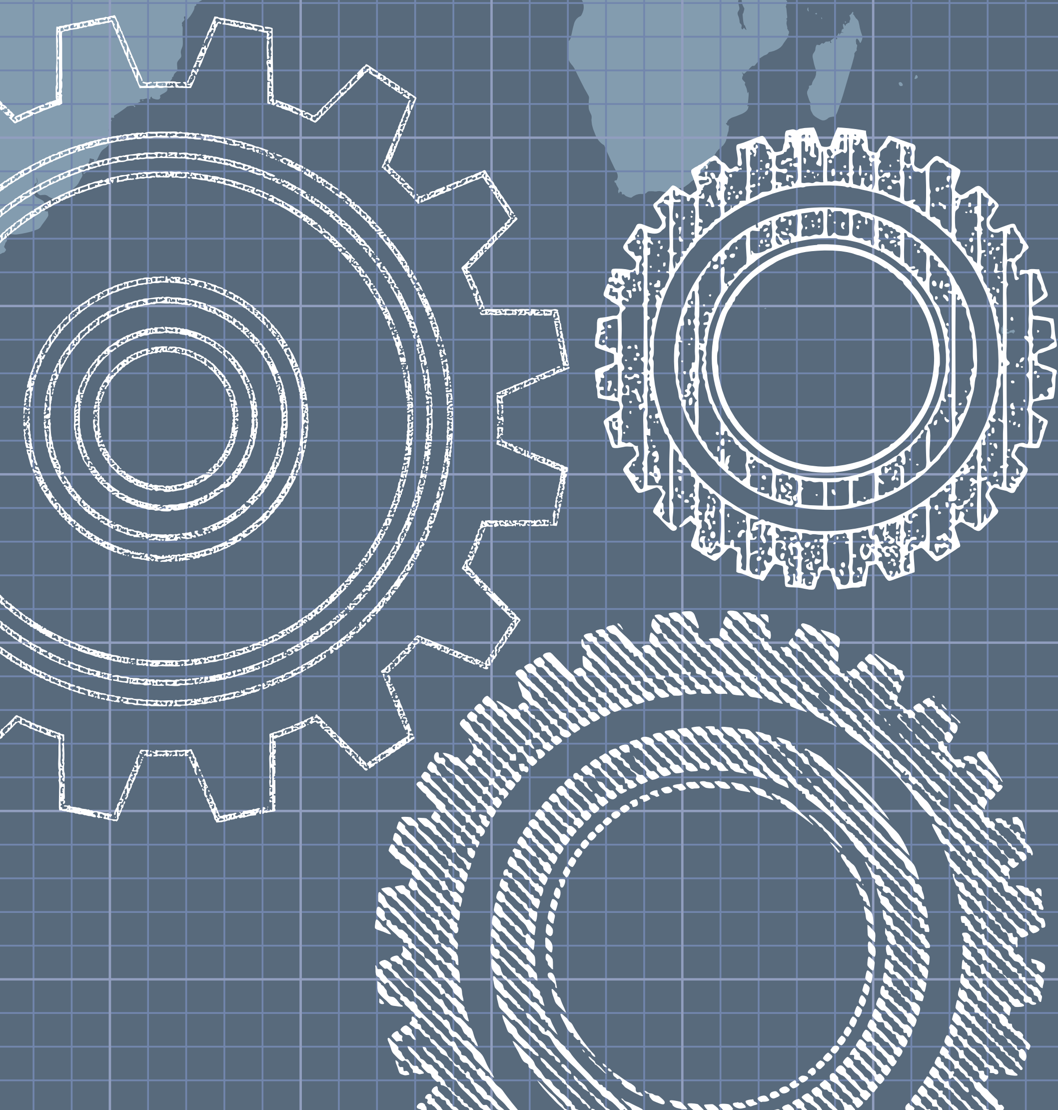
United Nations Development Programme

Readiness for Climate Finance

A framework for understanding what it means to be ready to use climate finance



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Contents

CONTENTS

LIST OF FIGURES

LIST OF TABLES

LIST OF BOXES

Preface and Overview

This discussion paper is part of a series of publications that draws upon the experience generated by the United Nations Development Programme's (UNDP) climate change adaptation and mitigation activities in some 140 countries over the past two decades.

The paper presents a framework for understanding what it means to be "ready" to use climate finance in a transformative way at the national level. In the context of the financial challenges posed by climate change, including the scale of financing required and the barriers to the effective use of climate finance (international and domestic; public and private), the paper presents a four-part framework through which to understand the different components of readiness and the specific capacities needed to underpin it. In this paper *climate finance readiness is defined as the capacities of countries to plan for, access, deliver, and monitor and report on climate finance, both international and domestic, in ways that are catalytic and fully integrated with national development priorities and achievement of the MDGs.*

By laying out this framework, the paper attempts to organise the many targeted support programmes, guidebooks, publications, and toolkits on climate finance—offered by a range of international, regional, and national partners. This paper itself is not intended as a guidebook per se, but rather as an introduction to both the national challenges arising from increasing flows of climate finance and some examples of the routes available for overcoming these challenges. The intended audience for the paper is policy-makers at both the international level and national level in developing countries. For an international audience the paper illustrates the critical importance, but also the breadth and complexity, of what is need to be "ready" at the national and local level. For a national audience, the paper aims to provide a framework to organise the plethora of tools, mechanisms, and modalities available from different development partners—ultimately improving the capacity of policy-makers to put in place nationally-appropriate systems to manage climate finance.

To support national policy-makers move forward, this paper also highlights a number of tools and examples available to overcome barriers identified in the paper and build ready systems at the national level. For example, UNDP has developed a suite of technical guidebooks that are referred to throughout the text and for which this paper serves as a chapeau, including:

- Preparing Green, Low-emission, Climate-Resilient Development Strategies: Executive Summary
- Catalyzing Climate Finance
- Catalyzing Finance: Financial Model and Technical Annexes
- Sector-Wide Approaches to Climate Finance (forthcoming)
- National Climate Funds
- MRV Systems for Climate Finance and Actions (forthcoming)

Introduction: Policy Context

The scale of the climate change challenge before the international community is vast. Holding global temperatures at 2 degrees C above pre-industrial levels will require a transformation in production and consumption processes across all countries. This transformation must involve a country-driven shift toward policies and technologies that catalyse new investments and mainstream climate change into existing systems. In addition, significant support must be provided to build the resilience of these systems, particularly for the poorest and most vulnerable in developing countries who have contributed least to the buildup of greenhouse gases in the atmosphere.

The scale of the financial challenge to achieve this transformation is in the order of hundreds of billions of US dollars. The financing available and the capacities to absorb resources vary across different countries; whereas developed countries have internal capacities to generate and use climate finance, many developing countries lack the financial resources necessary or the institutional, policy, and skills systems to use climate finance effectively. The impacts of these barriers are heightened for vulnerable groups, such as the poor and women, threatening the achievement of poverty reduction goals and the MDGs.

The international community has responded to this scarcity by increasing North-South public finance transfers for climate change activities over recent years. For example, governments have designed and reformed institutions such as the Global Environment Facility, the Adaptation Fund, the Climate Investment Funds, and most recently the Green Climate Fund, as well as new evolving financial mechanisms such as performance-based payments for reducing emissions from deforestation, degradation, and forest conservation (REDD+) and clean energy. In addition, developing countries have increased their own public spending on climate change activities, including through national budgets. However, while extremely important, increasing supply of public finance alone will not promote transformations in production and consumption processes. The scale of the financing required—which is likely to be many times the size of present levels of Official Development Assistance (ODA)—and the cross-sectoral nature of the climate challenge mean that volumes of international public finance will be far from sufficient.

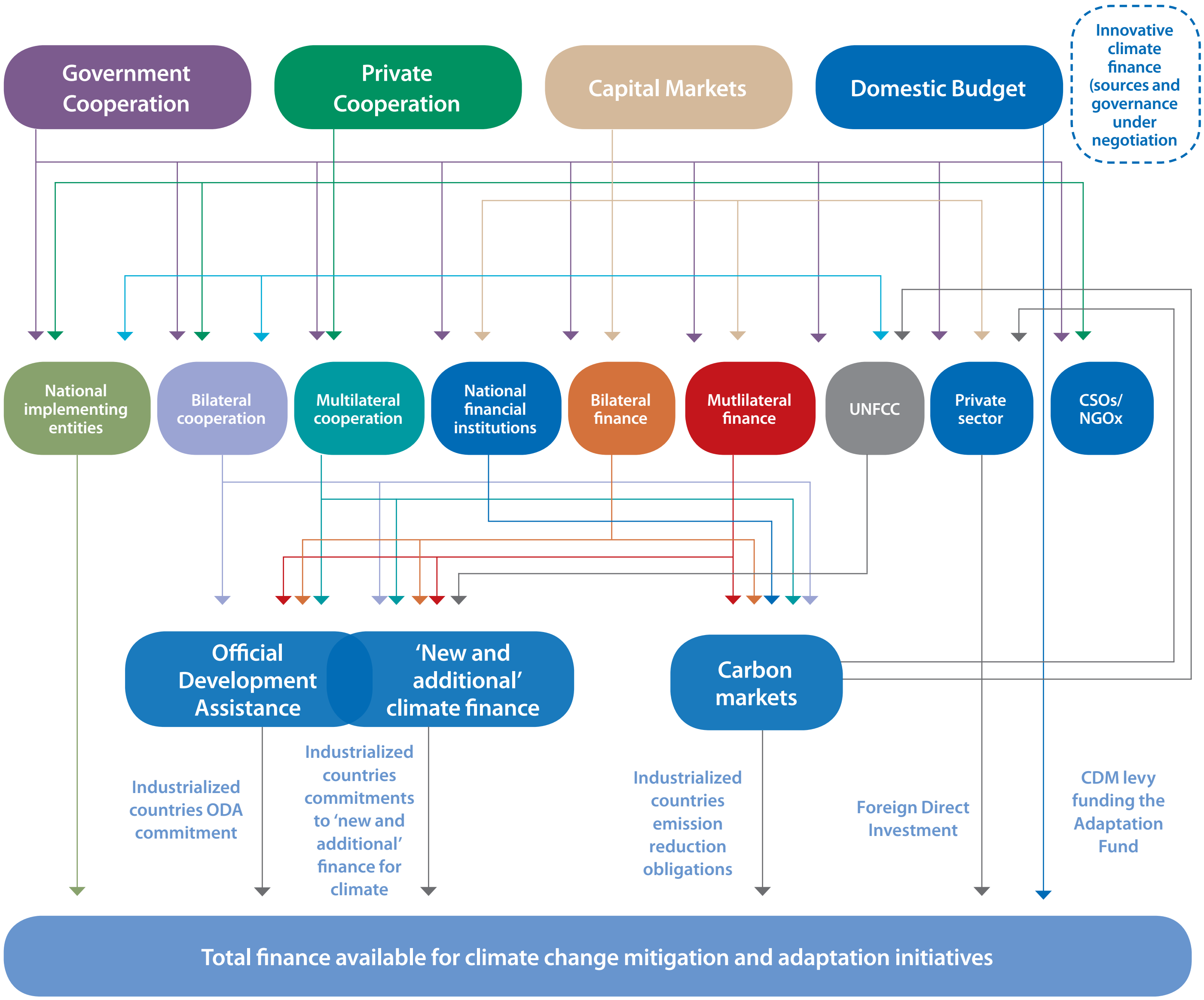
Therefore actions to promote low-emission and climate-resilient development must be largely public policy-based and private-sector financed where international public finance is used catalytically alongside much larger capital flows (AGF, 2010). For climate finance to be effective the international community must do more than simply increase resource flows toward isolated local interventions. The international community must address three key issues required to promote transformations at the national level:

"Actions to promote low-emission and climate-resilient development must be largely public policy-based and private-sector financed where international public finance is used catalytically alongside much larger capital flows."

- First, international public finance cannot simply be used as an end in itself to finance isolated interventions. The International Energy Agency (IEA) estimates that approximately 40% of the global investment needed to transform energy systems alone will likely come from households, 40% from businesses, and just 20% from government (IEA, 2009). In this context, the limited international finance must be used to support countries crowd in private sector and local finance and so drive transformational change at the scale required. Limited public finance must thus be used to develop an enabling environment at national and local levels that redirects existing public investments and provides the incentives for private finance to invest in low-emission and climate-resilient activities.
- Second, with more than 50 international public funds, 60 carbon markets and 6,000 private equity funds already providing "green" finance, mobilising external finance in ways that are aligned with national systems and priorities is extremely complex (**Figure 1**). Furthermore, multiple types of finance (such as carbon finance[1], finance for REDD+, etc.) and a variety of tools for delivering and packaging financing (such as sectoral approaches, performance-based payments, etc.) are rapidly emerging and evolving presenting additional challenges. International public finance must be used to support systems that are able to navigate and take advantage of this landscape by accessing and using this multitude of finance.
- Third, decades of research on development assistance indicates that the effectiveness of development actions, such as those needed to promote transformational change to address climate change, are severely undermined by isolation from mainstream national development planning and poverty reduction strategies (OECD, 2005). Without integration, actions are not fully mainstreamed into existing activities and risk being offset or undermined by other development activities. Thus public finance must be used to promote integration and ensure that developing countries are able to adequately embed climate finance within and alongside national development planning.

[1] Finance generated through offset projects that issue carbon credits for sale on international compliance and voluntary markets

Figure 1: Existing climate change finance flows (Source: UNDP, 2011a)



Attention to these issues has grown increasingly significant within international policy discussions on climate finance. In particular, there has been increased focus on building and strengthening national systems so they are "ready" to use climate finance effectively in ways that promote transformations in production and consumption patterns at the national level. This focus is embodied in recent international and national policy discussions on the concept of "readiness". In particular, the term is specifically referred to within the governing instrument of the Green Climate Fund (GCF), which states that *"The Fund [GCF] will provide resources for readiness and preparatory activities and technical assistance".*

However, at present no clear framework exists through which to understand what is required to be "ready" to use climate finance in an effective or transformational way or how to get there. While development assistance practitioners have significant experience and analytical material in assisting countries to access development finance more generally, there is a need to specifically understand the national systems required to use international and domestic climate finance in ways that will transform production and consumption processes. In particular, a framework for readiness is critical for the GCF to effectively support activities that will drive low-emission, climate-resilient development.

This paper responds to this gap by laying out a framework for conceptualising the elements of what it means to be ready for climate finance and taking stock of the key capacities required to build and strengthen these elements. The framework draws on examples and is the result of mapping and grouping national capacities and systems, rather than developing a top-down prescriptive model for all countries. It aims to provide both international and national policy-makers with an overview of the types of national systems needed to plan for, access, deliver, and monitor and report on effective climate finance, and the forms of support needed to build and strengthen these systems.

The paper begins by outlining the framework for understanding climate finance readiness in the context of the climate change challenge and then moves on to considering the different elements of this framework drawing on examples of current activities on the ground.

What does it mean to be ready for climate finance?

"Readiness" for climate finance is a relatively new term that has been used for a number of specific areas