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MOBILISING FINANCE FOR CLIMATE ACTION AND DISASTER-RESILIENT INFRASTRUCTURE IN DEVELOPING COUNTRIES

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Abstract

A fundamental obstacle all cities, especially those in developing countries, must overcome on the path to a low-emissions and climate-resilient future is the lack of capital and access to finance. International adaptation finance flows to developing countries remain between five and ten times lower than the estimated needs, and the gap is widening.[1] As the impacts of climate change intensify, the developing world urgently needs financial mechanisms to mobilise funds to help vulnerable countries and communities adapt and build disaster-resilient infrastructure.

The G20 can play an important role in addressing this challenge and help catalyse finance for climate action in developing countries. This policy brief recommends a multipronged approach for developing countries to finance their adaptation, mitigation, and resilience actions by (a) having access to finance sources, (b) utilising existing development budgets more effectively through tagging, and (c) creating a resilience lab at the most relevant tier of administration (national/sub-national) to facilitate the design and rollout of blended financing mechanisms for funding adaptation actions.

The Challenge

1

Most developing countries—which have had a lower historic contribution to climate change but are faced with the brunt of its impacts—are struggling to strike a balance between economic growth and sustainable development given their limited financial resources.[2] As such, the United Nations Framework Convention on Climate Change (UNFCCC), the Kyoto Protocol, and the Paris Agreement have called upon developed countries to provide financial assistance to developing economies that are likely to be more vulnerable to the impacts of climate change.[3] At the 15th Conference of Parties (COP15) of the UNFCCC in 2009, developed countries committed to mobilising US$100 billion per year by 2020 for climate action in developing countries. The goal was formalised at COP16 in 2010 and was reiterated and extended to 2025 at COP21 in 2015, but the scale and pace of finance mobilisation remains slow and insufficient.[4]

Developing countries are facing an increasing frequency and magnitude of climate hazards. However, most national governments do not have sizeable, dedicated budgets for climate adaptation and resilience actions. For instance, India launched its National Adaptation Fund for Climate Change in 2015-16 but the allocations have tapered down in the last few years to just sufficient to complete previously-approved projects. Developing countries neither have the mandate to integrate climate risks into development projects nor do they have exclusive finance for such efforts. Therefore, it is imperative for national budgets to mainstream climate actions with development budgets, which can be pilot-tested through the climate budget tagging mechanism. This will integrate climate risks with development budgets and mainstream climate actions with development finance discussions.

The complementary strengths of the different pools of finance must be utilised to meet developing countries' investment needs to build resilient infrastructure and ramp up ambitious climate action. Also, climate finance remains skewed towards mitigation and flows towards bankable projects. Adaptation is unlikely to offer commercially profitable opportunities for private financiers, which is a limiting factor.[5] At the COP27 in 2022, countries agreed to establish a 'Loss and Damage Fund' to compensate the most vulnerable countries for damages from climate-linked disasters.[6] The fund will at first receive contributions from developed countries and other private and public sources, but there still is a lack of clarity on which countries will be eligible to receive the funds.[7]

Most developing countries cannot identify, appraise, and select quality projects, and manage relevant fiscal risks. Additionally, the capacity of subnational and non-state actors in developing countries to mobilise finance for building resilience is limited. One of the reasons for this is the scarcity of high-quality and reliable data. The development of capacity is crucial to fortify the climate information framework, which plays a vital role in fostering the growth of capital markets and enhancing the viability of projects.

The G20's Role

2

The G20 forums brings together developed and developing countries to exchange ideas that foster growth, restructure development strategies, and meet the aims of the Sustainable Development Goals (SDGs). Additionally, many of its member countries have the knowledge, skills, and financial resources necessary to catalyse investments for disaster resilient cities and societies. The G20 can also provide a platform for member countries to coordinate their policies and approaches towards climate finance in developing countries. This coordination can help align efforts, share best practices, and create a more conducive environment for accessing climate finance.

As such, the G20 can to provide climate finance and investments in clean energy projects and support the capacity building initiatives in developing countries. This brief recommends four ways in which the G20 can provide such assistance to the developing countries.

Recommendations to the G20

3

Reforming multilateral banks to improve accessibility to and availability of climate finance

The developed countries have not provided adequate financial assistance to developing countries in their transition to clean energy.[8] Multilateral banks should take the lead and act a medium for bridging the funding gap. As the major shareholders of the multilateral banks, the G20 countries have the power to influence their governance structures, capitalisation, and decision-making processes to prioritise climate finance and align with the SDGs.[9]

The goal is to enhance the allocation of funds towards climate-related projects and establish targeted climate finance strategies that prioritise funding for endeavours focused on climate mitigation, adaptation, and building resilience in developing nations. Multilateral organisations should strive to simplify and streamline the process for developing countries to access climate finance. This encompasses efforts such as reducing administrative burdens, enhancing the accessibility of information, and offering user-friendly guidance and support at every step of the financing process.

The G20 has already taken a step in this direction under India's presidency by establishing an Expert Group on 'strengthening multilateral development banks' (MDBs). The expert group will thoroughly examine every facet of MDB evolution, encompassing vision, incentive structure, operational approaches, and financial capabilities. Their objective is to ensure that MDBs are adequately prepared to provide funding for a diverse array of SDGs and address transboundary issues such as climate change and health.[10]

Exploring blended finance mechanisms and governance structures to bring together public, private and market-based instruments to fund climate actions

Blended finance mechanisms refer to the combination of different sources of finance (international, public, private, and domestic) to support climate change mitigation and adaptation activities. The motive behind blended finance is to leverage public funds to mobilise additional private investment and to direct that investment to climate-specific projects.[11]

Blended finance mechanisms are increasingly being used by cities in developing countries to mobilise the investment needed to achieve the climate goals and for climate-proof development. For instance, Indonesian capital Jakarta is highly vulnerable to the impacts of climate change. The implementation of climate-smart infrastructure projects in Jakarta, such as the construction of flood barriers and the development of green spaces, have been financed through a combination of government funds, private investment, and international donor support, including from organisations such as the Asian Development Bank and Green Climate Fund.[12]

The G20 should promote the scaling-up of such financial instruments in cities in the developing countries. Identifying and addressing city-specific limitations can help in building their capacities to mobilise finance for climate specific actions. Additionally, the G20 can act as a coordination platform for knowledge sharing, such as on best practices related to blended finance mechanisms from across the member countries.

Establishing 'resilience labs' to support Loss and Damage Fund

The proposed 'Loss and Damage Fund' will give developing countries the opportunity to push the agenda for combating climate change through the appropriate allocation of financial resources. The creation of the fund is a significant step for climate financing, but operationalising the resources and encouraging resilient development are crucial.[13] As a forum that includes several large developing countries, including India (current chair) and Indonesia (past chair), the G20 can further this goal.

Importantly, estimating the loss and damage due to climate change must go beyond a simple evaluation of monetary losses, such as those caused by the destruction of infrastructure (for instance, embankments and homes). It is equally important to consider how ecosystem services are being damaged. The complexity of loss and damage risks should be addressed at the national and local levels, with governments employing a variety of "layered" financial instruments. Layering will allow highly susceptible groups to prevent a downward spiral after each climate-induced shock by ensuring that activities foster resilience. This means providing the right kind of funding to the right initiatives at the right time and location using methods that are easily available, adaptable, and correctly targeted locally.[14] This can be done through a national-level resilience lab, which can identify and allocate resources from the fund.

The resilience lab should include representatives from the country's vulnerable groups, central and state governments, and specialists from various sectors (such as finance, insurance, engineering, and humanitarian and development) to help construct first 'strawman solutions' to identify the key implementation issues and propose solutions to these challenges. There is also a need to understand, identify, and assess disaster risks, which can be done through risk transfer instruments designed by domain experts. The lab should test technologies, solutions, pilot test models, and policies, and study real-world cases to understand the resilience benefits in each instance. The lab should work to create awareness on pre- and post-disaster management, funding, and finances involved to create disaster resilience among vulnerable groups. A detailed review of the literature on infrastructure finance, and an analysis of the financial instruments currently in use and that are directly and indirectly related to resilience will serve as the foundation for the lab.

The lab's motive will be to encourage transparency on disaster fund usage, incentives and insurance, and innovative methods and techniques through research on catalysing investments for disaster resilience. It will also focus on raising awareness among the vulnerable groups and others through trainings, workshops, and seminars on disaster management and climate adaptation and mitigation strategies.

The resilience labs can help fill the gaps that remain in raising finance to build disaster-resilient infrastructure, especially in developing countries where there are often no guidelines or policies focused on such financial instruments. These labs can encourage the use of digital and participatory tools, GIS-based modelling, and real-time monitoring through various technical innovations to build resilience.

The Loss and Damage Fund is expected to be operationalised soon and many countries, including the G20 members, are expected to make contributions that can be utilised to establish resilience labs. This offers the G20 a chance to serve as a platform for the fund's discussions and for all member countries to expedite the disbursement of the necessary funding. Scaling up adaptation financing should be a top goal in addition to the Loss and Damage Fund. The G20 should make sure that the new adaptation finance commitments announced at COP27 are fulfilled.

Establishing standardised climate budget tagging and budgeting mechanisms at the national level to finance resilience actions

Globally, several objective-based frameworks have been adopted that tag expenditure based on their explicit and stated intent towards climate actions.[15] These include the Climate Public Expenditure and Institutional Review, Rio Markers, and Joint MDB Methodology. In the past, India has also tested benefits-based approaches, such as the phased climate change impact appraisal framework, that attempted to document the potential impact of public expenditure on ground and accordingly tag them based on their climate relevance and sensitivity[16]. Climate budget tagging will also provide a baseline estimate of the climate co-benefits (adaptation and mitigation) of public expenditure (national budgetary spending). It will also aid in prioritising budgetary allocations on an annual basis based on a climate mitigation and adaptation co-benefit perspective. For example, the Indian state of Odisha has adopted this approach and has now integrated the climate budgeting process with its annual budget discussions at the state assembly. National government should target a similar goal to mainstreaming climate budgetary discussions. The G20 can establish guidelines to help all countries adopt a standardised framework for climate budget tagging and budgeting, thereby enhancing the transparency and accounting for climate expenditures at the national level. This will also help both developed and developing countries supply and demand climate finance based on their climate finance gaps, which can be estimated through more nuanced climate budgeting practices. This will also ensure greater distributional equity of climate finance between both contributor and recipient countries.

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Endnotes

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