DELHI
businessline.
WEDNESDAY - JUNE 21 - 2023

Inclusive climate funding

Recasting multilateral lending framework will help

Suranjali Tandon

Economic slowdown, climate change and debt distress have reignited interest in reforming the international financial system. The G20 is committed to examining if existing institutions and their funding facilities are fit for purpose. This has been relevant as the IMF's surveillance framework and its financial resources have been considered inadequate during crises. As has been corroborated by its response to Pakistan's economic slowdown after the floods.

Business as usual for multilateral finance is a travesty of development finance. 'Poorer' nations pay interests of up to 14 per cent on borrowings as compared to 1-4 per cent for rich countries. This is problematic since 71 per cent of the climate finance to low- and middle-income countries is in the form of investment loans, whereas 9 per cent is given as grants and 3 per cent as guarantees. The macroeconomic consequences of an extreme weather event can be devastating. Thus, the inequities in finance must be overcome, though not exclusively, by re-examining the role of critical market makers such as credit rating agencies that influence flow of capital by projecting risk perceptions of sovereign.

BRIDGETOWN INITIATIVE

The Bridgetown Initiative is an effort at addressing such inequities through a loss and damage fund, inclusion of a 'natural disaster clause' to loans that temporarily suspend interest payments on debt of climate related disaster affected countries and financial support that is structured as grants and not as loans, available automatically when the estimated loss from an event exceeds 5 per cent of GDP.

Given that private finance lags in adaptation, the Bridgetown Initiative also suggests bridging the financing gap through a $500 billion Global Climate Mitigation Trust funded via unused Special Drawing at lower costs (2.4 per cent). Such loans from the fund's assets would not count as any country's liability or be a 'third debt'.

The loss and damage fund, which was announced at COP27, was a success for the Bridgetown Initiative. Although its other suggestions are still to be considered with similar gravity. Nevertheless, the recent G7

ON TAP. A spectrum of capital

communique offers a glimmer of hope as it recommends climate resilient debt clauses for loan agreements. To strike when the iron is hot, India can in its presidency encourage restructuring of debt and reconsideration of terms of lending to vulnerable countries.

Multilateral development bank (MDB) financing is considered key by climate finance specialists. However, at $58.8 billion, it remains limited. Demands of funders such as bond-holders for security are some of the factors that explain the conservative lending approach of MDBs. Experts suggest that revisiting the capital adequacy frameworks, engagement with credit rating agencies for proper risk assessment and use of callable capital to expand lending are ways to get around the problem.

However, a more practical approach is to focus beyond institutions, as restrictive investor and developed country shareholder mandates cannot be wished away. MDBs may be better placed to scale lending in particular mitigation projects. It is, therefore, essential to imagine new forms of funding facilities, especially for adaptation such as regional grants and guarantees financed by fossil fuel levies and taxes. The latter can be efficacious in raising necessary capital and responding to the trade based pricing measures committed to by advanced economies.

The most important task at hand is to recognise there is no silver bullet and that there exists a spectrum of capital from return seeking to outcome seeking. Each of these are willing to invest in different projects and the stages of such projects. Instead of placing disproportionate emphasis on a single institution or source, the G20 must prepare a practical template that maps the sustainable finance instruments with outcomes and track annual flows.

The writer is an Assistant Professor at the National Institute of Public Finance and Policy