



DIRECTORATE-GENERAL FOR EXTERNAL POLICIES  
POLICY DEPARTMENT



# CLIMATE CHANGE FINANCING: THE CONCEPT OF ADDITIONALITY

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DIRECTORATE-GENERAL FOR EXTERNAL POLICIES OF THE UNION

**DIRECTORATE B**

POLICY DEPARTMENT

**BRIEFING**

**CLIMATE CHANGE FINANCING: THE CONCEPT OF  
ADDITIONALITY IN THE LIGHT OF THE COMMISSION  
PROPOSAL FOR A DEVELOPMENT COOPERATION  
INSTRUMENT (DCI) FOR 2014-2020**

**Abstract**

Due to considerable overlaps between development and climate finance and the danger that funding is diverted from existing development assistance it would be important to define a baseline against which additionality can be measured. So far, no internationally agreed definition exists. The EU could step forward and come to a common approach even if this might temporarily disadvantage Member States under the current reporting practice. Any such definition should build on the commitment to raise ODA levels to 0.7 % of GNI by 2015. Although incentives are strong to try and count in as much private finance as possible, climate finance should come predominantly from public sources. Especially instruments using public funding to “leverage” private funds should be seen with caution. The funding commitments can be met, but they will likely require a wide range of innovative instruments for new financing to be put in place. Due to the overlaps, climate and development activities should be integrated as far as possible at the operational level. Despite a considerable increase of climate related financing in the proposal for the new instrument for Development Cooperation, it is not clear as to what extent these funds are additional. Therefore, additionality of climate finance should be clearly defined also in the DCI regulations.

This briefing was requested by the European Parliament's Committee on Development.

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## List of Abbreviations

AAU	Assigned Amount Unit
AGF	Advisory Group on Climate Change Financing
CIF	Climate Investment Funds
CRS	Creditor Reporting System
DAC	Development Assistance Committee
DCI	Development Cooperation Instrument
EC	European Commission
EFC	Economic and Financial Committee
EPC	Economic Policy Committee
ETS	Emission Trading Scheme
EU	European Union
FTT	Financial Transaction Tax
GCF	Green Climate Fund
GEF	Global Environmental Facility
GNI	Gross National Income
LDC	Least Developed Countries
LDCF	Least Developed Countries Fund
MDG	Millennium Development Goals
MFF	Multiannual Financial Framework
MIC	Middle Income Countries
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
UN	United Nations
UNFCCC	United Nations Framework Convention on Climate Change

## EXECUTIVE SUMMARY

Climate financing is understood to comprise the support to developing countries for both adaptation to climate change and for the mitigation of greenhouse gas emissions. Developed countries have committed themselves to providing USD 100 billion of “new and additional” financing annually by the year 2020 in order to address climate change needs in developing countries. However, so far, there is no internationally agreed definition of what “new and additional” actually means. While criteria for Official Development Assistance (ODA) have been defined quite clearly, there is no such clear-cut definition for climate finance. At the same time, there are considerable overlaps, both geographical and sectoral, between development and climate change concerns and integration of respective activities is important for reasons of effectiveness and efficiency. This is particularly true for adaptation measures, where activities that focus rather on vulnerability issues and activities that have a stronger focus on the impacts of climate change and adaptation are situated along a continuum. Therefore, it is difficult to draw a clear-cut dividing line to define exactly where climate finance starts and development objectives end. Indeed, there is a danger of relative shifts in the allocation of money, both geographical and sectoral, which could drive the focus away from traditional development objectives and development partners. This becomes even more obvious for mitigation related activities.

Therefore, the measurement, verification and monitoring of climate finance and its additionality is essential and would require an internationally agreed definition. However, finding a baseline against which additionality could be measured is not only a technical, but rather a highly political question that is currently characterised by the pressure of budgetary constraints. There are a number of options to define additionality which are presented in this paper; some of them are more ‘recipient friendly’ and describe what would be desirable to ensure a fair contribution of developed countries to climate change financing needs in developing countries. Indeed, from an ethical point of view additional climate finance should be above the long standing development target to provide 0.7 % of Gross National Income (GNI) for development cooperation. However, the best definition can be frustrated if budgetary constraints and political reluctance foil its compliance. Other options are therefore rather ‘donor friendly’ and focus on the political feasibility.

The European Commission (EC) itself has taken steps to come to a common definition within the EU by 2013 and has asked all Member States to declare their fast start climate finance and the definition for additionality they have applied. However, the answers are very diverse and the only obvious trend seems to be that ‘good ODA performers’ opt for more ‘recipient friendly’ options, i.e. options that imply strictly rising ODA or even are above the 0.7 % target. Overall, Member States remain reluctant in identifying a common internal definition for additionality as they fear to be disadvantaged at the global level, where reporting of climate finance takes place in the end, and where its success is evaluated. On-going efforts of the EC lie therefore rather on ensuring maximum transparency in reporting and avoiding diversion from existing or pledged ODA funds. Under these circumstances the EC wants to focus on the intelligent use of the funds and currently there are no further steps being taken to come to a common definition.

However, an internationally agreed concept of additionality could go a long way towards ensuring an effective and transparent provision of climate finance in the overall context of development cooperation. To advance the formulation of such a common definition, the EU could devise a stringent but effective common approach internally, as a proposal for debate at the UN level. Taking a clear step ahead within the EU might under the current reporting practice result in temporary disadvantages for

EU Member States against developed country counterparts, as an ambitious definition would suggest lower compliance with the commitments. At the same time, it could gain the EU favour among developing countries because of its higher level of ambition and the additional transparency, and thereby put pressure on other countries to follow suit.

Any definition should build on the twelve-point action plan (EU 2011b) to raise ODA levels to 0.7 % of GNI by 2015. Although intermediate goals have already been missed, the EU should not lose sight of this plan. As climate finance commitments are being more closely monitored by external partners they are currently a stronger moving agent than the 0.7 % target. Therefore, particular emphasis must be given to the problems of potential diversion from pledged levels of ODA and any definition of “new and additional” climate finance should include the pathway towards 0.7 %.

There is no doubt that current financial constraints in EU Member States severely curtail ambitious objectives with regard to full additionality of climate finance. Nevertheless, although incentives are strong to use ‘creative accounting’ and count in as much private finance as possible, climate finance should come to a large extent from public sources. One reason for this is that the committed USD 100 billion by 2020 is at the lower end of what is actually needed with regard to adaptation and mitigation. If private finance is to be included, it should therefore be above the USD 100 billion target. One option for increasing contributions from private sources is the expansion of leveraging instruments in climate related investment. While leveraging private money certainly has a place in climate financing that should not be underestimated, counting the public funds used for the leverage against the international financing commitment should be strictly limited. If there are no such limits, the seductive power of fulfilling the USD 100 billion target through private financing could open the doors for misuse of these instruments. Under that scenario, private money might rather leverage scarce public resources. For the same reasons, counting the leveraged amount against the international finance commitment should be banned altogether.

Providing USD 100 billion predominantly through public resources is likely to become feasible only through the introduction of innovative instruments to generate new sources of finance. However, if they are implemented widely, sufficient resources could be raised and could either be earmarked for climate finance, both national and international, or alleviate national budgets so that sufficient budgets are freed to fulfil development and climate finance commitments. However, provisions should be taken that revenues from innovative sources are raised in a way that earmarking is possible also at the level of national states (for instance revenues from auctioning or uniform fees for off-budget income). Otherwise, more binding commitments should be made with regard to ODA and additionality of climate finance. Nevertheless, the introduction of innovative financing instruments, especially when not introduced at a global level, is a delicate matter and will take a few years. In the mean-time, it may therefore be allowable to declare ODA and climate finance side by side (or climate finance as part of ODA) if ODA levels are rising. This practice should, however, be time limited and extend until 2015 or 2020 as a maximum.

Despite the need to separate the accounting for climate and development financing (at least in the medium term), climate and development activities should be integrated as far as possible at the operational level. While the proposal for establishing the Development Cooperation Instrument (DCI) foresees a rising amount of funds dedicated to climate change issues and benchmarks for climate change funding, it is not clear as to what extent these funds are really additional. Therefore, additionality of climate finance should be clearly defined also in the DCI regulations. Generally, the establishment of a European climate fund is not recommended, as it would contribute to the already

existing and rather confusing multiplicity of multilateral and bilateral funds without an obvious significant added value. Additional resources should rather be channelled to the new Green Climate Fund in order to secure adequate and sustained funding early on.

## INTRODUCTION

The Copenhagen Accord (2009) and the Cancún Agreements (2010) have further concretized developed countries commitments to provide “new and additional” climate change financing to developing countries. It was agreed that within a fast-start financing period from 2010-2012 USD 30 billion should be provided for adaptation and mitigation needs in developing countries and until 2020 USD 100 billion dollars annually should be mobilized jointly for the same purposes. “New and additional” means that the funding provided should be above previous climate financing levels and that it should be additional to existing funding for development purposes. It has also been stated rather vaguely that the committed funding is composed of several sources, both public (bilateral and multilateral) and private, and also includes innovative financial instruments.

This briefing tries to determine how additionality could best be measured. It is outside the scope of this briefing to discuss whether the pledged amount will be enough to meet the challenges that arise in connection with the adaptation to climate change as well as supporting development countries and emerging economies in their transition towards low-carbon and climate-resilient economies. Estimates of the investment requirements vary dramatically. Some analyses suggest that additional finance will be needed for adaptation and mitigation of USD 200 billion per year by 2020. This figure is calculated on estimates by the World Bank which forecasts that between USD 75 to 100 billion will be necessary annually between 2010 and 2050 only for adaptation (Weaver 2011: 2f.). As for mitigation the UNFCCC, Mc Kinsey and the EU have arrived at similar amounts (between USD 92 and 140 billion annually) for mitigation activities in developing countries (Brown, Cantore, te Velde 2009: 13). For the purpose of this briefing it should be made note of the fact that the pledged USD 100 billion rather seem to be at the lower end of what is likely to be needed in developing countries to tackle the challenges of climate change with regard to both, adaptation and mitigation.

Moreover, the challenges of climate change do not release donors from the long-standing commitment to take a fair share in the efforts of worldwide poverty reduction. On the contrary, the effects of climate change could actually jeopardize the achievements of the Millennium Development Goals (MDG), rendering anti-poverty efforts more important. Therefore, it should be clear that existing ODA should not be diverted in order to meet new climate change challenges. At the same time, it has often been stated that ODA will continue to be an important source of climate financing. In this context, it is one of the key issues to determine how the criterion of additionality can be met. This question will be addressed in the following chapter (2). Chapter 3 highlights some concerns with regard to the sources of the new funds that are to be raised. Moreover, with reference to the new proposal for establishing the DCI some analysis is undertaken as to what extent the requirement of additionality is respected and how climate related funds should be channelled. Chapter 4 integrates these considerations and draws conclusions.



## 1. DEFINING ADDITIONALITY

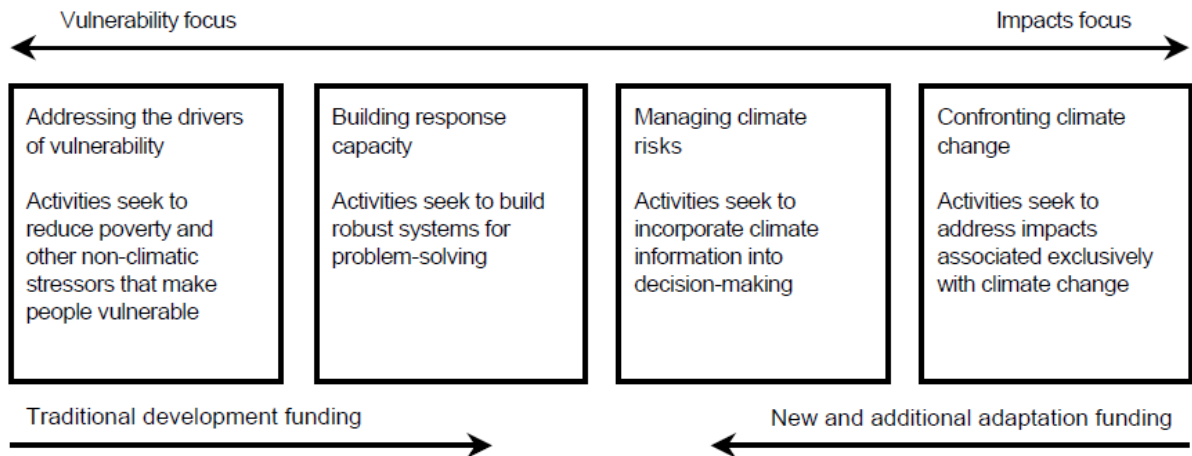
### 1.1 Overlaps between development assistance and climate financing

While criteria for ODA have been defined quite clearly by the Development Assistance Committee (DAC) of the Organisation for Economic Cooperation and Development (OECD), there is no such clear-cut definition for climate financing. Climate finance is understood to comprise the support to developing countries for both adaptation to climate change and for the mitigation of greenhouse gas emissions. With regard to adaptation there exists a considerable overlap with development financing not only in its geographic but also in its sector priorities: many poor countries that are traditional development partners of the EU are particularly vulnerable to the impacts of climate change, which pose a severe threat to achievements in the fight against poverty. While many impacts of climate change (sea-level rise, more extreme weather phenomena) are noticeable throughout the world, it is the combination of low capacity, high levels of poverty and weak institutions of those countries that make them so vulnerable. All these areas are specific objectives of development cooperation. Thus, “development is an essential component of adaptation as it enhances resilience and increases capacity” (Parker et al. 2009: 27).

At the same time, some sectors that are particularly relevant with regard to food security and poverty reduction, such as (smallholder) agriculture, rural livelihoods, the water or health sector, are also highly relevant to activities concerning adaptation to climate change. This shows the importance of climate-proofing for development activities on the one hand as well as ensuring compliance of climate financing with the main objectives of ODA on the other. However, it has also been noted that “climate change related activities may not have the highest potential impacts on poverty reduction” (Brown, Cantore, te Velde 2009: 9). The same authors identified possible shifts in sectoral and geographic spending if funds were allocated according to adaptation needs (Brown, Cantore, te Velde 2009: 23). It is, therefore, important that the introduction of climate finance does not divert funding away from development objectives. Otherwise there could be significant negative impacts for recipients of traditional development finance.

However, defining exactly where climate finance starts and development objectives end is difficult, which complicates the matter. Figure 1 shows the overlap of traditional development cooperation and new adaptation activities depicting a continuum from measures that focus on vulnerability to those measures that focus on the impacts of climate change. The same continuum can be adopted when thinking about the need of funding for adaptation (Klein and Persson 2008: 4). While for reasons of efficiency and effectiveness it is necessary to integrate climate and development financing in planning and implementation (Scholz et al. 2010: 6), it becomes clear, that there is not a clear-cut dividing line from which new and additional funding starts.

**Figure 1: Adaptation as a continuum from addressing the drivers of vulnerability to confronting the impacts of climate change**



Source: Klein and Persson 2008: 4 (adapted from McGray et al. 2007)

With respect to mitigation, there are also considerable overlaps and high potentials for synergies with traditional development activities, for instance with regard to energy supply, waste and sustainable resource management or forestry, or with regard to pro-poor growth within the implementation of low-carbon development strategies. However, the range of options for climate financing for mitigation in developing countries also comprises examples with high investment costs for abatement efforts that do not have an immediate effect on the main objectives of ODA and the achievement of the MDG, but at best take effect in the long run when “effective international emissions stabilising policies in which developing countries are also involved will reduce climate change damages for the poorest regions and this helps development goals” (Brown, Cantore, te Velde 2009: 11). Moreover, large sums of these investment flows are needed in emerging economies, i.e. in countries with already high and rising emission levels. As long as much of the climate change funding is merged with ODA, as it is still common practice among donor countries, this also bears the risk that aid is diverted not only away from existing development priorities but also away from Least Developed Countries (LDC). Especially with regard to mitigation investments that might only reconcile with development goals in the long run a high deviation from traditional development sectors to climate financing would be problematic if overall budgets are not increased. However, so far “with the exception of the CDM and the Kyoto Protocol’s Adaptation Fund (financed through a 2% levy on CDM proceeds) most international climate change funding instruments are classified as ODA” (Parker et al. 2009: 27).

Thus, while there are considerable overlaps, both geographical and sectoral, between development and climate change concerns and integration of respective activities is important for reasons of effectiveness and efficiency, some concerns need to be addressed with respect to additionality: First, even when only regarding adaptation, there is a danger of relative shifts in the allocation of money, both geographical and sectoral, which could drive the focus away from traditional development objectives and development partners. This becomes even clearer when mitigation measures are taken into account. Second, as activities that focus rather on vulnerability issues and those measures that have a stronger focus on the impacts of climate change and adaptation are situated along a continuum, it is difficult to draw a clear-cut dividing line to define the additionality dimension of climate funding.

## 1.2 Options for defining additionality

Although the term “new and additional” with regard to climate financing has found its way into the official language of climate negotiations (cf. Annex 1), so far, there is no internationally agreed definition of what “new and additional” actually means. With regard to the fast-start climate finance promises made in Copenhagen, it has been common practice, including in the Member States of the EU, to merge much of the climate funding with ODA budgets (Fallasch, de Marez 2010: 4). Due to the huge overlap between development assistance and climate financing, and due to a rather broad definition of ODA, which allows such a merging, as well as the high pressure to fulfil the EU’s twelve-point action plan to raise ODA to 0.7 % by 2015 (EC 2010), this practice has been further encouraged (Scholz et al. 2010: 8). In fact, analysis stipulates that most of the € 2 billion that is raised by Member States and the EC within the fast-start financing comes from ODA budgets (Gavas et al. 2011: 7).

Additionality can only be measured if there is a clear baseline against which “new funds” can be evaluated. Several options have been analysed to set such a baseline and define the additionality of climate financing (cf. Stadelmann, Roberts, Huq 2010; Brown, Bird, Schalatek 2010; Fallasch, De Marez 2010). The most important ones are featured in a separate table in Annex 2. The explanations below follow the information given in this table and are based on the sources cited. For an assessment of the different options see chapter 2.4.

Option No. 1 (funding above the 0.7 % target counts as additional) has the clear advantage that reference is made to the commitment of developed countries to provide 0.7 % of GNI for development purposes in poor countries, which was first formulated at a time when the calculation of development needs did not yet include the effects of climate change. This option could also easily measure additionality without necessarily separating development and climate funding and without the danger that climate funding is diverted from development spending. However, there are considerable political concerns as to the feasibility of this option, as so far very few countries actually meet the target. Therefore, it is highly unlikely that many donor countries would accept this definition, because it would mean that a) their overall ODA levels would have to increase substantially over current levels or b) none of their current climate finance would count as additional. Accordingly, only countries that already meet the target are in favour of this definition of additionality.

Option No. 2 (any increase over current levels of climate finance is additional) sets the climate related spending of a specific reference year as a baseline. The year 2009 (or the average from a period before that date) seems to be an adequate reference year as this marks the spending before the Copenhagen Accord. The advantage of this option also lies in its good feasibility of tracking additionality, especially for OECD/DAC Members (and some other countries) that already report their climate-related ODA within the Creditor Reporting System (CRS) (Brown, Bird, Schalatek 2010: 3). However, there could be a high risk of diversion from development funds (as it is politically easier to reassign existing financial allocations than to increase budgets). Moreover, depending on the reference year, those donors that started to raise their climate funding early could be disadvantaged. At the same time, however, choosing an earlier reference year (to mitigate the problem of early action being disadvantaged) could result in low baseline levels that in turn might suggest significant increases in additional funding while – if ODA levels are not rising – climate financing is simply diverted from ODA.

Option No. 3 (calculating additionality in the context of rising ODA which includes climate change finance) tries to rule out the disadvantage of ODA diversion as it implies rising ODA levels, and only counts as additional climate finance a certain share of the increase. An advantage of this option is that it

explicitly allows counting climate finance as part of ODA and therefore does not establish an artificial and ineffective separation of the two. At the same time, this option would also allow for other (non-ODA) sources of finance and suggests that ODA funds are only one element in climate related financing. Brown, Bird, Schalatek (2010: 3f.) suggest a limitation of the percentage of climate funding within rising ODA levels. In order to avoid diversion from development funding, the increase of overall ODA level needs to be above the nominal percentage of climate funding within ODA. Stadelmann, Roberts, Huq (2010) do not strictly include climate finance to ODA and do not explicitly demand rising ODA levels. However, the methodology they suggest could offer a workable definition within this option: They suggest that a realistic assessment of future ODA flows could be defined to which new climate finance would be additional and could be partly counted as ODA above this predefined level (but could also rank among non-ODA funding). If such ODA projections follow for example the EU action plan to raise levels of ODA to 0.7 % by 2015, the advantages of technically clear-cut definitions of additionality and predictability of funds could be maintained. Nevertheless, the diversion of ODA is still possible, especially as experiences so far with the compliance of such commitments are very poor for most countries. The EC also offered this option (“additional to the level of ODA spending in nominal terms”) in its annual monitoring questionnaire for the EU Accountability Report on Development Financing, however, without the imperative of rising ODA (cf. EC 2011e and chapter 2.3).

Option No. 4 (no ODA counts) rules out the danger of double counting of funds as both ODA and climate financing. However, depending on the sources of additional financing (stemming from national budget lines that otherwise might have increased ODA spending or stemming from new and innovative financing instruments) trade-offs between development and climate change objectives and their financing needs still remain to a smaller or bigger extent. Whether only new UN channels (e.g. Adaptation Fund or Green Climate Fund) would be accepted for the delivery of this kind of additional finance or more flexibility would be allowed by using any channel that suits the purpose best (both definitions are listed in Stadelmann/Roberts/Huq 2010 as different options), in any case the advantage is that additionality could easily be measured<sup>1</sup>. However, acceptance among those donors that are far from reaching the 0.7 % target is probably very low. Moreover, there is the danger that the budgetary separation of climate and development financing might also impede the necessary integration and mainstreaming of climate change activities into development strategies and programmes.

Option No. 5 (only funding from new sources is additional) equally separates development and climate financing, but does so via the sources from which funds are raised. This does not necessarily mean that one instrument needs to be agreed upon internationally (like Brown, Bird, Schalatek 2010 suggest), but would also allow for national approaches (e.g. revenues from a national air ticket tax, other taxes or auctioning of emission allowances for climate change financing) (Stadelmann, Roberts, Huq 2010). Especially those instruments that levy ecologically harmful behaviour and therefore have a positive steering effect (such as air ticket tax, emission allowances) are strongly related to climate change issues and would be very suitable instruments for raising additional climate finance. However, some countries already use such revenues either for development or climate change purposes, or to alleviate constraints in national budgets – and may thus be less inclined to allow for additional rules on the use of this money.

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<sup>1</sup> In another paper Stadelmann, Roberts, Michalowa (2010) suggest the introduction of a completely separate “new currency”, which they call “Official Climate Finance” and which could be similarly measured and equipped with specific criteria as ODA flows are.

### 1.3 Reporting additionality in the EU

The EU has always seen itself – and actually is – in the forefront of the fight against global warming (cf. Wurzel, Connelly 2011), which should also be paralleled in the compliance of climate finance commitments, including additionality. Indeed, the EU has taken steps to come to a common definition by 2013 and the EC has asked all Member States to declare their fast start climate finance and the definition for additionality they have applied<sup>2</sup>. In the questionnaire, the EC gave four predefined definitions, which compare to Options 1 – 3 mentioned above (with the fourth definition being a variant of Option 2), and the possibility to give another definition. Many Member States opted for the latter<sup>3</sup>. For the definitions given there was no clear tendency as answers were spread over three different options. The only obvious result that can be drawn from the answers is that ‘good ODA performers’ opt for more ‘recipient-friendly’ options, i.e. options that imply rising ODA or already are above the 0.7 % target.

The summary in the EU Accountability Report on the subject shows the diversity: “Some Member States aim for additionality related to climate related funding, while others include climate spending in their efforts to increase ODA. Three Member States define additionality as ODA over and above the UN ODA target of 0.7 % of GNI. One Member State states explicitly that fast-start financing is strictly additional to the aid budget and will not be reported as ODA. The most commonly used reference year is 2009, with some Member States using 2010. Some Member States finance climate efforts from outside the ODA budgets or through innovative sources. Some Member States use a combination of the definitions [...] and some have not yet decided on a definition of additionality” (EC 2011c: 43). Thus, this exercise showed that even within a rather homogenous group like the EU it seems very complicated to come to a common definition.

However, not having a common definition of which funds can be counted as climate finance raises severe problems of comparability, not only worldwide but also within the EU. “For example Australia, Belgium, Norway, Spain, Sweden, Switzerland and the US consider funding to the Global Environmental Facility (GEF) as part of their [fast start finance] pledges, others (Canada, Finland, France, the UK) only partly count it, while Denmark and Germany, for example, do not count it at all” (Brown, Stadelmann, Hörnlein 2011: 2). As reporting happens at an international level, a common baseline for measuring additionality should be agreed upon internationally. As long as this is not the case, one could argue that coming up with an EU-wide common and possibly relatively ambitious definition could lead to a lower amount of reported climate financing for EU Member States, which would then compare unfavourably to the figures resulting from the (less stringent) definitions of additionality applied by other nations. However, also within the current practice of arbitrary baselines this is already the case for many EU Member States, and so the argument does not hold much weight. Moreover, by coming up with a common internal definition, the EU could live up to its perception of being the spearhead in the fight against climate change, and its impulse could advance the international negotiations.

Overall, the efforts of the EC to come to a common definition have been rather unsuccessful so far, as Member States remain reluctant to identify a common internal definition for additionality. On-going efforts of the EC focus, therefore, rather on ensuring maximum transparency in reporting and no

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<sup>2</sup> Under Subchapter “G.1 Climate Change” of the *EU Accountability Report 2011 on Financing for Development* Member States were asked to fill in an Excel sheet on their fast start climate finance and to explain how they defined additionality for the reporting (cf. EC 2011e: 34).

<sup>3</sup> Annex 3 gives a more detailed overview of the answers given by the Member States.

diversion from existing or pledged ODA funds. Under these circumstances the EC wants to focus on an efficient and impact-driven use of funds and currently there are no further steps taken to come to a common definition (information given in conversations with EC staff).

#### 1.4 How could additionality best be measured and guaranteed?

There is no simple answer to finding the ideal methodology, as both technical and political aspects need to be taken into account. The best definition can be frustrated if budgetary constraints and political reluctance foil its compliance. Option No. 1 would certainly be the best (and from an ethical point of view maybe the only acceptable) option to ensure a fair contribution of developed countries to climate change financing needs in developing countries. Moreover, additionality could easily be measured under this definition without separating development and climate funding. However, it will most certainly not be achievable immediately for political and budgetary reasons. Considering the high diversity of definitions among Member States, the EC has arrived at the pragmatic view “that ‘traditional’ aid to reduce poverty should not be diverted in order to fund climate change activities” and concludes that “total ODA less climate related ODA would be an appropriate benchmark for gauging to new and additional climate finance, within the context of the specific definitions used by various Member States [...]. This would make it possible to check whether increases in ODA related climate finance are really additional or whether they encroach on other areas of ODA” (EC 2011b: 44). While such a benchmark is appropriate to track whether the principle of additionality is respected, it does not take any provision that climate finance is not diverted from traditional aid. Respective calculations for the year 2010 under this premise show that additionality could be measured in such a way but that it also implies the need for considerable scaling up of total ODA levels to meet both, fast-start finance commitments and ODA targets in 2015. Therefore, in order to truly guarantee additionality, Member States would not only need to come to a common definition that explicitly includes rising ODA levels, but also introduce more binding mechanisms to comply with such commitments.

For any common definition that is to be agreed upon there is a range of criteria that need to be met: (1) no diversion from pledged levels of ODA, (2) technical feasibility, (3) political acceptance (within the EU, but this criterion should also recognize that in the long run an internationally agreed baseline would be needed), (4) the necessity of integrating climate change activities into development financing. Table 1 shows that there is no definition that scores high on all these criteria.

**Table 1: Assessment of the Options mentioned above**

Options	No diversion	Feasibility	Acceptance	Integration
1: Above 0.7 % of GNI	++	++	--	++
2: Increase of current climate finance	-	+	++	+
3: Climate finance within rising ODA	+	+	+	++
4: No ODA counts	++	++	-	-
5: New sources only	++	++	+	+

*Source: own assessment*



The approach proposed by the EC (see above) allows for double counting of climate and development finance but requires separated accounting (along the OECD/DAC Rio-Markers<sup>4</sup>). While it wants to rule out diversion of ODA, reference is only made to the required additionality of climate finance to current ODA levels, but no reference is made to the EU's 12-point action plan to raise ODA to 0.7 % of GNI by 2015. Although intermediate goals have already been missed, the EU should not lose sight of this plan. As climate finance commitments are being more closely monitored by external partners and represent a thorny issue in the international negotiations, they are currently a stronger moving agent than the 0.7 % target. Therefore, particular emphasis must be given to criterion No. 1 (No diversion) and any definition of "new and additional" climate finance should include the pathway towards 0.7 %.

From a normative point of view, option No. 1 would be the only acceptable option, as it is the only one that ensures additionality over (long standing) commitments. However, due to current budget constraints and due to the fact that very few countries already meet this target, this option will most likely not be acceptable to most donors for the time being, as it would mean that none of their funding would count as additional climate finance. From a more pragmatic point of view, an ambitious but still possible definition could therefore be borne out of an improvement over the status quo. It is current practice by most Member States to count a certain amount of climate related funding also as ODA and it is separated out only according to the respective Rio Markers. For the year 2010, DAC EU Member States have reported an upper bound estimate of 12 % of their ODA to be related to mitigation objectives (either with a principal or a significant mitigation objective) and 7 % of their ODA to be related to adaptation objectives respectively<sup>5</sup>. With regard to mitigation, for which longer term trends can be analysed, it becomes obvious that mitigation related aid has increased significantly over past years (cf. OECD/DAC 2011b: 3). If this trend persists, which is not implausible regarding the pressure that arises from climate financing and ODA commitments, there is a real danger of more and more ODA being diverted to climate change financing. Annex 4 tries to visualise the implications for ODA funding according to various scenarios, different levels of ODA increase as well as double counting and separation of climate and development financing. Example B in Annex 4 shows the implications of unlimited double counting.

Therefore, in order to assure additionality of climate finance, the amount of double counted financing should be limited and rising ODA must be assured. As the year 2010 is the first year for which data on adaptation related ODA is separated out the status quo could be used as a starting point for limiting and gradually decreasing double counting. For a start, the percentage of funds assigned to adaptation should be fixed at 7 % and not be further increased. Due to the stronger overlap of development objectives and adaptation the assignable percentage for mitigation objectives should not be above this level. All other climate financing would then be counted separately and not be valid as ODA. For this purpose, the concept of "Official Climate Finance" has been framed, which could similarly to ODA as an indicator be equipped with special criteria, such as the "relation of flows to climate change mitigation or

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<sup>4</sup> The OECD/DAC is collecting information within its Creditor Reporting System (CRS) on how developed countries assist developing countries in the implementation of the Rio Conventions (implementing the so called Rio Markers). However, the application of these Rio Markers has been made mandatory only since 2007 and this implies only mitigation activities. A respective marker to track aid in support of climate change adaptation was only adopted in December 2010, and the corresponding data compiled and published in November 2011 for the first time (cf. OECD/DAC 2011a).

<sup>5</sup> Own calculations according to the OECD/DAC data base (OECD.Stat) for total ODA (USD 74,834 in current 2010 prices) ([http://stats.oecd.org/Index.aspx?DatasetCode=ODA\\_DONOR](http://stats.oecd.org/Index.aspx?DatasetCode=ODA_DONOR)) and OECD reporting of the Rio Markers ([http://www.oecd.org/document/6/0,3746,en\\_2649\\_34447\\_43843462\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/6/0,3746,en_2649_34447_43843462_1_1_1_1,00.html)) for the climate related objectives of mitigation and adaptation.

adaptation, level of concessionality required, and inclusion of private and carbon market flows” (Stadelmann, Roberts, Michaelowa 2010).

In the end, the EU must do both: a) stick to the plan to raise ODA levels to the 0.7 % target and b) fix levels for “Official Climate Finance”, additional to ODA, that comply with UNFCCC commitments. Interim solutions, such as the possibility of double counting should be time limited, and any double counting should be phased out preferably until 2015, but until 2020 at the latest.

As this definition might still meet with significant political reluctance, the second best option would be Option 2 (increase of current climate finance over current levels) with a reference year of 2009. However, strong provisions should be taken that the increase of climate finance does not eat up the increase of overall ODA.



## **2. ENSURING ADDITIONALITY**

For any option chosen, in order to assure additionality, a substantial amount of additional public sources will be needed, which could come from innovative financial instruments. Moreover, as far as, in the long run, a budgetary separation of development and climate finance is pursued, for reasons of efficiency and effectiveness a high level of integration of climate and development activities is to be assured in the operationalization.

### **2.1 Where should the money come from?**

Both, the Copenhagen Accord and the Cancún Agreements explicitly state that ‘new and additional’ resources “will come from a wide variety of sources, public and private, bilateral and multilateral, including alternative sources of finance” (cf. Annex 1). This is a very broad definition that certainly accounts for the budgetary constraints of many developed countries especially after the recent and on-going financial and economic crisis. As a consequence, the full variety of options has been explored (cf. AGF 2010, EC 2011f, World Bank et al. 2011). For reasons of limited scope the different options cannot be assessed here. Rather, two general points are raised which concern the use of innovative financing to increase public funding and the use of leveraging private funding.

#### **2.1.1 Public revenue and innovative financing**

Due to significant financial constraints in EU Member States and severe budget challenges the increase of public revenues would depend to a large extent on the introduction of innovative financial instruments. Indeed, innovative financing instruments play an important role in the debate on how sufficient funding can be assured and it would be fairly easy to assess its additionality. However, it needs to be stated that the debate on innovative financing instruments is not only linked to climate financing but “needs to be seen in a context of the wider search for new sources of financing to address both domestic and global challenges” (EC 2011f: 7). Therefore, there are competing interests for the use of the revenues raised from these sources, both, on a domestic level, i.e. the need for fiscal consolidation, and on an international level with regard to other global challenges and their financial implications.

It must further be noted that many states follow the general principle of tax revenues funding overall government spending, which generally would not allow earmarking of particular tax revenues for specific purposes. However, examples exist where earmarking, especially with environmental purposes, has taken place or where political commitments were installed in parallel (soft earmarking) (cf. EC 2011f: 8). Moreover, one of the most promising new sources of financing in the EU, the auctioning of emission allowances under the EU Emission Trading System (ETS), would generate revenues that are not directly linked to taxation. The revenues present a clearly identifiable stream and can therefore easily be earmarked, as it is done for instance in Germany, where earmarking of tax revenues is generally not possible. The ETS directive per its latest revision (2009/29/EC) already foresees in its preamble that at least half of the money generated should be used towards the fulfilment of a variety of climate related objectives. However, the directive does not include any enforcement of this provision.

Generally, the EC confirms the overall conclusion of the Report of the UN-Advisory Group on Climate Change Financing (AGF) that meeting the commitment by 2020 will be “challenging but feasible”, with the EU taking over one third of the committed USD 100 billion (EC 2011f: 4). In terms of the sources, the EC remains rather sceptical with regard to the revenue potential of international auctioning of Assigned

Amount Units (AAU) under a second commitment period of the Kyoto Protocol and with regard to the offset market within the CDM. The EC's analysis rather counts on increased revenues through auctioning within the EU ETS, which could raise up to € 20 billion annually by 2020, of which at least half should be spent on climate change related activities, including in developing countries (EC 2011f: 9). However, this instrument could even become more effective if the EU took on a 30 % reduction commitment, even if an international agreement is not reached, as this would stabilize prices potentially at a higher level than envisaged at present. Moreover, EU Member States should not only commit to spending 50 % of the revenues on climate related challenges, as the EC's proposal currently states, but also fix a minimum level of at least 25 % of the revenues for international climate finance.

Among other options for additional public money are carbon taxes, which are already in place in some Member States and contribute to their general budget income. However, for many Member States they still constitute a very good option for innovative financing that could help to alleviate national budgets and therefore assure rising ODA as well as additional climate financing. Moreover, the removal of subsidies on the use of fossil fuels (for instance through tax expenditure, market interventions or direct transfers) has also been identified as a source for public climate finance which along the way would also have steering effects towards the reduction of greenhouse gas emissions (World Bank et al. 2011: 22). With regard to very promising sources that have a strong multilateral dimension (including Financial Transaction Tax (FTT), or a levy on shipping and aviation) the EC states that an international agreement would be essential (EC 2011f: 9). While international implementation for all these proposals is undoubtedly most desirable and could raise more revenues, experiences with the stock-exchange turnover tax in Great Britain, air ticket taxes in several EU Member States and also the EU ETS show that national or EU-wide approaches are also possible without significant adverse effects.

In any case, an agreement at least within the EU as to what extent innovative sources are introduced and how revenues can contribute to national and international climate finance should be found as soon as possible as the fast start climate period is coming to an end already in 2012 and an agreement on a fixed scaling up until 2020 would help to avert a funding gap. A specific proposal to this end has been made by the international development organisation Tearfund: "As a start, developed countries should commit to specific targets for 2013–2015 based on the use of new innovative sources – and then scale up from these to the figures needed by 2020. [...] It would also provide intermediate steps to the 2020 figure and should help re-build trust between developed and developing countries on the provision of finance" (Weaver, 2011: 3).

Overall, if innovative sources are explored and implemented widely, sufficient resources could be raised and either be earmarked for climate finance, both national and international, or add to national budgets so that sufficient funds are freed to fulfil development and climate finance commitments. However, provisions should be taken that revenues from innovative sources are raised in a way that earmarking is possible also at the level of national states (for instance auctioning, uniform fees for off-budget income). Otherwise, more binding commitments should be made with regard to ODA and additionality of climate financing.

### 2.1.2 Leveraging private funding

The explicit inclusion of the use of private funds to raise the pledged amounts of funding have left the doors wide open for 'creative' accounting as for what is credited against the full amount. One key question that was left open is "whether the 100 billion US dollars are to be taken as gross or as net flows [...] and the AGF report notes that its members were divided on whether gross or net flows should be counted. This issue is relevant, for example, when financing is provided in the form of loans. Should the

full volume of the loan be calculated towards the 100 billion US dollars or only the extent to which the terms of the loan are more favourable than commercial loans, the so-called 'grant equivalent?'" (Sterk, Luhmann, Mersmann, 2011: 3).

Another key issue in this respect is the leveraging of private funding. Enabling and encouraging private funding can have to do with traditional public funding activities in developing countries, for instance in the fields of good governance, macroeconomic framework, capacity building to improve the investment and climate policy framework etc. However, some specific instruments of leveraging private money that are rather targeted directly towards private sector support (some of them already well known) have come into the discussion on climate financing. Caperton (2010: 3) pools these instruments into two categories:

1. Debt-based mechanisms, which include loan guarantees (for instance through an internationally backed fund), policy insurance against a change of specific policies that are decisive for the investment, and foreign exchange liquidity facility to alleviate exchange rate risks.
2. Equity-based mechanisms which include pledged funds, which would take over the analysis and evaluation of (small) projects to enhance engagement of equity investors, and subordinated equity funds, in which the fund acts as a lead investor itself.

Going along with increased support in recent years (both at an international level and the European level) for blending activities and facilities, which try to use public funds to mobilise a larger amount of private capital for a certain type of investment, the idea of leveraging is also very prominent in the debate on climate financing. While the use of public money to leverage additional private financing is widely acknowledged as beneficial in principle, there is no agreement so far whether the leveraged finance can be counted against the pledges made by governments. Within the European Union, the Joint EFC-EPC Working Group<sup>6</sup> held a workshop in 2011 on 'Leveraging private finance for climate actions in developing countries' and it was concluded that a "limited amount of the public finance committed by the EU and its Member States, both during the fast start and the longer-term period to 2020 could usefully be directed to support the leveraging of private investment in both mitigation and adaptation actions in developing countries" (Council of the European Union 2011: 4). So far it is not yet clear as to what extent leveraged funds would count against the pledge<sup>7</sup>.

With the proposed new regulations establishing the DCI, which foresee substantial modifications within the existing instruments, the EC also sees the possibilities for "a significant increase in the use of innovative financial instruments under all instruments (in particular through regional investment facilities), which should allow a greater share of grants to be blended with loans and used for equity and risk sharing instruments, so as to mobilise additional funding to cover the investment needs of partner countries" (EC 2011h: 205). While loans might be beneficial also in climate change activities especially "for more developed, less-indebted countries with good fiscal policies, and for low-risk revenue generating projects" "some NGOs feel that the inclusion of loans may lead to higher Southern debts, and that it is inconsistent with the notion of funds for adaptation as some kind of 'compensation' for damages" (Brown, Stadelmann, Hörnlein 2011: 4f.).

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<sup>6</sup> Joint Working Group of the Economic Policy Committee (EPC) and the Economic and Financial Committee (EFC) on the economic and financial aspects of climate change.

<sup>7</sup> New draft conclusions are being discussed and could be accepted in the ECOFIN meeting in May. The current proposal of the Commission is that leveraged funding should only be counted along specific rules in order to assure that funds were made available only through public funds. This is a very technical question and the rules so far are still vague in order to fix a broad consent and go into further discussions on the international level and to later narrow down the position internally (Information taken from conversation with EC staff).

While there is no room in this briefing to discuss the advantages and risks of the respective instruments it is important to recognize that currently there is no common approach to assess the net benefits of these leveraged private sector flows to developing countries (EC 2011f: 12)<sup>8</sup>; and as long as this is not the case “it is advisable to collect data so that concessional public flows can be analysed separately from private flows e.g. for the purposes of understanding the leveraging effects of public support” (Buchner, Brown, Corfee-Morlot 2011: 43). With regard to the main focus of this briefing, the question of additionality, Griffiths (2012: 5) rightly points out that two questions are crucial to determine additionality when it comes to such blended sources: “Would the private investment have happened anyway? Does the resulting investment achieve the aims of the public institution backing it?” The author remains rather sceptical on both questions and also points to ten problems with leverage, including the following: While private sector investment should be embedded in national strategies, most current initiatives are driven by global funds or multilateral institutions; there is a danger of increased debt; the money used for leveraging private funds is lost for straightforward public investment, where it might be needed most (e.g. adaptation); there is currently little transparency and accountability in these kind of leveraged private investments (Griffith 2012: 9ff.).

It should further be kept in mind that most likely the commitments made under the UNFCCC framework (USD 100 billion annually by 2020) will not be sufficient to achieve both objectives, adaptation and mitigation. Therefore, it should at least be assured that most of this commitment is met with public funding (including via private sources that contribute to public revenues through the innovative financing instruments mentioned above). Most of all, “[a]daptation funding for the poorest countries must come from public sources” (Weaver, 2011: 4). Private financing that comes in from the leverage instruments described in this section should not be counted against this amount, not even as net flows.

Overall, leveraging can contribute to raising amounts that go beyond the USD 100 billion commitment. Leveraging private money has a place in climate financing that should not be underestimated but counting the public funds used for the leverage against the Copenhagen/Cancún commitment should be limited for two reasons: first, the USD 100 billion is at the lower end of what is needed to meet the challenges of climate change adaptation and mitigation. Second, there are serious flaws that should not be underestimated either. If risks are low, private money might rather leverage scarce public resources and if risks are high, too much public money could be wasted. For the same reasons, counting the leveraged amount against the international finance commitment should be banned altogether.

## **2.2 How should the money be channelled?**

### **2.2.1 Climate financing within the EU budget/DCI**

While it is important to have a clear separation of climate and development financing - at least in the medium term - at the level of accounting, at the operational level climate and development activities should be integrated as far as possible. This was recognized by EU institutions in the early stages of the international debate on this issue and even long before the Bali Action Plan (cf. European Parliament 2011: 12). Consequently, the new Multiannual Financial Framework (MFF) states that “[c]limate policy will be mainstreamed and scaled up in the geographical external action instruments with the aim of significantly scaling up climate-related funding under the external action heading” (EC 2011g: 14f.).

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<sup>8</sup> The AGF report proposes a calculation which would lead to net benefits in the range of USD 20 to 24 billion for a potential gross private flow of USD 200 billion (cf. EC 2011f: 36).

This is also reflected in the proposed regulations of the next DCI. While the whole DCI faces an increase of 19 % of funding (in constant prices) (Gavas 2012: 2), the increase is by far the highest in the renamed thematic instrument 'Environment and climate change', accounting now for a bit more than € 2 billion. Additionally, a new thematic instrument 'Sustainable Energy' (€ 800 million) has been introduced. All together, 50 % of the newly framed programme for "Global Public Goods", which accounts for € 6,303.2 million (27 % of total DCI funds) and includes the two thematic instruments<sup>9</sup>, are to be spent on climate action and environment related objectives (EC 2011j: 47). Moreover, environmental sustainability including climate change is listed as one of the cross-cutting issues that are to be mainstreamed in all programmes of the DCI (Art. 3, EC 2011j: 19), including the geographic programmes.

Considering the magnitude of the challenge of climate change, it seems appropriate that a rising amount of funds is dedicated to issues of climate change. The increase shows the sincerity of the commitment of the EU to fulfil its international responsibility. Moreover, with the proposed benchmarks within the thematic instruments and the mainstreaming approach the best preconditions are laid for the integration of climate activities into development programmes. However, a large increase does not at all mean that funds are not diverted from development finance. Indeed, as climate related activities will be performed also in other areas, especially agriculture, concerns have been raised that there is the "risk to drag even more on the scarce resources left for the other themes. It is therefore essential that the 'additionality' principle be respected" (Concord 2012: 25). The principle of 'no diversion' becomes particularly important with regard to other cross-cutting issues, as their implementation might become sidelined in the thematic programmes due to the focus on climate change. Therefore, additionality of climate finance should be clearly defined also in the DCI regulations. If the EC's current proposal was applied to the proposed funding (total ODA less climate related ODA), the level of ODA that is dedicated predominantly to development issues would shrink considerably. Although many climate related activities serve development objectives, this still is an alarming sign. Moreover, there is no clarity about the envisaged balance between mitigation and adaptation activities and how they relate to sustainable energy activities (Concord 2012: 28). Therefore, a guideline to ensure additionality must be that funding for climate related activities within the DCI does not increase more than overall funding for the DCI. With the current proposal this does not seem to be the case. Moreover, as funding within the DCI is going to be concentrated on LDC and poor countries, climate related activities within the geographic instruments should be focussed clearly on adaptation for which a benchmark of at least two thirds of climate related funding should be introduced.

It stands out of question that promoting climate resilient development is one of the key global challenges and that mainstreaming climate activities is essential also for the DCI. The mainstreaming approach is therefore highly welcomed as long as the above mentioned precautions are taken. However, as the DCI is the only funding channel for activities in countries not covered by the European Development Fund (EDF) this must not be to the detriment of development objectives. Therefore, the establishment of a separated instrument on 'climate change challenges' directly under heading 4 (and under joined supervision of DG Environment and DG Development) should also be considered. Although the drive of recent years has been to simplify structures and reduce instruments, this could be a viable option. It could also confront the problem that with the proposed 'graduation' of more advanced countries out of bilateral aid programmes<sup>10</sup> more funds for these global challenges, to which they historically contributed a minor share, would still be available to them.

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<sup>9</sup> Others are: 'Human development', 'Food security and sustainable agriculture', and 'Migration and asylum'.

<sup>10</sup> It is envisaged that 19 countries, among them most Latin American countries and countries with a high global share in GNI like China, India and Indonesia are no longer eligible for bilateral aid as of January 2014 (cf. Annexes I and III of EC 2011j)

## 2.2.2 Setting up a separate European Climate Fund

Another option for the delivery of EU climate finance is via a dedicated mechanism created for this very purpose. This scenario has already been included in the EC's presentation of the MFF: "In addition to the mainstreaming of climate action into the external action budget, the EC is considering the creation of a mechanism/fund outside the budget to pool together contributions from the Member States and the EU budget" (EC 2011g: 15). So far, Germany and UK have established bilateral climate funds. If more EU Member States follow this example, it would indeed be much better to have one European fund through which new resources are pooled rather than having 27 bilateral funds for international purposes. However, Member States will only be interested in participating in such a fund, and not set up a national fund themselves, if there is a clear and substantial added value of such a European Fund. Otherwise, a new European fund would contribute to further fragmentation of the already confusing climate finance architecture. Currently most funding is channelled by multilateral funds, however, with regard to pledged amounts, there is an alarming trend towards the bilateralisation of climate funding<sup>11</sup>.

Another point to consider in deliberations over the pros and cons of a dedicated EU Climate Fund is the fact that a whole range of these exist now under the UNFCCC – the regime under which the EU's commitment was made and will be monitored – including the Green Climate Fund, established under the Copenhagen Accord (UNFCCC 2009: Decision 2/CP.15) just for that very purpose. It has taken two years for the Fund to become operational, and its design includes a modernised governance structure<sup>12</sup>. While much negotiation capital has been invested in the creation of the Green Climate Fund (GCF) itself, the long term sources for the hard currency that should make up the fund have not been agreed. Therefore, securing adequate and sustained funding for the GCF is a considerable challenge. For it not to be seen to fail, industrialized countries will need to contribute to the financial strength of this fund soon and indicate how much of their pledged medium and long term climate finance they are assigning to the GCF (Schalatek, Nakhooda, Bird 2012: 4). The EU should encourage channelling Member States climate financing through the GCF and also contribute itself substantially to the capitalisation of the fund rather than establishing another separate fund.

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<sup>11</sup> [www.climatefundsupdate.org](http://www.climatefundsupdate.org) lists 25 funds, of which six are bilateral funds, including the EU Member States Germany and UK. The UN Global Environment Facility (GEF) has the longest tradition and administers the highest amounts of disbursed funds with the GEF Trust Fund ranking first and the Least Developed Countries Fund (LDCF) ranking fourth. High amounts have also been approved to Funds administered by the World Bank, especially under the various funds pooled in the Climate Investment Funds (CIF) to which USD 6.5 billion have been pledged (Schalatek, Nakhooda, Bird 2012: 1).

<sup>12</sup> The following description of changes in fund governance structures is mirrored in the GCF set-up: "Most multilateral climate finance initiatives have broken from contributor country-dominated governance structures that are typical in development finance institutions, and given developing country governments greater voice and representation in decision-making. They have also taken steps to increase transparency and accountability in fund governance" (Nakhooda et al. 2011: 2).



### 3. CONCLUSIONS

The emergence of climate finance as a dedicated strand of funding is justified and necessary, but its current implementation creates a number of serious pitfalls. Due to large overlaps between development and climate related activities and due to the high incentives to count “new” climate financing as ODA (or reassigning existing ODA as climate finance), focus and funds could be (and are presently) diverted away from traditional development objectives, both at the geographical and the sectoral level. This scenario stands in contrast to both the spirit and the letter of international climate finance commitments, which are clearly meant to be in addition to current support to developing countries and not instead of. This situation has arisen, because, presently, there is no commonly accepted definition against which to assess the additionality of climate finance. Even within the EU there is a huge variety of different definitions among the Member States. An internationally agreed concept of additionality could go a long way towards ensuring an effective and transparent provision of climate finance in the overall context of development cooperation.

To advance the formulation of such a common definition, the EU could devise a stringent but effective common approach internally, as a proposal for debate at the UN level. Taking a clear step ahead within the EU might under the current reporting practice result in a temporary disadvantage for EU Member States against developed country counterparts, as an ambitious definition would suggest lower compliance with the commitments (compared to non-EU countries). At the same time, it could gain the EU favour among developing countries because of its higher level of ambition and the additional transparency, and thereby put pressure on other countries to follow suit.

Any definition should build on the twelve-point action plan (EC 2010) to raise ODA levels to 0.7 % of GNI by 2015. Although it does not seem to be achievable for the time being, the long-term objective should be to count only the amounts that go above the 0.7 % target as truly additional finance. This objective is likely to become feasible only through the introduction of innovative instruments of new financing, which will take a few years. In the mean-time, it may therefore be allowable to declare ODA and climate finance side by side (or climate finance as part of ODA) as long as ODA levels are rising. This practice should, however, be time limited and extend until 2015 or 2020 as a maximum.

With regard to the scaling up and the potential sources of climate funds innovative sources need to be implemented in order to raise the necessary revenues. Relying on such new measures comes with two important caveats – timing and dedication. Implementation of new measures would need to be speeded up in order to avoid a funding gap when the fast-start finance period ends in 2012 and sufficient and sustained levels of new funding are not yet raised. And there is the earmarking necessity. If funding from new sources was only used to alleviate national budgets this could in an end by itself free up existing revenues to fulfil development and climate finance commitments. But then, current ODA spending commitments have not been met even before the financial crisis. More binding provisions would be required to ensure that the commitments are met. To lessen the uncertainty over resource availability, it would be desirable to have new revenue streams earmarked specifically for climate finance purposes (at least partly), both at the national and the international level. To facilitate this, a good part of revenues from innovative financing should ideally (and indeed a good part of them could) be raised in a way that direct earmarking is possible also at the national level (for instance auctioning of tradable emission certificates, uniform fees for off-budget income). Especially with regard to the upcoming increasing revenues within the EU ETS it should be considered that a fixed (and

potentially increasing) share should be earmarked for international climate financing (for instance 50 % by 2020).

If potential sources of innovative financing for public authorities are implemented widely, then climate finance could come to a large extent from public sources. This would be essential for two reasons: First, developing countries and many observers see climate financing as an obligation of developed countries to recompense those countries that so far have not contributed to climate change for the damage occurred in these countries. Likewise, developed countries need to contribute substantially to mitigation efforts in developing countries as they have also contributed exorbitantly to the current global challenge of the transformation towards a low-carbon economy (polluter pays principle). Second, the committed USD 100 billion is at the lower end of what is actually needed with regard to adaptation and mitigation.

Private sources certainly will play a role for climate financing that goes above the USD 100 billion commitment, however, it is highly disputable as to what extent leveraging of private funds is counted or loans are calculated as full contribution. Leveraging private money can contribute to raising necessary investment and therefore certainly has a place in climate financing that should not be underestimated but there are also serious flaws to the logic that should not be underestimated either. For these reasons, counting the leveraged amount against the international finance commitment should be banned altogether.

Despite the need to separate the accounting for climate and development financing (at least in the medium term), climate and development activities should be integrated as far as possible at the operational level. In the proposal for a new DCI regulation a rising amount of funds are dedicated to climate change issues, which shows the high commitment of the EU to fulfil its international responsibility – and is an example of climate and development integration. While the DCI as a whole is set to increase by 19 % (in constant prices), the thematic instrument concerned with climate change is meant to be by far the most. Moreover, a benchmark has been introduced according to which 50 % of the funding under the thematic programme for "Global Public Goods" is to be spent on climate and environment related objectives. However, it is not clear as to what extent these funds are really additional. Therefore, additionality of climate finance should be clearly defined also in the DCI regulations, and provisions should be made to allow for separate accounting for climate finance. Moreover, there is no clarity about the envisaged balance between mitigation and adaptation activities and how they relate to sustainable energy activities or the complementarity between thematic and geographic projects. Respective policy guidelines should be introduced (Concord 2012: 28).

Generally, the establishment of a European climate fund is not recommended as it would contribute to the already existing and rather confusing multiplicity of multilateral and bilateral funds without an obvious significant added value. Additional resources should rather be channelled to the new GCF in order to secure adequate and sustained funding early on. The EU should encourage Member States to contribute to the capitalisation of the fund rather than establishing another separate fund.



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## Annex 1: Commitments within the UNFCCC context

Instances of the wording new and additional have been highlighted.

### United Nations Framework Convention on Climate Change (1992)

#### Article 4: Commitments

4.3 The developed country Parties and other developed Parties included in Annex II shall provide **new and additional** financial resources to meet the agreed full costs incurred by developing country Parties in complying with their obligations under Article 12, paragraph 1. They shall also provide such financial resources, including for the transfer of technology, needed by the developing country Parties to meet the agreed full incremental costs of implementing measures that are covered by paragraph 1 of this Article and that are agreed between a developing country Party and the international entity or entities referred to in Article 11, in accordance with that Article. The implementation of these commitments shall take into account the need for adequacy and predictability in the flow of funds and the importance of appropriate burden sharing among the developed country Parties.

### Kyoto Protocol (1997)

#### Article 11:

11.2 In the context of the implementation of Article 4, paragraph 1, of the Convention, in accordance with the provisions of Article 4, paragraph 3, and Article 11 of the Convention, and through the entity or entities entrusted with the operation of the financial mechanism of the Convention, the developed country Parties and other developed Parties included in Annex II to the Convention shall:

(a) Provide **new and additional** financial resources to meet the agreed full costs incurred by developing country Parties in advancing the implementation of existing commitments under Article 4, paragraph 1(a), of the Convention that are covered in Article 10, subparagraph (a); and

(b) Also provide such financial resources, including for the transfer of technology, needed by the developing country Parties to meet the agreed full incremental costs of advancing the implementation of existing commitments under Article 4, paragraph 1, of the Convention that are covered by Article 10 and that are agreed between a developing country Party and the international entity or entities referred to in Article 11 of the Convention, in accordance with that Article.

The implementation of these existing commitments shall take into account the need for adequacy and predictability in the flow of funds and the importance of appropriate burden sharing among developed country Parties. The guidance to the entity or entities entrusted with the operation of the financial mechanism of the Convention in relevant decisions of the Conference of the Parties, including those agreed before the adoption of this Protocol, shall apply mutatis mutandis to the provisions of this paragraph.

### Bali Action Plan (2007) Decision 1/CP 13

(e) Enhanced action on the provision of financial resources and investment to support action on mitigation and adaptation and technology cooperation, including, inter alia, consideration of:

(i) Improved access to adequate, predictable and sustainable financial resources and financial and technical support, and the provision of **new and additional** resources, including official and concessional funding for developing country Parties;

(ii) Positive incentives for developing country Parties for the enhanced implementation of national mitigation strategies and adaptation action;

(iii) Innovative means of funding to assist developing country Parties that are particularly vulnerable to the adverse impacts of climate change in meeting the cost of adaptation;

(iv) Means to incentivize the implementation of adaptation actions on the basis of sustainable development policies;

(v) Mobilization of public- and private-sector funding and investment, including facilitation of climate-friendly investment choices;

(vi) Financial and technical support for capacity-building in the assessment of the costs of adaptation in developing countries, in particular the most vulnerable ones, to aid in determining their financial needs.

### Copenhagen Accord (2009) Paragraph 8

Scaled up, **new and additional**, predictable and adequate funding as well as improved access shall be provided to developing countries, in accordance with the relevant provisions of the Convention, to enable and support enhanced action on mitigation, including substantial finance to reduce emissions from deforestation and forest degradation (REDD-plus), adaptation, technology development and transfer and capacity-building, for enhanced implementation of the Convention. The collective commitment by developed countries is to provide **new and additional** resources, including forestry and investments through international institutions, approaching USD 30 billion for the period 2010 - 2012 with balanced allocation between adaptation and mitigation. Funding for adaptation will be prioritized for the most vulnerable developing countries, such as the least developed countries, small island developing States and Africa. In the context of meaningful mitigation actions and transparency on implementation, developed countries commit to a goal of mobilizing jointly USD 100 billion dollars a year by 2020 to address the needs of developing countries. This funding will come from a wide variety of sources, public and private, bilateral and multilateral, including alternative sources of finance. New multilateral funding for adaptation will be delivered through effective and efficient fund arrangements, with a governance structure providing for equal representation of developed and developing countries. A significant portion of such funding should flow through the Copenhagen Green Climate Fund.

## Cancun Agreements Decision 1/CP.16

2. Further affirms that: [...]

(d) Mobilization and provision of scaled-up, new, additional, adequate and predictable financial resources is necessary to address the adaptation and mitigation needs of developing countries;

95. Takes note of the collective commitment by developed countries to provide new and additional resources, including forestry and investments through international institutions, approaching USD 30 billion for the period 2010–2012, with a balanced allocation between adaptation and mitigation; funding for adaptation will be prioritized for the most vulnerable developing countries, such as the least developed countries, small island developing States and Africa;

“developed country Parties commit, in the context of meaningful mitigation actions and transparency on implementation, to a goal of mobilizing jointly USD 100 billion per year by 2020 to address the needs of developing countries”

97. Decides that, in accordance with the relevant provisions of the Convention, scaled up, new and additional, predictable and adequate funding shall be provided to developing country Parties, taking into account the urgent and immediate needs of developing countries that are particularly vulnerable to the adverse effects of climate change;

98. Recognizes that developed country Parties commit, in the context of meaningful mitigation actions and transparency on implementation, to a goal of mobilizing jointly USD 100 billion per year by 2020 to address the needs of developing countries;

99. Agrees that, in accordance with paragraph 1(e) of the Bali Action Plan, funds provided to developing country Parties may come from a wide variety of sources, public and private, bilateral and multilateral, including alternative sources;



## Annex 2: Overview of the options for defining additionality

No.	Definition	Technical considerations	Political considerations	Advantages	Disadvantages	Countries in favour
1.	<b>Funding that is above the 0.7 % ODA target</b> (Stadelmann et al. 2010 Brown et al. 2010 EC 2011e)	Easy to track and technically feasible (0.7 % target already tracked by OECD); Questions arise as to what gets counted as climate finance. The system of the DAC Rio Marker would need to improve.	Most countries have difficulty reaching the 0.7 % target in the first place, so it will be politically challenging to raise the target. Supported by international development community, most developing countries and some European countries that already meet this ODA standard.	<ul style="list-style-type: none"> <li>Objective criterion</li> <li>Easy to track</li> <li>Based on past ODA pledges</li> <li>Climate finance not limited to ODA</li> </ul>	<ul style="list-style-type: none"> <li>No pressure on countries above the threshold</li> <li>Countries that are far from the threshold are likely to ignore the criterion</li> </ul>	Denmark Netherlands Luxembourg Sweden  (Norway, Developing countries)
2.	<b>Increase of current climate finance</b> (against specific year/period of reference) (Stadelmann et al. 2010 Brown et al. 2010 EC 2011e)	Easy to track and technically feasible but system of the DAC Rio Marker would need to be improved. No diversion from development objectives for donors who have already met their 0.7 % target, but not necessarily for other donors. Requires controversial decisions on whether projects are climate related or not.	Setting the reference year (e.g. 2009) as baseline has different implications for donors depending on whether they already meet the 0.7 % level and on their level of ODA-related climate finance. (implies problems of “last mover advantage” and cross-donor equity)	<ul style="list-style-type: none"> <li>Acceptable for contributors</li> <li>Easy to track</li> </ul>	<ul style="list-style-type: none"> <li>Diversion of ODA still possible for most donors</li> <li>Classification problems may arise</li> <li>Equity problems may arise among donors</li> </ul>	Austria Finland Germany Spain Slovenia (all 2009 as reference year)  Estonia (reference year 2011-12)
3.	<b>Rising ODA which includes climate change finance</b> (Stadelmann et al. 2010 Brown et al. 2010 EC 2011e)	Problems in defining an adequate percentage level (ideally, for countries that meet the 0.7 % target climate change, finance should be above that level). Aid diverted to climate finance can change the composition of finance if ODA is not raised sufficiently. This option recognizes that also other (non-ODA) sources of finance are needed.	If 0.7 % target is not met, setting the percentage in relation to ODA spending implies that funding is based on current contributions rather than actual financing needs. Countries that already meet the 0.7 % target might not approve this merging of development and climate change objectives.	<ul style="list-style-type: none"> <li>Easy to track</li> <li>ODA diversion still possible but less likely</li> <li>Better predictability</li> <li>Climate finance not limited to ODA</li> </ul>	<ul style="list-style-type: none"> <li>adequate percentage level difficult to assess</li> <li>ODA levels need to raise sufficiently</li> </ul>	Belgium Latvia Slovak Republic Hungary Portugal UK

4	<b>No ODA counts</b> (Stadelmann et al. 2010 Brown et al. 2010)	Clear cut definition and easy to track additionality. Theoretically rules out diversion from ODA, but trade-offs still remain. Need to ensure that funds are mainstreamed with existing ODA flows – technically challenging.	Might not be accepted by donors that are far from reaching the 0.7 % target as additional funding for climate change does not help to reach the target.	<ul style="list-style-type: none"> <li>• Easy to track</li> <li>• Relabelling of aid as climate finance is avoided but trade-offs remain</li> </ul>	<ul style="list-style-type: none"> <li>• Probably unacceptable for most contributors</li> <li>• Integration of development and climate change activities might be impeded</li> </ul>	
5	<b>New sources only</b> (Stadelmann et al. 2010 Brown et al. 2010)	Clear cut definition and easy to track additionality. Theoretically rules out diversion of ODA, but trade-offs still remain. Need to ensure that new sources of finance are mainstreamed with existing ODA flows – technically challenging.	Some countries already use revenues from potential new financing mechanisms either for development or climate change objectives or to improve national budgets. Especially financing from carbon markets would require an internationally binding agreement to maximize revenues	<ul style="list-style-type: none"> <li>• Easy to track</li> <li>• Relabelling of aid as climate finance is avoided but trade-offs remain</li> </ul>	<ul style="list-style-type: none"> <li>• Some donors already use such revenues for development or climate financing</li> <li>• Integration of development and climate change activities might be impeded</li> </ul>	Germany Poland

**Sources:** Stadelmann/Roberts/Huq 2010; Brown/Bird/Schalatek 2010; EC 2011e

**Note:** This table combines the different options of the sources cited above and merges the different considerations mentioned there with some own reflections. Stadelmann/Roberts/Huq (2010) list 8 options altogether, which are partly merged in this table to fit the options presented here. The 8 options are (the option to which they are assigned in the table above is given in brackets): a) Above 0.7 % of GNI (1); b) No agreed baseline (not included); c) New UN channels only (not included); d) No ODA counts (4); e) Above current climate finance (2); f) Above updated projection of development aid (3); g) Above predefined projection of development aid (3); h) New sources only (5).

Countries preferences are taken from EC 2011e (for European Member States) and the other sources cited for non EU-Members.



### Annex 3: EU Member States replies to the annual monitoring questionnaire for the EU Accountability report (2011)

Replies of EU Member States to Section G “New challenges and cross cutting issues”:

The following tables give an overview of how Member States answered these questions and defined additionality<sup>13</sup>.

Applied definition of additionality	Countries
A) additional to climate related funding in a specific reference year	Austria, Finland, Germany, (Portugal), Spain, Slovenia (2009), Estonia (2011-12)
B) additional to the average annual climate related funding over a specific reference period (e.g. 2007-2009)	-
C) additional to the level of ODA spending in nominal terms, please specify base year (compares to Option F below)	Hungary, Portugal (2009), Cyprus, Czech Republic, Slovak Republic (2010 initial estimate/budgeted) Malta (no base year given) (Luxembourg - no specific base year)
D) additional to an ODA spending target in % of GNI	Netherlands, Sweden, Denmark (0.7 % ODA/GNI) Luxembourg (1 % ODA/GNI)
E) Other definition of additionality (Specifications see below)	EC, Belgium, (Denmark), France, Italy, Latvia, Poland, (Sweden), (Slovak Republic), United Kingdom

**Note:** Some countries ticked two boxes or their definition under E) can be applied to one of the options (A-D) mentioned. They are listed (in brackets) in their second or original option.

<sup>13</sup> Replies taken from: [http://ec.europa.eu/europeaid/how/accountability/eu-annual-accountability-reports/country\\_answers\\_en.htm](http://ec.europa.eu/europeaid/how/accountability/eu-annual-accountability-reports/country_answers_en.htm)

Other definitions of additionality	Countries
F) additional to funding originally programmed for development cooperation and climate action (implies rising ODA budget or combined ODA/climate financing) (compares to Option C above)	EC (2010-12) Belgium Latvia Slovak Republic
G) drawn from rising ODA budget	United Kingdom
H) special budget line to finance climate change activities, included in overall ODA budget (above 0.7 % target)	Denmark Sweden
I) Funding from innovative sources of financing	Germany (ETS auctioning) Poland (AAU surplus sales)
J) integration of development and climate change financing, without specification target levels or additionality	France
K) A combination of the above definitions	Italy
L) additional to the level of ODA spending in absolute terms (reference year/period)	Poland (2007-2009)

**Note:** The specifications made under option E do not necessarily define additionality.

#### **Not answered / available:**

Bulgaria, Greece, Lithuania

#### **Other countries not assignable:**

**Ireland:** Given the absence of a clear OECD definition on Climate Change adaptation in 2009 Irish Aid did not estimate climate related funding in that year. In 2010 in a mapping exercise across all Irish Aid programmes, using the new OECD CC adaptation marker it was estimated that projects with a total value of €10 million had a strong CC and development relevance. In addition in December 2010 a total of €23 million was allocated to the EU Global Climate Change Alliance for climate change adaptation actions in sub Saharan Africa.

**Romania:** We are still in the process of reaching a definition on these issues. In 2010 a 100.000 EUR contribution to the UNFCCC was made.

#### **Specifications made under Option E**

**EC:** €150 m fast start funding pledged by the European Commission is additional to funding originally programmed for development cooperation and climate action in 2010-12. It comes from the un-allocated margin under the ceiling for external expenditures of the EU budget and therefore, does not reduce any other programmed development financing.

**Belgium:** The fast start contribution in 2010 (total amount: 42 million EUR) comes out of the rising ODA budget and covers only commitments taken after Copenhagen.

**Denmark:** In 2007 up to COP13 in Bali, the Danish Government decided to establish a special budget line to finance climate change activities; the so called Climate Envelope, for the five year period 2008-2012. This Envelope is foreseen to increase from DKK 300 mill. in 2010 to DKK 400 mill. in 2011 and to

DKK 500 mill. in 2012. To ensure synergies, support to activities to build resilience to climate change is also an integral part of existing official development assistance to reduce poverty and promote growth. The Climate Envelope is included in the overall Danish ODA budget. Denmark's ODA budget will be maintained at its present, comparatively high, level of DKK 15.2 billion. The increase of the Climate Envelope in 2011 and 2012 remains untouched. The Danish ODA budget excluding the Climate Envelope is in any case over and above the UN target of 0.7% ODA/GNI and will continue to be so over the period 2010-2012. The Danish contribution to the Fast Start Finance of DKK 1.2 billion is financed from the Climate Envelope.

**France:** [...] Nous avons considéré pour notre part des actions nouvelles, dans la perspective nouvelle dictée par l'Accord de Copenhague. Il s'agit en particulier de financer les actions préfigurant le cadre post-2012 ou nécessaires à sa mise en place, c'est-à-dire qui répondent à des besoins urgents des pays en développement d'une part ou facilitent la mise en place de stratégies de lutte contre le changement climatique à moyen et long terme d'autre part. En termes financiers, ces montants s'inscrivent dans les engagements croissants consacrés au climat par la France ces dernières années.

De manière générale, la France prône une approche globale, soulignant qu'il convient de ne pas opposer lutte contre la pauvreté/action en faveur du développement et lutte contre le changement climatique, ces deux objectifs devant être menés de pair. [...] La lutte contre le changement climatique est à notre sens difficilement dissociable du développement et il est illusoire de vouloir séparer leur financement. [...]

**Germany:** Concerning the "Fast Start" pledge 2010-2012, Germany defines "new and additional" funding as

- a) funding which is additional to climate finance in German international cooperation in 2009 and/ or
- b) funding which is based on innovative sources, such as proceeds from the sale of emissions allowances in the European Trading System (ETS).

**Italy:** A combination of the above definitions

**Malta:** 1. The Fast Start Climate finance reported in the excel sheet is

- x Additional to your existing ODA levels and reported as ODA
- x Additional to your ODA target and reported as ODA
- Not reported as ODA

Explanation: Malta provided the first tranche' payment for the "fast-start" financing on climate change in 2010 and this will be included as new and additional to our ODA.

**Latvia:** With reference to the decision of the European Council of December 9 – 10, 2009, government of Latvia has made a decision to make a financial commitment as a part of the EU's commitment to fast start financing.

This financing is a special appropriation from the state budget separate from any other funding channels.

Note: it is not clear whether this additional contribution is counted as ODA.

**Poland:** The level of fast start financing will depend on the AAUs surplus sales as an innovative source of financing. For the years 2010-2012 Polish ODA, counted without fast start financing, expressed in absolute terms, should not be lower than the average ODA level in the years 2007 to 2009

**Sweden:** Sweden's definition of what is considered to be new and additional CC activities is the following

1. Funding over and above the internationally agreed goal for ODA of 0.7% of GDI. Sweden's commitment to allocate approximately USD 800 m for new climate change activities forms part of this increase. Currently Sweden provides 1% of GNI for ODA. The overarching objective is poverty reduction by empowering poor people to improve their living conditions. Climate related activities form a substantial part of this funding, via bilateral, regional and multilateral channels;
2. Additional budget allocations for climate change related activities. Sweden's most recent allocation for this purpose is a specific Climate package of approximately 405 million euro for the period until close of 2012.

**Slovak Republic:** Additional to the level of budgeted ODA funding for the year 2010. Fast-start within rising ODA.

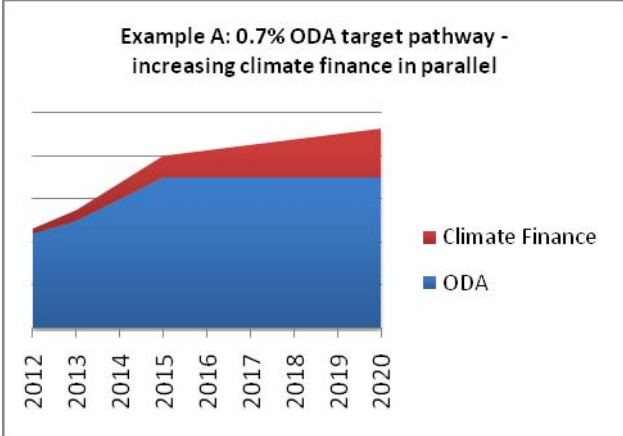
**United Kingdom:** The UK's Fast Start commitment is drawn from the UK's rising ODA budget which is due to reach 0.7% of GNI by 2013.

It is important that a definition of additionality is simple and communicable and we therefore consider that the option of looking at how ODA has risen across the EU as a whole against a base year is one which could be explored.

## Annex 4: Visualization of different options for defining additionality and their financial implications

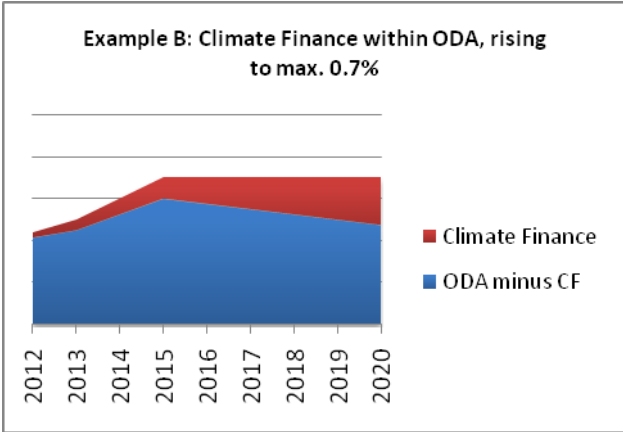
Note: The different examples do not correspond directly to the options illustrated in chapter 2. Examples A - D part from the 0.7 % ODA target with different levels of double counting. Example E implies overall funding remaining below 0.7 % of GNI.

**Example A:** ODA is increased up to 0.7 %, Climate Finance is disbursed in parallel with no double counting allowed (corresponds to Option 4: No ODA counts).



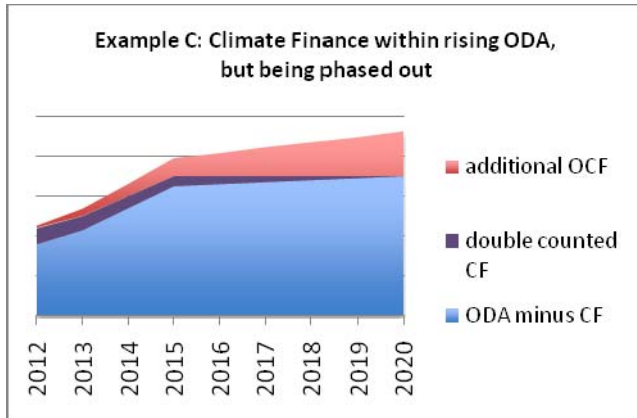
This example describes the most desirable pathway of reaching the 0.7 % ODA target with additional Climate Finance according to international commitments.

**Example B:** ODA is increased up to 0.7 % but includes Climate Finance (complete double counting)



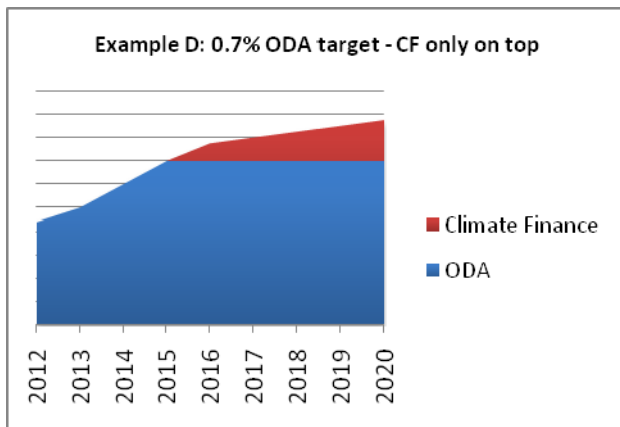
This example shows what could happen if complete double counting was allowed: ODA levels would fall according to the increase of climate finance.

**Example C:** ODA is increased up to 0.7 % with double counting being phased out until 2020 (as proposed in chapter 2.4)



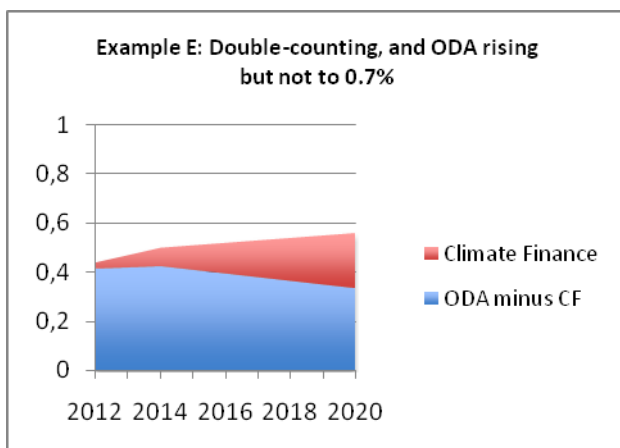
This example shows what could happen if double counting was phased out (parting approximately from current levels of double counting): compares to Example A with a temporary possibility of double counted financing.

**Example D:** Only funding that is above the 0.7 % ODA target (corresponds to Option 1)



This example shows the implications if only funding above the 0.7 % ODA target counted as climate finance: Until then no funding would be counted as climate finance.

**Example E:** Double-counting and increasing ODA levels but not to 0.7 %



This example shows what could happen if double counting was going along with only slightly rising ODA levels (compares to Example at generally lower funding levels).

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