Climate Finance under Conflicts and Renegotiations:
A Dynamic Contract Approach[*]

- Preliminary and Incomplete -

Byeong-Hak Choe[†]

December 30, 2018

Abstract

Considering climate funds (e.g. the Green Climate Fund) as the financial mechanism to provide funding to developing countries, this paper examines a long-term climate funding relationship between two agents—the rich country and the poor country. Conflicts between the rich and poor countries arise when determining 1) the size of climate funding that the rich country contributes to the poor country, and 2) the funding allocation between climate adaptation and mitigation projects in the poor country. In addition, the rich country cannot be forced to commit contractual contributions to the poor country, and the climate funding relationship can be repeatedly renegotiated. This paper suggests the following main results: climate funds work in the long-run, in terms of the size of climate funding and its balance between adaptation and mitigation projects, if and only if climate damage becomes *sufficiently* severe. Fewer conflicts and fewer renegotiations between the rich and poor countries make climate funding contracts more efficient. Heterogeneous marginal climate costs across the rich and poor countries and the rich country's preference on adaptation and mitigation projects in the poor country play an important role in funding allocation between adaptation and mitigation projects.