The World Needs a Bank for Global Public Goods and the World Bank should be reformed to play that role

A new Global Public Goods Bank within the World Bank Group

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Context and Overview

The World Bank's shareholders and senior staff are consulting and inviting submissions on how it should evolve as an institution to advance its' mission of a more sustainable, resilient, and inclusive world. At the 2023 Spring meetings of its shareholders, conflicting views were on display about striking the right balance between traditional development challenges, which are particularly acute after a global pandemic, spillover effects from an on-going war, and in a high-interest environment, and other global challenges like climate change and pandemics, which are proven to reverse development gains and threaten future prosperity the world over.

Categorically, the World Bank must continue to support people out of extreme poverty and help countries tap into the economic forces that will power their future progress and prosperity. Given the stiff headwinds, we need a strong International Development Association (IDA) and donors should increase their contributions in the next replenishment round to mobilize over $100 billion for lending to the poorest countries[2]. The balance sheet of the International Bank of Reconstruction and Development (IBRD) also needs to be much larger to help middle-income countries through the current circumstances. To that end, we welcome the recent decision to lower the loan-to-equity ratio which is expected to unlock an additional $50 billion for IBRD over the next ten years[3]. We state this explicitly and upfront but that is not the subject of this paper.

There is a way for the World Bank to do all three tasks at once -- tackle poverty, barriers to growth and climate change – and that is by creating a third lending window focused on Global Public Goods (GPGs) to sit alongside IDA and IBRD. In this paper we explain our rationale, suggest a financing and capitalization model, and propose a governance structure and funding allocation mechanism. We share this idea now as part of a menu of options being considered by the future President of the World Bank Group, the hosts of a summit in France on solutions to the global finance challenges, the UAE as President of COP28, and shareholders of the World Bank looking for a way to deliver real outcomes from the evolution roadmap. Climate change is urgent, and it's not going away. It is time to grip the scale of the challenge and coalesce around a commensurate solution. We do not see an alternative proposal that realistically provides a shot at bending the emissions curve to safer levels. We propose the World Bank's shareholders

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[2] IDA 20 mobilized $23.5 billion from donors which combined with IDA borrowing and reflows amounted to a total size of $93 bn. Many are calling for donors to double their IDA contributions in the next round. At the very least IDA 21 should mobilize $30bn or more, for a total size surpassing $100bn.

[3] Chair's Statement: 107th Meeting of the Development Committee (worldbank.org)

mobilize to have a GPG Bank operational by 2025, on the 10th anniversary of the Paris Agreement.

Introduction

There have been growing calls for reform of international financial institutions because the international community has been unable to rise to the existential threat of climate change, with progress too slow, official financial transfers to the Global South well short of agreed amounts and growing evidence of loss and damage affecting the most vulnerable populations and ecosystems. At the same time, there are several other global environmental problems with transboundary impacts, such as biodiversity loss, persistent organic pollutants, and plastics pollution. The Covid-19 pandemic also demonstrates the importance of international financial support to the Global South to address health emergencies with global ramifications.

No single country has an incentive or the ability to solve such problems, which is why solutions are seen as Global Public Goods (GPGs), generating benefits for all. Furthermore, countries of the Global South often do not have the resources to sufficiently invest in these areas. See Box 1 for a summary of factors that have hindered the achievement of more transformative impacts on climate change.

Box 1: **What factors to date have hindered the achievement of more transformative impacts on climate change?**

• **Other national priorities take precedence in funding decisions because:**

– National investment/program decisions don't fully consider global public good benefits. IEG reports show a disconnect between country priorities and global priorities. Developing countries are understandably reluctant to increase their borrowing for investments to mitigate global public "bads" which they had a minimal role in creating, and where they might not capture many of the benefits from the investment. Yet delivery of climate programs is likely to produce both local and global benefits. [Evans, J. Warren, and Robin Davies, eds. 2015. Too Global to Fail: The World Bank at the Intersection of National and Global Public Policy in 2025. Direction in Development. Washington, D.C.: World Bank. Doi:10.1596/979-1-4648-0307-9.]

– There is not a full understanding of or priority commitment to issues related to climate change and measures to respond to climate challenges. In some countries, there has been skepticism about the urgency of the climate change problem and the cost-benefit analysis for taking immediate climate action. Needed investments may be associated with a risk of significant short-term political costs (job loss and prices increases) while investing in competing priorities may be more expedient (raising short term income, investing in familiar technologies as opposed to more costly climate-friendly innovations, supporting industries that have already made substantial investments in the economy). [Custer, S., Sethi, T., Knight, R., Hutchinson, A., Choo, V., and M. Cheng. (2021). Listening to Leaders 2021: A report card for development partners in an era of contested cooperation. Williamsburg, VA: AidData
at the College of William & Mary.]

• **Countries may lack financially viable alternatives in current carbon intensive sectors.**

• **Countries may face supply and demand constraints in borrowing**—The Bank's lending capacity is limited by its capital and may set lending ceilings, the so-called single borrower limits, to mitigate credit risk (see Box 3). On the demand side, many countries have limited debt capacity, particularly after the Covid pandemic, others may have a risk profile that constrains the amount they can borrow.

The Bank does not have access to adequate volumes of concessional finance to compensate for the divergence between domestic benefits and global benefits and the additional costs of climate-smart development.

Source: **REFORMING THE WORLD BANK TO PLAY A CRITICAL ROLE IN ADDRESSING CLIMATE CHANGE, Pedro Alba, Patricia Bliss-Guest, and Laura Tuck, Center for Global Development (March 2023)**

Many funds have been established to address specific GPGs, but their reach and scale of financing are limited, and they introduce additional complexity and bureaucracy to the international financial architecture. There have also been calls to establish a new global Green

Bank, but experience shows that it takes many years for new institutions to become effective, and a Green Bank would not have a mandate to tackle other GPGs.

However, there is already a global institution with deep capital leverage, expertise across sectors, and a presence in virtually all countries of the Global South. It is the International Bank for Reconstruction and Development (the World Bank), established after the Second World War to rebuild Western Europe, and then expanded in the 1960s to focus on infrastructure development and poverty reduction in the Global South.

Table X shows how the Bank has evolved and added institutions to date. What we are proposing is similar to the decision to create IDA because the existing structures at the time – IBRD and IFC – were not fit for the purpose of poverty alleviation in lower-income countries.

World Bank Group[4]	Founded	Rationale	Net Commitments
International Bank of Reconstruction and Development (IBRD)	1944	To provide non-concessional loans and guarantees to middle-income governments	$33.1 billion (FY22)[5]
International Development Association (IDA)	1960	To provide concessional loans and grants to low-income governments	$37.7 billion (FY22)[6]
International Finance Corporation (IFC)	1956	To provide non-concessional loans, equity investments and loan guarantees to private sector firms in middle- and low-income countries	$32.82 billion (FY22)[7]
Multilateral Investment Guarantee Agency (MIGA)	1988	To provide political risk insurance (guarantees) to encourage foreign direct investment into development countries	$4.9 billion (FY22)
International Centre for Settlement of Investment Disputes (ICSID)	1966	To mitigate and arbitrate investment disputes to encourage the international flow of investment	N/A

Some of the World Bank's shareholders have rightly called on the Bank's management to prepare a roadmap for the reforms necessary to dedicate more resources to climate change. This is not a consensus view as many of the Bank's clients have expressed concern about what they perceive as the one-sided and zero-sum nature of the conversation so far. A formal consultation process is underway.[8] The appointment of a new Bank President in the coming months provides an opportunity for fresh thinking and a course-correction in terms of the level of ambition, creativity, and urgency the moment calls for.

Best of Both Worlds

In an article for the Policy Center for the New South, Hafez Ghanem (former World Bank Vice President for Africa)[9], argues that the existing multilateral development banks, as currently

[4] While the focus of this paper is the World Bank Group, for fuller reference, the Inter-American Development Bank (IDB) was founded in 1959; the African Development Bank in 1964, the Asian Development Bank in 1966 and European Bank for Reconstruction and Development (EBRD) in 1991. The African Development Fund was created in 1972 to channel grants to low-income governments in the region. Likewise, with the Asian Development Fund in 1973. The point is there has been continual evolution of the multilateral development banks architecture when the need is well documented and political will mustered. This is not to mention universe of national development finance institutions and their innovations.

[5] IBRD-Financial-Statements-June-2022.pdf (worldbank.org)

[6] IDA-Financial-Statements-June-2022.pdf (worldbank.org)

[7] Annual MD&A and FS Document FY22 (ifc.org) – combined LTF and STF

[8] Consultations on the WBG's Evolution Process | World Bank Consultations

[9] https://www.policycenter.ma/index.php/publications/world-needs-green-bank

structured, could not effectively meet the climate challenge, for three reasons. First, reaching the needed level of climate financing will require a substantial capital increase that will be a huge burden on its shareholders. Second, the World Bank is not able to mobilize sufficient private-sector climate funding. Third, the governance structure of the World Bank and other MDBs is not conducive to increasing climate financing. He concludes:

> "If the World Bank and other MDBs are pushed to become green banks, the focus on development and poverty reduction risks being diluted. Furthermore, because of their governance structures and their country-focused operating model, they may not be successful green banks. The result could be the worst of both worlds: ineffective development institutions and ineffective green banks."

However, it is our view that one could have the best of both worlds with the establishment of a new financial institution, separate and distinct from IBRD but part of the World Bank Group, dedicated to supporting global public goods, and with an innovative governance and financing model. Rather than broadening IBRD's mission, the World Bank Group should include a bank with a sharp focus on GPGs. Rather than creating yet another international organization or the further proliferation of trust funds with their own bureaucratic structures, the international community should draw on the strengths of the existing global bank and use this as an opportunity to rationalize and right-size the existing architecture, with each institution playing to its strengths.

A recent paper prepared for the Center for Global Development by three former senior leaders of the World Bank -- Pedro Alba, Patricia Bliss-Guest, and Laura Tuck[10] -- makes a similar argument. They call for the establishment of a new (third) World Bank financing window, alongside IBRD and IDA, for funding GPGs, with an initial focus on climate change. They, too, argue that GPGs are not adequately addressed through IBRD/IDA country programs and the scale of financing required to address climate change (let alone several GPGs) far exceeds IBRD and IDA's financial capacity.

Alba et al review various options for the World Bank to address GPGs more effectively and conclude that a new financing window would be more practical and more likely to achieve the financing objectives than other options, such as an omnibus financial intermediary trust fund or extending the existing GPG Fund in IBRD. They note that a new window would have potential for greater scale as well as provide transparency for shareholders who want to ensure that additional capital is used for GPGs and that financing for GPGs is not at the expense of IBRD and IDA lending for non-GPG development needs.

Box X: A new GPG window at the World Bank – pros and cons of different options

A new GPG/climate window could be established with its own balance sheet and income statement, or it could use IBRD's balance sheet. Alternatively, an omnibus climate trust fund could be established, consolidating existing climate trust funds and financial intermediary funds (FIFs) and raising additional funds, harmonizing and simplifying the criteria for access and terms. There are advantages and disadvantages of each approach.

Using the IBRD balance sheet

Using the IBRD balance sheet would take advantage of the Bank's existing portfolio diversification, which is likely to be positively affected if climate funding is provided to UMICs that are not currently borrowing for them to make significant emission-reduction

[10] https://www.cgdev.org/publication/reforming-world-bank-play-critical-role-addressing-climate-change

investments. Overall, the use of IBRD's existing balance sheet is likely to be more financially efficient than creating a new window that would have to be rated and would need to establish a reputation among bond investors. On the other hand, the challenge to using the existing IBRD balance sheet is the need to raise capital from all member countries (proportional to their existing shares) even though some countries may not be interested in contributing to a climate-focused agenda. If capital is raised from only a few countries, this could lead to an increase in their voting shares and other member countries could object.

In addition, the Bank would have to develop a process to ensure that these new funds are used exclusively for the delivery of climate finance. This is likely to prove technically complicated and difficult to monitor over time as capital is returned by borrowing countries. Without such assurances, it is unlikely that shareholders interested in furthering the climate agenda would increase their contributions significantly. This is evident by the fact that they fund so many climate-related TFs and FIFs, rather than making larger contributions directly to the Bank. Note too that the lack of clarity on how funds are being deployed may also cause concerns among borrowing countries that IBRD resources which had previously been used for poverty reduction programs might be redeployed for mitigation programs.

Opening a third window (in addition to IBRD and IDA)

Opening a third window would allow for the provision and use of climate funds to be clear and transparent. This could potentially generate additionality in resource mobilization as many donors strongly support the climate agenda and would like to see a significant scale up. It is expected that many could be enticed to increase their contributions if it would enable the Bank to make a step change in global climate impact, given its outstanding financial, technical and governance reputation. Donors would have the added benefit that their funds would be indisputably credited toward their climate finance commitments. The third window could also serve to mitigate any concerns from borrowers that the existing IBRD lending capacity for broader development objectives would be compromised.

On the downside, opening a new window would be complex from a financial and governance perspective. A new balance sheet would have to be created and a new Board established. Determining voting shares could be politically time consuming. These difficulties and potential delays are not, however, likely to be more so than those of using IBRD with the need to secure agreement from all shareholders and develop credible processes for ensuring the use of new resources are used only for climate purposes.

Establishing an omnibus FIF

Establishing a FIF dedicated to climate could also bring significant climate benefits. If it were to consolidate many (if not most) existing climate TFs and FIFs, and harmonize and streamline the criteria for access, procedures, requirements, and terms, this would bring significant benefits for clients. Such a reform, however, is not as straightforward as it sounds since the multiplicity of criteria across existing funds is a result of many donor requests or requirements, and this has thwarted many attempts to make progress in this area over the last decade or so. A new FIF would make the provision and use of climate funds clear and transparent and would have the added benefit that funds could be allocated to other MDBs, as done currently with the Climate Investment Funds -- although a new window could also be designed to provide co-financing for MDB operations.

On the downside, in order to match the Bank for financial efficiency, the FIF would have to create its own balance sheet, secure a rating, issue bonds to leverage the capital newly provided by potential shareholders, and create its own governance structure. This would be in many ways equivalent to creating a new financial institution with the resulting complexities. Furthermore, such a new institution would unlikely be able to be as financially efficient (that is, achieve as large a leverage and maintain the same rating) as IBRD or a new window, at least initially. Depending on the extent to which the new FIF is not able to rely on the Bank and potentially other MDBs for critical back-office functions, it would have to duplicate these functions using scarce financial resources and time.

As mentioned, each of these three options has advantages and drawbacks. Any of the three could lead to increased climate financing, but on balance, the creation of a third window, is recommended. We believe it has the most potential to secure significant additional financial resources for investments in mitigation and adaptation and to deploy these resources quickly and efficiently.

Source: REFORMING THE WORLD BANK TO PLAY A CRITICAL ROLE IN ADDRESSING CLIMATE CHANGE, Pedro Alba, Patricia Bliss-Guest, and Laura Tuck, Center for Global Development (March 2023)

This paper further develops the proposal for a third World Bank window – a new GPG Bank – with newly raised capital and repurposed IBRD capital. It would be broadly modeled on IDA, the Clean Technology Fund (CTF), and the International Financing Facility for Education (IFFEd), and would be established consistent with the following principles put forth by the 'G11' group of World Bank member countries:

- Expanded concessionality or lending volumes for middle-income countries must not come at the expense of concessionality or lending volumes for low-income countries.

- Expanded lending volumes for global public goods must not come at the expense of existing lending for core development challenges in IBRD and IDA countries.

- Expanded concessionality or lending volumes for global public goods must not come at the cost of increased pricing for IBRD and IDA countries.

The proposed GPG Bank would also be consistent with the concept of an IBRD Concessional Fund, presented in the *Evolution of the World Bank Group – A Report to Governors," for the April 12, 2023 Development Committee Meeting*, which would need the following design parameters to be fit for purpose: separate governance from IBRD (recognizing levels of donors contributions from IBRD), substantial capital injections that are ring-fenced for the agreed global public goods, and internal decision making about project preparation and budget allocations that would need to be taken jointly by country units and global practices.

Scope of Global Public Goods

The GPG Bank would focus on the subset of global challenges that meet the definition of global public goods. These should have a global transnational nature, with global externalities, and for which countries incur additional costs or face specific barriers to deliver global public goods. Countries in the Global South do not have the same level of access to capital markets for borrowing in times of crisis as do say the United States and Europe. Public debt ratios are on the increase after a series of exogenous shocks, further constraining financing for domestic development priorities and global challenges, even if the incentives were aligned.

The purpose of the GPG Bank would be to promote country actions on agreed global public goods and the achievement of related Sustainable Development Goals, by providing finance to meet their additional costs on terms which are more flexible and bear less heavily on the balance of payments than those of conventional loans, thereby furthering the developmental objectives of the World Bank Group.

For expediency, we propose the scope of GPGs to be covered by the new bank would in the first instance be primarily climate change mitigation, with tailored solutions for other global public goods with contagion potential developed separately and phased in. Not all GPGs are the same: we invite proposals from groups with more knowledge on the specific investments required and allocation models better suited for pandemic preparedness, food insecurity, financial instability, displaced people and host communities, and post-conflict reconstruction. In the interim, we suggest an 80:20 split, with 20 percent of financing reserved for non-climate global public goods through a crisis window.

Climate mitigation investments would address both the sources and sinks of greenhouse gas emissions. The GPG Bank would support countries of the Global South in their efforts to reach net-zero emissions globally by 2050, recognizing the principle of common but differentiated responsibilities under the climate change convention. The GPG Bank would seek to mobilize at least $100 billion per year -- from its own capital and through co-financing from IBRD/IDA/IFC, other bilateral and multilateral development banks, and the private sector.

GHG emissions reductions at the scale necessary to limit global warming to 1.5C predominantly originate from a few sectors, chief among them the energy sector. For each sector, the GPG Bank should develop a strategic objective. For example, in the energy sector, the objective could be to achieve the following target by 2050: development of an energy sector based largely on renewable energy and electricity accounting for about half of energy consumption.

This would be achieved by investments, at scale, in energy efficiency, renewable energy generation (including support for national incentive schemes, such as tax credits, and risk sharing facilities); regulatory regimes, transmission and distribution systems (including regional interconnections and distributed renewable energy systems), energy storage, demand-management systems, and grid ancillary services for integrating variable renewable energy; coal phase-out, including for just transition; green hydrogen production and distribution; workforce development for the energy transition; modal shifts in transport; and, decarbonization of buildings, cooling, heating, industry, and transport.

The GPG Bank would also invest in the planet's carbon sinks; a 2018 UN report found that deforestation alone contributed about 10 percent of all anthropogenic greenhouse gas emissions. Investment would include restoration of land (e.g., agroforestry and grazing management) and the protection of critical ecosystems.

The United Nations Biodiversity COP15 agreed to address biodiversity loss, restore ecosystems, and protect indigenous rights, with the objective of putting 30 per cent of the planet and 30 per cent of degraded ecosystems under protection by 2030. It also set a target of raising international financial flows from developed countries to developing countries to at least US$30 billion per year. The GPG Bank would support the implementation of this agreement by mobilizing about 50% of this target, from its own capital and through co-financing from IBRD/IDA/IFC, other bilateral and multilateral development banks, and the private sector.

The remainder of this paper focuses on how the GPG Bank could be established to address climate change mitigation; the other GPG focal areas could be the subject of further consultations on and responses to this paper. Climate adaptation and resilience would continue to be funded by IBRD/IDA, the Green Climate Fund, the Global Environment Facility's Adaptation Fund, and the Loss and Damage Fund -- although some adaptation and resilience investments could also be eligible under the biodiversity and food security GPGs. For example, certain investments in improving the resilience to extreme weather events of agricultural systems that are critical for global food supply could be considered a global public good.

Key Operational Features

A key feature of GPG operations would be the requirement to have IBRD/IDA/IFC co-financing and/or co-financing from other multilateral and/or bilateral development banks. In fact, coordination with other international financing institutions and joint work on project development and financing should be baked into the design of the GPG Bank and help to strengthen the MDB ecosystem. This could be achieved through the adoption of co-financing agreements with all international development finance institutions whose objectives align with the GPG Bank. These co-financing agreements would also define how the GPG Bank would deploy other financial instruments, such as guarantees and interest buy-downs, to reduce the cost of borrowing from other banks by public and private entities for projects that produce global public goods. Box X summarizes specific measures that could be taken for an enhanced MDB collaborative partnership on climate change finance.

Box X: **Measures to promote collaboration among MDBs on climate finance.**

Among the MDBs, active partnership and collaboration would contribute to better planning, reduced transactions costs for shareholders, recipient countries and the MDBs themselves, as well as improved sharing of knowledge and lessons. The Bank, with its global scope, size and analytical and knowledge capacity is well placed to lead an MDB collaborative partnership on climate change finance. Such a partnership could be structured to ensure the following.

Regular meetings and consultations could be held with the heads of the MDBs on the climate change strategy and agenda. MDB leaders currently meet twice a year on the margins of the Bank/IMF Spring and Annual Meetings. These meetings could include a standing agenda item on climate change with significant time and preparation to ensure meaningful oversight of a joint climate change strategy and its implementation. The bi-annual reviews would be an opportunity for MDB leadership to provide recommendations to strengthen the collective agenda through action by the MDB Boards, MDB staff and the global community. Agreement should be reached by the MDB heads on a shared strategy for their contributions to net zero emissions and other aspects of the Paris Agreement, and climate change adaptation and resilience. In preparing a collective strategy to be endorsed by the Board of each MDB, consideration should be given to experience, knowledge and lessons learned from past MDB collaboration in climate finance, especially experience gained through multi-MDB Financial Intermediary Funds, such as the Global Environment Facility and the Climate Investment Funds. The strategy could usefully consider, among other things:
– identifying useful collaboration among MDB staff for developing climate analytics.
– setting collective climate change outcomes and outputs.
– agreeing on common definitions and measurement of outcomes for global climate.
– establishing collective monitoring capacity and strengthening collective reporting to the MDB boards and the international community.
– harmonizing MDB climate finance standards and processes.
– providing opportunities and means to share transaction costs to scale the pipeline of projects and investments, in particular through joint consultations at the country level.
– ensuring regular consultations and information sharing amongst MDB management
and staff working on climate. These consultations could be expanded on a regional basis (i.e., Boards of large MDBs working in a region) to selected committees of the Boards of the MDBs.

Adoption of co-financing agreements between the GPG Bank and MDBs would provide shared access to concessional climate finance, similar to the Climate Investment Funds operations.

Source: REFORMING THE WORLD BANK TO PLAY A CRITICAL ROLE IN ADDRESSING CLIMATE CHANGE, Pedro Alba, Patricia Bliss-Guest, and Laura Tuck, Center for Global Development (March 2023)

The GPG Bank would provide financing through lending to national governments, to sub-national entities (public or private) through on-lending by national governments, or lending directly to public or private sub-national entities. For sub-national entities not considered creditworthy by the World Bank, additional credit enhancement would need to be provided, such as a guarantee from the government or another creditworthy entity. While unconventional, there is precedent for non-sovereign and sub-national lending by the World Bank.

The GPG Bank's focus on climate action opens space for new thinking on this front, especially given the federalized nature of many of the key emerging markets. That said, recognizing the fundamental over-arching principle of country-based engagement in the World Bank Group, all GPG Bank-financed operations would need to be signed off by the appropriate national authority, as is currently the case for IBRD/IDA operations.

The GPG Bank would first assess whether risk mitigation instruments could be a more efficient means to mobilize private capital for a project or portfolio of projects, instead of or in combination with loan support from the GPG Bank. The GPG Bank would also adopt a private capital mobilization target and seek to dramatically increase private finance for specific projects or portfolios. The GPG Bank could also take a position in investment funds alongside private

investors and/or sovereign wealth funds, perhaps in a first loss position. The GPG Bank could also be a clearing house for private banks and funds actively seeking help to aggregate and apply de-risking instruments, especially in emerging markets. These ideas could be a design feature from the get-go and dovetails with wider endeavors to operationalize a county platform approach to achieve scale and speed and attract larger institutional investors.

Financing

The GPG Bank should enable country action on GPGs by providing low-interest loans with longer tenors than IBRD, as part of an overall World Bank Group and MDB blended financing package that tailors terms to a target level of concessionality to make a project viable. For example, concessional funds are essential to addressing the high up-front capital costs of renewable energy and energy efficiency investments, particularly in low- and middle-income countries with limited fiscal space and high cost of capital.[11]

A simple and politically palatable approach might be to apply IDA terms in the new bank, which would ensure that terms would be no more concessional than those offered to low-income countries for poverty alleviation and development projects, while providing a high level of grant element for the provision of global public goods.

IDA financing terms are determined with reference to recipient countries' risk of debt distress, the level of GNI per capita, and creditworthiness for IBRD borrowing. The GPG Bank would offer low-income countries the same terms as they receive from IDA. Middle-income countries would be eligible for IDA blend terms. Commitment charges and guarantee fees would also follow IDA terms. It is likely that most, but not all, of the financing will be to middle-income countries, since the largest emissions reductions potential is in these countries and financing can be deployed with greater leverage. In addition, low-income countries should also have access to a strong and expanded IDA funding envelope. Differentiated loan pricing also might be considered for different types of investments.

It is proposed that the GPG Bank be sufficiently capitalized to lend about US$35-40 billion per year, at about the same level as robust IBRD and IDA lending in recent years. [12] Assuming about 80 percent of the GPG Bank's funding would be allocated to climate change mitigation (given the scale and urgency of the problem), this would double the World Bank Group's FY22 lending for climate finance.[13] If every dollar from the GPG Bank could mobilize $4 in co-financing (from IBRD/IDA/IFC, other bilateral and multilateral development banks, and private capital), the total financing package for climate mitigation would be in the range of US$175-200 billion annually.

According to a recent World Bank report[14], power sector investments in low- and middle-income countries (excluding China) would need to quadruple to achieve SDG7 on access to reliable, sustainable, and modern energy and the Paris Agreement. Doubling WBG climate finance with

[11] According to Homi Kharas and Amar Bhattacharya in "The Trillion Dollar Bank" (Center for Sustainable Development at Brookings, April 2023), "As a rough rule-of-thumb: Each percentage point difference in the cost of capital will affect the levelized cost of electricity by 0.5 cents/KwH. See for example, the DOE Office of Indian Energy, Levelized Cost of Energy, https://www.energy.gov/sites/prod/files/2015/08/f25/LCOE.pdf"

[12] Insert: actual amounts & latest figures for IDA and IBRD

[13] The World Bank Group would continue to have Paris Alignment targets and track climate finance in IBRD, IDA, MIGA and IFC, so that the GPG Bank's financing would count as additional.

[14] Scaling Up to Phase Down (worldbank.org)

the addition of the GPG Bank would go a long way towards filling the investment gap, if it is accompanied by fossil-fuel subsidy reforms, improving the creditworthiness of utilities, and other sector planning, policy, and regulatory reforms that lower the cost of capital and create the necessary investment climate in the Global South.

This estimate is also generally consistent with the argument made by Kharas and Bhattacharya for IBRD to triple its sustainable annual lending to about US$100 billion per year as its contribution to the annual incremental external financing needed "to drive a strong recovery from the present crisis, to restore momentum to the SDGs, and to ensure that we can keep climate and nature goals within reach." They argue that about one-half of the incremental investments will be needed for climate action, and the remainder for the rest of the SDGs. Therefore, if the GPG Bank (rather than IBRD) is capitalized for the climate change mitigation portion of the increased lending, then half of the proposed increment of about US$65 billion annually would be lent by the GPG Bank – which is in the range proposed by us.

Capitalization

We reaffirm our view that a strong IDA replenishment is a priority for already constrained donors. Implementation of the G20's Capital Adequacy Framework recommendations is necessary but not sufficient to speed-up low carbon transition, build resilience to climate shocks; protect, and restore natural capital while ensuring a just transition within and across countries. For all this to be made manifest, a stepwise mobilization of resources is going to be required. The sooner we grasp that fact and marshal the political will and ingenuity to act, the more likely we will be able to meet the Paris Agreement targets.

With that said, the GPG Bank should have Preferred Creditor Treatment as a member of the World Bank Group and seek to have a AAA-rating like IDA. It would be based on a hybrid financial model consisting primarily of quasi-equity and concessional loan and grant contributions. Given its highly concessional nature, the GPG Bank would require periodic replenishment.

The World Bank would invite the private sector (such as philanthropies and sovereign wealth funds) and official development partners to be shareholders of the new GPG Bank, recognizing that donor funds alone will not suffice and with a clear understanding that it should not adversely impact IDA or IBRD's lending capacity and AAA rating.

The World Bank would propose a reform of the fragmented international financial architecture for climate finance. The World Bank would draw on its role as trustee of various funds to rationalize the patchwork of funds and work with governments to develop a framework that better aligns the Bank's capital with international environmental agreements and streamlines country access.

In particular, the World Bank Group would phase out all its climate change mitigation trust funds, negotiate with donors the transfer of their assets to the GPG Bank, and re-direct new contributions to the GPG Bank – except for the Green Climate Fund and the Global Environment Facility (which have special status under the climate change convention) and World Bank Group trust funds specifically for advisory services, analytics, and project preparation. The Green Climate Fund and the Global Environment Facility (GEF) also have the unique feature of providing direct access for a wide variety of entities; once the GPG Bank is

operational and providing concessional finance to the MDBs, they would no longer require access to the GCF and GEF for their climate change mitigation operations.

The capital structure of the GPG Bank would be based on voluntary contributions (rather than a burden-sharing arrangement) with the following building blocks, which would be a mix of existing and new financing approaches (summarized in Table 1):

Block 1: IBRD. IBRD shareholders have agreed on several steps to increase its financing capacity to meet the needs of an enhanced World Bank Group mission.[15] A package of measures were announced during the Spring meetings that amounted to US$50 billion over ten years (revising IBRD's minimum equity-to-loan (E/L) ratio from 20 to 19 percent, increasing the limit for IBRD shareholder guarantees from current US$10 billion to US$15 billion). It is proposed that about half of the increased IBRD capital from these measures be made available for lending by the GPG Bank, along with some net income transfers, to be blended with other concessional resources for global public goods.

There is an alternative or additional proposition: IBRD shareholders could agree to further lower the E/L ratio to 18 percent, with the US$40 additional billion unlocked (over 10 years) be fully allocated to the new GPG window. Development Committee records show that this option was actively considered, and it goes without saying this could only be pursued if it did not jeopardize IBRD's AAA credit rating.

Another option would be to treat the IBRD capital like an endowment and use only the investment income to provide the grant element in the GPG Bank's concessional loans. Assuming 5 per cent returns, this would mean the GPG Bank would have about US$1.25-2 billion in concessional lending capacity. Alternatively, IBRD could transfer this amount from its own net income.

Block 2: Donor guarantees, The GPG Bank would adopt the innovative models of IFFEd and the Asian Development Bank's IF-CAP. This would combine sovereign donor guarantees to the GPG Bank as a form of quasi-equity with concessional loans and grants from contributors to enhance the overall concessionality of GPG Bank lending. Donors could include governments and philanthropies.

Following the IFFEd model, donor guarantees would provide a form of quasi-equity to the GPG Bank. This would allow the GPG Bank to raise significant additional low-cost financing in capital markets and provide funding to countries on below-market terms. According to IFFEd's structure, for every $1 in guarantees, donors would only need to provide $0.15 in cash as paid-in capital, with the remaining $0.85 in the form of a commitment to disburse should loans not be repaid. For every $1 of quasi-equity provided, the GPG Bank would be able to provide an additional $4 in financing. This means $0.15 paid-in capital could trigger about $4 in GPG Bank lending. Therefore, US$4 billion in paid-in capital, alongside US$23 billion in donor guarantees, could mobilize about U$105-125 billion in new financing.

Block 3: Concessional partner loans and grants. Contributors would also provide grants and concessional partner loans (with high grant elements) to the GPG Bank, which would be like the IDA and CTF financing frameworks. It is proposed that sovereign donors contribute about

[15] Evolution of the World Bank Group – A Report to Governors," for the April 12, 2023 Development Committee Meeting.

US$15 billion in grants and highly concessional loans, half of which could be achieved from phasing out existing and planned World Bank Group climate change trust funds – and possibly more if donors discontinue a significant number of the 73 climate funds that are partially or fully financed by public monies.[16] In fact, there could be significant efficiency gains from such streamlining of climate finance, not least for developing countries to access them.

Block 4: Transfer of CTF Assets. Once assets of various World Bank Group climate trust funds are transferred to the GPG Bank, it would be possible to leverage the amount from the CTF's balance sheet in the capital markets. Based on the CIF Capital Market Mechanism, this would mobilize about US$500 million of concessional capital per year, or about US$2.5 billion between 2025-2030.

Block 5: Hybrid Capital. World Bank shareholders who have AAA ratings and low cost of borrowing could provide hybrid capital to the GPG Bank, which could be leveraged in capital markets and potentially allow for concessionality in lending. The GPG Bank could also explore whether philanthropies might be interested in the hybrid capital option. Assuming 6-10 such countries and philanthropies exercise this option with US$3 billion in hybrid capital, this could leverage US$9-15 billion in lending capacity.

Block 6: Surplus SDRs. With the recent issuance of SDRs, countries with surplus SDRs could decide to channel their excess SDRs to the GPG Bank. The rationale to do so would be strong: investments in global public goods would contribute to the long-term stability of the international financial system, for example by avoiding balance of payments crises in countries affected by climate change. Furthermore, the scale of investments required in the next decade to mitigate climate change and meet the Paris Agreement targets could impose liquidity challenges for many developing countries.

As stated in a 2022 Policy Brief prepared by Lazard:[17] "… there is a need to use excess SDRs in a way that meets the demand of developing economies, even if this requires a pragmatic interpretation of what a reserve asset is. It would be odd in the end if high income countries which, by their own confession, do not need such SDRs, would not be able to lend them to low-income countries that need them, because of concerns around addressing a hypothetical future balance of payments crisis." The Policy Brief argues that "the most effective way to re-channel the excess SDRs is to invest them into MDBs who: (i) are prescribed holders; (ii) can leverage their balance-sheet (if conservatively); and (iii) can undertake maturity transformation to finance long-term projects around the climate transition and other areas".

In 2021, the G7 had asked their Finance Ministers and Central Bank Governors to consider the details of a global reallocation of US$100 billion. It is likely that US$60 billion will be channeled through the IMF. It is proposed that countries with surplus SDRs consider the option of allocating some of the balance to the GPG Bank. Several options have been proposed for such transfers; it is possible that the various requirements of central banks, treasuries and parliaments might require a menu of options for SDR Holders.

The African Development Bank has proposed an approach in which SDR Holders invest into an SDR-denominated hybrid debt instrument issued by an MDB. The instrument would be treated as quasi-equity by the MDB. Simultaneously, SDR Holders would commit to providing liquidity

[16] https://www.devex.com/news/opinion-before-setting-up-new-climate-funds-consolidate-existing-ones-105186
[17] 20220208-lazard-white-paper.pdf

support in case an investor faces balance of payment needs. Such hybrid capital would be junior to unsecured and other unsubordinated debt obligations of the MDB, but senior to the paid-in capital.

Another option would be for the GPG Bank to issue an SDR-denominated bond.[18] In this approach, countries with surplus SDRs would lend those SDRs to the GPG Bank, which would then convert them into usable currencies through IMF and on-lend to developing countries (ensuring that that SDR interest rate is covered by the lending terms).

It is proposed that the GPG Bank aim to mobilize US$40 billion from surplus SDRs, through a combination of hybrid capital and SDR-denominated bonds, optimized for concessionality in GPG lending. A key issue to address is to what extent any gap between rising SDR interest rates and the GPG Bank's concessional lending terms would need to be filled by grant support from contributors.

Block 7: Private equity. Sovereign wealth funds have assets of more than US$8 trillion; some of them might be interested in stable, low-risk, long-term returns from climate investments. The GPG Bank could establish a parallel financing facility with institutional investors, with a . It could follow the approach of the ILX Fund[19], which would allow private institutional investors to invest in syndicated loans originated and structured by the GPG Bank, thereby co-investing pari-passu with the GPG Bank and MDBs. This would expand the pool of private capital for climate mitigation projects in borrower countries, while providing attractive risk-adjusted returns to institutional investors.

Block 8: Asset sales. The GPG Bank, upon successful project completion – and once revenues start to flow – could sell its loan assets, thereby raising private capital and freeing up equity for additional lending. Kharas and Bhattacharya have proposed an approach for IBRD that could also be applicable to the GPG Bank:

> "The solution is to design a new instrument with a step-up interest rate clause or a time-bound put option. In such a design, the interest rate would rise to commercial levels upon successful completion of the project, permitting IBRD to sell remaining maturities without taking a loss. These commercial levels would, however, be far lower because construction and other project implementation risks would no longer be applicable. Such an instrument could be particularly attractive for UMICs [Upper Middle-Income Countries] where domestic financial institutions and institutional investors might find a sovereign loan an attractive addition to their portfolio."

[18] How an SDR Denominated Bond Could Work | Council on Foreign Relations (cfr.org)
[19] Ilxfund.com

Table 1: Illustrative GPG Bank Capitalization

Sources	**Amounts 2025-2030**
IBRD	US$1.25-2 billion
Capital Markets based on Donor Quasi-Equity - Paid-in - *Guarantees*	US$105-125 billion US$4 billion *US$23 billion*
Donor Grants and Concessional Loans	US$15 billion
Capital Markets based on CTF balance sheet transfer	US$2.5 billion
Hybrid capital from sovereign shareholders and philanthropies based on - Paid-in	US$9-15 billion US$3 billion
SDR Allocations	US$40 billion
Sovereign wealth funds/pension funds (pari passu parallel financing)	US$5 billion
Sale of Assets	tbd
TOTAL	**USD$177.75 – 204.5 billion**

Governance

A governance agreement to support the objectives and effective operation of the new institution would be agreed by initial contributors and representatives of eligible recipient countries, prior to the establishment of the new institution.

As stated by Ravi Kanbur: "Countries which contribute most, and countries which the world needs to do most to address cross-border global issues, should surely be prominent in the governance of the institution. It is only with this combination that the World Bank can best serve the global needs that only a global institution can do."[20]

[20] https://static1.squarespace.com/static/58cc36ed03596e3341b757ac/t/59369005725e258c00eb1ad9/1496748037864/Whats+The+World+Bank+Good+For-WP.pdf

To assure that it maintains the trust of shareholders and other stakeholders in its work, the governance structure should be attentive to preserving the following characteristics:

a) ***legitimacy*:** governance and management structures should facilitate the participation of core partners (eligible recipients and contributors) and opportunities to benefit from the voice of stakeholders. The GPG Bank's Board should be structured to help foster voice, inclusion and ownership from both borrowing members and sovereign and non-sovereign contributors.

b) ***accountability*:** accountability should be defined, accepted, and exercised by all partners. The overarching governing body should have a clear mandate and adequate authority and competency to carry out its functions.

c) ***transparency*:** strategies, policies, decision-making, reporting, and evaluation processes should be open and freely available.

d) ***efficiency*:** governance and management structures should enhance efficiency in the allocation and use of resources.

e) ***effectiveness*:** results in terms of outputs and outcomes should be measured and shared; and,

f) ***independence*:** decision-making and oversight should be unconstrained by conflicts of interest.

As in the case of IDA, the President of the World Bank would be the ex-officio head of the GPG Bank, and the World Bank's staff would be its ex-officio staff. However, its board would need to incorporate sovereign and non-sovereign contributors and a stronger voice for the Global South than current World Bank Group governance arrangements. The new institution would have no impact on voting shares in IBRD.

It is proposed that a new board be established as the highest-level oversight body of the institution, with responsibility for overseeing that the institution is effectively fulfilling its goals and objective and for developing, adopting and evaluating the operational policies and activities financed by the institution.

There are many precedents among existing multilateral financing arrangements to draw upon in structuring the board, but one that is particularly relevant is the GEF Council, a model that has stood the test of time for over three decades.

The board could consist of 24 Directors, representing constituency groupings formulated and distributed taking into account the need for balanced and equitable representation of all members of the GPG Bank and giving due weight to the funding efforts of all contributors. There would be 12 Directors (and Alternates) from countries eligible to receive funding and 12 Directors (and Alternates) from sovereign contributors. Each constituency would be responsible for appointing its Director (and Alternate). Non-sovereigns providing hybrid capital would have non-voting Board membership.

The President of the World Bank would serve as non-voting Chairman of the board. The board would have similar responsibilities to the current World Bank Group boards in terms of project approval and policy decisions.

Decisions requiring a formal vote by the board would be taken by voting procedures that would recognize decision-making by an agreed majority of all constituencies as well as support of contributors. As in the GEF, decisions would require a double-weighted majority. This could be either: (i) an affirmative vote representing both an agreed majority of the total number of members of the GPG Bank and an agreed majority of the total contributions, or (ii) an affirmative vote of an agreed majority of the board seats that includes an agreed majority of contributor seats and an agreed majority of borrowing country seats.

Recognizing the innovative nature of the GPG Bank, the urgency and complexity of the problems to be addressed, and the need to foster broad consensus on climate action, the board could establish two standing committees to advise it and to promote a deliberative process that includes the voice of other stakeholders. These committees would consist primarily of independent external experts, with board and MDB representation.

One committee could focus on finance and the other on scientific and technical matters. The finance committee would advise the board on resource mobilization strategies, capital markets, financial innovation, private sector engagement, lending products and terms, and capital adequacy framework for the GPG Bank. The scientific and technical committee would advise the board on the emerging evidence from innovations, the economics of policy and technology options, and criteria for allocating and prioritizing GPG Bank funding.

Both committees would be chaired by an external expert. The committee chairs would be non-voting members of the GPG board and responsible for sharing the Committee's deliberations and recommendations with the board.

To promote voice of a broad range of stakeholders at the level of the board, the following representatives would be invited to observe board meetings, and such observers would be afforded opportunities to engage in the deliberations of the board:

a) representatives from each bilateral and multilateral development bank with a co-financing agreement;
b) representatives of other climate financing mechanisms, such as the Green Climate Fund;
c) representatives of other relevant international organizations and conventions;
d) representatives from civil society organizations and the private sector.

Development of strategies, priorities and projects at the country level should also facilitate inclusion of stakeholder voice at the country level.

Funding allocations

Country resource allocations from the GPG Bank – and associated internal World Bank administrative budgets for country programs -- should be based on country ambition, criticality, and capacity related to the GPG agenda. As Alba et al have noted this would involve an adjustment to the country-based model with the introduction of a global allocation model alongside IBRD and IDA's allocations. With respect to climate mitigation, concretely this would

mean that funding would be allocated where the largest cost-effective GHG reductions can be found and to countries that opted in. There is room for innovation, for example, employing a reverse auction to maximize GHG reductions at the lowest cost. While internal incentives and decision-making structures would need to evolve, this does not require a major restructuring of the World Bank.

One approach would be for the World Bank's country directors (in consultation with their country partners, IFC, MIGA and other bilateral and multilateral development banks) to bid for two-year lending and budget envelopes from the GPG Bank. The World Bank's CCDRs would provide the core diagnostic for identifying investments across the MDB ecosystem, further honed and sharpened to provide what the private sector needs to fast-track deal flow, particularly the needed policy and regulatory reforms.

Funds would be allocated based on countries' short-term plans and targets (i.e., by 2030) to implement their Paris Agreement commitments, possibly using the following criteria:

- [40] per cent weight to cost-effectiveness (dollars per ton of carbon reduced) of proposed investments.
- [30] per cent weight for adoption of policy and regulatory reforms identified in CCDRs.
- [10] per cent weight to size of carbon reduction from proposed investments
- [10] per cent weight to private capital mobilization in proposed investments.
- [10] per cent weight to performance of country's IBRD/IDA portfolio (based on disbursement record and World Bank Group Internal Evaluation Group assessments)

Implementation of this resource allocation system would require changes in the World Bank's decision-making structures. Authority for budget and funding allocations and lending decisions would shift from being the exclusive domain of the Regional Vice Presidents and Country Directors to being a shared responsibility with the Global Vice President for Climate Change.[21]

Country Directors and Regional Directors would continue to be the primary interlocutors with country counterparts and remain responsible for developing Country Partnership Frameworks and the delivery of country lending and non-lending operations. However, the Climate Change Vice Presidency and Development Finance Vice Presidency, working with the Global Practices, would:

- Develop criteria and priorities for GPG Bank funding allocations.
- Determine country allocations of GPG Bank funds, along with the budgets for project preparation and supervision.
- Assess the kinds of instruments and the level of concessionality that are necessary to achieve the greatest climate impact.
- Develop global strategies with metrics and a results framework for the GPG Bank.

In the interim, the new President might get this process started in his first weeks by calling on the Bank's country directors to compile a list of projects with the most cost-effective GHG reduction potential that could in theory be eligible for financing from a new GPG Bank with additional concessional financing, partnership with other multilateral and bilateral development

[21] Alba, Bliss-Guest and Tuck have described in more detail the potential division of labor between the various World Bank units.

banks. A preliminary list drawn from the World Bank's CCDRs is highlighted in Box X for illustrative purposes.

Conclusion

Reforms along these lines would require the World Bank's current shareholders to acknowledge that addressing the immense climate challenge requires a fundamentally different institutional, legal, and financial approach to multilateralism than the past eight decades. They would need to face the reality that the World Bank, as currently structured or stretched, might mobilize a few billion dollars more for climate change which is far short of the needs. The step-change needed to finance the economic and social transitions would require more fundamental reforms.

Sixty-two years ago, the World Bank created IDA, recognizing the need for concessional terms for poorer countries; now, the Bank should step forward with a similarly bold idea to accelerate climate action. We propose that the World Bank's shareholders aim to have GPG Bank operational by 2025, on the 10th anniversary of the Paris Agreement.

In terms of concrete next steps, there are several live diplomatic processes in addition to the Bank's Evolution Roadmap this proposal might land and relates to. Box X on how a GPG Bank might relate to other ideas and initiatives. In the best-case scenario, to advance global consensus, the President of the Bank should announce his vision for a new GPG Bank at the planned Paris summit on financing solutions and reforms to the International Financial Institutions in June 2023. At the Marrakech Annual Meetings later this year, the World Bank's shareholders should then provide guidance to the Bank's management to proceed with the drafting of Articles of Agreement for the GPG Bank, with a view to negotiations being conducted in 2024 and completed by the Spring Meeting in 2025.

Box X: Live diplomatic processes and adjudication moments that could drive attention and support bigger, bolder ideas such as a 3rd window at the World Bank:

Bridgetown Agenda

A global South led initiative championed by Barbados Prime Minister Motley for "urgent and decisive action to reform the international finance architecture". There are six priority actions: i) provide immediate liquidity support by fast-tracking the re-channeling of SDRs; ii) restore debt sustainability by a revamp of the Common Framework, updated debt sustainability analysis, new natural disaster debt clauses, and tapping into new sources of revenue to finance a Loss and Damage Fund; iii) mobilize private finance to tune of $1.5 trillion per year through forex guarantee and support for pipeline development; iv) Increase official sector development lending for SDGs to $500 billion per year through implementation of the CAF review, an additional $100 billion of paid-in capital contributions to MDBs, rechanneling SDRs to the MDBs, increasing the leverage of and contributions to IDA balance sheet; offer new terms to invest in resilience and streamline processes; v) ensure multilateral trading system supports the green and just transformation; and vi) reform the governance and operations of the IFIs. Specifically, "update the 1945-based institutions to be more inclusive and equitable including issues of governance, voice, representation, and access to finance.

G20 Expert Group on MDB

Under their G20 Presidency India set-up an Expert Group on strengthening multilateral development banks (MDBs). The nine-member group, co-convened by NK Singh and Lawrence Summers, is likely to focus on greater coordination among more than a dozen MDBs and channeling private capital into green finance. The initial report is expected June 2023 with further proposals by the end of the year.

French-hosted Summit for A New Global Financing Pact, June 22-23

The Summit is aiming to affirm a level of ambition with respect to financial commitments; bring clarification on the different sources of finance available and how they should be used, and through which institutions and instruments; and outline recommendations that may be brought later in the formal processes of G20 and COP, including the MDBs and their operating model.

COP28 hosted by United Arab Emirates

Due to take place in November in Dubai, COP President-Designate Dr. Al Jaber has said there will be a big emphasis on finance. The UAE presidency has laid out four pillars to mobilize the quantum of finance required to half emissions by 2030: i) *fundamentally* reform the international finance institutions (italics added); ii) better leverage private-sector finance; iii) establish well-functioning carbon markets; i) unlock finance for innovation. “Tinkering around the edges” is no longer acceptable according to Majid Al Suwaidi of the COP28 team.

Key Adjudication Moments will add political pressure for ambitious reforms:

The 2023 Global Sustainable Development Report is slated for release in September 2023 as the world approaches the half-way point of the 2030 Agenda. Practical solutions that can accelerate progress on the SDGs will be urgently needed.

Under the **Paris Agreement**, the first ‘**Global Stocktake**’ will happen in 2023. It will assess whether the net result of the climate actions being taken is consistent with the goal of keeping the increase in global average temperature from pre-industrial times to within 2 degree Celsius. This stocktaking process is aimed at informing the next round of NDCs to increase ambition. It will also show the need for new thinking, collective action, and a step-change in political will.