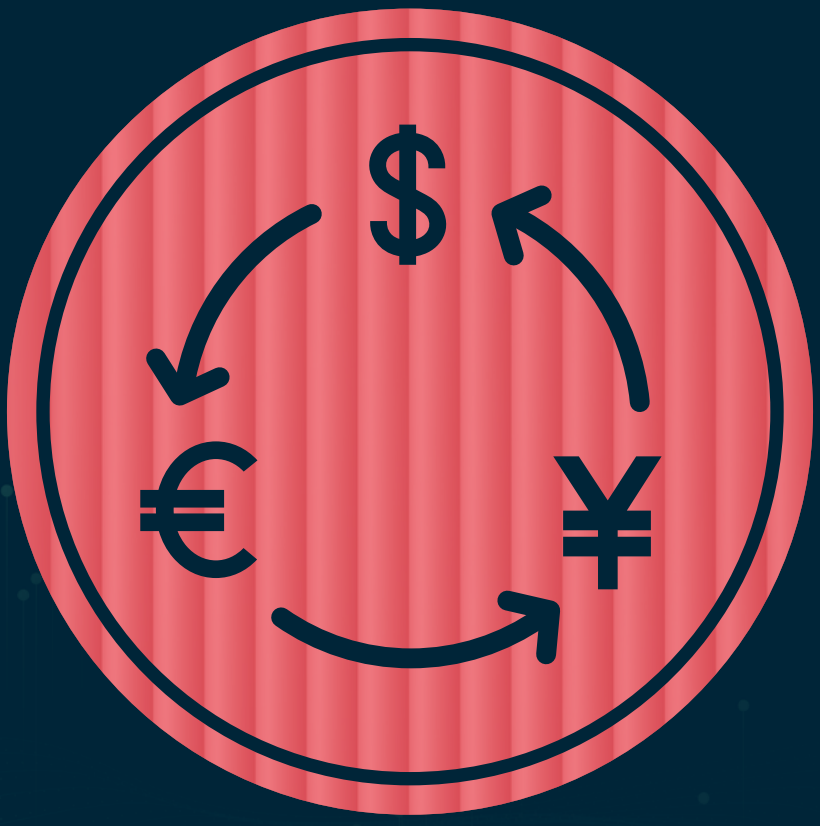
UNLOCKING THE POTENTIAL OF

# INTERNATIONAL FINANCIAL INSTITUTIONS

IN THE

# CIRCULAR ECONOMY TRANSITION



A high-level roadmap

CIRCLE ECONOMY

Ministry of Infrastructure and Water Management

## ABOUT THIS PAPER AND THE IFI EXCHANGE NETWORK

This roadmap proposal is the culmination of six months of collaboration with an IFI exchange network. The network, commissioned by the Dutch government and developed by Circle Economy, hosts content specialists from: the Ellen MacArthur Foundation, Chatham House, UNEP-FI, and the Dutch Ministry of Infrastructure and Water Management, alongside technical representatives of major international financial institutions and private banks (acting in their own capacity), all of whom work directly on the circular economy strategy of their respective institutions. Over a series of working sessions, the group convened to discuss the opportunities, bottlenecks and best practices in financing circular projects—and the key actions required to address them. The inclusion of the private sector perspective was invaluable, as its approach to financing the circular economy is often the most advanced.

Although these discussions formed the basis for this high-level roadmap— as this was first an endeavour to unify the experience and viewpoint of many parties—the suggested milestones and objectives have been deduced and positioned by Circle Economy. This high-level roadmap should spur further debate and fine tuning, with the expectation that it can develop into a widely supported and actionable roadmap. The release of this work initiates the development of a formal IFI roadmap for financing the circular economy, which will expand to engage private institutions to follow a similar path. The proposed future steps are formulated in the final chapter; Call to action

### LIST OF ABBREVIATIONS

| | |
|---|---|
| GHG | Greenhouse gas |
| HIC | High-income country |
| IFI | International financial institution |
| LIC | Low-income country |
| MDB | Multilateral development bank |
| MIC | Middle income country |
| SDG | Sustainable Development Goal |
| UN | United Nations |
| WEF | World Economic Forum |



# CONTENTS

# EXECUTIVE SUMMARY

The circular economy is a crucial instrument in optimising resource use to fulfil the needs of society. In this way, the model is key in mitigating the worst impacts of environmental change, such as rising greenhouse gas (GHG) emissions and biodiversity loss, where a large proportion of both are tied to material use and handling. To drive the transition to a global circular economy at the speed and scale necessary, transnational cooperation and significant targeted investment are fundamental—thereby highlighting the critical role of international financial institutions (IFIs).

Today, IFIs face a number of challenges in financing circular projects effectively. Aside from still being an emerging topic for IFIs, the circular economy is typically seen as separate to traditional sustainable development methods—or worse, as a tool only for rich countries. Ultimately, it attracts less funding than other approaches. This is also due to a lack of demand for circular funding from clients in national agencies of low-income countries (LICs) and middle-income countries (MICs), where extractive-led growth has largely dominated development approaches—thereby marking circularity as a considerably different approach. When funds are allocated for circularity, the absence of international standards, alongside a lack of awareness of the topic among both strategic and client-facing staff, renders it difficult to prioritise circular projects.

This paper presents a high-level roadmap for IFIs to ignite and fund the circular economy transition. Moreover, the paper highlights the need for collaboration between IFIs and private banks to strengthen the financial ecosystem. Both IFIs and private banks participated in the development of this roadmap, which is structured around four main goals:

1. **Link circularity to the environmental objectives** to ensure that the circular economy becomes both a standalone objective and a critical tool in alignment with the goals of the Paris Agreement.
2. **Improve assessment methods for circular economy investments** so that high-impact circular projects can be identified and compared effectively and at scale, and that circular assessments become the default in lending and investment practices.
3. **Build internal capacity for the circular economy transition** so that it is embedded in operations as a means to achieve both economic success for countries and partners, and as a systemic approach to meeting environmental objectives.
4. **Develop mechanisms to de-risk investments and improve funding for the circular economy** that leverage public-private collaboration.


LINK CIRCULARITY TO THE ENVIRONMENTAL OBJECTIVES

IMPROVE ASSESSMENT METHODS FOR CIRCULAR ECONOMY INVESTMENTS

BUILD INTERNAL CAPACITY FOR THE CIRCULAR ECONOMY TRANSITION

DEVELOP MECHANISMS TO DE-RISK INVESTMENTS AND IMPROVE FUNDING

*The high-level roadmap visualises the suggested objectives that are detailed in this whitepaper.*

# 1 - INTRODUCTION

## 1.1 UNDERSTANDING THE POTENTIAL OF THE CIRCULAR ECONOMY

The formation of the Sustainable Development Goals (SDGs) in 2015, upon the signing of the **Paris Agreement**, confirmed the recognition of the circular economy as essential to addressing the root causes of multiple cross-cutting sustainability challenges.[1] The agreement stated that extractive-led growth has been detrimental to the environment and that fundamental changes in resource use would be imperative to limit global warming to a 1.5°C temperature rise.

A **circular economy** is restorative by design[2] and, if implemented well, will reduce resource depletion and greenhouse gas (GHG) emissions significantly.[3,4] The circular economy promotes resources being used in continuous cycles: waste is designed out, materials' value is preserved at its highest level and natural systems are regenerated.[5] The primary result from organising production and consumption in this way is a reduced need for virgin (new) materials, thereby relieving **resource shortages**. A second outcome is a reduction of GHG emissions throughout supply chains—especially in the case of heavy industry[6] therefore contributing to **climate change mitigation**. Finally, there are demonstrable reductions in biodiversity loss associated with a circular economy.[7]

## 1.2 THE ROLE OF THE FINANCIAL SECTOR

The **financial sector** can be a major driver for economic change thanks to its ability to steer development through the **mobilisation and direction of financial flows**.

At some banks, a previously dominant 'tunnel vision' regarding carbon emissions (carbon monetisation) is lifting as they explore nature-based solutions, for example. But many factors remain that prevent financiers from making informed investment decisions for *circular*-focused investments. Experience is limited and proof of concept is often unavailable, which increases the perceived risk, hence a better understanding of risk management in the circular economy is key. Moreover, circular projects tend to pay-off in the long run and generate a combination of financial, societal and environmental value, instead of financial profits in the short run. Also, in the absence of widely adopted assessment and due diligence frameworks, there is no unified understanding of the **potential value and risks** associated with circular projects, and nor is there a unified approach to financing them. For the financiers that attempt to apply circular assessment methodologies, data availability is a significant barrier. These factors restrict the mobilisation of capital for a circular economy.[8,9,10]

## 1.3 THE ROLE OF INTERNATIONAL FINANCIAL INSTITUTIONS

To date, large-scale action and impact is lacking; further effort to shape policy, shift business practices, reallocate financial flows and address financing gaps is still required to decouple raw material use from economic development. This is especially true in **low- and middle- income countries** (LICs and MICs) where extractive-led growth is historically high.

**International financial institutions** (IFIs) are those that have been established by two or more national bodies that act as shareholders. This includes all multilateral development banks (MDBs), as well as other pooled development resources such as the International Monetary Fund (IMF) and the Global Environment Facility (GEF). Their **goal is to finance and implement development projects** within their respective focus regions and around the world.

In regions where processes of industrialisation are often still emerging, the circular economy provides an alternative approach to development that relies on new production capacities to avoid resource depletion and emissions from the outset. Countries that implement circular approaches can improve biodiversity conditions and maintain natural capital by mitigating virgin (new) material use, while less waste means reduced harmful pollution on land and in oceans. Building a development strategy with the circular economy as the foundation provides the blueprint for LICs and MICs to further **socio-economic progress in a regenerative and resilient way**.

However, in LICs and MICs, businesses and governments often lack the experience and access to capital required to initiate wide-scale circular economy projects. In these contexts, dedicated **technical advisory services**[11] and sizable **initial investment** are needed to kickstart new and/or scale existing projects with the support of private businesses. This emphasises the importance of IFIs.

Today, IFIs are seeking new funding directions that pivot away from extractive-led development[12] and towards impactful **circular projects** in LICs and MICs. Given the remit of IFIs, the overarching goal should be to help to restructure lower-income economies to accommodate circular activities that boost socio-economic development and climate-resilience. This will ensure that circular projects align with existing development agendas and help **de-risk** more commercial involvement, facilitating the necessary experience and market development to **mobilise private capital** to further engage.

This approach will require **strategic investment** in critical infrastructure projects - access to technology and technological development are foundational to delivering circular solutions, while as is focus on preventing upstream waste generation for critical materials such as steel, cement, and plastic. Many projects will involve value chains that span national borders. Fortunately, as multilateral public institutions, IFIs are uniquely positioned to oversee such engagements: providing **financing and advisory services** throughout value chains and **facilitating strategic collaboration** between national governments, donors and private financiers.

Though remaining aware of the crucial role that **government policy** and **regulatory change** hold in both empowering finance for sustainable development and in the circular economy more generally, such changes are not included in this proposal. Besides underwriting the need for policies that create incentives for businesses and financial sector participants to focus their attention on circular projects, the topic of governmental policy remains outside the scope of this work.

## 1.4 A HIGH-LEVEL ROADMAP FOR FINANCING THE CIRCULAR ECONOMY

This high-level roadmap was developed from the outcomes of the **IFI exchange network** (see text box for more information) that aimed to identify IFIs' experiences, challenges, opportunities and best practices in financing the circular economy transition. The scope of this work aligns with that of IFIs: focusing on providing both funding and advisory support to development projects, and almost exclusively in the context of LICs and MICs where they typically operate.

The following section details the four focus areas that can unlock the potential of IFIs in the circular economy transition. The proposal suggests objectives and milestones in each of these four areas that, if met, would make IFIs the catalyst for circular projects in LICs and MICs. These **four key focus areas** are:

1. **Link circularity to the environmental objectives**
2. **Improve assessment methods for circular economy investments**
3. **Build internal capacity for the circular economy transition**
4. **Develop mechanisms to de-risk investments and improve funding for the circular economy**

# 2 - MILESTONES FOR A HIGH-LEVEL CIRCULAR FINANCING ROADMAP

This section describes each of the four focus areas in more detail and suggests corresponding milestones. These milestones are meant as a topic for further discussion to be developed into a formal roadmap with specific timelines and goals.

## 2.1 LINK CIRCULARITY TO THE ENVIRONMENTAL OBJECTIVES

**Goal:** Make a concerted effort to sustain countries' transitions to a circular economy, leveraging the circular economy as a key tool to meet the objectives defined in the Paris Agreement.

**Description:** Today, a large majority of climate initiatives focus on the critical role of renewables and energy-efficiency, but research shows that energy-use only covers 30 percent of current emissions - the other 70 percent stems from production processes.[13] Meanwhile, more than 90 percent of all biodiversity loss stems from natural resource extraction and processing.[14] As such, the first goal of the roadmap should be to specify the link between the circular economy and the existing environmental objectives of IFIs, and to recognise the role that the circular economy can play in decarbonisation and the mitigation of biodiversity loss and pollution. By leveraging circular approaches as a systemic means to address the triple planetary crisis of climate change, pollution, and biodiversity loss, IFIs would be better placed to meet the environment objectives of the Paris Agreement and the topic would be given greater salience both within their institutions and their stakeholders.

**Proposed objectives to be developed:**

i. **Identify country-specific target sectors and high-impact value chains where circularity has wide systemic benefits**

   Identify the value chains where mitigating material use and waste has compounding environmental benefits. Focusing on the specific sectors that can bring other socio-economic benefits such as job creation, reduced supply volatility, and greater climate resilience would maximise the IFIs impact in LICs. Target sectors that can yield compounding environmental benefits are construction, automotive, agrifood and electronics.

ii. **Bolster assessments of key circularity metrics for all new investments**

   To understand the level of circularity in all projects, it is essential to develop and implement an assessment methodology to determine the level of material extraction, waste generation and material efficiency in existing portfolios and for new investments. To properly institutionalise circularity in the funding approach of IFIs, material extraction and waste—as two key indicators of circularity—should be integrated into the safeguard instruments of the IFIs, with the aim of raising the minimum requirement of circularity in every project or investment that IFIs undertake. The safeguards are in place to protect local communities and the environment when development projects are implemented by IFIs - including resource ambitious resource and waste limits here would ensure these concerns are applied to every project the banks undertake.

iii. **Assess the level of GHG emissions associated with material use for specified investments**

   Having developed an assessment methodology for resource use and waste per project, it is then necessary to understand the level of GHG emissions being emitted from these projects. Assessing the level of emissions for specified projects or funds, then seeking to understand the proportion of these attributed to resource use, would allow IFIs to properly calculate the climate effects of their circular economy projects. Given the complexity of this objective, this could be implemented using a tiered approach within the portfolio; if IFIs account for scope 3 GHG emissions in their assessments[15], this would encourage value chain partners to work more collaboratively to reduce resource use and GHG emissions. Several institutions have already committed to 'net zero', the environmental industry's global commitment, requiring science-based targets from its signatories to tackle greenhouse gas emissions within their organisations.[16]

iv. **Develop new transition support mechanisms**

   LICs and MICs suffer from a sizable investment gap regarding infrastructure, production capacity and technological innovation.[17] With regards to the circular economy specifically there is also a project pipeline gap: there is a lack of projects at the kind of scale where IFI financing makes sense. IFIs should develop specific transition support mechanisms to restructure economies to accommodate more circular economy endeavours, and this work should use advisory services as much as it does financing. Much of the focus in the coming years should be on providing the initial infrastructure required for the essentials of a circular economy, such as waste take-back and processing facilities. However, specific transition support should ensure that IFI operations de-risk investment opportunities in the circular economy, provide smaller-scale funding for regional and municipal projects, bolster advisory services throughout project lifetimes, and ensure more active collaboration with private sector actors to engage in projects too.

## 2.2 IMPROVE ASSESSMENT METHODS FOR CIRCULAR ECONOMY INVESTMENTS

**Goal:** Assess and identify high-impact circular projects effectively and at scale.

**Description:** To support the circular economy transition it is imperative that the most impactful projects can be identified swiftly and funded accordingly. To date, attempts to develop indicators, taxonomies, frameworks, and tools for assessing circularity have been pursued independently in different regions, and at the micro- and macro-levels. This has resulted not only in a lack of transferability when engaging in cross-border investment projects—but also when undertaking micro-level projects to meet macro-level targets. Standardisation is key so that circular economy projects can be better compared. IFIs can seek alignment in a shared vision of how they measure and report on circularity in their projects and portfolios, and then communicate clear and structured parameters of what they consider eligible criteria for sustainable—and more specifically circular economy—focused funding.

**Proposed objectives to be developed:**

i. **Align on the key definitions related to the circular economy**

   The first step to unify the circular indicator landscape will be to align on definitions for the most fundamental concepts. These include: *circular economy; circular business models* (recycling versus fully circular); and *resources* (i.e. critical raw material, substances of concern); *resource extraction/use/intensity/effectiveness*. This should lead to a shared set of definitions that is developed and supported by sustainability standards setters such as the International Organization for Standardization (ISO), Global Reporting Initiative (GRI), International Sustainability Standards Board (and its SASB standards), EU Taxonomy, and national standardisation organisations like the British Standards Institution.

ii. **Standardise a set of key performance indicators for assessing circularity**

   A structured approach to consolidating indicators for circularity is also lacking. As such, IFIs should work towards developing a standardised set of indicators and metrics to assess the level of circularity of focus regions, existing portfolios and potential investments. They can build on existing methodologies, such as the Circular Transition Indicators, Circulytics or the GRI standards and consult institutions such as the Circular Economy Indicator Coalition (CEIC) that create an overview of existing methodologies and support harmonisation and standardisation of definitions. A key obstacle to overcome in this process is the lack of data. Regional differences must also be considered when measuring and comparing circularity. For instance, the nature of industries may vary greatly between countries as well as the extent to which data are readily available. In regions where data collection is less common, efforts to build the data management capacities of local businesses may be needed.

iii. **Harmonise taxonomies for classifications in the circular economy**

   In the absence of a globally recognised circular economy taxonomy, some IFIs have worked with local development banks and private banks to create region-specific taxonomies that streamline circular financing in those areas. The finalisation of the EU Taxonomy and specifically the European sustainability reporting standard on circular economy (ESRS 5) will provide direct clarification for the European region. IFIs should collaborate across regions to harmonise taxonomies as much as possible, potentially even developing a globally supported taxonomy. For the finance sector as a whole, aligning classifications on the circular economy will aid the uptake of circular solutions considerably, reducing the barriers to cross-border financial flows.

iv. **Report the circularity of investment portfolios**

   Successful completion of points (i), (ii) and (iii) would ensure that reporting on circularity became significantly easier for IFIs. IFIs could go beyond the requirements of the Paris Agreement by reporting the level of circularity of their investment portfolios as standard. Quantifying the impact that the IFIs' circular projects have on GHG emissions would improve transparency considerably, setting a precedent for the private sector and differentiating the circular champions from the laggards. This level of assessment and transparency will drive further circular action on the side of businesses and will enable IFIs to engage with stakeholders that do not adhere to the benchmarks. A final measure can be to divest from unnecessary extractive projects that do not show progress towards circularity.

## 2.3 BUILD INTERNAL CAPACITY FOR THE CIRCULAR ECONOMY TRANSITION

**Goal:** The circular economy is considered to be a critical topic in IFIs' development strategies and is embedded in operations as a means to achieve both economic success for countries and partners and as a systemic approach to meeting environmental objectives.

**Description:** To promote engagement with the circular economy as a key funding direction it is necessary to build greater understanding and awareness of the topic to build internal capacity and competencies. This is most critical with top level management of IFIs, and so specific strategies should be developed to detail the multi-faceted benefit of circular projects to key decision-makers at the IFIs. Client-facing staff are also not often familiar with circular strategies, opportunities and risks, and so concerted efforts should be made to address this within IFIs, and to support value chain partners and private sector actors to do the same. This should be a simple and convincing story about the opportunity provided by the circular economy to mitigate resource risk while impacting both socio-economic and environmental objectives.

**Proposed objectives/milestones to be developed:**

i. **Build an advocacy strategy for involvement in the circular economy**

   It is critical that the circular economy becomes an embedded part of IFIs' development strategies. To ensure this happens, a concerted advocacy strategy should be developed within banks. Given that few existing commitments exist with a focus on circularity, it is not yet considered a priority by top management. IFIs can show internal and external leadership by shifting the strategic focus of their institutions so that the circular economy is recognised as an important standalone issue—as well as a strategic tool to reach other developmental objectives such as Net-zero and Paris alignment commitments. Only this way will circular projects be substantially resourced by IFIs.

ii. **Provide internal training on the circular economy**

   The role of both client-facing staff and investment analysts in financial institutions should not be overlooked. The circular economy represents a considerable paradigm shift compared with traditional theories of development where the approaches are well understood, and metrics of value and success are more evident. To circumvent the alienation that staff may feel when faced with the novelty and complexity of circular assessments, IFIs should offer internal training on the relevance of the circular economy to their mission. This should be in terms of both the economic dimension (new growth opportunities, de-risking and increased resilience) and in regards to social and environmental impact. This knowledge can finally be transferred to clients, to help them identify where circular economy can be implemented in their processes.

iii. **Recognise circularity in their mission statement**

   The most logical and impactful way for IFIs to embrace the circular economy in their funding, advisory services and internal operations is to communicate this as a core objective of the institution. IFIs' value or mission statements should acknowledge the role of the circular economy in furthering their development agenda. A next step could be to include internal targets, for instance relating to the total turnover of loans and investments relating to the circular economy.

iv. **Mainstream circular economy objectives across strategies, investments and technical support**

   It is important that the circular economy is not seen as something entirely new or separate. The circular economy is sometimes considered a 'new sector' of our economy that entails new actors. We propose taking the perspective of circularity not being a new sector, but a new economic rationale that is applicable to all sectors. This shows the level of ambition of the circular economy transition, in which all economic entities, new and old, small and large, will have to rethink their production and consumption processes. When making this actionable, it means the logical starting point is the current situation. Companies and financial sector participants alike can get started on understanding the circular economy concept, strategies and tools to support in order to make circular economy a cornerstone of their strategies, investments and technical support. Ultimately, financial institutions could measure and disclose the percentage of circular economy investments on their balance sheet.

## 2.4 DEVELOP MECHANISMS TO DE-RISK INVESTMENTS AND IMPROVE FUNDING FOR THE CIRCULAR ECONOMY

**Goal:** New financing instruments are developed - that consider risks and securities of circular projects - to support circular initiatives more effectively.

**Description:** Access to finance is a catalyst for innovation and progress in key sectors. It is important to make distinctions as to which types of financing are most effective in given situations. As well as making existing approaches more effective, innovative new financing instruments will be required that suit circular projects that are characterised by retaining control over resources, increased collaboration in the value chain and the development of new markets for circular products and supporting technology and services. To ensure sufficient funding becomes available against reasonable rates, de-risking is needed.

**Proposed objectives/milestones to be developed:**

**i. De-risk circular economy investment**

Circular economy projects are characterised by more long-term value generation and (often) less short-term profit. Understanding the risks and securities of such projects is key. Due to the newness on the one hand, and a lack of level playing field on the other hand, investing in circular projects is often considered high risk for financiers. To de-risk investments, both policy instruments and financial instruments are needed. *Policy de-risking instruments* can create a level playing field and may include further extending producer responsibilities, design- and material composition policies, taxation reforms and green investment policies. Financial de-risking instruments can help transfer some of the risks that investors face to public actors, such as governments and IFIs. Loan guarantee schemes, political risk insurance, public equity co-investments and public-private blended finance initiatives could be mechanisms to de-risk circular investments and engage more private sector finance for circular projects. Transition finance is needed to bridge the gap between current financing structures and new circular projects for which sufficient historical data or a proof of concept is lacking.[18,19,20]

**ii. Develop strategic public-private partnerships for circular financing**

To further develop circular financing mechanisms, IFIs should collaborate more with the private financial sector and policymakers. Such collaboration should actively support the development of special agreements, (public) grant funding and public warranties and thematic bonds, such as transition bonds or circularity linked bonds. Such a collaboration would also provide opportunities for exchange, as well as help to develop strategic partnerships between IFIs, local agencies, and private actors throughout the value chain. This could promote the further uptake of definitions and indicators and spur widely accepted benchmarks of circularity in loan and investment criteria. Moreover, financial sector participants should urge governments to formulate and implement the aforementioned de-risking policy measures thereby creating the level playing field that circular projects need in order to be competitive.

**iii. Set up a global circular economy fund**

IFIs could set up a global circular economy fund, resourced by bilateral donors and designed to support and incentivise country-level reforms with wide transnational implications. The fund could be leveraged for critical infrastructure innovations in waste management, manufacturing, and food systems, helping to close resource loops while supporting market development and new trade opportunities. Given the demonstrable influence of circular strategies on the SDGs, the dedicated circular economy fund would align with the existing sustainable development objectives of IFIs.

# 3 - CALL TO ACTION

## 3.1 COLLABORATION AND CONTINUATION

The milestones and objectives in this proposed roadmap represent a new frontier in development finance and the utilisation of circularity in such. The scale and effectiveness of circular financing is still in its infancy, but the initial action taken by IFIs has the potential to attract significantly more financial resources from private actors who do not currently see LICs and MICs as a viable investment landscape in terms of circularity.

Fundamentally it requires agenda setting from **top-level management**, who can provide more resources to the financing of the circular economy transition. IFIs and private financial sector participants should explicitly **link their circular economy goals to their net-zero commitments or Paris alignment commitments** as funding circular economy projects offers a major part of the solution.

While the challenges detailed throughout this proposal were explored in collaboration with representatives from IFIs and private banks, the roadmap designed to address them has been compiled by Circle Economy. Circle Economy, along with the Dutch government who have commissioned this work to date, will **continue to seek commitment from IFIs, private banks and supporting governments** in formalising the roadmap for financing the circular economy into more specific milestones, activities and timelines.

## 3.2 NEXT STEPS

i. **Continue the IFI circularity** exchange network to carry this initiative forward, with IFIs taking a more active role in developing the high-level roadmap presented in this paper towards formulating an actionable **detailed roadmap.**

ii. **Consider existing exchange mechanisms** between the IFIs that can be leveraged for this initiative and ignite closer collaboration on the roadmap and its milestones to present it to the G20 for endorsement.

iii. **Support financial institutions' agenda-setting** to increase the internal capacity of both IFIs and private financial sector participants to commit to the roadmap.

iv. Create a mechanism for continued **engagement between private sector actors and IFIs** to develop the circular economy in LICs and MICs, with the potential to create an interlinking private sector roadmap.

v. Leverage the position of IFIs to make recommendations and i**nfluence the policy landscape** towards designing and implementing policies that create a level playing field. This also includes understanding what subsidies governments are currently providing that support linear business models versus circular business models and how this is factored into the financing analysis.



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