International climate finances

In the existing global panorama, sustainable finance has become a crucial element for addressing the challenges of climate change.

As the climate crisis worsens, there is a growing need for financial resources with which to fund projects designed to mitigate and adapt to its effects. At May of 2021, 21,925 climate financing needs had been identified in 153 countries, for a projected total cost of US$28.32 billion[1]. This can be broken down into an average need for US$2.8 billion a year up until 2030.[2]

International climate finance, in this context, emerges as an essential tool for facilitating the transition toward climate change resilient low-carbon economies. Channeling resources toward these projects, however, confronts a multitude of barriers that limit both their effectiveness and their reach.

BARRIERS TO CLIMATE FINANCE

One of the main difficulties of climate finance is the lack of solid evidence regarding the financial returns and impact benefits of these projects. The absence of universal metrics hampers the precise evaluation of the returns on the investments and, even if such metrics were to be established, the limited capacity for monitoring and compiling data at the local level could raise the costs, thus reducing the expected returns. To this, we must add the challenge of identifying whether a project truly produces further benefits, determining just what percentage of those benefits can be attributed exclusively to the project and guaranteeing that the results continue to hold true

in the long term. These constitute critical challenges for ensuring the effectiveness and sustainability of the investments.

Capital markets, for their part, also confront significant barriers. Furthermore, these markets are not always able to allocate capital or transfer risks efficiently, thus limiting the adequate financing of sustainable projects. In addition, environmental problems tend to transcend geographic and political borders, thereby complicating the existence of a centralized institution to lead fund-raising and implementation of climate projects. Furthermore, individual agencies, landowners or interested groups frequently lack the necessary capital with which to carry out large-scale projects.

Financial institutions, likewise, have their own limitations. Many of them lack the necessary skills and tools for properly assessing project risks and returns and structuring investments in the best way possible. The limited offer of training and knowledge products specializing in sustainability hamper the capacity of financial professionals to identify and take advantage of opportunities for investment in sustainable projects. In addition, the poorness of risk-return profiles, lack of suitable projects for commercial investment and economic vulnerability are, in the final instance, significant barriers to the funneling of financial resources into climate projects.

FIGURE N.º 1:
PRINCIPAL BARRIERS TO CLIMATE FINANCE

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FINANCIAL INSTRUMENTS FOR CLIMATE FINANCE

Development finance institutions (DFIs), together with other public and private institutions, have developed a variety of financial instruments and tools with which to surmount these barriers by facilitating capital flows towards sustainable initiatives that would promote investment in clean technology and sustainable projects. Some of the products in widest use because of their simple structure and easy adoption are green bonds and debt swaps

We also find other financial mechanisms in the market, designed to overcome barriers to finance and facilitate investment in sustainable projects. Each of these instruments offers specific solutions that improve access to capital and mitigate risks associated with investments in sustainability.

One of the key mechanisms in this context is the use of guarantees, which provide crucial financial support in adverse scenarios, thus reducing the risk perceived by lenders and facilitating access to credit. This backing is particularly important in sustainable projects that confront additional uncertainties, in that it allows for investors and lenders to commit themselves more confidently. Similarly, collateral utilizes assets as a guarantee to ensure loans. By increasing lenders' trust in the capacity of the project to comply with the financial obligations, this mechanism guarantees more favorable loan terms, thereby facilitating the necessary financing to move ahead towards its sustainable objectives.

Sales agreements, by guaranteeing a future and predictable flow of income, play a crucial role, as well. Such agreements

Green bonds

Green bonds are debt instruments issued by public or private institutions for the specific purpose of financing projects that will produce environmental benefits. These bonds guarantee that the funds collected will be used exclusively for initiatives relating to climate sustainability and change, thereby contributing directly to environmental conservation.

Debt swaps

Debt swaps enable developing countries to reduce their external debt in exchange for sustainability commitments. This mechanism not only alleviates the debt burden, but also channels funds towards sustainable projects, like the adoption of renewable energy and enhancement of energy efficiency.

reduce the demand risk and provide financial stability, thus significantly improving the project's loan profile. The foreseeability of the income also enables projects to plan more efficiently and to attract investors interested in stable returns. In addition, the use of first-loss or subordinated capital acts as a buffer in financial structures. This type of capital absorbs the first losses in case of financial difficulties,

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protecting the principal investors and attracting those with a lower tolerance for risk, thereby facilitating greater fund-raising for the project.

In like manner, insurance and coverages play an essential role by providing protection against specific risks and price fluctuations. Although these mechanisms can add further complexity and additional costs, they are of key importance for ensuring the operational and financial stability of the project. By mitigating the risks, insurance and coverages enable projects to operate with greater security and foreseeability, which is essential for maintaining the trust of investors and ensuring success in the long term.

To conclude, the use of results-based incentives is also common. This mechanism offers financial compensation for reaching preestablished performance goals. These incentives not only strengthen the project's credit profile, but by aligning the interests of the investors with the project results, also improve the foreseeability of the cash flow. This alignment contributes to the establishment of a positive sustainable investment and development cycle, thereby promoting successful execution of projects that produce both economic and environmental benefits.

TABLE N.º 1:
FINANCIAL INSTRUMENTS FOR SURMOUNTING MARKET FAILURES AND BARRIERS

INSTRUMENT	DESCRIPTION
Guarantees	Third-party intervention to cover financial obligations in adverse scenarios, which can improve access to financing and reduce the margin of interest.
Collateral	Pledge of guarantees like property or land for loan repayment, although the risks relating to land tenure can limit its use.
Sales agreements	Signing of contractual agreements with future product buyers to improve the loan profile and reduce the demand risk.
First loss or subordinated capital	Subordinated capital layer in a fund that acts as a buffer to enhance the access of investors adverse to risk.
Insurance and coverage	Financial solution to protect against specific risks or fluctuations in the prices of basic products, which can improve access to financing.
Results-based incentives	Contractual agreements that offer financial compensation based on reaching performance goals, thereby strengthening the credit profile and improving the foreseeability of the cash flows.

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In this sense, the financial actors' commitment to promoting climate finance is made evident. Through the use of their green financial products and mechanisms, they are helping to transform key economic sectors and establish a route towards more sustainable development. Even so, the challenge is enormous and requires continuous collaboration between governments, the private sector and civil society. Financial institutions are expected to continue making greater efforts, developing new financial products and exploring innovations to hasten the transition towards a green economy. The integration of environmental, social and governance (ESG) criteria into all investment decisions is shaping up as a key trend, furthered both by stricter regulations and a growing demand for conscious investors, thus showing that international climate finance represents a powerful tool for addressing the most pressing environmental challenges of our time.

1 UNFCCC (2021). First report on the determination of the needs of developing country Parties related to implementing the Convention and the Paris Agreement (NDR).

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