5 Are COVID-19 fiscal recovery measures bridging or extending the emissions gap?

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5.1 Introduction

In response to COVID-19, government fiscal investment in climate change mitigation and adaptation can bolster long-term prosperity by creating jobs and accelerating economic growth while also meeting environmental, gender and social objectives. Academic evidence and political narratives support this approach (Barbier 2020; O’Callaghan and Murdock 2021). Countries that fail to capitalize on this opportunity for low-carbon and climate-resilient economic transformation risk their economic prosperity, environmental sustainability and long-term social cohesion.

Despite this, most governments have so far failed to prioritize a transformative low-carbon recovery, with the relatively insignificant low-carbon investment announced to date likely to maintain current unsustainable situations.1 As at May 2021, only 2.5–12.1 per cent of US$16.7 trillion in total COVID-19 spending (excluding unallocated European Union spending) has been low-carbon or had mitigation co-benefits, while of a total US$2.25 trillion in announced COVID-19 ‘recovery’ spending, only 17–19 per cent has gone towards low-carbon spending, representing an insufficient commitment to align fiscal policies with the Paris Agreement (Andrijevic et al. 2020; O’Callaghan et al. 2021; Organisation for Economic Co-operation and Development [OECD] 2021; Vivid Economics 2021). A small number of wealthy economies account for the overwhelming majority of low-carbon spending,2 with emerging market and developing economies in danger of being left behind. Although low-carbon recovery funds have supported a range of initiatives, they have so far been skewed towards clean energy and natural capital investments.

This chapter explores three questions:

1. How could COVID-19-related public spending bridge the emissions gap?

Section 5.2 summarizes key principles for low-carbon public spending in response to the pandemic. The section considers: (i) short-term rescue spending, to keep businesses and people alive; (ii) longer-term recovery investment, to reinvigorate the economy; and (iii) reinforcement processes, to embed new economic trajectories from recovery investment into long-term development plans. Targeted low-carbon rescue spending incentivizes the decarbonization of hard-to-abate sectors3 by including low-carbon conditionalities or commitments in liquidity and other short-term business support and/or by sustaining the industries likely to foster low-carbon economic growth (Barbier 2020). Low-carbon recovery investment accelerates the low-carbon transition both directly and indirectly by incorporating low-carbon incentives into traditional investment. Low-carbon reinforcement initiatives build long-term support for the projects and sectors targeted by low-carbon recovery investment, aligning long-term development pathways with a low-carbon and climate-resilient transformation of the economy. At every stage, low-carbon spending and regulatory reforms should be

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1 Low-carbon investment is defined in this chapter as spending that is likely to reduce net greenhouse gas (GHG) emissions.

2 Fiscal ‘recovery’ initiatives are defined in this chapter as taxation or expenditure measures that aim to reinvigorate economic growth. Recovery initiatives are distinct from ‘rescue’ initiatives, which act over the short term and aim to keep businesses and people alive in the face of immediate crisis.

3 China, France, Germany, the Republic of Korea, Spain and the United Kingdom together account for 77.4 per cent of total low-carbon spending (O’Callaghan, Bird and Murdock 2021a).

4 Hard-to-abate sectors are those in which low-carbon means of production are significantly more expensive or lacking in scalability than traditional means of production. Many of these sectors will require significant technological innovation to enable economically competitive GHG abatement without productivity loss.
considered in tandem, as successful implementation of the latter can amplify the impact of the former.

2. **What are the characteristics of fiscal rescue and recovery spending to date and how may they impact the emissions gap?**

Section 5.3 shows that low-carbon recovery measures have received only 17–19 per cent of fiscal investment and policy focus to date. Status quo policymaking risks a lock-in and possible expansion of high levels of greenhouse gas (GHG) emissions towards and beyond 2030. While examples of low-carbon investment are numerous and wide-ranging, they largely come from a small set of advanced economies. Long-term human capital development, including skills development, remains underprioritized. Without a substantial pivot towards higher low-carbon investment, countries risk lower economic and social returns, as well as a significant rebound in GHG emissions (United Nations Environment Programme [UNEP] 2020).

3. **Do lower-income nations face greater barriers for low-carbon recovery spending? If so, what can be done?**

Section 5.4 indicates that although emerging market and developing economies have suffered disproportionately under the pandemic and are more exposed to climate risk, their recovery spending has been low, inhibited by restricted access to affordable finance. A global green recovery will require concessional finance, including direct grants, to vulnerable countries that are significantly above current proposals.\(^5\)

**5.2 How could COVID-19-related public spending bridge the emissions gap?**

This section discusses trends in fiscal response towards recovery investment before asking why a low-carbon recovery should be pursued and what it should incorporate.

In the early stages of the pandemic, fiscal packages focused overwhelmingly on ‘rescue’ through the immediate protection of lives, livelihoods and business continuity. As death rates have gradually been controlled in many advanced economies, packages have slowly shifted to incorporate funds for reinvigorating the economy through ‘recovery spending’ (figure 5.1). However, recovery efforts continue to be inhibited by persistent COVID-19 outbreaks in many countries, particularly emerging market and developing economies (International Monetary Fund [IMF] 2020).

**Figure 5.1.** Announced rescue, recovery and unclear spending for advanced economies and emerging market and developing economies

\(^{5}\) Concessional finance refers to loans and other financial instruments that are extended on terms substantially more generous than market financial instruments.
Opportunities for rescue spending: Low-carbon rescue spending can ease industrial decarbonization, particularly in hard-to-abate sectors, through including green incentives in business liquidity support and other short-term support mechanisms (e.g. reduced taxation) and/or by directing support to industries likely to foster green growth (International Renewable Energy Agency [IRENA] 2020).\(^6\) These programmes should empower businesses to make cost-efficient choices to transition to carbon neutrality without compromising jobs and livelihoods.

Opportunities for recovery spending: Growing evidence suggests that low-carbon investment can deliver stronger economic returns than conventional stimulus, while strengthening climate mitigation, adaptation, air pollution reduction, natural capital protection,\(^7\) health outcomes, inequality reduction, human mobility and broad social progress and prosperity.\(^8\) Carbon-intensive recovery packages that grow fossil fuel industries without conditions for a sustainable transition endanger economic returns as fossil fuel assets become devalued with reduced demand for their outputs (Mercure et al. 2018; Ansari and Holz 2020; van der Ploeg and Rezai 2020). An expert survey in Hepburn et al. (2020) identified traditional transport and energy infrastructure investment as the most harmful recovery policies for long-term GHG emissions, although this analysis did not consider armed forces infrastructure spending, which is also harmful compared with others (O’Callaghan, Murdock and Yau 2021).

Some of the most attractive recovery measures for reducing emissions — those which balance the potential to spur economic growth in a contractionary environment and the potential to mitigate emissions — include electric vehicle incentives and public transport modernization, clean energy infrastructure investments, energy efficiency upgrades, natural capital investments and clean research and development programmes (Barbier 2020, Garret-Peltier 2017, United Kingdom, Climate Change Committee 2020; Hepburn et al. 2020). Continental unions and regional economic commissions of the United Nations have highlighted similar priorities (see appendix B.1). Although the accessibility of these options depends on the development of technological infrastructure and the availability of natural and human resources, input-output modelling indicates that low-carbon investment could generate significantly more jobs and greater economic value than traditional ‘dirty’ and ‘neutral’ alternatives.\(^9\) This is true for both advanced economies and emerging market and developing economies.

Opportunities for reinforcement spending: The role of low-carbon reinforcement measures following recovery remains largely undisussed in academic and professional literature. However, as COVID-19 spending becomes integrated into regulatory budgetary processes, it becomes increasingly less distinguishable from normal ‘peacetime’ spending. Going forward, sustainability-proofing the entire budgetary process and increasing policy coherence across sectors and levels will be crucial to maximize the impact of a low-carbon recovery. This could be achieved through implementing green budget tagging processes (Eltokhy et al. forthcoming) or applying more advanced green public financial management frameworks.

Non-governmental and academic advisers collectively propose at least seven key principles for designing a low-carbon fiscal response to the pandemic, as summarized in figure 5.2. Consensus opinion suggests that policy design should be consultative, evidence-based and gender-sensitive, while ensuring prompt implementation that is considerate of pandemic realities. Importantly, fiscal action represents only one of several mechanisms available to advance climate action and stimulate economic growth following COVID-19. Regulatory and market interventions, among others, can play a key role.\(^10\) Fiscal measures are also likely to prove most effective when combined with appropriate regulatory and market interventions (OECD 2020b).

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\(^{6}\) Publicly-financed liquidity support and other short-term business support help businesses meet their immediate costs and continue operations, without the threat of expeditious liquidation. Low-carbon conditionalities may require businesses to take environmental commitments as a condition of receiving public funds (or having a lower temporary tax or expense load). Since these measures incentivize innovation, they may increase the economic impact of taxpayer spending while also delivering environmental and social benefits (O’Callaghan and Hepburn 2020).

\(^{7}\) Natural capital refers to ecosystems, biodiverse habitats, clean water and air, productive soils and a stable and resilient climate.


\(^{10}\) For instance, in renewable energy generation, streamlined approval processes, contracts for difference models, and feed-in tariffs drastically accelerated uptake in pre-pandemic times (Haas et al. 2011, Schumacher 2019, Welisch and Poudineh 2020).
5.3. What are the characteristics of fiscal rescue and recovery spending to date and how may they impact the emissions gap?

This section provides a high-level assessment of the characteristics of global COVID-19 rescue and recovery spending so far with respect to mitigation.

To support accountability and transparency, low-carbon recovery investment of all kinds should include appropriate management structures for monitoring, reporting and verifying the effective implementation and use of recovery funds (Agrawala et al. 2020), as well as designated funds and standards for ex-post impact assessment. Such measures may also improve understanding of the relative strengths of low-carbon fiscal investment over alternatives. Oversight tools, such as the ‘do no significant harm’ principle included in the European Union’s Recovery and Resilience Facility regulation, can counter measures that endanger environmental objectives (European Commission 2021).

Across countries and data sources, several primary themes have emerged:

1) Only 2.5 per cent of US$16.7 trillion in total COVID-19 fiscal spending (excluding unallocated European Union spending) has been low-carbon, with only 17–19 per cent of a total US$2.25 trillion in announced COVID-19 recovery spending likely to reduce GHG emissions (O’Callaghan et al. 2021). Seven countries account for almost 90 per cent of this spending: China, France, Germany, Japan, the Republic of Korea, Spain and the United Kingdom (figure 5.3). The percentage of recovery spending that is low carbon has slowly increased since Emissions Gap Report 2020 (UNEP 2020), perhaps driven in part by a better understanding of the potential for low-carbon investments to deliver strong economic, environmental and social returns. High-carbon, neutral and unclear spending (87.9–97.5 per cent of total spending) either worsens or maintains the unsustainable status quo of the current global emissions trajectory (O’Callaghan et al. 2021; OECD 2021; Vivid Economics 2021).

Proposed economic indicators include short- and long-term multiplier effects and labour impacts, environmental indicators, such as GHG emissions and air and water quality, and social indicators, such as cost-of-living, inequality, public health and gender equity impacts (Jotzo, Longden and Anjum 2020; World Bank 2020).
Figure 5.3. Non-exhaustive overview of total fiscal rescue and recovery measures of G20 members with high-carbon, neutral and low-carbon impacts as a share of 2020 gross domestic product\textsuperscript{12}

<table>
<thead>
<tr>
<th>Country</th>
<th>Total (US$ bn, GRO)</th>
<th>% of GDP</th>
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<tbody>
<tr>
<td>Argentina</td>
<td>Highly negative</td>
<td>10%</td>
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<tr>
<td>Australia</td>
<td>Negative</td>
<td>10%</td>
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<tr>
<td>Brazil</td>
<td>Relatively neutral</td>
<td>0%</td>
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<tr>
<td>Canada</td>
<td>Positive</td>
<td>0%</td>
</tr>
<tr>
<td>China</td>
<td>Highly positive</td>
<td>10%</td>
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<tr>
<td>France</td>
<td>Unclear</td>
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<td>USA</td>
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</table>

Notes: GRO – Global Recovery Observatory of the University of Oxford, UNEP, Green Fiscal Policy Network and United Nations Development Programme (UNDP); OECD – OECD Green Recovery Database; E3G – Green Recovery Tracker of Third Generation Environmentalism (E3G) and Wuppertal Institute.

\textsuperscript{12} Data for the overall spending bar are from the Global Recovery Observatory, as it is the only current tracker that accounts for ‘neutral’ measures. The International Monetary Fund (IMF) and Climate Action Tracker (CAT) have discontinued their trackers since the release of the 2020 Emissions Gap Report. The Greenness of Stimulus Index from Vivid Economics has changed its methodology, such that it no longer directly assesses policy-level climate impacts. Instead, the Greenness of Stimulus Index assigns a ‘greenness value’ (positive or negative) to each sector of every tracked country, with the final index for each country being an average of sectoral impact. As this methodology is not comparable with other trackers, Vivid Economics advised excluding the Greenness of Stimulus Index information from the figure. The IEA’s Sustainable Recovery Tracker and the Energy Policy Tracker only cover energy spending and are therefore excluded from this analysis. Many discrepancies between the included trackers relate to key differences in methodology: for instance, the Green Recovery Tracker (E3G undated) does not include certain types of rescue spending, while the Global Recovery Observatory (O’Callaghan et al. 2021) accounts for all fiscal measures. Trackers also vary in their definitions of ‘low-carbon’: one measure may receive a low-carbon tag by one tracker and a neutral tag by another, resulting in substantial differences in spending recorded in either category. A comparison of trackers and their methodologies can be found in appendix B4.
2) **Low-carbon fiscal investment has covered a wide range of policy types.** Over 500 low-carbon rescue and recovery measures have been introduced worldwide, covering most emerging and established low-carbon industries (figure 5.4). The range of spending has been notably wider in advanced economies, with emerging market and developing economies focusing their low-carbon recovery funds on clean energy generation and natural capital investments. Spending on worker retraining initiatives remains low across countries, indicating an insufficient focus on long-term human capital development. A minor portion of investment in what have traditionally been considered ‘neutral sectors’ include accompanying low-carbon incentives (appendix B.2 lists a few examples of this type of investment).

3) **International disparities are significant in both total spending and low-carbon spending.** Some countries are already well into their economic recovery while others have been unable to act at all, constrained by low access to capital and continuing COVID-19 mobility restrictions. Of those who have spent significantly, some have integrated green priorities to a considerable degree, with others having failed to consider environmental concerns in any way. The Global Recovery Observatory has found that Canada, Denmark, Finland, France, Germany and Norway can be considered as ‘leaders’ in low-carbon recovery, with their low-carbon spending as a share of recovery spending ranging between 39 and 75 per cent. Spain, Sweden and the United Kingdom also rank highly according to Vivid Economics’ Greenness of Stimulus Index.13

**Figure 5.4.** Global recovery spending as of May 2021 across sectors by region (US$ billions)

As chapter 2 shows, global emissions dropped in 2020, but are expected to bounce back in 2021. Studies on the impact of announced fiscal investment on global emissions suggest that decisions made so far will maintain the unsustainable trajectory of pre-pandemic economies (Forster et al. 2020; Malliet et al. 2020; Meles et al. 2020; Pollitt et al. 2020; IEA 2021; Shan et al. 2021). In line with the 2020 Emissions Gap Report, the studies suggest that a more carbon-intensive recovery would increase emissions substantially in the medium to long term, while a low-carbon recovery would significantly reduce emissions (see also appendix B.3).

5.4. **Do lower-income nations face greater barriers for low-carbon recovery spending? If so, what can be done?**

This section describes the disproportionately negative impacts of COVID-19 on vulnerable nations. It then discusses the need for significantly increased international aid to simultaneously support economic recovery, long-term economic development and climate priorities.

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13 Leaders’ are classified as having spent above 1 per cent of gross domestic product (GDP) on fiscal recovery and above 30 per cent of this on low-carbon measures (O’Callaghan and Murdock 2020). The Greenness of Stimulus Index score is calculated by combining the flow of stimulus into five key sectors with an indicator of each sector’s environmental impact (Vivid Economics 2021).
5.4.1. Vulnerable nations are being left behind

The COVID-19 crisis has had an especially negative impact on vulnerable nations: global extreme poverty rose in 2020 for the first time in over 20 years, with an estimated 120 million additional people estimated to be living in poverty due to the pandemic (World Bank 2021a). Foreign direct investment fell by 8 per cent in developing countries in 2020 compared with 2019, driven by a 15.6 per cent decline in Africa and a 45.4 per cent decline in Latin America and the Caribbean (United Nations Conference on Trade and Development [UNCTAD] 2021). Despite these trends, COVID-19 spending has been far lower in low-income economies (~US$60 per person) than advanced economies (~US$1,800 per person; see figure 5.5).

Figure 5.5. COVID-19-related spending per capita across development categories (US$)

![Figure 5.5](image)

Source: O’Callaghan et al. (2021)

Unequal access to finance is a key driver of disparities in COVID-19 spending between high- and low-income nations (O’Callaghan and Murdock 2021). In 2020, development partners committed US$89.5 billion to support African nations in response to COVID-19, of which US$59.5 billion has been disbursed (figure 5.6). This represents just 0.4 per cent of total global COVID-19 spending. Without a substantial increase in foreign aid, the difference in spending between advanced economies and emerging market and developing economies will exacerbate gaps in development, while also restricting progress against climate change. Emerging market and developing economies are also likely to become the world’s top GHG emitters if climate finance does not significantly increase (World Resources Institute undated), all while disproportionately suffering the burden of climate change, which has historically been caused by high-income economies (see IMF 2021a).

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14 Foreign direct investment refers to cross-border investment where an investor establishes lasting financial interest in and influence over an enterprise domiciled in another economy.

15 Although many advanced countries have announced dramatic increases in expenditure at near- or below-zero financing costs (Blanchard 2019), the same is not true of most emerging market and developing economies. Severe pandemic-induced economic contractions in most emerging market and developing economies have caused a dramatic rise in debt-to-GDP ratios (IMF 2021b), temporarily increased credit default insurance premiums as measured by credit default swap spreads (Council on Foreign Relations [CFR] 2021) and reduced current account balances (World Bank 2021b), leaving emerging market and developing economies in the Latin America and the Caribbean, and Europe, the Middle East and Africa regions with historically low credit risk ratings (S&P 2021a; S&P 2021b). Across both advanced economies and emerging market and developing economies, climate change is likely to expose some forms of debt to even more risk, particularly debt to finance climate-exposed investments such as agriculture (Dibley, Wetzer and Hepburn 2021; European Central Bank 2021).
Figure 5.6. Funding commitments and disbursements to Africa by development partners in 2020–2021 (US$ billions)

![Diagram showing funding commitments and disbursements to Africa by development partners in 2020–2021 (US$ billions).](chart)

Key:
- World Bank
- Islamic Development Bank
- International Monetary Fund
- Arab Monetary Fund
- European Union
- Global Partnership for Education
- African Development Bank
- Arab Bank for Economic Development
- African Export-Import Bank
- WB Debt Service Suspension Initiative
- Gavi Vaccine Alliance

Source: Non-public UNECA analysis (2021)

5.4.2. How to support vulnerable nations

As in advanced economies, low-carbon investment in emerging market and developing economies has the potential to shorten the duration of COVID-19 impacts, address climate concerns and set strong long-term development pathways. Natural resource endowments in many low-income nations make investments in renewable energy generation facilities and natural capital solutions particularly attractive (Kim 2020). By prioritizing local supply chains, long-term partnerships between emerging market and developing economies and high-income economies can enable sustainable growth and build future-proof infrastructure.

Wealthier economies could support vulnerable nations in several ways:

- **Debt forgiveness**

Based on IMF and World Bank debt sustainability analysis, debt treatments, including debt write-offs, must be considered for vulnerable countries. Debt relief programmes, including debt-for-climate swaps, could help support low-carbon recovery and a transition to low-carbon growth. A haircut of 10 per cent in debt repayments could result in savings of US$100 billion for reinvestment in low-carbon recoveries (Jensen 2021). Debt restructuring, including private debt, through new bond issuances aligned with the Sustainable Development Goals (SDGs) and the Paris Agreement could help avert a ‘lost decade’ and provide fiscal resources for investment in a low-carbon recovery (Volz et al. 2021).

- **Direct grants and concessional finance**

New low-carbon and climate-resilient recovery investments can improve inclusion while advancing progress on the SDGs. Advanced economies can accelerate this by providing resources commensurate with the scale of the required transformation, i.e. significantly more than the commitments agreed at the sixteenth United Nations Climate Change Conference of the Parties (COP16) of US$100 billion per year.

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16 Debt for climate-resilience swaps exchange the cancellation of a developing country’s public debt for increased investment in climate-related projects in that same country. These instruments offer a vehicle for generating low-carbon recovery investment in sectors that facilitate the transition to low-carbon growth.
(United Nations 2010). Disjointed interventions may widen further divergence.

- **Concessional finance for green and blue bonds**

  The proceeds of green and blue bond issuances respectively finance environmentally-friendly projects and ocean conservation projects, often unlocking new finance to advance climate goals (Banga 2018, World Bank 2008). Green and blue debt markets are growing in emerging market and developing economies, yet several challenges remain, including only a small pricing benefit of green and blue bonds over regular bonds (Doran and Tanner 2019; Otek Ntsama et al. 2021). Foreign monetary authorities and governments could commit to purchasing green and blue bonds at lower interest rates in emerging market and developing economies (Liaw 2020). Robust, standardized and stringent certification and monitoring systems could provide greater credibility for such issuances.

- **Guaranteeing private sector debt**

  The impact of public investment in climate resilience and mitigation can be significantly improved by ‘crowding-in’ additional private sector resources. Blended finance and partial guarantees have a key role in supporting this for emerging market and developing economies, particularly following the pandemic-induced crash in international project finance and other forms of foreign direct investment (UNCTAD 2021).

- **Redistributing multilateral finance to vulnerable nations**

  The proposed IMF issuance of US$650 billion in new special drawing rights could strongly support a low-carbon recovery if funds are directed to future-oriented low-carbon and climate-resilient investments. On-lending a substantial amount of such funds to the world’s most vulnerable countries could significantly enhance the issuance. Without such an action, only 3.2 per cent of the issuance will be directed to low-income countries (The Economist 2021). While the current IMF call for US$100 billion to be on-lent is positive, it remains insufficient given the extreme disparity in fiscal space between advanced and vulnerable economies. Appendix B5 compares alternative approaches that could be implemented.

- **Considerations for carbon border adjustment mechanisms**

  Carbon border adjustment mechanisms, such as those proposed by the European Union, could provide highly effective trade-based regulations to drive down emissions and reward sustainable supply chains. However, although such mechanisms are primarily intended as protective environmental measures, their unequal trade implications and potentially high burden on vulnerable nations must be acknowledged. If carbon border adjustment mechanisms are implemented, standards and controls must be developed that both support global environmental needs and development priorities of vulnerable nations. These mechanisms (and their standards and controls) must be implemented with significant financial and technical resources to support capacity-building in vulnerable nations (see Gore 2021).

  To ensure a successful sustainable and inclusive transition, emerging market and developing countries require significant technology transfer and capacity-building in addition to financial support, needs that should be reflected in updated nationally determined contributions (NDCs). Support for low-carbon recovery in emerging market and developing economies often relies directly on the nation’s demonstrated interest to pursue public policy reforms that are consistent with the Paris Agreement goals, such as, for example, consideration of and action on carbon pricing, fossil fuel subsidies reform, green budgeting systems and regulations for financial sector greening.

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17 For example, Egypt’s October 2020 issuance of a US$750 million green bond was broadly price aligned to its normal standard bond issuances (London Stock Exchange 2020).
18 Carbon border adjustment mechanisms act to “equalise the price of carbon between domestic products and imports” to eliminate financial incentives to relocate production outside of regions with strong climate controls (European Commission undated).
19 Emerging tools, such as the sustainable development and climate action green recovery screening tool (SCREEN, of the NewClimate Institute) can assist in identifying high-potential opportunities.