

Climate Finance

Developing Countries' Perspective



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Climate finance is vital to help poor and most vulnerable countries cope with the adverse effects of climate change, but it is still a hotly debated issue at the international level. At the 15th Conference of the Parties (COP15) to the United Nations Framework Convention on Climate Change (UNFCCC) in Copenhagen and COP16 in Cancun, developed countries pledged to provide precise amounts of new and additional resources, with a balanced allocation between adaptation and mitigation, to address the needs of developing countries. Nevertheless, until now, developed countries have failed to fulfil their promises, thus leaving developing countries doubtful of rich countries' ability to raise the

necessary funds, even more in light of the current unfolding economic and political events in some of the major developed economies. At the two-day international conference of the Climate Vulnerable Forum that ended in Dhaka exactly two weeks before COP17 in Durban, vulnerable countries once again underscored that "[...]it is incumbent upon the developed countries, given their historical responsibility to climate change and taking into account their commitments to reduce [poor countries'] vulnerability, to extend all necessary support [...] to respond to the challenges posed by climate change." They also renewed calls for a "comprehensive legally-binding global agreement capable of fully attaining the objective of

the UNFCCC", and voiced the imperative for a "well-calibrated balance in the global focus on adaptation and mitigation". Further, they demanded that "climate finance [...] must be truly new and additional to official development assistance commitments, as well as adequate, predictable, transparent and with comparable reporting, easily and directly accessible, and that may be supplemented through innovative sources of financing". This policy brief investigates key flaws in existing international climate agreements as well as the consequences of excessive climate finance fragmentation. It also highlights the progress made at COP17 in Durban and the work that still remains to be done.

Background

Climate change is having devastating effects on the environment: Rising temperatures are causing the extinction of many habitats and species; changes in rainfall patterns are leading to severe water shortages and flooding; rising sea levels are increasing risks of wave damage to coastlines; melting glaciers are causing flooding and soil erosion. All these are having severe socio-economic impacts around the world, particularly in developing countries. On average, about 350,000 people die each year because of climate-related malnutrition and diseases, and over 99 percent of mortality cases occur in developing countries.¹ Moreover, US\$150 billion are lost each year due to climate-related impacts, of which US\$65 billion are borne by developing countries.²

Although developing countries have little or no responsibility for climate change, they are the ones most affected by and most vulnerable to its impacts because of their geography, high dependence on climate-sensitive resources, low adaptive capacity, high poverty rates, and vulnerable social, institutional and physical infrastructure.³ This implies that poor countries need huge investments to counteract the effects of climate change, in particular, to minimize the consequences of actual and expected changes in the climate (adaptation) as well as to tackle the causes of climate change such as reducing greenhouse gas emissions (mitigation). Developed countries have pledged to help developing countries to cope with climate change by providing the necessary financial support. Nevertheless, the resources committed so far cover just 5 percent of the needs of developing countries,⁴ and that too does not always reach the most vulnerable.

A number of key factors have prevented international efforts from addressing the growing climate finance gap. First, developed and developing countries have failed to reach a consensus upon the definition of additionality of climate finance. Second, fragmentation of climate finance and lack of coordination among donors have reduced developing countries' accessibility to the much-needed funds. Finally, the allocated amounts of climate finance have favoured mitigation projects at the expense of adaptation investments.

Issue of additionality

In order to meet the climate mitigation and adaptation needs of developing countries, the Copenhagen/Cancun agreements promised to provide poor countries with “new and additional” resources of US\$30 billion over the period 2010–2012, and to mobilize US\$100 billion per year by 2020. While the target numbers have been secured, the definition of what should count as “new and additional” has not. Should climate funds be new relative to existing pledges and funding? Should they be additional to development aid? So far, eight possible options for defining the meaning of “new and additional funds” have been put forward (Box), but only a few of them are acceptable to developing countries. Hence, no consensus has yet been reached.⁵

A number of criteria may be used to assess the definitions of “new and additional” funds.⁶ According to these criteria, the best definition should ensure that funds directed to climate change i) do not divert ODA from traditional development needs; ii) are separate from funds that have already been promised for supporting developing countries' climate or development actions; iii) are environmentally effective; iv) shift the burden away from developing countries which are less

responsible for climate change and least capable to adapt; and v) are institutionally feasible in the sense that they are politically acceptable to both developing- and developed-country governments, are feasible given the budget constraints in developed economies, can be easily assessed (transparency), and do not interfere with the development assistance regime. Hence, it appears that the most appropriate definition is the one describing “new and additional” resources as climate funds provided through new sources only. This definition guarantees additionality, novelty, acceptability by parties, as well as transparency and consistency with the development assistance regime. Moreover, it is in line with the international agreement that alternative sources of finance are needed to mitigate climate change and allow developing countries to adapt to climate change impacts.

Fragmentation and lack of coordination

Over the last few years, there has been a proliferation of funds and funding initiatives to support developing countries to cope with climate change. These include both bilateral and multilateral initiatives, as well as private sector initiatives (Figure 1). On the one hand, developed-country governments—especially Japan, Germany and Australia—have channelled a considerable amount of funds to climate change projects through bilateral initiatives such as the Hatoyama Initiative, the International Climate Initiative, and the International Carbon Initiative. On the other hand, among multilateral actors, the World Bank has been particularly active through the Climate Investment Funds, the Kyoto Protocol Adaptation Fund, and the Global Environmental Facility (GEF), which is the largest source of multilateral climate-related funding. Multilateral Development

Banks have also increased their involvement in environmental activities in recent years by providing funding (especially to the private sector) through loans, equity, concessional financing and to a less extent grants. In addition to this, the Clean Development Mechanism has emerged as the main vehicle for the private sector to invest in carbon mitigation in developing countries.

Such an increasing number of international climate funding mechanisms (currently over 20) have made it more difficult for developing countries to access climate-related funds. Indeed, climate finance fragmentation, compounded by deficient coordination among donors, has created a confusing environment and increased transaction costs for

recipient developing countries. Moreover, it has complicated accounting, transparency and delivery of funds, thus leading to duplication of efforts and inefficiencies in funds allocation. The creation of a comprehensive “Measuring, Reporting and Verification” (MRV) system is therefore important to overcome these issues as well as to ensure the additionality of climate finance and allocation of funds to countries most in need.

According to the MRV process, the amount of climate finance flows from developed to developing countries should be first monitored and measured. The data should then be reported to the international community and finally verified by a central entity to ensure that commitments are fulfilled.

In order to simplify the complex network of multilateral and bilateral funding mechanisms that currently provide climate change assistance to developing countries, the Cancun Agreement proposed the establishment of the Green Climate Fund (GCF). This is a new body meant to complement, or perhaps replace, many of the existing multilateral dedicated climate funds such as the GEF or the Adaptation Fund, and to become the official UNFCCC mechanism to deliver large-scale financial resources to poor countries for climate change adaptation and mitigation. Even though the agreement to create such a fund is considered a success, especially by developing countries which envisage the opportunity to create a more legitimate institution able to provide the necessary

Box Definitions of “new and additional” funds

- 1 *Funds above the official development assistance (ODA) target of 0.7 percent of developed countries’ gross national income (GNI):* This is by large the preferred definition of developing countries. It is transparent and objective, but unlikely to be adopted since most donor countries are struggling to reach the 0.7 percent ODA target. Moreover, those countries which already exceed the 0.7 percent threshold may be tempted to divert aid commitments from traditional development needs.
- 2 *Additional funds as defined unilaterally by each donor country:* Developed countries are in favour of this approach, which is rejected by developing countries since it lacks transparency, prevents cross-country comparisons, and may allow diversion of ODA.
- 3 *Only funds disbursed through new UN channel such as the Adaptation Fund or the Copenhagen Green Climate Fund:* Although this definition is clear, it has the drawback of limiting the number of channels through which climate finance may be disbursed.
- 4 *Funds which do not count as ODA:* This approach allows distinguishing clearly between development assistance and climate finance, but is rejected by most developed countries since they tend to use climate finance to reach their ODA targets.
- 5 *Funds above current climate finance (i.e., existing climate funds and those pledged before Copenhagen):* Although this definition may be favoured by donor countries, it makes it difficult to distinguish between old and new finance leaving again the door open for ODA diversion and lack of transparency.
- 6 *Funds above current development assistance:* According to this definition, any increase from current ODA levels may count as new and additional climate finance. This approach is clearly not acceptable for developing countries since it is difficult to assess and allows for ODA diversion.
- 7 *Funds above updated projections of development assistance:* Unlike the previous one, this definition takes into account the economic cycles in donor countries. This implies that during periods of recession, climate finance may fall, while during economic booms, donor countries’ obligations may increase. This approach may add uncertainties to developing countries since the climate funds would be totally dependent on donor countries’ economic performance.
- 8 *Funds provided through new sources only, such as international air transport levies, levies on carbon trading or carbon taxes:* This definition guarantees newness and additionality of climate finance, but it limits the channels through which climate funds may be provided. The characterization of new sources may also be arbitrary.

climate support, new issues are emerging. In particular, it is becoming difficult to reconcile the role of the GCF with that of the other existing funds, and in particular with the GEF, which is the longest serving body dealing with climate finance but risks being overshadowed or even replaced. To overcome this and other issues related to the improvement of coherence and coordination in the delivery of climate financing, a Standing Committee has been established, but there is a controversy surrounding its roles and responsibilities.

Balancing mitigation and adaptation

The Copenhagen/Cancun Accords pledged to achieve a “balanced allocation between adaptation and mitigation”. Nevertheless, current allocations are far from being balanced. Adaptation accounts for less than 25 percent of the total disbursed climate finance, while mitigation allocations reach a value of about 65 percent (Figure 2). The fact that climate finance is skewed towards mitigation leaves developing countries dangerously exposed to major impacts and threats of climate change. In Africa, climate change is increasing water scarcity and making extreme weather events more frequent, severe, and widespread.⁷ In Asia, rainfall is expected to increase especially during the monsoon season leaving most of the region more exposed to flooding, erosion and mudslides. On the other hand, Latin America is facing a bigger number and intensity of tropical cyclones as well as more forest fires due to warmer and drier weather. Small island developing states are the most vulnerable to the adverse impacts of climate change. They are under pressure from rising sea levels and are also experiencing a reduction in the quantity of available fresh water due to less

rainfall and salinization of water supplies. A recent report of the United Nations Intergovernmental Panel on Climate Change⁸ also confirms that climate change is increasing the intensity of extreme weather events. If adequate funding for adaptation is not provided, climate-related disasters in poor countries will continue to translate into increased hunger and diseases such as malaria and diarrhoea, more deaths, loss of income and livelihoods, and reduced well-being.

Estimated funding needs

Several estimates have been recently provided on financial needs for adaptation. The UNFCCC Secretariat has estimated that by 2030, developing countries will need to invest US\$28 billion to US\$67 billion to adapt to climate change. Other estimates are even higher.⁹ Nevertheless, funding gaps remain huge in all developing regions. For example¹⁰:

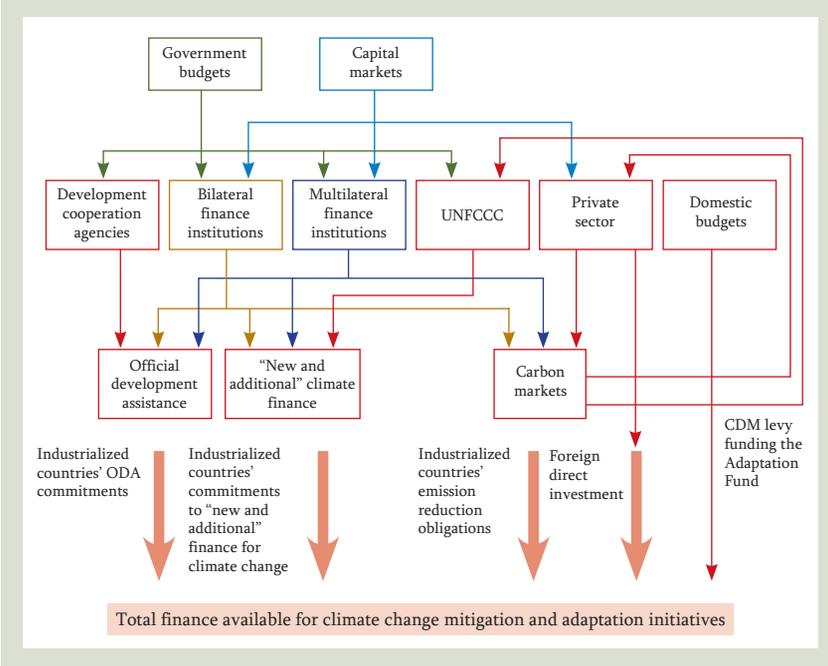
- In Africa, the annual adaptation cost is estimated to be US\$18

billion between 2010 and 2050, while so far only US\$154 million have been allocated through the bilateral and multilateral climate funds and funding mechanisms.

- Within Asia and the Pacific, the least-developed countries (LDCs) alone would need US\$15 billion over the next decade, but until now only US\$66 million have been channelled to the region.
- In Latin America and the Caribbean, the costs of climate-related disasters exceed US\$5 billion each year, whereas up to now only US\$57 million have been allocated for adaptation.
- In the Middle East and North Africa, the annual net cost of adaptation for agriculture alone is estimated to be in the order of US\$250 million for the period 2010–2050, although, as yet, only US\$27 million have been provided for adaptation in the region.

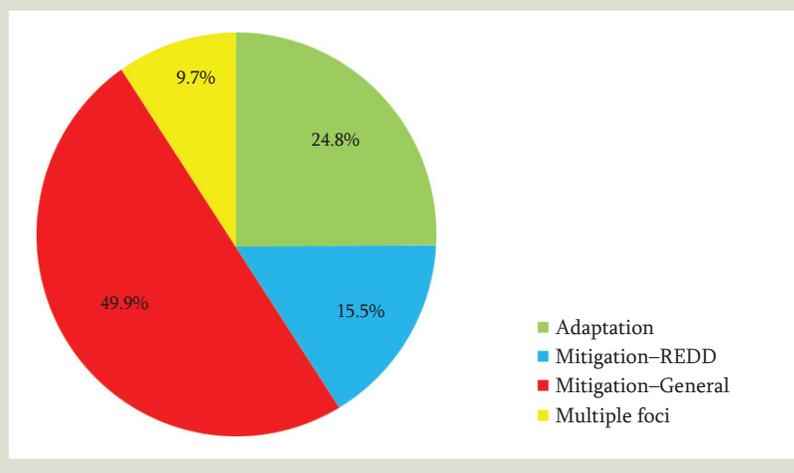
Furthermore, funds allocated to climate-related human health concerns such as malnutrition, diarrhoea and malaria are still scarce.¹¹ Also, only limited

Figure 1 Climate finance actors



Note: UNFCCC includes the various funds under the GEF as well as the Adaptation Fund. Source: Atteridge, A., C.K. Siebert, R.J.T. Klein, C. Butler, and P. Tella. 2009. “Bilateral finance institutions and climate change: A mapping of climate portfolios”. Stockholm Environmental Institute Working Paper, November 2009.

Figure 2 Climate funding disbursement



Source: Adapted from *Climate Funds Update, Graphs and Statistics* (accessed April 2012).

resources have been provided so far by developed countries to improve adaptation technologies in the most vulnerable countries, even though a potentially important Technology Mechanism has been recently introduced and is expected to become operational within 2012. The main goal of the Technology Mechanism, which consists of two bodies (i.e., the Technology Executive Committee (TEC) and the Climate Technology Centre and Network), is to enhance action for technology development and transfer, particularly to developing countries, in support of climate change mitigation and adaptation. However, technology needs are very heterogeneous across countries. In order to ensure that significant attention is devoted to the LDCs and adaptation technologies rather than to middle-income countries and mitigation technologies, the decision to create the Technology Mechanism highlights that “technology needs must be nationally determined, based on national circumstances and priorities”. It also gives special consideration to the LDCs in the mandate of the TEC in relation to its role in “recommending guidance on policies and programmes priorities related to technology development and transfer”.¹² Adaptation funds have been disbursed mainly through five

multilateral financial mechanisms: the Least Developed Countries Fund, Special Climate Change Fund, Strategic Priority on Adaptation, Pilot Programme for Climate Resilience, and the Adaptation Fund. However, given the significant existing financing gap, new sources for adaptation should be identified. New instruments may include public carbon market revenues, financial transaction taxes and revenues from taxation of international transport. More importantly, the private sector should play a bigger role in enhancing funds for adaptation.

Durban outcomes

At COP17 in Durban, important progress has been made.¹³ First, the Durban Platform for Enhanced Action has been established with the aim to produce by 2015 a “protocol, legal instrument or agreed outcome with legal force” covering all countries, and to plan work including “mitigation, adaptation, finance, technology development and transfer, transparency of action, and support and capacity building”. Second, steps have been taken particularly in relation to transparency of climate finance, long-term financing, the GCF, the Standing Committee and the Technology Mechanism.

The MRV system has been improved. More details have been provided on which information developed countries should include in the new “Biennial Reports” to be submitted from January 2014, and new modalities and procedures have been adopted for the process of “International Assessment and Review” of developed countries’ mitigation targets, actions and other commitments. Moreover, new guidelines have been adopted for the new “Biennial Update Reports” developing countries are required to submit starting from December 2014, and new modalities and guidelines have been introduced for “International Consultation and Analysis” of developing countries’ mitigation actions.

Similarly, GCF was operationalized, and it is expected to mobilize US\$100 billion per year in new financing by 2020 for mitigation and adaptation projects in developing countries through grants, concessional lending or other modalities approved by the GCF Board. It has also been agreed that the GCF will have a private sector facility and will employ a results-based approach for allocating resources. However, there was no clarity on which funds (if any) are available to capitalize the GCF. In addition to this, an agreement was reached on establishing in 2012 a work programme on long-term financing which should identify sources for new climate change finance.

In addition to these, the roles, functions, composition and working modalities of the Standing Committee were further defined. For example, it has been agreed, among others, that the Standing Committee will provide a forum for discussion on climate finance, prepare an overview of climate finance flows, and make recommendations on how to improve the coherence, effectiveness and efficiency of

operating funding mechanisms such as the GEF, the GCF, etc.

Arrangements were also made to make the Technology Mechanism fully operational within 2012. For example, the terms of reference of the Climate Technology Centre and Network have been adopted and a tender process has been launched for selecting its location.

Way forward

As highlighted above, developed and developing countries are at a crossroads facing two big challenges. On the one hand, increased transaction costs, excessive fragmentation of climate funding mechanisms, unbalanced allocation between mitigation and adaptation activities, and above all, donor countries' non-compliance with existing agreements are limiting poor countries' access to the much-needed climate funds. On the other, adverse climate-related events are on the rise with severe socio-economic consequences in developing countries.

Notwithstanding the achievements made at Durban, there is still significant work to do in the coming years. A common reporting format for climate finance, for example, needs to be defined to ensure comparability, transparency and accuracy of information provided under the reporting guidelines agreed at Durban. Also, the issue of how to finance the GCF needs to be sorted out quickly because an inadequate

capitalization of this Fund is likely to produce important knock-on effects on other institutions established at Durban such as the Technology Mechanism. Finally, much more progress needs to be made in finding innovative sources of finance, which are particularly important for supporting adaptation activities. ■

Notes

- ¹ DARA. 2010. "Climate vulnerability monitor 2010. The state of the climate crisis". Madrid: Fundación DARA Internacional. Available at: http://daraint.org/wp-content/uploads/2010/12/CVM_Complete-1-August-2011.pdf
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- ³ Schroeder, F. 2010. "A shot in the arm of climate finance? New directions for delivering on international pledges and development". Friedrich Ebert Stiftung Study, Dialogue on Globalization, December 2010.
- ⁴ World Bank. 2010. "Monitoring climate finance and ODA". Development, Climate and Finance Issues Brief No. 1, May 2010. Washington, D.C.: The World Bank.
- ⁵ Stadelmann, M., J. Timmons Roberts, and A. Michaelowa. 2010. "Keeping a big promise: Options for baselines to assess "new and additional" climate finance". CIS Working Paper No. 66, November 2010.
- ⁶ Stadelmann *et al.* 2010. Note 5.
- ⁷ UNFCCC. 2007. Climate change: Impacts, vulnerabilities and adaptation in developing countries. Bonn: United Nations Framework Convention on Climate Change. Available at: unfccc.int/resource/docs/publications/impacts.pdf
- ⁸ Field, C.B., V. Barros, T.F. Stocker, D. Qin, D.J. Dokken, K.L. Ebi, M.D. Mastrandrea, K.J. Mach, G.-K. Plattner, S.K. Allen, M. Tignor, and P.M. Midgley (eds.). 2012. IPCC special report on managing the risks of extreme events and disasters to advance climate change adaptation. A Special Report of Working Groups I and II of the Intergovernmental Panel on Climate Change. Cambridge, UK, and New York, NY: Cambridge University Press.
- ⁹ Caravani, A., N. Bird, and L. Schalatek. 2010. "Adaptation finance". Climate Finance Fundamentals Brief 3, November 2010.
- ¹⁰ For more details see the Climate Finance Regional Briefings. Available at: <http://www.climatefundsupdate.org/resources/climate-finance-fundamentals>
- ¹¹ Climate Vulnerable Forum. 2011. "Briefing Notes". Climate Vulnerable Forum Dhaka Ministerial Meeting, 13–14 November 2011. Available at: http://daraint.org/wp-content/uploads/2011/10/cvf-Briefing_Notes.pdf
- ¹² ICTSD. 2011. "The Climate Technology Mechanism: Issues and challenges". Information Note No. 18, March 2011.
- ¹³ For more details see: http://unfccc.int/files/meetings/durban_nov_2011/decisions/application/pdf/cop17_lcaoutcome.pdf. For a summary of COP17 decisions, see also The Climate Group. 2011. "Durban: Post-COP17 briefing". Briefing Note, 23 December 2011; and on progress on transparency of climate finance, see Stasio, K. 2012. "Transparency of climate finance: Did Durban show us the money?". *WRI Insights*, 27 January 2012.