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Mainstreaming climate finance into international public financial flows: What role for the G20?

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The adoption of the Paris Climate Agreement and the Sustainable Development Goals in 2015 firmly anchored the issue of climate change at the centre of international and national development policy. These agreements set out an ambitious set of universal targets, as well as national policy engagements (in the field of climate change, nationally determined contributions). The issue of finance is at the heart of these policy agendas.

This Issue Brief examines the role of the G20 and related institutions in driving the mainstreaming of climate change into international public finance. The transition to low-carbon, climate-resilient economies will require a large-scale shift of investment from high to low-carbon sectors. The scale of this shift means that private (and mostly domestic) capital will be crucial to this transition. In line with this, the Paris Agreement sets the objective of "making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development" (UNFCCC 2015, Article 2.1c). However, domestic public capital can provide an important catalyst; and international public flows will be even more important for poorer, vulnerable countries; and for activities where market failures mean that private capital will not invest.

This paper argues that the G20 can make an important contribution to this objective of mainstreaming climate concerns into public financial flows. This holds also of private financial flows, although this paper limits itself to public financial flows.

* This paper does not necessarily reflect the views of the government of the People's Republic of China, nor those of the National Centre for Climate Change Strategy and International Cooperation of China (NCSC).

KEY MESSAGES:

- Public climate finance can provide a crucial complement to the necessary, economy-wide shift of investments required for the transition to low-carbon, climate-resilient societies. Developed countries have notably an important obligation under the Paris Agreement to continue to provide climate finance. However, the landscape of international public finance is growing more diverse. New international financial institutions are emerging, promoting important flows of South-South funding.
- There is thus a need for a new set of principles reflecting this trend and the objectives of the Paris Agreement and the Sustainable Development Goals. Notably, public financial flows should contribute to the objectives of both agreements; should be based on nationally determined contributions (NDCs) and long-term low emissions development strategies (LT-LEDS); and should take care not to divert funding from traditional development objectives like education, health, poverty reduction, good governance, etc.
- The G20 can play a role in promoting principles of mainstreaming climate finance into international financial institutions, thanks notably to its financial expertise, policy weight, and geographic coverage. The G20 could further articulate its role in this regard, and continuously improve experience sharing and transparency of different international financial institutions' data and policies.

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SCOPE AND DEFINITIONS

The Paris Agreement and the Addis Abeba Action Agenda on Financing for Development (FFD) present an important paradigm shift in the international community's understanding of the challenge of financing sustainable development. Broadly speaking, we can define two policy agendas:

- *Transforming financial flows.* As noted above, the transition to low-carbon, resilient economies will require a transformational investment shift. A number of studies have come up with a ballpark figure of around 5% of annual capital investment that will have to be withdrawn from high-carbon activities, and invested into low-carbon activities. Most analysis agrees that the net incremental investment will be small. However, the shift in investment will in itself be a significant policy challenge. We can call this the *transformational policy agenda,* and it is reflected in Article 2.1c of the Paris Agreement.
- *Helping developing countries address climate change.* Developing countries have limited access to capital, weak financial markets, competing development priorities, and little historical responsibility for climate change. For these countries, international public finance is a crucial solidarity tool to promote the transition to a low-carbon, resilient economy. This is reflected in the Paris Agreement's obligation on developed countries to provide financial resources to assist developing countries with adaptation and mitigation (UNFCCC 2015, Article 9.1) alongside commitments to provide Overseas Development Assistance (ODA), and well as the voluntary provision by other Parties of support for adaptation and mitigation in developing countries (UNFCCC 2015, Article 9.2). We can call this the *solidarity agenda*.

Thus the issue of mainstreaming climate concerns into public financial flows is one that pertains to both agendas. Of course, this broader mainstreaming policy discussion must be conducted while still recognizing the diversity of countries' national circumstances, responsibilities and objectives (such as poverty eradication and social and economic development for developing countries), and the principle of 'national determination' which is at the core of the Paris Agreement. Mainstreaming does not mean a one size fits all approach.

There are several understandings of what the term 'mainstreaming' means. These include:

1. Policies and processes to take into account the risks and opportunities related to climate change when allocating investment.

2. Exploiting co-benefits and synergies between other policy objectives and climate mitigation and adaptation.

3. Scaling up the allocation of investment to climate change mitigation and adaptation, at the same time as not affecting the ratio of traditional ODA for poverty reduction and development, for example through the use of quantified targets, etc.

There is value in all of these definitions. **For the purpose of this paper we understand 'mainstreaming' to mean policies and processes that aim at ensuring due consideration in the allocation of public financial flows of the risks and opportunities arising from climate change, and thus increasing investments in adaptation and mitigation while maximizing synergies and minimizing trade-offs between climate mitigation and adaptation and other development priorities.**

WHY A ROLE FOR THE G20?

There are a number of existing initiatives that aim at developing best practices for mainstreaming climate concerns into public financial flows. These include the Ecuador Principles as well as the "Five Voluntary Principles for Mainstreaming Climate Change within Financial Institutions" adopted in 2015 by a group of public development finance institutions and commercial financial institutions. In the context of this existing work, the G20 could have a number of areas of value added.

Coverage. The world of public financial flows is undergoing a significant shift, in line with the transfer of economic power away from the OECD countries and towards non-OECD counties, in particular East Asia and the Middle East. Non-traditional donor countries are increasing their importance in the global development finance landscape (Figure 1). For example, the last few years have been marked by the emergence of a number of new development financing institutions, responding to a number of conditions. These include: the surplus savings of creditor countries; the desire to find stronger returns on these savings than given by persistently low-yield securities; the large infrastructure investment needs in developing countries; and the justifiable perception that the governance of existing institutions such as the World Bank was not responding adequately to the emergence of new economic powers. **The last point raises a crucial issue, namely the risk of a fragmented governance of an increasingly diverse international development cooperation landscape.** In addition, as highlighted above, the financial transformation required for the transition to a low-carbon, resilience global economy creates a policy challenge that goes beyond international development cooperation, and also concerns the allocation of *domestic resources* to achieve the commonly agreed objectives and nationally determined contributions of the Paris Agreement. As noted by the OECD-led, G20 mandated survey on infrastructure investment in G20 countries: "Strategies to stimulate the role of public investment funds are also present in most G20 countries" (G20 and OECD, 2015). This means that issues of policy learning and cooperation go beyond existing networks of multilateral and bilateral development finance institutions, to include emerging international financial actors.

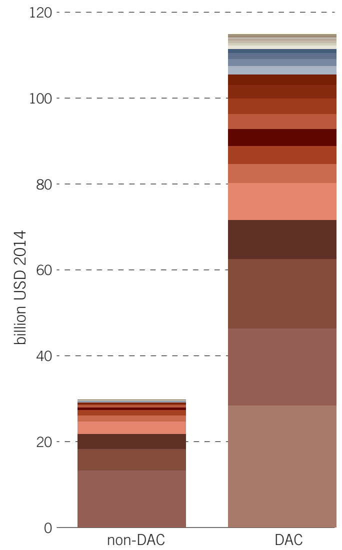
Clearly, the G20 should not replace multilateral decision making on climate change. Nonetheless, it can play an important complementary role. G20 countries are responsible for 85% of global GDP, and 88% of domestic investment and roughly 78.5% of development cooperation assistance and 89% of GHG emissions.[1] Progressively strengthening the role of the G20 on mainstreaming climate change into public financial flows can help to reflect the growing diversity of this landscape, and ensure that different institutions contribute synergistically to the goals agreed in Paris and the SDGs.

Policy weight. The G20 is the world's foremost political forum for global economic and financial governance. It plays a crucial role as coordinator of diverse international governance institutions working on economic and global financial governance, as well as a forum for the discussion and alignment of member countries' policies. As such, it can have a normative weight that other networks focusing on the issue of financing the transition to a low-carbon, climate resilient economy lack.

Policy expertise and mandate. The G20 focuses primarily on economic growth and financial stability, although its portfolio has broadened after the acute crisis of 2008/9 passed. With the adoption of the SDGs and the Paris Agreement there is an argument to be made that the G20 should have a crucial role to play in delivering on these new global agreements for sustainable development, including the financing of the transition that they envisage. At the same time, the G20 has a considerable body of expertise in the area of financial and economic policy, including through its links with the IMF, OECD, securities regulators, banking and insurance regulators, etc. In addition, the G20 is already working in a structural way on the issue of infrastructure investment, including through the establishment of the Global Infrastructure Hub and the G20 Infrastructure and Investment Working Group. Yet, there is still scope for mainstreaming climate concerns within this work and improving data collection and analysis, as noted by the report of G20 and OECD on Member States' investment strategies (G20 and OECD, 2015).

1. Data from Enerdata for GDP and investment and are for 2015. Data from OECD DAC for development cooperation assistance and are for 2014. Brazil is not represented in the DAC data.

Figure 1. Non-DAC bilateral development cooperation and DAC total overseas development assistance, 2014



Source: (DAC 2016).

G20 PRINCIPLES AND PROCESSES FOR MAINSTREAMING CLIMATE FINANCE

In this section we develop several proposals for actions that the G20 could take in order to advance this agenda of mainstreaming climate concerns into public financial flows.

Principles

Currently, the G20 Climate Finance Study Group is studying the adoption of an "'*Outlook from G20 countries on how to mainstream climate change considerations into development assistance and climate finance programs*". This should contain a list of key principles that should guide the mainstreaming of climate concerns into public financial flows. Here we provide a potential list of such principles:

1. *Public financial flows should be in line with the objectives and principles of the Paris Agreement and the SDGS.* As discussed above, the Paris Agreement and the SDGs provide a crucial, multilaterally agreed framework of common objectives and national engagements.

2. *Mainstreaming climate finance should take care not to divert funding from traditional development objectives like education, health, poverty reduction, good governance, etc.*

3. *Public financial flows should be driven by domestic development priorities, in particular as*

outlined by NDCs, Low Emissions Development Strategies (LEDS) and domestic strategies to implement SDGs. Governments should actively develop implementation strategies, and public financial support should be provided to support governments to develop these strategies and translate them into investment plans. These plans should contain more detailed and investment relevant indicators in order to translate the NDC and related strategies into more granular policy and investment strategies. Over time, the quality and transparency of national low-carbon development plans, encompassing NDCs, SDGs and a longer-term transition perspective, should become an important benchmark.

4. *Efforts to mainstream climate finance should be nationally owned and determined, and reflect the different circumstances of different institutions and actors.* In this vein, cross border public finance should enhance the indigenous capacity of developing countries.

5. *All public financial institutions should develop climate strategies.* These should detail high level prioritization of climate change mitigation and adaptation, quantitative targets, processes and benchmarks for integrating climate change into decision making at all levels, as well as specific funding instruments for climate change mitigation and adaptation.

6. *Public financial institutions should mainstream risk management.* Institutions should assess the risks posed by the physical impacts of climate change, at both the project and the institution level. Institutions should also assess the risks posed to projects and institutions by the transition to a low-carbon economy (e.g. the stranded assets risk). There is a need for further learning and refinement of climate risk management systems.

7. *Public flows should be targeted to where they can be of most impact.* Concessional finance will be needed for low-income countries and for projects and sectors where attracting private capital is difficult. Beyond these areas, public flows should aim to be as catalytic as possible through the use of innovative instruments such as syndications, guarantees, securitization, as well as technical investments to improve the extent and the quality of the project pipeline. Cross-border public flows should promote technology transfer to developing countries. Public financial flows should ensure a balance between mitigation and adaptation. Public flows should address financing needs from diversified sectors (energy efficiency, renewable energy, green building, LULUCF, etc.)

- 8. *Approaches to mainstreaming climate concerns should improve climate performance over time, as well as account for this performance.* All public financial institutions should provide, in time, regular reporting of investments for climate mitigation and adaptation, as well as other relevant data points such as the footprint of investments, the carbon intensity of investments, etc.
- 9. *There should be continuous learning by doing and representative platforms for exchange on efforts to mainstream climate action.* Existing coordination networks between MDBs and DFIs should be enhanced and enlarged to new actors, including by increasing the representation of national development banks.

Processes

In addition to the adoption of the above principles, over time the G20 could strengthen its work on mainstreaming climate concerns into public financial flows in a number of ways. Here we provide a list of three areas.

- 1. *Further articulate the role of G20.* G20 is well positioned to transform the overarching objective of the Paris Agreement and the SDGs into political momentum as well as guiding principles to facilitate IFIs to implement these objectives. The facilitation work of G20 in this regard should be in line with the principles and provisions of the UNFCCC, and the objectives of the Paris Agreement and SDGs.
- 2. *Promoting experience sharing.* As noted above, the SDGs and the Paris Agreement represent an important new step in terms of defining the challenge of financing the transition to sustainable development and low-carbon, resilient societies. This will take time to be translated into the strategy, board decisions, working procedures and programs of IFIs. As these actions are being undertaken, G20 should serve as a platform to learn the lessons and share the experience of these practices.
- 3. *Improving transparency.* The implementation of both policy agendas mentioned above requires further development of transparency system to track the progress regarding whether and to what extend the financial flow are directed to the low GHG emissions and climate resilient development and also whether, and, in parallel, to what extend the obligation of developed countries on provision and mobilization of financial resources to developing countries are fulfilled. The G20 can help to facilitate this transparency, reporting and data gathering exercise from relevant international financial institutions.