ASEAN Socio-Cultural Community
POLICY BRIEF

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EXECUTIVE SUMMARY

- In response to the growing urgency to combat climate change, the public sector plays an enabling role in facilitating the implementation of integrated government strategies to meet sustainability targets.
- Among ASEAN Member States, governments are making efforts to support climate-sensitive policies. Still, progress is held back by economic and regulatory obstacles, alongside a lack of national and global coordination.
- The lack of government policies is inhibiting the effective mobilisation of climate finance. Governments also need to ensure efficient implementation of existing policies such as enforceable standards for green bonds.
- A key challenge for policymakers is integrating public policy with Nationally Determined Contributions (NDC) targets, as current public policies, including national budgets, still need to be integrated with climate metrics.
- As climate finance is still in its infancy in ASEAN, several ASEAN Member States rely heavily on public financing, including government funding and multilateral and bilateral agreements, to meet their NDC commitments.

POLICY RECOMMENDATIONS

- Addressing climate-sensitive issues requires integrating public policy with NDC and Sustainable Development Goals (SDGs) targets via a bold whole-of-government and whole-of-society approach, sustained by continuous government commitments and assessing political and policy risk.
- Strengthening fiscal resiliency should be supported by sound public financial management strategies and frameworks aligned with climate action initiatives.
- Re-evaluating fuel and energy subsidy mechanisms and introducing instruments such as carbon tax and carbon pricing mechanism is critical.
- Identifying new partnership opportunities through blended finance for scaling up climate actions and empowering institutional investors as a vital form of public-private collaboration to unlock innovative climate financing instruments.
- Strengthening international collaboration on standard harmonisation, capital mobility, capacity building and promoting knowledge flows to enhance the public sector's support for climate financing.

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Accelerating Public Sector Support for Climate Financing in ASEAN

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1. Introduction

The role of the public sector in tackling climate change issues is indispensable, especially in developing countries. Given the climate change classification as a public good, governments take the lead in promoting climate action and climate financing. Nonetheless, public finance is not solely confined to government contributions at the national level but also international assistance from bilateral and multilateral arrangements, such as contributions from Multilateral Development Banks (MDB) and Official Development Assistance (ODA). Meeting the ambitious Nationally Determined Contributions (NDC) and Sustainable Development Goals (SDG) targets require bold commitment from governments and buy-ins from businesses, investors, and citizens to achieve net zero targets in the long run.

The lack of integrated public policies can inhibit the mobilisation effectiveness of climate finance. Governments also need to ensure the efficient enforcement of existing policies. Barriers such as the lack of incentives, the unwillingness of firms to be accountable for environmental externalities, lack of information on projects' climate-related consequences and shortages of bankable climate-resilient projects continue to impede the mobilisation of funds to address climate change in the region. The absence of proper policy coordination compounds these barriers. Climate finance policies should be adaptive, consistent, and well-coordinated for ASEAN Member States to achieve their climate change goals.

The public sector can contribute to climate financing by investing directly in climate change projects or providing support such as regulations, policies, and action plans and offering de-risking instruments. This policy brief highlights possible key policy actions in accelerating public sector contributions to climate finance in ASEAN, such as integrating public policy with the NDCs and SDGs, strengthening fiscal resilience, adopting partnerships, and strengthening regional and international collaboration.

2. Integrating public policy with NDC and SDG targets

A key challenge for policymakers is integrating public policy, including national budgets, with NDC and SDG targets, as these still need to be integrated with sustainability metrics. Integrating NDCs and SDGs into all levels of government and public policies can provide a clear direction to the market and avoid risks related to political instability and policy failures. This strategy will also encourage private sector participation in climate financing. ASEAN should ensure taking collective actions in accordance with the NDC goals outlined by members and facilitate processes that can generate climate finance and investment in response to the needs identified for implementing priority projects and programmes

2.1. The "whole-of-government" and "whole-of-society" approach

Policy interventions and financing measures must be coordinated at various levels of government (i.e., federal, state, and municipal) and between multiple government agencies. The coordination will improve efficiency in public service delivery and provide a feedback loop for policy improvements. The linking of various stakeholders within the government sector can improve policymakers' understanding of the complex systems and issues involved in addressing climate action. Taking a "whole-of-government" approach facilitates coordinated activities across ministries, public agencies, and regulators to provide joint solutions to climate issues. Development policies should integrate climate policy. For instance, procurement activities should prioritise greening efforts, and the actual procurement cost should reflect the climate externalities of the project.

Meanwhile, the "whole-of-society" approach requires governments to build trust and work closely with civil society and the public to tackle climate and environmental problems. Engagement with the public is crucial, especially during a transition period whereby implemented climate policies could disproportionately affect industries and segments of society. For instance, executed acts such as removing fuel and energy subsidies and enforcing carbon tax could result in profit reduction and job losses in carbon-intensive industries. To address these challenges, it is crucial to continuously engage civil society and communities on the direction of government policies, with clear climate targets for a smooth transition. In ASEAN, decision-making on climate change should engage civil society actors (such as NGOs, academia, and civil society organisations (CSO)) in addition to state management and national commitments on carbon emissions.

This can also help governments disseminate information and build public consensus around the reforms related to climate finance. For instance, to remove fuel subsidies in the Philippines, the government administration launched nationwide information dissemination on the issues caused by price subsidies and the need for change, thereby securing significant support. As most ASEAN Member States aim to achieve net-zero targets by 2050, countries should have a clear blueprint for governments' plans for meeting these targets and help businesses, investors, and the public to navigate the necessary changes.

2.2. Managing political and policy-related risks

Climate policies need to create attractive conditions for low-carbon investments, whereby investment flows need to shift from high to low-carbon innovations. However, in developing countries, low-carbon investments often suffer from high risks. De-risking investments against climate change requires governments to offer financial instruments to reduce investment risks. Public resources can address viability gaps and project risks that would otherwise repel private investors. It also provides policy clarity and strengthens institutional capabilities to manage political and policy-related risks.

ASEAN Member States should focus on transparency and the rule of law to be competitive. Improvements in institutional capacity will bring confidence to investors and the business community to invest in climate change initiatives. In contrast, policy inconsistency, political violence, unjustified expropriation, and breach of contracts will undermine the government's ability to attract private sector investments in climate action projects. Countries with weak institutional set- ups have to bear a higher cost of capital to fund climate activities. As a regional entity, it is crucial for ASEAN to design policies and procedures that minimise the adverse impacts of climate change, support risk and vulnerability assessments, and support global partnerships in finance, technology, and capacity building.

3. Strengthening fiscal resiliency

Fiscal resiliency is vital for a country's macroeconomic stability, requiring a balance between tax revenues and public expenditures at the national level. The fiscal consequences of high climate change-related spending or lower tax revenues cause imbalances in public budgets. Fuel and energy consumption subsidies have been a perennial issue in several ASEAN Member States. About two-thirds of the global greenhouse gases (GHG) are from fossil fuels and industrial processes. Therefore, to facilitate the transition to decarbonisation, ASEAN may need to revise its subsidy policy and work on possibly introducing a carbon tax with proceeds going towards climate action initiatives.

3.1. Evaluating fuel and energy subsidy mechanism

Continuing blanket subsidies on fuel and energy consumption is counterintuitive to climate change action and unsustainable for fiscal management in the long run. Incentives to provide cheaper fossil fuels are counterproductive to promoting renewable energy. A high dependency on fossil fuel subsidies poses significant challenges in overcoming global inflation caused by the ongoing surge in fossil fuel prices. Instead of providing blanket subsidies on fossil fuel and energy, ASEAN Member States can deploy direct subsidies for vulnerable groups and incentives to attract private investment into renewable energy, including offering government incentives to de-risk renewable energy investment by providing guarantees, subsidies on borrowing costs, grants, and tax credits for capital expenditure.

Effective and efficient provision of government incentives can be a catalyst for transitioning from fossil fuels to green and renewable energy, alongside better management of fiscal policies. Although some of these incentives are already practised in several ASEAN Member States, they must be reassessed and intensified to accelerate green and renewable energy adaptation. For instance, Thailand has introduced incentives to encourage investment in renewable energy, including offering capital grants for renewable energy equipment, such as solar thermal systems and biogas installations. Thailand also provides tax exemptions for the import of renewable energy equipment. Likewise, Singapore has created incentives for R&D in renewable energies to encourage investment in energy, water, and green building solutions. These incentives are also common in other ASEAN Member States, but assessing the effectiveness of such incentives is critical. ASEAN is currently working towards increasing the share of renewable energy – the target is to increase the renewable energy component to 23% by 2025.

3.2. Introducing carbon tax and carbon pricing mechanism

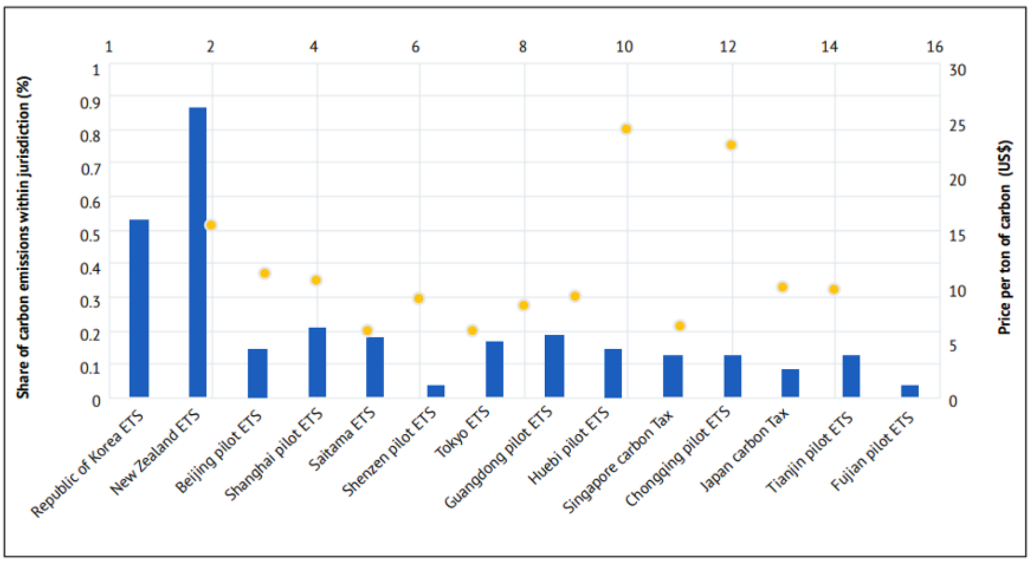
Strategies to maximise social returns from government spending and improve government revenue can be enhanced by improving tax collection mechanisms. Imposing a carbon tax is a potential innovative solution to increase government funding while contributing to the achievement of carbon neutrality by 2050. The UN Handbook on Carbon Taxation recommends two basic approaches for introducing a carbon tax in developing countries. The Fuel Approach sets tax rates based on carbon content and focuses on taxing the volume of fuels, giving rise to emissions when combusted. A Direct Emission Approach imposes a tax on emissions directly at the source and can consider any emission. Both approaches contain distinct features and incentivise the reduction of carbon emissions.

Similarly, the government can introduce carbon pricing mechanisms such as the cap-and- trade approach and set up Emission Trading Systems (ETS). Under Article 6 of the Paris Agreement, countries implementing carbon pricing mechanisms can mobilise their finance by scaling up international cooperation through carbon credit trading. Article 6.2 allows countries to trade emission reductions and removal through multilateral and bilateral agreements. This would improve fiscal space for spending on clean energy and green projects and foster a green recovery in ASEAN.

The progress on carbon tax and ETS is still nascent in the region. However, a growing number of initiatives have been taken as ASEAN Member States are more informed of the potential benefits of carbon pricing mechanisms. Singapore emerged as the first ASEAN Member State to implement a carbon tax in 2019, while others plan to introduce it within the next few years. The Indonesian government has set a mandate to implement ETS by 2024, while in Malaysia, carbon pricing mechanisms currently exist in the form of Internal Carbon Pricing (ICP) practices through voluntary carbon market. While ASEAN is relatively lagging in implementing carbon pricing, its major partners in ASEAN+3 have advanced infrastructure and knowledge in implementing carbon market mechanisms (Figure 1), which ASEAN Member States can learn from. Likewise, the region should leverage technical assistance from multilateral development banks (MDBs) to develop carbon pricing instruments. For example, under Partnership for Market Readiness (PMR), the World Bank supports Thailand in deploying carbon pricing instruments to encourage energy efficiency.

In the region, debate on the risks and benefits of carbon tax and carbon markets is still ongoing, and there are delays in the implementation of the carbon trading market, with unclear regulations and unfavourable global economic conditions being cited. The Asian Development Bank (ADB) report on "Carbon Pricing for Green Recovery" has emphasised the need to adopt carbon taxes and ETS to support green recovery. The report highlights opportunities for carbon pricing with well-designed instruments to minimise near-term risks (Asian Development Bank, 2021) . The report puts forward carbon prices to be fixed at a low cost, price shock reduction on the economy and facilitation of a gradual transition towards NDC targets. The ASEAN State of Climate Change report suggests the introduction of an ASEAN-wide carbon tax alongside the need for a proper management, reporting, and verification (MRV) system to assist Member States in determining the level of emissions in all sectors. Policymakers should convey the benefits of carbon policies to businesses and the general public. To reduce adversities from the carbon tax policy, targeted assistance should be provided to vulnerable groups while tax and monetary incentives can be offered to businesses.

Figure 1: Carbon Pricing Mechanism in Asia Pacific



ETS = emissions trading scheme, tCO2e = ton of carbon dioxide equivalent.

Carbon price: April 2021, US$/$tCO_2e$.

Source: (Economic Research Institute for ASEAN and East Asia (ERIA), 2022)

4. Encourage public-private partnerships

Coordination and collaboration between the public and private sectors are crucial for climate financing, as public finance and international grants alone are inadequate to meet financing needs. Strategies may also include building partnerships and expanding blended financing initiatives with the assistance of international organisations and MDBs to make the best use of concessional loans, grants, guarantees and philanthropic contributions. Likewise, institutional investors and Development Financial Institutions (DFI) also have a critical role in supporting climate financing in ASEAN.

4.1. Blended finance for scaling up climate actions

Blended financing is critical in mobilising new capital sources to fund sustainable development. Blended finance, as depicted in Table 1, uses catalytic capital from the public sector and philanthropic contributions to enhance the investment attractiveness of sustainable initiatives while achieving the capital owner's investment objectives, i.e., financial and social returns. De-risking instruments from the public sector, international organisations, and philanthropic contributions help to accelerate private sector funding as project failure risk is distributed. Indeed, public sector financing is crucial in high- risk business cycle projects, while the private sector could contribute to the same project at a lower risk.

Table 1. Types of Climate Financing

Types	Agents and Engagement
Development Funding	Grants and Philanthropy & Public Sector
Concessional Funding & PPP	Public and Private Sectors
Social Enterprise	Grants and Philanthropy & Private Sector
Blended Finance	Grants and Philanthropy, Public Sector & Private Sector

Source: (Buchner et al., 2021) and (Convergence, 2021)

Asia has become an important destination for blended financing activities, accounting for 36% of blended transactions in 2020. Notably, from 2018-2020, Vietnam, Myanmar, and Indonesia represented the top ten recipient countries for blended financing, receiving more than 30% of blended transactions with 8, 11, and 10 transactions, respectively (Convergence, 2021). MDBs and DFIs have clear mandates to create a consistent and prominent source of blended financing among ASEAN Member States, particularly for large-scale projects such as infrastructure development. Major blended financial funds linked to ASEAN Member States include the Private Financing Advisory Network targeted for clean energy projects, ADB's and Japan International Cooperation Agency's

(JICA) US$ 1.5 billion investment in infrastructure development and GuarantCo's US$ 13.5 million guarantee for Thai Biogas Energy Co. Ltd on waste to energy projects.

Meanwhile, ASEAN Member States could also emulate Indonesia's blended financing facility under the SDG Indonesia One (SIO) initiative. The SIO supports infrastructure financing undertaken by PT Sarana Multi Infrastructure with blended financing instruments from various public and private funding channels. The ADB is a key partner of the project in which it has approved a US$ 150 million loan to fund the SIO-Green Financial Facility (SIO-GFF), which aims to finance at least ten projects, whereby at least 70% of the financing supports green infrastructure. In addition, ADB also estimates that SIO-GFF will catalyse up to eight times the fund invested in supporting climate-friendly infrastructure and helping Indonesia transition its economy to a sustainable path (Asian Development Bank, 2022).

4.2. Empowering institutional investors

Besides direct funding, governments can leverage institutional investors to invest in climate action initiatives, mainly through government-linked investment companies, state-owned enterprises, pension funds and sovereign wealth funds. Institutional investors globally have been shifting their portfolios to green investments. The United Nations' Principles for Responsible Investment (UNPRI) signatories have exceeded 4900 in the first quarter of 2022 with over US$ 121 trillion of assets under management (AUM). A total of 128 signatories were committed to net-zero targets, amounting to US$ 43 trillion AUM. In ASEAN, institutional investors are exposed to climate change risks as the region is highly vulnerable to natural disasters. Moreover, the portfolios held by institutional investors are focusing more on domestic assets.

State-owned enterprises and sovereign wealth funds are directly involved in business activities, strategic investment holdings and investments in the energy and mining sectors. The revenue generated from the carbon-intensive extractive industries can be channelled into the development of low-carbon economic activities which are more sustainable for the future. Government-linked-investment companies can create a demonstration effect in which institutional investors can attract private sectors to invest in green activities. In addition, institutional investors also play a stewardship role in setting the green agenda through shareholder activism and voting rights. Meanwhile, pension funds can utilise long-term savings to finance sustainable infrastructure, which would require an extended period for return realisation. Pension fund management in the region can learn from the Japanese Government Pension Investment Fund's (GPIF) experience, whereby pension funds contribute to the adoption of ESG principles in the capital market.

5. Strengthening regional and international collaborations

It is important to understand that the impact of climate risk is beyond national and regional boundaries and that climate action spillover can be non-excludable. Therefore, the role of regional and international organisations is critical to ensure that the world works together to ensure humankind's survivability in the future. ASEAN has made efforts to promote regulatory harmonisation, knowledge and data sharing, transparency, and information flow to foster greater mobility of capital within the region while narrowing the financing gaps among ASEAN Member States. There is a need to continue and strengthen the ASEAN Working Group on Climate Change (AWCCC), which enhances regional cooperation in addressing the adverse impacts of climate change.

5.1. Taxonomy and harmonisation of standards

The introduction to the ASEAN Taxonomy for Sustainable Finance has become instrumental in creating a guide for ASEAN Member States to define economic activities that are considered 'sustainable' in the region. The ASEAN Taxonomy is unique compared to other regional taxonomies, offering a multi-tiered framework to account for the differences in the region – Foundation Framework (FF) and Plus Standard (PS). The ASEAN Taxonomy Version 1 focus on environmental objectives as part of the FF, which is universal and applicable to all and is intended to help issuers and investors understand the sustainability impact of a project or economic activity. It aligns with national environmental laws, with objectives such as climate change and adaptation and protection of a healthy ecosystem and biodiversity. Meanwhile, the PS provides additional guidance and scope for the region to further qualify and benchmark eligible green activities and investments. The ASEAN Taxonomy Version 2, released in June 2023, focuses on the classification of activities by developing Technical Screening Criteria (TSC) for the PS and includes social aspects as part of the essential criteria. The Taxonomy is developed to facilitate access to finance and investment in green activities and emphasizes interoperability across the region. Hence, the ASEAN Member States should incorporate the taxonomy at the national level to develop financing instruments domestically and attract regional and global investments.

While taxonomy provides overarching guidance, disclosure standards and MRV requirements can be complex and confusing due to the evolving state of climate reporting and disclosure standards with different thresholds and metrics. Challenges to the harmonising of disclosure standards are not specific to ASEAN, but it is a global issue. The fragmented financial sector development in ASEAN further complicates climate reporting in the region. The ASEAN Capital Market Forum (ACMF) presented the Roadmap for the ASEAN Sustainable Capital Market with four (4) priority areas, whereby the priority focuses on strengthening foundations by promoting common disclosure standards. This is a critical step to ensure ASEAN Member States adheres to common global standards, and increasing market access to all ASEAN Member States is subject to their willingness to adopt and implement the disclosure requirements. While several ASEAN Member States would argue that they need time to adapt to global standards, it is important to note that there is a rapid shift in the global movement of capital towards green assets. This growing trend will further limit the access of capital to countries that cannot adapt to changes, and they will eventually lose the ability to attract capital to fund climate actions.

5.2. Improve capital mobility and access to finance

ASEAN's capital market connectivity needs to be enhanced to facilitate cross-border product access and fund distribution to investors and issuers. The ACMF offers various recommendations to improve market access, product development and incentive structures. The recommendation to strengthen the ASEAN Collective Investment Schemes (CIS) and streamline the review framework for the ASEAN Common Prospectus is moving in the right direction to facilitate cross-border flows.

The CIS' progress is encouraging, with the Philippines becoming the latest signatory to the collective scheme. However, continuing efforts are needed to encourage other ASEAN Member States to join the scheme. The CIS must have the scale to attract domestic and foreign capital in green asset investments in ASEAN. To accelerate the product offering, ACMF has recommended the ‘green lane’ to expedite green cross-border, social and sustainable bond issuance and distribution of the sustainable fund without compromising regulatory standards. This will allow ASEAN to be a major player in offering green and sustainable asset classes that will draw more foreign capital into the region.

The Technical Assessment of Climate Finance in South-East Asia highlights ASEAN’s commitment to continuously improve ways of accessing finance. To translate the climate finance needs into action, ASEAN Member States are focused on capacity-building, improving institutional arrangements, technology transfer and knowledge-sharing, as well as enhancing institutional capacity. Indeed, ASEAN can play a crucial role in helping its members cope with climate change risks by enhancing cooperation and assessing their financial needs and priorities.

5.3. Encourage capacity building and promote knowledge flows

Besides knowledge transfers within ASEAN Member States, the MDBs and international community can also assist the region in building infrastructure and know-how to enhance access to climate financing. To accelerate public sector support for climate financing, establishing a region-wide multisectoral dialogue among diverse stakeholders can be essential to facilitate the prioritisation of public investment on the climate change agenda. This dialogue can support knowledge exchange on sustainable investment opportunities, identify innovative financing mechanisms, and mobilise sufficient financial resources to address climate challenges. Technical assistance and funding for climate action by MDBs will accelerate the implementation of the Paris Agreement. The MDBs could also assist ASEAN Member States in accessing the capital market for climate financing by developing cost-effective financial instruments and matching them with their future liabilities. To enhance access to climate financing, MDBs can develop innovative financing instruments to facilitate the development of large-scale climate projects.

Technical support and assistance to develop a well-functioning financial market in the region help reduce dependency on public finance and increase the pace of funding for climate action initiatives. Meanwhile, developed countries should adhere to their commitment to deliver financial support of US$ 100 billion a year in climate change initiatives. Without funding assistance from developed countries, the target to achieve the Paris Agreement can be compromised. Indeed, every nation should unite to fulfil their pledges to solve global climate change issues collectively.

6. Conclusion

An effective public sector funding and management system can be a powerful instrument to pursue and achieve climate-sensitive goals. However, implementing effective strategies can be a long journey and entails a series of challenges that have to be addressed. Efficient capital allocation and strengthening institutional capabilities will accelerate investments in climate action initiatives in ASEAN. Some of these initiatives have already been established, and ASEAN Member States should leverage them to develop and modify them based on individual countries’ economic requirements.

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