Asia has a lot more catching up to do in green investments

Asia may have made headway in channeling investments into green projects, but it needs $26.2 trillion between 2016 and 2030 or $1.7 trillion annually to finance sustainable and climate-resilient infrastructure. Southeast Asia alone needs an estimated $110 billion annually for investment in power, transport, information and communication technology, and water and sanitation through 2025.

Asia has a lot more catching up to do than other regions. In 2016, green investments in Asia, excluding Japan, totaled $52 billion, accounting for only 0.8% of all funds under management in the region. This pales in comparison with 52.6% in Europe, 50.6% in Australia and New Zealand, 37.8% in Canada, and 21.6% in the United States.

To bridge the gap, Asia needs to green its financial system and encourage more investments in sustainable projects. It has to do something about weaknesses and failures within the financial system that are hampering its ability to respond to risk and to opportunities for viable, resilient investments. It also needs to strengthen enforcement of environmental regulations and phase out fossil-fuel subsidies.

Asia is not starting from scratch.

A number of countries are already at the forefront of introducing sustainable-finance guidelines and regulations. Bangladesh; the People's Republic of China; Hong Kong, China; India; Indonesia; Japan; Mongolia; Singapore; and Viet Nam have already taken steps to align the financial system or parts of it with sustainable development. Cambodia, the Lao People's Democratic Republic, Nepal, Pakistan, the Philippines, Sri Lanka, and Thailand are working on green-finance policies.

Some countries have also introduced innovations. In China, for instance, the Shanghai Stock Exchange launched an index in 2013 that tracks the stocks of companies with sustainable business practices. The following year, Malaysia's stock exchange launched an index that tracks companies with strong environmental, social, and governance practices. Indonesia was the first Southeast Asian country to launch a green index when it started the Social and Responsible Investment index in 2009.

Developments in Asia's green-bond market have been encouraging in the last few years, thanks to bond issuances from China, the Republic of Korea, India, Singapore, and Japan, among others. Demand for green bonds has grown among institutional investors such as pension funds and insurance companies after efforts were made to standardize how the bonds are labelled, specifying what constitutes green projects and activities. The creation of green-bond indexes by banks and rating agencies in 2014 also attracted institutional investors to green bonds.

Efforts to promote green lending in Asia have also increased, with China and Bangladesh the notable pioneers. Green lending has increased substantially in China, rising to 7.5 trillion renminbi in 2016, from 341 billion renminbi in 2007. In 2017, 21 Chinese banks reported more than 8.2 trillion renminbi in lending to green projects.

While all this is encouraging, challenges remain:

- Lack of awareness that environmental and climate risks can pose a threat to the financial sustainability of single projects or firms as well as entire industries. These risks can also cause problems for individual lenders and investors or even constitute a systemic risk to the entire financial sector.
- Lack of staff with training to assess environmental and climate risk and with experience in green lending, for example for renewable-energy projects.
- Shortage of bankable and investment-worthy projects.
- Lack of or insufficient disclosure requirements that protect against environmental or long-term systemic risk.

There is no easy fix. Financing sustainable infrastructure requires new approaches to mobilizing and managing long-term finance. Integrating environmental and social considerations into lending and product design is only the first step in creating a green economy. Funding energy efficiency, renewable energy, and sustainable infrastructure requires new concepts and new financial instruments adapted to local circumstances. Green banks, green bonds, and appropriate regulatory frameworks need to be introduced and coordinated. Climate-risk insurance is needed to protect the vulnerable from extreme weather events. Such instruments are needed, particularly for agriculture, in many developing countries in Asia.

How can countries align the financial system with sustainability?

- Raise awareness among financial regulators and market participants of environmental and climate risks.
- Train people in the financial industry to analyze and manage environmental risk by building and sharing knowledge.
- Train them to develop sustainable financing practices and new lending instruments to finance sustainable projects such as renewable energy.
- Increase transparency through environmental, social, and governance disclosure requirements.
- Provide incentives to banks and non-bank financing institutions to fund green projects.
- Support the development of new market segments such as the green-bond market or climate-risk insurance.
- Develop long-term, local-currency refinancing sources for banks to enable them to extend long-term credit.

All domestic stakeholders must talk to each other. Public financial institutions, including central banks, development banks, and public pension funds, should help develop and promote the adoption of green financial products. International initiatives and networks pushing for green investments and financing can help to share experiences and develop best practice.

The path to becoming a low-carbon economy is riddled with challenges. To succeed, aligning the financial sector with sustainable development is key.

This episode is based on [research] done for ADBI by Ulrich Volz, head of the Department of Economics at SOAS, University of London.

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