YIN SHAO LOONG

KHAZANAH RESEARCH INSTITUTE

Building back better: Sustainable finance for green industrialisation and inclusive structural transformation

Session 2, March 22, 11am-1 pm CET

Mr. Raphaël Mahaim

Excellencies,

Distinguished panelists and delegates,

Ladies and gentlemen,

It is my pleasure to participate in this panel today to discuss financing challenges and solutions towards green industrial policy in developing countries.

I would like to focus on challenges and solutions involving **climate action**, **national strategy**, and a **positive role for sovereign wealth funds and state-owned enterprises**.

My examples are drawn from Malaysia, where I am based, but there are similar challenges and opportunities in other developing countries. I would also like to caveat that while I am based at a public policy think tank spun off from one of Malaysia's sovereign wealth funds, I am not speaking on behalf of the fund as we are institutionally separate.

Ladies and gentlemen,

The 2020s pose a triple challenge of:

1) recovery from the pandemic;
2) effective climate action; and,
3) finding answers to the long-standing challenge of industrialization.

Finance plays a critical role in realizing solutions to all of these. Equally important is that finance is partnered with appropriate implementing agents guided by clear national and sub-national strategies.

If developing country governments are not clear on their strategy to overcome structural limitations, we can expect to suffer greater loss and damage from the pandemic and climate change, struggle with mediocre industrialization, and find it difficult to leverage climate finance. We've heard from other panelists about the perils of increased debt to finance vaccine purchases.

One of the economic reform initiatives to emerge from the pandemic in Malaysia was PERKUKUH, an effort to revamp the mandates of our government-linked investment companies, which include sovereign wealth funds and institutional investors, such as pension funds. Together they govern some RM1.7 trillion (~US$410 billion) in assets under management and represent one fourth of the market capitalization of our stock exchange.

Malaysia's sovereign wealth funds (SWF) include Khazanah Nasional Berhad and the National Trust Fund (KWAN).

- Khazanah Nasional (fund size RM120 billion; US$28.6 billion) focuses on investment to deliver long-term risk adjusted returns and is able to undertake catalytic investments and other activities to create impactful economic and social benefits.
- The National Trust Fund, KWAN (RM15 billion; US$3.6 billion) is derived primarily from natural resource payments from Malaysia's national oil company PETRONAS.

I single out these two sovereign wealth funds because they are playing critical roles in pandemic recovery and finding solutions to climate and industrialization challenges. How?

Despite global vaccine inequity Malaysia has achieved a vaccination rate of around 80% of the population during its first phase (a figure comparable to Europe) and recently financed a second round of booster shots and vaccines for under 12s. Prior to the pandemic, this "rainy day" Fund had only been used once to finance a wetlands project around the administrative capital of Putrajaya.

The decision to tap into this Fund was controversial largely on account of its novelty. However, in the policy context of an orthodox commitment to pursuing fiscal consolidation, its use to save lives and relieve the burden on the health service represented an innovation. Via an amendment to its governing act to finance vaccine purchases The National Trust Fund was tapped twice to finance both rounds of vaccine programmes to avoid raising sovereign debt.

Khazanah Nasional, which plays a more active and strategic role, has directly and indirectly contributed solutions for the climate crisis. Khazanah is establishing a strategic Impact Fund, or Dana Impak, of RM6 billion (US$1.4 billion) covering six themes:

1. Competing in global markets
2. Building climate resilience
3. Food & Energy security
4. Decent work & social mobility
5. Quality health & education for all
6. Digital society & technology

The specific strategies in these six areas are still under development, and the fund amount is relatively modest, but the planned approach aims to establish catalytic partnerships with the private sector.

An SWF of this sort has the resources to undertake strategic research and potentially act as a loss leader to crowd in private finance.

Khazanah has also indirectly advanced domestic climate action via an urban regeneration and heritage initiative called Think City.

Established in 2009, Think City was initially designed to support the UNESCO World Heritage listing of the city of George Town, Penang via US$4 million in grants to conserve and protect the city’s unique heritage. Today, Think City fosters SDG City Zones.

Significantly this year, Think City and the local council in Penang successfully secured US$10 million from the World Banks’s Adaptation Fund. This is the largest climate adaptation project in Malaysia to date. The two-year application process was supported by technical experts in urban climate issues and community consultation. The latter revealed some surprising results. While floods cause more acute loss and damage, community respondents cited daily heat stress as the single worst climate change impact that they were experiencing. The project’s financing thus reflects these community-driven priorities.

This example highlights the potential role of sovereign wealth funds and their social initiatives as a focal point for local and international climate finance. In a policy environment clouded by political uncertainty, SWFs can help provide a clear policy signal that generates private sector confidence. Likewise, international climate finance can help domestic efforts leap ahead. Malaysia is still 2-3 years away from finalizing its National Adaptation Plan. With its advance financing, the Think City project could offer some valuable lessons for the national plan.

Strategy and Climate Finance

I'm going to return to the theme of building **climate resilient development** without prejudice as to what may be finally proposed or adopted under the aforementioned Impact Fund. By climate resilient development I mean implementing mitigation and adaptation together in support of sustainable development.

Developing countries face a strategic tension around striking a balance between mitigation and adaptation in climate action. As a whole, the developing world is neither historically responsible for climate change, nor are we emitting as much on a per capita basis as developed nations. We also generally lack the financial and technological means to aggressively decarbonize our economies.

However, there is great pressure on developing countries to pursue decarbonization, net zero and the like, over other pressing climate issues such as adaptation or securing compensation for loss and damage. This undermines the principle of **common but differentiated responsibilities** enshrined in the climate convention which is fundamentally an issue of distributive justice.

This is an industrial policy and sustainable development conundrum that each country needs to resolve according to its national priorities, not based on the priorities of those funding countries that may be richer or more powerful.

There are three broad temporalities for climate change policy. The long-term of 80 years until 2100, which is the mitigation battle to prevent catastrophic global warming and lower hard limits to adaptation. A medium-term of 20-40 years where significant climate impacts have been identified by science and there is a policy window for appropriate adaptation measures to be deployed. Finally, there is a short-term horizon of around two decades where large emitters need to make big cuts, and vulnerable societies need to weather loss and damage from climate changes already set in motion by historical emissions, and rapidly deploy adaptation measures in response to them.

I would argue that there is a greater policy burden on developing countries to take national action on the short to medium-term threats – especially adaptation – because they will be least prepared to withstand impacts and loss and damage will further exacerbate poverty and inequalities.

Finance is limited. Climate finance even more so. Developed country pledges for $100 billion annually for developing countries have failed to materialize. Financing is skewed towards mitigation, with adaptation only making up a quarter of climate finance. Does the bias towards mitigation represent developed countries' preference for business opportunities, a desire to push mitigation burdens onto developing countries, or both?

Sifting through competing priorities is an essential task for national strategy to make the best use of limited financial resources. Separating false solutions from necessary actions is an important process that will differ for every country. It is imperative to filter out greenhouse gaslighting to take on excessive mitigation burdens.

Adaptation is highly local and context specific. Scientific research and community engagement are important components in developing effective and inclusive national strategies and ensuring that targeted infrastructure investment adequately meets adaptation needs. Climate funding thus needs appropriate national and local partners to be deployed effectively.

Without sufficient funding for science and consultation – and I mean community consultation, not management consultants – there is a risk of maladaptation, such as building sea walls too low. International cooperation and knowledge sharing is very valuable here. As a Malaysian, I find grassroots climate adaptation approaches taken in the Philippines offer valuable lessons for other developing countries in terms of science communication and community engagement.

Developing country policymakers will also have to think hard to avoid limited finance being diverted into ineffective or false solutions that delay real climate action.

Carbon markets have an appeal that far exceeds their ability to deliver genuine climate solutions. We are seeing carbon credit deals that play on developing countries' desperation for development finance while short-changing rights and ultimately transferring atmospheric space from developing to developed nations.

Carbon capture and storage is another problematic diversion. CCS has become a popular public relations tool for private oil companies from the Global North to show that they are doing "something" about the climate crisis, namely staying in their comfort zone of geoengineering and maintaining fossil fuel consumption instead of focusing on a just energy transition. Developing country National Oil Companies (NOCs) are qualitatively different from developed country private oil companies. NOCs may have a dividend obligation to finance national development. Should they gamble it on high risk, high cost, low success rate ventures like CCS?

The quest for appropriate solutions that meet the needs and aspirations of developing countries is essential to maximise the utilization of finance. It is equally important to continue efforts to ensure that financial pledges by rich countries are honoured and expanded. Recognise that distinctive features of developing economies can offer solutions. Indigenous knowledge and a significant role played by state-owned enterprises and sovereign wealth funds may have much to offer.

Thank you.