EDC2020

SEVENTH FRAMEWORK PROGRAMME

Project funded under the Socio-economic Sciences and Humanities theme

[OPINION]

Looking at effectiveness as well as transparency in climate finance

By Jessica Brown and Leo Peskett

International finance for climate change has become an important focus for how rich countries with high historical emissions will help developing countries shift away from carbon-intensive development to lower carbon development pathways. The 2010 Cancun Agreements state that developed countries should provide new and additional resources for developing countries approaching $30 billion for the period 2010 to 2012 and that longer-term funding should come from both public and private sources to mobilise $100 billion per year by 2020. Much of this conversation has stayed at the level of demanding transparency in pledges and commitments from contributor countries to address climate change in developing countries, and ensuring that governments adhere to the United Nations Framework Convention on Climate Change (UNFCCC) principle of ›responsibility‹ and ›capability‹ to pay.

But what is often missing from the international debate is evidence of what is happening ›on the ground‹ as international pledges are increased and recommendations for future action are often made without significantly supported evidence of what the situation is. Is finance actually reaching climate change mitigation and adaptation activities? How is it being delivered? Are lessons from the aid effectiveness debate being considered? And what can we learn for the future? These are important questions for European donors, especially given European fast start funding (FSF) pledges at Cancun and a new Green paper on the future of budget support that covers quality, value for money and impact of budget support[1].

While the focus on transparency cannot be lost, it needs to be complemented by an analysis of what is really needed at the national and local levels to address climate change. Depending on the needs of a country, the appropriateness of the public-private finance mix changes drastically.

For example, in a middle-income country like Indonesia which has a fairly strong domestic tax base and only receives roughly 0.24 percent of its gross domestic product from official development assistance, some argue that very little international public finance is needed to address climate change mitigation. Instead, what is needed is strong policy engagement for structural reform (such as subsidy reform and creating new fiscal incentives to reduce deforestation), and a greater emphasis on private investment. Yet many are still focused on bringing in international public money, despite the fact that it may not be the most appropriate form of finance to address the problem.

Recent research by the Overseas Development Institute (ODI) on climate finance in Indonesia showed international donors are supporting several different methods of climate finance funding:

1. The Climate Change Policy Loan. This is a loan, often with a low interest rate and extended payment terms, provided to develop a lower carbon, more climate-resilient growth path. The loans are directly incorporated into the country's general budget to cover the government's fiscal deficit.

2. The Indonesia Climate Change Trust Fund. This is a national trust fund owned and managed by the government of Indonesia which provides grant funding to ministries for climate change activities. The Trust Fund

1. http://ec.europa.eu/development/icenter/repository/green_paper_budget_support_third_countries_en.pdf

has been established to reduce transaction costs by cutting the number of free-standing projects, and by harmonizing the financing into a ›basket fund‹ where many agencies can contribute to one fund.

3. The Indonesia Green Investment Fund. This is a ›special purpose vehicle‹ under the Ministry of Finances Government Investment Unit, aimed at leveraging private and market-based sources of funding for private sector low emissions development projects.

4. The Norway-Indonesia ›Letter of Intent‹. This is a bilateral agreement between Norway and Indonesia intended to finance REDD-plus activities, aimed at reducing deforestation to curb emissions, at the national level. The majority of funding is conditional on ›performance based‹ verifiable emissions reductions.

5. Other Bilateral and Multilateral Project Support. This is support for specific projects and programmes, through technical assistance, capacity building, REDD-plus demonstration projects, support for measuring, verification and reporting systems, and so on.

Stepping beyond the debate around ›responsibility to pay‹, an assessment of these different funding methods in terms of their effectiveness is needed – how well the tools are responding to the needs; how they are targeting direct emission reduction opportunities; how sustainable these approaches are in the longer term; how they are impacting growth and equity within the country and the results should be circulated widely to assist other countries beginning to engage with climate finance.

Findings from the research demonstrate that several issues need to be addressed going forward to improve the effectiveness of climate finance. Implementers and contributors of climate finance should focus on the following needs:

- Better understand what climate change mitigation activities need to be funded within countries and to build financing modalities that meet these needs, rather than to be guided by which modalities are available. Currently there is a poor understanding (among donors and within government) of what activities need to be supported and the appropriate financial modalities to address these needs: This has led to a lot of ›business as usual‹ support that only indirectly target abatement needs. While national economic needs assessments have been carried out, the assessments are often too general or broad to give accurate cost projections for different sectors. Some of the methodologies used also have severe limitations.[2] In order to build more effective responses, it will be important to better understand these needs and to build financing modalities accordingly.
- Move beyond the question of scale of finance as an indicator of effectiveness, especially in emerging economies in which public international climate finance flows are likely to remain small compared to national budgets;
- Move donor coordination beyond information sharing, towards more combined strategies and joint coordination with government;
- Increase flexibility among donors in the way they deliver finance (e.g. in terms of procurement rules). While a few donors are working through national institutions and procurement processes, many donors chart a course outside the government's institutional framework in order to maintain control and accountability over resources, and as a way to avoid dealing with national and local systems that are often regarded as slow and ineffective. The restrictions of existing financing modalities (e.g. in terms of procurement guidelines; funding cycles) exacerbate this challenge.
- Better consider lessons from earlier international development cooperation debates in the development of new ›performance based‹ financing modalities such as REDD+.

For more detailed information, please see www.edc2020.eu. These findings are summarised from the EDC2020 Working Paper: Climate Finance in Indonesia: Lessons for the Future of Public Finance for Climate Change Mitigation by Jessica Brown and Leo Peskett, 2011. The research findings are based on in-depth country research and extensive donor and government interviews.

2. These are not problems specific to Indonesia. For example, the use of opportunity costs estimates to cost REDD+ strategies has been questioned because of the difficulty of determining such costs for different actors who may be involved in REDD+. This is for reasons such as the inability to make accurate cost estimates in non-market environments and identifying all of the actors who have opportunity costs (Gregersen, 2010).

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This publication is an outcome of ongoing research in the framework of the project on European Development Co-operation to 2020 [EDC2020]. This project carries out research on three major emerging issues: new actors in international development, the linkage between energy security, democracy and development and the impact of climate change on development.

Consortium partners: European Association of Development Research and Training Institutes (EADI, Germany), Overseas Development Institute (ODI, United Kingdom), Institute of Development Studies (IDS, United Kingdom), German Development Institute (DIE, Germany), Fundación para las Relaciones Internacionales y el Diálogo Exterior (FRIDE, Spain), Society for International Development (SID, Netherlands).

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