

The SEI Initiative on Climate Finance

Avoiding the most dangerous impacts of climate change will require the global economy to become less carbon-intensive and more resource-efficient. Developing countries will have to “leapfrog” over conventional technologies, and build “green” economies and energy systems from the start. At the same time, they will need to adapt to the unavoidable impacts of climate change caused by past greenhouse gas emissions.

Climate change poses enormous financial challenges. The combined cost of mitigating greenhouse gas emissions and adapting to the unavoidable impacts of climate change has been estimated at several hundred billion U.S. dollars per year, with the most pressing needs in developing countries. Mobilizing the right kinds of finance to enable the necessary investments is therefore essential to reducing climate risk and avoiding the worst impacts of climate change.

Within the global climate policy regime under the United Nations Framework Convention on Climate Change (UNFCCC), finance is seen as one of three pillars of support for action in developing countries, along with technology transfer and capacity-building. Despite disagreements on many aspects of climate policy, there is broad agreement that developed countries should mobilize climate finance that can support adaptation and mitigation in developing countries.

There are commitments to mobilize 100 billion USD per year for this purpose from 2020 onwards, yet how these funds will flow is far from straightforward. The global climate finance architecture is inherently complex, including multilateral and bilateral funding streams as well as private sector investments

Along with a major new UNFCCC agreement expected to be reached at the Paris Climate Change Conference in December, 2015 has also brought two other new global governance regimes: the Sendai Framework for Disaster Risk Reduction 2015–2030 and the Sustainable Development Goals (SDGs). Each of these agreements requires finance for implementation. This raises questions about how they might interact and how to best align them to achieve the best outcomes for developing countries.

This document describes the SEI Initiative on Climate Finance, which focuses on how to ensure that climate finance serves to achieve meaningful, long-term change in economic and social development trajectories, particularly for developing countries.

A focus on effectiveness

As climate finance flows – and pledges – increase, so do concerns about whether funds are being delivered as promised and achieving the kinds of change envisaged at the global level and within developing countries. Thus, gauging the effectiveness and efficiency of climate finance is a priority.

Yet just quantifying climate finance support can be difficult. The data can be thin and difficult to compare, with little transparency about the flow of funds. For private finance, data may not be publicly available at all.



A field technician for the USAID-funded HARVEST climate resilience and food security programme in Cambodia works with a local farmer.

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Defining effectiveness and efficiency is also challenging, because the different actors in the finance chain often have very different objectives and priorities. Moreover, the use of finance is not always transparent, and often the merits of alternative uses are unknown. And climate finance may be only one of several flows, both public and private, that support or undermine efforts to build local resilience or reduce GHG emissions. Any assessment of effectiveness therefore needs to consider the net impacts of climate finance on the achievement of climate goals, which poses methodological challenges.

Even defining “climate finance” has proven a challenge. The distinction between climate and development finance is not always clear in accounting efforts, either by international organizations or by individual donors or institutions. Expenditure for social and economic development and disaster risk reduction, for example, can have climate co-benefits. Interpretations of what is considered “adaptation” in particular vary quite considerably among donors and finance institutions.

Finally, it is important to distinguish between climate finance and expenditure. When households or businesses install solar panels, take out a flood insurance policy, or re-plant their land with a different crop variety, they incur real costs, but the upfront costs might be financed from other sources, such as bank loans. Just mapping the relationships between public and private finance and public and private expenditures is a complex task; Figure 1 presents a simplified model.

The SEI Initiative on Climate Finance

SEI has done extensive research and policy analysis on climate finance in the context of the UNFCCC, bilateral and multilateral climate finance (including development assistance), and private-sector finance, including carbon markets.¹

Building on this previous work, this SEI Initiative aims to help identify ways to improve international governance of the emerging global climate finance regime, to help make it more effective, efficient and fair. It also has relevance for the design and implementation of finance for sustainable development

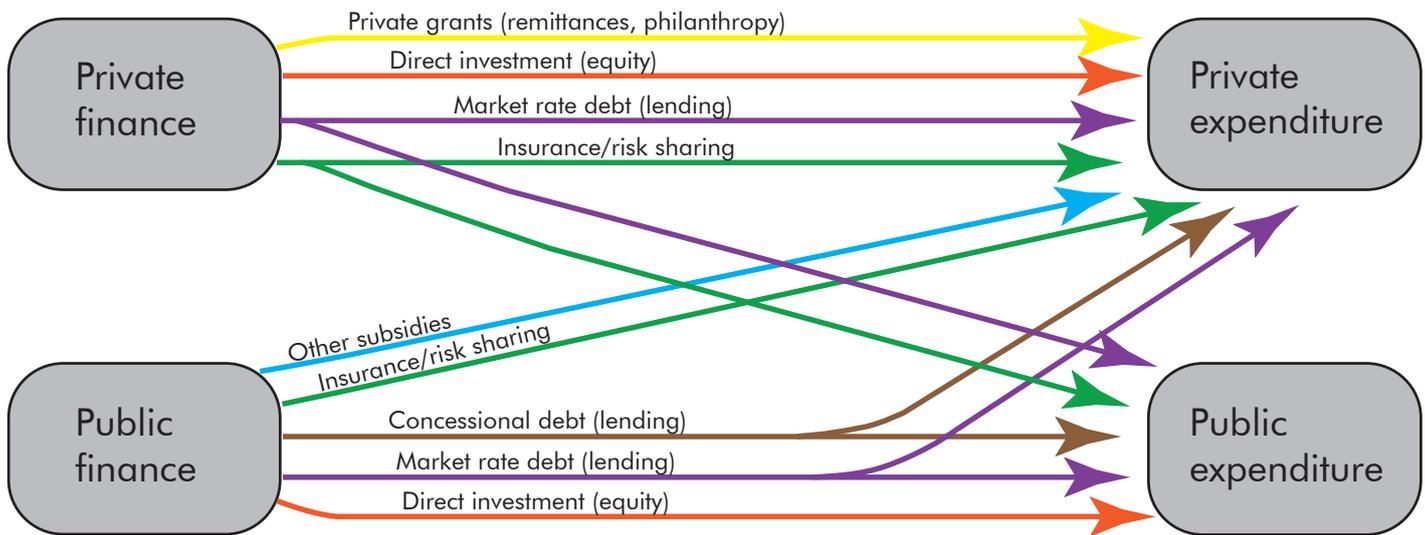


Figure 1: A simplified mapping of relationships between public and private climate finance and expenditures

more broadly, since finance for climate and for development are inextricably linked.

It focuses initially on four key issues that are crucial to the successful mobilization, delivery and scaling-up of climate finance:

- Defining and evaluating “effectiveness” in a way that it can be operationalized and connects with the priorities of developing countries;
- Reinvigorating the global climate finance paradigm to improve effectiveness;
- Private finance and its implications for the use and prioritization of public climate finance; and
- Defining and operationalizing the concept of “intolerable risks” and its implications for finance.

The work takes a multi-disciplinary approach, building on the SEI team’s knowledge of political science, international relations, development studies, economics, human geography, law and other disciplines, as well as an in-depth understanding of international climate policy and negotiations, and other relevant institutional processes. We are also working closely with research partners and stakeholders in both developed and developing countries.

Defining and evaluating effectiveness

Although the concept of “effectiveness” is rising up the agenda, in relation to climate finance effectiveness it is not clearly defined nor universally understood. This lack of clarity – and ultimately a lack of focus on long-term outcomes – reduces the likelihood of finance producing the right kind of long-lasting change for developing countries.

In the emerging literature on climate finance effectiveness, the concept is variously described in relation to inputs to the finance regime (e.g. the amount of funds mobilized), the process of managing these funds (e.g. how funds are allocated and disbursed, the role of different actors) or short-term outputs (e.g. monitoring and evaluation at the project level).

A significant gap so far has been any real focus on the quality and longevity of the actual change induced in livelihoods, resilience and development pathways – probably in part because this is difficult to measure or to attribute to individual interventions. Nonetheless, without understanding what kinds of change

finance is supporting, and how sustainable it is over time it is difficult to say anything meaningful about effectiveness.

The development community offers valuable insights, as aid effectiveness has been studied extensively for decades, with multiple guidance documents published over the years. The 2011 Busan Partnership for Effective Development Co-operation² suggests that the principles by which the quality of aid delivery has been judged can also be used as a lens through which climate finance delivery can also be assessed.

Our work will also draw on the growing literature on the effectiveness of adaptation, including insights from the Intergovernmental Panel on Climate Change (IPCC) Fifth Assessment Report. By bringing together the thinking about effectiveness from different, related fields, it may be possible to propose a more powerful framework for thinking about – and evaluating – the effectiveness of climate finance.

Reinvigorating the global climate finance paradigm

Different kinds of concerns have been raised in critiques of the development- and climate finance “regimes”. Some of these relate to various forms of “fragmentation” and thus relate to the structure of the international finance architecture and the way international public finance is delivered to developing countries.

There are debates over the merits and problems of an increasingly fragmented funding landscape. Fragmentation can take different forms. In international finance, funds are delivered through a wide array of channels. The allocation of funds follows many different sets of norms, and donors and finan-

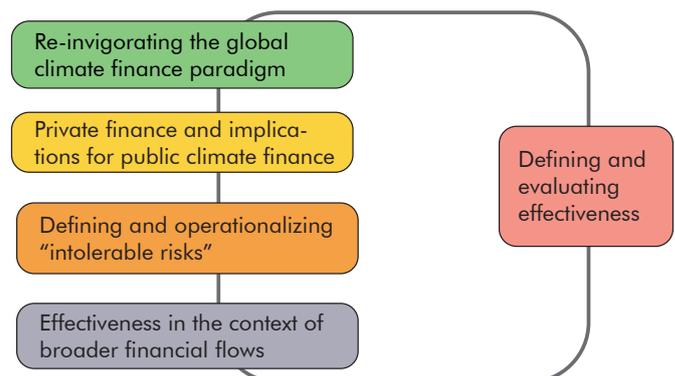


Figure 2: Thematic focus of SEI's Initiative on Climate Finance

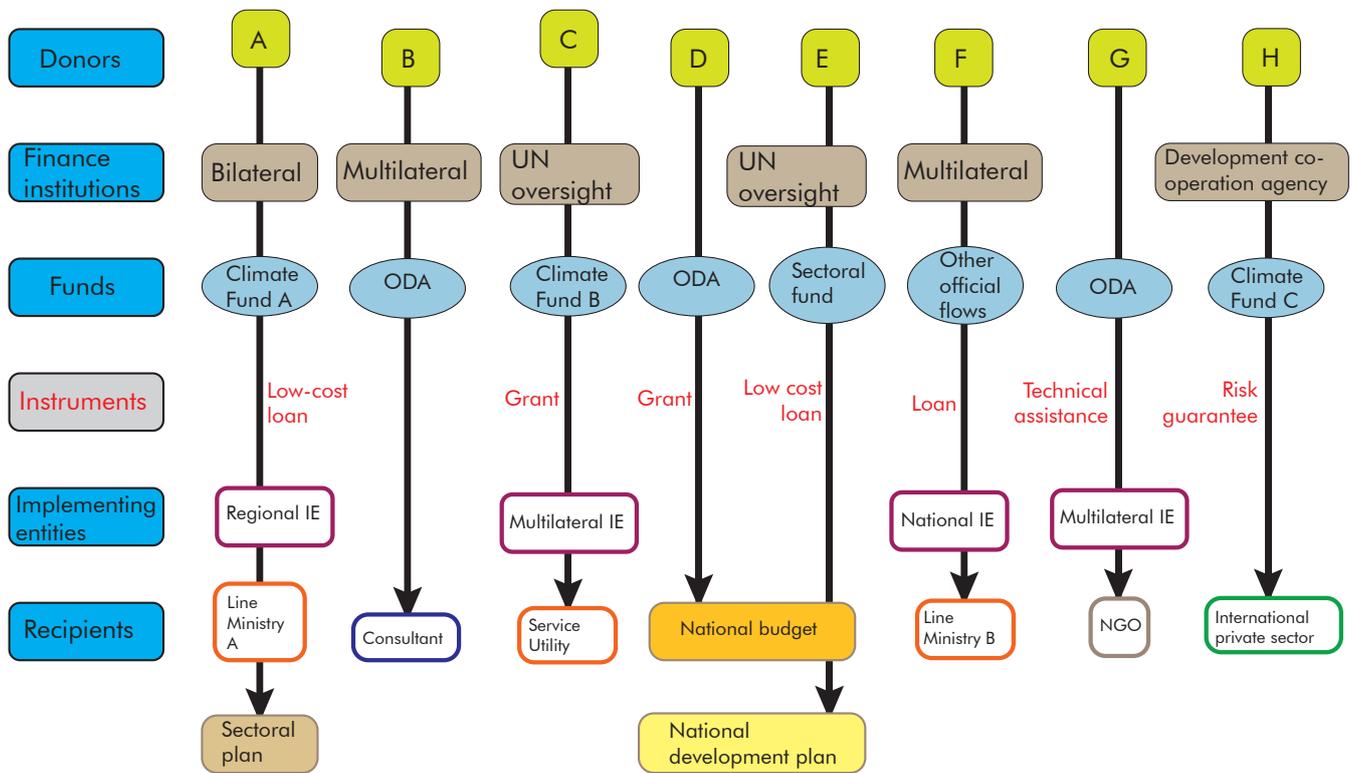


Figure 3: Schematic of the fragmented global architecture for delivering climate finance

cial institutions have different strategic goals and investment priorities. On the ground, there are different entry points for delivery of funds within countries. And the funds themselves often come in small, short-term bundles rather than predictable, long-term commitments.

For developing countries, the sheer number of funding channels, coupled with its packaging as short-term projects and poor coordination among donors and implementing entities, can create high transaction costs and make it difficult to access and use the available climate finance to catalyse long-term, structural change. These problems are compounded where there is also a lack of coherence between climate funding and development aid on the one hand, and wider policy and investment landscapes on the other.

The approval in a single year of the SDGs, the Sendai Framework, and the expected new climate agreement provides an opportunity to think about how to reorient the current regimes – including their finance architecture – to make them more effective, and to have them work better together.

SEI is exploring developing countries’ past experiences with climate finance, to identify some of the common challenges faced in trying to ensure that climate finance effectively addresses local priorities. This includes a case study of the Pacific region. It seeks to understand in what ways the international regime, as depicted in Figure 3, supports and/or impedes effective use of funds at the ground level.

We will also explore the prospects for major change in the current finance paradigm. The question of how finance for sustainable development and climate change might be better aligned is central to this work. In addition to looking at alternative models for the delivery of finance at the global level, we will look at the feasibility of major change. It is not enough to call for reform; we need to understand what it might look like, how it might be achieved, and how it would

work in practice. The current system has a rationale and a set of material and normative factors that perpetuate it.³ We thus need to start by understanding the political economy of the existing system.

Private finance and its implications for public climate finance

Private finance is expected to play an ever-larger role in global climate finance. This dynamic and its potential implications remain relatively unexplored: How should private finance flows be accounted for within the UNFCCC climate finance regime? And can private finance and expenditure be mobilized to generate meaningful climate benefits, in accordance with local priorities?

Interest in the way private finance might support climate-related objectives – both mitigation and adaptation – is increasing rapidly. A wide range of public and private-sector actors – including insurers and reinsurers, investors and individual businesses – are exploring opportunities for private investment in developing countries. However, it is unclear how big a role the private sector can play in meeting climate finance needs – particularly in adaptation, since little analysis has been done on the quantity or nature of existing private investments in developing countries, which makes it difficult to gauge its contributions.⁴

Drawing on insights from development finance, SEI research has raised questions about the viability of private finance for meeting some of countries’ most pressing adaptation needs.⁵ Many studies have also raised questions about the extent to which carbon markets deliver genuine emission reductions. In general, some countries are better positioned than others to attract investment in climate-related activities, due to their overall business environment.

Growing pressure on public coffers makes it crucial to mobilize private finance to contribute to adaptation, mitigation, and sustainable development more broadly. We are examining

the potential role of private finance in adaptation (particularly in Least Developed Countries) and energy transitions (especially in middle-income countries), to highlight existing barriers and opportunities. We are also exploring how developing countries can create enabling environments to make the most of private finance, and how public finance and new or existing mechanisms might encourage scaled-up private investment.

Defining and addressing 'intolerable' climate risks

It is increasingly clear that many climate risks and impacts will exceed what is considered "tolerable".⁶ Intolerable risks are those that threaten to have severe impacts on personal or social norms despite adaptation action. Even if global warming is kept below 2°C, and particularly if it exceeds this threshold, intolerable risks are expected to occur in many parts of the world.

Recognizing this, at the Cancún Climate Change Conference (COP16) in 2010, the Parties established a work programme to consider how to address "loss and damage" from unavoidable climate change impacts. The underlying idea is that different mechanisms beside adaptation are needed to respond to and provide redress for these impacts. At COP20 in 2013, the Warsaw International Mechanism on Loss and Damage was established; one of its functions is to enhance action and support, including finance.

SEI's research is working to fill a number of significant knowledge gaps in this area, and builds on recent research on limits of adaptation, as well as on our expertise in climate finance, disaster risk reduction, and political and institutional aspects of climate adaptation.

Beyond "loss and damage" and "intolerable risks", various other related concepts have emerged in the context of this discussion, including "unavoidable risks" and "residual risks". If these are to be meaningfully operationalized – and financed – there is first a need to clarify what precisely each term means and how they relate to one another: are they synonyms, or does each provide some unique insight into the notion of impacts we cannot avoid or adapt to? How might we distinguish "intolerable" from "tolerable" risks? This has large practical implications for future finance mechanisms.

There is also a gap in our understanding of what social responses to intolerable risks might look like. Risk-sharing mechanisms such as insurance and sovereign risk sharing have been discussed as one tool for this purpose, and are specifically mentioned in the Warsaw Mechanism text. Therefore, SEI's work also focuses on understanding what contribution such mechanisms might make to addressing intolerable risks. This includes reviewing existing risk-sharing schemes and the extent to which these might already be considered to address risks that are characteristic of "intolerable risks" (for example, slow onset events). We will also look in more detail at several case studies of regional risk-sharing mechanisms, to better understand the opportunities and limitations of these kinds of mechanisms for addressing specifically intolerable risks.

To learn more about the SEI Initiative on Climate Finance, including new publications and activities, see: <http://www.sei-international.org/climate-finance>.



An evaluation officer speaks with a family on the Barotse plain that is a beneficiary of the Pilot Project for Climate Resilience in Zambia.

Endnotes

- 1 For an overview of SEI's past work on climate finance, see: Davis, M., Klein, R.J.T., Lazarus, M. and Persson, Å. (2014). *SEI Research Synthesis: Climate Finance and Carbon Markets*. Stockholm Environment Institute, Stockholm. <http://www.sei-international.org/publications?pid=2494>.
- 2 See: <http://www.oecd.org/development/effectiveness/busanpartnership.htm>.
- 3 See, e.g., Van Asselt, H. and Zelli, F. (2014). Connect the dots: managing the fragmentation of global climate governance. *Environmental Economics and Policy Studies*, 16(2). 137–55. DOI:10.1007/s10018-013-0060-z.
- 4 Buchner, B., Stadelmann, M., Wilkinson, J., Mazza, F., Rosenberg, A. and Abramskiewh, D. (2014). *The Global Landscape of Climate Finance 2014*. Climate Policy Initiative. <http://climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-2014/>.
- 5 Atteridge, A. (2011). *Will Private Finance Support Climate Change Adaptation in Developing Countries? Historical Investment Patterns as a Window on Future Private Climate Finance*. SEI Working Paper No. 2011-05. Stockholm Environment Institute, Stockholm. <http://www.sei-international.org/publications?pid=1986>.
- 6 Dow, K., Berkhout, F., Preston, B.L., Klein, R.J., Midgley, G. and Shaw, M.R. (2013). Limits to adaptation. *Nature Climate Change*, 3(4). 305–7. DOI:10.1038/nclimate1847.

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