

### Keywords:

Finance, climate change, forestry, energy access, urban



## OVERVIEW

### IIED Shaping Sustainable Markets, Climate Change, Natural Resources, Human Settlements Groups

#### Project name:

Financing the SDGs and Paris climate agreement: the role of local finance

#### Project leader:

Paul Steele and Clare Shakya

#### Time frame:

April–December 2016

#### Budget:

£240,000

#### Objective:

To understand the catalytic power of local finance, drawing on insights from IIED's partners, and to identify ways to enable public and private financiers – including donors and investors – to channel more finance to local communities for effective action.

## PROJECT SUMMARY

During 2016, IIED explored with partners the value of local finance in urban and rural settings, comparing innovation from across climate, energy, forestry and urban services. The 'Money where it matters' event, on December 7–8 2016, brought together southern partners with public and private financiers and wider development experts to reflect on insights from this analysis, and distil the opportunities and challenges of harnessing international and domestic finance for local investment. The process identified outstanding questions and built shared commitment for the next phase – to deliver effective investment in climate and socially positive local action.

## CHANGE IN ACTION

**Delivering the Paris Agreement, the Sustainable Development Goals and the Addis Action Agenda requires local action at scale.** Yet too little finance reaches local levels and citizens often have little or no say in how funds are spent.

# Money where it matters: an emerging agenda for local finance

## Harnessing finance for local action, from public and private, international and domestic sources

IIED has been innovating with partners to develop mechanisms for effective decentralised finance for more than 25 years, working with grassroots women's groups such as Shack/Slum Dwellers International (SDI) to support collective approaches to saving since the early 1990s. IIED has gone on to build partnerships and evolve approaches across a range of areas to tackle the perceived risks of local finance and prove its value.

In the drylands of Kenya, the Isiolo County Climate Change Fund enables communities to set priorities for adaptation investment and agree rules for resource management. Five counties now have these funds, overseen by the National Drought Management Authority with technical assistance from the Adaptation Consortium, led by IIED.

In Guatemala and Mozambique, IIED's work with partners encourages investment in local forest businesses. In Tanzania, IIED is exploring how to make finance for decentralised energy solutions more accessible. In both cases, getting finance to help small businesses grow requires public and private finance in complementary roles.

This body of work shows that public finance can be more effective if

communities are involved in identifying and shaping development investments. Local actors know their needs best and, with the right enabling conditions, can significantly reduce costs through mobilising collective action. Both public finance and local collective action can increase the confidence of private investors. They can invest at adequate scale and in ways accessible to small businesses. But significant barriers remain.

A rethink of development finance is urgently needed to deliver the Sustainable Development Goals (SDGs) and the Paris Agreement. Both require substantive investment, requiring public and private finance from international and domestic sources.

IIED's 'Money where it matters' event reflected on the value of local finance and identified opportunities for increasing its flow – future research frontiers. The 45 participants represented southern partners, northern financiers, donors and development experts. Together, participants shared experiences of local finance in urban settlements, forestry, climate and energy sectors. They agreed the common challenges and distilled the five frontiers to unlocking finance for local action:

**Local finance makes sense.** Local ownership of decisions makes investments relevant, longer-lasting and accountable, delivering better value for money.

**But local finance remains limited.** We estimate that less than 10 per cent of public climate finance is for local investment, and 11 per cent of development partners' energy funding in Tanzania is for decentralised energy access.

Drawing on 25 years of innovation, IIED is deepening understanding of local finance and building financiers' commitment. Our work demonstrates the need to tackle perceptions of risk in local finance, support further innovation to unlock private investment, and harness home grown innovation and entrepreneurship — because public finance alone is not enough to tackle poverty and transform economies and societies to be climate positive.

### KEY LESSONS LEARNT & INNOVATIONS

- Reflecting on the analysis and partners' experience from across climate change, energy access, natural resource management and urban settlements, it became apparent that there are common hurdles and solutions to local finance, regardless of sector or region
- We identified five common 'future frontiers' to be explored in further work on local finance:
  - \* Risk: building a shared understanding
  - \* Aggregation: reaching the right scale
  - \* Complementarity: structuring public and private roles and finance
  - \* Capabilities: growing technical and financial skills
  - \* Bridges and brokers: dialogue across scales and through trusted intermediaries.

### PARTNERS' VIEW

*[To be a successful intermediary] first of all you have to be able to understand local peoples' needs. And to do that you need cultural and geographical proximity*

Aurora Malene, Gapi, Mozambique



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Boys polish chairs for sale in the furniture market, Nampula, Mozambique

Credit: Mike Goldwater

### Five frontiers for unlocking local finance

<b>Risk: building a shared understanding</b>	Risk is a central challenge for finance providers and recipients, but is understood differently by both parties. Those receiving local finance tend to think of risks to successful development outcomes — such as risks from climate shocks, or inadequate infrastructure. Those providing local finance focus on fiduciary risk — the risk that their money will not be used for its intended purpose, or will not be properly accounted for. A first step for those working in local finance is to build a shared understanding of what risk means, and to innovate to mitigate and track risk effectively.
<b>Aggregation: reaching the right scale</b>	On both the supply and demand side, joining up investments, or aggregating, is essential to provide financing opportunities at the right scale for public and private investors. Communities can aggregate by joining up in cooperatives, federations or community-owned enterprises to secure finance, leveraging their own investment. On the demand side, investing through intermediaries such as brokers, local governments, banks or nongovernmental organisation consortia can bring opportunities together.
<b>Complementarity: structuring public, private and community roles</b>	Public and local action improves the enabling environment for private investment, tipping the balance in favour of local projects. Blending finance between public and private actors — with concessional funding or guarantees — can de-risk investments. Public finance is important to pump prime. Having public finance with 'skin in the game' gives confidence to investors in policy stability, and private finance scales up the impact of public investment.
<b>Capabilities: growing technical and financial skills</b>	Across the board, more funding is needed to support local organisations to build the technical and financial skills to access finance. That includes supporting initiatives that aggregate and train small producers and enterprises, and supporting institutions, including local governments or local banks, which have reach at local level, to improve their capacity to engage communities and to provide the products and services that benefit local communities.
<b>Bridges and brokers: dialogue across scales and through trusted intermediaries</b>	Building dialogue between local organisations and investors — whether of public or private finance — would create a shared language and understanding. This could identify projects of interest to both sides, explore how to tackle risk and identify best practice in financial and technical management, and in terms of social and environmental impact. Brokers, trusted by both sides, are another means to reach greater scale.



### Knowledge Products

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