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Policy pointers

To reach the whole of society, climate finance must seek convergence across interventions and be patient, reliable, flexible to learn and adjust, risk-seeking and innovative, and robust to a range of futures.

Deliberate, long-term investment will develop delivery mechanisms that reach across societies, give meaningful voice to local communities and enable more inclusive and equitable climate solutions.

Donors and climate funds must reform to support incubation and early-stage finance to build institutions and delivery mechanisms for governance and investment that engages the whole of society in climate action.

Intermediaries should commit to act as honest brokers and ensure they leave a legacy of institutional climate capability with their partners.

Calling for business unusual: reforming climate finance

The climate finance system is failing to respond to the triple crises of poverty, climate and nature. Going further and faster on climate action requires a whole-of-society response and more, and better, climate finance that reaches local levels. So, what needs to change? This briefing sets out some principles for reforming the current climate finance system. These will help strengthen the quality of outcomes by incubating the delivery mechanisms needed to: provide climate advice and investment behind local priorities, help enterprises pivot towards climate-positive production and enable grassroots and civil society actors to work with communities to develop their own solutions. With the right support, governments can strengthen their institutions to incentivise robust, climate-informed decisions across society, enable convergence across delivery mechanisms, improve accountability and learn what works.

It is almost 30 years since the Global Environment Facility was asked to deliver climate finance and ten years since the Copenhagen Accord led to wider commitments to climate finance. But much still needs to be done to improve the governance and investment of local climate action and deliver thriving, just societies that can tackle the fundamentally intertwined triple crises of: poverty and rising inequality; ecosystem degradation and biodiversity loss; and catastrophic climate change. There is no magic bullet to resolve these crises; tackling them requires a whole-of-society response.

What is climate finance?

As part of the deal that gave us the Paris Agreement, climate finance has justice at its heart. Although a clear definition has yet to be agreed, there is consensus that its purpose is to support adaptation and mitigate emissions.¹

This broad definition is gaining clarity through practical decisions, where global climate funds expect climate finance to support environmental sustainability and social justice regarding gender, for indigenous peoples and local communities.² And, given that climate finance flows are relatively small compared to the challenge, indigenous people and local communities also expect to see an argument for how the funding influences or mobilises larger finance flows and seeks to transform systems and enable a paradigm shift.

Business as usual is not working

Climate finance should nudge climate action into viability and the mainstream. It can do this by: providing additional resource to ensure meaningful social and environmental sustainability; de-risking to influence the flow of wider investment; and testing and incubating experimental and innovative

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approaches. But the experiences of the last 30 years show us that finance flows are not good enough, in quantity or quality. Specifically, we have learnt that:

Climate finance is not flowing to the most vulnerable: just 18% reaches Least Developed Countries (LDCs)³ and from 2003–2016, less than 10% of all global climate funds was earmarked for local action.⁴

It does not support their priorities: developing countries need US\$140–300 billion a year to finance

adaptation actions by 2030. Yet only US\$22 billion was committed globally in 2016. Disbursements are also slow.

Wider investment flows do not reach the vulnerable: climate finance aims to influence development and private investment, but these face the same issues. Despite the humanitarian sector's goal of channelling 25% of aid directly to national and local NGOs,⁵ these received just 2.7% in 2017.⁶ Most of this funding flowed through multilaterals and international NGOs. Green private finance increased by one third in two years to reach US\$31 trillion globally in 2018. But less than US\$0.5 trillion went towards targeted impact investment and community investment.⁷ Private investment flows into decentralised renewables aimed at climate action in poorer countries are also tiny.^{8,9}

International intermediaries control most resources: most climate and development finance flows through layers of intermediation, reducing the amount, speed and flexibility of funds that reach delivery partners on the ground. The Green Climate Fund (GCF) channels 87% of its portfolio through international intermediaries, with the World Bank, UN Environment Programme, UN Development Programme, Asian Development Bank and Food and Agriculture Organization managing 72% of its active proposals. Only seven LDCs — Nepal, Bangladesh, Rwanda, Uganda, Ethiopia, Benin, Senegal — have direct access to GCF resources.¹⁰

Intermediaries are transaction-heavy: each intermediary has its own preferred solutions

and administrative rules, so country delivery partners must understand and adhere to multiple requirements. Many set up project units outside of national institutions, therefore leaving no legacy of strengthened institutions. They charge administration fees for managing the finance, diverting funds from the ground. Most struggle to provide the predictable, flexible and patient finance required to incubate delivery mechanisms that can support governance and investment for local climate action.

Finance is for short-term projects: institutions need long-term, patient investments to build their capabilities for strategic climate action, ensure sustainable outcomes and create agile institutions that can cope with future uncertainties to build meaningful, local-level resilience. But climate finance is caught in a trap of short-term pilot projects.

It is designed by distant experts: climate and development projects are often designed by external consultants and intermediary institutions on fly-in, fly-out missions. As well as undermining the ability to respond to changing political opportunities or contexts, this approach excludes local voices and prevents the integration of insights from technical knowledge and science with traditional indigenous knowledge. The resulting projects are less relevant: they are not informed by local realities and do not tackle the underlying drivers of vulnerability.

It is upwardly accountable: project managers and intermediaries are often more accountable to donors than to communities. Although scoping studies help set project priorities, long approval times mean these quickly become outdated. While donors must be accountable to their own citizens, conditionalities and output-based contracts reduce the opportunity for rapid, flexible responses to complex, evolving local contexts. Top-down decision making allows powerful actors along the delivery chain to take over the process and fails to respond to the priorities of those best placed to find synergies and resolve trade-offs.¹¹

Country ownership does not necessarily result in just outcomes: although international intermediaries must partner with a central ministry when they manage and disburse financial resources, they often choose ministries that agree with their preferred solutions. With direct-access climate finance, countries tend to promote a sectoral approach. Both scenarios lead to one-size-fits-all solutions that overemphasise technological and infrastructure solutions.

What works in delivering local climate action?

This briefing is part of our 'Money where it matters' series on what works in delivering local climate action. The series presents the thinking from a range of actors' experiences — gleaned from evaluations, reports, interviews and stakeholder meetings. Read more at: www.iied.org/mobilising-money-where-it-matters

Climate finance reform: principles for business unusual

Achieving a rapid, whole-of-society response to the triple crises will require significant reform of the climate finance system. There needs to be deliberate investment in developing long-term strategies to identify delivery mechanisms that reach across societies, give meaningful voice to local communities and enable more inclusive and equitable climate solutions.

Building on our earlier work and derived from discussions with intermediaries, global funds and grassroots organisations, these **principles for a reformed system** outline factors that have already led to good practice.¹²

1. Patience and predictability: countries need regular, predictable allocations over at least seven years to build effective institutions that can develop, test and adjust delivery mechanisms that support governance and investment in effective local climate action. Donors must not impose expected results, administration rules or governance arrangements. Rather, these should be negotiated through long-term partnerships between national and local institutions, donors and technical partners. Building an open and accountable finance system will allow local partners to innovate in tackling the underlying drivers of climate vulnerability.

2. Flexibility to learn and adjust: delivery mechanisms are needed that seek to enable whole-of-society responses to tackle the triple crises and underlying drivers of vulnerability in order to resolve highly complex issues. We must invest in experimentation, not look for elegant solutions. Learning rapidly from clumsy solutions will create agile delivery mechanisms that can adapt to rapidly changing contexts. Ensuring the delivery mechanisms have the authority and resources to make decisions at the right level and healthy monitoring and learning budgets will also deliver context-specific solutions. Donors should therefore commit finance based on assurance of the governance structure, rather than expectation of specific results.

3. Ability to risk seek to incubate innovation: it takes time to develop effective delivery mechanisms that can support the governance of and investment in distributed climate action across a country. It also takes time and trust to develop an understanding between stakeholders with different interests. Responding to immediate needs means that initial priorities may not appear to be strategic. But donors often only release financial support

once partners have proven their track record in financial management and results delivery. And as most developing country institutions struggle to meet GCF requirements, they cannot develop a track record. Accountability mechanisms should enable learning and adjustment through checks, not control. After all, learning from experience is a sign of success. Donors should commit long term to incubate strategic delivery mechanisms with the potential for transformative action, strengthening core institutional capabilities to meet benchmarks.

4. Robustness in the face of climate futures: given the complex and interrelated nature of the triple crises, actors can no longer ignore uncertainties. Instead, they must ensure their decisions are supported with climate information, integrated with local and technical knowledge systems. Considering the possible range of climate futures would minimise regrets of poor investment or maladaptation, leading to decisions that value flexibility and are agile enough to respond to changing conditions. Investing first in low-regret options that are effective against all climate futures would help build redundancy into systems, ensuring they could operate in extreme events. To offer transformative potential, climate finance must support robust decision making.

5. Convergence across interventions: delivery mechanisms need to support local action at household, enterprise and landscape levels. Layering them will ensure they operate effectively and help us learn what works collectively. There have been efforts to coordinate projects; there must now be effective collaboration within specific places. Local and national government structures and producer and grassroots organisations offer a framework for strengthening coherence across responses, which would support rapid learning and maximise the impact and efficiency of climate finance.

Implications for current practice

Although the climate finance landscape faces deep challenges, it is feasible to enshrine our 'business unusual' principles largely within existing structures. The first climate finance commitment period under the 2010 Cancun Agreement comes to an end in 2020. With countries due to make a new commitment over the coming year, the time for reform is now.

Developing countries are demanding change. At the UN Climate Action Summit in September 2019, the 47 LDCs set out their 2050 vision for a coherent climate finance architecture where

70% of climate finance supports transformative local-level climate action. They also asked for a new financial partnership to strengthen their institutions' climate capabilities at national and local levels.¹³

There is strong evidence of a 'missing middle' in finance provision. There are small grants for innovation and larger investments for proven approaches; but very little finance is available for incubating innovative approaches that support early growth, learning and adjusting with experience.^{4,14,15} With their focus on short-term, sectoral projects, financing intentions do not match the scale of the challenge developing countries face in tackling the poverty, climate and nature crises coherently.

As such, we recommend that:

- Small grants refocus on building the long-term vision for whole-of-society responses and enabling experimentation in what will work: They should support politically astute processes that enable meaningful engagement across stakeholders, finding synergies and resolving trade-offs to create the political courage for transformative action
- Medium grants focus on incubating strategic delivery mechanisms that integrate local and national actors and enable cross-sectoral collaboration, building their capabilities and track records so they can access larger and longer-term finance commitments, and
- All climate finance providers commit to building systems for the long-term response needed to tackle the scale of the climate change challenge: they must prioritise investments in the agility of countries' institutions and in accountability systems that enable learning and adjustment at every level. Intermediaries should aim to work themselves out of a job within a given timeframe, leaving a legacy of capable institutions.

An emerging mandate for climate finance

The world's poorest communities have done least to cause climate change, yet their countries face the greatest risks from it. Developed countries commit climate finance to help these countries onto climate-resilient, low-emission pathways to development. But the latter have the most at stake and are the main investors in their own futures.¹⁶

Climate finance must help country governments and their development partners reduce risks and help communities thrive by strengthening the core systems that support the whole of society with strategic delivery mechanisms. This will enable climate-informed governance and investment at local and national levels and make development, private and households' investment decisions more effective and efficient. Focusing on governance, institutions and power relations does not necessarily increase the cost of climate action; but patient, predictable finance does increase impact.

Given the complexity of responding to the triple crises, strengthening institutions' climate capabilities with accountability mechanisms is paramount to enable rapid learning with communities on what really works. Climate finance providers must therefore stop focusing on technical solutions delivered through short-term parallel projects. Instead, they must reimagine how development happens and start experimenting. Only then will they develop the right delivery mechanisms that aggregate and influence multiple actors' decisions, thus truly transforming systems to be climate resilient and low emission.

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Knowledge Products

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Notes

¹ The UNFCCC Standing Committee on Climate Finance defines its aims as reducing emissions, enhancing sinks of greenhouse gases and reducing the vulnerability of — and maintaining and increasing the resilience of — human and ecological systems to negative climate change impacts. UNFCCC (2014) Summary and recommendations by the Standing Committee on Finance on the 2014 biennial assessment and overview of climate finance flows. See: https://unfccc.int/sites/default/files/2014_ba_summary_and_recommendations_by_scf_on_the_2014_ba.pdf / ² Patel, S, Shakya, C, Rai N and Skinner J (forthcoming) Climate finance for the transition: why hydropower matters. IIED, London. / ³ Oxfam (2018) Climate finance shadow report 2018. See: www.oxfam.org/en/research/climate-finance-shadow-report-2018 / ⁴ Soanes, M, Shakya, C, Walnycki, A and Greene, S (2019) Money where it matters: designing funds for the frontier. IIED, London. pubs.iied.org/10199IIED / ⁵ Metcalfe-Hough, V, Fenton, W and Poole, L (2019) Grand Bargain annual independent report 2019. ODI, London. <https://tinyurl.com/wjzghlr> / ⁶ Oxfam (2018) Localization in aid – why isn't it happening? What to do about it? <https://oxfamblogs.org/fp2p/localization-in-aid-why-isnt-it-happening-what-to-do-about-it> / ⁷ Global Sustainable Investment Alliance (2018) Global Sustainable Investment Review 2018. / ⁸ SEforAll (2019) Energizing finance: understanding the landscape 2019. / ⁹ Rai, N, Best, S and Soanes, M (2016) Unlocking climate finance for decentralised energy access. IIED, London. <https://pubs.iied.org/16621IIED> / ¹⁰ See GCF Accredited Entity Directory: www.greenclimate.fund/how-we-work/tools/entity-directory / ¹¹ Kaur, N and Geoghegan, T (2013) How climate finance can support sustainable development. IIED, London. <https://pubs.iied.org/17169IIED> / ¹² This builds on earlier work to distil broader principles of local climate action, summarised in Soanes et al. (2019, see note 4) and Lewis, S, Shakya, C and Steele, P (2017) Money where it matters: financing the Sustainable Development Goals and Paris Agreement through local finance. IIED, London. <https://pubs.iied.org/17419IIED> / ¹³ LDC Group (2019) LDC 2050 Vision: towards a climate-resilient future. <https://tinyurl.com/wklhzxa> / ¹⁴ Alibhai, S, Bell, S and Conner, G (2017) What's happening in the missing middle? Lessons from financing SMEs. World Bank. / ¹⁵ Barnett, M, Omari-Motsumi, K and Schalatek, L (2019) Broken connections and systemic barriers: overcoming the challenge of the 'missing middle' in adaptation finance. Global Center on Adaptation/WRI. / ¹⁶ Eskander, S and Steele, P (2019) Bearing the climate burden: how households in Bangladesh are spending too much. IIED, London. <https://pubs.iied.org/16643IIED>