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**DEVELOPMENT CO-OPERATION DIRECTORATE
DEVELOPMENT ASSISTANCE COMMITTEE**

Cancels & replaces the same document of 9 October 2017

DAC Network on Environment and Development Co-operation

Development banks and development finance institutions: scaling up green investment in developing countries

Draft scoping paper

19th ENVIRONET Meeting, 19-20 October, 2017

The DAC PWB 2017-18 includes work on “Development co-operation for trade, green investment, and private sector development for the 2030 Agenda”. This scoping note outlines 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.

Members are requested to:

- Provide comments and suggestions on the scope of the work
- Suggest relevant work within the development finance and climate finance communities where synergies could be sought
- Indicate their preliminary interest in providing voluntary contributions to support this work

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Note by the secretariat

This document outlines work to support the delivery of Output Area 9 “Development co-operation for trade, green investment, and private sector development for the 2030 Agenda” under the DAC Programme of Work and Budget (PWB) for 2017-18, and which will contribute to work under the OECD Centre on Green Finance and Investment. It is being circulated for comments to the DAC Network on Environment and Development Co-operation (ENVIRONET), and will be discussed at the 19th Meeting of the DAC ENVIRONET.

As an area of work that is considered under 'optional' funding under the DAC PWB 2017-18, this work is contingent on raising support through voluntary contributions from members.

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 changing role of development banks and development finance institutions (DFIs) and what is needed for these institutions to boost investment in sustainable infrastructure in developing countries.

The project will:

- map the climate / green finance activity of development banks and DFIs operating in developing countries with a focus on sustainable infrastructure,
- collate best practice on how private / commercial investment is being mobilised for sustainable infrastructure by development banks and DFIs,
- convene global policy dialogues with major development banks, DFIs and governments to identify and tackle critical challenges and issues in order to boost investment in sustainable infrastructure in developing countries.

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 development finance institutions from emerging economies (national and regional) that are poised to play a more important role in the context of south-south co-operation.

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Draft scoping paper
Development banks and development finance institutions:
scaling up green investment in developing countries

1. Introduction

Investment for 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 countries¹ 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. Issues around energy infrastructure in developing countries illustrate this challenge. Significant investment will be required to push electricity access rates toward universal access. As part of this, the energy sector needs to transform with greater emphasis on energy efficiency, off-grid renewable energy as well as ensuring that on-grid energy systems are sustainable. This transformation will require a combination of policy reforms, enhanced 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.

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] and 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

¹ Estimated at USD 2.2 trillion per year (NCE, 2016)

finance. Many have relationships with private companies operating in the local market and can supply adequate long-term financing in local currency. Some regional development banks - like CAF - also work in a south-south context, backed by developing countries and working in developing countries.

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. 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.

Development banks and DFIs are critical actors in the changing development and climate finance architecture

5. 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 resources². The 2017 G7 Environment Ministers' communique calls for more alignment of financial support from MDBs and other DFIs with the goals of the Paris Agreement³.

6. 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 Integration⁴. In addition, national development finance actors provided just under half (45%) of public climate finance flows in 2013-14, on average (CPI, 2016). An analysis of what this changing role for national and regional banks implies for international actors, such as MDBs and

² G20 Leaders Statement 'Shaping an interconnected world' and Annex on G20 Hamburg Action Plan on Climate and Energy, Hamburg, 7-8 July 2017, available at https://www.g20.org/Webs/G20/EN/G20/Summit_documents/summit_documents_node.html

³ 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/Comuniqu%C3%A9%20G7%20Environment%20-%20Bologna_0.pdf

⁴ Green climate Fund Accredited Entity Directory, accessed on 6.10.17, available at www.greenclimate.fund/how-we-work/tools/entity-directory

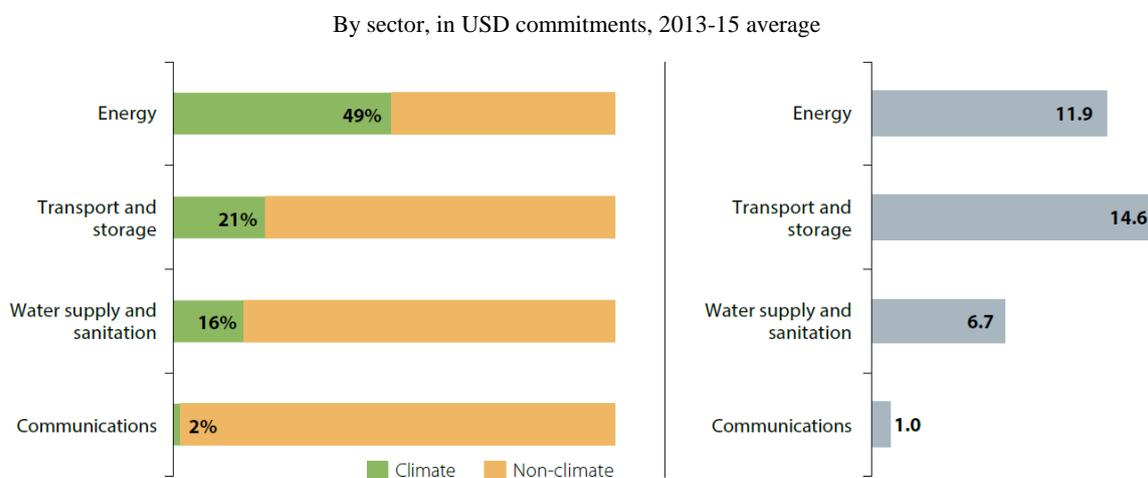
bilateral development banks and DFIs, will be important for policy makers and the banks themselves.

Development banks and DFIs face several barriers in scaling up green financing

7. A greater role for development banks and DFIs in the climate arena will mean working with client countries to shift their infrastructure portfolios away from carbon-intensive infrastructure towards cleaner choices. Analyses of existing portfolios and activities of development banks reveals gaps that need to be addressed. In 2013-2015, a third of overall infrastructure financing committed by MDBs targeted climate change 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).

8. MDBs are putting in place climate 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. Amidst demands for support on a variety of development challenges, MDB support for low-carbon and climate-resilient development - especially efforts to mobilise private capital - is dependent on concessional climate finance which helps to support 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). In addition to coherent direction from shareholders to take a stronger role in the supporting the implementation of NDCs, systematic integration of climate risk screening, as well as reporting on portfolio wide carbon footprints would be also be important going forward.

Figure 1. Share of MDB support for infrastructure that is climate related and total MDB support for infrastructure,



Source: OECD (2017)

9. Among NDBs, the absence of widely adopted standards for reporting climate-related investment makes tracking and assessing what these banks finance difficult. Initial inroads are being made in this area through the harmonised International Development Finance Club - MDBs methodologies for tracking climate finance, which has enabled individual banks to collect information in a comparable way. Despite this, 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 development finance institutions 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 (Abramskiehn 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 more carbon-intensive 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 do not have the capacity nor the experience needed to access international climate support and roll out green financing at scale.

10. Another issue is for development banks and DFIs to scale up their efforts to crowd-in private investment for low-carbon, climate-resilient 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 through market development. Moving forward on this agenda requires a much stronger focus overall on mobilising commercial / private finance for low-carbon and climate resilient infrastructure. Bilateral development finance institutions (DFIs) are well placed to take 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

11. 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.

12. 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. Underpinning this is a need for more evidence and information on the changing role of development banks and finance institutions in financing sustainable infrastructure within the broader international climate and development finance architecture. Reporting on climate-related development finance to the OECD DAC statistical system allows for a detailed and comparable picture of multilateral and bilateral development banks and DFIs; however there is a need for more research on what national and regional development banks are financing. Greater consideration is also needed on how the different institutions - national / regional, multilateral and bilateral - can work together and with others to deliver climate finance. 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.

2. Proposed scope and approach

13. This work will improve the understanding and awareness of the changing role of development banks and DFIs in supporting sustainable infrastructure in developing countries. It will analyse how these banks are aligning themselves with climate-friendly pathways, and will collate and share best practices in mobilising private finance for sustainable infrastructure, highlighting their role within the local development and climate finance architecture. The results and discussions from this work will help governments to better consider these institutions as actors to implement the Paris Agreement and SDGs, including the major challenges and constraints they face in delivering sustainable infrastructure finance, and what is needed to address these.

14. A special focus will be development banks from emerging economies that are important actors in regional contexts, supporting infrastructure development in other developing countries. Among infrastructure sectors, the priority focus will be on energy infrastructure as one of the main enablers of both the SDGs and the Paris Agreement, but other infrastructure types, such as transport or water, will also be considered, depending on the region in question.

15. This work will continue from previous OECD efforts in analysing and improving policies on development finance and green investment, including:

- Flagship OECD report *'Investing in Climate, Investing in Growth'*, developed in support of the German G20 Presidency in 2017, highlighted the key role of development banks in financing low-carbon and climate resilient infrastructure
- 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

16. This work will complement the extensive programme of work on private sector issues in the DAC⁵. 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 green finance and investment, 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.

17. 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'* report⁶, 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.

18. The four areas of work will be as follows:

2.1. Mapping the role of development banks in promoting green finance

19. 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 finance activities to the OECD DAC system, and a selection of NDBs report green finance to the IDFC Secretariat, the information is not comparable, 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

⁵ See DCD/DAC(2017)30

⁶ 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.

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.

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

20. Several instruments and innovative approaches are emerging to mobilise private investment for climate action. Examples include, amongst others, results-based financing (RBF)⁷ 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).

21. 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 be analysed against overarching principles for public-private approaches, such as those set out in draft OECD/DAC principles on Blended Finance⁸. 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. It would also complement other related initiatives in this area such as the World Resources Institute-led NDC Partnership and other platforms set up to accelerate investment in NDCs.

2.3. Promoting global policy dialogue among development banks and policymakers

22. International policy dialogue - through a series of high level meetings - would be convened to discuss the key issues facing development banks at global, regional and

⁷ 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.

⁸ 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

national levels. These meetings would be held in different regions with governments, development banks and other stakeholders, and build on existing partnerships and activities, such as the 'Mainstreaming Climate Action in Financial Institutions Initiative'⁹. The dialogues could tackle key cross-cutting issues such as:

- Barriers to green finance inherent in the **regulatory and policy environment**, including the lack of adequate infrastructure and investment plans, project pipelines and bankable sustainable infrastructure projects
- Improving **mainstreaming within banks** including through increasing the clarity and consistency of what development banks finance, climate risk screening, and assessment and disclosure of portfolio-wide carbon footprints.
- 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 for improving infrastructure projects in developing countries

3. Proposed deliverables

23. There are four main deliverables proposed for this work. These include:

- A synthesis report on the role of development banks in promoting green investment and implementing climate finance 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.
- Global survey of development banks and development finance institutions on current climate / 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
- 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.

4. Timeline

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

⁹ www.mainstreamingclimate.org/initiative/

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