DAILY EDITORIAL ANALYSIS

TOPIC

Climate Finance

www.nextias.com

CLIMATE FINANCE

Context

- The role of the private sector in 'climate finance' has so far been somewhat of a blind spot.

About Climate finance

- Climate finance refers to **local, national or transnational financing**—drawn from **public, private and alternative sources of financing**—that seeks to support **mitigation and adaptation actions** that will address climate change.
- The Convention, the **Kyoto Protocol and the Paris Agreement** call for **financial assistance** from **Parties with more financial resources to those that are less endowed and more vulnerable**.

Significance

- It is critical to addressing climate change because **large-scale investments** are required to significantly reduce emissions, notably in **sectors that emit large quantities of greenhouse gases**.
- It is equally important for adaptation, for which significant financial resources will be similarly required to allow societies and economies to **adapt to the adverse effects and reduce the impact**s of climate change.

Global Position on Climate Finance & role of Private Sector

- **Paris Pact for People and Planet:**
  - Recently, more than 100 countries as well as representatives from global private sector entities gathered in Paris to affirm a single goal: No country should have to choose **between fighting poverty and fighting for the planet**.
  - The Paris Pact for People and Planet proposed actions aimed at scaling up private capital flows to transform emerging and developing economies.
- **Shift from billions to trillions:**
  - Much discussion and controversy have focused on the public sector, especially the commitment by developed countries **to provide USD 100 billion** in climate finance **per year** between **2020 and 2025.**
    - This goal is now **expected to be met in 2023** for the first time.

Challenges of private climate financing

- **Underperformance of private sector:**
  - **The OECD 2020 data** shows that the mobilisation of private climate finance has **underperformed against the expectations of developed countries**.
  - The SCF (Standing Committee on Finance) report notes that **it is unclear:**
    - to what extent this was due to a **lower-than-expected potential to mobilise private finance** or
    - to a relatively **lower proportion of projects** with **mobilisation potential** in the overall climate finance portfolio.
- **Demands of developing countries:**
  - Developing countries have for a long time insisted that a significant portion of climate finance **should come from public funds** as **private finance will not address their needs and priorities** especially related to **adaptation**.
- **Issues with adaptation priorities:**
  - Adaptation is u**nlikely to offer commercially profitable opportunities** for private financiers.
  - Vulnerable, debt-ridden and low-income countries with poor credit ratings needing adaptation finance the most, find it challenging to access private finance.
- **Contradictory claims:**
  - Many **developed countries and multilateral development banks** have emphasised the **importance of private finance** mobilised in their **climate finance strategies**, including by **de-risking** and creating enabling environments.

- According to the reports, these efforts have **not yielded results at the scale required** to tap into the significant potential for investments by the private sector and **deliver on developed countries' climate ambition**.

Suggestions and Way Ahead

- **Building & reviewing climate-finance architecture:**
  - The need is to engage in a review of the global vertical climate funds in order to optimise the use of their resources.
  - It is also needed to increase partnerships between peers and with the rest of the climate-finance architecture.
- **Structural requirements:**
  - More **simplicity and consistency** in the rulebook is required to **lower risk and risk perception for global investors** who fund sustainable projects in developing countries.
  - Providing the right signals and labels to invest in sustainable projects, maintaining a stable and transparent environment, and promoting investment opportunities are also essential.
- **Role of Credit-rating agencies:**
  - Credit-rating agencies must be included in the reform agenda of **multilateral development banks (MDBs)**.
  - Rating agencies should take into account the **innovative blended finance schemes** we are designing and **use the new data on actual defaults**.
  - This new data shows that in many developing economies, contrary to most OECD countries, projects with good multilateral guarantees are less prone to default than companies, which are less likely to default than sovereigns.
- **Country-led, multi-actor partnerships:**
  - There is a need to push further the thinking on the "green finance" framework to make the most of the global savings pool.
    - The objective is to align the financial sector with the **objectives of the Paris Agreement**.
  - In this respect, country-led, multi-actor partnerships such as Just Energy Transition Partnerships are the right way to raise the required investments.
  - These partnerships are already operative in Indonesia, Vietnam, South Africa and Senegal.
    - We should do more with countries willing to phase out coal from their electricity mix.
- **Addressing debt vulnerabilities:**
  - Unlocking private sector finance for the green transition does not exonerate governments from addressing debt vulnerabilities in developing countries.
  - Too many **low-and middle-income countries** face unsustainable debt trajectories.
  - All **major creditors** in the region should now **avoid contributing further to debt vulnerability**.
- On many of these issues, India's G20 Presidency has enabled path breaking progress.
  - We now need to **jointly support the G20 Brazilian presidency** to bring this agenda to the finish line.
- **India has a crucial role to play** because of its economic size, but more than that, because of its unique capacity to build bridges rather than stir up divisions within the international community.
  - India's Vasudhaiva Kutumbakam, must guide our efforts to make the global financial system more efficient and more just.
  - In order to address the overlapping challenges of poverty reduction, climate change and biodiversity protection, **we need a shift from billions to trillions** in global investments.

Mains Practice Question

[Q] What role can India play in developing 'more efficient and more just' Green Financing framework? Identify the challenges & suggest a way out.