

Submission to the UNFCCC Standing Committee on Finance

Response to the Standing Committee's **"Call for evidence: information and data for the preparation of the 2020 Biennial Assessment and Overview of Climate Finance Flows"**

February 2020

Dear Standing Committee Members,

On behalf of our colleagues at the Stockholm Environment Institute (SEI), we would like to thank you for soliciting input on these important questions.

Since our founding over 30 years ago, SEI has been at the forefront of climate change research, connecting scientific findings and insights with practical policy advice. We support and advise decision-makers around the world grappling with, among other challenges, how to transition to a low-carbon future and how to prepare for and adapt to the unavoidable impacts of climate change. We also have a portfolio of research and engagement work focused on climate finance, and on development finance more broadly.

We draw upon some of our more recent work in these fields in order to provide this submission to the Standing Committee, which responds to your call for evidence to support preparation of the 2020 Biennial Assessment and Overview of Climate Finance Flows. We would be happy to provide further information as useful and offer our ongoing support to the Standing Committee as it continues to support international progress on these important topics.

Yours sincerely,

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Datasets and platforms for tracking climate finance

In 2019, SEI developed an online platform to allow users to easily and quickly explore global development finance. *Aid Atlas* (<https://aid-atlas.org>) uses data from the OECD's Creditor Reporting System (CRS), which is reported to the OECD annually by bilateral, multilateral and some private funders. It provides a simple, user-friendly interface and easy to understand visualisations and text, and users are able to search development finance commitments and disbursements from the perspective of all donors, recipients (including recipient groups such as least developed countries (LDCs) and small island developing states (SIDs)), sectors and global objectives (including climate change), or combinations of individual donors, recipients and/or sectors and global objectives. The rationale behind *Aid Atlas* is to make data about development finance – including climate finance – more accessible to a wider range of stakeholders, and hence improve transparency.

Aid Atlas allows users to analyse flows of development finance that have climate change as their principal objective (following the OECD's Rio Markers system). Users can analyse finance for climate adaptation, climate mitigation, and we have developed a new category for “climate finance” which allows both to be summarised together – to be launched April 2020. *Aid Atlas* allows for analysis of sector-specific finance flows including, among others: clean energy; industry, mining and construction; transport and storage; agriculture, forestry and fishing; disaster prevention and preparedness; and water supply and sanitation. It includes a breakdown of support by different financial instruments such as grants, loans, equity, private development finance and other official flows as defined by the OECD CRS (Creditor Reporting System).

By making complex analysis of global flows simple and very fast, we hope *Aid Atlas* will also enable effort to shift from tracking finance towards more exploration of what impacts it is having over time. Further to this end, in 2020 the *Aid Atlas* platform will be further developed to integrate a range of indicators of social, economic and environmental change in developing countries. This will allow deeper exploration of questions about what long term impacts climate finance is generating for recipients, by integrating finance data alongside indicators of change over time.

Methodological issues relating to measuring, reporting, and verifying climate finance flows

Based on the OECD's data, we consider it essential that estimates of public international finance for climate change are based only on the activities coded by funders as “principally” targeting climate change (Rio Marker 2). Some reports and published estimates also include a second category of activities, i.e. those coded by funders as “significantly” targeting climate change (Rio Marker 1). However, a review of the activities tagged for adaptation and/or mitigation using Rio Marker 1 quickly shows that the quality of the data is highly questionable. Many activities that indicate climate change was a “significant” objective appear to have little or no relevance to mitigation or adaptation (our observations are supported by other detailed studies, see for example Michaelowa and Michaelowa 2011; Junghans and Harmeling 2012; AdaptationWatch 2015; Donner et al. 2016; Weikmans et al. 2017).

We also note that some funders are not tagging climate change as an objective when they report to the OECD (specifically, most of the Multilateral Development Banks (MDBs)). The reason for this is that the MDBs have developed their own methodology for what to count as “climate finance”, which is not being used by bilateral funders that report to the OECD. While acknowledging these concerns of the MDBs, we see no reason why the MDB data could not be added to the OECD's CRS dataset – which is the most comprehensive global data set on development finance. The MDB's could use their own methodologies for defining what counts as “principally” targeting climate change and still report to the CRS; it is unclear to us whether, to facilitate this, the OECD may need to change the reporting templates or whether the CRS already allows this.

Assessment of the effectiveness of climate finance flows, including drivers, impact results, meeting needs, and access

We draw attention to a number of patterns that are evident in the data about climate finance which we believe are indicative of problems in the way climate finance is working in practice. Specifically:

1. Climate finance has a much lower disbursement ratio than all development finance, suggesting problems in the delivery of funding;
2. Finance for adaptation is surprisingly concentrated in a small number of sectors, which could be hindering adaptation efforts more broadly; and
3. Funders do not appear to be prioritising the most vulnerable countries when programming financial support for adaptation.

We also provide below some comments on efforts to track the effectiveness or long-term impacts of climate finance, and on climate risk insurance as an emerging issue within discussions about climate finance.

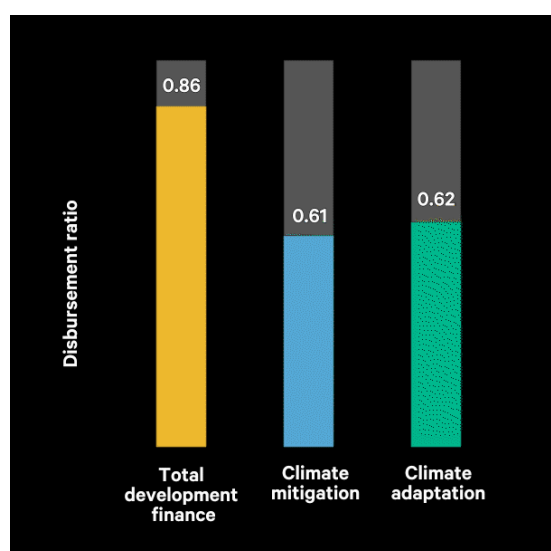
Challenges disbursing climate finance

(Source: Atteridge and Savvidou, 2019)

There are a lot of commitments being made on climate-related activities in developing countries, but are approved projects actually being executed?

Figure 1 shows the disbursement ratio of total development finance (i.e. funds paid out across all sectors, globally) from 2013 to 2017, alongside the disbursement ratios of finance specifically targeting climate mitigation and climate adaptation. This ratio shows the extent to which funding that has been committed (i.e. approved) has been paid out. A low ratio of disbursements to commitments might indicate, for instance, that there are challenges in executing projects on the ground, or that there are other problems in the delivery of funding.

Figure 1. Disbursement ratios for all development finance, all mitigation finance and all adaptation finance worldwide from 2013–17, inclusive



While the disbursement ratio for all development finance was around 86%, for all finance that had climate change as its principal objective the ratio was only 62%. In other words, approved climate change activities are less likely to be implemented than other activities, or are significantly delayed in their implementation. In reality, it is probably both.

This picture needs to change, given the urgency of addressing climate change, and a first step is to look at why the problem exists. Although the data doesn't tell us why climate change activities are less likely to be implemented, it does provide some clues.

Are the sectors that climate finance targets the cause of the problem?

It does appear that climate activities tend to cluster in sectors that have a lower disbursement ratio than the global average for all development finance.

Figure 2, from Aid Atlas, shows that around two thirds of all financial commitments from 2013 to 2017 for mitigation are in the energy sector and the transport and storage sector. Globally, the disbursement ratio in the energy sector is 62%, while for transport and storage it is 70%.

Figure 3, for adaptation, shows that funding commitments are clustered under the following sectors: general environment protection; agriculture, forestry and fisheries; and water supply and sanitation. Globally, the disbursement ratio in the general environment protection sector is 88%, in agriculture, forestry and fisheries it is 72%, and in water supply and sanitation is 73%.

In other words, the disbursement ratios in those sectors where climate finance is concentrated are indeed significantly less than the global average for all development aid, which is 86% (see Figure 1).

However, while this suggests that the sectors where climate finance is a contributing factor to the very low disbursement ratios, it doesn't fully explain them.

Figure 2. Sectors targeted by finance for climate mitigation, with amounts committed and percentage of total

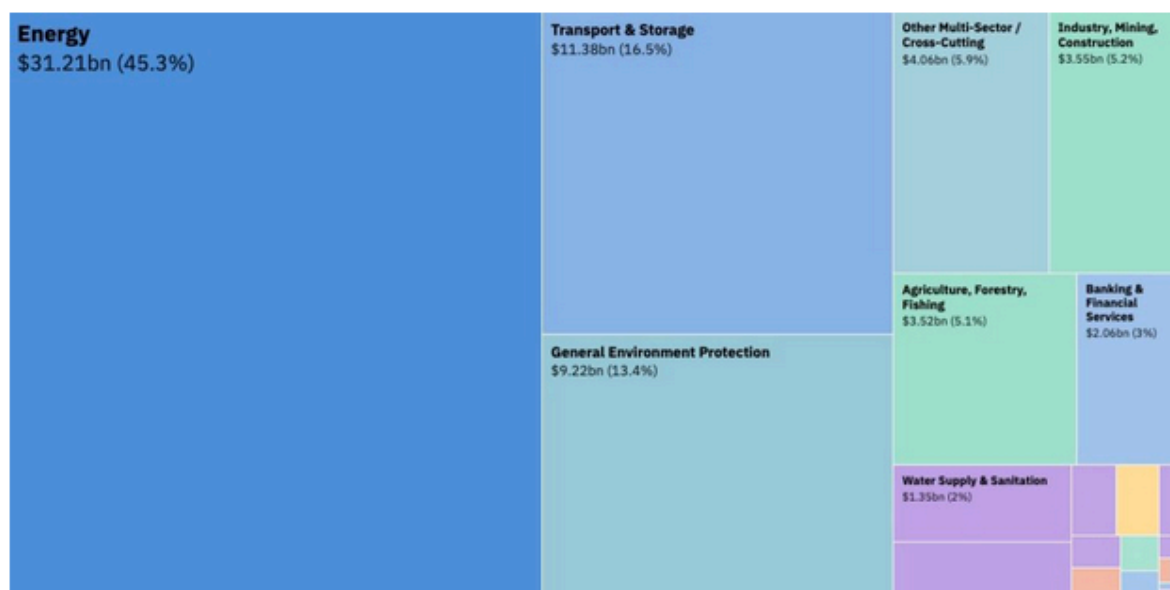


Figure 3. Sectoral distribution of development finance principally targeting climate adaptation, with amounts committed and percentage of total between 2013 and 2017 inclusive



Are the climate funds to blame?

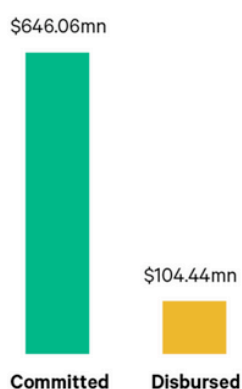
Second, the multilateral climate funds report very low disbursements. The climate funds are a unique feature in the climate finance picture, because while other bilateral funders and multilateral institutions are involved in financing other activities beyond climate change, the climate funds focus only on activities that have addressing climate change as their main purpose (with the exception of the Global Environment Facility, which has a broader mandate).

All the climate funds report very low disbursement ratios over the period 2013 to 2017. The World Bank’s Climate Investment Funds (CIFs) disbursed only 19% of funds committed for adaptation, and 12% for mitigation. The Adaptation Fund does better at 57%. On the other hand, while the UNFCCC’s flagship multilateral fund, the Green Climate Fund, reports commitments of US\$ 2.44 billion between 2013 and 2017, it reports no disbursements at all over this period (note: this does not necessarily mean it has not disbursed funds, but that nothing has been reported to the OECD).

Oddly, the GCF doesn’t tag any of its activities as principally targeting climate change in its reporting to the OECD’s Creditor Reporting System, which is the data set underlying Aid Atlas.

Finally, the Global Environment Facility (GEF) reports disbursement ratios of 16% for activities targeting adaptation, as Figure 4 shows, and just 7% for finance targeting mitigation. The GEF also implements projects with objectives other than climate change, and for their financial support in total they report a disbursement ratio of 72% – so the problem does seem to be concentrated around their climate portfolio.

Figure 4. The Global Environment Facility's disbursement ratio for adaptation, 2013–2017



That said, while the climate funds all report low disbursement ratios, they make up only a small portion of total climate-related finance reported to the OECD. So, while these institutions do influence the global picture, they don't fully explain the poor disbursement ratio for climate finance.

Are the major climate financiers just generally poor at disbursing development aid?

We also explored, using Aid Atlas, whether poor disbursement performance by the largest climate finance providers might affect the low disbursement ratio.

All the biggest providers of climate finance – France, the European Bank for Reconstruction and Development, EU institutions, the US, Germany, and Japan – have a much higher disbursement ratio for non-climate projects than they do for climate projects. So, the problem does not seem to lie with how effective they are at disbursing funds in general.

The data highlights problems – now we have to fix them

Many developing countries have voiced the concern that the vertical climate funds, like the Green Climate Fund, are particularly difficult to access. But the data revealed by Aid Atlas shows that this is not the only problem with the availability of climate finance: it is also that funding that is being pledged by donors and then approved for projects and programmes is often not being disbursed. We need to urgently figure out why this is happening and address the problem. It is after all in everyone's interest that the money that donors commit to projects actually gets spent, and spent wisely, so that developing countries are meaningfully supported in tackling the climate emergency.

Concentration of adaptation finance in certain sectors, especially for adaptation

For the global picture from all funders (reporting development finance to the OECD) to all recipients, finance commitments that principally targeted adaptation from 2013 to 2017 inclusive are shown figure 3. The data shows that almost 60% of adaptation finance has been approved for projects in just three sector codes, i.e. General environment protection; Agriculture, forestry and fishing; and Water supply and sanitation.

This pattern is mirrored in separate analysis of the priorities included (by SIDS) in Nationally Determined Contributions (NDCs) to the UNFCCC (see Atteridge, Verkuijl and Dzebo, 2019) which also concludes that developing countries seem to be giving emphasis to relatively few development sectors in their NDCs. This paper (p11) argues these patterns “*may be the result of a normative and/or material bias. A normative bias is one that frames how people think about certain problems and solutions; in this case, the way planners decide which activities or sectors are relevant (and which not) for responding to climate change. Norms about what is climate-related ultimately affects who is involved in the planning process and what kinds of issues are understood as relevant or legitimate for inclusion in the NDCs. It is also plausible that the bias may have a material nature, meaning it is related*

to how countries secure access to finance. Climate finance for SIDS has been allocated to a relatively narrow range of sectors in recent years (Atteridge and Canales 2017; Atteridge, Canales, and Savvidou 2017; Canales, Atteridge, and Sturesson 2017). As a result, countries may be deliberately focusing their NDC priorities in sectors where they know international funders are already inclined to provide support”.

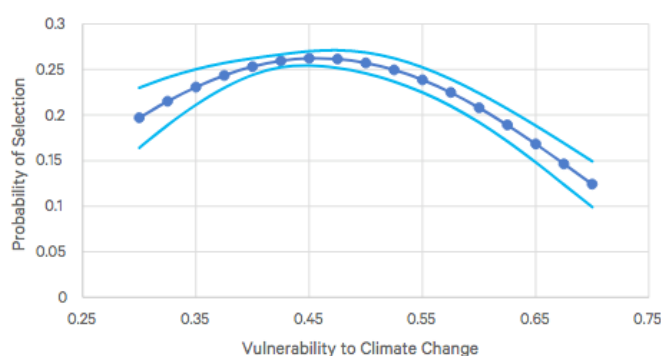
This looks to be a problem, because the distribution of funding support does not reflect either (i) the acknowledged need for adaptation and resilience to be mainstreamed across many sectors of society and the economy, and (ii) the benefits of targeting underlying vulnerabilities in a local context as part of a comprehensive adaptation strategy.

Is adaptation finance targeting the most vulnerable?

Finally, we draw attention to analysis presented in Saunders (2019), which looks at whether climate finance is prioritising the most vulnerable. The paper concludes that the most vulnerable countries are not being prioritised by funders for adaptation support. This is the case for both bilateral funders and multilateral funders, as shown in the figures below.

As the first figure (Figure 4 from Saunders, 2019) below indicates, “the effect is clearly concave in the bilateral case... while an increase in vulnerability improves the probability of selection up to a point, ultimately bilateral donors are less likely to select the most vulnerable countries as finance recipients” (Saunders 2019). In other words, on average “countries most vulnerable to climate change are found to receive smaller allocations of adaptation finance from bilateral donors than their less vulnerable counterparts”.

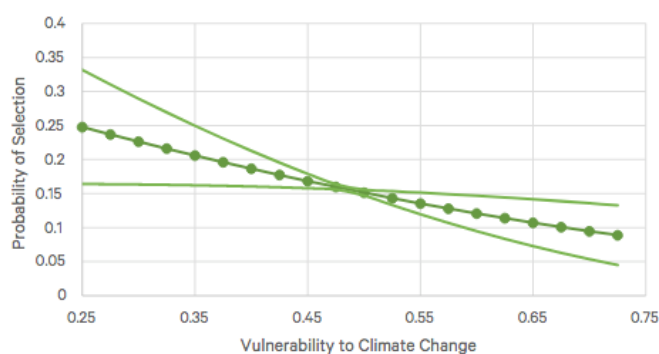
Figure 4. Bilateral Selection



(Predictive Margins with 95% Confidence Intervals)

For multilaterals, this finding is even more stark. The analysis (shown below in Figure 5 from Saunders, 2019) finds “no indication that multilateral donors are more likely to select countries that are most vulnerable to climate change. The calculated marginal effect of (lagged) vulnerability on the probability of selection by a multilateral donor indicates that the least vulnerable nations are approximately 15% more likely to be selected as funding recipients than those most vulnerable to climate change” (Saunders, 2019).

Figure 5. Multilateral Selection



(Predictive Margins with 95% Confidence Intervals)

A further finding of the paper is that, when it comes to recipient selection, bilateral donors are more responsive than multilateral donors to recipient need. This is something that needs exploration in the discussion about climate finance, given the MDBs provide a significant share of the available international public funding for climate change.

Tracking effectiveness of climate finance flows

As mentioned above, Aid Atlas will be further developed in 2020 to integrate a range of indicators of social, economic and environmental change in developing countries. The purpose in doing so is to support deeper exploration of the lasting impacts of development finance, including finance for climate change mitigation and adaptation. As an example, in Atteridge and Savvidou (2019) we assessed total financial commitments in the energy sector in all SIDS globally with changes in electricity access rates over the same period. The results of this study suggest there is considerable value in this methodology of correlating financial flow data with indicators of change over time.

Integrating climate-related insurance into economic modelling for SIDS

For developing countries, regional risk pools have been promoted as a vehicle to make insurance more affordable, as they offer savings in premium costs compared with each country acquiring insurance on its own. Given that catastrophes can be linked to climate related events (e.g. droughts, tropical cyclones), risk pools have been linked to climate change. In the Caribbean, the Catastrophe Risk Insurance Facility Segregated Portfolio Company (CCRIF SPC), is considered by the Caribbean community as a financial instrument linked to climate change adaptation.

Kemp-Benedict et al. (2020) presents an economic simulation model for Barbados, a small island developing state. This model is an updated version of a macroeconomic model for Caribbean states (Kemp-Benedict et al. 2018), a model storm damage to capital stocks for Barbados (Kemp-Benedict et al. 2019) and a tourism sector model by Laframboise et al. (2014). The model in Kemp-Benedict et al. (2020) includes global GDP growth, economic growth in tourism source markets, and payouts from the CCRIF SPC. While the model can benefit from further development, it illustrates the importance for SIDS of incorporating climate change into national planning, and reflects on the potential implications of climate-related insurance.

“The major policy lesson the model provides at present is that climate change is a major external uncertainty that should be built into planning decisions. [...] Specifically, the model shows that, under a changing climate, it can become more difficult to manage the external debt [...]. As discussed in Kemp-Benedict et al. (2019), the model allows for standards to change in response to expected climate change. If an expectation of stronger and more frequent storms were incorporated into planning, then

damage costs would be lower but would be partially offset by higher adaptation costs” (Kemp-Benedict et al. 2020 p. 13-14)

The paper also reflects on the implications on insurance over behaviour related to adaptation. “Behaviour is further shaped and budgets are affected by insurance. In the present model, only the CCRIF is represented. Following Kemp-Benedict et al. (2019), firms are assumed to carry out their cost–benefit analysis of climate adaptation with the expectation that they will pay for damages out of their own funds, with no insurance and no government assistance. Insurance, whether private or public, would change that calculation” (Kemp-Benedict et al. 2020 p.14)

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