

# How lessons from development finance can strengthen climate finance

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## Introduction

Covid-19 has exposed the precarity of the current economic and financial system. Aid budgets have been slashed,<sup>1</sup> social security gaps have been exposed<sup>2</sup> and the fragility of healthcare systems has been laid bare.<sup>3</sup> This pandemic has further exacerbated the inequality and divide within and between societies – including gender inequalities, and has highlighted the impacts of historic disinvestment<sup>4</sup> in marginalised communities.

Tackling these crises will require a huge amount of resources. It is in the interest of all countries and international institutions to ensure that the world recovers from the pandemic together to engage in a pathway towards a peaceful, safe and dignified future. Without this, gains made in poverty eradication and towards sustainable development risk being further undermined.<sup>5</sup>

Tackling climate change and ensuring that there are liveable environments for people, biodiversity and ecosystems to flourish is in part of achieving the sustainable development agenda. Ensuring that communities address and adapt to climate impacts enables them to maintain and strengthen their livelihoods, and helps future generations to thrive. It also supports the sustainable development of equitable societies within which citizens have access to education, justice, health and affordable energy. As such, climate finance is a vital and powerful sustainable development tool.

This brief argues that, in order for climate finance to adequately support vulnerable communities' efforts to tackle climate change and develop sustainably:

- i. The climate finance agenda must be driven by the most vulnerable
- ii. The quality of climate finance must improve
- iii. Greater access to climate finance is needed to minimise debt
- iv. Climate finance must be gender-responsive.

This brief also highlights lessons learned from long-standing work on development finance that need to be taken into account in climate finance discussions taking place in 2021. The objective of the brief is to help strengthen synergies between the agendas of the Paris Agreement and Sustainable Development Goals (SDGs).

## A. Climate finance: The key issues

### Country ownership of climate finance

Many climate-vulnerable countries in the global south are attempting to respond to the Covid-19 pandemic whilst experiencing ongoing climate impacts.<sup>6,7</sup> Although developing countries have contributed the least to climate change, they are experiencing the worst effects of climate change and have been for decades.<sup>8</sup> The compounding nature of these impacts is making it difficult to put in place and implement domestic Covid-19 health measures.<sup>9</sup> This is impacting on the ability of developing countries to meet their own needs during these crises, thereby exacerbating vulnerable countries' risk of falling into a debt trap.<sup>10</sup> Despite all of this, increasingly there is a lack of alignment between climate-vulnerable countries' strategies for climate resilient, sustainable development<sup>11</sup> and developed countries' development cooperation commitments. 2021 is a year of opportunity to realign these two.

The Climate and Development Ministerial (CDM)<sup>12</sup> taking place in late March, is one such opportunity, particularly as its stated aim is to connect the climate, development and recovery agendas in 2021 in a way that supports climate-vulnerable countries and communities. In addition to this, throughout the year, a series of relevant events will take place, notably the Petersberg Climate Dialogue (PCD) and the US Climate Summit, both taking place in late April, and the Finance in Common Summit (FiC) in the second part of the year, culminating in the resumption of the United Nations (UN) climate negotiations (COP26).

However, what this line-up of meetings shows us is that the climate agenda is still largely driven by the largest emitters of greenhouse gases. The multilateral nature of UN climate negotiations provides the foundation for all relevant stakeholders to be part of identifying the problems and solutions. However, many of the meetings taking place in 2021 are hosted by large economic powers, which are also the biggest contributors to the current climate crisis.<sup>13</sup> Only a select group of developing countries are invited to join these meetings.

Given that developing countries are the most impacted by climate change, it is crucial that all relevant countries and stakeholders are at the table, to ensure that these discussions – and the subsequent efforts agreed – are driven by equity and the needs of those most affected.

### Quantity, quality and composition of climate finance

Implementing solutions and addressing climate impacts will require a substantial amount of finance. Current estimates of climate finance needs range between “USD\$1.6 trillion to USD\$3.8 trillion annually between 2016 and 2050”.<sup>14</sup> What is more, the impacts of the Covid-19 pandemic have led the UN to estimate that developing countries will need an extra US\$ 2.5 trillion if they are to stay on track to achieve the Sustainable Development Goals (SDGs) by 2030.<sup>15</sup> However, worryingly, there are three ongoing trends that are undermining the quality of climate finance:

- i. non-concessional finance
- ii. over reporting on climate finance, and
- iii. dichotomy between needs and granted finance.

**The majority of climate finance is provided in the form of loans,**<sup>16</sup> which are counted at their full face value,<sup>17</sup> instead of only counting the grant equivalent of a loan.<sup>18</sup> When only the grant equivalent is factored in, then climate finance between 2017-18 is worth US\$ 25 billion,<sup>19</sup> which is less than half of the estimated public climate finance for this same period.<sup>20</sup> Seventy-six per cent of climate finance loans given by Multilateral Development Banks (MDBs) and 46 per cent of multilateral climate funds are given in the form of non-concessional instruments.<sup>21</sup> This is compared to 20 per cent of non-concessional finance that is provided by bilateral climate finance providers.<sup>22</sup> This excessive reliance on loans means that climate finance makes climate-vulnerable countries more vulnerable to debt, which in turn reduces the ability of these countries to adapt and to address loss and damage, or to invest in public services and social protection.

**Another worrying trend is that climate finance is being over-reported.** Oxfam estimates that over-reporting of climate relevance means that bilateral climate finance could be around a third lower than reported.<sup>23</sup> This is further echoed by research from CARE Denmark and CARE Netherlands, which shows that the World Bank is over-reporting on climate finance provided for adaptation.<sup>24</sup> This comes when finance from development finance institutions, especially MDBs and members of the International Development Finance Club (IDFC), is expected to grow significantly. 2019 was predicted to have the most climate finance flows in a single year.<sup>25</sup>

One of the reasons for over-reporting on climate-relevant finance is because the current methodologies used under the United Nations Framework Convention on Climate Change (UNFCCC) are not being applied consistently to the data reported by climate finance providers.<sup>26</sup> All of this adds further complexity to determining whether climate finance providers are truly on track towards achieving existing, global climate finance goals. Vulnerable communities cannot afford to be ‘short-changed’ if they are to address the ongoing impacts of climate change, as well as developing sustainably.

Added to this, analysis by Oxfam shows that there is a **clear dichotomy between where climate finance is most needed and where it actually goes.**<sup>27</sup> Figures from the Organisation for Economic Co-operation and Development (OECD) show that 72 per cent of public and private climate finance goes to mitigation.<sup>28</sup> This shows that, whilst vulnerable communities have identified mitigation as an area where finance is needed,<sup>29</sup> other areas of need are being severely under supported. The most commonly identified areas where finance is needed are both **mitigation** (specifically on renewable energy, energy efficiency, transport and forestry) and **adaptation** (specifically on water, agriculture, coastal protection and resilience).<sup>30</sup> Increasingly, these needs include access to finance to address severe losses and damages caused by ongoing climate impacts,<sup>31</sup> the severity of which cannot be overlooked.

## Accessing high-quality climate finance to minimise debt

Accessing finance is the other component of quality finance. However, as the Overseas Development Institute (ODI) states “the climate finance architecture is too complex with insufficient resources spread thinly across many small funds with overlapping remits”.<sup>32</sup> In the midst of this complex landscape, development finance and climate finance streams are often drawn from the same well. Significantly, it is estimated that, for 2017-18, reported climate-related development finance was 25.5 per cent of bilateral Official Development Assistance (ODA), and the “majority of this climate finance was counted towards donor commitments to increase aid to 0.7% of gross national income”.<sup>33</sup> This highlights the difficulties in ensuring that climate finance is ‘new and additional’ to existing finance commitments.

Limited to no-capacity to tackle climate change in a fiscally responsible and sustainable manner creates a continuous cycle of i) climate-impacts induced debt, which leads to ii) debt-induced climate vulnerabilities, and repeats. Low resources and capacities to tackle climate change creates the conditions for climate impacts to drain countries’ financial resources, as countries are forced to redirect their budgets to address the immediate extreme climate impacts they face; this is climate-impacts induced debt.

The debt they accumulate then reduces their ability to invest in adaptation initiatives or to address the losses and damages that they are facing, which further exacerbates their climate vulnerabilities;<sup>34</sup> this is debt-induced climate vulnerabilities. Additionally, research from Imperial College London has shown that developing countries are paying extra interest due to their climate vulnerabilities – equivalent to an extra \$1 for every \$10 of interest paid.<sup>35</sup> 2016 projections estimated that an additional US\$ 146 billion to US\$ 168 billion could be paid in interest by developing countries over the next decade.<sup>36</sup> This highlights how finance mechanisms, prudential assessments and risk management systems are contributing to this cycle of indebtedness – all of which is further impacting vulnerable communities’ capacity to tackle the climate crisis that they have historically contributed to the least.<sup>37</sup>

When identifying financial instruments to use, it is imperative that climate finance providers use methodologies that adequately account for climate impacts (physical manifestations of climate change), climate vulnerabilities (sensitivity to climate impacts) and climate risks (possible negative financial and non-financial impacts). As these all impact a country’s fiscal space in different, mutually reinforcing ways.

## Gender-responsive climate finance

Gender policy is commonly seen as a way of mitigating the effect of the learned social differences between females and males. These social differences have deep cultural roots and are also changeable over time. Accordingly, research shows that women and men can have different solutions to addressing the same climate impact,<sup>38,39</sup> and often outreach to engage women results in better outcomes for all parts of a community.<sup>40</sup> Demonstrating that pursuing gender-responsive finance investments is crucial and there is a real benefit for the whole community, particularly as it can help to transform power relations and structures within communities.

For example, a renewable energy project that powers a community fridge reduces the impact that heatwaves have on food stores and helps to ensure that food is available during heatwave-induced drought, as food preparation typically uses water. In turn, this reduces the time girls spend on food preparation and creates the opportunity for girls to have a similar level of access to education as boys. This highlights the benefit of gender-responsive climate finance for achieving both the Paris Agreement and several of the SDGs.

However, the rise in over-reporting of climate-relevant climate finance,<sup>41</sup> particularly from stakeholders that do not follow development effectiveness principles,<sup>42,43</sup> means there is also a lack of data on how gender-responsive finance is. This is because there’s a lack of consistent, transparent and publicly available information on the various finance streams being reported as climate relevant.<sup>44</sup> All of this undermines the additionality and impact of the finance.

Understanding the intersectionality of gender inequality is also necessary to develop transformative policies that create deep-rooted, sustained and positive change. “Intersectionality refers to the way in which multiple forms of discrimination – based on gender, race, sexuality, disability and class, etc. – overlap and interact with one another to shape how different individuals and groups experience discrimination”<sup>45</sup> This can only be adequately assessed through the use of a gender analysis, which should also help reveal the interests and power relations within a community, both of which can impact project development and implementation.<sup>46</sup>

## B. Learning from development finance to ensure more effective climate finance

Eurodad has identified six key lessons on development finance that are relevant for understanding how to strengthen climate finance as a tool for supporting sustainable development:

- 1) **Instrumentalising policies for other interests does not allow for developing country ownership or enable democratic country driven strategies.**<sup>47</sup> Increasingly, developed country providers of public climate finance have been including their own interests within climate policies and agendas.<sup>48,49</sup> Doing so reduces climate vulnerable countries' ownership of climate finance, and also makes it easier for policy conditions to be attached to climate finance, which severely impacts the development of strong domestic economies, as well as livelihoods.<sup>50</sup>
- 2) **Private sector involvement can be costlier than public service investments and can lead to additional, unplanned costs.** Research shows that policy conditions, such as those that encourage private sector access to the domestic markets of developing countries, or partly or fully privatise public services e.g. water services, amongst others things, severely impacts access to finance,<sup>51</sup> quality jobs<sup>52</sup> and can lead to proposed forced displacement of communities.<sup>53,54</sup>
- 3) **Export-driven approaches to sustainable development have intensified an over-reliance on certain industries to support entire economies.** Export-driven strategies focus on using international trade as a growth strategy to achieve economic development. However, if these industries are fossil fuel based and reliant on fossil fuel subsidies to function, then the risk and reward aspect associated with export-driven approaches can actually lead to stranded assets, due to other countries' transition away from fossil fuels. What is more, export-driven approaches can lead to disastrous impacts on the local environment, impact livelihoods and have high financial risks for the public purse/taxpayers,<sup>55</sup> especially when they are not coupled with social programmes designed to support local communities and counter-cyclical benefits.<sup>56</sup>
- 4) **The economic prowess of certain (richer) economies influences countries' macroeconomic policies.** This can be seen in the results of studies on spatial inequality and justice.<sup>57,58,59</sup> Some of these results highlight the effect of (higher) consumption rates of developed countries on what developing countries choose to produce and export, and the subsequent poor environmental and social conditions under which production is carried out.<sup>60</sup> This further highlights the need to ensure true country ownership of climate and development strategies.

5) **The involvement of Public Development Banks (PDBs) does not automatically lead to positive development outcomes.** PDBs are state-owned financial institutions meant to serve the public good. Despite their overarching objective or mandate being to "deliver on public policy objectives to support the economic development of a country or region",<sup>61</sup> most of the practices and policies of these institutions have not adequately supported sustainable development outcomes, protected human rights and the environment or been accountable and democratic.<sup>62</sup>

6) **Group dynamics play a significant role in project development and implementation.** The attitudes and behaviours of groups in society (e.g. policy-makers, project implementers, change agents etc.) affects project development and implementation. This depends as much on who is involved in the development of the project as it does on the capacity of local communities and local stakeholders to adequately engage with the project's implementation.<sup>63</sup> Additionally, differences in power held by stakeholders, coupled with specific narratives, has an impact on the extent to which priorities and agendas are prioritised,<sup>64</sup> which in turn can impact on project development and implementation.

## Conclusion and policy recommendations

In the wake of the Covid-19 pandemic, there is an opportunity to ensure that a new norm in climate finance emerges that is structured to ensure that vulnerable communities have access to high-quality financial support, technological assistance and capacity building. To make sure this is the case, Eurodad makes the following recommendations:

**Democratic country ownership of climate finance strategies is a necessity:** It is imperative that climate-vulnerable countries have the agency to design policies to suit their own specific circumstances and domestic needs, as opposed to the priorities of other economies. Particularly since "Three-quarters of climate investment in 2017/18 flowed domestically to projects in the same country as the source of finance, highlighting the importance of strong domestic regulatory frameworks".<sup>65</sup> Empowering domestic policy design will also help to build trust, contribute to empowering the domestic economies of climate-vulnerable countries and set a good precedent for continued, equitable, sustainable development.

**Public climate finance in the form of grants should be prioritised:** Particularly for projects related to strengthening the resilience of public services to climate impacts, as public climate finance can help reduce the risk of unnecessary higher public debt, which is typically incurred when private finance investments are used.<sup>66</sup> In addition to public finance, climate finance providers should also identify new finance instruments, or repurpose finance instruments, and use these innovative sources of climate finance<sup>67</sup> to provide a stream of scalable and predictable climate finance grants.

**Mandatory debt payments suspension and debt relief in the aftermath of climate disasters, coupled with direct access to climate finance:** An interest-free moratorium on debt payments should be provided in the immediate aftermath of a climate disaster, as this allows climate-vulnerable countries immediate access to financial resources already in their accounts. Which in turn increases the capability of these countries to carry out essential services to adapt and address loss and damage, or to provide public services in the wake of extreme climatic events. More policy recommendations on debt and climate finance can be found in this [Eurodad paper](#).<sup>68</sup>

**Supporting greater access to finance for women and indigenous communities.** Those most impacted by ongoing climate impacts and inequality are also the core implementers of these pledges.<sup>69</sup> However, they often do not have the access to finance. A gender analysis must be conducted to determine the differing needs and interests, accessibility to finance mechanisms, and power dynamics. It will also help to understand what the gendered-intersectional impacts are (e.g. age, race, gender identity etc.) – as well as helping to determine what the social additionality of climate and development finance on local communities could be (e.g. creating equitable societies, social justice and economic empowerment within communities, notably for women and girls, including from indigenous communities). This will also support developing countries' objectives to have at least 70 per cent of climate finance going to support local-level climate action by 2030.<sup>70</sup>

**PDBs must embed climate action and biodiversity objectives across all of their operations, investments and macroeconomic frameworks, and apply a 'do no harm' principle to all investments and approved projects.** This is to ensure that their activities and operations do not undermine the goals of the Paris Agreement, and that they support sustainable development that enables climate-vulnerable countries to transition to net-zero emission economies. These institutions must implement global economic good governance, responsible finance standards, and design finance mechanisms that support the evolving needs of climate-vulnerable countries.

**Creating a comprehensive monitoring and reporting framework** that includes private finance and multilateral finance. This will help create clarity on the additionality of climate finance, and contribute to reducing double-counting. It will also increase transparency, accountability and good governance, which in turn should allow the vested interests of those with significant levels of power to be exposed, instead of prioritised.<sup>71</sup> Reporting should also record how gender-responsive a climate finance intervention is and take place at the level of activity. Doing so will help determine more effectively what the impact of a project actually is.

**Policy coherence between the Paris Agreement and SDGs should be pursued by all climate finance providers.** Climate and development finance decisions must be taken with a long-term view. Whilst these two agendas have differing timelines and policy structures, they are mutually reinforcing and are an opportunity to develop coherent long-term domestic efforts to tackle climate change and achieve sustainable development. This recommendation fits with the trend of more and more countries seeking to create coherence between their climate efforts and the SDGs; with a particular focus on the opportunities of coherence for cost-effectiveness whilst under fiscal constraints brought on by the Covid-19 pandemic and subsequent unsustainable debt levels.<sup>72</sup>

**Countries should institutionalise engagement and participation processes** to ensure that all relevant stakeholders are able to engage in policy and project development and implementation, listening to the views of all marginalised groups within society including women, indigenous groups and rural communities etc. These processes must also be gender-sensitive. In order to ensure that the voices of those in the communities carrying out the efforts are taken into account, more efforts should be made to decentralise decision-making, policy and project development processes, in order to support community-based policy development and implementation.

Now is the time to act before this window of opportunity closes and the world returns to pre-Covid-19, business-as-usual norms. It is the moment to ensure that climate considerations become an integrated, integral part of economic and societal functioning. Doing so will remove the impression that climate action is an additional burden for governments and non-governmental stakeholders to grapple with.



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