A New Climate Finance Partnership

Ria Kasliwal & Mihir S Sharma

Observer Research Foundation[1]

Identification of the problem & relevance to the strategic partnership (400):

Climate change is a major focus for the relationship between India and the European Union (EU). Since 2016, India and the EU have been part of a Clean Energy and Climate Partnership[2]. Following the 15th India-EU Summit on July 15, 2020, the political leadership released a joint "roadmap to 2025" for the strategic partnership that emphasised strengthening this partnership and "the preparation of a new work programme". Specifically, the leaders suggested a focus on "mobilising finance and improving the market and investment environment with a view to enhancing sustainable energy access and resilience."[3]

Financing climate-smart infrastructure is indeed a major problem for India. Even before the COVID-19 pandemic hit, the costs of an infrastructure buildout that maintained momentum towards meeting or surpassing India's targets under the Paris agreement were vast. According to Indian government estimates, it would need seven to eight per cent of its GDP to be spent on green infrastructure per year[4]; other authorities, such as the International Finance Corporation, think it might require over $3 trillion[5] in the next decade, an even higher estimate. Figure 1 provides some details of the IFC's estimate.

Yet India's current yearly spending is only a third of what would be needed to hit the IFC target, as shown in Figure 2. Clearly, there is a significant gap here, and one that can and should be addressed in the context of the India-EU climate partnership, in which challenges related to climate change are a core sectoral issue for co-operation.

It is our belief that such co-operation between India and the EU must be specifically focused and targeted on the mobilisation of private capital into sustainable infrastructure in India or the Indo-Pacific more broadly. Any sustained progress towards building climate-sensitive, quality infrastructure will need the participation of private sector capital – especially from

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1 Kasliwal is a Junior Fellow and Sharma is a Senior Fellow at the Observer Research Foundation. New Delhi. This draft policy paper is a submission for the EU-India Think Tanks Twinning Initiative.

2 "EU and India Agree on Clean Energy and Climate Partnership". Climate Action - European Commission. https://ec.europa.eu/clima/news/articles/news_2016033101_en.

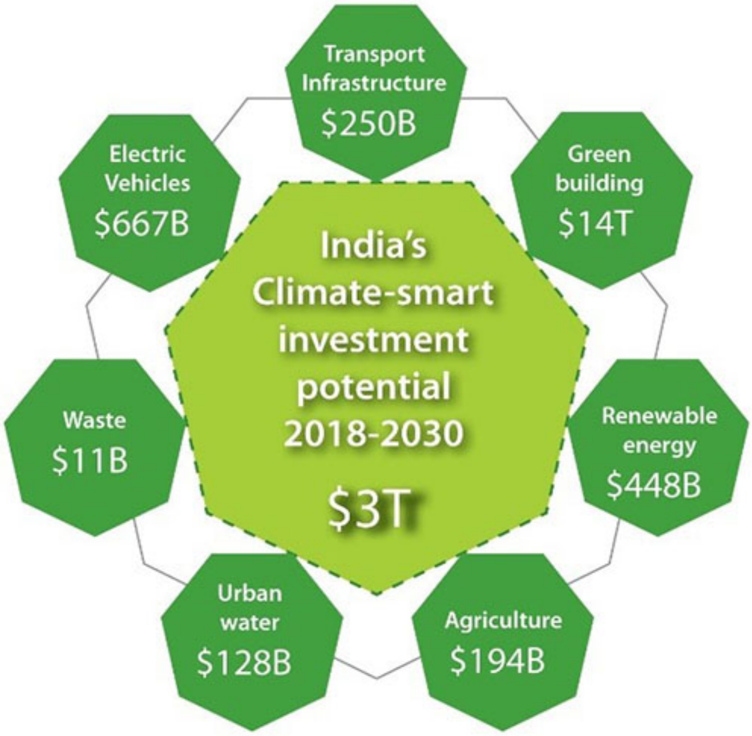
3 "EU and India Agree on Clean Energy and Climate Partnership". Climate Action - European Commission. https://ec.europa.eu/clima/news/articles/news_2016033101_en.

4 "Economic Survey 2018-19". Finance Ministry, Government of India.

5 "Climate Investment Opportunities in South Asia - An IFC Analysis". Ifc.org. https://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/Climate+Business/Resources/FINAL+Climate+Investment+Opportunities+in+South+Asia+-+An+IFC+Analysis.

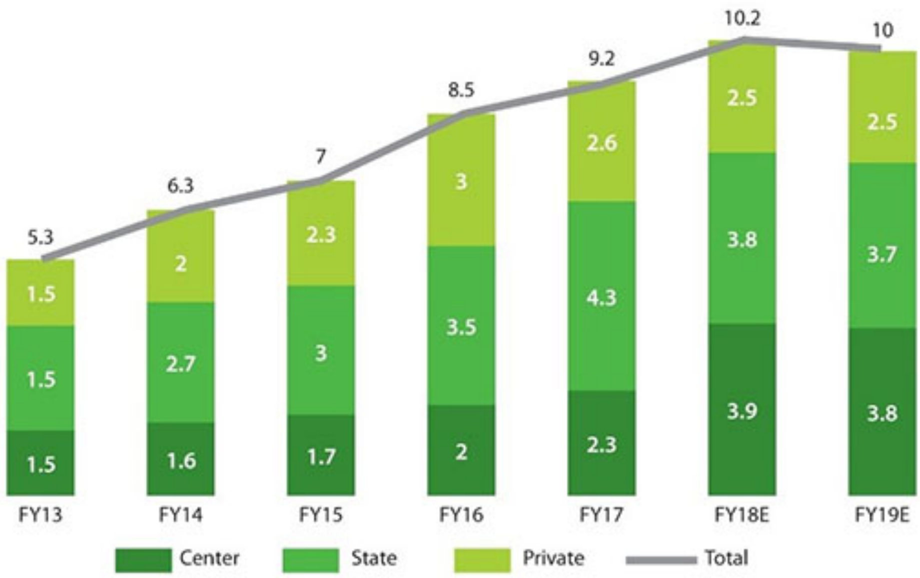
pools of "patient" capital such as pension and insurance funds in the global north, including Europe in particular.

FIGURE 1: India's climate investment potential up to 2030



Source: International Finance Corporation

FIGURE 2: Infrastructure investment in India since 2013



Source: National Infrastructure Pipeline

Critical analysis of the issue (600 words):

1. The world's success achieving the Paris agreement's goals for climate change, as well as on the SDGs, depends most of all upon India's success at paying for and creating resilient, quality climate-sensitive infrastructure over the next decade.

2. India faces capital constraints that have become increasingly tight in recent years. Domestic sources of capital are suffering under a crisis of bank and institutional finance. Local pools of institutional capital are insufficient; government revenue is not keeping up with requirements; and the state faces a problematic choice between financing climate infrastructure and financing the SDGs.

3. Global institutional finance has so far been unable to fill the gap. According to the World Bank, in the six years to 2017, institutional investors did not finance a single infrastructure project in South Asia.[6]

4. Part of this is because of a lack of understanding of the risk profile of such investments, particularly those in emerging "green" areas. This has been expressed by global investors in terms of a demand for a de-risked "project pipeline" of investible opportunities.

5. The Indian government has partly reacted to this by creating a $1.4 trillion infrastructure pipeline for the next five years. However, there remain significant barriers to investment in this area.

6. From the point of view of developed markets, particularly Europe, there is a need to tap into the higher yields and returns available in emerging economies such as India. Too much of Europe's savings are invested in securities that effectively earn zero per cent interest, rendering Europe's citizens significantly poorer in the long run.

7. India's pre-2008 growth and infrastructure boom was financed in large part by European savings through European bank finance. That route has been closed off by post-crisis Basel banking changes, which have had the unfortunate side-effect of shutting down cross-border lending, particularly in infrastructure.[7]

8. Since 2008, the financial and political economy reasons to centre sustainability – both in terms of the Paris targets and in terms of the SDGs – have grown.

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[6] Deblina Saha et al., "Contribution of Institutional Investors: Private Investment in Infrastructure", The World Bank, January 1, 2017, http://documents.worldbank.org/curated/en/674561524549509963/Contributionof-institutional-investors-private-investment-in-infrastructure

[7] Mihir S Sharma, 'The Political Economy of Basel', in *Financing Green Transitions*, ORF, 2019 https://www.orfonline.org/wp-content/uploads/2019/01/ORF_Monograph_Financing-Green-N1.pdf

9. The European Commission in 2018[8] adopted the recommendations of the High-Level Group on Sustainable Finance to directly connect finance with projects that have sustainability as a focus.

10. The various components of this significant shift in EU intentions mostly revolve around the creation of norms and standards for green bonds and labels for financial products, so as to increase transparency in the market for sustainable finance and the incorporation of environment and SDG-related issues into investment managers' risk calculations.

11. This reflects not just a commitment to climate change but the very real demand from member states and the EU's savers. Such demand from Europe for "green finance" that also provides a reasonable return – and it is irrelevant whether this is viewed in terms of the European saver, the investment manager, or the large pension / insurance fund – is vast.

12. The scale of this pent-up demand can be comprehended from reports that the Commission itself believes it could issue green bonds for the first time. According to the *Financial Times*, "Thomas Buberl, chief executive of French insurer Axa, and Pascal Canfin, the head of the European Parliament's environment committee, told the *Financial Times* that €200bn of the €750bn [being raised by the Commission for post-pandemic recovery] should be in the form of green bonds." [9]

13. Hitherto the EU's external action on this front, however, has been mainly through the External Investment Plan, which focuses on Africa and the immediate EU neighbourhood to the south and east.[10]

14. There is thus a significant opportunity to create partnerships between India and the EU on benchmarking, norms and standards for green infrastructure finance, particularly in the period of post-pandemic recovery.

Policy recommendations (500 words):

The creation of a green infrastructure investment partnership must take into account the specific context of the slowdown and the pandemic, as well as the constraints on both the GoI and the EU.

Previous occasions of such a recovery, especially those accompanied by a large stimulus programme, have witnessed large inflows into emerging economies. There is an opportunity

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[8] "Renewed Sustainable Finance Strategy and Implementation of the Action Plan on Financing Sustainable Growth". 2018. European Commission. https://ec.europa.eu/info/publications/sustainable-finance-renewed-strategy_en#action-plan.

[9] Mehreen Khan. "EU Explores Green Bonds As Part Of €750Bn Borrowing Spree". Financial Times, 2020. https://www.ft.com/content/7a893f6d-08c9-426c-8f19-aa19d434b018.

[10] "About the Plan - EU External Investment European Commission". EU External Investment Plan - European Commission. https://ec.europa.eu/eu-external-investment-plan/about-plan_en.

on this occasion to correct mistakes made after 2008, and ensure these inflows are into sustainable, quality-focused sectors and provide a remunerative and transparent return to investors in Europe.

Given that Europe now seeks to lead the world in the development of norms, standards and benchmarks surrounding green finance, and is committed for reasons of both public demand and broader systemic shifts to incentivising private capital into sustainable projects, we make the following four recommendations:

- GoI and EU should facilitate a regular dialogue between Indian and European regulators and legislators, including the Reserve Bank of India, focused on the harmonisation of green financial standards.
- Through workshops and exchanges under EU auspices, relevant personnel associated with the Indian securities market regulator SEBI and the two largest Indian stock exchanges should be sensitised to the new and emerging trends in sustainability disclosures that emerging from Europe in particular. The EU Sustainability-Related Disclosure Regulation takes effect from March 10, 2021.[11] As India moves piecemeal towards creating its own sustainable finance model, it should seek to ensure minimal differences with existing European standards so as to ensure the smooth flow of capital across geographies.
- In 2019, India became a part of the EU-founded International Platform on Sustainable Finance, or IPSF, which is meant to "scale up the mobilisation of private capital towards environmentally sustainable investments".[12] Thus a suitable multilateral location for such exchanges of information between regulators already exists, but it needs to operationalised at a bilateral level.
- Issuance of green bonds and the preparation of climate-sensitive projects cannot and must not happen only at the level of the Union government in India. The European Commission must set up an exploratory project to find ways to create capacity in states and municipalities to prepare world-class sustainable projects that would be of interest to European investors. The "technical assistance" component[13] of the External Assistance Plan does not apply to India, but there are useful learnings that can be applied to increase effectiveness at the capacity-constrained levels of the Indian government.

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[11] "Sustainability-Related Disclosure in the Financial Services Sector". European Commission. https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/investor-disclosures-climate-related-information_en.

[12] "International Platform on Sustainable Finance". European Commission. https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/international-platform-sustainable-finance_en.

[13] "How It Works - Expertise EU External Investment Plan European Commission". EU External Investment Plan - European Commission. https://ec.europa.eu/eu-external-investment-plan/about-plan/how-it-works-expertise_en.

Europe's efforts and its leadership in the setting of ESG and sustainable finance norms cannot be allowed to go to waste as India's nascent green finance sector develops. Co-operation at every level will need to be sustained and supported in order to create a harmonisation of norms and regulations that reflects the underlying consonance of Indian and European values.