Finance for climate action

Scaling up investment for climate and development

Report of the Independent High-Level Expert Group on Climate Finance

November 2022

Finance for climate action: scaling up investment for climate and development

Vera Songwe, Nicholas Stern and Amar Bhattacharya

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The COP26 and COP27 Presidencies, together with the UN Climate Change High-Level Champions, launched a new Independent High-Level Expert Group on Climate Finance last July, co-chaired by Vera Songwe and Nicholas Stern. Amar Bhattacharya was appointed as the Executive Secretary of the Group. The members of the group are indicated on the following page. Eléonore Soubeyran served as the Secretariat of the group. This independent group was tasked to help develop and put forward policy options and recommendations to encourage and enable the public and private investment and finance necessary for delivery of the commitments, ambition, initiatives and targets of the UNFCCC Paris Agreement, further reflected within the Glasgow Climate Pact, building momentum and further action for the Sharm el-Sheikh agenda and beyond.

The report, which was prepared by the co-chairs and the Executive Secretary, benefitted enormously from the active and high-quality participation, guidance and input of the members of the group. The views expressed are the responsibility of Vera Songwe, Nicholas Stern and Amar Bhattacharya and not necessarily those of individual members, nor does the report purport to represent the views of either the COP26 or COP27 Presidencies or the Climate Champions.

Special thanks go to Eléonore Soubeyran for anchoring the preparation of the report. The authors would also like to thank Georgina Kyriacou, with support from Natalie Pearson, for copy-editing and production. The writing team was led by Amar Bhattacharya under the guidance of Vera Songwe and Nicholas Stern. The team included Eléonore Soubeyran (ch. 2, 3, and appendices), Homi Kharas (ch.6), Mattia Romani and Katherine Stodulka (ch. 7), Josué Tanaka (ch. 8), Rob Macquarie (ch. 9.3 and 10), and Danae Kyriakopoulou (ch. 10).

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Members of the Independent High-Level Expert Group on Climate Finance

Co-chair

Ms Vera Songwe

Co-chair

Professor Lord Nicholas Stern

Executive Secretary

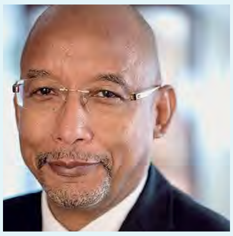
Mr Amar Bhattacharya

IHLEG members

Dr Amal-Lee Amin

Dr Barbara Buchner

Dr Frannie Léautier



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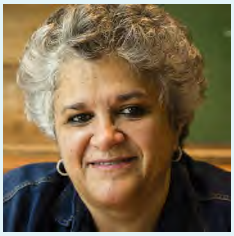

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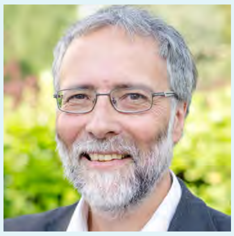

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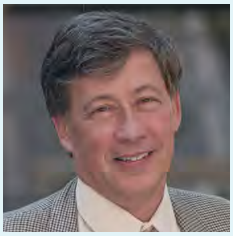

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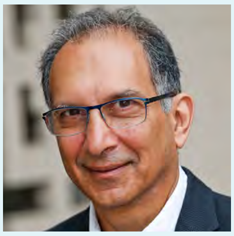
Mr Frédéric Samama



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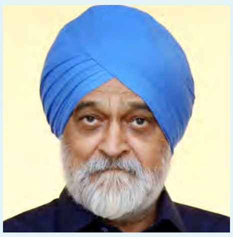
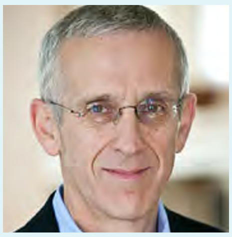
Mr Jean-Paul Adam

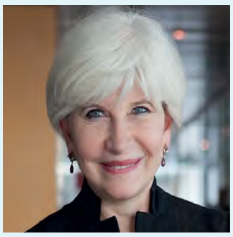
Mr Joaquim Levy



Mr Montek Singh Ahluwalia



Mr Todd Stern



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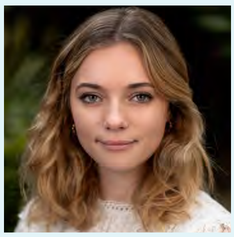
Professor Richard Calland

Secretariat



Ms Eléonore Soubeyran

Contents

Summary

A critical moment for climate action (Section 1)

Our world is in peril: the climate crisis is accelerating. Current action is too weak and too slow; to delay is dangerous. This is also a moment of great opportunity. One path leads to attractive growth and development, the other to destruction, catastrophe and loss of lives and livelihoods on a massive scale, especially for the vulnerable. As shown by each successive report from the Intergovernmental Panel on Climate Change, climate change is occurring at a faster pace than previously anticipated, the impacts and damage are greater than foreseen, and the time for remedial action is rapidly narrowing. Emissions are still rising and tipping points getting closer. What happens in this decade is decisive for the world.

Acting on climate is about transforming our economies, particularly our energy systems, through investing in net zero, adaptation, resilience and natural capital. That investment leads to a much better form of growth and development than the dirty and destructive pathways of the past. There are new technologies, which are costing less and less, and a growing realisation of the tremendous co-benefits, including for health and general wellbeing, that come with climate action. Acting decisively will deliver not only on climate but on strong and inclusive growth and development and the drive towards the attainment of the Sustainable Development Goals. It is the growth story of the 21st century: sustainable, resilient and inclusive.

Achieving this transformation will not be easy. It requires strong investment and innovation, and the right scale of finance of the right kind and at the right time. This report sets out the investment that will be necessary and how it can be financed. It is finance for action; the action, particularly the investment, that can deliver on the agreements made at COP21 in Paris and COP26 in Glasgow. And the challenges require action across the board: on mitigation, adaptation/resilience/damage, and natural capital.

The failure to deliver the climate finance commitment of $100 billion per year by 2020 made by developed countries at successive COPs has eroded trust. According to the latest assessment of delivery plans, the $100 billion commitment will be met only in 2023, three years past the target date, and only then mainly because of increased financing from the multilateral development banks (MDBs). Bilateral public finance, which is the most important indicator of the direct contribution by developed countries, has not increased measurably since 2016 and there remain important shortfalls in its quality. The delivery of the $100 billion is an immediate task, but governments of developed countries need to go well beyond that, starting now.

The world needs a breakthrough and a new roadmap on climate finance that can mobilise the $1 trillion per year in external finance that will be needed by 2030 for emerging markets and developing countries (EMDCs) other than China. There is a significant role for public policy and government action to foster investment, and complementary roles for the private sector, MDBs, international financial institutions (IFIs), and concessional finance of various forms. Powerful multipliers can emerge from the complementary strengths of all sources of finance.

In particular, the realisation of the necessary investments and their finance requires:

- **Accelerating investment**: Rapid delivery of investment projects, at scale
- **Mobilising private finance at scale**: The private sector making the largest increase in financing, both foreign and domestic
- **Revamping the role of MDBs**: Stepped-up engagement and tripling of the annual flows from the MDBs and other development finance institutions (DFIs) in the next five years
- **Delivering on and expanding the scope of concessional finance**: A doubling of concessional finance from rich countries by 2025 from 2019 levels, together with strong expansion of the envelope of low-cost finance through innovative ways (including special drawing rights, voluntary carbon markets, philanthropy, and guarantees similar to those of the International Financing Facility for Education [IFFED])
- **Tackling indebtedness**: Resolving the debt and liquidity issues facing many countries.

These actions will also play a crucial role in fostering the recovery of the world economy and tackling its short-term pressures. At the same time, the rapid movement away from fossil fuels will radically reduce the likelihood of energy crises in the future.

The argument is therefore about what is necessary for delivery of the Paris Agreement, reinforced by the Glasgow Pact. It is about implementation. In this sense it is a deductive argument or an 'engineering approach', given the objectives the world wisely set in Paris. More than being 'nice to have', in the hope that 'we'll get there in the end', it is what the world *has* to do, rapidly, this decade, to mitigate the terrible dangers we now face. That is the starting point for working out the different kinds of finance that must be involved. At the same time, doing what is necessary for climate will deliver a new form of development. And it will help protect our precious natural resources and biodiversity.

Scope of the paper

The logic of this paper follows from the logic of delivering on the goals of the Paris Agreement and the Glasgow Pact. The first part (Sections 1– 3) focus on this purpose and the necessary investment and actions, drawing on earlier work on the analysis of investments by members of the group and others. The second part (Sections 4–9) is about the scale and nature of the different forms of finance that are necessary for this investment and how they complement each other. Section 10 is on how the framework and the key elements described can be taken forward through our systems for international collaboration, while Section 11 concludes with overall next steps.

The paper is intended to provide a framework for finance for climate action covering the overall needs for the comprehensive approach embodied in the Paris Agreement and UNFCCC. All the elements are necessary and urgent; it is a complementary and mutually supportive package. Most of the actions must start now; it is the science and the world's perilous condition that set the urgency and timing. The paper also looks ahead to the coming decade and beyond. We do not attempt to provide great detail on every element of the package, but we are clear that there is a practical way forward on each.

A major, rapid and sustained investment push (Sections 2–4)

A major push is needed to drive a strong and sustainable recovery out of current and recent crises, transform economic growth, and to deliver on shared development and climate goals, in particular those agreed at COPs 21 and 26. While the investment push is needed across all the Sustainable Development Goals, the key investment and spending priorities to ramp up climate action and deliver on the Goals must encompass:

- **The transformation of the energy system,** which is vital for both development and climate.
- **Responding to the growing vulnerability of developing countries to climate change.** This will mean greatly accelerating investments in adaptation and resilience and much better mechanisms to deal with loss and damage.
- **Investing in sustainable agriculture and restoring right away the damage human activity has done to natural capital and biodiversity** in terms of degraded land, deforestation, and damage to water supplies and the oceans.

For all three of these priorities, timing is crucial; delay is dangerous. Developing countries will not be able to meet these goals on their own. Developed countries have a crucial responsibility from the standpoint of climate justice, given historical responsibilities and the interrelationship with poverty reduction. Acting strongly is also in their own self-interest.

The starting point for a big investment push must be strong country leadership and actions. Investment demand depends critically on confidence in future pathways, and therefore all countries need to set out well-articulated investment programmes to stimulate recovery and transformation. These programmes should be anchored in sound and convincing long-term strategies to deliver on development and climate goals. The programmes need to be translated into concrete pipelines of projects and supported by a favourable investment climate. Clarity and credibility over the medium term are crucial if potential investment opportunities are to become investment realities.

All countries need to build the institutional capacity that can shape and manage the long-lasting investments needed in sustainable infrastructure, to reform policies that can ensure the quality and sustainability of the investments, including carbon pricing and removal of distortionary subsidies, and to provide supportive standards and regulations.

Country/sector platforms driven by countries can bring together key stakeholders around a purposeful strategy, scaling up investments, tackling obstacles or binding constraints, ensuring a just transition and mobilising finance, especially private finance. **Regional and sub-regional platforms** can also play an important role in accelerating investments and mobilising the necessary finance.

Recasting domestic and international finance for sustainable investment (Section 5)

The scale of the investments needed in EMDCs over the next five years and beyond will require a debt and financing strategy that tackles festering debt difficulties, especially those of poor and vulnerable countries, and that leads to a **major expansion of both domestic and international finance, public and private, concessional and non-concessional.**

Emerging markets and developing countries other than China will need to spend around $1 trillion per year by 2025 (4.1% of GDP compared with 2.2% in 2019) **and around $2.4 trillion per year by 2030** (6.5% of GDP), on the specific investment and spending priorities identified above. These numbers are based on the analytical work set out in Bhattacharya et al. (2022) assessing sector and geographical requirements for investments and actions to keep the target of capping warming at 1.5°C in reach and to meet the goals of the Paris Agreement across all its dimensions. The numbers are broadly consistent with the work of the International Energy Agency and the Energy Transition Commission. They are translated in this paper into UNFCCC and COP climate investment and spending categories, rather than by sector. They are the per-annum flows necessary in the years indicated.

An overall financing strategy must be built, based on a granular understanding of the different areas being financed. It would utilise the complementary strengths of different pools of finance to ensure the right scale and kind of finance for different needs. It would blend finance with different costs and maturities, including grants and concessional finance, in order to match the financial returns and risks from investments. It would therefore consider different strands of finance as a complementary package, rather than simply focusing on the aggregate number. It would align all finance with sustainability, including climate goals, in line with Article 2 of the Paris Agreement, and it would create the necessary financing partnerships to deliver concrete results.

Around half of the required financing can be reasonably expected to come from local sources, from strengthening domestic public finance and domestic capital markets, including tapping into large pools of local finance that national development banks are able to mobilise. Strengthening tax collections and reducing fossil-fuel-linked subsidies will be important, partly for the fiscal space freed up and partly for the improvement in incentives for private investment that is created when instruments like a carbon tax are applied. The focus of this report, however, is on external financing, so these local financing issues are not treated in depth, although they are integral to the judgement that around $1 trillion per year of external finance will be required by 2030 to meet the scale of the investment needs.

These aggregates are therefore very different from the famous '$100 billion per year by 2020' target, negotiated first in Copenhagen at COP15 in 2009 (and part of the Copenhagen Accord), and embodied in the agreements of COP16 in 2010 in Cancun, and COP21 in 2015 in Paris. **The $1 trillion per year is a very different concept – it is a requirement based on an analysis of the investment and actions necessary and the domestic finance potentially available, for an internationally agreed and vital purpose. The $1 trillion is not the new $100 billion.** The latter was negotiated, not deduced from analyses of what is necessary for a purpose.

Tackling debt difficulties (Section 6)