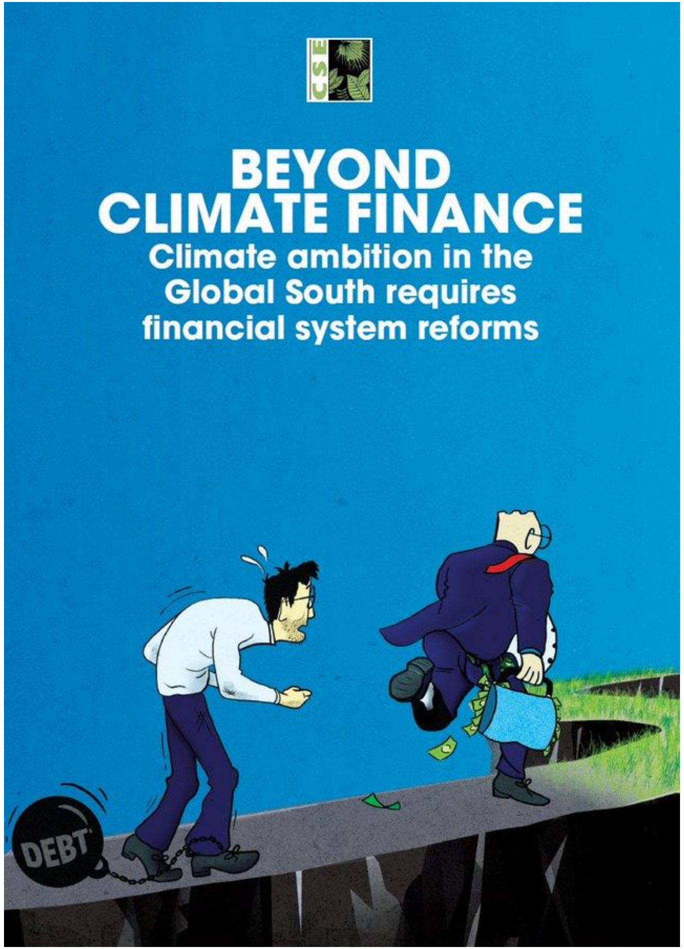

Beyond Climate Finance | A CSE position paper

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Poor countries are hit harder economically by climate disasters

Developing countries are the places where losses and damage due to climate change are concentrated

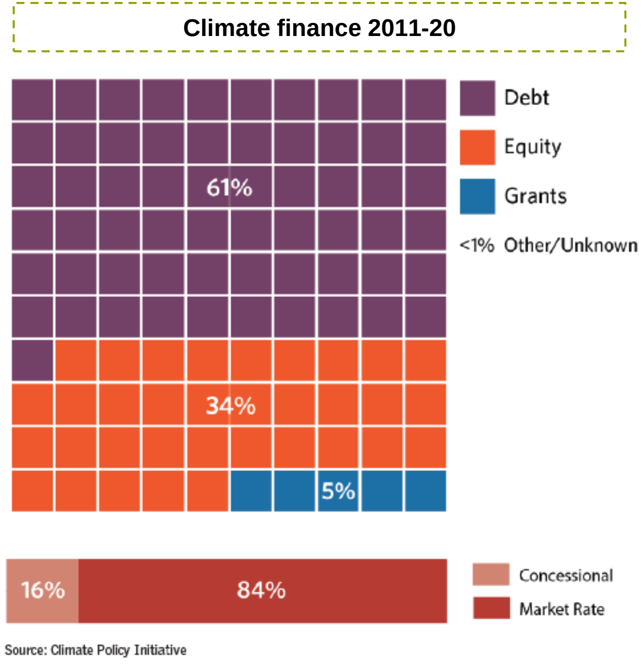
Country	Impact	Damages as % of GDP
Germany[1]	Floods in 2021	0.9%
British Columbia, Canada[2]	Heatwave 2021	3–5%
Europe[3]	Heatwaves 2003, 2010, 2015, and 2018	0.3–0.5%
Dominica[4]	Hurricane Maria 2017	226%
Pakistan[5]	Floods in 2022	9%
Vanuatu[6]	Tropical Cyclone Pam 2015	64%

These are also the countries that need finance for the climate transition to help them develop, without adding significantly to the stock of greenhouse emissions.

Source: 1. Munich RE; 2021 GDP data from World Bank 2. Canadian Centre for Policy Alternatives 3. European Commission, Joint Research Centre and others 4. Post-Disaster Needs Assessment by the Government of the Commonwealth of Dominica 5. Post-Disaster Needs Assessment by The Government of Pakistan, Asian Development Bank, European Union, United Nations Development Programme, World Bank; 2021 GDP data from World Bank 6. Post-Disaster Needs Assessment by the Government of the Republic of Vanuatu

Climate finance is inadequate, and heavily geared towards loans

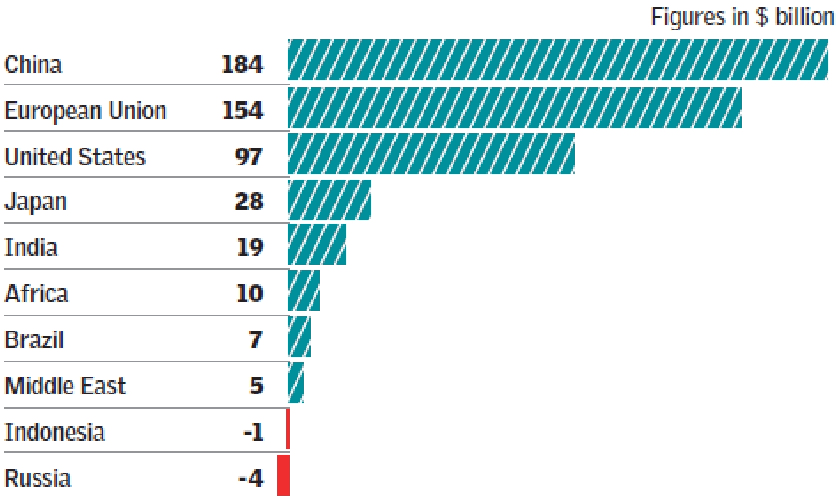
- $83.3b flowed from developed to developing countries in 2020 (OECD); Oxfam considers it to be closer to $21 – 24.5b
- In 2011-20, only 5% was provided as grants; concessional finance (grants and low-cost debt) was only 16% (CPI)
- The private sector is not rushing in – only 16% of the OECD's estimate $83.3b was private finance mobilized by public climate finance
- $100b figure proposed under UNFCCC in 2009 is outdated and inadequate - emerging markets and developing economies other than China will require $1 trillion in external finance needed by 2030 (Stern-Songwe 2022)



Climate finance is not going where it is needed the most

- 75% of all climate finance was concentrated in North America, Western Europe, and East Asia & Pacific, primarily led by China (CPI)
- Clean energy investment has risen faster than fossil fuel investment in recent years, but heavily concentrated in China, the US and the EU (IEA)
- Regions where the majority of low-and middle-income countries are located, receive less than 25 per cent of climate finance flows

Increase in annual clean energy investment in selected countries and regions, 2019–2023

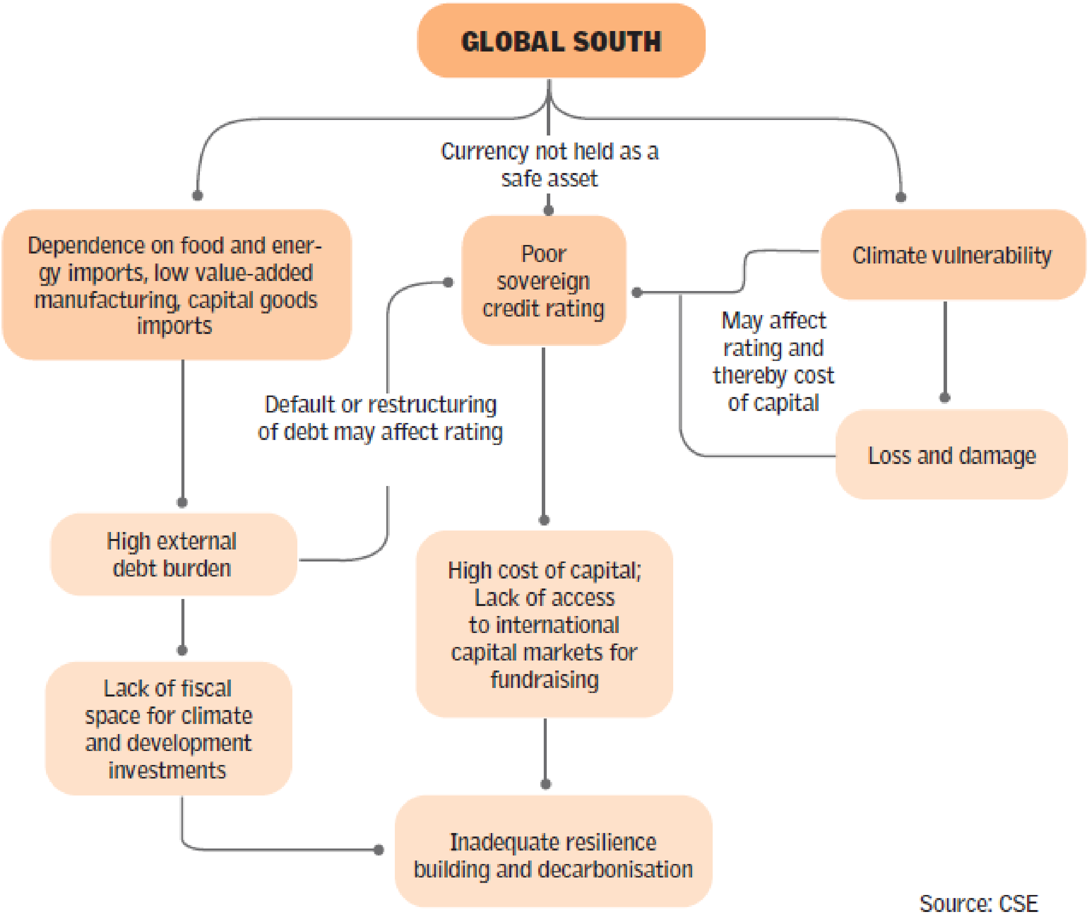


Source: IEA, 2023

Developing countries face other systemic financial barriers

- Historic inequalities have made developing countries dependent on imports of food, energy, capital goods
- They have high debt, particularly in foreign currencies
- They are left with limited funds to spend on development and climate
- Shocks like COVID have stretched their spending capabilities further – demand for LNG has starved countries like Pakistan and Sri Lanka, and hindered Indian industry's aspirations to switch from coal to gas
- **Climate ambition cannot be unlocked whilst operating in a financial system that is inequitable by design.**

Financial barriers faced by the Global South



Source: CSE

Spotlight on 3 barriers hindering climate ambition in the Global South

Spotlight on 3 barriers hindering climate ambition in the Global South

#1 High cost of capital, particularly for green technologies

The **cost of capital** is a broad term applied to the costs an entity incurs to access funding for a new project or investment. It typically encompasses the cost of debt, or the interest rate charged on a loan and the cost of equity, or the return rate that an investor expects while offering funding to a project.

Developing countries are perceived to have a more ‘high-risk environment’ – a subjective assessment. They thereby face higher cost of capital.

This means higher interest rates on loans and higher expected returns on equity

Financing costs can be up to seven times higher in emerging and developing economies than in countries in Europe, and the United States (IEA)

Country	10 Year Bond Yield	S&P Rating	GDP Per Capita ($)
Zambia	30.56	SD	1,137.34
Pakistan	15.18	CCC+	1,505.01
Nigeria	14.47	B-	2,065.75
Kenya	14.26	B	2,081.80
Brazil	12.75	BB-	7,507.16
Turkey	11.72	B	9,661.24
Colombia	11.70	BB+	6,104.14
South Africa	9.88	BB-	7,055.04
Mexico	8.83	BBB	10,045.68
India	7.23	BBB-	2,256.59
Indonesia	6.68	BBB	4,332.71
Italy	4.09	BBB	35,657.50
United Kingdom	3.50	AA	46,510.28
Vietnam	3.45	BB+	3,756.49
United States	3.39	AA+	70,248.63
Spain	3.29	A	30,103.51
South Korea	3.26	AA	34,997.78
Canada	2.90	AAA	51,987.94
China	2.83	A+	12,556.33
France	2.76	AA	43,658.98
Netherlands	2.60	AAA	57,767.88
Sweden	2.32	AAA	61,028.74
Germany	2.24	AAA	51,203.55
Switzerland	1.17	AAA	91,991.60
Japan	0.46	A+	39,312.66

Source: CSE; Data from Trading Economics (accessed on Apr 11 and 12, 2023), and World Bank

Spotlight on 3 barriers hindering climate ambition in the Global South
#1 High cost of capital, particularly for green technologies

This particularly affects green technologies – which are newer and require more upfront capital investment.

This hinders the economic attractiveness of clean energy investment in these countries, even if they possess rich renewable resources

And climate impacts are further raising the cost of capital

Country	Weighted average cost of capital of utility-scale solar PV projects, 2021 (nominal, after tax)
Europe	3.0% - 5.0%
United States	3.5% - 5.0%
China	4.0% - 5.5%
Brazil	12.5% - 13.5%
India	9.0% - 10.5%
Indonesia	9.5% - 10.5%
Mexico	9.5% - 10.0%
South Africa	9.5% - 11.0%

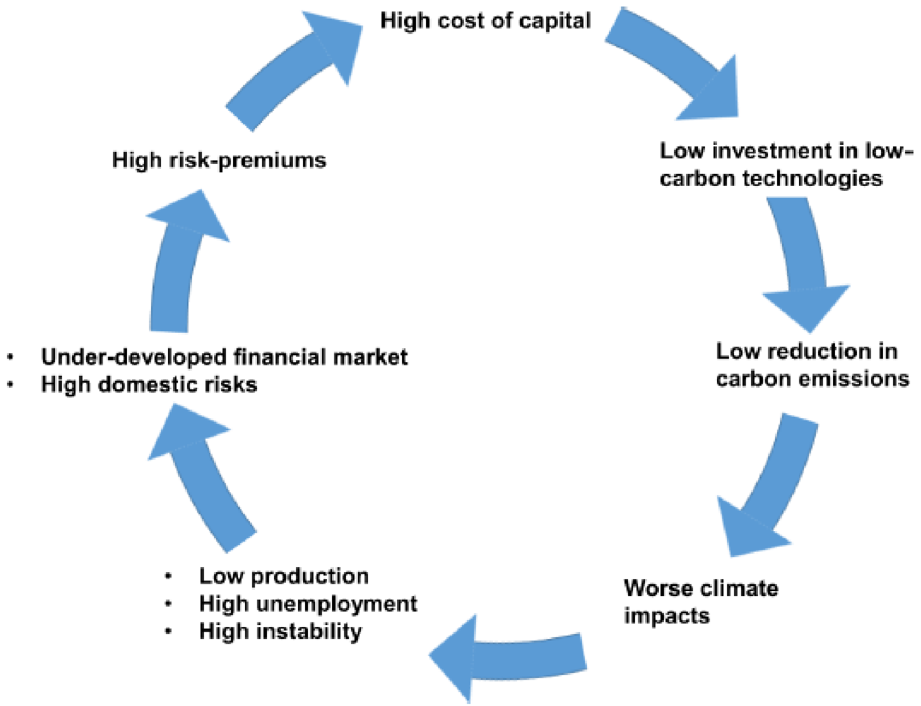
Source: IEA World Energy Outlook 2022

Spotlight on 3 barriers hindering climate ambition in the Global South

#1 High cost of capital, particularly for green technologies

This exacerbates what researchers have called a '**climate investment trap**'

High-risk perceptions produce high premiums, increasing the cost of capital for low-carbon investments, thus delaying the energy system transition and the reduction of carbon emissions. And unchecked climate change, leads to further economic losses, and increases risk further.



Source: Higher cost of finance exacerbates a climate investment trap in developing economies, University College London, 2021

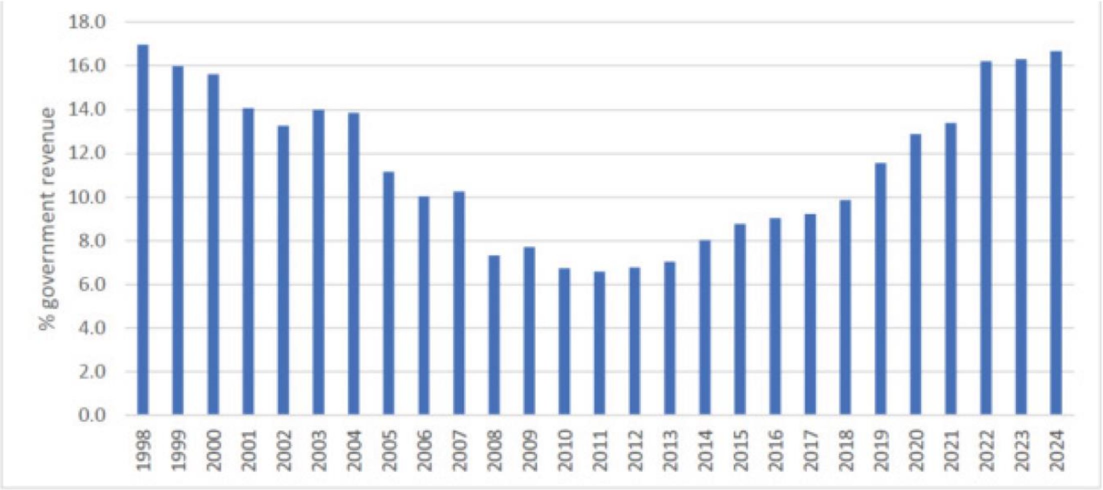
Spotlight on 3 barriers hindering climate ambition in the Global South
#2 High external debt burden

The Global South is currently facing a growing debt crisis

Debt-payments made by low-income countries are at their highest since 1998, with external debt-service payments from 91 countries averaging 16.3% of government revenue in 2023 (Debt Justice)

The reduced ability of governments to spend on critical areas such as climate change and the social sector have a negative impact on a country's development.

External government debt as percentage of government revenue of 91 countries



Source: Debt Justice, 2023

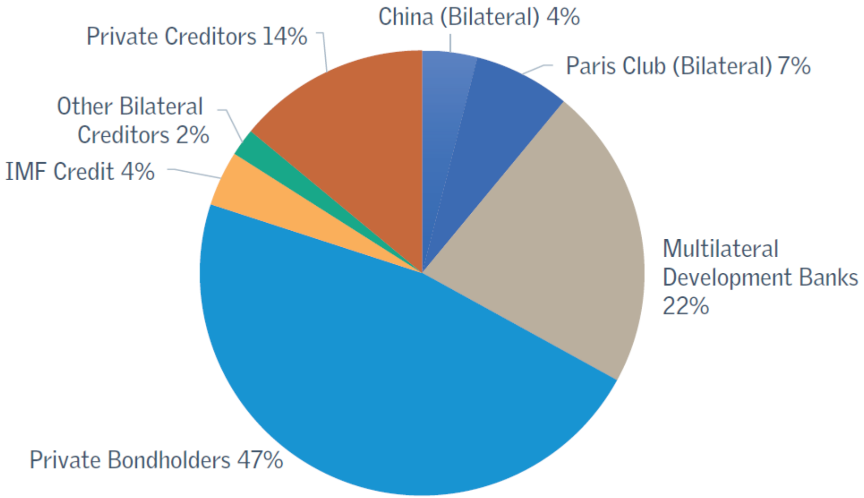
Spotlight on 3 barriers hindering climate ambition in the Global South

#2 High external debt burden

US$ 3.6 trillion in debt held by emerging markets and developing economies (EMDE)

The composition of debt ownership has changed from 2008 to 2021. For instance, the share of MDBs and bilateral aid from the Paris Club* have declined, whereas the shares of private bondholders and China as a bilateral lender have seen the largest increase.

Who owns the debt?



Source: Debt Relief for a Green and Inclusive Recovery: Guaranteeing Sustainable Development, 2023

**A group of 22 of mostly wealthy countries comprising Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Ireland, Israel, Italy, Japan, Netherlands, Norway, Russia, South Korea, Spain, Sweden, Switzerland, the United Kingdom, and the United States*

Spotlight on 3 barriers hindering climate ambition in the Global South

#2 High external debt burden

CSE found that debt burden exceeds annual cost of achieving the NDC for many low and middle-income countries; it is plausible that their **climate ambition is being hindered by debt obligations**.

In the absence of a comprehensive approach to solving the debt and climate crisis in the Global South, countries will be unable to make the urgent investments needed towards transitioning their economies towards a low carbon trajectory.

Sl. No.	Countries	Income classification, World Bank	Risk of debt distress, UNCTAD August 2022	ND-GAIN Vulnerability Score*, 2020	Total Debt Service (TDS) on External Debt in 2021 (in USD billion)	Annualised NDC Cost (USD billion)
1	Burkina Faso	Low-income	Moderate	0.55	0.50	0.41
2	Cambodia	Lower-middle-income	Low	0.51	2.19	0.40
3	Gambia	Low-income	High	0.55	0.04	0.02
4	Ghana	Lower-middle-income	High	0.47	3.23	0.93
5	Laos	Lower-middle-income	High	0.53	0.72	0.43
6	Lesotho	Lower-middle-income	Moderate	0.48	0.34	0.02
7	Liberia	Low-income	Moderate	0.60	0.06	0.05
8	Mozambique	Low-income	In debt distress	0.52	7.24	1.27
9	Myanmar	Lower-middle-income	Low	0.53	2.31	0.12
10	Nicaragua	Lower-middle-income	Moderate	0.45	1.37	0.17
11	Papua New Guinea	Lower-middle-income	High	0.54	4.05	0.20
12	Saint Lucia	Upper-middle-income	Moderate	0.36	0.05	0.04
13	Senegal	Lower-middle-income	Moderate	0.53	1.75	1.30
14	Sudan	Low-income	In debt distress	0.62	3.00	0.82
15	Tanzania	Lower-middle-income	Moderate	0.52	1.96	1.92
16	Zimbabwe	Lower-middle-income	In debt distress	0.55	0.58	0.48

Spotlight on 3 barriers hindering climate ambition in the Global South

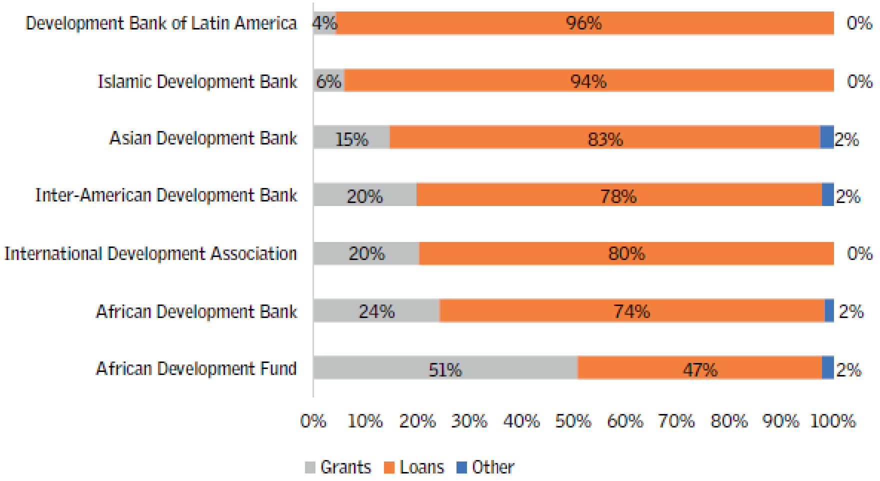
#3 Multilateral Development Banks are not serving the needs of the South

MDBs are an important source of concessional finance - with high credit rating of AAA, they can raise money from the markets at very low rates, and provide low-interest loans, and grants as well in some cases

But they are risk-averse; there is limited eligibility for middle-income countries for concessional finance; and MDB financing is heavily geared towards loans – they provide 80% of climate finance as loans. In fact, MDBs currently hold 22% of emerging market debt but do not participate in debt relief efforts

MDBs' mandate is being expanded to make financial flows "Paris-aligned" which could be paternalistic and impose top-down criteria that may narrow funding streams to developing countries

MDB Climate Finance 2010-20



Source: CSE, data from Aid Atlas

The way ahead

Way ahead

- Scholars and Global South countries have tabled various proposals focused on expanding MDB lending, increasing the flow of concessional finance to developing countries, and frameworks for debt relief

- It is a question of political will and adequate civil society pressure to have the most transformational solutions implemented

	PROPOSALS								
	Bridgetown Agenda	Debt Relief for a Green and Inclusive Recovery	Brad Setser and Stephen Paduano	African Development Bank	G20 Capital Adequacy Framework Report	V20 Countries	Civil society organisations	UNDP 2013	G20 Common Framework
Financial barriers for developing countries' green transition									
Poor sovereign credit rating, weak currency, dollar hegemony									
High cost of capital (both debt and equity) Lack of access to international capital markets due to high interest rates	Global Mitigation Trust using SDRs. Concessional finance from MDBs for adaptation		Use SDR denominated bonds to provide low interest loans	More finance from MDBs at lower interest rates	More finance from MDBs at lower interest rates	Accra-Marrakesh Agenda for more concessional finance		De-risking Blended finance	
High debt burden Inadequate fiscal space for climate investments	Debt suspension during natural disasters	Debt relief for public debt Debt hair cut and sustainability linked bonds for private, with guarantee facility				Enhanced Debt Sustainability Analysis	Debt cancellation Mandatory participation for private creditors Debt for climate swaps		Debt relief for select countries
Loss and damage	Reconstruction grants using fossil or shipping levies/ taxes						Grant-based finance through L&D Fund Taxes on shipping, fossil fuels, air passengersm financial transactions, wealth		

Source: Compilation by CSE

Way ahead

While the technical and political feasibility of the various proposals can be debated, we advocate for the following goals to guide discussions:

More concessional finance

- ❖ The Global South needs additional, and concessional finance flows for climate mitigation, adaptation and loss and damage. Additionality is crucial, existing funding pools cannot be repackaged via creative accounting. Increasing the capital base of MDBs and recycling of SDRs by rich countries must be considered for getting additional concessional finance.

Stop the ‘divide and conquer tactic’ against the poor

- ❖ 62% of the world’s poor live in middle-income countries; middle-income countries must be eligible for more additional, concessional finance and debt-relief.

Paris-Alignment of global finance cannot be a way to dilute a national government’s role in decisions

- ❖ Funds for climate change must be based on national action plans. For the South, climate action will be seeking co-benefit for development. We cannot lose sight of the need for development in the South.

We need a multilateral, rules-based approach to solving the debt and climate crisis

- ❖ The debt burden in the developing world must be urgently reduced, including the debt owed to private creditors. But as importantly, we need to stop the creation of new debt.

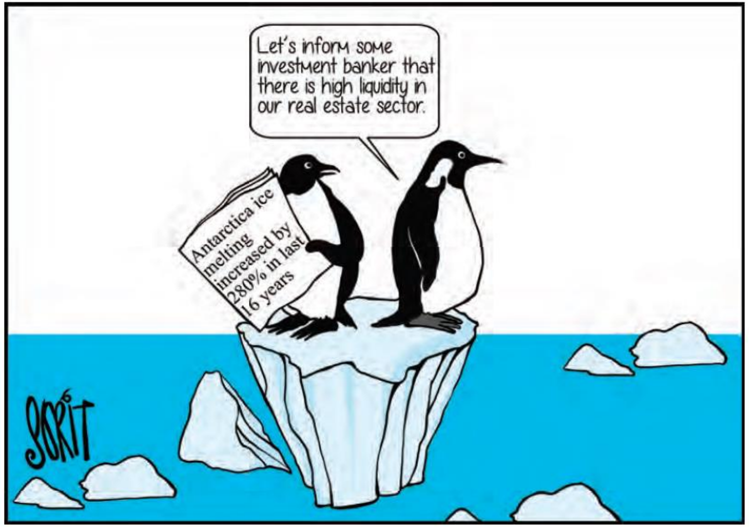
We cannot rely on the private sector to solve climate change—climate action is a public good

- ❖ Climate funding needs to be strategically driven by governments—and where appropriate—by multilateral institutions to ensure equitable allocation of funds to countries who need it the most.

Way ahead

It is unacceptable that it is being said at UNFCCC forums that developing countries do not want to take on climate ambition. The reality is that most of them **simply cannot afford it**.

2023 must be the year that civil society and scholars build pressure and scale up demands for the urgent systemic reforms that the Global South needs. The urgency of correcting the broken financial system cannot be overemphasized.



Thank you

Download our paper here: https://www.cseindia.org/beyond-climate-finance-climate-ambition-in-the-global-south-requires-financial-system-reforms-11753

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