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Climate finance: why institutions matter

Introduction

International climate funds, such as the Green Climate Fund (GCF) and Adaptation Fund, offer a limited but important source of climate finance for LMICs[1]. While small in scale – three-quarters of climate finance flows are in fact from domestic sources (see Figure 1) – international climate funds are additional, flexible, and cheaper than a comparable loan from a development finance institution (Climate Policy Initiative, 2020).

They are also intended to catalyse greater sources of public or private sector financing by piloting innovative new approaches to both climate change mitigation and adaptation. However, accessing these funds is not straightforward and (partly by design) requires governments to strengthen their prioritisation, planning, implementation, monitoring, reporting, and verification functions (see QR code for our paper on mainstreaming climate change within governance systems).

Key messages

- **Accessing international climate funds requires low- and middle-income countries (LMICs) to invest in institutional capacity to prioritise, prepare, implement, and monitor climate change projects and programmes.**
- **This investment will bring a double return: stronger institutions will not only help countries to access climate finance from various sources but will also strengthen the impact of this finance.**
- **There is no single correct model for the institutional structure for delivering these functions: countries will need a bespoke approach.**
- **A coordinating entity is needed that has clear authority and sufficient capacity to coordinate between line ministries and sub-national governments.**
- **Governments should be strategic in setting priorities for international climate funds, based on national, sectoral, and sub-national priorities, and how these funds complement domestic sources of finance.**
- **Sectoral ministries and sub-national governments need to enhance their capacity to develop relevant and successful funding proposals.**
- **Governments should be pragmatic and strategic when investing in Direct Access Entities (DAEs), focusing on those which have both the capacity to meet the accreditation criteria and a mandate and expertise which aligns with the government's priorities for the funds.**

[1] International climate funds are multilateral funds that support climate change mitigation and/or adaptation activities. The Climate Funds Update identifies 23 such funds, with some of the largest being the GCF, the Clean Technology Fund, the Least Developed Countries Fund, the Global Climate Change Alliance, the Global Environment Facility, and the Adaptation Fund. While this paper is relevant for all such funds, it focuses particularly on the GCF and the Adaptation Fund, given their emphasis on country ownership.

Countries have to invest in building their 'readiness' for climate finance so they are able to access global climate funds, and to ensure that any funds received deliver real value and impact for the country. There is therefore a clear return on investment rationale for governments, which is further helped by the GCF and Adaptation Fund offering grants for related capacity building activities.

There is no single correct model for the institutional structure for delivering these functions. This paper explores how countries should address four critical institutional capabilities, arguing that form should follow function, and it provides examples of how different countries have approached this.

Box 1: Prioritisation of climate financing needs and institutional structure in Cambodia

In 2021, Cambodia set out its priorities for the GCF in its GCF Country Programme, including a short-list of around five projects the country plans to submit over the next few years. Oxford Policy Management (OPM) provided capacity support and technical inputs in particular to line ministries that were struggling to engage in the process due to limited understanding of the GCF. This involved formal training on GCF processes and how to develop funding proposals, as well as informal discussions on why they should invest resources in the process and the relevance of climate finance for their sector.

This process highlighted the need to strengthen the institutional architecture for engaging with the GCF and other funds. OPM's subsequent policy and institutional assessment identified the need for greater coordination across government, and with non-government actors, as well as increased capacity within the Nationally Designated Agency (NDA). OPM provided options, based on experiences from other countries, for establishing an NDA Secretariat that would be responsible for coordinating and mobilising all external climate financing. This would have a dual purpose and structure, with a Climate Finance Coordination Unit and an Appraisal Panel to formally review and approve all submissions to the funds. The National Council for Sustainable Development is currently in the process of finalising its new structure, including defining detailed roles and responsibilities, and its composition.

Cross-government decision-making and coordination

An institution is required that can coordinate between multiple sectoral line ministries (such as those managing energy, water resources, infrastructure etc.) that have a crucial role in planning and leading the design and delivery of projects in their sector, and sub-national governments, which are best placed to identify local priorities, are directly involved in the delivery of the project, but are often overlooked as the 'missing middle' (Omari-Motsumi et al., 2019). This institution should be granted authority by the highest decision-making body, such as the prime minister's office, so that decisions made by the coordinating institution are respected and enforced.

Many countries have established a dedicated coordination entity, often called a Climate Finance Unit (CFU), which may be located within the ministry of finance or key sectoral line ministry, such as the ministry of environment. The CFU is sometimes the same entity as the NDA for coordinating with the GCF, or the two may work closely together.

To strengthen decision-making and coordination capabilities, governments should do the following:

- **Empower and strengthen CFUs:** In many cases, the CFU needs to be granted sufficient authority and capacity to bring stakeholders together. For example, in Nepal, the CFU works through an existing high-level inter-ministerial committee on climate change. In Pakistan, the CFU has developed clear terms of reference, so that all stakeholders – particularly other government entities – understand its role and mandate.

- **Designate focal points** in relevant line ministries and sub-national governments, which should invest in their own capabilities for engaging with climate funds, such as dedicated climate finance cells responsible for coordinating with the national-level institutions and delivery partners on accessing climate funds. See Box 2 for an example from India.

Box 2: A special purpose vehicle for climate change management in Assam, India

The State Government of Assam in India has put in place an innovative structure for coordinating the state's strategy on climate change and mobilising climate finance in the state. With OPM's support, the government established a special purpose vehicle, the Assam Climate Change Management Society (ACCMS). The incentive for doing so was the desire to access the National Adaptation Fund, which required an institutional structure and sign-off of funding proposals. The ACCMS has high-level authority from its Governing Body and Steering Committee, chaired by the Chief Minister and the Chief Secretary, respectively. However, it has day-to-day autonomy, with a Chief Executive Officer managing the functions with a team of nodal officers from 14 sectoral line departments. The ACCMS is responsible for implementation of the State Action Plan on Climate Change, and for reporting on progress by each relevant department. However, it is most active in coordinating with donor agencies on the scope and design of climate programmes.

Setting national priorities for global climate funds

The GCF is rightly pushing for countries to move away from ad hoc proposal submissions and towards setting out their strategic priorities (for the fund) in a GCF Country Programme document. This requires strategic decision-making and a prioritisation process, which is relevant for climate finance from all sources. One particular challenge is to mobilise all relevant line ministries to submit funding priorities and to participate in the prioritisation process. In Cambodia, the NDA had to proactively reach out and meet each relevant line ministry individually, raise their awareness of the GCF, and provide expert support in developing GCF funding ideas (see Box 1).

To strengthen capabilities in priority-setting, governments should do the following:

- **Undertake holistic thinking on the role of global climate funds alongside other climate finance sources:** Given that international climate funds will only offer a small fraction of what is required to finance a country's adaptation and mitigation needs, CFUs can also coordinate and mobilise other sources of climate finance. In Ethiopia, the CFU is undertaking a climate change expenditure review, involving tagging public budgets by the extent to which they contribute to adaptation and/or mitigation (see Box 3). This will help to identify the key financing gaps and opportunities for climate funds, as well as potential sources of co-financing for the country's funding proposals to the GCF and others.

- **Translate national climate policy into sectoral and sub-national priorities:** This is a first step to allow these stakeholders to influence the decision-making process on accessing global climate funds. Line ministries, such as agriculture or energy, may already have detailed climate change strategies in place, while others still need to develop their priorities. Some countries, such as India and Kenya, have also undertaken large sub-national climate planning exercises, but these are often incomplete. In Nepal, the seven provincial governments are preparing climate change strategies and action plans, and putting in place a focal entity within their own structure.

Box 3: Aligning domestic and international sources of climate financing in Ethiopia

In Ethiopia, the Climate Resilient and Green Economy (CRGE) Facility is the nodal institution for climate change, sitting within the Ministry of Finance. OPM is supporting the facility, under the Building Resilience in Ethiopia programme (2019–2022), to mobilise additional climate financing from both international and domestic sources. This includes direct support to accessing international climate funds, by building the capacity of the CRGE to coordinate engagement across sectors and institutions, and by strengthening technical skills in proposal writing. At the same time, OPM is supporting the CRGE to review public expenditure to identify the climate 'relevance' of each budget line and to highlight where there are opportunities to deliver greater climate co-benefits from existing development investment.

These parallel streams of work are reinforcing. For example, the domestic budget review will identify gaps which could be filled by global climate funds, as well as opportunities to deliver on the co-financing requirement of the GCF.

Developing winning funding proposals

LMICs often struggle to design and develop full funding proposals for international climate funds due to capacity constraints. As a result, NDAs often submit the proposals of international development partners who are able to access funds directly (with NDA endorsement). This works against the objective of building country ownership.

To strengthen proposal development capabilities, governments should do the following:

- **Strengthen technical capacity for proposal development:** Sectoral ministries are best placed to design and develop the funding proposal, ideally in combination with local governments and other stakeholders who will be involved in project delivery. In Pakistan, the CFU itself mentored and supported various line ministries to develop detailed project proposals, which was effective in mobilising nearly US$ 100 million from the GCF alone between 2016 and 2019.

- **Move beyond ad hoc external support for proposal development:** The GCF and others provide technical support for project design through Project Preparation Facilities and similar. However, this usually involves consultants providing one-off support to drafting the proposal and does not build longer-term capacity. Governments should insist that their officials are mentored by the consultants throughout the development process, rather than handing over responsibility to consultants.

Direct access to climate funds

Directly accessing financing, without going through an international intermediary institution, is extremely attractive to LMICs and is crucial in order to realise the ambition of country ownership of the funds. However, the process of accrediting DAEs is complicated, lengthy, and resource-intensive. A DAE in Bangladesh reported that accreditation had taken almost two years and involved uploading 188 documents (Tanner et al., 2019). The accreditation criteria, particularly relating to fiduciary principles and standards and environmental and social safeguards, are challenging for many entities. In reality, the accreditation of DAEs may not yet be realistic for all countries, and should instead be part of their longer-term institutional strengthening objectives.

To strengthen direct access capabilities, governments should do the following:

- **Be pragmatic about the potential for DAEs:** Even after undertaking the accreditation process, the DAE will likely secure only a few funded projects. In the case of Nauru, a small Pacific island state, there are very few international entities that are interested in, or have a mandate for, working on climate change in the country, and the government is therefore interested in establishing a DAE, but in reality there are few, if any, national entities likely to be able to meet the accreditation criteria.
- **Strategically select DAEs:** Countries have to select DAEs which have both the capacity to meet the accreditation criteria and a mandate and expertise which aligns with the government's priorities for the funds. In Nepal, the government is developing a Climate Finance Strategic Roadmap, which includes as a priority diversifying and building capacity for national DAEs to ensure there are entities that are able to deliver projects in the government's priority sectors (see Box 4).

Box 4: Climate Finance Strategic Roadmap for Nepal

In Nepal, the Ministry of Forests and Environment is carrying out a comprehensive process of reviewing its success to date in engaging with global climate funds, and setting strategic priorities for addressing institutional barriers. OPM is supporting the government to develop a comprehensive strategy to scale up access to, manage, and utilise climate finance, while managing the recovery from the COVID-19 pandemic. This includes strengthening and widening the scope and role of the CFU, as well as establishing a joint NDA spread across more than one government entity. Currently, Nepal has two entities that are accredited by the GCF – the Alternative Energy Promotion Centre and the National Trust for Nature Conservation – but the government is keen to expand and diversify these entities to ensure all of its priorities can be directly funded. The government is also considering various modalities for improving institutional coordination, particularly in the new federal structure, which devolves many relevant functions to sub-national governments.

In conclusion, efforts to strengthen the domestic institutional architecture needed to enhance access to and use of global climate funds will also bring wider benefits for climate and finance planning. The incentive of receiving additional and low-cost financing can mean there is political and bureaucratic interest in strengthening institutions, and reform can happen quickly. There is therefore a window of opportunity to put in place an effective institutional set-up to manage climate financing in general, covering both domestic and international sources.

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