Policy Brief

SUPPORTING NATIONAL DEVELOPMENT BANKS (NDBS) AND NATIONAL CLIMATE FUNDS (NCFS) IN DEVELOPING COUNTRIES TO PROMOTE COUNTRY-DRIVEN CLIMATE ACTIONS

Task Force 3
Governing Climate Targets, Energy Transition, and Environmental Protection
SUPPORTING NATIONAL DEVELOPMENT BANKS (NDBS) AND NATIONAL CLIMATE FUNDS (NCFS) IN DEVELOPING COUNTRIES TO PROMOTE COUNTRY-DRIVEN CLIMATE ACTIONS

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Abstract

National development banks (NDBs) and national climate funds (NCFs) in developing countries are capable of mobilising international climate finance to local beneficiaries. However, NDBs and NCFs face fundamental obstacles, such as unclear mandates to promote climate programmes, the inability to mobilise climate finance, and suboptimal engagement with private investors. Based on the cases of Indonesia and Brazil, we are proposing several recommendations for the Group of 20 (G20). First, G20 donor countries should provide NDBs and NCFs in recipient countries with robust capacity-building programmes. Second, recipient countries should maintain the enabling environment of NBDs and NCFs. Lastly, NDBs and NCFs themselves should be proactive in leveraging private investments while expanding their reach.
Challenges

CONTEXT: NATIONAL DEVELOPMENT BANKS (NDB) AND NATIONAL CLIMATE FUNDS (NCF) ARE PIVOTAL TO THE GROUP OF 20 (G20); ALTHOUGH GENERALLY, THE CLIMATE FINANCING NEEDS OF EACH MEMBER COUNTRY ARE SPECIFIC.

The role of NDBs in mobilising climate finance has been pivotal among G20 member countries. Each G20 country has at least one NDB, 15 of which are members of the International Development Finance Club (IDFC). In 2020, climate finance accounted for 20 percent of the IDFC’s committed finance (US$178.5 billion) (CPI; Trinomics 2021).

Unfortunately, 94 percent of the IDFC’s climate finance commitments are in the form of loans. Grants account for only 6 percent, which is disproportionately small. While this is understandable as loans for projects should be larger than the grant assistance normally used for project preparation purposes, the 6 percent — against 94 percent — is far too low for countries whose NDBs and NCFs still require assistance for their institutional setup.

There are countries such as Brazil that have succeeded in utilising their NDBs to mobilise climate finance through the Amazon Fund (BNDES 2019). Then there are countries like Indonesia that just recently established a concentrated fund management agency for environmental and climate objectives (Mafira, Mecca and Muluk 2020) and still require a higher proportion of grant assistance for their institutional capacity.

THE FIRST PROBLEM IS A LACK OF CLEAR STATE-INITIATED MANDATES IN DEVELOPING COUNTRIES TO PROMOTE CLIMATE FINANCE THROUGH THEIR NDBS AND NCFS.

The first challenge for NDBs and NCFs in promoting climate financing at scale is the lack of state-sponsored mandates for them to prioritise development finance for climate-related objectives (CCFLA; FELICITY 2020). The lack of mandates may cause policy uncertainties, and as a result, will diminish the confidence among donors in providing further financing assistance for NDBs and NCFs in the long run. This lack of prioritisation happened in Brazil because of shifting political priorities (Pereira and Viola 2021). In Indonesia, meanwhile, there is still a lack of climate-focus objectives as its NDB-functioning institution, PT. Sarana Multi Infrastruktur (SMI), are focused on Sustainable Development Goal (SDG) infrastructure in a broad sense and not specific on Paris-Aligned climate mitigation and adaptation goals (ADB 2022).
THERE IS ALSO THE INABILITY OF NDBS AND NCFS TO STRUCTURE INNOVATIVE FINANCING FOR CLIMATE PROJECTS AND FACILITATE PROJECT PREPARATIONS, ESPECIALLY SMALL-SCALE PROJECTS, TO MEET DONORS’ STRICT REQUIREMENTS.

Multiple studies and reports have shown that the inability to create non-conventional and effective financing structures for climate projects — the ones that reduce investment risks and improve investment appetite for small- and medium-scale climate projects — is common among NDBs and NCFs in developing countries (IADB 2013, IADB 2012, CCFLA; FELICITY 2020) (Mafira, Larasati, et al. 2021).

Further assistance is then needed, especially from G20 donor countries, to improve access to climate finance for small- and medium-scale project proponents through developing countries’ NDBs and NCFs. Such assistance is needed because medium and small-scale projects have a higher tendency to lack the experience and expertise to meet donors’ strict requirements and leverage non-conventional financial instruments. Both Brazil and Indonesia, for example, face difficulties accessing climate funds and reaching beneficiaries in remote areas, as it may take several months for a project to be assessed (IADB 2012, Correa, Hoff and Rajao 2019, Mongabay 2018).

LASTLY, NDBS AND NCFS IN DEVELOPING COUNTRIES ALSO TEND TO HAVE THE SUBOPTIMAL CAPACITY TO LEVERAGE PRIVATE INVESTMENTS, DESPITE HAVING A STRATEGIC POSITION AND BETTER UNDERSTANDING OF THE LOCAL CONTEXT.

Since NDBs and NCFs are mostly state-sponsored, they are well-positioned and well-connected with the government, financiers and project proponents for climate programmes. However, it is often the case that such connections are not properly optimised to mobilise climate finance (IADB 2012, UNDP 2011, Mafira, Larasati, et al. 2021). Hence, further assistance is needed for NDBs and NCFs to be able to provide attractive terms and conditions, including financial incentives for local actors to mobilise climate finance.
Proposal

NDBs and NCFs in developing countries generally enjoy the privilege of being allowed to blend international climate finance with domestic financial resources and distribute them to local beneficiaries. As quasi-state institutions, they are uniquely positioned, well-connected with local agents and well-aware of the local barriers to investment. In other words, they are an effective conduit in mobilising finance for country-driven climate action as they can aggregate small-scale projects on the ground. At their full potential, they may outperform the classic multilateralism financing model, which is either unwilling or unable to aggregate smaller projects because such a decision normally requires more resources while offering small financial returns (IADB 2013, IADB 2012, OECD 2018).

In the context of global climate cooperation, the mobilisation of finance from donor governments to developing countries intermediated by multilateral institutions is the classic climate financing model. The main drawback of this model is that multilateralism imposes huge transaction costs while often underperforming in leveraging domestic private investments. In some extraordinary cases, the efforts to align international climate finance with national climate targets can be undermined by requests coming from donor governments (OECD 2018).

The strength of NDBs and NCFs compared to multilateralism is that as quasi-state institutions, they can channel international climate finance for local needs that are more strategically aligned with their country-driven targets. Based on the case studies of Indonesia and Brazil, we recommend three main actions for G20 member countries, both donors and recipients, as well as NDBs and NCFs in recipient countries to address the obstacles of mobilising international climate finance for local-led efforts:

**G20 DONOR COUNTRIES SHOULD FOCUS THEIR INTERNATIONAL CLIMATE FINANCE CONTRIBUTIONS ON BUILDING THE CREDIBILITY OF NDBS AND NCFS IN DEVELOPING COUNTRIES, AS WELL AS PROVIDING THEM WITH ROBUST TECHNICAL ASSISTANCE PACKAGES AND CAPACITY-BUILDING PROGRAMMES.**

First, G20 donor countries should redirect climate finance to help build the credibility of NDBs and NCFs by providing them with robust capacity-building programmes. More investment should also flow into building their capacity to measure the multiplier effects of climate finance (i.e., social benefits, private finance leveraged, etc.). The table below describes the types of capacity building that are generally required for NDBs and NCFs in developing countries to mobilise climate finance at scale.
Table 1. Key institutional capacity of NDBs and NCFs for further supports from the G20

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<tr>
<th>No.</th>
<th>Institutional capacity</th>
<th>Description</th>
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<tbody>
<tr>
<td>1.</td>
<td>Prioritising and designing robust climate investment plans</td>
<td>Ensuring that investment plans are clear, robust and prioritise climate-related objectives, or at the very least, do not preclude climate-related objectives.</td>
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<td>2.</td>
<td>Financial structuring for climate-related projects</td>
<td>The ability to structure financial modalities for climate-related projects that distribute the risks appropriately among the involved parties based on their acceptable risk tolerance. Such an ability is also related to the institutional capacity to design innovative or non-conventional climate financing instruments.</td>
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<td>3.</td>
<td>Accessing international climate funds</td>
<td>This is the ability to source international climate funds to meet local climate finance needs. Such an ability also means the skill to better enable NDBs’ and NCFs’ access to concessional international climate finance and support project preparation and capacity-building efforts.</td>
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<td>4.</td>
<td>Preparing project pipelines to become bankable, especially small- and medium-scale projects</td>
<td>This is the critical ability to diagnose and address the main barriers to climate-related investments, not only for large-scale projects but also for small- and medium-scale projects. The ability is also related to project design, including the use of risk mitigation instruments.</td>
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<td>5.</td>
<td>Monitoring, Reporting, and Verification (MRV) skills and fiduciary standards</td>
<td>This is the skillset for creating a robust MRV system to ensure the environmental and financial integrity of any climate-related project, including the ability to measure the multiplier effects of climate finance (i.e., estimate the positive impacts of investments on climate).</td>
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DEVELOPING COUNTRY GOVERNMENTS AS THE HOST OF NDBS AND NCFS SHOULD STRIVE TO MAINTAIN THE ENABLING ENVIRONMENT FOR THE OPERATIONALISATION OF NDBS AND NCFS WITHIN THEIR JURISDICTIONS

On the other hand, the governments of recipient countries — within G20 or beyond — should ensure an enabling environment for the operationalisation of NDBs and NCFs. The table below
highlights the key enabling environment for the effective operationalisations of NDBs and NCFs in mobilising international climate finance for country-driven climate actions.

**Table 2.** Key enabling environment for NDBs and NCFs for further supports from the host government

<table>
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<tr>
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<th>Description</th>
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<tr>
<td>1</td>
<td>Ensuring clear state mandates for climate actions</td>
<td>Clear mandates, especially those underpinned with concrete legal underpinning, will ensure the prioritisation of finance for climate actions among the existing NDBs and NCFs operating in the country.</td>
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<td>2</td>
<td>Ensuring legal certainty in the case of recourse</td>
<td>The case of legal certainty refers to ensuring transparency and accountability over the use of international climate finance. The ability of governments to provide legal certainty will ensure the confidence of donors and may result in continuing or increasing international climate finance mobilised into the country.</td>
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<td>3</td>
<td>Optional: introducing or strengthening state-sponsored guarantee instruments</td>
<td>The existence of state-sponsored guarantee instruments ultimately acts as reassurance for climate finance donors or project proponents. For example, guarantees can act as a “sweetener” for private investors, especially in countries deemed as relatively high-risk investment destinations. Indonesia’s PT. Sarana Multi Infrastruktur (SMI), for example, has provided guarantee instruments backed up by the Finance Ministry for some of its infrastructure projects under the public-private partnership (PPP) model (Rakhmadi and Sudirman 2019).</td>
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4. Ensuring robust risk-sharing mechanisms and incentive packages for private investors

|   |   | A robust risk-sharing and clear incentives mechanism will result in a higher appetite for private investors in climate-related projects. Some of the examples of this enabling environment are risk-sharing through PPPs where governments will assume the highest risks (usually at the early and construction stage of the projects) and incentive mechanisms for private investors on climate-related projects in the form of credit enhancements and tax breaks. |

LASTLY, NDBS AND NCFS SHOULD GEAR UP THEIR AMBITIONS TO PROACTIVELY LEVERAGE PRIVATE INVESTMENTS AND EXPAND THEIR OUTREACH TO WIDER LOCAL RECIPIENTS.

Given the right support, NDBs and NCFs should be able to increase their ambition and ability to mobilise climate finance for the right recipients in the country. Brazil’s Amazon Fund is one of the examples where a fund is managed not only by the state but also by indigenous groups acting to supervise.\(^1\) Meanwhile, Indonesia’s Environment Fund also provides small-size incentives to support the construction of new solar rooftops.\(^2\) Such ambitions should be replicated and amplified through support from the G20.

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\(^1\) Based on the Amazon Fund 2020 Activity Report

\(^2\) Based on I-SURYA program
References


