# SUSTAINABLE DEVELOPMENT AND FINANCING IN DEVELOPING AND LEAST DEVELOPED COUNTRIES:

## THE IMPORTANT ROLE OF DEVELOPMENT FINANCE INSTITUTIONS AND OFFICIAL DEVELOPMENT ASSISTANCE

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Sustainable development and financing in developing and least developed countries: The important role of Development Finance Institutions and Official Development Assistance

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## Executive summary

With the world headed for a temperature increase of over 3ºC pre-industrial levels, life on Earth becomes unsustainable if no immediate action is taken. This decade will be decisive in determining the 'quality of life' future generations will have on this planet. The actions we take today towards sustainable development will shape the future of the planet, its people and all living beings on it.

Sustainable development is broad and experimental: there is no obvious 'good practice' from the past to use as an example and lead the way forward. The European Union (EU) has adopted the European Green Deal, which is considered a sustainable growth economic strategy to try to transform the economic model, policies, business practice and daily lives to address and overcome climate and environmental challenges and ensure prosperity for future generations as well. As shown in the European Green Deal, transiting from our current economic models towards sustainable development requires not only big policy actions, but also significant financing – the European Green Deal is estimated to cost Europeans an astonishing €1 trillion.

Sustainability is not just a business for developed countries whose greenhouse gas (GHG) emissions have mostly peaked but should be reduced further. To safeguard planetary boundaries makes practical sense too. However, it is a challenge for developing and least developed countries, which are following the same growth path as followed by developed countries in the past: in which they prioritise wealth and economic growth at the expense of the planet. In this sense, it may be more of a challenge for developing and least developed countries to take a gamble and adopt a new sustainable growth approach, for which there is no precedent of success. In addition, these countries may neither have the political will to undertake all the necessary policy and practical changes needed, nor can they afford these transformations.

The latter is a challenge identified by the United Nation's Sustainable Development Goals (SDG) particularly, SDG 17, which recognises the need to mobilise financial resources to developing countries. The United Nation's Addis Ababa Agenda of Third International Conference on Financing for Development (Addis Ababa Action Agenda

or AAAA) in 2015 also recognised the price of sustainable development. The AAAA notes that financing sustainable development should come from domestic public resources, the private sector and financial markets, Official Development Assistance (ODA) and Development Finance Institutions (DFI).

ODA and DFIs consist of public funds drawn from developed countries and allocated to the public sector and private sector respectively of developing and least developed countries. The SDGs and AAAA urge developed countries to attribute a minimum of 0.2% of their Gross National Income (GNI) to ODA. Added ODA to DFIs financing, and there are trillions of dollars that can be mobilised and used to guide their recipients towards sustainable development.

Global challenges such as climate change, biodiversity loss, social unrest and human rights do not recognise borders and in some form impact all countries. Therefore, approaching these issues requires a common global approach. This particularly includes in how DFI and ODA are distributed: what goals do these financing instruments aim to meet and what conditionalities are applied to their financing.

While there is no commonality between the differing ODA and DFIs distributions, inspiration can be drawn from the private sector reporting and financing approaches to sustainable development. DFIs and ODA could adopt and adapt these approaches to leverage financing as a tool to help transform the economic models of developing and least developed countries, and bringing them onto a sustainability agenda, in time to save the planet and its habitants.

# 1. Introduction

In 1987, the World Commission on Environment and Development defined sustainable development as development that "*meets the needs of the present without compromising the ability of future generations to meet their own needs*" (The World Commission on Environment and Development, 1987, page 16).

The science proving that the effects of the current economic models were affecting the habitability of planet Earth had been there for many decades, however, the prospect of economic growth, wealth and development were put at the forefront. Indeed, the first article pointing out that carbon dioxide released from burning coal was gathering up and covering the atmosphere and potentially causing climate change dates back in 1912.

Now more than a century later, we have recognised that economic activity and life is constrained by the resources in our planet and the nine planetary boundaries which include: climate change, biodiversity loss, ozone depletion, ocean acidification, land deterioration and water scarcity.

Therefore, life and economic activity must adapt to ensure sustainable development. Countries and their respective governments are the main actors to drive this change, not only because their own activity impacts (as enablers of the main industries operating in the country), but also because the most polluting sectors such as energy supply or transportation are under their management.

The Sustainable Development Goals (SDGs) provide sustainable development globally agreed targets to be achieved by 2030. Achieving some of them has become impossible. Limiting global temperature rise to 1.5$^{o}$C from pre-industrial levels as per the Paris Agreement is one example of an ambition that is obviously unreachable. This is due to many reasons such as taking action too late, not taking the right action, denying the need for change, rejecting the science driving the agenda, and sometimes simply because sustainable development is an expensive undertaking.

With many countries, particularly developing and least developed countries, lagging behind, we look at developed countries to lead the way in policy actions, innovations, practical solutions. For some developed nations we expect leadership to take other

countries with them in this path. Directing financing for developing and least developed countries to match these ambitions and drive this change plays a huge role, particularly due to the reliance of the private sector and governments of these countries on these sources of finance.

## 1.1. The problem being addressed in this dissertation

Recognising that financing has a significant role to play in sustainable development is key. In countries where there may not be enough political will or capabilities of change, it is a lever for change. However, directing financing to achieve sustainable development and address global environmental and social issues is challenging.

Two very important sources of financing for developing and least developed countries are Development Finance Institutions (DFI) and Official Development Assistance (ODA). First, DFI direct public funds to private enterprises in these countries to impact development indirectly: in enabling private enterprise growth, they drive production of more goods and services, improve employment and working conditions. This ultimately affects the economy and development of the country. Second, ODA direct public funds to the public sectors of developing and least developed countries to improve the economy of those countries and the wellbeing of their citizens.

Collectively, DFIs and ODA mobilise trillions of dollars around the world, offering the potential to drive real change. Sadly, such change has not yet happened in practice. There is no singular set of generally agreed upon standard, methodology or common strategy on how these funds will be deployed to meet globally agreed targets. Neither is there a common understanding on how DFI and ODA financing could use their conditionalities to drive change. Therefore, even though these institutions deploy trillions of dollars, they fail to use their two main tools, the financing and their linked conditionalities to drive change.

They do not drive change because each institution interprets sustainable development their own way. They develop investment policies based on their own ambitions, rather than global challenges to them all. Consequently, investments are mainly allocated to meet the needs of their stakeholders and funding countries, rather than the needs of their debtors or global needs. Perhaps it is not these institutions that are to blame. They are all accountable to the developed countries that fund them.

The failure to drive change may also be due to the lack of a common approach or a set of common standards in distributing these funds to achieve sustainable development. Each institution makes their own rules and solves problems their own way. However, this has not worked. Challenges such as climate change, biodiversity loss or human rights are global issues that need to be tackled collectively in a common approach, not by everyone acting in their own way.

While a methodology to help guide public financing does not yet exist, it can be built from private sector experience, which although not fully globally aligned, is considerably more advanced. The private sector has been reporting on sustainability for years now, using various sustainability reporting standards. These standards are drafted based on common science, international conventions and targets and aim to enable a better understanding of the impacts a company's operations have on people and the environment. A framework to copy or adapt therefore exists and could be applied to DFI and ODA funding.

DFIs finance the private sector in developing and least developed countries, so it makes perfect sense they use the same private sector standards when asking finance recipients to report-back or setting conditionalities on the recipients of finance. ODA too may build on these standards as again, the global issues we are trying to address impact countries and companies the same way, even though in different scales. There is no sustainability issue that is important for one party and not for the other, i.e., important for a country but not a company, because the sustainability dilemma revolves around a common basis: one planet and all the living beings on it.

## 1.2. The structure of the dissertation

Section 2 breaks down 'sustainable development' and the important issues to address as part of this term. It directs the reader to the economic aspect of the topic, highlighting the need to undertake actions to transform current economic models to adapt to the planetary boundaries. It becomes clear that such transformation requires great political will and that this transformation comes at a huge financial cost.

Section 3 summarises the challenges developing and least developed countries face in putting sustainable development into practice and highlights the importance of financing for these countries. The reader is lead through the role of DFIs and ODA and

dives into the investment policies of these institutions to understand how they incorporate the ambition of sustainable development in the way they allocate funds.

Section 4 looks at how sustainability reporting is interpreted and adapted in the private sector. It draws parallels between the private and public sector. It proposes that most developing and least developed countries may have more in common than we think with giant, multinational corporations. Therefore, it proposes building from the experience in sustainability reporting from the private sector to develop an approach applicable in financing developing and least developed countries.

### 1.3. The methodology

The methodology used in this thesis combines analysis of reports and research that particularly address financing in sustainable development. It includes an exclusive stock-take from all the DFIs and ODA investment policies in how these institutions incorporate environmental, social and governance topics and then use these to guide the institutions' distribution of their financing.

In proposing a solution that informs DFI and ODA financing, I build from my experience in the private sector, where I have been involved in developing sustainability reporting standards.

# 2. The ‘sustainable development’ maze

Sustainability is a complex and sometimes controversial issue. Its development can be more so. There are many seemingly obvious directions along which it could be progressed, only to find increasing complexity, cost or controversy. The term ‘maze’ is fitting. Like any maze however, there is a pathway through it and good definition of sustainable development, as well as addressing each components at a time, can enable progress along it.

## 2.1. Definition and analysis of the term ‘sustainable development’

There are many definitions to ‘sustainability’ and ‘sustainable development’. However, both terms lack a generally accepted definition. Despite that, perhaps the most popular and common-sense definition to sustainable development may be: development that “*meets the needs of the present without compromising the ability of future generations to meet their own needs*” (The World Commission on Environment and Development, 1987, page 16).

Perhaps late, but the definition reminds us of the basic economics principle of scarcity: people have theoretically unlimited wants but have limited (i.e., scarce) resources available to them (Samuelson & Nordhaus, 2009, page 4).

Classical economics lists land, labour and capital as primary resources (also labelled as ‘factors of production’ or ‘inputs’) used in the creation of products or services (Smith, 1776). ‘Land’ is the term used to broadly refer natural resources such as water, soil, climate used in the production process of products or services (outputs). ‘Labour’ refers to any human efforts put to create outputs. ‘Capital’ refers to human-made goods (e.g., machines), including financial capital, used in the production of other goods or services. Therefore, limited resources include a range of factors from micro such as personal finances, to macro such as the planet and all it encompasses (land, water, climate, sun, rain, etc.).

If seen in conjunction, it looks like the classical economists of three centuries ago already accounted for limited resources in their theories of economics: they addressed important sustainability issues such as the planet (i.e., in ‘land’ as an input) and people (i.e., in ‘labour’ as an input). However, the interpretation of the principle of scarcity was

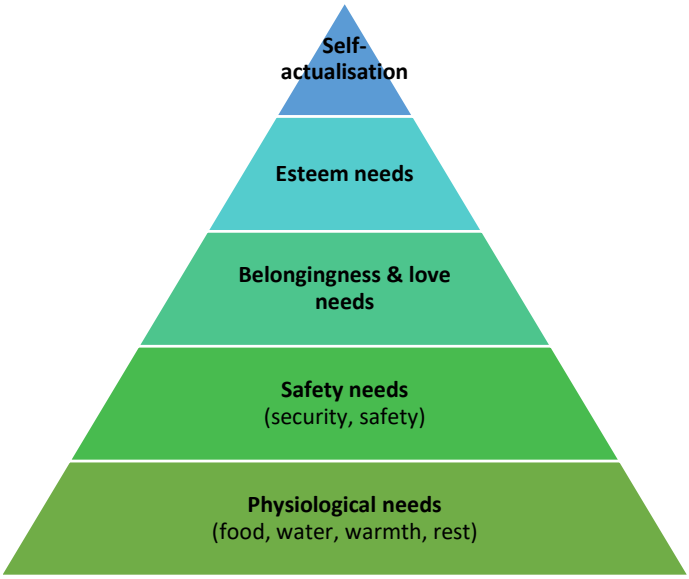
short-term and narrow-focused. Just as we did until recently, they then, looked at the ‘wants’ (or needs) of people alive at a certain moment in time, not considering past experiences or future generations. In addition, they and we looked at resources available to these living people at the same fixed and (what was then) present point in time, without considering changes from the past in these resources or further effects to the planet from economic activity.

When we expand the time horizon and the scope of the principle of scarcity, the equation becomes more complex. First, we must consider the ‘wants’ and ‘needs’ of current and future generations. Second, we realise that resources are not only limited or scarce, but also depleting in time. Needs of one person or group at a point in time or geography may differ from those of another. However, thinkers like Maslow, have provided us with a useful framework which finds echoes in the United Nation’s own Development Goals.

### 2.1.1. What are the target ‘needs’ and how to meet them?

Maslow’s pyramid of needs considered physiological needs (food, water, warmth, homeostasis, sleep, clothes and shelter) and safety needs (personal, emotional and financial security, health and wellbeing) as the pyramidal base of the famous pyramid (see ***Error! Reference source not found.***). Level 1 of Maslow’s pyramid of needs are considered to be the bare minimum of ‘needs’ for an individual to exist and Level 2 to survive safely. Together, level 1 and level 2 form ‘basic needs’.

*Figure 1: Maslow's pyramid of needs*




*Source: Maslow, 1954*

The more one fulfils the lower levels of the pyramid, the more their needs go up on the pyramid. For instance, a person who has what he/she needs in terms of safety and phsycological needs (level 1 and 2 of the pyramid), will look to fulfil needs of belongingness and love (level 3 of the pyramid).

Moving up the pyramid is also catalysed by wealth. To illustrate, the EU, USA, United Kingdom (UK) are the main markets of luxury goods sales (Deloitte, 2020) which may be linked to fulfilling the 'esteem' needs of the pyramid.

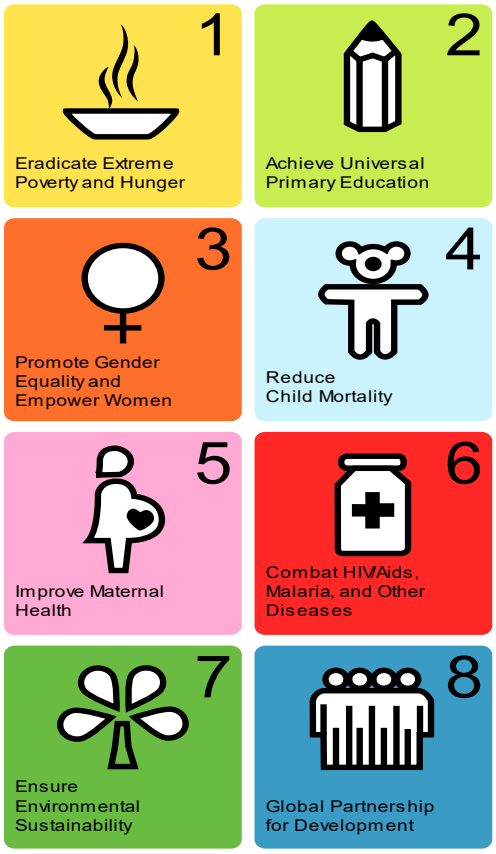
In line with Maslow's pyramidal base, the UN listed food, safe drinking water, sanitation facilities, health, shelter, education and information as basic human needs (United Nations, 1995, page 41).

Ideally, all people on Earth should have these 'needs' satisfied. This conclusion is particularly important when we consider people living in the least developed countries of the world. If we consider the food element, the World Health Organisation estimates that a healthy adult should consume approximately 2000 calories per day. Unfortunately, this is not the case for many countries. For example, at least 25% of the population in Venezuela and Afghanistan are undernourished. This figure is above 35% in Chad and Madagascar (UN World Food Programme, 2020).

The UN noted that such basic needs were conditioned by poverty. The number one goal of the UN's Millennium Development Goals (MDGs), launched in 2000, was 'eradicating extreme poverty and hunger'.

***Error! Reference source not found.***, which was extracted from the UN's MDGs website, summarises the 8 MDGs, which clearly focus on people and improving living conditions.

*Figure 2: UN's 8 MDGs*




*Source: UN's MDGs website*[1]

Under the caveat of their scope and objective, the MDGs can be deemed successful as they contributed to the considerable reduction of world poverty, improved access to education, a reduction of child and maternal mortality and treatment of diseases (United Nations, 2015, pages 4-6).

[1] United Nations, see: https://www.un.org/millenniumgoals/

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The MDGs expired in 2015, the year in which the UN reconvened to define the development goals that would succeed the MDGs.

As a result, the UN's 17 Sustainable Development Goals (SDGs) were launched. The SDGs focus on people, planet, prosperity, peace and partnership, referred to as the 5Ps in the UN's Resolution adopted by the General Assembly on 25 September 2015 (UN, 2015, p. 1-2 and 14).

The SDGs under the 'people pillar' continue the MDGs fight to end poverty and hunger in all forms and ensure dignity and equality. These include SDG 1 'no poverty', SDG 2 'zero hunger', SDG 3 'good health and well-being', SDG 4 'quality education' and SDG 5 'gender equality' – matching what Maslow and the UN themselves consider to bes basic needs.

***Error! Reference source not found.*** below, extracted from the UN's website,[2] summarises the 17 SDGs.

*Figure 3: UN SDGs*


*Source: UN's website [3]*

[2] United Nations, see: https://www.un.org/sustainabledevelopment/blog/2015/12/sustainable-development-goals-kick-off-with-start-of-new-year/
[3] United Nations, see: https://www.un.org/sustainabledevelopment/blog/2015/12/sustainable-development-goals-kick-off-with-start-of-new-year/

### 2.1.2. Scarce and depleting resources and how to safeguard them?

The UN's goals while admirable, are criticised for being too short-term and do not provide a clear vision and neither do they address the need to emergently transform the current economic and life models to more sustainable ones. The targets do not adequately account for the current global state of play, and they may not be ambitious enough as they fail to recognise the emergency of many of these environmental and social challenges (FutureLearn). Sustaining planet Earth as a living organism depended on scarce resources that must be protected and maintained for all life on the planet.

In 2009, a group of scientists (Steffen, et al., 2015) defined 9 planetary boundaries, which are essential not to be crossed but rather be maintained for survival of all life on planet Earth:

1. climate change;
2. change in biosphere integrity (biodiversity loss and species extinction);
3. stratospheric ozone depletion;
4. ocean acidification;
5. biogeochemical flows (phosphorus and nitrogen cycles);
6. land-system change (for example deforestation);
7. freshwater use;
8. atmospheric aerosol loading (microscopic particles in the atmosphere that affect climate and living organisms); and
9. introduction of novel entities (e.g. organic pollutants, radioactive materials, nanomaterials, and micro-plastics).

Often these boundaries are interconnected (e.g. climate change affects many of the other boundaries as well).

Going back to the definition of scarcity, the environmental factors which constitute these boundaries may be the finite resources which must be continuously made available to mankind and the planet.

Crossing these boundaries will risk the life and health of human, other terrestrial and marine creatures and biodiversity. It will affect food and fresh water supply and access to both. It will lead to submerging of cities and regions, creating unintended secondary

effects such as migration and in the worst-case, conflict – compromising safety needs and physiological needs. Consequently, meeting basic needs are conditioned from sustaining and not crossing these nine boundaries.

Unfortunately, four out of the nine planetary boundaries have already been crossed: climate change, biodiversity loss (which are both considered critical), land-system change and biogeochemical flows.

The effects and risks of climate change are systemic. Currently we are seeing the loss of sea ice, accelerated sea level rises and longer, more intense heat waves. In the future we could see more extreme weather events (droughts, storms, heat waves and rising sea levels), that may end up drowning parts of the world, affecting food production and freshwater access. (NASA, n.d.)

Biodiversity loss affects and risks the extinction of species, food supply and the supply of freshwater. These have a direct impact on human health, and indirectly, affect livelihoods, income and migration. (WHO, 2015)

Land-system change consists of transforming forests or other ecosystems land, mainly for agricultural purposes. This impacts the food systems and markets. (Verburg, et al., 2013)

Biogeochemical flows, which are part of fertilizers, make their way to the sea and impact marine and aquatic systems. For example, the decline in the shrimp catch in the Gulf of Mexico's 'dead zone' was caused by fertilizer transported in rivers from the US Midwest. (Steffen, et al., 2015)

Safeguarding these planetary boundaries will require changing lifestyles and transforming economic models, for which not everyone is fully on-board.

In the 1992 Earth Summit in Rio de Janeiro, then US President George H.W. Bush notoriously declared that when it came to the sustainability agenda "*the American way of life is not up for negotiations. Period.*". However, if everyone on the planet would live like the Americans do, we would need 4.4 planet Earths.[4]

[4] International Business Degree Guide, see: https://internationalbusinessguide.org/hungry-planet/#:~:text=Humanity%20is%20outstripping%20the%20Earth's,stewards%20of%20the%20Earth's

The citizens of the European Union (EU) are not much better: if everyone on the planet were to live like the citizens in the EU, we would need 2.8 planet Earths (WWF and Global Footprint Network, 2019).

Current linear economic models (i.e., produce-use-dispose) are unsustainable. To safeguard the boundaries collectively, we should move towards a circular economic model (i.e., recycle-reuse).[5] Such planetary economic considerations, though not explicitly depicted as a circular model, are part of the UN's SDGs:

- under the 'planet' pillar, SGD 6 'clean water and sanitation', SDG 12 'responsible consumption and production', SDG 13 'climate action', SDG 14 'life below water' and SDG 15 'life on land', aim to protect the planet natural resources and climate for future generations; whereas
- under the 'prosperity' pillar, SDG 7 'affordable and clean energy', SDG 8 'decent work and economic growth', SDG 9 'industry, innovation and infrastructure', SDG 10 'reduced inequalities', SDG 11 'sustainable cities and communities', aim to ensure prosperous and fulfilling lives in harmony with nature.

At the time SDGs were being crafted, it was probably impossible for the UN executive to secure the political support required to depict a circular economic model as the way forward. However, circular sustainable economic models were available at that time in academia and are now becoming mainstream. The challenge remains to implement them.

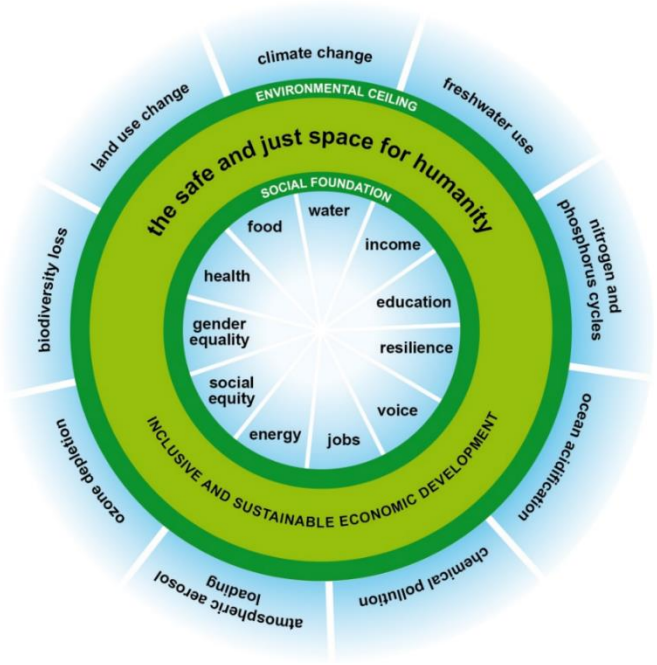
## 2.2. Sustainable development as an economic model

Raworth (2012) visualised the sustainable development economic model in a doughnut shape (see Figure 4: The Doughnut Economy).

%20environment%3F&text=U.S.&text=FACT%3A%20Americans%20constitute%205%25%20of,24%25%20of%20the%20world's%20energy.

[5] The European Parliamentary Research Service defines circular economy as "a production and consumption model which involves reusing, repairing, refurbishing and recycling existing materials and products to keep materials within the economy wherever possible".

*Figure 4: The Doughnut Economy*




*Source: Raworth, 2012*

The hole in the middle addresses basic needs, similar to those noted by the UN and Maslow, whereas the borders represent the planetary boundaries that we need to operate within. Therefore, its three main items are social, economic and planetary considerations – mirroring the SDGs 'people', 'planet' and 'prosperity' pillars.

However, as noted by Bourdages (1997), integrating sustainability in an economic model presupposes good governance in the public sector, including democracy, autonomy, fairness between populations and generations, interdependence, responsibility and accountability. This is acknowledged by the 'peace' pillar of the SDGs, and specifically SDG 16 'peace, justice and strong institutions', which seeks to foster peaceful, just and inclusive societies.

In addition, it requires engagement from both the public and private sectors to re-shape the economy. This includes redesigning public policy, transforming sectors and the businesses that make up the economy and directing financing to sustainable investments. In its core, it is therefore, an economic growth model.

Like the UN, the EU's approach to sustainable development is also based on these 3 pillars: economic, environmental and social.

Currently, the EU is the only region pursuing a comprehensive sustainable growth model, based on the European Green Deal (Green Deal), presented on 11 December 2019 by the European Commission (EC) led by President Ursula von der Leyen.

Sub-section 2.2.1 summarises the European Green Deal (Green Deal), including policy actions to provide an example of the extensive policy action and changes needed in addressing sustainable development.

### 2.2.1. The European Green Deal

The European Green Deal is "*a roadmap for making the European Union's (EU) economy sustainable*" and Europe's strategy towards achieving the SDGs. As a sustainable (economic) growth strategy, it mobilises investments to allow a just transition, which does not leave anyone behind, from the current economic model towards a clean, circular economy to stop climate change and revert biodiversity loss.

The following sections map elements of the Green Deal to the SGDs and summarise the respective policy actions and investments to match these ambitions.

#### *Climate action*

The EU's ambition is to become the first continent to achieve climate neutrality by 2050. Simply put, by 2050, the EU aims to emit enough greenhouse gas (GHG)[6] for the natural ecosystem of the planet to absorb on its own (European Parliament, 2019).

This element of the Green Deal matches SDG 13 'climate action' and also the ambitions of the UN's Paris Agreement, which aimed to keep the global temperature rise below 2 degrees Celsius above pre-industrial levels[7] - however, based on the UN's Emissions Gap Report 2020, the world is still heading for 3 degrees Celsius increase this century. Six policy actions are being and will be undertaken for this Green Deal

[6] Climate neutrality is broader than carbon neutrality as it addresses GHG, including carbon. (Levin, Song, Morgan, 2015)

[7] The Intergovernmental Panel on Climate Change (IPCC) considers the temperature during the years 1850-1900 as the 'pre-industrial levels', thus as the baseline for calculating the global temperature rise.

item, including leveraging the Emissions Trading System (ETS),[8] the carbon pricing,[9] and implementing a carbon border tax.[10]

### *Biodiversity*

The EU's ambition is driving four main policy actions to preserve and restore its natural capital. One of these is implementing a Biodiversity Strategy for 2030. The Biodiversity Strategy 2030 aims to enlarge the EU-wide network of protected land and water areas and restore degraded ecosystems.

This element of the Green Deal corresponds to SDG 6 'clean water and sanitation', SDG 14 'life below water' and SDG 15 'life on land'.

### *Clean energy*

This element of the Green Deal is closely linked to EU's climate change ambitions, which recognise that the production and use of energy accounts for more than three quarters of the EU's GHG emissions. It corresponds to SDG 7 'affordable and clean energy'. So far, the EU has undertaken five policy actions aiming to make renewables more cost-efficient[11] and accessible,[12] as well as phasing out coal and decarbonising gas.

### *Sustainable industry*

The EU's ambition is to transform the current linear economic model to a circular economy by reusing outputs as inputs, instead of disposing of finished products after they have served their purpose. This element of the Green Deal corresponds to SDG 12 'responsible consumption and production'.

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[8] The ETS is a 'cap and trade' system whereby EU companies receive or buy emission allowances based on their GHG emissions. If a company emits GHG below the cap, it receives ETS rights which it can sell to other companies that perhaps emit above the cap. This mechanism is used to net GHG emissions and keep the overall economy within a common target (i.e. the cap). The cap is constantly reduced in order to lower emissions as much as possible. The Green Deal aims to include more sectors in this scheme.

[9] Carbon pricing aims to reflect the carbon footprint of goods and services in the price, for example, by imposing a carbon tax imposed on producers for their emissions in their business activities.

[10] Carbon border tax would work as an import tax on imported goods in order to ensure fair competition and a level playing field for EU and non-EU businesses.

[11] Further investments in renewable technologies, improve production efficiencies, therefore decrease costs of production and ultimately decrease the price the consumer pays. Currently, the levelised cost of energy (the minimum price that energy must be sold for so that the investment to repays itself) for wind power is 28-54 US dollars, whereas for coal it is 66-152 US dollars (Lazard, 2019).

[12] Accessibility is linked to the renewables source itself (e.g. wind or sunshine) for production, but also to the distribution channels.

As part of its six policy actions, the EU introduced the Circular Economy Action Plan to incentivise the development of more sustainable products across the value chain, reducing waste and establishing a well-functioning internal market for secondary raw materials.

### *Building, renovating and sustainable mobility*

Building and transport are important sectors in energy consumption and emission. Globally, building is responsible for 38% of all energy-related CO2 emissions (UN Environment Program, 2020). Transport accounts for 24% of the global CO2 emissions, (International Energy Agency) where three quarters alone comes from road vehicles. There are advances to reduce these emissions as technological developments and growing use of electric vehicles may tackle this issue. However, other sectors such as aviation or shipping may be more difficult to decarbonise.

These elements of the Green Deal correspond to SDG 9 ‘industry, innovation and infrastructure’ and SGD 11 ‘sustainable cities and communities’.

In its seven policy actions in this area, the Green Deal aims to ensure that future or reconstructed buildings are resource efficient, and that sustainable mobility is made more accessible.

### *Greening the Agricultural Policy*

With its two policy actions, the EU aims to ensure healthy but affordable food consumption based on a circular economy. Amongst other SDGs noted above, this item of the Green Deal also helps address SDG 2 “zero hunger”.

### *Eliminating pollution*

The EU aims to create and maintain a toxic-free environment and prevent pollution from air, water, soil, and consumer products. Three policy actions are planned to eliminate pollution, including adopting a zero-pollution action plan for air, water and soil and restoring the natural functions of ground and surface water.

This element of the Green Deal mostly corresponds to SDG 3 ‘good health and well-being’.

### 2.3. The price of sustainable development

In order to achieve the ambitions of the European Green Deal, the EU is undertaking 32 targeted policy actions, including legislative proposals and amendments, to meet the respective ambitions, transform their economy and adopt a sustainable growth economic model. In addition, the EU will further incorporate sustainability in all its policies (an additional 9 policy actions), addressing SDG 16 'peace, justice and strong institutions'. Whereas for SDG 17 'partnership for the goals', the EU has undertaken 5 major policy actions in order to contribute to sustainability globally.

The economic cost of changing the current model into a circular one is considerable. The EU's climate and energy targets will require an additional €260 billion of investments per year by 2030. Overall, to achieve all its ambitions and transform its economy, the EU will mobilise €1 trillion, both from the public and private sector over this decade.

Even though challenges such as climate change and biodiversity loss are global concerns, not all countries are aboard the sustainable agenda.

The US have returned to the agenda after a presidency of denying the science and therefore any need for action - former US President Trump even called climate change a "hoax". However, even the strategy adopted under US President Biden may be too narrowly-scoped by focusing only on climate.

Even though less ambitious than the EU approach, the US too will undertake significant policy actions in the energy sector, transport sector, innovation and technology, etc. Based on US President Biden's plan ahead of the 2021 United Nations Climate Change Conference (COP26), US$1.75 trillion will be mobilised towards a sustainable infrastructure, building and industries, clean energy and agriculture (discounted pricetag from the original US$ 2 trillion estimated in his presidential running campaign).

The EU and US adoption of sustainable growth strategies is not only expensive but also needs sophistication in policy making. Both the public and private sectors must contribute to achieve sustainable development. For some nations, the challenges financially or politically on the domestic front may be too great and although global problems need global solutions, not all countries in the world can afford to transform

their economies, nor do they have the necessary governance and policy tools to do so.

The UN identified this challenge in SDG 17 ‘partnerships for the goals’, part of the ‘partnership’ pillar of the SDGs, which aims to implement the agenda through a solid global partnership. Financing, particularly mobilising financial resources to developing countries, is a main part of SDG 17.

### 2.3.1. The Addis Ababa Action Agenda

The UN’s Addis Ababa Agenda of Third International Conference on Financing for Development (Addis Ababa Action Agenda or AAAA) in 2015 aimed to provide a global framework for financing sustainable development. It follows up financing for the SDGs and other development-related projects and in terms of financial sources to sustainable development, the AAAA addresses the following elements.

#### *Domestic public resources*

Recognising that domestic public resources are a main source of financing to sustainable development, the AAAA addresses:

- tax systems, by broadening the tax base and strengthening the tax administration to improve tax collection and domestic revenue and by combatting tax evasion and corruption;
- government spending, by phasing out subsidies in polluting industries (e.g. fossil fuel); and
- ODA and long-term investment of development banks, to fill any national gaps.

#### *Domestic and international private business and finance*

The AAAA recognise the important role of the private sector and need to direct financing to sustainable development. The AAAA addresses:

- businesses, by encouraging the adoption of sustainable business models and investing towards sustainable projects with a positive impact on the agenda;
- countries, by issuing green/sustainable bonds; and
- financial markets, by ensuring market stability and maintaining an adequate service coverage.

### *International development cooperation*

Recognising the challenge for developing countries, the AAAA addresses:

- ODA, whereby developed countries continue to attribute 0.7% of their GNI as ODA, where at least 0.2% of GNI will go to least developed countries;
- multilateral development banks, by continuing to provide concessional finance supporting the sustainable development agenda; and
- multi-stakeholder partnerships, by using their financing to support country-driven priorities and strategies.

Nonetheless, the AAAA remains high level, leaving it to countries' own discretion on how to mobilise their resources, as well as to international financing institutions' discretion on how they use their financing.

The success of the MDGs proved that progress can be made towards development. The SDGs, even though consisting of short-term targets, together with the acknowledgment of planetary boundaries, help provide a map through the sustainable development maze, particularly through circular economic models. However, the cost of shifting to that model in economic and political terms is considerable. Despite the collective global challenge of addressing the needs of sustaining planet Earth and its population, the model seems to be available to and achievable by only the wealthiest and most economically advanced countries, despite institutional support and incentives to enable that shift for developing and least developed countries.

The following sections and subsections analyse sustainable development challenges in developing countries and focuses on the impact financing could make.

# 3. The challenge of sustainable development in developing countries

The sustainability development challenge falls hard and perhaps hardest on developing countries. Among the many definitions and classifications for countries on their policy and economic advancement, 'developing countries' share the following characteristics based on the most used taxonomies (Gbadamosi, 2021).

As per the UN Development Programme's (UNDP) Human Development Index (HDI)[13], developing countries fall in the lower 75 percentile of the classification. Under the 2020 HDI ranking, these are all countries ranked below 47 and having an HDI of lower than 0.845.

The World Bank's country classification is based on GNI per capita[14] and developing countries fall under the 'low income' and 'lower middle income' World Bank category. As per the 2020-2021 classification, these are countries with a GNI per capita of lower than US$4,045.

The International Monetary Fund (IMF) classifies countries based on 3 indicators: i) per capita income level; ii) export diversification; and iii) degree of integration into the global financial system. Developing countries, also referred to as 'emerging and developing economies' by the IMF, are the countries in Central and Eastern Europe, Commonwealth of Independent States, Developing Asia, ASEAN-5, Latin America and the Caribbean, Middle East and North Africa, Sub-Saharan Africa.

The most obvious challenges faced by developing countries are outlined in the sub-section below. Some could be claimed to be within their control, others clearly are not and only exacerbated under existing global economic models and environmental change. Financial bodies established to ease the challenge of developing countries towards development and more recently towards sustainable development, find their roots in predominantly developed parts of the world. While their aspirations may be

[13] The HDI accounts for a country's longetivity, education and gross national income (GNI), whilst also considering factors like security and freedom.
[14] GNI per capita is the gross national income converted to US dollars, divided by the midyear population.

admirable, their collective approach is incoherent with the overall purpose of achieving global development and remaining within planetary boundaries.

### 3.1. The challenges facing developing countries

By 2025, 80% of the world's population, for whom the respective governments must ensure basic needs are met, will be living in developing countries. For all our futures, these countries need to balance development and sustainability.

Developing countries are typically the raw material suppliers or manufacturers of products and services consumed mainly in the developed countries. The policies followed in these developing countries aim to maximise value to these industries so the countries can continue on their traditional growth trajectories and maintain their worldwide comparative advantage. Such policies assume that natural resources (water, air, land) are free for use without considering planetary boundaries – similarly to what the developed countries did before them (Khan, 2012). Indeed, in 2019 most of the world's largest CO2 polluters were from developing countries, with China on top. However, China is still polluting less than what the US has for the last three centuries (Statistica, 2020).

These developing countries are on a traditional trajectory growth model, based on a linear economy, which the developed countries adopted before them and used to develop themselves. However, developed countries, perhaps a bit cynically, are warranting that following that model will not sustain life on this planet, arguing that the impact on the planetary boundaries from developing countries (if they do not become more sustainable), will be bigger than the impact the developed countries ever made.

Developed countries are looking to transform their economies and adopt sustainability as an economic growth strategy; however, developing countries' priorities are elsewhere: fostering growth to ensure basic needs for their people. For example, whilst there was progress towards eradicating poverty (no.1 goal for the MDGs and SDGs), the coronavirus crisis increased global poverty for the first time in decades, pushing 71 million people into extreme poverty[15] in 2020. As a result, the first challenge for these developing countries is to strike the right balance between immediate growth

[15] Based on the World Bank Group, income below 1.9 US dollars/day is classified as extreme poverty.

(which seeks to continue supporting short-term profits and respective industries) and sustainable development (which also includes shifting investments to sustainable industries such as renewables).

In a second challenge, many developing countries simply lack the necessary governance to undertake the necessary policy changes needed, or even mirror what the EU or USA are doing. This is not just a matter of maturity in governance, though corruption and lack of efforts at a lower (e.g., municipal/regional) level play their part. Corruption, in particular, impairs the progress of foreign investments (e.g., grant or aid) in countries where funding leaks to pay off officials responsible to undertake the necessary policy measures or implement projects. Such is a case in Nepal where parts of international grants mainly from the UK, had to be paid to Ministers and on other service fees to ensure the passing of certain development projects (UKAid Development Tracker).

Thirdly, developing countries lack the financial resources to finance sustainable development. As the UN put it: the primary responsibility for financing sustainable development comes from the countries themselves. However, developing countries cannot afford EU or USA comparable levels of investment towards sustainable development, i.e., €1 trillion or US$ 1.75 trillion respectively. There are limitations due to developing countries' recurring challenges to collect taxes, ensure efficient government spending and engage private investments (Benedek, et al., 2021). Kharas and McArthur, 2019 noted that public spending for the SDGs in developing and least developed countries will increase by 145%, from US$ 850 billion in 2015 to US$ 2.08 trillion in 2030. By comparison developed countries spending will increase by only 50% from US$ 20 trillion in 2015 to more than US$ 30 trillion in 2030. This is not simply a measure of the economic weakness of developing countries compared to their developed neighbours; it is also a reality of developing countries governments' available funds.

In a fourth challenge, these countries may be torn by war or political instability – the absence of which is itself a precondition to sustainable development.

Fifth and finally, natural catastrophes like earthquakes, tsunamis, flooding, wildfires also limit a country's capacity to focus its attention toward sustainable development.

While climatic catastrophes pay little heed to national boundaries, their impact falls heaviest in countries whose infrastructure, governance, funding availability and economies are weakest. In short, many developing countries lack the necessary infrastructure to amortise the effects of such catastrophes, requiring policy and financing attention (International Young Naturefriends, 2018).

It is not sensible to continue the old path of slowly moving developing countries towards development at a pace they can cope with and in a model which helped others before. Ensuring development in a linear economic model is simply not enough nor sensible anymore – all the countries in the world should aim for sustainable development. Sustainability issues, fuelled by the climate crisis, are global issues and can only be tackled by combined global efforts towards sustainable development. This requires developed countries and bodies to lean in and use their means to support developing nations. One such way of doing so is through ensuring foreign investments drive sustainable development in developing countries by driving capital flows to sustainable investments (Delgado, et al., 2020). However, there are governance and economic aspects within international financing which need attention.

## 3.2. State of play of international financing to developing countries

Montaldo (2013) noted that economic and financial governance, both at national and international levels had not yet adopted the concepts of sustainable development. The Organisation for Economic Co-operation and Development (OECD) also confirmed that within the financial system to finance sustainable development, there was a lack of progress and even that development had regressed as a result of the crisis caused by the coronavirus pandemic.

In their report, the OECD highlights the following main challenges for developing countries in financing sustainable development:

- the debt crisis, which conditions implementing a more sustainable economic model;
- lack of clarity in environmental, social and governance (ESG) investments; and
- fragmentation of metrics used in the finance sector to progress towards sustainable development and achieving the SDGs, which increase the risk of greenwashing and delay real investments towards a circular economy.

The OECD also notes that recovery packages from the coronavirus pandemic crisis offer a unique opportunity for countries themselves, but also to DFIs to help build back a more resilient and sustainable economic model.

However, it is acknowledged that the OECD, international regulations, finance sector and the private sector, should align their policies and metrics toward a common standard to shift investments to sustainability. By doing so the financial system and its actors would acknowledge the link between financial growth, including profitability and sustainability factors. The extent of the misalignment reported by the OECD is exposed below.

### 3.2.1. Development Finance Institutions (DFIs)

For the purposes of this stock take, we will use some of the data from the mainDFI as listed by the OECD. A DFI, also referred to as 'development bank' or 'development finance company' is a specialised financial institution which finances the private sector in developing countries. There are different types of DFI, depending on who owns them and where they source their capital from. The two main forms of DFI are Bilateral DFIs and Multilateral DFIs.

Bilateral DFIs are either independent institutions, or part of larger bilateral development banks. The largest and main bilateral DFIs include:

- the Austrian Development Bank (OeEB)
- the Belgian Investment Company for Developing Countries (BIO)
- the Belgian Corporation for International Investment (BMI-SBI)
- the Development Finance Institute Canada (FinDev Canada)
- the Danish Investment Fund for Developing Countries (IFU)
- the Finish Finnfund
- the French AFD/Proparco
- the German Investment and Development Company (DEG)
- the German Investment Corporation (KfW/DEG)
- the Italian CDP/SIMEST
- the Dutch Entrepreneurial Development Bank (FMO)
- the Norwegian Investment Fund for developing countries (Norfund)
- the Portuguese Company for Development Financing (SOFID)

- the Spanish COFIDES
- the Swedish Development Finance Institution (Swedfund)
- the Swiss Investment Fund for Emerging Markets (SIFEM)
- the British CDC Group
- the US International Development Finance Corporation (DFC), previously called the USA Overseas Private Investment Corporation (OPIC).

In a Norwegian Church Aid report, 15 European DFI were surveyed to determine the impacts of their development programs and financing impacts. *Table 1: Bilateral DFI sustainability conditionalities* summarises the result of this study focusing on sustainability factors' conditionalities applied by these DFI and builds upon further research done for the purposes of this thesis. As part of this research, information has been extracted from the investment strategy, and/or particular financing contracts, and/or sustainability reports, and/or annual reports of these DFIs, to understand the metrics used in measuring the impacts financing from DFI has towards advancing sustainable development:

*Table 1: Bilateral DFI sustainability conditionalities*

| DFI | Sustainability metrics used |
|---|---|
| **OeEB** | The International Finance Corporation (IFC) performance standards, including information for:<br>• labour<br>• community<br>• land resettlement<br>• biodiversity<br>• indigenous people<br>• cultural heritage. |
| **BIO** | Own ESG considerations, mapped to SDGs. They include:<br>• positive impact to local communities<br>• decent and safe working conditions<br>• respect for human rights<br>• environmental sustainability<br>• general governance considerations. |
| **BMI-SBI** | Own considerations, focusing on social and governance/political impacts. Metrics include:<br>• paid work for the local population<br>• stabilization of political authority |

| DFI | Sustainability metrics used |
|---|---|
| | • creation of social, environmental and economic regulations. |
| **FinDev Canada** | Own Environmental & Social policy mainly built from the IFC's Performance Standards, but also from other international frameworks.[16] Metrics include:<br>• gender balance<br>• human rights<br>• climate change mitigation and adaption. |
| **IFU** | Own Sustainable Investments Handbook addressing ESG factors. The main social metrics address decent work and occupation health and safety:<br>• provide employment contracts<br>• provide reasonable wages<br>• set reasonable limitations on working hours<br>• ensure adequate housing and living conditions<br>• comply with minimum age standards<br>• not participate in or be connected with forced labour<br>• prevent workplace harassment and avoid discrimination<br>• strengthen gender equality and empowerment of women<br>• respect workers' right to privacy<br>• ensure freedom of association and collective bargaining<br>• consider alternatives to retrenchment<br>• prevent and protect workers against health and safety risks<br>• ensure workers are trained in handling health and safety risks<br>• provide and require the use of protective equipment<br>• establish a health and safety committee<br>• improve workers' health conditions.<br>Environmental, climate and biodiversity metrics include:<br>• reduce emissions of greenhouse gases<br>• focus on sustainable resource consumption<br>• establish procedures to prevent pollution |

[16] Other international frameworks upon which FinDev Canada builds its own Environmental & Social policy include:

- UN Guiding Principles on Business and Human Rights
- ILO Declaration on Fundamental Principles and Rights at Work
- OECD Guidelines on Multinational Enterprises
- World Bank Group Environmental Health and Safety Guidelines

| DFI | Sustainability metrics used |
|---|---|
| | • ensure adequate handling and disposal of waste from livestock<br>• minimise the use of hazardous substances<br>• raise environmental awareness among workers<br>• protect and conserve biodiversity and ecosystem services<br>• manage living natural resources in a sustainable manner<br>• avoid introducing alien species.<br>Governance related metrics address anti-corruption and business ethics:<br>• commit to anti-corruption<br>• assess and manage corruption risks<br>• create an anti-corruption culture<br>• avoid facilitation payments<br>• inform business partners about anti-corruption commitment<br>• ensure fair competition<br>• comply with local tax regulation<br>• maintain good business standards. |
| **Finnfund** | Sustainability policy with metrics built from the IFC's Performance Standards. Environmental considerations include climate change, natural resources and biodiversity protection and pollution prevention and energy efficiency. Metrics used are:<br>• reduce or avoid greenhouse gas emissions,<br>• adapt and mitigate climate change risks, including a preference for projects on sustainable forestry, renewable energy, improved energy and material efficiency<br>• protect biodiversity<br>• maintain and enhance ecosystem services<br>• increase the capacity of forests to store carbon<br>• protect water resources and access to water through sustainable water management<br>• sustainable agriculture<br>• cleaner energy.<br>Social considerations address human rights, labour, land use and land use change, gender, including metrics such as:<br>• elimination of child labour and forced labour<br>• elimination of discrimination in the workplace, and access to marginalised groups |

| DFI | Sustainability metrics used |
|---|---|
| | • protection of employees' freedom of association and the right to collective bargaining<br>• deign working conditions, including wages, gender equality and equal opportunities, health and safety.<br>Governance considerations address corporate governance, corruption and anti-money laundering and tax planning and payments. Metrics used include:<br>• existence or adoption of a corporate structure and governing bodies<br>• structure and functioning of the Board of Directors<br>• control processes<br>• transparency, including reporting practices and systems<br>• shareholders' rights<br>• zero-tolerance on corruption<br>• compliance with tax legislation and fair tax planning. |
| **AFD/Proparco** | Own policy addressing climate and social elements. Metrics include:<br>• reaffirmation of climate priority as per the Paris Agreement<br>• financial inclusion of social groups<br>• gender balance<br>• health and education. |
| **DEG and kfW/DEG** | General development and sustainability impacts, particularly focused on energy-saving technologies.<br>Reference is made to using the metrics by UN Principles for Responsible Investment (PRI). |
| **CDP/SIMEST** | No references of sustainability metrics used or of their investment policy. |
| **FMO** | Own sustainability policy aligned with the SDGs and the AAAA focusing on people and the environment, i.e. the E and S lens of ESG. Metrics build on many frameworks, including IFC's Performance Standards and PRI. Some metrics referred in their policy are:<br>• job creation and quality of jobs<br>• respect for human rights<br>• contributing to limiting global temperature increase to 2$^{o}$C, aiming 1.5$^{o}$C<br>• anti-money laundering<br>• good corporate governance. |

| DFI | Sustainability metrics used |
|---|---|
| **Norfund** | Own ESG policy aligned with the SDGs and the AAAA and built from the IFC's Performance Standards and the World Bank Environmental, Health and Safety Guidelines. Metrics address human rights, gender equality, climate and environment, anti-corruption. Some of them are:<br>• labour relations<br>• education and training programmes<br>• health measures<br>• local community development. |
| **SOFID** | No particular policy or metrics. However, overall focus on general development and ESG impacts. |
| **COFIDES** | Own policy addressing E and S aspects of ESG. Metrics on the social prism of ESG include:<br>• respecting human rights,<br>• abolition of child labour and forced labour<br>• providing a reasonable salary based on the cost of living<br>• ensure all workers have contracts<br>• ensure housing for displaced workers<br>• respect the rights of indigenous people<br>• improve working conditions, including the working environment<br>• improve public health conditions.<br>Metrics on the environmental prism of ESG include:<br>• preventing pollution<br>• protecting biodiversity<br>• mitigation of global warming.<br>Another important aspect of the policy addresses anti-corruption and include metrics on developing internal controls and systems, training employees and payment processes. |
| **Swedfund** | Own policy built on the SDGs and AAAA. They report based on the private sector's frameworks and standards, particularly on the International Integrated Reporting Framework and Global Reporting Initiative standards. Metrics address human rights, gender equality, climate goals as per the Paris Agreement, and good governance. |
| **SIFEM** | Own ESG targets. On the environmental aspect, they address:<br>• compliance with environmental regulations<br>• sustainable use of natural resources<br>• avoiding or reducing CO2 emissions<br>• avoiding or reducing the pollution of air, water and land |

| DFI | Sustainability metrics used |
|---|---|
| | • avoiding the production of hazardous and non-hazardous waste.<br>On the social aspect, they address:<br>• elimination of forced and child labor<br>• paying wages that meet or exceed industry or the legal national minima<br>• fair treatment of employees in respect to their employment and working conditions, regardless of gender, race, colour, political opinion, sexual orientation, age, religion, social or ethnic origin and/or HIV status<br>• healthy and safe working conditions.<br>On the governance aspect, they include:<br>• transparency and accountability grounded in sound business ethics<br>• employee rules, such as not accepting gifts or improper payments<br>• tax and financial reporting transparency<br>• appropriate effective systems of internal control and risk management<br>• prohibiting contributions to political parties or political candidates, where these could constitute conflicts of interest<br>• clearly defined company responsibilities, procedures and controls. |
| **CDC** | Own code of responsible investing focusing on gender equality, climate change, job quality, ESG, skills and leadership. Environmental and social (E&S) metrics include:<br>• having E&S management systems<br>• elimination of forced and child labour<br>• paying at least minimum legal wages<br>• eliminating discrimination<br>• safe working conditions<br>• adequate use of land and protecting natural resources<br>• minimising negative impacts on biodiversity<br>• reducing emissions and waste. |
| **US DFC** | Own policy built from the IFC's Performance Standards. |

*Source: Norwegian Church Aid, 2011 and Bilateral DFIs investment policy documents*

Collectively these Bilateral DFIs cover all the developing and least developed world and have the potential to impact a system change from a traditional linear economy to a circular sustainable one. Some DFIs are positively contributing to achieving sustainable development. For example, US DFC's equity contribution to Kasha Global Inc. (East Africa) is conditioned by empowering women and their economic development. CDC's debt to Diversity Urban Property Fund (South Africa) to build quality and affordable housing is conditioned by making this housing available for low and middle-income households, investing in needed areas to increase essential services infrastructures, build based on green building standards to mitigate GHG and create at least 4,000 construction and permanent operational jobs.

However, their targets and metrics of Bilateral DFIs are not aligned. Whilst they build on international frameworks (which do not classify as "standards" as they do not provide metrics), each Bilateral DFI has their own goals to achieve. Therefore, they have the luxury to cherry-pick from various frameworks to build their sustainable investment policy goals. This misalignment does not help to achieve sustainable development and neither does it resonate with SDG 17 "partnership for the goals".

It is also the case that sometimes these DFI invest in projects by mainly using the traditional metrics of stimulating economic growth and development, rather than considering the impact of their financing on people and the planet, despite having such ESG metrics in place.

For example, Propaco's loan in 2019 to ETG, an African Trading company operating mainly in the Global South, was linked to the following conditionalities:

1. completing 50 sub-projects ranging from processing plants in warehouses and production of vehicles;
2. improving the company's supply chain, particularly by linking up smallholders with the formal economy, by offering them market opportunities; and
3. expanding the processing capacity.

As noted, all of these conditionalities are economic, even though they may improve ESG factors such as social balance and better access to goods for communities where the group operates. However, they do not consider Propaco's own ESG policy. In another example, Finnfund's 2020 loan to the First National Bank Ghana

conditionality, was for the bank to contribute to the improvement of the mortgage market. Again, none of the ESG metrics in the Finnish DFI were linked to this loan.

The alignment in the Bilateral DFI form is therefore erratic and often poor. The various Bilateral DFIs are not aligned to a common standard and sometimes the application of their own standards is inconsistent to their individual investment policy. Unfortunately, as will be seen below, this is also the situation with the Multilateral DFI.

Multilateral DFIs are private sector arms of international financial institutions established by more than one country, thus having a greater financing capacity than bilateral DFIs. They finance private sector projects mainly through equity investments, long-term loans and guarantees. The main multilateral DFIs include:

- the African Development Bank (AFDB)
- the Asian Development Bank (ADB)
- the European Bank for Reconstruction and Development (EBRD)
- the European Investment Bank (EIB)
- the Inter-American Development Bank (IDB)
- the International Finance Corporation (IFC)
- the Islamic Development Bank (ISDB).

Like Bilateral DFIs they use sustainability metrics in their investment policy. *Table 2:* Multilateral DFI sustainability conditionalities summarises the metrics used by Multilateral DFI as part of their investment policies.

*Table 2: Multilateral DFI sustainability conditionalities*

| Multilateral DFI | Sustainability metrics used |
|---|---|
| **AFDB** | ESG considerations in the lending policy include:<br>• reversing land degradation and desertification<br>• protecting the coastal zone<br>• protecting global goods (e.g., natural parks and nature reserves, mangroves, reefs and lagoons)<br>• enhancing disaster management capabilities<br>• improving public health. |
| **ADB** | Addressed as “operational objectives” ESG considerations include:<br>• human and social protection enhanced for all |

| | |
|---|---|
| | • quality jobs<br>• increased opportunities for the most vulnerable<br>• gender equality<br>• mitigation of climate change<br>• build climate and disaster resilience<br>• enhance environmental sustainability<br>• enhance public management and financial stability<br>• improve government and institutional capacity for service delivery<br>• effectively utilise country systems and procedures |
| **EBRD** | Environmental and social sustainability factors adopted as a set of specific Performance Requirements in their own policy. They include:<br>• labour and working conditions<br>• resource efficiency and pollution prevention control<br>• health, safety and security<br>• land use<br>• biodiversity conservation<br>• indigenous people<br>• cultural heritage. |
| **EIB** | ESG metrics aligned with EU ambitions (as noted in the following section). Main goals include:<br>• limit global warming to 1.5°C above pre-industrial levels<br>• adapt to the impacts of climate change<br>• combat environmental degradation<br>• halt biodiversity loss<br>• stop widening inequalities. |
| **IDB** | Own environmental and social sustainability policy aiming to impact:<br>• pollution prevention and resource efficiency<br>• climate change adoption and mitigation<br>• biodiversity<br>• human rights<br>• social issues such as gender equality, indigenous people and vulnerable groups, people with disabilities<br>• working conditions, etc. |
| **IFC** | Metrics based on their own Performance Standards on Environmental and Social Sustainability. Environmental related performance standards include: |

| | |
|---|---|
| | • assessment and management of environmental and social risks and impacts (e.g., having systems in place to identify the risks and impacts)<br>• resource efficiency and pollution prevention (e.g., reduce GHG emissions, better water consumption, eliminate waste, manage hazardous materials, manage use of pesticides)<br>• land acquisition and involuntary resettlement (e.g., compensation of displaced persons, community engagement, resettlement and livelihood restoration planning and implementation, grievance mechanisms, physical and economical displacement)<br>• biodiversity conservation and sustainable management of living natural resources (e.g., modified, natural and critical habitat, legally protected and internationally recognised areas, invasive alien species).<br>Social related performance standards include:<br>• labour and working conditions (e.g., non-discrimination and equal opportunities, worker's organisations, avoiding child and forced labour, etc.)<br>• community health, safety, and security (e.g., infrastructure and equipment design and safety, hazardous materials management and safety, exposure to diseases, emergency preparedness and responses)<br>• indigenous peoples (e.g., avoid adverse impacts, participation and consent, relocation, heritage, land use, etc.)<br>• cultural heritage (e.g. finding procedures, consultation and community access, removal of critical and non-critical cultural heritage, critical cultural heritage). |
| **ISDB** | Own sustainable finance framework built on the SDGs and their targets. They define the following Green Project categories for environmental impacts, including mapping them to a particular SDG and the respective targets:<br>• renewable energy (matching SDG 7 and SDG 11)<br>• energy efficiency (matching SGG 7 and SDG 9)<br>• pollution prevention and control (matching SDG 6 and SDG 12)<br>• environmentally sustainable management of natural living resources and land use (matching SDG 2)<br>• sustainable water and wastewater management (matching SDG 13). |

| | |
|---|---|
| | In addition, the following Social Project categories apply for social impacts. Similarly to the projects on the environmental impacts, these categories also mapped to a particular SDG and use the respective targets as metrics:<br>• employment generation / SME financing (matching SDG 1, SDG 8 and SDG 9)<br>• affordable housing (matching SDG 11)<br>• affordable basic infrastructure (matching SDG 6, SDG 7, SDG 11)<br>• access to essential services (matching SDG 3 and SDG 4)<br>• socioeconomic advancement and empowering (matching SDG 5 and SDG 10). |

*Source: Multilateral DFIs investment policy documents*

In practice, Multilateral DFIs are doing better than bilateral DFIs in allocating capital towards sustainable investments (IsDB, ADB, et al., 2020).

For example, AFDB's investment to the rural electrification in Burkina Faso is conditioned by ESG factors such as building functional legal and regulatory systems and empowered institutions, supporting women's inclusion in the project, supporting local entrepreneurs, creating between 200 and 700 permanent jobs. In another example, the EBRD's loan and investment grants to Tunisian utility company STEG is conditioned by ESG metrics such as wastewater treatment and recycling, equal opportunities for women and young professionals, decarbonisation of Tunisia's energy sector. IFC's loan on solar energy to Uzbekistan is conditioned by a public-private partnership to funding, reduction of GHG by promoting renewable energy (particularly solar).

However, and similarly to bilateral DFIs, these multilaterals DFIs policies, targets and metrics are not aligned to a common standard, and sometimes their own application of their own metrics is inconsistent with the overall purpose of their own investment policy. Therefore, it is difficult to understand the overall progress towards sustainable development.

The two main forms of DFI are unable to clarify progress of alignment between economic and sustainable policies, targets and metrics as one would expect under the SDG umbrella. They could do so if they all adopted a common standard of reporting –

even if that was the minimum standard – from which a reasonable assessment could be made towards sustainability.

Without one, we to turn to other older measures pre-dating SDGs and even MDGs, in the hope of determining if financial institutions are achieving the required alignment (indirectly), between economic and sustainability to deliver a circular economic model of development in the developing world, or simply 'greenwashing' results for the sake of public consumption.

Unfortunately, the situation of misalignment towards sustainable development in DFIs is the same also for other types of assistance.

### 3.2.2. Official Development Assistance (ODA)

The ODA is a long standing and mature development programme. ODA is also a category of foreign aid as measured by the OECD. It consists of resources given by the developed countries (i.e., their public agencies) to developing and least developed countries to promote the economic development and the welfare of their people. ODA come to play an important role when private financing fails due to potential private investments in certain countries being considered too risky or low priority. In these countries, ODA has an important role to play in sustainable development by distributing grants, loans or other types of financing to improve certain ESG factors. This is particularly the case for least developed countries where DFIs and private investments are lacking due to high systematic risks associated with investing in these countries.

The AAAA also reaffirms ODA commitments to developing countries and least developed countries. Specifically, as per the AAAA, developed countries will continue to contribute 0.7% of their gross GNI to developing or least developed countries (0.15%-0.20% of these developed GNI's should be directed to least developed countries). However, out of all these countries, only Sweden, Norway, Luxembourg, Denmark and Germany met their 0.7% of GNI target as per the AAAA.

*Table 3*: ODA in 2020 summarises the OECD's preliminary ODA figures for 20 countries in 2020, as well as summarises these ODA's aid policy priorities as evidenced by the OECD and DonorTracker. They are ranked based on the amount of ODA distributed.

*Table 3: ODA in 2020*

| Rank | ODA | Amount | Respective aid policy priorities |
|---|---|---|---|
| 1 | USA | US$35.5 billion | The US Interim National Security Strategy guides the US ODA priorities which include:<br>• global heath and security, including combating covid-19<br>• climate<br>• global stability<br>• better economic foundations<br>• better democracies, including fighting authoritarian regimes and corruption<br>• fighting discrimination, social inequalities and other injustices. |
| 2 | Germany | US$28.41 billion | German ODA priorities include:<br>• stability and peace<br>• social infrastructure services, including human rights and gender equality<br>• protecting the environment, including climate change mitigation, water and sanitation. |
| 3 | EU institutions | US$ 19.38 billion | EU's priorities include:<br>• sustainable development<br>• climate change<br>• social infrastructure and services, including humanitarian assistance and gender equality. |
| 4 | United Kingdom | US$18.56 billion | As provided by the Secretary of State for the Foreign, Commonwealth and Development Office, UK ODA adopts the following priorities:<br>• climate change and biodiversity<br>• COVID-19 and global health security<br>• girls' education<br>• science, research, and technology<br>• open societies and conflict resolution<br>• trade and economic development<br>• humanitarian preparedness and response |
| 5 | Japan | US$16.27 billion | Japan's ODA priorities include:<br>• peace and stability within the international community<br>• responding to global challenges |

| Rank | ODA | Amount | Respective aid policy priorities |
|---|---|---|---|
| | | | • economic diplomacy; and<br>• promotion of "high-quality growth". |
| 6 | France | US$14.14 billion | The French Interministerial Committee for International Cooperation and Development defines the following priorities for French ODA:<br>• international stability<br>• climate<br>• education<br>• gender parity<br>• healthcare |
| 7 | Sweden | US$6.35 billion | The 'Policy framework for Swedish development cooperation and humanitarian assistance' lists the following ODA priorities for Sweden:<br>• human rights, democracy, and the rule of law<br>• gender equality<br>• environment and climate change, and the sustainable use of natural resources<br>• peace and security<br>• inclusive economic development<br>• migration and development<br>• health equity<br>• education and research. |
| 8 | Netherlands | US$5.36 billion | The Dutch policy document 'Investing in Global Prospects: For the World, For the Netherlands' lists the following priorities:<br>• preventing conflict and instability, including adopting the rule of law<br>• reducing poverty and social inequality<br>• climate change mitigation and promoting sustainable development<br>• water management<br>• agriculture and food security. |
| 9 | Canada | US$5.03 billion | Led by their 'Feminist International Assistance Policy', Canada's priorities are:<br>• gender equality and the empowerment of women and girls, including sexual and reproductive health,<br>• human dignity<br>• inclusive economic growth |

| Rank | ODA | Amount | Respective aid policy priorities |
|---|---|---|---|
| | | | • environment and climate change<br>• inclusive governance<br>• peace and security. |
| **10** | Norway | US$4.20 billion | Norway's ODA priorities are guided by the SDGs themselves and include the following:<br>• humanitarian assistance<br>• global health, focusing on non-communicable diseases, women's and children's health, sexual and reproductive health, health coverage and security<br>• education, focusing on countries in conflict in order to address the proper education of children, particularly girls<br>• private sector development, agriculture, and renewable energy; and<br>• climate change, environment, and oceans. |
| **11** | Italy | US$4.19 billion | Italy's focus is on migration and health, particularly in the African continent. In their 'Documento Triennale di Programmazione e di Indirizzo' they lay out their strategies for every three years. For 2019 – 2021 the priorities build on the SDG pillars (i.e. people, planet, prosperity, peace, partnerships) and their ODA prioritises:<br>• economic development and opportunities<br>• human development (including health and education, gender equality and disabilities)<br>• environment and use of natural resources<br>• rural development and food security, and<br>• conflict-affected and fragile states. |
| **12** | Switzerland | US$3.56 billion | Switzerland's ODA is guided by its International Cooperation Strategy and prioritises:<br>• creating decent local jobs<br>• climate change<br>• social issues, including addressing forced and irregular migration, and |

| Rank | ODA | Amount | Respective aid policy priorities |
|---|---|---|---|
| | | | • promoting the rule of law building on its extensive multilateral and humanitarian experience. |
| **13** | Spain | US$2.97 billion | Spain's Master Plan builds on the SDGs and its ODA is focused to Latin-American countries and sub-Saharan Africa countries. Their priorities are:<br>• sustainable development<br>• peace and security<br>• institutional strengthening<br>• migration. |
| **14** | Denmark | US$2.65 billion | The Danish Ministry of Foreign Affairs published 'The Government priorities for Danish development cooperation 2021' which prioritises:<br>• the environment, including building resilience to climate change with investments in sustainable industries, protecting water and the biodiversity<br>• social issues, including putting additional efforts in areas affected by conflict. |
| **15** | Australia | US$2.56 billion | Australian primary ODA priority is the Pacific region, and they focus on protecting vulnerable groups, particularly women and girls. The priorities address:<br>• health security,<br>• social stability, including education, governance, and violence against women<br>• economic recovery, particularly post COVID-19. |
| **16** | Belgium | US$2.29 billion | Belgian ODA is focused primarily in Africa and aims to:<br>• develop the private sector<br>• mitigate climate change<br>• enable digitalisation<br>• social infrastructure and services, including focusing on education, population policies and health. |
| **17** | South Korea | US$2.25 billion | Once an ODA recipient itself, South Korea makes the top 20 list of ODA donors. Their |

| Rank | ODA | Amount | Respective aid policy priorities |
|---|---|---|---|
| | | | Framework Act on International Development Cooperation, revised in 2018 sets out the following pillars for development:<br>• poverty reduction<br>• the human rights<br>• gender equality<br>• sustainable development and humanitarianism<br>• economic cooperation, and<br>• peace and prosperity in the international community. |
| **18=** | Finland | US$1.27 billion | Finnish ODA's main goal is to eradicate poverty. Other priorities address:<br>• gender equality, including the rights of women and girls to training and education<br>• sustainable economy and decent work<br>• democratic societies<br>• climate change<br>• biodiversity and sustainable use of natural resources. |
| **18=** | Austria | US$1.27 billion | The 'Three-year Programme for Austrian Development Policy' prioritises:<br>• poverty eradication<br>• peace and security<br>• protecting the environment<br>• inclusive societies, including gender balance. |
| **…** | … | … | … |
| **23** | Luxembourg | US$0.45 billion | Luxembourg's 'The Road to 2030' prioritises:<br>• access to quality basic social services<br>• socio-economic integration of women and youth<br>• inclusive and sustainable growth, and<br>• inclusive governance. |

*Source: OECD and DonerTracker*

As should be clear from the table above, a country's ODA policy and priorities are aligned with the respective country's own development policies and foreign policies.

So, despite their own labelling, ESG considerations are overarching the ODA priorities. Therefore, in principle, ODA should promote sustainable development.

However, sustainable development is a common global goal: climate change is a global problem and needs unified and aligned global action towards reducing overall global emissions by the use of common standards. Similarly, biodiversity, social issues and human rights transcend borders and individual country's goals – they are global common issues.

Therefore, while the priorities may be ESG aligned, the metrics used are not and there is no common standard. This is due to the fact that there are no globally recognised metrics to address ESG progress, i.e., there are no International Public Sector Sustainability Reporting Standards for the receiving countries to report on. To make up for that, ODA, like the DFIs, follow a cacophony of different standards and goals – none of which collectively, can be measured coherently.

The public and nations particularly are the ones promoting the sustainability agenda, including meeting the SDGs and moving to a circular economy. There are examples which could be used and quickly enough to impact the challenges we collectively face. The next section proposes using a framework built from the private sector's sustainability reporting standards to report on ESG progress for countries receiving ODA or financing from DFI.

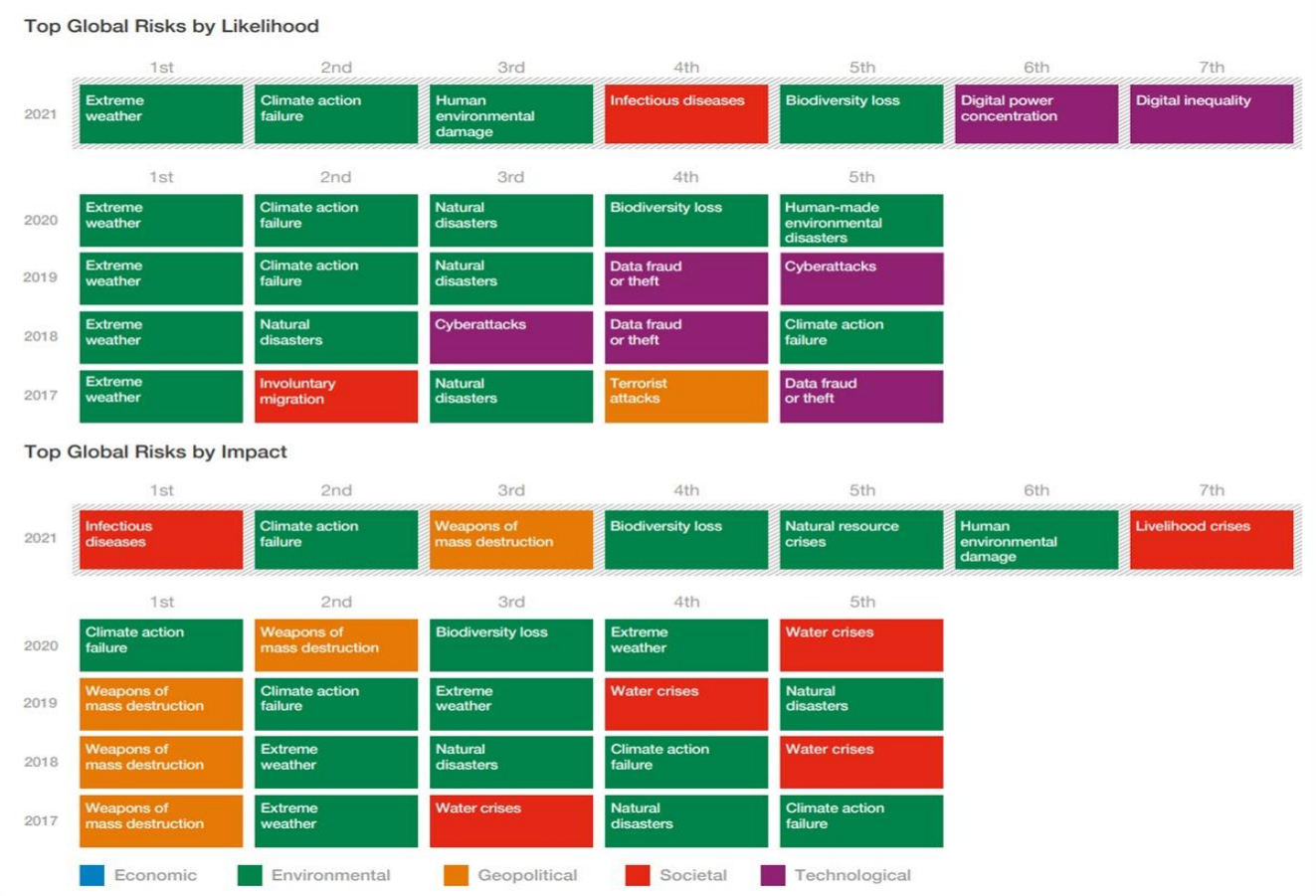
# 4. Financing sustainable development in developing countries: a framework built from the private sector

The private sector also recognises sustainability as a challenge to business continuity and in some ways, may be more attuned to the implications of failing to address sustainability than development financing or aid institutions, or nations. Sustainability concerns such as climate change, biodiversity loss, social and health concerns can have an impact on their operations, transactions, markets and 'bottom line' at a quicker pace. In addition, depending on the size of the company, sometimes their impacts are larger than those of certain nations, as multi-national companies have a spread into many parts of the globe, when a nation-state's geographic reach may not be so wide.

*Figure 5*: 2021 top global risks by likelihood and impact[17] below, adapted from page 14 of the World Economic Forum's Global Risk Report 2021, demonstrates that for the last five years almost all the top risks in terms of likelihood and impact are environmental and social related.

[17] World Economic Forum, 2021, The Global Risks Report 2021, see: https://www.weforum.org/reports/the-global-risks-report-2021

*Figure 5: 2021 top global risks by likelihood and impact*




Source: Word Economic Forum, 2021

As can be seem, 4 out of 5 risks in terms of likelihood are environmental related and a last one is societal related. On the impacts side, 3 out of 5 risks are environmental related, one social related and a last one geopolitical. These include climate action failure, biodiversity loss and natural resource crisis on the “E” element of ESG.

Therefore, it is obvious that ESG issues are core issues for companies, especially global ones, as they directly affect their many aspects of their business and particularly their operations.

Companies that are directly engaged in resource extraction are very aware of ESG issues. Many seek and have committed to being responsible for achieving sustainable development and transitioning to a circular economy. They are increasingly recognising that their company cannot simply take for granted its license to operate anymore – it has to earn it. For example, Rio Tinto’s destruction of sacred rock

shelters, a 46,000-year-old Aboriginal heritage, in view of its iron ore mine expansion in 2020 caused public stir. Rio Tinto's miscalculation of the impacts its operations have on the social dimension of ESG, costed the jobs of three of its executives and two board members (Reuters, 2021). As a result, companies are increasingly considering how to deliver positive impacts to people and the environment (or at least do no significant harm), in addition to returning a profit.

Not all are so incentivised. For some the transition to ESG and circular economic models will be financially impossible in the near term or simply too complex to undertake in their current business environment - they need to remain afloat to change. However, other businesses they rely upon, are creating pressures to incentivise these 'laggard' companies.

The finance industry is applying pressure. Climate change is increasingly being recognised as a systemic risk (Reuters, 2020) and if left unaddressed and its effects come to be realised, it may become an uninsurable risk for companies (Fernyhough, 2019). With the world's majority of investments being pension funds, thus having a long-term prospect, understanding ESG issues is critical to ensure a stable asset allocation. Therefore, it is important to ensure that capital flows are being directed to sustainable investments in order to preserve the value of the investment in the long-term. Consequently, companies which do not embrace ESG transition and so shift to a circular economic model, may find it harder and harder to acquire capital and shareholder support.

In some ways therefore, there are parts of the business world in a similar situation to developing countries. They know they need to change for the good of their long-term future, but the immediate challenge is too painful to embrace or just too complex in their current market conditions.

### 4.1. Parallelisms between developing countries and the private sector

Currently, sustainability reporting in the private sector is most popular with large companies, which provide these data either because they are mandated to, or because of their stakeholder responsibility programs. In the EU, the EC's proposal for a Corporate Sustainability Reporting Directive (CSRD) will mandate that

approximately 49,000 companies provide sustainability reporting based on the double materiality perspective. Double materiality as defined in the new CSRD proposal, encompasses reporting on important matters for the decision-making of investors and broader stakeholders (society at large) on the company – this includes investment decisions in the company but also business decisions such as engaging with the company as a supplier or client in the value chain, as well as more simple decisions such as employment decision (e.g., people choosing to work for that company or not). To meet the information needs for all these stakeholders, the company needs to report on its financial matters and dependencies on ESG, which may affect how a company generates profits and cash flows in the short-term, medium-term or long-term. In addition, a company also needs to report on the impact its operations have on the economy, people and the environment, regardless whether these impacts materialise financially for the company, in order to fully meet these information needs.

In a survey conducted by KPMG in 2020, almost 96% of the 250 largest companies in the world provide sustainability information. In addition, 90% of the companies in the S&P index provide such information (Governance & Accountability Institute). Small and medium enterprises (SMEs) usually provide this information on a voluntary basis due to their resource constraints.

If we consider the top 100 global companies by market capitalisation as of March 2021, these companies collectively account for €26.7 trillion of market cap (PwC, 2021) and employ 17 million people. The last company on the list has a market capitalisation of US $128 billion and generates US $46.8 billion, which is more than many developing countries' gross domestic product (GDP). In addition, collectively these companies impact the lives of over 17 million workers and their immediate families, for a total of around 83.3 million people.[18] As a comparison, Albania, considered a developing country, records a GDP of US $14.8 billion and has a population of approximately 3 million people (Eurostat).

Furthermore, most of these large companies operate globally rather than in a single country, impacting the environment in different locations based on their operations. They also engage with global value chains, including suppliers and clients from all

[18] The world average family size is 4.9 people (Pew Research Centre, 2019)

over the world. These suppliers and clients too depend on and have an impact on the economy, people and the environment. Therefore, these large companies' impacts and dependencies are not solely limited to their own operations, but also to the ones of their partners throughout the value chain.

It should be clear, that large global corporations face the same sustainability development challenges that developing countries face. In many ways their impact on the planet can be as significant as that of a developing nation. Like nation's governments, the Boards of these companies also have stakeholders (shareholders, media, lobbyists, customers and suppliers) who hold them accountable, often more so than some nation's populations. Yet when closely examined how these global corporations report to their stakeholders (and especially shareholders) on sustainability issues, to justify their continued use of company resources (which shareholders own), they all report based on common private sector reporting standards.

The question one is forced to ask therefore, is why is there different information required from the private sector for investors and broader stakeholders to justify the use of resources than there is from developing countries to justify their use of resources and especially financing provided to them through DFI and ODA financial instruments?

It seems particularly irrational that DFIs, which also finance the private sector, use unaligned standards in setting their conditionalities when they can use the same standards and metrics as currently used in the private sector DFIs finance the private sector, for which there is significant progress to reporting sustainable development progress and achieving ESGs. Under the current state of play, large companies are generally asked to report against these sustainability reporting standards, whereas companies receiving DFI financing are asked to report against each of the DFI own framework reporting requirements, which have been shown above to be anything but aligned and standard. This misalignment hampers correctly measuring advancement towards achieving sustainable development.

This is the same situation in ODA financing and reporting. While the objectives are generally aligned, metrics and standards to assess progress towards these objectives

are not. Therefore, an ODA recipient will tailor their reports based on the requirements of their donor.

It is incredible that when nation-sized, billion-dollar corporations across the planet report their financial use of resources in standards aligned with sustainability measures, we have billions of dollars of investments from DFIs and ODA that are being distributed using a misaligned and unstandardised method. Especially when one considers that these private sector standards could very easily be applied because the funding source and funding recipient in many cases are private and commercial ventures who may have to report their other business activities according to private sector global standards. Standards, which will be seen below, are increasingly converging at an increasing pace.

## 4.2. Towards sustainability reporting standards for corporate reporting

Investors and broader stakeholders recognise that ESG issues have a double materiality (EC, 2019) perspective, often addressed as impact-dependencies perspective:

(1) companies' development, performance and position *depend* on these factors, and at the same time
(2) companies' operations *impact* the economy, environment and people.

Companies' dependencies on ESG factors may either be short-term or long-term.

On the one hand, they affect current financial performances, thus affecting the company's access to financing and ultimately its share price. The International Financial Reporting Standards (IFRS) Foundations' educational material outlines how climate considerations affect financial statements items such as the value of assets and provisions. For example, a company's products (inventory) may become obsolete or too costly in case its operations and output do not comply with climate legislation, thus imposing on the company additional fines or taxes. In another example, a company's carbon-intensive assets may be impaired as they will not be utilised

throughout the planned useful lives,[19] or they will not be able to generate the planned economic benefits, including revenues. In addition, a company's carbon-intensive operations may give rise to future liabilities (provisions) if it operates in a region with very high political agenda on climate mitigation where changes in legislations may result in fines, penalties, higher taxes, or less room to operate which affects the company's ability to generate revenue.

On the other hand, ESG factors affect the ability of the company to continue operating in the future. In a practical example, Coca-Cola recognises the water problem and has adapted a water security strategy. Water is the main ingredient in most of the company's beverages, therefore, water issues are business issues for the company: they affect the ability of the company to continue producing beverages, therefore, affecting the operations and financial stability in the long-term. If Coca-Cola do not adopt a sustainable approach to water, the company's future can be materially damaged, perhaps even ended as its business model and its ability to generate revenue and profits would be compromised. ESG therefore drive change towards sustainable circular practices in companies, adjusting the way a company views long term survival over near-term profit.

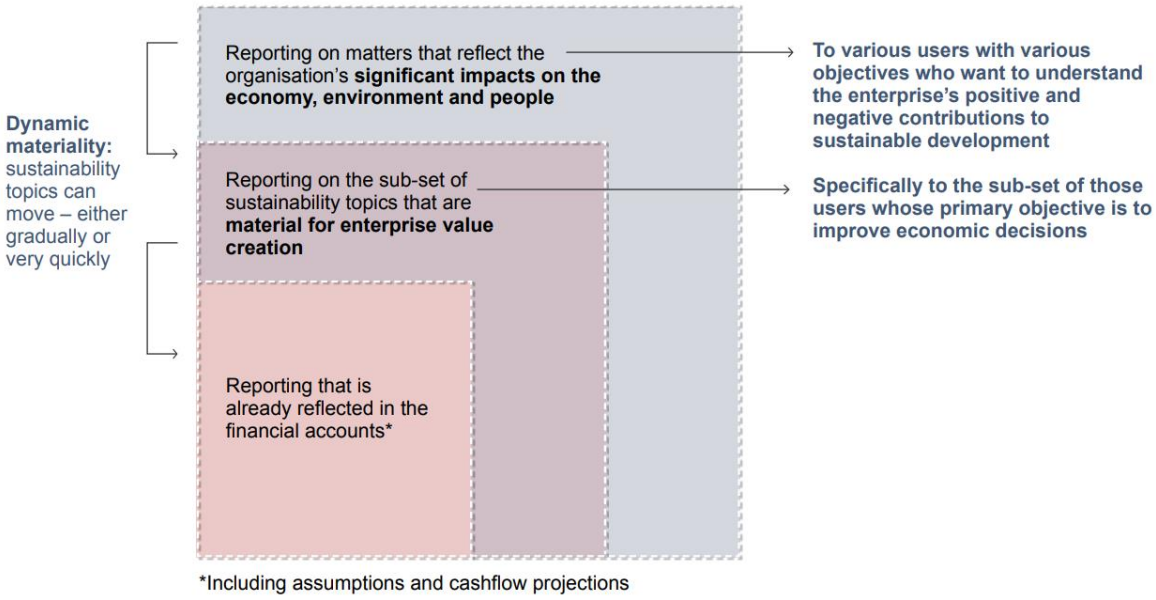
In terms of the 'impact' lens of double materiality, it is recognised that a company's operations affect the economy, environment and planet. The current linear economic model is a result of how companies have historically mainly focused on pursuing short-term targets and built their businesses, vision and strategies around maximising economic profits (Samuelson, Mark, 2012) and being accountable to only shareholders. However, companies will play a vital role in the circular economy transformation by recognising that they have a responsibility not only to shareholders, but also the broader stakeholders representing the planet and the society who make up or influence their customers and suppliers. Therefore, the companies' impact should not only consider and account for the economy (as per the old linear economic model), but also the other two elements: people and the environment.

[19] The International Accounting Standard 16 "Property, Plant and Equipment" defines the term as "
*(a) the period over which an asset is expected to be available for use by an entity; or*
(b) *the number of production or similar units expected to be obtained from the asset by an entity.*"

This has another important impact. It clearly allows investors to target those companies which are driving towards a sustainable business model and often those that are not. ESG investing is growing at a significant rate across the world, driving the flows of funding away from traditional, stables companies who have maintained a linear economic model in the belief that they are 'too big to fall'. In Shareholder meetings across the planet, vocal opponents of Board shareholder proposals maintaining the status quo, are finding support from large institutional investors.

Recognising the above, CDP, the Climate Disclosure Standards Board (CDSB), the Global Reporting Initiative (GRI), the International Integrated Reporting Council (IIRC) and the Sustainability Accounting Standards Board (SASB), being the world's most popular corporate sustainability reporting standard and framework setters, elaborated their vision for corporate reporting. As per their vision, corporate reporting includes both financial and sustainability data and adheres to dynamic materiality, a concept built from double materiality. *Figure 6*: Dynamic materiality as per CDP, CDSB, GRI, IIRC, SASB visualises dynamic materiality and was extracted from page 5 of the CDP, CDSB, GRI, IIRC and SASB *Statement of Intent to Work Together Towards Comprehensive Corporate Reporting*.

*Figure 6: Dynamic materiality as per CDP, CDSB, GRI, IIRC, SASB*




Source: CDP, CDSB, GRI, IIRC, SASB, 2021

In the current state of play in corporate reporting, only financial reporting (smaller pink box) is standardised with generally accepted accounting standards. This would be either IFRS globally, or the US Generally Accepted Accounting Principles (GAAP). Reporting sustainability topics material for enterprise value (middle purple box) would include financial reporting but also reporting on the long-term-aspect of the 'dependencies' lens of the double materiality. This would give a full picture of a company's performance both in the short-term and longer-term. Lastly, reporting on the 'impacts' lens of the double materiality (big grey box) is important to understand a company's contribution to sustainable development. All these aspects (boxes) feed into one another and create an interconnected cycle: a company's performance ultimately has impacts to the economy, environment and people, and equally all the latter gradually impact a company's performance.

Currently, the IFRS Foundation is pursuing the possibility of extending its standard-setting activities to address reporting material to enterprise value, by creating an International Sustainability Standards Board (ISSB). This initiative aims to provide investors and capital markets with material data that will affect their investing and financing decisions.

In parallel, the EU will mandate EU sustainability reporting standards, as outlined in the CSRD. These standards will adopt a double-materiality perspective. These standards are expected to intercept with the ISSB's ones on the 'dependency' aspect of double materiality and will go further by also addressing the impact lens.

Both these initiatives are expected to collaborate to deliver aligned standards to minimise duplications and avoid resource inefficiencies. However, only the EU one tackles the issues comprehensively as their ultimate goal is to contribute to sustainable development. Therefore, moving forward, the analysis will start from the data needed in the EU and will feed from other international initiatives too where needed.

The European Financial Reporting Advisory Group (EFRAG) Lab project task force noted in its report to the EC that sustainability reporting standards need to be sector agnostic, sector specific and entity specific. For each of these 3 layers, there will be specific ESG factors to consider such as:

- on the environmental aspect:

  - climate change mitigation;
  - climate change adaption;
  - water and marine resources;
  - resource use and circular economy;
  - Pollution; and
  - biodiversity and ecosystems.
- on the social aspect:
  - equal opportunities for all;
  - working conditions; and
  - respect for the human rights, fundamental freedoms, democratic principles and standards.
- on the governance aspect:
  - the role of the company's administrative, management and supervisory bodies;
  - business ethics and corporate culture;
  - political engagements of the company;
  - the management and quality of relationships with business partners; and
  - the company's internal control and risk management systems.

The analysis should follow a three-layered approach:

First, it would consider sector-agnostic ESG factors. These consist of metrics that would be applicable in every sector. Obvious elements would be the ones in the social dimension such as equal opportunities for all, working conditions, as well as elements on the governance dimension such as the role of the boards and business ethics.

Second, the analysis should then consider sector-specific ESG factors. These would include metrics that are equally applicable in companies in a particular sector, therefore ensuring comparability within the sector, but would not necessarily be applicable to all sectors. SASB provides sector-specific metrics that fit the 'dependencies' materiality lens, whereas GRI have started developing sector-specific metrics to fit the 'impacts' materiality lens. Used together, these standards provide full metrics under a double materiality perspective.

Third, the analysis would conclude with entity-specific ESG metrics, which a company would use to tell its own story. Whilst providing the least comparable information, it is important to understand the particular position of an entity in its transition to sustainability. To this end, the EU has adopted the EU Taxonomy Regulation for Sustainable Activities which consists of a classification system for environmentally sustainable economic activities (European Commission, 2020). At this moment, there is only a taxonomy for the environmental element of ESG, focusing on the contribution an entity's activities have on climate change, mitigation and adoption. To determine this, an entity needs to assess which part of its revenues, capital expenditures (CAPEX) and operational expenditures (OPEX) contribute to or harm the environment.

As can be seen, the private sector has matured and continues to mature in its approach to financial sustainability reporting. The bodies driving the approach are representative of the financial industry and financial governance bodies in countries or major international bodies, such as the EU. In many cases, they are applying 'best practice' and workable practice in a sensible and pragmatic way to encourage adoption - which is not always mandated. There seems to be a lot which would make common sense within the public sector.

### 4.3. Applying the private sector rationale to the public sector

The SDGs are considered as short-term targets; however, they are the only globally accepted targets to sustainable development. The SDGs pillars and each particular SDG, can be matched to ESG factors, as categorised in pillars as summarised in *Table 4*: SDGs matched per ESG below.

*Table 4: SDGs matched per ESG*

| SDG | SDG pillar | ESG |
|---|---|---|
| SDG 1 'no poverty' | People | Social |
| SDG 2 'zero hunger' | | |
| SDG 3 'good health and well-being' | | |
| SDG 4 'quality education' | | |
| SDG 5 'gender equality' | | |
| SGD 6 'clean water and sanitation' | Planet | Environmental |
| SDG 12 'responsible consumption and production' | | |
| SDG 13 'climate action' | | |

| | | |
|---|---|---|
| SDG 14 ‘life below water’ | | |
| SDG 15 ‘life on land’ | | |
| SDG 7 ‘affordable and clean energy’ | Prosperity | Environmental |
| SDG 8 ‘decent work and economic growth’ | | Social |
| SDG 9 ‘industry, innovation and infrastructure’ | | Environmental |
| SDG 10 ‘reduced inequalities’ | | Social |
| SDG 11 ‘sustainable cities and communities’ | | Governance |
| SDG 16 ‘peace, justice and strong institutions’ | Peace | Governance |
| SDG 17 ‘partnerships for the goals’ | Partnerships | Governance |

In financial reporting too, public sector reporting could be consolidated after the private sector reporting, it has happened before.

Even before IFRS became the (mostly) globally accepted financial reporting standards for the private sector, the accounting principles and frameworks applied in different jurisdictions were quite aligned. This continues to be the case for IFRS and US generally accepted accounting standards (GAAP), the latter being the other most important set of standards in financial reporting worldwide. Therefore, when it came to developing standard for the public sector, they looked to the private sector for input. The resulting International Public Sector Accounting Standards (IPSAS), which are used by governments to prepare their financial reporting, adapt IFRS to their needs, whilst retaining important concepts such as measurement, which provide the data for any metrics. However, the IPSAS Board, the body which develops IPSAS, was established in 1986 – 13 years after the body that developed IFRS.[20] If history is to repeat itself, it will take more than a decade for the public sector to come up with sustainability reporting standards for governments. Assuming the ISSB and the European Sustainability Reporting Board (SRB) are up and running in 2022, with their first standard published (on climate), we may not want, or have the luxury, of the public

[20] The current IFRS are developed by the International Accounting Standards Board (IASB), which was set up in 2001 under its new remit. However, it is transformed from the International Accounting Standards Committee (IASC), which was established in 1973. The IASB inherited many of the IASC’s standards at face value, called International Accounting Standards (IAS), some of which are still applicable today. Thus the date used in this comparison is the date of establishing the IASC.

sector taking another 13 years (to 2035) to catch up and perhaps another decade before their impact is felt on sustainability.

Based on the IPCC's latest report, the Earth is headed for more than 1.5$^{o}$C of temperatures rises compared to pre-industrial levels, making the targets of the Paris Agreement unreachable. However, the hope is still to keep the temperature rise below 2$^{o}$C for this century, if the world manages to reach net-zero at most in 2050. For this more realistic goal, the world needs to measure progress consistently.

In financial reporting, standards are adapted to their regions and their respective economic and financial market sophistication, e.g., a company may not use many of the most sophisticated IFRS as they may not be applicable. However, sustainability reporting standards address global issues that impact companies equally around the world, e.g., climate change will affect all companies around the globe equally. In practice, when a company talks about budget constraints, it looks at its own financial resources. However, when talking about the carbon budget, it is the same carbon budget left for everyone in the world before we reach critical life-threatening levels, which of course also translate to business disruption. This rationale would apply to companies as well as government activities.

As a result, the rationale and metrics used in sustainability reporting, which then informs decision-making, should in theory be aligned for the private and public sector.

This could begin in practice, by operationalising the SDGs, which most countries are committed to, into ESGs. The CSRD provides a list of ESG elements and sub-elements with the topics for which information is needed for decision-making. Afterwards, information on each of these ESG topics would be provided using the same architecture of sustainability standards, using the three-layer approach.

Even in the public sector there should be country-agnostic and country-specific information.

Country-agnostic data would mirror the sector-agnostic data of the private sector sustainability standards, i.e., address ESG matters that are applicable globally. Examples of what such data would consist of are climate change challenges,

biodiversity loss, human rights matters, good governance, and other matters ESG matters with consistent global impact.

Country-specific information would address the particularities of a country, including for example, reporting on its most prominent industries using sector-specific metrics. For example, some countries' main GDP is linked to agriculture, others to oil and gas, others to financial sectors, and so on. Depending on the main sectors of the economy and their particularities, such countries could provide further ESG information per sector so that it is possible to compare progress towards transitioning towards a circular economy for those particular countries.

The first two layers would ensure comparability and consistent data points for everyone: companies, governments and regions. These data points would help stakeholders such as investors (including private and public based investors such as different DFIs or ODA) and society to understand progress of a country towards a more sustainable future, including transformation to a more circular economy. Civil society would be better informed to hold their own governments accountable for such progress and make better voting decisions if needed. Investors would understand the needs of funding to better contribute to countries, sectors globally, or even particular sectors in a country, which are lagging in their transformation towards sustainable development.

These country-agnostic and country-specific datapoints would ultimately allow understanding the clear picture of the situation currently as well as provide reliable information for forecasts in the future.

To conclude, standardising sustainability related information is key towards achieving the SDGs in the short-term and transitioning towards circular economies and sustainable development in the medium and long-term. However, this requires a combined effort from everyone, countries specifically, who have the biggest weight towards this change. Developed countries have a broader responsibility in both for their own transitions but also in helping developing countries and least developed countries via their development programs, funded by public funds. Thankfully, significant progress has been made in standardising the private sector sustainability

reporting, which may serve as a good starting point to standardising sustainability at large.

## 5. Conclusions

Achieving sustainable development involves combined efforts from the public and private sector as well as people. However, an important driver is money and financing. The current linear economic model of producing and wasting as well as disregarding planetary boundaries are no longer supported or sustainable. Prioritising economic growth and wealth over a sustained life on the planet is a source of the environmental and social challenges we face today. It is clear that money is one of the main reasons we got ourselves into this problem, but it may also be an important tool to get us out of it.

Transiting to a circular economy is therefore crucial to economic growth, development and ultimately, sustainable development. However, this transition is an expensive business that perhaps only developed countries can afford. Developing and least developed countries are left challenging the transition due to its unfair nature: the current linear economic model brought prosperity to today's developed countries, who are asking the rest of the world not to follow this example, but trust in a new model. Nobody wants to be the guinea pig, particularly in more and more politically charged environments where economic growth is a winning recipe to clinging to power. These countries are also less equipped, both in political will and financing to adopt their models and systems towards sustainable development.

Thus, the role of financing institutions becomes key. DFI mobilise public funds of developed countries to finance the private sector, i.e., companies, in developing and least developed countries. ODA mobilise funds of developed countries to finance the public sector, i.e., developing and least developed countries directly. Directing where this money goes and under what conditions, meaning choosing what companies or sectors in a country to finance and setting out conditionalities for these financing respectively, may drive indirect change.

However, the current state of play is that each DFI uses their own interpretation of how to achieve and contribute to sustainable development with its financing. Not only are their investment policies not aligned, but neither the conditionalities they use and the data they require from the recipients of financing. This is unusual and unnecessary,

particularly when we think that the private sector has advance greatly in reporting on its sustainability impacts.

For the private sector, there are various frameworks and standards whose concepts and metrics are well aligned and whose data are based on science. By means of these standards, companies manage to provide reliable datapoints and information on the impacts of their operations to the economy, people and the environment. Similarly, they use the same standards to understand which resources, which may be endangered due to these environmental and social challenges, their operations depend on. This allows investors, society and broader stakeholders to understand how ESG factors such as climate change, water loss, social unrest etc impact the company and its future prospects, including its ability to generate profits and cash flows in the short, medium and long term. It also allows these same stakeholders to understand, in a standardised manner, the impact of each of these companies to each element of the ESG spectrum. Having such comparable data allows budgeting and forecasting for the future, an element particularly important when we think of carbon budgeting – whilst we are able to calculate exactly the carbon budget left every year, we are not yet able to understand in advance exactly what these emissions will be due to global unstandardised data, i.e., everyone using their own methodology and metrics to measuring sustainability.

Resultantly, it seems common sense that DFIs adopt private sector approaches to sustainability reporting in their investment policies, addressing how they distribute financing, how they set conditionalities, but also what reporting and data they expect from the companies they finance.

On the other hand, there are ODA, where each country provides ODA based on their own priorities and investment policies. As these are public funds financing the public sector of developing and least developed countries, the way funds are distributed are linked to what goals the respective developing country wants to achieve in allocating these funds. The result is that each developing country is focused on achieving its own priority with its ODA, and different ODA result in different requirements even if these ODA are allocated to the same country. The public sector is a sector of its own too, responsible for some of the main polluters such as energy and transportation systems.

Therefore, transformation towards a circular economy should be encouraged by adopting consistent methodologies that serve to a common goal: achieving sustainable development. It is therefore important to also align how ODA are allocated and understand the broader impact different ODA can have in a country.

Differently from DFIs which can easily adopt the experience in the private sector with sustainability reporting standards as they too finance the private sector, there are no readily available or well recognised sustainability reporting standards for the public sector. However, it is accepted that sustainable development requires a common and aligned approach from all actors, including the private and public sector as the challenges to address are common around the world. Therefore, adapting the data, metrics and standards used in the private sector for the public sector may be easier than we think, and possibly easier than with financial reporting standards, just because of the common challenge ahead.

To conclude, whilst developed countries, including the EU countries via the European Green Deal, lead by example towards sustainable development by undertaking the necessary policy actions and mobilising the necessary finances, developing and least developed countries may be driven into the necessary changes by means of DFI and ODA, both of which they are heavily reliant upon. There is no time to wait and see if the European Green Deal or other similar sustainable development strategies work: the results may take years and as per the IPCC report, we do not have time to waste if we want to limit global warming. Collective action is needed and, in a situation where there is no globally agreed approach and no globally aligned voice towards sustainability, money may be the ultimate tool to use.

There is a saying that goes: “money is the root of all evil”. The prospect of wealth and the economic growth at the expense of the planet and people got us into this mess. But perhaps and if we take all the necessary actions in time, in the years to come we may look back and also admit that money helped us out of this difficult position.

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