

BACKGROUND PAPER

Greening investments: Make Multilateral Development Banks work for the Paris Agreement

Policy options and recommendations to the G20

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Brief Summary

In the landmark Paris Climate Agreement, the international community committed to limit global warming to well below 2°C, if not 1.5°C above preindustrial levels. World leaders also committed to foster adaptation and to make all financial flows consistent with climate resilient, low greenhouse gas development. The G20 as group of the leading industrial nations and emerging economies, being responsible for 80% of global greenhouse gas emissions, provides an important platform for joint action towards implementing the Paris Agreement.

Multilateral Development Banks (MDBs), which are dominated by G20-states, play a major role in this regard. This background paper describes most important areas of action for MDBs to achieve the climate and development goals as set out in the Paris Agreement and Agenda 2030. Specific measures for making MDB-portfolios climate-compatible, scaling-up financial means for MDBs, providing technological and institutional support for climate-compatible capacity building in MDB target countries, as well as tools for mobilising and shifting private finance are presented and discussed with a view to current developments.

Specific policy recommendations to the G20 are provided, such that the G20 states as major MDB shareholders use their power in the MDB boards to work towards comprehensive climate-compatible investment- and multiplier-strategies.

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1 Introduction

The United Nations Paris Climate Agreement obliges the international community to keep global warming well below 2°C and to make efforts to limit it to 1.5°C in order to prevent dangerous climate change. In addition, all countries committed in the Agreement to intensify their adaptation efforts and to making financial flows consistent with low greenhouse gas (GHG) and climate-resilient development (Article 2.1c). The latter requires all investment – public and private – to abandon unsustainable, carbon-intensive practices and projects, and shift towards green infrastructure and low-carbon development.

To this end, the internalisation of external costs is key for example via effective CO₂ pricing, phasing out fossil fuel subsidies, disclosure of climate risks and carbon footprints as well as strategies for reaching greenhouse gas neutrality for large companies and financial institutions. In addition, considering sustainability and climate criteria in the evaluation of companies and investments and aligning public procurement with climate criteria would be required. To avoid carbon lock-in in emission-intensive development paths and to reduce the risk of stranded assets, public investments, in particular long-lasting infrastructure, must be aligned with the Paris climate goals and Agenda 2030¹.

The central role of reliable, modern infrastructure for economic development and the welfare of humankind is expressly acknowledged in the Agenda 2030's ninth universal Sustainable Development Goal (SDG9). SDG7, that is, access to affordable, reliable, sustainable and modern energy supply, also requires considerable investments in energy infrastructure, especially in developing countries. Worldwide infrastructure investment needs in transport, waste management, electricity generation and distribution, telecommunications and healthcare are estimated to be about 90 billion US dollars by 2030². In addition to demographic development, urbanisation and replacing outdated infrastructure are important drivers for investment needs in industrialised countries. The under-financing of public infrastructure is a problem in all countries, even though the highest needs occur in the large emerging economies and the fast-growing developing countries. This presents a unique opportunity to providing sustainable and climate-friendly basic infrastructure in many countries with only slightly higher investment of capital³.

Because of their central role in mobilising climate finance and implementing infrastructure investments in developing countries, MDBs can be effective on many levels. As public financial institutions, it is their job to implement state goals and obligations like those in the Paris Climate Agreement and Agenda 2030.

The G20 as an economic and financial policy forum of the economically strongest industrial and emerging countries has been pursuing various initiatives for years to promote global infrastructure development⁴. At the same time, the G20 states are the most important shareholders of MDBs and could set the tone for thorough climate-friendly investment policies. At the present time, the G20 infrastructure agenda is, however, still to a great extent disconnected from climate and sustainability goals. The MDBs, even though they are involved in climate finance, are still far away from truly climate-friendly investment and multiplier strategies that are compatible with the 1.5°C target.

This background paper describes possible means and measures for the MDBs to carry out their activities in the service of Article 2.1c, and to mobilise urgently needed additional private funds for climate-friendly development. Corresponding policy recommendations for the G20 are being developed and presented.

Multilateral Development Banks

Multilateral Development Banks (MDBs) are supranational financial institutions whose shareholders are sovereign states – they are, therefore, part of public finance.

MDBs play a central role in financing and executing capital-intensive projects such as building infrastructure like roads, ports or energy-generation facilities in developing countries. In doing so, they also implement the development policy targets of their shareholders. Furthermore, they play an important role in international capital markets, as they borrow considerable capital to refinance loans.

New actors joined the classic MDBs, which are mostly dominated by industrialised countries, in the year 2014 with the foundation of the New Development Bank (NDB) of the BRICS states (Brazil, Russia, India, China, South Africa) and the Asian Infrastructure Investment Bank (AIIB). There is little experience with these to date, however, because of the central role played by the fast-growing emerging states and the increasing significance of south-south co-operation in the global transformation, they are important actors for sustainable public finance.

In addition to the multilateral, there are also bilateral, regional and national development banks with a corresponding geographical focus. Many of the measures discussed and the recommendations presented in this paper can be applied to these banks.

2 MDBs' climate strategies: status and gaps

Since the industrialised countries committed to mobilise billions US-dollars for climate finance for the so-called developing countries at the 2009 Climate Conference in Copenhagen, MDBs have become important partners in fulfilling these commitments.

In the meantime, most of the MDBs declared to increasing the share of climate finance in their own portfolios to 40% of investments by 2020. A majority of the MDB's climate-finance strategies is based on this commitment and other measures, for example, in the area of CO₂ pricing (see Table 1). Overall, climate finance is seen as a *separate* section in the portfolios of the MDBs.

However, with the Paris Agreement entering into force, international law requires to align *all* financial flows with the goals of the Paris Agreement, as stated in its Article 2.1c. This means that the MDBs need to expand their climate strategies, adapt their own investments, broaden their activities in the areas of capacity-building and mobilise private funds in line with the requirements of the Paris Agreement.

Climate finance can no longer be seen as a separate area of investment. Rather, the MDBs should now align their entire portfolio with the goals of the Paris Agreement. To date, this is the biggest gap in MDBs' climate strategies, as can be seen in Table 1. There is still an enormous need for action concerning portfolio-wide decarbonisation measures (see Chapter 3).

In view of the high investment needs, scaling-up overall MDB finance for the climate-compatible transformation in emerging and developing countries is still necessary. Under the United Nations Framework Convention on Climate Change (UNFCCC), the industrialised G20 states are obliged to

Table 1: MDBs climate action overview

	AfDB	AsDB	EBRD	EIB	IADB	WBG	AIIB	NDB	CDB
Climate finance									
Climate finance target	Yes	Yes	Yes	Yes	Yes	Yes	N/A	N/A	N/A
Decarbonisation strategy									
Comprehensive climate strategy for own investments	Partly	Partly	Partly	Partly	Partly	Yes	Partly	No	No
Portfolio-wide GHG reduction target	No	No	No	No	No	No	No	No	No
Climate considerations in project planning									
ESG safeguards include climate	Partly	No	Partly	Yes	Partly	Partly	Yes	No	N/A
Climate risk analysis in financial analysis	Yes	Yes	Yes	Yes	Partly	Yes	N/A	N/A	Yes
Internal CO ₂ -Price	No	No	Yes	Partly	No	Start in 2018	No	N/A	N/A
Climate criteria for project planning									
Application 1.5°C/<2°C investment criteria	No	No	No	No	No	No	No	No	No
Coal exclusion	No	No	Partly	Partly	Partly	Partly	No	No	N/A
Further fossil fuels exclusion	Partly	Partly	No	No	Partly	No	N/A	N/A	N/A
Carbon accounting and disclosure									
Project-level	Partly	Partly	Partly	Yes	Partly	Partly	N/A	N/A	N/A
Portfolio-wide	No	No	No	Yes	Partly	No	No	N/A	N/A

Note: This table represents own analysis of information collected from various sources (see below). AfDB: African Development Bank, AsDB: Asian Development Bank, EBRD: European Bank for Reconstruction and Development, EIB: European Investment Bank, IADB: Inter-American Development Bank, WBG: World Bank Group, AIIB: Asian Infrastructure Investment Bank, NDB: New Development Bank and CDB: Caribbean Development Bank. N/A: not available. ESG: Environment, Social, Governance.

Sources: Draft Joint Multilateral Development Bank Initiatives on Climate Action (March 19th 2017), urgewald e.V., Christian Aid, Oil Change International, Bank Information Center, Overseas Development Institute, AsDB, EBRD, EIB, IADB, WB.

provide climate finance for developing and emerging economies, yet they still lack behind their commitments (see Chapter 4).

Apart from that, with their experience and support for capacity-building, MDBs can be important partners for governments to implement the Paris Agreement domestically. They can help to strengthen institutions and to raise public revenues for investments in climate-friendly infrastructure. Furthermore, they can provide support for adapting the regulatory framework in such a way that private capital is being shifted and climate-friendly projects are realised. Capacity-building and strengthening good governance are among the traditional tasks of the MDBs (see Chapter 5).

Ultimately, to achieve the goals of the Paris Agreement and Agenda 2030 also requires that MDBs use their institutional and financial capacities to mobilise private investments. Beyond capacity-building for states, MDBs are pioneers and important partners to bring the private sector onto the path towards climate-friendly transformation. To this end, there are already a great number of instruments and initiatives available. However, it needs to be ensured that these actually serve a climate-friendly transformation in the light of Agenda 2030 (see Chapter 6).

3 Aligning investments with the Paris Agreement

To limit global warming to well below 2°C if not 1.5°C, investments in fossil fuel infrastructure are subject to tight restrictions – this applies in particular to the planning of new projects. In comparison to MDB investments, investments from the private sector are more difficult to control. That is why MDBs must be especially ambitious and align their overall portfolio with a 1.5°C-compatible development path that also complies with the goals set down in Agenda 2030.

In the year 2015, more than 20 finance institutions launched an initiative to mainstream climate action within financial institutions at the sidelines of COP21 in Paris. Meanwhile, more than 30 institutions, among them AfDB, ADB, EBRD, EIB, IADB and the World Bank Group as traditional MDBs along with NDB as multilateral newcomer, and private finance actors joined the initiative. The initiative builds on five comprehensive climate mainstreaming principles. The principles range from committing to climate strategies, managing climate risks, promoting climate smart objectives, improving climate performance, to accounting of own climate action⁴. Adherence to the principles is voluntary, however, and the degree to which they are implemented is unclear.

At this year's Global Infrastructure Forum of the MDBs, which was set up in the year 2015 as part of the Addis Ababa Action Agenda on development finance, the MDBs set out three priorities for their future work⁵. These focus on capacity-building for governments, creating an enabling environment for the private sector, and using the MDBs as catalysts for mobilising private investments. Strategies for shifting their own portfolios towards climate-friendly investments are, however, lacking.

No MDB has to date come up with a comprehensive strategy for aligning their portfolio with the goals of the Paris Agreement and Agenda 2030. Only the World Bank's climate strategy targets its entire portfolio (see Table 1). However, whether it implements the strategy consistently remains to be seen⁶. Portfolio-wide emission reduction goals cannot be found for any of the MDBs, as shown in Table 1.

The G20-governments as shareholders of the MDBs should demand that such strategies for achieving the climate and development goals be developed. Having these in place by 2018 would benefit and strengthen the dynamics of the so-called Facilitative Dialogue (FD) as part of the UNFCCC,

which is to take place in 2018. The FD serves to make states increase the level of ambition in their nationally determined contributions (NDCs), because the goals of the Paris Agreement cannot be achieved with the existing NDCs. Ambitious MDB climate strategies would send out an important signal to developing countries and emerging economies that increased ambition in the FD-context can also be funded. This is important so that increasing ambition can even be taken into consideration.

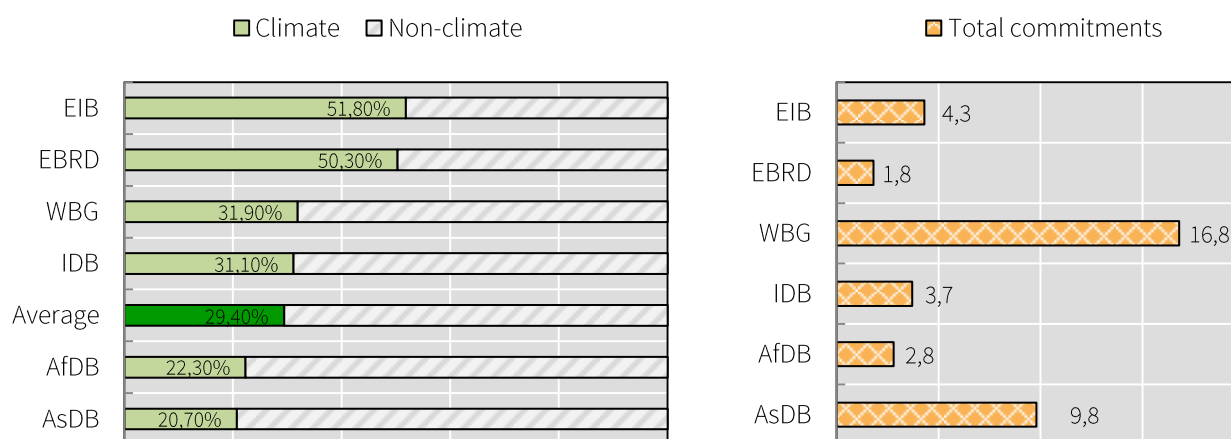
The existing development, infrastructure and climate action plans of the MDBs could serve as a basis for comprehensive MDB climate strategies, but must be coordinated with one another and expanded to the entire portfolio.

As part of the G20 process, MDBs committed for example to increase their investments in infrastructure⁷. The OECD has stated that it is extremely important to align these with the goals of the Paris Agreement in order to prevent carbon lock-in and thus an increased risk of global warming exceeding 2°C⁸. A corresponding provision lacks to date. According to the OECD, only around a third of infrastructure investments by the MDBs are climate-related – with the figure ranging from around 50% (EIB and EBRD) to a good 20% (AsDB, see Figure 1).

The MDB climate strategies should contain concrete measures with time schedules for implementation and verifiable intermediate goals, with regular progress reporting. Reports should not only focus on emissions that have been avoided in mitigation projects, but take emissions of all investments into account. Furthermore, MDBs need to ensure that projects that are carried out by financial intermediaries are also climate-friendly and in line with Agenda 2030.

The following measures would contribute considerably to climate-friendly project planning and project evaluation in the MDBs and should thus become central components of the MDBs' climate strategies.

Figure 1: Share of climate-related and total MDB commitments for infrastructure, by institution (USD billion), 2013-15 average



Note: This figure is taken from the 2017 OECD Report “Investing in Climate, Investing in Growth” and is based on data reported to the OECD Development Assistance Committee by the following MDBs: the African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the Inter-American Development Bank and the World Bank Group (WBG), which also includes the International Finance Corporation. Climate-related components of projects are those that target mitigation, adaptation, or both mitigation and adaptation, based on the joint MDB Climate Finance Tracking Methodology. MDB commitments include concessional and non-concessional support. Infrastructure sectors include transport, energy, water supply and sanitation, and communications.

Source: OECD 2017, p.278.

3.1 Applying Paris-compatible investment criteria

Most MDBs assess their projects according to ESG (environmental, social, governance) criteria. The applied criteria differ, however, in the level of ambition and seldom consider the compatibility of the investment with the goals of the Paris Agreement.

With the exception of EIB and AIIB, climate-related effects of investments are only partially included in ESG-assessments (see Table 1)⁶. The AfDB⁹, EBRD¹⁰ and IADB⁶ only pay attention to climate resilience effects and do not examine whether the investment itself contributes to climate change. While the World Bank takes the contribution of an investment to climate change in the ESG criteria into account, it only does so for certain projects.⁶

Most MDBs have until now pursued a technology-neutral approach. Yet, in fact, investments in emission-intensive infrastructure are frequently given preference over climate-friendly investments, since their true costs are still not adequately priced-in. Due to their longevity, however, all investments that involve mining and burning fossil fuels bear the risk of carbon lock-in – or, alternatively, they may have to be written off prematurely as “stranded assets” in the near future in view of ambitious climate protection measures. Both contradict the effective use of public funds for sustainable development and thus the declared goals of the MDBs, as well as the obligations for the MDB shareholders arising from the Paris Agreement and Agenda 2030.

Investments in coal-related projects by MDBs have decreased since 2010⁸. Nevertheless, the MDBs are still far from excluding emission-intensive fuels and technologies from their financing activities. As such, the annual increase in finance for renewable energies of 13% (excluding hydropower) in the past ten years was accompanied by an increase in the financing of fossil fuels by almost 16%⁸.

None of the MDBs uses hard investment criteria that are aligned with 1.5°C or 2°C scenarios (see Table 1). Even investments in coal have not been completely ruled out by any of the MDBs, despite the fact that the fossil-fuel phase-out must be initiated immediately if the climate goals are to be reached. EBRD, IADB and the World Bank, however, strictly limit coal projects, only providing funds if they are the only economically available option and have a high degree of efficiency^{11,12}. The EIB links investments in coal power to fixed efficiency benchmarks that can de facto only be fulfilled by coal-fired power stations with carbon capture or combined heat and power¹².

While investments in the exploration of new oil and gas fields are excluded by the AfDB, AsDB and IADB, these banks nevertheless still invest in fossil infrastructure and in the exploitation of already developed sites¹³. However, it must be recognised that the AfDB and IADB make far lower investments in fossil fuels than other MDBs (respectively 3% and 9% of the entire portfolio)^{14,15}. The EBRD, EIB and the World Bank, in contrast, invest more into fossil fuels than into renewables¹⁵.

MDBs should use their funds exclusively for the most sustainable infrastructure. This is also important in order to send the right investment signals to the private sector. Experience has shown that private investments mostly follow public investment projects. Besides pioneering projects for the private sector, public investments also shed light on the political will and thus the way future policy frameworks and investment environments might be heading. The Climate Action Network International therefore demands that all fossil investments be taken out of the portfolios and project pipelines of the MDBs by 2020.

In addition to the ESG criteria, it is therefore important that the MDBs apply strict criteria on the 1.5°C-compatibility of a project. Specific criteria can be derived from 1.5°C scenarios, such as those currently being developed for the special report on 1.5°C by the Intergovernmental Panel on Climate Change (IPCC). By aid of these scenarios, exclusion lists and no-regret lists could be drawn

up. For those technologies that are ambiguous, i.e. neither clearly climate-friendly, nor in any case harmful to the climate, quantitative and qualitative benchmarks should be defined. The EIB already applies such benchmarks for coal investments, as described above.

3.2 Applying adequate CO₂ prices

Cost-efficiency is a central criterion in all investment decisions. The costs for fossil fuels, however, are kept artificially low. They are subsidised and their negative effects (negative externalities) are not adequately priced-in.

To balance out this market distortion, MDBs can apply CO₂ shadow prices for the financial project assessment. This means that a CO₂ price is used in the bank's internal calculations, even if there exists only a low or no CO₂ price in the country in question. In this way, assessments of economic viability and the cost-benefit ratio in CO₂-intensive projects become more realistic.

To date, CO₂ prices have only been used comprehensively by the EBRD¹⁶, but the World Bank wants to catch up from 2018 (see Table 1)¹⁷. With around 30 Euro/tCO₂e (tonnes of CO₂-equivalent) the mean CO₂ prices applied or aimed at by both MDBs are, however, far too low. This applies for the 2°C target, and in particular for 1.5°C. The High-Level Commission on Carbon Prices concludes in its most recent report that at least 40-80 USD/tCO₂ must be taken as a reference in order to be compatible with the temperature goals of the Paris Agreement¹⁸.

3.3 Adapting and disclosing climate risk assessment

Climate risks have a great influence on the economic performance of investments. The finance sector is increasingly aware of this issue. Two types of climate risks are relevant for the MDBs. First, physical risks, for example when a coastal road can no longer be used due to rising sea levels caused by climate change; and second, transformation risks, for example due to the establishment of high CO₂ prices or strict technology benchmarks that lead to the premature closure of emission-intensive facilities. If this is not taken into consideration during project planning, both can lead to considerable financial losses.

MDBs already began at an early point to develop and apply instruments for assessing climate risks; especially in the context of financial risk assessments (see Table 1). AfDB, AsDB, EBRD, EIB, the World Bank und CDB apply specific climate risk analysis and management tools, IADB will follow suit in 2018⁶.

The instruments for assessing climate risk are, however, not yet adapted to the goals of the Paris Agreement. As such, the physical risk of an investment in a 1.5°C scenario might drop considerably, while the transformation risk is rapidly rising, as the world is currently even further away from a 1.5°C development path than it is from a 2°C path. The MDBs must adapt their climate risk assessment accordingly.

Furthermore, the results of risk analyses should be disclosed. It would be beneficial if MDBs exchanged best practices amongst themselves and with other investors in this regard.

3.4 Accounting and disclosing all greenhouse gas emissions

Central for climate-friendly project planning are strict ESG criteria, exclusion lists and CO₂ prices. In order to apply these instruments, greenhouse gas emissions at project level must be comprehensively assessed ex-ante. For ex-post project evaluation and for assessing whether own decarbonisation targets will be achieved, precise and comprehensive accounting and disclosure of investments' life-cycle greenhouse gas emissions are important, both at project level and at portfolio level.

Accounting and disclosure of greenhouse gas emissions at project level is relatively widespread. The EIB, for example, has been recording and disclosing its project-related greenhouse gas emissions since 2009¹⁹. However, accounting and disclosure often only applies to projects with emissions above a certain threshold (EBRD: more than 20,000 tCO₂e per year²⁰; AsDB: more than 100,000 tCO₂e per year), or only to projects in certain sectors (IADB, World Bank, AfDB)¹⁴. In addition, no MDB accounts and reports on emissions of their investments across their entire life cycle.

Nine international financial institutions, among these the AfDB, ADB, EBRD, EIB and WBG, recently agreed to a joint Framework for a Harmonized Approach to Greenhouse Gas Accounting for accounting and disclosing their CO₂ footprint at project level using sector-specific approaches²¹. However, the framework targets emissions avoided in mitigation projects, and accounting and disclosure of net emissions of the entire portfolio remains voluntary.

Net emissions of the entire MDB-portfolio are not near to being comprehensively accounted and disclosed (see Table 1). Until now, only the EIB²² and IADB report on emissions of their entire portfolios in their annual sustainability reports⁸. The EBRD and the World Bank only report about emissions avoided through green investments, which should not be mixed up with reporting about net emissions of the entire portfolio¹⁴.

A first step would be that MDBs jointly implement the recommendations of the Task-force on Climate-related Financial Disclosures (TCFD). This would also send an important signal to and act as an example for the private sector.

4 Scaling-up climate finance

In the run-up to COP21, most MDBs committed to increase climate finance in their portfolios (see Table 2). This is urgently required as a complement to the alignment of the overall portfolio towards the Paris Agreement. There are areas which require further targeted public climate finance so that the low-emission, climate-resilient transformation can be achieved in developing countries at the necessary pace.

This applies, in particular, to those areas that are not attractive for private investments. This includes all projects that do not generate a constant stream of revenues, which is for example the case with adaptation projects, or with infrastructure improvements (see Figure 2).

Mitigation investments tend to generate such a constant stream of revenues, also in areas beyond the energy sector (For a discussion of potential problems, see Chapter 6). Nevertheless, investments by MDBs are still required in these areas. Private investors consider mitigation projects in developing countries to be more risky from a political and technological perspective than in industrialised countries. The investments therefore come with a double risk premium. Investments to reduce emissions, for example in the area of energy efficiency and renewable energies, involve

Table 2: Climate finance from MDBs to developing countries: Status and future targets

	MDB targets to scale up climate action	Climate fi- nance in 2015 (USD '000)	Share of climate fi- nance in MDB portfo- lios in 2015
AsDB	Double climate finance to USD 6 billion annually by 2020	2 917	15.3%
AfDB	Triple climate financing to reach 40% of investments by 2020	1 359	15.6%
EBRD	40% of annual business investment in green finance by 2020	3 217	25.5%
EIB	Global target of greater than 25% of all lending. Increased target of 35% of lending in developing countries by 2020	5 137	26.2%
IADB	Double climate finance to 30% of operational approvals by 2020, to an average USD 4 billion per annum	1 744	16.1%
WBG	Increase climate financing by one-third, from 21% to 28% of annual commitments by 2020	10 722	17.9%

Note: This table is taken from the 2017 OECD Report “Investing in Climate, Investing in Growth”. AsDB: Asian Development Bank; AfDB: African Development Bank; EBRD: European Bank for Reconstruction and Development; EIB: European Investment Bank; IADB: Inter-American Development Bank; WBG: World Bank Group.
Source: OECD 2017, p.277.

high upfront costs (but by comparison low costs over the life-cycle of the investment). With a double risk premium on invested capital, fossil fuel projects with usually lower upfront investment costs become even less costly than capital-intensive climate friendly investments.

Increasing concessional finance for climate action in developing countries is important to reduce the upfront costs of the projects and to assume the initial risk of projects so that the private sector can follow suit (see Chapter 6)²³. It is therefore required that the G20 governments, as the largest shareholders (and in particular the industrialised countries among them), increase their funds for the MDBs, who then must use these in a targeted manner for climate finance. Last but not least, this is important in order to fulfil the promise given by the industrialised countries to make 100 billion US dollars available by 2020 to implement the Paris Agreement.

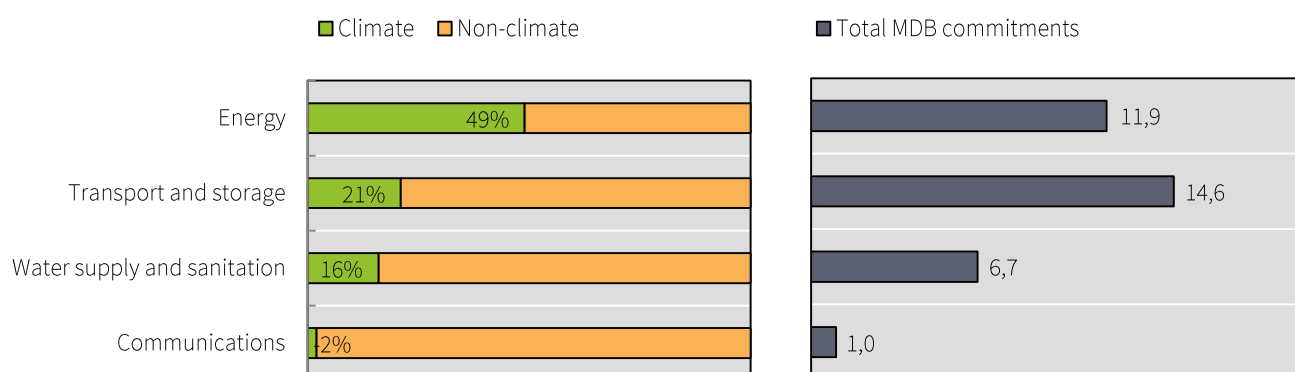
Some states also specify access to concessional finance as a precondition for more ambitious climate action. To unlock these so-called conditional NDCs, sufficient financial means for the MDBs as well as ensured access to climate finance needs to be provided.

5 Supporting states through capacity-building

MDBs are experienced institutions that matter in terms of finance but also in capacity-building for implementing NDCs and the low-carbon transformation in their recipient countries⁸. Technical and institutional support is particularly important, and can build on experience gained in current capacity-building initiatives, such as the World Bank’s Partnership for Carbon Market Readiness.

In April 2017, finance ministers from the most vulnerable countries, the so-called V20, welcomed in their communiqué existing support from AsDB and WBG for climate action capacity building, and encouraged further co-operation with the regional MDBs in the V20 Action Plan²⁴. The MDBs for their part agreed at the 2017 Global Infrastructure Forum to focus on capacity building to address countries’ infrastructure challenges as one of three priorities. Amongst others, they aim to share international best practices and increase support for project planning⁵.

Figure 2. Share of climate-related and total MDB commitments for infrastructure by sector (USD billion), 2013-15 average



Note: This figure is taken from the 2017 OECD Report “Investing in Climate, Investing in Growth” and is based on data reported to the OECD Development Assistance Committee by the following MDBs: the African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the Inter-American Development Bank and the World Bank Group (WBG), which also includes the International Finance Corporation. Climate-related components of projects are those that target mitigation, adaptation, or both mitigation and adaptation, based on the joint MDB Climate Finance Tracking Methodology. MDB commitments include concessional and non-concessional support.

Source: OECD 2017, p. 279.

Capacity building should promote and enable comprehensive domestic policy frameworks that cease the preference for fossil fuels in favour of climate-friendly investments.

5.1 Technical support

Technical support is twofold. First, it encompasses grants for education and training in habitats from recipient countries at home or abroad to acquire the required knowledge and skills. Second, it includes payments for consultants, qualified advice and training in recipient countries²⁵.

Through technical advice, knowledge-sharing, project management support, feasibility studies, demonstration and pilot projects, MDBs can draw attention to climate projects which are also beneficial to the development agenda, as well as expand planning- and absorption capacity for climate-friendly investment in the recipient countries⁸.

5.2 Institutional support

Institutional support aims to introduce specific political frameworks as well as to ensure that good governance and anti-corruption represent a risk-free and reliable investment environment.

MDBs provide expertise and enable knowledge transfer and exchange of experience between different states to set up a political framework for the domestic low-carbon transformation. At the same time, loans and support can be conditional on capacity-building and certain political reforms.

In supporting the implementation of appropriate framework conditions, MDBs can play a major role in reducing market distortions and market failures that lead to preferential investment in fossil infrastructure. This serves to shifting private capital towards climate-compatible invest-

ments, and also alters the business cases for MDBs' own investments in fossil projects. In concrete terms, institutional support should aim for factoring-in climate risks, phasing-out fossil fuel subsidies in a socially acceptable manner, and introducing an effective CO₂ price.

The latter would also generate public revenues that are urgently needed for climate-compatible public infrastructure investments. In this context, MDBs can generally contribute to the introduction of an effective tax system in countries with low government revenues due to a low tax base²⁶.

Green bonds, issued in local currency, would also be beneficial to mobilise capital for public infrastructure investments. Particularly in developing countries, such Green Bonds can minimise the problem of currency mismatch. Currency mismatch occurs if the currency in which capital is borrowed differs from the local currency in the state where the capital is invested in. For example, if a state borrows capital in US dollar and the local currency has no fixed US dollar exchange rate, debt might simply increase as a result of an exchange rate deterioration of the local currency relative to the US dollar. Particularly with high large long-term loans, as required for infrastructure investments, currency mismatch can cause excessive debt.

Support from the MDBs in setting up and issuing green bonds in local currency can ensure that investors have confidence in the green bonds issued and that the capital actually goes into climate-friendly projects, despite the lack of a general definition of what is "green" in this context. For example, MDBs should ensure that best practice approaches are followed, such as those from the Climate Bonds Initiative.

In any case, the political framework conditions can only have the desired effect if they are implemented in an environment of good governance. This particularly includes rigorous anti-corruption measures. A variety of studies reports that corruption can increase project costs in the infrastructure sector by up to 30%²⁷.

6 Mobilising private capital

Framework conditions and good governance are an important basis for mobilising and shifting private sector investment, as outlined in Chapter 5. However, further drivers are necessary to mobilise the large amount of capital required to implement the Paris Agreement and Agenda 2030.

In 2015, the G20 initiated the "From Billions to Trillions" MDB action plan, published by the World Bank in the run-up to the Third Conference on Financing for Development in Addis Ababa. The action plan aims to use MDB capital more efficiently, leveraging more private capital to achieve the goals of Agenda 2030²⁸. The final document of the Financing for Development conference, the Addis Ababa Action Agenda, re-emphasises the need to mobilise more private capital for development financing, particularly in the infrastructure sector.

At this year's Global Infrastructure Forum, which was established as part of the Addis Ababa Action Agenda, MDBs identified measures to mobilise private infrastructure investment as one of three priority areas. Specifically, risks should be reduced, public-private partnerships (PPPs) promoted and finance for long-term infrastructure projects by institutional investors should be unlocked⁵. The MDB Principles to Crowd in Private Sector Finance, issued in April 2017, restate the need to create an enabling investment environment that responds to investors' needs²⁹.

In addition to considering investors' needs, it would be important that all MDB-strategies and principles consider also the risks that mobilising private capital might pose to public services and public debt, especially if blended finance and public-private partnerships are not carefully designed (see Chapters 6.3 and 6.4).

In the past, MDBs focused particularly on mobilising private capital in renewable energies. While investments in these areas are now economically viable in most countries, it is important that MDBs pay special attention to those areas of climate-friendly transformation where the private sector has previously been reluctant due to high risk and the significant gap between social benefits and private returns⁸.

6.1 Green bonds

Banks, as well as governments, can issue green bonds to finance climate-friendly projects. MDBs increasingly issue their own green bonds to mobilise private capital.

The EIB has been a pioneer in this area and still holds the leading position. In 2007, it introduced the first “Climate Awareness Bond” (CAB). In the meantime, with CABs worth 16 billion euros in 11 currencies, it is still the world's largest supranational issuer of green bonds⁶. The other MDBs are also becoming increasingly active in this regard.

In lack of a common definition of what is “green” in this context, compliance with generally accepted standards, such as the Green Bond Principles (GBP), or the Climate Bond Initiative, is essential to prevent the threat of greenwashing. To date, from the MDBs, only the AfDB, the EBRD, the EIB and the World Bank have committed to the GBP principles³⁰. None of the MDBs have so far applied the more ambitious standards of the Climate Bond Initiative³¹.

6.2 De-risking

Private investment is driven by the ratio of risk to return. In particular, long-term infrastructure investments are often associated with political and regulatory, macroeconomic, economic and technical risks, which make private actors reluctant to invest in this area.

Risk mitigation reduces capital costs for climate-friendly infrastructure investments, which significantly improves the competitiveness of climate-friendly technologies where upfront investment is relatively high compared to fossil technologies³². MDBs can reduce investment risks through capacity-building in the recipient countries (see Chapter 5)⁸ and by aid of specific risk mitigation techniques.

Traditionally, MDBs have often taken on the initial risks for infrastructure investments by investing in pilot projects in their recipient countries, thus road-testing technologies, as well as carrying out projects in an exemplary manner in countries perceived as risky⁸. If these projects prove to be successful, the initial risk for subsequent investments by the private sector is mitigated.

In addition, there are financial instruments to reduce investment risks for the private sector. Through various approaches such as guarantees, insurances and hedging, subordinated loans and syndicated loans, governments and international financial institutions try to address various risk types. Subordinated loans and syndicated loans have been the risk mitigation tool most frequently used by MDBs so far. In the future, however, MDBs might play an increasingly important role in guarantees and assuming regulatory risks, as well as in risk diversification through insurance solutions¹.

6.3 Blended finance

Blended finance uses the risk mitigation strategies set out in Chapter 6.2 but is more comprehensive. Both drivers of investments, risk and return, are addressed.

Investment platforms and investment partnerships bring governments, local financial institutions, MDBs and private investors together. These initiatives aim to mobilise private sector investment through targeted use of public funds, such as concessional or non-concessional finance, subordinated loans and guarantees as well as through accompanying support with professional expertise⁸.

MDBs can also play a major role in developing bankable projects and national investment pipelines, especially to mobilise institutional investors in infrastructure investment. Blended approaches are important in this regard because institutional investors such as pension funds are usually only permitted to invest in very secure investment projects. If the recipient country and the MDB take the first credit defaults, suitable low-risk asset classes can be created for institutional investors.

Blended finance involving, amongst others, MDBs and national development banks can be especially promising as the latter are able to borrow and lend money in the local currency³³. This gives local investors and banks the opportunity to invest their limited financial resources locally, which can also help to build local financial structures. It also reduces the problem of currency mismatch (see Chapter 5).

However, blended finance also carries the danger of the investment risk being born by the public sector, whilst returns accrue to the private sector. Therefore risks and returns must be shared adequately between different financiers. Moreover, MDBs and public financial institutions need to ensure that blended finance models do not crowd-out the private sector, i.e. that the public sector does not finance those projects that the private sector would have carried out on its own⁸. Particularly in times of low interest rates, the private sector is more willing to invest in projects that were previously classified as too risky. The macroeconomic environment should always be considered in blended approaches.

MDBs have set up a working group with other international financial institutions to develop common principles for blended finance. The Working Group for blended finance for private sector operations is expected to publish its first results in October 2017⁵. The results need to address the appropriate risk-return distribution between the different stakeholders and make specific proposals in this regard. It also needs to be ensured that private incentives are created in a way that reflects the actual macroeconomic context - for example, taking the current interest environment into consideration.

In addition, blended finance should not just be understood as refinancing⁸. Refinancing releases public funds for further projects and caters to the need (especially of institutional investors) for stable and, if possible, low-risk income streams. However, refinancing and trading assets on the secondary market does not leverage additional private finance⁸.

6.4 Public-private partnerships

While blended finance focuses on bringing private and public actors together to collaborate on project financing, public-private partnerships (PPPs) go beyond finance. PPPs make public and private actors collaborate for joint project implementation²⁶.

MDBs can provide valuable expertise due to their long-term experience in infrastructure investments in their recipient countries, particularly for project planning and project implementation. Moreover, they can be a stable partner for international investors if projects are carried out in different countries. However, it is important that PPPs are always adapted to local conditions.

In view of the rather mixed to negative experiences with PPPs in the past, it would be important that MDBs in their role as mediators between private and public sector ensure that PPPs are only set up in areas where they are appropriate. In particular, provisions should be made to ensure that infrastructure investments are pro-poor and that PPPs do not put more pressure on public debt than financing a project with public means, only.

A balanced distribution of risks and returns between contractual parties also needs to be taken into account. Potential payments, in particular in the form of income guarantees and maintenance costs when project partners do not fulfil their obligations, have often led to a significant and unexpected increase in costs for the public sector³⁴. It is essential that MDBs develop common approaches to ensure that previous problems with PPPs are not replicated.

7 Policy recommendations to the G20 and outlook

In the Paris Agreement, the international community committed to shifting all financial flows towards climate resilient, low greenhouse gas development. MDBs play an important role in this regard. Since states own the MDBs, governments can oblige them to carry out any appropriate measure. A consensus about the corresponding measures between the G20 governments is particularly important as they are the MDBs' largest shareholders – and therefore in a position to determine their way forward.

The recently published OECD report “Investing in Climate, Investing in Growth”, commissioned by the German G20 presidency, lists a variety of possibilities as to how the MDBs can align their activities with the goals outlined in the Paris Agreement. The June 2017 G7 environment ministers' communiqué calls on the MDBs to mainstream climate considerations across all their activities and to agree to strategies to mobilise private finance. A joint MDB action plan is very much welcomed in the communiqué.

The G20 should pick up on the important demands of the G7 environment ministers and the OECD and encourage MDBs to develop a corresponding MDB joint climate action plan. Such an **action plan for aligning MDB portfolios with the goals of the Paris Agreement** should include the following measures:

- To use 1.5°C-compatible investment criteria during project planning and to assess the climate-compatibility of investment pipelines and the entire portfolio
- To use exclusion lists for emission-intensive projects and no-regret lists for 1.5°C-compatible investments for project planning and selection
- To use effective CO₂ shadow prices for the financial assessment of projects, during project planning as well as for project evaluation
- To extend and adapt climate risk assessment and climate risk disclosure for both project planning and the entire portfolio
- To account and disclose life-cycle GHG-emissions of all investments, at project level for project planning and evaluation, as well as for the entire portfolio

In this context, it is also important that all MDB plans concerning infrastructure investments, which are a traditional G20 topic, be harmonized with the goals of the Paris Agreement. At their annual Global Infrastructure Forum, MDBs could agree on corresponding measures with other actors.

In addition, those G20 countries, which are obliged to **provide financial support**, should deliver on their promise to mobilise 100 billion US dollars per year by 2020 for mitigation and adaptation in developing countries. It is important that the funds provided are new and additional to existing development aid. Furthermore, the G20 should realise the opportunities arising from a profound partnership with the countries of the Climate Vulnerable Forum, which undertook in their Marrakesh Declaration³⁵ to carry out ambitious measures and move forward with climate finance innovations.

The G20 should also urge the MDBs to prioritize the following measures in **technical and institutional capacity-building** to support countries to align private and public investments with low-carbon development pathways and to implement the Paris Agreement in the light of Agenda 2030:

- To phase-out fossil fuel subsidies in a socially-responsible manner to put an end to artificially low fossil fuel prices
- To implement effective CO₂ prices to generate public revenues as well as to correct market distortions and market failures that favour investments in fossil fuels
- To identify and disclose climate-related investment risks to correct existing information asymmetries that favour investments in fossil fuels
- To issue green bonds with strict definitions of what “green” is for financing climate-friendly investment, especially in infrastructure

Leading by example, the G20 states should implement these measures themselves. Furthermore, implementing effective, ambitious tax systems to generate the required public revenues to finance the climate-friendly transformation in developing countries would be required. This should be done in coordination with the G20 and other states to minimise tax competition.

At the present time, MDBs are working on a joint statement of ambition for crowding-in private sector finance to support infrastructure investments⁵. The G20 should ask the MDBs to develop a strategy so that every initiative to **mobilise private capital**, especially in the area of infrastructure, contains the following provisions:

- To ensure compatibility of the required investments with the goals of the Paris Agreement
- To ensure careful selection and pro-poor conception of projects
- To realistically assess the costs for the public sector, including potential expenditures, for example, through income guarantees
- To ensure an appropriate distribution of risks and returns among all actors involved
- To prevent crowding-out the private sector, i.e. when MDBs assume risks that private investors would have borne themselves

Furthermore, it is important that an MDB climate action plan and its implementation be developed and monitored with **relevant stakeholders**, in particular civil society. To achieve this, it is vital that the relevant actors be provided with the necessary information promptly and in an easily accessible manner.

It is particularly important that the G20 exerts its influence on the MDBs given their financial capacities, the far-reaching impact they have in sending signals to others, and their long-standing experience and extensive expertise. However, individual G20 states should also ask their national development banks (NDBs), bilateral development banks and other development finance institutions (DFIs) to act in a climate-friendly manner. The measures recommended in the present paper for restructuring MDB's portfolios are to a great extent transferable. The measures in the area of

capacity-building and mobilising the private sector are, however, not readily implementable for all development finance actors.

For bilateral development banks, for example, capacity building depends to a great deal on the experience, capability and capacity of the individual bank. This also applies to the mobilisation of private investments. Not all bilateral development banks are as much trusted by international investors as the MDBs, especially when it comes to their expertise and their ability to bear financial risks.

These issues may also arise with national development banks. For example, a lack of technical and institutional capacities in a state might also significantly limit the possibilities and abilities of the national development banks to carry out capacity-building. With regards to regulatory measures, good governance and anti-corruption in particular, strong national interest groups lobbying in favour of the existing system might exercise more influence in the political process than the national development banks. In such circumstances, institutional capacity-building initiatives from outside via MDBs can be far more effective. MDBs' experience with other states might also be helpful to introducing policy reforms.

Development finance institutions generally focus rather on financial aspects than on capacity-building. They have special expertise in mobilising the private sector. It makes sense to use this expertise and combine it with other institutions' expertise in capacity building.

In any case, while MDBs have the most comprehensive set-up and long-standing experience with large investments in very different contexts, the local know-how of national and bilateral development banks, and development finance institutions' close connections to the private sector, are highly valuable for successful project implementation. It is therefore important that all financial institutions make use of their complementary competences to jointly contribute to the realisation of the Paris Agreement and Agenda 2030 goals.

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