On the Virtues of Strategic Divisions of Labour: Some thoughts on strategies for the Green Climate Fund and the Financial Mechanism of the Paris Agreement

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Some thoughts on strategies for the Green Climate Fund and the Financial Mechanism of the Paris Agreement

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1. Background

After three years of intense work, focusing initially on internal governance matters – such as adopting Board Rules of Procedure (2013), followed in 2014 by a focus on the Initial Resource Mobilization, and in 2015 on 'getting a project on the ground' by Paris – the Green Climate Fund (GCF) Board has now, some would say 'finally', turned to considering the matter of formulating GCF strategies.

At the tenth meeting last July, the Board requested[1] the Accreditation Committee to work on a 'Strategy on Accreditation', and introduced a new agenda item 'Strategic Plan for the Fund' inviting the members to submit inputs 'in order for the Secretariat to produce a progress report on the strategic plan for consideration by the Board at its eleventh meeting.' This is not to say that strategies have not featured in the previous Board deliberations at all, but they have appeared mainly in the context of discussing the strategies of other entities. The only reference concerning a strategy of the fund – other than the above-mentioned two – in the Decisions of the tenth meeting, for example, is to its 'strategic objectives' in the context of the Fund's risk appetite methodology. Strategic objectives are, of course, important but there is more to having a strategy (strategic plan) than having such objectives. Indeed, the aim of this blog is to highlight certain elements that are of key importance but which seem to be in danger of being left out of the GCF

strategy discussions.

At the eleventh meeting earlier this month in Zambia, the Secretariat presented reports on the progress of both the Strategy on Accreditation, and the Strategic Plan.

2. The Strategy on Accreditation

The focus of the accreditation strategy report was almost entirely on ***procedural*** improvements, such as accelerating the process, and developing priority criteria, if applications continue to outnumber the processing capacity. Again these are important issues, but they are not really strategic. As it happens, the report does refer in passing to a number of questions as having been raised by observers that actually are strategic, namely whether 'the current pool of accredited entities [could] achieve the following objectives of the GCF: allocating 50 per cent of resources to adaptation; allocating 50 per cent of adaptation resources to SIDS, LDCs and African States; leveraging large volumes of private climate finance; and maintaining a geographical balance.'

These are questions not about process but about the ***outcome*** of the accreditation procedures, with respect to certain distributional aspects, and ultimately about (distributive) fairness. Given that currently 100 per cent of the medium, and 80 per cent of the large accredited entities are international, while 80 per cent of the current disbursement potential lies with international entities, it stands to reason that they ought to be addressed as a matter of urgency. There are other equally important strategic 'architectural' questions which observers have raised, but which are not mentioned in the report, namely:

- *Is there need for an overall cap on the total number of accredited entities?*
- *Is there a strategic aim regarding the distribution of accredited entities (by type, size, geography, etc.)?*

As alluded to in a number of previous blogs (A case for Jumping the Queue!, GCF Direct Access Accreditation: A Simple Strategy, Access to Green Climate Fund: In Desperate Need of a Strategy), I believe that these are the real strategic accreditation elephants in the Board room that should be faced head-on in the Fund's accreditation strategy.[2]

3. The Strategic Plan

I wholeheartedly support the idea of a strategic plan for the GCF. However, I think it is again absolutely key that certain 'architectural' considerations take centre stage, in particular the issue of what is to be administered 'in-house' (in Songdo) and what is to be left to others, or 'outsourced'.

We have for some time supported the view that the GCF should ultimately outsource all 'retail' activities – that is, to use the GCF terminology, micro projects (less than $10 million) – and only keep 'wholesale' programmes to be administered in-house, so as to avoid the scenario that the Economic Council in post war West Germany wished to avoid when establishing KfW in 1948, namely to create: *'a large institution entrenching itself with a huge bureaucracy and encroaching on the territory of the established banks. The KfW is to be a small and unbureaucratic body with a small management board, a capital distribution agency that passes on capital from domestic sources, from international sources or from counterpart funds as quickly as possible.'* [3]

Outsourcing could be to national implementing entities under the (enhanced) direct access modality, or to international implementing entities as part of international access. Before turning to discuss these options, let me briefly comment on a common concern in this context, namely that outsourcing is inefficient, because it is seen to merely add additional administrative layers which 'all want their

cut'. Well, this is indeed a danger, but it is not inevitable. It really depends on how the outsourcing is structured. Proper outsourcing means delegating responsibilities which should then no longer be catered for in-house. If it were otherwise, i.e. if outsourcing was necessarily less efficient than in-house management, why would so many private sector firms choose to outsource a large variety of activities?

3.1. Division of Labour through Outsourcing to the National Level: Enhanced Direct Access

I am convinced that this can best be achieved by emulating the KfW experience in Germany through Enhanced Direct Access, as envisaged in the Pilot Phase launched at the tenth Board meeting. This is why I am particularly pleased to find that in Decision B.11/03 the measures to be considered in the Strategic Plan should inter alia focus on 'ensuring that the GCF is responsive to developing country needs and priorities, while ensuring country ownership, [and] enhancing direct access […].'

Not everyone shares my view on this, of course. The Mayor of Songdo, for example,[4] envisages the GCF HQ being home to 8000 staff members from around the world, which would be theoretically in keeping with administering in-house $30 billion annually.[5] When I say 'theoretically' I mean that I do not think it would actually work. Not only has it proven to be difficult to recruit personnel for the GCF Secretariat,[6] it is highly unlikely that a centralized 'in-house' business model would be able to attract $30 billion worth of projects on an annual basis. Decentralization and devolution of decision making is, to my mind, as essential to achieving paradigm shifts as is finding the right type of projects and programmes to fund.

These retail decisions must be outsourced, and they should predominately be outsourced to in-recipient-country institutions through what has been referred to at GCF Board level as 'signature access modality' of Enhanced Direct Access

3.2. International Division of Labour

As it is highly likely that there will be a demand for internationally funded micro projects for many years to come, such projects would under a 'GCF wholesale model' need to be catered for by an international division of labour, either through outsourcing or through some form of explicit or implicit understanding between the GCF and other international funders.

It is therefore particularly interesting to see that this is precisely what has happened in the recently approved fifth project proposal, the KawiSafi Ventures Fund (see Appendix below for more details), to be managed by a private sector company based in Delaware, US which will approve individual micro investments (up to $10 million) to SMEs in Rwanda and Kenya.[7]

If a private sector entity can be used for such purposes, there should, to my mind, really be no reason why international public sector entities could not serve the same purpose. What springs to mind are the other funds created by the international climate regime, in particular the Adaptation Fund (AF) and the Least Developed Countries Fund. Why these two funds in particular? I believe they could both serve as boutique expert retailers in a particular specialized market segment.

The Adaptation Fund has a proven track record, not only in funding concrete micro adaptation projects, but also in pioneering the direct access modality and managing an innovative finance resource (a 2 per cent share of proceeds from CDM activities). At the moment it is facing considerable financial uncertainty because its innovative resource has all but dried up due to circumstances beyond its control. While there are voices which say that the AF should be closed (and its business transferred to the GCF), this would obviously be completely contrary to a wholesale-only business model for the GCF. It would, to my mind, be extremely unwise to let the AF

go under at this stage, because it would then only have to be re-created if the GCF is to follow the strict wholesale model, for there will always be a demand to have concrete micro adaptation projects funded through international channels..

The LDCF is facing similar problems with regards to securing funding for its pipeline of fundable projects. The most recent draft guidance to the Global Environment Facility (GEF) – which manages the LDCF – by the Standing Committee on Finance (to be considered and approved by the COP in Paris) 'requests the GEF to carry out a technical review of LDCF programming priorities with a view to identifying possible alternative roles for the LDCF in the evolving climate finance architecture, in consultation with relevant stakeholders, particularly the UNFCCC LDC Group, and focus on:

piloting concrete climate change activities particularly relevant for LDCs;
enhancing longer-term institutional capacity to design and execute such activities.'

I believe that with such a realignment of programme priorities, the LDCF would have a viable niche market which would deliver genuine value added to the poorest and particularly vulnerable countries.

Of course, it makes no sense to agree on a division of labour, if there is no funding to carry out the agreed tasks. This is why one would need to ensure that all these specialized retail funds are adequately and predictably funded. In some cases, this could happen by getting at least part of the required funding directly from the GCF as a division of labour through outsourcing. In the longer term, possibly the best way forward for the funds that will be included in the financial Mechanism of the new agreement, could be similar to that proposed by a number of senior developing country negotiators in a recent Concept Note on A Paris Replenishment Cycle.

4. Summary

It is imperative that the recently launched GCF strategic planning process focus not only on strategic objectives and the like, but also on institutional and governance architecture, and in particular on enhancing complementarity, effectiveness, and efficiency through a division of labour between the GCF as wholesale agent, and other funding entities as specialized retailers, be it in-country (preferably) through Enhanced Direct Access, or through designated international funds, in particular those that will be serving the financial mechanism of the new Paris Agreement.

Appendix. The Acumen KawiSafi Ventures Fund

The KawiSafi Ventures Fund will be comprised of portfolio companies in the clean energy sector in East Africa and is targeting an ecosystem approach to investing in small to medium enterprises that serve bottom-of-the-pyramid customers.

The Fund will invest in approximately 10–15 companies (with capital including $20m lent by the GCF). In accordance with Acumen's accreditation for micro on-lending and/or blending (loans and equity), the Fund will not invest more than $10 million in a single portfolio company.

A Technical Assistance Facility (TAF) funded by grant capital ($5m from GCF) is to be established to augment the Fund's investment strategy of building profitable, scaling, and socially responsible businesses that serve bottom-of-the-pyramid markets and provide a financial return to the Fund and its investors.

Acumen Capital Partners LLC, a wholly owned for-profit private sector subsidiary of Acumen, based in Delaware, will be the Manager of the Fund. All due diligence and deal execution of Fund

investments will be led by an Investment Team member. The Managing Director of the Investment Team will review Acumen's entire pipeline of potential investments, to ensure that all available investment opportunities consistent with the Fund's investment criteria are appropriately considered for investment from the Fund.

The Investment Committee of the Fund (the 'IC') is the core decision-making body for the Fund and controls all decision gates in the investment process prior to its final approval or rejection of a deal and in connection with exits. The primary responsibilities of the IC will be to:

Approve/reject deals at key decision gates in the investment process and at exit;
Review current pipeline, post-investment management activities, and deal outcomes;
Review investment and portfolio performance against annual goals and recommend potential corrective action, if necessary;
Review and provide guidance on global investment and portfolio management strategy.

The IC will typically meet at least two or three times per prospective investment prior to the final meeting at which a deal is approved or rejected. The IC will be comprised of up to five members. Initially, the IC will include: Jacqueline Novogratz, CEO of Acumen, Sachin Rudra, Chief Investment Officer of Acumen, C. Hunter Boll, formerly Managing Director of Thomas H. Lee Partners, and the Managing Director of the Fund.

Source: Funding Proposal Summary (GCF/B.11/04/Add.05/Rev.01)

Notes

[1] Decision B.10/06

[2] The authors of the Report are aware of these issues. After all, they suggest, in Next Steps: 'The strategy may also include further information based on the accredited entities and accreditation of applicants, such as the distribution of the types of entities, access modalities (for subnational, national and regional entities under direct access and international access) and application criteria (size of an individual project or activity within a programme, fiduciary functions, and environmental and social risk and impact category), in an effort to inform the further development of the accreditation strategy with regard to the types of partners the GCF requires in order to achieve its objectives.'

[3] Alfred Hartmann, Finance Director of the Economic Council, as quoted in Heinrich Harries, Financing the future: KfW – the German Bank with a Public Mission, Frankfurt a.M.: Fritz Knapp Verlag, 1998.

[4] See A Delhi Vision for the Green Climate Fund Business Model Framework.

[5] See How many people does it take … to administer long-term climate finance?

[6] Green Climate Fund directors warn it faces staffing crisis.

[7] Strictly speaking, this is classified as a 'direct access' activity implemented by a 'regional accredited entity' (i.e. Acumen). However, given that the intention behind having regional (enhanced) direct access entities was to have the decisions taken by people selected by the recipient countries in question, I think that, in light of the proposed composition of the Investment Committee (see the Appendix), this should more accurately be classified as falling under the international access modality.

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