FRONTIERS OF CHANGE

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SUSTAINABLE FINANCE FOR LOCAL CLIMATE ACTION

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Federal Ministry for the Environment, Nature Conservation and Nuclear Safety

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ACUMEN CHANGING THE WAY THE WORLD TACKLES POVERTY

WHITE PAPER

Author:

David Henry

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Climate change disproportionately affects the countries and people who have contributed least to its causes and are ill-equipped to deal with the effects of rising global temperatures. Local communities and smallholder farmers, who produce about a third of the world's food, are most vulnerable to drought as they rely on rain-fed agriculture for their subsistence and incomes.

Despite wealthy nations' pledge of USD 100 billion annually for climate mitigation and adaptation, the 46 least developed countries have been paid less than 3 percent of the funds they need for adaptation. Almost half of the USD 5.9 billion received was intended for projects giving local people some decision-making power, yet there is little evidence that local communities lead these programmes, according to the International Institute for Environment and Development (IIED).

Local communities have been participating in climate action initiatives on the ground through land restoration, carbon credit schemes and sustainable land management. However, they still lack access to funding that would allow them to scale up such projects and businesses. Their local adaptation needs are also inadequately reflected in national policies or considered in decision-making processes.

For example, while most international and national development agencies set out to improve the lives of people at local community level, they generally retain control over the finances and make all the important decisions. "International climate and development funders have the power to help local people deliver more effective solutions to climate change, the destruction of nature and poverty. But to do so, they must cede resources, rights and power to local actors, who are closer and more accountable to local people," according to an IIED study in 2020.

How can sustainable finance help?

Sustainable finance, also known as green finance, means making investment decisions that consider social and environmental impacts rather than just financial returns. This approach can provide financing mechanisms that are aligned with the needs of local communities and smallholder farmers, while delivering the innovations that support local climate action. These solutions include:

- Green funds: funding bodies that invest in low-emission and climate-resilient development
- Blended finance: different forms of public and private capital that combine to catalyse more funding for projects that contribute to sustainable development, while providing financial returns to commercial investors
- Microfinance: financial services offered to low-income individuals or groups who are typically excluded from traditional banking
- Green bonds: a financial instrument where securities (or bonds) linked to a specific climate-related or environmental project, are issued to investors
- Index insurance: an innovative approach to insurance provision that pays out benefits based on a predetermined index such as temperature for loss of assets due to weather and catastrophic events
- Guarantees: an agreement under which the guarantor agrees to pay (part of) an amount due on a loan, equity or other instrument in case of non-payment, thereby reducing the risk of investment
- Alternative financing mechanisms, such as the Mesoamerican Territorial Fund: these are managed directly by Indigenous Peoples and local communities to protect their traditional lands and forests

Sustainable finance also includes carbon finance, which is a funding tool that places a financial value on carbon emissions. Companies can offset their own emissions by buying carbon credits earned from sustainable projects. This also benefits local communities and smallholder farmers through the financing of projects that support sustainable agriculture.

Why are climate adaptation measures more effective at the local level?

One of the reasons the world is not doing enough to mitigate climate change is that the people who can (the Global North) are not experiencing climate change in the same way as those on the front line (the Global South), according to a 2021 study on the economic geography of climate change. Therefore, the financing frameworks of governments and donor organizations would be more effective in addressing climate adaptation if grants, concessionary loans and private-sector incentives were aligned with the needs expressed by local communities, especially in the Global South. There are several reasons for this:

- Integration of development and climate action is easier to implement on the ground with input from smallholder farmers and local communities.
- Local institutions are more accountable to their own communities and can build trust between stakeholders.
- People at the local level better understand the necessary compromises between social groups and are more aware of the realities on the ground.
- Women, Indigenous Peoples and minority groups broaden the scope of climate action when they are able to express their views at community level.

Who are some of the players helping local communities and smallholder farmers to access climate finance?

There are many different climate finance vehicles active within this field. Here are just a few of them:

The Rwandan Green Fund, also known as FONERWA, is an engine for green growth in Africa. For example, its flagship project aims to strengthen the climate resilience of rural communities in northern Rwanda.
Pandan Green works through financial institutions that reach the most vulnerable communities in selected developing nations, least-developed countries (LDCs) and small island developing states (SIDS) in the Asia-Pacific region.

Acumen, an impact investing pioneer, supports smallholder farmers in Pakistan to build climate resilience through its USD 80 million Acumen Climate Action Pakistan Fund. This makes early- and growth-stage investments in high-impact agritech and agribusinesses, enabling farmers to better manage adverse climatic risks and events. Acumen also partners with the Green Climate Fund to support three climate-focused initiatives.

The Mesoamerican Territorial Fund is an alternative financial mechanism because it is managed directly by Indigenous Peoples and local communities to sustain the last great forests and natural territories in six Mesoamerican countries.

Key recommendations

- Support local communities and smallholder farmers with climate action in a way that is appropriate to the local context.
- Investors should contextualize the design of financing mechanisms and funds, ensuring that they are suitable for the communities that should benefit from them.

- Make available more innovative financing mechanisms, such as blended finance, to fund climate adaptation and mitigation to the benefit of local communities and smallholder farmers.
- Adapt policies and funding flows to match local needs.

Further reading

- *Climate finance needs rethinking to reach Indigenous Peoples on the ground*, International Institute for Sustainable Development, 2022.
- *Understanding market demand: How to use focus group discussions in the development of inclusive insurance*, IFAD, 2022.
- *Mobilizing private climate financing in emerging market and developing economies*, International Monetary Fund, 2022.

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GLOBAL LANDSCAPES FORUM

The Global Landscapes Forum (GLF) is the world's largest knowledge-led platform on integrated land use, dedicated to achieving the Sustainable Development Goals and Paris Climate Agreement. The Forum takes a holistic approach to create sustainable landscapes that are productive, prosperous, equitable and resilient and considers five cohesive themes of food and livelihoods, landscape restoration, rights, finance and measuring progress. It is led by the Center for International Forestry Research (CIFOR), in collaboration with its co-founders UNEP and the World Bank and Charter Members.

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