a showcase of innovative climate change financing owned by government, in an efficient, transparent, and accountable manner.

The reason for choosing the national trust fund model for these purposes was that it is viewed as the *most suitable instrument to reduce transaction costs* by reducing the number of free-standing projects and programmes, and by harmonizing the financing into 'basket funds'. Owned and managed by the government, the creation of this fund is fully consistent with government efforts to strengthen the effectiveness of *national ownership over development* as outlined under the Jakarta Commitment of 2008.

The design of the ICCTF is guided by a number of principles. The ICCTF is to *mainstream* not only *sustainable development*, but *good governance*, as well as *civil society participation* and *local community empowerment*. It is to ensure that all eligible Indonesian institutions have *access in a balanced and equitable manner*. The funding of activities is to be *country-driven*, taking particular account of *national development plans*. The governance is to be *transparent* and *open*, with independent monitoring, evaluation, and financial audits (including the use of *international fiduciary standards*).

The ICCTF is likely to cover two funding mechanisms. The first is an *Innovation Fund*, to be replenished through bi- and multilateral non-refundable contributions. It is to be used for activities with indirect economic and social benefits that will not provide any direct financial return to the participants.

In a second stage, a *Transformation Fund* may be introduced where funding sources – such as domestic funds, loans, all the international funds under the UNFCCC, and the world capital market – would generate direct financial revenues and support stakeholders – including both the government and private sectors – in mobilizing investment in a low-carbon economic development path.

## CONCLUSIONS AND WAY FORWARD

The idea has been around for some time that if funding is *to be mainstreamed effectively* into recipient country policy, then it must be handled through dedicated national funding entities. However, it is only now – in the context of climate change – that it is being implemented (on developing country initiative). Recipient countries are realizing that they will not be able to provide the financial support for domestic climate change activities in an *adequate, efficient, and effective* manner without such national funding entities. As far as they are concerned, the time is clearly right for the idea of consolidated national funding, quite independently of the degree of consolidation of the international climate finance regime.<sup>i</sup> What is needed now, is the support of the international community and, in particular, of the financial regime of the UNFCCC, as envisaged in the language submitted to the AWG-LCA by India.<sup>25</sup>

It must be stressed that countries should not be coerced into establishing national trust funds, and that consequently the international regime should be able to accommodate those who are unable or unwilling to do so.<sup>26</sup> However, what must be done is to *encourage countries to establish such designated national* (or, where more appropriate, regional<sup>ii</sup>) *climate change funding bodies*, by assuring that they will be adequately provided for under the international finance regime. It must also acknowledge that these bodies will have the authority *not only to make plans, but to spend the funds* thus provided.

As concerns institutional and governance arrangements, the RFM model, for example, envisages that the Executive Board of the (Reformed) Financial Mechanism of the Convention would develop:

- (i) *criteria for disbursing funds* to the national/regional funding bodies for each of the thematic windows,
- (ii) *accreditation criteria* for designated funding bodies,
- (iii) *international fiduciary standards* (as envisaged in the Indonesia Climate Change Trust Fund).

To address the latter two, one could simply adopt the criteria and standards adopted by the Adaptation Fund Board. Indeed, by introducing *National Implementing Entities*, the Adaptation Fund Board may well have paved the way for the idea of designated funding entities even *at the international level*. In other words, the time may actually be doubly right! It is now up to the international community, in the shape of the UNFCCC COP, to seize the day by following the Indian lead and create an *overall architecture* for climate change funding and finance which is *fit for purpose*.

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<sup>i</sup> The time is right whether or not the future international regime becomes more consolidated or remains in its current fragmented state. The main rationale for introducing these national funding hubs is their domestic effectiveness, particularly in mainstreaming climate change into national policies.

<sup>ii</sup> The fact is that for some very small countries, it might make more sense to have a ‘regional’ designated funding entity, rather than a national one for each.

### 3. 'UNDER THE AUTHORITY OF THE COP'?<sup>i</sup>

In the current negotiations on the future institutional arrangements for international public climate change finance, there is a concept which divides developed and developing countries: the concept of 'authority', or more precisely, of being '*under the authority of the COP*' (Conference of Parties of the UNFCCC).

This division is by no means new. It dates back at least to the negotiations of the Kyoto Protocol's Adaptation Fund (AF), where developing countries insisted that the AF Board (AFB) should not only be *under the guidance of* and *accountable to* the relevant UN body (viz. the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol, or CMP, the governing body of the Kyoto Protocol), but *also under its authority*. This was in reaction to dissatisfaction, among developing countries, with the performance of the Global Environment Facility (GEF) as an operating entity of the UNFCCC financial mechanism, particularly with respect to a widespread frustration with regard to non-observance of COP guidance.<sup>27</sup>

The issue has resurfaced in the context of how a proposed Executive Board or Body (EB) for the UNFCCC financial mechanism should relate to the COP. The majority of developed countries that have a position on this issue insist that the *relation of the EB to the COP* should be modelled on the GEF/COP relation (guidance + accountable), while the G77+China insists that the AFB/CMP model should be followed (guidance + accountable + *authority*). Indeed, the issue of COP authority over an EB (indeed over any climate change finance body) seems to have become a 'red line' issue for both sides, a situation which at first sight might not look too promising for the finance negotiations. However, the division might be easier to bridge than many of the other differences that threaten success at the Copenhagen COP later this year.

#### *THE CONCEPT OF 'BEING UNDER THE AUTHORITY'*

What exactly does 'being under the authority (of the COP)' mean? In the UNFCCC context, the phrase lacks an explicit definition, leading to widely divergent views of what it means and, more importantly, what *others take it to mean*. Unfortunately, as is more often than not the case in these negotiations, this simply reflects the considerable distrust and inability to communicate between the different actors. However, it also leaves open the possibility that there might be a commonly acceptable interpretation of the phrase.

While there is no explicit definition, the phrase has been used to characterize the relationship of the AFB to the CMP. Indeed, it can be seen as referring to all the elements of that relationship, over

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<sup>i</sup> This section was originally published by the lead author as an *Oxford Energy and Environment Comment* under the same title in October 2009.

and above that between the GEF and the COP.<sup>i</sup> In that sense, Decision CMP.3/1 on the Adaptation Fund can be seen as providing an *implicit definition* of the term, which is why a closer look at that decision is warranted.

#### *THE BALI ADAPTATION FUND DECISION CMP.3/1*

The first of the Bali CMP decisions starts by designating the Adaptation Fund Board (AFB) as an *operating entity* to *supervise and manage* the Adaptation Fund, and stipulating that it shall be *under the authority and guidance of*, and *fully accountable to* the CMP. It then turns to define 12 permanent functions of the AFB. Of these, three involve the COP, while the rest are functions within the exclusive remit of the AFB. All but one of the latter – viz. responsibility for monetizing CERs – are functions that are also carried out by the GEF; key among these:

- *To decide on projects, including the allocation of funds, in line with the AF principles, criteria, modalities, policies and programmes, ...*
- *To develop and decide on specific operational policies and guidelines, including programming guidance and administrative and financial management guidelines, ..., and to report to the CMP;*
- *To develop criteria based on principles and modalities ... to ensure that the implementing and executing entities have the capacity to implement the administrative and financial management guidelines of the AF, and report on it to the CMP;*
- *To regularly review performance reports on implementation and ensure independent evaluation and auditing of activities supported by the AF;*

The three functions which, by contrast, do require CMP assent are:

- *To develop strategic priorities, policies and guidelines, and recommend their adoption to the CMP;*
- *To develop and agree on additional rules of procedure to those included in this decision and recommend these for adoption by the CMP;*
- *To develop and approve draft legal and administrative arrangements for secretariat services and the trustee for approval by the CMP;*

Importantly, these are ‘one-off’ functions with only a single interaction with the CMP. Thereafter, the CMP has no direct involvement in the functions of the AFB. This means that – apart from a number of start-up approvals of basic rules and criteria – the meaning of ‘being under the authority’ implied by the AFB Decision is *nothing more than the right to select the members of the*

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<sup>i</sup> COP to GEF = guidance + accountable; CMP to AFB = guidance + accountable + *authority*.

*subordinate body* in question. The fear of COP micromanagement if the financial mechanism were to be ‘under the authority’ of the COP is therefore not well-founded, and the perceived threat can be completely dissipated by an *explicit separation of the functions* of the COP and of the envisaged Executive Board of the financial mechanism, which not only explicitly stipulates what the two entities can do, but also what, respectively, they *cannot do*.

Before turning to some of the reservations that have been raised to the idea that the COP would have the authority to ‘hire and fire’ the members of the Executive Board, it is useful to have a look at the experience of the AFB which is under the authority of its governing body.

#### *ADAPTATION FUND PROGRESS<sup>i</sup>*

While the first two meetings of the AFB were still bedevilled by ‘political’ problems – to do not only with the usual North-South issues, but also with the relation of the AFB and its secretariat service provider (GEF) – the atmosphere in the meetings soon started to improve considerably, not least because everyone realized that there was a considerable job to be done to get the AF off the ground.

During its seventh meeting (AFB 7 in Bonn from 14 to 16 September 2009), the AFB made critical progress towards full operationalization, particularly with respect to the idea of ‘direct access’ to funding, without the need for multilateral implementing entities to serve as intermediaries.

The *Provisional Operational Policies and Guidelines for Parties to Access Resources from the Adaptation Fund* is the main document that lays out how funds are to be accessed under the AF. While most of the document was already agreed in previous meetings, AFB 7 still had to discuss some key outstanding issues.

One of the core elements in the direct access model developed by the Adaptation Fund Board is *National Implementing Entities* (NIEs). Traditionally, international funding has been channelled through bilateral aid agencies or international *implementing agencies* such as the World Bank, UNDP, etc. Under the AF, however, countries can access the funds directly by nominating an NIE, which will receive the AF resources to be used for in-country activities. NIEs will generally not be the executors of activities (projects/programmes) on the ground, but will have financial and fiduciary oversight functions over activities carried out with AF resources, functions which have traditionally been performed by the multilateral implementing agencies.

The challenge in developing these standards has been to balance the need for standards which

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<sup>i</sup> This section is largely based on Sven Harmeling and Alpha Kaloga, ‘Adaptation Fund: Critical progress at the 7th Meeting’, *Germanwatch*, September 2009. Reports of further progress, such as the accreditation of the first NIEs can be found at the same source.

ensure sound fiduciary management, with the need to avoid setting up barriers which impede direct access for many vulnerable developing countries. AFB 7 fine-tuned the standards that had been broadly agreed in previous meeting, made consistency checks, and ***approved the document by consensus***.

While the direct access model of the AF still retains the actual funding decision centrally at the AFB level, the NIEs could clearly very easily become the ***National Funding Entities*** envisaged in the RFM model and the Indian proposal.<sup>28</sup> Indeed, as concerns the eligibility criteria for participation in AF direct access, including the fulfilment of international fiduciary standards, the AF has managed to provide an important precedent for the RFM model.

#### *THE KEY TO (THE AFB) SUCCESS*

The fact that the strategic priorities, policies, and guidelines, the rules of procedure, and the draft legal and administrative arrangements for secretariat services and the trustee sailed through the CMP in Poznan<sup>i</sup> – and more importantly, that the developing country Parties in the CMP have taken genuine ownership of the AF – is due to one key factor, namely that they trust their own representatives on the AFB, and that they know ***their interests were properly represented*** in the drafting of these documents.

One of the most frequent objections to the selection of members of an EB by the COP is that it would not select the ‘right’ people for dealing with the sort of issues an EB of the financial mechanism would have to deal with. That, of course, all depends what type of functions one envisages an EB to perform.

Obviously, if these functions ***require detailed technical expertise*** of some form or other – such as would be needed in the assessment of project/programme proposals – then the objection might be pertinent. However, given the projections of the magnitude of funding needs (upper tens of billions), it is clear that funding decisions could not be retained at the international level, but would have to be devolved to the country level (as envisaged in the Indian proposal and the RFM). To put it more provocatively: the current practice of making decisions on what gets funded through multilateral funds is an option only if no significant increase in the level of funding is envisaged.

In the case of the proposed Reformed Financial Mechanism, the two key functions of an EB would be:

- to ***supervise, on behalf of the COP, the drafting of key rules/criteria*** (such as were needed for disbursement of funding to the designated funding entities), and

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<sup>i</sup> The only real debate erupted over the relationship of the AFB with the GEF as service provider, and the World Bank as Trustee. The former was resolved by putting the secretariat unit (provided by the GEF Sec) under the guidance and ***instruction*** of the AFB.

- to *oversee, on behalf of the COP, the operating entity/ies* of the financial mechanism once these are operational.<sup>i</sup>

In other words, the key functions of the RFM EB would not be technical. They are *political functions delegated by the COP*. For this essential delegation to work, it is key that Parties and Party groupings in the COP are convinced that *their interests are properly represented* in this supervisory and oversight body.

The very different experiences with existing operating entities (GEF, AFB) strongly suggest that this requires an EB to be ‘under the authority of the COP’ in the AF sense of the term. Unless this is the case, the system is unlikely to inspire the required level of trust among developing country Parties, even if the members of these independently existing bodies represent the same countries/groupings.<sup>ii</sup> It is also unlikely to work if members are selected by the COP, but are not delegated the powers/functions mentioned above. It is highly doubtful whether existing entities with their own rules and procedures would be willing/able to submit to such a regime.<sup>iii</sup> The key to resolving the COP authority controversy is to agree on the key functions of the envisaged EB and to genuinely ascertain whether one would trust the AF model in this context.

#### CONCLUSIONS

It can be argued that for the climate change negotiations, the concept of ‘being under the authority’ is (implicitly) defined in the Bali Adaptation Fund Decision (CMP.3/1) where the Adaptation Fund Board (AFB) is stipulated to be not only accountable to and under the guidance of the CMP (the governing body of the Kyoto Protocol) but also under its authority. By contrasting this relation to that between the COP and the GEF (accountability + guidance only), it is possible to infer two key features of what ‘under the authority’ is implied to mean in terms of an Executive Board (EB) of the financial mechanism, namely that the COP has:

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- <sup>i</sup> Note that one of the key insights behind the RFM model is that the COP is simply not the sort of body that can carry out effective oversight, and that consequently this function has to be delegated to a trusted oversight body, i.e. the EB.
  - <sup>ii</sup> The point here is that UNFCCC delegates are not necessarily selected by the same domestic agencies as those that are sent to the other existing bodies, and that consequently they might have different points of view: finance and economics ministry officials do not always see eye to eye with their colleagues from environment or development agencies. If one is therefore of the opinion that an EB should be populated by finance ministry officials, then one should put them forward for selection by the relevant COP constituencies, as opposed to foisting them on the COP as externally selected representatives. Note that in the case of single Party constituencies – which are likely to include all the major Parties – it would be the respective governments who select their EB member, and they are completely free to decide which agency they are from.
  - <sup>iii</sup> For example, even if the World Bank CIF Committees were to be selected by the COP, it is highly unlikely that the WB would be able/willing to accept operational procedures other than their own.

- (i) the authority *to select* ('hire and fire') *the members* of the EB, and
- (ii) the authority *to approve general rules and guidelines* proposed by the EB.

Such an arrangement has the potential to generate trust among the Parties, that their interests are adequately represented in the EB, which in turn is why they would be willing to delegate all operational functions to the subordinate body. Without this trust, it is furthermore unlikely that they would delegate powers to the EB to oversee the operating entities of the financial mechanism, which is the only way to overcome problems such as those that have persistently bedevilled the relationship between the GEF and the COP.

Contrary to the fears expressed by some Parties, there is actually no chance of COP 'micromanaging' the operations of the financial mechanism under this interpretation of being 'under COP authority', particularly if the separation of functions/powers between the COP and the EB is made explicit by stipulating what each of the two entities can and cannot do. As witnessed by the latest achievements of the AFB, this sort of governance can be very effective. The fact that the AFB has managed to create a set of international fiduciary standards and accreditation criteria for the envisaged national designated implementing entities speaks for itself: prior to the establishment of the AFB, this sort of North-South consensus would have been unthinkable.

## IV. Independent Oversight<sup>i</sup>

As larger amounts of resources become available to developing countries, many will voice concern that these countries might not have the capacity, institutions, and most importantly, independent oversight institutions to ensure that the resources will be used effectively and for the intended purposes. If this is the case, what is required to satisfy these concerns? In order to try to answer these questions, the focus of this report is on independent oversight, both internal and external.

Oversight – internal and external – is a generic term used to refer to activities designed to introduce checks and balances, accountability, and transparency. There are several categories of activities which fall under this generic term, among which are: internal audit, financial audit, compliance auditing, performance auditing, and monitoring and evaluation. For businesses, organizations, and governments, independent oversight generally involves a combination of some of these activities, rather than just taking the form of one of the discrete activities mentioned. Many also add one additional function to strengthen accountability – the function of recourse and outreach. A brief survey of existing institutions and their practices is given below.

The area of oversight is rich in instruments, methodologies, and approaches. In each of the areas described, there are strong global professional associations and networks to improve quality, develop standards, and provide support to peers. There is no shortage of knowledge: most important, it is knowledge that is easily accessible to all.

### A. Global Networks, Standards, and Best Practices

#### 1. GLOBAL PROFESSIONAL ASSOCIATIONS AND KNOWLEDGE NETWORKS

*AUDIT.* Since World War II, particularly in the USA and Europe, the audit and public accountant professions have established numerous, strong, professional associations. These have been created not only to share knowledge, but also to lift the level of confidence in the profession and its search for greater transparency and accountability. There are many such organizations, and equally as many areas of specialization. A large number have international branches to support local audit professionals and private groups throughout the developing world. Two which are relevant, and influential for any disbursement of resources to be channelled through the UN system, are the International Organization of Supreme Audit Institutions (INTOSAI) and the United Nations Board of Auditors. INTOSAI has been providing not only professional support, but also promoting

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<sup>i</sup> This Chapter is based on Luis Gomez-Echeverri, *The Reformed Financial Mechanism of the UNFCCC: Promoting Transparency & Accountability*, OIES EV 51, March 2010. Available at [www.oxfordenergy.org/pdfs/EV51.pdf](http://www.oxfordenergy.org/pdfs/EV51.pdf)

transparency, accountability, and quality of audits around the world. The United Nations Board of Auditors was established to audit the accounts of United Nations organization, funds, and programmes.

*MONITORING AND EVALUATION.* These two activities are complementary to each other. Most organizations and entities follow their own protocols for monitoring their own activities, and for systematizing the information collected. In the area of evaluation, however, similar to the case of the auditing profession, there has been a growing trend to organize and provide guidance to those practicing evaluations and to ‘professionalize’ the evaluation function. Because of their large body of work throughout the world, international and Official Development Assistance (ODA) agencies and their evaluation practices have been particularly influential in developing countries, and in the practices adopted by other global funds and programmes. These agencies include:

- the United Nations Evaluation Group (UNEG), a professional network that aims to bring together all the units responsible for evaluation in the UN system, including the specialized agencies, funds, programmes, and affiliated organizations;
- the Global Environment Facility (GEF), which promotes standards and minimum requirements for monitoring and evaluation of GEF-funded activities, covering project design, application of monitoring and evaluation at the project level, and project evaluation;
- the World Bank, which has a Independent Evaluation Group whose mission is to consider whether the loans have a lasting contribution to the overall development of the country where the loan is being granted and whether the activities are in line with the objectives established and to provide an objective basis for assessing the results of the Bank’s work and to provide accountability;
- ODA agencies with their evaluation practices throughout the developing world.

## **2. GLOBAL STANDARDS**

*INTERNATIONAL STANDARDS ON AUDITING (ISA).* These are standards issued by the International Federation of Accountants (IFAC) through the International Auditing and Assurance Standards Board (IAASB), a standard-setting body operating independently under the auspices of IFAC. These standards are being used by over 100 countries, not only by governments but also by businesses and NGOs. The UN Board of Auditors follows the International Standards of Auditing in carrying out its functions throughout the UN system.

*STANDARDS FOR EVALUATION OF THE UN SYSTEM.* In 2004, in response to a resolution of the General Assembly, an initiative was taken to prepare some common standards on evaluation for the United Nations system. These standards built upon the best practices of the UN system; many policies and guidelines existing within the various UN organizations; the national standards of OECD countries;

evaluation policies of international financial institutions; evaluation policies of the European Union; and standards of evaluation associations.

*INTERNATIONAL FIDUCIARY STANDARDS ADOPTED BY THE ADAPTATION FUND BOARD.* Sound financial management, including the use of international fiduciary standards, is among the principles established for the Adaptation Fund.<sup>29</sup> Thus, in relation to accessing funds, both the NIEs and the MIEs have to meet fiduciary standards governing the use, disbursement, and reporting on funds issued by the Adaptation Fund covering the following broad areas:

1. *Financial Integrity and Management:*

- Accurately and regularly record transactions and balances in a manner that adheres to broadly accepted good practices, and are audited periodically by an independent firm or organization;
- Manage and disburse funds to recipients on a timely basis efficiently, and with safeguards;
- Produce forward-looking financial plans and budgets;
- Have the legal status to contract with the Adaptation Fund and third parties

2. *Institutional Capacity, given by:*

- Procurement procedures which provide for transparent practices, including in competition;
- Capacity to undertake monitoring and evaluation;
- Ability to identify, develop and appraise project;
- Competency to manage or oversee the execution of the project/programme including ability to manage sub-recipients and to support project/programme delivery and implementation.

3. *Transparency and Self-investigative Powers:* The competence to deal with financial mismanagement and other forms of malpractice.<sup>i</sup>

## B. Selected Case Studies of Present Practices

There are many examples of good practice in institutional innovation, oversight, accountability, and transparency. Much of this current best practice can be emulated or adapted by new national funds and institutions according to their national needs and requirements. A few examples are briefly presented here. These are good examples to examine and to identify features that are relevant and useful for the national circumstances of each country. It is by no means meant to be a comprehensive list but a sampling of diverse practices.

This section draws some insights and conclusions of a much longer background study.<sup>ii</sup> To avoid misunderstandings, please read the ‘Case Study Disclaimer’ in Chapter 1.

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<sup>i</sup> Operational Policies and Guidelines for Parties to Access Resources from the Adaptation Fund

<sup>ii</sup> Luis Gomez-Echeverri, *The Reformed Financial Mechanism of the UNFCCC: Promoting Transparency & Accountability*, OIES EV 51, March 2010.

## **1. UNDP MULTI-DONOR TRUST FUND**

### **– THE SIMPLICITY OF PASS-THROUGH FUNDS MODALITY IN ACTION**

The UNDP acts as Administrative Agent for multi-donor trust funds which use a pass-through fund management model. Under this arrangement, participating UN organizations appoint an Administrative Agent, in this case UNDP, through a Memorandum of Understanding (MOU). The UNDP, as Administrative Agent, receives, administers, and transfers donor funds to the participating UN Organization in accordance with the MOU. What is unique about this arrangement is a) that each fund has its own governance arrangement to suit the circumstances and needs of donors and recipients, and b) that the UNDP has developed an online system by which each of the donors and recipients can check the status of the funds, the expenditures, and the pledges online. It is a unique system in the UN in terms of transparency.

## **2. UN NATIONALLY EXECUTED PROJECTS AND CASH TRANSFERS**

### **– BUILDING ON AND TRUSTING THE NATIONAL SYSTEMS OF AUDITING AND OVERSIGHT**

For the last 20 years, UNDP has been using the modality of nationally executed/implemented programmes and projects. Over this time it has also developed and strengthened its methods for oversight, and for ensuring transparency and accountability. Under the nationally executed/implemented modality, projects of the UNDP are carried out either by the government or other national entities, which are given responsibility, with the condition that they will be subject to auditing by independent entities. .

## **3. CLIMATE INVESTMENT FUNDS OF THE WORLD BANK**

### **– AN EXPERIMENT IN TRANSPARENCY BY A LARGE MULTILATERAL INSTITUTION**

The recently created Climate Investment Funds (CIFs) consist of a Clean Technology Fund and a Strategic Climate Fund. The goal of the CIFs is to scale up the level of financing, and channel it through the multilateral development banks and the World Bank. In response to criticisms of lack of transparency and balanced governance structures, the World Bank has set up a dedicated governance structure that aims to provide not only transparency and accountability, but also more participation by stakeholders, both at the international as well as the national level.

## **4. GLOBAL FUND TO FIGHT AIDS, TUBERCULOSIS, AND MALARIA**

### **– A UNIQUE PUBLIC/PRIVATE PARTNERSHIP THAT PROMOTES INNOVATION IN ACCOUNTABILITY WITH CIVIL SOCIETY INVOLVEMENT**

The Global Fund was created in 2002 to significantly increase the resources to fight three of the most devastating diseases in the developing world. To date, it has committed some 19 billion US dollars to some 600 projects in 144 countries. It is unique in that it is truly a partnership between governments, business, and civil society. Its mode of operation involves partnering with bilateral and multilateral agencies for the implementation and monitoring of programmes and projects through a core structure that is designed to do a lot of its work through participants at the country level.

## **5. MEDICINES TRANSPARENCY ALLIANCE (META)**

### **– PROMOTING GOOD DECISION-MAKING AND EFFICIENCY THROUGH DISCLOSURE OF INFORMATION**

META is a multi-stakeholder alliance working at both national and international levels to improve access to medicines and to increase the affordability of medicines for that large portion of the population in the world unable to benefit due to high costs or unavailability. The central idea of META is that information improves decision-making all along the supply chain. The simple principles of openness and disclosure of information promotes good decision-making and efficiency.

## **6. THE INDONESIA CLIMATE CHANGE TRUST FUND (ICCTF)**

The main objective of the ICCTF is to mainstream and align climate change within the national development agenda. As such, the ICCTF acts as a financial mechanism for the Indonesian policy framework. The governance consists of a Steering Committee with donors and government representatives with the right to vote; an Advisory Committee consisting of government, donors, NGO and CSO representatives, responsible for overall strategic policy recommendations; a Technical Committee which advises on technical matters; and a Secretariat.

## **7. AMAZON FUND**

### **– PROMOTING INNOVATION AND ACCOUNTABILITY THROUGH HYBRID INSTITUTIONAL APPROACHES<sup>i</sup>:**

The creation of new institutions, one of the options for developing countries, is not always the best option, as shown by the Amazon Fund. The Fund is one of a new generation of hybrid institutions that was able to be put into place in a remarkably short period of time by assigning responsibilities to existing institutions under strict criteria. From first conception to launch took only about two years, supported by a strong political will and a Plan of Action for the Prevention and Control of Deforestation in the Amazon. For the first time ever for Brazil, it had a commitment to incorporate targets for rates of deforestation. This was an essential element for the success of the Fund, because with that in place, international funding would be more easily forthcoming – as proved to be the case.

## **8. BRAZIL'S NATIONAL FUND ON CLIMATE CHANGE**

### **– USING EXISTING STRONG NATIONAL INSTITUTIONS RATHER THAN CREATING NEW ONES**

The Government of Brazil created its National Fund on Climate Change on 9 December 2009 under the responsibility of the Ministry of the Environment for the 'provision of funds to support projects or studies and financing for enterprises that aim at climate change mitigation and adaptation to climate change and its effects'<sup>30</sup>. The Fund is administered by a Managing Committee reporting to the Ministry of the Environment. The Committee's duties and responsibilities are established by law, as is

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<sup>i</sup> This sections draws heavily on 'Lessons from the Amazon Fund', Climate Policy Briefing Series, Briefing 2, 2009, Accountability by Simon Zadek, Maya Forstater, Fernanda Polacow, and Joao Boffino.

its composition – six representatives of the Executive power and six members of the NGO community.

Brazil chose not to create a new institution, but rather to assign the responsibility of Trustee of the Fund of Operating Agent to one of the strongest and largest banking institutions in the country and in the Latin American region, the National Social and Economic Development Bank (BNDS). It simplified its decision on how the Fund would be sourced, by making modifications and revisions to existing laws. This created strong funding overnight, as many of the laws cited pertained to well-funded sources of the Brazilian government. By doing this, Brazil was able to establish the Fund quite quickly and without the need to create structures for management, supervision, and oversight.

#### **9. THE CHINESE CDM FUND (CDMF)**

##### **– ENHANCING CHANCES OF SUCCESS THROUGH HIGH LEVEL POLITICAL COMMITMENT AND DIRECT LINK TO NATIONAL CLIMATE CHANGE PROGRAMME.**

The government of China decided to create the Clean Development Mechanism Fund (CDMF) to support CDM projects in China and to collect, manage, and utilize the national share of proceeds of CDM projects. However, the CDMF does not target only CDM projects and the limited proceeds from CDM transactions. The objective is to become an innovative financial mechanism to implement China's National Climate Change programme, to actively support and promote national action on climate change and related sustainable development, to actively engage in and promote international cooperation, and to mobilize resources and contribute to global sustainable development. As such, the CDMF performs as a funding source, a platform for financial cooperation, for cooperative action, and for information and knowledge sharing.

### **C. Conclusions and Recommendations**

At the end of 2010, the Parties to the UNFCCC will get together once again to try to agree on a plan to address climate change in the decades to come. The success of these negotiations rests on whether developing countries fully engage and commit to taking action. Many Parties have argued that the basis of the agreements will need to rest on the legal framework of the Framework Convention, which calls for developed countries to support the efforts of developing countries. The former group took a major step in this regard at Copenhagen by committing to abide by this obligation, and pledged to transfer significantly larger amounts of resources in the next decade.

The challenge for developing countries will be to ensure that adequate institutions and skills are in place to make use of the resources effectively, efficiently, and fairly. Many countries are already well equipped, but a large majority require much effort in institution building and capacity development. However, the greatest need rests not so much in the areas which appear to be of so much concern to some developed countries – accountability and transparency – but rather in developing expertise to resource the new institutions so that they can identify, formulate, and implement effective

programmes to tackle climate change.

The evidence shows that the knowledge, networks, and present practices of management, accountability, and oversight are very well developed and available to all. It is also evident that the expertise exists worldwide, so it can be contracted to play an independent role and to provide oversight.

Lastly, developing countries have many choices. They can create new institutions, adapt or strengthen existing ones, or assign the role to existing financial institutions in the country. This suggests a large potential need, and an equally large task in capacity building, in the years to come in developing countries. Helping to map out these needs and providing resources and assistance to create the capacities that will enable developing countries to take determined action on climate change should be one of the major priorities of the deal to be reached in Mexico at the end of 2010.

## V. Compliance Oversight

### A. Introduction

The history of financial support for developing countries in meeting international environment and development goals is littered with broken and/or unverifiable promises, and regurgitated funds. The reluctance of most developed country governments to provide adequate, predictable, new, and additional climate finance received considerable media attention during the build up to the Copenhagen conference in 2009, as did the developing country call for a credible and transparent compliance system to track financial contributions by developed countries.<sup>31</sup>

This not the first time in the history of environmental negotiations, or indeed even of climate change negotiations, that developing countries have called for transparency regarding the financial commitments, and a compliance system to ensure commitments are met. As the case study mentioned later in this chapter indicates, many of the very same issues were discussed in the 1980's, during the negotiations for the Montreal Protocol on Substances that Deplete the Ozone Layer. Developing countries met with some degree of success (a Multilateral Fund governed by a representative Executive Committee was created, and action by developing countries was clearly conditional to the provision of finance by developed countries), but they did not succeed in establishing a compliance system for financial contributions.

In subsequent years, analytical literature on the Montreal Protocol has focused mostly on developing country compliance with targets for reducing use of ozone depleting substances, with little scrutiny of compliance by developed countries. Although the latter provided 'nearly all' the 'incremental costs' of phasing out ozone depleting substances in developing countries,<sup>32</sup> they appear to have defaulted on their commitment to provide 'new and additional' finance. It seemed to go largely unnoticed when developed country governments decided to include their contributions to the Multilateral Fund (MF) in Overseas Development Assistance (ODA) reporting, although the Montreal Protocol clearly calls for these contributions to be 'additional' to other financial transfers. Moreover, whereas hard measures are in place to ensure the compliance of developing countries (including trade sanctions), soft measures are used for developed countries which delay or default on their share of MF contributions – they are usually gently 'urged' to do so by the Executive Committee.<sup>33</sup>

Under the climate negotiations, developing countries first voiced their preference for a separate financial mechanism, controlled by the UN and under the authority of the Conference of Parties, as early as 1991, during the meetings of the Intergovernmental Negotiating Committee (INC) negotiating the UNFCCC text.<sup>34</sup> Much as it is now, they were opposed to multilateral institutions such as the World Bank and the then fledgling Global Environment Facility (GEF) serving as a financial

mechanism. They also wanted financial contributions to be made obligatory, rather than voluntary, on the basis of the polluter pays principle.

Their concerns were brushed aside by developed countries, which preferred the World Bank-dominated GEF. They argued that it would not need the creation of a new bureaucracy, and that the Bank was an efficient and competent manager of trust funds (although the GEF was a new bureaucracy that had been hastily patched together in preceding months by developed country governments, and presented to the climate and other Rio negotiations as a *fait accompli*).

### **Box 2. False declaration, or simply unverifiable?**

The future of the multilateral climate negotiations – particularly the Kyoto Protocol – stood in peril in 2001. Talks at the sixth conference of parties (COP 6) in The Hague in November of the previous year had collapsed. Shortly after, George W Bush became US President and declared that the US would not ratify the ‘fatally flawed’ Kyoto Protocol. The Hague negotiations were continued at COP 6 ‘bis’ in Bonn in July 2001, where there were fears that other industrialised countries might follow the US example and abandon the Kyoto Protocol. Much like the aftermath of COP 15 in Copenhagen, few were optimistic and many predicted ‘a descent into environmental anarchy’.<sup>1</sup>

In return for several concessions by developing countries to save the Protocol (including, for instance, the demand for mandatory levels of funding, or in fact, any level of assured funding), the EU15, Canada, Iceland, New Zealand, Norway, and Switzerland made a ‘political commitment’ to collectively provide US \$410 million annually to developing countries by 2005, for climate change activities. This was written into a Bonn Declaration, which also listed four ways in which the contributions could be provided: contributions to GEF climate change related activities; *additional* bilateral or multilateral funds provided against funding levels of 2001; funds directed towards either the Special Climate Change Fund (SCCF), the Least Developed Country Fund (LDCF) or the Kyoto Protocol Adaptation Fund (AF); and funding derived from the share of proceeds of the CDM.

Although the level of funding was to be reviewed in 2005, such a review never took place. A 2009 study set about trying to track whether the EU15 met this promise.<sup>1</sup> The authors, Marc Pallemmaerts and Jonathan Armstrong, were able to ascertain easily how much was paid into the dedicated multilateral climate change funds and instruments. However, they faced considerable difficulties in analysing the fragmented bilateral transactions: recent data was unavailable in National Communications; countries followed varied formats while reporting bilateral funding, and complied inadequately with reporting guidelines; and the authors found there was no clarity on what constitutes ‘new and additional funding’, or for determining the bilateral aid projects which are directly relevant to climate change mitigation or adaptation. The authors concluded that it was very difficult to prove whether the EU15 had indeed met its commitments:

*‘...average annual level of financial support to developing countries collectively provided by the 15 EU Member States...through specific multilateral climate change related funding channels falls well short of the level ... to which they committed themselves. Whether or not the EU is complying with its political commitment under the Bonn Declaration depends entirely on these Member States’ bilateral aid efforts and any additional contributions through other multilateral channels. Unfortunately, the information on such efforts ... is insufficient to enable even an informed observer to make a reliable judgment about the volume of aid additional to 2001 levels that is effectively being provided at the present time.’*<sup>2</sup>

Regardless of the legal nature of commitments, this situation, where it is extraordinarily difficult to establish whether financial commitments (or in the case of the Declaration, promises) have been kept, is clearly untenable. One of the key elements of the future climate finance regime, therefore, must be a transparent compliance system to ensure that financial commitments and associated criteria have been met. A central registry should be maintained, and made freely accessible to all.

After the GEF was named as a financial mechanism to the UNFCCC despite their efforts to the contrary, developing countries continued to push for transparency around contributions. ‘We will accept GEF, and we will accept that it will be administered by the OECD-dominated World Bank’, a Malaysian delegate at the UN Conference on Environment and Development in 1992 is reported to have said. ‘But can we not have a little say? Can we not have more transparency in the administration of this fund? Surely, this does not amount to the South squeezing the North?’

Two decades later, many of the discussions on climate finance sound like an echo of the discussions that took place during the writing of the convention – in some cases, even the actors remain the same. Developing countries continue to call for a transparent, accountable system under the UNFCCC, based on obligatory finance. Developed countries favour the use of existing institutions over which they have greater control, such as the World Bank and GEF. They still quote efficiency as a justification for this choice, with vague promises of ‘reform’ to address governance concerns. Reform in the past appears not to have worked – the post-reform ‘GEF II’ was no more acceptable to developing countries than its earlier avatar.<sup>35</sup>

The new element in this long-running tragicomedy, however, is the accumulation of evidence justifying developing country concerns (*see box: False declaration, or simply unverifiable?*). It is impossible for even ‘an informed observer’<sup>36</sup> to keep track of whether developed countries have lived up to their financial commitments under the climate convention and subsequent protocol and political declarations. Moreover, the ‘efficiency’ of existing international financial institutions is even more questionable.<sup>37</sup>

The run-up to the Copenhagen COP saw hopes of a resolution to this problem, as the Ad Hoc Working Group on Long-Term Cooperative Action under the Convention (AWG-LCA) made some progress towards a system of mutual accountability. While many references to climate finance remained bracketed, agreement appeared to have been reached on some crucial building blocks of a compliance and certification system, including the kinds of finance that could count:

*Scaled up, new and additional, predictable and adequate funding shall be provided to developing country Parties (para. 35). The main source ...shall be new and additional financial resources provided by developed country Parties (para 36)... Private-sector financing and other innovative sources of funding shall supplement the provision of public financial resources (para 37)*

Agreement was also at hand on some of the procedural and institutional questions. It was agreed that *(t)he Conference of the Parties shall adopt provisions to measure, report and verify the support provided for enhanced action by developing country Parties (Para 41)*. The establishment of a Finance Board to oversee financing arrangements under the UNFCCC, the review of modalities of existing entities, the creation of a new Climate Fund or Facility, and direct access to funds for developing countries without the need for international implementing agencies were all under discussion.<sup>38</sup>

Unfortunately, although the Copenhagen Accord promises fast-start and long-term finance (starting at US\$10 billion a year from 2010 to 2012, increasing to US\$100 billion by 2020), it is short on critical details that would make the promise credible. It does not indicate, for instance, how the money will be raised; whether both private and public sources will be counted; whether the funds will be additional to ODA; whether the funds will be provided as grants or as loans; or how these funds will be managed.<sup>39</sup> The Accord does not set a baseline, or a starting year or starting amount from which to reach the promised US\$100 billion a year by 2020. Nor does it make any reference to a system to register or report financial contributions.

One of the enduring lessons of the last two decades of international diplomacy on climate change – and indeed of the Copenhagen conference – has to be the hopelessness of negotiating in an atmosphere of distrust, where even the best intentions raise suspicion and make progress impossible. A credible, trustworthy system to track financial contributions and ensure that developed countries are complying with their commitments under the UNFCCC will go a long way in building trust. It is hoped that the AWG–LCA will continue to progress towards the design of just such a system during the course of its negotiations this year.

This chapter aims to elaborate on a certification system for climate finance. It briefly examines the question of what should be counted, and considers the channels through which such funds might flow. Existing financial certification systems such as those employed for ODA and the Montreal Protocol’s Multilateral Fund are examined.

## B. The Case Studies<sup>i</sup>

### 1. TRACKING ODA

Overseas Development Assistance (ODA) is tracked by the OECD Development Assistant Committee (DAC), which comprises 22 bilateral donors and the European Commission. Donor countries report ODA to DAC annually. The DAC Working Party on Statistics (WP-STATS) brings international aid statisticians together to look at how statistics respond to key development issues. DAC monitors financial flows and their allocation, producing two databases:

- The *DAC annual aggregates database*, which provides comprehensive data on the volume, origin, and types of aid and other resource flows.
- The *Creditor Reporting System (CRS)*, which provides detailed information on individual aid activities, such as sectors, countries, project descriptions etc.

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<sup>i</sup> To avoid misunderstandings, please read the ‘Case Study Disclaimer’ in Chapter I.

Generation of the databases is based on direct reporting by donors. The reporting is classified by sector and by policy objective. The sector code identifies ‘the specific area of the recipient’s economic or social structure which the transfer is intended to foster’. In DAC reporting (as well as in most donors’ internal reporting systems), each activity can be assigned only one sector code. For activities cutting across several sectors, either a multisector code or the code corresponding to the largest component of the activity is used.

Reporting on the policy objectives of aid – environmental sustainability, gender equality, reduction of poverty, and participatory development/good governance – is based on a marking system with three values: ‘principal objective’, ‘significant objective’, and ‘not targeted to the policy objective’. ‘Principal’ policy objectives are those which can be identified as being fundamental in the design and impact of the activity, and which are an explicit objective of the activity. ‘Significant’ policy objectives are those which, although important, are not one of the principal reasons for undertaking the activity. The value ‘not targeted’ means that the activity has been screened against, but not targeted to, the policy objective. Each activity can have more than one policy objective.

*WHAT COUNTS AS ODA?* To be counted as ODA, payments must be provided by official agencies, including state and local government, or by their executive agencies. In addition, each transaction has to be:

- a) administered with the promotion of the economic development and welfare of developing countries as its main objective; and
- b) concessional in character, with a grant element of at least 25 per cent, calculated against a notional reference rate of 10 per cent per annum.

Where concessional and non-concessional financing are combined in so-called ‘associated financing packages’, the official and concessional elements may be reported as ODA, provided that they have a grant element of at least 25 per cent. Such contributions must also meet the special concessionality tests for associated financing, which are based on market interest rates and set out in the *Arrangement on Guidelines for Officially Supported Export Credits*, a ‘gentleman’s agreement’ among participants that sets out the most generous export credit terms and conditions that may be supported by participants.

*WHAT IS EXCLUDED?* Activities not eligible for funding through ODA include military or security assistance, cultural programmes for the donor’s nationals resident in other countries, aid from NGOs financed from private sources, Foreign Direct Investment, official export credits or other commercially motivated transactions, guarantees on private export credits or investments, and reduced tariffs or other concessions on imports from developing countries. DAC statistics measure resources for development (not just ODA) including Other Official Flows (OOF), Private Flows, and Net Private Grants.

*TRACKING CLIMATE-RELATED CONTRIBUTIONS.* DAC tracks contributions towards climate change mitigation through a ‘Rio marker on climate change’. An adaptation marker has recently been introduced (starting January 2010). The mitigation marker tracks climate change-related aid, defined as *activities that contribute to the objective of stabilization of greenhouse gas (GHG) concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system by promoting efforts to reduce or limit GHG emissions or to enhance GHG sequestration.* A similar marker to track aid in support of adaptation to climate change in developing countries came into effect from January 2010.

*PROBLEMS WITH THIS SYSTEM.* As aid targets are considered aspirational targets rather than legally binding commitments, the DAC system is not really a compliance instrument designed to generate trust among recipients – it is entirely managed by and for contributors. Classification is carried out on the basis of donor reporting. No independent verification or certification is carried out, and there appear to be no systems in place to rule out double counting or to indicate whether funds are ‘new and additional’.<sup>40</sup> There is no verification or certification process.

## **2. THE MONTREAL PROTOCOL’S MULTILATERAL FUND**

The Multilateral Fund (MF) was created through a 1990 Amendment to the Montreal Protocol on Substances that Deplete the Ozone Layer. This was the first time that a separate financial mechanism, governed by a representative Executive Committee including developed and developing countries, and with equal voting power over how funds will be distributed had been established under an environmental convention. (For this and other reasons, the US in particular wanted to make sure that the Fund should not establish a precedent. Hence Article 10 of the Protocol, which relates to the creation of the Mechanism, also lays out that *the financial mechanism set out in this Article is without prejudice to any future arrangements that may be developed with respect to other environmental issues*).<sup>41</sup>

The main objective of the Multilateral Fund is to assist developing country parties to the Montreal Protocol to comply with the control measures of the Protocol. Developing countries that qualify for funding are referred to as Article 5 countries. Action by developing countries in reducing the use of ozone depleting substances is clearly made conditional to financial and technological support in Article 5.5 of the Montreal Protocol:

*Developing the capacity (of Article 5 developing countries) to ... comply with the control measures ... and their implementation will depend upon the effective implementation of the financial co-operation as provided by Article 10 and the transfer of technology as provided by Article 10A.*<sup>42</sup>

The MF operates under the authority of the Parties to the Montreal Protocol, who decide both on its overall policies and, every three years, on the level of replenishment of the Fund. An Executive

Committee, comprising seven developed and seven developing countries, oversees MLF operations. Members are selected annually at the Meeting of the Parties to the Montreal Protocol, based on equitable geographic representation. Members have equal voting rights, but the Executive Committee has never voted; decisions are based on consensus. The Chair and Vice-chair of the Executive Committee alternate annually between the developing and developed countries.

*WHAT COUNTS?* The MF is financed by mandatory contributions from developed country Parties to the Montreal Protocol<sup>i</sup> on the basis of the standard United Nations scale of assessments.<sup>43</sup> The bilateral element is restricted to 20 per cent of annual contributions. Before they count as contributions towards the Fund, the Executive Committee annually assesses whether bilateral contributions comply with the following criteria set out by the Parties:

- strict compliance with the provisions of the Protocol;
- additionality;
- incremental cost criteria.<sup>44</sup>

*Although contributions to the Fund are meant to be additional according to the provisions of the Montreal Protocol, DAC members later agreed that 100 per cent of contributions to the Montreal Protocol could be reported as ODA from 1994.*<sup>45</sup> The additionality criterion was an extremely controversial one during its negotiation, opposed particularly by the US, but completely non-negotiable by developing countries. Thereafter, it seems to have been swept under the carpet where possible. For instance, a later ‘formal’ interpretation of the Protocol (described rather generously as ‘one of the most impressive environmental books ever written’ by Richard Benedick, lead US negotiator for the Montreal Protocol) appears to drop the reference to additionality altogether – see Andersen, Sarma, and Sinclair (2002).<sup>46</sup>

The Protocol and Fund put in place a strong compliance regime for Article 5 (developing) countries if they fail to reduce ODS use (including the use of trade sanctions). However, there appears to be no compliance system to ensure that developed countries pay their contributions and stick to the criterion of additionality laid down in the Protocol. In 1991, an Ad-Hoc Working Group of Legal Experts on Non-Compliance with the Montreal Protocol considered whether non-payment of contributions by non-Article 5 countries constituted non-compliance.<sup>47</sup> Views diverged – while some argued that non-payment is obvious non-compliance, others argued that it could not be considered non-compliance, since the Protocol does not mention that the contributions are ‘assessed’ as in the

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<sup>i</sup> Contributions from other sources are encouraged but not mandatory.

United Nations. Although a number of countries have defaulted on payments since,<sup>48</sup> this argument has not been put to the test or resolved.<sup>49</sup>

*PROBLEMS WITH THIS SYSTEM.* The Multilateral Fund is a good example of how funds can be mostly channelled through a single consolidated mechanism, with a smaller percentage flowing through bilateral sources. However, its procedures for tracking compliance with financial commitments are far from adequate. There appear to be no procedures or transparency measures in place to ensure that contributions to the Multilateral Fund, as well as bilateral contributions, meet agreed criteria such as additionality. The Executive Committee is expected to ensure that bilateral contributions are additional and comply with the Protocol, but exactly how this happens is lost in the fog. The decision by DAC to include contributions to the Multilateral Fund in ODA reporting suggests the need for a more robust system to ‘certify’ that agreed criteria have been complied with.

## C. Essential Elements for a Climate Finance Compliance System

### 1. MORE THAN MRV

The acronym MRV, coined during a dramatic final night of negotiations at COP 13 in Bali, is now commonly used in the context of tracking climate financial contributions. As defined in para 1.b.ii of the Bali Action Plan, MRV applies only in the context of Nationally Appropriate Mitigation Actions (NAMAs). Originally devised to characterize mitigation action by developing countries, it was extended to cover also the financial, technical, and capacity building support for such NAMAs.<sup>50</sup> However, financial commitments under the UNFCCC cannot just be about supporting and enabling NAMAs. Financing will also be required for many other purposes, not least for adaptation.

The use of the term ‘MRV’ for climate finance in general is problematic, as it could lead to the incorrect inference that all activities funded by MRV finance should also be subject to MRV. More importantly, it fails to capture an essential aspect of payments that are meant to count towards compliance with financial commitments under the UNFCCC: the payments need to be reportable and verifiable<sup>i</sup>, but they will also have to comply with certain specific criteria (the AWG-LCA text, for instance, lists new and additional finance). Much like Certified Emission Reductions (CERs) under CDM, such finance must be *certifiable as having met the agreed criteria*. As we saw in the case study above, this is one element that appears to be missing in the arrangements under the Montreal Protocol’s Multilateral Fund.

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<sup>i</sup> ‘Verifiable’ here is taken to qualify the payment, i.e. refer to ascertaining whether it has occurred or not.

In order to avoid any confusion as to what is covered by MRV (NAMAs *only*) – this paper proposed the use of the terms ‘registration’ and ‘certification’ for financial flows that are meant to count against compliance with financial commitments under the Convention.

The Annex to an earlier negotiating draft included reference to such a registration and certification system under the new financial mechanism, which shall:

*...manage a certification and registry system for receiving, delivery of and deploying financial resources to enable developing country Parties to count financial contributions and technology support from developed country Parties towards compliance of their commitments under Article 4.3, 4.4, 4.5, 4.8 and 4.9 of the Convention and under paragraph 1(b) (ii) of decision 1/CP. 13. Financial resources will be made available to support an effective system to measure, report and verify the support provided by developed countries. (non-paper 54)*

Unfortunately, this reference has since been removed, and the current AWG-LCA draft only refers to MRV in the context of financial support.

## **2. CRITERIA FOR CLIMATE FINANCE**

From the early days of the UNFCCC (and other global environmental negotiations), several negotiating hours have been spent on arriving at a common understanding of which North–South financial transfers can be counted as meeting financial commitments under the convention. A clear understanding of what counts is an important prerequisite for a compliance system. The COP will have to clearly list the conditions under which contributions will be counted.

*NEW AND ADDITIONAL.* The terms ‘new and additional’ make a regular appearance in this context. Article 4.3 of the UNFCCC calls on Annex II (developed) country Parties to provide finance that is ‘new and additional’. The Kyoto Protocol (Article 11), the Bonn Declaration described in Box 1, as well as the recent Copenhagen Accord call for climate finance to be ‘new and additional’. The reference to ‘new and additional’ is considered crucial to overcome two existing problems related to climate finance:

- a) the practice of ‘double counting’, where funds are delivered for climate change purposes, and at the same time counted as ODA,<sup>51</sup> and
- b) the practice of diverting funds from ODA (and hence compromising global development goals) for climate change purposes. Several development organizations have warned that cannibalizing aid to rebrand it climate finance will have disastrous consequences for crucial sectors such as health and education, and also for the poorest and least developed regions of the world such as Africa.<sup>52</sup>

However, as the experience with the Bonn Declaration funds shows, after all these years it still remains very difficult to establish whether this criterion is fulfilled (or will be fulfilled, in the case of

the Copenhagen Accord). The overwhelming perception of Southern governments and NGOs involved in the climate negotiations is that this condition is rarely met.<sup>53</sup>

As a matter of fact, even the meaning of the term remains surprisingly ambiguous, despite its repeated usage. ‘New’ is mainly taken as referring to funds which are separate from those that have already been promised, for climate change or as overseas development aid. However, it is also increasingly interpreted as referring to funds from ‘new’ or ‘innovative’ sources (such as a percentage of the proceeds from carbon trading, or an air passenger levy). ‘Additional’ is interpreted by some as ‘additional to existing aid flows’, and by others as ‘additional to existing developed country promises to provide 0.7 per cent of their GNP as ODA’.

*CATEGORIZATION ACCORDING TO SOURCE, AND CHANNELS.* Funds for climate change are also often categorized according to their sources, or according to the channels through which they will be disbursed. European Commission documents, for instance, often refer to public, private, domestic (i.e. from developing country domestic budgets), and new/innovative sources of financing, including funds raised through an expanded carbon market.<sup>54</sup> Developing countries have expressed a preference for all climate finance to flow through a new financial mechanism controlled directly by the UNFCCC in order to be counted.<sup>55</sup> The Copenhagen Accord refers vaguely to a ‘wide variety of sources’, including ‘public and private, bilateral and multilateral, including alternative sources of finance’.

Clarity on which of these contributions will count is important, as this will determine the complexity of the compliance system. For instance, if climate funds are ‘consolidated’ under a UNFCCC mechanism, as developing countries prefer, it becomes relatively easy to keep track of contributions. Developed countries, on the other hand, would prefer to use existing bilateral and multilateral channels. If climate funds are ‘fragmented’ into a number of multilateral and bilateral sources, they become more difficult to track. The current system of ODA, for example, is largely fragmented and based on bilateral payments, with a smaller degree of consolidation through multilateral organizations such as the Multilateral Development Banks (MDBs) and UN agencies.<sup>56</sup>

This paper relies on the analysis behind the proposal for a Reformed Financial Mechanism (RFM) to support a system where the majority of funds flow through this consolidated mechanism. It recognises, however, that there will be situations where a small portion of the funds may need to be channelled through existing institutions and processes. For example, in the case of ‘climate proofing’ ODA it does not seem reasonable to split the incremental climate change finance from the main ODA payments. However, this would only be a relatively small percentage of the public sector finance that is expected for climate change in developing countries. According to a World Bank study, the cost of ‘climate-proofing’ ODA and concessional finance is between US\$4 and US\$8 billion annually, or about 10 per cent of the expected needs for adaptation finance.

Likewise, concerns have been raised about blurring the boundaries between ‘public’ and ‘private’ finance. Public sector funds are often used to leverage private sector funds. Should the public and private elements be counted together as contributing towards a country’s commitment? <sup>57</sup>

Finally, the appropriateness of including all proceeds from the carbon market should be considered carefully. For instance, payments for Certified Emission Reduction units (CERs) under the Clean Development Mechanism (CDM) are often characterized by developed countries as a form of financial transfer for mitigation. However, if they are acquired for the purpose of *offsetting* developed country emissions, the transaction is purely commercial. It enables the developed country buyers to achieve compliance with their *mitigation commitments* more cheaply than would otherwise be the case. In light of this, it is difficult to see how the money paid in exchange for the CERs could be considered as financial support to be counted also towards financial obligations.

However, if the CERs acquired were *not used for offsetting*, but retired – as proposed by Müller and Ghosh (2009) – then there may be good reasons why the money spent on acquiring these ‘Retirement CER Obligations’ (R-CEROs) should be certified as counting towards financial obligations under the Convention.<sup>58</sup> For example, a country might decide to impose on some private sector institutions in order to provide support for mitigation, or to use public funds to generate R-CEROs. In both cases, the funds would flow outside of the consolidated RFM, but should they count towards financial compliance? It can be argued that the use of the CDM to generate R-CEROs is a legitimate implementation of MRV support as envisaged under the Bali Action Plan. At the same time, it can be argued that it would be better if the country paid the funds into the consolidated mechanism, and leave it to the RFM to decide whether it would wish to use part of its mitigation budget to buy R-CEROs.

#### D. Proposal for certification and registration of climate finance

Once it is clear which financial transfers are to be counted towards contributions, clear-cut procedures will have to be agreed on the process of measuring, reporting, verifying, certifying, and registering.

As pointed out earlier, the latest negotiating text only refers to MRV of climate finance – the reference to certification and registration has been removed. It is important that certification of payments is reinserted into the text and a procedure agreed, because *certification involves more than just MRV. It involves complying with the guidelines and criteria set out by the UNFCCC COP or the RFM on such payments.*

Given the uncertainty about the institutional arrangements that will oversee future contributions, this paper uses as its basis the proposal for a Reformed Financial Mechanism. The RFM, as described earlier in this report, proposes that whereas the majority of climate funds will flow through a

consolidated UNFCCC financial mechanism, there will be some payments that could reasonably count as contributions, but flow through existing ‘fragmented’ channels.

## 1. CERTIFICATION OF CONSOLIDATED FUNDING

The certification and subsequent registration of direct contributions to a consolidated RFM under the UNFCCC would be relatively straightforward. A central financial compliance registry, maintained by the RFM secretariat, could carry out both certification and registration once they receive notification from the RFM Trustee that payments have been received. The certification procedure will, however, need to be robust in order to ensure that the contributions comply with all agreed criteria.

## 2. CERTIFICATION OF FRAGMENTED FUNDING

How should unconsolidated payments be certified? There are the following two options for funds which pass directly from contributors to recipients:

- i. **Self-certification** by the payer, as practiced in the current ODA registry under the OECD DAC. However, as pointed out in the case study, while this might work in the context of voluntary ODA payments it is unlikely to be acceptable in the context of certifying payments with respect to financial obligations.
- ii. **Recipient certification.** The likely problem here might be that recipients could find themselves compelled to certify and overlook certain criteria, or lose the money altogether.

Neither is ideal, but the second option is certainly likely to generate more trust. The key to avoid recipients feeling that they are compelled to certify – in particular with respect to the concept of ‘additionality’<sup>59</sup> – is simplicity and transparency. The criteria for certification must be as simple as possible, and based on measurable parameters. The certification process, in turn, must be transparent, with public feedback as practised in the case of CDM approvals. The CDM experience clearly demonstrates that if a financial additionality criterion is to be adopted, then it is crucial that it be operationalized – made ‘measurable’ – without the need to second-guess intentions of decision makers. An additional advantage of recipient certification is that certification can be carried out at the point of registration, thus avoiding institutional proliferation.

As illustrated in Figure 3 of this report (*RFM2: Disbursement, Funding, Certification, and Registration*), this Report therefore proposes the relevant national Climate Change Fund certified fragmented funding as fulfilling agreed RFM criteria. The payments can then be entered into a **national financial compliance registry**, from where the information is collected by the RFM Secretariat to be entered in the central compliance registry. This *ex post* in-country certification avoids the dangers of double counting and unfulfilled pledges, as can happen under other accounting systems.

At the same time, it does not exclude the possibility of multilateral agencies (or Multilateral Implementing Agencies, as they are called under the Adaptation Fund) playing a role in implementing climate change related activities that are certifiable towards financial compliance, but not funded through the consolidated financial mechanism.

### **3. WHO SHOULD REGISTER?**

This working paper proposes that the registration of the payments as having been received should take place *at the receiving end*, in *National Climate Finance Registries*. The principle of parsimony<sup>60</sup> suggests that if the country has a Designated Funding Entity (DFE), then it should keep this registry. In those cases where there are no DFEs, a ministry could be designated to perform the necessary registrations and notifications.

The National Registries would then report to an *International Finance Registry*, which would be an essential part of the RFM. All the information relevant to the issue of compliance with financial commitments under the Convention would be collated from national reports into an international registry, and reported annually by the RFM Executive Board to a Compliance Committee of the COP.

The national and financial registries should aim for the highest level of clarity and transparency, ensuring that the information can be easily accessed and fully understood by all stakeholders.

#### Conclusions

Properly designed, a trustworthy certification and registration system will contribute significantly to restoring at least part of the trust that has been squandered. It is therefore long overdue that developed countries overcome their reluctance to have their contributions scrutinized, and that certification of payments is retained in the current negotiations on institutional arrangements for international climate finance.

The Montreal Protocol's Multilateral Fund provides a good example of how funds can be mainly channelled through a consolidated mechanism governed by a representative body, with an agreed percentage channelled through bilateral sources. However, the compliance procedures for ensuring that financial commitments are kept, and that they meet agreed criteria, are weak or even non-existent.

The apparent assumption in international negotiations that whereas a gentleman's agreement will suffice to hold developed countries to their financial commitments, while developing countries need good measures of both the carrot and the stick, belongs to a different century. A reformed climate finance mechanism will need a robust and transparent compliance system, if trust is ever to be regained.

## VI. Public Oversight<sup>i</sup>

### A. Renegotiating a space for civil society in the governance of climate finance

Existing international financial institutions (IFIs) have often been criticized for the ‘exclusivity’ of their decision-making processes.<sup>61</sup> With even developing country governments struggling to be counted, civil society is a distant third or even fourth (after business) when it comes to influencing these institutions. The grassroots communities that are most directly affected by IFI policies are at an even greater disadvantage than ‘global’ civil society: far away from the corridors of power where decisions are taken by people who are in no way accountable to them, the chances that they can defend their interests in any meaningful way have been slim.

However, the importance of civil society engagement is widely acknowledged – especially in a world where ‘global governance’ (to the extent that that term can be used to describe current arrangements) functions in a democratic vacuum with little by way of direct representation or accountability. IFIs, in particular, *need* civil society engagement to provide them with a veneer of legitimacy and openness. In addition, the strengths that civil society organizations and institutions bring to planning, implementing, and monitoring global and national goals, are now well documented.

Most IFIs, therefore, have formal processes in place for civil society engagement at the level of policy making (by the IFI Board, Council or Executive Body), as well as measures to encourage civil society participation in implementation of funded activities. To what extent have such processes succeeded in bringing the voices of poor and disadvantaged sections of civil society to the decision-making table?

This question is more pertinent than ever, as the world gears up to deal with the causes and impacts of climate change. Every lesson from past development and environment efforts must be brought to bear in the delivery of climate finance in order to ensure that poor and vulnerable communities, already bearing the brunt of climate change, benefit most. In the specific context of climate change finance, civil society has at least three key roles in protecting the interests of local communities:

- relay information, translating local-level experiences to inform national and global decision-making, and global and national policies for local implementation;
- ensure accountability, transparency, equity, and effectiveness in global and national decision-making and implementation; and

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<sup>i</sup> This Chapter is based on Anju Sharma, *The Reformed Financial Mechanism of the UNFCCC: Renegotiating the role of civil society in the governance of climate finance*, OIES EV50, March 2010. Available at [www.oxfordenergy.org/pdfs/EV50.pdf](http://www.oxfordenergy.org/pdfs/EV50.pdf)

- plan and implement activities to achieve national and international goals (often at lower cost and with greater effectiveness than government agencies), while promoting innovative approaches.

An analysis of the processes for civil society engagement instituted by the Global Environment Facility (GEF) and the World Bank's Climate Investment Fund (CIF) provides several lessons for the design of a climate change finance institution or mechanism. The GEF and CIF models are similar, characterized by a centralized, top-down structure for civil society participation based on 'self-selection' by NGOs; limited funding for civil society representatives, mainly to participate in global-level meetings; and limited rights for civil society participants to be present and make interventions during global policy-making meetings.

Although both liberally employ the terminology of inclusivity and democratic process with regard to civil society (such as 'GEF Family', 'NGO self selection', 'partnership', and 'active observer status'), they do very little more than provide an occasional venue for civil society to voice concerns. Interactions between the IFI governance bodies and civil society are mostly staggered events rather than a continuous and integrated process of mutually beneficial engagement. Even these events are sometimes carried out as 'orchestrated token participation designed for non-input' (as the first CIF Partnership Forum was described by one civil society representative).

This analysis suggests three main problems with the GEF/CIF model of civil society engagement: its top-down structure; the lack of resources for civil society to be effective; and the lack of processes or redress mechanisms to ensure that concerns raised by civil society are addressed.

## B. Top-down process of engagement

Both the GEF and CIF models of civil society engagement are designed to mirror the top-down and dubiously representative functioning of IFIs, and end up being more successful in reaching out to 'global' civil society than to local communities and grassroots organizations. The term 'civil society' is left largely undefined, to paper over differences between its global, national, and local constituents, and their varied interests and perspectives. The importance of bringing *local* experiences to the decision-making table, or of providing a space for local and national civil society to influence global policies, is often forgotten and seldom achieved. For instance, a 2007 desk-based review of the treatment of indigenous people's and social issues in large and medium-sized GEF biodiversity projects over 2005-2006 found that the treatment of indigenous peoples' rights continues to be

superficial, with the treatment of critical issues such as free, prior and informed consent; informed participation, resettlement and economic displacement often remaining perfunctory or ambiguous.<sup>i</sup>

### C. Lack of resources

A model that merely creates a space for civil society to ‘engage’, without addressing their existing limited capacity, can only expect superficial engagement. The crippling effects of the lack of resources to back up civil society engagement are well documented in an independent review of the GEF NGO Network carried out in 2005.<sup>62</sup> The review found that lack of resources hampered the ability of regional focal points to reach out to national and local members, and constrained NGO engagement. There were no resources to gather and channel lessons learnt from local implementation to the GEF Council or Assembly. Attempts by the NGOs to raise funds from the GEF initially proved unsuccessful, as the previous GEF CEO felt such funding would compromise the integrity of the Network. (Following the review, the amount of funding made available to the Network has increased, and a Voluntary Trust Fund is being revived). With hardly any investments in civil society at the national and local level, the effectiveness of the Network in bridging the gap between GEF decision-makers and communities has not been very successful.

### D. Lack of redress mechanisms

Finally, accountability seems to be missing on both sides of the relationship between IFIs and civil society. The latter may be given space to voice their concerns, but there is little they can do to ensure that these concerns are acted upon. As the case of the India Ecodevelopment Project (Box 3) shows, the GEF may have access to the ‘ombudsman’ bodies of implementing agencies, but these have not yet proven sufficient. The World Bank’s three-member Inspection Panel itself was formed in 1993 as a result of pressure from international NGO coalitions with leverage over donor governments, protesting the negative social and environmental impact of Bank projects.<sup>ii</sup>

The NGO Network was also found to be lacking accountability measures by the 2005 review - for instance, allegations of electoral violations were glossed over and no response or action was taken. Under these collective circumstances, ‘civil society engagement’ ends up merely as a fig leaf to grant weak legitimacy to IFIs where in fact none has been earned.

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<sup>i</sup> Taylor, L and Griffiths, T (2007). *A desk-based review of the treatment of indigenous peoples’ and social issues in large and medium-sized GEF projects (2005-2006)*. Forest Peoples Programme

<sup>ii</sup> Fox, J.A and Brown, L.D (1998). *The Struggle for Accountability: The World Bank, NGOs and Grassroots Movements*. Massachusetts Institute of Technology.

### **Box 3. The GEF NGO Network in practice**

The US\$67 million India Ecodevelopment Project was launched in seven National Parks across India in 1994. The project was to be funded partly by GEF (US\$20 million), the World Bank (US\$28 million), the Indian government and 'village beneficiaries'. The World Bank was the Implementing Agency.

In almost all the seven project areas, local communities protested at their lack of involvement in planning – including plans for the so-called 'voluntary relocation' of communities living inside the forest areas. The Centre for Science and Environment (CSE), then the GEF NGO focal point for the South Asia, made several attempts to get the concerns of the communities heard in New Delhi, as well as in Washington through interventions made in the GEF Council meetings and during the 1998 GEF Assembly (where affected communities were present to make their case).

Frustrated by the lack of response, local NGOs and communities in Nagarhole National Park in south India wrote to the World Bank Inspection Panel. The Panel is considered an important precedent in international law, as it provides an opportunity for local citizens to challenge the activities of an international institution. It was created in an attempt to increase the accountability of the World Bank and to improve compliance with its social and environmental policies.

The Report of the Inspection Panel, placed before the Executive Directors of the Bank in October 1998, agreed that the concerns raised by the communities were valid. They confirmed serious flaws in the design and basic premises of the project: *The Panel finds that certain key premises underlying the design of the project at the Nagarhole site are flawed, as a result of which there is a significant potential for serious harm. It therefore recommends that the Executive Directors authorize an investigation into the case.*

However, Bank directors ruled that a full investigation was not warranted and merely called for these flaws to be rectified during the course of implementing the Project. The project continued into a second and third phase, although Nagarhole was excluded in Phase III. Bank documents record the Project as completed satisfactorily – including an unbelievable satisfactory rating for social and community benefits.

Source: Inspection Panel (1998). India Ecodevelopment Project. Report and Recommendation on Request for Inspection. Rajiv Gandhi (Nagarhole) National Park. October

## E. Review the Terms of Engagement

This chapter calls on civil society to lay down their ‘terms of engagement’ – a set of minimum conditions that they need in place to play a role in the effective use of funds – before they agree to engage in any formal civil society process. At a minimum, the terms should include devolved decision-making on the use of the funds supported by a more ‘bottom-up’ model of civil society engagement that invests in national and local civil society; adequate resources for civil society engagement; and effective redress mechanisms at the nation and global level.

### 1. A ‘BOTTOM-UP’ MODEL FOR CIVIL SOCIETY ENGAGEMENT

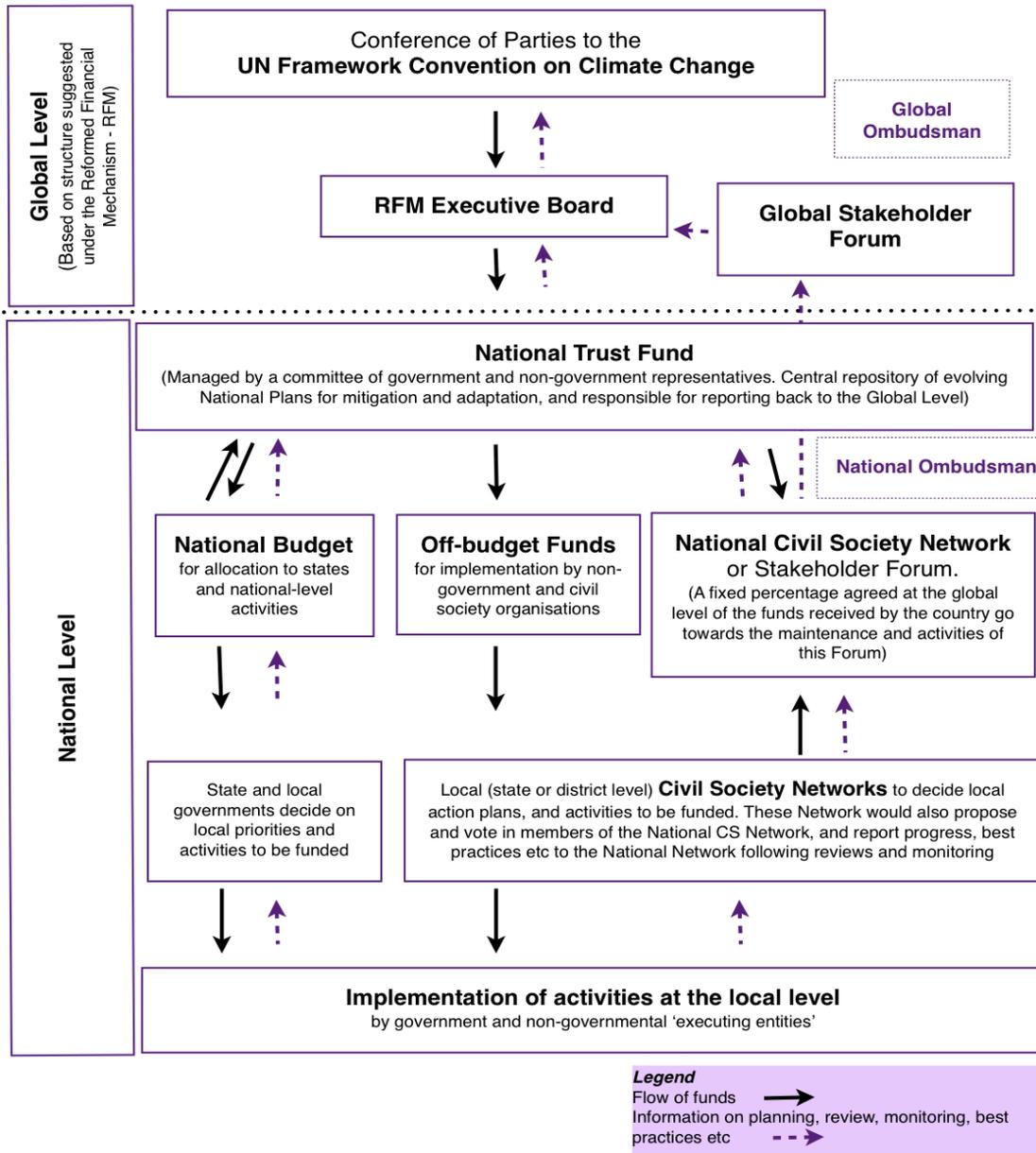
This module proposes a model for ‘bottom-up’ civil society representation, based on the creation of adequately funded and accountable National Civil Society Networks (NCSNs), with an integral decision-making role in the National Trust Funds (NTF) proposed under the RFM model. The NCSNs should include all non-government actors that are involved in planning, implementing or monitoring activities funded through the NTF. The members of the NCSN would regularly elect a National Civil Society Board (NCSB), including a Chair and other office holders (to be decided by the country depending on factors such as its size and diversity) for a fixed term of two to three years.

The key roles of the NCSB would be to establish rules and procedures to ensure the accountability of the National Network to its members; influence national government policies and decisions related to the use of the funds through participation in the governance of the National Trust Fund; and to represent the Network at national, regional and global levels (including, for instance, meetings of the Executive Board of the RFM, thus eliminating the current random selection of representatives).

Such a system will allow civil society to respect the principle of subsidiarity in their functioning. Transnational civil society will have an important role in ensuring that the international governance arrangements are fair, in the effective delivery of results, and in guaranteeing that the functioning of the global mechanism itself is transparent and accountable. They also have a role in supporting national and local civil society organisations by acting as a conduit for information and providing support and resources. However, it is the latter (national and local civil society), which has a key role in planning, prioritising, implementing and monitoring funded activities. This division must be respected, to ensure that the ultimately intended recipients of the funding – the ‘grassroots level’ – can directly influence how the money is used.

The GEF Small Grants Programme (SGP) demonstrates the success of such an approach. The relatively decentralised structure of the SGP comes closest to allowing for national and local level decision-making – grants of up to US\$50,000 are channelled directly to community and non-government organisations, through National Coordinators (NC) guided by voluntary National Steering

**Figure 5. Proposed structure of a climate change finance mechanism, to benefit from civil society engagement at the local, national and global level**



Committees (NSCs). The NSCs include representatives from local NGOs, indigenous peoples' organizations, government, academia, UNDP and occasionally co-funding donors, the private sector and the media. The NSC develops a country programme strategy, considers whether proposals for grants are feasible and meet SGP criteria, and what kind of technical support is needed for implementation. It is also responsible for final approval of grants, helps undertake site visits and review, advises on design of grant proposals, and ensures monitoring and evaluation.

A Joint Evaluation carried out in 2007 concluded that the SGP has a slightly higher success rate in achieving global environmental benefits and a significantly higher rate in sustaining them than GEF medium- and full-size projects. An earlier 2002 Overall Performance Study (OPS) of the GEF

attributed the success of the SGP to *the way in which it links global, national and local-level issues through a transparent, strongly participatory and country-driven approach to project planning, design and implementation.*

## **2. ADEQUATE RESOURCES**

The OPS mentioned above noted that the SGP National Committees have been extraordinarily successful in mobilizing and energizing inputs from a wide range of talented and experienced individuals now working towards GEF goals *on a voluntary basis*. The evaluation noted that not only are the committees being asked to do too much with too little resources, they could achieve much more with greater support.

Funds for the functioning of the proposed NCSN are a critical element for their success. These funds should be made available in a way that does not compromise the integrity of civil society, and does not make them rely on either the global institution or national governments for the funding. In order to achieve this, the global governing body could agree that a set percentage of the funds received by a country should be automatically allotted to the civil society network. This would address concerns such as those raised by the GEF, about the independence and integrity of the Network.

## **3. EFFECTIVE REDRESS MECHANISM**

From the very start, the institutional arrangements and procedure for dispute settlement at the national and global levels must be made clear. In case of a dispute or disagreement at the national level, a local or national-level dispute settlement mechanism easily accessible to individuals and civil society must be the first port of call, rather than an international body or panel. Either the existing national legal system could be modified and strengthened to accommodate this, or an existing body, if found suitable, could fulfil this role.

At the global level, considerable analysis exists of the form and function of a redress mechanism, done both before and after the creation of the World Bank Inspection Panel. Three minimum criteria emerge from this analysis, in order to ensure the credibility and independence of such a mechanism: *independence, public accountability and effectiveness.*<sup>1</sup>

To ensure the *independence* of the mechanism, members should be chosen from outside the institution, and their budget should be independent and adequate. For instance, the Bank's Inspection Panel was criticised because panel members were nominated by the Bank President and approved by

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<sup>1</sup> See for instance Hunter, D (undated). *The World Bank's Inspection Panel: Will it increase the Bank's accountability?* Centre for International Environmental Law.

the Executive Directors; panel members were subject to the requirements of the Bank's Articles of Agreement that demand exclusive loyalty to the Bank; and the President decided the salaries for the members.

For *PUBLIC ACCOUNTABILITY*, the public should have access to every stage of the investigation. The Inspection Panel was criticised for excluding the public from access until after the Bank's Executive Directors consider the reports – thus excluding the public from the very stage where additional comment and information concerning panel findings could be important to the Directors' decisions.

For *EFFECTIVENESS*, the mechanism must have the authority to ensure that their recommendations are acted upon. The power of the World Bank's Inspection Panel is limited - nothing in the resolution through which the Panel was formed commits the Bank to rectifying problems uncovered by panel investigations. The Bank President is only required to respond to panel findings by informing the Executive Directors of actions that she or he intends to take, if any. The Executive Directors resolve any conflicts between panel findings and staff responses.

## F. Conclusions

In recent decades civil society organisations have contributed towards making the existing global governance system, such as it is, more accountable and transparent. They have also proved their ability to implement projects and activities that promote innovative solutions, often at lower costs. Often, they have better access to target audiences, are able to promote better synergies and contribute to more effective monitoring.<sup>i</sup>

Civil society can lend legitimacy to existing global institutions that currently function in a (global) democratic vacuum where affected communities have no representation in decisions that affect their lives. However, global institutions must be willing to earn such legitimacy, by providing civil society with the conditions and resources they need to be effective. Civil society must be engaged from the very start, during the design of institutional architecture and policies, to ensure a well-integrated *process* rather than staggered events such as the GEF NGO Consultation or the CIF Partnership Forums.

At the same time, civil society must take steps to promote more accountability in its own functioning, and refuse to engage with processes that call such accountability into question. In their own functioning, they must be wary of repeating the very mistakes they seek to correct.

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<sup>i</sup> Bleaney, A. and Saint-Laurent, C. (2009). Review of practices on NGO/ CSO participation and recommended measures for NGO representation at meetings of the CIF Trust Fund Committees. IUCN

## List of Acronyms

ADF	Autonomous Development Funds (Africa)
AF	Kyoto Protocol Adaptation Fund
AFB	Adaptation Fund Board
AWG-LCA	Ad Hoc Working Group on Long-term Cooperative Action under the Convention
BAP	Bali Action Plan
BNDS	National Social and Economic Development Bank (Brazil)
CCM	Country Coordinating Mechanism
CCSAP	Climate Change Strategy and Action Plan (Bangladesh)
CCSR	Climate Change Sectoral Roadmap (Indonesia)
CDM	Clean Development Mechanism
CDMF	Clean Development Mechanism Fund (China)
CER	Certified Emissions Reduction
CGCF	Copenhagen Green Climate Fund
CIAF	Carbon Intensity Adjustment Factor
CIF	Climate Investment Fund (World Bank)
CMP	Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol
COP	Conference of Parties
CPIA	Country Policy and Institutional Assessment (World Bank)
CPR	IDA Country Performance Rating
CRS	Creditor Reporting System
CSO	Civil Society Organization
DAC	OECD Development Assistant Committee
DFE	Designated Funding Entity
EB	Executive Board
GBI	GEF Benefits Index
GEB	Global Environmental Benefit
GEF	Global Environment Facility
GEF TF	GEF Trust Fund
GF	Global Fund to Fight AIDS, Tuberculosis, and Malaria
GHG	greenhouse gas
GOB	Government of Bangladesh
GOI	Government of Indonesia
GPI	GEF Performance Index
IAASB	International Auditing and Assurance Standards Board
IAPAL	International Air Passenger Adaptation Levy
IBRD	International Bank for Reconstruction and Development
ICCTF	Indonesia Climate Change Trust Fund
IDA	International Development Association
IFAC	International Federation of Accountants
IFI	international financial institution
INC	Intergovernmental Negotiating Committee
INTOSAI	International Organization of Supreme Audit Institutions
IRAI	IDA Resource Allocation Index
LCA	Long-term Cooperative Action
LCAP	Low Carbon Action Plans
LDCF	Least Developed Country Fund
LDCs	Least Developed Countries
MAC	marginal abatement cost
MDB	Multilateral Development Bank
MDB	Multilateral Development Bank
MDTF	Multi-Donor Trust Fund for Climate Change (Bangladesh)

MF	Multilateral Fund
MIE	Multilateral Implementing Entities
MLF	Multilateral Fund
MOF	Ministry of Finance (China)
MOP	Meeting of the Parties
MOU	Memorandum of Understanding
MRV	Measurable, Reportable and Verifiable
NAMA	Nationally Appropriate Mitigation Action
NAPA	National Adaptation Programme of Action
NCP	National People's Congress (China)
NIE	National Implementing Entity
ODA	Official Development Assistance
ODS	Ozone Depleting Substances
OOF	Other Official Flows
POP	persistent organic pollutant
PPCR	Pilot Programme for Climate Resilience
RAF	Resource Allocation Framework
R-CEROs	Retirement CER Obligations
RDBs	Regional Development Banks
REDD	Reduced Emissions from Deforestation and Degradation
RFM	Reformed Financial Mechanism
RFM1	original RFM proposal
RFM2	Extended Reformed Financial Mechanism
SCCF	Special Climate Change Fund
SIDS	Small Island Developing States
STAP	Scientific and Technical Advisory Panel
TNAs	Technology Needs Assessments
TRP	Technical Review Panel (of GF)
TT	Technology Transfer
UNEG	United Nations Evaluation Group
UNFCCC	UN Framework Convention on Climate Change
WP-STATS	DAC Working Party on Statistics

## Endnotes

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- <sup>10</sup> Ernesto Zedillo et al., *Repowering the World Bank for the 21st Century: Report of the High Level Commission on Modernization of World Bank Group Governance*, October 2009: p.x.
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- <sup>12</sup> Procrustes, in Greek mythology, had an iron bed on which he compelled his victims to lie. If a victim was shorter than the bed, he stretched him by racking the body to fit. If he was longer, he cut off his legs to make the body fit the bed's length. In either case the victim died. (See 'Procrustes' (2009) in *Encyclopædia Britannica*.)
- <sup>13</sup> The philosophical principle referred to by the nineteenth century Scottish philosopher Sir William Hamilton as '*Ockham's razor*' (also known as *principle of economy/parsimony*) is attributed to 14th century English logician William of Ockham and sometimes expressed as *pluralitas non est ponenda sine necessitate*; (plurality should not be posited without necessity), or *entia non sunt multiplicanda praeter necessitatem* (entities should not be multiplied unnecessarily). See, for example, Panaccio, Claude (1998), 'William of Ockham'; or Craig, Edward (1998), 'Pluralism', both in In E. Craig (Ed.), *Routledge Encyclopedia of Philosophy*, Routledge, London; or 'Ockham's razor' (2009) in *Encyclopædia Britannica*.
- <sup>14</sup> For more on the RFM proposal, see [www.oxfordclimatepolicy.org/publications/mueller.html](http://www.oxfordclimatepolicy.org/publications/mueller.html)
- <sup>15</sup> For more on this, see, for example, 'Message from the ecbi Director' in *ecbi Annual Report 2007/08*: pp.3-4. Available at [www.eurocapacity.org](http://www.eurocapacity.org).  
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- <sup>21</sup> See Dräger, S., G. Gedick, and M. R. Del Poz (2006) “Health workforce issues and the Global Fund to fight AIDS, Tuberculosis and Malaria: an analytical review” *Human Resources for Health*, 4:23 (available at: <http://www.biomedcentral.com/content/pdf/1478-4491-4-23.pdf>).
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- <sup>23</sup> See: Berwick, D. (2002), ‘A learning world for the Global Fund’, *British Medical Journal*, 325, 55–6 Available at: [www.ncbi.nlm.nih.gov/pmc/articles/PMC1123621/?log%24=activity](http://www.ncbi.nlm.nih.gov/pmc/articles/PMC1123621/?log%24=activity)
- <sup>24</sup> Benito Müller and Luis Gomez-Echeverri, *The Reformed Financial Mechanism of the UNFCCC. Part I: Architecture and Governance*, Oxford Institute for Energy Studies Background Paper EV45, April 2009. Available at: [www.oxfordclimatepolicy.org/publications/mueller.html](http://www.oxfordclimatepolicy.org/publications/mueller.html)
- <sup>25</sup> x.9 *The national entities, designated by the developing country Parties, shall approve funding for projects, programs, actions, subject to the guidelines and procedures established by the specialized thematic assessment units duly approved by the Executive Board. The thematic assessment units under the Executive Board shall carry out the relevant assessments for disbursement of funds to the designated national entities under their respective specialized funding windows.*
- x.12 *The designated national funding entities could also accept contributions directly, as per guidelines agreed in the COP, from and facilitate linkages with other private or official national, regional, subregional, international bodies and/or stakeholders that may seek to implement actions relating to mitigation, adaptation and technology transfer and related activities directly.*[FCCC/AWGLCA/2009/INF.1:p.159]
- <sup>26</sup> On how this might be achieved, see Benito Müller, *Is There Room for Compromise? The Debate on Institutional Arrangements for Climate Finance*, Oxford Energy and Environment Comment, October 2009, available at [www.oxfordclimatepolicy.org/publications/mueller.html](http://www.oxfordclimatepolicy.org/publications/mueller.html)
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- <sup>29</sup> Decision 5/CMP.2.
- <sup>30</sup> Presidency of the Republic of Brazil, Civil House (Executive Office), Legal Affairs Sub office, Law no. 12, 114, of 9 December, 2009.
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- <sup>34</sup> Agarwal, A et al. (1999), *Green Politics: Global Environmental Negotiations – 1*, Centre for Science and Environment, New Delhi, pp. 33, 37
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- 41 [www.unep.org/OZONE/pdfs/Montreal-Protocol2000.pdf](http://www.unep.org/OZONE/pdfs/Montreal-Protocol2000.pdf)
- 42 [www.unep.org/OZONE/pdfs/Montreal-Protocol2000.pdf](http://www.unep.org/OZONE/pdfs/Montreal-Protocol2000.pdf)
- 43 UNEP/OzL.Pro/2/3 Decision II/8, para. 7. The United Nations scales are adjusted to ensure that no one Party is assessed in excess of 22 per cent of the total. Furthermore, no contribution shall be required when the UN scale leads to a contribution of less than 0.1 per cent of the total.
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