Why the World Bank is ill-fitted for climate finance

Key principles and recommendations for equitable climate finance governance

A Eurodad position paper **April 2010**

The Copenhagen Accord, negotiated in the closing hours of the Fifteenth Conference of the Parties (COP) to the United Nations Framework Convention on Climate Change (UNFCCC), included a collective commitment by developed countries to provide resources approaching **$30 billion in fast start financing for the period 2010-2012**. The accord also committed to a goal of mobilising $100bn annually by 2020, for action on both adaptation and mitigation in developing countries. The Accord, which was only "noted" by the UNFCCC COP,[1] does not mention specific institutions that will receive the fast-start funding, and only makes a vague reference to the Copenhagen Green Climate Fund – which is yet to be established – as a channel for a significant portion of the long-term funds.

In this context, Eurodad notes that many contributing countries have expressed support for the World Bank to play a meaningful role in channelling climate finance. This is evidenced by government contributions to existing World Bank climate funds and support expressed in negotiations, including backing for the fast start finance pledged in Copenhagen. In addition, since the adoption of the Strategic Framework on Development and Climate Change in October 2008, the **World Bank has demonstrated its intention to position itself as a key, if not central, institution for channelling climate finance.**

Eurodad is concerned, that disbursement of the fast-start finance through the World Bank may establish important precedents for the governance of long-term climate finance, raising questions about the appropriateness of the institutions, funding criteria and modalities available for managing such funds. In this context, **it is of utmost importance that fast-start finance does not compromise the opportunity to build a fair and effective architecture for the future** under the UNFCCC, building on the Least Developed Country Fund, Special Climate Change Fund and the Kyoto Protocol Adaptation Fund.

The World Bank's poor track record on legitimacy and effectiveness

The World Bank's undemocratic governance structures and its track record of imposing programmes and policy conditions on developing countries, seriously discredit the institution as the appropriate channel to disburse climate finance, even in the short term.

According to the recent report commissioned by the World Bank itself,[2] the Bank "has not kept up with historical change and today is not adequate to deal with global problems that require forward-looking, flexible, inclusive, and legitimate multilateral institutions".

On governance, the report is damning: "**the decision-making process is widely seen as too exclusive, offering many member countries too little voice and too few opportunities for participation.** Insufficient institutional accountability for results weakens the World Bank's effectiveness and legitimacy".

[1] The secretariat of the United Nations Framework Convention on Climate Change (UNFCCC) has emphasised that the Copenhagen Accord is not legally binding under the UNFCCC.
[2] High-level commission on modernisation of the World Bank Group governance: *Repowering the World Bank for the 21st century*, October 2009.

In addition to its poor democratic credentials, the World Bank has all too often bypassed the principles of country ownership and alignment to national priorities, including by attaching sensitive economic policy conditions to the Bank's development finance, thus undermining the effectiveness of its financial flows. Although the Bank does not attach specific economic policy conditions to climate finance, developing countries are often required to have a WB programme in place to be eligible for climate funds,[3] effectively establishing cross-conditionality between general Bank lending and climate finance.

Lack of alignment to national country priorities, and insufficient use of country systems to channel development finance remain serious concerns for civil society and developing country governments. Civil society is additionally concerned by the allocation of World Bank finance to countries on the basis of a scorecard composed by a set of unrelated, overly detailed and prescriptive criteria, instead of allocating funds according to need.

These long-standing and unresolved problems call into question the Bank's ability and legitimacy to deliver accountable, equitable and effective climate funding. European civil society, in conjunction with southern and international colleagues, strongly advocate for the key principles outlined below to be the benchmarks against which an effective climate finance institution is measured.

The World Bank's harmful impact on the environment and contribution to climate change

The World Bank's own positioning as a major player on climate finance is controversial, among other reasons, because it continues to support fossil fuel projects despite an increase in its lending portfolio to renewable energy. However, fossil fuel projects lack evidence of positive impacts on poverty reduction and have proven significant negative impacts on the environment and climate change.

In fact, World Bank support to the fossil fuel sector has consistently increased in the last decade. Since 2008 the World Bank has resumed financing of large coal power plants, despite coal being the most polluting among fossil fuels. According to a 2009 analysis by the Bank Information Center, **World Bank lending for fossil fuel projects has increased on average by 22% between 2007 and 2009.[4]** In the same period, lending to other energy projects with negative social and environmental impacts also increased.

Moreover, the World Bank has yet to agree on a methodology to assess overall greenhouse gas emissions resulting from its lending portfolio. It has also shown little consideration for the potential impacts on climate change and has failed to seriously explore either the available options to reduce emissions or the costs of adopting more climate friendly approaches to its lending. According to the World Resource Institute, **more than 45% of the Bank's investments, particularly those that support developing countries to develop and implement energy policy, do not take climate change into account**.[5]

Increased Bank lending in the context of the global crisis focused mostly on extractive sector infrastructure, including energy infrastructure. More than an additional $1 billion of crisis response finance is linked to fossil fuel-related infrastructure.[6]

[3] Equitable Adaptation Finance: The case for an enhanced funding mechanism under the UN Framework Convention on Climate Change, ActionAid International, November 2009

[4] World Bank Group Energy Sector Lending Trends, FY2009 Fact Sheet. Bank Information Center.(2009), http://www.bicusa.org/en/Article.11675.aspx

[5] Correcting the World's Greatest Market Failure: Climate Change and the Multilateral Development Banks, World Resource Institute, June 2008.

[6] Forthcoming study of Eurodad member Campaign for the Reform of the World Bank, Bretton Woods Project and Urgewald.

The World Bank needs to acknowledge its responsibility and compensate for the impact of environmentally harmful lending that contributes to ecological and climate debt.

Key principles for climate finance: why the World Bank's Climate Investment Funds are not up to the mark

The Climate Investment Funds (CIF's), hosted by the World Bank as interim climate financing mechanisms,[7] appear to be favoured by many donors for channelling the almost $30 billion in fast-start finance in 2010-2012. Some developed countries are also advocating for a role for the CIF's to house the new foreseen Copenhagen Green Climate Fund. The amounts of money that have been pledged to the CIF's in comparison to alternatives show a preference among powerful donors to channel public funding through the World Bank.[8]

The CIF's have demonstrated some important innovations vis-à-vis the broader operating modalities of the World Bank and of other existing climate finance institutions such as the Global Environment Facility (GEF), including the institutionalisation of civil society observers on executive boards and attempts to move beyond a purely project-based approach. However, the CIF's have ultimately failed to fulfil the following key principles that need to be in place to ensure fair and effective climate finance:

Under the Authority of the UNFCCC Conference of Parties (COP)

The UNFCCC requires that funding for adaptation and mitigation should be under the authority of the Conference of Parties (COP). This is also a key demand of the G77. The COP would need to have authority to approve proposed operational rules and procedures, and to endorse the members of the executive board of the funds. This is not the case with the CIF's. It is unlikely, that any of the Bank's numerous other funds or roles in managing climate finance would be subjected to the authority of the UNFCCC. [9]

Country ownership

Although the CIF committees have equal representation of developing and developed countries, there have been shortfalls in the level of involvement from developing countries**.** The design of the CIF's was largely donor driven; encouraged by the UK's commitment of £800 million and without much consultation with the countries the funds seek to benefit.[10] A discussion paper commissioned by the World Bank on lessons learnt from the CIF's so far, found that in-country stakeholder engagement on investment plans and proposals has been limited.[11]

While civil society representatives have been permitted to CIF committee meetings as observers, they are not allowed to be present when decisions are made, nor do they feel that their views have adequately been taken up.

Fast-start finance should support the democratic country ownership including the full and effective participation of local and affected communities and people, particularly women, in decision making at all stages of activities. The projects supported by these funds must respect human rights and international

[7] The CIF's consist of two funds the Clean Technology Fund (CTF) and the Strategic Climate Fund (SCF). The SCF consists of three programmes to pilot new approaches to climate action: the Pilot Program for Climate Resilience (PPCR), the Forest Investment Program (FIP) and the Program for Scaling up Renewable Energy in Low Income Countries (SREP).
[8] So far donors have pledged $6.2 billion to the CIF's, with the largest portion, $4.9 billion, going to the CTF.
[9] Don't Bank on It, Challenging the World Bank's role in future climate finance, Bretton Woods Project, December 2009 and Mueller, B. (2009) 'Under the authority of the COP?' Oxford Institute for Energy Studies. http://www.oxfordenergy.org/pdfs/comment_02_10_09.pdf
[10] Are we nearly there? Bridging UK supported funds and a post 2012 climate architecture, Bretton woods Project, June 2009
[11] Radner, J. (2010) 'Looking ahead for lessons in the climate investment funds: a report on emerging themes for learning. Consultative draft for comment.' http://www.climateinvestmentfunds.org/cif/node/1100

environmental and social standards. This is an area in which the World Bank has repeatedly shown shortcomings.

Transformational

The CIF's set out to be transformational**,** but there are several ways in which they fail to achieve that standard. In the case of the Clean Technology Fund, there are concerns over insufficiently rigorous funding criteria, which continue to allow funding for coal power plants.[12]

Furthermore, in many of the programmes being funded, the rush to attract large-scale private sector investment and to get programme work going does not leave adequate time for instituting an appropriate regulatory environmen**t.** An appropriate regulatory environment would set policies and regulations through investment plans which promote renewable, sustainable energy, and build institutional capacity to implement this.[13]

Grants/Loans

Each of the funds offers funding as a mixture of grants and loans. This is particularly problematic for the Pilot Program for Climate Resilience (PPCR), the Bank's only fund designed to address adaptation. According to the polluter pays principle, **climate finance should be delivered as grants not loans,** because it is intended to enable Southern countries to cope with the negative impacts of climate change, primarily caused by developed countries. The use of loans rather than grants will lead to a further illegitimate indebtedness in Southern countries.

Finally, there are disparities in which countries will most benefit from the CIF's. For example, the CTF – where the vast majority of the CIF's finance is housed – is targeted at middle income countries for industrial purposes, while programmes targeted at poorer countries to promote energy access for the poor, such as the SREP, have far more limited resources to offer.

Accountability

The **World Bank has repeatedly failed to effectively provide reporting at the project level,** a problem which has been highlighted in numerous reports by the Independent Evaluation Group, among others. [14] This lack of competency presents significant risks for the effectiveness of the CIF's and other climate finance placed at the World Bank. Weak accountability is worsened by an increasing trend for the World Bank to lend through financial intermediaries, which are not required to implement World Bank environmental and social standards.

Recommendations

If the international community is to live up to its commitments to make progress towards accountable, equitable and effective climate adaptation funding, **it is of utmost importance that short-term financing does not compromise the opportunity to build a fair and effective architecture for the future.**

The Bank's undemocratic governance structures, its poor track record of promoting country ownership, and its continued lending for projects that harm the environment and contribute to climate change discredit the institution's capability and legitimacy to serve as the appropriate channel for disbursing climate finance, even in the short term.

[12] CIF's Update March 2010, Bretton Woods Project, http://www.brettonwoodsproject.org/art-566053
[13] See Box 2 of The Clean Technology Fund, WRI Working Paper http://www.wri.org/gfi
[14] Environmental Sustainability: An Evaluation of World Bank Group Support; Climate Change and the World Bank, IEG, July 2008.

Moreover, the failure of the CIF's – which appear to be favoured by many donors to channel the foreseen $30 billion in short-term financing for 2010-2012 – to live up to key principles that should inform both short term and long term climate finance, strongly discourages the use of the World Bank as a climate finance institution.

Therefore, Eurodad recommends that:

- **The role for the Bank in climate finance must be limited and phased out** by upholding the sunset clause of the CIF's.
- **New money, including that for fast-start finance, should be channelled to institutions that are more appropriate than the World Bank** such as the Adaptation Fund and the Least Developed Countries Fund that are housed under the UNFCCC. Governments must ensure that fast start finance does not encourage the Bank becoming the default institution to house long-term climate finance.
- **The World Bank must be held accountable for the climate impact of its lending portfolio**, with clear project by project accounting of greenhouse gas (GHG) emissions, and a clear action plan for phasing out of fossil fuel and other most polluting and environmentally sensitive projects.
- **The global climate fund -** an enhanced financial mechanism established under the authority of the UNFCCC - **proposed by the G77 and backed by civil society must be supported as a long term solution to climate financing**.