POLICY BRIEF

Multilateral Development Banks Must Deliver on Climate

The G7 Communiqués' References to MDBs, Why They Are Important, and What They Mean in Practice

Anja C. Gebel

GERMANWATCH

Brief Summary

When the G7 leaders met in Elmau at the end of June 2022, they called on Multilateral Development Banks (MDBs) to further strengthen ambitious climate action. A few weeks prior, G7 Climate, Energy, Environment, and Development Ministers presented more detailed demands for development finance institutions including MDBs to move forward on climate action. Given that the G7 countries hold significant shares and voting power in several MDBs, their positions carry considerable weight.

This policy brief explains what the G7 called on the MDBs to do, why this is important, and what it means in terms of concrete steps that should be taken in the short and medium term to halt the climate crisis and successfully support the global transformation towards green and resilient economies.

Imprint

Author:
Anja Carolin Gebel, with input from David Ryfisch and Alexandra Goritz

Editing:
Elisa Thomaset

Publisher:
Germanwatch e.V.

Office Bonn:
Kaiserstr. 201
D-53113 Bonn
Phone +49 (0)228 / 60 492-0, Fax -19

Office Berlin:
Stresemannstr. 72
D-10963 Berlin
Phone +49 (0)30 / 5771328-0, Fax -11

Internet: www.germanwatch.org
E-mail: info@germanwatch.org

July 2022

This publication can be downloaded at:
www.germanwatch.org/en/87203

Federal Ministry
for Economic Cooperation
and Development

This publication is financially supported by the German Federal Ministry for Economic Cooperation and Development.
Germanwatch is responsible for the content of this publication.

Content

1 Finalise Paris alignment methodologies

During the summit in Elmau in June 2022, the G7 called on MDBs to finalise their methodologies for Paris alignment of both direct and indirect operations and to publish them by COP27.[1] They also asked MDBs to set out how they collectively report on the alignment of their portfolios. The G7 Members committed to use their 'roles as shareholders of the relevant institutions to facilitate these actions'.[2]

Why is this important?

Seven years after the international community signed the Paris Agreement, and five years after the MDBs committed to align their portfolios, they still lack specific plans for making their investments compatible with a 1.5°C pathway, and thus are not yet playing the important role they should in supporting the transition.

What is the status quo?

While MDBs have focused on aligning their direct investments with the Paris goals and have put indirect finance instruments second, these efforts have not been sufficiently ambitious, nor are they complete. For example, instead of the much-needed stop sign for climate-damaging investments, MDBs apply an exclusion list of activities 'considered universally non-aligned regardless of the national context'[3] as the lowest common denominator. At COP26, the MDBs presented a long-awaited methodology and technical note for direct finance.[4] The methodology includes five tests to check a project's compatibility with the mitigation goals of the Paris Agreement. However, the tests are kept very general and the technical note leaves their concrete interpretation to the bank. So far, none of them has stated what methods and thresholds they will use to determine said alignment. In the absence of Paris-compatible and sufficiently detailed Nationally Determined Contributions (NDCs), national low-greenhouse-gas (GHG) strategies,[5] or equivalent MDB country strategies necessary for tests 1 and 2,[6] it remains unclear how tests 3 to 5 should be implemented. Questions as to how MDBs will determine and consider the 'differentiated responsibilities and capabilities of countries' for Paris alignment[7] in the assessment and whether this will be a loophole for

[1] G7 Leaders' Communiqué: '[…] we call upon MDBs to develop methodologies for Paris alignment before UNFCCC COP 27'; G7 Climate, Energy and Environmental Ministers' Communiqué, no. 54: '[W]e call on all multilateral development banks to finalize and make publicly available robust methodologies for Paris alignment before COP27 for all its activities, in particular for indirect and policy-based lending, and to set out how they collectively plan to report on the alignment of their portfolios by COP27'.

[2] G7 Climate, Energy and Environmental Ministers' Communiqué, no. 54

[3] The list only includes four activities: Mining of thermal coal, electric power generation from coal, extraction of peat, and electricity from peat. See AfDB et al. (2021) Progress Report: 'Multilateral Development Banks Working Together for Paris Alignment.'

[4] AfDB et al. (2021) Progress Report: 'Multilateral Development Banks Working Together for Paris Alignment,' https://www.eib.org/de/events/joint-mdb-paris-alignment-update-cop26; AfDB et al. (2021) BB1 and BB2 Technical Note Joint MDB Assessment Framework for Paris Alignment for Direct Investment Operations (Working Draft as of November 2021), https://www.eib.org/attachments/documents/cop26-mdb-paris-alignment-note-en.pdf

[5] UNFCCC (09/2021) Full NDC Synthesis Report: 'Some Progress, but Still a Big Concern,' https://unfccc.int/news/full-ndc-synthesis-report-some-progress-but-still-a-big-concern

[6] Test 1: Is it [the project/economic activity] inconsistent with the NDC of the country in which it takes place?, Test 2: Is it inconsistent with national economy-wide/sectoral/regional low-GHG strategy that is compatible with the mitigation goals of the PA [Paris Agreement] over its lifetime?

[7] Test 3: Is it inconsistent with sector-specific PA criteria considering the differentiated responsibilities and capabilities of countries? See AfDB et al. (2021) Progress Report: 'Multilateral Development Banks Working Together for Paris Alignment'

supporting emission-intense activities, or how they will assess lock-in risks[8] and stranded asset/transition risks[9] (test 5) in their financial analyses and consider these in Paris-alignment decisions arise.

Furthermore, MDBs have made only slow progress on their methodologies for aligning indirect investments. So far, only the European Bank for Reconstruction and Development (EBRD) has presented a draft approach to aligning investments via financial intermediaries, and none of the four MDBs providing policy-based finance[10], a favoured instrument during times of crisis, has developed a methodology for aligning this type of financing. MDBs might therefore continue to support climate-damaging activities through their investments via financial intermediaries, as several cases have already proven. [11] Without provisions for counterparty alignment, there is also a potential threat that MDBs could indirectly support climate-damaging activities of companies or financial institutions by propping up their balance sheet–even if they limit their financing to climate-compatible projects. . Policy-based operations, on the other hand, might incur climate risks as well as miss out on supporting much-needed green development opportunities as long as suitable instruments to detect such risks and opportunities have yet to be developed.

What has to be done next?

In light of this and the recent G7 demand, MDBs should

- Specify and improve the methodology for the Paris alignment of direct financing:
  - Expand the list of universally non-aligned activities to include all forms of support for fossil fuel extraction, production, and provision in line with the IEA net-zero emissions scenario
  - Clarify and publicly announce the exact implementation of the five tests in order to ensure the compatibility with a 1.5°C pathway
  - Support countries according to their differentiated responsibilities and respective capabilities, ensuring that different premises do not result in different mitigation outcome or speed[12]
- Finalise and publish joint Paris-alignment methodologies for indirect financing:
  - For policy-based finance: Mainstream consideration of climate risks (both direct and indirect) into the entire design process of policy-based operations; develop an approach that facilitates the systematic identification of green development opportunities, including for adaptation[13]

[8] Test 4: Does it prevent opportunities to transition to the PA aligned activities OR support misaligned activities in a specific country/sectoral context?; this might become the most important test, since, according to the Technical Note, '[a] "No" response to questions SC1 to SC5 can either mean that the answer to the question is "No," or that no data were available to answer the question. It is expected that SC4 can always be answered.'

[9] Test 5: Is it unviable taking into account stranded asset/transition risks in the national /sectoral context? See AfDB et al. (2021) Progress Report: 'Multilateral Development Banks Working Together for Paris Alignment'

[10] Policy-based finance is provided by ADB, AfDB, IADB, and the World Bank. PBOs provide general budget support to partner countries in exchange for policy and institutional reforms.

[11] For example, the IFC has invested in several coal plants in the Philippines, violating the World Bank's pledge from 2013 to stop funding coal. See Compliance Advisor Ombudsman (04/2022) Philippines: Rizal Commercial Banking Corporation (RCBC)-01, https://www.cao-ombudsman.org/cases/philippines-rizal-commercial-banking-corporation-rcbc-01; and Rappler (06/2022) The World Bank is blocking the way to renewable energy transition, https://www.rappler.com/voices/thought-leaders/opinion-world-bank-blocking-way-renewable-energy-transition/

[12] For more guidance on Paris Alignment methodologies for direct investment see Bartosch, Fekete, Krishnan, Larsen, Smith, Weischer (2018) 'Toward Paris Alignment - How the Multilateral Development Banks Can Better Support the Paris Agreement,' https://www.germanwatch.org/de/16085

[13] For more guidance on Paris Alignment methodologies for policy-based finance see (forthcoming) Gebel, Kachi, Laxton, Neunuebel (2022) 'Aligning Policy-Based Finance with the Paris Agreement'

  - For lending via financial intermediaries: Develop an approach that combines ring-fencing elements with provisions for a counterparty alignment of financial intermediaries[14]
- For Paris alignment of both direct and indirect finance: Develop and apply supplemental diagnostics to compensate for insufficient or lacking NDCs and Long-Term Strategies (LTSs) (such as a 1.5° compatible pathway modelling for different sectors and countries)
- Ensure transparency and improve reporting with regard to Paris alignment:
  - Each bank should publish the details of its Paris alignment methodologies for each instrument including internal guidance notes
  - Each bank should report climate finance per project (components) to enable verification and accountability
  - Each bank should publish its assessment for Paris alignment per project to enable verification and accountability

[14] For more guidance on a Paris Alignment methodology for financial intermediary lending see Fuchs, Kachi, Sidner, Westphal (2021) 'Aligning Financial Intermediary Investments with the Paris Agreement,' https://germanwatch.org/sites/default/files/aligning-financial-intermediary-investments-paris-agreement.pdf

2 Scale up climate-transformative development policy operations

The G7 also expect MDBs to scale up climate-related policy-based operations to support the transition. They particularly called on the World Bank to take a leading role in this measure.[15]

Why is this important?

Policy-based operations can help provide the policy and institutional framework needed for effective climate action and thus have great transformative potential.

What is the status quo?

Policy-based operations are currently not used to their full capacity concerning climate action. The G7 specifically call on MDBs to support countries in reforming fiscal, regulatory, and macroeconomic policies. Reorienting economies towards net-zero emissions and building climate-proof economic and social systems require system-wide transformations and incentives to take the necessary measures. However, the volumes of climate finance disbursed in policy-based operations associated with 'economy-wide' reforms (such as public sector management or public financial management) have yet to reflect the need for transformative change: On the one hand, there is the lack of financial incentives in the form of grants or highly concessional loans for climate action to accompany the policy-based operations.[16] On the other hand, MDBs' diagnostics and partnership processes do not sufficiently consider climate opportunities. Both would be necessary to increase demand and country support for transformative economy-wide reforms that help countries foster a 1.5°C-compatible development.[17]

Due to its outstanding financial and diagnostic capacities, the G7 have called upon the World Bank to take a leading role in scaling up climate-related policy-based operations. However, rather than setting an example for other banks in terms of climate action, the World Bank has recently been reprimanded by the US treasury for its lack of action.[18] To name a few examples, its Climate Change Action Plan does not rule out support for gas infrastructure: it continues funding coal infrastructure through the IFC and other channels;[19] and it has extended the Paris alignment dates for the International Finance Corporation (IFC)

[15] Development Ministers' Communiqué, no. 30: 'We strongly call on MDBs, DFIs and multilateral funds to further strengthen their efforts to support ambitious climate and biodiversity action, including by […] supporting countries in reforming fiscal, regulatory and macroeconomic policies to sustain a green transition. We recognize the role of green taxes as a relevant source for domestic revenue mobilization. We expect MDBs to systematically provide climate-related development policy operations in line with each country's Paris-aligned transition path, with the World Bank Group taking a leading role, and will support this.'

[16] For volume and share of climate finance grants see AfDB et al (2021) '2020 Joint Report on Multilateral Development Banks' Climate Finance,' https://www.ebrd.com/news/2021/mdbs-climate-finance-rose-to-us-66-billion-in-2020-joint-report-shows.html

[17] See (forthcoming) Gebel, Kachi, Laxton, Neunuebel (2022) 'Aligning Policy-Based Finance with the Paris Agreement'

[18] Financial Times (06/2022) 'US Treasury takes aim at World Bank over climate change inaction,' https://www.ft.com/content/57963fee-ad5c-47af-a125-79db9cba06fd; furthermore, UN special adviser Selwin Hart has accused the World Bank at COP26 for being 'an ongoing underperformer,' and former US vice-president Al Gore has described the bank as 'missing in action'.

[19] Climate Home News (10/2020) World Bank branch indirectly backs coal megaproject despite green pledge, https://www.climatechangenews.com/2020/10/22/world-bank-branch-indirectly-backs-coal-megaproject-despite-green-pledge/; there are also studies showing how the World Bank backs coal by means of other instruments such as technical assistance and policy-based finance: Mainhardt (2021) 'The World Bank Drives Billions into Fossil Fuel Investments,'

and the Multilateral Investment Guarantee Agency (MIGA) (both part of the World Bank Group) to mid-2025.[20] Most importantly in this context, the World Bank has not yet provided a draft methodology for aligning its indirect investments with the Paris Agreement which is important for ensuring that its policy-based operations are consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.

What has to be done next?

In light of this and the recent G7 demand, MDBs should

- Provide more policy-based financing, in particular in highly concessional loans, along with technical assistance to maximise transformative impact
- Adapt bank structures and country engagement processes to systematically identify green development opportunities within the scope of partner dialogue and strategy as well as sector strategies, and at the different stages of project design and implementation
- Propose and support PBO policy actions that
  - Increase fiscal space and institutional capacity for climate action
  - Integrate green development opportunities and environmental co-benefits in revenues and expenditures
  - Incentivise sustainable technologies and practices

The World Bank in particular needs to take a lead in:

- Drafting an ambitious and effective methodology for policy-based finance and using it for the design of effective climate operations;
- Providing countries and other banks with climate-related diagnostics that point out reform options, including policy and institutional analyses. The bank's Country Climate and Development Reports highlighting the key high-level climate issues in countries represent an important measure in this direction.[21]

https://www.urgewald.org/world-bank-drives-billions-fossil-fuel-investments; and Mainhardt (2021) 'World Bank helps develop Asia's Largest Coal Field: How the World Bank's coal road map leads Pakistan into a debt spiral and undermines the Paris Climate Agreement,' https://www.urgewald.org/sites/default/files/media-files/World%20Bank%20Policy%20Lending%20Pakistan_Urgewald.pdf

[20] World Bank Group (2021) Climate Change Action Plan 2021-2025, https://openknowledge.worldbank.org/bitstream/handle/10986/35799/CCAP-2021-25.pdf?sequence=2&isAllowed=y

[21] The first of these reports (on Türkiye) has been published on 13 June 2022 and more are to follow in the run-up to COP27. See World Bank (2022) 'Key Highlights: Country Climate and Development Report for Türkiye,' https://www.worldbank.org/en/country/turkey/brief/key-highlights-country-climate-and-development-report-for-turkiye

3 Mobilise climate finance–support NDCs and LTSs, leverage private finance, and pioneer innovative instruments

The G7 call on MDBs to 'mobilize substantial finance towards a climate-neutral, climate-resilient and nature-positive economy, including facilitating just energy transitions'[22]. This includes leveraging their balance sheets and enhancing their private sector engagement to "support the enhancement of NDCs and LTSs, support economic development in alignment with a 1.5 °C pathway and climate resilience, and to increase the use of risk mitigation tools such as guarantees".[23]

Why is this important?

The world is still far from being on track for limiting global warming to well below 2 or to 1.5°C. New and updated NDCs only take 7.5% off predicted 2030 emissions, while a percentage of 55% is needed to meet the 1.5°C Paris goal.[24] Apart from shifting investments out of the fossil fuel industry, finance flows need to be integrated in a pathway towards low greenhouse gas emissions and climate-resilient development. This requires scaling up targeted and effective investments in mitigation and adaptation as well as a just transition enabled by a variety of sources, instruments, and channels.

What is the status quo?

Industrialised countries have fallen short of their 2009 pledge to provide 100 billion USD annually for climate finance from 2020 onwards.[25] Additionally, climate finance volumes worldwide are nowhere near the investments needed for the transition. An increase of at least 590% from 2019/2020 levels in annual climate finance is required to meet the Paris climate objectives by 2030 and to avoid the most dangerous impacts of climate change. That equals an increase from USD 632 billion to USD 4.35 trillion.[26] Grant finance

[22] Development Ministers' Communiqué, no. 30: 'We call on multilateral financing institutions, climate and environment funds, philanthropies and the private sector to mobilize substantial finance towards a climate neutral, climate-resilient and nature-positive economy, including to facilitate just energy transitions.'

[23] Climate, Energy, and Environmental Ministers' Communiqué, no. 53: 'We strongly call on all relevant finance institutions, such as MDBs, DFI and multilateral funds to further strengthen their efforts, including by setting ambitious adaptation finance targets and by supporting the scaled-up participation of the private sector'; no. 54: 'We urge Development Finance Institutions, including MDBs, […] to leverage their balance sheets and enhance their private sector engagement to support the enhancement of NDCs and LTSs, support economic development in alignment with a 1.5 °C pathway and climate resilience, and to increase the use of risk mitigation tools such as guarantees.'

[24] UNEP, UNEP-CCC (2021) Emissions Gap Report 2021, https://www.unep.org/emissions-gap-report-2021

[25] OECD (09/2021) Statement from OECD Secretary-General Mathias Cormann on climate finance in 2019, https://www.oecd.org/newsroom/statement-from-oecd-secretary-general-mathias-cormann-on-climate-finance-in-2019.htm; Carbon Brief (2021) Analysis: 'Why climate-finance 'flows' are falling short of $100bn pledge,' https://www.carbonbrief.org/analysis-why-climate-finance-flows-are-falling-short-of-100bn-pledge/

[26] Climate Policy Initiative (2021) Global Landscape of Climate Finance 2021, https://www.climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-2021/

constituted only 6% of total flows,[27] which poses problems for highly indebted low-income countries struggling with fiscal constraints arising from the COVID-19 pandemic and the war in Ukraine.

Private-sector finance makes up almost half of total climate finance,[28] but given that the sector manages more than USD 210 trillion in assets, this is only a minor part of its investments.[29] Private co-finance rates for MDB investments fell for the second year in a row in 2020, defying the MDBs' 'From Billions to Trillions' agenda of 2015. For every dollar invested, more than another dollar should have been co-financed from private sources. Instead, an amount of just USD 0.29 of co-financing was reported.[30] In order to steer private-sector investments in the right direction, MDBs thus need to take further measures, for example by creating policy environments affable to the development of green markets.

However, there are also technical challenges in this matter. Current NDCs vary in detail and ambition as well as in the degree to which they align with other government plans and policies and rarely translate into investment plans and pipelines of bankable projects. Developing countries also need technical help in enhancing and implementing their commitments; a task MDBs are well equipped for. Several MDBs now have technical assistance programmes focused on NDCs;[31] however, the number of countries supported by these programmes as well as their budget remain rather limited.

Other promising instruments to spur the transition include the so-called Just Energy Transition Partnerships (JETPs), the first of which has been agreed between South Africa and France, the UK, Germany, the EU, and the US.[32] Such long-term partnerships aim to coordinate donors for targeted support, such as early retirement of coal platforms, scaling up of renewables, investments in low-carbon infrastructure, enabling policy frameworks, and the development of a green labour market. Due to their financial capabilities, technical and local expertise and development mandate, MDBs can play an important role in JETPs. Furthermore, innovative ways to incentivise climate and environmental action need to be developed, for example by rewarding the provision of important ecosystem services, particularly in agriculture, forestry, and land-use.

What has to be done next?

In light of this and the recent G7 demand, MDBs should

- Provide more concessional climate finance for sectoral transitions, macroeconomic and governance reforms, and building resilient social security systems (which can be supported through balance sheet optimisation[33] but also increased capitalisation by shareholders)
- Support the enhancement of NDCs and LTSs:

[27] Climate Policy Initiative (2021) Global Landscape of Climate Finance 2021, https://www.climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-2021/
[28] Climate Policy Initiative (2021) Global Landscape of Climate Finance 2021, https://www.climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-2021/
[29] Green Climate Fund (n/a) Private Sector Financing, https://www.greenclimate.fund/sectors/private
[30] AfDB et al. (2021) 2020 Joint Report on Multilateral Development Banks' Climate Finance, https://www.ebrd.com/news/2021/mdbs-climate-finance-rose-to-us-66-billion-in-2020-joint-report-shows.htm; see also Neunuebel (2021) 'The Good, the Bad and the Urgent: MDB Climate Finance in 2020,' https://www.wri.org/insights/mdb-climate-finance-joint-report-2020
[31] For example, the NDC Invest Programme by the IDB, and the World Bank's NDC Support Facility.
[32] For a recent update on JETPs see COP26 Presidency UK (2022) Six-Month Update on Progress in Advancing the Just Energy Transition Partnership (JETP), https://ukcop26.org/six-month-update-on-progress-in-advancing-the-just-energy-transition-partnership-jetp/; besides South Africa, plans have also been announced for India, Indonesia, Vietnam, and Senegal.
[33] This could include, for example, risk transfer arrangements, hybrid capital products, and rethinking the role of ratings based on callable capital. Other than that, the G20 instituted a commission to investigate MDBs' Capital Adequacy Frameworks in 2021: http://www.g20.utoronto.ca/2021/210710-finance-annex-1.html

    - Scale up technical and financial support for the development of Paris-compatible NDCs, LTSs, and sectoral decarbonisation strategies
    - Make countries' NDCs and LTSs an integral part of country diagnostics, policy dialogues, and investment decision-making
- Leverage more private climate finance:
    - Directly: for example, through green equity investments, credit enhancement, closed investment funds, or other blended finance
    - Indirectly: by supporting policy reforms that create an enabling environment for private climate investments, including carbon pricing and other tax reforms; through sovereign guarantees, lowering capital costs, providing start-up funding and removing administrative obstacles for green business; as well as through market signalling
- Pioneer innovative instruments:
    - Engage in JETPs, supporting ambitious mitigation and adaptation goals, ensuring both social sensitivity of reforms and the consistent involvement of actors from civil society, science, and business; and ensure transparency regarding this engagement
    - Provide additional funding for ambitious climate-related reforms and for the provision or conservation of public goods such as clean air and water and other ecosystem services

4 Enhance action and support for adaptation

The G7 expressed their support for the Glasgow Climate Pact's goal of doubling the 2019 levels of adaptation finance by 2025 and for achieving a balance between mitigation and adaptation finance. Therefore, they called on MDBs to set ambitious adaptation-finance targets.[34]

Why is this important?

Even if mitigation targets were reached by 2030, climate change would still cause drastic changes worldwide. Between 2000 and 2019, more than 475,000 people lost their lives and losses of USD 2.56 trillion (in purchasing power parity [PPP]) were incurred as a direct result of more than 11,000 extreme weather events.[35] Financial damage will reach annually approximately USD 438 billion in the 2030s, further rising to USD 1,067 billion by 2050 if current trends continue.[36] Every day of delayed adaptation will further increase the costs for loss and damage and will risk lives. The IPCC warns that in particular small island developing states will reach hard limits to adaptation very fast.[37]

What is the status quo?

Notwithstanding the above, adaptation investments fall short of what is required. The UNEP Adaptation Gap Report 2016 estimates that by 2030, global adaptation costs will amount to between USD 140 and 300 billion annually and by 2050 to between USD 280 and 500 billion;;[38] the more recent report from 2021 estimates costs to be in the higher end of these brackets.[39] According to climate finance figures in 2020, however, only USD 586 million were spent globally on adaptation projects.[40]The IPCC thus demands that investments in transformative adaptation be scaled up by three to six times by 2030 if the Sustainable Development Goals are to be kept in reach.[41]

[34] Climate, Energy, and Environmental Ministers' Communiqué, no. 53: 'We strongly call on all relevant finance institutions, such as MDBs, DFI and multilateral funds to further strengthen their efforts, including by setting ambitious adaptation finance targets and by supporting the scaled-up participation of the private sector'; Development Ministers' Communiqué no. 30: 'We strongly call on MDBs, DFIs and multilateral funds to further strengthen their efforts to support ambitious climate and biodiversity action, including by setting corresponding adaptation finance targets.'

[35] Germanwatch (2021) Global Climate Risk Index 2021, https://germanwatch.org/sites/default/files/Global%20Climate%20Risk%20Index%202021_1.pdf; Note: CRI 2021 excludes data about the US with which the figure would be even higher (CRI 2020: 3.54 trillion PPP).

[36] Brot für die Welt (2021) Analyse 102: 'Climate change, Debt and COVID-19,' https://www.brot-fuer-die-welt.de/downloads/analyse102-climate-change-dept-covid19/

[37] IPCC (2022) Climate Change 2022: Impacts, Adaptation, and Vulnerability. Contribution of Working Group II to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change, https://www.ipcc.ch/report/ar6/wg2/

[38] UNEP (2016) The Adaptation Finance Gap Report, pp. 40ff.

[39] UNEP (2021) The Gathering Storm - Adapting to climate change in a post-pandemic world, https://www.unep.org/resources/adaptation-gap-report-2021

[40] UNFCCC (11/2021) 'The Climate Finance Question,' https://unfccc.int/blog/the-climate-finance-question; USD 894 million went to projects that focused on both mitigation and adaptation; however, a significant part can be expected to have gone into mitigation

[41] IPCC (2022) Climate Change 2022: Impacts, Adaptation, and Vulnerability. Contribution of Working Group II to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change, https://www.ipcc.ch/report/ar6/wg2/

The lack of adaptation finance is also reflected in the fact that we are currently far from a balanced allocation of finance between adaptation and mitigation, with 64% of climate finance going to mitigation (USD 1.6 billion) and 11% to cross-cutting projects.[42] Among the MDBs, this deteriorates to 76% on mitigation versus 24% on adaptation.[43] At present, only the AfDB spends more of its finance on adaptation than on mitigation. After achieving parity in 2018, it has since exceeded it.

One part of the problem is that there is too little highly concessional climate finance. As the IPCC states, most climate finance is focused on mitigation, and there is a widening disparity between the estimated costs of adaptation and documented finance allocated to adaptation–with the largest gaps among lower income population groups. This makes it difficult to finance these projects, particularly for highly indebted countries.

Besides scaling up volumes, however, MDBs also need to improve the quality of their adaptation finance. Supporting countries in their development and pursuit of climate-resilient pathways requires the consideration of both the *resilience of* and the *resilience through* their investments.[44] This means identifying vulnerabilities to climate-change impact, assessing opportunities for reducing risk, and considering the impact of investment decisions over both short- and long-term time horizons.[45] It also requires developing methods to assess the impact of resilience measures and to learn from the insights.

Finally, an isolated approach to adaptation finance might not be particularly helpful after all, since ensuring resilience and adaptation should be an integral part of any investment. From this perspective, mainstreaming adaptation should be a priority measure to scale up overall climate finance for adaptation.

What has to be done next?

In light of this and the recent G7 demand, MDBs should

- Set ambitious adaptation finance targets to mainstream adaptation into all investments and to increase volumes to resilience-centred projects
- Provide more highly concessional adaptation finance for highly indebted countries, especially by means of grants
- Improve the quality of their adaptation finance by
  - Considering climate risk across timescales in project preparation
  - Systematically evaluating opportunities and adaptation options in countries for reducing risks
  - Incorporating decision-making under uncertainty in project preparation
  - Adopting resilience metrics to measure the effectiveness of their adaptation finance across sectors

[42] OECD (09/2021) Statement from OECD Secretary-General Mathias Cormann on climate finance in 2019, https://www.oecd.org/newsroom/statement-from-oecd-secretary-general-mathias-cormann-on-climate-finance-in-2019.htm
[43] EBRD (2021) 2020 Joint Report on Multilateral Development Banks' Climate Finance, http://www.ebrd.com/2020-joint-report-on-mdbs-climate-finance
[44] Both dimensions of resilience have been articulated in the World Bank's proposed resilience ratings system (2021), https://openknowledge.worldbank.org/handle/10986/35039
[45] Sidner and Westphal (2020) 'Enhancing Adaptation and Climate-Resilient Operations within the Multilateral Development Banks,' https://www.germanwatch.org/sites/default/files/Memo2%20-%20Adaptation.%20MDB%20Paris%20alignment.pdf

5 Stop funding fossils

The G7 Climate, Energy and Environment Ministers have committed to supporting the implementation of the Glasgow Statement on Clean Energy,[46] which involves ending new direct public support for the international unabated fossil fuel energy sector by the end of 2022. Only in 'limited circumstances clearly defined by each country that are consistent with a 1.5°C warming limit and the goals of the Paris Agreement'[47] might investments in fossil fuel energy still be acceptable. The Ministers also called on MDBs and bilateral DFIs, multilateral funds and public banks (among others) to adopt these commitments too, and announced that they would guide their approach as shareholders on the boards of MDBs.

Why is this important?

The commitment made in the Glasgow Statement for Clean Energy to stop financing fossil energies is crucial since countries continue to invest far more money into fossil fuels than is compatible with limiting global warming to 1.5°C. Currently planned fossil fuel extraction would already heat up the world beyond 1.5°C, so nearly 40% of already developed fossil fuel reserves will need to stay in the ground to keep the 1.5°C target in reach with a 50% probability.[48] Instead of thinking about reducing fossil fuel extraction sometime in the future, the existing infrastructure and further plans for fossil exploitation need to be stopped and withdrawn immediately.

What is the status quo?

Policymakers and banks worldwide are adding fuel to the fire. G20 public finance institutions and MDBs are still backing at least USD 63 billion per year in oil, gas, and coal projects–which is 2.5 times more than they spend in support for renewable energy (USD 26 billion per year).[49] With many countries joining the 'coal pledge' at COP26, gas is suddenly considered as an allegedly cleaner alternative. However, the fossil fuel still releases a lot of harmful CO_2 and methane along its production and combustion chain.[50] Therefore, unabated fossil gas power generation needs to be effectively phased out by 2045 in all regions of the world.[51] Arguments that it could serve as a transition fuel for a number of developing countries, especially in Africa, are equally questionable. Compared with renewables, gas expansion offers no advantages in terms of supporting socio-economic development and universal energy access. Rather, it is likely to exacerbate countries' indebtedness if fossil fuel infrastructure becomes 'stranded assets'. Furthermore, any

---

[46] UN Climate Change Conference UK 2021 (2021) Statement on International Public Support for the Clean Energy Transition

[47] Climate, Energy, and Environmental Ministers' Communiqué, no. 74: 'International fossil fuel finance: […], we commit to end new direct public support for the international unabated fossil fuel energy sector by the end of 2022, except in limited circumstances clearly defined by each country that are consistent with a 1.5 °C warming limit and the goals of the Paris Agreement. […] This will also guide our approach in public finance institutions and on the boards of MDBs and bilateral DFIs. We therefore call on other major economies, the MDBs and bilateral DFIs, multilateral funds, public banks and relevant agencies to also adopt these commitments. We commit to review our progress against our commitments.'

[48] Kelly Trout et al. (2020) 'Existing fossil fuel extraction would warm the world beyond 1.5 °C,' in: Environmental Research letters Vol.17(6)

[49] Oil Change International (10/2021) 'Past Last Call: G20 public finance institutions are still bankrolling fossil fuels,' https://priceofoil.org/2021/10/28/past-last-call-g20-public-finance-institutions-are-still-bankrolling-fossil-fuels/.

[50] Methane is 86 times more potent than carbon dioxide over a timescale of 20 years and therefore a very powerful greenhouse gas.

[51] Climate Analytics (2022) Fossil gas: a bridge to nowhere, https://climateanalytics.org/publications/2022/fossil-gas-a-bridge-to-nowhere/

increase in emissions will turn against the allegedly profiting African countries, which are among the most impacted by global warming.[52]

MDBs have considerably increased their investments in renewables over time. However, more than USD 3 billion of MDB finance was still directed to fossil fuel projects in 2020 alone.[53] Even though most MDBs have pledged to end coal finance, they continue to finance coal indirectly, for example through financial intermediaries, as the IFC did in the Philippines,[54] and are even more hesitant to end their support for gas. The absence of ambitious exclusion lists[55] as well as a lack of systematic consideration of climate risks in project design and investment decision-making further encourages this development.[56] So far, only the EIB claims to be Paris-aligned, though it has still loopholes in its transport sector strategy, which allow it to support LNG terminals, for example. The EIB has also joined the Glasgow Statement for Clean Energy, while other MDBs are still absent.[57] Instead of holding MDBs accountable for their Paris alignment commitment, some shareholders do the exact opposite: In the face of the war in Ukraine and European countries' resulting scramble for gas, plans have been announced to use development banks such as the EIB and KfW to finance gas infrastructure projects in developing countries to satisfy European energy needs– which effectively means fuelling the climate crisis.[58]

By contrast, a potentially promising initiative is the Energy Transition Mechanism that the ADB is piloting in Indonesia and the Philippines along with private partners. The aim of the initiative is to retire coal plants before the end of their lifetime and to replace them by clean alternatives.[59] Under this scheme, Public Private Partnerships buy up coal-fired power plants. With concessional financing from a Carbon Reduction Facility, the cost of capital is then reduced to such an extent that the power plants can generate similar returns in a shorter time. This would allow them to be shut down earlier without incurring losses. There is, however, very little transparency on the details of the mechanism. Civil society organisations have highlighted a set of criteria that need to be ensured to secure its quality in terms of climate change mitigation and sustainable development.[60]

---

[52] BankTrack, Milieudefensie, Oil Change International (2022) 'Locked out of a Just Transition: Fossil Fuel Financing in Africa,' pp. 31ff.

[53] The Big Shift Global (2021) 'Still Funding Fossils: An assessment of MDBs' energy finance since Paris and in COVID-19 recovery,' https://bigshiftglobal.org/MDB-finance-2020; see also Mainhardt (2021) Suriname's oil development made possible by IMF, IDB and World Bank public finance, https://www.urgewald.org/sites/default/files/media-files/Urgewald_ActionAlert_Suriname_HMainhardt.pdf, for a recent example of how different MDBs indirectly supported oil development in Suriname

[54] Compliance Advisor Ombudsman (04/2022) Philippines: Rizal Commercial Banking Corporation (RCBC)-01, https://www.cao-ombudsman.org/cases/philippines-rizal-commercial-banking-corporation-rcbc-01; see also Rappler (06/2022) The World Bank is blocking the way to renewable energy transition, https://www.rappler.com/voices/thought-leaders/opinion-world-bank-blocking-way-renewable-energy-transition/, for an interesting opinion piece on this

[55] The joint MDB list of activities that are generally considered as misaligned with the Paris Agreement includes only energy from coal and peat. MDBs have been reluctant to expand it since its creation.

[56] Bartosch, Fekete, Krishnan, Larsen, Smith, Weischer (2018) 'Toward Paris Alignment - How the Multilateral Development Banks Can Better Support the Paris Agreement,' https://www.germanwatch.org/de/16085; Gebel, Kachi, Laxton, Neunuebel (forthcoming, 2022) 'Aligning Policy-Based Finance with the Paris Agreement'

[57] For an evaluation of signatories' shares in MDBs, see Big Shift Global (2022) Multilateral Development Banks Absent from Glasgow Pact to Shift Fossil Finance to Renewables Signed by Major Shareholder Governments, https://bigshiftglobal.org/multilateral-development-banks-absent-glasgow-pact-shift-fossil-finance-renewables-signed-major

[58] Clean Energy Wire (06/2022) 'Build up new global gas supply chains rather than fight over existing volumes – chancellor Scholz,' https://www.cleanenergywire.org/news/build-new-global-gas-supply-chains-rather-fight-over-existing-volumes-chancellor-scholz

[59] Asian Development Bank (11/07/2021) Energy Transition Mechanism Explainer: 'How ETM Will Support Climate Action in Southeast Asia,' https://www.adb.org/news/features/energy-transition-mechanism-explainer-support-climate-action-southeast-asia

[60] NGO Forum on ADB (11/2021) 'Towards a swift and just end to coal,' https://www.forum-adb.org/post/towards-a-swift-and-just-end-to-coal

What has to be done next?

In the light of this and the recent G7 demand, MDBs should

- Join the Glasgow Statement (as EIB, AFD, and FMO have done already) and thereby commit to ending fossil fuel finance by the end of 2022
- Establish comprehensive and immediately valid exclusion lists containing all fossil energy investments (upstream, midstream, downstream); if gas is still to be financed, establish and publish a clear-cut methodology that unambiguously defines the very limited circumstances under which this is acceptable to be consistent with a 1.5°C warming limit and the goals of the Paris Agreement[61]
- Advance early retirement mechanisms such as the Energy Transition Mechanism, and ensure
  - Civil society participation (especially of the affected communities) in their design processes
  - That coal plants are retired as early as possible
  - That fossil investors are not incentivised to continue investing in coal plants
  - That fossil activities of the private partners are not subsidised
  - That emissions savings are not linked to offsetting or emissions-trading schemes
  - That investment for energy substitution exclusively supports the expansion of renewable energies (and not of gas)
  - That electricity end users do not have to pay for unprofitable coal-fired power
  - That early retirement processes go along with support for a socially just structural change and energy transition of the country

[61] For guidance see, e.g., 'New Climate Institute (2021) Paris alignment of gas? A review of overall sectoral compatibility, lock-in, transition, and physical climate risks,' https://newclimate.org/sites/default/files/2021/10/NewClimate_Paris_Alignment_Gas_Report_Oct21.pdf

6 The time for implementation is now

The success of MDBs is measured in terms of their progress in supporting development. Advocating the Paris agenda should therefore be a clear priority for MDBs since achieving the Sustainable Development Goals depends on our success in limiting and adapting to global warming. The G7's demands on MDBs might not be innovative themselves, but they have highlighted five priority areas in which immediate action is required if MDBs are to make a meaningful contribution to the climate transition and to development.

The finalisation of their Paris alignment methodologies, the commitment to ending development finance for unabated fossil fuels by 2022 (that is, joining the Glasgow Statement for Clean Energy), and the setting of ambitious adaptation targets are three aspects that MDBs can accomplish in the short-term– ideally by COP27. Scaling up climate finance, especially by means of transformative development policy operations and engagement in JETPs, will require more preparatory work. This, however, can be tackled immediately: MDBs need to improve their diagnostics, internal processes, and country engagement now to be able to provide more climate-transformative development policy operations in the following years. Concerning JETPs, MDBs need to engage now with other donors as well as partner countries and offer their expertise to negotiate successful partnerships.

In the MDBs' Paris alignment process, systemic inertia has proven to be an obstacle to rapid implementation. Yet in this critical decade of implementation, quick outcomes are more important than ever before and MDBs are called upon to catch up. Especially the World Bank will be assessed in terms of its ability to step up its climate ambitions and to lead the MDBs' engagement in those areas.

... did you find this publication interesting and helpful?

You can support the work of Germanwatch with a donation to:

Bank fuer Sozialwirtschaft AG

BIC/Swift: BFSWDE33BER

IBAN: DE33 1002 0500 0003 212300

Thank you for your support!

Germanwatch

Following the motto of *Observing. Analysing. Acting.* Germanwatch has been actively promoting global equity and livelihood preservation since 1991. We focus on the politics and economics of the Global North and their world-wide consequences. The situation of marginalised people in the Global South is the starting point for our work. Together with our members and supporters, and with other actors in civil society, we strive to serve as a strong lobbying force for sustainable development. We aim at our goals by advocating for prevention of dangerous climate change and its negative impacts, for guaranteeing food security, and for corporate compliance with human rights standards.

Germanwatch is funded by membership fees, donations, programme funding from Stiftung Zukunftsfaehigkeit (Foundation for Sustainability), and grants from public and private donors.

You can also help us to achieve our goals by becoming a member or by making a donation via the following account:

Bank für Sozialwirtschaft AG,
BIC/Swift: BFSWDE33BER
IBAN: DE33 1002 0500 0003 2123 00

For further information, please contact one of our offices

Germanwatch – Bonn Office
Kaiserstr. 201
D-53113 Bonn, Germany
Phone: +49 (0)228 / 60492-0
Fax: +49 (0)228 / 60492-19

Germanwatch – Berlin Office
Stresemannstr. 72
D-10963 Berlin, Germany
Phone: +49 (0)30 / 5771328-0
Fax: +49 (0)30 / 5771328-11

E-mail: info@germanwatch.org

or visit our website:

www.germanwatch.org