INDEPENDENT EVALUATION OF THE GREEN CLIMATE FUND'S APPROACH TO PRIVATE SECTOR[1]

June 2021

BACKGROUND

As an operating entity of the financial mechanism of the United Nations Framework Convention on Climate Change (UNFCCC) under Article 11, a role confirmed in the Paris Agreement, the Green Climate Fund (GCF) is "accountable to and function[s] under the guidance of the Conference of the Parties (COP)".

MANDATE AND PRIORITIES FOR THE GCF'S PRIVATE SECTOR APPROACH SET OUT BY THE PARIS AGREEMENT AND COP DECISIONS

Article 9.4 of the Paris Agreement

> The provision of scaled-up financial resources should aim to achieve a balance between adaptation and mitigation, taking into account country-driven strategies, and the priorities and needs of developing country Parties, especially those that are particularly vulnerable to the adverse effects of climate change and have significant capacity constraints, such as the least developed countries and small island developing States, considering the need for public and grant-based resources for adaptation.

The concept of 'balance between adaptation and mitigation' is not quantified by the COP, and as such, it is rather difficult to measure its achievement and compliance. Balance might mean different things to different parties and might be achieved in each developing country differently depending on their needs. This concept was one of several language alternatives proposed by developing country parties, i.e. in the Geneva negotiating text[2], such as '50:50 allocation' or 'equal allocation' between adaptation and mitigation. Subsequently, the Board of the GCF agreed to maintain the 50:50 balance of adaptation and mitigation funding over time while seeking to deliver portfolio-level mitigation and adaptation outcomes that exceed average initial resource mobilization outcomes[3]

There are additional considerations. Article 9.4 and associated COP decisions explicitly and clearly refer to ensuring financial resources deployed take into account country-driven strategies and the priorities of developing country Parties, including technological and capacity-building needs, and in translating climate finance needs into action. According to relevant analyses and guidance[4] operationalization of this article and associated COP decisions requires considering that programming capacity and pipeline development should be driven by a 'country-driven prioritization' of financial, capacity building, and technology development and transfer's needs and priorities. Catalyzing the engagement of the private sector (in particular, local private sector) is expected to be guided and informed by developing countries' country-driven prioritization of needs and priorities across mitigation and adaptation.

Article 9.9 of the Paris Agreement

> The institutions serving this Agreement, including the operating entities of the Financial Mechanism of the Convention, shall aim to ensure efficient access to financial resources through simplified approval procedures and enhanced readiness support for developing country Parties, in particular for the least developed countries and small island

[1] This series is designed to socialize early 'pre-findings' from the independent evaluation of the GCF's approach to the private sector. The contents of this series are a preliminary reflection and will inform the final report, but do not constitute findings and recommendations.

[2] FCCC/ADP/2015/1, Ad Hoc Working Group on the Durban Platform for Enhanced Action. Avalaible at https://unfccc.int/sites/default/files/resource/docs/2015/adp2/eng/01.pdf

[3] Decision GCF/B.27/06, paragraph i(i). Further, the Updated Strategic Plan notes that the outcome achieved in the Initial Resource Mobilization was 54 per cent adaptation funding and 46 per cent mitigation funding in grant equivalents.

[4] Atteridge, A., Verkuijl, C. and Dzebo, A. (2019). Nationally determined contributions (NDCs) as instruments for promoting national development agendas? An analysis of small island developing states (SIDS). Climate Policy. Available at https://dx.doi.org/10.1080/14693062.2019.1605331; Saunders, N. (2019). Climate change adaptation finance: are the most vulnerable nations prioritised? Working paper.Available at https://www.sei.org/wpcontent/uploads/2019/04/climate-change-adaptation-finance-are-the-most-vulnerable-nationsprioritised.pdf.

developing States, in the context of their national climate strategies and plans.

This paragraph mandates the institutions serving the Paris Agreement, including the operating entities of the Financial Mechanism, to ensure their processes and procedures are transparent, efficient, suitable, and predictable. According to relevant analyses and guidance[5], operationalization of this article and associated COP decisions requires consideration of the following:

a) Accreditation of private sector entities is expected to be informed by country-driven prioritization of needs, with a view of engaging accredited entities/direct access entities that are best suited to meet countries programming priorities.

b) There is an emphasis on the importance and role of focusing on creating enabling environments for catalyzing private sector engagement.

a) The emphasis of leveraging may have negative effects, with public finance flowing into sectors and/or regions that can attract private capital on their own terms, at the expense of others.[6] The emphasis on leverage ratios may also exaggerate the shortcoming of limited private sector investment in least developed countries (LDCs) and small island developing states (SIDS), and by local private sector actors. Unlocking investment in high-risk markets or funnel investments into new markets (particularly, the LDC or SIDS), new industries and private sector deployment of new technologies and business models – will likely attract no co-financing from the private sector and have negative rates of return.[7]

The COP[8] has noted that many climate funds use leverage ratios as one of their key results indicators, but that high leverage ratios may not always indicate an effective use of public finance, as ratios can also be high in interventions that are the most commercially viable. Moreover, though leverage ratios can be helpful to track the flow of private capital to specific projects, it is inadequate—and sometimes even misleading - to measure the success of public climate finance in leveraging private capital.[9] Traditional leverage ratios do not capture important public sector activities like policy development and technical support, which are critical to fostering attractive investment conditions but not easily measured.[10]

The Global Environment Facility (GEF) newly adopted Private Sector Engagement Strategy (PSES) takes the above into consideration and aims to focus on enabling environments, and on developing more accurate calculation methods and consistent reporting for measuring effectiveness in catalyzing private sector engagement (see Box 1).

[5] UNFCCC Climate Finance Decision Booklet; CFLI, EDFI and GIF (2020). Unlocking Private Climate Finance in Emerging Markets: Private Sector Considerations for Policymakers. Available at https://assets.bbhub.io/company/sites/55/2021/03/CFLI_Private-Sector-Considerations-for-Policymakers-April-2021.pdf

[6] Carter, P. (2018). The pitfalls of leverage targets, CDG Blog, Centre for Global Development. Available at https://www.cgdev.org/blog/pitfalls-leverage-targets; Küblböck, K. and Grohs, H. (2019), Blended finance and its potential for development cooperation. Available at https://www.econstor.eu/bitstream/10419/200507/1/1669044459.pdf

[7] Attridge, S. and Engen, L. (2019). Blended finance in the poorest countries: The need for a better approach, Report for Overseas Development Institute.

[8] FCCC/CP/2016/10/Add.1 Decision 8/CP.22 - Annex , paragraph 35.

[9] Srivastava, A. and Venugopal, S. (2012). Moving the Fulcrum: A Primer on Public Climate Financing Instruments Used to Leverage Private Capital. Available at http:// www.wri.org/publication/moving-the-fulcrum.

[10] Center for Clean Air Policy (2017). Mobilizing private sector investment in support of Nationally Determined Contributions.

Box 1. GEF's PSES approach for measuring effectiveness in catalyzing private sector engagement

In terms of metrics and reporting, the PSES of the GEF notes that the overriding reason for engaging the private sector is to ultimately leverage a powerful way to achieve global environmental benefits in a sustainable and cost-effective manner at the systems level. The indicators for success at the systems level will be the same as for engaging the public sector, namely global environmental benefits in the focal areas.

However, the indicators for success at the outcome and output levels will be different in the case of private sector activities. To the extent that the private sector is engaged instrumentally to achieve global environmental benefits in the focal areas, there will need to be metrics, corresponding indicators and evaluation developed over time for:

1) Bringing about policies and frameworks conducive to private sector approaches to the provision of global environmental benefits.
2) Creating sustainable markets for global environmental goods by identifying, demonstrating, replicating, and mainstreaming innovative private sector approaches.
3) A better regulatory and business enabling environment.
4) Internal changes to company policies and operating standards.
5) Mobilizing private capital that will share the financial risk with GEF of providing global environmental benefits.
6) Accessing and transferring innovative technology.

The metrics used for the purpose of annual reporting to the GEF Council to assess the effectiveness of private sector engagement will include:

1) The number of companies formally engaged in GEF activities (in the process of design, planning meetings, information shared, implementation, technical assistance etc., according to the modality).
2) A classification of companies based on the Global Industry Classification Standard (GICS)[11] industry code at the level of sector and industry.
3) An assessment of the geographies where the private sector engagement has been most effective and least successful.
4) The number of multi-stakeholder platforms engaged, their geographic coverage and share of the global market.

Where information is available, annual reports will include considerations of additionality to ensure that the resources provided to the private sector bring about investments and activities which would not otherwise have happened. While there is no agreed set of standard criteria for additionality assessments, an adapted version of the Donor Committee for Enterprise Development (DCED) good practice criteria for assessing additionality[12] will be used to assess the net positive difference that results from GEF private sector engagement, namely the global environmental benefits (and associated outcomes) that

- i) are larger in scale.
- ii) take place quicker.
- iii) extend across wider geographies than those funded through the GEF.
- iv) increase the durability of projects over time, and which occur as a result of private sector engagement in GEF programs and that would otherwise not have occurred in the absence of the private sector.

[11] The GICS structure consists of 11 sectors, 24 industry groups, 69 industries and 158 sub-industries. Annual reporting on private sector engagement will use this taxonomy to show which sectors are represented through the GEF partnership, their relative weighting and to identify sectors which may need greater engagement focus.

[12] Donor Comittee for Enterprise Development (2014). Demonstrating Additionality in Private Sector Development Initiatives. A practical exploration of good practice. Available at https://www.enterprise-development.org/wp-content/uploads/DCED_Demonstrating-Additionality_final.pdf