Optimising Climate Finance: Principles for Improving the Next Phase of Climate Finance Commitments

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Developing countries' climate finance needs are clear and growing, but expiring pledges, aid cuts and a stressed multilateral system have lowered confidence in delivery. Contributors must urgently step up with new multi-year commitments, especially for adaptation. A three-tier framework offers a path forward: a transparent 'grant-equivalent' or 'budgetary' core, a stretching public finance target comprising a wider set of instruments and channels, and an accompanying strategy setting out actions to unlock investment across the financial system. Such pledges can restore trust, respond to growing needs and put the global $300 billion and $1.3 trillion goals within reach.

Despite recognition of the $1.3 trillion needed in external investment for climate action in developing countries – with the conclusion of the New Collective Quantified Goal (NCQG) at COP29 in Baku and the establishment of a $300 billion goal to be mobilised from public sources, led by developed countries – there remains little certainty about how public finance will be delivered to help meet these needs. While the multilateral development banks (MDBs) estimate that they will provide $120 billion by 2030, and to mobilise a further $65 billion from the private sector,[1] major government commitments expire this year or next. This creates a cliff face for predictability of climate finance that risks damaging confidence and leaving delivery up in the air as the world enters the second half of a definitive decade for climate action and at a crucial moment for ambition. Constrained budgets, cuts to Official Development Assistance (ODA) by several major contributors only add to this uncertainty and concern from the Global South.

[1] World Bank Group, November 2024, **Multilateral development banks to boost climate finance**

Not only do finance pledges indicate a commitment to fulfil an important obligation underpinning the Paris Agreement, they create the confidence necessary for developing countries to set and implement ambitious Nationally Determined Contributions (NDCs). As we approach COP30, **contributors must urgently come forward with commitments** that set out how they are increasing the provision of high-quality support for climate action, as well as using the wider range of measures available to them to increase overall flows of climate finance into developing countries.

A summary ten-part checklist for future climate finance commitments is found in Annex A and converts this policy briefing into a usable tool for policymakers.

A three-tier model for climate finance commitments

Since the last round of climate finance pledges, there have been a number of shifts in the nature of the financing challenge for both recipients and contributors as well as an emerging set of key learnings from climate finance to date. These include:

- Recognition of the wide range of public finance instruments needed to achieve the goals of the Paris Agreement, from grant-based ODA to the contribution of development finance institutions to market-oriented actors such as export credit agencies and sovereign wealth funds; and of the need to incentivise the most effective use of public finance.
- A parallel need to ensure that concessional finance continues to increase, even in challenging circumstances, and that climate finance provision is predictable and comparable across countries.
- Recognition that many measures that developed economies – especially financial centres – can undertake to mobilise finance to developing countries are not through the direct provision of climate finance but through policy measures to enable investment or fiscal space, or through their actions in international financial institutions.
- The particular need to address the shortfall in finance for adaptation and loss & damage, including by providing much greater levels of high-quality public finance and ensuring this reaches the most vulnerable.

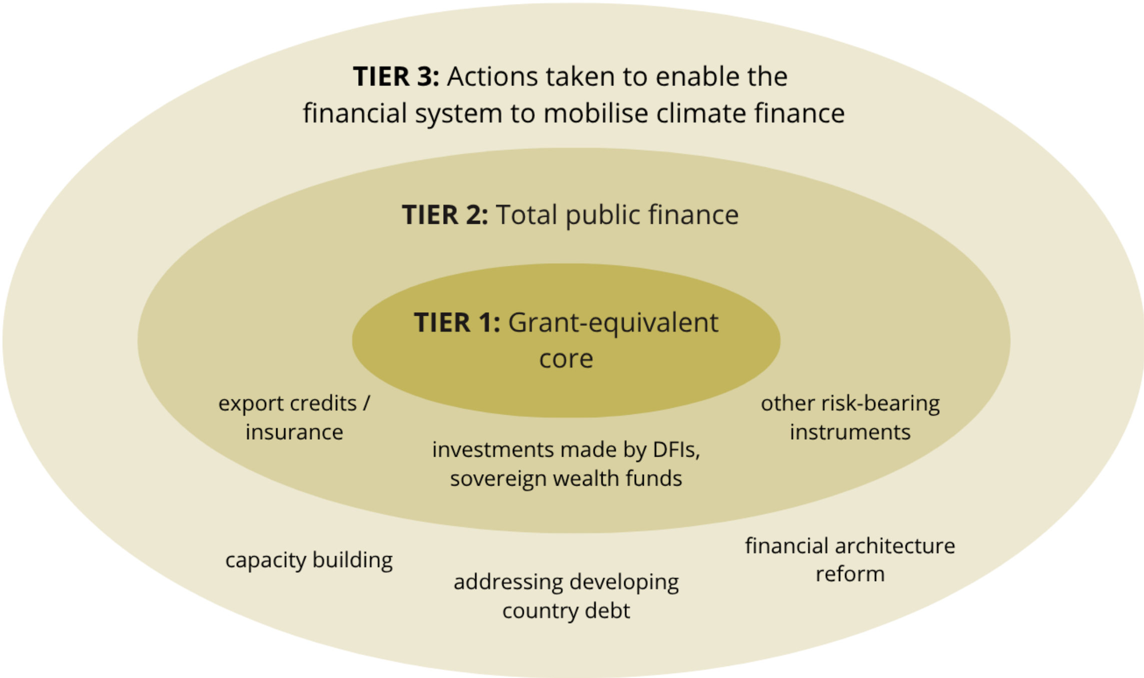
In order to respond to these developments and learnings while ensuring a credible pathway to increased climate finance in the current fiscal and political context, we propose that future climate finance commitments should set out how countries will contribute to climate finance mobilisation in developing countries in three tiers:

- **A grant-equivalent core** that provides clarity on how much new government budget is being allocated to climate finance. This is important for building trust, assuring quality of climate finance and enabling comparability between countries. This is analogous to existing ODA-based climate finance commitments made by traditional development ministries and agencies, but in order to enable a significant increase in funds while ODA budgets are restored should incorporate new sources of revenues such as levies and trade measures.
- A wider target setting out a **total level of public climate finance** in support of developing countries. This would help encourage the efforts of a wider range of public finance institutions like development finance institutions and issuers of risk-bearing instruments like guarantees. Transparency on the 'core' commitment above is particularly important to ensure that the inclusion of this wider set of channels and instruments does not mask the need to increase concessional and grant-based finance.
- An accompanying **strategy to enable the financial system to mobilise climate finance**, ranging from policy measures that help unlock finance flows to developing countries to efforts to reform the international financial architecture, as well as capacity building and technical assistance.

Recognising the particular importance of increasing public and grant-based finance for adaptation, new commitments should also include a dedicated sub-target for adaptation focused on public finance provision. This would also respond to the particular uncertainty facing adaptation finance after 2025. The existing 'Glasgow Pact' urging developed countries to double public adaptation finance is due this year and what follows is uncertain, especially given the lack of a numerical target for adaptation finance in the NCQG. **Such commitments should be heavily grant-based and prioritised for the most vulnerable.**

Finally, the next phase of climate finance commitments should ensure they enable a response to some of more qualitative challenges that are critical for both effective delivery and trust-building. This should include providing sufficient predictability by being made over at least a five-year period, greater commitments to longer-term and country-driven programming cycles, and reaffirmation of commitments to key multilateral climate funds as efforts to improve the delivery architecture are pursued.

Three-tiered climate finance commitments



Tier 1: A grant-equivalent core

To maximise comparability and transparency, contributors should make clear the total 'grant-equivalent' or 'budgetary' allocation for climate finance. This is particularly important for providing reassurance to developing countries that climate finance will continue to flow, and to scale, over time.

While recognising the significantly enhanced role that the private sector and financial reform must play, there is also unequivocal evidence that such concessional support must increase in coming years.[2] It is therefore integral that such commitments represent an increase in previous levels. There is a need to address and reverse recent reductions in development budgets, but contributors should also look to innovative sources of finance to scale their core climate finance commitments, including proceeds from levies such as the EU's Carbon Border Adjustment Mechanism (CBAM), or from proposed solidarity levies.

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[2] Of the estimated $1.3 trillion needed in external investment in developing countries (excluding China) by 2035, approximately half is projected to come from public sources. See Bhattacharya, A. et al., November 2024, **Raising Ambition and Accelerating Delivery of Climate Finance**, Third report of the Independent High-Level Expert Group on Climate Finance

Tier 2: Total public climate finance

Contributors should prioritise scaling up the core grant-equivalent amount of climate finance they provide, and then distribute it in an instrument-agnostic way that best suits the needs of their development partners, paying particular attention to adaptation needs. In addition to grants, the face value of loans, equity investments, risk-bearing instruments, etc., should be included in this second tier, as they would be in reporting towards the $300 billion goal within the NCQG.

Setting a dedicated target for private finance mobilised by public interventions can create major pitfalls, skewing investments towards high-return projects without regard for development partner needs and, perversely, crowding out the private sector instead of investing where private actors will not. Nevertheless, private finance mobilised is a key indicator to track the outcome of investments and ensure efficiency in delivery and will be an important factor in meeting the $300 billion. Demonstrating effective mobilisation also builds confidence within contributor governments that their public finance is being efficiently allocated.

Full-government mobilisation

This should reflect a full-government mobilisation effort in which climate finance commitments are encouraged from all relevant government departments and agencies, helping to orient the full set of relevant government actors towards the challenge of mobilising finance for climate action in developing countries and maximising synergies with the many other demands on international cooperation. In addition to traditional development cooperation agencies focused on dispersing ODA such as Germany's KFW or France's AFD, this could include:

- Loans and risk-bearing instruments provided by development finance institutions (DFIs) such as British International Investment (BII), FinDev Canada or Finnvera
- Export-import banks or export credit agencies (ECAs) such as Atradius Dutch State Business, the Export-Import Bank of Korea or Japan's JBIC
- Loans and equity investments made by sovereign wealth funds such as Norway's Government Pension Fund Global (GPFG), Saudi Arabia's Public Investment Fund (PIF) or Singapore's Temasek
- Debt-for-climate swaps initiated by treasury departments or development ministries, often in partnership with other agencies/multilateral institutions.

Thought should be given to how to most effectively deploy these tools, and how to scale up the finance they mobilise for climate in developing countries. Governments should promote coherence and synergies between different levers, for instance, ensuring that opportunities to pair technical assistance, capital investment and broader development partnerships are not missed.

It is also imperative that those DFIs and ECAs that have not yet ended financing for fossil fuels do so as soon as possible, and ideally redirect this capital towards climate projects.

Risk-bearing instruments

Particularly in a fiscally constrained context, more risk-bearing instruments will be needed to maximise the impact of climate finance (while continuing to prioritise grants for adaptation finance and the most vulnerable). Thoughtfully designed targets for scaling such instruments – such as MIGA's goal to triple guarantees by 2030[3] – can be useful in this context. These instruments have the further advantage of backing developing countries' own climate action priorities, rather than dictating the spending program.

Tier 3: Enabling the financial system to mobilise climate finance

While direct public support remains the foundation for climate action in developing countries, all sources must be brought to bear on the challenge of reducing emissions and building resilience. Governments in wealthy countries should use all the tools at their disposal to catalyse sustainable finance flows into developing countries, ensuring that existing flows are Paris-aligned and working to actively increase investment in low-carbon development. Actions in this third category represent the efforts contributors are making to achieve the $1.3 trillion goal in the NCQG,[4] though not all may be quantifiable.

Contributors can take a variety of actions on this front, including:

- Support for international financial architecture reform efforts, including implementing the recommendations of the G20 MDB Capital Adequacy Framework Review and the World Bank Evolution Roadmap
- Efforts to create fiscal space that enable an increase in international investment, such as introducing climate resilient debt clauses in sovereign lending and supporting efforts at the International Monetary Fund to protect developing countries from climate-related macro shocks and liquidity constraints
- Efforts to reform international prudential policies to support the full recognition of climate risk by supervisors while also incentivising investment in risk management and resilience, and removing any structural disincentives to investing in EMDEs

[3] Reuters, July 2024, **World Bank Group kicks off $20 bln annual guarantee push**

[4] E3G has written in further detail on the $1.3 trillion in our report, **Getting on the path to $1.3 trillion**

- Disclosure and transition planning requirements that enable the shifting of financial flows to EMDEs
- Efforts to build capability and capacity in EMDEs to establish a strong enabling environment for private investment that also supports national development goals
- Support for data initiatives to improve the understanding of climate risk and effective risk management strategies
- Strong signals to credit rating agencies that they are expected to adequately integrate climate risk and risk management into their credit risk rating methodologies
- Support the scale-up of insurance tools in developing countries, including improving financial literacy, monitoring and surveillance tools, as well as efficient layering of public and private finance instruments including micro-insurance products to ensure that insurance is accessible to those who need it

The three-tier framework in practice: What does this mean for specific contributors?

In order to bring this model to life and reflect what it means for individual contributors, we have translated it to take into account the unique arrangements of individual countries and institutions. We have selected these case studies to reflect countries at a mature stage of consideration of future commitments, as well as to highlight the specific role of EU institutions and the prospective application of this model to a new contributor. However, this model is readily adaptable to the full range of traditional and prospective new contributors, and if universally applied would allow much greater comparability of contributions.

Table 1: Three-tiered commitments in practice

Contributor	Tier 1: Grant-equivalent core	Tier 2: Total public finance	Tier 3: Catalysing sustainable finance
UK	An updated budget commitment along the same lines as the UK's existing International Climate Finance (ICF) pledge, plus any additional "budget" elements such as levies or CBAM revenues	All grants, plus the face value of instruments deployed by publicly owned financial institutions such as BII and UKEF, with a breakdown by institution	UK policy/regulatory tools to increase finance flows to EMDEs, such as those set out in the Green Finance Strategy.[5] This includes the use of policy measures like transition plans to incentivise private sector investment, as well as strategies for engaging via IFIs such as the IMF and World Bank and multilateral

[5] UK government, March 2023, **Mobilising green investment: 2023 green finance strategy**

Contributor	Tier 1: Grant-equivalent core	Tier 2: Total public finance	Tier 3: Catalysing sustainable finance
			negotiations on prudential measures and fiscal space
EU Institutions (European Commission plus European Investment Bank)	The portion of the Neighbourhood, Development and International Cooperation Instrument (NDICI) (or the new Global Europe Fund under the proposed new MFF budget) dedicated to climate finance in developing countries, plus any additional "budget" elements such as CBAM revenues, with a clear portion for adaptation finance	All grants, plus the face value of climate finance mobilised through the European Fund for Sustainable Development Plus (EFSD+) and finance provided through EU financial institutions such as the European Investment Bank's global arm	Overall strategy for using wider EC policy/regulatory tools to work with the private sector in developing countries, including the Sustainable Finance Advisory Hub, the EU's sustainable investment taxonomy and disclosure regulations with a focused effort on how these can contribute to growth in climate finance flows in EMDEs
Canada	A refresh of Canada's traditional climate finance commitment, plus the grant-equivalent value for any other international assistance with a climate component, with a clear portion for adaptation finance	All grants, plus the face value of climate finance mobilised through FinDev Canada and Export Development Canada	Wider policy/regulatory tools such as mandatory climate-related disclosures and the sustainable finance taxonomy currently under development
South Korea	The grant-equivalent portion of ODA dedicated to climate finance, including contributions to the GCF and other climate funds	All grants, plus the face value of climate finance mobilised through the Economic Development Cooperation Fund and the Export-Import Bank of Korea	Overall strategy for using wider Korean policy/regulatory tools to work with the private sector in developing countries

Thematic focus: Increasing finance for adaptation

Finance for adaptation should feature throughout the three tiers of a climate finance commitment and it is essential that private finance mobilisation for adaptation increases significantly and that markets are geared to channel investment to resilient projects. However, an increase in the provision of grant-based and highly concessional resources for adaptation and loss & damage is widely acknowledged, including being explicitly highlighted in the NCQG decision.[6]

[6] UNFCCC, **New Collective Quantified Goal on Climate Finance**, paragraph 14

We propose that any numerical target should be expressed in absolute terms, (i.e. '*$x bn*') instead of a percentage target of overall climate finance provided (i.e. '*50% of climate finance*'). This avoids perverse incentives that can artificially depress mitigation finance, especially where greater volumes of mitigation finance are needed but where the instruments for delivering mitigation finance are less concessional in nature (e.g. through blended finance or loans). To the extent that loss and damage finance is included in a contributor's commitment, this should similarly be made clear.

Ideally, this would also be expressed in grant-equivalent terms as part of the 'core' commitment, given the particular need to increase grant-based resources for adaptation. Governments should also consider committing specific allocations to the most vulnerable countries, such as LDCs and SIDS, to ensure that more adaptation finance reaches those most in need and respond to repeated calls to action in multilateral negotiations. Specific consideration of how the wider use of public finance levers and broader policy measures could increase mobilisation of finance flows for resilient investment should also be set out in future strategies.

Ensuring the next generation of pledges builds trust and ensures effective delivery

In addition to headline pledges, there is an opportunity for the next generation of climate finance pledges to help build trust, enhance predictability and respond to some of the widely documented challenges that have impacted climate finance delivery to date. These include:

- Providing a pledge of a sufficient timeframe to align with strategies for taking climate action. This should include **setting out pledges for at least a five-year period**, in line with NDCs. Many countries have done this historically, overcoming conventional national budgetary constraints to provide greater predictability. This also aids effective delivery by enabling multi-year strategies.
- Beyond this, seeking to increase their ability to provide **multi-year programming** (in terms of both technical assistance and capital investment), which in practical terms has a more material impact in providing predictability than aggregate commitments. This can also support the delivery of multi-year commitments to climate action which require international support, such as those undertaken via country platforms.
- Committing to **continued support of key multilateral climate funds,** such as the Green Climate Fund, Global Environment Facility, Adaptation Fund, and Fund for Responding to Loss and Damage, should feature in contributors' core contributions,

especially given the NCQG's call to triple outflows from these funds from 2022 levels by 2030.[7]

- **Transparency and clarity on channels** used, in order to ensure comparability with historical pledges as well as other countries. This should include providing clarification on how finance channelled through MDBs is treated, which can have material and misleading impacts on comparisons between countries.

[7] UNFCCC, **New Collective Quantified Goal on Climate Finance**, paragraph 16

Annex A: Checklist for a quality pledge

With most contributors' current climate finance commitments expiring this year or next, it is imperative that wealthy countries come forward with new or renewed pledges at COP30. New pledges are an opportunity to respond to lessons learned from previous rounds of commitments and set forth quality frameworks for how countries will contribute to climate finance mobilisation in developing countries. This checklist is a practical tool to assist policymakers in setting such pledges.

All new climate finance pledges should aim to fulfil the following

- Core commitment expressed in 'grant-equivalent' or 'budgetary' terms (i.e. to provide clarity on how much new dedicated public money is allocated)
- An overall public climate finance target including a wider range of sources and instruments, such as development finance institutions
- Include a dedicated adaptation finance commitment prioritising grants and highly concessional finance
- Undertaking actions to enable the international financial system to mobilise climate finance at scale, including through policy and regulatory measures and through shareholdings in international financial institutions, which combined with other measures would effectively reflect the country's contribution to the $1.3 trillion
- Commitment covers at least five years, in line with NDC timeframes
- As well as conventional sources of public finance such as ODA, dedicate revenues from new sources such as levies and trade measures

In addition, in setting and implementing climate finance pledges, contributors should also commit to the following

- Enabling the use of multi-year, programmatic funding to aid predictability in delivery and enable better partnerships and coherence
- Continuing to support the major multilateral climate funds, in particular ahead of upcoming replenishments of flagship UNFCCC funds
- Providing full clarity and transparency on channels covered (including setting out how contributions to multilateral development banks are treated)
- Reporting on finance provided and mobilised, as well as results achieved

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