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

Amar Bhattacharya

Senior Fellow, Brookings Institution

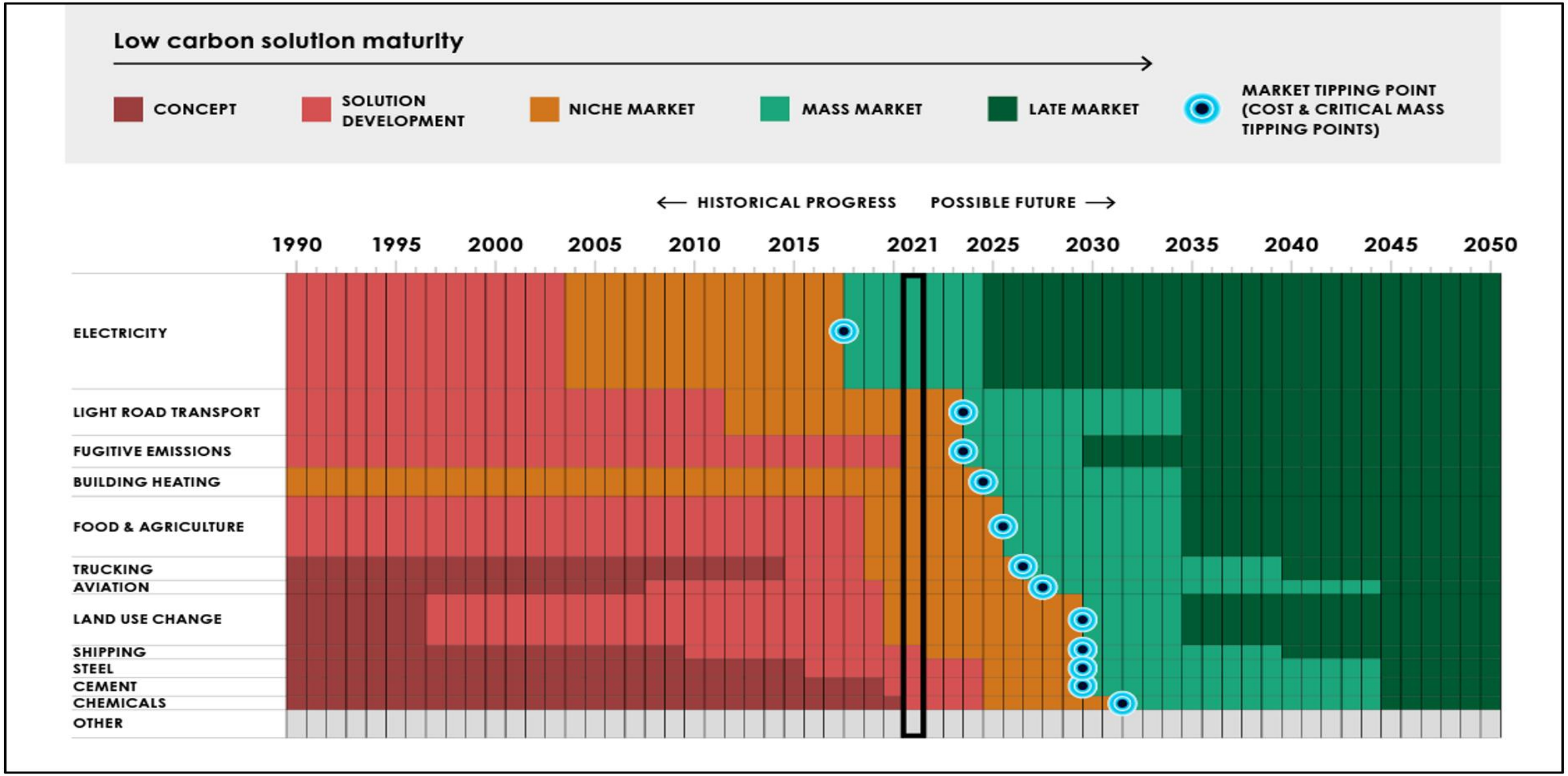
G24 Technical Group Meeting
Abidjan
July 18, 2023

A critical moment in time

- A moment of **great risk and great opportunity**. One path leads to attractive growth and development, the other to great difficulties and indeed destruction.
- Even before the COVID-19 pandemic, emerging markets and developing countries (EMDCs) were facing challenges. As a result of the Covid pandemic and the war in Ukraine, **EMDCs are under great pressure**.
- The present trajectory is one of slow growth, low investment and public spending, and rising debt service burdens in many, if not most, EMDCs. **Risk of a lost decade for development**.
- We are **off track on virtually all SDGs** and ill prepared for the **major demographic transitions** ahead.
- At the same time the **urgency and opportunity of tackling climate change** is becoming ever clearer.
- **Equally urgent challenge to protect and restore nature**.
- Acting on climate and nature is not a cost but rather an **opportunity to unlock new and better forms of growth.**
- **A major push on investment and innovation** can drive a sustainable recovery and make a breakthrough on both development goals and climate.
- Seizing that opportunity will **require a clear strategic direction, strong and purposive policies, a massive scaling up and shift in investment and the mobilisation of the right finance at the right scale.**

Tipping points for green transformation by sector

Historical progress and indicative future timeline



Source: Stern et al. (2023)

Investment must scale up by several points of GDP

Investment/spending needs per year for sustainable development and climate action for EMDCs (other than China):

Estimate	2019 US$ billion	2019 % GDP	2030 US$ billion	2030 % GDP	Gap (2030 minus 2019)[1] US$ billion	Gap (2030 minus 2019)[1] % GDP
SDG-related investment[2]	2,385	11.3%	5,400	18,2%	3,000	6.9%
Of which climate and related investments[3]	550	2.4%	2,400	7.2%	1,800	4.8%

Notes:
1. Gap is defined as difference between estimated investment needs in 2030 and current baseline of investment in 2019.
2. Human capital, sustainable infrastructure (including on the energy transition), adaptation and resilience, AFOLU.
3. Energy transition, adaptation and resilience, AFOLU.

Source: Bhattacharya et al. (2022)

The growth and structural change agendas in EMDCs will already entail substantial energy investment. Savings from avoided investments in fossil fuels in EMDCs dwarf additional climate investment needs.

Investment requirements in natural capital, adaptation and resilience, and spending on loss and damage will be additional.

Investment and spending priorities for climate action and sustainable development

While the investment push is needed across the full spectrum of the sustainable development goals, the key investment and spending priorities to ramp up climate action and deliver on the related sustainable development goals are:

- **Transformation of energy systems**: major and rapid scale up of renewable energy; complementary public infrastructure; energy efficiency and transformation of demand; just transitions; curb methane emissions.
- **Respond to the growing vulnerability of developing countries** to climate change: both more frequent and damaging extreme events and the effects of "slow onset" especially on heat, precipitation and water. This will mean much better mechanisms to deal with loss and damage as well as greatly accelerating the investments in adaptation and resilience.
- **Investing in sustainable agriculture and natural capital,** which will be key to mitigation, adaptation and development. We must also ensure that we begin to restore right away the damage that we have done to our natural capital in terms of degraded land, deforestation, and damage to our water supply and oceans.

The climate and the biodiversity crises are deeply intertwined: they share common drivers, and each global challenge can worsen the other. As such, they must be addressed together.

Translating investment opportunities to reality: unlocking ambitious investment programmes

- Investments to ramp up climate action, for both mitigation and adaptation, will remain academic, unless countries are able to develop and implement investment programmes in a purposeful way.
- These **programmes need to be translated into concrete pipelines of projects and supported by a favorable investment climate**. Investment depends on expectations, and clarity and credibility over the medium term are crucial.
- Countries will need therefore **strong and sustained policy and institutional reforms** to unlock the scale and quality of investments and mobilise the domestic resources that will be needed. A concerted push will be needed on **capacity building**.
- **Country/sector platforms**, driven by countries, help bring together key stakeholders around a purposeful strategy, scaling up of investments, tackling binding constraints, ensuring a just transition and mobilization of finance especially private finance.
- It will also be important to make market mechanisms work more effectively and efficiently to direct capital where needed.

Reaching the $100 billion goal: a crucial first step

Assessments of finance provided and mobilised by developed countries for climate action in developing countries in 2020 (US$ billion)

	Biennial Assessment, 2022	OECD, 2022
Public climate finance provided	68.1	70.2
Private climate finance mobilised	22.7	13.1
Total climate finance mobilised	**90.8**	**83.3**

Source: Songwe et al. (2022)

- The long-standing commitment by developed countries to provide $100 billion a year for climate action in developing countries is both an important **symbol of trust** and **fundamental to progress** on climate action.
- **Donors committed to deliver $100 billion in 2023** at the Petersberg Dialogue in May, and G7 Leaders reaffirmed this intent in the Hiroshima Declaration in May.
- What we now need are concerted efforts on these commitments. Together with the sustained progress on the delivery of climate finance by MDBs, including by the International Development Association (IDA), which provides crucial support for low-income countries, and improved private mobilisation efforts, **there is a good likelihood that the $100 billion commitment can be met in 2023**.

A new approach to finance: scale, urgency and options

- 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.
  - ✓ leads to a major expansion and **revamp of both domestic and international finance, public and private.**
- An overall financing strategy must utilize the **complementary strengths** of different pools of finance to ensure the right scale and kind of finance and to reduce the cost of capital rather than simply focusing on the aggregate number.

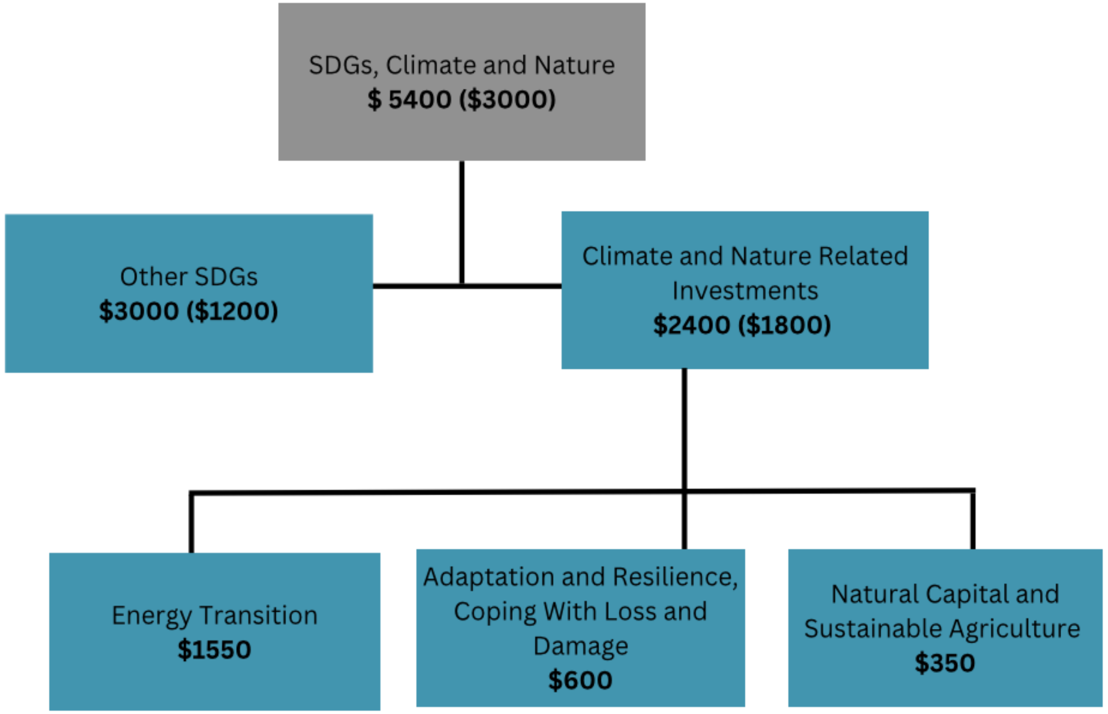
It must embody a **holistic and comprehensive approach** to climate finance**.**

It must **align all finance with sustainability, including climate goals**, in line with Article 2.1c.

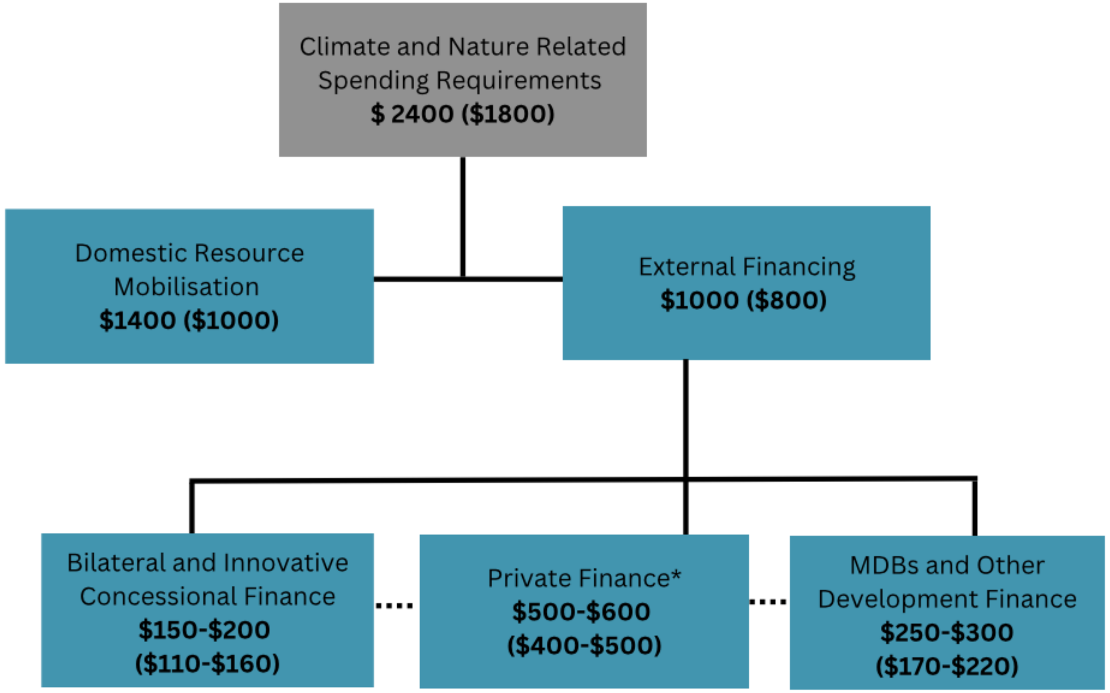
It must **create the necessary partnerships** to deliver concrete results.

An additional $1 trillion per year is needed in external finance from different sources (1)

Investment / Spending Requirements for Climate and Sustainable Development ($ billion per year by 2030, increment from current in parentheses)



Financing the Green Transition ($ billion per year by 2030, increment from current in parentheses)

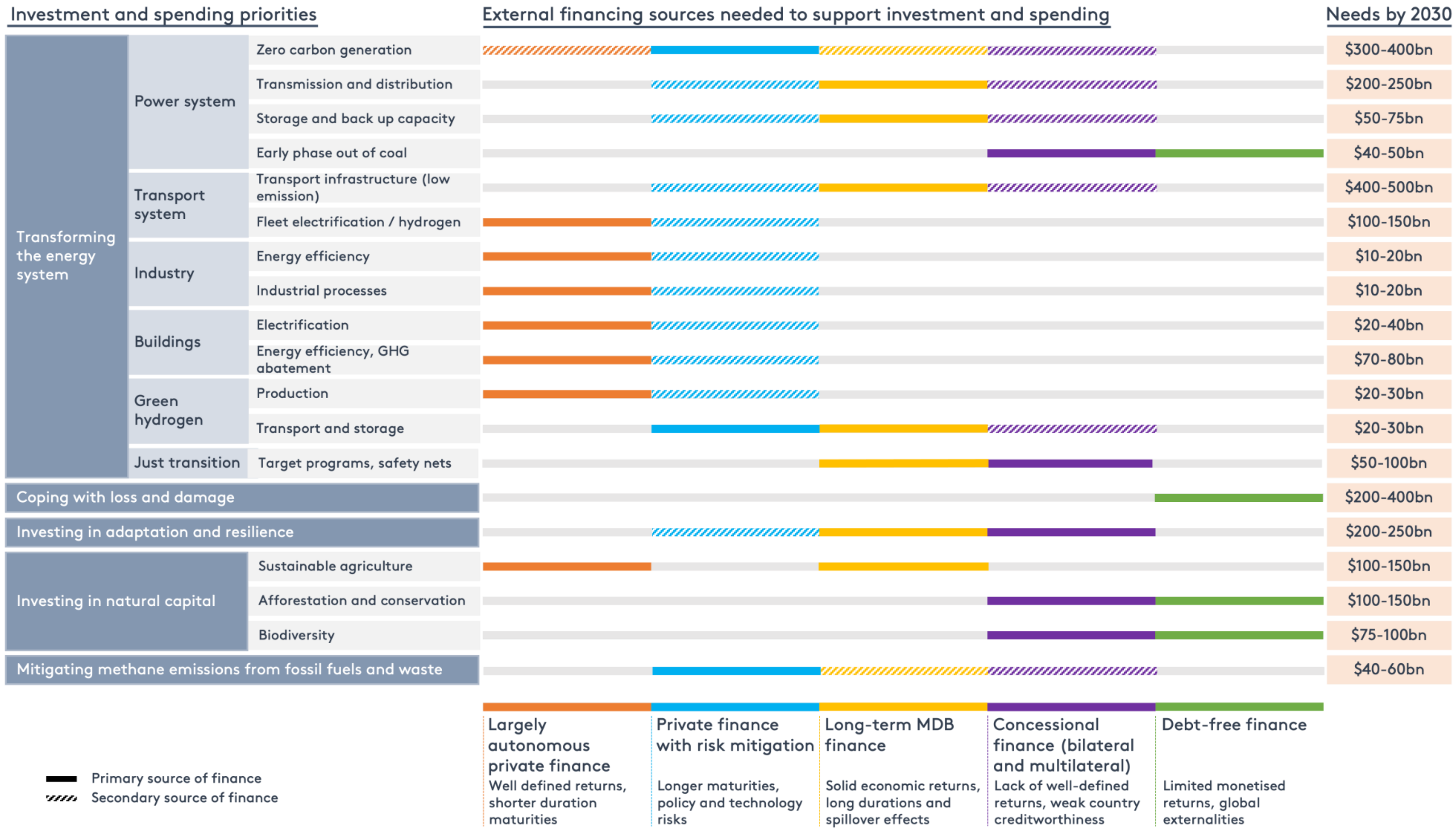


Source: Bhattacharya et al., 2023

*More than half of this private finance would be directly and indirectly catalysed by MDBs, other development finance institutions, and bilateral finance.

An additional $1 trillion per year is needed in external finance from different sources (2)

External financing sources for investment and spending priorities for climate action and related development goals



Notes:
The categories of investment and spending necessary to meet climate and development goals are shown on the left-hand side. For each, we outline the mix of financing needed from external sources to support the related investment and spending priorities.

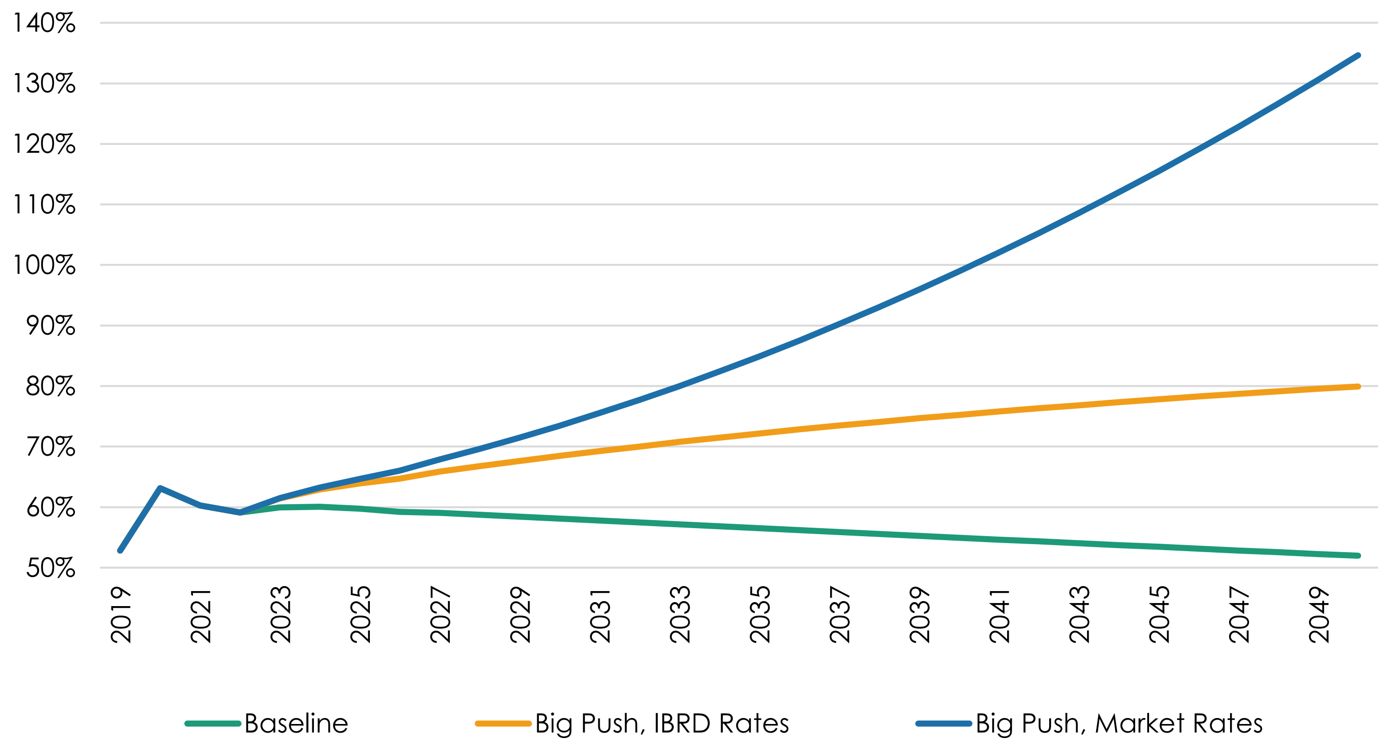
We distinguish between sources that would constitute the primary source of financing for one sector, and those that would play a secondary role.

On the right-hand side we outline the estimated investment and spending requirements by 2030 for each category.

Source: Songwe et al. (2022)

Addressing the debt challenge

Average developing county debt projections from 2019 to 2040



Source: Songwe et al. (2022)

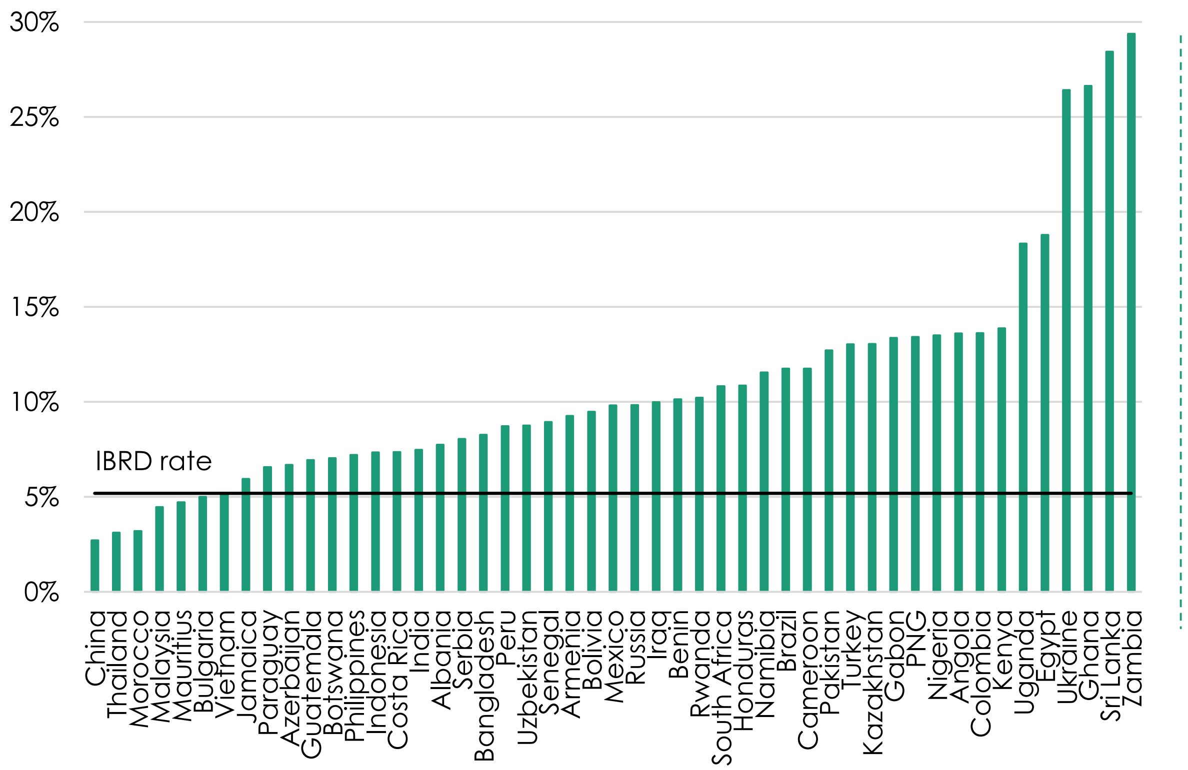
A big push strategy is feasible only if the incremental financing comes largely on terms that are affordable, comparable to IBRD rates of interest.

Mobilizing private finance at scale

- A growing proportion of investments can now be undertaken by the private sector. However, the **mobilization of private finance today is far too low** and will have to increase many times over.
- **Several private-sector led initiatives** have been launched over the past two years. MDBs have also come forward with important new initiatives to catalyze private finance.
- **Must create a new highway for private finance.** Need to shift from the present "blame the other" approach to a proactive engagement between governments, the private sector, and DFIs to **co-create investment opportunities, tackle impediments, put in place effective risk mitigation structures** that can go to scale, and use blended finance judiciously to bring down the cost of capital.
- **Need to develop concrete and standardized approaches** that can unlock institutional capital at scale.
- **Sustainable finance agenda** to help expand and improve the alignment of climate finance.

The cost of capital must be tackled

Developing country 10-year bond yields



Source: Trading Economics and World Government Bonds, Market Insider, and Haver Analytics

Return expectation from solar projects in EMDCs

Country	S&P Rating	Required return from solar project (%)
Germany	AAA	7%
USA	AA+	9%
UAE	AA	10%
Saudi Arabia	A-	12%
Chile	A	12%
Morocco	BBB-	15%
India	BBB-	17%
Algeria	B	18%
Oman	BB-	18%
Peru	BBB	20%
Costa Rica	B	21%
Namibia	BB-	21%
Ghana	B-	22%
Brazil	BB-	22%
Nigeria	B+	22%
Bolivia	B+	24%
Tanzania	B	24%
Egypt	B	28%
Zambia	CCC-	38%
Argentina	CCC+	52%

Source: CPI, forthcoming

MDBs are central to the expansion of investment in climate and development action in EMDCs

- Considering the scale and urgency of current climate and development challenges, MDBs and the development finance system as a whole will need to significantly increase their activities.

  - ✓ Working as a system, the MDBs should engage with countries and the private sector to play a purposive and **proactive role in helping countries define, identify, enable and foster the investments and programmes necessary**.
  - ✓ MDBs have a critical role to play in **catalysing private finance** and in supporting the large **necessary public investments.**
  - ✓ The MDBs and their shareholders must explicitly recognise that these tasks **require a multiplying of their flows of finance by a factor of three.**
  - ✓ This scaling up of financial flows from the MDBs can be built in part on **more effective utilisation of the capital already available.**
  - ✓ Shareholders must recognise that **substantial capital increases for the MDBs over the coming five years will be required** to achieve the necessary three-fold increase in flows.
  - ✓ Beyond the MDBs, there is great potential to **harness the entire public development bank system**.

- Recommendations of G20 Expert Group on MDB Reform

Scaling up concessional finance is critical

- Donors must:
  - ✓ Deliver on the $100 billion commitment in 2023 and meet immediate priorities: IDA cliff, GCF replenishment, loss and damage facility.
  - ✓ Double **bilateral climate finance** to $60 billion by 2025 from its 2020 level.
  - ✓ rapidly scale up their commitment to **adaptation finance** in line with the Delivery Plan.
  - ✓ enhance their support to the **multilateral concessional** climate-related funds.
  - ✓ Improve effectiveness and alignment with country priorities, access and transparency
- Expand the envelope of low-cost finance:
  - ✓ **Augment the use of special drawing rights** (SDRs) for climate finance by bolstering further the Resilience and Sustainability Trust; modernize the architecture for rechanneling SDRs; augment the pool of SDRs through regular issuance; expand channels for use including MDBs; and leverage SDRs to catalyze private finance.
  - ✓ **Tap voluntary and compliance carbon markets** for priorities such as restoration of forests, peatlands and degraded land and the accelerated phase-out of coal.
  - ✓ **Create International Financing Facility** like mechanisms for climate and nature and **leverage the growing flows of private philanthropy**
  - ✓ **Expand debt-for-climate and nature swaps**
  - ✓ **Options to tax fossil fuel use globally including in the maritime and aviation sectors**

Conclusion

- We are at a **critical moment for the future of people and planet**.
- A **big push on investment on development, climate and nature**, together with innovation and a sharp focus on sustainability, can drive a sustainable recovery from the present crisis, restore momentum on development and poverty reduction, and is the ONLY way to keep climate goals in reach.
- We have in our reach a much **more attractive form of growth**—more sustainable, inclusive and resilient.
- Such a **big push will be challenging but feasible. Delay is deeply dangerous**.
- **Domestic leadership and action** on policies and resource mobilization will be foundational.
- But will **need to mobilize substantial external resources and support** given the scale and urgency of the challenge. Three main pillars of such finance:
  - A **major revamp of the MDB and broader DFI system** to triple their financing flows in the next five years and enable them to catalyze private finance.
  - Creating a **new highway for private finance**.
  - **Greatly expand the scale of concessional financing and debt-free finance** through renewed donor commitment starting with the immediate delivery of the $100 billion and expanding the envelope through innovative options.
- Cooperation and coordination on this big push can be accelerated through **country/sector, regional and global platforms** with buy-in of all stakeholders.
- **Immediate debt difficulties** of poor and climate-vulnerable countries and the vicious cycle of climate and debt vulnerability must be tackled with urgency.