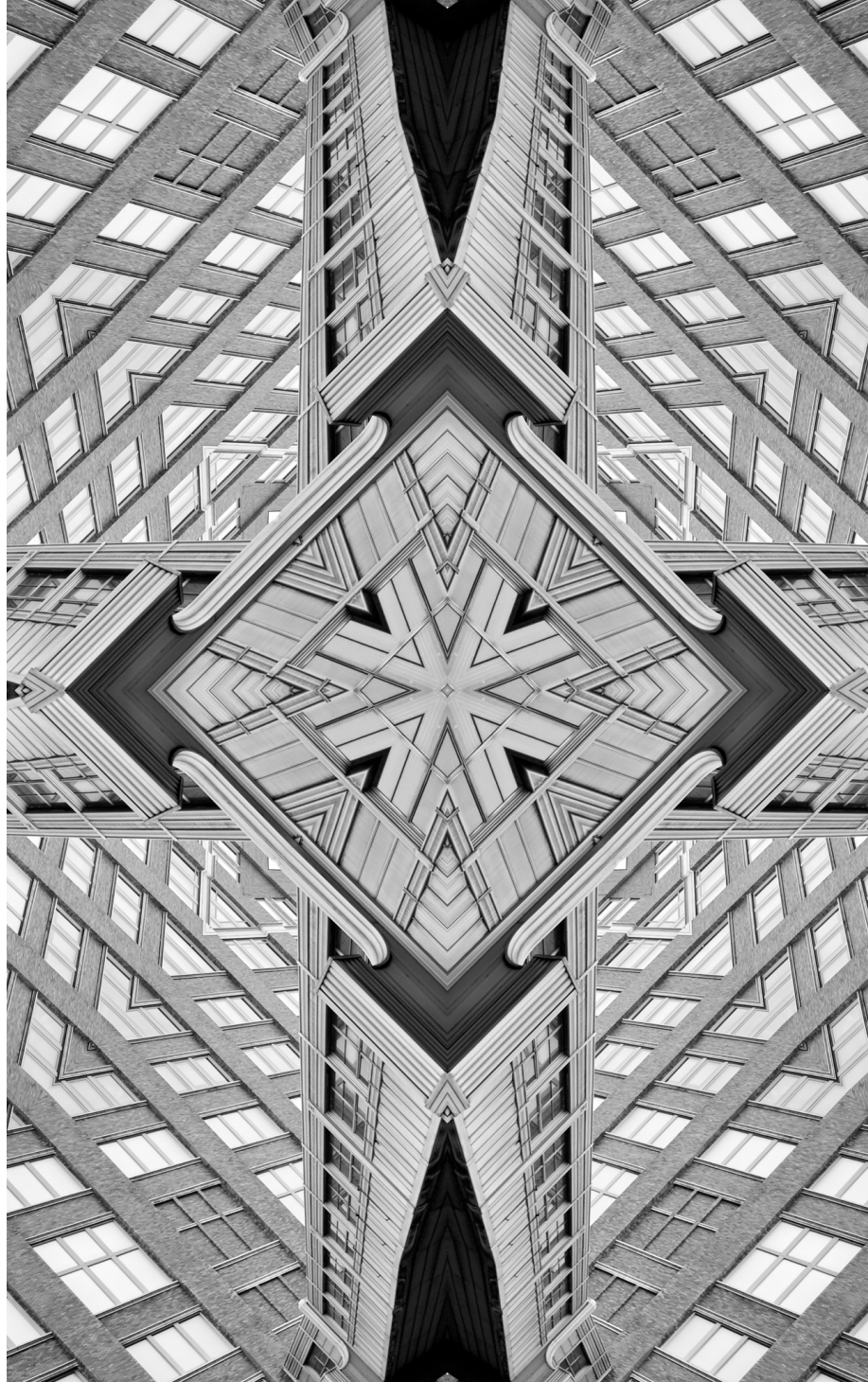


Issue

Brief

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A Green Bank for Global South Climate Finance

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Abstract

A private sector-oriented Global Green Bank is required to overcome the market gaps that prevent Global North capital from flowing to the best decarbonisation investment opportunities among Global South enterprises. The Global Green Bank should operate as a world-class investment firm, capable of developing innovative financial solutions and investing through externally raised investment fund-of-funds and its own proprietary book. Such a Global Green Bank can absorb country and climate risk, and deploy blended finance instruments that can protect Global North investors and companies. This will reduce investment hurdle rates and make it possible to mobilise trillions of dollars of capital from Global North investors to green Global South enterprises.

Trillions of dollars¹ of incremental private sector investments are required over the next few decades in the Global South to reach net zero. These investments are required to switch power generation to renewables, electrify transportation, scale up green hydrogen and biofuels, and enable carbon markets to work. In addition, adequate insurance is required for the catastrophic risks driven by extreme weather events.

Given the limited domestic financing capacity in the Global South, the Global North will have to provide most of this financing. Multiple studies have shown that current investment flows must immediately double to finance the Global South net zero transformation. This is unlikely unless several market gaps, such as currency hedging and affordable debt financing, are closed. The current multilateral development bank (MDB) system is not well-equipped to overcome these market gaps and provide innovative financing solutions. A new bank is required to deliver large-scale blended finance instruments to close market gaps. Only then will it be possible to mobilise trillions of dollars of capital from Global North investors to green Global South enterprises.

This brief lays out the requirements for a new financing institution, a Global Green Bank, to overcome the market gaps that are impeding Global North capital flows. As Gavi, the global vaccine alliance, has demonstrated, innovative institutions can unleash market-based solutions to solve major Global South problems. We now need a Gavi for Global South climate financing.

To that end, this brief establishes that:

- Global South decarbonisation depends on market-driven capital flows from the global North;
- The MDB system alone cannot resolve the market gaps;
- A Global Green Bank is required to supplement the MDB system;
- The Global Green Bank could focus on five key blended finance areas; and
- By working with in-country green financing institutions, the Global Green Bank can play a vital role in shaping local green markets.

Global South Decarbonisation Depends on Global North Market-Driven Capital Flows

Net zero is massively net positive for the Global South. By investing in low-carbon technologies, these countries can grow GDP and jobs while reducing air pollution and chronic balance-of-payments issues. Most of these mitigation (decarbonisation) investments will have to be made by Global South enterprises in the energy, transportation, materials, chemicals, and food processing sectors. Global South enterprises (including large companies, small and medium enterprises, and startups) will require trillions of dollars of additional equity and debt financing to undertake this net zero transformation. While there is some limited Global South financing capacity available, most of these investments will have to come from Global North equity and debt investors.

According to several studies, current market-driven Global North capital flows (including foreign direct investment from companies, venture capital/private equity (VC/PE) funds, commercial banks, development financing, and public market investors) to the Global South for climate finance amount to about US\$300 billion per year.² These capital flows are largely low-risk debt financing, with limited at-risk equity capital available. One study has estimated that the Global South (ex-China) will require at least US\$300-400 billion dollars in incremental private sector investment every year to reach net zero by mid-century.³ Global South countries are capital deficient, with governments running large fiscal deficits and crowding out private enterprises. Most Global South enterprises rely on Global North capital to finance their investments. Thus, Global North capital flows will have to increase massively to finance the Global South green transformation.

“Current market-driven Global North capital flows to the Global South for climate finance, amounting to about US\$300 billion per year, are largely low-risk debt financing, with limited at-risk equity capital available.”

Limitations of the MDB System

Several market barriers and gaps need to be addressed to massively increase Global North capital flows to Global South enterprises. These include:

- **Macroeconomic stability and currency depreciation**

Many major emerging markets have volatile currencies that continuously depreciate against G7 currencies. Investors are not just worried about predictable depreciation driven by inflation rate differentials, they are also worried about overall macroeconomic stability that drives sudden, unexpected currency depreciation. Further, Global South countries have shut down hard currency repatriation by investors and companies and expropriated assets.

Such Global South currency crises have happened multiple times; for example, the 1999 Asian financial crisis⁴ and the post-pandemic debt crisis afflicting several countries such as Argentina and Sri Lanka. Investors are thus worried about both the availability and volatility of Global South currencies. To protect themselves from these losses, they demand exorbitant returns, which have been estimated to be much higher than equivalent investments in G7 countries.⁵ Even large, well-reputed companies in the Global South, which may have a sterling credit history, have to pay a large currency premium.

- **Nascent entrepreneurial ecosystem**

The venture capital and private equity ecosystem is nascent in most Global South countries. As a result, entrepreneurs who are developing Global South-appropriate green business models and then scaling up these successful business models are not able to raise sufficient at-risk equity capital or affordable debt financing. The limited equity capital available is often at such punitive terms that entrepreneurs simply decide not to start or scale their businesses.⁶ This naturally results in insufficient innovation and limited competition, stunting market development.

- **Affordable collateral-free, non-prime debt financing**

Global South green enterprises are finding it difficult to raise sufficient debt financing at reasonable rates. Since collateral is limited and repossession

Limitations of the MDB System

is difficult, commercial banks ask for extremely high financing rates. This makes it difficult to raise sufficient debt capital for green assets and to grow quickly. For instance, distributed solar rooftop businesses in India and Africa typically finance their solar equipment at 15-18 percent financing rates in local currencies. This makes these businesses unviable.

- **Payment timeliness and security**

Many smaller green businesses find it difficult to get paid on time even when they have delivered their services. This happens not just with governments that delay and defer payments, but also with larger companies that have the buying power to squeeze smaller companies. Green enterprises need payment security, such that if they have satisfactorily delivered their services, they will be paid within 30 days and minimise their working capital requirements. Government agencies, particularly at the provincial level, are notoriously slow to pay their bills since low-level officials use this as an opportunity for rent-seeking. As such, even larger companies find it difficult to get paid for their services from government agencies.

- **Extreme weather events**

The Global South is being buffeted by extreme weather events, including flooding, droughts, extreme heat, and cyclones. These are leading to severe weather-driven losses for the private sector. No insurance is available for such events,⁷ leading to higher costs for all types of green investments.

In combination, these market gaps drive up the return expectations from green investments in the Global South. Global North capital market investors stay away from less investible projects that are unable to overcome these market gaps. There is an additional complication. Today, there is no clear global standard for identifying, evaluating, and tracking decarbonisation investments. This makes targeted policy action to close these market gaps even more confounding. Given these circumstances, the stock of investible projects and green enterprises is limited and well below what is required.

Traditionally, MDBs such as the World Bank Group and the African Development Bank have served as a bridge between Global North capital and Global South development financing. However, it is unclear whether they will be able to resolve the market gaps outlined above.

Limitations of the MDB System

There are three main reasons for this. First, most greenhouse gas emissions will likely emanate from a few major Global South countries⁸ such as India, Brazil, Nigeria, Indonesia, South Africa, and Egypt. Since MDBs by charter must serve all countries, it is difficult for them to concentrate all their efforts on a few, selected countries. Second, most of this financing must be provided to Global South enterprises for decarbonisation. Moreover, many of these green enterprises work globally and have global financing needs. For example, a globally competitive electric vehicle (EV) auto parts company in India will have to do business across Asia, Africa, and North America. MDBs typically focus all their financing efforts on public finance (to central and provincial governments) in countries and not on private sector financing worldwide. They are government-oriented, not market-oriented. As a result, they lack the capabilities, people, and relationships to work with green enterprises at scale around the world.

Only about 20 percent of MDB financing goes into commercial investments through pure return-generating or blended capital instruments.⁹ Moreover, only a few institutions, such as the International Finance Corporation and the Asian Development Bank, have the capability to invest billions of dollars per year into the private sector. As a result, the MDB system has not built up the deal origination, risk assessment, investment monitoring, portfolio construction, and exit generation capabilities required to do successful private sector equity and debt investing required for a market-driven green transformation.¹⁰

Finally, financing Global South enterprises will require risk-taking and agility. MDBs have complicated multi-country governance arrangements and long-established operating processes that make it difficult for them to respond quickly to fast-evolving market needs. While they can certainly participate in innovative financing solutions once they are developed, it has generally not been their approach to be the risk-taking pioneers.

“MDBs such as the World Bank Group and the African Development Bank have typically served as a bridge between Global North capital and Global South development financing, but it is unclear whether they will be able to resolve the major market gaps.”

A Global Green Bank to Supplement the MDB System

A new financing institution—a Global Green Bank—focused on providing innovative, market-driven financing solutions to green enterprises in a few selected Global South countries will likely have the most impact in driving the net zero transformation in the Global South.

The Global Green Bank should concentrate on closing the market gaps facing green enterprises in the Global South. Once these issues are resolved, there will likely be sufficient financing available in the Global North to help these green companies scale up rapidly. As they scale up in their own countries, these green enterprises will develop solutions that can apply across the Global South as well. For instance, business models used by startups scaling up distributed rural solar installations in India could be replicated by startups in Indonesia and Nigeria. This has already happened in the fintech industry, with the Kenyan Mpesa-like business model now widely prevalent across multiple Global South countries.

The Global Green Bank should be capitalised (say, with a few billion dollars in equity capital) by a few sponsoring countries, sovereign funds, and philanthropies. These sponsors could provide both equity capital as well as hard callable capital to ensure sufficient capital adequacy and to ensure AAA or AA ratings. Many AAA-rated countries (such as Norway, Canada, Saudi Arabia, and the United Arab Emirates) have generated windfall gains from fossil fuels in 2022; Norway alone has generated US\$138 billion.¹¹ Such countries could proactively underwrite equity and callable capital for the Global Green Bank. The Global Green Bank would leverage this capital base with market borrowings in the Global North from institutional investors to rapidly build up its financing capacity. The Global Green Bank's financing capacity can increase over time as it demonstrates success.

The Global Green Bank should be based in the Global South, primarily focusing on the major Global South economies such as India, Indonesia, Brazil, and South Africa. The Global Green Bank will need to hire private-sector executives with deep global and domestic financial expertise, well-established networks in their local economy and global financial centres, and an in-depth understanding of policy matters. A top-notch global board should ensure that the Global Green Bank operates with the highest standards of corporate integrity, prudence, and transparency.

The Global Green Bank will need to hire around 50 professionals, with entry-level hiring from the top business schools and mid-level hiring from investment banks and firms. The Global Green Bank should be organised into country teams with headquarters-based domain experts in various industry sectors, such as distributed solar, battery storage, and green hydrogen. In sum, the Global Green Bank should operate as a world-class investment firm capable of intermediating financial products and investing through externally raised investment fund-of-funds and its own proprietary book.

Five Key Focus Areas for the Global Green Bank

The Global Green Bank can immediately work to resolve five key market gaps:

- **Green accounting and reporting standards**

The Global Green Bank would work with financial sector regulators in the Global North and South to gain agreement on green standards for classification, tracking, disclosure, and reporting. These are not yet standardised across the world. Global Green Bank professionals would help in the consensus-building process on proposals from various standards bodies such as the International Financial Reporting Standards or Sustainable Accounting Standards Board to implement such standards and then help converge them across various jurisdictions. This will enable investors to clearly and comprehensively identify green investments, evaluate their decarbonisation impact, and track their impact over time. Notably, the decarbonisation impact has to be tracked accurately to enable any type of carbon pricing, taxes, or markets to work.

- **Long-term currency hedging**

The Global Green Bank would assist in lowering the cost of currency hedging in the Global South. Today, it is not possible to establish long-term currency hedging between Global North currencies and volatile Global South currencies. Sufficient long-term currency hedging solutions¹² would lower the cost of capital for Global South companies by hundreds of basis points while protecting Global North investors from both currency availability and depreciation risk. Consider the case of a Global North investor who would like to repatriate a multibillion-dollar investment in a solar plant after 20 years from a Global South country. After 20 years, the investor could not be sure that the central bank would have the funds available at that time to convert local currency into hard Global North currency. Moreover, if the country's macroeconomic situation deteriorates suddenly (for example, during the Asian financial crisis), then the investor would have to take a more-than-anticipated currency hit.

A long-term currency hedging market that protects against these types of risks does not exist because no counterparty wants to take such long-term exposure. The only way to hedge this is to keep rolling over one-year currency hedges. This is very expensive, and most investors do not do this. Instead, they ask for very high domestic currency investment returns to protect against such risks. This immediately increases the hurdle rate for green investments and makes

Five Key Focus Areas for the Global Green Bank

it possible to finance only very few high-return opportunities. For example, a venture capital fund might be willing to fund an EV-charging software company but not an EV-charging infrastructure firm.

The Global Green Bank would price these risks and could become the market maker for long-term currency hedging for many countries. By pricing prudently and diversifying their currency risk, they could provide long-term currency hedging that could be hundreds of basis points cheaper than rolling over one-year hedges. The Global Green Bank would have to maintain adequate capital reserves to finance losses if currency contracts move against it.

- **Startup and growth financing**

The Global Green Bank could accelerate the growth of focused climate venture capital and private equity funds by serving as an anchor investor across multiple funds in Global South countries. To that end, the Global Green Bank would have to launch low-cost fund-of-funds vehicles to direct investments to the best green funds operating in Global South countries.

Many green decarbonisation solutions will be developed by innovative startups. They require significant value-added financing for innovation, research, testing of business models, scaling up of businesses, and then high-return exits for investors. This cycle will need to repeat itself across at least three innovation waves and multiple sectors. Focused green investment firms are required to catalyse this style of growth investing. Innovation clusters and green investment firms are already emerging, albeit at a modest scale, in India and driving early-stage investments in green hydrogen, e-mobility, sustainable consumer goods, and alt-proteins. This vibrant startup ecosystem with multiple unicorns should emerge in all the major Global South countries.

- **Debt financing solutions**

The Global Green Bank could provide large-scale debt financing solutions for green capital assets such as e-buses, swappable batteries, or solar rooftops. Since these are new business areas with seemingly high risk, most commercial banks provide high-cost financing solutions. Corporate bond markets or investment trusts for such capital financing do not currently exist. As a result, there is a significant green premium for funding these capital assets. Using its pristine global credit rating, the Global Green Bank should be able to raise low-cost

Five Key Focus Areas for the Global Green Bank

wholesale financing in deep Global North capital markets. It can then deploy these debt solutions for green assets at a far lower price than commercial banks and financing institutions in Global South countries. The Global Green Bank will also be able to quickly use various loan guarantee programmes that are being established by MDBs and governments, such as the recent e-bus payment guarantee programme launched by the US government for India¹³.

- **Climate insurance**

The Global Green Bank needs to help develop innovative insurance solutions for the private sector for climate calamities, such as the recent destruction of a hydropower plant in Sikkim, India. This plant was operated as a private sector hydropower generating company with 60 percent ownership by the state of Sikkim and 30 percent ownership by Greenko Energies, a privately owned Indian company. Due to glacial melting upstream, there was unprecedented flash flooding downstream in the Teesta River.¹⁴ This resulted in the death of more than 40 people, swept away the dam, bankrupted the generation company, and resulted in significant financial write-offs for banks. This catastrophic loss does not appear to be covered under existing insurance policies. Consequently, it is unlikely that any financial institution will ever finance hydropower dams in India again. These types of losses due to extreme weather events are likely to become more common as the world warms. Without appropriate insurance solutions, private companies will face extremely high-cost financing requirements.

“The Global Green Bank should focus on five key areas: green accounting and reporting standards, long-term currency hedging, startup and growth financing, debt financing solutions, and climate insurance.”

The Global Green Bank can work with national development finance institutions that are already operating in key Global South countries. These include the National Investment and Infrastructure Fund in India, BNDES in Brazil, and the Indonesian Investment Authority. The Global Green Bank can work alongside these existing development financing institutions, MDBs, commercial banks, and VC/PE investment firms to help catalyse their green financing activities.

The Global Green Bank, working with local financial institutions, would comprise a Global South green financing network (GFN), which should be able to undertake some important functions to shape green markets.

- **Ecosystem development**

Most urgently, the GFN must take an ecosystem view of how different sectors have to be transformed in each country. This comprehensive yet practical perspective is difficult to achieve within siloed government departments, narrow financial institutions, and think tanks. For example, the national deployment of electric buses requires bus manufacturing (including battery availability), sufficient grid power, dedicated charging depots, adequate financing solutions, integration with travel portals, and trained manpower for maintenance and operations. Any delay in these activities could easily slow down ecosystem development by many years. Developing these sectoral perspectives requires industry experts, management expertise, and deep financial acumen. Further, these perspectives will have to be developed for different countries and different provinces within each country.

- **Stakeholder participation**

The GFN must be able to work with a wide variety of stakeholders to enable the development of such ecosystems. They should be able to work closely with government policymakers at national and provincial levels to ensure supportive policies. For instance, in the electric bus example, the GFN will have to ensure that the bus manufacturing supply chain is adequately established, and critical investments are jumpstarted through innovative start-ups. The GFN must conduct deep market research to understand consumer acceptance barriers and pricing expectations. Additionally, existing bus companies will need to be supported through such a transition, with an intense focus on existing and new workforce demands.

- **In-country financial mobilisation**


Along with an ecosystem perspective and stakeholder engagement, the GFN will also have to mobilise a wide network of in-country financial partners. Considering the electric bus example again, the Global Green Bank may have to assist in funding the scale-up of electric bus manufacturing among existing bus manufacturing companies. The Global Green Bank and its financial partners may have to provide leasing and financing support to bus operators to adopt electric buses rapidly. Government agencies (such as the Small Industries Development Board or Solar Energy Corporation in India) may be able to provide subsidies to electric bus companies or electric distribution companies for special charging tariffs. Leasing companies could require access to low-cost wholesale financing with appropriate currency hedging. It may be necessary to provide start-up financing for charging companies that can operate charging depots. New software solutions could probably also be developed by start-ups to manage bus batteries and develop innovative billing solutions. Thus, in the electric bus ecosystem example, the GFN will probably have to work with asset management companies, commercial banks, leasing companies, venture capital companies, electric distribution companies, and a wide variety of government financing agencies.

- **Global best practices**

The GFN can also play a vital role in sharing best practices, business models, and financing approaches worldwide. There may be innovative companies and government programmes in Indonesia that might work well in India. However, no organisation is charged with tracking these innovations and then being able to transfer them from one country to another. Regular research reports, conferences, and in-country experiments are required to be able to cherry-pick the best innovations across countries.

There are many organisations today (such as MDBs, investment banks, and management consultancies) that fulfil some of these functions. However, few have the global reach, stakeholder credibility, large-scale investment expertise, and policy understanding to catalyse massive capital flows from the Global North to the Global South. The Global Green Bank can play that role.

Several global institutions have been created in the past few decades to shape Global South markets to fulfil urgent development needs. Gavi, the global vaccine alliance, is perhaps the most successful example. Today, Gavi operates across 73 low- and middle-income countries. To date, over a billion children have been vaccinated, with 68 million vaccinated in 2022 alone. Importantly, Gavi¹⁵ has developed a thriving affordable vaccine market for the Global South, with 19 manufacturers competing to provide vaccines. This has been accomplished by using advance market commitments, an innovative financing solution, that guarantees manufacturers five years of committed purchases. This vibrant market is also demonstrating significant product innovation, with new vaccines being developed constantly, such as the recent liquid rotavirus vaccine. Gavi is supported by Global North countries, philanthropies, and the MDBs. Global South countries are also co-financing vaccine deployment. Thus, every year, hundreds of millions of incremental dollars are being deployed for immunisation programmes through Gavi.

Just like in the case of Global South vaccine deployment, the climate change planetary crisis cannot be solved by markets alone. Policy interventions are required to shape and unleash markets. A private sector-oriented Global Green Bank is required to overcome the market gaps that prevent Global North capital from flowing to the best decarbonisation investment opportunities in the Global South. The Global Green Bank can absorb certain types of risks and deploy blended finance instruments that protect Global North investors and companies. This can unleash massive investment flows into the Global South driving GDP growth and jobs. Net zero can be net positive for all. 

Jayant Sinha is a Member of ORF's Global Advisory Board, and is the Chairperson of the Parliamentary Standing Committee for Finance.

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