

Designing the Green Climate Fund: Issues for Consideration

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Background

At the 16th session of Conference of Parties (COP) to the United Nations Framework Convention on Climate Change (UNFCCC), the COP adopted decisions in which it decided to establish a Green Climate Fund (GCF), to be designated as an operating entity of the financial mechanism of the Convention under Article 11, with arrangements to be concluded between the COP and the Green Climate Fund to ensure that it is accountable to, and functions under the guidance of the COP. The motive of the Green Climate Fund is to support projects, programmes, policies and other activities in developing country Parties using thematic funding windows.

The COP also decided that the GCF was to be designed by a Transitional Committee (TC). It was decided that the TC will comprise 40 members, with 15 members from developed country Parties and 25 members from developing country Parties, with members having the necessary experience and skills, notably in the area of finance and climate change.

In accordance with the terms of reference given in Annex III to decision 1/CP the TC is to develop and recommend for approval to COP 17 a number of operational documents for the GCF. In the conduct of its work, the COP requested the TC to encourage input from all Parties and from relevant international organizations and observe.

It is essential that the developed countries provide resources to developing countries to undertake climate change mitigation and adaptation actions. If successful, GCF could account for the flow of a significant part of the US\$ 100 billion pledged by the Parties at Copenhagen, which would be made available annually from 2020. Therefore, it is expected that the GCF would be the main

channel of international funds to address climate change actions in the developing countries in the future. Thus, an agreement of Parties on the design and operationalising the GCF is being touted very crucial.

In view of the above background, I was awarded this contract for conducting a short term study on designing the green climate fund, so as to provide inputs to the team assisting India's member to the Transitional Committee Dr Y.V Reddy. The architecture and the design of the green climate fund will be very crucial part of the negotiations as it will set the stage for more important elements like factors influencing and controlling the flow of funds, funding windows, functioning of the GCF etc. In the light of the above issues, I have tried to capture the most crucial elements we would expect as a developing country, in the design that is being negotiated for the Green Climate Fund. These elements could be best reflected in terms of important redlines and greenlines that should be kept in minds at the time of the negotiations. Hence, I have designed this report in a question answer format which would facilitate the negotiating team in terms of providing coherent expectations in the answers provided to the questions that are expected to arise while deliberating on this issue.

Issues for Consideration

- (i) We have to decide whether we want the Fund to be a treaty based Fund or a corporate entity registered as a society in one of the member countries.

Ans: In my view, the Fund should be treaty based because under a treaty it would be feasible to ensure that specific governance requirements and accountability (i.e. respective nos. of votes in the Board, accountability to the CoP) can be unambiguously ensured. In case of a corporate entity registered in a member country, these issues may be overridden by the country's sovereign corporate law, including future amendments, and disputes on operational matters may be subject to the country's own laws. Of course, certain safeguards by way of a side-agreement with the host country could be built in, but it would always remain an open question on how the country's courts will interpret such arrangements.

- (ii) Frequent interchangeable references to "developed" and "developing" countries and "Annex-I" and "Non-Annex-I" countries- should it be avoided and consistent references should be used in various parts of the document ?

Ans: The UNFCCC distinguishes between Annex I/non-Annex I on the one hand, and developed/developing countries on the other, i.e. the two are not necessarily the same (see Art 4.2, 4.7; developed countries/parties are listed in Annex II, a subset of Annex I, see Art 4.3. However, the Convention does not explicitly identify "developing countries" as "non-Annex I" or a subset thereof). However, the respective roles of "developed" and "developing" countries in respect of

climate change finance are clearly forth in Art 4.3/4.7, being the basis for the GCF. I thus feel that in relation to the provision of funding and eligibility for receipt, the terms “developed” and “developing” respectively are appropriate. However, in matters of governance and accountability of the GCF, the more general political categories of Annex I and non-Annex I would be more appropriate.

(iii) Considering the fact that decisions can be blocked by one member of the TC even if proposals of interest of developing countries have been generally endorsed, we should qualify the principle of consensus by saying that the decisions will be reached by consensus to the extent possible provided that, in the absence of consensus, the chair may put the proposal to vote and the decision shall be taken by a two thirds majority of the parties present and voting under the double majority principle. What should be the language for this?

Ans: We need to be careful on this point. Our greater stake in the climate change game is not the GCF, but the basis of allocation of GHG emissions entitlements (in the KP/LCA). Currently the CoP operates on consensus, (although this was diluted somewhat by the CoP President at Cancun by gaveling consensus despite the objections of Bolivia – it remains an open question, however, of whether consensus would still be found if a more important country were the sole dissenter). There is a proposal before the CoP of changing the requirement of full consensus to 2/3rds majority (tabled by Mexico and others). Given the political reality of the EU/US being able to arm-twist/incentivize a large number of AOSIS/African/LAC countries, the rule of 2/3rds majority may work to the detriment of the BASIC group. It is therefore being resisted at CoP by the BASIC. The political effect of adopting a 2/3rds decision making rule at the TC, which, though not a UNFCCC body is nevertheless politically linked to the AWG-LCA

process, in relation to the question of the rule of decision making at the CoP needs to be carefully considered. I feel that MEAs advice should be sought on this point, before we commit ourselves to a voting based, rather than full consensus decision making at the TC.

(iv) The Chair and Vice Chair should be chosen from amongst the members of the Board and not from outside?.

Ans: The Board members should be elected by the regional groups, and comprise one developed and one developing country Party in each case. If the choice of Chair/Vice-chair were to be open to other CoP members (i.e. non-members of the Board), this would require consensus or election by the CoP. This could be divisive, and by carrying the weight of consensus/election at the CoP, the Chair/Vice-Chair could assert primacy over the Board members (whose respective constituencies would be more limited). I believe, therefore, that a more appropriate course would be for the Chair/VC to rotate among the regional groups, and alternate between developed/developing countries.

(v) There is no provision for change in the permanent trustee of the Fund. There should be an exit clause and there should be a process for review of the function of the trustee and a mechanism for termination of the contract of appointment of the trustee.

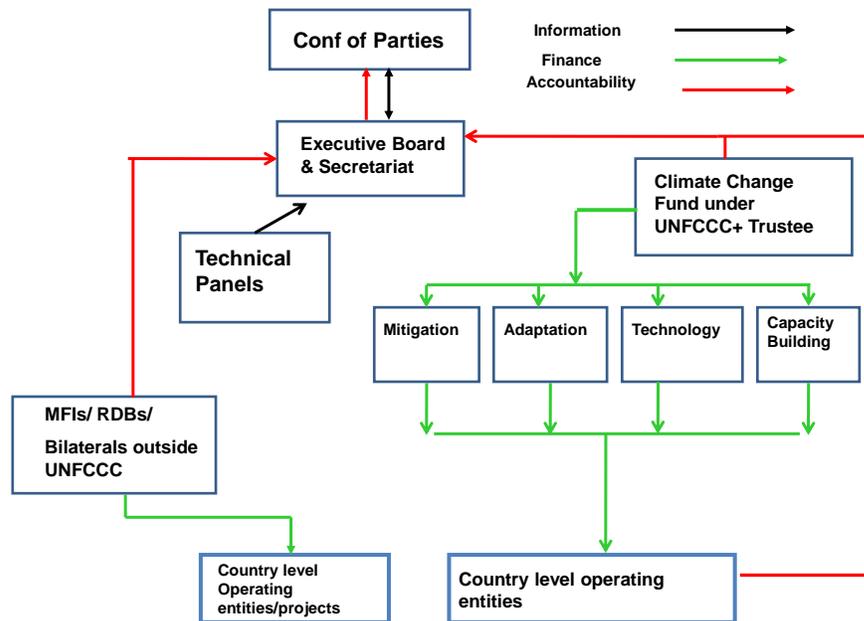
Ans: I believe that the trustee should have a term of 5 years at a time, renewal being subject to the decision of the CoP, and with an annual report on its' activities to be presented to, and its' discussion by the CoP. This will help ensure that the

trustee remains sensitive to the concerns of CoP members, and not only of its own Board.

(vi) The relationship of the Fund with other bodies and entities – Can it be clarified through a relationship chart?. The functions of the Board vis-a-vis that of the standing finance committee should be clarified.

Ans: See the attached chart giving the structure of the financial mechanism, one component of which is the GCF:

Figure 1: Illustrating the Proposed Climate Change Finance Architecture



The GCF Board would be responsible for taking financing decisions on proposed activities (including oversight of country-level operating entities). The standing finance committee’s (should be under CoP) role would be to assist the SBI in evaluating the annual reports of the entities comprising the financial mechanism

for presentation to the CoP. It may also draft and recommend guidelines for appraisal and funding of activities, which on CoP approval would form the CoP guidance to all entities of the financial mechanism.

(viii) In the discussion on eligibility, there should also be a definition of 'eligible Party' besides the eligible country and the implementing entity.

Ans: The UNFCCC (Article 4.7) only refers to “developing” countries, and not further subsets of “eligible” and “ineligible”. Article 4.8 permits a prioritization in terms of specified categories of developing countries for climate finance in respect of adaptation and “response measures”, but does not refer to eligibility. I believe that, a categorization of developing countries as “eligible” and “non-eligible” is not permissible under the UNFCCC, and in any case not by any individual entity under the financial mechanism.

Since, only developing countries are, in any case eligible to receive funds under Art 4.7, and since (unlike the EU) developing country members and Parties are identical, it makes little material difference in their case whether one refers to “Parties” or “countries”.

(ix) The governance of the Board is an important issue. We should pitch in for an independent Board that is governed by clear principles. It has to be decided how the membership of the Board will be chosen since this is not mentioned in the Cancun decisions. India has to clarify whether it wants the principle of one country, or one person (i.e. a country chosen by the regional group irrespective of its size and status, or a country chosen on the basis of its economic strength/GDP or a country chosen on the basis of its’ population), to be the basis for such

membership. We should give a small note containing our views and circulate it in the TC at an appropriate stage.

Ans: See the response to query no. (iv) above (i.e. the Board members to be elected by the respective regional groups). On independence of the Board, I believe that, this should relate to individual funding decisions, and the Board should be guided by the CoP in terms of general Principles and prioritization (among groups of countries and kinds of activities), and be accountable to the CoP for fidelity to the same. I believe that, it is now a politically foregone conclusion that the Board would have equal voting strengths of developing and developed countries (judging from adoption of this norm in respect of the Adaptation window in the Copenhagen Accord). This fact would make it difficult to further apportion votes among individual Board members in terms of population, GDP etc. As another practical consideration – it is unlikely that there would be general agreement on the population criterion alone, and introducing GDP as another criterion for determining voting strengths could easily lead to a situation where the developed countries hold the majority of votes. This would render the voting structure of the GCF similar to the Bretton Woods institutions, the avoidance of which has been among the major objectives of developing countries in respect of the financial mechanism of the UNFCCC.

(x). The issue of coverage of risk in granting loans has to be addressed. This will depend on how the risk capital is provided and on what terms. There are both types of risks-financial and reputational. In the case of Green Climate Fund, where sovereign countries are going to be recipient, the reputational risk is larger. There should be a mechanism for mitigation of such risks in the operation of the Fund.

Ans: In general, the GCF should avoid loans and equity, and provide only grant-funding. The former should be left to the proponent to obtain from other sources, national and international capital markets, and MDBs. However, since no modality can be a-priori excluded, I believe that it would be politically difficult to distinguish among sovereign borrowers in terms of their risk profiles (in the matter of tenure, interest rates). Risk mitigation in such cases should be ensured by overall portfolio balance, as is typically done by MDBs. (This would also ensure that low credit-risk countries such as India would have a substantial share of such funding).

(xi). The principle of contribution- on assessed basis or otherwise is an important issue. India has to clarify and decide the approach it will take to this issue.

Ans: This is the single most important distinction between “development aid” and “climate finance”. The latter is premised upon differentiated responsibility and respective capabilities, while the former is entirely at the discretion of the “donors”, without acknowledgement of responsibility for the underlying condition to be addressed by the “aid”.

The CBDR principle would also distinguish between the UNs system of assessed contributions, being based principally on GDP, and the basis of assessment under climate change finance. Empirical data is available for historical and current emissions of countries going back to 1850 (for determination of historical responsibility), and together with current GDP data (for determination of capability), enables formulation of a specific CBDR based formula.
