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Making the Green Climate Fund Transformational

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We argue that by linking its revenue stream to the Green Climate Fund (GCF), the Mechanism in article 6.4 of the Paris Agreement can provide a basis to achieve substantial transformational change.

As countries negotiate the rulebook for the implementation of the Paris Agreement, there is an opportunity to make the Green Climate Fund truly transformational. Similar to the Kyoto Protocol's Clean Development Mechanism (CDM), Article 6 of the Paris Agreement establishes a "Mechanism" to promote the mitigation of emissions while fostering sustainable development.[1] Unlike the CDM, the Mechanism is global and does not limit implementation to actions in developing countries only. We argue that by linking its revenue stream to the Green Climate Fund (GCF), the Mechanism can provide a basis to achieve substantial transformational change.

An ambitious and transformational GCF will need a diverse set of instruments.[2] So far, an exclusive reliance on donor contributions has limited the nature of financial instruments that the GCF can deploy. At the climate finance roundtables hosted by the Climate Policy Lab (with the World Resources Institute), participants consistently expressed the need for the GCF to be able to accept higher levels of risk for it to realize its potential. As the Paris Agreement allows a share of proceeds from activities under the Mechanism to be used to meet the costs of adaptation, the GCF would be able to use a more diverse set of financial instruments including equity, first-loss, and subordinated debt.[3] In addition, we argue that a share of proceeds can also be generated from emissions reductions that are internationally transferred under Article 6.2.[4] As the share of proceeds cannot be attributed to any particular country as its contribution, the GCF can substantially increase its risk appetite.

Article 6.6 has stipulated the share of proceeds be used for meeting the costs of adaptation. As engaging with the private sector on adaptation is an ongoing challenge, a flexible funding stream is essential. Furthermore, given how existing multilateral climate funds have been capitalized, it is difficult for these funds to structure programs by subordinating their capital to leverage far greater amounts of private climate finance.[5] Being able to provide different types of favorable finance would make the Green Climate Fund a unique addition to the climate finance landscape. Policy makers should consider the following issues as they elaborate the details of the Mechanism and the GCF's role in it.

Scale and Volatility Unlike the Kyoto Protocol, the Mechanism's demand and supply will be generated by any party to the Paris Agreement that decides to participate. Such an arrangement provides a stable basis for the supply of emissions reductions. A key challenge, however, will be to increase the scale from boutique projects to a wide range of 'mitigation actions' at program and

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1 We use the term, the Mechanism, to refer to the mechanism established by the Paris Agreement in Article 6.4. Given the diverging views on the name of this mechanism, we simply refer to it as the Mechanism.

2 In the case of forests, see the portfolio approach to financing: http://fletcher.tufts.edu/~/media/Fletcher/Microsites/CIERP/Publications/2012/Designing%20FFM.pdf

3 The share of proceeds from the Mechanism will be used for both supporting the administrative expenses of the Mechanism as well as meeting the costs of adaptation for developing countries.

4 http://bit.ly/2e6cYrd

5 See online appendix for a comparison of instruments: http://fletcher.tufts.edu/~/media/Fletcher/Microsites/CIERP/Publications/2016/CIERPpb_Mechanism_Appendix.pdf

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sector-level scales.[6] The five-year cycles of nationally determined contributions and global stocktakes will provide further policy clarity. Policy certainty, particularly on how emissions reductions achieved under the Mechanism relate to each party's NDCs, will be critical for the Mechanism's market volatility.

Additionality and Linkages We need to view additionality bearing in mind that the Mechanism goes beyond allowing countries flexibility in meeting their mitigation goals and aims to deliver 'an overall mitigation in global emissions.' Parties will need to ascertain additionality in the context of diverse NDCs and their varying forms including their conditional, un-quantified, and non-legally binding nature.[7] A key issue is whether the application of additionality is different for developed versus developing countries.[8] Similarly, while there is a clear stipulation for the internationally transferred mitigation outcomes under Article 6.2 to apply 'corresponding adjustments' to avoid double counting, it is not clear whether corresponding adjustments will be applied to transactions under the Mechanism as well. Policy consistency on the eligibility of the Mechanism's outcomes will be essential.

Share of Proceeds Policy makers should recognize the trade-off involved in setting a high levy and encouraging investments via the Mechanism.[9] Similarly, parties have the option of defining the levy in absolute values or percentage terms. [10]

Capacity building and enabling environments Parties should explore ways to build capacity to ensure wide participation. Building on lessons learned from the CDM and maximizing synergies with GCF readiness programs are critical. Similarly, establishing "market-formation" policies and improving the clarity of enabling environments in host countries will be important to moving money across borders. For example, there is a high degree of correlation between foreign direct investment and CDM-related investments.[11]

Fostering sustainable development The Mechanism firmly ties mitigation with fostering sustainable development. The scholarly literature finds scant evidence for the CDM's contribution to sustainable development as most of its projects targeted industrial gases with high global warming potential and limited additional impact.[12] How the Mechanism will resolve this trade-off is worthy of further consideration.

While this call for linking the share of proceeds to the GCF does not make replenishments redundant, parties have an opportunity to expand its flexibility and potential for leading transformational change.

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6 We refer to scope both in terms of the nature of actions — projects, programs, sectoral approaches, among others — and the greenhouse gases and sinks targeted. One of the major areas of contention is likely to be whether the Article 6.4 mechanism includes REDD-plus or not. Please see submission from Norway on Article 6. October 2016 http://bit.ly/2e4rYrF

7 While the Kyoto Protocol Article 12(5)(c) defines additionality in relation to a 'certified project activity,' paragraph 38(d) of 1/CP.21 says "reductions in emissions that are additional to any that would otherwise occur."

8 Paragraph 17, LMDCs submission, September 29 2016 http://bit.ly/2d5vh3T

9 CARICOM has called for a consideration of whether the exemption of SOPs granted to LDCs led to an increase of CDM projects. See page 8: http://bit.ly/2e6cYrd

10 A 2% levy was applied to the value of Certified Emissions Reductions for adaptation costs while $0.10 was charged for the first 15,000 tCO_2 and $0.20 for the remainder to cover administrative expenses. https://cdm.unfccc.int/EB/023/eb23_repan35.pdf

11 Byiegro, A. Clancy, J., and M. Skutsch. 2010. "CDM in Sub-Saharan Africa and the prospects of the Nairobi Framework Initiative." Climate Policy 10(2): 181-189.

12 Online appendix: http://fletcher.tufts.edu/~/media/Fletcher/Microsites/CIERP/Publications/2016/CIERPpb_Mechanism_Appendix.pdf

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