



Policy Brief

# REALISING THE POTENTIAL OF NATIONAL DEVELOPMENT BANKS AND FOUNDATIONS IN SCALING UP GREEN AND INCLUSIVE INFRASTRUCTURE

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*Task Force 8*

**Inclusive, Resilient, and Greener  
Infrastructure Investment and Financing**

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# Abstract

This policy brief discusses the unique role that national development banks (NDBs) and foundations could play in supporting their governments to scale up sustainable infrastructure, including both climate-compatible economic infrastructure and social infrastructure. The brief provides a conceptual framework that looks at the critical dimensions that must be in place to tap into NDBs and foundations for sustainable infrastructure building. The recommendations can be grouped under four parameters: (i) public policies and mandates, (ii) operational and financial performance, (iii) partnership, (iv) labelling and data collection.

# Challenges

As the world battles global and regional challenges such as COVID-19 and climate change, there are huge infrastructure investment needs worldwide. While fiscal support will be substantial, this effort will not in itself be sufficient to close the infrastructure gap. The Organisation for Economic Co-operation and Development (OECD) estimates a gap of around US\$15 trillion until 2040 for infrastructure spending (OECD, 2020). In emerging markets and developing countries, the investment requirements are substantial, especially considering current fiscal constraints. In advanced economies, there is an urgent demand for new funding to ensure security and upgrading of ageing infrastructure. Funding to maintain public infrastructure typically relies on government spending, in particular for difficult to reach areas like adaptation and resilience<sup>1</sup>. However, as seen in OECD (2021) a lack of reliable and stable funding as a result of short-term horizons, political priorities and pressured public budgets, are major barriers to maintenance spending and building resilient infrastructure.

In this policy brief the spotlight is on relevant flows of capital from two sets of institutional actors, national development banks (NDBs) and foundations<sup>2</sup>, and in two sectors, low carbon infrastructure and social infrastructure. Sitting at the nexus of public policy and the financial sector, NDBs are uniquely positioned to support transformative action for scaling up green and inclusive infrastructure that maximising growth potential. Foundations are uniquely positioned to advance social welfare whose financing may go beyond the ability and willingness of the private sector. The strong knowledge of the local contexts and the vast experience in long-term investment and financing put these actors in a privileged position to mobilise private financing, to address market failures and to shift capital flows towards more sustainable infrastructure projects. They can also contribute to identifying and mitigating various risks in the project cycle and taking the lead in the governance, leadership and monitoring of sustainable infrastructure projects.

<sup>1</sup> The term “financing” indicates how to meet the upfront costs of infrastructure (equity or debt financing) and “funding” indicates how the asset is paid off over its life-cycle.

<sup>2</sup> Philanthropic actors such as foundations can be defined as independent, non-state entities that associate private resources and deploy these through funding or by running their own programmes to advance social, cultural, economic, environmental, scientific and/or international levels under a defined legal status (OECD, 2014).

Given that economic, political and financial circumstances are unique to each country, no single “model” exists that determines NDBs and foundations’ success in scaling up inclusive and climate-compatible infrastructure. However, certain factors can be identified that shape the way in which these actors can improve their performance. In this brief, the challenge of harvesting a large enough quota of capital to channel towards low-carbon and social infrastructure assets are discussed. The brief will also assess how far NDBs and philanthropic actors can complement locally or nationally driven policies and how they can benefit from collaboration with other networks.

In particular, the brief illustrates how major bottlenecks can be removed considering a range of models for the involvement of institutional actors in sustainable infrastructure and makes proposals for how to determine which model fits best. Among these, creating a consistent policy and regulatory framework, establishing clear mandates, enhancing internal capacity, promoting risk-mitigation strategies, advancing labelling and certification and better data availability are all necessary conditions to bolster the capacity of NDBs and foundations and to realise the benefits of sustainable infrastructure more broadly.

## **A. FOUNDATIONS**

The COVID-19 health crisis has exposed the chronic underinvestment in social infrastructure in most developed and emerging countries repositioning the issue of social infrastructure as a core question. According to the Global Infrastructure Hub, over the last decade investment in social infrastructure declined, with primary transactions falling from \$19 billion globally in 2010 to less than \$3 billion in 2019 (Infrastructure Monitor, 2020). At the same time, in the post pandemic scenario, governments attach more importance to economic infrastructure, targeting mostly assets in transport, energy and communications with less attention given to social infrastructure (Global Infrastructure Hub, 2020a). Yet, from a recovery perspective, social infrastructure should be at the core of global investment efforts as better social infrastructure leads to greater resilience, growth and wellbeing.

Global, regional and national philanthropic actors such as public and private foundations are among the growing number of impact investors with estimated total assets of over \$2.3 trillion, just under 3 percent of the world’s total GDP (Citibank, 2021). This community has technical and analytical expertise, well-established means for financing projects, and a vast local public and private sector network. Despite this positive outlook, substantial challenges remain before philanthropic actors realise their full potential as financiers of social infrastructure.

The investment climate is affected by many factors, including government regulations, rule of law and property rights, government transparency and accountability. In addition to the policy environment, other factors preventing the flow of impact investing in social infrastructure assets

include a lack of dedicated financial instruments, the bankability of the infrastructure pipeline, as well as high costs and high management fees. A shortage of standardised, high-quality data on the impact of social infrastructure could also represent a challenge. Weak data, for instance, could lead to the misallocation of resources. Investing in developing countries for many foundations based in OECD countries, adds a layer of challenges including knowledge barriers. In this context, the main burden is on governments to create favourable conditions and devise robust and innovative initiatives to leverage the role of foundations in social infrastructure investment.

## **B. NATIONAL DEVELOPMENT BANKS**

Climate change is one of the most pressing issues of our time and a source of risk to macroeconomics and financial stability. Low-emission and climate-resilient infrastructure is critical to underpin economic growth while avoiding locking societies into carbon-intensive emissions pathways; however, current investment levels are insufficient. To avoid the worst climate-related impacts, financing flows will need to quickly flow towards low-carbon and climate-resilient infrastructure. In this context, it is essential to understand which financing channel is most efficient and how existing risks and barriers can be best addressed.<sup>3</sup>

While there has been much discussion on the role of multilateral development banks (MDBs) in catalysing investment for infrastructure financing, there has been far less attention paid to NDBs. This oversight means there is a major gap in evidence on the role they could play as mediator and financier of low-carbon, climate-resilient infrastructure. With 342 NDBs holding over US\$18.97 trillion in assets, NDBs greatly exceed the assets of US\$ 2.30 trillion held by 46 MDBs (Xu et al., 2021a)<sup>4</sup> or the total amount of annual official development assistance provided by OECD donor countries, totalling \$161.2 billion in 2020 (OECD, 2021). Although there are vast diversities among NDBs in terms of official mandates, asset size, business models and geographical scope of operations (Xu et al., 2021a), common challenges NDBs face can be identified at the policy, financial, business and operational levels.

<sup>3</sup> See recent events on blended finance and financing sustainable development <https://www.oecd.org/dac/financing-sustainable-development/blended-finance-principles/blended-finance-impact-week.htm>

<sup>4</sup> The data cited here is as of July 2022. For the latest dataset on development financing institutions worldwide developed by the Institute of New Structural Economics at Peking University in collaboration with French Development Agency, please visit the data visualization website at <https://www.nse.pku.edu.cn/dfidatabase/index.htm>.

More fundamentally, the role of NDBs in long-term financing can be affected by broad mandates, fragmented policies and regulatory disincentives, limited expertise in climate infrastructure financing and risk management, viability issues and a lack of appropriate and quality data on infrastructure (Alliance, 2020). Insufficient capitalisation and lack of access to large-scale, long-term and affordable funding sources can limit the ability of NDBs to finance green infrastructure projects (Xu et al. 2021b).

# Proposals for G20

To reverse the decade-long decline in investment in social infrastructure and to develop a model capable of attracting public and private philanthropy into these investments, the brief identifies several strategies and solutions for Group of 20 (G20) members:

## **1. Facilitate a clear policy, legal and regulatory regime and an efficient and independent dispute-resolution mechanism to safeguard investor rights**

Uncertainty related to policy and regulatory risks is feared by foundations. To foster greater capital expenditure in social infrastructure, a stable and efficient regulatory framework is required. Policymakers need to develop a model able to attract long-term finance, by establishing national infrastructure plans and removing barriers in the way of philanthropic actors seeking to invest more in social infrastructure. We identify four objectives: political and legislative stability; fast administrative procedures; light regulatory and soft bureaucratic constraints; and a reliable judicial system.

## **2. Support the development of innovative financial instruments and well-designed guarantees for social infrastructure**

Social impact bonds (SIBs) represent innovative financing mechanisms where governments enter into agreements with social service providers such as foundations to directly support the delivery of social services. The main rationale for introducing SIBs is the need to improve the outcome delivery, through innovation in social service provision. In many cases, private investors do not bear the risk of achieving the social outcomes, since the public sector or, more frequently, philanthropic investors, such as foundations, provide guarantees to cover up to 95 percent of capital losses (Casalini, 2018). In this context, developing well-designed guarantees are necessary to mitigate the risk for philanthropic actors and attract private investments, in particular in the developing-country context.

## **3. Implement de-risking mechanisms to make social infrastructure investment more attractive to philanthropic actors**

Risks and the perception of risk, impact the actions of all stakeholders involved in the development, construction and management of social infrastructure. To improve the bankability of a social infrastructure project, governments could promote blended finance schemes that would ultimately contribute to lowering credit risk and enabling private finance flows into the project. Given their characteristics, social infrastructure assets are particularly well-suited for blending: a mix of grants, subsidies and guarantees.

#### **4. Enable the bundling of projects that could give foundations access to portfolios of smaller sized social infrastructure**

Social infrastructure projects often have a small-medium average capital investment size. This means that infrastructure investments tend to become unattractive to large long-term investors as they face high costs and high management fees for low levels of investment (EU, 2018). On the contrary, bundling has the potential to lower the risk profile for foundations and philanthropic bodies. Unique procurement provided by the bundling of similar assets allows investors to reduce costs and make significant savings on the design and construction phases (a larger volume of materials can be used) and on maintenance activities (raw materials can be bought in bulk).

#### **5. Promote labelling and certification targeting social infrastructure investments**

The current lack of alignment around performance and standards related to the sustainability characteristics of infrastructure contributes to the generation of inefficiency. It is also crucial to ensure that infrastructure projects supported by public and private foundations are well-planned and well-managed, implemented in a transparent manner, consistent with best practices in terms of environmental and social impacts. It is thus essential to promote labelling and certification that will enable the take-up of social investments. The label certification is useful for all the actors involved: it can increase financing potential, it can be an incentive to design projects with sustainability criteria at their core and it can encourage developers to pursue high environmental, social and resiliency standards at all stages of the infrastructure lifecycle. GRESB is a good example of this endeavour.<sup>5</sup>

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<sup>5</sup> GRESB provides a consistent framework to measure the ESG performance of individual assets and portfolios based on self-reported data.

For NDBs to scale up green infrastructure more effectively there is a need to:

- 1. Enhance coordination between national policymakers and NDBs to promote a proactive role for NDBs in setting a mission-driven vision to mobilise intermediate resources towards the implementation of green infrastructure.**

National governments should facilitate NDBs with a mandate that includes a climate focus for infrastructure alongside their other social and economic objectives and assigning NDBs with a clear role in national climate policy discussions. This allows for greater alignment of policy priorities and transformative climate actions and enables NDBs to promote climate-smart infrastructure that aligns with the Paris Agreement goals as well as broader development objectives.

- 2. Providing NDBs with sufficient funding sources and capital to leverage their role and execute their mandate.**

NDBs must be sufficiently capitalised to be able to operate on the scale required and support the transition to a low-carbon economy. In addition to strengthening mandates for climate action, the government should ensure that NDBs are well funded to execute their mandate. Besides government fiscal resources, NDBs should rely on sovereign creditworthiness to issue bonds to scale up their investments or rely on government guarantees to receive on-lending from MDBs. Access to international climate finance – for example, through the Green Climate Fund – is also an additional source of funding.

- 3. Review the legal and regulatory framework to overcome barriers for NDBs in scaling up low-carbon and climate-compatible infrastructure.**

Creating a positive enabling environment and ensuring that NDBs are included in relevant policy and planning efforts is a necessary condition to tap into NDBs. Given the complex nature of infrastructure investments, it is crucial to find effective means to strengthen NDBs' risk-management framework. National governments can facilitate the development of suitable financial instruments that allow NDBs the flexibility to take higher risks to attract private investments and build private sector confidence (Griffith-Jones et al., 2022). Additionally, regulatory frameworks should be tailored to accommodate high-risk innovations related to technologies and climate change while ensuring financial stability (Gottschalk, Castro and Xu, 2022).

**4. Improving NDBs internal capacity to plan, measure, report and verify the impact of interventions, including the measurements of social and environmental benefits.**

Good governance and effective management of NDBs are critical. To access international climate finance, the effectiveness of programmes and the achievement of environmental results of investments need to be verified, requiring considerable internal capacity. A particular capacity that NDBs will have to strengthen to become credible, reliable intermediaries in climate finance is related to the monitoring, reporting and verification of social, environmental and climate impacts. Training and awareness raising of staff members are also needed to build capacity and knowledge about best practices in green infrastructure projects and climate finance.

**5. Fostering the collaboration between NDBs and MDBs to tap into their comparative advantages to achieve the goal of scaling up green infrastructure.**

To become successfully involved in climate change mitigation, NDBs' collaboration with MDBs should be promoted. To take advantage of the local knowledge and networks of NDBs, MDBs can increase their on-lending to NDBs. If the on-lending denominated in hard currencies from MDBs cannot increase the supply of foreign exchange in borrowing countries, MDBs should allow more time to pay back the loans while reducing the interest rate charged (Schclarek and Xu, 2022). Additionally, MDBs are well fitted to foster peer learning with NDBs and to support their ambitions to become accredited to access international climate finance. These entities can also provide technical assistance to NDBs to build internal capacity in both identifying bankable projects and preparing them for investment. The D20 is a mechanism to foster collaboration between NDBs and MDBs that can support further collaboration in the G20 context.

**6. Strengthen data collection to ensure that green infrastructure is recognised globally as an investment asset class through better measurement of how these type of infrastructure investments perform.**

Robust data availability and analysis and enabling credible outcomes measurement in a reasonable timeframe are necessary for the planning of infrastructure investments and enhanced resilience, and longer asset life. Information technology systems such as digital twins, earth observation, remote sensing, and artificial intelligence used in conjunction with distributed ledger technology, can potentially facilitate the collection, sharing and analysis of data, and improve both time and cost efficiency in green infrastructure planning and development

## **RELEVANCE TO G20**

The G20 has provided efforts for scaling-up infrastructure investment but needs better leadership to crowd in more capital, set up a more actionable blueprint and agenda for the long-term global infrastructure landscape and for achieving a climate friendly and more socially inclusive economy.

Considering the COVID-19 pandemic's multidimensional impacts, implementing sustainable infrastructure will require concerted efforts, additional resources and a proper normative framework unfolded both at the international and country level. Gathering the most important shareholders, the G20 is particularly well positioned to promote a dialogue to alleviate the obstacles and find suitable solutions with regards to the more active role of NDBs and foundations to scale up resilient, green and social infrastructure.

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