



TECHNICAL REPORT

Closing the climate investment gap and promoting a Green Recovery in Latin America and the Caribbean.

Challenges and opportunities for policy makers and development practitioners on how to bridge the climate finance gap

This document summarizes the key elements of the discussion held at the brainstorming lab session "Partnerships for climate finance and a green recovery - How to close the climate investment gap and promote a green recovery in Latin America and the Caribbean?"¹ organised by EUROCLIMA+, LAIF and CIF at the European Development Days 2021¹

Credits

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Where do we stand now?

Despite the half-trillion record mark reached by the climate finance flows in the last few years, increasing climate ambition is necessary to meet the global goal of keeping the temperature increase below 2°C or even 1.5°C². Governments need to send clear policy signals to promote a real decarbonization across the entire economy. **Development Finance Institutions and multilateral development banks play a key role** when partnering with the private sector, embedding sustainability into their lending activities, and ultimately leveraging more capital.

This means that **all actors should work together to adapt the entire financial system**, aligning their strategies, business models, investment flows, risk management frameworks and markets to bring these financial flows to the volumes called for under Article 2.1.c of the Paris Agreement. This is not only a challenge but an opportunity. Pursuing a low carbon development can result in global GDP growth and social and environmental

¹ The event, held on June 15th 2021, was organized by the European Union EUROCLIMA+ programme and its implementing partners Agence Française de Développement (AFD) and the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH; the regional Blending Facilities Latin America Investment Facility (EU-LAIF) and the Caribbean Investment Facility (EU-CIF) with the support of the European Investment Bank (EIB), the Inter-American Development Bank (IDB) the Climate Policy Initiative (CPI) and the Economic Commission for Latin America and the Caribbean (ECLAC). Sixty participants joined the session– including European and Latin American authorities, representatives of the financial sector and innovation experts – who split into three parallel breakout groups that were moderated by José Luis Samaniego, Chief of the Division of Sustainable Development and Human Settlements of the United Nations ECLAC; Kristin Lang, Head of Division for the Public Sector in Latin America and Caribbean at EIB; and Mike Enskat, Head of Energy, Water and Mobility at the GIZ Global Programmes Area. Barbara Buchner, Global Managing Director of Climate Policy Initiative opened the session with an inspirational keynote speech.

² CPI, 2021. Global Landscape of Climate Finance 2019, London, <https://www.climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-2021/>

benefits exceeding 26 trillion USD by 2030.

This is particularly relevant for Latin America and the Caribbean (LAC). Although the region has access to 6% of the total climate finance mobilised annually, this amount is not representative of the region's needs for climate action. If climate investment is not scaled-up, then the region is bound to become a major contributor of emissions in the future and will suffer greater climate-related physical impacts.

While the challenge is even greater during the COVID 19 pandemic, as the region was hit with GDP declines by about 5.3%³, it is possible to mobilize additional climate finance, engage the private sector and deliver economic multipliers by sending green recovery signals. This is especially feasible in green energy and infrastructure, building efficiency retrofits, education and training in green activities, sustainable rural development, and natural capital investment⁴.

This document provides recommendations to policy makers and development practitioners on how to bridge the climate finance gap by focusing on three key work areas: create enabling frameworks, develop bankable projects, and generate strategic partnerships between technical cooperation and the financial sector.

1. Enabling frameworks

There is an urgent need to increase access to climate finance from all sources (international finance, public funds and capital markets) in Latin American economies, as their growth is expected to contribute a large share of emissions in the upcoming years. There is a strong reliance on domestic finance and insufficient enabling framework to attract other funding sources to move towards a sustainable low-carbon and climate-resilient economy.

Lack of awareness and clear long-term policy signals.

The main reason why some countries' climate targets are not ambitious enough and not aligned with the Paris Agreement is because some decision-makers lack awareness in the urgency needed to attend the severe climate change impacts. There are also countries that, despite being aware of the risks, face limited fiscal space and choose not to invest

in climate change. Therefore, no clear and ambitious signals are sent to stakeholders (including financial institutions and the private sector) to help them understand what the governments' priorities are on climate change. **Countries have also failed to mainstream these signals into the whole economy, beyond the Ministry of Environment,** resulting in sectoral plans and investment systems still being carbon intensive.

Inconsistent and unclear regulatory frameworks. While governments send weak signals for decarbonisation and resilience that do not support climate change policy goals, they continue to clarify the rules and benefits from certain polluting activities. Climate targets need to be backed up by clear rules and institutional architectures that reduce the risk to low-carbon and resilient activities. In addition, **incentives or disincentives need to be created to motivate the decarbonisation of the economy and close the climate investment gap.**

The financial sector is misaligned with the 2050 carbon neutrality target set by the Paris Agreement. Although climate finance has reached record marks in recent years, the number of financial resources and instruments allocated to polluting activities still constitutes most of the operations. While at the international level, the green taxonomy model is being promoted to guide sustainable finance, **some financial institutions in the LAC continue to invest in activities that rise GHG emissions and increase vulnerability without taking note of the risks in their portfolios.**

2. Availability of bankable projects

The bankability criteria for a project depend, inter alia, on the profile of the potential investors and the specificities of the institutions in charge of the operation. Certainly, risk reduction and profitability are key to attract private sources, however there are several additional factors to be considered by public and private financial institutions to make a financial decision: (i) political alignment; (ii) regulatory framework and enabling conditions; (iii) governance and leadership or project promoter; (iv) technical capacity; (v) choice of technology and (vi) maturity of the financial markets.

³ ECLAC 2020, Report on the Economic Impact of Coronavirus Disease in Latin America and the Caribbean (COVID-19), Santiago, https://repositorio.cepal.org/bitstream/handle/11362/45602/1/S2000313_es.pdf

⁴ Smith School University 2020, "Will COVID-19 fiscal recovery packages accelerate or retard progress on climate change?", Oxford, <https://www.smithschool.ox.ac.uk/publications/wpapers/workingpaper20-02.pdf>



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Setting up and financing climate-change related investments can encounter a lack of political backup, and an unclear or complex regulatory framework,

including contracting and procurement procedures. An enabling political and legal environment with adequate public incentives to back up climate objectives are important factors to reduce risks and attract investment. In climate projects, investors lean on predictability of regulatory issues such as obtaining licenses or assuring costs and prices associated with the investment (e.g., energy price). However, stability and predictability are affected in many countries in the region due to a frequent change of the government's priorities or a change in structures and responsibilities of government departments.

Projects are largely influenced by the technology selected for the climate transformation proposed.

If this decision is not properly appraised, the selected low carbon technology may not be accessible or competitive enough compared to the traditional carbon intensive technology, discouraging private investment. The technology selected needs to be supported by pre-feasibility and feasibility studies, analysing the installed capacities as well as market demand and pricing to ensure the sustainability of the investment in the medium and long term. When technical capacities are not in place, they need to be developed early to ensure solid technical project management. Supporting technical assistance and capacity development plans contribute to reducing risks associated with low installed capacities. All the above is particularly challenging for

adaptation-related technologies, whose benefits are difficult to quantify and often cannot be monetized and therefore, do not attract private sector interest.

The lack of institutional and technical capacities to structure and manage bankable climate projects are key barriers to accessing finance.

Project designs usually don't reveal enough or reliable data and relevant information about institutional commitment, markets, installed capacities, risks, etc. This situation doesn't allow for funding decisions to be made. In addition, these investment operations sometimes rely upon weak government departments, that lack the required institutional skills to manage financial and operational aspects of the project. Operations involving multiple organizations and unclear leadership usually face coordination problems, increasing implementation risks and reducing investors' interest. **A solid and competent technical organisation in the lead, backed up with a public policy aligned with the Paris Agreement and providing stability to the private sector, facilitates the bankability and credibility of the project vis-à-vis financing institutions.**

This situation is more relevant at the subnational level. Since mitigation and, above all, adaptation is intrinsically linked to the geographical and socio-economic context, cities and local communities are stakeholders that should be involved in the design of climate projects. However, in addition to the lack of capacity, there are not enough stakeholders (i.e. intermediaries) or mechanisms available to channel funding to the local level.

3. Collaboration and coordination between key actors in the financial system

Lack of technical capacities of financial institutions.

Some economies do not have a well-developed financial market/system to bring together a significant level of savings and generate willingness to invest in green projects. The costs associated with financing can be particularly high for climate related projects and it is not common to find affordable green financial products that respond to the NDC's needs. Therefore, most financial institutions are not committed to moving away from traditional, polluting investments. **It is important to build capacity in the financial sector to assess the social cost of carbon and climate risks and to test green financial products that respond to the climate change agenda and private sector interests.**

Lack of communication and mutual reliance between the public, private and financial sectors affect the sustainability of climate projects and the interest of private investors. Even with clear policy signals in the long term, the architecture related to climate finance in LAC countries is failing to promote dialogue with the public, the private sector, and financial institutions to reach a common understanding of the climate change agenda. Moreover, the climate goals of policies and projects are not translated into a language that allow the private and financial sectors to identify business opportunities. **Permanent dialogue and participation of relevant stakeholders in the design and implementation of project pipelines will improve ownership and successful implementation.**

How to move forward?

1. Public policies to create an enabling framework for climate finance

Building **a strong climate investment pipeline requires long-term policy signals** that are realistic, science-based, and impact-oriented. Such long-term strategies (LTS) can provide clarity and a common understanding of the climate goals to stakeholders in the financial system, reducing uncertainties and investment risk.

Country-driven strategies are key for this purpose, as they identify the actions and stakeholders needed to scale up climate finance. To have the expected impact, **climate finance**



strategies should be supported by strong governance.

They should have a well-defined role for key ministries and have space for a dialogue with financial institutions, the private sector, and other stakeholders.

Close coordination and collaboration between the Finance and Environment Ministries

is important to ensure that climate policies are effectively supported by macroeconomic policy, fiscal planning, budgeting, and public investment⁵. Although environment ministries are usually the lead institutions for climate change management, working in tandem with finance ministries is key to unlocking new sources of finance, including financing from the private sector.

SISCLIMA FINANCIAL MANAGEMENT COMMITTEE, COLOMBIA.

Created in 2011 and **formalized in 2016** as part of the Intersectoral Commission on Climate Change - the SISCLIMA Financial Management Committee is a body for inter-institutional coordination and public-private dialogue on finance and climate change. It constitutes 22 institutions including the National Planning Department, the Ministry of Environment, the Ministry of Finance and also the commercial banks and the national development banks. The Committee has an institutional framework including rules of procedure, a national coordinator, and a Green Finance Subcommittee.

The Committee has successfully led the design of the **monitoring, reporting and verification (MRV) system for climate finance** and a **National Climate Finance Strategy**. In addition, the Green Finance Subcommittee (comprising of four national development banks) is receiving support of the **NDC Policy Programme (ProNDC), implemented by GIZ**, to: (i) build capacities for designing innovative economic and financial instruments, (ii) assess the costs and available funds for those innovative instruments, (iii) consolidate a mechanism for exchanging information and best practices, and (iv) build capacities to create and maintain innovative financial instruments.

2. Capacity building of government institutions

There are different initiatives to support governments in attracting investments for climate projects. For example, the **Clifit4SE training courses** or the **EUROCLIMA+ & INCAE Business School capacity building programme on bankable climate project development** are aimed at **strengthening stakeholder's capacities to prepare climate change project proposals. This is to ensure that projects are better structured and more attractive to different types of investors.**

It is necessary to work hand in hand with other public institutions such as the national and regional development banks.

They can play an important role in shaping national climate finance strategies using specific financial instruments for the investment mix and the design of appropriate guarantees for the potential investors' benefit.

In addition, progress needs to be made in developing a **regulatory framework that is consistent with climate policies and goals, to provide certainties to the private sector, but also to the financial sector.** Therefore, green taxonomies can provide the necessary clarity by defining which activities or businesses are truly green, increasing space for green finance, and, ultimately, avoid greenwashing.

⁵ The Coalition of Finance Ministers for Climate Action N.D., The Helsinki Principles, <https://www.financeministersforclimate.org/>

GREEN TAXONOMY IN LATIN AMERICA, MEXICO'S EXPERIENCE

Inspired by the international experience, GIZ and the Mexican Banking Association have promoted the **green taxonomy for Mexican banks** as a tool to facilitate green recovery and increase the sustainability of the national economy. This is a system of principles, criteria, methodologies, governance, and reporting mechanisms. While the taxonomy does not discourage unsustainable investments, it is a useful tool for investors who want to mitigate and manage climate-related financial transition and legal liability risks by increasing green assets in their portfolios. In addition, with AFD's support to the Ministry of Finance, the potential users of the taxonomy for the financial system and the expected benefits for each relevant market will be identified. A proposal for reporting guidelines on the taxonomy will also be developed to improve the measurement and monitoring of financial flows that support sustainable development.

3. Attracting public and private interest on financing climate related projects should be a priority

Funding sources should include reimbursable and non-reimbursable resources and innovative financial instruments should also be used to finance climate projects. **The participation of public investors gives the private investors a sense of confidence.**

The source of funding for climate operations can be a combination of financial instruments, which include senior debt, green bonds, concessional loans, and financial guarantees. Financial guarantees can play a key role in mobilising domestic financing. **The mix of financial instruments will depend on the type and level of risks associated with the investment.** Green financial instruments must be tailor-made for each activity and each type of investor.

Grants and technical assistance can also play an important role to ensure capacity and/or technological development and improve bankability. **Blended finance programmes such as LAIF (The Latin America Investment Facility) or CIF (The Caribbean Investment Facility) of the EU can play a key role to customize finance solutions according to local needs and to support partnerships between public and private investors.**



SUPPORTING PARTNERSHIPS BETWEEN PUBLIC AND PRIVATE INVESTORS TO FACILITATE CLIMATE INVESTMENT, THE INNOVATIVE LAGREEN FUND

The [Latin American Green Bond Fund](#) (LAGREEN) was launched in December 2019 as a joint effort of the German Federal Ministry for Economic Cooperation and Development (BMZ) and the EU LAIF programme. It is managed by KfW. The fund aims to generate climate, environmental and social impact through the provision of responsible finance in Latin America and the Caribbean by promoting green bond issuance.

LAGREEN is an open-ended specialised investment fund that mobilises resources from the private sector to leverage capital provided by public investors. It also has an independent technical assistance facility to support issuers, partner institutions or to promote an enabling environment for green bonds and sustainable businesses. Currently, the fund has about 90 million USD as a funding base and foresees its first investments to be made in Brazil, Mexico, Ecuador, El Salvador, Panama, Costa Rica, Colombia, and Peru.

The EU is building LAGREEN's first loss tranche to enable it to deploy its investment activities, while establishing sufficient protection levels, and providing confidence for private investors to enter the Fund at an early stage.

4. Partnerships between technical cooperation and the financial sector in order to mobilise climate finance

Closing the climate investment gap requires an integrated approach between technical expertise, capacity building and financial cooperation. Under this premise, **technical cooperation is a strategic ally, which can strengthen the capacities of both project developers (to move forward with the subsequent creation of project portfolios) and financial intermediaries (identifying how to integrate climate into their pipeline and investment strategies).** Ultimately, this will make it possible to generate the financial instruments and conditions to attract investors.

Financial cooperation can also help implement an ambitious long-term plan (or NDC) jointly through policy-based-financing: a mixture of finance based on climate actions, policy dialogue (with the body or institution(s) in charge of national coordination) and technical support.

This will require a definition, at a national level, of what activities are green through local taxonomies, to provide clarity to the stakeholders in the financial system and avoid greenwashing. **Local taxonomies must be aligned with international principles and architecture.**



STRATEGIC PARTNERSHIP BETWEEN TECHNICAL AND FINANCIAL COOPERATION TO ATTRACT LONG TERM CLIMATE INVESTMENT, COLOMBIA

In 2019, Colombia started the formulation of its **long-term strategy for resilient and carbon-neutral development by 2050**. This process has benefited from technical assistance from the AFD, through the **2050 Facility**, which will also support its operationalisation until 2022. The strategy, published in 2020, has sent decarbonisation signals to financial actors, attracting climate finance for the implementation of climate-related policies and actions.

Colombia is also receiving a pluri-annual climate policy support through the AFD's Policy-Based Lending modality for a total of 657 million EUR. This funding was strategically combined with technical cooperation to allow progress in the development of the MRV (Monitoring, Reporting and Verification) of climate and "green" finance, as well as the implementation of the GEMMES model (**General Monetary and Multisectoral Macrodynamics for Ecological Change**) in the Ministry of Finance, the National Planning Department and the National University (UNAL). The AFD in partnership with the IDB, KfW, SIDA (Sweden) and KEXIM (South Korea), is appraising another Policy-Based Loan for Colombia of 200 million EUR to (i) strengthen the country's capacities for monitoring the implementation of climate action; (ii) increase the sustainable, efficient, legal use of natural capital and develop a circular economy; (iii) to accelerate the country's energy transition.

How can the EU through its EUROCLIMA+ and CIF/LAIF programmes support partner countries to close the climate investment gap?

The European Union is at the forefront of efforts to **adapt the entire financial system in the light of the European Green Deal** to support a resilient economy and a sustainable recovery from the impacts of the COVID-19 pandemic.

The EUROCLIMA+ programme, supports their partner countries in **formulating climate policies, climate finance strategies and strengthening governance schemes and processes** in order to send long-term decarbonisation signals across the economy.

EUROCLIMA+ can **help implement ambitious long-term policies (LTS or NDCs) through innovative financial instruments**, such as **policy-based loans**, including climate action-based financing, policy dialogue and technical support.

EUROCLIMA+ also offers support to **strengthen enabling frameworks for unlocking and mobilizing climate investments, build institutional capacities, develop financing and investment instruments for the achievement of national climate goals, and support green recovery planning**. EUROCLIMA+, through GIZ and UN Environment, is currently supporting **Costa Rica** and **Panama** in strengthening

financial systems through their alignment with the climate change goals of the Paris Agreement.

Aiming to **strengthen regulatory frameworks to attract new finance sources**, EUROCLIMA+ through ECLAC, supports 9 countries in the LAC region in developing incentives and disincentives to decarbonisation through the **incorporation of carbon valuation mechanisms for the change of relative returns in favour of a low-carbon development**.

The European Union blending facilities **LAIF and CIF, unlock, accelerate and leverage investments in LAC**. This is done by **combining** grants, loans and guarantees from the EU, partner countries, international financial institutions, local development banks and the private sector. They also promote the development of institutional frameworks, technical capacities and strategic partnerships needed to improve the bankability of projects.

Moreover, these blending instruments will now integrate the new **European Fund for Sustainable Development + (EFSD+)**. EFSD+ will offer, among other instruments, guarantees to partly reduce the risk of loans provided

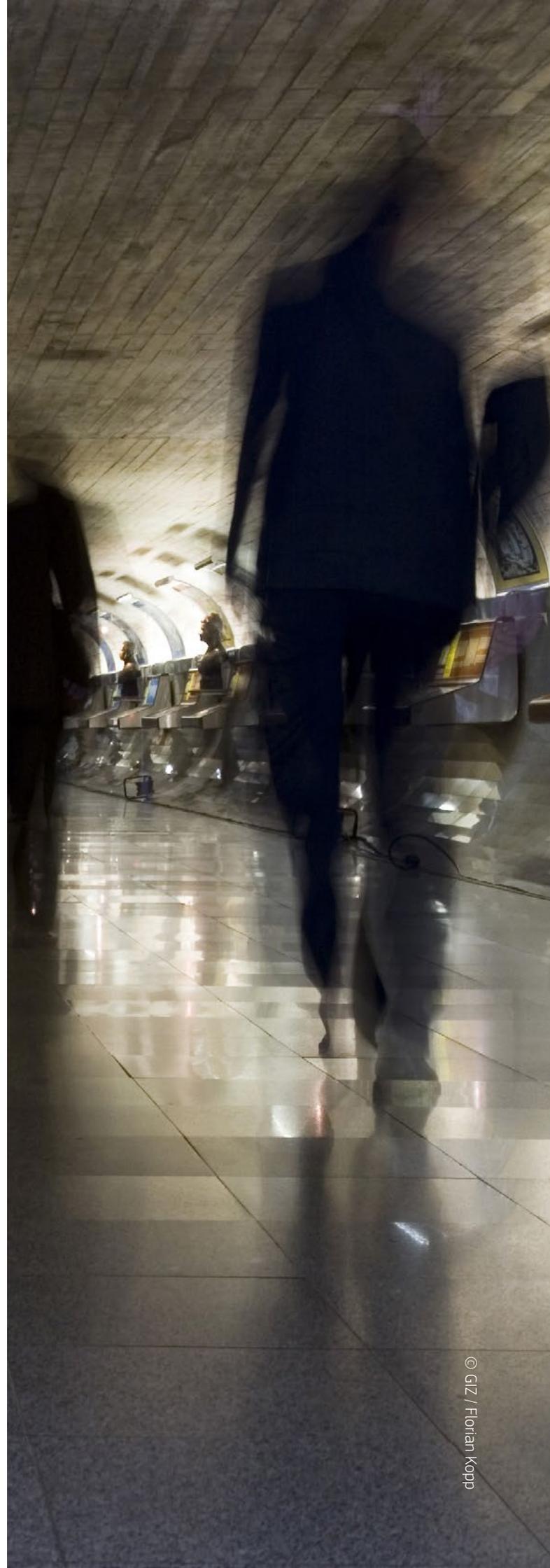
by European and international financial institutions to governments, administrations and businesses. By lowering risk, these guarantees will help generate much needed funding to close the climate investment gap.

EUROCLIMA+ also **strengthens the capacities of stakeholders in charge of NDC implementation to improve access to finance**. GIZ, in partnership with INCAE Business School, has developed a training programme in the **formulation of bankable climate projects**, and is piloting a software tool to **improve project structuring and portfolio management**.

The AFD, as a development bank, offers project loans and **green credit lines** to regional or local public and private banks for the promotion of energy efficiency and climate change adaptation. The aim is **to strengthen the financial sector's capacities, to support the design and piloting of green financial products and to incorporate sustainability into their lending activities**.

The EUROCLIMA+ programme also supports the objective of the European Green Deal by **assisting partner countries in developing strategies that put climate at the heart of recovery in order to build a better future**. Currently, through GIZ, support is being delivered to Ecuador, Dominican Republic, and Peru in the development of green recovery strategies, plans and indicators.

The European Union will continue to support Latin American and Caribbean countries to reach a decarbonisation pathway and to achieve net zero emissions by mid-century. It will promote adaptation to climate change, protect people and nature from the worst effects of climate change. It will facilitate access to finance, increase available funds, and foster collaboration with business, civil society and other actors. All of this, in order to **close the climate investment gap needed to achieve the goals of the Paris Agreement**.



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