POLICY BRIEF COMPETITION OUTPUT

Connecting the Dots: How A National Intermediary Can Enable the Mobilization of Climate Finance in Indonesia

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Summary

Climate finance plays a critical role in addressing climate change issues. Global donors have provided much of this finance to help developing countries adapt and cope with ongoing climate change effects. However, limited technical capabilities and political interference in said countries can cause difficulties for donors, particularly when they want to implement it themselves. In this brief, we examine key problems faced by global donors in deploying their climate funds to developing countries and propose solutions on how the government can enable the mobilization of such funds. We find that the government of Indonesia (GoI) has established a national intermediary called the Indonesian Environment Fund (IEF) under the Ministry of Finance. However, the IEF still has shortcomings, and could be rectified to unleash its full role in mobilizing climate finance. Improvement of the IEF is necessary to help scale up the amount of funding, encourage more blended financing, and develop local implementation capabilities.

Climate Finance and The Need For National Intermediaries

Climate finance has been a topic of considerable interest due to its critical role in enabling transition to a low-carbon and climate-resilient economy (Bhandary et al., 2021). Developed countries have agreed to mobilize climate funds to help developing countries respond to climate change (Yamineva, 2016). This funding derives from various sources: public, private, bilateral, multilateral, and alternative sources (Cui & Huang, 2018). Climate finance aims to accelerate the achievement of the Paris Agreement, but for it to be successful, adequate local delivery is required.

Climate finance has faced a myriad of challenges that potentially hamper the achievement of the climate agenda in developing countries, especially due to the mismatch between the planned and actual funding allocations at the local level, as well as climate underinvestment. Donors feel unsure about the delivery of their projects due to limited technical capacity and political interference that restricts their intended objectives (Ampaire et al., 2017). Hence, the presence of national intermediaries between global donors and local-country level implementers is needed, such intermediaries functioning to mobilize finance has been gaining recognition in recent climate policy discussions.

In general, national intermediaries play three important roles: (1) they work as brokers between actors (Klerkx & Leeuwis, 2009; Winch & Courtney, 2007), (2) they bridge between key constituents and stakeholders (Bakici et al., 2013; Choi, 2015), and (3) they provide information, standards, procedures, and solutions for others as well as connect different actors (De Silva et al., 2018). Intermediaries can also play a wider role as system builders, through shaping policies and building capacities (Musiolik et al., 2020).

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National Intermediaries and The Indonesian Environment Fund

Understanding and developing projects that meet the donors' stringent criteria requires good project development and robust implementation plans with measurable outcomes. Otherwise, developing countries will find it difficult to encourage financing toward local green projects since the donors are worried whether or not the funds are used properly. National intermediaries are set up to address such issues, acting as a conduit for conceiving, developing, planning, implementing, and governing climate projects. Bridging climate funds from donors to local-level green project owners with four main roles: (1) information providers, (2) brokers, (3) concept and project designers, and (4) project implementers (Chaudhury, 2020).

First, national intermediaries provide information, data, and analysis on the Global Climate Fund (GCF) activities and projects, aimed at encouraging the interest of wider climate funding providers. Second, intermediaries act as a bridge between parties since direct interaction is inhibited by high transaction costs, as well as communication and knowledge gaps (Parag & Janda, 2014). Intermediaries can also help set up project consortiums and facilitate the funding application process in exchange for a fee. Third, intermediaries as concept and project designers not only act as service and information providers or brokers, but also as architects, co-creators, and enablers of project creation (Agogué et al., 2013). National intermediaries play an important role in designing and creating projects as they sit in between fund owners and a country's priorities, thus orchestrating what activities get funded and promoted. Fourth, intermediaries are responsible for delivering climate projects. Intermediaries play an important role in bringing much-needed technical expertise for successful implementation of climate projects. These four combined roles are highly essential in allowing intermediaries to influence how action is shaped, which local priorities are addressed, which projects get funded, how projects are implemented, and which actors are involved in the process.

The establishment of a government agency under the Ministry of Finance called Indonesian Environment Fund (IEF) in 2017, fully operating in 2020, with legal autonomy to conduct its activities seems to correspond with the urgency of national intermediaries. The IEF is a Public Service Agency (Badan Layanan Umum – BLU) that manages funds aimed at environmental purposes. It is unique compared to the other fund-managing public agencies since it is the first designed to receive funds from international donors.

The BLU legal vehicle offers flexibility in terms of the sources of finance it can accept, and the funding instruments it can offer. In addition, the IEF has diverse sources of revenue, including revenue from international donors and carbon markets, as well as a diverse project portfolio. As a result, the IEF has potential to achieve bigger impacts. The IEF is the first BLU with flexibility to source both state funds and international financing; that is, the IEF can act as a "funding hub" for various funding mechanisms focusing on environmental protection and management in Indonesia.

The IEF is designed to manage multiple programs and recipients from various funding sources. The IEF channels and distributes climate finance to support Indonesia's objective of addressing environmental degradation (Soejachmoen, 2017). To date, the IEF has been successful in addressing legal and political inference risks (CNBC, 2022). However, due to its limited technical skills and missing linkages among actors, the IEF needs further improvement and rectification to better channel climate funds to local-level beneficiaries via diverse financing schemes. Additionally, the fund managed by the IEF is still predominantly derived from the state budget (Figure 1), thereby limiting the autonomy of the IEF over the use of its funds toward green and local projects.

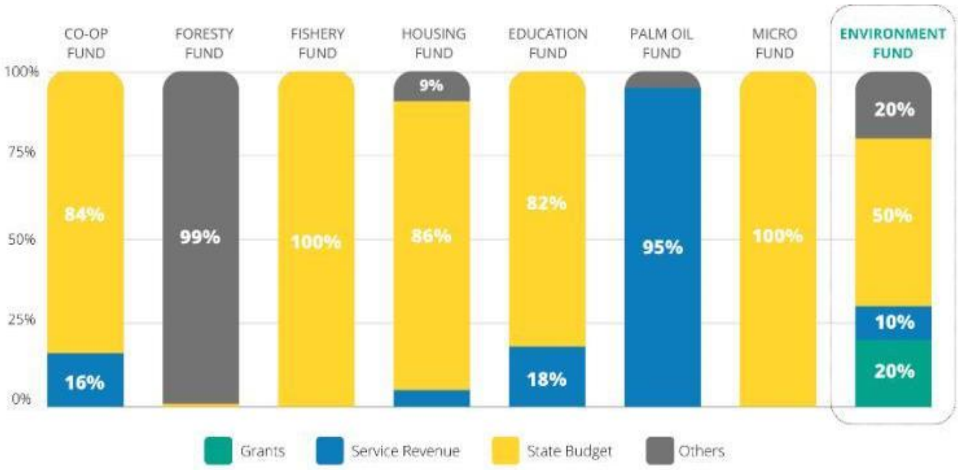

Figure 1. Comparison of Fund Management by BLUs
Source: Climate Policy Initiative (2022)

While the private sector has been the dominant funding source for climate finance, its trend (Figure 2) is lower relative to the public sector in terms of Compound Annual Growth Rate (CAGR). This condition needs to be addressed since there is a huge potential for additional flows of private capital into such projects, especially given the persistent investment gap in developing countries (Zhan & Santos-Paulino, 2021). IEF itself has distributed only small amounts of micro-loans to projects in 2021, totaling IDR 23 billion. Moreover, IEF put its managed IDR 1,6 trillion fund into low-interest traditional banking instruments, thus returns that can potentially be used for climate projects are low. Consequently, a more creative and collaborative financing should come into play since a new wave of finance has been gaining traction through innovative partnerships between private fund managers and public entities such as The Climate Finance Partnership (AFD, 2020).

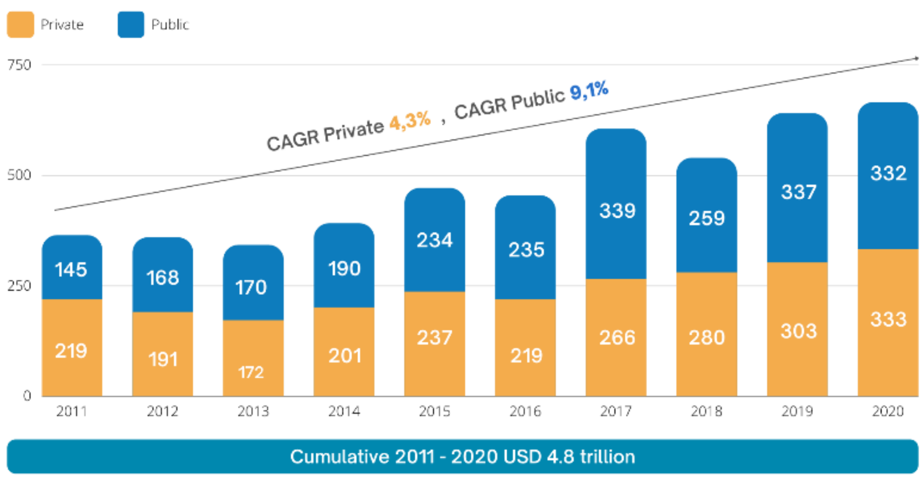

Figure 2. CAGR of Private and Public Investment in Climate Finance
Source: Climate Policy Initiative (2022)

Policy Implication and Recommendation

The establishment of the IEF has been a “game-changer” in bringing climate finance to local-level projects. However, further rectifications are still necessary to help scale up the distribution of funding, promote more creative financing, and develop local implementation capabilities. The implications of climate finance go beyond fulfilling Indonesia’s shared responsibilities of global climate change: it will accelerate the achievement of the sustainable development goals. Therefore, fixing the shortcomings inside the IEF will unlock the huge potential of growing climate funds since global donors become more confident in distributing such funds.

Nonetheless, simply relying on the donors will slow the progress of bridging funds to the local beneficiaries. Hence, the IEF should play an active role in connecting actors relevant to achieving the core objectives of climate finance (Parag & Janda, 2014). From the top-down perspective, initiatives can be brought by government regulation, climate funders, and new technologies. From a bottom-up perspective, initiatives can arise from civilians and grassroots. In other words, the IEF should play the role of “connecting the dots”, sitting in between actors who participate in climate finance.

There are four recommendations for rectifying the roles of the IEF.

1) First, the IEF should act more as an enabler that matches the needs and expectations of donors and beneficiaries, playing a role as a trustee to operate and use the funds for implementing approved projects.
2) Second, since the IEF is in a moderately low position in terms of capacity in managing projects (2021), the IEF should improve the technical quality of its manpower by bringing in more professionals and training more staff to better manage the projects (Burch, 2010).

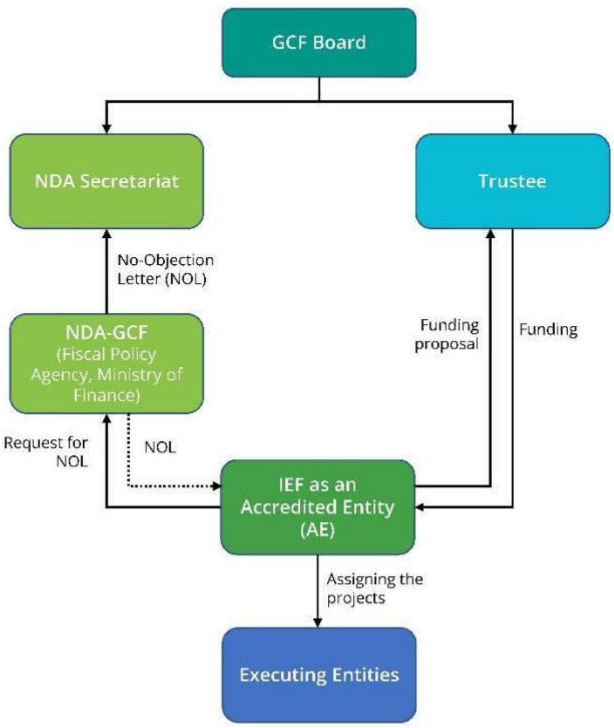

Figure 3. Indonesian Environment Fund as an Accredited Entity
Source: Authors Analysis (202)

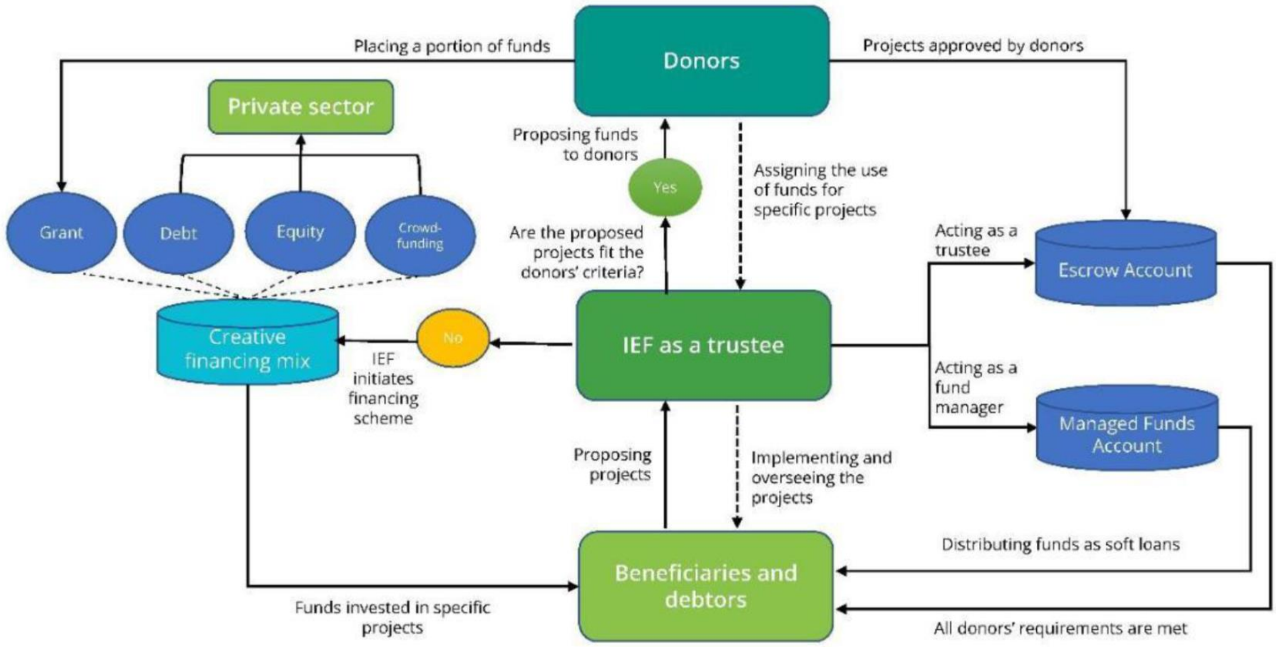

Figure 4. Indonesian Environment Fund as an Accredited Entity
Source: Authors Analysis (202)

3) Third, we propose two schemes under which the IEF can obtain more funds from donors (Figure 3 and 4): (1) the IEF can submit a proposal to be accredited as an accredited entity (AE) by the NDA Secretariat or (2) the IEF remains as a trustee with further improvements, playing a role in connecting the dots without being accredited as an AE.
4) Lastly, to allow for financially unfeasible projects to run, the IEF should distribute its managed fund as soft loans to the project investors rather than putting it into low-yielding traditional banking instruments. It will also allow for the IEF to create blended finance scheme (Kim & Jun, 2022; Rode et al., 2019) given its importance in boosting private investment (Tonkonogy et al., 2018), covering not only grants, but also debt and equity finance as well as alternative funding such as crowdfunding (Kukurba et al., 2021; Martínez-Climent et al., 2019; Motylska-Kuzma, 2018).

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