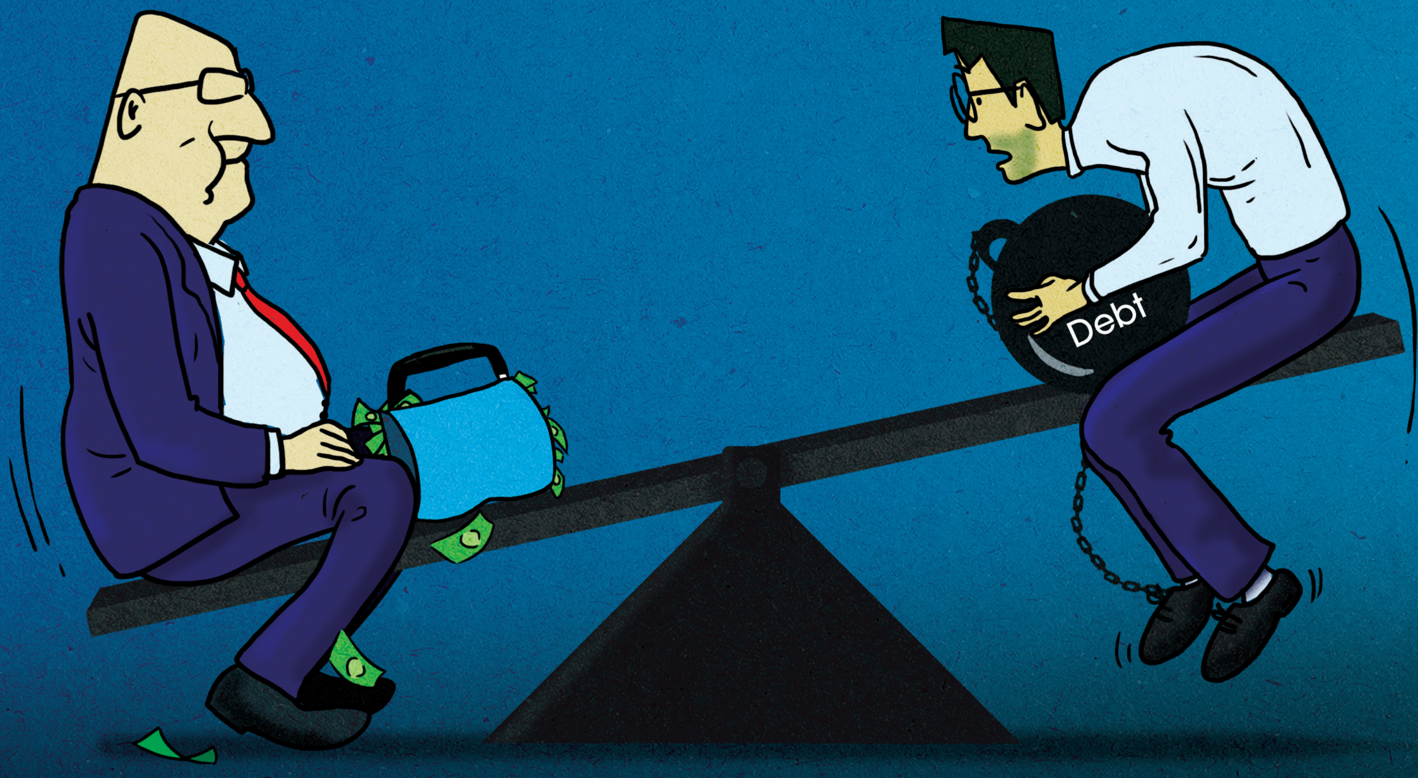
FINANCIAL SYSTEMS TRANSFORMATION

Tracking progress since CSE's paper 'Beyond Climate Finance'



FINANCIAL SYSTEMS TRANSFORMATION

Tracking progress since CSE's paper 'Beyond Climate Finance'

Research Direction: Sunita Narain and Avantika Goswami

Author: Sehr Raheja

Editor: Rituparna Sengupta

Cover and design: Ajit Bajaj

Graphics: Ritika Bohra

Production: Rakesh Shrivastava and Gundhar Das

The Centre for Science and Environment is grateful to the Swedish International Development Cooperation Agency (Sida) for their institutional support

Maps used in this document are not to scale.

Citation: Sehr Raheja 2023, *Financial systems transformation*, Centre for Science and Environment, New Delhi

Published by
Centre for Science and Environment
41, Tughlakabad Institutional Area
New Delhi 110 062
Phones: 91-11-40616000
Fax: 91-11-29955879
E-mail: sales@cseindia.org
Website: www.cseindia.org

1. INTRODUCTION

The 28th Climate Change Conference in Dubai this year (COP 28) marks a pivotal moment in time, with parties slated to participate in the first ever Global Stocktake. As part of reflecting on the progress made on climate goals, COP 28 is expected to highlight the contentious and urgent issue of finance for climate change once again.

It was established at COP 27 in Sharm el-Sheikh, that an annual investment of at least US $4–6 trillion would be required for a global transformation to a low-carbon economy.[1] It was also highlighted that delivering such funding would need a transformation of global financial systems, along with its structures and processes. One year since, the focus on engaging central banks, commercial banks, institutional investors, governments and other financial actors for reforming financial systems has intensified along with the focus on increasing the quantum of climate finance required by developing countries.

In June 2023, CSE gave an assessment of the financial barriers hindering climate ambition for developing countries in the paper, 'Beyond Climate Finance'. It put a spotlight on these barriers by broadly classifying them into three themes:

- High external debt burdens of countries
- High cost of capital due to perceived risks
- Roles of international financial institutions and multilateral development banks

These developments are crucial to note as they highlight the challenges faced by countries of the Global South in accessing adequate scale and types of funds for carrying out climate action. As such, the paper provided an assessment of the systemic barriers hindering climate ambition.

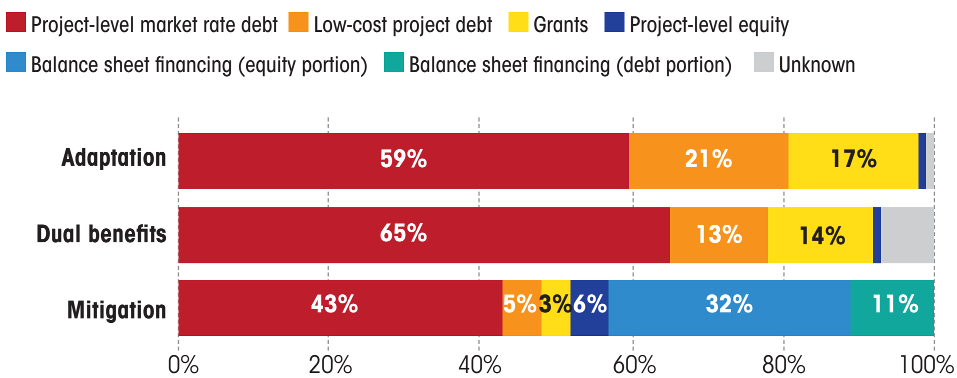
It brought together major global developments relating to financial systems reforms until June 2023. This factsheet sets out the state of discussions and progress that has happened on these three themes since then.

2.FINANCE AND CLIMATE AMBITION ARE INEXTRICABLY LINKED

A majority of the countries that are vulnerable to the impacts of climate change have limited space in their fiscal budgets to adequately act on it. According to the UNFCCC Standing Committee on Finance, estimates for implementing the Nationally Determined Contributions (NDCs) of developing countries stand at US $5.8–5.9 trillion for the pre-2030 period.[2]

The economies of vulnerable nations and low-income countries are routinely impacted by the shocks brought on by the interconnected crises of natural disasters, pandemics and growing socio-political conflict.[3] A vast majority of the spending allocation of low-income countries remains restricted to servicing external debt. The Climate Policy Initiative's latest estimation of global climate finance flows, published in October 2023, suggests that over 17 per cent of public finance that goes to the least developed countries takes the form of market-rate debt, adding to their existing debt burdens.[4] 43 per cent of all mitigation finance and 59 per cent of adaptation finance comprises project-level market rate debt (see *Figure 1: Climate finance by use and instrument*).

Figure 1: Climate finance by use and instrument



Source: Climate Policy Initiative

Additionally, the high cost of capital (such as higher interest rates, perceived risks for green technology), and inadequate concessional finance and grants from international lending institutions, renders them unable to adequately scale up their climate ambition despite the urgency of today's times. These countries, which contribute the least to global greenhouse gas emissions, are thus the worst hit, both in terms of climate change impacts as well as a lack of capacity to respond to the same.

3. WHAT HAS CHANGED SINCE COP 27?

Against this backdrop, the need to fast track access to sufficient and high-quality finance for developing countries has never been more pressing. To this end, the COP 28 vision for climate finance negotiations has been spelled out clearly in the United Arab Emirates' Presidency's letter to the Parties—transforming climate finance by delivering older promises and setting the framework for a 'finance system of the future'.[5] The former mainly comprises the unmet promise by developed countries of providing US $100 bn per year for climate action to developing countries from 2020 onward. In no year since 2009—when this promise was made at COP 15—has this goal been reached. According to the Organisation for Economic Cooperation and Development's latest forward-looking analysis, the goal 'could be met in 2023', but this has not yet been verified.[6] The latter demands an assessment of the progress on financial systems reforms in recent months. Various fora have discussed these issues since COP 27, including but not limited to—the UNFCCC Bonn Climate Change Conference, the Summit for a New Global Financing Pact, the Africa Climate Summit, the G20 New Delhi Summit, the Global Sovereign Debt Roundtable, the Climate Ambition Summit, the Spring and Annual Meetings of the World Bank and the International Monetary Fund, the five Transitional Committee Meetings of the Loss and Damage Fund, and the two global dialogues of the UNFCCC Mitigation Work Programme.

Table 1: Milestones in discussions on financial system transformation for climate change: COP 27 to present

S.No.	Summit	Initiative/outcome
1	COP 27 (Nov 2022)	1. Loss and Damage Fund established
		2. First High level Ministerial on New Collective Quantified Goal on climate finance conducted
		3. Sustainable Debt Coalition Initiative announced highlighting links between debt and climate pressures
		4. Framework to guide formulation of Global Goal on Adaptation established
2	1st Transitional Committee Meeting for the Loss and Damage Fund, Luxor (Mar 2023)	1. Substansive and procedural milestones laid out as part of workplan towards COP 28
3	5th Technical Expert Dialogue on the New Collective Quantified Goal on climate finance, Vienna (Mar 2023)	1. Renewed focus on deciding a quantum for the goal, as well timelines and scope discussed (first Technical Expert Dialogue -TED- after COP 27, until which most TEDs ended with procedural outcomes rather than substantive technical ones)
4	World Bank - International Monetary Fund Spring Meetings, Washington D.C. (Apr 2023)	1.Global Sovereign Debt Roundtable discussions on debt restructuring and sustain-ability conducted
		2. Vulnerable 20 Ministers Dialogue with IMF and WB held, communique released
		3. Vulnerable 20 representatives put forward Accra to Marrakech Agenda
5	2nd Transitional Committee Meeting for the Loss and Damage Fund, Bonn (May 2023)	1. Santiago Network on loss and damage seen as a key part of funding arrange-ment, for technical assistance and potentially hosting the fund
		2. Discussions focussed on potential location of fund, and potential sources of finance to meet scale of funding required
6	Bonn Climate Change Conference (Jun 2023)	1. Short Framework on elements to be included in the global stocktake exercise at COP 28 decided
		2. 6th Technical Expert Dialogue on New Collective Quantified Goal on climate finance conducted,focused on quantum, and that decision of goal should be done by COP 29. LMDCs, G77 and China group all emphasised need for climate finance discussions in agenda, to little avail.
7	Summit for a New Global Financing Pact, Paris (Jun 2023)	1. Vulnerable 20 countries' Emergency Coalition for Debt Sustainability and Climate Prosperity launched. Coalition focused on aligning sovereign debt architecture with development and climate goals.
		2. Global Expert Review on Debt, Nature and Climate announced to study links between sovereign debt and climate action. To be established at COP 28.
		3. Sustainable Debt Coalition roundtable held at Summit's sidelines discussing actionable recommendations on debt and climate change
		4.Multilateral Ddevelopment Bank (MDB) Vision Statement endorsed as main out-come of summit. MDB reform agenda laid out, contentious issues prevailed
		5.WB announced natural disaster clauses for debt suspension in case of extreme weather events
		6. IMF announced US $100 billion SDRs target achieved
		7. Barbados special envoy Avinash Persaud introduced paper on Partial FX Guarantee Mechanism for reducing cost of capital for renewable energy projects

CONTINUED...

…CONTINUED

S.No.	Summit	Initiative/Outcome
8	First workshop under the Sharm el-Sheikh Dialogue on Article 2, paragraph 1(c) of the Paris Agreement and its complementarity with Article 9, Bangkok (Jul 2023)	1. Discussions on existing work in relation to Article 2.1c inside and outside the intergovernmental process, and the scope of Article 2.1c and its complementarity with Article 9 of the Paris Agreement
9	3rd Transitional Committee Meeting for the Loss and Damage Fund, Santo Domingo (Aug 2023)	1. Developed countries first put forward suggestion of restricting eligibility for the fund to LDCs and SIDS alone
		2. Continued discussions on concerns related to funding arrangements, sources of funding, delivery modalities also held
10	Climate Ambition Summit, New York (Sep 2023)	1. Countries called to pledge to Green Climate Fund
11	Africa Climate Summit, Nairobi (Sep 2023)	1. Nairobi Declaration on Climate Change and Call to Action released
		2. Call for new 'Global Finance Charter' by 2025
12	G20 New Delhi Summit (Sep 2023)	1. New Delhi Leader's Declaration issued, endorsed various items related to global financial systems reform, MDB reform
		2. Sustainable Finance Working Group recommendations noted
13	7th Technical Expert Dialogue on the New Collective Quantified Goal for climate finance, Geneva (Sep 2023)	1. Discussions focused on transparancy arrangements for tracking progress and ways of reflecting qualitative issues in new goal
		2. Elements needing political consideration to be discussed at the upcoming High Level Ministerial Dialogue at COP 28 also discussed
14	2023 Sustainable Development Goals (SDG) Summit, New York (Sep 2023)	1. Summit marked 'half-way' point to the timeline for achieving SDGs
		2. Closing remarks included a call for mobilizing investment, including through the SDG Stimulus, climate finance, debt relief, and a reform of the international finance architecture for enhancing SDG achievement
15	Second High Level Dialogue on Financing for Development, New York (Sep 2023)	"1. Discussions on debt sustainability reforms,mobilizing domestic resources, strengthening the global financial safety net and promoting international tax cooperation in relation to fastracking the achievement of SDGs were held"
		2. Need to reform the global financing system emerged as a point of agreement at the summit
16	Second workshop under the Sharm el-Sheikh Dialogue on Article 2, paragraph 1(c) of the Paris Agreement and its complementarity with Article 9, Geneva (Oct 2023)	1. Discussions building on outcomes from the first workshop to advance the understanding of the scope of Article 2.1c and its complementarity with Article 9 of the Paris Agreement
		2. Report on the deliberations at both workshops prepared by the secretariat to be presented for consideration by the CMA at its fifth session at COP 28 in Dubai.

CONTINUED…

...CONTINUED

S.No.	Summit	Initiative/outcome
17	World Bank - IMF Annual Meetings, Marrakech (October 2023)	1. Vulnerable 20 countries' Accra to Marrakech Agenda adopted
		2. Vulnerable 20 countries' Finance Ministers High Level Ministerial XI conducted at sidelines
		3. Global Sovereign Debt Roundtable Cochairs Progress Report issued
		4. WB Evolution Roadmap highlighted
		5. IMF updates on SDRs, progress on Resilience and Sustainability Trust announced
		6. Africa High-Level Working Group meeting on Global Financial Architecture convened
		7. Fourth G20 Finance Ministers and Central Bank Governors Meeting released Communique
		8. High level meeting of African Development Bank (AfDB), Inter-American Development Bank (IDB), the Rockefeller Foundation, and the Center for Global Development on rechanelling SDRs through MDBs conducted
		9. G20 Independent Expert Group Report Volume 2 released
18	4th Transitional Committee Meeting for the Loss and Damage Fund, Aswan (October 2023)	1. Supposed to be final Transitional Committee (TC)meeting, but concluded with call for an extra 5th TC meeting in Abu Dhabi in November
		2. Developed countries insisted on World Bank hosting the fund, developing countries opposed
19	5th Transitional Committee Meeting for the Loss and Damage Fund, Abu Dhabi (November 2023)	1. Operationalisation of the year's work of committee adopted but without consensus, to be debated at COP 28
		2. World Bank selected as interim host of fund, despite vocal opposition from most developing country parties

Additionally, actors across the board, including the current COP Presidency, have continued to categorically emphasize the need for harnessing increased private capital for climate action in developing countries. Detailed below are all major developments since COP 27 on the systemic issues impacting finance for climate action and ambition.

4.DEBT DILEMMAS: SLOW MOVEMENT IN TACKLING DEBT DISTRESS LEAVES CLIMATE QUESTION LOOMING

The link between the debt burden faced by countries and their inability to scale sufficient climate action has become increasingly clear, particularly for low-and middle-income nations. According to new data from Debt Service Watch released in October this year, the debt service levels of 139 countries with borrowings from the World Bank have surpassed those of Heavily Indebted Poor Countries (HIPC) and the Latin American debt crises levels. Their debt service equals their total spending on education, health, social protection and climate adaptation combined, while in African countries the debt amount exceeds this spending by 50 per cent. With an average of 38 per cent of the budget revenue

Table 2: Developments on debt issues, June 2023 – present

S.No.	Forum	Initiative/Outcome
1	Summit for a New Global Financing Pact, Paris (Jun 2023)	1. Emergency Coalition for Debt Sustainability and Climate Prosperity launched by Vulnerable 20 (V 20) countries. Coalition focused on aligning sovereign debt architecture with development and climate goals.
		2. Global Expert Review on Debt, Nature and Climate announced. Aim to study links between sovereign debt and climate action. To be established at COP 28.
		3. Sustainable Debt Coalition roundtable held at the sidelines of Summit. Actionable recommendations on debt and climate change discussed
2	Africa Climate Summit, Nairobi (Sep 2023)	1. Nairobi Declaration on Climate Change and Call to Action released
		2. Call for new 'Global Finance Charter' by 2025 announced
3	World Bank - IMF Annual Meetings, Marrakech (Oct 2023) [Includng G20 related updates]	1. Accra to Marrakech Agenda adopted by V 20 countries. Calls for inernational financial system reform on four fronts: debt, IFIs, carbon finance and risk management
		2. V 20 Finance Ministers High Level Ministerial XI conducted at Annuals sidelines
		3. Global Sovereign Debt Roundtable Cochairs Progress Report issued
		4. G20 Finance Ministers and Central Bank Governors 4th Meeting, communique adopted
4	COP 28 (Nov 2023)	1. Global Expert Review on Debt, Nature and Climate. Expert group as suggested by Colombia, Kenya and France at Paris Summit to be created at COP 28 in Dubai

being spent on debt servicing by Global South countries, the need to address the debt crisis in order to enable economies to spend on climate change without reducing essential spending on education, healthcare etc. is more urgent than ever.[7]

Over the last year, discussions on the need and modes to address the debt-climate crises have taken place across various platforms. This section discusses the updates in the following milestones—the adoption of the V20 Accra to Marrakech Agenda, progress on the Global Sovereign Debt Roundtable, the fourth meeting of the G20 Finance Ministers and Central Bank Governors, updates on the Sustainable Debt Coalition, the Africa Climate Summit's Nairobi Declaration, and the upcoming Global Expert Review on Debt, Nature, and Climate.

4.1 V20 Accra to Marrakech Agenda, High Level Ministerial XI

The Vulnerable 20 (V20) group of 68 nations that are highly vulnerable to climate change advocated for urgent interventions to 'make debt work for climate' in October 2023. Through the Accra to Marrakech Agenda, which was proposed at the Spring Meetings of the World Bank (WB) and the International Monetary Fund (IMF) in April, these countries called for immediate reforms to global financial architecture. Adopted on 15th October, 2023 at the World Bank-IMF annual meetings in Morrocco, this agenda called for systemic changes to support climate-threatened economies. Debt related demands in the agenda included:

- Reform of the G20 Common Framework for Debt Treatment (the only multilateral system for forgiving/restructuring sovereign debt at present, beyond the Debt Service Suspension Initiative) to help climate vulnerable economies obtain necessary debt relief in a timely manner, and allow them to pursue their climate prosperity plans.[8]
- Provision of guarantees and incentives to all creditor groups to smoothen the pace of debt relief negotiations.
- Facilitation of debt restructuring to be accompanied by credit enhancement (including 'shock resilient debt and

swaps') to attract investment in development-positive climate action.

- For debt treatment and debt-sustainability analysis to support climate resilience of economies, and be carried out in consideration of national climate strategies and plans.[9]

At the Summit for a New Global Financing Pact in June this year, the V20 group of countries also launched the Emergency Coalition for Debt Sustainability and Climate Prosperity, which also focused on aligning sovereign debt architecture with development and climate goals. The Finance Ministers of the economies met at the V20 High Level Ministerial on the sidelines of the World Bank-IMF Annual meetings in Marrakech in October, to further specific proposals to debt reforms for directly addressing climate change needs.[10] Notably, member ministers have been demanding the recognition of the V20 as an official group in the International Monetary Fund (IMF), to facilitate a fairer allocation of Special Drawing Rights (SDRs), and for receiving

Box 1: What is debt restructuring?

Countries often borrow money from various external lenders, including other governments and international finance and development institutions for a range of purposes, from everyday government expenses to managing budget shortfalls. At times, countries may struggle to repay their borrowed funds due to factors such as economic slowdown, high debt relative to their GDP, currency devaluation, natural disasters, and more. In such a situation a country is said to have defaulted on its debt. When facing financial difficulties, countries turn to international organizations—typically the International Monetary Fund—for assistance. Through debt restructuring agreements, debtor nations work with these organizations to renegotiate the terms of repayment. This can involve extending repayment deadlines, spreading payments over a longer period, reducing interest rates, or even decreasing the total amount owed. Restructuring occurs in stages, and is sometimes a prerequisite for receiving 'rescue' loans from the IMF. Although easy on paper, the process of a country defaulting on its debt, seeking IMF involvement, and moving towards a workable resolution with all its creditors is often a difficult and long-drawn one.

What happened in 2023? The Global Sovereign Debt Roundtable convened for the second time at the World Bank–International Monetary Fund Annual meetings in Marrakech in October 2023. Three debt restructuring cases under the G20's Common Framework for Debt Treatments were discussed—Zambia, Ghana and Ethiopia. Varying progress on each has been made.

a proportionate voice at the IMF table. COP 28 is the next milestone where these demands of the V20 are slated to see some outcomes.[11]

4.2 Global Sovereign Debt Roundtable

Set up in February 2023, the Global Sovereign Debt Roundtable (GSDR) comprises representatives of the official bilateral creditors of the Paris Club (an informal group of predominantly wealthy Western creditor nations with the stated aim of mediating negotiations and offering debt

Box 2: Highlights from Zambia, Ghana and Ethiopia

Zambia

- Defaulted in November 2020; Africa's first 'pandemic era' sovereign defaulter.
- China is the country's largest bilateral creditor, Zambia owes China US $6 billion.
- In June 2023, Zambia announced a landmark restructuring agreement worth US $6.3 billion with its official creditors (co-led by China and France). The final Memorandum of Understanding for this deal was finalized in October 2023.
- The terms of the October 2023 agreement includes restructuring Eurobonds, a type of international bond denominated in a currency different from the currency of the country where it is issued and used by borrowing countries to raise capital/borrow money from international investors.
- The Eurobond restructuring includes permanently waiving about US $700 million owed, and reduced debt servicing payments for the duration of Zambia's existing IMF programme, which will provide the country about US $2.5 billion in cash flow relief, according to a statement by the country's Ministry of Finance and National Planning.
- The Zambian government is working towards adequate agreements with its private creditors (who hold approximately US $6.5 billion of debt) as well.

As of November 2023, IMF and Zambia's official creditors have "expressed reservations" about the agreement. Reportedly, this is because the deals entail that bondholders be repaid a third more than government creditors even though they lent at higher interest rates initially. According to the advocacy group Debt Justice, the disparity of treatment between private and government creditors is a violation of G20 Common Framework requirements, which asks that private creditors give 'at least as favourable' restructuring terms as government creditors.

treatment solutions to nations facing financial distress) and other countries, private sector creditors, as well as borrowing countries. Co-chaired by the IMF, WB and India's Finance Minister (as G20 Presidency), GSDR's objective is to build a common understanding on debt sustainability and debt restructuring at a principle and procedural level.
The GSDR Progress Report was released at the WB-IMF Annual meetings in Marrakech in October this year. Discussions on debt service suspension and treatment of arrears were carried out but concluded without consensus.

Ghana

- Defaulted in December 2022. At the time, its total external debt amounted to US $ 29.1 billion in December 2022.
- Requested assistance under the Common Framework (CF) in January 2023. Ghana aims to restructure US $20 billion of this amount, officials at the IMF Annual meetings in October 2023 stated.
- At the IMF annual meetings in Marrakech, IMF officials mentioned that preparations for reaching an agreement were underway.
- It was stated that a deal to rework debt to China and Paris Club creditors amounting to US $5.4 billion could pave the way for a second disbursement from a 'rescue loan' worth US $3 billion from the IMF.
- As of the publishing of this factsheet a Ghanian debt agreement is at the discussion stage.

Ethiopia

- Ethiopia requested assistance for debt relief under the CF in 2021, but saw the process delayed due to its civil war.
- The Official Creditor Committee (OCC) was formed under the CF in 2021. Since then, it has continued engagement with authorities. Agreements on an IMF support program is underway.
- In November 2023, Ethiopia reached an in-principle agreement with its bilateral creditors on interim debt service suspension for the period of 2023–24. Discussions on restructuring Eurobond worth US $1 billion over the next year are also reportedly underway.
- In August, the country had announced that China (which co-leads its OCC) had allowed the country to suspend debt payments for the year until 7 July 2024. The deal with other bilateral creditors mentioned above is said to be mirroring this previous agreement.

Progress on actual debt restructuring cases was also discussed (see Box 1 and 2).

Experts, including David McNair of the ONE Debt Campaign have said that Zambia's case is noteworthy. Being the first major resolution to come under the G20's Common Framework, it has allowed a precedent to be set. Perhaps other countries can see some relief on their debt distress in the coming years following the progress of this deal, the beginnings of which are already being seen in the cases of Ghana and Ethiopia.

According to Debt Relief for a Green and Inclusive Recovery (DRGR), a multi-stakeholder project working on the links between the debt crisis and transitions to low carbon economies, no real markers of concrete progress were seen this year. DRGR mentioned that the lack of private creditors from most of the deals so far is crucial to note as they comprise the largest creditor group in the Global South. Additionally, though the progress of Zambia, Ethiopia and Ghana could be seen as encouraging, need for the Common Framework to include middle-income countries remains important.[12]

4.3 Fourth meeting of the G20 Finance Ministers and Central Bank Governors

The fourth session of the G20 Finance Ministers and Central Bank Governors Meeting (FMCBG) concluded in Morocco at the World Bank-IMF Annual meetings as well. The communique put forward the latest recommendations from the G20 group on sustainable finance, multilateral development bank (MDB) reform, and addressing debt vulnerabilities, among others. No new reform related actions were put forth, particularly on addressing global sovereign debt.[13] On debt vulnerabilities, the communique merely underlined the groups' continued support for/appreciation of the G20 Common Framework and the Global Sovereign Debt Roundtable discussions for effective debt treatment, efforts of the International Financial Architecture Working Group, and the efforts of other stakeholders, including private creditors, towards enhancing debt transparency.

4.4 Sustainable Debt Coalition

The Finance Ministry of Egypt launched the Sustainable Debt Coalition at COP 27, which aims to reduce green borrowing costs for developing countries and act as a platform for like-minded nations to formulate solutions at the intersection of debt, development and climate change.[14] The recommendations suggested by the coalition on directly addressing debt distress in order to accelerate the potential for climate action have been endorsed by the Ministers of the Economic Commission for Africa. These include, identifying debtor-defined key performance indicators, sustainable budgeting approaches, mechanisms for automatic debt suspensions during climatic events, debt relief guarantees among others. [15]

4.5 Africa Climate Summit

Another development centering voices of the Global South materialized as the Nairobi Declaration on Climate Change and Call to Action, adopted at the conclusion of the Africa Climate Summit held in Kenya in September 2023. African leaders called for promoting the sustainable use of Africa's natural assets to increase investment for the continent's transition to low carbon development. The Declaration emphasized that multilateral finance reform, though important, cannot alone provide the necessary climate funding for the 45 per cent emission reduction required under the Paris 2030 agreements. It also recognized that the national borrowing capacity of the continent does not at present measure up to its needs for achieving 'climate-positive' growth. Leaders advocated for accelerating ongoing initiatives to reform the global financial system, such as the Bridgetown Initiative and Accra-Marrakech Agenda among others. The summit called for a new financing architecture, including debt restructuring and relief and the development of a new 'Global Finance Charter' through the UN General Assembly and COP processes by 2025.[16]

4.6 Global expert review on debt, nature and climate

The spotlight on the debt-climate nexus is likely to continue at COP 28. Colombia, Kenya and France jointly suggested the creation of a 'Global Expert Review on Debt, Nature, and Climate' at the Paris Summit in June 2023.[17] The proposal aimed to form this expert group by the time of COP28, to thoroughly evaluate the impact of sovereign debt on the capacity of low- and middle-income countries to tackle climate change, preserve nature, and transition to low-carbon economies.

4.7 Has the needle on debt shifted?

Despite some movement on debt relief to facilitate raised climate ambition, the lack of engagements with private creditors has remained stark. Zambia still needs to explore ways of participation of its private creditors, for instance. And, none of the forums mentioned above saw active dialogue with this large creditor group. In 2021, private bondholders held 47 per cent of the US $3.6 trillion EMDE debt.[18] Other estimates show that private creditors hold nearly 60 per cent of all Global South debt, further underlining the need for their participation in debt relief.[19] Although the G20 Common Framework for Debt Treatments does include the objective of facilitating private creditor participation, in practice, this does not seem to have occurred.

In fact, the G20 Common Framework's (CF) overall 'uptake' among different creditor groups has been slow. The CF appears to operate on an ad-hoc basis for bringing debtor and creditors together, without clear timelines, leaving room for delays. More importantly, the changing nature of the share of debt held by creditors plays a role as well. With private creditors and MDBs holding a larger share of sovereign debt in recent years, the restructuring efforts have become complicated.[20] According to David McNair of the ONE Debt Campaign, the major challenge stems from the fact that different creditors are not treated on the same terms. Certain creditors are fearful that the relief provided by them may lead to other creditors benefitting unduly by being paid off in full. For instance, the Paris Club does not want its concessions to assist China, and China does not want the same for Western creditors. In these circumstances, the fact that China co-led the Zambian debt restructuring deal is significant, but a lot more of such cooperation is needed to truly provide the scale of debt relief required today.

The three debt deals under the G20 Common Framework demonstrate the only progress in the year since COP 27. Given the scale of the debt crisis across the Global South today, the need to quicken the pace of debt relief measures to allow for climate action remains.

5. INTERNATIONAL FINANCIAL INSTITUTION REFORM: WHERE DO THINGS STAND?

International Financial Institutions (IFIs) are institutions that have been established or sanctioned by more than one government, and therefore are subject to international law. Some of the key IFIs relevant to climate and development finance include the International Monetary Fund (IMF), and the multilateral development banks such as the World Bank (WB), African Development Bank, Inter-American Development Bank etc. Since the Spring Meetings of the WB and IMF in April 2023, discussions on the need and modes of reforming IFIs have gained momentum across forums. Developments among key forums or outcomes in this regard have been detailed in this section. Those discussed are—the Summit for a New Global Financing Pact, World Bank-International Monetary Fund Annual Meetings, the G20 Roadmap for the Implementation of the Independent Review of Multilateral Development Bank (MDB) Capital Adequacy Frameworks, the proposal of rechanneling of Special Drawing Rights through MDBs, and other smaller but significant announcements related to the overarching theme of financial institution reform and its links to unlocking climate ambition.

Table 3: Major developments on IFI reform, June 2023–present

S.No.	Forum	Initiative/Outcome
1	**Summit for a New Global Financing Pact, Paris (June, 2023)**	1. MDB Vision Statement endorsed as main outcome of summit. MDB reform agenda laid out, contentious issues prevailed
		2. WB announced natural disaster clauses for debt suspension in case of extreme weather events
		3. IMF announced US $100 billion SDRs target been achieved
		4. Broad consenus on need for shipping taxes achieved; discussions on financial transactions taxes commenced
2	**G20 New Delhi Summit (September, 2023)**	1. New Delhi Leader's Declaration endorsed: i) 'Technical Assistance Action Plan (TAAP) and the voluntary recommendations made to overcome data-related barriers to climate investments' ii) Annual progress report on the Financial Stability Board's Roadmap for Addressing Financial Risks from Climate iii) Adoption of G20 Roadmap for implementing CAF recommendations iv) Call for continued increase in financial capacity of MDBs, and IMF's commitment to SDR enhancement
		2. Sustainable Finance Working Group recommendations noted
3	**World Bank-IMF Annual Meetings, Marrakech (October, 2023)**	1.WB Evolution Roadmap, the Bank's new approach for addressing crises of development, poverty and climate change highlighted
		2. IMF announced updates on SDRs, progress on Resilience and Sustainability Trust
		3. Africa High-Level Working Group meeting on Global Financial Architecture
		4. Fourth G20 Finance Ministers and Central Bank Governors Meeting released Communique
		5. G20 Independent Expert Group Report Volume 2 released
		6. High level meeting of African Development Bank (AfDB), Inter-American Development Bank (IDB), the Rockefeller Foundation, and the Center for Global Development on rechanelling SDRs through MDBs

5.1 Summit for a New Global Financing Pact

The Summit for a New Global Financing Pact held in Paris in June this year, brought together leaders from at least 40 countries and heads of international institutions to discuss the lack of financial support for developing countries, particularly in the context of climate change. The pact aimed for convergence on the need and mode of moving towards a new financial system. A result of the rallying cry from Barbadian Prime Minister Mia Mottley's Bridgetown Initiative, the summit in Paris was a highly anticipated event.

Although some deemed the affair lacking in enough concrete outcomes, the event spotlighted the Global's

South concerns, the scale of the climate finance problem that lies ahead, as well as an update on the Global North's commitments so far. These included:

- The World Bank announced it would begin using 'natural disaster clauses' that would suspend debt payments in case of extreme weather events, and that an additional US $200 billion would be unlocked for developing countries.
- The IMF announced that it had achieved the US $100 billion target of Special Drawing Rights for rechanneling to vulnerable countries. Although, US $20 billion of this has not yet been passed by the US congress.[21]
- An MDB Vision Statement was signed by 53 countries and more than 10 MDBs. Major points featured in the statement included—need for MDBs to deepen cooperation and work collaboratively, enable voluntary channeling of SDRs through MDBs, preserve focus of concessional finance on low-income countries, scale up private finance through creative tools, etc.[22] Most components of the statement were deemed consistent with existing MDB/IFI 'reform' language, which does not challenge the status quo to a large extent, according to analysis by the Centre for Global Development. [23]
- Role of polluter taxes such as taxes on shipping emissions and financial transactions tax were discussed. Many countries showed support for the former.
- On the long overdue promise of US $100 billion to be provided by developed to developing countries the IMF suggested that 2023 may be the year the target is met.

Despite some movement, the overarching calls for debt cancellation and increased concessional finance by developing country voices seemed to go unheard. Suggestions such as the use of carbon pricing (which may be potentially useful as part of larger packages) made in response to such calls underscored the denial of Western entities of the sheer scale of finance needed, as well as the systemic nature of the issues at hand. The Summit however, has managed to center stage the conversation on the climate-financial reform nexus, with voices from the Global South being represented as well.

This is momentum gained that could prove worthwhile at COP 28.

5.2 World Bank-International Monetary Fund Meetings

World Bank Evolution Roadmap

The World Bank's 'new playbook' for the crises of today is slated to materialize through its Evolution Roadmap. Introduced in January 2023, and highlighted at the annual meetings in Morocco, the Evolution Roadmap (ER) constitutes the WB's vision and framework for reforms to better serve the 'people and planet.'

To begin with, the ER has doubled down on the WB's long standing "cascade approach". This prioritizes private finance over public finance and aims to "mobilize trillions of dollars of private sector capital using billions in public sources". So far used for development needs, the ER suggests the same be applied for advancing the climate finance needs of developing countries.

At the same time, the WB stated progress on the climate front with the announcement that investment in climate finance has tripled from US $11 billion to US $39 billion, direct investments in fossil fuels have been slashed to only US $180 million (0.2 per cent of the previous year's total), and an increase in adaptation financing to being equal to that of mitigation.

On increasing scale and quality of finance and progressing on delivery of climate objectives, the WB Evolution Roadmap includes:

- Increasing the bank's financing capacity by leveraging its balance sheet and mobilizing additional finance
- Increasing its engagement to mobilize private sector capital, and strengthening private sector development
- Increasing the funding capacity of the International Development Agency (IDA), WB's concessional lending arm
- Increasing additional lending capacity over the next decade, above the US $50 billion that has been unlocked based on the CAF recommendations

- Using a new scorecard to measure progress of the bank's achievement of these goals[24]

Additionally, the WB's new playbook includes measures such as increasing collaboration with nine other MDBs to bolster collective efforts on climate (among other common objectives).[25]

Evolution Roadmap: Too little, too slow?

According to David Mcnair of the ONE Debt Campaign, though some of the ER promises could be considered steps in the right direction, the pace and scale are insufficient. Civil Society Representatives present at the WB Annual meetings in Marrakech too highlighted that the ER may use new language, but it doubles down on WB's historical roles. Spotlighting the bank's focus on climate/adaptation explicitly is new, and arguably a welcome move.

Firstly, civil society organizations including the Bretton Woods Project, EURODAD, Third World Network and others have criticized the cascade approach, which is highlighted in the WB ER. They have questioned the efficacy of the cascade in providing concrete results. They have stated that the emphasis on private finance mobilization is a route to abdicate responsibility of developed countries to provide climate funds to developing countries.[26] Crucially, in an analysis of the 2022 Joint Report on Climate Finance published by several MDBs, Joe Thwaites of the US-based environmental advocacy group, Natural Resources Defense Council, showed that in 2021, for every dollar of climate finance provided by MDBs, only 25 cents in private finance was mobilized, (a decrease from 26 cents of the previous year).[27] To be able to mobilize private investments worth trillions of dollars from billions of dollars of public money to fight climate change, this ratio will need to be higher than one.

Secondly, the use of blended finance (an umbrella term for the use of public money for subsidizing private investment) in green initiatives and projects was promoted at the WB Annual meetings, though its performance so far has reportedly been poor. Jon Sward of the Bretton Woods Project illustrates this point with an example: South Africa's Just Energy Transition Investment Plan (JET-IP) has called for the WB-IMF model of privatizing the power sector to ensure a speedy transition to clean energy. The question that has arisen is who is going to pay for transmission infrastructure to connect the renewable energy projects to the rest of the grid, because the private sector cannot due to its low profitability. For IDA-eligible low-income countries in particular, this model does not seem to have worked at all. Western investors are still only interested in products that guarantee at least 10 per cent returns. So, the question of just how much more publicly-backed funding is needed to crowd them in becomes pertinent, particularly given the WB's insistence on not centering government/public finance for such green projects. South Africa's Just Transition Investment Plan has a total financing requirement of almost US $99 billion, one-third of which is expected to come from private sector investments.[28]

Lastly, though the WB ER has stated it will analyze each country's needs individually to inform their approach about the roles of public and private finance going forward, no concrete evidence of the same has emerged so far, said Jon Sward of the Bretton Woods Project.

5.3 International Monetary Fund–Climate Change Commitments

On the IMF's latest developments related to climate action, two broad themes emerged at the annual meetings in Marrakech in October 2023. Managing Director Kristalina Georgieva spotlighted the achievements of the Resilience and Sustainability Trust Facility (RSTF) and emphasized the role of Special Drawing Rights (SDRs) in channeling necessary financial support to countries in need.

Resilience and Sustainability Trust

The IMF works towards ensuring global financial stability and economic growth. Operationalized in October 2022, the Resilience and Sustainability Trust works in alignment with this mandate. It is a fund set up to provide financial assistance to countries whose economies are impacted by shocks such as pandemics or climate change. It provides resources to IMF supported programs under the Resilience and Sustainability Trust Facility (RSTF). In particular, the RSTF provides financing that is to be repaid over a term of 20 years, much longer than usual IMF short-term lending, with a focus on supporting policy reforms and funding of projects that can reduce the risks associated with climate change.

The trust's resources are mobilized through voluntary contributions of IMF members, including through the rechanneling of countries' Special Drawing Rights (SDRs) to low-income and vulnerable countries. Rechanneling SDRs through the RSTF to support economic stability in the face of climate risks has been the IMF's attempt at supporting global climate action. Previously, the Poverty Reduction and Growth Trust of the IMF has also played this role.

The civil society group EURODAD argues that the RST is not accessible to all countries that need additional climate support. Firstly, the RST imposes several policy conditionalities on countries receiving the SDRs, which do not always align with domestic priorities and goals of the Paris Agreement, also heightening the concern that the IMF could be prescriptive in its approach on climate policies despite lacking the needed expertise. Secondly, the fact that access to RST funding is contingent on pre-existing IMF programs in a country, with a minimum of 18 months of operation remaining underscores its onerous nature, said Nabil Abdo of OXFAM. Further, experts have pointed out that countries could count contributions to the RST as part of their climate finance pledges to developing countries.

Most recently, Oman, Luxembourg, Italy and the United Kingdom have finalized agreements with the RST. In total, the agreements provide for about SDR 4.7 billion[29] (the currency valuation of SDRs is linked to a basket of five currencies, US dollar, Euro, Japanese Yen, pound sterling and Chinese renminbi)[30].

Special Drawing Rights

SDRs are a type of reserve asset issued by the IMF to various countries. They are allocated based on countries' IMF quotas. SDRs can be rechanneled or recycled, i.e., transferred from one country to another. Receiver countries can use them for repayment of loans, for exchange of other currencies (Foreign Exchange), meeting balance of payment needs, etc. Due to their lower interest rates and longer maturity periods, they constitute tools for reducing the cost of capital for climate solutions for developing countries. The IMF announced that it had achieved the US $100 billion target for rechanneling SDRs to vulnerable countries at the Paris Summit in June 2023. Although, US $20 billion of this has not yet been passed by the US congress, with no progress on the same as yet.

According to Federico Sibaja of the non-profit Recourse, it is a bit difficult to assess whether these efforts truly constitute contributions towards 'climate finance', i.e., there is little guarantee for rechanneled SDRs being used for tackling climate change. In essence, SDRs are instruments designed to assist countries in responding to liquidity issues (the ability of an entity to convert assets to cash/ to acquire cash), not directly for development needs. He pointed out that as such, many developing countries need them for addressing debt issues. However, since climate change induced shocks and increasing interest rates affect developing countries, this is a tool that can be used for financing climate resilience. According to a UN policy brief on the need for reforming international financial architecture, the issue with SDRs is also the fact that a small share of SDRs have so far actually been allocated to developing countries. The continent of Africa for instance, with a population of 1.4 billion people and over 60 per cent of the world's poor received only 5.2 per cent of the last issuance of SDRs (this was in 2021).[31]

Rechanneling SDRs through MDBs

Rechanneling SDRs through multilateral development banks (MDBs) apart from WB has also gained traction, as was highlighted recently by the high-level meeting of African

Development Bank (AfDB), Inter-American Development Bank (IDB), the Rockefeller Foundation, and the Center for Global Development at sidelines of the IMF-WB Annual meetings in October 2023 in Marrakech. The AfDB and IDB hybrid capital-based proposal for rechanneling SDRs was well received by the IMF, with representatives of countries with unused SDRs expressing their support for the same. They committed to working towards unlocking progress on rechanneling SDRs at COP 28.[32] African Ministers of Finance, Planning and Economic Development have also called for larger reforms to the IMF's SDR system as part of the Africa High-Level Working Group meeting on Global Financial Architecture held in Sharm el-Sheikh earlier this year.[33] The World Bank has also announced its willingness to participate in the re-channeling of SDRs. The notion that such rechanneling could be a catalyst for private capital has been emphasized. This is in line with WB's overall vision of enhancing private capital 'crowd in' through every avenue possible.

5.4 The G20 Processes in 2023

Through the G20 process, an Independent Expert Group (IEG) on Strengthening Multilateral Development Banks was established by India's G20 Presidency in March 2023. Led by Lawrence Summers and N. K. Singh, the group produced two reports during the year with a mandate to lay out an agenda for MDB reform to address the current polycrisis.

The IEG states that MDBs should provide an incremental US $260 billion of the additional annual official financing needed for climate action, of which US $200 billion would be in non-concessional lending, and help mobilize and catalyze most of the associated private finance.

They call for full implementation of the recommendations made in the G20 Capital Adequacy Frameworks report, published during the Italian G20 Presidency that could generate headroom to lend US $80 billion more each year. The IEG also calls for a new mechanism called the Global Challenges Funding Mechanism that "could crowd-in a coalition-of-the-willing among sovereign donors and non-sovereign investors wishing to be associated with specific MDB activities".

Table 4: MDBs updates on CAF recommendations implementation

Under Implementation	To be implemented in the short term (2023/2024)	Preparing to be implemented in the long term (Beyond 2024)	Not largely considered by MDBs[3]
1a Shift risk appetite definition toward shareholder-defined limits.			
AfDB, ADB, AIIB, EBRD, EIB, IDB, IsDB, NDB, WBG			
1b Ensure frameworks account for MDB-specific features.			
AfDB, ADB, AIIB, EBRD, EIB, IDB, IsDB, WBG	**NDB**		
1c Relocate specific numeric leverage targets from MDB statutes.			
	AfDB, ADB, AIIB[4], EBRD, IDB, WBG[5]	EIB[6]	, IsDB, NDB
2a Incorporate a prudent share of callable capital into the calculation of capital adequacy.			
IDB, EBRD, WBG[7]	IsDB[8]		EIB, ADB, AIIB, AfDB, NDB
3a Endorse MDB consideration of non-voting capital classes (paid-in equity or hybrid) to contribute to available capital.			
	AfDB, WBG, ADB	EBRD, IDB, NDB,	AIIB, EIB, IsDB
3b Introduce & scale portfolio risk transfers to the private sector, including through outright shares, insurance and securitization. *Note: mostly implemented in a different way through portfolio risk transfers between MDBs and risk transfers to private sector.*			
AfDB, ADB, AIIB, IDB, EBRD, WBG	IsDB, NDB	EIB	
3c Encourage shareholder guarantees on loans related to crosscutting priorities.			
AfDB, ADB, EBRD, EIB, IDB, WBG	AIIB, IsDB	NDB	
3d Support collective shareholders commitments of pools of additional callable capital.			
	AfDB	WBG	ADB, AIIB, EBRD, EIB, IDB, IsDB, NDB
3e Support adaptation of MIGA's products & reinsurance capability to transfer portfolio level risk from MDB balance sheets.			
		AfDB, EBRD, IDB, NDB	ADB, EIB, AIIB, IsDB
3f Consider ways to provide MDBs access to central bank liquidity.			
EIB, IsDB[9]		IDB	AfDB, ADB, AIIB, WBG, EBRD, NDB
4a Strengthen communication with credit rating agencies.			
AfDB, EBRD, EIB, AIIB, IDB, IsDB, NDB, WBG, ADB			
4b Encourage steps by rating agencies to strengthen their MDB evaluation methodologies.			
	AfDB, ADB, AIIB, EBRD, EIB, IDB, IsDB, NDB, WBG		
4c Take proactive approach to incorporation of ESG factors in rating methodologies.			
WBG	AIIB, EIB, IDB, IsDB, NDB	EBRD	AfDB, ADB,
5a Strengthen the ability of shareholder boards to effectively set parameters of capital adequacy policies and overseeing their implementation.			
WBG, EBRD, EIB, AIIB	, IDB, IsDB, NDB		ADB, AfDB,
5b Establish yearly capital benchmarking report presenting key elements & data in comparable format with harmonized definitions. Support regular reviews of capital resources.			
EIB	AfDB, ADB, AIIB, EBRD, IDB, IsDB, NDB, WBG		
5c Establish enhanced dialogue and cooperation on capital adequacy and risk management.			
EIB, EBRD	AfDB, ADB, AIIB, IDB, IsDB, NDB, WBG		
5d Transform GEMs into stand-alone entity to support improved knowledge for MDBs, private investors and CRAs.			
	AfDB, ADB, AIIB, EBRD, EIB, IDB, IsDB, NDB, WBG		

Above all, the need to increase the capital base of MDBs is reiterated, stating that it should occur concurrently with the balance sheet optimization procedures of the CAF report.

In July 2023, the G20 also released its 'Roadmap for Implementation of the Recommendations of G20 Independent Review of Multilateral Development Banks' Capital Adequacy Frameworks', which provided some updates on the capital adequacy framework (CAF) reforms being implemented by different MDBs, as per the recommendations put forth under the Italian G20 Presidency. These are detailed in the Table 4.

5.5 Has the needle shifted on IFI reform?

In April 2023, the WB announced that it had found a way to 'squeeze' out US $40 billion over 10 years by adjusting its loan to equity ratio. At the Annual meetings in October 2023, it was stated that the WB had successfully created up to US $50 billion of additional lending capacity over the next 10 years through existing resources, by implementing the G20 Capital Adequacy Frameworks recommendations.[34, 35]

WB also announced that through the launch of new financial tools and mechanisms which could help it provide over US $157 billion in lending capacity over the next decade.[36] The addition of US $10 billion signals progress, but the compared the scale of what is needed, and to the Bank's own ambitious goals, the pace is arguably still quite slow.

Overall, increasing the capital base of MDBs remains a contentious issue. Developing countries like India mentioned at the Paris Summit for a New Global Financing Pact, the importance of increasing MDBs' capital base. Indian Finance Minister Nirmala Sitharaman pointed out that MDBs are "being asked by non-borrowing shareholders to address transboundary challenges alongside their core development mandate". Thus, the pressure on MDBs' resources will increase manifold, and the G20 Capital Adequacy Framework recommendations, while welcomed, are still not enough due to the scale and scope of development challenges, she added. This reveals the politics at the core of the MDB reform discussion, where developed countries want to squeeze more out of existing MDB resources while simultaneously adding on climate as a part of their mandate. US Treasury Secretary Janet Yellen assured all at the Summit that evolving the MDBs is not about displacing their institutional core development and poverty work, but about building resilience to shocks. However, developed countries are resistant to paying in more money from their budgets and risking more influence from large economies like India and China if their paid-in share rises. Experts such as economist Rakesh Mohan have suggested that increasing the paid-in capital of MDBs is a low-hanging fruit that developed countries are dragging their feet on. He suggests that if all countries can double paid-in capital to US $40 billion, you can unleash another US $200 billion of lending capacity.

On the larger issues of IFIs, one of the oldest critiques of the IMF in particular has been the lack of fair and equitable representation of countries within these institutions. In this regard, the IMF announced that it has called for the creation of a 25th chair on the IMF Executive Board for Sub-Saharan Africa, in an attempt to improve the regional representation imbalance.[37] Additionally, the 16th general review of IMF quotas is scheduled to be completed by December 2023. Quotas indicate the contributions that member countries provide to the fund, and in turn determine each member's voting power and access to funds. Whether the review is used as an opportunity to expand IMF lending capacity and improve developing country voice representation will have to be assessed.[38]

6. COST OF CAPITAL

High cost of capital has acted as a barrier to accessing climate finance for countries most in need. The cost of capital is described as the costs incurred by an entity to access funding for a new project. Developing countries are perceived as having high risk environments and are therefore subject to higher costs of borrowing. One of the major barriers faced by developing countries is the high cost of capital for renewable/ clean energy projects, thus making the energy transition

Table 5: Developments related to cost of capital as barrier to climate ambition

S.No.	Forum	Initiative/Outcome
1	UNFCCC SP 58 (Bonn Climate Change Conference, Jun 2023)	1. Mitigation: Inclusion of Mitigation Work Program in agenda highly contentious issue, finally was not accepted
		2. Adaptation: Discussions on Global Goal on Adaptation Framework, Adaptation Committee, Nairobi Work Programme and National Adaptation Plans (NAPs) also held
2	Summit for Global Financing Pact, Paris (Jun 2023)	1. Barbados special envoy Avinash Persaud introduces Partial FX Guarantee Mechanism for reducing cost of capital for renewable energy projects
		2. Limited discussion on IMF SDR targets
3	Mitigation Work Programme	1. First global dialogue and investment focused event: accelerating just energy transition
		2. Second global dialogue and investment focused event: accelerating just energy transitions in transport systems
4	Climate Ambition Summit, New York (Sep 2023)	1. Countries called to pledge to Green Climate Fund

a tough task in often already precarious circumstances. Over the year since COP27, in addition to all the milestones mentioned above, some standalone developments pertaining to cost of capital issues for addressing climate change have emerged. These are detailed below.

6.1 Partial Forex Guarantee for lowering cost of capital

Avinash Persaud, climate finance envoy to Barbados Prime Minister Mia Mottley proposed a new tool for enhancing access to affordable finance for renewable energy projects for emerging and developing economies. Discussed at the Summit for a New Global Financing Pact in Paris in June 2023, the paper proposed a 'Partial forex (FX) Guarantee Mechanism' to increase affordability of finance for renewable energy projects for emerging economies. The paper divides cost of capital into three parts, namely, risk-free rate of return required by investors, and macro and micro-risk premiums. Macro-risk premiums comprise factors like sovereign credit risk, political instability, and currency risks, which lead to higher yields demanded by investors from developing countries. On micro-risk premiums, the paper notes that in developing countries, they are comparable or smaller than those in developed countries. Thus, the role of macro-risk premiums in increasing the cost of capital for emerging economies is significant. Additionally, the paper suggests that macro-risks are often overestimated, thereby further stressing the need to mitigate these in order to lower the cost of capital for emerging economies. Foreign exchange (FX) markets act as a proxy for other macro-risks. With this premise, the paper calculated the cost of hedging foreign currency risks to analyse the overestimation of macro-risks. Hedging cost is the price paid by an investor to protect itself against currency exchange rate fluctuations. It is the difference between future price and current price for exchanging currencies, and is expressed as a percentage of the total amount being exchanged by an investor. The paper found that historically, an overpayment of average 2.2 per cent per annum has been made on FX hedges, when the cost is below the three-year moving average.

The solution proposed is the 'Partial FX Guarantee Mechanism', to be implemented by a joint agency of MDBs and the IMF, which can provide partial FX guarantees and pool currency risks strategically to avoid losses. Persaud suggested that the agency could wait until the hedging costs were above the three-year average in order to avoid losses. The agency could help investors by providing reduced hedging costs that account for historic excesses, and cutting market expenses in half and shielding against future currency risks. This could make it cheaper for developing countries to access funding and attract investors.[39]

6.2 UNFCCC Mitigation Ambition and Implementation Work Program

First Global Dialogue and Investment Focused Event
Established at COP 27 in Sharm el-Sheikh, the objective of the Mitigation Ambition and Implementation Work Program (MWP) is to accelerate progress towards implementing just energy transitions worldwide, with a focus on scaling mitigation efforts in this critical decade. The first global dialogue under the MWP took place in conjunction with the

Bonn climate change conference of SP 58 in June this year. Youba Sokona, Vice-Chair of the Intergovernmental Panel on Climate Change (IPCC), highlighted that despite progress in reducing greenhouse gas (GHG) emissions, the world is not on track to meet the goal of keeping warming to 1.5 °C with current policies projected to lead to an increase of up to 3.2 °C. He added that CO2 emissions from energy and industry represent the largest share of GHGs, which is only going to increase. Against this urgency, the Parties discussed solutions, opportunities and challenges on enhancing efforts towards clean energy transitions. Interventions relating to capital cost barriers of clean energy technologies and broader climate finance included[40]:

- Participants noted that though the cost of renewable energy (RE) technologies has fallen sharply, their deployment remains concentrated in few regions. Options for energy storage, access to finance and technologies, and costs of enabling technologies, need to be prioritized, particularly in countries which are not transitioning their energy system but building them
- It was highlighted that concessional and grant finance is needed, especially for developing countries, as access to affordable finance for RE was mentioned as a key barrier.
- It was highlighted that public finance is essential for the energy transition and should be used to crowd in additional capital, including private capital. Parties stated that risk mitigation instruments such as guarantees, currency hedging instruments and liquidity reserve facilities will continue to play a crucial role in addressing real and perceived barriers to investment. It was added that public finance and policy environments must go beyond risk mitigation, for example, by including support for pilot projects, capacity-building and blended finance initiatives.
- Participants discussed that private sector investment in energy infrastructure remains insufficient, with most grid and storage plans relying on government investment.
- Finance expert Chienyen Goh highlighted that cost of financing has increased in sub-Saharan Africa, reflecting a

higher risk profile for low-income countries in the region.
- Some participants emphasized that scaling up mitigation ambition in developing countries 'is contingent upon the provision and mobilization of finance from developed countries, which should be new and additional, predictable and primarily grant-based and concessional.'
- Participants called for the use of innovative climate finance instruments for countries with high levels of investment risk. Blended finance as a tool for de-risking investments, and debt-for-climate swaps were suggested
- Examples of collaborative efforts were shared, such as the Just Energy Transition Partnerships; the Danish Energy Agency 'one-stop shop' approach; large-scale financing for renewable energy in China; blended finance platforms in the United States of America; the multidimensional vulnerability index for vulnerable countries; and the forthcoming handbook on blended finance from the Network of Central Banks and Supervisors for Greening the Financial System, etc.
- It was acknowledged that even though RE and batteries are cost competitive, the challenge of substantial capital costs remains.

Second Global Dialogue and Investment Focused Event

More recently, the second global dialogue and investment-focused event under the MWP took place in October this year. The focus of the second dialogue was on accelerating just energy transition in transport systems. Interventions relating to financing the same during the event included the following.

1. Insights on barriers and challenges on financing just energy transition in transport by the World Bank Group (WBG):
    - It is the hardest to finance clean transport as part of the energy transition
    - WBG released a flagship study at COP27 last year, according to which the economic case for electrification of transport was found viable in half of countries they studied. It noted that though capital costs are still high

for many countries, it is expected to reduce by 30-40 per cent in due time.

- There is not enough money to finance the transition of transport, so innovative financing methods need to be used.
- On why there is a high capital cost for cleaner vehicles and mobility services in developing countries, among others, the representative mentioned that from the demand side, vehicle sales markets are fragmented and do not have large-enough demand to attract investment or lending from financial institutions and investors. Whereas from the supply side, domestic financial institutions perceive high risk in lending to vehicles and mobile assets.

2. Insights on Climate Finance for Equitable Transitions by representatives from University of Warwick:
   - The cost of energy transition is not just the cost of projects such as electrification of infrastructure. It includes the cost of mitigating the impact of transition on impacted communities, such as transport workers, commuters etc., and cost of enhancing their adaptive capacities, such as through upskilling workers, implementing climate resilience planning etc.
   - Finance for just energy transition in transport sector must acknowledge the disproportionately high cost of finance for developing countries, particularly low-income countries and SIDS, and other climate-vulnerable countries. The representative mentioned two issues here: high borrowing costs, and existing debt service burdens of countries (which are the highest they have been in decades).
   - Transition financing should also account for the disproportionately high costs of an 'unjust' or disorderly energy transition in the transport sector for developing countries. For instance, costs that could be incurred as a result of stranded assets, displaced workers, possibility of economic stagnation, and environmental externalities.

- Financing must be accompanied by technology transfers and capacity building
- On the challenges of financing energy transition in the transport sector, the representative mentioned:

- Reliance on debt instruments and private finance could pose challenges, as it creates legal, regulatory financial risks particularly for developing countries.On increasing reliance on international capital
- Markets for financing the transition, it was stated that diversification of the creditor base should be considered in context of gaps of existing sovereign debt architecture which has led to protracted and often messy restructuring when countries face sovereign debt crisis, which are difficult to extricate. This should be considered if shift from public to private based finance is to be considered.
- It was also reiterated that since private investors are interested in commercial returns, this might be a gap in the case of transport sector transition

- The representative recommended that financing of the just energy transition should be a part of a broader package of reforms to current systems of global economic governance and international law, including how debt burdens of developing countries are dealt with.

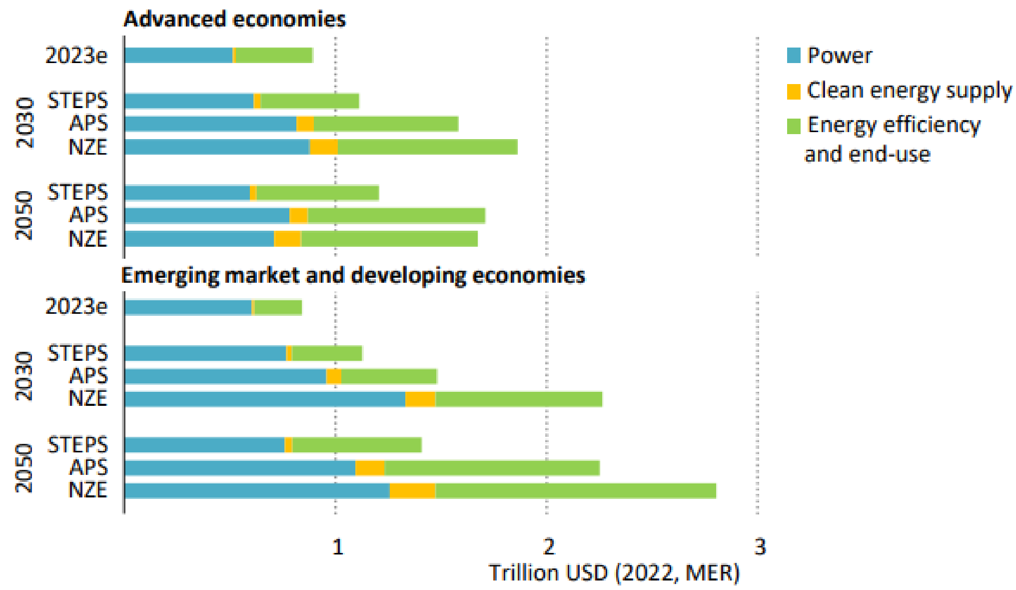
6.3 IEA shows that clean energy investment on the rise, but emerging economies' needs are much larger

The International Energy Agency's (IEA) flagship report, World Energy Outlook 2023 published in October 2023 highlighted the latest trends in renewable and clean energy investment. The report noted over 500 gigawatts (GW) of renewable generation capacity is set to be added in 2023. The report notes the need to rapidly scale clean energy investment, particularly in emerging markets and developing economies (EMDEs) excluding China. It states that from 2015 to 2022, advanced economies and China saw over 95 per cent of global electric car and heat pump sales, along with nearly 85 per cent of wind and solar capacity addition worldwide. In order to achieve Net Zero goals, EMDEs need a fivefold increase in clean energy spending from 2022 levels by 2030, the report states.

The report notes that the current higher interest rate environment has increased financing costs for energy, and this has impacted capital-intensive clean energy technologies to a large extent. In particular, EMDEs are struggling with high costs owing to the higher base rates which push up the cost of capital. The figure below shows that clean energy investment gaps are largest in emerging market and developing economies. The IEA suggests a combination of policy reforms and de-risking measures such as revenue guarantees, currency hedging, and first loss guarantees to address both real and perceived project risks and country risks.

Figure 2 shows the investment in clean energy for each scenario presented in the report, i.e., the Net Zero Emissions (NZE), Stated Policy Scenario (STEPS), and Announced Pledges Scenario (APS).

Figure 2: Investment in clean energy by scenario, 2030 and 2050



The report notes that 80 per cent of financial assets are held by advanced economies today, and calls upon the need to transform global financial architecture to meet future energy transition investment needs. In the Net Zero Emissions scenario, the report sees increased private sector backed financing, domestic financing, and more concessional finance from Development Finance Institutions along with tools such as carbon markets to contribute to closing the investment gap in EMDEs.

6.4 UN policy brief on reforms to International Financial Architecture

A UN policy brief on reforming international financial architecture identified the need to make reforms that respond to capital market volatility to safeguard developing countries as well. It provides suggestions to promote cooperation among countries to, among other objectives, promote market risk perceptions. The suggestions include coordination among countries when designing monetary policies (such as interest rates). It stressed the need for source countries of capital flows to actively work towards reducing volatility by designing exchange rate policies, capital flow management measures etc.

7. CONCLUSION

This question of financial systems transformation or reforms to the international financial architecture has come into the spotlight in recent years, catalysed by Barbados Prime Minister Mia Mottley's call for reforms through the Bridgetown Agenda. At COP 27 in 2022, language in the Sharm el-Sheikh Implementation Plan called for "a transformation of the financial system and its structures and processes" and a reform of MDBs to be "fit for the purpose of adequately addressing the global climate emergency".

As a result, 2023 saw a number of major fora that brought together two vital communities: development finance and the climate policy communities. From the World Bank and IMF meetings to the Summit for a New Global Financing Pact in Paris, to the G20 Summit - these questions of deep systemic transformations that are needed to enable climate ambition and development in the Global South were prominent everywhere. Questions about the debt crisis, the need to reform MDBs, the high cost of capital for green technologies have come into the vocabulary and demands of civil society and leaders and this is a positive shift.

However, progress remains slow. The needle still needs to move further to produce transformative outcomes that will result in real debt cancellation and scaling up of concessional and grant-based finance for the Global South.

In August 2023, the UAE COP 28 Presidency convened a meeting of world leading economists and finance leaders from the Independent High Level Expert Group (IHEG) with figures from leading global institutions including the World Bank, IMF, ECF and IFC, UN Climate Change High-Level Champions for two days in Abu Dhabi. The meeting concluded with experts agreeing to bring a new framework for climate finance to COP 28 along with a roadmap to implement it. Discussions at COP 28 must further the demands of Global South leaders for financial system reforms to meet the scale of the current crises.

REFERENCES

1. Anon 2022. *Sharm el-Sheikh Implementation Plan*. United Nations Framework Convention on Climate Change. Accessed at: https://unfccc.int/sites/default/files/resource/cop27_auv_2_cover%20decision.pdf
2. Anon 2021. *UNFCCC Standing Committee on Finance*. United Nations Framework Convention on Climate Change. Accessed at: https://unfccc.int/sites/default/files/resource/54307_2%20-%20UNFCCC%20First%20NDR%20technical%20report%20-%20web%20%28004%29.pdf
3. Anon n.d. *Signal Spotlight*. UNDP. Accessed at: https://www.undp.org/future-development/signals-spotlight/climate-changing-financial-system
4. B. Buchner, B. Naran, R. Padmanabhi et al 2023. *Global Landscape of Climate Finance 2023*. Climate Policy Initiative. Accessed at: https://www.climatepolicyinitiative.org/wp-content/uploads/2023/11/Global-Landscape-of-Climate-Finance-2023.pdf
5. Sultan Ahmed Al Jaber 2023. *COP Presidency letter to the Parties*. United Nations Framework Convention on Climate Change. Accessed at: https://unfccc.int/sites/default/files/resource/COP28_Letter_July_2023_1.pdf
6. Anon 2023. *Aggregate trends for 2013–21*. OECD. Accessed at: https://www.oecd.org/climate-change/finance-usd-100-billion-goal/#:~:text=The%20most%20recent%20one%2C%20released,be%20met%20as%20of%202023.
7. Anon 2023. *The worst ever global debt crisis*. Debt Service Watch briefing. Nation Builder. Accessed at: https://www.development-finance.org/files/Debt_Service_Watch_Briefing_Final_Word_EN_0910.pdf
8. Anon 2023. *Climate Prosperity Plans*. The Vulnerable Twenty (V20) Group. Accessed at: www.v-20.org/climate-prosperity-plans
9. Anon 2023. *Accra-Marrakech Agenda*. The Vulnerable Twenty (V20) Group. Accessed at: https://www.v-20.org/accra-marrakech-agenda
10. Anon 2023. *Collective Statement. Emergency Coalition for Debt Sustainability and Climate Prosperity*. The Vulnerable Twenty (V20) Group. Accessed at: https://www.v-20.org/our-voice/statements/group/v20-statement-on-emergency-coalition-for-debt-sustainability-and-climate-prosperity
11. Nabiha Shahab and Denise Fontanilla 2023. *V20 Ministerial Dialogue: XI Securing Shared Prosperity and Sustainable Development in a Climate Insecure World*. Institute for Climate and Sustainable Studies. Accessed at: https://icsc.ngo/v20-ministerial-dialogue-xi-securing-shared-prosperity-and-sustainable-development-in-a-climate-insecure-world-v20/
12. Sarah Ribbert and Arabella Wintermayr 2023. *The Annual Meetings: A Missed Opportunity to Provide a Systemic Response to a Systemic Problem*.

Debt Relief for Green and Inclusive Recovery. Accessed at: https://drgr.org/news/the-2023-imf-world-bank-group-annual-meetings-in-marrakech/

13. Anon 2023. *Communiqué. Fourth G20 Finance Ministers and Central Bank Governors Meeting*. G20 Accessed at: https://www.g20.org/content/dam/gtwenty/gtwenty_new/document/Final_G20_FMCBG_October_2023_Communique.pdf
14. Anon 2023. *The Sustainable Debt Coalition. United Nations Economic Commission for Africa*. Accessed at: https://www.uneca.org/eca-events/sustainable-debt-coalition
15. Anon 2023. *Roundtable discussion with the sustainable debt coalition and friends*. United Nations Economic Commission for Africa. Accessed at: , https://www.uneca.org/stories/roundtable-discussion-with-the-sustainable-debt-coalition-and-friends
16. Anon 2023. *Africa Climate Summit: Nairobi Declaration makes strong push for accelerated climate action and financing mechanisms*. United Nations. Accessed at: https://www.un.org/africarenewal/magazine/september-2023/africa-climate-summit-nairobi-declaration-makes-strong-push-accelerated
17. Luma Ramos, Rebecca Ray Rishikesh Ram Bhandary, et al. 2023. *Debt Relief for a green and inclusive recovery: Guaranteeing Sustainable Development*. Boston University. Accessed at: https://www.bu.edu/gdp/files/2023/05/DRGR_Report_May_2023_FIN.pdf
18. Matthias Goldmann 2022. *Solving global debt crises, involving private creditors – the role of national legislation in G7 countries*. Friedrich-Ebert-Stiftung Foundation. Accessed at: https://www.fes.de/en/shaping-a-just-world/article-in-shaping-a-just-world/solving-global-debt-crises-involving-private-creditors-the-role-oft-national-legislation-in-g7-countries#:~:text=Private%20creditors%20hold%20more%20than,to%20participate%20in%20debt%20relief
19. Rakan Aboneaaj , Jocilyn Estes and Clemence Landers 2022. *The ABCs of Sovereign Debt Relief*. Centre for Global Development. Accessed at: https://www.cgdev.org/publication/abcs-sovereign-debt-relief
20. Avantika Goswami and Ananya Anoop Rao 2023. *Paris finance meet: Key takeaways from a summit that showed the scale of the challenge*. Down to Earth. Accessed at: https://www.downtoearth.org.in/news/climate-change/paris-finance-meet-key-takeaways-from-a-summit-that-showed-the-scale-of-the-challenge-ahead-9023
21. Anon 2023. Multilateral Development Banks vision statement. Official website of the French Presidency. Accessed at: https://www.elysee.fr/en/emmanuel-macron/2023/06/23/multilateral-development-banks-vision-statement#:~:text=We%20believe%20that%20the%20fight,%2C%20fragility)%20are%20mutually%20reinforcing.

22. Karen Mathiasen 2023. Key Takeaways from the Paris Declaration on Multilateral Development Banks. Centre for Global Development. Accessed at: https://www.cgdev.org/blog/key-takeaways-paris-declaration-multilateral-development-banks
23. Anon 2023. Ending Poverty on a Livable Planet: Report to Governors on World Bank Evolution. International Monetary Fund. Accessed at: https://www.devcommittee.org/content/dam/sites/devcommittee/doc/documents/2023/Final%20Updated%20Evolution%20Paper%20DC2023-0003.pdf
24. Anon 2023. World Bank Announces Historic Collaboration Between Multilateral Development Banks. The World Bank website. Accessed at: https://www.worldbank.org/en/news/press-release/2023/10/13/world-bank-announces-historic-collaboration-between-multilateral-development-banks
25. Anon 2023. Civil Society calls for rethink of World Bank's Evolution Roadmap as part of wider reforms to highly unequal global financial architecture. Bretton woods Projects. Accessed at: https://www.brettonwoodsproject.org/wp-content/uploads/2023/07/CSO-reaction-to-WBG-evolution-roadmap_FINAL-1.pdf
26. Joe Thwaites 2022. The Good, the Bad and the Urgent: MDB Climate Finance in '21. Natural Resources Defense Council. Accessed at: https://www.nrdc.org/bio/joe-thwaites/good-bad-and-urgent-mdb-climate-finance-21
27. Anon 2022. Debt-Funded Energy Transition Schemes Unlikely to Weigh on EM Credit Profiles. Fitch Ratings. Accessed at: https://www.fitchratings.com/research/sovereigns/debt-funded-energy-transition-schemes-unlikely-to-weigh-on-em-credit-profiles-11-11-2022
28. Linda Kaltani, Jonathan Swanepoel et al 2023. Resilience and Sustainability Trust – 2023 Contribution Agreements with Italy, Luxembourg, Oman, and the United Kingdom. International Monetary Fund. Accessed at: https://www.imf.org/en/Publications/Policy-Papers/Issues/2023/11/04/Resilience-and-Sustainability-Trust-2023-Contribution-Agreements-with-Italy-Luxembourg-Oman-541020
29. Anon 2023. SDR valuation. International Monetary Fund. Accessed at: https://www.imf.org/external/np/fin/data/rms_sdrv.aspx
30. Anon 2023. Our Common Agenda Policy Brief 6. Reforms to the International Financial Architecture. United Nations. Accessed at: https://sdgs.un.org/sites/default/files/2023-08/our-common-agenda-policy-brief-international-finance-architecture-en.pdf
31. Anon 2023. Marrakech Meeting on SDRs Rechanneling: Accelerating Development Finance Through Multilateral Development Banks. African Development Group. Accessed at: https://www.afdb.org/en/news-and-

events/press-releases/marrakech-meeting-sdrs-rechanneling-accelerating-development-finance-through-multilateral-development-banks-65249#:~:text=The%20African%20Development%20Bank%20

32. Anon 2023. African Ministers call for reforms of the IMF's Special Drawing Rights system. United Nations Economic Commission for Africa. Accessed at: https://www.uneca.org/stories/african-ministers-call-for-reforms-of-the-imf%E2%80%99s-special-drawing-rights-system
33. Mohamed bin Hadi Al Hussaini 2023. Chair's Statement: 108th Meeting of the Development Committee. Development Committee, International Monetary Fund. Accessed at: https://www.devcommittee.org/content/dam/sites/devcommittee/doc/statements/DC-S2023%200068%20DC%20Chair%20Fall%20Statement%20final.pdf
34. Anon 2023. Ending Poverty on a Livable Planet: Report to Governors on World Bank Evolution. Development Committee, International Monetary Fund. Accessed at: https://www.devcommittee.org/content/dam/sites/devcommittee/doc/documents/2023/Final%20Updated%20Evolution%20Paper%20DC2023-0003.pdf
35. Anon 2023. World Bank Annual Summary. The World Bank. Accessed at: https://www.worldbank.org/en/news/immersive-story/2023/10/13/world-bank-president-on-ending-poverty-on-a-livable-planet
36. Nadia Calviño 2023. Chair's Statement: Forty-Eighth Meeting of the IMFC. International Monetary Fund. Accessed at: https://www.imf.org/en/News/Articles/2023/10/14/pr23353-chairs-statement-forty-eighth-meeting-of-the-imfc
37. Anon 2023. Our Common Agenda Policy Brief 6. Reforms to the International Financial Architecture. United Nations. Accessed at: https://sdgs.un.org/sites/default/files/2023-08/our-common-agenda-policy-brief-international-finance-architecture-en.pdf
38. Ananya Anoop Rao 2023. Paris finance meet: Barbados envoy proposes tool to make green finance affordable. Down to Earth. Accessed at: https://www.downtoearth.org.in/news/climate-change/paris-finance-meet-barbados-envoy-proposes-tool-to-make-green-finance-affordable-90206
39. Anon 2023. Report on the first global dialogue under the Sharm el-Sheikh mitigation ambition and implementation work programme. United Antions Framework Convention on Climate Change. Accessed at: https://unfccc.int/sites/default/files/resource/MWP_GD1_report.pdf

Centre for Science and Environment
41, Tughlakabad Institutional Area, New Delhi 110 062
Phones: 91-11-40616000 Fax: 91-11-29955879
E-mail: cseindia@cseindia.org Website: www.cseindia.org