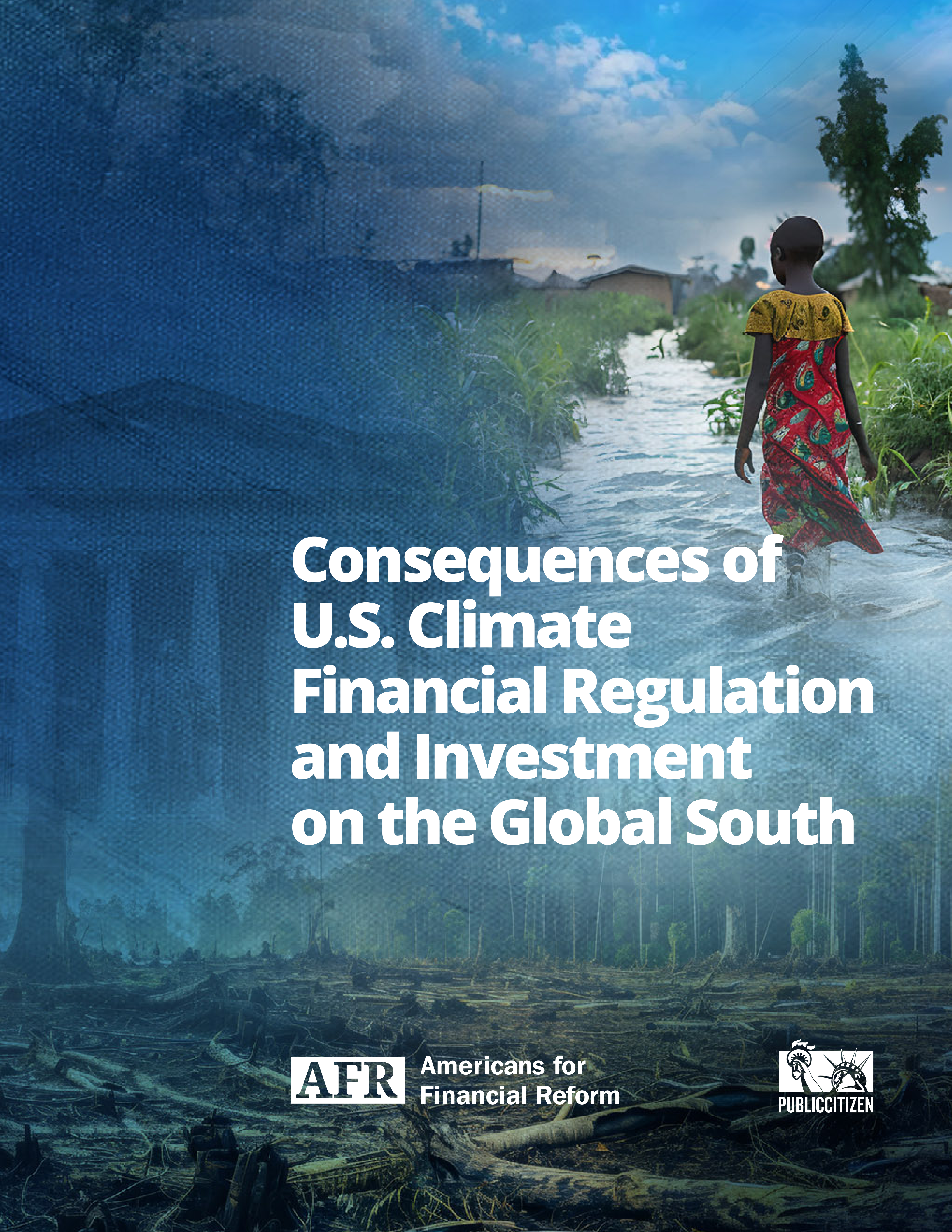

Consequences of U.S. Climate Financial Regulation and Investment on the Global South

AFR Americans for Financial Reform

PUBLIC CITIZEN

Acknowledgements

Americans for Financial Reform (AFR) is a nonpartisan, nonprofit organization that works in coalition with more than 200 civil rights, community-based, consumer, environmental justice, labor, business, investor, faith-based and civic groups, along with individual experts. Our mission: fighting to eliminate inequity and systemic racism in the financial system in service of a just and sustainable economy.

Public Citizen is a nonprofit consumer advocacy organization that champions the public interest in the halls of power. We defend democracy, resist corporate power, and fight to make government work for the people—not big corporations. Founded in 1971, we have more than 500,000 members and supporters throughout the country.

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Executive Summary

The multifaceted, catastrophic impacts of climate change, long predicted as existential threats and risks but now evident, have generated global attention and urgency for mitigation, adaptation, and just transition measures. Ambitious global commitments (e.g., the Paris Agreement),[1] national regulations and public subsidies, and private sector initiatives, like the Climate Pledge,[2] Net-Zero Banking Alliance,[3] and Task Force on Climate-related Financial Disclosures,[4] have advanced in response, but global emissions are still rising.[5] The past decade has been notable as a time when world economic powers have come to acknowledge that climate-related impacts will not be isolated to vulnerable countries in the Global South; rather, climate change represents a global systemic macroeconomic risk.[6] As a result, attention has turned to the need to mobilize private and public finance to address the problem through massive investments in climate mitigation and adaptation, the latter of which has been especially severely underfunded.[7]

The essential goal in these regions is to progress in a manner that factors climate alongside development when deciding how to allocate capital and public resources.

Reports from the Intergovernmental Panel on Climate Change show the urgent need to mitigate climate change and build resilience to the climate impacts that are causing significant losses globally, and to the future impacts that are already partially locked in and represent an existential threat.[8] This imperative comes while many Global South countries are already struggling to meet fundamental human needs, such as access to energy, healthcare, clean water, education, housing, and jobs, while also experiencing high rates of sovereign debt and reduced sovereign credit ratings.[9] The essential goal in these regions is to progress in a manner that factors climate alongside development[10] when deciding how to allocate capital and public resources.[11] For instance, climate-vulnerable countries like small-island developing states that are most at risk from climate change are currently paying off debts almost 18 times as large as the insufficient climate funding they receive, on average.[12] In fact, the Global South collectively will likely repay about $50 billion more in debt than it receives in grants and loans in 2024.[13] Global South countries face the likely impossible task of paying down debt while investing scarce capital to achieve their sustainable development goals.

Adding to the challenge, Global South countries are located in some of the most climate-vulnerable regions in the world and are the least able to recover from environmental disasters.[14] And though Global South countries have contributed the least to climate change, they face the highest relative burden in mitigating and adapting to climate change.[15] Responsibilities for climate mitigation efforts by Global North and South countries must be viewed according to the principle of "common but differentiated responsibilities," first formalized by the United Nations Framework Convention on Climate Change in 1992, under which Global North countries are responsible for remedy commensurate with their outsized contribution to global historical emissions.[16]

PHOTO: PIXABAY

Climate change has led to increasing severe flooding in Bangkok City, Thailand.

The injustices inherent in the global climate crisis are deeply connected to the historical legacy of imperial colonialism. The Global North has built its economies—and its power—by offloading many costs and risks to Global South countries. And the Global North continues to leverage asymmetric power dynamics in the global financial architecture to use the Global South for its resources without adequate compensation, often producing negative environmental and social impacts at the local level and human rights violations.[17] These disparities have contributed to an enormous climate investment gap in the Global South. Wealthy countries have pledged billions of dollars toward climate finance for Global South countries, but at the same time, have consistently failed to appropriate those funds, with no formal accountability mechanism in place.[18] Public finance, consisting of financial contributions from governments and public institutions, is inadequate to close the financing gap between the Global North and the Global South in addressing climate change issues, and most finance provided to the Global South is in the form of loans. Major problems with private finance exist as well, which require effective regulation to yield equitable, safe, and racially just climate investment.

The United States plays a pivotal role in climate finance. Notably, U.S. policymakers have contributed substantially to public finance policies that have created the current intractable sovereign debt spirals, and they also influence global private climate investment flows through regulation of major U.S. financial institutions, some of the largest in the world. Recent progress in climate financial regulation by U.S. regulators, however, has opened the door for new thinking and, hopefully, new opportunities to improve and expand private financial flows toward climate mitigation and resilience.[19]

Despite these developments, the voices of the Global South remain largely unheard within the global financial architecture, often due to structural design. For example, Global North countries hold disproportionately high allocations of International Monetary Fund (IMF) Special Drawing Rights, which grant them outsized voting control for future allocations.[20] There is also a need for more leadership opportunities and inclusive engagement with community groups from the Global South on climate finance and regulation. Host communities in the Global South rarely receive adequate transparency or the ability to influence and coordinate climate investment choices that greatly affect them. This document aims to continuously emphasize the important role of the Global South in the discourse of climate finance and the need to foster robust climate financial regulations to ensure accountability, inclusivity, and transparency.

In 2023, COP28[21]—hosted by the United Arab Emirates, one of the world's leading oil producers—fell well short of discussing the types of transformational changes needed to restructure the global financial architecture. Still, one of the most significant announcements to come out of COP28 was the formalization of a climate change loss and damage fund for vulnerable countries.[22] The Loss and Damage Fund (discussed further in Section 4) will be hosted by the World Bank for an interim period, with contributions not limited to governments; private investors and corporations (fossil fuel corporations in particular) are encouraged to contribute to the LDF. Many critics object to the World Bank hosting the LDF and are pressing for an alternative permanent host less controlled by the Global North.[23] Some observers have promoted the idea of taxes or mandatory contributions from corporations in proportion to profits gained and environmental damage caused.[24] The meetings concluded with an insufficient commitment to "transition away" from fossil fuels,[25] a stark difference

PHOTO: GULSHAN KHAN / CLIMATE VISUALS

A technician in Johannesburg checks and cleans the inlets of the ambient air quality monitoring station managed by South African Weather Services. This system measures traffic pollution and mine dump dust.

from the initial draft phrasing—to "phase out" fossil fuels—which would have better captured the necessity of moving away from fossil fuels entirely.

The $700 million pledged for the LDF is far insufficient in the face of $400 billion in annual damages being accrued by Global South countries.[26] On top of those recovery costs, Global South countries with emerging and developing economies will need more than $2 trillion annually in clean energy investment by 2030 to be on track to reach the goals of the Paris Agreement,[27] and those sums will largely need to flow through public, private, and blended finance mechanisms from the Global North. An immense financing gap remains, and existing efforts are too often extractive or create collateral harm, including through the saddling of countries with untenable debt. As much as possible, climate finance should come in the form of grants, not loans, to avoid further indebtedness.

This paper aims to explore ways that U.S. policymakers can help close the financing gap and enact reforms that account for the unique challenges faced by Global South nations in accessing safe, equitable, and racially just climate finance and redressing harms of existing financial flows. Shifts in our approach to financial regulation will be critical to achieving those goals.

Our focus is on how U.S. policymakers should:

- Reform climate financial regulation of private markets and firms (Section 2); and
- Advocate for reforms to global trade rules (Section 3).

We also discuss what U.S. policymakers should do to:

- Support a more equitable global public finance architecture (Section 4); and
- Explore and support other financing mechanisms that have been put forward to bridge the climate finance gap (Section 5).

Optimum solutions will require policymakers to consider reforms in each of those areas, and their interaction. The writers' expertise lies primarily in private financial regulation and global trade; in these areas we propose novel policy solutions. On public finance, we largely summarize the proposed reforms put forth by other experts and policymakers.

And though Global South countries have contributed the least to climate change, they face the highest relative burden in mitigating and adapting to climate change.

Our recommendations, discussed in more detail throughout the paper, include the following:

The U.S. Department of the Treasury (Treasury), with other agencies as appropriate:

- Treasury should support international efforts to achieve a global standard for science-aligned mandatory corporate transition plans, and push large U.S. corporations and financial firms to reduce their absolute Scope 1, 2, and 3 emissions and commit to providing equitable, safe, and racially just climate investment and aid in the Global South.
- Treasury should strengthen its Principles for Net-Zero Financing and Investment by stating that financial firms need to meet their commitments by reducing emissions and respecting human rights, and not through buying carbon credits, which often lead to human rights abuses and environmental and racial injustices in the Global South. Treasury should call on financial institutions to have net-zero plans aligned to the Principles.
- The Financial Stability Oversight Council (FSOC) should designate high-emissions non-bank financial companies (NFCs), including large insurers, asset managers, and private equity firms, as "systemically important" and therefore subject to enhanced supervision by the Federal Reserve.

- Treasury should push for and support the quantifiable goals and timelines in the World Bank's proposed Evolution Roadmap so that the institution can better address the multiple crises facing Global South countries according to the particular needs of the people and communities affected.
- Treasury should set green, social, and sustainability bond standards or principles, which could include reduced interest rates for certified public projects domestically and abroad, and third-party verification mechanisms.
- Treasury should request to be an observer for the Green Bond Principles and encourage expansion of the Green Bond membership and observers list to more countries and organizations in the Global South to promote inclusivity and transparency.
- For debt relief mechanisms, Treasury should prioritize and explore grants, traditional debt relief, comprehensive debt restructuring, and concessional finance before considering debt-for-nature swaps. Debt-for-nature swaps may still be useful in contributing to a small, tailored portion of the financing pool for climate-vulnerable, low-income/high-debt countries in the Global South.
- Treasury should facilitate discussions with Global South countries to provide technical assistance and promote technology transfer to help Global South countries develop and add value to their raw materials and industrialize in a climate-friendly manner.
- Treasury along with the Department of Justice and the Securities and Exchange Commission should encourage covered U.S. corporations to comply fully with any and all obligations under the EU Corporate Sustainability Due Diligence Directive.

U.S. Banking Regulators

- U.S. banking regulators should closely oversee the alignment between large banks' climate pledges, net-zero transition plans, and internal strategies, as indicated in their "Principles for Climate-Related Financial Risk Management for Large Financial Institutions."[28]
- U.S. banking regulators should require all large banks and NFCs under their supervision to develop and implement net-zero transition plans that include measures to provide equitable, safe, and racially just climate investment and aid in the Global South.
- U.S. banking regulators should impose a capital surcharge on systemically important global banks and designated non-bank financial companies based on their financed and facilitated emissions.

The Global North has built its economies—and its power—by offloading many costs and risks to Global South countries. And the Global North continues to leverage asymmetric power dynamics in the global financial architecture to use the Global South for its resources without adequate compensation, often producing negative environmental and social impacts at the local level and human rights violations.

PHOTO: GEORGINA SMITH / CIAT

Colleagues at the Kenyan Water Resource Management Authority testing water samples from a river.

U.S. Securities and Exchange Commission (SEC)

- The SEC should hold corporations accountable for failing to report or inaccurately reporting their climate and environmental impacts and human rights violations in the Global South, and corporations should be required to disclose their engagement and partnership work plans with local communities.
- The SEC should look to the International Sustainability Standards Board (ISSB) climate disclosure regime as a minimum baseline for all large registrants, and work with ISSB and other market regulators on international harmonization.
- The SEC should implement a mandatory net-zero transition plan disclosure regime for large U.S. public corporations and financial firms that have made public net-zero commitments.
- The SEC's disclosure rules should be updated to incorporate impacts on local communities, including those related to climate vulnerability, environmental damage, and human rights abuses, and any grievance redress mechanisms in place to remedy harms.
- The SEC should work to reverse the trend of capital migration from public equities markets to less-regulated private markets, and require climate-related disclosures for private debt issuances.
- Accounting, corporate, disclosure, and audit regulators in the United States and around the world should require incorporation of environmental liabilities' projected costs and asset retirement obligations in financial reporting. That would encourage corporations to maintain sufficient capital to cover those costs, and allow investors to account for them, particularly in the Global South, where the lack of remediation by Global North corporations is still especially prevalent.

U.S. Commodity Futures Trading Commission (CFTC)

- The CFTC should establish a benchmark for high-quality carbon credit derivatives, which are based on underlying carbon credits that are independently verified as providing genuine carbon removal, permanence, and additionality. Such credits must also be created with robust community engagement and respect for the rights of local Indigenous communities, to minimize the potential for abuse of human rights and negative environmental, social, and economic impacts.

PHOTO: RAPHAEL POUGET / CLIMATE VISUALS COUNTDOWN

In southern Mauritania on the banks of the Senegal River, a women's cooperative uses solar energy to operate the borehole that supplies water to the market garden.

Financial Accounting Standards Board (FASB) and the Public Company Accounting Oversight Board (PCAOB)

- The FASB and PCAOB should create and enforce a standardized accounting and audit framework to account for, disclose, and verify climate-related impacts on financial statements to ensure transparency within the global markets.
- The FASB should create, and the SEC enforce, a standardized accounting methodology for voluntary carbon credits expenditures. This would enable investors to make informed decisions about corporations purchasing credits.

U.S. Congress

- Congress should adopt a law similar to the EU Corporate Sustainability Due Diligence Directive, which would require corporations to identify actual and potential risks to human rights and the environment within their value chains, and establish procedures to mitigate those risks or face financial penalties.
- Congress should substantially increase funding for safe, equitable, and racially just climate investment in the Global South through direct aid, concessional finance without indebtedness, and other forms of support.

U.S. Trade Representative

- The U.S. Trade Representative should promote a "Climate Peace Clause" (i.e. a commitment by governments to refrain from using outdated trade rules to challenge one another's climate policies) to protect climate-related financial regulation from being challenged at the World Trade Organization (WTO) or through new and existing trade agreements.
- The U.S. Trade Representative should work to remove Investor-State Dispute Settlement (ISDS) provisions from existing U.S. trade agreements and investment treaties to promote environmental protection and sustainable, equitable trade practices.

International Financial Institutions

- The United States should use its significant voting power at international financial institutions, such as the WTO, World Bank, and IMF, to shift the focus from the prior emphasis on global economic liberalization to prioritizing a "just transition" and phasing out fossil fuels. It should also support significant restructuring and democratization of these institutions to ensure just attention to Global South concerns.

- Wealthy countries and the large corporations responsible for driving the climate crisis—and benefiting financially and in terms of economic development—should contribute to financing the loss and damage fund operationalized at COP28 to meet all immediate and ongoing needs of climate-vulnerable countries and communities.

Definitions

- The **Global South** is a term used to describe a diverse group of countries, primarily in the Southern Hemisphere, that share similar experiences of historical colonization, resource extraction, and other forms of exploitation from Global North countries; economic and social challenges; and ongoing efforts toward sustainable development. While countries within this group, including many in Africa, Latin America, Asia, and Oceania, face various obstacles like poverty, limited resources, and inequities, the term focuses on their collective potential and agency rather than solely highlighting their struggles. It's important to remember that the Global South is not a homogenous group, as each country has its unique cultures, histories, and aspirations.

  The term **Global North** refers to a collection of countries, predominantly in the Northern Hemisphere, characterized by their historical economic dominance, wealth, and political influence. These countries, including the United States and European nations, often share a legacy of colonialism and extractivism that have played a large role in shaping their current global positions. While economic prosperity and development are often linked with the Global North, it is crucial to recognize the historical power imbalances and persistent inequalities that have resulted from the colonial activities and extractivism of these countries.

- **ESG** stands for Environmental, Social, and Governance. It refers to a set of standards, frameworks, and data that investors and organizations consider when evaluating the sustainability and ethical impact of a company's operations on the environment and beyond. Each component of ESG represents a different aspect:
  - Environmental (E): This relates to a company's impact on the environment. It includes factors such as carbon footprint, energy efficiency, waste management, and adherence to environmental regulations.
  - Social (S): This considers a company's social impact and relationships with its employees, customers, communities, and other stakeholders. Social factors include labor practices, cost of labor, diversity and inclusion, community engagement, and adherence to human rights.
  - Governance (G): Governance focuses on the internal policies and structures of a company or organization. This includes corporate governance practices, board composition, executive compensation, transparency, and adherence to ethical business practices.

- The distinction between loss and damage and reparations lies in their focus and purpose. While **loss and damage** refers to the negative impacts and harm caused by climate change, including irreversible losses and the costs incurred, **reparations** involve the compensation or restitution for historical injustices or damages inflicted.

  While this document will not cover reparations, the case for them is important and must be acknowledged, and some reviewers of this paper noted that achieving a just transition will likely be impossible without decolonization and reparations. Readers are encouraged to learn more about reparations from Global South experts who can speak to how reparations are important to not only climate justice but also to address colonial and other extractive injustices caused over centuries and to this day.

Private Finance

U.S. corporations and the financial institutions that serve them have long profited by extracting natural resources from the Global South with minimal accountability, transparency, and regulation. Many corporations have tried to bolster their reputations in recent decades with inadequate sustainability- and climate-related commitments which often fail to translate to a meaningful shift in strategy to advance a just transition. Additionally, corporations have failed to account for transition risk and many have fought against disclosure regimes and accounting rules that would reveal their greenwashing.

Our ability to 'unlock private finance' to meaningfully improve climate investment in the Global South will depend on adequate financial regulation and enforcement mechanisms. In this chapter, we discuss:

- Extractive business models of Global North corporations and investors and the lack of accountability
- The inadequacy of private financial commitments and initiatives
- The problems with carbon credits
- Effective net-zero transition planning requires regulation
- Enhanced market disclosure and accountability mechanisms
- Accounting for remediation and asset retirement provisions for fossil fuel assets
- Addressing U.S. financial institutions' contributions to global systemic risk

Extractive business models of Global North corporations and investors and the lack of accountability

Many U.S. corporations and industries are dependent on extractive business models that rely on acquiring natural resources from communities and countries in the Global South and returning profits to shareholders in the North, where their businesses enjoy substantial public subsidies that increase private profits.[29] With inadequate transparency around activities, and without robust grievance redress mechanisms,[30] human rights abuses and environmental injustices remain inevitable. Nonetheless, there is a growing wave of pressure from governments and investors in demanding transparency regarding these activities, which is aimed at delivering adequate information and compelling corporations and their financiers to bear the costs that are usually shifted onto the host communities in which they operate.[31]

Many corporations claim that their activities have a positive impact on the communities where they operate, while at the same time concealing detrimental negative impacts of their actions in those communities. For example, Shell, a British multinational oil and gas company, has been present in Nigeria since 1937, and claims that Nigeria represents the "largest concentration of social investment spending in the Shell Group."[32] Before Shell's arrival, the Niger Delta was home to a rich diversity of ecosystems, from lush rainforests and shimmering mangrove forests to sprawling swamplands,[33] with farming and fishing central to the local economy of the communities.[34] Today, the Niger Delta is recognized as "one of the most polluted places on Earth."[35] According to Nigeria's National Oil Spill Detection and Response Agency, there were 1,156 documented incidents of oil spills in the area in 2023.[36] Over decades, regular spills have damaged crop yields and "have led to a decline in the local food production and deepened poverty in communities in the Niger Delta."[37] A 2019 study found that infants born to mothers who lived near spill sites in Nigeria before conception were two times as likely to die as their counterparts before reaching one month of age.[38]

PHOTO: PIUS UTOMI EKPEI/AFP VIA GETTY IMAGES

A man scoops spilled crude oil floating at the bank of waterways in the oil-producing Niger Delta region.

Longlife Bob, a fisher in the region, shared his story of how an oil spill destroyed his livelihood. Before a major recent oil spill, Bob regularly made 80,000 Nigerian naira (equivalent to $108 USD) on a good day selling his catch from the Oluku River, income that he used to support his family for ten years.[39] However, a 2023 oil spill contaminated the river and damaged his equipment, leaving him with no means of earning an income.[40] In 2008, four farmers, along with the environmental group Friends of the Earth, filed a suit against Shell seeking damages for "lost income from contaminated land and waterways in the region" caused by oil spills that occurred between 2004 and 2007.[41] Shell settled the suit by agreeing to pay $15 million to affected communities.[42]

In 2024, Shell agreed to sell its onshore Nigerian oil and gas subsidiary for $2.4 billion, part of a "broader retreat by western energy companies from Nigeria as they focus on newer, more profitable operations."[43] Researchers at the Centre for Research on Multinational Corporations assert that with this move, Shell is leaving behind "petroleum-contaminated rivers and streams and large areas of polluted land that have devastated the lives and livelihoods of millions of people living in the Niger Delta" and that Shell "has divested to many newly created companies that do not appear to have the funds or willingness" to safely decommission abandoned pipelines.[44]

In another example, Vale S.A., an international mining company that runs the Onça Puma mine in Brazil, was accused of contaminating the Cateté River with heavy metals, leading to various adverse health and environmental implications for neighboring communities.[45] An action against Vale on behalf of the tribes of Kayapó and Xikrin do Cateté resulted in an award of $26.8 million in favor of the tribes for contamination of the Cateté River.[46] Additionally, in 2019, a Vale mining dam in Brumadinho, Brazil collapsed, resulting in the deaths of more than 270 people, with the majority being Vale employees.[47] The company allocated $7 billion to compensate the victims.[48] Sixteen people, including Vale executives,

PHOTO: DHANA KENCANA / CLIMATE VISUALS COUNTDOWN

A former wildlife, and wood hunter taking care of a coffee tree that grows wild in a tropical rain forest in Indonesia. Together with the villagers are rangers to keep the forest sustainable and avoid environmental destruction and the adverse effects of climate change.

were charged with criminal homicide due to their alleged negligence in ignoring numerous safety complaints regarding the dam, though a court recently suspended the charges against Vale's former chief executive officer.[49]

In 2004, Starbuck , a U.S.-based coffee company, launched its first set of ethical sourcing standards called Coffee and Farmer Equity (C.A.F.E.) Practices.[50] C.A.F.E. was deployed to assess farms based on economic, social, and environmental standards in order to encourage transparent, profitable, and sustainable coffee cultivation methods while also safeguarding the welfare of coffee farmers and workers.[51] However, in 2018, labor inspectors in Brazil found and rescued 18 workers at a C.A.F.E.-certified coffee farm who were working under terrible conditions—including 11 hour work days, six days a week; rodent infested housing; a lack of drinking water; unhealthy sanitation; and a rigged payment system."[52] In 2024, Starbucks was sued by the National Consumers League for allegedly misleading consumers by claiming that its products have '100% ethical' sourcing despite these documented reports that producers in its supply chain utilized child and forced labor, and had patterns of sexual harassment and assault in their workplaces.[53]

Another issue of concern is the trending practice in which agricultural investors based in the Global North are buying land in the Global South with little consideration for the environmental and economic impacts on local communities.[54] This practice has been called "land grabbing,"[55] and it can have significant environmental and social consequences. For instance, an open letter addressed to the prosecutor at the International Criminal Court in the Hague mentioned that land grabs in Cambodia have led to large-scale deforestation and pollution.[56] Some U.S.-based financial firms like the Teacher's Insurance and Annuity Association (TIAA) which claims to aim to "reduce inequalities to achieve a more equitable and sustainable future for all," are buying farmland in the Global South.[57] ActionAid US claims that land deals like these cause "deforestation, violence, forced displacement, and agribusiness operations that use up all the water and pollute the waterways that remain."[58]

Investors and the public are beginning to recognize the significant risks posed by corporations that exploit the natural resources of marginalized communities and neglect human rights and environmental concerns.[59] Efforts by regulators, such as the SEC, to hold corporations accountable for their false reporting and omissions are a step in the right direction. For example, in March 2023, the U.S. Securities and Exchange Commission (SEC) announced that Vale agreed to pay $55.9 million to resolve charges filed in April of the previous year.[60] Those charges were related to the company's purportedly false and deceptive disclosures concerning the safety of its dams before the collapse of the Brumadinho dam. In its complaint, the SEC had pointed to evidence that the company had been aware that the dam was not in compliance with internationally recognized safety standards, despite Vale's reports reassuring investors that all of its dams were certified as stable.[61]

Investor discipline is another way to hold corporations accountable for their harmful business operations in communities. Investors—including public benefit and pension programs and sovereign wealth funds—should use shareholder engagement and divestment to hold corporations accountable, compelling them to engage in more equitable and racially just practices or be forced to internalize costs through reputational or legal damages and a higher cost of capital.

Investors and the public are beginning to recognize the significant risks posed by corporations that exploit the natural resources of marginalized communities and neglect human rights and environmental concerns.

Investors should also demand that corporations carry out inclusive engagement with local communities in the development of projects, and respect the “right to say no” to projects on Indigenous territories.[62] For a project to move forward communities should be guaranteed informed prior consultation, meaningful ongoing participation, transparency, and grievance redress mechanisms.

The inadequacy of private financial commitments and initiatives

As climate impacts become more obvious and salient to the public, many consumers have made demands of corporations to commit to climate action and sustainability, including by reducing their own greenhouse gas emissions and cleaning up their supply chains. In response to the pressure, many major corporations have committed to setting climate targets and goals. However, most of these pledges are vague and lack any accountability mechanisms. Many appear only in public advertising and sustainability reports, with no through lines to the audited financial statements or other regulatory filings, calling into question the credibility and sincerity of the claims. Increasingly, corporate climate commitments are being scrutinized, particularly in the context of the proliferation of pledges to reach net-zero emissions by 2050.

“Net-zero” is a problematic term, used in many public commitments, because it implies that carbon emissions can continue so long as they are balanced by carbon removals of the same magnitude. Removing carbon from the atmosphere occurs via natural carbon sinks (e.g., oceans or forests absorbing carbon) or can be carried out using carbon capture technologies. Indeed, carbon removals are at the heart of the carbon offsetting programs that corporations increasingly seek to rely on to meet their goals. However, these removals are not necessarily permanent or scaleable; for example, a forest fire can quickly wipe out a major natural sink, releasing huge amounts of carbon. In the case of proposed technological solutions, such as direct air capture and point source carbon capture and storage, the cost remains very high,[63] making it generally cost prohibitive at scale.

Nevertheless, the false promise of these removals has emboldened fossil fuel corporations, airlines, auto manufacturers, and agribusinesses to eschew genuine emissions reductions while simultaneously marketing based on deeply flawed decarbonization plans. The climate crisis cannot be fixed by technological or financial innovation alone. It requires a fundamental realignment of energy systems and consumption patterns—and building out of circular economies—to match the limits of the natural world. Trying to patch the problem with more finance toward uncertain technologies will primarily benefit polluters and delay needed decarbonization; it will not advance the fundamental shift in priorities necessary to protect people and the planet.

In fact, carbon-intensive industries continue to propose false and inadequate solutions to the climate crisis to maximize profits and delay the inevitable transition away from fossil fuels. According to a common narrative, nature, natural resources, and energy are commodities with a price. The Global South is positioned as a provider of raw material, and the Global North as the consumer. Further, the strict focus only on greenhouse gas emissions intensiveness ignores the socio-environmental damage that the fossil fuels industry is causing in Global South countries. For example, the Vaca Muerta gas mega-project in Argentina is owned and operated by multinational and regional oil corporations including PanAmerican Energy, Total, and Chevron, the project included fracking, which one study suggests has led to an increase in earthquakes.[64]

Giant oil corporations are promoting net-zero plans while at the same time expanding their fossil fuel business, particularly in petrochemicals and liquified natural gas, as well as exploring new fossil reserves.[65] Chevron, for example, claims to support "well-designed climate policies" and says that it "aims to lead in lower carbon intensity oil."[66] However, the reality is that oil corporations, with the help of their financiers and insurers, are expanding operations,[67] increasing their gross emissions, making huge profits,[68] signing new "megadeals,"[69] and consolidating their political and economic power. This calls into question the strength of the companies' commitment to their net-zero plans and should serve as a clarion call for regulators to take a strong stand to protect communities at home and abroad.

Last year, the Net Zero Tracker, a non-profit corporate climate plan watchdog, discovered that while 67 percent of fossil fuel firms had net-zero commitments, those commitments lacked transparent transition and phase out plans to meet the targets.[70] A recent report by the New Climate Institute examined the climate commitments of 25 major global corporations and found that most have failed to put forward ambitious targets, and many rely on creative accounting to reduce the meaning of their targets.[71] The report further revealed that, on average, the companies that backed their net zero pledges with explicit reduction commitments, only actually pledged to reduce emissions by an average of 40 percent rather than the full 100 percent implied by the term "net-zero." Due to the challenges and potential for fraud in a net-zero approach, climate justice-oriented organizations have begun to call for a "real zero" framework instead, which would strive toward absolute decarbonization by 2050.[72]

Finance sector initiatives like the Glasgow Financial Alliance for Net Zero (GFANZ)[73] and its finance sector-specific sub-alliances have yet to produce results as measured by actual decreases in financed emissions, and many commentators argue that its framework and the resulting transition plans lack rigor.[74] Recent research finds that banks that have made voluntary net-zero commitments have neither divested from emissions-intensive clients nor decreased financed emissions through engagement with existing and new clients.[75] Further, finance firms continue to back out of voluntary climate-related and ESG initiatives; JPMorgan, Wells Fargo, Citi, and Bank of America all recently withdrew from the Equator Principles, an industry-led initiative that seeks to avert adverse environmental and social impacts created by large infrastructure and industrial projects financed by the banks, though they claim this withdrawal will not impact their practices.[76]

Effective net-zero transition planning requires regulation

A corporate net-zero commitment without a transition plan that details *how* a corporation will meet its decarbonization goals is an empty pledge.[77] To be credible, transition plans should include clear emissions targets, with benchmarks and timelines against which progress is measured. Transition plans must be transparent, eschewing carbon offsetting and greenwashing and instead focusing on real emissions reductions within a corporate value chain. Further, while there is a broad and general consensus among governments that the world must decarbonize, there is a significant risk that the transition toward decarbonized economies will perpetuate the same distributive ecological injustices between the Global North and Global South. Effective transition plans must respect human rights, prioritize environmental justice, and consider the rights of affected communities.

Guidance on transition planning to date has been largely disappointing. Existing efforts are typically voluntary, giving corporations the choice whether to adopt the guidance or not. Transition planning frameworks lack penalties for non-compliance, misrepresentation, or greenwashing, and often fail to fully consider human rights and other environmental standards. Mandatory and enforceable transition plan regulations that include human rights and environmental justice protections are essential to ensure that corporations make meaningful commitments to reduce their emissions and move toward a phase out of fossil fuels.

Global regulators and standard-setters have begun to understand the urgent need to harmonize transition plans frameworks to ensure that they are fair, credible, and effective. Treasury should support international efforts to achieve a global standard for science-aligned mandatory corporate transition plans, and push large U.S. corporations and financial firms to reduce their absolute Scope 1, 2, and 3 emissions and commit to providing equitable, safe, and racially just climate investment and aid in the Global South.

In September 2023, the U.S. Department of the Treasury (Treasury) issued a report highlighting a series of best practices to guide financial institutions to carry out their net-zero commitments.[78] The Principles for Net-Zero Financing & Investment (U.S. Transition Principles) are a start. However, it is essential that policymakers address key loopholes and vulnerabilities in order to prevent banks and other financial

Traditional farmers are adjusting to the wind turbine farms that have been set up next to their village in North West Sri Lanka over the last few years.

PHOTO: TASHIYA DE MEL / CLIMATE VISUALS COUNTDOWN institutions from making empty climate pledges that further violate human rights and endanger communities, including those in the Global South most vulnerable to climate impacts and economic extractivism.

The biggest shortcoming of the U.S. Transition Principles is that they are entirely voluntary: Financial institutions can choose whether or not to abide by them or, indeed, whether to have a transition plan in the first place. This is true even if the company in question decides to issue a net-zero pledge for marketing purposes. A net-zero pledge without a credible transition plan is fundamentally misleading. Yet this is accepted practice in the United States. A second crucial failure of the U.S. Transition Principles is that they lack accountability mechanisms to ensure banks and other financial institutions abide by them. Banks can issue transition plans alongside their net-zero commitments *and* continue to increase their financial support for fossil fuels—through corporate debt, project finance, investment, advisory services, and more—because there are no penalties or oversight. Another major shortcoming of the U.S. Transition Principles is their virtual silence on the inappropriate use of carbon credits, as we discuss in the next section.

Additionally, Treasury's Transition Principles are silent on the matter of directing just transition support for the Global South. To achieve a climate-resilient and decarbonized world in a fair and just manner, it is important to address the particular vulnerabilities created by the extractive global economic model that has left many Global South countries with few resources to transition their own economies and adapt to climate change. Corporations and financial institutions cannot claim to be aligned with a just transition unless they work to counteract the damage caused by extraction. One way regulators can create this alignment is to require that large financial institutions contribute, for example, at least 3 percent of their assets under management to fair and just decarbonization and adaptation efforts in the Global South.

Treasury must revisit its Transition Principles to correct these deficiencies and issue firmer guidance on 'transition finance' and carbon credits to provide meaningful guardrails and promote credible and just transition plans for financial firms. Treasury should also call on financial institutions to have net-zero plans aligned to the Principles.

PHOTO: TOM VIERUS / CLIMATE VISUALS

Mangrove seedlings growing in the small bay of an island south of Fiji's main island. Fiji's government sponsors several mangrove reforestation initiatives throughout the country to combat eroding coastlines and restore mangrove forests. When re-planted they increase the resilience of coastal communities, enhance fish life around Fiji's shores, clean and filter seawater, and serve as a natural wave barrier in times of storms.

Further, President Biden's Executive Order on Climate-Related Financial Risk specifically instructed regulators to connect the dots between climate change and increasing financial risks, and directed FSOC to address growing systemic climate-related financial risk as part of "a whole-of-government approach" to climate change, and to act to mitigate the "drivers" of climate-related financial risk.[79] The Treasury Secretary is the Chair of the FSOC, and should look to the President's executive order and to Treasury's financial stability authorities to make referrals to relevant prudential regulators for enhanced supervision and oversight over net-zero transition plans. In particular, the U.S. banking regulators should closely oversee the alignment between large banks' climate pledges, net-zero transition plans, and internal strategies, as they indicated in their "Principles for Climate-Related Financial Risk Management for Large Financial Institutions."[80]

Transition plans are not just a "nice to have" for financial firms; rather, they are critical risk-management tools that should be subjected to prudential oversight and regulation. As such, U.S. banking regulators should require all large banks under their supervision to develop and implement net zero transition plans. And the SEC should implement a mandatory net-zero transition plan disclosure regime for other large U.S. public corporations and financial firms that have made public net-zero commitments.

This must be a global effort with domestic regulators working with their international counterparts through multilateral forums such as the Organization for Economic Co-operation and Development, the Basel Committee on Banking Supervision, International Monetary Fund, World Bank, G7, and G20 to foster global political consensus on the need to create both common principles—and regulatory mandates—around just transition planning and related accountability frameworks for tracking net-zero commitments.[81] This process must include meaningful representation from Global South countries, with a particular focus on civil society organizations and local and Indigenous communities.

The problems with carbon credits

The voluntary carbon market is one of the primary tools that corporations use to substantiate their net-zero plans and demonstrate progress toward emissions targets. As discussed above, "net-zero" in practice does not necessarily mean reducing corporate emissions to zero or anything close to it; rather, it often means that substantial emissions will be "offset" by carbon removal or by the purchase of carbon credits. Unfortunately, carbon credits often serve as a false solution to corporate climate pollution, allowing corporations to carry on with their "business-as-usual" approach without the necessary reduction of carbon emissions. Carbon credit projects can also be harmful to the communities in the Global South where the projects are situated, with economic benefits (e.g., direct revenue from projects and/or reputational benefits) accruing to corporate credit purchasers and their investors, who are generally situated in the Global North.

Carbon credits can be issued based on a broad spectrum of projects. While some projects purport to "avoid" emissions that would have been generated but for the credit project (e.g., a solar project replacing a planned gas plant), others plan to rely on carbon removal technologies that extract carbon dioxide from the atmosphere through methods like afforestation or through new technologies, such as direct air capture, that are cost-prohibitive and unproven at scale.[82] Corporations in high-emitting sectors are loudly supportive of carbon removal and carbon capture and storage technologies because the prospect of those technologies provides a license for business-as-usual operations, reserve development, and emissions.

Voluntary carbon markets have been plagued by scandal in recent years, as multiple investigations have revealed deceptive accounting and exaggerated claims.[83] A recent study found that for 33 of the top 50 corporate carbon credit buyers, more than a third of their entire portfolios were "likely junk."[84] This is just one of many analyses over many years exposing the cracks in the system. The U.S. Federal Trade Commission raised concerns about the potential for fraud in the carbon markets more than a decade ago.[85] A 2018 report from the Norwegian government revealed a "high" risk of fraud associated with carbon credits in its International Climate and Forest Initiative.[86]

In addition to a failure to reliably provide climate benefits, carbon credit projects face scrutiny because they often create other social, environmental, economic, and human rights harms to local communities. Indeed, one prominent Global South NGO, Power Shift Africa, explicitly characterizes carbon credits as "pollution permits."[87] In a trenchant 2023 report, the organization uncovered how fossil fuel corporations and carbon credit brokers are the true beneficiaries of credit schemes, while local communities benefit little or suffer direct harm through land-grabbing that pits project developers against Indigenous Peoples and local communities.[88]

These challenges have led to a crisis of confidence in carbon markets that a prominent nongovernmental standard-setter for credit quality, the Integrity Council for Voluntary Carbon Markets (ICVCM), has been working to counteract, by hosting numerous consultations in an attempt to define "high-integrity" credits that could be credible tools for climate mitigation. It has recently released its long awaited Core Carbon Principles, Assessment Framework and Assessment Procedure to help credit purchasers navigate their options.[89] However, there is no sign that these private initiatives are capable of making a substantial difference without government regulation.

Indeed, the battle over carbon credits is emerging as one of the great greenwashing battles of our time. A recent scandal erupted when the Science Based Targets Initiative (SBTi) appeared to roll back its longstanding exclusion of carbon credits as a means for corporations to satisfy their climate targets and commitments. In response, staff of SBTi called for the resignation of the firm's CEO.[90] It subsequently came to light that SBTi's decision was made after pressure from a number of prominent carbon market standards and lobbying groups.[91] The SBTi dropped Amazon from its rolls in 2023, finding the company failed to establish a credible timely goal for reducing carbon emissions; to the contrary, data showed its emissions had grown 40 percent since 2019, the year it set its net-zero target.[92]

The SBTi had long been a model for the climate community due to its steadfast commitment that science—not politics—should be the guiding light for corporate sustainability pledges and climate targets. The policy before was clear: Credits cannot be used to greenwash emissions, at any stage in the value chain.[93] In the wake of staff dissent and widespread media coverage, the SBTi board has walked back any changes that would allow credits for transition planning and has reaffirmed its commitment to rigorous processes before making any official policy changes.[94]

Carbon credits have been exposed time and again as a delay tactic in the fight against climate change. The world needs rapid decarbonization across transportation, power, industry, and agriculture—not pollution permits. Yet, despite the proliferation of fraud and abuse in the voluntary carbon market, Morgan Stanley forecasts that the market will grow from $2 billion in 2020 to $250 billion by 2050.[95] Of particular concern to the Global South is the widespread use and growth of nature-based credits linked to forestry, wetlands, and agriculture. In addition to being of dubious value to climate mitigation, these projects are often made possible by disregarding human rights norms of prior and informed consent.[96] Often, they are outright land grabs.[97]

Attempts to reform the voluntary carbon market have failed repeatedly. Meanwhile, the climate crisis is intensifying, with brutal impacts on communities around the world. The economic costs of climate disaster are mounting, as are the risks to the global economy writ large. U.S. regulators must act within their remit and tackle the misleading claims and fraud within carbon markets, and not be cowed by pressure to prop up this market that has long served as a dangerous distraction. Carbon credits enable high-emission entities to avoid taking responsibility for their emissions, and unfortunately disincentivize and divert resources away from the capital-intensive actions needed to actually decarbonize their businesses.

In May 2024, the White House released a policy statement and principles for voluntary carbon markets intended to provide clear guardrails and realign incentives for carbon credits and offsets in an attempt to restore faith in the market.[98] Recognizing the challenges inherent in the deeply flawed system was an essential first step. Now, U.S. regulators must urgently turn to supporting accountability and enforcement mechanisms to eliminate the use of dangerous and low-quality credits, which comprise most credits on the market today.

Specifically, the Treasury should make clear that credits can not be credibly used in transition planning across Scope 1, 2, and 3 emissions. Instead, policymakers can encourage corporations to purchase credits as a form of voluntary charity to decarbonization—so-called “beyond value chain mitigation” credits.

The CFTC should establish a benchmark for high-quality carbon credit derivatives, which are based on underlying carbon credits that are independently verified as providing genuine carbon removal, permanence, and additionality. Such credits must also be created with robust community engagement and respect for the rights of local Indigenous communities, to minimize the potential for abuse of human rights and negative environmental, social, and economic impacts.

The Financial Accounting Standards Board (FASB) should create, and the SEC should enforce, a standardized accounting methodology for voluntary carbon credit expenditures that ensures transparency within the market. This would enable investors to make informed decisions about corporations purchasing credits.

Most importantly, agencies across the federal government must take measures within their remit to ensure that the rights of local Indigenous communities are prioritized throughout the implementation of carbon credits projects.

Enhanced market disclosure and accountability mechanisms

Many Global North retail and institutional investors are interested in applying their money toward safe, equitable, and racially just climate investment,[99] but rampant greenwashing and inadequate disclosure, transparency, and accountability mechanisms have resulted in few effective investment options, difficulty in improving those options, and inability to discern between different investments.[100] Additionally, experts suggest that private-sector “green finance targets may not lead to enough funding for less well-developed solutions, or for the Global South.”[101]

Various investor initiatives have been formed specifically to apply capital and shareholder power to solve sustainability-related goals. The Investor Alliance for Human Rights is an investor consortium that has $12 trillion in assets under management. The United Nations Principles for Responsible Investment has more than 5,000 signatories that represent $121 trillion worth of assets under management. Members of the Glasgow Financial Alliance for Net Zero (GFANZ), with $66 trillion assets under management, have committed to achieve net-zero emissions by 2050.[102] In addition to institutional investors, a survey found that two-thirds of wealthy individuals, family offices, and foundations[103] would like their investments to be aligned with the Paris Agreement. However, less than 1.5 percent of investment funds are delivering on that goal.[104] To meet the needs of these investors, market


PHOTO: NABIN BARAL / IWMI

A vegetable farmer in Nepal waters his fields with a solar panel powering an irrigation pump.

participants and their regulators need to work to deliver more high-quality financial products that are aligned with the Paris Agreement, and for that to be the case nonfinancial corporations will also need to develop more-robust transition plans with provisions to benefit and remedy the harms in the Global South.

It is important to have accurate and comprehensive information on how Global North capital flows impact people and communities in the Global South. Without this information, regulators, investors, and the public will be unable to make informed decisions on how to allocate capital in a responsible and beneficial manner to affected communities in the Global South. Unfortunately, many of those communities are not provided access to communicate with foreign investors or corporations to notify them of harms that result from their investments and operations. And once harms are discovered, there must be opportunities for remedy. Grievance redress mechanisms are more common in the international public finance contexts[105] and between state actors,[106] but far less so in the private finance context. It is often virtually impossible for communities to obtain information or contact foreign corporations or their investors and receive redress, or even a response. Investors should avoid investing in projects and corporations that are unable to establish transparent communication channels with local communities, and in a language and communication format that is accessible to that community.

Additionally, there is a lack of standardized rules for investment funds around climate-related disclosure, naming, and marketing. This means that even investments described as aligned with the interest of the Global South communities may not in fact operate that way. For example, many funds purport to promote a just transition through "transition finance," but financial firms define that term differently, resulting in reasonable investor confusion.[107]

The Task Force on Climate-related Financial Disclosures (TCFD) succeeded in creating a standardized global framework for corporate climate disclosures and encouraging more corporations to make voluntary disclosures. However this private ordering has not succeeded in eliciting comparable and standardized disclosure, and investors find the uneven application of TCFD frustrating.[108]

Market regulators have a critical role to play by ensuring sufficient public information is available for market participants to properly protect their investments and prevent harm to affected communities.

In 2023, the International Sustainability Standards Board (ISSB) and the European Union finalized climate disclosures standards for international uptake that include information about greenhouse gas emissions, carbon credits, supply chains, and transition plans. Market regulators across the world—including the SEC—should adopt the ISSB standards and make them mandatory for all large participants. Global North countries and the ISSB should work to internationalize the ISSB standards and give technical assistance to Global South countries for implementation of ISSB standards and regulatory oversight of the resultant disclosures.

In the United States, the SEC must go beyond its recently finalized rule on climate disclosure[109] as quickly as possible, and incorporate full scope greenhouse gas emissions, just transition strategies, and elements related to corporations' climate-related risks and impacts on the Global South.

In particular, the SEC should update its public company disclosure regime to include the following disclosures:

- *Describe how the issuer manages risks associated with* ***climate-related impacts on communities, regions, and countries*** *(e.g., those caused by land use change and deforestation, natural resource use, associated disruption to local economies, harm to public health, and worker dislocation) that stem from regular business operations, climate mitigation efforts, and/or transition activities.*
    - *Examples:*
        - *An issuer's water usage leads to an acute water shortage and price increases for a community that is already experiencing climate-driven drought, disrupting the local economy.*
        - *An issuer's development or destruction of a community green space exacerbates climate-driven intensive heat, harming public health.*
        - *An issuer's deforestation or land-use change activity harms a natural buffer zone, leaving a community more vulnerable to climate-induced disasters or chronic conditions like hurricanes and sea level rise.*
        - *An issuer's land-based carbon offset project that they are using to reach net zero is poorly done, a monoculture reforestation that harms biodiversity and destabilizes a local economy that relies on natural forest products and forest health.*
        - *An issuer's climate transition plan dislocates workers and the local community and economy that relied on a fossil fuel plant for jobs and tax revenue.*
- *Describe your outreach and engagement efforts toward members of communities that have faced or are likely to face climate-related impacts due to corporate activities, any grievance resolution procedures in place, and the nature of any grievances in the past year and their resolution.*

Other important priorities for the SEC include finalizing its proposal to require additional information from ESG-related investment funds, which should include disclosures around climate risks and impacts, greenhouse gas emissions, and impacts on communities and the Global South throughout the value chain. The SEC also needs to take further steps to enhance disclosure from private equity firms and within the private markets; this coverage is critical as much of the international private financing for climate justice will come through those financial firms and sectors with the highest risk tolerance. The SEC must generally work to reverse the movement of capital out of public equity markets that is occurring through regulatory exemptions, and specifically require climate-related disclosures for private debt offerings that rely on Rule 144A and 506 exemptions,[110] which are a major financing vehicle for fossil fuel firms.

In the European Union, the Corporate Sustainability Due Diligence Directive has put some measures in place that will require corporations to identify the actual and potential risks of their activities to human rights and the environment, and establish processes to decrease those risks within their value chain.[111] It is expected that corporations with more than 1000 employees will need to publish detailed Paris-aligned transition plans, and the variable pay of directors would be linked to achieving progress on those plans.[112] Treasury, the Department of Justice, and other relevant regulators should not try to interfere with these standards being applied to U.S. firms, as Secretary Yellen implied in her testimony before the Senate Finance Committee in June 2023,[113] and should instead support U.S. corporations in complying with the E.U. regulation. These requirements should also be adopted in the United States.

Accounting for remediation and asset retirement provisions for fossil fuel assets

The rules and norms governing fossil fuel asset underwriting and accounting unfortunately fail to capture the full costs associated with their development, operation, and retirement, and thus bias financial flows in the direction of these assets. A lack of robust accounting rules around future remediation and asset retirement obligations allows corporations and investors to hide the expected cost associated with end-of-life treatment of assets.[114] This creates a misleading picture of the financial health of firms in the past and present, and facilitates capital planning that ignores the costs of asset retirement, leading to numerous cases where insolvent firms simply abandon their obligations, leaving communities facing ongoing pollution from toxic sites.

These deficiencies have significant implications for Global South countries that have fossil fuel infrastructure, such as Nigeria, where unbooked Asset Retirement Obligation (ARO) liabilities may exceed $9 billion.[115] The transfer of assets from large oil corporations to smaller ones in Nigeria has given rise to increased environmental degradation. Also, there are many abandoned oil facilities, including wellheads, manifolds, flow stations, and pipelines, that require proper decommissioning. Abandoned facilities scattered across the Niger Delta create a "risk of groundwater contamination, ecosystem damage, and serious human health issues".[116]

Accounting, disclosure, and audit regulators worldwide, including the FASB, SEC, and Public Company Accounting Oversight Board in the United States, should require corporations to include the costs of retiring fossil fuel infrastructure in their financial reporting. This is essential to investors having a clear understanding of the financial, regulatory, and legal risks and encouraging corporations to plan for asset remediation so that communities are not exposed to ongoing pollution from abandoned infrastructure. Lenders, insurers, and investors should include covenants in their financial contracts that promote responsible retirement of assets, putting more pressure on operators of this infrastructure to act responsibly.

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Further, corporate and sector-wide accounting for AROs and environmental remediation—both met and unmet obligations—is critical to establish appropriate contributions from fossil fuel firms and Global North countries into the recently created Loss and Damage Fund.

The International Energy Agency has stated that meeting the world's energy needs while achieving a global net zero by 2050 scenario will not require any new oil and gas fields beyond those already approved for development.[117] This means that further investments in fossil fuel expansion will either jeopardize the goals of the Paris Agreement and lock in local pollution for decades to come, or quickly become stranded assets; investors in fossil fuel expansion will have a financial interest in promoting the former outcome. Further, given the scarce capital available for energy development benefitting the Global South, investors should prioritize clean energy development which benefits the entire world, the relative attractiveness of which will be more evident if the full costs of fossil fuel development, operation, and retirement are accounted for.

Addressing U.S. financial firms' contributions to global systemic risk

Through the financing and underwriting of fossil fuel-related activities which contribute to climate change, large banks and non-bank financial corporations, including asset managers, private equity firms, and insurance companies, are creating and distributing risks to consumers and the financial system. Increased emissions heighten physical risks for consumers and other financial entities; for example increased emissions heighten climate-related acute and chronic weather events that impair infrastructure and the availability of public services such as water. And continued investments in fossil assets that are likely to become stranded, given policy and technological shifts to renewable energies, heighten transition risks for entities that invest in and purchase those assets from banks and non-banks.

Many Global South countries and residents are particularly vulnerable to the significant physical impacts and environmental and health risks that large U.S. entities are causing through financed fossil emission projects. These countries face significant exposure to climate hazards such as storms, floods, sea level rise, heat waves, and water stress, but with exceedingly limited fiscal space to reduce, avoid, or respond to this exposure. As a result, their capacities to pay their debts are compromised, their sovereign credit ratings are impaired,[118] and their abilities to raise funds to repair climate-related damage and build resilience—including by investing in physical infrastructure, social services, health, and education—are jeopardized. Threats to the financial health of these countries are not only unjust, but also endanger global financial stability, given global interconnectedness.

In this context, Treasury, FSOC, and U.S. regulators need to secure the adoption of macroprudential policies that provide a more just allocation of costs and financial risks. One key step, as discussed above, is for the agencies to require science-aligned transition plans to phase out financing of fossil assets. FSOC should also designate non-bank financial companies (NFCs), including large insurers, asset managers, and private equity firms, as systemically significant and subject to enhanced supervision and regulation by the Federal Reserve Board. Regulators should also impose, on these large banks and any designated NFCs, a macroprudential surcharge that disincentivizes support for greenhouse gas-emitting activities. Finally, regulators should explore other measures that shift costs and risks, such as a global reinsurance fund that could be established through fees proportional to emissions, with access contingent on commitments to no new financing or underwriting of fossil fuel assets.

PHOTO: ABIR ABDULLAH / CLIMATE VISUALS COUNTDOWN

Workers in Bangladesh sort out plastic bottles for recycling. Plastic production, use, and disposal not only poses an immense water and air pollution problem — it also exacerbates climate change due to its significant life cycle greenhouse gas emissions.

Cross-Border Trade Barriers and Considerations

The intersection of global trade and environmental protection presents a complex and contentious landscape, particularly when scrutinized through the lens of existing Bilateral Investment Treaties (BITs), Free Trade Agreements (FTAs),[119] and World Trade Organization (WTO) regulations. The entrenched power imbalances and the intricate web of trade rules, particularly in the financial services sector, pose significant challenges to equitable and effective climate action. This text explores these issues, highlighting the need for substantial reforms such as the removal of Investor-State Dispute Settlement (ISDS) and the enactment of a Climate Peace Clause to foster a more balanced and environmentally sustainable global trade system.

Problems with the status quo

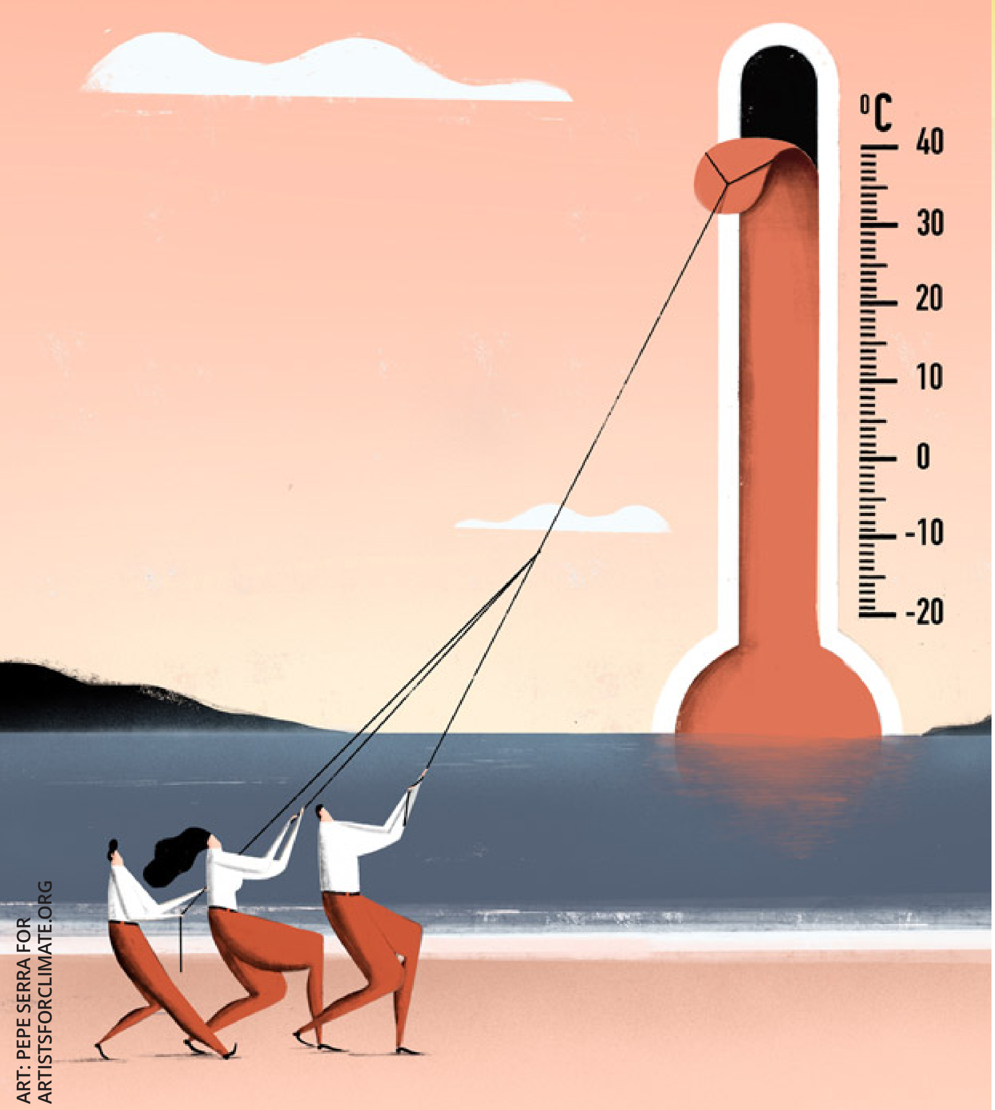
Many governing FTAs were written and enacted before the fight against climate change became a global priority, and include outdated trade rules that may inhibit bold climate action. Therefore, the actions necessary to meaningfully address climate finance gaps for the Global South are irreconcilably at odds with existing trade rules, in part because global trade rules create inequality between the Global North and Global South by catering to the former, often at the latter's expense.[120]

The WTO ostensibly operates by consensus and equal representation amongst all member countries, regardless of economic size or power. Theoretically, all members have an equal say in creating and shaping global trade rules. However, reality has never lived up to those principles, especially in the context of the power dynamics between the Global North and the Global South.

Decision-making within the WTO is heavily influenced by the economic and political power of the Global North. The majority of global capital is concentrated in Global North countries, giving them significant leverage in shaping global economic policies and trade rules. This power imbalance is reflected in the decision-making processes, where the interests and priorities of the Global North often take precedence, leaving the Global South noticeably underrepresented at the negotiating tables where broader international agreements are created. This underrepresentation is not just numerical but also qualitative, as these countries often lack the same level of resources, expertise, and diplomatic influence to effectively assert their interests.[121]

The so-called “green room” process that is often employed at the WTO worsens those inequalities. The green room is the informal name of the WTO director-general's conference room, and the green room process refers to undemocratic, private negotiations typically dominated by major players from the Global North, where crucial decisions are made outside the formal committee and decision-making structures that include all WTO members. These meetings have become common leading up to and during ministerial meetings, resulting in outcomes that reflect the interest of the powerful few and sideline the majority of WTO members, particularly from the Global South, from meaningful participation.[122]

This inequality results in trade rules and agreements skewed in favor of the Global North, with insufficient consideration for the developmental needs, economic vulnerabilities, and environmental challenges faced by countries in the Global South due in large part to extractive actions of Global North countries.[123] Instead, WTO trade rules reinforce existing inequalities, limit policy space for development, and constrain Global South nations’ ability to adopt domestic regulation that better suits their needs.



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One such example is the limitation of regulation of financial service sectors through the WTO's General Agreement on Trade in Services (GATS) and the financial service chapters of FTAs. The GATS, which all members of the WTO are party to, sets out rules for how countries can regulate their economies' service sectors, including the financial services sector.[124] The WTO Secretariat made the implications and reach of the GATS very clear: "Governments are free in principle to pursue any national policy objectives provided the relevant measures are compatible with the GATS."[125]

The limitations on regulating financial service sectors ban common forms of financial regulation, even if such policies apply to domestic and foreign firms equally.[126] Some countries have taken it further and committed to even greater deregulation by adopting an additional WTO agreement called the Understanding on Commitments in Financial Services.[127] The agreement binds the signatories to extremely broad WTO obligations to stay out of the regulation of banking, insurance, and other financial services.[128]

If the laws of any country in the WTO fail to comply with the rules set forth by the WTO or FTAs, the laws can be challenged before foreign tribunals, and the country may be subjected to trade sanctions until its laws comply.[129] Further, the investment chapters embedded in many FTAs even allow individual financial services firms to sue governments directly in extrajudicial tribunals to obtain compensation from the taxpayers for violations of their new trade agreement/ investor rights.[130]

The WTO's expansive reach on the financial service sector regulation not only guarantees foreign financial firms and their products access to markets but also limits how domestic governments may regulate foreign firms operating in their jurisdictions, even if for the protection of their people and environment.

WTO rules could be used to impede the financial regulation necessary to protect consumers and mitigate climate-related risk in the following ways:

1. **Certain forms of regulation are banned outright:** The WTO rules prohibit governments from setting limits on the size of financial firms, the types of financial services one entity may provide, or the types of legal entities through which a financial service may be provided in the broad array of financial services signed up to the WTO.[131] These WTO rules conflict with countries' efforts to put size limitations on banks (so that they do not become "too big to fail") and to "firewall" different financial services (a policy tool used to limit the spread of risk across sectors, as Glass-Steagall did between commercial and investment banking).[132] Proposed policies such as those designed to ensure that large banks maintain sufficient capital to respond to significant risks, including climate-related risks, could be potentially challenged.[133]

PHOTO: RUSSELL WATKINS / DFID

A 62-year-old Tanzanian woman who now has solar lighting and electricity in her home at the flick of a switch.

2. **No bans on risky financial service "products" in committed sectors:** A WTO tribunal already ruled that a ban, even if it applies to domestic and foreign firms alike, constitutes a forbidden "zero quota" that violates service sector market access obligations.[134] This restriction conflicts with proposals to ban various risky investment instruments, such as certain derivatives, which might be considered in a policy toolkit for climate-related financial regulation.

3. **No new regulation:** Some countries agreed to a "standstill" provision, which requires that they not enact any new regulations (or reverse trade liberalization) for the list of financial services bound to comply with WTO rules.[135] Indeed, when regulators began to issue new rules in the United States after the passage of the Dodd-Frank financial re-regulation law in 2010, European and other financial firms claimed that some of the strongest proposals violated WTO rules.[136]

   This restriction is particularly harmful to addressing climate change, as it could hamper the implementation of critically important policy tools needed to mitigate climate-related financial risk and support the transition to a clean energy economy. With less influence in the WTO and more vulnerabilities, Global South nations may face even greater constraints than Global North nations when attempting to enact similar climate-related financial regulations.

4. **Treating foreign and domestic firms alike is insufficient:** The WTO's market access limits on domestic regulation apply in absolute terms. In other words, even if a policy applies to domestic and foreign firms alike, if it goes beyond what WTO rules permit, it is forbidden.[137] Additionally, forms of regulation not outright banned by these rules must not inadvertently modify "the conditions of competition in favor of services or service suppliers" of countries, even if they apply identically to foreign and domestic firms.[138]

5. **Other non-discriminatory domestic regulations also subject to review:** WTO rules subject policies of general application that may affect financial service sector firms to review, with WTO tribunals empowered to determine if they are "reasonable," whether they "could not reasonably have been expected," and whether licensing and qualification requirements and technical standards limit foreign firms' access.[139] The urgency of climate change demands that governments enact climate-related financial regulations deemed beneficial for their financial system and consumers without concern for a potential "review" of those policies by an unaccountable trade tribunal.

The only exception to these rules is viewed by many as woefully insufficient to protect policy space. The WTO rules and some FTAs contain a "prudential exception" that can be invoked as a defense if a financial policy is challenged.[140] However, the provision contains a clause that many deem "self-canceling." That is to say, the effectiveness of the provision is, at best, contested in that its acceptable use is explicitly limited to circumstances where invoking the exception does not contradict a country's trade pact commitments.[141] Essentially, this simply means that a country would only use the provision if they believed that a particular financial policy would contradict the WTO trade agreements.

Remove investor-state dispute settlement

Since the 1960s, BITs and, starting in the 1990s, FTAs have included ISDS clauses, granting multinational corporations the power to sue governments in front of secret, ad-hoc tribunals typically composed of three corporate lawyers.[142] The corporations only need to convince the tribunal that a domestic law or policy—even if protecting the public at large or the environment—violates their rights as investors under trade agreements.[143]

An ISDS tribunal can issue an award and order governments to pay corporations unlimited sums of taxpayers' money, including for the loss of "expected future profits" that the corporation would have earned if not for the domestic law.[144] The awards are final and cannot be appealed, and therefore, the governments have no choice but to comply with the enforcement.[145] Even if a case is dismissed, the governments are typically responsible for paying their own legal and arbitration fees, often resulting in millions of wasted taxpayers' dollars that could have gone to public funding.[146] By elevating individual corporations to the same status as sovereign governments, ISDS drastically consolidates and formalizes corporate power, acutely affecting the Global South.

Consequently, corporations have fully taken advantage of the ISDS system by extracting egregious sums from host countries, undermining attempts to regulate climate policies.[147] ISDS cases are primarily conducted in international arbitration forums such as the World Bank's International Centre for Settlement of Investment Disputes and the United Nations Commission on International Trade Law, leading to a complex web of confidentiality, limited public participation, and legal uncertainty.[148]

It is important to note the inequitable nature of ISDS, as it disproportionately impacts countries in the Global South. In Latin America, governments in the region have paid $33.8 billion to corporations in awards and settlements, with many of these ISDS claims stemming from environmental regulations.[149] ISDS is detrimental to economies in the Global South, such as in the case of *Próspera v. Honduras*, in which a U.S. corporation has sued the Honduran government for two-thirds of the country's national budget, up to $11 billion, for repealing a law that allowed foreign corporations to establish private cities within the country.[150]

The actions necessary to meaningfully address climate finance gaps for the Global South are irreconcilably at odds with existing trade rules, in part because global trade rules create inequality between the Global North and Global South by catering to the former, often at the latter's expense.

Peru was ordered to pay an estimated $30.4 million for halting a silver mining project due to concerns of pollution and environmental degradation.[151] Similarly, Mexico was ordered to pay around $40 million to a

Spanish firm after Mexico refused to grant the company permits to operate a waste management facility following concerns about ecological hazards.[152] Efforts to protect the environment have often conflicted with investment protections, and trade deals do not protect the environment to the same degree they protect investments.

Governments may feel constrained from enacting domestic regulations to safeguard the environment or protect public health and safety under the threat of potential ISDS cases, as there would be major financial implications if foreign investors were to take legal action based on adverse investment damages. Sometimes just launching an ISDS claim can chill regulatory action by governments before the case advances, forcing governments to change or reverse domestic policies to avoid costly litigation or limit the sum they would be forced to pay otherwise.[153] For example, in *Philip Morris v. Uruguay*, American tobacco giant Philip Morris sued Uruguay for requiring large warnings on cigarette packaging to inform consumers of the health risks associated with smoking tobacco as part of its public health policy reform.[154] Philip Morris argued that Uruguay's policy reform reduced the value of its investment, thus expropriating it.[155] Although the tribunal ultimately sided with Uruguay, the possibility of losing in a similar case discouraged other countries from adopting similar measures. Singapore and New Zealand planned to launch similar plain tobacco packaging policies for public health but delayed doing so until the ISDS dispute against Uruguay was finalized.[156]

Further, ISDS hinders cross-border collaboration in developing international environmental agreements by providing corporations an avenue to challenge such initiatives. When countries attempt to create unified environmental policies or agreements to address global issues such as climate change, ISDS allows corporations to sue governments if these policies are perceived to infringe on their broad investor rights. This legal mechanism could deter governments from pursuing ambitious environmental collaborations for fear of costly legal battles. As a result, the mere threat of ISDS claims can undermine international efforts to establish cohesive and effective environmental standards, impeding progress toward sustainability goals.[157] The European Union recently exited the Energy Charter Treaty, which granted ISDS powers to fossil fuel companies, citing concerns that it undermined the fight against climate change.[158]

The number of ISDS cases and breadth of policies being challenged are increasing rapidly, and governments are growing concerned about the system's threat to democracy, taxpayers, and domestic public interest regulation. Consequently, countries such as Bolivia, Ecuador, Honduras, India, Indonesia, Pakistan, South Africa, and Venezuela have taken steps to curtail their ISDS liability.[159]

There is also growing bipartisan support in the United States government to remove ISDS from U.S. trade agreements. Bipartisan opposition to ISDS was a key reason that the Trans-Pacific Partnership, negotiated during the Obama administration, did not receive majority support in Congress.[160] Republican members of Congress wrote to United States Trade Representative Robert Lighthizer during the renegotiation of the North American Free Trade Agreement (NAFTA), urging for the removal of ISDS, citing Chief Justice John Roberts to explain the impacts of ISDS sovereignty as it "effectively annul[s] the authoritative acts of its legislature, executive, and judiciary."[161]

Thus, during the Trump administration, the United States-Mexico-Canada Agreement (USMCA) phased out NAFTA's ISDS provisions, eliminating ISDS between Canada and the United States and drastically reducing its scope between the two countries and Mexico.[162] President Biden has committed to not including ISDS in future trade agreements, echoed by U.S. Trade Representative Katherine Tai.[163]

Nevertheless, ISDS provisions persist in many existing trade agreements, and its eradication from all trade agreements would constitute a significant step forward in safeguarding the environment and promoting equitable trade practices.[164] In May 2023, Senator Elizabeth Warren and Representative Lloyd Doggett, alongside numerous other congressional signatories, sent a letter to the U.S. Trade Representative Katherine Tai, urging the government to "investigate and pursue an effective path to removing consent to ISDS arbitration by the U.S. and our treaty partners in

PHOTO: LANCE CHEUNG/U.S. AIR FORCE

A technician inspects a wind turbine on Ascension island (a 35 square miles in a remote island location midway between Brazil and Angola).

existing bilateral investment treaties and free trade agreements … signaling to trading partners that they will not be penalized for prioritizing the public interest."[165]

Enacting a climate peace clause

Climate and public interest groups have been urging governments to commit to a Climate Peace Clause, which would be a time-bound, self-enforced commitment from governments wherein they pledge to abstain from using state-to-state dispute settlement mechanisms at the WTO, in FTAs, or in investment treaties to challenge climate-related mitigation and adaptation efforts, clean energy transition initiatives, or related financial regulations of other nations.[166] Commitments to a Climate Peace Clause, especially by governments in the Global North, would be an important step toward ensuring that governments have the policy space to adopt the necessary financial regulation measures to tackle climate change.

The Climate Peace Clause commitment would extend to any measure that the adopting nation can substantiate as aiming to reduce greenhouse emissions, promoting the shift toward a clean energy economy, or mitigating climate-related financial risk, vulnerability, and instability. Essentially, the Climate Peace Clause would safeguard measures falling within its scope against disputes initiated by other signatory nations.[167]

Protecting countries that enact domestic policies aimed at environmental conservation while also preventing them from facing penalties should those measures interfere with trade would allow governments to take action without fear of adverse consequences. Commitments to a Climate Peace Clause by governments would protect climate-related financial regulation from being challenged at the WTO or through new and existing trade agreements.

In the United States, more than 150 environmental organizations[168] and nearly 200 state legislators[169] have urged the U.S. government to promote a Climate Peace Clause under which governments agree not to use trade rules to attack one another's climate policies.

Public Finance

Public financial support from the Global North must be expanded and reoriented towards building climate resilience and facilitating a just transition in the Global South. Major structural shortcomings in the global financial architecture present challenges that will require substantial reform to overcome. In this section, we highlight how the International Financial Institutions have contributed to the sovereign debt trap for many Global South countries, and discuss what U.S. policymakers should do to support a more equitable global public finance architecture.

International Financial Institutions and the sovereign debt trap

The World Bank and the International Monetary Fund (IMF) were created in the aftermath of World War II to promote global trade and development, and to foster a united, global economy.[170] They have been widely criticized, however, for advancing policies and practices that have harmed middle- and low-income countries in the Global South.

The IMF was designed to secure international monetary cooperation, stabilize currency exchange rates, and expand international liquidity,[171] while the World Bank was established to grant loans for post-World War II construction through the International Bank for Reconstruction and Development.[172] These two organizations, along with the World Trade Organization (WTO), founded in 1995, have since grown into the dominant institutions of international capital, and they have also been widely accused of coercing the Global South into trade and development deals with inequitable conditions.[173] The IMF, in particular, has been criticized for serving as a tool for wealthier countries to exploit countries in the Global South through the use of restrictive conditionalities on social and economic policy. Critics assert that the IMF imposes unjust political and economic conditions—including unreasonably high interest rates and abusive surcharges on loans—with enforcement mechanisms that enable further extraction of a country's resources in case of default.[174]

Through such levers, these institutions have significantly influenced Global South economic policies and practices, frequently in ways which are hugely detrimental to progress on climate change and climate justice.[175] World Bank and IMF policies have, for example, fostered a privatization and commodification of natural resources—facilitating their sale for private profit, rather than their protection for the public good. This has impaired the property rights of local communities and, in turn, weakened community access to and protection of resources needed to respond to climate change. These policies weaken, for example, local community access to crops and water, and local community protection of forests and water.[176] In Mexico, post-North American Free Trade Agreement (NAFTA), community-owned agricultural land was appropriated from communities for private profit, and communal water rights were privatized.[177] Similarly, under the heavy influence of the World Bank, water was privatized in certain communities in Bolivia.[178] This focus on the privatization of resources has been a common goal of these institutions across the Global South. As community rights are impaired, community capacities to protect resources are impaired. Research has established that "lands managed by local peoples with secure rights experience lower rates of deforestation, store more carbon, hold more biodiversity, and benefit more people than lands managed by either public or private entities."[179]

The World Bank and the IMF have also been accused of predatory lending practices that keep Global South countries impoverished by debt.[180] These practices include enforcing structural adjustment programs[181] as

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prerequisites for loans, particularly affecting governments that view such loans as a last resort.[182] Both institutions have systematically utilized loans to influence state policies, while geopolitical factors rather than economic conditions have often influenced the IMF's loan distribution.[183] In 2021, Oxfam published a report that showed how the IMF used its influence to impose strict financial measures on economically disadvantaged countries through COVID-19 pandemic relief loans.[184] The report also revealed that in 16 West African countries, IMF policy reforms have historically resulted in a decrease in healthcare investment. This debt and the resultant poverty and reduced capacity to invest in healthcare severely disadvantages Global South countries attempting to adapt and become more resilient to climate change.

Finally, despite their tremendous resources and mandate to boost global prosperity, these institutions have an abysmal record of aligning their policies and practices to measures needed to tackle climate change and its disproportionate impact on Global South countries. When, for example, they could have been financing and otherwise creating conditions for renewable energy projects—and, in turn, helping Global South countries leapfrog the disadvantages associated with carbon-intensive development—they, instead, continued to support coal and oil and gas extraction in these countries.[185] Moreover, while the World Bank Group recently raised its target for climate-related projects, billions of dollars were poured into fossil fuels as recently as 2022, raising serious concerns about the Bank's commitment to addressing the climate crisis.[186]

Due to their policies and governance structure, the World Bank and IMF have too often heightened inequality and hindered progress toward climate justice in the Global South. Addressing these issues will require thoughtful, concerted efforts to reform lending policy and practices, fulfill financial commitments, increase authoritative representation from Global South leaders, and foster equitable global cooperation,including by providing finance, aid, capacity building, and technology transfer to the Global South.

Reforming the International Financial Institutions

A Global South response to several shortcomings of public finance described above has been advanced by the Bridgetown Initiative,[187] led by Prime Minister of Barbados Mia Mottley. The Initiative was established to secure immediate financing to address the climate crisis and other needs, and to usher in longer-term reforms to the international financial architecture for public finance and trade.[188] The Initiative's first proposal—a loss and damage fund to help climate-vulnerable countries and to respond to climate justice concerns—was adopted at the 2022 United Nations (UN) climate change conference (COP27). The modalities for this fund were established at COP28 in 2023, with the World Bank serving as the interim host. Many civil society organizations (CSOs) in Global South countries view the Initiative as a step forward, but are concerned that Global South countries lack information needed to ensure its responsiveness to local community needs. With the support of the UN, the group has more recently offered Bridgetown Initiative 2.0.[189]

Key elements of the Bridgetown platform include:

1. **Debt Relief and Restructuring:** The initiative calls for a comprehensive approach to debt relief and restructuring, one that responds to the unsustainable debt levels of Global South countries and recognizes that debt is exacerbated by crises like the COVID-19 pandemic. It calls for a pause on debt payments for countries affected by disasters, to enable their focus on immediate relief and rebuilding, as well as a restructuring of debt with long-term low interest rates.[190]

2. **Access to Finance for Climate Action:** Recognizing the disproportionate impact of climate change on small and vulnerable economies, the Bridgetown Initiative emphasizes the need for better access to finance for climate adaptation and mitigation. This includes calls for expanding International Financial Institution (IFI) lending by $1 trillion and exploring innovative financing mechanisms that contribute to the economic development of small and vulnerable economies.[191]

3. **Special Drawing Rights (SDRs):** The initiative advocates for reallocating SDRs from wealthier nations to developing countries. SDRs are international reserve assets created by the IMF to supplement member countries' official reserves. More specifically, the proposal would rechannel at least $100 billion of unused SDRs through the IMF and multilateral development banks to provide immediate liquidity support for developing countries.

PHOTO: GEORGINA SMITH / CIAT

Testing the results of minimum tillage to integrated soil fertility management practices in Western Kenya.

4. **Global Public Investment:** Global public investment is central to the Bridgetown Initiative, emphasizing the need for collective investment in global public goods, such as health systems, climate resilience, and sustainable development.

5. **Reform of International Financial Institutions:** The initiative calls for the reform of international financial institutions, like the IMF and the World Bank, to make them more responsive to the needs of developing countries and to ensure fair representation and decision-making.

6. **Reform of International Trade System:** The Initiative advocates for an international trade system that supports global green and just transformations through resilient supply chains that benefit countries that possess raw materials.[192] Moreover, the focus on maximizing GDP must, instead, be replaced with a focus on establishing a healthy and just planet.

Under current conditions, the International Financial Institutions cannot credibly implement the Bridgetown Initiative. Since these institutions are largely influenced by Global North powers, a significant change in political dynamics will be required to pass many of Bridgetown's proposed reforms. Although many CSOs and Global South countries have demanded reforms to decision-making processes at these institutions, the necessary political will to support critical reforms has not materialized.[193] The WTO, preferential trade and investment agreements, dispute settlement bodies, and standard-setting bodies, among others, currently serve as hurdles to accomplishing many of these reforms.[194] The success of the Bridgetown Initiative in making meaningful impact requires institutional reform of the WTO, World Bank, and IMF, including to their goals. A "just transition" that responds to Global South perspectives and needs must become the priority.[195]

The Bridgetown Initiative reflects a growing recognition of the need to address systemic inequalities in the global financial system and to ensure that it serves the needs of all countries, particularly those most vulnerable to external shocks and global challenges like climate change.

Research has established that "lands managed by local peoples with secure rights experience lower rates of deforestation, store more carbon, hold more biodiversity, and benefit more people than lands managed by either public or private entities."

Recognizing the need to reform public finance to support climate goals, the World Bank has proposed an "Evolution Roadmap" to revise the vision and mission and operating model of the Bank.[196] The current proposal acknowledges and attempts to address constraints facing developing countries in responding to climate change, but several shortcomings have been identified. The proposal, for example, does not give quantifiable goals or a timeline for what it hopes to achieve on the challenges of climate change.[197] One group estimates[198] that the World Bank must deliver finance in the range of $100 billion per year to have a meaningful impact on climate change—finance not clearly offered in the proposal.

Currently, the United States is the largest shareholder and has the largest percentage of voting power at the World Bank. The Department of Treasury, which leads U.S. engagement at the World Bank,[199] should push for quantifiable goals, timelines, and indicators in the World Bank's proposed Evolution Roadmap to ensure that climate change-related challenges for Global South countries are actually robustly addressed, as well as for voting structure reform to remedy the current North-South imbalance. It should also support the fundamental reforms to the World Bank advanced under the Bridgetown Initiative, including around addressing the power asymmetry and boosting representation and influence of Global South countries in policy and financing decisions.

Existing and Emerging Finance Mechanisms Intended to Bridge the Climate Investment Gap

Many financing mechanisms and products—public, private, and blended—have been proposed and developed over time in an attempt to close the staggering climate finance gap in the Global South. However, public and private actors have consistently fallen short of providing promised funds or of providing debt-free funds. A 2024 report by Oxfam estimates that for 2022 the "true value" (i.e., the value of climate-related loans calculated by their grant equivalents rather than at face value) of climate finance provided by Global North countries was only between $28 billion and $35 billion, whereas $100 billion per year was promised from 2020 onward. $92 billion of the $116 billion that was reported as mobilized climate finance by the Global North in 2022 was public finance, and 70% of that was committed to in the form of loans.[200]

This section will discuss prominent potential solutions that state and financial actors are attempting to scale, and will highlight guardrails that are needed to promote a just transition. Note that none of these potential solutions are sufficient to address the full range of complex climate, development, and economic challenges facing Global South countries.

Loss and damage funds

In the context of international climate negotiations, although there is no agreed-upon definition, "loss and damage" generally refers to economic and non-economic losses from climate disasters and chronic conditions such as wildfires, floods, droughts, famine, and extreme heat. Non-economic losses can include loss of life, the displacement of communities and their history or culture, or loss of biodiversity.[201] Loss and damage accounts for the effects of climate change that are beyond the capacity of human adaptation or, in cases where solutions are theoretically available, where a community lacks the resources to access them. This can involve the destruction of coastal heritage assets as a result of increasing sea levels or the fatalities and property losses resulting from severe flooding, slow-onset events, or other extreme weather events.[202]

Financing adaptation measures in the Global South is essential to minimize further loss and damage as the world simultaneously ramps up urgently needed greenhouse gas mitigation efforts. Unfortunately, the adaptation finance gap is growing rather than closing, as climate change outpaces efforts to ramp up financial resources.[203]

According to one study, the Global North is responsible for 90 percent of excess emissions, which are the primary driver of climate change and the attendant loss and damage in the Global South.[204] However, Global North countries and corporations responsible for the emissions have largely refused to pay for damages they are causing. Fossil fuel emissions have played a significant role in exacerbating the climate crisis and its harms while fossil fuel companies have profited greatly; the oil and gas sector has generated an average of $1 trillion per year in annual profits for the last 50 years.[205]

Most of the world's poorest countries are threatened with injustices caused by the extractive activities of the

PHOTO: MOHAMED SEENEEN

Minister of Fisheries and Agriculture of the Republic of the Maldives Dr. Ibrahim Didi signs the decree of an underwater cabinet meeting, calling on countries to cut down carbon dioxide emissions ahead of a major UN climate change conference in the Maldives, October 17, 2009.

Global North's largest corporations, particularly fossil fuel firms. One recent article argues that the top twenty-one fossil fuel companies should be held financially liable and together pay $209 billion in reparations annually over a 25-year period, to compensate as a result of their environmentally destructive, unsustainable activities.[206] This is one of the first attempts to quantify the financial responsibility of corporations that have profited from the extraction and continued use of fossil fuels. The study further projected that the top 21 polluters will be responsible for causing $5.4 trillion in climate-related disasters between 2025 and 2050, such as droughts, wildfires, rising sea levels, and melting glaciers. Fossil fuel and other large corporations have also sowed seeds of doubt among the public about the reality of climate change and successfully lobbied governments for decades against policy changes that would have resulted in clean energy alternatives to their products far sooner, and less climate change today.[207]

One region where the disproportionate impacts of Global North emissions on the Global South are particularly stark is Sub-Saharan Africa. Despite being the smallest continental contributor to greenhouse gas emissions, the region and Africa at large face the greatest vulnerability to the impacts of climate disasters.[208] This region accounts for two-thirds of the global extremely poor population,[209] and its poverty rate is decreasing at a slower pace than any other part of the world.[210] In this context, loss and damage is an attempt to address the disproportionate impacts of climate change in Africa, Latin America, the Caribbean, South Asia, and other Global South regions and countries.

At COP28, parties agreed to operationalize a funding mechanism for loss and damage known as the Loss and Damage Fund (LDF) with an initial capitalization of $700 million. Stakeholders expect the funds in the LDF to increase as more countries in the Global North disclose their financial commitments to supporting the recovery of communities most vulnerable to climate disaster in the Global South.[211] At $700 million, the current funding of the LDF is not even 1 percent of the amount of money needed by the Global South through 2050.[212]

In order to remedy some of the harm done to the Global South, wealthy countries and the large corporations responsible for fueling the climate crisis should contribute at least $400 billion annually to the LDF by the 2030s and through the 2050s. A recent study by the international think tank Climate Analytics found that the top 25 oil and gas firms have been so profitable in the period from 1985 to 2018 that they could have contributed the estimated $20 trillion incurred in global loss and damages due to their activities and still made a profit of $10 trillion.[213] If these firms contribute to the LDF on an ongoing basis, it would free up fiscal space for Global South countries to meet their rising energy and forward-looking climate investment needs.[214] Contributions to this fund should be determined by considering each party's historical responsibility for and capacity to have addressed and mitigated its emissions.

The World Bank was selected as the interim host of the LDF, but many critics argue that it is not independent enough to host the LDF, will not give communities direct access to the funds, and will maintain the problematic status quo of Global North empowerment to decide how finance will flow to the Global South.[215] Other critics argue that the World Bank's hosting fees—administrative charges, overhead fees, and costs of services[216]—are not competitive enough to draw in private capital and that those fees are exorbitant and rising.[217]

The World Bank has yet to be confirmed as the permanent host[218] and concerns from the Global South should be heeded that another entity is needed to host the LDF. The United Nations (UN) is not immune to similar criticisms, for example, the Santiago Network—which was established in 2019 to advise on loss and damage and which is hosted by the UN Office for Project Services and the UN Office for Disaster Risk Reduction—chose a Global North country (Switzerland) to be the physical location for the network headquarters instead of one of the proposed African cities.[219]

Furthermore, the development and implementation of this initiative must involve direct participation of representatives from communities across all countries in the Global South who are most affected by the

PHOTO: ABIR ABDULLAH / CLIMATE VISUALS COUNTDOWN

In 2007, extreme flooding in Bangladesh destroyed 332 schools and damaged 4,893 others. Flloating schools, libraries, health clinics, solar workshops and floating training centres with wireless internet access, serving close to 97,000 families in flood-prone regions.

impacts of climate change-induced disasters through a broad, inclusive consultation process.[230] Finally, and most importantly, the LDF should be managed by a body that is truly representative of the Global South, and democratic and inclusive in its process. Countries in the Global North should not use their contribution as a means to control this new body and dictate self-interested terms when the purpose of the LDF is to recognize disproportionate impacts of climate change hazards on the Global South.

Green, social, and sustainability bonds

The growing green bond market may provide a useful opportunity for investors to finance climate projects in the Global South, if these bonds are issued under rigorous standards with adequate transparency and safeguards. Green bonds, sometimes called "environmental" bonds or "climate" bonds,[221] function the same as most traditional bonds in that they are fixed-income debt instruments most often issued by local governments, financial institutions, or other corporations to finance large, capital-intensive, climate or environmentally oriented projects[222] such as energy efficiency project, sustainable agriculture, or renewable energy.[223]

We note that while investment in climate change mitigation, adaptation, and other environmental objectives is critical, Global South countries face challenges around employment, affordable housing, utilities, healthcare, education, and reconnecting to Indigenous knowledge systems which have been diminished by colonialism. The urgency to mitigate climate change through green bonds should not overshadow the importance of broader environmental, social and sustainability, and economic development objectives.

Another important category of bonds are "social" bonds,[224] which raise capital for projects with positive social outcomes, such as improving food security and access to education, healthcare, and financial services.[225] Social bonds have been issued less than green bonds, but can also provide important benefits.[226] Given the minimal issuance of social bonds, but the importance of social benefits for any projects in the Global South, sustainability standards that would require projects that address both types of positive impact are ideal. For this, sustainability bonds exist, which direct proceeds toward positive environmental and/or social impact projects or activities.[227] This section will speak primarily to green bonds because they are currently the most commonly issued type, but regardless of what a bond is called, climate-related projects or activities financed in the Global South should ensure environmental *and* social benefits—and guard against negative externalities.

In addition to the issuer and the investor, third-party firms[228] are usually involved in underwriting, certifying, and monitoring the issuance of green bonds, but there are no established international regulatory standards for green bonds. The Green Bond Principles ("the Principles")[229] and the voluntary Climate Bonds Standard and Certification Scheme ("the Standard")[230] are commonly used by issuers and third-party firms, but green bonds aligned with the European Union and China have been on the rise as well (see below). Ultimately, standardization and regulatory oversight will be important to produce equitable outcomes.

The Principles provide guidelines for transparency, disclosure, and integrity in the green bonds market to facilitate the tracking of funds to environmental projects. They explicitly recognize a few broad categories that contribute to environmental objectives including climate change mitigation, climate change adaptation, natural resource conservation, biodiversity conservation, and pollution prevention and control. The Principles emphasize the importance of green bond issuers communicating with investors, and recommend that issuers complete an annual report listing the projects to which green bond proceeds have been allocated, a brief description of the projects, the amounts allocated, and their expected impact.[231]

The Climate Bonds Standard and Certification Scheme launched in 2012 and run by the Climate Bonds Initiative goes further than the Principles by using scientific criteria to label certified investments in climate mitigation if they correspond with the 1.5 degree Celsius warming limits of the Paris Agreement.[232] Certification with this Standard confirms alignment with the Principles. The Standard has sector-specific criteria and issues certification after the issuer completes the application, and the Initiative confirms the certification at the end of the project only after receiving a post-issuance certification report. The Initiative keeps a public database of all certified bonds and loans that have been issued, though many of the issuing amounts are kept confidential.[233]

The Climate Bonds Initiative is governed by a Trustee Board, with an advisory panel of mostly Global North experts. The Governors of the Climate Bond Initiative also have a Climate Bonds Standard Board that consists of not-for-profit institutional third-party investor organizations; however, all of the advisors are based in the United States, the United Kingdom, or Australia, highlighting the need for more Global South voices and leadership in the space.

Demand for green bonds has been greater than supply, a gap which worsened in 2022 after a 25.6 percent decline in green bond issuance.[234] Nonetheless, the demand and predicted market for green bonds continues to grow, raising the possibility that they can serve an important role in facilitating climate investment. The first half of 2023 showed a rebound with new issuance reaching more than $300 billion—the biggest ever half year of issuance[235]—and the green bonds' lifetime aligned total reached $2.6 trillion by the third quarter of 2023.[236] Energy, buildings, and transportation are the three largest categories for green bond capital, collectively contributing 77 percent of the total international green debt volume. There does seem to be a slow trend toward financing a broader range of projects in other categories, such as water, waste, and land use.[237]

Technical assistance is a critical component to engaging new markets in Global South regions to build local knowledge and technical capacity.

While European firms have a longer track record of issuing green bonds, some market analysts predict more participation from the United States and from other emerging market issuers moving forward. In the first half of 2023, the issuance of green bonds was dominated by Global North countries, with China, Germany, Italy, Netherlands, and the United States issuing the largest sums. All regions experienced growth in issuance of green bonds except Africa and Latin America.[238] Africa has seen less than 1 percent of global green bond issuance, a disparity that must be remedied for finance to reach the areas most in need of safe and equitable climate investment.

In December 2023, the African Development Bank Group signed a joint partnership agreement with the coalition of development finance institutions of the EU Global Green Bond Initiative (a consortium of European development finance institutions and the Green Climate Fund) to collaborate on technical assistance that promotes green bond markets in Africa. The EU Global Green Bond Initiative is also engaging with Latin America and the Caribbean for the same purpose. The Initiative aims to generate from €15 billion to €20 billion in green investments, by drawing in private investors through a dedicated de-risked fund, which would act as an anchor investor in these green bonds.[239]

Non-European Global North development banks and other multilateral institutions should join the EU Global Green Bond Initiative or develop a similar one of their own, and focus on project development in the Global South, given that the Global South has continued to experience underdevelopment and underinvestment despite economic prosperity that Global North countries have already extracted for themselves from these regions. Technical assistance is a critical component to engaging new markets in Global South regions to build local knowledge and technical capacity. 'De-risking' investment is an additional step that public institutions may be willing to take with the engagement of reliable private capital, though it should be noted that where 'de-risking' mechanisms imply a significant transfer of risk from the private to the public sector, it can also create public costs.

ART: SILVANA P. DUNCAN FOR ARTISTSFORCLIMATE.ORG

In the last two years, two of the largest green bond market jurisdictions—Europe and China—have set green bond standards. The European voluntary green bond standard[243] requires that 85 percent of the funds raised by the bond be allocated to economic activities that align with the EU Taxonomy for sustainable activities, which defines green economic activities, requires a baseline of transparency, and establishes supervision of corporations carrying out pre- and post-issuance reviews.

Many stakeholders have expressed concerns with the Taxonomy's inclusion of fossil gas and nuclear activity, which have been labeled as "transitional activities" as a subcategory in the Taxonomy. Under the Taxonomy, fossil gas activities must meet specific emission thresholds, should replace an existing coal facility that cannot be replaced by renewables, achieve certain targets in terms of emissions reductions, and fully switch to renewable or low-carbon fuels[244] by 2035. For nuclear, the Taxonomy allows investments in new nuclear plants and upgrades or modifications to existing plants, with certain stipulations around comprehensive nuclear safety and waste management requirements.[245] Many other countries and regions are influenced by decisions in the EU and the Taxonomy in particular, including its allowance for fossil gas; however, it is important to note that some countries like Colombia, Mexico, China, and South Africa did not include fossil gas in the first versions of their taxonomies.[246]

In the United States, financial regulators like the U.S. Department of the Treasury (Treasury), the banking regulators, and the Municipal Securities Rulemaking Board have a role to play in the regulation and supervision of a safe and equitable use of green bonds when their regulated entities issue, underwrite, or invest in these bonds. The Securities and Exchange Commission also has a role in regulating green bond mutual funds and exchange-traded funds,[240] and the Federal Housing Finance Agency has a role as the conservator of Fannie Mae and Freddie Mac, since both government-sponsored enterprises issue green bonds (under their own frameworks).[241] Fannie Mae was the largest global green bond issuer for the decade from 2010 to 2020.[242]

China has a similar approach to the EU, with the China Green Bond Principles (CGBP).[247] Aligned with the Green Bond Principles, the CGBP requires that 100 percent of green bond proceeds be used for green projects,[248] as outlined in China's Green Bond Endorsed Project Catalogue,[249] which functions similarly to the EU taxonomy. Unlike the Principles, the CGBP does not clarify disclosure requirements on the issuer's ESG risk-management process or the disclosure of environmental performance indicators such as greenhouse gas reduction or renewable energy capacity.[250] The lack of disclosure for the CGBP is particularly problematic for social factor concerns in green bonds issued, and should not be adopted by other countries.

To encourage rigor and accountability as the green bond market continues to grow, Treasury can establish green bond standards, principles, or a taxonomy for U.S. issuers. Those standards could help attract investment for certified public projects for sustainable development and infrastructure domestically and abroad, with lower risk and lower cost capital for borrowers. If Treasury adopts a standard it should consider working closely with the existing voluntary standard setters, China, and the EU, to facilitate alignment to the highest standards. Another option is for Treasury to issue a mandatory transparent reporting framework for corporations, financial institutions, and investors for green bonds, so that all stakeholders are held accountable for their actions and commitments toward the promotion of environmental sustainability, especially in the Global South, and to attract more investors to the market by improving data access and transparency.

Success will depend partly on the promotion of more leadership and advisory positions for Global South representatives across all public and private initiatives, including for existing voluntary green bonds frameworks and standard setting. Treasury could request to be an observer for the Green Bond Principles, and in that role request prioritization of outreach to expand the list of members and observers to smaller, underrepresented countries in the Global South.[251]

To meet international climate change and development goals, more climate mitigation and

Janet Yellen, Secretary of the Treasury, United States (left) and Ngozi Okonjo-Iweala, Director-General, World Trade Organization (right) attend the Development Committee Meeting of the IMF/World Bank in Washington, D.C. in October 2022.

PHOTO: WORLD BANK / GRANT ELLIS

adaptation projects are needed on the ground in the Global South—and green bonds are one potential mechanism for public and private investors in the Global North to help support development of those projects, particularly those at larger scale. As with many investment products, there are valid concerns about industry greenwashing, particularly when monitoring, supervision, and enforcement for bond financing in meeting its objectives are lacking. That can result in, for instance, the financing of non-green projects or the issuance of bonds by polluting corporations without detailed decarbonization objectives and commitments to stop financing fossil fuel expansion projects at the same time.[252] Reporting mechanisms and performance assessments of green bonds must be robust to minimize the potential for greenwashing.

Given the climate change and development goals of the Global South, U.S. investors, regulators, and corporations should encourage development of more robust sustainability bond standards because all bonds issued in the Global South should meet environmental and social objectives particularly because of historical colonial exploitation and the continuing practice of extractivism from the Global North. Finally, regarding transparency it is important that public and private investors for any of these bonds request disclosure from issuers on any potentially negative social and environmental impacts and mitigation plans for such impact, particularly for projects in the Global South.

Just Energy Transition Partnership

Over the past decades, various forms of public-private climate financing mechanisms have been created and funded, including the Global Environment Facility, the Climate Investment Funds, and the Green Climate Fund, but none of those funding frameworks has fully succeeded in achieving the anticipated levels of public and/or private financial flows.

The newest mechanism, the Just Energy Transition Partnership (JETP),[253] aims to help countries reduce power infrastructure generated by coal and develop just transition plans for dislocated workers and communities. In 2021, the governments of South Africa, France, Germany, the United Kingdom, the United States, and the European Union committed to the mobilization of $8.5 billion via grants, concessional loans, and risk-sharing instruments in order to accelerate the decarbonization of South Africa's economy, with a focus on the electricity system.[254] However, two years into the decarbonization effort, progress has been slow, with South Africa having closed just one coal-fired power station, with five more power station closures delayed to 2032.[255] Plans for JETP projects in Indonesia and Vietnam faced challenges raising capital but are both now moving forward based on recent announcements at COP28,[256] as is a JETP project in Senegal.[257]

Whether JETPs can overcome their many challenges—including fundraising, deal structuring, the applicability and tailoring for different projects and countries, and as Grant Hauber of Institute for Energy Economics and Financial Analysis[258] puts it "decades of entrenched interests, legacy infrastructures, and fossil mindsets"—remains to be seen, but no other large scale finance mechanisms have been developed to quickly decarbonize Global South countries' national energy systems like the JETP proposed projects.[259] JETP projects also might offer more climate-resilient benefits if they supported more distributed and cooperative models instead of primarily large-scale projects.

U.S. policymakers at the State Department and Treasury should only promote JETP projects that are determined to be clearly in the best interest of Global South countries, taking into account the expected effects and challenges around climate, development, and debt burden. For appropriate projects, they can coordinate the development process, identify fair, equitable, and just deal structures, advocate for greater contributions from the U.S. government, find private capital donors, and oversee successful implementation. Critically, U.S. policymakers should advance the highest possible standards around racial, environmental, and economic justice, as well as human rights, and ensure that projects serve to benefit the host communities and countries of the Global South, from project identification through implementation.

Debt conversions

Debt conversions, also called "debt-for-nature," "debt-for-environment," or "debt-for-conservation" swaps, are a financing mechanism that allows for sovereign debt restructuring in return for commitments for the conservation of biodiverse land (e.g., savannahs or forests) or water (e.g., coral reefs or wetlands). These types of debt conversions have existed for several decades, and the mechanisms for restructuring could include partial or full cancellation of debt, a pause and extension on repayment with lesser interest rates, refinancing the principal and interest terms, and repurchasing of debt by third parties like impact investors or nongovernmental organizations.[260] "Debt-for-climate" swaps or "debt-for-adaptation" swaps are newer iterations that follow a similar financing model but with major focus on climate change mitigation or adaptation.[261] Conservation and regeneration of biodiversity are viewed by many countries and experts as needing to happen in conjunction with climate mitigation activities and so an ideal debt conversion recognizes those values.

The need for sovereign debt relief is evident. More than 50 of the world's poorest countries are at risk of defaulting on their debt, which would have serious local and global social, economic, and political repercussions, including threats to global financial stability and threats to national and global climate change goals.

As discussed above, the lowest-income and most highly indebted countries in the Global South are the most vulnerable to climate change, which creates a vicious debt cycle on top of existing sovereign debt challenges. The need to fulfill sovereign debt payments poses a conflict in priorities as doing so reduces the country's available budget for investments to mitigate or build resilience to climate change. Climate change-related hazards such as drought, flooding, and heatwaves can also reduce a country's economic and financial stability, and increase the need and costs for infrastructure reconstruction—all of which makes it harder for a country to pay its sovereign debt on time or in full.[262]

Debt conversions that benefit nature or climate might be considered as one of many sustainable financing solutions available to Global South countries with high sovereign debt. In addition to debt restructuring and environmental or climate benefits, these deals may also draw attention to participating countries from new actors, including investors that are increasingly interested in ESG investment opportunities in various forms. New revenue streams could form from increased conservation and biodiversity protection as well as revenue-generating projects that could enhance investor confidence among participating countries.[263] Generally, debt conversions should be paired with plans and commitments for equitable climate investment with the input of affected communities.

Unfortunately, debt conversions are incredibly complex transactions, and the costs of bringing together and compensating all necessary financial stakeholders often leave less for the conservation or climate work and reduce the scope of debt relief. Belize entered into one of the most cited conversions when its debt-to-GDP ratio was 125 percent. The deal was able to save Belize's credit rating by averting another default and diverted some financing for marine conservation, although it only wiped out enough debt to lower its debt-to-GDP ratio by 12 percent, less than what was hoped.[264] That deal had drastically higher-than-anticipated transaction costs, due to the number of public and private actors who were involved; debt conversions are easier to accomplish when there are fewer stakeholders involved in the negotiations. The more intermediaries and service providers involved, the less money available for conservation.[265]

Another consideration for the appropriate use of debt conversions is additionality. Investors could view restructured deals as their contributions to climate- or conservation-related development efforts, minimizing the amount they perceive they need to give outright to Global South countries.[266] Transparency on the deals is scarce and more public documentation about the costs to different actors and the proceeds and use of proceeds from any involved entity is critical to building trust among creditors, debtors, and any foreign organizations involved in the debt conversions. Many commentators view debt conversions as insufficient for reducing sovereign debt, while others view these agreements as impinging on a country's sovereign freedom for investment decisions.[267]

Still, the need for sovereign debt relief is evident. More than 50 of the world's poorest countries are at risk of defaulting on their debt, which would have serious local and global social, economic, and political repercussions, including threats to global financial stability and threats to national and global climate change goals.[268] Grants, traditional debt relief,[269] comprehensive debt restructuring, and concessional finance should be explored first before debt conversions are considered.

Some Global South leaders have indicated openness to debt conversions being a part of a larger suite of solutions for sovereign debt crises. President Akufo-Addoof of the Republic of Ghana has called for Global North countries to first make good on their "pledge to mobilize and make available one hundred billion dollars ($100 billion) annually to the poorer countries to assist in the fight against climate change, and commit, as agreed at COP26 in Glasgow, to doubling resources for adaptation." He also called for a "radical restructuring of the global financial architecture" and urged "those who hold African debt to commit to debt-for-climate swap initiatives."[270] Any debt conversion that does occur should involve more genuine sacrifices from creditors, be used to support sovereignly-defined and community-supported climate and conservation policies, and provide significant debt cancellation to help free the country from the sovereign debt trap.

Watering fields using a solar irrigation pump outside of Kitale, Kenya.

PHOTO: JEFFERY M WALCOTT / IWMI

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