May 2016

Fit for Purpose: Negotiating the New Climate Finance Accounting Systems

Policy Brief
No.3, 2016

Summary and policy recommendations

Pledges by developed countries to help poorer ones deal with climate impacts and move toward low-carbon development pathways have been crucial to advance the UN climate change negotiations in the run up to the landmark Paris Agreement of December 2015. Yet sharply competing claims on the fulfilment of past climate finance promises threatened one more time to derail the whole process. Observers have for many years called for a robust accounting framework of climate finance under the UN Convention. In this regard, a notable but little discussed decision was reached in Paris to develop by 2018 a much-needed accounting framework for climate finance under the UNFCCC.

Significant political challenges await negotiators on the road toward the elaboration of robust accounting modalities. This brief aims at facilitating the future discussions on that matter by making explicit two different purposes of a climate finance accounting system: The assessment of developed countries' financial effort toward developing countries' adaptation and mitigation on the one hand and the assessment of resources devoted to climate activities in developing countries or in the whole world on the other hand. We argue that these different purposes have important implications for the features of the accounting systems that need to be built. In addition, we illustrate how the fraught contestations around current climate finance accounting practices can be understood as reflecting those two different purposes. Finally, we call on UNFCCC negotiators to acknowledge the specific features associated with each accounting approach in order to develop new systems or improve existing ones to make them truly fit for purpose.

The Issue

Pledges by developed nations to help poorer countries deal with climate impacts and move to low carbon economies have been a crucial part in advancing the UN climate change negotiations through contentious periods. However, sharply competing claims on the fulfilment of climate finance promises remain. The issue flared at the Paris negotiations in a spat between the Indian delegation and the OECD[1], but has more broadly poisoned the climate negotiations since their very inception.

A notable but little discussed development happened at the climate negotiations in Paris: A Decision was reached to request the Subsidiary Body for Scientific and Technological Advice (SBSTA) of the UNFCCC to develop "modalities for the accounting of financial resources provided and mobilized through public interventions [by developed country Parties to support developing country Parties]"[2]. Such a decision is long overdue: Observers have for many years called for a robust accounting framework of climate finance promises made under the aegis of the UNFCCC.

Climate Strategies

Authors:

Romain Weikmans, Postdoctoral Research Fellow at the Climate and Development Lab, Brown University and Fellow of the Belgian American Educational Foundation

Timmons Roberts, Ittleson Professor of Environmental Studies and Sociology at Brown University and co-director of the Climate and Development Lab; Member of Climate Strategies

Editor of the series: Charlotte Streck

We argue here that one of the most fundamental ambiguities that negotiators will be confronted with in the development of such modalities is the purpose of the accounting system: Is it to assess the financial effort made by developed countries? Or is it to assess the financial resources devoted to mitigation and adaptation in developing countries (or worldwide)? These two different purposes have important implications for the features of the accounting systems that need to be built. We first describe these features and then illustrate how they can help us understand the fraught contestations around current climate finance accounting practices. We conclude by suggesting some next steps and a timeline up to the 2018 deadline for negotiators to develop climate finance accounting systems that are truly fit for purpose.

Two Approaches to Climate Finance

When it comes to climate finance, two distinct approaches are apparent in international debates. A first approach stresses the fact that the developed nations created the problem of climate change, and also are the ones with the resources to help developing nations avoid increasing their emissions and deal with the impacts already occurring from a destabilized climate system. In this view it is critical to prove that funding is coming from wealthy nation governments and that this funding is actually being delivered, as specified under various provisions in the UNFCCC Convention, in the Paris Agreement, and in multiple other COP decisions. Under this approach the implicit or explicit purpose of the climate finance accounting system is to account for developed countries' financial effort toward developing countries. This approach has been taken by developing countries, but also by environmental and development NGOs, and developed countries themselves sought ways to hold each other accountable to their collective promises.

A second approach gives prominence to the fact that it doesn't matter much to know where the money comes from, but rather that we need to "shift the trillions" of private and public investors to drive a green energy revolution and shift toward climate-resilient development pathways, both in poor and rich countries. In this approach which reflects the shape of global financial markets, the aim of the climate finance accounting system is to assess the scale of financial resources globally devoted to the fight against climate change. This is the approach followed in the authoritative Climate Policy Initiative's reports published each year since 2011[3], and is gaining adherents, perhaps starting with the multilateral development banks and some other international aid agencies, some NGOs and analysts.

As detailed in table 1, the specific purpose of each approach has huge implications for the features of the underlying accounting systems that need to be built. That is, they vary by their aims, the parts of the Paris Agreement they align with, which flows they focus upon, whether the flows need to be public grants or can also be "mobilized" private finance, whether loans and export credits can count, how granular data needs to be, and whether self-reporting is seen as adequate. We call these approaches "meeting financial obligations" (Approach 1) and "Tracking resilient/low carbon finance" (Approach 2).

The History: An Accounting System that Mixes the Two Approaches

In the absence of any accounting system under the UNFCCC, most developed countries have so far heavily – though not exclusively – relied on data collected using the OECD Development Assistance Committee (DAC) Rio marker methodology[4] to report to the UNFCCC Secretariat on their bilateral public climate finance flows to developing countries[5].

This practice has been widely challenged in the literature[6] and has been called into question by the DAC Secretariat[7] and by the UNFCCC Standing Committee on Finance[8]. Here we argue that most contestations in this regard stem from the fact that this methodology mixes the two approaches described above, and is not successful at either. In particular, most of the critiques concern the lack of appropriateness of this methodology to accurately reflect the level of contributor countries' financial effort.

Some characteristics of the Rio marker methodology could partially make it a relevant accounting system to assess contributors' financial effort. Indeed, this methodology is used for the quantification of public finance committed at concessional terms to developing countries by DAC donor countries for mitigation and adaptation objectives. However, the Rio marker methodology lacks several other features that would make it fit for this purpose.

Table 1: Climate Finance Accounting Systems: Different Purposes, Different Features

	APPROACH 1: MEETING FINANCIAL OBLIGATIONS	APPROACH 2: TRACKING RESILIENT/LOW CARBON FINANCE
Aim of the accounting system	Assessing the financial effort made by developed countries toward developing ones	Assessing the financial resources devoted to mitigation/adaptation
Climate finance objective/rationale	USD 30 billion for 2010-12 (Fast Start Finance) USD 100 billion/year by 2020[1]	"Shifting the trillions"
Implicit goal of climate finance	Financial transfers between rich/highly polluting countries to low polluters and/or most vulnerable/poor countries	Transition to a low carbon and climate resilient economy
Main relevant provisions under the UNFCCC Paris Agreement[2]	"Developed country Parties shall provide financial resources to assist developing country Parties with respect to both mitigation and adaptation in continuation of their existing obligations under the Convention" (Art. 9.1).	"Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development" (Art. 2 (c)).
Flows	Only North-South flows (So it's important to determine who are the contributors and who are the beneficiaries)	Domestic and international flows (North-South flows; North-North flows; South-South flows) (It's less important to differentiate between contributors and beneficiaries)
Effort sharing between contributing countries	Very important	Less important
''Provided'' versus ''mobilized''	Provided climate finance[1]	Mobilized climate finance
Focus on public/private flows	Public flows[1]	Public and private flows
Underlying Accounting System		
Additionality (above existing aid)	Very important	Not important
Concessionality (grants or low-interest loans)	Very important	Not important
Grant equivalent/budget effort versus face value	Grant equivalent/budget effort	Face value
Granularity	Very important: Only components, sub-components, elements or proportions of projects can be reported as "climate finance"	Possibly less important
Accounting based on intention or proven impact?	In theory: proven impact, but this has not really been discussed under the UNFCCC. The focus has rather been on the intention (of mitigation/adaptation). This is categorized by simple declaration of contributors (of funding as climate related or not), but some intervention types could be excluded (for example support to "high efficiency" coal plants).	
Control on self-reporting	Very important: Could be for example achieved through triple validation (by the donor and by the recipient country, and/or by an independent board or its agent)	Less important; This approach relies more on existing large datasets (e.g., foreign direct investments, export credits, Bloomberg New Energy Finance data).

[1] See also Box 1.
[2] UNFCCC (2015), *Report of the Conference of the Parties on its twenty-first session, held in Paris from 30 November to 13 December 2015 Addendum Part two: Action taken by the Conference of the Parties at its twenty-first session*, *Annex: Paris Agreement*, United Nations Framework Convention on Climate Change, Available at: http://unfccc.int/resource/docs/2015/cop21/eng/10a01.pdf.

In particular, as highlighted by the OECD, "the Rio markers *do not* allow the identification of 'new and additional resources' as stipulated in the [Rio] Conventions"[9]. This makes it impossible to assess if the financial resources provided by developed nations for mitigation and adaptation activities that are simply diverted from other financial pledges toward developing countries. In addition, the Rio marker system allows for an aid project to be marked as targeting several Rio markers. While it is useful to recognize potential overlap between Rio Conventions objectives, the situation is more problematic when the same aid project is marked as "principally" targeting more than one of the four Rio markers. In those cases – which are common for many DAC donors –, the use of the Rio marker methodology for financial accounting may result in double, triple or even quadruple counting towards different financial pledges made under the three Rio Conventions[10].

The Rio marker methodology also lacks granularity: When an aid project is marked as "principally" or "significantly" targeting mitigation or adaptation, the whole cost of the project is considered to be mitigation or adaptation related – though only a component of the project may target a mitigation or adaptation objective. In addition, all financial instruments are accounted for at cash face value in the Rio marker methodology. This inflates reported climate finance figures of those donors with a predominance of loans in their portfolio in comparison with donors that mainly provide their climate finance in grants. We can also note that the Rio markers are applicable to bilateral ODA commitments; data on climate-related *disbursements* are not available in DAC statistics. Consequently, there is no way to know whether or not an intended aid project has been carried out: It could have been modified or even cancelled but may still appear unchanged in DAC commitments statistics.

Box 1. A Quick Note on the USD 100 Billion Goal

The two approaches described in Table 1 can also shed light on the much contested goal of developed nations to "jointly mobilize" USD 100 billion per year by 2020 from public and private finance (without any precision regarding the respective proportions of each). Indeed, the meaning of this quantified goal is hugely obscured by mixing of an input objective (the financial effort made by contributors through the provision of public finance) and an output objective (private finance mobilized in developing countries through public finance provided by contributor countries). This is partly why a number of observers have called for a strict delineation between a public finance goal and a private finance one. From an approach that stresses the importance of evaluating contributors' financial effort, this USD 100 billion goal is also problematic because it is not accompanied by details on effort sharing modalities between contributing countries.

In addition, several studies[11], [12] have questioned the quality of the "mitigation" and "adaptation" Rio markers data. All of them highlight the fact that the current reporting system is prone to huge overestimations, notably because of the self-reporting dimension of this exercise by donor countries and because of the absence of independent verification or systematic quality control. Importantly, governments are under pressure to show they are taking action on climate change, and the Rio marker self-reporting system allowed pressures to result in "over-reporting" of projects[13].

All developed countries – with the notable exceptions of the United Kingdom and the United States which use their own accounting approaches – base their bilateral public climate finance reporting to the UNFCCC on the data that they collect with the Rio marker methodology[14]. However, most developed countries have modified the Rio marker methodology in different ways in an attempt to overcome the many problems associated with the use of this methodology for their financial reporting to the UNFCCC. The result of this is a variety of poorly harmonized monitoring and reporting practices[15].

Box 2. Proposed timeline for the development of modalities by 2018

- **May 2016:** Agreement of work programme for developing modalities for accounting climate finance
- **Nov 2016:** Details of work programme and update from SBSTA to the COP
- **Jan-Feb 2017:** Parties submissions due for proposed language
- **May 2017:** COP combines submissions into zero order draft text
- **Nov 2017:** Draft text developed
- **May 2018:** Draft text debated
- **Nov 2018:** Draft modalities proposed to Parties: agreement on a recommendation to the CMA
- **CMA 1:** Consideration and adoption of the recommendation by the CMA

This makes it impossible to meaningfully compare each contributor's performance regarding the provision of climate finance. This is particularly problematic under an approach that stresses the importance of assessing contributor countries' financial effort.

Conversely, it is important to note that the Rio marker methodology lacks fundamental dimensions that would make it relevant for the second approach described in table 1 above; indeed, for example, it does not account for private climate finance, domestic climate finance or South-South climate finance.

The Upshot

Both approaches described in table 1 are important for different sets of reasons. However, when it comes to designing an accounting system, the worst outcome is one that mixes the two and results in modalities that are inappropriate for the underlying purpose of each approach.

In their efforts to develop accounting modalities for the 2018 deadline (see box 2 for a proposed timeline), we call on UNFCCC negotiators to acknowledge the fundamentally different features of the accounting system associated with each approach described in this brief, and to develop climate finance information systems that are truly fit for purpose.

Going forward, the most adequate option would probably be to develop two different accounting systems that each targets one of the two aims identified here: (i) the assessment of the financial effort made by developed countries in assisting developing countries with adaptation and mitigation; and (ii) the assessment of the financial resources devoted to the fight against climate change in developing countries or worldwide. In starting its work on the development of accounting modalities, we suggest that the SBSTA follows a two-track approach reflecting these two purposes.

A significant step forward in the elaboration of an accounting system that would aim at meaningfully assessing the effort of donor countries would be an internationally-agreed baseline against which any claim of additionality of financial contributions for climate purposes could be stated. More than five years after the Copenhagen financial pledges, such a baseline still does not exist[16]. This is particularly problematic: if we compare this with mitigation policy, for example, this would be like the European Union or the United States committing to reduce its emissions by 30 per cent by 2020, without indicating if this percentage is below 1990 or 2005 levelsand whether it was absolute or relative reductions. Without such a baseline, it is impossible to assess – and compare – the level of financial effort made by contributing countries. An even more fundamental task is agreeing definitions of what counts in each category and which flows the Parties find acceptable under which categories.

More broadly, the elaboration of sound accounting modalities for climate finance could relieve the climate negotiations process of longstanding conflicting claims on the fulfilment of promises that have poisoned the negotiations for many years. Such an opportunity for inclusivity and trust-building should not be missed.

Acknowledgement:
We would like to thank Christa Clapp and Charlotte Streck for their useful comments. Any errors remain our own.

Published by Climate Strategies

Climate Strategies
www.climatestrategies.org

Climate Strategies
40 Bermondsey Street
London SE1 3UD
United Kingdom
info@climatestrategies.org

Climate Strategies is a leading independent, international research organisation based in the UK. Through our network of global experts, we assist governments and industrial stakeholders around the world in developing climate change and energy policies. We are a not-for-profit organisation with all our activities funded through a broad spectrum of governments, businesses and foundations.

Companies House Number 05796323.
Climate Strategies
www.climatestrategies.org

@climatestrat climate-strategies climatestrategies

Endnotes

[1] See Arun, S. (2015), "India questions OECD claim on climate finance", *The Hindu*, November 29, 2015, Available at: http://www.thehindu.com/news/national/oecd-report-on-climate-change-fund-flows-flawed-finance-ministry/article7930104.ece; Sethi, N. (2015), "Developing countries irked by report saying climate change funds delivered: OECD report says $62bn given in 2014-15; developing nations allege creative accounting and greenwashing", *Business Standard*, October 23, 2015, Available at: http://www.business-standard.com/article/international/developing-countries-irked-by-report-saying-climate-change-funds-delivered-115102200764_1.html.

[2] Paragraph 57 of the Paris Decision text reads as follows: "Requests the Subsidiary Body for Scientific and Technological Advice to develop modalities for the accounting of financial resources provided and mobilized through public interventions in accordance with Article 9, paragraph 7, of the Agreement for consideration by the Conference of the Parties at its twenty-fourth session (November 2018), with a view to making a recommendation for consideration and adoption by the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement at its first session [CMA 1]"; UNFCCC (2015), *Report of the Conference of the Parties on its twenty-first session, held in Paris from 30 November to 13 December 2015 Addendum Part two: Action taken by the Conference of the Parties at its twenty-first session*, United Nations Framework Convention on Climate Change, Available at: http://unfccc.int/resource/docs/2015/cop21/eng/10a01.pdf.

[3] CPI (2011; 2012; 2013; 2014; 2015), *The Landscape of Climate Finance*, Climate Policy Initiative, Venice, Available at: http://www.climatefinancelandscape.org/.

[4] Since 1998 a purpose-based scoring system of three values is used by OECD DAC countries, in which all bilateral official development assistance (ODA) projects are "marked" as targeting climate change mitigation as its "principal" objective or as a "significant" objective, or as not targeting the objective. The climate change adaptation marker was only introduced in 2009 and the first data on this marker were available in March 2012 for 2010 flows. Projects marked as having a "principal" mitigation or adaptation objective would theoretically not have been funded but for that objective; projects marked "significant" have other prime objectives but have been formulated or adjusted to help meet mitigation or adaptation concerns. The Rio Markers data, which are notified to the DAC Secretariat by donor countries, are then made available online without systematic quality control by the DAC Secretariat or by any other third party institution.

[5] This section only deals with the accounting and reporting of bilateral climate finance. The coverage and robustness of current accounting and reporting systems for multilateral climate finance and private finance remain even more limited. See UNFCCC SCF (2014), *2014 Biennial Assessment and Overview of Climate Finance Flows Report*, United Nations Framework Convention on Climate Change Standing Committee on Finance, Bonn, Available at: https://unfccc.int/files/cooperation_and_support/financial_mechanism/standing_committee/application/pdf/2014_biennial_assessment_and_overview_of_climate_finance_flows_report_web.pdf; OECD-CPI (2015), *Climate finance in 2013-14 and the USD 100 billion goal*, A report by the Organisation for Economic Co-operation and Development (OECD) in collaboration with Climate Policy Initiative (CPI), Paris, Available at: www.oecd.org/environment/cc/OECD-CPI-Climate-Finance-Report.htm. (UNFCCC SCF, 2014; OECD-CPI, 2015).

[6] See *e.g.*, AdaptationWatch (2015), *Towards Mutual Accountability: The 2015 Adaptation Finance Transparency Gap Report*, p. 28, Available at: http://adaptationwatch.org/; Weikmans, R. (2015), *Vietnam, a Donor Darling of Adaptation Aid? The Credibility of the Rio Marker 'Adaptation' Put to The Test*, KLIMOS Working Paper 8, KLIMOS-ACROPOLIS, Brussels, Available at: https://ees.kuleuven.be/klimos/papers/weikmans_working_paper_8_en_adaptation_aid_vietnam.pdf.

[7] As highlighted by the OECD, the Rio marker methodology was not originally designed to monitor financial pledges; it was rather intended to produce descriptive data to track the mainstreaming of Rio Conventions considerations into development cooperation practices. The OECD has therefore called for care in using the Rio marker data for reporting on climate financial support to developing countries. See OECD (2012), *Development Co-operation Report 2012*, Organisation for Economic Co-operation and Development, Paris, p. 62, Available at http://www.oecd.org/dac/dcr2012.htm.

[8] The UNFCCC Standing Committee on Finance (SCF) recently observed that: "There is scope for interpretation in how the markers are applied. This provides flexibility, but can lead to non-comparable data submissions from donors"; UNFCCC SCF, *2014 Biennial Assessment and Overview of Climate Finance Flows Report*, *op. cit.*, p. 82.

[9] OECD, *Development Co-operation Report 2012*, *op. cit.*, p. 62.

[10] *Ibid.*

[11] Michaelowa, A., and Michaelowa, K. (2011), "Coding error or statistical embellishment? The political economy of reporting climate aid", *World Development*, vol. 39, n°11, p. 2010-2020, Available at: www.sciencedirect.com/science/article/pii/S0305750X11001951; Junghans and Harmeling, *Different tales from different countries: a first assessment of the OECD "Adaptation Marker"*, *op. cit.*; Oxfam (2012), *The Climate Fiscal Cliff: An Evaluation of Fast Start Finance and Lessons for the Future*, Briefing, November 25, 2012, Oxfam, Washington, D.C., Available at: www.oxfam.org/sites/www.oxfam.org/files/oxfam-media-advisory-climate-fiscal-cliff-doha-25nov2012.pdf; AdaptationWatch, *Towards Mutual Accountability: The 2015 Adaptation Finance Transparency Gap Report*, *op. cit.*

[12] Many critiques leveled by those studies against the quality of the Rio marker data have also been acknowledged by the DAC Secretariat; see OECD (2013), *Climate Adaptation Marker: Quality Review*, Organisation for Economic Co-operation and Development, Paris, Available at: www.oecd.org/dac/environment-development/Climate%20Adaptation%20Marker_Declassified.pdf. They have also been voiced by several DAC donors: for Sweden, see Wingqvist, G.Ö., César, E., Atteridge, A., Berg, H., Drakenberg, O., Axelsson, A., and Schultz, M. (2011), *Environmental Statistics at Sida: A Review of Policy Markers on Climate Change Adaptation, Climate Change Mitigation, Biodiversity, Ecosystem Services, and Environment*, Internal report by Sida Help Desk for Environment and Climate Change and SEI, SIDA, Stockholm; for Finland and Switzerland, see OECD, *Development Co-operation Report 2012*, *op. cit.*, p. 66; for Belgium, see ADE (2013), Evaluation thématique de la Coopération belge en matière d'environnement – Inventaire critique, Service public fédéral Affaires étrangères, Commerce extérieur et Coopération au Développement, Service de l'Évaluation spéciale de la Coopération international, p. 23-24, Available at: http://diplomatie.belgium.be/nl/binaries/evaluation_environnement_inventaire_critique_fr_tcm314- 248276.pdf.

[13] Some researchers (*e.g.,* Michaelowa and Michaelowa, "Coding error or statistical embellishment? The political economy of reporting climate aid", *op. cit.*) found a relationship between levels of over-coding and the political pressure on governments to show they were doing something about climate change (varying, for example, by the level of environmental or left-wing party representation in parliament).

[14] OECD-CPI, *Climate finance in 2013-14 and the USD 100 billion goal*, *op. cit.*, p. 31.

[15] Most notably, the volume of finance associated with the Rio markers is often scaled down by using "coefficients" to differentiate between funding marked as targeting climate change as a "significant objective" – reflecting that these projects have other "principal objectives." These coefficients differ across DAC members and range from 0 to 100 per cent. As the OECD acknowledges "there has been limited transparency regarding these practices to date"; OECD-CPI, *Climate finance in 2013-14 and the USD 100 billion goal*, *op. cit.*, p. 32.

[16] Stadelmann, Martin, J. Timmons Roberts, and Saleemul Huq. "Baseline for trust: defining 'new and additional'climate funding." *International Institute for Environment and Development Briefing* (2010): 1-4.