ENERGY FOR ALL

Are stars aligning for clean energy financing?

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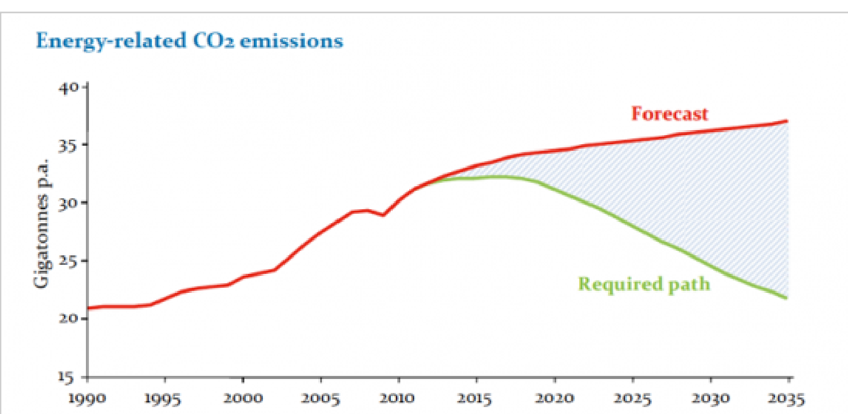
How sovereign and hybrid funds may help address climate change

One of the biggest bangs at the opening day of the Paris COP21 climate summit was without doubt the dual financing announcements by the Breakthrough Energy Coalition, led by Bill Gates and other high-net-worth individuals, and the Mission Innovation, whose signatory governments have committed to doubling their allocations to clean energy research. The two initiatives aim to increase financing for clean energy innovation, from the basic research stage, funded by governments, to commercialization of promising new technologies—with venture financing provided by private investors.

In developing countries, where many households and companies have very limited access to energy, new clean energy technologies will serve the dual purpose of expanding energy access and constraining carbon emissions. For this to happen, innovative thinking will be needed not only in the development of new technology, but also in financing the deployment of these technologies.

The two initiatives announced in Paris reflect the realization that carbon dioxide emissions would continue to rise even if every commitment to cut carbon emissions were fulfilled. By 2035, the concentration of carbon in the atmosphere will already exceed the estimated levels required to maintain the internationally agreed 2 degrees Celsius limit. The development of new technologies will increase the options available to efficiently address climate change.



Leveraging to bridge the technology finance gap

Mission Innovation and the Breakthrough Energy Coalition aim to address the technology finance gap. Even if these initiatives turn out to be highly successful, the challenge still remains of substantially scaling up financing for the deployment of clean energy technologies, including in developing countries. Pooling public funding and leveraging it with private sector capital could increase the uptake of existing and new clean energy technologies.

Indeed a new trend is emerging in the deployment of public capital: an increasing number of governments are considering the use of investment structures that combine public and private capital, mainly for the purpose of infrastructure investment and venture financing for young firms. This trend has been underpinned by shrinking government budgets since the 2008 financial crisis, a persistent infrastructure financing gap, and a realization that the active involvement of private capital is critical for the achievement of national development goals.

Climate-smart sovereign and hybrid investors

Global public funds are a convenient way to pool individual countries' resources for the common purpose of addressing climate change. But multilateral funds' resources are insufficient to meet countries' needs for clean energy investment. Could national or regional government-owned strategic investment funds, or public-private "hybrid" funds, also become important actors in financing the deployment of climate-smart energy?

Public-private "hybrid" funds could be another possible investment vehicle to support or fast-track the uptake of climate-smart energy infrastructure. These funds manage pools of combined public and private capital, and may offer a variety of investor return-enhancing mechanisms, including differential timing of investment draw-downs of public and private investors, leveraging the returns of private investors with publicly provided debt, capping the profit entitlement of the public investor, and partial guarantee of compensation to the private investor for loss of invested capital.

A central issue for publicly owned or capitalized funds is the independence of investment decisions from political pressures. In "hybrid" funds, investment decisions are left in the hands of a private general partner, with countries participating as limited partners. The capital of strategic investment funds and sovereign wealth funds may be managed internally and/or externally, subject to governance and transparency requirements, as well as market-based checks and balances including co-investment and partnership arrangements.

A new way to address climate change

Climate change has already generated a considerable amount of financial innovation, notably emissions trading and green bonds. Following the lead from Paris, this innovation must continue. Sovereign and hybrid funds may have a significant role to play in the provision of truly patient capital for clean energy infrastructure.

More about Investment Funds at the World Bank Group.

This blog post also appeared in the EconoMonitor. The blog post is an excerpt of an article in the Winter 2015-2016 edition of Capital Finance International.

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SUBMITTED BY JYOTIRAM ON MON, 01/18/2016 - 14:27

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