EXECUTIVE SUMMARY

Climate finance: is it making a difference?

A review of the effectiveness of multilateral climate funds

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Key points

• Multilateral climate funds have helped countries begin to confront the challenges that climate change poses for development. They have largely channelled finance to the places where emissions are significant and growing fast, and vulnerability to climate change is substantial. But their modest financial capitalisation has constrained what they can directly achieve.

• Funds must become more flexible and less risk averse if they are to support the innovative approaches that will likely be required to green development trajectories of fast-growing economies and foster resilience for the most vulnerable.

• Funds and their implementing entities need to work more closely with a wider range of national stakeholders in order to strengthen the policy and regulatory frameworks that enable scaled-up investments in low-carbon solutions.

• Improved measurement, reporting and understanding of impact is essential, and can help build the case for continued and increased contributions of climate finance.

• The climate finance architecture is too complex with insufficient resources spread thinly across many small funds with overlapping remits. The current operationalisation of the Green Climate Fund provides an opportunity to take the best of the experiences of existing funds.

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Overview

International efforts to tackle climate change are at a critical juncture. At the end of 2015 governments will gather at the Paris climate summit to frame a new international agreement aimed at preventing 'dangerous climate change'. Achieving that goal requires a high level of ambition backed by practical policy commitments. Finance has a pivotal role to play in supporting developing countries to reduce emissions, decarbonise their economies, and adapt to the impacts of climate change. Governments across the world's poorest countries see financial commitments as key to a global deal in 2015 that can deliver meaningful climate action.

There is a great deal at stake. Developing country governments are rightly concerned about potential tensions between sustaining the economic growth needed to generate jobs and reduce poverty, and reducing greenhouse gas emissions. International cooperation on finance has the potential to help countries manage such trade-offs, and create new incentives for low carbon development. For millions of the world's most vulnerable people in developing countries, international climate finance has the potential to support the policies that can build resilience against the threats posed by a changing climate. It follows that finance for action on climate change should occupy a central position in post-2015 development goals as well. Multilateral funds are a particularly important piece of the global climate finance architecture as they are direct products of international policy processes.

But are climate funds making a difference? Governments of contributing countries need evidence that climate funds are making good use of their scarce tax dollars if they are to justify a continuation or scale-up of commitments. This report provides a critical review of the climate finance architecture. It examines more than a decade of experience of multilateral climate funds including the Global Environment Facility (GEF), the Climate Investment Funds (CIFs), and the Adaptation Fund (AF). It also considers the experience of national funds created to receive international funding such as Brazil's Amazon Fund and the Indonesia Climate Change Trust Fund (ICCTF). We ask whether the existing architecture is fit for the purpose of delivering finance to the right countries on the scale, terms and conditions required. Our findings draw on the first global ranking of recipients of multilateral climate finance (see Box 1).

Our answer to this question is largely positive. Climate funds have broken new ground by helping countries begin to confront the implications of climate change for development. The finance they spend is targeting countries that need it. Mitigation funding is concentrated in developing countries with relatively high (and rising) greenhouse gas (GHG) emissions, maximising with opportunities for efficient mitigation. Adaptation finance is targeting some of the poorest countries. Against this backdrop, efforts should be made ahead of the Paris summit to ensure that the Green Climate Fund (GCF) is adequately resourced. Recent pledges send a much needed signal to this end: by November 2014 the GCF had raised more than $9 billion, just seven months after its official resource mobilisation process began.

There is considerable scope for improvement, however, and opportunities to learn from past experience. Funds need to be more flexible and less risk averse. They need to become more transparent in the way that they report the results achieved and the impact of international public finance. Transaction costs can be lowered, and decision-making processes made more efficient. Funds should also support a wider range of government, business, and community actors within countries. Greater emphasis needs to be placed on the development of national capacity – and on appropriate approaches to engage private businesses and investors. Climate funds need to develop innovative relationships with the financial institutions that are most active in climate relevant sectors, notably infrastructure.

Mitigation
An intervention to reduce greenhouse gas emissions

Adaptation
An intervention to reduce the harm and impacts of climate change

REDD+
An intervention to reduce greenhouse gas emissions by reducing deforestation, forest degradation, and increasing forest stock

Box 1 ODI's Global Ranking of Climate Finance

This report presents the first comprehensive break-down of how multilateral climate finance has been spent in 135 countries over the last decade. It shows that Morocco, Mexico, Brazil, South Africa and India are the top beneficiaries, each receiving over half a billion dollars, largely as loans. The pool of funds available for climate change adaptation is smaller: Bangladesh, Nepal and Niger have been the most successful low-income countries, each receiving more than $110 million to invest in early warning systems and other resilience enhancing activities. But some countries have been left behind. Fragile states such as the Ivory Coast and South Sudan, gained much smaller sums - $350,000 and $700,000 - respectively, reflecting the difficulty of spending funds in these environments. Several middle income countries, highly vulnerable to the impacts of climate change, such as Namibia, El Salvador and Guatemala also received much smaller volumes of finance, less than $5 million. Saudi Arabia and Oman, with high per capita incomes, have benefited least from climate funds. These countries have the potential to contribute to climate funds, as other richer developing countries such as Mexico and Korea have begun to do. Half of the $7.6 billion approved to date has been concentrated in the top ten countries, largely reflecting the focus of the Clean Technology Fund to provide large loans to support countries with fast growing emissions.

How was the data gathered?

This report draws on data gathered through the ODI and Heinrich Böll Foundation's (HBF) Climate Funds Update (CFU) which compiles data on how much finance climate funds have raised, where it is spent, and what the projects funded seek to achieve. CFU is the world's leading source of information on climate funds: our data is updated quarterly and available at www.climatefundsupdate.org. The report also draws on ODI's work on the effectiveness of climate finance, including a series of reviews of international climate funds, which were informed by interviews with fund administrators, contributors and recipients. We reviewed more than 880 projects and programmes funded between 2003 and September 2014 by funds analysed in this report. We used data on national greenhouse gas emissions from WRI's Climate Analysis Indicator Toolkit (cait2.wri.org) and data on vulnerability from the 2013 ND-GAIN (http://index.gain.org/) to understand whether climate finance was targeting mitigation opportunities and vulnerabilities.

The current finance architecture

The threat posed by climate change to the development gains made over recent decades demands an urgent, comprehensive and global response. Since 1992, the United Nations Framework Convention on Climate Change (UNFCCC) has set out a framework for international action to stabilise GHG emissions to prevent dangerous climate change. The UNFCCC recognises that developed countries have contributed the most to the global accumulation of GHG emissions, while developing countries bear less historical responsibility. This recognition has led to a commitment from developed countries to mobilise finance to help developing countries respond to climate change, and such 'climate finance' has become a central issue in international negotiations.

Commitments to deliver climate finance to developing countries are longstanding. Developed countries pledged to deliver finance approaching $30 billion between 2010 and 2012, in the context of a commitment to mobilise $100 billion per year from public and private sources by 2020 in the Copenhagen Accord of 2009. These commitments were affirmed in the Cancun Agreements of 2010. In addition, the need to achieve 'balanced finance' for adaptation was recognised, with an emphasis on the needs of particularly vulnerable countries, including small-island developing states (SIDSs), least-developed countries (LDCs), and African states. It was in this context that parties agreed to create the GCF as a new operating entity of the financial mechanism for the UNFCCC.

Effective spending of multilateral climate finance and delivery of successful outcomes are critical in building consensus on the imperative to take action in response to climate change. The funds reviewed in this report have approved about $1 billion a year since 2008 and overall levels of approved finance have increased rapidly in recent years (see Figure 3). This remains a relatively small share of the total climate-related investment that already takes place in developing countries from both the public and private sectors. While climate funds have played a significant role in reported climate finance contributions from developed countries, the share of finance directed through their bilateral agencies is often much greater.

Four of the funds reviewed – the GEF, which also provides secretariat services for the SCCF, the LDCF and the Adaptation Fund – are linked to the UNFCCC. The CIFs were created in 2008 as new multilateral funds managed by the World Bank in partnership with regional development banks to pilot new multilateral approaches to the delivery of climate finance at scale. The creation of climate funds without links to the UNFCCC was controversial, but the CIFs have tested many new approaches to climate finance. They have increased the scale of funding available, extended the range of financial instruments, and helped mainstream climate change considerations into investments by multilateral development banks (MDBs). The CIFs are expected to close their operations once a new UNFCCC climate finance architecture (in the form of the GCF) is operational.

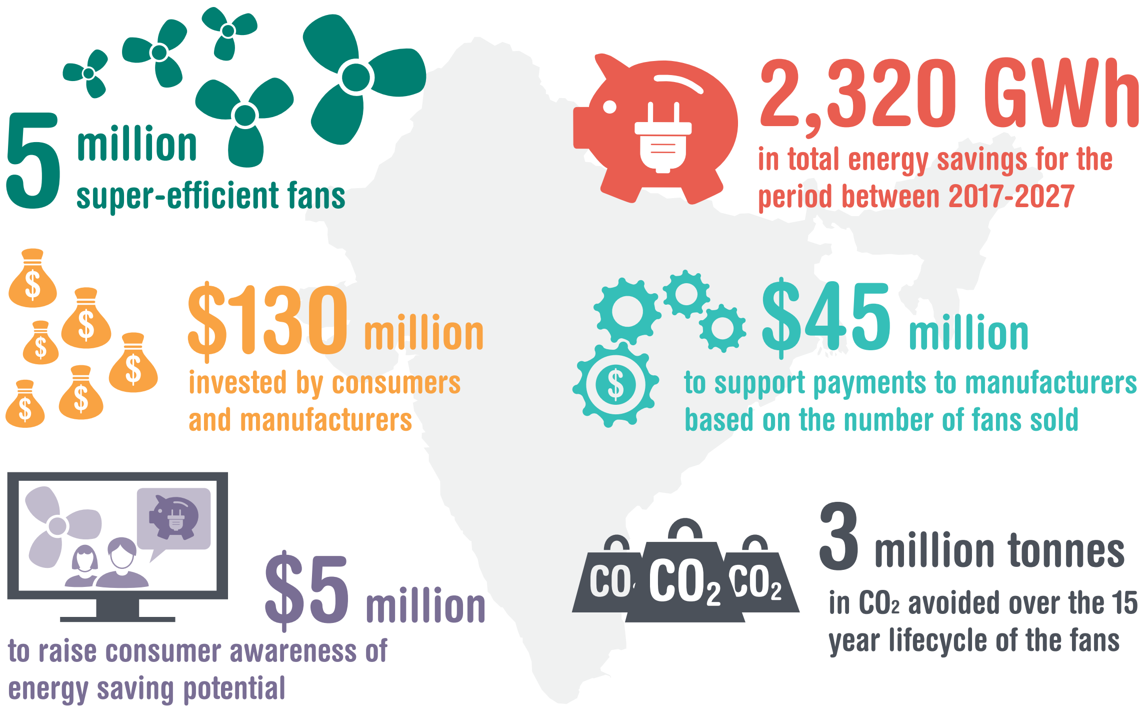
Funds have been subject to considerable scrutiny and have become increasingly inclusive, seeking to respond to guidance from diverse stakeholders. Active engagement from civil society and the private sector with these funds can bring new issues and perspectives to bear on decisions made. But sustaining substantive engagement from non-governmental stakeholders takes commitment on their part, and may benefit from support.

How effective have multilateral climate funds been at reducing emissions and building resilience to climate change?

Climate funds have spent money in places that can use it, on activities that can reduce emissions and increase resilience to climate change. There are now more than ten international multilateral funds created by the global community, to channel climate finance to developing countries (see Figure 3 for timeline), including the GCF. Ensuring that the climate funds created under the UNFCCC have adequate finance is critical to securing the ambitious global agreement on climate change hoped for in Paris in November 2015.

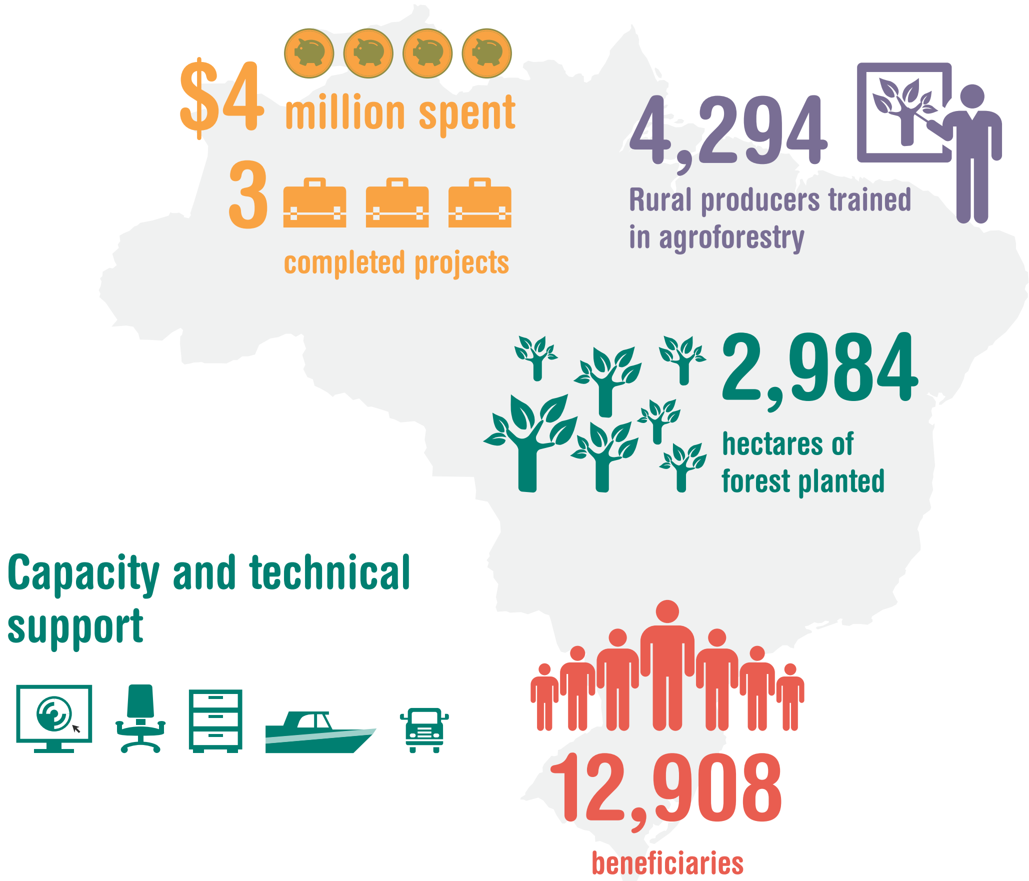
Mitigation finance has targeted middle-income countries, where emissions are already high and growing rapidly. In Mexico, the second highest recipient of multilateral climate finance over the last decade, programmes funded by the GEF and the CTF have enabled a significant scale-up in

Figure 1: Expected results of climate finance for India's Super Energy-Efficient Equipment Program (SEEP)



Source: GoI/IBRD (2012)

Figure 2: Results of completed Amazon Fund projects in Brazil



Source: Amazon Fund (2014)

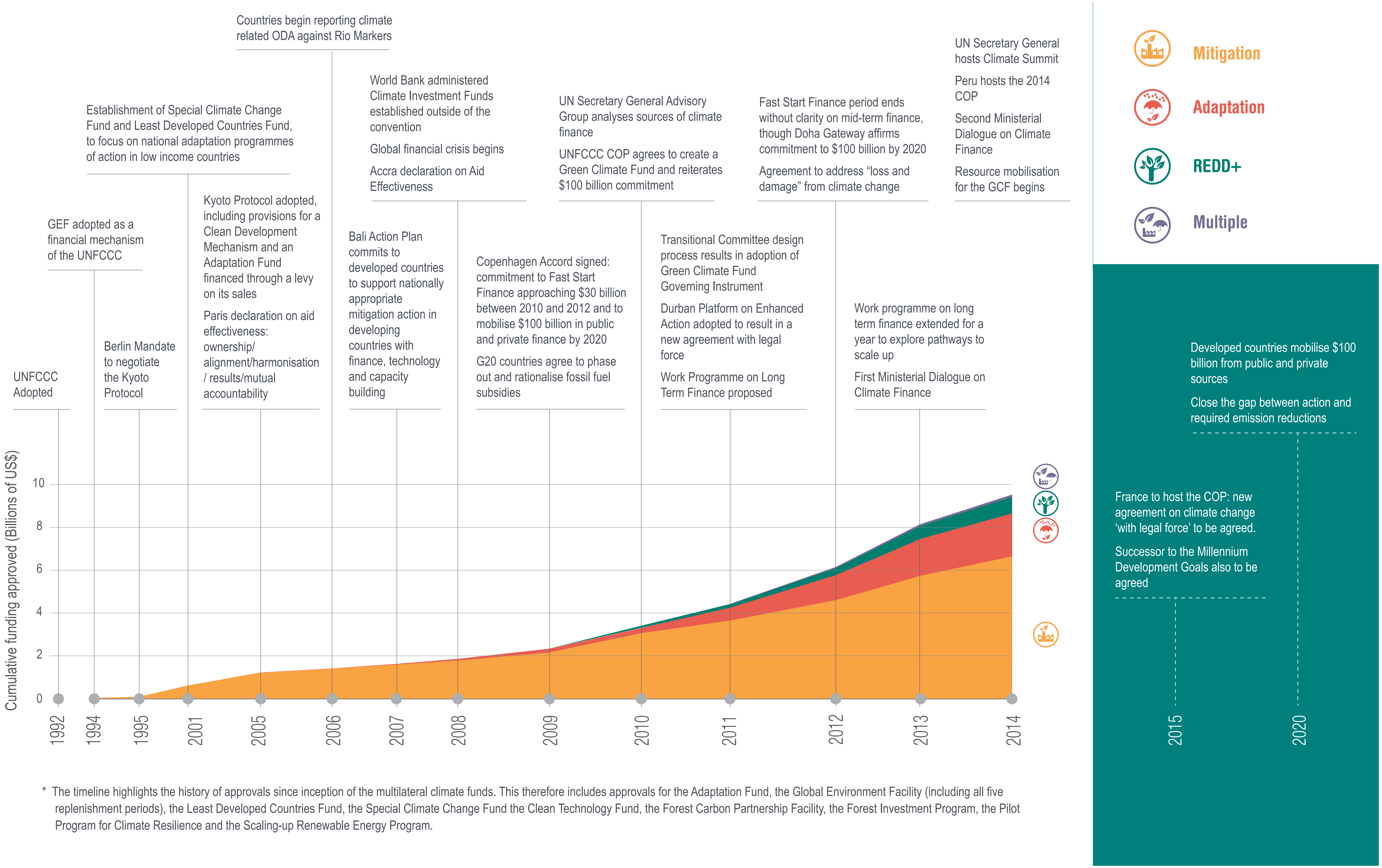
installed renewable energy in a system that was once powered solely by fossil fuels. Furthermore, the cumulative investments that the GEF and CTF have made in solar thermal power over the years in countries, such as the top recipient Morocco, have the potential to increase installed solar capacity in developing countries by 40%. In India, climate funds are financing the deployment of super energy-efficient fans, supporting the implementation of new climate change response policies: $50 million in performance-based finance will enable consumers to invest $130 million to purchase these appliances (see Figure 1).

Climate funds are also supporting efforts to reduce emissions from deforestation and degradation in forest rich countries that have shown political commitment to Reducing Emissions from Deforestation and forest Degradation plus conservation(REDD+). National funds, such as the Amazon Fund in Brazil, are creating new incentives for local government to develop plans to combat deforestation. The three projects completed so far have supported the reforestation of nearly 3,000 hectares of land, trained 4,000 rural producers in better agroforestry techniques and have strengthened forest oversight capacity (Figure 2).

Adaptation funds have targeted poor and vulnerable countries, particularly in sub-Saharan Africa and South Asia. Both regions are highly vulnerable to climate change, including disasters associated with climate extremes. Niger, Bangladesh and Nepal are amongst the largest recipients of climate finance, largely for adaptation. The Pilot Program for Climate Resilience (PPCR) in Nepal, for example, is working to ensure that people in 27 high-risk settlements are covered by a community-based early warning system (EWS). All three countries are also accessing some mitigation finance to invest in more sustainable land-use management, and renewable energy systems, which also promote resilience benefits (see Figure 4).

Small-island developing states (SIDS) such as Samoa, the Maldives, Jamaica, and St Lucia are among the largest recipients of adaptation finance for disaster risk reduction. However, not all poor

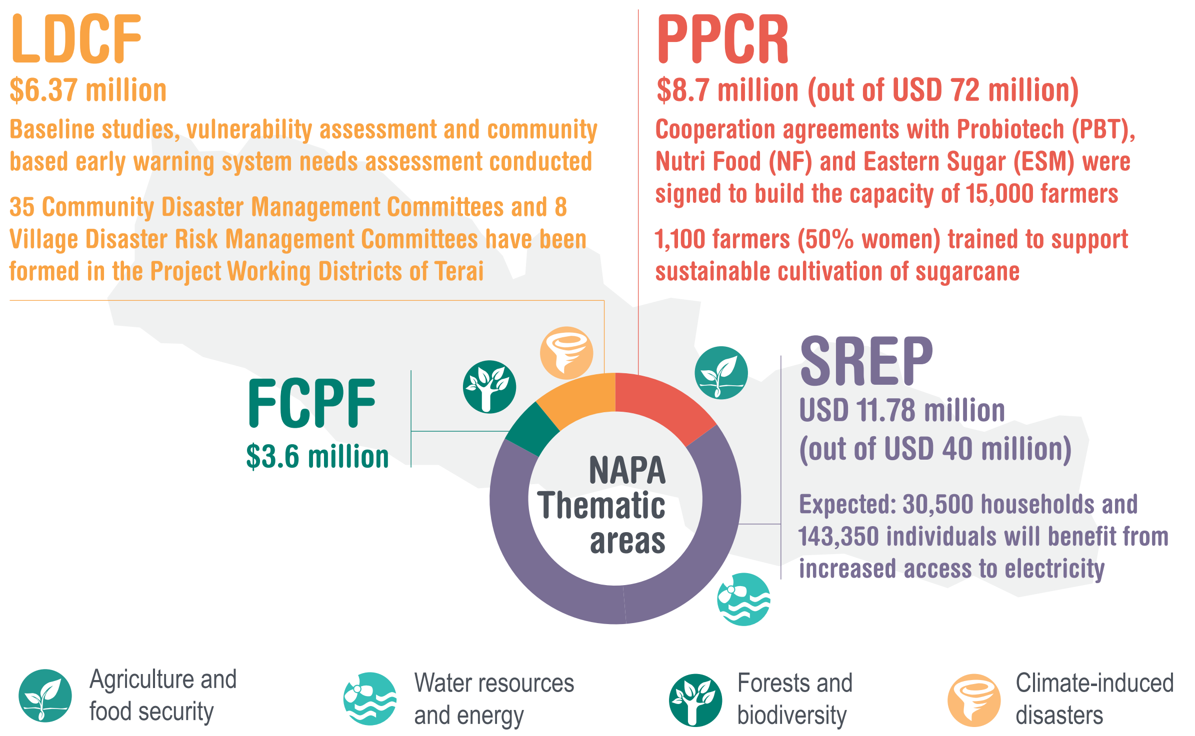
Figure 3: The evolution of multilateral climate finance



* The timeline highlights the history of approvals since inception of the multilateral climate funds. This therefore includes approvals for the Adaptation Fund, the Global Environment Facility (including all five replenishment periods), the Least Developed Countries Fund, the Special Climate Change Fund the Clean Technology Fund, the Forest Carbon Partnership Facility, the Forest Investment Program, the Pilot Program for Climate Resilience and the Scaling-up Renewable Energy Program.

Source: Climate Funds Update (2014)

Figure 4: Expected and achieved climate finance results in Nepal



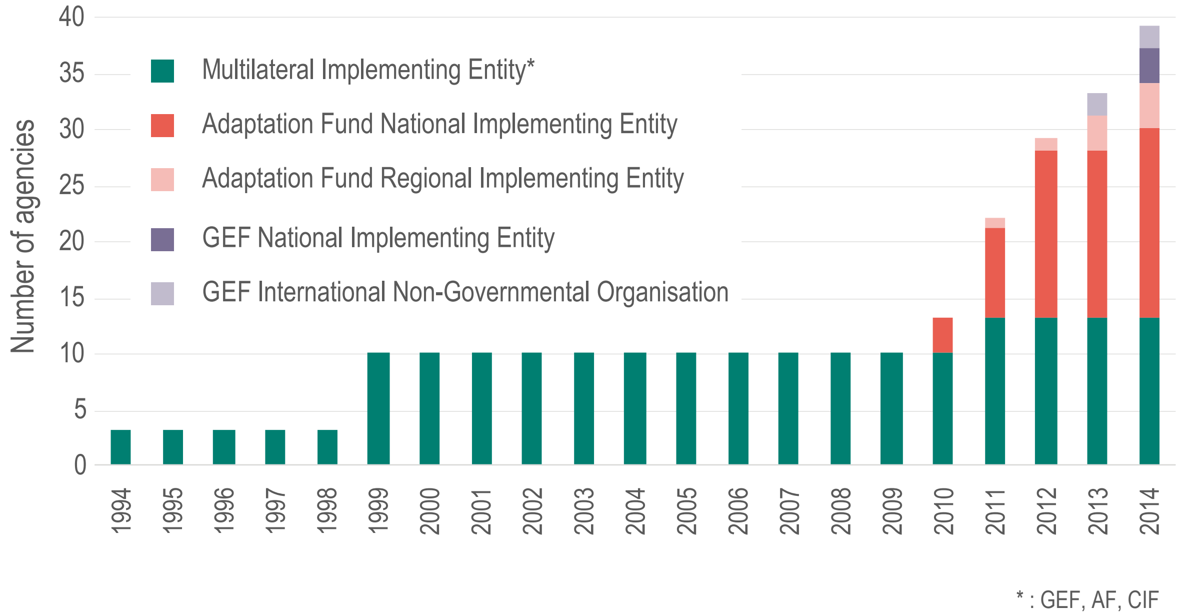
Sources: CIF (2014b,c); GEF (2012); FCPF (2013a). SREP and PPCR figures are illustrative examples for a subset of projects.

and vulnerable countries have been able to access climate funds.

Larger funds, such as the CIFs, have succeeded in engaging lead ministries responsible for strategic investment planning and financial management decisions at country level. Historically, climate funds have been small actors involved in niche activities, commanding low levels of political attention. As such, they have struggled to bring climate finance into the mainstream of economic and development decision-making. In some cases, however, climate funds have supported new institutional arrangements that bring key ministries together to address climate change. In Zambia, for example, the PPCR has supported the Ministry of Finance and National Planning to collaborate with a broad range of government departments, including the Ministry of Agriculture and Cooperatives, the Ministry of Tourism, Environment and Natural Resources and the Ministry of Local Government and Housing as well as wider non-governmental stakeholders to implement adaptation programmes. There is, of course, an important role for ministries of the environment in bringing expertise and insight on climate change issues to bear on these vital topics.

Climate funds are now partnering with a growing diversity of international and developing country based institutions, and helping them to do more on climate change. The number of multilateral implementing agencies has expanded from the three original founding partners of the GEF i.e. the World Bank, the United Nations Development Programme (UNDP) and the United Nations Environment Programme (UNEP), to include about 40 institutions (see Figure 5). This expansion results, in great part, from innovations introduced through the Adaptation Fund that facilitated developing country-based institutions to have direct access to climate finance. The range of partners for climate funds now includes regional development banks, a range of international organisations, developing country ministries, trust funds and NGOs. The involvement of development finance institutions in developing countries is particularly noteworthy: the Development Bank of South Africa and Brazil's FUNBIO are now implementing agencies of the GEF. The Amazon Fund sits within efforts to encourage the Brazilian Development Bank (BNDES) to scale up

Figure 5: The diversity of implementing agencies is increasing



Sources: Adaptation Fund (2014), GEF (2014), CIF (2014a)

sustainable investment, and to improve the Bank's environmental and social impacts.

But, funds have not been universally successful. There are many examples of programmes that were not well designed to reflect national circumstances. Too often, there has been a failure to consider how policy, regulations and institutional capacity will affect intended outcomes. National stakeholders have sometimes voiced concerns that some programmes have tended to reflect the priorities of the international implementing institutions and the donors that fund them, rather than responding directly to their national needs and circumstances.

Ultimately the amounts of funding available have been small, and often difficult to access. While funds have developed elaborate measures to safeguard programme quality and promote low-risk investments, resulting procedures can be extremely cumbersome. Furthermore, the capacity of countries to formulate creative and transformational ideas about how to maximise the impact of available finance has varied greatly. There remains an urgent need to invest in the institutions and people in government, the private sector and civil society who can put this funding to the best possible use.

To date, funds have struggled to mobilise private investment. Climate funds must engage both the public and private sectors. This has been particularly challenging. Funds have created private sector set-aside programmes to focus attention on these opportunities, but their impact remains to be seen.

How can the climate-finance architecture become more effective?

It is clear that the climate-finance architecture needs to mobilise much larger scales of finance to support climate mitigation and adaptation activities and focus more on supporting underlying policy, regulatory and enabling environments alongside efforts to make large investments. Without such strategic elements, climate funds are unlikely to achieve the desired impact. The following steps can increase the effectiveness of climate finance initiatives:

1. **Take more risk, and support innovation.** Climate funds need to be more flexible and willing to take risks to foster greater innovation, including for the adoption and improvement of new technologies that can reduce emissions and

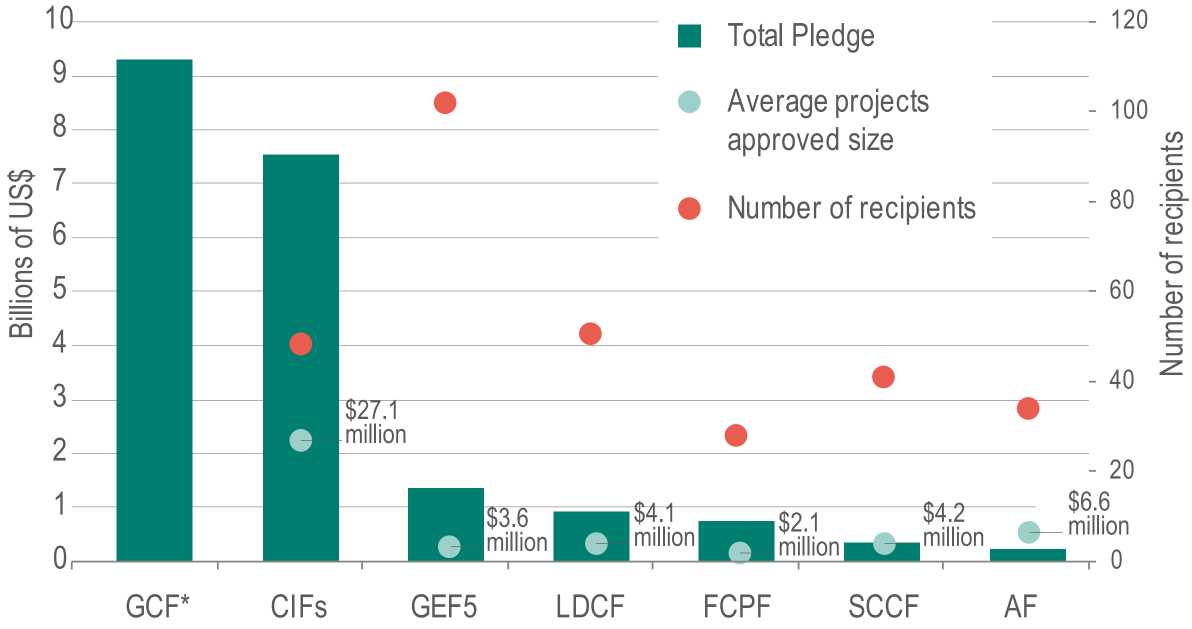
increase resilience. This is a major shortcoming of the current system,given the continued need to reduce the costs of low-emission and climate-resilient approaches and find better responses to climate change.

2. **Support national stakeholders to strengthen policy, regulation and institutional capacity.** Climate finance needs to incentivise a wide range of actors to shift their investments in the most efficient ways possible. As such, climate funds should focus on strengthening national institutions and enabling environments, particularly in countries where a clear policy commitment to climate change is emerging, and where public financial-management systems allow the monitoring of progress.

3. **Use the right types of finance for the appropriate purpose.** Climate funds are focused increasingly on finding the most appropriate instruments to encourage low carbon and climate-resilient investment at the lowest possible cost. In many cases, however, climate funds need to consider the full suite of financial options, including grant and concessional funding and consider opportunities to support institutional capacity building and create incentives that encourage investors to engage on new issues that they perceive to be higher risk. Even relatively small amounts of grant finance can complement the use of less concessional and non-concessional financial instruments, and greatly increase their impact.

4. **Create new incentives for the institutions, investors and businesses that are shaping infrastructure and development finance choices to step up their efforts to reduce emissions and increase climate resilience through new partnerships.** Funds and the implementing entities through which they work need to find better ways to engage with national stakeholders, including domestic investors from the public and private sectors, and navigate domestic economic priorities and politics. There is an opportunity to extend the range of partnerships, particularly with the new infrastructure financiers (which include many developing country development finance institutions). A wider range of partnerships, including with new and emerging sources of infrastructure finance, for example the anticipated for example the anticipated New

Figure 6: Initial pledges to the GCF are significantly higher than those made to existing funds



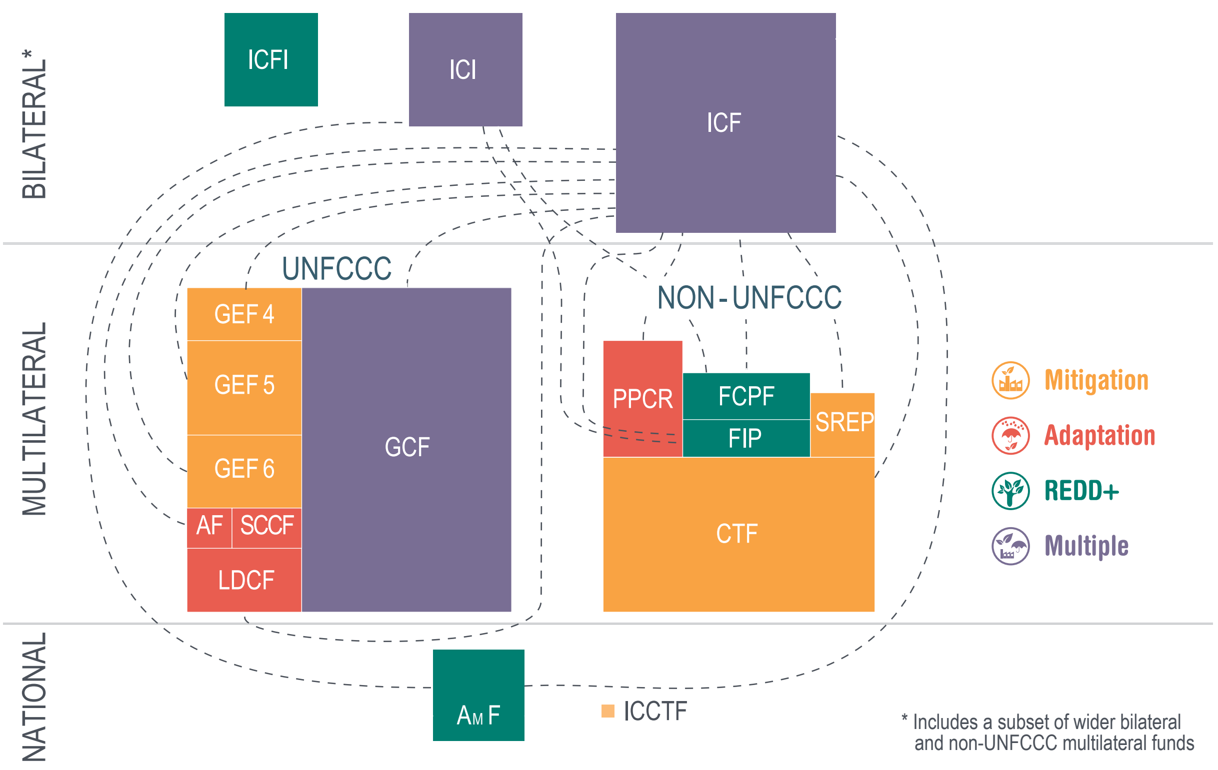
* Based on pledges as of 20 November 2014

Source: Climate Funds Update (2014)

Box 2 Key features of the GCF

- The GCF has adopted an active risk-management framework from the outset. Loan contributions will be complemented with a capital cushion that will be calibrated to help ensure the fund can make relatively risky investments. This should allow it the potential to offer the range of forms of finance required to target national needs.
- The GCF has a dedicated private sector facility to help it meet the particular challenge of finding more effective ways to engage. It will be especially important for the fund to be able to take more risks and forge new partnerships.
- The GCF is also well placed to use a range of types of financial instruments, including for capacity building and institutional strengthening, and to support deeper engagement of national stakeholders. The country programming division of the fund already administers a readiness programme to offer up-front investments in national processes and institutional capacities. But the needs for institutional and enabling activities go beyond readiness and will also need to be reflected in the projects and programmes that the Fund supports.
- The GCF accreditation framework allows it to work with a potentially vast range of implementing partners. From the outset it will be able to work with developing country based institutions, including those accredited to the GEF and Adaptation Fund.

Figure 7: The climate finance architecture



Source: Climate Funds Update (2014)

Development Bank set up by Brazil, India, China and South Africa (the BRICS) or the Asian Infrastructure Investment Bank, may help these institutions realise their stated commitments to sustainable development by taking concrete action on climate change.

5. **Set a high bar for the ambition of supported programmes, and understand impact.** Climate funds need to set a high bar for impact, and help countries to identify investment opportunities that can really transform sectors and economies. These interventions may be more complex to design, as they require greater iteration and partnership with national stakeholders. While existing funds have focused on measuring results, the transparency and consistency of approaches has been less successful with significant variations in how basic rules for GHG emission accounting are used and applied, and in the quality of the data collection that underpins these estimates. Similarly, there is a recognised need to deepen metrics of resilience, and systematise approaches across actors in the global climate-finance architecture. Funds must adopt more consistent and transparent monitoring and reporting of results to enable a more robust understanding of what they are achieving.

While these findings are of relevance for all actors in the climate finance architecture, these are also opportunities that the newly created GCF has the potential to help address. As an operating entity of the UNFCCC, the GCF has unique legitimacy to provide finance for climate action in both developed and developing countries. The pledges made to the GCF by 20 November 2014 made it nine times larger than the GEF (see Figure 6).

As developing countries also make contributions to the GCF, it is taking on a more global character. Over time, this may help to break some of the traditional divides between contributors and recipients. Of course, pledging is often the easy step, and it could take a long time for these pledges to be deposited. The experience of existing funds suggests that better efforts to deepen engagement with the right players within recipient countries will be essential if funding is to be disbursed quickly. Nevertheless, the GCF is already well positioned to **mobilise significant levels of finance** and to take a different approach to many of the key challenges our research identifies (see Box 2).

It is now time to simplify, and consolidate the global climate finance architecture, and scale up finance.

There are now too many multilateral climate funds, both under and beyond the UNFCCC convention that support adaptation and mitigation in developing countries. Each of these funds had a particular purpose and function at the time of their establishment, but there is now too much overlap, and too little money available through these disparate channels. There is a particular proliferation of adaptation funds, each with their own governance and administrative structures, and very small amounts of funding (see Figure 7).

The current capitalisation and development of the GCF presents a significant opportunity to learn from the past decade and work to improve engagement with the private sector, encourage flexibility and set a high bar for implementation to reduce emissions and build resilience to climate change. Of course, the GCF still needs to demonstrate that it can deliver a vibrant portfolio of programmes. The GEF, for its part, has been replenished to fund climate-change activities through 2018. The question of what to do with the CIFs, however, requires attention: much of what the CIFs were designed to pilot has now informed the design of the GCF. Work to map the options for consolidation and their implications is now needed, with strong commitment to improving on the experience of multilateral climate funds over the past decade.

UK aid from the British people

This material has been funded by UK aid from the UK Government, however the views expressed do not necessarily reflect the UK Government's official policies.