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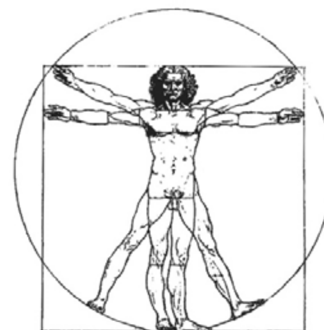

ecbi policy brief

2009 Bonn Seminar

On Future Financial Architecture & Governance

Benito Müller

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Table of Contents

Executive Summary 1

A. The Seminar Presentations 3

1. The Compact Model 3
2. The Swiss Proposal 3
3. The Prince's Rainforest Project (PRP) 3
   Institutional arrangements in Rainforest Nations *4*
   New International Architecture: A Tropical Rainforest Facility (TRF) *4*
   Compatibility with the RFM proposal *5*
4. The Reformed Financial Mechanism (RFM) Model 5
   Political Oversight *5*
   Independent Oversight *6*
   Compliance Oversight *6*

B. The Seminar Discussion 7

C. The AWG/LCA.6 Finance Text 8

D. Conclusions and Way Forward 10

1. Coordination or Consolidation? 10
2. Coordination and Consolidation! 10
3. The Way Forward 11

Endnotes 12

Executive Summary

This ecbi Policy Brief is based on the presentations and discussion at the 2009 round of the annual ecbi Bonn Seminars held on 7 June 2009 at *La Redoute* in Bonn/Bad Godesberg, during the sixth session of the Ad-hoc Working Group on Long-term Cooperative Action (AWG-LCA). Unlike previopus meetings, this event was focused on a single theme, namely the future of climate change finance, with a focus on institutional and governance issues. For this reason it was also decided to replace the usual proceedings with a more analytic policy brief, based also on the draft negotiating text on *enhanced action on the provision of financial resources and investment* that emerged from the negotiations.

The Seminar began with a number of presentations of architectural and governance proposals – the UK ***Compact Model***, the Swiss ***Multilateral Adaptation Fund*** Model, the ***Reformed Financial Mechanism*** proposal and the ***Tropical Rainforest Facility*** proposal of the Prince of Wales' Rainforest Project (see Section A). The thread uniting these proposals is that they all incorporate in some way two key design principles, namely

- the ***devolution of funding decisions*** to the recipient country-level, and
- the ***consolidation of funding streams*** both at the national and the international level,

− principles that later in the week found themselves reflected in language introduced by India into the LCA finance negotiation text (see Section C).

In the discussion that followed (see Section B) it became clear that while the idea of

devolution and consolidation at the national level was not really an issue, the idea of consolidating funding streams at the international level faced a number of detractors among developed countries (although that sentiment was by no means unanimous). There are a number of important developed country actors who not only feel that the acknowledged problems of the current fragmented funding model could be overcome by (i) ***increased coordination***, and (ii) ***making 'fit for purpose' existing institutions***, but also that creating any form of 'centralized' system would be too cumbersome to work. The latter may indeed be correct, if the 'centralization' envisaged refers to a consolidation without devolution. But in the context of the models considered here, this is clearly not the idea. The international consolidation only makes sense in the context of a throughput ('money-in-money-out') consolidation at the international level, with all funding-related decisions (priorities, evaluation, approval and monitoring of projects/programmes) is devolved to the recipient country level.

The resistance even to such a ***throughput model***, however, continued, not least on the grounds that it would take time to establish not only the consolidated fund for the financial mechanism, but particularly the '***designated national funding entities***' (Indian LCA language).It was argued that, since we do not have the luxury to wait for this to happen, we are left with having to make do with (an improved version of) the current system. Notwithstanding the fact that these improvements of existing entities would also not be instantaneous, it is clear that establishing the national funding entities will indeed be a gradual process. Yet, as came out in the discussion, this very fact may provide the room for compromise between the international 'coordination' and 'consolidation' camps.

The fact that any devolved system will have a transition phase during which more and more national funding entities are established means that the demand for internationally consolidated funding will also begin modestly and increase gradually. This leaves the possibility (see Section D) of designing a ***transition phase from coordination to consolidation***: this would give the consolidated devolved model the proof-of-concept opportunity needed to convince the status quo critics (or to be abandoned by mutual consensus if it fails to prove itself).

What are the steps that could lead to such a transition scenario? The key is, of course, to ***establish a new operational entity/consolidated fund for the UNFCCC financial mechanism***, headed by an Executive Board, with devolved decision-making to designated national funding entities (as suggested in the LCA negotiating text). In order not to overburden the mechanism during its start-up phase, it is essential to ***limit its operations to two core thematic windows***. At the same time, the newly established Executive Board should be charged with establishing a general Climate Registry to accommodate the general coordination concerns. Last, but by no means least, one will have to devise a ***demand-driven*** dynamic contribution regime, such that a minimum of 80% of the agreed funds for Parties with established national entities are disbursed through the consolidated financial mechanism. This will ensure a predictable and transparent transition from the status quo to the consolidated and devolved approach.

As there is significant cross-Party support for the idea of a consolidated and devolved financial mechanism, there is a reasonable chance that, with sufficient political will, this strategy could work and bring about the ***much needed crucial first success*** in the current negotiations, without which there will be no outcome either on financial or any other targets in Copenhagen!

A. The Seminar Presentations

1. The Compact Model

Hannah Ryder (DECC, UK) gave an update on the latest thinking regarding the Compact Model. She described the current international climate change funding as complex and fragmented, with difficulties in measuring flows and results, as well as having a small-scale focus on projects and limited responsiveness to recipients priorities. The Compact Model was presented as a compromise between a 'centralized' and a 'decentralized' decision model. The former would see funding decisions taken centrally at the international level (as envisaged in the original G77/China proposal for the future UNFCCC financial mechanism), while the latter would leave them to a diversity of international and bilateral agencies (World Bank, GEF, bilateral donors etc.). Neither would necessarily be desirable or palatable to contributors or recipients. The Compact Model is meant to overcome this by putting 'function before form'. In particular, it would

(i) ***devolve specific decisions about spending*** of bilateral, carbon market and multilateral finance to recipient countries, based on priorities identified in their plans, drawn up with the involvement of national stakeholders such as civil society, etc, and
(ii) ***channel multilateral finance*** via an independent High-level Body (HLB).

The envisaged HLB would follow the COP's guidance to regularly decide on and review general priorities for climate finance (e.g. between mitigation/adaptation/technology, etc), and decide to what institutions/funds/bodies this finance should be given to spend, provided those institutions/funds/bodies had balanced representation and were working towards other international priorities identified in the Copenhagen agreement such as country-allocation criteria, programmatic delivery, etc. It was argued that only such an overhaul will provide the incentives for the financial architecture to become fit for purpose, capable of operating at scale and sufficiently demand driven.

2. The Swiss Proposal

Reinhard Gasser (Federal Office for the Environment, Switzerland) gave a brief presentation of the ***Swiss Proposal***. Although mostly known for including the idea of a global carbon tax, the Swiss proposal also contains some very interesting architectural features which have been underplayed in the debate on climate change and which fit with the idea of consolidation and devolution. The model envisages ***National Climate Change Funds*** for *all* countries, covering both adaptation and mitigation activities. The carbon tax revenue collected in country is, in part, to flow directly into these national funds, and in part into a consolidated ***Multilateral Adaptation Fund*** (MAF). The MAF is to disburse about $18bn annually to developing countries through two different thematic windows ('Pillars'), namely

(i) a *Prevention Pillar*: Climate change impact (risk) reduction.
(ii) an *Insurance Pillar*: Climate impact response: relief, rehabilitation, recovery.

3. The Prince's Rainforest Project (PRP)

The Rainforest Programme of the Prince of Wales aims to put together an ***emergency package for tropical rain forests***. As it is not as well known in climate circles as the other proposals that were presented, it warrants a slightly longer summary of the presentation by Paul McMahon from the Prince's Rainforest Programme.

The idea is to deliver significant reduction in deforestation within 2-3 years by providing

sufficiently strong financial incentives to Rainforest Nations ***to cover the opportunity costs*** of switching to a low-deforestation development trajectory by ***paying for performance at a national-level using simple, verifiable metrics*** (e.g. hectares of avoided deforestation per year). It is envisaged that, based on opportunity costs, capacity building etc, it may at peak require $10-$15bn annually to halve emissions from tropical deforestation.

For this purpose, it is envisaged to create a light, temporary global institutional framework ('Tropical Rainforest Facility') that

(i) coordinates multiple existing forest initiatives
(ii) facilitates and accelerates the transition to a long-term UNFCCC REDD solution, and
(iii) respects national sovereignty of Rainforest Nations – allowing them to develop and execute their own low carbon development plans

Given the focus of the Seminar on governance and financial architecture, the key part of the presentation was on the institutional arrangements envisaged in the PRP proposal.

INSTITUTIONAL ARRANGEMENTS IN RAINFOREST NATIONS

Realizing that reducing deforestation requires involvement of all stakeholders in a country – central government, local government, private sector, local communities, indigenous peoples, etc., the PRP envisages the possibility of establishing special ***national funds*** in each of the eligible recipient countries (similar to the Brazilian Amazon Fund: see Box 1), governed by boards containing central and local government representatives, as well as representatives from civil society. These national funds would have to fulfil a number of design requirements before they could participate in the scheme. For one, forest dependent peoples would have to be consulted in the framing of national low carbon development plans. There would also have to be full transparency on the use of funds, including ***external audits*** and an ***appeal procedure*** for local communities. As to beneficiaries, the PRP proposal envisages a variety of implementing actors, ranging from governments (to change policies and build institutions on or off budget), civil society (for community-level projects), to the private sector (for incentives and support to shift activities away from forests).

Box 1. The Amazon Fund

The Brazilian Amazon Fund aims to reduce deforestation 80% by 2020 (relative to 1996-2005 average) and is replenished by donations. It is governed by a ***Steering Committee*** − with members from the Federal and Amazon State Governments, as well as from NGOs, indigenous peoples, the business sector, or scientists − which defines guidelines and criteria for projects. There is a six-member ***Technical Committee*** verifying avoided deforestation and emissions, an ***Independent Project Auditor,*** and a ***Trustee*** (Brazilian Development Bank). The Fund allows for a variety of ***project implementers***, among them the Federal and local Governments, civil society, international NGOs, and the private sector.

NEW INTERNATIONAL ARCHITECTURE: A TROPICAL RAINFOREST FACILITY (TRF)

The PRP envisages a 'Tropical Forests Facility' at the international level charged with negotiating agreements with Rainforest Nations, raising finance from developed countries, disbursing annual performance-based payments, and coordinating a global monitoring and verification system.

The governance of the TRF would include representatives from Rainforest Nations, donor countries, civil society, local communities and multi-lateral agencies. One idea that is being considered is to establish a new, independent foundation, backed by governments and perhaps supported by the World Bank as Trustee (along the lines of the Global Fund to Fight Aids, TB and Malaria, headquartered in Geneva).

COMPATIBILITY WITH THE RFM PROPOSAL

The presentation ended with a short discussion of the compatibility of the PRP proposal with the idea of a Reformed Financial Mechanism (see below). The proposed national funding and decision-making hubs, with flexibility for on-budget and off-budget support, are clearly consistent with the RFM approach, as is the requirement for transparency and external auditing and the use of consolidated (annual) disbursements. Indeed, reducing emissions from deforestation could become as one of the 'thematic disbursement windows' under the RFM proposal and the TRF could transform into such a window if the RFM structure becomes fully operational.

4. The Reformed Financial Mechanism (RFM) Model

The RFM proposal[i] is similar not only to the Compact Model (see above), but also to the proposal submitted by India to the LCA negotiations, as reflected in the current AWG-LCA negotiation text (see below). It is based on two key design principles, namely (i) devolution of decision-making and (ii) consolidation of funding streams (both nationally and internationally). There were three short presentations on some preliminary results of a project (RFM.2) on 'oversight' under the RFM.

POLITICAL OVERSIGHT

Benito Müller gave a presentation on preliminary RFM.2 findings on 'political oversight,' referring to two issues: (i) the relationship between the COP and the RFM Executive Board, particularly with respect to budgeting decisions, and (ii) the manner of determining the size of country disbursements. The analysis was using the idea that the relationship in question could be interpreted as that between a legislative and an executive branch, and involved four national case studies, on China, India, US, and Switzerland.

Regarding the 'power relationship' between the executive and legislative branches of these countries in the national budgeting process, there was no general pattern. What was interesting, however, was that the existing power relations were exactly the opposite of what one would expect from the debate of the relationship between the COP, and an Executive Board *qua* legislative and executive branch of the financial mechanism, respectively. In the developed countries studied, the executive branch has practically no say in the budgeting process, while in the developing one, the powers to determine the budget lay mostly with the executive branch.

It was suggested that '***being under the authority' has a minimal meaning***, differentiating it, in particular, from having an 'MoU relationship'. While the latter is a relationship between two independently existing entities or bodies (e.g. the GEF Council and UNFCCC COP), the former ('being under the authority') entails minimally that the entity with the authority can select the members of, or indeed dissolve, the subordinate body.

As to the issue of ***disbursement of funds to countries***, the project had looked at the way in which, if at all, the countries dealt with the issue of redistributing federal/central fiscal revenue to sub-national (state/provincial) governments. As it turned out, this was not only a general practice, but – for reasons of fairness and transparency – it was largely based on some form of distribution formula. This led to the conclusion that a formulaic approach to resource allocation can be acceptable, but only if – unlike in the case of the ill-fated Resource Allocation Framework of the GEF − the formula is generally acceptable, which in turn depends on the acceptability of the process under which it is adopted. This is why political ownership by recipients of the governance becomes crucial in this context.

INDEPENDENT OVERSIGHT

The RFM model envisages both ***internal and external independent oversight*** including (i) (financial, compliance, performance) auditing, (ii) monitoring and evaluations, and (iii) a complaints procedure. The interim results on this topic were presented to the Seminar by Luis Gomez-Echeverri.

At the ***international level***, the internal oversight needs to cover financial, compliance and performance monitoring and evaluation of the internal activities (Board, Assessment Units, Secretariat, Expert Panels) which could be carried out by the *UN Office for Internal Oversight Services* (OIOS) or by more technical monitoring and evaluation dedicated services at the Secretariat. The internal oversight is also meant to cover a complaints procedure covering malpractice at the level of the internal or contracted external institutions of the RFM. External auditing needs to cover the same types of audits (on a spot check basis). The institutional scope needs to go beyond the internal bodies to include contracted institutions, such as the RFM Trustee and the in-country Climate Change Funds (following accepted practices). Institutionally, the external auditing could be carried out by the UN Board of Auditors (BOA), or – given the size of the task – perhaps – and to be explored - by a newly dedicated *Board of Auditors* for the FM, based on the model of the UN BOA. ***Nationally*** external oversight is principally to be carried out by the relevant national Supreme Audit Institutions ('National Audit Offices'), following guidance from the Board of Auditors (approved by the COP). The RFM will reserve the right to carry out external spot checks, following, for example, UNDP practice with nationally executed projects.

As to precedents with regards to standards and best practices, there are a very large number to be considered, such as

- National Audit System Practices
- Audit Arrangements in International Institutions : International Organization of Supreme Audit Institutions (INTOSAI)
- World Bank Group and IFIs
- UN family of organizations: Standards established and applied across the board
- Global Funds and Programs
- International and National NGOs

COMPLIANCE OVERSIGHT

The RFM envisages a system of Certification and Registration (C&R) of financial flows in order for them to be counted against compliance with (future) financial commitments under the Convention. Certification is required if, as is likely, the COP will decide that not all financial flows will be eligible to count towards compliance. The envisaged C&R system, while related to the notion of 'MRV support,' should not be mistaken for it. 'MRV support' is, on the one hand, specifically directed to NAMAs (Nationally Appropriate Mitigation Actions), and, on the other, encompasses support other than of a financial kind. C&R is neither: it is concerned only with financial flows, but not exclusively with supporting mitigation. A number of different kinds of flows may be considered for certification – and certified if they satisfy the relevant criteria, namely (i) contributions to UNFCCC funds, (ii) bilateral flows (e.g. for 'climate proofing' ODA), and even certain private sector flows (such as those involved in retirement CER obligations).[ii]

B. The Seminar Discussion

The discussion that followed the presentation was far-reaching. It would go beyond the scope of this brief to report on more than a number of points that were raised with respect to the key issues of consolidation and devolution.

With respect to the latter, there was consensus that given the expected size of financial flows, ***there is no alternative to devolving funding decisions to the recipient country level***. Indeed, the idea of consolidating climate change funding at the national level was generally well received, although there was a worry that this might entrench sectoral divisions. 'If you fund a dam from an infrastructure fund and add a meter because of climate change, it does not make sense to fund this additional meter from a different funding stream, planned by a different institution.' However, given that the governing bodies of the envisaged domestic climate change funds/hubs were meant to design the countries' climate change strategies, and as such to involve all the relevant stakeholders, this worry seems unwarranted, at least for domestically funded ('on-budget') development activities. The situation is, of course, slightly different for bilateral off-budget ODA projects where it would indeed be awkward if the climate proofing money would have to be channelled separately from the development funds. But, as mentioned above, this can be accommodated in an appropriate certification and registry system.

By far the larger part of the discussion was on the contentious issue of ***international consolidation*** of funding streams. The Multilateral Fund (MF) of the Montreal Protocol − with its binding assessed contributions, and the requirement that Parties must contribute at least 80% of their commitments to the MF (with the option to carry out the remainder bilaterally) − was put forward as an example of consolidation in practice. There was consensus that the MF was working well, and that one of the reasons was its being 'compliance-driven.' With respect to the ***80% consolidation rule***, it was pointed out that most Parties actually contribute more than their mandated 80% share to the fund, not only because this is less onerous than carrying out bilateral projects, but also because of the compliance regime. When it comes to assuring compliance, it is easier to put the remaining dues into the fund than to go looking for a project.

However, it was also suggested that the consolidation rule of the MF was only acceptable because of the relatively small sums involved and the fact the MF is seen as a time-limited instrument. In other words, the argument was that developed countries (treasuries and/or parliaments) would not agree to the same rule in the context of the much larger sums required for addressing climate change in developing countries. Hence, it was suggestedthat there is a need for a ***functioning MRV and coordination system*** to overcome the problem of 'darlings' and 'orphans' (i.e. preferential choices by donors of some countries, leaving out others) and of imbalances of funding between themes due to donor preferences (e.g. with most of the funding going to mitigation)

At the same time, it was acknowledged that developing countries have not unreasonably been complaining about ***too many fragmented funding streams***, including vertical funds. Thus it would indeed not be reasonable to create a new funding stream under the financial mechanism without a significant degree of consolidation, i.e. of merging existing streams.

Another topic raised during the discussion was that of ***new versus existing institutions***. While there was an agreement that (improved versions of) ***existing institutions would have a role to play*** in the future climate financing, it was also suggested that − given the scale of operations − we will inevitably have to create new bodies, either to oversee a consolidated financial mechanism or to coordinate a scaled-up version of the existing funding system. It

was also pointed out that new institutions will take time to start-up, and that there is a need for immediate action which could only be achieved through existing institutions. This led to an interesting discussion of a potential dynamic evolution of the future funding regime, under which the current fragmented system gradually becomes consolidated, and where the body that oversees the consolidated fund also provides the forum for coordinating the remaining fragmented funding channels.

C. The AWG/LCA.6 Finance Text

The 6th meeting of the Ad-hoc Working Group on Long-term Cooperative Action (AWG/LCA.6) generated a text – based on an earlier Chair's draft – that will be the basis for the negotiations on the future financing regime in general, and the UNFCCC financial mechanism, in particular. Given its early stage, the document is not surprisingly still rather bewildering, even if one focuses only on the sections concerning *institutional arrangements, including funds* (pp. 16–29). While space limits a detailed analysis of the different elements in the context of this brief, a rough overview and some quotations may be helpful to prepare for the concluding discussion in the next section.

The substantive text on institutional arrangements begins with detailed language on operationalizing the financial mechanism submitted by the Government of India, which will be discussed presently. This is followed by language reflecting the original G77+China proposal (the basis of the Indian submission).

Following that, there are a number of proposals to manage a *financial framework and the related facilitative mechanism and bodies* and to *make efficient and effective use of current institutions, including the GEF, multilateral development banks, specialized UN institutions and other existing funds, as well as specific funding windows … with financial support provided by developed country Parties and availed of by developing country Parties through bilateral, regional and other multilateral channels, in accordance with Article 11.5 with a robust system of measurement, reporting and verification of financial resources provided through these channels.*

The third part of the text is essentially a list of themes (thematic funds, funding windows) on what the funding could be used for, ranging from a Multilateral Technology Acquisition Fund, a Venture Capital Fund and a Convention/Multilateral Adaptation Fund to a Capacity-building Fund, Solidarity Funds and insurance mechanisms, and even a Special Fund for the Economic and Social Consequences of Response Measures. The language proposed by India (see Box 1) is of particular interest in this context for a number of reasons:

- First of all, unlike the spending options listed in the third part of the text, it describes an architectural framework which could accommodate most of these options as thematic windows.
- Second, while it fully subscribes to the above-mentioned principles of devolution and consolidation, it also envisages a *coordination of financial resources*, deemed essential for fragmented funding.
- Third, it appears to subscribe to the minimum interpretation of 'being under the authority' (see A.4) in the Executive Board *being appointed by* the COP.

Box 1. The Indian Submission on operationalizing the UNFCCC Financial Mechanism

e. *The Financial Mechanism, established under the Convention, will be managed by an Executive Board appointed by the COP in accordance with the Convention. The Executive Board shall have an equitable and balanced representation of all Parties within a transparent system of governance and shall function under the guidance of and be accountable to the COP which shall decide on its policies, program priorities and eligibility criteria. The Executive Board will be supported by a professional Secretariat.*

f. *The Financial Mechanism, established under the Convention, shall have separate specialized windows for funding projects, programs and actions aimed at mitigation, adaptation and technology transfer. Each of the funding windows shall be assisted by a specialized thematic assessment unit. The thematic assessment units shall be under the authority of the Executive Board and, together with the professional secretariat of the Executive Board, shall constitute the operating entity of the Financial Mechanism.*

g. *The Funding provided by the Financial Mechanism established under the Convention should be demand driven and enable direct access to funds by the ultimate beneficiaries.*

h. *A Trustee selected through open competitive bidding among reputed pre-qualified institutions would administer the funds of the Financial Mechanism established under the Convention.*

i. *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.*

j. *A transparent, efficient and competitive procurement regime with conditionalities limited to those warranted by prudent fiduciary norms and the MRV regime foreseen under Decision 1/CP 13 should characterize funding from the Financial Mechanism established under the Convention.*

k. *The Financial Mechanism established under the Convention shall manage a certification and registry system for receiving and deploying financial resources to enable developing country Parties to count their financial contributions and technology support towards compliance of their commitments under the Convention and under paragraph 1(b) (ii) of Decision 1/CP 13.*

l. *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, sub-regional, international bodies and/or stakeholders that may seek to implement actions relating to mitigation, adaptation and technology transfer and related activities directly.*

m. *The Executive Board of the Financial Mechanism, with approval of the COP, shall institute suitable external independent oversight as well as internal monitoring and evaluation of the management and operation of the Financial Mechanism established under the Convention.*

n. *The resources of the Financial Mechanism established under the Convention shall be used to meet the costs associated with the functioning of the Executive Board, the Secretariat and the thematic assessment units, subject to the approval of the COP.*

o. *Institutional arrangements for the operation of the financial architecture have the following functions including, inter alia:*
   (i) *assessment of needs for financial resources for the fulfilment of this Agreement;*
   (ii) *effective use of resources, including those generated under paragraphs x;*
   (iii) *coordination of financial resources, including those generated under paragraphs x for the fulfilment of this Agreement;*
   (iv) *measurement, reporting and verification/monitoring and review.*

p. *The institutional arrangements shall be periodically reviewed to assess its fulfilment of these functions.*

D. Conclusions and Way Forward

1. Coordination or Consolidation?

No one seems to deny the unfitness-for-purpose of the current fragmented funding regime for the purpose of handling the level of funding required. The question is 'merely' whether it can be sufficiently improved through some form of 'coordination,' or whether it has to be 'defragmented' through consolidation of the funding streams. Opinions are, not surprisingly, divided. A recent Options Paper[iii] on institutional architecture, for example, proposes a '***Climate Registry***' as a compromise between two 'polarized options': a 'fully decentralized' model and a fully centralized' one, said to be espoused by developed and developing countries respectively.

The idea is *to align country needs with financial resources and expertise provided by contributing countries or made available from market sources.* This 'alignment process' is meant to use two kinds of inputs. First, it requires *statements of national objectives, needs and financing requests.* Second, it needs information about the flow of *private sector and carbon market finance, national budgets, bi- and multilateral financing and financing from COP-mandated funds provided through public resources*. The combination of these two sets of data is then meant to allow public institutions and private investors *to align their specialized financial and technical products with the registered needs of individual countries*.

The Registry is to be managed by an 'Operating Body' described as *the principal business entity of the COP*. One of the three functions of this OB is *to manage the COP-mandated funds for adaptation and mitigation* […] *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. In addition, managing public resources channelled through COP-mandated funds is absolutely critical in absorbing business risks that the private sector will not absorb; it is equally critical to provide resources for additional costs associated with creating enabling conditions such as policy, institutional and regulatory reforms*. In other words, not only is the Climate Registry proposal compatible with the consolidated models discussed earlier, but the authors implicitly agree that there is a need for a ***significant degree of consolidation of public finance*** for the system to be fit for purpose.

2. Coordination and Consolidation!

In other words, 'big picture' coordination is not only compatible with public sector consolidation but cannot substitute for it. And the same holds the other way round. It is therefore not an issue of either coordination or consolidation, but of ***coordination and consolidation***! The latter is particularly critical for public sector finance. Fortunately, there is no inherent contradiction between the two functions. Indeed, as envisaged in the language submitted by India (Box 1), it is perfectly conceivable that the Executive Board of a consolidated financial mechanism could also be charged with managing the sort of 'big picture' Climate Registry mentioned above. Unfortunately, there are a number of significant obstacles, both political and pragmatic, to the notion of a significant consolidation of public financing.

(a) First, there is the reluctance of developed countries (treasuries/parliaments) to release significant amounts of money from their control, let alone commit large sums to a new

international body. To overcome this reluctance, the proposed reformed financial mechanism would have to demonstrate its advantages over the traditional fragmented funding model. This will be impossible in the absence of sufficient consolidated revenue. In other words, we seem to be facing a typical 'Catch 22' situation.

(b) On the practical side, it will take some time for the domestic climate change funding and decision-making hubs to be piloted and deployed in a sufficient number of countries for the international consolidated disbursement model to become effective. At present a number of such national hubs − such as the Bangladeshi Multilateral Trust Fund or the Indonesian Climate Change Facility – are under consideration, but all of them are still in the planning stage. Establishing the sort of consolidated financial mechanism envisaged in the Indian submissions will thus have to involve a transitional period to establish the required *designated national funding entities*.

There is, however, a positive side to this practical drawback, for it may well help in resolving the political Catch 22. The required level of consolidated funding will depend on the number of designated national funding entities. This means that under the likely assumption that establishing these entities will take some time and that their number will increase gradually, the need for consolidated public sector funding will initially also be modest and will grow gradually. In doing so, the consolidated funding model will be given the chance to prove itself through this transition period.

In order to ensure that these modest but growing needs for consolidated funding are actually met, one could − following the example of the Multilateral Fund (MF) of the Montreal Protocol – stipulate that Parties have to contribute 80% of the (agreed) financial entitlements of countries with approved designated national funding entities to the consolidated financial mechanism. In other words, if it is agreed that the approved designated funding entities should jointly receive x from Parties with financial commitments, then they should be obliged to contribute (at least) 80% of x to be disbursed by the financial mechanism This would ultimately lead to the same consolidation rule as currently applied in the MF, where Parties are required to contribute 80% of their financial commitments to the consolidated fund.

3. The Way Forward

What are the steps that could lead to such a transition scenario? The key is, of course, to establish a new operational entity/consolidated fund for the UNFCCC financial mechanism, headed by an Executive Board, with devolved decision-making to designated national funding entities (as suggested in the LCA negotiating text).

In order not to overburden the mechanism during its start-up phase, its operations must be limited to, say, two core thematic windows. At the same time, the newly established Executive Board would be charged with establishing a general Climate Registry to accommodate general coordination concerns

A 'demand-driven' dynamic contribution regime would have to be devised so that 80% of the funds required to cover the agreed contributions to Parties with established national entities are contributed to the consolidated financial mechanism for disbursement.

As there is significant cross-Party support for the idea of a consolidated and devolved financial mechanism, there is a reasonable chance that, with sufficient political will, this strategy could work and bring about the ***much needed crucial first success*** in the current negotiations, without which there will be no outcome either on financial or any other targets in Copenhagen!

Endnotes

[i] Benito Müller and Luis Gomez-Echeverri, *The Reformed Financial Mechanism of the UNFCCC: Architecture and Governance*, ecbi Policy Brief, April 2009

[ii] See, B. Müller and P. Ghosh, *Implementing the Bali Action Plan: What role for the CDM?* Oxford Institute for Energy Studies, Energy and Environment Comment, October 2008.

[iii] David Reed, Athena Ballesteros, Edward Fendley, Maria del Socorro Flores Liera, Jochen Harnisch, Saleemul Huq, Hans Olav Ibrekk, *The Institutional Architecture for Financing a Global Climate Deal: An Options Paper*, June 2009