PAYNE INSTITUTE COMMENTARY SERIES: **COMMENTARY**

Governments' Recent Steps to Advance Climate Impact; Select World Investment Forum Highlights

By Brad Handler

The 8th World Investment Forum, sponsored by the United Nations Conference on Trade and Development, was held October 16-20 in Abu Dhabi, UAE. WIF, which had over 7,000 attendees from 160 countries, focused on spurring sustainable development across low and middle income economies. The Payne Institute's Sustainable Finance Lab contributed, leading discussions on the climate opportunity and the implementation considerations of retiring fossil assets.

WIF highlighted the multi-US$ trillion annual investment need to decarbonize the planet while also fulfilling the UN's Sustainable Development Goals (SDGs) by 2030. Speaker after speaker made clear that private capital would have to comprise the lion's share of such spending, with governments providing the enabling environments to foster that private investment.

The challenges loomed large, as speakers noted that not only were absolute spending levels far short of what was needed to be "on track" to meet energy transition and SDG targets, but that recent spending in the developing world was far too concentrated in select economies.

And yet, sessions included evidence of a will to act as well as specific government and government partnership actions that might spur more spending. There was much discussion of these government activities is three areas throughout the event: World Bank reform, Just Energy Transition Partnerships, and carbon market development.

WORLD BANK REFORM

WIF came on the heels of the World Bank (WB) annual shareholders meeting, during which World Bank governors approved a package of reforms. The WB's reform objective is to reshape its lending/support to include climate change and protecting natural resources. It is also seeking to raise its lending (and private capital mobilization) capacity while bringing in more incentives and flexibility for countries to invest in climate mitigation and handle the impacts of climate change. Finally, it seeks to integrate a country-wide focus as opposed to a strictly project one.

In terms of raising the WB's lending capacity, some steps to had already been enacted earlier in 2023, including reducing its required equity-to-loan ratio by 100 basis points to 19%. The shareholders meeting, however, included the rolling out of "hybrid capital", a form of junior, i.e., subordinated, debt that may be convertible to equity. Germany was the first country to announce a hybrid capital contribution (€305 million); France, Canada and the Netherlands have also signaled their interest in contributing. The World Bank has estimated that hybrid capital could foster a 6-10x multiple of private investment/lending. In total, the WB avers it has raised its lending capacity by over US$150 billion through its reforms and new mechanisms.

Beyond lending capacity, the WB reform also includes the possibility of giving recipient countries more flexibility to deal with natural disasters, for example by suspending their debt repayments. The WB has indicated it will begin piloting this option for small states that are particularly affected by climate change. And the WB is considering elongating loan tenors to 35-40 years, a portfolio guarantee program, and "reduced rates to incentivize exiting from coal as part of energy transitions."

Finally, leading WB shareholders also highlighted non-lending/facilitating steps such as technical information sharing. To name just one example, an attending representative from the German Federal Ministry for Economic Affairs noted Germany's 30 "Energy and Hydrogen Partnerships," bilateral agreements with other countries to address renewable energy (RE) expansion, power systems integration, energy efficiency, climate instruments such as carbon pricing, social dimensions of the transition and energy security.

JUST ENERGY TRANSITION PARTNERSHIPS

There was strong support for the potential of Just Energy Transition Partnerships (JETPs) to catalyze private investment. JETPs, introduced in 2021 and since formalized with South Africa, Indonesia, Vietnam and Senegal, are country-wide programs developed by the host country to transition to clean energy and spur economic development. As part of the JETP programs, International Partner Groups (IPGs) have agreed to provide specific financing amounts to JETP countries. These funds are to be matched by private financial institutions; for example, Vietnam's US$15.5 billion, three-to-five year commitment is ½ coming from its IPG and ½ from large banks in the Glasgow Financial Alliance for Net Zero (GFANZ) Working Group.

For South Africa, a representative of the country's Presidential Climate Commission told the audience that a domestic study had verified that its JETP was already helping to spur local private investment, with an uptick seen versus three years ago. The study recorded that 82.5% of the country's investment had been financed with local sources. The representative noted further his believe that local commercial banks are looking at more projects and seem open to taking more risk because of the national government commitment to the transition, expressed through the JETP investment plan and elsewhere.

Indonesia's Director General of New Renewable Energy explained that the (investment) planning process associated with its JETP is helping the country to raise their decarbonization ambition. He cited the country's higher Nationally Determined Contribution target rising to 358 million tons of CO_2-equivalent at the end of last year, raised from its initial 314 million tons, and that even higher ambition for carbon reduction could be announced next year. As has been said publicly, the country's formal investment plan is still being deliberated within the government; it is hoped it can be released by COP28.

As an aside, the Indonesian government representative as well as representatives from the Asia Development Bank that attended the conference noted that work continues to finalize the first Energy Transition Mechanism (ETM)-backed plan: to retire the Cirebon 1 coal plant in Indonesia.

Within the context of JETPs and the ETM, several conference participants noted the lack of approved country-level taxonomies specifying that financing coal plant retirement could be considered "green." Taking that further, one panelist noted that some of the IPG commitments to the JETPs only allowed for RE. With that said, a panelist from GFANZ mentioned progress by members in developing internal policies that can allow them to lend to coal plant retirement/decommissioning schemes (in line with recommended principles). The GFANZ representative also mentioned that member institutions had, to some degree, also made progress with policies for financing schemes in which the coal plant might be kept in reserve to be used only for energy flexibility/security.

CARBON MARKETS

Event speakers consistently supported carbon markets as a mechanism to foster capital formation. This included support for (voluntary) carbon offset crediting, albeit with the understanding that the integrity of any offsets must adhere to solid principles. As the Sustainable Finance Lab has discussed previously, host country UAE has committed to fostering carbon market development (within the UAE, for example in sponsoring the world's first regulated market, and in developing economies) and a COP28 Presidency representative at WIF detailed the ambition to finalize an "end-to-end" framework of integrity at the upcoming COP.

A carbon markets panel included representatives from newly forming carbon markets in Egypt and Greece, as well as from Saudi Arabia, which has hosted two auctions for carbon offsets using its Public Investment Fund as a market maker. All the panelists were enthusiastic about markets' potential, yet it is also clear that the new exchanges are bringing a "walk before you run" mentality.

This slower start includes some carbon markets starting with an in-country-only approach. Countries, including Indonesia, have allowed only domestic entities to be buyers, in part until terms are agreed for cross-border/corresponding adjustments of carbon emissions (as contemplated in Article 6 of the Paris Agreement). Panelists noted that having every country with its own exchange is less efficient and less liquid than a single market. (With that said, at least one observer from ACX noted a silver lining: the company's digital trading architecture can link the various markets, once enabling country policies are in place.)

If there is a thread connecting these three areas, it is that countries are increasingly asserting control over decarbonization. Energy transitions present a set of opportunities, based on countries' respective natural resources and skills, and risks, both socioeconomic and physical. Countries are indicating that both opportunities and risks are best addressed by industrial policy that they themselves develop and manage. It is only through that structure that they looking to rich countries to help them with funding.

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ABOUT THE AUTHOR

Brad Handler
Payne Institute Program Manager, Sustainable Finance Lab, and Researcher

Brad Handler is a researcher and heads the Payne Institute's Sustainable Finance Lab. He is also the Principal and Founder of Energy Transition Research LLC. He has recently had articles published in the Financial Times, Washington Post, Nasdaq.com, Petroleum Economist, Transition Economist, WorldOil, POWER Magazine, The Conversation and The Hill. Brad is a former Wall Street Equity Research Analyst with 20 years' experience covering the Oilfield Services & Drilling (OFS) sector at firms including Jefferies and Credit Suisse. He has an M.B.A from the Kellogg School of Management at Northwestern University and a B.A. in Economics from Johns Hopkins University.

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