# QDD.

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# How are public development banks operationalizing the Sustainable Development Goals ?

**Financial institutions, especially public development banks (PDBs), have developed a range of frameworks and tools to operationalize the Sustainable Development Goals (SDGs). But what are the strengths and shortcomings of these mechanisms in delivering the action needed to achieve the SDGs by 2030 ? Based on a review of more than 40 practices, this document summarizes the primary approaches being used by different PDBs and impact investors to implement the SDGs.**

**Authors**
**Clémence GUIRESSE** AFD
**Carolyn NEUNUEBEL** World Resources Institute

Developing countries have fallen further behind in financing the SDGs in recent years. The Organization for Economic Cooperation and Development (OECD, 2022) estimates that the SDG financing gap grew from $2.5 trillion per year pre-pandemic to at least $3.9 trillion today. Since this gap represents only about 15 % of global gross fixed capital formation, much of which is detrimental to the SDGs, reorienting public and private financial flows for sustainable development is tantamount to tackling overall financing needs. Given their collective financial capacity and ability to catalyze action in partners, PDBs are essential to bridging these divides. Doing so implies a shift from business-as-usual ; PDBs require novel tools and processes to make systematic investment decisions that ambitiously aid countries' priorities for achieving the SDGs while avoiding potential harm toward these objectives.

## The need for an institutional framework for SDG alignment

Tools or mechanisms for implementing the SDGs in PDBs' activities need to serve a more comprehensive and ambitious institutional framework. Common analytical approaches for SDG alignment (Natixis, 2022 ; ETTG, 2021) converge on the need for financial institutions to evolve four complementary areas : strategic vision ; organizational capacity ; financial decision-making ; accountability and transparency.

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A clear **strategic vision** for how financial activities will support progress toward the SDGs is required at the highest institutional level to generate coherent organizational momentum. The strategy should inform a conceptual framework for identifying core indicators used to measure progress toward quantitative and qualitative targets.

PDBs' activities are the result of a culture that needs to be transformed in part by building **organizational capacity** to implement projects and programs that are aligned with the SDGs. As the SDGs are "integrated and indivisible" by nature, trade-offs and synergies are essential considerations which need to be managed with adequate geographic scope and analyzed in terms of potential short and long-term effects. Building such capacity requires staff training and collaboration across experts.

Some PDBs have developed change management exercises for SDG alignment, for example:

The International Development Finance Club (IDFC) supported the following activities for SDG alignment in its members:

- **Islamic Corporation for the Development of the Private Sector** used a "Stop, Adjust, Amplify, Undertake" framework to diagnose and guide an improved approach for alignment
- **Development Bank of Southern Africa** partnered with **Natixis** to design and test SDG integration trackers

Inspired by the practices of traditional private finance investors,

- **British International Investment, KfW Group** and **European Bank for Reconstruction and Development (EBRD)** have set up collective compensation incentive mechanisms that link staff bonuses to SDG impacts

PDBs need to translate their strategic vision into the design, monitoring, and evaluation of their operations to align **financial decision-making** with the SDGs. Thus, the procedures that comprise the project cycle need to embed essential considerations for sustainable development while accounting for local contexts, especially during dialogue with clients and partners.

Progress against SDG-aligned targets and indicators should be communicated using clear language that is fair and objective for **accountability and transparency** that fosters trust across staff and with external counterparts. In addition to being high-level targets formulated for States, there are statistical challenges to measuring progress toward the SDGs in terms of the impacts of PDBs' financial activities. As a result, the targets and indicators used should facilitate repeated measurement and comparability across activities and, wherever possible, with other institutions. Some PDBs participate in initiatives to harmonize impact management systems and indicators, such as:

•The **Impact Principles** for private development finance institutions

•The **Global Europe Results Framework** for interventions funded by EU financing instruments

Figure 1 - Building Blocks to SDG Alignment in Financial Institutions

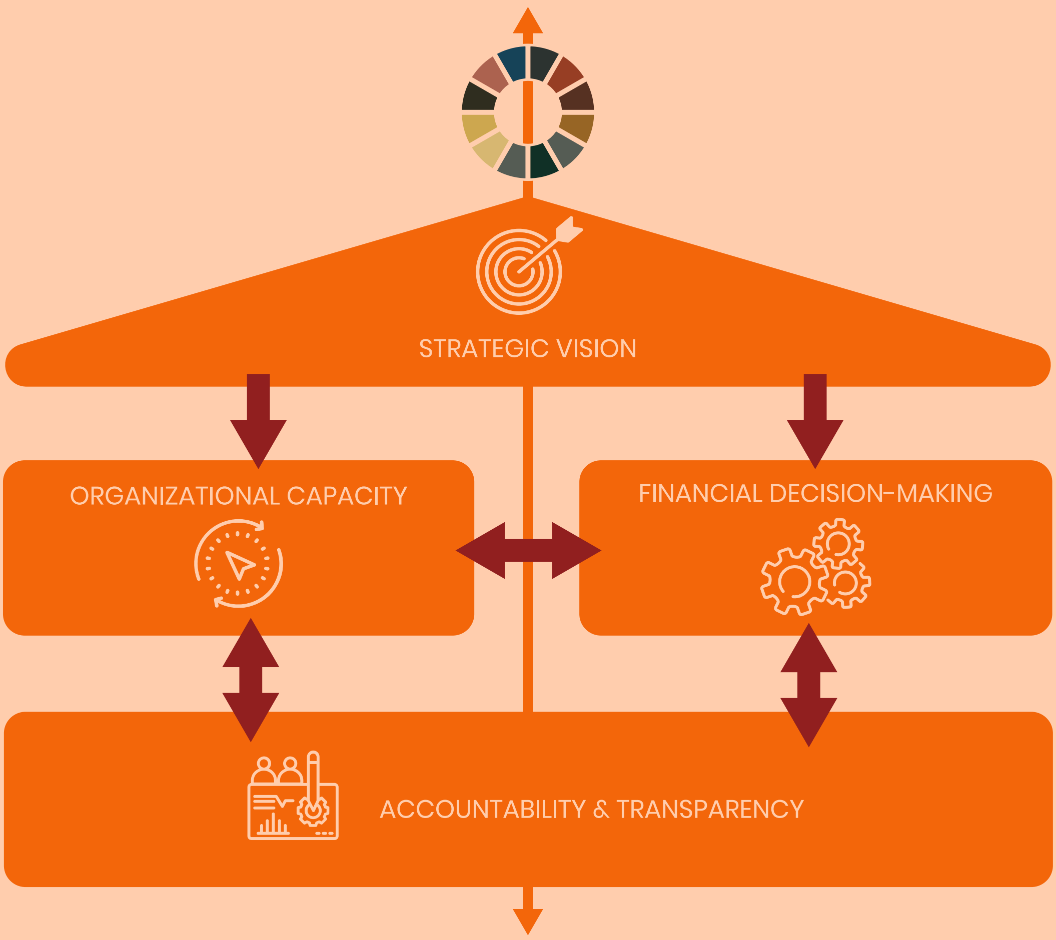

Figure 2 - Toolbox for SDG Alignment in Financial Institutions


## Merits to different tools and approaches for SDG alignment

Public development banks and impact investors have developed a set of tools and approaches to make their financing more sustainable. ***Ex-ante* mechanisms** are used by PDBs to a) exclude financial activities that undermine the SDGs according to the "do no harm" principle, b) map financial activities to SDGs, and c) steer finance based on an impact analysis which determines how activities are expected to contribute to the SDGs. For cross-cutting considerations, PDBs use **complementary approaches** that can a) catalyze further action by enhancing dialogue with clients and partners, and b) scale impacts through an iterative learning loop.

***Ex-ante mechanisms enhance staff training to boost organizational capacity***

**Exclusion lists** have emerged to prevent funding for activities or sectors that undermine progress toward the SDGs regardless of context, for example:

- To align with the Paris Agreement, **European Investment Bank (EIB)** published an extensive list that excludes funding (including interim financing) for activities that support fossil fuels, harm high-carbon forests or negatively impact the ocean (including the seabed and fishing by explosives)

**Financial mapping** improves tracking across PDBs' portfolios by labelling activities according to their relevance to the SDGs, for example:

- **KfW Development Bank** was among the first to publish the expected positive contributions of its new financial commitments to the SDGs. The mapping it produces annually was an important input to the bank's development of a sustainability-driven impact management system
- **Asian Development Bank** redesigned its reporting system to link project indicators to SDG targets. This allows the bank to course-correct its activities toward SDG targets during monitoring and evaluation

However, the issue of steering funding toward SDG alignment remains unresolved in financial mapping.

Some PDBs conduct **impact analysis** which use quantitative and qualitative indicators to determine the expected level of contribution or effect of their activities on the SDGs. This *ex-ante* approach has been used to incentivize innovations toward the SDGs in project design by integrating minimum impact thresholds, lower financial contribution requirements for high impact projects, correction of profitability arbitrage, bonus offers, etc. For example:

- **International Finance Corporation (IFC)** uses its AIMM (Anticipated Impact Measurement and Monitoring) system, to assess the potential direct, indirect and market impacts of investments and technical support. AIMM defines, measures, and monitors outcomes based on IFC's sector and economic impact estimation frameworks. JP Morgan's Development Finance Institution uses a system inspired by AIMM.
- **IDB Invest**, the private sector arm of the Inter-American Development Bank, designed its DELTA (Development Effectiveness Learning, Tracking, and Assessment) tool to score the expected impacts of its activities between 0 and 10 and facilitate performance monitoring in implementation. DELTA complements a Strategic Selectivity Scorecard to promote projects with greater impact potential.
- **EBRD and EIB** qualify the impact of their financing and public/private integration according to a portfolio-wide impact logic. EBRD evaluates projects according to three criteria : i) the return/risk ratio ; ii) additionality ; and iii) potential impact on the transition. Staff must also assess two "transition qualities" among the following six : competitiveness, governance, greening, inclusion, resilience, integration.

The above tools positively influence project design but require significant human resources, expertise, time, and information systems. Resulting in average ratings, these approaches also mask the disaggregated impacts of a project on different aspects of sustainable development. In a context where SDGs can compete, this system does not account for trade-offs between objectives. Others, including impact investors, use a more qualitative approach, for example:

- **Mirova** performs a disaggregated analysis which includes environmental, social and governance risks and positive contributions to the SDGs to influence investment decisions. Without offsetting effect, the tool systematically excludes transactions with negative impacts.
- **AFD (Agence française de développement)** uses its Sustainable Development Analysis and Opinion Mechanism (SDM) to determine the expected level of impact (positive, neutral, or negative) of activities on planetary boundaries, human development, prosperity, governance. Matrices are used by project teams to analyze SDG alignment. Then, an internal independent "opinion" informs internal debate, optimizes the impact of projects, and directs flows toward operations with higher expected impacts (i.e., catalyzes impacts beyond the project scope).

Once again, the tools above have their own limitations. Comparison across activities and aggregation of impacts at the portfolio level could be improved. The embedment of these tools into the project cycle should also be considered. AFD and the Green Climate Fund have independent teams that systematically review *ex-ante* staff assessments for homogeneity and accuracy.

***Complementary approaches strengthen cross-cutting considerations***

**Partnerships** can spur action beyond the scope of the project or program itself. PDBs are enhancing dialogue with clients and partners to best address needs for the SDGs and co-construct theories of change, for example:

- **AFD** integrates counterparty dialogue into its SDM matrices for analyzing potential SDG impacts. Dialogue with counterparts is notably required for a positive rating in the biodiversity and gender dimensions.

Iterative learning facilitates responsiveness to change and PDBs are improving the impact and scale of SDG alignment in their activities over time with virtuous feedback loops, for example:

- **World Bank** (International Development Association, International Bank for Reconstruction and Development) uses its DIME (Development Impact Evaluation) model to engage with counterparties in policy and design and builds their capacity to make systematic use of data and guide midcourse corrections in implementation.

## Learn together to grow together for SDG alignment

The SDG alignment journey will naturally differ from one institution to another according to their culture, strategic ambition, mandate, and means. However, many of the practices that have been developed by PDBs for SDG alignment are not mutually exclusive to one another, and each has its own advantages and limitations. By sharing these tools within coalitions and adapting their merits to different institutional contexts, PDBs can accelerate progress toward SDG alignment.

To meet the ambition of the 2030 Agenda, PDBs should emphasize their catalytic potential by supporting all financial actors – public, private, domestic, international – to align with the SDGs. PDBs can work together to design and finance more transformational projects, programs, and policies that diffuse the SDGs across the systems in which they operate.

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**Agence française de développement (AFD)**
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