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Progress with climate finance ahead of COP28 will be vital in 2023

One of the major themes for advancing climate mitigation and adaptation in 2023 will be the status and progress of climate finance. The years following the Paris Agreement in 2015 were marked by a sustained growth of capital allocation towards climate mitigation and adaptation,[1] with major innovations also in terms of financing instruments adopted to channel capital.[2] However, 2022 marked a major break in this trend with the focus of global policy-makers moving from long-term environmental governance to short-term energy and debt affordability, while investors became less interested in pro-environmental investments and more concerned about inflation, interest rate, and currency risks. While the current energy crisis is likely to increase the longer-term motivation to develop low-carbon energy sources, it has also highlighted that the costs of the energy transition and of limiting climate change are far higher than previously thought. As a result, in 2023 the challenges of navigating the current uncertain economic environment could undermine hope for any major innovations in climate finance, despite the fact that it will become increasingly clear that more finance is needed if the world is to get back on track to meet its climate goals.

Looking back at 2022, two main themes are particularly notable and whose consequences will be particularly relevant to monitor for 2023. First are the outcomes and consequences of recent international climate negotiations. A core objective of delegates at COP27, particularly those representing developing countries, was to bring the spotlight back onto the role of climate finance. The fact that COP27 was hosted in Africa gave major impetus for the host country to ensure this topic was high on the agenda, despite the major headwinds created by the energy and geopolitical crises in 2022.[3] The main achievement was the announcement, on the final days of the conference, of the commitment to set up a fund for loss and damage arising from climate change. While the announcement has huge significance and reiterates once again the principle of 'common but differentiated responsibilities'[4], the operationalization and actual financial commitments still need to be agreed with the details expected to be part of more complex negotiations between developed and developing countries in 2023 and during future COPs.

The second key issue for 2023 is whether there will be a recovery in the scale of climate financing, following a sharp decline in global issuance volumes in 2022 as a result of the global economic headwinds. Recent developments in instruments such as green bonds (and more generally Green,

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[1] Global investment in assets and projects directed to climate mitigation and adaptation reached USD 650 billion in 2022 alone according to IMF estimates. The International Energy Agency (IEA) estimated total investments between 2016 and 2020 averaged USD 1.5 trillion. See: "Net Zero by 2050. A Roadmap for the Global Energy Sector", 2021, https://www.iea.org/reports/net-zero-by-2050.

[2] For instance green and other thematic loans/debt market as well as carbon markets in its various forms. Green bonds grew as an important asset class in the same period reaching the milestone of USD 1 trillion of debt outstanding in 2021.

[3] Already ahead of COP27, developed countries had promised to meet their USD100 billion financing target, as agreed in COP15 in Copenhagen, by 2023 at the latest after a delay from 2020 due to the covid pandemic. Limited results have been achieved so far on that front.

[4] The 'common but differentiated responsibilities' in the United Nations Framework Convention on Climate Change acknowledges that developed economies carry a major responsibility in addressing the current climate crisis

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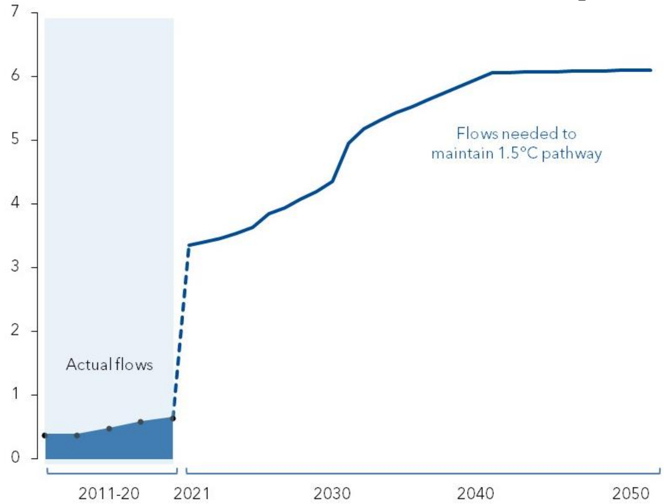
Social, and Sustainability Bonds collectively referred as 'GSS' bonds) and Sustainability-Linked bonds, have marked an important milestone in facilitating the allocation of capital towards projects and assets for climate mitigation and adaptation. However, the current global economic environment, with rising interest rates in major economies, has created major challenges for the ability of emerging countries to attract investors and repay current outstanding debts due to the sharp appreciation of the US dollar against other currencies. Against this background, multilateral development banks (MDBs) can play an important role in supporting risk mitigation and promoting financing structures for developing countries. While MDBs have historically mostly focused on private blended finance transactions, 2022 marked the first transaction in which the World Bank supported the de-risking of publicly-traded green bonds issued by developing countries.[5] The role of MDBs globally will be carefully monitored in 2023, especially as the need for change was actively discussed at COP27.

The global stocktake will also have significant implications for climate finance in 2023. It will review the performance of countries against their climate plans and will outline what is needed to achieve the 2050 climate goals, most likely highlighting the need to scale-up investments (and thus financing) towards climate mitigation and adaptation.

Current figures estimated by the IMF show a large gap between current commitments and the required scale. Only USD 630 billion were invested in 2022 compared to the need to achieve stable flows of investments of the order of USD 3 - 6 trillion between 2030 and 2050, see Figure 1.[6] With the total share of global financial assets at USD 470 trillion,[7] the main challenge that policymakers will face in 2023 and for the years ahead is how to shape incentives to direct capital towards climate mitigation and adaption assets and projects while navigating the current challenging economic and geopolitical environment.

Figure 6: Climate finance flows, actual and needed to limit warming to 1.5°C



Sources*:* Georgieva K., Adrian T., Global Landscape of Climate Finance 2021, Climate Policy Initiative, IMF, August 2022, https://www.imf.org/en/Blogs/Articles/2022/08/18/public-sector-must-play-major-role-in-catalyzing-private-climate-finance

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[5] https://pressroom.ifc.org/all/pages/PressDetail.aspx?ID=26688

[6] The International Energy Agency (IEA) estimates that in a net-zero scenario (NZE), investments in the global energy system need to increase from the current level of USD 1.5 trillion a year to USD 4.5–5.0 trillion a year between 2030 and 2050. Total investments range between USD 100 trillion and USD 150 trillion between 2020 and 2050. See: "Net Zero by 2050. A Roadmap for the Global Energy Sector", 2021, https://www.iea.org/reports/net-zero-by-2050.

[7] In 2020 total global financial assets exhibited strong growth in 2020, increasing by 11 per cent with the global non-banking financial Intermediation (NBFI) sector, constituting mainly pension funds, insurance corporations, and other financial intermediaries experiencing asset growth of 8 per cent, reaching USD 230 trillion. See: https://www.fsb.org/2021/12/global-monitoring-report-on-non-bank-financial-intermediation-2021/