TACKLING INEQUALITY IN CLIMATE FINANCE FOR THE GREEN TRANSITION

A Discussion Paper:
Recommendations for Governments, Development Banks, and Institutional Investors

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With this Discussion Paper, we hope to spark dialogue and collaboration on tackling inequality for the green transition. We recognize that this is a dynamic and evolving agenda and welcome your questions, feedback, and insights. Feedback can be directed to Paul Rissman at paul@rightscolab.org or Joanne Bauer joanne@rightscolab.org.

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Introduction

Over the past 20 years, the ten worst extreme weather events have resulted in the deaths of more than 570,000 people.[1] On top of their devastating cost to human life, the economic toll of these events is enormous. Across a similar period, weather disasters have cost the U.S. economy at least $2.2 trillion, including $500 billion since 2021.[2] The continuous warming of our planet — which is now about 1.3° C hotter (on a 30-year average) than pre-industrial temperatures — has supercharged many of these disasters. And our circumstances will surely worsen, with the latest projections indicating that we will surpass 1.5° of warming, and potentially even 2°, by mid-century.[3] Add in sea-level rise, food insecurity, and mass migration, and the future seems fraught with danger.

These dire figures have spurred urgent calls to curb rising temperatures through the green or low-carbon transition, whereby our energy and industrial systems are rapidly decarbonized, fossil fuels are replaced by renewable energy, and agriculture is transformed to a more regenerative state. In this process, greater attention to supporting the decarbonization of emerging markets/developing economies (EMDE countries) is urgently needed. EMDEs account for two-thirds of current global greenhouse gas emissions,[4] and even excluding China, the world's largest emitter, 15 of the 25 highest emitting nations are EMDE economies.[5] But evolving practices for financing EMDE decarbonization hold hidden risks of widening both in-country and between-country wealth gaps, and stoking conflict, which stands to slow or even stop the progress of the transition. If climate transition finance isn't conducted with the consequences for systemic inequality in mind, it will sow the seeds of its own disruption.

EMDEs face significant challenges in securing the resources needed to fund the transition to renewable energy, climate adaptation, and resilience projects. The scale of

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1 "10 years of rapidly disentangling drivers of extreme weather disasters," World Weather Attribution, posted October 31, 2024, https://www.worldweatherattribution.org/10-years-of-rapidly-disentangling-drivers-of-extreme-weather-disasters/.

2 "Billion-Dollar Weather and Climate Disasters: Overview," National Centers for Environmental Information, last accessed December 2, 2024, https://www.ncei.noaa.gov/access/billions/.

3 Anne Olhoff et al., *No more hot air…please! With a massive gap between rhetoric and reality, countries draft new climate commitments - Executive Summary* (United Nations Environment Programme, 2024) 8, https://wedocs.unep.org/bitstream/handle/20.500.11822/46443/EGR2024_ESEN.pdf?sequence=20.

4 Torsten Ehlers et al., "Chapter 2 - Scaling Up Private Climate Finance in Emerging Market and Developing Economies: Challenge and Opportunities," in *Global Financial Stability Report: Navigating the High-Inflation Environment*, ed. Gemma Rose Diaz (International Monetary Fund, October 2022), 45, https://www.imf.org/-/media/Files/Publications/GFSR/2022/October/English/ch2.ashx.

5 Wolfgang Fengler and Homi Kharas, "Building a Prosperous World with Fewer Emissions," *Brookings*, April 13, 2023, https://www.brookings.edu/articles/building-a-prosperous-world-with-fewer-emissions/.

investment required far exceeds what public resources or traditional financing mechanisms can provide. This gap has led to strong interest in blended finance—a strategy that combines public, philanthropic, and concessional funding with private capital to de-risk investments in climate-focused projects. By leveraging public funds to mitigate risks, blended finance can attract private investors who might otherwise avoid EMDE markets due to perceived high risks and low returns. This approach is seen as a vital tool to bridge the climate finance gap.

Yet blended finance schemes that are blind to their contribution to socio-economic inequality can inadvertently set back progress toward a climate transformation. This Discussion Paper aims to demonstrate why that is the case, why worsening inequality will sow the seeds of disruption for green transition efforts, and how instead governments, development finance institutions, and asset owners working together can champion blended finance structures that embed the intention to tackle inequality. In doing so, these institutions can earn society's support for climate mitigation and adaptation, achieve climate goals, and reduce the existential threat to the planet.

Our four recommendations, which we describe in detail below, are:

1. **Governments** should enshrine commitments to reduce socio-economic inequality, within and between countries, in their Nationally Determined Contributions (NDCs) as required under the Paris Agreement.[6] Governments that fund Multilateral Development Banks (MDBs) should use their leverage to incorporate considerations of socio-economic inequality into MDB social and environmental frameworks since they facilitate the bulk of EMDE financing. (For brevity, "MDBs" in this paper refers to both development finance institutions and multilateral development banks.)
2. **MDBs** should channel blended finance opportunities to pension and sovereign wealth funds that recycle monetary returns back to society, and ban ultra-wealthy investors from profiting off the low-carbon transition.
3. **MDBs** should prioritize EMDE-based pension and sovereign wealth funds as beneficiaries of blended finance returns, thereby supporting financial system development in these regions and reduced inequality between countries.
4. **Asset owners and MDBs** should take measures to incentivize asset managers to build local EMDE capacity, supporting economic growth in these regions, and reforming investment practices that have historically exacerbated socio-economic inequality.

6 "NDC Registry," United Nations Climate Change, last accessed December 2, 2024, https://unfccc.int/NDCREG.

Climate Finance and the Just Transition

The social implications of decarbonization have been on the climate agenda for over a decade in the form of calls for a "just transition." In 2015, the International Labor Organization (ILO) released the "Guidelines for a Just Transition Towards Environmentally Sustainable Economies and Societies for All"[7] and later that year, the Paris Agreement was adopted by consensus with its preamble referencing the "just transition" and highlighting the need for equity, human rights, and support for vulnerable groups, aligning with the principles of a just transition. It declares that state parties

> should, when taking action to address climate change, respect, promote and consider their respective obligations on human rights, the right to health, the rights of indigenous peoples, local communities, migrants, children, persons with disabilities and people in vulnerable situations and the right to development, as well as gender equality, empowerment of women and intergenerational equity.[8]

Since then, many initiatives have contributed to advancing our understanding of just decarbonization.[9]

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7 International Labour Organization, "Guidelines for a Just Transition towards Environmentally Sustainable Economies and Societies for All | International Labour Organization" (International Labour Organization, February 2, 2016), https://www.ilo.org/publications/guidelines-just-transition-towards-environmentally-sustainable-economies.

8 United Nations Climate Change, "Paris Agreement" (2015) 1, https://unfccc.int/files/meetings/paris_nov_2015/application/pdf/paris_agreement_english_.pdf.

9 Laudes Foundation, "Mapping and Trend Analysis on Just Transition Initiatives," *Laudes Foundation*, September 19, 2024, https://www.laudesfoundation.org/. Particularly noteworthy contributions include: Council for Inclusive Capitalism, "Just Transition Framework for Company Action" (Council for Inclusive Capitalism, August 12, 2021), https://www.inclusivecapitalism.com/just-energy-transition-home/, The Just Transition Finance Lab, Oleksandra Plyska and Brendan Curran, "Moving from Pledges to Implementation: A Guide for Corporate Just Transition Action" (Just Transition Finance Lab, October 2023), https://justtransitionfinance.org/publication/moving-from-pledges-to-implementation-a-guide-for-corporate-just-transition-action/, OMFIF, Clive Horwood and Emma McGarthy, "Global Public Funds and Transition Finance: Risks, Barriers and Opportunities" (Official Monetary and Financial Institutions Forum, 2024), https://pdf.omfif.org/global-public-funds-and-transition-finance, Convergence Blended Finance, "State of Blended Finance 2024: Climate Edition" (Convergence, 2024), https://www.convergence.finance/resource/state-of-blended-finance-2024-climate-edition/view, The NDC Partnership and Green Climate Fund (GCF), "Climate Investment Planning and Mobilization Framework" (The NDC Partnership, December 2024), https://ndcpartnership.org/sites/default/files/2024-12/climate-investment-planning-and-mobilization-framework.pdf, and the World Resources Institute, Nadia Shah Naidoo et al., "Stronger NDCs With Cities, States, and Regions: Recommendations for National Governments," November 13, 2024, https://www.wri.org/research/stronger-ndcs-cities-states-regions-recommendations-national-governments.

The Paris Agreement's provisions regarding financial flows to support developing countries and its emphasis on equity (Article 2.1(c) and Article 9) build the foundation for integrating just transition principles into climate finance strategies. These provisions constitute a mandate for the mobilization and distribution of climate transition finance that supports vulnerable populations and fosters the right to development within planetary boundaries[10] and the equitable sharing of the benefits and burdens of the transition.

How Funding the Green Transition Could Make Inequality Grow

The enormous sums of money needed to finance successful EMDE decarbonization, and the limited number of institutions that can afford it, create a looming obstacle for climate change mitigation goals.

The UN High-Level Expert Group on Climate Finance estimates that by 2030, EMDEs exclusive of China will require $2.4 trillion in annual spending for the climate-related investments that satisfy the Paris Agreement.[11] This projected figure is four times today's figure, an amount that heavily indebted EMDEs cannot afford to pay. If they were to invest at desired levels, an estimated 47 EMDEs would violate the International Monetary Fund's external debt solvency thresholds and an additional 19 EMDEs, while not likely facing imminent solvency issues, would not be able to finance necessary investments without credit enhancement or liquidity support.[12]

Consequently, $1 trillion of the $2.4 trillion annual figure will need to come from international sources, versus the existing $150 billion annual figure. Developed economies are facing their own budget crunches, however, and many have been delinquent in their current commitments.[13] Direct government-to-government support, as well as

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10 "Planetary Boundaries," *Stockholm Resilience Center*, 2023, https://www.stockholmresilience.org/research/planetary-boundaries.html.

11 Amar Bhattacharya et al., *Raising ambition and accelerating delivery of climate finance: Third report of the Independent High-Level Expert Group on Climate Finance - Executive summary* (Grantham Research Institute on Climate Change and the Environment, November 2024) 3, https://www.lse.ac.uk/granthaminstitute/wp-content/uploads/2024/11/Raising-ambition-and-accelerating-delivery-of-climate-finance_Executive-summary.pdf.

12 Marina Zucker-Marques, Kevin P. Gallagher, and Ulrich Volz, *Defaulting on Development and Climate: Debt Sustainability and the Race for the 2030 Agenda and Paris Agreement - Executive Summary* (Debt Relief for a Green and Inclusive Recovery, April 2024) 2, https://drgr.org/files/2024/04/DRGR-Report-2024-FIN.pdf.

13 Sarah Colenbrander, Laetitia Pettinotti, and Yue Cao, "A fair share of climate finance? An appraisal of past

financing from MDBs such as the World Bank, are expected to account for at most half of the $1 trillion requirement[14] — not accounting for any reduction in support following the US presidential election.[15] This means that the private sector will need to increase its annual investment in EMDE climate finance to at least $500 billion by 2030, 10 times the current level.

While this should be achievable in a world where managed financial assets approach $120 trillion,[16] the private sector remains reluctant to fund EMDEs sufficiently, unless EMDE opportunities demonstrate equivalent or better risk-return profiles compared to developed market projects. Country risk — driven by high debt levels, underdeveloped law and policy, and corruption — contributes to the private investor view that EMDE investing is not worth the effort to staff up and conduct due diligence on deals,[17] while currency hedging costs can be prohibitive. Adding to the risk is the unfortunate litany of projects that have generated conflict with local communities and Indigenous Peoples for failure to conduct adequate due diligence and meaningful engagement.[18] As a result, project costs can rise,[19] and in some cases, operations can be suspended altogether.[20] Further, investors need adequate pipelines of large projects to justify the resources they would need for research and analysis, along with standardized project profiles and contract terms that enable syndication and securitization that allow them

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performance, future pledges and prospective contributors," *ODI Global*, June 26, 2022, https://odi.org/en/publications/a-fair-share-of-climate-finance-an-appraisal-of-past-performance-future-pledges-and-prospective-contributors/.

14 Amar Bhattacharya et al., *Raising ambition and accelerating delivery of climate finance: Third report of the Independent High-Level Expert Group on Climate Finance - Executive summary* (Grantham Research Institute on Climate Change and the Environment, November 2024) 3, https://www.lse.ac.uk/granthaminstitute/wp-content/uploads/2024/11/Raising-ambition-and-accelerating-delivery-of-climate-finance_Executive-summary.pdf.

15 Adva Saldinger, "World Bank under Trump: What's next for US Influence and Funding?" *Devex* (blog), January 14, 2025, https://www.devex.com/news/sponsored/world-bank-under-trump-what-s-next-for-us-influence-and-funding-109026.

16 Christopher Marchant, "Global AUM rises in 2023, even as profits fall — BCG," *Pensions & Investments*, May 6, 2024, https://www.pionline.com/money-management/global-aum-rises-2023-even-profits-fall-bcg.

17 Bryan Armour, "Is Investing in Emerging Markets Worth the Trouble?," *Morningstar* (blog), May 9, 2023, https://www.morningstar.com/funds/is-investing-emerging-markets-worth-trouble; Symbiotics Group, "Misperception of Risk in Emerging Markets" (Symbiotics Group, October 23, 2024), https://symbioticsgroup.com/publications/misperception-risk-emerging-markets/.

18 "Transition Minerals Tracker," Business & Human Rights Resource Centre, last accessed December 2, 2024, https://www.business-humanrights.org/en/from-us/transition-minerals-tracker/.

19 Rachel Davis and Daniel Franks, *Costs of Company-Community Conflict in the Extractive Sector* (Corporate Social Responsibility Initiative at the Harvard Kennedy School, 2014) 19, https://www.csrm.uq.edu.au/media/docs/603/Costs_of_Conflict_Davis-Franks.pdf.

20 Arnim Scheidel et al., "Environmental conflicts and defenders: A global overview," *Global Environmental Change* 63 (July 2020): 1-10, https://www.sciencedirect.com/science/article/pii/S0959378020301424?via%3Dihub.

to diversify their portfolios. So far, insufficient progress across all these areas has restricted the funding spigot to a weak trickle.

Blended Finance to the Rescue?

There is an emerging consensus among financiers and policy makers that blended finance is key to addressing these problems. Blended finance is a public-private partnership in which public financing is deployed to remove barriers to private investment. The US Inflation Reduction Act (2022) is one example. In the case of EMDEs, public finance is generally funneled through MDBs such as the World Bank, Inter-American Development Bank, Asian Development Bank, the African Development Bank, and the European Bank for Reconstruction and Development. These entities have deep experience in EMDE countries and financial controls that guard against corruption. Their ability to finance large numbers of transition projects also allows them to guide standardization of deal structure. Finally, MDBs have public commitments backed by environmental and social frameworks to respect human rights,[21] albeit with spotty results.[22] Together, these factors position MDBs and DFIs as key providers of the solutions needed for EMDE transition finance.

Nevertheless, no matter how skillful MDBs may be in mitigating country risk, adequate funding might never materialize if risk-adjusted project returns are not sufficiently attractive to private investors. MDBs can improve project risk-return profiles by subsidizing the cost of currency hedges or making "first-loss" guarantees,[23] whereby they take on subordinated debt and offer senior debt to private investors, who are paid back first.

The blended finance approach holds compelling potential. Case in point: In April 2024,

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21 The World Bank, "Environmental and Social Framework (ESF)" (The World Bank Group, 2017), https://www.worldbank.org/en/projects-operations/environmental-and-social-framework; International Finance Corporation, *Performance Standards on Environmental and Social Sustainability* (January 2012); European Bank for Reconstruction and Development, "Environmental and Social Requirement 1: Assessment and Management of Environmental and Social Risks and Impacts" (European Bank for Reconstruction and Development, October 2024), https://www.ebrd.com/documents/environment/environmental-and-social-policy-2024-esr-1-pdf.pdf; International Finance Corporation, "Performance Standards on Environmental and Social Sustainability" (World Bank Group, 2012), https://www.ifc.org/content/dam/ifc/doc/2010/2012-ifc-performance-standards-en.pdf.

22 Office of the United Nations High Commissioner for Human Rights (OHCHR), *Frequently Asked Questions on Human Rights and Multilateral Development Banks* (United Nations, n.d.) 1-10, https://www.ohchr.org/sites/default/files/Documents/Issues/Development/DFI/FAQonMultilateralDevelopmentBanksandHumanRights.pdf.

23 World Bank, *A Focused Assessment of the International Development Association's Private Sector Window: An Update to the Independent Evaluation Group's 2021 Early-Stage Assessment* (January 2024) viii, https://ieg.worldbankgroup.org/sites/default/files/Data/Evaluation/files/IDA_PSW.pdf.

asset manager Invesco launched a Climate Adaptation Action Fund — a closed-end debt fund intended for EMDE climate mitigation and adaptation — with a goal of raising $500 million.[24] MDBs have agreed to issue and hold junior, subordinated debt, which will comprise 25% of the fund. The remainder is senior debt reserved for private investors, guaranteeing their promised returns even if the fund loses as much as 25% of its value, which the public sector will absorb. Invesco is reportedly "blown away" by the demand it has seen.[25]

The Unintended Peril of Blended Finance

The MDB financing required to incentivize private sector investment in the EMDE green transition represents a massive transfer of risk from the private sector to the public sector.[26] It is worth considering the investors that stand to benefit from this subsidy.

Two broad classes of investors account for the $120 trillion in global assets under management. Approximately half are owned by retirement or sovereign wealth funds;[27] another large portion is controlled by ultra-high net worth individuals -- those with a net worth of at least $30 million -- which in aggregate hold an estimated $38 trillion in investable assets.[28] These two groups are likely to benefit significantly from concessional public finance. Unlike financial returns to retirement and sovereign wealth funds, which are recycled to the public in the form of pension and retiree benefits and improvements to public finance, returns to private investors are poised to make the wealthy even wealthier, exacerbating what is already an alarming level of inequality.[29]

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24 "Invesco Climate Adaptation Action Fund," Invesco, last accessed December 2, 2024, https://www.invesco.com/icaaf/en/invesco-climate-adaptation-action-fund.html.

25 Ahren Lester, "Invesco 'blown away' by demand for climate adaptation blended finance fund," *Environmental Finance*, October 25, 2024, https://www.environmental-finance.com/content/news/invesco-blown-away-by-demand-for-climate-adaptation-blended-finance-fund.html.

26 See, generally, Daniela Gabor, "The (European) Derisking State," *SocArXiv*, SocArXiv, May 17, 2023, https://ideas.repec.org//p/osf/socarx/hpbj2.html.

27 Marisa Hall et al., *Global Pension Assets Study* (Thinking Ahead Institute, 2024) 9, https://www.thinkingaheadinstitute.org/content/uploads/2024/02/GPAS-2024.pdf. Some analysts classify sovereign wealth funds as national pension funds, so these may be included in this figure. For example, Norway's "oil fund" is either termed the world's largest sovereign wealth fund or one of the largest pension funds.

28 Maya Imberg and Maeen Shaban, *World Ultra Wealth Report 2024* (Altrata, July 2024) 4, https://storage.pardot.com/311771/1721323630Rwc2rqof/Altrata_World_Ultra_Wealth_Report_2024.pdf.

29 "Facts: Global Inequality," Inequality.org, last accessed December 2, 2024, https://inequality.org/facts/global-inequality/.

How Rising Inequality Impacts Climate Change

Global socio-economic inequality has pernicious systemic effects on our climate. The ultra-wealthy are the world's heaviest emitters. Since 1990, the poorest 50% of the world's population has been responsible for 16% of total emissions growth, but the top 1% has been responsible for 23%.[30] While per capita emissions from low- and middle-income groups within rich countries have declined since 1990, those of the global top 1% have actually risen.[31] This imbalance has prompted calls, led by Brazil, for a climate wealth tax, which would impose a 2% surcharge on billionaires' assets to be used for climate mitigation and poverty reduction in EMDE countries.[32]

In another respect, inequality in the form of institutionalized discrimination generates the conditions that allow high emissions to continue. An example is when companies construct polluting facilities in sacrifice zones --the areas where communities facing discrimination (depending on the geographic context, Indigenous Peoples and other historically marginalized racial, ethnic, and religious groups) live and work. Residents of sacrifice zones are disenfranchised such that they struggle to mount successful "not in my backyard" campaigns and are often deprived of the agency to resist corporate power due to corporate capture of regulatory and legal bodies. The cost of harmful behavior to the private sector is therefore lower than it would be by locating a high-emissions facility in a wealthier enclave, turning sacrifice zones into "dumping grounds for negative externalities."[33] The economic and climate benefits of reducing inequality are clear: doing so will increase the agency of disenfranchised groups to "just say no," thereby raising the cost of emissions and incentivizing polluters to accelerate their reduction.

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30 Lucas Chancel, "Global carbon inequality over 1990–2019," *Nature Sustainability* 5 (September 2022): 931, https://www.nature.com/articles/s41893-022-00955-z.

31 Ibid.

32 Thomas Fischermann, "A Carbon-based Wealth Tax for Climate Protection - A Proposal," *Schwartz Center for Economic Policy Analysis at The New School*, September 17, 2024, https://www.economicpolicyresearch.org/insights-blog/a-carbon-based-wealth-tax-for-climate-protection-a-proposal.

33 Cary Martin Shelby, "Racism As A Threat To Financial Stability," *Northwestern University Law Review* 118, no. 3 (2023): 755, https://scholarlycommons.law.northwestern.edu/cgi/viewcontent.cgi?article=1550&context=nulr; Robert D. Bullard, "Review of Sacrifice Zones: The Front Lines of Toxic Chemical Exposure in the United States, by Steve Lerner," *Environmental Health Perspectives* 119, no. 6 (June 2011): 266, https://pmc.ncbi.nlm.nih.gov/articles/PMC3114843/pdf/ehp-119-a266a.pdf; Special Rapporteur on human rights and the environment, "Additional Sacrifice Zones: Supplementary Information to the Report of the Special Rapporteur, David R. Boyd, on the Issue of Human Rights Obligations Relating to the Enjoyment of a Safe, Clean, Healthy and Sustainable Environment" (United Nations Human Rights Office of the High Commissioner, February 3, 2022) 2, https://www.ohchr.org/sites/default/files/2022-03/Annex1_to_A_HRC_49_53.pdf.

Socio-economic inequality also diminishes the effectiveness of climate change mitigation, as it can drive political polarization and mass protest;[34] one study found that political backlash to climate change policies only occurs when inequality is at a high level.[35] Additionally, inequality harms the economy by increasing the probability of financial crises[36] and worsening other risks such as food insecurity,[37] pandemics[38] and other public health emergencies,[39] and antimicrobial resistance,[40] all of which sap resources that could otherwise be devoted to combatting climate change.

Reducing inequality may have other collateral benefits for climate mitigation. For example, scholars and campaigners have shone a spotlight on the role of tax havens, and their inherent lack of transparency, in fueling inequality.[41] This lack of transparency also hampers climate progress by hiding fossil fuel financing. A study by the Tax Justice Network found that 68% of the fossil fuel financing provided by the world's largest banks is granted to oil, gas, and coal subsidiaries in tax havens that specialize in financial secrecy, concealing the scale of the banks' fossil fuel exposure.[42] Eliminating tax havens can reduce inequality and at the same time enable greater transparency and

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34 Jacob R. Gunderson, "When Does Income Inequality Cause Polarization?," *British Journal of Political Science* 52, no. 3 (July 2022): 1315–32, https://doi.org/10.1017/S0007123421000053; Jung-In Jo and Hyun Jin Choi, "Enigmas of Grievances about Inequality: Effects of Attitudes toward Inequality and Government Redistribution on Protest Participation," *International Area Studies Review* 22, no. 4 (December 1, 2019): 348–68, https://doi.org/10.1177/2233865919833973.

35 Davide Furceri, Michael Ganslmeier, and Jonathan Ostry, "Are climate change policies politically costly?" *Energy Policy* 178 (July 2023): 1-13, https://www.sciencedirect.com/science/article/pii/S030142152300160X.

36 Anni T. Isojaervi and Sam Jerow, "Inequality and Financial Sector Vulnerabilities," April 19, 2024, https://www.federalreserve.gov/econres/notes/feds-notes/inequality-and-financial-sector-vulnerabilities-20240419.html; Paul Rissman, "Inequality Caused The Global Financial Crisis. Is It Happening Again?" *Forbes*, September 13, 2024, https://www.forbes.com/sites/paulrissman/2024/09/13/inequality-caused-the-global-financial-crisis-is-it-happening-again/.

37 Adam Drewnowski, "Food insecurity has economic root causes," *Nature Food* 3 (August 2022): 555-556, https://www.nature.com/articles/s43016-022-00577-w.

38 Sherin Varkey, Eeshani Kandpal, and Sven Neelsen, "Why addressing inequality must be central to pandemic preparedness," *BMJ Global Health* 7, no. 9 (August 2022): 1-3, https://pmc.ncbi.nlm.nih.gov/articles/PMC9453948/.

39 Jenna van Draanen et al., "Socioeconomic Marginalization and Opioid-Related Overdose: A Systematic Review," *Drug and Alcohol Dependence* 214 (September 1, 2020): 108127, https://doi.org/10.1016/j.drugalcdep.2020.108127;

40 Andrew Kirby and Annie Herbert, "Correlations between Income Inequality and Antimicrobial Resistance," *PLoS ONE* 8, no. 8 (August 29, 2013): e73115, https://doi.org/10.1371/journal.pone.0073115.

41 Annette Alstadsæter, Niels Johannesen, and Gabriel Zucman, "Tax Evasion and Inequality," *American Economic Review* 109, no. 6 (June 2019): 2073–2103; Oxfam International, "Inequality and Poverty: The Hidden Costs of Tax Dodging," Oxfam International, May 25, 2022, https://www.oxfam.org/en/inequality-and-poverty-hidden-costs-tax-dodging.

42 Alison Schultz and Franziska Mager, How "greenlaundering" conceals the full scale of fossil fuel financing (Tax Justice Network, September 2024) https://taxjustice.net/2024/09/11/how-greenlaundering-conceals-the-full-scale-of-fossil-fuel-financing/.

accountability for fossil fuel finance.

Recommendations for More Equitable Blended Finance

To immediately tackle the inequality problem in blended finance, it will be essential to either institute a climate wealth tax or restrict blended finance opportunities to retirement and sovereign wealth funds. Largely due to anticipated opposition from the United States under the new administration, international negotiators are reportedly pulling back their ambition for a wealth tax.[43] This positions pension and sovereign funds as ever more critical players in an equitable transition.

Based on these considerations, we offer the following recommendations to national governments, MDBs, and investment leaders, to help chart a path toward a green transition that supports more equitable outcomes.

1. **In their Paris Agreement commitments, national governments should make explicit a recognition that inequality affects climate mitigation and, in turn, urge MDBs to add this principle to their environmental and social frameworks.**

On their own, MDBs have no disincentive to allocate concessional finance opportunities to profit-seeking ultra-high net worth individuals and family offices. Any prohibition on this practice must be imposed from above, meaning that pressure to disallow finance opportunities allocated to ultra-high net worth recipients should come from the MDBs' shareholders and donor governments.

In this regard, it is a helpful start that references to human rights, climate justice, environmental justice, and just transition are interwoven throughout many nations' NDCs. For example, the European Union NDC update commits to "promoting a human rights-based and gender-responsive approach to climate action, promoting social justice, fairness and inclusiveness."[44] The UK update gives explicit consideration to climate

43 Henry Foy and Michael Pooler, "Donald Trump victory threatens to throw G20 initiatives into disarray," *Financial Times*, November 17, 2024, https://www.ft.com/content/b7c1e6a9-6d0b-40c8-a463-92664ae84520.

44 European Union, *Update of the NDC of the European Union and its Member States*, October 16, 2023, 8, https://unfccc.int/sites/default/files/NDC/2023-10/ES-2023-10-17%20EU%20submission%20NDC%20update.pdf.

justice,[45] while Canada addresses "income inequality within First Nations as part of the mobilization for a just transition."[46] The US NDC is "committed to advancing environmental justice."[47] Global North countries and blocs are the main contributors to the MDBs. As they improve their NDCs in the coming months,[48] they must genuinely commit to reducing socio-economic inequality to accelerate climate progress.

MDBs also recognize the importance of a just transition. The International Finance Corporation (IFC), the private sector financing arm of the World Bank, claims to be "accelerating a just and inclusive transition in the energy sector"[49] and recognizes that "[i]ntegral to IFC's mandate and aligned with the World Bank Group's goals are [Sustainable Development Goal]s 1 and 10: 'No Poverty' and 'Reduced Inequalities.'"[50] MDB environmental and social safeguards are largely based on, or consistent with, the IFC Performance Standards.[51] Aside from anti-discrimination and equal employment opportunity guidance, the systemic risk of inequality is a neglected topic. MDBs should include a provision within their environmental and social frameworks to exclude profit-extracting entities from concessional deals - and governments should strongly advocate that they do so.

To aid in reducing between-country inequality, MDBs should also incorporate best

45 United Kingdom of Great Britain and Northern Ireland, *Nationally Determined Contribution*, https://unfccc.int/sites/default/files/NDC/2022-09/UK%20NDC%20ICTU%202022.pdf.

46 Canada, *Canada's 2021 Nationally Determined Contribution Under The Paris Agreement*, August 12, 2021, 39, https://unfccc.int/sites/default/files/NDC/2022-06/Canada%27s%20Enhanced%20NDC%20Submission1_FINAL%20EN.pdf.

47 United States of America, *Nationally Determined Contribution - Reducing Greenhouse Gases in the United States: A 2035 Emissions Target*, 4, https://unfccc.int/sites/default/files/2024-12/United%20States%20 2035%20NDC.pdf. Upon assuming office, on January 20, 2025, Donald Trump signed an executive order for the US to exit the Paris Agreement. Given the statutory delay of 12 months, this means that this NDC commitment will be defunct in January, 2026.

48 "NDC 3.0 – Launching the next ambition cycle under The Paris Agreement at COP29," *E3G*, November 15, 2024, https://www.e3g.org/news/ndc-3-0-launching-the-next-ambition-cycle-under-the-paris-agreement-at-cop29/.

49 "Focus Area: Accelerating the Transition to Inclusive, Resilient Green Growth," International Finance Corporation (IFC), last accessed December 3, 2024, https://www.ifc.org/en/what-we-do/sector-expertise/climate-business/addressing-climate-challenges-in-key-sectors.

50 "IFC's Strategic Alignment with the Sustainable Development Goals (SDGs)," International Finance Corporation (IFC), last accessed December 3, 2024, https://www.ifc.org/en/our-impact/sustainable-development-goals.

51 Reidar Kvam, *IFC's Performance Standards: A Global Norm for Responsible Business Conduct* (Norad, February 2020) 2, https://www.norad.no/contentassets/994040ea5d9f415a8e690b300eee1b7b/1.20-evaluation-brief---ifcs-performance-standards#:~:text=This%20adoption%20of%20key%20principles,voluntary%20 basis%2C%20without%20being%20a.

practices of benefit sharing and remedy into their transition finance policies as well as their social and environmental frameworks.[52] Forestry carbon offsets and other green transition projects in the Global South too often divert financial returns to Global North entities while depriving local communities of adequate participation in the processes and the rewards, widening the gulf of inequality between developed and EMDE economies. The World Bank has explored best practices for fair agreements between developers and local communities,[53] and IFC Performance Standard 7 Indigenous Peoples advocates for "fair and equitable sharing of benefits associated with project usage."[54] To date, however, MDBs have not consistently provided for community participation in project design nor community benefits agreements.[55]

For green initiatives to move quickly, MDBs also need to strengthen access to remedy for harms that occur as a consequence of climate transition finance. Even though MDBs have in place environmental and social frameworks to prevent harm and redressal mechanisms for when harms occur, in practice people harmed by MDB financing routinely face significant challenges in seeking remedy.[56] Given the legacy of harms connected to MDB financing, ensuring remedy is critical, and can give MDB managers confidence that the organization "has the tools to course correct if things go wrong."[57] In short, MBD environmental and social policies and accountability frameworks need strengthening to support a just transition.

2. MDBs should channel blended finance deals to pension and sovereign wealth funds and must remove roadblocks for these investors.

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52 PowerSwitch Action, "Community Benefits Agreements," accessed January 2, 2025, https://www.powerswitchaction.org/resources/community-benefits-agreements#overview.

53 World Bank Group, "Benefit Sharing at Scale: Good Practices for Results-Based Land Use Programs" (World Bank, 2019), http://hdl.handle.net/10986/32765, License: CC BY 3.0 IGO.

54 International Finance Corporation, "Performance Standard 7" (World Bank Group, 2012) 4, https://www.ifc.org/en/insights-reports/2012/ifc-performance-standard-7.

55 See, for example, Berenika Drazewska and Kristin Hausler, "The Role of Multilateral Development Banks in the Protection of Intangible Cultural Heritage" (British Institute of International and Comparative Law, October 21, 2021), https://www.biicl.org/publications/the-role-of-multilateral-development-banks-in-the-protection-of-intangible-cultural-heritage.

56 Inclusive Development International, "BREAKING: World Bank Group Guilty of Coal Cash Cover-up despite Climate Commitments," *Inclusive Development International* (blog), January 21, 2025, https://www.inclusivedevelopment.net/coal/breaking-world-bank-group-guilty-of-coal-cash-cover-up-despite-climate-commitments/.

57 Margaux Day and David Pred, "A Proposal for Ajay: No Evolution without Remedy," *Bretton Woods Project* (blog), December 13, 2023, https://www.brettonwoodsproject.org/2023/12/a-proposal-for-ajay-no-evolution-without-remedy/.

Many pension fund trustees are eager to participate in blended finance. The UK has been implementing blended finance structures for some time, for example using National Lottery funds as the concessional financing source.[58] As of 2023, pension money has supported one-fifth of the UK's social impact funding. Designated for investment in affordable housing, pension funds represent the largest source of historical support for this endeavor.[59] Canadian pension fund Caisse de dépôt et placement du Québec (CDPQ) has experience with blended finance in its home country[60] and is evaluating EMDE opportunities as well.[61] The Net-Zero Asset Owner Alliance, comprised of 89 asset owners with nearly $10 trillion under management has called upon MDBs to scale up their blended finance efforts to enable increased asset owner participation.[62]

Nevertheless, the relationship between pension funds and MDBs is not without friction.[63] Some investors see MDBs as competitors whose practices inhibit effective collaboration with the private sector.[64] For example, MDBs possess data that investors would find valuable in making decisions, but they treat some information as proprietary, making it inaccessible to pension funds.[65] In addition, cultural factors — rooted in a more risk-averse banking approach versus the immediacy of investing — present hurdles to a successful blended finance. In a recent survey, one pension investor reportedly complained that "MDBs are 'operating in a totally different language to us as institutional investors.'" Another stated, "They like to say that they want to do it but then they can't execute."[66]

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58 "The Growth Fund: Blended grant and loan fund providing small, affordable, unsecured loans for social enterprises and charities," Better Society Capital, last accessed December 3, 2024, https://bettersocietycapital.com/portfolio/growth-fund/.

59 "Investors put £10 billion into a better society as Treasury considers budget cuts," *Better Society Capital*, October 7, 2024, https://bettersocietycapital.com/latest/investors-put-10-billion-into-a-better-society-as-treasury-considers-budget-cuts/.

60 EY, *Blended Finance Best Practice: Case Studies And Lessons Learned* (Sustainable Markets Initiative and Investor Leadership Network, September 2024) 78-81, *https://investorleadershipnetwork.org/wp-content/uploads/Blended_Finance_Best_Practice_Case_Studies_Lessons_Learned.pdf.*

61 Lucas Cacioli, "CDPQ Asia head: Blended finance's big potential for EMs," *Asian Investor*, January 9, 2024, https://www.asianinvestor.net/article/cdpq-asia-head-blended-finances-big-potential-for-ems/493666.

62 UN-convened Net-Zero Asset Owner Alliance, *Call on Policymakers to Support Scaling Blended Finance* (UN Environment Programme Finance Initiative (UNEPFI) and PRI) 5-6, https://www.unepfi.org/wordpress/wp-content/uploads/2022/09/NZAOA_Scaling-Blended-Finance.pdf.

63 Homi Kharas et al., *Strengthening Multilateral Development Banks: The Triple Agenda* (Independent Experts Groups, June 2023) https://www.cgdev.org/sites/default/files/The_Triple_Agenda_G20-IEG_Report_Volume1_2023.pdf.

64 Vibeka Mair, "Blended finance: Investors flag serious shortfalls," *Capital Monitor*, July 29, 2022, https://www.capitalmonitor.ai/analysis/blended-finance-investors-flag-serious-shortfalls/?cf-view.

65 Global Emerging Markets Risk Database (GEMs), *Analysis of Investor Perceptions and Market Demand* (October 2024) 7, https://www.gemsriskdatabase.org/wp-content/uploads/2024/11/IFC-GEMs-Report.pdf.

66 Clive Horwood and Emma McGarthy, *Global public funds and transition finance: Risks, barriers and oppor-*

MDBs looking to the private sector for financial partnership must institute reforms to bring pension and sovereign wealth funds into the fold. Reforms should include cutting red tape, sharing information, increasing transparency, and enhancing engagement with potential investors.[67] Funding governments themselves are a key source of pressure for MDB blended finance reform. For example, the NDC Partnership Support Unit, a 200-member organization of developed and developing countries and financial institutions, has urged investors to work with nations formulating their new Paris Agreement commitments to ensure more effective use of blended finance.[68]

3. MDBs should reserve special consideration for EMDE-based pension and sovereign wealth funds.

If Global North pension and sovereign wealth funds are the only beneficiaries of EMDE blended finance returns, between-country inequality will increase, worsening the Global North/Global South divide. To counteract this outcome, best efforts should be taken to favor EMDE-based pension and sovereign wealth funds, which are beginning to achieve the scale to take part in blended finance deals. For example, the Public Investment Corporation of South Africa manages the assets of the nation's Government Employees Pension Fund and has reached $170 billion in assets under management.[69] The fund has participated in a blended finance deal for a concentrated solar power plant in Cape Province.[70] Another example is Permodalan Nasional Berhad, a Malaysian sovereign wealth fund with assets exceeding $75 billion in 2022,[71] which has expressed interest in participating in blended finance structures as well.[72] Financial system development in EMDE countries will engender a virtuous circle of local autono-

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tunities (OMFIF, 2024) 36, https://pdf.omfif.org/global-public-funds-and-transition-finance.

67 Jason Channell, Andrea Fleming, Ying Qin, and Elizabeth Curmi, *Unlocking Climate And Development Finance: Creating Bankable Projects* (Citi, December 2023) 56, https://www.citifirst.com.hk/home/upload/citi_research/rsch_pdf_30206715.pdf.

68 Michael Hurley, "Investors told to help countries build next round of national climate targets," *Environmental Finance*, October 31, 2024, https://www.environmental-finance.com/content/news/investors-told-to-help-countries-build-next-round-of-national-climate-targets.html.

69 Loni Prinsloo "Top Africa Fund Manager PIC's AUM Reach Record $172 Billion," *Bloomberg*, October 2, 2024, https://www.bloomberg.com/news/articles/2024-10-02/top-africa-fund-manager-pic-sees-assets-up-3-6-to-155-billion.

70 Claire Njoki, "Scaling affordable access to Clean Energy in Sub-Saharan Africa through Blended Finance and PPPs," *Convergence*, September 21, 2021, https://www.convergence.finance/news/wxIPPF2vY7zmBF14A5Fcy/view.

71 Natalie Koh, "Blended finance opens doors for green investing – BlackRock, Temasek," *Pensions & Investments*, April 17, 2024, https://www.pionline.com/esg/blended-finance-opens-doors-green-investing-blackrock-temasek.

72 Ibid.

my, further supporting MDBs' prioritization of EMDE-based fund participation. It should be noted that petrostates' sovereign wealth funds may not necessarily be the optimal partners for equitable blended transition finance, however, and should undergo enhanced due diligence from MDBs.[73]

4. MDBs should incentivize asset managers to build local EMDE presence.

Blended finance takes the form of a partnership between the concessionary funder, the provider of market capital, and the arranger. The arranger is typically an asset manager such as Invesco, which acts as an intermediary to convey market demand signals to the MDB and then packages the financing for its clients. Asset managers see the economic potential of transition finance. For example, BlackRock calls the transition to a low-carbon economy one of five "mega forces" creating opportunities for investors[74] and has arranged several blended deals, going back to 2021 with its Climate Finance Partnership Fund.[75]

The asset management industry has itself played a role in worsening inequality, with asset managers among the most highly compensated professionals globally. In the U.S., financial sector employees have contributed significantly to rising income inequality.[76] Moreover, the industry is one of the least diverse, with minorities and women underrepresented in both the overall employment pool and in senior leadership roles.[77] When asset managers are helmed by diverse leaders, they tend to face great difficulty in attracting clients: in a sample representing $82.24 trillion USD in assets under management (AUM), the McKnight Foundation found that diverse-owned firms managed only 1.4% of total US-based AUM as of 2021.[78]

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73 Matt McGrath, "UN climate talks 'no longer fit for purpose' say key experts," *BBC*, November 15, 2024, https://www.bbc.com/news/articles/cx2lknel1xpo; Human Rights Watch, "Saudi Arabia: Public Investment Fund Linked to Abuses: Crown Prince Concentrates Power Through Control of Nearly Trillion-Dollar Fund," November 20, 2024, https://www.hrw.org/news/2024/11/20/saudi-arabia-public-investment-fund-linked-abuses.

74 "Mega forces: An investment opportunity," *BlackRock*, last accessed December 3, 2024, https://www.blackrock.com/corporate/insights/blackrock-investment-institute/publications/mega-forces.

75 Bruno Alves, "Is blended finance having its moment?" *Infrastructure Investor*, July 4, 2024, https://www.infrastructureinvestor.com/is-blended-finance-having-its-moment/.

76 Lawrence Mishel and Natalie Sabadish, *CEO Pay And The Top 1%: How executive compensation and financial-sector pay have fueled income inequality* (Economic Policy Institute, May 2012) 2, https://files.epi.org/2012/ib331-ceo-pay-top-1-percent.pdf.

77 Bridget B. Hughes and Alyssa Stankiewicz, "Key Takeaways From Our First Diversity in Asset Management Report," *Morningstar*, November 19, 2024, https://www.morningstar.com/funds/women-perform-well-men-asset-management-report-shows.

78 Josh Lerner, Rahat Dewan, Jake Ledbetter, and Alex Billias, *Knight Diversity of Asset Managers Re-*

MDBs and clients should incentivize asset managers to build capacity with EMDE managers through partnerships and joint ventures, up to and including taking equity stakes. After the development of a sufficient performance track record, local managers can be spun out to compete for blended finance deals as independent entities, deepening local capital markets in a virtuous circle for EMDE investment.

Finally, asset managers' own investment structures and preferences can contribute to systemic inequality.[79] MDBs should familiarize themselves with these practices and implement safeguards to ensure that blended finance is as equitable as possible.

Conclusion

When socio-economic inequality is ignored, climate mitigation and adaptation efforts are likely to under-deliver. But efforts explicitly designed to reduce inequality remove a significant roadblock to climate harm reduction. Rights CoLab has advocated for a "leading with justice" approach to climate change, which centers efforts to reduce discrimination and social harm in a way that brings climate benefits along.[80] We advocate for applying this approach to low-carbon transition finance. Reducing systemic inequality can reduce emissions. NDCs and MDB social and environmental frameworks should act upon the opportunity that narrowing systemic inequality presents for climate mitigation and adaptation.

Building on this fundamental understanding, countries must provide enough funding for MDBs to enable concessionary blended financing at scale. Additionally, MDBs must institute reforms that allow pension and sovereign wealth funds to more easily participate in blended finance opportunities and formulate deal terms that favor participation of EMDE-based funds. Among pension and sovereign wealth funds, there is more than enough funding to finance the EMDE low-carbon transition. There is therefore little need for ultra-high net worth profit-seeking investors to take part, and their participation should be restricted on the grounds that socio-economic inequality poses a systemic risk to climate mitigation and adaptation progress.

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search Series: Industry (Knight Foundation, December 2021) 5, https://knightfoundation.org/wp-content/uploads/2021/12/KDAM_Industry_2021.pdf.

79 Delilah Rothenberg, Raphaele Chappe, and Amanda Feldman, *ESG 2.0: Measuring and Managing Investor Risks Beyond the Enterprise-Level* (April 2021) 6, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3820316.

80 Pedro Henriques da Silva, *Leading with Justice: Net Zero Investing & Conversations on Climate Justice* (Global Endowment Management, 2022) https://assets.nationbuilder.com/intentionalendowments/pages/6052/attachments/original/1648052466/Leading_w_Justice_-_vF_%281%29.pdf?1648052466'.

Finally, MDBs should take a hard look at the asset management industry and provide guidance on best practices that will reduce systemic inequality. These practices encompass building the capacity of EMDE-based asset managers, diversifying the workforce of the asset management industry, and creating a typology of investment structures that put an end to extractive practices that worsen inequality.[81]

There is no time to lose in scaling low-carbon transition finance to the Global South. Climate financing that respects human rights and addresses the systemic risk of inequality will help to secure a social license to operate and can advance climate progress. Attention to systemic inequality by nations, MDBs, and investors must be the prerequisite foundation for the success of the low-carbon transition.

81 "Do no significant harm" is encapsulated in securities laws in Europe and therefore is well understood by European investors. The idea suggests a lower standard than the "do no harm" principle embedded in the UN Guiding Principles, however, which emphasizes that companies should avoid infringing on human rights, prevent harm through due diligence, and address harm when it occurs. European Securities and Markets Authority (ESMA), *'Do No Significant Harm' definitions and criteria across the EU Sustainable Finance framework*, November 23, 2023, https://www.esma.europa.eu/sites/default/files/2023-11/ESMA30-379-2281_Note_DNSH_definitions_and_criteria_across_the_EU_Sustainable_Finance_framework.pdf.