Policy Brief

Climate Finance:

Key for the Territories of Central America

The international resources for financing climate action are becoming a cornerstone of the future development of the countries in the global South. Since 2010, there has been a global commitment to mobilize, beginning in 2020, some $100 billion annually for climate finance, a sum that approaches the historic highs of Official Development Assistance (ODA). In 2013 and even though the sources of this unprecedented amount is still uncertain, the member countries of the United Nations Framework Convention on Climate Change (UNFCCC) made progress in defining the basic architecture for channeling these resources, in particular through the new Green Climate Fund (GCF).

Despite its vital importance for supporting green, low-carbon development ('mitigation') that is resilient to climate change ('adaptation'), the basic features of climate financing continue to be a great unknown for many political actors and their technical staff in the developing world. On the one hand, national governments have recently been approaching this type of complex financing that typically collides with the scarce capacities of the public sector. On the other hand, for the most part, territorial authorities – where climate change is palpable in daily life and in the economy on a daily basis – are often unaware of the available options and basic requirements for accessing, managing, and accounting for these funds.

These deep gaps between global decisions, national capacities, and territorial realities are very palpable in Central America. In the face of these severe limitations, the PRISMA Foundation together with MultiPolar and the climatefinance.info platform prepared in the beginning of 2014 a detailed report on climate finance in Central America and the opportunities for the territories of Central America to access these international resources for its climate action. Today, these Central American territories already suffer from the severe impact of climate change without sufficient capacities for responding. Therefore, our urgent attention is required looking toward a territorial development that ensures the welfare and security of its communities and the citizens that live in them.

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What is climate finance?

Over the course of the past two years, developing countries and their societies have faced the growing impacts of climate change. Fundamental questions emerge in this context regarding how countries can prepare their social and productive infrastructure for the effects of climate change ('adaptation'), for example in vulnerable sectors such as agriculture or public works. At the same time, a greener development trajectory is necessary, with fewer carbon dioxide emissions, i.e. 'low-carbon development' ('mitigation'), which is especially relevant in sectors with 'green potential,' such as energy and transportation.

To mobilize the resources necessary for these actions, the member countries of the United Nations Framework Convention on Climate Change (UNFCCC) agreed in 2010 to a commitment of 100 billion USD annually to combat climate change in the developing world beginning in 2020. This sum approaches the historical highs of Official Development Assistance (ODA) that is clearly in decline. Therefore, this climate finance constitutes a new window of opportunity for ensuring the continuity of external development financing. It is important to highlight that, in contrast to the voluntary nature of ODA, climate finance, as 'new and additional' resources beyond ODA, is a binding obligation shared among the countries.

The latest available data (for the year 2012) indicate that current climate financing already amounts to US$30 - US$35 billion annually, channeled in large part through large-scale bilateral funds and multilateral banks. The common features across climate funds include the fact that the majority of these resources are dedicated to mitigation (between 75 and 95%) and that a large part of this comes in the form of loans, not grants. Geographically, Latin America is typically one of the regions that benefit the most, but resources are concentrated in the large economies that have financial and institutional architecture adapted to climate change, in particular Brazil and Mexico.

In the management of these resources, there is a notable use of programmatic models such as multilateral and bilateral funds. Examples are the Global Environment Facility (GEF), created in 1991 and with a climate financing of 1.8 billion USD (2006-2014); the Adaptation Fund (AF), launched with the Kyoto Protocol in 1997 and a total capitalization of 325 million USD; and the Climate Investment Funds (CIF), created in 2008 and with a current volume of 7.8 billion USD, all of them managed by the World Bank. Moreover, there are different multilateral and bilateral funds that support the initiative launched by the United Nations in 2008 for the Reduction of Emissions from Deforestation and Forest Degradation in Developing Countries (REDD+), with financial commitments totaling 2.7 billion USD. Different governments of the North, such as Germany and Great Britain, also maintain bilateral funds, of 950 million and 4.7 billion USD, respectively.

The future of climate finance will be channeled through the Green Climate Fund (GCF). Endorsed by the Durban COP (South Africa) in 2011, the GCF is a fund is a part of the UNFCCC, which will be fully operational as of 2015 and will probably channel a substantial portion of the annual 100 billion foreseen starting in 2020. The GCF will take advantage of lessons learned in recent years, especially for ensuring adequate joint governance shared between resource providers and receivers, as well as facilitating direct access by accredited authorities of the governments (that will be in charge of channeling large-scale funds to national institutions). Among the challenges is the need to strike a good balance among climate priorities, specifically for investing sufficient resources in adaptation, benefiting the most vulnerable countries, and generating sufficient concessionary resources to avoid climate debt, which is very evident in a number of countries.

Against this backdrop, it is imperative for the countries of Central America to start to construct a regional vision that leads them to find common outlets for channeling large-scale resources. One the critical pathways could pass through the development of regional financial architecture for climate change that allows for growth in scale capable of attracting more and better climate financing, under the incentives that govern the channeling of large funds of climate change resources.

Climate finance: How to adapt national budgets?

Beyond accessing and managing external resources, it is vital for the future of developing countries to integrate the climate factor in their public finances. On the one hand, climate impacts national budgets, causing especially in the case of natural disasters, frequent reorientation of necessary public resources from ‘soft portfolios’ (such as health and education). On the other hand, through its various sector portfolios, public expenditure is already invested in adaptation (sustainable agriculture, resilient infrastructure, etc.) and in mitigation (renewable energy, more efficient public transportation, etc.). However, it is true that, to date, no country in Latin America has been able to quantify the amount of their own resources that they are already investing to combat climate change. Particularly in Central America there is still no capacity for analyzing the performance of public finances and the significant modification of public expenditures due to the impact of increasingly violent climate events.

The principal question is the extent to which public expenditures contribute to preparing countries for the effects of climate change and to driving greener development. Here, it is necessary to consider that climate change is a cross-cutting topic that affects practically all of the social and productive sectors of a country. The analysis of the extent to which sector expenditures contribute to combatting climate change (their ‘climate relevance’) requires a definition of criteria, ideally based in public policies, including National Climate Change Strategies.

The good news is that there are already some timid advances by Central American countries in understanding the role of climate change in their public finances. Costa Rica has initiated the work of identifying its climate expenditures in public investment and its budgets. Similar analyses are being conducted in El Salvador and Honduras, driven in both cases by loans received from the Inter-American Development Bank (IDB) that contain conditionalities regarding the management of the fiscal risks of climate change.

Indeed, the governments of Central America may be able to take advantage of lessons learned by countries of the Asia-Pacific that have, since 2012, analyzed their public expenditures utilizing the methodology of CPEIR (Climate Public Expenditure and Institutional Review). Among its many benefits, this type of analysis enables an understanding the weight of climate change in public expenditures (from 7% in Bangladesh to 42% in Samoa), a confirmation that governments usually contribute large-scale resources, and knowledge that these resources are direct primarily to adaptation and only to a lesser degree to mitigation.

For the countries of Central America, this type of analysis could be useful not only for understanding the scope of individual countries’ efforts, but also for generating strategic national processes. The latter could include the impetus for the political visibility and strategic relevance of climate change, the integration of the climate factor in active processes of the modernization of public finances, or the revision of incentive frameworks for private investments in climate change.

Effectiveness and quality of effective climate finance: Some guidelines

The volume and complexity of climate finance makes it urgent to reflect on how to appropriate, spend, and account for these resources. In Central America, the conditions are still not very favorable. Climate change typically occupies an irrelevant niche in the political sphere, with a lack of knowledge regarding the basic features of climate finance and, beyond the Ministries of Environment, the Ministries of Development Planning, Foreign Affairs, and Finance still have a passive role, though all of them are relevant for channeling large-scale external financing.

In the face of these challenges, since 2011 a debate has emerged regarding the effectiveness and quality of large-scale climate financing. For many developing countries, it is evident that it must respect the universal principles for international flows of development financing, which include national appropriation, the use of national systems (alignment), the harmonization of international contributions, a results orientation, and mutual accountability.

In this vein, some Latin American countries have embarked on an analysis of the barriers to access, management and accountability with respect to climate finance.[1] These studies have already been concluded in El Salvador and the Dominican Republic, and are currently in preparation in Honduras, and take a dual perspective in reviewing the capacities and performance both of national governmental institutions and of the agencies of the international community, in order to establish criteria and guidelines in the following phases of climate financing:

In access to climate financing, national *governments* need to have solid public policies articulated with clear financial frameworks (for example in plans and programs), to invest in human and institutional capacities, and ensure adequate inter-institutional coordination. The local offices of the international *community* should offer clear information on the modalities for accessing climate financing and ensure that these resources are consistent with the priorities of the government and national systems for registering external resources..

In the management of climate financing, *ministries and governmental institutions* need to utilize financial instruments adapted for managing large-scale climate financing (such as funds, sector-wide approaches, etc.), and climate change should be reflected in public finances. The *international community* should ensure that financial resources are channeled through national systems and instruments and that the various agencies harmonize their procedures.

In accountability for climate financing, national governments should integrate climate change in national processes of results-based management and accountability, including dialogue with parliament and civil society. For its part, the international community should utilize national systems of results-based management for its financing and support the generation platforms for mutual accountability and continuous dialogue with governments.

Regional processes and experiences of Central American governments

Recognizing the urgent need for preparing themselves for climate financing, a number of Central American governments have, since 2012, embarked on a systematization of their experiences and innovations in public policies, institutionality, and the financial management of climate change. As part of a series of Regional Dialogues on Climate Finance in Latin America and the Caribbean, governments reviewed and exchanged their national solutions. Unsurprisingly, the first two Regional Dialogues took place in Central America (Tela, Honduras, May 2012, and San Salvador, El Salvador, July 2013). Beyond the substantial existing political differences, these efforts were accompanied by initiatives of the Central American Integration System (SICA), in particular the Central American Commission for Environment and Development (CCAD) and, more recently, the Council of Finance Ministers (COSEFIN) as a

[1] The methodology of the studies on the barriers to climate finance have been elaborated by MultiPolar at the request of the governments participating in the process of climate finance in Latin America and the Caribbean.

forum of reflection on public finance and fiscal risk management as they relate to climate change.

In this valuable context, different governments of the region have begun to document their experiences and lessons learned in access, management, and accountability in climate financing.[2] In summary, one can highlight that, with the exception of El Salvador, every country has a National Climate Change Strategy, which in many cases is coordinated directly with the Ministries of Finance. At the sector level, Nicaragua, Costa Rica, El Salvador, and the Dominican Republic have climate plans in sectors such as agriculture, energy, education, or transportation. Only Nicaragua has strategies and plans at the sub-national level, which demonstrates the urgent need to involve territories in the strengthening of climate financing. The adaptation of financial architectures to climate change is a pending task throughout Central America, and only recently have countries such as Costa Rica and the Dominican Republic approached the design of climate-specific financial instruments. In this area one can also highlight the scarce comprehension of the weight of climate change in public finances.

Inter-institutional coordination regarding climate finance has moved forward only in El Salvador, while there are large deficiencies in the knowledge and capacities of the various governments of Central America for accessing this type of financing. No country in Central America has established clear guidelines for dialogue with the international community around climate finance, also reflecting the low capacity of the Ministries of Environment to conduct this type of political and strategic conversation. Finally, only Costa Rica and Honduras have well-formed mechanisms to involve the private sector in climate finance, above all in the area of mitigation. On this topic, all of the countries need to develop a greater capacity for public-private dialogue and promote among national businesspeople a greater awareness with respect to the many opportunities for investing in climate change adaptation and mitigation.

Climate finance in the territories: A first approach

As we have seen, the governments of Central America are, step by step, approaching climate financing. At the same time, the climate vulnerability of Central America is inherently territorial. However, to date, the national governments have made few efforts to seek communication, much less coordination, with individual territories around climate finance. A fundamental question is the extent to which territories are, or could be, able to access, manage, and account for climate financing, resources which are typically channeled primarily through national governments and their distinct sector ministries, with scarce influence and little access from territorial authorities.

Filling this profound gap, for this report, a brief process of consultation took place with territorial representatives from four Central American countries regarding the opportunities and challenges of climate finance in the territories. Specifically and preliminarily, it is possible to highlight a few factors affecting climate financing in the territories.

Among the opportunities for the territories to mobilize climate finance, one may highlight their capacity for strategic articulation, due to the closeness and level of familiarity of the actors in the territories among themselves. The Permanent Roundtable of Local Actors in Bajo Lempa (MESPABAL) is a good example of this type of multi-actor articulation. Another positive factor is an anchor in the local, given that a practical understanding of the regional and local conditions exists, the problems faced, and the

[2] Experiences reflected in the thematic papers elaborated by different Latin American governments for the First and Second Dialogue on Climate Finance in Latin America and the Caribbean, which took place in Tela, Honduras (May 2012), and San Salvador, El Salvador (July 2013), respectively. For more details, refer to the PRISMA report titled "Climate Finance – Key for the Territories of Central America.".

forms of overcoming them. In addition, the sustainability of territorial actions typically continues beyond the political cycles that often mark national agendas, and the possibility of closely integrating with climate finance providers in the area, especially with historical donors in the territories that, in addition to ODA, offer resources specifically for climate action.

Despite this ample potential, the territories also face limitations to accessing and managing climate resources. These include the lack of knowledge of climate financing modalities and opportunities. With a few exceptions, the territories are also disconnected from the design and implementation of public policies at the national level that in some cases fail to consider the feasibility that these policies should have in the municipalities, communities, and regions. On the other hand, territories have low technical capacity for strategic planning around climate change (action plans, programs, etc.) that could make them more apt for climate financing. A culture of small-scale action also persists, given that the majority of development activities in the territories occur through a very limited scope and budget, which typically runs counter to the preference of the climate finance mechanisms for very large financial frameworks. A possible response to this challenge could be the Trinational Fund of the Cross-Border Association of Bajo Lempa. Finally, except for pilots such as the Mesoamerican Community Carbon Reservoir (MesoCarbon), there are still no instruments or mechanisms strong enough to manage large-scale climate programs for the benefit of regions, communities, and municipalities.

How to prepare the territories of Central America for climate financing: Elements for a roadmap

Over the course of the past two years, climate finance has become a key source for developing countries that want to invest in low-carbon, climate-resilient development. While there have been timid advances at the national level, territories are still far from the pathways and options of this type of financing, despite having specific advantages and opportunities for receiving external resources for their climate action.

In this vein, it is possible to identify a few basic elements for the territories of Central America to develop their strategic, institutional, and operational capacities to access, manage, and account for climate finance. By actor, the following concrete actions are proposed:

The territorial authorities in Central America could strengthen their strategic planning for territorial development, design joint financial instruments shared among multiple territories, deepen the exchange of knowledge and promote mutual learning, and conduct an exercise in the mapping of territorial expenditures performed vis-à-vis the impacts or products of climate variability and that have committed other projected relevant expenditures.

The national governments of Central America[3] should ensure an adequate inclusion of territorial representatives in inter-institutional coordination, support the training of technical staff of territorial authorities and governments, provide access to all available information regarding current and potential sources of climate financing, and foster climate finance strategies that contemplate mechanisms for channeling resources towards the territories.

Through Central American Commission for Environment and Development (CCAD), Council of Central American Finance Ministers (COSEFIN), and Center for the Prevention of Natural Disasters in Central America (CEPREDENAC), SICA could support the territories by conducting the inevitable task of placing the topic of climate change within SICA,

[3] In particular the Ministries of Environment, Development Planning, Foreign Affairs, and Finance.

supporting the joint efforts of various territories in regional programs of territorial climate action, analyzing the feasibility of designing a Regional Climate Change Fund, and generating regional spaces for continual exchange among territories in different countries of Central America.

The specialized organizations and academia of Central America also have an important role to play in the development of the capacities and knowledge necessary for the territories, for which purpose they could systematize territorial experiences with climate financing, support the development of capacities in the territories and in particular territorial coordination mechanisms, and strengthen the multi-actor alliances that exist in different territories through a greater and more continued presence of civil society representatives.

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