The United Nations Climate Fund

An equitable financial mechanism under the UNFCCC

APRODEV is the association of the 17 major development and humanitarian aid organisations in Europe, which work closely together with the World Council of Churches (Including Church of Sweden, Diakonia, Norwegian Church Aid, Dan Church Aid, Finn Church Aid, ICCO, EED, Brot für die Welt, Bread for All, and Christian Aid). Those mentioned have all contributed to this paper.

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This financial proposal argues the following…

- The various financial proposals submitted so far have all attracted interest for different reasons.
- The Norwegian proposal allows a way of creating an institutionalised flow of resources, not linked to national treasury decisions, but operating at a global level. This could ensure an automatic, scalable, additional and predictable financial flow and so is very promising.
- Mexico creates a fund that addresses the issues of 'assessed contributions' and currently involves all countries. However, contributions to and disbursements from the fund are based on a set of equity based criteria.
- The G77+China proposal addresses important principles of governance and also express the expected overall need of flows.
- Our proposal combines the automatic funding of the Norwegian proposal, with the 'equity based assessed contributions of the Mexican proposal, together with the best existing equity criteria – the Greenhouse Development Rights Framework.
- We believe this best ensures the principle of 'common but differentiated responsibility and respective capabilities' and safeguards the right to development for the poor.
- We do not limit the financial sources to the auctioning of AAUs, but argue in the interest of accountability, additionality, predictability and scalability that this should be the main contributing source to the Fund.
- For the next commitment period we propose that only Annex 1 Parties take on binding obligations to contribute to the Fund. If these commitments are fulfilled, we propose that some of the major non-Annex 1 Parties take on their respective commitments in the subsequent periods.
- We propose a fully overhauled cap and trade regime as a basis for the auctioning of AAUs where the cap is set in consistency with a target to keep global warming as well below two degrees as possible. This will require a cut of more than 40 per cent by Annex 1 from 1990 levels by 2020.
- Such a cap, combined with other necessary regulatory measures, could give a carbon price in the range of 100 to 150 USD/tonne in 2020.
- Essential in our proposal is the bottom-up approach to the assessment and determination of the overall financial needs. Recipient governments prove their financial needs through NAMAs, NAPAs and other appropriate plans which undertake technical assessments from two panels of experts (mitigation and adaptation) and then are approved by an Executive Board. Hence, the Board suggests the scale of funding needed for the COP which decides the amount of AAUs to be auctioned.
- We propose one financial mechanism under the Convention and the authority of the COP with three separate funding windows. To ease the administrative burden and ensure ownership, oversight and effective access to funding, the mechanism is equipped with Multi Stakeholder National Groups which works as a combination of national disbursement hubs and climate strategy providers.
- This is not an attempt to describe what a politically feasible outcome of these negotiations could look like. It's simply a proposed just and equitable financial mechanism under the UNFCCC.

The United Nations Climate Fund

This proposal outlines a financial architecture that would raise sufficient resources for adaptation and non-Annex 1 mitigation based on Annex 1 mitigation efforts consistent with staying well below two degrees Celsius. In order to preserve the right to development for poor people, the mechanism is based on equity in its resource generation, effort sharing, governance and disbursement, thus funding rapid global mitigation while, at the same time, enabling access to effective financial flows for the poorest and most vulnerable in their effort to adapt to a climate that will threaten their lives, livelihood and dignity.

This proposal draws from and builds on other proposed mechanisms such as the Norwegian, the Mexican and the G77+China proposals by marrying the Norwegian auctioning idea with principles of governance and disbursement from the other two. The main new addition in this proposal is a differentiation of contributions to the auction from Annex 1 Parties. The differentiation formula, known as the Responsibility and Capacity Indicator (RCI), will bring the effort-sharing in line with the principle of 'common but differentiated responsibilities and respective capacities'. This is fully consistent with the first of the two options presented in the European Commission's Communication, which proposes to determine the annual financial commitment of developed countries on the basis of ability to pay and the polluter pays principle.

Principles

In the interest of efficiency, comprehensiveness and in order to exploit possible synergies, we propose a combined funding mechanism for mitigation, adaptation and technology provision, namely the United Nations Climate Fund (the Fund). The three areas can be best thought of as distinct but complementary windows under the Fund.

Besides being measurable, reportable and verifiable the funding will, according to the Bali Action Plan, need to meet the following basic criteria:

- Adequacy (Ensuring that adequate resources are mobilized)
- Sustainability (As funding requirements for adaptation are likely to increase at least in the medium term, the source of funds should not diminish)
- Predictability (Ensuring that there is certainty in terms of the amount and timeliness of money raised)
- Additionality (Ensuring this is a new financial obligation to existing ODA commitments)

Moreover, and in line with some of the principles embedded in the Mexican and G77+China proposals and the EC Communication, the funding also needs to be:

- Equitable in terms of effort sharing and disbursement.
- Governed by, and accountable to, the COP.
- Primarily and essentially grant based.
- Scalable (it should be possible to scale the funds up in a simple way if significant funding gaps are found)
- Effective and accessible (also for the poorest, vulnerable and marginalized groups)
- Efficient (minimizing mismanagement and ensuring non bureaucratic and swift delivery)

Sources of Funds

We are deeply concerned that the current carbon market is not regulated sufficiently to deliver the necessary scale of action required, that the current offset based CDM is only shifting emissions but not providing additional action, and that it delivers no technology transfers for the countries unable to attract CDM projects. New regulation and other streams of finance are necessary to provide such countries with clean development, decarbonization and adaptation.

We assume that a fundamentally revamped and restructured international cap and trade system containing clear and stringent domestic emission reduction obligations for Annex 1 Parties will be adopted to encourage mitigation as a result of the Copenhagen Agreement. While such a scheme will most certainly cover Annex 1 countries it will need to be accompanied with other national and international measures to ensure large scale mitigation actions in developing countries.

A sufficiently tight cap will generate a price for carbon significantly higher than that prevailing under the ongoing EU ETS where the price of carbon seems to have collapsed. Under a stricter cap and trade regime with a mitigation pathway consistent with a 350 ppm stabilization limit, the price of carbon is likely to be significantly higher than the prevailing EU price of today. This will require strong limitations to the current offset provisions.

We propose that a significant proportion of the permits will not be grandfathered but rather set aside and auctioned (like in the Norwegian proposal). This would enable the Fund to have a separate, independent source of funding that is not mixed with national budgets and which is stable, predictable and scalable. The proportion of the AAUs to be set aside would depend on the estimated revenue needed for all the Fund's activities and the prevailing carbon price. In particular, the scale of the funding shall be determined based on an assessment of the needs for financial support for mitigation in non-Annex1 countries (MRV) in order to maintain a global emission pathway that preserves a high likelihood of maintaining warming well below two degrees.

This assessment should be made by two Expert Panels – one for mitigation and one for adaptation – under the authority of the COP in concert with the development of national mitigation and adaptation plans by developing country parties. Such plans shall include an elaboration of tonnes of GHG reductions that shall be achieved in a monitorable, reportable, and verifiable manner, as well as explicit budgetary needs.

G77+China gives an estimate of the needs in their proposal in the range of 0,5 to 1 per cent of the GNP for Annex 1 Parties. Using projections by the World Bank for 2020, that is somewhere between 250 and 500 billion USD. The prevailing carbon price will depend on the mitigation obligations for the Annex 1 Parties, the efficiency of the market, the inclusion of offset mechanisms, etc. Given a 40 per cent reduction in GHG emissions from Annex 1 Parties in 2020 compared to 1990[1] and an estimated carbon price of 100 - 150 USD / tonne[2], the total market value in 2020 will be in the range of 1.062 – 1.593 billion USD. Auctioning 10 per cent of this will generate revenue between 106 and 159 billion USD for the Fund while doubling the percentage will double the revenue. However, as any assessment of the needs will not be exact, we propose a system where the revenue is scalable according to the proven needs.

[1] Annex 1 GHG emissions in 1990: 17,7 billion tonnes CO_2-eq

[2] A conservative estimate based on the three category stabilization scenarios from IPCC WGIII Chapter 3

Calculation of the Annex 1 contributions

We propose that the quantity of AAUs to be withheld from each Annex 1 Party shall vary and be determined based on the principle of common but differentiated responsibilities and respective capacities. Hence, we introduce a *Responsibility and Capacity Indicator* (RCI)[3] which will ensure a fair and equitable contribution to the Fund by assigning varying proportions of AAUs to be set aside from each contributing Party. The RCI was introduced as part of the *Greenhouse Development Rights* burden sharing framework.

Each Party's RCI is the average of their respective share of *responsibility* and their respective share of *capacity,* relative to the Annex 1 total.

Responsibility is defined as cumulative emissions of people with a yearly income above USD 7500[4] ppp since 1990. Capacity is defined as GDP excluding income below a threshold of USD 7500 ppp. Each country's share of population living on an income below this threshold will have no obligation in contributing to the Fund, nor are the emissions from these people adding to responsibility.

The inclusion of a 'development threshold' in the calculation of responsibility and capacity is meant to secure the right to development as the primary focus for those below that threshold by exempting them from having to shoulder the costs of action on climate change. (See the appendix for table and chart.)

Though the industrialized countries' historical responsibility is in fact far higher than their emissions since 1990, we propose to use the year of the first IPCC report as emissions after this year have not taken place in ignorance of the threat of climate change.

Such a RCI would meet the accepted principle of 'common but differentiated responsibilities and respective capabilities as embedded in the Convention and acknowledged by the Bali Action Plan.

For the next commitment period we propose that only Annex 1 Parties have legally binding obligations to contribute to the Fund through the auctioning of AAUs.

Future contributions from non-Annex 1 Parties

For the next commitment period any non-Annex 1 Party's contribution to the Fund which equals their RCI, will be on voluntarily basis. Assuming that the obligations of Annex 1 Parties are being fully fulfilled during the forthcoming commitment period, some developing countries, especially the major non-Annex 1 Parties, may take on their respective obligations due to their RCI during subsequent commitment periods.

Contributions could either be in the form of grants or AAUs depending on whether the respective non-Annex 1 Party has undertaken a cap and trade scheme.

[3] Baer, Athanasiou and Kartha (2008): The Greenhouse Development Rights Framework
[4] USD 7500 ppp is an indicative yearly income needed for a modest, yet dignified level of well-being.

Other possible sources

Depending on what sort of mitigation regime is agreed to, international aviation and international shipping might lie outside of these national targets but would of course need to also follow either 'cap and trade' or face a carbon tax in order to play their part in reducing GHG emissions. In this case, levies on both can be regarded as possible additional sources of income that should be allocated to the Fund.

Similarly, other additional sources might be identified and channeled to the Fund. However, we believe an auctioning mechanism based on the AAUs should still be the main source as it holds the Parties to the Convention accountable and allows for an equitable effort sharing.

The Governance of the Fund

The United Nations Climate Fund will operate under the authority and guidance of the COP and be fully accountable to it.

The Fund will operate at least three funding windows to address specific requirements namely Mitigation, Adaptation and Technology Research and Development. One can also assess the possibility of having sub windows under each funding umbrella for example a specific REDD window under the Mitigation window.

The Fund shall consist of the following bodies:

- The COP
- An Executive Board with a Secretariat
- An independent Expert Panel for Mitigation
- An independent Expert Panel for Adaptation
- Trustees
- Multi Stakeholder National Groups (MSNGs)

The COP is the supreme body of the Fund making all political decisions and electing its Executive Board. The COP is also responsible for approving the Fund's Guidelines on which the Executive Board will make operational decisions[5].

The Executive Board (the Board) shall operate the Fund with a Professional Secretariat and two independent Expert Panels to assist its work. The Board's main responsibility is to ensure the Fund's revenue meets the overall budgetary needs for adaptation, MRV support, REDD and technology. They also give policies for disbursement in line with the Fund's overall principles and its Guidelines and oversees the registries for NAMAs and NAPAs. The Board reports annually to the COP on the financial situation of the Fund on which the COP approves suggestions for necessary scaling of the Fund's income, hereby adjusting the amount of AAUs to be set aside for auctioning.

For the Executive Board, it is proposed that there will be a one country one vote rule and a majority representation for non-Annex1 countries with balanced geographic and gender representation and the possibility of designated representatives from the main recipient interest groups under the Mitigation and Adaptation window. Additionally, just like with the Global Fund and UNITAID, a provision will be made for appropriate civil society

[5] Benito Müller: *The Reformed Financial Mechanism of the UNFCCC. Part I: Architecture and Governance*

representation. The Fund will work with principles of full transparency making the fullest disclosure of records possible.

The two independent Expert Panels will include climate experts, technological experts, disaster management experts as well as experts in the field of development who are able to assess how successful proposed programs are likely to be in meeting their objectives. The Expert Panels will also, based on submitted NAMAs, NAPAs and its assessment of technology needs and capacity support, give recommendations to the Executive Board on the size of funding needed at which the Executive Board gives suggestions to the COP on the scale of finance needed. The Expert Panel on Mitigation shall also make calculations of the total GHG-reductions being undertaken in the non-Annex 1 countries through financial support from Annex 1 Parties, and report annually to the COP if the total – in terms of tonnes reduced – falls short of the required/agreed numbers for MRV action. The COP will then review its decisions on MRV-supported mitigation in the non-Annex 1 Parties in light of the financial support available and request further action if needed.

Trustees needed to audit and verify programs and disburse funds will be appointed on a rolling five year basis based on international competitive tender and minimum qualification.

In order to provide in-country direct access to funding and the oversight needed for the Executive Board, we propose that just as under the Montreal protocol where Ozone groups were formed nationally, it is imperative to form high level cross-ministerial and multi-stakeholder groups that include the government, technicians, representatives of the business community and civil society. These we call the *Multi Stakeholder National Groups* (MSNGs) which could act as the implementing partners of the UNFCCC and its subsidiary bodies (such as the Fund). The MSNGs will be responsible for formulating NAMAs and NAPAs and other national strategies regarding capacity building which in turn will be funded by the Fund to ensure national ownership and efficient implementation. All plans will have to be approved by national governments which are also responsible for the implementation.

- The governments of developing countries work with civil society organizations, experts and other partners through MSNGs to prepare proposals and programs that fill financing gaps for mitigation, adaptation and technology.
- Eligible proposals and plans (NAMAs, NAPAs, etc.) submitted to the Fund will be reviewed for technical merit by the respective Expert Panel.
- Those that are recommended would be considered by the Executive Board and approved for funding.
- The MSNG will together with the Trustees monitor the plans and actions and report to the Executive Board.

Some flexibility is required in setting up the MSNGs as no fixed solution will fit all. For some countries a regional MSNG will be more appropriate.

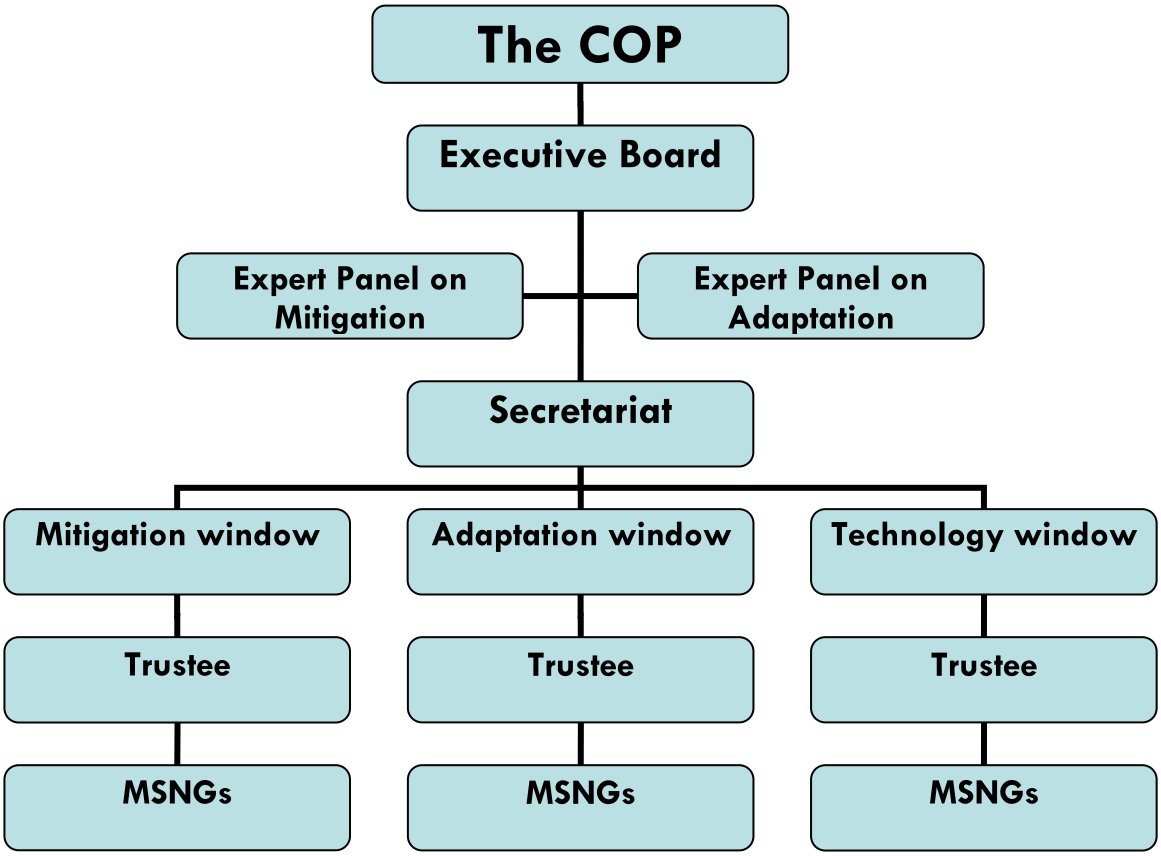


Figure 1: Possible institutional design for the United Nations Climate Fund

Disbursement windows

The total pooled resources of the Fund could either be fungible or divided in to different windows. We propose a division of funding between the Mitigation window, the Adaptation window and the Technology window. The Expert Panel will, based on their assessment of the needs, propose an adequate allocation for the different windows on which the Executive Board decides.

To ensure effective and equitable delivery and to guarantee the funds are used for what they are supposed to be used for and that the most vulnerable and impacted benefit from the funds, we propose that applications from governments, business and civil society groups shall be accepted for consideration by the MSNGs and be reflected in their submitted plans. Up to 10% of the total funding can, within the next commitment period, be used for capacity building, to adopt NAMAs and NAPAs and increase the absorptive capacity in the most vulnerable and least developed countries.

Governments communicate their budgetary needs through their NAMAs and NAPAs. These plans should also contain provisions that ensure that funding do not undermine, but rather contribute to the realization of human rights and long-term development objectives. As should the monitoring of the NAMAs and NAPAs also make note of the activities funded being in compliance with human rights standards.

The Mitigation window should cover MRV action in non-Annex 1 countries based on submitted NAMAs. This window will also finance REDD and the development of low-carbon development strategies for the Least Developed Countries.

The Adaptation window will finance the adaptation needs of poor and vulnerable people in developing countries based on the submitted NAPAs. This window will also contain an insurance provision for climate-induced disasters.

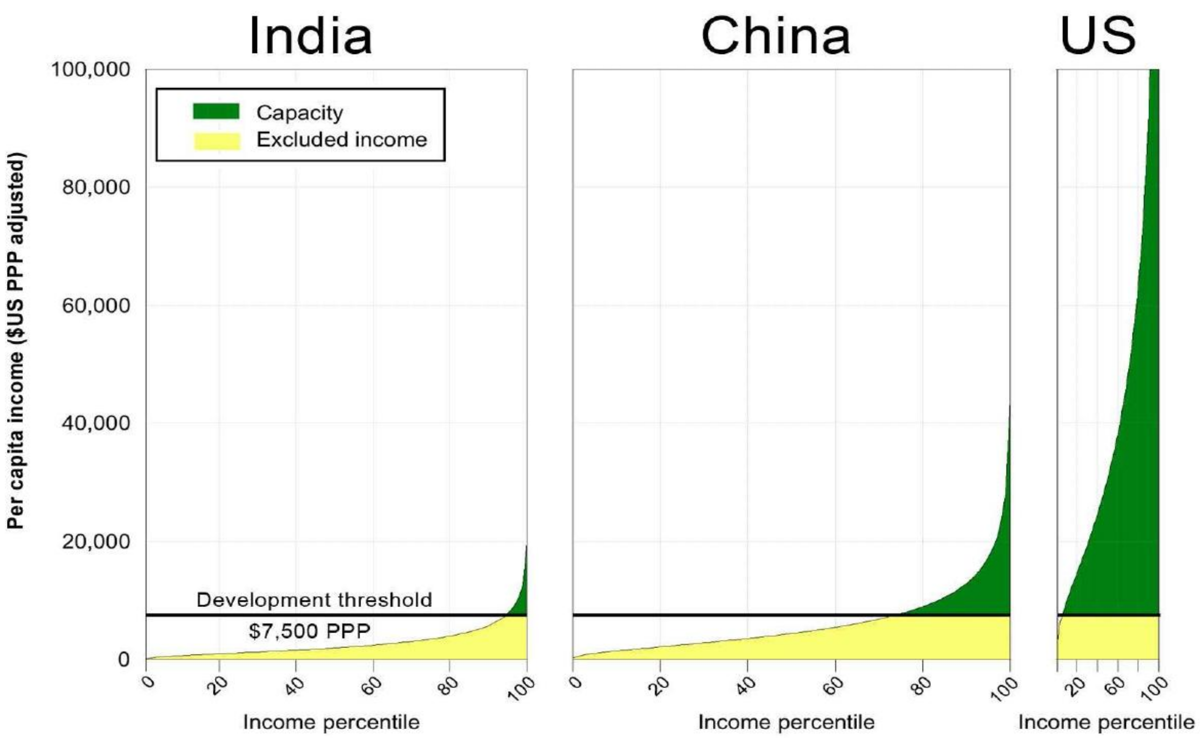
As the actual transfer and deployment of technology both for mitigation and adaptation measures will be provided for through the respective windows, the Technology window is meant to enable access to new technologies for non-Annex 1 Parties. First, it will provide funding for development of new technologies to meet the needs for both mitigation and adaptation in the South. Such funding could be made conditional to prevent the developer from seeking a patent on the new technology or force the developer to release voluntarily licenses on the patented technology. Second, funding should also be made available to buy off already patented technology that is required necessary to meet the needs on mitigation and adaptation in developing countries.

The MSNGs will be tasked with ensuring the NAMAs and NAPAs are coherent and complementary. Activities that contribute both to adaptation and mitigation objectives and are eligible for funding under more than one window should be judged on their merits against the both sets of objectives and should not lose out or be double funded. The Expert Panels will have a clear mandate of cooperation and communication to ensure this.

Appendix: The Responsibility and Capacity Indicator (RCI)

GDRs results for representative countries and groups	2010					2020	2030
	Population (percent of global)	GDP per capita ($ US PPP)	Capacity (percent of global)	Responsibility (percent of global)	RCI (percent of global)	RCI (percent of global)	RCI (percent of global)
EU 27	7.3	30,472	28.8	22.6	25.7	22.9	19.6
EU 15	5.8	33,754	26.1	19.8	22.9	19.9	16.7
EU +12	1.5	17,708	2.7	2.8	2.7	3.0	3.0
United States	4.5	45,640	29.7	36.4	33.1	29.1	25.5
Japan	1.9	33,422	8.3	7.3	7.8	6.6	5.5
Russia	2.0	15,031	2.7	4.9	3.8	4.3	4.6
China	19.7	5,899	5.8	5.2	5.5	10.4	15.2
India	17.2	2,818	0.7	0.3	0.5	1.2	2.3
Brazil	2.9	9,442	2.3	1.1	1.7	1.7	1.7
South Africa	0.7	10,117	0.6	1.3	1.0	1.1	1.2
Mexico	1.6	12,408	1.8	1.4	1.6	1.5	1.5
LDCs	11.7	1,274	0.1	0.04	0.1	0.1	0.1
Annex I	18.7	30,924	75.8	78.0	77	69	61
Non-Annex I	81.3	5,096	24.2	22.0	23	31	39
High-income	15.5	36,488	76.9	77.9	77	69	61
Middle-income	63.3	6,226	22.9	21.9	22	30	38
Low-income	21.2	1,599	0.2	0.2	0.2	0.3	0.5
World	100	9,929	100%	100%	100%	100%	100%

Table ES1: Percentage shares of total global population, GDP, capacity, responsibility, and RCI for selected countries and groups of countries. Based on projected emissions and income for 2010, 2020, and 2030. (High-, Middle-, and Low-income Country categories are based on World Bank definitions as of 2006. Projections based on International Energy Agency World Energy Outlook 2007.)



Calculation of capacity for India, China and the US – both from the Greenhouse Development Rights Framework.