



BEYOND CLIMATE FINANCE

Climate ambition in the
Global South requires
financial system reforms





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Global South requires
financial system reforms**

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CONTENTS

1	INTRODUCTION: IT'S ABOUT THE MONEY	7
1.1	Who is financing the climate transition?	9
1.2	There is not enough climate finance on the table	13
1.3	The money is not going where it needs to	15
1.4	Climate ambition cannot be unlocked without addressing systemic financial barriers	17
2	WHAT ARE THE PROBLEMS?	19
2.1	High cost of capital because of perceived macro risks	20
2.2	Emerging green technologies have additional risks leading to higher cost of capital	26
2.3	High external debt of countries	28
2.4	The Role of Multilateral Development Banks	34
3	WHAT ARE THE PROPOSALS ON THE TABLE?	39
3.1	Proposals addressing multiple financing challenges	41
3.2	Proposals focused on debt relief	44
3.3	Proposals to lower the cost of capital	51
4	WAY AHEAD	55
5	ANNEXURE	61
	Green Bonds	61
	Debt-for-Environment Swaps	61
	Concessional finance from MDBs	63
	REFERENCES	64

CONTENTS

LIST OF FIGURES

Figure 1:	Climate finance by source: percentage of total for 2019/20	10
Figure 2:	Climate finance by instrument type: percentage of total for 2019/2020	11
Figure 3:	Climate Finance 2011-20	11
Figure 4:	External financing sources for investment and spending priorities for climate action and related development goals	14
Figure 5:	Increase in annual clean energy investment in selected countries and regions, 2019–2023	16
Figure 6:	Financial Barriers faced by the Global South	17
Figure 7:	Impact of financing costs on wind and gas power generation costs	21
Figure 8:	Cost of capital for select emerging countries	23
Figure 9:	The climate investment trap at the macroeconomic level	27
Figure 10:	External government debt as percentage of government revenue ²⁸	
Figure 11:	Net financing flows from China to developing countries	32
Figure 12:	Who owns the debt?	33
Figure 13:	Developing Countries Debt Composition by Creditor, 2008-2021, in billions	34
Figure 14:	MDB Climate Finance 2010-20	35
Figure 15:	Mapping of current proposals to address financial barriers faced by the Global South	40
Figure 16:	The Bridgetown Agenda	41
Figure 17:	Three Pillars for Debt Relief for a Green and Inclusive Recovery	50

LIST OF TABLES

Table 1:	Poor countries are hit harder economically by climate disasters	8
Table 2:	Developing countries face a much higher cost of capital even today	21
Table 3:	Developing countries face poor credit ratings and high capital costs	25
Table 4:	Debt burden exceeds annual cost of achieving the NDC for many low and middle-income countries	29

IT'S ABOUT THE MONEY

Developing countries are the places where losses and damage due to climate change are concentrated

Moreover, they face financial barriers in the form of high debt and high cost of capital, that hinder climate ambition

Most climate finance is provided as loans, which only adds to the debt burden of countries hit by multiple crises.

INTRODUCTION: IT'S ABOUT THE MONEY

The pandemic and the effects of inflation following the Russia-Ukraine war have pushed the world's poorest populations to the brink. The World Bank estimates that the combined crises have pushed an additional 75 to 95 million people to extreme poverty in 2022.¹ The urgency of responding to the growing climate crisis has presented an added pressure. The impacts of climate change are disparately concentrated on developing countries and they continue to bear the brunt of the crisis, as their economies relentlessly endure significant blows caused by the escalating frequency of extreme weather events.

The Intergovernmental Panel on Climate Change (IPCC) has laid out a clear roadmap—if we can halve emissions by 2030, we stand a 50 per cent chance of achieving the 1.5 °C goal of the Paris Agreement. Yet, in line with the longstanding tradition of multilateral climate forums, the burden of making these changes has been placed equally on all countries, and not solely on advanced economies who have historically been the biggest contributors to pollution. This places equal pressure to decarbonise on all nations, including developing countries like India that still faces energy poverty, on African economies whose per capita emissions are already a fraction of the world average, and on the biggest historical emitter, the United States, which is also the largest oil and gas exporter today.

However, the climate crisis calls for action from all fronts,

Table 1: Poor countries are hit harder economically by climate disasters

Country	Impact	Damages as % of GDP
Germany ¹	Floods in 2021	0.9%
British Columbia, Canada ²	Heatwave 2021	3–5%
Europe ³	Heatwaves 2003, 2010, 2015, and 2018	0.3–0.5%
Dominica ⁴	Hurricane Maria 2017	226%
Pakistan ⁵	Floods in 2022	9%
Vanuatu ⁶	Tropical Cyclone Pam 2015	64%

Source: 1. Munich RE; 2021 GDP data from World Bank 2. Canadian Centre for Policy Alternatives 3. European Commission, Joint Research Centre and others 4. Post-Disaster Needs Assessment by the Government of the Commonwealth of Dominica 5. Post-Disaster Needs Assessment by The Government of Pakistan, Asian Development Bank, European Union, United Nations Development Programme, World Bank; 2021 GDP data from World Bank 6. Post-Disaster Needs Assessment by the Government of the Republic of Vanuatu

INTRODUCTION: IT'S ABOUT THE MONEY

and doing so requires a restructuring of global economies at an unprecedented scale, with accompanying financial flows to enable this change. A truly cooperative multilateral solution points us to the issue of climate finance—which should ideally flow from developed to developing countries—to enable rapid decarbonisation, in line with the principle of common but differentiated responsibilities.

According to the UNFCCC Standing Committee on Finance, climate finance is defined as that which 'aims at reducing emissions, and enhancing sinks of greenhouse gases and aims at reducing vulnerability of, and maintaining and increasing the resilience of, human and ecological systems to negative climate change impacts'.² However, there is no standard, internationally agreed upon definition of what can be counted as climate finance, or even what should be reported as 'new' or 'additional' climate finance.

1.1 WHO IS FINANCING THE CLIMATE TRANSITION?

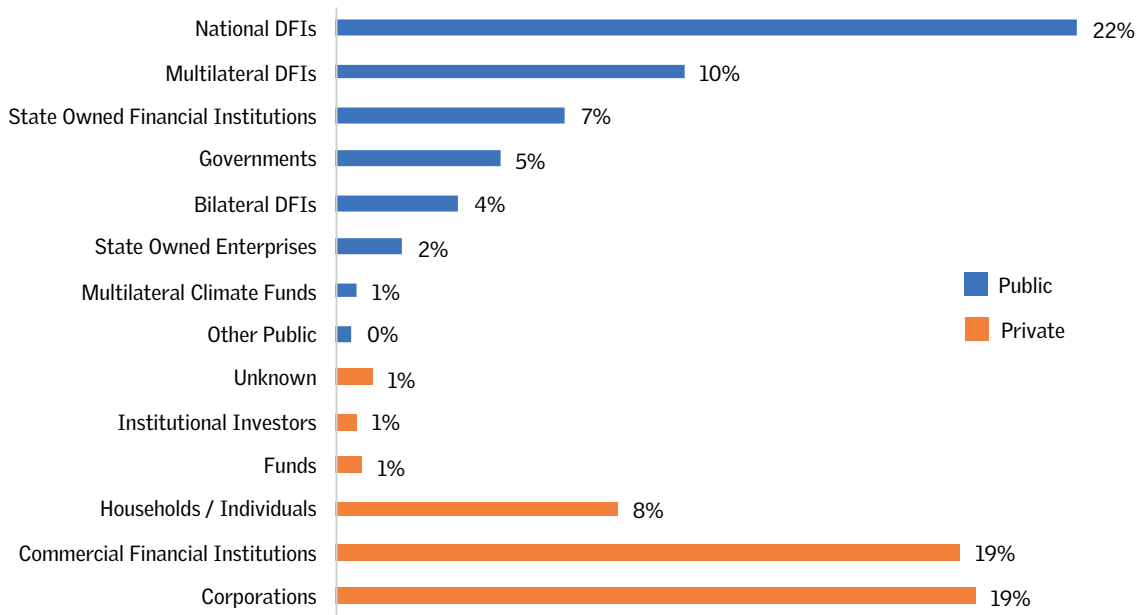
Even in the absence of an agreed definition, independent estimates of funding flows towards climate mitigation and adaptation are made.

For funding flows from developed to developing countries, the OECD's latest estimate suggests that in 2020, US\$ 83.3 billion was provided and mobilised by developed countries for climate action in developing countries—four per cent higher than the figure in 2019. This is the figure measured against the US\$ 100 billion pledged in 2009 at the UNFCCC. Oxfam considers this an overestimate, claiming that the true value stands at US\$ 21–24.5 billion for 2020, once over-reported loans and other discrepancies are accounted for.

A larger global view of all climate finance flows is provided by the Climate Policy Initiative (CPI), which found that in 2019 and 2020, an annual average of US\$ 653 billion of climate finance was made available. 52 per cent of this came from public sources, and 48 per cent from private sources. Bilateral climate finance stood at five per cent i.e., US\$ 32 billion.

INTRODUCTION: IT'S ABOUT THE MONEY

Figure 1: Climate finance by source: of percentage of total for 2019/20



Source: CSE; Data from Climate Policy Initiative

Concessional money constitutes a small chunk

There is also no standard definition for concessional finance; it applies to any financial instrument that is offered on better terms than commercial loans. It typically covers grants, loans provided at low interest rates or with long repayment periods, or at a first loss guarantee wherein the agency providing the concessional finance assures lenders that it will bear the costs of the first loss or that it will pay lenders if the borrowers default. It can also be in the form of equity investments where the lending agency asks for a much smaller share value than the actual investment.³

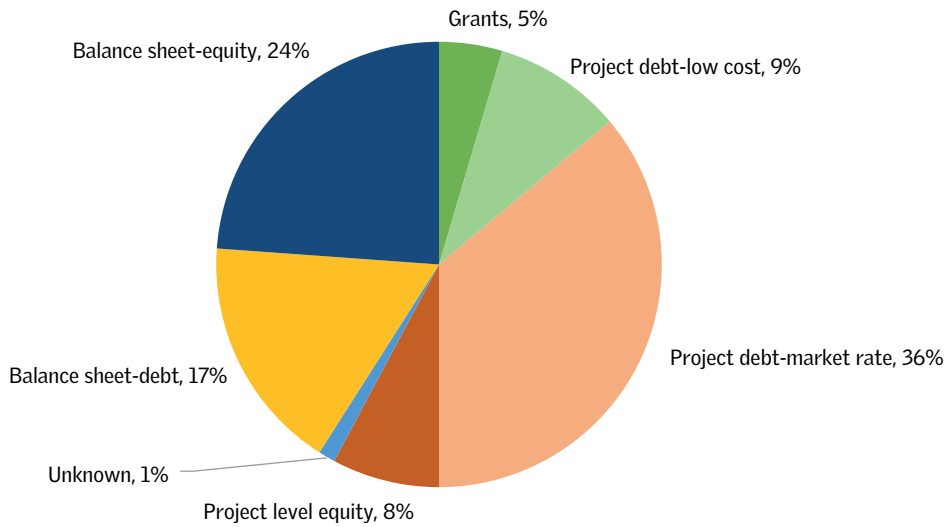
In 2019–20, a mere five per cent of climate finance, amounting to US\$ 30 billion, was allocated as grants, while the rest was disbursed as loans or equity financing.

This also applies to the decade of 2011–2020, where only five per cent of the money was provided as grants, while 61 per cent was provided as debt and 34 per cent as equity.⁴

Overall, concessional finance (grants and low-cost debt)

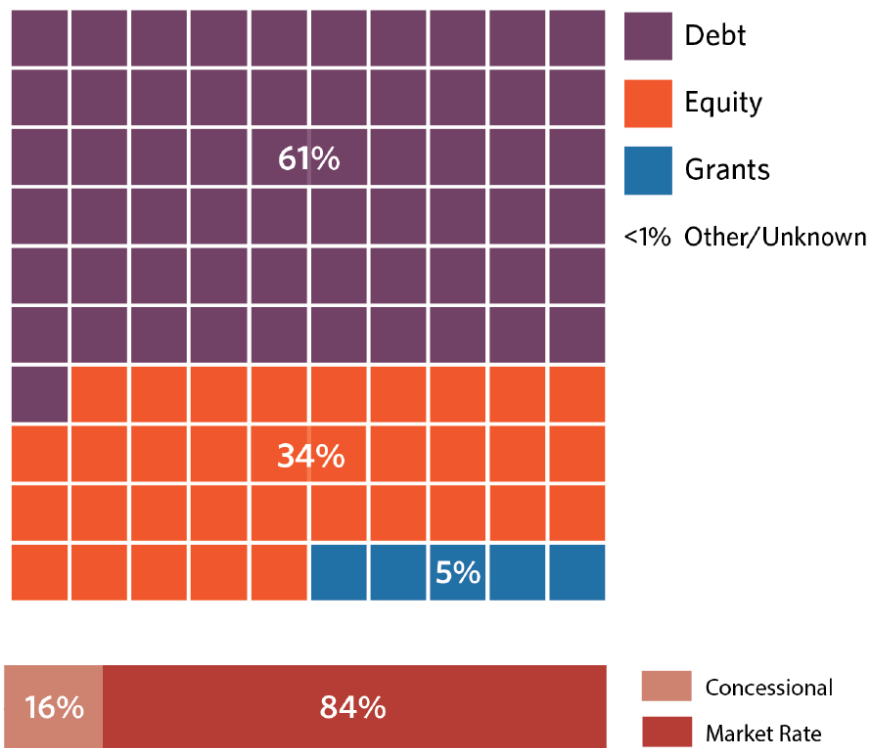
INTRODUCTION: IT'S ABOUT THE MONEY

Figure 2: Climate finance by instrument type: percentage of total for 2019/20



Source: CSE; Data from Climate Policy Initiative

Figure 3: Climate Finance 2011–2020



Source: Climate Policy Initiative

INTRODUCTION: IT'S ABOUT THE MONEY

constituted only 16 per cent—approximately US\$ 468.5 billion—of the total climate finance for the period 2011–2020.

Multilateral Development Banks are meeting their climate finance targets, but more support is needed

According to the MDBs' 2021 Joint Report on Climate Finance, the climate finance provided by MDBs to developing countries hit a record high of US\$ 58.9 billion in 2021. For the World Bank, this constituted about 30 per cent of its total operations in 2021.⁵ Many MDBs have already met their climate finance targets for developing countries. For example, the World Bank group set a climate finance target of 35 per cent of overall financing on average from 2021–25; it provided 32 per cent to developing countries in 2021. Of their total climate finance to developing countries, the share going to SIDS and LDCs, which are among the most vulnerable nations, dropped to 19 per cent in 2021 from 22 per cent in 2020.

The private sector is not rushing in to fund the climate transition, contrary to belief

The OECD's estimate suggests that of the US\$ 83.3 billion in climate finance from developed to developing countries in 2020, public sources dominated with 82 per cent share of the total, while private finance mobilised by public climate finance stood at only 16 per cent, decreasing from previous years.

In their global estimate, CPI adds that the growth rate of private climate finance was slower, at 4.8 per cent, than that of the public sector which stood at 9.6 per cent, for the period of 2011–2020. Factors such as high upfront costs of green technology investments and perceived risks are often to blame for this.

MDBs have had a heavy focus on 'mobilising' private sector money—the act of offering public financial support to subsidise private investment—through their 'billions to trillions' agenda launched in 2015. But they have been failing in this mandate. Analysis by climate finance experts shows that in 2021, for every dollar of climate finance that MDBs

INTRODUCTION: IT'S ABOUT THE MONEY

provided, they mobilised 25 cents in private finance, a fall from 26 cents in 2020,⁶ a ratio that should be higher than one if public billions are truly to attract private trillions in investment.

Despite offering co-financing and de-risking, efforts to incentivise adequate private sector investment in climate have thus far seen underwhelming results. Yet, calls for governments to facilitate private sector involvement have continued to grow with US Climate Envoy John Kerry claiming that 'no government in the world has enough money to get the job done', and that only the private sector 'has the ability to win this battle for us'. Tools like blended finance—an umbrella term for using public money to subsidise private investment—continue to get pushed at various forums. According to researchers of the think tank Climate and Community Project (CCP), the primary goal of blended finance is to enhance the appeal of investing in projects that align with public policy priorities, but it ultimately aims to make investments either less risky or more profitable for private investors.⁷ While some climate and environmental investments can be profitable, such as generating renewable power, the CCP researchers add that 'many of the most pressing ecological and development challenges are in the provision, protection, or repair of public goods like biodiversity, especially in countries that bear the least responsibility for the ecological crisis'.

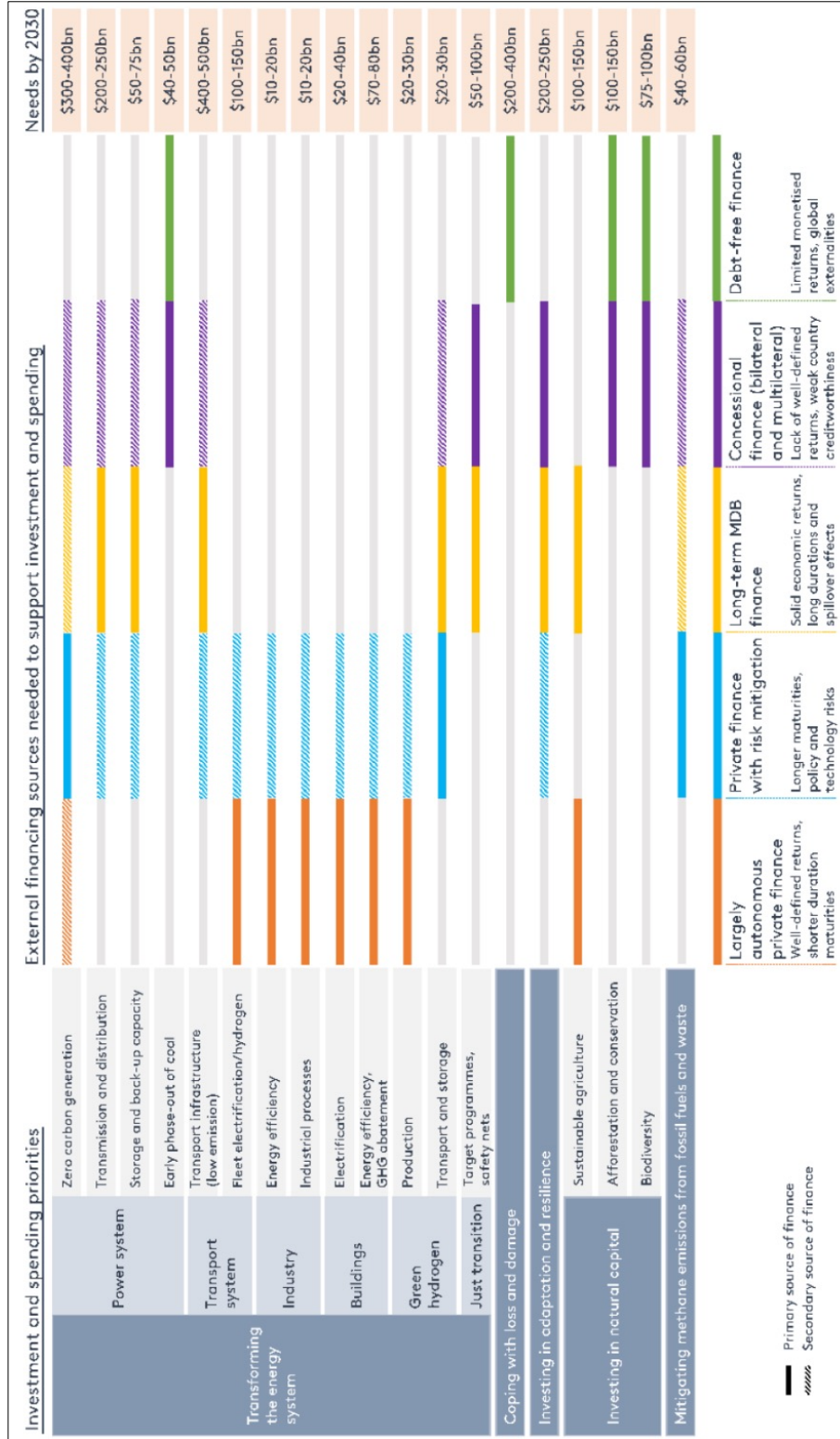
1.2 THERE IS NOT ENOUGH CLIMATE FINANCE ON THE TABLE

Up until 2022, the US\$ 100 billion climate finance goal pledged by governments in 2009 remained unfulfilled. Although donor countries suggest it will be fulfilled in 2023, current climate finance flows are far below the investment needed. The assessment of both public and private sources suggests that climate finance has doubled in the period 2011–2020, but this amount needs to be seven times higher by 2030 to meet the goals set by the Paris Agreement.

The report of the Independent High-Level Expert Group

INTRODUCTION: IT'S ABOUT THE MONEY

Figure 4: External financing sources for investment and spending priorities for climate action and related development goals



Source: Stern-Songwe Report, 2022

INTRODUCTION: IT'S ABOUT THE MONEY

on Climate Finance, also known as the Stern-Songwe report of 2022 that was published before COP 27, highlights that ODA and MDB lending is less than 10 per cent of what is required to finance the low-carbon transition. It also states that emerging markets and developing economies (EMDEs) other than China will require one trillion in external finance needed by 2030—a figure that rattles many, but a demand that civil society must make to confront the scale of the climate challenge.⁸ To put it in context, this amounts to only 1.2 per cent of the current global GDP of US\$ 85 trillion. The global military spending was US\$ 2 trillion in 2022.

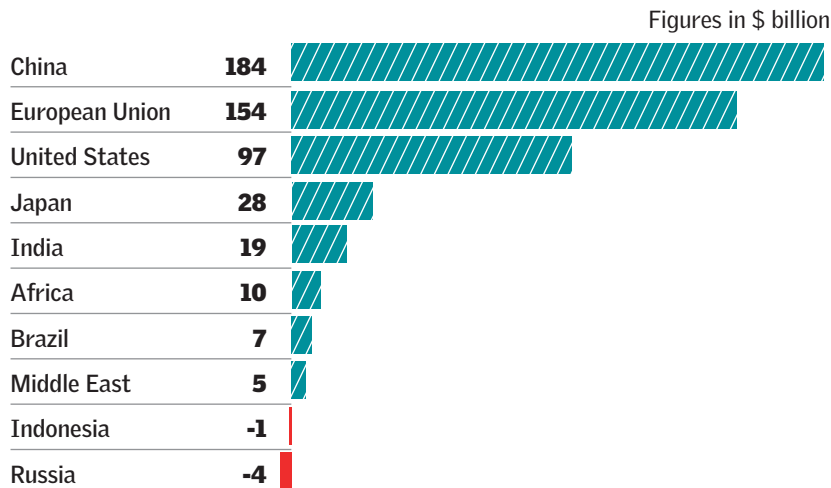
1.3 THE MONEY IS NOT GOING WHERE IT NEEDS TO

According to the Climate Policy Initiative, in the decade 2011–2020, 75 per cent of all climate finance was concentrated in North America, Western Europe, and East Asia & Pacific (primarily led by China). 24 per cent of concessional climate finance went to Western Europe, while Latin America and the Caribbean, and Sub-Saharan Africa each received only 14 per cent. Regions where the majority of low-and middle-income countries are located, receive less than 25 per cent of climate finance flows.⁹

In the financial sector there is a mismatch as well. Capital markets are international financial markets where stocks, bonds, and currencies are traded. Governments and private entities can issue bonds (debt-based tools) to raise money for various investments. Bonds marked specifically for sustainable investments are known as green, social, sustainability and sustainability linked (GSSS) bonds. These require that bond issuers to make a commitment to use the proceeds raised for green, social and sustainable projects.¹⁰ According to the OECD, about 97 per cent of the estimated US\$ 1.7 trillion in total sustainable investment funds are held in high income countries. All countries eligible for overseas development assistance (ODA) account for less than seven per cent and LDCs for less than one per cent of cumulative total GSSS bonds issued since 2014.

INTRODUCTION: IT'S ABOUT THE MONEY

Figure 5: Increase in annual clean energy investment in selected countries and regions, 2019–2023



Source: IEA, 2023

While clean energy investment has risen faster than fossil fuel investment in recent years, it is heavily concentrated in a handful of countries. According to the IEA's World Energy Investment 2023 report, most of the increase in clean energy investment between 2019 and 2023 took place in China, the US and the EU—amounting to an increase of US\$ 435 billion. Higher interest rates, unclear policy frameworks and market designs, financially strained utilities and a high cost of capital are holding back investment in many other countries, states the report.

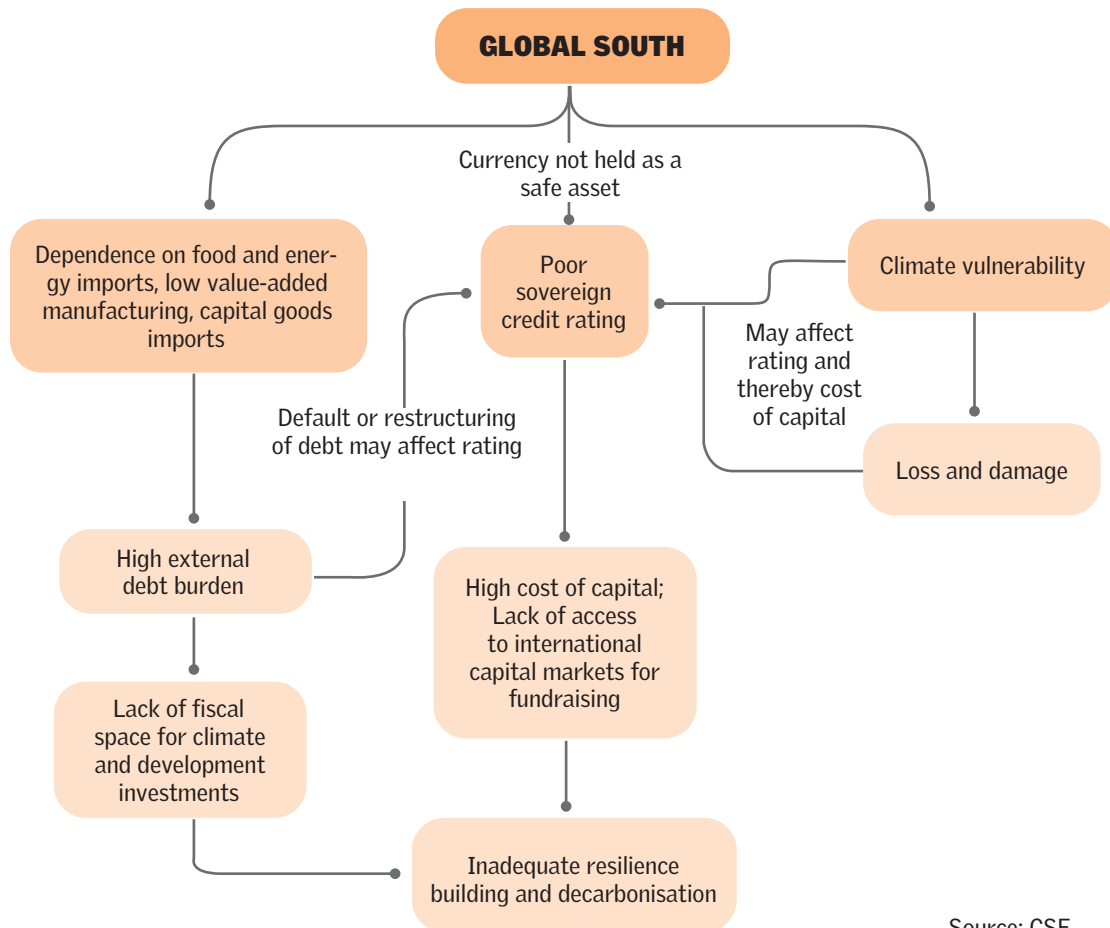
1.4 CLIMATE AMBITION CANNOT BE UNLOCKED WITHOUT ADDRESSING SYSTEMIC FINANCIAL BARRIERS

Current discourse on climate finance is myopic. We know that within climate finance flows, mitigation gets more money because projects are bankable, while adaptation projects remain underfunded. But beyond existing knowledge on climate finance, we need to look deeper at inequalities built into the current global financial system.

Economists have identified structural handicaps in developing countries such a 'lack of food sovereignty, lack of energy sovereignty, and the low value-added content of

INTRODUCTION: IT'S ABOUT THE MONEY

Figure 6: Financial barriers faced by the Global South



Source: CSE

exports relative to imports'.¹¹ Low value-added products are typically raw materials (also known as primary goods) which many developing countries are tapped to export.

This leads to a large trade deficit—imports exceeding exports, and a weak exchange rate, which means that imports of necessities such as food, fuel, and medicine will be more expensive. Developing countries are facing a high debt burden, particularly debt in foreign currencies like the dollar. This leaves them with limited funds to spend on climate and development. Access to international capital markets to raise funds is limited for many developing countries due to the high interest rates they encounter. The raising of interest

rates by central banks to tackle inflation, for instance the US Federal Reserve last year, adds pressure by increasing borrowing costs and debt servicing payments for dollar-denominated debt.

Recent shocks imposed by the COVID-19 pandemic has stretched their domestic spending capabilities. For gas-dependent developing countries like Pakistan and Sri Lanka, the energy crisis driven by the Russian war on Ukraine left them unable to afford the LNG supplies needed to keep the power running, and hindered fuel switch aspirations for industry in countries like India.¹²

Existing vulnerabilities are exacerbated by rising climate impacts in the form of heat waves, droughts, sea level rise and other phenomena which hurt countries economically, while also leading to the loss of lives and culture.

Now, when we view the pressure to decarbonise within the context of larger systemic financial barriers, it looks like the walls are closing in from all sides for the Global South. The COP 27 cover decision last year made mention of some of these issues since climate ambition cannot be unlocked whilst operating in a financial system that is inequitable by design.¹³

The Bridgetown Initiative tabled by the Prime Minister of Barbados, Mia Mottley, is one among many proposals attempting to start this conversation and get more money flowing to where it is needed. Civil society must now build pressure and scale up the demands at various forums.

This brief summarises some of these financial barriers present in the Global South, with a focus on ways in which international stakeholders from the Global North can intervene and be a part of the solution.

WHAT ARE THE PROBLEMS?

The cost of accessing funding for climate investments is much higher for developing countries which reduces the economic attractiveness of green investment

For green technologies, the cost of capital is higher due to the fact that they are newer and are also dependent on more upfront investment than fossil based technologies

Developing countries are also facing a growing debt crisis

Multilateral Development Banks are a major source of concessional finance, but there are challenges

WHAT ARE THE PROBLEMS?

2.1 HIGH COST OF CAPITAL BECAUSE OF PERCEIVED MACRO RISKS

The cost of capital is a broad term applied to the costs an entity incurs to access funding for a new project or investment. It typically encompasses the cost of debt, or the interest rate charged on a loan and the cost of equity, or the return rate that an investor expects while offering funding to a project.

Developing countries are perceived to have a more 'high-risk environment', and thereby face higher cost of capital.

This is highly relevant for the green transition in developing countries since clean technologies are highly sensitive to changes in the cost of capital (see Section 2.2). Discussions around the falling costs of renewable energy across the world often neglect the capital cost barrier that makes it unaffordable in many developing countries. For example, one estimate suggests that unsubsidised solar power costs 140 per cent more in Ghana than in the US solely because of differentials in cost of capital.¹⁴

A decade ago, the UNDP wrote in its report titled Derisking

A useful indicator of the cost of capital: Weighted Average Cost of Capital or WACC

Climate projects are funded either through corporate (balance sheet) financing, where firms raise money through bank loans, sale of bonds, or equity financing. Or they can occur as project finance, 'where a special purpose vehicle (SPV) is often used by the project sponsor to secure bilateral or syndicated financing (where multiple lenders pool together to finance one project)'. The cost of capital (COC) applies to debt and equity funding and refers to the level at which firms secure financing from equity and debt holders. This is often expressed as the weighted average cost of capital (WACC), i.e., the cost to be paid for raising money.

$$\text{WACC} = (\text{Proportion of total funding that is equity funding}) \times (\text{Cost of equity}) + (\text{Proportion of total funding that is debt funding}) \times (\text{Cost of Debt}) \times (1 - \text{Corporate tax rate})$$

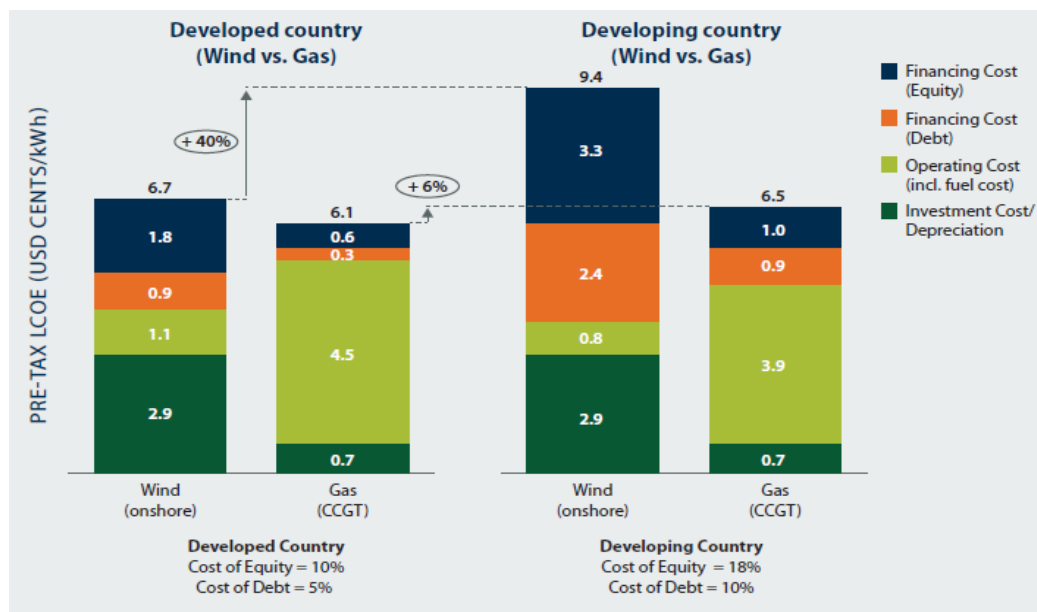
Cost of debt refers to the interest to be paid to lenders or bond subscribers, while cost of equity refers to financial return expected by shareholders.

WHAT ARE THE PROBLEMS?

Renewable Energy Investment:

'In a developed country benefiting from low financing costs, wind power can be almost cost-competitive with gas, despite the present affordability of natural gas. All other assumptions kept constant, in a developing country with higher financing costs, wind power generation cost becomes 40 per cent more expensive than that of gas because of the upfront capital intensity of wind technologies.'

Figure 7: Impact of financing costs on wind and gas power generation costs



Source: UNDP, 2013, Derisking Renewable Energy Investment

Table 2: Developing countries face a much higher cost of capital even today

Country	Weighted average cost of capital of utility-scale solar PV projects, 2021 (nominal, after tax)
Europe	3.0% - 5.0%
United States	3.5% - 5.0%
China	4.0% - 5.5%
Brazil	12.5% - 13.5%
India	9.0% - 10.5%
Indonesia	9.5% - 10.5%
Mexico	9.5% - 10.0%
South Africa	9.5% - 11.0%

Source: IEA World Energy Outlook 2022

WHAT ARE THE PROBLEMS?

Even today, financing costs can be up to seven times higher in emerging and developing economies than in countries in Europe, and the United States.¹⁵

Authors of a 2023 report titled *Debt Relief for a Green and Inclusive Recovery: Guaranteeing Sustainable Development* find that for a select group of 58 emerging markets and developing economies, the average cost of capital was 10.55 per cent. Such a high cost of capital makes it challenging for these countries to make new investments and generate growth.

Cost of capital is closely linked to a country's sovereign credit rating as assigned by agencies like Standard and Poor (S&P) and Moody's, as a measure of a country's creditworthiness (see Box: *The Ratings Trap*). It also has links to whether a country's currency is accepted as a 'safe asset'. Currently the major safe asset currencies are the dollar, the euro, the yen and the pound.¹⁶ These are held as international reserve currencies. For developing countries with weaker currencies that are not held as reserve currencies, there is an added 'currency risk' of foreign exchange fluctuations, domestic inflation, convertibility rules and lower returns for international investors stemming from the depreciation of the local currency.¹⁷

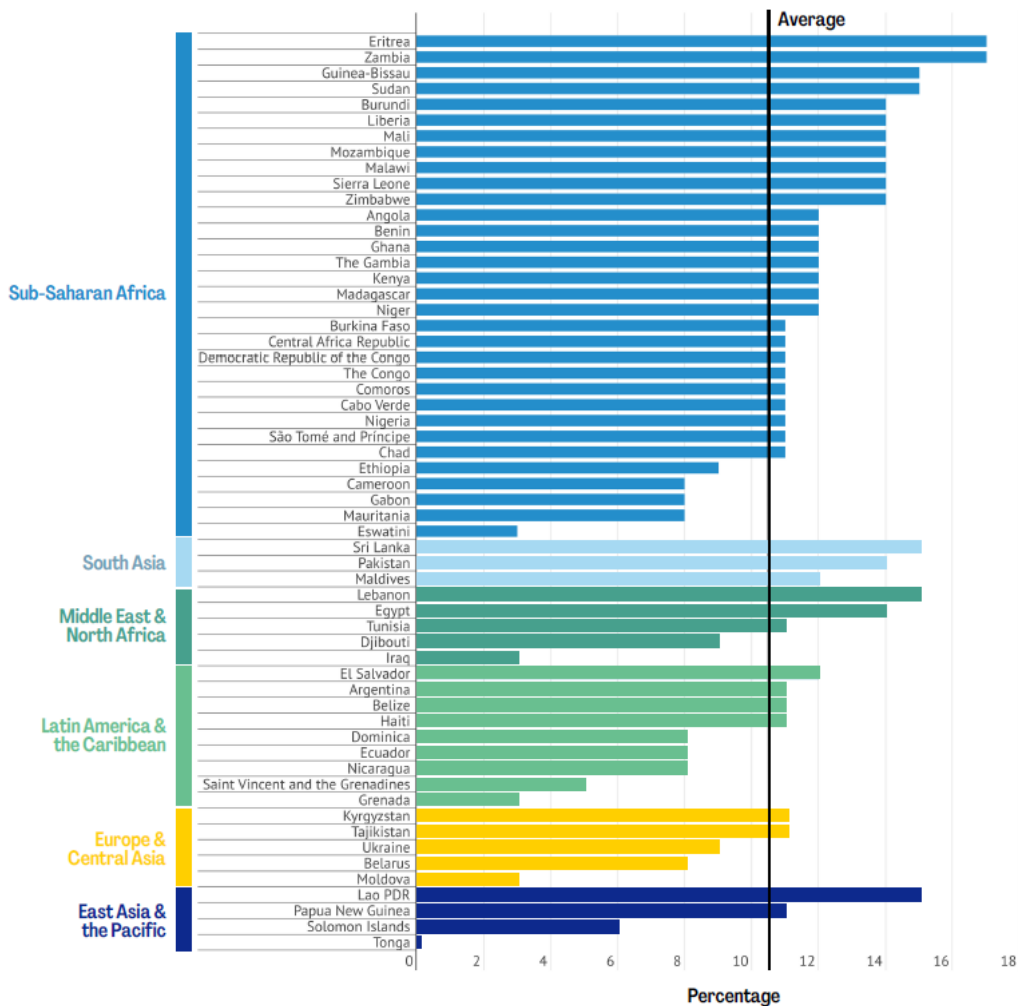
To counter this, a 'hedging cost' is added on by lenders which further raises the interest rates project developers have to pay.

Factors such as dominance of the dollar in global transactions play a role, and this is beyond the control of the developing country. When the US Federal Reserve and European Central Bank raise interest rates to control inflation, it leads to depreciation of currencies like the rupee.¹⁸ According to UNCTAD, about 90 developing countries saw their currencies weaken against the dollar in 2022. This raises borrowing costs in the developing country. The high cost of capital increases the debt servicing costs, thereby requiring a larger share of public finances to be spent on debt repayments.¹⁹

Perceived 'country risks' in developing countries are often subjective. They could be 'the extent of favourableness

WHAT ARE THE PROBLEMS?

Figure 8: Cost of capital for select emerging countries



Source: Debt Relief for a Green and Inclusive Recovery: Guaranteeing Sustainable Development, 2023

of economy-wide business conditions, including political stability, strength of the rule of law, ease of doing business and sovereign indebtedness'.²⁰ Further sector-specific risks include off-taker risk such as the non-payment from power distribution companies.

Calculating the cost of capital at the country level can be challenging, since data can be deemed confidential owing to its 'commercial' nature, and due to a varied range of metrics that can be used to calculate it. Country-level estimates are typically determined by interviewing market participants

WHAT ARE THE PROBLEMS?

The Ratings Trap: The subjectivity of sovereign credit ratings

Credit ratings provide an assessment of a debtor country's relative risk of default. Sovereign or country credit ratings are determined by three main private agencies—Standard and Poor (S&P), Moody's and Fitch. According to the UN's Department of Economic and Social Affairs, they face little competition and thereby wield a lot of power. Due to their dominance, 'ratings are developed by a small group of analysts and creditor committees, without market pressures to update methodologies'.

As more developing countries have started participating in bond markets to raise funds for various investments, the importance of credit ratings has also risen.

Sovereign ratings involve more subjectivity than corporate credit ratings because political risks and 'willingness to pay' are critical to sovereign credit analysis. Sovereign ratings have two components: a data driven component based on a country's ability to repay its debt, and a 'discretionary component' based on the judgement of a credit analyst and a credit committee comprised of staff of one of the agencies. There are objective factors such as exchange rate information, as well as highly subjective factors like 'credibility of monetary policy', UN DESA highlights.

Credit ratings impact the cost of borrowing for a country. A 2023 analysis by UNDP finds that if ratings for 13 African nations were less subjective and based 'more closely on economic fundamentals' they could access an additional US\$ 31 billion in new financing. Additionally, the countries studied could save nearly US\$ 14.2 billion in total interest costs (equivalent to US\$ 2.2 billion annually).

Because ratings measure the ability of a government to repay loans, the extent of a country's 'fiscal deficit' (expenses exceeding income) is an important factor. Faced with pressure to avoid a rating downgrade, developing countries might implement austerity and avoid vital developmental expenses. Participating in debt relief or restructuring efforts can further downgrade a country's rating. Additionally, a 2018 report by UNEP finds that climate change could affect ratings negatively, particularly for low-income countries.

Sources: UN DESA,²¹ UNEP,²² UNDP²³

in developing countries, or from publicly available data in capital markets in developed countries.

The yield on government bonds is one way to judge if a country is subject to a high cost of capital. Governments issue bonds—that are debt-based instruments—on the internal

WHAT ARE THE PROBLEMS?

Table 3: Developing countries face poor credit ratings and high capital costs

Country	10 Year Bond Yield	S&P Rating	GDP Per Capita (\$)
Zambia	30.56	SD	1,137.34
Pakistan	15.18	CCC+	1,505.01
Nigeria	14.47	B-	2,065.75
Kenya	14.26	B	2,081.80
Brazil	12.75	BB-	7,507.16
Turkey	11.72	B	9,661.24
Colombia	11.70	BB+	6,104.14
South Africa	9.88	BB-	7,055.04
Mexico	8.83	BBB	10,045.68
India	7.23	BBB-	2,256.59
Indonesia	6.68	BBB	4,332.71
Italy	4.09	BBB	35,657.50
United Kingdom	3.50	AA	46,510.28
Vietnam	3.45	BB+	3,756.49
United States	3.39	AA+	70,248.63
Spain	3.29	A	30,103.51
South Korea	3.26	AA	34,997.78
Canada	2.90	AAA	51,987.94
China	2.83	A+	12,556.33
France	2.76	AA	43,658.98
Netherlands	2.60	AAA	57,767.88
Sweden	2.32	AAA	61,028.74
Germany	2.24	AAA	51,203.55
Switzerland	1.17	AAA	91,991.60
Japan	0.46	A+	39,312.66

Source: CSE; Data from Trading Economics (accessed on Apr 11 and 12, 2023), and World Bank

markets to raise money for various purposes. The bond yield is the return to an investor who has purchased a bond. Higher yield is typically associated with higher risk, i.e., the riskier a borrower, the more yield the investors demand.

Moreover, the cost of capital for developing countries is increasing due to climate vulnerability. The loss and damage from the impacts of climate change are estimated to have cost 20 per cent in lost GDP in Vulnerable Twenty (V20) economies over the last two decades.²⁴ The UNEP finds that climate vulnerability is raising interest rates on debt in V20 countries. Through studies of declining rice production in

WHAT ARE THE PROBLEMS?

Bangladesh, hurricane impacts in Barbados, and drought exposure in Guatemala, it finds that V20 countries paid US\$ 62 billion in higher interest payments across the public and private sectors due to climate risk.²⁵

2.2 EMERGING GREEN TECHNOLOGIES HAVE ADDITIONAL RISKS LEADING TO HIGHER COST OF CAPITAL

Cost of capital varies by geography, and time, but it also differs between technologies. New, green technologies in particular, face two handicaps:

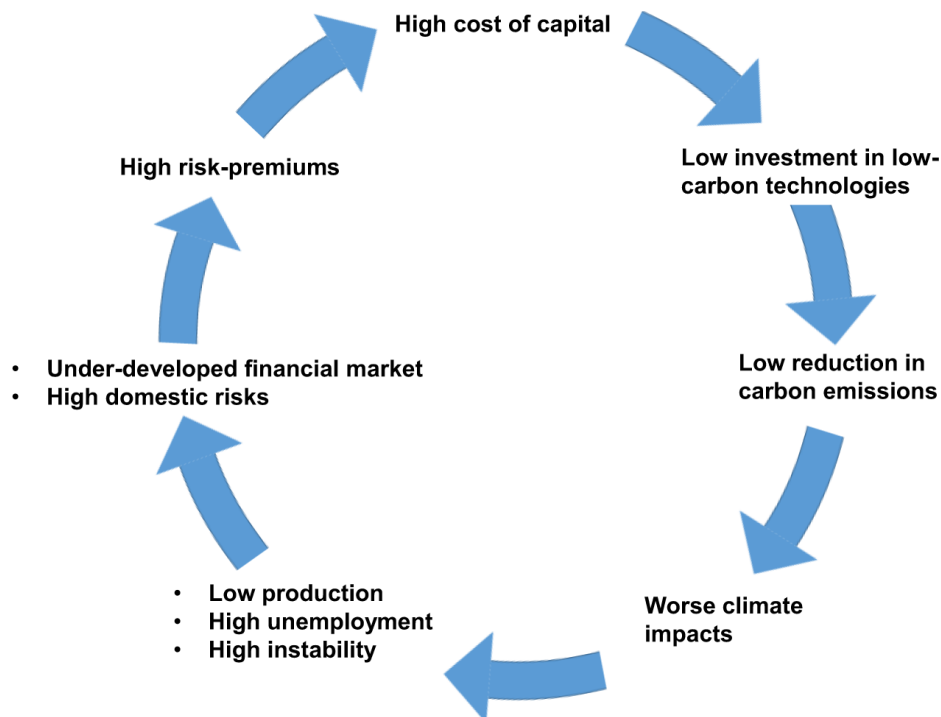
- Cost of capital is typically higher for newer, more nascent technologies, which applies to many green technologies that are displacing existing fossil-based systems. Solar PV may have matured past this categorisation, but many other sectors like battery storage, electric vehicles and green hydrogen are still nascent.
- For green technologies, more upfront investment is needed than existing fossil-based technologies. Most of the cost of setting up a solar power plant is the upfront cost since there is no variable fuel cost as in the case of coal power. Of course, multiple factors beyond the cost of capital can hinder their scale-up. For renewable energy, land availability and transmission costs play a role. Nevertheless, it is an established fact that the upfront capital requirement is much higher, and thereby the cost of capital is a crucial enabler or barrier. The weighted average cost of capital can account for 20–50 per cent of the levelized cost of electricity (LCOE) of utility-scale solar PV projects.²⁶ At the tariff end, this financing cost can account for 50–65 per cent of renewable energy tariffs in India, and even higher in other developing countries where risk premium is higher.²⁷

According to IEA, emerging and developing countries (excluding China) incur financing costs that are twice as high as those of advanced economies when it comes to heavy industries investing in carbon capture or green hydrogen.²⁸

High cost of capital and rising borrowing costs reduce the economic attractiveness of clean energy investment in

WHAT ARE THE PROBLEMS?

Figure 9: The climate investment trap at the macroeconomic level



Source: Higher cost of finance exacerbates a climate investment trap in developing economies, University College London, 2021

developing countries, even if they possess rich renewable resources.²⁹

This has been occurring at a time when losses and damages from climate impacts are concentrated in the developing world. It exacerbates a 'climate investment trap', as researchers at University College London have highlighted (see Figure: The climate investment trap at the macroeconomic level), wherein 'climate-related investments remain chronically insufficient, due to a set of self-reinforcing mechanisms with dynamics similar to those of the poverty trap'. High-risk perceptions produce high premiums, increasing the cost of capital for low-carbon investments, thus delaying the energy system transition and the reduction of carbon emissions. And unchecked climate change, leads to further economic losses, and increases risk further.³⁰

WHAT ARE THE PROBLEMS?

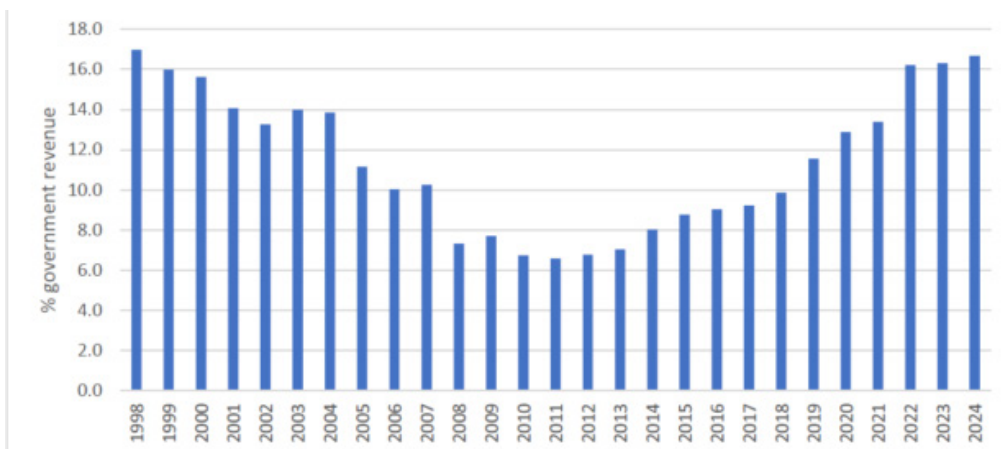
2.3 HIGH EXTERNAL DEBT OF COUNTRIES

The Global South is currently facing a growing debt crisis. Coupled with the after-effects of the global pandemic, high inflation rates, high debt-servicing costs, and rising instances of climate-related impacts, developing countries are now facing what experts have termed as a 'polycrisis'.

Developing nations often have limited public funds to invest in social and environmental projects. To supplement public funds that are available to them and bolster fiscal space for spending on essential activities, many developing countries rely on foreign debt to fund projects of national importance. Access to foreign debt is crucial for developing countries to make investments in specific areas to pursue public welfare and public policy goals. However, there exists a tipping point beyond which a country's debt could become 'unsustainable'. A country's public debt is said to be sustainable when the government is able to meet its payment obligations on debt instruments without requiring additional or exceptional financial assistance to make debt-service payments in the present and future, or without facing the risk of default.³¹ This adversely impacts a country's ability to ramp up investments in climate mitigation and adaptation projects.

Debt-payments made by low-income countries are at their highest since 1998, with external debt-service payments

Figure 10: External government debt as percentage of government revenue of 91 countries



Source: Debt Justice, 2023

WHAT ARE THE PROBLEMS?

from 91 countries averaging 16.3 per cent of government revenue in 2023.³²

Table 4: Debt burden exceeds annual cost of achieving the NDC for many low and middle-income countries

Sl. No.	Countries	Income classification, World Bank	Risk of debt distress, UNCTAD August 2022	ND-GAIN Vulnerability Score*, 2020	Total Debt Service (TDS) on External Debt in 2021 (in USD billion)	Annualised NDC Cost (USD billion)
1	Burkina Faso	Low-income	Moderate	0.55	0.50	0.41
2	Cambodia	Lower-middle-income	Low	0.51	2.19	0.40
3	Gambia	Low-income	High	0.55	0.04	0.02
4	Ghana	Lower-middle-income	High	0.47	3.23	0.93
5	Laos	Lower-middle-income	High	0.53	0.72	0.43
6	Lesotho	Lower-middle-income	Moderate	0.48	0.34	0.02
7	Liberia	Low-income	Moderate	0.60	0.06	0.05
8	Mozambique	Low-income	In debt distress	0.52	7.24	1.27
9	Myanmar	Lower-middle-income	Low	0.53	2.31	0.12
10	Nicaragua	Lower-middle-income	Moderate	0.45	1.37	0.17
11	Papua New Guinea	Lower-middle-income	High	0.54	4.05	0.20
12	Saint Lucia	Upper-middle-income	Moderate	0.36	0.05	0.04
13	Senegal	Lower-middle-income	Moderate	0.53	1.75	1.30
14	Sudan	Low-income	In debt distress	0.62	3.00	0.82
15	Tanzania	Lower-middle-income	Moderate	0.52	1.96	1.92
16	Zimbabwe	Lower-middle-income	In debt distress	0.55	0.58	0.48

*The Notre Dame-Global Adaptation Index (ND-GAIN) Country Index is a free open source index that shows a country's current vulnerability to climate disruptions. ND-GAIN assesses the vulnerability of a country by considering six life-supporting sectors: food, water, health, ecosystem services, human habitat and infrastructure. Lower scores of 0.2-0.4 are typically observed for Upper income countries, while Low income countries have higher scores between 0.4-0.6.

Note: An updated version of this table has been inserted on June 26, 2023.

Source: CSE; Data from UNCTAD, World Bank, IMF, UNFCCC NDC submissions, Climate Watch Data.

WHAT ARE THE PROBLEMS?

According to Debt Justice, a UK-based campaigning organisation, countries that had to allocate 15 per cent of government revenue towards debt payments saw a three per cent fall in public spending between 2019 to 2023, whereas countries with the lowest debt-payments saw an increase in public spending by 14 per cent.³³ The reduced ability of governments to spend on critical areas such as climate change and the social sector have a negative impact on a country's development.

The overlap between debt distress and climate vulnerability worsens the trap faced by developing countries. According to Action Aid, 93 per cent of the most climate vulnerable countries are already in debt-distress or face a high risk of being in debt-distress. Their research found that among the 63 countries deemed most vulnerable to climate change, nine are already experiencing debt distress. Furthermore, 20 countries categorised as climate vulnerable are at a high risk of falling into debt distress, while another 20 countries face a moderate risk.³⁴

CSE analysed a dataset by UNCTAD of 69 low-and middle-income countries (see Table 4: *Debt burden exceeds annual cost of achieving the NDC for many low and middle-income countries*).³⁵ 54 countries have complete data on debt servicing costs in 2021, and have also listed a cost figure in their conditional Nationally Determined Contribution (NDC). Of these, CSE found that about 30 per cent (16 of 54) face higher debt servicing costs in one year than what it would cost to achieve their NDC.. NDCs are an imperfect measure

Prioritise debt or NDC? Egypt's dilemma

Egypt, in their updated NDC released just prior to the COP27, mentioned that their foreign debt stood at a total of US\$ 145.5 billion, which would need 45 per cent of their revenues in the 2022–23 financial year. It further said that inflationary pressure would necessitate the Egyptian government's spending on poverty reduction efforts. Therefore, the lack of fiscal space limits Egypt's climate ambitions and ability to spend on climate investments.

WHAT ARE THE PROBLEMS?

Pakistan's debt trap

In 2022, Pakistan faced catastrophic flooding that affected 33 million people. The World Weather Attribution research group estimated that climate change probably intensified the rain by 50 to 75 per cent. The official Post Disaster Needs Assessment estimated the total damages at US\$ 14.9 billion, and the total loss at US\$ 15.2 billion. In January 2023, at the International Conference on Climate Resistant Pakistan held in Geneva, pledges up to US\$ 10.57 billion were made by MDBs and countries, but more than 80 per cent of this (US\$ 8.7 billion) was in the form of loans, according to Finance Minister Ishaq Dar.³⁶ This, when Pakistan's total stock of external debt already stood at US\$ 126 billion at the end of 2022. Its last resort currently is a US\$ 1.1 billion loan from the IMF which is a part of a US\$ 6.5 billion loan programme sanctioned in July 2019, but which comes with many conditionalities. According to economists Jayati Ghosh and C. P. Chandrasekhar, any resolution of the crisis must involve a considerable reduction in the stock of external debt. That requires 'creditors taking haircuts, restructuring the residual debt to postpone immediate interest and amortisation payments and extend loan maturities, and ensuring some flow of new capital', they add.³⁷

of required climate investment since they tend to vary by sectors presented in costing, and whether or not the cost indicated covers both mitigation and adaptation. However, this indicative analysis is intended to highlight that if debt service on external debt is higher for a country in a particular year than the cost of achieving its climate goal, then it is plausible that their climate ambition is being hindered by debt obligations.

As the climate emergency heightens in scale and severity, we urgently need a global mechanism to contend with the debt-crisis. In the absence of a comprehensive approach to solving the debt and climate crisis in the Global South, countries will be unable to make the urgent investments needed towards transitioning their economies towards a low carbon trajectory. Future climate impacts will only exacerbate the debt problem in developing and climate-

Role of China as the biggest bilateral lender

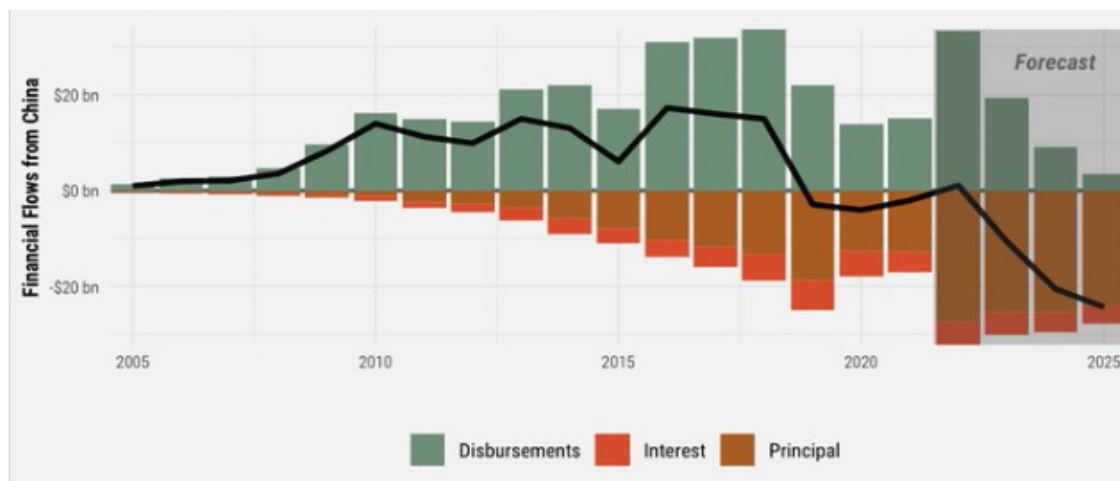
Today China is the biggest bilateral creditor to poor countries— extending loans exceeding US\$ 1.5 trillion to over 150 nations—many of which are in Africa. Prominent borrowers are Argentina, Pakistan, Egypt, Zambia, Ghana and Kenya, among others. Most of the loan commitments were made between 2008 and 2021 under its Belt and Road Initiative, a world wide infrastructure project aimed at expanding Beijing’s influence in key regions. For example, when it comes to Pakistan, China’s share of its external debt rose from 7.8 per cent of outstanding external debt in 2014 to 19.2 per cent in 2021. Loan commitments to 100 developing countries by the China Development Bank and the Export-Import Bank of China reached an all-time high in 2016, before reducing every year since 2016. Yet in 2022, 37 per cent of the total debt-service payments that 74 low-income countries owed their creditors were owed to China, approximating US\$ 13.1 billion, according to the World Bank.

Two types of lending has been identified:

- Lending by the government-owned China Development Bank and the Export-Import Bank of China
- Bailouts by the central bank, the People’s Bank of China, as the 'lender of the last resort' similar to the role played by the IMF

China charges higher interest rates on loans, and borrower countries have to sign non-disclosure agreements preventing them from revealing what they owe. US and other countries have exerted pressure on China to offer debt relief to low-income countries, and while the latter has offered some, its stance has been that MDBs should also participate in debt relief, along with private bondholders who are mostly located in the EU and US. Recent discussions at the April 2023 Spring meetings of the IMF and World Bank saw China soften its stance on demanding that MDBs participate in debt relief.

Figure 11: Net financing flows from China to developing countries



Source: Teal Emery, World Bank International Debt Statistics

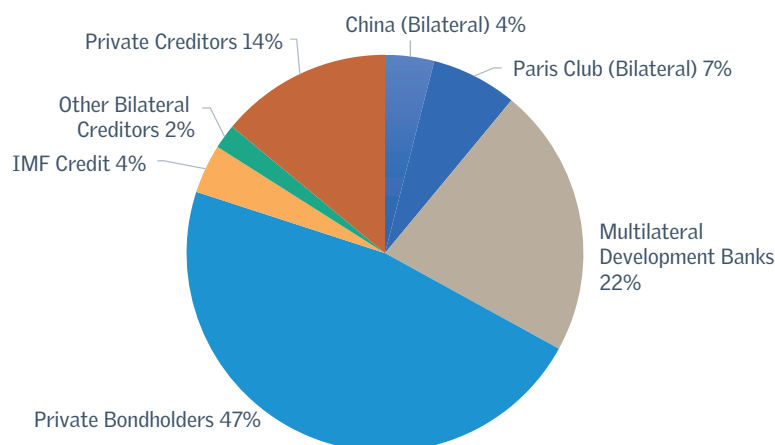
WHAT ARE THE PROBLEMS?

vulnerable countries in the absence of a global mechanism for debt relief. As countries prepare to ramp up climate action to meet their NDC goals, there is an urgent need to devise a long-term and equitable strategy for debt relief. Forcing countries to prioritise debt-service payments in foreign currency during such times will accelerate the climate and indeed the humanitarian crises that the world is facing post-pandemic.

Who owns the debt?

Of the US\$ 3.6 trillion in debt held by emerging markets and developing economies (EMDE), 47 per cent is held by private bondholders, 22 per cent is held by multilateral development banks (MDBs), 14 per cent by private creditors—these are essentially loans from the private sector. The IMF holds four per cent and seven per cent is owned in bilateral credit by the Paris Club, a group of 22 of the mostly wealthy countries comprising Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Ireland, Israel, Italy, Japan, Netherlands, Norway, Russia, South Korea, Spain, Sweden, Switzerland, the United Kingdom, and the United States. Four per cent of the debt is owned by China in bilateral credit, and two per cent by other bilateral creditors.³⁸

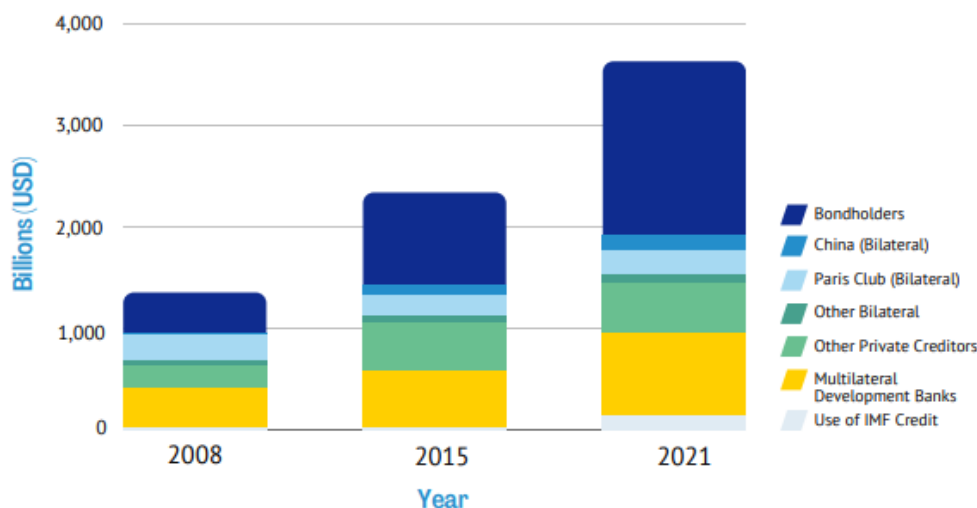
Figure 12: Who owns the debt?



Source: Debt Relief for a Green and Inclusive Recovery: Guaranteeing Sustainable Development, 2023

WHAT ARE THE PROBLEMS?

Figure 13: Developing Countries Debt Composition by Creditor, 2008–2021, in billions



Source: Debt Relief for a Green and Inclusive Recovery: Guaranteeing Sustainable Development, 2023

The composition of debt ownership has also changed from 2008 to 2021. For instance, the share of MDBs and bilateral aid from the Paris Club have declined, whereas the shares of private bondholders and China as a bilateral lender have seen the largest increase.³⁹

2.4 THE ROLE OF MULTILATERAL DEVELOPMENT BANKS

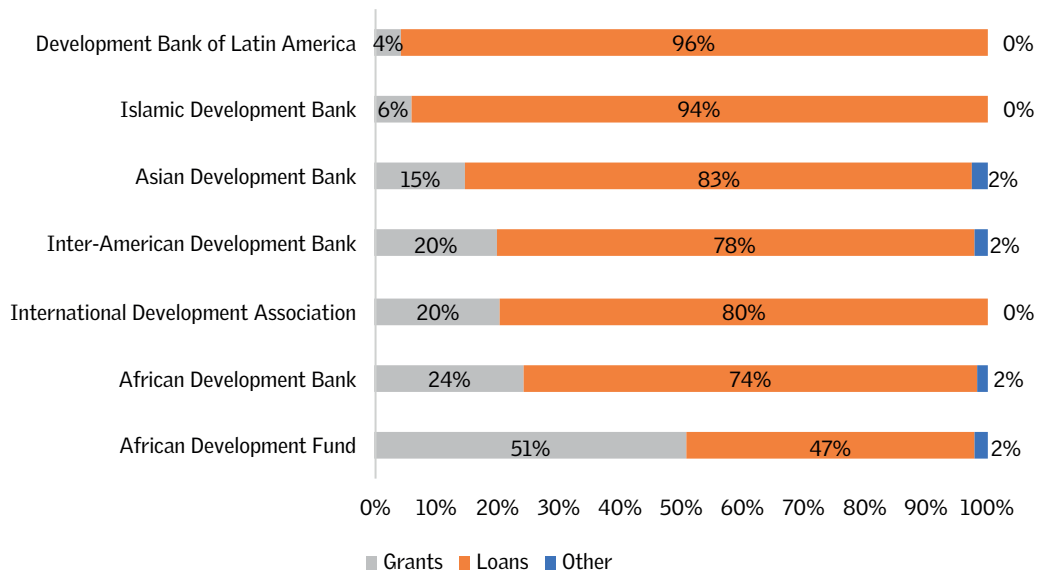
Although the COP 27 cover decision referenced the need to reform MDBs, calls for their reform to operate more effectively in the era of climate change pre-date COP 27. Two recent catalysts elevating the discussion were the issuance of US\$ 650 billion worth of Special Drawing Rights by the IMF in 2021 and the G20 Independent Review of MDB's capital adequacy in 2022 (discussed in Section 3).

Need for more concessional finance, particularly grants

MDBs are an important source of concessional finance (more details in Annexure). With their high credit rating of AAA, they can raise money from the markets at very low rates, and provide low-interest loans, and grants as well in some cases. But authors of the Bridgetown Agenda highlight the fact that

WHAT ARE THE PROBLEMS?

Figure 14: MDB Climate Finance 2010–20



Source: CSE, data from Aid Atlas

concessional finance by MDBs is offered only to 'the poorest countries, those with a GDP per capita of less than US\$ 1,253 per year, where 900 million people live or 12 per cent of the world's population'.⁴⁰ They argue that 62 per cent of the world's poor live in middle-income countries, and thus must be eligible for concessional money. MDBs can do this by implementing the CAF review panel's recommendations and by being allowed to hold rechanneled SDRs (see Section 3) to be able to lend more. Only some MDBs can hold SDRs and are known as prescribed holders. Many developing economies are keen to see more capital infusion or paid-in capital from shareholders to increase MDBs' resources and allow them to finance the additional demands from the climate crisis. Advanced economies have been resistant to paying in more funds to increase this pool of money.

For the World Bank in particular, the US has typically been resistant to more capital being added by shareholder countries, particularly China, since that would reduce the US' share below the veto level.⁴¹

Moreover, for seven major MDBs, of the total climate finance provided between 2010 and 2020, an average of 20 per

WHAT ARE THE PROBLEMS?

cent was provided as grants, and 79 per cent as loans (see *Figure 14: MDB Climate Finance 2010–20*). For MDBs to better serve the needs of developing countries, the share of grant-based financing must increase to avoid worsening the debt trap in the Global South.

MDBs are major holders of poor country debt

MDBs hold 22 per cent of emerging market economies' debt, and yet do not participate in current debt relief efforts. In 2020, on behalf of the African Union, South Africa's President Cyril Ramaphosa called on MDBs to join the G20's Debt Service Suspension Initiative. But the arguments resisting their participation suggest that MDBs maintain 'preferred creditor' status (see Section 3.1) so that their AAA rating can be maintained, and they can keep issuing cheap loans.⁴²

Moreover, most MDBs prioritise debt-service interest payments at the cost of reduced liquidity and ability of debtor governments to spend on essential spending. As the scale and frequency of climate impacts increase, MDBs should focus on enabling countries to direct investments towards climate action and development, rather than focusing on debt repayments as a first requirement. Debt-service payments should be suspended during times of natural disasters and extreme weather events, enabling these countries to direct resources towards disaster mitigation and rebuilding efforts.

Paris Alignment of MDB financial flows can be paternalistic

In a joint declaration in 2018, nine MDBs announced a joint framework for aligning their activities with the goals of the Paris Agreement. Article 2.1c of the Paris Agreement deals with 'making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.' The World Bank has published documents on its 'Paris Alignment Methodology', in which it committed to aligning 100 per cent of its new operations beginning 1 July, 2023, and with 85 per cent alignment for its two private sector arms—the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA). Experts and developing countries have expressed hesitation

WHAT ARE THE PROBLEMS?

about this top-down approach that MDBs plan to follow.

For example, for its Development Policy Financing Operations (DPFs), the World Bank's method suggests that:

- A DPF prior action is aligned with the Paris Agreement's mitigation goals if it (i) actively contributes to decarbonisation by supporting GHG emission reductions or increasing sinks (e.g., policies that incentivise renewable energy generation), or (ii) has little impact on decarbonisation on account of leading to negligible GHG emissions (e.g., reforms related to digital inclusion or connectivity), or (iii) generates significant GHG emissions but is in line with the country's longterm decarbonisation pathway and has a low risk of locking in carbon-intensive patterns.
- A DPF prior action is considered non-aligned with the Paris Agreement's mitigation goals when it is inconsistent with the country's decarbonisation pathway, taking into consideration the country's specific circumstances, and leads to a (higher than low) risk of carbon lock-in.

Economist Daniela Gabor at the University of the West of England, Bristol, has termed it as 'green structural adjustment' while speaking at a public webinar in May 2023. Structural adjustment refers to conditionalities that countries must adhere to in order to secure a loan from the IMF or World Bank. According to Gabor, the World Bank is creating its own taxonomies to distinguish between Paris-aligned and non-aligned projects, giving it the authority to decide whether an activity is conducive to mitigation, for example. Gabor believes that some of the 'straitjackets' on the ability of countries in the Global South to deviate from this approach are being tightened with the Paris-aligned World Bank lending and investment. We believe this could hinder crucial development investments in developing economies if they do not qualify for this top-down set of criteria.

WHAT ARE THE PROBLEMS?

Lack of accessibility of funds

Despite having a mandate to finance developmental causes, MDBs have been known to have a very slow speed of disbursing much needed funds. There are also conditionalities placed on to the loans they provide, which is why some governments prefer to borrow from capital markets even though the rates of interest are higher than MDBs.

WHAT ARE THE PROPOSALS ON THE TABLE?

Experts have tabled various proposals focused on expanding MDB lending, increasing the flow of concessional finance to developing countries, and frameworks for debt relief

It is a question of political will and adequate civil society pressure to have the most transformational solutions implemented

WHAT ARE THE PROPOSALS ON THE TABLE?

Figure 15: Mapping of current proposals to address financial barriers faced by the Global South

	PROPOSALS								
	Bridgetown Agenda	Debt Relief for a Green and Inclusive Recovery	Brad Setser and Stephen Paduano	African Development Bank	G20 Capital Adequacy Framework Report	V20 Countries	Civil society organisations	UNDP 2013	G20 Common Framework
Financial barriers for developing countries' green transition									
Poor sovereign credit rating, weak currency, dollar hegemony									
High cost of capital (both debt and equity) Lack of access to international capital markets due to high interest rates	Global Mitigation Trust using SDRs. Concessional finance from MDBs for adaptation		Use SDR denominated bonds to provide low interest loans	More finance from MDBs at lower interest rates	More finance from MDBs at lower interest rates	Accra-Marrakesh Agenda for more concessional finance		De-risking Blended finance	
High debt burden Inadequate fiscal space for climate investments	Debt suspension during natural disasters	Debt relief for public debt Debt hair cut and sustainability linked bonds for private, with guarantee facility				Enhanced Debt Sustainability Analysis	Debt cancellation Mandatory participation for private creditors Debt for climate swaps		Debt relief for select countries
Loss and damage	Reconstruction grants using fossil or shipping levies/taxes						Grant-based finance through L&D Fund Taxes on shipping, fossil fuels, air passengersm financial transactions, wealth		

Source: Compilation by CSE

WHAT ARE THE PROPOSALS ON THE TABLE?

The good news is that the world has moved beyond the imperative of providing additional ‘climate finance’ (which is already inadequate). It is discussing the structural barriers to why finance is unavailable to countries that need it the most for the transition to green energy. The issue of reform of multilateral banks as well as the question of the enormous debt burden of the most vulnerable countries is on the table at international forums. But will the world take the necessary steps to make concessional finance available to the emerging world? Will these funds be sufficient to allow for investments in both mitigation and adaptation? Or will we miss out on another opportunity in rhetoric and talk. This is the million dollar question; one that will either make or break our future.

CSE has looked at the different proposals to understand what they are advocating; this we hope will allow for informed discussions on the urgency of the change we need to see.

3.1 PROPOSALS ADDRESSING MULTIPLE FINANCING CHALLENGES

3.1.1 The Bridgetown Agenda: Short-term actions to finance mitigation, adaptation, and loss and damage

In July 2022, the Barbados government proposed the Bridgetown Agenda. This initiative calls for financial reforms that will steer funds towards ramping up climate action in developing countries with a focus on practical steps that can be achieved in 12 to 18 months.

Figure 16: The Bridgetown Agenda

Mitigation	<ul style="list-style-type: none"> Using Special Drawing Rights to back a Global Mitigation Trust which can lend money for mitigation at low interest rates
Adaptation	<ul style="list-style-type: none"> More concessional finance from MDBs via expanded lending
Loss and damage	<ul style="list-style-type: none"> Suspend debt during a natural disaster Grants for recovery through new taxes on fossil fuels, shipping, CBAM

Source: CSE representation

WHAT ARE THE PROPOSALS ON THE TABLE?

While the proposal has undergone subsequent changes, it put forth three main asks in its original iteration. One part focuses on financing mitigation in developing countries where cost of capital is still too high for climate projects to be considered commercially viable.⁴³ Bridgetown proposes setting up a Trust or agency 'backed' by US\$ 500 billion worth of Special Drawing Rights (SDRs), which are associated with low interest rates. With this backing, the Trust could borrow private sector funds and lend to developing countries for mitigation projects.

On adaptation, Bridgetown calls for more concessional lending from MDBs. For this it proposes 'a limited widening of the eligibility for concessional lending' for countries who need it but do not qualify, accompanied by a greater risk appetite by MDBs so they lend more.

And for loss and damage, the agenda calls for grant-based money for recovery in disaster-hit countries, funded by a tax on fossil fuels, shipping, or carbon border taxes. It also proposes suspending debt-service payments for 2 years during natural disasters.

Critics have said that the Bridgetown Agenda falls short of being transformational, as it asks for the bare minimum from the Global North, and perpetuates a system based on loans and dependence on MDBs who imposed harsh conditionalities on receivers of their finance.

3.1.2 The G20 Independent Review of MDBs' Capital Adequacy Frameworks: More money should be lent out from Multilateral Development Banks

The multilateral development banks (MDBs)—i.e., banks governed by multiple country shareholders—play an important role in providing financial assistance to developing countries. They are a stable source of long-term finance with a low cost of capital and a capacity to mitigate risk.⁴⁴ They also provide technical assistance to countries in addition to financing.

But MDBs are conservative with taking on riskier lending to preserve their high credit rating—10 out of 15 MDBs have

WHAT ARE THE PROPOSALS ON THE TABLE?

AAA rating—despite being backed by shareholder countries. They need to loosen their lending restrictions to increase the volume of money to developing countries.

MDBs raise most of their money by borrowing on international bond markets, while only a small share is held as 'capital' or security, from shareholder countries. They then lend the borrowed money for various purposes as per their mandate.

In 2021, the G20—then under the Italian Presidency—set up an expert panel to review MDBs' financing capacity through a review of their 'capital adequacy frameworks' (CAF)—i.e., how much money a MDB should hold to repay lenders if borrowers default on their debt. In 2022, the panel published their report, which asked MDBs to loosen their lending restrictions and thereby provide much more money without threatening their financial stability or AAA credit rating.

The CAF review panel concluded that while deciding how much of this capital is needed to manage financial risks, the risks have been overestimated by MDBs and credit rating agencies. MDBs have 'preferred creditor status', i.e., borrowers will always repay them first before repaying commercial lenders.⁴⁵ The CAF panel's data found that losses on public sector loans from 1991 to 2020 were 15 times lower than losses faced by commercial lenders (banks and bond investors) to the same borrowers. Even for MDB loans to private sector borrowers, the numbers were better than for commercial lenders. There is a second recommendation on callable capital—the money that shareholder governments will provide in the case of an extreme emergency if many borrowers have defaulted and the MDB is unable to pay its lenders. About US\$ 1.2 trillion exists in callable capital across 15 MDBs, and the CAF review panel believes that the financial security provided by it is not adequately built into MDBs' 'risk appetite'.

Thus, MDBs should take on more calculated new risk and increase the amount of money they lend out.

WHAT ARE THE PROPOSALS ON THE TABLE?

3.1.3 Imposing new taxes to generate funds for loss and damage, and beyond

Civil society groups have supported various options to impose new taxes and levies that could generate funds for activities such as loss and damage—which cannot be counted as profit-making investments and will not generate a financial return. The potential funding streams could also more broadly fund climate mitigation and adaptation in developing countries.

- **Shipping levy:** This refers to a levy on emissions from the international shipping sector for the use of fossil fuels. Depending on different modelling assumptions, estimates for carbon revenues from international shipping could imply an average of around \$40 billion to \$60 billion of annual revenues, according to the World Bank.
- **Air passenger levy:** A levy on air passengers, particularly frequent flyers, was first proposed by the Least Developed Countries (LDC) bloc in 2008 at COP14. A brief titled *Financing loss and damage: Overview of tax/levy instruments under discussion*, by the French think tank IDDRI, highlights an estimate that even at a low rate of two per cent, such a levy could raise up to US\$ 17 billion per year (assuming pre-Covid figures for the number of passengers).
- **Proceeds from carbon border taxes:** Some proposals, including the Bridgetown Agenda, have suggested that a share of revenue generated from carbon border taxes such as the European Union's carbon border adjustment mechanism (CBAM) due to be active from October 2023, should be directed towards addressing loss and damage in poor and vulnerable countries. CSE has argued against the regressive nature of a CBAM that would reduce the competitiveness of developing country manufacturing sectors, and a remittance of the tax to exporting countries in the form of grants or towards a loss and damage fund, would address this inequity to a partial extent.
- **Fossil fuel taxes:** A tax on extraction of fossil fuels by companies, also known as a Fossil Fuel Extraction Levy, at US\$ 6 per tonne of CO₂ could raise US\$ 150 billion per year, according to IDDRI's brief. In 2022, the UN Secretary

WHAT ARE THE PROPOSALS ON THE TABLE?

General called on “on all developed economies to tax the windfall profits of fossil fuel companies”, with some European countries and the United Kingdom going ahead and implementing such taxes in the wake of the Russian war.

- **Financial transaction tax:** This is a levy on financial instruments like bonds, stocks, options, and derivatives. In 2012, the UN High-Level Advisory Group on Climate Financing estimated in 2012 that FTTs could raise between US\$ 7-16 billion per year. Such a tax when applied to spot conversions of one currency into another, is known as a Tobin Tax. According to advocacy group Consumer Unity & Trust Society, even at 0.25 per cent of a transaction, the tax can annually raise US\$ 4.5 trillion globally.
- **Wealth tax:** Taxes on the wealth of individuals have long been proposed to redistribute money towards developmental purposes, and address inequality. A January 2023 briefing paper titled Survival of the Richest by charity and research organisation Oxfam states that a tax of up to five per cent on the world’s multi-millionaires and billionaires could raise US\$ 1.7 trillion a year, enough to lift 2 billion people out of poverty, and fund a global plan to end hunger.

3.2 PROPOSALS FOCUSED ON DEBT RELIEF

3.2.1 G20 Debt Service Suspension Initiative and Common Framework

In response to the 2020 pandemic, the G20 introduced the Debt Service Suspension Initiative to help developing countries to reduce their debt service burdens. Under the DSSI program, 48 of the eligible 73 countries participated and a total of US\$ 12.9 billion in debt service payments were suspended between May 2020 and December 2021. Although private creditors were also invited to participate in the DSSI, only one private creditor took part in it.⁴⁶ Private creditors such as bondholders in international capital markets, commercial banks and asset management firms like BlackRock, account

WHAT ARE THE PROPOSALS ON THE TABLE?

Debt Cancellations refer to debt that is written off by a creditor nation or private creditor. This is also known as a 'haircut'. A haircut essentially entails a creditor nation or private creditor writing off a loan. This results in a reduction in the debt-burdens of a debtor government.

Debt Service Suspensions refers to a postponement or pausing of interest payments on the debt amount. This gives debtor governments more liquidity to spend on essential spending in times of distress.

Debt Restructuring refers to a process by which countries, private companies, or individuals are able to change the terms of their loans such that it is easier for the debtor to pay back the loan. This could include negotiating for a reduced rate of interest on the loan or increasing the loan term by postponing the due date for when it has to be paid back so that it can be paid back more easily.

for an increasing share of low-and middle-income countries' external debt.⁴⁷ At year-end 2021, 61 per cent of the public and publicly guaranteed debt of low-and middle-income countries' external debt was owed to private creditors, up from 46 per cent in 2010, according to the World Bank's International Debt Report 2022. Thus, one major criticism of the DSSI has been that it did not mandate private sector participation. To reach meaningful and timely agreements on debt-restructuring efforts for debtor nations, it is essential that all creditor parties participate in similar negotiations. The DSSI was a stop-gap arrangement, introduced to enable countries with a high debt burden to prioritise domestic investments in improving public health measures during the pandemic. Debt suspensions were to last until the end of December 2020, with creditors willing to consider a possible extension during 2021, considering a report on the liquidity needs of eligible countries by the World Bank and IMF. On April 7, 2021, official G20 bilateral creditors agreed to extend the DSSI by 6 months, until the end of December 2021. Therefore, this end date was decided by the bilateral creditors. The DSSI expired in December 2021.

In November 2020, the G20 reached a consensus on a Common Framework on Debt Treatments, more commonly

WHAT ARE THE PROPOSALS ON THE TABLE?

known as the G20 Common Framework, which aims to look at long drawn liquidity issues and debt-solvency problems in the 73 DSSI-eligible nations. It provides debt-relief in accordance with a debtor country's ability to pay and maintain essential spending requirements.⁴⁸ The common framework brought China on board with the Paris Club. Although it was a welcome step, there is agreement on the fact that the Common Framework failed to engage all creditor parties in negotiations for debt relief, in addition to not being able to link debt-relief with climate action and SDGs. Another criticism of the Common Framework has been that it only included the low-income countries as eligible participants, whereas many middle-income developing countries are also struggling with their foreign debt.⁴⁹ Eligibility should be expanded to include climate vulnerable middle-income countries that are also facing debt-distress.

3.2.2 V20 Proposals on debt relief

A Debt Sustainability Analysis (DSA) is a tool that is used by the World Bank and IMF to analyse a country's debt to help detect, prevent, and mitigate a potential debt crisis. The Vulnerable Twenty (V20)— a group of 58 countries representing economies that are the most systematically vulnerable to climate change impacts—published a 'Statement on Debt Restructuring Option for Climate Vulnerable Nations' in 2021. It proposed that for climate vulnerable low-and middle-income countries, an enhanced DSA should be carried out that takes into account their goals for climate action and Sustainable Development Goals (SDGs).⁵⁰ In their statement, the V20 proposed that an equitable 'enhanced DSA' for climate vulnerable countries should integrate data for climate and sustainability risks, estimates of domestic financing needs for climate adaptation, mitigation, and achieving SDGs, and benefits from improving climate resilience while assessing debt sustainability capacity in order to enable required domestic investments towards climate resilience.

In April 2023, V20 Group of Ministers of Finance put forward the Accra-Marrakech Agenda. This is a four-part

WHAT ARE THE PROPOSALS ON THE TABLE?

Global Debt Sustainability Roundtable

The Global Debt Sustainability Roundtable (GSDR) was created in February 2023 to build a common understanding among stakeholders involved in the debt restructuring process, in addition to working together on addressing shortcomings in the process, including in the G20 Common Framework. The GSDR is co-chaired by the International Monetary Fund, the World Bank, and India in its capacity as the 2023 G20 Presidency. Its members comprise official bilateral creditors, including traditional Paris Club creditors as well as non-Paris Club bilateral creditors such as China, private creditors, and borrowing parties. Although there have been debt roundtables in the past, they were traditionally only attended by creditors, making this occasion the first time borrowers are also part of a roundtable on debt. Six borrowing countries are participating in the GSDR—Suriname, Ecuador, Zambia, Ghana, Ethiopia, and Sri Lanka. The GSDR focusses on the debt restructuring process and concepts. It does not replace debt restructuring mechanisms such as the G20 Common Framework, rather its focus is to build a greater common understanding of key concepts within the existing framework, so that individual country-level debt restructurings can be expedited and facilitated more smoothly. This could help get rid of delays that slow down the restructuring process, because of a lack of clarity on principles such as information sharing relating to macroeconomic projection and debt sustainability analysis among key stakeholders, debt-service suspension, and determining comparability of treatment—which means that all creditors must be treated in a balanced and comparable manner in the debt restructuring process.

proposal that essentially seeks to propose a re-wiring of the global financial system such that it supports climate vulnerable countries in accessing climate finance more easily. The Accra Marrakech Agenda was launched on April 16, 2023, at the IMF World Bank Spring Meetings in Washington D.C and will be finalised at the IMF-World Bank Annual Meeting in Marrakech later this year in November.

The V20 reiterated that the debt crisis is perpetuated and exacerbated by the climate crisis which ultimately

WHAT ARE THE PROPOSALS ON THE TABLE?

leads to an increase in climate vulnerabilities. In doing so, the V20 have proposed various measures to alleviate the problem of growing debt in climate vulnerable countries. In addition to their earlier recommendation to revise the DSA to consider climate risks faced by a country, they also propose a tripling of concessional financing from the International Development Association (IDA—concessional lending arm of the World Bank) for IDA eligible countries, and for Multilateral Financing Institutions to double international finance for adaptation in the coming two years, with Multilateral Development Banks (MDBs) ensuring that 50 per cent of their climate-related lending is being directed towards adaptation.⁵¹

3.2.3 Proposal by the Debt Relief for Green and Inclusive Recovery (DRGR) Project

A proposal by researchers at the DRGR Project calculates that 61 of the most debt distressed countries owe US\$ 812 billion in external debt. They recommend that:

- Public and private creditors will have to grant 'haircuts'—i.e., accept losses between US\$ 317 billion to US\$ 520 billion in debt relief.
- For a portion of the debt owed to private and commercial creditors, they can purchase new bonds, which will be backed by a guarantee facility funded by a multilateral institution. This guarantee facility will be the carrot to convince private creditors to swap debt for the new bonds. These bonds will have the backing of a multilateral institution, which means that the multilateral institution would be on the hook if a country misses a payment to a creditor. The risk of non-payment to the creditor is lower, as opposed to the current situation where there is a risk of default.
- Debt payment totalling to US\$ 30 billion should be 'suspended' or paused while larger debt restructuring negotiations continue.

WHAT ARE THE PROPOSALS ON THE TABLE?

Figure 17: Three Pillars for Debt Relief for a Green and Inclusive Recovery



Source: Debt Relief for a Green and Inclusive Recovery: Guaranteeing Sustainable Development, 2023

3.2.4 Other instruments: Green bonds, debt swaps

Other than international frameworks, such as the Common Framework on Debt Treatment, there are also multiple policy mechanisms and tools that are available for countries to ameliorate their debt burdens, such as green bonds and debt swaps (see Annexure).

Green bonds are similar to regular bonds that countries issue for large investment public projects, except that the funds raised through green bonds are earmarked for spending and investments in environmental or climate projects such as improving flood resilience, increasing renewable energy generation capacity, or improving the public transport network.

Debt-for-environment swaps, also called debt-for-nature or debt-for-climate swaps are another example of alternative mechanisms for debt relief, which could enable countries with a high debt burden to make increased domestic investments in environmental or social projects.

WHAT ARE THE PROPOSALS ON THE TABLE?

Ecuador's debt-for-nature swap

Ecuador reached a historic debt-for-nature swap deal on May 9, 2023, where it 'swapped' US\$ 1.6 billion in debt from the bank Credit Suisse for a US\$ 656 million in a Galapagos Marine Bond which it used to finance a loan that will be used towards conservation efforts in the Galapagos. Gabon is also in the process of reaching a debt-for nature deal with the Bank of America. Although debt-for-climate or nature swaps are becoming more popular in light of the deepening debt crisis, these swaps do not offer long term solutions for the debt and climate crises for multiple reasons. Firstly, these deals do not cancel enough debt to significantly contribute towards a solution to the debt crisis, or free up enough funds to meaningfully contribute towards climate or nature solutions. Ecuador's debt levels lie at more than US\$ 60 billion. Secondly, they do not create additional funds for the Global South which can be directed towards climate/nature-based investments. Thirdly, these deals have 'conditionality' attached, for example, lenders control how these funds will be used and where the funds will be allocated rather than the borrowing country whose debt has been 'swapped'. For nature conservation based swaps, these deals can also come with conditions related to the conservation model that will be used, negatively impacting Global South sovereignty and community rights in cases where certain conservation models inadvertently harm community livelihoods and customary rights to community commons. Debt-swap arrangements also lack transparency as many of the financial details and conservation commitments that are negotiated as part of a swap are considered confidential documents. Finally, these deals have high transaction costs that often take several years to negotiate and finalise, thereby underlining why they do not offer a meaningful solution to the debt crisis.

These instruments can address small proportions of debt load and have limited scalability but may be packaged with other measures.

WHAT ARE THE PROPOSALS ON THE TABLE?

3.3 PROPOSALS TO LOWER THE COST OF CAPITAL

3.3.1 De-risking—the UNDP Agenda

In 2013, the UNDP recommended the concept of derisking by public institutions to reduce the cost of capital for sectors that investors consider too risky in developing countries.⁵² Policy derisking could be done through institutional capacity-building, and grid connection in the case of renewable energy. Financial derisking would involve public actors absorbing the financial losses rather than private investors, such as through loan guarantees or public equity co-investments. But critics have suggested that this leads to a 'financialisation' of green projects with overwhelming preference for private sector finance for projects that should be considered public goods.

3.3.2 Using Special Drawing Rights

Special Drawing Rights (SDRs) are not a currency, but a reserve asset allocated by the IMF to various nations. Countries can use SDRs to facilitate the exchange of various foreign currencies. Five currencies are used to determine the value of a SDR—the US dollar, the EU euro, the Japanese yen, the UK pound sterling, and the Chinese renminbi. SDRs are allocated to countries based on their 'quotas,' which corresponds to their GDPs. For example, the US holds the largest allocation of SDRs equivalent to US\$ 162 billion. Currently 67 per cent of SDRs are allocated to high-income countries.

In 2021, the IMF issued US\$ 650 billion worth of additional SDRs to countries in response to the COVID-19 pandemic. The G20 pledged to redirect (also known as recycling) US\$ 100 billion worth of SDRs to vulnerable countries.⁵³ But only 11 countries have committed to redirecting some portion of their SDRs to developing countries, amounting to only US\$ 36.42 billion.

SDRs sit with rich country central banks as reserves, 'providing extra cushioning where none is needed'.⁵⁴ In other words, there is not much use for SDRs in rich countries. Excessive caution on their part, and the fact that they need to pay interest if the SDRs they hold are less than their quota

WHAT ARE THE PROPOSALS ON THE TABLE?

makes them reluctant to transfer some of their SDRs for use by low-income countries.⁵⁵ Thus, the current delay in rechanneling SDRs to countries that need them the most is a political problem largely.

According to Rishikesh Ram Bhandary, Assistant Director of the Global Economic Governance Initiative at the Boston University Global Development Policy Center, how easily you can re-channel SDRs depends on the rules of a country's central bank. Some central banks require that SDRs maintain their 'reserve characteristics'. This means that the SDRs could continue to be counted as reserves in the central bank's accounting. Preserving the reserve asset characteristic of SDRs, however, reduces the flexibility that the trust or the recipient of the SDRs will have.

SDRs are associated with lending at very low interest rates, and proposals have made been to use them as 'leverage' against which low interest loans can be given to developing countries for climate mitigation and adaptation.

The Bridgetown Agenda recommends setting up a Climate Mitigation Trust that is backed by US\$ 500 billion worth of SDRs, and borrows and lends money at an indicative 2.4 per cent interest rate to fill funding gaps in climate projects in developing countries and incentivise the private sector to invest.

Securing the participation of the United States—the largest IMF quota holder—in the Bridgetown proposal will be difficult according to some since it treats SDRs like grants. Rechanneling SDRs requires approval from the Congress in the case of the US, making it a difficult process to fulfil. An alternate proposal by Brad Setser, a Senior Fellow at the Council on Foreign Relations and Stephen Paduano, a PhD candidate at the London School of Economics (LSE), suggests that the World Bank should instead issue bonds denominated in SDRs rather than in dollars.⁵⁶ The US Congress has already authorised the US Treasury to purchase debt securities from highly rated issuers, which would cover an SDR bond from the AAA-rated World Bank, according to the authors of the proposal. Countries like the US could buy these bonds, and this would increase the amount of money the World Bank has for

WHAT ARE THE PROPOSALS ON THE TABLE?

onward lending to developing countries at a low interest rate.

Another proposal by the African Development Bank (AfDB) tabled in February 2023 calls to have excess SDRs from rich countries lent to the bank to be held as hybrid capital. Hybrid capital is a financial instrument with both debt and equity characteristics. The SDRs would act as security against which AfDB could issue bonds and increase its lending capacity by 3-4 times the number of SDRs invested. The bonds would fund 'projects supporting climate mitigation and adaptation, green growth, and food security' in Africa. The proposal preserves the 'reserve asset' status of SDRs that rich countries demand—that it is 'low risk, and lending countries can redeem their SDRs on demand'.⁵⁷

3.3.3 Recommendations of the Stern-Songwe Report 2022

The Stern-Songwe report of 2022 lays out a set of recommendations to reduce the cost of capital, such as private sector commitment to increase, over time, the amount of investment in developing countries and gradually absorb more of the risk through private sector balance sheets. It also recommends building on COP 27's initiative on 'regional fora to identify investable climate projects' to create a global pipeline. The initiative identified adaptation and mitigation projects to connect them with potential investors.

3.3.4 UNFCCC Mitigation Work Programme

Mechanisms under the United Nations Framework Convention on Climate Change can be harnessed to further constructive discussions on lowering the cost of capital for developing countries. Governed by the principle of common but differentiated responsibility, the UNFCCC offers a platform for developing countries to demand lowering of barriers to the green transition, when faced with calls for higher climate ambition. For example, the Mitigation Work Programme set up under the UNFCCC in 2021 must be used as a forum for countries to brainstorm further ways in which cost of capital for green projects can be reduced. In 2023, the Co-Chairs have announced that the dialogues taking place under the work programme will focus on 'accelerating just energy transition'.⁵⁸

WAY AHEAD

The developing world needs more concessional finance flowing in from developed countries and MDBs, for climate mitigation, adaptation and loss and damage.

There is a need to stop the 'divide and conquer tactic' against the poor-and allow middle-income countries to access concessional finance and debt-relief.

We need a multi-lateral, rules-based approach to solving the debt and climate crisis.

CLIMATE FINANCE: IT'S MONEY AND MORE

It is abundantly clear that the world is being hit by extreme weather events because of climate change. It is also equally clear that the burden of this devastation is disproportionate—impacting the poor in the poorest of countries. The injustice is also a fact—the poor in the world, who are most adversely affected by climate change are not the primary contributors to the stock of greenhouse gases that are ‘forcing’ temperatures to change.

Climate finance is not just payment or reparations that are needed for the disproportionate impacts of climate change on the poor of the world. It is also about providing finances for the transition that is needed in countries that still need to develop. They need to develop differently, so that they can grow without adding as much to the stock of emissions that will further jeopardise our common existence. This is why climate justice—as enshrined in the 1992 UN Framework Convention on Climate Change (UNFCCC)—matters so much. It was agreed that while countries that have been responsible for the stock of emissions (historical polluters) would need to reduce emissions, it was also important that the rest of the world, which had the right to development, would be provided with the finance and technology to grow sustainably. However, over the past 30 years, the world has convened countless conferences with the intention of diluting and eradicating this principle. Today, this means that 70 per cent of the world’s population has still not secured development in terms of energy or other essentials needed for their wellbeing. Meanwhile, the world has practically run out of the carbon budget that will keep us below the guardrail of 1.5 degree celsius rise in temperature from the pre-industrial period. So, climate finance is critical to ensure that the development in the world is sustainable; that these countries can be resourced to leapfrog into a cleaner tomorrow. On a more specific note, this is about additional finance that is not repackaged from other funding sources or demands. This has been illusionary till date.

The problem is compounded because there is no agreed definition of what the world means by climate finance—the

UNFCCC standing committee of finance says that it is funding for 'reducing emissions, and enhancing sinks of greenhouse gases and aims at reducing vulnerability of, and maintaining and increasing the resilience of, human and ecological systems to negative climate change impacts'. But this leaves it very much open to interpretation, and indeed misuse. Oxfam International has challenged the OECD accounting of climate finance, showing that it is a mere one-fourth of what is claimed.

The other problem is that the bulk of the funds provided for climate change is not in the form of grants or even concessional finance. Instead, it is given in the form of loans or equity. The overemphasis on loans then adds to the already crushingly high debt burden of countries.

Therefore, it is time we looked seriously at the issue of providing additional, concessional and debt-free finance to meet the mitigation and adaptation needs of the countries of the Global South. But it is equally important that climate financing must not take away the support required for development in these countries, from education, healthcare, energy, and other infrastructure to poverty reduction programmes. There are huge opportunities for co-benefits, where development support will also help build a greener and more sustainable present for millions. But this requires that countries develop national action plans, which are then supported.

Climate finance cannot be a ruse to provide new conditionalities to countries to drive their development strategies. Under the 2015 Paris Climate Agreement's there is a provision to make 'finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development' i.e., they should be 'Paris-aligned'. If applied to MDB finance, for example, the question now is what will this 'Paris alignment' mean for the decision-making powers of countries of the South to determine their own development strategies? Will this lead to a new taxonomy of conditionalities where donors and multilateral banks will determine the investment and development of countries? This could also mean that developed countries,

which are required to provide climate finance as additional funds and for reparations, could take advantage of backdoor conditionalities.

Therefore, in our view:

The developing world needs more concessional and additional finance flowing in from developed countries and MDBs, for climate mitigation, adaptation and loss and damage.

The Stern-Songwe report of 2022 asks for a doubling of bilateral climate finance to US\$ 60 billion by 2025 from its 2020 level.

MDBs must expand concessional money as well, particularly grants. This must not take away from the development priorities of countries. If the mandate of MDBs will be expanded beyond development and poverty eradication to climate investments, then they need more resources. Implementing the CAF review panel's recommendations must be accompanied by a capital increase from shareholder countries to inject more money into the MDB ecosystem.

Moreover, efforts on bringing about Paris Alignment of MDB financing flows can risk blocking crucial development investments in the Global South and also take away their abilities to decide on development priorities. The structural reforms that are required for MDBs, must not provide them with the right to impose conditionalities on countries of the South. This would mean that this added mandate for climate finance is being used to subvert the countries' right to development and its sovereignty. This does not bode well for our common future. This funding must be additional, and it must be provided to countries based on their national plans for development and climate co-benefits.

There is a need to stop the 'divide and conquer tactic' against the poor and allow middle-income countries to access more concessional finance and debt-relief.

Eligibility for concessional finance must be widened to include middle-income countries who face climate risks and

other vulnerabilities. But this must not come at a cost to the poorest countries, and in particular island nations.

For this to work, the funding pool must be enhanced so that there is additional money in the kitty that is used by MDBs and other agencies for climate finance. This is the bottom-line of climate finance discussions—additionality, and not creative accounting to transfer funds from one account head to another, or one country to another.

Debt relief as well, must be offered not just to the poorest countries, but to all vulnerable, debt-ridden countries who need it, even those that fall in the middle-income bracket.

We need a multilateral, rules-based approach to solving the debt and climate crisis.

Rather than piecemeal, case-by-case debt relief efforts, a rules-based system needs to be developed to reduce the debt burden in the developing world, including the debt owed to private creditors.

But more importantly, we need to stop the creation of new debt. The debt burden of these countries must not be further increased through climate financing of projects, which as can be seen in the past, has been heavily skewed towards loans, and not grants. Currently, data shows that 91 of the poorest countries made external debt-service payments averaging 16.3 per cent of their government revenues. In fact, our analysis shows that many low and middle-income countries pay more in annual debt servicing costs than what they would need to spend annually to achieve their NDC goals. This system is broken and needs urgent reform.

We cannot rely on the private sector to solve climate change—climate action is a public good.

We cannot depend on the private sector to achieve public policy aims for climate change, which is a global public good. Rather than focusing on only those investments that are profitable to private entities, climate investment needs to be strategically driven by governments—and where appropriate—by multilateral institutions to ensure equitable allocation of funds to countries who need it the most. Public

institutions and MDBs must also work to drive down the cost of capital in developing countries. Developed countries need to play a role here. The current trend of offering subsidies to green manufacturers under policies like the Inflation Reduction Act in the US and the Green Deal Industrial Plan in the EU is seeing vast amounts of public money being offered to the private sector in rich countries. Developed countries need to simultaneously ensure that developing countries can access money for necessary investments.

The issue of reforms in the global financial systems must be escalated this year as we dig down on one of the biggest roadblocks to climate ambition; money flowing from developed countries for both mitigation and adaptation.

At the UNFCCC, countries will meet to discuss the terms of the 'New Collective Quantified Goal of Climate Finance', which needs to go beyond the still controversial and undelivered US\$ 100 billion. There are also discussions on the financial packages for the Just Energy Transition Partnerships (JET-P) and on voluntary carbon markets to finance climate action. But the fact is that none of this will be enough unless we discuss and take apart the underlying systemic barriers that are holding back countries of the Global South from accelerating investment in development and decarbonisation and improving their resilience to climate shocks. We must remember that every extreme weather event makes a country more vulnerable and unable to manage multiple crises. We cannot expect transformations, let alone transitions in these countries for greener and more inclusive development, without the finance that will make this happen.

The question of finance is not easy, but it is at the core of what needs to be addressed for an effective and ambitious climate agreement. It is also clear that without inclusive development, countries cannot invest in climate change. This 'finance matter' is not about us versus them, but about a collective goal for a just and inclusive world, which will combat climate change together.

ANNEXURE

GREEN BONDS

Bonds allow borrowing countries, multilateral agencies, and private companies to spread a large sum of money and the associated risk over a long period of time and among many creditors. Lenders receive interest payments from the borrower over a fixed period of time. The interest rate for such bonds is determined by multiple factors, such as the associated risk, borrowers credit ratings, length of the investment period, and nature of use of the borrowed amount. At the end of the pre-determined time period, lenders are paid the principal amount in full. Developing countries can use green bonds to raise money for specific climate/environment projects, instead of relying on public money alone. Using green bonds, countries can fund climate mitigation and adaptation projects in the same way that countries use bonds to fund large infrastructure projects. While green bonds can be used to fund most environment/climate projects, a majority of the projects that are funded through these bonds are projects that produce economic returns. Therefore, funding certain kinds of projects that do not generate economic returns, such as climate adaptation projects which typically do not produce monetary benefits for investors is likely to be difficult.⁵⁹

DEBT-FOR-ENVIRONMENT SWAPS

In theory, a debt-for-environment swap entails a bilateral agreement between a debtor nation and a creditor nation, where the creditor nation agrees to cancel a specified amount of debt, and in return the debtor nation agrees to invest a pre-agreed sum of domestic currency into environmental projects such as biodiversity conservation projects or climate mitigation/adaptation projects. This enables debtor nations to earmark funds for environmental priorities while reducing some of their debt burdens. However, in practice these swaps are usually very complex legal and financial arrangements

between three (or more) parties—debtor governments, private or public creditors, and international non-profits that often act as intermediaries and implementing agencies. International non-profits typically negotiate with private creditors and buy debt at a reduced rate from creditor agencies or governments, while parallelly negotiating with debtor nations to earmark funds for specific environmental projects. Since the first debt-for-environment swap in 1987 which enabled Bolivia to cancel US\$ 650,000 in sovereign debt, more than 300 similar swaps have been executed, resulting in a total of US\$ 3.7 billion in sovereign debt being written off.⁶⁰ Although debt-for-environment swaps offer a mechanism that enable developing governments to increase expenditure on environmental projects while reducing their debt burden, they are not long-term solutions to the Global South debt crisis which stands at more than US\$ 400 billion.⁶¹

There is a limit to how much external debt can be swapped for a debt-for-climate scheme. Although a fraction of the total debt load can be swapped, it is not a solution for the entirety of the debt. Even well-designed debt swaps would have to be supplemented with other kinds of debt relief mechanisms. Secondly, the same issues that apply to debt-for-nature swaps, apply to debt-for-climate swaps. Ultimately, they could negatively impact decision-making and the sovereignty of the country receiving the swap, since these projects are typically designed by an intermediary that negotiates with the creditor party.

Furthermore, there are several concerns associated with these debt swaps—the first concern being that of ‘conditionality’ wherein the Global North creditor governments and international NGOs put conditions on the Global South debtor governments to pass policy reforms in exchange of debt relief, therefore poorly negotiated debt swaps could impinge on Global South sovereignty. Secondly, poorly designed swap projects could result in local communities and indigenous groups being dispossessed of their customary rights to their traditional waters and land/forests.

CONCESSIONAL FINANCE FROM MDBS

Concessional funds are disbursed by the lending arms of MDBs. Every MDB has different eligibility rules for their concessional financing arm. For instance, the International Bank for Reconstruction and Development (IBRD) and International Development Association (IDA) are the main lending arms of the World Bank through which it disburses finances. The IDA mainly provides concessional lending to the poorest 74 countries while the IBRD provides both commercial and concessional finance to middle-income countries. Similarly, the African Development Bank (AfDB) has the African Development Fund (ADF), which is the arm that provides concessional funding to low-income Regional Member Countries (RMCs). Concessional financing tools and conditions attached to these mechanisms differ from one MDB to another. Mostly these are in the form of concessional loans with long maturity periods, grants, technical assistance, and guarantees. MDBs also have criteria for disbursing concessional funds among eligible countries. For instance, AfDB uses the IMF/World Bank Debt Sustainability Framework (DSF) and Debt Sustainability Analysis to decide what proportion of funds will be given as grants. Countries at a high risk of debt distress or in debt distress as assessed by the DSA are given their ADF allocation fully in the form of grants. Countries at moderate risk of debt distress get their allocation in the form of 50 per cent grant and 50 per cent loan, and countries at low-risk of debt distress are given their allocation as 100 per cent loans.

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