



New Collective Quantified Goal Tenth Technical Expert Dialogue and Second Meeting of the AdHoc Work Programme

The International Peace Institute welcomes the opportunity to respond to the call for Parties and Observer Organizations to submit views to the next meetings of the New Collective Quantified Goal on climate finance (NCQG).

In accordance with Article 9.1 of the Paris Agreement, developed countries shall provide financial resources to help developing countries in their mitigation and adaptation efforts. To meet developing countries' climate finance needs, the next NCQG must deliver on two objectives: an ambitious target and a way to get us there.

To that end, at the last Technical Experts Dialogue, developing countries suggested that the NCQG should include a number of qualitative measures that would help raise, enhance, or leverage an ambitious quantum figure. These include provisions related to climate finance access, coordination, and delivery as well as “dis-enablers” such as the high cost of capital, lack of fiscal space, and “unilateral measures” related to trade restrictions.

These economic and bureaucratic obstacles discourage domestic and foreign investment in pro-climate projects and policies in developing countries. Due to long-standing structural inequalities in the global economy, they are also obstacles that are for the most part unique to developing countries.

In turn, addressing these obstacles through the NCQG would contribute to a viable path for fulfilling an ambitious climate finance goal at COP29 and encourage the development of more ambitious NDCs for all countries at COP30.

This submission expands on developing countries' suggestions to include a broader and more specific list of climate finance dis-enablers for consideration in the next TED.

High cost of capital: The high cost of capital is a major obstacle for green investment in developing countries. This challenge is particularly acute in emerging market and developing economies (EMDEs), which constitute the largest share of future emissions growth.

A recent survey of leading financiers and investors confirmed that the cost of capital for utility-scale solar photovoltaic (PV) projects in EMDEs is well over twice as high as it is in advanced economies.¹ This is compounded by lack of access to local capital. In India, the limited availability of local debt is the biggest barrier to financing renewable energy projects there, increasing the cost of renewable energy in the country by 24%-32% compared with similar projects in the US.² The funding challenge increases for small-scale projects such as off-grid solar-power needed in many rural areas and small islands.

High transaction costs: There is a saying: Being broke is expensive. This is doubly true for reducing emissions in many developing countries, where large capital investments are needed to upgrade outdated energy infrastructure (often installed decades ago by the World Bank). However, high upfront costs for capital-intensive projects locks countries into polluting technologies that might initially be less expensive but require persistent spending on—and combustion of—fossil fuels for their operation. Developing countries face a similar problem in the green bond market, where transaction costs are more than double those of comparable rated corporate bonds.³

Loss of money during currency conversion is another transaction cost faced by developing countries that diminishes the reach of climate finance. This problem extends from sovereign governments structuring long-term finance on large infrastructure projects, down to direct cash flows to citizens and local markets via remittances. Remittance costs, including fees and exchange rate margins, still range from 5% to 15%, and are highest for citizens in low-income countries and small-island states. (Conversely, Eastern Europe enjoys the lowest remittance costs.⁴) Reduced remittance flows inhibit local investment especially in countries where remittances are a high percentage of GDP (such as Bangladesh) and where projects tend to be smaller (such as in rural areas).

Lack of fiscal space: Another advantage advanced economies have, and which developing countries excluding China lack, is the ability to spend countercyclically during economic downturns. This was demonstrated amply during the COVID pandemic and is reinforced following

¹ <https://iea.blob.core.windows.net/assets/227da10f-c527-406d-b94f-dbaa38ae9abb/ReducingtheCostofCapital.pdf>. In Brazil and India, for instance, the weighted average cost of capital for renewable energy projects ranges between 9-12%, whereas in developed countries the range is closer to 5%. See <https://www.iea.org/data-and-statistics/charts/cost-of-capital-by-project-type-in-selected-countries-2022>.

² <https://www.climatepolicyinitiative.org/publication/finance-mechanisms-for-lowering-the-cost-of-renewable-energy-in-rapidly-developing-countries/>

³ <https://findings.co/esg-investing-what-green-bonds-are-and-why-do-they-matter/#:~:text=One%20of%20those%20critical%20challenges,rated%20corporate%20bonds%20since%202008>.

⁴ <https://www.elibrary.imf.org/view/journals/001/2022/218/001.2022.issue-218-en.xml>

extreme weather events, during which countries face difficult choices between the short-term need for fiscal transfers, the long-term need for reconstruction finance, and the creditors knocking at their doors.

Fiscal space is further constrained by many developing countries' crushing debt loads. Over two-thirds of developing countries are currently in debt distress but still lack any common framework or rules for restructuring. In other words, how much a developing country can spend during a climate or other emergency depends on the generosity of their creditors, not a country's needs. Expiring debt relief measures have worsened the situation, with 11 countries in debt distress and 28 at high risk.⁵ The result is a decrease in long-term investment in climate-friendly development and energy diversification, and an increase in investment in existing fossil fuel-based solutions.

Trade barriers: Developed countries have in the past few years enacted signature climate policies—namely, the Inflation Reduction Act (IRA) in the US, and the Green Deal and Carbon Border Adjustment Mechanism (CBAM) in the EU. Green energy sectors in developed countries will undoubtedly benefit from these measures, but they are not without consequence for developing countries. Advanced economies have the public resources and sovereign credit to decarbonize through subsidies; expecting developing ones to do the same is setting them up for failure. IMF chief Kristalina Georgieva has already cautioned against this trend, urging that green subsidies “be carefully designed to avoid wasteful spending or trade tensions, and to make sure that technology is shared with the developing world.”⁶

More worrying than a subsidy war is a trade war fought under the guise of climate action. “Green protectionism” in developed countries aggressively bends, if not altogether breaks, international trade rules under the WTO regarding equal treatment of foreign and domestic suppliers. The US IRA, for instance, incentivizes the use of pricier homemade components even though their makers will struggle to supply enough of them. This means that the protectionist path to decarbonization is also a slower and more expensive one.

Access barriers: Developing countries face numerous barriers to accessing public climate finance from multilateral institutions. At the World Bank, lower and middle income countries have limited access to grant-based finance through IDA, while at the IMF, only countries with “Upper Credit Tranche” status can borrow SDRs from its new trust. The result is a concentration of resources in a few successful countries and an overall lack of investment in countries that are struggling.

Some of the most notorious examples of access barriers come from the multilateral climate funds. Despite substantial overlap in focus and implementation, each climate fund has its own separate and lengthy application process. Developing countries have been particularly frustrated with the

⁵ <https://unctad.org/publication/least-developed-countries-report-2023>

⁶ <https://www.imf.org/en/Publications/fandd/issues/2023/06/green-trade-tensions-kaufman-saha-bataille>

Direct Access process at the Green Climate Fund. The GCF sets a high bar for Direct Access accreditation, so that these vetted and trusted entities can receive funds promptly and with minimal obstacles. Yet, the opposite has happened. Despite the relatively large number of Direct Access Entities that have been accredited, over two-thirds have yet to receive project approval. Initiatives like the Readiness Programme and the Project Preparation Facility have shown limited success, while the Simplified Approval Process, intended to expedite smaller projects, has not significantly reduced the burden or time required for approval.⁷

⁷ <https://www.wri.org/research/improving-access-green-climate-fund-how-fund-can-better-support-developing-country>