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HOW NATIONAL GREEN BANKS CAN BUILD COUNTRY OWNERSHIP OF CLIMATE FINANCE

INSIGHT BRIEF

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||||| ABSTRACT

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The conclusion of the Paris Agreement has shifted focus from global negotiation to national implementation. The climate finance system needs to evolve in parallel. Direct access cannot be the central tenet of country ownership, particularly for large emerging markets for which access to multilateral concessional resources is immaterial for their national low-carbon development. Instead, we should strive to create a climate finance architecture that vests true authority and responsibility in national institutions to combine resource mobilization with international capital flows in support of domestic low-carbon investment. Nationally owned, commercially operated green investment banks (GIBs) have become among the most sophisticated and comprehensive forms of public institution playing a key role in financing the low-carbon transition, even in advanced economies. GIBs offer a compelling, replicable institutional model for country ownership of climate finance for some of the largest emitters in the developing world.

||||| INTRODUCTION

Developing countries require an efficient, effective, and evolving climate finance system to better enable them to achieve their nationally determined commitments (NDCs) and build resilient, low-carbon economies. The architecture that was established to mobilize finance and build consensus around an international climate agreement, while appropriate for the last decade, must now align around supporting individual countries' circumstances.

The need for country-driven decision-making and capacity has been a central theme of the climate negotiations and discussions about climate finance. Fundamental to the debate have been principles of enhanced direct access and country ownership. Enhanced direct access gives developing countries the ability to secure financial support directly from regional or national funding entities,¹ and country ownership is a function of a country's autonomy over the funds it receives.² This paper builds on these two principles but extends the argument beyond how countries should access international climate finance resources. We reason that, over time, national financial institutions should play an increased role in coordinating all financial flows driving low-carbon development, including both foreign and domestic investments. We present national green investment banks (GIBs) as a replicable model that moves problem-solving and agency to the national level, empowering developing countries to benefit from international financial resources while also better attracting private and domestic capital.

||||| BACKGROUND

There is both a principled and practical rationale for evolving the climate finance system. In principle, countries should have the ability to enact their climate mitigation and adaptation agenda in the way that aligns with their individual needs and circumstances. Country-level decisions should not be controlled or hampered by a complex system of intermediaries. In fact,

it is neither desirable nor practical to funnel enough climate finance through current bilateral and multilateral funds and intermediaries at the scale necessary for countries to achieve their nationally determined contributions, let alone to keep average global warming below two degrees.

COUNTRY OWNERSHIP IN PRINCIPLE

Disagreements over direct access have been the primary manifestation of the country ownership debate within climate finance. Moving toward greater national agency and empowerment is generally accepted as desirable and important, but questions over the mechanisms for controlling and allocating resources are ongoing. The debate over the distribution, authority, and use of funds stems from a fundamental difference in perspective about the ownership over the funds once they are disbursed. One view holds that it is the right of developing countries to access and allocate public climate finance as they see fit in order to implement their climate goals. The other view is that “direct access to climate finance is less about a transfer of ownership and stewardship and more about accelerating the pace and effectiveness of delivery. In this second perspective, direct access is not by default a preferred option.”³

Recipient countries have pushed to codify direct access measures into multilateral climate fund distribution processes. Drawing on the Adaptation Fund (AF) for inspiration, such efforts have included advocating for more recipient-country representation on the boards of climate funds, as well as for allowing national institutions to become accredited as recipient institutions, making them eligible to accept donor funds directly.⁴ And there has been progress: whereas the Global Environment Facility (GEF) began to formally explore expanding its accredited entities to national institutions eight years ago,⁵ the Green Climate Fund has accredited 21 national institutions thus far,⁶ just under half of its total accredited institutions.

However, the mere fact that national institutions can directly receive multilateral funds does not mean they have achieved country ownership over climate finance. True country ownership involves influence over all national climate flows (both domestic and international, public and private) and having responsibility and accountability. We must now identify institutions that can support a climate finance architecture that achieves authentic national authority.

COUNTRY OWNERSHIP IN PRACTICE

Leaving aside the debate over principles, it is difficult to dispute that the current climate finance system is not fit for its purpose from a practical perspective. Heavy on international structures and funds but light on national capacity and agency, the system is not designed to effectively mobilize or allocate trillions of dollars to low-carbon projects within countries around the world.

Global and bilateral climate funds and initiatives have mushroomed in the last decade, tracking the political desire of donors to drive money into the system. However, duplicative entities, lack of coordination, and local capacity shortages mean that climate finance is not flowing to project implementation fast enough and is not optimized for impact and innovation. More broadly, capital allocation to projects does not typically happen at the global level (especially in the private sector), and the challenges of ramping up finance flows are very context-specific. Local institutions are always going to be better at assessing and pricing local risk, and more effective at pushing regulators to improve enabling environments. Foreign investment, while essential, is always harder, more expensive, and fraught with complexities like currency convertibility. For these reasons, evolving the climate finance system to better empower nationally appropriate institutions is not only the right thing to do in principle but the only way to drive high-volume, high-impact capital flows commensurate with a two-degree world.

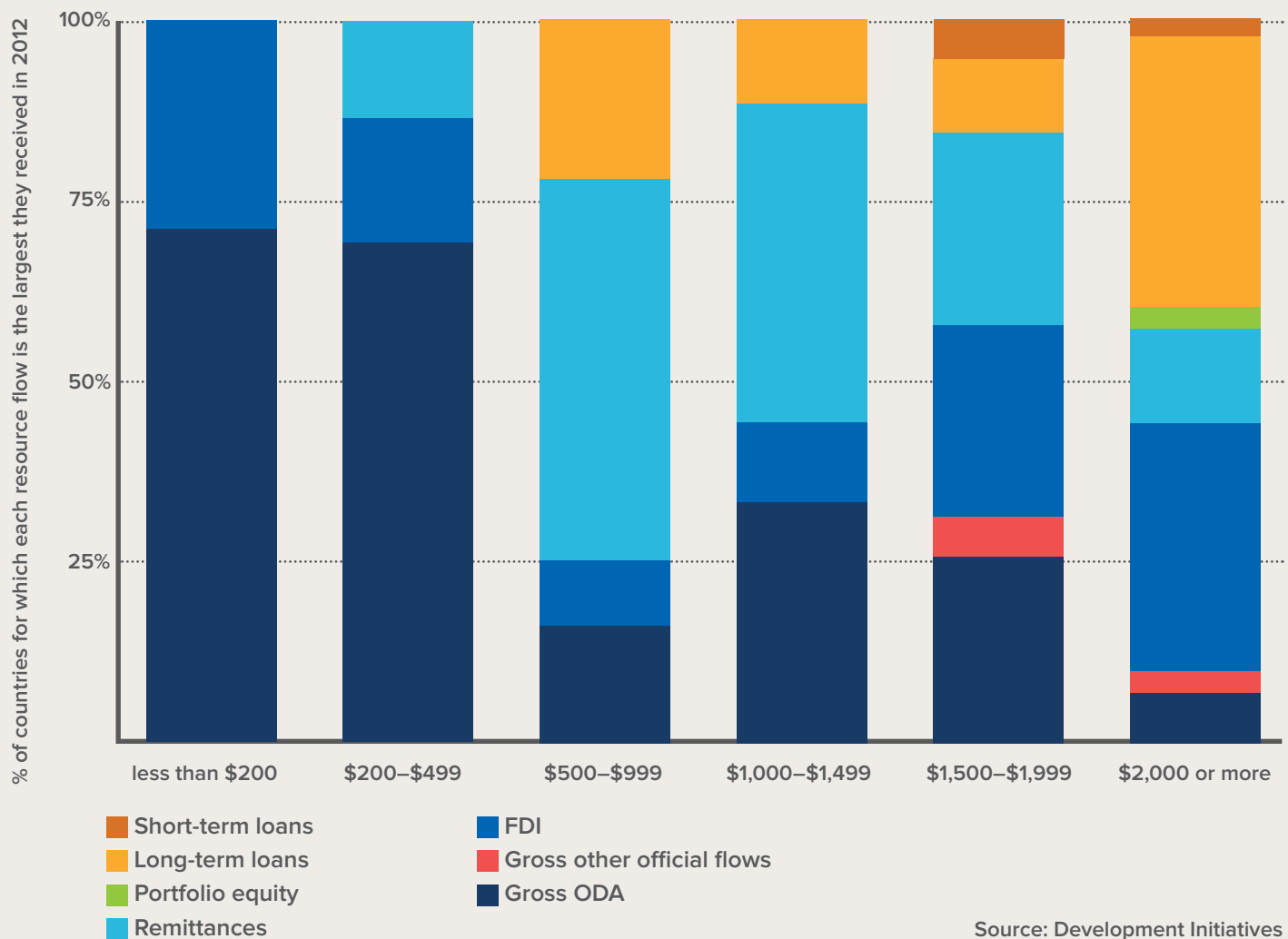
||||| TOWARD CONCRETE SOLUTIONS PROMOTING COUNTRY OWNERSHIP

In short, the push for direct access in multilateral climate funds like the Green Climate Fund, AF, and GEF is important, but is a comparatively small piece of the country-ownership puzzle. The aim of an evolving system should be to empower domestic institutions to become the loci of climate finance mobilization and allocation.

How this can be done in practice depends on national circumstances. As countries move up the income ladder, the most significant sources of international finance will change. Figure 1 shows that as least-developed countries become even marginally more prosperous, foreign assistance becomes less important and foreign direct investment becomes generally more critical.

Figure 1 shows how the types of financial resources countries rely on vary significantly with per-capita-income. As countries' populations become even slightly more affluent they rely on less overseas aid and their income consists of a wider variety of resources.⁷

Figure 1: Official Development Assistance (ODA) dominates where government resources are lowest, while Foreign Direct Assistance (FDI) is more important for countries with higher government resources

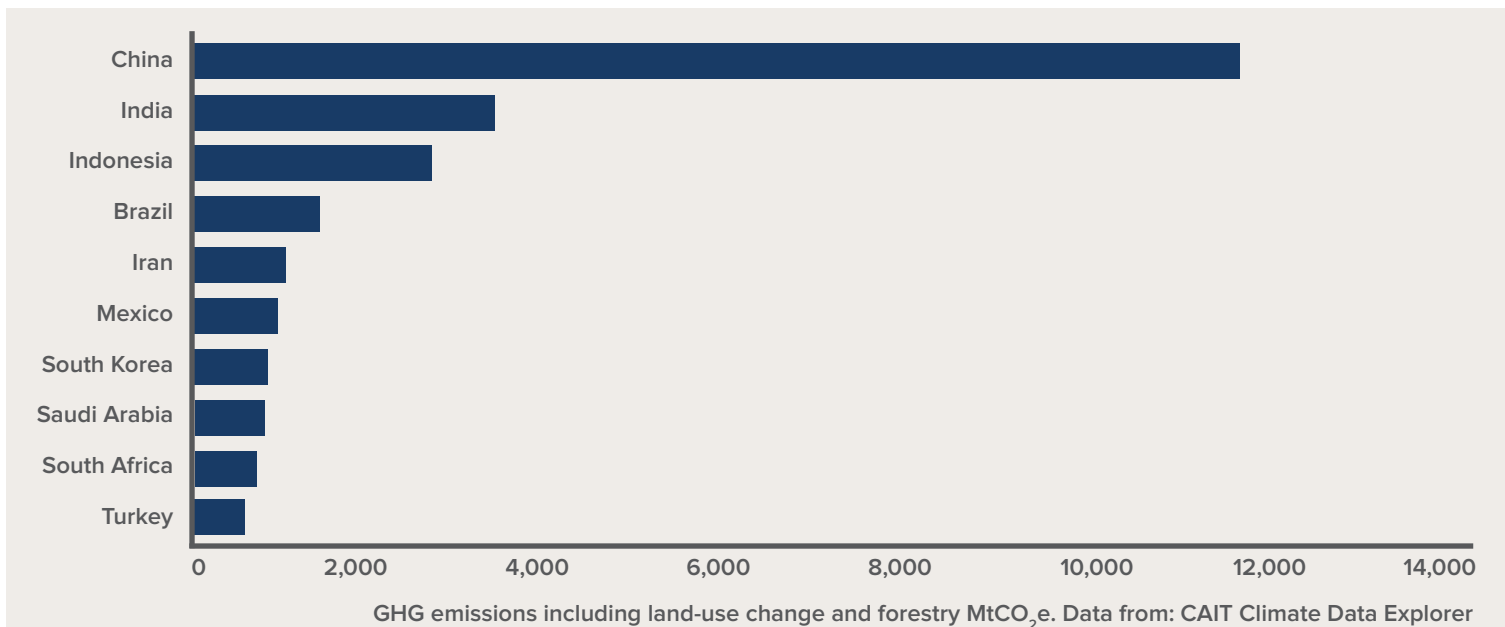


The shifting continuum of needs and circumstances within developing countries has often been obscured by the political bifurcation between developed and developing countries in the United Nations Framework Convention on Climate Change and the climate negotiation process. In this conception, OECD countries are responsible for financing their own energy transitions and are also obligated to support the mitigation and adaptation efforts of low-income nations. Developing countries, meanwhile, are to rely on developed countries to finance the incremental cost of low-carbon infrastructure.

The reality is more of a spectrum: a very large number of non-Annex I countries lack the wealth and technical capacity to take *full* responsibility for climate finance, but they are not reliant on grant-based aid, as is the case for least-developed countries. These countries in the middle have access to global climate finance—in fact they receive a significant amount of climate resources based on their emissions profiles—but also have growing domestic resources to transition away from foreign assistance and channel local savings into low-carbon investments. In 2014, China, India, and Brazil, three of the highest-emitting non-Annex I countries, received 32% of mitigation resources and, in general, countries with higher domestic resources (government revenue above \$2,000 per person) receive more than half of mitigation finance.⁸ An evolved climate finance system should enable these low- and middle-income countries and large emerging markets to move away from dependence on international foreign assistance and on competing for allocations from global climate funds. It should support the overall development of local institutions and financial and technical abilities rather than funding discrete projects. This would also allow for foreign assistance to concentrate resources in countries with the least capacity, helping to mobilize additional funds and build local knowledge and information sharing.⁹

Figure 2 shows the top 10 non-Annex I greenhouse-gas emitters. None of these countries are materially dependent on bilateral foreign aid or multilateral climate funds to finance their low-carbon growth plans. For the largest developing country emitters, success or failure in financing the low-carbon transition will influence global climate change outcomes, but it is not important for them to negotiate direct access from multilateral climate funds. They need to focus on acquiring the in-country financial and technical capacity to address market barriers and effectively leverage public resources to mobilize necessary private, domestic investments.

Figure 2: The top 10 greenhouse-gas emitting non-Annex I countries in 2014¹⁰



In some cases, national development banks (NDBs) can fill this role, given their access to local financial markets and risk-taking potential.¹¹ Commitments from NDBs and the deployment of mechanisms such as project-level debt, equity, and guarantees; green credit lines through local banks; direct lending to national banks; and capitalization of dedicated green investment banks can also help direct more private investment into low-carbon projects in emerging markets. Depending on unique domestic conditions, use of these instruments can help push toward fuller country ownership—that is, ownership of processes, institutions, holistic investment planning, and implementation.

||||| GREEN INVESTMENT BANKS, A SOLUTION FOR SOME

For markets with relatively high institutional and financial capacity, GIBs may be the most advanced form of national ownership for climate finance. As described throughout this paper, a sustainable approach to low-carbon finance fit for the two-degrees mission requires engaging and channeling local savings toward low-carbon infrastructure domestically. GIBs offer a transferable model for national climate-smart development that utilizes international financial resources while also mobilizing domestic private investment. These nationally capitalized and owned, commercially operated banks—which can be new institutions or divisions/extensions of existing national development banks—can perform a number of essential functions simultaneously:

- **Capital mobilizer:** GIBs can be capitalized with a combination of concessional resources (notably the Green Climate Fund) and domestically issued green bonds. Coinvestment arrangements with multilateral development banks, development finance institutions, and private investors can blend a variety of capital tools.
- **Capital provider:** GIBs can serve as the largest single source of capital for low-carbon infrastructure projects in-country, able to offer and blend instruments including senior debt, subordinated debt, equity, first-loss equity, mezzanine finance, guarantees, insurance, and project-preparation grants, with a core mission of leveraging private investment (preferably domestic).
- **Lead arranger:** By serving as the central node of the climate finance architecture, a GIB can provide an investment banking function, building a pipeline of deals and structuring/syndicating transactions to facilitate the involvement of other capital providers, both public and private, foreign and domestic.
- **Innovator:** GIBs can be the first to pilot/demonstrate financial-engineering solutions in the local context that can then be replicated by other market actors.
- **Capacity-builder:** GIBs can build the capacity of local banks and investors to understand and manage low-carbon investments, thus helping to mobilize local savings over the long term. More generally, they can build human capacity in the financial sector by serving as a training ground for professionals.
- **Enabling environment accelerator:** GIBs create a tight feedback loop to governments on how they can unlock capital flows through policy reforms, since as the sole/primary shareholder of a GIB and guarantor of its green bonds, the government has a strong vested interest in its successful deployment and return of capital.

GIBs have proliferated in OECD countries including the U.S., UK, and Australia, countries with ample financial resources and technical capabilities. GIBs have a focus on market development paired with deploying financing mechanisms.¹² This means they can play an important role in either creating or maturing low-carbon markets in ways that are relevant to both developed and emerging economies.

As emerging markets work to implement NDCs while simultaneously transitioning into the developed countries of the future, GIBs have the potential to play a role in building local capacity that would facilitate both goals. Leaving aside the debate about whether new institutions are needed (in our view, GIBs could be new or existing institutions, as appropriate to the circumstances), we posit that GIBs have the potential to mobilize and deploy capital much more efficiently and effectively than a stitched-together fabric of climate finance solutions reliant on multilateral and bilateral program support. GIBs are flexible institutions that can be structured to maximize private leverage, utilize a variety of financial instruments such as those listed above, and help create supportive policy environments that will benefit countries' overall development.

||||| CONCLUSION

The climate finance system should evolve to adequately reflect the needs of countries. For emerging markets, this means moving beyond access to multilateral climate funds (sources of concessional financial resources that are relatively unimportant to these countries) and toward a redesigned architecture that gives full authority—and accountability—to national institutions. These domestic institutions will be able to tap into and mobilize foreign and domestic sources of finance and support national investment. Nationally owned, commercially operated GIBs have emerged as among the most inclusive and flexible type of institution exclusively focused on financing the low-carbon transition, even in advanced economies. GIBs therefore offer a compelling, replicable model for country ownership of climate finance for some of the highest-emitting countries in the developing world.

ABOUT ROCKY MOUNTAIN INSTITUTE

Rocky Mountain Institute (RMI)—an independent nonprofit founded in 1982—transforms global energy use to create a clean, prosperous, and secure low-carbon future. It engages businesses, communities, institutions, and entrepreneurs to accelerate the adoption of market-based solutions that cost-effectively shift from fossil fuels to efficiency and renewables. RMI has offices in Basalt and Boulder, Colorado; New York City; Washington, D.C.; and Beijing.

||||| **ENDNOTES**

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