

# Climate Finance Priorities for Emerging Markets and Developing Economies

Policy Recommendations in  
the Context of COP29

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# Climate Finance Priorities for Emerging Markets and Developing Economies: Policy Recommendations in the Context of COP29

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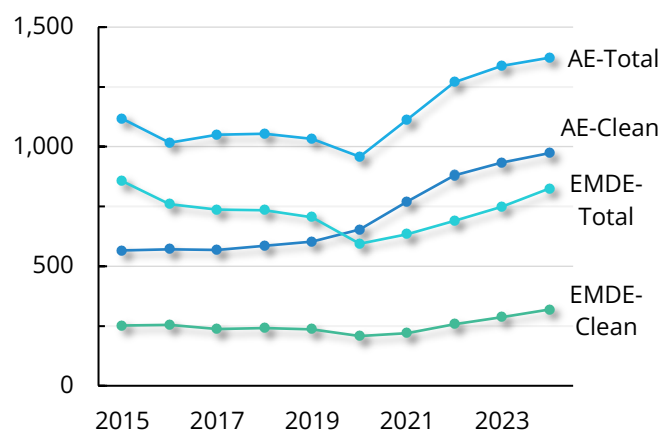
## 1. The Financial Imperative for Clean Energy in Developing Economies

COP29 offers a pivotal chance to shift global financial flows toward urgent climate and sustainability goals. Developing countries, in particular, require immediate financial support to drive a fair and equitable energy transition. These economies face a significant and persistent funding gap in their efforts to transition to clean energy and meet international climate targets. To reach net zero emissions by 2050, annual clean energy investment worldwide will need to more than triple by 2030 to around \$4 trillion (IEA, 2021a). This shortfall is primarily due to limited access to affordable financing, heightened investment risks, and underdeveloped local financial markets (UN, 2023). Due to financing constraints, a significant investment gap exists between Advanced Economies (AEs) and Emerging Markets and Developing Economies (EMDEs) in total and clean energy spending.

AEs consistently outpace EMDEs, with total energy investments approximately 50-60%

Fig 1: Energy Investment (\$ Billions)

Source: IEA



higher than those in EMDEs. AEs have demonstrated steady growth in clean energy, with investments increasing by nearly 30% from 2020 to 2024. In contrast, in EMDEs, clean investments remain relatively low, with only a modest increase of around 10-15%. This disparity highlights persistent barriers in EMDEs, including limited capital access and elevated investment risks, and emphasizes the urgent need for substantial financial support. Without closing this investment gap, EMDEs will struggle to achieve a fair energy transition, leaving them vulnerable to severe climate impacts. (See Fig 1)

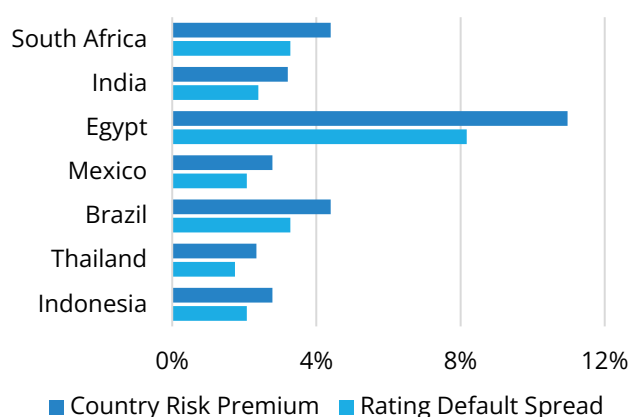
## 2. Barriers to Climate Finance for Developing Economies

### The Capital Cost Burden

The cost of financing clean energy projects in EMDEs is substantially higher than in their advanced counterparts. The effective cost of capital in EMDEs for various projects can range between ~7-13%, while for AE, it hovers around 4-6.40%. This elevated cost is primarily due to the higher perceived risks of these regions, making financing more expensive (Mirza et al., 2024). The cost discrepancies across project types and countries highlight the need for targeted interventions like concessional funding, risk-mitigating instruments, and capacity-building initiatives.

**Fig 2: Selected EMDE Country Risk Premium & Rating Default Spread**

Source: Damodaran, NYU Stern



### Fluctuating Exchange Dynamics

In addition to high capital costs, limited access to domestic financing increases EMDEs' reliance on foreign funding. Only 12-15% of climate finance in these economies is sourced locally. (IEA, 2021b; IFC, 2023). Consequently, this heavy dependence

exposes them to more significant external shocks and currency volatility risks. Depreciating local currencies drives up the real cost of servicing foreign-denominated debt, straining budgets, and constraining clean energy investments. Strengthening domestic capital markets is essential. Incentivizing local investments and establishing robust frameworks for sustainable finance can help stabilize funding and reduce currency-related risks.

### Sovereign Credit Uncertainty

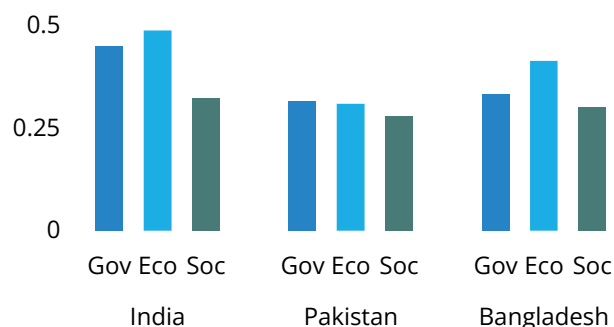
EMDEs face significant challenges due to the high perceived political and economic instability risk (Fig 2). This perception, combined with elevated default risk, leads to increased capital costs and restricted access to financing. The disparities in country risk premiums and default spreads across key EMDEs highlight the critical need for focused interventions. Sovereign risk mitigation measures, including multilateral guarantees and insurance solutions, are essential to improve investor confidence. Additionally, implementing credit enhancement mechanisms, such as blended finance models, can lower default risk for private investors, enhancing the appeal and accessibility of sustainable projects in EMDEs for long-term climate-focused capital.

## Capacity Constraints and Project Viability

EMDEs face significant challenges due to weak institutional frameworks and a lack of expertise in designing and implementing viable, clean energy projects (Fig 3a, 3b). Their investment readiness scores consistently lag behind Aes, reflecting a limited capacity to attract and leverage private and public investments for adaptive actions. Governance readiness remains critical in South Asia, East Asia, and the Pacific. Weak institutional structures, poor policy enforcement, and regulatory instability hinder progress and discourage investor confidence. Similarly, low economic readiness scores highlight barriers such as limited access to funding mechanisms, fiscal constraints, and inadequate infrastructure to support large-scale clean energy initiatives. Social readiness also presents significant obstacles. Low scores in this area indicate insufficient public awareness, weak societal acceptance, and gaps in human capital development. These factors weaken a country's ability to sustain green initiatives and ensure long-term success. Addressing these readiness deficits is essential for EMDEs to transition toward sustainable energy solutions and effectively attract the resources needed to drive meaningful progress.

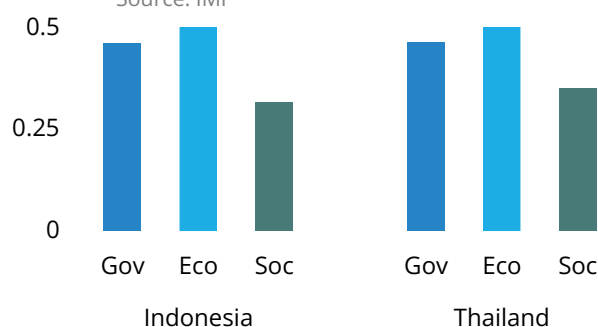
**Fig 3a : Readiness Scores - South Asia**

Source: IMF



**Fig 3b: Readiness Scores - East Asia and Pacific**

Source: IMF



## Limited Financial Instruments and Risk Mitigation Mechanisms

The limited availability of diverse financial instruments and risk mitigation mechanisms is a major obstacle to clean energy development in EMDEs. These countries face difficulties mobilizing capital for large-scale renewable energy projects due to the lack of innovative tools like green and blue bonds, blended finance structures, and securitization options. Such instruments are essential for narrowing the financing gap and attracting private-sector investment to meet sustainable development goals. Yet, their adoption remains restricted by underdeveloped financial markets and weak regulatory frameworks (Taghizadeh-Hesary and Yoshino, 2019).

Risk mitigation mechanisms are equally critical for driving clean energy investments. Tools like guarantees, political risk insurance (PRI), and currency hedging are underutilized in EMDEs. Partial credit and risk guarantees (PCGs and PRGs) help de-risk projects by protecting against loan defaults and other specific risks, lowering project financing costs by up to 40%.

### **3. Empowering EMDEs: Climate Finance Priorities for COP29**

#### **Establishing a Global Climate Finance Facility for EMDEs**

A global climate finance facility under COP29 can consolidate funds from multilateral banks, sovereign wealth funds, and private investors. This facility would simplify EMDEs' access to climate finance while offering technical support to enhance project readiness. By leveraging economies of scale, it could significantly reduce financing costs. It would also promote greater transparency and accountability in fund allocation, ensuring resources are directed to where they are most needed. A dedicated focus on EMDEs would help bridge regional disparities and unlock the capital required for clean energy development.

#### **Expanding Carbon Markets for EMDEs**

Expanding carbon markets offers EMDEs a stable revenue stream for financing clean energy initiatives. These economies can monetize emissions reductions through

carbon trading, reducing their reliance on debt-based funding. However, capacity-building programs are essential to enable EMDEs to engage in these markets and maximize their benefits effectively. The revenues generated from carbon credits can be reinvested in renewable energy projects, fostering long-term energy transitions. A well-functioning carbon market will support these regions' climate goals and economic growth.

#### **Improving Access to Risk Mitigation Mechanisms**

Risk mitigation tools such as guarantees, currency hedging, and insurance schemes are vital for attracting investments to EMDEs. These instruments lower capital costs and protect against risks like political instability and currency volatility, which deter private investors. Partnerships with multilateral development banks are crucial to expand the availability of these tools, ensuring broader access. Additionally, introducing tax incentives, concessional funding, and blended finance models can make clean energy projects more financially viable. These mechanisms can reduce barriers and boost private-sector participation in EMDEs' energy transitions.

#### **Building Institutional and Market Readiness**

Strengthened institutional frameworks and improved governance are critical for EMDEs to attract climate investments. Capacity-building programs should focus on

enhancing regulatory enforcement, ensuring policy stability, and improving project management capabilities. Developing scalable clean energy projects aligned with global sustainability standards is vital for investment readiness. Addressing governance and technical expertise gaps will enable EMDEs to mobilize climate finance more effectively and implement transformative energy solutions.

### Enhancing Local Financial Ecosystems

Developing robust local financial markets is essential to reduce EMDEs' reliance on foreign funding, which dominates their climate finance inflows. Encouraging the issuance of domestic green bonds and creating frameworks for sustainable finance will attract local investments, strengthening financial independence. Long-term currency hedging facilities are necessary to manage exchange rate volatility and reduce the burden of foreign-denominated debt. A strengthened local financial ecosystem will provide EMDEs with a stable, resilient foundation to support their clean energy transitions and ensure long-term sustainability.

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