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Working Paper

ALIGNING FINANCE TO DELIVER CLIMATE AMBITION AND CLIMATE RESILIENCE IN A 2015 CLIMATE AGREEMENT

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PURPOSE

It is not anticipated that the Conference of the Parties 21st Session (COP21) will be able to resolve every issue related to financing climate action; however, **Paris should provide a turning point in efforts to address the financial implications of decarbonisation and building climate resilience**. Considerable work will remain after the agreement has been delivered to develop and implement climate action.

This study considers the following:

- The financial challenges that will need to be addressed in the post-2020 climate agreement in order to secure an ambitious outcome and drive its implementation
- How the financial ecosystem[1] of climate change action could evolve in order to enable an ambitious outcome for both mitigation and adaptation
- Crucial climate finance policy options for the 2015 agreement that are both politically viable and deliver the outcomes required. The paper outlines these options but it does not provide an exhaustive attempt to capture all policies

CONTEXT

The New Climate Economy (NCE) report states that an estimated US$89 trillion of infrastructure investment will be required through 2030 to keep up with population and economic growth. A shift to low-carbon infrastructure will

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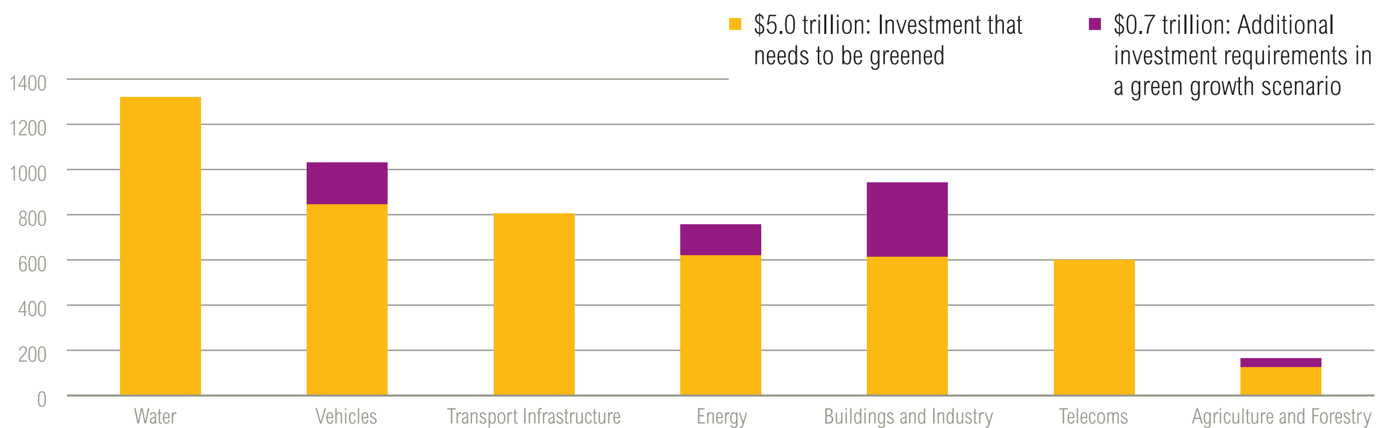
Figure 1 | **The Scale of the Investment Challenge**



Source: Green Growth Best Practice Initiative[4]

have an additional impact—a low-carbon transition across the entire economy could be achieved with only five per cent more upfront investment from 2015-2030.[2]

The World Economic Forum (WEF) argues that the incremental cost of investment in infrastructure to keep average global temperature rise below 2°C,[3] is US$0.7 trillion per year by 2020 (see Figure 1).

While there is no agreed-upon definition of climate finance, the Climate Policy Initiative (CPI), using its own definition[5] (which includes both public and private investments), estimates that climate finance totalled US$359 billion in 2012.[6] Therefore, the current levels of climate finance are inadequate to secure action that will limit temperature rises to below 2°C.

However, the NCE report also states that, "there is sufficient capital available to finance a low-carbon transition. Accessing this capital will require the right long-term policies..... Significant, near-term opportunities can reduce the costs of finance by up to 20 per cent for low-carbon energy in all countries through a mix of financial innovation, greater use of national development banks and concessional debt, and increased development capital flows into low-income countries."[7]

Because current levels of both public and private climate finance are dwarfed by the total investment required to avoid dangerous climate change, international public climate finance must catalyse broader shifts in financial investments to align them with sustainable development objectives.[8] The current approach is not fit for purpose to achieve the scale of shifts in financial investment that are required.

Despite the US$359 billion invested globally in climate actions (comprising public and private, domestic and international flows, in both developed and developing countries, including offsets), credible progress on securing the political commitment of developed countries to mobilise US$100bn per annum by 2020 for climate finance is slow. The US$100bn represents an obligation from developed countries to developing countries, and therefore not all investments can be counted. For example, domestic finance mobilized in developing countries does not comprise the $100bn obligation. Securing the US$100bn is essential if the legitimate concerns of many developing countries regarding the delivery of commitments are to be addressed. Tensions have arisen as to the specific nature of this undertaking. A number of issues have yet to be resolved, such as whether the US$100bn should all be "new and additional"[9] finance, whether and/or how the sources of private finance should be counted, and which financial instruments and channels should contribute to the US$100bn.

Unpublished analysis by the World Resources Institute (WRI) suggests that public climate finance alone is unlikely to reach $100bn[10] by 2020 unless the growth rate from current levels of assistance far exceeds historical precedents. The inclusion of private sector finance would allow the developed countries to meet the $100bn target, but meeting the target would require scenarios of high

growth rates and high leverage. However, focusing on what counts toward the US$100bn overlooks the ultimate objective, which is to secure high quality low-carbon, climate-resilient actions.

The Copenhagen approach to climate finance focused primarily on the quantity as opposed to the quality of finance available.[11] Relatively less attention has been paid to the effectiveness of these resources in delivering transformational impacts and creating the necessary shifts in investment patterns in real economies. In some cases, this is due to "gaming" from both developed and developing countries to deploy tactical agendas ahead of delivering outcomes.

International public climate finance alone will not solve the profound challenge of tackling climate change. Global decarbonisation and building resilience to the impacts of climate change will require all types of financial investments—public and private, domestic and international—to be redirected towards sustainable development objectives and outcomes. Therefore, international public climate finance must be deployed to achieve the highest quality outcomes in terms of catalytic and strategic results that will encourage a shift in existing investment towards transformative climate actions that can be replicated elsewhere and tip the balance of attention to climate.

The 2015 climate agreement will be negotiated in the context of emerging fiscal constraints in many developed countries. For example, within Western Europe, Gross Domestic Product (GDP) is expected to grow by only 1.5 per cent in 2014,[12] while the Japanese annual budget review forecasts just 1.4 per cent growth for the fiscal year 2014/15.[13] United States projections are more favourable (2.8 per cent according to the International Monetary Fund (IMF)).[14] Slow economic growth will complicate the issue of how developed countries will deliver on their existing commitments as part of a future agreement. This constraint reinforces the emerging and urgent focus on shifting broader financial investments, rather than focusing purely on the amount of public funds available for climate finance. Nevertheless, public climate finance will continue to play an important role in securing the 2015 agreement, as well as catalysing broader shifts in investments.

At the same time as negotiations continue under the United Nations Framework Convention on Climate Change (UNFCCC), Overseas Development Assistance (ODA) is under review as part of the post-2015 development agenda, with mixed expectations regarding how development finance and climate finance agendas and outcomes may be aligned.[15] Proposed reforms to be implemented through the Organisation for Economic Co-operation and Development—Development Assistance Committee (OECD-DAC) are due to be finalised in December 2014. They will include updates to the definition of ODA, with clearer rules about the measurement of private and concessional finance and better reporting of environmental aid (under the "Rio Markers").[16] These reforms provide an opportunity to align broader flows of development finance towards sustainable development objectives; they also have the potential to create false competition for a fixed pot of public money available for both the development and climate processes.

FRAMING CONDITIONS FOR A SUCCESSFUL OUTCOME ON CLIMATE FINANCE AS PART OF A 2015 AGREEMENT

Climate finance will play two critical roles in the 2015 climate agreement:

- Firstly, it is required to provide **the means and incentives** for countries to achieve a below-2°C outcome and to effectively build climate resilience
- Secondly, it is needed as a **signal of political intent** on the part of developed countries, which will help to rebuild confidence and trust amongst the parties regarding delivery of previous commitments to achieve agreement on future fair contributions

The 2015 agreement will, in significant part, require agreement on finance for the post-2020 timeframe, but it will also depend crucially on elements that create assurance for pre-2020 finance. Without a realistic understanding of how developed countries will mobilise and report on the US$100bn by 2020, the 2015 agreement in Paris is unlikely to be successful. In addition, meaningful contributions to the Green Climate Fund (GCF), as part of developed countries' commitments to the US$100bn, are a prerequisite if the agreement is to be considered successful and support the means of implementation in the run-up to 2020.

The post-2020 climate regime will need to ensure that international public climate finance serves to catalyse a shift in investment flows, such that

they deliver transformational outcomes and align broader financial investments consistent with a below-2°C outcome. It should also support the capacity and actions of countries seeking to build climate-resilient economies.

The sections below expand on the role of the three elements shown in Figure 2 in delivering a successful and ambitious climate agreement for 2015, which can shift international and national financial investments toward compatibility with a below 2°C outcome. They provide recommendations regarding the most effective direction of travel for the climate finance regime (that is, a broader scope than the international agreement alone). The sections outline some policy options that could be agreed in Paris to help secure the overall direction of travel, and lay out the implications of such policies and measures for both the short- and long-term future.

ACHIEVING PREDICTABLE PUBLIC CLIMATE FINANCE

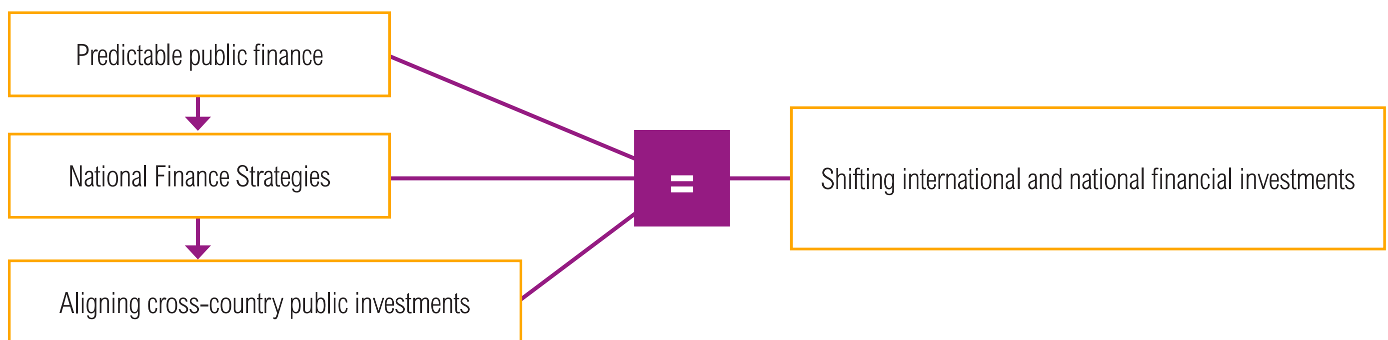
Developing countries require a significant degree of confidence in the consistency and the scale of international financial support that will be available, particularly if they are to plan for further increases in their mitigation contributions and build climate resilience into their development plans.[17] The lack of certainty regarding available finance raises the level of risk perceived by investors, thereby increasing the cost of decarbonisation.[18] Uncertainty over finance also reinforces uncertainty regarding future levels of mitigation action, which, in turn, contributes to uncertainty over the likely costs of adaptation. Predictability is recognised as a key requirement in financing for development,[19] and is considered essential to securing a more ambitious outcome in a 2015 climate agreement.

Predictability of public and private resources is of central importance to planning, programming and implementing activities. Predictability comprises three main elements—**a combination of measures will be essential to securing predictability:**

- Firstly, it requires some level of **certainty regarding the future scale** (and potential sources and timeframe) of financial support that will be provided
- Secondly, it **depends on clarity and transparency regarding the types of finance available and their impact** (for example, concessional, non-concessional, public, and private, etc.)
- Thirdly, predictability needs to be underpinned by **convergence and coherence of criteria and norms within the climate finance ecosystem** (that is, dissemination channels) facilitating the flow of climate finance towards actions achieving the greatest impact

The US$100bn commitment was a core feature of the Copenhagen Accord, yet the ambiguity of this commitment and the opacity in charting its delivery need to be addressed in order to rebuild confidence that developed countries intend to deliver on previous commitments. The ad hoc, voluntary, and mostly annual pledging/announcements of financial contributions that have taken place during the COPs in the post-Fast Start Finance period do not provide the requisite degree of assurance to recipients regarding the scale, consistency, and durability of financial support available. As noted earlier, establishing clarity and transparency regarding the progress towards future international public climate finance commitments in the pre-2020 timeframe will be critical to achieving an effective 2015 agreement. Forward-looking transparency of commitments will be essential beyond 2020.

Figure 2 | **Core Elements of the 2015 Agreement**



This will require a more uniform system (methodology, process and definitions) that facilitates the predictable supply and forecasting of international public climate finance and enhances the catalytic and/or learning impact, thereby improving the quality of outcomes it delivers. Going forward, the alignment of financial flows needs to be driven by common guidance and metrics, which can measure and compare mitigation and adaptation results, can better track financial flows to the national and local levels, and can distinguish between public and private sources.

The ecosystem of climate finance is currently fragmented and complex. Coherence between different providers of public climate finance is required to simplify and increase transparency of the highly fragmented ecosystem of climate finance. This process should include convergence towards criteria and norms that facilitate and streamline processes for: accessing climate finance, disbursing resources and enhancing the catalysing effect of future finance.

Policy Options: Ensuring the certainty of scale in post-2020 international public climate finance

The **options outlined below are not mutually exclusive.** Adopting a combination of the policies recommended could secure sufficient confidence in the scale of finance available to support the delivery of an ambitious outcome:

- **Quantified commitments by individual country contributors to scale up international public climate finance XX% or US$XXX[20] amount by 2025/2030. Country contributors should identify indicative national pathways for international public climate finance by 2017**

Quantified public finance commitments by country contributors might provide the first step towards enabling a degree of predictability. Firstly, contributor countries could put forward country-specific commitments for total climate finance as part of their intended nationally determined contributions (INDCs) in 2015. However, politicians constrained by national politics and budget cycles might be unable to make financial commitments beyond their administration. Developed countries could, and have in the past, put forward indicative quantified goals of public finance (for example, commitments to deliver 0.7 per cent of Gross National Income to ODA). For the 2015 agreement, governments could commit to developing the means/mechanisms by which to fulfill financial commitments through the formulation and adoption of national "pathways" for climate finance. It would be possible for contributor countries to commit to announce, on a biennial basis, their future levels of international public climate finance, in addition to their long-term (collective or individual) climate finance obligations.

It is unlikely that additional international innovative revenue-raising mechanisms for climate finance will be sufficiently ready for agreement in advance of the 2015 agreement, although they could be implemented by 2020. However, for contributors, the predictability of resources can be enhanced by linking country commitments to national revenue-generating instruments and mechanisms such as auctioning of emission permits, hypothecation,[21] revenue tools, guarantees and export credits (all of which can be quantified and subject to Measurement, Reporting and Verification (MRV)). National hypothecation of funds could provide a substantial degree of predictability; however, it is clear that some ministries of finance are generally reluctant to introduce any constraints on how they allocate resources.

- **Quantified aggregate commitments by country contributors to scale up international public climate finance by XX% or US$XXX[22] by 2030. Individual country contributors should identify indicative national pathways for international public climate finance by 2017**

The other approach, in place of individual country commitments, is for a group of countries to agree on an aggregate international public climate finance target, similar to the pledge of US$100bn per year by 2020, made by developed countries in Copenhagen. This approach has helped to create a valuable setting for ramping up overall climate finance, but the goal was ambiguous as to the sources and nature of finance, and not by itself conducive to creating the needed predictability. Therefore, any such target should be defined with greater clarity on the sources of finance (that is, the share of public contribution) and complemented by a commitment towards establishing a timeline or pathway according to which countries will meet their common target. As noted below, this aggregate target for post-2020 could include developing countries' contributions in some form.

Any collective financial commitment beyond 2020 will have to incorporate the increase in the volume of financial flows needed to fulfil the long-term ambition of the international community. However, as noted earlier, political cycles and the economic reality in many countries are not conducive to the formulation of ambitious post-2020 commitments, although examples such as the 0.7 per cent agreement demonstrate that this can be achieved. Alternative or complementary approaches will have to be considered alongside the setting of individual or aggregate finance commitments. It would be possible for contributor countries to commit to announce on a biennial basis their future levels of international public climate finance, in addition to their long-term (collective or individual) climate finance obligations.

- **Establish a formal link between a UNFCCC review mechanism that assesses the collective levels of mitigation and adaptation and the collective levels of finance available from all public sources**

In order to achieve a durable international climate regime, which can reduce and manage climate risk, it will be essential to develop a regular and established process to review and consider the science, policy and implementation issues.[23] An assessment of the financial resources available, outcomes, and the additional support required for further mitigation and adaptation, will be important to monitoring global progress toward a below-2°C temperature target. However, contributors have been reluctant to establish a formal link between the availability of finance and efforts to review the level of collective ambition. In practice, international public climate finance is one element that can shape national delivery, but alone it will not be able to achieve the change in investment patterns required. Therefore, whilst linking international public climate finance to a new procedure that focuses on the adequacy of support and action would provide helpful impetus to scaling up financial support, such linkage will require additional scrutiny of the quality of outcomes being delivered at the national level.

- **Countries agree to establish an automatic replenishment process for the Green Climate Fund (GCF) every four years with a view to achieving US$XXX by 2030**

The governing instrument of the GCF foresees a replenishment process, which would provide the opportunity to enhance the levels of predictability of climate finance. Once initial resources are mobilised (primarily by developed country contributors), a necessary precursor to success in Paris, ambitious replenishment targets for future dates would enhance the flow of public climate finance and allow the GCF to support programme activities with transformative impacts. However, it will be important to ensure that the process/conduct of replenishment is binding, and accompanied by clear future targets and commitments. This process could be fast-tracked to deliver in advance of 2020.

However, experience with other multilateral funds indicates that replenishment processes are resource- intensive and time-consuming. The 2015 agreement will need to provide assurance that countries will commit to supporting the establishment of a replenishment process. Discussions regarding future replenishment targets will need to examine the results obtained by the GCF in its initial resource mobilisation. As discussed below, contributions from developing countries to the GCF could form part of the finance landscape that could be considered in those discussions. It is important to note that, while the GCF is expected to channel most international climate finance, other channels of delivery will still exist in the form of multilateral and bilateral support; therefore finance commitments should not be equated only with GCF contributions and replenishment.

- **The initial contribution to the Green Climate Fund should be supported primarily by developed countries. Parties should welcome contributions by all countries to the Green Climate Fund thereafter, in line with the UN allocation system or other criteria**

Contributions by developing countries will be an important element to consider in the context of a new agreement in Paris. Increasingly, it has become difficult to distinguish clearly between contributors and recipients in international financial flows, reflecting a more complex reality than that which existed when the UNFCCC was

negotiated. Ultimately, aligning financial investment to be consistent with climate objectives will require emerging economies with significant domestic public financial flows to ensure that such flows, and any additional private sector investments that they mobilise, are consistent with meeting the ultimate objective of the Convention and limiting temperature rises to below two degrees. However, proposals for developing country contributions on international climate finance have been met with some resistance, primarily due to concerns that this represents a break in the distinction established under the Annexes of the Convention, which include identification of the countries that must provide financial support (Annex II).

A number of developing countries have already expressed their support to the GCF.[25] Nevertheless, it is difficult to foresee commitments by some emerging economies towards international funds, given the ambiguity around the fulfilment of pre-2020 financing commitments by developed countries. In order to rebuild trust and confidence, initial contributions should primarily come from developed country contributors.

If these conditions are met, an assessment or contribution key could be applied to all Parties,[26] so that finance commitments would be required according to certain criteria, including financial and economic capacity. The development of criteria would make much clearer the distribution of responsibility among countries for providing finance; this could take the form of the United Nations (UN) allocation system or another approach, for example, that all countries would contribute except the least developed, and developing countries would be net beneficiaries.[27] However, while this is a possibility in future, it is still not clear whether the political conditions in Paris will be ripe to achieve such an outcome.

Developing countries could indicate their intention to mobilise domestic resources for climate action. Many countries have now adopted national targets and explicitly acknowledge their interest in supporting and implementing climate action through the adoption of national policy frameworks for mitigation and adaptation. Developing countries could increase predictability through the use of internal resources, for example, by linking their ambition to revenue-generating instruments such as domestic taxes or carbon price mechanisms.[28]

- **Countries invite more progress in securing innovative sources of public climate finance**

The options for developing innovative sources of funding at an international level are numerous, but few are ripe for delivery before 2020. Our analysis assumes that innovative sources are more likely to be found at the domestic level, for example, through auctioning of Emissions Trading System (ETS) revenues, transferring ETS permits, Financial Transaction Tax, phasing out Fossil Fuel Subsidies, etc. However, although the political conditions required to develop global innovative sources (for example, revenue-raising mechanisms from shipping or aviation) will not be achievable before the 2015 agreement, this does not preclude such sources from contributing in the post-2020 regime, and the 2015 agreement could set expectations for their delivery.

To complement GCF funding, one approach might be for contributors to structure financial commitments so as to enable debt financing raised from capital markets to front-load capital for climate actions, following the example of other multilateral funds, for example, the International Finance Facility for Immunisation (IFFIm) and the Global Fund. As part of the 2015 agreement, the Board of the GCF could create the necessary financial vehicle(s) to mobilise capital in this manner. However, it is important to note that, for this to be feasible, contributing countries would need to underwrite the vehicle with a specific quantified level of funding. Depending on the governance[29] of the GCF/vehicle, this could appear as a contingent liability on the balance sheets of developed countries. If this were not done, capital markets would not have the certainty needed to provide debt finance upfront on the back of long-term public commitments.

Despite the immaturity of many of these global innovative financing mechanisms, it is crucial that the 2015 agreement provide momentum and encouragement for these innovative sources of finance to be pursued and explored.

Policy Options: Clarity and transparency regarding types of climate finance available and its impact and outcomes

The **options outlined below are not mutually exclusive**. A combination of the policies recommended could secure sufficient confidence by developing countries regarding predictability in the types of finance available which will impact the quality and delivery of outcomes:

- **Contributors will strive for a balance between adaptation and mitigation finance, with the aim of achieving at least a 50 per cent share for adaptation**

While there are opportunities for overlap and synergies between adaptation finance and mitigation finance, building climate resilience will probably continue to require a greater emphasis on public investment. Some of the investments needed for climate resilience involve public goods, such as research and development, technology diffusion, climate and weather information, natural disaster management, and extension services. Some of the actions undertaken in these areas will not bring returns on the investments made.

Adaptation finance has been consistently and significantly under-funded compared with mitigation finance—only six per cent of total climate flows[30] or 18 per cent of Fast Start Finance was directed at adaptation.[31] The recent GCF Board decision to balance adaptation and mitigation finance by aiming at a 50/50 division of GCF funding, with half of the adaptation funds to be directed to especially vulnerable countries, recognised the need to address the existing imbalance. Recent submissions[32] and statements in the UNFCCC have underscored the importance of strengthening adaptation within the 2015 agreement.

Providing greater clarity on both the levels and nature of financial support available for adaptation is an important component of an agreement in Paris. The agreement could distinguish adaptation commitments in climate finance from those for mitigation commitments. This could be expressed as a percentage of total public climate finance, expressing the importance of public funding as a core element of adaptation funding, or, the agreement could include commitments to an agreed level of public funding for adaptation.

Identifying specific commitments for adaptation might also facilitate increased synergies with development programmes. The potential to create synergies between adaptation and development is widely recognised, but proposals to mainstream and integrate funding for climate resilience-building and adaptation with development programmes have often been viewed with scepticism or even suspicion.[33] Yet creating rigid distinctions[34] between adaptation funding and broader development funding runs the risk of missing opportunities to expand the pool of financing that addresses needs and outcomes in both areas. One approach could be for countries to commit to increase ODA by a quantified amount, with the specific aim of ensuring that climate risks to development are minimised and adaptation and climate resilience are supported. Providing greater clarity regarding the levels of financial support available for adaptation and developing a workable model for its interaction with development assistance would help to provide a stronger basis for finance in the 2015 agreement. However, this issue is unlikely to be resolved inside the UNFCCC. Rather, the Financing for Development Summit in 2015 provides a complementary process for reaching agreement.

- **All countries commit to reporting on finance based on guidelines developed by the Standing Committee on Finance in consultation with the OECD, international finance institutions and developing country experts, taking into consideration the capacity of different countries. The guidelines shall undergo a continuous cycle of improvements based on the experience of countries in their use**

Currently the SCF is carrying out an important data-gathering exercise in preparation for its “first biennial assessment and overview of financial flows 2014.” Based on its initial work, the SCF could be given a mandate in Paris in 2015 to enhance current guidelines[35] for MRV of

support provided by contributors, and to consider ways for developing countries to report on both financial support they received and on the outcomes the support delivered. Examples of possible improvements include the development of:

- a definition of international public climate finance
- a methodology to report on international public climate finance provided and received in a manner that enables comparisons between the two categories
- methods to report on private sources and alignment of reporting systems used by the OECD-DAC and MDB

Given that the GCF is mandated to initiate discussions on coherence in climate finance delivery with other relevant multilateral entities, and the importance of the fund in relation to the wider climate finance ecosystem, the development of methodologies for tracking climate finance provided and received should be done in close consultation with the GCF (as well as other key institutions such as OECD and other bilateral and multilateral agencies), in order to ensure that the guidelines developed could be an integral part of the GCF. If this were the case, the GCF could help to collect key data.

Policy Options: Convergence and coherence of criteria and norms within the climate finance ecosystem

- **All countries commit to applying methodologies developed by the SCF for assessing the impact of domestic and international financial support on major infrastructure projects and other activities such as those identified in NAPs and INDCs by 2020[36]**

  - **All countries recognize the importance for alignment between the GCF investment and results-management frameworks with the methodologies of the SCF, to enhance coherency and ensure procedures for accessing and reporting on climate finance are streamlined**

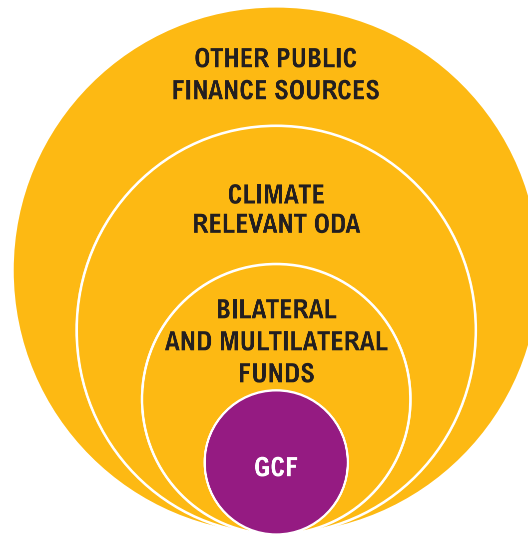
The current international system for climate finance is fragmented, inconsistent and opaque, resulting in a lack of clarity regarding the finance available. While it is important to retain an element of competition and variation among the various climate finance institutions, to ensure innovation and high quality outcomes, a beneficial degree of diversity should not result in complexity and confusion that inhibits the ambition of investors, companies and governments. Understanding the financial support that is available, and what it will deliver, will be key to enhancing developing countries' access to finance and to delivering transformational outcomes.

The SCF is currently advancing the development of climate finance methodologies, it should continue to elaborate these in conjunction with the emerging GCF Results Management Framework (RMF)—an important tool to ensure the transparency of funding flows and the actions that they deliver. The framework can also be a useful tool to increase country ownership and stakeholder engagement, while capturing lessons from the use of international climate finance at country level. Thus, countries can agree to evaluate the impact of climate finance by applying the GCF Result Management Framework. In this manner, countries would contribute to a coherent framework for the evaluation of climate finance effectiveness, and incentivise a project portfolio that aims to achieve both national objectives and the GCF objective of a paradigm shift in climate action.

The Green Climate Fund (GCF) aims to be a central actor in climate finance; however, many parties have failed to articulate a vision for GCF and what value it can bring to the current financial ecosystem. Clarifying the role of the GCF will be essential if it is to work effectively as a fund. This paper outlines a strong vision for the role of the GCF inside the wider climate financial ecosystem (see Figure 3), while understanding that it will take time to realize such expectations.

The design process of the GCF has addressed key ques-

Figure 3 | **The GCF Should Act As a Central Actor in the Wider Finance Ecosystem**



Source: E3G adaptation of the Summary and Recommendations by the Standing Committee on Finance (SCF) on the 2014 Biennial assessment and overview of climate finance flows.[37]

tions regarding the processes, norms and criteria that govern the use of climate finance aimed at transformational impacts. Design elements include definitions, recently adopted by the GCF's board, on an initial investment framework and an initial results-management framework,[38] which allow the GCF to set standards for the use of climate finance and for measuring its impact. The growing role of the GCF could be further supplemented if it were to act as a facilitator of broader harmonized standards, building on informed discussions and decisions in the SCF. For example, in its governing instrument, the GCF is mandated to promote coherence in programming at the national level through appropriate mechanisms.

In addition, the GCF board has agreed on accreditation processes and initial proposal approval guidelines. This work could be further developed alongside the SCF to draw up general guidelines for the design of mitigation and adaptation projects and programmes, and for their evaluation against the investment and results-management framework criteria. This would help to ensure that climate finance used widely by other bilateral and multilateral channels is coherently directed toward a transformational impact. Parties should be requested to ensure that all bilateral and multilateral sources of climate finance are consistent with these SCF norms operationalised by the GCF to 2020.

This vision for the GCF as the standard-bearer for guidelines developed by the SCF will take time to develop. In the meantime, therefore, it will be important for the agreement to incentivize interim measures. Developing an International Green Finance Protocol[39] (or code of conduct) that requests Development Finance Institutions (DFIs) to promote convergence towards criteria and norms for the use of climate finance will increase the coherence and transparency of the climate finance ecosystem. Such a code of conduct would result in a climate finance system that can be better understood by all potential actors, thus attracting wider investment flows towards a transformative impact.

DEVELOPING ROBUST NATIONAL FINANCE STRATEGIES

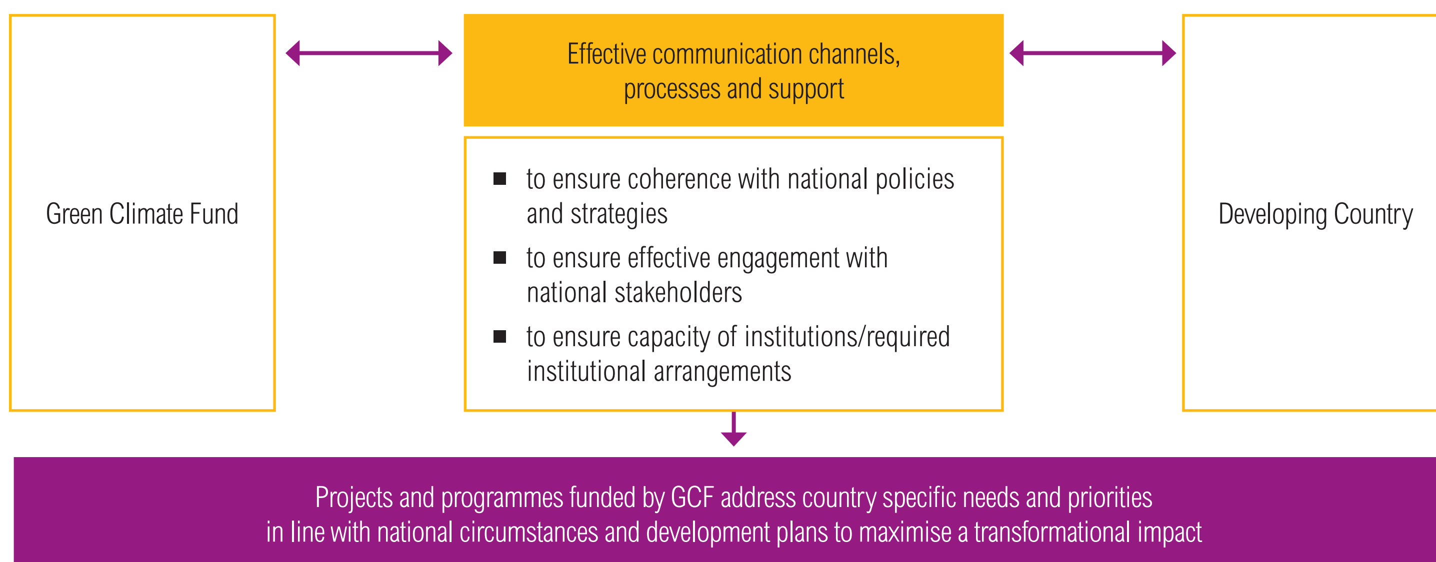
Country ownership, which requires appropriate domestic institutional arrangements and capacity, is critical to ensuring that climate finance delivers a meaningful shift in investments towards low-carbon, climate-resilient outcomes. The concept of country ownership[40] has grown in importance within the UNFCCC discussions, in particular the Long Term Finance work programme as well as in discussions regarding the design of the Green Climate Fund (GCF).

There is currently a mismatch between available international resources, developing country expectations and the requirements to deliver a below 2 degree outcome. Resource mobilisation at the national level, drawing upon the wider ecosystem of financial flows available, will be essential to achieve identified objectives. To ensure that both domestic and international public support for climate action is used strategically, and for greatest catalytic impact, international climate finance must support and be aligned with national finance and investment priorities set out by developing countries for instance enabling cleaner urbanization and more efficient transportation. However, international public climate finance must be used in ways that will enhance and transform these priorities into more sustainable and resilient outcomes.

Country ownership can help to:

- Ensure appropriate institutional reform and capacity to deliver the high levels of institutional innovation, public finance, and political commitment that will be required to deliver, and manage the risks of, the transformation required[41]
- Enable climate plans (including Low Emissions Development Strategies (LEDS), Nationally Appropriate Mitigation Actions (NAMAs) and National Adaptation Plans (NAPs)) to be translated into bankable propositions for implementation. At present, some of these plans are not being implemented at scale because they lack a strategy for optimizing the interaction of different sources of finance (domestic, international, public and private) and for leveraging international climate finance. Developing a financing strategy to implement these plans, which would include building a pipeline of bankable projects to attract both commercial and public investors, is a challenge that only a few developing countries are currently addressing[42]
- Enable countries that have not yet done so to identify how to address their vulnerabilities through the design of climate-resilient development paths. More effective development planning will require grant funding for technical assistance and in support of the institutional strengthening necessary to ensure that climate risks and climate-resilience measures are identified and fully integrated into development strategies and plans

Figure 4 | **The Significance of Country Ownership**



- Support country-specific efforts to improve the risk-reward profile of climate-relevant investments.[43] Countries will need to deploy a range of financial instruments, tailored to meet country-specific needs and circumstances. These instruments should channel public sources of climate finance in a manner that overcomes specific barriers and shares risks with the private sector to encourage scaled-up investment in climate technologies and solutions. To be effective, these instruments must be closely integrated with national policy
- Enable countries to implement measures that capture and share lessons. Rapid replication of good practice is vital
- Enhance stakeholder engagement in developing and implementing country strategies and plans. Transforming a country's development pathways will require a wide range of stakeholders to engage with and support the shifts required

Policy Options: Facilitating transformational national financing strategies

- **Developing countries are invited to enhance their enabling environments by integrating NAPs, NAMAs, Technology Needs Assessments (TNAs) and LEDs etc.; consulting with relevant domestic non-governmental stakeholders; and developing national finance strategies by 2020, with a view to attracting scaled-up climate finance for greatest catalytic impact**
    - **Guidance on appropriate financial strategies and pathways will be developed by the Standing Committee on Finance by xxxx[44] in collaboration with the Green Climate Fund**

Strategic national approaches to climate finance can help to align domestic interests and processes (for example, LEDS, NAMAs, NAPs) and increase the sense of country ownership, which in turn helps to attract climate finance. National strategic plans that involve the establishment and/or reform of national financial institutions capable of managing and distributing resources in a coherent manner will increasingly attract contributions and enhance their own effectiveness. While it is in their national interest for many countries to undertake such processes, initiating them will, in many cases, rely upon capacity building and financial support from international public climate finance.

The development of national strategic plans and financing pathways requires the prominent involvement of finance and planning ministers and coordination across government ministries and institutions. It is likely that countries that undertake strategic approaches to generating "bankable" measures for implementing mitigation and adaptation activities will attract higher levels of climate finance from international sources, and will mobilise scaled-up private sector finance. Such approaches may be consistent with the GCF focus on enhanced direct access to climate finance.

In Paris, the agreement should raise expectations (though not obligations) that developing countries will embark upon national finance strategies within a certain timeframe. Defining and adopting best practice guidance for consistent and financeable strategies and pathways will be essential to secure their development. Many countries and a number of informal initiatives, such as the LEDS Global Platform and Green Growth Best Practice (GGBP) Initiative, are already picking up on the benefits of such an approach. The right venue for sharing information and defining best practices for financing strategies and pathways will need to engage directly with finance ministers, whilst linking back to the Standing Committee on Finance.

ALIGNING CROSS-COUNTRY INVESTMENTS

In order to align broader financial investments to address climate change, the 2015 agreement will need to promote coherence and consistency not only to countries or organizations providing climate finance, but also within the area of broader public cross-country finance from all countries. The agreement must signal the need to ensure that all financial investments are aligned with the transition to a low-carbon and climate-resilient economy. Public cross-country investments represent the first stage in shifting broader investments in directions consistent with addressing climate change. Notably, this would affect ODA, Foreign Direct Investment (FDI) and Export Credit Agencies (ECA).

These public cross-country flows of finance should be stress-tested and benchmarked against the long-term mitigation objectives in the 2015 agreement, namely, to phase out of fossil fuels by 2050, and to enhance climate resilience. At present, **there is no mechanism to ensure that public financial institutions and their investments overseas (that is, investments made through National or Bilateral Development Banks or Development Agencies) are consistent with the objectives of the Convention.** Whilst such a mechanism might not be agreed in detail in 2015, it is important to set out expectations, goals and the initial means by which public cross-country investments will be held to account.

The post-2015 development process will need to address how international financial institutions and their investments are supporting and enabling sustainable development, of which managing climate change is just one element. Consistency among the plethora of sustainable development finance initiatives is critical to ensure clear signals regarding the political intent to decarbonise and enhance climate resilience. Creating effective synergies between the broader post-2015 development agenda and the climate agreement will be crucial to transforming global financial flows.

As mentioned above, aligning public cross-country financial flows is the first step in shifting broader private cross-country financial flows. A combination of measures, such as more integrated national planning with robust national targets, legislation for mitigation, raised expectations that foreign public finance will be held accountable, and the establishment of a measurable long-term goal, could be effective. Such a package could send a credible signal to international and national private investments regarding the need for them to align their portfolios to achieve climate stability.

Consequently, the Paris 2015 agreement will require an initial focus on creating compatible domestic and international public financial flows, whilst ensuring that this approach creates synergies and is consistent with other international processes, especially the Intergovernmental Experts Committee on Sustainable Development Financing (IECSDF).

Policy Options: Compatibility and consistency of all international public financial flows towards sustainable development outcomes

The **options outlined below are not mutually exclusive**. A combination of the policies recommended could secure compatibility of international public financial flows with sustainable development:

- **Countries invite the ICESDF to develop a methodology to ensure compatibility of all public cross-country investments to address climate change consistent with a phase out of fossil fuels by 2050**
- **By 2020, parties providing cross-country, public financial investments commit to disclose and report every X[45] years to the COP on compatibility of their financial portfolio with a phase out of fossil fuels by 2050**
- **Contributing countries commit to ensure all development finance outcomes, whether through multilateral, bilateral or national channels, is made resilient to climate impacts. The climate impacts will be assessed upon the most recent analysis of emissions trajectories through the Ratchet and Review mechanism**

An agreement in Paris on a long-term goal, against which countries can benchmark their public international financial investments, is important to securing alignment of broader finance flows. The decision to invite an institution to define the common methodological approach for benchmarking investment (public and private) will be challenging, given the lack of legitimacy or credibility of processes to develop such a methodology. It is still unclear how the Intergovernmental Committee of Experts on Sustainable Development Financing (ICESDF)[46] will evolve after the Financing for Development Summit scheduled in July 2015; this could be a process capable of initiating the development of a common methodology. In addition, national disclosure and reporting policies will be required to identify the material climate risks to the economy and financial stability.

A common commitment to ensure consistency of public finance with a long-term goal will involve constant tension between the need for consistency, differentiation between countries and comparability of actions. A flexible approach that facilitates different actions may find it challenging to identify common metrics and formats. Nevertheless, agreement on key definitions can provide some level of comparability. Given that many developing countries will not be ready to formalise quantified commitments on climate finance, individual countries might agree to qualitative commitments about shifting their international finance toward climate-compatible objectives, including both mitigation- and adaptation-related objectives. However, it is incumbent upon developed countries to provide both quantified finance for climate action and qualitative commitments on their broader financial flows.

Public sector financial institutions of all kinds—Multilateral Development Banks (MDBs), Regional Development Banks (RDBs), bilateral development finance institutions and export credit agencies, and aid agencies—should demonstrate their adherence to the long-term goal by mainstreaming climate mitigation and building climate resilience throughout their activities. Encouragingly, many development banks or other entities that mobilize significant private sector investment are already revising their policies in this regard, including the World Bank, European Investment Bank, and the U.S. Overseas Private Investment Corporation (OPIC). MDB and RDB Boards could be encouraged to make a voluntary pledge at the Paris meeting in 2015, whereby they would voluntarily commit to demonstrate the compatibility of their funding/financing with a goal of net zero greenhouse gas emissions by 2050. The International Development Finance Club (IDFC), comprising national development banks from developed and developing countries, should also come forward with an ambitious pledge.

CONCLUSIONS

Whilst international public climate finance alone will not deliver a pathway consistent with a below 2°C trajectory, an ambitious Paris agreement could catalyse bold and transformative outcomes as well as shift investments from 'brown to green'.

The agreement in Paris is unlikely to resolve all issues regarding international climate finance. The outcomes of the agreement must satisfy the demonstration of political intent as well as deliver the means of implementation to keep us on a below 2°C pathway. Thus, even as international public climate finance cannot deliver a 2°C course outright, failure to deliver a credible finance package will result in undermining the agreement which could lock-out a 2°C pathway.

In Paris, the opportunity to embed a more concrete and tangible long-term goal can enable a conceptual shift in the climate finance debate. This shift should culminate to hold all financial flows, not just climate finance accountable to a concrete target. Unless these broader investments are held accountable, climate finance will be destined to incremental progress and continue to be dwarfed by more significant investments in emissions intensive activities.

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ABBREVIATIONS

COP21	Conference of the Parties 21st Session
CPI	Climate Policy Initiative
E3G	Third Generation Environmentalism's
ECA	Export Credit Agencies
ETS	Emissions Trading System
FDI	Foreign Direct Investment
GCF	Green Climate Fund
GDP	Gross Domestic Product
GGBP	Green Growth Best Practice Initiative
IDFC	International Development Finance Club
IECSDF	Intergovernmental Experts Committee on Sustainable Development Financing
IFFIm	International Finance Facility for Immunisation
IMF	International Monetary Fund
INDC	Intended Nationally Determined Contributions
LEDS	Low Emissions Development Strategies
MDB	Multilateral Development Banks (MDBs)
MRV	Measurement, Reporting and Verification
NAMA	Nationally Appropriate Mitigation Actions
NAP	National Adaptation Plans
NCE	New Climate Economy
ODA	Overseas Development Assistance
OECD-DAC	Organisation for Economic Co-operation and Development—Development Assistance Committee
OPIC	U.S. Overseas Private Investment Corporation
RDB	Regional Development Banks
RMF	Results Management Framework
SCF	Standing Committee on Finance
TNA	Technology Needs Assessments
UN	United Nations
UNFCCC	United Nations Framework Convention on Climate Change
WEF	World Economic Forum
WRI	World Resources Institute

ENDNOTES

1. The financial ecosystem of climate change action encompasses the multiple funds, regulations and initiatives that aim to boost both mitigation and adaptation at the international, regional and bilateral levels.
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10. In 2012, members of the Development Assistance Committee (DAC) of the OECD provided USD 125.6 billion in net official development assistance (ODA), this includes both grant and concessional loans
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18. UK Sustainable Investment and Finance Association. 2013. Investors Decarbonisation Target Letter to George Osborne.
19. Through the IDA replenishment cycles
20. ACT 2015 has not defined the amount or percentage of international climate finance support from individual contributors or as an aggregate, therefore the amount is not inserted.
21. Ring-fence revenues from a particular source for a specific purpose – which despite political hesitation is legally feasible in many countries
22. ACT 2015 has not defined the amount or percentage of international climate finance support from individual contributors or as an aggregate, therefore the amount is not inserted.
23. For more information refer to the ACT2015 Ratchet Mechanism paper
24. ACT 2015 has not defined the aggregate amount for the replenishment process of the GCF
25. Yeo, S. 2014. Indonesia Pledges $250,000 to Green Climate Fund.
26. This requires an overall target/budget defined jointly for the GCF
27. The Office of the Prime Minister, Norway. 2009. The Mexican-Norwegian Proposal on Climate Change Financing: The Green Fund.
28. The concept of national financial pathways is further developed below
29. In order to achieve such a vehicle, the most effective method would be for the GCF to become a bank which some contributor countries have ruled out at present
30. Buchner, B., Herve-Mignucci, Trabacchi, C., Wilkinson, J., Stadelmann, M., Boyd, R., Mazza, F., Falconer, A., Micale, V. 2013. Global Landscape of Climate Finance.
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32. Independent Association of Latin America and the Caribbean. 2014. Submission on the Ad Hoc Working Group on the Durban Platform (ADP).
33. Klein, T. 2010. Mainstreaming Climate Adaptation into Development: A Policy Dilemma.
34. Terpstra, P. 2013. The Difficulty of Defining Adaptation Finance.
35. The biennial reporting guidelines for develop country Parties stipulate that Parties should fill in a separate table for each year, provide an explanation on methodology used for currency exchange for the information provided in table 7, 7(a) and 7(b), and should explain in their biennial reports how they define funds as being climate-specific; among other information. UNFCCC. 2013. FCCC/CP/2012/8/Add.3.
36. Examples that could be considered in the development of methodologies are the Climate Public Expenditure and Institutional Review process for estimating domestic public expenditures and the results management frameworks of international banks.
37. Standing Committee on Finance. 2014. Summary and Recommendations by the Standing Committee on Finance (SCF) on the 2014 Biennial assessment and overview of climate finance flows (Advanced Unedited Version).
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43. IMF. 2014.
44. ACT 2015 has not identified the date by which these guidelines should be developed. However, ideally these should be completed as far in advance of 2020 as possible.
45. ACT 2015 has not identified the frequency of such reporting. However, this should ideally be consistent with commitment periods and the ratchet and review cycle
46. Process established under the post-2015 development agenda to provide recommendations for aligning international and domestic public and private finance towards sustainable development outcomes

ACT 2015 Working Paper

This ACT 2015 paper is part of a series on elements of the 2015 climate agreement. It should be read in conjunction with the papers on adaptation and loss and damage, an ambition mechanism, compliance, characteristics of mitigation commitments, equity, legal form, MRV and Accounting, and variable geometry and incentives.

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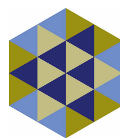

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E3G is an independent, non-profit organisation operating in the public interest to accelerate the global transition to sustainable development.

E3G builds cross-sectoral coalitions to achieve carefully defined outcomes, chosen for their capacity to leverage change.

E3G works closely with like-minded partners in government, politics, civil society, science, the media, public interest foundations and elsewhere.

ABOUT ACT 2015

The Agreement on Climate Transformation 2015 (ACT 2015) consortium is a group of the world's top climate experts from developing and developed countries that have come together to catalyze discussion and build momentum toward reaching a global climate agreement at the forthcoming UN Framework Convention on Climate Change (UNFCCC) summit in 2015.

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