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In search of the money tree

Is more money a good thing for climate finance? Discussion paper on multilateral banks' climate finance for agroforestry

Both ENDS
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Cover photo by Dorn Bouttasing
Picture was taken in 2016 at an open air photo exhibition at a village in Laos. During the event, villagers told each other about their way of life in the forest through pictures. Their way of life is threatened by dams, deforestation and climate change. Investments in forestry and energy should not be at the expense of each other or lead to the loss of biodiversity and the destruction of the livelihoods of millions of forest-dependent peoples.

GLOBAL ALLIANCE FOR GREEN AND GENDER ACTION

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INTRODUCTION

Natural forests are being cleared for agriculture, whileas trees provide lots of benefits for agricultural landscapes, not just ecologically but also economically. Economy and sustainability are not on opposite sides of the table. Agroforestry purposefully combines agriculture with the cultivation of trees on the same plot. However this viable combination of agriculture and forestry is often overlooked.

This paper takes a look at the significant role of Multilateral Development Banks (MDBs) in climate finance, and how this relates to their rather limited portfolio of forestry, notably of agroforestry. Evaluations so far show the lack of involvement of the local population in forest projects of MDBs. Moreover, this paper shows that multilateral development banks increasingly become dependent on the financial sector, which has far-reaching consequences for the investment choices these MDBs make. It leads to growing debt and less room for governments to stimulate and implement green policies. This, while debt cancellation would offer governments the financial space to support agroforestry initiatives. The current focus on the amounts of finance needed to tackle the climate crisis, almost obscures the fact that relatively small grants might suffice to realise agroforestry projects.

Agroforestry – the future of agriculture

From land regeneration to improving soil health – trees play a crucial role in almost all our ecosystems. Agroforestry makes use of these benefits by combining agriculture and forestry. This combination does not just have a positive impact on biodiversity and climate resilience. Agroforestry also provides a wide range of important products and services to both rural and urban communities.

SUMMARY

It is remarkable that discussions about climate quickly turn into discussions about climate finance and the amount of money that is needed to achieve a green transition of the economy. Moreover, proposals for climate solutions inevitably seem to focus on the volume of money needed for investments in these solutions. We urgently need to restore ecosystems and forests to tackle climate change effectively. A question raised in this paper is whether the use of agroforestry to restore forests will ultimately increase with the current focus on the amount of money needed. A subsequent question is whether (the large amounts of new) climate finance often channeled via multilateral development banks will (also) be used to support the restoring of forests, notably via agroforestry.

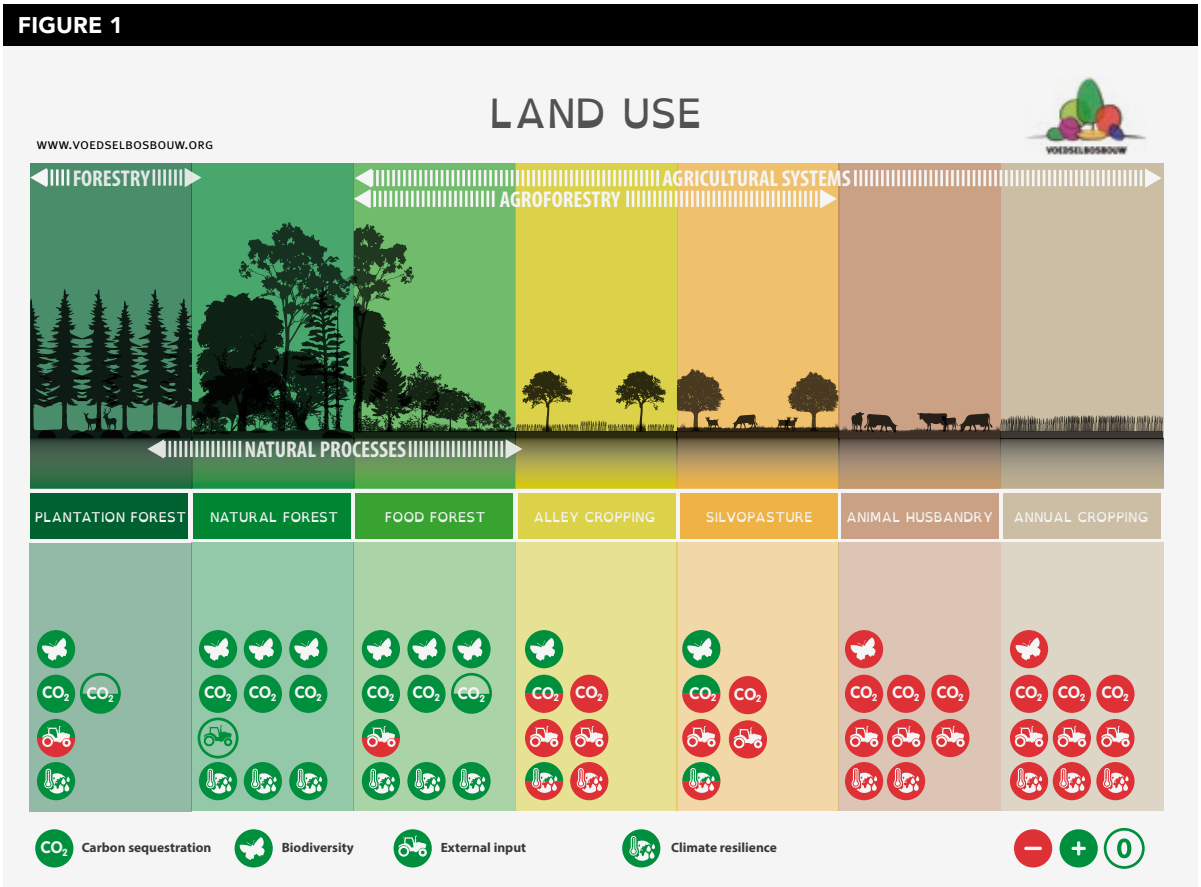
Paradoxically, the focus on amounts of finance can be counterproductive to the further support for and realisation of forests, notably agroforestry initiatives.

One argument that leads to a preoccupation with money is as follows: the climate crisis has introduced a sense of need to replicate and scale up climate solutions to a global level. This requires financing that cannot be covered by small grants. The larger the amount of money, the more powerful the players that are involved. And this is raising questions about the appropriateness of the source of financing. The way the economy is currently set up, the climate system is starting to depend on other complex systems, such as financial markets, and this creates (transferable) debt. In the past, governments of poor countries relied on credits from the World Bank and other multilateral development banks for investments in (fossil fuel dependent) infrastructure. More recently, development banks are increasingly dependent on the capital of financial markets. And this may affect the type of climate finance that is available.

LARGE SUMS VS SMALL LOANS

The first question is whether loans from these banks, which often involve 'investments in large sums', are appropriate to finance initiatives of climate solutions conceived by civil society organisations or local communities. Local initiatives do not immediately require large amounts of money. Rural communities often struggle to make a living in a healthy and autonomous way, to a large extent outside the money economy.

FIGURE 1



Land use practice sequestration rates show that a natural forest provides the best climate solution, with food forests (analog forestry) being the second best solution. This graphic was designed by Evelyn Derksen, Plantschap, Netherlands

NOTES

One of their solutions for countering their problems is to restore forests with analog forestry[1] and similar types of agro-forestry practices.

CHANGE, LED BY WOMEN

These climate solutions are often gender-just[2] climate solutions, initiated and led by women at the local level. There is some money available at this local level, but the amounts are relatively small. The women either tend to thrive with the support of small grants or micro-credits or persevere outside the money economy without any external support.

Climate finance in the form of loans reinforces the power of the financial sector over countries.

The next question is whether the finance generated through financial markets is frustrating the ambition of governments' green deal policies at the more aggregated level of a national economy, as it creates a further need for finance and debt. Seen from a macro-economic point of view, climate finance in the form of loans reinforces the power of the financial sector over countries, and this indirectly has clear implications for the 'woman who planted trees', that is, all (wo)men who depend on ecology and access to natural resources.

The volume of money in the world is growing, while the global area of natural forest is shrinking. Instead of allocating climate finance via MDBs, the cancellation of debts and reducing a dependency on financial markets might be more effective, because of the political space this creates for countries to develop their own *green deal policies,* including the support of agroforestry.

An important question is whether more money for climate investment will lead to more forest, biodiversity and gender-just climate solutions. Most financing mechanisms will merely create new opportunities for private investors and for the banks to create and lend money.

1 See: www.bothends.org/en/Whats-new/News/Analog-Forestry-sustainable-food-production-with-a-feminist-perspective

2 Gender-just solutions secure respect for women's rights, including their access to and control over natural resources, finance, income and decision-making. Opportunities are not limited on the basis of gender.

Photo by Dorn Bouttasing

1. WHAT IS THE MOST APPROPRIATE SOURCE OF FINANCING TO RESTORE ECOSYSTEMS AND FORESTS TO TACKLE CLIMATE CHANGE?

1.1 The agro-forestry portfolio of MDBs

One question we are posing here is whether the financing mechanism for vast amounts of money by multilateral banks is ultimately instrumental for scaling up existing women-led climate solutions in the form of agroforestry. Indeed, we believe that these solutions are guiding society along a path that respects the earth's carrying capacity. Therefore, they act as a touchstone for determining the suitability of finance.

SCALING UP AFFORESTATION

In principle, scaling up gender-just climate initiatives might tie in well with the international commitment to scale up afforestation in response to the escalating climate crisis. The ends and means are easily confused in the world of finance, though, and the goals of creating forests and generating finance seem to diverge. In past decades, the idea has always been that the money spent by the World Bank and other multilateral development banks on infrastructure, would multiply through the economy, creating larger economic output than the initial outlay. Seen through the prism of this multiplier effect, climate finance creates a larger 'green' economic output. And this, in turn, is a cue for development banks to jump on the climate finance bandwagon.

ARE BANKS THE RIGHT PARTNER?

An important question in assessing whether climate finance from multi-lateral banks is actually an appropriate source of finance for agroforestry types of agroforestry gender-just climate solutions, is how it is spent and who decides how it is spent. To answer that, banks need to examine what communities need and want. One could argue that the World

Banks need to examine what communities need and want.

Bank's (and other MDBs') track record in forestry does not particularly inspire confidence, especially when it comes to financing agroforestry. The World Bank portfolio of forest projects in 2019 amounted to approximately US$3.8 billion, which is about 1.2% of the total amount of IBRD/IDA (or World Bank) loans of $331.3 billon (6/30/18). Among the regional multilateral banks, the Inter-American Development Bank has invested about US$1.47 billion and the Asian Development Bank US$1.36 billion in forest projects. The African Development Bank, on the other hand, does not include forest projects as a separate category.[3] It is unlikely that more than a very small share of the money dedicated to forests goes to the recovery of natural forest or to farming systems that restore forests or create new forest (data are not available).

EVALUATION OF THE WORLD BANK FORESTRY PORTFOLIO

The last independent evaluation of the World Bank forestry portfolio (2013) shows that there is a lack of synergy between the World Bank's forestry projects and how local communities' use and protect forests, among other things. The Independent Evaluation Group (IEG) found that in projects specifically designed to conserve global biodiversity, there was little evidence that these had any impact on biodiversity. And only a third of the protected area projects that were designed since 2008 included climate change considerations in the project design. IEG also concluded that the level of community participation in the management of a protected area matters for both environmental outcomes and sustainability. Protected areas where the sustainable use of the forest is permitted, turned out to be better conserved than strictly protected forest areas. Yet too few of the World Bank's protected area projects have achieved this kind of synergy. Nonetheless and despite critical evaluations, governments still seem to automatically resort to the usual suspects whom they trust and who they believe can channel their financial resources towards large-scale projects: multilateral development banks. Of course, it does not hurt that these same governments are shareholders of these banks. There is the expectation that public banks are governed by national governments and that their agenda serves the public good.

1.2 MDB climate finance

Until very recently, the World Bank and other development banks viewed development as something driven by fossil energy and as a process which relied on the extraction of natural resources. As stated before, the climate crisis has opened new windows of opportunity for increased lending,[4] and this has dramatically intensified the role of development banks in climate finance.[5]

One of the issues discussed at the Conference of the Parties in 2022 in Egypt (COP 27) was the annual US$100 billion that rich countries had promised to poorer nations back in 2009. Since then, there have been efforts to increase the amount of finance available for climate initiatives in developing countries. In 2020, multilateral development banks already committed a total of US$66.5 billion to climate finance, with US$38 billion allocated to low-income and middle-income economies.[6]
The boost for climate finance, in addition to the banks' already available finance portfolio for forest projects, is unlikely to increase the small share of money dedicated to farming systems that restore forests or create new ones. The 2021 climate *mitigation* finance that was channelled to agriculture, aquaculture and forestry and land use amounted to US$1.5 billion for low-income and middle-income countries. Mitigation finance is meant for operations that reduce greenhouse gas emissions and operations that are compatible with low-emission development. The bulk of mitigation finance is energy related.
The multilateral development banks' *adaptation* finance for forests has also been limited. Adaptation finance is meant for efforts to adapt to the impacts of climate change. The latest (2020) report by multilateral development banks on climate finance indicated that about 4% of their adaptation finance is channelled to 'other agricultural and ecological resources' (including forests).
Indeed, the fact that the multilateral development banks' adaptation finance was 24% of the total of multilateral development banks' climate finance in 2020 confirms that adaptation finance for forests is not a top priority.[7]

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3 Is the World Bank Meeting its Forest commitments, Bank Information Center, Washington DC, April 2019.

4 The Asian Development Bank independent evaluation department released an evaluation document on its bank's support for action on climate change in the period 2011-2020. The bank's climate finance totalled US$40.2 billion over the evaluation period and has increased steadily by volume and project number. The evaluation concluded that the climate finance accounting at the bank was an ex-ante exercise that favours tracking financing targets over climate outcomes.

5 Climate finance refers to the financial resources committed by banks to enable activities that mitigate climate change and support adaptation to climate change.

6 2020 joint report on Multilateral Banks climate finance, June 2021.

7 Ibid, June 2021.

2. MDBS DEPENDENCE ON INTERNATIONAL CAPITAL MARKETS

2.1 Mobilisation of private capital

In addition to the multilateral development banks' forestry portfolio, and the allocation of newer climate money to agroforestry, it is important to consider the banks' business model underlying the financing of their operations and the effect this has on this allocation-decisions. Development banks are increasingly dependent on the capital of financial markets. The ways that the banks are borrowing from international markets, as well as dealing with risk, is impacting how they lend money and to which sectors.[8] The urgently felt need for finance for a green transition triggers a growing dependency of MDBs on financial markets.

THE CREATION OF MONEY

What are the origins of a money-centred approach? Partly, it is simply a case of: ask an economist for solutions to a problem and you will probably get an economic answer. To understand why a task has been assigned to international financial institutions, one needs to contextualise the function that international financial institutions, including multilateral development banks, are considered to fulfil in society. For most economists banks, both public and private, are considered to fulfil a societal function with the creation of money. The World Bank and the International Monetary Fund (IMF) were established in 1944 by the international community to prevent a financial and economic collapse of countries.

From a financial sector perspective, as though it were an economic crisis, also a systemic ecological collapse can be averted by making use of the peculiarity of the financial system which is that it organises the distribution of capital and resources. Currently, climate finance inevitably relies on what is a complex financial system. That is quite simply where the distribution happens. It is where vast amounts of money are exchanged nowadays and where investments can be sourced. This comes with a risk. Nowadays, when a crisis occurs in a small corner of the financial markets, a speculative spur may escalate this crisis to global proportions, which subsequently also could amplify the crisis of the climate system it interacts with.

THE ROLE OF PRIVATE CAPITAL

These days, multilateral banks consider the mobilisation of private capital to be the key to generating money for climate. Poor countries, which are struggling with high debt and fiscal austerity policies, do not have the firepower of stimulus spending through direct investment. This debt is partly due to earlier financial and economic policies promoted by the IMF and the World Bank. These policies were imposed on indebted countries to ensure debt repayment and economic restructuring. Debt repayment and reducing government spending have been made the top priority.

The level of a country's debt is measured against its export receipts (or its budget revenue receipts). The IMF's track record in implementing past policies include currency devaluation to discourage imports and encourage exports – causing farmers to switch to cash crops and rely on international commodity markets. These policies undermine customary communal rights and land use, and therefore threaten food security, especially for communities living in poverty.[9]

INVESTMENT IN DEVELOPING COUNTRIES

The World Bank's restructuring of economies encourages foreign direct investment in developing countries and supports export-driven economies. The transition to commercial forms of export agriculture to increase revenue and repay debts to banks further entrenches the domination of men as leaders of agribusiness. Agrarian restructuring makes women redundant in their role as subsistence farmers and relegates them to doing precarious, poorly paid work away from the land.[10]

ATTRACTING PRIVATE INVESTORS

The focus of economic policy on agricultural commodities did not lead to a reduction of country debts. Overall, there has been an increase in the supply of loans instead. In fiscal year 2022, the World Bank alone issued debt securities to mobilise private capital in a variety of currencies to the tune of approximately US$41 billion. For fiscal year 2022 and beyond, annual bond issuance is expected to be around US$45-US$55 billion. As of 30 June 2022, the total amount of outstanding loans was US$257 billion.[11] Bonds issued by banks are rated by the rating agencies Moody and S&P. Private money may be hard to mobilise, however, because of the perceived levels of risk and uncertainty associated with investing in poor countries. To attract private investors, the banks started to work with new financial products that dilute and minimise risk for those investors. Conventional debt securities (bonds) are used as an underlying asset for these derivatives. Consequently, development banks increasingly work in the same way as investment banks. This clearly has implications for how the banks handle environmental and social issues.[12] Bond markets, for example, can make use of their own private taxonomies for securities.[13]

DERISKING
It all revolves around risk and 'de-risk' in the financial world. Within debt and credit markets – derivatives have transformed the ways corporations dilute risk and raise money. The financial risk associated with investing in the poorest countries is normally rated as very high. Derivatives dilute the risk for investors by combining risky assets with less risky ones. Portfolio investments and loans from development finance institutions nowadays are used as the underlying assets (collateral) for these new financial products. The debt of countries in this way turns in a financing mechanism to increase finance and make the volumes of money grow. Though the impetus for participating in projects often comes from private banks, so-called de-risking ensures that the lion's share of the financial risk lies with governments. The poorer a country, the more risk has to be transferred to the government. Financial de-risking applies to public energy and captures a range of public subsidies and guarantees including direct grants, tax relief or debt-based instruments, for leveraging private finance, with long term liabilities for the state (preferential credit, loan guarantees, first-loss equity tranches in private equity funds, green bonds).[14] In the case of default on the debt, the private investor may have the option of taking title to underlying public assets. De-risking instruments are less applicable to analog forestry, and forestry seems less 'investible', because shorter-term commercial business models for private operators do not apply.

For banks, the climate crisis has created new windows of opportunity to lend more money and create climate investment related assets value.

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The rise in the amount of debt is mirrored by a growing volume of financial products for making money on the financial markets. The potential benefits of investments in climate solutions are negated by the implications these debts have on trade deficits, currencies, and the adjustment of land use and the landscape, and a financial crisis would certainly further exacerbate this effect.

Currently, climate finance is overwhelmingly provided in the form of loans. According to the Organisation for Economic Co-operation and Development (OECD), 71% of total public climate finance provided in 2020 was in the form of loans (concessional and non-concessional).[15] The growing debt burden limits the options to solve the climate crisis. Lower-income countries are spending five times more on debt repayment than on tackling climate change.[16]

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8 A few examples: The Asian Infrastructure Investment Bank's 'Asia ESG Enhanced Credit Managed Portfolio' (AIIB, 2019: 3) delegates ESG rule-making and enforcement to private finance. The World Bank's updated Environmental and Social Framework replaced mandatory safeguards with a risk-based, outcome-focused approach. The World Bank accepts the use of borrowers' environmental and social frameworks that are 'materially' close to the Bank's own.

9 Submission to IMF Consultation on Gender Strategy GAGGA, 23 March 2022.

10 International Financial Institutions and Gender Equality: a contradiction in terms?, Both ENDS, June 2017.

11 See: www.treasury.worldbank.org/en/about/unit/treasury/ibrd/debt-products-faqs

12 Is it accessible?, Both ENDS, May 2017.

13 The Wall Street Consensus, Daniela Gabor, 2021.

14 From the Washington Consensus to the Wall Street Consensus, Heinrich Boll Foundation, Washington DC, Rick Rowden, 11 October 2019

15 Aggregate trends of climate finance provided and mobilised by developed countries in 2013-2020, OECD, 2022.

16 'Lower income countries spend five times more on debt than dealing with climate change', Jubilee Debt Campaign, 2021.

2.2 Dependency on international finance markets and the implications it has for forestry investments

Development institutions issue bonds to attract private investors with financial returns that resemble those generated by commercial funds. And this has its implications in different ways: current figures show that overall a vast majority of the commercial money generated through bonds is invested in energy, buildings and transport, and so far only a small share is being used to restore ecosystems and grow forests.

There has been a substantial increase in climate-related development finance through the issuance of green bonds for all sectors since 2000, but little of this has been directed towards forestry. The share of climate finance channelled to forestry did not exceed 4% of the total between 2009 and 2019.[17] It is unlikely that more than a small share of the MDB money is being dedicated to forests or to farming systems that create new forest. Investments in forestry and energy should not come at the expense of each other or at the expense of biodiversity and the livelihoods of the millions of people who depend on the forest, and yet that may happen.

The need to restore ecosystems and forests is urgent.

The need to restore ecosystems and forests is urgent because it is a way of drawing down carbon dioxide that has already been released into the atmosphere. Indeed, forests are a long-term carbon sink; forests and ecosystems have the capacity to reduce the global peak temperature and suppress warming for the long term.[18] One of the reasons why investors prefer to focus on energy, real estate and infrastructure is that these investments can potentially generate a quick (short-term) financial profit through user fees and government-guaranteed cash flows to investors (through energy purchase agreements).[19] This kind of cash flow is preferred over long-term investments in forests by markets. Traditionally, an upfront investment (by a state forestry department, but not always) would bring down the costs of forest maintenance in the first years.

It takes some years for agroforestry to become productive.

It takes some years for (agro)forestry to become productive and turn a profit. Moreover, investment in forestry can be politically more intricate than dealing with clients from energy companies, whereas it should involve indigenous communities and be a democratic process.

2.3 Debt cancellation as alternative source of climate finance?

The World Bank and other development finance institutions who encourage engaging international financiers argue that the advantage of involving private investors is that income-earning commercial ventures can replace reliance on government funding, which might otherwise require developing countries – who are already in debt – to raise taxes or increase government borrowing.[20] On the other hand, replicating and scaling up women-led agro-ecological climate solutions could start to pick up. For that to happen, there needs to be a national political space to implement taxation policies and cancel international financial debt. That would free up money for climate projects which would otherwise have been used to pay off banks and institutions.[21]

A first step towards debt reduction appears to have been taken recently. In 2021, the World Bank announced that it is working with the IMF on ways to factor climate change into the negotiations on reducing the debt burden in some poor countries.[22]
IMF Director Kristalina Georgieva told reporters about the initiative, which links debt relief to climate resilience, and investments in low-carbon energy sources could help private sector creditors achieve their sustainable development targets.[23]
To single out the interest of the creditors (and not mention the debtors) probably shows where the IMF's priorities lie, which is partially attributable to the fund's function in society. The fund's main priority is to serve the world of international finance. It therefore spends money to salvage the monetary system and bails out the financial sector to prevent international financial instability and uncertainty.

The IMF's initiative is a cautious first step in the right direction. However, the fund would never go as far as to cancel debt, and its policies are inextricably linked to an agenda of international trade liberalisation and commodity production for international export as demanded by the market. Gender-just climate solutions partly depend on forests, so their loss – usually due to their conversion into agricultural land – is problematic. The conversion of forest into agricultural land is intricately linked to trade, which in turn depends largely on international finance. Countries need the income generated by the trade of commodities to pay off the debt they owe to the banks. Between 1990 and 2019, the external debt of poor countries rose on average from 90% of their GDP to 170%,[24] and the pandemic has accelerated this crisis.[25]

CONCLUSIONS

A question raised in this paper is whether whether the use of agroforestry to restore forests will ultimately increase with the current focus on the amount of money needed.

This document aims to demonstrate that there is a real risk that the large-scale deployment of climate finance will frustrate reforestation efforts. The need to scale up climate solutions to a global level will trigger large-scale finance from multilateral development banks. These institutions are arguably the main international candidates for catalysing the needed investments. The amount of money needed for climate finance is not forthcoming from governments. Many are in debt and struggling with fallout from austerity policies.

Another question is whether (the large amounts of new) climate finance via multilateral development banks will (also) be used to support the restoring of forests, notably via agroforestry.

As for the development banks, the climate crisis is creating new windows of opportunity to lend more money and sell debt-related derivatives, so they are trying to reinvent themselves as institutions that are prioritising climate issues. The ways that the banks are borrowing from international markets, as well dealing with risk, is impacting how they lend money and to which sectors. Investors prefer climate finance to be invested in the energy sector to long-term investments in forests. It takes some years for (agro)forestry to become productive and turn a profit. De-risking instruments can be more easily applied to energy utilities. In the case of debt default, the private investor may have the option of taking title to underlying public energy assets.

The types of climate finance described above reinforce the financial sector's power over countries, and this indirectly has clear implications for the 'woman who planted trees', that is, all (wo)men who depend on ecology and access to natural resources. Gender-just climate solutions, often women-led at a local level, can easily gain traction with the support of small amounts of money. Reforestation mainly requires tailor-made solutions in consultation with those directly involved.

RECOMMENDATIONS

We recommend the following to governments and policymakers:

- Do not create new debt. Limit the use of debt-generating instruments to scale up climate solutions.
- Do not only consider investment needs but consider the potential of debt cancellation in climate policies.
- Leave the national political space for countries to implement taxation policies and cancel international financial debts of poor countries.
- Women-led climate solutions at a local level should have access to small grants facilities and subsidies. These can help to bring down the upfront costs of forest maintenance in the first years.
- Governments should further address the urgent need to restore ecosystems and grow forests as a method to draw down carbon dioxide that has already been released into the atmosphere, and encourage democratic participation and the involvement of indigenous communities.

NOTES

18 'Nature-based solutions can help cool the planet – if we act now', Cécile Girardin, et al., Nature, Vol 593, 13 May 2021.

19 User fees arrangements and purchase agreements also can be used as underlying assets (collateral) for de-risking. Read more about de-risking in the text-box.

20 Brochure on PPP fiscal risk assessment model, IMF 2014.

21 See: www.debtforclimate.org.

22 World Bank, IMF to consider climate change in debt reduction talks, Reuters, Environment, February 20, 2021.

23 Ibid, 2021.

24 Redesigning debt, IEED issue paper, June 2021.

25 Global sovereign debt monitor, Misereor, Erlassjahr, 2022.

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