

February 2011

# Storm on the horizon?

Why World Bank Climate Investment Funds could do more harm than good

By Nora Honkaniemi

## **Eurodad**

The European Network on Debt and Development is a specialist network analysing and advocating on official development finance policies. It has 58 member groups in 19 countries. Its roles are to:

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## **Acknowledgments**

The author would like to thank the many people that provided invaluable assistance, input, advice and materials for this report. She would especially like to thank Ama Marston from Bretton Woods Project, Elena Gerebizza from Campagna per la Riforma della Banca Mondiale, Nick Hildyard from Corner House and Smita Nakhooda from the World Resources Institute.

Thanks also go to Nuria Molina-Gallart and Clare Birkett at Eurodad for comments and editing.



This report was produced with the financial support of the European Commission. The views presented in this report do not necessarily represent the views of the Commission.

# Storm on the horizon

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## Executive summary

The World Bank has actively promoted itself in the international climate negotiations as the institution of choice to manage climate funds. The Bank's pitch is based largely on the perception of its capacity to leverage large quantities of private finance.

The Bank's bid to administer climate finance has been so successful, that it has managed to secure itself an interim trustee role in the future climate architecture. This win for the Bank will have lasting implications on the delivery of climate finance and the transfer of resources through the UN Convention.

As the World Bank's role grows, it is increasingly crucial for civil society to monitor the extent to which public finance channelled by the World Bank contributes to climate and development objectives.

Global civil society actors have long been contesting the role of the World Bank as an appropriate channel for climate finance. The critique is founded on the Bank's questionable green credentials and its history of advising economic policy reforms to developing countries.

**This report focuses on yet another concern regarding the role of the Bank in climate finance: how the Bank is disbursing – or planning to disburse – the multitude of climate funds that it administers.** The choice as to which modality- whether grant, loan or guarantee- is the chosen instrument, has developmental impacts, either positive or negative.

While the World Bank manages and administers a plethora of climate funds,<sup>1</sup> it also channels funds for climate finance purposes through its own product lines.<sup>2</sup> This report examines only the Climate Investment Funds (CIFs) of which the World Bank is a trustee and an implementing agency.

Section one of this report, *The World Bank CIFs' financing instruments: fit for development?*,

critically assesses whether the financing instruments by the World Bank contribute to – rather than hinder – equitable and sustainable development in the South. It finds **that only one sixth of the pledged funds will be delivered as grants.** Following the financial crisis, many already heavily indebted countries have been pushed further over the brink, and providing loans for climate finance has the potential to deteriorate the financial situation of these vulnerable countries even further.

Section two, *Why allocation and eligibility criteria miss out the most vulnerable*, outlines how eligibility and allocation criteria may constrain the policy space available for developing countries to decide on their own pathways for sustainable development, and it may not favour a needs-based allocation of resources.

Section three, *Why private finance is a dangerous option for the climate crisis*, finds that **over one third of CIF funding is channelled to the private sector.** However, it is unclear what safeguards are in place to ensure that the private sector – which by definition will seek to maximise their profits - contributes to support the most vulnerable and to address the needs of the poor.<sup>3</sup> All too often, **public funds intended for climate and development purposes in the poorest and most vulnerable countries are being instead used for subsidising high and middle income countries' private sectors.** Other risks include the high failure rates for private equity investments, the lack of transparency and environmental and social safeguards.

The report concludes by **outlining the reasons why – in light of the analysis of the Bank's delivery of climate finance as it relates to the financing instruments - the World Bank is not the best-placed institution to channel climate finance** or to set the highest standards for a legitimate and development-friendly climate finance architecture for the future.

Based on the findings of this paper, Eurodad makes the following recommendations:

- While the greater share of funding for climate finance should be delivered as grants, **all adaptation funding must be delivered as grants.**
- **Lending for climate finance to countries in debt distress should not take place under any circumstances.** Grants should be provided instead. Where and if concessional lending is accepted for mitigation in Low- and Middle-Income Countries, existing **debt burdens must be taken seriously into account** and repayment feasibility assessed realistically.
- **The use of financing instruments must be considered in light of developmental outcomes.** Whereas loans and guarantees may pile up further debts for developing countries, private equity is a risky and opaque instrument, likely failing to deliver on intended climate purposes and often undermining developing country-led equitable and sustainable development.
- **No policy conditionality should be attached to climate financing.** Eligibility for funds and their allocation must be based on need and vulnerability to climate change, not on performance-based methods, meeting policy conditions or complex and irrelevant sets of eligibility criteria and allocation frameworks.
- Funding climate finance by channelling public funds through the private sector involves many risks. **Stringent criteria and standards must be applied to private finance to ensure the intended objectives of the funding are realised and that they benefit those most affected.**
- **The highest standards of transparency must be applied to the management and administration of climate funds, including the full disclosure of the terms and conditions of all financing agreements.**

## Introduction

Since the rise and fall of expectations that a comprehensive climate deal would be achieved at the 15th Conference of Parties (COP 15) in Copenhagen in December 2009, governments have been struggling to conceive of a comprehensive framework for managing the future of climate finance. The negotiations under the United Nations Framework Convention on Climate Change (UNFCCC) have a mandate to deliver on a new climate finance architecture by 2012. The Convention, which entered into force in 1994 and now enjoys near universal membership,<sup>4</sup> sets an overall framework for intergovernmental efforts to tackle the challenge posed by climate change.

In the interim, while waiting for the negotiators to hammer out the new structures, industrialised countries agreed to deliver USD 30 billion, referred to as “fast start finance,” as part of an initial package to provide USD 100 billion per year by 2020<sup>5</sup> for much-needed climate finance adaptation and mitigation needs in the South. However, the task of delivering on these commitments has been hampered by countless issues, amongst them, but not exclusively, the inability to agree on:

- how much is needed to finance climate change related needs,
- where the funds should come from,
- what should be done with the money and who should receive it, and
- which institutions should channel the funds?

The lack of legitimate institutions to channel the funds, and the non-existence of a definition of what constitutes climate finance and how it should be accounted for further hinder the advancement of discussions.

In this complex context of negotiations and high stakes, **the World Bank has been among the primary actors to actively promote itself as the institution of choice to manage climate funds**, at the very least in the interim before an international architecture is agreed upon. The Bank’s pledge is based on its perceived capacity to manage and distribute funds

through country programmes in a large share of developing countries without creating additional disbursement systems. Another argument that has convinced governments to deposit climate finance at the Bank is its promise to leverage large quantities of private finance. This perception of leverage power has gone so far, that the World Bank is now being referred to as a “source” of climate finance, as opposed to just a channel.<sup>6</sup> The World Bank’s bid to administer climate finance has been so successful, that the Bank has managed to secure itself an interim trustee role in the future climate architecture which is to be manifest in the new Green Fund, agreed upon in Cancun at the latest negotiations in December 2010. This success for the Bank, which was heavily supported by the European Union and the United States, will have lasting implications on the delivery of climate finance and the transfer of resources through the UN Convention.

### Is the Bank fit to manage climate finance?

Global civil society actors have long contested the role of the World Bank as an appropriate channel for climate finance because:

- It has questionable green credentials, stemming from the large scale support it provides to carbon intensive investments that make it **one of the largest contributors to climate change**.
- It has a history of advising economic policy reforms to developing countries with developmental outcomes that have been at best contestable and at worst harmful for developing countries.
- It is infamous for applying conditions to its grants and loans, thus reducing national ownership of development strategies and policies.<sup>7</sup> The Bank also lacks legitimate and democratic internal governance that gives fair representation to the countries that are most affected by the Bank’s policies in decision-making.
- Finally, its attempts to present itself as the best-suited institution to house climate

funds undermines the process under the UNFCCC that has been mandated by the international community to build a legitimate and inclusive climate finance architecture.

There is yet another reason for concern regarding the role of the Bank in climate finance which is related to *how* the Bank is disbursing – or planning to disburse – the multitude of climate funds that it administers. This is the focus of this report. **Financing instruments are not neutral by nature and thus have developmental impacts, either positive or negative.** If climate finance is provided in the form of loans, it can accumulate as new debt in developing countries at a time when debt levels in the world's poorest countries are causing increasing concern. If climate finance comes with conditions attached, it may risk reproducing old models of development financing which have had devastating effects on developing countries, both bypassing country leadership over national development processes and imposing policies which have all too often had harmful effects on the poor. Last but not least, the involvement of the private sector in the delivery of climate funds should also be carefully and critically assessed in light of past development finance experiences where reconciling for-profit objectives of the private sector while securing appropriate provision of global public goods has not always proved to be an easy – or feasible – task.

This report critically assesses whether the World Bank's choice of financing instruments to deliver climate finance contribute to – rather than hinder – equitable and sustainable development in the South.

### Which funds did Eurodad assess?

As the World Bank's role grows, it is increasingly crucial for civil society to monitor the extent to which public finance that it channels contributes to climate and development objectives. However, this is made particularly difficult as there is an information gap on the terms and conditions upon which these funds are being disbursed and whether they comply with key principles of effective development finance.

While the World Bank manages and administers a plethora of climate funds,<sup>8</sup> it also channels funds for climate finance purposes through its own product lines.<sup>9</sup> This report examines only the Climate Investment Funds (CIFs) of which the World Bank is a trustee and an implementing agency. Other funds and World Bank product lines are not assessed as the World Bank does not have a uniform tracking system across the Bank's lending operations to account for the funds that could be classified as climate finance. Therefore it is not possible, even for the Bank, to quantify its overall lending for climate finance, nor is it feasible to compare the various trust funds and lending instruments to each other due to their highly variant nature. This report assesses the CIFs only, as they are intended to serve as pilot programmes to model future global climate funds and have to date received a significant amount of funding and donor trust.

### Methodology

Eurodad reviewed the key documents publicly available on the Climate Investment Funds website addressing the two trust funds (the Clean Technology Fund, CTF; and the Strategic Climate Fund, SCF; and the three programmes under the SCF (the Forest Investment Program, FIP; the Pilot Program for Climate Resilience, PPCR; and the Program for Scaling-Up Renewable Energy in Low-Income Countries, SREP). The main sources for this research for both funds and the programmes were the documents on financing products, terms and review procedures for public and private sector operations, the investment criteria and operational guidelines, the investment plans, the financial statements, the non-disclosure agreements and the semi-annual operational reports. Supporting documentation from the bank and NGO research were also used, as well as interviews and extensive discussions with CIF and World Bank staff as well as CSO observers to the CIFs.

Eurodad research, supported by the recent findings of the World Resources Institute (WRI),<sup>10</sup> found that to date, financing agreements for the disbursed CIF funds have not been publicly disclosed. Information on disbursement

instruments, terms and concessionality was not available on more than a guideline level. As a result, actual per project information on instruments used, levels of concessionality and specific terms of financing was not available and concrete information on how the funds have been disbursed in practice, is missing.

For the public sector, the guidelines give a range of options that can be used for financing, but the individual investment plans give no details on the ratio of grants to loans, the level of concessionality or the repayment conditions. The guidelines state that concessionality of financing for the private sector will be assessed on a case by case basis, but information on the final terms of private sector projects will remain confidential for business reasons. The trust fund committee members who can access this information are bound by non-disclosure agreements.<sup>11</sup>

Tracing the funds once they leave the CIF for the implementing agency is difficult, as the CIF does not disburse by project; rather it disburses by lump sum to the implementing MDB which in turn channels the funds to direct projects.<sup>12</sup> A process to integrate monitoring systems of the CIFs with those of the other MDBs and to introduce monitoring of disbursements is under discussion according to civil society sources in the CIFs monitoring group. At the time of publication, tracked information on the final destination of CIF finance was also not available.

The lack of disclosure of the financing agreements of the pilot funds sets a poor

precedent for the future of climate finance. The guarantee of transparency is crucial in the CIFs operations, to verify the specific terms under which finance is approved, including the loan and grant element of the financing agreement, interest rates, and the share of participation of different public and private funders. In the absence of this information, the findings of this report are based on the analysis of the financing terms as foreseen in the guidelines of the CIFs rather than being based on the actual financing agreements approved for specific projects.

**Section one** of this report **critically assesses the financing instruments of the CIFs exposing the risks they may pose** to the finances of developing countries and their ability to deploy nationally-led equitable development strategies.

**Section two** examines how the available financing instruments may restrict policy space and limit developing countries' ability to genuinely lead their development processes, including regarding climate related challenges.

**Section three** analyses the involvement of private sector financing in the CIFs.

The report concludes by **outlining the reasons why – in light of the analysis of the Bank's delivery of climate finance as it relates to the financing instruments - the World Bank is not the best-placed institution to channel climate finance** or to set the highest standards for a legitimate and development-friendly climate finance architecture for the future.



### **Box 1: What are the Climate Investment Funds?**

The World Bank is both a trustee and implementer of the Climate Investment Funds (CIFs) which consist of the Clean Technology Fund (CTF) and the Strategic Climate Fund (SCF). The CIFs are administered by an independent secretariat that is housed in the World Bank. The CIFs have over USD 6 billion in pledges from 13 countries,<sup>13</sup> all of which is recorded as Official Development Assistance (ODA) by donors.<sup>14</sup> Of this six billion, as of March 2010, the CTF had disbursed only USD 27 million<sup>15</sup> and the SCF had disbursed a mere USD 8 million.<sup>16</sup>

The CIF funds are channeled via partnerships with five implementing agencies, four Regional Multilateral Development Banks (African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, Inter-American Development Bank) and the World Bank Group's (WBG) International Financial Corporation (IFC) and the International Bank for Reconstructions and Development (IBRD), to support mostly mitigation but also adaptation efforts in developing countries.

The Clean Technology Fund and the Strategic Climate Fund were designed and set up as pilots to test drive the delivery of funds for transformative low-carbon and climate-resilient development through the Multilateral Development Banks (MDBs). The SCF comprises three lines of programming for development, energy and forests. These are the Pilot Program for Climate Resilience (PPCR), Scaling up Renewable Energy in Low-Income Countries (SREP), and the Forest Investment Program (FIP).

**The CTF** aims to provide scaled-up financing to contribute to the transfer of low-carbon technologies with a significant potential for long-term greenhouse gas (GHG) emissions savings for recipient countries. The CTF is currently the only operational climate investment fund that is disbursing money, and is therefore also the richest fund of the four, funding only mitigation. 13 Investment

plans have been approved (in Egypt, Mexico, Turkey, South Africa, Ukraine, Vietnam, Philippines, Thailand, Indonesia, Kazakhstan, Colombia, Morocco and a regional plan for CSP-MENA covering Algeria, Egypt, Jordan, Morocco and Tunisia) or 14 when including the addition of Nigeria, which has been approved on a conditional basis. Under these investment plans 15 projects, totalling USD 888 million,<sup>17</sup> have been approved to date (in Egypt, Mexico, Turkey, South Africa, Ukraine, Vietnam, Philippines, Thailand) and one is pending final approval for South Africa.

**The three funds of the SCF** aim to provide financing to pilot new development approaches or to scale-up activities aimed at a specific climate change challenge or sectoral responses. From the three funds in the SCF, only the PPCR has so far approved funding for financing strategic plans in country. The objective of the PPCR is to effectively integrate climate resilience aspects into development financing. The PPCR has approved USD 11 million for preparatory activity in 9 countries (Bangladesh, Bolivia, Cambodia, Mozambique, Nepal, Niger, Tajikistan, Yemen and Zambia), and 2 regional initiatives in the Caribbean (Dominica, Grenada, Haiti, Jamaica, Saint Lucia, Saint Vincent and the Grenadines) and the Pacific (Papua New Guinea, Samoa, Tonga). The pledging level as of September 30, 2010 to the PPCR is USD 972 million. USD 614 million of the pledges are grant resources and USD 358 million are to be used as concessional finance.<sup>18</sup>

A key objective of the FIP is to initiate and facilitate steps towards transformational change in developing countries' forest-related policies and practices. The FIP supports developing countries' efforts to reduce deforestation and forest degradation (REDD) and promote sustainable forest management. To date the FIP has planned pilots in eight countries Brazil, Burkina Faso, Democratic Republic of Congo, Ghana, Indonesia, Laos, Mexico and Peru. The pledging level as of September 30, 2010 to the FIP is USD 558 million. USD 399 million of the pledges have been pledged as grant resources and USD 159 million as concessional finance.<sup>19</sup>

**Box 1: Continued**

The objective of the SREP is to pilot and demonstrate the economic, social and environmental viability of low carbon development pathways in the energy sector by creating new economic opportunities and increasing energy access through the use of renewable energy. The countries selected for SREP adaptation funding are Ethiopia, Honduras, Kenya, Maldives, Mali and Nepal. The current level of pledges to the SREP is

USD 296 million.<sup>20</sup>

The CIFs were set up as an interim arrangement to facilitate channelling so called “fast start finance”. The CIFs will conclude activities, meaning they will stop receiving funds, by 2012 as stated in their sunset clauses, or once a new long term financial architecture has become effective under the UNFCCC.<sup>21</sup>

# 1: The World Bank CIFs' financing instruments: fit for development?

Financing instruments are not neutral by nature and thus have developmental impacts, whether positive or negative. One of the crucial aspects of delivering on climate finance commitments is the choice of financing instruments (grants, loans, guarantees and equity) to disburse climate funds.

Multiple instruments are available under the different CIFs for project financing through both the public and private sector, including:

- grants;
- loans (including both softer and harder concessional loans);
- guarantees; and
- equity.

**Whether finance is provided on grant or loan terms has a huge impact on** developing countries' finances and their debt burdens as explained later in this section. The choice of other instruments such as **guarantees is not without controversy**, as civil society has repeatedly warned that guarantee financing has often resulted in increased debt burdens for developing countries. This happens when the original risk of a private company is passed on to the host government, turning business risks of private companies in industrialised countries into public sector debt of developing country governments.<sup>23</sup>

On the other hand, **private equity** is often regarded as a safer financing instrument, as it is considered to be non-debt creating. However, as explained further in section three below, it can also have harmful impacts on development as equity investments have high failure rates, they do not apply environmental and social

safeguards and also diminish ownership and control of funds which is crucial for the effectiveness of climate financing. Moreover, international institutions, such as UNCTAD, have raised concerns about the negative long-term development impacts associated with this kind of foreign direct investment, which remains highly non-transparent.<sup>24</sup>

This section assesses the above mentioned instruments that are used to disburse CIF funds and asks whether the preferred financing instruments are truly fit for development. Unfortunately, Eurodad could not assess to what extent each of these instruments is used in practice as the financing agreements for the CTF were not publicly available, and the remaining funds have not disbursed more than preparation grants at the most. Therefore, Eurodad's analysis is based on the instruments and their terms and conditions as spelled out in the financing guidelines of each of the CIFs.

## The overwhelming use of loans over grants

Global civil society and southern climate negotiators agree that no adaptation funding should be provided in loans. Instead, all funding should be provided as grants by the countries that have historical responsibilities for this global disaster.

However, based on the analysis of the financial statements of the CIFs and the recommendations of each fund's financing guidelines, Eurodad found **that at most only one sixth of all financing by the CIFs will be disbursed in the form of grants** and that the largest share of the CIFs will be delivered as concessional loans.

**Table 1: Financing instruments available for each of the CIFs** <sup>22</sup>

Fund/ programme	Grants		Concessional loans		Guarantees		Equity	
	public	private	public	private	public	private	public	private
CTF	x	x	x	x	x	x	-	x
PPCR	x	x	x	x	x	x	-	-
FIP	x	x	x	x	x	x	-	x
SREP	x	x	x	x	x	x	x	x

**Table 2: Pledges as of November 2010**

Fund/programme	Total pledges	Of which grants	Of which concessional loans
CTF	USD 4.4 billion	A fraction	majority
PPCR	USD 972 million	USD 614 million	USD 358 million
FIP	USD 558 million	USD 399 million	USD 159 million
SREP	USD 296 million	-	-

Only one sixth of CIF funds are available in grants due to the fact that the largest fund, the CTF, with almost USD 4.5 billion in pledges, will largely only deliver concessional loans. As outgoing financing from the CTF can be no more concessional than incoming financing, the ability of the CIFs to channel funding on grant terms is contingent on the donors fulfilling their pledges to provide finance on grant terms, which to date they have not. In fact, the lion’s share of CTF funding is provided by donors as loans, which means that the financing agreements under this fund will also mostly take the form of loans. This means that at most, only USD 1 billion of CIFs finance is left to be disbursed as grants.

Although two of the SCF programmes are planning to deliver the majority of their funding on grant terms (63 per cent of the PPCR and 71 per cent of the FIP),<sup>25</sup> the limited finance available under these funds does not manage to push up the overall average of grants delivered by the CIFs. So far, grants have only been used to finance technical assistance for project preparation, limited to a few million dollars per project.

**Tough concessionality rates on loans**

On the basis of the foreseen level of concessionality in the financing guidelines, both softer and harder rates of concessionality would be available, where the grant element in the average financing agreement with developing country governments would range from 45 per cent to approximately 75 per cent. Whereas the highest levels of concessionality

are comparable to International Development Association (IDA) terms, the lowest are well below what could be considered a reasonable concessional loan, particularly for the world’s poorest countries. Although more favourable terms of financing, such as longer repayment times and lower interest rates apply to softer loans for more vulnerable economies, encouraging loans for climate resilience can lead to unsustainable debt distress as they mount up on any previous debts. In addition, repayments on loans can reduce spending in other areas of essential services and social provisions.

A further concern is that the provision of concessional finance for climate finance should under no circumstances be considered to



Eurodad found that at most only one sixth of all financing by the CIFs will be disbursed in the form of grants and that the largest share of the CIFs will be delivered as concessional loans.

constitute or be counted towards donors' ODA commitments. Climate finance is not equivalent to aid, and concessional finance for climate change should not be able to divert resources from traditional development spending to achieve the Millennium Development Goals.

Data on the proportion of loans that will be available on softer or harder terms of lending was not available. This signifies that, **in a worst case scenario, the overwhelming majority of the funds that will be provided in loans could potentially be provided as unfavourable hard loan terms**, with a grant element of less than half of the whole financial envelope. The proportion of funds that will be delivered as guarantees and equity financing was also not available.

### Why loans as climate finance will increase debt distress in poor countries

**The new wave of lending for climate finance could add additional stress to the current precarious debt situation of vulnerable Low-Income Countries (LICs).** In the aftermath of the financial crisis, 24 percent of countries that have already received debt relief through the Heavily Indebted Poor Countries Initiative, and 27 percent of countries that have not qualified for debt relief through this initiative, have seen a swift increase in their debt to GDP ratios and

as a result are considered to be in debt distress or at high risk of debt distress.<sup>27</sup>

To illustrate how the CIFs are adding to this debt problem, the **PPCR will provide more than one third of its funds as loans for adaptation (see Table 2), including to seven (out of 18) countries that are at risk of debt distress.** Especially the Caribbean and Pacific regional initiatives foreseen under the PPCR

A basic principle of climate justice is that rich countries should pay for the damage that they have created.

World Development Movement and the Jubilee Debt Campaign

**Table 3: Level of concessionality for public loans<sup>26</sup>**

Fund/programme	Interest rate	MDB fees	Maturity	Grace	Grant element
CTF harder	10%	0.10%	20 yrs	10 yrs	45%
CTF softer	2% year 11-20 4% year 20-40	0.10%	40 yrs	10 yrs	75%
PPCR	2% year 11-20 4% year 20-40	0.10%	40 yrs	10 yrs	75%
FIP	2% year 11-20 4% year 20-40	0.25%	40 yrs	10 yrs	~75%
SREP	2% year 11-20 4% year 20-40	0.1%	40 yrs	10 yrs	~75%

could potentially have severe implications on Caribbean and Small Island Developing States if they involve significant amounts of loans.

In November 2010 the PPCR approved the first projects in the second phase of PPCR funding, aimed at beginning to implement adaptation activities at the national level. The three investment programmes consist of grants for Bangladesh, Tajikistan and Niger of USD 50 million each. The concern, as raised by the UK NGO World Development Movement is that these grants are only a small element of much larger loans that in turn increase severe indebtedness.<sup>28</sup> The example used to illustrate the issue is the Bangladesh programme package which consists of USD 49 million in grant money from the PPCR, USD 60 million in loans from the PPCR, plus a USD 300 million loan from the Bank's International Development Association (IDA) as well as a USD 215 million in loans from the Asian Development Bank.<sup>29</sup>

Effectively, **by pushing loans for adaptation, the World Bank, as the trustee of the CIFs, is facilitating the potential increase in debt levels of developing countries.** The Third World Network speaks for many southern voices when it states that "it is inappropriate to use loans [for climate finance] given that the problems that developing countries must tackle were largely created by rich countries in the first place."<sup>30</sup> The World Development Movement and the Jubilee Debt Campaign further state that "A basic principle of climate justice is that rich countries should pay for the damage that they have created. Developing countries and civil society organisations are adamant that adaptation money should be given in the form of grants."<sup>31</sup>

### Why blending encourages debt-creating instruments

**Blending** refers to the practice of combining resources from various climate change financing instruments and sources for the purpose of leveraging limited resources

where, supposedly, they can have the greatest impact.<sup>32</sup> The frequent practice of blending, combining grants and loans for example or concessional and non concessional loans in the same envelope, increases the use of debt-creating instruments by encouraging further borrowing from MDBs to complement the CIF funds which remain small compared to actual financing needs.

The financing guidelines for the CIFs advise countries to **use the range of financing instruments available under the CIFs** to tailor terms of funding to a target level of concessionality to drive down the costs of investments and thus make those investments viable.<sup>33</sup> A World Bank communication states that "Combining resources from the climate finance instruments can thus make otherwise unattractive low-carbon projects attractive."<sup>34</sup> "To achieve the largest possible impact, practitioners must learn to combine these resources in the same project or program in order to both reduce transaction costs and maximise synergies."<sup>35</sup>

This practice of combining resources ultimately implies that lending is the default financing instrument as all CIF funds, grants or concessional loans, are never stand alone, but are accompanied by other, potentially debt creating and non concessional, financial components from MDBs and other public or private investors. As the example of the PPCR grant to Bangladesh shows, this is problematic where the grant is a fraction of a much bigger loan from several other parties, thus increasing debt levels of already heavily indebted poor countries.

Finally, the practice of blending raises the question as to whether the management of trust fund finance could be influenced by desires to generate additional business for the MDBs overall by actively supporting further borrowing from financing institutions to accompany the grant financing, which remains a small fraction of a much broader financing envelope.

## 2. Why allocation and eligibility criteria miss out the most vulnerable

Civil society organisations have expressed concern that lending for climate finance will result in a significant part of the loans coming accompanied by conditions that would further restrict the effectiveness of the climate funds and undermine the recipient countries' ownership over the policies and processes.<sup>36</sup>

Although Eurodad did not have access to the actual financing agreements to assess whether unwarranted policy conditions are attached to CIF climate finance, eligibility and allocation criteria seem to confirm civil society groups' worst fears. The CIFs continue to uphold traditional donor-recipient relations by hand picking recipients and applying complex allocation and eligibility criteria largely irrelevant to climate financing.

As a result, the missing country ownership over the funds and the lack of national policy space under the CIFs' structures are preventing genuinely transformational outcomes. Rather than allowing true country ownership of the funds, the executing MDB plays an influential role in all stages of the design of

the programme and maintains a strong grip on the supervision of the finance through out, upholding traditional donor recipient relationships. This is demonstrated by for example the SREP, where the guidance note clearly states that "preparation grants will generally be recipient-executed, but may be executed by an MDB if justified. All preparation grants will be supervised by the MDB in order to ensure compliance with its operational policies and procedures, including procurement and financial management guidelines."<sup>37</sup>

### Eligibility criteria hinder access

In order to be eligible for CIF finance, governments have to go through various complex procedures of application and must meet certain set conditions. All recipients must have an active MDB country programme. As a result, countries already have to be integrated into the existing traditional aid regime, further entrenching the donor-recipient



What actually seems to be happening under the FIP is really 'business as usual' World Bank forest sector lending – particularly for plantations and 'sustainable forest management' that is industrial-scale logging of natural forests – all under the guise of 'doing something about climate change'.

Rainforest Foundation

relationship. This hinders thinking outside the traditional donor-recipient ODA box towards a more legitimate and transformative climate framework.

Eligibility for CIF funding is determined when a country expresses interest in accessing financing. Firstly a joint mission conducted by the World Bank, a regional bank, the government and CSO representatives takes place. The resulting investment plan goes to the Fund Trust Committee for review and potentially for further endorsement of the development of activities for financing. The investment plan facilitates the prioritisation of projects according to agreed criteria such as potential Green House Gas (GHG) emission savings from the project, potential development impact and implementation potential. While these are all important considerations, the needs or the vulnerability of the country are not considered as relevant criteria for making funding decisions.

Regards the FIP, for instance, civil society and private sector observers have on occasion expressed concerns that the criteria for country selection, which are almost exclusively technical, fail to take into account recipient countries' governance or absorptive capacities.<sup>38</sup> UK NGO the Rainforest Foundation notes that "What actually seems to be happening under the FIP is really 'business as usual' World Bank forest sector lending – particularly for plantations and 'sustainable forest management' that is industrial-scale logging of natural forests – all under the guise of 'doing something about climate change'."<sup>39</sup>

Notably, SREP criteria for eligibility include the existence in country of a vibrant private sector. In determining the countries for inclusion in the first SREP pilots, the underlying criteria include an enabling regulatory environment that promotes business, supports private sector participation, public-private partnerships, and availability of financing for renewable energy technologies and potential capacity for implementation, including a business friendly environment and sufficient institutional capacity.<sup>40</sup> Again, no mention of need or

vulnerability is listed as factors that would be taken into account when determining eligibility of countries to receive climate finance.

Tim Jones of the UK based, anti-poverty campaign World Development Movement emphasises that rich countries are hand-picking recipients. "Those developing countries which may receive some money in the future from the World Bank have been hand-picked by rich countries, further increasing the power of the rich to tell the poor what to do."<sup>41</sup>

### **Allocation criteria exclude the vulnerable**

Further problems arise when the allocation of the CIF funds is examined. CIF funds tend to more often than not, be allocated to lower and middle income countries that meet complex sets of criteria that determine country capacity to implement the projects instead of addressing the needs of the poorest and most vulnerable countries. The CTF, the richest fund of the CIFs, is specifically designed to serve MICs so by default CIFs financing is disproportionately weighted toward middle income countries.

Allocation systems are still being finalised, but apart from the PPCR which has taken into consideration some needs based options, they tend to be realised on a performance based system. The SREP financing guidelines state as an objective in the allocation framework "Increase revenue or reduce revenue volatility through performance based payments, which are often formally categorised as "results-based financing" (RBF). RBF describes payments where a principal entity provides a financial or in-kind reward, conditional on the recipient undertaking a set of predetermined actions or achieving a predetermined performance goal."<sup>42</sup>

TWN argues that the disbursement of financial resources through a donor-driven facility based on the principle of conditionality is contrary to multilaterally negotiated commitments of the developed country contributors to these funds, particularly if the resources provided to the CIFs by these countries will not constitute



any additional resources to funds set aside to meet these or other internationally agreed development obligations.<sup>43</sup> In addition, the intricate and cumbersome selection processes for accession to and allocation for funds should not be a model for future climate architecture and does not adequately serve those most in need.

Those developing countries which may receive some money in the future from the World Bank have been hand-picked by rich countries, further increasing the power of the rich to tell the poor what to do.

Tim Jones,  
World Development Movement

### 3. Why private finance is a dangerous option for the climate crisis

The precise figures for the ratio of public to private sector support by all the CIFs is not publicly available. However the **staff at the CIFs administrative unit estimate that aggregately over one third of CIF funding finances the private sector.**<sup>44</sup>

This is a sizable figure which is in line with a general tendency whereby governments and international financial institutions (IFIs) are increasing the share of their North-South transfers through private sector entities.<sup>45</sup> Indeed, the role of the private sector has been hailed as a panacea by governments and institutions as an answer to the dual dilemma of limited public North-South financing resources as a consequence of the financial crisis, and the unprecedented need for new funds to combat climate change. The private sector is perceived to have a leveraging capacity that would multiply scarce public funds. Despite this capacity for leveraging potential that the private sector is assumed to have, it is still perceived to be necessary to subsidise the private sector with scarce public funds for climate financing.

A report by the Secretary-General's High-level Advisory Group on Climate Change Financing asserts that for every USD 10 billion in additional resources, MDBs could deliver USD 30 billion to USD 40 billion in gross capital flows and *significantly* more by fostering private flows.<sup>46</sup> In addition, the report calls for additional resources for MDBs like the World Bank to fulfil this leveraging role over the next decade. The European Council conclusions also emphasise the role of the international financial institutions (IFIs) in leveraging private sector finance.<sup>47</sup>

However, channelling public funds through the private sector does not come without controversies. Channelling public funds through profit making entities may not always support the most vulnerable and address the needs of the poor.<sup>48</sup> These funds are moreover unlikely to be aligned with principles needed for addressing the climate such as the protection of the global common goods.


#### Private sector harmony with the CIFs

CTF funds are expected to target three types of private sector players:

- project sponsors (e.g. developers of clean technologies or large companies implementing new technologies);
- investors in climate mitigating projects (banks, pension and equity funds, insurance companies);
- and financial intermediaries developing new lines of credit for climate change investments (banks, leasing companies, energy service companies [ESCOs]).<sup>49</sup>

As outlined above, the use of financial intermediaries, such as equity funds and other institutional investors, raise concerns that would merit serious attention by donors when channelling climate finance to the CIFs, as well as when designing future climate funds that the CIFs are intended to pilot.

Guidelines for all the SCFs focus greatly on future private sector and market-based solutions. In PPCR funding, the financing framework for the private sector states that grants for the private sector may be justified when the intervention has clear demonstrated effects that provide



The staff at the CIFs administrative unit estimate that aggregately over one third of CIF funding finances the private sector.

benefits beyond the company itself.<sup>50</sup> The FIP will offer concessional finance and equity products to support private sector projects and programmes that have the potential of being replicated in the future without further subsidies.<sup>51</sup> For the SREP, MDBs will seek to use funds in private sector markets where the return on the initial projects do not compensate sponsors for the risks they assume, but where the future projects are eventually expected to be sufficient to encourage private investment without future subsidies. SREP funding to the private sector will likewise encompass grant and concessional finance, equity, guarantees and risk sharing.<sup>52</sup>

Already in 2008, Third World Network research concluded that “The World Bank’s climate investment funds appear to prioritise market-based solutions to dealing with the problems of climate change in developing countries. In its outline for the rationale of the Clean Technology Fund, the Bank states that ‘a priority for the international community has been the further development of innovative financing mechanisms designed to promote market-based solutions and trigger private investments in low carbon development’.”<sup>53</sup>

Civil society groups are concerned that these market-based solutions are likely to be driven solely by commercial interests - which are not always aligned with public interest. The CIFs will effectively use public money to subsidise private sector investments through a combination of project finance instruments. There is a danger that these subsidies will in the end benefit northern multinationals instead of building capacity and knowledge in developing countries. “Private sector involvement secures profits for the companies involved - not benefits for the poorest people. We have seen this time and again, where corporations reap the rewards from delivering basic services in developing countries. It is always the company that benefits not the people who need and use the services,” Eurodad member World Development Movement stated regarding the use of public funds for private investments in the name of climate finance.<sup>54</sup>

Mainstream views maintain that external private flows are positive for development

and that a vibrant private sector is crucial for development. However, an ample body of evidence suggests that not all private sector activities have a positive developmental impact, and the potential risks of private flows in developing countries are diverse. It is less clear what type of private sector could have positive development impacts. At the very least, in order to ensure that private sector finance contributes to positive climate and development outcomes, high standards of responsible financing and development effectiveness must be ensured. However, nowhere in the CIF’s guidelines are such provisions made.

### The problems with financial intermediaries and private equity

The MDBs and the CIFs in particular, channel public funds through implementing agencies such as the IFC, who in turn channel funds through financial intermediaries and use private equity funds to increase the value of the funds.

To use the CTF as an example, of the 13 projects approved to date (see Box 1), nine are led by the IFC, and this is finance that will be delivered through financial intermediaries as well as come attached with technical advisory programmes to build capacity of partnering institutions.<sup>55</sup> These methods, while fiercely defended by the CIFs and the IFC, raise many questions about the transparency, accountability, effectiveness and results of the climate funds.

Research by UK based not for profit company The Corner House<sup>56</sup> has analysed some of the problems foreseen in the use of private equity funds to channel public North-South funding. While this list is not exhaustive some important concerns include the following:

1. **Private sector investments largely have no environmental and social safeguards** and where there are some, there is ongoing relaxation of standards through for example investor or state contracts. Over the years, under pressure from civil society international financial institutions have increasingly improved social and environmental safeguards. While still lacking in many respects, increasing funding channelled through private equity funds allows immediate

loopholes to bypass all previously established responsibilities to affected communities and the environment.

2. **Private equity is a very uncertain channel for finance and thus should not be recommended for channeling public funds.** There are high failure rates for private equity investments, demonstrably, 75 per cent of private equity funds failed to deliver the 20 per cent annual returns that were expected of them, failing to deliver the returns that investors were seeking.<sup>57</sup> When resources for climate finance are as limited and hard to come by as they are, it should be **fundamental that the funds are not used for risky speculation** but invested in to ensure delivery of the funds for results. Climate finance is simply too important to be allowed to fail at this spectacular rate. As the private sector is being urged to participate in climate finance by banks and governments, it is likely to use increasingly risky ways of both raising capital and of spreading risks, further making the investments more uncertain to deliver on results and potentially have an adverse impact on markets and economies.

3. There is also **an issue of ownership and control that is crucial to the effectiveness of climate financing** and ensuring the creation of low carbon futures. Funding for climate must be delivered directly to those most affected, to their governments and to the communities for empowerment in the decision making process of how the funds will be spent. Using private equity for channeling climate funds will take this control away from the people who should be entrusted with the use of the funds and ultimately reduce the impact that the funds are intended to have.

4. There is another downside to using private equity for financing climate investments, **as often private equity investors use tax havens to increase their profits**,<sup>58</sup> resulting in capital flight from the recipient country that could be collecting tax revenue on the said investments. Further, most investment is going to wealthier emerging economies instead of low income countries that would actually have the highest need for investments in this area and would benefit the most.

5. Where private equity infrastructure funds invest directly in projects (as opposed to investing in the companies developing the projects) they have tended to pick schemes that are being financed as **public-private partnerships (PPP)**. Under PPP schemes, the government undertakes to pay investors an upfront lump sum – based on the project being “available” for use, rather than on projected levels of use – in return for the investors designing, financing, constructing and operating the project. As a result, **the public effectively shoulders many of the risks of developing projects, whilst the profits accrue to the private investors.** Unsurprisingly, PPPs have become extremely controversial in countries where they have been employed.<sup>59</sup>

6. Finally, further problems with private equity include the **lack of transparency** of the financing, a risky **speculative business model** under pressure to produce **high short-term returns**, the lack of regard for labour interests, employment, social concerns or other stakeholder interests such as of the consumer, who bear the burden of the profit requirements of the investors.<sup>60</sup>



The World Bank's climate investment funds appear to prioritise market-based solutions to dealing with the problems of climate change in developing countries.

Third World Network

## Conclusion: The last dance for the CIFs?

Global civil society actors have long been contesting the role of the World Bank as an appropriate channel for climate funds. This report finds that based on the examination of the Climate Investment Funds, there are serious limitations and controversies relating to the World Bank's involvement in climate finance, the financing instruments used and the conditions applied to the eligibility and allocation of the funds.

### Some financing instruments can have negative impacts on development

Regarding the choice of financing instruments of the CIFs, **Eurodad found that only one sixth of the pledged funds will be delivered as grants.** Out of the remainder that will be channelled as concessional loans – both covering mitigation and adaptation needs of developing countries – a majority could be delivered at harder concessional terms below the standards of the soft concessional loans given by the International Development Association (IDA) to the world's poorest countries. Following the financial crisis, many already heavily indebted countries have been pushed further over the brink, and providing loans for climate finance has the potential to deteriorate the financial situation of these vulnerable countries even further.

While the lack of information publicly available meant that Eurodad could not estimate the amounts channelled as guarantees and private equity, these instruments are foreseen to be actively deployed by each of the CIFs. These instruments present a number of risks, for example the debt-creating potential of guarantees, the prioritisation of short term high profits and returns over development outcomes, the lack of transparency and the use of offshore financial centres and the losses incurred, and the degree of risk involved in speculative finance amongst others.

### Complex allocation and eligibility criteria do not target the most vulnerable

The research finds that climate funds hosted at the Bank and channelled through the

CIFs lack country ownership, accountability and transparency. Eligibility for CIF finance requires meeting various conditions that are often largely irrelevant to climate financing and effectively exclude the poorest and most vulnerable countries.

The countries also have to be integrated into the existing traditional aid regime, further entrenching old donor-recipient relationships hindering moving towards a more legitimate and transformative climate framework. The intricate and cumbersome selection processes for accession to and allocation for funds cannot be a model for future climate architecture and does not adequately serve those most in need.

### Is private sector finance the answer to the climate crisis?

The private sector is perceived to have a leveraging capacity that can greatly multiply scarce public funds. While the precise ratio of public to private sector support by all the CIFs is not publicly available, **the staff at the CIFs administrative unit estimate that aggregately over one third of CIF funding finances the private sector.**

The increasing primacy given by the Bank to the role of the private sector and financial intermediaries for disbursing and applying these funds poses a number of risks for developing countries. **The main problem arises around the use of public funds intended for climate and development purposes in the poorest and most vulnerable countries being instead used for subsidising high and middle income countries' private sectors.** Questions related to results, responsibility, risk, measuring and achieving results, accessibility, affordability and who ultimately benefits also follow.

The frequent use of financial intermediaries, such as equity funds and other institutional investors, raise concerns for many reasons. These include the high failure rates for private equity investments, the lack of environmental and social safeguards and the frequent practice of blending that increases the use of debt-creating instruments by encouraging further borrowing from MDBs.

## Cancun and beyond

The future climate finance architecture is increasingly likely to involve a key role for the World Bank, which has successfully managed to carve a place for itself in administering and managing climate finance on many levels. In the latest instance this has been manifest in the international negotiations in Cancun where the new Green Climate Fund was established and the World Bank was invited to serve as interim trustee for three years after the fund has become operational. This job would involve the management of the financial assets of the Fund, maintaining financial records and other reporting required by the Board of the Green Climate Fund. This effectively gives the Bank a mandate under the UNFCCC to manage climate funds. Further it is likely that World Bank staff will be involved in the design of the fund, implying that critique of the CIFs and applying lessons learned are crucial at this juncture.

Giving the World Bank such an influential role in the design and management of the new climate architecture could have unintended and far reaching consequences. As has been demonstrated by the research, the financing instruments that the World Bank recommends and advises for climate financing have questionable climate and developmental impacts. Further, the Bank's interest in having an international mandate for managing climate finance may be largely based on increasing its own business as a bank, rather than on becoming a credible climate fund. Finally, donor confidence in the Bank which has resulted in this new role for the Bank is based on trust in its leveraging capacity, not on its expertise in finding sustainable and functioning climate solutions. This will likely have negligible impacts on development, based on past experience of Bank-managed funds as well as the evidence of the extensive difficulties and controversies of the CIFs to date.

Based on the findings of this paper, Eurodad makes the following recommendations:

- While the greater share of funding for climate finance should be delivered as grants, **all adaptation funding must be delivered as grants.**

- **Lending for climate finance to countries in debt distress should not take place under any circumstances.** Where and if concessional lending is accepted for mitigation in Lower and Middle-Income Countries, existing **debt burdens must be taken seriously into account** and repayment feasibility assessed realistically.
- **The use of financing instruments must be considered in light of developmental outcomes.** Whereas loans and guarantees may pile up further debts for developing countries, private equity is a risky and opaque instrument, likely failing to deliver on intended climate purposes and often undermining developing country-led equitable and sustainable development.
- **No policy conditionality should be attached to climate financing.** Eligibility for funds and their allocation must be based on need and vulnerability to climate change, not on performance-based methods, meeting policy conditions or complex and irrelevant sets of eligibility criteria and allocation frameworks.
- Funding climate finance by channelling public funds through the private sector involves many risks. **Stringent criteria and standards must be applied to private finance to ensure the intended objectives of the funding are realised and that they benefit those most affected.**
- **The highest standards of transparency must be applied to the management and administration of climate funds, including the full disclosure of the terms and conditions of all financing agreements.**

The World Bank must take responsibility accordingly for its new found position, by improving its practices and instruments of lending, ensuring that those most vulnerable receive the finances needed, greatly improving transparency and guaranteeing the channels and instruments used are appropriate, achieve results and do not take undue risks. The international community must take responsibility for the consequences of the mandate given to the Bank, for a task as consequential for the future as managing climate finance.

# Endnotes

- 1 World Bank administered climate funds are Global Environment Facility worth USD 1 billion; Least Developed Countries Fund worth USD 547 million; Special Climate Change Fund worth USD 685 million; The Adaptation Fund worth USD 40 million; 10 Carbon Funds worth USD 215 million; Forest Carbon Partnership Facility (FCPF) which includes the Readiness Fund - USD 110 million Carbon Fund - USD 50 million; Carbon Partnership Facility (CPF) which includes the Carbon Asset Development Fund - €7 million and the Carbon Fund-€100 million; Global Facility for Disaster Reduction and Recovery (GFDRR) USD 27 million. Source: Development and Climate Change: A Strategic Framework for the World Bank Group, Interim Progress Report; April 11, 2010 Washington DC.
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**Eurodad**  
Rue d'Edimbourg 18 - 26  
1050 Brussels  
Belgium

Tel: +32 (0) 2 894 4640  
eFax: +32 (0) 2 791 98 09  
[www.eurodad.org](http://www.eurodad.org)