Organisation for Economic Co-operation and Development

ENV/EPOC/EAP(2018)2

Unclassified **English - Or. English**

15 October 2018

ENVIRONMENT DIRECTORATE
ENVIRONMENT POLICY COMMITTEE

GREEN Action Task Force

Mobilising private finance for green growth: Role of governments, financial institutions and development partners

Discussion Note

The Third Annual Meeting of the GREEN Action Task Force
22-23 October 2018, Bratislava

This discussion note supports the High-level Panel Discussion 2 (Agenda Item 3)

Takayoshi Kato, Environment Directorate, OECD (Takayoshi.kato@oecd.org).

JT03437399

1. Policy frameworks in the countries of Eastern Europe, the Caucasus and Central Asia (EECCA) are becoming more supportive of green growth. Yet, the achievement of their national targets on climate change and wider green growth agendas requires massive investment. Mobilising "green" finance needs bolder, faster, and more coherent reforms in environmental and climate policies as well as other enabling conditions such as financial regulations, investment promotion, social protection, among others. This discussion note outlines key issues on mobilising green finance and role of different actors in EECCA. Such actors include the governments, financial institutions, financial regulators and various development co-operation partners.

2. The term "green finance" is used here to mean finance that supports greening of the economy from public and private sources. More specifically, green finance shall promote long-term and inclusive economic growth, while avoiding negative impacts of economic activities on the environment and communities. Examples used in this discussion note mostly relate to clean, efficient and affordable energy, and climate change adaptation and mitigation. Yet, green finance should also serve wider measures for green growth, such as biodiversity protection, air pollution abatement, access to clean water and sanitation, waste management and circular economy, sustainable agriculture, among others.

Questions for discussion:

- What can governments, financial-sector regulators and development partners do to incentivise the private sector to engage in green finance, mitigate various risks and fill the gaps in awareness, capacity and information?
- What should be the role of banking- and financial-sector regulations in mobilising green finance, such as disclosure policies on financial and non-financial information (e.g. environment, social and governance disclosure and reporting)?
- How do you see the potential of green bonds and other emerging financial solutions? What are roles of your institution in scaling up such instruments?

3. **Countries of EECCA have developed national strategies for green growth and climate change over the recent years.** For instance, all the 11 EECCA countries[1] have internationally communicated their own climate change goals through their (Intended) Nationally Determined Contributions (UNFCCC, n.a.; OECD, 2016a). Belarus, Kazakhstan and Kyrgyzstan have adopted and committed to implement long-term programmes towards green economy and sustainable development. Belarus, Georgia, Moldova and Ukraine, for instance, have developed the low emission development strategies and/or the national energy efficiency action plans (LEDS Global Partnership, 2018).

4. **Some preliminary estimates suggest that the achievement of EECCA countries' national targets on green growth and sustainable development may require gross investment in the order of, at least, several billions per year until 2030** (see also Table 1 for some examples). The investment needs for greening the economy of the region are significant, also because much of the energy, water, transport, building and industrial

[1] List the 11 countries?

infrastructure was built during the Soviet era and has not been renewed or replaced since then.

Table 1. Examples of estimated costs of achieving national climate change or green growth policy goals

Country	Estimated (gross) investment needs	Period	Sources
Kazakhstan	USD 120 bln (USD 3.3 bln/year)	2014 - 2049	Kazakhstan's Concept on Transition to Green Economy estimated that gross investment needs for its implementation of various sectors (e.g. energy, water, waste)
Georgia	USD 16 bln (USD 1.1 bln/year)	2017 - 2030	OECD analysis, based on Georgia's policy documents, estimates gross investment needs for achieving the country's climate change mitigation and adaptation targets between 2017 and 2030
Moldova	USD 5.1 bln (USD 340 mln/year)	2015 - 2030	Moldova's NDC estimates the cost of achieving its climate mitigation target that is conditional on international support until 2030

Source: Government of Kazakhstan, 2013, OECD, 2018a, Government of Moldova, 2015

5. **Allocation of public budgets for the environmental protection and climate change in the EECCA countries has been relatively low: about 0.2 to 0.3 % of GDP on average between 2000 and 2013.** (CIS Statistical Yearbook, 2014) [2] **Moreover, domestic budgets alone are unlikely to be sufficient to achieve the established goals on climate change and green growth.** The OECD countries spend their public budgets on environmental and climate-related investments at about 1.5 to 2% of GDP on average. Large sizes of energy subsidies in some of the EECCA countries also encourage wasteful energy consumption, discourage private-sector investment in energy efficiency and clean energy, and hence weaken the country's growth potential (OECD, 2018b; IMF, 2013). Public finance can be redirected towards green objective also through policy instruments such as sound tariffs (e.g. on water and energy) that promote resource conservation, financial support and de-risking for projects by private sector on environmental protection and climate change, well-targeted support to vulnerable populations, among others (OECD 2016c; UNIDO-OECD 2018).

6. **International development finance has been, and is likely to remain, one of the most important financial sources for green growth in the region** (OECD, 2016a; 2016b). For example, bilateral and multilateral providers committed annually more than USD 3 billion per year on average to 11 EECCA countries to support their climate mitigation and adaptation between 2013 and 2016[3] (OECD DAC, 2018). Development finance providers increasingly use "blended finance", and more and more commercial actors - both international and domestic - are participating (OECD, 2018c; Blended Finance Taskforce, 2018). The term "blended finance" means the strategic use of development finance for the mobilisation of commercial finance towards sustainable development, and gains an increasing traction across the world (OECD, 2018c).

7. **Private finance needs to be scaled up, as international and domestic public finance will not be enough to meet the climate change and green growth goals**. Deeper

[2] Public-sector investment in fixed capital for environmental protection and rational use of natural resources in Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan and Ukraine whose information is available in CIS Statistical Yearbook (2014).

[3] Note that these bilateral and multilateral providers of development finance are OECD DAC members and multilateral development banks and financial institutions which report to the OECD DAC annually. Further details on the external development statistics, see http://www.oecd.org/dac/financing-sustainable-development/development-finance-topics/climate-change.htm

and more stable banking and financial sectors can greatly contribute to economic growth in the region (EIB, 2012; Aslund 2013). Moreover, aligning financial-sector development with environmental and social considerations can help EECCA countries pursue not only efficient, but also green and inclusive growth of their economies (OECD 2018a; 2018d).While building "green" financial systems in the region will take time, interest is growing.

8. **Although domestic financial systems in EECCA countries have been growing steadily over the past years, access to low-cost, long-term capital remains a major barrier to mobilising finance, including for green projects.**[4] The local financial sectors in the region are not benefiting from the current low interest rates in the international financial market, especially for expanding credits to smaller scale entities and households (e.g. BIS, 2018; UNIDO-OECD, 2018; OECD 2018e). Businesses with financial needs still face relatively high lending interest rates (e.g. from 11.5% in Georgia to 19.8% in Kyrgyzstan in 2017), although the levels have been declining over the past decade (IMF, 2018). Borrowers also often face short repayment periods and high collateral requirements (UNIDO-OECD, 2018).

9. **Those who have debts in foreign currencies are also exposed to foreign exchange risks.** Some EECCA countries experienced sharp declines in official exchange rates between their local currencies and US dollar over the past few years. These countries included Ukraine (whose currency was devaluated by 233%), Azerbaijan (by 119%), Belarus (by 118%), Kazakhstan (by 114%) and Tajikistan (by 79%) between 2013 and 2017 (World Bank, 2018)

10. **International and domestic public finance helps to reduce such financial costs and various risks through, for instance, subsidies, public guarantees and insurance, seed funding and long-term credits from development banks.** These interventions have already contributed to catalysing domestic private financial resources in green projects in a range of EECCA countries (OECD 2018a;2018d, UNIDO-OECD 2018). Such projects and activities range from sustainable infrastructure investments to activities at micro-, small- and medium-sized enterprises (MSMEs), households and farmers.

11. **New non-bank intermediated financial instruments are attracting growing attention both in and outside the EECCA region as a means to lower capital costs, diversify financial sources and complement collateral lending by banks.** Examples include leasing, microfinance, and energy service company (ESCO) models, among others. Whilst these financial products are still relatively under-developed in the EECCA region, some countries have been pioneers at using them for green finance (e.g. Armenia, Belarus, Georgia, Kazakhstan, Kyrgyzstan and Ukraine) (see also UNIDO-OECD, 2018 and OECD 2018a; forthcoming)

12. **Many countries, including middle-income countries, are exploring the potential of green bonds** (OECD, 2017; UNEP, 2017). The estimated issuance of green bonds in 2017 amounted to USD 155.5 billion globally (CBI, 2018). There is growing interest in green bonds also among EECCA countries. Some of them have embarked on the development of their own green bond markets (e.g. Georgia, Kazakhstan and Ukraine: See Table 2).

[4] The ratios of domestic credits to GDP in the EECCA range from 18.2% in Kyrgyzstan to 65.4% in Georgia in 2016, suggesting a large room for improvement compared to other middle-income countries (143.4%), let alone the OECD member countries (207.3%) (World Bank, 2018).

Table 2. Examples of initiatives in green bond market development in EECCA countries (as of August 2018)

Country	Initiative
Kazakhstan	Astana International Exchange (AIX) adopted the AIX Rules Book that includes rules on the green bonds in February 2018, and are now working on the first issuance of green bonds.
Georgia	The National Bank of Georgia and the International Capital Market Association worked on the Georgian version of the Green Bond Principles, aiming to raise awareness of green bonds' advantage among market participants.
Ukraine	The State Agency on Energy Efficiency and Energy Saving has been working on the conceptual basis of green bonds market creation in Ukraine as a means of attracting investments in renewable energy and energy efficiency.

Source: Based on AIFC (2018), IFC (2017) and SAEE (2018)

13. **Despite the potential, mobilising bond markets for green projects in the region may not be an easy task**. First, before bonds can be issued, it is necessary to accumulate a critical volume of investment projects. Some of smaller EECCA countries may face difficulties in finding sizable projects. Second, in the EECCA countries, green bonds may be difficult to promote given the lack of the appropriate guidelines and eligibility criteria, under-developed capital market infrastructure, and the low level of sophistication of local institutional investors and financial service providers. Third, relating to the eligibility criteria, independent quality control and enforcement support schemes are still embryonic (e.g. usage of second opinion, third-party assurance, ex post monitoring/assessment) to make sure that the proceeds of bonds are used to meet their "green" objectives.

14. **Aligning the efforts to develop financial systems with green growth goals requires greater levels of awareness and knowledge base among financial institutions and their clients**. Both governments and financial regulators (e.g. central banks) can work to further engage private-sector partners in green finance and build their confidence. This can be done through: adjusting financial regulations and disclosure policies on financial and non-financial information; raising awareness among financial institutions and their clients; bridging information gaps in terms of both investment and the environment and climate risks. The National Bank of Georgia recently joined the IFC-led Sustainable Banking Network, and also launched in fall 2018 a project with the OECD on disclosure principles for environmental and social risks and opportunities and development of common reporting formats for commercial banks and microfinance institutions.

15. Potentially, measures to adjust banking regulations could also include considering differentiated policies for green projects (e.g. updated discount rates, differentiated reserve requirements for commercial banks linked to the composition of their portfolio). For instance, Bangladesh Bank (the central bank of Bangladesh) has set lower equity margin requirements for environmentally and socially favourable projects (New Economics Foundation, 2017).

References

AIFC (2018) AIFC: The financial hub of the region, the Astana International Financial Centre (AIFC), https://www.astanafindays.org/storage/media/5b45f8cd9c4cf.pdf

Aslund A (2013), How the Central and Eastern European Banking System Managed the Financial Crisis, Peterson Institute for International Economics, https://piie.com/blogs/realtime-economic-issues-watch/how-central-and-eastern-european-banking-system-managed

BIS (2018) Press release: Prolonged low interest rates could affect financial stability, central banks find, the Bank for International Settlements (BIS) https://www.bis.org/press/p180705a.htm

Blended Finance Taskforce (2018) Better Finance, Better World, Consultation Paper of the Blended Finance Taskforce, s3.amazonaws.com/aws-bsdc/BFT_BetterFinance_final_01192018.pdf

CBI (2018) Green Bond Highlights 2017, Climate Bonds Initiative (CBI): January 2018, https://www.climatebonds.net/files/reports/cbi-green-bonds-highlights-2017.pdf

EIB (2012), Banking in the Eastern Neighbours and Central Asia Challenges and Opportunities, www.eib.org/attachments/efs/economic_report_banking_enca_en.pdf

Government of Kazakhstan (2013) "Concept for Transition of the Republic of Kazakhstan to Green Economy", Decree of the President of the Republic of Kazakhstan No. 577, Executive Office of the President of the Republic of Kazakhstan, Astana,

Government of Moldova (2015), Republic of Moldova's Intended National Determined Contribution, Government of the Republic of Moldova, www4.unfccc.int/ndcregistry/PublishedDocuments/Republic%20of%20Moldova%20First/INDC_Republic_of_Moldova_25.09.2015.pdf

IFC (2017), Georgia Joins SBN, the Sustainable Banking Network website, https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/sustainability-at-ifc/company-resources/sustainable-finance/sbn_whatsnew

IMF (2013) Energy Subsidy Reform : Lessons and Implications, https://www.elibrary.imf.org/view/IMF071/20361-9781475558111/20361-9781475558111/20361-9781475558111.xml?redirect=true

IMF (2018), International Financial Statistics, data.imf.org/?sk=4C514D48-B6BA-49ED-8AB9-52B0C1A0179B

LEDS Global Partnership (2018), Low Emission Development Strategies Global Partnership website, http://ledsgp.org/?loclang=en_gb

OECD (2016a), Financing Climate Action in Eastern Europe, the Caucasus and Central Asia, Green Finance and Investment, OECD Publishing, Paris, https://doi.org/10.1787/9789264266339-en

OECD (2016b), Environmental Lending in EU Eastern Partnership Countries, Green Finance and Investment, OECD Publishing, Paris, https://doi.org/10.1787/9789264252189-en

OECD (2016c), Reforming economic instruments for water management in EECCA countries - Policy Perspectives 2016

OECD (2017), Mobilising Bond Markets for a Low-Carbon Transition, Green Finance and Investment, OECD Publishing, Paris, https://doi.org/10.1787/9789264272323-en

OECD (2018a), Mobilising Finance for Climate Action in Georgia, Green Finance and Investment, OECD Publishing, Paris, https://doi.org/10.1787/9789264289727-en.

OECD (2018c), Making Blended Finance Work for the Sustainable Development Goals, OECD Publishing, Paris, https://doi.org/10.1787/9789264288768-en.

OECD (2018d), Access to Private Finance for Green Investments: Energy Efficiency and Renewable Energy Financing in Ukraine, Green Finance and Investment, OECD Publishing, Paris, https://doi.org/10.1787/9789264303928-en.

OECD (2018e), Environmental Policy Toolkit for SME Greening in EU Eastern Partnership Countries, OECD Green Growth Studies, OECD Publishing, Paris, https://doi.org/10.1787/9789264293199-en

OECD DAC (2018) Climate Change: OECD DAC External Development Finance Statistics, www.oecd.org/dac/financing-sustainable-development/development-finance-topics/climate-change.htm

SEAA (2018) SAEE in synergy with partners will work on the drafting of a road map for the creation of green bonds market in Ukraine, State Agency on Energy Efficiency and Energy Saving of Ukraine (SAEE), https://www.kmu.gov.ua/en/news/derzhenergoefektivnosti-iz-partnerami-pracyuvatime-nad-dorozhnoyu-kartoyu-zapusku-rinku-zelenih-obligacij-v-ukrayini

UNFCCC (n.a.), Nationally Determined Contributions (NDCs), United Nations Framework Convention on Climate Change, https://unfccc.int/process/the-paris-agreement/nationally-determined-contributions/ndc-registry#eq-4

UNIDO and OECD (2018), Financing Resource Efficient and Cleaner Production by SMEs in the EU Eastern Partnership Countries: a Stakeholders' Guide, EaP GREEN Publication, http://www.green-economies-eap.org/resources/Stakeholders%20Guidebook%20for%20RECP%20finance%20in%20EaP.FINAL.pdf

World Bank (2018), World Development Indicators, https://datacatalog.worldbank.org/dataset/world-development-indicators