

Why the success of COP28 depends on climate finance

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Beginning this week, leaders from more than 190 countries will gather in Dubai for COP28, the annual climate global summit. This year, the stakes have never been higher: wildfires in Maui, partly exacerbated by



drought, killed at least 100 people and resulted in \$5.5 billion in damages. Flooding in Libya caused by extreme precipitation killed almost 4,000 people. Canadian wildfires blanketed North American skies. Massive sums of money are needed to address these and other disasters and to prepare for what's on the horizon. Enter the need for climate finance: money from public, private and other sources directed to developing countries to help them adapt to climate impacts and reduce their carbon emissions.

The good news? There's enough money to solve the crisis. "At the moment, we have enough technology, we have the capital," said Lisa Sachs, director of the Columbia Center on Sustainable Investment, and an expert on how laws, policies and business shape global investment flows.

And the bad? The pledges of developed countries and anticipated monies from other sources to deliver adequate <u>climate</u> financing has thus far fallen short of expectations and promises. "The amount of financial capital—whether it's from multilaterals, from the countries' own governments, or from the <u>private sector</u>—flowing into climate mitigation or adaptation in the vast majority of developing countries is very low," said Bruce Usher, co-director of the Tamer Center for Social Enterprise at the Columbia Business School. Developing countries' governments "have limited resources, the World Bank and other multilateral institutions are just not that large, and the private sector finds it very challenging to invest in those countries," he said. Ultimately, vast amounts of private equity are essential in closing the climatefinancing gap. Most <u>private investors</u>, however, are in the business of making money, and investing in climate finance in developing countries can be risky.

A moral imperative



Why should wealthy countries pay to fix other countries' problems? Many stakeholders feel the countries that largely engendered the climate crisis should assume the greatest responsibility for addressing it. Developing countries have contributed far less to climate change than have developed countries, yet they are often the most vulnerable to its impacts, and they tend to be more dependent on the natural world for their livelihoods. According to the UN, half the world's population lives in a climate "danger zone," where they are 15 more times likely to die from climate impacts than people in wealthier countries.

But developing nations need trillions of dollars each year until 2050 to achieve their adaptation and mitigation goals, according to the International Monetary Fund. (Here's a quick primer on adaptation vs. mitigation.) To this end, in 2009, developed countries pledged to deliver \$100 billion annually by 2020. Funding was supposed to come from public, private, multilateral and other sources of finance, but there were no official guidelines about what could be counted as climate financing. As a result, developed countries took advantage of undefined reporting requirements and failed to fully honor their commitments, although they say they expect to reach the goal this year.

A report by CARE Denmark, a member of the humanitarian organization CARE International, found that the pledges of wealthy countries together currently amount to only \$57 billion a year, just over half their commitments; some countries, including the U.S. and Germany, have not fully delivered on their pledges.

While there are no official numbers of how much each country contributed, Carbon Brief estimates that the U.S. gave \$7.6 billion in 2020. Because the U.S. is responsible for 52% of the historic emissions from developed countries, its fair share of the \$100 billion goal would be closer to \$40 billion. In 2021, President Biden announced he wanted to contribute \$11.4 billion annually to support developing countries deal



with climate change, but Congress has approved only \$1 billion thus far.

Helping developing countries cope with climate change is also critical to achieving the goals of the Paris Agreement because in a business-asusual scenario, middle- and low-income counties are expected to produce 66% of global <u>carbon emissions</u> by 2030. And for developing countries to meet less than half of their nationally determined contributions (NDCs) pledged at Paris, they will need at least \$6 trillion by 2030, according to an analysis by the United Nations Framework Convention on Climate Change (UNFCC).

While <u>wealthy countries</u> bicker over the logistics, developing countries suffer. "The devastating consequences of not solving this problem that we have created, and that we know how to solve, seems to me like the most profound moral failure," said Sachs. "What makes it worse is that those who contributed the most [to climate change] will certainly be impacted, but not as immediately or completely as countries who face livelihoods wiped out, economic upheaval or submerged shorelines."

Follow the money

About half of all climate finance currently comes from governments, multilateral institutions such as the World Bank, and development finance institutions like the Green Climate Fund (GCF), established in the wake of COP15 as the UN's main funding arm for dispersing climate finance. Regional development banks like the African Development Bank and the Latin American Development Bank also play a key role because they can make long-term loans to developing countries on good terms and can encourage private investment.

The GCF distributes its monies to local development banks and organizations to finance adaptation and mitigation projects in developing countries. The fund initially raised \$10 billion in pledges, and today has



\$9.9 billion in confirmed donations. In 2014, President Obama pledged to contribute \$3 billion to the GCF (though the U.S. has only given \$2 billion thus far).

At a recent conference to replenish the GCF for projects from 2024 to 2027, some countries increased their contributions: Japan pledged \$1.11 billion while Norway added \$300 million. The U.S. and China—the world's two biggest emitters—did not offer any additional funds as a divided Congress is preventing the U.S. from making any new pledges, and China has not pledged because it claims it is still a developing country.

The debt trap

Under the Paris Agreement, half of climate finance funds are to be spent on adaptation and half on mitigation. Yet over 90% of climate finance is currently directed toward mitigation, and most of it in the form of loans—loans that are very expensive for developing countries to repay.

"Developing countries are locked into a vicious cycle because creditrating agencies rate them as risky and sub-investment grade, largely as a result of their poverty," said Sachs. "The terms of the borrowing are incredibly high, with short maturities, increasing the risk of defaults, which exacerbates their risk profile." It leads to a situation where 60% of less-developed countries are in debt, with some spending five times more on their debt each year than on climate adaptation. One analysis found that in 2021, 59 countries paid debt service of \$33 billion while only receiving \$20 billion in climate finance.

Another issue is that while developing countries can acquire short-term financing, the investments they need require patient, long-term financing, said Sachs. Climate projects may take many years to recoup their costs. "A solar project is a very low-risk investment and attractive



to investors as long as you're comfortable making a 20- to 30-year commitment," said Usher. "But in many developing economies, the cost of capital for 20 or 30 years is very high. There is no capital willing to go that long because of risks specific to those countries." For example, a developing country's currency might be unstable and rapidly lose value, so an investor paid back in local currency that has devalued would end up losing money.

Investing in adaptive vs. mitigation strategies

While the most common mitigation strategies include investing in renewable energy, carbon capture and storage, electrification of transportation, making buildings more energy efficient, and improving water management, adaptation projects aim to make infrastructure resilient to climate impacts, develop agricultural practices that are efficient and sustainable, aid transition to more sustainable livelihoods, and restore biodiversity.

Adaptation efforts can also lower the cost of damages from climate impacts. For example, \$1 billion invested to forestall coastal flooding could reduce damages by \$14 billion, according to the UNEP Adaptation Gap Report 2023. But pledges for adaptation finance have added up to only \$14.3 billion annually—much lower than the aspirational \$50 billion goal.

Less money is directed towards adaptation and loss and damages than to mitigation because they have no clear returns on investments. "There's little case for the private sector to fund projects that are not likely to have a return," said Sachs.

To help vulnerable countries deal with <u>climate impacts</u> that cannot be adapted to or avoided, a Loss and Damage Fund was established during COP27. The U.S. backed the fund after it was agreed that compensation



would not signify legal liability, but has not pledged money for the fund. (No country is currently obligated to pay into the fund.) How the fund will be funded and how it operates are to be addressed at COP28.

Some development financial institutions like the World Bank are using <u>results-based climate finance</u> to provide incentives for developing countries. Most climate finance is given up front, but results-based monies are paid after the targets to reduce greenhouse gas emissions have been met. The verified emission reductions count as emission reduction credits which countries can trade in carbon markets or count towards their NDCs.

For example, in Ethiopia, the World Bank is buying the emissions reductions from the distribution of 2.8 million solar lanterns and over 200,000 home solar systems to replace kerosene lamps and diesel generators. Switching to solar in this way eliminates nearly 24,000 metric tons of CO_2 from the environment each year.

The status of climate finance

Not only have the initial goals for climate finance not been met, public climate adaptation finance for developing countries has decreased in the last few years. According to the UNEP <u>Gap Report</u>, funds have decreased by 15% since 2020.

In addition, the gap between the estimated amount that will be needed for adaptation (\$215 to \$387 billion) this decade and the amount of actual money coming in (\$21.3 billion) has grown. The longer the gap persists and the larger it becomes, the more developing countries stand to suffer losses and damages from climate change.

The financing gap also erodes trust between developing countries and wealthier ones. An Oxfam expert noted that when developing countries



see wealthier countries not fulfilling their finance pledges, <u>they begin to</u> <u>doubt</u> the promises wealthier countries make on other issues at climate talks.

Hopes for COP28

To help address all of this, and to make COP28 a success, Sachs believes we need a complete overhaul of the climate financial system.

The cost of capital for investing in developing countries needs to come down, and the ratings of developing countries need to be improved, she said. And since private capital is critical for climate finance, development finance institutions must spur private investment by providing funds and creating financing arrangements that are attractive to private investors. "If they can de-risk projects or provide guarantees or otherwise further leverage private finance, then private finance can become more affordable," said Sachs.

"It's really important that the World Bank and other multilateral institutions step up their financing in developing countries," said Usher. While the World Bank provided a record amount of climate finance in 2023— \$38.6 billion—the actual need is in the trillions of dollars. For development finance institutions to be able to lend more, however, they must get more paid-in capital from the rich countries. But rich countries are reluctant to capitalize the development finance institutions because many are facing their own budget deficits and high interest rates. Development finance institutions could potentially lend more even without additional paid-in equity or take on increased risk with the capital they have. "Their hesitation to do that, however, is because they don't want to jeopardize their Triple A credit rating," said Sachs. "Both more capital and more leverage should be part of the solution."

Countries and regions should have master plans-roadmaps that lay out



what the energy transformation is going to look like for them. "Each region or country needs to identify what the mix of solar and wind and geothermal and hydro is," said Sachs. "Where should these be sited? What infrastructure is needed for transmission and distribution?" Beyond the technical scenario, the master plan should also identify what investments are needed and which are suitable for public or private finance.

Some master plans are already in the works. The Council of Engineers for the Energy Transition, an advisory council to the UN Secretary-General, is developing technological roadmaps in each of the UN regions, while Sachs and the Columbia Center on Sustainable Investment are working on the financial side. They are studying the challenges, financing institutions, funds and financial possibilities in each of the regions.

As for the future of climate <u>finance</u>, Usher said, "It's incredibly important that the capital flows increase since we really can't reduce emissions in developing <u>countries</u> because they are not very polluting. And they can't continue to grow their economies and raise prosperity for their citizens without foreign investment." Usher reiterates the point that large enough pools of capital exist, albeit tied up in the private sector. "But that foreign investment is not available without some additional risk mitigation measures. And the only way that's going to happen is with the public sector and the private sector essentially working together."

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