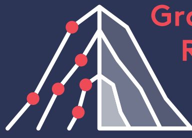

Grantham Research Institute on Climate Change and the Environment

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# Policy note

## Beyond the $100 billion: financing a sustainable and resilient future

This policy note has been written by **Amar Bhattacharya** and **Nicholas Stern.**

### Headline issues

- Developed countries' commitment to mobilise $100 billion a year by 2020 to support developing countries on climate action is both an intensely important symbol of trust and foundational to progress on climate action by developing countries.
- The commitment, made at COP15 in 2009, formalised at COP16 and reaffirmed in the Paris Agreement, reflected the importance of climate justice and what is possible with the right support. That spirit applies with equal force today.
- Donors collectively fell short of the goal in 2020, but there is an opportunity to step up and deliver in 2022.
- Developed countries must go beyond the $100 billion in three important respects: delivering on the scale and quality of climate finance needed to ramp up ambition; utilising the complementary strengths of the different pools of finance rather than simply focusing on the aggregate number; and creating the necessary partnerships to deliver concrete results.
- Effective finance that matches the scale and nature of challenges facing developing countries is critical if developing countries are to implement a green recovery from COVID-19, raise ambition on climate change mitigation, build climate resilience, and make the necessary investments in restoring natural capital, including biodiversity.
- In turn, the scale and pace of investments in developing countries will determine whether the world as a whole is able to stay on course to keep global warming to within 1.5°C, build adequate resilience against climate change impacts and meet global targets on nature.
- COP26 must pave the way for constructive discussions and substantive and credible proposals on how to mobilise the trillions of dollars that will be needed for a green recovery and sustained transformation. Weak and delayed action will further undermine trust and lead to a downward spiral in the ability of the world to act together on the scale and at the pace needed.

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## Where we are

While there has been progress in both bilateral and multilateral public finance flows since 2013, climate finance flows attributable to developed countries were around $20 billion short in aggregate of the $100 billion per annum target by 2019. This is indicated by the most recent biennial investment of the Standing Committee on Finance, annual assessments by the Organisation for Economic Co-operation and Development (OECD), and the review of the UN Independent Expert Group on Climate Finance.

At the request of COP26 President Designate Alok Sharma, Minister Jonathan Wilkinson of Canada and State Secretary Jochen Flasbarth of Germany have co-led a process of developing a climate finance delivery plan, assessing when and how developed countries will meet the $100 billion goal. This assessment of current and forward-looking plans suggests that donors collectively fell short of the goal in 2020.

In the lead-up to the G7 Summit in Carbis Bay in June, the UN General Assembly Summit in September and the COP26 conference, several bilateral donors and multilateral institutions came forward with more ambitious commitments. Based on a detailed assessment of these plans with the technical support of the OECD Secretariat, the Delivery Plan concludes that "developed countries will make significant progress towards the US$100 billion goal in 2022 and express confidence that it would be met in 2023. The data also gives us confidence that we will likely be able to mobilize more than US$100 billion per year thereafter."

The Delivery Plan also acknowledges the need to tackle shortfalls in the quality of climate finance. These include its poor predictability, an inadequate focus on adaptation and on poor and vulnerable countries, a low share of grants, and difficulties in access to climate finance, especially by poor and vulnerable countries.

## Where we must go now

International climate finance is critical now to help developing countries meet two urgent and overlapping needs. The first is the imperative and opportunity for a strong and sustainable recovery and to build back better from the COVID-19 pandemic. The second is sustained transformation to accelerate the transition to a net-zero and climate-resilient future.

Both will require an exceptional push on the scale and quality of investments. Investment collapsed in developing countries in the aftermath of the COVID crisis and most developing countries have not been able to put in place ambitious recovery packages, in part due to stringent fiscal and debt constraints. Recovery packages need to be in the order of 2–3% of GDP in order to restore growth and make a strong shift towards green investments. Beyond the immediate recovery, many developing countries will need a sustained increase in investment in the order 5–6% of GDP by the end of the decade if they are to put their economies on a credible path to deliver on development and climate goals. The articulation of needs by developing country Parties to the Standing Committee on Finance are broadly consistent with these estimates.

**The key priorities related to climate are:**

- To ramp up investment in sustainable infrastructure and accelerate energy transitions – to meet large and growing energy needs through renewable energy, accelerate the phase-out of coal, transform energy demand across the economy, and ensure a just transition.
- To scale up investments in climate change adaptation and resilience, especially in low-income and vulnerable countries.
- To invest in the restoration of natural capital (through agriculture, food and land use practices) and biodiversity.

Altogether, emerging markets and developing countries other than China will need to invest around **an additional $0.8 trillion per year by 2025 and close to $2 trillion per year by 2030** on these priorities.

- **About half the needed resources could come from improved domestic resource mobilisation,** including tax and subsidy reform and carbon pricing. International cooperation on a minimum tax threshold, tax avoidance and profit shifting, and equitable sharing of tax revenues, can bolster national efforts.
- **International climate finance must also step up, in two important ways:**
  - First, donors and multilateral institutions must step up in 2022 to support a green recovery from COVID in developing countries. *This means that there is a need and an opportunity to deliver on the $100 billion commitment in 2022*.
  - Second, international climate finance must be scaled up thereafter to support greater climate ambition and the build back better agenda in developing countries that can deliver on both climate and sustainable development.
- **Private finance, domestic and international, should have a much greater role** going forward, given the fiscal constraints and the much greater possibilities for the private sector to participate.

## An action agenda on climate finance

**The first priority is the delivery of the $100 billion.** Delivery of the $100 billion commitment is about more than the numbers adding up: it is about the impact and makeup of climate finance and about building ambition for 2025 and beyond. The needs of developing countries go far beyond $100 billion per year. Climate finance must therefore continue to grow over time and help accelerate the wider shift in finance flows needed to implement the Paris Agreement.

While private climate finance must play an increasingly important role, there is no credible route to meeting the Paris goals without there being a significant increase in international public climate finance in the coming years as part of the effort to mobilise the trillions needed to keep the 1.5°C target in reach. International public finance plays a critical role in financing public investment priorities and helping to reduce, manage and share risk in order to unlock and scale up private finance.

**The action agenda must encompass five elements:**

**1. Donors must double bilateral climate finance to $60 billion by 2025 from its 2018 level.**

Concessional finance from bilateral donors is the most critical component of the $100 billion commitment. It is central to COP26 priorities, including adaptation and resilience, nature and biodiversity and support for poor and vulnerable countries. It is also critical to scaling up other pools of climate finance, including the multilateral climate funds and the multilateral development banks, and ultimately leveraging the much larger sums of private finance that will be needed. To achieve this, all developed countries will need to increase their climate finance commitments, recognising that some are already providing a greater share of climate finance than others.

There is also an urgent need to increase the ***level of grant financing*** from its present low amount ($12 billion in 2018) and to ensure that ***at least half of concessional climate finance supports adaptation and resilience objectives, including by an immediate doubling of public climate finance for adaptation.***

**2. Donors should step up their financing of the multilateral concessional funds – starting with ongoing replenishments – given their important catalytic and leveraging role.**

The funds that operate under the climate convention, notably the Green Climate Fund, the Global Environment Facility (which is in the midst of a replenishment) and the Adaptation Fund, are of special significance. An ambitious replenishment of the International Development Association is also critical, given that it is the largest source of funding for climate action in low-income countries. Other multilateral funds that have an important role to play on the climate agenda and will need increased support are the African Development Fund, the Climate Investment Funds, including its new Accelerating Coal Transition (ACT) and Renewable Energy Integration facilities, and the Global Infrastructure Facility. There are smaller multilateral instruments such as the Systematic Observations Financing Facility (SOFF) that are filling important gaps on climate action and need urgent funding. A move to a more predictable and coherent system of financing these multilateral instruments will be needed over time.

**3. The multilateral development banks (MDBs) must be prepared to triple their level of financing by 2025 from their 2018 levels.**

MDBs need to use all their instruments at this moment of crisis to greatly expand their support for green recovery and sustained transformation in developing countries, encompassing both large emitters and poor and climate-vulnerable countries. MDBs can help countries to unlock investments and *increase the flow and reduce the cost of capital* by reducing, managing and sharing risk. The joint statement from the MDBs issued at COP26 highlights the significant scaling up of their climate activities since the Paris Agreement and commits to raising ambition further, through: enhanced support for more ambitious nationally determined contributions (NDCs), long-term strategies and national adaptation plans; integration of the transition to a net-zero and climate-resilient economy with development programmes in key sectors such as energy, cities, food and land use, water, and industry; support for decommissioning coal and other high-emissions systems, and for just transitions in communities, regions and sectors directly impacted; fostering of natural capital, biodiversity and nature-based solutions, as well as gender-smart solutions; and increasing the level of private capital mobilised in support of mitigation and adaptation investments, using platforms, investment vehicles, and blended finance instruments. The second edition of the Finance in Common Summit on 19–20 October 2021 brought together the entire development finance community on the achievement of the 2030 Agenda and the Paris Agreement, with a focus this time on the transformation of food systems for food security, adaptation to climate change and the preservation of biodiversity.

As MDBs ramp up these efforts, they will help countries greatly increase the scale of investments to support climate and sustainable development, and in turn must be prepared to provide and mobilise the necessary scale and mix of financing. All means must be explored to increase the scale of financing, including the review of capital adequacy methodologies by the taskforce established by the G20, more effective use of lending capacity and further steps on balance sheet optimisation. Shareholders must also be prepared to support proactive capital increases and alleviate specific lending constraints, for example to large borrowers, to ensure that ambitious climate transition programmes are not blocked because of a lack of financing.

**4. The private sector and the official sector must work together to greatly expand the mobilisation of private finance.**

Recent trends underscore the tremendous potential for the private sector to undertake climate investments in developing countries – including for energy transitions – and to mobilise and channel financing. Blended finance can help unlock investments that would

not otherwise materialise and mobilise private financing. However, far too little private finance is being mobilised today; it will have to increase many times over. In particular, private finance for sustainable infrastructure and climate are being held back 'upstream' by shortcomings in the policy and regulatory framework, by a scarcity of well-prepared, bankable projects, inadequate mechanisms to mitigate risks, and by a lack of financial channels connecting deep sources of funds with investments.

Several private sector coalitions are now seeking to tackle these constraints and scale up financing targeted at sustainable investments in developing countries. These include FAST-Infra, the Climate Finance Leadership Initiative, the Global Investors for Sustainable Development and now, very importantly, the Glasgow Financial Alliance for Net Zero. Stepped-up efforts have also been seen from the Global Infrastructure Facility, the MDBs and other stakeholders to enhance the partnership with the private sector, including through the country mobilisation platform announced by the Global Infrastructure Facility with the MDBs at the G20 Venice conference in July 2021. As the One Planet Summit paper 'Blended finance for scaling up climate and nature investments' underscores, "the world must scale up by linking public and private initiatives and working in a joined-up manner, harnessing private finance as an agent for the global public good."

**5. All parties should pursue innovative solutions to scale up and leverage climate finance.**

This should include using the **available firepower of the pool of unutilised Special Drawing Rights** (SDRs). The G7 and the G20 have committed to the reuse of $100 billion of SDRs. The IMF is proposing to use part of this pool to buttress support for the Poverty Reduction Growth Trust and to establish a new Resilience and Sustainability Trust to support climate action in low-income and vulnerable middle-income countries. Beyond this, SDRs could potentially be channelled through MDBs and related financing windows such as the Climate Investment Funds.

A second way of mobilising concessional financing is through the strong contributions of private philanthropy, which can meet needs that other donors may not be able to. And a third way to mobilise debt-free finance are voluntary carbon markets. Mechanisms need to be put in place to assure the quality and integrity of such finance, but there is scope to mobilise financing in the many tens of billions of dollars that could be used for priorities such as accelerating the phase-out of coal and the restoration of forests and degraded land.

## Partnerships to deliver results

Acting on these five priorities can help deliver climate finance of the right scale, right kind, and in the right time. It will be equally important to take concerted steps to foster and enable the investments needed for transformation to a low-carbon, climate-resilient economy. ***Powerful multipliers*** can emerge from using all sources of finance, from collaboration across countries and institutions, from the instruments of the multilateral development banks and the international finance institutions, and from working with the private sector to manage risk.

There is now a great opportunity to join up public and private initiatives to deliver results country-by-country, supported by structured partnerships at the international level. There is increasing recognition of the importance of stronger partnerships between developed and developing countries, for example in the proposals from the UK on the Clean Green Initiative and the G7 on the Build Back Better World Initiative. In addition, the action plan on country platforms along the lines that Mark Carney is proposing can build on the prior G20 initiative on country platforms to unlock ambitious investment programmes anchored in NDCs and long-term strategies, tackle barriers to private investment, and harness the right mix of public and private finance. The Just Energy Transition Partnership

with South Africa announced at COP26 by the leaders of South Africa, France, Germany, the UK and the United States, along with the European Union, can serve as a prototype of such a country platform; it is owned by all key stakeholders in South Africa and can now secure the requisite support from the international community. A structured global partnership can support similar platforms in other countries.

Another important partnership that was launched at COP26 is the Global Energy Alliance for People and Planet (GEAPP), which brings together philanthropic institutions, development finance institutions and country partners to accelerate investment in green energy transitions and renewable power solutions in developing and emerging economies worldwide. Over the next decade, the Alliance aims to unlock $100 billion in public and private capital to enhance energy access (reaching one billion people with reliable, renewable energy); tackle climate change (avoiding and averting four billion tons of carbon emissions); and create jobs (creating, enabling or improving 150 million jobs). The Alliance also announced that it is providing more than $10 billion to focus on fossil fuel transitioning, grid-based renewables, and distributed renewables.

**There is a special opportunity at COP26 to make a breakthrough on climate finance,** from the counting of the $100 billion to delivering the scale and quality of climate finance to match much greater ambition on climate action. The five action areas to bolster climate finance can together deliver the scale of international public finance that will be needed, and, in so doing, can unlock the trillions of dollars required for the scale of investments, private and public, necessary to keep the 1.5°C goal within reach and protect developing countries from the mounting costs of climate change. As countries move forward with ambitious emission reduction and just transition programmes, as South Africa and India are committing to, or adaptation and resilience programmes, as many vulnerable countries are doing, they must be assured of effective and timely support. Without such support, they will fail in meeting their ambitions, and the world will fail in meeting its collective climate goals.

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