

EQUALFIN – Finance and inequality in times of polycrisis – Doctoral Program

Research Area 2: Financial sector and inequality in the context of ecological transformation

Climate change has increased the frequency and intensity of natural disasters worldwide. The low-income countries of the global South and, in particular, poorer people in these countries are significantly more affected. While the majority of greenhouse gases can be attributed to the emissions and consumption of industrialized countries, many developing countries are much more affected by the consequences of global warming (IPCC 2022). According to estimates by the Independent High-Level Expert Group on Climate Finance (HLEG 2022), annual investments of more than two trillion US dollars are needed in developing and emerging countries to meet the global challenge of climate change. At the same time, the economic crisis triggered by the pandemic and the associated expansionary policies have put a strain on public finances in the global South, meaning that the scope for important climate-related financing is limited (World Bank 2022). Even now, 60% of low-income countries have already exceeded a critical level of foreign debt (IMF 2022). This places considerable restrictions on the financing of these enormous investments and their form.

On this background, it is to be expected that a significant proportion of global climate financing will have to be raised through **official development aid**, complemented by the private sector and capital markets. This raises considerable questions regarding the distribution of risk between creditors and debtors. On the one hand, this further increases the indebtedness of countries in the global South. On the other hand, financing climate investments in countries of the global South becomes considerably more expensive, partly due to the higher credit risk of these countries. Credit-financed global climate financing therefore harbors the risk of regressive effects, e.g. through an increased risk of debt crises and an increasing commitment of public revenues to (international) creditors for debt servicing. This is accompanied by the risk of a reduction in fiscal space in these countries for the provision of public goods such as education and health.

Within the scope of the graduate school, it is therefore of great importance to investigate the **possibilities of de-risking**, especially by the evaluation of previous mechanisms. This includes, for example, the hedging of exchange rate risks, the exchange of debt for climate investments (*debt for nature swaps*, as developed in the 1980s), repayment pauses in times of climate disasters, as in small new IMF credit facilities (see for the Seychelles: IMF 2023) or the mitigation of parts of the risk by public actors such as multilateral development banks (MDBs; see also Lee et al. 2023). For this purpose, it is also relevant to examine the design and effects of previous guarantee funds of MDBs (see EIB 2022), and to analyze the advantages and risks of different ways of increasing the lending capacities of MDBs (see, among others, Zucker-Marques and Gallagher 2023).

In addition, the distribution of costs and risks not only between creditors and debtors, but also between public and private creditors should be examined, in particular due to the risk of socialization of losses incurred by private investors.

International development aid in the form of direct transfers or concessional loans will have to play an important role in financing climate protection measures, particularly in view of the high level of debt. This necessity was recently recognized at the UN Climate Change Conference 2022 (COP27) in Sharm el-Sheikh, Egypt, with the long-awaited agreement on a "Loss and Damage" fund for developing countries threatened by natural disasters.

However, the effectiveness of a **global climate protection fund** depends not only on its size, but also on its **governance**. For example, the current system of international disaster relief, such as humanitarian aid, has significant shortcomings. Studies show that it is slow to respond to the timely needs of disaster-affected populations and is prone to discretionary and discriminatory spending in recipient countries (Clarke and Dercon 2016; Bommer et al. 2022). In light of this, it seems sensible to establish new models of financial support before disasters even happen and to implement them with clear and enforceable disbursement and spending rules. Recent case studies show that such a pre-financed, rules-based approach can successfully help mitigate disasters among vulnerable populations (see e.g. del Valle et al. 2020; and del Valle (forthcoming) for Mexico, and Pople et al. 2021 for Bangladesh). Although these initial results are promising, further program evaluations need to be conducted with different institutional approaches and in different contexts in the Global South. In addition, further research is needed to assess the distributional effects of these programs, especially their ability to reach the poorest segments of society, women and marginalized groups such as migrants and religious or ethnic minorities.

Since global funds for climate change mitigation in the global South have to be raised to a large extent by high-income countries of the global North, a minimum level of **support from voters in the donor countries** is required. However, little is known about the factors that determine voter support in rich countries for global redistributive policies related to climate change mitigation. In the area of tax acceptance, labeling has proven to be an effective tool (Hundsörfer et al. 2013). If properly designed, this could be used to increase the willingness of voters in rich countries to contribute significant amounts to combating the consequences of climate disasters. As this provision can take place both at a collective (state) and individual level - e.g. through donations or investments in non-profit microfinance institutions - it is important to analyze **the determinants of the willingness to invest or donate**. A better understanding of the interdependencies of economic shocks or natural disasters with other crises on the willingness to donate and invest also appears to play an important role here (Adena and Harke 2022). Here, the graduate school can draw on existing networks, such as the non-profit organization Oikocredit, which has many years of experience in microfinance in developing countries.

In order to make private financing of ecologically sustainable projects more attractive, the EU has introduced standards such as the **Green Bond Standard** and criteria such as the **EU Taxonomy Regulation**. As sensible as these standards are from an environmental perspective, they also harbor the risk of increasing market concentration. This is because these standards lead to high requirements of verification and documentation for debtors and institutional creditors, which must be borne by the debtors. Large companies with better access to financing and larger financing volumes can cope with these requirements more easily than small companies. Applied to national economies, this means that countries with a high proportion of SMEs can bear a lower proportion of sustainable financing. Even Germany has a lower proportion of companies with EU taxonomy-eligible economic activities compared to France (PwC 2022, p. 20).

It is likely to be even more difficult for companies in countries outside the EU to comply and demonstrate compliance with EU standards and criteria. Hartzmark and Shue (2023) also point to the

problem that compliance with (US) ESG standards hardly reduces the financing costs for low-emission companies, while the financing costs for high-emission companies increase, so that it is not certain whether the standards provide incentives for investments that reduce emissions. In a study on companies in Latin America, Ramírez et al. (2022) also point to the problem that high ESG ratings of companies are mainly due to good corporate governance, but hardly to high environmental standards. To sum up, more research is required regarding the distributional effects of standards and criteria for sustainable financial products: globally, between countries in a region and between companies of different sizes or sectors.

Possible research questions for this research focus are:

- Climate protection programs in vulnerable developing countries: What patterns of funding, design and evaluation do they follow? What impact do they have on poverty and distribution?
- Global climate finance: What incentives determine the provision of development cooperation funds, private donations and private investments?
- What role do pension funds play in financing the ecological-social transformation in view of their increasing relevance as institutional investors on the financial market?
- What role do multilateral development banks play in financing the energy transition in the global South? We are in close contact with the BMZ and Kevin Gallagher from Boston University on this topic.
- What global distribution effects can be expected from approaches such as debt for nature swaps for "greening the global financial system"? For these topics, we can draw on the accompanying expertise of Laike Yang (ECNU, China).
- What distributional effects (e.g. across countries, sectors, by company size) do the EU standards and criteria for sustainable financial products have on access to finance? For distributional effects within Germany on small versus large companies, cooperation with the DSGV (German Savings Banks Association: *Sparkassenverband*) would be possible.

Potential supervisors:

Prof. Natalia Danzer (FU Berlin)
Prof. Sebastian Dullien (HTW Berlin)
Prof. Barbara Fritz (FU Berlin)
Prof. Theocharis Grigoriadis (FU Berlin)
Prof. Heike Joebges (HTW Berlin)
Prof. Philipp Lepenies (FU Berlin)
Prof. Peter N. C. Mohr (FU Berlin)
Jun.-Prof. Manuel Santos Silva (FU Berlin)

List of references

Adena, M., Harke, J. (2022). COVID-19 and pro-sociality: How do donors respond to local pandemic severity, increased salience, and media coverage?. *Experimental Economics*, 25(3), 824-844; <https://doi.org/10.1007/s10683-022-09753-y> .

- Bommer, C., Dreher, A., Perez-Alvarez, M. (2022). Home bias in humanitarian aid: The role of regional favoritism in the allocation of international disaster relief. *Journal of Public Economics*, 208, 104604.
- Clarke, D. J., Dercon, S. (2016). Dull disasters? How planning ahead will make a difference. *Oxford University Press*.
- EIB (2022). Joint report on multilateral development bank's climate finance for the year 2021; https://www.eib.org/attachments/lucalli/mdbs_joint_report_2021_en.pdf.
- Hartzmark, S., Shue, K. (2023). Counterproductive sustainable investing: The impact elasticity of brown and green firms; <http://dx.doi.org/10.2139/ssrn.4359282>
- Hundsdoerfer, J., Sielaff, C., Blaufus, K., Kiesewetter, D., Weinmann, J. (2013). The influence of tax labeling and tax earmarking on the willingness to contribute – A conjoint analysis. *Schmalenbach Business Review*, 65, 359-377.
- IMF (2022). Crisis upon crisis. *IMF Annual Report, Debt, Debt dynamics*; <https://www.imf.org/external/pubs/ft/ar/2022/in-focus/debt-dynamics/#:~:text=About%2060%20percent%20of%20low,of%20or%20in%20debt%20distress>
- IMF (2023). Seychelles pioneers novel financing instruments and taps IMF climate facility. *IMF country focus*, July 5; <https://www.imf.org/en/News/Articles/2023/07/05/cf-seychelles-pioneers-novel-financing-instruments-and-taps-imf-climate-facility>.
- IPCC (2022). Climate Change 2022: Impacts, adaptation and vulnerability. Contribution of working group II to the sixth assessment report of the Intergovernmental Panel on Climate Change [Pörtner H.-O., Roberts, D.C., Tignor, M., Poloczanska, E.S., Minterbeck, K., Alegria, A., Craig, M., Langsdorf, S., Löschke, S., Möller, V., Okem, A., Rama B., (eds.)]. *Cambridge University Press*, Cambridge, UK and New York, NY, USA, 3056 pp; doi:10.1017/9781009325844.
- Lee, N., Laxton, V., Matthews, S. (2023). What would be the ideal development and climate MDB look like?. *Center for Global Development*, Policy Paper 299, June.
- Pople, A., Hill, R.V., Dercon, S., Brunckhorst, B. (2021). Anticipatory cash transfers in climate disaster response. *Working paper*, 6, Centre for Disaster Protection, London.
- Pwc (2022). Seminar für Entscheider:innen 2022, Dezember.
- Ramirez, A., Monsalve, J., González-Ruiz J., Almonacid, P., Peña, A. (2022). Relationship between the cost of capital and environmental, social, and governance scores: Evidence from Latin America; <https://doi.org/10.3390/su14095012>.
- World Bank (2022). World Development Report 2022: Finance for an equitable recovery. Washington, DC, World Bank; doi:10.1596/978-1-4648-1730-4.
- Zucker-Marques, M., Gallagher, K. (2023). Sustainable future bonds: Boosting MDB lending and improving the global reserve system. *Boston University GEGI Policy Brief*, 024.

