Organisation for Economic Co-operation and Development

ENV/EPOC/WPCID(2021)8

Unclassified

English - Or. English

27 April 2021

ENVIRONMENT DIRECTORATE
ENVIRONMENT POLICY COMMITTEE

Working Party on Climate, Investment and Development

Climate resilience through finance and investment

Concept note

16th WPCID, 17 May

Information Note: This note outlines the rationale and proposed framing for a new initiative by the OECD to align finance and investment flows to enhance climate resilience. This work is linked with two other notes being presented to WPCID:
- Scoping work on green finance and investment for the PWB 2021-2022 [ENV/EPOC/WPCID(2021)10]
- Measuring the alignment of investments and financing with climate mitigation goals [ENV/EPOC/WPCID(2021)11]

Delegates are requested to provide comments on this document at the WPCID meeting on 17 May 2021, and to send in any written comments by 1 June 2021

Michael.MULLAN@oecd.org

JT03475484

1 Climate resilience through finance and investment

Aim

The aim of this programme is ultimately to support the Paris Agreement's goal of aligning finance flows with climate resilience. This means avoiding investments that undermine climate resilience, while also encouraging patterns of finance and investment that actively contribute to societal resilience. This includes both the public and private sectors, in OECD countries and beyond.

The focus in this biennium will be to develop and begin to develop and operationalise a systemic framing of finance and investment for climate resilience. This will include longer-term efforts to identify and analyse relevant datasets to understand emerging trends, support for peer learning to share good practices and the contribution of emerging findings to influence and inform relevant international processes (such as G7, G20 and the UNFCCC).

Rationale

Climate change impacts are far-reaching, increasingly severe and happening now. These impacts include, for example, more frequent heatwaves, extreme floods and the inundation of coastal areas. The Chair of the UK Environment Agency recently stated that climate impacts in the UK were already hitting "worst case scenario" levels[1]. The diversity and complexity of climate risks will make impacts increasingly hard to predict in future.

Systemic changes will be required to address this challenge[2]. There is an urgent need to be on a pathway towards net zero emissions. Achieving this will require a range of interventions, ranging from electrification of transport to rethinking how we produce and consume food[3]. However, there is also the need to be on a pathway that builds resilience against the impacts of climate change, by managing exposure to climate hazards and strengthening adaptive capacity.

Finance flows have a critical role to play in enabling these systemic changes, as is recognised by article 2.1 c) of the Paris Agreement. This article calls for "making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development". Achieving this aim will require mobilising increased finance and investment to prepare for rising climate risks[4], but it also requires ensuring that all investments are climate resilient – i.e. consistent with the reality of mounting physical

[1] https://www.theguardian.com/environment/2021/feb/23/climate-crisis-hitting-worst-case-scenarios-warns-environment-agency-head

[2] IPCC AR5 WG2 chapter 20 - 20 — Climate-Resilient Pathways: Adaptation, Mitigation, and SD (ipcc.ch)

[3] Accelerating Climate Action: Refocusing Policies through a Well-being Lens | en | OECD

[4] Adapt now: a global call for leadership on climate resilience - Global Center on Adaptation (gca.org)

climate risks. There is a compelling economic case for doing so, with the Global Commission on Adaptation finding average benefit-cost ratios of 4:1 for a sample of investments, including nature-based solutions to manage flood risks and climate-resilient infrastructure[5].

A focus on consistency (or alignment) is necessary because, in general, resilience to climate change is a necessary condition for meeting other goals in a changing climate. For example, people want access to reliable, cost-effective and clean transport options in a changing climate. They want their homes to have protection from extreme events that is robust to a range of future climates. Businesses want to avoid costly disruption to supply chains. The implication of this is that majority of spending needed to prepare for the impacts of climate change will be an integral part of other expenditure, rather than being specifically for adaptation or climate resilience. Conversely, expenditure for other purposes may inadvertently increase exposure or vulnerability to climate change, such as new development in flood-prone areas.

The other implication of the focussing on adaptation as means to other objectives is that building resilience to climate impacts needs to be done on a cross-sectoral and system-wide approach, rather than just focussing on standalone interventions. Climate risks will propagate through systems – as when flooding in Thailand disrupted global supply chains for IT and automobiles[6]. These risks require a systemic response: at the urban level, for example, interventions to reduce the impact of heatwaves could include investments by local government (changing road surfaces, greening urban spaces and making water available in public spaces), building developers (energy-efficient buildings, light-coloured roofs) and social services (installing air conditioning in retirement homes). Taken as a whole, the interventions need to be coherent and at sufficient scale to address the underlying climate impacts, involving diverse actions by the private sector and different parts of the public sector.

This system-wide perspective means that building resilience through finance requires a multi-pronged approach that drives multiple sources of public and private finance away from potentially mal-adapted projects and towards activities that contribute to climate-resilient economies and societies.

The challenge of managing increasing climate risks is not only a question of spending more money: it is also a question of spending money differently. However, this is not yet the case[7]. As a recent example, less than 1/3 of the USD 20.5 trillion allocated to the economic recovery from COVID has explicitly considered resilience[8]. Only 21% of recorded climate finance towards the USD 100 billoin goal went to adaptation or related activities[9]. This programme is intended to provide the evidence, arguments and good practices to help achieve greater consistency between climate resilience, investment and underlying finance.

Recent policy developments

At the national level, OECD countries' adaptation plans often recognise the importance of finance, but few have established specific mechanisms or budgets for public action. In those countries that have specified budgets, the objective has been to identify public finance contributing to climate adaptation objectives, rather than the broader question of alignment. France, for example, has budgeted EUR 3.5 billion for the

[5] Adapt now: a global call for leadership on climate resilience - Global Center on Adaptation (gca.org)

[6] https://www.bbc.com/news/business-15285149

[7] https://www.unep.org/resources/publication/are-we-building-back-better-evidence-2020-and-pathways-inclusive-green

[8] Adaptation Finance in the Context of Covid-19 - Global Center on Adaptation (gca.org)

[9] Climate Finance Provided and Mobilised by Developed Countries in 2013-18 | en | OECD | OCDE

implementation of its 2018-2022 National Adaptation Plan[10]. Canada has undertaken considerable efforts to identify federal investments in climate adaptation, including the identification of major funding projects in the annual progress reports on climate change[11].

The European Union has been tracking the contribution of its structural and investment funds to climate objectives. An evaluation in 2018 found that the LIFE programme, which funds environment and climate action, spent EUR 184 million on adaptation-related projects[12]. Beyond this, EUR 13.9 billion of EU spending was recorded as having adaptation benefits. A further EUR 48.5 billion was recorded as contributing to both adaptation and mitigation. The EU's 2021 Strategy on Climate Adaptation includes a commitment to ensure that 30% of the EU's budget for 2021-27 contributes to climate action, as well as measures to support investment in key areas, such as nature-based solutions[13].

The private sector, including infrastructure owners and operators, are investing to reduce their vulnerability to climate risks[14]. These investments are driven by factors including the desire to avoid damage or disruption to their assets, ensuring compliance with regulations and avoiding reputational damage. These investments can have the effect of supporting climate-resilience, but are generally not labelled as such.

Initiatives to align private investments with climate goals have focussed mainly on the challenge of reaching Net Zero emissions. However, this is now starting to change and there is growing public recognition of the need to understand and manage physical climate risks. The Task Force on Climate-related Financial Disclosure's (TCFD) guidance has called for the disclosure of physical climate risks and opportunities. Reporting remains at an early stage, hampered by a lack of consistency and transparency for relevant metrics. New initiatives are aiming to address these barriers. For example, one of the COP26 Flagship Initiatives is the Coalition on Climate-resilient Investment (CCRI), which brings together investors with USD 12 trillion of assets under management to better price physical climate risks within financial markets.

There have been significant progress in developing taxonomies and definitions for sustainable finance[15], which aim to increase consistency and transparency in the labelling of financial assets. This includes work to define whether an asset can be said to contribute to climate change adaptation. As the demand for sustainable finance increases, the development of definitions will be critical in safeguarding confidence and ensuring environmental impact. The EU has taken a pioneering role through the establishment of the taxonomy for sustainable activities, which includes definitions for adaptation. Other countries are also discussing the issue of taxonomies.

Role of the OECD and recent work

This programme will engage with a wide range of partners, building on the OECD's strong capabilities in data and analysis, covering key topics such as climate adaptation, infrastructure and sustainable finance. It will also build on the OECD's capacity to take a "whole of government" perspective in establishing standards and identifying good practices. The OECD also works closely within key international processes, including the G7 and G20, as a trusted source of expertise and neutral party.

[10] French MMR 2019 (europa.eu)

[11] https://www.oecd.org/finance/climate-change-risks-and-adaptation-9789264234611-en.htm

[12] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018DC0738&from=EN

[13] eu_strategy_2021.pdf (europa.eu)

[14] Anchoring Event: Infrastructure - #AdaptationSummit - YouTube

[15] OECD (2020), Developing Sustainable Finance Definitions and Taxonomies, Green Finance and Investment, OECD Publishing, Paris, https://doi.org/10.1787/134a2dbe-en.

This programme will build on the extensive work underway across the OECD on climate policy, supporting the UNFCCC negotiations, sustainable finance, development co-operation and sectoral policies.

An initial analysis of OECD countries' approaches to financing domestic adaptation was included in the 2015 publication, *Climate Change Risks and Adaptation (*2015). This report found that the availability of finance was a barrier to the implementation of adaptation. At that stage, estimates were focussed on identifying expenditure directly linked to the implementation of adaptation plans or strategies, rather than attempting to measure the overall degree of alignment in the economy.

The OECD flagship report, *Financing Climate Futures* (2017)*,* provided comprehensive guidance on how governments can ensure alignment between infrastructure investment and the aims of the Paris Agreement. Focussing on climate mitigation, this report explored priorities for aligning finance through policies relating to innovation, fiscal sustainability, financial sector reform, urban financing and development finance. This report also outlined how improved infrastructure planning could support investments in resilience.

Sectoral work on climate adaptation has explored some of these issues in further detail. *Climate-resilient Infrastructure (*2018) examined current practices throughout the OECD and G20 countries to encourage resilient investment. The specific challenges of funding green infrastructure were explored in the publication, *Nature-Based Solutions for Adapting to Water-related Climate Risks (*2020). Work in this biennium on wildfires and resilient infrastructure will also generate insights on financing adaptation.

Work relating to adaptation and development co-operation has shed light on priorities for mainstreaming climate-resilience into development co-operation. This includes *Aligning Development Finance and Climate Action* (2019) and *Strengthening Climate Resilience in Developing Countries* (2021). The OECD Development Assistance Committee's *Blended Finance Principles* identifies how international public finance can be used to increase private sector investment.

The OECD has also been supporting transparency and ambition on climate action through data and analysis of international finance flows. *Climate Finance Provided and Mobilised by Developed Countries in 2013-18* (2020) explores the methodological challenges and political choices about what can and ought to be counted as climate finance. It found that, in 2018, international public finance was USD 16.8bn for adaptation, compared to USD 55bn for mitigation.

Work is ongoing, under the Research Collaborative on Tracking Finance for Climate Action to assess the alignment of finance with climate mitigation goals. Country-sector level pilots conducted in the 2019-2020 PWB have to explored data and methods. Areas of work proposed for the 2021-2022 PWB include the design of guidance on policy-relevant assessments, as well as investigating options to develop country- and sector-level indicators (reference to scoping note). Close synergies will be sought with the work proposed in the present scoping note.

The *Paris Collaborative on Green Budgeting*[16] was launched in 2017, with the aim of aligning national expenditure and revenue processes with environmental goals. Recent work in this area has included the use of green budget tagging to identify relevant expenditure, and analysis of the impacts of climate change on long-term fiscal sustainabiliy.

The work of the *Centre on Green Finance and Investment*, as well as relevant initiatives such as the *Round Table on Financing Water*, and the work programme on finance and biodiversity have provided platforms for discussion, generated analysis and supported action on these agendas. The *Task Force on Climate Change Adaptation* highlighted finance as a critical area for future work.

[16] Paris Collaborative on Green Budgeting - OECD

Proposed approach and outputs:

Given the crosscutting nature of this topic, this work will be undertaken in collaboration with existing initiatives wherever possible.

In particular, the Secretariat will explore the potential to integrate adaptation into ongoing projects for climate finance and investment. The scope of the work does not cover the measurement or definition of climate finance within the context of the UNFCCC negotiations, as these are issues that are being addressed by other OECD programmes.

Outputs for the current biennium (2021-2022):

Output 1: Framing paper (November 2021)

The framing paper will develop a vision for the contribution of finance and investment to a climate-resilient future. It will summarise key literature on financing needs, and make the case for increasing the alignment of public and private finance and investment with the reality of mounting risks from climate change. It will identify the key distributional issues raised by the transition to climate-resilient societies. It will highlight key (systemic) bottlenecks and areas of emerging good practice. It will also identify priorities for enhancing ambition and strengthening enabling environments to achieve better alignment.

Output 2: Foundational dialogue, evidence and analysis to support action (End 2022)

Work under this will explore one or more of the following issues, working jointly with other teams and projects overseen by WPCID. These will be refined during the production of Output 1, with the scope and level of ambition determined by the availability of resources:

- Implications of a systems approach for finance and investment: This work would examine the implications of taking a systems approach towards resilience, including the concepts of "resilience-by-design" and "resilience-by-intervention". It would build on the approach outlined in *Better Systems for Better Lives* [ENV/EPOC/WPCID(2021)3] to identify the implications for financing and investment of adopting a systems approach to climate resilience, including additional financing needs.
- Developing approaches for measuring alignment: This would focus on defining alignment in the context of climate resilience, and developing a framework for measuring alignment. This could build upon work undertaken for the EU taxonomy for sustianable activities. This would be done in collaboration with the Research Collaborative, as an extension to the planned work on *Measuring the Alignment of Investments and Financing with Climate Mitigation Goals* [insert cote].
- Integrating climate resilience into sustainable financial systems: this work could focus on identifying the implications of climate change impacts for sustainable finance. It could include scoping of needs and state of play with respect to impacts on different asset classes, integrating resilience into the assessment of environmental impacts and identifying taxonomies and definitions relevant to climate resilience. This would be done in collaboration with work under *Scoping work on green finance and investment for the PWB 2021-2022 [insert cote]*

Output 3: Peer-learning, engagement and outreach (continual)

Climate resilience needs to become part of the broader discussion around achieving a sustainable financial system. This work area will support the integration of climate adaptation into existing OECD platforms, such as building links with the *Research Collaborative* and the *Paris Collaborative on Green Budgeting.* It will also link with international processes, such as the G7 and G20. It will also include engagement in key international events, such as the UNFCCC COP26.

Potential further work for the next biennium (2023-2024):

The scope of the work in subsequent years will be determined through the development of the Programme of Work and Budget and initial scoping papers will need to be prepared for the EPOC meeting in October. At this stage, potential areas of work could include:

Quantitative and spatial analysis of climate-resilient finance and investment

Building on the framing work undertaken in Output 2, work in this area would intend to develop the evidence base on climate-resilient finance and investment. This could include application of the measurement of current trends in alignment and spatial distribution of benefits from investments in climate resilience. It could be used to underpin work to estimate additional financing needs for building climate resilience.

Country engagement on climate-resilient finance and investment

Engagement with countries will support the practical application of the insights gained from this work programme, while also supporting peer learning and informing the development of future work. For this country engagement, the OECD Secretariat would work with interested countries to facilitate the development of the financing components for their national adaptation strategies, or integration of climate resilience into key sectoral strategies (e.g. infrastructure pathways).

Guidance on mobilising and aligning finance for climate resilience

Building on the previous outputs, this would provide practical guidance for governments to support their efforts to mobilise and align finance through their adaptation strategies and plans. This could include topics such as macro-fiscal policy, policy appraisal, regulation (e.g. environment; procurement; finance), strengthening the enabling environment for private finance, public budgeting and sub-national financing. It would be produced in collaboration with relevant directorates to provide a "whole of government" approach to this topic, grounded in the needs of policymakers working on climate adaptation.

Project management and governance

This work will be overseen by WPCID and EPOC, benefitting also from regular input from the Task Force on Climate Change Adaptation. Relevant outputs will be presented to WPBWE and the Round Table on Financing Water. Other relevant committees (e.g. DAC, DAF, CFE and ECO) will be engaged as appropriate. Links will be made with other relevant initiatives, including the horizontal project on *Building Climate and Economic Resilience in the Low-carbon Transition.*

Budget and funding

The framing paper (Output 1) will be produced using Part 1 resources. The subsequent outputs will require additional Voluntary Contributions, the budget for which will be determined during the production of Output 1.

Questions for delegates:

1. Does the proposed framing resonate with the challenges faced in your country?
2. Are there initiatives underway in your country that would be relevant to the development of this programme of work?
3. What are the key partners the OECD should engage with to deliver value-for-money on this topic?