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The conundrum of climate financing

Where is the finance for sustainable, resilient, innovative solutions?

Discussion paper
Overview

While the prevailing narrative on climate finance has long been one of insufficient resources, recent developments reveal there is money, yet it remains largely uncommitted to climate action. The world is struggling to raise adequate funds to integrate climate adaptation into development activities and mitigate emissions in hard-to-abate sectors.

This raises critical questions: why do nations readily mobilise vast sums of money for defence and military aid, witness substantial investments in the expansion of the global space economy, and how did they manage to respond to the Covid-19 pandemic with such speed and volume, yet falter in their efforts to raise sufficient resources to combat climate change?

This discussion paper intends to start a conversation by proposing some foundations for just climate financing. It asks what needs to change to help actors navigate the climate finance gridlock and presents some suggestions for ways we might move forward.

These issues are relevant for discussions in Addis Ababa and online at the fifth Africa Climate Talk, at the Global Solutions Summit in May, the Bonn Climate Change Conference, and then at COP 29 in Azerbaijan. Development Initiatives (DI) is working to improve the definitions and tracking of climate finance, but we know the scope of these issues is much wider, involving global financial architecture reform experts, researchers, climate negotiators and civil society organisations working on climate justice and global financial architecture reform.
Estimates show that the needs are staggering

Several estimates indicate that a staggering amount of financing is needed to support meaningful climate action in developing countries. The report of the Independent High-Level Expert Group on Climate Finance noted that emerging and developing economies, excluding China, will need to spend US$2.4 trillion per year by 2030, based on certain specific investments and priorities of the countries.1

What is required for adaptation is more than current financial provisions. The 2023 Adaptation Gap Report2 suggested that developing countries require between US$194 billion and US$366 billion per year to adapt to climate change. This is estimated to be 10–18 times more than the current provision of international public adaptation finance.

The UN Economic Commission for Africa recently declared that African countries, whose contributions to the climate crisis are relatively minimal, require close to US$3 trillion to implement their Nationally Determined Contributions.3

US$400 billion per year is estimated to be required to cover the financial cost of loss and damage alone in developing countries.4 So far, the Loss and Damage Fund has managed to attract pledges from 18 countries and the EU, totalling US$661.90 million.5 However, of these total pledges, US$115.3 million is supposed to be for setting up the fund,6 indicating that the current pledges so far are a drop in the ocean in addressing the magnitude of loss and damage.

The good news: there is plenty of money. The bad news: just not for climate action

The issue is not a lack of money; rather, it’s a matter of organising available funds in a way that closes the climate financing gap and allows for impactful, long-term climate action.7 For example, it was recently reported that every year, financial transaction taxes raise US$30 billion.8

Despite claims of financial scarcity, substantial sums are being spent on military interventions and the expansion of space exploration. Global defence spending reached US$2.2 trillion in 2023 (up by 9% from 2022).9 The global space economy is expected to grow from its current US$630 billion (in 2023) to US$1.8 trillion (by 2035), surpassing the growth rate of global GDP. Since the beginning of 2022, military aid to Ukraine from the US, UK and EU has reached a total of US$69.2 billion. The Covid-19 pandemic crisis also showed that it is possible to mobilise trillions of US dollars when the problem is perceived to be urgent and significant enough. Figure 1 puts these figures in the context of climate needs.
Figure 1: Climate finance requirements compared with other funds raised

| Fund mobilised for Loss and Damage (by Dec 2023) | 0.7 |
| Military assistance to Ukraine (by Mar 2024) | 69.2 |
| Public climate finance by developed countries (by 2021) | 89.6 |
| Global space economy (by 2023) | 630.0 |
| Global defence spending (2023) | 2,200.0 |
| G20 advanced and emerging economies Covid-19 global fiscal support (by April 2020) | 8,000.0 |

US$ billions


Note 3: Public climate finance includes both bilateral and multilateral finances from developed countries to developing countries up to 2021. Data Source: OECD.

Note 4: Military assistance to Ukraine between February 2022 and March 2024. Military assistance from the US allocated US$44.2 billion and US$300 million in packages of extraordinary military assistance approved in March 2024. The UK allocated £7.1 billion (equivalent to US$9.5 billion) and the UK government announced a further £2.5 billion (equivalent to US$3.2 billion) of funding for 2024/25. The EU has committed €11.1 billion (or equivalent to US$12 billion of EPF (by March 2024). US$ conversion rates using historical exchange rates. Data Source: UK Parliament House of Commons Library.

Note 5: Figure for Loss and Damage is based on pledges made by 18 countries and the EU by Dec 2023. Data Source: NORDC.

Note 6: Covid-19 global fiscal support from G20 advanced and emerging market economies as of April 2020. Data source: IMF.
We do not even know how much is invested in climate action

There is no common definition, rigorous methodology or standard reporting approach

Without clear, agreed-upon definitions, rigorous accounting methodologies and standard reporting approaches, we cannot know how much is being genuinely invested in the name of climate finance.¹⁰

Furthermore, we lack a clear understanding of the impacts of climate investments because we are not asking the right questions. We expect a ‘yes or no’ answer to the question of whether an activity has a climate mitigation/adaptation objective and whether this activity will be carried out with or without the climate objective. Clearer methodologies for identifying the net contribution/impact of a climate project would help address this issue.

In some cases, pledges do not translate into actual disbursements¹¹ and, when they do, there is no guarantee that they are “new and additional” funds as directed by Article 4.3 of the United Nations Framework Convention on Climate Change (UNFCCC)¹² and Copenhagen Accord.¹³ However, it is not clear what ‘new and additional’ means. This could simply mean new disbursements made during the year,¹⁴ but there is no agreed-upon reporting methodology.

The US$100 billion story

The political figure of US$100 billion per year pledged by developed countries at COP15 in Copenhagen (2009) was perhaps met in 2020.¹⁵ However, in the absence of agreed definitions of what constitutes climate finance, inconsistent reporting practices have a substantial impact on whether targets are deemed to have been met.¹⁶ Even when investments are made towards climate activities, it is unclear what direct impact they have on actual climate action, and that is before considering whether numbers are being misreported, or whether funding is new and additional.

A recent investigative report from Reuters revealed that US$2.6 billion reported as climate finance had been used to fund ‘climate’ projects that supported opening chocolate and gelato stores, expanding a coastal hotel, producing a love story film, building a coal plant and expanding an airport.¹⁷

Climate finance data can also be – accidentally or deliberately – misreported. A recent investigation by DI into climate finance reporting practices found that 20% of the World
Bank’s projects (worth US$5 billion over five years) might have been labelled incorrectly as climate finance.\textsuperscript{18}

\textbf{Getting started right: Foundations for just climate financing}

It is evident that current approaches to delivering long-term, risk-tolerant funds for climate action in low-income countries and other climate-vulnerable countries are flawed. Before considering solutions, we should establish some foundational principles to guide our approach to equitable and effective climate financing. This means recognising the limitations and problems of our current financial and economic systems, including (but not limited to) challenges caused by international financial institutions, market-based approaches, debt-for-climate-action swaps, and the climate debt owed by advanced economies.

\textbf{We are trying to fix the problem using a broken system}

International financial institutions (IFIs) such as the World Bank and IMF dictate the global financial landscape. The current global economic governance architecture is not suited to addressing 21st century challenges, because it was designed by a minority in 1944 for different purposes.

IFIs use neoliberal approaches to address complex socioeconomic problems through market mechanisms. They have been accused of misprescribing policies, further plunging countries into crises.\textsuperscript{19} Multilateral development financial institutions (DFIs) are also pushing countries to take on additional debt to fund climate action. In Africa for instance, multilateral DFIs, the primary source of international public climate finance, channeled nearly half (47\%) of loans at market rate and slightly less than one-third (30\%) at a concessional rate – mainly in the energy sector and less than a quarter (20\%) was provided as grants.\textsuperscript{20}

\textbf{Markets are part of the problem}

Capitalism and economic expansion are directly and strongly correlated with global warming. Human activity in the form of increasing production and associated consumerism enabled by the Industrial Revolution signaled the start of increasing greenhouse gas emissions.

It is curious that we are now using the same market system searching for solutions to the climate crisis, through either private capital or carbon markets. Heavily indebted countries carry high debt borrowing for climate action while carbon markets do nothing to reduce emissions. In fact, this mechanism allows corporations to emit more because what we have currently is a rush to offset but not reduce emissions.\textsuperscript{21} Evidence is emerging that in the name of carbon credits, for example, local Africans are facing loss of livelihoods and even experience abuse, dubbed as the new green colonialism.\textsuperscript{22}
Parr (2013) articulates it well:

‘Advocating that the free market can solve debilitating environmental changes and the climate crisis is not a political response to these problems; it is merely a political ghost emptied of its collective aspirations.’

Climate-debt swap may be an ineffective solution

Debt has been outpacing economic growth in some regions. Ideally, providing debt relief in exchange for agreed-upon climate projects or policies is a win-win. However, there is no guarantee that the creditor’s priorities align with those of indebted developing countries. For example, pushing for policies and approaches for leaving non-renewable resources in the ground, when in fact the country’s carbon sink exceeds what it possibly emits stagnates economic growth, without a clear compensation roadmap for future prosperity.

More practically, some argue that there are challenges associated with the effectiveness of debt-for-climate swaps. One of the basic challenges is the capability of the indebted country to deliver on agreed-upon terms, which affects its suitability to be selected as a target country for such an initiative despite being in dire need of debt relief. Additionally, it defeats the purpose – countries that are in high debt stress happen to emit the least and hence the swap is likely to have little effect on the climate crisis. Nor have swaps been found to greatly expand the fiscal space of indebted countries.

A reminder: Advanced economies owe the rest of the world a climate debt

The emission damages (‘climate debt’) that advanced economies cause without compensation is higher than that of developing countries. It is already established that emissions and intensive use of fossil fuels are positively correlated to the size of the economy, so the bigger an economy, the higher its climate liability. Estimates show that OECD countries’ climate liability is about 44% of total climate debt. Emitting more than their fair share should entail compensation for historical and ongoing environmental damage, ensuring that low-income and climate-vulnerable countries are not unfairly burdened in implementing climate action, in accordance with the principles of the UNFCCC.
Navigating the climate finance gridlock

For low-income economies bearing the brunt of climate impacts, accessing long-term, risk-tolerant funds is crucial. Given the unsustainable nature of current offerings (such as market mechanisms or debt-for-climate swaps), reliance on the inequitable global economic governance architecture and the lack of accountability from wealthy polluters, we must explore practical long-term solutions. These options, albeit challenging, should mobilise greater funding against climate change without compromising the pathway for the prosperity of low-income countries.

Double down on domestic resource allocation for climate adaptation

Even amidst competing priorities such as a dire need for social sector investments and debt servicing, domestic expenditure plays a vital role in financing climate adaptation. It is reported that government expenditure for adaptation in Africa is greater than private adaptation spending and 10 times larger than international support for adaptation. Whatever the true scale of the need, various estimates suggest that a significant proportion of the funds need to come from domestic resources. For instance, of the US$2 trillion additional finance required by 2030 to fully implement the Paris Agreement and cap temperature, it is estimated that 40% could come from domestic resources. Similarly, it is estimated that half of the US$1 trillion required by developing and emerging countries other than China could be mobilised via domestic resources. The domestic sources could include domestic capital markets, stronger tax collection and reduced fossil-fuel-associated subsidies.

Domestic resource mobilisation is perhaps suitable for adaptation financing due to being more reliable and predictable. Delineation between climate adaptation and development activities could be impractical; in this case, domestic budget planning for priority areas allows climate-resilient development.

Strengthen agency for a fair global economic governance

It is, however, unjust and unfair to expect low-income countries to bear the climate bill burden, considering their minimal contribution to the current climate crisis. Regrettably, what prevails is a sense of dissatisfaction and frustration due to reliance on an unfair global cooperation architecture. With a fair and equitable global economic governance architecture, countries could unite in solidarity to address a grand global challenge like climate change. This could be through a complete overhaul of the current system, which appears unrealistic due to its complexity and entrenchment; reforms of the current system, but again there are doubts regarding the effectiveness of doing that and the motivations driving such reforms, particularly whether they will address fundamental
issues or merely represent cosmetic changes; or active engagement in strengthening an alternative system for a new global governance structure for checks and balances, potentially circumventing the limitations of the current system. Taking examples from Africa, this year’s launch of the ‘Africa Club’ or the African Multilateral Financial Institutions, increased membership of African countries in the BRICS group and the African Union’s membership of the G20 are all avenues for enhancing the continent’s proactive role in shaping a new global order to influence negotiations and multilateral decisions.

Strengthen publicly funded investment banks

It is increasingly evident that mission-oriented or challenge-led financing is better positioned to tackle the climate challenge than private capital, which tends to be ‘short-termist and risk-averse,’ as described by economists like Mazzucato.32 State investment banks (SIBs)33 are playing a crucial role in this regard, with their focus on promoting countercyclical finance during economic recessions and their willingness to fund long-term projects, high-risk research and development, and innovations addressing complex societal problems such as climate change. Importantly, SIBs ensure that investments are directed towards projects with long-term impacts, prioritising initiatives like renewable energy and sustainable infrastructure. Moreover, SIBs facilitate collaboration among governments, organisations, and communities, and mobilise resources and expertise for effective climate mitigation and adaptation efforts.

Consider historical emissions and carbon sequestration when determining flexibility of emissions space

In a recent interview, President Mohamed Irfaan Ali of Guyana reiterated that his country’s extensive forest cover, spanning 18 million hectares, stores approximately 19.5 gigatonnes of CO₂.34 This underscores the vital role of forests in absorbing emissions, contributing significantly to global climate action efforts. However, despite the immense carbon sink capacity of countries like Guyana, the current climate financing model struggles to recognise the contribution of their conservation efforts.

Countries that have made a minimal contribution to the climate crisis, yet remain economically disadvantaged and vulnerable to its impacts, should have flexibility in the emissions space to reduce reliance on international climate finance. This should be informed by two historical factors: their negligible emissions35 and their significant carbon sequestration capabilities. Some regions’ forests are possibly capable of capturing more carbon than actual and intended fossil emissions. However, there is a need to quantify the contributions that these forests and other natural sequestration sources make, while historical polluters should phase out emissions immediately.
Further reading

https://doi.org/10.1038/nature19082


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13 According to the Copenhagen Accord ‘The collective commitment by developed countries is to provide new and additional resources’. Available at: https://unfccc.int/documents/6103#beg


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19 This is mainly in relation to the now infamous Structural Adjustment Programme in Africa. See Structural Adjustment Policies in Africa by Adebayo Adedeji as listed in the reference section.

20 The remaining 3% is equity financing according to the Climate Policy Centre report: Landscape of Climate Finance in Africa. Available at: https://www.climatepolicyinitiative.org/wp-content/uploads/2022/09/Landscape-of-Climate-Finance-in-Africa.pdf

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33 Examples of State Investment Banks are China Development Bank, European Investment Bank and KfW Development Bank.

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35 The continent’s total greenhouse gas emissions are estimated at 7% of the world’s share. Read more at: https://unfccc.int/news/can-africa-be-a-continent-of-solutions-to-the-climate-crisis
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