The role of international climate finance initiatives

Financial institutions have a critical role in stepping up the actions against climate change. In Article 2 of the Paris Agreement, nations agree to scale up finance flows consistently, opening a pathway towards low greenhouse gas emissions and climate-resilient development. Consequently, 'climate finance' will continue to remain central to the climate change agenda. The recent United Nations Climate Action Summit brought together governments, the private sector, civil society, local authorities and international organisations to develop ambitious solutions to align public and private finance with a net-zero economy.

Private financial institutions and investors play a key role in achieving the global climate change target. According to the UNFCCC Standing Committee on Finance, between 2013-2014 and 2015-2016, climate finance flows grew 17 per cent, to USD 680 billion from USD 584 billion. The private sector accounted for more than 65 per cent of these flows in 2015, due, in particular, to the increase of investments in renewable energy and energy efficiency. However, as climate finance remains far below the estimates of what is needed, there is still much to be done to scale it up.

While there is no agreed definition, in most cases private climate finance refers to the capital provided by the private sector for reducing emissions, enhancing greenhouse gas sinks, and for reducing the vulnerability and maintaining and increasing the resilience of human and ecological systems. Given the international urgency to tackle climate change, the financial sector has become an increasingly prominent stakeholder, since it is able to act as financiers for clean development. It is also important to bring in the efforts of transnational non-state actors that can draw multiple stakeholders together to scale up the mobilisation of climate finance.

With this background, there is growing interest in how to mobilise further private climate finance. In this respect, the adaptive markets hypothesis could carry an interesting implication. Combining the concepts of behavioural finance and efficient markets, the adaptive markets hypothesis assumes that investor behaviours are consistent with the evolutionary model of human behaviour.

As Stephen Hall et al. (2017) argue, this sheds light on institutions in the evolutionary systems of sustainable financing. Institutional factors can be used to analyse if those evolving elements influence the financial sector's decision-making on investment.

Institutional factors can be external or internal. Important external pressures on financial institutions could come from governments' climate change policies or regulations, or from transnational non-state actors such as climate finance initiatives to expand climate-friendly and sustainable investment practices. As for internal factors, corporate governance against climate change could determine an institution's level of engagement in climate finance.

My research builds on the quantitative analysis of publicly available information on global financial institutions, with insights on the international governance of climate finance mobilisation. I'll start by considering the external factors. Transnational non-state actors have programmes to raise awareness of climate risks among member financial institutions. The more climate finance initiatives financial institutions join as members, the higher their level of climate finance engagement. Interestingly, the stringency of governments' climate policy is not positively associated with financial institutions' level of engagement in climate finance. This is consistent with existing studies that found that carbon policy does not influence carbon management.

With regards to internal factors: the understanding of climate risk in the senior management level is positively associated with their institutions' higher commitment on climate finance. On the other hand, employees' awareness of climate change is less likely to have an impact on climate finance, which denotes that, rather than the bottom-up approach, it's the top-down approach against climate change that can raise the ambition of financial institutions in engaging in climate finance.

As mentioned above, international climate finance initiatives are becoming a distinctive intermediary to mobilise private financial institutions. They have direct engagement with institutions and investors and raise their ambition towards sustainability and climate change. Those activities typically include capacity building, training, knowledge-sharing and dissemination of private governance schemes. Those initiatives also engage with multilateral organisations such as the UN Climate Change Secretariat to align global climate governance efforts.

Climate change is characterised by a fragmented governance structure, or what is called a 'regime complex'. In this sense, the orchestration of stakeholders surrounding climate change and finance is crucial to integrating financiers to shift their actions to achieve governance goals even within this fragmentation. As Kenneth Abbott and Duncan Snidal (2009) suggest, through a wide range of directive and facilitative measures, or 'orchestration', international climate finance initiatives could steer public and private actors, including the financial sector. The facilitative approach offered by those emerging transnational non-state actors can offer a way to accomplish global climate goals that are hardly achievable through conventional global governance.

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Notes:

- *This blog post is based on the author's paper What are the determinants for financial institutions to mobilise climate finance?, 2019, Journal of Sustainable Finance & Investment 9(4).*
- *The post gives the views of its author, not the position of LSE Business Review, the London School of Economics, Keio University or UNEP.*
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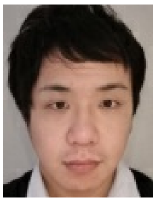

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