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## UCL IIPP calls on world leaders to rethink the role of finance at COP27

*To deliver a just transition to net zero, states must go beyond market-fixing and de-risking and embrace their role as market shapers.*

In the 12 months since world leaders gathered in Glasgow for COP26, the task of financing global decarbonisation has become even more urgent. Our reliance on volatile fossil fuels has once again left households and businesses at the mercy of soaring inflation, while fossil fuel producers enjoy record profits. In response, central banks have hiked interest rates to the highest levels in over a decade, while at the same time warning of impending recession.

Not only will higher interest rates do little to mitigate the underlying drivers of 'fossilflation', they also threaten to derail the global energy transition. It is estimated that clean energy-related investment needs to reach $4 trillion annually by 2030 to achieve net zero by 2050, up from around $1 trillion now. However, clean investments are more capital intensive than fossil fuel investments, and are therefore more sensitive to interest rate rises. At a time when scaling up renewable energy is more important than ever, there is a risk that tighter monetary policy will result in destructive 'green collateral damage'.

The forthcoming COP27 summit therefore represents a critical juncture for the financing of global climate commitments. At the last summit, a group of 450 private financial institutions [illegible] (GFANZ) – announced that its members have up to $130 trillion in funding ready "at their disposal" to tackle the climate crisis.

But if private finance has the means to fund the green transition many times over, why hasn't it happened yet? The answer is twofold.

Firstly, the claim that there is $130 trillion of private finance waiting to be deployed was a significant misrepresentation. The $130 trillion refers to total assets currently under management, not funds ready to be committed. Most importantly however, many of the required investments do not yet satisfy the risk-return preferences of commercial investors. For profit-maximising financial institutions, green investments that are long-term, high-risk and promise uncertain returns are not seen as a strategic priority. For the time being, it still makes financial sense to channel billions of dollars per year into fossil fuels and other dirty activities. In recent weeks

numerous members of the GFANZ have left the alliance due to concerns about the cost associated with monitoring and reporting against the commitments.

That state support is required to redirect investment from dirty sectors into green activities i

Perhaps most fundamentally however, the private finance-led approach seems at odds with the goal of delivering a global just transition, where costs and risks are shared fairly both within and between nations. In practice, de-risking involves transferring risks from private investors towards public balance sheets while leaving financial returns fully privatised. In order to satisfy the demand for these returns, climate-related investments are required to generate steady cash flows, which often necessitates the introduction of user charges or government fees. Building on initiatives such as the World Bank's 'Maximizing Finance for Development' and the G20's 'Infrastructure as an Asset Class', the emerging consensus aims to use de-risking instruments to turn green physical and social infrastructure, and more recently in nature, into investable 'asset classes'.

However, evidence shows that using de-risked private finance is often more risky and expensive for governments and/or users. It also perpetuates a system where money flows upwards from debtor to creditor – and from Global South to Global North. Many of these investments have essential public good characteristics that could be more effectively funded through direct fiscal spending.

None of this is to say that private finance does not have a crucial role to play in the green transition. But mobilising investment on the scale required to decarbonise the global economy requires a bolder approach. What should this look like?

**Firstly**, it means states must embrace their role as financial market shapers, not just market fixers. With regards to private finance, this means creating a strong regulatory framework to direct private investment away from dirty sectors into green activities. This could include central banks introducing allocative green credit policy regimes that are organised around green industrial policy objectives and democratically agreed green missions. It also means introducing stronger regulations to prevent greenwashing and prevent large non-bank financial institutions from engaging in regulatory arbitrage.

**Second**, states should embrace their role as 'investor of first resort', not just 'lender of last resort. Around the world public financial institutions – including multilateral development banks, national investment banks and state level banks – deploy many billions of dollars of capital each year. Because of their distinct design and governance features, they are able to supply the kind of long-term, patient, strategic finance that the private sector is often unwilling to provide. In recent years there have been growing calls for public financial institutions to retreat from direct lending in favour of providing de-risking instruments to 'unlock' private sector investment. This is deeply misguided: evidence shows that direct lending from well governed public banks can play a powerful market shaping role promoting structural change and crowding-in private investment.

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