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Professional Development Reading Pack No. 16

Climate finance and public finance management

Neil Bird
June 2015

***Neil Bird** is a Research Fellow at the Overseas Development Institute, London, where he works in the Climate and Environment Programme. His current research focuses on climate change policy, the international aid architecture and its relation to climate finance. At the national level, his interests include the delivery mechanisms for climate finance, national budgetary processes, sector policies and the institutional development of public sector agencies. Neil has led several multi-country studies that have examined climate change related public expenditure and explored developments and trends in global climate finance.*

Much attention has been directed at the international commitments to assist developing countries respond to climate change. This is reflected in the debate over the commitments made under the United Nations Framework Convention on Climate Change: at the UNFCCC negotiations in Copenhagen in 2009, developed countries committed to jointly mobilise $100 billion climate finance per year by 2020, from public, private and alternative sources, to address the needs of developing countries. It is also reflected in the attention given to the establishment of the Green Climate Fund, which is envisaged as the main multilateral vehicle for mobilising increased climate finance, as part of the effort towards reaching the $100 billion commitment.

Less attention has been paid to how such finance may be managed within recipient countries. The interplay of climate finance with domestically raised public funds parallels the longer experience of channelling official development assistance into national systems. Public finance for climate change can make use of either government or non-government systems. A key question facing both providers and recipients of climate finance is under what circumstances should funds go through government systems and when should extra-budgetary arrangements be used?

The general challenges facing public finance management (PFM) systems are well known, and these will apply to resourcing climate change actions as much as any other area of public policy. However, the nature of climate change heightens some of these challenges. First, being a new policy priority, there is little guidance (e.g. through budget circulars) on how to incorporate climate change considerations into national budget planning. This implies that greater involvement by ministries of finance is necessary if climate change policies are to be well reflected in the national budget.

Suggested citation: Bird, N. (2015). Climate finance and public finance management. GSDRC Professional Development Reading Pack no. 16. Birmingham, UK: University of Birmingham.

Relevant PFM reforms include extending the perspective of the public finances beyond the annual budget cycle, typically by developing a medium-term expenditure framework. This provides greater scope for climate change to be recognised as a new policy priority that requires additional funding. Climate change also places a heightened premium on the reliability of funding, especially for public service delivery (e.g. through local government), as many climate change programmes are investment-orientated.

Climate change has no strong institutional base in the government administration of most countries. Hence budget tracking using the administrative classification of ministries will not allow climate change spending to be readily identified and its performance assessed. The tracking of climate change expenditures therefore depends, in part, on programme-based budgeting reforms, with the identification of spending by outputs and strategic objectives. Even with such reforms, the scope to identify climate change relevant actions is constrained by the imprecision over what to include: a national consensus needs to be reached on what constitutes climate finance.

Two prominent themes related to climate finance and PFM that have been the subject of much discussion are national climate funds and direct access to multilateral public funds. National climate funds are a pragmatic attempt to 'fast track' the delivery of climate finance where national PFM systems are weak by using an extra-budgetary fund. Direct access to multilateral public funds reflects more of an attempt to invest in strengthening national capacities and ownership over the financial resources available to help countries respond to climate change-related development challenges.

The seven readings selected for this pack provide analysis and commentaries on key themes concerning the interplay between climate finance and national public finance management systems.

Reading 1: Thornton, N. (2011). *Realising the potential - making the most of climate finance in Africa: a synthesis report from six country stories; Cameroon, Ghana, Kenya, Morocco, South Africa and Tanzania.* Prepared for the African Development Bank and the Organisation for Economic Co-operation and Development.
http://www.oecd.org/dac/environment-development/48597031.pdf

This paper provides an early (2011) regional overview of six African countries' experiences in managing public climate finance. It uses the development effectiveness principles to analyse the strengths and weaknesses of national systems. The report challenges development partners to respect these principles when it comes to supporting climate change actions in recipient countries. Review the eight bullet points on page 46 – what would be your country score?

Reading 2: Miller, M. (2012). *Climate Public Expenditure and Institutional Reviews (CPEIRs) in the Asia-Pacific Region: What have we learned?* Prepared for the UNDP and the Capacity Development for Development Effectiveness (CDDE) Facility.
http://www.asia-pacific.undp.org/content/dam/rbap/docs/Research%20&%20Publications/democratic_governance/APRC-DG-2012-CPEIR-LessonsLearnt.pdf

Miller reviews experiences of implementing Climate Public Expenditure and Institutional Reviews (CPEIRs), a methodology developed by the UNDP in the Asia-Pacific region in 2011 (and since extended to other regions). The paper provides insights on the extent to which national climate change policy and public institutions guide public spending on climate change related actions. Further methodological development and complementary analyses are highlighted.

Reading 3: World Bank Group (2014). *Climate Change Public Expenditure and Institutional Review Sourcebook.* Washington DC: The World Bank (Chapter 6 on financial management). http://www.climatefinance-developmenteffectiveness.org/archive/documents/World_Bank_CCPEIR_Sourcebook_2014.pdf

Chapter 6 of this World Bank Sourcebook reviews national budget and expenditure planning processes to identify entry points for climate change policy. A major challenge in many countries is that significant expenditure decisions affecting climate change are made outside of the national budget and expenditure planning process.

Reading 4: Flynn, C. (2011). *Blending climate finance through national climate funds: A guidebook for the design and establishment of national funds to achieve climate change priorities.* New York: UNDP. (Chapter 2 on designing a national climate fund). http://www.undp.org/content/dam/undp/library/Environment%20and%20Energy/Climate%20Change/Capacity%20Development/Blending_Climate_Finance_Through_National_Climate_Funds.pdf

Flynn describes the potential of national climate funds (NCFs) to help manage project-based delivery of climate finance. Chapter 2 presents a conceptual framework to assist in the design of such funds. However, the report is silent on how such funds sit alongside national public finance management systems, an issue that warrants careful consideration (something which is picked up in the next paper).

Reading 5: Irawan, S., Heikens, A., & Petrini, K. (2012). *National Climate Funds: Learning from the experience of Asia-Pacific countries.* Discussion Paper. New York: UNDP. http://www.climatefinance-developmenteffectiveness.org/sites/default/files/publication/attach/UNDP_National_Climate_Fund_2012_Web.pdf

Irawan and her co-authors provide an analysis of NCFs in the Asia-Pacific region, acknowledging that such funds are, by definition, extra-budgetary arrangements. Section 5 provides a typology of the different types of funds that is helpful for the non-specialist. Annex 1 summarises the advantages and disadvantages of managing climate finance through the national budget system as against establishing a NCF; this can provide a starting point for in-country discussions.

Reading 6: Halimanjaya, A., Nakhooda, S., & Barnard, S. (2014). *The effectiveness of climate finance: a review of the Indonesia Climate Change Trust Fund.* Working Paper. London: ODI. http://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/8898.pdf

This paper analyses the implementation experience of the Indonesia Climate Change Trust Fund (ICCTF), which is one of the earliest NCFs, established in 2009. The UK has been the main funder of the ICCTF, contributing 86% of funds as of March 2014. However, it continues to play a relatively minor role in channelling international climate finance to

Indonesia, with the multilateral agencies continuing to use their own systems, leading to high fragmentation of international funding.

Reading 7: Bird N, Billet S and Colon C. (2011). *Direct Access to climate finance: experiences and lessons learned.* Discussion Paper. New York: UNDP, London: ODI.
http://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/7479.pdf

This paper provides an overview of the concept of direct access as it applies to multilateral public funding for climate change actions in developing countries. It describes how it has been defined so far and what it is seeking to achieve. Several possible arrangements for directly accessing international climate change-related funding are outlined.

Questions to guide readings

1. Does fragmentation in international public climate finance flows matter? What are the possible advantages and disadvantages of simple as opposed to complex national pathways?
2. How well do public expenditure reviews identify climate finance? What are the main challenges this type of analysis has to contend with?
3. What does it take to shift to programmatic forms of funding that can support the recurrent costs of public institutions and their response to climate change?
4. National ownership is a recognised principle of development effectiveness. What national capacities need to be in place for 'Direct Access' to be successful?
5. Using Flyn's and Irawan et al.'s analyses, how would you go about assessing whether a National Climate Fund is a feasible option for a country? What are the issues to consider when designing and establishing a National Climate Fund?
6. Taking Thornton et al.'s 2011 paper as a starting point, what are the key barriers to improving accountability of climate change related public expenditure?