Green Bonds

Environmental Finance in the Debt & Ecological Crises Brief #2

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February 2023

Key Points:

The structure of global economy creates borrowing conditions for the Global South that are predatory and extractive, but access to debt is critical to pay for needed environmentally and socially beneficial projects.

Green bonds are a key source of financing for climate-related spending; virtually identical to any other kind of bond, they have been widely issued by countries and multilateral development banks.

Amid the Global South debt crisis and the ecological crisis, continuing to pile on debt- either through issuing new sovereign debt or rent-seeking on-lending by multilaterals is hardly a just response to either crisis.

One of the paradoxes of the emerging Global South debt crisis is the importance of access to credit for countries to achieve their economic and environmental goals. Conceptually, debt is not necessarily a bad thing. Debt enables smoothing of large, 'lumpy' costs over time and spreads costs of projects paid for with debt over generations of beneficiaries. Debt can be used for investments in infrastructure and services that help people live healthier, wealthier, and safer lives. Debt becomes a problem when the cost of making payments begins to limit fiscal space to pay for other priorities, and it becomes a crisis when the debt itself is unpayable- a scenario that is playing out across the Global South in 2023 from Sri Lanka to Pakistan to Zambia. Around the world, periodic debt crises are virtually inevitable as a result of the interplay of structural economic dynamics, from raw materials export oriented economies dating back to colonization to the role of the US dollar in the global economy that can drive up borrowing costs quickly and uncontrollably.

Countries and international financial institutions (IFIs) like the World Bank and IMF have made access to borrowing a cornerstone of development policy over the 21st Century; as ecological imperatives have risen in profile, so has the drive to tie access to credit to achieving sustainable development priorities. This focus on enabling access to borrowing in the Global South has push and pull factors: Global South countries need finance to respond to the mounting impacts of the ecological crisis and achieve their social and economic priorities, while lenders in the Global North and China were, until very recently, searching for low risk, high return investments in a world of low interest rates and abundant excess profits. After 2008, a number of frameworks and financial products were rolled out to (ostensibly) respond to those demands, many of which will be discussed further on in this series. Among the most lauded, widely embraced, and clearest linking of debt to green development is the proliferation of green bonds.

Green bonds are not particularly complicated as far as climate financial mechanisms go. Their simplicity has been one of their selling points during their meteoric growth in the last 15 years. Bonds are among the oldest financial tools in the world and remain one of the most widely used. Bonds allow countries, companies, and multilateral development banks to crowdsource credit from individual and institutional investors, spreading the debt (and risk) among many lenders. The borrower then makes regular interest payments to bondholders, and then, at the end of a predetermined period, repays the principle of the loan in full. The interest rate the borrower pays is determined by the perceived risk that the borrower will be unable to repay the debt in full, informed by a number of factors including the length of the bond, how the money is going to be used and the borrower's creditworthiness, expressed as their credit rating. Green bonds are identical to any other kind of bond, except that the borrower promises to use the money to pay for environmentally-aligned projects like renewable energy capacity, water infrastructure, public transportation, or seawalls to hold back rising tides.

This brief is part of an occasional series on financial mechanisms meant to address aspects of the debt and ecological crises. All entries in the series can be found at climateandcommunity.org/debt-and-ecological-crises

In practice, they most often fund projects that have a clear path to generating economic returns, like the sale of renewable energy, which makes them less useful in the Global South for financing critical climate adaptation measures whose benefits are not easily monetized.

This 'green promise' is problematic in and of itself because it is highly susceptible to greenwashing despite numerous industry attempts to standardize and quantify what counts as 'green.' Another much bigger problem with green bonds in the debt and ecological crises is that, directly and indirectly, they have contributed to unsustainable debt across the Global South, endangering future prosperity and climate action.

Development banks invented green bonds and drove their early growth. For most of the early 2010s the World Bank Group was the biggest issuer of green bonds in the world and IFIs remain key issuers in the green bond market. The money raised by IFIs through green bonds is then on-lent to countries around the world, generally at higher interest rates than the World Bank itself pays. While privately held debt is the biggest component of the current Global South debt crisis, not all countries are beholden to the same types of creditors; many of the poorest countries in the world do not have access to global debt markets, and so they rely on borrowing from 'official creditors' like the World Bank and IMF.

This is not the only way that IFIs mobilize green debt. The prevailing attitude of IFIs and the Global North countries that control their policies is that there is not, nor will there ever be, enough grants and aid to cover the cost of climate transitions (just or otherwise) or slowing biodiversity loss in the Global South. Under this 'Wall Street consensus', the thing to do is enable countries to borrow money to pay for the transition by 'mobilizing' private finance through mechanisms like green bonds. As a result, the World Bank and an allied cadre of banks and NGOs have spent much of the last two decades focusing on making Global South countries more creditworthy by pushing 'market-friendly' reforms so that they too can issue green bonds- rather than focus on structural reforms to the institutions and practices of global political economy that have retrenched poverty and vulnerability to ecological crisis across the Global South.

On the other hand, most middle-income countries do borrow money on international bond markets, and some- including several already in debt distress- have issued green bonds. In 2021, Pakistan issued a $500,000,000 green bond that carried a 7.5% interest rate- more than double the rate Europe governments pay for similar debt. In a bitter irony, that money was earmarked for flood management and hydropower in a country now mired in an unresolvable debt crisis trying to recover from catastrophic flooding that has devastated the nation's electricity supply. This situation is emblematic of unmanageable sovereign debt across the Global South that has led to IMF-imposed austerity and radically reduced fiscal space to act on climate, biodiversity protection, and responding to disasters that have been turbocharged by global warming. Whether green bonds add to sovereign debt through direct borrowing, or on-lending from the World Bank, the result is ultimately the same- over-indebtedness that sends scarce public resources to bankers in the Global North while the countries that bear the least responsibility for the climate crisis bear the worst of its impacts.

On the whole, green bonds do not meaningfully represent a tool to be deployed in a just response to the climate crisis except in some limited circumstances that will require significant reform of international institutions to achieve. For example, the World Bank could continue to issue green bonds, but that money would then need to be distributed in non-extractive ways rather than interest-bearing loans. In the medium term, access to credit- through bonds or similar mechanisms- will still be important to smooth the costs of large projects that contend with the impacts of the ecological crisis that are now inevitable, and that will continue to worsen as the Global North drags its feet on decarbonization. Given the urgency and cost of mitigation and adaptation, in some ways the only thing worse than being gouged for credit is being unable to access credit at all. But in a global political economy that structurally disadvantages the Global South, expanding lending through green bonds does little to rectify long standing and ongoing predations of Southern countries through debt.