"RETHINKING CLIMATE FINANCING: ADDRESSING THE BUSINESS MODEL SYNDROME"

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Freeman Chiwele Mubanga1

The Center for Environment Justice (CEJ), Lusaka, ZAMBIA

1 INTRODUCTION

As Africa continues to navigate the complexities of climate change, it's evident that many climate solutions are driven by business models favouring developed nations. Too often, African nations must adopt these models without any input into their creation. When approaching international negotiation tables for climate financing or development aid, we often present arguments based on ecological and colonial debt owed to Africa. Meanwhile, our counterparts approach these issues from a business perspective, seeking economic benefits.

Climate financing is intended to help developing nations combat and adapt to the effects of climate change. However, the current system often benefits wealthy countries more than the recipient nations. A recent Reuters investigation reveals that much of the climate financing provided to developing countries comes with strings attached, often in the form of high-interest loans or grants requiring the use of suppliers from the lending countries. This business model undermines the primary goal of climate finance, which should be to support the needs and priorities of recipient developing countries.

Critics argue that climate finance should prioritise the needs and priorities of recipient countries rather than serving as a business opportunity for donors. Despite pledges to provide $100 billion annually[2] to help poorer nations, most of the direct climate funding still comes in the form of loans rather than grants. This financial model perpetuates a cycle of debt and dependency, hampering the ability of developing countries to invest in sustainable solutions and build resilience against climate change.

2 THE RATIONALE

Africa, despite contributing minimally to global emissions, bears the brunt of climate change impacts. Floods, droughts, and other extreme weather events disproportionately affect African nations, exacerbating poverty and hindering development. In response, developed countries have pledged

[1] Head of Research and Studies, Centre for Environment Justice (CEJ) Zambia <freemanmubanga82@gmail.com>

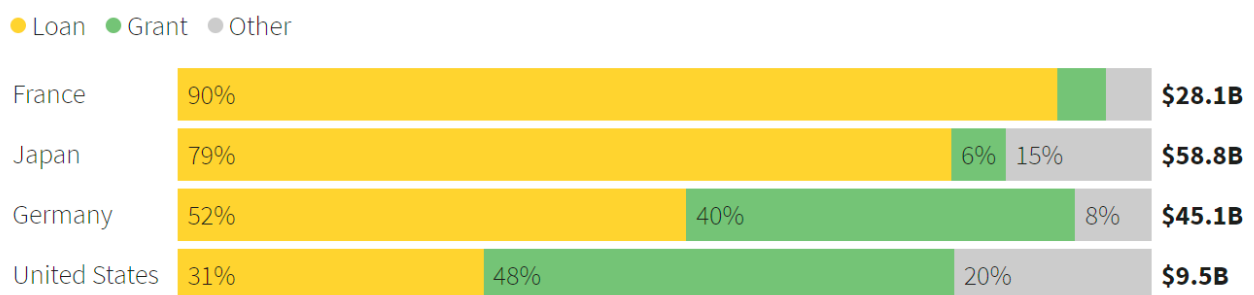
[2] https://www.reuters.com/sustainability/sustainable-finance-reporting/rich-countries-may-have-met-100-bln-climate-goal-last-year-oecd-2023-11-16/

substantial climate finance. However, the structure of this financing—often in the form of loans with market-rate interest or conditional grants—undermines the effectiveness and fairness of these efforts.

A Reuters investigation[3] revealed that wealthy nations, including Japan, France, Germany, and the United States, have funnelled billions back into their economies through climate finance. For instance, as illustrated in **Fig. 1** below, between 2015 and 2020, Japan loaned $10.2 billion, France $3.6 billion, Germany $1.9 billion, and the U.S. $1.5 billion at market rates, benefiting their own economic interests. Furthermore, $11 billion in loans required recipient nations to hire or purchase materials from companies in the lending countries, and $10.6 billion in grants had similar conditions.

This business-centric approach contradicts the principle that developed nations should assist poorer ones without expecting direct economic returns. It also exacerbates the debt burden on African nations, who must repay these loans often at significant financial and social costs.

Japan, Germany, France and the U.S. reported the most climate finance contributions to developing nations between 2015 and 2020. Climate funding representatives from these top countries say loans are appropriate for large, revenue-producing projects in nations with strong economies.



Note: The "other" category includes financial instruments, such as bonds, equities, guaranties and contributions that included both grants and loans.
Source: Reuters analysis of climate finance data nations reported to the U.N.

Figure 1: Three of the top four climate finance contributors favour loans over grants

The investigation by Reuters reveals that a significant portion of climate funding from wealthy nations to developing countries is structured in ways that ultimately benefit the donor countries economically. This finding contradicts the primary goal of climate finance: to support developing nations in reducing emissions and adapting to the impacts of climate change.

[3] Casado Sanchez, I., & Botts, J. (2024, May 22). A program meant to help developing nations fight climate change is funnelling billions of dollars back to rich countries. Reuters. Retrieved from https://www.reuters.com/investigates/special-report/climate-change-loans/

3 KEY TAKEAWAYS FROM THE REUTERS REPORT

3.1 Market-Rate Loans

- Wealthy countries, including Japan, France, Germany, and the United States, have extended at least $18 billion in climate loans at market-rate interest. Japan alone accounts for $10.2 billion of these loans.
- These market-rate loans are contrary to the common practice of offering low or no-interest loans for climate-related projects.

3.2 Tied Aid

- At least $11 billion in loans and $10.6 billion in grants were conditioned on recipients hiring or purchasing materials from companies based in the lending countries. Nearly all of Japan's $11 billion in loans had such conditions.
- This practice diverts a portion of climate finance back to donor countries' economies.

3.3 Economic Benefits to Donor Countries

- Developed nations are reaping significant economic rewards through interest payments and business contracts tied to climate finance.
- For instance, a $118.6 million loan from France to Guayaquil, Ecuador, for an aerial tramway, which was counted as climate finance, resulted in substantial interest payments and contracts for French companies, despite the project's limited environmental impact and financial burden on the local government.

3.4 Disproportionate Lending

- Over half of the climate finance from developed nations to poorer countries comes as loans, not grants. While grants are prioritized for the poorest nations, they receive significantly less funding overall compared to middle-income countries that receive loans.
- Loans contribute to increasing the debt burden of developing countries, making it harder for them to invest in necessary climate adaptations.

3.5 Criticism and Defence

3.5.1 Critics' Perspective

- Climate finance experts and activists argue that such practices are ethically and economically detrimental to developing countries. They contend that using climate finance as a business opportunity undermines the intent to help vulnerable nations build resilience against climate change.

- The imposition of hiring conditions on grants and loans is seen as a strategy that primarily benefits donor countries, preventing recipient countries from developing their own capacities and technology.

3.5.2 Donor Countries' Perspective

- Representatives from Japan, France, Germany, and the United States defend their practices, stating that a mix of loans and grants allows for greater overall funding. They claim that loans are necessary for substantial projects and that they consider the debt capacity of recipient countries when determining loan terms.
- They also assert that conditional aid often includes technology transfer and capacity-building components, which benefit recipient countries in the long run.

3.6 Broader Implications

3.6.1 Negotiating New Targets

- As global leaders negotiate new climate finance targets, the findings of this report underscore the need for greater transparency and more equitable practices in climate funding.
- There is a call for concessional loans with low interest rates and long repayment periods, along with clearer guidelines to prevent the exploitation of climate finance for donor countries' economic gains.

3.6.2 Debt and Climate Resilience

- Developing countries face a cycle of increasing debt and escalating climate impacts, which hinder their ability to invest in necessary adaptations and mitigations.
- More equitable climate finance practices are essential to breaking this cycle and ensuring that vulnerable nations can effectively address the challenges posed by climate change.

4 WHAT CAN BE DONE?

To address the inequities in climate financing, the following measures are recommended:

1. **Shift from Loans to Grants**

   Climate finance should prioritise grants over loans, especially for the most vulnerable nations. Grants do not add to the debt burden and allow for more effective and flexible use of funds. This flexibility enables recipient countries to respond more promptly and efficiently to their unique climate challenges, adapting solutions to local contexts without the constraints and repayment pressures associated with loans.
2. **Eliminate Conditional Aid**

Aid should be free from conditions that require hiring companies from donor countries. This will ensure that the funds genuinely benefit the recipient nations by enabling local economic growth and capacity building. Removing these conditions allows for more equitable distribution of resources and fosters a sense of ownership and empowerment within local communities.

3. **Enhance Transparency**

   Establish stringent reporting requirements for climate finance contributions. Transparency in terms and conditions will ensure that the funds are used effectively and fairly. Clear and accessible reporting mechanisms will hold donors accountable and build trust between donor and recipient nations.

4. **Prioritize Local Solutions**

   Encourage the use of local expertise and resources in climate projects. This not only builds local capacity but also ensures that solutions are tailored to the specific needs of the region. Mechanisms to achieve this could include policy changes that mandate a certain percentage of project funds be allocated to local contractors and experts, or incentives such as tax breaks or grants for local businesses and organizations involved in climate initiatives.

5. **Establish an Independent Oversight Body**

   An international body should oversee climate finance, ensuring that it meets its intended goals without being co-opted by donor countries' economic interests. This body should be composed of representatives from both donor and recipient countries, with a mandate to monitor, evaluate, and report on the use and impact of climate finance to ensure transparency, accountability, and fairness.

5 EXPECTED RESULTS

Implementing these recommendations will have several positive outcomes:

1. **Reduced Debt Burden**

   By shifting to grants and eliminating high-interest loans, developing nations can focus on implementing climate solutions without the looming pressure of repayment. For example, the Pacific Island nation of Samoa implemented a project funded entirely by grants to bolster its coastal resilience against rising sea levels. This approach allowed Samoa to invest in long-term solutions without adding to its debt burden, resulting in increased community resilience and reduced vulnerability to climate-related disasters (UNDP, 2018) [4].

2. **Empowered Local Economies**

[4] https://www.globalsupportprogramme.org/projects/af-samoa

Removing conditions tied to aid will allow local businesses and experts to play a central role, fostering economic growth and building local capacity. In Bangladesh, the Grameen Bank's microfinance model has empowered local communities to undertake climate adaptation projects, such as building flood-resistant housing and establishing sustainable agriculture practices. By providing access to funds and resources directly to local communities, the Grameen Bank has catalysed economic development and resilience-building efforts[5] (Scheyvens, 2015).

3. **Greater Trust and Cooperation**

   Transparent and fair climate financing will enhance trust between donor and recipient nations, leading to more effective and collaborative efforts in combating climate change. The Green Climate Fund's commitment to transparency and accountability has fostered trust among its member countries, facilitating partnerships and cooperation in climate finance initiatives. By providing a platform for open dialogue and information sharing, the Green Climate Fund has helped bridge the gap between developed and developing nations in addressing climate challenges.

4. **Sustainable and Tailored Solutions**

   Prioritizing local solutions will ensure that climate projects are relevant and sustainable, addressing the unique challenges faced by African nations. In Ethiopia, the Sustainable Land Management Program has successfully implemented community-led projects to combat soil erosion and improve land productivity. By involving local communities in project design and implementation, the program has ensured that interventions are tailored to the specific needs and priorities of each region, leading to long-lasting impacts on livelihoods and environmental sustainability (World Bank, 2020).[6]

6 CONCLUSION

The current model of climate financing, heavily skewed towards the interests of wealthy nations, undermines the very purpose it is meant to serve. By adopting a more equitable and transparent approach, we can ensure climate finance genuinely aids developing nations in their fight against climate change. Africa, and other vulnerable regions, need solutions that empower them rather than entangle them further

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[5] Scheyvens, H. (2015). The role of microfinance and microfinance institutions in climate change adaptation: Learning from experiences in Bangladesh. Hayama: Institute for Global Environmental Strategies (IGES).

[6] World Bank. 2020. Ethiopia—Sustainable Land Management Project I and II. Independent Evaluation Group, Project Performance Assessment Report 153559. Washington, DC: World Bank.

in economic dependency. Only through such reforms can we hope to achieve climate justice and a sustainable future for all.

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