IDDRI
IT'S TIME!
SUSTAINABLE DEVELOPMENT
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BACKGROUND NOTE

How to increase the supply of sustainable projects?

Meeting the 2030 Sustainable Development Goals (SDGs) requires more investment in sustainable and low-carbon projects. Today, over 90% of all investment flows, world-wide, go to projects that are not sustainable in the long run, or for which more sustainable alternatives exist. The fact that only a small fraction of investments finds its way towards sustainable projects is often either due to institutional impediments, knowledge and capacity gaps, and/or obstacles in accessing funds. How to increase the supply of sustainable projects which by conventional standards and within existing institutional settings are deemed risky—meaning too costly once returns are adjusted to risks—or are simply lacking? How to devise new financial mechanisms so the required diverse scope of sustainable projects can be adequately developed for interested investors and meet their investment requirements? How can a new economic system benefit all development partners in an open and transparent manner—while recognising that we are all in a process of development?

1. CONTEXT

Investment needs to achieve the SDGs are in the order of trillions of dollars. Given that global savings are of a similar order of magnitude, the issue at the level is not so much to raise more money, but to channel available savings from unsustainable to sustainable uses. This transition to greener, less carbon-intensive, more resilient economic development models requires not only audacious adjustments in policy and regulatory frameworks, but also new ways to assess and share the risk across different institutional settings. Today, we need a new narrative on how to finance the 2030 Agenda—and more importantly we need a new marketplace for SDG business.

2. ISSUES/SOLUTIONS

Currently, investment needs to meet the 2030 global goals far exceed actual investment in sustainable and low-carbon projects. Against this backdrop, one narrative emphasises the crucial role played by institutions and human capacities to bridge the funding gap. Following this narrative, getting institutions and projects right is a prerequisite for channeling investment toward sustainable objectives. The problem is not lack of money but lack of bankable projects, meaning projects likely to generate profits and positive returns for society. The problem is particularly salient for and seriously considered by development finance institutions such as AfD, KfW or EIB, which devote part of their funding to cover the cost of technical assistance for the design of viable sustainable projects meeting due diligence as well as social and environmental requirements in developing countries. The emergence of blended finance, mixing grants to cover such costs and loans for the execution of the project, boils down to the same rationale. A flow of sound and viable projects in sustainable agriculture, renewable-energy, low-carbon industry, health infrastructure, biodiversity protection, to quote but a few SDGs, needs to be set up so as to raise the interest of public and private investors and channel their funding. The alternative would simply mean that idle saving ends up in business-as-usual or light green investment projects—from urban highways to coal-fired power plants—simply because these projects could be funded at low risk within the existing institutional framework.

A second narrative shifts the focus from institutional impediments facing sustainable investment spending to the obstacles in accessing funds. The challenge is particularly acute for small-scale, bespoke projects we find in small-scale farming or small-sized sustainable energy generation systems. The financing of such projects, which can rarely be replicated on a large scale, entails significant administrative costs for investors when compared to returns. These costs per unit of added value are much higher than for large-scale, standardised and reproducible projects such as cash crops large-scale farming and large hydroelectric power stations. Access to finance—and even more so to green finance—is one of the most critical obstacles to Sub-Saharan African firms' growth according to surveys such as *World Bank/IFC: Enterprise Surveys*. Effective interest rates, when combined with fees, are high in Sub-Saharan Africa by many standards and can exceed twice the level of central banks' rate.

The two narratives and associated challenges are actually closely linked and are sub-parts of a holistic more comprehensive narrative on the transition

to new sustainable economic development models. For instance, the problem of high interest rates is exacerbated when small and medium-sized enterprises (SMEs) do not have the skills required to make project finance decisions. In addition to this, SMEs can be as risk-averse as banks, until public policies create an enabling environment for both supply of and demand for sustainable financing. This means sharing a long-term vision of what transformation involves, setting priorities in terms of financing, and aligning regulation and incentives accordingly.

3. OBJECTIVES OF THE SESSION/QUESTIONS

- For what reasons do over 90% of all investment flows worldwide continue to go to projects that are not sustainable in the long run, or for which more sustainable alternatives exist?
- How to use public financing to leverage private financing, and how can public money also benefit from such leveraging?
- What are the roles for donor communities and public finance in reducing the risk perceived by investors?
- Is there a specific role for local communities and sub-national policies for bridging the sustainable investment gap and accompanying projects from design to marketplace—in particular for activities such as sustainable farming and clean energy supply?
- Are the necessary institutes and mechanisms available to catalyse a transition to green economies at global, regional and local levels?

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