UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

Making sense of Article 2.1(c)

What role for private finance in achieving climate goals?

United Nations

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

Making sense of Article 2.1(c)

What role for private finance in achieving climate goals?

United Nations

Geneva, 2023

United Nations publication issued by the United Nations Conference on Trade and Development

UNCTAD/GDS/2023/8

eISBN: 978-92-1-358732-4

ACKNOWLEDGEMENTS

This publication was prepared by Katie Gallogly-Swan, under the overall guidance of Richard Kozul-Wright, Director of the UNCTAD Division on Globalization and Development Strategies. The report benefited greatly from review and feedback from UNCTAD staff members Pierre Kohler and Ilaria Crotti.

UNCTAD gratefully acknowledges the contributions to the draft by international consultants Jamie Rickman and Nadia Ameli, as well as the contributions, as external reviewers, of Daniela Gabor, Meenakshi Raman, Prerna Bomzan and Charlene Watson.

The document benefited from a workshop held with developing countries' climate negotiators on 29 September 2023 in partnership with the G77 and China Chair, Republic of Cuba and Third World Network, on the sidelines of the Second workshop under the Sharm el-Sheikh Dialogue on Article 2, paragraph 1 (c) of the Paris Agreement and its complementarity with Article 9, in Geneva, Switzerland. The report team are grateful for the invaluable input and guidance from developing country representatives.

Preparation of the publication benefited from background research undertaken through the UNCTAD project, "G77-UNCTAD Workshop: Development Priorities for a Climate-Resilient Financial System at COP28", which received support from the Climate Emergency Collaboration Group, a sponsored project of Rockefeller Philanthropy Advisors and the Rockefeller Brothers Fund.

The publication was designed by Jesús Alés Villota.

TABLE OF CONTENTS

EXECUTIVE SUMMARY

Aligning the whole financial system, encompassing public and private financial flows at the domestic and international level, with a "pathway towards low greenhouse gas emissions and climate resilient development," as stated in Article 2.1(c) of the Paris Agreement (PA), is fundamental to limiting global warming and supporting the development ambitions of developing countries.[1] Achieving this goal will require deep and wide-reaching changes in the way financial resources are mobilised, allocated and managed that go beyond simply 'scaling-up' climate-aligned finance and 'scaling-down' climate-inconsistent finance. To uphold the ambitions of Article 2.1(c) in the Paris Agreement (PA), governments will need work with central banks, financial supervisors, and multilateral financial institutions to change the rules and processes that underpin financial decision-making and keep financial markets locked into a high-emissions, business-as-usual pathway.

It is crucial to remember that the goal of Article 2.1(c) in the PA was both "low greenhouse gas emissions *and* climate-resilient development" [emphasis added]. However, despite the explosion of private credit in recent decades, not enough resources are flowing towards productive, development-enhancing, climate goals. At its launch at COP26 in 2021, the Glasgow Financial Alliance for Net Zero (GFANZ), the world's largest climate-related coalition of financial institutions, proudly advertised that they collectively managed $130 trillion in assets – a number that far exceeds investment needs in the coming years to achieve PA targets and the Sustainable Development Goals (SDGs) – yet many of these same GFANZ members are the biggest financiers of fossil fuels and other high-emitting sectors.[2] Inadequate accountability for the net zero claims of non-government financial actors, can fuel unrealistic expectations for mobilising private finance undermining the necessary scaling up of Article 9 climate finance (that provided from developed country to developing country Parties), and risking the integrity of Article 2.1(c) objectives.

Despite this, recent discussions around climate finance (and development finance more broadly[3]) signal an increasing expectation that private finance – delivered by banks, pension funds, asset managers, private equity, etc. – will play an important role in resourcing decarbonisation and adaptation, something that has yet no materialized in the data. According to the UNFCCC, private finance mobilization has, over the last decade, fallen far short of what was promised particularly by its proponents in developed countries, with a 60 percentage point gap in 2020 compared to their 2016 Roadmap to $100 Billion.[4][5] Moreover, there is increasing evidence to suggest that current 'derisking' models for scaling up investments in mitigation and adaptation, along with the financial instruments and mechanisms these models promote, have so far been unable to achieve their goals.[6]

---

1. UNFCCC (2015). *Paris Agreement*. Available at https://unfccc.int/sites/default/files/english_paris_agreement.pdf
2. GFANZ (2021). *Amount of finance committed to achieving 1.5°C now at scale needed to deliver the transition.* Available at https://www.gfanzero.com/press/amount-of-finance-committed-to-achieving-1-5c-now-at-scale-needed-to-deliver-the-transition/
3. For more background on development finance and the push to leverage more private finance, see: https://twn.my/title2/finance/2023/fi230702.htm
4. UNFCCC (2016). *Roadmap to $100 billion*. Available at https://unfccc.int/sites/default/files/resource/climate-finance-roadmap-to-us100-billion.pdf
5. UNFCCC (2022). *Report on progress towards achieving the goal of mobilizing jointly USD 100 billion per year to address the needs of developing countries in the context of meaningful mitigation actions and transparency on implementation*. Available at https://unfccc.int/sites/default/files/resource/J0156_UNFCCC%20100BN%202022%20Report_Book_v3.2.pdf
6. Emery T (2023). *Solar Can't Scale in the Dark*. Energy for Growth Hub. Available at https://energyforgrowth.org/article/solar-cant-scale-in-the-dark-why-lessons-about-subsidies-and-transparency-from-ifcs-scaling-solar-zambia-can-reignite-progress-toward-deploying-clean-energy/.

This poses challenging questions for the successful implementation of Article 2.1(c): if private actors play such a huge role in the global financial system, what can Parties do to ensure their alignment with Article 2.1(c) ambitions? What actions can enhance delivery of both Article 2.1(c) and total finance flows going towards climate-resilient development pathways? What impact will success in aligning private finance flows with low greenhouse gas (GHG) emissions and climate-resilient development have on Article 9 finance?

This report discusses the implementation of Article 2.1(c), and its complementarity with Article 9, with a particular focus on the private sector and the mobilisation of private capital towards low-GHG and climate-resilient development. Section 1 summarises current challenges in the climate finance landscape and the relationship between Article 2.1(c) and Article 9. Section 2 considers the misalignment of finance with PA targets, using the example of the role of the banking sector in financing the fossil fuel industry. Section 3 considers the realignment of private sector finance away from high-emissions industries and towards low-GHG and climate resilient investments through policy and regulatory measures. Section 4 explores the mobilisation of private capital towards low-emissions and climate-resilient development in developing countries, in relation to Article 9, discussing the barriers and opportunities to the just and equitable delivery of climate finance. Section 5 concludes with key policy messages.

In summary, the failure of voluntary initiatives thus far in shifting private finance flows in line with Article 2.1(c) demands stronger interventions from governments. It is crucial to apply a whole-of-Article 2 approach to the scope and operationalization of Article 2.1(c), including that Article 2.2 reflects the foundational principles of equity and common but differentiated responsibilities and respective capabilities in light of different national circumstances (CBDR-RC) under the Convention, recognizing the historical responsibility of developed countries. Considering these guiding principles and the reality that the major private financiers of GHG-intensive activities are concentrated in developed countries, there is an additional imperative for developed countries to move first and deploy domestic policy to ensure financial actors in their jurisdictions are climate-aligned while at the same time preserving needed policy space in developing countries for transition and climate-resilient development.

Policy and regulatory levers must be used to tip the balance of risk and reward away from high-emitting activities and in favour of low GHG and climate-resilient investments, including much-needed transition finance in GHG-intensive industries in developing countries. There are persistent issues with public policy approaches which focus only on market-based mechanisms. However, since prospective profits not prices are, ultimately, what drives investment decisions, these efforts are not getting the impact the world needs as long as high emitting sectors are immensely profitable. The alternative must therefore be a 'market-shaping' role for public policy, underpinned by policy coordination across fiscal, industrial, trade and financial measures, involving robust regulatory mechanisms for disciplining financiers of high-emitting assets[7], and establishing a clear trajectory for capital allocation in alignment with green transition plans which in turn encourages an orderly transition by creating certainty for private sector actors.[8]

As financial markets shift, it is incumbent upon standard-setting bodies at the national and international level to ensure that the playing field is not tilted against developing countries. This is challenging in a context where many international financial bodies suffer from a governance deficit with regards to acknowledging and accommodating the needs and priorities of developing countries, often leading

7. Kedward K et al (2022). *Aligning finance with the green transition: From a risk-based to an allocative green credit policy regime.* UCL Institute for Innovation and Public Purpose, Working Paper Series (IIPP WP 2022-11). Available at https://www.ucl.ac.uk/bartlett/publicpurpose/wp2022-11.
8. Idem.

to excessive policy conditionalities and top-down, one-size-fits-all agendas which do not respond to national circumstances, transition needs or poverty-eradication ambitions. While outside the scope of the United Nations Framework Convention on Climate Change (UNFCCC) and the PA, this signals an urgent need for governance reform in the major institutions of global economic and financial governance to achieve a CBDR-RC-aligned approach to Article 2.1(c).

Given existing inadequacies and inequities in the delivery of Article 9 of the PA, scaled up climate finance flows must be achieved by developed country Parties as part of efforts to fulfil Article 2.1(c). Rather than relying on the voluntary alignment of private finance to spontaneously resource just transitions, developing countries need a significant increase of targeted public finance support to break the 'climate investment traps' of chronically insufficient funding. This will be key to any hope of successfully mobilizing private sector capital as part of Article 2.1(c) implementation, particularly towards mitigation efforts and the energy transition.

It must be emphasised that developing country experiences must be central to Article 2.1(c) implementation to avoid undermining development goals, including, for example, acknowledging that fossil-fuel dependent economies will need additional support and flexibilities to achieve their just transitions. The principles of equity and CBDR-RC, foundational to Article 2, must therefore be integral to the design of a climate-aligned global financial system which can deliver on countries' Nationally Determined Contributions (NDCs) and wider development ambitions.

With each passing year of a business-as-usual financial system, the costs of the transition to a climate resilient economy increase, while the consequences of inaction fall most heavily on those least responsible and least able to cope. The Sharm el-Sheikh dialogue is a crucial chance to further establish the roles and responsibilities of Parties in the implementation of Article 2.1(c) and its relationship with Article 9 ahead of COP28 and the first Global Stocktake assessing the world's collective progress against PA targets. CBDR-RC should be the guiding anchor of these dialogues, ensuring a financial system and resourcing modalities that do not further constrict the policy space of developing countries, but instead help galvanise adequate and suitable financing for just and sustainable transitions.

CHAPTER 1.
ARTICLE 2.1(C) AND THE CURRENT LANDSCAPE OF CLIMATE FINANCE

Article 2.1(c) of the Paris Agreement (PA) aims at *"Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development"* in the context of sustainable development and efforts to eradicate poverty. While there is no agreed definition of the scope and implementation of Article 2.1(c), a common understanding on key aspects relating to the sources, objectives and scale of Article 2.1(c) finance flows emerged from a survey of Parties to COP27 undertaken by the Standing Committee on Finance (SCF).[9] Namely, that climate finance is expected to be delivered by both public and private actors at the domestic and international level; that a significant investment gap exists between current climate finance flows and what is needed to deliver the PA; and that consistency of finance flows refers to both its alignment and misalignment with PA targets.

With respect to making finance flows 'consistent' with low-GHG emissions and climate-resilient development, both misalignment and alignment must be addressed. This means redirecting finance flows away from GHG-intensive activities, in particular fossil fuel industries, and towards mitigation, adaptation, and climate-resilient development objectives. It is further acknowledged that national circumstances must be considered in the determination of 'consistent' financing models; sustainable development and the eradication of poverty is a key objective for developing countries, which may pose challenges to the pace and scale of mitigation pathways, and indeed the sorts of activities that will require financing in the coming years.

One Party surveyed highlighted that consistency of finance flows, as it relates to the cessation of fossil fuel investment, may differ depending on whether the recipient Party is a developed or developing country, given that per capita emissions in developing countries are relatively small and must grow to meet their social and development needs (see Section 1.2). Indeed, within the broader context of the PA, the 1.5°C target and CBDR-RC, the reality is that developed countries must accelerate mitigation, stop the expansion of fossil fuel production and rapidly phase out existing sources, in order not to continue overconsuming the remaining carbon budget needed to meet the energy access needs of the approximately 760 million people in developing countries who currently have no access to electricity,[10] requiring suitable financial support for transition and renewable buildout.

A significant investment gap exists between current finance directed towards low-GHG and climate-resilient development and what is required to implement Article 2.1(c). The Organisation for Economic Co-operation and Development (OECD) estimates that $6.9 trillion a year is required up to 2030 to meet PA targets,[11] while a yearly average of just $653 billion was accounted for in 2019/2020.[12]

---

9. UNFCCC (2022). *Report of the Standing Committee on Finance. Addendum. Synthesis of views regarding ways to implement Article 2, paragraph 1(c), of the Paris Agreement.*
10. Ritchie H et al (2019). *Access to Energy.* Our World in Data. Available at https://ourworldindata.org/energy-access
11. OECD/The World Bank/UNEP (2018). *Financing Climate Futures: Rethinking Infrastructure.* OECD Publishing, Paris, https://doi.org/10.1787/9789264308114-en.
12. Naran B et al. (2022). *Global Landscape of Climate Finance: A Decade of Data*. Climate Policy. Available at https://www.climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-a-decade-of-data/

Moreover, mitigation finance – primarily targeting renewable energy projects – dominates finance flows (however inadequate[13]) over adaptation efforts which comprised only around 8 per cent of total climate finance flows for 2019/2020. All Parties agree that climate finance must be scaled-up and rebalanced, and this is particularly true in developing countries where current flows meet only 10 per cent of requirements[14] and where investment in adaptation is an urgent priority.

Complementarity between Article 2.1(c) and Article 9: the Sharm-el-Sheikh dialogue

The PA acknowledges the greater responsibility for historical and current emissions borne by developed countries and their greater capacity to contribute to the global mitigation and adaptation effort. In their response to the survey undertaken by the SCF, Parties agree these foundational principles must be reflected in the implementation of Articles 2.1(c) and Article 9. Indeed, most developing countries' NDCs, through which PA targets are operationalised, are conditional upon the financial support pledged in Article 9. Many surveyed Parties recognised climate finance flows under Article 9 as integral to the implementation of Article 2.1(c) and that strengthening the implementation of Article 2.1(c) should not be at odds with, or a substitution for, existing commitments under Article 9. Article 9 finance should thus be considered as part of the implementation of Article 2.1(c), specifically with regards to the finance provided or mobilised by developed country Parties to developing country Parties. At the same time, Article 2.1(c) must reflect equity and the CBDR-RC principle, as clearly stated in Article 2.2 of the PA, by being sensitive to the different national circumstances and needs of developing countries.

However, epistemic ambiguity surrounds the scope, delivery, and governance of Article 9 finance flows. No consensus exists on their scope with regards to, for example, the climate centrality versus climate co-benefits of related activities, or the composition of delivery (for example through grants or loans). Moreover, the governance of climate finance delivery to developing countries is fragmented, using a multitude of international financial mechanisms as well as UNFCCC entities, multilateral and bilateral funds, and other public and private sources. Such ambiguities and lack of coordination mean that climate finance flows are difficult to track:[15] in the period 2019-2020, estimates of Article 9 climate finance flows range from $21 billion[16] to $83.3 billion,[17] pointing to challenges of double-counting and opacity which ultimately undermine trust. Although common standards and reporting methodologies are being developed, such disparities must be resolved to expedite efficient delivery of Article 9 finance.

Another important feature of existing climate finance flows is the current distributional inequity in the allocation of climate finance across developing countries. Climate finance from developed to developing countries flows disproportionately to large and emerging middle-income countries (MICs). The OECD estimates that the largest share of finance (public finance and mobilised private finance)

---

13. "The overwhelming majority of tracked climate finance is directed towards mitigation, but nevertheless falls short of the levels needed to limit warming to below 2°C or to 1.5°C across all sectors and regions (see C7.2)". (IPCC AR6 SYR SPM, A.4.5)
14. UNFCCC (2022). Fifth Biennial Assessment and Overview of Climate Finance Flows. Bonn: UNFCCC Standing Committee on Finance.
15. UNFCCC (2022). *Summary and recommendations by the Standing Committee on Finance. Fifth Biennial Assessment and Overview of Climate Finance Flows.* Available at https://unfccc.int/sites/default/files/resource/J0156_UNFCCC%20BA5%202022%20Summary_Web_AW.pdf
16. Carty T and Kowalzig J (2022). *Climate Finance Short-changed: The real value of the $100 billion commitment in 2019–2020.* Briefing Note. Oxford: Oxfam. Available at https://policy-practice.oxfam.org/resources/climate-finance-short-changed-the-real-value-of-the-100-billion-commitment-in-2-621426/
17. OECD (2022). *Climate Finance Provided and Mobilised by Developed Countries in 2016-2020: Insights from Disaggregated Analysis.* Climate Finance and the USD 100 Billion Goal, OECD Publishing, Paris. Available at https://doi.org/10.1787/286dae5d-en.

is channelled to the Asian region, totalling 43 per cent with South Asia receiving the largest allocation of 18 per cent, while the African region receives a 25 per cent share with East, North and West Africa capturing the largest allocations (approximately 5 per cent each). With respect to income levels, lower middle-income countries (LMICs) receive 40 per cent of finance, followed by upper middle-income countries (UMICs) at 29 per cent, while low-income countries (LICs) receive the least at 8 per cent.[18]

The ultimate challenge to building mutual trust in climate finance discussions is the reality that existing promises of support do not cover the costs of implementing conditional elements of NDCs, while stalled delivery of mitigation in developed countries imply escalating impacts and further costs. The OECD estimates that $68.3 billion of climate finance was provided by bilateral and multilateral public sources to developing countries in 2021 and $13.1 billion was mobilised from private sources.[19] The annual pledge of $100 billion of climate finance from developed countries in the Copenhagen Accord of 2009 has thus never been delivered and is acknowledged to be vastly insufficient to meet developing countries' needs. In their assessment of the needs of developing countries as reported in their various climate plans, the SCF concluded that developing countries will need close to $6 trillion up to 2030, with $502 billion annually coming from international sources,[20] revealing an annual investment gap of around $400 billion – likely a vast underestimation considering that estimations did not include the circa 60 per cent of Nationally Determined Contributions (NDCs) that were not costed.[21] An increased post-2025 commitment, the New Collective Quantified Goal, is set to be agreed by Parties in 2024, which must improve on these shortcomings to improve accountability and better reflect need.[22]

Private Finance, Article 2.1(c), and Article 9 commitments

Considering the scale of investment needs, private sector resources are increasingly presented as a viable solution to closing the financing gap, given the perceived squeezing of the fiscal space in countries at all levels of development and considering the large volume of available capital in financial markets that is not currently climate-aligned.[23]

Although a range of views exists regarding the relative role of public and private actors and how these roles may differ in developed and developing countries, one view has come to dominate discussions since 2015, which advances a common financing strategy for countries at all levels of development. In essence, the call is to deploy an array of market-based 'derisking' instruments to leverage a relatively small amount of public resources to unlock trillions of dollars in private capital for the big investments needed to achieve an inclusive and sustainable future for people and the planet. The approach was clearly laid out in the G20 Eminent Persons Report on Global Financial Governance.[24] This called for the creation of deeper and more attractive domestic capital markets to attract investors (pension funds, asset managers, private equity, insurance companies, as well as banks) into new asset classes aligned with the required investments for sustainable development such as infrastructure assets.

---

18. OECD. 2022. Aggregate Trends of Climate Finance Provided and Mobilised by Developed Countries in 2013-2020. Paris: OECD Publishing.
19. Idem.
20. UNFCCC. 2022a. Fifth Biennial Assessment and Overview of Climate Finance Flows. Bonn: UNFCCC Standing Committee on Finance.
21. Songwe et al (2022), estimate that emerging markets and developing countries other than China will need to spend around $1 trillion per year by 2025 (4.1 per cent of GDP compared with 2.2 per cent in 2019) and around $2.4 trillion per year by 2030 (6.5 per cent of GDP), to deliver on shared development and climate goals.
22. See UNCTAD (2023). *Principles for a New Collective Quantified Goal: Bringing accountability, trust and developing country needs to climate finance.*
23. Carney M (2021). *Clean and Green Finance*. Finance and Development, September. IMF
24. EPG-GFG (2018). *Making the Global Financial System Work for All: Report of the G20 Eminent Persons Group on Global Financial Governance*. October. Available at https://www.globalfinancialgovernance.org

According to the report, through "securitization" these assets could then become tradeable financial products whose risk-return profile would be boosted with public support (through liquidity backstops, loan guarantees, credit support, etc.) channelled through the appropriate local, regional, and global platforms and back-stopped by a stronger global financial safety net. Because investment risks (both actual and perceived) are presumed to be higher in developing countries, the strategy poses de-risking projects as an urgent task of the international community.

To this end, blended finance has been one of the primary tools used to leverage private finance into developing countries: in theory, projects perceived as 'risky' would become 'bankable' by combining concessional finance from public sources with private finance provided at commercial rates. However, the 'billions to trillions' scenario anticipated by the World Bank and other development finance actors through such leveraging and 'derisking' has not materialised.[25] The OECD estimates that development finance institutions (DFIs) have mobilised only $81 billion towards the SDGs through blended finance since 2000[26] and the mobilisation of private climate finance has underperformed against developed countries' expectations by up to 60 per cent.[27, 28]

As well as its limitations in actually delivering the levels of anticipated finance, some of the blended finance models have also been critiqued for entailing an unbalanced distribution of revenues and risks, when the former mostly accruing to private investors and the latter borne by international financial institutions (IFIs) and developing country governments. This creates a problem of moral hazard which can lead to governments being stranded with the financial obligations of failed projects.[29]

A key challenge that must be overcome to achieve the aims of Article 2.1(c) and improve total finance flows, therefore, is to distinguish the most effective ways for Parties to steer the significant pool of resources in the global financial system towards climate goals, whether through novel policy, regulation, international mechanisms, or positive and negative incentives.

It is important to note that while private finance could play a bigger role in mitigation efforts, there are severe limitations to successful deployment for adaptation, or indeed, loss and damage. The risk and return characteristics of mitigation investments are often better suited to the needs of private investors than adaptation investments, which can lack clear revenue streams, face long payback times and large upfront costs. Indeed, adaptation is primarily focused on avoiding future losses, rather than on turning a profit, signalling a much greater role for public investment.

The OECD estimates that only 4 per cent of mobilised finance was directed towards adaptation efforts between 2018 and 2020.[30] On the other hand, it is estimated that up to 70 per cent of global mitigation financing required during the 2020's across the world could be provided by private capital.[31] However, even with respect to investments in mitigation projects, there are significant obstacles and constraints at the portfolio level to channelling new sources of private finance (and repurposing the existing stock of assets) to meet climate ambitions that derive from the short-term profit calculus and

25. Gabor D (2021). *The wall street consensus*. Development and change 52(3): 429-459.
26. OECD (2022). *Aggregate Trends of Climate Finance Provided and Mobilised by Developed Countries in 2013-2020*. Paris: OECD Publishing.
27. Attridge S and Engen L (2019). *Blended finance in the poorest countries: the need for a better approach*. London: ODI. Available at https://odi.org/en/publications/blended-finance-in-the-poorest-countries-the-need-for-a-better-approach/
28. UNFCCC (2022). *Fifth Biennial Assessment and Overview of Climate Finance Flows*. Bonn: UNFCCC Standing Committee on Finance.
29. Griffiths J and Romero M J (2018). *Three compelling reasons why the G20's plan for an infrastructure asset class is fundamentally flawed*. European Network on Debt and Development (Eurodad).
30. OECD (2023). *Private Finance Mobilised by Official Development Interventions*. Paris: OECD Publishing.
31. UNFCCC Race to Zero (2021). *Net-Zero Financing Roadmaps*. Available at https://assets.bbhub.io/company/sites/63/2021/10/NZFRs-Key-Messages.pdf.

fiduciary responsibilities of the institutions holding these assets and their need to retain their credit worthiness.[32, 33]

For this reason, this paper focuses primarily on the role of aligning private sector finance for mitigation ends, with a particular focus on energy finance since this forms a large proportion of the mitigation needs expressed by developing countries.[34, 35]

32. Guardian (2021). Green investing 'is definitely not going to work', says ex-BlackRock executive. 3 March. Available at https://www.theguardian.com/business/2021/ mar/30/tariq-fancy-environmentally-friendly-greeninvesting.
33. Christophers B (2023). *Our Lives in Their Portfolios: Why Asset Managers Own the World*. London: Verso.
34. UNFCCC (2021). *First report on the determination of the needs of developing country Parties related to implementing the Convention and the Paris Agreement*. Bonn: UNFCCC Standing Committee on Finance.
35. UNFCCC (2022). *Report of the Standing Committee on Finance. Addendum. Synthesis of views regarding ways to implement Article 2, paragraph 1(c), of the Paris Agreement*. Bonn: UNFCCC Standing Committee on Finance.

CHAPTER 2.
DECARBONISING THE FINANCIAL SECTOR

The bank lending network and fossil fuel finance

Establishing a climate-aligned financial system in line with Article 2.1(c) requires both a fundamental shift in the structure and calculus of private investors towards green assets and an urgent phase-out of finance in high-emitting industries and particularly in energy, considering it takes up a large proportion of all countries' mitigation needs. Indeed, according to the Intergovernmental Panel on Climate Change (IPCC), public and private finance flows for fossil fuels continue to exceed those for climate adaptation and mitigation.[36]

However, as highlighted by many developing countries, this should not imply a universal pace of transition. A distinction must be made between expanded production from fossil fuel majors in developed regions which already enjoy high levels of energy access and greater degrees of economic diversification, and national fossil fuel companies in developing countries which often play an important role in financing development. While phase-out is necessary everywhere, applying the same standards across regions undermines the CBDR-RC principle, when instead developing countries need support to diversify, secure alternative revenue generation, and build resilient local renewable systems as part of a just transition.[37]

The International Energy Agency (IEA) has argued that investment in new fossil fuel assets is incompatible with agreed temperature targets since projected emissions from fossil fuel assets already in production take the world past 2°C of warming,[38, 39] indicating that the physical and transition risks of climate change are not being adequately priced in financial markets.[40] Short-termism, information failures, and investment lock-ins contradict neoclassical ideas of market efficiency, leading to what has been described as 'the greatest and widest-ranging market failure ever seen'.[41] Fossil fuel sector profits reached record levels in 2022 in the wake of the war in Ukraine, a matter of months after the formation of GFANZ: average global profits from fossil fuels over 1970-2020 was $1 trillion a year,[42] while net global income from fossil fuel production in 2022 was $4 trillion.[43]

Fossil fuel companies raise the majority of their capital as debt provided by banks[44] albeit continuing also to reinvest their own profits in the sector.[45] Divestment campaigns which target equity investors such as pension funds and university endowments have thus had little tangible impact on capital

36. IPCC (2023). *Climate Change 2023: Synthesis Report*. Available at https://www.ipcc.ch/assessment-report/ar6/
37. Idem.
38. Muttitt G (2016). *The sky's limit: Why the Paris climate goals require a managed decline of fossil fuel production*. Oil Change International.
39. Welsby D et al. (2021). *Unextractable fossil fuels in a 1.5° C world*. Nature 597(7875): 230-234.
40. Eren E (2022). *Pricing of climate risks in financial markets: a summary of the literature*. BIS Papers,.
41. Stern N (2006). *Stern Review: The economics of climate change*. Cambridge: Cambridge University Press.
42. Carrington D (2022). Revealed: oil sector's 'staggering' $3bn-a-day profits for last 50 years. *Guardian*.
43. IEA (2022). *World Energy Investment 2022*. Paris: International Energy Authority.
44. Rainforest Action Network, Indigenous Environmental Network, Reclaim Finance and Sierra Club (2023). *Banking on Climate Chaos 2023*.
45. UNCTAD (2023). *A World of Debt: A Growing Burden to Global Prosperity*. Geneva and New York,: United Nations Publication.

flows to fossil fuel companies. Indeed, fossil fuel lending by banks has shown no systematic decline over the last decade. Most recently, there has in fact been an increase: estimates vary but banks provided between $600 and $900 billion of bonds and loans for oil, gas, and coal companies in 2021, considerably more than the yearly average between 2010 and 2016 (the year the PA was signed).[46, 47] A step-change in the activities of the banking sector is urgently needed to phase out support for expanding production while ensuring adequate transition financing across regions, but in particular for developing countries.

However, strong inter-bank lending networks make fossil fuel debt markets highly resilient. The majority of fossil fuel debt is provided by banks in the form of syndicated bonds and loans, whereby multiple banks pool resources in a single deal. Syndication creates networks of lending relationships which facilitates the substitution of capital between banks with different stances on the climate transition and across a global banking system exposed unevenly to climate policy.[48] In other words, capital phased out by one bank may simply be replaced by another subject to less scrutiny and regulation.

On the other hand, the fossil fuel debt market is dominated by a relatively small cohort of banks in a few developed countries, acting as both financiers and arrangers of syndicated deals. The top 30 banks in the sector provided 78 per cent of total lending between 2010 and 2021.[49] Of these lenders, only a few European banks have made significant progress in decarbonising their lending portfolios (such as Deutsche Bank and DNB ASA), likely reflecting higher perceived transition risks due to stronger climate commitments and policy signals in the region.[50] However, major banks in other countries such as Canada (Scotiabank and BMO Capital Markets) and Japan (Sumitomo, Mitsubishi UFJ and Mizuho) are still increasing their lending. With regards to the 'big-four' US banks, who dominate the fossil fuel debt market (JP Morgan, Citi, Wells Fargo, and Bank of America), only $8 billion of the $160 billion of their average annual lending has been phased out in the years following the PA. Moreover, the biggest banks in the sector play a dual role as both financiers and 'arrangers' of syndicated deals. In their highly connected positions in the interbank lending network, these banks draw in capital from across the globe in their role as arrangers, for which they earn syndication fees. The activity of these influential banks will thus be decisive in setting the pace of the fossil finance phase-out and transition support, and highlights the additional responsibility developed country Parties have in regulating their financial sectors in line with Article 2.1(c).[51]

The limits of voluntary initiatives

It is increasingly clear that voluntary initiatives are not making progress in shifting private finance away from high-emitting sectors and towards "a pathway towards low GHG emissions and climate resilient development." The United Nations-convened Net Zero Banking Alliance (NZBA) was launched in 2021 and its signatories, including the biggest fossil fuel funders mentioned above, pledged to decarbonise their lending portfolios in line with Article 2.1(c). However, signatories to the NZBA have been accused of inadequate timelines and policy action mismatched with rhetoric, considering that in the period

46. Rickman J et al. (2023). *The Systemic Challenge of Phasing Out Fossil Fuel Finance*. DOI: https://doi.org/10.21203/rs.3.rs-3121305/v1.
47. UNCTAD (2023). *A World of Debt: A Growing Burden to Global Prosperity*. Geneva and New York,: United Nations Publication.
48. Beyene W et al. (2021). *Too-big-to-strand? Bond versus bank financing in the transition to a low-carbon economy*.
49. Rickman J et al. (2023). *The Systemic Challenge of Phasing Out Fossil Fuel Finance.* DOI: https://doi.org/10.21203/rs.3.rs-3121305/v1.
50. Reghezza A et al. (2022). *Do banks fuel climate change?*. Journal of Financial Stability 62: 101049.
51. Rickman J et al. (2023). The Systemic Challenge of Phasing Out Fossil Fuel Finance. DOI: https://doi.org/10.21203/rs.3.rs-3121305/v1.

2019-21, GFANZ banks lent billions of dollars to companies developing new coal.[52] More recently, influential NZBA members refused to support the United Nations Race to Zero initiative, which targets net-zero by 2050, and members are now 'encouraged and not required' to follow the Race to Zero rules.

The scale of credit support provided by members of the NZBA demonstrates the potential impact that implementation of Article 2.1(c) could have. Between their date of joining and August 2022, the 56 biggest banks in the NZBA provided at least $269 billion to major fossil fuel expanders and in addition they are the most prolific arrangers of syndicated deals.[53] A collective move by NZBA members to phase-out their capital from the sector would thus have a highly significant impact on the syndicated debt market, which would struggle to substitute the finance and arranging facilities provided by these key actors.

While shareholder pressure and increased public scrutiny may increase reputational risks for banks lagging on their climate transition, such efforts seem unlikely to bring about material shifts in banks' lending activities while super profits are still to be made in coal, oil, and gas. Mandatory transition plans, discussed in the European Union and United Kingdom, could place banks under legally binding requirements to publish clear, prudent, and detailed strategies to restructure their activities in line with Paris targets. Towards this effort, the Network for Greening the Financial System (NGFS) has developed methodologies for climate stress-testing and scenario analysis. Importantly, transition plans should be required to disclose the dual role of banks as financiers and arrangers of syndicated deals and to target the phase-out of both corresponding revenue streams. Analysis shows that while the 'big-four' US banks have made some progress in decreasing their individual lending and reducing their overall exposure to the sector, they may be compensating reduced direct investment through increased syndication fees i.e., arranging more deals while investing less.[54]

A more interventionist approach is needed

While mandatory transition plans are a crucial first step, there are persistent issues with focusing only on market-led mechanisms to nudge investors out of high-emissions and into green investments. Prospective profits not prices are, ultimately, what drives investment decisions. From a purely economic perspective, private finance is agnostic to climate goals, except insofar as they impact on the risk and return characteristics of their investment portfolio. For energy companies looking to expand production capacity, whether by reinvesting their own earnings and/or borrowing on capital markets, prospective profits across different energy sources is a more telling indicator of whether and how quickly they might move from fossil fuels to renewables.[55]

The alternative must therefore be a 'market-shaping' role for public policy, underpinned by policy coordination across fiscal, industrial, trade and financial measures, and involving robust regulatory mechanisms for disciplining financiers of dirty assets.[56]

---

52. Rainforest Action Network, Indigenous Environmental Network, Reclaim Finance and Sierra Club (2023). *Banking on Climate Chaos 2023*.
53. McCully P (2023). *Throwing Fuel on the Fire: GFANZ financing of fossil fuel expansion*.
54. Rickman J et al. (2023). *The Systemic Challenge of Phasing Out Fossil Fuel Finance*. DOI: https://doi.org/10.21203/rs.3.rs-3121305/v1.
55. Christophers B (2022). *Fossilised Capital: Price and Profit in the Energy Transition*. New Political Economy, 27:1, 146-159, DOI: 10.1080/13563467.2021.1926957
56. Kedward K et al (2022). *Aligning finance with the green transition: From a risk-based to an allocative green credit policy regime*. UCL Institute for Innovation and Public Purpose, Working Paper Series (IIPP WP 2022-11). Available at https://www.ucl.ac.uk/bartlett/publicpurpose/wp2022-11.

While a carbon-tax consistent with Paris temperature targets could play a role in incorporating climate-risk into financial decision-making, only 39 national jurisdictions have implemented carbon-pricing initiatives, and less than 4 per cent of global emissions are currently covered by a direct carbon price in the range needed to meet the 1.5°C goal.[57] Incomplete information and short-termism, as well as other market failures may undermine the efficacy of carbon pricing.[58]

Indeed, the methodologies of many models that attempt to price climate risks judge optimal outcomes at temperature increases that would render much of the planet uninhabitable.[59] At the same time, a focus on pricing mechanisms and carbon markets implies that decarbonization activities can be delayed as long as carbon-emitting firms invest in 'solutions' such as carbon credits, distracting from the need for more proactive policy levers to tip the balance of risk and return against high-emissions investments and towards just transitions. In reality, consumers have little choice when it comes to energy sources, hence the decarbonisation challenge cannot be solved only at the consumer level but must also focus on production.

More interventionist economic approaches are being considered by prudential institutions and central banks tasked with maintaining financial stability. Such institutions can foresee long-run consequences to climate-related shifts in financial markets that are beyond typical investment horizons.[60] One such approach is the exploration of capital requirements as a tool to address climate-related financial risks and reduce emissions. The Bank of England, for example, is exploring the use of capital requirements rules to limit the amount of fossil fuel assets a bank can have on its balance sheet due to climate-related financial risks, and similar regulation is due to be re-tabled in the European Parliament, after it was initially voted down. While more research is needed to understand the direct and indirect consequences such instruments may have on the wider financial system, including on spillover impacts on developing countries and their just transitions, preliminary research indicates capital requirements rules could play a role in stemming fossil fuel finance.[61] With capital requirements rules in place, the amount of capital available for substitution across the interbank lending network is limited, increasing the likelihood that fossil fuel deals fail as banks phase-out their capital. And if sufficiently stringent, capital requirements rules could lead to cascades of deal failures, accelerating a decline in fossil fuel finance that isn't aligned with just transition.

However, capital regulation has its limitations, paramount among them that the overall impact on mitigation outcomes remains unclear: it may effectively address climate-related financial risks but doing so does not necessarily reduce emissions.[62] With ample bank capital, capital regulation is largely powerless to deter the funding of financially profitable dirty activities and may in fact crowd out lending to clean firms. Steering credit price signals through lower capital requirements for green loans is similarly vulnerable to other credit pricing factors, including the central banks' response to inflationary pressures via higher interest rates.[63]

---

57. World Bank (2022). *State and Trends of Carbon Pricing*. Washington, DC: World Bank.
58. Krogstrup S and Oman W (2019). *Macroeconomic and Financial Policies for Climate Change Mitigation: A Review of the Literature*. IMF Working Papers.
59. Grubb M et al. (2021). *Modeling myths: On DICE and dynamic realism in integrated assessment models of climate change mitigation. WIREs Clim Change.* 2021; 12:e698. https://doi.org/10.1002/wcc.698
60. Carney M (2015). *Breaking the Tragedy of the Horizon – climate change and financial stability.* Bank of England.
61. Rickman J et al. (2023). The Systemic Challenge of Phasing Out Fossil Fuel Finance. DOI: https://doi.org/10.21203/rs.3.rs-3121305/v1.
62. Oehmke M and Opp M (2022). *Green Capital Requirements*. Swedish House of Finance Research Paper No. 22-16, Available at SSRN: https://ssrn.com/abstract=4040098
63. Kedward K et al (2022). *Aligning finance with the green transition: From a risk-based to an allocative green credit policy regime.* UCL Institute for Innovation and Public Purpose, Working Paper Series (IIPP WP 2022-11). Available at https://www.ucl.ac.uk/bartlett/publicpurpose/wp2022-11.

A promising and proactive intervention may be found in recent work exploring the decarbonisation of monetary policy. Establishing new macro-financial frameworks to decarbonise corporate bond portfolios establishes central banks as state institutions with a strong capacity to directly discipline GHG capital (via tilting) than indirectly via capital requirements.[64] With a more assertive, climate-sensitive approach to credit allocation, central banks could deploy both disciplines for high-emitting activities and incentives for green, just transition activities, targeting the banking system and market-based finance with both price- and quantity-based tools to ensure financial system alignment with PA objectives.[65] Countries hosting the biggest fossil fuel lenders, in North America, Japan and the European Union, bear the greatest responsibility to explore such regulations through their respective central banks, but such approaches in developing country central banks can also be beneficial in driving coordinated, orderly green development strategies, and all countries can participate in bringing pressure to bear through bodies such as the Financial Stability Board and the Basel Committee on Banking Supervision.

An abrupt decline in fossil fuel finance, however, has the potential to cause social and economic disruption in certain regions, particularly in producer countries that rely on fossil fuel revenues for their development and economic growth.[66] MICs in particular, responsible for 48 per cent of the world's oil production and 52 per cent of its gas production,[67] face a difficult and costly energy transition. Delivering a just transition in such countries will depend on the availability of fiscal and policy space to pursue economic diversification and capacity building, which must be provided through Article 2.1(c) and Article 9 finance flows. This will require any regulatory frameworks implemented in developed countries to be assessed for impact on transition pathways in developing countries to avoid the unintended consequence of choking off climate-resilient development.

64. Dafermos Y et al. (2022). *The ECB Paris gap: Substantive but treatable.* Greenpeace; SOAS University of London; University of Greenwich; University of the West of England.
65. Kedward K et al (2022). *Aligning finance with the green transition: From a risk-based to an allocative green credit policy regime.* UCL Institute for Innovation and Public Purpose, Working Paper Series (IIPP WP 2022-11). Available at https://www.ucl.ac.uk/bartlett/publicpurpose/wp2022-11.
66. Semieniuk, G., E. Campiglio, J. F. Mercure, U. Volz and N. R. Edwards. 2021. *"Low-carbon transition risks for finance"*. Wiley Interdisciplinary Reviews: Climate Change 12(1): e678.
67. Coffin M and Grant A (2021). *Beyond Petrostates: The Burning Need to Cut Oil Dependence in the Energy Transition.* London: Carbon Tracker Initiative.

CHAPTER 3.
EXISTING APPROACHES TO ALIGNING PRIVATE FINANCE

Risk-disclosure initiatives and green taxonomies have been the primary route to redirect high-emissions finance flows towards climate goals, on the assumption that once the climate-related risks of high-emissions assets and the opportunities presented by low-GHG and climate-resilient investments are made transparent to financial market participants, they will redirect their capital accordingly.[68]

Climate-related disclosure has gone from niche to mainstream in the last two decades under the umbrella of environmental, social, and governance (ESG) reporting, with the 'E' pillar increasingly used to select assets that are supposedly climate-aligned. The United Nations' Principles for Responsible Investing report, published in 2006, was the first prominent ESG framework and since then public and private sustainable investment taxonomies have proliferated. At present over 600 ESG frameworks and standards exist globally.[69] More recently, as the economic consequences of a climate-inconsistent financial system have become clear, climate-related risk disclosure is an increasing priority for policymakers and regulators. For example, the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) developed a framework for reporting climate-related risks in 2017.[70]

The green bond market has also grown rapidly with demand, as investors seek to diversify their portfolios against climate risks and increase their environmental credentials. Seeking to capitalise on private sector demand for ESG and SDG-aligned investments, governments and multilateral institutions are issuing green-labelled bonds which claim to provide environmental benefits. Since 2016 the green bond market has grown from $100 billion to over $600 billion in 2020, and future growth is predicted despite a stagnant bond market generally. Some jurisdictions have developed and adopted taxonomies for bond-labelling, such as the European Union Green Bond Standard, but standards are applied voluntarily, and issuers can designate their bonds as green without legal restrictions.

While markets for green bonds and ESG investments are growing, the question of additionality is unresolved. Some studies show that the risk and return profile of ESG investments is roughly congruent with their conventional counterparts.[71][72] In other words, the majority of ESG investments would have been implemented with or without the ESG label. While there is evidence of a slight cost advantage of green bonds over conventional bonds, it is unclear whether this reflects investors' willingness to pay a 'greenium' for such instruments, or a potentially temporary imbalance of supply and demand. However, stronger evidence for a greenium on government-issued and investment grade bonds that follow strict reporting standards implies that credibility matters.

---

68. For a discussion of the various risks facing project financing in the renewable energy sector, see UNCTAD (2023). *World Investment Report: Investing in Sustainable Energy for All*, Chapter IV.
69. Drolet S et al. (2021). *The future of sustainability reporting standards*, London: Ernst & Young Global Limited and Oxford Analytica.
70. European Investment Bank (2017). *Recommendations of the Task Force on Climate-related Financial Disclosures*. E. I. Bank.
71. Jain M et al. (2019). *Can sustainable investment yield better financial returns: A comparative study of ESG indices and MSCI indices*. Risks 7(1): 15.
72. Pietsch A and Salakhova D (2022). *Pricing of green bonds: drivers and dynamics of the greenium*.

The limited success of market-based initiatives

While strengthening the coherence of disclosure frameworks against greenwashing can help ground further action, there is little evidence that such initiatives can on their own produce a shift in capital from high-emissions to low-emissions assets at the scale needed.[73]

Firstly, climate-related risk is unlikely to pose a sufficient disincentive for the divestment of high-emissions assets as long as they are profit-returning and strong regulatory frameworks in the energy sector are lacking. On the one hand, the time horizon of climate-related risks is far longer than a traditional investment horizon (1-5 years). On the other hand, scepticism exists amongst investors as to the materiality of transition risk, given (i) the lack of stable and ambitious climate policy, (ii) questionable assumptions about the potential for negative emissions technologies to enable continued emissions and (iii) the prospect of compensation from governments to ensure a smooth transition and avoid political backlash. Because of this, high-emitting firms are perceived as only slightly riskier than green firms.[74]

Secondly, capital divested from fossil fuel markets will not intrinsically redirect to low-emissions markets. Taking the case of energy, for example, there is no 'energy investment system' which allows capital to be easily redirected from a fossil fuel to a renewable energy asset. To the extent that prospective profits in renewable energy sources are below those in fossil fuels, energy companies will, without more direct government intervention, continue to invest in the latter. Moreover, renewable energy markets are far less liquid than fossil fuel markets and therefore do not attract large institutional investors and asset managers who still consider renewable energy to be a developing asset class. Indeed, investors divesting capital from fossil fuel assets may instead reallocate to other sectors (such as IT or pharmaceuticals) with more similar characteristics.

To tip the risk and return balance in favour of low-emissions assets, it will therefore be necessary for governments also to strengthen interventions directly in the energy sector, using a variety of policy and regulatory levers, including public procurement, pricing mechanisms, subsidies and guarantees that can speak to the expertise and risk appetites of different kinds of investors.[75]

As discussed in the previous section, central banks should expand the use of monetary policy tools at their disposal to develop low-emissions markets and discipline private investment towards climate goals.[76] Green quantitative easing, for example, is the buying up of securities issued by 'green' corporations by central banks in order to increase capital stock in the green sector and bring down long-term interest rates for green firms. The collateral frameworks of central banks can also be 'greened' by including climate-risk exposure in the credit assessment of firms. Learning from the shortcomings of market-led mechanisms, the most effective policies will favour a move from a risk-based to a proactive approach, establishing a clear trajectory for capital allocation in alignment with green transition plans and shaping an orderly transition by creating certainty for private sector actors.[77] Optimal outcomes will depend on coordination with fiscal and industrial policy, aligning financial

73. Ameli N et al. (2021). *Misplaced expectations from climate disclosure initiatives.* Nature Climate Change 11(11): 917-924.
74. Scatigna M et al (2021). *Achievements and challenges in ESG markets.* BIS Quarterly Review, December.
75. Ragosa G and Warren P (2019). *Unpacking the determinants of cross-border private investment in renewable energy in developing countries*. Journal of Cleaner Production 235: 854-865.
76. UNCTAD (2019). *Trade and Development Report: Financing a Global Green New Deal.*
77. Kedward K et al (2022). *Aligning finance with the green transition: From a risk-based to an allocative green credit policy regime.* UCL Institute for Innovation and Public Purpose, Working Paper Series (IIPP WP 2022-11). Available at https://www.ucl.ac.uk/bartlett/publicpurpose/wp2022-11.

regulation, credit, and monetary policies with climate-resilient development plans to ensure that private capital allocation can work with rather than against the public policy effort.[78]

The efficacy of such monetary measures is being debated, with central banks generally showing reluctance to move beyond their primary mandate of interest rate control or to 'distort' market-led allocation, however the potential impact of efforts is vast.[79] Indeed, if developed countries forced their financial institutions with a global reach to substantively shift credit flows via penalties on dirty assets and incentives on climate-supporting activities, it could create a green portfolio glut that could chase green assets in developing countries, and over the longer term, reduce the carbon footprint of financiers in developed countries.

The Question of Global Frameworks

TFCD reporting is now mandatory in the United Kingdom and New Zealand for large firms, banks and insurers and similar legislation is being discussed in other jurisdictions including the United States of America, Canada, Brazil, Singapore, and the European Union. However, the wide variety of methodologies and frameworks and lack of oversight makes it hard to extract meaningful information from risk disclosures, ESG ratings and green taxonomies, and cases of greenwashing abound. The European Commission has recently published a proposal for a Green Claims Directive to address greenwashing concerns, which will require companies to comply with strict guidelines when communicating environmental claims. More generally, taxonomies are criticised for not providing relevant sustainability performance targets and indicators to meet them. As more taxonomies proliferate and jurisdictions issue their own standards and rules, the more difficult it is to find convergence between them and to adequately scrutinise their impact. Governments are recognising that coordination can help international comparability and cooperation, prompting the development of the Common Ground Taxonomy by the European Union and the People's Bank of China.

However, in seeking to overcome the chaos of proliferating standards with common taxonomies, it is vital that the transition needs of developing countries are not disadvantaged. While strengthening trust in ESG and green bond markets implies governments and international standard-setting bodies reaching a common set of definitions and reporting, international standard-setting carries the risk of imposing unsuitable frameworks on developing countries, introducing several negative risks for development outcomes.

Firstly, poor and vulnerable countries at higher risk of climate change impacts fare worst on climate-related risk disclosures and could thereby be excluded from ESG markets.[80] This in turn can impact on sovereign credit ratings and increase the cost of capital, making it even harder for developing countries to access needed finance. Secondly, international standard-setting can tilt the playing field against certain regions: the European Union's taxonomy, for example, excludes coal from accessing green finance while the Association of Southeast Asian Nations (ASEAN) taxonomy considers coal plants eligible so long as they adhere to a strict timeline for retirement. Holding all investments to the standard of the European Union's taxonomy could therefore draw capital away from fossil-fuel

78. Kedward K and Ryan-Collins J (2022). *A Green New Deal: Opportunities and Constraints*. In: P. Arestis and M. Sawyer, eds. Economic Policies for Sustainability and Resilience. [Online]. International Papers in Political Economy. Palgrave Macmillan, Cham. Available at: https://doi.org/10.1007/978-3-030-84288-8_7.

79. UNCTAD (2019). *Trade and Development Report: Financing a Global Green New Deal*.

80. Volz U and Ahmed S (2020). *Macrofinancial Risks in Climate Vulnerable Developing Countries and the Role of the IMF: Towards a joint V20-IMF Action Agenda*. Available at https://www.v-20.org/resources/macrofinancial-risks-in-climate-vulnerable-developing-countries-and-the-role-of-the-imf-towards-a-joint-v20-imf-action-agenda

dependent regions exactly when they require finance for their transition plans.[81] Thirdly, there is a persistent challenge with establishing international standards that are transparent and equitable – and therefore aligned with CBDR-RC – particularly when the governance of standard-setting institutions tends to be dominated by developed countries.

Considering the risks with universal frameworks, more understanding of developing country contexts and circumstances must be taken into account, where one-size-fits-all approach could impose burdensome conditionalities and constraints on transition. This includes acknowledging the need to expand policy space for developing country national governments according to their national circumstances to adapt and adjust consistent with their priorities and transition pathways.

81. Feyertag J et al. (2023). *Developing a collective framework for operationalising Article 2.1(c): lessons from six case studies*. San Francisco and London,: ClimateWorks Foundation and ODI.

CHAPTER 4.
ADDRESSING THE CLIMATE INVESTMENT GAP

The resources currently provided and mobilised by developed country Parties for the implementation of Article 9 cover only a fraction of the actual investment needed in developing countries.[82] The previous sections, however, have demonstrated that mobilising private finance for developing countries has not resulted from current attempts to align private finance with Article 2.1(c), whether depending on 'derisking' strategies or through disclosure frameworks and taxonomies that attempt to nudge the market towards green development. Therefore, bridging this investment gap will also require scaling up bilateral public contributions across mitigation, adaptation and loss and damage.

Any role for private finance is likely to be concentrated in supporting and continuing the big push in mitigation ambition. Planning the energy transition, in particular, requires a clear path from NDCs to investment policy measures that address the specific challenges of promoting investment in the energy sector. Constructing energy transition investment plans to achieve this, working with a broad set of stakeholders in the planning and implementation phases, is critically important. In developing countries in general, and in small and vulnerable economies such as SIDS and LDCs in particular, transition plans serve as road maps that allow countries to move towards agreed climate targets and energy inclusion goals.

In this respect, it is important that policy makers recognise the multiple challenges they can face in mobilising international sources of finance to undertake the energy transition (Table 4.1).

Table 4.1: *Investing in sustainable energy for all: key challenges*

FDI trends	
Geographical concentration	Despite strong growth in international investment in renewable energy at the global level, many developing countries are lagging behind.
Sectoral and supply chain concentration	International investment focuses very much on renewable energy generation and much less on other sectors that are crucial for the energy transition.
Investment paradoxes	The pipeline of new investment projects in fossil fuels is still flowing and will for another two decades or more, with asset lifetimes exceeding 30 years.
Project finance trends	
Reliance on international investors	FDI plays a significant role in renewables projects worldwide, but more so in those countries most in need of and least attractive to international investors.
Cost of capital constraints	The high cost of capital in countries in debt distress or with high risk ratings is a strong disincentive for investors to shift towards renewable energy assets.
Insufficient and unbalanced support	International support mechanisms are crucial to catalyse investment; a relatively low share of support reaches countries with low access to electricity.

82. UNFCCC (2021). *First report on the determination of the needs of developing country Parties related to implementing the Convention and the Paris Agreement*. Bonn: UNFCCC Standing Committee on Finance.

Investment policy trends	
Weak investment planning in NDCs	Nationally determined contributions and energy transition strategies in many countries do not provide a sufficient basis for effective investment promotion.
Generic investment promotion tools	Developing countries and especially LDCs rely to a large degree on investment promotion tools not designed specifically to support the energy transition.
Old-generation IIAs	Un-reformed IIAs can hinder the implementation of measures needed for the energy transition.
Capital market and sustainable finance trends	
Sustainable finance momentum	Climate finance slowed in 2022, trends in energy markets caused a shift in investment portfolios back to fossil fuels and greenwashing concerns remain.
Institutional investor inertia	A majority of the world's largest funds do not yet disclose or commit to net zero in their investment strategies.
Low coverage of carbon markets	More than three quarters of global emissions are not yet covered by carbon markets, and the spread in the price of carbon across markets is too wide.

Source: World Investment Report 2023: Investing in Sustainable Energy for All

Path dependency in mitigation finance: the case of wind and solar

Wind and solar energy are two crucial technologies for the energy transition and currently attract over 50 per cent of international mitigation finance.[83] Wind and solar finance thus serve as a useful case-study to understand the patterns of international mitigation finance more generally in developing countries.

In the four years following the signing of the Paris Agreement (2016-2019) LICs received 7 times less public investment in wind and solar than LMICs. With regards to private finance, LICs received 8 times less investment than LMICs and 18 times less investment than UMICs.[84] In addition, international public and private finance flows show a high degree of correlation: while still lower than needed flows, Egypt, Mexico, Jordan, Pakistan, and South Africa are top recipients of both public and private investment, while both types of investment are even more severely deficient in the poorest countries of Sub-Saharan Africa. Wind and solar finance flows typify the distribution of international climate finance more generally - into fast-growing developing economies and away from LICs.

Analysis of wind and solar finance flows show that macroeconomic conditions are a key determinant of investors' risk perceptions, highlighting the importance of local financing conditions for renewable assets with high upfront capital costs and long-term revenue streams. The business environment, renewables policy regime and electricity access levels further shape investors' risk perceptions and together determine perceptions of investment suitability.[85] LICs score lowest on these 'investment

83. CPI (2021). *Global Landscape of Climate Finance 2021*. United States: Climate Policy Initiative.
84. Rickman J et al. (2022). *The Unequal Distribution of International Climate Finance Flows and Its Underlying Drivers*.
85. Ragosa G and Warren P (2019). *Unpacking the determinants of cross-border private investment in renewable energy in developing countries*. Journal of Cleaner Production 235: 854-865.

suitability characteristics', based on relevant metrics, while UMICs score highest.[86] In particular, UMICs and LMICs have generally strengthened their renewables policies in the years following the PA, while LICs have not. In light of the reliance of the latter countries on external borrowing, particularly from IFIs, this likely indicates the adverse impact of excessively tight macroeconomic policies on their investment climate as well as a lack of policy space for costly green initiatives or the prioritisation of other development goals over renewable energy. These factors put LICs at a disadvantage in accessing international investment for renewables and emphasise the systemic barriers the poorest countries face in accessing mitigation finance from the private sector.

International public flows of wind and solar finance into developing countries are not observed to be as sensitive to countries' 'investment suitability', reflecting a stronger alignment of public finance with developing countries' needs and the more mission-oriented role of public finance.[87] On the other hand, macroeconomic conditions are a strong determinant of public investment, likely to ensure the recovery of finance provided. The renewables policy environment of countries is a significant driver of public investment, particularly in the period following the PA, indicating a growing complementarity between international and domestic climate agendas whereby the availability of dedicated public climate finance creates incentives for countries to strengthen renewables policies and public funds are then preferentially channelled into countries with strong climate ambitions. However, as with private finance, this disadvantages those countries that do not have the policy or fiscal space to implement expansionary, investment-led green strategies.

Climate finance flows into renewables markets are thus path-dependent: preferentially directed towards countries that have historically received more funding. Countries with a strong track record in low-emissions energy investments are far more likely to receive further funding from both public and private sources. Such evidence of path-dependency in renewables investments points to positive feedback processes happening within renewables sectors, whereby technological and financial learning bring down financing and development costs, signal confidence to international markets and attract further investments in a virtuous cycle. International public and private finance thus evolve through the strengthening of historical links, rather than the formation of new ones. Such an 'investment lock-in' perpetuates distributional inequities and contributes to a highly skewed distribution of finance across countries, as well as income groups. Between 2010 and 2019 approximately 70 per cent of wind and solar capacity additions in developing countries from public and private sources went to just the top 8 countries.[88]

To change course and improve the mobilisation of private finance, a critical 'renewables deployment threshold' must be reached. Path-dependent investment is observed to be non-linear, with the probability of private investment in a country remaining low until a significant wind or solar capacity base is installed (around 1GW). Such path-dependency indicates a form of investment learning that goes beyond technological learning and reflects the evolution of a growing renewables ecosystem. This could potentially arise from a combination of technology suitability and reliability, proven investment environment, and market and financial development – a complex interaction of these factors may lead to a reinforcing cycle of investment and potentially lower costs of financing.

Crucially, LICs fall far below this capacity threshold, highlighting the inefficiency of opening finance channels into poorer nations without sustained public investment and holistic renewable energy roadmaps that can develop whole sectors. This is a strong argument in favour of supporting publicly

86. Rickman J et al (2022). The Unequal Distribution of International Climate Finance Flows and Its Underlying Drivers.
87. Idem.
88. Idem.

owned renewables (and other climate-related infrastructure) to accelerate the achievement of climate goals, whereby governments directly finance the construction of public energy infrastructure as a way to surpass the 'renewables deployment threshold' and at the same time advance a planned and orderly approach to renewable energy expansion.

Mobilising private finance for developing countries' priorities: opportunities and limitations

Low investment in low-emissions technologies in countries perceived as high-risk by investors leaves climate change unchecked, and keeps those countries stuck in underdevelopment and high emissions pathways. Moreover, many countries perceived as high-risk are highly vulnerable to climate change impacts and least resilient to their effects. A 'climate investment trap' occurs when climate change impacts generate negative externalities such as low economic production, high unemployment and political instability which further increases these risk perceptions. This negative feedback loop is coupled, in financial markets, with increasing risk premia and cost of capital (CoC). CoC is strongly heterogeneous across developing countries and can reach 30 per cent in some African nations compared to just 3 per cent in developed countries such as Germany and Japan. High CoC in developing regions are particularly detrimental for capital-intensive low-emissions projects such as renewable energy infrastructure and could lead to delays of approximately eight years in meeting climate goals.[89] [90]

A more sustainable model to successfully mobilise private finance and break the climate investment trap is to build a track record of investments through public-led intervention. Investment decisions by public actors should thus move beyond a project-level focus to support more holistic roadmaps that can develop low-emissions markets, exceed the critical 'renewables deployment threshold' and in turn lead to creating a virtuous cycle that lowers risk premia and the CoC. International efforts should target the evolution of low-emissions sectors through public investment in infrastructure; strengthening of supply chains; expanding project preparation support and knowledge-sharing; and developing networks of relationships between domestic private actors.[91]

Because of the lack of detailed planning in many countries, the policy measures adopted for the promotion of international investment in the energy sector are often similar to those available for any industry. In developing countries, especially, traditional fiscal incentives (income tax reductions) abound, as do other common measures such as indirect tax reductions or exemptions on duties on the import of capital goods. Although these measures have an important role to play, approaches that specifically address the needs of the energy sector in transition have proven to be more effective. Feed-in tariffs and quota-based instruments such as renewable portfolio standards, renewable purchase obligations or renewable energy certificates, which are designed to increase the use of renewable energy, are increasingly common in more advanced energy markets. However, their effectiveness depends on a degree of forward planning for the availability of different sources of energy. Similarly, more sophisticated mechanisms to market renewable energy projects such as electricity price guarantees and auctions depend on adequate demand projections, asset planning

89. UNCTAD (2023). World Investment Report 2023: Investing in Sustainable Energy for All: 158;

90. Ameli N et al. (2021). *Higher cost of finance exacerbates a climate investment trap in developing economies*. Nature Communications 12(1): 4046

91. For an example of a more holistic framework to help manage the energy transition, see UNCTAD's "Global Action Compact for Investment in Sustainable Energy for All" in World Investment Report 2023: 184-187.

and regulatory preparation. Jumping from high-level NDC target-setting straight to investment policy measures precludes the use of the most effective tools for promoting energy transition investment.

Better energy transition investment planning should ensure that investment policy measures are better suited to country-specific situations. Taking into consideration the unique challenges faced by different types of countries in the development of renewable energy infrastructure is critical for selecting the appropriate promotion tools.[92]

Strengthening policy and regulatory environments will also aid in boosting total finance flows. Finance flows into wind and solar energy, for example, have been preferentially channelled into countries with strong climate ambitions and renewables policies. Egypt, Vietnam, and Jordan all saw sharp increases in investment following the introduction of renewable energy targets and strengthened renewables policies.[93] International efforts can support the expansion of policy and fiscal space to deploy industrial policy tools such as subsidies, tax-breaks, guarantees and information tools where developing countries are unable on their own to mount expensive green initiatives.

Strong transition planning is critical for transition finance and plays a crucial role in complementing other policy developments around mitigation ambition. Governments' NDCs and National Adaptation Plans (NAPs) should contain detailed green industrial policy, public procurement, and planning to send strong signals to investors and provide a long-run view on their investment risk. This will be crucial, particularly in fossil-fuel dependent economies where there is a risk of asset-stranding and community-stranding as fossil-fuel activities are phased-out. Such countries should seek to diversify their energy supply and their economies to lessen their dependence on fossil fuels and implement a just transition, which in turn, is dependent on delivery of adequate Article 9 climate finance commitments and expanded policy space.

Limited financial resources in developing countries coupled with a dependence on GHG-intensive activities necessitates the provision of increased levels of transition financing, to allow for a smooth and well-managed reallocation of labour and capital. Just Energy Transition Partnerships (JETPs) have been posed as a solution to finance a just energy transition in a selection of heavily coal-dependent emerging economies. They aim to support countries' self-defined transition pathways, while addressing the social consequences involved in a move away from fossil fuels by ensuring, for example, training and alternative job creation for affected communities. But the programme so far has fallen significantly short of countries' needs. $8.5 billion was provided to South Africa for its JETP, while its five-year plan for a just transition is costed at $95 billion. Moreover, less than 3 per cent of the money was provided as grants while the majority was concessional loans, adding to South Africa's debt burden. Indonesia's JETP faces similar ongoing negotiations around the type of funds provided. As long as international public finance continues to fall far short of needed targets, it will be next to impossible for countries to rapidly overcome the renewables deployment threshold and create virtuous investment cycles.

92. For more details, see UNCTAD (2023) *World Investment Report 2023: Investing in Sustainable Energy for All*.
93. Rickman J et al. (2022). The Unequal Distribution of International Climate Finance Flows and Its Underlying Drivers.

Expanding public finance sources for climate-resilient development

Development and climate goals need not be in conflict. At the Paris Summit for a New Global Financing Pact in 2023, leaders emphasised that no country should have to choose between development goals and a green transition. The consequences of the Covid-19 pandemic, the war in Ukraine and monetary tightening have reduced the fiscal and budgetary space in many countries, halting or even regressing development. It is imperative that the convergence between economic diversification, alleviating poverty and fighting climate change is found.

This and previous sections have demonstrated that increasing mitigation investment in developing countries will require scaling up of targeted public finance and structural changes in the architecture of international finance, particularly in developed countries who host the biggest private financiers of high emissions assets. Multilateral Development Banks (MDBs) and Public Banks are a potentially significant source of public finance with assets estimated at $23 trillion, but the current international financial architecture is structurally unfit to deliver these resources to where they are needed in order to break climate investment traps in developing countries. This was acknowledged in the outcome text of COP27 in Sharm el-Sheikh, which stated that delivering needed funding "will require a transformation of the financial system and its structures and processes, engaging governments, central banks, commercial banks, institutional investors and other financial actors."[94] This has led to rich debate between governments on the elements of a reform agenda for the international financial architecture.[95]

One proposal is for MDBs to expand their lending capacity by updating their capital adequacy frameworks. MDBs and DFIs have been reluctant to take on higher risks for fear of having their credit ratings downgraded. Rather than funding marginally bankable projects in regions perceived as higher risk by the private sector, they are criticised for providing funding to projects that could have been financed at commercial rates in MICs. However, the Independent Review of Multilateral Development Banks' Capital Adequacy Frameworks concluded that MDBs have sufficient headroom to expand their lending capacity to poorer and more vulnerable developing nations within a AAA rating target with certain reforms to capital adequacy frameworks. In particular, MDBs and rating agencies should reassess risk parameters assigned to borrower countries to reflect their strong repayment track record, given MDBs 'preferred creditor treatment'. In addition, MDBs and rating agencies should uplift MDB ratings as a result of the additional security provided by 'callable capital', a unique guarantee of capital by shareholders in the event of extreme shocks to MDB finances. Such reforms could increase risk appetite across MDBs and expand their lending from $598 billion to $1 trillion.[96]

Another element of a more resilient global economic governance regime is to improve outcomes for countries facing debt distress. Nearly half of LICs are at high-risk of both debt and climate crises.[97] Such countries do not have the fiscal space to adopt new debt without compromising development goals. In many instances, countries need significant debt reductions, but the current architecture of sovereign debt workouts in the form of the G20's Common Framework has been unable to provide timely and transparent restructurings for countries in need. Currently, the international community lacks a comprehensive and transparent framework for orderly and fair mechanisms to relieve and

94. UNFCCC (2022). *Sharm El-Sheikh Implementation Plan*. Available at https://unfccc.int/documents/624444
95. This includes the Global Financing Pact from the Paris Summit held in June 2023, the Bridgetown Initiative advanced by the government of Barbados and the Nairobi Declaration at the African Climate Summit held in Nairobi in September 2023.
96. Gallagher K et al. (2018). *Scaling Development Finance for Our Common Future*. Buenos Aires: G20 Insights.
97. UNCTAD (2023). *A World of Debt: A Growing Burden to Global Prosperity*. Geneva and New York,: United Nations Publication.

restructure sovereign debt in developing nations – a problem that will only gather pace as many countries find themselves on the receiving end of escalating climate impacts.

A central element of improving the capacity for the financial architecture to lead to strong development outcomes is to address the mitigation bias in climate finance. In addition to the geographic inequities discussed previously, the thematic distribution of climate finance is currently misaligned with countries priorities and the need to balance both mitigation and adaptation goals. Mitigation finance constituted around 90 per cent of climate finance flows (public and private) between 2019 and 2020 compared to 8 per cent directed towards adaptation.[98] Adaptation in highly climate-vulnerable and low-emitting countries must be recognised as a priority over mitigation efforts, requiring scaled-up adaptation finance from the world's largest contributor countries.

In addition to receiving only a small share of climate finance flows, adaptation is largely publicly funded. The private sector provided only 2 per cent of tracked adaptation finance in 2019 and 2020, compared to 98 per cent from public sources.[99] While mitigation investments, such as renewable energy infrastructure, have well understood cash-flow generating activity, adaptation investments have the characteristics of a public good: steep upfront costs, long investment timelines, and lack of clear revenue streams, which make them less attractive or indeed suitable to private investors.

However, 62 per cent of public finance for adaptation finance is currently provided in the form of loans, and this share has been increasing over the last five years.[100] Debt-distressed countries thus face the prospect of adding further debt to their balance sheets or turning down loans that are urgently needed to build resilience and prevent future costs. Justice and equity, enshrined in the CBDR-RC principle, as well as the economic realities of adaptation finance leads to a need for increased grant support from contributors, given the responsibility of developed countries for climate change impacts that necessitate adaptation investments. Grant-based finance, therefore, must be provided for adaptation and climate-resilient development, and modalities should explicitly bolster state capacity to deliver adaptive, green public infrastructure.

98. CPI (2021). Global Landscape of Climate Finance 2021. United States: Climate Policy Initiative. Available at https://www.climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-a-decade-of-data/
99. Idem.
100. OECD (2022). *Aggregate Trends of Climate Finance Provided and Mobilised by Developed Countries in 2013-2020*. Paris: OECD Publishing.

CONCLUSIONS

The global investment environment has weakened in recent decades.[101] Economic growth is increasingly decoupled from productive investment as profits are instead recycled into financial markets to generate shareholder value and accumulate assets.[102] This financialization of the economy has proven to be a source of instability,[103] increasing access to credit for speculative activities and leading to boom-and-bust cycles in financial markets.

At the same time, markets are far from the ambitions of Article 2.1(c), revealing their inability to adequately price the social and economic costs of carbon; costs which continue to fall most heavily on those least responsible. High-emissions industries continue to be profitable and the additionality of ESG markets, green bonds, and other emerging 'green' instruments is contested as allegations of greenwashing abound. This is in part an information failure and in part a failure of market participants to fully price externalities and risk due to short-termism, uncertainty, and investment lock-ins.

Notwithstanding the poor track record of blending and de-risking at mobilising private capital, shifting, rather than mitigating, the burden of risk does not address market failures or fragilities and has led to increased costs and pressures on the public sector. Furthermore, disclosure initiatives aimed at steering the private sector away from high-emissions activities have so far proved ineffective; notwithstanding that GHG-intensive and green assets are not necessarily substitutable, investors are not responding 'rationally' to disclosed risks.

Considering the scale of assets under management, private finance will need to play a role in delivering PA goals, but it will not do so automatically. If Parties are to successfully align private finance flows with low GHG emissions and climate-resilient development and improve their capacity and volume in delivering for developing country needs, they will first need to revitalise the role of public institutions and market regulation. Policymakers must face up to a weak global investment climate and the inherent failures of financial markets if progress is to be made towards the Paris targets. Wide-ranging, structural shifts of the financial system are needed, requiring ambitious and coordinated interventions by policymakers globally, while at the same time upholding the principle of CBDR-RC.

Key messages

Developed countries must take the lead in Article 2.1(c) implementation.

It is crucial to apply a whole-of-Article 2 approach to the scope and operationalization of Article 2.1(c). Article 2.2 reflects the foundational principles of equity and CBDR-RC under the Convention, recognizing the historical responsibility of developed countries.

While private sector actors are not technically Party to the Paris Agreement, it is incumbent upon the governments of their host countries to steer them away from high-emissions activities. To this end,

---

101. UNCTAD (2022). *Development prospects in a fractured world: Global disorder and regional responses*. Trade and Development Report.
102. UNCTAD (2017). Beyond austerity: Towards a global new deal. Trade and Development Report.
103. Carney, M. 2015. *Breaking the Tragedy of the Horizon – climate change and financial stability*, Bank of England.

developed countries must take the lead in implementing stronger incentives and disciplines in their jurisdictions for finance flows to align with climate goals, and must take every precaution to avoid unintended negative consequences on the needed policy space in developing countries for transition and climate-resilient development. This is imperative not only because of outsized responsibility of developed countries to move at a faster pace towards mitigation goals, but also because they host the major financial actors which continue to profit from the biggest emitting sectors in the world.

A one-size-fits-all approach will not deliver for the diverse needs and circumstances of developing countries, who need to move at an ambitious but different pace and scale. As financial markets shift, it is incumbent upon standard-setting bodies at the national and international level to ensure that the playing field is not tilted against developing countries, avoiding excessive policy conditionalities and top-down agendas which do not respond to national circumstances, transition needs or poverty-eradication ambitions. It must be emphasised that developing country experiences must be central to Article 2.1(c) implementation to avoid undermining development goals, including, for example, acknowledging that fossil-fuel dependent economies will need additional support and flexibilities to achieve their just transitions.

Pro-active, market-shaping strategies are needed to align private finance with Article 2.1(c).

Voluntary initiatives, such as GFANZ, have made scant progress, indicating that the compliance of net-zero pledges and targets are hard to monitor while profits are still to be made in coal, oil, and gas. Empirically, carbon markets and pricing mechanisms have had little impact on the fossil fuel profits, indicating more stringent interventions are required if fossil finance is to be halved next year as would be required according to the IEA net zero scenario.[104] Financial regulators could be mandated to use more interventionist tools such as macro-financial frameworks that can discipline capital allocation, redirecting it away from high emissions assets and into green assets to support orderly, coordinated just transitions. Capital requirements rules can play an additional facilitative role; the physical and transition risks faced by high-emissions firms means that adjusting the risk-weights of high-emissions assets falls well within the remit of prudential frameworks.

Disclosure and ESG markets cannot be depended on to achieve Article 2.1(c).

While disclosure initiatives can be essential groundwork for implementing Article 2.1(c) in financial markets, they will be more effective in conjunction with the regulatory measures outlined above. Parties can explore a wider issuance of disclosure mandates across the financial system and improved coordination between frameworks and reporting methodologies, but it is paramount that the national circumstances of developing countries and their needs for a just transition are respected. This means rejecting top-down, one-size-fits-all frameworks which are likely to be ill-suited for diverse contexts and need. To strengthen intended impacts, disclosure efforts should be tied to increased regulatory capacity, supervision, and enforcement mechanisms for corporate transition plans to ensure compliance.

104. IEA (2023). *Net Zero Roadmap: A Global Pathway to Keep the 1.5 °C Goal in Reach*. Available at https://www.iea.org/reports/net-zero-roadmap-a-global-pathway-to-keep-the-15-0c-goal-in-reach

Aligning private finance with Article 2.1(c) will not solve the outstanding climate finance deficit, which requires scaled up public contributions.

Rather than just relying on the voluntary and uncertain alignment of private finance to resource just transitions, developing countries need a significant increase of targeted public finance support to break the climate investment traps of chronically insufficient funding and develop publicly-owned, low-emissions infrastructure in countries where the private sector is currently unwilling to go. This implies a much bigger, upfront role for public finance support, whether from contributor countries or multilateral sources.

MDBs and DFIs, operating with a mandate beyond their own profitability, are best placed to provide the long-term investments for large-scale infrastructure and strategic investments that can eventually break the climate investment trap and potentially present a role for private capital. To fund this, developed country Parties must provide a significant step-up in capital for MDBs and DFIs in support of government-driven mitigation efforts. This will be key to any hope of successfully mobilizing private sector capital as part of Article 2.1(c) implementation, particularly towards mitigation efforts and the energy transition.

The international financial architectures must be reformed to increase access to public finance and address the debt crisis.

As argued for by the UN Secretary General SDG Stimulus package, capital adequacy frameworks must be reviewed by MDBs, DFIs and credit ratings agencies to ensure that public resources are channelled to where they are most needed. [105] At the same time, debt crises in developing countries must be addressed as transition plans cannot be implemented without the requisite fiscal space. Debt relief and restructuring, as well as an increased use of grant-based instruments and zero-interest loans is required, particularly for adaptation investments where there is no 'private option'. If such reforms are to be implemented effectively and equitably, developing Party voices must be heard. The governance of IFIs, dominated by developed country Parties since 1945, must be reshaped towards inclusivity and equity.

Strengthening transition planning will be key to resource mobilisation.

The conditional and unconditional elements of developing countries' NDCs require resources to be mobilised at the domestic and international level. This will require governments sending clear policy signals that the transition to a low-GHG and climate-resilient future is irreversible and will entail transformational action across sectors. Governments' NDCs and NAPs should contain detailed green industrial policy and public procurement plans, in conjunction with strong communication campaigns. Climate considerations should be mainstreamed within development plans, recognising that socio-economic vulnerability and climate-vulnerability go hand-in-hand. For fossil-fuel dependent economies, planning for a just transition is complex, requiring a whole-economy approach and collaboration across national and local scales.

105. United Nations Secretariat (2023), "United Nations Secretary-General's SDG Stimulus to Deliver Agenda 2030". Available at: https://www.un.org/sustainabledevelopment/wp-content/uploads/2023/02/SDG-Stimulus-to-Deliver-Agenda-2030.pdf

Developing countries should collaborate to set the international agenda and build trust.

Developing countries are increasingly being heard in their calls for more international support for climate goals. Developing countries should collaborate in their demands, while articulating their specific priorities. This will be particularly important to overcome universalist agendas with regards to Article 2.1(c) commitments, and the private finance-focused framing that developed countries have tended to in delivering Article 9.

Printed at United Nations, Geneva – 2325718 **(E)** – December 2023 – 277 – **UNCTAD/GDS/2023/8**