A climate finance framework:

decisive action to deliver on the Paris Agreement

SUMMARY

Second report of the Independent High-Level Expert Group on Climate Finance

November 2023

Preface and acknowledgements

The COP26 and COP27 Presidencies, together with the UN Climate Change High-Level Champions, extended the mandate of the Independent High-Level Expert Group on Climate Finance (IHLEG) in July 2022, to prepare a second report for COP28. The IHLEG is co-chaired by Vera Songwe and Nicholas Stern, and Amar Bhattacharya is 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, reinforced by the Glasgow Climate Pact, and the Sharm el-Sheikh agenda.

This report has benefited enormously from the active and high-quality participation, guidance and input of the group's members, and from feedback from a wide range of stakeholders. The views expressed are the responsibility of Vera Songwe, Nicholas Stern, Amar Bhattacharya and Eléonore Soubeyran and are not necessarily those of individual members, nor does the report claim to represent the views of either the COP27 or COP28 Presidencies or the Climate Champions.

The writing team was led by Amar Bhattacharya with Eléonore Soubeyran, under the guidance of Vera Songwe and Nicholas Stern. The following people led on different sections: Amar Bhattacharya (investment, climate finance framework, multilateral development banks) Eléonore Soubeyran (investment, climate landscape, climate finance framework), Homi Kharas and Charlotte Rivard (debt), Julia Turner, Mattia Romani, Katherine Stodulka, and Federico Apestegui Guardia (private finance), Rob Macquarie (climate finance alignment and carbon markets), Avinash Persaud (loss and damage) and Marilou Uy (domestic resource mobilisation and concessional climate finance). The authors are also grateful to Hans Peter Lankes and Josue Tanaka for their input and feedback on the role of multilateral development banks. The authors would like to thank Georgina Kyriacou for editing and production.

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Key messages

1. Finance with a purpose

- The Independent High-Level Expert Group on Climate Finance was tasked to assess how the climate finance system must change if it is to support the investment and actions necessary to deliver the goals of the Paris Agreement, within the broader goals of sustainable development. This is finance with a *clear purpose*.
- Our first report, published for COP27, focused on the *amount* of investment needed and *how* to deliver that finance. We concluded that around US$2.4 trillion of investment a year would be necessary by 2030 (in emerging markets and developing countries – EMDCs – outside China) across the priorities of a *just energy transition, adaptation and resilience, loss and damage,* and the *conservation and restoration of nature*. This is a four-fold increase from current levels devoted to these areas. The world is badly offtrack on the Paris goals, as the first Global Stocktake shows, the primary reason for which is insufficient investment in key areas, particularly in EMDCs.
- Despite the clear opportunity that this scale of investment would create *for better and more sustainable growth*, actual investment performance on key climate priorities in EMDCs has stalled. The focus of this report is therefore on *acceleration and implementation*.

2. The challenge of investment: acceleration and implementation

- We now need a much more *purposeful approach with strong and committed engagement of all key stakeholders* – countries, the private sector, the multilateral development banks (MDBs), donors and private philanthropy. Country leadership will be crucial and *country platforms* provide a promising way to bring together the main stakeholders.
- The first task is to act to *unlock investment at scale* through tackling impediments and buttressing institutional structures that can create *investable pipelines* of projects, anchored in a strategy of transformational change. This requires a shift from a do-it-alone approach to *co-creation* of investment opportunities and tackling obstacles with the combined involvement of countries, the private sector and development finance institutions.
- We must also tackle the immediate *debt constraints and lack of fiscal space* that are impeding the ability of many countries to invest, especially poor and vulnerable countries.

3. An integrated climate finance framework to deliver on the Paris Agreement

- Mobilising the scale and quality of finance to meet the large anticipated requirements will require an *integrated approach that boosts all sources of finance* – public and private, domestic and international – and uses their complementary strengths.
- *Domestic resource mobilisation* will be central, given its dominant role and importance in anchoring the macroeconomic sustainability of all finance. There is potential to boost tax revenues, including by harnessing new digital possibilities. Elimination of harmful subsidies and carbon taxation can generate much needed revenues to finance the transition.
- The role of the *private sector* in both investment and finance will be crucial and both domestic and international private finance must be boosted. *International*

private finance to EMDCs for climate action will need to be increased by more than *15 times* on current levels to deliver on climate mitigation goals.

- *MDBs are key* to both unlocking *investment opportunities* and *mobilising finance*, through own lending and catalysing private finance. They need to play a much stronger role in reducing, managing and sharing risk and in reducing the cost of capital. To deliver on the Paris targets, their role will need to change fundamentally and the scale of their support to *triple by 2030*. MDBs need to implement fully the recommendations of the G20 Expert Group on Capital Adequacy Framework to maximise capital efficiency, tap new sources of capital and guarantees to boost their immediate firepower, and secure strong shareholder support for regular capital increases to enable a sustained expansion of lending.
- *Concessional finance* is the scarcest and most vital source of finance for meeting urgent and high priority needs. A *fivefold increase* in concessional finance is needed by 2030. Developed countries must lead by *tripling the amount of bilateral concessional finance by 2030*, but concessionary finance cannot be provided at the right scale with bilateral official development assistance (ODA) alone. We must therefore pursue all options, including carbon markets (compliance and voluntary), expanded rechannelling of special drawing rights, international taxation and a bigger role for philanthropy, including from the corporate sector.
- These *four sources* of finance – from domestic public resources, the private sector, MDBs, and concessional – are *mutually supportive* and different combinations will be necessary for different investments and activities. The method of combination will be critical, as well as the overall total.

4. Seizing the opportunity – and the consequences of success or failure

- Momentum has been building over the past year to refine the elements of a more effective framework for climate finance. It is crucial to seize the opportunity at COP28 to secure a breakthrough and to put in place an action plan to deliver on this framework.
- Failure to generate investment and finance of the scale and nature required is to fail on Paris. The consequences would be devastating, particularly for the poorest people. Seizing the opportunity would unlock the growth story of the 21st century. This is truly *finance with a purpose*.

Context (Chapter 1)

The Independent High-Level Expert Group (IHLEG) on Climate Finance delivered its initial report at COP27, setting out the scale of investment that is necessary in emerging markets and developing countries (EMDCs – other than China) for climate and development, along with implications for different pools of finance. One year on, the pressing need for decisive action to tackle climate change and achieve development goals has become even more evident – yet EMDCs are falling behind. More ambitious and targeted strategies are needed to prevent these nations from being further disadvantaged in the global climate and development agenda. This new report from the IHLEG on Climate Finance, mandated by the COP27 and COP28 Presidencies, focuses on the actions required to deliver a reformed holistic framework for climate finance that can impart the necessary strong impetus to the acceleration and implementation of climate action in EMDCs.

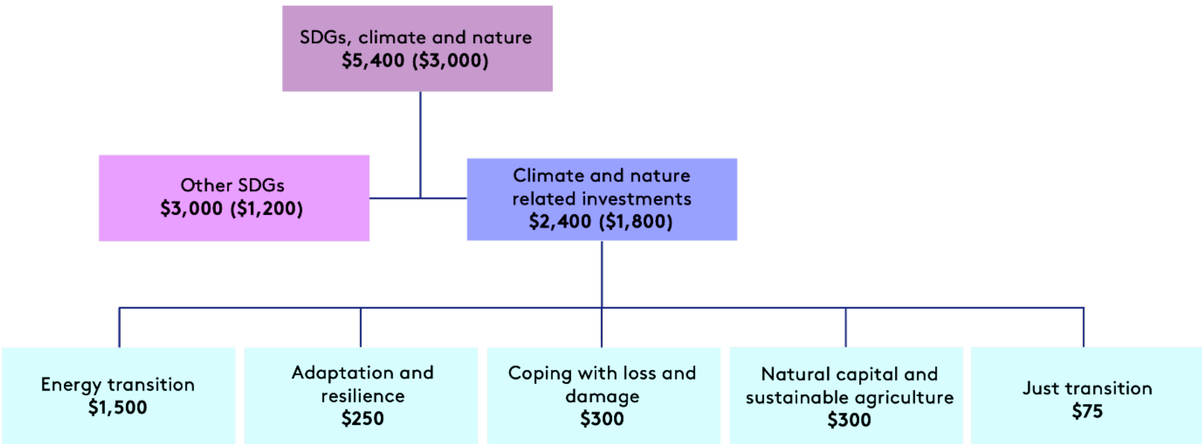
Urgency and scale of action

The urgency and opportunity for tackling climate change is becoming ever clearer. Climate change is occurring at a faster pace and with ever more severe impacts than previously anticipated and the window for remedial action is narrowing rapidly. At the same time, acting on climate change offers immense opportunities to unlock new and better forms and drivers of economic development. EMDCs can leapfrog the dirty and destructive phase of fossil fuel-based growth of developed countries and build cleaner, safer, more energy-secure, more resilient, more biodiverse and more inclusive ways of living and working – to unlock the growth story of the 21st century.

The first IHLEG report set out that to meet the Paris Agreement and related development goals, US$2.4 trillion is needed in EMDCs (other than China) by 2030 for climate-related investments, a four-fold increase from current levels.

The main investment and spending priorities fall into five categories (Figure 1). Not all of this investment will be additional to the amount EMDCs would need to invest in the expansion of energy systems and infrastructure, and there would be growing savings from the replacement of fossil fuel use.

Figure 1. Investment/spending requirements for climate and sustainable development ($ billion per year by 2030)



Note: Incremental investment from current levels is indicated in parentheses. $ = US$ throughout.

EMDCs are falling behind in the low-carbon transition

We are far behind on climate action globally, as evident from the first Global Stocktake. This is because the world is not investing sufficiently and too much of the investment is still misdirected. Investment in fossil fuel production and power generation still continues to outstrip what is being invested in renewable power generation.

While global efforts to tackle climate change are increasing, albeit more slowly than necessary, EMDCs are facing setbacks and obstacles in every critical aspect of the low-carbon transition. This includes the shift to clean energy in both its supply and use, enhancing adaptation and resilience, addressing loss and damage, the protection and restoration of nature, and ensuring a just transition.

EMDCs (other than China) are being left behind on clean energy. Global clean energy investments hit an all-time peak in 2023, driven largely by growth in solar PV and electric vehicles (EVs), but more than 90% of the increase in such investment since 2021 has taken place in developed economies and China. Low- and lower-middle income countries accounted for only 7% of clean energy spending in 2022. Challenges include higher interest rates, unclear policy frameworks and market design, financially-strained utilities and a high cost of capital. A massive increase in renewable energy is the cornerstone of an energy transition strategy for EMDCs that delivers on both Paris and development goals.

The adaptation finance gap is growing. Adaptation costs/needs are now estimated at around 10–18 times as much as current flows of international public adaptation finance. International public finance commitments for adaptation in EMDCs fell by 15% in 2021. Only 66% of the total bilateral adaptation finance committed to EMDCs for the period 2017–21 was disbursed, compared with 98% for all bilateral development finance.

Overall funding pledged for loss and damage is well below even the lowest estimates of financing needs in EMDCs, despite a clear shift in attitude towards loss and damage finance in 2022. Many uncertainties remain regarding the financial need to address loss and damage, but innovative funding sources and governance structures must be found to reach the necessary scale.

Investments in nature are skewed towards high-income countries. EMDCs (other than China) account for an estimated 90% of the investment opportunity in protecting and restoring nature from 2020–30. However, the majority of financing, at 80%, remains in developed economies. Explicit and implicit subsidies for fossil fuels, agriculture and fisheries, which have extremely detrimental impacts on nature, are at least $8 trillion, more than 56 times the actual investments in nature and biodiversity.

A just transition is needed, with investment in people and places, to manage the transition's impacts and ensure everyone can benefit, particularly vulnerable communities and workers. This includes investment in basic infrastructure, in education and lifelong learning, in training and skills, and in social protection measures for the most vulnerable.

Where are we on climate finance?

The amount of global climate finance committed has more than tripled over the last decade, reaching $1.27 trillion in 2021/22, approximately 1% of global GDP. Despite a clear increase, global climate finance flows are still too low compared with the levels needed to achieve the low-carbon transition and build resilience to climate change.

There are important shortcomings from the perspective of EMDCs: climate finance is concentrated in developed economies and China, and in mitigation rather than adaptation. Private finance is insufficient. Climate finance is primarily delivered in the form of debt. And most financing remains in its country of origin.

There are also long-standing criticisms on the lack of transparency around how climate finance is measured and delivered. There has been legitimate concern that climate finance and especially climate finance from some bilateral providers may be overstated and there is lack of accountability for what is actually delivered.

Restoring trust and delivering on immediate priorities (Chapter 2)

The commitment by developed countries to provide $100 billion per year by 2020 was not met as of 2021, eroding trust. Negotiated by Ethiopian Prime Minister Meles Zenawi in 2009, this promise was key to the breakthrough that ultimately led to the Paris Agreement. Developed countries must live up to past commitments and deliver on immediate priorities to restore trust.

According to the Organisation for Economic Co-operation and Development (OECD), preliminary and as yet unverified data indicate that the $100 billion goal is likely to have been met as of 2022, largely driven by an increase in financing from the multilateral development banks (MDBs). Informal consultations with bilateral contributors and multilateral providers suggest that this upward trend has been sustained in 2023.

Priorities for action:

- **Deliver on the $100 billion** per year commitment by developed countries for climate action in developing countries as a basis for much more ambitious climate finance goals.
- **Secure contributions from countries that have not yet contributed to the ongoing Green Climate Fund (GCF) replenishment and broaden the contributor base** to ensure that the current replenishment is 50% higher than the first replenishment.
- **Expand the pool of special drawing rights (SDRs) available for recycling beyond the initial $100 billion target and deploy these rapidly,** using the IMF's Poverty Reduction and Growth Trust (PRGT) and Resilience and Sustainability Trust (RST) and through the MDBs.
- **Deliver funding of the International Development Association (IDA) crisis facility** and embark on an ambitious IDA21 (i.e. the 21st replenishment process). Together with the recycling of SDRs, this can bolster urgently needed finance for the poor and vulnerable.
- **Ensure the operationalisation of a sizeable Loss and Damage Fund and secure credible commitments on its capitalisation.**

A framework for a climate finance system that is fit for purpose (Chapter 3)

A framework for a climate finance system that supports climate and development must:

- **Embody justice and inclusion:** ensuring an equitable distribution of resources, recognising the differential impacts of climate change on countries and communities, and addressing historical responsibilities.
- **Scale up all sources of finance and utilise them more effectively:** climate finance for EMDCs will need to quadruple between now and 2030.

A more holistic, comprehensive strategy is needed to deliver bigger, better and faster climate finance. An overall financing strategy must utilise 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 an aggregate number. It must also align all finance with climate goals and the Kunming-Montreal Global Biodiversity Framework (where applicable), and create the necessary partnerships to deliver concrete results.

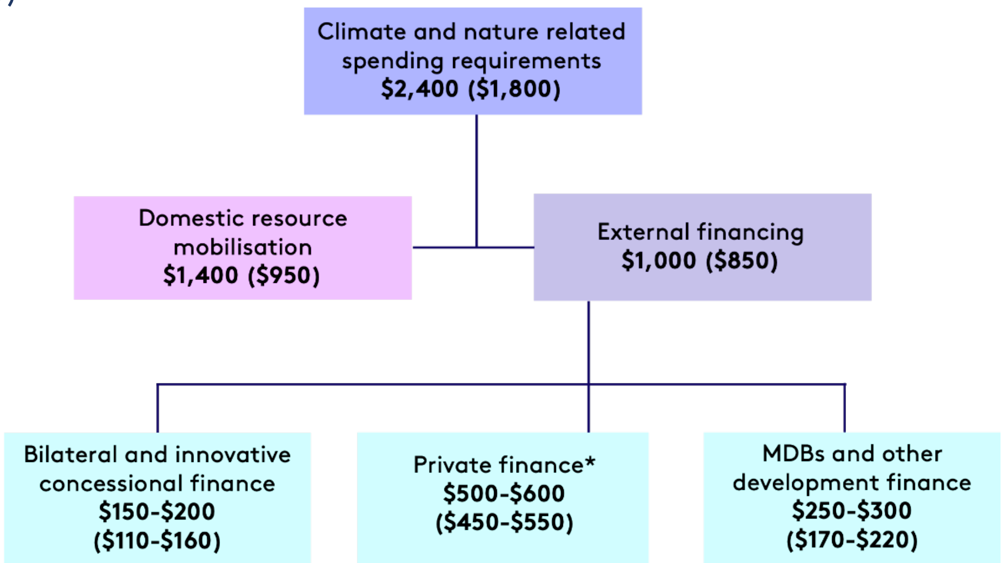
Acting on climate and nature will be mutually reinforcing: without climate action, it will not be possible to protect nature; and investing in nature and sustainable food and land use will make an important contribution to tackling climate change.

A mix of financing is needed to fit the varying attributes of investment requirements, including across differing country and market contexts. The initial report of the IHLEG on Climate Finance outlined the mix of financing for the $2.4 trillion spending required for climate and nature (see Figure 2 below).

Beyond scaling up, there is also a pressing need to tackle the shortfalls in the quality of finance provided, which will require:

- **Improved access to climate finance**, especially for poor and vulnerable countries.
- **Assurance of predictable support** to EMDCs.
- **Affordable climate finance.**
- **Improved focus on adaptation and on poor and vulnerable countries.**
- **More transparency and accountability for the delivery of climate finance.**

Figure 2. Mobilising the necessary financing for the green transition ($ billion per year by 2030)



Notes: Incremental investment from current levels is indicated in parentheses. *More than half of this private finance would be directly and indirectly catalysed by MDBs, other development finance institutions, and bilateral finance.

Aligning all finance with sustainability, including climate goals

Article 2.1(c) of the Paris Agreement states a goal to make "finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development". This is backed by the Sharm-El Sheikh Implementation Plan. The goal has proven difficult to implement, in part because of political challenges and differences in perceived interests. EMDC governments have concerns over the perceived and real risks that activities undertaken by public and private actors in pursuit of the goal will in fact lead to a decrease in financial flows to lower-income countries. Additionally, technical barriers to implementing the goal persist. Emphasising the development imperative of Paris alignment reinforces the importance of ensuring that a new climate finance framework is inclusive of lower-income countries, communities and marginalised groups.

Priorities for action:

- **All providers of finance, public and private, need to follow through to ensure that their finance is aligned with the Paris Agreement,** by boosting finance for low-carbon investments in EMDCs, incentivising transition, and curbing finance to activities that are inconsistent with the Paris Agreement.
- **Match net zero targets and commitments with plans, methods and indicators** to show how they will be implemented, to be robust and credible.
- **Central banks and financial supervisors need to continue their work to better understand risks but also lead on actions to reduce risks and benefit from transition,** even with imperfect information, to ensure that the reallocation of capital occurs at scale and on a timeline for an orderly transition.
- **Create an explicit goal on mobilising private finance for climate action in EMDCs.** This mobilisation should happen through removing barriers and taking positive action to facilitate the flow of international private finance.

Tackling debt and fostering investment (Chapter 4)

Tackling debt and fiscal constraints

Fiscal deficits that resulted from the response to COVID-19 and the current food and energy crises have left many EMDCs with a legacy of high public debt. All EMDCs feel this tension in how to manage their fiscal space. The immediate issue is to manage the bulge in debt service obligations falling due in 2024 and 2025.

Most EMDCs are facing commercial interest rates for external borrowing of well over 10 percentage points. Countries with severe solvency crises cannot expect to receive significant private capital inflows. They will need to agree on programmes with creditors for debt haircuts, and, for official creditors, on the provision of fresh money to permit investments in climate action. Vulnerable countries deserve special attention. Large, recurring natural disasters can create a vicious cycle of destruction and debt accumulation. Disaster relief as well as debt restructuring to restore solvency is needed in these cases.

Priorities for action:

- **Provide fiscal space for investment in climate action through:**
  - Strengthening international liquidity.
  - State contingent debt clauses, such as pandemic and natural disaster clauses, to offer fast, automatic, rules-based liquidity during a crisis.
  - Multi-year or multi-phase commitments from loans and guarantees from MDBs in support of public and private investment.
  - Pre-emptive, five-year, debt service cash flow relief from all bilateral creditors that do not make fresh money commitments.
  - Continued enhanced support from the IDA, accelerated disbursement of PRGT and RST funds, and an increase in ODA flows targeted to high priority investments.
- **Address situations of debt insolvency and acute debt distress, through:**
  - Purchasing private debt at a discount, with savings maximised by official guarantees and directed towards nature/conservation trusts.
  - Encouraging official bilateral debt holders to accept debt service in local currency and on-grant the proceeds to a conservation trust.

  - Streamlining the Common Framework for Debt Treatments and middle-income country debt restructuring processes to make it easier and faster to implement.
  - Expeditious and pre-emptive International Monetary Fund (IMF) agreements to forestall imminent defaults.
  - Protecting pro-growth infrastructure investments from austerity measures in IMF-supported programmes.
- **Break the vicious cycle between debt and climate vulnerability through:**
  - Including disaster- and pandemic-related clauses in debt contracts to provide immediate short-term liquidity that can help minimise damages (but these do not compensate for losses suffered).
  - An adequate architecture of concessional international assistance, with the highest priority for investments to improve resilience: climate-conditional debt relief to enhance adaptation and resilience spending would benefit all creditors; concessional assistance to compensate climate-vulnerable countries through a Loss and Damage Fund is morally appropriate.
- **Adapt fiscal rules, with countries considering options that preserve fiscal sustainability while creating room for sound investments, through:**
  - Establishing politically-independent Fiscal Councils to inform the public and guide Finance Ministers on appropriate medium-term budget frameworks.
  - Carving out selected high-priority, high-return investments for climate-related spending into a separate category, exempt from fiscal rules.
  - Creating a special purpose vehicle for public sustainable infrastructure, with an asset/liability approach and accounting practices to ensure creditworthiness.
  - Strengthening debt management offices to provide guidance on long-term fiscal sustainability.
  - Undertaking long-term (10 to 30 years) solvency risk strategies with alternative scenarios for climate-related fiscal spending.
  - Establishing debt transparency standards, including contingent liabilities and the disclosure of public debt contracts.
  - Evolving institutional norms, especially at the IMF, to favour sustainable growth strategies, even at the expense of higher rollover risk. Put in place stronger global safety nets.

Fostering investment and country platforms

Scaling up climate finance cannot happen without ramping up investment programmes and projects, but there are currently impediments to doing so. Many EMDCs lack well-articulated strategies and transition plans to provide clear direction, including in the private sector. There are often weaknesses in the investment climate and obstacles to attracting private investment, especially for the energy transition. Policy and institutional reforms, and institutional structures, are both needed to scale up project preparation and connect projects to investors. Creating country platforms with a focus on system transformation in key sectors is a promising way to bring stakeholders together behind purposeful change.

To tackle these impediments, action is needed in the five following areas.

Long-term climate and development strategies

Effective climate action begins with countries setting ambitious yet achievable long-term goals that are aligned with the temperature targets of the Paris Agreement. Articulating strategies in robust long-term strategies (LTS), nationally determined contributions

(NDCs), national adaptation plans (NAPs) and national biodiversity strategies and action plans (NBSAPs) is an important starting point, but these will need to be accompanied by clear implementation plans.

Priorities for action:

- **Ensure there are well formulated, credible pathways to meeting climate and development goals that incorporate milestones for shorter-term plans,** expressed in robust LTS, NDCs, NAPs and NBSAPs.
- **Define realistic investment and financing scenarios** that identify how much can be accommodated within state budgets and the extent of reliance on external sources.
- **Increase financial and technical support from the MDBs and bilateral agencies** for the development of clear strategies, particularly in small island developing states (SIDS) and the least developed countries (LDCs).
- **Take a comprehensive approach that considers the links between climate and development and addresses a range of factors,** including societal impacts, stakeholder engagement, governance and sector-specific strategies.
- **Set out clear implementation strategies, and create monitoring plans and revision processes** to assess their implementation and effectiveness.
- **Deepen understanding of a just transition through national dialogues, and develop country-specific just transition roadmaps,** integrated into national strategies.

Translating strategies into tangible investment programmes and project pipelines

To move from theoretical ambition to tangible climate action, countries need to build institutional capacity and address coordination failures to develop and implement investment programmes and project pipelines.

Priorities for action:

- **EMDC governments should lead on co-creating investment programmes** with the private sector and development finance institutions (DFIs) to strengthen project pipelines.
- **Increase capacity-building and technical assistance in areas where there are knowledge/skills gaps,** especially in early-stage project feasibility and preparation.
- **Provide matchmaking 'one-stop-shop' facilities with financial providers,** including for risk mitigation instruments and project preparation finance options.
- **Scale up existing project preparation facilities significantly, starting with the Global Infrastructure Facility**.
- **Provide support for corporates,** including through MDBs helping corporates access facilities when entering new locations, especially when they lack presence or previous experience there.
- **Scale up initiatives to connect prepared projects with investors,** such as the Regional Platforms for Climate Projects (RPCPs).

Implementing strong and sustained policy and institutional reforms

Creating a favourable investment climate will require a mix of policies that incentivise investment in the low-carbon economy and tackle the many market and government failures that still impede these investments. Raising and expanding the scope of carbon pricing will be crucial. Given that the path to net zero is riddled with barriers, it is insufficient to rely solely on pricing incentives: as such, effective climate policy packages will need to blend various strategies, appropriate to each country context.

Priorities for action:

- **Tackle barriers to investment in low-carbon and transition technologies.**
- **Use a mix of various policies that are designed to initiate transitions in critical systems such as energy and food**, including carbon pricing, labelling, regulations, subsidies, and direct investments (such as complementary investments in public sector infrastructure to support markets for private investment).
- **Employ technology support and demand support measures** to ensure the availability and affordability of needed technologies and infrastructure.
- **Implement policies aimed at greening existing flows in the financial system**, including requiring climate-risk tests, implementing regulatory reforms to help integrate climate risks into risk management, increasing governance and disclosure practices, and developing a green taxonomy.
- **Streamline planning and permitting**, while maintaining strong environmental, biodiversity and social safeguards.

Country/sector platforms led by countries

To get investment to the scale and quality required, key stakeholders need to come together around strategy, policy and finance in a coherent way: country/sector platforms are a promising option. These platforms, which are being pioneered in countries including Egypt, Indonesia, Vietnam and South Africa, can bring together national efforts and international support to accelerate progress through strategic collaboration. Country platforms should serve as a tool for allocating investment opportunities efficiently among the public and private sectors, using public finance to address non-commercially-viable priorities and catalyse private finance where possible.

Priorities for action:

- **Build on the ongoing country partnership efforts and the prior experience of the MDBs** to co-create country platforms that can quickly translate into investable projects, and create joint accountability with the private sector for delivery.
- **Convene all relevant stakeholders** to define priority areas to create a conducive local investment environment.
- **Develop country-level investment plans together with all players**, particularly the private sector.
- **Ensure that finance packages include sufficient concessional funding to tackle critical bottlenecks and address the human capital part of the transition**, especially for worker reskilling and community rehabilitation.

Promoting international cooperation on policy

Developed economies have rediscovered a more active role for the state, implementing industrial policies to promote domestic investment and jobs while transitioning to a green economy. Yet green policies can significantly erode the competitiveness of EMDC producers by favouring domestic suppliers either directly – through subsidies, near-shoring and local content requirements – or indirectly, as EMDCs struggle to meet the standards required and to qualify with the restrictive measures that regulate climate finance flows to emerging markets. The Carbon Club initiative launched by the G7 could provide a forum for discussion and agreement on a cooperative approach.

Priorities for action:

- **Design trade and industrial policies for cooperation, not competition,** and other fora for an inclusive approach.

- **Policymakers in developed economies should carefully assess the impact of green policies on EMDCs and ensure there are mechanisms** to create the conditions for increased investment and private finance across all countries.

Key pillars of the climate finance system (Chapter 5)

Domestic resource mobilisation (DRM)

Sixty per cent of the estimated investment financing required (and 55% of the incremental need) is expected to come from domestic resource mobilisation. EMDCs will need to mobilise domestic resources by an additional 2.7 percentage points of GDP to meet the spending gap by 2030, which is broadly achievable given potential tax capacity and scope for domestic private mobilisation. Fiscal policy will play a critical role.

Countries will need to implement a mix of policies to raise domestic revenues and improve spending efficiency. There is significant scope to increase tax revenues in many EMDCs. International tax cooperation needs to play an important supportive role.

Carbon pricing can also be significant in raising public revenues and providing incentives to decarbonise, but its implementation is politically challenging. Countries are likely to use a combination of pricing and non-pricing interventions to accelerate the net zero transition.

Harmful subsidies globally remain large and continue to expand. They weigh on government resources and cause environmental damage. Explicit and implicit fossil fuel subsidies amounted to 7% of global GDP in 2022.

Measures to improve the efficiency of public spending provide opportunities to enhance fiscal space. Evidence shows that countries waste on average about one-third of their infrastructure spending due to inefficiencies.

The role of Finance Ministers will be crucial in all of these areas and more broadly on the policy and institutional framework to drive the transition to a low-carbon, climate-resilient economy. The guide prepared by the Coalition of Finance Ministers for Climate Action with support from the Grantham Research Institute on strengthening the role of Finance Ministers in driving climate action provides a compelling case of that role, and of the policy and institutional agenda that they must grapple with.

Priorities for action:

- **Intensify efforts to raise fiscal revenues in EMDCs, through:**
  - Broadening the taxable base of consumption taxes, without necessarily raising tax rates.
  - More progressive taxation of income and wealth.
  - Implementing a minimum corporate tax rate and rationalising investment incentives.
  - Improving institutional capacity and increasing digitalisation in revenue administration.
  - Building institutional capacity on tax administration and public expenditure management, with support from the IMF, World Bank , OECD and UN.
- **Adopt carbon pricing much more widely in EMDCs and steadily increase the level of carbon taxation.**
- **Pursue phase-out of harmful subsidies, with due regard to political economy:** this will improve incentives to reduce emissions and environmental damage and release significant resources to redirect to climate-related investments.

- **Enhance the efficiency of public spending** in EMDCs through policies and capacity-building to improve the quality of public expenditure and procurement, and increase the speed of project implementation.
- **Strengthen international taxation arrangements to support EMDCs to tackle the erosion of their tax bases and profit shifting.** More work is needed to:
  - Tailor measures to administrative capacities of EMDCs, addressing challenges to participating in the Common Reporting Standards and other measures to contain profit shifting and base erosion.
  - Improve the fairness and progressivity of international taxation, such as through simpler and fairer rules to apportion profits of multinationals across jurisdictions.
  - Increase the global minimum tax rate and close loopholes to raise effective corporate tax rates relative to current levels.

Creating a new highway for private finance

At least $1 trillion a year of private capital will be needed in EMDCs excluding China by 2030 from different parts of the financial system, domestic and international, to meet climate and development goals. This is entirely feasible, given the viable business case. In addition to tackling policy and institutional gaps, action is needed in seven critical areas. The mobilisation of private finance will need to increase for all priority needs and for all markets, but will be greater for climate mitigation in middle-income countries than for low-income countries, where public or concessional finance will more likely be required.

Scale up tailored and efficient de-risking instruments

The current use of de-risking instruments to mobilise private investment is insufficient. MDBs and DFIs, donor agencies, export credit agencies, impact investors and philanthropy should explore how to increase the use of catalytic mechanisms to mobilise private capital and make it more affordable. There is a need to develop instruments and partnerships that can be taken to scale, to tackle risks and bring down the cost of capital, including foreign exchange risk, early stage and policy risks, and a need for aggregation and credit enhancement.

Priorities for action:

- **Deploy tailored, fit-for-purpose de-risking instruments in much more targeted ways** across the project lifecycle.
- **Deploy instruments to de-risk at an aggregated (portfolio) level,** where this can help reduce transaction costs and achieve greater leverage.
- **Streamline access to de-risking instruments for the private sector** by developing comprehensible and easily deployable risk mitigation instruments and guarantees.
- **Increase access to dedicated concessional funding for de-risking.**

Define parameters for transition finance

Countries, sectors, companies and financial institutions working towards net zero need clear, credible and actionable transition pathways, targets, standards and regulatory frameworks. Regulatory uncertainty and definitional ambiguities must be removed and parameters need to be more flexible to cater to different countries and sectors.

Priorities for action:

- **Align around categories of transition finance** that can together facilitate the necessary transition to a low-carbon economy.
- **Make transition frameworks fit for investors in EMDCs,** recognising differences in capabilities and technologies across regions and sectors.

- **Develop company transition plans in line with national transition plans or NDCs,** building on common global approaches, like the GFANZ transition plan framework.
- **Establish communities of practice** to identify issues and gaps, align on priorities, standards and frameworks, and share best practice.

Address bias in developed economy regulatory frameworks

Developed economy prudential regulatory frameworks can add to disadvantages faced by EMDCs by requiring higher levels of capital for banks and insurers for credit exposure and exposure to infrastructure project finance.

Priorities for action:

- **The G20 should set up an Independent Expert Group with good representation from EMDCs** to conduct analysis on historical risk and performance of infrastructure projects in EMDCs and assess implications for prudential rules across the full spectrum of financial regulation.
- **Assess the extent to which sovereign ceilings on ratings within countries unfairly punish creditworthy corporates.**
- **Address liquidity concerns and other design considerations** relating to capital treatment of guarantees and/or adjust credit risk mitigation guidelines to account for the risk-mitigating effects of guarantees.

Improve data quality and availability

Availability of comprehensive, credible, accessible data is crucial to catalysing the mobilisation of private finance towards sustainable projects and to accelerate transition.

Priorities for action:

- **Standardise data, based on robust standards and data collection methodologies,** to establish new asset classes and improve risk perception among investors.
- **Develop a broader set of metrics to measure progress in transition finance,** given existing metrics may disincentivise investment in high-emitting sectors.
- **Share data transparently to minimise the cost of accessing information.**
- **Improve data quality and verification to solidify investor confidence, mainstreaming its use in investment decisions.**
- **Build data architecture and infrastructure to develop and disseminate climate transition-related data.** The Net-Zero Data Public Utility could be a powerful platform to close this gap, with the involvement of relevant public and private partners.

Leverage domestic markets to unlock private capital

There is approximately $17 trillion of domestic financial capital in EMDCs, made up of household savings, pension capital, corporate and local bank finance. Deploying this capital will be critical to investing in low-carbon infrastructure, climate-positive technologies and transitioning companies. Developing bigger and deeper domestic financial markets should be an additional priority.

Priorities for action:

- **Increase the use of green finance products like green bonds and sustainability-linked loans,** which are underused in EMDCs compared with developed economies.
- **Mobilise domestic pension capital for infrastructure and alternative asset classes for climate action.**
- **Leverage the deep expertise within national and regional financial institutions** to build out the pipeline needed to attract private capital for climate action.

- **Expand technical assistance and capacity-building** to deepen expertise in climate and transition.
- **Develop local currency de-risking products** to mobilise domestic investors.
- **Ensure domestic fiscal rules enable investment in low-carbon solutions.**

Augment the role of corporates in EMDCs and strengthen financing channels

Corporates are key drivers of climate action. Their financial strength, innovative technologies and operational efficiency enable them to effectively marshal resources, conceive projects, and launch scalable low-carbon solutions. Global corporations are particularly crucial as they must accelerate efforts to decarbonise their value chains and can share contacts, skills and experience. In addition, investors targeting green investments in EMDCs can both identify and support investable opportunities and augment the supply of institutional capital.

Priorities for action:

- **Facilitate access to debt finance for corporate transition plans** in EMDCs, to enable companies to make investments in decarbonisation by creating green and transition bond frameworks that can be leveraged through credit enhancing mechanisms.
- **Incentivise scaling up of equity capital to support corporates in EMDCs** through public-private platforms that can provide early stage and growth capital.
- **Private financial actors should shift** towards actively developing low-carbon, resilient projects in EMDCs and channel finance towards these, to marshal larger volumes of corporate and emerging market finance.
- **Asset managers with strong experience in emerging markets can pave the way to help develop and finance green investments and provide transition finance,** and enhanced partnership between them and other providers of capital can bolster the supply of finance for EMDCs.

Promote private investment in adaptation and nature

Investments in adaptation and resilience are paramount to mitigating the escalating impacts of climate change, but current levels of investment are severely insufficient. There is a need to address climate risk in a systematic way to unlock private investment and finance in adaptation. There are several categories of resilience investment. Some generate revenue, some savings, some both or neither. Some generated savings are shared, some are internalised. Some revenue-generating investments provide clear business opportunities. Each category has different implications for where and how the private sector can engage; thus, tailored innovative financial mechanisms are required to address barriers to private investment in different situations.

There is also scope for innovative mechanisms for nature and biodiversity financing, including high-integrity biodiversity markets, blended finance vehicles, guarantees and insurance specific to nature. Key instruments include insurance, debt and blended finance models.

Priorities for action:

- **Develop country-specific, comprehensive resilience and adaptation plans**.
- **Consider insurance options that are well-suited to investments that generate savings but not revenue.**
- **Use debt instruments that can provide incentives and capabilities** to invest in resilience-building solutions.

- **Develop blended finance models for investments that are not revenue-generating in the short term.**
- **Enhance risk assessments to evaluate the financial benefits from adaptation and the costs of inaction**, clarifying the case for adaptation and resilience investments.

An MDB system that works for climate action

The critical role of the MDBs in the revamping of climate finance has been highlighted in all the deliberations and proposals on the reform of the climate finance architecture over the past year, from the Bridgetown Initiative to the Paris New Global Financing Pact to the G20. (Our first report of November 2022 has been a key foundation for this work.) The MDBs are central to a big push on investment because of their ability to help countries scale up their investment programmes and their unique capacity to mobilise low-cost financing and to catalyse much higher volumes of private finance.

The G20-mandated Independent Expert Group (IEG) on MDB Reform calls for a tripling in sustainable annual lending levels to $390 billion by 2030. The IEG's vision and agenda is based on: (i) converting operating models to support transformational investments; (ii) bringing engagement with the private sector to the centre; and (iii) significantly scaling up financing at an affordable cost. Heads of the MDBs have welcomed the recommendations and committed to a series of responses to scale up and make their role more effective. Four key areas where further agreement and follow-up are needed are described below.

A new country engagement model to ramp up transformative investments

Collectively and individually, the MDBs need to become much more proactive in scaling up transformative investments in energy transition, adaptation and resilience, and natural capital. The stalled progress on all three fronts in EMDCs should be a wake-up call for the MDBs. MDBs need to move from a project- and institution-led approach to working collectively to ramp up support. A starting point is good diagnosis of the system transformations that are necessary, as has been initiated through the World Bank's Climate Change Development Reports (CCDRs). Diagnoses now need to be quickly translated into programmes of action and support. The best way to do this is through country platforms with a clear objective, strategy and commitment from all key stakeholders under the leadership of the country.

Priorities for action:

- **Set collective MDB targets and joint scorecards for scaling up investments in the key sectors and geographies by 2030** and agree on strategies on how to meet them.
- **Work collectively and proactively on a country platform approach and set an implementation plan among MDBs**, including engaging with specific countries interested in this approach to achieve priority mitigation, adaptation and nature objectives.
- **Radically speed up project and programme approvals among MDBs,** simplify rules and procedures and improve support for policy and institutional reform with focus on these key areas.

A new partnership with the private sector

Private investment and private finance in EMDCs is dismally low and the MDBs are not playing their part. MDBs mobilised only $17 billion in private finance compared with $80.6 billion in their own lending for climate action in EMDCs in 2022. MDBs have so far lacked an effective strategy for boosting private investment and finance based on sector and country opportunities and challenges. There is insufficient cooperation with the private sector on identifying key opportunities and tackling barriers to private investment and finance. They have often competed for easy projects with the private sector and even among themselves. They have lacked the approach, incentives and instruments necessary to better manage and share risk with the private sector and bring down the cost of capital. MDBs need to establish a new partnership with the private sector, taking advantage of the sector's proactive engagement, including in the Glasgow Financial Alliance for Net Zero (GFANZ).

Priorities for action:

- **Adopt a whole-of-MDB approach to co-create investment opportunities with the private sector,** develop pipelines and provide de-risking and credit-enhancement tools to scale up private investment and finance, ideally through a country platform approach.
- **Tackle misaligned incentives and internal barriers for MDBs** to place catalysation of private investment and finance at the centre of MDB strategy, operations and scorecards.
- **Review and reform instruments for catalysing private finance,** including the role of guarantees and credit enhancement over the project cycle and at a portfolio level, drawing on lessons from the World Bank's Private Sector Investment Lab. MDBs should work to develop a market of tradable instruments of emerging market securities to mobilise institutional capital at scale.
- **Revamp the role of the Multilateral Investment Guarantee Agency (MIGA) in the provision of guarantees,** in partnership with the whole MDB system.

Boosting the firepower of the MDB system

As our first report and the IEG Report have underscored, MDBs will need to triple their lending to $390 billion by 2030 ($300 billion non-concessional, $90 billion concessional), with much of the incremental lending focused on climate in order to meet the Paris Agreement targets and related development goals. This new lending capacity can come from three sources that are complementary and mutually reinforcing: more efficient utilisation of existing capital; augmenting capital through voluntary contributions from shareholders and other contributors, through lending and portfolio guarantees and hybrid capital; and regular capital increases that can provide the basis for the sustained expansion of lending that will be needed.

Shareholder support will be critical, to enable MDBs to stretch capital while retaining their high credit ratings and to boost their capital in lock-step with increased efficiency. Funding climate finance through MDBs generates high leverage and yields a higher public return and impact than virtually any other means. All development partners, public and private, should therefore consider channelling resources through the MDBs to scale up finance for urgent climate action in EMDCs.

Measures already being implemented or under consideration by the MDBs could yield $300–400 billion of additional lending capacity over the next decade: a 40% increase in annual lending capacity. Further actions are now needed to both boost immediate lending firepower and achieve the goal of tripling lending by 2030.

Priorities for action:

- **Assess the scope for further efficiency measures based on a common approach, analytical underpinnings and benchmarks** among the MDBs, especially for callable capital; agree on this approach with credit rating agencies. Each MDB should then implement this approach expeditiously in consultation with its shareholders.

- **Expand innovative options for augmenting capital and lending by MDBs** by tapping willing shareholders and new contributors, to boost MDBs' immediate firepower.
- **Launch a systematic campaign by MDBs to mobilise such funding** from willing shareholders and other contributors, starting at COP28.
- **Major shareholders should commit to a regular system of capital increases** to provide the basis of sustained lending and support the governance and legitimacy of the institutions. Without such commitment it will be difficult for MDBs to ramp up in the short run as they might have to scale back strongly if capital constraints start to bite.

Tracking collective effectiveness of the MDB system

A robust system of reporting and accountability needs to be put in place to assess collective and individual progress made by the MDBs on these fronts. Several initiatives are collecting information and tracking progress against the agenda that has been set. The MDBs, too, are improving the quality and timeliness of their own reporting. The IEG could also play a valuable role in independently assessing progress.

Priorities for action:

- **Increase transparency in MDBs' climate finance reporting** and publish more detailed data, such as that on finance to the LDCs.
- **Launch a cooperative effort on independent monitoring of progress against agreed benchmarks,** based on the initiatives already underway.
- **Ask the IEG to take stock of and report on progress on MDB reform** in 2024, at the Spring and Annual Meetings of the World Bank and IMF and COP29, and at COP30 in 2025.

Delivering and expanding options for concessional climate finance

An inclusive architecture for climate finance will require access to concessional and debt-free financing for investments to address priority needs in EMDCs – from adaptation and resilience-building, to addressing loss and damage, restoring nature and supporting a just transition. Many of these investments do not yield the revenue streams necessary to attract private financing and, in some instances, can only be supported by highly concessional finance. Concessional financing of $150–200 billion annually will be needed by 2030 – more than four times the existing level. This can only be delivered by tapping all available pools of concessional finance, including new and innovative options. Developed countries need to lead on the expansion of concessional finance; the overall scale of needs can be met only through international taxation that can generate more predictable financing and by tapping the potential of voluntary contributions from the corporate sector and philanthropy.

Towards more ambitious concessional finance

Financing from bilateral donors is a core part of the $100 billion of annual climate financing that developed countries committed to deliver this year. The fact this target was missed reflects the slow pace of the increase in bilateral climate finance. The shortfall has been most evident in financing for adaptation. At the same time, there is a need to improve access to bilateral finance, the predictability of disbursements, and to better align with country-led processes to improve trust in the climate financing architecture.

Deliberations in technical discussions on the New Collective Quantifiable Goal (NCQG) reflect divergent views on the size of the quantitative target in relation to priority needs. We have learnt from the process around the $100 billion commitment that transparency through determining the layers and components of the overall financing goal will build trust, and this should inform the NCQG process.

The main vehicles for official multilateral assistance are the concessional windows in MDBs, of which the International Development Association is the largest, complemented by specialised multilateral funds. More than 40% of the IDA's annual lending now supports climate action.

Financing through multilateral climate funds has been increasing and they now provide $3.9 billion of annual concessional financing, mostly in grant terms, to EMDCs. The four largest climate financial intermediary funds – the Global Climate Fund (GCF), Global Environment Facility (GEF), Climate Investment Fund (CIF) and the Adaptation Fund (AF) – have cumulative commitments of more than $30 billion. The complex multilateral financing architecture has led to concerns regarding the coherence and effectiveness of these funds' different roles, as well as the adequacy and predictability of their financing.

Priorities for action:

- **Double bilateral climate finance from donors** from the 2020 level to $60 billion by 2025 and triple it to $90 billion by 2030.
- **Immediately double adaptation finance from donors** from the 2020 level and set targets commensurate with anticipated needs by 2030.
- **Provide developed country leadership and financial commitment for the operationalisation and funding of the Loss and Damage Fund.**
- **Enhance donor support of multilateral official financing by:**
  - Urgently replenishing the IDA's crisis window to bolster the IDA's capacity to respond to climate and other crises.
  - Increasing donor contributions to IDA21 and beyond with a view to tripling the IDA's annual lending by 2030.
  - Reforming the architecture and funding of the multilateral concessional climate-related funds to enhance their combined effectiveness and ensure adequate and predicable financing. The proposed review by the G20 offers a timely opportunity for assessing and improving the roles of these funds.
- **Define the scope of climate financing and the criteria for allocating concessional financing to low- and middle-income countries,** with efforts from donors and other climate finance providers:
  - The Paris Global Summit launched a process to agree on a common definition of the 'multidimensional effects of vulnerability' and their potential impact on determining eligibility to concessional resources.
  - Give consideration also to establishing a global window for concessional financing to address global public goods, as recommended by the G20's Triple Agenda Report.
- **Take steps among donors and climate finance providers to enhance the effectiveness of official concessional finance**:
  - Align support to country-led priorities and programmes.
  - Tackle bottlenecks to provide efficient access to, and predictability of, financing based on the recommendations of the Task Force on Access to Climate Finance, working with pilot countries and the Climate Finance Network.
  - Improve monitoring, tracking and accountability of the provision of climate finance.

Enhancing the use of Special Drawing Rights (SDRs)

The IMF and its members should take steps to improve the effectiveness of SDR rechannelling and tap the enormous potential of SDRs to boost liquidity and enhance development and climate finance.

Priorities for action:

- **Identify and tackle impediments to expanding lending through the RST and PRGT.**
- **Use SDRs to expand lending by MDBs that are prescribed SDR holders,** starting with implementing proposals from the African Development Bank and Inter-American Development Bank.
- **Modernise the framework for use of SDRs to make it less rigid and costly,** led by the IMF, working with central banks.
- **Initiate discussions under leadership of the IMF and G20 on the next cycle of SDR issuance** as part of a regular system of issuance to boost liquidity and further augment the pool of concessional finance for climate action.

Tapping carbon markets

Carbon markets, one way to put a price on carbon, have an important role in an overall financial strategy for transformation. Compliance markets, through which governments require firms to pay for their ongoing emissions, remain central to the policy toolbox in many countries and are an important source of government revenue. The growth of carbon credit markets – which trade verified emission reductions or removals (rather than permits) – is also an additional potential source of climate and development finance.

The voluntary carbon market (VCM) could provide up to $50 billion in the medium term but it has experienced setbacks and negative market sentiment, exacerbated by an uncertain regulatory and policy landscape, including questions over the precise relationship with the mechanisms created by Article 6 of the Paris Agreement. To counter these issues, robust and dynamic market design, greater transparency and oversight, and leveraging overlaps with policy frameworks, will be key. There should be convergence between the rules governing voluntary and compliance markets as an enabler of high-integrity finance to EMDCs.

EMDCs require strategies to access carbon credit markets. They must develop pipelines of projects or programmes that can generate high-quality credits and ensure that such issuance is compatible with their wider climate commitments and development plans. Support is required from international organisations, including bilaterally and through regional groups such as the Africa Carbon Markets Initiative (ACMI).

To scale up financial flows in the VCM, a complete, clear and credible governance framework and market architecture are needed, with end-to-end transparency accompanied by strong incentives to make investments. The many different initiatives and market players need to be joined up to deliver robust oversight.

Priorities for action:

- **All governments: continue to extend compliance markets**, ensuring sufficiently high carbon prices by design and, where possible, using the revenues for no-regrets investments in sustainable development.
- **EMDC governments: continue to prepare to receive carbon finance from high integrity activity,** including building project pipelines, linking these to climate and development strategies and NDCs, and developing institutions and capacity.
- **Advanced economy governments: develop regulations and carbon pricing instruments** that support demand for high-quality carbon credits and high integrity in companies' use of credits in their decarbonisation strategies.
- **Donors: assist EMDC governments to invest in their capability to attract high integrity carbon finance** and help to ensure that benefits are shared fairly, including by supporting Indigenous Peoples and local communities.

- **VCM integrity initiatives: deepen joint work,** inviting collaboration with market players and civil society stakeholders, urgently accelerate alignment of definitions and standards across demand and supply, and prioritise missing pieces from current frameworks in work plans for 2024.

International taxation measures to increase climate finance

Introducing international taxation on high-emitting sectors such as maritime transport and international aviation has enormous potential to close the climate financing gap and should be actively pursued. There is growing momentum behind the necessity and opportunities for such taxation, including through the Bridgetown Initiative, Paris Global Financing Pact and Africa Climate Summit. The Paris Global Summit drew attention to mandatory mechanisms, which incentivise decarbonisation, remove implicit fossil fuel subsidies, level the corporate tax playing field, embody the spirit of the polluter-pays principle, and can mobilise significant financing for a just transition.

Priorities for action:

- **Establish a Taskforce on Global Taxation,** as proposed by leading countries supporting the Paris Global Financing Pact, to consider the full range of options and build consensus on an integrated set of proposals.
- **Continue active discussions on the promising avenues of maritime and aviation levies** in parallel to setting up the taskforce, to secure agreement on options that can attract political support and take into account any potential adverse effects on EMDCs.

Leveraging private philanthropy

Climate financing accounts for only 2% of overall philanthropic giving, suggesting significant scope for philanthropy to play a bigger role in boosting climate finance, including for EMDCs. In 2022, $435 million, or about 20% of philanthropic giving by foundations, went to EMDCs (other than China). There is also significant scope to expand the pool of philanthropic contributions, including by tapping the corporate sector and rich individuals.

Priorities for action:

- **Philanthropy should assess its potential role in bridging climate financing gaps,** based on its particular strengths. This should happen in relation to country programmes such as the Just Energy Transitions Partnership (JETP) model and to priorities for which concessional financing is urgently needed, such as loss and damage, adaptation and resilience, investing in nature and biodiversity, and accelerating the energy transition in low-income countries.
- **Consider ways for philanthropy to provide flexible financing to develop new ideas that can catalyse transformative change** and advance opportunities for people.
- **Create partnerships between philanthropy and the MDBs to scale up support for climate action** through innovative structures and the provision of hybrid capital.
- **Explore the potential to tap corporate responsibility** to increase financing to achieve the Sustainable Development Goals (SDGs) and address climate change and other public goods, including by identifying areas and financial mechanisms that deliver effectively on corporate responsibility to unleash significant sources of voluntary contributions.