

COP-29 Baku: The political economy of international climate finance

Why the international community is unable to finance what needs to be done

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March 2025

Abstract

Why is the implementation of the 1987 Montreal Protocol a sensational problem-solving success, whereas the UNFCCC underperformance from one dreary COP to the next? The difference in complexity and in the scale of the financial challenge is not the main cause. A design error in the 1990 Rio Convention is to blame. The sharp “Annex I+II/Non-Annex I” country division in the assignment of obligations predestined negotiations at the COPs to be confrontational events. The UNFCCC imposed on the ‘Annex II’-countries (OECD-countries) the legal commitment to assist developing countries with technology transfer and financial support. But because the UNFCCC does not include an article defining adjustments of commitments to changes in the distribution of accumulated historical emissions and in global wealth generation, the assignment of the finance responsibility has come out of line with the UNFCCC’s “polluter pays” and “ability to pay” principles. But privileged positions become entrenched. The 134 countries in the ‘G-77 Group’ continue to insist that the external climate finance, which low-income countries need in order to achieve the aims of the 2015 Paris Agreement, must be provided by the 34 OECD-countries. The COP-29 communiqué opens up for voluntary contributions from G77-countries. Yet, the frozen situation prevents the mobilization of sufficient funds to enable the climate goals of the 2015 Paris Agreement to be achieved.

In the 1980s, the global community demonstrated with the adoption of ‘The 1985 Vienna Convention for the Protection of the Ozone Layer’ and ‘The 1987 Montreal Protocol on Substances That Deplete the Ozone Layer’ that it can react fast and implement effective joint measures against threats to the global environment. The Protocol created a successful structure for the solving of its ‘*global common good*’ issue. The obligation to phase out production and consumption of ozone depleting substances was universal, but developing countries with low levels of per capita consumption of the substances were given more time for the initiation of reduction measures. Technology transfer was facilitated. To give developing countries an incentive for early adoption of ozone protecting technologies, a Multilateral Fund funded by contributions from developed countries covered approved incremental costs of these. Annual meetings of parties, called COPs, monitored progress. The Protocol was amended six times to include new measures in response to scientific data.

In 1992, the United Nations Conference on Environment and Development in Rio addressed the triple planetary crisis of climate change, biodiversity loss, and pollution. The Conference resulted in the adoption of the [‘United Nations Framework Convention on Climate Change \(UNFCCC\)’](#) and the [‘Convention on Biological Diversity’](#).

The individual components of the ‘governance’ structure, established by the Conventions and later Protocols, were similar to the Montreal convention. But there was a significant difference: whereas, the Montreal Protocol imposed a joint, but differentiated commitment,

the “[Rio Declaration on Environment and Development](#)” in its Principle 7 determined “In view of the different contributions to global environmental degradation, States have common but differentiated responsibilities.” That had two implications for the UNFCCC.

The UNFCCC made a sharp distinction between ‘[Annex I countries](#)’ (OECD countries and East European former communist countries called Economies in Transition) who are committed to reduce their emissions and ‘[Non-Annex I countries](#)’ (developing countries) who could focus on their socio-economic development. The adoption in 1997 of the Kyoto Protocol legally binds Annex I countries during the Protocol’s 2008-2012 and 2013-2020 commitment periods to quantified emission reduction targets below the year 1990 emission level of 5% on average by 2012 and of 18% by 2020.

In addition, the UNFCCC imposes on the OECD-countries in Annex I, referred to as ‘[Annex II countries](#)’, the obligation to support developing countries with technology transfer and with finance to cover the incremental cost of their mitigation and adaptation actions. The scale of this commitment is far higher than the incremental funding of the ‘Multilateral Fund’ of the 1987 Montreal Protocol, which received some \$5 billion during its lifetime.

The ‘Annex I+II/ Non-Annex I’ differentiation of commitments was logical in 1990, when the historical GHG emissions from Annex I countries accounted for [almost 75% of the accumulated global GHG emissions](#) (‘responsibility principle’) and produced [78% of global GDP](#) (‘burden-sharing ability’) But, because the global economy and annual GHG emissions change fast, the distribution of commitments must be adjusted periodically to reflect global changes in emission responsibility and relative economic strength. The UNFCCC-text, however, does not address the issue. No article specifies that commitments of countries will be adjusted over time to changes in their share in accumulated emissions and in global GDP.

Most of the historical emissions, which the Annex I countries had accumulated by 1990, originated during the four decades from 1950 to 1990, driven by the mass consumption of the emerging welfare states and the heavy industrialization strategy of the COMECON states. After 1990, the Annex I countries reduced their annual emissions in line with their UNFCCC commitments. Yet, global emissions increased from 22.5 billion tons in 1990 to 37.4 billion tons in 2024 because rapid growth of per capita incomes in the emerging economies led to a repetition of middle-class consumption driven emissions. Outsourcing of manufacturing production from OECD to ‘Non-Annex I’ countries added to the emissions. In 2024, the ‘Non-Annex I’ countries produced 56% of the global GDP measured in purchasing power parity (PPP) while their historical GHG emissions had increased to 50% of the accumulated global total.

Examples are legion of privileged positions which become entrenched and resist changes. The five permanent members of the UN Security Council are the major countries winning World War II. The USA is the only country, with a decision blocking (larger than 15%) share of the voting capital of the IMF and of the World Bank; the President of the IMF is European,

the President of the World Bank is American. China, the World's largest exporter and host to 30% of the world's manufacturing capacity, clings to its developing country status at the WTO.

The negotiations at the COPs on adjustments to the UNFCCC are, therefore, confrontational. The 'non-Annex I countries' aim to maximize the financial contributions from the OECD countries; the OECD countries ask that commitments for GHG-reductions and for the payment of financial support to low income countries be imposed also on the higher middle-income countries in the 'non-Annex I' block.

The introduction by the two Rio Conventions of a North-South finance commitment for the two 'global common goods' biodiversity and climate protection raised the issue of its consequences for the overseas development finance (ODA) from OECD countries, which co-finance 'national goods' in developing countries. On this subject, the UNFCCC's Article 4.3 is very specific: "The developed country Parties and other developed Parties included in Annex II shall provide new and additional financial resources to meet the agreed full costs incurred by developing country Parties." Reality was different.

During the 1990s, instead of increasing their total North-South finance to accommodate the inclusion of 'global common goods' finance, the OECD countries awarded themselves a double peace dividend from the break-up of the Soviet Union: they reduced their defense expenditure in percent of Gross National Income (GNI) as well as their ODA, which decreased from 0.31% of the OECD's GNI during the 1980s to 0.25% during the 1990s. The adoption in 2000 of the Millennium development goals for 2015 influenced a return of ODA funding to 0.31% of OECD's GNI. But one had to wait until the COP-15 climate meeting in Copenhagen 2009 for a quantification of the developed countries climate finance. The Annex II parties committed to provide "additional climate finance" rising stepwise to \$100 billion per year from 2013 to 2020. The [Paris Agreement in 2015](#) extended the duration of the commitment period to 2025. The Annex II countries underperformed once again on their commitment. A significant share of the reported climate finance during the commitment period was [funded from ODA budgets](#) and did not fulfill the additionality criterion and the \$100 billion target was not reached before 2022 when OECD reported \$116 billion in annual [climate finance](#).

The finance-transfer maximizing strategy of the 'Non-Annex I' countries included lobbying for a third climate finance item: 'compensation for loss and damages' incurred from climate-fueled weather extremes and rising sea levels on infrastructure, buildings, natural ecosystems, cultural assets, etc.. The issue had been raised already at the Rio Conference, when Vanuatu, on behalf of the small island nations, proposed creating an insurance scheme to provide financial resources to countries impacted by sea level rise. It was not adopted. The 'Annex I' countries refuse to accept damage responsibility; due to the legal implications. But they recognized the issue as such at COP-21 in 2015 by accepting the inclusion of an Article 8 on loss and damages in the Paris Agreement. The article does not mention finance,

and the [COP-21 decision](#) states that loss and damage “does not involve or provide a basis for any liability or compensation.”

The Paris Agreement establishes the global responsibilities for the post-Kyoto commitment period from 2021 to 2035. The aim of the Agreement, based on the recommendations from the UNFCCC Scientific Panel, is to limit the rise in global temperatures well within 2° C above levels before the industrial revolution. All parties know that this cannot be achieved without the active participation of Non-Annex I countries in the global CO₂-reduction efforts and recognize the heavy costs imposed by global warming. The efforts of the Annex I countries to soften the Annex I / Non-Annex I division in favor of a framework for global ‘collective action’, therefore, managed to achieve positive results in the Agreement. The UNFCCC shifted away from binding reduction commitments and compliance to a system based on accountability, review and flexibility. Prior to the meeting, countries were asked to submit plans, named Intended Nationally Determined Contributions (INDCs), detailing how they intended to reduce greenhouse gas emissions. In these, countries like China and India announce targets for the reduction in the emission content per unit of GDP, for the year when their emissions peak and for the target year to achieve net-zero emissions.

The action plans presented in the INDCs in Paris were insufficient to achieve the preferred maximum 1.5°C increase. But since the INDCs are to be reviewed and updated every fifth year with additional efforts this was not a major obstacle to goal achievement. Most Non-Annex I countries present INDCs with two ambition levels: one for the situation without, the other with international financial assistance and technology transfer; and the Paris Agreement kept the exclusive legal obligation of the OECD countries to deliver it.

The OECD countries continued their fight against this situation. When a Loss and Damage Fund was created under the UNFCCC at COP28 in 2023, [the EU made its support for the fund conditioned](#) on contributions from high-emitting ‘developing countries’ such as China and on a focus of the fund on countries particularly vulnerable to climate change. The host country UAR, as the only non-OECD country, broke the ice by committing \$100 billion to the Fund, which by end 2024 has received [\\$754 billion in funding](#).

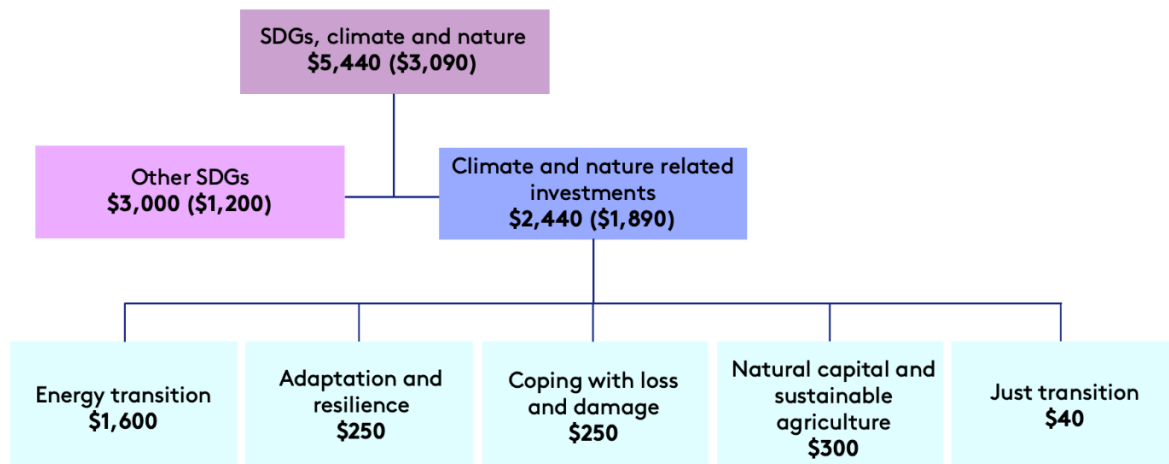
The primary task for COP-29 at Baku was to reach agreement on a finance pledge for the 2026-2035 period, called the “New Collective Quantified Goal on Climate Finance (NCQG)”.

To provide an independent perspective on the finance required to achieve the goals of the [Paris Agreement](#), the COP 26 and COP 27 Presidencies had launched the Independent High-Level Expert Group on Climate Finance (IHLEG). Article 2.1 defines the goal: “(a) Holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels”; “(b) Increasing the ability to adapt to the adverse impacts of climate change and foster climate resilience and low greenhouse gas emissions development, in a manner that does not

threaten food production”; and “(c) making finance flows consistent with a pathway towards low greenhouse gas (GHG) emissions and climate-resilient development”.

The first task was to establish the investment need. The IHEG’s [November 2024 report](#) gave figures both for the year 2035, the final year of the Paris Agreement’s commitment period, as well as for 2030, the final year for the UN ‘Development Goals for 2030’, which were adopted in 2015. The report concludes that achieving the goals of the Paris Agreement requires a four-fold increase in the global climate investments from \$1.5 trillion in 2023 to \$6.3-6.7 trillion in 2030 - amounting to 5% of world GDP that year. The ‘Emerging Developing Countries (EMDCs) other than China’ need to invest \$2.3–2.5 trillion in 2030; and an additional \$3 trillion to achieve other “Sustainable Development Goals (SDGs)”. The composition of the climate-related investment is shown in Figure 1 below. Numbers in parentheses show the increment from the current volume of yearly investments.

Figure 1: Investment EMDCs other than China 2030



Source: IHLEG(2024)

“Just transition” refers to support given to vulnerable groups of the population who are disadvantaged by the changes imposed by the transition.

The assessment of the IHEG follows the estimates of reports published by the leading international organizations in the field of climate finance, such as the joint IEA-IFC publication [“Scaling up Private Finance for Clean Energy in Emerging and Developing Economies”](#) from 2023; [UNEP’s 2024 Adaptation Gap report](#) and [State of Finance for Nature report](#) and [studies on Loss and Damages](#). The realism of the numbers was, therefore, not questioned by the parties at COP-29.

The IHEG estimated, see figure 2 further below, that the ‘EMDCs other than China’ would need US\$1 billion in external finance to implement the US\$2.4 billion investment package and US\$1.3 billion in 2035 for yet higher climate investments that year. The parties at COP-29 accept the estimate. But to turn it into the “New Collective Quantified Goal on Climate

Finance (NCQG)” requires agreement on its finance. As usual, the ‘Annex II/Non-Annex I’ division blocked the reaching of an adequate agreement.

The ‘G77 bloc of developing nations +China’ demanded at Baku that the developed nations countries should allocate 0.8% of their GNI to climate aid, providing at least US\$1.3 trillion annually by 2035; and that the NCQG should be [an exclusive public finance goal rather than a global investment target](#). . The OECD countries insist that higher-middle income emerging countries also contribute to the NCQG.

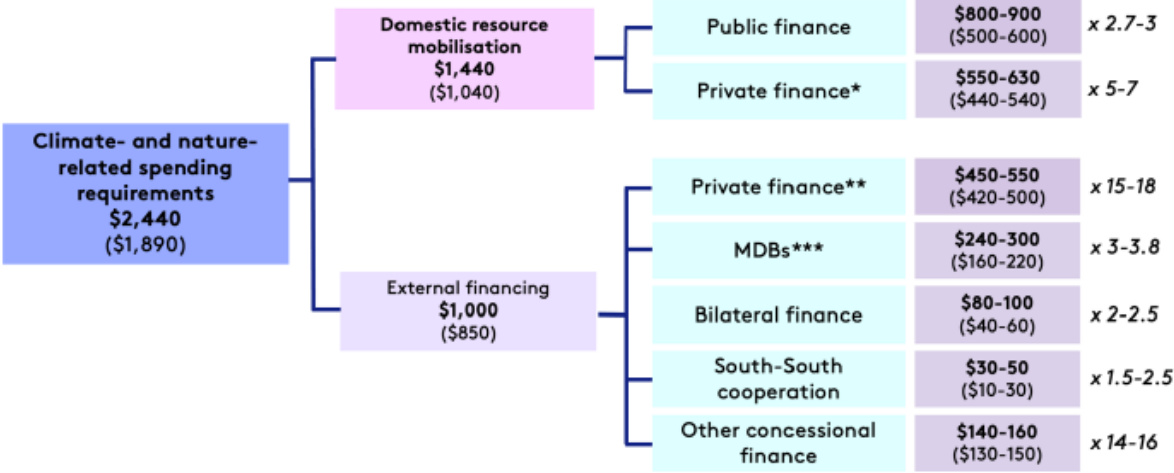
The US\$1.3 trillion represent an eight-doubling in real terms of the US\$100 billion commitment made in 2009. The amount exceeds OECD’s development finance of [\\$483 billion](#) in the year 2022, of which ODA provided \$213 billion, private finance flows \$210 billion, export credits the bulk of the rest. ODA (excluding in-country expenditures on refugees) has never been higher than 0.32% of the Gross National Income (GNI) of OECD-countries

The grant-debt composition of the public finance is another source of friction. Loans made up more than two thirds of the public finance from bilateral and multilateral sources during 2013 to 2023. The EMDcs insist, with reference to the polluter-pays-principle, that the public money be given primarily as grants; and [that loan finance is inappropriate given their debt distress situation](#).

The allocation of the climate finance for mitigation, adaptation, loss and damage purposes is a third dividing point. In 2022, mitigation projects received 60% of the reported climate finance, adaptation projects 28%, cross-cutting activities that address both mitigation and adaptation 12%. The EMDCs prefer that most of the climate finance is used to cover the adaptation expenses and damage costs which climate change is imposing on them now; a self-interest position as these are national goods.

The IHLEG cut through the minefield of opposing interests with the NCQG finance proposal shown below. Numbers in parentheses show increments from the present.

Mobilising the necessary financing for EMDCs other than China
 (\$ billion per year by 2030, increment from current in parentheses)



Notes: *Includes household savings. **A significant proportion of this private finance would be directly and indirectly catalysed by MDBs, other development finance institutions and bilateral finance. ***Includes multilateral climate funds.

To serve as a useful input to the debates, the IHLEG’s proposal had to be feasible, at least in principle. One can see that the IHLEG had concluded that a high public finance share was impossible; instead they put their hope on the ability of private finance flows and of new innovative finance sources to provide the bulk of needed finance.

“Multilateral public” provided US\$51 billion, “bilateral public” US\$41 billion and “mobilized private” US\$22 billion of the OECD’s US\$116 billion climate finance in 2022. Aware that most developed and developing countries are experiencing budget deficits and high public debt levels in percent of GDP, the IHLEG envisages ‘public finance’ to provide only one third of the NCQG. A 15-fold increase in ‘private finance’ and in ‘other concessional finance’ within six years is to deliver the other two thirds of the required US\$1 trillion in 2030. ‘Other concessional finance’ covers a wide range of sources such as covers a wide range of sources such as [transfer of Special Drawing Rights \(SDRs\)](#), [debt-for-nature swaps](#), [voluntary carbon credits](#), [solidarity levies on internationally-polluting activities](#) such as [international carbon taxes on aviation](#) and on sea transport emissions and on fossil fuel extraction. Most of these instruments have not yet been introduced. The growth in private finance depends on an intensified application of [credit enhancement instruments](#) and the ability to identify revenue generating investments also in adaptation projects and in loss and damage projects.

In the end, the developed countries agreed at COP-29 in Baku to provide \$300 billion per year by 2035, which doubles the year 2009 \$100 billion promise in Inflation adjusted terms. The climate finance that developing countries provide via multilateral development banks counts towards the \$300 billion goal. The word “additional” does not appear and there is no specific target for ‘Loss and Damage’ in the US\$300 billion, just acknowledgement of the need for urgent action.

The Baku Agreement makes it clear that the NCQG includes contributions from developing countries: “Encourages developing country Parties to make contributions, including through South–South cooperation, on a voluntary basis.”

This is progress. But as long as the legal obligation to finance applies to Annex II countries only, the US\$1.3 billion goal will be out of reach. Voluntary contributions will not be based on a formula composed of two or three elements (e.g. share of accumulated emissions, share of global GDP, volume of fossil fuel extraction), they will result from cynical and dreary give-and-take negotiations at the annual COPs.

The OECD countries may even find it difficult to honor the \$300 billion NCQG pledge. The legal implication of a “collective quantified goal” is unclear at individual country level. Are the other OECD countries legally committed to step up their intended contributions because Trump’s USA has decided to leave the Paris Agreement?

It is also difficult to understand how countries can commit to a NCQG-finance goal, two thirds of which is composed of private finance flows – which can be leveraged only up to a point by public finance risk sharing instruments – and of not yet agreed new international sources of finance?

From a self-interest point of view, financing ‘common global goods’ is more attractive for OECD countries than the conventional ODA finance of ‘national goods’. But they will not go on alone; it de-motivates when other countries do not pay their share.

Unless the antiquated ‘Annex II/Non-Annex I’ division is broken, international climate finance will fall short of requirements.