MULTILATERAL DEVELOPMENT BANKS AND CLIMATE FINANCE

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The Paris Agreement aims to hold the increase in the global average temperature to well below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5°C above pre-industrial levels. Its signatories also seek to increase the ability of countries to adapt to the adverse impacts of climate change and foster climate resilience. To implement these objectives and finance the transition to a low-carbon world, the Paris Agreement calls for ensuring that finance flows are consistent with a pathway toward climate-resilient development and low GHG emissions. Multilateral development banks have commitments to facilitate the transition to a low-carbon economy, to avoid or reduce project-related GHG emissions and to increase support to renewable forms of energy.

Multilateral Development Banks (MDBs) have a critical role to play in helping countries meet the temperature goal laid out in the Paris Agreement. MDBs are major finance providers to developing countries. MDBs also directly or indirectly mobilize additional finance by acting as lead investors and attracting others to invest alongside them. MDBs do not only have impact through their direct investments and mobilization of additional finance, but they also set standards that are often followed by other financial institutions, companies, and governments through the projects they invest in and the policies they apply. Many of the banks also conduct policy research, offer technical assistance, and provide policy-based finance, all of which can have a significant positive impact on policies, laws, and institutions in countries where they operate.

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This report focuses on the following development banks: 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 (IADB), and the World Bank Group (including IBRD, IDA and IFC).

This article presents conclusions on the engagement of MDBs in the climate finance and mobilisation of private funds for the purposes of climate finance and delivers key recommendations for necessary changes of the climate finance in the future.

Keywords: multilateral development banks, climate finance, climate change

JEL classification: *Q43*

INTRODUCTION

Multilateral development banks, or MDBs, are supranational financial institutions set up by sovereign countries as their shareholders. Their activities and operations reflect the development aid and cooperation policies established by these countries. Their common mandate is to foster economic, social and sustainable development and progress, particularly in the developing countries. They fulfil its mandates and goals in developing countries by financing projects, supporting investment and generating capital for the benefit of all global citizens. Currently, due to an urgent concern in relation to detrimental effects of climate change, significant investments are needed to support the global transition to a low-carbon, climate-resilient future. International climate finance and multilateral development banks are essential in this regard.

By 2030, total annual additional investments that will be needed in developing countries to address climate change are estimated at between US$140 billion and US$175 billion (World Bank, 2010). Significant increase in climate finance is needed to attract additional financial resources, particularly from the private sector since scarce public resources cannot achieve transition to a low-carbon economy by themselves. Developing countries have fiscal limits and already constrained public budgets. Unlocking private capital and resources will be essential to achieve tangible results.

Significant problem remains about how to mobilize private investment in climate change activities and finance, and how to design risk-return arrangements that will attract private capital. Therefore, multilateral development banks can play a catalytic role.

Contribution of this paper is twofold. First, it is reflected in proven efficiency of individual MDBs in attracting private capital in financing climate-related projects. Second, it represents a contribution to the existing literature describing key recommendations for necessary climate finance changes in the future.

The paper is divided into five chapters. The first chapter describes the role and importance of MDBs in climate finance. The second chapter focuses on the description of instruments employed by MDBs in climate finance. Next chapter delivers the data on the significance of individual MDBs in attracting private capital. The fourth part of the paper deals with MDBs as a distribution channel for global climate finance. Last chapter sets out conclusions and recommendations for necessary changes needed to upgrade climate finance in the future.

MULTILATERAL DEVELOPMENT BANKS AND CLIMATE FINANCE

In November 2019, 11,000 scientists from around the world stated that the world was now facing a climate emergency (Ripple et al., 2019). A key challenge in this collective endeavour is shifting the global investment and financing flows that underpin current and future growth to a low-carbon climate-resilient trajectory (Griffith-Jones, Attridge and Gouett, 2020).

The mandates and operations of multilateral development banks (MDBs) have evolved and expanded in recent decades. Many were created in the 1960s, during the period of decolonisation, while others came into being after the end of the Cold War to support reconstruction, development and regional integration. MDBs were called upon to step up these efforts in the pursuit of the Millennium Development Goals (MDGs) to be achieved by 2015, and now the ambitious, universal, and cross-sector Sustainable Development Goals (SDGs) and Agenda 2030 (Engen and Prizzon, 2018:8).

In September 2019, at the UN Secretary General's Climate Action Summit in New York, the MDBs announced their climate action targets for 2025. They made a collective commitment of climate finance of at least US$ 65 billion, with US$ 50 billion for low-income and middle-income countries. They also agreed to increase adaptation finance to US$ 18 billion and co-financing of US$ 110 billion, including private direct mobilisation of US$ 40 billion. In 2015, MDBs and the International Development Finance Club (IDFC) agreed on a set of Common Principles for finance to mitigate climate change and an initial set of Common Principles for finance to support adaptation to climate change. Their intention was to take a common approach to tracking and to re-

porting climate finance. In December 2019, MDBs and members of the IDFC published the joint Framework and Principles for Climate Resilience Metrics in Financing Operations, setting out the core concepts and characteristics of climate resilience metrics alongside a high-level framework for such metrics in financing operations. The Climate Change Mitigation Working Group plans to finalise the review of the tracking methodology for climate mitigation finance during 2020, with the aim of commencing tracking in 2021 using the new methodology. The new version of the methodology will include a more granular breakdown of types of eligible activity, clear criteria that must be met and additional guidance to facilitate the application of these criteria (Joint Report on Multilateral Development Banks Climate Finance, 2019:3).

Based on the Joint Reports on Multilateral Development Banks Climate Finance in the period of 2011-2019, the total committed amounts in climate finance are presented in Table 1.

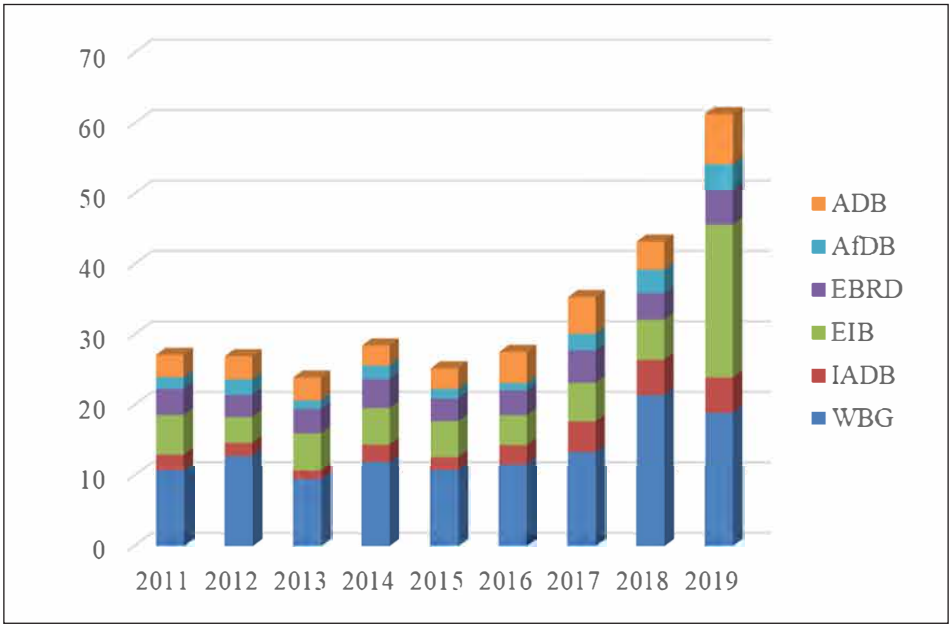
Table 1. Total MDBs' climate finance 2011-2019 in billion USD

	2011	2012	2013	2014	2015	2016	2017	2018	2019	Total MDB
WBG	10.662	12.656	9.426	11.787	10.722	11.494	13.213	21.3	18.8	120.06
IADB	2.17	1.87	1.22	2.461	1.744	2.689	4.348	5	5	26.502
EIB	5.637	3.663	5.224	5.214	5.137	4.266	5.477	5.7	21.7	62.018
EBRD	3.729	3.131	3.46	4.111	3.217	3.495	4.601	3.8	5	34.544
AfDB	1.639	2.22	1.205	1.916	1.359	1.061	2.347	3.3	3.6	18.647
ADB	3.177	3.284	3.268	2.856	2.917	4.437	5.234	4	7.1	36.273
Total MDB	27.014	26.824	23.803	28.345	25.096	27.442	35.22	43.1	61.2	298.04

Source: the authors based on the data from Joint Reports on Multilateral Development Bank's Climate Finance 2011-2019.

As evidenced in Table 1 and Figure 1, in the period from 2011 up to the end of 2019, MDBs committed over 298 billion USD in climate finance. The largest contribution for climate finance in the period from 2011 up to 2019 came from the World Bank Group (40% of the total committed amount). The second largest contributor to climate finance is the European Investment Bank (21% of the total committed amount). The smallest contribution came from the African Development Bank (6% of the total committed amount). On a yearly basis, the World Bank Group had the highest share, except for 2019, when the European Investment Bank became a leader in the climate finance total committed amount.

Figure 1. Total MDBs' climate finance 2011-2019 in billion USD



Source: the authors based on the data from Joint Reports on Multilateral Development Bank's Climate Finance 2011-2019.

Climate financing by seven of the world's largest multilateral development banks (the Islamic Development Bank has been presenting its data since 2019) accounted for US$ 61.6 billion in 2019. Climate finance directed toward low- and middle-income economies was 41.5 billion USD (67%). The 2019 Joint Report shows that US$ 46.6 billion (76%) of the total financing for the year, was devoted to climate change mitigation investments that aim to reduce harmful greenhouse gas emissions and slow down global warming. Of this, 59 percent went to low- and middle-income economies. The remaining US$ 15 billion (24%) was invested in adaptation efforts to help countries build resilience to the mounting impacts of climate change, including worsening droughts and more extreme weather events from extreme flooding to rising sea levels. Ninety-three per cent of this finance was directed at low- and middle-income economies (https://www.isdb.org/news/mdbs-climate-finance-in-low-and-middle-income-countries-reaches-us-415-billion).

MDBs are additionally acting as a channel of distribution for climate funds, such as the Climate Investment Funds (CIF), the Global Environment Facility (GEF) Trust Fund, the Global Energy Efficiency and Renewable Energy Fund

(GEEREF), the European Union's funds for Climate Action, and the Green Climate Fund (GCF). These additional funds play an important role in boosting MDB climate financing. In 2019, MDBs reported additional US$ 102.7 billion in net climate co-finance – investments from the public and private sector – taking the total of climate activity financed in the year to US$ 164.3 billion (Joint Report on MDBs climate finance, 2019).

INSTRUMENTS EMPLOYED BY MULTILATERAL DEVELOPMENT BANKS IN CLIMATE FINANCE

The World Bank – International Bank for Reconstruction and Development (IBRD) is the public sector arm of the World Bank Group; provides finance to governments and the public sector. The IBRD comprises 189 member countries. It offers grants to assist development projects and flexible loans with fixed or variable spreads offered for up to 30-year maturities to developing country governments. It also offers trust funds for concessional official development assistance. De-risking instruments offered are: disaster risk financing, financial risk management, partial risk guarantees, partial credit guarantees and policy based guarantees.

The World Bank –International Development Association (IDA) is the public sector arm of the World Bank Group; provides finance to governments and the public sector in 81 least developed countries. The IDA comprises 173 shareholder countries. Grant funding is based on the country's risk of debt distress. It also offers concessional loans to IDA eligible (low income) countries, including a grace period. Partial Risk Guarantees are also offered as a de-risking instrument.

The World Bank –International Finance Corporation (IFC) is the private sector arm of the World Bank Group. It only finances private sector projects. The IFC comprises 184 member countries. It offers technical assistance and advisory services.

The Asian Development Bank (ADB): provides loans for the public and private sector. It provides financing for sovereign and non-sovereign projects. The ADB comprises 67 member countries. Besides loans, it offers technical assistance and grants.

The African Development Bank (AfDB) is the parent bank group of the African Development Fund (ADF), which is the concessional window of the African Development Bank (AfDB) Group. The AfDB comprises 80 member countries. It offers technical assistance grants. It also offers Sovereign Guar-

anteed Loans and Non-Sovereign Guaranteed Loans, Concessional loans, A and B Loan Structures (Non-Sovereign). Equity and quasi equity investments are offered in the form of direct and indirect equity investments, subordinated loans, redeemable preference shares, convertible subordinated loans. Special funds offered are: the Emergency Liquidity Facility and the Trade Finance Fund. De-risking instruments are Synthetic Local Currency Loans, Partial Credit Guarantees, Interest Rate Swaps, Currency Swaps, Interest Rate Caps and Collars, Commodity/Index Swaps (Venugopal, Srivastava, Polycarp and Taylor, 2012).

The European Bank for Reconstruction and Development (EBRD) is an international financial institution that mainly invests in the private sector and supports projects in 29 countries from central Europe to central Asia. Shareholders include 67 countries, the EU and the EIB. Loans for larger projects: can range from €5 million to €250 million, with maturities from 5–15 years. Loans for smaller projects: the EBRD supports local commercial banks, which in turn provide loans to SMEs and municipalities. It invests equity ranging from €2 million to €100 million. Instruments offered include ordinary shares, preference shares, subordinated loans, debentures and income notes among others. It provides debt guarantees, local currency loan guarantees and guarantees for trade facilitation.

The European Investment Bank (EIB) was established in 1958 - the shareholders of the bank are the 27 member states of the European Union, all of whom have together subscribed its capital. 90% of their financing is through loans. It provides technical assistance through grants. It also offers project loans for developments greater than EUR 25m, senior loans, subordinated loans, project bonds, microloans, and intermediated loans for Small and Medium Enterprises (SMEs) and local authorities. The EIB offers mezzanine finance, investment in technology transfer funds, and business angel matching funds. It offers securitization, project-related derivatives, and venture capital funds. It also provides guarantees for senior and subordinated debt, loan guarantees for Trans-European Transport Network projects, direct guarantees, co-guarantees and counter guarantees to microfinance institutions, equity guarantees, and export credit insurance (Venugopal, Srivastava, Polycarp and Taylor, 2012).

MULTILATERAL DEVELOPMENT BANKS AND PRIVATE CO-FINANCE

To achieve transformation to a low-carbon economy and climate-resilient sustainable development, it will be essential to unlock private sector capital in climate change activities. It will be crucial to design risk-return profiles and methodologies that attract private capital and international climate finance, and multilateral development banks can and must play a catalytic role in this process.

The process of financing infrastructure projects, particularly in developing countries, is especially challenging. In the majority of cases, initial funds necessary to start a project are substantial, the payback period is usually long, and it is necessary to provide long-term maturity financing arrangements. In many developing countries, capital markets are underdeveloped and long-term financing scheme is scarce. Additionally, the viability of projects is related to the technological risk of new technologies. Private capital is reluctant to flow in areas with much uncertainty and related risks. MDBs have a favourable financial advantage by accessing finance at longer maturities and at lower cost compared to private sector investors. Based on that fact, multilateral development banks can provide lower-cost and long-term financing.

MDBs could be critical players in finance flows from developed to underdeveloped and developing countries for climate change activities. These institutions are well placed to ensure that public development projects address climate change concerns and to attract private climate finance flows toward climate-relevant projects.

MDBs could provide policy guidance, technical assistance in project co-financing but also advice on how to structure the financing package. In this regard, MDBs can play a catalytic role to sufficiently change the risk-reward balance and to attract private capital to infrastructure projects in developing countries.

Private sector investors are driven by risk-reward considerations, and they are shaped by the policy environment and investment opportunities in recipient countries. Private sector investors often lack ‘bankable projects’ in the sense that they expect their financing to be repaid with adequate return. The role of MDBs is to assist in unlocking, leveraging and catalysing private sector finance.

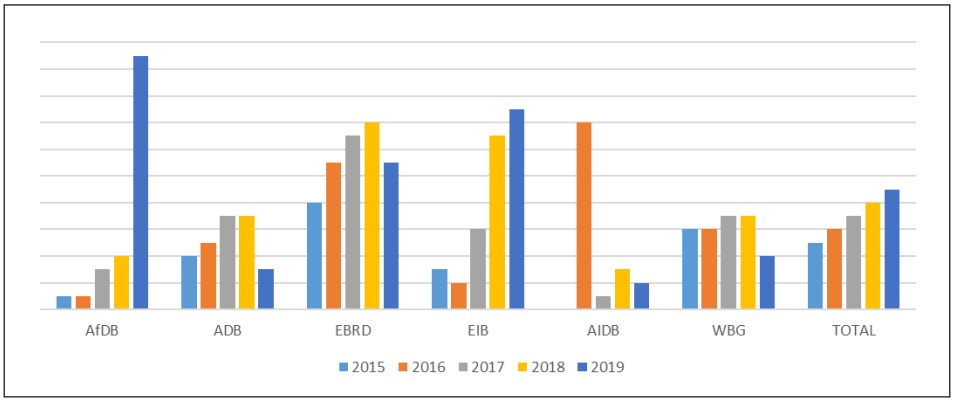
MDBs were analysed by how much of private capital was attracted by 1 USD they invested in climate finance. The results were analysed per MDB and per year.

Table 2. Amount of private climate finance attracted by 1 USD of the MDB's climate finance (in USD)

	2015	2016	2017	2018	2019
AfDB	0.1	0.1	0.3	0.4	1.9
ADB	0.4	0.5	0.7	0.7	0.3
EBRD	0.8	1.1	1.3	1.4	1.1
EIB	0.3	0.2	0.6	1.3	1.5
AIDB	0	1.4	0.1	0.3	0.2
WBG	0.6	0.6	0.7	0.7	0.4
TOTAL	0.5	0.6	0.7	0.8	0.9

Source: the authors based on the data from Joint Reports on Multilateral Development Bank's Climate Finance 2015-2019.

Figure 2. Efficiency of the MDBs in attracting private climate co-finance



Source: the authors based on the data from Joint Reports on Multilateral Development Bank's Climate Finance 2015-2019.

Table 2 and Figure 2 represent the conclusions based on the analysis of how much of private climate finance attracted 1 USD of committed climate finance by multilateral development banks in the period from 2015 to 2019. The conclusion is that the highest impact in attracting private climate finance had the African Development Bank.

Table 3. Growth rate of efficiency in attracting private climate finance (in %)

	Growth rate 2015-2019
AfDB	20.57
ADB	0.30
EBRD	0.29
EIB	4.70
AIDB	15.92
WBG	-0.37

Source: the authors based on the data from Joint Reports on Multilateral Development Bank's Climate Finance 2015-2019.

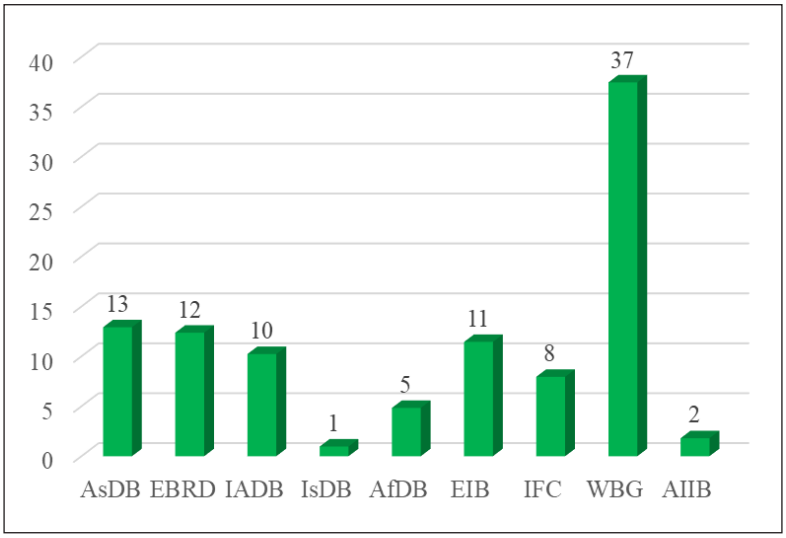
Table 3 presents growth rates of efficiency in attracting private climate finance in percentages. In the period from 2015 up to 2019, the highest growth rate of 20.51% for attracting private capital is evidenced in the African Development Bank data. The Asian Development Bank and the World Bank Group had a negative growth rate evidencing that in this period these MDBs didn't manage to attract additional amounts of private capital for climate-related purposes.

MULTILATERAL DEVELOPMENT BANKS AS A CHANNEL OF DISTRIBUTION FOR GLOBAL CLIMATE FINANCE

It is useful to examine the importance of MDBs' role as a distribution channel for climate finance in general.

By examining bilateral and multilateral climate finance from 2012 up to 2018, from the recipient's perspective, the committed amount for climate finance was 230.2 billion USD. The share of climate finance that was allocated through multilateral development banks and development funds was 37.9 billion USD or 16.4% of the total amount. The highest share of multilateral development banks and development funds is present in Greece (63%) and Slovakia (53%), and the lowest in Japan (7%).

Figure 3. Shares of the Multilateral Development Bank's climate finance in the total climate finance from 2012 to 2018 – donor perspective (in %)



Source: the authors based on the data from Joint Reports on Multilateral Development Bank's Climate Finance 2011-2019.

Figure 3 explains the importance of individual MDBs serving as a channel of distribution for global climate finance. The highest importance as a channel of distribution for climate finance, measured in the OECD databases, had the World Bank Group (37%).

CONCLUSIONS AND RECOMMENDATIONS

Multilateral development banks have a favourable financial advantage by accessing finance at longer maturities and at lower cost compared to private sector investors. Based on that fact, multilateral development banks can provide lower-cost and long-term financing.

It can be concluded that the World Bank Group has the highest share in the total amount of the committed climate finance funds, but it is not effective in attracting private capital for financing climate-related projects. The African Development Bank has the smallest share in the total amount of the committed climate finance funds, but it is most effective in attracting private capital for financing climate-related projects.

Key recommendations for necessary changes of climate finance in the future can be summarized as follows:

- MDBs should act as a partner to private sector investors and enhance project quality and financing environment since profit margins for investments in climate finance that encompass new and unfamiliar technologies are often low compared with the cost of employing necessary services. MDBs could mitigate these risks and improve project environment with its technical assistance, de-risking instruments and co-finance services through innovative financing tools;
- MDBs should encourage and ensure that the recipient developing country and its citizens receive sustainable benefits through environmental standards, social considerations, transparent procurement, and project governance, ensuring adequate maintenance and debt sustainability. In other words, they should help countries achieve sustainable growth and financial stability;
- MDBs' activities in climate finance should be coordinated. The coordination of MDBs' work and activities internationally and globally is essential for a faster and efficient transition to a low-carbon climate-resilient economy both globally and particularly in developing countries where large opportunities for long-term investment projects exist, and the choice of a proper low-carbon technology is crucial for sustainable development.

ACKNOWLEDGEMENT

This work has been fully supported by by the University of Rijeka under the project number uniri-drustv-18-61.

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