SCALING UP SUSTAINABLE FINANCE IN THE GLOBAL SOUTH

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The green bond market: a potential source of climate finance for developing countries

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CONTEXTUAL ELEMENTS

- IPCC's Climate Change 2023: Synthesis Report: a survival guide for humanity (IPCC, 2023).
- WB estimates that developing and emerging economies would need between 2 and 8% of GDP per year for investments in new and climate resilient infrastructure by 2030 (WBG, 2019)
- According to the IPCC, an annual average investment of around USD 2.4 trillion is required in the energy sector between 2016 and 2035, representing about 2.5% of the world GDP (IPCC 2018).
- Developed countries have committed to mobilize $ 100 billion per year for adaptation and mitigations projects in developing countries. Yet this promise has never been fully delivered, despite the historical responsibility of developed countries in global warming.
- This means that developing countries are unlikely to meet their climate goals by only relying on those pledges. Hence the need to explore other sources of climate finance, such as green bonds.
- Cumulative GB issuance increased from $895 billion in 2017 to around $2 trillion in 2022, and is expected to reach $5trillion a year by 2025 (CBI, 2022).

1. What are the drivers of the green bond market?
2. What are the barriers to its uptake in developing countries?

KEY DRIVERS OF THE GREEN BOND MARKET

1. **Similar risk/return profile like plain vanilla bonds**

Figure 2. Yield to maturity: green bond vs. conventional bond. Data Source: Bloomberg as of 1/31/2017.

- Environmental-related investment does not necessarily jeopardize return on investment.
- Low-interest rate environment in most developed countries and the hunger for return on investment.

2. Better understanding of the nexus between climate change and financial stability

- ***Carney (2016):***

  Transition risk, physical risk, and liability risk

- ***Schoenmaker (2017)***

  The need to shift away from the shareholder investment model to the stakeholder investment model

3. Paris Agreement & G20 meeting in Hangzhou

- Strong political signal is important for the development of the green bond market

BARRIERS TO SUSTAINABLE FINANCE IN DCs

1. Institutional barriers

- Lack of integrated policy and institutional frameworks
- lack of a common taxonomy for GB
- Lack of coordination mechanisms:
- lack of transparency and accountability (including lack of monitoring and reporting standards.

2. Political barriers

- Political instability
- Lack of political will and awareness
- lack of influence in international climate negotiations

3. Market barriers

- Weak domestic capital markets (currency issue)
- High transaction costs
- Low absorptive capacities (issue of minimum size)
- lack of clear adaptation investment plans
- High perceived risks

4. Capacity constraints

- Lack of clear understanding of climate risks and opportunities from an investment perspective
- Lack of technical knowledge and expertise
- lack of MRV skills
- Lack of information

ENTRY POINTS FOR SCALING UP THE GB MARKET IN THE GLOBAL SOUTH

- Develop required policy and institutional frameworks (harmonized & clear GB taxonomy, better coordination mechanisms, MRV tools).

- Green stripping: only a fraction of the proceeds of the bond- the green stripe – should be used to finance the green project. This option could lead to greenwashing

- Use of Development Banks as intermediary for the issuance of green bonds: adoption of a pooling strategy to cope with the market's minimum requirements for green bond transactions.

- Support the development of local green bond markets where it is possible to issue local currency-denominated GBs.

- Establishment of green banks