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STEERING TOOLS FOR THE TRANSITION

Money, money, money: Financing plans for the climate transition

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I4CE is a non-profit research organization that provides independent policy analysis on climate change mitigation and adaptation. The Institute promote climate policies that are effective, efficient and socially-fair.Our 40 experts engage with national and local governments, the European Union, international financial institutions, civil society organizations and the media.

Our work covers three key transitions – energy, agriculture, forest – and addresses six economic challenges: investment, public financing, development finance, financial regulation, carbon pricing and carbon certification.

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EXECUTIVE SUMMARY

France should publish mid-year its first multi-annual strategy for financing the ecological transition. This is a long way from the first 2015 climate strategy, which barely touched funding aspects. And it is good news. We at I4CE believe that such plans are essential tools to support the transition to low-emission, climate-resilient economies. Credible, multi-year public spending targets help to embark the private sector and the funders of public action (debt holders, international donors) in the transition, and redirect financial flows as demanded by the Paris Agreement. Comprehensive financing plans also avoid simplistic approaches based on case-by-case project appraisal on the basis of limited cost-benefit considerations, which can ultimately result in significant additional costs.

We believe this is the right time to discuss such plans.

Beyond France, international climate discussions have taken a resolute turn towards the financing aspects of the transition. UN's **Simon Stiell reminded us last week** that USD 2, 400 billion are needed every year, starting now, to finance climate action in the global South (excluding China). The reform of the global financial architecture, initiated in 2022, is underway. So is the re-negotiation of the target for climate finance flows from developed to developing countries, currently standing at USD 100 billion per year. To come up with meaningful solutions, these two processes will need to rely on tangible information on the needs and priorities of recipient countries. Brazil, which is hosting this year's G20 and next year's COP30, has made climate finance one of its priorities. At the EU level, ambitious commitments such as the freshly out **"90% emissions reduction by 2040"** still lack predictable financial support over the next 5 to 10 years. The NextGenerationEU recovery plan, which will phase out by 2026, leaves a void in the EU climate finance policy, and the fund-by-fund approach lacks the overall consistency which is needed to provide a real answer to the United States' Inflation Reduction Act.

Within France, the subnational context is ripe for working on medium-term climate-sensitive financing plans at the local government level. We now have a figure for subnational public climate investment needs: around €12 billion annually. Roughly a third of France's overall climate investment gap, and a doubling of the current investment pace. That is, leaving adaptation out. The national discussion on ecological planning is now being taken to the local level through regional COPs, under the Prime Minister's authority. France is once again opening up the debate on decentralization and the roles, responsibilities and resources of its local authorities. Ecological planning at the local level is one of the unavoidable topics of such a discussion.

In 2024 and 2025, I4CE will keep supporting the emergence of multi-annual strategies for funding the transition at the international, European, national and subnational levels. This note summarizes why we strongly believe such strategies matter, presents our work so far in supporting their shaping and making, and more importantly, what is coming up next.

I. A FRENCH TALE

This is a story about a country's progress towards a credible multiannual strategy for funding the climate transition. This story is long already, not over yet, and full of twists and turns.

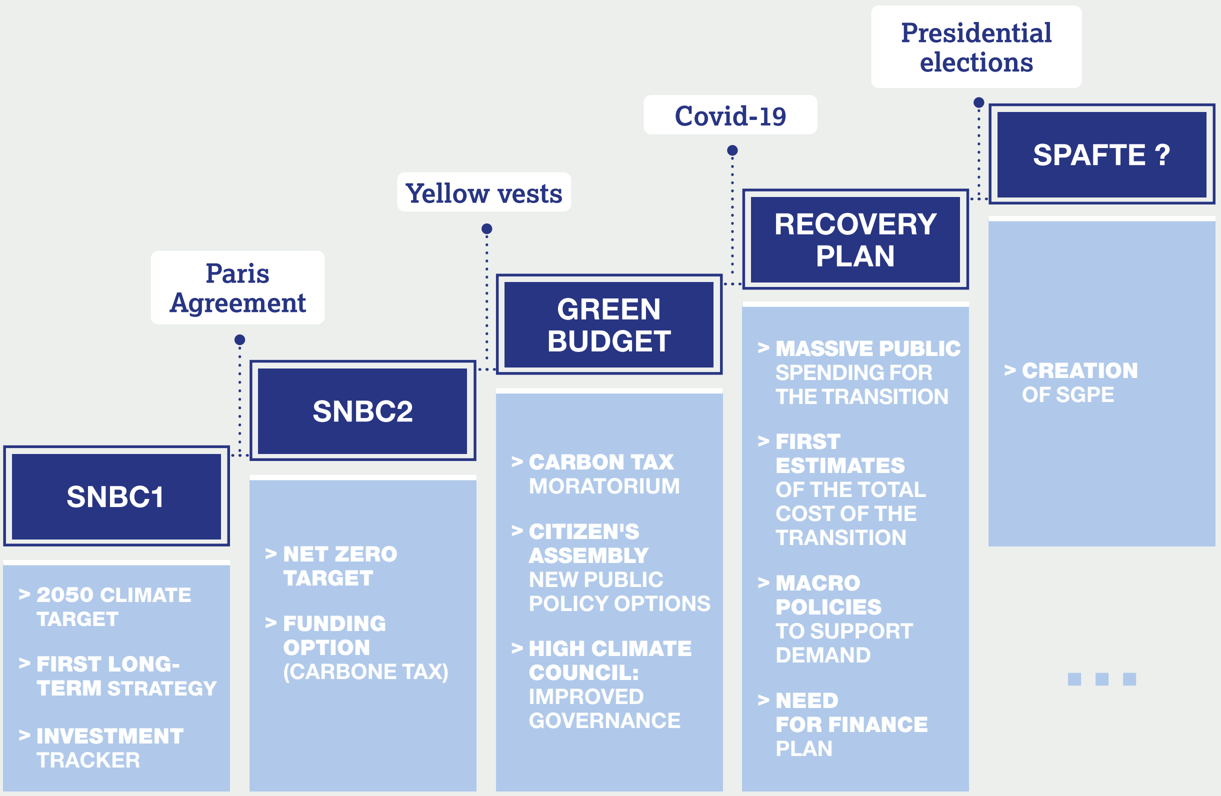
France's first national low-carbon strategy was adopted in 2015, with the aim of dividing emissions by 4 between 1990 and 2050. Yet at the time, few people outside the Environment Ministry knew or cared for its technical content. It had no specific funding, only a form of economic monitoring through I4CE's incipient **Landscape of climate finance.**

After the Paris Agreement, and with renewed ambition, the French Government drafted its second strategy (first released as a draft in 2017), this time aiming for climate neutrality by 2050. The new document did look at the funding issue – and solved it with a carbon tax. Both an incentive climate policy and a revenue-raising tool to fund additional climate projects, it seemed for a while that France had cleared the climate issue, delivering on its climate commitments and even balancing the books. Yet, in the fall of 2018, the Yellow Vests movement showed the limits of this approach. Rapid increases in the rates of the new carbon tax, added to rapidly rising fossil fuel prices, led to a situation in which people and companies had no time to adapt and felt as "energy prisoners". The fact that this carbon tax was riddled with legal loopholes and provided no clarity on the use of proceeds, put the government in an impossible situation; the way out of the crisis included freezing the carbon tax rates and abandoning the initial schedule for rate increases.

Even if the Yellow Vests crisis left the second climate strategy financially toothless, it triggered three major advances. First, a Citizens' Convention for Climate was tasked with exploring alternatives to the carbon tax. It introduced proposals for new regulations and subsidies in the debate, of which a handful were turned into law (but this handful excluded any funding proposal). Second, to make up for the difficulty of tracking carbon tax revenues separately, the government set in motion France's **Green Budget** i.e. an annual analysis of all environment-related central budget spending, environmental fiscal tools, and other environmental funding for climate action in France. Third, because the carbon tax crisis had called into question even the raison d'être of France's climate strategy, the government set up a High Council on Climate, whose advice would transform the strategy from a bureaucratic ghost into solid ground for policy-making across several ministries. Still, governance alone did not provide the necessary funding to make up for the void left by the carbon tax. Many objectives in the national climate strategy were left out of reach, including its overarching climate neutrality target.

Paradoxically, it was the Covid pandemic that provided the opportunity to rescue this stranded strategy. When it became clear that a major form of economic stimulus would be needed to recover from a two-month lockdown, I4CE used its detailed estimates of the climate investment gap to argue that the national climate strategy could be a blueprint for a post-Covid recovery plan that would support both economic recovery and the achievement of climate targets. The French post-Covid recovery plan represented €100bn, out of which c. €20bn were targeted towards climate, and €10bn towards other environmental issues.

FIGURE 1: IMPLEMENTATION OF FRANCE'S MULTI-YEAR FINANCING STRATEGY: KEY MILESTONES



Source: I4CE_2024 @I4CE_
Note: SNBC= low-carbon strategy |SPAFTE = Multi-annual Strategy for financing the ecological transition

Hence, the recovery plan allowed public money to fill the void that had been created by the 2018 crisis around the carbon tax. Thanks to extra public funding, and despite the economic slowdown of 2020-21, climate investments rose in buildings, transport infrastructure, and industry. Policymakers and many observers became convinced that these sectors, among others, would need sustained public support; economic public action for the climate broke free from the previously dominant "carbon tax" thinking, and took the measure of the macro-economic aspects of the far-reaching transition to be implemented.

In 2022, the Prime Minister tasked Jean Pisani-Ferry, a leading French macroeconomist and University Professor, to produce a **report on the economic impact of climate action.** Under his direction, a community of macroeconomists hitherto rather remote from these subjects acted on the macroeconomic challenges attached to the climate transition, and in particular the need for structural policies to increase investment, mobilize savings or support technological change; but also the need to flesh out the economic planning of the transition more widely.

In 2022 still, Emmanuel Macron, then campaigning for re-election, promised the creation of a General Secretariat for Ecological Planning, sitting directly under the authority of the Prime Minister, to 'plan' the future of the transition. Soon after its creation, this new Secretariat was set the task of increasing the consistency of France's national climate strategy with economy-wide investment targets and public spending. The Government is expected to publish its **multi-annual strategy for financing the ecological transition** in mid-2024, which will be the next decisive step in this journey.

II. SO FINANCING PLANS MATTER, AND THEY MATTER NOW

The story for France is far from being over. While the government is currently drafting its third national strategy, taking in lessons from the past, the road ahead is narrow. In many sectors, there is virtually no credible alternative to public funding to support the transition, yet more than ever, the country needs to reduce public deficits. This is exactly what a multi-annual strategy for funding the transition is about: providing a space to ask and discuss difficult questions, with a comprehensive view shaped by the realities of financing needs and capacities.

We, at I4CE, believe that financing plans are an essential tool to support the implementation of the transition to low-emission and climate-resilient economies. Moreover, the current state of international, national and local discussions calls for the emergence of such tools.

1. Three reasons why they matter…

Financing plans are instrumental for the transition, at least for **three** reasons:

1. **They help to establish a country-driven consensus.**
   - Designing an exhaustive financing plan requires a clear understanding by the Ministry of Finance and/or Planning of how long-term climate goals translate into short- and medium-term public spending needs. This capacity is also instrumental in piloting the transition further down the road, through budgeting tools such as climate budget tagging.
   - It also requires broad discussion with line Ministries, project promoters, and national and international investors and donors. This facilitates a country-level (or local authority-level) consensus that respects local needs, priorities and specificities.

2. **They reconcile climate and development goals in a whole-of-economy approach.**
   - This integrated perspective guarantees national development objectives related to energy and food security, to name a few, will be given due attention, and makes room for issues related to the just transition.
   - It also avoids simplistic, case-by-case cost-benefit reasoning, particularly for climate change mitigation. Indicators such as abatement costs offer a useful and attractive metric for comparing emission reduction options but caricaturing a deep decarbonization process in a simple merit-order approach risks leading to a disorderly transition and, ultimately, significant costs resulting from stranded and/or unsuitable assets.

3. **They include short and medium-term public spending targets within a more systemic view which encompasses regulation, private action, domestic resources, and international finance.**
   - This gives a clear signal to the private sector, as well as international funders, as to where public efforts should be supported and/or supplemented, how, and who is expected to step in.
   - It facilitates this “crowd-in” by providing visibility and credibility to public action, clearly linking it to long-term objectives and financing sources. This, in turn helps governments to increase their impact by focusing their own resources on harder-to-fund priorities.

Overall, financing plans can foster an efficient transition by contributing to the redirection of all financial flows towards national low-emission and resilient trajectories. Rather than considering climate action as an additional effort, they reconcile different priorities and time horizons: climate and development, the end of the world and the end of the month.

2. … and a lot more why they matter now, at the international, European, national, and local levels

This goes beyond and below the level of the central state. And of course, it does not apply only to France.

THE EMERGENCE OF FINANCING PLANS IS PARTICULARLY ENCOURAGED BY THE CURRENT INTERNATIONAL CONTEXT.

- **In 2022, a deep reform of the global financial architecture** was initiated in 2022 to identify solutions to better respond to the multiple challenges the world is currently facing and that require extensive financing. It is estimated that USD 2,400 billion per year are needed to finance climate action alone in the global south (excluding China). National financing plans are a central piece of these discussions as they anchor international finance at the national level.

- **Since 2022, the Coalition of Finance Ministers for Climate Action has gained significant momentum,** with over 90 Ministries now committed to taking climate action and aligning their policies with the Paris agreement.

- **In 2023, the Global Stocktake text adopted in December at COP28** stipulates that countries must submit new, more ambitious NDCs within two years, in line with the 1.5°C goal. The UN Climate Change Executive Secretary Simon Stiell **calls for these new NDCs** to be “backed by robust policy instruments, costed out and translatable into shovel-ready investment opportunities”.

- **In 2024,** at COP29, the **’New Collective Quantified Goal’** (NCQG) for climate finance is due to be adopted. This new target should increase the existing (and still to be achieved) USD 100 billion per year commitment made by developed countries in 2009 to finance climate action in developing countries. The NCQG is expected to consider the “needs and priorities” of the recipient countries and to therefore rely on national strategy documents.

- **At the end of 2024, and again at the end of 2025,** Brazil will chair two events of major importance for climate action: the G20 summit, and COP30. In the run-up to the G20, the **Task Force for Global Mobilization against Climate Change** has already begun its work to support " the formulation and implementation of comprehensive plans targeting economic and sustainable transformation".

THE EUROPEAN UNION IS ALSO ACKNOWLEDGING THE NEED FOR SUCH A PLAN.

The EU keeps on showing strong climate leadership and ever-renewed ambition, as shown by the European Commission’s recent proposal of a new EU 2040 target. However,

- The EU still lacks a long-term climate investment plan that provides predictable financial support over the next 5 to 10 years, to support the implementation of the EU climate legislations and targets.

- The NextGenerationEU recovery plan, which is slowly being phased out by 2026, leaves a void in the EU Climate finance policy.

- The Fund-by-Fund approach lacks the overall consistency necessary to drive decisive climate action that would provide a real answer to the United States’ IRA.

- The current EU rules on national fiscal policies are unlikely to lead to major positive changes to support national financing plans among EU Member States.

In France at least, the subnational context is ripe for working on how to design medium-term climate-sensitive financing plans at the local government level:

- **Mitigation investment by local governments should double from their current levels** to reach around €12 bn annually, excluding adaptation measures, according to a **2022 assessment by I4CE**. This is nearly 20% of the total investments borne by subnational governments, and the subnational investment gap represents a third of all additional investments that France needs to trigger in the public and private sector (which also covers both the State, and private actors). Sustaining over time such a large increase in effort calls for dedicated planning and piloting tools.

- The national discussion on ecological planning is now being taken to the local level through **regional COPs, under the Prime Minister’s authority**. This process aims to replicate the consensus-building work of the General Secretariat for Ecological Planning, which landed with the multi-annual strategy for financing the ecological transition.

- France is once again opening up the debate on decentralization and the roles, responsibilities and resources of its local authorities. Ecological planning at the local level is one of the **unavoidable topics of such a discussion**.

- Green budgets are becoming mandatory for subnational governments, paving the way for a better understanding on how much is currently spent in the transition (eg in retrofit) and a better understanding for the agents and elected officials of what matters in terms of ecological impacts in the subnational governments' budgets.

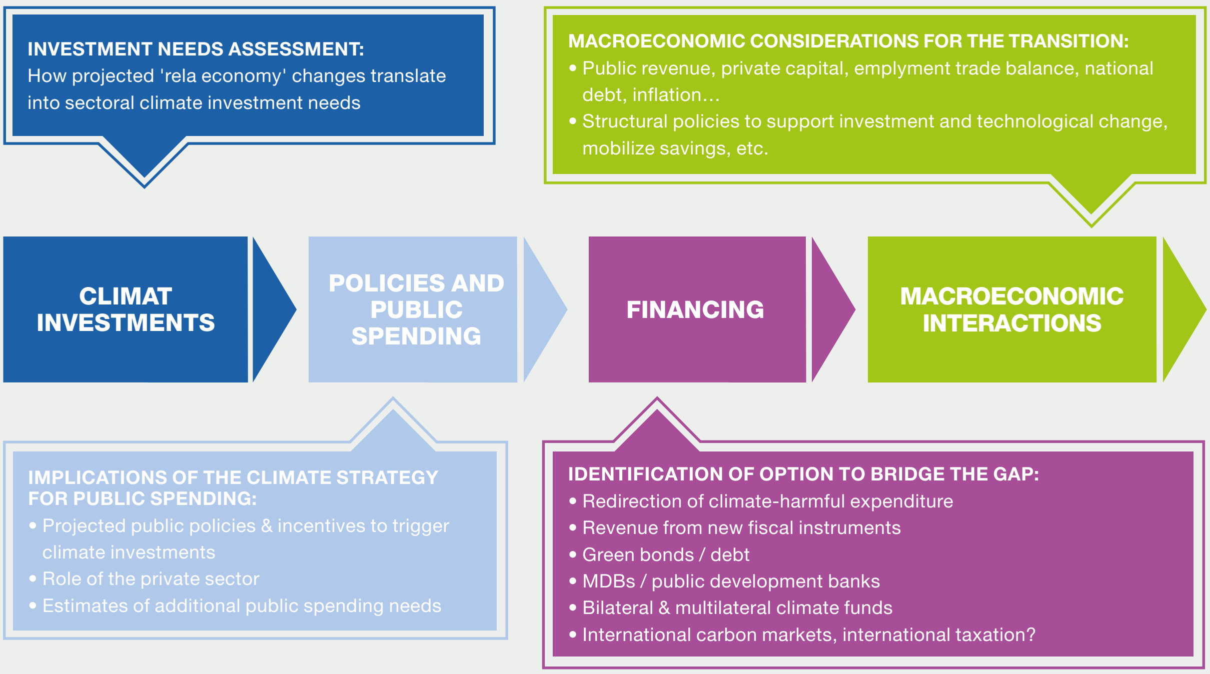
III. HOW TO GET THERE

1. A 4-step process

The construction of a financing plan is necessarily iterative as knowledge, willingness and tools need to progress in parallel. As shown by France's example, the first climate strategy brought the development of the first tracking tools, which in turn helped develop a funding plan for the second one. Climate budgeting tools emerged following the carbon tax crisis yet proved instrumental when the Covid recovery plan called for rapid assessment tools to make quick decisions on large amounts of fresh money. These crises and their responses created the call for a dedicated planning body during the 2022 election, and so on… There is no good starting point, nor overall level of progress. Finding the right balance between what is feasible and what is needed to get things off the ground may well be the most important question in many countries. This is especially true for developing countries, which need to adapt to the consequences of climate change but often lack the necessary administrative and economic resources to do so.

However, to identify key elements of discussion, it can be thought of as a 4-step process, with the country's –or local government's– long-term climate goals as a starting point. These goals can be embedded in a **Nationally Determined Contribution** (NDC) to the UNFCCC, a mid-century **long-term, low GHG, climate-resilient development strategy** (LTS), or in the example of France's local governments, a territorial climate, air and energy plan (PCAET, for its French name).

FIGURE 2 : FINANCING STRATEGIES: KEY BUILDING BLOCKS



STEP 1: Translate climate goals into an investment roadmap

- 85% of the emissions we need to reduce by 2030 require investing in low-carbon equipment and infrastructures[1]. Our homes, vehicles, factories and farms, roads and bridges, canals and railways, power stations and electricity grids, and much more, are the enduring foundations of our economy and our daily lives -yet most of them are incompatible with a net-zero emission scenario. Most of them are not ready for the consequences of a changing climate, and even more so in developing countries – which are particularly vulnerable due to socio-economic factors and are already disproportionately suffering climate impacts.

- These investments will not happen overnight. The investment targets therefore take the form of a roadmap, spread over time and covering the whole economy: households, businesses, local authorities, government and public agencies.

STEP 2: Assess the investment gap

- **"Who is investing?" and "How these investments are financed?"** are the first key questions. The "who" alone is not sufficient: securing subsidies, loans or guarantees is often a condition for projects to go ahead. In order to decide realistically who will be responsible for a given investment, the state –or local government– needs to know whether or not these actors will be able to (and willing to) finance themselves to carry out the projects.

- **"Who should invest, and how much"** comes next. More specifically, what share of projects should be led by the State? By public agencies, or subnational governments? Which investments should be triggered by households? By companies? This question is about national choices of who should bear the burden, and also about realism: it is deeply connected to the question below on how to fund public action. One key point of this decision, the share of public and private contributions should account for the fiscal space of the State and its financial perspectives.

STEP 3: Decide on policy options and associated funding

- **"How to support and / or encourage these investments"** is the next logical step. The answer is a mix of regulation, capacity building, co-investment, loans, subsidies, enabling investments, de-risking interventions… Depending on sectors and project holders, the policy mix is grounded in a country's specificities at a given point in time.

- "How to fund public action" is the last question. This should cover both direct public investments, and the cost of the supporting policies to the private sector, in the framework of the general public budget. Funding sources include redirection or increase of available fiscal resources, new fiscal or extrabudgetary tools (such as resource funds, or, in the case of the EU, ETS-funded Funds), debt instruments such as green or sustainable bonds, along with external finance. In the case of developing countries, this takes the form of generic development finance, or specific climate and/or environment finance. The crucial point here is to be able to integrate these financing sources as part of an orderly funding picture, not a project-by-project basis where the overall efficiency is undermined by a lack of consistency in public action.

Macroeconomic considerations arise throughout the planning process. One issue is to build financing plans within an accurate macro forecast. For example, in the recent context of high inflation, public funding in support of climate investment needs to increase to keep up with prices. Moreover, climate action profoundly reshapes the economy, altering public revenues, private capital, job creation or the trade balance, far beyond the sectors initially targeted in the financing plan. Macroeconomic analysis helps not only to grasp these wider consequences, but also to advise which structural policies are required to help increase investments, mobilize savings or sustain technological change.

1. This figure is from the 2023 Report on the economic impacts of climate action by French leading economists Jean Pisani-Ferry and Selma Mahfouz. As such, it is valid for France, but the order or magnitude is still a good reminder in other contexts.

STEP 4 : Piloting and implementation

> **Governance** is one crucial aspect of a financing strategy. As the transition implies major and coordinated changes, the institutional arrangements should ensure that the efforts are supported at the highest level, and cascaded through the whole administration to private decision-makers. Much work exists here to provide guidance to countries embarking in such a process, from UNDP's **Climate Change Financing Frameworks** to I4CE's proposal for **dedicated adaptation agencies**.

> **Piloting tools** such as **climate budget tagging** or simpler **dashboards** can usefully support the implementation of a funding plan by providing a comprehensive, near real-time view of actual spending and its impact, allowing for rapid corrective action and adaptation to external developments. They also help build capacity among administrations and report towards various stakeholders (administrations, elected officials, civil society, international funders).

> **Processes** blend governance arrangements and tools to ensure a smooth implementation. Initiatives such as the **climate-sensitive PEFA framework** track the readiness of PFM systems, at both local and national level, for the implementation of financing plans.

Such plans are, by nature, living documents. First because the first version rarely meets the needs: the strategy needs to adjust in time to account for unforeseen flexibilities, on in the contrary choices that prove to be dead ends. Second, because unexpected contextual developments, such as the repeated crises the world has known in the past few years, must also be factored in along the way. Lastly, because national choices and targets may also evolve, and financing plans are not only a reality-check for technical long-term strategies: they are first and foremost a means to an end – an end which may change.

2. I4CE's work: Where we stand and what are the next steps

It took 10+ years for France to move from its first long-term climate strategy to today's multiannual strategy for funding the transition. We have detailed above why we are convinced that no such process can happen overnight. Knowledge and awareness need to be built; the conversations need to happen at their own pace.

However, we also believe that it does not always have to be this long.

First, France's journey started out in a pre-Paris Agreement world, in which long-term strategies (LTS) were barely nascent and costing them was out of the picture. Today, more than 70 countries already submitted an LTS to the UNFCCC, and the third generation of Nationally Determined Commitments, which will be presented at COP30, are expected to include funding elements as well as more detailed emissions outlooks. Most of the building blocks that did not exist in the past are now available out there.

Second, France's story was one of learning by doing, of trials and errors. Each country, each local government needs to develop its own plan, based on its own country process, but there are many lessons to draw to ease this process.

And most importantly, there is now an urgent need to develop these plans, and we cannot afford to wait another decade to see the first elements come up. As a consequence, I4CE is committed to supporting the development of multiannual funding strategies for the transition, realistic and funded, at the local, national, European and international level, building on 10+ years of experience with such tools in France and abroad.

WITH FRENCH LOCAL AUTHORITIES,

> We built on our 2022 analyses of the **climate investment gap for local governments,** and **how current climate investments are financed** to assess in 2023 **the perspectives of 4 levers for financing local climate action,** under contrasted national choices (namely debt, displacement of other investments, increased State support, and increased own resources through local taxes) in a joint study with the French bank La Banque Postale

> In 2024 and 2025, we will (i) update our investment gap analysis and (ii) **support dialogues towards a harmonized methodology** to:

- Assess the cost of reaching carbon neutrality for local authorities, on a bottom-up basis;
- Integrate these elements in routine financial planning processes, to ensure climate priorities are funded in a consistent way with other, non-climate targets.

So far and to our best knowledge, no local government has made public such a fully developed plan. The 100 cities of the European mission piloted by **NetZeroCities** are the closest to reaching this goal, in their strive toward climate neutrality in 2030.

AS FRANCE'S NATIONAL PROCESS UNFOLDS,

> I4CE will investigate in 2024 a range of financing scenarios for the transition, under several policy mix assumptions, covering direct investments, subsidies, regulation and taxes. We will explore their merits and challenges, how they translate into additional public spending needs in the short- to medium-term, and their implications for the shares of overall funding needs that will be borne respectively by the public sector, companies and households.

> We will explore the question of whether all households in France today can access the transition, i.e. if they have the means to undertake investments in low-carbon mobility and energy-efficient renovations.

> We will also support the ongoing debate around the soon-to-be-published SPFTE, by making its content accessible to a wider audience. To voice their opinion and concerns in this debate, MPs as well as NGOs or researchers must first find their way through a maze of assumptions (investment needs, additional vs. total climate investment figures, State vs. public vs. national finance, etc.) that we will try to interpret and explain.

WITH THE EUROPEAN ELECTIONS LOOMING LARGE IN 2024,

> On behalf of the European Commission, **we trained Finance and Environment Ministry officials from more than 20 Member States** on how to undertake a Green Budgeting process. We also contributed to the creation of the **European Climate Neutrality Observatory** that provides a comprehensive overview of the EU progress in all key sectors, from agriculture to industry, from renewable energy to climate finance.

- We are now contributing to mainstreaming climate considerations in the framework of the next Multiannual Financial Framework (2028-2034) and will publish on February 21 the first annual assessment of the **European Climate Investment Deficit**, which serves as the EU equivalent to the French Landscape of Climate Finance.

WITH 2024 AND 2025 KEY YEARS FOR THE FINANCING DISCUSSIONS AT THE INTERNATIONAL LEVEL,

- We supported integrating finance components into LTS from both a **private sector** and **state government** perspective, with finance institutions benchmarks and practical, turnkey piloting tools. We also recently expanded our work on **carbon pricing** with a focus on the **use of carbon revenues** – exploring their contribution to low-carbon and climate resilient pathways from a wider perspective, and continued **historical work on green budgeting** tools by making room for social considerations in existing tagging exercises (final report forth coming).

- I4CE also actively contributes to the debate on how Public Development Banks (PBDs) can effectively contribute to funding LTSs. In 2022, we published a report on **the role of LTSs in the Paris alignment approaches of Development Finance Institutions**, exploring the possible roles of both the LTS development process and the resulting LTS document in this processes. We have been supporting PDBs and commercial banks in aligning their activities with Paris agreement objectives since 2016. Through our role as Secretariat of **Mainstreaming Climate in Financial Institutions** and extensive **research on the subject**, we contribute to the broader debate on how to make all financial flows consistent with Paris agreement objectives.

- In 2024 and 2025, we started a wide benchmarking work on **existing practices towards multiannual financing plans across G20 countries + pioneers in the field**. This stocktaking exercise will also focus on supporting peer-to-peer dialogues, as we recognize that these considerations are often still nascent in many contexts. We will also interact more closely with a reduced number of countries to concretely support the making of such strategies. This discussion will also include engaging with public development banks to look at systemic ways of delivering impact, ambitious alignment of PDBs and supporting the early retirement of fossil fuel assets.

INSTITUTE FOR CLIMATE ECONOMICS

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