TCW Sustainable Insights

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(Still) Minding the Financing Gap for Climate Action at the IMF/WBG Spring Meetings

Rising geopolitical uncertainty in Europe and the Middle East, growing indebtedness and higher global rates crowding out fiscal space in low-and middle-income countries, and upcoming elections in major economies cast a pall over fundraising for climate action at the 2024 International Monetary Fund and World Bank Spring Meetings, held in Washington D.C. earlier this month. TCW's sustainability team joined the firm's Emerging Markets sovereign research team to take the pulse of the international community and low-and-middle income sovereigns on what's next for climate action efforts in 2024.

Low- and middle-income countries have committed to advancing efforts to less carbon-intensive and more sustainable growth. However, most of these countries will need a mix of public and private capital to meet the estimated $2.4 tn investment needed every year to make real progress on their climate agendas.[1]

Although international financing has historically helped bridge the climate finance gap, low-and-middle income countries are increasingly facing limited fiscal choices. For one, public external debt service as a share of revenue is growing – the U.S. Treasury estimates that it is now 14% for the median low-income country, which typically exceeds country spending on health, education, and other social programs by a substantial margin.[2] Domestic resource mobilization efforts and the development of deeper and more liquid domestic capital markets are key objectives but will take time. Some recent efforts by wealthier countries to fund sustainability efforts in low- and middle-income settings could help but will not offset total needs.[3]

Against this backdrop, it's little surprise that a key focus of the spring meetings' sustainability discussions focused on ways that private capital could be mobilized at scale and with greater speed. In February, the World Bank announced a significant overhaul to its **guarantee business** to help the institution achieve its new goal of tripling the annual guarantee issuance, bringing it to $20 bn by 2030. Given that the World Bank Group offers 20 separate guarantee instruments across its separate institutions, an overhaul is surely needed and can bring more efficiency to the deployment of this risk capital.[4] Still, the jury is out on whether guarantee instruments remain the most efficient use of the development bank's balance sheet. Other calls to mobilize capital through development bank originate-to-distribute securitization models may hold more promise.[5]

Use of **blended finance** approaches remains a topic of heated discussion and debate. These approaches typically involve instruments that leverage public and concessional capital to crowd-in additional private capital for climate and sustainability. Though the concept has been discussed for some time, a consensus has yet to be attained on what approaches can be taken to scale. The think tank Convergence estimates that blended finance has mobilized around $213 bn in capital towards sustainable initiatives in low- and middle-income countries over the past ten years – a drop in the bucket relative to the need. Many analysts believe that better use of multilateral and bilateral development finance balance sheets – including through the use of previously mentioned guarantees – could help attract more private capital for climate projects that might not have been able to raise capital in the absence of those tools. TCW continues to actively participate in the conversation through our participation in industry groups, including the Institute for International Finance's Blended Finance Working Group.

Debt-for-nature or climate swaps, a type of blended finance instrument, were also a central discussion point. Under such an arrangement, debt issuers (mainly sovereigns) swap out high interest-bearing debt for lower cost bonds or loans, promising to channel the implied savings to projects for climate action, marine preservation, or aquatic biodiversity. Critical to the arrangement is the involvement of a third-party guarantor, such as a multilateral development bank, to assume a portion of the risk, thereby partially offsetting the credit risk of the issuer. Morgan Stanley estimates that approximately $1.7 bn in debt-for-nature swaps have been issued from five issuers over the course of the past ten years, another drop in the bucket.[6] Additional sovereigns signaled their interest in the transaction type during the meetings.

These instruments lack a formal structure and transparency, which makes widespread adoption challenging. At TCW, we have engaged with institutions such as The Nature Conservancy, banks and structurers, and issuers of these instruments to support the introduction of additional clarity in issuance documentation, reporting, governance, and other areas. As issuers continue to contemplate these instruments, it remains important for us to continue to contribute to the conversation on how we can enhance the sustainability aspects as well as the attractiveness to investors (through improved liquidity and index inclusion) of this still-nascent transaction type.

With more than half the world's population headed to the polls this year,[7,8] uncertainty around the policymaking path for climate action remains high. In Mexico, a former climate scientist is on the presidential ballot, which could have impacts on the country's support for renewable energy and water management initiatives. In Europe, key aspects of the bloc's Green Deal have seen implementation changes and delays, influencing company and investor plans and reporting. In the U.S., the Securities and Exchange Commission's landmark Climate Disclosure Rule has similarly been stayed, though companies and investors are traversing a patchwork of state-level policies and reporting rules set for implementation in 2024-2025. And with control of the White House and both chambers of Congress in flux, the future direction of U.S. climate policy and its support for official financing remains uncertain.

As global stakeholders continue to explore new ways that private capital can be put to work for climate action in low- and middle-income countries, TCW will continue to be an active participant in this dynamic debate. ■

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Mr. Loevinger is a Sovereign Analyst for the TCW Emerging Markets Group, covering the Asian region. Prior to joining TCW in 2012, Mr. Loevinger was the U.S. Department of Treasury's Senior Coordinator for China Affairs and the U.S.-China Strategic and Economic Dialogue. While at Treasury, he also served as minister counselor for financial affairs at the U.S. embassy in Beijing and Deputy Assistant Secretary for Latin America, Asia, Africa and the Middle East. Mr. Loevinger was previously an economist for the International Monetary Fund and also worked in the office of the IMF's U.S. executive director. He started his career in the Office of the U.S. Trade Representative, the Senate Banking Committee, and the U.S. Commerce Department. Mr. Loevinger earned a Master's in Public Policy from Harvard University's Kennedy School of Government and a BA in Government and Economics from Dartmouth College.

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