

Seeking Synergy Solutions

A New Financial System to Enable
Both Climate and SDG Action



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The Centre international de recherche sur l'environnement et le développement (CIRED) is an interdisciplinary research laboratory at large economic dominant. The work of CIRED is devoted to the study of the relationship between modes of economic regulation and the genesis of the technical universes that structure the relationship between human activities and the natural and constructed biophysical environment. www.centre-cired.fr/en



Climate Policy Initiative (CPI) is an analysis and advisory organization with deep expertise in finance and policy. Its mission is to help governments, businesses, and financial institutions drive economic growth while addressing climate change. Its vision is to build a sustainable, resilient, and inclusive global economy. www.climatepolicyinitiative.org



International Institute for Applied Systems Analysis (IIASA) is an international research institute that advances systems analysis and applies its research methods to identify policy solutions to reduce human footprints, enhance the resilience of natural and socioeconomic systems, and help achieve the Sustainable Development Goals. <https://iiasa.ac.at>

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Executive Summary

In the 2023 report *'Synergy Solutions for a World in Crisis: Tackling Climate and SDG Action Together'*¹ ample evidence was provided supporting the argument that without synergies, the Sustainable Development Goals (SDGs) and Paris Agreement objectives would remain out of reach. The report showed that by maximizing these synergies, investment gaps worth trillions of dollars could be bridged. Through strategic synergist action, resource allocation could be optimized to address the ongoing immense financial challenges for climate and development objectives. Despite climate finance almost doubling in the last decade, a shortfall of over USD 9 trillion in annual finance flows by 2030 remains to meet the 1.5°C global climate scenario of the Paris Agreement, with severe impacts and consequences especially for low-income countries.²

There are many financial barriers to the realization of potential synergies between climate action and the SDGs. These range from: competing economic priorities adopted in isolation and without proper assessments; the absence of long-term planning; the fragmentation resulting from the multiplicity of funding streams for both climate and inclusive development which create complexities in combining both agendas; to climate and development finance flows that are not only insufficient but also unbalanced, with more financing moving to higher income countries, leaving the Global South under-resourced. The 2023 Report concluded that these barriers resulted in four major failures: (i) failure to invest in the amounts needed – investments in both climate action and SDGs are inherently inadequate and more often than not, fragmented; (ii) failure to invest in the sectors most in need – climate resilient infrastructure, climate resilient food systems, health, gender, indigenous groups, and overall social needs; (iii) failure to invest in the areas most in need, primarily in adaptation and other major needs of poorer developing countries; and (iv) failure to invest in geographies that are most vulnerable and most in need, and more broadly failure to focus on the quality of investments.

Finance for climate and development have always been at the center of both the climate negotiations and the development agenda. These agendas, however, have primarily been debated and developed separately. Since April 2023³, the landscape of this debate has shifted. The decisions adopted at the Forum on Financing for Development laid the foundation for work leading to much-needed reforms of the international financial architecture to adapt to the current needs and challenges of the 21st century. In May 2023, the UN Secretary General published a policy brief⁴, the sixth of 11 elaborating his proposals for this reform⁵ as part of his recommendations to be considered at the Summit for the Future in September of 2024. *"The existing architecture"*, says the policy brief, *"has been unable to support the mobilization of stable and long-term financing at scale for investments needed to combat the climate crisis and achieve the Sustainable Development Goals for the 8 billion people in the world today. It is plagued with inequities, gaps and inefficiencies that are deeply rooted in the system"*. Among these inequities, gaps and inefficiencies, the policy brief focuses on the following: higher borrowing costs for developing countries in financial markets; vast variation in countries' access to liquidity in times of crisis, with only a small share of special drawing rights (SDRs) allocated to developing countries; significant underinvestment in global public goods; and volatile financial markets and capital flows, financial crises, and sovereign debt distress.

Not surprisingly, the response of the international community has been enthusiastic and proactive. At COP28 in Dubai, leaders issued a declaration on a global finance framework⁶ that urged global leaders to introduce reforms so that *"no country has to choose between fighting poverty and fighting climate*

change". The declaration goes on to endorse and call for support of the various pathways and initiatives that have emerged as a response. These include the Bridgetown Initiative, the Paris Pact for People and Planet, the Accra Marrakesh Agenda, the G20 India Leaders' Declaration, and the African Leaders' Nairobi Declaration on Climate and Call to Action.

Notably, these initiatives call for: (i) addressing the mounting problem of increasing debt, debt sustainability, and the higher costs of borrowing of poorer developing countries; (ii) increasing the levels of concessional finance to invest in projects with high aggregate return but low financial return and to catalyze larger private capital flows through risk sharing; (iii) rationalizing the allocation of SDRs to be more balanced between rich and poor countries (currently, the larger allocation goes to rich countries); and (iv) accelerating the reforms of the MDBs and other public finance institutions and reinforcing the mandates of these institutions to explicitly support climate and climate risks and development goals and rethinking their capital adequacy. The purpose of this report is to reflect on how the current efforts to reform the international financial architecture can be more supportive of the need for climate and development synergistic action and how to make the global financial system more equitable and responsive to the needs of poorer developing countries.

The report builds on both the recommendations of the 2023 report on *Synergy Solutions for a World in Crisis* and on those of a panel of global experts from various geographies and backgrounds convened by the climate and development synergies initiative of UNDESA and UNFCCC. Together, these provided the basis for the report and the measures needed to address the failures:

- Develop integrated national investment plans that align finance with domestic priorities and mid-term debt plans, maximize synergies and project development models that facilitate access to long-term resources through front-loading origination work.
- Strengthen access of developing countries to long-term affordable finance through domestic capital development and greater availability of credit enhancement mechanisms.
- With a focus on developing countries and those most affected by the impacts of climate change, encourage more research to enhance the science and address the knowledge gaps on the impacts of climate change, the cost of inaction, and the business case for adaptation, its role in addressing risk, and the return on investments on certain adaptation actions.
- Develop new modalities for finance to reach the last mile: building resilience and resilient communities through anticipatory action programs, social protection, and climate risk insurance, to support vulnerable communities and small holder farmers through financial protection.
- Increase the volume and quality of financial flows and rethink the criteria of ODA to focus on the development needs of developing countries and the support of climate and development synergistic action and continue to improve the performance of public finance institutions and MDBs.
- Improve the methodologies for tracking climate and development finance to ensure that financial resources reach the intended recipients and to measure progress on synergies between climate action and SDGs, consolidating performance metrics and using available tools such as blockchain.

Introduction

By any set of measures, it is evident that progress towards achieving the goals of either the Paris Agreement or Agenda 2030 is significantly off track. The eight years since the Paris Agreement came into force have been the warmest on record and carbon emissions and temperatures are increasing unabated. The recent [Sustainable Development Goals Report 2023: Special Edition](#) states *“Halfway to the deadline for the 2030 Agenda we are leaving more than half the world behind. Progress on more than 50 per cent of targets of the SDGs is weak and insufficient; on 30 per cent, it has stalled or gone into reverse. These include key targets on poverty, hunger and climate. Unless we act now, the 2030 Agenda could become an epitaph for a world that might have been”*.

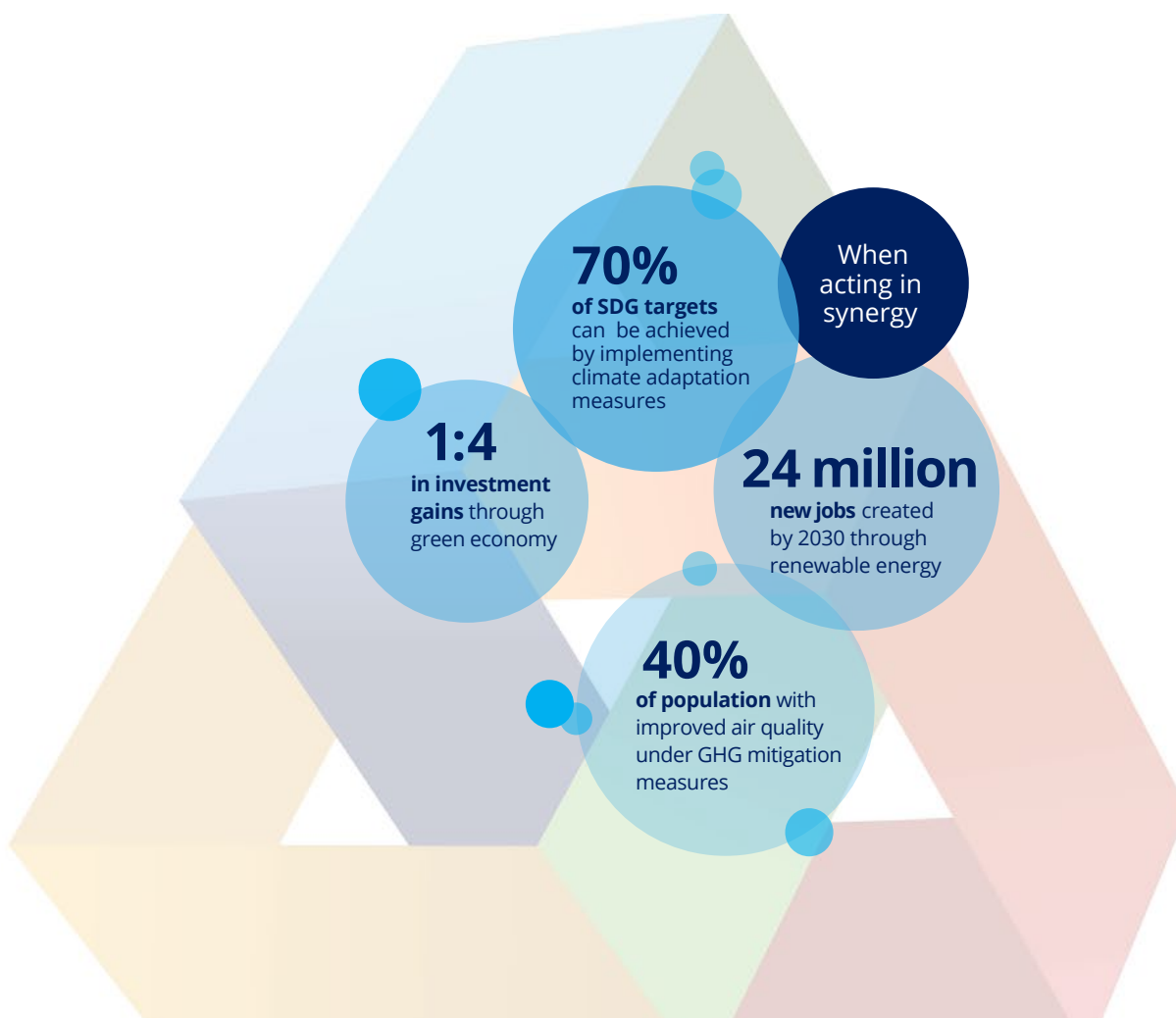
In the words of the UN Secretary-General, *“developing countries have limited access to the financial resources they need to address the dramatic challenges they face and implement the Sustainable Development Goals (SDGs). The global financial architecture, created for a very different world eight decades ago, needs urgent reform to make it fit for purpose”*.

As mentioned below, despite finance, and more specifically climate finance, increasing significantly in the last decade, the shortfall in annual finance flows by 2030 required to meet the 1.5°C global climate Paris Agreement target is immense. What is evident, therefore, is that financial resources need to be raised at a much larger scale to make any major impact. More important, is that the investment of these financial resources achieve a greater impact. The argument of this report is that synergistic action between climate and development can achieve this higher impact and efficiency, thus requiring less resources for greater outcomes. It is, therefore, about both the quantity and quality of these resources.

In his recent briefing to the General Assembly, the UN Secretary-General stated, *“Climate action is the 21st century’s greatest opportunity to drive forward all the Sustainable Development Goals”*. This was his urgent call for the need to act jointly on both the climate and the development agendas and to remind everyone that the 2030 Agenda for Sustainable Development and the Paris Agreement are intrinsically linked — one cannot be achieved without the other. The science is clear: sustainability cannot be achieved without climate action, and vice versa. Addressing developmental goals and climate change requires integrated, synergistic policies. Optimizing and exploiting the synergies between climate action and the developmental pathways under the Sustainable Development Goals (SDGs) are essential to advancing the achievement of both developmental and global climate targets.

FIGURE 1. Synergies between SDGs and Climate Action

- **Reduce financial gaps:** Pursuing development and climate targets together reduces investment gaps.
- **Achieve targets faster:** Integrating social dimensions enhances chances of reaching climate targets.
- **Facilitate long-term vision:** Synergistic co- benefits balance short- and long-term gains, gaining stakeholder support.
- **Ensure just transition:** Synergistic planning will ensure a just transition and limit the trade-offs of climate action.



The Inadequacy of Climate and Development Financing

One of the most important outcomes of the recent COP 28 in Dubai was the breakthrough agreement on the establishment of a new 'Loss and damage Fund for Vulnerable Countries'. This was a remarkable achievement given that it had been a contentious and long-standing issue in the negotiations for over three decades. As important as it was, however, this was only one of a long list of issues that needs to be addressed and resolved, not only by the UNFCCC, but by the gamut of institutions that make up the global financial architecture. The purpose of this report is to recommend action on some of these other issues affecting the poorer and most vulnerable countries.

Despite climate finance almost doubling in the last decade to a USD 1.3 trillion annual average, there remains a significant shortfall of USD 8-9 trillion in annual finance flows by 2030⁷ to be able to meet a 1.5°C global climate scenario and avoid the worst impacts of climate change especially in low-income countries, which benefit from only 8% of the current global climate finance. Similarly, despite the 7% growth in ODA from the Development Assistance Committee countries between 2019-2020, the SDG financing gap in developing countries rose to USD 3.9 trillion in 2020, exacerbated by the COVID-19 outbreak and global inflation (OECD, 2022b). Both figures, when considered separately, would typically mean that countries would opt for one to take precedence due to inadequate financial resources. However, what is often not realized in these evaluations are the developmental co-benefits of climate finance and the climate co-benefits of ODA. Had the synergies between climate action and SDGs been properly realized, the total investment gaps would have been significantly lower, and it would have been easier to mobilize the finances to respond to multiple objectives.

To ensure that investments are getting to the people who need them most, both the quantity and quality of climate finance are critical. Over the last decade, multilateral and bilateral donors have strengthened their standards for social, environmental, and climate-risk impact assessments and promoted the use of a sustainability strategy when developing projects. Some have pledged to guarantee that a certain proportion of their projects have a positive impact on the climate and SDG agendas. But mechanisms that only increase financial resources are not enough. Accountability measures and standardization, as discussed below, are also essential.

In 2009, developed countries agreed that they would mobilize USD 100 billion per year to support developing countries' climate action by 2020. When countries signed the Paris Agreement in 2015, they decided to replace the existing goal of USD 100 billion per year and set a 'new collective quantified goal on climate finance' (NCQG), which is due to be adopted at COP29 in Azerbaijan⁸. The new finance goal will channel greater funds toward urgently needed climate action in developing countries. It will support implementation of low-carbon, climate resilient solutions in energy, transport, agriculture and other vital systems. By increasing financial support, it should enable developing countries to step up their climate ambitions in the next round of national climate plans (NDCs), which are due in 2025.

One of the most important outcomes on climate and development finance at COP 27 was the text urging for reforms of multilateral development banks and other financial institutions, and the response of these institutions through a joint statement pledging to reform. The Parties and civil society argued that such reforms were necessary to ensure these institutions align with the Paris Agreement and its Article 2.1(c), making finance flows consistent with a pathway towards greenhouse gas emission reductions and climate resilient development. In addition, these institutions were called upon to develop and transparently publish reports on impacts, namely sustainable development, and climate impacts, to increase accountability.

Strengthening the framework of cooperation to improve access and catalyze the flow of climate finance more easily and effectively to countries most in need is perhaps the most important, but also the most challenging, of the reforms needed. Given the major new focus provided by Article 2.1(c) of the Paris Agreement mentioned above, there is now an opportunity to discuss the overall financial architecture which includes, among others, governments, multilateral development banks, and private financial institutions.

Many countries are calling for reforms to make these institutions more climate-responsive and easier for them to work together toward climate and development goals (including debt) and to facilitate blended finance. This, and other initiatives are promoting the use of public finance to effectively unlock other pools of capital, most importantly private finance. It is, therefore not so much about searching for bankable projects but maximizing sustainable development impact.

Much of the early evidence on climate finance reflected a strong bias toward mitigation, and on finance provided by the financial mechanism of the UNFCCC and through public, multilateral, and bilateral sources. The Paris Agreement, through Article 2.1(c), introduces a major shift by referring to the collective effort to tackle climate change that is supportive of development and a climate resilient world. With this language, the Paris Agreement sought to rebalance the importance of both mitigation and adaptation, as well as highlighting the need to include all financial resources (private, public, domestic, and international) to support these efforts (ODI). However, this aspiration is yet to materialize, although the recent COP28 in Dubai made some efforts to reverse this. The hope is that the ongoing debate on the reform of the financial architecture can address some of these failures.

FIGURE 2. The spectrum of sustainable investing Impact of the international financial architecture on the Sustainable Development Goals and Climate⁹



A stable international system is a foundation of national economic growth and sustainable development. Financial shocks and crises set back progress on social goals, increasing poverty and hunger. High debt servicing can lower spending on health, education, social protection and other social priorities. Sustained economic growth is also the basis of domestic public resource mobilization, which is essential to finance public goods and services. Domestic resource mobilization also needs effective international tax cooperation to prevent tax evasion.



Entrenched gender biases affect the design and functioning of all aspects of the international financial system. Gender equality objectives should be part of international leadership selection and the mandates and accountability metrics of multilateral development banks.



Developing countries have massive investment needs to deliver infrastructure, including for water, sanitation, and clean energy. A reformed international financial architecture should deliver affordable, long-term financing for such investments.

Increased productive investment also drives growth and sustainable industrialization. Preventing debt and financial crises contributes to decent work and helps the financial system to sustainably expand access to financial services for all.



Reforming international financial institution governance can reduce inequalities in the representation and voice of developing countries in global economic decision-making. Excessive financialization also contributes to inequality. The international financial architecture includes the standards for the regulation and monitoring of financial markets and institutions.



Dedicating more finance to resiliency will reduce the losses from disasters. Investment in urban infrastructure can be boosted by the public development bank system.



Climate change and environmental sustainability need to inform all aspects of the international financial architecture. Climate- and environment-related standards and metrics should inform business, finance, investment, and financial regulation including standards set at the international level. Systemic coherence is between environmental standard setting and economic management is essential.



Financial integrity is a core requirement for a sustainable international financial system. Strengthening international financial integrity standards and their implementation will reduce corruption, boost trust, and enhance the social contract. A reformed international financial architecture should also provide concessional financing for conflict affected countries.



Finance issues are central to the partnerships for the goals and the means of implementation. Reforming the global tax architecture can enhance domestic revenue mobilization. Donors can channel official development assistance commitments through multilateral development banks. Reforms to the debt architecture aim at attaining long-term debt sustainability.

Barriers to Finance Synergistic Action

The siloed nature of actions on development (Agenda 2030) and climate change (Paris Agreement) makes it difficult to account for multiple impacts across various SDG targets and climate mitigation potential. This results in incoherence in policies, undermining the feasibility and effectiveness of any original climate action. Policy incoherence can cause trade-offs in the SDGs and climate risks in other unexpected areas.

Investments in a low-carbon economy, adaptation or climate finance, often fail to realize the value of SDGs and associated co-benefits of different green investments thus limiting the mobilization of climate finance, especially from the private sector (Karlsson *et al.*, 2020). Conversely, the limited incorporation of climate risk in socio-economic development and investment decision-making creates maladaptation risks and reduce the socio-economic development impact climate finance.

The current financial flows for SDGs and for climate action reflect this siloed approach. Several planning, institutional, financing and capacity barriers hamper the alignment of financial flows to maximize synergies between SDGs and climate action:

Integrated Planning and Coordination

- Poor understanding of the economic need to pursue synergies, as well as the ambiguous relationship between climate and development finance.
- The Paris Agreement and the 2030 Agendas are considered separately and in isolation, resulting in a multiplicity of separate funding windows, high complexity, and transaction costs; and poor monitoring and evaluation of impacts.
- The frequent lack of long-term planning to balance short- and long-term benefits and to gain stakeholder and investor support by connecting multiple issues.
- Lack of integrated budgeting procedures, standardized taxonomies, accountability, and mandatory disclosure to systematically incorporate SDG and climate action into all public spending decision.
- Competing priorities of ministries within the same government.

Financing Gaps

- Despite the rhetoric of the global importance of tackling the climate crisis and sustainable development, financing for these agendas is often compromised by what are often seen as more pressing priorities, or simply competing requests.
- The inadequate and unbalanced flow of climate finance with more finance going to mitigation and to higher income countries leaving the Global South under-resourced.
- Limited access to, or knowledge about, financial products such as green, social, sustainable, and sustainability-linked bonds that can maximize synergies between SDGs and climate action.
- Widening protection gap (availability of insurance) to mitigate the impact of extreme weather event and enable vulnerable countries to building back better.

Institutional

- The international financial architecture was designed 75 years ago to serve a substantially different set of priorities and is no longer fit for purpose.
- Official Development Assistance criteria do not take climate vulnerability into consideration.
- The absence of sufficient collaborative frameworks for public and private institutions to work together (e.g., through blended finance) toward climate and SDG implementation.
- Lack of disaster-responsive social security systems to integrate SDGs and Climate Change priorities into relief and recovery efforts.
- The need to make credit rating agencies more fit for purpose, not penalizing positive action.

Capacity Gaps

- Limited awareness of public and private financiers of the value of SDGs and associated co-benefits of different green investments; and limited capacity to incorporate climate risks into socio-economic and investment decision-making.
- Limited capacity to design financial structures to derisk green investment and catalyze larger financial flows.
- Limited capacity to design and issue integrated financial products such as GSSS bonds and to develop domestic financial markets attuned to national development priorities, risks and opportunities.
- Limited capacity to track climate and development finance to ensure that financial resources reach the intended recipients and to measure progress and impact on synergies between climate action and SDGs.

Recommendations

The following is a set of recommendations for improving finance in support of climate and SDGs synergies, and in support of the needs of developing countries.

Planning Gaps

I. Develop integrated national investment plans that align finance with domestic priorities and needs, maximize synergies, possibly through country platforms that help coordinate across actors.

National development and transition planning can maximize synergies between the SDGs and Climate Action. The number of countries with a national development plan increased from 62 in 2006 to 134 in 2018 (Chimhowu *et al.*, 2019). Several factors are driving this growth, including the need to plan for the Sustainable Development Goals (SDGs) and Nationally Determined Contributions (NDCs) to climate action as well as the reexamination of the role of the state in driving sustainable development. Rapid transformations require strong political signaling and enabling policy environments to help all actors align their actions.

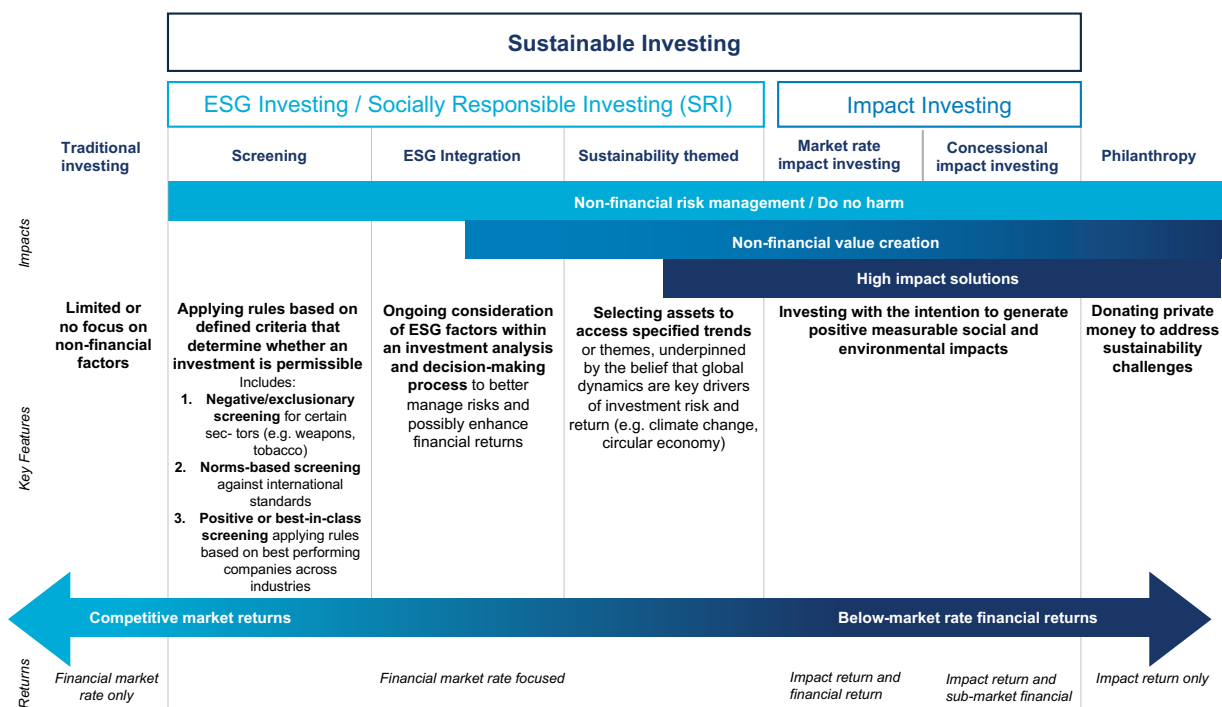
A key consideration for any plan to achieve these objectives is for it to be properly costed with the most appropriate sources of financing and need for each priority identified. Without a robust financing strategy, a plan will lack credibility and its capacity to influence future investment decisions will be diminished. A 2019 review of 107 national development plans found that 79 did not explain how they would be financed, except for vague references to domestic and foreign sources (Chimhowu *et al.*, 2019).

The preparation of Integrated National Financing Strategies (INFF) can serve as a new generation of integrated SDGs, Climate Plans and transition plans and roadmaps. The concept of INFFs was first introduced in the Addis Ababa Agenda, in which Member States noted that “*cohesive nationally owned sustainable development strategies, supported by integrated national financing frameworks, will be at the heart of our efforts*”. In the absence of an INFF linked to national priorities, international development finance will be channeled through one-off projects without a long-term vision for maximizing synergies across developing priorities. Similarly, private investors will lack clarity on policy directions and the pipeline of bankable projects. This lack of clarity will translate into a higher risk perception and financing costs.

The INFFs for SDGs and Climate Action should reflect the different risk-return expectations of an increasingly broad spectrum of financiers and identify the most appropriate source of finance for each national priority. This will ensure that scarce public resources do not crowd out private investment but are either deployed to crowd it in through risk sharing or directly finance priority investment with high aggregate return but low financial return.

Several approaches are available to enable blended finance providers to engage with the private sector and optimize the deployment of scarce concessional resources such as the Financing Waterfall codified by the World Bank (2017).

FIGURE 3. The spectrum of sustainable investing



Source: UN DESA and Global Investors for Sustainable Development Alliance based on RIAA (Responsible Investment Association of Australasia), CFA Institute, Global Sustainable Investment Alliance, and Principles for Responsible Investment

The reform of the international financial architecture provides a unique opportunity to leverage the re-emergence of national planning processes to maximize synergies between SDGs and Climate Action. Concessional finance partners should prioritize the development of integrated national financing frameworks and align their financing with these frameworks to support the implementation of nationally determined sustainable development priorities.

Financing Gaps

II. Increase access to finance by bolstering domestic capital markets and reducing the cost of capital

The development of local capital markets is a priority for facilitating access to both domestic and international long-term, stable finance. Finance is parochial. Financiers prioritize investment in familiar technologies and jurisdictions. Three-quarters of sustainable finance is deployed in the same country from which it is sourced, revealing a strong preference among investors for home-country investments where risks are well understood (CPI 2021).

The issuance of domestic bonds can accelerate the development of domestic capital markets by engaging local investors with a greater appreciation of local risks and opportunities. It can also reduce exposure of local issues to currency risks, as the currency of the financing matches their revenues streams. Local issuance can also facilitate a changing perception of risks and diversify the pool of international investors in an emerging market.

Bond issuances can be directly linked to the achievements of integrated national SDG and climate change strategies. In 2022, Uruguay raised its first sustainability-linked bonds, centered on two key performance indicators related to the country's nationally determined goals under the Paris Agreement: (i) to cut its aggregate gross GHG emissions intensity by half by 2025 and (ii) to maintain 100 percent of its native forest cover ('zero-deforestation' commitment). A step-down mechanism is activated if it fails to reach certain environmental targets, by October 2022. The issue attracted 188 investors from Europe, Asia, the USA, and Latin America, of whom 21% are new holders of Uruguayan debt. Total demand for the bond was USD 3.96 billion, greatly exceeding the USD 1.5 billion Uruguay planned to issue. The yield spread between this bond and the US Treasury bond used as a benchmark is 170 basis points.

However, green sustainable and sustainability linked (GSS bond) issuances were highly concentrated in high-income countries – accounting for 73% the total GSS bond market. In 2022, GSS bond issuances in sub-Saharan Africa accounted for only 0.7% of the global labelled bond market. In addition to nascent domestic capital markets, this is partially explained by the fact that many Sub-Saharan African countries do not have well-functioning domestic capital markets and only thirteen Sub-Saharan African countries have access to international capital. Of the 32 African countries that have received a sovereign credit rating from one of the three major credit rating agencies, only two (Botswana and Mauritius) have investment grade status as of 2023 (UNDP, 2023).

Enhancing domestic capital markets requires a multi-pronged strategy. As an illustration, the Absa Africa Financial Markets Index¹⁰) scored domestic capital markets on six pillars comprised of over 40 indicators (Figure 4).

International climate finance can accelerate the development of domestic markets through the provision of technical assistance and the derisking of the issuance of climate financial products. For example, issuance of domestic bonds can accelerate the development of domestic capital markets by engaging local investors with a greater appreciation of local risks and opportunities. It can also reduce exposure of local issues to currency risks, as the currency of the financing matches their revenues streams. Local issuance can also facilitate a changing perception of risks and diversify the pool of international investors in an emerging market.

The OECD (2023) identified five entry points for international financial partners to engage in GSS bonds: (i) Investment: act as anchor investors; (ii) Insurance: provide credit enhancement to GSS bonds issuances via credit risk guarantees or political risk insurance; (iii) Issuance: support project preparation through project development facilities; (iv) market Infrastructure: provide technical assistance to market regulators and actors (validators, verifiers, etc.); and (v) Impact: enhance the quality of impact reporting.

There are many hurdles to implementing this 'five Is' framework. For example, some donors and their DFIs are reluctant to act as anchor investors and systematically purchase GSS bonds from developing countries (OECD, 2022, 2023) due to the ambiguous ODA eligibility rules of these instruments. While concessional loans to the private sector have been included in the ODA definition for decades, it is unclear how this guidance relates to other debt instruments, such as bonds. An important step would be to finalize the OECD DAC Private Support Instrument review to clarify rules on ODA eligibility of donor investment in GSS bonds.

FIGURE 4. The Absa Africa Financial Markets Index

Pillar 1: Market depth

Size of market

- Domestic equity market capitalisation, sovereign bonds and corporate bonds outstanding, all as a share of GDP

Liquidity

- Total turnover of domestically listed sovereign bonds, corporate bonds and equities as a share of bonds outstanding and market capitalisation, respectively

Product diversity

- Financial asset classes available, including sustainable finance and hedging products
- Currency availability of stock exchange products

Depth

- Ability to clear local currency government securities in international markets
- Existence of secondary market makers for bonds
- Existence of closing auctions for fair tradeable market prices
- Primary dealer system
- Existence of primary dealer system
- Average daily horizontal repo turnover

Pillar 2: Access to foreign exchange

FX reserves adequacy

- Foreign exchange reserves in months of import coverage

FX liquidity

- Annual interbank market foreign exchange turnover

Capital restrictions

- Restrictions on capital transactions
- Existence of multiple, dual or unified exchange rate
- Adoption of FX Global Code

Official exchange rate reporting

- Frequency of reporting and publishing exchange rate data

Pillar 3: Market transparency, tax and regulatory environment

Financial stability regulation

- Basel Accords implementation stage
- Climate stress testing

Corporate reporting standards and governance

- Use of international accounting and reporting standards (IFRS)
- Existence of corporate action governance structure

Tax environment

- Level of withholding taxes on interest and dividends
- Number of double taxation treaties

Financial information availability

- Existence of fixed dates and times for market reporting
- Publishing of data on sector and domestic versus non-resident ownership of domestic assets

ESG initiatives and standards

- Incentives for issuing sustainable finance products
- Initiatives integrating ESG into financial market standards

Existence of credit ratings

- Existence of international sovereign credit rating (Fitch, Moody's, S&P)
- Number of corporate credit ratings (Fitch, Moody's, S&P) and coverage by regional ratings agency (GCR)

Pillar 4: Capacity of local investors

Pension fund size

- Value of pension assets per capita

Pension fund assets to domestically listed assets

- Pension fund assets as a share of listed equities and bonds, weighted by market liquidity

Pillar 5: Macroeconomic environment and transparency

GDP growth

- Five-year average annual GDP growth, historical and projected

Inflation

- Year-on-year change in consumer price index

Non-performing loans

- Non-performing loans as a share of gross loans

External debt

- External debt as a share of GDP

Macroeconomic data standards

- Publication and frequency of GDP, inflation and interest rate data

Monetary policy committee transparency

- Publication and frequency of MPC decisions and meeting schedules

Budget release

- Publication of annual fiscal budget

Pillar 6: Legal standards and enforceability

Enforceability of netting and collateral positions

- Existence of legislation for close-out netting and financial collateral positions

International standards

- Clean legal opinions for ISDA, GMRA and GMSLA master agreements
- IOSCO multilateral memorandum of understanding signatory

Although GSS bonds are important instruments, they are not a panacea for closing the SDGs and climate financing gaps. At their core GSS bonds remain debt instruments and can increase debt distress for developing countries in the face of rising interest rates. For financing investments with high aggregate return and low financial return, highly concessional finance instruments are more appropriate. The reform of the international finance architecture is an opportunity to develop a common set of principles for the optimal deployment of different debt instruments and financial actors and priority development axis for domestic capital markets.

III. Prioritize adaptation and resilience funding to channel resources to the most vulnerable, through innovative financial mechanisms, awareness raising, and capacity building.

Despite significant investment and spending on anticipating and responding to increasingly destructive climate disasters, the populations most highly affected by climate-related risks tend to be excluded from financial protection due to geographic isolation, the lack of identification, social protection and access to financial literacy and inclusion. Smallholder farmers account for a significant share of agricultural output in low-income countries and are important in national economies. However, they are among the most vulnerable groups affected by climate variability and climate change. This highlights the importance of targeted development and financial inclusion strategies to enhance financial security and productivity, promote innovation and ultimately enhance livelihoods within these communities. The call for greater synergistic climate and development action is more relevant than ever in these most affected geographical areas and communities. As in many other cases, access to finance is both the center of problem and the potential solution. But major challenges need to be overcome.

To ensure that funds directly reach the most vulnerable groups in a timely manner it is critical to overcome regulatory, social, market, technology, and knowledge-based hurdles. This includes lack of personal identification, especially in rural areas, fragmented social protection programs, restrictive account opening requirements, financial system fragmentation and service cost, as well as technological connectivity and lack of digital and financial literacy and trust.

To address these challenges, it is critical to deepen the Global Shield Against Climate Risks launched at COP27 across three dimensions:

- **Improve financial access:** Based on country-specific financial inclusion strategies, governments need to foster participation in the formal financial sector through provision of official identification documents to vulnerable groups in rural areas. This serves as the key enabler to meet know-your-customer requirements (KYC) for account opening. A tiered approach to KYC supports access of risk-prone low-income groups to participate in anticipatory action and climate risk insurance programs, while alleviated or remote KYC protocols drive crisis response.
- **Invest in financial systems and services:** Given the lack of physical access to banking services in affected areas, phone and internet connectivity have been drivers for financial inclusion in vulnerable communities. Together with tailored services such as mobile- mini- and micro-wallets, peer-to-peer payments, climate risk insurance, flexible savings and loan products or digital vouchers and remittances, financial institutions need to cater to this non-traditional customer group in terms of user experience and pricing, and governments

should incentivize this trend. National payment switches and systems interoperability with rural providers will allow peers, governments, and humanitarian actors to reach these last-mile financial instruments instantly, while allowing for people's choice.

- Leave no one behind: Use of financial services requires trust, and financial and digital literacy, which need to be built through stringent interventions to close the knowledge gap in vulnerable areas. As governments integrate and digitize social safety nets and protection programs, programmatic targeting, delivery, redemption, reconciliation and overall transparency and resource efficiency is increased, while eradicating exclusion errors.

Insurance is also important for addressing the protection gap. Insurance coverage can reduce the economic consequences of adverse climate impacts. Higher levels of insurance penetration or coverage have been found to reduce contractions in economic activity after disaster events. In high-income countries, 52% of reported economic losses from climate-related events were insured. In developing countries, however, less than 10% of reported economic losses were insured. For some especially vulnerable countries, this percentage can be as low as 1-3%¹¹.

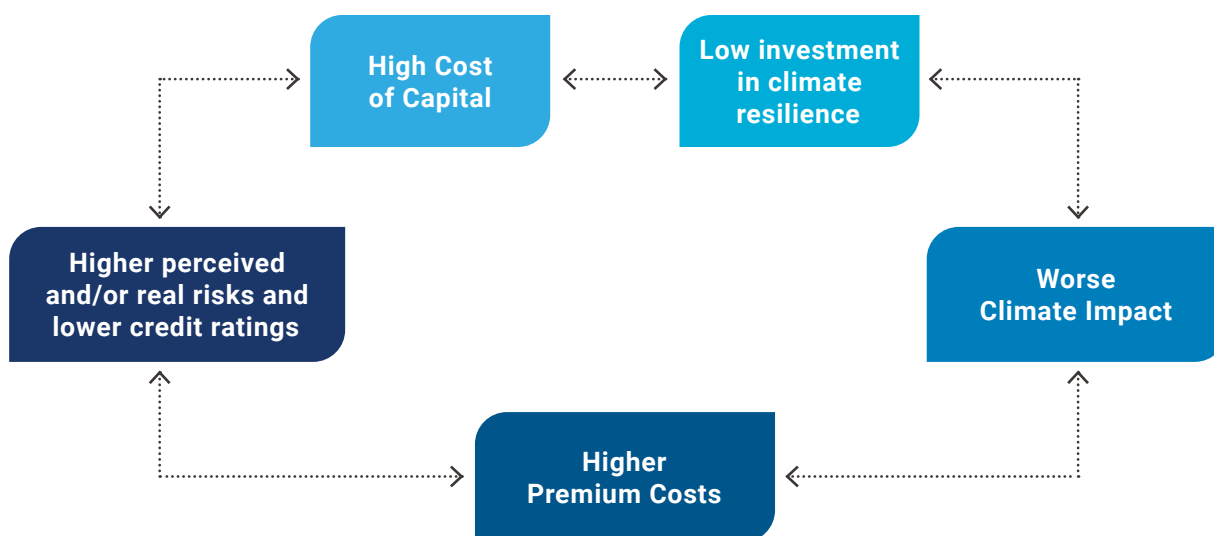
As the costs of the climate crisis escalate, this insurance protection gap is at risk of worsening. Since 2017 annual insured losses from natural catastrophes such as floods, hurricanes, wildfires, and droughts have averaged over USD 110 billion, more than twice the USD 52 billion average of the previous five years¹². An increasing number of insurance companies are withdrawing their cover from regions particularly affected by climate change in vulnerable countries, causing a spike in premiums¹³.

What is un-insurable is un-investable. Numerous governments are exploring public private partnerships to maintain the insurability of vulnerable communities and sectors. In the United Kingdom, for example, insurers threatened to withdraw from continued coverage for approximately 500,000 homes in high-risk areas in the wake of increased flooding events in 2005–10. In response, the industry and government developed Flood Re in 2016, which reinsures the coverage of high-risk homes, subsidized by a levy of approximately £10 on all UK domestic property insurance policies. The program is not open to new properties built in flood zones and was subject to government commitments to ongoing flood defenses.

Debt-stressed, vulnerable countries can ill-afford to finance such schemes on their own. Furthermore, small and vulnerable economies can lose over 100% of their GDP from natural disasters in a single day. They could fall into a financing trap where lower insurance coverage translates into lower access to affordable and long-term finance, lower capacity to build back better in the aftermath of a natural disaster and higher vulnerability to future disasters and crises.

Countries have a range of options for the financing of natural disaster losses accruing to the assets of households, companies, and the public sector (savings and current funds, emergency burrowing, insurances, etc.). Insurance is a relatively expensive form of disaster risk finance and is more cost effective when employed to cover low frequency high impact hazards. Umbrella stop-loss insurances capping losses to a percentage of the national economies is one innovation being investigated to address the unbearable risks posed by climate change on small, vulnerable economies. In addition to insurance schemes at the national level, governments can help close the protection gap with smart premium and capital support mechanisms to increase the affordability of insurance premium for households and SMEs.

FIGURE 5. The Resilience Financing Trap



The new global Loss and Damage Fund, established by the international community at COP 28, is set to play a key role in reducing the protection gap and provide highly concessional sources of finance to build back better. Several proposals have been developed to capitalize the L&D Fund at scale, including the application of the polluter-pay-principle either at the jurisdictional level (levy on cumulative emissions of countries, etc.); at the producers' level (taxes on profits from the oil and gas industry; etc.) or in individual consumption (wealth taxes, etc.).

The only long-term option to preserve the insurability of highly vulnerable groups is to invest in resilience. Insurers can incentivize investment in climate resilience through the terms and conditions of insurance policies. At present policyholders are not consistently rewarded for their risk-reduction measures. Insurers should pass on these benefits transparently to their customers through reduced premiums. For example, premium discounts should be applied to climate-resilient infrastructure such as enhanced roofing construction.

While insurance companies are withdrawing their cover from communities affected by climate risks, they continue to underwrite the expansion of fossil fuels. The IPCC and the International Energy Agency have concluded that new fossil fuel projects were not compatible with the 1.5°C target. No new fossil fuel projects can go forward without insurance. While the insurance industry has adopted restrictions on underwriting coal, most continue underwriting the expansion of oil and gas production. According to estimates by market intelligence company *Insuramora*, gross direct premiums from the fossil fuel industry increased from USD 20 billion to USD 21.25 billion in 2022¹⁴.

To understand the total decarbonization and resilience financing opportunity available to them, insurers need to look across the whole business – their underwriting portfolio but also their investment portfolio. The insurance industry manages more than USD 26 trillion in assets globally, giving it considerable influence

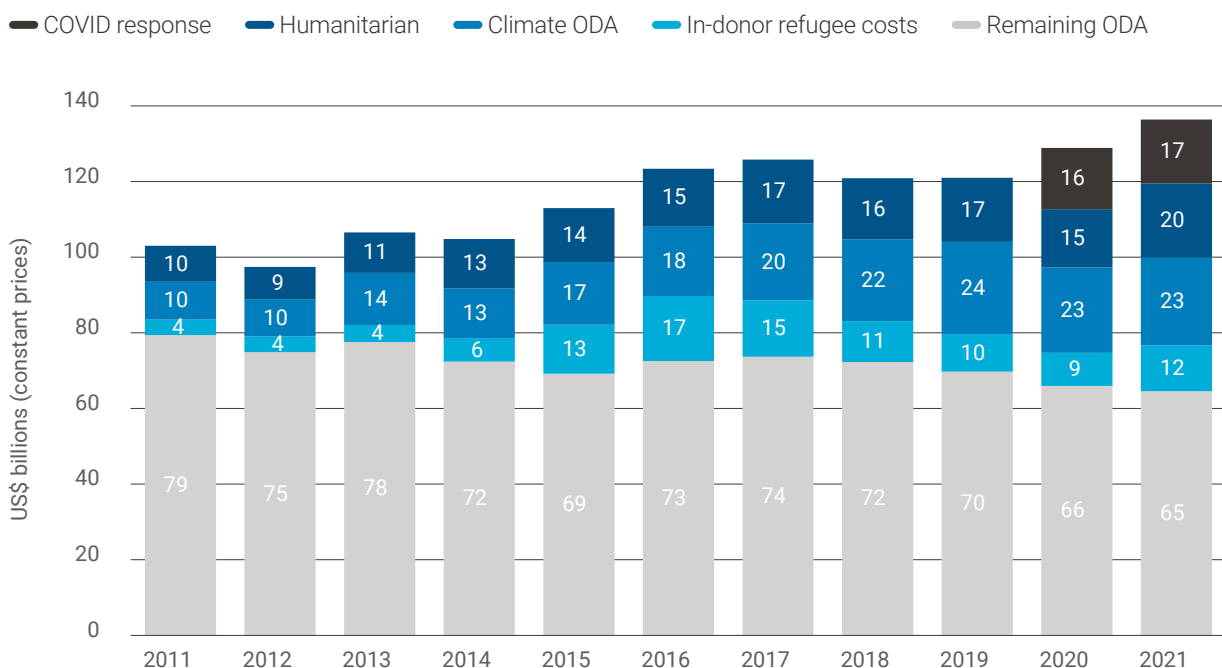
over business decision making. As major shareholders, for instance, insurers are indirectly responsible for a portion of the emissions their investees produce¹³. While some insurers have set ambitious long-term climate targets as underwriter and investors, few have articulated short-term business priorities to help reach these targets.

Institutional Gaps

IV. Increase the financial flows and rethink the criteria of ODA to focus on the development needs of developing countries, on vulnerability and the support of climate and development synergistic action; and continue to improve the performance of public finance institutions and MDBs to address these needs.

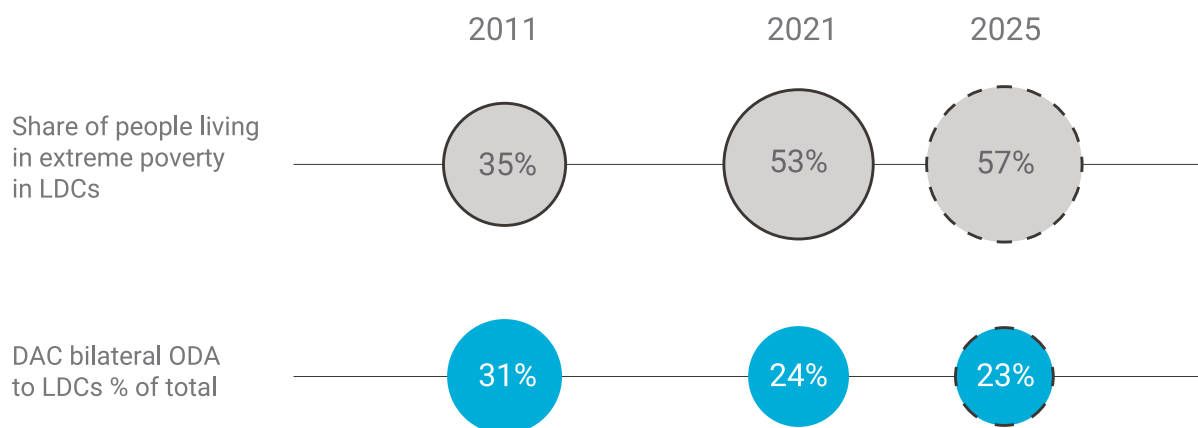
As can be seen from the figures below, there is an urgent need to redefine and clarify what is meant by ODA today and the criteria for granting it. Some are arguing for a return to the original definition of financial assistance to promote economic development and welfare of developing countries. As the figures below indicate, this original definition no longer applies, and that is a major concern for many. The argument is that while ODA is reported as having increased, in fact, the number of financial resources going to the traditional definition of ODA has actually decreased over the past few years. Some go further to suggest that ODA should be reserved to provide financial assistance to those countries most in need, supporting their argument by citing the worsening economic situation of many developing countries and their increasing risk and low resilience.

FIGURE 6. Composition of gross bilateral DAC ODA, 2011–2021



Source: Development Initiatives based on OECD-DAC.

FIGURE 7. People living in extreme poverty in LDCs, and ODA to LDCs, 2011, 2021 and 2025



Source: Development Initiatives based on OECD DAC and World Bank PovcalNet data.

But there are others who are growingly in favor of the current trend, arguing that ODA should focus not only on addressing poverty but also on addressing extreme vulnerability, wherever that may occur. In other words, it should not be a choice between poverty and vulnerability but rather on making sure that one does not grow at the expense of the other. To make this argument more acceptable and credible, some are arguing for the need of a vulnerability index that is accepted universally, such as the ongoing work in the UN to come up with a credible and recognized 'multidimensional vulnerability index' (www.un.org/ohrlls/mvi).

Many have welcomed the joint statement by MDBs at COP27 in which they recognized the *"interconnected challenges of sustainable development, climate change and nature loss"* and *"committed to address these challenges in an integrated manner, maximizing co-benefits while minimizing trade-offs"*¹⁶. Some of the most important commitments made were: support to countries in the formulation of long-term strategies that address climate and development synergies; support to countries in the formulation of policies that can promote systemic change and attract investment; mobilize financing sources including blended finance; increasing adaptation finance to support climate resilience in particular to Low Income Countries and SIDS, and vulnerable populations; increasing concessional finance; and helping to mobilize private sector funding. The question remains as to how all of this will be tracked and reported. The call is for MDBs and public finance institutions to improve their methodologies for tracking and reporting on where the money goes and the impact of this finance.

Capacity Gaps

V. Improve data and knowledge around the synergies of climate and development, including their impact, the related costs of inaction, and the opportunities -including the return on investments on certain adaptation actions.

Strengthening synergies between SDG and climate action is particularly critical for adaptation to (i) prevent maladaptation due to economic development and investment decision taking with incorporating the medium to long-term impacts of climate change; and (ii) to close the adaptation financing gap.

The recent IPCC Sixth Assessment Report¹⁶ “notes with alarm and serious concern “that most observed adaptation responses are fragmented, incremental, sector-specific and unequally distributed across regions, and that, despite progress made, significant adaptation gaps still exist across sectors and regions and will continue to grow under current levels of implementation”. The UNEP Adaptation Gap report adds that actions on adaptation most often do not address those climate impacts that are longer term. The result, the report says, is that these actions may end up reinforcing existing vulnerabilities making it much more costly and more difficult to fix in the future¹⁸.

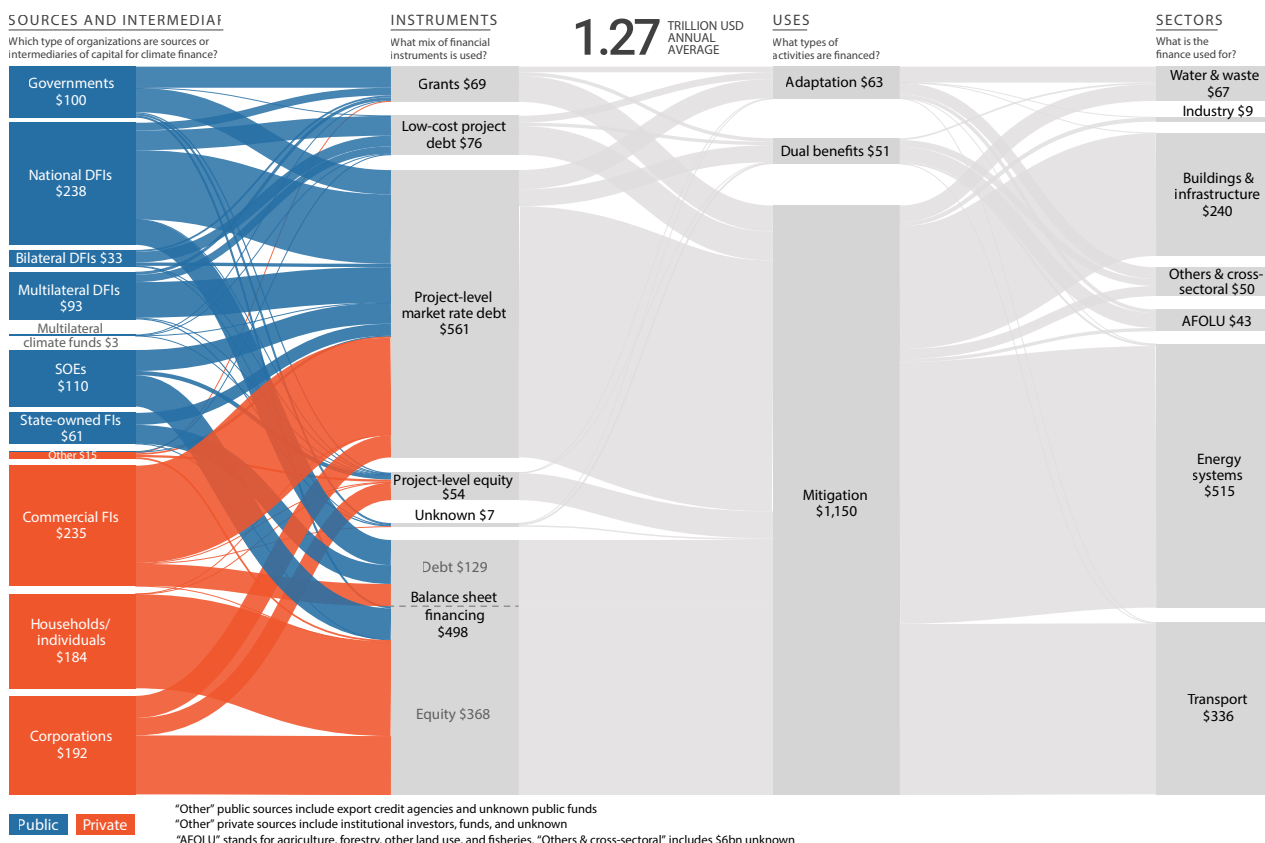
The Outcome document of the recent Global Stocktake at COP 28 makes reference to “the significant challenges developing country Parties face in accessing finance for implementing their national adaptation plans” and highlights that “the adaptation finance needs of developing countries are estimated at USD 215-387 billion annually up until 2030” and notes with concern that “the adaptation finance gap is widening, and that current levels of climate finance, technology development and transfer, and capacity building for adaptation remains insufficient to respond to worsening climate change impacts in developing country Parties, especially those that are particularly vulnerable to the adverse effects of climate change.”¹⁹

What is often not realized is that nearly half of the global population – some 3.6 billion – are vulnerable to the impacts of climate change²⁰. These impacts include food insecurity, droughts, floods, and severe storms. Some of those vulnerable populations are not only in developing countries but most regions of the world. As global temperatures continue to rise, the number of vulnerable people will increase. Any adaptation financing will result in higher loss and damage. Yet, the support for both those most vulnerable and action on adaptation continues to lag. However, there is also some good albeit mixed news. According to the most recent Global Landscape of Climate Finance 2023 report of the Climate Policy Initiative, climate finance is on the rise, and the data to track these flows have improved (Figure 6). However, these flows are still lagging and not increasing in sufficient numbers to the areas, sectors, and those most in need. Although adaptation funding shows a significant increase of some 28%, to USD 63 billion, this is still far below the estimated needs. Tracked adaptation finance mostly originates from the public sector with very little and fragmented private sector finance, and the data to track these flows are still non-existent or of poor quality.²¹

FIGURE 8. Global finance flows in 2021/2022

Landscape of Climate Finance In 2021/2022

Global climate finance flows along their life cycle in 2021 and 2022. Values are averages of two years' data to smooth out fluctuations, in USD billions



Source: Climate Policy Initiative Landscape of Climate Finance 2023

In that same report, the Climate Policy Initiative²² makes several recommendations – we extract and list those that are most relevant to our theme of adaptation finance for the most vulnerable and in need. Focusing on these priorities is a way to address many of the challenges mentioned above:

- Transforming the financial system: reforming the international financial institutions and leveraging concessional finance to expand private flows;
- Bridging climate and development needs: harnessing synergies between development and climate action and mainstreaming climate adaptation and resilience into financial systems;
- Mobilizing domestic capital: improving the local ecosystems for climate investment; and
- Acting to improve data: simplifying and standardizing taxonomies and reporting and making climate finance data widely available and accessible.

A separate report jointly co-authored by the Climate Policy Initiative and the Global Center on Adaptation²³ presents a series of important trends and messages with the areas most in need of attention and action:

- As shown in Figure 8, adaptation finance is not only much lower than mitigation, but the proportion in relation to mitigation has declined while the needs are rising;
- Institutional public commitment to adaptation finance is poor and opaque;
- Climate commitment to date by the private sector has focused almost entirely on mitigation;
- Debt remains the main financial instrument for adaptation;
- Knowledge and data gaps, plus methodological inconsistencies, make it difficult if not impossible to track flows and impact; and
- Proactive adaptation can reduce the burden of humanitarian aid, thus, a coordination of those providing both is important.

Improving the science and tackling the knowledge and data gaps would strengthen the case for adaptation finance. A recent report²⁴, by the World Bank and the Global Facility for Disaster Reduction and Recovery, lists what needs to be addressed with urgency:

- Improve knowledge, data and information on country-level climate and risk vulnerability to guide decision-making, which can be addressed by making data available and making climate risk a key component of capital investment planning by government and development partners;
- Provide clarity on where private investment is needed to address investment gaps for adaptation, which could be addressed by better long-term planning and setting of long terms goals; and
- Address the low perceived or actual returns on investment, which could be addressed by strengthening financial incentives for private investments.

VI. Improve the methodologies for tracking climate and development finance to ensure that financial resources reach the intended recipients and to measure progress on synergies between climate action and SDGs, consolidating performance metrics and using available tools such as blockchain.

Tracking climate and development financial flows has been a major challenge for years for various reasons ranging from methodological challenges, lack of regulations and policies to make it a requirement to track and report, data availability, and lastly, to occasional misinformation where activities included have little or nothing to do with adaptation.²⁵ Institutions such as the Climate Policy Initiative, who have been working on tracking climate finance for over a decade, report that despite the many advances and improvements in tracking and monitoring adaptation finance, many challenges remain including: the context-specificity of what counts as adaptation; the complexities involved in linking risks with adaptation measures; the lack of clear impact metrics; and a general lack of confidentiality. To overcome these challenges, the CPI says major efforts are needed to get the public and private sector actors to agree on the principles, framework, and the terminology for tracking adaptation finance²⁶.

Most recently, the multilateral development banks have updated the methodologies they have been applying for over a decade to climate adaptation (See Box 1).

These challenges pose serious obstacles for the type of tracking required to ensure that financial flows reach the intended recipients and vulnerable communities, and to assess the impact of the investments made. This is not only critical for accountability but also for effective implementation. Additional measures are therefore required, including, among others:

- Ensuring a more transparent reporting system by public finance institutions with detailed information on where the funds were allocated, disbursed and used and what the impact was;
- Introducing greater stakeholder engagement in the process of tracking to improve transparency and accountability, including local communities and civil society organizations;
- Having independent monitoring and evaluation to assess impact of investments made;
- Taking advantage of available technology, such as digital platforms and blockchain to enhance transparency and traceability of funds to ensure that it reaches the intended recipients; and
- Applying some of the available standards developed to enhance transparency and accountability such as the International Trade Transparency Initiative and others.

BOX 1. Updated joint MDB methodology for tracking adaptation finance²⁷

Between 2021 and 2022, the MDBs carried out a review of the Joint MDB methodology for tracking adaptation finance. The review built on collective experiences of applying the methodology over the preceding decade. It aimed to better characterise adaptation activities for the purpose of tracking adaptation finance and provide guidance on the application of the joint methodology in a broader range of financing instruments.

The outcome was an update to the methodology¹⁴ that reflected the evolving understanding of adaptation and climate resilience and advances made in the fields of adaptation finance. These developments include the following:

- a. Adaptation is no longer viewed purely as an add-on to development investments, but rather as an imperative for putting development on the path to resilience. As a result, adaptation support has expanded from traditional infrastructure sectors to a wider range of sectors, such as education, health, social protection, financial services, and research and innovation for adaptation solutions.
- b. Financing modalities supporting adaptation have broadened from typical investment loans and programmes to other financial instruments, including policy-based loans, working capital and credit lines.
- c. Relevant advances concerning green and sustainable finance have emerged in recent years, notably the EU taxonomy for sustainable finance and impact reporting for green bonds, introducing new concepts and approaches for better defining, reporting and monitoring adaptation activities, including private investment in adaptation.

The biggest challenges in tracking these financial flows are for those going to adaptation. Closing this data and knowledge gap is a priority for: (i) helping make the case for adaptation for business and the economy; (ii) tracking where the resources provided actually go and what impact they create; and (iii) monitoring progress locally with reliable indicators which currently do not exist and are critical given the local context and context specific nature of adaptation needs and impact, and for socio-ecological security.

After almost a decade of a very low and almost insignificant progress, the Global Goal on Adaptation (GGA) was agreed at the recent COP 28 in Dubai. While not perfect, because it leaves some important issues unresolved, it is a major achievement and one that will help provide an overarching framework to advance the case for the most vulnerable. Including major themes such as food, water and health, the framework will help bridge the gap between global and local adaptation priorities and establish targets, and in so doing, help build the case for adaptation and the need for finance. The next important task, which should be acted on as soon as possible, is the establishment of measurable indicators to monitor adaptation activities and to track progress.

Endnotes

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About the Expert Group on Climate and SDG Synergy

Co-conveners



United Nations

Department of
Economic and
Social Affairs



United Nations
Framework Convention on
Climate Change

The report is part of the series of four Thematic Reports contributing to the final, Synthesis Report, which together constitutes the 2024 edition of the Global Report on Climate and SDG Synergy led by the Expert Group on Climate and SDG Synergy. Co-convened by the United Nations Department of Economic and Social Affairs (UNDESA) and the United Nations Framework Convention on Climate Change (UNFCCC) Secretariat in May 2023, the Group consists of 14 renowned experts from diverse thematic and geographic backgrounds. Its task is to provide up-to-date analysis and recommendations based on scientific evidence and innovative approaches on how to tackle climate and SDG action in synergy. The Group is composed as follows:

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- **Luis Gomez Echeverri** (Colombia) International Institute for Applied Systems Analysis (IIASA)
- **Heide Hackmann** (South Africa) Future Africa, University of Pretoria

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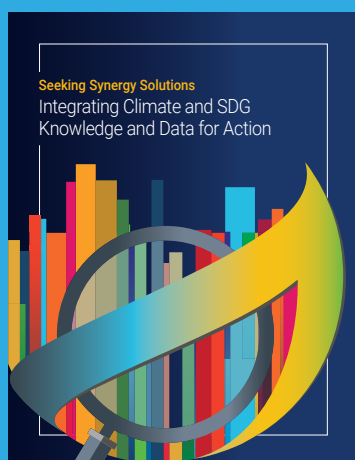
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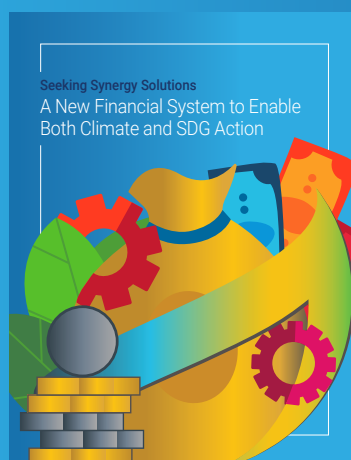
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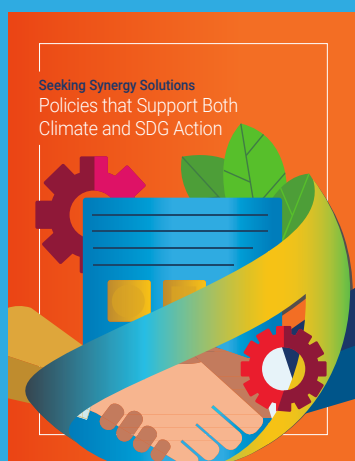
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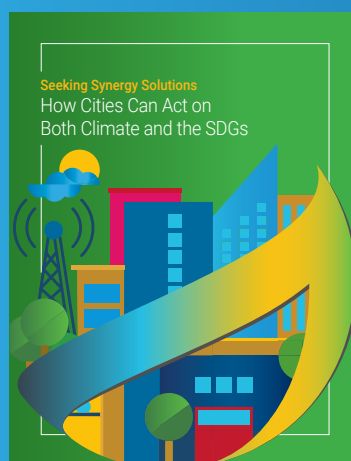
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