UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

Making sense of Article 2.1(c)

What role for private finance in achieving climate goals?

Report Summary

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MAKING SENSE OF ARTICLE 2.1(C): WHAT ROLE FOR PRIVATE FINANCE IN ACHIEVING CLIMATE GOALS?

Aligning the whole financial system, encompassing public and private financial flows at the domestic and international level, with a “pathway towards low greenhouse gas emissions and climate resilient development,” as stated in Article 2.1(c) of the Paris Agreement (PA), is fundamental to limiting global warming and supporting the development ambitions of developing countries.

The scale of resources managed by private financial actors that are not flowing towards productive, development-enhancing, climate goals implies an additional urgency for Parties to consider ways to discipline private finance in line with Article 2.1(c). Inadequate accountability for the current net zero claims of such financial actorscan fuel unrealistic expectations for mobilising private finance undermining the necessary scaling up of climate finance.

The Sharm el-Sheikh dialogue was launched at COP27 to enhance understanding of the scope of Article 2.1(c) and its complementarity with Article 9, the provision of climate finance from developed to developing country Parties.[1] This report responds to the ongoing dialogue with a particular focus on the role of private finance, proposing recommendations to Parties on the key actions they can take to deliver the ambitions of Article 2.1(c) while upholding commitments on the basis of equity and the principle of common but differentiated responsibilities and respective capabilities in light of different national circumstances (CBDR-RC).

Key Messages

Developed countries must take the lead in Article 2.1(c) implementation

It is crucial to apply a whole-of-Article 2 approach to the scope and operationalization of Article 2.1(c). Article 2.2 reflects the foundational principles of equity and CBDR-RC under the Convention, recognizing the historical responsibility of developed countries.

To this end, developed countries must take the lead in implementing stronger incentives and disciplines in their jurisdictions for finance flows to align with climate goals, and must take every precaution to avoid unintended negative consequences on the needed policy space in developing countries for transition and climate-resilient development. This is imperative not only because of outsized responsibility of developed countries to move at a faster pace towards mitigation goals, but also because they host the major financial actors which continue to profit from the biggest emitting sectors in the world.

A one-size-fits-all approach will not deliver for the diverse needs and circumstances of developing countries, who need to move at an ambitious but different pace and scale. As financial markets shift, it is incumbent upon standard-setting bodies at the national and international level to ensure that the playing field is not tilted against developing countries, avoiding excessive policy conditionalities and top-down agendas which do not respond to national circumstances, transition needs or

1. UNFCCC (2015). Paris Agreement. Available at https://unfccc.int/sites/default/files/english_paris_agreement.pdf

poverty-eradication ambitions. It must be emphasized that developing country experiences must be central to Article 2.1(c) implementation to avoid undermining development goals, including, for example, acknowledging that fossil-fuel dependent economies will need additional support and flexibilities to achieve their just transitions.

Pro-active, market-shaping strategies are needed to align private finance with Article 2.1(c)

Measures to decarbonize private financial flows have so far resulted in piecemeal or voluntary commitments from major financial institutions and institutional investors in developed countries who also continue to be the biggest financiers of fossil fuels. There are also persistent issues with public policy approaches which focus only on market-led mechanisms such as risk-disclosure, carbon pricing, ESG frameworks and green taxonomies. These are designed to nudge investors out of high-emissions and into green investments, but since prospective profits not prices are, ultimately, what drives investment decisions, these efforts are not getting the impact the world needs as long as high emitting sectors are immensely profitable.

The alternative to a market-led, 'derisking' strategy is a 'market-shaping' role for public policy, underpinned by policy coordination across fiscal, industrial, trade and financial measures, involving robust regulatory mechanisms for disciplining financiers of high-emitting assets[2], and establishing a clear trajectory for capital allocation in alignment with green transition plans which in turn encourages an orderly transition by creating certainty for private sector actors.[3]

Aligning private finance with Article 2.1(c) will not solve the outstanding climate finance deficit, which requires scaled up public contributions

Even by conservative estimates, annual financing for climate goals is orders of magnitude too low. According to UNFCCC analysis, delivering less than half of developing countries' NDCs will cumulatively amount to around $6 trillion by 2030.[4] Before the pandemic, UNCTAD estimated that delivering both climate and development goals demanded closer to $2.5 trillion of annual financing – a number that will have surely risen thanks to ongoing economic shocks, inadequate financial support and delayed climate action.

At the same time, advanced economies have not met their collective goal to deliver $100 billion in annual climate financing and have consistently failed to meet the 0.7 per cent Official Development Assistance target, while at times double-counting these financial flows and delivering most climate finance as debt. Bilateral financing in general has significantly slowed, while according to the UNFCCC, private finance mobilization has severely underperformed when compared to past predictions.[5]

Rather than just relying on the voluntary and uncertain alignment of private finance to resource just transitions, developing countries need a significant increase of targeted public finance support to

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2. Kedward K et al (2022). Aligning finance with the green transition: From a risk-based to an allocative green credit policy regime. UCL Institute for Innovation and Public Purpose, Working Paper Series (IIPP WP 2022-11). Available at https://www.ucl.ac.uk/bartlett/publicpurpose/wp2022-11.
3. Idem.
4. UNFCCC (2021). First Report on the Determination of the Needs of Developing Country Parties. Available at https://unfccc.int/topics/climate-finance/workstreams/needs-report
5. UNFCCC (2022). Report on progress towards achieving the goal of mobilizing jointly USD 100 billion per year to address the needs of developing countries in the context of meaningful mitigation actions and transparency on implementation. Available at https://unfccc.int/sites/default/files/resource/J0156_UNFCCC%20100BN%202022%20Report_Book_v3.2.pdf

break the climate investment traps of chronically insufficient funding and develop publicly-owned, low-emissions infrastructure in countries where the private sector is currently unwilling to go.

This implies a much bigger, upfront role for public finance support, whether from contributor countries or multilateral sources. This will be key to any hope of successfully mobilizing private sector capital as part of Article 2.1(c) implementation, particularly towards mitigation efforts and the energy transition.

To achieve the development dimension of Article 2.1(c), parties must move beyond piece-meal, ineffective tinkering to wider, systemic reforms in global economic governance

Article 2.1c of the Paris Agreement calls on "making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development." It is crucial that Parties do not forget this obligation to the development dimension of climate goals when attempting to align financial flows with climate-related needs.

Since even before the onset of the pandemic, many developing countries have been struggling to achieve their climate and development goals: saddled with expensive debt that squeezes the fiscal space they need to invest in resilience, grappling with barriers to the developmental pathways necessary to diversify and transform their economies, and swimming against the tide of boom-bust flows from crisis spillover effects they have little power over. The financial system of today has brought great prosperity for a few, but it has also turbocharged inequality between and within countries, overseen the acceleration of volatile financial flows, and diverted productive investment into speculation and profiteering.

The inadequacy and injustice of this system is emphasized by the central paradox of the climate crisis: that those least responsible continue to pay the highest price. Indeed, the COP27 outcome text highlighted that tackling climate change will require a transformation of the financial system and its structures and processes. This recognizes that underpinning the successful delivery of adequate financing is an enabling multilateralism, equipped with the governance and institutional norms, practices and regulations necessary to respond to contemporary challenges and drive climate-resilient development.

UNCTAD has long called for a transformation in global economic governance such that finance flows can be shifted towards development goals – whether through improving debt resolution outcomes, expanding financing for public development banks, allocating Special Drawing Rights' for development ends, reforming Credit Rating Agencies and other market-makers to work with rather than against development, reforming governance to better represent developing countries, or improving coordination to tackle illicit financial flows. While many of these initiatives are outside the scope of the UNFCCC, implementing Article 2.1(c) relies on all Parties working together to build consensus on a transformative agenda for the global financial system.

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