



The Role of Multilateral Development Banks in Closing the Climate and Energy Transition Finance Gap

Report from the Climate and Energy Transition Finance (CETF) Project Team

PREFACE

The central tenet of the Bretton Woods Committee is that multilateral cooperation and coordination lead to better outcomes than noncooperation and competition. That principle applies not only to the global financial architecture—which includes the activities of the International Monetary Fund (IMF) and the World Bank—but also to newer realms: the emerging digital finance ecosystem and finance for climate action and the energy transition.

For this reason, the Committee has established the Future of Finance Working Group and its two project teams—the Digital Finance Project Team and the Climate and Energy Transition Finance (CETF) Project Team—to tackle each of these issues.

The CETF Project Team covers a broad scope of climate finance issues, ranging from the specific role of the multilateral development banks (MDBs) to the challenge of reforming and coordinating the wider international financial system to debt distress in low- and middle-income (LMI) countries.

We are examining these questions in the context of the cumulative climate, health, energy, and inflation crises. Those crises have put enormous pressure on advanced and developing economies alike over the past three years and have led to growing calls for a fundamental rethinking of how the system for multilateral development finance works.

The CETF team's mission is to tackle the urgent question of how to close the current vast gap in financing climate action and the energy transition, encouraging mitigation, and boosting adaptation, particularly in LMI countries.

It plans to publish briefs designed to explain the key issues, assess possible routes of action, and recommend practical solutions. It plans to publish briefs designed to explain the key issues, assess possible routes of action, and recommend practical solutions.

In carrying this work forward, the CETF team has followed the current debate on MDB reform, including the proposals put forth by multiple groups, including IPCC, IEA, and the Bridgetown Initiative,¹ the preparations ahead of the Summit for a New Global Financing Pact to be hosted by French President Emmanuel Macron last June,² as well as the G20's call for, "better, bigger and more effective Multilateral Development Banks."³ These ideas are expected to be further developed at the World Bank–IMF Annual Meetings in Morocco (October 9–15), and COP28 in Dubai (beginning November 30), among others.⁴ The CETF Project Team is also factoring in broader themes that motivate both developed and developing economies, such as the urgent quest for energy security and the response to rising geopolitical tensions.

This first brief examines the **specific role of MDBs in closing the gap in climate and energy transition finance**. How can the MDBs' contribution—either direct or indirect, via leveraging private finance and philanthropies—be enhanced quickly and effectively? How can this be achieved while protecting the other essential roles of MDBs in provision of development finance? And what will it mean for MDBs' relationships with other institutions that provide private and public climate finance—such as the United Nations' Green Climate Fund and Global Environment Facility (GEF), and the IMF's Resilience and Sustainability Trust (RST)?

Context

In the Intergovernmental Panel on Climate Change's latest AR6 Synthesis Report,⁵ scientists have highlighted the urgency of making more rapid progress to address the causes and impacts of climate change, some of which are already determined as part of our planet's future.

Efforts to control greenhouse gas emissions ("mitigation") will increasingly focus on developing countries. Whereas developed economies have historically contributed 70 percent of the global stock of greenhouse gases, developing economies will contribute more emissions as their economies grow and they require more energy. Emissions from China

and India have more than doubled since 2005 and accounted for 32 and 7 percent of global CO₂ emissions, respectively, in 2021, with China leading the world in emissions.^{6,7} The world's fastest-growing economies must have access to reliable renewable energy if there is to be any hope of fighting climate change successfully.

In addition, low-income economies, which have made only a very small contribution to greenhouse gas emissions to date, typically face the biggest challenges in responding to the impacts of climate change that are already predetermined ("adaptation"). This reflects not only the scale of their needs but also their very limited access to private finance.



Box 1. The immediate impact of the climate crisis.

Cedeño, Honduras, is a small fishing village on the Pacific Gulf of Fonseca—which is shared by Honduras, El Salvador, and Nicaragua. Cedeño has steadily and systematically been swallowed by the rising sea. As a local nongovernmental organization has documented, the gulf has advanced 105 meters (344 feet) into Cedeño in the last 17 years, flooding everything from homes to the primary school to soccer fields where children once played.

"The sea is advancing," Telma Yadira Flores, who lost her home, told the AFP recently. "If the sea comes again, we will have to move. We will have to see where."*

That fate, shared by Cedeño's 7,000 residents, is mirrored on every continent. The United Nations estimates that 900 million people—1 in 10 people on earth—live in low-lying areas at risk from sea level rise.

Sea level rise is only one catalyst of climate migration. The UN Refugee Agency estimates that extreme heat, pervasive wildfires, torrential floods, and crippling drought have forced 21.5 million people from their homes each year, on average, since 2008.† The World Bank estimates that by 2050, 216 million people across six regions will be forced to move within their own countries.‡

¹Victoria Masterson, "The Bridgetown Initiative: Here's Everything You Need to Know," World Economic Forum, January 13, 2023, <https://www.weforum.org/agenda/2023/01/barbados-bridgetown-initiative-climate-change/>.

²"Summit for a New Global Financing Pact: Towards More Commitments to Meet the 2030 Agenda?," Focus 2030, June 9, 2023, <https://focus2030.org/Summit-for-a-New-Global-Financing-Pact-towards-more-commitments-to-meet-the-2030-Agenda/>.

³G20 New Delhi Leaders' Declaration, September 10, 2023, https://www.g20.org/content/dam/gt2023/gt2023_new/document/G20-New-Delhi-Leaders-Declaration.pdf.

⁴Alongside efforts to increase public international climate finance is a parallel effort to ensure that private financial institutions take into account the implications of climate change for financial risk (e.g., through the work of the Network of Central Banks and Supervisors for Greening the Financial System, or NGSF) and respond to the vast requirement for additional finance to achieve net zero (e.g., through the Glasgow Financial Alliance for Net Zero, or GFANZ).

⁵Intergovernmental Panel on Climate Change, Climate Change 2023: Synthesis Report (Geneva: IPCC, 2023), <http://dx.doi.org/10.59327/IPCC/AR6-9789291691647>.

⁶See the interactive chart titled "2021 Fossil CO₂ Total Emissions" at EDGAR (Emissions Database for Global Atmospheric Research), accessed August 15, 2023, <https://edgar.jrc.ec.europa.eu/>.

⁷It should, however, be noted that some of these emissions result from the production of goods exported to, and consumed in, Western economies.

* "Rising Seas Eating Away at Honduran Fishing Village," France 24, March 1, 2023, <https://www.france24.com/en/live-news/20230301-rising-seas-eating-away-at-honduran-fishing-village>.

† "Frequently Asked Questions on Climate Change and Disaster Displacement," UNHCR UK, November 6, 2016, <https://www.unhcr.org/uk/news/latest/2016/11/581f52dc4/frequently-asked-questions-climate-change-disaster-displacement.html>.

‡ Viviane Clement, Kanta Kumari Rigaud, Alex de Sherbinin, Bryan Jones, Susana Adamo, Jacob Schewe, Nian Sadiq, and Elham Shababat, Groundswell Part 2: Acting on Internal Climate Migration (Washington, D.C.: World Bank, 2021), available at Open Knowledge Repository, <https://openknowledge.worldbank.org/entities/publication/2c9150df-52c3-58ed-9075-d78ea56c3267>.

The scale of global financing required to meet mitigation and adaptation needs is vast, and current financing falls well below the necessary levels.

There are a wide range of estimates over different time frames of overall climate financing needs. But in all cases the estimated shortfall is very large. For example, according to a November 2022 report from the Rockefeller Foundation and Boston Consulting Group (BCG), “To achieve net zero, public and private sector entities across the globe will need approximately \$3.8 trillion in annual investment flows [equivalent to 3.8 percent of global GDP] through 2025. But only a fraction of this capital is currently being deployed. Even when viewed with a wider lens that considers funding such as transition finance, expected needs still outweigh flows by 66%.”⁸

Energy transition projects alone will need a substantial amount of climate finance. While estimates for this component vary as well, it has been estimated that up to several trillion dollars annually in new investments is needed for this purpose through 2030.⁹

There are some encouraging signs in response to this challenge. For example, according to the Climate Policy Initiative, total annual financial flows for climate mitigation and adaptation increased by more than 70 percent between 2013/14 and 2019/20. Clean energy investment is now growing faster than fossil fuel investment. However, climate finance is overwhelmingly concentrated in China, Western Europe, and North America, which, according to the Rockefeller Foundation/BCG analysis, accounted for about 80 percent of investment flows in 2020.^{11, 12}

At the same time, the financing available for climate and energy transition finance in many low- and middle-income countries remains dire. According to the Rockefeller-BCG report “Excluding China from the computation, emerging markets and other developing economies will require about \$1 trillion in climate finance per year, or about one-third of global need—but data suggests that they are currently receiving only 27% of the necessary flows.”¹³

And investment pools receiving windfalls from the spike in hydrocarbon prices that followed Russia’s invasion of Ukraine are getting mixed messages from different shareholders on whether to invest in new hydrocarbon reserves or redeploy into renewable energy.

Moreover, the situation is most serious in the poorest countries, according to the World Bank. Looking at its recently completed Country Climate and Development Reports (a new core diagnostic report) for 24 countries, in March 2023 the Bank noted: “Financing needs for climate action across the 24 countries average 1.4% of GDP by 2030, but there are large differences across country income classes: 1.1% of GDP, on average, in upper-middle-income countries (UMICs), increasing to 5.1% in lower-middle-income countries (LMICs) and as much as 8.0% in low-income countries (LICs).”¹⁴

Much of the climate finance in developing economies is needed for **new or upgraded infrastructure** devoted to mitigation or adaptation.

Adaptation infrastructure in developing countries is generally closely related to other development needs. It is a public good with benefits spread widely across society and often has less certain and immediate returns than mitigation infrastructure, which means it typically requires a major contribution from public financing.¹⁵

The bulk of developing-country **mitigation projects** will be in a limited number of LMI countries with the potential to become huge emitters.

In both cases, the availability of private finance for projects—which may well involve new concepts, new locations, and new partners—is often limited by **investment “path dependency”** (i.e., conventional investment projects with established technologies and contractors are judged by investors to have lower risks and governance/transparency concerns than climate-related projects).

Adding to this challenge is the difficulty many private sector investors and philanthropists have in finding an

⁸ “New Rockefeller Foundation and BCG Research Reveals Size of Gap in Climate Finance” (press release), Rockefeller Foundation, November 4, 2022, <https://www.rockefellerfoundation.org/news/new-rockefeller-foundation-and-bcg-research-reveals-size-of-gap-in-climate-finance/>.

⁹ The International Energy Agency estimates clean energy investments of \$4.5 trillion annually are required up to 2030 to stay on track for net zero by 2050. This includes redeployment of investment that would otherwise be used for hydrocarbon energy sources. IEA, World Energy Investment 2023, <https://www.iea.org/reports/world-energy-investment-2023>.

¹⁰ Barbara Buchner, Baysa Naran, Pedro Fernandes, Rajashree Padmanabhi, Paul Rosane, Matthew Solomon, Sean Stout, Costanza Strinati, Rowena Tolentino, Githungo Wakaba, Yaxin Zhu, Chavi Meattle, and Sandra Guzmán, “Global Landscape of Climate Finance 2021,” Climate Policy Initiative, December 2021, <https://www.climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-2021/>.

¹¹ IEA, World Energy Investment 2023, 12.

¹² “New Rockefeller Foundation and BCG Research Reveals Size of Gap in Climate Finance.”

¹³ “New Rockefeller Foundation and BCG research reveals size of Gap in Climate Finance.”

¹⁴ World Bank Group, “What You Need to Know about How CCDRs Estimate Climate Finance Needs” (CCDR Explainer Series), March 13, 2023, <https://www.worldbank.org/en/news/feature/2023/03/13/what-you-need-to-know-about-how-ccdrs-estimate-climate-finance-needs>.

¹⁵ Gaia Larsen, Carter Brandon, and Rebecca Carter, “Adaptation Finance: 11 Key Questions, Answered,” World Resources Institute, October 25, 2022, <https://www.wri.org/insights/adaptation-finance-explained#:~:text=Mitigation%E2%80%99s%20focus%20on%20GHG%20>.

inventory of projects that are prioritized by rate of return as well as climate impact.

The availability of both public and private finance from global sources is further limited by the already high, and rising, incidence of sovereign debt distress in developing countries. Today, 39 low-income countries are at high risk of debt distress or are already experiencing it.¹⁶

For the poorest countries and those in debt distress, there is no realistic solution to climate finance needs involving only conventional public or private finance. Their needs will have to be met very largely through grant aid or deeply concessional funding, or both, at a time when many developed countries are holding steady—and even reducing—foreign aid.

The Role of MDBs in Climate and Energy Transition Finance

MDBs currently fill five main roles in delivering climate finance for adaptation and mitigation in developing countries:

1. Along with other international financial institutions (IFIs) and international organizations, MDBs contribute to improving the overall policy and technical know-how for marshaling climate finance. This includes supporting the creation of shared sustainable finance key performance indicators, improving data collection on the climate risk exposure of investments, strengthening accountability and transparency to protect climate finance flows, and including climate considerations in debt sustainability analyses and economic policy advice.
2. MDBs also lend directly to sovereign governments to finance individual projects and improve policy, sometimes in conjunction with other public funders. Such projects will deliver mitigation and adaptation outcomes and play a crucial role in improving the enabling environment for other publicly or privately financed projects. The scale of this lending partly depends on an MDB's overall lending capacity, which in turn is linked to the size and use of its capital base. But it also depends on the availability of suitable projects and the partnerships

and relationships with local governments.

MDBs' respective private sector arms, such as the World Bank Group's (WBG's) International Finance Corporation, the Inter-American Development Bank's IDB Invest, and others, lend directly to—and make equity investments in—private companies in developing countries. Public sector loans are also paired with private sector investments.

3. MDBs facilitate the provision of grant funds for climate action, through relevant financial intermediary funds (FIFs) and other avenues.
4. MDBs may underpin private financial flows to climate mitigation and adaptation projects by taking on some of the risks that the private sector is not willing to bear, whether through provision of insurance, provision of guarantees, or more complex risk-sharing arrangements.
5. MDBs may choose to promote innovative climate financing techniques in international capital markets by demonstrating what can be done (for example, the World Bank Treasury's pioneering green bond program, launched in 2010) and how to scale it. The World Bank Treasury has a long history of market innovations and a strong team of innovators.

Key Factors in Enhancing MDBs' Role in Climate Finance

In considering how MDBs can contribute to closing the climate finance gap, it is important to ask how their aforementioned functions can be reformed or enhanced, or whether the MDBs should take on entirely new roles.

Several factors need to be considered:

First, the **traditional model of MDBs—raising public international finance and allocating it to critical projects where private finance is either not available or requires policy enhancements to become viable—has many advantages.** In 2022, MDBs provided more than \$150 billion in funding for development projects, largely by issuing bonds on international capital markets underpinned by their capital base and triple-A ratings.¹⁷ A key constraint in scaling up this model to close the climate financing

¹⁶ World Bank, Debt Sustainability Analysis (Washington, D.C.: World Bank, 2023), available at <https://www.worldbank.org/en/programs/debt-toolkit/dsa>

¹⁷ Report to Congress from the Chairman of the National Advisory Council on International Monetary and Financial Policies, US Department of the Treasury, June 2023, <https://home.treasury.gov/system/files/206/2023-NAC-Report-US-Treasury.pdf>.

gap is the lack of political consensus on providing additional capital to MDBs among US and some other leading shareholders. Nonetheless, there is a strong case for doubling down on the traditional model, alongside other enhancements. The opportunity cost for doing so is limited, as the outcome from providing additional capital can be viewed as a win-win situation for all concerned.

Second, there are **important and distinct structural features in climate and energy transition projects.**

As mentioned earlier, mitigation projects are generally easier to finance through private sector channels than adaptation projects as they are more easily designed in a manner that generates attractive financial returns.

In 2021, MDBs committed more than \$50 billion in public climate finance to LMI countries, with 65 percent of those commitments toward mitigation finance.¹⁸ While that is a significant amount in absolute terms, it falls far short of what is needed to close the climate finance gap in developing economies described earlier.

In a world where global public finance is scarce, it is essential to focus the funds that are available on situations where they have the highest impact, including where private finance cannot be readily deployed. In practice this will mean the MDBs undertaking both adaptation and mitigation projects, though the former may require low- or zero-cost public finance in the form of International Development Association (IDA) loans or grants or the use of surplus Special Drawing Rights (SDRs). MDBs may choose to finance mitigation projects to achieve policy improvements or demonstration effects, which create long-term conditions for much larger flows of private finance for climate and the energy transition.

Third, MDB finance is characterized by important, unique features, including preferred creditor status and the ability of MDBs to lend to countries in arrears under certain circumstances. Such features mean that MDBs may play a unique role in kick-starting climate finance projects in countries that are otherwise constrained by debt distress.

Fourth, it is important to keep the global financing architecture for climate action as transparent and straightforward as possible. MDBs suffer from relatively high degrees of bureaucracy. Multiple layers

in several organizations may duplicate each other's work. Excessive complexity undermines MDB donor and shareholder confidence if the latter group cannot see what their resources are being used for or track the impact. At times, there may be no choice but to add complexity to the architecture. For example, while the IMF's Resilience and Sustainability Trust (RST) took the IMF into an entirely new field—20-year development finance—this was arguably politically or technically unavoidable, given that the underlying resources came from surplus SDRs. However, as far as possible, it is important to ensure that the roles of different institutions within the international architecture are as well defined as possible and fall within an easily understood framework.

Fifth, it is critical, even as the MDBs expand their role in climate finance and climate action, to **safeguard MDB's other important roles.** Climate change is an existential crisis, and the financing needs are vast. But enhancing the MDBs' role with regard to climate change must not prevent them from doing other things that member countries regard as important—such as lending in pursuit of the Sustainable Development Goals (SDGs) and pandemic preparedness and response.

This tension may be partly addressed by the deep and growing links between climate change and other development objectives, and the fact that many projects have important “co-benefits.” This makes the concept of “additionality” (i.e., that aid and finance for climate action should be in addition to that provided for other development purposes) difficult to implement in practice. But it remains important that the shareholders and management of MDBs ensure adequate attention to both climate and non-climate objectives.

Overall, the CETF Project Team takes the view that MDBs can and should play a substantially larger role in closing the climate and energy transition financing gap; however, they cannot be expected to take on the entire responsibility.

Recommendations

The CETF Project Team makes the following recommendations for urgent action to expand the contribution of MDBs to closing the climate and energy transition finance gap.

¹⁸ 2021 Joint Report on Multilateral Development Banks' Climate Finance (October 2022), <https://publications.iadb.org/publications/english/viewer/2021-MDB-Joint-Report.pdf>.

1. Lend more: Increase MDBs' public lending capacity as much and as quickly as possible

Accomplishing this should be done through two main routes:

First, increase the MDBs' capital base through further conventional capital raising from shareholders. This requires strong political leadership and can be justified on the grounds that the traditional model is fundamentally sound and that MDBs have a unique role in climate finance. Those opposing further capital allocations to the MDBs should urgently reconsider their position, while those in favor should step up their efforts to make a positive case.

Second, move quickly to (1) review and implement as many as possible of the recommendations of the **Independent Review of Multilateral Development Banks' Capital Adequacy Frameworks** commissioned by the Indonesian Presidency of the G20¹⁹ and (2) deploy a new mechanism to **channel remaining surplus SDRs** from the 2021 global allocation directly to MDBs. It is critical, however, that the Capital Adequacy Frameworks (CAF) recommendations are seen as a starting point for MDB financing reforms. Further work is needed to consider the implications of the proposals for the MDBs' financial structure and access to capital markets.

2. Lend prudently, but much faster: Dramatically increase the speed with which MDB climate finance is provided

There is scope to improve the attractiveness of MDB climate finance for recipient countries by making lending processes faster and less bureaucratically onerous (without weakening essential safeguards). This is critical, given the need for urgent action in response to climate change.

At the World Bank, the timeline from project inception to loan disbursement has ballooned, in recent years in some cases by up to seven years.²⁰ From the data available, World Bank project loan disbursement takes five to 10 years, while policy loans take one to two years to disburse. A relative lack of MDB project loans—which are key to climate-related infrastructure—may reduce the impact of MDB lending in reducing path dependency in private climate finance as there are fewer demonstration projects.

The CETF team therefore recommends that MDBs set a target of shortening the average period from climate finance project inception to loan disbursement to 12 to 18 months and commit the additional resources to make this possible while not jeopardizing asset quality.

3. Build local capacity

The MDBs should also put as much emphasis as possible—through their project and policy lending—on developing **local skills** in climate finance, project preparation, appraisals, and related risk management and on fostering **domestic public and private sources of climate finance**. Such work inevitably takes time, but it will be critical to closing the climate finance gap on a sustainable basis.

4. Innovate the model: Set up a new Climate Action Accelerator within the WBG to dramatically increase the scale, speed, and impact of the WBG's climate financing

In fiscal year 2022, the WBG, based on its own definitions, delivered \$31.7 billion to help countries address climate change, the highest figure to date. This represented a 19 percent increase over the previous fiscal year. It also represented 36 percent of total WBG financing, while nearly half of the lending supported investments in adaptation and resilience.²¹

¹⁹ Boosting MDBs' Investing Capacity: An Independent Review of Multilateral Development Banks' Capital Adequacy Frameworks (2022), https://www.dt.mef.gov.it/export/sites/sitodt/modules/documenti_it/news/news/CAF-Review-Report.pdf.

²⁰ Eeshani Kandpal, Julia Kaufman, and Janeen Madan Keller, "The World Bank Should Harness Evidence to Deliver Greater Impact," CGD Note, June 2023, <https://www.cgdev.org/sites/default/files/world-bank-should-harness-evidence-deliver-greater-impact.pdf>.

²¹ World Bank, "10 Things You Should Know about the World Bank Group's Climate Finance" (factsheet), September 30, 2022, <https://www.worldbank.org/en/news/factsheet/2022/09/30/10-things-you-should-know-about-the-world-bank-group-s-climate-finance>.

The CETF Project Team recognizes that the WBG has improved its performance on climate finance in recent years, but it believes in a further step change to dramatically increase the scale, speed, and impact of the Group's climate financing, as well as to clarify definitions of what fits into the climate category. This reflects both the size of the overall climate financing gap facing low-income and emerging economies and the evidence of areas where reform is needed.

To accomplish this, the CETF team recommends that the WBG establish a new climate unit to be housed within the Group and known as the Climate Action Accelerator, or WBG-CAA.

The new unit would have the lead responsibility for coordinating all the WBG's climate finance activities (covering mitigation, adaptation, project and policy lending, debt, and equity in LMI economies) and would be tasked with bringing a much sharper strategic and financial focus to the Group's climate activities. It would draw on the World Bank's traditional strengths but also bring in additional expertise and act quickly to streamline practices and approaches; it may also facilitate lifting some of the current financial constraints on the Bank's climate activities through, for example, greater use of "hybrid capital."²²

See Box 2 on the following page for further details of the WBG-CAA's responsibilities and financial and organizational structure. Although this may not be as radical as some of the World Bank reform proposals currently being debated, it is designed, in the context of current geopolitical tensions, to deliver substantial benefits while being politically realistic and therefore quick to implement. Certain aspects would need board endorsement, but most of the changes required should fall substantially within the remit of President Banga.

Through the creation of this new accelerator unit, the Bank would be able to begin reforming the financial and institutional structure designed for the International Bank for Reconstruction and Development at the end of World War II and added to piecemeal subsequently. It would also help the Group prioritize reform in those activities with the highest climate impact. Many MDB projects have important climate co-benefits; however, there is a risk that too much effort will go into refining or promoting the climate benefits of existing lending programs (albeit

with such co-benefits) rather than developing new projects with high mitigation and adaptation impact and where MDB intervention is needed to get them off the ground.

Many of the innovations developed in the WBG-CAA might also be suitable for adoption in the whole WBG; however, given lengthy time horizons, a strong case exists to undertake these reforms first in relation to climate finance, where there is a very high degree of urgency.

5. Provide more help managing risk: Increase MDB risk management services and risk management capacity for countries unable take on complex risks themselves

In contrast to MDBs themselves, many low-income countries lack the technical capacity to manage foreign exchange currency exposures. Moreover, local currency exposure would help recipient countries manage potential climate shocks, since their financial obligations would not be as sensitive to sharp reductions in the exchange rate following an extreme weather event. MDBs should therefore take concerted steps to increase the share of the funding they provide in local currency.

Greater use of equity finance may also help low-income and emerging economies improve their economic and financial resilience. However, cross-border equity finance raises sovereignty concerns in recipient countries and further work is required on how public financial institutions may support the cost-effective scaling up of equity finance for climate mitigation and adaptation.

6. ...including working with the private sector: Expand MDB risk sharing arrangements with the private financial sector, while ensuring value for money

In addition to the risk reduction MDBs can offer the private sector through the traditional "halo" effect of their lending, scope may also exist for MDBs to

²² World Bank, "World Bank Announces New Steps to Add Billions in Financial Capacity" (factsheet), July 17, 2023, <https://www.worldbank.org/en/news/factsheet/2023/07/17/world-bank-announces-new-steps-to-add-billions-in-financial-capacity>.



Box 2. A new Climate Action Accelerator within the World Bank Group

The purpose of the proposed World Bank Group Climate Action Accelerator (WBG-CAA) is to dramatically increase the scale, speed, and impact of the Group's climate financing.

Operationally, the new unit would:

- have lead responsibility for **coordinating all the WBG's "high impact" climate finance activities** (covering mitigation, adaptation, project and policy lending, debt, and equity in LMI economies);
- play a leading role, including working with the Group's Treasurer, in (a) ensuring that existing **capital allocated to climate finance** is deployed as effectively as possible, and (b) raising **additional capital** for climate finance from shareholders, other donors and entirely new sources;
- develop new **"fast track" procedures** for use in high-impact climate project lending across the WBG to cut average loan disbursement times to 18 months;
- develop and deliver **large-scale and/or "demonstration" climate mitigation and adaptation projects** at speed, while maintaining safeguards (e.g., anti-corruption);
- allocate funding to, and provide support for, high-impact climate finance projects run by World Bank **country teams** to be undertaken at speed;
- become the WBG's **center of expertise** on all climate finance-related issues, with staff recruited and seconded from other WBG units and the private sector; and
- maintain a **comprehensive database** of climate and energy transition projects—to be called IMPACTS (Investment Monitoring and Project Analysis for Climate Solutions)—which would enable WBG financing teams and private investors to search for projects by country, sector, impact, estimated rate of return, and risk profile.

In conjunction with establishing the WBG-CAA, the WBG would assess how much of its current asset portfolio and capital allocation is assigned to high-impact climate adaptation and mitigation projects and related policy lending and set an ambitious target for increasing that figure at a given percentage rate over the period to 2030.

To deliver this target, the Bank would seek to raise new capital from shareholders, which would be specifically assigned to high-impact climate finance under the control of the WBG-CAA. Contributions would not be required to follow the standard capital key. New forms of hybrid (or subordinated) capital with AA or A ratings could also be considered while preserving the WBG's overall triple-A rating.

The WBG-CAA would also look at other means to raise new "climate-hypothecated" capital—including "SDR rechanneling" and the IFFIm model—as well as potentially fast-tracking certain proposals to increase leverage ratios for existing World Bank capital.

The WBG-CAA would develop new pricing models for use in climate finance that would support the resale or securitization of World Bank climate finance loans. This would include being clear about the extent to which the loans would/would not enjoy preferred creditor status once they are off the World Bank balance sheet.

The WBG-CAA would also work with the Bank Treasurer to develop new financing instruments to increase the attractiveness of World Bank climate finance to recipient countries (through risk-sharing arrangements, longer terms, local currency denomination, and so forth).

Organizationally, the WBG-CAA would:

- be part of the WBG but set up to ensure it is collaborative with other MDBs;
- be led by a managing director in the WBG with extensive experience of internal World Bank procedures and systems who would report directly to the president; and
- have premises, corporate services, and so forth provided by the WBG.

leverage public finance by sharing climate finance risks directly with the private sector through innovative financing instruments. For example, the IMF has estimated that in some cases MDBs have used syndicated lending to leverage \$7 of private finance for every \$1 of public money.²³ However, currently, MDB involvement in such activities is on a small scale.

Such “blended-finance” approaches may more quickly address risks that block private sector involvement than traditional project lending or policy loans. MDBs may scale up long-standing instruments, such as guarantees and insurance, or draw on new proposals, including for loan securitization.²⁴ However, in stepping up their involvement, it will also be important for MDBs to see their role primarily as one of demonstrating to the private sector how climate finance risks can be effectively managed.

Such risk sharing should also be carefully managed to ensure that it meets the test of being at least as effective as other possible uses of public finance and using scarce public finance only on things that the private sector cannot do. The private sector will need incentives to take part. But that should not be accomplished by MDBs effectively subsidizing the private sector or by MDBs taking on unsustainable levels of risk.

7. Address contradictory policies—particularly the continuing use of hydrocarbon subsidies

While the size of the climate finance gap is daunting, recent World Bank research shows that governments continue to spend \$7 trillion annually on explicit and implicit subsidies in agriculture, fishing, and fossil fuels.²⁵ Many of these are inefficient subsidies that are making climate change worse.

The CETF Project Team therefore recommends that the MDBs make a renewed effort to use their leverage through policy and project lending to persuade and incentivize member governments to cut back on such subsidies and redeploy the scarce public funds released into climate mitigation and adaptation.

8. Let the sunshine in: Protect climate finance from corruption, lack of transparency, and weak governance

The speed, scale, and destination of much climate finance means the risk is great that much of it could be lost, or made ineffective, by lack of transparency, poor accountability, weak governance, and corruption. So MDBs should play a central role in protecting climate finance—both public and private—from such risks. This can be done by encouraging transparency (particularly with the use of new fintech and digital technologies) and the participation of civil society in climate finance decisions.

MDBs should set an example for transparency in their own decision making and provision of data to the public domain. Doing so would help increase their legitimacy and build greater trust with the public, shareholder governments, and the private sector.

9. Lead and coordinate: Strengthen information sharing and coordination across MDBs and the wider international economic architecture

Collectively, MDBs can bring unmatched resources—intelligence, research, and planning—to the fight against climate change. But too often their impact, and that of the wider group of organizations in the international economic architecture, is less than the sum of the parts.

MDB coordination and cooperation on the issue of climate change must be much more frequent and intensive if these institutions are to achieve their full impact potential.

The CETF Project Team therefore recommends that the MDBs and the IMF establish a high-level committee (at the managing director/first deputy managing director level) to meet quarterly to coordinate their climate activities and engage collectively with other key international economic organizations.

²³ Ananthakrishnan Prasad, Elena Loukoianova, Alan Xiaochen Feng, and William Oman, “Mobilizing Private Climate Financing in Emerging Market and Developing Economies,” IMF Staff Climate Note, July 27, 2022, <https://www.imf.org/en/Publications/staff-climate-notes/Issues/2022/07/26/Mobilizing-Private-Climate-Financing-in-Emerging-Market-and-Developing-Economies-520585>

²⁴ See a description of the African Development Bank Group’s Room2Run and other similar risk-sharing transactions in Mahesh Kotecha, “MDB Loans: A New Asset Class for CLOs,” *Journal of Structured Finance* 28, no. 4 (2023): 28–39, <https://doi.org/10.3905/jsf.2022.1151>.

²⁵ World Bank, “Detox Development: Repurposing Environmentally Harmful Subsidies,” June 15, 2023, <https://www.worldbank.org/en/topic/climatechange/publication/detox-development>

The new group should have a clear mandate to ensure that the institutions work together as effectively as possible within their remits and can thereby make the greatest possible contribution to closing the climate finance gap.

The group's mandate should include working to avoid fragmentation and competition between individual MDBs and development financial institutions, both ex ante (e.g., on standards, taxonomies, data availability, financing conditionality, transparency, and accountability) and ex post (e.g., in relation to debt restructuring or rescheduling).

Key areas for proactive collaboration include increasing the overall scale and effectiveness of public climate finance, derisking and leveraging flows of private finance, and developing the strongest possible pipeline of climate finance projects.

Conclusion—The Imperative to Act

Bending the arc of climate disasters will require enormous financial resources, on a scale unmatched in human history. But it is also one of the greatest opportunities humankind has encountered. The needs are in the trillions. The opportunities are in the trillions. And the urgency has never been greater.

In this brief we set out why and how MDBs can play a greater role in urgently addressing the climate finance gap in developing countries. The recommendations are designed to be practical and politically realistic. They build on several innovative proposals already being considered in public debate.

But the brief also highlights that a key part of the solution involves MDBs fulfilling their traditional role, using existing approaches to financing projects and shaping policy, albeit on a much bigger scale and with much greater speed, in a renewed effort to overcome long-standing obstacles. All of this, of course, is motivated by the existential nature of the climate crisis.

The role of the MDBs will need to continuously evolve as the climate threat itself changes. Moreover, the MDBs cannot close the financing gap on their own. They need to work much more closely with their client countries as well as a wide range of other IFIs, international organizations, philanthropists, and—most critically—the private sector.

The private sector must play a much larger role in closing the climate financing gap. While such involvement needs to make sense financially, the overall effort must be on a much bigger scale; span a much greater range of financial institutions, intermediaries, and professional service providers; and recognize that there are no easy options. Considerable work (and learning) will be needed for the private sector to make the contribution the world requires. The next brief in this Bretton Woods Committee series will look at what this entails in more detail and how the IFIs should further develop their catalytic role.

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