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KEYS TO CLIMATE ACTION

CHAPTER 11: CLIMATE ACTION IN THE MOST VULNERABLE COUNTRIES

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Introduction: Creation of the Vulnerable Group of Twenty Ministers of Finance

Vulnerable countries are often left out of global strategies to avert climate breakdown. Steadily, however, it has been precisely these countries that have built up one of the largest and most consistent coalitions of nations to do just that. Not only have they formed the political backbone of ambition behind centerpieces of global climate policy like the 1.5°C goal of the Paris Agreement. They are also a pioneering frontier of economic and financial solutions to fighting the climate crisis. What is more, any lasting solution on climate will require the kind of reform to the international financial architecture—to making debt work for the most vulnerable, to overcoming capital hurdles to investment, facilitating global exchange via carbon finance, fully integrating climate risks, development finance institutions (DFIs) prioritizing of climate action, and establishing pre-arranged and trigger-based funds—that these nations have been calling for and which will work for them. Getting the financial system to work for the most vulnerable not only serves the interests of those least responsible and most exposed to this crisis, it will also make the whole world better off.

In 2009, 11 countries from Africa, Asia, the Caribbean, and the Pacific met near Malé, Maldives, to form an international partnership of developing countries most threatened by a global climate emergency.[1] The Climate Vulnerable Forum (CVF), as it was called, has since grown and evolved as a platform to help members act together to deal with climate change. In October 2015, two months before the Paris Agreement, the CVF launched a dedicated group of its ministers of finance, called the Vulnerable Twenty (V20) Group to translate political ambition into real economy outcomes. It has also identified five thematic ambassadors to take the climate agenda forward and has launched a global parliamentary group to enable parliamentarians from across the CVF member states to share experiences and good practices on legislative measures to accelerate efforts to ensure a supportive climate financing and regulatory environment. As of early 2023, the CVF/V20 spans 58 countries representing almost 1.5 billion people, $2.4 trillion of gross domestic product (GDP), and 5 percent of global emissions. Most pertinently it comprises the set of countries most vulnerable to the impacts of climate change.

[1] The original CVF members were Bangladesh, Barbados, Bhutan, Ghana, Kenya, Kiribati, Maldives, Nepal, Rwanda, Tanzania, and Vietnam.

Here and now costs

For V20 countries, climate change is not a distant challenge. It compounds fiscal stress and has set aflame national budgets here and now. Government liabilities are increasing from growing extreme weather events and from managing volatility in fossil fuel prices. As climate-fueled risk intensifies, losses and damages due to insufficient adaptation responses and an almost total lack of financial protection are a fast-emerging major macroeconomic concern for climate vulnerable economies (IPCC, 2022). Climate-fueled impacts permeate through national economies, affecting their infrastructure, supply chains, social protection, and micro, small, and medium-sized enterprises, which a majority of people rely on for employment opportunities.

The loss and damage from man-made climate change has been quantified at the macroeconomic level by a 2022 "Climate Vulnerable Economies Loss Report" commissioned by the V20 (V20, 2022a). The report concludes that the V20 would have been 20 percent wealthier today had it not been for losses attributable to climate change. The reduction in economic growth was estimated at slightly less than 1 percent each year on average between 2000 and 2019—growth could have compounded at 4.6 percent annually, instead of the 3.7 percent that was registered. However, for the 6 worst affected V20 economies, the relative economic losses due to climate change since 2000 are estimated to have made challenging situations even worse. These countries only grew at 0.4 percent per year, half the rate at which they would have grown in the absence of climate losses. In aggregate dollar terms, V20 economies are estimated to have lost approximately $525 billion due to climate change over the two decades—a devastating amount of wealth destruction for frontline economies and communities.

The Climate Vulnerable Economies Loss Report found that nearly all V20 economies have already warmed to mean temperatures that are far beyond what would be optimal for generating economic growth, and additional warming will only carry the countries further from the optimum, greatly increasing climate-induced losses. Lack of adaptation to new rainfall patterns could induce losses of −15 percent in Timor Leste, Yemen, or South Sudan; for the majority of V20 countries, losses could be in the range of −5 to −10 percent of GDP. Across the V20 members, the frequency and intensity of extreme weather and weather- related events, including extreme rainfall, drought, cyclones, and wildfires, are increasing, which can compound losses (IPCC, 2021). For example, alterations in rainfall patterns are increasing the frequency of flood events, which increase the risk of infectious disease transmission, loss of assets, and death; while in parallel, the frequency and intensity of drought is rising, putting food and water security at risk (IPCC, 2021).

The same V20-commissioned report is clear on the implications of these trends: Adaptation investments need to accelerate sharply both to prevent loss and damage at current levels, as well as to offset compounding economic losses and damages. The report also provides evidence that international support supplied to V20 economies affected by hydro-meteorological extremes can reduce the negative macroeconomic effect that would otherwise occur, but that such support is scarce. Within the V20, only an estimated 2 percent of assets and livelihoods are protected against adverse shocks, implying a 98 percent “financial protection gap” against climate and disaster risks. This underscores the importance of new, well-funded mechanisms for loss and damage that can be deployed with speed and at scale.

Challenges in climate vulnerable economies

V20 countries have found that the efficient use of power and renewable energy brings cost competitiveness and has been an important job creator. Yet, there is little they can do on their own to make a material difference to global climate change or to self-insure against climate-related losses. The main response and responsibility of V20 governments is adaptation, but this must be done in a context of limited project preparation support, poor bankability of projects associated with a high cost of capital, and few business models that can be viable without financial protection mechanisms. A greater incidence of natural disasters of growing severity makes it ever more difficult to support communities on the frontline. These challenges are compounded by the development overhang of poverty and the lack of access of over 350 million people across the V20 to modern energy services (Ritchie et al., 2022).

Cost of capital

Climate vulnerabilities are a credit risk multiplier for the V20, raising the cost of capital, risk premiums, and debt levels. Rising debt and cost of capital are not simply the result of the pandemic. These are also products of an out-of-date and out-of-tune global financial architecture that does not address the multiplicity and complexity of risks that V20 Finance Ministers are required to manage in order to serve their people.

One such risk arises in implementing a transition to clean energy. Because renewable energy investments are capital intensive compared to fossil fuel energy projects, the choice between the two is very sensitive to the cost of capital. Capital costs can vary between 1 and 4 percent in the advanced economies on average, and between 6 and 28 percent in the V20, and this has profound implications for the choice of technology and adaptation (Trading Economics, 2022).

To illustrate the issue, a 2017 UNDP study showed that, in a low financing cost environment, an onshore wind project generates a pre-tax levelized cost of energy (LCOE) of 6.2 cents/kWh, slightly better than 6.3 cents/kWh for a comparable gas turbine plant. But in a high financing cost environment, the same wind project generates an LCOE nearly 50 percent higher, at 9.2 cents/kWh, compared to 6.7 cents/kWh for the gas project (UNDP, 2017).[2]

[2] In the low financing cost environment, this assumes a 7 percent cost of equity and 3 percent cost of debt. In the high financing cost environment, this assumes a 17 percent cost of equity and an 8 percent cost of debt.

The UNDP report indicates that onshore wind is slightly more cost effective than gas when the costs of equity and debt are at levels seen on average in low financing cost environments (UNDP, 2017). The same projects, however, have radically different cost structures in the high financing cost environment prevalent in V20 countries. There, the gas project becomes significantly cheaper. More expensive financing raises the cost of the onshore wind project by almost one half.

Technology is constantly evolving so these figures are purely illustrative. However, they underline the complexity of transitioning to a low carbon economy in the V20. A further complication is that V20 countries usually fund such investments with foreign currency denominated debt, while local currency debt is available in the G-20. High interest rates and currency risk make V20 investments in renewables far riskier than in the G-20. In similar fashion, adaptation is also hard to implement in V20 countries because some (although not all) adaptation projects do not generate immediate cash flows that can be used to service the debt, despite long-term resilience benefits.

The high capital cost and interest rates add to country risk which in turn adds to the expected failure rates of climate-action deals. Climate change could already account for 10 percent of the V20 capital risk premium, and this will grow as climate change intensifies (Buhr and Volz, 2018). Reducing capital costs to levels equivalent to those enjoyed by major emerging economies is crucial for energy projects to become commercially viable, and so make them "bankable" or "investable." Moreover, the cost of capital is even more important for adaptation, resilience, and natural capital projects, where there is a lack of direct revenue streams and returns accrue over a long period of time. This requires concessional resources including low to zero percent interest rate debt and grants.

Debt

Funding and liquidity are needed by the V20 to deal with their increasingly complex interlinked crises. Over time, V20 countries have had to borrow funds externally to cope with climate-related and other shocks, and these debts have steadily accumulated. As of late 2022, the V20 as a group has a total of $686 billion in external public debt. This amounts to 27 percent of the group's GDP and is of the same order of magnitude as the previously mentioned $525 billion in climate-related losses registered in V20 countries since 2000 (Ramos et al., 2022).

The V20's total debt stock is one fifth of all developing country public and publicly guaranteed debt (Ramos et al., 2022). External debt stocks in V20 countries are held by private creditors (36 percent), the World Bank (20 percent), and other multilateral development banks (MDBs) (20

percent (Ramos et al., 2022). Paris Club nations hold 13 percent of V20 debt in official bilateral credits, and China holds 7 percent of the total (Ramos et al., 2022). While their debt compositions vary, Lebanon, Bhutan, the Maldives, and Mongolia have the highest debt-to-GDP ratios in the V20. For Lebanon and Mongolia, private creditors hold most of their debt; for the Maldives, China is the largest creditor. Bilateral debt is the largest share of Bhutan's debt, but China's share of debt is uncertain (Ramos et al., 2022).

The liquidity crunch now faced by V20 members is not all of their own making. A global financial system unresponsive to climate change realities means more developing countries are forced into situations of fiscal distress or default, not because of long-term insolvency, but due to a lack of cash on hand, hard currency, and exchange rate volatility. These shorter-term liquidity challenges are where the international public finance community and central banks need to help the V20. Debt restructuring, debt-for-climate swaps, and credit enhancement as a climate resilience tool can safeguard creditors' assets while unlocking new resources.

In terms of external debt service payments, V20 countries owe more than $435 billion in payments to various creditors between 2022 and 2028, with 2024 being a particularly critical year with payments reaching nearly $69 billion (Ramos et al, 2022). Private creditors top the payments list (nearly 35 percent), alongside the World Bank (12 percent), other MDBs (16 percent), and China (10 percent). Colombia has the largest outstanding commitments ($51 billion), followed by Vietnam ($33 billion), Sri Lanka ($31 billion), Bangladesh ($30 billion), and the Philippines ($30 billion) (Ramos et al, 2022).

Structural issues

Beyond the cost of capital and high debt levels, V20 countries face specific challenges due to the structure of their economies. In many countries, the power sector (generation, transmission, and distribution) is largely publicly held, which presents its own complications in terms of technical expertise, access to latest technologies, business models for innovation, and political interference in policy setting and pricing. Beyond that, public finances have been built on a fossil-fuel economy base. Import and sales duties on fossil fuels and automobiles remain an important revenue source for V20 governments. These have to be replaced by other forms of public income as countries transition toward a low-carbon future. Adding to the challenges is the limited financial protection of assets and livelihoods that communities and medium and small enterprises can access. Climate-related shocks, therefore, place an immediate burden on public finance.

Economic transformation strategies for a climate-insecure world: Climate prosperity plans and the V20 vision 2025

In 2020, at the start of the COVID-19 pandemic, Prime Minister Sheikh Hasina from Bangladesh, during her Chairing of the CVF, and former President Mohamed Nasheed from the Maldives, CVF Ambassador for Ambition, launched the climate prosperity agenda to drive new investment and renewed efforts to deliver on the 2030 Sustainable Development Goals (SDGs) (V20, 2021). Climate prosperity was conceived as describing a state where systemic climate vulnerability had been reversed and where economies had become systemically climate resilient.

Climate prosperity plans

An important tool for realizing the climate prosperity agenda is the articulation of a country-led climate prosperity plan (CPP). The aim of CPPs is simple: Launch a decade of progress aimed ultimately at achieving climate prosperity, by 2030—not 2050. A CPP is a strategic investment agenda to tackle frontline climate threats while boosting planetary prosperity. It is an investment agenda for economies on the climate frontline that targets prosperity enhancement.

Under the CPP, there are significant opportunities for developed countries, major developing countries, and private capital to strengthen economic partnerships with the V20 in the form of climate-centered investment and trade, including technology transfer and innovative business model creation for a resilient and modernized global economy that crowds in market participants and investors that can bring urgency, scale, and quality of investment.

By integrating measures that counteract climate risks and leverage transition opportunities, the CPP catalyzes a green transition as a byproduct of what is ultimately a smarter development strategy than business as usual. The CPP envisages a decade of progress with 5 years of fast-tracked action. It aims to leverage and scale up the first of trillions in new economic investments needed by 2030—from international, regional, and domestic sources—toward critical infrastructure and services for delivering climate prosperity. The objective is optimized, high prosperity outcomes that deliver fast-paced economic growth, jobs, disposable income growth, positive welfare effects, improved trade, and other critical socio-economic results, while

also rapidly accelerating resilience to climate dangers, low and zero carbon technology deployment, and spurring SDG progress.
The CPPs aim to maximize renewable energy wealth and nature-based solutions. Renewable energy wealth is shared by all and promotes unity because it represents shared abundance, and thus shared opportunity. It can best be exploited in smart energy grids that remove inefficient natural monopolies to help the energy economy become more inclusive. The vision is to modernize the grid using technology and finance which enables a transmission system that builds retail markets for renewable energy and storage providers, manufacturers, operators, and investors. These markets serve as green finance investment opportunities, with technology transfer and innovative business model creation for a modernized energy economy that crowds in market participants and investors.

Key components of the CPP include scenario analysis and socio-economic outcomes to shift planning norms and drive key projects and programs. These can drive new investment and proposed legislation and regulation, with itemized financing and investment needs.

As reflected in the CPPs, the V20 Vision 2025 goals to leverage renewable energy wealth and maximized resilience for economic gains are to:

- Accelerate the exploitation of domestic wealth in the form of renewable energy resources of all kinds and promote investments in grid modernization and energy efficiency that benefit domestic businesses.
- Work to end off-grid energy poverty through decentralized renewable energy solutions and the improvement of energy affordability and disposable income for the lowest socio-economic groups that are most vulnerable to climate disruptions.
- Progressively shift reliance away from costly, price-volatile imported fossil fuels, thereby also reducing external inflationary pressures, improving the balance of trade, and building resilience to price shocks.
- Cut the prevailing 98 percent financial protection sinkhole drive by accelerated climate-related disaster risks in half through upscaled access to risk financing and adaptation.
- Boost job growth ensuring new opportunities, responsive wage replacement support and worker re-skilling.

Lowering the cost of capital

Lowering the cost of capital starts with optimizing public finance and improving fiscal practices. The V20 is leveraging growing public support for tackling the global climate emergency to develop new sources of public revenue to finance climate prosperity actions, including through carbon pricing, pollution taxation, and other public financing approaches, while ensuring no

adverse impacts on the disposable income of the lowest socio-economic groups who are most affected by climate disruptions. In this, it calls on member states to minimize distortionary subsidies, reform taxation practices, and reform export credit agencies to progressively eliminate economic activity counteractive to climate prosperity. It further recommends improving the tracking of public climate-related expenditure of all kinds to fully monitor and highlight the extent of growing public spending needs in response to climate challenges.

There are limits to what V20 countries can do on their own. While vulnerable economies bear the brunt of economic damages, including increased cost of capital from evolving transition risk and physical climate risk, they are poorly represented when global agendas are set and dominated by rich developed countries. New forms of economic cooperation that recognize the V20 as a constituency group with whom to engage on the climate emergency can offer an immediate course correction. When members of advanced economies talk about the importance of a rules-based multilateral system, they fail to acknowledge that they are favored by the current rules. Advanced economies do not face the same constraints they impose on other countries within the IMF; their ability to respond to the pandemic and provide record stimulus serves as a stark reminder of the asymmetries within the international financial system. For example, prior to the pandemic, the IMF's Rapid Credit Facility and Rapid Financing Instrument had quota limits of 50 percent annually and 100 percent cumulatively. This was increased during the pandemic to 100 percent annually and 150 percent cumulatively. Moreover, there are further access limits for the most vulnerable. For example, under the G-20 Common Framework, it would be important to expand eligibility to include climate vulnerable least developed countries (LDCs) and highly indebted countries.

There is an opportunity to work with and benefit from vulnerable country experience and expertise so the global financial system can establish a truly effective, enduring global response. One critical avenue is to sustain reform and establish a fit-for-climate IMF. Its Article IV surveillance activities with all economies should have ongoing efforts to improve its "surveillance" approach to climate risks. In 2018, the V20 advocated for the IMF Article IV instrument to integrate physical climate and transition risks (V20, 2022b). The questions bear repeating - can fiscal space be assessed properly without including physical risk, transition risk and spillover transition risks? Fossil fuels are sources of financial liability and the way they continue to generate new dimensions of financial vulnerability. This is just the starting point. Debt limits should be rethought and recalculated to consider climate change. Debt flexibility, climate action support, and guarantees should all be linked to avoid liquidity crises and risk of increasing cost of capital.

Allocations of Special Drawing Rights (SDRs), some of which should be rechanneled into the IMF's newly created Resilience and Sustainability Trust (RST), can also be aligned with country ownership by making V20 CPPs the core of the reform effort supported by the RST. Some SDR allocations should be redirected into the IMF's new Resilience and Sustainability Trust (RST). In fact, the V20 calls on the IMF to align all IMF lending, including the emergency liquidity it is providing to many V20 members, with climate and development goals through CPPS. Through careful engagement with the IMF, V20 countries could seek financing under the RST and perhaps a future expanded use of SDRs to enable new investment and to facilitate a quick recovery aligned with green and inclusive prosperity. Furthermore, the need to reconcile long-term climate and resilience goals through the financing of a CPP program can provide a basis for negotiations to ring-fence financing of a CPP from accompanying IMF programs that may include conditionalities and reforms that jeopardize the ability to make needed adjustments in support of a development-focused climate reform agenda (TCDIMF, 2022).

Equally important is for the World Bank to anchor Country Climate and Development Reports in the CPPs. The V20, therefore, calls for support from the G-7 and G-20 for recognition as an official constituency of the World Bank and IMF. The V20 would contribute the experience and expertise of 58 of the world's most climate-threatened developing economies. These include LDCs, small island developing states, and nations typically without representation in Bretton Woods Institutions' discussions and deliberations on monetary and development. The V20 can further contribute to the International Monetary and Financial Committee, the joint World Bank–IMF Development Committee, and other relevant fora agendas. A key starting point is for the IMF and the World Bank to hold regular, bi-annual meetings with the V20. Joint actions for MDBs and bilateral partners, especially with the G-7 and G-20, could be developed and recommended through these meetings.

Alongside these measures, the V20 has outlined goals for 2025 to achieve a sustainable trajectory in overcoming cost of capital constraints, by directly unlocking at least $30 billion equivalent as a starting point of private sector investments, through more systematic and optimized financial de-risking for resilient infrastructure and renewable energy, working through MDBs and national financing institutions (V20, 2021).

To meet this goal, the V20 also supports the call for the World Bank and other MDBs to implement all the recommendations in the 2022 G-20 expert panel report on capital adequacy frameworks that indicates that MDBs can significantly expand their financing without jeopardizing their credit ratings (Expert Panel, 2022). The V20 urges multilateral financing institutions to specify climate investment commitments and double international finance for adaptation within the next 30 months. In addition, climate adaptation should be at least 50

percent of the focus of all MDB climate portfolios. To enable development-positive climate action, it may be key to substantially augment the capital of MDBs.

Another key cooperation opportunity for the G-7 and the G-20 with the V20 is to bring down the cost of capital through credit strengthening with guarantees instruments, long-term financing, and local currency financing. The benefits this could bring in building robust trade and durable trust cannot be overstated. The V20 is developing an Accelerated Financing Mechanism in order to provide off-balance sheet guarantees, including the creation of subsidy accounts to enable local currency financing opportunities. This is the next big opportunity for the G-7 and G-20 to make a quick difference on risks and an economic transformation for climate vulnerable developing countries.

Financial protection cooperation

The V20's 98 percent financial protection gap is not just a gap, but a sinkhole—one that is a danger to the most vulnerable economies and communities. V20 states must act now but must also learn to cooperate better, more efficiently, and with a greater sense of urgency. Financial protection becomes more acute given that the debt crisis is perpetuated by the climate crisis. As disasters strike, countries are forced to borrow to replace bridges or roads, and people are forced to borrow to replace homes or jobs that were lost. The losses stack up, one atop the other, and the financing options are shrinking.

The financial protection agenda has evolved from the first G-20–V20 InsuResilience Global Partnership launched in 2017 with the aim to protect 500 million poor and vulnerable. What was learned, and what remains critical, is the importance of country ownership and the centrality of building local and regional markets. By 2025, the V20 seeks to cut the financial protection gap in half, by supporting the development of regional and local disaster risk financing and insurance, focusing particularly on protection for micro, small, and medium sized enterprises (MSMEs) and social protection for communities (V20, 2021).

In 2021, the V20 and G-20 members began working on an expanded risk financing architecture reform agenda under the InsuResilience Global Partnership and, toward 2022, this evolved into the G-7–V20 Global Shield against Climate Risks. Losses and damages are happening today and being paid for by communities, enterprises, and economies that cannot afford it. Going on in this way is neither sustainable nor just. The Global Shield raised over 210 million euros in 2022 as a starting point, largely from Germany, and aims to scale over time to match the urgency of the climate emergency. The hope is that experience from the Global Shield can be useful for the United Nations Climate Change Conference of the Parties (COP) negotiators as they work toward delivering a Loss and Damage Fund.

The Global Shield against Climate Risks works with new and existing partners and institutions to systematically analyze countries' protection gaps and design, fund, and facilitate needs-based pre-arranged and trigger-based financing. It has an important role to play through pre-arranged and trigger-based finance, such as shock resilient social protection, parametric and forecast-based financing for anticipatory action, risk transfer for regional or municipal risk sharing, climate-resilient debt structuring, debt payment suspension, and business liquidity protection, to name a few mechanisms. This financial protection gets delivered in a fast and effective manner for communities, on the sovereign level, and for MSMEs. Pre-arranged options are important to improve the access, management, and delivery of resources ahead of time, instead of post-disaster. Post-disaster resources usually take about 9 months to deliver and if the government must borrow, the cost of capital is higher due to heightened instability. The trigger base is important so that resources and financing are unlocked based on data and science instead of after-the-fact assessments, which often place the burden of proof on those most vulnerable. Moreover, the analytics from the Global Shield can make clear where long-term investments in adaptation are required to build resilience for business continuity and critical functionality of the economy. It is important to also note that the Global Shield works with existing institutions to help them level up and stay relevant to the needs of the most vulnerable.

The Global Shield is proposing an improved system to make financial protection more systematic, coherent, and sustained: Composed of an international coordination unit supported by financial vehicles and led by in-country processes. So, instead of having disparate ad hoc projects and programs, solutions are integrated into a package.

Critical to the Global Shield’s success is the building of local and regional risk markets supported by international risk capital across climate vulnerable economies. The Global Shield will kick start in pathfinder countries that are also pursuing CPPs toward attracting new investment this decade. These include Bangladesh, Costa Rica, the Pacific, Ghana, Pakistan, Senegal, and the Philippines.

On the structure, the Global Shield is led by governments and advised by technical partners, including multi-stakeholder processes that draw upon civil society, academia, development partners, the risk industry, and governments. There are three key instruments within the financing structure: A World Bank Global Shield Financing Facility, the CVF and V20 Joint Multi Donor Fund; and the Global Shield Solutions Platform in the Frankfurt School. The aim is to improve financial protection in a coordinated way that makes protection is systematic, coherent, and sustained. A central premise key point is that the vulnerable countries hold the pen in designing the approaches.

Some design elements on the V20 side in the Global Shield include working on a slow-onset risk pool to deal with displacement. Displacement is not just a tomorrow problem; it is already happening today. Other design elements include distribution channels and premium and capital support to drive affordability and an opportunity to recognize value. The V20's Loss and Damage Funding Program is part of the Global Shield which aims to show how the multilateral system can deliver grants to communities to repair and replace community infrastructure and livelihoods, but also to ensure that adaptation resources are made available to build forward better through more resilience infrastructure and diversified livelihoods.

Altogether, the G-7–V20 Global Shield offers important learning on how an element of the global financial system (focused on risk financing) can attempt to coordinate and improve its instruments to deal with the severe threats of climate change. Taking from the call of the V20 in 2018 for a fit-for-climate Bretton Woods system and all the efforts in 2022 in the G-20, the G-7, and V20 toward this goal, there is hope for the establishment of a fit-for-climate global financial system and for MDBs and international financial institutions (IFIs) to scale up resources, to tailor instruments, and improve access and delivery at both national and community level.

As climate vulnerable economies, enterprises, and communities cannot afford to wait any longer, resources such as access to data, more knowledge sharing and awareness activities, predictable and accountable finance, cannot come at a better time. There needs to be streamlined access to existing models and data and more granular regional and sectoral detail. Capacity to analyze climate risk to capital stock in financial terms is essential to upgrading climate-resilient business models responsive to long-term investment planning. There needs to be people-centered metrics to create safety nets for the most vulnerable. This requires open access to risk and resilience planning analytics. The V20 and the Insurance Development Forum (IDF) have put forward to the Global Risk Modelling Alliance (GRMA) a recommendation to make accessible risk and resilience analytics in order to drive and steer risk information to drive investment. Gaining country-driven views of risk is fundamental to constructing a responsive risk management system of institutions and resources.

More broadly, the V20 continues to pioneer contributions to the global financial protection agenda such as the V20-led Sustainable Insurance Facility hosted in UNEP Finance Initiative Principles for Sustainable Insurance, which aims to drive local market development of climate-smart insurance for MSMEs as crucial growth engines for V20 economies. The V20 has also put together a Loss and Damage Funding Program (see Box 11.1) to demonstrate that loss and damage can be funded effectively and efficiently through existing institutions that require up-scaling, and that loss and damage can be funded in a way that could be scaled globally both geographically and in volume, including to leverage adaptation funding toward project

investments that better equip communities to withstand future extreme events. The Loss and Damage Funding Program aims to support communities first in the form of grants which can complement other forms of loss & damage funding. Initial results from financing loss and damage projects are intended to inspire efforts at the UNFCCC level noting the cover decision of COP27 that includes the creation of a loss and damage fund for vulnerable countries.[3] The vehicles for the V20 Loss and Damage Funding Program will be the GEF, UNIDO, and other partners. The adequate scale for the proposed UNFCCC Loss and Damage Fund should be scaled according to trajectories of warming including increasing resource mobilization efforts in relation to the 1.5°C safety limit of the Paris Agreement.

Moreover, the V20 slow onset risk pool aims to disprove the fallacy that slow-onset risk is uninsurable or that it cannot use the analytics in the insurance industry. There is an analogy with health insurance. There, even chronically ill people continue to benefit from health insurance, under certain conditions and designs. Similarly, financial protection for slow-onset climate risks can be designed even for countries that are known to be vulnerable. Everyone would be better off if an effective market to handle climate risks is built in this fashion.

[3] See Sharm el-Sheikh Implementation Plan: https://unfccc.int/documents/624444

Box 11.1: V20 climate change-related loss and damage funding program

Looking forward to 2023, taking from the call of the V20 in 2018 for a fit-for-climate Bretton Woods system and all the efforts in 2022 in the G-20, the G-7, and V20 toward this goal, there is hope for the establishment of a fit-for-climate global financial system and for multilateral development banks and international financial institutions to scale-up resources, to tailor instruments, and improve access and delivery at both national and community level.

The new V20 program focused on loss and damage aims to demonstrate how funding can be efficiently channeled through existing institutions. A range of investment types will be eligible:

<u>Community infrastructure projects</u>
Repair and reconstruction of the following affected community buildings damaged by extreme weather events/disasters/shocks/impacts:

- Health and medical clinics and facilities, including hospitals, community clinics, and other medical facilities.
- Educational facilities, including schools, teachers training facilities, student accommodation, and other educational facilities at primary or secondary level.
- Housing infrastructure, including social and public housing, or community-held accommodation facilities.
- Utilities infrastructure, including water and sanitation facilities, power lines and electrical grid infrastructure, roads, bridges, dams, dikes, drains, and other community utilities infrastructure.

<u>Livelihood assets projects</u>
Replacement, repair and/or reconstruction of the following affected community or private livelihood assets damaged by extreme weather events/disasters/shocks/impacts:

- Livestock, crops, stored foodstuffs, and grain.
- Livelihood resources, including tools and implements.
- Private houses.
- Temporary housing and relocation.
- Pumping and filtration costs to replace/re-stock contaminated water sources.
- Natural (i.e., blocked waterways/rivers/roads) or human-origin (i.e., strewn waste and damaged goods) rubble removal.

<u>Adaptation component projects</u>

- Elements of investments which contribute to rendering the replaced or repaired infrastructure, community assets, or community itself more resilient to future extreme weather events/disasters/shocks/impacts.

<u>Development/reconstruction/humanitarian/disaster risk reduction component programs</u>

- Elements of investments in addressing loss and damage to community infrastructure or livelihood assets which could probabilistically not be attributed to climate change (nor specifically relate to climate change adaptation funding).

Debt restructuring and immediate liquidity cooperation

For V20 economies, the combined systemic risk of high debt servicing costs and climate change could trigger a vicious cycle that depresses revenues and exchange rates and increases the cost of capital—all of which would exacerbate climate vulnerabilities (V20, 2022b). A pressing area for cooperation is on debt restructuring and access to immediate liquidity. V20 countries face considerable climate change-induced macrofinancial risks that threaten debt sustainability and which harm investment and development prospects. To have effective delivery of climate finance requires a fit-for-climate global financial system and institutions enabled to support economies at the frontline of the climate emergency. Considering international volatility and spiking prices of fossil fuels, decarbonization should be thought of as a resilience building strategy to reduce exposure to inflationary pressures and volatility. It requires more systematic planning on how adaptation, resilience, and the low-carbon transition can be financed—especially in countries facing dire debt sustainability challenges.

The V20 recommends unpacking, redesigning, and improving options such as debt-for-climate swaps and climate-smart debt restructuring with debt relief elements. In 2021 and 2022, the V20 called for sovereign debt restructuring architecture reform (see Box 11.2). V20 member circumstances should be incorporated into debt sustainability analyses. All creditor classes can work together to reduce the level of debt in V20 countries through guarantee facilities and regulatory action to mobilize new financing for climate and development goals. For example, creditors to the V20 economies could consider debt restructuring options (e.g., debt servicing payments to climate resilience and energy transition investments and debt for climate swaps) (V20, 2022b).

Box 11.2. The CVF/V20 advocated for the following outcomes during COP27

- Loss and damage: The creation of a new dedicated fund for loss and damage specific only to "particularly vulnerable" developing countries.
- Adaptation (finance): An implementation plan on the doubling of adaptation through the commissioning of a UNFCCC report by the Standing Committee on Finance into the doubling of adaptation finance by 2025.
- Mandate for the development of a framework for the Global Goal on Adaptation and for adaptation efforts to be transformational.
- Keeping 1.5°C alive: Stronger language than in Glasgow "urging" governments who failed to so, to align their Paris Agreement 2030 nationally determined contribution emission targets with 1.5°C by 2023 at the latest.
- Finance: Explicit calls to establish a fit-for-climate global financial system and for MDBs and IFIs to scale up and simplify access to climate finance.
- Voluntary carbon markets: COP27 advanced the implementation of Article 6 of the Paris agreement. Article 6.2 permits countries to meet with net zero goals by paying for emissions reductions in another country. Article 6.2 working rules are starting to be implemented after being agreed to at COP26. At COP27, Ghana and Switzerland authorized the first-ever "internationally transferred mitigation outcome" under Article 6.2 (Luhn, 2022).

<u>Elements of financial system reform from the October 2022 V20 communique (V20, 2022b)</u>

- "An immediate reform of the sovereign debt restructuring architecture. Debt sustainability analyses need to be tailored to V20 member circumstances. Then, through guarantee facilities and regulatory action, all creditor classes must reduce the level of debt in V20 countries in order for them to mobilize financing for their climate and development goals."
- "The World Bank and other MDBs to implement all of the recommendations in the G-20 expert panel."
- "Multilateral financing institutions to specify their commitment to climate investment and to deliver at least a doubling in international finance for adaptation within the next 30 months, with all MDBs ensuring their climate portfolios are at least 50 percent focused on climate adaptation.
- "Further allocations of SDRs, some of which should be "rechanneled" into the IMF's newly created RST that should be enshrined in country ownership whereby V20 CPPs form the core of recovery efforts."
- "Sustain reform and establish a fit-for-climate IMF with ongoing efforts to review, rethink, and continuously improve its "surveillance" approach to climate risks of all kinds in its Article IV surveillance activities with all economies. Likewise, it is important to rethink and recalculate IMF debt limits to take into consideration climate change, and to link debt flexibility and support to climate action along with guarantees, to avoid liquidity crises and cost of capital repricing."

Source: V20 Ministerial Communique IX (V20, 2022b)

Conclusion

The implementation of the Paris Agreement must go beyond COP negotiations and into the real economy with multilateral reform as a critical step to complete over the next two to three years. This would ensure that development aid and economic cooperation does not end up exacerbating the climate crisis, because genuinely effective development support should help countries meet climate goals. By mainstreaming development and economic cooperation considerations into climate finance and likewise climate considerations into development aid, countries should be encouraged to tackle the two intrinsically linked challenges together. Doing so avoids conflicting investments or duplicating efforts in a period when resources are expected to remain scarce. In particular, any and all increases in climate finance must not come at the expense of development aid, because a country's ability to meet its climate goals is directly tied to its capacity to realize its development priorities. An effective approach to additionality must focus on ensuring that development aid and climate finance are both scaled up sufficiently to meet both the SDGs and Paris climate objectives.

Moreover, the challenge to uproot fossil fuels from V20 economies is not just a battle for the climate. It is also to reduce price spikes and all the instability and energy insecurity that carries. V20 states cannot promote growth by obstructing development. They cannot rise if enterprises and the welfare of communities are tied to a fossil fuel industry in long-term decline.

Advanced economies and large emerging economies already have cost-effective technology in the form of renewables, energy storage, and grid upgrades, to displace unreliable, volatile, expensive, and economically harmful fossil fuels. There will be tradeoffs for sure in the energy transition, but the historic choice of accelerating transformation will bring greater stability and energy security sooner. For example, partnering with China on elements such as grid modernization can bring an opportunity with climate vulnerable countries that together represent the demand for transformational strategies for over 2.6 billion people worldwide, one third of the whole world's population.

A historic choice lies before the world's governments. Amid a time of conflict, developing countries and emerging economies are in a strong position to establish the direction everyone should take in realizing world peace, because accelerating the energy transition and resilience enables energy security, secures national sovereignty, and enhances territorial integrity by highlighting what is actually shared across borders—wind, solar, and moving water, and shared prosperity. More importantly, there is an opportunity to course correct the global financial architecture to deliver for economies that face extreme vulnerability and to shift financial flows

toward the 1.5°C safety limit of the Paris Agreement. To this end, moving into 2023, the reform of the global financial architecture to making debt work for the most vulnerable, to overcoming capital hurdles to investment, facilitating global exchange via carbon finance, fully integrating climate risks, DFIs prioritizing of climate action, and establishing pre-arranged and trigger-based funds.

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