Financing Climate Futures

RETHINKING INFRASTRUCTURE

Key messages

Aligning financial flows with low-emission, resilient development pathways is now more critical than ever to meet the goals of the Paris Agreement and deliver on the 2030 Agenda for Sustainable Development. Current energy, transport, building and water infrastructure make up more than 60% of global greenhouse gas emissions. Yet infrastructure has suffered from chronic underinvestment for decades, in both developed and developing economies. The OECD estimates that USD 6.9 trillion a year is required up to 2030 to meet climate and development objectives.

An unprecedented transformation of existing infrastructure systems is needed. The investment gap and the urgency of the climate challenge is a unique opportunity to develop infrastructure systems that deliver better services while protecting the environment and increasing resilience worldwide. Harnessing the benefits of rapidly emerging technologies, new business models and financial innovations will be key in opening new pathways to low-emission, resilient futures.

Mobilising public and private resources across the financial spectrum is an essential part of generating the trillions of dollars needed for sustainable infrastructure. Public finance institutions, banks, institutional investors, corporations and capital markets all have a crucial role to play, both in their own right and as part of the broader financial ecosystem. Governments need to set the right incentives to mobilise finance away from emissions- intensive projects, and provide investment and climate policy frameworks that support the rapid and radical transformations required.

While there has been some progress, current policies continue to foster an incremental approach to climate. Existing policy frameworks, government revenues and economic interests continue to be entangled in fossil fuels and emissions-intensive activities. Deeper efforts are needed to drive systemic change, overcome institutional inertia and break away from the vested interests that are often barriers to low-emission, resilient development.

Enhanced international co-operation, through the Paris Agreement or fora such as the G7 and the G20, is an essential part of the transformation: almost all G20 countries confirmed their willingness to embark on a global energy transition in line with climate and development goals in the 2017 G20 Hamburg Climate and Energy Action Plan for Growth. There is also growing awareness that the push for greater climate action must be accompanied by a just and inclusive transition to address inequalities and provide equal opportunities for all parts of society. Governments need to ensure that the transition benefits everyone and does not disproportionately affect the poor and most vulnerable.

This report lays out an agenda to enable societies around the world to undertake the kind of systemic actions that the transformation towards a low-emission, resilient future will require. It highlights 6 transformative areas and 20 actions that are key to aligning financial flows with climate and development goals in the areas of planning, innovation, public budgeting, financial systems, development finance and cities.

OECD BETTER POLICIES FOR BETTER LIVES

UN environment

WORLD BANK GROUP Climate Change

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1. Plan infrastructure for a low-emission and resilient future

Long-term strategies can be formidable tools for governments and non-state actors to create consensus on their economic trajectories, provide long-term signals to markets and inform near-term policy and investment decisions. Infrastructure planning must be improved at all levels of government to create pipelines of sustainable infrastructure projects aligned with long-term climate and development objectives. Priority actions include:

- Develop new institutional configurations to align infrastructure plans with a long-term low-emission, resilient development vision.
- Make resilience the norm to limit vulnerability to climate damages, mainstream nature-based solutions and demand-management tools into planning to ensure a resilient future.
- Future-proof infrastructure investment decisions through approaches such as strategic foresight to monitor emerging socio-economic and technological changes and regularly adjust long-term strategies.

2. Unleash innovation to accelerate the transition

To deliver the economic transformation required to address climate change, governments must accelerate the deployment of existing technologies, business models and services, and swiftly move the next generation of climate solutions from the lab to the market. To scale up climate solutions, governments should:

- Deploy targeted innovation policies to create and shape markets for climate innovations.
- Scale up public investment in research and development to create the next generation of climate solutions.
- Overcome the financial barriers to demonstration and early-stage commercialisation to bring existing technologies to scale.
- Promote international technology diffusion to ensure that innovation benefits all.

3. Ensure fiscal sustainability for a low-emission, resilient future

The power and influence of public budgets, if channelled towards climate objectives, can provide significant momentum towards building a low-emission, resilient economic future. In order to make meaningful progress on climate, there are four priority policy actions:

- Diversify government revenue streams to prepare for carbon neutrality in the long run, and reduce governments' exposure to incumbents and vested interests in fossil fuel technologies.
- Align fiscal and budgetary incentives with climate objectives to discourage emissions-intensive behaviours or investments by economic actors.
- Leverage public procurement practices and indirect spending through state-owned enterprises, development finance institutions, export credit agencies and public investments to align with climate objectives.
- Ensure an inclusive transition along the way, fostering public support for raising climate ambition.

4. Reset the financial system in line with long-term climate risks and opportunities

There is an urgent need to mobilise all sources of private finance to scale-up and shift infrastructure investment towards low-emission, resilient projects. An array of rules governing the financial system favours the status quo and stands in the way of the necessary reallocation of capital. Decision-making processes are distorted by inadequate climate risk pricing, capabilities and biased incentives in the investment value chain. The following actions will help move sustainable finance from momentum to transformation:

- Encourage the integration of climate impact into investment decisions and strategies to improve climate-risk management strategies.
- Incentivise the disclosure of climate-related risks and opportunities for investors to increase transparency in financial markets.
- Support financial supervisory authority to better assess and manage climate-related risks that could threaten the financial stability of the system in the short and long term.

5. Rethink development finance for climate

While many different actors will need to be mobilised to help address the sustainable infrastructure challenge, development banks and development finance institutions are critical, particularly in developing country contexts. But for these banks to play a transformational role, they need to do more to integrate climate into underlying development objectives, better align overall portfolios with the Paris Agreement and scale up efforts to unlock commercial investment. Development banks cannot do this alone – their activities are dependent on, and strongly influenced by, shareholder and client governments. Scaling up climate action requires governments and development banks to make three key changes:

- Strengthen development banks' mandates and incentives to deliver transformative climate action.
- Bring new investors and sources of finance to investments to create new climate markets.
- Use concessional finance to enable development banks to drive the transformation.

6. Empower city governments to build low-emission and resilient urban societies

Empowering local and city governments to plan and finance low-emission, resilient infrastructure is an essential part of achieving climate and development goals. The way cities expand and develop will determine the emissions of 70% of the world's population in 2050. Cities are particularly vulnerable to climate risks and must develop strategies that ensure urban resilience. The failure to invest in the right urban forms will put residents, the local economy and social cohesion at risk, potentially exacerbating existing inequalities. National and local governments should work together to pursue the following transformative actions:

- Rethink institutional configurations to integrate land-use and transport strategies and seize the immediate development benefits of low-emission, resilient planning.
- Align national and local fiscal policies to encourage and enable low-emission, resilient investments and behaviours.
- Build climate-related and project finance capacity in cities to efficiently finance and deliver complex low-emission, resilient infrastructure projects.
- Seize the social and economic benefits of low-emission, resilient planning to deliver inclusive urban growth.

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Six transformative areas to align financial flows with low-emission, resilient infrastructure

BUDGET
Disentangle public budgets from fossil fuel revenues

RESET
Reset the financial system in line with long-term climate risks and opportunities

INNOVATE
Unleash innovation in technologies, institutions and business models

RETHINK
Rethink development finance for climate

PLAN
Plan infrastructure for a low-emission and resilient future

EMPOWER
Build low-emission and resilient urban societies

Project background

The **Financing Climate Futures: Rethinking Infrastructure** initiative is a collaborative effort between the Organisation for Economic Co-operation and Development, the UN Environment and the World Bank Group. The initiative aims at helping countries move beyond an incremental approach to financing low-emission, resilient infrastructure towards the transformational agenda needed for decisive climate action.

The initiative, supported by the German Federal Ministry for the Environment, Nature Conservation and Nuclear Safety (BMU) was launched in response to an invitation from the 2017 G20 Hamburg Climate and Energy Action Plan for Growth to *"compile ongoing public and private activities within the G20 for making financial flows consistent with the Paris goals and, building on this, to analyze potential opportunities for strengthening these efforts"*.

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