



Financing the 2030 Agenda

An SDG alignment framework for Public Development Banks

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KEY MESSAGES

During the first 'Finance in Common Summit', in November 2020, public development banks (PDBs) from around the world committed to align their activities with the 2030 Agenda and Sustainable Development Goals (SDGs)¹. While there is increasing interest in mainstreaming the SDGs, we still lack an open and deeper discussion of what that means. As a consequence, there is as yet no broad-based ambitious operational approach. The present study is the product of a European Think Tanks Group (ETTG) collaboration aiming both to propose a definition of SDG alignment and to provide concrete principles to further operationalise and promote such alignment in practice.

To align with the multidimensional scope of the 2030 Agenda and SDGs, PDBs must incorporate the imperative of the transition to low-carbon, climate-resilient and equitable socio-economic models in all their financing decisions and project cycles. Up to now, many SDG alignment discussions have been limited to mapping exercises. Some actors perceive "SDG investments" as equivalent to infrastructure investments, without questioning whether infrastructures are designed sustainably. The present study applies a much deeper comprehension of the 2030 Agenda, arguing that alignment with the Paris Agreement and SDGs must go hand in hand.



KEY MESSAGES (CONTINUED)

Implementing the 2030 Agenda requires PDBs to ensure coherence and spur a profound change on the scale of the entire PDB organisation and across its full range of operations. As such, SDG alignment demands high-level commitment, together with deep governance and, probably, business model restructuring. However, moving from a clear understanding of the 2030 Agenda to a truly operational approach is no easy task. Hence, this study develops four operationalisation principles, along with practical steps to implement them. Together, these provide a guiding checklist for PDBs' efforts to align their activities with the 2030 Agenda and SDGs.

- **Operational principle 1: Lead internally and foster a sustainable development culture.** PDBs need to facilitate and enable a sustainable development culture throughout their respective organisations. To this end, banks could, for instance, start to require qualifications in strategic sustainable development areas when hiring new financial experts and ensure regular monitoring and development of these skills in performance appraisals. As a result, awareness and buy-in of the overarching principles of the 2030 Agenda could be both deepened and accelerated among all employees, leading to more systemic, coherent and integrated decisions.
- **Operational principle 2: Develop a holistic strategy and long-term vision.** PDBs need to develop a holistic strategy and long-term vision for their contribution to global sustainable development. By adopting a robust strategy, or aligning an existing strategy or policy framework to the ambition of the 2030 Agenda, PDBs can become a driving force for the SDGs. As PDBs have differing mandates and geographical scopes, they should promote open exchanges with one another to maximise their collective contribution in this regard. This study presents practical tools to guide such a strategy-building process. These can provide a basis for discussion between stakeholders and help ensure that new or aligned strategy reflects a balanced approach, particularly across the social and environmental dimensions of the SDGs. The presented tools can also help PDBs analyse interactions between different bank priorities within a specific context.
- **Operational principle 3: Mainstream SDG priorities within internal operations.** Ambitious SDG alignment means moving beyond the strategy level to mainstream SDG priorities within internal operations. This entails building a systematic and coherent internal process for analysing finance with SDG considerations embedded in both the ex ante and ex post phases of investment. Such an approach to management will ensure that alignment becomes part and parcel of the whole investment cycle. Pioneering PDBs have developed promising tools to support such a process. Examples are portfolio alignment applying categorisation and differentiation according to context and adopting a value chain approach to finance sustainable transformation. As this paper will show, merely approving disparate SDG-aligned projects is no guarantee for an aligned and coherent portfolio.

- **Operational principle 4: Mobilise and catalyse truly transformative investments.**

The core of SDG alignment for PDBs lies in the mobilisation and provision of truly transformational investment supporting sustainable development trajectories. This is where PDBs can be game changers. If PDBs want to play the role of catalyst of sustainability transformations, they have to step out of their comfort zone. Doing so requires fostering proactive external engagement within their ecosystem of partners, capitalising on both their financial and non-financial services. PDBs thus need to move beyond projects that respond to opportunistic, standalone opportunities, and broaden their investment philosophy and approach to a more active stance that is both strategic and collaborative. They should also be ready to engage in policy dialogue at the country level to affect transformational change. This requires developing new competencies and incentive structures within their organisations.



The present study is the product of a European Think Tanks Group (ETTG) collaboration aiming both to propose a definition of SDG alignment and to provide concrete principles to further operationalise and promote such alignment in practice.



1. <https://financeincommon.org/sites/default/files/2021-06/FICs%20-%20Joint%20declaration%20of%20Public%20Development%20Banks.pdf>



CONTENTS

1.	Introduction	5
1.1	Purpose of the study	5
1.2	What are public development banks	6
1.3	PDBs and their role in SDG alignment	7
1.4	Proposed framework	9
2.	How to make alignment operational?	10
2.1	Principle 1: Lead internally and foster a sustainable development culture	12
2.1.1	What is the principal objective?	12
2.1.2	How can your bank work towards this principle?	12
2.2	Principle 2: Develop a holistic strategy and long-term vision	18
2.2.1	What is the principal objective?	18
2.2.2	How can your bank work towards this principle?	19
2.3	Principle 3: Mainstream SDG priorities within internal operations	24
2.3.1	What is the principal objective?	24
2.3.2	How can your bank work towards this principle?	24
2.4	Principle 4: Mobilise and catalyse truly transformational investment	31
2.4.1	What is the principal objective?	31
2.4.2	How can your bank work towards this principle?	31
	Concluding remarks	42
	Bibliographical references	43

1. INTRODUCTION

1.1 PURPOSE OF THE STUDY

The United Nations 2030 Agenda for Sustainable Development “Transforming Our World” is a transformational political project conveying the commitment to make development choices that simultaneously consider the different dimensions of development: access for all to health and essential services, restoration of the environment, reduction of social inequalities and more. It is at the interfaces of these various dimensions that development paths can be found to reduce vulnerabilities and build genuinely more resilient societies. These development paths should ensure, at the very least, that efforts affecting one dimension do no harm to others and, as far as possible, bring about positive reinforcements. **The true transformative potential of the 2030 Agenda lies in its integrated and indivisible nature, its emphasis on adopting a long-term time horizon, the primacy of systemic changes and its commitment to enhancing the lives of the poorest and most marginalised people while achieving sustainable development.**

Public finance can play a critical role in work towards the SDGs and in alignment of finance with the SDGs. There are some 510 public development banks (PDBs) in the world, operating at the sub-national, national, regional, international and multilateral level (Xu et al., 2020, 2021). “The volume of activity of these institutions amounts to about US\$2 trillion annually – a staggering 10 percent of the total amount invested in the world every year by all public and private sources combined.”²

Most PDBs have an interest and willingness to take the necessary steps to mainstream SDG priorities in their strategies and operations (Riñón et al., 2020). However, considerable work remains to be done to really align these banks with the 2030 Agenda and SDGs. To accomplish this, PDBs will need to harmonise the terms they use and approaches they take and obtain tools and solutions to support their quest to implement this ambitious agenda. A step in this direction is to make available clear and practical

guidelines for PDBs on what it means to be aligned with the 2030 Agenda and SDGs, and how they can achieve a better operationalisation of this alignment within their strategies, governance structures and operations, both internally and externally.

As part of an effort to elevate the SDG alignment debate, the European Think Tanks Group (ETTG) has developed practical starting points for PDBs to embed the SDGs in their existing and future activities and investments. In this regard, the present study makes three main contributions:

- Providing a common **conceptual basis for alignment with the SDGs** for the PDB community
- Sharing practical ways, tools and processes to implement such alignment and make it **operational through all decision levels**
- Laying the groundwork for **future in-depth discussions and alliances among stakeholders** interested in SDG alignment and financing for sustainable development

The target audience for this study includes staff of all types of PDBs around the world, decision-makers within governments interacting directly with PDBs and financial stakeholders (public and private) sharing PDBs’ interest in SDG alignment and seeking to work together to accelerate and scale up investments related to sustainable development. The present study draws on inspiring examples, practices and tools implemented by pioneering PDBs. Its policy proposals and recommendations can serve sub-national and national development banks, while also being useful to the large multilateral development banks (MDBs) that might be at initial stages of 2030 Agenda alignment. All can draw on the proposed framework to refine their tools, processes and actions.

2. <https://financeincommon.org/sites/default/files/2021-06/FICs%20-%20Joint%20declaration%20of%20Public%20Development%20Banks.pdf>

1.2 WHAT ARE PUBLIC DEVELOPMENT BANKS

Although there is no internationally agreed-upon terminology to refer to public development financing institutions, the recent work initiated by the Institute of New Structural Economics (INSE) and then collaborated between INSE and Agence Française de Développement (AFD) refines the qualification criteria of public development banks (PDBs) and development financing institutions (DFIs) and proposes potential typologies to reveal their vast diversities (Xu et al., 2021). In this sense, to qualify as a PDB or DFI, an institution must fulfill all the following five criteria: (1) be a stand-alone entity with an independent financial and legal status; (2) the entity should deploy financial instruments as its main products and services; (3) funding sources go beyond periodic budgetary transfers; (4) proactive public policy-oriented mandate; (5) governments should play a steering role in ensuring that PDBs and DFIs pursue public policy objectives.

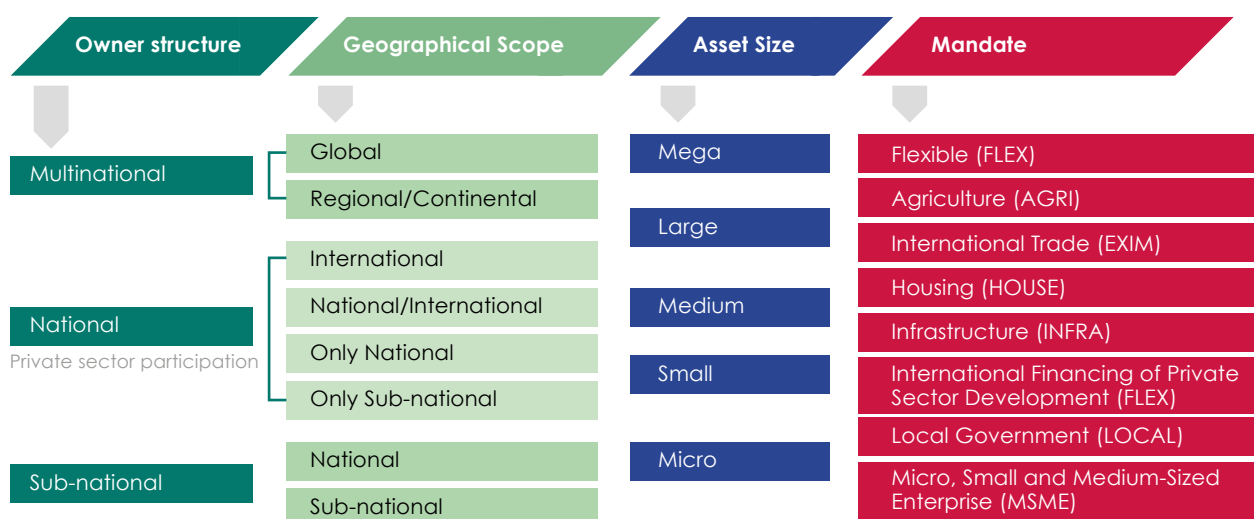
PDBs are thus a very diverse set of institutions. After rigorously applying the above five qualification criteria, Xu et al. (2021) identified 527 PDBs and DFIs worldwide, among which 510 (97%) are PDBs, 4 (1%) are equity funds, and 13 (2%) are

guarantee funds. Furthermore, these researchers propose a classification based on ownership (who owns them), geographical operation (where they operate), size (how big their total assets are), official mandate (what they aim to do), and income levels of their home countries (for national PDBs and DFIs, which income level their home country belongs to). As a result, we have:

- Multinational development banks (MDBs), or regional development banks (RDBs), owned by two or more countries
- National development banks (NDBs), created by a single government or national public entity
- Sub-national development banks (SDBs), created and owned by a local government entity

Each of these can be divided into further subcategories, depending on the scope and geographical area in which they operate. Furthermore, applying a broad definition, we use the terms "PDB" and "DFI" in parallel, primarily with the same objective of designating all in the community, as PDBs are the main category in the DFI family.³ Figure 1 presents categorisations of PDBs.

Figure 1 - The variety of typologies of PDBs and DFIs



Adapted from: Xu et al., (2021) Mapping 500+ Development Banks Qualification criteria, stylized facts and development trends. AFD Research Papers. N. 192

3. PDBs include international financial institutions (IFIs) providing development-oriented finance on a bilateral or multilateral basis. PDBs are frequently referred to as "development finance institutions" (DFIs) but DFIs may additionally be non-governmental in status.

1.3 PDBS AND THEIR ROLE IN SDG ALIGNMENT

1.3.1 A catalyst role for sustainable development

Since the SDGs were adopted in 2015, and particularly during the two recent Covid-19 dominated years, despite promises to “build back better” or “differently”, stimulus measures have been primarily aimed at just building back by boosting consumption and restoring production to previous levels. In this regard, ensuring that all financial flows are compatible with the SDGs is a major challenge of the 21st century (Marodon, 2020) – even more so in the context of recovery from the global pandemic.

PDBs at the multilateral, regional, national and sub-national levels have the ability to adapt their roles to changing needs at different stages of development and points in time. Thus, PDBs are well suited not only for providing countercyclical lending during a crisis but also for reigniting growth after a crisis. With this, PDBs are well positioned to drive growth towards achievement of the 2030 Agenda.

When it comes to implementing the 2030 Agenda and SDGs, the focus needs to lie on the principles of integration, transformation and leaving no one behind. All actors should take steps in this direction, but PDBs have certain advantages that enable them to take a position at the forefront of this movement. With their clear knowledge of the specific context in each region or country in which they operate, and unequalled flexibility in the design of concessional loan programmes, in recent years these banks have become an essential voice and valuable complement to traditional official development assistance (ODA) and commercial investors (Xu et al., 2019). PDBs have a key role as a catalyst for projects that are economically viable, environmentally sustainable and socially just (Carlino et al., 2017).

PDBs have significant potential to generate additionality in sectors and economic segments with restricted credit but the potential to make positive contributions to sustainable development. It is not about financing just for the sake of meeting financial performance goals, as if PDBs were private banks. For instance, as suggested by Fernández-Arias et al. (2019), “[s]ubsidized lending to SMEs [small and medium enterprises] may be futile or counterproductive on productivity grounds unless such lending targets young firms that bring innovation and have high-productivity



PDBs are well positioned to drive growth towards achievement of the 2030 Agenda.



potential”. The same is true in sectors such as agriculture and housing. In these, financing traditional approaches may solve market failures, but only marginally contribute to catalyse the structural transformations needed to attain the SDGs. The 2019 Global Sustainable Development Report (GSDR, 2019) identifies six **transformations to invest in that can have an accelerating effect in meeting basic human needs within planetary boundaries:** Human well-being and capabilities, Sustainable and just economies, Food systems and nutrition patterns, Energy decarbonisation with universal access, Urban and peri-urban development and Global environmental commons. PDBs need to think about how they can actively contribute to these big sustainability transformations.

PDBs can support these transformations through **long-term investments. They are risky and PDBs can play a role in mitigating these risks.** PDBs have a solid reputation in the market and fulfil the role of an honest broker. They are known for their trusted and long-term client partnerships, convening power, close relationships with governments and rigorous due diligence processes. They can therefore provide a signalling function for sound projects. By mitigating risk, PDBs can facilitate long-term transformations within particular sectors, types of activities and types of investors and clients, providing “comfort” to new streams of transformative finance aligned with the SDGs.

The constellation of PDBs around the world can play a vital role not only in supporting recovery, but also in financing structural transformation, helping to lay the foundation for a financial model that is conducive to green and inclusive development, in line with the 2030 Agenda and SDGs.

1.3.2 Financing the 2030 Agenda entails ensuring that investments are not contradictory

Lack of SDG alignment starts with lack of a common language and interpretation of the objectives underlying the SDGs in the public and private sectors. "Too high-level goals or targets, and insufficiently ambitious definitions of SDG-alignment, run the risk of SDG washing – for example, any economic activity contributes to at least one or more SDGs through job creation" (OECD & UNDP, 2020).

The biggest transformative potential of the 2030 Agenda lies not in pursuing the 17 SDGs individually, but rather in its systemic approach that advances multiple SDGs in an integrated manner.

A report by the World Wide Fund for Nature (WWF) and The Biodiversity Consultancy Ltd (2021) confirms a lack of regard for environmental dimensions in PDBs' investment. Where PDBs have developed emergency rescue facilities for clients, the report found that these focused almost entirely on social and health aspects – not nature. Nonetheless, in today's context, many climate and biodiversity trends are clearly headed in the wrong direction. Even before the Covid-19 pandemic, there was a need to place more emphasis on environmental aspects like climate and biodiversity, though these have continued to lag (Mélonio & Tremel, 2021). The same is true for income inequality, which was among the most neglected SDGs even before Covid-19 but worsened during the pandemic (Mélonio & Tremel, 2021).

In order to counter these trends, PDBs could focus their financing more on nature-positive investments and create incentives for beneficiaries (public and private recipients alike) to embed environmental protection and equality in their decision-making, as well as engage in nature-positive strategies and improve financing outcomes for nature. They should also invest in "leave no one behind" policy and practice by investment and loan decisions that benefit the bottom 40% and by monitoring inequality outcomes from investments.

For PDBs, alignment with the 2030 Agenda means that the design and implementation of projects and strategies, the structuring and financing of projects, and the monitoring of effects should all be focused on maximising synergies and co-benefits between green and social investments, while reducing trade-offs. In other words, successful implementation of this paradigm shift relies upon disentangling complex interactions between the SDGs and their targets. More PDBs need to adopt a bold transformative mindset that sees SDG alignment and implementation as a development opportunity and asset, rather than as a box to check or even a burden.



The biggest transformative potential of the 2030 Agenda lies not in pursuing the 17 SDGs individually, but rather in its systemic approach that advances multiple SDGs in an integrated manner.



1.4 PROPOSED FRAMEWORK

Today, it is essential to mobilise and align all forms of financing in support of sustainable development. We cannot waste more time in addressing existing conceptual and methodological gaps. “Mobilising greater quantities of resources will be counter-productive if the activity they support is unsustainable” (OECD, 2021a).

Currently, there is no common understanding among PDBs about SDG alignment. Does contributing to one or a few SDGs mean that they are aligned? Does any one SDG need to be prioritised over the others? Can PDBs claim to be SDG-aligned if they contribute to one SDG but harm another?

Of course there can be no “model bank”, since each country’s political, social and economic circumstances are unique and practices that work in one country may well be detrimental in another context. Notwithstanding this inherent diversity, there is a need to harmonise PDBs’ practices and develop common norms and standards for how they align with the SDGs. There are various forms and methodologies for promoting such alignment, with each producing different results (Riaño et al., 2020).

Developing a framework for understanding SDG alignment and a common methodology would facilitate PDB support for SDG attainment. Hence, ETTG would like to propose an approach comprised by key principles to guide SDG alignment operationalisation through all decision levels within PDBs (Figure 2).

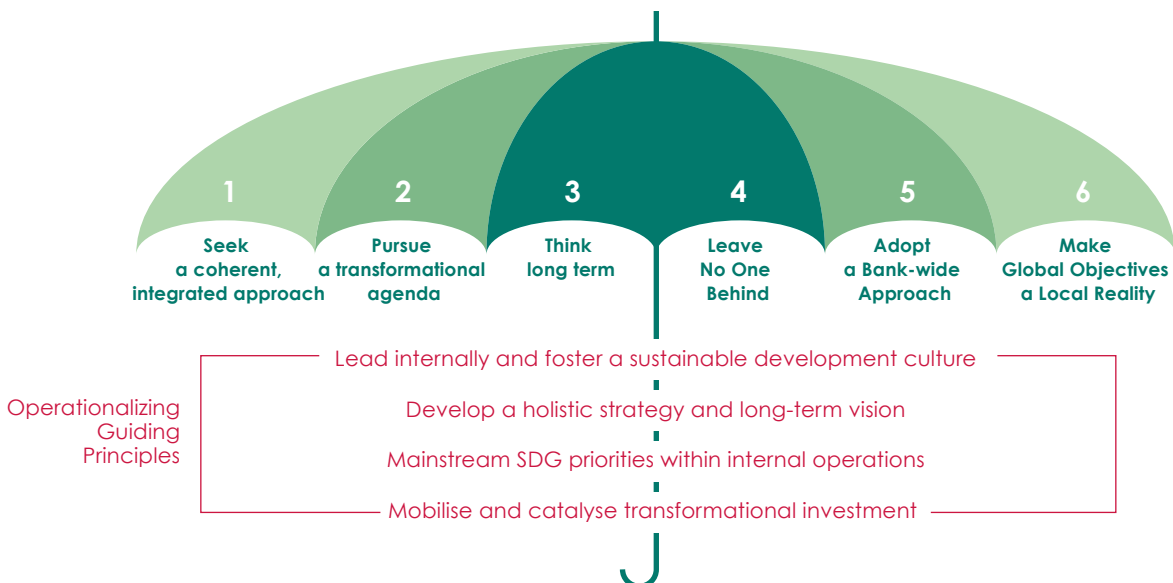
We propose four key operating principles as follows:

- Lead internally and foster a sustainable development culture
- Develop a holistic strategy and long-term vision
- Mainstream SDG priorities within internal operations
- Mobilise and catalyse transformational investment

These principles are not presented in order of priority or in any fixed sequence, though they do follow a logical flow and build on one another.

These principles can help orient PDBs’ efforts to align their activities, investments and services in support of implementation of the 2030 Agenda and SDGs and therefore, contributing to an integrated, transformational and long-term agenda that leaves no one behind. They cover key areas on which PDBs must focus and place greater emphasis, but they are not intended to be exhaustive and cover all possible improvements or needed changes. As mentioned, we are aware that there can be no “model bank”. Each PDB will integrate the available practices differently, according to its business model, areas and sectors of intervention, and capacities. Nonetheless, the principles can serve as tools to elevate the strategic debate within and about PDBs as gateways for SDG-aligned finance. As such, they can help drive a more holistic decision-making that includes careful consideration of the links between all dimensions of sustainable development.

Figure 2 - Transformational alignment with the 2030 Agenda and its SDGs





2. HOW TO MAKE ALIGNMENT OPERATIONAL?

Implementing the 2030 Agenda demands profound change on the scale of the whole PDB organisation. It demands high-level commitment, deep governance and, probably, business model restructuring. Any PDB seeking alignment with the 2030 Agenda will have to bring the entire institution on board, to embed environmental, social and economic considerations throughout bank decision-making and day-to-day operations, thus maximising its positive contribution to sustainable development.

Merely mapping PDB activities at the project level can never bring about such complete alignment, as this bypasses a deeper comprehension of the 2030 Agenda. Only bank-wide endorsement of SDG alignment can lead to a complete, comprehensive and systemic integration of the SDGs. They must be the main objective of bank activities. This new compass for action should orient the design and implementation of projects and strategies, the structuring and financing of projects, and the monitoring of effects.

Alignment should be understood here as the process by which PDBs ensure that all of their activities – individual and together as a whole – actively support achievement of the principles stated in the 2030 Agenda. This requires “scaling down non-consistent activities and seeking whenever possible to contribute to both the incremental and transformative changes needed at the national and global levels” (Cochran & Pauthier, 2019). Adopting a *bank-wide approach* helps address systemic challenges that extend beyond individual SDGs.

Moving from strategic intent to true ownership of the 2030 Agenda, and its promises, implies understanding that the power of the agenda lies in its interconnected and transversal focus. Challenges set forth in the 2030 Agenda are systemic and therefore require systemic solutions. It is not just a matter of marginally adjusting strategies and processes or classifying current efforts according to the 17 goals. Structural transformations are called for to really contribute to the SDGs, translating high-level declarations into concrete mainstreaming actions on the ground.

Nonetheless, current efforts have continued to be piecemeal and fragmented (Riaño et al., 2020). Long-term, sustainable impact at scale remains elusive. PDBs are certainly contributing to sustainable development through their financial and non-financial instruments, but they have not systematised these scattered actions in their portfolios and in their organisations as a whole. Therefore, the forcefulness and visibility of their actions is lost; we find ourselves with a kaleidoscope of diverse responses.

Pursuing a *bank-wide approach* requires PDBs to fulfil several demands: establishing an effective architecture to support delivery of the SDGs within the bank; integrating the SDGs into strategic plans and setting priorities to this end; delivering finance for projects and programmes that support progress on the SDGs, alongside wider reforms and innovations to mobilise the finance necessary to achieve them and ; developing appropriate data and monitoring systems to track and assess progress towards the SDGs⁴, among other things.

This chapter will develop the proposed **four guiding principles** that will help PDBs operationalise their 2030 Agenda and SDG alignment, both internally and externally within their ecosystem of partners (Figure 3). As mentioned, these four principles are not presented in order of priority or any fixed sequence, but they do follow a logical flow and build on one another.

The four principles and their respective recommendations provide a common language and interpretation of the alignment objective among PDBs. While all banks differ, these principles offer them support and direction towards 2030 Agenda alignment, according to each bank's own business model, areas and sectors of intervention and capacities. Together, the principles and recommendations provide a complete framework for operationalising alignment. Figure 4 brings together the principles and the associated recommendations for each, providing a “checklist” to elevate strategic debate about PDBs as gateways for SDG-aligned finance.

4. Adapted from ADB (2021).

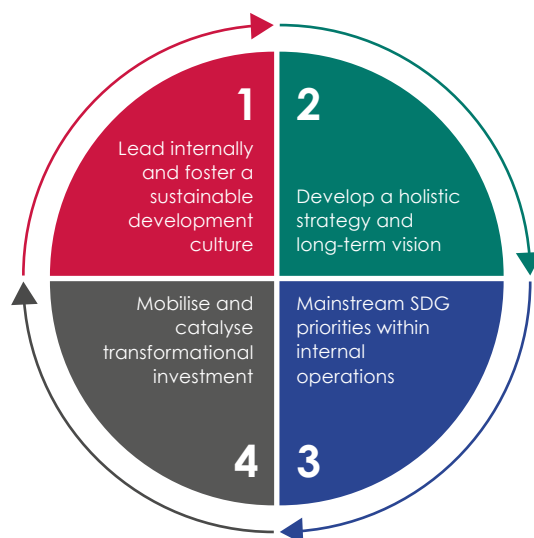


Figure 3 (above) - Four guiding operational principles

Figure 4 (below) - Framework for operationalising PDB alignment with the 2030 Agenda and SDGs

PRINCIPLE 1. Lead internally and foster a sustainable development culture

- 1 Enhance SDG qualifications among high-level decision-makers
- 2 Create SDG-related governance structures and assign clear roles and responsibilities
- 3 Build a sustainable development culture among employees
- 4 Link employee SDG performance with PDB key performance indicators
- 5 Closely guide financial intermediaries

PRINCIPLE 2. Develop a holistic strategy and long-term vision

- 6 Check and rethink the bank's mandate and vision
- 7 Define the missions that drive you
- 8 Ensure you have a balanced approach
- 9 Base your long-term strategy on a broad consultation process
- 10 Assess if your bank will require an additional policy framework

PRINCIPLE 3. Mainstream SDG priorities within internal operations

- 11 Move from project-based alignment to comprehensive portfolio alignment
- 12 Monitor SDG ambition throughout the entire project development cycle
- 13 Establish and update exclusion lists
- 14 Use ex post assessment to determine the real negative and positive impacts of investments

PRINCIPLE 4. Mobilise and catalyse truly transformational investment

- 15 Enhance policy influence to promote territorial development
- 16 Support countries/region towards sustainable development trajectories and foster Knowledge-based interventions to leave no one behind
- 17 Project development to ensure SDG bankability
- 18 Provide high-risk capital to kick start market development of sectors with strong potential for transformational change
- 19 Increase use of mobilisation structures to activate private investment at scale

2.1 PRINCIPLE 1: LEAD INTERNALLY AND FOSTER A SUSTAINABLE DEVELOPMENT CULTURE

2.1.1 What is the principal objective?

Operational principle 1 is “lead internally and foster a sustainable development culture”. That means promoting an **organisational culture and sound governance** that anchors sustainable development at the heart of the bank.

Though PDBs have independent financial and legal status, they do operate under the authority and supervision of their government or shareholders. From an organisational perspective, this means that PDB decision-making bodies often include representatives of national-level ministries (finance, foreign affairs, environment and/or energy transition, depending on the PDB type and mandate). Moreover, the government typically appoints the bank president or head, making this placement a political decision.

How, then, can we encourage the structural and human transformations needed to root systemic change within PDBs? Mainstreaming sustainable development within bank structures requires bold high-level commitment to SDG implementation. Bank leaders must be willing to encourage investment strongly aligned with longer term sustainability pathways and facilitate divestment away from less sustainable pathways (Riaño et al., 2020).

Therefore, undertaking governance and culture reforms is an indispensable requirement for PDBs to move from strategic intent to operationalisation of SDG alignment. Ownership of the alignment agenda must come from inside the bank, from the core of the institution. **The bank’s DNA has to be fundamentally and prominently linked to sustainable development. From top to bottom – from the highest level directors to those in planning, review and credit approval positions, the 2030 Agenda needs to be a cornerstone for action.**

This commitment requires full mobilisation of all bank areas around a culture of sustainable development backed by a solid architecture supporting delivery of the SDGs. Such commitment and full mobilisation will deepen and accelerate all employees’ awareness and buy-in of the overarching principles of the 2030 Agenda, leading to more systemic, coherent and integrated decisions.

2.1.2 How can your bank work towards this principle?

Enhance SDG qualifications among high-level decision-makers

Enhancing SDG qualifications among high-level decision-makers is a structural mean of implementing the “lead internally” principle. If SDG implementation is to become a cornerstone of PDB action, ensuring the full commitment of those in management and board positions should be non-negotiable. Only then can wishful thinking regarding contributions to SDG delivery be transformed into real alignment of strategy and operations – pursuing a *bank-wide approach* – vis-à-vis relevant national, regional and international frameworks such as the 2030 Agenda and the Paris Agreement.

Besides wishing or expecting the government or shareholders to nominate qualified representatives to occupy seats in directive bodies, PDBs need to become proactive advocates. They have to push for the skills and technical qualifications they need within these decision-making positions to advance SDG operationalisation, depending on the bank’s size and business model.

To operationalise alignment requires a qualified board and employees who are standard-bearers of the SDGs. They need determination and interest in permeating bank strategy, operations and external engagements with the conviction that the 2030 Agenda is the only way forward. The board of directors, bank president and chief executive officers should possess appropriate qualifications, for instance, knowledge and experience on sustainable finance, climate change, circular economy, agroforestry and food security, as this will allow them to drive decisions towards achievement of inclusive, equitable and sustainable development. The above will serve as a lever for PDBs to foster breakthrough thinking capacity and capability, especially among management and leadership.

Drawing on the Principles for Responsible Banking developed by the United Nations Environment Programme Finance Initiative (UNEP-FI) for private banks,⁵ PDBs should consider formally including sustainability criteria in the terms of reference or charter for board member nomination, remuneration and audit committees, or create a dedicated board committee focused on sustainability. The ideal scenario is that of a board which ensures its composition is sufficiently varied in knowledge, skills, experience and background to effectively discuss and take decisions that are informed by an awareness and understanding of sustainable development challenges and opportunities. "Sufficient awareness at the board level will also set the tone for the organization and drive greater awareness for senior management and staff" (World Economic Forum, 2019).

Create SDG-related governance structures and assign clear roles and responsibilities

In light of their efforts to align with the 2030 Agenda, PDBs should engage in internal discussions to identify their governance gaps and establish whether there is a need for personnel and structural changes such as the following:

- Creation of new positions
- Restructuring of existing committees or departments
- Creation of new specialised teams to strengthen decision-making at the different managerial and operational levels

Creating specialised committees attached to the president's office to act as study bodies on specific matters, with their own operating regulations and ability to present recommendations to the board can be a way to provide additional technical support to high-level officials. Such committees can be ad hoc or permanent, depending on the PDB's needs, and could be tasked, for instance, with carrying out cross-cutting sector analyses to uphold the bank's SDG strategy or determine ways to implement new international principles or standards that might be relevant for SDG alignment, such as the OECD Positive Impact Standards.

Another option is **creation of dedicated teams to oversee and support the SDG-alignment process** of the institution. These could be specialised according to the bank's mandate and defined strategic priorities, such as energy, carbon neutrality, social inclusion and biodiversity. If the bank already has a sustainability department or a climate-change team, it will be a matter of enlarging and strengthening its mandate and giving it the clear role of putting SDG alignment at the heart of the bank's agenda. For these teams to be successful, other bank units need to perceive the shift as a priority endorsed by the bank president and high-level officers. Of course, the bank needs to provide such teams with the necessary financial and human resources to perform the given role. Otherwise these become "influencers without budget" drawing power only from "CEO sponsorship". To avoid duplication of efforts, these teams should be cross-functional, with the following roles:

- Awareness raising
- Meeting regularly with operational teams to ensure influence in day-to-day financial decisions
- Providing ongoing training and development activities to qualify all employees from top to bottom to perform their duties and contribute to achievement of organisational goals
- Monitoring reconciliation of the Paris Agreement and SDG alignment processes, as both feed into PDBs' ultimate goal of contributing to carbon neutral, equitable, just and long-term sustainable development

As also recommended by I4CE and the NewClimate Institute (Lütkehermöller et al., 2021) in their "Operationalization Framework on Aligning with the Paris Agreement", the team's final form, full set of responsibilities and where it sits within the bank will very much depend on the organisational set-up and preferences.

5. <https://www.unepfi.org/banking/bankingprinciples/> and <https://www.unepfi.org/wordpress/wp-content/uploads/2019/09/PRB-Guidance-Documents-Final-19092019.pdf>



Finally, **decentralised sustainable development specialists can be designated as focal points** in operational departments and core business sectors to consolidate systemic and cross-cutting analysis of investments. In so doing, the bank provides additional support to employees who might be financial experts but lack the technical knowledge needed to conduct, for instance, biodiversity-related internal assessments with full understanding of what outputs should be expected.

The cases of both Germany's KfW and the European Investment Bank (EIB), and more recently, the Scottish National Investment Bank, serve as examples of PDBs that are prioritising recruitment of staff with the right skills and expertise. In the case of the first two, this includes not only looking for employees with financial expertise, but also providing significant in-house expertise in engineering and scientific fields related to sectors in which the banks are active and the nature of the investments being made. In the case of the recently created Scottish PDB, recruitment explicitly targets people with the ambition to help the bank fulfil its three missions, concerning the environment, people and place (see also the discussion under principle 2 on mission-based approaches) (Author Interviews, 2021). The bank was called into existence by NGOs, and its chief executive maintains that its three missions must be a filter for everything the bank does. New recruits interview not only with the team they would be joining, but also with the bank CEO and a "people and culture team" that helps determine whether the candidate is aligned with the bank missions. So, in addition to financial skills, the bank looks at candidates' knowledge and strategic expertise, for example, in sustainable transport and social and eco-housing.

Build a sustainable development culture among employees

Hand in hand with the required organisational changes, there has to be investment in human capital. Staff need appropriate information, education and training to build and maintain internal expertise on environmental, social and economic topics relevant to the bank's context. PDBs need adequate internal capacity and skills to scale up transformational action on SDGs.

To do this effectively, staff – especially those working in design, approval, follow-up and assessment of investments – need sufficient and ongoing training and information access. The sustainability field is changing rapidly, and only with the appropriate training will staff be able to embed the SDGs into their decision-making and analysis at the different stages of the investment process. Mainstreaming a sustainable development culture means much more than informing employees about what the SDGs are or how many targets they have, though this is mainly where the PDBs have thus far focused their educational efforts (Riaño et al., 2020). Mainstreaming entails fostering critical, innovative thinking that goes beyond understanding sustainability issues as the environmental component, or the environmental risk component, of investments. All personnel need the necessary tools to capitalise on the interconnected nature of the 2030 Agenda.

Sowing an SDG culture within PDBs ensures that all bank teams and functions have the right mindset to drive the necessary transformations and generate positive impacts in the territories they operate in.



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Link employee SDG performance with PDB key performance indicators

Leadership and culture changes must be accompanied by mechanisms that encourage behavioural changes and lead employees and institutions as a whole to take ownership of the new goal of alignment with the 2030 Agenda. To achieve this, PDBs need to define SMART⁶ key performance indicators (KPIs) reflecting the bank's strategic SDG priorities, and put in place incentives for board members, directors and staff to act accordingly. The chosen performance indicators should act as a catalyst to drive forward the bank's sustainability imperatives. "[S]ome KPI may produce perverse incentives or lead to outcomes such as prioritizing quantity over quality and [they] should therefore be carefully selected" (Lütkehermöller et al., 2021: 60). Appropriate KPIs will prove useful in PDBs' efforts to divest from business-as-usual activities, and invest in strategic and underserved SDG-related sectors. They, thus help banks avoid bias towards more traditional projects within their focal areas, when assessing investment opportunities.

Why think about linking employee performance to key SDG milestones? Linking employee performance to key SDG milestones can reinforce commitment and motivate different teams to introduce changes and new goals. Projects that aim to generate transformations with a long-term horizon and that seek sustainable development often bring considerable structural challenges. For example, they may not fit into the usual categories regarding aspects like beneficiaries, sites and resources required. Therefore, if there is no extra incentive to focus on them, employees are likely to prioritise other deals. For instance, a large infrastructure project may be put ahead of a nature-positive investment project implemented by local communities.

Once performance incentives have been determined, the next step is to **adopt internal incentive systems** that encourage staff to promote ambitious, transformative sustainable development action, and **provide tools** to enable staff to contribute to these at a greater pace and scale. Options to take into consideration include the following:

- Including KPIs as explicit goals in employee work plans and performing regular monitoring of these in performance appraisals
- Linking KPI performance to executive pay considerations
- Defining short-term incentives such as annual bonuses
- Linking KPI achievement with access to training or courses at top-ranking institutions

Closely guide financial intermediaries

A large portion of PDB investments comes in the form of corporate loans or investments via financial intermediaries.⁷ Efforts to adequately support and monitor such intermediaries are therefore essential to ensure alignment with the 2030 Agenda throughout the entire investment cycle. The scale on which this has to be done will depend on the size and scope of each PDB. Larger MDBs and bilateral PDBs with NDBs and SDBs as intermediaries need to place stronger focus not only on follow-up but also on provision of technical assistance and capacity building.

Operationalising alignment with the 2030 Agenda among intermediaries requires efforts in at least two areas:

- **Raising awareness and creating capacity** within intermediaries. To produce an effect on a significant scale, beyond what the bank finances itself, it is imperative to train financial intermediaries and partners to transform themselves, to align all of their activities and portfolios with national SDG trajectories and stop any "brown" or anti-SDG activity.
- **Performing the true role of supervision, monitoring and oversight of compliance with social and environmental performance standards.** A corollary to this is ensuring that intermediaries are not ruling out projects that may be strategic in supporting SDG implementation, based for example, on financial utility reasons.

By operating through financial intermediaries PDBs widen their scope of action and reach far more beneficiaries. Furthermore, when it comes to impacting local communities and grassroots organisations, operating through intermediaries close to the ground can be an asset.

6. Smart indicators are specific, measurable, attainable, realistic, and time-bound.

7. These intermediaries, depending on the size and business model of the PDB can be national governments, local authorities, grassroots communities, private commercial banks or NGOs.

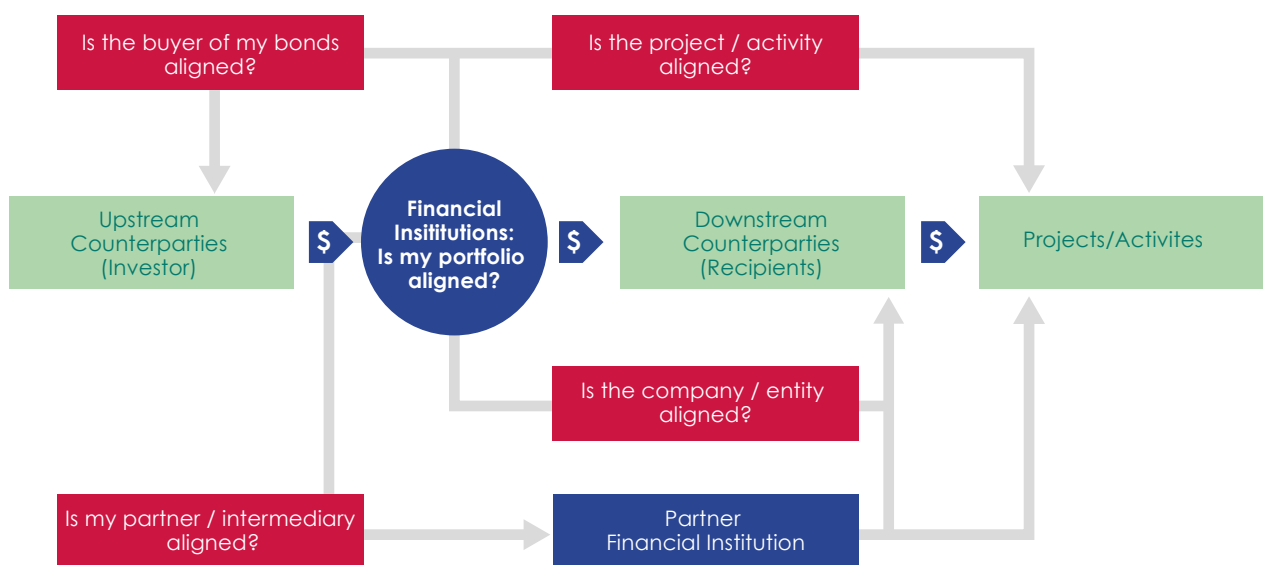
However, by doing so (in the case of second-tier banks), PDBs lose control over how fund disbursement is decided, which projects are awarded funding and whether recipients really contribute to catalyse the desired sustainable development transformations that perhaps the PDB has established in its own long-term strategies and sustainability frameworks. Figure 5 depicts the necessary alignment of the entire financial chain.

Private commercial banks, for instance, are vital economic intermediaries for NDBs and SDBs and as such can become key allies in SDG implementation, by “encouraging sustainable practices and accompanying their customers and clients in their transition towards more sustainable business models, technologies and lifestyles” (UNEP-FI, 2019). Still, they are sometimes unwilling to fully integrate environmental conditionalities, such as safeguards, as observed in a recent study of PDBs and biodiversity (WWF & The Biodiversity Consultancy, 2021). Reluctance also resides in perceptions that such requirements are merely procedural hurdles that make investments more complex (as also occurs within some PDBs) (Riaño et al., 2020). This is often linked to a lack of buy-in among staff, who are then unwilling to enact stringent requirements on their credit applicants.

Working towards leaving no one behind and making the global goals a local reality entails committing additional efforts to educate intermediaries and beneficiaries on the shared benefits that come with promoting and financing projects that contribute to sustainable development. It is important for both PDBs and intermediaries to see SDG-related priorities as strategic investments, rather than as costs. Therefore, educating and communicating the importance of the SDGs when talking to clients is a key practice that should be part of PDBs' daily activities. This applies both to first-tier banks and to second-tier banks, where the challenges are even tougher and even more relevant. These PDBs need to ensure that institutions that serve as their intermediaries are sufficiently aware, knowledgeable and capable of assessing whether or not a project proposal positively contributes to attainment of the SDGs.

Banks need to review and modify the external circulars they distribute to private financial intermediaries in order to clarify the desired financial and operating conditions, as well as the envisioned destination for their resources. It is important to provide specific requirements that beneficiaries must meet, in addition to debtor credit analyses and other procedures, in order to guarantee a better selection of beneficiaries according to the SDG priorities established by the PDB.

Figure 5 - Alignment of the entire financial chain



Source: Adapted from I4CE <https://www.i4ce.org/the-next-step-for-financial-institutions-aligning-the-entire-financial-chain-climate/>

The European Bank for Reconstruction and Development (EBRD) serves as a good reference in this regard. Over the years it has put guidelines and manuals in place for its private intermediaries to follow, including banned activities, prioritised projects considered likely to have significant positive social and environmental impacts, and other sectoral directives to guide intermediaries in their task of making the best possible use of

the available funds. EBRD also provides capacity building and ongoing training to credit operators working in these private institutions, to ensure that they have the required sustainable development knowledge to assess credit applicants. Box 1 presents some of the tools that PDBs can use to monitor and provide clear guidance to financial intermediaries regarding the biodiversity footprints of potential investments.

Box 1. Tools for biodiversity assessment of particular relevance for PDBs and intermediaries⁸

There is a gap in approaches, assumptions and processes between the conservation and finance sectors. To bridge this divide at national and regional level, PDBs can make use of emerging tools to require corporate and financial intermediary clients to quantify their biodiversity footprints – and opportunities – in a standardised manner and to integrate the results into risk management. In this sense, they can begin by:

- Increasing the use of biodiversity footprinting tools in due diligence for corporate and financial intermediary investments
- Developing and publishing guidance on use of portfolio- and corporate-scale biodiversity footprinting tools (in the same way that some commercial investors have) so as to send an advance market signal and drive uptake and innovation
- Requiring quantified estimation of biodiversity impacts and opportunities as part of client Environmental and Social Management System (ESMS) for corporate and financial-intermediary investments.

Sector-level tools

ENCORE is a free tool that provides information on the potential direct dependencies and impacts of economic activities on natural capital, including proxy measures for biodiversity. The links between economic activities and natural capital are assigned qualitative materiality ratings (from “very high” to “very low”) to help users gain a sense of priority issues per industry. The underlying data is based on sector averages, scientific and grey literature, and expert opinion. The tool has been used by financial institutions to

obtain a “big picture” understanding of investment portfolios’ impact on and exposure to different biodiversity impact drivers. It is most suitable for institutions wishing to understand the overall materiality of biodiversity impacts of investments in a sector or across sectors. The inclusion of impacts as well as dependencies and a finer-grained division of impact types (aligned with the Natural Capital Protocol) represents a significant advance over traditional materiality matrices used by the financial sector, such as the SASB materiality matrix, while the open availability of the tool and underlying database enables greater transparency. ENCORE is a relatively new tool and as such is still being actively developed.

Portfolio- and corporate-scale tools

Three notable recently developed tools for assessing biodiversity impacts on the portfolio or corporate scale are the Biodiversity Footprint for Financial Institutions (BFFI), the Global Biodiversity Score (GBS) and the Corporate Biodiversity Footprint (CBF). These tools all apply the same general process of using trade and life-cycle inventory databases to convert company activity data (e.g., turnover, quantity of a commodity consumed or produced) into physical impacts (e.g., area of land used, quantity of emissions), then a biodiversity model is used to convert physical impacts into a quantity of biodiversity lost. All three tools are under active development: BFFI and GBS have both been piloted with companies and financial institutions, while CBF is due to be launched in 2021.

At present the tools are most suitable for (1) obtaining an overall understanding of the order of magnitude of a company’s or portfolio’s biodiversity footprint and (2) identifying particular components, or “hotspots”, of an investment that make a disproportionate contribution to the overall footprint and can therefore be prioritised for further assessment and mitigation.

8. Adapted from WWF and The Biodiversity Consultancy (2021)

2.2 PRINCIPLE 2: DEVELOP A HOLISTIC STRATEGY AND LONG-TERM VISION

2.2.1 What is the principal objective?

Operational principle 2 is “develop a holistic strategy and long-term vision”. By this, we mean that all institutional decisions should be informed and guided by a **strategy** that reflects the SDG approach of the bank.

Strong and determined internal leadership should materialise in a vision and mandate that can transform the PDB into a driving force for the 2030 Agenda and SDGs. The bank’s investment strategy will therefore be explicitly linked to sustainable development outcomes and in line with a public commitment to have an overall positive impact on a holistic set of social and sustainability imperatives.

Mainstreaming an integrated approach that seeks both equality and sustainability outcomes, with its sights set on a long-term horizon, while leaving no one behind, can start by revisiting the bank’s guiding policies, frameworks and public pledges. This crucial step of alignment will subsequently percolate to the operational level. For alignment to be impactful, it is of course crucial that the bank’s strategy, mission, vision and other medium- and long-term frameworks are not just cosmetic communication papers, but actually linked to the strategic choices made in daily operations. The bank’s strategy and vision should therefore be based on a solid forward-looking theory of change for transforming political commitments into concrete actions.

This section presents steps PDBs can take to align their strategy, vision and mission with the 2030 Agenda and SDGs. This can start with a dialogue on how the bank can impact the 2030 Agenda as a whole. The strategy process might require prioritisation of certain SDGs. However, to avoid this becoming a simple “cherry picking” exercise, the PDB needs to evaluate its impact on the other SDGs as well, even if these are not direct priorities, particularly ensuring a “no harm” policy. The Stockholm Environmental Institute’s (SEI) SDG Synergy Approach presented below can be a useful tool for such an evaluation.



Strong and determined internal leadership should materialise in a vision and mandate that can transform the PDB into a driving force for the 2030 Agenda and SDGs.



2.2.2 How can your bank work towards this principle?

Check and rethink the bank's mandate and vision

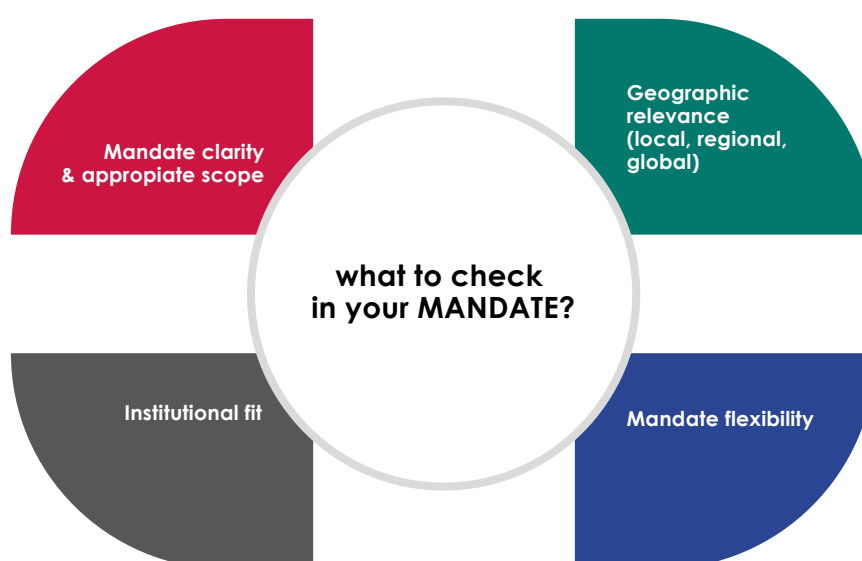
A key means to establish stronger institutional mandates commensurate with the ambition of the 2030 Agenda is through a wholesale rethink of the mandate and functioning of the PDB (Clark et al., 2019; Griffith-Jones et al., 2020). Notwithstanding that PDB mandates are established in their legal founding documents, it is essential for governments and shareholders to take a step back and amend these if necessary to allow the PDB to drive the ambitious transformations needed, or if the present mandate does not allow or limits investments in sectors with high developmental impact (Figure 6).

Whether the PDB works at the sub-national, national or global level, each has a defined mandate that describes the bank's sector or areas of intervention and the beneficiaries or pursuits the institution is expected to serve (Luna-Martinez & Vicente, 2012). Depending on the scale and geographical scope of intervention, PDBs face different contexts and specific conditions that impact their effectiveness in

attaining their targets. For example, according to the recent book, "The Future of Development Banks" (Griffith-Jones & Ocampo, 2018), NDBs can be more effective if they have a clear development strategy or mandate linked to a modern production sector. This ideally means that the PDB's mandate and strategy are aligned with public policy objectives, identified for example, in a medium- or long-term national sustainable development strategy.

The desire to align with the 2030 Agenda is an opportunity for renewal of each bank's historical development financing objectives and, at the same time, a chance to reaffirm the significance of its mission as an institution that catalyses structural transformations which are as essential as they are complex. Banks should push for such a discussion, whether they have a broad mandate or focus exclusively on one market segment (e.g., housing, trade, SMEs, industry or infrastructure). The need for change in the given mandate will vary from one institution to another. For every PDB, however, a mandate that offers clear and strong guidance on alignment with the 2030 Agenda and SDGs will be a game-changer, enabling them to propel transformation in and beyond their area or sector of expertise.

Figure 6 - What to check for in PDB mandates





Define the missions that drive you

There should be a close dialogue with policy experts from government but also with civil society, to ensure that PDB activities are in line with current public SDG needs and priorities. To best serve these public purposes, a bank's strategic approach should revolve around the structural problems that it hopes to solve. Mazzucato and Macfarlane (2019) propose a "mission-based approach" for public banks and underline the importance of alignment with the government's wider policy objectives. "This close alignment can create a powerful synergy between policy, regulation and financing, which can be simultaneously coordinated for maximum impact. For example, new government policies can be complemented with new financing instruments in order to transmit policy objectives more efficiently. This close alignment between the KfW and government policy has been instrumental to the systemic greening of Germany's economy through the Energiewende policy. Although potentially powerful, this relationship is highly dependent on effective governance arrangements, which are particularly important for public banks." If such national targets exist, they are, of course, an ideal starting point for defining and aligning the PDB mission and providing "patient" strategic finance to national sustainable development challenges. Yet, even where national policy is lagging, PDBs can themselves adopt a mission-based approach.

But what is a mission-based approach? Instead of picking sectors or technologies in a bank's strategy, a mission-based strategy revolves around a problem. The bank's objective is then to stimulate multiple forms of cross-sector activity to find solutions to the problem. Problems or development challenges that are identified in the national context and chosen as a mission for the PDB should not be achievable by a single development path or technology, but rather encourage multiple bottom-up solutions towards the expected outcome, through different pathways. The outcome of the mission should, however, be clearly defined, measurable and time-bound.

According to Mazzucato and Macfarlane (2017), "There is a growing consensus that NIBs that are 'mission driven', with investment activities guided by specific missions aligned with government policy, tend to be more effective than those which are focused on more neutral economic objectives such as promoting 'growth' or 'competitiveness'." Whereas presented differently in each case, the mandates of large, leading PDBs, such as KfW, the Asian Development Bank (ADB), the Brazilian Development Bank (BNDES), the European Investment Bank (EIB) and the China Development Bank, are all linked to overcoming particular economic, social and environmental challenges. This allows them to play a leading strategic role in their respective economies. In contrast, Mazzucato and Macfarlane (2019) argue that the mandate of Italy's Cassa di Risparmio di Roma is broader, focusing on "economic development" and "competitiveness" and hence possibly less impactful than its Peers.

A recent example of a mission-based public bank is, again, the newly created Scottish National Investment Bank. It is organised around three missions: climate, people and place. Any new investment must contribute to one, and ideally several, of these mission areas, which have been set by national legislation as the result of a broad consultation process. These missions are the first criterion that any investment choice must meet. The whole bank is organised to tackle the three areas, and this impacts all internal processes, including recruitment (see also section 3.1.3).

PDBs with mission-driven mandates can be particularly successful in mobilising additional commercial capital to contribute to the 2030 Agenda, delivering on both the equality and sustainability dimensions of the alignment agenda.

Ensure you have a balanced approach

One of the most innovative features of the 2030 Agenda is its holistic, integrated nature. Yet, this integrated nature is not easy to operationalise in PDBs' daily operations. At minimum, a PDB can ask itself whether it has developed both a sustainability and an equity pillar.⁹

9. the OECD and UNDP (2020) have suggested that **financing be targeted across two dimensions: equality and sustainability**. Equality here means that resources should be mobilised to leave no one behind and fill SDG financing gaps. The reference to sustainability points to deployment of resources in such a way as to accelerate progress across the SDGs, while doing no significant harm to any individual objective.



With their proximity to local markets and embeddedness in the national context, **NDBs and SDBs are well positioned to make a significant contribution to equality and sustainability.** They are closer to the local financing, policy and development environment of their country of operation and may be more adept at identifying priorities for interventions to **ensure that no one and no SDGs are left behind in their territories of operation.** On the sustainability dimension, this proximity often translates into longstanding relationships with local partners that enable PDBs to more readily target projects with high sustainable development impact. Additionally, sub-national governments, municipalities and local communities are more easily reached by domestic institutions, including SDBs (Hakenes & Schnabel, 2010; OECD & UNDP, 2020).

An important first step to ensure the bank has a balanced approach is to analyse at the strategic level both the positive and negative impacts the PDB can have on the SDGs. There are different tools that can inform this analysis and feed into holistic strategy setting. Here, we describe three of these.

The first is the **SDG Synergy Approach** developed by the Stockholm Environmental Institute (SEI). This is a tool for institution-level strategic analysis. There are 169 SDG targets, which have 30,000 possible direct interactions.¹⁰ This can, of course, be overwhelming. Therefore, the first step of analysis in the SDG Synergy Approach is to narrow the scope and choose a subset of targets. To maintain the integrity of the 2030 Agenda, the PDB should consider at least one target per SDG and come up with a whole of 20-40 relevant targets for their operations. Once the targets are chosen, stakeholders involved in implementation of these areas are chosen to participate in step two, which is scoring interactions between the targets. Using a cross-impact matrix, stakeholders explore in consultation how progress made towards one target influences another target, categorising these using terms ranging from “strongly promoting” to “strongly restricting”. These initial discussions focus on direct interactions. Then, step three brings a collaborative analysis that also considers indirect interactions. The end result is identification of clusters of positively interacting targets that could be a relevant focus for PDB strategy. For more information, see sdgsynergies.org.

During their reorientation process towards a more SDG-aligned strategy, PDBs might also consider using the free online **SDG impact assessment tool**. This self-assessment tool guides exploration of how the PDB affects the SDGs. It can therefore stimulate internal debate about the complexity of sustainable development and the different aspects of the SDGs, leading to increased understanding and better prioritisation of actions ahead. For this tool, see sdgimpactassessmenttool.org/en-gb/articles/about.

A free online resource for creating an organisation's matrix of SDG synergies is the **Joint Research Centre's Enabling SDGs tool**. This helps organisations to map, visualise and analyse how the SDG targets that are most relevant in an organisation's specific context influence each other. The tool brings science and systems thinking to PDBs' efforts to strengthen their SDG alignment. For more information, see knowsdgs.jrc.ec.europa.eu/enablingdgs.

Base your long-term strategy on a broad consultation process

PDBs cannot translate expectations and commitments into actions if these are not clearly anchored within their medium and long-term strategies. **Henceforth, banks need to update their long-term strategies and annual corporate goals to set strategic orientations and overarching objectives that increase the level of ambition and intensify actions in support of the 2030 Agenda.** Concrete actions for developing such a long-term strategy can range from rearranging PDB sectors of intervention to defining new dimensions to frame their policies, and establishing drivers to ensure financial sustainability, while maximising impact and development to generate value for society at large.

An inspiring example of a shift towards a more sustainable long-term strategy is provided by the Entrepreneurial Development Bank (FMO) of the Netherlands (the Dutch NDB). To generate greater impact with its portfolio, FMO decided to focus its investment efforts on underserved markets and fragile states. In 2017, FMO published its “Strategy 2025”, outlining its shift towards sectors where FMO could deepen its expertise and client relationships. The path chosen was to move away from infrastructure, manufacturing and services, towards investment in financial institutions, energy and agribusiness, food and water. The new strategy also increased FMO's geographical focus on Africa, Asia and countries around Europe, with only selective activities in Latin America and an intention to withdraw from the Balkans and China. FMO's “Strategy 2025” is geared



An important first step to ensure the bank has a balanced approach is to analyse at the strategic level both the positive and negative impacts the PDB can have on the SDGs.

for more equity and more direct investments, and it raises questions about the quality of environmental, social and governance (ESG) risk assessments and mitigation, and the need to use a human rights lens. The bank chose three SDGs (8, 10 and 13) as umbrella themes. As in the example of the Scottish National Investment Bank, FMO is building its value creation model by ensuring additionality – providing financial services that the market does not provide or does not provide on an adequate scale or on reasonable terms – stressing its role as a mobiliser in providing for public investment needs.

To stay attuned to these public needs, FMO has instructed its management board to participate in ongoing key stakeholder dialogues, to improve bank decision-making and reporting. Furthermore, FMO is eager to work with NGOs and think tanks, both as subject-matter experts and to tap their local knowledge, for a better informed investment process and policy development.

Long-term thinking is at the heart of sustainable development. Therefore, PDBs should not simply consider whether a specific project is improving sustainable development in the short term, or match an SDG number to a specific project. Rather, they must understand the catalytic effect projects may have to trigger longer term transformative effects towards sustainable development. This requires moving away from an individual deal culture, in which each project is assessed only on its own merits, towards more comprehensive transformative approaches in which the impacts of deals are considered in a more collective manner, over time, and their catalytic impact is more specifically monitored.

Assess if your bank will require an additional policy framework

PDBs should not only devote efforts to rethink and update their long-term strategies in order to include SDGs. When possible, they may need to introduce additional policies or frameworks, such as sustainability policies. Many PDBs are developing independent sustainability policies to serve as frameworks and guidelines for their investments on different scales, from project to sector to portfolio. Having such a roadmap can provide clear guidance to management and operational teams and, if well implemented, can incentivise action to foster transformative outcomes.

In some cases, these sustainability policies become a cornerstone of PDBs' SDG alignment. The Inter-American Development Bank (IDB), with its new Environmental and Social Policy Framework, is a strong example. The IDB framework contains a policy statement and ten standards through which the bank aims to maximise the environmental and social outcomes of its investments, while minimising risks and negative impacts on people and the environment. The framework is not just a pen-and-paper exercise. It is accompanied by an implementation plan and will be applied to all new IDB projects.¹¹ For existing projects, IDB has planned a transition period of about seven years, during which projects may continue to run following the previous policies. In line with the 2030 Agenda, the new framework includes provisions for vulnerable groups. For example, it stipulates when free, prior and informed consent is required from indigenous peoples, it mandates protections for African descendants and persons with disabilities, and it requires consideration of race, ethnicity, age and social conditions.

The new performance standards are based on those of the International Finance Corporation (IFC), adapted for the public sector and the Latin America and Caribbean region. To these, IDB added two performance standards: gender equality and stakeholder participation. It also includes an exclusion list of activities (see also section 3.3 on this topic).

Box 2 presents how a holistic strategy and long-term principle might look in the context of investment in sustainable food systems.

10. <https://www.sei.org/featured/developing-a-visual-language-for-sdg-interactions/>

11. <https://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=EZSHARE-1646886943-1944>

Box 2. Invest in long-term transformations while capitalising on synergies and reconciling trade-offs: The example of sustainable food systems

Covid-19 has hit complex and fragile food systems hard. It comes as no surprise, then, that 720-811 million people faced hunger in 2020 – as many as 161 million more than in 2019 – according to the recent State of Food Security and Nutrition in the World (SOFI).¹² Business-as-usual pathways are not an option, as these are insufficient for scaling up current food production practices to meet the projected food needs of the global population in 2050, while also complying with the Paris Agreement and delivering on the SDG. Moreover, sustainability and equity of the global food system must be key objectives for the future (GSDR, 2019). As pointed out by the Global Sustainable Development Report, leaving no one behind requires a focus on more equitable access to nutritional foods, including through substantial changes to the existing food system infrastructure and attention to relative prices. Improvements in global nutrition must be accompanied by a reduction in the environmental impact of food systems and an increase in food system resilience to climate change and other potential disrupters, including political instability and conflict (GSDR, 2019).

Ensuring adequate resource mobilisation is essential to drive a deep and long-term food system transformation and combat malnutrition. Moreover, according to the World Bank, an additional US \$1.2 billion is needed annually to tackle the impact of Covid-19, in addition to the previously estimated \$7 billion per year needed for food security and nutrition.¹³

PDBs that invest in food and agriculture as part of their portfolio currently account for almost two thirds of the formal financing for agriculture. In November 2020, 13 PDBs made a joint commitment to strengthen their investments in food and agriculture,¹⁴ stressing the need to improve regulations, policies, governance and institutional capacity to allow them take on the necessary investment risks, while remaining financially viable and institutionally sustainable in a rapidly changing financial market. Such a transition will not be an easy task, as it will require unprecedented resources, estimated at US \$300-350 billion per year up to 2030. Nonetheless, these transformations are crucial to avoid current and future costs (saving up to \$5.7 trillion), and can unlock \$4.5 trillion per year in opportunities for businesses.¹⁵

PDBs have a clear and decisive role to play in supporting the needed long-term transformation of food systems to achieve the SDGs. They can help drive the shift to more environmentally sustainable and fairer food systems delivering nutritious diets and equitable livelihoods for all. They should have a particular focus on assisting small-scale farmers, who produce almost a third of the world's food, and are critical for food security and the SDGs.¹⁶ All PDBs, not only those with a dedicated agricultural and rural mandate, can play a crucial role both as mobilisers of capital for sectors that struggle to be financially remunerative and as catalysers for investments by other public and private providers. Private capital flows are hindered by a series of structural risks and weaknesses, such as poor basic infrastructure, low economic returns and weak rule of law. This makes it even harder to align commercial finance to the SDGs and to climate-related goals.¹⁷

12. <http://www.fao.org/3/cb4474en/cb4474en.pdf>

13. <https://scalingupnutrition.org/news/global-leaders-committed-to-address-hunger-and-nutrition-crisis/>

14. The statement was signed by 13 agriculture and rural banks from sub-Saharan Africa, Asia and Latin America, and regional rural and agricultural credit associations.

15. https://www.ifad.org/en/web/latest/-/news/historic-statement-by-public-development-banks-signals-greater-commitment-to-tackle-global-hunger-and-poverty?p_back_url=%2Fen%2Fweb%2Flatest%2Fnews%3Fmode%3Dsearch%26catTopics%3D41840151

16. Idem.

17. <https://financeincommon.org/sites/default/files/2020-11/FICS%20-%20Declaration%20-%20Investing%20in%20sustainable%20food%20and%20agriculture%20systems%20the%20role%20of%20PDBs.pdf>

2.3 PRINCIPLE 3: MAINSTREAM SDG PRIORITIES WITHIN INTERNAL OPERATIONS

2.3.1 What is the principal objective?

Operating principle 3 is “mainstream SDG priorities within internal operations”. Mainstreaming, in this sense, regards having a **systematic and coherent internal process** in place that embeds SDG considerations in analyses of financing, both initially and in the ex post phase. Alignment thus becomes part and parcel of the investment cycle as a whole. This means making informed choices about sustainable development considering the long-term implications of today’s policy decisions on the well-being of future generations.

Once PDBs have established a bold strategy, hand in hand with their explicit and renewed mandates (where appropriate), they should aim for a complete, comprehensive and systemic integration of the SDGs, percolating throughout all of their internal processes. At the operational level, alignment requires changes in how investments are assessed and how capital is deployed. To finance sustainable development, capital flows need to be redirected towards critical priorities, rather than being earmarked in the customary way, for assets that tend to deplete natural capital or reinforce the low environmental sustainability of economic activity.

There is no one-size-fits-all approach to achieve this. Each PDB, depending on its size, business model and mandate, will need to seek out the best way to review its internal processes and ensure that SDG considerations are integrated at all stages of investment and project cycles. The approach chosen must be tailored to the constraints of each PDB and the development level of the country or countries in which it operates (Himberg et al., 2020).

At present, PDBs around the world are putting in place a wide variety of tools to measure both ex ante and ex post how their operations align with the SDGs (Himberg et al., 2020; Riaño et al., 2020). The recommendations made here spotlight some of the aspects found to require more attention from banks, suggesting ways forward for particular phases in which there are opportunities for improvement.

To be fully SDG compatible, PDBs need to be able to guarantee that their decision-making committees are informed of the SDG characteristics of all projects. This requires an ex ante assessment tool, beyond simple environmental and social safeguards. Limiting alignment efforts to classification of existing projects according to the individual SDGs they contribute to, bypasses important areas of analysis.


2.3.2 How can your bank work towards this principle?

Move from project-based alignment to comprehensive portfolio alignment

One of the key challenges that PDBs face and in particular NDBs and SDBs as they embark on the process of aligning their operations with the 2030 Agenda and SDGs, is coming up with both a pipeline of good individual projects and a coherent portfolio, while applying an SDG lens that aims to reallocate capital flows towards critical sustainable development priorities – instead of allocating available funds to traditional projects and programmes that represent less risk and associated implementation costs. MDBs on the other hand, need to foster coherence among their counterparts investing in the same country or region.

The need for such comprehensive approaches is linked to the concept of coherence, three spheres of which affect PDBs:

- **Internal coherence.** Coherence within the portfolios of individual PDBs in relation to their own mission and objectives
- **Inter-institutional coherence.** Coherence of collective engagement across PDBs, linked to the overarching objectives they pursue
- **Policy coherence for sustainable development (PCSD).** Coherence of PDBs’ collective contribution with overarching development policy strategy and the 2030 Agenda in particular



Based on PDBs' annual and sustainability reports and interviews conducted in 2020 (Riaño et al., 2020) and 2021, most PDBs seem to still be at a stage where alignment efforts are seen mostly at the project level. It is uncommon to find banks that are using the 2030 Agenda as a driving force to comprehensively build and assess new and existing projects, programmes, areas of intervention and desired impacts. Most banks have yet to realise that although having a systemic analysis at the project level has advantages, if they do not widen their scope of analysis to the portfolio level, they will certainly fall into wrong assumptions. For example, if a project that was initially designed for a particular objective is expanded to cover additional ground in order to comply with SDG alignment expectations, the result is more likely to be project overload than transformative potential. A fully SDG compatible portfolio calls for deep, consistent shifts in PDB operations.

Privileging a programmatic approach¹⁸ to support portfolio SDG alignment can be a way forward for PDBs to get beyond the business-as-usual, project-driven stance. On one hand, initiatives with the potential to support local sustainable development transformations are sometimes

not big enough to attract investment and need to be part of a larger initiative. On the other hand, the medium and large clients and beneficiaries who can fulfil PDB credit conditions more easily, and their intermediaries, may not be interested in or incentivised to invest in projects in which increased profit is not the main outcome. Thus, PDBs can increase their potential for transformational impact by defining thematic, sectoral or geographic scopes of action (in line with their renewed mission, see section 3.2). These can provide a basis for clustering sets of smaller interlinked projects that are unified by a coherent vision, common objectives and contribution to strategic goals. Figure 7 provides options for such clustering.

Endorsing this approach can add significant value to a bank's portfolio, relative to a series of one-off projects. More importantly, it can support the scaling up of investment for innovative sustainability-related start-ups and underserved vulnerable communities and territories that are key for delivering the SDGs. Box 3 looks at actions the Asian Development Bank has taken to increase its impact towards a sustainable agribusiness value chain.

Box 3. Investing in the agribusiness value chain: The case of the Asian Development Bank¹⁹

Interventions can have positive and negative impacts. In agribusiness, they can have a domino effect, given the nexus between farming, the environment, water and energy. Interventions should maximise benefits and minimise the risk of harm. To achieve the SDGs, agribusiness needs sustainable levels of investment. Long-term investment is also an effective way to bring stakeholders together, because it generates trust. When farmers see that an agribusiness has invested millions in a processing plant near their fields, they know that the investors are there for the long haul. Farmers are then themselves more apt to invest, and governments are more willing to provide support. Consumers are also better off when quality food is locally produced. The agribusiness value chain comprises agriculture, manufacturing and services companies, starting the moment a seed is produced and ending when the consumer purchases the product, perhaps at a local supermarket. Agribusiness boosts agricultural productivity and quality, while helping farmers sell their produce by connecting them with markets and consumers.

For the Asian Development Bank (ADB), a key element of agribusiness support is improving market connectivity and agricultural value chain links through technology solutions. For example, the Gansu Internet-Plus Agriculture Development project is integrating network-connected technology along the entire value chain, from production to marketing. This will allow consumers to obtain product information and give farmers access market information and production support services to help them tap into high-value e-commerce markets. ADB's investments also help boost farmer incomes and improve rural livelihoods. In Indonesia, Papua New Guinea, Timor-Leste and Vietnam, ADB's non-sovereign loan for agricultural value chain development supports Olam International Ltd and its subsidiaries, Café Outspan Vietnam Ltd and PT Dharmapala Usaha Sukses, to improve the agricultural value chain and bring significant positive impacts to farmers and the agribusiness industry. ADB's assistance also enables Olam to increase its sourcing volumes from smallholder farmers. The project leverages Olam's sustainability programmes to provide agricultural extension services, training and livelihood support to smallholder farmers.

Figure 7 - Clustering PDB programmes based on SDG- and mission-compatible thematic, sectoral and geographic scopes of action

Value-chain perspective: Seek to have a positive impact in an entire value chain

- Consider both upstream sources and downstream users.
- This means building bridges and promoting collaboration between stakeholders who differ in business models, size or priorities but who are part of the same value chain and will now share the ultimate goal of accelerating sustainable development transformations on the ground. This can be the case for instance of water security related investments that work with both business, government and local communities linked to an specific water basin or supporting transition investments in existing industries, e.g., in large-scale regenerative agricultural supply chains. The Inter-American Development Bank (IDB) is part of the founding members and key supporter of the Latin American Water Funds Partnership. The partnership is an agreement between the IDB, FEMSA Foundation, the Global Environment Facility, IKI and The Nature Conservancy. <https://www.fondosdeagua.org/en/>

Identify landscapes and sectors with potential for clustering nature-positive projects

- Contribute to financing sustainable landscape initiatives
- "PDBs that have set targets for nature-positive investment could work towards meeting these by identifying high-potential landscapes, e.g. where habitat restoration or sustainable use of natural products could be developed into an investable business proposition. By focusing on these landscapes, and providing technical support where needed, they can facilitate development of clustered nature-positive projects at an investable scale." (The Biodiversity Consultancy & WWF, 2021)

Target the nexus

- The nexus approach is particularly relevant for capitalizing on synergies and working on the trade-offs to be made between SDGs. It can be a good starting point for finding ways to overcome conflicts of resource usage and antagonisms between objectives. This approach addresses the links between sectors, scales and actors, seeks to connect scientific analysis with territorial realities, and therefore, makes it possible to go beyond institutional and intellectual silos. This approach can usefully respond to the need of PDBs to find tools to operationalize alignment: analysis in terms of the life cycle for a product, impact analyses, etc. It can facilitate and rationalize the decision, for example on structuring choices in terms of energy, food, water management, but also for the protection of biodiversity and health (Melonio & Tremel, 2021)

18. See GCF's (2020) policy on programmatic approaches (<https://www.greenclimate.fund/sites/default/files/document/gcf-b25-08.pdf>) and GEF's (2018) evaluation of programmatic approaches (http://www.gefio.org/sites/default/files/ieo/evaluations/files/programmatic-approaches-2016-vol1_5.pdf).

19. Extracted and adapted from "Here's a Surprising Way to Achieve Most of the SDGs" (2019) <https://blogs.adb.org/blog/here-s-surprising-way-achieve-most-sdgs> and ADB's Support for the Sustainable Development Goals Enabling the 2030 Agenda for Sustainable Development through Strategy 2030 (2021) <https://www.developmentaid.org/api/frontend/cms/file/2021/03/adb-support-sdgs-2030-agenda.pdf>

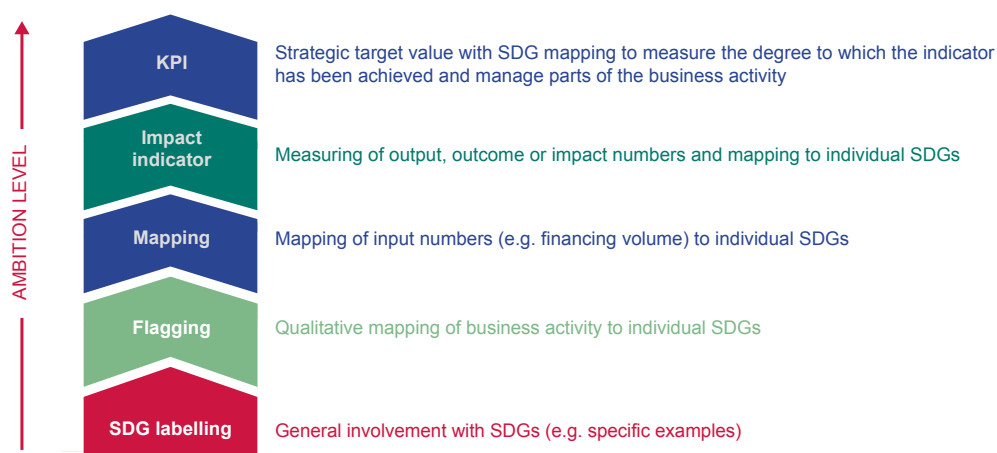
Monitor SDG ambition throughout the entire project development cycle

The most common mechanism that PDBs use for analysing and measuring the contribution of their activities to the SDGs is what we call “mapping”. This practice entails linking bank activities to one or more of the 17 SDGs. Platforms like the OECD SDG Tracker²⁰ and PDBs’ own mapping tools (e.g., KfW’s robust mapping methodology)²¹ allow visualisation of where financial flows are being invested. The International Development Finance Club (IDFC, 2020) presents mapping as a relatively easy exercise to carry out and quite useful: (1) as a mobilisation tool to identify what SDGs are affected by an organisation and (2) as an analytic tool to identify the strengths of a development bank’s portfolio, as well as orphan sectors. Figure 8 presents mapping bank activities as a medium level alignment approach, according to a scale of SDG reporting ambition level.

This practice by itself, however, is by no means enough to reorient a PDB’s portfolio and projects to the SDG priorities enshrined in its strategy. **Mapping is not alignment, and it bypasses a deeper comprehension of the 2030 Agenda**, one that reflects on capitalising on synergies among objectives and targets, while deploying strategies to alleviate trade-offs. In other words, mapping might actually prevent banks from performing a truly comprehensive analysis at the portfolio level and reinforce “siloed” approaches. These can compromise overall SDG operationalisation by leading to support for potentially counterproductive actions.

To give an example, PDB financing for a digital technology and renewable energy initiative might be tagged to SDG 13, since it contributes to climate action. However, this neglects to acknowledge or make visible potential negative effects – both for the environment and for human rights – for example, linked to extraction of rare minerals that may be required or changes in land use away from food production. Such negative consequences could contradict SDG 8, on decent work and economic growth, or jeopardise actions against hunger (SDG 2).²²

Figure 8 - Ambition level of SDGs reporting methods



Source: <https://www.kfw.de/PDF/Download-Center/Konzernthemen/Research/PDF-Dokumente-Fokus-Volkswirtschaft/Fokus-englische-Dateien/Fokus-2019-EN/Fokus-No.-267-September-2019-SDGs.pdf>

20. <https://sdg-tracker.org/> ; <https://sdg-financing-lab.oecd.org/about>

21. <https://www.kfw.de/nachhaltigkeit/Dokumente/Sonstiges/SDG-Methodenpapier-DE-EN-2.pdf>

22. <https://ksapa.org/an-antidote-for-sdg-washing-5-key-progress-points-for-businesses-and-investors-to-uphold-the-2030-agenda/>



This requires PDBs to work harder within the project development cycle itself, in three areas in particular:

- **Integrating robust ex ante verification practices to address the interconnections between SDGs and curb negative impacts.** For instance, developing positive lists that establish clear eligibility criteria to screen potential investments is a practice PDBs can explore. Another is to move beyond narrow environmental and social risk (ESR) analysis systems and set up a **"sustainable development analysis grid** to select operations, based on criteria that help maximize development impact; [as] financial returns are important, but secondary for PDBs" (Giffith-jones et al., 2020).
- **Monitoring clients' progress and supporting them with technical assistance.** Appropriate monitoring and support can help clients build a sustainable business for the long term. PDBs need monitoring systems which ensure that projects under implementation not only fulfil financial execution targets but also adhere to standards such as respect for environmental and social procedures. They need to be able to go further and question throughout the project life cycle the probability of achieving sustainable development results, while having the means to verify that activities are achieving the objectives set.
- **Ex post capitalisation of lessons learned.** PDBs need to know what is working and why. An additional sustainable development assessment should be performed at the end of projects, and the knowledge acquired incorporated into subsequent strategic plans, turning lessons into criteria for credit allocation.

Agence Française de Développement (AFD) periodically revises and renews its thematic strategies and seeks to move away from purely sectoral projects and support projects that contribute to alignment with the long-term SDG trajectories prioritised by the different countries. AFD's stringent eligibility criteria for screening projects enable the bank to analyse potential activities with an eye to determining whether they might have unacceptable environmental or social impacts that cannot be prevented or mitigated by suitable measures and therefore are ineligible for funding.

During the past 18 months, AFD has been actively involved in strengthening the accountability of its activities, using the SDGs as an "analytical backbone" to better categorise, rate and support alignment of its project portfolio with the 2030 Agenda. This new approach has three key components: (1) portfolio analyses (of strategies, pipelines and projects in execution) around the notion of trajectories and transitions, mobilising learning mechanisms and internal capitalisation; (2) ex ante analysis of project alignment with sustainable development (the AADD system, which is detailed further below), to give correct orientation to AFD's multi-year programming and to allow for adjustments; and (3) periodic reviews of awarded projects (conducted by each technical directorate) with respect to the transition strategy, to learn from successes and failures and inform future choices.

First developed in 2013, **AFD's Sustainable Development Analysis and Advice (AADD) system**²³ facilitates cross-cutting consideration of sustainable development issues in projects financed by the bank. The AADD raises questions and encourages consideration of sustainability impacts as early as possible in project preparation. The system considers six dimensions that englobe the 17 SDGs. Projects are analysed according to these. The procedure consists of answering a list of questions about the project to identify and evaluate its impacts in the dimensions. To ensure an objective assessment, the evaluation is done by several AFD teams.

An even more interesting experience for PDBs would be to move from mapping of individual investments and projects to ex ante SDG screening and categorisation at both the project and the portfolio level. This will enable the bank to transcend the traditional approach of classifying projects by disbursements or execution timeframe to a logic of differentiation considering the intensity in which the project supports sustainable development, while taking into account the challenges that projects face. This innovative practice would position the PDB to monitor SDG alignment throughout the entire cycle, from project inception to evaluation, and to distinguish between "problematic projects" in terms of sustainable development, "good" avant-garde projects and "new frontier" sustainable development projects.

23. <https://www.afd.fr/en/ressources/sustainable-development-analysis>

Establish and update exclusion lists

Exclusion lists categorically prohibit an organisation from involvement in specific types of projects. Establishing and periodically revising such lists is a key task **to ensure that the bank does not support activities that could undermine its efforts to deliver on the SDGs**. Sectors and activities normally identified as ineligible for investment include gambling, arms trade, tobacco and mining. The AFD Group has maintained a consolidated exclusion list since 2011, which is periodically revised.

However, very few PDBs as yet have a robust taxonomy available to help them avoid sectors with negative sustainable development impacts – to do no harm. Research shows that a relevant number of MDBs has not fully updated their exclusion lists to match the institutions' public commitments on climate change. "Only the European Investment Bank has gone so far as to end all fossil fuel financing by 2021 and estimate the emissions from all projects, whereas others such as the AIIB [Asian Infrastructure Investment Bank] and JICA [Japan International Cooperation Agency] are just beginning to exclude coal financing" (Himberg et al., 2020).

There should be a careful evaluation of the destination of funds in relation to exclusion lists. Investments to be avoided include projects accentuating lock-in to carbon-intensive technologies, activities aimed at production of fossil fuels and production of goods with a highly unfavourable impact on the environment, for example, those that indirectly drive deforestation (Carlino et al., 2017).

Use ex post assessment to determine the real negative and positive impacts of investments

PDBs should aim to assess both the negative and the positive social and environmental impacts of their investments. Most "pioneer" PDBs include in their annual reports results related to attainment of certain SDG targets. They might even have a separate report dedicated to sustainability. However, most PDB reporting still focuses on flow volumes – loans provided – rather than on outcomes and qualitative impacts of their portfolio as a whole. There is a lack of quality performance indicators, segmentation of end-beneficiaries and estimated lifetime results of projects to measure the contribution of the various flows to sustainable development. The assessment of direct results, such as numbers of companies served, credits granted and disbursements, is insufficient, as it overlooks the additionality achieved by PDBs towards the SDGs.

In this respect, the concept of **additionality** is useful. This refers to the notion that PDB activities should make contributions beyond what is available in the market, without crowding out the private sector. MDBs have developed a harmonised framework to guide their approach to additionality, which could be followed by others (MDBs, 2018). In particular, principles of non-financial additionality provide valuable insights into transformative approaches, whereas financial additionality principles are directly relevant to avoid crowding out private sector participation.

Already, non-financial additionality is often considered ex ante, to provide a possible additional rationale for undertaking an individual project. However, it is seldom assessed ex post. Even when evaluations do include this dimension, they tend to lack ex ante baselines to provide a yardstick for the transformative additionality resulting from a PDB intervention. Moreover, ex post assessments are generally done at the project level only, not considering the impact of the PDB's overall actions, at a portfolio level or through the range of projects and activities in a particular context. Evaluations also frequently fail to include contributions of other stakeholders, again focusing narrowly on the specific project evaluated. Finally, assessments are often done in an overly quantitative manner, with insufficient attention for the sustainable transformative processes triggered or supported by PDB actions. The above applies mostly to NDBs and SDBs, as these do not always possess such comprehensive assessment frameworks. Yet, MDBs need to work harder as well to thoroughly review the positive and negative impacts of their overall actions at portfolio level.

Impact measurement should be guided by clear and transparent sustainability criteria linked to transformative outcomes. It should integrate quantitative as well as qualitative aspects. One key criterion could be the extent to which a set of interventions (at portfolio level or by country, sector or theme) collectively contributes to the following:

- Specific transformations (e.g., the set of transition impacts defined by the EBRD)
- Non-financial additionalities
- Virtuous combinations of activities (investment, technical assistance and policy dialogue) as part of a consolidated PDB approach
- Collaboration with, or complementarity to, activities of other relevant stakeholders towards sustainable transformations



PDBs should also ensure that sufficient budget is allocated for supervisory visits and monitoring. Project follow-up is essential, not only to identify areas that might require additional technical assistance, but also to assess how initially identified impacts have materialised on the ground, if expected transformational benefits are indeed manifesting and if sustainability trade-offs that occurred, such as negative impacts on people and the environment, in fact override benefits.

An interesting ex post practice is for PDBs to create a record of projects that were not approved on grounds of SDG misalignment. The rationale underlying SDG alignment is the belief that the results will foster the global public good. However, operationalisation of SDG-aligned practices and

policies will involve trade-offs. Having a register of projects that were not approved due to SDG misalignment can help PDBs take stock of trade-offs. As such, categorisation and quantification of rejected projects can deliver important lessons for future projects. It would enable a PDB to account for potential economic losses resulting from project rejection and provide a way to compensate for these losses by other means. In general, practitioners should engage with the notion of direct and indirect impact on the SDGs. For example, a question that might be asked in this context is, “Do we exclude projects that would result in high yields, which could then be reinvested in transformative technologies?” Box 4 examines a set of standards developed by the OECD and UNDP to help donors deploy public resources in a way that maximises positive contributions towards the SDGs.

Box 4. The OECD's positive impact standards

In 2021, the OECD and UNDP jointly developed a set of impact standards for financing sustainable development (OECD & UNDP, 2021). The objective of the standards is to support donors in the deployment of public resources so as to maximise positive contributions towards the SDGs. Approved by the OECD Development Assistance Committee (DAC), the standards are accompanied by detailed guidelines outlining best practices for their implementation. For each component, “success signals” are defined to indicate best practice, taking into account constraints such as individual deal structure and resource availability.

According to the OECD and UNDP, the impact standards for financing sustainable development guarantee that scarce public resources are deployed to areas with the greatest need in order to meet the SDGs, in line with cross-cutting development objectives and DAC priorities. A specific focus is “leaving no one behind”, thus avoiding outcomes that are detrimental to people and the planet. By recognising the interconnectedness of the SDGs, the standards can “reduce SDG cherry picking and push investors to consider the unintended negative consequences of their actions” (OECD & UNDP, 2021).

The impact standards frame four interconnected and interdependent themes: (1) impact strategy, (2) impact management approach, (3) transparency and accountability, and (4) governance. The standards were designed for use by both public and private investors. They could be very useful for PDBs in aligning their investments with the 2030 Agenda. Concretely, for PDBs, elaborating these respective themes would mean:

1. Setting development impact objectives, framed in terms of the SDGs, with particular attention to the overarching commitment to “leave no one behind”
2. Adopting an impact management approach that integrates development impact; human rights safeguards; the SDGs; and environment, social and governance (ESG) effects into operational design and management
3. Disclosing to donors and beneficiaries how the PDB manages and measures the development impact and SDG contributions of private sector operations deploying public resources, as well as how development impact is integrated into its management approach and governance practices
4. Expressing a commitment to contributing positively to the SDGs in all governance practices and arrangements

2.4 PRINCIPLE 4: MOBILISE AND CATALYSE TRULY TRANSFORMATIONAL INVESTMENT

2.4.1 What is the principal objective?

Principle 4 is “mobilise and catalyse truly transformational investment”. This entails work by the PDB to foster **proactive external engagement** within its ecosystem of partners, capitalising on both financial and non-financial services.

PDBs are well placed to support mobilisation of transformational investment towards achievement of the SDGs and the transition to low-carbon climate-resilient economies. Due to their funding models, PDBs can often access funding that is both cheaper and longer term than what private investors can obtain. This enables PDBs to provide affordable, “patient” capital. Further, due to their development mandates, PDBs prioritise development impacts over profit maximisation. PDBs can therefore target their operations to address market failures and invest in markets underserved or not served at all by commercial finance, such as low-carbon climate-resilient infrastructure, technological innovation, social infrastructure and micro, small and medium enterprises (MSMEs).

Traditionally, PDBs, both national and international, have focused on provision of ordinary “vanilla” senior lending²⁴ and co-financing, often driven by internal incentives based on lending volumes. But change is afoot, with PDBs increasingly expected to mobilise private investment at scale in support of the SDGs and to support investment that advances transformational change, including the transition to low-carbon climate-resilient economies, as well as action to support realignment of private investment to meet the goals of the Paris Agreement. **However, to fulfil this role and affect transformational change, PDBs will need to move beyond investment that responds to opportunistic standalone opportunities, towards a more active approach that is strategic and collaborative at the sector and country level.**

PDBs should develop their financial and non-financial services and decide how they will offer these with more awareness of context: What are the real social, economic and environmental needs of the stakeholders that will benefit from their products? What populations should be targeted to leave no one behind? What SDG tensions and synergies might the bank encounter in a particular territory that should feed its decision analysis?

This requires bolder action in four key areas: (1) policy influence at government level; (2) support for countries' and regions' own sustainable development trajectories; (3) market creation, with project development and deployment of high-risk capital; and (4) greater use of mobilisation structures.



To fulfil this role and affect transformational change, PDBs will need to move beyond investment that responds to opportunistic standalone opportunities, towards a more active approach that is strategic and collaborative at the sector and country level.



24. For example, 95% (\$187 billion) of the green finance commitments of the International Development Finance Club (IDFC), a partnership of 26 PDBs, were loans in 2019, with non-concessional and concessional lending accounting for 74% (\$146 billion) and 21% (\$41 billion), respectively. Other instruments, including grants, guarantees and equity, accounted for 4% (\$7 billion) of green finance commitments (IDFC, 2020).

2.4.2 How can your bank work towards this principle?

Enhance policy influence to promote territorial development

Stable and predictable policy and regulatory frameworks are a fundamental prerequisite to work towards the 2030 Agenda and SDGs (Riaño et al., 2020). Commercial finance will not flow freely in countries where the investment climate is challenging and where the risk-adjusted rate of return is uncompetitive. Government has a very clear role here to lead the design and implementation of supportive policy and regulatory frameworks and to ensure that national PDBs are integrated into these frameworks, including the government's climate and environmental planning such as in nationally determined contributions (NDCs). **PDBs are well placed to influence and shape the development of these frameworks and should act as policy influencers and innovators to the greatest extent possible.** This role is especially important for supporting the transition to low-carbon climate-resilient economies, as political, policy and regulatory uncertainty can be a particular barrier to investments in renewable energy (Griffith-Jones et al., 2020). An illustrative example is the role played by the Development Bank of South Africa (DBSA) in working with the Department of Energy and the National Treasury to develop the South African Renewable Independent Power Producer Programme. This competitive tender process to enable private investment in grid-connected renewable energy has helped mitigate policy and regulatory risk for private investors in renewable energy in South Africa. The programme is now recognised as one of the top ten renewable energy programmes in the world (Eberhard & Naude, 2017). Other examples of this important role are the China Development Bank (CDB) and KfW helping their respective governments design policy and regulatory frameworks to incentivise private investment in solar power, complementing this with provision of high-risk catalytic capital (Griffith-Jones et al., 2020).

Support countries and regions towards sustainable development trajectories and foster knowledge-based interventions that leave no one behind

PDBs have the potential, and ideally a strong mandate, to support the discussion and emergence of SDG trajectories and finance their implementation. PDBs should stand proactively to keep sustainability issues at the heart of the political debate. This does not mean writing down, or even deciding, the sustainable development trajectory of a country, or identifying objectives and sectors to be prioritised, as this is not PDBs' role.

To start, **a country strategy and/or a sector or thematic strategy should be identified** based on ex ante assessment of the situation, including the political, governance and macroeconomic context; the business environment; the quality of institutions; and social dimensions. In this process, it will be useful to bring in political economy considerations, identifying structural, institutional and political dynamics and key stakeholders that could act as drivers of change, bottlenecks or obstacles to sustainable transformation outcomes. Crucially, such country assessments and strategies should emphasise sustainability dimensions, in particular, sustainable transformations. Key priority areas of intervention can be identified (e.g., particular sectors or thematic areas), along with driving sustainability objectives for each. Potential sustainability trade-offs should also be identified. Finally, the guiding strategies should clearly distinguish between short-term outcomes and longer term transformative objectives.

Sustainability and transformative dimensions can be based on national SDG implementation plans, as well as nationally determined contributions. A trajectory will be all the more "SDG oriented" if it complies with achievement of targets adopted for the relevant indicators (e.g., a 1.5 °C or 2 °C global warming scenario, or promotion of the "bottom 40%" with regard to inequalities). Some PDBs have the capacity to undertake such strategic contextual assessments themselves. Others can join forces with counterpart PDBs, donors, international organisations and local stakeholders, or rely on such assessments conducted by others. Many MDBs conduct their own assessments for each country in which they operate (this applies to the African Development Bank, ADB, EBRD and the Inter-American Development Bank). The ADB calls these "country partnership strategies", aligned to national development priorities, while the EIB relies mainly on EU assessments and policy orientations.

These priorities and principles should guide the targeting and composition of portfolios of interventions, under which specific projects can be developed and selected. A coherent portfolio approach, driven by sustainable transformative guiding strategies, is a precondition for moving from a deal-focused approach towards more systemic operations and impacts. **This implies explicitly connecting investment and lending interventions to technical assistance and policy dialogue.**

Beyond the SDG coherence of projects and portfolios, support for national SDG trajectories should be predicated on support and transformation of major national actors, including municipalities, industries, utility companies, development banks and large NGOs, as well as the processes that connect these. PDBs will thus benefit from engaging more systematically with their partners, counterparts and clients to promote national and regional public policy dialogue, as this is where new resilient trajectories consistent with the 2030 Agenda will be shaped. **PDBs need to move from transactions to transformations, with local actors.** In so doing, they can identify complementarities, synergies and collaborative endeavours and embed their operations in broader endeavours, as well as benefit from other actors' insights, actions and dynamics (Bilal & Preston, 2019). Local presence, either directly or via partnerships and cooperative efforts with actors at the local level, is another critical condition for operations that are anchored in local realities and ensure no one is left behind.

Most PDBs can and should cover this range of activities. However, many banks are still focused on the investment dimension. For all PDBs, cooperation with other transformative actors will be needed, particularly other relevant PDBs and financial actors, donors, and international and local entities, in order to complement and synergise the different types of interventions. **The overly fragmented nature of many PDBs' activities, being insufficiently coordinated with development partners and local initiatives, is a major hurdle to achievement of more ambitious, longer term transformative agendas.**

Project development to ensure SDG bankability

For increased transformative potential, PDBs have to shift away from opportunistic deal-driven investments to strategic and coordinated investments that complement national regulatory and policy reform. Market creation is a foremost means of achieving this. For effective market creation, PDBs must address two key constraints: weak enabling environments and lack of investible opportunities (Attridge & Gouett, 2021). For the former, PDBs need to enhance their policy influence, as discussed above. For the latter, PDBs need to take bolder action in project development and provision of high-risk capital.

Regarding project development, lack of bankable and scalable projects remains a major barrier to transformative investment. This is especially so with regard to infrastructure to support the transition to low-carbon climate-resilient economies. **PDBs need to get involved much earlier in the development phase of projects.** Enabling project development, thus boosting demand for SDG-compatible capital, is as important as strengthening the availability of such finance and ensuring better portfolio planning. Of course, as highlighted by the International Development Finance Club (IDFC),²⁵ there is sometimes a mismatch between banks' and clients' risk appetites and tolerances, whereby requests and needs of the latter may be disconnected from the sustainability agenda. Therefore, despite the rapidly growing demand for impactful investment focused on, for example, nature-positive outcomes, PDBs still face the challenge of incorporating ambitious climate and SDG standards into bankable projects.

Many PDBs have or are developing in-house technical and sectoral expertise to support project development and have or are establishing project preparation facilities. All PDBs should consider creating new concessional windows that earmark sufficient funds for project preparation and technical assistance. These services can help align borrowers' strategies and operations to the sustainable development vision and **provide beneficiaries the means to seize opportunities to work in tandem to help secure the transition to a low-carbon environmentally sustainable future in their territories.** Project preparation facilities can help fund initial project expenses such as feasibility studies and environmental, social and economic assessments.

25. <https://www.idfc.org/wp-content/uploads/2020/11/idfc-sdg-alignment-position-paper.pdf>

Figure 9 - Examples of how PDBs have responded to the project development barrier

DBSA's Project Preparation Fund

- DBSA has created its Project Preparation Fund, reserved for projects the bank's financing divisions can include in its pipeline. The funds are to be used to build an enabling environment for infrastructure project implementation, to conduct pre-feasibility and bankable feasibility studies and to assist with costs to reach financial close.
- For every project the bank assesses among others, the mandate fit (that comprises SDG alignment), development results and the alignment with government priorities.
<https://www.dbsa.org/solutions/project-preparation>

The Natural Capital Lab at IDB

- IDB's Natural Capital Lab was set up to drive innovation in nature positive financing. It bridges the gap between the environmental and finance sectors and works to incubate, accelerate and scale new solutions. The Lab uses blended finance and a risk-tolerant approach to implement projects across all parts of the IDB Group. The financial innovation activities of the lab "funding in the form of grants, loans, equity, risk capital, or guarantees" to a range of activities, include testing new models, creating enabling regulatory frameworks, identify and support entrepreneurs, link projects to finance, and experiment with investments based on natural capital valuation and risk. The lab also undertakes strategic dialogues and develops partnerships with global initiatives, finance ministries and international actors (such as the CBD) to promote innovation and position natural capital as a driver of development.
- As a very recent example, the IDB has approved a \$20 million loan and \$2 million in nonreimbursable investment financing from the **France-IDB Natural Capital Lab Trust Fund (NCL)** to increase biobusiness investments in the Amazon region of Peru and contribute to sustainable use of natural capital. In addition, the program will receive a \$3 million as technical cooperation in the form of nonreimbursable NCL resources to help the Peruvian Amazon region's biobusiness ecosystem actors such as producers, financial intermediaries, and development banks. The program will directly benefit nearly 6,500 private biobusinesses. Its indirect beneficiaries include all value chain participants through better coordination and distribution of benefits, and the region's communities as a whole, thanks to the implementation of practices that promote biodiversity conservation and services promoting sustainable use of the ecosystem. The program will help meet the target market's diverse needs by offering a menu of innovative financial products for private investment in biobusinesses engaged in the restoration and conservation of the region's natural heritage. To ensure diversification among the beneficiaries, the program will mostly target micro-, small- and medium-sized enterprises (MSMEs). Larger firms will also be eligible in some subsectors and will act as anchor companies in specific value chains.
- To this end, the **Corporación Financiera de Desarrollo (Development Financial Corporation, COFIDE)** will establish and manage a trust that will be capitalized by the Environment Ministry as trustee. This trust will finance eligible projects both directly and through financial institutions that have completed an accreditation process.
<https://www.iadb.org/en/news/peru-foster-amazon-regions-sustainable-growth-idb-support>

SDG Indonesia One in PT SMI

- PT SMI, although not entirely a PDB, serves as such for the Indonesian government and has as main purpose the promotion of sustainable development in the field of infrastructure. In 2018th, PT SMI and the Ministry of Finance of Indonesia created SDG Indonesia One, a platform composed by different facilities and fund with the aim to channel resources to support the roadmap for SDGs created by the government of Indonesia. According to their records, during 2018th they reunited 25 partners among them donors, multilateral banks, climate funds and mobilised almost \$2.46 billion. The platform arranges tailored facilities according to the lender's appetite and cover the project from end-to-end. There are four types of facilities: the development facility, the financial facility, the equity fund and the de-risking facility. The first one is for fostering preparation of infrastructure projects. The second one is deployed if a stimulation is necessary to attract private capital. The third one is intended to foster private investors and strengthen capital capacity for infrastructure projects. Finally, the de-risking facility is aiming to increase the commercial viability of infrastructure projects. PT SMI is a state-owned company under the Ministry of Finance that is engaged to finance infrastructure projects. During the interview, the bank stated that PT SMI was transitioning to a National Development Bank. This new broad mandate will allow them to have more public funding and more support from the government of Indonesia when catalysing capital for SDGs.
<https://ptsmi.co.id/sdg-indonesia-one/>

These facilities are sometimes funded by retained earnings. Alternatively, PDBs may rely on external concessional resources to finance project development, as this upfront investment is risky. Some PDBs structure their project development grants so that they are recoverable if the project reaches financial closure, or they might convert these grants to debt or equity finance in the project upon financial completion. Examples of PDBs working in this way are Indonesia's PT Sarana Multi Infrastruktur (PT SMI), the Development Bank of South Africa (DBSA) and Mexico's Nacional Financiera (NAFIN).

Establishment of project preparation facilities, natural capital lab units and SDG platforms within PDBs as incubators for innovative financing for people and nature, and therefore promoting sustainable and inclusive development, is a promising practice that can offer great leverage potential. Figure 9 presents illustrative examples of how PDBs have responded to the project development barrier. For instance, within Indonesia's PT SMI, US \$2.40 billion of \$3.04 billion secured has been ringfenced for infrastructure project development, funded primarily by concessional finance from donors, philanthropic organisations, international climate funds and impact investors.

Project preparation facilities with embedded SDG alignment criteria can also ease access to finance for the poorest and most vulnerable communities and countries. In fact, these countries continually express difficulties encountered in accessing finance from multilateral funds, bilateral sources, development finance institutions, and multilateral banks. For them, application requirements and selection processes may appear unclear, overly lengthy and complex.

In light of the principle of leaving no one behind and seeking to contribute both to equality and sustainability, PDBs at all scales should use these facilities to reach and guide vulnerable communities, grassroots organisations, local governments and SMEs, among others, to ensure that their initiatives are rooted in real needs and coherent with vital sustainable development transformation processes. Besides, clients and end-beneficiaries in developing countries are usually at the frontlines of climate-change impacts, and closest to delivery of benefits, such as local livelihoods, nature-positive impacts, health and food security.

Provide high-risk capital to kick start market development of sectors with strong potential for transformational change

Another aspect of market creation is increasing provision of high-risk capital. As noted, PDBs predominately deploy senior debt funded by their own balance sheets. This form of lending usually finances investment that is commercially bankable, but cannot be financed affordably in the market due to gaps in capital markets or the unfamiliarity of commercial investors with particular markets. For investment that is not yet commercially bankable (e.g., for new renewable energy technologies), PDBs can provide high-risk capital to make the risk-adjusted rate of return competitive and projects bankable. Some PDBs have financed this kind of investment by blending external concessional resources provided by governments, donors and international climate funds. Such pioneering or demonstration investment can be critical to kick start market development where there is a scarcity of private investors willing to take early-stage risks. It usually requires the PDB to deploy high-risk capital, for example, in the form of grants, equity and "mezzanine financing" (e.g., preferred equity, convertible finance and subordinated debt), as well as the issuance of guarantees.

Transformative investment will require PDBs to step up their deployment of high-risk capital. For some, especially NDBs, this will require access, or increased access, to external concessional resources. Again, Indonesia's PT SMI provides an example. It manages a blended finance platform funded by a diverse group of investors ranging from donors to philanthropic organisations, climate funds, commercial banks and institutional investors. The platform enables PT SMI to make high-risk investment and structure innovative financing solutions that its own balance sheet would not allow.

Box 5 presents a related concept, that of "making markets work for the poor" (MMW4P), which has gained renewed relevance in the context of equity and leaving no one behind.

Box 5. Making markets work for the poor

"Making markets work for the poor" (MMW4P) was initially defined as both an objective and an approach, grounded on the fact that markets are extremely important for vulnerable groups. Poor people participate in business activities in various forms. They are producers (farmers and business owners), employees (providers of labour) and consumers of goods and services (Gibson et al., 2004).

MMW4P emerged at the time of the Millennium Development Goals (MDGs) – a point when the development agenda was strongly focused on results rather than processes and root causes of underdevelopment. It acknowledges that the countries which have been "more successful in reducing poverty tend to have done better at getting people into markets effectively rather than relying on redistribution through transfers" (Gibson et al., 2004: 2).

This paradigm has guided programmes and projects of development agencies such as the former UK Department for International Development (DFID) and the Swedish International Development Cooperation Agency (SIDA). It can be particularly useful in, for instance, governance interventions related to land tenure and microfinance schemes, as well as in initiatives serving poor groups as producers and capital owners, as consumers of financial services, and as labourers and job creators.

In this sense, the concept appears suitable for market-oriented interventions catalysed by PDBs. For instance, at least five of the nine areas targeted by the World Bank (2021) are directly linked to poor people's role in markets: (1) ensuring debt sustainability and transparency, (2) tackling corruption and promoting good governance, (3) unleashing the economic power of women, (4) supporting job creation and transforming economies, and (5) supporting robust human capital outcomes.

Given its holistic nature, more recently, UNDP has adapted this paradigm to the 2030 Agenda. "Making markets work for the SDGs" thus has become a guiding principle of UNDP's 2018-2022 private sector development strategy. Although the aim is to transcend the objective of poverty reduction and approach market functioning from the whole set of the SDGs, the renewed approach sticks to the key objective of poverty reduction and the focus on vulnerable groups, given that "poor people's potential for consumption, production, innovation and entrepreneurial activity is largely untapped" (UNDP, 2018: 2).

Moreover, it could be argued that the original MMW4P concept remains valid in the wider 2030 Agenda context, as many SDGs directly involve market functioning and affect poor people. Examples are no poverty (SDG 1), zero hunger (SDG 2), gender equality (SDG 5), affordable and clean energy (SDG 7), decent work and economic growth (SDG 8) and responsible consumption and production (SDG 12).

Increase use of mobilisation structures to activate mobilise private investment at scale.

PDBs should make increased use of mobilisation structures to activate private investment at scale. This section introduces four such structures of potential value to PDBs: cooperation and syndication; securitisation; issuance of sustainable finance products; and blended finance as a tool for accelerating SDG implementation. All PDBs can make better use of structured investment approaches and blended finance. PDBs that issue on the capital markets can create sustainable finance products to stimulate the development of capital markets. Large PDBs, especially international institutions with substantial balance sheets, can make better use of pooled portfolio and securitisation approaches to mobilise institutional investment at scale.

Cooperation and syndication are particularly interesting portfolio approaches. **These take advantage of each PDB's own added value and priorities, as well considering limitations to their capacities, risk exposure, scope and operational reach.** Cooperation among PDBs can be a useful way to share knowledge, expertise, networks and possibly projects and finance. Some PDBs have a more highly developed understanding of SDG alignment criteria and ways of operating in line with the 2030 Agenda and SDGs. Some have a strong local presence, while others may be more agile and flexible, better anchored in policymaking or closer to donors. Building on their respective strengths, collective action by PDBs can lead to a positive-sum game. **Syndication and co-financing facilities offer a deeper form of cooperation between PDBs.** These provide a way towards more aligned approaches and the involvement of PDBs in operations that they would not invest in alone, resulting in catalysation of more private finance.

To significantly scale private investment in support of the SDGs and low-carbon climate-resilient growth, finance must become more accessible to institutional investors who can deploy capital at scale but are unable to do so for various reasons – including a lack of investment products that meet their needs (Tyson, 2018). As noted, many PDBs invest on a deal-by-deal basis, and their investments are structured accordingly. This constrains PDBs' ability to mobilise institutional investors, as the ticket size is typically small and risk is concentrated in one investment. This is not attractive to institutional investors, which have large ticket

size investment requirements and fiduciary responsibilities. Pooled portfolio investment approaches, such as the IFC Managed Co-Lending Portfolio Program (MCP), enable PDBs to aggregate projects into funds to meet the large ticket size requirements of institutional investors and enable diversification of risk (Box 6). PDBs can then structure large-item products into tranches with differing risk profiles to meet the risk appetites of a range of institutional investors, often with blended finance for the higher-risk junior tranches (Attridge & Gouett, 2021).

Box 6. Mobilising institutional investment at scale: The International Finance Corporation's Managed Co-Lending Portfolio Program

The Managed Co-Lending Portfolio Program (MCP) of the World Bank Group's International Finance Corporation (IFC) is an example of a successful pooled loan syndication platform. By the end of 2018, it had mobilised US \$7 billion from eight large global investors. MCP deploys a "blind pool" approach, which enables institutional investors to passively invest in IFC's diversified future loan portfolio. Investors commit capital up front and sign agreements with

IFC concerning the design and make-up of the portfolio. The MCP builds a loan portfolio for the investor that mirrors the IFC's own loan portfolio. IFC originates eligible transactions, which are co-financed with the MCP in line with the terms of the agreement. Depending on the risk appetite of the investor, a first loss structure may be deployed, whereby IFC invests in a junior tranche in the portfolio to provide credit enhancement for the portfolio. IFC, in turn, benefits from a guarantee from the Swedish International Development Cooperation Agency (SIDA), which shares the risk with IFC on the first loss tranche.

In practice large PDBs with substantial balance sheets and active in diverse geographies and/or sectors are better placed to deploy such approaches. Smaller PDBs may need to work with other PDBs to achieve the required scale and diversification of pooled assets. Finally, access to external concessional capital may be required to enable a PDB to take the junior tranche, enabling investors to take investment-grade exposure in the senior tranche.

Securitisation is the second mobilisation structure. **Very few PDBs have engaged with securitisation approaches to date, but this financial structuring technique has the potential to make investment in low-carbon climate-resilient infrastructure more accessible to institutional investors.** A good example of the use of securitisation is provided by the Development Bank of Japan and the Japan Wind Development Wind Fund. In infrastructure investment, PDBs add most of their value during the pre-construction and construction stages, when risk is high. Once operational, investment risk is much lower, as the asset generates a

steady stream of positive cash flow. Thus, as projects mature, the added value of PDB intervention rapidly diminishes. Too often, however, projects are kept on the balance sheet of PDBs throughout their life cycle, limiting these institutions' capacity to invest in new projects. PDBs can adopt faster exit strategies once projects are up and running. **Rather than keeping loans on their balance sheets, PDBs can seek to securitise these flows. This involves the sale and pooling of infrastructure assets into a special purpose vehicle (SPV) which would diversify risk and achieve scale.** The SPV then issues securities backed by the aggregated pool of infrastructure assets, generating revenue to service the securities. This can be an attractive idea: not only does it enable PDBs to develop products that meet the need of institutional investors to match their long-term liabilities with long-term cash-generating assets, it also supports the development of capital markets and frees up PDB capital, allowing capital to be recycled more frequently (Griffith-Jones et al., 2020).



International PDBs and large NDBs in advanced and emerging markets are potentially well placed to make use of this technique. Nevertheless, the approach should be explored with caution, as it is very complex, thus possibly creating risk and presenting challenges for risk management.

Issuance of sustainable finance products, is another approach that PDBs can take to affect transformational change in the capital markets. Products such as green bonds, social bonds and sustainability-themed funds can kick start sustainable finance markets. The United Nations Conference on Trade and Development (UNCTAD) has estimated the value of these products at US \$1.3 trillion globally (Zhan & Santos-Paulino, 2021). As more and more investors in advanced and developing economies adopt environmental and sustainability impact objectives, the demand for sustainable investment is set to grow.

The green bond market has been at the forefront of the development of sustainable finance markets. There is no doubt that PDBs, especially international PDBs, have played a pioneering role in getting these markets off the ground. NDBs that issue in domestic capital markets have also established regular programmes of green bond issuance, often being the first country issuer, paving the way for other public and private providers of such products. This supports the development of domestic capital markets while mobilising domestic institutional capital to “green” investment. Several PDBs, have started to issue sustainability-themed bonds and targeted SDG bonds. The role PDBs have played in development of the green bond market is instructive and demonstrates the catalytic power that PDBs possess.

One prominent example is that of the Minas Gerais Development Bank (BDMG) in Brazil. Based on its new strategy to intensify its actions in support of the 2030 Agenda, BDMG launched a sustainability bond framework in 2020,²⁶ reinforcing a 2018 charter on green bonds. The BDMG framework outlines a process by which proceeds will be tracked, allocated and managed and includes categories of social and environmental projects considered in line with 13 of the 17 SDGs and with 28 of the 169 SDG targets. The

framework also delimits eligible activities for each category. Clients need to show that their project belongs to a category by providing certifications or demonstrating appropriate practices, such as particular irrigation systems and energy efficiency equipment. BDMG will use the funds raised via sustainability bonds to finance or refinance projects and operations with clear and relevant environmental and social impacts and aligned with the SDGs. BDMG has furthermore expressed its determination to push for a bold whole-of-bank alignment approach. Its 2021-2025 strategic roadmap seeks to maximise the bank’s impact and development in line with the SDGs, and based on specialised local and regional knowledge, strengthened global partnerships and ongoing transformation of the bank into a digital and innovative institution. These efforts are reinforced by BDMG’s 2020 corporate goal to have 30% of its total disbursements in line with at least one SDG.

A challenge, however, as noted by Zhan and Santos-Paulino (2021), is that the vast majority (90%) of global sustainable financing investment bypasses developing countries. **PDBs must therefore focus their efforts on tapping the growth in demand for sustainable investment by developing financial products that can channel this capital at scale to address the sustainable development needs of developing countries.** An interesting example in this regard is Mexico’s recently created SDG bond framework (Box 7).



As more and more investors in advanced and developing economies adopt environmental and sustainability impact objectives, the demand for sustainable investment is set to grow.



26. <https://www.bdmg.mg.gov.br/titulos-sustentaveis/>

Box 7. Targeting beneficiaries: Mexico's SDG bond framework²⁷

Mexico's SDG Sovereign Bond Framework, put into effect in 2020, applies the SDGs as entry points. It implements a two-fold eligibility (programme and geospatial) and involves an international organisation (the UNDP) at various phases. The framework exhibits a number of unique features and innovative pledges for SDG alignment operationalisation.

Localised finance to leave no one behind. The framework combines programme²⁸ and geospatial eligibility for social-related expenditures. Geospatial, or territorial eligibility, enables prioritisation of vulnerable populations living in landlocked and disadvantaged areas, including those in extreme poverty, indigenous populations, the elderly and children.

Eligible sustainability expenditures. Not all SDGs are targeted within the framework. For the selected SDGs, tangible contributions have been identified in relation to budgetary expenditures. For every selected priority, there are detailed guidelines for use of the proceeds, the targeted population, outputs and impact indicators.

Exclusion list and screening to avoid negative impacts. Projects and assets related to particular budgetary activities are ineligible as sustainability expenditures under the framework. These are exploration, production or

transportation of fossil fuel; generation of nuclear power; and alcohol, weapons, tobacco, palm oil, cattle/beef production, conflicted minerals and adult entertainment industries. In addition, all expenditures are to be screened to ensure they involve none of the following activities: deforestation or degradation of biodiversity; child labour or forced labour; breaches of Mexico's anti-corruption laws and all environmental, social and governance laws, policies and procedures.

Systematic revision of eligible expenditures. The pool of eligible expenditures is to be monitored on a dynamic basis. If an expenditure that was originally included in the pool no longer meets the criteria, the ineligible expenditure will be removed.

Impact reporting, beyond budget allocation reporting. The Secretariat of Finance and Public Credit (SHCP) is tasked to publish an impact report detailing, among other things, the environmental benefits and positive social impacts of the projects and assets; quantitative and qualitative performance indicators; segmentation of budgetary expenditures by end-beneficiaries (e.g., gender, age, income, employment situation and location); as well as estimated lifetime results and/or economic life (in years) of projects. Mexico intends to continue refining the indicators over time, shifting from outcome-based measures towards those focused on impacts.

27. For framework documents and other relevant information, see <https://gsh.cib.natixis.com/our-center-of-expertise/articles/mexico-s-sdg-bond-framework-a-two-fold-eligibility-and-unique-governance>

28. For instance, eligible expenditures include training to small farmers, educational scholarships, hospitals and medical equipment, prevention and care of sexual transmitted infections, technical training to young unemployed people, and rehabilitation of public water treatment plants.



The final category of mobilisation structures examined here is **use of blended finance** to accelerate SDG implementation. Blended finance mechanisms have provided an innovative way for public and private investors to work together. However, they do not always contribute to financing the 2030 Agenda. Harnessing the potential of this tool demands real commitment to invest in areas critical to sustainable development. It also means overcoming the short-term approaches and the aversion to investments in fragile settings that have thus far characterised private investors (Riaño & Barchiche, 2020). **PDBs need to take the lead in structuring blending platforms and be assertive in determining areas of focus: cross-cutting transitions that catalyse sustainable development. In the end, they are the ones assuming the largest part of the risk compared to their private partners.**

The blended finance guidelines recently published by the OECD DAC (OECD, 2021b) can help PDBs ensure that they deploy blended finance in the most effective way to accelerate implementation of the 2030 Agenda. PDBs need to formulate a strategic ambition and policy objectives for blended finance and link these to the 2030 Agenda. In particular, the OECD DAC guidelines point to the need to anchor blended finance use to a development rationale. This

is a useful approach for PDBs, as it can help banks ensure that their projects maximise SDG outcomes by asking questions like the following: Does the project focus on sectors where development impact can be achieved? Does the project build incentives that promote public-private cooperation, hence balancing expectations of development outcomes with financial risks and returns? Is the project in line with the 2030 Agenda and the Paris Agreement? Is it aligned with local priorities?'.¹

Depending on the local context and project opportunities, PDBs, as blended finance providers, may wish to prioritise SDGs that can catalyse other positive development effects while protecting people and the planet. As the OECD DAC points out, proper prioritisation and sequencing can accelerate progress towards sustainable development by facilitating realisation of positive spillovers and limiting negative trade-offs without downplaying the importance of any specific SDG. Blended finance providers, such as PDBs, can work with local actors to identify the least financed sectors, to which the private sector can bring new solutions or expertise to tackle specific development challenges. Box 8 outlines efforts within the G20 to support PDBs in accelerating sustainability transformations.

Box 8. The G20: Supporting PDBs to accelerate sustainability transformations

The Italian G20 Presidency²⁹ has made access to resources a core priority in the roll-out of initiatives to counter the effects of the global pandemic. Access to sustainable financing is particularly crucial for low-income countries (LICs), which need an estimated US \$450 billion to address the immediate and long-term impacts of the crisis.³⁰ The International Monetary Fund (IMF) estimates that African countries will need up to \$285 billion during the next five years to step up their spending response to the pandemic.³¹ The G20 members and PDBs will play a crucial role in providing these funds. For this they will need to agree on the most appropriate and effective measures to drive the transformation towards greener, more just, more digital and inclusive societies.

Despite the tendency for development issues to fall off finance ministers' immediate agendas, the Italian G20 Presidency has worked to ensure a stronger coherence between the Development Working Group and the Finance Tracks. It has revised the G20 Action Plan to serve as a lighthouse to guide future responses. Against this backdrop, MDBs have committed a \$230 billion financial package to support LICs and emerging market economies in addressing the pandemic, and they have the resources to provide financial support on the order of \$360 billion up to the end of the 2021 calendar year.³² Before the Italian G20 Presidency ends, G20 members are being called upon to reach consensus on three main issues that are essential to building back better.

The first regards the future of the Debt Service Suspension Initiative (DSSI). The decision to extend the DSSI until the end of 2021 was a good first move,³³ but it is not enough. This is particularly so considering that, as of July 2021, only 47 out of the 73 eligible countries had requested DSSI participation,³⁴ and most of the debt relief that had materialised was provided by China.³⁵

Second, the G20 needs to reach agreement on the reallocation of \$650 billion in Special Drawing Rights (SDRs). This is likely to be done in the framework of the IMF's Poverty Reduction and Growth Trust (PRGT). However, several voices have called for SDR reallocation to ensure stronger LIC and African ownership and fully harness the potential of other options, such as the World Bank, other MDBs and even the Liquidity and Sustainability Facility of the United Nations Economic Commission for Africa (UNECA).³⁶ The support provided will be complemented by ODA, an ambitious IDA-20 replenishment, the future ADF-16 replenishment in 2022 and mobilisation of scaled-up concessional financing from the IMF, MDBs and funds, as well as bilateral development agencies.³⁷

Third, the Italian G20 Presidency has worked to identify effective strategies to implement the Common Framework for Debt Treatments beyond the DSSI.³⁸ This framework will be important to stimulate private creditors to assume a portion of the burden from debt treatments that is at least equal to that assumed by the official creditors, through stronger regulations than the DSSI. At the same time, successful application of the Paris Club's principles may result in expansion of the club's membership (to include China). This could increase transparency and strengthen the international debt resolution framework.

For these reasons, the forthcoming Finance in Common Summit³⁹ under the Italian Presidency offers a unique chance to achieve alignment between the G20 policymaking process and the role of PDBs, especially MDBs, in creating a fertile soil for resilient and long-term societal transformation, mobilising investments in green and social infrastructures, climate-change mitigation and adaptation, biodiversity protection, capacity building and equitable digital transformations.

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29. Italian G20 Presidency, People, Planet, Prosperity: The Italian G20 Finance Track, <https://www.mef.gov.it/en/focus/People-planet-prosperity-The-Italian-G20-Finance-track-00001/>
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CONCLUDING REMARKS

PDBs are natural allies of the 2030 Agenda and its Sustainable Development Goals. They have the ability to adapt their roles to changing needs at the multilateral, regional, national or sub-national level. In the context of the global pandemic and the planetary crisis, sustainable development needs are tremendous.

With their ability to provide long-term financing, PDBs are well positioned to invest in the big sustainability transformations that are needed to respond to basic human needs within planetary boundaries - which is how the key challenge of the 2030 Agenda could be summarized. This calls for more nature-positive investments as well as "leave no one behind" policies.

Moving from this radical ambition to an operational approach is not an easy task. It is a continuing process, and where to begin with might depend on the PDBs mandate and the context in which it operates. This study shows concrete steps PDBs can take, illustrated with pioneering and inspiring examples. It argues that merely mapping the bank's activities against the SDGs is not alignment. It rather calls for a *bank-wide approach* that understands SDG alignment as the process by which PDBs will ensure that all their activities from the design and implementation of projects and strategies, the structuring and financing of projects, as well as the monitoring of its effects should actively support the achievement of the 2030 Agenda. In that sense, no example is complete, all the PDBs cited are 'on the journey' and hopefully this study helps others to join and to fuel a fruitful discussion and exchange of practice between PDBs.

Therefore, the study proposes a framework for PDBs' alignment based on four concrete principles that will allow PDBs to operationalize their alignment efforts both internally and externally within their ecosystem: 1) Lead internally and foster a sustainable development culture; to 2) Develop a holistic strategy and long-term vision; 3) Mainstream SDG priorities within internal operations and 4) Mobilize and provide transformational investment.

At the First Finance in Common Summit (2020) PDBs engaged to collectively shift their strategies, investment patterns, activities and operating modalities to contribute to the achievement of the SDGs and the objectives of the Paris Agreement, while responding to the Covid-19 crisis. Here and now, an ongoing collective dynamic of PDBs, grounded by exchanges and experiences from all financial stakeholders (public and private), is needed to concretize the strategic debate about PDBs as gateways for SDG-aligned finance. The second edition of the Finance in Common Summit (October 2021) is a great opportunity to reaffirm and reinforce pledges made in 2020th. ■



With their ability to provide long-term financing, PDBs are well positioned to invest in the big sustainability transformations that are needed to respond to basic human needs within planetary boundaries - which is how the key challenge of the 2030 Agenda could be summarized.



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