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CLIMATE FINANCE

In 2009, developed countries committed to jointly mobilise US \$100 billion in climate finance annually

Wealthy nations have repeatedly failed to meet their own US \$100 billion target

Calls for ramping up climate finance are high, as the debt crisis and climate change threaten the future of the developing world



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Finance: A contentious issue

The United Nations Climate Change Conference in Egypt this year (COP 27) is all set to be a battleground for developing and emerging economies. They will be fighting for resources needed to reduce greenhouse gas emissions and adapt to climate change. These nations have contributed little to the current climate crisis, yet, they are the least equipped to protect themselves from the rising threat of climate change.

At COP 15 held in 2009, an important decision was made.

Developed countries committed to jointly mobilise US \$100 billion in climate finance annually to aid climate action in the developing world. The United Nations Convention on Climate Change (UNFCCC) defines climate finance as "local, national or transnational financing to support mitigation and adaptation actions to address climate change". It can be drawn from public, private and alternative sources of financing. Article 9 of the Paris Agreement also stipulates that developed

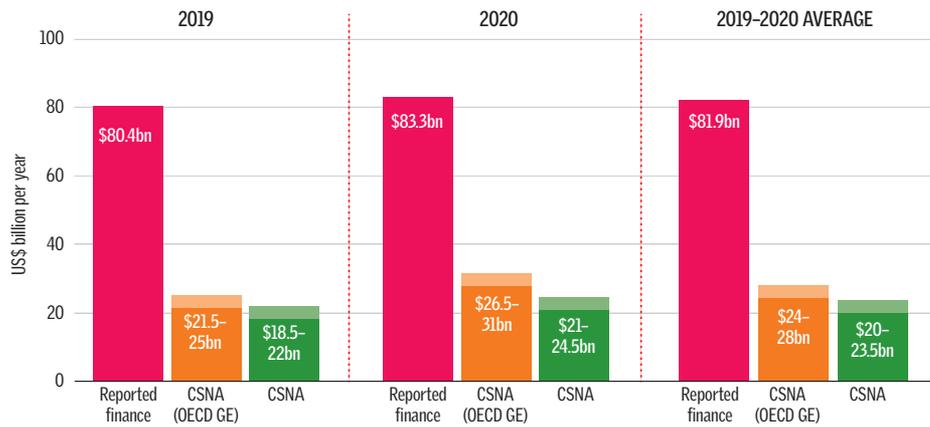
country parties provide financial resources to assist developing country parties in mitigation and adaptation measures. But these wealthy nations have repeatedly failed to meet the US \$100 billion target. There is also a question of what is being accounted as climate finance.

According to data from the Organization for Economic Co-operation and Development (OECD), an intergovernmental body consisting of wealthy nations, some US \$52.5 billion was mobilised in 2013.¹ After dropping to US \$44.6 billion in 2015, the finance flow has steadily increased. In 2020, the developed countries raised US \$83.3 billion, a jump from US \$80.4 billion in 2019.

Some reports, however, have questioned these figures (see *Graph 1: Reported climate finance versus Oxfam's estimates of climate-specific net assistance*). The charity organisation Oxfam has estimated that climate assistance provided to

Oxfam has estimated that climate assistance provided to developing countries was one-third of the estimates provided by the OECD

Graph 1: Reported climate finance versus Oxfam’s estimates of climate-specific net assistance (2019, 2020 and 2019–20 average)



Note: This graph compares climate finance estimates between OECD (red bar) and Oxfam (orange and green bars). Oxfam has used two different methodologies to calculate climate-specific net assistance (CSNA): OECD Grant Equivalent (CSNA OECD-GE) and CSNA in 2019 and 2020. The green bar is calculated using a more robust methodology. The graph captures the difference between what is claimed and actual climate finance.

Source: T. Carty and J. Kowalzig (2022) Climate Finance Short-changed: Methodology note. Oxfam

developing countries was found to be around US \$21–24.5 billion which amounts to one-third of the OECD’s estimates for 2020. Oxfam arrived at these figures after excluding US \$13.1 billion mobilised in private finance and US \$1.9 billion in export credits from the OECD numbers, arguing that they do not count as climate finance.² Though the remaining US \$68.3 billion was raised as public money, a major chunk was given as loans at market value. The Oxfam analysis, therefore, included only concessional loans (low-interest loan financing).

The disparity in estimates from OECD and Oxfam stems from the fact that the world has not consensually agreed on a definition of climate finance. For example, there is no clarity on the kind of financial instruments (traditional loans, grants, debt swaps, national climate funds, carbon markets, and insurance instruments) that could be used and the types of projects that could be counted as eligible for climate finance.

The issues arising from this lack of definition of climate finance are highlighted in a joint 2022 study by researchers from the Switzerland-based ETH Zurich and the Germany-based Potsdam Institute for Climate Impact Research published

in the journal, *Nature Climate Change*.³ The report focused on bilateral climate finance projects and financial flows from 32 donor countries to 141 countries across continents, from 2000 to 2019.

The analysis found that bilateral climate finance is overreported—roughly 40 per cent less than what countries report. It is likely that the lack of an independent vetting mechanism also contributed to the reported inconsistencies.

Germany, France, Norway, the United Kingdom, the United States and Japan were the top contributors to bilateral

climate finance. According to the report, India, Morocco, Mexico, Vietnam and Indonesia were the top recipients.

The United States, the United Kingdom, Canada, Sweden and Switzerland prioritize adaptation finance. But France, Germany and Japan invested more in mitigation. Mitigation finance primarily went to middle-income countries such as

Brazil, India, Mexico and Indonesia. According to the *Nature Climate Change* report, Egypt and Morocco—countries with high potential for renewable energy—also attracted significant mitigation finance.

Another major funding channel is multilateral climate financing, which includes multilateral development banks (MDB) and multilateral climate funds. They contributed US \$36.9 billion in climate financing in 2020, according to the OECD data. Further, the *Delivery Plan Progress Report*⁴ released by Canada and Germany found that many Multilateral Development Banks lack an adaptation finance goal.

World Bank is one of the largest multilateral financiers of climate action in developing countries, accounting for 56 per cent of the total flow from all multilateral development banks combined. It delivered a record US \$31.7 billion in the fiscal year 2022. This accounts for a 19 per cent increase from

There is little clarity about the quality and quantity of the World Bank's climate financing

US \$26.6 billion in 2021 which was then considered an all-time high, according to the World Bank.⁵

The Bank reported US \$17.2 billion climate finance in the fiscal year 2020; but another Oxfam report titled *Unaccountable Accounting* has raised questions on this.⁶ The report says the number could be either higher or lower by 40 per cent. Oxfam has noted that there was little clarity about the quality and quantity of financial flows. This lack of disclosure was of concern as other financiers could follow suit.

A growing chorus of voices is calling for a reform of the World Bank. In October 2022, Germany, the United States and other major economies put together a proposal to help developing economies fight global challenges such as climate change. German Development Minister Svenja Schulze said World Bank's loans could be made more attractive by providing targeted budget support for governments. The Bank is expected to present a roadmap before the end of 2022 to show how it can gear its vision, incentive structure, operational approach and financial capacity towards addressing global challenges.

In October this year, Secretary of the US Treasury, Janet L Yellen noted that even if these reforms were successful, there is only so much that multilateral banks could do. She urged individual countries to make important policy reforms, calling for quality financing. She also said that the private sector needs to ramp up investments and technology needed to address the rising threats.

Private sector disinterest

The private sector channelled US \$13.1 billion in climate finance in 2020. In 2019, it was US \$14.4 billion. The OECD in its *Disaggregated analysis for 2016 to 2020* pointed out that contributions from the private sector were lower than

Private investment largely flowed into middle-income countries that have enabling environments and low-risk profiles

anticipated. Their investments majorly flowed into middle-income countries that had relatively conducive, enabling environments and low-risk profiles.

The world needs to mobilise US \$3–6 trillion to transition to net-zero emissions and become climate-resilient by 2050. To make this goal a reality, experts believe that it is crucial to tap into private finance—a task that is proving to be a challenge.

According to the *Global landscape of climate finance: a decade of data*, the growth rate of private climate finance was slower (4.8 per cent) than that of the public sector.⁷ A 2021 study published in the *Journal of Sustainable Finance & Investment* reported that the lion's share of climate funds flow into mitigation projects such as renewable energy and energy efficiency while

adaptation is sidelined.⁸ This is because mitigation provides greater financial returns to investors than adaptation.

Green projects have not attracted sufficient investments because they often accompany high upfront costs, multiple technical challenges, and unproven business models. According to New York based news agency, Bloomberg, with coal and gas markets emerging stronger, global lending by top private bankers, including the likes of JP Morgan, Bank of America, and Morgan Stanley, went up 15 per cent to over US \$300 billion in the first nine months of this year compared to the same period in 2021.⁹ These entities made more than US \$1 billion in revenue during the same period from financing fossil fuel. More than 500 financial sector entities pledged that their banks would reach net-zero carbon emissions by 2050 through the Glasgow Financial Alliance for Net Zero (GFANZ). But this recent surge in fossil fuel investment suggests that this goal could be far off.

The *Delivery Plan Progress Report* recommended that developed countries honour their pledge using only public

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resources at COP 27. Else, uncertainty and delay will continue to plague climate finance efforts, it added.

Cancelling debt

The call for ramping up climate finance is getting louder. According to a paper published by the United Nations Development Programme in October 2022, the COVID-19 pandemic and the Russia-Ukraine war have pushed as many as 54 countries into a severe debt crisis.¹⁰ These nations represent a little more than 3 per cent of the global economy and 18 per cent of the world's population. Of the 54 countries, 28 rank among the 50 most climate-vulnerable countries in the world. Sub-Saharan Africa constituted the largest geographical group with 25 countries, followed by Latin America, and the Caribbean with 10 countries.

The combined onslaught of debt and climate change is also putting the future of Small Island Developing States (SIDS)—tiny islands that dot the world's oceans—in peril; 31 SIDs face a critical debt crisis. These nations were given US \$1.5 billion in climate finance, from 2016 to 2020. However, according to a recent analysis by the European Network on Debt and Development (Eurodad), 22 of the SIDs paid more than US \$26.6 billion to their external creditors during the same period.¹¹ Overall, these nations have spent 18 times more in debt repayments than they received in climate finance. It also does not help that government expenditure in these nations is predicted to decline in the next three years. This will adversely impact investment in public services, climate action and other economic measures.

These island nations are highly vulnerable to climate change. People residing in the Maldives, the Marshall Islands, Kiribati and Tuvalu may be forced to relocate if sea levels rise above a metre. According to the World Bank report, 360°

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Resilience, in the Caribbean alone, hazards, including those brought on by climate change, have caused an estimated US \$12.6 billion per year in damage.¹² These nations had access to only US \$1.5 billion out of the US \$100 billion climate finance pledge in 2019. In October 2022, former Maldives President Mohamad Nasheed suggested that the 20 most vulnerable countries should stop making debt repayments amounting to US \$685 billion in protest if lenders continue to be indifferent to their problems.

According to Debt Justice, a UK-based campaigning organization, the situation in Africa is also dire. African governments owe three times more debt to western banks, asset managers and oil traders than to China. Yungong Theo Jong, Head of Programmes at the African Forum and Network on Debt and Development (Afrodad), has noted that western nations pin the blame on China for debt crises in Africa. But this analysis paints a different picture.

Sub-Saharan Africa recorded a total external debt stock of US \$702.4 billion in 2020, compared to US \$380.9 billion in 2012. Experts estimate that the energy and food crisis triggered by the Russia-Ukraine war could take a further toll on the debt-ridden region. A report from Debt Justice and Climate Action Network International states that if wealthy nations do not provide adequate climate finance, the debt of

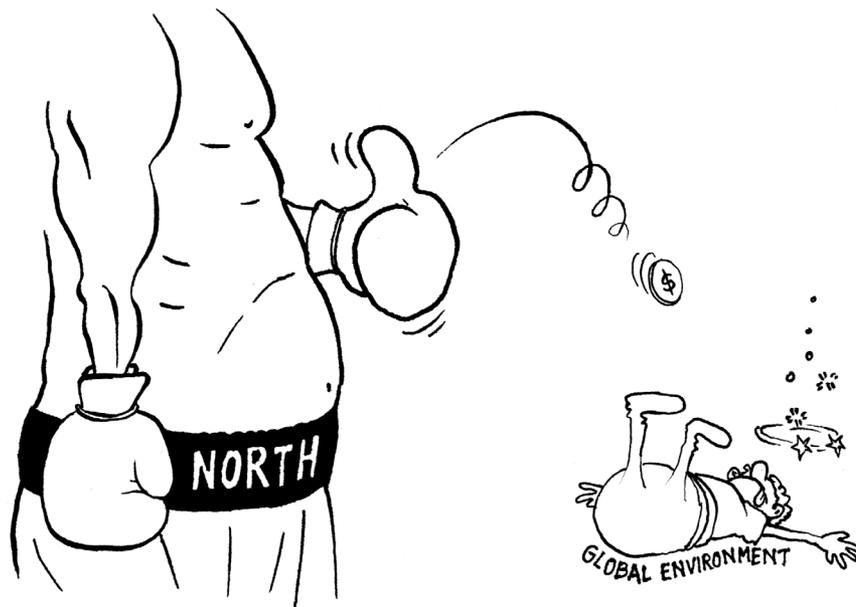
Sub-Saharan African countries may reach almost US \$1 trillion over the next 10 years.¹³

Africa is highly vulnerable to climate change. The continent requires US \$2.8 trillion between 2020 to 2030 to meet its Paris Agreement goals. But it receives only US \$30 billion annually as climate finance according to a 2022 report on Landscape of Climate Finance in Africa.¹⁴ The largest gaps in investments were recorded in Central and East Africa while North Africa faces the lowest climate investment gaps. Still, the

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finance demands exceed flows by three to six times. The private sector, too, has contributed only 14 per cent of total climate finance in Africa, much lower than it has in South Asia, East Asia and Pacific, and Latin America and the Caribbean. The report calls for an increase in private capital as governments' budgets have been hit by the COVID-19 pandemic and Russia-Ukraine war.

Asia received 25 per cent of global climate finance despite being home to roughly 60 per cent of the world's population, according to the briefing paper, *Climate Finance in Asia*. Much of the flow went as loans, increasing financial burdens and forcing already indebted countries to cut public services to repay debts. Laos and Myanmar are now at high-risk of debt distress.¹⁵ Only 17 per cent of bilateral climate finance and six per cent of multilateral climate finance to Asia came in the form of grants.

High interest rates are an added pressure. Vulnerable countries are often charged high interest rates owing to their vulnerability. A report from the UK-based non-profit, Debt Justice, notes that these countries may have to shell out a whopping US \$168 billion over the next decade.¹⁶ The Global

South is currently spending five times more on debt repayments than on addressing the impacts of the climate crisis. Additionally, the rising value of the US dollar has exacerbated the problem. The dollar is now at its strongest since the early 2000s.

Against this backdrop, nations are looking beyond conventional financing tools such as grants and loans. One such solution is debt-for-climate swaps, where the recipient nation commits to investing the savings from debt forgiveness into climate adaptation or mitigation. The International Monetary Fund (IMF) and Green Climate Fund, a multilateral funding body, have shown interest in deploying debt-for-climate swaps to address the problem. The approach is inspired by “debt-

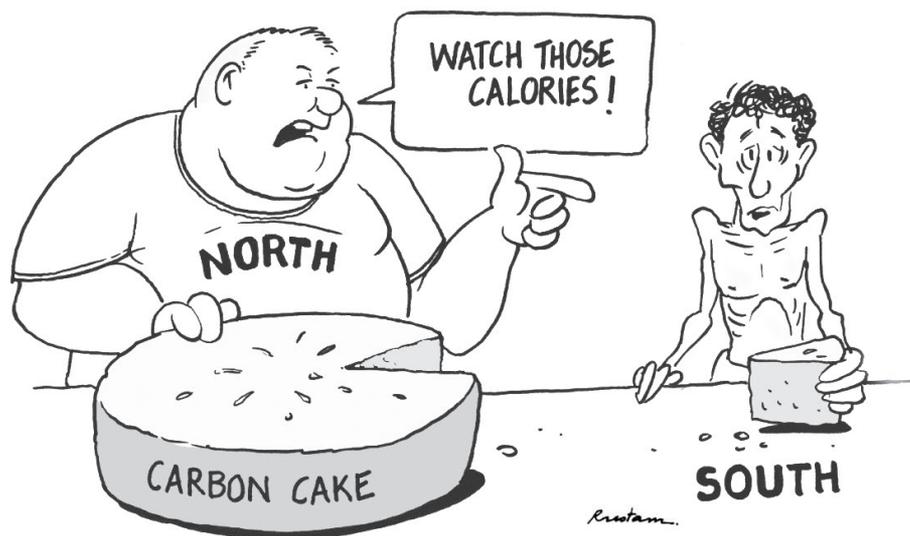
for-nature” or “debt-for-development” swaps. Over 100 debt swaps have been recorded, but the transactions have been small, according to a working paper from the IMF. The largest swap was recorded 30 years ago, in 1992, between Poland and a group of creditors and had a total value of US \$580 million.

The IMF suggests that blending public and private finances could help de-risk investments for private sector capital. Under blended finance, the

public sector could invest in equity which bears much of the investment risk if an asset becomes unprofitable. Alternatively, they could enhance credit to improve the creditworthiness of the projects. Multilateral Development Banks, too, can do the same to harness more private capital. This approach could also help developing and emerging markets which are already saddled by heavy debt burdens.

The other novel innovative financing mechanisms include the Pay-As-You-Go (PAYG) solar finance model. One of the major hurdles in widespread adoption of clean energy in the developing world is the upfront cost of solar products. The PAYG mechanism allows off-grid customers to pay for high-quality

Along with climate finance, the New Collective Quantified Goal (NCQG) will be on the table for deliberations at COP 27



solar products in small monthly installments. According to a study published in the Energy for Sustainable Development, this model has been a huge success in Sub-Saharan Africa where Kenya pioneered it as a cost-competitive modern alternative for kerosene.¹⁷

Expectations from COP 27

Climate finance deadline was set for 2020. It has been extended through 2025. A delivery plan released at COP 26 suggested that it is unlikely that the developed world would fulfil its goal until 2023. Along with climate finance, the New Collective Quantified Goal (NCQG) will be on the table for deliberations. Signed in 2015 as part of the Paris Agreement, member states agreed that NCQG should be set from a floor of US \$100 billion per year before 2025, after considering the needs and priorities of developing countries.

Deliberations at COP 27 would clarify whether the NCQG will deal with financial flows from developed to developing countries or whether it will include all flows. There is also a need to define whether NCQG will focus on a single global goal or multiple sub-goals such as adaptation and mitigation. It also includes capacity-building, technology

development and transfer. Loss and damage finance, and finance for a just transition are other sub-goals. The other topics of discussion would be about quantifying the sub-goals, updating them in response to changing needs of the developing world, and deciding on how NCQG could support the goal of making financial flows consistent with the Paris Agreement, according to a policy brief from Climate Service Advisory Service, an initiative delivered by a consortium of experts led by Germanwatch e.V. and funded by Climate and Development Knowledge Network (CDKN).¹⁸ The report also highlighted that NCQG should address the question of transparency, unlike the current finance goal.

In 2022, three technical dialogues were held to discuss different aspects of NCQG. But the policy brief stated that the first and the second meetings failed to provide a clear and concrete roadmap through 2024.

The initial discussions on the new climate goal did not take off well. With little time left, stakeholders have to ensure that mistakes made while framing climate finances are not repeated.

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