

# THE GOAL OF 100BN USD OF CLIMATE FINANCE

ACCOUNTING ISSUES REGARDING PRIVATE  
FINANCE

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## Brief Summary

This discussion paper addresses and raises different questions regarding what kind of private finance could be included in the 100bn USD of climate finance, which developed countries committed to mobilize annually by 2020. It argues that not all kinds of private climate finance should be included in the 100bn USD but rather that there is a need for a clear definition on which private finance to include. In addition, it refers to what kind of state action is needed to account the private finance towards the “100bn USD”-commitment (resp. towards the state's share of this commitment). Besides the requirement for a certain level of state involvement, it must be ensured that no double counting with other commitments occurs and hence no finance flows of the carbon market should be accounted. And finally it argues that with regard to both private and public finance flows only net flows should be accounted. Further it raises questions regarding a categorization of different instruments (e.g. grant, concessional loans, guarantees) towards public or private finance. Overall, as much public finance as possible should be provided in order to on the one hand invest into areas which have difficulties for attracting private finance and on the other hand use public funds in a way which can mobilize effectively much more private finance for climate action; therewith lowering the gap between the finance needed and the finance provided.

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# 1 Introduction

In Cancún industrialized countries formally agreed on their previous commitment of Copenhagen to mobilize together 100bn USD by 2020 annually for supporting climate action in developing countries.<sup>1</sup> This includes climate change mitigation actions as well as adaptation actions; aiming together at ensuring a low-emission and climate-resilient development.

While 100bn USD is already a large sum of funding especially in times of financial constraints of many developed countries, many studies suggest that far more is needed in order to remain on a pathway which stays below a global average temperature increase of 2°C. For instance the World Bank assumed in its World Development Report in 2010 that over the next 20 years mitigation costs for developing countries could range between 140-175bn USD annually and adaptation costs between 30-100bn USD annually in the period 2010-2050.<sup>2</sup> A group of non-governmental organizations suggested in their proposed Copenhagen Climate Treaty that already for the period 2013-2017, industrialized countries should provide 160bn USD annually for climate action in developing countries.<sup>3</sup> It will also be essential to provide more details on the question how international climate finance shall continue after 2020, since the Cancún Agreements do not indicate for how long developed countries shall provide 100bn USD annually, whether there shall be an increase of climate finance after some years and whether also additional countries will contribute to international climate financing which might be necessary for adequately addressing the needs. These aspects would need to be reflected in the new agreement which shall be negotiated under the Durban Platform for Enhanced Action until 2015.

However, besides above mentioned aspects of the scale of the 100bn USD goal, questions remain also with regard to its content. The Cancún Agreements do not in any way make clear, how the 100bn USD goal shall be reached in terms of their detailed composition as well as in terms of an increase of climate finance until 2020. While more financing could be generated when the promised 100bn USD would be only public funding and be used to mobilize additional private finance<sup>4</sup>, the Cancún Agreements made in para. 99 explicit that the 100bn USD can come from public as well as private sources. While much of the discussions so far have focused on financing needs, the adequacy of the commitments, innovative sources for climate finance and the need for scaling up climate finance, discussions on how specifically private finance can be part of the 100bn USD are rather recent. This question however needs to be solved in order to ensure a credible fulfilment of the promise to mobilize 100bn USD which could build up – and not reduce – the trust between industrialized and developing countries which has grown through new alliances in Durban. The need to come to an agreement on this issue is also increasing, since reference to reporting on private finance flows is done both in the UNFCCC guidelines for Biennial Update Reports agreed upon at COP 17 in Durban, as well as in the current proposal of the European Commission for a Monitoring Mechanism Regulation of the EU.<sup>5</sup>

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<sup>1</sup> UNFCCC, 2011, para. 98.

<sup>2</sup> Worldbank, 2010, 257; see also Griebhaber, 2011, 6.

<sup>3</sup> IndyAct et al., 2009, 10.

<sup>4</sup> See also CAN International, 2009, 1 et seqq.

<sup>5</sup> UNFCCC, 2011, para. 19, Annex I, 2/CP.17, European Commission, 2011b, art. 17.

A broad overview on what could potentially all be included under the term “climate finance” is for instance provided by the Climate Policy Initiative. While their description of “the landscape of climate finance” includes many different both public and private sources, they indicate that opposing opinions exist on whether or not all these could and should potentially be included in the 100bn USD.<sup>6</sup> Especially around the concept of private finance, many questions and discussions remain. This discussion paper describes therefore different positions and questions regarding some of the most important issues.

The question which private finance might count towards the 100bn USD could be approached from two sides: from the states’ side in terms of which state action might be needed in order to say that the private finance has been mobilized by the state and from the private finance side in terms of which part of the respective private finance might count. Therefore, after addressing the overall potential shares of public and private finance, the perspective first goes towards the state’s side (question of mobilization/additionality, double counting), followed by the focus on the private sector side (application of a gross or net approach). Finally this is followed by a discussion on accounting issues.

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<sup>6</sup> Buchner et al., 2011a, 5 et seqq.

## 2 Share of public and private finance

While earlier there was the anticipation that public sources would constitute the 100bn USD, the Cancún Agreements have made it clear, that public and private finance can be included, and more and more expectations are now being put by industrialized countries on private finance.<sup>7</sup> The Cancún Agreements do not provide any indication on how much of the 100bn USD shall be public and how much private finance. In 2009, the European Commission assumed that the share of public international climate finance could constitute something between 22bn and 50bn of the 100bn USD (with the other shares coming from developing countries' public and private domestic finance as well as the international carbon market).<sup>8</sup> The European Commission confirmed again in 2011, that it believes that a "major share will have to be financed by private sources".<sup>9</sup> This perception is shared by World Bank et al., which base this upon the great amount of finance available in the private sector and on the fiscal problems of many industrialized countries.<sup>10</sup> While the Climate Action Network International acknowledges that much of the finance will also come from the private sector, it nevertheless suggests that the financing must predominantly come from public sources.<sup>11</sup> If most finance comes from public sources, these resources can be used to mobilize additional private finance and help closing the gap between finance needed and finance provided. Therefore the 100bn USD should predominantly come from public sources – with more private finance flowing on top of that.

While it might be difficult to set a fix percentage for public and private finance in the 100bn in advance, at least some general direction would be helpful. Such overall direction might differ slightly between the different thematic areas of mitigation, adaptation and REDDplus (Reducing Emissions from Deforestation and Forest Degradation).

For *mitigation*, it can be argued that one of the benefits of mitigation projects – namely emission reductions – is a public good and that private investors need therefore public support i.e. through leveraging private finance via public finance input.<sup>12</sup> However, overall, for mitigation projects it might be easier to attract private finance since they have greater potential for generating financial returns for private investors than adaptation or REDDplus projects. Thus in the field of mitigation – and to the extent possible for adaptation and REDDplus – it will be an important task of public finance to set the right incentives for further large amounts of private investments.

*Adaptation* projects focusing on adaptation in favour of whole populations such as the construction of dams for whole cities also have a benefit for the overall public. Therefore, public finance is also here of crucial importance; even more since for such cases private investors might be difficult to find and hence full public finance might be needed. The limited private flows for adaptation projects are also reflected by the finding of Atteridge, that private flows related to infrastructure have been going rather to mitigation sectors such as the energy sector than to adaptation sectors as the water sector.<sup>13</sup> Compared to other countries, there was very little private investment in Least Developed Countries

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<sup>7</sup> Eurodad, 2012, 5.

<sup>8</sup> European Commission, 2009.

<sup>9</sup> European Commission, 2011a, 11.

<sup>10</sup> World Bank et al., 2011, 12.

<sup>11</sup> CAN International, 2011, 8.

<sup>12</sup> See AGF, 2010b, 31.

<sup>13</sup> Atteridge, 2011, 25.

(LDCs)<sup>14</sup> of which some belong to the most vulnerable countries to climate change – hence those which are in special need for climate finance. According to the European Commission public finance could leverage private finance through for instance employing a “market-based insurance scheme covering natural disasters”.<sup>15</sup> If the reason for the finance flows is more on making a company’s own properties more climate resilient, then this benefits the investor directly. Then, public finance might not be needed to mobilize private finance since investors would probably already be interested in these investments themselves.<sup>16</sup>

Regarding *REDDplus* projects, solely public finance will probably not be sufficient. However, leveraging of private finance needs to be addressed in a cautious manner. Principles like sustainability, effectiveness and climate effectiveness need to be implemented in order to safeguard forest ecosystems as a natural and social good. The primary focus on CO<sub>2</sub> and carbon markets to generate incentives for investments carries the danger of offsetting emissions in other sectors and jeopardizing the functionality and balance of forest ecosystems. Yet, alternative investment options for the private sector need to be analyzed and considered to help fulfil the financial global demand for reducing deforestation and forest degradation and the underlying drivers.

In general public finance needs to serve two purposes: On the one hand, it should be used to finance projects which otherwise would have difficulties to attract private finance (for instance due to the technology chosen or the investment environment of the respective country), especially regarding adaptation and REDDplus projects. On the other hand it should be used to leverage private finance especially regarding mitigation. At the end, the latter would also ensure that more of the limited public finance will be available for adaptation projects for instance in LDCs.<sup>17</sup>

However, while private finance is important and needed for addressing climate financing needs, it faces several difficulties, making reliance on public finance even more important. Such difficulties are according to Atteridge for instance that it is difficult to predict private finance flows and that there is, as mentioned above, no equal distribution of private flows among recipient countries.<sup>18</sup> Eurodad even describes in regard to leveraging private funds with public finance the risk “that low-income countries will be by-passed unless significant efforts are made to fill this gap.”<sup>19</sup> Some limitations of private finance for climate finance are based on the fact that its flows are mainly driven by economic interests and hence investments are taking place in projects and areas where capital returns are highest and best predictable but not necessarily where they are most needed.

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<sup>14</sup> Atteridge, 2011, 25, on this topic, see also Wamsler/Söderberg, 2012, 10.

<sup>15</sup> European Commission, 2011a, 11 et seq.

<sup>16</sup> See AGF, 2010b, 31.

<sup>17</sup> See de Nevers, 2011, 9.

<sup>18</sup> Atteridge, 2011, 25.

<sup>19</sup> Eurodad, 2012, 14.

### 3 Mobilization of additional funds: Action on the states' side is essential

The fact that the Cancún Agreements also allow private finance flows to count towards the 100bn USD goal, should however neither mean that all private finance flows may count towards this goal nor that the ambition for public climate finance may decrease as a result thereof. Rather, as much public finance as possible should be provided in order to on the one hand invest into areas which have difficulties for attracting private finance and on the other hand to use public funds in a way which can mobilize effectively much more private finance for climate action; therewith lowering the gap between the finance needs as indicated above and the 100bn USD goal.

For that reason a clear definition would need to be agreed upon in order to define what type of private finance may count towards the 100bn USD. Such guidelines could be placed with regard to the donor action needed (to mobilize private finance) as well as with regard to the private finance provided. Therefore, these areas will be described separately.

#### 3.1 Criteria

One could use different criteria in order to determine whether or not the specific private finance flow may be counted towards the 100bn USD. In this paper, we will refer to some specifically, mentioned explicitly by Stadelmann et al.<sup>20</sup> They suggest six criteria which could be used for this assessment – however highlighting that a balance needs to be found between neither including all nor including only very few private finance streams.<sup>21</sup> These criteria, which they derive for instance from the Cancún Agreements, are:

- “*additionality*”<sup>22</sup> (mobilized by public actions),
- *predictability* [...],
- basic *equity* (no negative redistribution and finance to the most vulnerable),
- [...] *no double counting* with emission reduction targets,
- [...] *address barriers* [...],
- reliable and complete *data available* to verify the level of funding.”<sup>23</sup>

The importance of the fulfilment of these by Stadelmann et al. suggested criteria for each finance flow differs in the author's view. After a short discussion on the criterion ‘no double counting’ (3.1.1), a reflection upon the most important criterion, namely ‘additionality’ (3.1.2) follows. In the author's view, ‘predictability’ would not necessarily need to be ensured by each specific private finance flow, but rather for overall climate finance.

<sup>20</sup> For other criteria mentioned in the context of private climate finance, see Wamsler/Söderberg, 2012.

<sup>21</sup> Stadelmann et al., 2011a, 16 et seq., Stadelmann et al., 2011b, 19 et seqq.

<sup>22</sup> In this context, the term ‘additionality’ does not refer to the discussion around the concept of ‘new and additional’ climate finance, but rather to the fact that the private sector action is additional to business as usual and would not have happened without the state's action to trigger this private finance.

<sup>23</sup> Stadelmann et al., 2011a, 16 et seq., Stadelmann et al., 2011b, 19 et seqq.

A mean of at least increasing the probability for private climate finance would be clear long term framework conditions, which are trustworthy to investors. The specific distribution of private finance (included as one aspect of the ‘basic equity’ criterion) is rather important for overall climate finance but less for each specific private finance flow. The other aspect of this criterion (namely that the investment shall not have negative impacts on the recipient country<sup>24</sup>) is very important.<sup>25</sup> This criterion should on the one hand not only be relevant for private but also for public climate finance. On the other hand it should look at the overall effect not only at the effect of the specific finance flows. Since clearly the necessary transformation will have negative effects for some sectors but should have overall positive effects for the relevant recipient country. The criterion ‘data availability’ in turn is a practical rather than a qualitative requirement but would nevertheless need to be kept in mind when defining what to count as private finance, since the lack of good and reliable data would decrease transparency significantly and therewith counteract trust building efforts. According to Wamsler/Söderberg, private finance could only be counted towards the 100bn USD if it is being measured<sup>26</sup>; the first prerequisite for the possibility of measuring is of course data availability. While those private funds which ‘address barriers’ would surely be the most preferential, it is not clear whether all private funds which do not do so, would need to be excluded. As a first step, it would need to be checked in how far private finance flows can – together with the necessary political framework conditions – actually address and overcome barriers, as for instance in the case of feed in tariffs in developing countries. Even if they can do so, it is questionable whether there are many private investments which are specifically addressing barriers. Further, private finance flows not addressing barriers could for instance be those which are only possible because public finance addressed the barriers – hence those which only flow due to public involvement (reflecting the criterion ‘additionality’). One could say that such private flows would to a small extent still address barriers (even though the barrier was mainly addressed by the state) since each investment towards which a barrier existed previously, lowers the barrier for future investments.

### 3.1.1 No double counting with emission reduction commitments

Various studies mention carbon market finance (including the Clean Development Mechanism (CDM) and the Joint Implementation (JI) of the Kyoto Protocol) as a potential source for international climate finance.<sup>27</sup> One can argue that state involvement is given here through providing the political framework via setting up the CDM and JI at international level. But here, the afore-mentioned criterion “*no double counting with emission reduction targets*”<sup>28</sup> appears of crucial importance. Trading of carbon credits takes place, since industrialized countries have committed to an emission reduction target and since they are allowed to buy credits from projects, which reduce emissions in another country. Thus, the finance flows for carbon offsets are simply a mean to reach the emission reduction commitment of the respective industrialized country. If finance flows of carbon offsets were counted towards the finance commitment and at the same time the emission reductions caused by the carbon offsetting were counted towards the emission reduction commitment of the respective developed country this would constitute double

<sup>24</sup> Stadelmann et al., 2011b, 21 et seq.

<sup>25</sup> On this issue, see also Wamsler/Söderberg, 2012, 15.

<sup>26</sup> Wamsler/Söderberg, 2012, 13.

<sup>27</sup> See for instance AGF, 2010a, 34.

<sup>28</sup> Stadelmann et al., 2011a, 16 et seq.

counting. One could argue that double counting could be avoided through simply deciding for either of the commitments. However, since accounting towards the climate finance commitment would probably cause a great methodological/administrative burden of extracting those certificates which have been accounted towards climate finance from those accounted for the reduction commitment, one should exclude finance flows from the finance commitment and only account the emission reductions towards the emission reduction commitment.<sup>29</sup> This would then without any greater administrative burden clearly ensure that no double counting takes place.

### 3.1.2 Additionality – state action needed

The fact that private finance must have been mobilized by industrialized countries, thus the criterion of additionality<sup>30</sup>, is in the author's view the most important criterion. This is also one of the three tasks for public finance identified by one of the working groups of the AGF, namely "direct transfers to developing countries, [...] support for specific developing country public sector actions, [...] instruments to stimulate private investment"<sup>31</sup>.

One aspect of mobilization is the concept of leveraging which is sometimes also used as an equivalent term<sup>32</sup>. While different definitions of the term leverage exist, Word Bank et al. define it as follows: "At the retail level the term leverage [...] generally refers to the ability of a public financial commitment to mobilize some larger multiple of private capital for investment in a specific project or undertaking. At a broader level it refers to the potential for catalytic or transformational public investments or initiatives to encourage much more widespread climate-friendly changes in behaviour by private firms across the whole economy [...] typically by addressing economy-wide market failures or barriers to investment."<sup>33</sup>

If the criterion of additionality was not fulfilled, this private finance would not comply with the Cancún Agreements which clearly states that industrialized countries have to *mobilize* the 100bn USD. Hence, it needs to be ensured that the public finance was decisive for the private investment to take place i.e. that the public finance removed previous investment barriers in such a way that made private investment possible.

In many cases where public finance aims to attract further private investment, one could at a first glance, easily identify a linkage between the private finance invested and the public finance and hence a mobilization action. Yet, the question remains whether this assessment would also hold true at a second glance. Since here one could question, whether the public support was truly decisive for the private investment or whether the private investment would have happened anyways. For a truly precise conclusion on this question, conducting a case by case assessment would be necessary, requiring large amounts of resources. Jotzo et al. argue that due to the difficulties arising in regard of proving that private capital flows would not have taken place anyways and in regard to a

<sup>29</sup> If a country can clearly demonstrate that it has fulfilled its share of emission reductions for staying below a 2°C average temperature increase and even goes beyond these reductions, then for these additional offsets, the situation might be different. Then one could consider whether these additional offset finance streams which go beyond the emission reduction target could count towards the climate finance commitment.

<sup>30</sup> For a discussion on additionality see also Wamsler/Söderberg, 2012, 14; Bretton Woods Project, 2012, 5.

<sup>31</sup> AGF, 2010b, 3.

<sup>32</sup> According to the Bretton Woods Project, the term 'leverage' is often not used consistently by different actors (Bretton Woods Project, 2012, 8).

<sup>33</sup> World Bank et al., 2011, 34.

precise calculation of private capital flows, those private flows leveraged through public funding should be subtracted from overall climate finance.<sup>34</sup> However, despite such difficulties, leveraged private finance would at least involve state action in contrast to private donations or other private investment<sup>35</sup>. Therefore – in consideration of the fact that the Cancún Agreements clearly state private finance as a potential source – a full exclusion of leveraged private finance seems not in line with the Cancún Agreements. In addition, such leveraged finance where state involvement took place appears in comparison to other private finance flows to be the most appropriate form of private finance for inclusion in the 100bn USD – even if one cannot truly prove that public finance was fully decisive but was potentially only very supportive for the private investment to take place.

While overall, the private finance investment may not – without the state's involvement – have taken place anyway<sup>36</sup> (if it shall count towards the 100bn USD) one could in regard to the state's involvement also question whether the donor country's involvement for mobilizing private finance differs, depending on the actual state input (i.e. provision of non-concessional loan, concessional loan<sup>37</sup>, guarantee, insurance or grant). For instance the provision of grants provides a clear and strong state input, since here the donor provides the finance without expecting its return. However, if a donor provides a state guarantee or insurance real finance flows from the donor country generally happen only if the insurance or guarantee case occurs.<sup>38</sup> Yet if this case occurs then strong state involvement is obvious.

Overall such differing state input in regard to different instruments used could potentially be reflected in requiring that in order to include the mobilized private finance, the public finance used for this purpose would as well need to be accountable as climate finance. As a first result, this would imply that for instance private finance triggered through public non-concessional loans would, if a net approach (see section 4) is chosen, not count as climate finance because already the public finance would not be classified as climate finance. Second, this would imply that the state action would need to have addressing climate issues as the – or at least one of the – primary objective(s). However, this could as a negative side effect imply that instruments such as guarantees and insurances which obviously can help in mobilizing private finance, would not be favoured anymore by donor countries and hence that one way of mobilizing private finance would not be explored. This question would hence need further research.

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<sup>34</sup> Jotzo et al., 2011, 34.

<sup>35</sup> Private donations and other private investment where no state involvement is visible should not count towards the 100bn USD, since in these cases no mobilization by states has taken place.

<sup>36</sup> For a discussion on the “new and additional” criterion also for private finance, see AEA, 2011, 60, 84.

<sup>37</sup> Overall, concessional loans should, if used for triggering private investment, predominantly be used in low income countries, since this is where the included grant element will specifically be needed. The Bretton Woods Project assumes that concessional loans will probably not trigger much private finance since they are normally provided to projects which cannot apply for loans at commercial rates and hence might not be able to provide much private investment (Bretton Woods Project, 2012, 7).

<sup>38</sup> See for an assessment of risk reducing instruments Bretton Woods Project, 2012, 8. For a discussion on the potential grant-equivalent included in these instruments, see Ecofys, 2011, 17.

## 4 Determining climate finance: counting gross or net flows

When determining what the 100bn USD contain, a crucial question regarding both, public and private finance is, whether to use a gross or net approach. However, since the focus of this paper is on accounting of private finance, implications for public finance shall only be touched upon slightly. The final approach chosen will have great implications on how fast the 100bn USD can be achieved, how much of climate action can be supported therewith and hence how adequate the 100bn USD goal is.

### 4.1 Gross flow approach

If a gross flow approach was to be applied, this would include

“private capital flows, offset finance and non-concessional lending mobilized through the multilateral development banks”<sup>39</sup> and bilateral funding institutions.<sup>40</sup>

In addition, this would encompass all public grants and concessional loans – thus the full finance flows towards developing countries for climate change action.<sup>41</sup> The use of such an approach allows for a calculation of the overall finance going into climate action.<sup>42</sup> Recently, a study on Monitoring, Reporting and Verification (MRV) systems in EU member states concluded that no member state which participated in the study differentiated in its reporting between gross and net flows, but that all member states reported upon all finance provided, thus applying a gross approach.<sup>43</sup>

### 4.2 Net flow approach

In contrast, a net flow calculation allows for quantification of the donor countries’ net share of climate action investments taking place in developing countries’.<sup>44</sup> There are three (and potentially even more) different ways of calculating net flows:

- 1) Increase in liabilities minus decrease in liabilities,
- 2) Foreign Direct Investment (FDI) inflows minus FDI outflows and
- 3) Net benefit in the recipient country.<sup>45</sup>

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<sup>39</sup> AGF, 2010a, 22.

<sup>40</sup> See also Buchner et al., 2011b, 21.

<sup>41</sup> See also Buchner et al., 2011b, 21.

<sup>42</sup> Buchner et al., 2011b, 21.

<sup>43</sup> AEA, 2011, 44.

<sup>44</sup> Buchner et al., 2011b, 21.

<sup>45</sup> Stadelmann et al., 2011b, 7.

### **Increase in liabilities minus decrease in liabilities**

Stadelmann et al. suggest that option 1, where the financial liabilities which a private company repays to its foreign creditor are deducted from the initial investment of this creditor, could be used for calculating climate finance.<sup>46</sup> This is also the calculation method suggested by Buchner et al. indicating that net flows are the remaining flows, after flows returning to the investor (either private or public) have been subtracted from gross flows.<sup>47</sup>

For public concessional flows this would de facto result in the same amount as the grant equivalent, yet this process could also be used for other flows than concessional loans. This approach could be applied for calculating both, the net climate finance provided through public and through private sources – calculating with repayments by either the recipient state resp. a private company. Data for such calculation on country level is for instance provided by UNCTAD.<sup>48</sup> How to apply this approach to guarantees and insurances would need further research.

### **Foreign Direct Investment (FDI) inflows minus FDI outflows**

With regard to option 2 it does not become evident, why FDI outflows from a developing to another (potentially developed) country should have an impact on the calculation of international climate finance provided to the respective developing country.<sup>49</sup> Therefore applying this approach for calculating net climate finance flows does not appear appropriate.

### **Net benefit in the recipient country**

Option 3 is also included in the description of the net approach provided by the AGF, stating that:

“A net approach would include only the grant-equivalent transfers from developed countries for concessional public flows and the net benefit to the developing countries for non-concessional public and private flows.”<sup>50</sup>

While, according to the AGF there is no common definition on how to calculate the net benefit, they provide one example for an underlying assumption: A private investor can reduce its expected return by X% due to the fact that its investment is co-financed by the investment of for instance a multilateral development bank (MDB) or through risk reduction financed by public finance.<sup>51</sup> This decrease of expected return could then remain in the recipient country and would constitute the net benefit to this country.<sup>52</sup> Stadelmann et

<sup>46</sup> Stadelmann et al., 2011b, 7. This calculation method is also used by UNCTAD for calculating net FDI flows towards a country (Stadelmann et al., 2011b, 7).

<sup>47</sup> See also Buchner et al., 2011b, 21.

<sup>48</sup> UNCTAD, n.d.

<sup>49</sup> For more problems with applying this approach to climate finance, see Stadelmann et al., 2011b, 7.

<sup>50</sup> AGF, 2010a, 22.

<sup>51</sup> AGF, 2010a, 23.

<sup>52</sup> AGF, 2010a, 23. As an exemplary calculation they assume that if 200bn USD were invested by the private sector in developing country A and co-financed by investment of MDB B, then the private sector could for instance reduce its expected return by 2%, thus 4bn USD. These could then remain in country A and would lead, assuming a project lifetime of 10 years and cost of capital between 10-15%, to an annual “net private flow” of 20-24bn USD. (AGF, 2010a, 23).

al. perceive the net benefit option as possible for calculating climate finance, highlighting however the potential for extensive administrative work needed and potentially remaining uncertainties for calculating such net benefits.<sup>53</sup> Also the European Commission sees regarding the net benefit option further practical difficulties (the need to determine the incremental costs of the project and the fact that “lower return expectations are difficult to measure and may be associated with other reasons such as higher risks or restricted access to finance in a developing country”).<sup>54</sup> While the AGF suggests to calculate under the net approach the grant equivalent of concessional public loans, Buchner et al. describe several difficulties therewith (e.g. that this is not applicable to flows, which are not defined as official development assistance).<sup>55</sup>

While applying a gross approach would make the 100bn USD goal much easier achievable, it would also imply that the gap between finance provided and finance needed would remain much larger than if a net approach was used. Therefore in order to reflect finance needs better in the actual finance provided, a net approach should be used. However, non-concessional public flows should not count at all to the 100bn USD goal, thus not even the net benefit as suggested by the AGF should count towards this goal. This would also be the result if one subtracted here the decrease in liabilities from the increase in liabilities and furthermore, this would be in analogy to their exclusion from Official Development Assistance (ODA) flows. However, since this is a discussion on public finance flows and their accountability for climate finance this is not within the scope of this paper and will therefore not be further discussed. The fact that the AGF mentions the net benefit approach for non-concessional public flows and private flows could serve as an indication that this approach might be chosen – although there also were different opinions regarding the preciseness of net benefit calculations.<sup>56</sup> Then Parties would need to agree on a common calculation method for this net benefit in order to ensure the greatest amount of transparency and comparability possible. The difference between a gross and a net approach – shown on the example of concessional public loans for public finance and separately for private finance – is displayed in figure 1. Yet, in the overall calculation it would need to be ensured that counting the net benefit of the private sector investment and counting at the same time the grant equivalent of the public finance would not lead to double counting of the same financial amount. Since in many cases, it might be exactly this grant element which leads to the net benefit of the private sector investment in the recipient country.

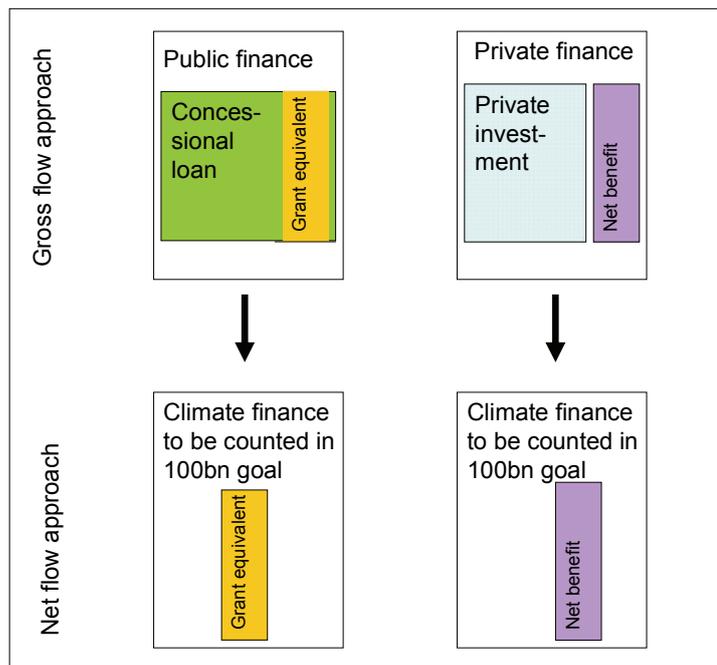
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<sup>53</sup> Stadelmann et al., 2011b, 7.

<sup>54</sup> European Commission, 2011a, 36.

<sup>55</sup> Buchner et al., 2011b, 21.

<sup>56</sup> AGF, 2010a, 10.



**Figure 1 Example for a possible calculation of international climate finance** (Source: own)

## 5 Instruments

As indicated above, different instruments can be used to trigger private finance. In the following, some interesting examples of initiatives where public finance is used to trigger private investment shall be displayed.

### 5.1 Examples for public instruments aiming at triggering private investments

#### German Initiative for Climate and Environmental Protection

The German Initiative for Climate and Environmental Protection (IKLU) has emerged from the previous “4E Facility” (focusing on renewable energy and energy efficiency) and is run by the German Ministry for Cooperation and Development (BMZ) and KfW Entwicklungsbank, Germany’s development bank. KfW uses funds from state budgets or funds raised on the capital market to provide low interest loans for projects focusing on six areas: renewable energy, energy efficiency, industrial environmental protection, energy saving mobility, adaptation to climate change and ecologic development of urban agglomerations.<sup>57</sup> While target recipients are mainly governmental or quasi-governmental institutions, private sector actors can also become recipients of these low interest loans.<sup>58</sup> Thus in the latter case private investment would be triggered through these public concessional loans.

<sup>57</sup> KfW Entwicklungsbank, 2008, 2.

<sup>58</sup> KfW Entwicklungsbank, 2008, 2.

### Climate Public Private Partnership

A rather new initiative has been announced by the British Government in January 2012 which is being conducted by the British Government in cooperation with the International Finance Corporation and the Asian Development Bank.<sup>59</sup> The Climate Public Private Partnership (CP3) shall consist of two private equity funds which are run on a commercial basis; by doing so CP3 aims at triggering private investment with a ratio of 1:30 per pound spent.<sup>60</sup> In addition the UK will provide finance to a facility for technical assistance in the Private Infrastructure Development Group.<sup>61</sup> Further it is intended to use the investment's returns for ODA.<sup>62</sup>

The focus of the initiative is on various types of renewable energy production in developing countries, such as hydropower or solar energy with investments taking place directly or through investments into sub-funds.<sup>63</sup> In contrast to the IKLU, it is interesting that CP3 "will be run on a strict commercial basis [...] demonstrating that investment in climate projects in developing countries offers real opportunities for investors."<sup>64</sup> 50 million pound were as part of CP3 spent from "UK's International Climate Fund" to the IFC Climate Catalyst Fund (which is an equity fund).<sup>65</sup>

Since this initiative is still in its early process, it is not yet possible to draw conclusions on how effectively private finance could be triggered with this approach; but it appears to be an initiative that might trigger a lot of private investment.

### Global Climate Partnership Fund

The Global Climate Partnership Fund (GCPF) is a public finance instrument intended to mobilize private finance which is mentioned in various private finance papers and deserves therefore closer consideration. It was initiated by the German Ministry for Environment, Nature Conservation and Nuclear Safety (BMU) and KfW with current investors being BMU, KfW, IFC, Danish Ministry of Foreign Affairs and Deutsche Bank and with regard to its Technical Assistance Facility BMU and the Austrian Development Bank.<sup>66</sup> The fund's assets are covered by investors at different risk levels: senior tranches (KfW, IFC), mezzanine tranches (KfW, IFC, Deutsche Bank) and junior tranches (BMU, Danish Ministry of Foreign Affairs).<sup>67</sup> It can trigger private finance in three ways: a) through directly co-financing specific projects via debts or equity (however limited to no more than 30% of overall assets), b) through providing loans at commercial rates to financial institutions (local banks, leasing companies, or other financial institutions)<sup>68</sup> or c) "professional private investors" can – attracted by the fact that governments are investing in the highest risk tranche – become investors of the GCPF<sup>69</sup> in the lowest or medium risk tranche<sup>70</sup> and therewith increase the fund's capital. Especially the third option is an inno-

<sup>59</sup> DFID, 2012.

<sup>60</sup> DFID, 2012.

<sup>61</sup> DFID, 2012.

<sup>62</sup> DFID, 2012.

<sup>63</sup> DFID, 2012.

<sup>64</sup> DFID, 2012.

<sup>65</sup> IFC, 2012.

<sup>66</sup> GCPF, n.d.d.

<sup>67</sup> GCPF, n.d.a.

<sup>68</sup> GCPF, n.d.b., GCPF, n.d.c.

<sup>69</sup> GCPF, n.d.a.

<sup>70</sup> Stadelmann/Newcombe, 2011, 8.

vative way for attracting private investment. With regard to all three types of potential private sector involvement, a link to the provided public finance is clearly visible.

While the IKLU focused on low interest loans, the GCPF has as its special characteristics the underwriting of risks through different tranches, co-financing for specific projects (debts, equity) or loans (at commercial rates) to financial institutions. The GCPF uses hence a broad variety of instruments. While for direct project finance the raised private investment can be easily calculated, this might entail more complexity for loans going via financial institutions to local debtors and even more for private investment in the lower risk tranches. Regarding this third type of private finance, the specific private finance raised could exist out of the investment provided in one of the tranches and potentially the respective share of private finance raised through direct project investment and the private finance raised by financial institutions which received loans from the GCPF (since here the private investment in one of the tranches allowed for this GCPF co-financing or loan).

## **5.2 Categorization as public or private finance?**

While not necessarily linked to the question of mobilization, a closer look at such different instruments might be relevant for the question of the overall share of public versus private finance. While some of the instruments could be clearly identified as public finance, for others such categorization might be less clear.

Grants provided by a donor country are normally retrieved from the respective country's budget and do not need to be repaid; thus here one can clearly say that these are public funds. For concessional loans however, only the grant element does not need to be repaid and comes directly from state budgets. The other share must be returned and can for instance be raised at the capital market through a national development bank. A development bank is able to do so, since it often has the back up of the respective state; for instance Germany is liable for, amongst others, loans taken by KfW.<sup>71</sup> Non-concessional loans do not contain a grant-element and therefore they need to be repaid in their full amount.

For other instruments, including equity, guarantees and insurances, a clear categorization might be much more difficult. According to Ecofys, the provision of equity could or could not contain a grant-equivalent – depending on whether in the long run, the public investor will retrieve profits or financial losses from its investment.<sup>72</sup> Thus this topic would need to be further investigated before a clear categorization is possible, and such categorization could also be case dependent. In regard to state guarantees and insurances, real finance flows generally happen only (as indicated above) in the case the insurance/guarantee case occurs. In case of occurrence of the insurance/guarantee case the funding would constitute public finance flows. Thus also here, further research might be necessary for a clear categorization. Ecofys suggests, that guarantees and insurances both have a “grant-equivalent”: for guarantees this would be the risk taken by the guarantee provider (thus the state) to have the investment not fully secured, for insurances in the

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<sup>71</sup> Para. 1a Act on the KfW.

<sup>72</sup> Ecofys, 2011, 18.

risk taken by the insurance provider or the difference of the rates between the commercial and the provided insurance.<sup>73</sup>

While this made evident that there may certainly be difficulties in categorizing the instruments into potential public or private flows and that further research might be needed, such identification would need to be conducted in case a specific public/private share was to be agreed upon in regard to the 100bn USD.

## 6 Accounting issues

Overall one can assume that the 100bn USD will be split according to some calculation method among developed countries in order to determine how much each country has to contribute.<sup>74</sup> Thus here the question arises, towards which state the mobilized private finance would be counted?

Japan has accounted private finance already to its 15bn USD of support announced in 2009 – with about 11bn being public, 3bn USD being private finance “catalyzed” by public finance, and the remaining (thus 1bn USD) being co-financing to the Japan Bank of International Cooperation.<sup>75</sup> While Japan has used public finance to mobilize about 3bn USD of private finance (e.g. via co-financing or trade insurances) and has accounted the latter to its climate finance, it has not included it in the Fast Start Finance reported upon in its Fast Start Finance report.<sup>76</sup>

Thus one could say that the state which mobilized the private finance may also count this share towards its own commitment. However this might not be simply applied in all cases. As indicated before, a clear linkage with the state’s action would need to be proven and the fact that this action was decisive for the private sector investment. In addition, it might not always be clear which state was responsible for the mobilization of the private finance. For instance with the above mentioned GCPF, different donors (Germany, Denmark and the IFC) invest into the fund and thus they all might claim that their funding has triggered the private finance. A similar problem might arise in the case of the Green Climate Fund, where many donors are expected to put money into. Thus some method would need to be established to avoid double counting of the leveraged private finance. Obviously the same question would apply to multilateral funds which leverage private finance, since also here many countries invest into the same fund. In both cases it might be an option, to make the share of private finance, which a state may account towards its own obligation, dependent on the share of the funding provided for this instrument/fund by the respective state.

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<sup>73</sup> Ecofys, 2011, 17.

<sup>74</sup> The European Commission suggested in 2011 a calculation method, according to which the EU’s share of the 100bn USD would be between 29 and 38 % (European Commission, 2011a, 18).

<sup>75</sup> These 15bn USD should be provided up to 2012 (Delegation of Japan, 2011, p. 1.).

<sup>76</sup> Delegation of Japan, 2011, pp. 2 and 7.

## 7 Conclusion

This paper has shown that there are still many questions around the precise inclusion of private finance in the 100bn USD goal. While private investment for climate action is important and needed in order to address the immense sums of investment needed, it is crucial to provide clearer guidance on which part of private finance can be counted towards the 100bn USD goal and which not. This will be important on the one hand to allow for a reliable and predictable plan for scaling up climate finance from current Fast Start Finance levels towards the 100bn USD by 2020 and on the other hand to ensure transparency on climate finance flows and hence to increase trust (from states but also from potential investors) in this regard.

In order to ensure that the gap between climate finance needed and climate finance provided is as small as possible only net flows should be counted towards the 100bn USD – by accounting only the grant equivalent of public flows and by calculating the net benefit of the private investment in the recipient country. If the latter should be chosen, a common calculation method for the net benefit would need to be agreed upon. In the overall calculation it would need to be ensured that counting the net benefit of the private sector investment and counting at the same time the grant equivalent of the public finance would not lead to double counting of the same financial amount. Since in many cases, it might be exactly this grant element which leads to the net benefit of the private sector investment in the recipient country. Further, only such private finance should be included in the 100bn USD, where it can be proven that the investment could only take place due to public finance, thus only such private finance which would not have taken place anyways (therewith excluding for instance private donations or private investment not linked to state action). In addition, double counting of carbon finance flows as climate finance and at the same time counting the emission reductions towards the emission reduction commitment must be avoided.

Thus overall, the fact that some types of private finance may be included in the 100bn USD goal, may not imply, that developed countries need to do less. Rather, public finance should still be the predominant source of the promised annual 100bn USD of international climate finance by 2020. Public finance is crucial for policy frameworks for sectors or entire countries which have difficulties in attracting private finance. And public finance is needed in order to set the right incentives for attracting private finance for climate action and to raise the overall amount of climate finance provided as close as possible towards the amount of climate finance needed.

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