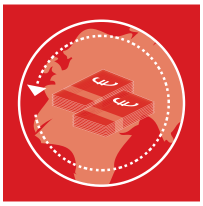
Discussion Paper

Political economy – the biggest stumbling block for national climate finance?

A snapshot of the impacts of political economy on access to and the use of finance for climate change projects

Background



A significant volume of climate finance is required to implement the climate change mitigation and adaptation activities outlined in the (Intended) Nationally Determined Contributions (NDCs), which were put forward by developing countries for the 2015 Paris Agreement.[1] Although these NDCs are chiefly based on existing national climate policies and strategies, in developing countries, the finance required to implement them is often lacking, which means the countries need to mobilise financing and put in place transparent and effective implementation structures for their climate change policies and strategies.

In general, developing countries can mobilise public finance from two different sources. One source, is government-allocated national funds from the state budget. However, state funds are often insufficient, especially in least-developed countries that face competing development priorities.[2] For this reason the second public source, international finance from bilateral and multilateral climate change funds, is important to complement domestic funding. A prominent example of this kind of funding is the Green Climate Fund (GCF), which is currently the single biggest dedicated climate change fund.[3]

To secure external public funding for the implementation of climate policies and to ensure both national funding from the state budget and international funding is spent as effectively as possible, the development of a coherent national planning framework is usually required. Indeed, a key criterion of GCF-financed projects is that they be fully owned by the national government ('country ownership') and factored into national planning processes.[4] Many countries are being supported to develop these kinds of planning frameworks (including, among others, climate change action plans and country work programmes) in order to get ready for climate finance.

While there are a number of challenges with making finance available at the international level, such as conflicting donor priorities, donor coordination or fund disbursement, a number of factors at the national level are also still hindering the achievement of visible and fast results in the implementation of climate change activities. One factor that is rarely addressed, but is very important in practice, is the political economy of climate finance at the national level – namely the interests of stakeholders, their (dis)incentives and the power structures that can prevent the development of a coherent governmental approach to integrated planning of this kind.

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The challenge

**The transparent and effective implementation of climate change policies requires a broad consensus among government stakeholders to address climate change as a priority and to allocate resources accordingly.
Political economy factors can impede an integrated and effective national approach to climate finance.**

A core element of the successful implementation of a climate policy/strategy is the integration of climate-relevant aspects into national planning and budgeting. Sector ministries can only apply for additional funds for climate-relevant activities during the national budget process if the system provides for this. Even climate change projects that are primarily internationally funded require an allocation for operation and maintenance in national budgets to be sustained over the long term.

For this integration to happen, climate change needs to be made a government priority so that it receives budgetary allocations from the national level. Often, however, climate change is perceived as a topic that is promoted by donor partners and that falls to environment ministries, which frequently lack the power of other line ministries. Furthermore, the direct impact of climate change on government priorities like poverty reduction, health and food security is not clear to all national stakeholders. Consequently, governments rarely allocate additional resources for climate-related investments, which, in turn, means that line ministries already faced with scarce national resources do not necessarily prioritise climate-related measures in their sectoral planning – especially not at the expense of other priorities.

To be able to access international funding such as the GCF, national procedures need to be adapted to some degree or established. For example, to access the GCF a National Designated Authority (NDA) must be nominated, which serves as the national interface with the GCF, ensures that project proposals are in line with national priorities, and carries out a no-objection procedure (N-OP) on project proposals being put forward for submission to the GCF. The NDA's role of coordinating (and approving) access to a significant source of funding as well as its considerable influence over decision-making on climate finance can therefore lead to conflicts of interest between government actors.

When carrying out N-OPs it is important to consider not only the climate dimension, but also the fiscal policy dimension of the project proposals, as the projects might involve loans that are relevant to national fiscal policy. To illustrate the magnitude of the financing involved, at the time of writing a total of USD 168 million had been committed to fund eight projects around the world,[5] but the GCF is viewed as a key conduit for the 'new multilateral, multi-billion dollar funding that will be mobilized to meet the climate finance goal of USD 100 billion per year by 2020.'[6] The GCF's ambitious vision for funding means it is aiming to approve bigger grants and loans in the future. Countries are at liberty to design their own N-OP based on the GCF Initial Good Practice Guidelines,[7] hence the process to coordinate and to consult stakeholders on their submission of project proposals to the GCF is not prescribed. In the absence of binding GCF regulations on the operation of the N-OP, the risk arises that not all relevant stakeholders, including those from finance, planning or indeed environment, are involved in the decision-making process.

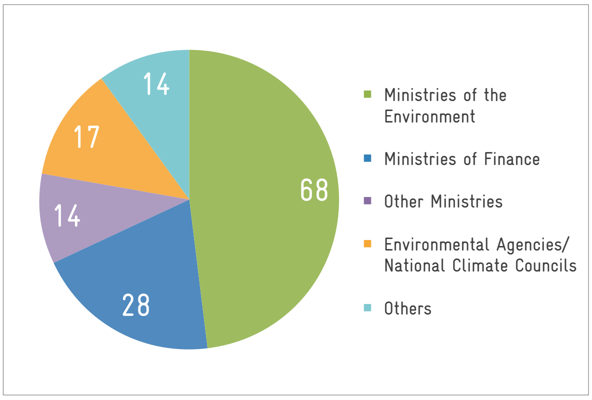
At the same time, national accountability institutions such as parliament and the supreme audit institutions are typically unaware both of the increasing significance of the topic of climate change and of the additional funding entering the country from international sources. As such, these additional resources are not overseen by the national control mechanisms, which leads to a lack of accountability in how the resources are managed.

Main national climate finance actors and their interests

When it comes to accessing and using national and international climate finance, the interests, (dis)incentives and power structures of climate finance stakeholders all play a key role.

A national climate change policy/strategy can only be implemented and the relevant resources mobilised if the main government stakeholders support it. This support hinges on the political economy in the country, which is determined by the mandates and responsibilities of a number of different actors:

- The responsibilities of the ministry of environment (MoE) typically lay with the development of national environmental policies, including those on climate change, which it implements in concert with sector ministries. As an advocate of climate change issues it thus has an interest in the actual implementation of the policy. Furthermore, the MoE also often plays an important role in international climate negotiations, serving as the national representative and it therefore also has an interest to use this role to increase its national influence. If the MoE is designated the role of the National Authority, its level of influence is automatically enhanced, as it will decide on the priorities for accessing international GCF funding, a clear incentive for the institution. An analysis of the GCF's NDA database[8] shows that, out of a total of 141 NDAs, almost half (68) are located within the MoE. However, in many countries the MoE holds a comparatively inferior position in the institutional power structure and therefore faces challenges in coordinating the implementation of cross-sectoral policy such as that on climate change. Additionally, as climate financing begins to receive more attention at the national level, the ministry of finance (MoF) may well seek to take on the NDA function, which can 'undermine' the role of the MoE as the institution that deals with climate-related issues. Moreover, MoEs may also lack sufficient technical expertise and dedicated manpower for tackling the financing of activities related to climate change.
- Typically, the MoF is responsible for managing the nations' finances. Its interests are twofold: (1) to maximise the national budget, which can prompt MoF interest in the additional climate funds available at the international level, and (2) to control fiscal risks like rising debt levels. Debt levels are affected when currency exchange rates fluctuate or when national institutions planning to access loans from international climate funds are affected by rising levels of national expenditure on the operation and maintenance of climate-related investment projects. Given the potentially sizeable funding available from international sources like the GCF, the MoF may also have incentives to be engaged in international climatefunding processes. Indeed, 28 (or around 20%) of the existing 141 NDAs are located within the MoF (*see Figure*).



The institutional allocation of GCF NDAs (total numbers)

However, the expertise required to factor climate change impacts into national budgets is typically limited and, as MoFs generally have a limited technical knowledge of the subject, they are often not fully cognisant of the climate dimensions of national policies. Close collaboration with the MoE is therefore necessary to ensure that climate funds are managed jointly, both financially and technically. However, where the MoE holds an inferior position to the MoF in the national power structure, as is typically the case, there may be a tendency to neglect such collaborations.

- The ministry of planning (MoP) or a comparable planning institution – in countries where they exist – is responsible for the mid- to long-term planning of a country's development and sometimes also for drafting investment plans. The MoP typically has an interest to control, or at least approve, the investment budget and is tasked with ensuring that all investments cohere with relevant national plans. If the MoP is not sufficiently informed about climate change policies, it may lack the commitment required to steer the process of integrating climate change aspects into the planning process and investment plan. If there are other stronger national development interests, the MoE may find it difficult to convince the MoP to allocate national resources for climate-related projects. Additionally, the MoP is in charge of the monitoring and evaluation (M&E) of national policy implementation. As such, a sound and effective approach for the M&E of climate-related expenditure needs to be developed that aligns with the national M&E framework. It is important that the MoP is sensitized on the importance of this effort so that it has an interest to closely coordinate.

- Line ministries can play an important role in the process of planning climate change financing and their interests may be different to those of the MoE. Tasked with implementing specific development priorities for their respective sectors, line ministries will seek to maximise national and international funding in order to achieve their objectives. Instead of adhering to nationally agreed priorities, these ministries may seek to mobilise resources for climate-related measures independently (e.g. through sectoral donor dialogues and support) or may be resistant to any prioritisation of climate change. To receive additional funding for climate-related policies, line ministries need to coordinate with the MoF and possibly the MoP. In the government hierarchy they may be more powerful than MoE and consequently may not be willing to report to and coordinate with the MoE on the implementation of climate-related projects under their authority.

In addition to the key actors mentioned above, a variety of national stakeholders also play a role in national climate financing processes. The involvement of parliaments, supreme audit institutions and civil society is crucial to ensure accountability and can be key in awareness raising, assessment of the implementation of national climate change policies and the efficient use of funding. Moreover, the private sector plays a vital role in delivering climate-relevant projects in collaboration with national and international implementing entities. As such, private actors are key constituents of the NDA-run stakeholder consultations on GCF projects.

The data shows that in almost half of the countries seeking GCF funding, ministries of environment host the GCF NDAs. As such, they take on a financing role that is of relevance to the respective ministry of finance. To ensure that the planning of national and international climate finance is joined up and promotes consensus and collaboration among relevant institutions, effective and transparent coordination is required. However, the differing interests, (dis)-incentives and power structures can impede such coordination.

Addressing political economy challenges

A sustainable and transparent structure for the implementation of international climate finance requires coordination, which, in turn, requires awareness-raising, close engagement between the key stakeholders in the climate finance landscape, and appropriate political incentives.

Through its work on integrating climate change into budgeting and planning processes, assisting with the set-up of NDAs and strengthening institutional coordination on climate finance, GIZ has gained invaluable insights into how important political economy is in national climate financing processes.

Its experience, which is aggregated and summarized in this paper, suggests that official institutional mechanisms, processes and procedures (e.g. climate change committees, working groups or N-OPs) alone are not sufficient to address political economy issues. More importantly, appropriate political incentives designed to encourage collaboration and coordination need to be put in place to ensure that, across government, a coherent approach is developed for financing climate change measures. Taking into account the country's existing political economy, the following measures should be considered to support the development of such incentives:

- **Strengthen ownership at the highest political level:** The government's commitment to act on climate change needs to be strengthened, ideally with cabinet-level backing, as this will impact on the country's development priorities and the effectiveness of the climate change policies implemented. This applies not only to those government institutions obviously implicated, such as the ministry of environment or environment authorities, but also to the finance, planning and sector ministries. An early decision taken at a high political level on the division of tasks and responsibilities strengthens the institutions involved and empowers them to act.

- **Broaden ownership:** Diverse actors need to be engaged in climate finance issues because the coordination of relevant sectors, institutions and actors outside government is vital to ensure coherent climate policy. Actor landscape analyses and capacity assessments play an important role to this regard.

- **Facilitate the integration of climate change into planning and budgeting procedures:** To ensure commitment to and the sustainability of NDCs and national climate change policies, the integration of climate change considerations into existing national procedures is key. NDCs and their associated climate change policies have a far higher chance of being implemented if they are consistently integrated into relevant documents such as development plans, sector plans, medium-term expenditure frameworks, budget circulars, etc. and thus become binding for all government institutions. Making sector ministries aware of the significance of climate change and the benefits of integrating respective considerations in their sectors is an important step towards achieving this commitment, as is strong leadership from a committed and high-ranking government institution and, perhaps most importantly, institutional capacity building on climate change issues.

- **Get ministries of finance involved in climate finance:** If they are not yet involved, finance ministries need to be sensitized to the relevance and opportunities of international climate finance to achieve national climate change- and development priorities. Firstly, internationally financed programmes will have fiscal policy implications for the national budget. Secondly, to ensure sustainability of climate projects there is a need to mobilise national state budget resources for the mid- to long-term operation and maintenance costs of sustainable climate investments.

- **Support the coordination efforts of the ministry of environment:** The MoE should be supported in its efforts to coordinate the implementation of a climate policy/strategy. This relates, for example, to the coordination with and sensitization of the MoP, which lays the ground for the integration of climate change in sectoral planning. Capacities for coordinating and monitoring cross-sectoral processes and providing ongoing technical support on climate-related matters should be strengthened. While this will not increase the MoE's political clout, it will help to ensure that its staff has the skills and competencies required to manage coordination as best as possible under the given circumstances.

- **Consider the political economy when setting up processes and procedures:** To prevent the risk of any abuse of decision-making power within a specific ministry, the political economy for the design and review of new structures and processes should be considered. This includes, for example, the active engagement of the ministries of finance, planning, and the environment in the GCF no-objection procedure. Moreover, it is important to clearly define the division of labour, coordination, and control and monitoring responsibilities involved in implementing climate financing.

- **Apply accountability mechanisms and broaden national participation:** Countries' existing accountability structures or newly developed ones for climate finance – e.g. parliament, supreme audit institutions and civil society – need to be strengthened. These stakeholders often need to be made aware of the significance of climate change (finance) for their country's development, so that they can play a stronger role in scrutinising government use of climate finance. Involving other important stakeholders like the private sector, academia and NGOs will help to generate the support and impetus required to promote and implement climate change action and to prioritise as well as build this action into the country's development process.

Conclusion

For governments to respond effectively to climate change and to ensure sustainable access and use of climate finance, the political economy behind national processes and procedures needs to be taken into account.

If developing countries want to plan and spend national and international climate finance in an effective and integrated way, solely formulating new policies and establishing required mechanisms and procedures, such as, for example, climate change coordination committees or a GCF no-objection procedure, will not suffice. The interests of and power structures among different stakeholders must also be considered. Furthermore, the right incentives need to be put in place to overcome barriers to the effective and transparent planning of, access to and use of climate finance. Ultimately, when government institutions respond in unison to the threat of climate change, the whole nation benefits.

The Climate Finance Readiness Programme (CF Ready)

On behalf of BMZ and with co-finance from USAID, the Czech Ministry of the Environment and the Green Climate Fund, GIZ implements the CF Ready Programme, which is currently supporting 14 partner countries and one region to access and effectively use climate finance. The Programme is implemented jointly with KfW. It supports national climate finance institutions and NDAs to coordinate in the area of climate finance and assists potential national implementing entities and/or intermediaries during accreditation. Furthermore, the Programme provides support in developing strategic frameworks, national climate strategies and policy packages for ambitious, climate-resilient low-carbon development paths. The work in each country is based on an initial assessment of the challenges and barriers. In close dialogue with the partner countries, the services are customised to best respond to each countries' needs, to optimally supplement existing programmes in this field and to build expertise in each country. In addition to this Programme, GIZ also supports climate finance readiness as part of large climate change support programmes, and currently works on climate finance in more than 40 countries.

1 *According to the 2015 Germanwatch Briefing Paper Investing in Ambition – Analysis of the financial aspects in (Intended) Nationally Determined Contributions, as much as USD 4.4 trillion will be required to implement the climate change mitigation and adaptation activities put forward. Available at: https://germanwatch.org/de/download/15226.pdf*

2 *In addition, governments can also contribute to the mobilisation of private sector finance, which is not covered in this paper.*

3 *www.climatefundsupdate.org, last accessed on 12 June 2016.*

4 *GCF Investment Framework, Decisions of the Board – Seventh Meeting of the Board, 18–21 May 2014, available at: http://www.greenclimate.fund/documents/20182/24943/GCF_B.07_11_-_Decisions_of_the_Board_-_Seventh_Meeting_of_the_Board__18-21_May_2014.pdf/73c63432-2cb1-4210-9bdd-454b52b2846b?version=1.1*

5 *GCF Consideration of funding proposals, Decisions of the Board – Eleventh Meeting of the Board, 2–5 November 2015, available at: http://www.greenclimate.fund/documents/20182/87610/GCF_B.11_24_-_Decisions_of_the_Board___Eleventh_meeting_of_the_Board__2___5_November_2015.pdf/47a44df4-82f4-420e-881f-5d6ade76882c?version=1.2*

6 *See: http://www.greenclimate.fund/partners/contributors/resource-mobilization*

7 *GCF Initial best practice guidelines for the selection and establishment of national designated authorities and focal points, Decisions of the Board – Eighth Meeting of the Board, 14–17 October 2014, available at: http://www.greenclimate.fund/documents/20182/24946/GCF_B.08_45_-_Decisions_of_the_Board_-_Eighth_Meeting_of_the_Board__14-17_October_2014.pdf/1dd5389c-5955-4243-90c9-7c63e810c86d?version=1.1*

8 *The GCF's list of NDAs is available at: http://www.greenclimate.fund/documents/20182/318991/NDA_and_Focal_Point_nominations_for_the_Green_Climate_Fund.pdf/eeace75b-aa59-489c-8914-c0940debe01f, last accessed on 12 June 2016.*

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