



Climate-Smart
Investment Potential in Latin America:
A Trillion Dollar Opportunity

IFC

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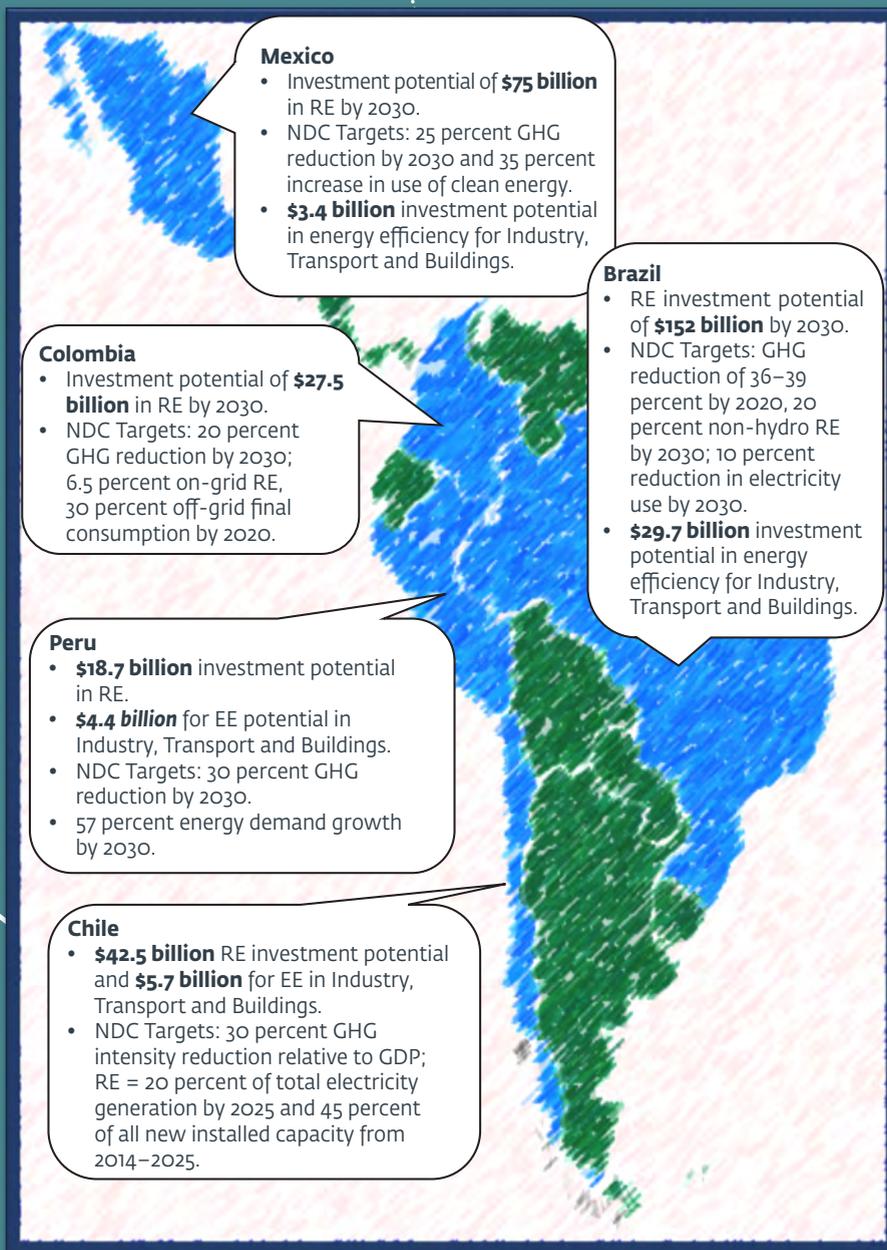
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EXECUTIVE SUMMARY IN NUMBERS



GLOBAL OUTLOOK: GROWING PRIVATE SECTOR OPPORTUNITY IN CLIMATE-SMART INVESTMENT AFTER THE PARIS AGREEMENT

As a result of the successful United Nations Framework Convention on Climate Change’s (UNFCCC) 21st Conference of the Parties (COP21) in Paris in December 2015, the international community has committed to limit the level of global warming at or below 2° Celsius. The historic agreement made in Paris will be implemented through country-led greenhouse gas (GHG) reduction commitments known as Nationally Determined Contributions (NDCs), which to date have been submitted by 189 countries covering 95 percent of global GHG emissions. For the private sector, NDCs¹ offer a clearer signpost of the investment direction countries intend to follow as the global economy travels down a low-carbon, climate resilient highway.

How countries across the globe—especially growing middle income nations—respond to their infrastructure needs will play a major factor in whether they can deliver on their GHG reduction commitments. Estimates show that the world needs anywhere from \$57 trillion to \$93 trillion² worth of low-carbon, climate resilient infrastructure investment by 2030—numbers far in excess of the current infrastructure in place—valued at \$50 trillion.³

The energy sector alone will require around \$13.5 trillion in investments from 2015–2030⁴ to match the level of ambition contained within the nascent crop of NDCs. However, analysis has shown that the current level of ambition in the NDCs is not enough to meet the 2° Celsius target agreed to in Paris and that an additional \$3 trillion of cumulative investment in energy efficiency and low-carbon



¹ For more information on NDCs, see http://unfccc.int/focus/NDC_portal/items/8766.php.

² *Financing change: How to mobilize private sector financing for sustainable infrastructure*, McKinsey, January 2016.

³ *Ibid.*

⁴ Energy and Climate Change, World Energy Outlook Special Briefing for COP21, IEA, October 2015.

technologies are required in order to match that of the International Energy Agency’s (IEA) “Bridge Strategy.”⁵

There is both an urgent need and an enormous opportunity for the private sector to help turn NDCs and the climate policies and plans that underpin them into climate-smart infrastructure investments. Current estimates of infrastructure investment indicate that private sector spending is on the order of \$1 trillion to \$1.5 trillion⁶ yearly, about half of total global infrastructure investment. Of this amount, corporations invest some 65 to 75 percent with the remainder coming from institutional investors, such as private equity and pension funds.⁷ If the aforementioned projection of \$6 trillion (\$93 trillion over 15 years) in annual sustainable infrastructure investment is indeed necessary between now and 2030, then this leaves a gap between public and private investments of roughly \$3 trillion to \$4 trillion annually.

As overstretched national and sub-national budgets will be unable to meet the levels of financial support required to reach the 2° target, it is clear that major investment is needed from the private sector. In fact, according to the United Nations 80 percent of the capital needed to transition to a low-carbon future must come from the private sector.⁸

This report offers IFC’s assessment of how the formulation and adoption of NDCs by Latin American and Caribbean (LAC) governments presents the private sector with huge investment prospects of untapped climate-smart opportunities in a part of the world that is endowed with a wealth of natural capital and already is regarded as one of the great frontiers for climate smart investment.

LATIN AMERICA IS ALREADY LEADING THE WAY

The LAC region’s economies are not just ripe for climate-smart development—it is imperative for their future sustained growth. By mid-2016 the population of Latin America will rise to 625 million.⁹ The

⁵ *Ibid.*

⁶ *Financing change: How to mobilize private sector financing for sustainable infrastructure*, McKinsey, January 2016.

⁷ *Ibid.*

⁸ *Catalyzing Climate Finance*, United Nations Development Programme, 2011.

⁹ <http://www.cepal.org/en/news/latin-america-population-will-reach-625-million-inhabitants-2016-according-eclac-estimates>.

LAC region is also the most urbanized in the world with 80 percent of the population living in cities, a figure that is expected to reach 90 percent by 2050. Encouragingly, from 2002–2014 LAC was the only region in the world to reduce income inequality, adding 102 million people to an emerging middle class.¹⁰ As a result of these profound demographic and socioeconomic structural changes, the LAC region occupies a highly enviable position in terms of attracting significant climate finance for sectors such as renewable energy generation and green urban infrastructure.

The LAC region occupies a highly enviable position in terms of attracting significant climate finance for sectors such as renewable energy generation, energy efficiency and green urban infrastructure

The low-carbon policies and plans that reinforce the LAC region's NDCs are in large part reflective of the region's decades of experience with generating electricity from carbon-friendly sources of power. Thanks to the abundant use of hydropower, which dominates the region's energy portfolio, the LAC region possesses the highest rate of clean energy penetration in the entire world.¹¹ Large hydro production currently generates 45 percent of LAC's electricity demand, while biomass, wind, small hydro, solar and geothermal power projects make up a smaller, but growing share (11 percent) of the total 352 gigawatts (GW) of installed power capacity in the region. All told, over half (56 percent) of LAC's energy mix is comprised of non-carbon dioxide (CO₂) emitting sources of power.

Thirty-three countries from the LAC region have put forth NDCs¹² which vary in terms of sector priorities, rigor, specificity, and ambition. Most NDCs submitted to the UNFCCC were built on existing climate change, development and investment policies.

The table provided offers a snapshot of some of the priority sectors and actions from the NDC commitments made by a selection of LAC countries. For example, in December 2015 Mexico's Congress approved the

¹⁰ World Bank Group, Office of the Chief Economist for the Latin America & the Caribbean (LAC) region.

¹¹ *ClimateScope 2015, Latin America & The Caribbean Regional Summary*, Bloomberg New Energy Finance, November 2015.

¹² Nicaragua has yet to submit an NDC.

Selected LAC Countries		Total 2010 GHG Emissions & Global Rank (MtCO ₂ e)
Countries	Priority Sectors for GHG Action	
Brazil	Urban mobility; water and sanitation; green buildings; sustainable cities; logistics & transportation; renewables (esp. wind); energy distribution; agribusiness	923,544 (10)
Mexico	Renewable energy: wind and solar; green buildings; sustainable cities; urban mobility and infrastructure	632,880 (12)
Argentina	Renewable energy (wind); promotion of rail for cargo and passengers; energy efficiency and product labelling; biodiesel and biofuels requirements	332,499 (28)
Colombia	Energy efficiency and renewable energy (including large hydro); water and sanitation; green building codes; incentives for clean tech	153,885 (38)
Peru	Energy efficiency and renewable energy (including large hydro); replacement of inefficient vehicles; biofuel production and commercialization; green building codes; incentives for clean tech	80,591 (52)
Chile	Sustainable construction; street lighting; energy efficiency and renewable energy (all sources); green buildings; urban mobility and infrastructure	91,576 (53)

Energy Transition Law, calling for a 35 percent increase in the use of clean energy by 2024.¹³ Mexico's NDC establishes a 25 percent GHG reduction by 2030 (relative to business-as-usual projections) which translates to total anticipated GHG emissions of 759 million tons of carbon dioxide equivalent (MtCO₂e) in 2030, slightly lower than today's levels.

Also in December 2015, Brazil approved its latest 10-Year Energy Expansion Plan. Among other actions, the plan includes new solar energy targets of 7 gigawatts of utility-scale solar and 1.3 gigawatts of

¹³ Mexico includes large-scale hydropower, nuclear power and co-generation with natural gas in their definition of clean energy.

distributed solar photovoltaic (PV) capacity to be installed by 2024. In its NDC, Brazil commits to reduce GHG emissions by 37 percent below 2005 levels by 2025 and 43 percent by 2030.

Chile's NDC commits the country to reduce GHG emissions 30 percent from 2007 levels by 2030. In order to achieve their goal, Chile will lean on its Energy 2050 agenda which includes an energy efficiency target to reduce energy consumption 20 percent by 2025 as well as a goal for its energy mix to consist of 70 percent renewable energy¹⁴ compared to 43 percent today.

While some countries nudged up their climate ambition levels for their NDCs, the Paris Agreement requires governments to formulate new national climate plans every five years. Each successive NDC must increase the level of ambition beyond the previous one so as to maintain momentum towards reaching the 2° goal. After taking stock of their collective progress in 2018, governments must then submit updated plans in 2020 together with long-term strategies to reduce emissions out to 2050, providing added policy certainty to the private sector.¹⁵ The importance of this element of the Paris Agreement encouraging countries to continue to raise the bar with respect to their GHG reduction aspirations should not be understated and is the private sector's gain for the foreseeable future.

CLIMATE FINANCE IN LATIN AMERICA AND THE CARIBBEAN

In terms of climate finance for GHG mitigation and adaptation projects, the private sector has been the largest source of investment for years. In addition to escalating support from the public sector, global levels of climate finance reached approximately \$391 billion¹⁶ in 2014 as a result of record private investment in clean power technologies. Of this amount, the private sector provided 62 percent of climate finance in 2014 (\$243 billion) while installing record amounts of new generation capacity from sources of renewable energy in the process (103 gigawatts).¹⁷

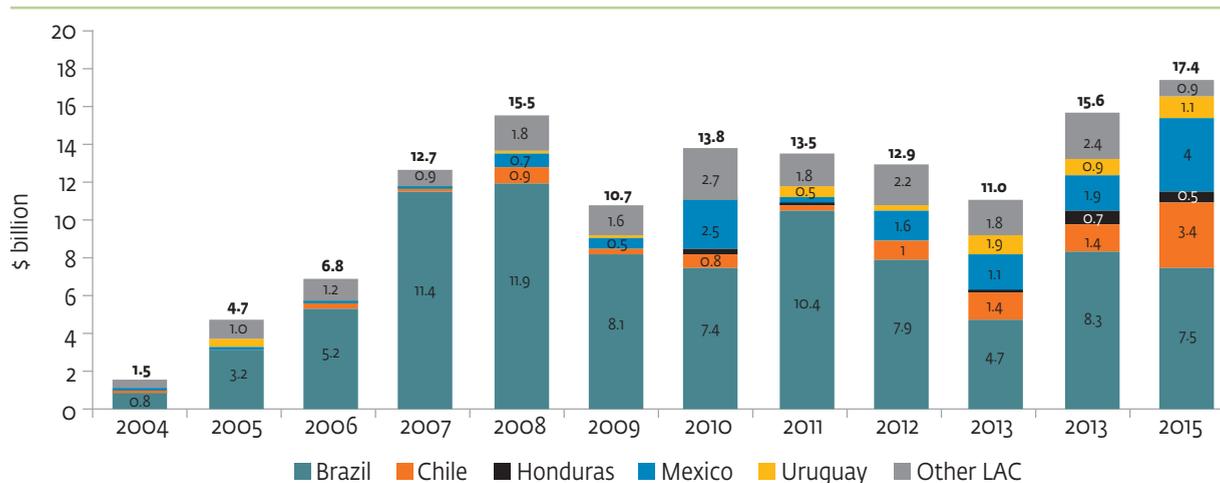
¹⁴ Includes large-scale hydropower.

¹⁵ UNFCCC Synthesis Report, May 2016.

¹⁶ *Global Landscape of Climate Finance 2015*, Climate Policy Initiative, November 2015.

¹⁷ *Ibid.*

LAC TOTAL INVESTMENT IN NEW CLEAN ENERGY BY COUNTRY, 2004–2015 (\$BILLION)



Source: Bloomberg New Energy Finance.

In 2015—for the first time ever—new renewable energy capacity installations (excluding large hydro) outpaced conventional power with 53.6 percent of total capacity installed.¹⁸ Another notable first that occurred in 2015 was that developing countries leapfrogged developed countries in terms of total investment in renewable energy.¹⁹

Looking at the investment amounts for individual LAC countries in 2015, Brazil (\$7.5 billion), Mexico (\$4 billion) and Chile (\$3.4 billion) were among the top 10 magnets for renewable energy finance globally.²⁰ Other countries in the region, however, failed to sustain the strong investment levels seen in 2014; a fact that is not entirely unusual as smaller markets tend to see more intermittent patterns of investment. For example, Honduras (\$567 million in 2015, down 27 percent), Peru (\$155 million, down 48 percent), Panama, Costa Rica and Guatemala all saw clean power investment slip in 2015; each of these last three countries saw investments of less than \$100 million flow in—down from figures of around half a billion each in 2014.²¹

¹⁸ *Global Trends in Renewable Energy Investment 2016*, Frankfurt School-UNEP Centre/Bloomberg New Energy Finance, March 2016.

¹⁹ *Ibid.*

²⁰ *ClimateScope 2015, Latin America & The Caribbean Regional Summary*, Bloomberg New Energy Finance, November 2015

²¹ *Global Trends in Renewable Energy Investment 2016*, Frankfurt School-UNEP Centre/Bloomberg New Energy Finance, March 2016.

Climate finance in the LAC region has to date been very concentrated in Brazil and Mexico, followed by Chile, Colombia and Peru. Public and private investment in GHG mitigation projects accounted for 93 percent of total climate finance in 2014, 81 percent of which went toward renewable energy.²²

CLIMATE-SMART INVESTMENT POTENTIAL IN LAC

Stretching from Mexico to Panama to Argentina, the LAC region is witnessing unprecedented increases in energy demand, population growth, and urbanization, as well as an acute need for improved infrastructure for more efficient industry, transport, and power. For this paper we looked at five of the largest countries facing these challenges head on and sought to examine the areas where private sector investment opportunities and healthy returns were greatest.

Our assessment of selected clean energy opportunities in Brazil, Chile, Colombia, Mexico and Peru reveals a conservative estimate of **\$359 billion** in investment potential by 2030 distributed across these five countries, **88 percent** of which is for renewable energy. We also estimate over **\$43 billion** in energy efficiency opportunities for the Industry, Transport, and Buildings sectors in these countries.

The rest of the LAC region also demonstrates great investment potential of approximately **\$196 billion** for renewable energy alone, marking a cumulative investment opportunity for renewable energy in the region of **\$555 billion**.

All together, we can estimate the market for low-carbon investments in LAC to be **\$1 trillion** by 2040 with **\$600 billion** materializing by 2030

All together, we can estimate the market for low carbon investments in LAC to be **\$1 trillion** by 2040 with **\$600 billion** of this materializing by 2030. These numbers equal low-carbon investments of **\$40 billion** annually from 2015 to 2040. Although these figures take into account the national plans and policies that underpin the NDCs put forward by the region's countries, we consider these estimates very conservative for the following reasons:

²² *Global Landscape of Climate Finance 2015*, Climate Policy Initiative, November 2015.

- The estimates do not capture the full range of mitigation and adaptation opportunities available.²³ For example, climate-smart agriculture is a huge private sector investment opportunity for the region.
- Most NDCs do not capture or foretell the ambition of future climate policies. Under the Paris Agreement each country is expected to ratchet up the ambition of their climate commitments every five years. As ambition levels among countries rise, so too will the aggressiveness of their GHG reduction and clean energy production targets and in parallel the opportunities for private sector investment in these areas.
- Private sector investments for adaptation, energy efficiency and other sectors are difficult to track for a variety of reasons and thus the level of actual investments being made today is likely underestimated.²⁴ For example, tracking investments made in energy efficiency is difficult as they often exist under a larger project umbrella (e.g. a new building project) and are hard to disaggregate. IFC will continue to examine and update these data in future studies of private sector investment in low-carbon opportunities.

ADAPTATION AND RESILIENCE

The LAC region also has a tremendous opportunity to scale up private sector investments in climate-resilient infrastructure as a way to adapt to climate change. The region's ecological diversity is mirrored by the range of serious challenges climate change poses to its inhabitants, such as threats to drinking water resources, potential reduction in crop yields and flooding caused by rising sea levels. Caribbean islands are particularly susceptible to climate change and are expected to suffer natural disasters such as hurricanes and floods with increasing intensity in the coming decades. Also, how the region's cities evolve over the next few decades is fundamental, as inadequate transportation and building infrastructure and services

²³ Other sectors and sources of potential investment were also not accounted for in this paper such as adaptation and resilience, waste and wastewater management, sectors with industrial GHG emissions (e.g. cement) or commercial opportunities to introduce clean technologies that help deploy clean energy such as smart meters.

²⁴ Data for this report is largely derived from BNEF and IEA forecasts together with data extracted from country strategies and other market intelligence, where available. In some cases, countries have not explained in their NDCs how they estimated the costs of action, or the basis on which they concluded that climate finance is needed from the international community. For the countries that have included such numbers, the costs have been calculated in various ways and the transparency around the methods used is often insufficient. The extent to which international support is essential for proposed actions is often unclear, which means that a simple summation of the estimated costs of NDC implementation is not recommended as a proxy for private sector investment opportunities.

drive up costs and reduce efficiency, undermining the potential benefits from urbanization and posing constraints to competitiveness.

Climate change also presents unwelcome operational risk into Latin America’s energy systems. In 2015, for example, Brazil experienced drought so severe that water levels dipped below 37 percent of capacity—in a country that generates nearly 80 percent of its electricity from hydroelectric dams.

As shown in the picture, the drought almost dried up one of Brazil’s most iconic natural treasures—Iguazu Falls.²⁵



Globally, climate finance for adaptation measures reached \$25 billion in 2014²⁶ which was equal to 17 percent of total climate finance from the public sector. As described by the Climate Policy Institute, the climate finance estimates for adaptation represent “a partial and uncertain estimate as it is affected by the different accounting approaches used for tracking finance, and tracking gaps for domestic budgets and private investment.”²⁷

THE PRIVATE SECTOR CAN HELP UNLEASH INVESTMENT POTENTIAL IN LAC

The private sector has an essential role to play in the achievement of LAC countries’ NDC targets. A growing number of companies realize that putting in place a low-carbon business strategy across their entire value chain will grow their bottom-line. The *We Mean Business* coalition found that companies in the LAC region are achieving an average annual internal rate of return (IRR) on their climate-smart

²⁵ “3 Big Challenges for Latin America’s Electricity Sector, 3 Big Strategies for a Successful Future.” http://www.huffingtonpost.com/jake-levine/3-big-challenges-for-lati_b_5276684.html.

²⁶ *Global Landscape of Climate Finance 2015*, Climate Policy Initiative, November 2015.

²⁷ *Ibid.*

Companies in the LAC region are achieving an average annual internal rate of return (IRR) on their climate-smart investments of 17 percent

investments of 17 percent, a healthy margin compared to similar investments in other emerging markets.²⁸

In April 2016, 26 Latin American companies supported the creation of the *Pacific Alliance Green Growth Platform*. Chile, Colombia, Mexico, and Peru are members of the Alliance and have stated their commitment to fostering more effective public-

private partnerships to spur interest in building clean, innovative and resilient infrastructure.

In terms of the top 20 clean energy investors in LAC in 2014, Brazil's National Development Bank (BNDES) provided the most investment by a wide margin and is in fact a major global clean energy investor. Regional and international development banks play critically important roles, but levels of participation from private commercial banks such as Spain's Santander, Brazil's Bradesco and Itaú, and Chile's CorpBanca are also increasing.²⁹

The LAC region's clean energy market is also attracting ever larger sums of foreign investment from multinational corporations like GDF Suez, BP (Pan American Energy), ENEL and Pacific Hydro to name a few. Using Chile as an example, private equity firms Actis and Mainstream Renewable Power established Aela Energía in 2013—a joint venture to develop 600MW of wind and solar projects at an estimated cost of \$1.4 billion, while Enel Green Power's *Finis Terrae* solar PV project—the largest photovoltaic installation in Chile—started operating in late May 2016 and is expected to meet the annual electricity needs of nearly 198,000 Chilean homes by generating more than 400 gigawatt hours per year.³⁰

Across the globe, companies are accounting for the potential impact that climate change will have on their businesses as a function of changing weather patterns, resource scarcity, client and shareholder demands, potential legislation and the likelihood of a price on carbon. Major institutional investors are also joining

²⁸ *The Climate Has Changed: Latin America and the Caribbean*, We Mean Business, December 2014.

²⁹ Norton Rose Fulbright, *Renewable energy in Latin America*, April 2016.

³⁰ *Ibid.*

the effort and many have pledged to assess and decarbonize the carbon footprint of their investment portfolios as part of the *Portfolio Decarbonization Coalition*.³¹

NEXT STEPS TO ACHIEVE LAC'S CLIMATE-SMART POTENTIAL

It is IFC's belief that due to strong projections for population and economic growth, the abundance of clean energy options coupled with growing energy demand, a substantial infrastructure gap and now political will in the shape of formal commitments to decarbonize LAC's future growth, provide the right environment for private sector investments in large and impactful climate-smart projects. Despite these favorable headwinds, however, a few steep steps remain for governments to climb before the region can unlock the full potential of the private sector.



CARBON PRICING

For the past several years, the private sector has been increasingly advocating for a long-term, predictable price on carbon to help companies shift their investments to cleaner options.³² In 2015, 435 companies reported to the Climate Disclosure Project (CDP) that they are using an internal price on carbon—an almost threefold increase from the previous year. Furthermore, an additional 583 companies disclosed that they are planning to implement an internal carbon price over the course of 2016–2017.³³ The momentum towards carbon pricing is manifested in a majority of the NDCs submitted to date, more than 90 of which include proposals for emission trading systems (ETs), carbon taxes and other carbon pricing initiatives.³⁴

³¹ Portfolio Decarbonization Coalition: <http://unepfi.org/pdc/>.

³² See the Carbon Pricing Leadership Coalition's website at www.carbonpricingleadership.org.

³³ *Carbon Pricing Watch 2016*, World Bank Group and Ecofys, May 2016.

³⁴ *Ibid.*

LAC countries are essential to maintaining this momentum and are making progress by putting a price on carbon pollution. Chile, for example, has enacted a carbon tax to take effect in 2017 of \$5 per metric ton of carbon dioxide (mtCO₂) for power plants with a capacity of 50MW or greater. Mexico implemented a carbon tax in 2014 and has also recently announced plans for a national carbon market starting in 2018.³⁵

Latin American companies are also moving forward to test options for carbon pricing as a way to guide governments. In Brazil, 20 major companies are simulating an emissions trading system that will ultimately develop a set of proposals for the Brazilian government that are informed by experience.³⁶ This will then be shared with other business groups, fostering knowledge sharing and advancing corporate readiness for eventual government policy.

POLICY INCENTIVES AND REGULATION

In addition to carbon pricing, certainty on other GHG reduction and fiscal policies is a major consideration for how and where the private sector chooses to invest. LAC governments must continue to create the regulatory frameworks and business opportunities that encourage private investment in climate-smart infrastructure markets to bolster long-term sustainable growth. On aggregate, countries that can offer greater legal security and political stability as well as clarity about their climate change plans will be the first to see significant investment flows.³⁷ If these conditions are in place, businesses will be able to advance new innovative projects and trends that are high impact, replicable, scalable and provide attractive return on investment.

On green fiscal policy, the financial sector in LAC is gearing up to align with green investment opportunities. Stock exchanges are critical levers for improving the depth, consistency and comparability of corporate disclosure on sustainability performance, including climate change risks. Several stock exchanges in the LAC region have joined the *Sustainable Stock Exchange Initiative*, including those in Peru, Brazil, Chile and Colombia. In March 2016, Mexico's Stock Exchange launched a green bond segment to support the local

³⁵ See World Bank Group, *State and Trends of Carbon Pricing* (2015).

³⁶ See <http://www.cisl.cam.ac.uk/news/blog/testing-carbon-pricing-in-brazil-20-companies-join-an-innovative-simulation>.

³⁷ Bhattacharya, A., Oppenheim, J., & Stern, N. (2015). Driving sustainable development through better infrastructure: key elements of a transformation program (No. 91).

issuance and listing of green bonds. Also, several ministries in Brazil are now working together to form a plan to develop the domestic green bond market.

Green banking is also taking off, with around 10 percent of bank loans in Brazil classified as “green loans,” and The Mexican Banking Association developing a Sustainability Protocol to provide guidance on risk management and sustainable lending, coupled with a plan to provide capacity building and tools for implementation.³⁸

PIPELINE DEVELOPMENT

Less than 50 percent of Group of 20 (G-20) countries currently publish a clear pipeline of “bankable” infrastructure projects.³⁹ Similar to improving regulations, publishing a pipeline of low-carbon infrastructure projects would raise investor awareness of government needs for sustainable investments and shore up confidence in the viability and profitability of such investments, thus accelerating the development of climate-smart projects in the region. A visible pipeline of projects would also allow LAC countries to tap the substantial and growing investor appetite for green bonds.⁴⁰

CORPORATE PLEDGES TO REDUCE GHGS IN SUPPLY CHAINS

As the global economy becomes ever more entwined, the private sector’s exposure to the risks of climate change also grows. Companies must now actively plan for potential disruptions to their operations and supply chains whether it be from extreme weather events or energy price volatility. In response, thousands of companies have committed to reducing—or in some cases eliminating altogether—the carbon embedded in their products and businesses by setting aggressive, GHG reduction targets that span the entire value chain. Governments looking to meet their international climate obligations must create the right enabling environment to further incentivize the private sector to invest in their own climate and clean energy solutions. In doing so, the private sector will itself be further incentivized to align their core business strategies with the NDCs of their governments.

³⁸ For more information, visit IFC’s Sustainable Banking Network home page at http://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/IFC+Sustainability/Partnerships/Sustainable+Banking+Network/.

³⁹ *Financing change: How to mobilize private sector financing for sustainable infrastructure*, McKinsey, January 2016.

⁴⁰ *Trends in Private Sector Climate Finance*, UN, October 2015.



Whether it is through the submission of a robust and transparent NDC or by enacting new climate-friendly business legislation, countries have the power to create an environment where risk is rewarded and allows the private sector to do what they do best—innovate. Likewise, when the private sector takes proactive measures to act on climate, the political will of governments to increase their climate ambition and leadership—regionally and internationally—will be greater, as will their confidence of meeting or exceeding their international climate commitments.

The private sector is standing before a future trillion-

dollar opportunity to help turn the GHG reduction commitments of countries in Latin America and the Caribbean into climate-smart investments on the ground. That future is now.

LAC INDICATORS

\$1,000,000,000,000
Clean energy investment potential in LAC through 2040

56%

Non-CO₂ emitting sources
in LAC's energy mix

90%

Percentage of LAC population
living in cities by 2050

33

NDCs submitted by
LAC countries

\$16.5 trillion

Investment needed to transform the energy sector from
2015–2030 to meet the 2°C target

17%

Average annual IRR of
climate-smart investments
made in LAC

62%

Current share of global
climate finance from the
private sector

2015

The first time renewable energy capacity installations outpaced
conventional power and developing countries leapfrogged developed
countries in terms of total investment in renewable energy.

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