

2nd LAC Regional Policy Dialogue

Enhancing Climate Finance and Promoting Technology Transfer in the LAC region

Background Note – Day 2 (19 October 2022)

Day 2. Climate finance in LAC: the international commitments and private finance mobilisation

The OECD estimates that USD 6.9 trillion a year of infrastructure investment is required up to 2030 to meet climate and development objectives (OECD, 2017^[1]). Yet, the latest OECD work on progress by developed countries to achieve the USD 100 billion goal by 2020 for climate action in developing countries, shows that even though climate finance provided and mobilised is increasing yearly since 2015, the target is yet to be reached. In 2020, the total climate finance provided or mobilised reached USD 83.3 billion. The Americas¹ is the region receiving the least climate finance, with the exception of Europe, at 17% of the total (USD 12.5 billion), even though low- and upper-middle income countries were allocated 70% of the climate finance. Only USD 1.5 billion was received for Small Islands in Developing States (SIDS), where the Caribbean is the part of the world with more countries with that status (OECD, 2022^[2]).

Loans accounted for 81% of the public climate finance provided in the Americas during the period 2016-2020, while grants accounted for 17%, and equity for the remaining 2%. During the same period, the Americas benefited of 26% of the total private climate finance mobilised. It is worth mentioning that even though the regional distribution of private finance mobilisation was relatively similar to that of total climate finance, in the case of the Americas there was a greater focus on private finance mobilisation, contrary to other regions such as Asia and Africa. (OECD, 2022^[3]). Following the overall trend, the majority of funding in the LAC region is directed towards mitigation over adaptation (OECD, 2022^[3]), even though LAC countries are prioritising and accelerating adaptation projects targeting water, agriculture, infrastructure and Nature-based Solutions. Financing for adaptation projects is especially needed in the Caribbean, due to vulnerabilities against climate change and extreme weather events (Miranda, 2021^[4]).

The Glasgow Pact emphasised the need for developed countries to deliver on the USD 100 billion goal, and urged multilateral development banks and other financial institutions to increase both their investments and climate finance effectiveness. Scaling up financial resources requires a clear understanding of each country's vulnerabilities and needs impacted by climate change, as well as simplified and enhanced access to finance (UNFCCC, 2022^[5]).

Countries are obliged to communicate their long-term low greenhouse gas emission development strategies reaching until 2050, if they wish to achieve their net-zero emission and/or carbon neutrality targets. For LAC countries in particular, economy wide transformation would be in some cases necessary, including infrastructure investments, demand-side adjustments and introducing national legislation (Miranda, 2021^[4]). LAC countries estimated their costed needs via their Nationally Determined Contributions (NDCs) to the cumulative amount of about USD 168.2 billion, even though almost 60% of the costing comes from one country. This amount, however, does not cover the totality of their needs nor does it represent an accurate cost calculation, as often countries do not have the right data, tools or capacity to complete their estimations (UNFCCC, 2021^[6]). In addition, some LAC countries are also lacking in both addressing climate change through their national budgets, and aligning their income and

¹ The Americas covers geographically the following list of developing countries and territories: Antigua and Barbuda, Argentina, Bahamas, Barbados, Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, Cuba, Dominica, Dominican Republic, Ecuador, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Montserrat, Nicaragua, Panama, Paraguay, Peru, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, Trinidad and Tobago, Uruguay, and Venezuela (OECD, 2022^[2]).

expenditures to their climate goals, especially in the case of countries that depend highly on carbon-intensive activities; such as exploration and extraction of hydrocarbons and minerals, and fuel trading (GFLAC, 2021^[7]).

To achieve the Paris Agreement's temperature and adaptation goals, LAC countries need to play their role. Immediate actions on achieving countries' climate commitments through implementing robust climate policies need to be complemented by reforms in investment policies that remove barriers, stimulate the creation of markets, and mitigate risks to allow for bankable projects to be developed (OECD/The World Bank/UN Environment, 2018^[8]). Such efforts would need to be supported by capacity building, such as in the case of budgeting, enhancing LAC countries advocacy for more financial support and external resources for their conditional NDCs.

The majority of climate finance provided world-wide over the period 2013-2020 was public (bilateral and multilateral), despite the fact that mobilised private climate finance increase by about 30% over the period 2016-2020² (OECD, 2022^[2])

Bilateral donors, through their development co-operation agencies and finance institutions, such as German GIZ and IKI, the Norwegian International Climate and Forest Initiative (NICFI), the French Development Agency (AFD), the Spanish Agency for International Development Co-operation (AECID) USAID and the UK are stepping up their efforts to support the LAC countries in achieving climate neutrality. International donor programmes, such as EUROCLIMA+, a flagship programme of the European Union in Latin America, supports LAC countries to overcome what is considered a complex architecture of climate financing. The programme focuses on strengthening both financial instruments which support the development and implementation of national climate financing strategies, but also capacities within institutions formulating the national economic and fiscal policies. It also provides support to countries wishing to develop methodologies to monitor financial resources allocated to combat climate change (EUROCLIMA+, n.d.^[9]).

On the other hand, multilateral banks have made ambitious commitments to scale up climate action and are stepping up their efforts to increase their green and climate finance activities. The Development Bank of Latin America (CAF) announced, during COP26, that it will increase green projects' financing from 24% in 2020 to 40% in 2026, representing an allocation of USD 25 billion over the next five years to promote green growth (CAF, 2021^[10]). The Green Climate Fund (GCF) annual results report 2021 points out that approximately USD 3 billion were approved for 32 climate projects around the world in 2021, surpassing the 2020 record of USD 2.1 billion. By the end of 2021, GCF's portfolio reached USD 10 billion, amounting over USD 37 billion in co-financing and 190 projects in 127 countries (GCF, 2021^[11]). The Inter-American Development Bank (IDB) Sustainability Report 2021 showcases that in that year, it approved almost USD 4.5 billion for climate-related operations, accounting for 30% of total IDB annual approvals (IDB, 2022^[12]). The World Bank's International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA) have provided over USD 5.8 billion in lending to support climate actions in LAC countries (World Bank, 2021^[13]).

Considering the trillions needed globally to meet climate and development objectives by 2030 (OECD/The World Bank/UN Environment, 2018^[8]), development banks need to not only mobilise domestic and foreign private sector capital, but also support governments in their project planning, development and deployment (OECD/The World Bank/UN Environment, 2018^[8]); (Prasad et al., 2022^[14]).

Investing in green and climate projects, albeit important, will not guarantee moving closer to the net-zero targets, unless a sustainability perspective is introduced. It is necessary to guarantee that the climate transition is financed in an inclusive way, especially in emerging markets and developing economies, as they experience vulnerabilities and their financing capacity is lower (IPCC, 2022^[15]). Several sustainable finance mechanisms and instruments are incorporating concerns from shareholders, investors and consumers, as in the case of Environmental, Social, and Governance (ESG) loans, climate or climate

² Comparable data on mobilised private finance is only available from 2016 onwards.

bonds or blended finance. Panama, for example introduced in 2019 guidelines for voluntary reporting and disclosure of ESG factors. Colombia in 2020 issued its Green Bonds and Best Practices Guide to promote developing a bond market in the country. The Dominican Republic also released Green Bond Guidelines to standardise good practices for issuers. In the case of public green bonds issued in the LAC region, there seems to be a clear prioritisation of energy projects, while transport, water and land use follow (Climate Bonds Initiative, 2021^[16]).

Blended finance can help in addressing the risk-return and low bankability of several investments, not only by combining public and private financing, but also by structuring several financial instruments (direct investments, credit lines, bonds, grants etc.) together. In cases of high financial or commercial risk, blended finance instruments and mechanisms can facilitate private investments in the financing structure of a project, and at the same time lift some or all of the risk of default, which usually desensitise investors (OECD, 2018^[17]).

In addition to green and climate finance, the role of transition finance needs to be recognised, as it could contribute in supporting businesses and sectors to adopt cleaner technologies, increase energy efficiency, and eventually transform the economy. Further examination is required on how transition finance can best ensure that it translates into actionable and credible targets, supporting investments with positive environmental impacts.

The OECD Guidance on Transition Finance aims to enable a shift towards (i) mainstreaming credible transition planning across public and private entities; and (ii) including meaningful assessment of transition plans as part of financial market participants' core considerations. By identifying challenges and barriers, such as lack of clarity on standards and definitions, difficulties in measuring sustainability performance, and the risk of greenwashing, the Guidance proposes a set of elements of credible corporate climate transition plans, which can support a growing transition finance market while also ensuring environmental integrity (Box 1) (OECD, 2022^[18]).

Box 1. Credible corporate climate transition plans

Ten elements to ensure credibility

1. Setting temperature goals, net-zero, and interim targets
2. Using sectoral pathways, technology roadmaps, and taxonomies
3. Measuring performance and progress through metrics and Key Performance Indicators (KPIs)
4. Providing clarity on use of carbon credits and offsets
5. Setting out a strategy, actions, and implementation steps, including on preventing carbon-intensive lock-in
6. Addressing adverse impacts through the Do-No-Significant-Harm (DNSH) Principle and Responsible Business Conduct (RBC) due diligence
7. Supporting a just transition
8. Integration with financial plans and internal coherence
9. Ensuring sound governance and accountability
10. Transparency and verification, labelling and certification

Source: (OECD, 2022^[18])

Developing sustainable finance taxonomies can also support the private sector in identifying environmentally sustainable activities. LAC countries are slowly developing official definitions on sustainable finance linked to Paris Agreement goals; with Colombia being the only country in the region implementing a Green Taxonomy. Developing a common regional framework for taxonomies in the LAC region would further provide clarity and transparency, facilitating the comparability and interoperability between the LAC region and other regions that are introducing their own frameworks. It would also support increasing climate flows in sustainable projects (UNDP, 2022^[19]).

Questions for consideration***Session 2. Climate Finance in LAC from an international perspective***

1. How can countries better quantify and align their climate action needs with the finance provided?
2. What do LAC countries need in order to improve absorption capacity of climate finance? Would capacity development on budgeting and on assessing the cost of climate action be under consideration?
3. Which type of climate finance would best fit the needs of LAC countries?

Session 3. Climate Finance in LAC: Setting the right incentives to mobilise private climate finance

1. What are the main challenges in accelerating climate finance to achieve the net zero targets in LAC?
 2. How to maximise the predictability and transparency of climate finance?
 3. How can tools such as the OECD Guidance on Transition Finance, or a common regional framework for taxonomies be useful for the LAC region?
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