

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

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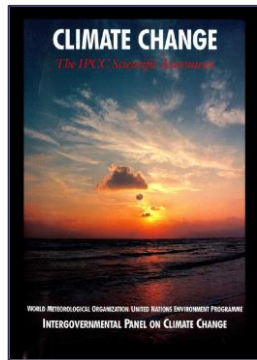
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18 November 2022

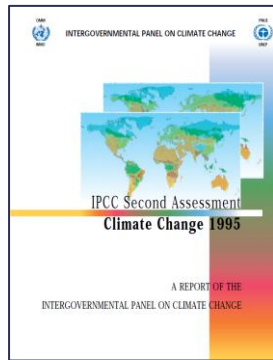
Structure

- **Policy context & urgency of action**
- Investment needs & finance
- Mechanisms for delivery

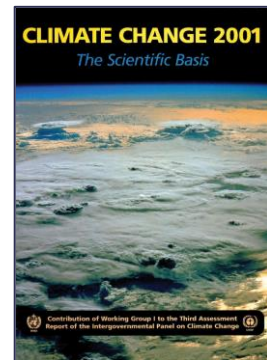
Urgency and opportunity of climate action now even clearer



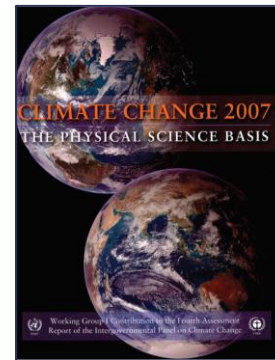
1990



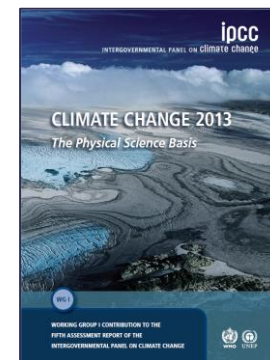
1995



2001



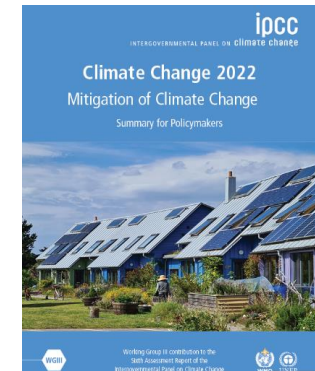
2007



2013



2018



2022

“There is **new and stronger evidence** that most of the warming observed over the last 50 years is attributable to human activities.”

“An increasing body of observations gives a collective picture of a **warming world and other changes** in the climate system.”

– Third IPCC Assessment Report, 2001

“It is **unequivocal** that human influence has warmed the atmosphere, ocean and land.”

“Human-induced climate change is **already affecting** many weather and **climate extremes** in every region across the globe.”

– Sixth IPCC Assessment Report, 2021

“The world faces **unavoidable** multiple climate hazards over the next two decades with global warming of 1.5°C. Even temporarily exceeding this warming level will result in **additional severe impacts**, some of which will be **irreversible**.”

“People and ecosystems **least able** to cope are being **hardest hit**.”

– IPCC, February 2022

Historic demographic transition: opportunity and challenge for breakthrough on climate and development

🏠 Welcome to the United Nations

World population to reach 8 billion on 15 November 2022

Amid falling growth rates, global population projected to peak around 10.4 billion in the 2080s



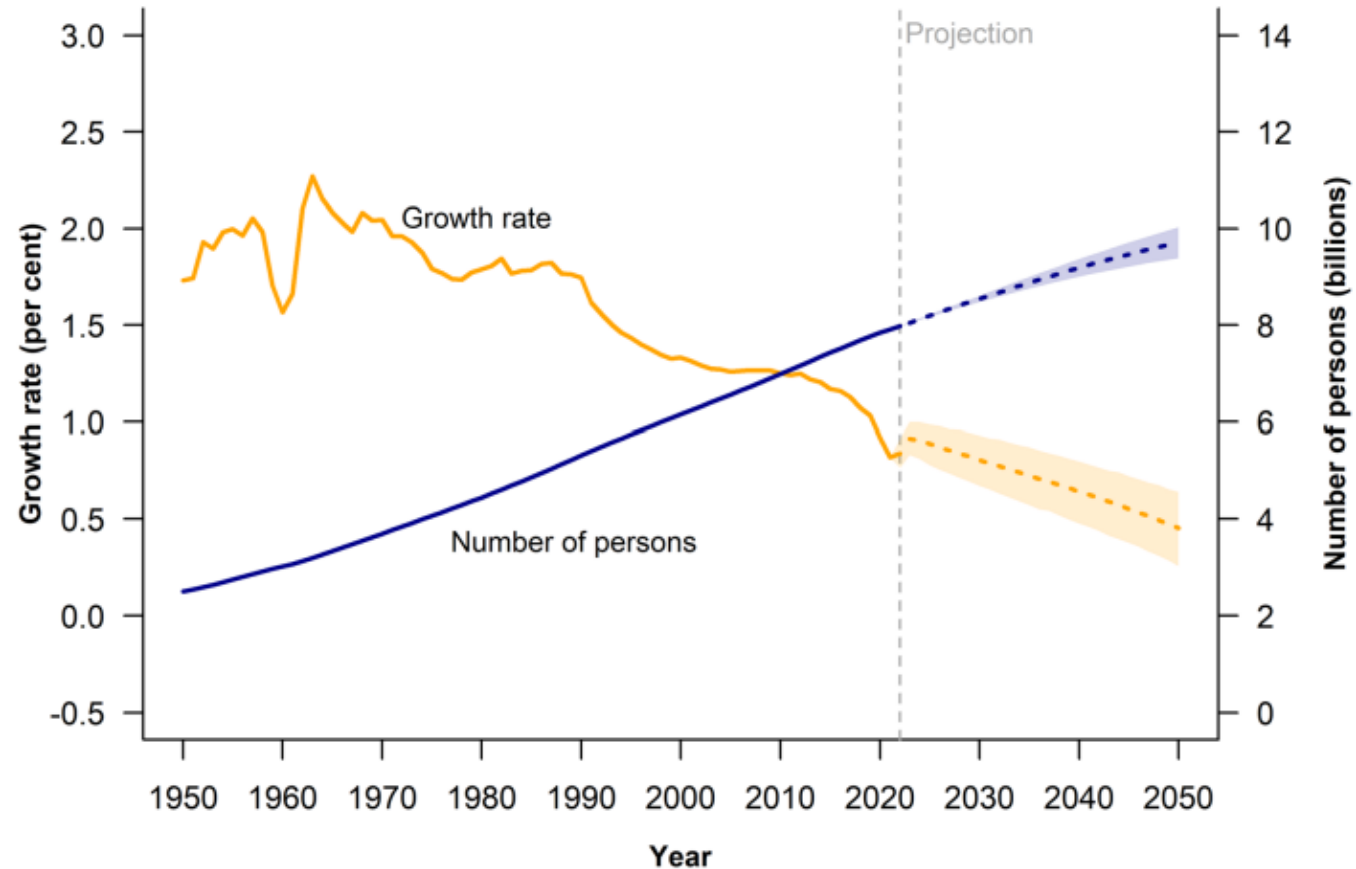
In just days, our planet's population will cross a new threshold.

The 8 billionth member of our human family will be born. This milestone puts into perspective what this climate conference is all about.

-UNSG's remarks to High-Level opening of COP27

Historic demographic transition: opportunity and challenge for breakthrough on climate and development

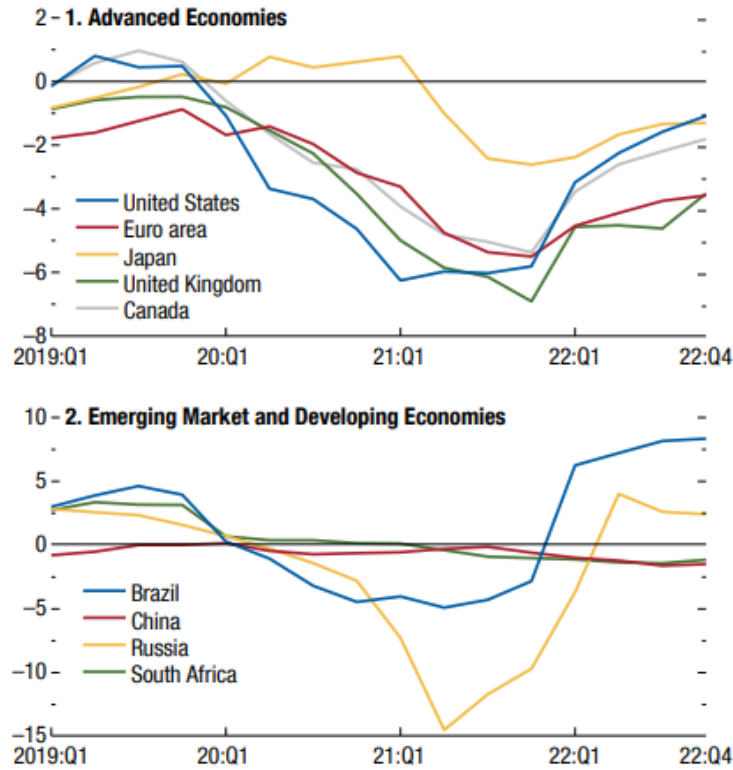
Global population size and annual growth rate: estimates, 1950-2022, and medium scenario with 95 percent prediction intervals, 2022-2050



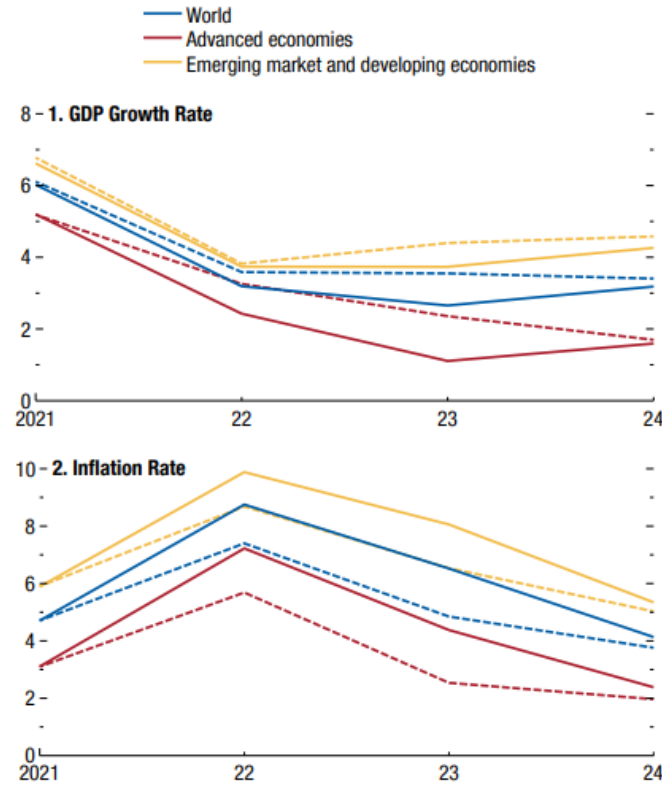
Source: United Nations World Population Prospects 2022

Investment push against tight finance conditions...

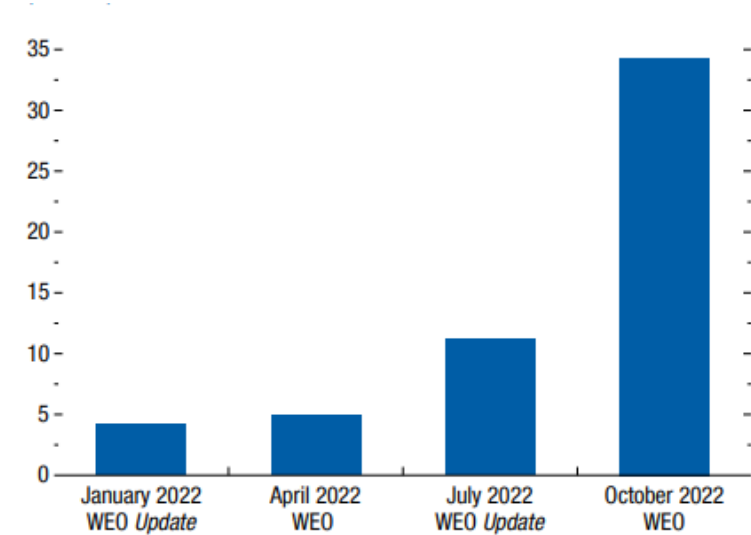
Real Short-Term Rates, %



Growth and inflation forecasts, %



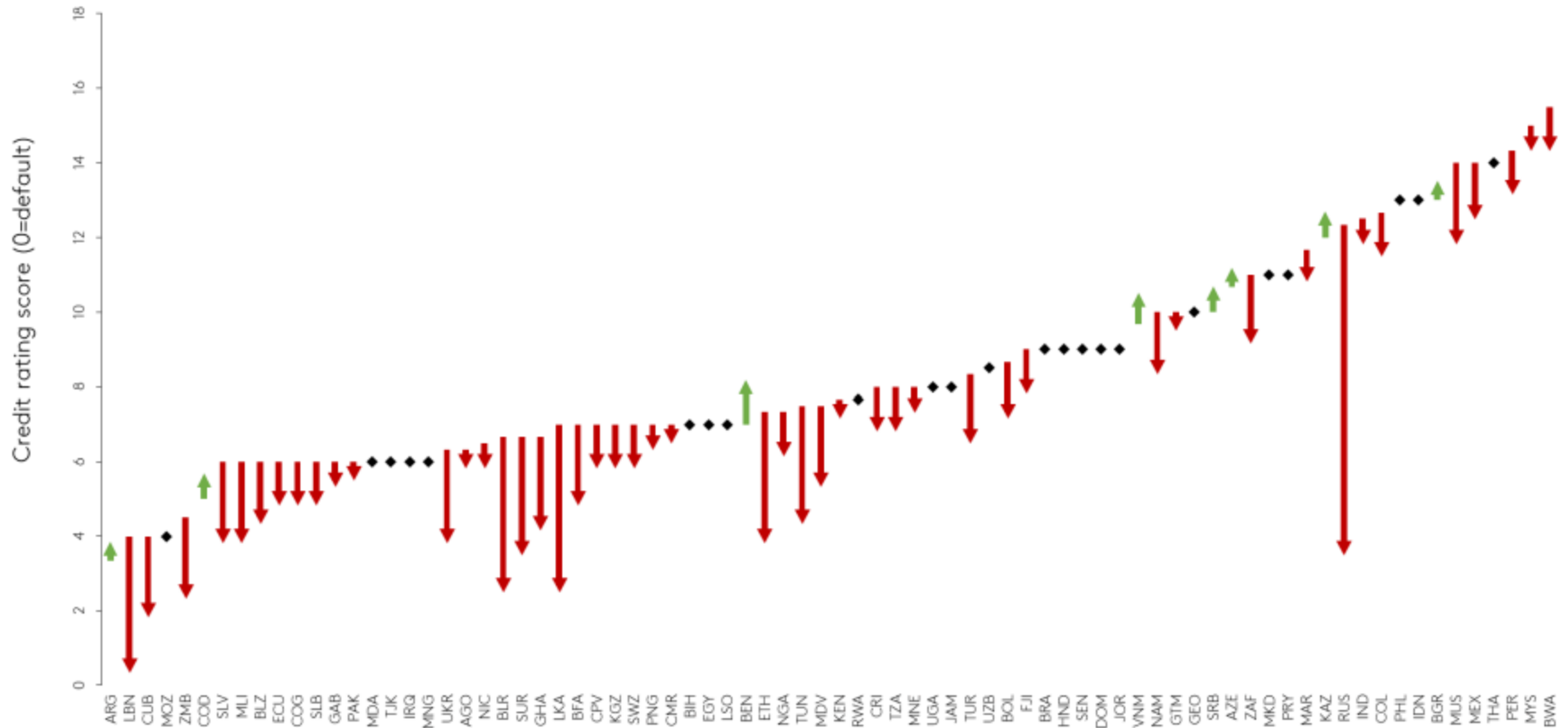
Countries in contraction, % of global GDP



Source: International Monetary Fund World Economic Outlook 2022

...including a worsening debt outlook

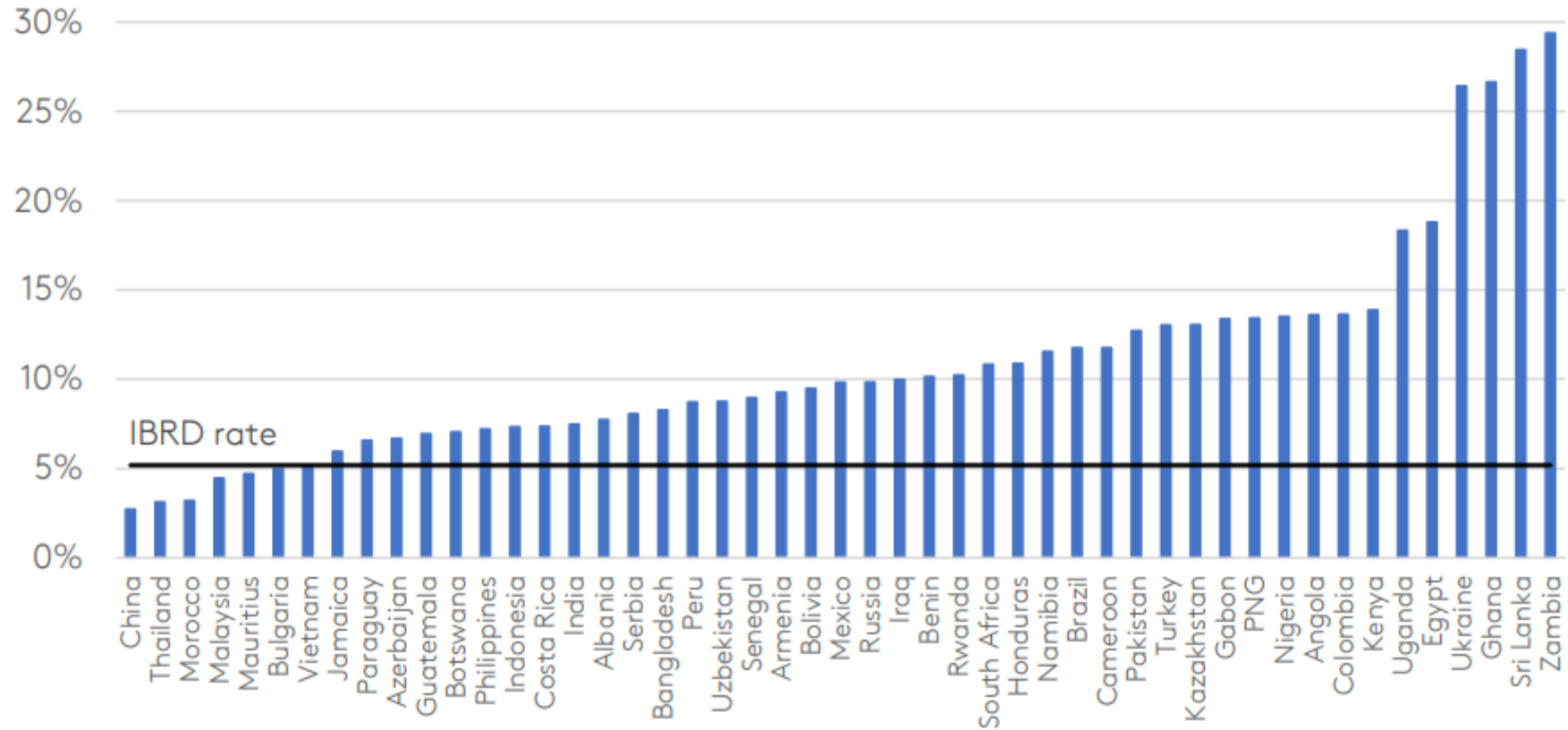
Sovereign credit ratings, December 2019 versus October 2022



Source: Songwe, Stern et al 2022

Resulting in high cost of capital for EMDEs

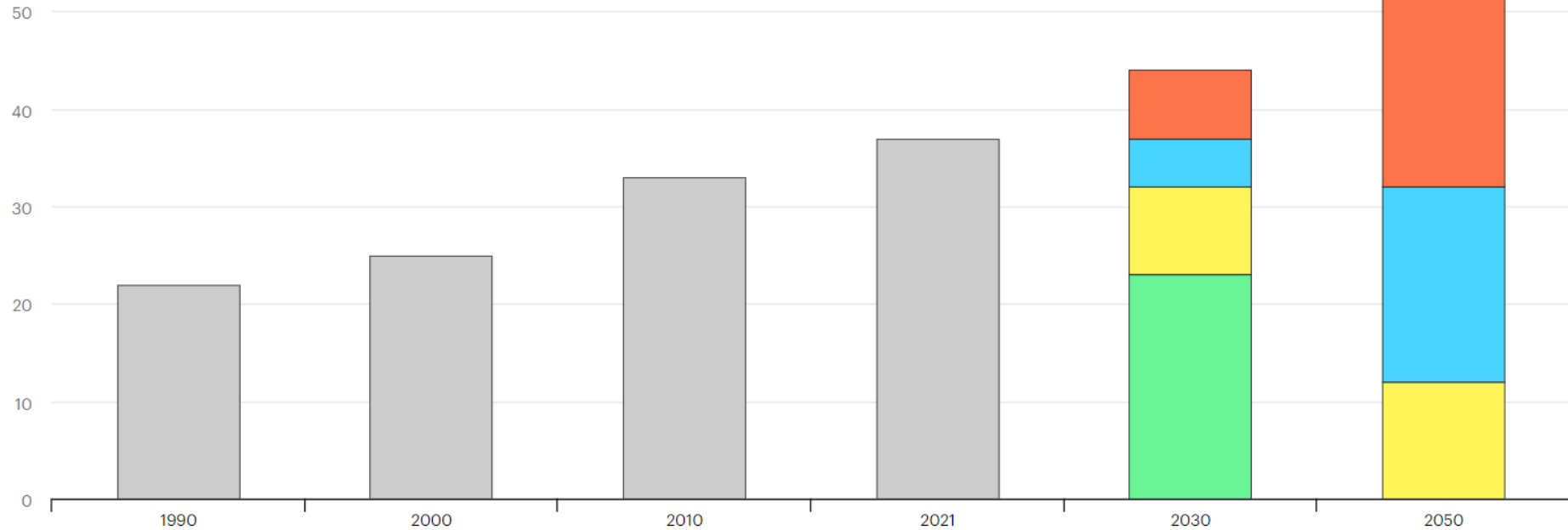
Developing country 10-year bond yields



Source: Songwe, Stern et al 2022

Action must start today, not tomorrow

Global CO2 emissions by scenarios, 2000-50



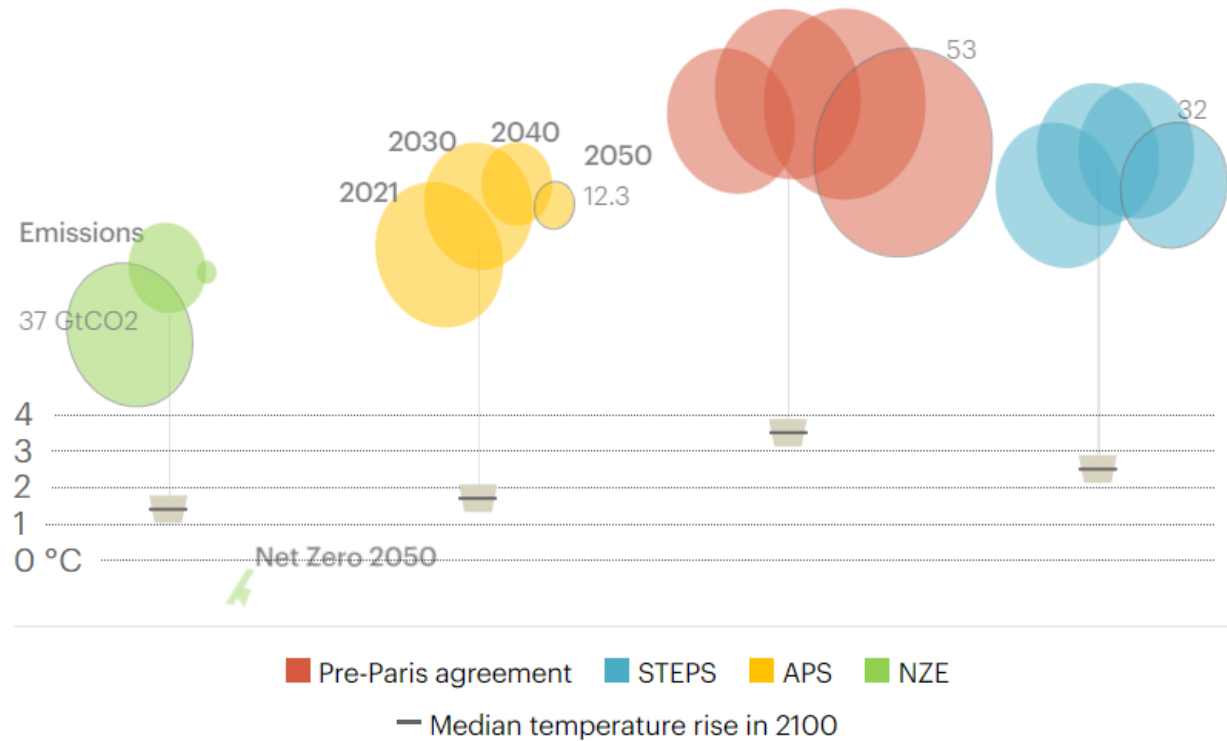
IEA. License: CC BY 4.0

● Historical ● Net Zero Scenario ● Announced Pledges Scenario ● Stated Policies Scenario ● Pre-Paris baseline

Source: International Energy Agency World Energy Outlook 2022

Action must start today, not tomorrow

Projected temperature increases by scenarios



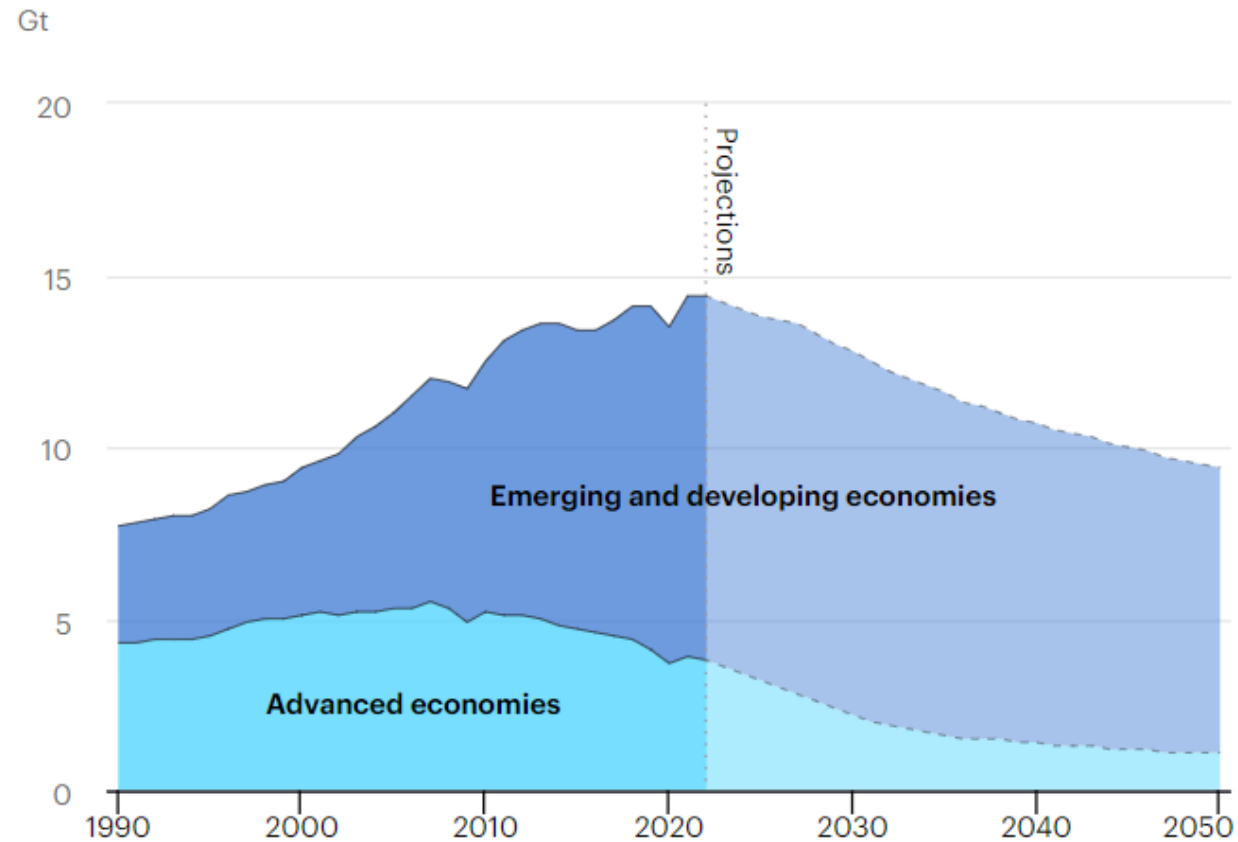
Source: International Energy Agency World Energy Outlook 2022

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EMs at the heart of the transformation

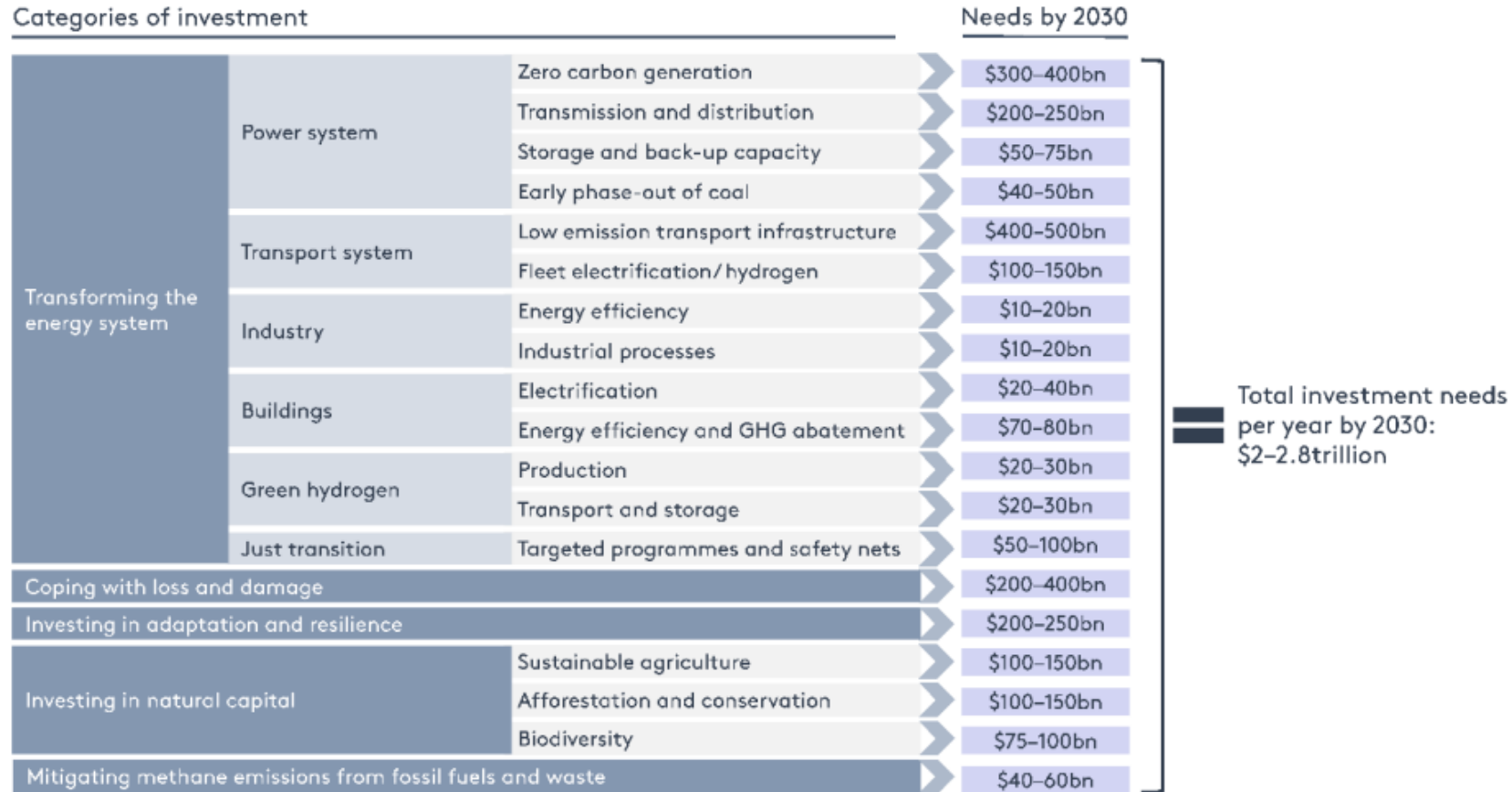
Power sector CO2 emissions, 1990-2050



Source: International Energy Agency World Energy Outlook 2022

Energy transformation lion's share of investment needs

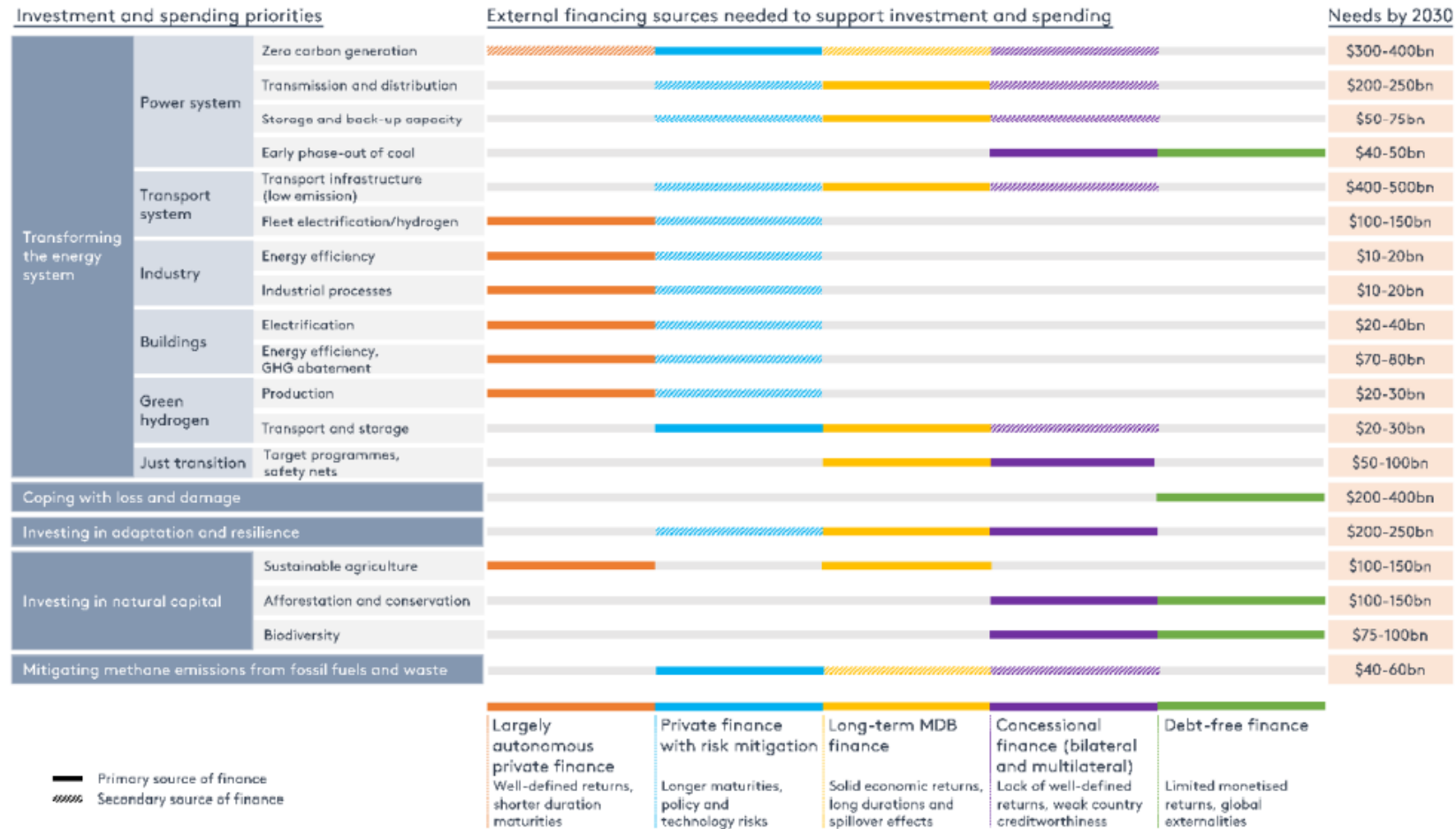
Investment/spending needs for climate action per year by 2030



Source: Songwe, Stern et al 2022

Finance for what: mix of sources depends on investment needs

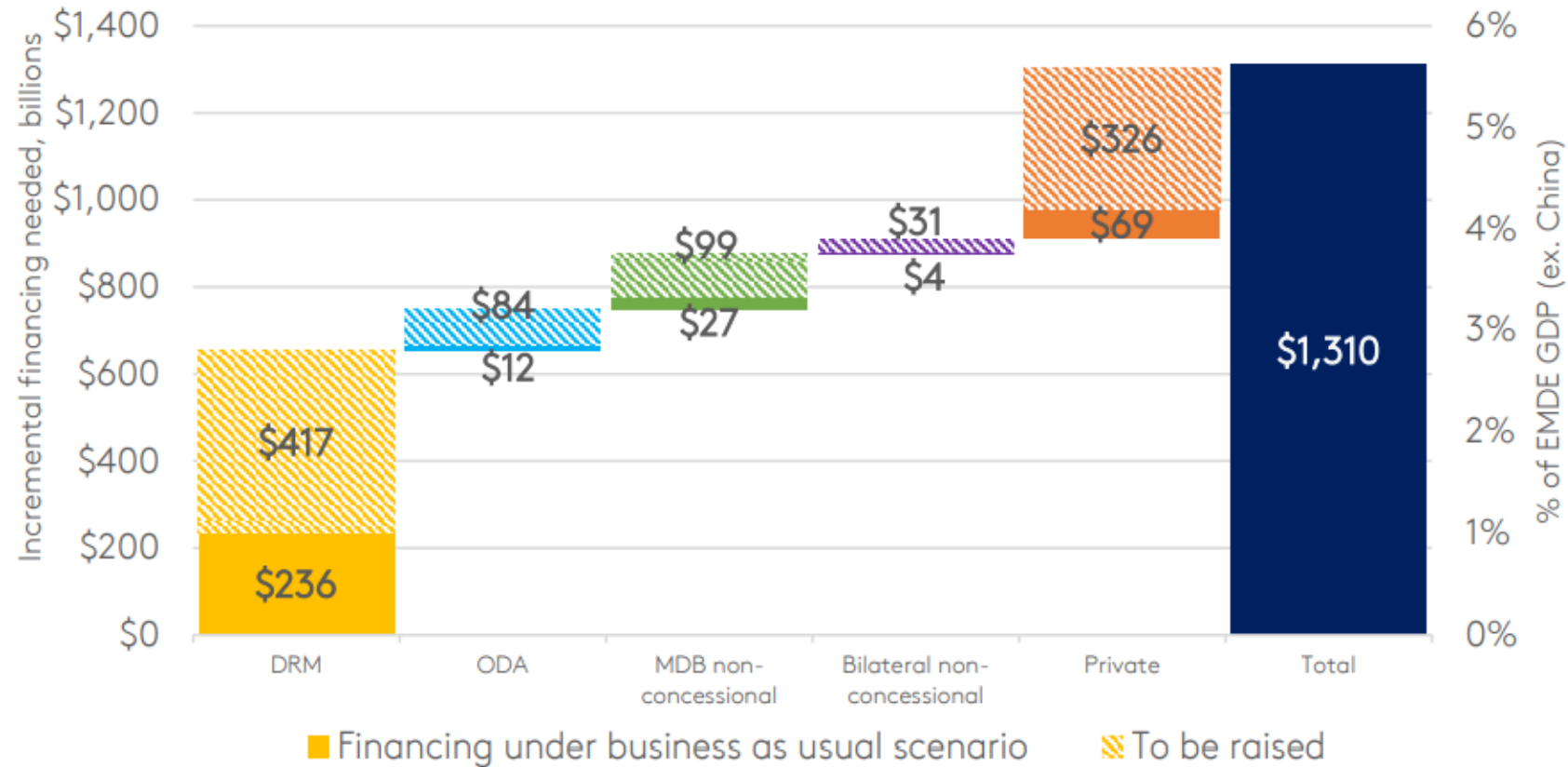
External financing sources for investment and spending priorities for climate action and related development goals



Source: Songwe, Stern et al 2022

Finance for what: mix of sources depends on investment needs

. Grand match financing strategy – incremental financing needed between 2019 and 2025 (billions 2019 US\$)



Source: Songwe, Stern et al 2022

Key elements of proposed financing package

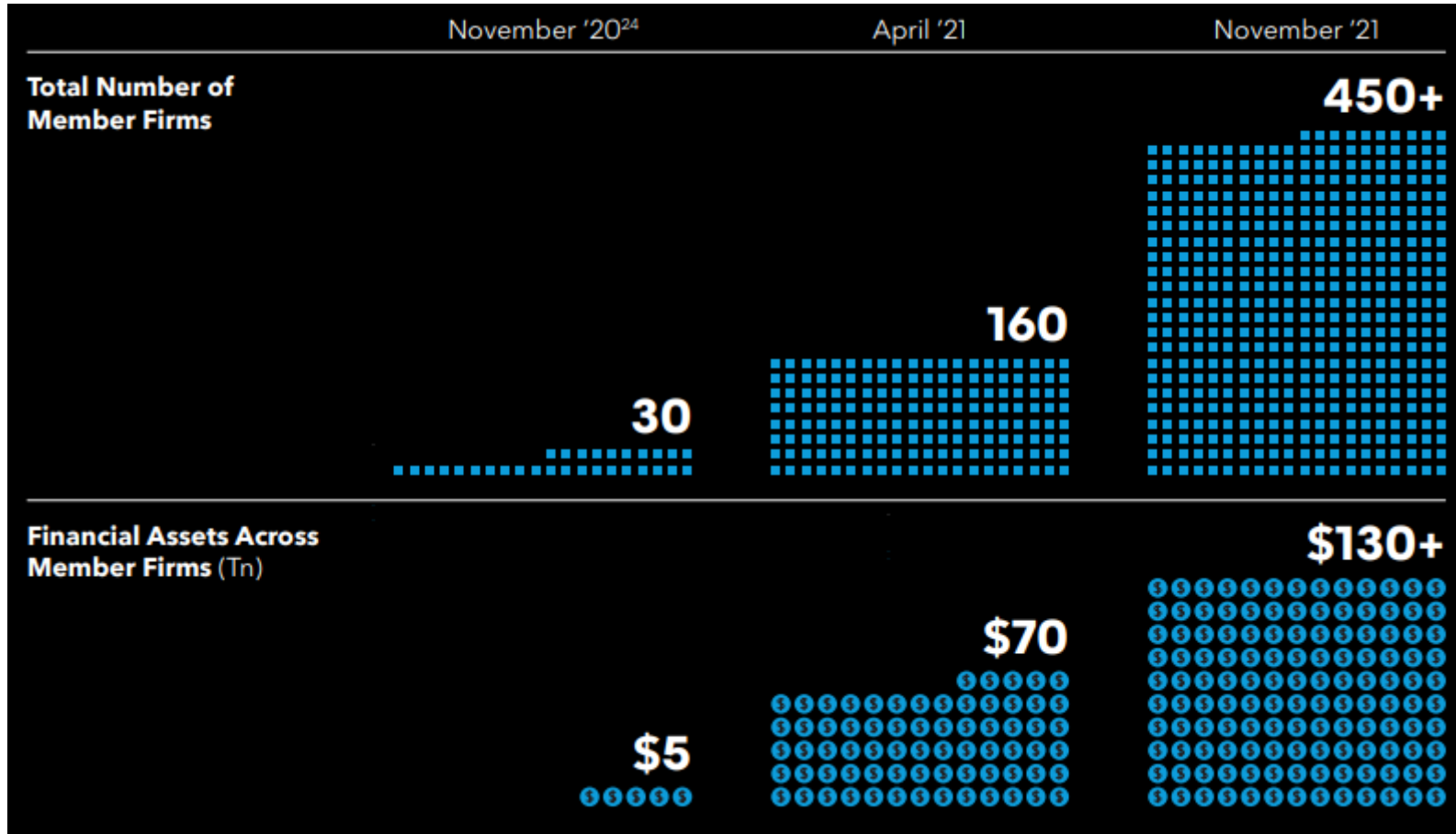
- Concerted push to resolve **debt difficulties**, enable new debt for investments.
- Acceleration in **private sector Investment and finance**, with proactive approach from private sector to translate commitments into tangible investments and finance, and with efforts from countries and DFIs to create new highway for private finance.
- Major scaling up of effort and finance from **the MDBs and wider development bank system** to help tackle barriers to scaling up investments, catalyse private finance to their full potential, and help finance urgent public investments and transitions.
- Rich countries to deliver on and double **official concessional finance** by 2025, especially for key priorities such as adaptation and resilience, loss and damage and accelerating decarbonisation in middle-income countries.
- Expand sources of **low-cost finance through innovative approaches** (such as the International Finance Facility and use of guarantees) and tapping all available pools of finance such as **SDRs, carbon markets and private philanthropy**.

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Rare moment in time: 'the financial stars align'

GFANZ and race to zero membership and the financial assets they represent



Source: GFANZ progress report

What can investors do? Three strategies for sustainable investment

Divestments: Attempt to address climate change by divesting of assets including stocks, bonds, and other financial instruments connected to companies involved in contributing to climate change (e.g. fossil fuel companies with no credible transition plans).

Active ownership/shareholder engagement: Tactics used by investors to influence the companies they own on questions of sustainability. Methods include proxy voting or direct engagement of management in investment dialogues.

Investment in sustainable asset classes: Allocating parts of portfolios to industries and companies that contribute to addressing climate change

How can the rest of the financial system align itself?

What can finance ministries do?: Correcting market failures: economic toolkit of subsidies, taxes (e.g. on carbon), incentives, direct public investment

What can central banks do?: Embed climate variables in macro modelling, green prudential policy (e.g. transition plans and stress tests), responsible investment of portfolios

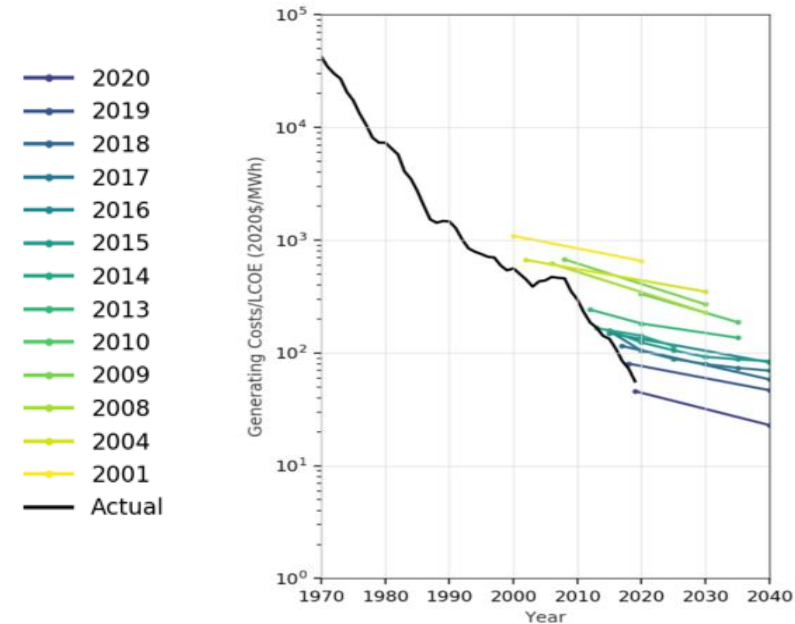
What can development banks do?: Derisking, concessional finance, issuing sustainable bonds, supporting sustainable capital markets

The good news: tech progress has moved faster than hoped

Renewable power technologies: decreases in levelized cost of electricity



Actual versus IEA projected LCOE of solar PV



Renewables with storage now competitive (without subsidy or carbon price in much of the world). In 2020, solar/wind was the cheapest form of new power generation in countries representing over 70% of GDP (SYSTEMIQ, 2020).

Capital costs for renewables continue to fall much faster than those for conventional technologies. Strong increasing returns to scale in technologies and in discoveries. Much of it unanticipated.

But high perceived risks translate into high required returns

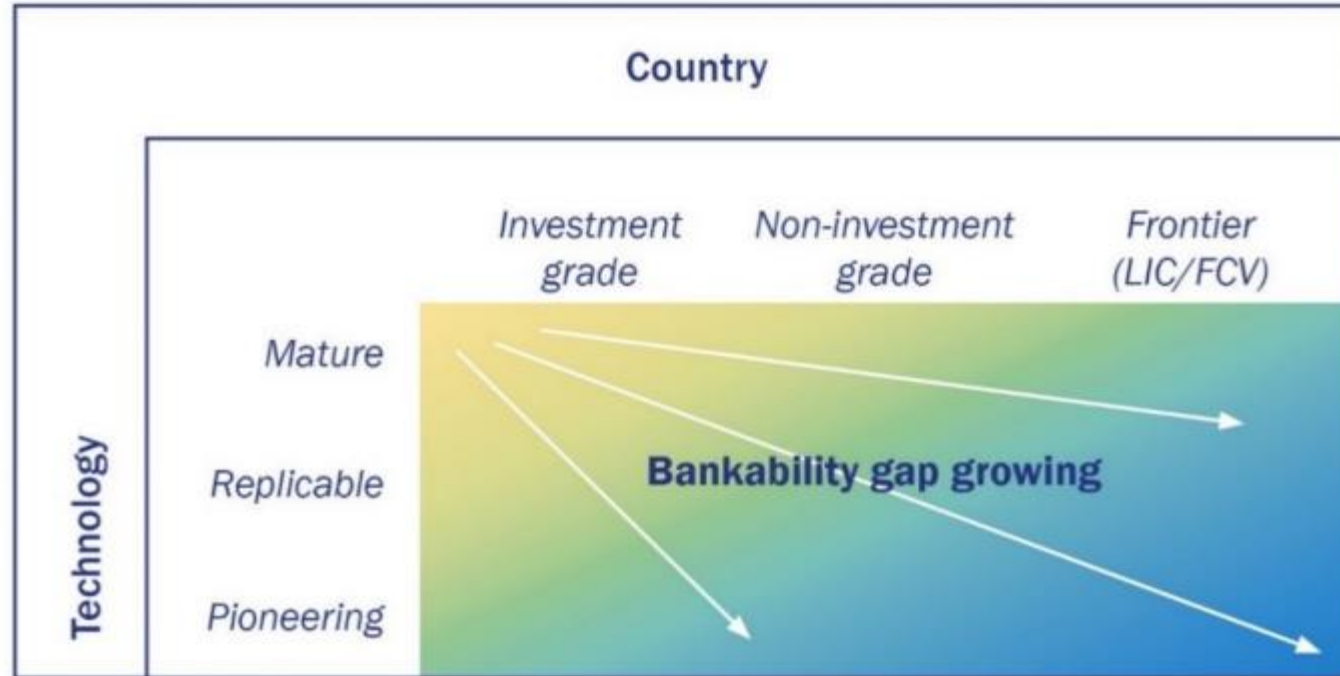
Return expectation from solar projects in EMDCs

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: Climate Policy Initiative (forthcoming)

And so finance fails to connect to needs

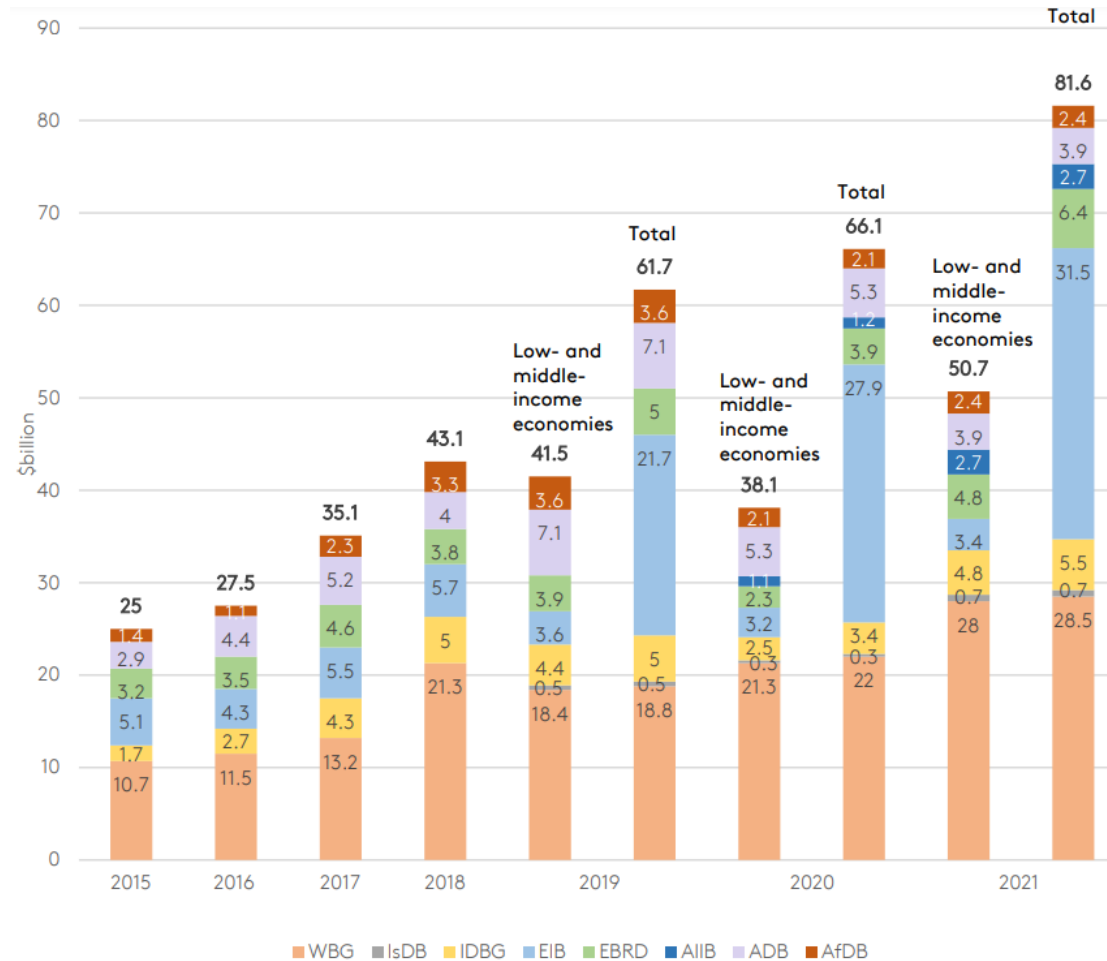
Bankability gap at the geographic and technological frontiers



Source: *Blended Finance for Scaling up Climate and Nature Investments*, GRI (2022) <https://www.lse.ac.uk/granthaminstitute/wp-content/uploads/2021/11/Blended-Finance-for-Scaling-Up-Climate-and-Nature-Investments-1.pdf>

Finance package will require tripling of MDB climate finance

MDBs' climate commitments from 2015 to 2021 (US\$ billion)



Source: Songwe, Stern et al 2022

And complemented by wider envelope of non-debt innovative finance

Voluntary Carbon Market Value, pre-2005 to 2021



Source: Ecosystem marketplace

A six-point action plan to mobilise finance

- 1. Diagnostics:** Private sector to work together with country governments and IFIs to tackle constraints to private investment and finance in priority countries and sectors. Examples that can be scaled up: Climate Finance Leadership Initiative (CFLI), Global Infrastructure Facility (GIF), World Bank's Climate Change Development Reports (CCDRs) and IFC's Country Private Sector Diagnostics (CPSDs)
- 2. Project preparation:** Capacity building in both public and private sector for priority technologies, e.g. for renewables, storage and green hydrogen.
- 3. Tackle risks:** Develop innovative and country-specific solutions for exchange rate risk (macro level) and policy-induced risk (sector level) to impart confidence to private sector investors.
- 4. Blended finance:** Secure necessary scale and concessionality for complementary public investments and for reducing the cost of capital especially in more challenging sectors and markets.
- 5. Country platforms:** Bring key stakeholders together in structured way. Examples that can be developed as blueprints: South Africa, Egypt, Indonesia.
- 6. Public-private partnerships:** Enhanced cooperation between private investment community (e.g. GFANZ) and multilateral development banks to strengthen the international architecture to foster scalable approaches.

Pioneering country platforms across regions: SSA, MENA & APAC



South Africa Just Energy Transition Partnership (JETP)

- Launched at COP26
- \$8.5bn commitment from France, Germany, UK, US, EU
- Intended to mobilise further finance to accelerate retirement of coal plants & shift to renewables



Egypt Nexus of Water, Food and Energy (NWFE)

- Launched at COP27
- \$15bn commitment of concessional finance from US, Germany, EU, France, Netherlands, Denmark and UK
- Partnership with EBRD, IFAD and AfDB on three pillars



Indonesia Energy Transition Mechanism (ETM)

- Launched at G20 meetings in November 2022
- Blended finance approach with wide range of institutional partners including concessional country finance, philanthropies, MDBs, NDBs and private sector

Not only about managing risk, also about more attractive economies

Understanding the co-benefits - and linking through them climate action to issues that the public care about - can help policy-makers prioritise policy options that have a greater chance of public support for such changes (in the face of occasional public opposition to the transition)

- Sustainable investments are not only about managing risk, but can also lead to a more attractive form of development compared with the dirty paths of the past.
- **Health:** Better air quality from reductions in pollution; Healthier diets; increased wellbeing from access to energy efficient homes
- **Economic:** Savings on fuel bills (especially for energy importing countries; improvements in productivity through reduced traffic and better health
- **Social:** Reduced fuel poverty and inequality; protection from energy price increases
- **Resilience:** Reduction to dependence on fossil fuel; improved energy and water security; reduced risk of conflict over access to resources