Sustainable Finance Index 2023

(data as of 2022)

Executive summary

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GRUPO DE FINANCIAMIENTO CLIMÁTICO LAC

Introduction

The most recent scientific reports on climate change, such as the reports by the Intergovernmental Panel on Climate Change (IPCC), have been clear that temperature changes are mainly attributed to human activities such as the burning of fossil fuels and deforestation (IPCC, 2022). This has required a rapid and accelerated transformation of the sectors responsible for these emissions, such as the energy sector, which is the focus of much of the action to reduce emissions. In 2022, financing directed to this sector reached USD 506 billion, representing 44% of total financing (CPI, 2023). However, the growing climate problem and its already evident effects in the world, particularly in Latin America and the Caribbean, call for an accelerated adaptation process. In spite of this, global financing for adaptation reached USD 63 billion, constituting only 9% of total financing. In the LAC region, only USD 6.1 billion was allocated (CPI, 2023). This contrast highlights the critical need to redirect and increase resources towards adaptation, given the urgency of addressing climate impacts in the region.

In this context, there is a need to transform the way the financial sector operates, not only to mobilize more climate finance and sustainable finance, but also to reduce the funding that is creating the problem. Therefore, under the Paris Agreement, there are two dimensions of finance, the requirement for developed countries to increase their mandatory contribution to meet the needs of mitigation, adaptation and to address the loss and damages resulting from climate change (Article 9). This also comes in addition to the demand for the fulfillment of

commitments such as transferring USD 100 billion per year from developed to developing countries. According to the Organisation for Economic Co-operation and Development (OECD), this commitment has not been met. The OECD estimates that, in 2021, climate finance reached USD 89.6 billion, an increase of 7.6% over the previous year (OECD, 2023). However, this amount is still insufficient to meet the target and highlights the urgency of stepping up efforts to effectively address global climate challenges.

But there is also talk of the need to achieve target 2.1.c, which calls for bringing “finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development" (Paris Agreement, 2015). This means transforming the way the financial apparatus, both public and private, operates. This is critical, but must not deepen crises, such as the current public debt crisis most developing countries are facing, as Barbados' Prime Minister Mia Mottley has pointed out through the Bridgetown initiative. This issue is critical not only in the context of the climate change agenda, but also in the context of meeting the Sustainable Development Goals and targets such as those on biodiversity.

Given this scenario, it is necessary to understand the financing needs and gaps at the national level, and with the interest of contributing to this understanding, the Climate Finance Group for Latin America and the Caribbean (GFLAC), developed the Sustainable Finance Index (SFI), which is a tool that allows the monitoring of national and international revenues and expenditures of developing countries to address the problem of climate change and other sustainable development objectives. It also identifies sources of carbon-intensive revenues and expenditures that could hinder progress towards low-carbon and climate-resilient development. The SFI therefore seeks to monitor both compliance with Article 9 and Article 2.1.c of the Paris Agreement.

In 2023, GFLAC presents this fourth edition of the SFI with data up to 2022, and it is applied to the 20 most emitting countries in the Latin America and Caribbean region (LAC) through four variables: 1) Sustainable Revenues (SR); 2) Carbon-Intensive Revenues (CIR); 3) Sustainable Budgets (SB); and 4) Carbon-Intensive Budgets (CIB). In this sense, the SFI seeks to identify the gaps, challenges and opportunities for transforming public finance systems in developing countries to move towards more sustainable finance.

This edition of the SFI 2023 includes a first section detailing the methodology used. It also includes an analysis of the regional context based on qualitative indicators. It is important to note that while the quantitative variables of the SFI are updated annually, the qualitative indicators that contextualise the situation in the region are updated every two years. Consequently, the 2023 version of the SFI provides a summary of the qualitative indicators, while their full analysis will be carried out in the next edition in 2024.

The SFI annually updates the four quantitative variables of which it is composed and which allow the results of the sustainable finance ranking to be established. In addition, the 2023

edition incorporates an analysis of spending on biodiversity within the environmental sector, a component of the Sustainable Budgets variable.

As in previous editions, a comparative analysis of the four editions SFI results four was made to analyse regional trends. Subsequently, the conclusions and general limitations identified in this edition are presented. This is because the data used and presented in the SFI come from public and open access sources, mostly from finance ministries of the studied countries, as well as from databases from organisations such as the OECD. However, these data may not be fully up to date, disaggregated and/or presented in a comprehensive way, which could impact the calculation of the SFI. We therefore urge governments to have systems for measuring, reporting and verifying climate and sustainable finance that allow information to be processed in a clearer and more transparent way.

The various sources of information used for the estimation of the SFI and the sources of information collected per study country are also presented at the end of the SFI.

The content of the SFI and the overview presented is always under constant review and evolution, so any recommendations for improvement are most welcome (alianzas@gflac.org).

Sustainable Finance Index

The Sustainable Finance Index (SFI) monitors national and international revenues and expenditures on climate change and sustainable development, and tracks those resources that may be hindering progress towards the transition to low-carbon and climate-resilient development, primarily resources from activities related to the extraction and production of fossil fuels and mining, which are the reason of the problem.

The FPI is calculated based on four variables composed of various national and international public finance items:[1]

- **Sustainable Revenues (SR):** Includes international development finance and disbursed climate finance received by countries from bilateral and multilateral sources.
- **Carbon-Intensive Revenues (CIR):** Includes revenues generated by the exploration and exploitation of hydrocarbons, minerals, and fuels.
- **Sustainable Budgets (SB):** Represents the budget allocated for climate change, energy efficiency, renewable energy, and natu
- ral disasters.
- **Carbon-Intensive Budgets (CIB):** Corresponds to the budget allocated to the exploitation of hydrocarbons, including industrial processes and the budget of state-owned companies, if existing.

[1] The variables selection and construction of the Sustainable Finance Index is theoretically based on the work of Guzmán, Sandra (2020). Mainstreaming climate change in the public budgets of developing countries: A mixed method analysis applied to Latin America and the Caribbean Countries. Department of Politics, University of York, UK.

The SFI is a tool for reporting on progress, gaps and funding opportunities for central governments, non-governmental organisations and institutions, and donor agencies and institutions that want to know the status and progress of sustainable finance in the studied countries.

Main findings of the Sustainable Finance Index 2023 (data as of 2022)

General context:

- **The Latin American and Caribbean region contributes 4.8% of global greenhouse gas (GHG) emissions.** According to data from the International Energy Agency (IEA) for the year 2022, the region emitted a total of 4,800 tonnes of GHGs, reflecting an increase of 1.2% compared to the previous year. Although GHG emissions in the region are lower compared to other parts of the world, it is crucial to take meaningful action to reduce these emissions and meet established climate commitments.
- **The Latin American and Caribbean region experienced the lowest Gross Domestic Product (GDP) growth compared to other parts of the world.** According to World Bank (WB) data, in 2022, the region's GDP reached USD 4.9 trillion, representing only 4.7% of the global GDP of USD 104.3 trillion. This low regional growth rate was affected by several factors, including the COVID-19 pandemic and political tensions that impacted the region's economic stability.
- **Countries in the region have a higher unemployment rate compared to the global average**. According to World Bank (WB) data, in 2022, the region recorded an unemployment rate of 8.1%, exceeding the global rate of 6.2%. This disparity highlights the need to address specific labour market challenges in the region to promote more inclusive and sustainable economic growth.

Considering the index results:

- **None of the 20 analysed countries, representing the most emitting countries in the LAC region, have "Very High" levels of sustainable finance.** According to the SFI 2023 results, with data as of 2022, none of the 20 analysed countries scored 4.0 points. 4.0 points means that their sustainable revenues and expenditures would be higher than their carbon-intensive revenues and expenditures, thus achieving a **"Very High"** level of sustainable finance. All countries face challenges in achieving this transformation, while some countries maintain a high dependence on fossil fuels for revenue generation and therefore maintain a high budget allocation to this sector; others have low levels of sustainable revenues, meaning that they have little

international funding to address climate change. Other countries, while they have improved their climate change budget allocations, still have limited climate change budgets.

- **El Salvador is the highest ranked of the analysed countries, with sustainable finances at a "High level"**. El Salvador received 2.9 out of 4.0 points, although it is not the best score, it ranks higher than the rest of the countries because it has more balanced finances, does not have high carbon-intensive revenues, and has one of the highest allocations of budgetary resources to climate change issues, with 2.11% of its total budget.
- **Ecuador, Bolivia, Mexico, Uruguay and Trinidad and Tobago are the countries with the lowest levels of sustainable finance.** Ecuador scored 1.1 points, Bolivia scored 1.0 points, Mexico and Uruguay scored 0.7 out of 4.0 points, placing them at the **"Low"** level of sustainable finance. While Trinidad and Tobago is in the **"Very Low"** level of sustainable finance, scoring 0.5 out of 4.0 points. In most cases, these results are associated with being the countries with the highest carbon-intensive revenues and budgets among the studied countries, i.e. their economies have high levels of dependence on carbon-intensive revenues and therefore spend more on maintaining these industries domestically. In the case of Uruguay, it is associated with the fact that no sustainable income has been identified that would allow the country to have sufficient sources to address the problem, and public spending on climate change is the lowest, at 0.005 of the total.
- **Cuba is the country with the highest income associated with climate change.** Cuba ranked first for the Sustainable Revenues variable, as 49.96% of its total revenue from development finance in 2021 (which is the most updated year for this variable) was associated with climate change, placing it at the **"Very High"** level of sustainable revenue. While Paraguay with 6.37% and Jamaica with 5.55% are the countries that obtained the least funding associated with addressing climate change out of total development f Paraguay with 6.37% and Jamaica with 5.55% are the countries that obtained the least financing to address climate change as a percentage of total development financing, placing them at the **"Very Low"** level of sustainable income.
- **Climate finance has been delivered mostly in the form of loans, accounting for 88%, while only 12% has been allocated in the form of grants in the study countries.** According to the analysis of the Sustainable Revenues variable based on OECD data, countries such as Argentina, Costa Rica, Panama, Paraguay and the Dominican Republic have received all of their climate financing in the form of loans, accentuating their dependence on this type of financial instrument. In contrast, Cuba is the only country that has received all its funding in the form of grants. The delivery of most of the financing in the form of loans intensifies the public debt crisis that countries in the region are facing.
- **Guatemala and El Salvador allocated more than 2.0% of their public budget to activities associated with climate change.** Guatemala ranked first for the

Sustainable Budgets variable, allocating 2.91% of its total public budget to sectors related to climate change, such as investment in renewable energy, energy efficiency, climate policy and natural disaster management. El Salvador follows with 2.11%, placing it in the **"High"** level of sustainable budgets. Although the allocation of more than 2% of the budget is still limited, it is the highest among the studied countries.

- **None of the 20 study countries allocated more than 1.0% of their budget to biodiversity conservation.** Dominican Republic allocated the largest budget to biodiversity conservation, with 0.11% of the total budget, followed by Nicaragua with 0.10% and Bolivia with 0.06%. In contrast, the rest of the countries allocated less than 0.05% of their budget to this crucial area. Even though biodiversity conservation represents one of the most significant challenges in the region, the allocation of resources to this sector does not seem to be a priority in government spending.
- **Bolivia and Mexico are the countries with the highest levels of carbon-intensive budgets.** Of its total budget, Bolivia allocated 19.80% to carbon-intensive activities, followed by Mexico with 15.43%, placing it in the **"Very High"** level of Carbon-Intensive Budgets. This is associated with the fact that both are oil-producing countries, with significant national spending on oil.
- **Ecuador and Mexico are the countries with the highest levels of Carbon-Intensive Revenues.** Ecuador ranked first in the Carbon-Intensive Revenues variable, with 38.76% of its total income coming from carbon-intensive activities, followed by Mexico with 36.35%, placing it in the **"Very High"** level of Carbon-Intensive Revenues. El Salvador with 0.14% and Jamaica with 0.10% are the countries with the lowest levels of carbon-intensive income, placing them at the **"Very Low"** level. While Ecuador and Mexico are oil producing countries, El Salvador and Jamaica are not major fossil fuel producers, which may explain this result.
- **Carbon-intensive revenues outweigh sustainable revenues by 15 times.** Together the 20 studied countries received USD11.049 billion to address climate change, while revenues from carbon-intensive activities were USD160.162 billion. This means that they receive more resources for activities that cause the problem than for activities that address the problem, with incentives misaligned to the scope and fulfilment of the Paris Agreement.
- **Carbon-Intensive Budgets outnumber sustainable budgets by 31 times.** Overall, the 20 studied countries spent USD1.96 billion on sustainable budgets, while they spent USD62.484 billion on carbon-intensive budgets. This means that the budget countries is allocated more to activities that cause the problem than to activities that will help address it.
- **The SFI comparative analysis reveals that 5 countries have improved their position in the 2023 sustainable finance ranking compared to the 2022 edition.** El Salvador, Guatemala, Jamaica, Dominican Republic, and Uruguay have scored higher in the SFI 2023 compared to the previous edition. In contrast, Chile has maintained its score, while the remaining 14 countries decreased in their scores. This analysis

provides valuable insights for governments and non-governmental actors to understand how policies and priorities are evolving in response to climate challenges.

Conclusions:

- **Countries in the region urgently require a just energy transition to cope with the negative impacts of climate change and to address challenges such as high rates of poverty and indebtedness.** The SFI results show the challenges that countries in the region face in achieving more sustainable finances, which are generally associated with the fact that many of the economies remain significantly dependent on oil revenues and outflows. This emphasises the need for countries to decouple their economies from these activities, through energy and financial transition in a fair and equitable way. The region needs to inject financing and investment into low-emissions activities to create jobs in new industries that in turn generate new revenues. This must come from instruments other than debt instruments to avoid deepening the current levels of indebtedness.
- **Latin America and the Caribbean require more transparency in the management and use of climate finance, both national, international, public and private**. The implementation of the SFI allowed to see the degree of progress that various countries have made in terms of opening up data on financing, especially climate finance, but there are still major challenges for this data to be updated, disaggregated and accessible. In addition to other recommendations, the SFI emphasises the need for more and better transparency schemes in the creation, management and reporting of financial data associated with climate change and nature protection.

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