Roundtable on Financing Water

The Roundtable on Financing Water

4th meeting, 26-27 June 2019, Washington, D.C.

Session 5. Improving the environmental performance of development finance

BACKGROUND PAPER[1]

[1] This background paper summarises key findings from Crishna Morgado, N. and Ö. Taşkın (2019), "*Managing environmental risks in development banks and development finance institutions – what role for donor shareholders?*", OECD Development Co-operation Working Paper as well as key messages from a joint OECD-EDFI-IDFC workshop on the same topic in May 2018.

1.1. Introduction

The 2030 Agenda is a universal, collective responsibility that covers all levels – global, national and territorial – and a multitude of actors. Yet, it ascribes the distinct responsibility of facilitating whole-of-government and whole-of-society approaches for sustainable infrastructure investment to national governments. Enhancing co-ordination and alignment across government, financial and civil society actors can improve the effectiveness and efficiency of water-related investment decisions and ensure the delivery of desired outcomes.

How and where infrastructure is built – and how environmental and social risks related to infrastructure are managed – will have a direct influence on whether developing countries pursue more sustainable development pathways or not. Ensuring that infrastructure is sustainable and of quality will require 1) developing countries to promote environmentally sustainable infrastructure options; and 2) for all new infrastructure to be built with minimal negative impacts on people and on the environment. Where residual risks and adverse impacts remain, sustainable infrastructure projects foresee to compensate affected communities and the environment. Development banks and development finance institutions (DFIs)[2] are critical to this agenda as they support developing countries in designing and financing projects, and support policy reform on issues related to environmental and social protection.

Donor governments, as shareholders of multilateral and bilateral development banks and DFIs have a specific role in improving environmental performance of development finance, in particularin the context of 1) water resources protection and 2) water-related investments. Amongst other tools, this includes The possibility to co-ordinate efforts across ministries and institutions to promote the integration of environmental considerations into financing decisions at the policy, portfolio and project level.

This paper provides a brief summary of key findings from recent OECD work on the role of donor shareholders in improving environmental performance in development banks and DFIs. These findings provide pertinent background for discussing the roles of various stakeholders (today and in the future), and how they might work better together to improve the environmental performance of water-related investments.

1.2. Key findings

The last decades have seen the world achieve unprecedented development gains – halving of poverty rates, increased per capita incomes and improved human development overall. At the same time, economic growth in developing countries has often gone hand in hand with extensive degradation of natural resources and other environmental impacts, which in turn affect development prospects, livelihoods as well as the health and well-being of people everywhere.

Development banks and DFIs continue to serve as important channels for development co-operation and green investment, including for infrastructure. They inform policy reform for green growth, and design and finance infrastructure projects in partner countries. Development banks and DFIs have adopted environmental and social safeguards systems to minimise and manage the environmental and social risks

[2] Development banks and DFIs are publicly owned financial institutions with a development mandate. Multilateral development banks (MDBs) work primarily in developing – ODA-eligible – countries and have multiple shareholders from both developed and developing countries. Bilateral development banks and DFIs support the development assistance agenda of their governments, and channel development finance from member countries of the OECD Development Assistance Commmittee (DAC) to developing countries.

associated with their projects. These systems are an important element of development finance that delivers sustainable development outcomes. By assessing environmental and social impacts at the start of a project, development banks and DFIs can minimise and manage risks, which in turn can support the development impact of a project.

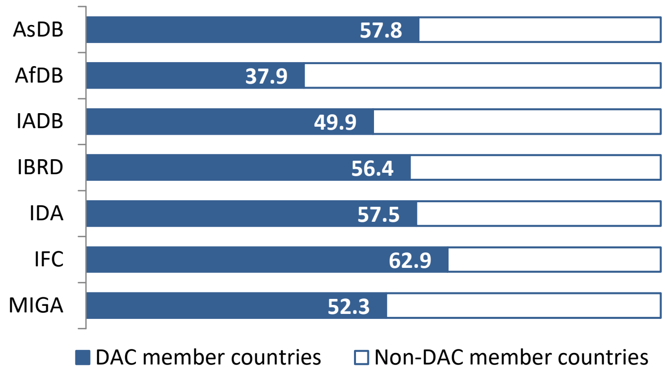
Beyond development outcomes, environmental and social impacts have repercussions on financial performance and economic viability of projects, in particular within infrastructure. The private sector increasingly recognises these linkages, as well as the key role of environmental and social frameworks in ensuring that blended finance achieves its intended outcomes across the financial, economic, environment and social space.

The implementation of safeguards systems face several challenges, however. While bilateral and multilateral development banks have improved their safeguards policies with respect to monitoring, reporting and disclosure, safeguards are also perceived to cause delays in project processing (Humphrey, 2015[1]). At a May 2018 OECD workshop[3] convening donor goverments, development banks and DFIs, participants noted that there is increasing emphasis on the need to better use partner country systems – national domestic policies and regulations – rather than the standards of international financing institutions when assessing environmental and social impacts. Concurrently, it is well recognised that gaps in enabling policy and regulatory environments in developing countries, ack of capacity in implementing agencies, and on-the-ground complexities and competing interests hinder the assessment of risks at pre-approval stage as well as the implementation and monitoring of risk mitigation measures once the project is complete. More profoundly, lack of awareness regarding the role of environmental and social standards in ”doing more good” – in financial, environmental and social terms – hinders the systematic consideration of environmental and social risks in development and commercial finance.

Donor governments can influence the policies and activities of development banks. As shareholders of MDBs, DAC members can contribute to the steering of MDB policies and operations, including on the implementation and effectiveness of safeguards practice. Figure 1.1 shows the voting power of DAC member countries in selected MDBs.

[3] Some workshop participants questioned the term “safeguards,” and instead considered the use of “performance.” This shift in thinking emphasises a more forward-looking agenda, whereby environmental mainstreaming is considered essential through project design, selection, and implementation.

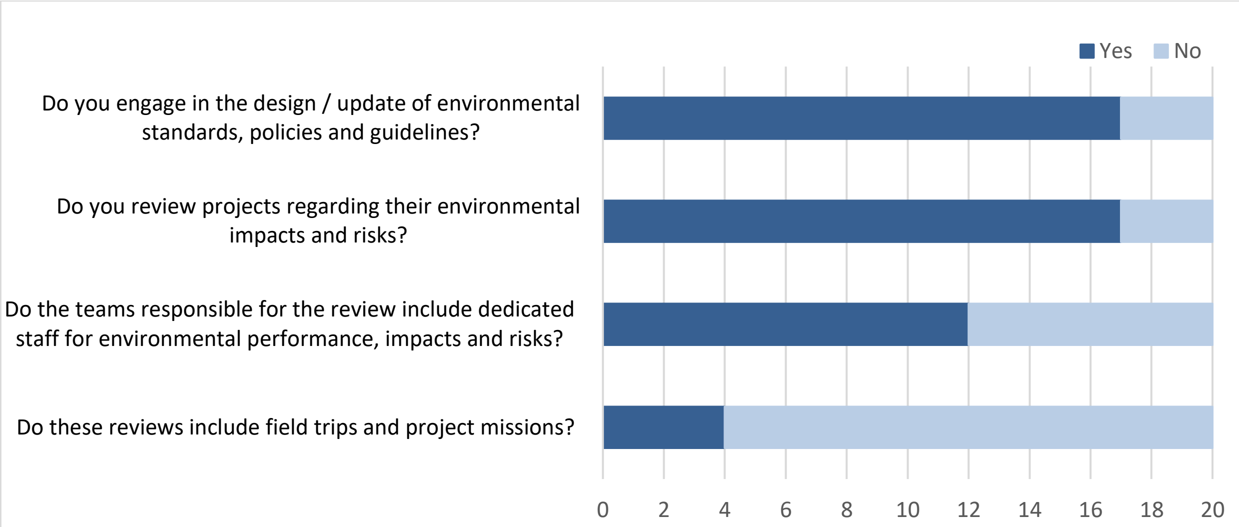
Figure Error! No text of specified style in document.**.1. Voting power for selected MDBs, DAC and non-DAC countries**



Note: AsDB – Asian Development Bank, AfDB – African Development Bank, IADB – Inter-American Development Bank, IBRD – International Bank of Reconstruction and Development, IFC – International Finance Corporation, MIGA – Multilateral Investment Guarantee Agency.
Source: Based on annual reports and MDB websites

A survey of DAC members shows that donor governments usually engage with bilateral and multilateral development banks on environmental issues at both a strategic level (on policy) and at an operational level (on projects). However, this engagement differs for MDBs and bilateral institutions. As shareholders of MDBs, 17 out of 20 donor governments responding to the survey stated that they engage in the review of environment-related policies and strategies of the banks. (see Figure 1.2). Donor shareholder governments also review individual MDB projects for potential negative impacts – mostly through Executive Director's offices. But the level of engagement varies significantly, often determined by available staff resources. Moreover, only four countries reported that they conduct independent field missions to review MDB projects. For bilateral development banks and DFIs, donor shareholder governments engage by influencing policies, and usually delegate safeguards implementation and review to the banks themselves. Fourteen donor governments who responded to the survey have bilateral development banks. Of those, eight reported conducting individual project reviews of their bilateral institutions.

Figure 1.2. DAC member engagement in the review of environmental impact of policies and projects of MDBs



Note: This figure is based on responses from 20 members.
Source: Survey of OECD DAC members

Governments can collaborate to further strengthen safeguards application by development banks and DFIs and to help shift thinking from a focus on "safeguards" (e.g. "do no harm") towards improving environmental performance (e.g. "doing more good"). Development banks' policies and priorities, and the emphasis in their portfolios, are driven by the overarching demands governments place on them. Donor shareholder governments must continue to play an important role in encouraging development banks and DFIs to strengthen the implementation of safeguards. This will require further collaboration: (i) internally (between different ministries of one country); (ii) externally (across different countries), (iii) between development banks and DFIs.

The following five areas for further cooperation were identified during the development of this paper:

- Collaborate internally and externally to support project-level review
- Provide technical assistance to build partner country safeguards systems
- Encourage harmonisation of safeguards across different development banks and DFIs
- Build the evidence base on the actual impacts of safeguards in projects
- Promote policy dialogues across DAC and non-DAC governments to maintain momentum on environmental performance of development activities.

Questions for discussion

- What are the specific levers or entry points in investment decision making processes that can be used to promote improved environmental performance of water-related investments (and development finance more generally)? Is there adequate scope to challenge the necessity of a project before it moves beyond project concept and design?
- How can we increase constructive collaboration and co-ordination -- among different ministries, countries, development banks and DFIs -- to protect natural capital and water resources in the context of water infrastructure projects as well

as projects outside of the “water domain”, which have important impacts on water resources?

- How can we ensure that efforts to reduce the negative environmental impacts of projects are effective over time, particularly those intended to protect and mitigate negative impacts on water resources?
- How can DFIs and development banks’ private sector operations uphold environmental and social safeguards in working with the private sector? Do safeguard frameworks need to evolve as development banks and DFIs increasingly work with and through the private sector?

References

Humphrey, C. (2015), "Challenges and Opportunities for Multilateral Development Banks in 21 st Century Infrastructure Finance", *Infrastructure Finance in the Developing World Working Paper Series*, , Global Green Growth Institute and Intergovernmental Group of Twenty Four on Monetary Affairs and Development (G-24), www.g24.org/wp-content/uploads/2016/05/MARGGK-WP08.pdf (accessed on 22 April 2018).