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Climate Finance: a Matter of Justice?

Sabina Wölkner

› Although climate finance is always on the agenda at annual global climate conferences, a common understanding of what the term means is still lacking. The absence of any real consensus on what climate finance is actually all about is one of the main reasons why rows about money keeps reigniting.

› The UN now estimates that developing countries will need at least USD 6 trillion by 2030 to achieve around half of their national climate targets. The paucity of public funding means that private investors, companies and capital markets along with bilateral and multilateral development banks have to focus their financial resources more strongly on climate targets in these countries.

› The risk of corruption rises in tandem with ever-increasing sums, as flows of financial resources are not subjected to adequate monitoring, while they also face complex disbursement mechanisms and decision-making procedures. Effective climate finance hinges not only on technical or financial resources, but also on good governance and accountable institutions.

› China now tops the list of the biggest emitters in terms of annual global CO_2 emissions. This country's participation in multilateral climate funds and negotiations over the new financing target for the period after 2025, but this time sitting on the donor countries' side of the table, is long overdue.

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Money isn't everything...

Money isn't everything, but without money it will be difficult to limit the global temperature rise to 1.5 degrees Celsius by 2100 compared to pre-industrial times. Especially given that the Intergovernmental Panel on Climate Change warns that only an immediate and drastic reduction in global greenhouse gas emissions can have any real impact. By 2030, emissions will have to be throttled by 43 per cent compared to 2019. Even if all the reduction measures agreed by nation-states were implemented, however, global temperatures would still be expected to rise by about 2.7 degrees. The global assessment at this year's World Climate Conference in Dubai underscored that there can be no question of "carrying on business as usual". Resources do not suffice to reverse this trend, however, especially in developing countries. Nonetheless, simply pouring more and more public funds into the effort will not produce a solution enabling a global energy transition. Moreover, private investment in many developing regions is still too modest to be able to spark any new momentum there. Ultimately, the future of climate finance will be decided not only at the World Climate Conference, but also in negotiations on the new financing target beginning in 2025. While countries of the "Global South" are hoping that financial commitments pledged to date will be further augmented, this alone will not be enough to allow them to attain their climate targets. More transparency and accountability in expenditures of funds is also a *sine qua non*, as corruption poses a mounting problem. Combating and preventing it would significantly boost the effectiveness of funding while at the same time strengthening trust and confidence between donor countries and their recipients. Investing in good governance is therefore not merely a matter of more money, but above all else political will. There have been scant signs of any such will in Dubai to date, however.

So what is climate finance?

Although climate finance is always way up on the agenda in negotiations taking place at annual world climate conferences, there is still no concurring understanding of what it designates.[1] The UN understands it to mean local, national and transnational financing which can come from public, private and alternative[2] financial sources, with the aim of reducing greenhouse gas emissions and adapting to climate change.[3] The OECD, which plays a key role in monitoring climate finance channelled by industrialised countries to developing and emerging countries, adopts this definition. In its calculations and estimates, this organisation recognises bilateral public climate finance provided to developing countries through bilateral and multilateral development banks and agencies, as well as multilateral public climate finance that flows through multilateral banks and funds belonging to industrialised countries. This also includes climate-related public export credit guarantees and private finance leveraged by means of bilateral and multilateral public climate finance.[4] This approach has been heaped with criticism, however. In particular, civil society organisations often argue that the inclusion of private funds is misleading. One frequently heard criticism in this connection is that OECD members use this ploy to overestimate their true share of climate finance.[5] Many developing countries are also demanding that only state aid be counted and that only additional money above and beyond public financing counts. Although Germany has ramped up its climate funding enormously in recent years, now nearing a magnitude of EUR 10 billion,[6] Oxfam considers this figure to be a fallacy. The NGO concludes that between 2019 and 2020, the German government only provided USD 3.8 billion instead of the almost USD 7.2 billion claimed.[7] It is namely common practice to include loan volumes for climate finance in addition to grants. At the same time, the climate protection agreement notes that funds mobilised through the industrialised countries may come from various sources, although it underscores the special importance of public funding.[8]

Germany is not an isolated case in the eyes of NGOs, however. The USA is accused of not only presenting hazy information on payments, but also of contributing far less than its "fair" share to climate finance, even though it is one of the leading greenhouse gas emitters.

The lack of consensus on what climate finance actually means therefore constitutes a key reason why the wrangling over money reignites with regularity. This never-ending quarrel emanates from the fact that – and this all links to Article 9 of the Paris Climate Agreement – industrialised countries (*developed countries*) are obliged to provide developing countries funds for climate protection while helping to mobilise additional climate finance. The countries of the "Global South" are particularly adamant about this obligation, which is based on the principle of "common but differentiated responsibilities". According to this principle, all countries are to be held accountable for combating climate change, but are assigned different weights of responsibility. Contributions to climate protection are also contingent upon the different capabilities of individual national economies.

How much? What for?

Mitigation and adaptation

In order to settle the row over the understanding of international climate finance, the *UN Standing Committee on Finance*[9] has initiated a process to clarify the terminology. A snapshot of the current status of negotiations shows that the terms vulnerability and resilience are being moved closer to the core of the definition. The intertwining of development cooperation, climate action and sustainable development we are witnessing is an indication that climate finance involves more than just global greenhouse gas mitigation.

Much still needs to be done to better illuminate this context, however. Although Article 7 of the Paris Agreement recognises the importance of adaptation in limiting climate change at a meta level, according to UNCTAD 94 per cent of global climate investments went to CO_2 mitigation projects having a focus on renewable energies.[10] Financing resources for adaptation measures in developing countries therefore lie below the threshold required to facilitate an effective response to climate change there.

One of the main reasons for the insufficient allocation of funds is to be found in the complexity of projects. Not only reduction targets, but also sustainable development goals need to figure into the equation. This challenge is compounded by the dearth of reliable data with which to guage progress in developing countries, especially as the methods to be applied are still a subject of international discord. Given the many imponderables in the equation, it is not surprising that private investors have thus far shied away from it all. The situation in Kenya, for example, illustrates that virtually all private investment flows into the lucrative energy sector, while only an insignificant share (under 12 per cent) goes into adaptation projects, even though there is also a massive need for investment there.[11] This imbalance repeats itself across the entire Sub-Saharan region in Africa, literally crying out for action. According to the latest UNEP report, "*Underfinanced. Unprepared*", in this decade the financing gap for developing countries totals somewhere between USD 215 and 387 billion annually.[12]

In order to gain more traction in the financing of adaptation going forward, many stakeholder countries are pinning their hopes on adoption of the *Global Goal on Adaptation* (*GGA*) laid down in the Paris Agreement. This is to be based on an internationally harmonised technical framework, including a consensus on measurement methods. In the view of COP28 President Sultan Al Jaber, such a framework is essential for adaptation projects in order to scale up investments urgently needed in developing countries.[13] Underlying these ostensibly technical discussions are very tangible political and economic interests, however. While the developing countries, with China in their ranks, are pushing for strict targets for the adaptation goal in order to obtain more money, many industrialised countries, with the USA leading the way, are calling for flexibility in view of tight budget constraints. In the first draft of the resolution to be adopted at COP28, a volume to a tune of around USD 400 billion per year is being bandied about.

From billions to trillions – a bottomless pit?

But time is running short. The UN now estimates that the developing countries alone will need at least USD 6 trillion by 2030 in order to achieve roughly half of their national climate targets.[14]
For Africa alone, the need for climate finance in the period from 2020 to 2030 is estimated at around USD 2.8 trillion.[15] Even if these figures sound astronomical: Experts agree that the current sums are nowhere near enough for the developing countries.[16] Whether it will be possible – as set out in the Paris Agreement – to "harmonise financial flows with a pathway that leads to climate-resilient development with low greenhouse gas emissions" remains to be seen and also hinges on negotiations over the *New Collective Quantified Goal (NCQG)* for the period after 2025, which must be concluded next year. One thing is for sure: in view of the high estimated needs, current financing, according to which the industrialised countries will provide the developing countries with USD 100 billion per year between 2020 and 2025 to achieve climate targets, should only serve as a starting point for the post-2025 negotiations. Since, in contrast to the agreement reached in Copenhagen, developing and newly industrialised countries are also to be allowed to participate in the decision-making process for the first time, costs are highly likely to soar higher in future, although according to current OECD calculations, the industrialised countries collectively will only be able to reach the "USD 100 billion target" for the first time at the end of this year.[17]

Due to the permanent shortfall registered in previous years, there has already been a tide of frustration among recipient countries. The prevailing atmosphere was aptly demonstrated by the latest *replenishment of* the multilateral *Green Climate Fund* last September.

The fund, which finances both mitigation and adaptation projects, is still today the most important vehicle for low-income countries. Only around half of the 40 participating governments have made firm commitments for the period 2024 to 2027, though. Key donor countries such as Sweden and the USA also initially showed up empty-handed due to domestic political issues. When the target of USD 10 billion yet again failed to be reached, it was perceived by developing countries as confirmation that the industrialised nations were not serious about solidarity when it comes to climate protection.[18] This criticism ignores the fact, however, that almost USD 9.3 billion was raised, while some industrialised countries upped their contributions, in some cases significantly. Germany, whose funds come from the budget of the Federal Ministry for Economic Cooperation and Development, made the highest pledge at the time at USD 2.2 billion, followed by the UK (2 billion), France (1.7 billion) and Japan (1.2 billion). At the climate conference in Dubai, the United States then followed suit after all, announcing that it would contribute USD 3 billion to the fund, placing it at the top of the list of donor countries.[19] The multilateral development banks also managed to post a new record, with flows of finance resources from this source surpassing the mark of USD 60 billion in 2022. They stressed in no uncertain terms, however, that additional sources of financing would be needed to meet the climate finance needs of the developing and newly industrialising countries.[20]

The risk posed by corruption is also swelling with ever-increasing sums of money, though. Anti-corruption experts attest that climate finance already faces a massive challenge in this regard.[21] This finding is hardly surprising, however, as the increasing flow of money into many developing and emerging countries takes place in a setting of inadequate monitoring as well as complex disbursement mechanisms and decision-making procedures, compounding the inherent risks of corruption. Another open door to corruption in many recipient countries relates to the fact that climate finance is focussed on the energy sector, which is relevant for mitigation projects and is in many cases already rife with corruption. Risks are likely to be greatest among the top recipients and the so-called "*least developed countries" (LDCs*) in particular. A random sample of climate projects in Bangladesh revealed, for example, that more or less all of them were tainted by corruption.[22] The fact that we are not talking about "*peanuts*" becomes particularly evident from a global perspective: it is said that around USD 100 billion could be saved annually if these risks could be effectively countered. This is commensurate with the sum that regularly serves as the bone of contention between industrialised and developing countries.

As grants and loans are mainly channelled through multilateral funds and development cooperation structures, there are definitely levers available to combat corruption more effectively. This would require a keener realisation and awareness that effective climate finance depends not only on technical or financial resources, however, but also on good governance and accountable institutions. This is all the more true in the wake of Germany's announcement in Dubai that it will contribute EUR 320 million to the International Climate Initiative (IKI) with the aim of supporting large-scale projects in developing and emerging countries.

Who is going to pay for it all?

Mobilisation of the private sector

Greater accountability in climate finance would be pivotal to ratcheting up the involvement of the private sector. In view of the scarcity of public resources, it is clear that private investors, business enterprises and capital markets, in addition to bilateral and multilateral development banks, need to align their financial flows more closely with climate goals in these countries. The hosts of this year's climate conference did indeed succeed in presenting a whole range of plans while voicing intentions to channel not only public, but above all private capital into developing and newly industrialising countries.[23]

The *Energy Transition Accelerator* submitted by the USA sounds particularly promising with its objective of bringing business enterprises and countries together to raise capital by means of carbon certificates for the energy transition in newly industrialising and developing countries. Even if realisation of these projects is another matter, there is certainly ample time to act. This is because private investment has only played an inconsequential role to date, even if there are differences between regions. While for Africa as a whole private investment merely accounted for 14 per cent of the total financing volume on average in 2019/2020, this figure was 37 per cent for South Asia and 49 per cent for Latin America/Caribbean.[24] With a few exceptions, sub-Saharan Africa in particular appears to be lagging behind. In the view of the members of *African Business Leaders,* a stable political environment is particularly important for private investors.[25] According to Jonathan First from the Climate Policy Initiative (CPI) think tank, governments need to create platforms and build trust and confidence while minimising risks in order to foster private sector financing.[26] The fact that stability, legal certainty and liquid financial and bond markets can be improved in many developing countries in Africa is particularly evident in the least developed countries. Only a small portion of private climate finance has been channelled to these countries, with Mozambique, Ethiopia and Burkina Faso being the biggest recipients. The majority of private capital in sub-Saharan Africa is concentrated in the local dynamos of South Africa, Nigeria and Kenya.

But there are also deficits in these economies that are hampering expansion of the private sector and tarnishing the attractiveness of the market there. In South Africa, for instance, the unreliable supply of electricity is one of the main concerns causing investors to hesitate. One of the reasons for this unreliability is that almost 90 per cent of electrical power is supplied by outdated coal-fired power plants, which not only churn out a phenomenal amount of pollution, but also plague the country with power cuts on an almost daily basis. Although President Ramaphosa has pledged to sweep away obstacles hindering cooperation with the private sector and to encourage it to invest, especially in the electricity sector,[27] this sector suffers from an image problem due to years of mismanagement and corruption. The "*Just Energy Transition*" partnership agreed with South Africa at the UN climate summit in Glasgow, which was initiated by Germany, France, the UK and the EU and is intended to help the country phase out coal with more than USD 8.5 billion in support, can only make one contribution to this. A recent study conducted by BloombergNEF estimates that South Africa will need around USD 136 billion for its energy transition. The country will therefore have no choice but to initiate reforms to strengthen good governance in order to attract more private capital to the electricity sector. Calls for more subsidies and public loans alone will not be able to meet the challenges.

Towards a "just energy transition"

Preferential financing, which is granted through bilateral donor countries, multilateral development banks and climate funds, dominates the field of international climate finance. South Africa as well receives half of its JETP funding through preferential loans. The rest is accounted for by loans granted at standard market conditions and investment guarantees. Only a lower percentage sum are outright grants. A financing package tailored to meet the respective needs of individual countries can be the right recipe for acquiring private investment and developing these countries' financial markets at the same time.

But it is often not all that simple. UN Secretary-General Antonio Guterres recently criticised a major inhibiting factor for private investment in the area of climate finance, but also in other areas: the high cost of capital characterising developing countries. Interest rates on loans are on average four times higher for African countries than for the USA and eight times higher than for wealthy European countries.[28] This makes the transition of energy systems in these countries unaffordable, he noted. High costs also reflect the risks perceived by investors, however, which can consequently lead to heightened restraint on the part of lenders.

While the prospect of lucrative profits in many emerging markets is a major attraction for financiers, systemic risks such as the lack of accountable institutions, impenetrable tax systems, exchange rate risks and other poor underlying conditions frequently act as a constraint on financial commitments in these countries. The result is often a shortage of affordable capital. The high cost of capital particularly affects emerging economies, as their energy requirements pick up continuously at the same time. This is precisely why the *African Development Bank* and other development banks have committed themselves to the goal of reducing risks for private investments in middle-income countries with the help of financially potent partners. However, it is also the case that the financing gap can often not be closed due to the lack of bankable projects. Against this backdrop, the task at hand is to strengthen capacity-building efforts in order to nurture projects that can gain the confidence of investors. Since the multilateral development banks are considered to be able to do this through their financially sturdy partnerships and local advisory services, they ought to be further strengthened in their work.[29]

Another major cause of the poor financial rating is the massive mountain of debt that many developing countries have been suffering from since even before the coronavirus pandemic and which is exacerbating the problem of a shortage of capital. In fact, the debt report published by Misereor in March 2023 indicates a growing risk of over-indebtedness in many of these countries. Civil society in particular is therefore calling for debt relief for the main stakeholder countries. It is important, however, to bear in mind that some problems, e.g. corruption, are home-grown and will not go away even if debt is cancelled. It is nonetheless rightly criticised that African countries are shouldering the main burden in the fight against climate change, even though these countries and the continent as a whole account for less than four per cent of global carbon dioxide emissions.

Indeed, the sub-Saharan region has the lowest emission rate per capita in the world. At the same time, in many poorer countries the most pressing issue is not expensive energy transitions, but first and foremost a reliable supply of electrical power. In sub-Saharan Africa, around 600 million people still have no access to electricity.[30] According to Anja Berretta, it is questionable whether the understanding of "just transformation" in sub-Saharan Africa coincides with the German or European understanding. There is reason to believe, she asserts, that an energy transition based on the Western model cannot be realised due to the societal, social and economic situation there.[31]

The so-called "*Bridgetown Initiative*" is an attempt to link up these worlds, founded on the conviction that low-income countries should not have to choose between their development goals and climate protection measures due to a scarcity of affordable capital. Instead, the initiators believe it is important to invest in building climate resilience through subsidised loans.[32] The "*Resilience and Sustainability Facility*" initiated by the International Monetary Fund in 2022, with a capital outlay totalling around USD 650 billion, points in this direction. The facility, whose loans have long maturities, is directed in particular at low- and middle-income countries, where the interrelationship between climate, environment and development is particularly evident as a result of ongoing climate change.

International financial reform: China – a developing country?

But it is not all just about money. Against the backdrop of geopolitical rivalries, pressure is mounting to fundamentally reform the international financial architecture. The industrialised countries would like to see the World Bank at the centre of a new financial architecture. This approach was reaffirmed at the World Climate Conference in Dubai. Following the Bank's annual meeting held in Marrakesh in October 2023, it adopted a new mission statement affirming its desire to "end poverty on a planet worth living on", thereby expanding the fight against poverty to include sustainability and climate protection goals.

This new purpose must be attained through greater financial capacity, stronger partnerships and more cooperation with the private sector, commented World Bank CEO Ajaj Banga at the annual meeting. Germany has for the first time provided the bank with so-called "hybrid capital"[33] totalling over EUR 305 million. Over the next ten years, this capital is intended to mobilise an additional approximately EUR 2.4 billion to expand the bank's investments. At the same time, innovative financial instruments such as *climate resilient debt clauses* are to be inserted in loan agreements in order to help countries that are particularly exposed to climate change or external shocks by temporarily suspending debt servicing in such situations.

It remains to be seen to what extent other countries will fall in behind Germany's lead. The USA, the largest shareholder in the World Bank, has voiced its willingness to provide additional financing, preferably in the form of guarantees, but only if Washington's voting rights in the bank remain unchanged following the reform. This is because the expansion of the Bank's financial capabilities is also intensifying the discussion about more say for shareholders in the "Global South", which have been pushing for more influence in the institution's decision-making bodies for years. As is so often the case, the elephant in the room is China. The USA wants to prevent its rival from coming away stronger from such a reform because Beijing, despite its economic strength, still fancies itself a developing country.

China's argument would appear at first glance to be legitimate, as governance of the World Bank and the International Monetary Fund has long since ceased to reflect the global balance of power, which is why Beijing together with the other developing and emerging countries is pushing for a new distribution of votes there. It is also evident, however, that China is using this designation as a developing country as a pretext to plant its own structures in the World Bank and elsewhere. At the same time, a revision of Beijing's status would appear more urgent than ever for another reason: China now heads the list of the main emitters in terms of annual global CO_2 emissions, with emissions at present soaring to more than twice as high as those of the USA, which follows in second place.[34] Although the western industrialised nations continue to bear the greatest responsibility for climate change from a historical perspective, China's gap to the USA has narrowed enormously in recent years.[35] Against this backdrop, US Treasury Secretary Yellen recently underscored that China's participation in the multilateral climate funds would significantly enhance the impact of this financing. At the same time, she stated that China should take part in negotiations on the new 2025 financing target, but this time on donor countries' side of the table, in order to bring Chinese financial flows more in line with the ideas laid down in the Paris Climate Agreement.

Paradigm shift in climate finance?

At the moment, anyway, Beijing would appear to have missed the first chance to make good on this opportunity, which surfaced when the fund for damage and losses was established. The fund, which was set up in Sharm el-Sheikh last year and whose mode of function was finalised in Dubai, is intended to help poorer countries and those particularly affected by climate change to cope with damage and the losses incurred. According to estimates, costs in developing countries are already soaring to over USD 100 billion a year. The fund could potentially trigger a paradigm shift in climate finance elsewhere, however, with newly industrialising countries perhaps also becoming more willing to contribute to these funds alongside industrialised countries in future. While the usual suspects – Germany, the USA, the UK, Japan and the EU – moved first to submit pledges, the United Arab Emirates (UAE), which like China has been designated a "developing country", declared its willingness to also engage for the first time, pledging the same amount as Germany (USD 100 million each). Even if Beijing did not follow suit, the UAE's pledge could put China and the other Gulf states under pressure to commit to climate finance in future.[36]

In spite of all this, it is important not to hold exaggerated expectations at the present juncture. While the mechanism of the fund is extremely complex and a board of directors staffed with representatives of both the industrialised and developing countries is supposed to decide where the money goes, it must first be determined whether an extreme weather event has actually been triggered by climate change. Causal attribution is often only possible after some time has passed, however. There are hence many technical issues still to be clarified, and these can quickly assume a political dimension. To ensure that no targeted compensation payments or even claims can be derived, the industrialised countries have instituted a safeguard by avoiding use of the term compensation in the negotiation texts and by effecting payments into the fund on a voluntary basis.

Conclusion

An agreement on what climate finance should be understood to mean would constitute a crucial step toward resolving a permanent source of strife between industrialised and developing countries while advancing the instrument itself. Donor and recipient countries need to reach out to one another: Realistically, then, private investment should continue to be understood as part of climate finance. A clear-cut definition is becoming increasingly difficult to arrive at, however, due to the steady convergence of climate protection, development cooperation and sustainable development.

In developing and newly industrialising countries, the "needs gap" means that more attention needs to be devoted without delay to financing adaptation projects. As these are usually not projects associated with profit margins, it would be warranted to earmark government funds more for this area. At the same time, a specific framework for scaling up investments in adaptation as is being called for is relevant, but in view of tight budget constraints in many industrialised countries, it is important to allow flexible approaches and avoid insisting on rigid targets.

The greater the financial flows, the more crucial it is to focus on combating and stifling corruption in the implementation of climate-related projects. The effectiveness of climate finance hinges not only on technical or financial resources, but also on good governance and accountable institutions in the recipient countries. This could also be a key factor in encouraging greater private sector involvement in climate finance. In view of the dearth of public funds, private investors, business enterprises and capital markets as well as bilateral and multilateral development banks need to align their financial flows more closely with climate targets in these countries.

In view of China's vast CO_2 emissions, there are no two ways about it: the country has to participate in multilateral finance funds in future. Even if a breakthrough along the lines of the Fund for Loss and Damage has yet to be achieved in Dubai, the financial commitment made by the United Arab Emirates will put Beijing and the other Gulf states even more on the spot. This could translate into an opportunity to bring about a paradigm shift in climate finance. Negotiations on the new post-2025 financing target could provide the perfect opportunity for this.

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The author

Sabina Wölkner is Head of the 2030 Agenda Department in the Analysis and Consulting Division of the Konrad Adenauer Foundation.

Sabina Wölkner
Head of Department 2030 Agenda
Analysis and Consulting Division
T/p +49 30 26996-3522

sabina.woelkner@kas.de

Coordination of the publication series:

Gisela Elsner
Global Sustainability Officer
Analysis and Consulting Division
T/p +49 30 / 26 996-3759

gisela.elsner@kas.de

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