Sovereign ESG bonds in the global south:

10 questions for those concerned about debt and climate justice

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November 2023
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Executive summary

The past few years have seen a surge in interest in ethically labelled bonds for southern countries. This includes so-called ‘green’ and ‘social bonds’ and derivatives, including ‘sustainability-linked bonds’ and ‘blue bonds’, now being heavily promoted for small island developing states (SIDS). In the past five years, at least 22 countries in the global south have issued sovereign environmental, social and governance (ESG) bonds, raising well over US$60 billion. Most international organisations view this as a positive development, and the expansion of ESG bonds is now a common recommendation made in international meetings and agreements on climate and biodiversity.

This report, therefore, offers a succinct introduction to sovereign ESG bonds and explores some of the limitations and risks around the push for ESG financing as a way for global south countries to close the financing gap for Sustainable Development Goals (SDGs) and climate action. It is organised into 10 basic questions. The answers to these demonstrate not only the complexity of the ESG bond market but also point to several problems with its expansion. Indeed, the enthusiasm for ESG bonds reflects a highly questionable ideology that promotes private finance as the optimal solution to our multiple global crises.

This paper aims to serve as a basis for further discussions, particularly within civil society, in order to be able to define a well-informed and strategic position. Ultimately, the paper will help Eurodad, civil society allies and policymakers define future actions towards mainstream narratives and public support for expanding ESG financing for global south countries.

Rapid evolution of ESG sovereign bonds

The growing market in green bonds, first issued in 2007/8, has inspired various ‘ethically’ labelled bonds, such as gender, blue and SDG bonds. Recent innovations in the so-called environmental, social and governance (ESG) bond market include bonds where investors are given higher rates of return if issuers fail to meet key performance indicators, commonly called ‘sustainability-linked bonds’. ESG bonds do not have an agreed formal and functional definition.

Inadequate voluntary guidelines for ESG bonds

International regulations for ESG bonds are based on voluntary guidelines and principles, with those provided by the International Capital Markets Association (ICMA) being the most influential. However, the inadequacies of these have motivated the European Union to develop an EU Green Bond Standard, although it is unlikely governments outside the EU will use this. The voluntary nature of ESG bond labelling means that any issuer can declare their bonds ESG-labelled. However, for most ESG bonds, an external evaluator is employed. Companies that offer these evaluations provide differing methodologies and grading systems, and these have been subject to multiple revisions. Traditional credit rating agencies headquartered in the US have also taken over the businesses of rating and evaluating ESG bonds.

ESG sovereign bonds trends in the global south

Over the past five years, while sovereign ESG bonds have become more prevalent in the global south, few lower-income countries have entered the market. This likely reflects the increasing difficulties such countries face in borrowing from international capital markets due to their deteriorating financial situations and poor credit ratings. Most ESG bonds issued by developing countries have been classified as social or sustainability bonds. Most have been issued in foreign currencies and are targeted at foreign investors.
Donor strategies to advance ESG bonds
The expansion of sovereign ESG bonds for global south countries, particularly for SIDS, is now high on the agenda of international development organisations, including the World Bank, the United Nations and the European Union, and most bilateral donors. Collectively, they provide various forms of financial and technical assistance to southern governments to issue ESG bonds, making these financial instruments an emerging area for blended aid and public–private partnerships (PPPs). A range of mechanisms are being used by international financial institutions (IFIs) to ‘de-risk’ ESG bonds for developing countries and crowd-in investors, including credit guarantees, technical support, provision of direct subsidies, cost coverage of issuing ESG bonds, design of bankable projects and the provision of independent analysis, as well as verification reports on projects for investors.

The rise of sustainability-linked bonds
While issuing traditional ‘use of proceeds’ sovereign ESG bonds has not taken off in global south countries, sustainability-linked bonds (SLBs) are gaining more interest, being viewed as more appropriate for lower-income countries. Unlike the use-of-proceeds bonds, capital raised through SLBs does not need to be ringfenced for ESG spending and can be used for refinancing existing debt. SLBs also offer a way to address the lack of investor confidence in the ability of governments to deliver on ESG promises, as they come with clearly defined and measured key performance indicators and financial penalties for non-delivery.

The missing ‘greenium’ in sovereign ESG bonds
A claim made for ESG bonds is that they can provide issuers with preferential and cheaper access to capital, which is referred to as a ‘greenium’. However, evidence for this is weak. Generally, southern countries can expect to pay interest rates on ESG-themed bonds similar to those they pay for other non-themed bonds. Interest rates are, therefore, largely dependent on international credit ratings. This makes ESG bonds expensive debt for the least developed countries and SIDS.

Greenwashing: a major issue in ESG bonds
ESG bonds are widely discredited because of greenwashing. Accountability mechanisms, including external evaluations and impact reports, offer limited assurances. ESG bonds that link dividends to the delivery of specific environmental or social targets are considered by some to address greenwashing. However, these performance-based bonds have their weaknesses and are unlikely to be effective. It is also morally dubious to reward investors for the failures of southern countries to meet environmental or social targets.

A (failed) transparency claim
In theory, ESG bonds are better than normal sovereign Eurobonds regarding transparency. However, public access to information on ESG bonds and the use of resulting proceeds is limited. Public participation in deciding the purpose of ESG bonds – including among those most affected by them – is absent from international guidelines and is overlooked by international development organisations.
ESG bonds as fuel to the debt fire
ESG bonds are often referred to as ‘sustainable debt’. However, sovereign borrowing through ESG bonds is usually raised in foreign currency and close to, if not at, commercial lending rates. Inevitably, the expansion of the ESG markets in the global south will come with risks of worsening the debt vulnerabilities in these countries. In addition, and given the extent of the greenwashing problem, there is also the risk that the use of proceeds does not result in the promised ‘sustainable growth’, limiting the possibilities that governments can increase revenue and, therefore, pay back investors without incurring public spending cuts.

ESG bonds as a magic wand for the ‘financing gap’
Sovereign ESG bonds can be understood as the cause and effect of a superficial narrative that equates social and environmental problems with a lack of finance. This falsely equates things such as biodiversity loss and unsustainable natural resource management with poverty in southern countries, as opposed to affluence and the behaviours of external organisations and global finance. A considerable risk of ESG bonds, therefore, is to divert attention from the cultural and political changes needed to achieve a more sustainable and just society. At the same time, they may also operate as a convenient distraction for policies urgently needed to tackle the unjust and unsustainable transfer of wealth from the south to the north.
Introduction

Since the financial crisis of 2008, an innovation in financial markets has been ethical labels for financial bonds. That was started via the concept of a ‘green bond’, which inspired many others, including those linked to the delivery of social objectives, such as gender equality. A common term to refer to all these is environmental, social and governance bonds, or ESG bonds. The global market in these has grown rapidly over the past decade, hitting a record of about US$1 trillion of new issues in 2021.

The growth of ESG bonds was led by multilateral development banks, but most are now issued by the private sector and predominantly in the US, Europe and China. However, the ESG bond market has been widely promoted as an opportunity for raising capital by governments in the global south. The primary rationale is that these bonds will help bridge a substantial funding gap to meet global targets on climate, biodiversity and the Sustainable Development Goals (SDGs). According to this view, other funding sources, such as concessional finance and aid, are considered insufficient, with limited prospects for growth.\(^1\)

However, the funding gap is not the only justification for developing countries raising ESG bonds: increasing private finance for development is now mainstreamed in the strategies of international development organisations, which reflects an ideology that promotes the efficiency of ‘the market’ for driving growth.\(^2\) As such, international development agencies, with the World Bank being the most powerful, aim to facilitate the expansion of global financial flows in developing countries, mainly by de-risking private investment with public resources. Daniela Gabor aptly refers to this ideology as the ‘Wall Street Consensus’.\(^3\)

Despite the weight of global advocacy, ESG bonds issued by the governments of southern countries have been slow to take off. The government of Fiji was the pioneer when in 2017 it issued a green bond for US$50 million, which was shortly followed by a green bond worth US$29 million from the government of Nigeria. However, it was not until the global pandemic that sovereign ESG bonds from countries in the south gained momentum.

The author’s list, covering 2017 to early 2023 (attached as an annex), suggests that at least 21 global south countries had issued sovereign ESG bonds, raising approximately US$64 billion. While that might seem an impressive amount, it is still a small portion of the borrowing of developing countries. Furthermore, sovereign ESG bonds have been concentrated among middle- and high-income countries. Very few lower-income countries and small island developing states (SIDS) have entered the market.

A key question now is whether the growth in sovereign ESG bonds will continue and, if so, whether it will become more prominent among a broader range of global south countries. Many organisations argue it should, and there are intensifying efforts to make this happen. However, a hindrance is the enormity of the present debt crisis. For many countries, their precarious economic situation and high levels of debt distress mean that further borrowing from international capital markets is increasingly difficult. SIDS are particularly precarious, given that many have been classified as middle-income countries and are therefore ineligible for concessional finance.\(^4\) Still, equally, they are among the ‘riskiest’ countries for private capital investments and experience the highest borrowing rates on financial markets. It is, therefore, reasonable to believe that the further growth of ESG bonds might be limited, and the pressure for alternatives will grow.
Alternatively, the debt crisis may stimulate innovative ways of ‘de-risking’ ESG bonds, making them more attractive to investors and developing country governments. One way this is already happening is through ‘performance-based ESG bonds’, which some recommend could be used as part of debt restructuring strategies. There is also an added complexity in the sovereign ESG bond market caused by the recent development of ESG bonds used to finance ‘debt swaps’, as seen in the ‘blue bonds’ of Belize, Barbados, Ecuador and Gabon.

In this uncertain context, this briefing covers 10 questions about the sovereign ESG bond market from the perspective of countries in the global south and SIDS. Several of the questions remain poorly researched and difficult to answer. Therefore, this brief aims to increase knowledge about these financial instruments and stimulate further research and analysis, particularly among organisations working on the intersection between debt, the climate crisis and biodiversity conservation. As will be explained, although there are elements of ESG bonds that might be viewed as positive (at least in comparison to standard non-labelled bonds), there are strong reasons why resisting the spread of sovereign ESG bonds aligns with campaigns on debt and climate justice, as well as those opposing the further financialisation of development.

**Question 1. What are sovereign ESG bonds and how has the market evolved?**

The origin of ESG bonds can be traced to 2007, when the European Investment Bank (EIB) launched the first bond with an environmental theme. This was named the ‘Climate Awareness Bond’, with the funds dedicated to renewable energy and energy efficiency projects. Subsequently, the EIB declared this to be the world’s first ‘green bond’. As described by the EIB, the importance of this was not simply in the choice of projects it funded but also in the commitment it made to report on the use of the bond’s proceeds according to environmental impacts. Based on a proposal by Swedish pension funds, the World Bank followed in 2008 with its first green bond, issued in Swedish kronor, marketed to investors as a loan where the proceeds would be used solely for advancing projects to lower emissions and mitigate climate change in developing countries.

The move by the World Bank and the EIB to introduce the concept of a green bond proved inspiring. Other bond issuers, including other development banks, followed their lead. In 2013, the International Finance Corporation (IFC) issued the world’s first ‘billion-dollar green bond’, followed by the world’s first green bond issued by a corporation, Vasakronan, a Swedish property developer. This opened a flood of corporate green bonds in Europe, the USA and then China. The government of Poland was the first to issue a sovereign green bond, in 2016. Thus, by the mid-2010s, the global green bond market had spread to bonds issued at multiple scales, involving multilateral lenders, national governments, subnational authorities and the corporate sector.
The market in green bonds has led to various novelties and spinoffs among bond issuers and investors. This has resulted in a complex landscape of financial instruments, subject to confusing and variable terminology. To simplify, the concept of a green bond has developed in four main directions:

- First, although the loose definition of green bonds appears to encapsulate various environmentally positive themes, the market has been characterised by specialisation and differentiation. This has resulted in bonds labelled for specific sectors or thematic issues. This includes, for instance, ‘climate bonds’, ‘forest bonds’, ‘blue bonds’, ‘wildlife bonds’ and so on. This process will likely continue as bonds become targeted at a wider range of niche issues that interest investors.

- Second, the green bond label has inspired bonds to be issued for other ethical spending, such as on health or poverty reduction. Thus, the green bond market has stimulated the creation of a ‘social bond market’. This has also followed the path of its own specialisations, with distinct bonds labelled for things such as gender equality outcomes (hence ‘gender bonds’), as well as pandemic bonds and ‘fight Covid-19 bonds’. The social bond market has also inspired ‘Sustainable Development Goal’ bonds, which are marketed to deliver on some or multiple pledges of the SDGs.

- Third, there have been innovations in the way bonds are structured. The original green social bonds were so-called ‘use of proceeds’ bonds, where the bond issuer is committed to using all or part of the capital for spending on projects that will have environmentally (or socially) positive outcomes. However, over the past few years, bond issuers have created a new asset class in ‘performance-based’ bonds. The primary difference with these is that they provide investors with variable rates of return, depending on the extent to which the use of proceeds meets pre-defined targets. A failure to meet these key performance targets results in investors receiving a higher rate of return (a step up in coupon payments). There are, however, variances in how performance-based bonds work. The World Bank is pioneering a model (through ‘rhino bonds’ and ‘wildlife conservation bonds’) that sees investors paid a premium when an environmental target is met. According to research by Bloomberg, in 2020, the total value of performance-based bonds was US$9 billion. By 2021, the total value had risen to over US$100 billion, roughly 10 per cent of the total value of all ESG bonds issued that year. Performance-based bonds are similar to social and development impact bonds, pioneered by the UK and now used in many countries in the world, although these are used for specific projects and not at a national scale.

- Finally, the green bond market has innovated to create ‘transition bonds’. The concept was developed for companies that could not meet the requirements of a green bond, particularly those companies with a high carbon footprint. Therefore, the idea of a transition bond was to allow companies to raise money for spending that helps them move towards becoming a greener business. There has yet to be a transition bond applied to the social bond market but, given the imagination of financial institutions, that remains a possibility.
Question 2. How is the international market in ESG bonds regulated?

ESG bonds are regulated through voluntary standards. The development of these standards has been reactive to market developments: bond issuers have created new themed bonds, and voluntary standards that seek to formalise procedures and categories of bonds have followed thereafter. An early mover was the Climate Bond Initiative (CBI), set up in 2010 in the UK, which provides an 'eco-label' for bond issuers. As the market in environmentally themed bonds has proliferated, the CBI has created dedicated certificates for 17 subsectors and, according to the CBI, the list will continue to grow. An estimated 17 per cent of all ESG bonds pay for the CBI label, although few governments have used it for sovereign bonds.

However, the most important development was led by the World Bank. In 2012 it established a multistakeholder process tasked with producing principles to which green bonds should meet to ensure credible labelling. The resulting multistakeholder dialogue, primarily involving investment banks and asset managers, produced the Green Bond Principles in 2014. The International Capital Market Association (ICMA), an organisation based in Switzerland that provides policies and guidelines for managing financial markets, was chosen as the secretariat for this.

A key characteristic of the ICMA principle for green bonds is a reluctance to define what green means. The ICMA principles do provide examples of appropriate objectives for green bonds but these remain illustrative only. Instead, the ICMA principles emphasise processes for issuing a labelled bond. These include:

- that the proceeds of the green bond should be reserved entirely for green spending.
- that issuers provide investors with clear information on how the proceeds will be used.
- that the proceeds of the bonds should be held in a separate or clearly visible account.
- that there is reporting on the environmental impact of the bond.

To keep pace with innovations in bond markets, the ICMA has produced ‘guidelines’ for issuing different types of bonds, and then more formal ‘principles’ for three other categories. The second principle it produced was for ‘social bonds’, followed by those for ‘sustainability bonds’, defined as bonds that have both environmental and social objectives. A fourth principle was developed in 2021 for performance-based bonds, now known as ‘sustainability-linked bonds’ (SLBs).

For now, these four categories are widely used as the overarching system for defining the ethical bond market. Most sovereign ESG bonds issued by developing countries are marketed as compliant with them. However, the ICMA is likely to produce further guidelines. For example, it published a report in 2020 entitled The Climate Transition Finance Handbook, which suggested transition bonds as a viable option for companies. Although this handbook did not represent principles for issuers, its text encouraged issuers to refer to it when issuing transition bonds, so it is heading in that direction. Others have continued to promote these bonds, including the Bank of England in its proposal for climate finance ahead of COP26.

Another development is the rising popularity of ‘blue bonds’ – which are targeted at ocean conservation. Again, the World Bank has pioneered these, having helped the Seychelles launch the world’s first blue bond in 2018. According to the ICMA standards, these are treated by some organisations as a form of a green bond. However, others consider them to be a subset of sustainability bonds.
Several international organisations, including the World Bank and its IFC branch, the United Nations Food and Agriculture Organization, United Nations Environment Programme Finance Initiative (UNEP FI), the UN Global Compact and the Asian Development Bank (ADB), have produced guidelines for issuing blue bonds. However, each has adopted slightly different definitions and criteria. The most detailed guide on *Bonds to Finance the Sustainable Blue Economy* was recently produced in September 2023 by the ICMA together with the IFC, the UN Global Compact, the UNEP and the ADB.

There has also been a growth in the issue of ‘gender bonds’. For the time being these are treated as a subset of social bonds. However, international efforts to establish guidelines for gender-based bonds have been launched. In 2021, UN Women, the IFC and the ICMA published their guide to integrating gender bonds into sustainability bonds, while the ASEAN Low Carbon Energy Programme, supported by the UK government, produced something similar. Whether the ICMA will produce a gender bond principle remains a possibility.

**How are ESG bonds verified?**

Because of the voluntary nature of ESG bonds, any issuer can declare its bonds to be ESG-labelled. However, for most ESG bonds, an external evaluator is employed to produce an independent report that demonstrates the bond meets a standard, usually that set by the ICMA. Three research institutes have gained an international reputation for being able to provide these so-called ‘second opinions’: the Center for International Climate and Environmental Research (CICERO) in Oslo; Sustainalytics, headquartered in Amsterdam; and Vigeo Eiris, headquartered in Paris. These are not the only firms offering second opinions but they have captured a large portion of the market. Most sovereign ESG bonds issued by developing countries have used one of these three firms for external evaluation.

Each of these companies provides differing methodologies and grading systems, and these have been subject to multiple revisions. CICERO, for instance, has developed a ‘shades of green’ methodology, with dark green being the best outcome of three options and light green being the worst, but acceptable. Sustainalytics provides risk assessments across multiple criteria, scored from negligible to severe. Vigeo Eiris offers something similar, with a scoring system from weak to advanced.

As the market in ESG bonds has increased, traditional credit rating agencies headquartered in the United States have taken over these businesses. Moody’s acquired Vigeo Eiris in 2019, Sustainalytics was fully taken over by Morningstar in 2021, and S&P Global Ratings acquired CICERO in December 2022. Thus, the organisations producing independent assessments of the credibility of ESG bonds are the same ones that provide credit ratings that determine interest rate payments to investors.

**The EU’s Green Bond Standard**

Although the ICMA is the most important and influential international standard for ESG bonds, many others exist. Several countries are developing their national standards for ESG bonds, primarily for domestic bonds in local currencies issued by the government, national banks, municipalities and corporations. Examples of developing countries producing their own standards include China, Japan, Nigeria, South Africa, Indonesia and India. Although an evaluation of these standards will not be done here, some have been criticised for allowing too much flexibility on what can be included. International pressure for revisions has meant most now follow the ICMA principles.
However, the most significant new standard has been developed by the European Union (EU). This is embedded in a range of policies to promote the EU's Green New Deal. A key activity linked to this has been the development of the EU Taxonomy for Sustainable Investing, which came into force in 2020. This classifies types of investing that are sustainable, and it offers some clarity on what should be excluded from this list, although several subsectors, such as agriculture and aviation, are yet to be integrated into the regulation. The Taxonomy Regulation requires mandatory reporting by companies (above a threshold) on the proportion of their activities that are aligned with the taxonomy.

The development of the Taxonomy Regulation was handed to the EU's High-Level Expert Group on Sustainable Finance, formed in 2016. Following the conclusion of the taxonomy, this group produced a proposal for an EU Green Bond Standard in 2021. At the time of writing, the final text for the EU Green Bond Regulation has been produced by the European Commission and recently approved by the European Parliament (5 October 2023) and Council (23 October 2023). This regulation aims to create a European Green Bond label that aligns bonds with the EU Taxonomy Regulation and requires more detailed public disclosure than those required by the ICMA. There will be a stronger oversight role provided by the European Securities and Markets Authority, and the regulation allows European member states to fine bond issuers for fraud in the use of the label. These provisions are intended to prevent greenwashing. Nevertheless, the regulation is highly complex and includes several elements that allow flexibility. It is a voluntary initiative and therefore it is difficult to predict how many issuers will use this instead of the less burdensome ICMA principles.

The EU Green Bond Regulation explicitly encourages non-EU sovereigns to issue EU Green Bonds. However, it also prohibits countries from doing so if they are identified on the list of countries that are not cooperating with the EU on tax purposes and those listed by the EC as ‘high-risk’ countries for money laundering and the financing of terror. Many SIDS are included on this list, as are countries in sub-Saharan Africa and Central and Southern America.

**Question 3. What are the trends in sovereign ESG bonds issued from developing countries and SIDS?**

International support for the launch of green bonds culminated in 2017 in the first sovereign green bond issued by a developing country. This was a green bond, valued at US$50 million, issued by the government of Fiji. That was an outcome of a three-year ‘capital markets development project’ funded by the Australian government and technical and financial support from the World Bank. Documentation on how this deal was finalised suggests it was treated as a proof-of-concept, with the launch of the green bond timed to coincide with Fiji’s role as the president of COP23. Fiji’s green bond was also listed on the London Stock Exchange. However, as it was issued in the local currency, this was most likely for publicity only: no foreign investors bought notes in the green bond, and the issue was entirely financed through national investors in Fiji.

In 2018, the World Bank assisted the Seychelles to launch another proof-of-concept bond: the world’s first blue bond, which raised US$15 million for ocean conservation spending. In this case, the World Bank preidentified three international investors and the Seychelles bond was not made available to others. The World Bank also supported the bond through a credit guarantee and a grant of US$5 million from the Global Environment Facility (GEF) to cover part of the cost of repaying the bond.
However, that year’s breakthrough was the launch of Indonesia’s first green sukuk bond, valued at US$1.25 billion, followed by a second issue the following year of US$750 million. This was facilitated by technical and financial support from the United Nations Development Programme and the ADB. As a result, Indonesia became the global example of the scale of borrowing that could be achieved. In this case, the green bond was issued in US dollars and was primarily bought by international asset management firms.

Since then, according to the preliminary research undertaken for this briefing (up until March 2023), at least 21 global south countries have issued their first ESG bond, with the total value of these being approximately US$64 billion (see the annex). Chile has been the most active in the ESG bond market, having issued 25 separate ESG bonds, accounting for roughly half of the value of all sovereign ESG bonds from developing countries.

Beyond the overall growth in issues, several other notable aspects are useful for understanding trends in the development of sovereign ESG bonds from developing countries:

- Although green bonds have tended to gain the most attention from an international perspective, the majority of ESG bonds issued by developing countries have been classified as social or sustainability bonds. Less than 15 per cent of the funds raised through ESG bonds issued by developing countries have been for green spending (see the annex). Sustainability bonds are the most popular, accounting for roughly half of all the issues. The reason that these have become more popular is not well documented. However, governments may have used bonds to cover health-related spending due to the Covid-19 pandemic. Ultimately, the popularity of sustainability bonds suggests national governments prefer financing that targets a wide range of project spending beyond the focus of environmental themes.

- Most sovereign ESG bonds have been issued in foreign currencies and are targeted at foreign investors. Larger countries with more developed national financial sectors, such as Malaysia, Thailand and Colombia, are the only ones that have issued substantial local currency bonds.

- ESG bonds have been issued primarily by countries from outside of the group of least developed countries. Benin is the only example of a country classified as least developed that has issued a sovereign ESG bond. It issued a SGB in 2021 that raised €500 million, with support from the IMF and the UNDP.

- Finally, most of the ESG bonds issued by developing countries have been verified by one of the three third-party companies providing second opinions. All these ESG bonds are aligned with the ICMA principles. There are, however, some exceptions. Most notably, all the ‘blue bonds’ have been issued without second opinions, and none of them has been aligned with international standards. Indeed, although these are widely reported as examples of ESG bonds, that appears contentious. In the cases of Belize, Barbados and Ecuador, blue bonds were issued through the Credit Suisse Bank, but the money raised was used to finance a debt buyback scheme, with part of the saving from these transactions used for marine conservation spending. The blue bonds would therefore not meet the requirements of the ICMA principles for green, social and sustainability bonds, which necessitates the use of proceeds to be entirely spent on green or social spending.
Question 4. What strategies are used by donors in advancing sovereign ESG bonds?

The progress among developing countries in issuing ESG bonds has been the result of considerable efforts by multilateral development banks (MDBs) and international development agencies. Consequently, there has been a vast array of conferences and workshops devoted to raising awareness among developing national governments and there have been many programmes delivered by multilateral and bilateral organisations to provide technical and financial support for governments issuing their first ESG bonds. Among the leaders of this work have been the World Bank, regional MDBs, several agencies of the United Nations (FAO, UNEP, UNDP), the EU and the OECD. The World Bank, for example, has established a dedicated unit for ‘Sustainable Finance and ESG Advisory Services’. At the same time, the UNEP has a similar Finance Initiative department, which runs regular workshops and training events for governments in issuing ESG bonds. Numerous reports have also been written to help developing countries launch ESG bonds, such as the IMF’s Guidance Note for Sovereign Debt Managers and the OECD’s report on Scaling Up Green, Social, Sustainability and Sustainability-Linked Bonds in Developing Countries. However, it is useful to understand the range of mechanisms now used to ‘de-risk’ ESG bonds for developing countries and crowd-in investors. This includes the following:

- Providing credit guarantees attached to sovereign ESG bonds, which lower sovereign credit ratings. For example, the World Bank has provided this for the Seychelles, while the US Development Finance Corporation has provided credit guarantees for blue bonds in Belize, Barbados, Ecuador and Gabon. Similarly, the African Development Bank (AFDB) provided a partial credit guarantee for Benin’s SDG bond. The Inter-American Development Bank (IADB) also provided a guarantee in the case of Ecuador and the EIB is considering similar operations. In theory, this means developing countries will gain support if they reach the point of default in payments, although there is a lack of clarity on exactly how this would work.

- Liasing with potential investors. The World Bank has provided support in pre-identifying asset management firms to be purchasers of ESG bonds, and they also support developing country governments in ‘road shows’ targeted at investors.

- Providing direct subsidies to support the purchasing of ESG bonds. In the Seychelles, the World Bank, through the GEF, provided a grant of US$5 million to cover part of the payment to investors by the Seychelles government. Similarly, the GEF is used as a source of funds to provide bonuses to investors through a rhino bond. Additionally, the IFC, the investing arm of the World Bank, provided an ‘anchor loan’ of US$256 million to help Amundi – Europe’s largest private asset management firm – to establish a fund specialising in buying ESG bonds from emerging markets. This is known as the ‘Amundi Planet Emerging Green One’.

- Covering the costs of issuing ESG bonds. This includes, for instance, paying for second-opinion reports and other expenses incurred in managing funds and providing investor reporting. UKAID, for example, has provided financial support to the government of Nigeria in issuing its green bonds. However, more research is needed to understand the extent of financial assistance and whether this is used to subsidise the fees of legal and commercial service providers.

- Identifying and designing bankable projects for the use of proceeds. This support is provided in numerous examples, including, for instance, the current programme led by the UNDP to develop a framework of projects to launch a blue bond for Benin.
▪ Providing independent analysis and verification reports of projects for investors. Again, the UNDP provides this role in countries such as Uruguay, where it has a contract to deliver assurance reports on the delivery of key performance indicators of the country’s SLB.26

As such, the strategies for de-risking and crowding in are substantial and cover multiple steps in the process. Donors are involved in establishing standards for ESG bonds, providing various forms of direct and indirect subsidies, and assuming responsibility for project design, implementation and independent verification. The extent to which this creates conflicts of interest is worthy of more reflection. It also highlights the considerable investments and pressures to ensure ESG bonds are successful.

**Question 5. What is the significance for global south countries of SLB bonds?**

The lack of ESG bond issues from least developed countries and those with high levels of debt distress is an emerging feature of the sovereign bond market. It is a situation that may change, given the range of efforts by international organisations and bilateral donors to promote and facilitate the issuing of ESG bonds by low-income countries and SIDS. The US government, for example, launched the ‘Climate Finance +’ initiative in November 2022. Led by USAID and the Millennium Challenge Corporation, this project will facilitate the issuing of green bonds among low-income countries, with Mozambique and Zambia being two countries that have already entered the programme. Nevertheless, there are reasons why the traditional ‘use of proceeds’ ESG bonds may not be appropriate for many of these countries and why governments may find it difficult or unappealing to issue these types of bonds.

A key reason, which is becoming more acute, is the high borrowing costs and the limits these countries have in taking on additional debt, particularly in foreign currency. Indeed, accessing international capital markets is becoming more difficult given the scale of the debt crisis experienced in an increasing number of countries, which is partly caused by the build-up of reckless borrowing through Eurobonds over the past decade, with many of these nearing maturity (when the face value of the bond needs to be repaid). In sub-Saharan Africa, new issues of sovereign Eurobonds have declined dramatically, with only South Africa, Nigeria and Angola having issued these since the beginning of 2022.27

However, another market barrier for the least developed countries is withering investor confidence in the ability of host governments to deliver on ESG promises, influenced by growing awareness of ‘greenwashing’ (see below). Again, the extent to which international partners can de-risk ESG bonds to make them more accessible to least developed states and attractive to investors remains uncertain.

In this context, SLB bonds are gaining more interest. In several reports, they are viewed as particularly appropriate for lower-income countries, although the issuance of SLB bonds in the global south has been mostly in middle-income countries.28 There are three main reasons for this:

▪ Unlike the use-of-proceeds bonds, capital raised through SLB bonds does not need to be ringfenced for ESG spending. They can, therefore, be used for refinancing existing debt. In theory, this prevents ESG bonds from simply piling up the debt owed by countries to foreign creditors.
SLB bonds offer a way to address the lack of investor confidence in the ability of governments to deliver on ESG promises. This is due to having clearly defined and measured key performance indicators and financial penalties for non-delivery. In theory, this provides investors with less exposure to greenwashing.

SLBs do not require issuing governments to establish separate bank accounts or budget line items for the use of proceeds: the capital generated can go into the national budget. This also provides issuers with far more flexibility in budget allocations and does not tie them to project-based spending that might cover a long-time span, that is, 10 years or more.

In 2022, Chile and Uruguay issued the world’s first sovereign SLB bonds, which might prove inspiring for others to follow.

Understanding SLBs: Chile and Uruguay

Chile issued the first sovereign SLB in March 2022, which raised US$2 billion. The key performance indicators related to greenhouse emissions and the development of renewable energy. Under the terms of the agreement, the country commits to ensuring it does not emit more than 95 metric tons of carbon annually by 2030, and that by 2028 50 per cent of electricity generated will come from renewables, rising to 60 per cent by 2032, when the final payment for the SLB is due. Regarding the financial penalties, Chile will pay 0.125 per cent extra in interest rate payments for each of its two targets if the country fails to deliver, which is additional to the basic 4.36 per cent interest rate. Penalties will be applicable for targets measured at the halfway point of the bond, and then at the bond’s end.

Uruguay issued its SLB in October 2022, which raised US$1.5 billion. In this case, the performance-based indicators cover a commitment to ensure native forest cover in the country is increased by 3 per cent to the levels recorded in 2012, and a commitment to reduce its greenhouse emissions per GDP unit by 50 per cent from the levels recorded in 1990. The structure of this agreement is different from that in Chile. If the government fails to meet its targets by 2027, investors will be paid a ‘step up’ in their coupon payments of 0.2 per cent for the remainder of the agreement, which runs to 2034. However, if the government meets the targets, investors will receive a ‘step down’ in their payments of 0.2 per cent. In Chile’s SLB, there is only provision for a step up in payments, not a step down.

The World Bank, in collaboration with the US-based consulting firm Potomac Group, is also developing a new model for financing SLB bonds targeted at debt-distressed countries, which seeks to address market barriers. This involves an international financial institution (that is, an MDB) establishing a dedicated fund where sovereign issuers of SLB bonds pay in the money ‘up front’ to cover the costs of any additional payments caused by the delivery or non-delivery of performance indicators. As a third party holds the money, this would add security for investors. A second feature of this proposed model is that the international financial institution managing the offshore trust also provides additional money into the fund. This will be paid out to sovereigns when the key performance indicators are met. This bonus is thought to further incentivise sovereigns to deliver on key performance indicators. This approach is already being used in rhino bonds, where bonuses to investors are covered by the GEF but would be scaled up in sovereign SLBs.
A report drafted by the Potomac Group and published by the AFDB advances a strategy for maximising private finance for ESG spending in African countries. This is based on a hierarchy of funding instruments:

- For countries that have manageable debt levels and are forecast to achieve good economic growth, ESG bonds should be used for straight use of proceeds. There are, of course, a decreasing number of countries that meet these conditions.
- For those in a more precarious situation, the SLB bond approach, as designed by Potomac, will be preferable. Part, or all, of the money raised could be used to refinance outstanding debt.
- For those countries that are in severe debt distress – close to default – then a debt-for-nature swap might be called for. That involves partial debt forgiveness by creditors, in return for pledges by developing country governments to spend the forgone revenues on environmental projects.

While this proposal has yet to filter into many of the reports on ESG bonds, it could be a strategy that is taken forward, determining the approach to leveraging debt in developing countries and SIDS for ESG spending. In this vision, SLB bonds are, therefore, a halfway house – or compromise – between the commercial use-of-proceeds ESG bonds and debt swaps.

Question 6. What is meant by the ‘greenium’ for sovereign ESG bonds and how significant is it?

International support for developing countries issuing ESG bonds is partly based on the view that the positive ethical label attached to bonds allows them to be sold to investors with lower interest rate payments. This is potentially a powerful reason why ESG bonds will be seen as attractive to the governments of developing countries. The difference between the yield of non-labelled (or ‘vanilla’) bonds and ESG bonds (typically measured in ‘basis points’) is the premium achieved by the green credentials of the bond, commonly referred to as a ‘greenium’.

Evidence on the extent of the greenium for all ESG bonds, not just sovereign ones issued by developing countries, has been subject to extensive research. However, it is not clear whether the greenium exists, how substantial it is and whether it applies to some ESG bonds and not others. Furthermore, it has been speculated that, if there is a greenium attached to ESG bonds, this is caused by their novelty: as ESG bonds proliferate, the ability for issuers to achieve a discount may fade, with some reports suggesting this has already happened in the corporate bond market. This may also have been influenced by negative publicity surrounding greenwashing (see below), which has devalued ESG bonds.

Nevertheless, several reports, including those produced by the IMF, the OECD and the World Bank, describe that sovereign ESG bonds from developing countries have achieved interest rate payments that are lower than what could have been expected if the country had issued an unlabelled bond. In Benin, for example, it was estimated that the sovereign SDG bond came with an interest rate of 4.95 per cent but a non-themed bond would likely be issued for a rate of 5.15 per cent (a reduction of 20 basis points, or 0.2 per cent). These claims are hard to substantiate. Rarely is it the case that two similar bonds – one labelled and one not labelled – have been issued by developing country governments close together.
Furthermore, comparing sovereign vanilla bonds and ESG bonds is complicated by the efforts of international partners to de-risk ESG bonds and provide forms of subsidies, such as credit guarantees and technical assistance in marketing bonds to investors. In Benin, the reduction of 20 basis points was likely caused by the partial credit guarantee provided by the AFDB, not international demand from investors or their willingness to offer a premium for a good cause.

Despite the assistance given by international partners, evidence suggests that the greenium for sovereign ESG bonds is not as significant as some reports suggest. This is revealed in a World Bank survey of ESG bonds in emerging markets published at the end of 2022. The results showed that the greenium accounted for no more than 0.2 per cent variations in interest rates achieved by ESG bonds compared to others. There were also examples where national authorities did not believe they achieved a greenium at all. When governments were asked what their motivations behind issuing ESG bonds were, accessing cheaper debt was the least mentioned of all, highlighted by three out of 12 countries surveyed. The governments reported that the main motivation for issuing ESG bonds was diversifying their investor base. A similar result was found in a survey of sovereign ESG bonds in 2021 by the CBI: cheaper pricing for borrowing was raised by a minority of developing and emerging market governments as a reason for issuing their sovereign ESG bonds, while the primary reason was to stimulate a local market in privately issued ESG bonds.

The experience of Chile is also of interest, given that it has issued so many ESG bonds and for large amounts. Its first sovereign ESG bonds were reported to have attracted a greenium of 0.1 per cent. However, the greenium declined thereafter, and its most recent ESG bonds have failed to achieve a greenium at all, suggesting that the novelty of the ESG label has worn off.

Other reports also point out that ESG bonds come with unique costs that can add up, thereby negating the greenium, if it exists. This includes the expense of establishing reporting processes required by investors. Indeed, many sovereign ESG bond offerings have involved establishing new government departments to manage the funds and prepare regular investor reporting. The IMF has conservatively estimated that the expenses of issuing a standard sovereign green bond of US$750 million will be at least US$2.6 million, although the costs will rise for more complex bonds, such as sustainability bonds, SLBs or blue bonds.

A lack of strong evidence for a greenium reveals a problematic dimension to the sovereign ESG bond market. As the cost of borrowing through ESG bonds is largely determined by the vagaries of credit rating agencies, countries least able to service debts will face the highest borrowing costs. Indeed, research has shown that the most climate-vulnerable countries in the world, which include many SIDS, pay higher interest rates for commercial borrowing on international capital markets. Unfortunately, this problem will become more extreme with the intensification of the climate crisis, as the main credit rating agencies are increasingly factoring in vulnerability to climate disasters in their decision to set credit ratings. The ESG market, therefore, expects the most vulnerable to pay the most for raising capital. Seen in this way, ESG bonds are the antithesis of an economically just and equitable system of climate finance.

**Are SLB bonds any different to other bonds?**
The approach to structuring SLB bonds might increase the ability of developing countries to borrow below market rates. Therefore, the existence of a greenium might be stronger for these bonds than the use-of-proceeds bonds. However, the contracts of these deals so far suggest the greenium is small and potentially negative.
In Chile, for example, the greenium for its SLB bond has been estimated at 10 basis points. However, if the key performance targets are not met, then the step up in coupon payments will represent an increase in payments to investors of 12 basis points. That is, under the scenario of failing to meet the targets, Chile has issued a sovereign bond at slightly above market rates. In the case of Uruguay, there was no greenium reported for the issuing of the SLB bond, but the terms of the bond mean that there is a step up in coupon rates payable to investors to a maximum amount of 20 basis points if targets are missed, and a step down that is limited to 20 basis points if targets are made. Again, Uruguay has issued an ESG bond that could end up above market rates if it fails to deliver, or will achieve a modest greenium if it does deliver.

In future sovereign SLB bonds, the financial incentives may increase if MDBs decide to top up performance-based payments. The problem, however, is that the success of SLB bonds in providing lower-than-market rates for sovereign borrowers is contingent on delivering on key performance targets. Those that fail will be punished by paying higher returns to creditors and losing their bonuses. The troubling ethical dimensions to this can be seen in Uruguay, where one of the performance-based indicators relates to maintaining native forest coverage in the country. Yet the climate crisis is one of the biggest threats to forests in Uruguay – as it is in so many countries. In this case, if forest cover is judged to have decreased by 2027, the country has agreed to pay investors a step up in their bond repayments covering the years from 2027 to 2034. What is not clear is whether, if a heat wave or severe drought causes the outbreak of forest diseases and mass forest fires, investors will accept the step up in bond repayments. If so, is it possible that investors in these deals will be rewarded for the failures of international responses to the climate disaster?

**Question 7. How serious is the risk of ‘greenwashing’ and can SLBs prevent it?**

The problem of greenwashing has become a dominant theme in international coverage of the ESG market. The frequency of scandals demonstrates that greenwashing is not an exceptional occurrence but normalised within the ESG market. This is not a view held only by civil society; it is also frequently heard from industry insiders. A prominent asset management fund CEO writing in *Forbes* magazine argued: “Is ESG a scam? Unfortunately, the answer is often yes. Fund managers know a marketing opportunity when they see one. They have lured socially conscious people into thinking that their investments can save planet Earth from climate disaster—if they just pay inflated management fees.”

The resulting crisis in the credibility of ESG bonds was captured in a recent study entitled *Green Bonds, Empty Promises*. This was based on an analysis of 1,000 ESG bonds and interviews with over 50 investors and bond issuers from the US and Europe. A consistent theme expressed by industry representatives was that the rush to offer green bonds has been driven primarily by the surge in demand for ESG investing by the clients of large asset managers. Still, scrutiny over the use of proceeds is poor or even non-existent. An important finding of this study was that, over time, the commitments made by bond issuers have reduced in their ambition. Additionally, there has been an increase in disclaimers in ESG bond prospectuses and investment contracts, so there is a “concerning lack of enforceability of green promises”.
These protect bond issuers from legal recourse if they are judged to have failed in delivering on their promises, and they allow bond issuers to use proceeds for other purposes if required. Nearly 70 per cent of all ESG bonds reviewed included these disclaimers. Others have documented that these disclaimers are now common in sovereign bond issues.

Thus, the regulatory norms governing ESG bonds have been weakened over time, making greenwashing more likely. Calls to empower financial regulators to prosecute those abusing the ESG label are growing, although so is the realisation that litigation is difficult, partly because there is no clear definition of what ‘green’ means.

The widespread appreciation of greenwashing in the ESG bond market is reflected in the proposed EU Green Bond Regulation. In theory, this will provide a more robust framework for bond issuers to report on the use of proceeds and demonstrate compliance with the EU taxonomy. The regulation also strengthens the ability of national authorities to administer fines for a failure to uphold green commitments by bond issuers. However, as there have not been any EU Green Bonds issued, it is impossible to predict how these regulations will be interpreted and applied.

Three shades of greenwashing

The concept of greenwashing is used regularly by those working on ESG bonds. There appear to be several distinct issues applicable to the ESG bond markets, of which the following three are useful to isolate:

1. One involves bond issuers using the label of ‘green’ for project spending that is tenuously, if at all, linked to positive environmental outcomes. An example of this is a green bond issued to the Jirau dam in Brazil, which required the destruction of large areas of rainforests.

2. Another involves a bond that fails to deliver on its promises, including not using the proceeds for stated objectives or mismanagement of a project. An example is the green bond raised by Michelin tyre manufacturers for reforestation work in Indonesia to compensate for deforestation caused by rubber tree plantations. Investigations revealed that the money was partially spent on paying off bank loans and the tree-planting projects were largely bogus.

3. A third involves an environmental or social bond issued by an organisation that is otherwise environmentally or socially problematic. In this case, the bond itself may be genuine but the organisation's overall impact is anything but green or socially positive. The bond, therefore, provides the organisation with flattering public relations, which are undeserved. An example is a green bond issued by Korea Electric Power Corp in 2020 to finance renewable energy projects. However, the company simultaneously increased its funding for coal production.

There has been a lack of research into the extent and nature of greenwashing in sovereign ESG bonds. Most of these bonds are quite recent, so evidence of problems might not be available yet. There are, however, some examples. For instance, in 2022 an investigation by journalists in Nigeria showed that the afforestation project funded by the proceeds of the sovereign green bond had been a failure. Reporters and representatives of national civil society organisations surveyed the areas where the government claimed to have reforested, but their report demonstrated that no tree planting had occurred. This finding was confirmed in a study commissioned by Heinrich Boll Stiftung, which also documented that the government’s solar projects had produced less than a fifth of the energy promised. There are also examples of policy incoherence.
The Philippines issued a sustainability bond valued at US$2.5 billion in late 2021, designed to meet the nation’s climate-action commitments. However, in tandem with this have been policies that expand the oil and gas industry in the country, including by offering tax exemptions for foreign investors in oil and gas exploration and drilling. The Philippines has also been heavily criticised for continuing with investments in coal mining despite community protests.

What is evident is that the systems in place to limit greenwashing are inadequate. One of these is using independent assessments before ESG bonds are issued. These should identify where the use of proceeds is intended for projects that have potentially negative environmental or social outcomes, and they should flag the dangers of policy incoherence that undermines the delivery of environmental and social objectives. However, there are considerable weaknesses in these so-called second opinions. The quality and scope of their evaluations are limited, and they are undermined by abundant optimism, including in contexts where there is substantial evidence that project implementation is likely to be difficult, with past failures of similar projects being abundant. What may contribute to these shortfalls is an underlying conflict of interest. The industry providing these assessments is lucrative and no doubt competitive. The IMF reported that assessments for sovereign ESG bonds are typically conducted over a few weeks, usually based on government information, although they can cost up to US$100,000. Furthermore, the three big companies providing second opinions also offer other services to clients, including undertaking reporting requirements for the duration of the bond. This arrangement could dissuade third-party companies from providing negative assessments.

A second mechanism for accountability lies with annual reports issued to investors on the impact of ESG bonds. Generally, bond issuers are left to self-report their successes. This is an improvement on traditional vanilla bonds, which have almost no obligations for accountability. However, there appears to be a wide variance in practices, with several countries that have issued ESG bonds having failed to provide regular annual reports (see below). Furthermore, a fundamental problem in the ESG bond market is that, once bonds have been issued, investors have limited options (or incentives) for punishing bond issuers for the non-delivery of green or social pledges.

What is further cause for concern is that international organisations supporting ESG bonds appear resistant to acknowledge these problems. In the case of Nigeria, a few months after damaging reports surfaced in national and international media about the implementation of their country’s ESG bonds, the government and foreign partners in the country’s green bond programme, including UKAID and the CBI, produced an ‘impact report’ on the progress made by the Nigerian government. This was positive, and considered the green bond to be a success.

However, the likely failure of sovereign ESG bonds to deliver on commitments should not be surprising. Decades of research into the ability of governments to implement development policies that advance social and environmental objectives shows that failure is common. This needs to be contextualised in the failure of traditional development policies that are being designed and implemented in the global south by institutions dominated by the global north. These policies are presented as technocratic and apolitical ad hoc proposals, seeking to ameliorate and address the historical impacts of climate and developmental coloniality without addressing structural problems of ongoing coloniality.
The subject of greenwashing for sovereign ESG bonds is therefore complex. While there may be instances of blatant abuses of ESG bonds, this will be difficult to disentangle from the broader struggles facing developing countries in delivering on social and environmental objectives, which are influenced by a multitude of factors, many beyond the control of central governments, such as international free trade agreements or conditionalities imposed by international financial institutions.

**Are SLBs better?**

One of the reasons that organisations are promoting SLBs is to diminish the problem of greenwashing. This is because they require issuers to identify key performance indicators and provide evidence that these have been met. However, they open opportunities for different types of greenwashing. This derives from manipulation of baseline information and misreporting of results. This has become a well-reported flaw of SLBs among corporate bond issuers.

In the case of Uruguay, whose SLB runs from 2022 to 2034, what look like ambitious targets are not as impressive on closer inspection. One performance indicator of its SLB is that the country will maintain the native forest cover to 100 per cent of what it was in 2012, while another indicator is that it will increase native forest cover by 3 per cent over the duration of the bond, with a reference level taken from 2012 as well. However, other reports describe that Uruguay had already expanded its native forest cover from levels observed in 2012 by 3 per cent before the SLB was issued. Furthermore, a third indicator of Uruguay’s SLB is a reduction of greenhouse emissions per GDP unit by 50 per cent from the levels recorded in 1990. Yet, even in the second-opinion report, it was described that by 2019 the country had reduced its carbon emissions per GDP unit by more than 47 per cent compared to the levels recorded in 1990 and the rate of decline was continuing. Therefore, Uruguay was likely close to the 50 per cent target set in the bond prospectus by the end of 2022. In this case, the key performance indicators attached to the SLB appear to be for achievements already made.

The further development of sovereign SLB bonds will, therefore, require scrutiny of how performance-based indicators are decided and how they are measured. As has been evident in national schemes for reducing deforestation and forest degradation, there are substantial opportunities for abuse in reporting, including inflating baseline measures to present the illusion of additionality. This highlights the potential risks of SLBs rewarding governments without achieving progress on environmental or social commitments, which might work as a barrier to progress. These hazards may be particularly controversial in data-deficient countries and for SLBs that include social objectives for which appropriate indicators may be difficult to agree on.

**Question 8. How do sovereign ESG bonds respect transparency and public participation?**

Regarding transparency, ESG bonds have several positive attributes compared with other sources of government debt. Generally, but with some exceptions, the terms and conditions of ESG bonds are well publicised. This is in stark contrast to sovereign borrowing through traditional Eurobonds or foreign bank loans. Most sovereign ESG bonds are also launched with second opinions. While these might not provide a reliable assessment of the ‘greenness of bonds’, they do provide information on the intended use of proceeds and a description of reporting commitments. The primary exceptions to this have been blue bonds.
The blue bonds issued by the Seychelles and the Bahamas have been accompanied by limited information on the borrowing terms and the use of proceeds. Blue bonds issued for debt refinancing in Belize, Barbados, Ecuador and Gabon have also been non-transparent, with no public access to the bond prospectus. This lack of transparency is a concern because blue bonds are gaining momentum among coastal and small island states. However, the situation with green, sustainability and sustainability-linked bonds is better.

There are multiple efforts by international financial institutes to collate information on ESG bonds into publicly accessible databases. One of these is the global database of ESG bonds provided by the ICMA, although it is incomplete and missing recent sovereign bonds. The CBI also provides an extensive database of ESG bonds. At the same time, the IADB has launched the ‘green bonds transparency platform’, which provides freely accessible and searchable data on ESG bonds from the region, including more granular information on the use of proceeds. Again, however, blue bonds are missing from these databases.

ESG bonds, which are aligned with international principles, require governments to have transparent systems for financial reporting on the use of proceeds, either through establishing separate accounts or via tagging ESG bond proceeds within existing national accounting frameworks. There is limited research that demonstrates how governments approach this and whether governments follow through, but in theory it is another positive attribute of ESG bonds over other forms of debt. However, separate financial accounting for SLBs is not required. There is less transparency on how capital raised through these bonds is used, which is potentially a (further) drawback of them.

Furthermore, most ESG bonds are launched with a commitment by national authorities to produce annual reports on the use of proceeds. There is a wide range of practices in this regard. Several countries do not seem to have produced publicly available annual reports, including Nigeria, the Philippines and Thailand. Some reports are summary documents only (Fiji), while others provide more in-depth analyses. Indonesia’s annual reports on the use of proceeds from its green bonds seem to be one of the most comprehensive.

There are, however, several aspects where transparency and public accountability are lacking for ESG bonds. Companies producing second-opinion assessments only provide summary information to the public, not the underlying data and analysis used to reach conclusions. There are no provisions for external review or public comments either. The ability of these reports to stimulate public debate and oversight of ESG bonds is limited, and this adds to the risk that these are misleading assessments.

Most importantly, the process of developing and launching sovereign ESG bonds is also characterised by confidentiality. Public knowledge of ESG bonds tends to come after the bond has been launched and finalised. This means there is limited scope for public consultation, including among those most affected by the use of proceeds. This is contrary to several international human rights agreements that require prior informed consent to be achieved by governments when agreeing to new investments, and it is contrary to the demands for debt transparency made by civil society organisations, such as the African Borrowing Charter proposed by AFRODAD. Indeed, the need for public consultation on ESG bonds is a recommendation overlooked by international partners. The IMF, for example, has produced a substantial ‘how-to guide’ on sovereign ESG bonds directed at debt managers of emerging and developing countries. While it repeats the importance of working closely with international partners and gaining second-opinion reports for investors, public consultation and participation are conspicuously absent.
The various reports on ESG bonds aimed at developing countries and SIDS produced by the UNDP and the UNEP are also lacking in recommendations for public consultation, which is a surprising omission given the importance of public consultation in these agencies’ work. It appears that a human rights-based approach is forgotten when it comes to ESG bonds.

International principles for ESG bonds, including those produced by the ICMA and the CBI, also lack provisions for bond issuers to undertake public consultations and link ESG borrowing to transparent policy and legal frameworks. This demonstrates that international principles for ESG bonds have been developed for the needs of investors, not the rights of citizens where ESG bonds are raised on their behalf. The EU’s Green Bond Standard does not strengthen this aspect either. One theme that requires further exploration is the need for international guidelines on ESG bonds to be aligned to international norms on access to information and public participation, such as the Escazu Agreement and the Aarhus Convention.

Question 9. What are the risks of ESG bonds to the debt crisis?

ESG bonds are often referred to as ‘sustainable debt’. However, sovereign borrowing through ESG bonds is usually raised in foreign currency and close to, if not at, commercial lending rates. Inevitably, borrowing through ESG bonds comes with risks of being unsustainable debt, diverting crucial streams of public finance to payments of private creditors.

One risk with ESG bonds lies in governments raising excessive capital, above and beyond what is required for underlying project spending. This is not a unique problem to ESG bonds and is characteristic of other types of lending. However, it is potentially exacerbated in the case of ESG bonds by high levels of international demand for investing in these assets, particularly among asset managers in Europe and North America. This demand is usually – and falsely – considered a positive feature of the ESG bond market for developing countries, causing the opportunity for a greenium. However, a more likely outcome of high demand is to encourage governments to increase the bond’s value or return to the market with subsequent issues. It is a dilemma that might be compounded by the vested interests of financial service providers and intermediaries in these transactions, linked to commission fees for example.

These risks might be evident in the case of Egypt’s maiden sovereign green bond. This was initially designed to raise US$500 million. However, the order book reached a staggering US$4.93 billion, which resulted in the government increasing the bond by 50 per cent, to US$750 million. Similarly, high investor demand for Hungary’s maiden sovereign green bond meant the government doubled its value from HUF15 billion to HUF30 billion (€40 million to €80 million). In such cases, the potential benefits of achieving a lower market yield for ESG bonds (which at most might correspond to a reduction of interest payments of 0.2 per cent) are therefore negated by the hazard of governments borrowing excessively.

A second risk is that the use of proceeds does not stimulate economic growth or increase direct government revenues to the extent predicted. This risk is typically downplayed by international organisations advocating sovereign ESG bonds, often based on optimistic forecasts of ‘green growth’. For example, in a conference hosted by UNDP in West Africa, where sovereign green bonds were marketed to African governments, the deputy executive of the UN’s Economic Commission for Africa stated that “a green recovery, based on green investments, can generate up to 420% better returns in gross value added and up to 250% better returns in job creation”. This message is largely consistent with the international narrative of green growth being more robust than ‘business as usual’.
However, there is no credible evidence for these claims, which makes them potentially reckless sales pitches for the ESG bond market. Indeed, many projects targeted by ESG bonds are not obvious engines for economic growth. This includes, for example, the reduction of pollution and the increase in protected areas for biodiversity conservation.

While these are important objectives for governments, they are not necessarily projects that justify borrowing through international capital markets at high-interest rates, particularly in countries experiencing debt distress and diminishing public budgets for other public services.

However, the extent to which sovereign ESG bonds will become a significant feature of the debt crisis in developing countries is uncertain. So far, borrowing by developing countries through ESG bonds has involved relatively small amounts. Furthermore, few countries that are highly debt-distressed have issued ESG bonds. Least developed countries (apart from Benin) have so far not issued use-of-proceeds sovereign ESG bonds, and few SIDS have done so either (apart from the Seychelles and the Bahamas, and those where blue bonds have been used to finance debt swaps). As noted above, the situation might change. Many international programmes that advance sovereign ESG bonds target least developed countries and SIDS. How the US government, through its ‘Conservation Finance’ programme in Zambia and Mozambique, will avoid saddling these countries with expensive debt for ESG projects remains important to monitor.

There has also been momentum in programmes to promote sovereign ESG bonds among SIDS, particularly blue bonds. In the case of the UNDP, for example, a report co-authored with the Pacific Island Forum presented a questionable view that sovereign ESG bonds are critical for SIDS to bridge the funding gap for the development of their ‘blue economies’, with access to increased development aid described by the UNDP as unlikely. Again, a source of concern in this report was that it downplayed fears of the resulting debt being unsustainable while misleadingly characterising ESG bond debt as a ‘lower cost’ option:

Appropriately structured loans, including thematic bonds, can be a feasible lower cost option for PICs [Pacific Island Countries], to meet the cost of their recovery as well as their sustainable development priorities. It has been argued that the concerns about current debt sustainability for PICs may be misplaced. The worries of excessive debt are less relevant in the context of the pandemic, as long as increased spending stimulates the economy and is therefore enough to justify the additional debt servicing costs.12

The dilemma with this advice is that the available sectors of the blue economy that provide SIDS with opportunities for stimulating the economy are those with high environmental costs, such as foreign tourism, industrial aquaculture and mining. Therefore, transitioning to an ecologically sustainable blue economy is not easily compatible with growing the blue economy by borrowing from international capital markets. Promoting blue bonds for SIDS is, therefore, a recipe for ‘bluewashing’ or increasing their struggles with unsustainable debt, and potentially both.
Proponents of ESG bonds for developing countries depict these as a vital source of finance to bridge the funding gap for meeting climate and biodiversity targets and the SDGs. Additionally, increasing private finance for development is now mainstreamed in the ideology of international development organisations, such as the World Bank, which considers its role catalytic to the penetration of global financial flows in developing countries. Thus, the expansion of ESG bonds is not only depicted as a necessity in the context of scarcity but also desirable for other ideological reasons.

However, this enthusiasm for borrowing from capital markets through ESG bonds is in stark contrast to a range of alternative strategies to achieve a more sustainable and just global architecture for financing environmental and social development. Indeed, as noted already, the logic of ESG bonds is contradictory to a progressive agenda. They are regressive as they require the most vulnerable countries to pay the most to finance their social and environmental needs. Consequently, they provide new opportunities for lucrative income streams to financiers, which looks increasingly objectionable as ESG bonds evolve towards performance-based payments, where investors are rewarded for the failures of southern countries.

On the other hand, while ESG bonds can be considered suboptimal, they are convenient for a range of vested interests in global capital markets. As argued by Daniela Gabor, the enthusiasm for ESG bonds represented a shift from the post-financial crash era when many governments promised to crack down on the environmentally and socially damaging practices of financial capitalism. Instead, the ESG bond market established a narrative of working with finance to solve global environmental and social challenges. In doing so, the political will to address the inequitable flow of resources between the developed and developing world lost momentum, of which the diminishing commitment to address illicit financial flows is illustrative. Yet this analysis should not overlook the possibility that ESG bonds are also considered convenient by governments of developing countries. They offer the chance to raise large sums from international capital markets within a short time, with the responsibility for fully repaying this debt delayed for at least 10 years.

An appreciation of the full range of solutions to increase public funds to address climate, biodiversity and development goals challenges the notion of a funding gap. At the least, it demonstrates that bridging the funding gap is not so dependent on developing countries opening up to global financial markets.

Yet the funding gap is potentially problematic for other reasons. It presents a superficial view of social and environmental challenges in which money – or the lack of it – is the root cause. Several issues are targeted by ESG bonds where the relationship between finance and 'success' is far more uncertain. This is particularly evident in biodiversity conservation and the governance of natural resources, such as fisheries and forestry. Few serious accounts of the unsustainable and inequitable management of nature conclude that simply increasing government spending is a panacea. Many of the problems experienced by people dependent on nature for their livelihoods derive from too much financing (such as foreign investments in industrial agriculture or fisheries), forms of political corruption, and the appropriation of resources by governments and multinationals.
Yet advocacy on ESG bonds perpetuates faulty thinking, resulting in highly questionable statements that saving nature requires billions in additional finance. This is not consistent with the demands made by many organisations representing the interests of indigenous peoples and coastal communities in developing countries and SIDS, for whom the preservation of the commons is a political and cultural struggle, not a financial one.

Conclusion

Over a relatively short period, the ESG bond market has proliferated, even if it still represents a small segment of total borrowing through bond markets. Although sovereign ESG bonds might be out of reach for the poorest of countries, there is massive support for these bonds to be scaled up as solutions to the so-called funding gap for multiple crises, including, most prominently, the climate disaster. Yet there are several reasons why this strategy is worrying.

While a lot of critical attention to ESG bonds is given to the problem of ‘greenwashing’, this distracts from a range of other concerns. ESG bonds are yet another debt instrument that will build on the already unsustainable debt levels of most global south countries, resulting in the transfer of wealth from the south to rentiers concentrated in the north. The assumption that the multiple crises facing global south countries are caused by insufficient finance is also a convenient simplification, diverting attention from the policies and structural changes needed to achieve more sustainable and just societies.

The growth in ESG bonds must be viewed as one component of financialisation. Confronting this is daunting for many civil society organisations working at the intersection of debt and climate justice, partly because the world of financial markets – and its colourful jargon – can be so difficult to understand. The challenge is to demystify financial instruments such as ESG bonds and their derivatives, enabling a more informed and inclusive debate on their risks.
## Annex

Sovereign ESG bonds issued by global south countries (January 2017 – March 2023)

<table>
<thead>
<tr>
<th>Year</th>
<th>Country</th>
<th>Type</th>
<th>Bond value in US$</th>
<th>Issue currency</th>
</tr>
</thead>
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<tr>
<td>2017</td>
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<td></td>
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</tr>
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<td>USD</td>
</tr>
<tr>
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<td>Guatemala</td>
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<td>USD</td>
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<td></td>
<td>Ecuador</td>
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<td>Total</td>
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<td><strong>US$64.1 billion</strong></td>
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</table>

Notes: The list of sovereign ESG bonds may not be complete. The USD equivalent is based on the average exchange rate for the year, and therefore is indicative only.
Acknowledgements

This report was written by Andre Standing, with the contributions from Farwa Sial and Iolanda Fresnillo (Eurodad).

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Brot
für die Welt

All opinions are the author’s alone, and all errors and omissions are the authors’ responsibility. This briefing has been produced with financial assistance from the Open Society Foundations and Bread for the World.
Notes

1 For example, in a recent report by the UNEP on the state of finance for nature, it was described that, to deliver on globally agreed targets for biodiversity and land use change, US$366 billion is required to be spent every year, which amounts to US$8.4 trillion from now until 2050. Likewise, at the COP26 meeting, the Glasgow Financial Alliance for Net Zero (GFANZ), which is a global alliance of private financial institutions and companies that are separate to the UNFCCC, where the mandates for climate action lie, described how their research indicated that US$32 trillion was needed by 2030 to meet global commitments on climate change, and that 70% of this would need to come from private investors. ESG bonds are not the only instrument that is hoped to bridge these funding gaps but they are considered among the most important.

2 Summary as communicated in the World Bank’s flagship report From Billions to Trillions and then more recently in its Maximizing Finance for Development strategy.


4 See the investor presentation on green bonds by the European Investment Bank, ‘Climate Awareness Bonds’, no date, https://www.eib.org/en/investor-relations/cap/index.htm


7 For more information on social and development impact bonds, see the online resource by Social Finance: https://www.socialfinance.org.uk/what-we-do/social-impact-bonds

8 Voluntary standards for labelling bonds have also been joined by many third-party indexes. These collate information on the performance of organisations according to ESG criteria. Indexes serve various purposes: most are marketed to investors to help them choose where to put their money, whereas others seem to be designed to put pressure on organisations to improve their scores. Although the power of these indexes is important – as is the credibility of their methods – they will not be reviewed in this report.


14 For example, China’s national regulations on its green bonds have been criticized in the past for allowing up to 50 per cent of the proceeds of green bonds to be spent on non-green projects. ICMA principles require all the proceeds to be used for ESG spending. Recent reforms within China are claimed to bring its national standards up to global norms. Similarly, while India’s Securities and Exchange Board published its first green bond requirements in 2016, criticisms over the vague language led the government to create a revised Green Bond Framework in 2022. This has clarified a list of non-eligible spending and improved reporting requirements.
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[3] The webpage for the World Bank’s dedicated unit can be found at: https://treasury.worldbank.org/en/about/unit/treasury/client-services/sustainable-finance-advisory, while information on the UNEP’s Finance Initiative can be found at: https://www.unepfi.org


[8] News on the EIB interest on guaranteeing ‘debt-for-climate’ swaps can be found here: https://www.reuters.com/article/climate-change-debtswaps-eib-idAFLN38P1QT


[10] See project information at: https://mptf.undp.org/project/00132305


[14] The government of Chile provides an overview of the SLB here: https://www.hacienda.cl/english/work-areas/international-finance/public-debt-office/frequently-asked-questions#collapse_0


The UK’s green bond provided a vivid example; see Hardy, note 39 above.


There is a large and contested literature on the failures of AID projects. See, for example, Development Aid, ‘Why Do International Development Projects Fail?’ 26 November 2022, https://www.developmentaid.org/news-stream/post/79729/why-do-international-development-projects-fail


https://www.icmagroup.org/sustainable-finance/sustainable-bonds-database/#HomeContent

https://www.climatebonds.net/cbi/pub/data/bonds

https://www.greenbondtransparency.com

The 2022 annual report can be accessed here: https://api-djppr.kemenkeu.go.id/web/api/v1/media/D7023CD4-0862-4EF6-A633-2299EC86C31


Hardy, note 39 above.

