

Staying the course on decarbonisation

Scaling up climate finance and greater follow-through on global green funding initiatives for developing economies are needed to achieve net zero by 2050. BY BHAVYA GUPTA AND RAMKISHEN S RAJAN

THERE are signs that the global inflationary surge is gradually tapering off – the belated but aggressive monetary policy tightening by the Federal Reserve and other central banks worldwide, coupled with an easing of some of the transitory forces fuelling higher price growth globally.

However, other more structural factors – encapsulated by three Ds – could contribute to some inflation persistence over the medium term. The first among these are concerns about decoupling, if not outright deglobalisation, due to the ongoing tech cold war between the US and China. As firms build redundancies in their supply chains in response to a more uncertain geo-political environment, these increased costs will inevitably feed into higher consumer goods prices.

Second, the changing demographics – particularly declining labour force participation rates across advanced and many middle-income economies, along with a discernible shift in the labour-leisure trade-off of workers post-Covid and choices on the type and quality of work – could keep labour markets tight, with rising wages in excess of productivity growth being absorbed by increased prices.

Third, the ongoing (and much needed) decarbonisation drive is expected to be inflationary over time, due to sharply higher fossil-fuel-driven energy prices but also because of more expensive renewable energy inputs, that is, the so-called “Greenflation”.

Climate geopolitics and finance

Greenflation is the result of a supply-demand mismatch of critical green metals (such as copper, nickel, graphite, lithium, rare earth metals, to name a few) needed for the large-scale decarbonisation and electrification of economies. The World Bank estimates that the production of critical minerals like lithium, cobalt and graphite could increase by 500 per cent by 2050 to meet the demands of the clean energy transition.

Apart from a need to scale up the global supply of these critical metals by setting up new mines and mineral exploration projects, the International Energy Agency has raised concerns about the supply concentration of these metals in a handful of countries. China, in particular, controls the lion's share (80-90 per cent) of the production and processing of rare earth metals, 60-70 per cent of the global refining capacity of lithium and cobalt, 70 per cent of the production capacity for manufacture of electric vehicle batteries, and 80 per cent of all manufacturing stages of solar panels.

In a more bifurcated world, this excessive geographic concentration of global metal supply chains adds to the geopolitical risks in the clean energy transition which could delay the scale and pace of the transition process itself.

Beyond this resource geo-politicisation of critical metals, the transition to net zero requires substantial public and private financing. This includes both green financing to support new environment-friendly and low-carbon industries and activities, but also transition finance to help today's supposedly “dirty industries” become greener over time.

Estimates vary widely based on the climate scenarios used, but studies by the Citigroup and McKinsey highlight a 30-40 per cent current shortfall in finance required for a green transformation.

With the bulk of the funding to date having originated from the public sector (governments, state-owned banks, and multi-



Smoke rises from chimneys at the Suralaya coal power plant in Cilegon, Indonesia. A US\$20 billion deal was announced on the sidelines of the G20 Summit in Bali, Nov 2022, to wean Indonesia off coal. PHOTO: AFP

lateral development banks), there is an urgent need to crowd-in the private sector to help “close the funding gap on climate change initiatives in developing countries”, as International Monetary Fund managing director Kristalina Georgieva put it.

Scaling up private climate finance

The most notable private sector initiative thus far, the Glasgow Financial Alliance for Net Zero (GFANZ) launched by former Bank of England governor Mark Carney in 2021, aimed to mobilise US\$130 trillion from global financial institutions to cut carbon emissions at the COP26 summit in Glasgow last year. However, its commitments have been diluted progressively, with members refusing to agree to halting all fossil fuel-related exploration projects, criticisms over greenwashing, and a recent potential exodus of the biggest US financial participants over rising legal liability concerns.

More generally, the role of private sector finance in funding clean energy projects has thus far been inhibited by large upfront costs, the un-bankability of projects (high risks in green projects not perceived as being consistent with expected returns), gestation lags, and ambiguity on definitions, lack of data and proper disclosures.

It is often suggested that multilateral development banks (MDBs) and governments can spur private capital via blended finance by providing risk underwriting and/or seed capital to private investors, thereby improving the risk-return profile for green ventures, particularly in developing countries. However, it is important to point out that while the idea of blended finance looks appealing in theory, its takeup has been subdued in the decade since it was first floated in late 2000s.

Several factors have contributed to this slow pace of progress, including the institutional set-up of MDBs, which is tilted towards grant-making as opposed to leveraging public funds for blending, and the difficulty in finding viable projects in developing economies.

Additionally, private financiers and institutional funds have been reluctant to participate in blended finance initiatives partly owing to the lack of transparency about the past record of such projects. Greater innovation in the use of this financing instrument along with a dissemination of best practices among stakeholders may help boost its uptake going forward, though optimism should be tempered.

Equitable green transformation

While unlocking private capital for climate finance is crucial to put the world on a path

to net zero by 2050, it is important to acknowledge the acutely uneven distribution of these funding opportunities across developed and developing economies.

In this regard, the recently concluded COP27 “implementation summit” in Egypt, while disappointing on various other counts, managed at least to carve out a last-minute agreement for setting up a “loss and damage” fund for developing economies by the developed world.

Regarded as the third stop-gap in climate negotiations after mitigation and adaptation, the fund aims to pool resources from advanced economies, whose early high-emissions development trajectory contributed to much of the climate change we see today.

These funds are to be used to provide compensation to developing countries hit by the adverse effects of climate change, such as extreme-weather events.

While this initiative is timely and much needed, details pertaining to the amount of funds to be committed and by which donor countries remain to be worked out. There is also understandable scepticism on its follow-through and potential effectiveness, since the last declaration by developed countries to mobilise US\$100 billion annual finance to developing economies more than a decade ago remains largely unmet.

Slightly more under the radar but more substantively, leaders of the advanced economy G7 grouping have initiated financing to developing economies under the Just Energy Transition Partnerships (JETP) to fast-track their emissions reduction targets. During the recent G20 summit in Bali, a US\$20 billion package (over the next three to five years) was announced to Indonesia under this scheme.

Similar such assistance under the JETP was announced earlier for South Africa in 2021 through a mix of concessional loans, grants, and private investments, while others are being explored for India (the next G20 host) and Vietnam to accelerate deployment of renewable energy in these countries.

While these initiatives are welcome, their effectiveness can be enhanced by ensuring greater transparency on the specifics of the partnership and better engagement of civil society in their design and implementation.

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