


# Climate Finance Readiness

## LESSONS LEARNED IN DEVELOPING COUNTRIES



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## Acronym List

<b>ABC</b> » Agricultura de Baixo Carbono	<b>GEA/CER</b> » Grupo Especializado de Asistencia del Perú/ Centro de Ecoeficiencia y Responsabilidad Social
<b>ASERCA</b> » Apoyos y Servicios a la Comercialización Agropecuaria	<b>GEX</b> » Grupo Ejecutivo sobre Mudança do Clima
<b>BANCOMEXT</b> » Banco Nacional de Comercio Exterior	<b>IDB</b> » Inter-American Development Bank
<b>BANOBRAS</b> » Banco Nacional de Obras y Servicios Públicos	<b>MEF</b> » Ministerio de Economía y Finanzas del Perú
<b>BNDES</b> » Banco Nacional de Desenvolvimento Econômico e Social	<b>MINAG</b> » Ministerio de Agricultura del Perú
<b>CAN</b> » Comunidad Andina de Naciones	<b>MINAM</b> » Ministerio del Ambiente del Perú
<b>CDM</b> » Clean Development Mechanism	<b>MINEM</b> » Ministerio de Energía y Minas del Perú
<b>CEF</b> » Caixa Econômica Federal	<b>MTC</b> » Ministerio de Transportes y Comunicaciones del Perú
<b>CFE</b> » Comisión Federal de Electricidad	<b>NAFIN</b> » Nacional Financiera
<b>CIM</b> » Comitê Interministerial sobre Mudanças do Clima	<b>NAMA</b> » Nationally Appropriate Mitigation Action
<b>CONAFOR</b> » Comisión Nacional Forestal	<b>PCM</b> » Presidencia del Consejo de Ministros del Perú
<b>CONAM</b> » Consejo Nacional del Ambiente	<b>PNMC</b> » Plano Nacional sobre Mudança do Clima
<b>FAO</b> » Food and Agriculture Organization of the United Nations	<b>PRODUCE</b> » Ministerio de la Producción del Perú
<b>FBMC</b> » Fórum Brasileiro de Mudanças Climáticas	<b>Pro-MDL</b> » Projetos de Mecanismo de Desenvolvimento Limpo
<b>FCID</b> » Fondo de Cooperación Internacional para el Desarrollo	<b>REDD</b> » Reducing Emissions from Deforestation and Forest Degradation
<b>FFM</b> » Fondo Forestal Mexicano	<b>SAGARPA</b> » Secretaría de Agricultura, Ganadería, Desarrollo Rural, Pesca y Alimentación
<b>FIDE</b> » Fideicomiso para el Ahorro de Energía Eléctrica	<b>SEMARNAT</b> » Secretaría de Medio Ambiente y Recursos Naturales
<b>FINEP</b> » Financiadora de Estudos e Projectos	<b>SENAMHI</b> » Servicio Nacional de Meteorología e Hidrología del Perú
<b>FIP</b> » Forest Investment Program (Mexico)	<b>SENER</b> » Secretaría de Energía
<b>FIP</b> » Fundos de Investimentos em Participações (Brazil)	<b>SHCP</b> » Secretaría de Hacienda y Crédito Público
<b>FIRA</b> » Fideicomisos Instituidos con Relación a la Agricultura	<b>SRE</b> » Secretaría de Relaciones Exteriores
<b>FNMC</b> » Fundo Nacional sobre Mudança do Clima	<b>UKP4</b> » Unit Kerja Presiden Bidang Pengawasan dan Pengendalian Pembangunan
<b>FOMECA</b> » Fondo Mexicano de Carbono	<b>UNDP</b> » United Nations Development Programme
<b>FTE</b> » Fondo para la Transición Energética	
<b>FVM</b> » Fondo Verde Mexicano	

# 1 Introduction

**C**limate finance readiness is a term increasingly being used in the international arena and in general terms it refers to the processes at regional, national and local levels through which developing countries get 'ready' to access, allocate, distribute, and make use of financial resources for climate change action, as well as the monitoring and report of its use and results. Readiness initiatives may then include capacity development and pilot activities to:

- Strengthen capacity and expertise to enhance cross-sectoral planning and coordination for allocation of resources for climate change action (or what we would call in this document “in-country financial architecture”);
- Enhance existing or create new financial vehicles, fiscal approaches, procedures and instruments to ensure resources are effectively and transparently managed;
- Identify mechanisms for coordination of international financial flows, as well as for structured donor engagement.

Overall, it is understood that addressing climate finance readiness would help recipient countries improve their capacity to absorb financial resources (i.e. “absorptive capacity”) and ensure that these countries have the mechanisms in place to access international financial resources for climate change directly by national financial intermediaries rather than only through international/multilateral financial intermediaries (i.e. “direct access”). In other words, recipient countries are building up their respective internal financial infrastructure in order to act as full participants in emerging international climate financing arrangements.

Developing countries are setting up in-country processes and mechanisms to address climate finance readiness needs, and actively engaging in communities of practice and other multi-country collaboration and knowledge-sharing platforms and initiatives to learn from other countries’ experiences.

In this context, this document is the result of a process begun by the Government of Peru with support from the Swiss Development Corporation to analyze and evaluate different options available inside and outside the country for the design and implementation of Peru’s in-country institutional and climate finance arrangements.

In conjunction with this project, several comparative analyses were conducted regarding the in-country institutional arrangements in other countries. In addition to Peru, we selected Brazil, Mexico and Costa Rica based on their political similarities with the former, and also considering the strong political will at the President of State’s level and below they have enjoyed over the past five years to advance their in-country climate change agenda. This reality has translated into across-the-board efforts at the national and subnational levels to integrate climate change strategies into national development planning.

We also selected Indonesia to expand the sample of countries beyond Latin America, and in recognition of interesting developments on integration of their climate change strategy into core national fiscal frameworks, and through it, into their national development planning.

Although limited, the literature developed on the issue of climate finance readiness (which has been included to the best of our knowledge in the Further Resources Section at the end of this document), either proposes a theoretical framework or focuses only on a particular financial vehicle.

Taking this current context of the literature into consideration, we decided that the discussions on climate finance readiness would benefit from an analysis that approached the issue by describing and interpreting the existing landscape of in-country financial architectures, and the strategies and processes for decision-making, coordination, and distribution of financial resources and implementation.

In sum, we have tried to capture the reality of these countries' efforts to: (i) create new institutions and/or organize their existing institutions to deal with the challenge posed by climate change causes and impacts (Section 2); and (ii) to mainstream climate change into development planning processes and deal with an increasing number of actors, projects and financial flows (Section 3).

Following that analysis, we have reflected on lessons learned from those processes and present a set of recommendations on the in-country financial architectures (Section 4.1); and the planning process to be put in place for increasing the likelihood that climate change variables would be considered as part of national development policies and strategies (Section 4.2).

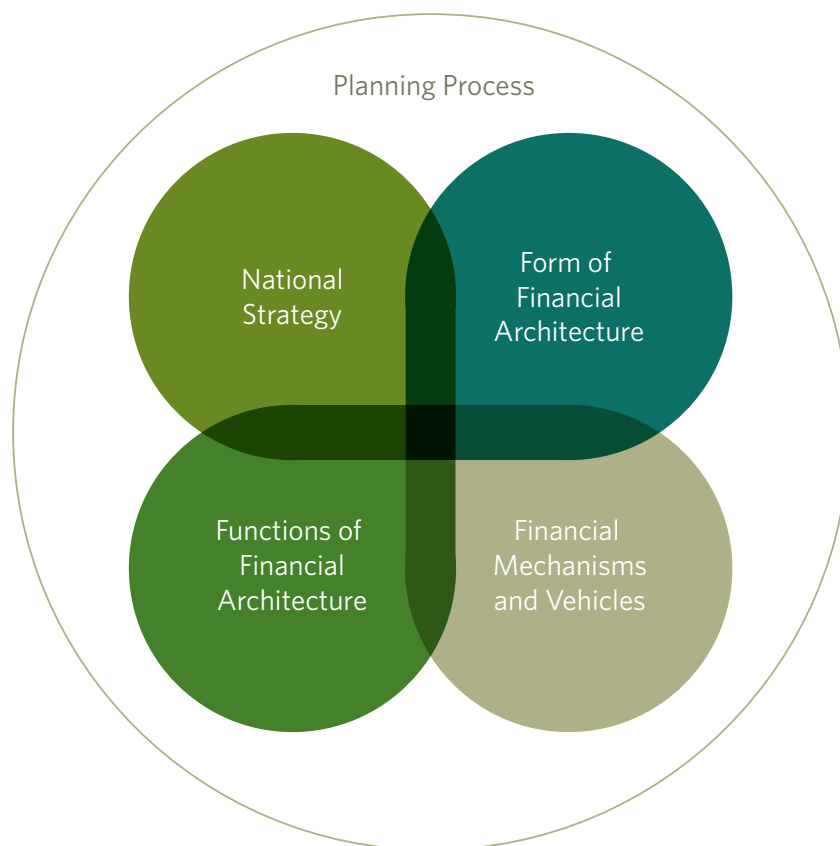
In essence, we argue in this document that a climate finance readiness process presents 5 key components to be considered by governments: planning process, national climate change strategy, functions of a financial architecture, form of a financial architecture, and the financial mechanism and vehicles/windows. The diagram and table below provide a graphic representation and explanation of these key components.

Our purpose is to contribute to the creation of a common understanding of key elements to be considered when designing and implementing in-country financial architectures. By learning from what recipient countries currently have in place, we can enhance the efficiency and transparency of climate finance mechanisms and the consequent implementation of action.

At a higher level, this paper also aims to provide a clear set of findings for use by donor countries and agencies which currently recognize the increasing importance of providing support to recipient countries on climate finance readiness efforts.

We hope that these findings and recommendations also stimulate a discussion between donor and recipient countries and increase sharing of lessons between recipient countries on readiness approaches. Moreover, we hope that it will be used in the broader process of building an international financial architecture, especially around the implementation of the Green Climate Fund and strengthening of direct-access mechanisms.

**Diagram 1: Key Components of Climate Finance Readiness Processes**



**PLANNING PROCESS**

- Five Stages: policy, national strategy, sectoral and regional strategies, action plans, and feedback mechanism
- Not a linear relationship between stages
- Stakeholder engagement and participation

**National Strategy**

- At the core of the Planning Process
- Answers the what, how, where, with whom and why
- Linked to national, sector, and territorial, as well as local/city level development strategies

**Functions of Financial Architecture**

- Form follows function
- Four key functions: political, strategic, financial, and monitoring, reporting, verification

**Form of Financial Architecture**

- No silver bullet
- Multiple levels of coordination
- High-level entity
- Executive agency
- Financial Mechanism
- Cadre of Financial vehicles and windows

**Financial Mechanism and Vehicles**

- Financial mechanism: as fiduciary agent(s) of the financial architecture/system
- Financial vehicles: as executing agencies for projects and programs
- Existing institutions already playing important role

## 2 Current In-Country Financial Architectures in Developing Countries

**B**ased on the review of in-country financial architectures in multiple countries, we have arrived at some initial reflections regarding the use of particular arrangements to address climate finance readiness processes. These reflections, however, do not by any means imply that there is a silver bullet to address institutional arrangements and climate finance readiness processes at the country level.

Broadly speaking, countries that are in the process of implementing their institutional and climate finance arrangements share a similar set of characteristics, including:

- 1. High-level Commission/Committee/Council on Climate Change:** This is usually comprised of key Ministries such as the Environment, Finance, Foreign Affairs, Agriculture, and Productive Industries. In the majority of cases, this institution has the necessary political clout to mainstream the National Climate Change Strategy into diverse sectoral and sub-national plans.
- 2. Executive Team/Secretariat:** The Executive Team/Secretariat is housed alternatively in the Ministry of Planning, Finance or Environment, with participation from a set of experts from other key Ministries. This agency usually acts to coordinate, follow up and report on results, as well as delivering capacity building initiatives.
- 3. Fiduciary Agent/Financial Mechanism:** In some cases, National Development Banks play the role of Fiduciary Agent (see Annex 1 for the role of national development banks in Mexico's climate change financing); in other cases, it is a centralized financial or fiscal mechanism. In yet other cases, countries are creating national climate funds. These bodies serve to match needs with available resources, coordinate international cooperation, facilitate financial intermediation and blending of resources and tools, and track and report public financial flows, both from domestic and external sources.
- 4. Cadre of Financial Vehicles and Windows:** This set of financial vehicles and agencies consists of existing and new funds, as well as financial facilities; is operated by public and/or private actors; and can be located at the national or sub-national levels. In some cases, vehicles and agencies have a loose coordination mechanism, allowing them to effectively operate as a whole, and thus overcoming the need to have a centralized financial mechanism or national climate fund.

In order to provide a better conception of how these different institutions operate together and the functions they deliver, Box #1 describes the case of the institutional and climate finance arrangements in Brazil.

Finally, our interpretation of the existing in-country financial architectures in Brazil, Mexico and Indonesia, based on the analysis contained in this document, is captured graphically in the three diagrams included in Annexes 2, 3 and 4 at the end of this document.

### Box 1: *In-country Institutional and Climate Finance Arrangements of Brazil*

The nation of Brazil provides a good model of in-country institutional and climate finance arrangements which follow the structure detailed above.

The Comitê Interministerial sobre Mudança do Clima (Inter-ministerial Committee on Climate Change, or CIM) was created in 2007 to oversee the National Plan on Climate Change (PNMC). As a cross-sectoral group, membership includes Ministers of State, presidents of Regulatory Agencies, business representatives, non-governmental agencies, universities, and members of the public. Within the Committee, the Grupo Executivo sobre Mudança do Clima (Executive Group on Climate Change, or GEx) is coordinated through the Ministry of Environment and responsible for the creation, implementation, monitoring, and assessment of the PNMC, which was approved in 2008. Currently, CIM, and through it the GEx, is focused on helping the different Government ministries align their sectoral plans to the PNMC. Brazil also has the Fórum Brasileiro de Mudanças Climáticas (Brazilian Forum on Climate Change, or FBMC) that facilitates public discussion on climate change matters to increase awareness and catalyze action among civil society, though they are not granted any decision-making power.

A few principal fiduciary agencies exist in Brazil to organize the dispersal of climate change adaptation and mitigation resources. Banco Nacional de Desenvolvimento Econômico e Social (Brazilian National Development Bank, or BNDES) is the central financing agency for development in Brazil. Regional financial institutions, including Banco da Amazônia and Banco do Nordeste do Brasil, also work with BNDES to provide sustainable development assistance in rural areas. Financiadora de Estudos e Projetos (Financer of Studies and Projects, or FINEP) is housed within the Ministry of Science and Technology and promotes innovation in the public, private and academic sectors. From its position within the Ministry of Finance, Caixa Econômica Federal (Federal Savings Bank or CEF) acts as the largest government-owned financial institution in Latin America, enabling credit lines for targeted projects, including those related to environmental sustainability and climate change.

BNDES manages a number of financial vehicles for climate change activities. El Fundo Amazônia, or the Amazon Fund, provides resources to projects that combat deforestation and promote sustainable use of the Amazon; and Fundo Clima (National Climate Change Fund or FNMC) finances via loans (managed by BNDES) and grants (managed by the Ministry of Environment), mitigation and adaptation efforts in the fields of energy, agriculture, desertification, education, training, REDD+, technological development, public policy, sustainable production chains and environmental services, based on the actions and priorities identified in the sectoral plans aligned with the PNMC. BNDES additionally finances Clean Development Mechanism projects through an Investment Participation Fund (FIP). Also notable is the Programa Agricultura de Baixo Carbono (Low-Carbon Agriculture Program or ABC) which funnels money from the Ministry of Agriculture to rural producers who adopt sustainable techniques that minimize emissions, and in which BNDES and Banco do Brasil play a role as financial intermediaries. Finally, FINEP also manages the Programa de Apoio a Projetos do Mecanismo de Desenvolvimento Limpo (the 'CDM Projects Support Program' or 'Pro-MDL'), which provides funds to promote partnerships and development initiatives related to Clean Development Mechanism projects.

## 3 Findings on Challenges in Climate Finance Readiness Processes

In their efforts to establish in-country financial architectures for climate change, governments are being confronted by challenges with regard to their strategic planning processes and their coordination mechanisms. This occurs both internally between agencies at the national and subnational levels, as well as externally with donor agencies. Our analysis has identified three major challenges, all of which are complementary. Each must be addressed if governments intend to achieve effective and strategic management of low emissions and climate resilient development strategies.

**Challenge #1:** Climate change national strategies need to chart a clear road map (the “what?” the “how?” and the “why?”) for climate change to be mainstreamed into development planning

Over the past ten years, many developing countries have developed climate change strategies that attempt to mainstream climate change considerations into development planning at several levels of government (national, subnational, and local). In developing these strategies they have involved several development and environmental actors (public sector, including regulators; private sector; as well as civil society at large) through participatory processes.

In order to show the extent to which developing countries have adopted climate change strategies, in Table 1 on the following page, we provide a sample list of examples of national climate change strategies, which include a diverse selection of developing countries, both in terms of size and location. While all of these strategies, programs, or plans aim to further the consideration of climate change in the national agendas of their respective countries, they are not entirely comparable. Some are short (a few pages) and contain very vague objectives while others are hundreds of pages and detail specific projects, responsible agencies, financial vehicles, and mitigation targets as well as other aspects.

Some countries, especially those whose dominant share of emissions comes from one sector, such as forests, have developed quite robust national plans to address emissions from that sector, even if an overall national climate strategy is less developed. In the case of forests, the informal multilateral initiatives of the Forest Carbon Partnership Facility and UN-REDD have provided readiness preparation templates and additional guidance helpful to many countries in cultivating readiness for REDD+.

Based on the observations from the process followed by the Government of Peru to develop their in-country financial architecture, **we identified four key components that any climate change strategy would need to have in order for climate change action to be integrated into development planning of a country:**

- a. The long-term objectives to be achieved, with quantifiable (e.g. emission reductions) and qualitative indicators (e.g. process improvements on stakeholder and inter-ministerial dialogues, in-country coordinating mechanisms, revision/feedback mechanisms of strategies) in the short and medium terms;



**Table 1: Sample List of National Climate Change Strategies<sup>1</sup>**

<b>COUNTRY</b>	<b>STRATEGY</b>	<b>YEAR</b>
<b>Latin America</b>		
Argentina	National Climate Change Strategy	2011
Brazil	National Plan on Climate Change	2008
Mexico	National Climate Change Strategy	2007
Peru	National Strategy on Climate Change	2003
Chile	National Climate Change Strategy	2006
Honduras	National Strategy for Climate Change	2010
Costa Rica	National Strategy on Climate Change	2008
<b>Asia</b>		
Vietnam	National Climate Change Strategy	2012
Laos	National Strategy on Climate Change	2010
China	National Climate Change Program	2007
Bangladesh	Climate Change Strategy and Action Plan	2009
India	National Action Plan on Climate Change	2008
Indonesia	National Action Plan Addressing Climate Change	2007
<b>Africa</b>		
South Africa	National Climate Change Response Strategy	2004
<b>Island Countries</b>		
Papua New Guinea	Climate Compatible Development Strategy	2010
Seychelles	National Climate Change Strategy	2009
Saint Lucia	National Climate Change Adaptation Policy and Strategy	2003

<sup>1</sup> The names and years are based on the English translations of the strategies or executive summaries of the strategies published by the respective governments.

- b. The priorities for action (what, where, how, with whom, and why);
- c. The mechanisms through which the objectives will be achieved (strategic lines of work that include implementation and financial instruments as well as adequate institutional arrangements); and
- d. Roles and responsibilities of the different actors, including measuring, reporting and verifying actions and feedback mechanism to adjust and enhance public policies.

With the purpose of getting a general sense of how far countries have gone into integrating climate change action into their development planning, we have conducted a preliminary review of a set of climate change strategies using these components as the main evaluation criteria. In addition to Peru, we selected Brazil, Mexico and Costa Rica based on their political similarities with the former, and also on the strong political will they have enjoyed over the past five years to advance their in-country climate change agenda. We also selected Indonesia to expand the sample beyond Latin American countries, and in recognition of their current efforts to integrate their climate change strategy into the core national fiscal framework.

Generally, all of the strategies have detailed long-term objectives and have identified the sectors in need to address climate change variables, but in some cases they may need further clarity with respect to which institutions and financial vehicles will implement these objectives. Below, we review the status of the components in these five countries.

*Component 1: Long-term objectives, with quantifiable and/or verifiable objectives in the short and medium terms*

All five of the strategies included long-term objectives for both mitigation and adaptation. They differ in how specific these long-term objectives are (e.g. including percentages for the reductions in GHG emissions) and whether they include short and medium-term objectives that can be used to quantify progress. The most concrete objectives were often presented as priorities for an industry or region of the country.

*Component 2: Priorities for action (what, where, how, with whom, and for what purpose)*

Many of the strategies are presented as plans for the next 30 years, and therefore the countries have divided their strategies and priorities into stages: assessment and data collection, planning, and implementation. As work has been completed in the first stage, some countries have been able to establish clear priorities with specifics pertaining to the industry or region, institution, goal, and funding source. Others are still collecting the data and establishing the institutions and financial vehicles needed to set forth specific priorities.

*Component 3: Mechanisms through which the objectives will be achieved (strategic lines of work that include implementation and financial instruments)*

In most strategies, the financial vehicles and implementation mechanisms have recently been established, and the portfolio of projects that each entity will be responsible for is still being developed. Importantly the countries have begun to develop funds that will distribute financing to mitigation and/or adaptation projects.

*Component 4: Roles and responsibilities of the different actors, including measuring, reporting and verifying actions and feedback mechanisms to adjust and enhance public policies.*

The countries are still solidifying the responsibilities of each entity and coordination mechanisms between them. Most have established a council, commission, or office dealing with climate change, but what the main coordinating entity will be and who the other important government ministries and funds are, was only clear in some strategies. Thus, few verifying, reporting and measuring mechanisms appear to be in place. So far, only Mexico's strategy included a clear feedback mechanism to consult experts, refine policies, and coordinate between the ministries, funds and other institutions.

## **Challenge #2:** Limited in-country coordination mechanisms may create dispersion and disorder in decision-making processes.

The increasing number of initiatives and actors involved in climate change at national and subnational levels is an encouraging signal of the mainstreaming of climate change issues. However, this situation also increases the need for coordination mechanisms between various institutions and actors. Our analysis has shown that in many cases these mechanisms have yet to be established and applied in such a way as to guarantee efficiency, complementarity, coherence and a more organized decision-making process. Box 2 on the following page presents the exponential increase of climate change-related initiatives and actors in Peru.

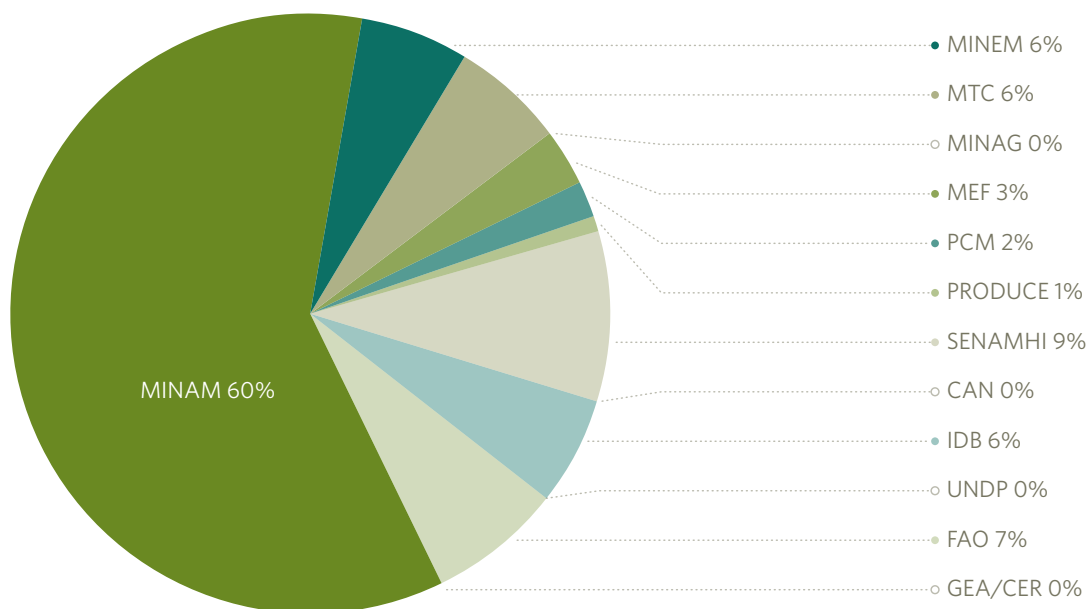
Ministries, especially those with environment-related responsibilities, tend to be under-resourced, and thus cannot devote sufficient time to their crucial role as policy and strategy makers. As a result, many valuable initiatives lack the planning needed for them to be successful.

While short-term investments may be worthwhile, they lack the long-term sustainability (e.g. initiatives that are not 'climate-proof') needed to generate substantial positive impacts over time to deal with climate change. The absence of effective coordination results in overlapping objectives and a dispersion of efforts, making it harder to approach problems holistically, and to make use of the comparative advantage of each project. As a result, the following tasks are more difficult to complete:

- Quantifying financial resources to be allocated to finance adaptation measures and emissions reductions;
- Identifying financial tools and mechanisms to be used for these measures and actions;
- Assessing the expected combined effects of these measures; and
- Negotiating with international cooperation agencies, as well as with national and subnational financial stakeholders and private sector financiers, on priority areas for funding.

## Box 2: Exponential increase of climate change-related initiatives and actors in Peru

The actors participating in the management of climate change today have increased substantially: there are 12 times more projects than there were in 2006 and potentially 160 times more resources available. In 2006, CONAM (formerly the country's environmental authority) had seven projects in their portfolio with a two-year implementation period for a total amount estimated at \$4.78 million. At that time, nearly all climate change resources came from international aid sources. By contrast, in 2011, 88 projects were found in the execution or negotiation phase with a total estimated \$858 million (provided by domestic resources, international donations and loans). The chart below shows the distribution of international aid (in percentages) between actors in 2011.



### Challenge #3: Investments in international climate cooperation, and related structures and arrangements, need to be better aligned with developing countries' ongoing institutional and policy developments

As a result of the fast-start financial commitments made by developed countries in Copenhagen in 2009, the international community is in the process of creating new structures and approaches through bilateral and multilateral channels, as well as expanding their dimensions directly (through new climate funds) and indirectly (through existing aid cooperation channels and local financial systems).

These new structures and approaches of international cooperation are diverse and complex and may need effective arrangements by developing countries for accessing financial resources in a more systematic and coordinated manner. Our analysis demonstrated that recipient countries have intensified their efforts to evaluate their existing institutions in order to enhance their in-country financial architectures. These evaluations should be recognized by donor countries and integrated into their funding priorities.

## 4 The What and How of Climate Finance Readiness: Recommendations

**B**ased on the analysis conducted in Sections 2 and 3 we have arrived at a set of recommendations on what functions an in-country financial architecture should deliver as part of the climate finance readiness process (Section 4.1). In addition, we provide recommendations on how to overcome some of the challenges of the climate finance readiness process to increase the likelihood that climate change variables would be considered as part of national development policies and strategies and enhance the coordination between actors, both domestic and international (Section 4.2).

### 4.1 Functions of In-Country Financial Architectures in Developing Countries

As indicated in Section 2, there is no silver bullet to address the challenges of designing and implementing an in-country financial architecture. Each country brings a set of political and economic realities that make general formulas difficult to apply across the board. However, the design and implementation process could certainly be enhanced by focusing first on the set of functions, before deciding on the form the arrangements would take.

In other words, before proposing the creation of new arrangements and financial vehicles, governments should conduct a thorough evaluation of the functions that existing institutions and financial vehicles—public and private, local, regional and international—can deliver (or have the potential to deliver).

Coordination mechanisms could also be sought between existing institutions and financial vehicles to enhance complementary functions and financial intermediation. As a last resort, new institutions and financial vehicles can be created to fill the gaps not covered by existing institutions, financial vehicles and/or coordination mechanisms.

Based on our research, the minimum functions that in-country financial architecture should aim to deliver, are:

#### **Political Function:**

- Establish and revise on a regular basis the priorities of the national climate change strategy (including regarding implementation modalities) and their alignment with the overall development strategies of the country;
- Strategically mainstream a climate change agenda into national development policy agendas;
- Align the institutional and climate finance arrangements with public policies and fiscal mechanisms established by the government, and vice versa;
- Oversee the implementation of the national climate change strategy;
- Make political decisions in a consistent and transparent fashion about the roles and responsibilities of the institutional arrangements vis-à-vis the national climate change strategy;
- Adopt the necessary actions to maintain up-to-date institutional arrangements and national climate change strategy.

### **Strategic Function:**

- Support the design and implementation of actions and instruments of the national climate change strategy;
- Identify priority actions for the implementation of the national climate change strategy;
- Support alignment of the national climate change strategy's priorities into sectoral and subnational plans;
- Propose financial mechanisms for research and development, and for attracting third-party investments (public and private);
- Ensure that updated information on activities, resources, and priority goals for climate change action is available, and that it is shared with relevant actors, as well as through the required reports corresponding to national commitments;
- Propose regulations that allow for an increase in the number of project implementers (both public and private institutions), as well as for the establishment of projects' registries (including Nationally Appropriate Mitigation Actions or NAMAs registry);
- Coordinate the identification, design, implementation, and registry of NAMAs;
- Propose mechanisms and instruments for capacity building in public agencies and private/civil society institutions; special emphasis should be placed on developing the capacity of subnational and local governments to implement projects;
- Establish feedback mechanisms and periodically conduct reviews on the operation and effectiveness of existing institutional and climate finance arrangements and national climate change strategy; identify actions to be updated.

### **Financial Function**

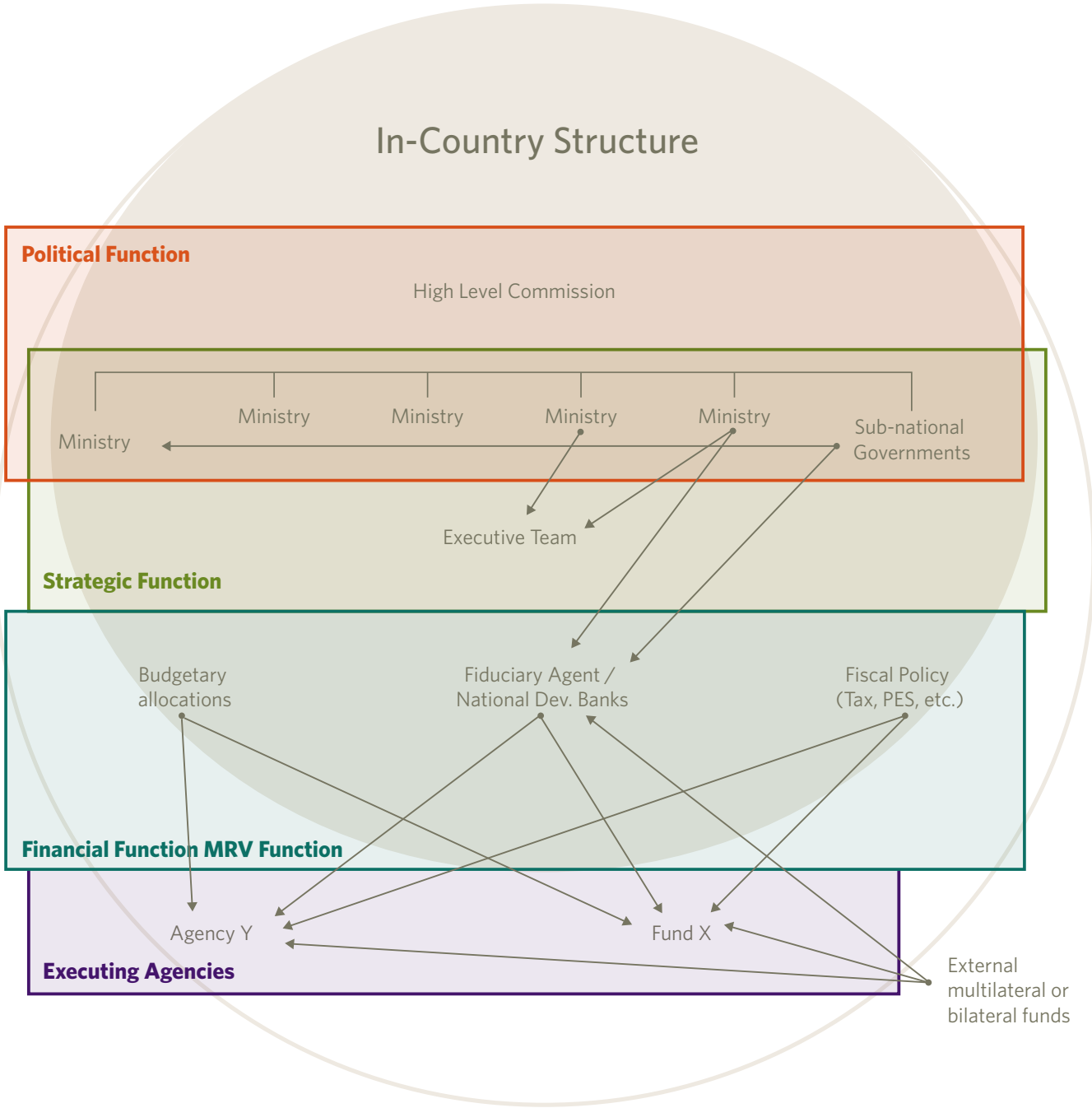
- Facilitate coordination between international cooperation and domestic sources with the purpose of evaluating the adequacy of demand (needs) and supply (resources), as well as enhancing complementarity between the multiple financial channels available and coherence within this financial architecture, and with the national/sector/local strategies and priorities;
- Ensure the provision of financial and non-financial (i.e. technical assistance) services for the implementation of national climate change strategy plans and actions;
- Coordinate access to resources: international cooperation (technical and financial), loans and other financial instruments and mechanisms, investments, and budget allocations;
- Develop financial products and instruments (reimbursable and non-reimbursable) to take advantage of external and domestic resources available, and optimize their combined use (e.g. financial intermediation);
- Provide technical and financial assistance to public agencies and private institutions in the design and implementation of programs (as opposed to individual projects with lower overall impact).

### **Monitoring, Reporting and Verification Function**

- Follow up and report on activities, products, results, and goals achieved in the implementation of the priorities established in the National Climate Change Strategy;
- Report on financial flows to cooperation sources;
- Build capacity in public agencies and private institutions for the preparation, monitoring and evaluation of programs (financial and non-financial) and processes.

In Diagram 1 on the next page, we have represented graphically the distribution and relationship (and eventual complementarity and/or overlapping) between the different set of functions.

**Diagram 2: Functions of an In-Country Financial Architecture**



## 4.2 Objectives of Climate Finance Readiness Processes

The three challenges identified in Section 3 present as a common denominator the fact that governments need to have a strong and effective national climate change strategy in place that covers the set of key components discussed previously in this paper, namely:

- a. The long-term objectives to be achieved, with quantifiable and qualitative indicators in the short and medium terms;
- b. The priorities for action (what, where, how, with whom, and why);
- c. The mechanisms through which the objectives will be achieved; and
- d. Roles and responsibilities of the different actors, including measuring, reporting and verifying actions and a feedback mechanism to adjust and enhance public policies.

However, a national strategy is a result of a functioning planning process where mechanisms are in place to: (i) mainstream climate change into national development plans, and (ii) allow for the consideration of inputs resulting from bottom-up consultation and participation processes.

**Based on our analysis, the basic steps in planning for climate change can be broken down into five stages: initiating policy, creating a national strategy or plan, mainstreaming climate change considerations into sectoral and subnational plans, the completion of detailed action plans, and a feedback process to revisit on a regular basis the strategies and underlying methodologies to develop such strategies and plans.**<sup>2</sup>

The planning process would require substantial feedback between the steps, which are not necessarily linear steps. In addition, several steps of the process would require participatory approaches to include different stakeholders in decision-making instances.

Diagram 2 is a representation of how, based upon our observations, in-country planning is best conducted to improve existing and/or to develop new institutional arrangements for climate finance. In this diagram, we also indicate the type of actions that would usually occur during each of the five stages of planning.<sup>3</sup> The actions shown during each stage of planning differ from country to country; however, most countries participate in all five planning stages.

The more developed climate change planning becomes in a country, the more likely it is that the adaptation and mitigation actions could be identified, appraised and matched to funding opportunities; these can then be covered by external funding and domestic budgets and/or a combination of both through financial intermediation. When funds are obtained through the latter, both direct allocations and targeted fiscal policies and instruments can be used.

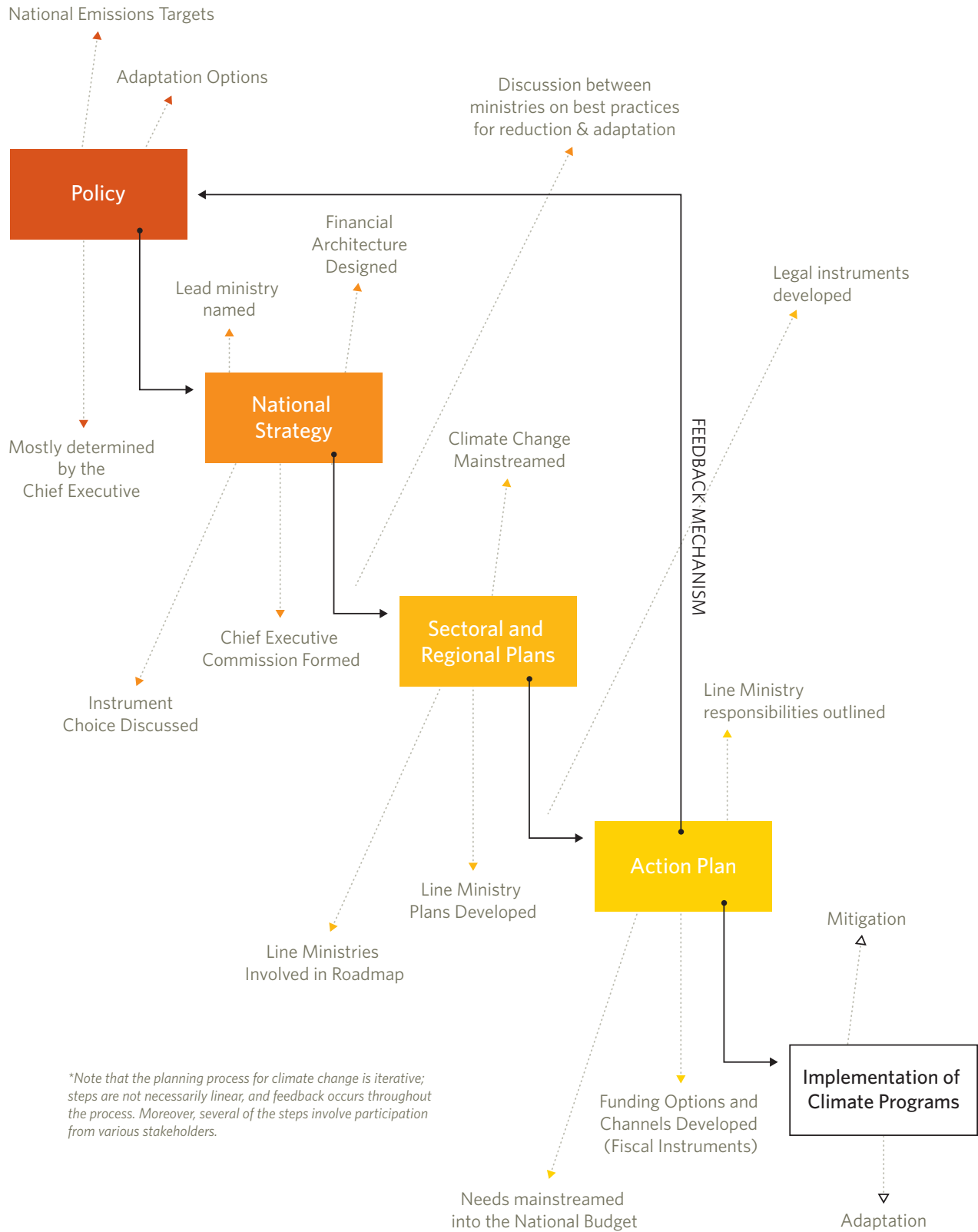
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<sup>2</sup> The terms for the stages reflect the most generic description of the phases. The terms used nationally may vary.

<sup>3</sup> Actions are designated by the dotted arrows.



**Diagram 3: The National Planning Process for Climate Change**



In conclusion, setting up a planning process for climate change is the most significant component in the design of the national climate financial architecture, and a national climate change strategy is at its core. This reality would also help insulate existing policies and strategies from changes in Government, ensuring a minimal continuity over a longer period of time for greater predictability for partners and stakeholders involved.

Hence, we have identified the following set of objectives to be pursued by governments when thinking about the design and implementation of their climate finance readiness processes.

#### *Overall Objective*

- Facilitate the implementation of the national climate change strategy by ensuring efficient and transparent disbursement of available funding towards identified priorities.

#### *Specific Objectives*

- Deliver instruments and mechanisms that provide guidance and facilitate the implementation of the national climate change strategy. At the same time, these should be capable of monitoring developments and impacts on quality of life and other national development indicators.
- Design and establish institutional arrangements for the coordination of public management and decision-making on climate change within government agencies and with local and international cooperation and financial systems, meanwhile initiating climate finance readiness processes in alignment with initiatives identified by the national climate change strategy.
- Develop the capacity of public agencies (including national development banks and other adequate national agencies) to take on their roles in the management of climate change as well as promote private sector investment and research in technology development.

In conclusion, governments from developing countries embarking on climate finance readiness programs would benefit from setting objectives early in the process, such as the ones proposed here, or others that are similar. By doing this, they increase the likelihood of mainstreaming climate change variables into their national development agenda.

## Annex 1: The Role of National Development Banks in Mexico's Climate Change Financial Architecture

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The in-country financial architecture in Mexico is a dense matrix of financial institutions that offer loans, grants, and technical training programs related to climate change adaptation and mitigation. The following four National Development Banks act as first- and second-tier lending institutions (fiduciary agents) in Mexico, responsible for the efficient organization and dispersal of resources both directly and through intermediary trust funds and financial windows. Together, they play a central role in Mexico's overall climate change strategy and help to integrate climate change solutions into an overarching development agenda.

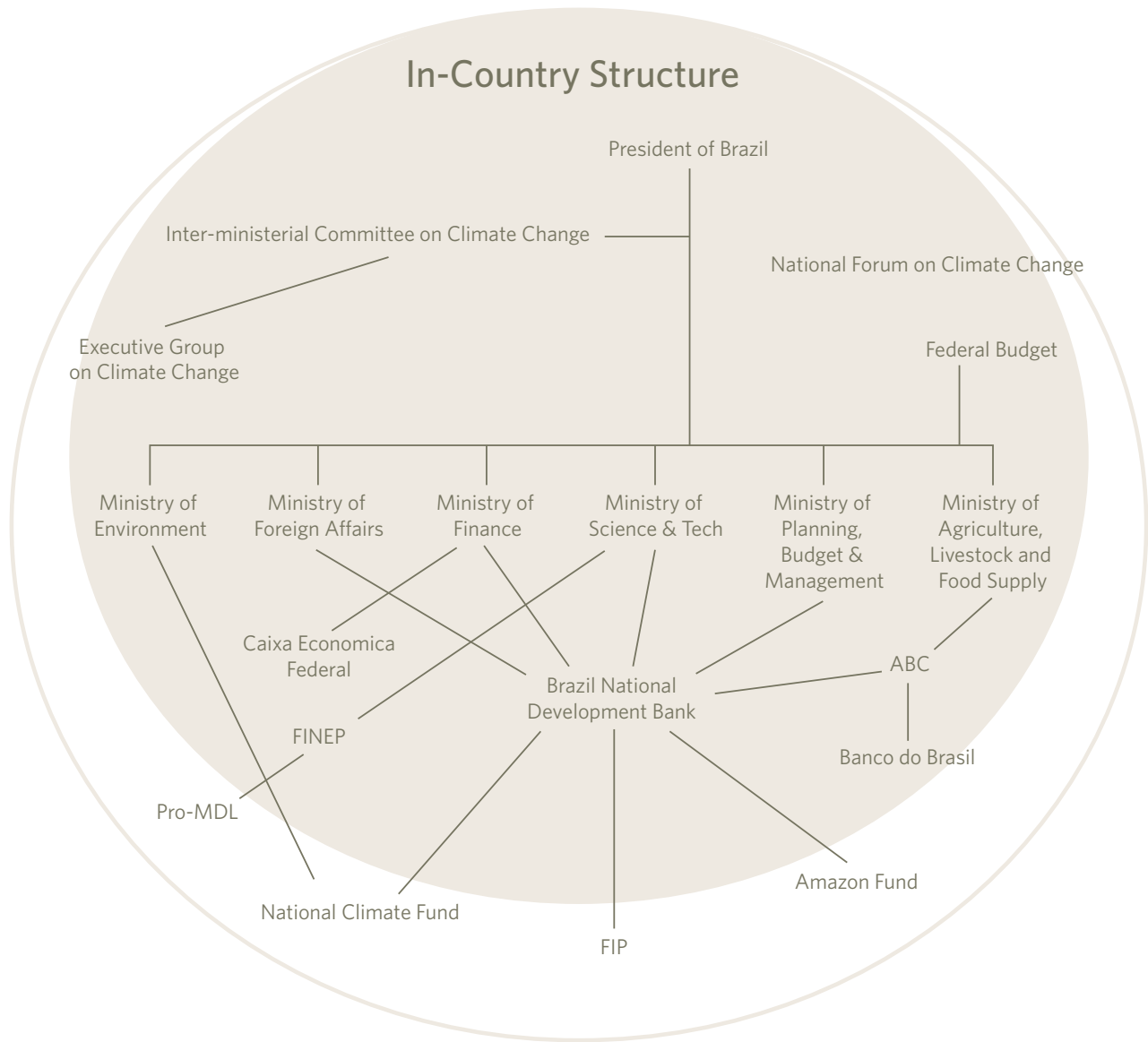
Nacional Financiera (NAFIN) is the principal financial agent of the Mexican federal government for negotiating and obtaining lines of credit from the World Bank, the Inter-American Development Bank and the Export-Import Bank of the United States and works as a second-tier institution to coordinate and efficiently pass financial, technical and training resources to micro, small and medium-sized enterprises. NAFIN is the strategic nexus that orchestrates support for a number of individual programs, including: the Mexican Forest Fund (FFM) which provides payment for environmental services; the Mexican Carbon Fund (FOMECAR), which promotes the development and use of low-carbon-emission technologies; the Trust Fund for Electric Energy Savings (FIDE) which promotes efficiency; and Support Services for Agricultural Marketing (ASERCA) which works to liberalize markets and channel financial resources directly to producers.

Dedicated to the promotion of rural development, Financiera Rural (Fin. Rural) is an agency within the Mexican Ministry of Finance that offers two primary forms of assistance: loans and technical training. Funded through Congressional appropriation, they act as both a first- and second-tier lending institution. Financiera Rural has forged partnerships with the Inter-American Development Bank to finance low-carbon emissions strategies for rural development. Their Forest Investment Plan (FIP) has been integrated into the national REDD+ strategy.

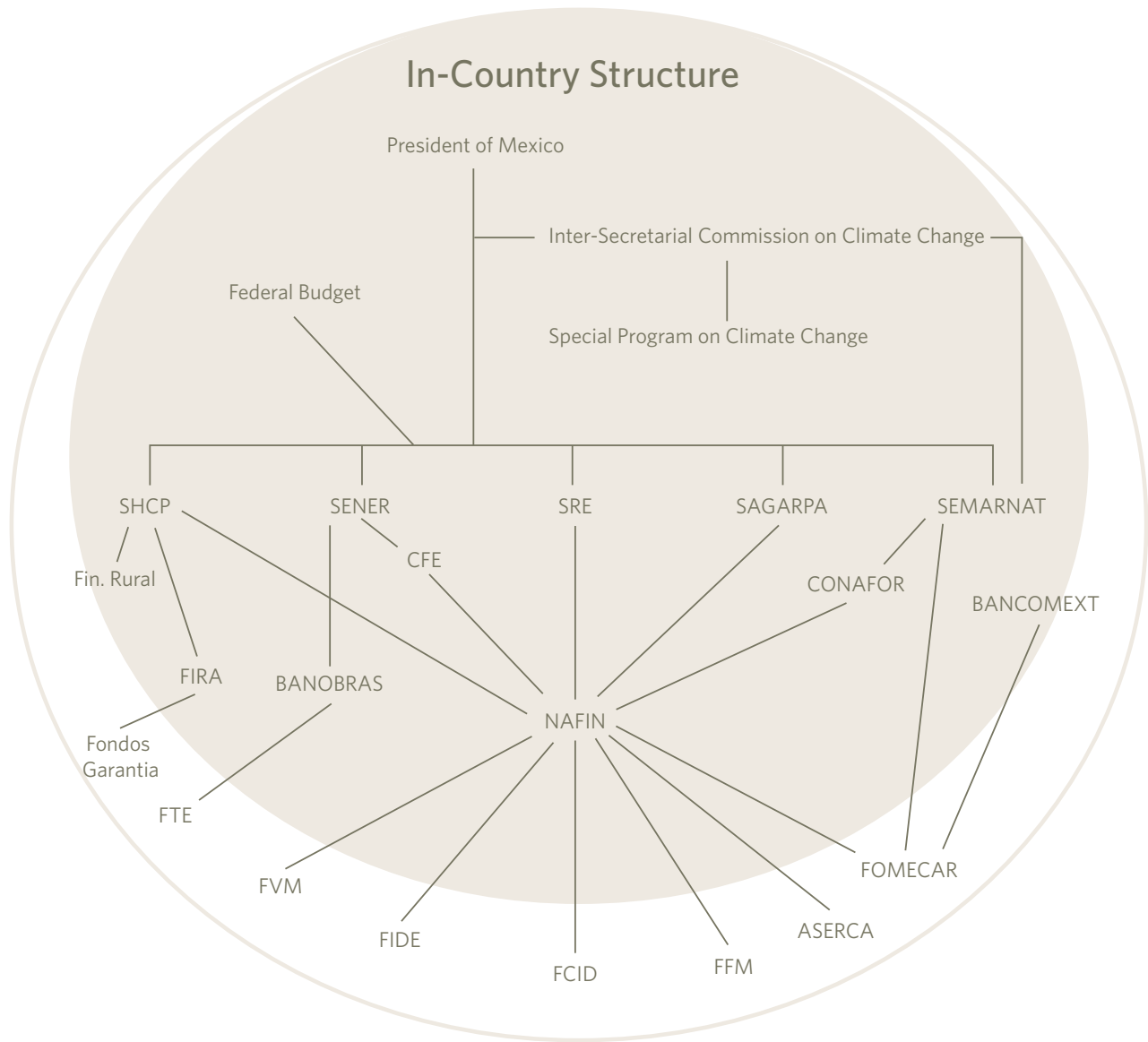
The National Bank of Public Works and Services (BANOBRAS), specializing in urban development, operates the Energy Transition Fund (FTE) to provide municipalities and low-income households with grants to increase energy efficiency through appliance and streetlight modernization.

Fideicomisos Instituidos en Relación con la Agricultura (FIRA, or Trust Funds for Rural Development) are a collection of four trusts which operate as second-tier development banks to pass resources through intermediaries (including commercial banks, credit unions, and other financial institutions) to eligible borrowers in rural areas. Priority is given to projects that encourage producer sustainability, including climate change risk-management plans, access to carbon markets, production of biofuels, installation of anaerobic digesters, conservation of soil and irrigation water, and reforestation.

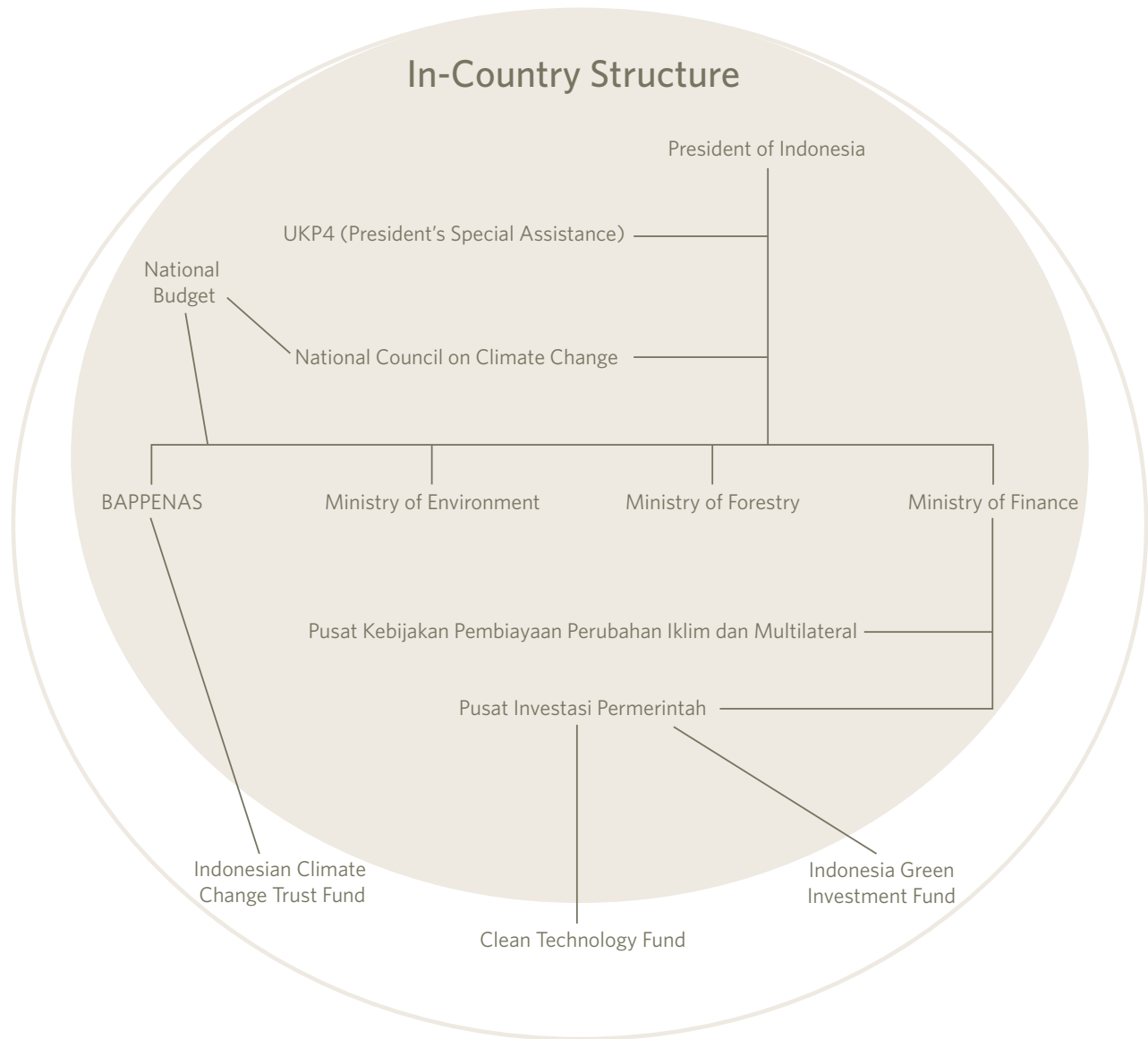
## Annex 2: In-Country Financial Architecture of Brazil



## Annex 3: In-Country Financial Architecture of Mexico



## Annex 4: In-Country Financial Architecture of Indonesia



## Further Resources

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**Photo on the cover:** A Boat glides through coastal mangroves in the Reserva de la Biosfera la Encrucijada near the town of Salto De Agua; Chiapas, Mexico. The mangrove reserve is a major nesting area and also used for managed shrimp farming. © Mark Godfrey/The Nature Conservancy

