

BRIEF ACTIONABLE RESEARCH AGENDA ON:

Mobilizing new climate investment models

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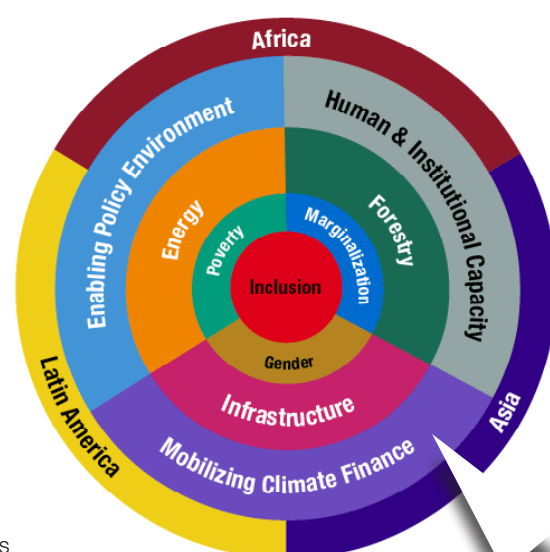
■ ■ Increasing strategic and large-scale investments in low-and middle-income countries are required to ensure a just, equitable and predictable low-carbon transition. Mobilising Climate Investment Models is part of a larger initiative to identify the most promising research issues to support an actionable low-carbon transition in the Global South.

Aim: Increasing climate investment in developing countries “from billions to trillions” will require significant use of private capital, as well as the alignment of Nationally Determined Contributions (NDCs) with the realities of climate investment instruments and institutions. Research is needed to identify the necessary connections among public development finance, private capital, export credit, and philanthropic resources. Research will be essential to quickly demonstrate and scale up low-carbon technologies and business models, while enabling Global South-led innovation.

Background: In 2020, global climate finance flows were about \$632 billion annually. These investment flows differ dramatically by region. They also differ by the extent to which the private sector or public sector is providing the finance, and by whether it is sourced domestically or internationally. Only a small share of total investment flowed to lower-income regions of the world, including just \$19 billion to sub-Saharan Africa and \$30 billion to South Asia. Yet, it is estimated that developing countries will need an additional \$800 billion annually by 2025, and close to \$2 trillion a year by 2030, to address climate change mitigation, adaptation, and resilience.

How much of that finance will need to come from public versus private sources depends on the climate needs of each country and on the commercial attractiveness of climate projects. Nearly half of total climate investment in Latin America comes from private sources. In Asia, private finance is just under 40% of total climate investment. Africa has seen comparatively little investment from the private sector, with private finance representing just 11% of climate investment. Public finance makes up the majority of climate investment across all of these regions. This is a stark contrast to the US, Canada, and Western Europe, where private investment constitutes 59-95% of total climate finance.

The source of finance matters because it influences the type and aims of that finance, and where it is invested. Multilateral climate funds are the only major source of climate financing that is specifically tied to priorities outlined in Nationally Determined Contributions, yet they only represent 4% of global climate finance. Instead, roughly three-quarters of climate finance for lower- and lower-middle-income countries is delivered through bi-lateral Deve-



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development Finance Institutions and Multilateral Development Banks, which have their own mandates and national agendas. Some countries, especially in sub-Saharan Africa, rely on overseas capital for 90% or more of climate investments.

A key barrier to low-carbon development is the high cost of capital, which can be seven times higher than in developed countries. Public sector capital can be deployed in various ways to reduce some of these risks and mobilize private sector investment, such as through guarantees and blended finance instruments.

Payments for environmental services, green bonds, and “blue bonds” (for coastal and island regions) are additional innovative sources of financing. An example of payments for environmental services is the UN’s REDD+, which provides compensation for forest conservation and reforestation. REDD+ has been widely implemented in developing regions.

For climate finance to be effective, efficient, and scalable, it must be aligned with the specific climate mitigation and adaptation needs of different regions, countries, and localities. At present, there is not enough capacity in most developing countries to drive the bottom-up processes needed to identify and build consensus around those needs, leaving politics and external forces to disproportionately drive policy. Similarly, there is a vast gap in the evidence needed to drive effective and equitable policymaking.

The evolving global market for carbon is providing a growing opportunity to move additional capital into key sectors like agriculture, renewables, and forestry in lower-income and middle-income countries. The corporate net zero movement is creating demand for premium carbon credits, with complementary benefits related to empowering women, improving food security, and increasing clean water access.

However, small and medium-sized businesses are largely left out of such carbon credit schemes because certifying projects requires significant upfront investment and technical capacity. This is of particular concern because of the substantial role of small and informal businesses in the Global South. Without attention to this group of businesses, climate finance could increase the inequities affecting young, female, and otherwise marginalized entrepreneurs.

The Global South should be more than just a market for green technology developed and built in high-income countries. However, there is strong North-South tech transfer bias inherent in the western development finance model, which poses challenges for investment in locally-developed solutions. In addition, the US-China rivalry has significant implications for how capital is delivered to developing countries and how growing debt loads are managed. China now holds upward of 40% of the debt of the world’s poorest nations; restructuring sovereign debt will likely require bringing them to the table with western government lenders, multilateral organizations, and private bond holders. At the same time, China has announced that it will no longer finance coal power systems and is promoting a “Global Development Initiative,” which is expected to focus more on sustainable development. Similarly, the G7 is promoting Just Energy Transition Partnerships to support large-scale public and private investment to support an off-ramp for coal in key developing countries.



Images: unsplash

Opportunities for High Impact Research:

Defining a just energy transition – what transitions need to occur, how they can be achieved, and what support is needed for marginalized communities to benefit – is a participatory, context-specific exercise, which must be done locally. Priorities during the transition may include job creation, energy price stability, and protections for vulnerable populations. Researchers have an important role to play in building the evidence base that is used to debate and define what a just transition means locally and how policy and investment can be structured to enable transition scenarios. This includes examining how sectoral shifts will impact local employment and well-being, modeling the trade-offs between different energy pathways, and developing decision support tools to help evaluate tradeoffs and support regional economic planning. It will be important to identify how public works or education programs can support vulnerable segments of the population and how training and investments can bring marginalized groups—including women—into priority low-carbon sectors.

Deeper knowledge of project and firm impacts is needed to strengthen carbon markets, prioritize high-impact investment, and establish the case for public-private investment. The net zero movement has high ambitions, but data-poor environments open up opportunities for greenwashing and inefficient capital allocation. Carbon markets currently lack the integrity to mobilize high volumes of capital, and adaptation projects requiring public-private investment partnerships remain unrealized, in part because benefit streams remain undefined. Many corporate carbon buyers are willing to pay a premium for high-integrity carbon credits that offer complementary benefits related to sustainable poverty reduction. However, there is not currently a strong understanding of which business models, firms, and value chains have the most potential to deliver those impacts. Researchers have an opportunity to drive investment by enhancing certainty around the impacts of projects, especially those driven by the private sector.

At a higher level, a lack of standardized definitions and accounting methodologies for what constitutes climate finance, as well as limited access to certain data, limits the understanding of climate capital flows, especially those pertaining to private sector investment, domestic finance, and adaptation investments. The impacts of different investment approaches, including investments that have a gender lens, are not well studied.

Aligning climate finance with national climate priorities will need innovative risk mitigation approaches to reach less developed regions and economic sectors. There is a need to better understand which risk-mitigation features work best in which context.

Finally, research is needed on how investments can be channeled to key actors, including small businesses and women, as well as other marginalized groups that face high barriers to accessing finance. There are a host of challenges that small businesses face in developing countries. These included underdeveloped markets and technical capacity. However, access to capital is a key barrier that limits the growth of most green businesses in the Global South. How to get cash or credit to green businesses at a small scale, and how to evaluate the effectiveness of such efforts, are key research topics that could promote inclusiveness in a low-carbon transition.

**Access the High-Level
Research Agenda:**
<https://bit.ly/3zyfp1P>

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