RBC Economics | Current Analysis

Closing the global sustainable finance gap

November 4, 2021

The Insights:

- Sustainable finance is top of mind in Glasgow, with major financial institutions committing to financing the global energy transition.
- Sustainable finance has grown rapidly to nearly $450 billion annually, but by some estimates is only one eighth of what's needed.
- Carbon pricing policies in advanced economies and international standards on offsetting can both increase green finance flows and shift where they are heading.

The Stakes:

We must urgently increase spending on emissions cuts if we're to avoid the worst impacts of climate change. The cost of failure is high: the planet has warmed some 1.1°C since the mid-1800s—and investing enough in abatement and adaptation is critical to combatting the existential threat of further increases. Doing too little, or acting too late, could set off climate tipping points that balloon the costs associated with climate change, from heat waves and storms to mass migration and biodiversity loss.

The Context:

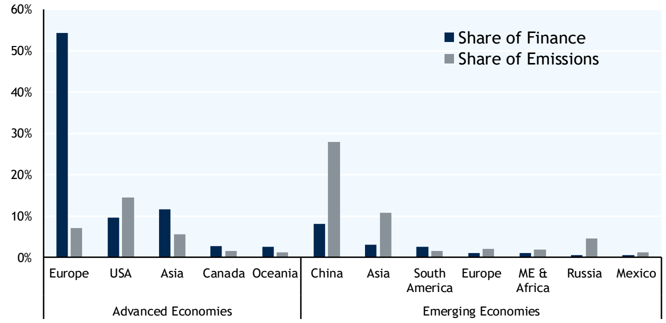
Global green and sustainable finance has grown rapidly in recent years, nearly doubling since 2018. But it remains far from the estimated US$4 trillion the International Energy Agency expects we need to invest annually by 2030 to meet our climate targets. As we highlighted in our recent report, much of the investment so far has been aimed at electricity generation. Increasing sustainable finance flows, and broadening which countries and sectors can access private sustainable finance, remains the challenge.

Our Analysis:

Governments and businesses in advanced economies make up 30% of emissions and have issued 80% of sustainable finance.

Europe leads the West in climate financing

Share of green bonds/loans and share of global CO2 emissions, top 40 countries, 2019



Source: Bloomberg, Our World in Data, RBC Economics

Europe stands out in this group, issuing more than half of annual green finance. European investment is roughly at the scale needed for transition, relative to their share of emissions. But maintaining the current pace while also investing in harder-to-abate sectors may yet prove challenging. Other advanced economies have devoted larger shares of green financing to retrofitting buildings—a key effort all economies must accelerate. Outside Europe, though, green financing needs to increase.

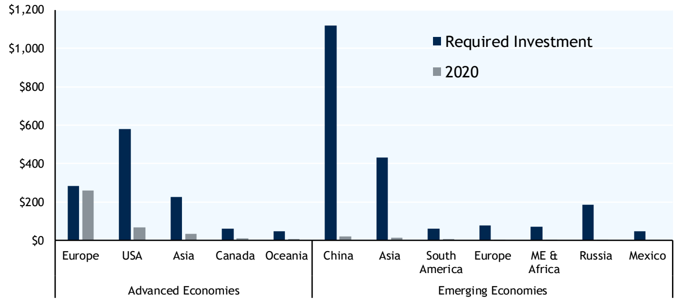
A bigger shortfall in green financing exists in emerging markets. In

Colin Guldiman | Economist | 416-974-6192 | colin.guldiman@rbc.com

all, investors may need to funnel over US$2 trillion annually into emerging market decarbonization by 2030, relative to just US$70 billion today. In Glasgow, advanced economies strengthened efforts to fulfill their US$100 billion annual commitment to fund emerging market transition—but the real challenge is of a much greater magnitude.

Few regions are making sufficient climate investments

Estimated annual clean investment required and 2020 flows, top 40 countries, US$ billions



Source: Bloomberg, Our World in Data, RBC Economics, IEA

The Road Ahead:

In advanced economies, the task is to maintain current growth in sustainable finance, and ensure all sectors of the economy are funded. Industry sees little finance for instance, despite being responsible for many emissions. As we noted in our prior report, that's not due to a lack of money. Advanced economies must work together to establish guidelines for sustainable projects that reflect differing economic realities, expanding on the foundational work of the EU in writing green taxonomies. This, coupled with efforts to boost the profitability of green industrial projects, will get more projects done and bring long-term investors to the table.

Boosting climate finance to emerging markets will be more challenging, but no less important. For now, advanced economies can de-risk projects with "blended" finance: providing guarantees and taking first loss positions that help crowd in private sector investment. Using some of the US$100 billion already committed to do this could begin to move the needle towards the US$2 trillion annual goal. But over the long term, strategies that encourage large emitters to invest in cuts across their global operations could be more fruitful. International standards that allow investments in foreign operations to count against domestic carbon taxes in major pricing systems, and against national goals via Article 6 of the Paris Agreement could move us one step closer to an integrated global carbon market. That would achieve more emissions reductions sooner and more cost-efficiently, including by accelerating climate-related financial flows from advanced economies to emerging markets, where they would have great impact.