



Bridging the Finance Gap: Leveraging National and Subnational Public Financial Institutions for Localised Climate and Development Action

2025

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Financing for
Sustainable
Development

Abstract

National Public Banks (NPBs) and Subnational Public Financial Institutions (SPFIs), including development banks and agencies as well as climate and green funds at the subnational level, play an increasingly vital role in financing climate action and the just transition. While national governments provide frameworks aligned with nationally determined contributions (NDCs), actual implementation occurs largely at the subnational level, which currently lacks sufficient funding. SPFIs can work as financial intermediaries, as they not only understand local needs and have stronger ties with local governments and businesses, but also access much larger volumes of capital from more diverse sources.

A key challenge in funding climate projects is project ticket size, as large investors prefer bigger deals to mitigate risks and maximise returns. A Global Impact Investing Network (GIIN) survey shows that major private and development impact investors have been channelling more capital into fewer but larger transactions (GIIN, 2024). This trade-off between economies of scale and local needs affects funders like the Green Climate Fund and Multilateral Development Banks, which increasingly strengthen a programme funding approach rather than single-project funding.

National and subnational financial intermediaries can bridge this gap by enhancing the bankability of local projects to meet new volume and additionality financial requirements. They can also advance local capacity to address finance and climate issues, development impact, and safeguards, provide tailored guidance, concessionality allocation based on a more holistic and climate-resilient approach, pilot scalable solutions, and innovative financial mechanisms to reduce risks.

There are a wide range of examples, from the Cajas Municipales in Peru to state-owned and managed development banks and agencies in Brazil, including São Paulo's novel climate fund to the longer-established Deposit and Investment Fund of Quebec and Baden-Württemberg's bank in Germany. Building on current analysis and understanding of best practice, this Policy Brief will explore how subnational financial intermediaries can continue to channel investments to climate and development goals and otherwise less bankable projects. For instance, by leveraging guarantees and enabling blended and sustainable finance mechanisms, thereby expanding access to finance in critical areas from innovation to climate resilience and adaptation.

Keywords: Scaling Up Finance; Financial Intermediaries; Development Effectiveness; Global Financial Architecture; Subnational Climate Finance; Climate Finance; Local Climate Action

Diagnosis

National Public Banks (NPBs) and Subnational Public Financial Institutions (SPFIs) are singular in their potential to translate global solidarity, equality and sustainability priorities into positive impact for local communities. As such, they must have a central place in any reform of the global financial architecture.

Cognisant of this need, the Triple Agenda under the Indian G20 Presidency , and the final G20 Roadmap towards better, bigger, and more effective Multilateral Development Banks (MDBs) under the Brazilian G20 Presidency called on MDBs to partner with governments, national and subnational development banks, and the private sector, to act as facilitators of private and local financial partnership mechanisms, including with national and subnational financial institutions.

The South African G20 Presidency has noted that we are in times of mounting climate crisis and slow progress towards the 2030 Agenda for Sustainable Development. For being closer to communities and having a better understanding of local needs, NPBs and SPFIs are in a strategic position to help delivering positive change. They work with local governments, often the first responders to natural disasters , who also commonly possess shared or exclusive jurisdictional powers in key sectors for decarbonisation and climate resilience building, including transport, water and sanitation, waste, energy, and land use and agriculture.

SPFIs are uniquely positioned to support local governments in at least three ways: strengthening local capacity and preparedness; diversifying financial instruments and available sources of capital; and unlocking investments at scale.

First, NPBs – and SPFIs – have both the finance and investment skills and the contextual knowledge and networks, allowing them to act as translators between financial markets and local interests. By engaging directly with governments, companies, communities, local banks and non-bank financial institutions, SPFIs

can facilitate more cost-effective and accurate credit risk assessments, framing various needs as bankable projects and investment opportunities, thereby extending the reach of global finance. They can also work with local governments to develop long-term transition plans that increase trust and reduce actual and perceived risks by investors.

Secondly, different mandates and structures of NPBs and SPFI can allow them to use innovative financial instruments to tap into a wider range of sources of capital. Particularly in the case of developing economies, which face financially prohibitive challenges related to high-risk premiums and cost of capital, SPFI can help mitigate those risks and attract lower-cost and longer-maturity financing from different sources. Diversifying capital sources is essential to our current need to decarbonise and build resilience for the entire economy. In doing so, SPFI can also help subnational governments boost a just transition. That is particularly true in a competitive and increasingly protectionist global context. As a few examples, NPBs and SPFI can:

- Secure long-term financing through green bonds and guarantees to drive the energy transition;
- Support climate-resilient and low-emissions development of regions, cities and sectors through pooled finance mechanisms and performance-based finance;
- Help build syndicated and first-loss protection mechanisms to advance strategic infrastructure projects;
- Attract foreign direct investments to boost green sectors by mitigating currency risk (hedging); and
- Support and chip into sub-funds to channel catalytic capital and strengthen local innovation ecosystems etc.

Finally, as financial intermediaries, NPBs and SPFI can mobilise investments at scale while maintaining their ability to fund smaller, local projects in the local currency.

According to the Global Impact Investing Network (GIIN)'s 2024 Survey Report, the volume of invested capital grew at a compound annual growth rate (CAGR) of 6% while the number of transactions decreased by a CAGR of 1% in five years. That means larger deals on fewer transactions. This trend is in line with recent commitments by MDBs and vertical funds such as the Green Climate Fund (GCF) and Global Environment Facility (GEF), which are moving from project-based investments to larger programmes and country-led platforms .

In conclusion, MDBs – and other DFIs – can only become “better” and “more effective” once they succeed in voicing local government priorities. From decarbonisation and climate resilience building to implementing other SDGs, finance must flow to those priorities. Integrating NPBs and SPFI into the core of the global financial architecture is an emerging and increasingly important avenue to ensure that will happen.

Recommendations

Recommendations target two levels of G20 governments for a complementary top-down and bottom-up approach. First, G20 national governments should work with MDBs towards greater inclusion and coordination with subnational governments, NPBs and SPFI. Second, G20 subnational governments should continue building the means to access and have a voice in the global financial architecture.

To G20 National Governments

1. **Support the creation of a joint MDB working group on NPBs and SPFI:** the working group should discuss opportunities, develop processes and set transparent expectations for the engagement of MDBs with NPBs and SPFIs. The group should collaborate with the IFAWG, build on precedents such as the MDB working group on scalable solutions to increase private capital mobilisation, and aim at improving NPBs and SPFIs role as trusted partners in strengthening country systems and implementing development and climate operations locally.
2. **Ensure that NPBs and SPFIs are supported and centrally placed in the implementation of the G20 Roadmap towards Better, Bigger and More Effective MDBs:** national governments must support NPBs and SPFIs directly and call MDBs to help building the capacity and expanding the ability of NPBs and SPFIs to mobilise climate finance, including by – but not limited to:
 - Supporting NPBs and SPFIs to reflect global best practices, to ensure minimum safeguards and to maximise positive impact. MDBs can, for example, (i) provide capacity building for the implementation of their environmental and social frameworks, and (ii) engage with NPBs and SPFIs to support organisation-wide alignment with the Paris Agreement, strengthening their role as financial intermediary counterparts .
 - Scaling-up co-financing and jointly-implemented operations with the use of emerging financial instruments and mechanisms, thus serving a demonstration role on how to step up ambition on private capital and domestic resource mobilisation. In 2024, the European Investment Fund provided a counter-guarantee of up to 70% on a €30 million portfolio of German Landeskreditbank Baden-Württemberg (L-Bank). This allowed a support for sustainability and innovation of up to €61 million to small and

medium enterprise financing, through L-Bank and regional banking partners .

- Improving the ability of national and local actors to access finance (i) by supporting NPBs and SPFIs to de-risk sectors and technologies that are strategic for the transition, (ii) by offering local currency financing options to subnational governments, NPBs and SPFIs, and (iii) by developing hedging facilities . The Brazilian EcolInvest Program is an example of a de-risking solution, with hedging funding from the Inter-American Development Bank (IDB) and over BRL 6,811 million (USD 1,206 million) of catalytic capital already allocated for blended finance operations by NPBs and private banks in its first auction .
- Promoting knowledge-sharing and networks of NPBs and SPFIs that face similar climate funding challenges, seeking to enhance project pipelines and local support for project preparation. National initiatives such as the Brazilian Development Association (ABDE) can bring SPFIs together for peer-learning, as well as technical and political coordination.

3. **Give a seat to formal roles for subnational governments and SPFI representations in G20 Finance Track working groups:** subnational governments and SPFI representation groups must gain a seat so they can formally participate, feed into and influence Finance Track working groups such as the IFAWG and the SFWG. Among potential groups to formally represent subnational governments are the Global Taskforce of Local and Regional Governments (GTLR) and the Coalition for High Ambition Multilevel Partnerships (CHAMP) , while the Alliance of Subnational Development Banks in Latin America and the Caribbean , created within the Finance in Common (FiCS), serves as an example of potential representation by SPFIs.

To G20 Subnational Governments

4. **Consider the creation of SPFIs and support existing and new NPBs and SPFIs in setting up appropriate mandates, governance and transparency mechanisms:** SPFIs should be able to support local governments' efforts to allocate public funds efficiently and effectively in the transition, have autonomy from the public budget and be equipped with appropriate tools to leverage financial investments and mobilise different sources of capital. For example, by improving reporting and transparency, as with the Climate MRV by the Development Bank of the State of Minas Gerais (BDMG), in Brazil, SPFIs can ensure that positive impacts are delivered, measured and reported , also potentially unlocking access to innovative types of funding such as performance- and results-based finance.
5. **Involve NPBs and SPFIs in governmental policy planning processes:** NPBs and SPFIs can provide local governments with a financial perspective and skills, helping build better policies with long-term funding awareness and, whenever possible, clearer investment targets from planning stage. They can also support with strategies to identify, unlock and promote investment opportunities for the transition, and help with the management of associated risks. Governments of the Brazilian states of Mato Grosso, Pernambuco and São Paulo have included representatives from SPFIs in financial task forces aimed at translating climate plans into bankable projects and investments. Besides adding crucial know-how in finance, these specialists have also brought in networks, knowledge of existing programmes, needs and opportunities, and hands-on experience in local financial implementation.

T20 South Africa Convenors



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