



Private gain, public interest

Can private finance help communities adapt to climate change?



Peter Catton / Tearfund

Executive summary

At the international climate talks in 2009 in Copenhagen, developed countries promised that by 2020 they would mobilise \$100 billion a year for climate change mitigation and adaptation in developing countries.¹ The funds would be raised from various sources, including private finance.

Given the scale of the climate challenge, there is a need to draw on all possible financial provision – and private finance clearly has a role to play. Overstretched aid budgets are already providing the bulk of climate finance, to the potential detriment of other key development areas such as education and health. And after an initial flurry of activity during the fast-start finance period 2010–2012, the amount of public climate finance from aid budgets appears to be falling. Little

progress has been made on developing innovative public sources of finance, such as levies on international transport.

The private sector is increasingly championed as a solution that will plug the current gap in international climate finance. The UK government is a key

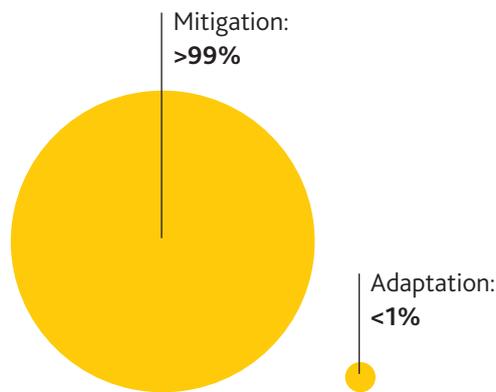


Figure 1: ODI assessment of sectors benefiting from \$8.5 billion of investments aimed at mobilising private climate finance in 2010–2012.

proponent of this view and has taken a lead in using its own public climate finance to explore how private sector finance can be mobilised. It has also strongly supported the development of the Green Climate Fund's Private Sector Facility.

Our research suggests that private finance lends itself more naturally to funding mitigation in developing countries rather than adaptation; furthermore, mechanisms for providing private sector finance for mitigation are better developed. Evidence for private sector engagement with adaptation is minimal, and what little there is indicates a number of problems in relying on private finance to deliver adaptation for the poorest communities.

For example, ODI recently compiled data around 73 climate finance investment initiatives totalling \$8.5 billion by the UK, Japan, Germany and the US between 2010 and 2012 aimed at mobilising private climate finance. Of these investments more than 99 per cent went to mitigation projects and there was virtually no direct investment involving the private sector that targeted adaptation to climate change. Eighty-four per cent of investment flowed to middle-income countries.²

1 Copenhagen Accord, FCCC/CP/2009/11/Add.1, December 2009 <http://unfccc.int/resource/docs/2009/cop15/eng/11a01.pdf>

2 Whitley, Shelagh (February 2013) *Five early lessons from donor's use of climate finance to mobilise the private sector*. ODI

Header photo: Margaret Chandler / Tearfund

Recommendations

UK bilateral and multilateral initiatives

- The UK and other donors should seek to provide a stronger evidence for private sector engagement in adaptation, demonstrating how benefits will flow to the poorest and most vulnerable communities.
- The UK government should assess its bilateral and multilateral private adaptation initiatives at the earliest opportunity to ensure that they benefit the poorest communities, and that they contribute to country-led integrated approaches to adaptation. Private finance initiatives should be subject to the same performance indicators DFID has developed for the International Climate Fund.
- The UK government should review its use of ODA to fund the CP3 Platform

against OECD guidelines and the 2002 International Development Act to ensure that it genuinely meets the criteria for ODA, especially around poverty reduction. If this is not the case then the CP3 should be discontinued, or funded outside ODA.

Private Sector Facility (PSF) of the Green Climate Fund

- The Green Climate Fund's PSF must support a country-led integrated approach, including a 'no-objection' procedure. Clear guidelines for when and how the private sector should engage with adaptation should be developed. The PSF must also ensure that support goes to developing country Small and Medium Enterprises (SMEs) and to the poorest and most vulnerable countries, and to the poorest communities within those countries.

Public finance

- The UK government should be open and public in championing public sources of finance for climate change, and should continue to acknowledge that private finance will not work for all countries and needs – particularly because, based on the current evidence, it is unlikely to benefit adaptation in the poorest countries.
- Developed countries should meet their commitment to provide \$100 billion a year by providing new additional public finance. This means that they must look at innovative sources of public finance as a matter of urgency: for example, a levy on international shipping and aviation, financial transaction tax or other options. Private finance should be additional to the \$100 billion a year of climate finance that developed countries have committed to mobilise by 2020.

The underlying need for companies to make a financial return in a low-risk investment environment means that Least Developed Countries (LDCs) and other low-income countries are less likely to benefit from investment as any returns would be low and slow. Adaptation generates tangible benefits for people and communities but, in contrast to mitigation, it may not produce significant monetary gains for investors. There are some exceptions around infrastructure and utility projects such as water management, but here the need to generate a return for investors may price poor communities out of the market.

Funding for adaptation is an obligation of wealthy countries that bear most responsibility for climate change – it must be accessible for poor communities hit hardest by climate change.

At the outset, it should be made clear that \$100 billion a year in new additional, predictable public finance is not enough to meet adaptation and mitigation needs in developing countries. The World Bank estimates that an average of \$75–100 billion of public finance a year is needed

for adaptation alone in 2010–2050.³

Public finance has certain key advantages over private finance: predictability, specific developmental objectives, ability to reach the poorest, among others. Tearfund believes that \$100 billion should be the minimum raised in public finance and that any leveraged private finance should make a contribution over and above this amount. This underlines the need to explore and instigate innovative sources of public finance, such as levies on international aviation or shipping, or a globally agreed financial transactions tax, to avoid putting further pressure on overstretched aid budgets.

The private sector is increasingly championed as a solution that will plug the current gap in international climate finance.

Conclusion

Private sector engagement in adaptation is in its early stages and governments and donors should proceed with caution. Private sector investment is a more natural fit for mitigation initiatives and evidence to date about the effectiveness of private finance for adaptation is weak. Analysis from private development financing suggests that LDCs and other low-income countries are unlikely to benefit from private investment, and that financing is unlikely to flow to the most appropriate sectors for adaptation. It is probable that smallholders and local businesses in developing countries will be neglected. Therefore, governments cannot rely on private finance to meet the adaptation needs of the poorest communities and countries. Tearfund makes the recommendations shown in the box above.

³ World Bank (2009) *The costs to developing countries of adapting to climate change: new methods and estimates. The global report of the economics of adaptation to climate change study* <http://siteresources.worldbank.org/INTCC/Resources/EACCRpt0928Final.pdf>

Overview of private finance for adaptation

How could public finance be used to raise private finance for climate adaptation?

Developing countries, especially LDCs and other low-income countries, can find it difficult to attract open-market investments because the profit yields are likely to be low and the risks associated with investment may be high. This can be due to issues such as weak infrastructure and weak political and institutional frameworks. The purpose of leverage is to use public investment to attract private sector investment in adaptation and mitigation which would not have happened otherwise.

There are serious questions as to how well leverage works to generate new private sector investment for both adaptation and mitigation. The 2010 High-level Advisory Group on Climate Change Financing report claims, for instance, that \$35–60 billion in public finance combined with \$30–50 billion in carbon offset flows could leverage \$100–200 billion in private flows for climate finance – on the basis of a leverage ratio of 1:3.⁴ However, a recent report by Eurodad observes that this claim

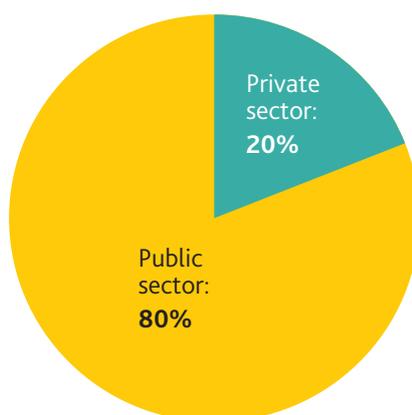


Figure 2: ODI assessment of \$8.5 billion of climate finance investment initiatives intended to leverage private finance.

is generally untested.⁵ There is a lack of clarity in how leverage is assessed and some leverage ratios have been challenged. (For example, a Clean Technology Fund investment in Turkey that claimed a 1:10 leverage ratio actually raised very little private finance at all.)⁶ Recent data from ODI found that of 73 climate finance investment initiatives totalling \$8.5 billion by four donor countries, including the UK, aimed at mobilising private sector climate

finance only 20 per cent came from the private sector.⁷

Also, there is little evidence, if any, to date around how leverage might work for adaptation. One risk of leverage is that investment may shift to places where the private sector is already more engaged, rather than actually shifting financial flows to new places and new sectors. In fact, leverage may simply displace investment from one location or sector into another – so that there is no new or additional finance being released – undermining the concept of additionality in climate finance.

A recent policy briefing for the European Parliament by the Directorate General for External Policies concluded that leveraged funds should not be considered as part of the \$100 billion pledged, for two main reasons:

- The \$100 billion is insufficient to meet the challenges of adaptation and mitigation in developing countries; and
- If risks are low, private investment would have happened anyway without public finance; if risks are high, then large amounts of public money could be

Public finance may be used in the following ways:

■ **Loan finance:** for example, International Finance Institutions (IFIs), public institutions which include the Multilateral Development Banks, invest about \$40 billion in operations that focus on the private sector in developing countries. About 20 to 40 per cent of this investment is given in the form of concessional loans (loans that are made with more generous conditions than the normal market rate). A further example of loan finance would be issuing green or adaptation bonds in the capital markets to be repaid with interest to creditors on maturity.

■ **Equity investments in private initiatives:** public finance is used to buy shares in private companies. This might

help give greater geographic and sectoral balance than would otherwise have been achieved in an open market.

■ **Grants** may be given to companies where opportunities for profit are low, sometimes in the form of public-private partnerships.

■ **Credits, guarantees and insurance:** developed country governments underwrite the risk of investing in the developing country. This can take the form of export credit guarantees – supporting foreign investment for large projects overseas by providing insurance against non-payment. Guarantees exist to protect donor companies making the investment, but they do not take account of recipient country priorities.

4 UN (2010) *Report of the Secretary-General's High-level Advisory Group on Climate Change Financing*, 5 November 2010 http://www.un.org/wcm/webdav/site/climatechange/shared/Documents/AGF_reports/AGF_Final_Report.pdf

5 Pereira, Javier (May 2012) *Cashing in on climate change? Assessing whether private funds can be leveraged to help the poorest countries respond to climate challenges*. Eurodad

6 Ibid

7 Whitley, Shelagh (February 2013) *Five early lessons from donor's use of climate finance to mobilise the private sector*. ODI



Most existing models and institutions operate through global funds or international financial institutions that are not always well linked to national plans'.⁹

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wasted and it may be better to spend this money directly, as straightforward public investment.⁸

The Bretton Woods Project identifies ten key problems with private finance leverage, looking specifically at the World Bank Group. One is that national strategies and policies may be overridden

because 'most existing models and institutions operate through global funds or international financial institutions that are not always well linked to national plans'.⁹ The principle of country ownership is a crucial one, and leveraged private finance could well distort or subvert this. Furthermore, 'transparency and accountability are currently very low for

publicly backed private investment in developing countries', with much weaker reporting standards. Where financial intermediaries are used, there is a further decline in transparency, which threatens to undermine social and environmental standards. Also, if the risk of investment is transferred to public institutions, then this could fuel unacceptably high risk-taking, as private companies would be shielded from the consequences of investments going wrong.¹⁰

In the UK, mainstream politicians are increasingly criticising the lack of transparency in private spending. In 2008, the House of Commons Liaison Committee said claims of commercial confidentiality were making it difficult for MPs to scrutinise the growing number of private finance initiative (PFI) contracts and other outsourced deals.¹¹ In his Autumn Statement 2012, Chancellor George Osborne used the word 'discredited' to describe the PFI model in the UK.¹² If such mechanisms are to be employed in climate financing in developing countries, then lessons must be learnt – and issues of transparency and value for money must be resolved.

What about insurance?

Insurance schemes aim to compensate for losses after an event, rather than contributing to preparedness for climate change. Having insurance does not necessarily reduce the physical risks people face: it simply transfers the risk of financial loss. But recent debates around 'loss and damage' – the harm caused by climate impacts when mitigation and adaptation efforts have failed – indicate that insurance may play a key role in helping poor communities address climate change. Poor communities generally struggle to access appropriate insurance schemes, a situation which is unlikely to improve as climate change takes hold: commercial insurers are even less likely to offer insurance to affected areas. Insurance is unlikely to work for the most vulnerable communities in the poorest countries unless it is part of a publicly backed initiative.

As an example of public-private collaboration on insurance, the Munich Climate Insurance Initiative (MCII)

brings together NGOs, insurers and other experts to help develop insurance-related solutions to climate change. The MCII launched a pilot project linking the Caribbean Catastrophe Risk Insurance Facility (CCRIF) with a micro-insurance broker (MicroEnsure) and the world's biggest reinsurer (Munich Re). This programme aims to overcome barriers in extending access to risk management solutions, including insurance and risk reduction, to low-income communities in the Caribbean. This programme is part of the International Climate Initiative (IKI) by the German Federal Ministry of the Environment.¹³

However, the MCII is taking international public climate finance and using it for climate insurance mechanisms, rather than raising new and additional funds – though this may change over time. One risk is that it may divert into public-private insurance schemes public adaptation finance that would have been spent on better adaptation priorities.

8 EU Directorate-General For External Policies, Policy Department (June 2012) *Climate change financing: the concept of additionality*, p.19

9 Griffiths, Jesse (April 2012) 'Leveraging' private sector finance: how does it work and what are the risks? Bretton Woods Project, p.9

10 Ibid, p.11

11 *Financial Times* (2 September 2008) 'PFI deals "not doing a good job", says watchdog'

12 *Hansard* (5 December 2012) Column 877

13 Munich Climate Insurance Initiative: http://www.climate-insurance.org/front_content.php?idcat=860

Which countries and sectors are likely to benefit from private adaptation finance?

There is very little evidence to date for private adaptation financing specifically. This is partly because private finance is not yet flowing towards adaptation initiatives and partly due to the lack of information about where private finance is flowing and difficulty in assessing these flows. ODI's assessment of \$8.5 billion of investments by the UK, Japan, Germany and the US between 2010 and 2012 found that more than 99 per cent went to mitigation projects and there was virtually no direct investment in adaptation. Eighty-four per cent of investment flowed to middle-income countries.¹⁴

There is no hard evidence around leveraged private finance for adaptation. However, the Stockholm Environment Institute undertook a broad assessment of where international open-market private finance currently flows. Its conclusions raise serious doubts about the ability of private finance flows to contribute to adaptation in the poorest and most vulnerable countries – even taking into account the potential for leverage to redirect flows to more vulnerable regions.

Case study – Flood warnings in Bangladesh

US company Riverside works in the fields of water resource management and disaster risk reduction. Working with local partners in Bangladesh, Riverside adapted the latest flood warning technologies (remote sensing, hydrologic models and geographic information systems) to the Bangladeshi context. To generate and disseminate accurate and timely flood warning messages to the village level, Riverside used a text message-based

model for flood warning dissemination that gave vulnerable communities access to science. Riverside works with local partners and communities from both the private and public sectors during project design and implementation, ensuring that these local engineering, consulting and planning entities build their own capacity and resilience to respond to climate change scenarios.¹⁵

In 2010, two-thirds of equity Foreign Direct Investment (FDI) to developing countries went to Asia and only ten per cent to Africa. About half of flows went to high-income

developing countries and only 15 per cent to low-income ones.¹⁶ By 2010, the top recipients of FDI were China, Brazil, Russia, Singapore, India, Mexico, Chile and Indonesia – all middle-income developing countries.¹⁷ Overall, FDI to developing countries has increased despite the financial crisis, but such investment to LDCs, Africa, Landlocked Developing Countries (LLDCs) and Small Island Developing States (SIDS) has fallen. According to DanChurchAid, the BASIC countries (Brazil, South Africa, India and China) received \$240 billion of FDI in 2010, whereas LDCs received only \$26 billion.¹⁸

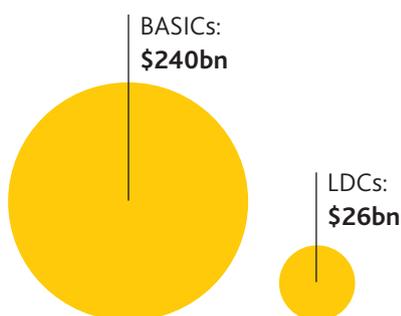


Figure 3: Foreign Direct Investment flows in 2010

LDCs = least-developed countries
BASICs = Brazil, South Africa, India and China

Furthermore, there is massive inequality in the spread of FDI flows within regions – for example, North Africa receives about four times more FDI than East Africa.

14 Whitley, Shelagh (February 2013) *Five early lessons from donor's use of climate finance to mobilise the private sector*. ODI

15 http://unfccc.int/adaptation/nairobi_work_programme/private_sector_initiative/items/6547.php and <http://www.oxfamamerica.org/files/a-fresh-look-at-the-green-economy.pdf>

16 Atteridge, Aaron (2011) *Will private finance support climate change adaptation in developing countries?* Stockholm Environment Institute, Working paper, p.13

17 Ibid, p.14. Note: Russia is still defined as a developing country according to the World Bank and other sources, despite being an Annex 1 country under the UNFCCC.

18 DanChurchAid (2012) *Will the private sector pay the Climate Bill?* p.10





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LDCs receive only about three per cent of developing country FDI flows and the private investment that does reach them is very unevenly distributed across regions and sectors. For Africa, a third of FDI inflows between 2000 and 2006 went to six major petroleum-exporting nations (Algeria, Angola, Congo, Gabon, Libya and Nigeria).¹⁹

Looking specifically at debt finance, the World Bank's 2009 *Global Development Report* shows that Africa receives a tiny proportion of FDI debt financing. The same is true for international bank lending, which suggests that Africa is likely to have problems raising finance through international loans. Latin America and Asia receive the bulk of international bank lending.²⁰

Even the World Bank's International Finance Corporation (IFC) directed more than half of its investments in 2009 to just ten middle-income countries while the rest was shared between 80 poorer countries that borrow from the International Development Association (IDA).²²

Eurodad conducted an assessment of whether Financial Intermediaries (FIs)²³ adequately targeted low-income countries (LICs). It examined five Development Finance Institutions (DFIs), including the IFC and the European Investment Bank (EIB), and found that only a tiny

'Few of the sectors categorised by the UNFCCC in its summary of NAPA priorities (UNFCCC, 2010) appear well matched with private patterns of investment and lending. In the agricultural sector, FDI tends to follow cash crops rather than food staples, and to benefit large industrial production rather than small-scale farming. Hence, agricultural FDI may not necessarily be generating food security benefits, nor the right kind of investments for buffering livelihoods and reducing wider vulnerabilities among local communities...

*It is plausible that investments in telecommunications can play a significant positive role in supporting early warning systems, among other adaptation benefits. Water sector investments seem highly concentrated in East Asia. Finally, there is virtually no evidence of FDI supporting either the health or education sectors. Overall, these coarse level patterns do not look promising for adaptation outcomes.'*²¹

STOCKHOLM ENVIRONMENT INSTITUTE

19 Atteridge, Aaron (2011) *Will private finance support climate change adaptation in developing countries?* Stockholm Environment Institute, Working paper, p.14, 15

20 Ibid, pp16-17

21 Ibid, p.26

22 DanChurchAid (2012) *Will the private sector pay the Climate Bill?* p.10

23 Defined as institutions that connect those who want to lend money with those who want to borrow it – including banks, credit unions, insurance companies, and private equity, investment and pension funds.

fraction of finance flowed to LICs. When the focus was narrowed down to climate investments in LICs, Eurodad found that the IFC had no such investments and the EIB had only three projects worth a total €125 million in LICs.²⁴

This indicates that, quite apart from the limited capability of private flows, as detailed above, the hard reality is that money is unlikely to flow to the most vulnerable countries if current investment patterns continue. Private investors must make a financial return and it seems that LDCs and other poor countries are perceived as offering insufficient opportunity for a good return. While public sector leverage options may help direct some private investment towards LDCs by providing incentives, it is difficult to see how leverage can create a massive shift in finance for poorer countries.

There is little data about sectoral prioritisation of international private finance flows, but one clear trend is that a significant portion of FDI flows to Africa centre on the exploitation of natural resources – especially oil and mining. Between 2002 and 2004, 22 LDCs saw no new investment projects at all in any sector.²⁵

When the sectoral prioritisation of private investment is compared with the sectoral prioritisation of developing country adaptation plans (which tend to focus on food security, agriculture, water, livelihoods, disaster management etc), there appears to be almost no overlap. And in contrast to mitigation, where the

creation of clean energy sources offers obvious potential for profit, it is more difficult to see where any profit might lie in adaptation activities that benefit communities more widely.

The current geographic and sectoral spread of private finance investment indicates that, even if there is significant public finance investment to leverage private finance for adaptation initiatives in the poorest and most vulnerable countries, it is unlikely that money for adaptation will flow to these countries.

This means that it is likely that public finance will have to fill enormous gaps in adaptation funding, in terms of getting money both to the most vulnerable countries and to the most vulnerable sectors.

Will private adaptation finance flow to small or large businesses?

A further concern with how private sector investment is delivered is that very little appears to go to small and medium enterprises (SMEs). It is vital that adaptation finance reaches SMEs and smallholders in developing countries working at community level. The OECD notes that 'SMEs and informal enterprises account for over 60% of GDP and over 70% of total employment in low-income countries, while they contribute over 95% of total employment and over 70% of GDP in middle-income countries'.²⁶ Eurodad reports that DFIs provide



24 Pereira, Javier (May 2012) *Cashing in on climate change? Assessing whether private funds can be leveraged to help the poorest countries respond to climate challenges*. Eurodad, p.14

25 Atteridge, Aaron (2011) *Will private finance support climate change adaptation in developing countries?* Stockholm Environment Institute, p.19, 20, 24

26 OECD (2004) *Promoting entrepreneurship and innovative SMEs in a global economy, towards a more responsible and inclusive globalisation*.



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*'The overwhelming experience of successful developing countries is that private sector investment needs to be directed and influenced by a national strategy... However, most existing models and institutions operate through global funds and international finance institutions that are not always well linked to national plans.'*²⁹

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substantial support to SMEs in middle-income countries, but not in low-income countries. Only 2.4 per cent of the IFC's investments (of which 0.2 per cent relates to climate investments) go to SMEs – and only 0.4 per cent of the EIB's investments in low-income countries;

these investments are mainly channelled through financial intermediaries.²⁷

However, in considering the need for investment to reach small businesses, it is also worth noting that the World Bank defines SMEs as having up to 300 employees and sales/assets of up to \$15

million; the EU defines SMEs as having up to 250 employees and a turnover of up to €50 million. This is extremely sizeable, particularly for low-income countries.²⁸

Adaptation must reach the poorest and most vulnerable communities. If private finance does not flow to smallholders and micro-enterprises, it is unlikely to reach those most vulnerable to climate change. Some investors will have concerns about profit and fiduciary risk around such small investments, which further substantiates the claim that private finance is not a particularly appropriate vehicle for adaptation.

OVERVIEW OF FUNDS

Climate Investment Funds – Pilot Programme for Climate Resilience (PPCR)

The PPCR is one of the Climate Investment Funds set up under the World Bank in 2008. It was designed to pilot and demonstrate ways to integrate climate risk and resilience into countries' core development planning. The UK has committed £310 million of its climate finance to the PPCR.³⁰ Among other aims, the PPCR offers additional financial resources to help fund public and private sector investments that are prioritised in national climate-resilient development plans. It looks to scale up and leverage further investment in climate resilience.³¹

Private sector adaptation initiatives currently proposed under the PPCR include projects in the following countries: in Bangladesh, around promoting climate-resilient agriculture and food security, and technical assistance for a feasibility study for climate-resilient housing in the coastal region; in Mozambique, for developing

climate resilience in the agricultural water sectors through provision of credit lines from Mozambican banks, and developing community climate resilience through private sector engagement in forest management; and in Nepal, for building climate-resilient communities through private sector participation.³²

Tearfund is concerned about numerous aspects of the PPCR which has not performed well against criteria of country ownership and active participation of affected citizens and local actors.³³ The PPCR's outlook has been focused on short-term results, which has often led to a failure to integrate activities into national plans and meant that it has not managed to be truly consultative of affected communities. This does not bode well for ensuring any private sector activity is integrated and accountable to poor communities.

27 Pereira, Javier (May 2012) *Cashing in on climate change? Assessing whether private funds can be leveraged to help the poorest countries respond to climate challenges*. Eurodad, p.14

28 Ibid

29 Griffiths, Jesse (April 2012) *'Leveraging' private sector finance: how does it work and what are the risks?* Bretton Woods Project, p.9

30 DECC/DFID/DEFRA (2011) *UK Fast Start Climate Change Finance*

31 Climate Investment Funds PPCR Fact Sheet, March 2012

32 *PPCR Semi-Annual Operational Report*, PPCR/ SC.10/3, April 16, 2012

33 Wiggins, S et al (2012) *Quick off the blocks? UK adaptation finance and integrated planning (summary)*. Tearfund, p.2

Challenges of using private finance for adaptation



Eleanor Bentall / Tearfund

What risks must be managed to ensure that private finance for adaptation contributes to sustainable development?

There are a number of concerns around some current private sector investment in developing countries. For example:

- Failure to put in place social and environmental safeguards, which could lead to environmental problems and abuses of worker and community rights;
- Tax avoidance – leading to a missed opportunity for developing countries to benefit from the tax revenues due to them;

- Appropriation of land – land-grabbing is already a significant problem, with poor countries losing an area of land the size of a football pitch to banks and private investors every second;³⁴
- Negative impacts on the local economy and livelihoods (eg investment displaces local activities); these may undermine rather than strengthen resilience.

The design of any private sector funds for climate change adaptation must ensure that these concerns are addressed

and not exacerbated. Furthermore, while development assistance has direct poverty reduction aims, these aims are not generally shared by private investment, though, of course, poverty reduction can occur as a by-product of investment. Private climate finance directed towards adaptation must be subject to objective sustainable development standards to ensure that it contributes to appropriate development aims.

Case study – Irrigation technology in Zambia

John Deere is a multinational corporation that sells tractors, tillage, hill and forage equipment, and some precision irrigation technologies for high-value crops. Drip, or precision, irrigation systems increase crop productivity and water-use efficiency. These systems have predominantly been used to support large-scale agriculture because of the need to access electricity; however, systems are now being designed and implemented for small-scale use, an urgent need as community farmers face more frequent and severe droughts.

John Deere is working to create products and services more suitable for small-scale farmers, and has made a commitment to provide advisory services coordinated with technology sales in the developing world. In Zambia, John Deere is exploring a partnership with the World Bank to test innovative microfinance options, such as providing loans through cooperatives, to support and build resilience of local farmers in developing countries.³⁵

34 www.oxfam.org.uk/get-involved/campaign-with-us/our-campaigns/grow/guide-to-land-grabs

35 http://unfccc.int/adaptation/nairobi_work_programme/private_sector_initiative/items/6547.php



Chris Boyd / Tearfund

Learning from the Clean Development Mechanism (CDM) indicates that it is not enough to require of projects a general commitment to sustainable development, without clearly defining what that means or placing specific requirements on project developers, if environmental and social

problems are to be averted. Profit almost always overrules other priorities, so the sustainable development component in CDM projects has had little concrete effect. The same mistake must not be made with adaptation finance.

OVERVIEW OF FUNDS

World Bank Group's International Finance Corporation

The International Finance Corporation (IFC) is the private sector arm of the World Bank Group. The IFC invests in for-profit and commercial projects which aim to reduce poverty and promote development. The IFC states that it has doubled its investment in climate-friendly projects to \$1.7 billion per year over the five years leading up to 2012.³⁶ However, evidence for its involvement in adaptation investments is weak – its 2012 publication, *Telling our story: climate change*, refers to water projects in Bangladesh, India and Egypt. It also highlights the Climate Investment Funds' Pilot Programme for Climate Resilience, where the PPCR is funding IFC market assessment teams in Mozambique, Niger, Zambia, Bangladesh and Nepal.³⁷

The IFC has been criticised for its social and environmental record, despite adopting Environmental and Social Standards in 1998. For example, in July 2012, a full investigation was ordered by its own Compliance Advisor/Ombudsman (CAO) into investments

in the Tata Mundra coal power plant in India as a result of complaints by local fishermen who fear adverse impacts on livelihoods and economy.³⁸ In August 2012, the CAO launched an audit of its \$30 million investment in a palm oil and food company in Honduras in response to NGO concerns, including allegations that the company 'conducted, facilitated or supported forced evictions of farmers', and the 'inappropriate use of private and public security forces'.³⁹ Numerous other examples exist showing a lack of regard by IFC initiatives for sustainability and the rights of poor communities. In February 2013, the CAO released an audit into the social and environmental outcomes of the IFC's funding of financial intermediaries which found that the IFC undertook 'no assessment of whether the [environmental and social] requirements are successful in doing no harm'. The result is that the 'IFC knows very little about potential environmental or social impacts of its [financial market] lending'.⁴⁰

The use of financial intermediaries by the IFC and other DFIs, often as a result of their efforts to leverage additional private finance, has led to real problems regarding transparency, safeguard implementation, community consultation and consent.⁴¹

What impact is private finance likely to have on a country-led integrated approach to adaptation?

Tearfund believes comprehensive, country-owned adaptation strategies and action plans are crucial because each central government needs a clear roadmap to ensure a fully integrated approach to adaptation across ministries. In addition, it is vital that stakeholders, including civil society, are involved in the design and implementation of such plans – to ensure their effectiveness and also because citizens should be able to influence decisions that affect them.⁴² There is some evidence of this taking place: for example, the Pilot Programme for Climate

36 IFC (2012) *Telling our story: climate change*, Vol 6, Issue 5, p.4

37 Ibid, p.36

38 Bretton Woods Project website article: 'World Bank's climate record in the dark', 2 October 2012 <http://www.brettonwoodsproject.org/art-571181>

39 Bretton Woods Project website: 'IFC failed to act on "forced evictions"?' 3 October 2012 <http://www.brettonwoodsproject.org/art-571265>

40 Bretton Woods Project website: 'IFC oblivious to impact of lending to financial sector', 13 February 2013 <http://www.brettonwoodsproject.org/art-572062>

41 Orenstein K, Redman J and Tangri N (2012) *The Green Climate Fund's 'no-objection' procedure and private finance: lessons learned from existing institutions*, Friends of the Earth US, IPS and GAIA, p.3

42 Martin L, Venton P and Wiggins S (2012) *Quick off the blocks?* Tearfund



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Resilience (PPCR) in Bangladesh has involved some private sector stakeholders in the delivery of its programme. However, there is a risk that private climate finance could fail to align with national adaptation planning (a question raised about the PPCR in Bangladesh) and with an integrated approach to adaptation, if such considerations are not prioritised when planning private sector engagement. The lack of alignment of current private finance flows with National Adaptation Plans of Action (NAPA) priorities is a danger sign.

Clearly, many governments, including the UK's, place a strong emphasis on using public finance leverage to attract private finance for adaptation to the 'right' priorities and regions. But it is also possible

that, in the quest to leverage private finance, national priorities are ignored in favour of approaches that have more appeal for private investment. The Bretton Woods Project's report, *'Leveraging' private sector finance*, states that 'the overwhelming experience of successful developing countries is that private sector investment needs to be directed and influenced by a national strategy... However, most existing models and institutions operate through global funds and international finance institutions that are not always well linked to national plans.'⁴³

It is essential that private finance initiatives do not undermine or run counter to national climate plans and programmes, and that there is proper consultation of communities, civil society and other affected groups, and across government departments. Private sector instruments for climate adaptation such as the Green Climate Fund's Private Sector Facility must be aligned with national adaptation planning.

How should private finance adaptation initiatives be monitored and evaluated?

Measuring, reporting and verifying private finance poses huge challenges. One of the key observations regarding existing flows of private finance towards development and climate initiatives is how difficult it is to track them – let alone measure their impact. It is also extremely hard to attribute particular flows to public action, especially where private finance flows through an array of different hands. As Eurodad notes, 'Leveraging private finance through financial intermediaries will involve several different instruments and dozens of organisations and governments, not to mention the diversity of intermediaries.'⁴⁴ Aside from the difficulty of following and evaluating the impact of money, many private institutions regard their data as commercially sensitive and are unwilling to disclose it in a

43 Griffiths, Jesse (April 2012) *'Leveraging' private sector finance: how does it work and what are the risks?* Bretton Woods Project, p.9

44 Pereira, Javier (May 2012) *Cashing in on climate change? Assessing whether private funds can be leveraged to help the poorest countries respond to climate challenges.* Eurodad, p.14

meaningful way. What's more, definitions of terms such as leverage, mobilisation, and additionality are hotly debated. So there is no accepted baseline against which to measure additionality or clear methodology to calculate leverage ratios (or to measure whether such ratios have actually been achieved).

This provokes some scepticism around the UK's focus on private finance as a source of climate finance while at the same time pushing a strong 'value-for-money' and results agenda. To date, the evidence for successful private sector adaptation is almost non-existent. Furthermore, it is not clear that the UK's private equity

climate initiatives (CP3) will be able to report results accurately and show value for money, as the UK government will effectively hand over control of investments to fund managers.

To date, governments have not managed to agree methodologies for measuring straightforward public finance flows for climate change. There is also a significant lack of transparency around existing climate finance flows, including the \$30 billion in fast-start finance. It is difficult to see how monitoring will work for private finance where investments are often regarded as commercially sensitive.

What are the barriers to private sector investment in adaptation?

The IFC published *A strategy to engage the private sector in climate change adaptation in Bangladesh* in 2010. It suggested that the private sector as a potential 'supplier of innovative goods and services' could contribute through 'innovative technology, design of resilient infrastructure... improved information systems and the management of major projects'.⁴⁵ The report identified agriculture (irrigation, fertilisers and seed development), water (water purification, waste-water treatment, desalination) and environmental services (including weather derivatives) as a particular focus.

The report identified barriers to private sector involvement, including: the need to 'pay the innovator'; the need to bridge gaps in awareness; the need for the public sector to share risk; addressing the mismatch between the long-term investment required and the short-term approaches of many banks; and the need to create a positive environment for climate investments via tax breaks, low-cost debt financing, equity investments and R&D cost sharing.⁴⁶



Marcus Perkins / Tearfund

45 Asian Tiger Capital Partners for the IFC (September 2010) *A strategy to engage the private sector in climate change adaptation in Bangladesh*, p.3

46 Ibid, pp.3-4

Implications for climate finance



Richard Hanson / Tearfund

How should the Private Sector Facility of the Green Climate Fund be designed to safeguard the interests of poor communities?

It is crucial that the GCF benefits the poorest communities and countries and that it honours international commitments to spend at least 50 per cent of international climate finance on adaptation. If its design leans too far towards an emphasis on private sector engagement, then it may not fulfil these criteria and thus fail. The Private Sector Facility is one part of the GCF and it must not become the only part that developed countries focus on: a drive to

leverage private finance is likely to benefit mitigation in middle-income countries and neglect less profitable adaptation initiatives in the poorest countries. The GCF must be a balanced institution, and developed countries must fulfil their public finance obligations to it to ensure its success.

The GCF governing instrument states that the operation of the PSF 'will be consistent with a country-driven approach and that it will promote the

participation of private sector actors in developing countries, in particular local actors, including small- and medium-sized enterprises and local financial intermediaries. The facility will also support activities to enable private sector involvement in SIDS and LDCs.⁴⁷ The PSF should specifically support this by ensuring that its operations follow a country-driven, integrated approach, which includes the application of a 'no-objection' procedure and a central role for

OVERVIEW OF FUNDS

Green Climate Fund's Private Sector Facility (GCF PSF)

The Green Climate Fund (GCF) was agreed at the Cancún climate talks in 2010 and established at the Durban talks in 2011 (though it is as yet an empty vessel, with no money pledged to it). The 2011 decision provided for a Private Sector Facility that directly and indirectly finances private sector mitigation and adaptation activities at the national, regional and international levels, consistent with a country-driven approach; it promotes the participation of private sector actors in developing countries, including small- and medium-

sized enterprises and local financial intermediaries. The facility will also support activities to enable private sector involvement in SIDS and LDCs.⁴⁸ Thus far, much interest in the PSF has been around mitigation finance, but the 2011 decision clearly also provides for adaptation activities. It is vital that the PSF learns from the experience of private sector engagement in development finance as it establishes access modalities and becomes operational, so it can truly prioritise the needs of poor communities.

⁴⁷ GCF (2011) *Governing instrument for the Green Climate Fund*

⁴⁸ UNFCCC 3/CP.17 Annex (2011) http://unfccc.int/files/meetings/durban_nov_2011/decisions/application/pdf/cop17_gcf.pdf



Clive Mear / Tearfund

National Designated Authorities (NDAs). It is also crucial that the PSF ensures that support goes to developing country SMEs – including micro-enterprises – and to the poorest and most vulnerable countries. Furthermore, NDAs should have a key role in developing appropriate participatory planning approaches that bring affected communities and civil society to the table as well as government and private sector actors. If the PSF is isolated from broader stakeholder engagement it is unlikely that projects will have country and community ownership or benefit the poorest communities.

Given the need for country ownership, community engagement and social and environmental safeguards, it is vital that a no-objection procedure is applied to ensure that countries can act to veto any unsuitable private investments. According to Friends of the Earth US and others, this should 'serve to filter out projects that are incompatible with national strategies, conflict with better programs and projects or impose undue harm or costs upon host communities and their environment'.⁴⁹ Clear, binding and uniform standards and criteria, including compliance mechanisms

based on best international practice, should be adopted for no-objection procedures by which NDAs can endorse or refuse proposals. Civil society must have a voice in this process, and appeal mechanisms are also essential.⁵⁰

Currently, there is no guidance around how the PSF will work for adaptation specifically. Tearfund would advise caution: the evidence base for private finance's contribution to adaptation is currently weak, and the experience of private finance for development raises salutary lessons around geographic and sectoral spread and participation of the poorest people. The GCF should look at developing clear guidelines on private sector adaptation that protect the rights of poor communities.

Should the UK government be spending its public climate finance on private finance initiatives for adaptation?

The UK government is a vocal advocate for the benefits of leveraging private finance for both mitigation and adaptation, but with a strong focus on mitigation finance.

It is difficult to judge the UK's overall record on private climate finance as it is in its relative infancy. However, the record of CDC (the UK's bilateral development finance institution) raises concerns. CDC's mission is to encourage growth in sustainable businesses and help raise living standards in developing countries. Until recently, investment was through externally managed private equity investment, but CDC has been through a process of reform and now offers debt, guarantees and direct equity investments. Concerns highlighted by The Corner House and Jubilee Debt Campaign included: the unsuitability of private equity funds in delivering poverty alleviation; the fact that only four per cent of CDC's investment portfolio was directed to SMEs; the need for tighter restrictions to prevent the use of tax havens; the need to prioritise development rather than commercial outcomes; and concerns about monitoring and evaluation.⁵¹

49 Orenstein K, Redman J and Tangri N (2012) *The Green Climate Fund's 'no-objection' procedure and private finance: lessons learned from existing institutions*, Friends of the Earth US, IPS and GAIA

50 Ibid, p.3

51 *International Development Committee* (10 January 2011) 'The Future of CDC - evidence from The Corner House and Jubilee Debt Campaign'

The CP3 Platform (see 'Overview of Funds' below) is not specifically an adaptation fund and it seems unlikely that it will finance adaptation due to its highly commercial aims. However, it is surprising that the UK is willing to spend £110 million of ODA intended for development in poor countries on an experiment, putting money into high-risk commercial initiatives while retaining little control over where and how the money will be spent. There is thus potential for breaching social and environmental safeguards and undermining poverty alleviation. Given the scrutiny applied to most UK aid, it may be very difficult to assess where and how this money has been spent and so to ensure value for money – and to make sure that tax avoidance or evasion does not occur as the money passes through various intermediaries. Documentation for the CP3 specifies that it must 'avoid being perceived as too *developmental* in nature because of the risk of otherwise deterring private sector investors who are looking for good financial returns'. It makes no mention of any poverty reduction aims.⁵²

The CP3 is a potential diversion of a significant amount of climate finance from key areas such as adaptation which would be better spent as straightforward public finance in poor countries. The UK government should review its use of ODA to fund the CP3 Platform against OECD guidelines and the 2002 International

Development Act to ensure that it genuinely meets the criteria for ODA, especially around poverty reduction.⁵³ If this is not the case then the CP3 should be discontinued, or funded outside ODA.

The limited private finance adaptation initiatives (see 'Overview of Funds' below) that the UK is currently undertaking must be assessed at the earliest opportunity to ensure that they do benefit the poorest and most vulnerable communities and that they do not undermine country-led integrated approaches to adaptation. If a clear evidence-based picture emerges of how these initiatives contribute to climate

adaptation for the poorest, it would be possible to have greater confidence in supporting smaller-scale public-private initiatives. Currently, our concern is that there is insufficient evidence of the benefits for the poorest communities of private sector adaptation initiatives over straightforward public community-based adaptation. It would be helpful if DFID shared research and evidence that contribute to an understanding of the risks and benefits of private sector adaptation.

OVERVIEW OF FUNDS

UK's International Climate Fund and Climate Public Private Partnership (CP3) Platform

The UK government has led the way in embracing the private sector as a source of overall climate finance. Its International Climate Fund (ICF) is spending £2.9 billion of ODA in 2011–2015 on adaptation and mitigation (some multilaterally via the World Bank CIFs and other institutions). Most of this money is being spent on public climate finance initiatives. However, the ICF's objectives include mobilising private climate finance in ICF-priority countries that would otherwise be overlooked, to create a sustainable climate investment market. Its objectives also include mobilising private sector engagement and finance in specific sectors and/or technologies that experience difficulties in accessing private finance.⁵⁴

In terms of bilateral funding, the UK's CP3 Platform will invest £110 million in two commercial private equity funds run on a strict commercial basis by professional fund managers, which will aim to leverage private co-investment; a further £20 million will be paid into a Technical Assistance facility to support investments in lower-income countries and first-time fund managers.⁵⁵ It appears the two larger funds will focus on mitigation, and will be directed mainly at upper- and middle-income developing countries – but this will be almost entirely at the

discretion of fund managers. Fifty million pounds will go to a joint initiative with the IFC called the IFC Catalyst Fund – DFID, and £60 million will go to CP3 Asia which will involve the Asian Development Bank plus a fund manager.⁵⁶

In addition to the CP3, the UK has a number of modestly sized private sector projects in operation under its fast-start finance allocation, though these are mainly mitigation-focused. On the adaptation front, the UK has provided £1.5 million in fast-start finance to the Hazard Micro-Insurance programme for small-scale farmers in the Caribbean, aiming to provide up to 15,000 farmers across the Caribbean with access to insurance to protect their livelihoods.⁵⁷ It also funds the Renewable Energy and Adaptation to Climate Technologies (REACT) fund, a window of the \$100 million Africa Enterprise Challenge Fund (AECF – a \$100 million private sector fund managed by KPMG). The adaptation aims of REACT are to support the private sector to develop and introduce new products and services that help smallholder farmers adapt to climate change. This might involve, for example, increasing water efficiency in agriculture or introducing new varieties of drought-resistant seeds, or improved weather forecasting services.⁵⁸

52 DFID/DECC document (2012) *Intervention summary: Climate Public Private Partnership (CP3) Platform*

53 International Development Act 2002 <http://www.legislation.gov.uk/ukpga/2002/1/contents>

54 DECC, (2011) *The UK's International Climate Fund & Capital Markets Climate Initiative*

55 DFID/DECC document (2012) *Intervention summary: Climate Public Private Partnership (CP3) Platform*

56 Bretton Woods Project, Update 80, *False solutions? The IFC, private equity and climate finance* (5 April 2012)

57 DFID (November 2012) *UK Fast Start Climate Change Finance*

58 DFID (2010) *Climate change case study: UK fast start finance in action: mobilising the private sector to benefit the poor*

Conclusion and recommendations

Private sector engagement in adaptation is in its early stages and governments and donors should proceed with caution. Private sector investment is a more natural fit for mitigation initiatives and evidence to date about the effectiveness of private finance for adaptation is weak. Analysis from private development financing suggests that LDCs and other low-income countries are unlikely to benefit from private investment, and that financing is unlikely to flow to the most appropriate sectors for adaptation. It is probable that smallholders and local businesses in developing countries will be neglected. Therefore, governments cannot rely on private finance to meet the adaptation needs of the poorest communities and countries. Tearfund makes the following recommendations:

UK bilateral and multilateral initiatives

- The UK and other donors should seek to provide stronger evidence for private sector engagement in adaptation, demonstrating how benefits will flow to the poorest and most vulnerable communities.
- The UK government should assess its bilateral and multilateral private adaptation initiatives at the earliest opportunity to ensure that they benefit the poorest communities, and that they contribute to country-led integrated approaches to adaptation. Private

finance initiatives should be subject to the same performance indicators DFID has developed for the International Climate Fund.

- The UK government should review its use of ODA to fund the CP3 Platform against OECD guidelines and the 2002 International Development Act to ensure that it genuinely meets the criteria for ODA, especially around poverty reduction. If this is not the case then the CP3 should be discontinued, or funded outside ODA.

Private Sector Facility of the Green Climate Fund

- The Green Climate Fund's PSF must support a country-led integrated approach, including a 'no-objection' procedure. Clear guidelines for when and how the private sector should engage with adaptation should be developed. The PSF must also ensure that support goes to developing country SMEs and to the poorest and most vulnerable countries, and to the poorest communities within those countries.

Public finance

- The UK government should be open and public in championing public sources of finance for climate change, and should continue to acknowledge that private finance will not work for all countries and needs – particularly because, based on the current evidence, it is unlikely to benefit adaptation in the poorest countries.
- Developed countries should meet their commitment to provide \$100 billion a year by providing new additional public finance. This means that they must look at innovative sources of public finance as a matter of urgency: for example, a levy on international shipping and aviation, financial transaction tax or other options. Private finance should be additional to the \$100 billion a year of climate finance that developed countries have committed to mobilise by 2020.

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With thanks to Richard Weaver, Sarah Wiggins, Sam Barker, Laura Taylor at Tearfund and Su-Lin Garbett Shiels at DFID.

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