E3G

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FINANCING CLIMATE PARTNERSHIPS

G7 SOLIDARITY AND INFRASTRUCTURE INVESTMENT

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The window of opportunity for keeping 1.5C within reach is closing. In 2022, the test will be whether emerging economies in particular are able to shift from heavily fossil-dependent development to low-carbon and climate-resilient development pathways. Yet the capacity of low- and middle-income countries to attract at-scale investment for a just transition is limited. There is growing interest in South Africa-style Just Energy Transition Partnerships – particularly amongst G7 members. To scale up these sorts of partnerships in 2022 and beyond will require a concerted movement to enable the financial architecture that can free up the trillions needed – for South Africa-style deals and keeping 1.5C in reach. This paper explores actions the G7 can take to unlock finance for climate partnerships.

Strategic context

Shifting trillions for 1.5C and the need for new finance amid COVID-19

The Glasgow Pact saw all parties recognise the need for accelerated action on finance: emphasising the need to mobilise climate finance from all sources to "significantly increasing support for developing country Parties, beyond USD 100

[1] This paper benefited from the insights and review provided by Camilla Bausch, Anthony Cox, Marianne Lotz, Leon Martini, Claire McConnell, Viviane Raddatz and Alex Scott; as well as discussions in the informal "G7 expert round".

billion per year" and calling on "multilateral development banks, other financial institutions and the private sector to enhance finance mobilisation in order to deliver the scale of resources needed to achieve climate plans"[2]. The challenge for 2022, particularly traditional finance provider countries and major shareholders of these international financial institutions, will be agreeing on what actions will be taken to mobilise affordable finance this year. Low- and middle-income countries (LICs and LMICs) must see improvements in both the accessibility and availability of finance to build their confidence that the transition can take place at scale, but the pathway to accessing affordable finance has been complicated for many by COVID-19 economic impacts and debt distress[3]. So far, G7 leaders have not deployed enough financial resources to address the COVID-19 crises, let alone begin to address the pre-existing structural challenges faced by the global economy[4].

South Africa Just Energy Transition partnership as a pilot and key example

The Just Energy Transition Partnership (JETP) with South Africa[5] was launched at COP26 in Glasgow. It has quickly galvanised interest in a possible new model for international replication on partnerships for coal phase-out, expansion of renewables and just transition, with an analysis in Foreign Policy going so far as to proclaim the South Africa deal "A New Model for Climate Progress"[6].

The Partnership with South Africa as it stands is a political declaration, and its success ultimately will depend on the implementation and further assurance of the initial USD 8.5 billion on specific financial terms. The $8.5 billion are currently intended to be delivered through a mix of grants, concessional instruments and risk sharing mechanisms to crowd-in private investments[7]. The quality of finance flows is as important as the scale. Additional non-concessional debt for the already debt-laden utility Eskom will not help South Africa's transition[8]. A significant share of the $8.5bn will need to be delivered in grant or concessional finance[9]. Just Transition finance must plug holes for innovative or new sectors that

[2] https://unfccc.int/sites/default/files/resource/cma3_auv_2_cover%20decision.pdf

[3] https://unfccc.int/sites/default/files/resource/cma3_auv_2_cover%20decision.pdf

[4] https://www.e3g.org/news/the-political-stars-have-aligned-but-are-not-shining/

[5] As part of **the deal**, Germany, France, the UK, the EU and the US committed to mobilise USD 8.5 billion over the next few years, covering power sector decarbonisation as well as economic diversification into future energy sectors, including electric vehicles and green hydrogen.

[6] https://foreignpolicy.com/2021/11/12/coal-climate-south-africa-cop26-agreement/

[7] https://ec.europa.eu/commission/presscorner/detail/en/IP_21_5768

[8] https://www.e3g.org/news/coal-in-2022-south-africa-s-just-energy-transition-partnership/

[9] https://www.e3g.org/news/coal-in-2022-south-africa-s-just-energy-transition-partnership/

existing **financial instruments** don't service. Further consensus is still needed on how to best resource and implement this Partnership, as well as any future such partnerships.

The approach piloted in South Africa relies heavily on concessional and grant equivalent finance provided by donors, but full implementation of South Africa's clean energy potential offers the opportunity to mobilise wider private investment. Political environments in G7 economies have not yet delivered the expansion of grant-equivalent budgetary donor spending consistent with the expansion of ambitions in country partnerships, and therefore the G7 will not be able to pursue country partnerships based wholly on concessional or grant-based pledging for the time being.

Recent analysis by the Grantham Institute extrapolates roughly $80 Billion would be the equivalent of a South-Africa style deal for India. Meanwhile, the overall annual investment needed for clean energy in emerging and developing countries is set to increase by a factor of seven, from $150 billion in 2020 to over $1 trillion by 2030, if the aim is to achieve net-zero emissions in 2050[10].

Finally, the South Africa deal benefited from the fact that the South African government largely designed the programme, and the Just Transition Fund which it hopes will be the main channel of the investment, itself[11]. But not all Lower-or Middle-Income economies will have the same capacity, or political capital, to navigate a complex international funding landscape on their own.

G7 opportunities & risks in 2022

Appetite for country partnerships is high across G7 countries[12] and coordinating a comprehensive approach to the development of climate partnerships for shifting trillions into the green transition in LICs and LMICs is a centrepiece of the German G7 presidency[13].

A G7 consensus was reached on partial aspects of this agenda through the launch of the **G7 Partnership for Infrastructure and Investment** in 2021. To follow up on

[10] International Energy Agency, World Bank and World Economic Forum (2021) Financing Clean Energy Transitions in Emerging and Developing Economies. IEA. **https://www.iea.org/reports/financing-clean-energy-transitions-in-emerging-and-developing-economies**

[11] **https://foreignpolicy.com/2021/11/12/coal-climate-south-africa-cop26-agreement/**

[12] See various interviews with G7 officials. Next to the big coal phase-down candidates (Indonesia, India at sub-national level and Viet Nam), **France announced to launch** a series of pilot projects with Senegal, Egypt, Ivory Coast, Kenya and Morocco.

[13]**https://www.g7germany.de/resource/blob/998352/2000328/6cb78b73c9f000183e69738c255d9cc9/2022-01-21-g7-programm-en-data.pdf?download=1**

this commitment the EU launched its Global Gateway with strong focus on partnerships with African economies[14]. At COP26 the United States, the European Commission and the United States issued a statement committing to "mobilise the trillions needed to meet net-zero 2050 and keep 1,5 degrees within reach" through a "new paradigm of climate finance spanning both private and public sources" of finance[15].

The new German government has put climate partnerships, alongside climate clubs[16] at the centre of its climate offer. However, the German G7 programme has so far given less clarity on Germany's commitment to deliver on the existing G7 Partnership for Infrastructure and Investment, or whether Germany will support the commitment to mobilise trillions for 1.5C[17].

Similar discussions on mobilising the trillions are also ongoing in the G20. The G20 International Financial Architecture Working Group (IFAWG), has been tasked to "explore ways to maximise MDBs' development impact, including through balance sheet optimisation measures and other options for increasing MDBs' development financing", while the Infrastructure Working Group has been asked to "develop a framework to best leverage sustainable infrastructure financing, particularly through mobilising private sector resources, to complement investment from other sources including public investment and finance provided by MDBs"[18]. However, while the G20 is creating the space to discuss these larger reforms to the enabling financial environment, neither G20 formats are doing so with a specific climate focus – leaving the opportunity for strong complementarity for a G7 willing to tackle the complementary climate and sustainable development elements of this larger financial reform agenda.

Given Germany's commitment to climate partnerships, this creates a unique opportunity for Germany to build on the existing G7 consensus on infrastructure investment and work with G7 partners and the Indonesian G20 presidency to

[14] https://ec.europa.eu/commission/presscorner/detail/en/fs_22_871

[15] https://www.whitehouse.gov/briefing-room/statements-releases/2021/11/02/u-s-president-biden-european-commission-president-von-der-leyen-and-uk-prime-minister-johnson-announce-commitment-to-addressing-climate-crisis-through-infrastructure-development/

[16] In August 2021, the German ministries published a white paper calling for an "alliance for climate, competitiveness and industry." The paper sketches out an initiative to overcome the risk of carbon leakage through close cooperation on industrial decarbonisation, coordinating carbon leakage measure and jointly creating lead markets for low carbon products. The ambition to create a club was subsequently reiterated in the new government's coalition agreement and has since become a central priority for the 2022 German presidency of the G7.

[17] https://www.g7germany.de/resource/blob/998352/2000328/6cb78b73c9f000183e69738c255d9cc9/2022-01-21-g7-programm-en-data.pdf?download=1

[18] https://www.bundesfinanzministerium.de/Content/DE/Downloads/G20-Dokumente/2022-02-18-g20-kommunique.pdf?__blob=publicationFile&v=7

develop the climate-focused elements of this investment agenda. This would allow Germany to complement the focus on climate alliances, reaching an agreement on concrete actions at the G7 Summit that would help unlock the trillions needed to underpin scaled-up South African style climate partnerships.

Pillars for Financing Partnerships

Different countries will need different forms of partnerships to meet their decarbonisation and resilience requirements. Each partnership will require a different combination of co-developed financial offers. These partnerships must be inclusive and should involve civil society actors to help build acceptance and ownership. The financial pillars highlighted below are not intended as stand-alone approaches, rather are intended to complement each other. It is possible that a combination of these approaches will be needed to deliver individual climate partnerships, and the combination and implementation of these will vary depending on the deal and particular country or regional context.

Beyond the need to step up public climate finance to close the USD 100 billion gap in 2022, it is clear that to shift from billions to trillions, stronger coalition-building is needed across developed countries, LICs and LMICs. Success in building these coalitions will determine whether investment in a better future becomes a reality – and whether there is broad enough support in the G20 and beyond on the necessary financial architecture to enable much greater public and private investment flows, including on climate. Under the German Presidency, G7 coordination on outreach to key partners can be an important first step. The G7 can establish its common plan for building coalitions outside the G7 and into the G20, to drive significant reforms to MDBs as well as national DFIs, in terms of Paris alignment and enhancement/scaling leverage of private investment – while instituting protections to ensure that maximising private finance mobilisation does not underprivilege key areas such as adaptation or certain profiles of countries.

Alongside significantly scaling up G7 public climate finance, this discussion paper proposes three pillars for G7 actions to unlock the financial underpinnings for partnerships:

1. Reforms and recapitalisations of development finance institutions
2. Unlocking private finance via new de-risking efforts
3. Catalysing wider investment via cooperation on finance platforms

Reforms and recapitalisations of development finance institutions

> One key avenue to unlock finance to support climate partnerships, particularly around energy transition infrastructure, is harnessing financial firepower from the world's development finance institutions (DFIs).

> Several multilateral development banks have committed to supporting just transitions to net zero as far back as the 2019 UNSG summit[19]. However progress remains slow. The World Bank is particularly coming under heavy criticism as being "missing in action" in efforts to update its existing portfolio to give greater priority to climate investments.

> **E3G analysis examining** past energy projects suggests that DFI funding for climate partnerships could be increased six-fold (from the current USD 7.4 billion to USD 43.5 billion) through reforms to MDB mandates to allow for better use of existing capital (i.e. using de-risking tools combined with more risk-tolerant capital offsetting). A deeper reform package combining full of portfolio alignment with the Paris Agreement, changes to risk management and a modest recapitalisation could increase funding eightfold to around USD 59.5 billion. But this would require a G7 decision to accept more risk tolerance in DFI balance sheets[20].

Unlocking private finance via new de-risking efforts

> The G7 can make progress in 2022 in operationalising a new strategic framework for unlocking the trillions of dollars held by institutional investors on behalf of sustainability-oriented saver consumers. Institutional investors are estimated to be able to close the USD 3.7 trillion gap required to reach the Sustainable Development Goals (SDGs) in the Global South through a shift of only 3.7% of their assets towards sustainable activities in developing countries[21].

> Despite the growing consumer drive towards sustainable investments through green bonds, green investment remains shallow in many emerging economies and risk-return profiles make it difficult for consumers to invest[22]. While globally over USD 754 billion in green bonds were issued from 2007 to 2019, for instance only a small share was issued in Africa and the LAC region[23].

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19 https://www.isdb.org/news/mdb-just-transition-high-level-principles

20 https://www.e3g.org/publications/closing-the-trillion-dollar-gap-to-keep-1-5-degrees-within-reach/

21 https://www.e3g.org/publications/closing-the-trillion-dollar-gap-to-keep-1-5-degrees-within-reach/

22 https://www.iea.org/reports/financing-clean-energy-transitions-in-emerging-and-developing-economies/executive-summary

23 https://www.climatebonds.net/files/reports/cbi_sotm_2019_vol1_04d.pdf

> One of the concrete issues that have held back the development of the green-bond market is that guarantees are currently excluded from OECD ODA accounting rules[24] unless these guarantees are activated[25]. However, changing ODA reporting rules could take several years to take effect.

Catalysing wider investment via cooperation on finance mobilisation platforms

> COP26 gave political hooks for new cooperation structures[26] but there are not currently any sustained formats to coordinate on investment mobilisation at scale. This gap can be addressed by establishing platforms at regional levels to bring together blended finance approaches. For example, using public finance to de-risk new opportunities in infrastructure investment that can attract sustainably oriented institutional investors.

> In launching the G7 Partnership for Infrastructure and Investment (PII) in December 2021, G7 leaders agreed to establish "regional and country-owned platforms" as match-making mechanisms "supporting developing and emerging market economies to develop and deliver their pandemic recovery, sustainable development and climate plans; and matching finance to these plans, backed by our coordinated support"[27]. In the same statement, G7 leaders also agreed to work together within the G20 to operationalise country platforms.

> As a first step, these platforms work to address barriers to investment up and down the investment value chain, analysing public finance needs and potential for private investment. In the medium term, these platforms could be resourced to help countries develop and gain political attention to support an investible pipeline of projects over the next decade.

> Regional platforms can also be an opportunity to significantly scale up green capital markets by creating architecture with innovative risk mitigation measures that can help attract the capital of sustainably oriented savers into developing country infrastructure. These could bring increased funding into existing country platforms where they exist, such as in South Africa, and also serve as trusted intermediators for future country packages in countries including Pakistan or India.

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[24] https://www.oecd.org/development/stats/What-is-ODA.pdf

[25] https://9tj4025ol53byww26jdkao0x-wpengine.netdna-ssl.com/wp-content/uploads/Closing-the-trillion-dollar-gap-to-keep-1.5-degrees-within-reach_E3G-report.pdf

[26] https://www.governo.it/en/articolo/pm-mario-draghi-s-address-cop26-world-leaders-summit-opening-ceremony/18441

[27] https://www.g7uk.org/g7-leaders-statement-partnership-for-infrastructure-and-investment/

> Aligned G7 action could support moving from discussions to operationalisation of platforms that focus on just energy transition and sustainable and climate-resilient development pathways.

For Discussion: 2022 G7 Outcomes that would unlock finance for South-Africa-style partnerships

What can be done "inside" the G7 structures?

> **Develop and communicate a shared political narrative in G7 communiqués, reinforcing a commitment to shift trillions in public and private finance in support of sustainable and climate-resilient infrastructure in LICs and LMICs**. This should be underpinned by a strong commitment to financing domestic green energy sector transitions, strengthening the 2021 G7 agreement to achieve 'overwhelmingly decarbonised energy systems in the mid-2030s' to 'having a zero-emissions power sector by 2035'.

> **Agree on a standing coordination approach that can help G7 counties collectively and individually raise and deliver finance for climate partnerships ahead of, and beyond, COP27.** This could take the form of a **task force or standing dialogue space, bringing together Leaders' offices with senior climate, finance and development officials from G7 countries.** Such a task force could also offer space to coordinate financial resources and agree on how investment might be delivered through existing initiatives (Global Gateway, B3W, Clean and Green, Quality infrastructure).

> Work out outstanding issues on the collective mobilisation ambition of the G7 to shift trillions and build a robust accountability architecture to ensure that investments follow a high-standard approach and include the guarantees needed to expand.

What could be done through greater coordination of G7 efforts (in their bilateral outreach, in the G20, in international institutions)?

> **Working with MDBs, national development banks and other IFIs, prioritise the launch of a small set of regional finance mobilisation platforms in 2022 that can develop investment opportunities for low carbon technology assets and match public and private finance with pipelines of low-carbon technology projects.** These platforms could work closely with existing capacity-building and technical assistance formats like the NDC Partnership.

> **Make a major G7 move with a new framework and commitment on guarantees and risk-mitigation instruments to massively scale-up green capital markets and attract private capital, particularly from institutional investors.** This would facilitate access to relatively less expensive sources of funding for developing economies and ensure that infrastructure in developing countries can become an investible asset class for climate-aware investors. A first step could be developing aligned options to bring to upcoming G20 seminars and discussions on helping developing countries mobilise and improve access to sustainable private finance.[28]

> Beyond a transactional "partnership" or "deals" like the South Africa example, the G7 can **commit to working with partner LICs and LMICs to develop long-term NDC investment plans and financing strategies** (e.g., working with the NDC Partnership).

> **Work together to champion reforms that will better leverage and recapitalise development finance institutions (e.g., via the G20 Sustainable Finance and International Financial Architecture Working Groups).** This can involve aligned engagement of the G7 and partners in the G20 heading into World Bank/IMF Spring and annual meetings, as well as clear timelines for MDB recapitalisation, and concrete steps to align these with a broader global ecosystem of public banks to support the transition.

About E3G

E3G is an independent climate change think tank with a global outlook. We work on the frontier of the climate landscape, tackling the barriers and advancing the solutions to a safe climate. Our goal is to translate climate politics, economics and policies into action.

E3G builds broad-based coalitions to deliver a safe climate, working closely with like-minded partners in government, politics, civil society, science, the media, public interest foundations and elsewhere to leverage change.

More information is available at **www.e3g.org**

[28] **https://www.bundesfinanzministerium.de/Content/DE/Downloads/G20-Dokumente/2022-02-18-g20-kommunique.pdf?__blob=publicationFile&v=7**

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