

# Key Issues Brief; climate finance architecture in BASIC countries

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**Prepared for DFID India**

Final, March 2012

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<sup>1</sup> Consortium comprises Harewelle International Limited, NR International, Practical Action Consulting, Cranfield University and AEA Energy and Environment

## A. Context

DFID India commissioned three country papers via the DEW Point Resource Centre. These examined the domestic climate finance situation in three of the four BASIC countries; China, Brazil and South Africa. This brief seeks to summarise common themes from the descriptions of the three countries domestic finance arrangements, and to highlight some key issues in relation to domestic and international climate finance. The focus of this brief is on issues (international and domestic) that may be of importance to India's specific climate finance context.

## B. Key issues arising from the three case studies

There are a number of common themes that arise from the overview of the arrangements in China, Brazil and South Africa.

- All three countries either have specific national climate change strategies/plans (South Africa and Brazil) or have begun the process of integrating climate change considerations into its broader development plan (China).
- Brazil and China have developed (a number of) national climate funds while this idea has been advocated and is under review in South Africa.
- In line with India's coal tax, both South Africa and China have announced their intention to introduce some form of carbon pricing: South Africa plans to introduce a carbon tax from 2013/14 while China has announced emission trading scheme pilots
- China has already achieved a significant scale up in renewable electricity generation while South Africa has ambitious goals in this direction. Brazil's primary effort is focussed towards reducing emissions from deforestation, although energy from waste also receives significant public support.
- Different incentive models are being used to encourage renewables investment. In China, conventional feed-in tariffs are the dominant incentive mechanism. Intriguingly both Brazil and South Africa have moved towards a model where rights for renewable generation capacity is auctioned. This may be due to an expectation that the competition for these contract will deliver renewables capacity at lower cost<sup>2</sup>.
- This initial scoping research indicates that less focus is being placed by these countries on adaptation than it is on mitigation. This is consistent with the global picture; for instance, a recent report indicated that around 95 per cent of climate finance was allocated towards mitigation (including REDD)<sup>3</sup>.
- The scoping research also suggests that there may not be too many lessons that can be taken from these countries in relation to decentralised (federal) structures for disbursing national climate finance. Although further research could yield additional insights, processes to allow for decentralised decision making do not appear to be a prominent feature in the climate finance architecture in each of these countries. The main exception appears to be Brazil where for example, the Amazon Fund includes the relevant state governments within its Board while a system for linking redistribution of VAT receipts according to ecological criteria has been developed. The Brazil example also provides examples of the challenges associated with achieving effective decentralisation with some expressing concerns that overlapping responsibilities and misaligned priorities between different tiers of administration has led to confused decision making.

As concerns resource mobilisation, the three case studies have not yielded any specific information regarding differentiated treatment between domestic and foreign capital, other than perhaps some erstwhile Chinese local content provisions for renewables. Public resources were raised in a number of different ways:

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<sup>2</sup> China previously adopted this model for renewable generation capacity but moved away from it due to the concern that the successful bids were too low and bidders ultimately chose not to invest (winner's curse)

<sup>3</sup> Climate Policy Initiative (2011) 'The landscape of climate finance'.

- In many cases, no statements are made about the origin of the resources, which can be read as implying general taxation as the source, i.e. state subsidies in China; and part of Brazil's national climate fund which can also be resourced from general taxation.
- There are examples of hypothecation/earmarking revenues being used in a number of the countries e.g. China's CDM fund. Brazil's national fund receives up to 60 per cent of the revenue from a special tax on the profits made in the petroleum production chain
- There is a certain ambiguity/opacity as to where the resources will come from in China.
- Brazil and South Africa complement domestic public resources with international public money (Amazon Fund; CTF – and, it is hoped - SARi in South Africa)

In addition to these specific points arising from the country case studies, there are a number of key issues that need to be taken into account, related to the current status of the international negotiations on climate change finance and to previous experience with domestic arrangements for development finance.

## **C. Other key issues**

### ***1. International***

At the international level, there are three issues that will be of immediate importance to domestic climate finance, to be decided over the course of the next year or so by the Green Climate Fund Board.

#### *(i) National Funding Entities*

National Climate (Trust) Funds are a relatively recent phenomenon, but they are becoming more and more popular, as a result of the expectation that national climate strategies are most effectively 'mainstreamed' through such dedicated national funding instruments: they can have advantages whether or not they are used for the purposes of enhanced direct access to multilateral funding bodies, such as the Green Climate Fund (GCF). Having said this, the GCF Instrument is instructing the GCF Board to "consider additional modalities that further enhance direct access, including through funding entities," and it stands to reason that these additional modalities may have a significant effect on the design of national climate trust funds.

#### *(ii) No-objection Procedure.*

One of the GCF design issues resolved at COP 17 in Durban was the extent of government 'say' over what GCF funded activities are to be implemented in their countries. Paragraph 7 of the GCF Decision *requests the Board to develop a transparent no-objection procedure to be conducted through national designated authorities ..., in order to ensure consistency with national climate strategies and plans and a country driven approach and to provide for effective direct and indirect public and private sector financing by the Green Climate Fund.* The nature of this procedure could have profound effects on in-country climate change activities, particularly with regards to the operations of the GCF Private Sector Facility.

#### *(iii) Private Sector Finance 'Mobilization'*

In light of the fact that most developed countries envisage a significant proportion of the \$100 billion Cancun finance commitment for developing countries to be 'mobilized' through the private sector, it stands to reason that they would see the GCF Private Sector Facility (PSF) as primarily mobilizing foreign direct investments through developed country private sector entities. However, it will be important that the private sector facility also seeks to engage and mobilize the private sector in developing countries, especially as this will remain responsible for the vast majority of investments in developing countries. This can be ensured by careful design of the GCF PSF with appropriate safeguards.

*(iv) Attracting foreign resources*

While India has in the past stated that it would not be seeking international funding for adaptation purposes, it is clear that this is not the case for mitigation. Indeed, India's latest submission to the UNFCCC reiterated the position that in the context of the Durban Platform negotiations, developing countries "could enhance their mitigation actions, *depending upon provision of finance, technology and capacity building support by developed countries Parties*"[emphasis added]. Whether or not India will be able to attract public sector funding for this purpose is difficult to say.

An alternative to foreign public sector funding is funding through market mechanisms such as the CDM. Given the uncertainty over the fate of the CDM post 2020, particular attention will have to be given to the design of new market mechanisms under the Durban Platform, if India is to access mitigation funding via this channel.

## **2. Domestic**

The key challenges of (a) national climate change funding instrument(s), such as funding strategies or funding bodies (National Funding Entities), are likely to include the following five interlinked elements:

- i. **Integration / mainstreaming** of climate change activities with existing national development sectors, activities and priorities;
- ii. Ensuring that adaptation funds are **channelled effectively** to the most vulnerable communities/ those most in need/ the local level in a timely and effective manner; ensuring that mitigation funds are channelled towards activities that deliver significant emissions savings, as well as development benefits.
- iii. Ensuring the funding instrument(s) is (are) **flexible** enough to meet evolving and changing needs at every level of governance (national, state, district, village);
- iv. Involving a wide **range of government and non-government stakeholders** necessary to implement action on climate change;
- v. Building in an **effective accountability and transparency mechanism**.

These five elements are discussed in greater detail below.

*(i) Integration/ mainstreaming with national development sectors, activities and priorities:*

Key elements to be taken into consideration:

- Channelling climate funds through existing national and sub-national budgetary processes will enhance the chances of better integration and mainstreaming with existing development activities, and also result in better efficiency and effectiveness as the funds for climate change and development are pooled and used to consolidate and strengthen existing and new activities for mitigation and adaptation.
- Climate change mitigation and adaptation action will need the active involvement of a very wide range of government and non-government stakeholders in order to be effective. This should be taken into account in the architecture of the national instrument(s) from the very start. The inclusion of representatives from these stakeholder groups in the coordination body of the instrument(s) will result in better ownership and participation. For instance, rather than have one ministry leading the coordination in India, it may be preferable to house the coordination committee in the Prime Ministers Office which has already played a strong role in the development of the National Action Plan on Climate Change, and will have the 'convening power' to engage the other sectoral ministries which will avoid ineffective coordination. If a specific ministry takes the lead, it will be preferable to have a ministry with 'convening power' (such as the Ministry of Finance or the Planning Commission) to coordinate activities. The inclusion of representatives of vulnerable communities, NGOs and the private sector in the coordinating body will help build better ownership and inclusivity.
- Considerable capacity development will be needed, particularly for stakeholders from sectors that have not hitherto been engaged in climate change, to ensure effective integration (for

instance, through the provision of strong and credible analysis on the economic impacts of climate change on the particular sector/segment of society).

- Existing national development strategies could be the best vehicle for integrated climate action, rather than ‘stand-alone’ plans. For instance, India’s 12<sup>th</sup> Five Year Plan’s focus on Inclusive Growth for 2012-2017 would be a good vehicle for integrated climate action, with a focus on the poor and vulnerable.

*(ii). Ensuring that adaptation funds are **channelled effectively** to the most vulnerable communities/ those most in need/ the local level in a timely and effective manner; and ensuring that mitigation funds are channelled towards activities that deliver significant emissions savings, as well as development benefits.*

Key elements to be taken into consideration:

- As mentioned earlier, processes to allow for decentralised decision making and implementation do not appear to be a prominent feature in the climate finance architecture in each of the countries considered in the case studies (with the partial exception of Brazil). However, this is an area where India already has considerable experience (for instance, through the *Panchayats*, and through programmes such as NREGA and community and joint forest management), and can lead the way.
- The ‘implementing body’ functions of the funding instrument(s) (including the identification and approval of activities) will need to be decentralised to the extent possible, to make the instrument(s) more responsive to local needs.
- It will be more effective to use and strengthen existing and proven mechanisms of decentralised governance to reach out to the local level from the point of view of efficacy (pooling of resources), as well as integration, rather than build new ones. In India, for instance, the effectiveness of using the *Panchayats*, NREGA, NABARD, etc. could be considered.
- There will be a strong need for capacity building of state and local governments, and of non-government stakeholders, to convince them of the need to take climate action – including the need for tailored scientific and technological information and resources.
- The sometimes greater capacity of non-government actors to reach out to far-out communities should be taken into account, and a role built in for them formally.
- An effective national (or even state-level) ‘ombudsman’ will be needed to ensure that the interests of poor and vulnerable communities are protected. This will greatly enhance the credibility of the instrument(s).

*(iii) Ensuring the funding instrument(s) is (are) **flexible** enough to meet evolving and changing needs at every level of governance:*

- Adaptation action and the response to climate change impacts, in particular, will need to be flexible to respond to changing needs. Decentralised decision-making will help making the instrument(s) more flexible and responsive to local needs.
- Local action plans, which can be periodically revised, may be a better way to map the way ahead rather than broader national or even state level plans.

*(iv) Involving a wide **range of government and non-government stakeholders**, necessary to implement action on climate change*

- A formalised, institutionalised structure for engaging stakeholders at the local level will help to sustain engagement in the long term, rather than one-off participatory meetings.
- Capacity development, awareness raising, and the provision of localised information will be key concerns.
- Stakeholder consultations will need to be designed to encourage the resolution of potential conflicts among stakeholders (for instance, the private sector and local communities)

*(v) Building in an effective monitoring, accountability and transparency mechanism*

- In (a) instrument(s) that is (are) so heavily decentralised and where there are so many actors, effective ways of monitoring results, ensuring accountability and transparency will be essential.
- Non-government involvement in monitoring will enhance the credibility of the instrument(s)
- A local system of independent ombudsmen for dispute resolution will make the instrument(s) more accountable to local communities.
- Civil society can play a key role in insuring accountability and transparency, and a formalised role in this regard can be very effective. Accountability systems for civil society will need to be in place for this.