

Climate Finance in and between Developing Countries: An Emerging Opportunity to Build On

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Abstract

The United Nations Framework Convention on Climate Change (UNFCCC) negotiations are evolving to reflect changes in national and global economic circumstances. However, this shift has been far smaller in the critical issue of climate finance, which remains too mired in an increasingly antiquated North–South, developed–developing country dichotomy. This inertia poses a serious threat to our ability to mobilize the finance required to meet the climate challenge, and could hamstring the new climate agreement countries are seeking. However, an important new trend can help move this discussion forward: the rise of climate finance within and among developing countries. Far from diminishing the need for developed countries to increase their support for mitigation and adaptation in developing countries, so-called ‘South-South Climate Finance’ (SSCF) can help unlock much needed additional resources for the climate challenge. This article provides an initial mapping of SSCF and argues that: (1) the emergence of SSCF offers countries an opportunity to mobilize additional climate finance, including through multilateral development banks (MDBs); and (2) parties to the UNFCCC should track and foster the role of SSCF so as to more effectively align it with ‘traditional’ climate finance that flows from developed to developing countries.

One of the world’s largest solar plants will open in Pakistan’s Punjab province this year, eventually providing 300 MW of much needed power to businesses and households in the region (Shaikh, 2015). While the Quaid-e-Azam Solar Power Park will deliver an immediate benefit to the people of Punjab, the trend it represents presents an even bigger opportunity for the world’s struggle against climate change. Built by a Chinese company and financed with support from Beijing, the solar plant rising in Punjab signals an important new chapter in global climate finance.

It is evident that reducing greenhouse gas (GHG) emissions and achieving sustainable, long-term economic growth will require large amounts of new investment. Precise figures are difficult to estimate because of uncertainty around climate impacts, emerging technologies and broader economic factors. But all major studies (see below) show that the world is spending far less than what is required to build low-carbon, resilient economies.

Marshaling such resources is a core objective of the United Nations Framework Convention on Climate Change (UNFCCC). In 2009, developed countries pledged

to mobilize US\$100 billion per year from public and private sources to finance adaptation and mitigation activities in developing countries (UNFCCC, 2009). And a new international financial institution, the Green Climate Fund (GCF), has been created to help to achieve this. Even if this money is indeed mobilized, and even if the GCF and other institutions can effectively channel it, a wide gap will remain between what is available and what is needed.

New solutions and smarter investments are required. But the climate finance discussion in the UNFCCC is still largely mired in antiquated and acrimonious ‘North–South’, developed–developing, donor–recipient, public–private disputes that do not reflect today’s more complicated global economic reality. Gridlock over finance, in turn, can spill into other issues, and therefore poses a threat to achieving a successful outcome in Paris and beyond.

Meanwhile, outside of the halls and conference rooms of the UNFCCC, important but often overlooked new developments are happening on the ground. As developing countries grow and play a larger role in the world

economy, they are increasingly financing and supporting low carbon, resilient development at home and in other developing countries – which in turn opens up opportunities for additional climate assistance and investment from developed countries. This phenomenon has yet to be explored in depth by the academic or policy communities, but offers significant potential to reshape the global politics of climate change. In this article, we provide an initial mapping of the emerging landscape of climate finance within and between developing countries – so called South-South Climate Finance (SSCF) – showing that it is rapidly growing and taking a variety of new institutional forms.

We then argue that SSCF offers an opportunity to move toward a more productive climate finance discussion by ameliorating North–South distributional conflict. SSCF does not replace traditional climate finance or risk creating new obligations for developing countries. Nor can it be expected to fill the finance gap. But by bringing new resources to the table and transcending traditional political cleavages, SSCF can help countries move beyond the zero-sum political dynamics that have made finance perhaps the most contentious issue within the UNFCCC negotiations. To seize this opportunity, we recommend that countries track SSCF in the UNFCCC reporting framework, recognize the full scope and various forms SSCF can take (including bilateral, multilateral, public, private, financial and in-kind instruments), and that new multilateral development institutions coordinate with existing institutions to progressively green all financial flows.

The state of global climate finance: how big is the gap?

Estimating how much money will be required to mitigate and adapt to climate change is plagued by uncertainty. Any concrete estimate must make a number of assumptions about how climate change will impact a wide range of complex natural and human systems, about how the economy will grow, and about how technologies will develop. A number of major studies have projected expenditures in the range of US\$480–2,200 billion¹ per year globally until 2050 to keep the global temperature rise below 2°C (McKinsey & Company, 2009; IEA, 2010; GEA, 2012). Estimates of financing needs for developing countries ranges from US\$140–565 billion (World Bank, 2010a) to \$1,100 billion (United Nations, 2011) per year until 2050 for mitigation and from US\$70 billion (World Bank, 2010b) to \$380 billion (Montes, 2013) for adaptation.

Significantly, these estimates only capture the ‘incremental’ investments required on top of the business-as-usual investments, the vast sum – US\$90 trillion, by one estimate (New Climate Economy, 2014) – to be invested in the world’s urban, land use and energy systems in the next 15 years.

How much of this necessary investment are we actually making? While estimates vary because there is no global standard for reporting and measuring climate finance, the data indicate that the amount is already substantial and growing. The UNFCCC Standing Committee on Finance estimates the world currently spends US \$340–650 billion per year mitigating and adapting to climate change (UNFCCC, 2014). These figures include the full investments rather than the incremental climate component. Flows from developed countries to developing countries range from US\$40–175 billion per year including both public and private finances. The Climate Policy Institute’s (2014) estimate is US\$331 billion comprising 57 per cent from private investments and 43 per cent from the public sector.²

All of these studies reach different conclusions about the precise scale of climate finance, but none finds that a sufficient amount is currently being mobilized to meet the climate challenge. The issue of how to mobilize more such funding has long been grappled with under the UNFCCC. In that context, developed countries have committed to provide assistance to developing countries to support mitigation and adaptation activities.

The Kyoto Protocol, for instance, helped to mobilize climate finance through an offset program whereby developed countries could receive credit toward their domestic targets by investing in lower cost emission reductions in developing countries (UNFCCC, 1998). This Clean Development Mechanism generated an estimate of US\$215.4 billion of climate finance through 2012 (UNFCCC, 2012).

The last major set of financial targets in the UNFCCC were established at the Copenhagen climate conference in 2009. There, developed countries agreed to mobilize from public and private sources some US\$100 billion in climate finance per year by 2020; to provide US\$30 billion of ‘fast start’ public finance over the 2010–2013 period; and to establish a new multilateral institution, the GCF.

To meet these commitments, developed countries are mobilizing funding through a variety of channels: bilateral assistance, multilateral funds, international financial institutions, national development finance institutions and export credit agencies, as well as various forms of private finance. A recent study by the OECD (2015) estimated that wealthy countries mobilized US\$62 billion in 2014, representing notable but incomplete progress toward the US\$100 billion goal. But even if the goal is met, the needs, which, as noted above, exceed even USD100 billion/year, are clearly still outstripping the available resources.

What is the current and potential scale of SSCF?

The global economic picture looks very different today than it did when countries adopted the UNFCCC in 1992.

Developing countries now contribute more and more to global outputs and resource flows. Developing economies' share of world GDP increased from 23 per cent to 40 per cent between 2000 and 2012 alone (WTO, 2014). This shift is transforming old patterns of trade, investment, GHG emissions, and overseas development assistance, trends that dominate both newspaper headlines and academic literature. Unsurprisingly, it is also changing the nature of climate finance, though this shift is not widely appreciated.

There has not yet been any attempt to systematically and comprehensively track SSCF, in part because it used to be quite small in volume and in part because the dynamics of the climate finance discussion in the UNFCCC, locked in a North–South paradigm, discourage consideration of the topic. But some inroads are being made. Here we provide an overview mapping, noting that some estimates look at transborder financial flows between developing countries, while others also include developing countries' domestic investments.

The Climate Policy Initiative (CPI) estimated that South–South cross-border climate finance reached US\$10 billion in 2013 (Buchner et al., 2014). Putting it into context, that is as much as 30 per cent of the climate finance that CPI calculates was mobilized from public and private sources in developed countries to developing countries in the same period (US\$34 billion), and 10 per cent of total climate finance flows globally (US\$331 billion) (see Table 1).

There are signs of continued expansion of SSCF. Recent investment trends in clean energy reveal that the share of developing country investments is rising exponentially. Domestic investments by developing countries have increased from US\$4 billion in 2004 to US\$63 billion in 2011. Investments from developing countries to other developing countries have grown by more than 15-fold from less than US\$0.2 billion in 2004 to US\$4 billion in 2011 (WEF, 2013).

Meanwhile, at the time of writing, five non-Organisation for Economic Co-operation and Development (OECD)

developing countries have pledged to the GCF. While the pledges were relatively small in scale, they were symbolically significant and are an early indication of the potential of the UNFCCC's approach to climate finance to develop in the direction we are advocating.

What forms does SSCF take?

SSCF takes three major forms: developing countries' contributions to established multilateral funds; bilateral initiatives; and new Southern-led international organizations like the 'BRICS bank' and the Asian Infrastructure Investment Bank. In addition, as with the climate finance that flows from developed to developing countries, SSCF can mobilize additional private sector investment, but our focus here is on the public finance that governments directly control.

1. Contributions to existing multilateral funds

We looked at all multilateral climate funds listed by the Overseas Development Institute's Global Climate Finance Architecture (ODI, 2014) to see what share of these funds, if any, were provided by developing countries. Based on the public information available, only the Global Environment Facility (GEF) and the GCF receive direct contributions from developing countries, both less than 1 per cent of total funds, while the multilateral development banks (MDBs) climate activities are supported indirectly through developing country contributions.

The *Global Environment Facility Trust Fund* is the longest standing public fund dedicated to climate change. Several developing countries have contributed to the GEF across three periods – Argentina, Brazil, China, Côte d'Ivoire, Egypt, India, Indonesia, Nigeria, Pakistan, South Africa and Turkey – although the amount is minuscule with less than 1 per cent of total replenishment.

The GCF was made operational in mid-2014, with the first major round of pledging taking place later in the year. Thirty-three countries committed a total of US\$10.2

Table 1. South-South Climate Finance flow in 2013 (US\$ billion)

Global total climate finance flow in 2013	331			
North to South	34			
South to South	10			
Division of South-South flow by origins and destinations	<u>Origins</u>		<u>Destinations</u>	
	East Asia & the Pacific	3	East Asia & the Pacific	3
	Multilateral – mitigation	3.7	Latin America & Caribbean	3
	Multilateral – adaptation	3.3	South Asia	1
			Sub-Saharan Africa	1
			Middle East and North Africa	1
			Central Asia & Eastern Europe	1

Source: Climate Policy Initiative database for Buchner et al. (2014)

billion as of May 2015, of which US\$23.6 million (0.23 per cent) are from seven developing countries – Chile, Colombia, Indonesia, Mexico, Mongolia, Panama and Peru.³

2. Bilateral initiatives

China is by far the most active developing country providing climate finance on a bilateral basis. Early efforts mainly took the form of bilateral technical cooperation, such as knowledge exchange in flood prevention and other adaptation issues. China's official report on foreign aid does not specify the exact amount contributed towards climate change, but the estimation is around US \$40 million spent since 2011 out of US\$14.4 billion total aid spent, administered by the Ministry of Commerce's South–South cooperation project (Liu, 2014).

More recently, two significant developments have suggested that China is taking a bold new stance on these issues. First, China made a high profile announcement at the UN Climate Summit in September 2014 that it would establish a South–South Climate Fund. It then reiterated that announcement and provided further details during COP20 in December 2014. As currently known, the fund would follow several key principles (Friedman, 2014; Lan, 2014; Sunder, 2014; Edwards et al., 2015):

- The Fund will be operated with a market-based approach.
- The Fund will target climate change adaptation.
- Potential design options are being explored to increase the Fund's impact, including the option of developing the Fund as a multilateral one, which would provide opportunity for partner countries to shape its governance and investment approaches.

Second, during Chinese President Xi Jinping's state visit to Washington DC in September 2015, China announced that it would be providing \$3.1 billion to help developing countries combat climate change, which is a large increase over its original pledge to deliver US \$80 million over the course of three years through its South–South Climate Fund (The White House, 2015).

Encouragingly, China is linking its SSCF directly to the UNFCCC process. In April 2015 China signed a memorandum of understanding with the UN, as a follow up to its US\$6 million commitment made at the 2014 Climate Summit to South–South cooperation on climate change (IISD, 2015).

China's willingness to link its own climate finance to the UN process shows how the traditional 'firewall' in the UNFCCC between developed and developing countries in the area of climate finance is becoming more porous, much as it has in the area of mitigation since the 2009 Copenhagen Accord, where all major economies – not just developed ones – agreed to establish 2020 GHG emission reduction targets or goals.

China has also been active in regional climate change cooperation. For example, in Latin America, China set up a US\$2 billion co-financing fund with the Inter-American Development Bank (IDB) for various projects including poverty reduction and climate change mitigation. China's membership coincides with the IDB's strategic shift to promote climate-related goals that require 25 per cent of the bank's lending portfolio to support tackling climate change by 2015 (Edwards et al., 2015).

In Africa, China entered into a technical cooperation agreement of US\$2 million with the African Development Bank. A series of technical cooperation activities have been implemented in the areas of the environment, agriculture, water and health and other activities are planned (AfDB, 2013).

India and Brazil are also rising as international climate finance providers. Although these countries do not have a stated international climate finance agenda as China does, they have provided loans, grants and technical support to other countries. For example, India provided about US\$1.5 billion between 2006 and 2014 in grants and loans to other developing countries, of which over 35 per cent were towards the energy sector based on India's expertise on hydropower plants, low-cost solar units and power transmission systems (IDCR, 2014). Brazil's total foreign aid expenditure in 2010 was US\$923 million (IPEA, 2014). It is unknown how much of this total is spent on climate change, as the official aid data is not accounted by themes/sectors. Only looking at the technical cooperation funded by the Brazilian Cooperation Agency (ABC) from 2005 to 2012 where thematic data is available, environment accounted for 13 per cent of technical cooperation projects in Latin America and the Caribbean, and 5 per cent each in Africa and Asia (Leite et al., 2014).

3. New multilateral institutions

As developing countries come to play a larger role in the global economy, they are not only seeking to have greater influence in existing international financial institutions but looking to establish their own. Two of these are particularly significant: the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank ('BRICS bank').

With vast balance sheets, these new institutions can lead to a fundamental revolution in SSCF by directing substantial funds and mainstreaming climate in infrastructure investments. But to do so, they will need to actively pursue projects that are consistent with broader climate objectives, and it is too soon to know whether or not this will be the case.

The AIIB already has commitments to join from 57 countries,⁴ including 20 non-Asian countries. The authorised capital of AIIB will be US\$100 billion and the initial

subscribed capital is expected to be around US\$50 billion. No specific information is yet available about climate finance in either the AIIB or and BRICS bank, but the establishment agreements clearly state their commitments for sustainable development projects.

How can countries seize the SSCF opportunity?

Recognizing the emerging role of SSCF offers an opportunity to reinvigorate a climate finance debate that remains too frequently mired in a standoff between developed and developing countries. As we have shown above, this dynamic is disconnected from important developments on the ground. Moreover, recognizing SSCF as part of the solution is likely to help unlock additional climate finance from developed countries as well.

Developing countries are already investing in climate mitigation and adaptation at home and – in the case of the major emerging economies – abroad. They are doing so not because of a sense of historical responsibility or international obligations – they do not have any such existing obligations under the UNFCCC – but rather to achieve cleaner, more sustainable economic growth, to develop the market potential of new technologies, to reduce the domestic and trans-border risks they and others face from climate change, and a host of other reasons. Unfortunately, this reality has yet to be addressed by the UNFCCC, either through direct decisions by the Conference of the Parties or its Long-term Finance work program.

Such a shift would not be unprecedented. As the share of global CO₂ emissions from developing countries rose from 31 per cent in 1990 to 57 per cent in 2013 (PBL, 2014) – and with that share expected to continue rising for decades – the negotiations have moved away from the Kyoto Protocol paradigm in which only developed countries made commitments to reduce their GHG emissions to one in which all major emitters commit to take actions. A similar shift may be on the horizon for climate finance as well. How can the emerging climate regime best recognize and stimulate this enormously promising trend?

First, it is important for the UNFCCC process to recognize and welcome the fact that SSCF is growing, rather than fear that it will relieve pressure on developed countries to make good on their financial commitments or absolve them of any other responsibilities. To date, some developing countries, NGOs and other actors have been reluctant to emphasize the SSCF's role for fear that it would let developed countries off the hook and sap urgency from vulnerable countries' pleas for assistance. For instance, at last year's COP in Lima, Indian and Chinese negotiators pushed for a definition of climate finance that would limit it to that which is provided by developed countries and those countries listed in Annex I of the Convention. (IISD, 2014).

But this fear is misplaced, and often counterproductive, as it can reduce political support for climate finance in developed countries. Recognizing the full scope of climate finance builds confidence that the world can achieve the ambitious transition needed to address climate change. This narrative shift can have important political effects. SSCF, for example, offers a powerful rejoinder to critics in developed countries that oppose climate assistance because it shows that developing countries are leading their own transition away from fossil fuels. It also shows that climate finance is not just a charitable instrument for well-meaning donors, but a tool for technology investment and economic growth. And it reflects the way the world has changed since the UNFCCC was negotiated in 1992.

To implement this shift, all countries engaged in climate finance should begin reporting their activities to the UNFCCC's Standing Committee on Finance, to be made public on the UNFCCC's finance portal. Current UNFCCC climate finance tracking only relies on biannual reporting of how much developed countries have provided to developing countries. The 2014 report recommends future reporting to include the amount of climate finance received by developing countries (UNFCCC, 2014). However, we suggest that all countries – developed and developing – commit to report how much they give and receive in climate finance. Developing countries are free to do so under current rules, but most development reports from emerging donors like South Africa, Brazil, China and India do not include climate as a spending category, even though much of what is being financed is in fact highly climate-relevant. Developing countries may fear that reporting their climate finance, even if voluntary, will build expectations that they commit to doing more in the future. We suggest, however, that the political dynamics will benefit developing countries, by offering an opportunity to showcase leadership and in doing so put greater pressure on developed countries to fulfill their own finance commitments. Merely reporting may seem like a small step, but it is crucial to showing that the true scope of climate finance is not constrained by the outmoded division between developed and developing countries agreed a quarter century ago.

Second, we should be aware that SSCF will take a variety of forms. Some developing countries may wish to make additional contributions to the GCF. Others may prefer bilateral initiatives, or new multilateral institutions emerging in the developing world. Still others may be less able to write a check, but able to share valuable technology and experiences. Countries who have similar development levels or vulnerability to climate change can share solutions that are adaptable to local economic and social conditions, such as partnerships between island nations in the Pacific and the Caribbean (UNDP and UNDESA, 2010). Beyond the knowledge shared, more

valuable are the effects of empowerment, mutual trust and participation in the international system generated from these exchanges.

Third, the ultimate goal of climate finance is to build a climate-safe and climate-resilient world. A recent study of China's power sector shows that 68% of currently operating capacity and 77% of under-construction capacity is in coal. Failure to decarbonize current investments could contribute to the long-term lock-in of fossil infrastructure (Hannam et al., 2015). Only by mainstreaming climate finance across the economy – including China, other emerging players, and all countries – will the world achieve the transition and resilience needed to address the climate challenge. SSCF marks an important step in this process – it broadens the actors involved in financing and helps to bridge the infrastructure needs with clean development. To nurture it, MDBs, old and new, global and regional, can lead a broader transition to climate-safe financing.

Under the leadership of the G20 or similar high-level political body, development banks – old and new – should begin meeting at regular intervals to coordinate climate finance strategies, and to seek ways to collectively and progressively eliminate the climate-harming investments in their portfolios. Many of these conversations have already begun. Seven MDBs have been publishing joint annual climate finance report since 2012 (AfDB et al., 2014). New MDBs should be engaged early to ensure timely and effective coordination on climate finance.

Finally, recognizing SSCF can help to ease the North–South finance schism that risks poisoning other elements of the climate negotiations. A more productive finance discussion would be a powerful boost. A core challenge for any new climate agreement in Paris will be to find ways to increase the ambitions of national actions to a sufficiently high level in the years that follow. This requires a finance system that can marshal and strategically align resources from the widest possible range of actors. This transition is just starting. It is now up to countries to recognize that and seize the opportunity it offers.

Notes

1. McKinsey & Company (2009) estimates the total upfront investment in abatement measures needed would be EUR 530 billion (US\$660 billion) in 2020 per year or EUR 810 billion (US\$1000 billion) per year in 2020 – incremental to business-as-usual investments. IEA (2010) estimates that implementing the 'BLUE Map' scenario, which is to halve global energy related CO₂ emissions by 2050 compared to 2005 levels using the least cost means of the existing and new low-carbon technologies, will require investments to reach approximately US\$750 billion per year by 2030 and rise to over US\$1.6 trillion per year from 2030 to 2050. GEA (2011) indicates that the global energy systems investments need to increase to some US\$1,700–2,200 billion annually to 2050.

2. Another useful indicator is the OECD-DAC Rio Markers which estimates the total climate-related development finance in 2013 as US\$40 billion combining both bilateral and multilateral sources. This compares to US\$34 billion tracked by CPI (2014) for the same year.
3. Available from: http://news.gcfund.org/wp-content/uploads/2015/04/GCF_contributions_2015_may_08.pdf
4. As of September 2015

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