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GREEN FINANCE MECHANISM FOR DEVELOPING COUNTRIES – EMERGING PRACTICE

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GREENING THE FINANCIAL SECTOR

- ✓ Environmental risks are not taken into account in Basel III which provides the main regulatory guidelines for the global banking system
- ✓ Central banks have a role to play in 'greening' financial systems, esp in developing economies where environmental regulation is weakly implemented
- ✓ Potential tools for CBs (1) Introduce green macroprudential regulation and climate-related stress testing (2) Directed Green Credit Policy Instruments (3) Green differentiated reserve requirements (4) Differentiated capital requirements for low-carbon activities or green projects (5) Develop green finance guidelines and frameworks for greener lending (6) mandatory disclosure requirements for all financial organizations in their public financial

DEVELOPING GREEN SEGMENTS

- ✓ **Global green bond market rose** from $155.5 billion in 2017 to $250 – $300 billion in 2018
- ✓ Issuing green bonds can become an important financial mechanism to support a green economic recovery
- ✓ Green bonds have a big potential for growth with investors keen on containing global warming BUT markets with negative credit ratings are a NO NO for them
- ✓ Green bonds **tend to be oversubscribed**, have advantages such as tax exemptions making them a good option for countries that had to approach financial institutions like the IMF for funding to mitigate the effects of covid-19
- ✓ NB for first-time African sovereign green bond issuers to **develop green framework legislation** to encourage green finance, promote transparency & signal a commitment to green finance to global markets
- ✓ Govts to make public policy shifts in favor of greener and more climate-resilient economies while also creating fiscal policies that **make holding green assets more attractive**
- ✓ There are developments that make the **continent a prime candidate for funding through sovereign green bonds** – in Ethiopia, South Africa, Kenya, Morocco, Namibia, Ghana, Gabon, etc

Green/Environmental Funds

- ✓ Climate finance has led to a broadening of scope and mandate of **Environmental Funds** (Efs)
- ✓ Efs have become vital financing mechanisms for the implementation of national environmental action plans and green programmes. **Key success factors** of EFs include:
  - Strong govt commitment to ensure Efs are used only to prove funding and technical expertise, building capacity and supporting the transition to a green economy
  - Strong governance system with representation from diverse sectors
  - LT financial commitment, strong legal and financial practices
  - Govt funding should be used to capitalise EFs and also to act as a stimulus to crowd-in private and donor investments
  - EFs should however aim to have diverse revenue streams in the medium to LT
  - Have clear priorities in order to help attract grant funding
  - Fund innovative & strategic capacity-building programmes to support & strengthen domestic capabilities (infrastructure, resources and products, skills, etc.)

Other market-based mechanisms

- ✓ Govt must **improve the policy and regulatory environment**, in order to attract private sector investments for climate resilience programmes & create **market-based mechanisms** to incentivize the private sector

- ✓ For any market strategy to be successful in unlocking green finance, focus on:

  - **De-risking** by providing LT grant and concessionary funding to an investment
  - Provide **credit enhancements** which will attract private capital to sustainable green investments & serve to partially de-risk investments
  - Allow **co-investments** by the private sector & create **umbrella facilities** to local financial institutions (esp. to SMEs with good investment opportunities but with high transaction costs)
  - Creation of green and ethical banks. **Ethical banks** are by ethical principles and only invest ethically and sustainably. **Green banks** are dedicated to green investment with the aim to fill the local market's climate investment shortfall

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GREEN FISCAL REFORM

- ✓ Range of **Environmental Fiscal Reform** instruments - suitability differs by country and sector
- ✓ Green fiscal reforms can be a valuable instrument for medium-LT **rationalisation of inefficient expenditures**
- ✓ Green fiscal policy instruments can help generate and **re-allocate significant resources** for economic recovery measures
- ✓ On the other hand, the removal of harmful subsidies is also a financing mechanism employed to achieve certain SDGs. EG, Egypt halved the fiscal cost of subsidies to bring average electricity tariffs closer to cost recovery
- ✓ However, Green **fiscal reform has not taken off** due to obstacles such as lack of political will; limited transparency and awareness; etc
- ✓ BUT assess the efficiency and distributional implications of any proposed fiscal reforms

RENEWABLE ENERGY

- ✓ The difference between the 2008 GFC & the covid-19 crisis is that the **cost of renewable energy generation is now competitive** with fossil fuels
- ✓ **Policy reforms** to enable a decrease in renewable power costs
- ✓ Govts should implement **regulations that are fit for purpose** putting clean energy investments at the centre of eco recovery & eco stimulus packages. Eg, remove regulatory barriers enabling the private sector to freely purchase renewable energy in South Africa (**SAWEA)**
- ✓ Govts must **deregulate** to allow competition – eg. allow private actors to meaningfully participate in the sector by supplying energy directly to the national grid
- ✓ Govts can stimulate demand by electrifying economies with renewable energy & deliver new electricity infrastructure with private investments
- ✓ International Renewable Energy Agency: accelerating investment in renewable energy could underpin the global economy's Covid-19 recovery by adding $100 trillion to GDP by 2050, return between $3 and $8 for every $1 invested, & quadrupling the number of jobs in the sector to 42 million over the next three decades

INFRASTRUCTURE INVESTMENT

- ✓ Countries to pursue a recovery strategy that places the **State at the centre** of their eco. growth - infrastructure the driver of growth
- ✓ Govts so enact policy measures to stimulate economic activity by catalysing investing in a **modern, zero-carbon and sustainable infrastructure**
- ✓ **Private equity** could also be an effective alternative source of funding as many funds are now assessing new strategies to allocate capital including finding appeal in links to SDGs
- ✓ Core to the economic recovery strategies of African countries will be the measures taken to stimulate supply and demand through substantial **infrastructure build programmes**

REDIRECTING EXISTING FUNDING

- ✓ Sustainable finance is also about finding ways to **reorient existing financing streams** to advance multiple SDG goals at the same time
- ✓ **Public procurement** can also be used as a lever to achieve development impact. Eg, at least 30% of public procurement must be allocated to green projects or used as green finance.
- ✓ Review and update of existing expenditure plans with the aim of **adding green energy and public transport projects**
- ✓ **National budgets can be reallocated** with the view of establishing national green/environmental funds to be at the centre of economic recovery plans

STIMULUS INVESTMENTS FOCUS ON GREEN

- ✓ A green stimulus should be at the core of Africa's recovery effort - plans must be tailored to domestic socio-economic conditions instead of transferring green-stimulus models from developed countries
- ✓ Ensure **stimulus investment in Africa should focus on resilient infrastructure, food and water security** – all 3 have been affected by both the pandemic and climate change
- ✓ 5 key pillars for green-recovery packages that can be adopted by African countries: (1) **Build network infrastructure** required for a green and just transition. (2) Make the **regulatory changes to unlock private sector investment** in sustainable energy, water, waste and sanitation systems. (3) Support **localization of manufacturing technologies**. (4) Improve **access to sustainable services**. (5) Implement **fiscal reforms**

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Thank you