Scaling-up Climate Finance in the post-Covid Context

Guidance for short term action in a nutshell

We live in pivotal times for climate policies: the 2023 Global Stocktake may well be the last opportunity for a global agreement on coordinated efforts to stay 'well-below 2°C'.

Paradoxically, the post-COVID-19 era opens an opportunity to seize it. Indeed, *closing the infrastructure gap worldwide* (energy, transportation, buildings, water, irrigation, drought protection, sanitization) *with 1.5°C compatible options would boost global recovery while contributing to poverty alleviation and reaching the Sustainable Development Goals.* This requires to jointly:

- *Redirect the immense global pool of private savings* and change the preference of financial players for liquid products and real estate over long-term investments.
- *Reduce the mismatch between where the savings are and where they are needed*, namely in developing countries, representing 70% of investment needs.

This is both a matter of justice by harnessing the savings of 56 million millionaires who hold a bit less than 50% of global financial wealth *and of economic efficiency of climate policies* by preventing the lock-in of developing countries into carbon-intensive development paths and by *opening a potential of reciprocal gains* between countries with very different income levels. Coordinated initiatives from governments, direct or through changes in the regulation of the financial system, are needed to open this potential by creating the conditions of a *circle of trust* between:

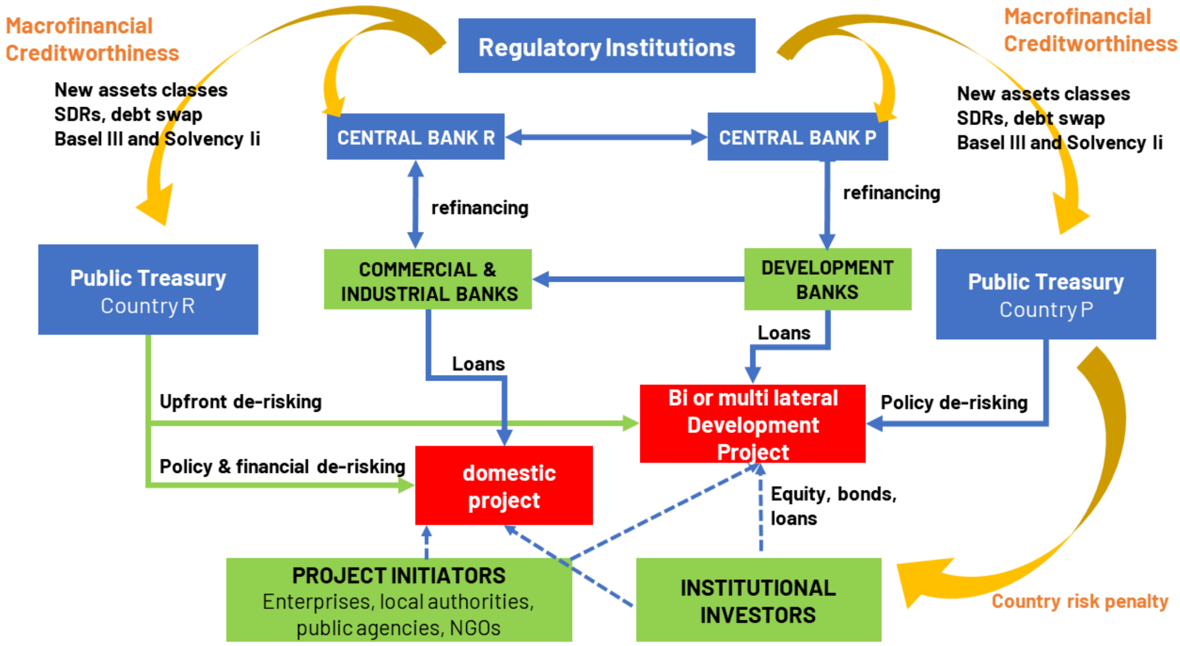
1. *Project developers who are currently deterred from committing their own capital to economically sound low-carbon investments* by very high up-front costs in the early phases of the projects' lifetime. This deterrent can be offset by:
   - A *larger use of public guarantees* in various combinations of policy instruments (subsidies, grants, feed-in tariffs, standards). Public guarantees tackle directly up-front risks and maximise the leverage of public money in a context of competing demands on public budgets (health, security, social safety nets).
   - *Lowering the administrative, information and institutional barriers* to project proposals including the access to fragmented financing windows and contract renegotiations

2. *Institutional investors who are in search of safe investment havens*. It is about transforming built infrastructures into *credible safe climate remediation assets* and developing innovative forms of public-private partnerships. Public de-risking devices should then be framed by *transparent and rigorous project selection methods* which will

   - constitute an implicit *certification of positive environmental impact and development adequacy of projects and dispel the 'greenwashing suspicion' against green bonds;*

- facilitate aggregation methods to *unlock the proposal of small projects* that are barely significant for institutional investors, and facilitate their *bundling*, securitisation and repackaging in *standardised financial products*.

3. *Banks that are prevented from offering loans at low interest rates and with long maturity* given the Basel III rules and the high spreads of interest rates on sovereign bonds in countries under hard *creditworthiness constraints*. Accelerating the *recognition by Central Banks of climate remediation asset classes as collateral of climate targeted debts* in the balance sheet of commercial, industrial and development banks might help overcoming these two obstacles and facilitate the emission of bonds *in local currencies.*



It is illusive to wait for a fully-fledged architecture combining these three elements to create a circle of trust. To the contrary, it is now about starting a learning process, building on the large spectrum of experience in development assistance and on the lessons of innovative ways of tapping into the saving pools to finance projects on the ground.

It is possible to trigger this learning process before the 2023 stocktake by:

1. Encouraging cross-borders capital flows through AAA multi-sovereign guarantees of developed countries to de-risk climate-friendly investments in developing countries, and help Development Banks, institutional investors and Climate Funds to work together. This can generate transfers far higher than the USD 100 billion climate finance promise.
2. Reduce the debt burden in developing countries and increase their creditworthiness to widen their fiscal space through targeting new debt facilities (debt cancellation and swaps, SDRs) towards climate friendly investments, issuing bonds in local currency to mobilize local capital markets and accelerate the recognition of climate remediation asset classes in their public balance sheet.
3. Help, through *reducing the fragmentation of climate and development finance*, integrating post-COVID-19 recovery policies, climate objectives and SDGs into investment plans that identify, combine and sequence the available sources of funds *with easy access to loans at low interest and long maturity.*