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The climate change windows of the EU Blending Facilities: mitigation and adaptation strategies, national ownership and dialogue processes

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Content

1. Introduction

Climate finance is one crucial issue and is needed to support mitigation and adaptation in developing countries and emerging economies. Mitigation and adaptation need to be addressed through e. g. the UNFCCC, but also financially supported through countries, national and regional institutions and organisations. The European Union, as one of the largest economies of the world and with a key priority of the issue of preventing dangerous climate change, is one of the most important actors in the field of mitigation, adaptation and climate finance. In the context of this paper, climate finance involves flows of funds from industrialised to developing countries or emerging economies to help poorer countries to cut their emissions and adapt to climate change. At the climate change conference in Copenhagen (COP15)[1] in 2009, the industrialised countries committed to mobilise USD 100 billion per year for climate finance by 2020 from a wide variety of sources (public and private, bilateral and multilateral, including alternative sources of finance).

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EU Blending Facilities are instruments set up by the European Commission. They describe facilities that have the possibility of blending and cover a specific region. “Blending is an instrument for achieving EU external policy objectives, complementary to other aid modalities and pursuing the relevant regional, national and overarching policy priorities. The principle of the mechanism is to combine EU grants with loans or equity from public and private financiers.”[5] There are EU Blending Facilities for seven different regions: Neighbourhood Investment Facility (NIF), Latin America Investment Facility (LAIF), Asian Investment Facility (AIF),

[1] The abbreviation COP15 means the parties of the United Nations Framework Convention on Climate Change (UNFCCC) met for the 15th time.

[2] The European Commission is divided into several departments (number: 33). The departments are known as Directorate-Generals (DGs). Each DG is classified according to the policy it deals with.

[3] DG DEVCO is responsible for designing European international cooperation and development policy and delivering aid throughout the world.

[4] DG CLIMA leads the European Commission's efforts to fight climate change at EU and international level and was established in February 2010, climate change being previously included in the remit of DG Environment of the European Commission.

[5] European Commission, International cooperation and Development, Policies, Innovative Financial Instruments (blending), https://ec.europa.eu/europeaid/policies/innovative-financial-instruments-blending_en, 29.06.2015.

Investment facility for Central Asia (IFCA), Caribbean Investment Facility (CIF), Investment Facility for the Pacific (IFP) and the EU-Africa Infrastructure Trust Fund (ITF). The ideas of Climate Change Windows (CCWs) were announced in November 2010 by Commissioners Piebalgs, Hedegaard and Füle and should be "to ensure better tracking and visibility of climate actions within the investment facilities". For this reason "specific CCWs have been set up in all of the regional investment facilities […]. The aim of the CCW is to allow for transparent tracking of climate change projects in strategic areas like energy, transport, environment, forests, water, sanitation and support for the private sector."[6]

The request of DG Devco and DG Clima was in order to make recommendations on the most effective approaches to use the CCWs of the EU Blending Facilities in support of the implementation of mitigation and adaptation strategies in EU partner countries and to consider the need to further increase local ownership beyond the current responsibilities of the Lead Finance Institution and to strengthen the link to local dialogues on climate change action. To meet the requirements of the EU Commission, the authors of this paper have decided to address the question in two steps (reflecting the request to address deliverables 1 and 3 of EUBEC TG7[7] by the EU Commission): first reflect on the profile of EU blending facilities and their specific strengths and weaknesses in the context of international climate finance, then deliberate about need and the scope to enhance national ownership and the link to national mitigation and adaptation strategies and respective dialogue processes in using resources of the climate change windows of the EU blending facilities.

[6] Directorate-General for external policies, Policy Department (2012), Blending grants and loans in the light of the new DCI, p. 29.

[7] The abbreviation "EUBEC" stands for "EU Platform on Blending in External Cooperation" and TG7 describes the technical group No. 7 of EUBEC with the theme: "climate change financing".
Deliverable 1: Recommendation: Building on the outcome of the programming exercise, recommendations on the most effective approaches to use blending/Climate Change Windows (CCWs) to support the implementation of mitigation and adaptation strategies in EU partner countries.
Deliverable 3: Recommendations on further increasing local ownership and strengthening the link to local dialogue on climate change action.

2. The international framework

The international framework is moving towards a closer integration of traditional development cooperation and climate change financing, exemplified by the ongoing process for identifying and defining Sustainable Development Goals (SDGs).

Climate Finance is a field of development finance which receives increasing political attention. The international framework is emerging rapidly with an increasing number of players and instruments. These are intended to help to bring the world on a development pathway commensurate to keep the average global temperature below 2°C. The commitment to mobilise USD 100 billion of climate finance by 2020 annually by industrialised countries for mitigation and adaptation related projects in developing countries via multilateral, bilateral and private sector channels is a major milestone for this.

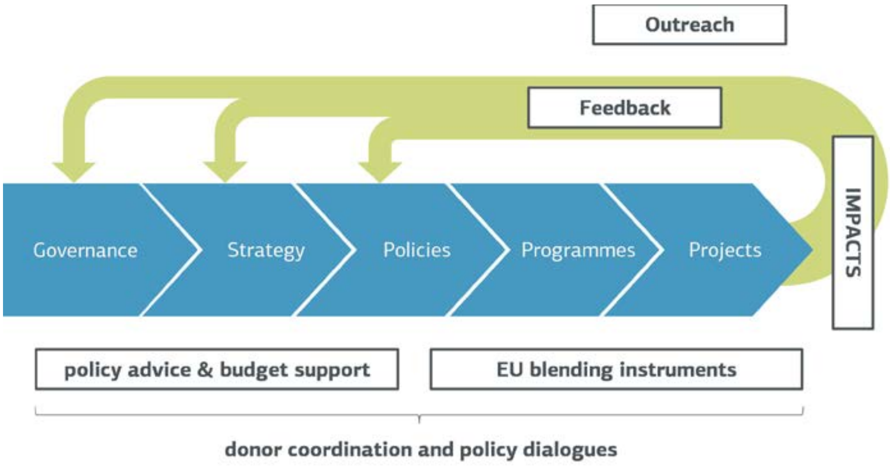
The **Green Climate Fund (GCF)** was agreed at COP16 in Cancún and is scheduled to start its funding operations in 2015 with focus on adaptation, mitigation (including forests) – frequently working together with the private sector and placing great emphasis on the ambition level and transformative potential of its projects. The GCF will be targeting its initially relatively small funds towards Readiness Programs[8] in targeted countries, in view to pave the way for larger GCF investments in the future. The first resources mobilisation session took place on November 20th, 2014, and to date, more than USD 10 billion have been pledged to the GCF from developed countries.

There is no agreed definition or a widely accepted theory of **"transformational change"**. For this document we define it as **"rapid and comprehensive innovation process affecting a sector or country"**. In our understanding it can be triggered by **technological or social innovation** as well as by **economic or political crises**. Development cooperation typically is neither a direct source of innovation nor an immediate and comprehensive remedy against crisis. Instead development cooperation is frequently expected to foster innovation processes, to demonstrate and scale-up innovation or to support the design and implementation of response strategies or measures against a crisis. A specific activity within the framework of development cooperation can be supportive at a specific part of the innovation and transformation process chain (Figure 1). Integration and coordination is to be achieved within the dialogue among recipient and donor governments. Several instruments have recently been set up by EU institutions and Member States in the field of climate change in order to increase investment levels for mitigation and adaptation (i. e. specifically for scaling-up innovation niches) as for

[8] "The readiness and preparatory support programme seeks to maximise the effectiveness of the Fund by empowering developing countries […]. The programme is driven by recipient country governments through their National Designated Authorities (NDAs) or focal points. It seeks to build on ongoing initiatives to strengthen developing country capacity to make effective use of climate finance."
http://www.gcfund.org/fileadmin/00_customer/documents/Readiness/2014-11-28_GCF_Readiness_Overview.pdf

instance the **NAMA Facility**[9] that was set up by the UK and Germany to foster sectoral approaches on climate or the **Interact Climate Change Facility (ICCF)**[10] gathering together European Development Finance Institutions (EDFIs), EIB and AFD to enhance finance to private climate investments.

Figure 1: The chain and reinforcing feedback loop of a top-down transformation process



The **EU Blending Facilities** are significant in volume already after just a few years of operation and exhibit a successful track record of financing of projects. Their efficient use of public funding in combination with other finance e. g. from development banks or governments, their focus on large funding volumes provided in co-financing arrangements, and their timely, efficient and predictable project preparation and implementation along with maximisation of regionally specific development benefits, constitute the specific added value of the EU Blending Facilities. Notwithstanding the multi-sectoral character of the facilities, the share of climate related projects under the EU Blending Facilities has grown considerably; 62 % of all EU commitments made on the facilities since 2007 have been directed towards projects with climate change objective. Considering the dynamic evolution of the global climate finance architecture, the EU Commission is reviewing its strategy on the consideration of climate change in the EU Blending Facilities. This is because, in the context of the new EU Multi-annual Financial Framework (MFF), a target of 20 % of investments is set across the budget to be dedicated to climate action. Beyond this, of course, another challenge is to ensure that climate change issues (mitigation and adaptation) are mainstreamed as far as appropriate across the entire portfolio of activities supported by the Blending Facilities.

[9] The abbreviation "NAMA" stands for: "nationally appropriate mitigation actions". The NAMA-Facility is designed to support developing countries on tackling climate change and who want to implement transformational country-led NAMAs.

[10] ICCF "is a private limited liability company established under the laws of the Grand Duchy of Luxembourg, and is owned by 13 shareholders. ICCF finances renewable energy and energy efficiency projects in the private sector in developing countries and emerging markets." EDFI, about, ICCF, http://www.edfi.be/about/iccf.html, 29.06.2015.

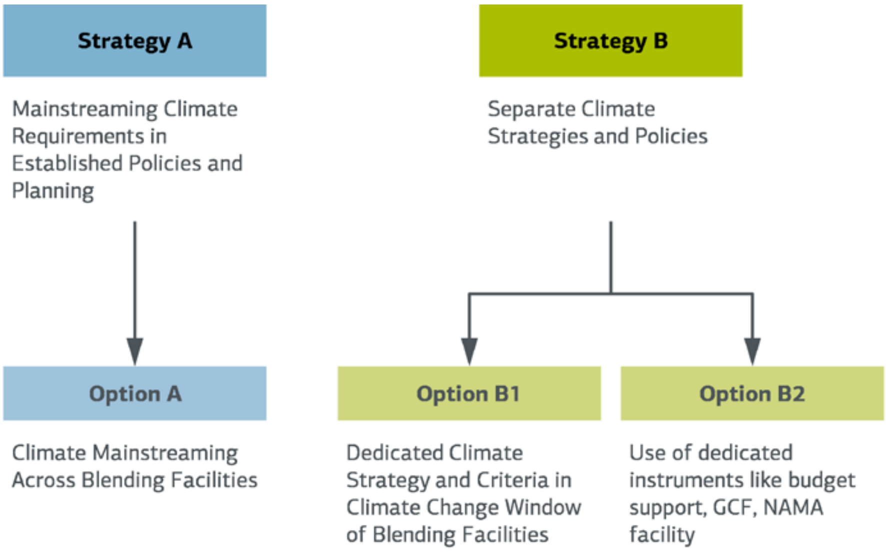
In this context, two complementary options (see Figure 2) to maximise the efficiency and effectiveness of the climate activities within the EU Blending Facilities have now been under discussion in EU fora for a number of years:

A. Enhancing integration of climate challenge and constraints in the global operational strategy of the EU Blending Facilities, reflecting a strategy of mainstreaming climate requirements into existing planning and decision making processes.

B. Implementing a specific climate strategy and criteria of investments when employing climate change windows resources, reflecting a strategy of dedicated climate strategies and policies with transformative ambition.

To date strategy and option "A" has remained the preferred approach to maximise climate impact while avoiding a thematic fragmentation of the EU Blending Facilities. To implement strategy "B", which may have a growing role in addition to strategy "A", different options exist inside and outside of the EU Blending Facility.

Figure 2: Complementary climate strategies and implementation options for the EU blending facilities and other instruments available to the EU



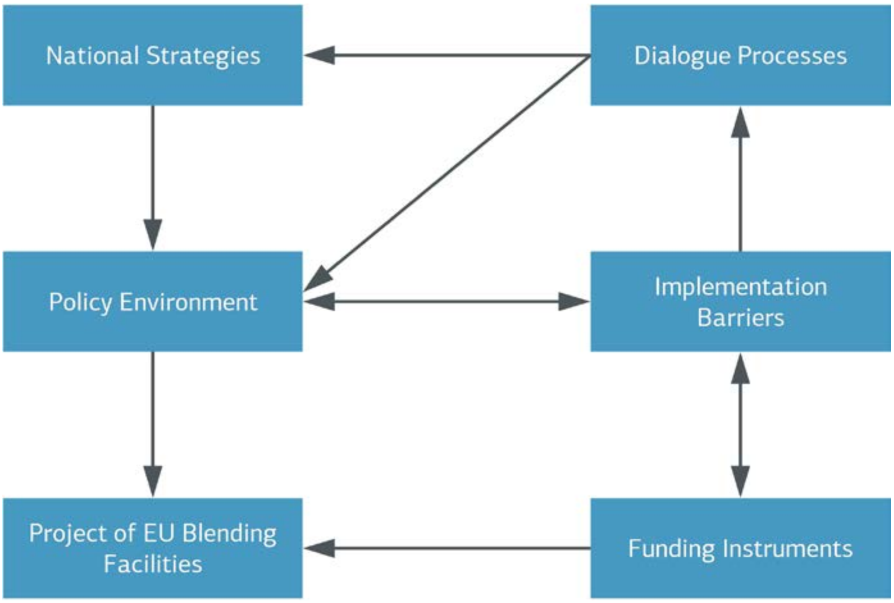
To the authors of this paper, it is not a question which of the two strategies the appropriate one is, but whether both strategies can be pursued within one single instrument like the EU blending facilities. Beyond the technical considerations of how many objectives can realistically be combined in one instrument, it bears significant relevance as to whether we expect "*progressing international convergence of climate finance*" or "*strengthened differentiation and complementarity of instruments*[11]" i. e. whether there will be a standardisation of instruments for the implementation of concepts derived from the UN climate negotiations e. g. NAMAs or National Adaptation Plans (NAPs) or whether there will be an increasing division of labour among different instruments aiming at different phases and dimensions of the desired transformative processes of development.

[11] This relates to the range of instruments available to the EU or a Member State government as well as to the global level with the emerging GCF, existing bilateral and multilateral development cooperation as well as new bilateral, multilateral or private sector instruments.

3. Profile of EU Climate Change Windows and link to strategy and dialogue processes

The EU Blending Facilities have quickly built up a strong track record of successfully implemented projects and exhibit a strong pipeline of bankable projects proposals. In most cases, proposals are prepared and submitted by eligible development banks with a proven track record, in consultation with partner countries and EU delegations. This ensures a fast track to bankable projects, provides a formalised role for development banks and ensures low transaction costs for implementing countries. Most projects under the EU Blending Facilities are designed to work within the existing or emerging economic and legal environment of the partner country, delivering concessional finance by means of funding instruments which help to overcome existing investment barriers (compare Figure 3). They thus support the implementation of national strategies and strengthen their credibility. E. g. dialogue processes will be needed and will be informed by remaining implementation barriers. This will help to advance the national policy and strategy environment (see figure 3 below).

Figure 3: Relation between project, national strategy, policy environment and dialogue processes



While the existence of suitable regulatory frameworks and the projects' alignment to existing national strategies is a key eligibility criterion for projects, the EU Blending Facilities place less emphasis on policy reform processes, national strategy processes and related dialogue processes. Beyond project-specific technical assistance and investment support, transformative policy reform processes by EU partner countries are typically supported by other, complementary instruments including budget support under management of the EU external action service, outside the Blending Facilities.

Tables 1 to 3 show results of the authors' indicative comparative SWOT analyses of the EU Blending Facilities, the CIFs[12] and the GCF. The profiles of these three climate finance vehicles in terms of strengths, weaknesses, opportunities and threats are found to be rather distinct.

Table 1: Results of a SWOT-Analysis of the EU blending facilities

Strengths: Large financing volume/projects, quick implementation, predictability, focus on investment, strong project pipeline, range of accredited implementing organisations, regionally specific focus and broad range of eligible countries and of financial instruments, flexibility.	**Opportunities**: Strengthening of clear and distinct profile, high specific visibility of EU, complementarity to existing and emerging instruments, synergies with EU policy reform support and respective aid instruments.
Weaknesses: Limited influence on political reform processes, limited visibility of instrument to date.	**Threats**: Loss of independent profile, loss of focus, loss of perception as implementation channel, loss of regional specifity.

Table 2: Results of a SWOT-Analysis of CIFs

Strengths: Large financing volumes, high visibility, structured creation of project pipeline, critical mass to support transformation processes; utilisation of wide range of financing instruments, equal representation of donors and recipients in governance.	**Opportunities**: Rewarding early mover countries, more scope to strengthen its private sector focus, possibility to receive additional donor resources in short term, growing pipeline, adding new countries.
Weaknesses: Limited country scope with initial pilot, underdeveloped risk management tool, limited direct access by beneficiary country institutions, no direct access to capital markets.	**Threats**: Unclear use of sun-set clause, losing momentum in climate finance, possibility of financing gap in global climate pipeline if no additional resources are paid in and no swift GCF operationalisation.

[12] "The CIFs are investment programs administered by the multilateral development banks (MDBs) that aim to help finance developing countries' transitions toward low-carbon and climate-resilient development. Formally approved by the World Bank's Board of Directors on July 1, 2008, the CIFs are composed of two trust funds — the Clean Technology Fund (CTF) and the Strategic Climate Fund (SCF) — each with a specific scope, objective, and governance structure." Lattanzio, Richard K. (2013), International Climate Change Financing: The Climate Investment Funds (CIFs), Congressional Research Service 7-5700, https://www.fas.org/sgp/crs/misc/R41302.pdf

Table 3: Results of a tentative SWOT-Analysis of the emerging GCF

(Potential) Strengths: Transformational ambition, country ownership, high visibility of the instrument, utilisation of wide range of financing instruments, strong international political support.	**Opportunities**: Test, demonstrate and implement innovative approaches, be at the centre of consolidation of climate finance architecture, be the biggest player.
(Potential) Weaknesses: Slow and politicised decision making, missing banking perspective and functions, very limited implementation capacity, uncertainty about application of investment criteria, lack of visibility for individual donors.	**Threats**: Lack of attractiveness for good projects, conceptually weak project pipeline, premature or delayed disbursements, lack of focus, lack of sufficient number of suitable, accredited implementation organisations.

The EU Blending Facilities as well as the CIFs exhibit a profile making them very suitable to scale-up activities within an emerging environment. To do so, they rely on a suitable economic and political environment. Typically, they do not directly link to policy reform processes. The EU addresses these using policy loans and budget support which are coordinated as separate programs under EU External Actions.

In relation to the emerging profile of the GCF, the EU Blending Facilities and CIFs exhibit a very focused and potentially complementary profile. While the GCF is expected to try to act as a policy reform catalyst with transformative ambition, the EU Blending Facilities and CIFs are established implementation vehicles, delivering already concrete projects and impacts on the ground. Both have a track record of scaling-up technologies, systems and approaches which are not yet commercially viable without concessional finance.

4. Conclusions

Taking into account their specific nature investment projects, the EU blending facilities typically score well in respect to national ownership, their link to national mitigation and adaptation strategies and respective dialogue processes. It is clear that dedicated instruments and modes of cooperation exist which may score higher on one or more of these dimensions, however, with significant trade-offs to the speed and scale of interventions. In the future, all these aspects will be better highlighted in a consistent and harmonised way in the new template for the project documents of the EU blending facilities.

Based on these analyses the authors conclude that, in the emerging landscape of climate finance, the EU Blending Facilities and the GCF should co-exist because of their likely complementary profiles in respect to transformational ambition and implementation effectiveness. Because of the substantial risks to the proven working modalities of the EU Blending Facilities, the authors caution against the attempt to transform their climate change windows into separate instruments which could serve as direct vehicles to influence the design and ensure the implementation of national mitigation and adaptation strategies. In view of the authors these objectives are better addressed by means of budget support instruments and should not be added on top of the existing objectives of the EU Blending Facilities. Otherwise the proven implementation effectiveness, scale of the interventions as well as credibility and acceptance in partner countries of the EU Blending Facilities may not be maintained. Over time DG Clima, DG Devco and the EU External Action Service (EEAS)[13] could increasingly align their different instruments in order to support transformational processes. Also the EU could provide support to instruments which aim at other phases and dimensions of climate related transformation processes.

[13] “The EEAS is the European Union's diplomatic service. It helps the EU's foreign affairs chief – the High Representative for Foreign Affairs and Security Policy – carry out the Union's Common Foreign and Security Policy.” European Union External Action, About the European External Action Service (EEAS), http://eeas.europa.eu/background/about/index_en.htm, 29.06.2015.

5. Recommendations

The EU Blending Facilities and especially the described climate change windows are important instruments to improve international climate finance from a European perspective. For the EU to confirm and maintain its leadership on climate finance the authors of this discussion paper recommend to:

- Strengthen communication on:
  - profile/focus of EU Blending Facilities on demonstration and scaling-up of outcomes,
  - how the EU Blending Facilities successfully promote policy development,
  - the relevance of individual projects in ongoing policy dialogues,
  - best practice case studies in mainstreaming climate change.

- Position the climate change windows of the EU Blending Facility based on its proven strengths in a potentially complementary role vis-à-vis the GCF and other European instruments such as ICCF, the Low Emission Capacity Building Programme (LECB) or NAMA-Facility by focusing on efficient and effective project implementation.

- Strengthen relations with EU policy reform instruments including sector budget support instruments.

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