# Building inclusive, green and resilient economies

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**Recovery from the Covid-19 pandemic has provided countries with a unique opportunity to 'build back better'. Leveraging this opportunity will entail ensuring that stimulus and policy packages are both inclusive and green. Yet recovery-related spending must be directed in accordance with evidence of what works. Support from the international development finance community will enable lower- and middle-income countries to deliver evidence-backed inclusive and green recovery measures.**

With the first cases of Covid-19 now over two years behind us, it is clear that, among its many other human consequences, the pandemic has been expensive. Governments have spent to protect their populations, to cushion the economic blow of recession, and to support the recovery. Spending to sustain that return to growth continues today. Amidst such significant public outlays, it is relevant to ask what kind of future this money is directing us towards. Countries face a once-in-a-century opportunity to ensure major public stimulus and policy packages are consistent with climate resilient development pathways to net-zero emissions by 2050.

Former Governor of the Bank of England Mark Carney has highlighted1 that a properly managed recovery from the Covid-19 crisis has the potential to accelerate the reallocation of capital towards sustainable pathways. Meanwhile, failure to embed principles of inclusivity, sustainability and resiliency within public-led recovery programmes threatens to exacerbate the dual climate and inequality crises, with investment in new carbon-intensive infrastructure and businesses locked-in

for decades.

It is already known that significant green investment is necessary to deliver net-zero emissions by 20502, and if recovery-related spending is to contribute to the green transition, it must be directed based on the available evidence of what works, and what does not. Support from the international development finance community will also be essential to ensure that lower- and middle-income countries receive the support they need to ensure that the delivery is inclusive, as well as green.

## Context for building back better

Government-led recovery plans in the face of Covid-19 have generally comprised two kinds of measures: fiscal stimulus packages of public spending and investment, and accompanying policies to incentivise private sector output and investment. Fiscal stimulus packages include both capital investment (e.g. energy, digital infrastructure and lending to businesses) and public expenditure (e.g. health care, social protection, and public works programmes).

Policies to incentivise private sector output and investment include measures such as tax breaks, de-risking and the strategic use of public procurement. The two measures are not rigidly separated and can be mutually reinforcing, particularly in the case of the green transition. Measures taken to reform fossil fuel subsidies and increase spending on green energy options can level the playing field for private investors in low carbon power and mobility, and the reform of inefficient agricultural subsidies can incentivise climate-smart and resilient farming practises.

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For economies heavily dependent on fossil fuel exports, fiscal stimulus measures taken in the shorter term could help diversify economic output, supporting the phasing out of less competitive assets, and investment in new workers and skills. Governments have demonstrated a willingness to spend trillions3 to support the recovery, in many cases with the conscious4 (if not always realised) intention to ensure the funds will allow countries to "build back better". National budgets and political will being finite, it is important that spending reflect the evidence. A working paper by Hepburn et al. (2020)5 assessed the potential value of different fiscal recovery measures across G20 countries in terms of their capacity to act as an economic multiplier and to deliver on climate impact metrics. The top five recovery options, identified as having high economic multipliers and positive climate impact, were the following:

- **Clean physical infrastructure investment** in the form of renewable energy assets, storage (including hydrogen) and smart grids/ modernisation;
- **Building efficiency investment** in the form of renovations and retrofits, including improved insulation, heating, and domestic energy storage systems;
- **Education and training investment** to tackle both the immediate impacts of Covid-19 on employment and wider structural shifts from decarbonisation;
- **Natural capital investment** to improve ecosystem resilience and the restoration of degraded land and habitats;
- **Rural support and investment**, to accelerate the adoption of sustainable agriculture, ecosystem regeneration, and accelerate clean energy installations.

The above policy options are generally applicable to countries at a range of different development

stages, while the authors identified “Clean R&D investment” to bring down the cost of innovative new clean technologies as being better suited for less developed economies. Importantly, several of these policies also directly connect to the private sector, as suppliers, sources of innovative technology, and investors. Governments will not be able finance the green transition without private capital, and this is particularly true of the developing world, where the needs are greatest.

The pandemic has demonstrated again that wealthier nations cannot afford to ignore the developing world. Just as public health measures in Europe can be undermined by virus variants that have arisen in countries without the benefit of widespread vaccination, ambitious climate policies will not shield developed nations from the effects of climate change if developing countries are not also supported in their efforts to reform their economic models This does not even take into consideration the moral case for helping developing nations, who will suffer disproportionately effects of climate change whilst also having contributed least6 to its causes. Development finance institutions (DFIs) are an effective tool to channel this support to the developing world, while also helping to attract and mobilise private investment, and such institutions have made significant progress recently in improving their own capacity to deliver green investment.

## The role of DFIs

DFIs stand to support the green transition in the developing world in several ways, including by delivering green finance, technical support to clients, and policy support, while also prioritising the mobilisation of private sector investment. The experience of the Association of European Development Finance Institutions (EDFI), whose membership of 15 DFIs includes the UK’s British International Investment (BII, formerly CDC Group), provides an illustrative example.

The most recent available data, from 2020, when the pandemic was already a significant barrier to investment, shows that EDFI members delivered a total of almost €1.4 billion in new climate finance (approximately one-third of which was invested in renewable energy projects), adding to an overall climate finance portfolio in excess of €10 billion. This investment is supported by having adopted a harmonised definition of climate mitigation finance, to ensure comparability across institutions, and ambitious recent public commitments7 (see box below) to align investment with the Paris Agreement and develop common methodologies to ensure this.

EDFI’s recent public climate commitments also included a recognition that DFIs must support clients in their own transitions, and much of the nearly €40 million in technical assistance funds that EDFI members deployed in 2020 (over 40% of which are going to Africa) went into supporting climate-related improvements. With one-third of EDFI members’ portfolio in Africa, 18% in Latin America and the Caribbean, and 15% in South Asia, the investment is being directed to countries where it is sorely needed, and in ways that support a just transition.

As public-backed institutions, DFIs have demonstrated their ability to deliver investment on behalf of developed countries in ways that support a green and inclusive transition in the developing world. Increasingly, DFIs are also seeking to partner with public authorities in developing countries to create enabling conditions for such investment, whether made by DFIs or private investors. EDFI members have partnered with the Climate Finance Leadership Initiative (CFLI)8 on delivering a report for policymakers entitled “Unlocking Private Climate Finance in Emerging Markets9”.

This report has been followed by the development of “country platforms”, led by governments, to promote a “whole of financial system” approach to addressing climate investment needs. CFLI, the UK Government, the City of London, the Global Infrastructure Facility (GIF), BII and other EDFI members are now working together as part of CFLI India to generate a pipeline of bankable opportunities for scaling up investment in sustainable infrastructure in India. This includes renewable energy and the associated grid infrastructure and storage capacity (e.g., electromobility

charging stations). The ability to combine investment with policy advice, while bringing in the voice of the private sector, is unique to DFIs and makes them a vital tool in the effort to support sustainable growth in developing countries.

**EDFI statement on climate and energy finance**

**1/** EDFIs **will align all new financing with the objectives of the Paris Agreement** by 2022 and will transition our investment portfolios to net-zero GHG emissions by 2050 at the latest.
**2/** EDFIs **will exclude new coal and fuel oil financing**, and will limit other fossil fuel financing to Paris-aligned projects until generally excluding them by 2030 at the latest.
**3/** EDFIs **will build on our track record in climate finance and mobilizing private sector finance** by holding ourselves to ambitious individual targets and by reporting publicly on our progress.
**4/** EDFIs **will invest strategically** and provide assistance to our clients to support the development of Paris-aligned projects, and to promote green growth, climate adaptation and resilience, nature-based solutions, access to green energy, and a just transition to a low-carbon economy.
**5/** EDFIs **will make climate-related financial disclosures in line with high international standards**, specifically adopting the recommendations of the Task Force on Climate-related Financial Disclosures.
**6/** EDFIs **will embed climate action and climate risk management a**t every level of our institutions.

## Conclusion

The pandemic, and the associated public spending, provides an opportunity that the planet cannot afford to miss. The declared aspirations around much of this spending have been encouraging, and we must continue to ensure that the money is directed towards a recovery that is more sustainable than the economies that preceded it, in particular by reflecting on the growing body of evidence around policy effectiveness.

The interconnected nature of the problem also demands a global response. DFIs have demonstrated that they are capable of effectively directing green investment, while also providing insight into reform initiatives, and should be a cornerstone of efforts to support a just transition in low- and middle-income countries.

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