This scoping note outlines a proposed OECD work programme on "Development banks and development finance institutions: scaling up green investment in developing countries" under the Programme of Work and Budget for 2017-18 and 2019-20. It describes the intended scope and approach of work in this area, which will consider development banks and development finance institutions (national, regional, bilateral and multilateral) and their role in promoting green investment in developing countries.

This paper is based on a draft note (DAC/DCD/2017/1) discussed at the 19th meeting of the OECD Development Assistance Committee (DAC) Network on Environment and Development Co-operation (ENVIRONET), and at a round table meeting with development banks and finance institutions organized by the OECD and IDFC on the 11th of November 2017 in Frankfurt.

Naeeda Crishna Morgado, OECD (Naeeda.CRISHNAMORGADO@oecd.org)
Jens Sedemund, OECD (Jens.SEDEMUND@oecd.org)

JT03430994
Note by Secretariat

Note on this document

In October 2017, the High Level Meeting of the OECD Development Assistance Committee (DAC) agreed to enhance efforts to understand how they – ‘as shareholders and investors in these institutions’ - can support operations that further environmental and social sustainability. This document outlines work under a proposed OECD work programme on "Development banks and development finance institutions: scaling up green investment in developing countries" under the Programme of Work and Budget for 2017-18 and 2019-20.

This paper is based on a draft note discussed at the 19th meeting of the OECD Development Assistance Committee (DAC) Network on Environment and Development Co-operation (ENVIRONET), and at an invitation-only round table meeting with development banks and finance institutions organized by the OECD and IDFC on the 11th of November 2017 in Frankfurt.

Summary

Decisions made on infrastructure investment in developing countries today will determine whether the SDGs and Paris Agreement goals will be met or not. This project aims to highlight the critical and evolving role of development banks and development finance institutions (DFIs) and what is needed for these institutions to boost green investment in developing countries, especially for sustainable infrastructure.

The project will:

- Analyse critical and emerging policy issues facing development banks on green finance and convene global policy dialogues with major development banks, DFIs and governments to discuss these,
- Map the green finance activity of different types of development banks and DFIs operating in developing countries,
- Collate best practice on how private / commercial investment is being mobilised for sustainable infrastructure by development banks and DFIs.

The work will consider the whole gamut of institutions, international (i.e. multilateral and bilateral development banks and DFIs) as well as domestic (i.e. national and regional development banks). It will place a special focus on development banks and DFIs from emerging economies (national and regional) that are poised to play a more important role in financing environmental solutions.

The implementation of this work is subject to members’ support.

---

1. Introduction

Investment in sustainable infrastructure in developing countries needs to be scaled up

1. Current investment levels in developing countries are not sufficient to meet the ambition set out in countries’ Nationally Determined Contributions (NDCs) and the Sustainable Development Goals (SDGs). The annual investment required for low-carbon, climate-resilient infrastructure is estimated at USD 6.9 trillion per year (OECD, 2017). As roughly 60% of this will be needed in developing countries, current infrastructure investment in developing countries will need to double to ensure countries meet the SDGs and Paris Agreement goals (NCE, 2016). Two years on from the Addis Ababa Action Agenda (AAAA) on financing for development, efforts to mobilise financing in the volumes needed in developing countries are yet to materialise (IATF, 2017). At the same time, the window to meeting the 2°C target of the Paris Agreement is narrowing - decisions made on infrastructure in the next ten years will determine whether all countries can meet the Paris Agreement’s goals (OECD, 2017).

2. The developing world is at a crossroads; there is a crucial need to scale up public and private finance for infrastructure, and at the same time, this investment needs to help countries to transform and ‘green’ their economies rather than locking in emissions-intensive, climate-vulnerable infrastructure that contributes to pollution and degradation of natural resources. Choices around energy infrastructure in developing countries illustrate this challenge; the energy sector needs to transform with greater emphasis on energy efficiency, renewable energy, and decentralised energy systems to help achieve universal access, while ensuring that existing and expanding on-grid energy systems move towards more environmentally sustainable forms. At the same time, as many large-scale infrastructure projects are associated with environmental and social impacts, adequate and efficient environmental and social safeguards systems are critical for ensuring that new infrastructure projects achieve their intended outcomes. This transformation will require a combination of policy, strengthened country systems for environmental protection, enhanced in country capacity and access to cleaner technologies and innovative solutions. Underpinning all these is the need to scale up green investment i.e. finance and investment flows that support green growth and environmental sustainability.

Development banks and finance institutions are important catalysts for the sustainable infrastructure challenge

3. While many different actors will need to be mobilised to help address the sustainable infrastructure challenge, development banks - publicly owned financial institutions with a specific development mandate - are critical. Within this group, national / domestic public financial institutions (including national development banks [NDBs]), regional development banks, multilateral development banks (MDBs), and bilateral development banks and development finance institutions (DFIs) play complementary roles. NDBs - like BNDES in Brazil or NAFIN in Mexico - are domestic institutions with connections to local markets and actors, and will be essential in scaling up domestic finance. Many have relationships with private companies operating in the local market and

---

2 Estimated at USD 2.2 trillion per year (NCE, 2016)
can supply adequate long-term financing in local currency. Some regional development banks - like CAF in Latin America - also work in a south-south context.

4. On the other hand, MDBs - like the World Bank - and bilateral development banks - like Germany’s KfW or France’s AFD - are backed by strong credit ratings and the support of their shareholders, and can bring knowledge and experience from different regions. These actors can help countries at national and regional levels to finance projects, develop infrastructure projects and pipelines, while also supporting essential policy reforms that can help attract private finance and investment. Bilateral DFIs - like UK’s CDC, US's OPIC and France's Proparco - also work directly with the private sector, helping to build local capital markets and financial capacity in developing countries.

5. Together, development banks and DFIs bridge the gap between public and private actors, helping to crowd in private finance and to foster market development. They can play a dual role by financing cleaner infrastructure and helping build the capacity required to enable climate action.

International development and climate finance architecture is evolving

6. Internationally, more emphasis is being placed on the whole array of development finance institutional actors, including national, regional, multilateral and bilateral development banks, than ever before (Amerasinghe et al., 2017). In 2017, the G20 Leaders Statement and the G20 Hamburg Action Plan on Climate and Energy both call for MDBs to enhance their climate activities, including promoting access to clean energy, scaling up adaptation finance and mobilising private resources. The 2017 G7 Environment Ministers’ communiqué calls for more alignment of financial support from MDBs and other DFIs with the goals of the Paris Agreement.

7. At the same time, the global climate finance architecture is evolving, and with the ramping up of the Green Climate Fund's (GCF) activities, there is more emphasis on the role of domestic actors in designing and implementing climate finance, including for infrastructure. Currently, half the 54 accredited entities of the GCF are either national or regional, including several national and regional development banks, such as India’s National Bank for Agriculture and Rural Development, Banque Ouest Africaine de Développement and Central American Bank for Economic Integration. In addition, national development finance actors provided just under half (45%) of public climate finance flows in 2013-14, on average (CPRI, 2016). An analysis of what this changing role for national and regional banks implies for international actors, such as MDBs and bilateral development banks and DFIs, will be important for policy makers and the banks themselves.

---

4 Communique of the G7 Bologna Environment Ministers’ Meeting, held in Bologna, Italy, on 11-12 June 2017, available at http://www.g7italy.it/sites/default/files/documents/Communiqu%C3%A9%20G7%20Environment%20-%20%Bologna_0.pdf
Issues and challenges in scaling up green finance

8. A greater role for development banks and DFIs in the green finance arena will mean working with client countries to shift their infrastructure portfolios towards cleaner, more sustainable infrastructure choices. Analyses of existing portfolios and activities of development banks reveals gaps that need to be addressed. When considering climate change only, in 2013-2015, a third of overall infrastructure financing committed by MDBs targeted mitigation or adaptation - Figure 1 (OECD, 2017). Among the different sectors, efforts need to be significantly scaled up for large-scale transport and water infrastructure. For example, only 21% of financing for transport and 16% for water targeted climate goals on average in 2013-15, as opposed to 49% for energy. While progress has been made in the energy sector, much of what is being financed could either help or hinder the Paris goals, depending on how the projects are developed and built. A review of the energy project pipelines of ADB, IFC and the World Bank showed that most of what these banks finance could be considered 'conditional' in terms of aligning with the well below 2°C climate goal i.e. these projects could align with low-carbon pathways 'if they are designed and implemented properly and with the right strategies and policies in place’ (Christianson et al., 2017).

Figure 1. MDB support for infrastructure that is climate-related as share of total MDB support for infrastructure

By sector, in USD billion, commitments, 2013-15 average

Source: OECD (2017)

9. MDBs are putting in place climate and environmental strategies and targets but what they do is driven and often limited by demand from client countries as well as interests of a diverse group of shareholders from developed and developing countries. As a result, amidst demands for support on a variety of development challenges, MDB support for sustainable infrastructure - especially efforts to mobilise private capital - is dependent on concessional environmental finance which helps to bridge the viability gap for investments in countries where markets are maturing and are not yet optimal for mobilising purely commercial finance (Trabacchi et al., 2016). Coherent strategic direction from shareholders to take a stronger role in supporting the implementation of NDCs and other environmental plans will be important against this background. In addition, systematic
integration of climate and other environmental risk screening, as well as reporting on portfolio wide carbon footprints would be also be important going forward.

10. Among NDBs, the absence of widely adopted standards for reporting green investments make tracking and assessing what these banks finance difficult. Initial inroads are being made in this area through the harmonised International Development Finance Club - MDB methodologies for tracking green finance, which has enabled individual banks to collect information in a comparable way. Despite this, granular information on the composition of NDB portfolios is not readily available or comparable. Some NDBs - like those prevalent in Latin America - have made significant progress to finance green and sustainable infrastructure. For example, 12 domestically focussed DFIs in Brazil, Chile and Mexico provided USD 11 billion in climate finance in 2015, the majority of which went to infrastructure sectors, and supported the scale up of private investment (Abramskikh et al., 2017). However, financing from NDBs reflects the policy directions of their government, and their financing can - in many cases - go side by side with investment in less environmentally sustainable projects. At the same time, while entities like the Green Climate Fund are beginning to channel climate finance through national institutions like NDBs, many of these institutions lack strong mandates or expertise on climate and may not have the capacity nor the experience needed to access international climate support and roll out green financing at scale.

11. Another issue is for development banks and DFIs to scale up their efforts to crowd-in private investment for sustainable infrastructure and to support green market development. Approaches like blended finance are well-suited for large-scale low-carbon infrastructure investments, such as grid-based renewables projects and sustainable urban transport systems, and could be scaled up across all development banks. Infrastructure finance models and early stage venture capital that target decentralised energy solutions can help achieve energy access and development goals though market development. Moving forward on this agenda requires a much stronger focus overall on mobilising commercial / private finance for sustainable infrastructure, underpinned by robust environmental and social safeguards systems. The European Commission's External Investment Plan is one example of how donor governments are moving towards using their support to mobilise commercial finance through blended approaches. Bilateral development finance institutions (DFIs) are well placed to take this agenda forward, however, their efforts will need to extend their focus beyond renewable energy. For example, while a fifth of commitments (22%) by members of the European Association for DFIs (EDFI) in 2015 targeted climate change, much of this went towards renewable energy and limited attention in other sectors, and with less than 1% targeting climate change adaptation (OECD, 2017). National and regional development banks can also play an important role in this regard, and by providing financing in local currency they can help support local financial markets and mobilise local commercial investors.

**Cooperation at the international level can help development banks and DFIs take on a greater role in financing sustainable infrastructure**

12. OECD (2017) calls on policymakers to support development banks and finance institutions to put in place targets and action plans to boost support for sustainable infrastructure, improve disclosure of climate risks, scale up efforts to mobilise private investment, and continue to support relevant policy reforms and planning frameworks in developing countries. Implementing this ambitious action plan across NDBs, MDBs, and
bilateral development banks and DFIs will require a concerted effort by governments in developing countries, donor governments and the institutions themselves.

13. There is a need for more evidence and information on the changing role of development banks and finance institutions within the broader international climate and development finance architecture. There is no widely accepted framework for assessing sustainable infrastructure and finance, though initial efforts to define ‘Sustainable Infrastructure Principles’ have been initiated by the Inter-American Development Bank. In terms of understanding the extent to which development banks are already implementing and mainstreaming green finance, reporting to the OECD DAC statistical system allows for a detailed and comparable picture of multilateral and bilateral development banks and DFIs when considering climate change, but not necessarily other environmental variables. In addition, there is a need for more research on what national and regional development banks are financing.

14. More insights and examples of how development banks can mobilise commercial investment for sustainable infrastructure and support the development of pipelines, including on the potential issues and challenges, will be important to support scale up of these approaches. Greater consideration is also needed on how the different institutions - national / regional, multilateral and bilateral - can work together and with others to deliver green finance. Greater cooperation and multilateral dialogue can help to raise awareness of the comparative strengths of national/regional, multilateral, and bilateral actors and on the constraints they face in scaling up investment for infrastructure and making sure it is green.

2. Proposed scope and approach

15. This work will improve the understanding and awareness of the changing role of development banks and DFIs in supporting sustainable infrastructure through green investment in developing countries. It will help governments to strengthen the role of development banks and DFIs in implementing the Paris Agreement and SDGs, including the major challenges and constraints they face in delivering green investment and finance, and what is needed to address these.

16. The project will analyse how these banks are improving the environmental footprint of their portfolios, and will collate and share best practices in mobilising private finance for sustainable infrastructure, highlighting their role within the local development finance architecture. It will facilitate discussions on critical and emerging challenges such as scaling up adaptation finance, designing green finance that address environmental issues beyond climate change, framing and assessing sustainable infrastructure, developing strategies and tools to support mainstreaming (including through robust environmental and social safeguards systems), mobilising commercial green investment etc.

17. A special focus will be development banks from emerging economies that are important actors in regional contexts, supporting infrastructure development in other developing countries. The project will consider energy, transport and water infrastructure, with an emphasis on sustainable infrastructure that addresses environmental concerns, such as climate change, improving resource use efficiency, addressing pollution, and sustaining natural capital.

18. This work will continue from previous OECD efforts in analysing and improving policies on development finance and green investment, including:
• Forthcoming OECD report on ‘Making Blended Finance Work for the SDGs’ that considers the role of bilateral and multilateral development banks and finance institutions in mobilising commercial investment for the SDGs and Paris Agreement.
• Flagship biannual OECD reports on Multilateral Aid which emphasise the role of multilateral organisations as important channels of development co-operation.

19. This work will complement the extensive programme of work on private sector issues in the DAC. It will benefit from and leverage extensive OECD experience in tracking bilateral and multilateral climate-related development finance, as well as publicly-mobilised private investment. As a work item under the OECD Center on Green Finance and Investment it will benefit from extensive OECD experience in this area, including work areas on Green Finance and Investment Country Reviews, Green Infrastructure Project Pipelines, and Green Investment Banks, as well as work on Long Term Investment for Infrastructure.

20. The project will build on and continue collaboration with development banks and DFIs initiated in the course of the development of the OECD ‘Investing in Climate, Investing in Growth’ report, especially partnerships with key stakeholders such as the International Development Finance Club (IDFC), the European DFI Association (EDFI), and major MDBs, among other groups of stakeholders. It will benefit from evidence mapping and literature reviews on NDBs that is being planned for 2018 by IDFC members. In addition, it will build on discussion channels focussed on specific topics such as the OECD Senior Advisory Group on Blended Finance Principles. The project will also seek to complement other international initiatives related to green finance in developing countries such as the UNEP Inquiry for a Sustainable Financial System.

21. The three areas of work will be as follows:

2.1. Policy analysis and dialogue to address critical and emerging issues on green finance

22. Targeted policy analysis would be conducted on critical and emerging issues related to green finance, and discussed through a series of high level meetings with development banks and governments. The international policy dialogues could be held in different regions with governments, development banks and other stakeholders, building on existing partnerships and activities, such as the 'Mainstreaming Climate Action in Financial Institutions Initiative'. They could feature analytical work from the project as well as other initiatives such as the IDFC mapping study on national development banks. Some key issues that could be addressed include:

• Barriers to green finance inherent in the regulatory and policy environment, including the lack of adequate infrastructure and investment plans, project pipelines

---

6 See DCD/DAC(2017)30
7 Two roundtable meetings were held during the course of the OECD G20 report ‘Investing in Climate, Investing in Growth’ in order to develop policy recommendations for the report. The first meeting was held in Casablanca in November 2016, back to back with the IDFC Climate Finance Forum, discussed key policy issues and challenges in scaling up climate action. A second meeting, held in Paris in February 2017, reviewed draft OECD research and recommendations for the G20.
8 www.mainstreamingclimate.org/initiative/
and bankable sustainable infrastructure projects, and key actions for policymakers to address these barriers:

- Improving **mainstreaming within banks** including through increasing the clarity and consistency of what development banks finance, climate and other environmental risk screening, and assessment and disclosure of portfolio-wide carbon footprints;
- Enhancing the **effectiveness of environmental safeguards** systems to green overall investments;
- Issues around **improving bank efforts to mobilise private investment** such as access to concessional finance to ‘blend’ with development bank resources to mitigate risks and attract private investors, especially for new technologies and solutions;
- Effective approaches to **demonstrate and scale up business models for finance of decentralised energy or other sustainable infrastructure options**, for example results-based financing such as PAYG to promote off-grid energy access; NDBs may be particularly interested to learn from each other as well as from MDBs and bilaterals in this area;
- **Scaling up financing for adaptation and resilience** within infrastructure, including from private sector sources.

2.2. **Mapping the role of development banks in promoting green finance**

23. There is a clear lack of consistent, harmonised information to assess what role development banks currently play in promoting green finance. While bilateral development banks and MDBs report climate and other environmental finance activities to the OECD DAC system, and a selection of NDBs report green finance to the IDFC Secretariat, the information is not comparable in terms of its granularity, and estimates are not necessarily available as a share of their portfolios. Beyond financial flows, even less harmonised information is available to ascertain what role the different groups of development banks play in supporting infrastructure investment in global, regional and national contexts. Recent studies have focussed on specific actors (e.g. NDBs or MDBs), but few have considered both international and domestic institutions together. As part of this work, a mapping study would be conducted to identify the development banks active in each region and shed more light on their green finance activities, within the context of infrastructure portfolios. Based on a list of indicators to assess progress on green finance for infrastructure, a survey of development banks and DFIs active in developing countries - including both international and domestic institutions - will be conducted to provide a clearer picture of the activities of these banks. The results of the survey would be discussed at regional consultations to validate the findings.

2.3. **Collating case studies and best practice on how private / commercial investment is being mobilised by development banks for sustainable infrastructure**

24. Several instruments and innovative approaches are emerging to mobilise private investment for climate action. Examples include, amongst others, results-based financing
(RBF) for decentralized off-grid systems, which can spur market development and engage SMEs, and green credit lines and guarantees through local financing institutions that can build local financial capacity and offer support the uptake of energy efficient equipment in industries characterised by small and medium sized enterprises (SMEs). In some regions, bilateral development banks and MDBs are working to build the capacity of NDBs to mobilise green finance and investment (Abramskiehn et al., 2017).

25. Case studies will be developed on how development banks and DFIs are mobilising private investment for sustainable infrastructure and some of the major challenges they are facing in this area. The cases will analysed against overarching principles for public-private approaches, such as those set out in draft OECD/DAC principles on Blended Finance. Cases will also be considered within country / regional contexts to analyse the changing role of development banks in supporting Nationally Determined Contributions (NDCs), especially targets related to infrastructure. This work would benefit from national / regional consultations with national and multilateral development banks, governments and development partners.

3. Proposed deliverables

26. There are five main deliverables proposed for this work. These include:

- Global / regional high level roundtable dialogues with governments, development co-operation providers and development banks on the main issues and challenges facing development banks in aligning their infrastructure portfolios with more sustainable pathways.
- Targeted short reports / policy papers on emerging and critical issues related to green finance
- Survey of development banks and DFIs on current climate and green finance activities
- Case studies of how development banks and DFIs (national/regional, multilateral and bilateral) are mobilising private finance for infrastructure in developing countries
- A synthesis report on the role of development banks in promoting green investment for sustainable infrastructure in developing countries. The report will outline the landscape of development banks across developing countries, highlight best practice cases of private finance mobilisation and financing for adaptation, and include policy highlights for governments and development banks.

9 Rather than a large up-front payment (or delivery of physical systems) to an implementing entity (private sector or NGO) with the expectation that the systems be installed, with RBF a payment is made only after a system is installed. Early results of RBF pilot programs suggest that the incentive structure can quickly spur market development by pushing the entities to 1) forge their own relationships with vendors, 2) recruit and train personnel, 3) devise marketing strategies and 4) develop customer payment options. Companies and NGOs that succeed in receiving RBF payments drive down their transaction costs through their experience and are well-positioned to continue in the market as RBF payments are reduced or phased out.

10 Draft OECD/DAC Principles on Blended Finance highlight important considerations for such approaches, namely the need to mobilise investors not currently supporting sustainable infrastructure, supporting the development of local capital markets, balancing risks and returns, and enhancing transparency on public-private approaches.
4. Timeline

27. This work would be carried out over an 18 month period, starting in 2018, and be completed in 2019.

5. References


