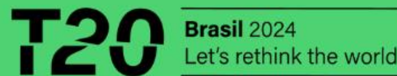
T20 Policy Brief



Task Force 02

SUSTAINABLE CLIMATE ACTION AND INCLUSIVE JUST ENERGY TRANSITIONS

Financing for Just Transition: Urgent Call from Developing Countries to the G20 Visions from Latin America and the Caribbean

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Abstract

Developing countries need to transition to more sustainable finance, but major emitters in Latin America and Caribbean (LAC), as well as many countries in the Global South, rely on an extractivist development model for revenue. The Sustainable Finance Index (SFI)[1] reveals that these countries, including G20 members Brazil, Mexico and Argentina, receive 15 times more carbon-intensive revenues than sustainable revenues. Moreover, they spend 31 times more on activities that cause climate change, such as oil extraction and production, than on activities that help tackle it. At the national level, the gap between carbon-intensive and sustainable revenues is $140 million in Argentina, $8.693 billion in Brazil and $85.066 billion in Mexico. Similarly, in terms of carbon-intensive and sustainable budgets, Argentina has a gap of USD $1.083 billion, Brazil of USD $4.465 billion and Mexico of USD $43.373 billion. Changing this trajectory is essential to comply with article 2.1.c of the Paris Agreement, but also requires compliance with article 9, which calls for finance from developed countries to achieve this transition in a just manner.

Financing for the just transition is urgent and needs to go in several directions. It involves decoupling economies from extractivism, implementing structural changes in the financial sector, including tax reforms to reduce fiscal advantages for carbon-intensive activities, such as fossil fuel subsidies; reallocating budgets to expand fiscal space and address public debts; and developing national climate finance strategies to align needs with international climate finance and cooperation. Therefore, meeting developed

[1] Guzmán Luna, S., Barbosa Mejía, O., and Alvarez Soriano, F. "Índice de Finanzas Sostenibles 2023," in Panorama de las Finanzas Sostenibles en América Latina y el Caribe (2023)

countries' financing obligations, beyond the $100 billion committed since 2009, is crucial. Defining a new collective and quantifiable financing target in 2024 is among the critical issues that the G20 needs to address during this year along the task to furrher operationalize the Loss and Damage Fund.

The Challenges of a Just Transition in Latin America and the Caribbean

Many developing countries, rich in natural resources, have faced a development model imposed by external forces like multinational corporations, international financial institutions, free trade agreements and local interests. This model, primarily based on extractivism, has led to resource extraction without benefiting the general population. Instead, it deepened indebtedness and exacerbated inequality. LAC possess abundant natural resources and favorable conditions to transition, especially towards clean energy. However, the region heavily depends on fossil fuels for income and employment generation. Fossil fuel revenue supports fiscal income, public services, exports, and foreign exchange reserves, posing challenges for transitioning to low-carbon industries[2].

In this context, transforming various sectors, particularly the financial sector, is essential for enabling the transition. This involves increasing climate finance to support transitions, while reducing finance that exacerbates the problem. Under the Paris Agreement, there are two dimensions of financing: first, developed countries must increase their contributions to meet mitigation, adaptation and loss and damage needs (article 9). Second, there is the need to achieve compliance with article 2.1.c which calls for "financial flows at a level consistent with a pathway towards climate-resilient development and low greenhouse gas emissions"[3]. This issue is critical not only for the

[2] IPCC, Climate Change 2022: Mitigation of Climate Change*: Contribution of Working Group III to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change* (2022).

[3] United Nations Framework Convention on Climate Change, Paris Agreement (2015), Article 2.1.c.

climate change agenda, but also for meeting the Sustainable Development Goals and the objectives of the Convention on Biological Diversity.

In this scenario, understanding national financing needs and gaps is crucial. According to the Sustainable Finance Index (SFI), a tool which monitors the revenues and expenditures of developing countries to address climate change, as well as the sources of carbon-intensive revenues and expenditures (mainly from fossil fuel production) , LAC countries face significant challenges in transitioning to low-carbon and climate resilient development[4].

The SFI 2023 results reveal that none of the 20 most emitting countries in LAC included in the study have a "VERY HIGH" level of sustainable finance, which would indicate that their sustainable revenues and expenditures are higher than their carbon-intensive ones. For example, with data from 2022, El Salvador had the highest levels of sustainable finance among the 20 countries, because it is a country with lower fossil fuel-related revenues and is spending more on activities to address climate change. However, countries such as Ecuador, Mexico, and Trinidad and Tobago have the lowest levels of sustainable finance, due to their high revenues and carbon-intensive budgets compared to the other countries analyzed.

Overall, the 20 countries analyzed received 15 times more carbon-intensive finance than climate finance. While the latter amounted to around $11.049 billion, revenues generated by carbon-intensive activities amounted to $160.162 billion. This shows two things: first, that climate finance from developed countries is insufficient, and second, that carbon-intensive revenues keep many economies in a carbon lock-in.

[4] Guzmán Luna, Barbosa Mejía, and Alvarez Soriano, Índice de Finanzas Sostenibles (2023).

At the national level, the discrepancy is significant. For example, among the LAC countries that are part of the G20, the difference between carbon-intensive income and sustainable income is shown to be $140 million in Argentina, $8,693 million in Brazil and $85,066 million in Mexico.

The budget analysis shows that public resources allocated to hydrocarbon exploitation activities exceed 31 times the budget allocated to climate change actions. The 20 countries as a whole allocated $1.96 billion dollars to initiatives aimed at combating climate change, while $62.484 billion dollars were allocated to carbon-intensive activities. In the G20 countries, the gap is shown to be $1.083 billion for Argentina, $4.465 billion for Brazil and $43.373 billion for Mexico.

Changing this trajectory is essential to reverse the climate crisis and to comply with article 2.1.c of the Paris Agreement, but in order to get there, it is also necessary to comply with article 9, which calls for the provision of finance by developed countries to achieve the transition in a just manner.

Recommendations to Achieve a Just Transition in LAC

To deliver on the Paris Agreement commitments and achieve a just transition in LAC, the G20 must advocate for concrete actions to develop a clear financial package tailored to the region's needs, with a particular emphasis on the journey leading to COP29 and COP30.

First, the IPCC[5] emphasizes international cooperation for developing countries and vulnerable regions to enhance low-carbon and climate-resilient development, including improving access to finance, considering national and local circumstances and needs. It is critical to ensure the annual transfer of $100 billion for climate finance from developed to developing countries, and maintain this funding until the establishment of a New Collective and Quantifiable Goal on climate finance (NCQG). This will not only ensure a steady flow of resources but also ensure that developed countries meet their obligations under the principle of common but differentiated responsibilities.

G20 countries should prioritize supporting the design and adoption of the NCQG, ensuring it aligns with developing countries' needs, for effective climate actions implementation, vulnerabilities reduction, and sustainable development. Advocating for a significant increase in adaptation finance is crucial, since evidence suggests adaptation

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[5] IPCC, Summary for Policymakers, in "Global Warming of 1.5°C: An IPCC Special Report on the impacts of global warming of 1.5°C above pre-industrial levels and related global greenhouse gas emission pathways, in the context of strengthening the global response to the threat of climate change, sustainable development, and efforts to eradicate poverty" (2018).

finance needs are 10–18 times current levels[6]. Additionally, developing countries outline their finance needs in their Nationally Determined Contributions (NDCs), which are conditional on international climate finance. As countries fully cost their NDCs, the demand for finance is likely to exceed available funds from bilateral and multilateral sources[7]. It is essential for this finance to come primarily from public resources to ensure predictability and traceability and to avoid increasing developing countries' public debt.

It is also crucial to capitalize the Loss and Damage Fund, following its operationalization at COP28, as current funding commitments are insufficient for the scale of the unavoidable impacts of climate change. Prioritizing direct access to these funds by vulnerable developing countries, including local communities, indigenous peoples, women, youth and children, is essential, as they are often the most affected.

Fair taxation of the super-rich, who have utilized the globalized financial system to avoid their fair share of taxes[8], can be a significant source of finance. The 15% global minimum tax developed by the OECD's Inclusive Framework in its two pillars is a first step to curb the way the world's largest corporations have pressured countries, especially

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[6] United Nations Environment Programme, Adaptation Gap Report 2023: Underfinanced. Underprepared. Inadequate investment and planning on climate adaptation leaves world exposed (2023).

[7] IPCC, *Climate Change 2022: Mitigation of Climate Change: Contribution of Working Group III to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change* (2022)

[8] Gabriel Zucman; Thomas Torslov; Ludvig Wier (June 2018). "The Policy Failure of High-Tax Countries" (PDF). National Bureau of Economic Research, Working Papers. pp. 44–49.

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the poorest, to pay less tax, eroding the tax bases of precisely those countries most vulnerable to climate change[9]. However, a third pillar is still needed to address personal fortunes, eliminate tax havens and create the fiscal space needed to increase sustainable investments[10].

G20 countries must lead a comprehensive transformation of the international financial system, placing climate change at its core. This entails mobilizing high-quality and innovative finance to address climate challenges, making big polluters pay for the social, environmental and climate impacts, phasing out fossil fuel subsidies, and boosting investment in renewable energy and sustainable projects. The transition to a low-carbon economy is essential to combat climate change and ensure a sustainable future for generations to come. Initiatives like the International Tax Task Force[11], the ongoing reform of the Multilateral Development Banks (MDBs)[12], the necessary reform of the

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[9] OECD, Minimum Tax Implementation Handbook (Pillar Two), OECD/G20 Base Erosion and Profit Shifting Project (2023)

[10] Saez, E., and Zucman, G., Progressive wealth taxation, Brookings Papers on Economic Activity 2019, no. 2 (2019)

[11] This initiative was launched at COP28 and co-chaired by Barbados, France and Kenya, with the aim of fostering political will around options for progressive levies to support climate and development action, and to bring together coalitions of willing countries to become front runners for implementing specific progressive tax options.

[12] These multilateral institutions were not designed to respond to the current context of polycrisis, so they have started to incorporate changes in their operations to incorporate climate change into their priorities and to increase the quantity and quality of its resources to meet the Sustainable Development Goals and the objectives of the Paris Agreement.

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governance and operation of the International Monetary Fund (IMF)[13], among others, are already underway.

Furthermore, G20 countries should prioritizeaddresing public debt in developing countries, especially given the sharp rise in debt levels caused by the COVID-19 pandemic, the cost-of-living crisis and climate change. According to the United Nations[14], the number of countries facing high debt levels surged from 22 in 2011 to 59 in 2022. Effective debt treatment requires considering different capacities and needs, including debt cancellation in low-income countries and implementing debt-for-climate action swap mechanisms in middle-income countries. The Bridgetown Initiative, proposed by Barbados Prime Minister Mia Mottley, aims to prevent developing nations from sliding into debt crises due to climate disasters. It advocates for discounted lending from development banks to aid vulnerable countries in building climate resilience and proposes a new mechanism for funding post-disaster reconstruction[15]. Additionally, at COP28, Colombia, Kenya, and France launched the Expert Review on Debt, Nature, and Climate

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The pioneer was the World Bank, when it presented its Evolution Roadmap, which sets out a series of steps and recommendations for reforming its governance structure and decision-making process.

[13] The IMF created two funds, the Poverty Reduction and Growth Trust (PRGT) and the Resilience and Sustainability Trust (RST), however, the problem is that it has managed to disburse less than 10% of these funds due to the conditionalities which the IMF places on its lending.

[14] United Nations, A World of Debt: A Growing Burden to Global Prosperity (2023).

[15] Government of Barbados, *The Bridgetown Initiative* (2022).

to examine necessary reforms at national and international levels to ensure the debt sustainability of developing countries.

At the national level, developing national climate finance strategies is crucial to identify needs and funding sources and to create a portfolio of projects for the implementation of NDCs), adaptation policies and addressing issues such as loss and damage. In addition, innovative financing mechanisms should complement traditional sources.

Promoting the decarbonization of public finances is essential, decoupling financial systems from fossil fuels in a fair, orderly and equitable way to address economic inequities, overcome the climate investment trap in developing countries, reduce fiscal costs of climate change, navigate financial challenges exacerbated by the multiple crisis, and enhance climate finance for a greener post-pandemic recovery[16]. G20 leaders should support fiscal reforms increasing taxes on carbon-intensive activities, such as environmental and carbon taxes. Revenues generated can be reinvested in just energy transition actions, creating economic incentives for changes in investment, production and consumption decisions. The choice of instrument, coverage and pricing should be tailored to national circumstances, priorities and needs[17]. It is crucial that revenues are directed to sectors generating employment and sustainable economic revival. Moreover, taxes should reflect the real cost of pollution, progressively increasing to effectively transform behaviour in polluting sectors.

[16] IPCC, *Climate Change 2022: Mitigation of Climate Change: Contribution of Working Group III to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change* (2022)

[17] World Bank Group, State and Trends of Carbon Pricing 2019 (2023)

Similarly, countries should reallocate budgets away from carbon-intensive activities toward climate change and sustainability-related areas. It is necessary to rethink the resource use and mainstream climate change across budget cycle, analyzing how different economic sectors would be affected by climate events to integrate them into planning and budgeting.

G20 countries must recognize that transitioning to more sustainable financial systems is not just about climate change, but also about ensuring social equity and fairness, leading to improved societal and environmental well-being. This transition offers an opportunity to develop a just transition strategy, ensuring no one is left behind and implementing targeted measures to minimize negative impacts while maximizing benefits. Upholding key principles of just transitions, such as respect for vulnerable groups, fairness in decision-making, and economic diversification, is crucial. Additionally, fostering international cooperation, eradicating poverty, and promoting alternative job prospects are essential for equitable outcomes in the transition process[18].

These recommendations converge at the Brazilian G20 summit in Rio in November 2024. Brazil's presidency's push for international financial architecture reform aligns with COP30 in 2025 being hosted in Brazil, offering a two-year coordinated effort to mobilize G20 action and integrate it into the UNFCCC, facilitating increased and more effective finance for climate action and sustainable development.

[18] IPCC, *Climate Change 2022: Mitigation of Climate Change: Contribution of Working Group III to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change* (2022).

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Key Factors for Successful Outcomes

It is essential to understand that when it comes to just transition, there is no single measure that can change the scenario. Therefore, the financing and fiscal measures mentioned above must be seen and treated as a comprehensive package. The results depend on this context, encompassing factors such as socio-economic conditions, political landscape and environmental considerations.

The countries of Latin America and the Caribbean must become aware of their structural challenges[19] and ensure a just transition towards zero net emissions. This implies internalizing these challenges in an equitable manner, distributing the benefits fairly and mitigating the negative impacts through policies that reduce and compensate them.

For example, if G20 countries advocate for fulfilment the commitment to increase climate finance for developing countries and succeed in pushing for the establishment of a new funding target based on the needs of developing countries, a significant increase in the resources available not only for climate change adaptation and mitigation, but also to address the loss and damage caused by climate change could be expected. This increased availability of funds could catalyze renewable energy, energy efficiency and climate

[19] The main structural challenges in Latin America and the Caribbean are the high dependence on fossil fuels for income and employment production, high socioeconomic inequality, the lack of formal employment, especially in rural areas, the gender gap in the labor market with lower employment rates and wages for women, the lack of access to social protection benefits for informal workers, the dependence on consumption-based tax structures and the low redistributive capacity of public spending.

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resilience projects, creating green jobs, stimulating sustainable economic growth, and thereby reducing financial dependence on fossil fuels.

However, certain measures could have a negative impact if not adequately addressed. For example, the reduction of fossil fuel subsidies could affect lower-income segments of the population that rely on these subsidies, due to its negative effect on the cost of utilities, food and public transport[20]. Therefore, measures that imply the reduction of subsidies must be accompanied by incentives and investments that guarantee alternatives. One approach could involve redirecting fossil fuel subsidies towards clean and renewable technologies that benefit different groups of the population.

Overall, it is essential to ensure that transition policies are inclusive and consider social impacts to avoid further marginalization of already marginalized groups, by encouraging increased investment in job-creating investments that are accessible to excluded groups, such as the care economy, sustainable agriculture and renewable energy[21].

Accelerating progress requires a shift away from structures and systems built for the fossil fuel era. In this sense, the energy transition can be a tool with which to proactively shape a more equal and inclusive world, by overcoming existing barriers across infrastructure, policy, workforces and institutions that hamper progress and impede inclusivity[22].

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[20] Saget, C., Vogt-Schilb, A., and Luu, T. El empleo en un futuro de cero emisiones netas en América Latina y el Caribe (Banco Interamericano de Desarrollo and Organización Internacional del Trabajo, 2020).

[21] Oxfam, Inequalities kill (2022).

[22] International Renewable Energy Agency (IRENA), World Energy Transitions Outlook 2023: 1.5°C Pathway (2023).

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In conclusion, while the adoption of the proposed recommendations could boost the transition towards more sustainable finance, it is necessary to consider economic, environmental and social aspects, to prevent exacerbating inequality gaps. In this sense, the finance and fiscal package that the G20 should promote must respect human rights, gender equality and the well-being of populations, especially the most vulnerable, by establishing socio-environmental safeguards and ensuring that no person, worker, place, sector, country or region is left behind in the transition to a low-carbon and climate-resilient economy.

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