



Policy brief

# Climate-smart reform of multilateral development banks

Priorities for the G20

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# 1 Introduction

**Multilateral development banks (MDBs) have been key players in supporting countries in their low-carbon transition and in building resilience.**

- MDBs are the **largest contributors** to the annual international climate commitment of \$100 billion (2021 MDB Joint Report, 2022). Their ability to scale up financial resources is largely a function of their business model. MDBs can raise cheap finance on capital markets thanks to their preferential creditor treatment and back-up from governments as their shareholders. The largest MDBs have leveraged more than 30 times their paid-in capital since their creation (Humphrey and Prizzon, 2022).
- MDBs are taking advantage of their **regional or global reach**: they are well-placed to address transboundary challenges and share learning in client countries.
- MDBs have **deep experience of implementing large, climate-relevant projects**, which many countries lack. MDB staff are directly involved in project negotiation and design and oversee project implementation.

**MDBs can be more effective** in supporting countries in designing and implementing low-carbon transition strategies and in building resilience to the effects of climate change. More specifically:

- **MDBs need a different narrative about climate and development.** Addressing climate change and pursuing development objectives are sometimes perceived as mutually exclusive and partly incompatible goals (see Saputra et al., 2023). A siloed approach and short-termism might mean MDBs miss opportunities to support countries in realising synergies (e.g. around public health) or in crafting long-term economic strategies fit for a climate-changed world. It also means that existing resources are often not used appropriately or strategically. For example, development finance is often not Paris-aligned (i.e. consistent with a 2°C trajectory let alone 1.5°C), as evidenced by continued investments in fossil fuel exploration and extraction or highway and airport construction (Colenbrander et al., 2023).

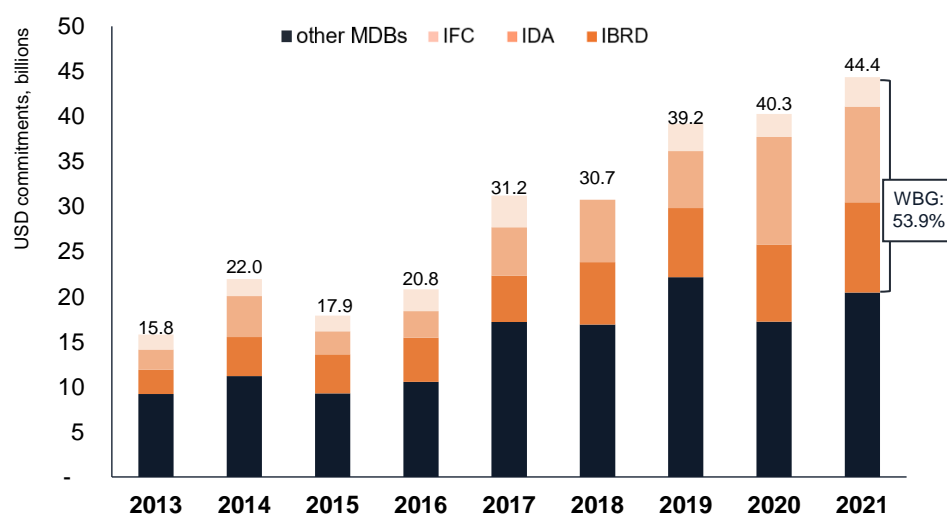
- **MDBs can scale up finance for climate goals.** Even if used well and despite the large leveraging effect of paid-in capital of MDBs, current resources do not match the scale of the climate challenge. The management of MDBs must look into ways to sweat their balance sheets, truly foster private capital mobilisation and stress the value for money of capital increases for shareholders (Humphrey and Prizzon, 2022).
- **MDBs must create more effective incentives for client countries** to take up finance to support the low-carbon transition and build climate resilience as fiscal space shrinks and the risk of debt distress mounts. While expanding financial volumes is critical, how MDBs lend matters too. Despite the strengths of the operational model of MDBs, borrowers nevertheless see some drawbacks and challenges (Miller et al., 2023). Furthermore, there is even greater pressure to allocate scarce concessional finance across low and middle-income countries to incentivise demand for new loans focusing on climate action.

This policy brief outlines how MDBs have been (financially) contributing to climate adaptation and mitigation in low- and middle-income countries. We then identify what G20 members and MDB management should prioritise to address the main challenges preventing MDBs from being truly transformative in mitigating climate change and building resilience in low- and middle-income countries.

## 2 Climate finance: the contribution of multilateral development banks

**Climate financing across MDBs has significantly increased, almost tripling between 2013 and 2021** (Figure 1). This increase is largely a response to pressure from shareholders who are contributing to international climate commitments to reduce greenhouse gas (GHG) emissions and changes in reporting (Miller et al., 2023). **The World Bank Group is the major financial contributor to climate finance.** In 2021, its funding for climate adaptation and mitigation amounted to nearly \$23.9 billion, 53.9% of all climate finance across MDBs (Figure 1).

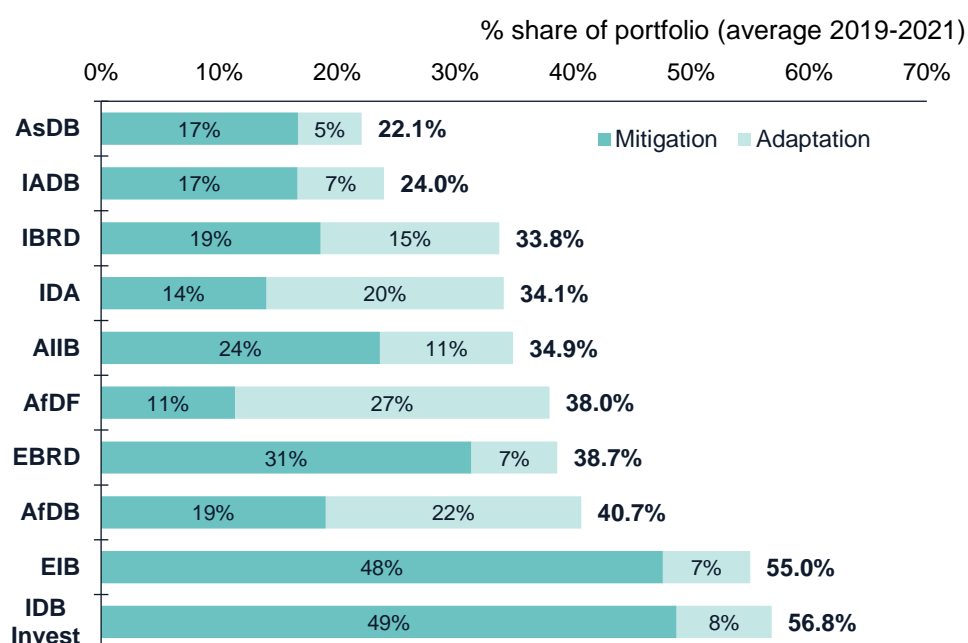
**Figure 1 MDB commitment volumes to climate mitigation and adaptation, 2013–2021**



Source: Author calculations based on OECD-Climate Finance Database. Current USD prices. Notes: 'Other MDBs' are AfDB, AfDF, AsDB, AIIB, EIB, EBRD, IADB. Compared to the 2021 MDB Joint Report, which reports \$50.7 billion for climate finance in 2021, this analysis excludes IsDB (\$0.7 billion in 2021) and MDBs' externally managed resources like Climate Investment Funds (total of \$3.5 billion in 2021). All other minor discrepancies relate to harmonising data to fit OECD reporting guidelines (for example the OECD's exclusion of guarantees and attempts to minimise double counting and overlaps between mitigation and adaptation flows).

Even if MDBs such as the EBRD and IDB Invest spend less than other MDBs in absolute volumes, they are proportionally investing more in climate change because their client base includes several high GHG emitters. Climate finance between 2019 and 2021 accounted for over half of IDB Invest (57%) and EIB Global’s portfolio (55%). This was 34% for the World Bank Group over the same period (Figure 2). Higher portfolio shares for adaptation in concessional windows, like IDA, and in African institutions (AfDB/AfDF) reflect lower demand for climate mitigation among lower-income and African countries.

**Figure 2 Climate finance as share of total MDB portfolio, by type, average 2019–2021**



Source: Author calculations based on OECD-CRS and OECD-Climate Finance database.  
 Notes: The share of portfolio is based on a three-year average (2019–2021) of commitments to each area based on total portfolio commitments reported to the OECD-Climate Finance database and OECD-CRS by each MDB. The IFC only reports to the OECD-Climate Finance database, not the CRS, so its climate finance portfolio share was not calculated.

**The share of climate finance going to adaptation is rising.** While in 2013 climate mitigation accounted for around 80% of total climate finance across MDBs, by 2021 this had fallen to 66% (see Table 1) as more MDBs set explicit financing targets for climate adaptation. In contrast to mitigation, the majority of adaptation funding is provided by a subset of the largest MDBs (WBG, AsDB, IADB). For example, in 2021 the WBG provided 70% of adaptation finance across the MDBs, compared to 45% of mitigation finance.



**Table 1 Mitigation and adaptation as a share of total MDB climate finance, 2013–2021**

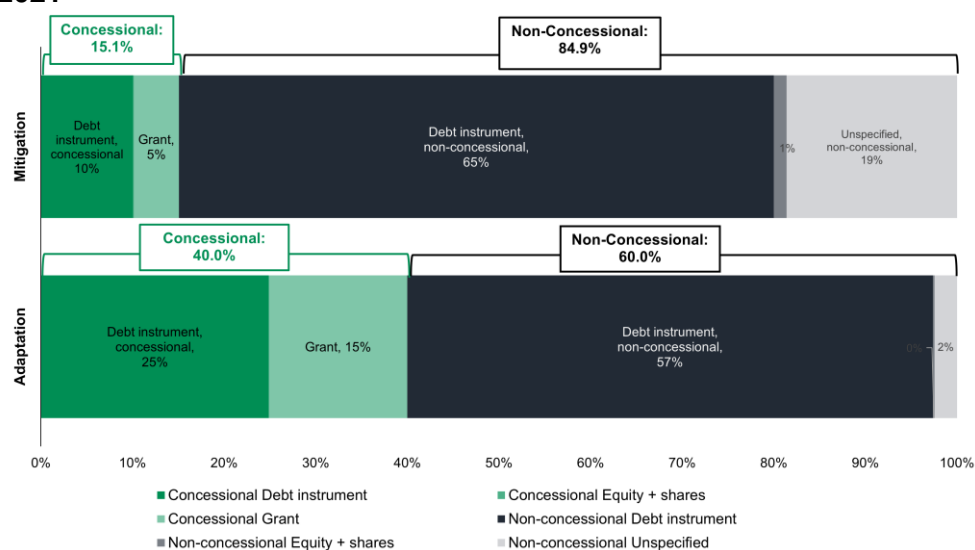
Year	Adaptation	Mitigation
2013	20.5%	79.5%
2014	23.8%	76.2%
2015	20.8%	79.2%
2016	25.3%	74.7%
2017	27.9%	72.1%
2018	34.7%	65.3%
2019	35.8%	64.2%
2020	35.8%	64.2%
2021	33.8%	66.2%

Source: Author calculations based on OECD-Climate Finance Database. Adaptation and mitigation flows may include overlapping activities since share of adaptation and mitigation is calculated based on the combined sum of reported commitments to each area. It is not a share of what is reported by the OECD as climate-related development finance.

Notes: MDBs analysed are WBG (IDA,IBRD,IFC), AfDB, AfDF, AsDB, AIIB, EIB, EBRD, IADB (IDB Invest). Unlike the 2021 MDB Joint Report, which reports 65% for mitigation finance and 35% for adaptation finance in 2021, this analysis excludes IsDB and externally managed resources.

**Debt instruments dominate the financing of both climate mitigation and adaptation** (see Figure 3). On average between 2019 and 2021, concessional loans and grants accounted for 40% of MDBs’ total adaptation finance against 15% for mitigation finance (Figure 3). This reflects the concentration of adaptation finance in lower-income countries. Over the same period, the majority of adaptation finance was still channelled via non-concessional debt instruments (57%).

**Figure 3 MDB climate finance by financial instrument, average 2019–2021**



Source: Author calculations based on OECD-Climate Finance Database. 2021 constant prices.

Notes: MDBs analysed are WBG (IDA, IBRD, IFC), AfDB, AfDF, AsDB, AIIB, EIB, EBRD, IADB. Shares report the percentage of financial instruments assigned to each category of climate finance. Between 2019 and 2021 all unspecified funding represents a sum of activities aggregated for confidentiality reasons by the IFC and IDB Invest.

**‘Reorientation’ of investment towards climate goals.** Between 2009 and 2019, a significant proportion of reported increases in climate finance went towards the energy and transport sectors. For each marginal dollar of increase, 74 cents of MDB funding goes to these two sectors (Miller et al., 2023). This does not seem to be funded through displacing finance in other sectors traditionally more associated with poverty reduction. Overall volumes of finance in these sectors have been flat (in the case of the energy sector, overall finance volumes have fallen). Instead, most of the increase can be attributed to a ‘reorientation’ or a ‘rebadging’ of investments in the energy and transport sectors (ibid.).

**The entire portfolios of MDBs should be aligned with the 2015 Paris Agreement.** MDBs are jointly developing an alignment framework to Article 2.1c of the PA. The EIB and IFC have developed specific approaches to align their private sector clients’ operations with Paris goals. To match their intentions, all MDBs have been decreasing their funding for fossil fuels, and have increased their investments in low-carbon energy. The best performer has been the EIB, which reduced its fossil fuel finance from an annual average of \$4.5 billion pre-PA to \$1.4 billion post-PA and increased its renewable energy finance from \$4.3 billion to \$6.5 billion (Oil Change International, 2021). While MDBs have stopped financing new coal projects, they have continued to provide finance to oil and gas fossil projects.

### 3 Multilateral development banks need a different narrative about climate and development

Part of the problem MDBs face in delivering genuinely transformative strategies on low-carbon transition is the lingering misconception that climate action inevitably entails a trade-off with economic development, that the climate agenda is essentially a burden-sharing exercise, and that lower-income countries should instead focus on poverty reduction. While governments in these contexts do not prioritise climate change adaptation and mitigation over other issues, such as energy access, agriculture or infrastructure development (Prizzon, Josten and Gyuzalyan, 2022), it is becoming overwhelmingly clear that inaction on climate change undermines and sets back inclusive development and the fight against poverty, and that action on climate change, when structured well, provides considerable benefits and opportunities (see IPCC AR6, World Bank CCDRs) (Lankes and Prizzon, 2023).

Second, several MDBs, in particular the World Bank, have faced persistent calls from civil society to phase out 'lending to activities that can undermine efforts towards climate change mitigation (Colenbrander et al., 2023).

Finally, climate finance is notoriously fragmented. It is disbursed through more than 20 bilateral channels, eight MDBs and 15 multilateral climate funds. As a result, even countries with remarkable levels of climate ambition and delivery capabilities struggle to secure the concessional resources necessary for a structural shift towards low-carbon, climate-resilient development (Pickering et al., 2017).

To address these three challenges, shareholders and MDB management should prioritise the following:

- *Support countries to think through the costs and benefits of climate-smart development paths.* Issues that countries see as vital to development – e.g. energy, transport, water, sanitation and hygiene, agriculture – are core to effective climate action (Prizzon et al. 2022) . But countries need support to align

national development goals for these sectors with international climate goals, given that climate-smart approaches often require fundamentally different financing arrangements, business models, technical skills and policy arrangements. MDBs can help governments identify and evaluate these different sectoral paths.<sup>1</sup>

- *Define a more robust methodology for Paris alignment frameworks.* Each MDB should be proactively considering what a 1.5°C world would look like, and allocate concessional finance accordingly. This implies a much more rigorous and transparent approach to Paris alignment, with climate goals integrated into MDBs' core operations and decision-making, as opposed to tagging a subset of finance with the relevant Rio marker or siloing it into a new trust fund. The experiences of the EBRD and EIB can offer some lessons (see previous section).
- *Work more closely with other donors.* With its exceptional convening power and financing capacities, the World Bank could play a unique coordinating function. Such coordination might be undertaken by country offices in contexts where climate is a clear priority (e.g. in Small Island Developing States) or globally to enable learning in climate-relevant sectors where MDBs play a significant role (e.g. energy and transport). In particular, the World Bank should adopt much more inclusive approaches to the Country Climate and Development Reports (CCDRs), with a greater emphasis on drawing in national expertise, facilitating national dialogue and coordinating donors to unlock the concessional finance necessary to implement these strategies (Colenbrander et al., 2023).

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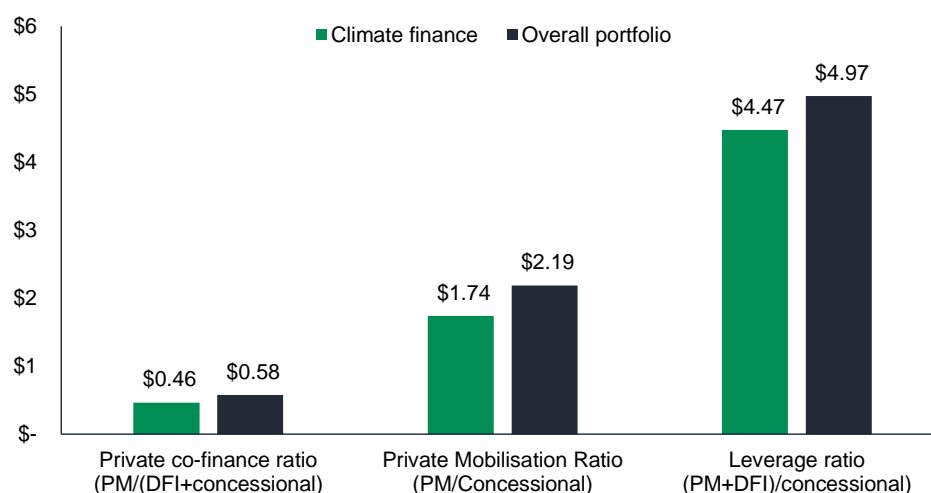
<sup>1</sup> One example is incentivising investment by independent power producers using renewables through feed-in tariffs. This can overall be cheaper than centralised coal- or gas-fired power funded by the state, but requires supporting utilities to manage grid connections and intermittency and supporting commercial banks to establish new financing approaches given higher upfront costs.

## 4 Multilateral development banks can scale up finance for climate goals

The recommendations of the Independent High-Level Expert Group on Climate Finance are clear: \$1 trillion a year by 2030 must be mobilised for emerging and developing countries other than China to meet their climate and development goals (Songwe et al., 2022). We are nowhere near this.

Many MDBs have either already implemented measures or are reviewing how they could stretch their existing resources as suggested by the G20 Expert Group on the reform of MDB capital adequacy frameworks (CAF). At the same time, a long-standing issue for MDBs is the low mobilisation of private finance, often as a result of a weak understanding of pricing and financial additionality for climate activities. This is particularly the case with climate finance. Leverage ratios for climate finance tend to be lower than across the overall portfolio (Figure 4).

**Figure 4 Co-financing ratios: climate vs across all sectors, 2021**



Source: Author calculations based on Blended Finance Joint report, 2021.

Notes: Private co-financing represents both direct and indirect mobilisation, as per guidance in the MDB methodology.

How can shareholders and MDB management scale up the financial resources at the disposal of MDBs to help address the climate challenge?

- *Progress on implementation of the CAF recommendations.* MDBs should create additional lending capacity by making more efficient use of their balance sheets, as recommended by the G20 Expert Group. More lending capacity could be achieved first, by MDBs taking a modicum of additional risk while continuing to observe the requirements for top credit ratings; second, by creating hybrid non-voting capital and tapping non-traditional sources of funding; and third, by engaging in more systematic transfer of risk to the private sector or guarantors (Colenbrander et al., 2023).
- *Mobilise private capital at scale for climate impact by increasing risk tolerance and updating business models.* As a first step, MDBs should set institutional targets for mobilisation (currently IFC is the only MDB to do this), and improve collaboration between their public and private arms. MDBs should also shift towards instruments like guarantees, equity and local currency finance, which are better suited to mobilising private capital than loan financing (DFI Working Group on Blended Concessional Finance, 2023: Fig. 13). MDBs could replace their focus on risk-adjusted market returns with a focus on positive financial returns adjusted for environmental and development impact. They could also mobilise climate finance at scale by shifting some of their portfolio from an originate-and-hold model to an originate-and-share model. The latter would avoid keeping late-stage profitable assets on the balance sheet of MDBs. Instead, these assets would be shared with or transferred to private investors (e.g. the AfDB Room2Run initiative), freeing up lending headroom.
- *Tap into new sources of concessional finance and agree on capital increases for selected MDBs.* This might include deploying budgets other than those for bilateral cooperation (e.g. defence or climate budgets); channelling proceeds from cross-border financial transaction taxes or carbon border adjustment mechanisms, as proposed under the Bridgetown Agenda; or redirecting a share of proceeds from donor country carbon markets or carbon taxes (Lankes and Prizzon, 2023). Even with greater resources from the baseline (existing capital) and private capital mobilisation, the scale and urgency of the climate challenge will require an additional injection of fresh resources into the capital of MDBs. At a time when many shareholder governments are attempting to balance their books, investing in MDBs – especially in their non-concessional windows – offers excellent value for money to

mobilise financing at scale. Cumulative MDB development lending since their establishment is 40 times that of the International Bank for Reconstruction and Development, and counting.

## 5 Multilateral development banks must create more effective incentives for client countries

Expanding the volume of lending of MDBs is critical, but how they lend matters too. Even if all the reforms suggested here are implemented, the risk remains that client countries will choose to borrow limited amounts. Despite the many demonstrable strengths of the operational model of MDBs, borrowers nevertheless see some drawbacks and challenges.

First, the emphasis on climate change has led to concerns that proposed MDB reforms are overly focused on problems prioritised by high-income countries. This is consistent with the evidence that government officials see climate mitigation and adaptation as less of a priority than MDB staff do (Prizzon et al., 2022).

Second, for many countries borrowing from MDBs can be a complex and resource-intensive exercise. Approving projects involves multiple steps (including several country missions), each requiring lengthy preparation and internal reviews, while documents must be prepared and circulated in advance. MDBs apply stringent environmental and social safeguards; these play a critical role in protecting vulnerable groups and the environment, but MDBs often fail to provide the time and financial resources needed to follow them. Borrowing countries must navigate the rules established by the MDBs, which vary according to the lender and change over time. All these factors raise the effective cost of borrowing from MDBs and can discourage borrowers from taking out loans (Miller et al., 2023).

Finally, technical assistance is not responsive or adapted to local contexts. Only a third of government officials believe that MDBs are

responsive to client demands when providing technical assistance and policy advice (Prizzon et al., 2022). MDBs also struggle to adapt to local circumstances and tend to prioritise ideas and advice issued from headquarters at the expense of local expertise. The analytical products offered by MDBs are not always suited to the realities of policy-making. Analysis often comes in the form of long, set-piece reports.

How can shareholders and MDB management address these challenges?

- *MDBs can change their technical offer and support countries to craft climate-smart development strategies* which offer more energy security – i.e. less dependence on fossil fuels – lower and more predictable operating costs – i.e. more energy-efficient with no fossil fuel inputs – and co-benefits such as job creation, cleaner air and increased fiscal space in the medium term.
- *Make lending operations more agile.* To address borrowers' concerns, MDBs could do much more to streamline their requirements and safeguards. For instance, they could harmonise their rules and procedures and further delegate project approval to management (the Asian Infrastructure Investment Bank already does this). Much more of this process could be digitised rather than paper-based. Safeguarding units also require proper resourcing. This might mean non-borrowing shareholders investing grant-based resources in specialist implementation teams who can help governments work through complex processes, especially in lower-income contexts.
- *More responsive and targeted advice and expertise.* Changing the approach to technical cooperation is likely to require revisiting how advice and analysis are funded and finding ways to prioritise longer-term relationship-building over 'fly-in, fly-out', stand-alone reports. MDBs should seek to attract a wider range of expertise, while staff should be rewarded for the impact of their advice rather than the quality of their report writing.



## 6 Conclusions

What should the G20 and its members prioritise in MDB reform to help client countries tackle the consequences of the climate crisis and develop climate-smart strategies and development trajectories? In this note we considered three priorities and argued for a set of recommendations. First, MDBs must strengthen the integration of climate and development objectives and strategies. Second, MDBs must reach their full potential lending capacity and ability to mobilise private sector finance. Finally, MDBs must create stronger incentives and support for client countries to take up MDB finance.

While MDB management has ultimate responsibility for addressing these challenges, shareholders – especially among G20 members – must create incentives and accountability mechanisms for MDB management to follow through with these policy priorities. Shareholders must also equip MDBs with the resources to deliver on this ambitious transformative agenda for climate mitigation and resilience.

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