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Can IFA Reform Increase the Quantum of the NCQG?

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Introduction

Parties to the United Nations Framework Convention on Climate Change (UNFCCC) are set to adopt a New Collective Quantified Goal (NCQG) on climate finance at COP29 in Baku, Azerbaijan, in November 2024. The new goal will succeed the USD 100 billion commitment after 2025. The quantum of the NCQG remains unknown. As Parties have committed to taking into account developing countries' climate finance needs, the NCQG will have to be significantly larger. While estimates of financial needs vary significantly depending on assumptions, methodologies, and data sources used, they agree that USD 100 billion falls significantly short of what is needed. For instance, the UNFCCC's First Needs Determination Report estimates that between USD 655 billion and USD 1.27 trillion will be required annually to address the needs of the Global South for mitigation and adaptation efforts.[1] The Independent High-Level Expert Group (IHLEG) on Climate Finance estimates that by 2030, USD 1 trillion of public and private finance[2] will need to flow to developing countries (other than China). It seems unlikely that these needs can be met purely from public budgets within the current system – independent of whether the base of contributors expands. The ongoing debate on reforming the international financial architecture (IFA) might offer partial solutions. While the IFA reform elements are being debated in fora independent of the UNFCCC, the agendas are clearly interconnected, as they both intend to address key challenges hindering climate investment in the Global South, such as limited fiscal space, debt crises, and high capital costs*.

This paper aims to explore the extent to which reforms of the IFA can potentially increase the amount of available climate finance and by extension the quantum of the NCQG. This analysis is subject to significant uncertainties surrounding both processes. Key elements of the IFA reform agenda have yet to reach the implementation phase, causing a degree of unpredictability. Moreover, multiple issues within the NCQG remain contentious. These include aspects related to transparency, including the lack of a universally accepted definition of climate finance within the UNFCCC. There are structural questions relating to whether only climate finance provided and mobilised is relevant to the goal, or whether the goal also encompasses the broadest possible range of financial flows. Consequently, the extent of the IFA's role in contributing to the final NCQG remains indeterminate, and this determines the exploratory nature of this paper.

Analytical approach

The 2023 annual report on the NCQG[3] identified three distinct approaches to structuring the financial quantum and mainly discusses two of them. The first approach, the 'onion' structure, includes different layers of sources of finance: public provision, mobilised finance, and wider flows. Citing Article 2.1(c) of the Paris Agreement, which asserts that 'financial flows must be consistent with a pathway towards low greenhouse gas emissions and climate-resilient development', some countries advocate including national investments, policy-driven financial shifts, and philanthropic contributions within the broader scope of the NCQG. The second approach, the 'thematic' structure, segments the quantum based on purposes, such as mitigation, adaptation, and potential loss and damage. These structural ideas are combined and modified in the technical expert dialogues (TEDs). After three meetings under the ad hoc work programme on the NCQG on climate finance in April, June, and September, a clear trend as to which sources will ultimately be included in the structure of the NCQG is not yet apparent.

This paper combines the structural dimensions into a 'maximal approach' (see Figure 1, below). This approach allows us to expand on all possible ways that IFA reform can contribute to the finance

* Niedermayer, R., Ryfisch, D., 2024, IFA Reform and the NCQG – How Are They Interlinked?

available for climate action. From all the evidence, responding to loss and damage, and a very large part of adaptation, will require public finance because private finance is not investing. Instead of using 'wider flows', the policy brief uses the term 'catalysation' as used by, for example, the OECD.[4] Within the negotiation context, developed countries tend to speak of investments.

The inclusion of wider flows or catalysation of climate-relevant finance flows remains heavily debated in the NCQG negotiations. At the core of this question is the relation between Article 2.1(c) of the Paris Agreement, which stipulates a shift in all financial flows towards low greenhouse gas emissions and climate-resilient development pathways; and Article 9 of the Paris Agreement, which lays out the provisions related to climate finance.[5] Under the UNFCCC, there is the Sharm El-Sheikh Dialogue on Article 2, paragraph 1(c), and its complementarity with Article 9 of the Paris Agreement. At these dialogues, Parties exchange their views on the relationship between Art. 2.1(c) and Art. 9. The dialogue itself has no decision-making power, however.

A focus primarily on public provision and mobilisation of climate finance would make some elements of the reform agenda irrelevant for the NCQG. In choosing the maximal approach in this discussion paper, we intend to contribute to the wider understanding of how IFA reform could potentially contribute to making the NCQG bigger; however, we do not aim to introduce a structure for the NCQG or prejudge certain IFA reform elements.

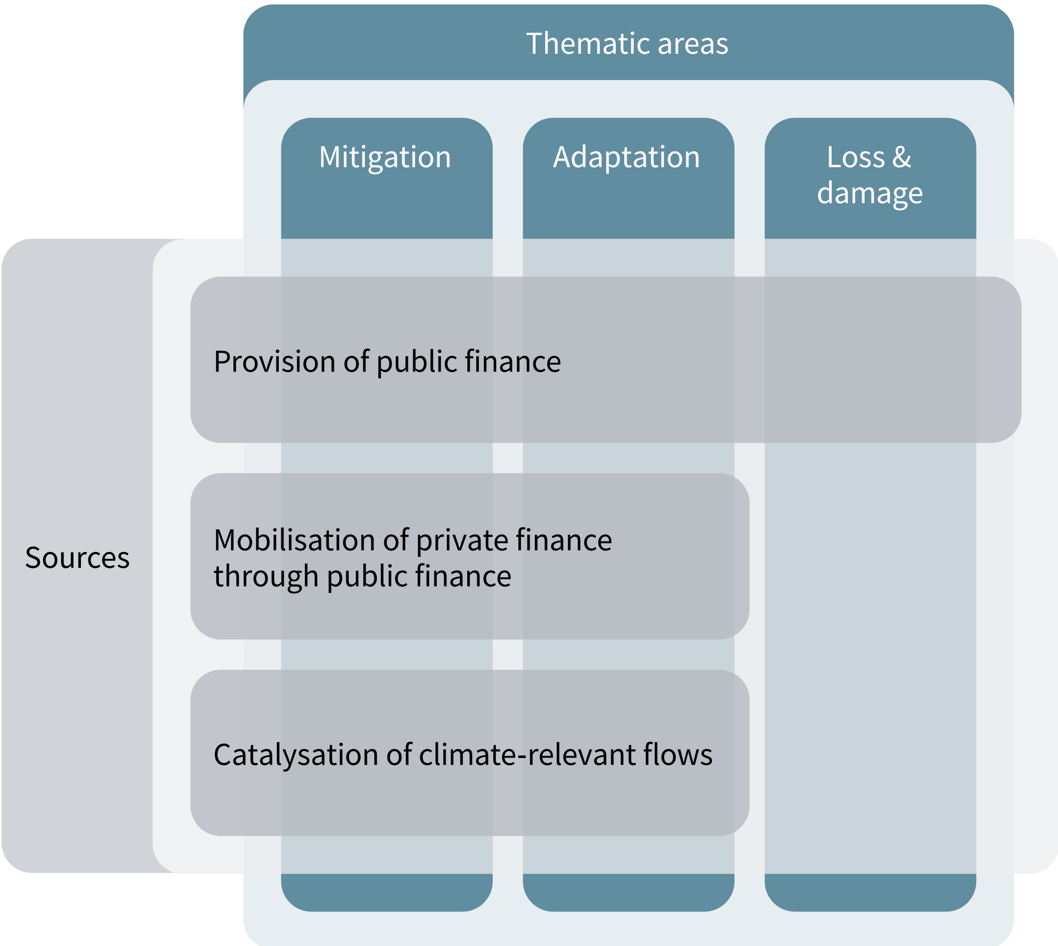

Figure 1: Potential sources and themes of the NCQG – a maximal approach

An additional challenge in determining the potential agenda of the IFA reform is the lack of a commonly accepted climate finance definition, and related shortcomings in transparency. This paper relies on the definitions of climate finance currently used.[6] Under this assumption, the paper includes all financial flows as potential climate finance in the NCQG, even though this approach is not necessarily accepted by all countries. Increased definitional clarity and transparency would ease this problem in future analyses. It is also important to highlight that in this paper we address a question purely of quantity and not of quality. Some of the financial instruments analysed might conflict with the growing debt burden that an increasing number of developing countries face. If countries are at high risk of debt distress, supplying grants is the only option.

Against this backdrop, the paper analyses the IFA reform agenda in its interaction with the three potential layers of sources: public provision, public and private finance mobilised, and catalysation. The assumption is that when IFA reform actions are taken they will trigger changes in climate finance flows. In practice, these interactions will have varying degrees of causality. In the absence of a clear definition of what the IFA reform agenda entails, this paper focuses on different elements of four commonly included pillars of the IFA reform agenda: multilateral development banks (MDBs), the International Monetary Fund, debt, and international taxation.

Can the IFA reform measures increase climate finance in the context of the NCQG?

1. MDBs

The MDB reform agenda builds on three core components: bigger, better, and bolder or more effective. The 'bigger' component of the triple agenda will quasi-automatically increase climate finance if the share of MDBs' climate finance remains at a minimum constant and the accounting rules remain unchanged. It will increase because MDBs' lending capacity will increase. So far, the 'bigger' component of the triple agenda has already made significant progress. The World Bank has led the charge; other MDBs are following suit and are implementing similar reforms. The Capital Adequacy Framework (CAF) review recommendations that have been implemented as part of the World Bank's evolution roadmap include a lowered equity-to-loan ratio[7] and the introduction of hybrid capital and a guarantee platform,[8] enabling shareholders to strengthen MDBs' capacity without a full-fledged capital increase. Additional reform work is underway associated with the enhanced use of callable capital and the rating of MDBs by credit rating agencies. As more concessional finance will be necessary, contributions to trust funds and funding windows will also play a role, such as this year's International Development Association (IDA) replenishment[9] and the World Bank's global public goods windows under the new Framework for Financial Incentives.

The 'better' component will not automatically increase climate finance provided and mobilised, but it is likely to do so. The components, as set out in the triple agenda, e.g. working together as a system and co-creating multiyear country platform programmes, will increase the efficiency of use of scarce resources. By providing the opportunity to implement transformational approaches through coordinated, targeted financing, this component might increase countries' demand for these approaches and therefore translate into a further increase in demand for climate-relevant projects. Moreover, these transformational approaches have the potential to also increase the private finance mobilised through public interventions. Country platforms are intended to increase the blending of finance for climate action by deploying the policy toolkit of MDBs more efficiently. Policy reforms, technical assistance, diagnostics, etc., are intended to contribute to a conducive policy environment that reinforces a positive feedback loop. While not included explicitly in the triple agenda, MDBs' commitment to Paris alignment has the potential to further increase climate finance. The MDBs are transitioning to a fully-aligned portfolio;[10] assuming that this will eliminate non-aligned activities, it will free up lending capacity, and, while not all Paris-aligned activities are about climate finance, it is not unlikely that some of the freed-up capacity will contribute to MDBs' climate finance.[11],**

Similarly, the 'bolder' component will not automatically translate into increased mobilised climate finance. While the bolder component focuses predominantly on mobilising a larger volume of private climate finance through different instruments, private finance mobilisation has fallen short of expectations during the past decade. Given the recent uptick in private climate finance mobilised through public interventions, as suggested by the most recent climate finance data, the bolder component might effectively contribute to increased climate finance.[12] It remains to be seen whether this uptick can be maintained and expanded. The ultimate impact on climate finance will depend on MDBs' capacity to increase their effectiveness in leveraging private finance, and this increase in MDBs' effectiveness can largely benefit from the implementation of the instruments mentioned under the 'better' pillar.

In summary, the IFA reform elements associated with the MDBs will very likely translate into a significant increase in the quantity of climate finance provided and mobilised. A growing lending capacity that could triple by 2030, a shift in portfolio towards ever more climate action driven by both supply and demand, and a more effective mobilisation of private finance will all contribute to increased climate finance – notably, by and large non-grant-based.[13]

	Change in climate finance	Provided	Mobilised	Catalysed
Bigger	↑	✓	✓	
Better	↑ →	✓	✓	✓
Bolder	↑ →		✓	

2. IMF

Most International Monetary Fund (IMF) reform measures would only indirectly link to the NCQG. If Parties decided to take into account reflections of wider flows in the NCQG, most of the proposed IMF reform elements could indirectly be reflected in the NCQG numbers, as they could enable increasing climate investments and alignment of financial flows with the Paris long-term goals more generally.

Ever since IFA reform has gained more traction, special drawing rights (SDRs) have been one of the centrepieces. During the pandemic, they enabled developing countries to more adequately respond to the pandemic's impacts by injecting liquidity, even though two thirds of the issued SDRs were allocated to developed countries in line with the quota.[14] Accordingly, stakeholders have asked developed countries to rechannel a larger proportion of their unused SDRs or, alternatively, to agree to a new issuance to respond to the climate crisis. At least two destinations for rechan-

** This refers to MDBs' finance projects in sectors such as health and education that can be considered neutral in their climate effect. In this case, they are Paris-aligned but do not contribute to climate finance, notwithstanding that MDBs also increasingly include climate-relevant activities in sectors such as health and education.

nelled SDRs have been set up: the IMF's Resilience and Sustainability Trust (RST)[15] and the hybrid capital rechannelling mechanism at the IMF under the leadership of the African Development Bank and the Inter-American Development Bank.[16] The RST focuses on climate change and pandemics. So far, however, countries that have benefited from the RST have focused entirely on climate-relevant macro policy reforms. Accordingly, the SDRs rechannelled to the RST constitute financial resources that have clearly been used for climate measures. The RST's mechanism behaves similarly to MDBs' policy-based lending. Just as MDBs count a share of their policy-based lending as climate finance, one could argue that at least some of the RST funds are climate finance.[17] The new hybrid capital mechanism pioneered by the African Development Bank and the Inter-American Development Bank allows MDBs to leverage SDRs to increase their lending capacity. Other MDBs will likely follow. The SDRs are rechannelled to the MDBs' accounts at the IMF and operate as quasi-capital for the MDBs, allowing them to mobilise more capital from capital markets to increase their lending capacity.[18] This additional lending capacity might directly or indirectly translate into additional climate finance provided by the MDBs. A more direct link occurs when the contributions are earmarked, e.g. Germany earmarked its hybrid capital contribution to the World Bank as additional funds for projects supporting global public goods.[19] As described above, the MDBs already report their climate finance; hence, if the country that recycles its SDRs reports this as climate finance, it would ultimately translate to double counting. So, while the SDRs might increase climate finance, it is most adequately reflected through the MDBs' climate finance reporting. The attribution to the NCQG could occur through imputed multilateral shares, similar to the process under the USD 100 billion commitment.

Other proposed reform measures focus on the IMF's surveillance competency: i) to treat climate investments differently within Debt Sustainability Analysis (DSA), and ii) to more adequately reflect climate risks – both physical and transition risks – in Article IV consultations. A change in treatment of climate investments in DSA would elevate incentives for climate investments.[20] As climate investments would be counted more positively, it would reduce the costs associated with debt burden, freeing additional resources that could be sustainably invested. Similarly, a stronger emphasis in Article IV consultations on climate risks and the value of investments would provide additional incentives for countries. This should ultimately also eliminate the risk that the IMF's advisory will translate into a deepening of countries' dependence on fossil fuels. Neither reform measure will increase climate finance directly, but both would positively influence the catalysation of climate-relevant investments.

Last but not least, stakeholders have advocated for an IMF governance reform. The IMF's shareholder voting power still suffers from inertia introduced to the system when the IMF was set up 80 years ago. Developing countries have long argued that the governance needs to be reformed to reflect more adequately the economic and geopolitical power structure of the 21st century. This is essentially the same argument that developed countries use in calling for a widening in the contributor base in the NCQG negotiations – only in the opposite direction. A tit-for-tat widening of the contributor base, in exchange for an IMF governance reform, could hypothetically result in an increase in climate finance if the contribution by new contributors were additional to the climate finance provided by traditional contributors. That said, many potential new contributors already provide south–south climate flows that go unrecorded.[21] In the first instance, these additional contributions would be primarily on paper, yet with the potential to grow over time.

	Change in climate finance	Provided	Mobilised	Catalysed
SDR rechannelling RST	↑	✓	✓	
SDR rechannelling hybrid	↑ →			
Climate in DSA				✓
Climate in Art. IV consultation				✓
Governance reform	↑ →	✓	✓	

3. Debt

Various debt-relief measures could potentially contribute to an increase in climate finance, or at minimum favour increases in the wider finance flows under a multilayered NCQG. Independent of the NCQG, many countries urgently need debt relief, as more than 50 countries are currently in debt distress.[22] Especially, climate-vulnerable nations burdened with heavy debt find themselves ensnared in a relentless cycle. Servicing debt limits funds for vital climate change investments, while climate impacts worsen, causing costly disasters and hindering debt management.[23] To tackle the debt crisis, the international community talks about debt cancellation and restructuring, debt-for-climate/nature swaps, and debt pause clauses. All of these aim to free up fiscal space for domestic investments.

Currently, debt is addressed in the Expert Review on Debt, Nature and Climate, which is intended to provide innovative ideas and recommendations to address the debt crisis.[24] Furthermore, the G20 established a Common Framework that is intended to allow debt restructuring for certain countries on a case-by-case basis.[25] The G20 Framework has faced criticism for not being sufficient or prompt in addressing global debt issues: it is not available to all highly indebted countries and is hampered by slow, bureaucratic processes.[26] Key concerns include its failure to involve all creditor classes and its lack of integration of debt relief, climate action, and development goals. By depending on the IMF's DSA, the framework overlooks the true scale of investment needed for climate initiatives and the potential impact of climate-related shocks.[27] New mechanisms and reforms are crucial to address the debt crisis because fiscal space is a necessary condition for climate action and the achievement of other Sustainable Development Goals (SDGs). Countries with high debt distress cannot afford loan-based climate finance. As MDB and IMF reforms provide primarily loan-based financing, these reforms do little to help countries already in high debt distress; thus, they depend on receiving grants.

A debt-for-climate swap could hypothetically be considered climate finance. Debt swaps often involve complex transactions where the creditor country or third parties forgive or renegotiate the terms of a country's debt in exchange for the country allocating funds for agreed-on purposes.[28]

In a for-climate swap, the freed-up resources will be used for climate action. One could thus argue that the original creditors' finance is used for climate action. Methodologically, questions would arise regarding how large the actual climate finance would be, i.e. depending on whether the original loan was already intended for climate; how high the debt relief is and the addition to the existing grant-equivalent component of the loan; and how much finance is actually directed towards climate. Double counting of contributions is a definite risk.[29] Besides these methodological questions, there is controversy as to whether debt swaps can be counted as conditional debt relief and as public grants in the first place. Unlike with receipt of public grants, recipient countries must reallocate domestic resources rather than accessing new financing or full debt relief. In purely theoretical terms, one could argue that debt-for-climate swaps at minimum foster the catalysation of climate-relevant flows and can potentially also be counted as climate finance provided.

Whether a debt pause clause could contribute to climate finance depends on the specificity of the clause. Debt pause clauses allow countries to suspend debt repayments for a specified period following a natural disaster. By allowing countries to temporarily halt debt repayments in such an event, they free up liquidity that governments can use to respond to disasters and their aftermath.[30] The discussed debt pause clauses are considered neutral in the net present value. Nonetheless, debt pause clauses do not come for free: they carry a cost premium or markup on the loan.[31] Per se, debt pause clauses do not translate into new finance flows as countries instead reallocate domestic resources and debt repayments are merely postponed. Therefore, these clauses would ultimately only translate into increased catalysation for climate if domestic resources were used for loss and damage; however, countries would thereby forgo capacity for other investments. There is one condition under which debt pause clauses could constitute climate finance: if contributors covered the cost of the premium, this could count as finance provided for loss and damage. One example is the Catastrophe Containment and Relief Trust, whereby the trust pays for the debt service owed to the IMF if the affected country meets certain trigger criteria. Under the current NCQG negotiations, however, it remains unclear whether finance for loss and damage will be included.

Debt swaps and debt pause clauses fail to address the root cause of the debt crisis due to the absence of a comprehensive long-term sustainability strategy and the continuously high cost of capital. Debt cancellation constitutes a more far-reaching approach to solving the debt crisis: by relieving developing countries of debt burdens, resources are freed up to invest domestically – potentially in climate mitigation and adaptation efforts. It seems very unlikely that debt relief is directly attributable to these domestic efforts; still, while debt cancellation may not directly finance climate initiatives, it indirectly enables countries to allocate resources to addressing climate challenges and could potentially be counted in a catalysation target.

Similar in its direction of impact, debt restructuring would also free up much-needed domestic resources. Per se, this would not necessarily translate into additional catalysed finance for climate action, but it could enable countries to catalyse such finance – just like in the case of debt cancellation. A more direct linkage could be established if countries implemented more innovative suggestions for debt restructuring that redesign the G20 Common Framework. One such innovative idea suggests that creditors receive sustainability-linked bonds in exchange for their old debt.[32] Sustainability-linked bonds have key performance indicators linked to the achievement of certain climate or sustainability goals, e.g. those determined in national plans. Hence, if innovative ideas like those mentioned above are implemented, this would further increase the likelihood that the restructuring contributes positively to the catalysation of additional investments in climate action.

	Change in climate finance	Provided	Mobilised	Catalysed
Debt swaps	↑ →	✓		
DPC	↑ →	✓		✓
Debt cancellation	↑ →			✓
Debt restructuring	↑ →			✓

4. International levies and taxation

There is potential to raise new funds through international taxes and levies, with some of these funds possibly allocated to climate initiatives. The relevance of these new revenues for the NCQG will depend on the NCQG's structure. The nature of the levies and taxation, in particular the point of revenue collection, will influence how easy it will be to appropriate some of the revenues for climate initiatives. Some of these funds might become new grant finance for developing countries, while others could be collected and retained domestically. Implementing taxes and levies that follow the 'polluter pays' principle would potentially catalyse behavioural shifts, such as transitioning away from certain industries due to increased costs, ultimately limiting the negative externalities induced by polluters' actions and aligning economic incentives with environmental goals. This would support a wider shift in financial flows.

Several levies and taxes are currently under consideration. The levies discussed most prominently include a fossil fuel extraction levy; a levy on shipping emissions under the International Maritime Organization (IMO); or an air passenger levy that could be included in first- or business-class tickets or alternatively imposed on frequent travellers – or, alternatively, a tax could be imposed on kerosene or private jets.[33] Several air passenger levies are in place already; however, the lion's share of the revenue from these is used domestically.[34],[35] An exception is France: France's air passenger levy transfers the funds to an international drug purchase facility, benefiting developing countries. This showcases how levies could be used for climate finance purposes even if collected domestically. Negotiating Parties in the IMO are considering establishing an emissions levy that could be collected at the point that fuel is provided to ships.[36] The IMO has already established joint funds, i.e. the International Oil Pollution Compensation (IOPC) Funds, that raise a levy for joint purposes.[37] It is, however, unclear whether the IOPC Funds could be seen as a precedent for a levy on carbon emissions from shipping. The fossil fuel extraction levy would impose a charge on each ton or barrel of fossil fuel produced. This could in fact be considered closer to the original purpose of the IOPC as it would be the producers and polluters paying for the cost of their actions. Interestingly, the incoming COP29 Presidency temporarily considered the idea of implementing a fossil fuel extraction levy to raise resources for a climate-oriented investment fund.[38] However, this idea has recently disappeared. In summary, all these levies could hypothetically provide new grant-based climate finance if so decided. This is independent of the point of revenue collection, as the example of France displays. At minimum, the levies would increase the cost of pollution and would potentially support a shift in the wider finance flows, e.g. triggering investments in the decarbonisation of the shipping and aviation sector.

The most dynamic tax initiative currently underway is taking place in the G20. G20 Finance Ministers have agreed to cooperate on international taxation, with the emphasis on effectively taxing high-net-worth individuals (HNWIs); these efforts build on a report by Gabriel Zucman.[39] In the G20 declaration, however, the Finance Ministers highlight every country's sovereignty. Hence, while a wealth tax would generate new revenues, they would contribute to climate finance only if a country or multiple countries decide to use at least a share of the revenues for that purpose. Doing so, i.e. utilising the revenues for climate finance, would also ensure a positive impact on wider finance flows; otherwise, it is not guaranteed that a tax on HNWIs would effectively have positive impacts on wider finance flows. While HNWIs are the most polluting individuals, most of their wealth is held in assets that are not directly polluting; a redistribution could potentially increase emissions because additional revenues for lower-income branches will more likely be used for consumption. An additional tax that has been repeatedly suggested for use in generating revenues for development and climate finance purposes is a financial transaction tax (FTT). It has been implemented in several jurisdictions, in both developed and developing countries. Experts agree that an FTT could generate substantial revenues even at a low percentage rate because of the large numbers of financial transactions happening every day. Here, as well, the financial burden would be carried predominantly by the wealthiest,[40] not only generating revenues but also reducing inequalities. Views differ, however, as to whether FTTs have a noticeable impact on market behaviours. Also, as with the other levies and taxes, the revenue use would depend on the individual country. An FTT would likely not have an impact on the wider financial flows.

In summary, levies and taxes have the potential to generate substantial amounts in public resources for climate finance. However, their availability hinges in most cases on domestic willingness to redistribute these revenues to international climate action. Also, besides the uncertainty about the allocation of generated revenues, the timeline for implementing these levies and taxes remains uncertain as it depends on political will and the many interlocked debates. In an ideal scenario, the introduction of levies and taxes would increase the quantum of climate finance provided under the NCQG, as well as contributing to a larger quantum of financial flows aligned with the long-term goals of the Paris Agreement.

	Change in climate finance	Provided	Mobilised	Catalysed
IMO levy	↑ →	✓		✓
Aviation levy	↑ →	✓		✓
Fossil fuel levy	↑ →	✓		✓
HNWI tax	↑ →	✓		✓ ✗
FTT	↑ →	✓		

What can we clearly count as climate finance?

Determining what qualifies as climate finance is the most complex issue addressed in this paper and cannot be answered here, as it is inherently a highly political question. There is no common definition of climate finance in the UNFCCC; as noted in the analysis of this paper, countries currently apply their own definitions of climate finance. As a consequence, climate finance under the UNFCCC suffers from low precision. There are fundamentally different perspectives on what climate finance entails across developed and developing countries. Given this impasse, it is unlikely that the negotiations on the NCQG will resolve the challenges associated with the lack of a more stringent and robust climate finance definition. The structure of the NCQG, however, will shape and limit which IFA reform actions will play a role in climate finance and climate-relevant flows. The uncertainties surrounding many IFA reform proposals and complex justice-related issues further complicate the accounting of climate finance; for example, questions arise about how new tax revenues should be distributed or whether debt-relief measures can be considered climate finance at all.

Conclusion

In this working paper we analysed the potential impact of IFA reform measures on the availability of climate finance. It has become evident that IFA reform measures can play a crucial role in closing the finance gap by providing and mobilising additional climate finance and catalysing a shift in financial flows towards a climate-positive impact. Overall, most measures will to different degrees of causality positively impact climate finance. The ultimate impact on the quantity of climate finance that forms part of the NCQG will depend on the goal's structure and, eventually, what is ultimately counted as climate finance. Hence, the robustness of this working paper's results is substantially restricted by the numerous open variables and uncertainties.

Given the demonstrated importance of IFA reform measures to increasing the availability of finance for climate action, Parties may consider expanding on the linkages between IFA reform and debates under the UNFCCC, even if the NCQG structures ultimately do not allow for a maximal approach. Assuming that Parties will continue their dialogues and deliberations on Article 2.1(c), some of the IFA reform elements could also be taken up here.

This working paper has consciously been focused only on the quantitative aspects of the NCQG and IFA reform. The quality of climate finance is equally important in ensuring that climate finance operates to the benefit of developing countries. Further research should address the question of the quality of the climate finance generated through IFA reform measures. The question of quality standards is of fundamental importance when deciding on the NCQG, including in relation to the quantum.

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