

Climate Finance Policy Brief No.2

Climate finance additionality: emerging definitions and their implications

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I. Introduction

The Copenhagen Accord calls for a collective commitment by developed countries to provide ‘new and additional resources...approaching USD 30 billion for the period 2010- 2012 with balanced allocation between adaptation and mitigation... [and] 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.’ Rapid and successful deployment of this international public finance is a critical first step in allowing developing countries to adapt to climate change and pursue actions that will allow them to move onto a low carbon development pathway. However, it remains unclear (1) how additionality is defined in the Copenhagen Accord when it promises ‘new and additional resources’; and (2) how such large sums of money are going to be raised. These considerations remain elusive in the Accord, but are fundamental to ensuring that financial commitments are met and secured in such a way that international public funds are not diverted away from long-term commitments to support development in poor countries. Therefore, further reflection is needed around how ‘new and additional’ is being defined and what this implies for developing countries.

This paper explores the following two main issues:

- How is additionality being defined by different political actors?
- What are the technical and political implications of these different definitions? And what do the varying definitions require in terms of tracking and the measurement, reporting and verification of finance?

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II. Emerging definitions of climate finance additionality

The European Commission is currently requesting that all EU Member States declare their working definitions of new and additional finance, with the goal of having a common and unified definition by 2013. In light of this, the EU, through the European Council's Economic and Financial Committee (EFC) and Economic Policy Committee (EPC) Joint Working Group on the Financial Aspects of Climate Change, is putting together definitions to assess 'additional' international public finance for climate change (EU Presidency Questionnaire on fast start finance, 2010). The four following definitions are prominent in the current debate:

- 1. Climate finance classified as aid, but additional to (over and above) the '0.7%' ODA target:** This definition makes reference to the repeated commitment of the world's governments to commit 0.7% of rich-countries' gross national index (GNI) to official development assistance (ODA). This goal was first pledged in the 1970 UN General Assembly Resolution, which stated, 'Each economically advanced country will progressively increase its official development assistance to the developing countries and will exert its best efforts to reach a minimum net amount of 0.7 per cent of its gross national product ... by the middle of the Decade' (UN General Assembly, 1970). This goal has been reaffirmed in many international agreements over the years and, in 2005, individual donors unilaterally pledged to reach the 0.7% target by 2015 (Council of the European Union, 2005). Under this first definition, any finance that goes towards climate change should be in addition to, that is over and above, this 0.7% GNI commitment, which was made in the context of developing countries' needs *before climate change was recognized* and therefore does not factor in the additional finance necessary to address climate change. This definition is supported by Norway and the Netherlands.
- 2. Increase on 2009 ODA levels spent on climate actions:** This definition implies that 2009 ODA disbursements on climate change should set the reference level, above which any new ODA finance going to climate change measures can be considered additional. For example, if Country X gave \$1 million towards climate change efforts in 2009, and is planning to give \$2.5 million in 2010, \$1.5 million would be considered additional (subtracting the reference level \$1 million from \$2.5 million). This definition is supported by Germany.²
- 3. Rising ODA levels that include climate change finance but where it is limited to a specified percentage:** This definition, supported by the UK's last Prime Minister Gordon Brown, suggests that finance for climate change should be part of traditional aid spending but be limited to a certain portion. Brown specified the following: 'In the UK we will limit such expenditure to up to 10% of our official development assistance' (Brown's speech, 2009). It is recognised that in addition to the 10% of ODA, other (non-ODA) sources of finance will be needed to meet climate change needs.
- 4. Increase in climate finance not connected to ODA:** this definition suggests a complete separation between ODA and climate change finance. Under this approach ODA should continue to be used specifically for traditional development activities, and finance for climate change should come from other sources of finance not categorised as ODA.

What do these different definitions imply? And what are the technical and political implications of each definition?

² Germany employs officially a two-part definition of additionality which, in addition to the 2009 baseline of ODA spending on climate change activities counts all funding generated by new financing sources, such as the revenue from auctioning off its share of emissions allowance units under the EU emission trading system, a part of which flows into Germany's International Climate Initiative (ICI), began in 2008.

Definition 1: Climate finance classified as aid additional to (over and above) the 0.7% ODA target

Defining additionality as finance for climate change that is over and above the donor government 0.7% of GNI target for ODA is relatively straightforward. There is also likely to be considerable support for this definition from the international development community who do not want to see funds diverted from longstanding commitments to support traditional development needs for poor countries. Also, this definition does not necessarily limit climate finance to ODA, but instead suggests that climate finance which is counted as ODA should be in addition to the 0.7% target. From a technical angle, it is possible to determine ODA climate finance given that the 0.7% target is already being tracked by the OECD in terms of funds disbursed by donor governments. However, from a political perspective, most donor governments have had considerable difficulty reaching the 0.7% target. Of the 23 donor governments recently reported in an OECD database, only 5 have met the target (OECD website, 2010). This definition also needs to be placed in the context of current global fiscal constraints and the Euro crisis in Europe. If overall economies shrink, 0.7% of this year's GNI will be smaller than 0.7% of last year's GNI. There is also some evidence that some EU countries are starting to revisit their ODA growth projections and may reduce it as a percentage of GNI for 2011 (see for example '*Denmark freezes spending to shrink public deficit*', 19 May 2010).

Definition 2: Increase on 2009 ODA levels directed at climate change activities

This definition, implying that 2009 ODA disbursements should set the reference level for climate change finance, is similarly straightforward to track as Definition 1. There is a baseline which is already being reported to and tracked by the OECD. However there are serious deficiencies with the OECD's current tracking of climate-related ODA and as such, the 2009 baseline for climate-related ODA funding by country is likely to be an imprecise estimate at best (deficiencies in OECD tracking are discussed below in Section III). In addition, because each donor country has provided different amounts of ODA (and climate-related ODA) in 2009, some adhering to previous development finance commitments and some not, the implications of a 2009 baseline are not the same for all donor countries.

If applied to a country like the Netherlands, a country that has already reached the 0.7% target for ODA, this means that for the Dutch any additional money that is spent can go to climate change and is guaranteed not to divert from previous development commitments. In contrast, for a country like the US which has only provided 0.2% towards ODA in 2009 (OECD website, 2010) and has made limited contributions to supporting climate change actions in developing countries (see for example US deposits reported at www.ClimateFundsUpdate.org), setting 2009 as a baseline means that future ODA going to climate change may in fact be diverting from their 0.7% target for development, whilst suggesting significant additionality. It also gives such countries a 'last mover advantage' over countries that have already met the 0.7% target, who would have to adhere to a higher baseline for contributions to climate change. These two examples demonstrate that such a definition, if accepted internationally, would have different implications in terms of cross-donor equity and potential diversion from the previous 0.7% target for ODA.

Definition 3: Rising Official Development Assistance (ODA) which includes climate change finance but limited (e.g. to X %)

Here climate finance is considered part of ODA, whilst being limited to a certain percentage of ODA spending. If overall ODA levels increase so that the increase exceeds the nominal percentage allocated to climate, the percentage will not have an impact on financial flows going towards development. For example, the UK spent \$11.5 bn towards ODA in 2009 (<http://webnet.oecd.org/oda2009/>). In order to avoid a drop in traditional ODA support and

assuming 10% would go towards climate change, UK's ODA levels would need to increase to \$12.65 bn in 2010 in order to avoid diverting the spending away from development ($\$11.5 \times 110\% = \12.65).

What percentage is the right level to limit climate-related development spending? Assuming ODA is the *only* international public finance channel for climate change, this could be calculated by gathering data on estimated global development needs along with estimated climate-related needs in developing countries and assessing what percentage of the total amount is needed for climate finance. However, it may be fair to assume, as Prime Minister Brown declared for the UK, that the percentage coming from ODA is only part of the overall picture of financial flows to address climate change. (Prime Minister Brown stated there would need to be a combination of the carbon market, new and additional sources of predictable finance, and a limited amount of development aid).

The UK's declaration of 10% of ODA to go towards climate change was set in the context of delivering funding that 'clearly meets both poverty reduction and adaptation or mitigation objectives' (Brown speech, 2009). Therefore to understand what percentage of ODA is right for climate finance, one needs to know the costs of climate change where 'both poverty reduction and adaptation or mitigation objectives' overlap. This is certainly a hard cost to assess.

In reality, many, if not all developing countries will need to develop and begin to implement low carbon development pathways; this implies that 'mitigation' investments and pro-poor growth, poverty reduction, private sector development, infrastructure and other sectoral developments will be closely interlinked, as both growth and development need to be low carbon. The same is true (and even more obvious) with adaptation, as it is closely interlinked with issues of poverty reduction, agriculture and food and water security. In fact, distinguishing between development goals and climate investments does not make much sense in many cases, as 'low-carbon' and 'climate-resilience' are not specific sectors but approaches that need to be integrated into development and growth. This argument undermines the rationale for adopting a percentage target.

Given that for some climate related goals there is very clear and striking overlap with poverty reduction, such as adaptation in least developing countries, it is logical that a percent of ODA could perhaps go to such efforts. But because there is not likely to be a clear cut-off point between development and climate change, the most important need is to ensure that other non-ODA funding channels created for climate change are mainstreamed with international development spending.

For governments that have not met the 0.7% target, setting the percentage in relation to ODA spending implies that funding is based on one's current contributions, even if they are currently insufficient. It also means that for countries which have not met their 0.7% target, diverting a percentage away from the goal signifies a diversion in priorities unless there is significant year-on-year increase in total ODA.

Definition 4: Complete separation between ODA and climate change financing

Complete separation of ODA from climate change finance would allow concerns regarding diversion of ODA funds away from development goals to be allayed. Given that ODA is simply a way to measure and track international public financial flows, separating ODA from climate finance does not imply how funds would be raised. This definition could either imply that additional funds would be raised from a national budget line (the source of finance for ODA) or from new revenue generation mechanisms, or both. The key point is that these funds would not be counted towards ODA targets. The emphasis here is on separation of finance at source. However, as mentioned above, international public financial flows for climate change still need to be mainstreamed with existing ODA flows, ensuring that funds are coordinated at the recipient level. This is likely to be technically challenging but nevertheless a necessity. Moreover, if this definition is agreed upon internationally and a new financial mechanism is introduced, it will be a significant political challenge

for donor countries to agree on what this new mechanism should look like, who should be in charge of tracking the finance, and how it will be tracked.

Using this definition of additionality would signify a progressive political stance that could lead to increased trust between the North and South. Creating a new financial mechanism with different rules and procedures from tradition development cooperation may also break the donor-recipient relationship commonly associated with ODA and its unequal power relationship.

The four definitions of climate finance additionality

	Definition	Technical considerations	Political considerations
1	Aid that is additional to (over and above) the 0.7% ODA target	Easy to track given that it is measuring an increase at disbursement level and technically feasible but raises same questions around the validity of the ODA tracking system and what gets counted as climate finance.	Most countries have difficulty reaching the 0.7% target in the first place, so politically challenging to raise the target. Supported by international development community.
2	Increase in climate finance on 2009 ODA levels directed at climate change activities	Easy to track given that it is measuring an increase at disbursement level and technically feasible but current issues with ODA tracking. There will be no diversion from development objectives for donors who have already met their 0.7%, but may not be the case for those who have not.	Some issues with setting 2009 as financial baseline – implies different things depending on if donor has met the 0.7% target or not. Those donors who have not given to ODA-related climate finance before 2009 will have a lower baseline compared to those who have, implying equity issues.
3	Rising Official Development Assistance (ODA) which includes climate change finance but limited (e.g. to X%)	Aid diverted to climate finance causes changing the composition of finance if overall levels of ODA are not raised sufficiently. Issues around how to know what percentage is the right level – and should ideally only apply to governments who have already met their 0.7% so that the percentage of ODA spending going to climate change is above the 0.7% for development related efforts. Still need to secure additional channels of funding over and above a percentage of ODA, especially if limited to only 10% as is the case with UK proposal.	Countries which have already met their 0.7% target will not want those who have not to sacrifice this original goal for climate change objectives. It signifies a diversion in priorities. Setting the percentage in relation to ODA spending means funding is based on a country's current contributions, even if they are insufficient. Contributions are therefore not based on ability to pay, unlike one set on percentage of GNI.
4	Complete separation between ODA and CC financing	Emphasis on separation of funds at source. Need to ensure that new sources of finance are mainstreamed with existing ODA flows - technically challenging.	Would allow concerns regarding diversion of ODA funds away from development goals to be allayed. Politically challenging to agree what a new financial mechanism would look like, who should be in charge of the tracking, and how it will be tracked.

In sum, there are different implications for how climate change finance is raised, measured, channelled and counted depending on which definition of additionality is used. Clearer definitions are required and an international agreement need should be sought, taking into account the various implications highlighted above. While some of these definitions reflect the positions of EU Member States, more information is needed regarding the definitional preferences from other traditional donors, such as the US and Japan (clearly one of the major supporters of international public finance), and those new countries offering international climate finance, such as Brazil and China.

III. Moving forward: ways to operationalise climate finance additionality

Current situation

Most of the definitions of additionality imply that ODA will continue to be a source of finance for climate change and in the short term, at least, this will likely remain a significant channel. Therefore the tracking of ODA flows is important to ensure that we know how much money is going to climate change and what may be considered additional. However, this raises issues around the validity of the current ODA tracking system.

Currently, the OECD Development Assistance Committee (OECD DAC), which is in charge of reporting on all ODA flows, relies on donor governments to report on 'Rio Markers' for climate change. When developed countries signed the three Rio Conventions in 1992, they agreed to support developing countries in the implementation of these Conventions. Since 1998, the DAC has monitored aid targeting the objectives of the Rio Conventions through its Creditor Reporting System (CRS) and its Rio Markers including the 'climate change-related' objective. According to the Rio Marker definition on climate change-related funding, an activity should be classified as climate change-related if 'it contributes to the objective of stabilisation of greenhouse gas (GHG) concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system by promoting efforts to reduce or limit GHG emissions or to enhance GHG sequestration.'³ Activities are then marked depending on whether climate change is a 'principal' objective (marked a '1'), or 'significant' objective (marked a '2'). In practice, tracking of ODA flows, and particularly climate-related ODA flows, is an imperfect system. Limitations include:

- The application of Rio Markers by donors reporting to the DAC was not made mandatory until recently; therefore trends cannot be meaningfully measured until 2013-2014 at the earliest (Huhtala, et al., 2010).
- The climate change-related marker has only been applied to mitigation actions. In December 2009 the DAC members approved the inclusion of a new marker to track adaptation (reporting will start on the new adaptation marker next year on 2010 flows).
- Only bilateral climate change flows are reported. Multilateral agencies do not use the marker when they report their flows to the DAC.
- Reporting on climate change-related projects funded over many years may be mis-characterised given that aid is reported on an annual basis. Parties are not required to remove projects that were listed in one year but cancelled in subsequent years (Tirpak et al., 2010).
- OECD DAC only allows project or sectoral tracking of climate change related flows; such flows cannot be tracked via general budget support. This may become more prominent in the future as climate-related development support continues to move towards programmatic forms.
- Since donor governments define their own projects as climate-related or not, each donor agency is likely to have different interpretations of what is meant by 'climate-related'. Reporters may also be under pressure to determine spending as climate-related to satisfy the 'new and additional' criterion and may over-report (Roberts et al., 2010).
- Given that the markers are open for interpretation by each donor agency, there is no strict comparability across countries.
- Currently, both categories 1 and 2 of climate markers ('principal' and 'significant') are counted towards a country's climate-related ODA. These categories are loosely defined and up for interpretation. There is currently no international agreement on whether either or both of these categories should be counted towards an additionality target.

³ Note this limits the definition of climate change-related actions to mitigation activities.

- There is no internationally agreed methodology for tracking the exact share of aid spending that contributes to climate change mitigation or adaptation (OECD DAC, 2009).

With the exception of targeted funds (such as the Adaptation Fund and the Climate Investment Funds), tracking donor contributions to climate action is challenging. This is particularly difficult for adaptation given its linkages with development. The Rio Markers provide an approximate quantification *at best* and a misleading figure *at worst* of the amount of aid for climate change.

The United Nations Framework Convention on Climate Change (UNFCCC) also requires that Parties report on climate change financing for developing countries. Guidelines require Parties to indicate what ‘new and additional’ funds they have provided pursuant to Article 4.3 and to explain how they have determined that such financial resources are in fact ‘new and additional’. However, in preparing a summary of financial information based on the reporting, the UNFCCC Secretariat noted multiple methodological and reporting issues that limited the usefulness of their analysis (for more details, see Tirpak et al., 2010). UNFCCC reporting is not comprehensive and efforts by other institutions to fill this gap are still a work in progress.

Future options for tracking climate finance

Assuming ODA will continue to be prominent source of finance for climate change, what are possible solutions to tracking climate finance in the future that can help ensure that finance is additional? One option is to create a new form of tracking which gets rid of the Rio Markers altogether and instead separates flows for development from flows for climate change, both which reflect the primary objective for financial assistance to avoid inflated numbers and double counting. Flows for climate change could be subdivided by theme (energy efficiency, water-related adaptation, deforestation, etc) as well as by country. Another potential solution would be to stick with the current mode of tracking and strengthen the monitoring of climate finance by (1) making the Rio Markers for both mitigation and adaptation compulsory, (2) refining the Rio Markers to make them more exact and easier to substantiate, (3) report only level 1 Rio Markers, and (4) create monitoring and reporting standards for multilateral funders and non-DAC donors in a manner consistent with methodologies adopted by OECD DAC. Consideration should also be made for the accounting of other non-ODA sources of finance (such as private, domestic, and South-South financial transfers).

An important context to consider is that international public financial support to developing countries is moving towards ‘programmatic’ forms of financial delivery, involving shifts towards budgetary support and away from project-based aid. This move towards programmatic aid delivery will make it nearly impossible to separate out ‘development’ from ‘climate’ funding, and not easy to match the ‘downstream results to specific upstream support (Huhtala et al., 2010). External financing will be entirely fungible within the recipient country’s national financing system (i.e. up to national (recipient) governments to transfer funds to differing policy objectives as they see fit). If this trend continues, the monitoring and tracking of international public finance flows may need to do away with the amount of detail currently reported in the OECD CRS (e.g., Rio Markers, purpose codes, policy objectives, etc). Programmatic financial support may make tracking of climate finance flows more difficult, and emphasises the importance of creating a new and additional *source* of finance for climate change which can easily be tracked but just as easily channelled together with programmatic development finance flows. This will also make tracking of how recipient governments allocate their spending all the more important.

IV. Conclusion: remembering the end goal – how to raise the necessary levels of finance

All of the above definitions only address how funds are to be counted and channelled from donor to recipient governments. They do not consider how the funds will be raised. On the positive side, this

allows the countries themselves the flexibility to decide how best to raise the additional finance needed for climate change. Whether the funds are raised through traditional channels such as national budget expenditure, or through innovative channels such as the auctioning of international allowance units, the definitions of additionality above leave donor countries to decide how the additional finance should be raised. However, given current strains on public resources, earmarked public funding is unlikely to generate sufficient funding. This is an important and necessary consideration given the end goal remains to raise significant and predictable sums of finance to help developing countries deal with climate change. Therefore, relying on new and innovative sources of finance – going beyond traditional budgetary expenditure – will likely be required to meet this objective. The key is to avoid reliance on funds generated through traditional channels that already have significant pressure from other interest groups.

In light of this, a number of bilateral and multilateral proposals have been put forward in the international climate change negotiations to raise additional revenue to address climate change in developing countries⁴. These proposals aim to generate income by tapping into some of the revenue from the carbon market, or more broadly through carbon or international travel-related taxes or levies, rather than from conventional ODA funding sources. At present, all international climate funding instruments (with the exception of the Kyoto Protocol's Adaptation Fund, which is financed through a 2% levy on CDM proceeds; and part of the German International Climate Initiative which is financed through national auction of emissions allowance units) rely on ODA.

Additionality is an important issue on which to focus attention at the present time to ensure that sufficient finance is channelled towards climate change needs while simultaneously avoiding diversion from development needs. Thus the way additionality is defined by donor governments needs focused attention and debate. However, underlying this concern around financial additionality is the need to secure new innovative sources of finance within governments' power to control and regulate. Such sums need to be in sufficiently large to guarantee fulfilment of development and climate change funding obligations by developed countries and developing countries' needs. Once new sources of finance in sufficient amounts are secured, financial additionality may become less of a concern, as it will eliminate the need to rely on ODA as a major funding source. The challenge will then be to provide seamless delivery with aid flows on the ground.

Further resources

IIED, 'Baseline for trust: defining 'new and additional' climate funding' (June 2010)
<http://www.iied.org/pubs/display.php?o=17080IIED>

Project Catalyst, 'Making Fast Start Finance work' (June 2010)
www.project-catalyst.info/images/publications/2010-06-07_project_catalyst_fast_start_finance_full_report_7_june_version.pdf

World Bank, 'Monitoring Climate Finance and ODA' (May 2010)
<http://beta.worldbank.org/climatechange/sites/default/files/documents/DCFIB%20%231-web.pdf>

WRI, 'Guidelines for Reporting Information on Climate Finance' (May 2010)
<http://www.wri.org/publication/guidelines-for-reporting-information-on-climate-finance>

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Tirpak, Dennis et al (2010) "Guidelines for Reporting Information on Climate Finance". WRI Working Paper. World Resources Institute, Washington DC. Available online at <http://www.wri.org>.

UN General Assembly resolution 2626 (XXV), paragraph 43, November 19, 1970

Climate Finance Policy Briefs

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