

1 Introduction

Achieving low-greenhouse and climate-resilient development in developing countries requires a significant mobilisation of finance from all sources: public, private, domestic, and international. The estimated financing gap for climate action in developing countries is significant. International public climate finance needs to be deployed more effectively to accelerate and scale up the mobilisation of private finance. This chapter provides context for the report. It presents the global challenge, both in the context of the USD 100 billion climate finance goal and beyond, and the fundamental questions this report seeks to address – what are the barriers to private finance mobilisation, and what are the opportunities to overcome them? – and the report’s scope and methodology for answering them.

Global efforts to reduce greenhouse emissions and adapt to the impacts of climate change are off-track. Without a major, immediate course-correction, the goal of limiting the global average temperature rise to 1.5°C above pre-industrial levels will slip away (IPCC, 2023^[1]), with the crossing of climate change tipping points leading to catastrophic impacts on human life, nature, societies, and economies (OECD, 2022^[2]). Meanwhile, efforts to adapt to and build resilience against the impacts of climate change remain inadequate (UNEP, 2022^[3]).

Finance remains one of the most intractable barriers to accelerated climate action; but it is also an essential enabler. While governments and the private sector have ramped up investments in climate action in recent years, finance flows remain significantly below what is needed. The financing needs for climate action in developing countries¹ alone are estimated at USD 2.4 trillion a year between now and 2030; this requires a four-fold increase on pre-pandemic levels (Battacharya, Songwe and Stern, 2023^[4]).² These figures stand in stark contrast to the tens of trillions of capital globally, which could be tapped to close this gap (IPCC, 2023^[1]).

Meanwhile, significant public resources and private investment continues to flow towards business as usual. Civil society studies estimate that the world's 60 largest banks provided an estimated USD 742 billion of fossil fuel financing in 2021 (RAN, 2022^[5]), while official estimates indicate that fossil fuel subsidies in 51 major economies doubled from USD 362 billion in 2020 to USD 697.2 billion in 2021 (OECD and IEA, 2022^[6]). This underscores the urgency of rapidly accelerating efforts to make all sources of finance consistent with a pathway towards low greenhouse gas emissions and climate-resilient development, in line with Article 2.1c of the Paris Agreement (UNFCCC, 2015^[7]).

Given the scale of financing needs, and against the wider economic backdrop of constrained fiscal capacities and high indebtedness, combined with rising interest rates, governments will need to much more effectively tap private resources to finance climate action: between 2013 and 2020, it is estimated that public finance accounted for 70% of climate investments – including decarbonisation of energy systems and use, agriculture, forestry and other land-use, and adaptation and resilience – in developing countries (Songwe, Stern and Bhattacharya, 2022^[8]). In the context of the collective goal of developed countries to mobilise USD 100 billion per year for climate action in developing countries, USD 73.1 billion came from public sources in 2021, whilst only USD 14.4 billion was mobilised from the private sector³.

Significant barriers to private investment in climate action remain. Though all countries face these issues to varying degrees, risks – perceived and real – in developing countries are often deemed by investors to be prohibitively high relative to the prospective returns. Commercial investors face uncertainty around the direction of policy and the supportive measures required for investments in climate mitigation and adaptation, in addition to other long-standing, economy-wide and sector-specific issues that dampen private investment, which remain unresolved in many countries (Kreibiehl, 2022^[9]). Mobilising private resources at the pace and scale required to meet climate investment needs and wider sustainable development goals in developing countries will require a systemic shift in development finance to meet these challenges. Developed countries and multilateral climate finance providers have a key role to play.

Providers of international public climate finance recognise the need to improve their effectiveness in mobilising private finance in the context of the USD 100 billion goal (Ministry of Environment and Climate Change, Canada and Federal Foreign Office, Germany, 2022^[10]). Ahead of the *Summit for a New Global Financing Pact* in June 2023, a number of leaders underscored the importance of scaling up private capital flows to achieve development and climate goals (Le Monde, 2023^[11]), whilst the G20 has called for multilateral development banks to enhance private capital mobilisation (G20, 2023^[12]).

This report seeks to identify evidence-based action areas to increase and accelerate the mobilisation of private finance for climate action in developing countries, and the role of international public finance providers in doing so. It draws on best-available data to provide disaggregated analysis of the sectoral, geographic and other features of private finance mobilised by public climate finance (Chapter 2). It then explores some of the key economy-wide, climate action area-specific, and institutional challenges to

private finance mobilisation and, building on the data analysis presented in Chapter 2, sets out opportunities for international public climate finance to more effectively mobilise private finance (Chapter 3). In particular, the report identifies specific actions that can be taken to scale up private finance mobilisation. These span more effective use of context-specific blended finance instruments at the sector level, more tailored technical assistance to support the enabling conditions required for private investment, and the institutional, governance, and structural steps required to recalibrate the international development architecture towards mobilisation. Specifically:

- The remainder of Chapter 1 provides a brief overview of climate finance in the context of developing countries.
- Chapter 2 deep dives into trends in private climate finance mobilised by bilateral and multilateral public climate finance interventions, providing disaggregated analysis by climate action area, development actor, country income group, and within these, the role of different public finance mechanisms in mobilising private finance.
- Chapter 3 draws on the quantitative analysis in Chapter 2 as well as further empirical evidence to provide insights on barriers to the mobilisation of private finance towards climate action in developing countries and sets out opportunities for greater private finance mobilisation through public climate finance interventions. It explores: (i) policy, regulatory and wider constraints in recipient countries and their impact on investor perceptions and sentiment; (ii) specific constraints to private investment and possible solutions in two core climate action areas (clean energy, and agriculture and forestry); and (iii) the state of the multilateral development architecture and related constraints that limit private capital mobilisation.
- Chapter 4 draws on the challenges and solutions identified in Chapter 3 to set out recommendations for increasing and accelerating the mobilisation of private finance. It also sets out recommendations on wider steps beyond finance that climate finance providers and development practitioners can take to improve co-ordination on climate action within the international development architecture and its interaction with domestic actors, with a view to increasing private sector participation, as well as in-country enabling environments.

The action areas and underlying analysis presented in this report mainly address the mobilisation of private finance for climate change mitigation. The complementary OECD report – *“Scaling up adaptation finance in developing countries: Challenges and opportunities for international providers”* – examines options for scaling up adaptation finance in developing countries (OECD, 2023^[13]).

1.1. Climate finance for developing countries

1.1.1. Overview of current flows and needs of climate finance for developing countries

To achieve the 1.5°C temperature goal of the Paris Agreement whilst adapting and building resilience to the impacts of climate change, developing countries will need to draw on all sources of finance – public, private, domestic, and international – to be able to deploy an estimated USD 1 trillion per year by 2025 and USD 2.4 trillion per year towards climate investment by 2030 (Songwe, Stern and Bhattacharya, 2022^[8]). Along a similar order of magnitude, the nationally determined contributions (NDCs) of 153 developing countries are estimated to require a total of almost USD 6 trillion of investment up until 2030 (UNFCCC SCF, 2021^[14]).

Available estimates indicate that total finance towards climate action in non-OECD member countries³ from all sources (public, private, domestic, and international), were around USD 600 billion in 2020 (CPI, 2022^[15]) (Bhattacharya, Songwe and Stern, 2023^[4]), which falls significantly short of needs. According to these same estimates, the flow of finance in and to developing countries is uneven, both geographically and across sectors: 70% of the total investments in climate for developing countries were directed towards

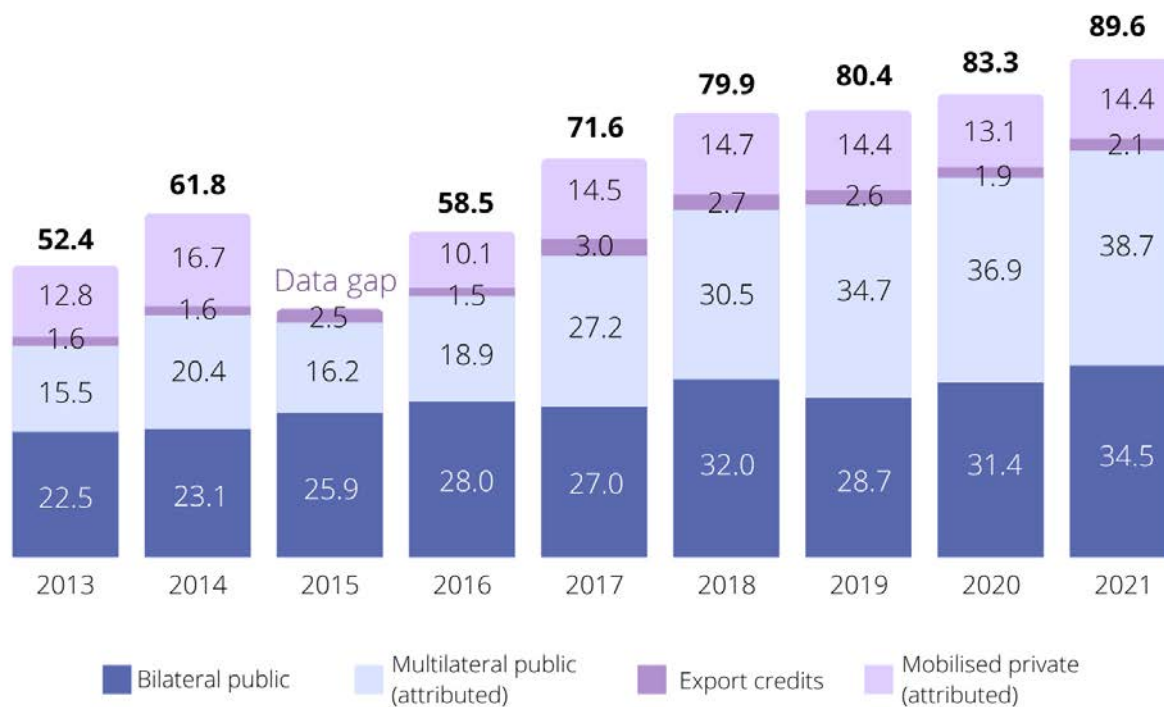
East Asia and the Pacific, while South Asia and Sub-Saharan Africa received a considerably smaller share. Across sectors and climate action priorities, most finance is concentrated in renewable energy and energy efficiency projects, while finance for adaptation and resilience accounted for only 25% of total climate finance in 2022 (CPI, 2022^[15]).

1.1.2. Climate finance provided and mobilised by developed countries in the context of the USD 100 billion goal

Though representing a small fraction of total climate-related investment needs in developing countries, climate finance provided and mobilised in the context of the USD 100 billion goal plays a crucial role in financing climate activities that would otherwise not be financed, building local capacity, as well as supporting the mobilisation of larger volumes of climate finance from other sources, notably the private and commercial sector.

In 2021, according to OECD figures, developed countries provided and mobilised a total of USD 89.6 billion in climate finance for developing countries (see Figure 1.1). Public climate finance accounted for the majority of the total between 2016 and 2021 and drove the year-on-year progress towards the goal. Private climate finance mobilisation proved to be challenging, stagnating between 2017 and 2019, dropping in 2020, and slightly recovering in 2021. Box 1.1 provides further context to the four climate finance components.

Figure 1.1. Climate finance provided and mobilised by developed countries for developing countries, 2016-21 (USD billion)



Source: Based on Biennial Reports to the UNFCCC, OECD DAC and Export Credit Group statistics, complementary reporting to the OECD.

Box 1.1. Climate finance components and attribution shares

In its exercise of tracking progress towards the USD 100 billion goal, the OECD identifies four different components of climate finance, with each component playing a different role in the context of supporting developing countries to address climate priorities (OECD, 2022^[16]):

- **Bilateral public climate finance** provided by donor countries' development finance agencies and institutions to developing countries to address climate change. It typically takes the form of grants and concessional loans to help developing countries implement climate change mitigation and adaptation measures.
- **Multilateral public climate finance** provided by multilateral development banks (MDBs) and climate funds to developing countries to address climate change, based on paid-in capital from bilateral public providers and, for some multilateral institutions, additional funds raised from capital markets. The support provided by MDBs and climate funds is typically larger than that provided by donor countries through bilateral channels, and is therefore often directed towards larger-scale climate change mitigation and adaptation projects.
- **Climate-related export credits** provided by developed countries' official export credit agencies for the sale of climate-related goods and services. Climate-related export credits are most notably used to help promote the deployment of clean energy technologies in developing countries, mainly renewable energy.
- **Private finance mobilised** by bilateral and multilateral public climate finance. Public climate finance can leverage private finance through risk mitigation instruments, such as guarantees and insurance.

Given the nature of the USD 100 billion goal climate finance accounted for in this context does not capture all finance for climate action in developing countries. Due to the geographical scope, the figures do not account for: (i) the share of multilateral public finance and mobilised private finance attributable to developing countries themselves; (ii) developing countries' domestic public climate finance; and (iii) bilateral public climate finance between developing countries in the context of the so-called "South-South" cooperation. Further, the figures presented do not include private finance catalysed by public policy interventions, for which there remains a lack of measurement methodology, nor private finance invested in the absence of public interventions altogether.

Note: Further technical detail on the methodologies used to calculate the attribution of multilateral public and mobilised private climate finance can be found in Annex A of (OECD, 2022^[17]).

Source: Authors.

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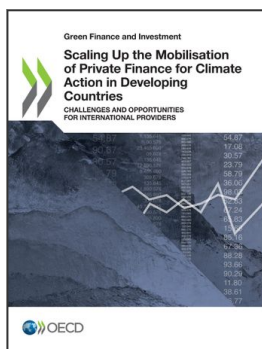
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Notes

¹ “Developing countries” refers to countries and territories included on the DAC List of ODA Recipients for 2018 development finance and/or on the non-Annex I list of Parties to the UNFCCC. This definition may not align with definitions and categorisations of developing countries in other literature, including that referenced throughout this report, and includes countries often referred to as “emerging markets/economies”.

² Estimates of needs are uncertain, while estimates of current flows partial. They should therefore be used with caution, and as providing indications rather precise and definitive assessments.

³ The OECD / non-OECD member countries categorisation is different to country groupings under the UNFCCC; for example, OECD member countries include Parties included on the UNFCCC non-Annex I list and vice versa.



From:
Scaling Up the Mobilisation of Private Finance for Climate Action in Developing Countries
Challenges and Opportunities for International Providers

Access the complete publication at:
<https://doi.org/10.1787/17a88681-en>

Please cite this chapter as:

OECD (2023), "Introduction", in *Scaling Up the Mobilisation of Private Finance for Climate Action in Developing Countries: Challenges and Opportunities for International Providers*, OECD Publishing, Paris.

DOI: <https://doi.org/10.1787/ecea4994-en>

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