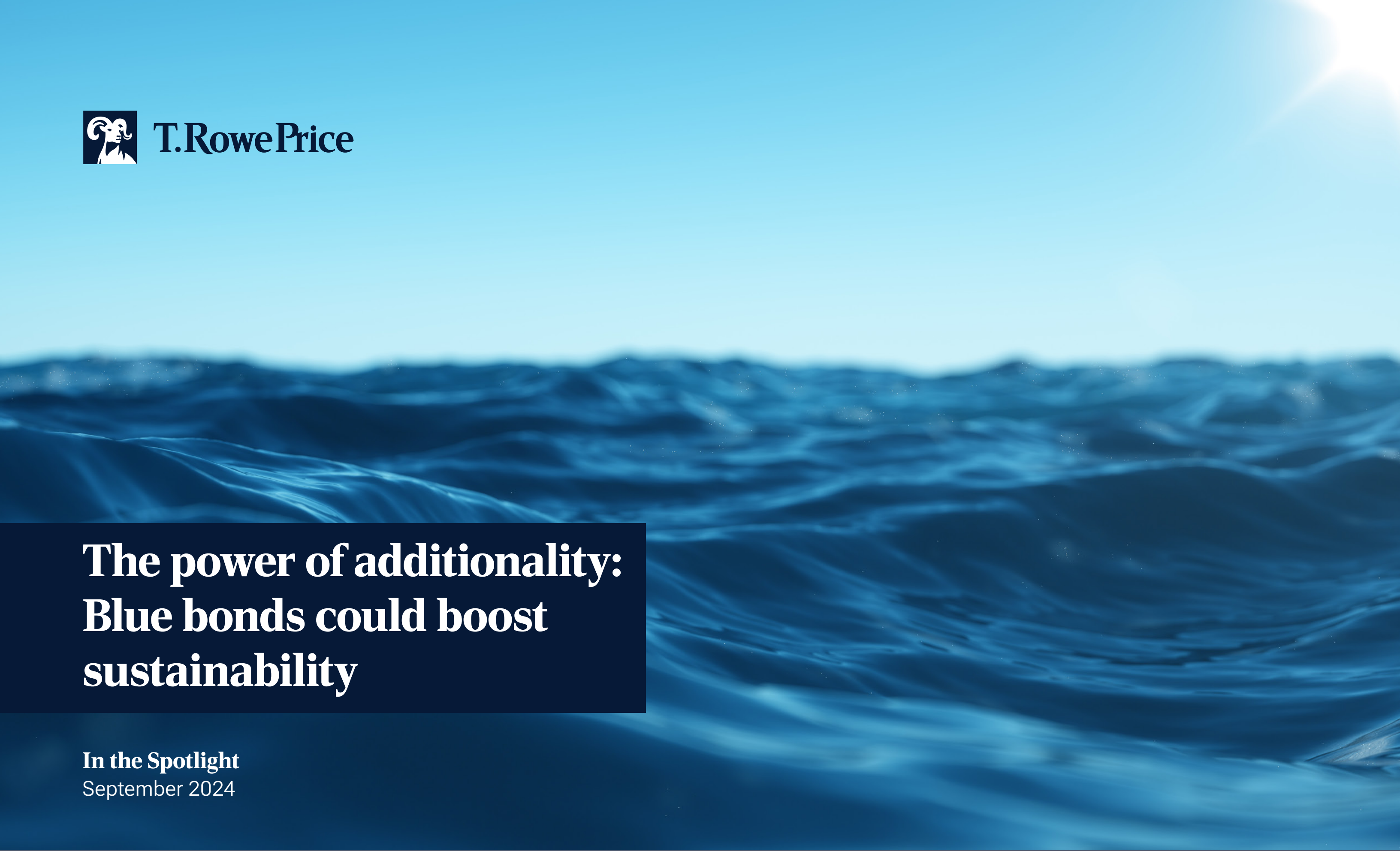

The power of additionality: Blue bonds could boost sustainability

In the Spotlight
September 2024

Key Insights

- Despite a surge in sustainable debt, the funding gap for SDGs—especially in emerging markets—continues to grow, necessitating innovative financial tools.
- Blue bonds, targeting ocean-friendly and clean water projects, address underfunded SDGs 6 and 14, offering additional positive impacts in emerging markets.
- Investments in emerging markets to enhance water resources can help to drive economic growth and advance SDGs like health, reduced inequalities, and gender equality.

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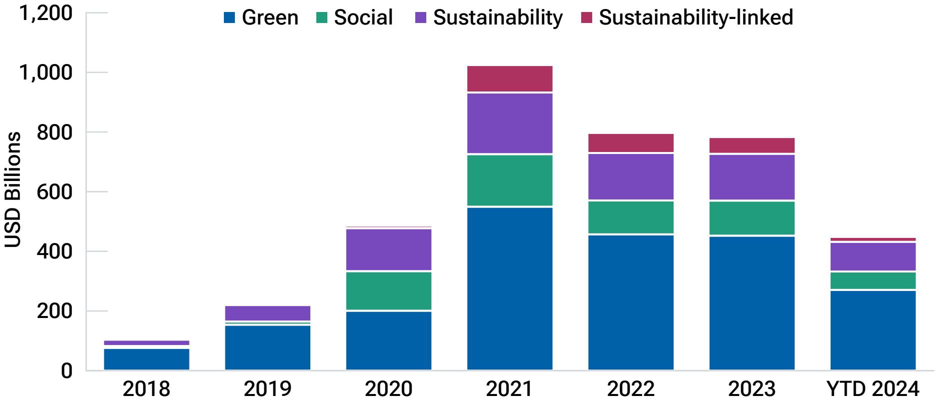
Issuance of sustainable debt has exploded over the past 10 years as many investors seek to allocate capital to sustainability efforts while pursuing investment returns. But the amount of annual investment required to achieve the United Nations Sustainable Development Goals (UN SDGs) continues to grow, while the time available to achieve them diminishes. The United Nations estimated in 2023 that an additional USD 4 trillion was needed reach its goals. This funding gap is especially acute in emerging markets countries.

Climate-related disasters and water scarcity troubles continue to make headlines around the globe, with 44% of humanity (approximately 3.4 billion people globally) having been directly impacted by the greater than 4,600 climate-related disasters that have occurred between 2000 and 2020.[1,2] At the same time, we edge ever closer to the 2030 target set by the 2030 Agenda for Sustainable Development adopted by all United Nations Member States. Based on decades of work, this agenda serves as a blueprint for global growth and development. The 17 SDGs detail necessary actions to tackle poverty, improve health and education, and encourage economic growth, while also confronting climate change and caring for our oceans and forests.

[1] The Emergency Events Database (EM-DAT).
[2] Donatti, C.I., Nicholas, K., Fedele, G., Delforge, D., Speybroeck, N., Moraga, P., Blatter, J., Below, R., and Zvoleff, A., 2024. Global hotspots of climate-related disasters. *International Journal of Disaster Risk Reduction*, 108, p.104488.

The sustainable debt market size has remained elevated

(Fig. 1) Annual sustainable debt issuance in USD by instrument type



As of June 30, 2024.
Sources: BloombergNEF and Bloomberg Finance L.P.

Additionality—bigger impact potential by zeroing in on emerging markets

The challenge of achieving all 17 SDGs by 2030 is acute. For investors, it means that we must consider ways to gain greater "additionality" from investments to accelerate progress toward the SDGs. Additionality represents the degree of positive impact or outcome that would not have otherwise occurred without additional resources or capital investment. In our view, investments in blue economy initiatives, especially in emerging markets, have significant potential to begin to address SDG funding needs and amplify progress toward the 2030 goals.

Blue bonds are a nascent asset type within the sustainable debt market. They are used exclusively to finance ocean-friendly or clean water projects. Sovereigns, development banks, quasi-sovereigns, and corporate issuers, among others, can finance projects that align with UN SDG 6 (clean water and sanitation) and SDG 14 (life below water) via blue bonds. SDGs 6 and 14 are currently underfunded.

Blue bonds could help accelerate the growth of the sustainable bond market and facilitate capital flow to address this funding gap. Like its guidance on green, social, and sustainability-linked financing, the International Capital Market Association (ICMA) recently established industry guidance to help investors direct capital toward projects aligned with the blue economy. By enabling investors to deploy capital at scale, asset managers can be a catalyst for such sustainable development initiatives.

Blue bonds can support projects globally, but we see heightened pressures—and therefore opportunities—in emerging market economies where capital is scarce. SDGs are funded at a lower level in emerging markets than in developed markets, increasing needs in those countries. Northern Africa and Western Asia are known water-stressed regions. Latin America has distinct needs relating to aquaculture and agriculture. Meanwhile, Asia is contending with elevated levels of plastic pollution.

Investing in blue bonds in emerging markets not only addresses local challenges, but also provides greater additionality by driving impactful change where it is most needed. Since emerging markets have contributed the majority of growth in global gross domestic product (GDP) over the past decade, supporting improved water resources can also work to bolster this vital engine of global growth.

"Investing in blue bonds in emerging markets not only addresses local challenges, but also provides greater additionality by driving impactful change where it is most needed.

Water at the center of achieving many of the SDGs

(Fig. 2) Potential additionality gains from blue investments

Direct links

Water is crucial for climate change adaptation and mitigation: 90% of all disasters are water related, oceans generate 50% of all oxygen and absorb 25% of all CO_2.[6,7]

Water projects such as offshore and marine renewable energy solutions can help fight climate change[8]

Co-benefits

2 billion people lack access to safe drinking water[1]

Lack of adequate sanitation services contribute to 1.6 million preventable deaths a year[2]

Approximately 31% of schools lack access to safe water and adequate sanitation[3]

Girls and women spend 200 million hours a day globally collecting water[4]

Agriculture (69% of fresh water drawn), industry, and energy (19% of fresh water drawn) are dependent on water to operate[5]

As of June 30, 2024.

[1] Kashiwase, H., & Fujs, T. (2024, April 17). World Water Day: Two Billion People Still Lack Access to Safely Managed Water. *World Bank Blogs.*

[2] WaterAid. (2021, July 6). *Mission-critical: invest in water, sanitation and hygiene for a healthy and green economic recovery | WASH Matters.*

[3] World Economic Forum. (2023, September 13). Achieving the SDGs requires public-private collaboration on water. Here's why.

[4] UNICEF. (2016, August 29). *Collecting water is often a colossal waste of time for women and girls.*

[5] *Statistics.* (2024, February 26). UN World Water Development Report.

[6] *Climate Change and Water-Related Disasters.* (n.d.). UNEP - UN Environment Programme.

[7] United Nations. (2024, February 26). *The ocean – the world's greatest ally against climate change | United Nations*.

[8] Wood, K. (2023, September 20). *The Ocean Can Play a Bigger Role in Fighting Climate Change than Previously Thought*. World Resources Institute.

Why water?

SDG 6: Clean water

When it comes to clean water, sustainability impact has significant potential in emerging markets. Access to safe and clean water, the goal of SDG 6, is arguably complicated by the billions of people who are disproportionately found in emerging markets countries. Shortages exacerbate agricultural challenges and hinder humanitarian efforts.

One quarter of the world's population lacks safe drinking water, and one half does not have access to safe sanitation, such as sewage removal and wastewater treatment. Targeting more universal access to safe drinking water, sanitation, and hygiene enables progress toward several other SDGs, such as good health (SDG 3), reduced inequalities (SDG 10), and gender inequality (SDG 5).

Investing in water and sanitation generates additionality through saved medical costs and increased productivity. United Nations Children's Fund (UNICEF) estimates that globally women and girls spend 200 million hours every day collecting water for their families. This can limit opportunities for work or education. The World Health Organization estimates that many countries experience productivity losses of up to 5% of GDP due to water- and sanitation-related diseases. Access to safe drinking water, sanitation, and hygiene would reduce global disease burden by 10%.

> “When it comes to clean water, sustainability impact has significant potential in emerging markets.

Investment in clean drinking water and sanitation can produce notable benefits

(Fig. 3) The potential economic benefit per USD spent on basic drinking water and sanitation

Economic benefit for every USD 1 invested in:	
Urban basic drinking water	USD 3
Urban basic sanitation	USD 2.5
Rural basic drinking water	USD 7
Rural basic sanitation	USD 5

Source: Hutton et al. 2015. Via UNWater.org

Emerging markets countries have increased support for water-related efforts. Brazil, for example has established a goal of universal access to basic water and sanitation services by 2033. Similarly, Chile and Cambodia have developed programs to enhance water management. These efforts could provide opportunity for public-private partnerships to accelerate development.

SDG 14: Life below water

Climate change has been increasing the frequency and intensity of natural disasters, leading to human loss as well as economic devastation. The UN estimates that over 90% of this devastation is water-related, including drought, wildfires, and floods. Oceans play a central role in regulating the climate. They generate oxygen, absorb excess heat and carbon emissions produced by human activity, and support vital ecosystems. We cannot achieve climate goals without protecting marine life.

Funding in emerging markets is especially important because these regions often experience disproportionate impacts from climate change due to their geographic and socioeconomic vulnerabilities. Additionally, they lack the financial resources and infrastructural resilience that more developed countries possess, making external investment crucial for effective mitigation and adaptation efforts.

Oceans are also vital global economic engines. The UN Environment Programme Finance Initiative estimates that oceans contribute USD 2.5 trillion to the global economy annually, spanning industries such as tourism, waste management, sustainable fisheries, and marine transport. Additionally, oceans support over 30 million jobs and provided a vital source of protein to three billion people. Yet our oceans are under threat from climate change, pollution, overfishing, and habitat damage, among a host of other pressures.

Emerging markets frequently depend on oceans for economic activities such as fishing, tourism, and marine transport, making them highly vulnerable to marine ecosystem degradation. Investments in these regions can bolster sustainable practices, preserving these economic sectors and ensuring long-term economic stability and growth. Through efforts to improve ocean health, it could be possible to make gains in other SDGs, such as zero hunger (SDG 2), clean energy (SDG 7), and climate action (SDG 13). The alignment of funding toward sustainable ocean initiatives in emerging markets not only addresses local environmental and economic challenges, but also contributes to global sustainability goals.

Closing the gap: Blue bonds in emerging markets

The surge in sustainable debt issuance is encouraging but remains insufficient to meet the United Nations Sustainable Development Goals by 2030. The significant funding gap, especially in emerging markets, underscores the need for innovative financial tools such as blue bonds for ocean-friendly and clean water projects. These bonds specifically address underfunded SDGs 6 (clean water and sanitation) and 14 (life below water), offering immense benefits.

Over and above the direct blue economy impacts, there are significant social co-benefits. Targeted investments in emerging markets can mitigate severe water stresses and foster economic growth by enhancing water resources. Access to clean water and sanitation is vital, improving living standards, productivity, and broader economic development.

Achieving the SDGs requires innovative, concerted efforts. By directing capital toward sustainable projects, particularly in water management, investors and asset managers can drive substantial, positive impacts. This approach not only helps bridge funding gaps, but also aligns financial returns with critical environmental and social outcomes.

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