

# Finance Policy Proposal



**SUBJECT:** Just Transition Financing Strategy:  
Climate-for-Debt Swaps, Carbon Tariffs, and Blended Finance

**TO:** Climate Policy Makers, Influencers, and Stakeholders

**FROM:** Finance Team, Emerging Leaders for Climate Action

*Authors: Benjamin Guggenheim, Cathleen Jeanty, Christopher Jackson, Cynthia Yue, Dylan Mibu, Rituraj Yadav, Sydney Rovner, Yejide Olutosin.*

---

## Executive Summary

A just transition requires innovative finance mechanisms and alignment to maximize capital flows from the finance ecosystem. Historically, public and private capital has fallen short of financing goals for global climate action objectives. While a plurality of measures are needed to address the gap, this paper provides recommendations related to blended finance, climate-for-debt swaps, and carbon tariff strategy as a means to increase global climate finance flows to emerging markets and developing economies (EMDEs).

## Introduction & Context

The world is warming at an alarming rate, with average temperatures having risen by 1.2°C since pre-industrial times. Failure to limit warming to well below 2°C would unleash devastating consequences – rising seas, deadly heatwaves and fires, drought and famine, rising risk of disease and mass extinctions.



EMBASSY OF THE  
UNITED ARAB EMIRATES  
WASHINGTON, DC



Advanced economies, which are the biggest historical emitters, are racing to develop and deploy clean energy alternatives to reduce long-term environmental impacts. However, EMDEs will be responsible for the majority of future carbon emissions as their populations and economies grow. These countries face tensions between the imperative for economic transformation and the urgent need for an energy transition. A just transition will be essential to reconcile these objectives. Estimates suggest to meet rising energy needs in ways that adhere to the Paris Agreement, EMDEs (excluding China) will require a seven-fold rise in annual investment from \$260 billion to between \$1.4-1.9 trillion (IEA). However, structural challenges inhibit the mobilization of capital for a just transition at the speed and scale required.

First, political and economic risks in many EMDEs increase the costs of financing climate projects. Particularly in Africa, real and perceived investment risks lead to high interest costs charged to sovereigns that exceed what their credit ratings warrant. As a result, climate investment has progressed slowly in developing countries despite their outsized future emissions.

The COVID-19 crisis pushed many EMDEs into debt distress after they borrowed heavily to mitigate economic impacts. This, combined with higher food and energy costs due to Russia's invasion of Ukraine, led to 23 EMDEs finding themselves in or on the brink of debt distress in 2022 – the highest count in over two decades. With debt burdens now exceeding 100% of GDP in some countries and recent interest rate hikes by major central banks, poorer developing countries are challenged to service their debt obligations and greater public resources are being channeled toward debt repayments rather than social programs and climate action.

Finally, heightened tensions due to emerging protectionist industrial policies for reshoring manufacturing facilities and jobs – stemming from US-China competition and discontent among domestic populations about economic conditions – threaten to fragment trade and investment flows between advanced economies and EMDEs. This leads to inefficient capital allocation and duplication of supply chains. Carbon border taxes could further bifurcate clean tech markets if unaccompanied by exemptions and/or development support for EMDEs.

Targeted solutions could help mobilize capital and technologies for an equitable clean energy transition in EMDEs. Increasing blended finance flows via multilateral development bank (MDB) reform and rechanneling special drawing rights (SDRs) could help derisk EMDE climate investments and catalyze private capital inflows. Debt-for-climate swaps, as a supplement to existing debt restructuring instruments, could ease debt overhang and free up fiscal space for green investments. Reimbursing carbon tariff revenues to finance EMDE climate efforts could significantly reduce the risk of trade and investment fragmentation. For all of these solutions, global cooperation is vital to align economic development with environmental sustainability.



# Policy Recommendations

## *Debt-for-climate swaps*

Debt-for-climate swaps allow heavily indebted countries to reduce debt obligations in exchange for committing freed-up resources to climate action. Creditors offer debt relief, and debtors undertake decarbonization, adaptation, and conservation of carbon sinks (forests, oceans, etc.), thereby enabling a transition to a low-carbon economy while simultaneously providing capital relief for EMDEs. Newly available public finance can further be directed towards climate spending, or take on more debt-financed sustainability projects. In this way, debt-for-climate swaps can contribute to a key COP28 presidency goal of creating 11,000GW of renewable capacity by 2030.

Recent deals show these swaps growing in scale and impact. In a landmark debt-for-climate swap in May 2023, Ecuador agreed to a \$1.6 billion debt buyback engineered by Credit Suisse. This saved the country around \$1 billion in debt repayments over 17 years. The freed-up resources will finance the conservation of the ecologically vital Galapagos Islands. In some instances, swaps can lead to an upgrade of a nation's sovereign credit rating, as exemplified by Belize's 2021 swap, thus reducing the cost of government borrowing for additional climate projects.

The most appropriate targets for debt-for-climate swaps are countries with high public debt burdens coupled with significant emissions reduction potential, either through preserving natural carbon sinks or transitioning away from fossil fuel dependence. Swaps should not substitute for traditional debt relief or concessional financing. Furthermore, the IMF points out that debt-for-climate swaps, which subsidize non-participating creditors, are less efficient than projects through conditional grants. However, grant and concessional loan financing from donors and development banks falls short of the climate investment needs of EMDEs. Therefore, debt-for-climate swaps have the potential to be expanded in scale to supplement existing climate finance instruments.

To scale debt-for-climate swaps, an international framework and coordination body must be established. The IMF and World Bank could establish a joint Debt-for-Climate Facility for technical expertise, project administration, guaranteeing refinanced bonds, and monitoring compliance. This centralized facility with an expert advisory board and analytics teams would identify eligible debtor countries and existing loans for swap opportunities, hold negotiations among the various relevant creditors, governments, and NGOs to a specific deal, and help implement optimized swaps.



EMBASSY OF THE  
UNITED ARAB EMIRATES  
WASHINGTON, DC



The US Treasury could champion the creation of this facility through IMF and World Bank leadership roles and G20 engagement. United States Agency for International Development (USAID) and the Environmental Protection Agency (EPA) could then assist implementation through climate investment planning, verifying outcomes, building developing country capacity, and engaging stakeholders. A coordinated approach can enable large-scale, impactful debt-for-climate exchanges to advance urgent climate goals in indebted developing countries.

## ***Carbon tariff reimbursement***

In the coming years, many developed markets are expected to adopt CBAMs to tackle carbon leakage, encourage global climate efforts, and safeguard their domestic industries' competitiveness. In the short term, the US may not introduce a domestic carbon pricing system to avoid CBAM tariffs but could implement a CBAM based on national sector-specific emission rates, following a structure similar to the Global Arrangement on Sustainable Steel and Aluminium (GASSA).

Many countries in the Global South face the prospect of penalties due to carbon-intensive manufacturing processes, largely attributable to technological disparities, both at the level of individual entities and in national averages. Notably, China, India, and South Africa have contested the EU's CBAM, decrying it as protectionist and formally raising their concerns at the World Trade Organization (WTO). In response to CBAM, these nations may explore the implementation of their own tariff regimes that specifically target more technologically advanced economies. For example, India has contemplated a framework that accounts for historical emissions, with the US (25%) and Europe (22%) being the largest cumulative contributors since the onset of the Industrial Revolution. Countries might consider augmenting tariffs or imposing import restrictions on clean technologies developed in advanced economies. Furthermore, resource-rich countries, especially those holding critical minerals, may retaliate by instituting export bans and raising taxes and royalties, actions that could deter investment and impede progress in the broader energy transition.

Failure to assist EMDEs in their adjustment to CBAMs may drive a wedge between advanced economies and developing countries whose economies are reliant on carbon-intensive sectors. These countries may instead continue to trade amongst themselves in conventional energy commodities, rather than progress towards a just transition. Alternatively, countries in the Global South may depend more on China and Russia for trade and technology. Reduced capital flows and trade to EMDEs would also negatively impact the energy transition in advanced economies as the global supply chains for clean hydrogen, EVs and battery inputs, solar panels, and other decarbonization technologies – for which demand is expected to expand significantly – would be constrained by higher manufacturing costs.



The US should seek to negotiate with the EU and EMDEs on carbon pricing mechanisms to ensure alignment. Funds generated from carbon tariffs could be used, in part or whole, to support climate transition programs of the Global South as an incentive for buy-in from countries adverse to carbon taxation. Bilateral negotiations between the US and EU – led by the US Trade Representative and State Department – could agree on CBAM design, exemptions, and use of revenue for climate finance. At multilateral forums like the G7 and G20, Treasury and the State Department could further build consensus on minimizing CBAM impacts on developing nations.

## ***Blended finance***

Blended finance is the strategic structuring of catalytic capital from public or philanthropic sources to increase private sector investment toward the SDGs in developing countries. This concept has gained increasing recognition as a tool to help decarbonize EMDEs, leveraging risk sharing between multiple financiers to make investments in uncertain regulatory environments or new technologies more appealing. If done correctly, the use of philanthropic or government funds can help crowd in private finance, creating a three to five times multiplier effect. Blended finance can take a variety of forms, including first-loss guarantees, project insurance, and technical assistance. For example, the World Bank's International Finance Corporation helped finance Uzbekistan's first grid-scale renewable energy project, a 100-megawatt solar power plant. As part of this financing package, the IFC provided \$35 million in concessional loans.

As blended finance becomes increasingly employed for climate finance, particularly in EMDEs, standardized design and structures must be established to rapidly scale and engage private investors. Many private financiers find it challenging to participate in blended financing due to the small size of clean energy projects often found in emerging markets. MDBs and DFIs could play an intermediary role in connecting investors with projects and structuring deals appropriate for each project's size and country context. Over time, this work could grow to include standardized templates for deals, monitoring, and evaluation. This standardization would further build the case for the additionality of blended finance deals and make data on the impact of projects more accessible.

MDBs and DFIs could accelerate the use of blended finance tools by amending their targets to increase the share of private capital they mobilize in transactions. Instead of measuring and setting targets for the amount funded, they could set additional, clear targets for private capital mobilized. Incorporating such a metric into mandates and strategic planning would properly incentivize development banks to participate in blended finance deals and crowd in more private capital. Further, MDBs and DFIs could position themselves as second-tier capital instead of a primary capital provider, shifting focus to attract private investors rather than deployment of their funds.



MDBs could additionally expand the Global Emerging Markets (GEMs) Risk Database Consortium to project and investor partners when related to Nationally Determined Contributions (NDC) projects. The GEMs database is one of the largest credit risk databases for EMDEs but is currently proprietary to member institutions (MDBs and DFIs). Expanding access to this valuable default and recovery data would enable private investors to better assess risk and underwrite projects in countries where they would historically be unwilling to participate in deals. The G20 has called for the establishment of a GEMs 2.0 database; the US, broader G20, and private investors should continue efforts to make this data more readily available.

Lastly, blended finance flows could be increased through SDR rechanneling through MDBs. The African Development Bank (AfDB) has recently been a big proponent of this, meeting with other stakeholders during the IMF Annual meeting in October 2023. As negotiations and discussion continue, one avenue to increase private capital flows could be facilitated by MDBs allocating a percentage of the increased capital via SDR rechanneling toward blended finance projects, specifically by providing mezzanine-level debt or blending with philanthropic capital. This would create a better de-risking layer in the capital stack, incentivizing private investor participation.

## Background

The 2009 Copenhagen Accord was a landmark climate agreement reached during the 15th UN Climate Change Conference recognizing the need to limit global warming to 2° C above pre-industrial levels. In addition to pledges by signatories, it established a goal of providing developing nations with financial assistance, aiming to mobilize \$100 billion per year by 2020 to help them adapt to climate change impacts and transition to low-carbon economies. This laid the groundwork for subsequent climate agreements and helped shape the global approach to addressing climate change. The Paris Agreement, adopted in 2015 under the United Nations Framework Convention on Climate Change, stands as a landmark accord, setting the global agenda for climate action and emphasizing specifically the need for financial flows to be consistent with a pathway towards low greenhouse gas emissions and climate-resilient development. The Bridgetown Initiative, introduced at COP27, calls for \$500 billion Global Climate Mitigation Trust, expanding concessional lending by \$1 trillion, suspending debt payments for countries hit by natural disasters, establishing a fund with \$100 billion annually to reduce foreign-exchange risk and unlock additional private investment in mitigation projects.



EMBASSY OF THE  
UNITED ARAB EMIRATES  
WASHINGTON, DC



## Conclusion

While significant progress has been made in advancing climate finance flows, challenges persist. Disparities in funding distribution, lack of transparency, and the urgency to scale up climate finance remain pressing issues. Developed countries still fall short of the \$100 billion per year commitment by 2020 under the Copenhagen Accord. Further, global climate finance flows are not sufficient to maintain the average investment needed to maintain a 1.5° C pathway. An increase of at least ~590% in annual climate finance is required to meet internationally agreed climate objectives by 2030. Global financial markets hold enough liquidity but barriers to effective and sufficient deployment exist. Bridging these gaps requires strengthening international cooperation, enhancing policy coherence, fostering public-private partnerships, and leveraging innovative financial instruments to unlock more capital flows

There is a pressing need for the international community and finance ecosystem to allocate more capital to address the climate finance gap and meet global targets, but barriers and misaligned incentives present challenges to sufficient deployment. Improving blended finance capacity, debt-for-climate swaps, and carbon tariff reimbursement and aligned strategy are three levers to increase finance flows. Collaboration between nations, regions, and international bodies is paramount. By aligning efforts, sharing best practices, and fostering a collective commitment to climate finance, the global community can navigate the complexities of climate change and move towards a more sustainable future.



EMBASSY OF THE  
UNITED ARAB EMIRATES  
WASHINGTON, DC



## Appendix

### **Appendix A: Contact Information**

Dylan Mibu (dylanmibu@gmail.com)

Benjamin Guggenheim

Cathleen Jeanty

Christopher Jackson

Cynthia Yue

Rituraj Yadav

Sydney Rovner

Yejide Olutosin

### **Appendix B: References**

Adrogué, Bernat Camps, and Rakan Aboneaj. “Debt-for-Climate Swaps Won’t Solve the Climate or Debt Crises, but Can They Help?” Center For Global Development | Ideas to Action, 12 Dec. 2022, [www.cgdev.org/blog/debt-climate-swaps-wont-solve-climate-or-debt-crises-can-they-help](http://www.cgdev.org/blog/debt-climate-swaps-wont-solve-climate-or-debt-crises-can-they-help).

Andrews, David, and Plant, Mark “Rechanneling SDRs to MDBs: Urgent Action Is Needed to Jumpstart the Green Equitable Transition.” Center for Global Development, 12 Oct. 2021, <https://www.cgdev.org/blog/rechanneling-sdrs-mdbs-urgent-action-needed-jumpstart-green-equitable-transition>.

Barbara Buchner, Baysa Naran, et al. “Global Landscape of Climate Finance 2021”. Climate Policy Initiative, 21 December 2021, <https://www.climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-2021/>

Chamon, Marcos, Erik Klok, Vimal Thakoor, and Jeromin Zettelmeyer. 2022. “Debt-for-Climate Swaps: Analysis, Design, and Implementation.” IMF Working Paper 2022/162, International Monetary Fund, Washington, DC.



Convergence Blended Finance (2023). The State of Blended Finance 2023: Climate Edition. Convergence Report.

Dimond, Victoria. "Mining for Gems." MDB Reform Accelerator, 3 Aug. 2023, [www.mdbreformaccelerator.cgdev.org/mining-for-gems/](http://www.mdbreformaccelerator.cgdev.org/mining-for-gems/).

"Marrakech Meeting on SDRs Rechanneling: Accelerating Development Finance Through Multilateral Development Banks." African Development Bank Group, [www.afdb.org/en/news-and-events](http://www.afdb.org/en/news-and-events).

Jonas Nahm, Johannes Urpelainen, et al. "Debt-for-Adaptation Swaps: A Financial Tool to Help Climate Vulnerable Nations." Brookings, 29 May 2023, [www.brookings.edu/articles/debt-for-adaptation-swaps-a-financial-tool-to-help-climate-vulnerable-nations/](http://www.brookings.edu/articles/debt-for-adaptation-swaps-a-financial-tool-to-help-climate-vulnerable-nations/).

"Playing by New Rules: How the CBAM Will Change the World." Wood Mackenzie, WoodMac.Site.Features.Shared.ViewModels.Metadata.Publisher, 21 Sept. 2023, [www.woodmac.com/horizons/how-the-cbam-will-change-the-world/](http://www.woodmac.com/horizons/how-the-cbam-will-change-the-world/).



EMBASSY OF THE  
UNITED ARAB EMIRATES  
WASHINGTON, DC

