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Lively exchange on challenges of developing countries on climate investments

New Delhi, July 1 (Radhika Chatterjee)-- At the 'Investment Focused Event' (IFE) held under the Sharm-el-Sheikh Mitigation Ambition and Implementation Work Programme (commonly referred to as Mitigation Work Programme [MWP]), on May 28 in Bonn, Germany, speakers and delegates from developing countries highlighted the challenges they faced on climate finance and investments in relation to mitigation actions.

The IFE was held along with the third global dialogue under the MWP and was presided over by the programme's Co-chairs **Amr Osama Abdel-Aziz** (**Egypt**) and **Lola Vallejo** (**France**).

Introducing the IFE, Amr Osama Abdel-Aziz said the event was "an opportunity to take forward the conversations from the global dialogue and to consider the cost of implementation, overcoming barriers to access finance, while identifying investment opportunities and actionable solutions." Recalling discussions held at the global dialogues and IFEs of last year, he added that "last year, we have heard several common barriers and challenges ranging from political barriers, financial barriers, cultural, technology barriers, and capacity constraints." The idea "this year is to identify actionable solutions to address some of these key challenges and barriers."

The IFE was held in two parts: a panel discussion followed by pitch hub events that were held in breakout format, held on both May 28 and 29. The panel presentations saw rich discussions on structural barriers to investment with a focus on various limitations that countries face in their fiscal spaces. The panel discussions were shaped by two guiding questions, shared by Co-Chair Vallejo. The first question focused on "primary structural barriers related to fiscal constraints hindering mobilization of investments and how do they vary across regions and sector?" The second one was about identifying "most promising solutions that the international community should focus on."

Dr. Omar E. El-Arini, a former Green Climate Fund (GCF) Board member, spoke as a panel member of the IFE. Dr El-Arini said that "there is a real barrier, political and institutional... the barrier is to enlarge what we have [and] to build on what we have."

Lamenting on the low levels of funds that countries were able to mobilize for existing climate funds like the Green Climate Fund (GCF), Adaptation Fund (AF), and the Global

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Environment Facility (GEF), El-Arini urged countries to "go back to what we have as legally binding treaties," referring to the UNFCCC, the Kyoto Protocol (KP) and the Paris Agreement, which he said are "legally binding obligations" of developed countries and are not simply "aspirational".

Emphasizing the need to look at existing realities, he said, "we have the system of the existing Financial Mechanism of the UNFCCC. The issue of finance [is] dealt with in UNFCCC's Article 4 which talks about resources, funding, and finance. Article 11 [is about the] Financial Mechanism." Stressing on the need for making best use of existing institutions, he asked for removing "all barriers in the existing Financial Mechanism", adding further that "If you look at the aggregate amount of money in all these institutions, it is not enough to finance the needed money to implement the nationally determined contributions (NDCs) of developing countries. This is the reality [that] looks us in the eyes every day as we look at the future of the planet."

Within the context of mitigation, he said it is known that "it is capital intensive. We need to either phase down emissions or to avoid emissions completely… note that the Convention and the Financial Mechanism tell us [that] for mitigation, incremental costs would be paid, not all costs," said El-Arini further. Elaborating further, he said, "most of the time [the] incremental cost component of a project capital is not enough to implement. The owner of a project, whether it is a public utility or private… seek private finance. They have been successful under different Protocols and Conventions, (and the) same would be under UNFCCC."

On NDCs, he said, "we are talking about our new crop of NDCs without having to showcase the implementation of NDCs, whether it is developing or developed country. I want us to be grounded in reality and…remain faithful to the MWP. All inputs and outputs are tangible in this work programme. We are not talking about resilience and adaptation, we are talking about mitigation, where everything…can be quantified and incremental costs [are] needed."

"Developing countries have been struggling for decades…and when they get loans, the conditions are very difficult. Some governments change over the havoc set on many countries [due to loan conditionalities] and some governments are in very difficult situation. At the end of the day the poor pay the price. The world cannot continue to rely on the poor paying the price… we will take a different course of action to remedy their plight," added El-Arini.

Daouda Sembene, CEO of AfriCatalyst, said one of the main difficulties many developing countries face across regions arises from their complex tax systems which are not delivering the required revenue. Adding to this is a challenging regulatory framework, especially in many African countries, where the complexity of tax codes makes domestic revenue mobilization difficult. Further, tax system of these countries is not designed specifically to incentivize clean energy investments.

Focusing on African countries, he said a key barrier is their "significant debt vulnerabilities that leaves very little fiscal space for mobilizing clean energy investment. Eight countries are in debt distress, and 13 countries in high debt distress" in Africa. Highlighting the importance of the politics in financing and debt mechanism instruments that are deployed he said, "if we talk about developing countries which are responsible for very limited part of greenhouse gas emissions (GHG), to ask them to do more in terms of investments, [then] they need to find some political and financial benefit for making progress on that". Especially in a region like Africa, "the best way to do this is to reduce this prohibitive cost of clean investment projects. You cannot do much if countries are not only politically convinced" but it also has to "make economic sense".

In the context of international cooperation and the 'common debt framework', which is referred to in G20 discussions, he said "We need to set clear objectives of what this international cooperation is going to be for. One key barrier is debt; we have to make sure to put in place the right international cooperation to help those countries which are struggling under international debt. The G20 talks about the common [debt] framework, but it is not delivering on the outcomes so far. [We] need to make sure it is" delivering.

He also highlighted the "high risk perception" as a key issue that many African countries were dealing with because it was limiting their market access to global capital, making it difficult for mobilizing public investment. The "perceived risk" inflates the cost of capital (COC) for many African countries, where it is "at least 2 or 3 times higher" compared to that of advanced economies or China.

Advocating the need to address risk perceptions, he said, "there are two parts [to this]. [When] there is actual risk, countries have to work with partners to de-risk and mitigate risk. There is also perceived risk that is sometimes baseless. The United Nations Development Programme's (UNDP) recent research shows that due to subjectivities of credit rating agencies African countries had to pay more than USD 74 billion in terms of additional debt service that they would not have paid if the credit rating agencies did not place them in high risk category. If we do not address this, these countries would have to pay risk premium, and this would divert (resources) from their meagre budget."

Elaborating on ways of reducing cost of capital, Sembene said, "we have to ensure that traditional financing works. You cannot reduce the cost of capital if you don't have enough equity financing… [which is] lacking in many developing countries, particularly in Africa. You cannot reduce the cost of capital without de-risking investment." There is a "need to put in place credit enhancement, including guarantees and risk sharing mechanism," added Sembene. He further said "there are examples of this in countries of innovative solutions that work, whether it is through dedicated guarantee to providers, currency hedging products… to really have adequate liquidity support mechanism. Another "innovative solution" he mentioned was "debt for climate swaps,". He pointed out however that currently, the experience of Africa showed that "very limited amount of savings have been made" through debt for climate swaps.

Dr. Mahmoud Moheildin, COP27 High Level Champion, identified three main areas of actions and said there is a "need to double bilateral finance from today's levels, triple finance from multilateral development banks (MDBs, and quadruple finance from the private sector." Bilateral finance was hindered due to political constraints.

For addressing the problem of debt faced by many developing countries, he raised the concept of "moral debt" advanced by Esther Dufflo. Elaborating on this, he said "advanced economies are rich countries and owe the Global South and developing economies no less than USD 500 billion/ year… [this is] calculated by multiplying 14 billion additional unnecessary tonnes of emissions by USD 37 / tonne." This he said "will bring us to that big figure" and asked for "some sort of trading and settlement between what developing countries owe as commercial and public debt" and this moral debt.

For MDBs, he asked for improving their efficiency and pointed to the need for better development banks. "Without decent substantive capital finance increase of these institutions, they cannot leverage the private sector, and they cannot de-risk the private sector. As a result, they cannot work with the government."

He also stressed the need for the private sector to do more on the mitigation front, adding that "we need to multiply whatever we have today from the private sector by 5." Referring to the argument advanced about developing countries lacking bankable projects, he said developing countries have already demonstrated they have bankable projects. The problems of developing countries relate to business environment and red tape, which has "nothing to do with project specific pipelines."

Moheildin also stressed the "need to be emphasizing the importance of trade restrictions, harmful investment policies and industrial trade policies that have serious implications on the fairness of doing business." In this regard he mentioned the Carbon Border Adjustment Mechanism (CBAM) of Europe, the Inflation Reduction Act (IRA) of the United States (US) and said "they have national security and geopolitical concerns, supply chain resilience concerns, competitiveness concerns and trade restrictions components."

Elaborating on the "spillover effects of CBAM and IRA" he said "we have projects in our pipeline that have a promise of funding and scaling up," but we don't receive funding "because the US is becoming more attractive." Highlighting the difficult plight of African countries, he said "even if we try to call them (CBAM and IRA) as green policy measures and not trade protectionism, [there are] certain trade implications… that will make business, social, and political environment in African countries very complicated." There is a need instead for "designing policies without intervening in sovereign matters".

Speaking in the context of the USD100 billion annual goal and the new collective quantified finance goal (NCQG), he said "it is much more important to know about methodology, governance, composition (debts, grants, investment with returns), and risks mitigation elements. In the current system the whole funding flown from the North to South and the issues related to reporting leave a lot to be desired." Pointing to the vast differences in the figures reported by Organisation of Economic Cooperation and Development (OECD) and Oxfam on the amount of climate finance provided (from developed countries), he said "we have the technical capacity in good and impartial reporting. We need the voice of the beneficiaries and need to have a better reporting system [which is] more inclusive than it is today."

Amar Bhattacharya, Senior Fellow at the **Centre for Sustainable Development, Brookings Institution**, shared that the main reason for the failure on climate is because "we are failing on investment." He said the needs of developing countries in clean energy investments are very clear, i.e. around 1.4 to 1.5 trillion USD by 2030, and the task was "how to ramp it up" and what kind of instruments could be used for that. Advocating for a greater role of private finance, he said the most important barrier to that was the "lack of strong viable projects and the high cost of capital". Highlighting the importance of public finance, he said public investment was needed especially for public infrastructure like grids, storage and so on. Development finance institutions have a key role to play in providing this public finance, he added. "Affordable private finance and affordable long term public finance" are the two pillars that are currently lacking, said Bhattacharya.

Another barrier that he identified was that of debt faced by many developing countries, and stressed the need for tackling debt and fiscal constraints. Speaking about the ways by which liquidity challenges faced by developing countries could be addressed, he mentioned the "deployment" and "recycling" of Special Drawing Rights (SDRs) as one option, and also called for "stepping up financing from other kinds of low-cost sources". He also called for revamping the 'common debt framework' of the G20, and mentioned aviation levy, shipping levy, financial transaction tax, and wealth tax, as various means of generating the scale of revenue required for dealing with the problem of debt.

The need of the hour was "significant public investment" that is affordable from development finance institutions, and which should be anchored by "strong domestic resource mobilization", said Bhattacharya further.

Regarding the solutions, he said a country-based approach needs to be adopted. Recalling the goal of tripling renewable energy that was agreed upon at COP28, he said there is need for more "ambitious NDCs" which "need to be articulated in a way where investments are centre staged."

On finance, he said developed countries have to live up to their commitments, which means going well beyond what they contributed to USD 100 billion. The bilateral concessional component of the USD 100 billion has been about USD 30-35 billion. This needs to increase further [as] that is the essence of climate finance. It is certainly a small part of the whole, but it is very crucial. It needs to be primarily focused on adaptation; it is not the big solution for mitigation," he added further.

On the role of MDBs, he argued for tripling the finance component from them and said "the business of multilateral finance banks needs to fundamentally change from a project based approach to proactively supporting system change and scaling up."

He said the private sector should be encouraged through a "co-creation of investment opportunities". There is need for "dealing with closing the gap between actual and perceived risks," he added and also highlighted South-South cooperation as a potential option for producing "important results in the clean energy space".

Highlighting challenges of recent trade and industrial policies of developed countries like the IRA and the European Green Deal, Bhattacharya said that they "have sucked out a lot of investment from the Global South because everyone is now investing in those countries. There is a need for these countries and multilateral institutions of the North to ensure that investments to the developing world are not affected."

Speaking about the challenges that developing countries face for mobilizing domestic resources, **Mohammad Nasr** of **Egypt** cited a United Nations Economic Commission for Africa (UNECA) report and said "African countries are now putting 5% of their GDP for climate change adaptation and loss and damage. If we want them to put their own resources to deliver on their current NDCs from their own money, they will have to put 10% of their GDP…[we] don't know if they will be able to do so…Interest payment of Africa for paying back its debt on an annual basis is [already] exceeding what they spend on climate change from their pockets."

Highlighting a second challenge he said, "the issue of impact of unilateral measures [like] the EU Green Deal, the IRA of the US, the CBAM of the EU - all of those actions are creating non enabling environments. If you are talking about investments, why would investments go to Africa, if they can make much more profit in developed countries that are secure and have better credit rating. They would go to countries which are secure and have better credit rating." Stressed Nasr further, "how can developing countries compete with those incentives," adding that he did not know of any developing country that can put up USD 300 billion in incentives or have major trade measures for that.

Raising the issue of providing climate finance in the form of loans he said according to recently published reports, "most of USD 100 billion provided by developed countries was provided in terms of loans. How do you define climate finance [especially if] 40-60% of it comes in loans… that is not climate finance. These are commercial loans."

He said discussions on moving from billions to trillions need to keep in mind that "if we don't have the right scale, we are not delivering on climate action. If you are having wrong instruments, if we don't have the right scale, we are not delivering on climate action…If we are not delivering on [the first round of] NDCs, we are not delivering on [the second round of] NDCs," stressed Nasr further.

Responding to the proposal of using innovative sources, he said, "taxes is easy thing. [But] even if we agree on a tax, where are these tax revenues going? How are we going to split that?" Adding further, he said, "the revenue of CBAM goes to the European budget to green the European industries… How can you ensure that these innovative sources are being directed and used for delivering ambition in developing countries?"

Regarding fossil fuel subsidies, Nasr asked, "is there a study on how much is put on tax incentives for the fossil fuel industry in developed countries versus how much is being put as a social support / social contract in developing countries? We need to differentiate between the two." He said there "a lot of reports about tax breaks in developed countries for fossil fuel exploration and expansion [including] Europe and US. When we talk about fossil fuel subsidies, [we] need to understand which fossil fuel subsidies we are talking about."

Mohammad Ayoub of **Saudi Arabia** said the barrier "could also be an issue of outdated systems and process. Budget approval and allocation process in those countries…make it a political question. For example, in 2022, Annex II countries (of the Convention) spent USD 13 trillion in expenditure. Money is there." "(The) question is whether there is political will to channel funds to climate. How can processes in these countries be adjusted in a way that treats climate change as a priority issue?", asked the Saudi delegate further.

On the issue of debt sustainability and responding to the proposal of relying on stronger domestic resource mobilization for addressing climate change, he said, "developing countries are facing limited fiscal space." Referring to United Nations Conference on Trade and Development (UNCTAD) reports, he said developing countries "have to decide between spending on health care and investments in education due to the amount they have to spend on debt servicing and they have to do it on an annual basis…[it is] not clear why they have to focus on domestic resource mobilization…[it] seems unrealistic" he said further.

Stressing on the distinction between development finance and climate finance, he said, "we cannot conflate obligations of countries with voluntary contributions. Obligations lie with developed countries not only because of (the principle of) CBDR (common but differentiated responsibilities) but also because of historical responsibility [and] agreements governing our climate efforts."

Responding to the discussion on enabling environments, Ayoub said, "it is also important to talk about the dis-enabling environment", and referred to issues such as currency exchange, unilateral measures like CBAM, and the subsidy package such as the IRA and asked what can be an approach to scaling down some of these policies and what the impact of climate protectionist policies on investment in developing countries are.

Tulio Andrade of **Brazil** said the challenge is about how we can accelerate the scaling up of finance and stressed that the provision of climate finance is not voluntary but a legal obligation. "The challenge is to move from billions to trillions" but the "reality is that while developing countries receive millions in international cooperation, they pay out billions from international cooperation that they receive. Billions are flowing out, while millions are flowing in… this process does not make sense." Highlighting on the need for structural reform of MDBs, Andrade shared that a recent tragedy experienced in Brazil had shown them that "the institutions that jumped in to help Brazil were not World Bank, or the International Monetary Fund but it was the new development banks like the Latin American Development Bank and the Inter-American Development Bank (IDB) who provided USD 3 billion without imposing conditionalities first but actually recognised the needs of the country.

The **European Union (EU)** representative, responding to the proposal of changing the business model of development finance institutions (DFIs) and MDBs said, "there has already been a strategic shift in a lot of DFIs towards more green disbursements," and asked speakers what other steps could be taken towards that? He also raised the point of "what kind of new and innovative types of policy instruments" could be created by those institutions and the role that MDBs could play in "closing the gaps between real and perceived risks." He emphasized the need for dealing with energy subsidies. Citing research by the International Monetary Fund (IMF), he said "globally we have direct and indirect fossil fuel subsidies that amount to USD 7 trillion, [which] create sizeable fiscal consequences… encourage pollution, [and are] not even targeted to low-income households." Given this context, he asked "what role do fossil fuel subsidies play in the provisions of clean energy investments."

The **US** representative said the key issue that they and "other countries have been finding in Just Energy Transition Partnerships (JETP) processes [is] the centrality of least cost planning for projects. Looking at the enabling environment and issues, and how to present and show that the money is the best of use of capital," he said "these are investments, but that can go either way depending on the enabling environments… this issue of not having least cost planning for allocation of resources [acts as] enabling environment barriers." He also stressed on the need for integrating least cost planning into NDCs and asked what kind of barriers existed that were preventing that. The challenge he said is about convincing the "private sector [that] this is an efficient use of money."

The webcast of the IFE is available here. Details and webcast of pitch hub events can be found at this link.

The topic of this year's global dialogue is 'Cities: Buildings and Urban Systems'. The global dialogue began with scene setting presentation by Dr. Yamina Saheb, the lead author of the chapter on 'buildings' of the 6th Assessment Report (AR6) of the Intergovernmental Panel on Climate Change (IPCC) in Working Group 3 on 'Mitigation'. Experts from around the world also shared presentations on the following subtopics: "Reducing operational emissions (heating, cooling and appliances); Designing building envelope for efficiency (retrofitting, new construction); Reducing embodied emissions (building materials)". This was followed by breakout group discussions on opportunities, best practices, actionable solutions, barriers and challenges on the various subtopics. More details on the list of speakers and webcast of discussions are available here.