Dear Mr Ahmed,

My name is Manjeev Puri, and I am a former Ambassador of India to the EU and was Deputy Permanent Representative to the UN. I have a long association with climate change negotiations and am writing to you in that context as I see financing for climate change an absolute imperative that the MDBs must embrace.

Indeed, with capital availability really being in the developed world and its need being acutely in the developing countries, ways and means need to be developed to attract capital from the developed to the developing countries. This certainly includes private capital for which attractiveness of the investment is a must.

At the same time for developing countries, such private capital from the developed world, must be affordable. Here the critical impediment faced is the far higher landed cost of such capital as compared to the borrowing rate. A key issue is managing the foreign exchange costs, including hedging costs, and levelling other attendant developing country risks.

As you deliberate strengthening of the MDBs, I am taking the liberty of forwarding a copy of a piece that has recently appeared in the Indian media regarding creation of an entity or mechanism at the MDBs that would help with Foreign Exchange hedging for private capital flows from developed countries for green projects in developing countries.

It is my view that the World Bank and IMF are best suited to create such an arrangement, given their scale and global operation, and become major players to facilitate private flows for climate projects in the developing countries. Indeed, there are a couple of examples of such facilitation, but their scale remains very small – this is what the WB/IMF can tilt definitively. And, to my mind, run on a large scale and across currencies, such a mechanism can be a relatively low-cost operation with the lower costs passed on to the developing countries.

I am aware that foreign exchange costs are not the only impediments to greening in the developing world, but I believe the creation of such an entity or mechanism would be a practical and doable step by the MDBs which would greatly facilitate private capital flows from the developed to the developing countries to meet the challenges of climate change. I understand that mitigating foreign exchange costs in developing countries have also been identified by the Bridgetown Initiative.

Thanking you and very much hoping that the idea of institutional action at the MDBs for mitigating foreign exchange costs for climate related projects in developing countries will find favour with your group.

Warm regards
Manjeev Puri

My calculations based on the India Human

When surveys occur during this period,

internationally.

Views are personal

Paying for global well-being

Reform of MDBs must ease flow of capital for climate action in developing countries

MANJEEV SINGH PURI

THE G20 HAS set up a high-level committee to suggest reform of multilateral development banks (MDBs) so that they are fit for purpose in the contemporary global scenario. It is co-chaired by N K Singh, former chairman of India's Finance Commission and Larry Summers of Harvard. A good augury is the appointment of Ajay Banga as president of the World Bank. Though best known as the CEO of Mastercard, Banga was schooled in India and is more than au fait with the requirements of the developing world.

Poverty eradication and reduction of inequality has been the mission of the World Bank for years and the need to keep this emphasis has not disappeared, no matter the global gains on these fronts. However, with climate change now clearly recognised as the greatest global challenge, MDBs must rise and help developing countries in their "green" challenge.

Estimates of monies required annually for greening in developing countries (excluding China) are in the region of $2-3 trillion. These are relatively manageable figures given annual global savings, coming mostly in the developed world, of around $20 trillion. But small as these sums may appear in global terms, they are way beyond the domestic capacities (private as well as public sector taken together) of developing countries.

For example, in India, solar and wind energy attracted investments worth $66 billion in the last eight years. But going forward, this requirement will increase manifold, and India will require around $1.15 trillion in the next eight years to realise its climate ambitions — 450 GW of renewables by 2030, including the ancillary infrastructure of transmission and storage, the push for Green Hydrogen and the efforts to increase the share of electric vehicles in annual automobile sales to 30 per cent by 2030, among other initiatives. A total investment of $1.15 trillion is the estimated requirement, with the debt requirement being around $850 billion and equity roughly $300 billion.

Placed in perspective, the $850 billion debt requirement alone equals more than a quarter of the total loan books of all commercial banks in India. Moreover, these requirements will have to compete with other developmental and individual priorities. Other domestic financing routes such as bonds, pension funds and insurance funds have limited prospects for clean-tech segments and are concentrated in high-quality assets, that is, AA+ rated assets. The gap of around 40-60 per cent of the total debt requirement, $350-$500 billion, can only be filled by foreign sources. But here, the scenario in developed countries for governmental support doesn't even appear to be on the horizon. Indeed, no matter the protestations at the UN's annual climate conference, the more than decade back promised $100 billion a year for developing countries remains illusory, let alone a significant increase in this amount.

This leaves little choice but to turn to private capital in the developed world. These funds are available, but green financing for developing countries is not an attractive opportunity for financiers from developed economies. The key issue is the very high landed cost of foreign borrowed capital due to hedging costs and other risks despite the actual cost of borrowing funds in the developed world is relatively low.

Again, taking the India example, the annual cost of rupee-dollar hedging is around 6 per cent. This is significantly higher than the long-term annual rupee depreciation rate of around 3 per cent. Moreover, long-term hedging is not available, as a result leaving projects exposed to currency risk in the medium to long term. The problem is exacerbated if the money borrowed is in a currency other than the US dollar or euro as it requires two-pronged hedging, further increasing the cost of hedging. For example, if a loan is borrowed in yen, hedging is first required between the yen and Indian rupee and then between the rupee and US dollar.

It is here that global MDBs can be particularly instrumental and provide a segue for the flow of private capital in the developed world for green projects in developing countries. This can be done by the creation of an International Foreign Exchange Agency linked to the WB to provide hedging support for foreign exchange borrowings by green projects in developing countries. Large-scale pooling of projects and currencies coupled with reinsurance could, theoretically, self-finance by acting in a manner akin to insurance. Of course, the pricing of the product plus other risks need to be considered, but all in all, such an arrangement should considerably lower the costs of foreign borrowed capital for green projects in the private sector in developing countries. Residual risks could be covered by sovereign support from developed countries, though most of this should be "callable capital" or contingent liability.

The idea of a foreign exchange agency is operational in a small manner between Europe and West Africa. But the requirement is for something on a truly large scale covering several currencies and reaching the largest populations in developing countries. The hedging agency proposal is not a panacea for the massive climate finance needs in developing countries, but it would provide a cover in a significant area (private finance) and, thus, help lower the cost of capital and bridge a critical gap in the efforts to mobilise financing to tackle climate change.

While the G20 committee will focus on several aspects of reforming the MDBs, including capital adequacy and borrowing parameters for MDBs, their governance and the issues of developing countries' debt, climate financing in developing countries also needs to be accorded a high priority. Unlike many other areas of divergence in the present geopolitics, climate change sits well with all the major global economic players allowing for multi-partisan consensus. This must be leveraged at the MDBs with an agency or any other appropriate mechanism taking care of the currency risk. This is a relatively low-cost option for global well-being that could be piloted during India's G20 presidency.

The writer is Distinguished Fellow, TERI and former Ambassador and lead climate negotiator