Is International Climate Finance Unfair and Inefficient?

Thibaud VOÏTA

Key Takeaways

- Climate finance is suffering from many issues: it would need to be increased by at least 590% annually to address the current needs and overlooks important areas: e.g., the African continent (3% of the flows) and adaptation (90% of the flows are going to mitigation projects).

- The problems come from pledges that are not met, but also from an inefficient multilateral system that suffers from a proliferation of funds, and development banks that are yet to fully adapt their activities to the reality of climate change.

- For example, credits offered to emerging economies are in dollars, which fuels the currency mismatch.

- However, reforms are being discussed, for instance through the Bridgetown Initiative, carbon markets, “debt-for-climate” swaps. The IMF and World Bank are also expected to make a change.

- Finally, new actors are emerging, including multilateral banks initiated by China and may play a major role in the future of climate finance.
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Finance is arguably the most sensitive climate negotiation topic. Different studies have shown that rich countries emit the majority of greenhouse gas (GHG) emissions, while the climate footprint of the poorest countries is much more limited. In addition, the countries that emit the less often turn out to be among the most vulnerable to climate change, with high needs in terms of adaptation finance. According to some analysis, the 46 least-developed countries suffer from a high risk of loss and damage, and the countries that are the least at risk are in Europe.¹ Therefore, developing countries are demanding contributions from the developed world to address their climate finance needs (both in terms of mitigation and adaptation). These demands have been somehow met with a pledge made at COP 15 in 2009, where developed countries announced a yearly contribution of 100 billion dollars (USD) by 2020. However, this pledge has not been honored (see Figure 1).

Meanwhile, climate change is accelerating and, as a result, countries’ needs in terms of adaptation are increasing, as well as their loss and damage. The finance gap is widening and though the 100 USD billion pledge is expected to be achieved in 2023, analysis from the think tank Climate Policy Initiative (CPI) shows that it will not be enough to address the current needs. According to their analysis, the current flows need to be increased by at least 590% annually (Figure 2). This briefing will show that, in addition, climate finance is not accessible to the poorest and therefore increases inequalities and the exclusion of the most vulnerable countries. The Prime Minister of Barbados, Ms. Mia Motley, complains that the “international financial system [...] is broken, outdated, infested with short-termism and downright unfair”.²

² “With clock ticking for the SDGs, UN Chief and Barbados Prime Minister call for urgent action to transform broken global financial system”, United Nations, April 26,2023, available at: www.un.org.
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Figure 1. Evolution of the climate finance provided for developing countries by developed countries, 2017, 2019 and 2020 (USD billion)

Source: OECD, 2022.³

Figure 2: Global rack climate finance flows and estimated annual climate investments need through 2050 according to CPI

Source: CPI.⁴

In parallel, the multilateral climate finance governance is evolving: new multilateral banks and donors are gaining ground and could be the first step of a power shift in climate finance from Western countries to emerging economies. Meanwhile, the Bretton Woods institutions are being reformed, and new mechanisms may bring promising developments (e.g., under Article 6 of the Paris Agreement). The Paris Summit for a New Global Financial Pact on 22-23 June 2023 is an opportunity to address these issues, though it also risks highlighting the North-South tensions further.⁵

The climate finance gap: losers and winners

The United Nations Framework Convention on Climate Change (UNFCCC) defines climate finance as follows: it “aims at reducing emissions and enhancing sinks of GHG and aims at reducing the vulnerability of and maintaining and increasing the resilience of, human and ecological systems to negative climate change impacts.” ⁶ There is however a lack of consensus on the way to measure these flows, nor a global taxonomy to agree on what investments can be categorized as climate or not. Oxfam, a global non-governmental organization (NGO), has been raising the issue for a few years now, pointing out the lack of disclosed data on the climate relevance of the funds, which leads different actors to over-report their climate financial flow.⁷ Typically, projects can be reported as contributing to climate finance, though climate is only a small component of the overall project. Projects with no real impact on GHG emission reduction may also be categorized as participating in climate finance.⁸

These flows are extremely unbalanced, as shown in Figures 3 a to 3 e. More specifically:

- Over 90% of the finance is directed at mitigation measures, leaving only USD 50 billion for adaptation and 15 for combined measures (Figure 3 a). This is well below the needs estimated by the UN, that is to say, USD 160 to 340 billion by 2030, and 315 to 565 by 2050.⁹

- Close to 54% of the flows are directed at the energy sector and an additional 28% at transportation (Figure 3 b),

- 49% of the flows originate from OECD countries¹⁰, and are directed to non-OECD countries (Figure 3 c),

- over 47% of the flows are directed to Asia, and only 3% (USD 19 billion, USD 29 billion when including North Africa) to Sub-Saharan Africa (figure 3 c). This is far from the USD 277 billion needed every year in order to implement Africa’s (including North Africa) nationally determined contributions (NDCs) by 2030.¹¹

Overall, adaptation projects in Africa are the most important blind spot in climate finance: they only receive USD 3.5 billion every year, though the continent is disproportionately vulnerable to climate change.¹² There are many reasons that can explain these limited flows. The main ones being real and perceived risks listed as such by

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10. That is to say, country members of the Organization for Co-operation and Economic Development. These represent developed countries.
12. Ibid.
the Africa NDC Hub: currency instability, regulatory and governance problems, lack of bankable project pipelines, counterparty risks, lack of technical capacity, transparency and accountability mechanisms, and information asymmetries. Some of the main reasons for the limited attention adaptation gets from international finance lie with the complexity of the actions required, the difficulties to identify the metrics to measure the impact of the measures, the need for long-term and not short-term actions, or the fact that the most affected populations are marginalized groups, leaving the elites the chance to capture the resources.

Figure 3 a. Finance split between adaptation and mitigation (2020, USD billion)

Figure 3 b. Breakdown of global climate finance by use and by sector (2020, USD billion)

Figure 3 c. International climate finance flows (2020, USD billion)

Note: these data do NOT include domestic climate flows.

Figure 3 d. Breakdown of global climate finance by region of destination (2020, USD billion)

Source for Figures 3 a to d: CPI, Global Landscape of Climate Finance 2021, op. cit.
The difficulties to access Climate Finance

Multilateral funds are often out of access for developing countries. A first problem is the proliferation of these funds. The OECD lists 99 climate funds (a list of the main ones can be seen in Table 1). This creates confusion for both donor and recipient countries, useless competition, and a waste of effort, to the point that some development agencies had to deploy tools to help countries identify the funds that can address their needs. However, the proliferation does not seem likely to slow down, as highlighted by a new Loss and Damage Fund announced during COP27, even when instruments exist to address these and could have been improved or replenished.

### Table 1. USD 1-billion and above Climate Funds

<table>
<thead>
<tr>
<th>Name</th>
<th>Focus</th>
<th>Pledge (USD, bn)</th>
<th>Projects approved</th>
</tr>
</thead>
<tbody>
<tr>
<td>GCF (Initiation Resource Mobilization and First Replenishment)</td>
<td>Multiple</td>
<td>20320,2</td>
<td>571</td>
</tr>
<tr>
<td>Clean Technology Fund</td>
<td>Mitigation</td>
<td>5404,31</td>
<td>148</td>
</tr>
<tr>
<td>Global Environment Facility (GEF, Replenishment cycles 4 to 7)</td>
<td>Multiple</td>
<td>4040,69</td>
<td>834</td>
</tr>
<tr>
<td>Least Developed Countries Fund</td>
<td>Adaptation</td>
<td>1606,42</td>
<td>285</td>
</tr>
<tr>
<td>Global Climate Change Alliance</td>
<td>Multiple</td>
<td>1332,90</td>
<td>109</td>
</tr>
<tr>
<td>Amazon Fund</td>
<td>Mitigation – REDD</td>
<td>1288</td>
<td>103</td>
</tr>
<tr>
<td>Pilot Program for Climate Resilience</td>
<td>Adaptation</td>
<td>1144,79</td>
<td>68</td>
</tr>
<tr>
<td>Adaptation Fund</td>
<td>Adaptation</td>
<td>1039,20</td>
<td>239</td>
</tr>
</tbody>
</table>

Source: Heinrich Böll Stiftung, ODI, Climate Funds Update.

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16. See initiatives such as the NDC Partnership’s Climate Finance Explorer, available at: www.ndcpartnership.org.
The establishment of this new fund brings more questions than answers: how long will it take for it to be established and operational? How much money will it get? How will it differ from the other funds (Adaptation Fund, Green Climate Fund...)? Despite these, the announcement of an additional fund in the already-crowded multilateral system was welcomed as a victory by many developing countries and climate activists.

Climate funds are also difficult to access and often deemed inefficient. Most of them require lengthy and complex application processes that are only available in English. This poses problems for countries with limited capacities, typically the least-developed African francophone countries. The Green Climate Fund (GCF) stands as a synthesis of the main problems climate funds are facing. From the onset, the GCF was criticized for its lack of staffing, transparency, and funding. Its 2023 review came to the conclusion that many issues remain, highlighting shortcomings in terms of project management, lengthy processes, and maladaptation among other problems. Some projects are said to have been counterproductive and even to have resulted in an exacerbation of violence toward indigenous people in Nicaragua. To make things worse, a few years ago, the Fund secretariat was also described as a toxic workplace environment, with situations of racism and harassment. Finally, the GCF also suffered from the resignation of two of its executive directors before the end of their mandates in the 2010s.

Multilateral development banks (MDBs) are also struggling to fully support climate action. Nine of them have committed to aligning their activities with the Paris Agreement goals, typically through a Joint MDB Assessment Framework for Paris Alignment for Direct Investment Operations. However, these commitments consist mostly of a phase-down of activities that are not compatible with the Paris Agreement, and the results have proven disappointing so far: in 2020-2021, an estimated USD 519 billion had been pledged by 8 MDBs and 38 major economies to

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fossil-fuel intensive sectors, in the context of the post-Covid-19 recovery plans.\textsuperscript{24} Furthermore, the Assessment Framework is limited to only 9 banks. Meanwhile, the money allocated to developing countries (as defined by the UNFCCC) by MDBs is not steadily increasing, with a 5% decline in 2020 as compared to 2019. In addition, the MDBs still need to harmonize how they count and price emissions.\textsuperscript{25} In this context, it is no surprise that the declaration of the World Bank President David Malpass in early 2023, who failed to recognize the role of fossil fuels in the climate crisis, triggered a crisis and led him to resign.\textsuperscript{26}

**The original sins**

A majority of public climate finance is delivered through loans (see Figure 4). Oxfam considers that this should be considered in the calculation of climate aid from developed to developing nations. According to them, the actual financial contribution amounted to USD 22.5 billion in 2020, that is to say, less than ¼ of the 100 billion promised during COP 15.\textsuperscript{27} This also creates important challenges for the country receiving the loans: in terms of interest rates that are nowadays particularly high, but also as developing countries most of the time cannot borrow in their own currencies, leading to “currency mismatch”, a phenomenon named the “original sin” in the early 2000s: developing countries have their external debt mostly denominated in foreign currency, and are therefore vulnerable to depreciation to their domestic currencies in case of a degradation of their economic conditions.\textsuperscript{28} Moreover, climate change is precisely a factor which can severely affect, and weaken, these economies. This is extremely problematic as of early 2023, 54 lower-income countries were at high risk of debt distress, including 24 African economies.\textsuperscript{29} These are called “original sins” and are issues that depend on factors that are completely outside of the control of these economies.\textsuperscript{30}

New Sources to bridge the gap?

The contribution of the private sector is often seen as a solution to bridge this finance gap. Some big corporations or CEOs are pouring money into climate and biodiversity projects: for instance, Amazon’s founder Jeff Bezos established the USD 10 billion Bezos Earth Fund, Kering and l’Occitane’s Climate Fund for Nature, with a (more modest) EUR 300 million target, and managed by the sustainable finance fund Mirova. Meanwhile, countries are discussing the next GCF replenishment and new climate finance targets to succeed the USD 100 billion by 2020 pledge. These could take the form of “innovative” targets that would take better account of developing countries’ needs.

However, the biggest lever for private sector contribution probably is carbon markets. Advancements in the climate negotiations around carbon markets are creating new opportunities and speeding up the development of voluntary carbon markets: their estimated value amounted to USD 300 million in 2020, and reached USD 2 billion in August 2022, with an impressive 60% yearly growth. Assessing the future size of these

33. Private conversations during the 58 Subsidiary Bodies Meeting in Bonn (Germany), June 2023.
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Markets is challenging, but it is estimated that by 2030, they could represent USD 5 to 180 billion\(^{34}\). In Africa only, carbon markets could represent between USD 120 and 200 billion by 2050\(^{35}\).

However, carbon markets are suffering from many hurdles. Their mechanisms and organization are complex to understand and require important resources and also some institutional maturity. Many developing countries need some technical and institutional support to develop these. The confusion around carbon markets and their operations can even create some opportunities for scams.\(^{36}\) Also, the current form of carbon markets can be inappropriate for some countries. For instance, high forest and low-deforestation countries like Gabon have had 90 million tons of carbon certified but cannot sell them, as the REDD+ mechanism used in carbon markets rewards reforestation or forest restoration projects, but ignores forest protection policies.\(^{37}\) Other issues relate to the low price of the ton of carbon, which encourages offsetting while not reducing direct emissions. The continuous rapid development of the markets could result in an oversupply of credits as compared to the demand, leading to a drop in their price.\(^{38}\)

Finally, carbon markets are currently suffering from a credibility crisis. Reforestation and forest restoration programs (the so-called REDD+ projects) had been accused of promoting greenwashing for some years, but these accusations reached a new high with the publication in early 2023 of an investigation on projects from the biggest carbon certifier in the world, the US company Verra, which represents \(\frac{3}{4}\) of the voluntary carbon compensations in the world.\(^{39}\) 94% of Verra’s forest projects are said to be failing to reduce emissions, and the deforestation assumption these projects should address have been exaggerated by 400%. The investigation also names a Peruvian project that would...

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have led to human rights violations of local populations. These revelations have severely damaged the reputation of REDD+ projects and highlighted the need for a reform of the carbon markets.

Meanwhile, new public actors are also emerging. In 2015, China had pledged USD 20 billion of aid per year. The actual amount is being debated, remains far from these USD 20 billion, and is not necessarily used for projects aligned with the Paris Agreement goals. However, Beijing is also a key stakeholder in two MDBs, the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank. In 2022, the AIIB delivered USD 2.4 billion in climate finance and recently announced it aims to allocate half or more of its annual finance to climate projects by 2025, with the high ambition of jumping up to a total of USD 50 billion by 2030. The AIIB has the potential to become a significant climate finance actor. The OPEC Fund for International Development (OFID) is also starting to inject money into climate projects, with a significant part of its 2023 – USD 300 million budget dedicated to climate change, possibly reflecting a growing interest of Gulf states (among other OFID members) in climate action.

New Solutions to Improve Climate Finance?

While new actors are emerging, important efforts are made to improve the existing systems.

The Prime Minister of Barbados, Ms. Mia Motley, launched the Bridgetown Initiative (BI) in late 2022. It proposes a USD 500 billion Global Climate Mitigation Trust, to be seeded with the International Monetary Fund (IMF) Special Drawing Rights, as well as concessionary finance from MDBs extended to more countries. In addition, and in order to loosen the impact of debt, the BI suggests the adoption of a natural disaster and pandemic clause in all debt instruments that would allow for a two-year suspension of the debt and extend the instrument’s maturity for two years at the initial interest rate. Finally, the BI also argues for a mechanism to address the costs of loss and damages, with an automatic payment inspired by the Oil Pollution Compensation Fund and made to governments for reconstruction.

The initiative has received support from the UN.

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Secretary-General and many governments, including France. These reflections are complemented by the ongoing discussions about a reform of the World Bank and the IMF at the G20 and will be discussed at the New Global Financing Pact Summit in June 2023.45

Meanwhile, new tools can help lighten developing countries’ debt burden and increase investments in adaptation, by promoting adaptation-linked debt relief programs.46 These for instance include “debt for climate” or “debt for nature” swaps, a mechanism that involves a third party who purchases a national debt at a discount, restructures it, and finally uses it to finance conservation and adaptation measures. The US NGO The Nature Conservancy (TNC) has already been using this tool to restructure the debt of Seychelles in 2016, supervising the acquisition of more than USD 20 million of its debt, which was later managed by the Seychelles Conservation and Climate Adaptation Trust, in charge for five years of 400,000 km² (a larger area than the size of Germany) of protected marine area.47 TNC later used the same tool with Belize and announced in 2022 a new similar project in Barbados (the country of origin of the Bridgetown Initiative).48

Finally, the changes and reforms of the carbon markets may also result in positive changes in terms of climate finance. The advancements in climate negotiations are now allowing for new mechanisms such as internationally transferred mitigation outcomes, which consist of transfers of emission reductions from one country’s GHG inventory to another, with the backing of the UN. Carbon credit certification bodies are also developing innovative solutions, for instance blockchains, to improve the markets. Finally, a new type of credit is currently being experimented and discussed at a high level. The Global Environment Facility is pushing for a new generation of carbon credits that would include more robust verification mechanisms, and possibly cover biodiversity elements.49 These credits would be sold at a “premium” price and would therefore prevent the price of carbon to fall.50 However, the high-integrity credits still need to be better defined, accepted by the market, and scaled up.

45. Carbon Pulse, May 31, 2023
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