

# Options for Resource Allocation in the Green Climate Fund (GCF)

## Design elements of the GCF allocation mechanism

Background Paper 1

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The paper has been drafted as part of a compilation of background papers on possible options for resource allocation in the Green Climate Fund. The background papers were financially supported by the German Federal Ministry for Economic Cooperation and Development (BMZ) and the Federal Ministry for the Environment, Nature Conservation and Nuclear Safety (BMU).

**Disclaimer:**

The views and opinions expressed in the paper reflect those of the author(s) and do not reflect the position of any institution.

**Acknowledgement:**

Thanks to Katrin Enting, Marion Vieweg and Ian Noble for contributions and critical review.

September 2013

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## 1 Background

This paper summarizes possible options for design elements of a GCF allocation mechanism. By specifying certain elements of the allocation mechanism, the paper intends to provide insights into how such an allocation mechanism could work. The approach chosen is not thought to be a recommendation, but rather aims at providing a basis for discussion. Numbers provided are for illustrative purposes only.

## 2 Guidance by the UNFCCC/GCF

The Governing Instrument for the GCF sets the objectives “to make a significant and ambitious contribution to the global efforts towards attaining the goals set by the international community” and to „to contribute to the ultimate objective of the UNFCCC“.

Specifying the ultimate objective of the UNFCCC we recall that Parties to the UNFCCC agreed that

“...Parties will urgently work towards the deep reduction in global greenhouse gas emissions required to hold the increase in global average temperature **below 2 °C above pre-industrial levels** and to attain a global peaking of global greenhouse gas emissions as soon as possible...”  
[UNFCCC, 1/CP18]

The Governing Instrument provides guidance related to the Fund’s resource allocation. Key elements are to:

- promote the paradigm shift towards low-emission and climate-resilient development pathways (Para 2 GI)
- balance the allocation of resources between adaptation and mitigation activities (Para 3 GI)
- take into account the urgent and immediate needs of developing countries that are particularly vulnerable to the adverse effects of climate change (Para 2 GI), including LDCs, SIDS and African States, using minimum allocation floors for these countries as appropriate (Para 52 GI)

Further important provisions from the Governing Instrument to consider are:

- to ensure appropriate allocation of resources for capacity-building and technology development and transfer (Para 38 GI)
- to provide resources for readiness and preparatory activities and technical assistance (Para 40 GI)
- to aim for appropriate geographical balance (Para 52 GI)
- to provide resources for innovative and replicable approaches (Para 38 GI)
- that the Fund will have a private sector facility to directly and indirectly finance private sector mitigation and adaptation activities at the national, regional and international level (Para 41 GI)
- that a results-based approach will be an important criterion for allocating resources (Para 51 GI)
- to strive to maximize the impact of its funding for adaptation and mitigation (Para 3 GI) use an integrated approach to funding mitigation and adaptation to allow for cross-cutting projects and programmes
- that all developing country Parties to the Convention are eligible to receive resources from the Fund. The Fund will finance agreed full and agreed incremental costs for activities to enable and support enhanced action on adaptation, mitigation (including REDD-plus), technology

development and transfer (including carbon capture and storage), capacity building and the preparation of national reports by developing countries (Para 35 GI)

- that the Fund will pursue a country-driven approach (Para 3 GI)

Implementation of the GCF resource allocation framework will have to take into account trade-offs between these elements as well as with external constraints. Maximization of impact may for example need to be reconciled with a geographical balance, while overall restrictions on available resources will limit the ability to promote true paradigm shift.

### 3 Funding windows and resource allocation

#### 3.1 General outline of a possible overall framework

The GCF will have an adaptation and a mitigation window as well as a Private Sector Facility (PSF).

The proposal for an allocation framework for the GCF outlined in this document assumes that allocation of resources for adaptation will be differentiated based on country categories. At the beginning of the replenishment period, a certain percentage of the resources of the adaptation window may be allocated ex-ante to “the urgent and immediate needs of developing countries that are particularly vulnerable to the adverse effects of climate change, including LDCs, SIDS and African States, using minimum allocation floors for these countries as appropriate.”<sup>1</sup> (Special consideration category, see Figure 1)

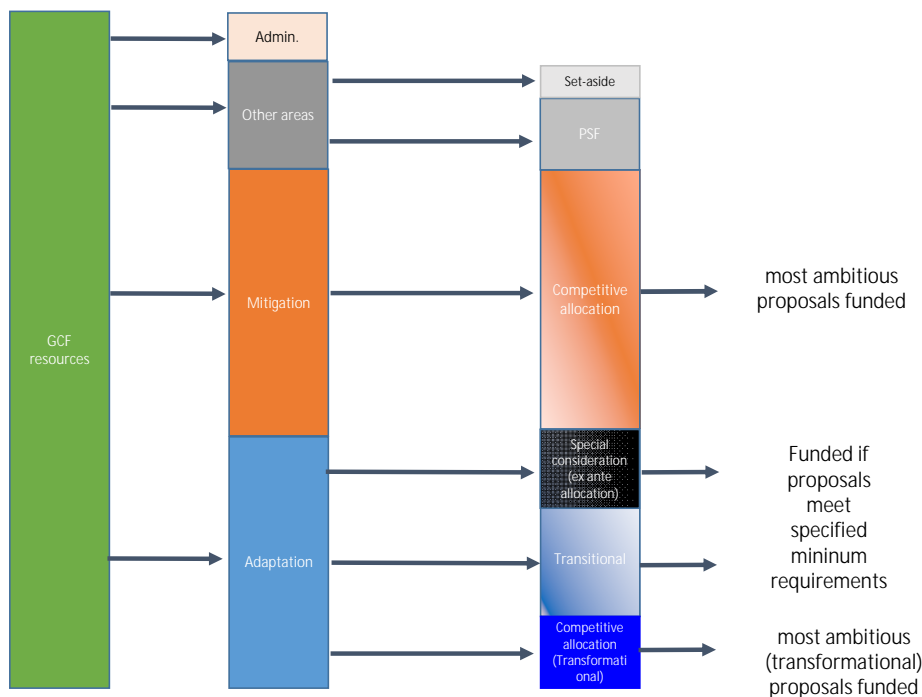


Figure 1: Overview of proposed resource allocation framework

A fixed portion of the adaptation funding is further available to countries (so called “transitional category”) that do not belong to “Special consideration” group of countries. The remaining

<sup>1</sup> Governing Instrument of the GCF, paragraph 52.

resources in the adaptation window as well as all resources in the mitigation window are allocated – as depicted in Figure 1 - in a purely competitive manner based on proposals submitted by countries (competitive allocation). The ambition of all proposals is evaluated based on investment criteria. Funding for proposals of countries belonging to Special consideration as well as the Transitional country categories (adaptation) are approved if a minimum ambition level (as defined by the investment criteria) is reached. Within the competitive allocation, (adaptation and mitigation) funding is disbursed to the most ambitious and transformational activities in each tranche<sup>2</sup>.

In order to allow countries to prepare such ambitious proposals, resources for the competitive allocation are not allocated in the beginning of the replenishment period, but in the second and third year.

### 3.2 Balance between adaptation, mitigation and other areas

The governing instrument asks the board to balance the allocation of resources between adaptation and mitigation<sup>3</sup> activities and to ensure appropriate allocation of resources for other activities which can comprise capacity-building, technology development and transfer, readiness and preparatory activities, technical assistance, innovative and replicable approaches and the private sector facility<sup>4</sup>.

Since there is no agreed definition of or a single scientific approach for how to balance mitigation and adaptation<sup>5</sup>, the approach to allocate resources to these two windows as well as to other areas will have to be based on a pragmatic and flexible approach. Therefore, the allocation of resources should not be static, but needs to develop taking into account the respective resources available and capacities of countries to implement transformational projects as well as other developments. Since the Governing instrument states that the GCF should be a learning institution<sup>6</sup>, the resource allocation for each replenishment period could be evaluated against the actual disbursement and be adapted in regular intervals based on the lessons learnt.

### 3.3 Resources allocation to windows and resulting funding volumes

One important question with regard to resource mobilisation and allocation is: 'What funding volume is needed in order to achieve transformational change and at the same time be able to finance a sufficient number of proposals (covering a sufficient number of countries) in each replenishment cycle'? In order to shed some light on this question, in following, we show two possible scenarios using simplified assumptions on resource allocation in order to illustrate:

- the amounts of financing available in each window and tranche per replenishment cycle assuming certain levels of resource mobilisation
- the number of proposals/countries that can be funded per replenishment cycle assuming certain project sizes in each window and tranche
- the amount of funding available for proposals considering potential leverage ratios

The first scenario (Figure 2) represents the starting period of the GCF with 10 billion USD of resources (grants) mobilised in the first replenishment cycle (equal 2.5 billion USD per year) and the second (Figure 3) could be seen as a target scenario for resource allocation of the GCF in the

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<sup>2</sup> As defined by the investment criteria

<sup>3</sup> Currently, the mitigation window includes REDD+ activities.

<sup>4</sup> See E. 50 of the Governing instrument of the GCF

<sup>5</sup> See Klein, R.J.T., S. Huq, F. Denton, T.E. Downing, R.G. Richels, J.B. Robinson, F.L. Toth, 2007: Inter-relationships between adaptation and mitigation. Climate Change 2007: Impacts, Adaptation and Vulnerability. Contribution of Working Group II to the Fourth Assessment Report of the Intergovernmental Panel on Climate Change, M.L. Parry, O.F. Canziani, J.P. Palutikof, P.J. van der Linden and C.E. Hanson, Eds., Cambridge University Press, Cambridge, UK, 745-777.

<sup>6</sup> I. 3. of the Governing instrument for the Green Climate Fund

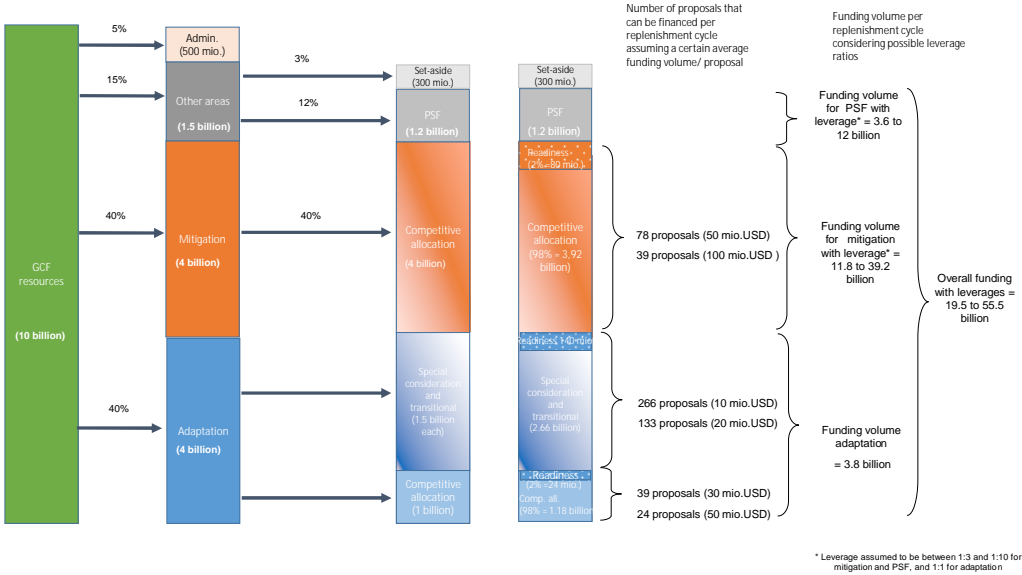
mid-term (assuming 40 Mio. USD resources in form of grants per replenishment cycle, equal to 10 billion USD per year). The scenarios rather serve illustrative purposes as they have to build on a range of assumptions, such as resources available within the GCF, capacities of countries to submit transformational proposals etc. that are difficult to predict.

**Resource allocation to windows and tranches**

After subtracting estimated costs for administration of the fund<sup>7</sup>, in a first step, resources are allocated between adaptation, mitigation and other areas (see Figures 2 and 3). Assuming that 12% of resources are made available to the Private Sector Facility (PSF), the resting resources are allocated evenly between the adaptation and mitigation window.

A part of the resources of the adaptation window will be allocated ex ante to a set of “Special consideration countries”. A second part is available for countries that do not receive an ex ante allocation (Transitional category), while the third part of the adaptation funding will be allocated in a purely competitive manner to transformational adaptation proposals (competitive allocation).

A certain percentage (e.g. 3%) of overall resources could be set-aside as a buffer for the mitigation and the adaptation window (300 Mio. and 1.2 billion USD in the Scenario 1 and 2 respectively) and could provide some flexibility for resource allocation to mitigation and/or adaptation (including integrated projects) in each replenishment period. A certain percentage of the resources in the mitigation and adaptation windows (e.g. 2-5%% of overall funding volumes) will be reserved for readiness and preparatory support linked to concrete proposals.<sup>8</sup>



**Figure 2: Scenario 1 – Resource allocation and possible funding volumes with 10 Mio. USD resources per replenishment cycle <sup>9</sup>**

<sup>7</sup> Administration cost of other funds varies between ca. 2 and 13% of net disbursements (see GCF/B.04/08). While it is still difficult to predict what the exact structure and thus administrative costs of the GCF will be, we make the simple assumption that administrative costs are 5% of total resources available.

<sup>8</sup> This does not necessarily apply to the phase before the first replenishment, as there are still less concrete proposals and readiness and preparatory support could be provided also independent from project proposals.

<sup>9</sup> Some numbers do not sum up completely due to small rounding errors



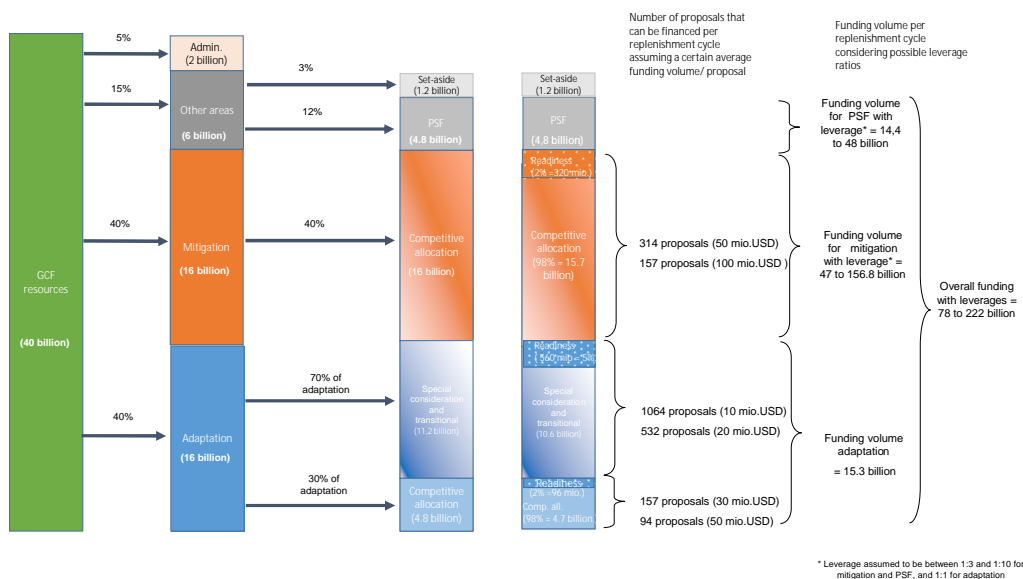


Figure 3: Scenario 2: Resource allocation and possible funding volumes with 40 Mio. USD resources per replenishment cycle<sup>10</sup>

Since it can be expected that it will take some time for countries to develop capacities to use direct access modalities, allocation to international and direct access should – at least in the first years of fund operation - not be fixed and capped, but be allocated independent from the access channels.<sup>11</sup>

### Funding volumes per proposal

Considering that the GCF is supposed to finance transformational change, the scenarios can provide a first impression of how many proposals could be financed per replenishment cycle assuming a minimum average funding volume per proposal. The numbers provided in Figure 2 and 3 are serving illustrative purposes only and do not represent recommendations for project size or number of proposals to be funded.

If for the mitigation window, the average funding volume per proposal would be 50 Mio. USD (grant funding<sup>12</sup>), then 78 mitigation proposals can be funded in scenario 1, and 314 proposals with a resource allocation of 40 Mio. USD in the mid-term (Scenario 2). It is however likely that the size of proposals would increase over time, e.g. to 100 Mio. USD per proposal which would still amount to 157 proposals in the mitigation window in scenario 2.

With an average funding volume of 10 Mio. USD per proposal, in the short-term around 266 adaptation proposals of “Special consideration” as well as “Transitional category” countries could be financed, while this could grow to more than 1000 proposals in scenario 2. Funding for transformative adaptation proposals (average of 50 Mio. €) in the competitive adaptation tranche would result in funding for only 24 proposals in the starting period of the GCF, and around 94 proposals in scenario 2.-These calculations only represent examples to illustrate the number of proposals that can be funded with certain project sizes.

<sup>10</sup> Some numbers do not sum up completely due to small rounding errors

<sup>11</sup> Half of the resources of the Adaptation fund have been reserved for direct access. This has led to a situation in which funds that can be accessed via international access are already committed almost entirely, while the majority of funding for the direct access channel is still available and unused.

<sup>12</sup> For simplicity reasons, all resources are calculated to be in grant funding only. Figure 3 and 4 includes a calculation using possible leverage ratios for mitigation and the private sector facility.

Considering these numbers, it seems that a resource mobilisation of 10 billion USD would amount to a number of proposals period that is relatively small, but still considerable when taking into account that modalities and procedures as well as structures of the GCF are just being developed. In the mid-term, the amount of resources mobilised would have to increase beyond the 10 billion USD per replenishment cycle in order to really reach transformational potential. Project sizes are however likely to increase which would help to avoid that the GCF will actually have to deal with such a high number of proposals as illustrated in Figure 3.

## Overall funding volumes

Figure 3 and 4 further provide a rough estimate of overall funding volumes (per tranche and for the GCF as a whole) considering potential leverage ratios. For mitigation as well as the private sector facility, funding volumes are calculated using a 1:3 (minimum) and a 1:10 (maximum) leverage ratio which is not applied to the funding going to readiness and preparatory support as well as the set-aside.

For adaptation, no leverage is assumed. However, adaptation proposals will usually be linked to wider development activities. In the Special Consideration Category proposals in which the main focus is adaptation will be funded fully (c.f. the Adaptation Fund), but in the other categories, proposals will need to provide evidence of how the adaptation activities are incremental to, and integrated with national development and adaptation plans, and quantify the associated expenditure from national budgets or other sources of external support, including private sector investment.

Resulting funding volumes, range between ca. 20-56 billion per replenishment cycle in Scenario 1 and ca. 78 to 222 billion per replenishment cycle in Scenario 2. Assuming a four-year long replenishment cycle, this is equal to around 5-14 billion per year (Scenario 1) and 20 - 56 billion USD per year.<sup>13</sup>

## 4 Allocation process and institutional implications

### 4.1 General process

While chapter 6 describes a proposal for allocation principles and criteria (thus the WHAT and WHICH countries will be financed), this chapter focuses on some selected aspects of the allocation process (the HOW). The following presents suggestions on how the process could be operationalized in more detail within the guidance provided by decisions already taken.

The fund will mobilise resources for each replenishment cycle which will last 4 years. Once resources for a replenishment cycle are known, ex-ante country allocations for the adaptation window will be determined and the GCF will publish calls for proposals (e.g. once a year).

Based on the call for proposals, countries submit proposals in a one or two-step process. A two-step process might be more appropriate in the beginning of fund operations, while with growing experience and numbers of proposals, a one-step process could be more effective against the background of keeping the work load for the Board, the Secretariat and the respective technical expert committees manageable. Within the two-step process, countries submit an outline of the activity which would have to show how the proposal meets the set minimum ambition level (based on the investment criteria). If the evaluation of the outline comes to the conclusion that this is the case, the GCF would ask for the submission of a more detailed proposal. The detailed proposal can however still be rejected in case in case it does not reach a minimum ambition level. In a one step process, the detailed proposal would be elaborated and directly submitted to the GCF for evaluation.

It remains to be answered which information and what level of detail the outlines as well as the detailed proposals need to provide. In specifying requirements for such outlines, a balance has to

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<sup>13</sup> For some estimates on costs and expenditures of mitigation scenarios, see Box/Annex x

be found between the efforts of countries preparing them and the detail needed to be able to evaluate them properly. This aspect needs further consideration and would benefit from a more detailed analysis of formats and processes applied by other funds. For the Special Consideration Category of adaptation funding there is a strong practical case for applying the procedures of the Adaptation Fund.

## 4.2 Institutional structure and expert advice with regard to allocation

Due to the level of expert knowledge and analysis that is needed at various points in this process, the Board will need to draw upon advice from technical experts. This is also reflected in the decision of the Board<sup>14</sup> to consider the establishment of

- permanent and ad hoc committees of the Board that will assist the Board in fulfilling its roles and functions as well as
- mechanisms to draw on appropriate expert and technical advice, including independent scientific and technical advice and from the other relevant thematic bodies

Furthermore, the Board notes convergence on a structure of the Fund and the secretariat that is “thematic, with a Private Sector Facility, a strong country and programmatic focus, internal coherence and linkages, and the flexibility to evolve over time”<sup>15</sup>. This implies that the Fund and the secretariat are likely to start with a unit for Mitigation, Adaptation, the Private Sector facility as well as a Country Strategy and Programme Support (CSPS) unit<sup>16</sup>. Considering this structure as well as the proposed allocation framework, technical support with regard resource allocation is needed for the following aspects:

1. Country level indicators for determining the country categories and ex ante country allocation for adaptation
2. Evaluation of proposals

### 4.2.1 Country level indicators

The determination of the country categories and the ex ante country allocation for adaptation is based on country level indices (e.g. capacities, vulnerability). Furthermore, the evaluation of proposals (for mitigation) could include some country level indices that need to be available and updated on a regular basis. Establishing and updating these indices, collecting data for the respective indicators and evaluating countries based on the indices is a technical, but at the same time also politically sensitive task. In order to make sure that the analytical basis, data collection and evaluation are done according to accepted quality standards and in a comparable manner<sup>17</sup>, a certain institutional continuity is needed for this task. At the same time, the advice needs to be independent and technical. It is likely that such a task could be best fulfilled by a small sub-group within the GCF secretariat, maybe with support from an ad-hoc technical advisory group and using expertise available in the different units of the secretariat.<sup>18</sup> In order to increase political acceptance of the ex ante allocation and its methodological approach, the work of the sub-group working on indicators and determining country categorisation and ex-ante country allocations could be audited by independent, external experts. Such audit would need to comprise the validity of the data as well as compliance with procedures and guidelines for

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<sup>14</sup> See GCF/B.04/17, Decision B.04/09 c) and d)

<sup>15</sup> See GCF/B.04/17, Decision B.04/09 a)

<sup>16</sup> See GCF/B.04/08

<sup>17</sup> Once every replenishment cycle for the ex ante country allocations and before each call for proposals for country specific indices in the proposal evaluation process

<sup>18</sup> Such a unit could e.g. be located within the CSPS unit in order to use the insights gained by the staff working with the respective countries. While an ex-ante country allocation is only needed for adaptation, there is still a need for some country-level indicators that are used for the evaluation of proposals for mitigation as well. Therefore, it makes more sense to locate this team outside the adaptation unit.

applying the pre-defined methodology. In the long-run, the Board should not be able to change the results produced by the unit in order to guarantee that country categories are determined in a technical and non-political manner.

Since the secretariat might not have the staff to fulfil this function in the beginning of fund operations, an ad hoc technical committee could be a way to fill gaps in expertise available in the secretariat in a temporary manner. Furthermore, this ad hoc technical committee could be tasked with the elaboration and/or improvement of the methodology and the internal procedures and guidelines.

A second option for determining country categorisation and allocations could be the one to fully outsource the task to an independent third party (e.g. a think tank). This is however likely to be more problematic in the sense that the GCF would be responsible for guaranteeing the independence as well as the quality of the work of this institution. Furthermore, such an institution is likely to lack political acceptance (e.g. due to its location and structure).

#### **4.2.2 Evaluation of proposals**

Considerable expertise is needed for the evaluation of proposals, covering a wide range of areas, including knowledge about the respective country, sector, policy instruments, technologies, environmental and social safeguards etc. The evaluation of proposals will most likely need to be performed by a team consisting of operational staff within the Secretariat, e.g. a team consisting of members of the mitigation and/or adaptation unit, members of the CSPS unit, and relevant experts from other units. This core team could be expanded by additional experts providing advice on specific technical, policy, financial and other aspects. A roster of experts could be established from which such external experts can be recruited.

It is unlikely that in the beginning of fund operations the Secretariat will have the staff to elaborate the methodologies and procedures for evaluating proposals. Also here, an ad-hoc committee could be established to take over this task.

For each call, the evaluation team evaluates the received proposals based on the investment criteria and proposes a distribution of the available resources in each window and tranche to the Board. The Board can then decide to approve, reject proposals, ask for modifications or reduce the amount of financing proposed.<sup>19</sup>

The composition of any technical expert committee or panel set up should take into account a balance between developed and developing country experts, a mix of practitioners and academics and needs to make sure that members do not have a conflict of interest in fulfilling their functions. Furthermore, qualifications of experts (expertise in mitigation, adaptation, index development, etc.) need to be specified in detail.

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<sup>19</sup> Direct access would not have any influence on the described process, as the board would still be the body taking decisions on proposals.