

Bridging funding gaps for climate and sustainable development

Pitfalls, progress and potential

Exploring barriers and solutions to ‘unlock’ private finance, to support global agendas and a transition towards a sustainable low-carbon economy.

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Key messages

- Policy reform is required to more accurately value natural capital and incentivize green investments through aligned subsidies, supportive financial measures, and risk mitigation support.
- A centralized system that synthesizes evidence and connects projects to investors would both improve awareness of initiatives and funding sources, and build capacity and financial literacy.
- Key information gaps persist in reporting, monitoring and impact assessment. Leveraging a centralized system could reduce redundancies, enhance cost-effectiveness and bridge finance gaps.

Introduction

The ratification of the Paris Agreement and adoption of the SDGs have brought renewed focus to international challenges such as climate change and sustainable development. This attention has, in turn, piqued financiers’ interest in being involved in international discourses and actions to achieve and finance these global goals. While globally conceived commitments have been welcomed and almost universally supported, implementation and the fulfilling of such ambitious goals will present new challenges. One key challenge is how to bridge gaps between levels of finance required to achieve the agreed goals, and the levels of finance currently invested in climate action and sustainable development. The ‘unlocking’ of private finance to fulfill sustainable development commitments offers significant potential as a prevailing solution. The recommendations of this policy brief are based on a critical literature review of current mechanisms for financing sustainable development. We examine the extent to which current investment aligns with the figures regularly purported as required to fulfill global commitments (Clark et al. 2017). Our findings show a disconnect between global ambitions and financial realities, and that mechanisms by which such commitments will be fulfilled will likely require transformations across scales of geographies, policies, and economies.

Addressing shortcomings through reform and innovative collaboration

In a world where natural capital is often unpriced or undervalued, unsustainable resource exploitation inevitably remains both lucrative and normative. As such, without intervention, environmentally degrading activities will continue to dominate the economy. Regardless, there is clear and encouraging momentum from across a range of sectors towards globally conceived commitments for climate and development. Achieving such commitments, however, will require significant upscaling of financing, and in particular, enhanced private sector commitments. Our review reveals that although there is potential for upscaling finance, progress remains insufficient; persistent obstacles hinder private sector engagement. Significant barriers to bridging finance gaps were also identified, including: reliance on voluntary commitments, market failures, information gaps, short-termism, undervaluation of natural capital, and inconsistent, and often counterintuitive, policies that have created market environments that dis-incentivize wide-scale private investment in sustainable development (see Table 1).

Current mechanisms for mobilizing finance for sustainable development are diverse and expanding; however, the majority of funding continues to be dependent on government sources, including official

Table 1. Four key barriers to private investment

Barrier	Summary	Recommendations
Information gaps	Limited, non-existent, or asymmetrical information on the risks associated with climate change, leading to ill-informed decision-making.	Centralized information hub and convening body; Further research to collect empirical evidence; Leverage proven track record of development finance institutions (DFIs).
Short-termism	Preference to maximize short-term profits, undermining long-term investment decision-making.	Institutional and policy reform, recognizing the value and benefits of long-term investment strategies.
Undervaluing natural capital	Exploitation of natural resources due to undervaluation, leading to negative externalities (i.e. unpriced greenhouse gases, water pollution).	Policy reform to accurately value natural resources; Adoption of natural capital accounting (NCA).
Voluntary commitments	Reliance on voluntary commitments, which lack recourse and regulation.	Political and institutional reform; Regulatory reporting requirements; Legally binding agreements.

development assistance (ODA) and foreign direct investment (FDI). Across the range of mechanisms, we found consistent gaps between the amounts required to achieve global climate and sustainability agendas, and actual current investment (see Table 2¹). For example, total climate financing in 2014 reached USD 361 billion - yet after analyzing the national climate change commitments and policies in 21 emerging markets, the International Finance Corporation (IFC) forecasts that there will be approximately USD 23 trillion of climate investment opportunities between 2016 and 2030 in these markets (IFC 2016). Similar gaps exist within the SDG agenda, where required annual investment is an estimated USD 3.3-4.5 trillion for developing countries (OECD 2016) and USD 5-7 trillion globally (Almassy et al. 2015). However, total ODA in 2015 fell far short of this at approximately USD 132 billion (OECD 2016). Expecting such a shortfall to be picked up by the private, or indeed any other sector, is arguably misguided, and clearly represents the current disconnect between stated ambitions and reality.

Various studies aim to estimate the amount of funding currently directed towards specific actions, such as climate change mitigation or adaptation, as well as aiming to investigate existing gaps (Financial Stability Board 2016). However, information is lacking on the current scale of private investment flowing to landscape approaches, the forest sector, climate action, and environmental remediation, for example. This is due to an absence of

¹ This table provides a brief overview of some known current investments and how this relates to the global scenario. Despite certain comparisons being unfair (e.g. SDG row), even if we sum the 'current known investment' column there remains a significant shortfall to meet the global funding requirement for the SDGs. All figures are calculated on an annual basis (adapted from Clark et al. 2017).

coordinated and systemic efforts to collect information on investment flows, a lack of obligatory reporting requirements and insufficient overall transparency, making it extremely difficult to fully comprehend the current state of private financing and identify areas of potential opportunity (Castren et al. 2014).

Despite the lack of transparency, areas of potential do exist, for example leveraging of voluntary commitments, innovative partnerships, and collaboration and utilization of existing expertise, such as that of development finance institutions (DFIs) and other successful public-private partnerships. Despite apparent disconnects between investable projects and investors, DFIs (including multilateral, bilateral, and national banks) have become important sources of finance, with valuable expertise in advisory services and in-depth understanding of markets, policies and regulations affecting investment in sustainable development. Harnessing this momentum and further catalyzing private sector investment to transition to a low carbon economy is a fundamental challenge; institutional and political reforms, as well as improving collaboration to efficiently access and allocate limited funding, will be crucial to create an enabling investment environment for sustainable development. Such change is not only necessary, it is also potentially economically viable; this will however require enhanced political will that recognizes the limitations of planetary boundaries (Steffen et al. 2015). A recent 25-year forecast report by CitiBank compared the costs and benefits of a low-carbon future (action scenario) versus the business-as-usual path (inaction scenario). The report suggests a similar cost of investment in each of the scenarios, with the low-carbon scenario actually being a less costly

Table 2. Financing overview

Financing source/ objective	Current known investment	Private sector/ market contribution	Current investment relative to global scenario
Global climate finance	USD 361 billion (USD 131 billion from DFIs)	USD 141 billion	USD 1.6 - 3 trillion (required investment)
Sustainable Development Goals	USD 132 billion (ODA)		USD 5-7 trillion (required investment)
Conservation initiatives	USD 52 billion (based on total annual spend accurate at 2012)	USD 10.4 billion (USD 6.5 billion via green commodities)	USD 250-350 billion (required investment)
Green bonds	USD 118 billion (labeled green bonds)		USD 90 trillion (current global bond market)
Foreign direct investment	USD 1.23 trillion		USD 54 billion (1980 investment)

investment at USD 190.2 trillion as opposed to the USD 192 trillion investment in the business-as-usual scenario (Channell et al. 2015).

Despite obstacles and bleak outlooks for the scaling up of private finance, we have shown documented cases of positive momentum driving private sector investment. By identifying key barriers to the upscaling of private investment, we are able to provide select recommendations that we consider would expedite future progress.

Recommendations

1. Government and policy reforms, to create an enabling investment environment and move beyond voluntary commitments

- Reform policies to accurately value natural resources and environmental degradation.
- Incentivize the scaling up of private investment through aligned subsidies, supportive financial measures, and risk mitigation support.
- Address political risks and policies, including implementation of regulatory reporting requirements to improve transparency.

2. Develop an international convening body to synthesize evidence and connect projects and investors to resources

- Create a centralized resource to reduce redundancies through coordination of efforts, and provide a platform for information sharing, including a database of research, projects, investors, and advisory services.
- Improve awareness of initiatives, funding sources, and projects, and build capacity and financial

literacy to improve the financial system.

- Provide support networks, and identify collaboration opportunities.

3. Bridging finance gaps, through enhancing the cost effectiveness of projects

- Improve and upscale monitoring, reporting, and impact assessment to address information gaps.
- Leverage centralized information and convening body to improve coordination and communication between various actors and investors.
- Develop a strong evidence base for sustainable development projects.
- Generate concrete financial information using existing projects and investments, such as those made by DFIs.

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