Regional Response to the Climate Challenge – Climate Financing by the Multilateral Development Banks

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Introduction

The purpose of the study is to present the context of climate change, climate protection and climate finance, and to address the role played by Multilateral Development Banks (MDBs) in it.

The topic is highly relevant as on June 1, 2017 US President Donald Trump gave a notice to quit the Paris Climate Agreement accepted by UN member states. In this epoch-making agreement, UN member states have committed themselves to limiting global warming to below 2 degrees Celsius by reducing emission of carbon dioxide. President Trump's decision sparked protests throughout the US and brought to life the America's Pledge initiative, to voluntarily comply with the Agreement and organise extensive campaigns to win the widest possible support. The US attitude is very important not only because of the emission by the US itself, but the strong US influence on the international order and institutions.

1. From climate change to climate finance

"'Climate change' means a change of climate which is attributed directly or indirectly to human activity that alters the composition of the global atmosphere and which is in addition to natural climate variability observed over comparable time periods" (UNFCCC 1992, Article 1. Point 2. 7), – as defined by the United Nations. Others associate climate change directly with global warming: "Climate change is the catch-all term for the shift in worldwide weather phenomena associated with an increase in global average temperatures" (Wired 2018). Widely used dictionaries underline the role of emission in defining climate change: "Changes in the world's weather, in particular the fact that it is believed to be getting warmer as a result of human activity increasing the level of carbon dioxide in the atmosphere" (Cambridge Dictionary s. a.). A Hungarian curriculum quotes: "Climate change means the long-term and essential change of the Earth' climate and weather on local or global level.

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For example, changes in the temperature, the quantity and distribution of the rainwater, wind or the number of sunshine hours" (Climate change s. a.).

Climate change is a global issue and the failure to tackle it was the most important global risk factor in 2016 according to the Global Risk Report 2016 of the World Economic Forum (WEF) (WEF 2016; Zilahy 2017, 658). "Environmental risks have grown in prominence in recent years. This trend has continued this year […] risks in the environmental category being ranked higher than average for both likelihood and impact over a 10-year horizon" − as stated in the report from 2018 (WEF 2018, 6).

Actions against climate change are called climate protection. Major milestones of international cooperation in this field are the United Nations Framework Convention on Climate Change (UNFCCC) adopted in 1992 at the Rio Earth Summit, the Conference of Parties (COP) held each year and the Paris Climate Agreement signed in 2015. The UN Sustainable Development Goals adopted in 2015 also focuses on "Combating Climate Change and its Effects" (UN 2015, Goal 13: Climate Action).

The key question of climate protection is climate finance. It is a "heavily contested term. From a *climate justice* perspective, it refers to the transfer of public resources from North to South to cover the costs of dealing with the long-term impacts of climate change. This money, a key component of *climate debt,* should also be provided to help Southern countries to pursue low-emissions paths without repeating the unsustainable reliance on fossil-fuels that was central to the industrialization of Northern countries […]. Other definitions are more broad, and refer to all financial flows relating to climate mitigation and adaptation" (Reyes 2012, 9). They include aid, private and equity investments, in case they are related to climate protection.

Climate finance is part of the environmental finance and partly overlaps with green finance. The two main directions of climate finance are mitigation and adaptation. Mitigation is far more in the focus, while adaptation is much less spent on.

Estimated global total climate finance amounted to USD 340–650 billion in 2014. Developed countries transferred USD 40–175 billion to developing countries, out of which USD 35–50 billion was coming from public and USD 5–125 billion from private sources (Yeo 2015). Public climate finance is constantly increasing. From the annual USD 35 billion in 2011–2012 it increased to USD 42 billion in 2013–2014, and it will reach USD 67 billion by 2020 (Nakhooda–Watson–Schalatek 2016, 1; UN 2016, 6). This is getting closer to the USD 100 billion pledge, but still there is a gap. More than half of this amount is bilateral financing, 40% is provided by MDBs, some percentage is financed through multilateral climate funds, part of which is managed also by MDBs, mainly by the World Bank.

The institutional structure of climate finance is rather complex and includes many actors. Contributors are the developed donor countries, the European Union and some subnational organisations, creating dedicated climate finance funds and initiatives, and establishing bilateral and multilateral development institutions, including MDBs. Recipients are the beneficiary developing countries, regional and national implementing agencies and funds.

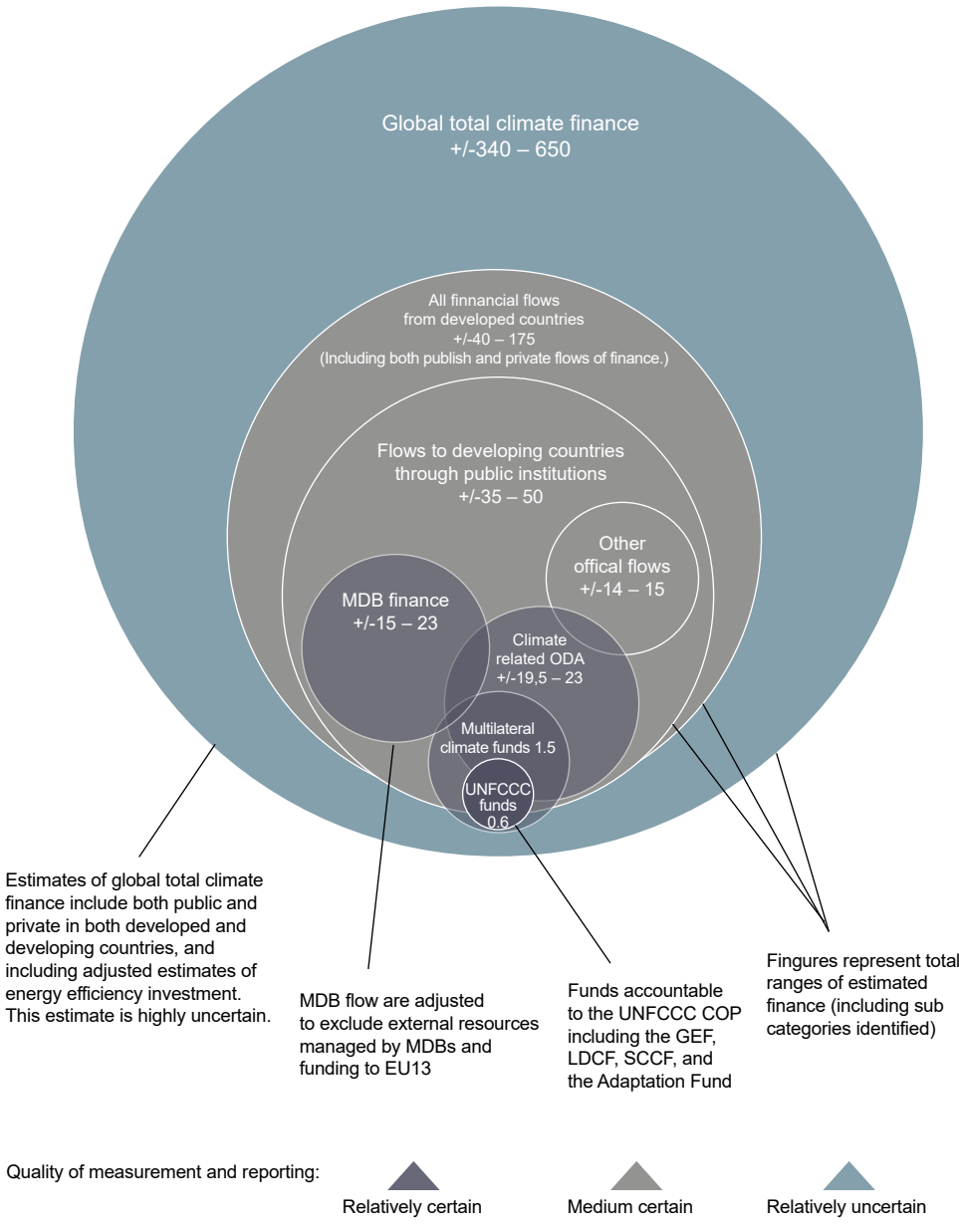

Figure 1.
Climate Finance Flows

Source: Yeo 2015

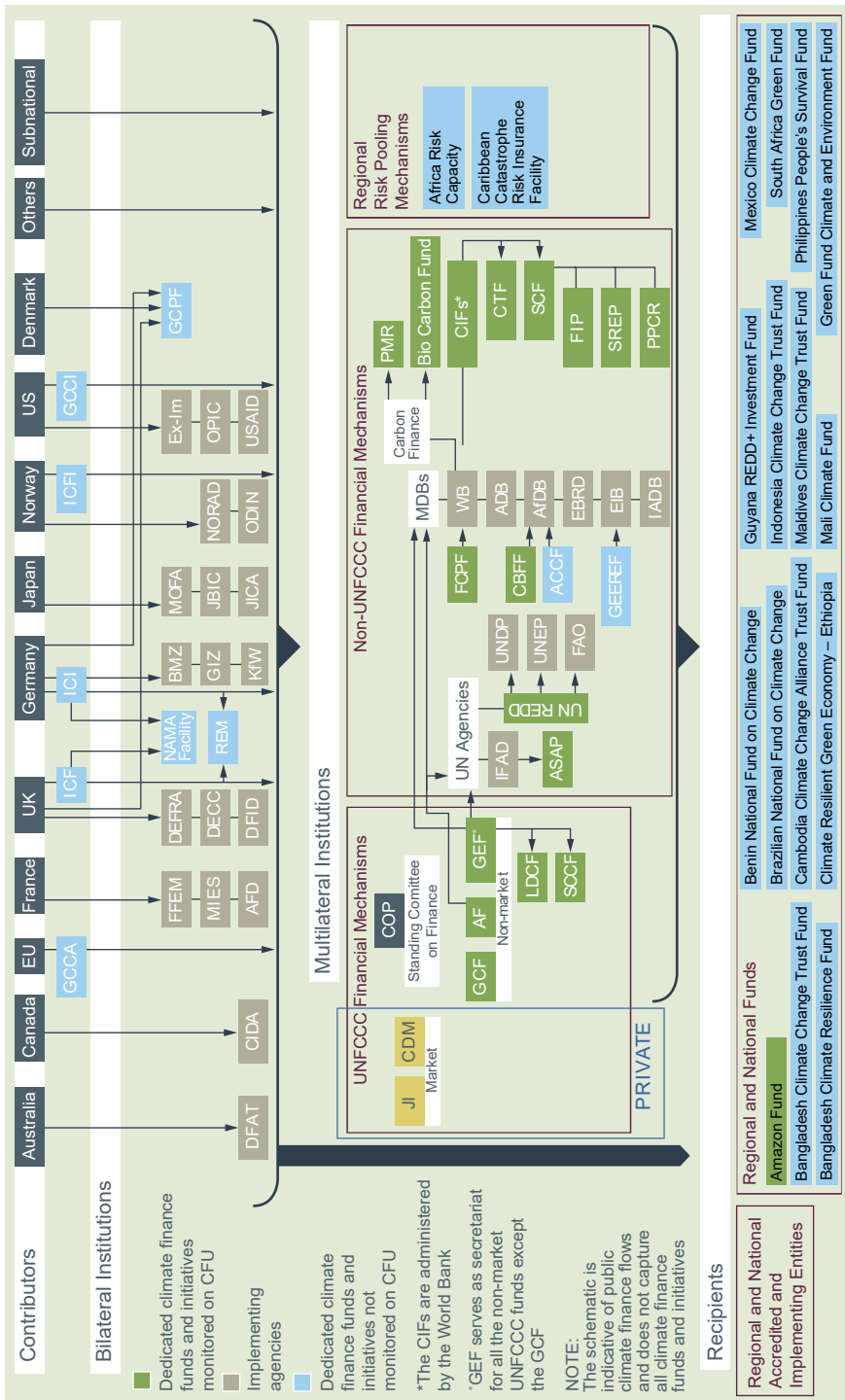

Figure 2.
Institutional structure of climate finance

Source: NAKHODA–WATSON–SCHALATEK 2015, 3.

2. The role of multilateral development banks in climate finance

2.1. The importance of multilateral development banks

MDBs are international financial institutions (IFIs). They are key members of the Bretton Woods financial system established after World War II by sovereign states to foster reconstruction and development. They are important financial intermediators providing finance for long-term and risky investments which are not attractive enough for the private sector but badly needed for development, such as infrastructure, economic and social environment etc. They are focusing on the developing and the transition countries providing loans and guarantees, technical advice and make equity investments. The largest and globally operating MDB is the World Bank, which serves as a model for the regional development banks: the African, Asian and Inter-American Development Bank, the European Investment Bank and the European Bank for Reconstruction and Development. These institutions are only one group of the most important players in global climate finance and can satisfy part of the development needs only. Their role is unique, they cooperate with other climate finance institutions to mobilise as much resources as possible for climate finance through the best use of opportunities and risk sharing. In addition, they are extremely important in the development and dissemination of norms (Park–Vetterlein 2010).

However, MDBs and their activities are also heavily criticised. On the one hand, the influence of the US in their governance and decision-making is said to be problematic, which is a consequence of their ownership structure. On the other hand, their caution and risk aversion make it difficult to finance many of those who are in need. As they are regularly rated by large international credit rating agencies, and the rating determines their position in the capital markets, they only provide loans to creditworthy borrowers and under strict conditions, which does not necessarily coincide with development needs. Criticism is also concerned with their bureaucracy, sluggishness and inflexibility, which makes it difficult and time-consuming to dynamically implement projects in the fast-paced world (Ben-Artzi 2016).

2.2. The commitment of multilateral development banks to climate finance

Climate finance ranks high on the strategic agenda of the MDBs. They play an important role in delivering the annual USD 100 billion climate finance commitment of the developed countries. Under climate finance, MDBs understand the use of financial resources for development activities devoted to mitigating and/or adapting climate change impacts in the developing and emerging countries. For accounting purposes, they have developed and used a common methodology based on the list of activities that can be linked to low carbon emissions (Joint Report 2016, 8–9).

MDBs spend over USD 25 billion annually on climate finance, 80% of which is for mitigation, and 20% for adaptation. Additionally, they provide approximately USD 55 billion co-financing per year. Between 2011–2016 their cumulative climate finance investment amounted to USD 158 billion. The overwhelming majority of climate finance (97%) is made from own, the rest is from external resources. They are provided by bilateral donors or the climate funds managed also by the MDBs.

MDBs provide 75% of the climate finance in loans. Aid, guarantees, budget support, capital investments and other assets represent a relatively small share − between 6 and 1% – but their amount is not to be neglected as they are extremely important to mobilise the private sector for co-financing.

The main beneficiary of climate finance of the MDBs is the public sector. It receives two-third of climate finance from the MDBs' own sources, and three quarters of the external sources, which is a much smaller amount. Interestingly, AfDB finances only the public sector, while EBRD is the only MDB that finances the private sector more than the public sector.

Regarding geographical targeting, 20% of MDBs' climate finance is directed to non-EU Europe and Central Asia, 19% to South Asia, 15% to Latin America and the Caribbean, 14% to East Asia, 13% to 11 EU countries, 9% to the Middle East and North Africa, and another 9% to the sub-Saharan region. Least developed countries receive 15% of climate finance and small island states another 2%. As climate finance is mainly used for mitigation, it is expected to bring the most benefit in the major polluting countries.

Climate finance represents 15–18% in the investment portfolio of MDBs in general. There is one exception, EBRD invests more than 25% of all investments in climate finance (Joint Report 2016, 8–9).

Climate investments of the MDBs have fundamental impact on many people's lives. For example: "Renewable energy projects representing 10 gigawatts of generation capacity, and 10 new operations, that when in place will improve the climate resilience of over 50 million people" – said John Roome, Senior Director for Climate Change of World Bank Group (Press release 2018). This way, MDBs are key to upscale climate protection and reach out to regional or even to global level.

These figures show that MDBs have a prominent role in climate finance, which became even more important after the Paris Climate Agreement. Each of them has set ambitious targets for rapidly expanding climate finance and is enhancing its activity in this field.

Table 1.

MDBs' commitment to climate finance

	2020 Climate Finance Target
ADB	To double climate finance to USD 6 billion per annum, USD 4 billion for mitigation and USD 2 billion for adaptation (up from USD 3 billion in 2015)
AfDB	To triple climate finance to 40% of the annual investments, ca. USD 5 billion (up from 26% on average between 2011–2014)
EBRD	40% of annual investments for green finance (composed of climate finance and finance for projects with a possible environmental impact) (up from 25% on average between 2010–2014)
EIB	35% of annual lending, ca. EUR 2 billion per year (25% in 2015)

	2020 Climate Finance Target
IDBG	To double climate finance to 30% of approved loans, an average of USD 4 billion a year, and climate risk assessment, identification of opportunities and measures to improve resistance and mitigate the effects of climate change (up from 14% on average between 2012–2014)
WBG[2]	To increase the amount of climate finance by one third to USD 16 billion annually, and its share in the annual commitment to 28%. WBG wants to maintain the current level of co-financing, which would increase climate finance by another USD 13 billion a year. The combined value of direct and co-financing would thus reach USD 29 billion a year. (up from 21% in 2015)

Source: Joint Report 2016, 7; Cuntz et al. 2017, 13.

To reach these ambitious targets MDBs need to enlarge the scope of their activities and improve efficiency. There are many ways to enlarge the scope: establish new MDBs, increase sources for climate finance, mobilise private capital and co-finance with the private sector, provide risk sharing facilities by partial credit guarantees, introduce financial innovations like green bonds, cat bonds, green credit lines, insurance products etc., include environmental and social assessment in all projects, raise awareness, share knowledge, build up capacity and knowhow in risk assessment, help to create bankable and environmentally sustainable projects. To increase efficiency project design and management as well as coordination could be improved, technical and financial experts could be involved, multiple barriers should be tackled, initial interventions could be scaled up and expanded, specific interventions could be replicated in different locations, and scaling up and reproduction could be mixed.

Keeping in mind the strong US influence in these institutions, it is an open question now how the US exit from the Paris Climate Agreement will influence all these efforts and initiatives and affect the climate finance activities of the MDBs (Babb 2009, 20–21).

3. Summary

Climate change has highlighted the need for climate protection including international agreements, voluntary commitments, and investments for mitigation and adaptation which requires tremendous additional financing. Multilateral Development Banks play an important role to provide considerable funding. They account for about 40% of the total climate finance, while climate finance represents about 15–25% in their investments. Their role is extremely important not only due to financing they provide but because of the norms, standards and expectations they create and implement. They are committed to include climate finance into their priorities and increase climate investments. This way they are key to upscale climate protection globally and fight against climate change. To meet targets, they need to enlarge the scope and increase efficiency. The question arises though, how their commitments will be influenced by the new approach of the US President to climate change.

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