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**Book Part — Published Version**

## Climate finance: What lessons from development aid in the past?

**Provided in Cooperation with:**

Kiel Institute for the World Economy – Leibniz Center for Research on Global Economic Challenges

*Suggested Citation:* Nunnenkamp, Peter (2011) : Climate finance: What lessons from development aid in the past?, In: Natalia Trofimenko (Ed.): Climate Change: Current Issues, Kiel Institute for the World Economy, Kiel, pp. 10-11

This Version is available at:

<https://hdl.handle.net/10419/60983>

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## CLIMATE FINANCE: WHAT LESSONS FROM DEVELOPMENT AID IN THE PAST?

*Much of the effort to mitigate climate change will have to be made in the developing world. However, the ability of less advanced countries to shift to lower-carbon trajectories without compromising economic growth will depend on industrialized countries providing financial and technical assistance. Donors on their part are concerned about huge financial demands being placed on them without any guarantee that the recipients will deliver the required mitigation and adaptation results. Which lessons could be drawn from previous development aid? How should climate finance be allocated across recipient countries, and under which conditions is it most likely to be effective?*



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There are no easy answers to these questions. Decades of experience notwithstanding, the allocation and effectiveness of aid remain highly contested among development economists and experts in the field. This implies that donors will not do the trick by just raising more funds. At the same time, deserving recipients run the risk of receiving too little from donors unwilling to try harder by making their aid more effective.

Naïve as it may be, an important requirement for more effective support would be that donors no longer allocated aid according to their (commercial and political) self-interest. Aid allocation should be guided exclusively by the need and merit of recipients. Likewise, though probably no more realistically, donors should pay heed to frequent calls for less aid proliferation and thereby reduce transaction costs and the administrative burden for recipients.

Fighting global public bads such as climate change provides a clear case for donors to co-finance common pools, rather than showing their flag by individually financing prestigious projects. The common-pool approach would avoid the earmarking of aid by donors. Earmarks tend to be futile to the extent that recipients can redirect local funds according to their own preferences (“fungibility of aid”). They are even harmful if project-specific aid financing is tied to supplies from the donor country, which reduces the welfare of recipients by constraining their choices. The implementation of projects should rather be decided through open tenders in which donor agencies with different specialization profiles can compete.

The effectiveness of aid depends at least as much on

the behavior of recipients. The World Bank’s message of the late 1990s that aid works when recipients pursue reasonable economic policies and basic institutional requirements are in place has been widely blamed for over-simplification. Yet it cannot seriously be disputed that greater selectivity may help aid effectiveness. This applies especially for large-scale aid programs, including those required for sustaining the environment. In contrast to small projects, it is hardly possible to sideline the – often corrupt – governments of recipient countries and, instead, entrust local communities and non-governmental organizations with aid delivery and project implementation.

Recent experience, e.g., in health-related aid programs, suggests that recipients should be selected and rewarded according to actual performance. Donors would pay for measured delivery of, say, climate-related services by recipients, rather than perpetuating the failed attempt to buy such services by disbursing aid if only recipients *promise* to deliver. An important caveat is in order, however: performance-based aid would still suffer from time-inconsistency problems if not supplemented by sanctions when recipients reverse earlier reforms after having received financial rewards.

### BACKGROUND FACTS

- Developed countries are responsible for about two-thirds of the cumulative energy-related CO<sub>2</sub> now in the atmosphere.
- Developing countries will account for 90% of the projected increases in global energy consumption,

coal use, and energy-related CO2 emissions over the next twenty years.

- 75-80% of the costs of damages caused by the changing climate will be borne by the developing countries.
- Even 2 degrees Celsius warming above preindustrial temperatures—the most optimistic scenario—could result in permanent reductions in GDP of 4-5% in Africa and South Asia.
- By 2030 the incremental investment needs for mitigation in developing countries could be \$140 to \$175 billion (with associated financing requirements of \$265 to \$565 billion) a year.
- The financing needs for adaptation by that time could be \$30 to \$100 billion a year. This is additional funding beyond baseline development finance needs.

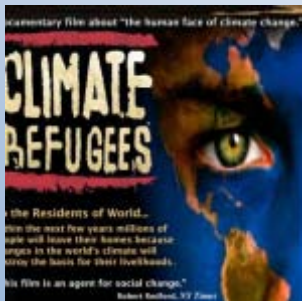
#### DOCUMENTARIES ABOUT CAUSES AND CONSEQUENCES OF CLIMATE CHANGE



##### BLUE GOLD: WORLD WATER WARS by Sam Bozzo

"This isn't about saving the environment, it's about saving ourselves."

Only 3% of global water supply is freshwater, with two thirds of it being frozen in glaciers and polar ice caps and much of the rest being subject to increasing pollution. How do governments and corporations deal with this increasingly scarce product? Are Coca-Cola and Nestle the new face of colonialism? In which parts of the world has access to water ceased being a human right?



##### CLIMATE REFUGEES by Michael Nash

"Whether you believe man is causing a climate change or we just happen to be in another natural climate cycle, the fact remains: our climate is changing and it's affecting millions and millions of people in ways that we never thought possible."

A collection of expert opinions and personal accounts from the survivors of natural disasters and rising sea levels all over the world that has won its producer over twenty awards, including being selected as the feature production at the 2009 UN Climate Change Conference in Copenhagen.

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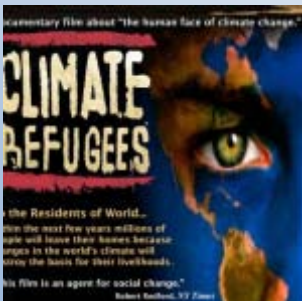
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