

The Essentials of Climate Finance

What is climate finance?

To reduce worldwide greenhouse gas (GHG) emissions, increase GHG sequestration, and adapt to the harmful impacts of changing GHG levels, both developed and developing countries must participate in climate change mitigation and adaptation. While efforts to achieve these goals have long-term benefits and are essential for the sustainability of life on earth, significant investment is required in the near term. Climate finance is an effort to support developing countries by providing funding from the developed world to assist these countries in mitigation and adaptation, and to embark on green development paths. While climate finance can be broadly defined, this document will focus on those monies under discussion in the UNFCCC.

A glossary of acronyms and definitions is located in the [Annex: Table 1](#).

How much climate finance is needed?

The costs of mitigating and adapting to climate change in developing countries are still being understood. A study by the World Bank estimates that \$70-100 billion dollars per year will be needed for adaptation and indicates that costs may be even higher.¹ For mitigation, estimates indicate that \$139-175 billion/year will be needed in 2030.² Developing countries have advocated for a goal as high as USD \$600 billion, or 1.5% of developed nations' GDP.

In 2009, developed countries committed to provide Fast Start Finance (FSF) totaling USD \$30 billion between 2010 and 2012³ and to mobilize USD \$100 billion/year by 2020.⁴ Given the context above, this commitment should be viewed as a starting point, not an end goal. However, an explicit plan for scaling up to that level of financing remains elusive. Governments are struggling to effectively deliver their FSF commitments. Even more worrisome, little progress is being made to commit further public funding and to develop innovative financing methods that will reach the USD \$100 billion/year goal.

What is the Green Climate Fund?

The Green Climate Fund (GCF) was established at UNFCCC COP16 in December 2010 as a mechanism under the UNFCCC to deliver adaptation and mitigation finance in developing countries. The Fund will be overseen by a Board with balanced representation from both developing and developed countries. Its interim trustee is the World Bank, though the future role of the World Bank remains controversial. Many developing countries do not feel the Bank represents their interests.⁵ At the same time, the World Bank

¹ Economics of Adaptation to Climate Change. The International Bank for Reconstruction and Development/The World Bank. 2010.

² World Development Report 2010: Development and Climate Change. The World Bank. November 2009.

³ <http://www.faststartfinance.org/content/fast-start-finance>

⁴ "Copenhagen's Climate Finance – Six Key Questions." International Institute for Environment and Development. February 2010.

⁵ Green Climate Fund Policy Background

already has in place the financial architecture that could enable the GCF to begin functioning in the near term. The Fund will be designed to be directly accessible to developing nations through their own implementation entities, though the exact implementation mechanism is still unclear. Most importantly, the Fund does not have a fundraising role, and therefore will be ineffective without sufficient levels of financial flow, which have not yet been identified. The design of the GCF is slated to be finalized at COP17 in Durban, South Africa in December 2011. Currently, a Transitional Committee (TC) is in the process of designing the Fund, with the help of a Technical Panel of experts.

What are the existing sources and vehicles of climate finance?

The relationship between the Green Climate Fund and existing funds is unclear, though existing climate funds are meant to be harmonized and better coordinated after the operationalization of the GCF. A variety of financial sources already exist, though their scales are small compared with the financial flows anticipated under the GCF. Little collaboration and coordination has taken place between existing funds to date. The majority of these funds are managed by the World Bank, the UNFCCC Secretariat, or other UN agencies. The Global Environmental Facility (GEF), an independent financial organization, assists developing countries by providing grants in support of UN environmental agreements such as the UNFCCC. Since its founding in 1991, it has allocated a total of USD \$9.5 billion to environmental initiatives. Prominent climate funds include:

- **The World Bank's Climate Investment Funds (CIFs):** Funds to help developing countries progress in low-emissions and climate-resilient development, on a scale of USD \$6.5 billion as pledged by participating countries in 2008. The funds were created with a sunset clause that will phase them out with the establishment of a UNFCCC financial mechanism.⁶
- **The GEF's Least Developed Country Fund (LDCF) and Special Climate Change Fund (SCCF):** The LDC Fund promotes adaptation efforts for the least developed countries, specifically by financing mainly the design, but also the implementation, of National Adaptation Programs of Action (NAPAs), on a total scale of USD \$415 million. The SCCF provides support for long- and short-term adaptation efforts and technology transfer in all developing country parties to the UNFCCC on a total scale of \$218 million.⁷ These funds will likely remain in place with the establishment of the Green Climate Fund.
- **Adaptation Fund (AF):** The Adaptation Fund was created within the Kyoto Protocol in order to provide funds for adaptation programs in developing countries. The Fund is financed with a small percentage of revenue from the trade of Certified Emission Reductions (CERs) allocated for the Clean Development Mechanism and other sources. Total value of assets stood at USD \$211 million as of January 31, 2011.
- **REDD+ funding from UN-REDD, implemented by FAO, UNEP, and UNDP:** Supports governments in designing and implementing REDD+ initiatives, on a scale of USD \$150.84 million.⁸

A chart mapping out the current climate finance sources is included in the [Annex: Chart 1](#).

What are possible future sources of climate finance?

The need for climate finance is clear and a number of ideas have been offered regarding possible sources. No one single mechanism is likely to yield sufficient finance, so a combination of mechanisms will be required. The Report of the UN Secretary-General's High-level Advisory Group on Climate Change Financing⁹ and the draft report by the G20 on Mobilizing Climate Finance¹⁰ examine potential sources in detail. Some of these include the auction of allowances, carbon offset markets, redirection of fossil fuel

⁶ <http://www.climateinvestmentfunds.org/cif/>

⁷ <http://www.thegef.org/gef/LDCF>

⁸ <http://www.climatefundupdate.org/listing/un-redd-programme>

⁹ http://www.un.org/wcm/webdav/site/climatechange/shared/Documents/AGF_reports/AGF_Final_Report.pdf

¹⁰ <http://www.guardian.co.uk/environment/interactive/2011/sep/21/mobilising-climate-finance-report-g20>

subsidies, and a variety of options to leverage private sector finance. While a diversity of options need to be pursued, public funding, including innovative sources of finance, will be critical and should make up the majority of adaptation finance in particular. A few potential sources are examined here, though this list is by no means comprehensive:

- **International Maritime Shipping:** Regulating GHG emissions from the marine transportation sector could generate finance through levies, carbon offsetting, or the sale of allowances. This method could produce between USD \$2-19 billion per year.
- **International Aviation:** A market-based mechanism, such as sectoral cap-and-trade, has been proposed to decrease aviation-related GHG emissions. It could also raise revenue; estimates project that such a mechanism could generate USD \$1-6 billion per year.
- **Direct Budget Contribution:** Developed nations pledge a specific contribution to climate finance from their national budget. Developing countries prefer this method, though it depends on developed nations' willingness to make and meet pledges, which can vary greatly depending on the current political and economic climate. Currently, the scale of this source is reflected in the scale of Fast Start Finance—USD \$30 billion over 3 years.
- **Financial Transaction Tax (FTT):** This source would impose a global .005% tax on each trade of financial instruments such as currency and stocks. While implementing such a mechanism would require a device for global taxation and collection, estimates project that this could generate USD \$2-27 billion/year.
- **Special Drawing Rights (SDR):** This source uses the financial mechanism of a foreign exchange reserve that is held in each country's name at the International Monetary Fund (IMF). Although not a currency, it may be traded for (and is priced against) major currencies. Countries pay and receive interest from the IMF depending on their allocation, which can change as countries trade SDRs or exchange them for currency; for example, if they trade in SDRs for currency, they will have to pay interest, while if their holdings rise above their allocation, they earn interest.

October 2011

For more information contact: Rebecca Chacko, Senior Director, Climate Policy;
rchacko@conservation.org

Annex

Table 1: Glossary of Useful Acronyms and Definitions

Adaptation Fund (AF)	This Fund was established under the Kyoto Protocol in order to provide funds for adaptation programs in developing countries. The Fund is supervised and managed by a Board composed of representatives from both developing and developed nations.
Carbon Market	A trading system through which entities buy and sell greenhouse gas emission reduction units. Carbon markets can be voluntary, or mandatory as part of a mitigation initiative under the Kyoto Protocol or other agreements.
Carbon Offset	Credits for emissions reductions that are used to offset an emission made elsewhere under the cap-and-trade system for unregulated or regulated activities.
Certified Emission Reductions (CER)	A type of emissions reduction unit associated with the CDM.
Clean Development Mechanism (CDM)	A mechanism under the Kyoto Protocol through which developed countries may finance greenhouse gas emission reduction or removal projects in developing countries, and receive credits for doing so which they may apply towards meeting mandatory limits on their own emissions.
Climate Investment Funds (CIF)	Multi-donor trust funds overseen by the World Bank. See: "Existing Sources."
Emissions Trading System (ETS)	Provides economic incentives for reducing emissions through the trade of Emission Allowance Units (EAUs).
United Nations Food and Agriculture Organization (FAO)	Helps developing countries modernize agriculture, forestry, and fishery practices. FAO is a partner, along with UNDP and UNEP, in the UN-REDD Programme.
Fast Start Finance (FSF)	Provides funds to developing countries for enhanced immediate action on mitigation, adaptation, and capacity building. Developed countries have made commitments totaling USD \$30 billion for the 2010-2012 period. ¹¹
Financial Transaction Tax (FTT)	A very small tax on each trade of financial instruments, such as stocks. A potential source of climate finance.
Green Climate Fund (GCF)	See: "Green Climate Fund."
Global Environmental Facility (GEF)	A financial organization independent of the UNFCCC that provides grants to developing countries. See: "Existing Sources."
Greenhouse Gas (GHG)	The atmospheric gases responsible for causing climate change. The major GHGs are carbon dioxide (CO ₂), methane (CH ₄) and nitrous oxide (N ₂ O). Less prevalent --but very powerful -- greenhouse gases are hydrofluorocarbons (HFCs), perfluorocarbons (PFCs) and sulphur hexafluoride (SF ₆). ¹²

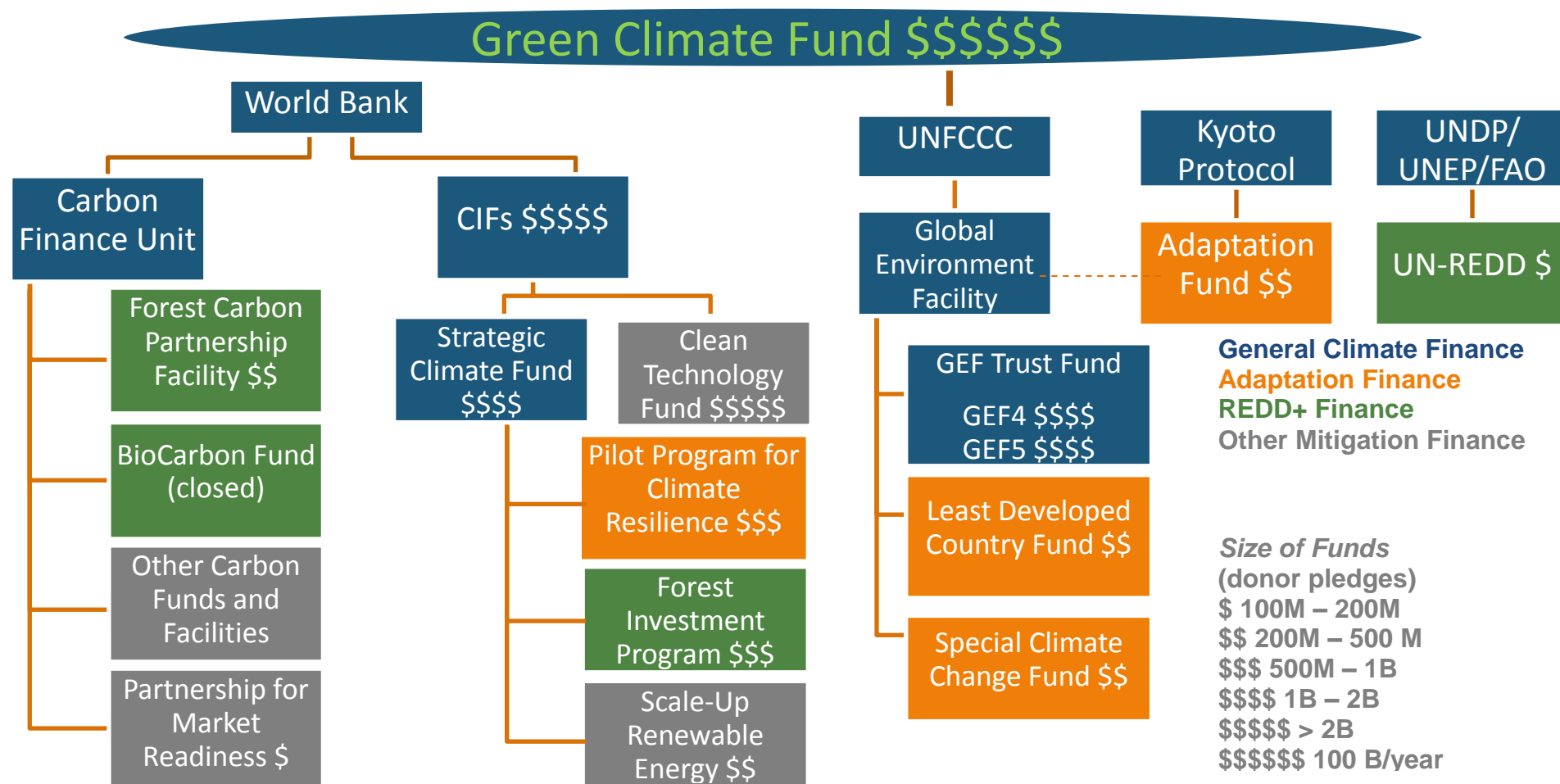
¹¹ <http://www.faststartfinance.org/content/fast-start-finance>

¹² http://unfccc.int/essential_background/glossary/items/3666.php

International Monetary Fund (IMF)	The International Monetary Fund (IMF) is an organization of 187 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world. ¹³
Joint Implementation (JI)	A mechanism under the Kyoto Protocol that allows developed countries to finance projects to reduce greenhouse gas emissions in former eastern bloc countries such as Russia, and, in return, receive emission reduction units.
Multilateral Development Bank (MDB)	Financial institutions overseen by many countries that provide financial assistance to development projects. MDBs already play a role in climate finance, which can be scaled up.
National Adaptation Programme of Action (NAPA)	Provides a process for Least Developed Countries (LDCs) to identify priority activities that respond to their urgent and immediate needs to adapt to climate change – those for which further delay would increase vulnerability and/or costs at a later stage.
No Net Incidence (NNI)	The condition under which developing countries do not suffer financially from climate change policy.
Reducing Emissions from Deforestation and Degradation (REDD+)	REDD includes efforts to reduce deforestation and forest degradation, while the + includes the further activities of conservation, sustainable forest management, and forest carbon stock enhancement.
Special Drawing Rights (SDR)	A foreign exchange reserve that is not a currency, but can be exchanged for various currencies. A potential source of climate finance.
Transitional Committee (TC)	A body that is in charge of designing the Green Climate Fund with the help of a Technical Panel of experts. The TC commenced its work in April 2011.
United Nations Development Programme (UNDP)	A branch of the United Nations that focuses on developing local capacity in the specific fields of poverty reduction, democratic governance, crisis prevention/recovery, energy and environment, and HIV/AIDS. Specifically, the UNDP has contributed to REDD+ funding.
United Nations Environment Programme (UNEP)	A branch of the United Nations that assists nations in caring for the environment while improving their quality of life. The UNEP contributes to REDD+ funding, as well as other climate financing initiatives.
United Nations Environment Programme Finance Initiative (UNEP FI)	The UNEP Finance Initiative is a partnership between the UNEP and the global private sector, including banks, insurers, and fund managers, to understand and promote the linkages between sustainability and financial performance.

¹³ <http://www.imf.org/external/about.htm>

Chart 1: Existing Financial Sources



The relationship between the GCF and existing funds is unclear, yet existing climate funds are meant to be harmonized and better coordinated after the operationalization of the Green Climate Fund. The World Bank’s CIFs have a sunset clause which will cause them to cease to exist after the operationalization of UNFCCC’s financial mechanism, but the GEF’s Least Developed Country Fund and Special Climate Change Fund will most likely stay in place since they give additional support to the most vulnerable and poorest countries. Some of the REDD+ funds have already been coordinating their work; they could be subsumed by the GCF or complement REDD+ funding in the GCF. While the Green Climate Fund can help to ensure harmonization and coordination of climate finance, other funds can also contribute to efforts to provide scaled-up and effective climate change.