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**Research
Commentary**

U.S. Leadership in Scaling Capital for Multilateral Clean Energy Finance

Lily Bermel, Brian Deese, Brad Setser, Tess Turner, and
Michael Weilandt



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U.S. Leadership in Scaling Capital for Multilateral Clean Energy Finance

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The global effort to accelerate the clean energy transition can only be successful if underpinned by an ambitious and concrete effort to mobilize finance. The multilateral development banks (MDBs) are essential to solving this challenge.

Current efforts to scale multilateral finance to accelerate the clean energy transition are moving too slowly. High-profile announcements have not generated significant concrete action. On net, global creditors [withdrew](#) funding from low and lower-middle-income countries in 2022 and 2023.

However, there are concrete actionable steps that the MDBs and their shareholders can take beginning this year to expand capital for clean energy finance. In this commentary, we present five opportunities for action. Achieving any one of them would represent an important step forward. Progress across multiple could help change the game on clean energy finance. But progress this year cannot be measured in more pledges, targets, and frameworks for reform. Now is the time to mobilize real dollars, euros, pounds, and yen to support real and impactful clean energy projects in developing countries.

Specifically, we present five opportunities for reform:

1. In advance of its fall meetings this year, the World Bank should incorporate a prudent portion of its callable capital into its capital adequacy framework.
2. To help meet the International Development Association (IDA) current need for long-term financing, the World Bank should issue a special series of Special Drawing Rights (SDR) bonds.
3. To set up IDA for success in its next replenishment cycle, the United States and other shareholders should make ambitious pledges of capital.

4. To encourage innovation, the United States and the Green Climate Fund (GCF) should create “challenge funds” that competitively allocate capital to MDBs based on their climate ambition, ability to scale that climate finance quickly, and private capital mobilization.
5. Ultimately, the World Bank should establish a Dedicated Clean Energy Window to prioritize, price, and properly direct needed resources to clean energy financing.

Taken together, these creative proposals discussed could nearly double World Bank lending capacity within the decade, compared to current levels.

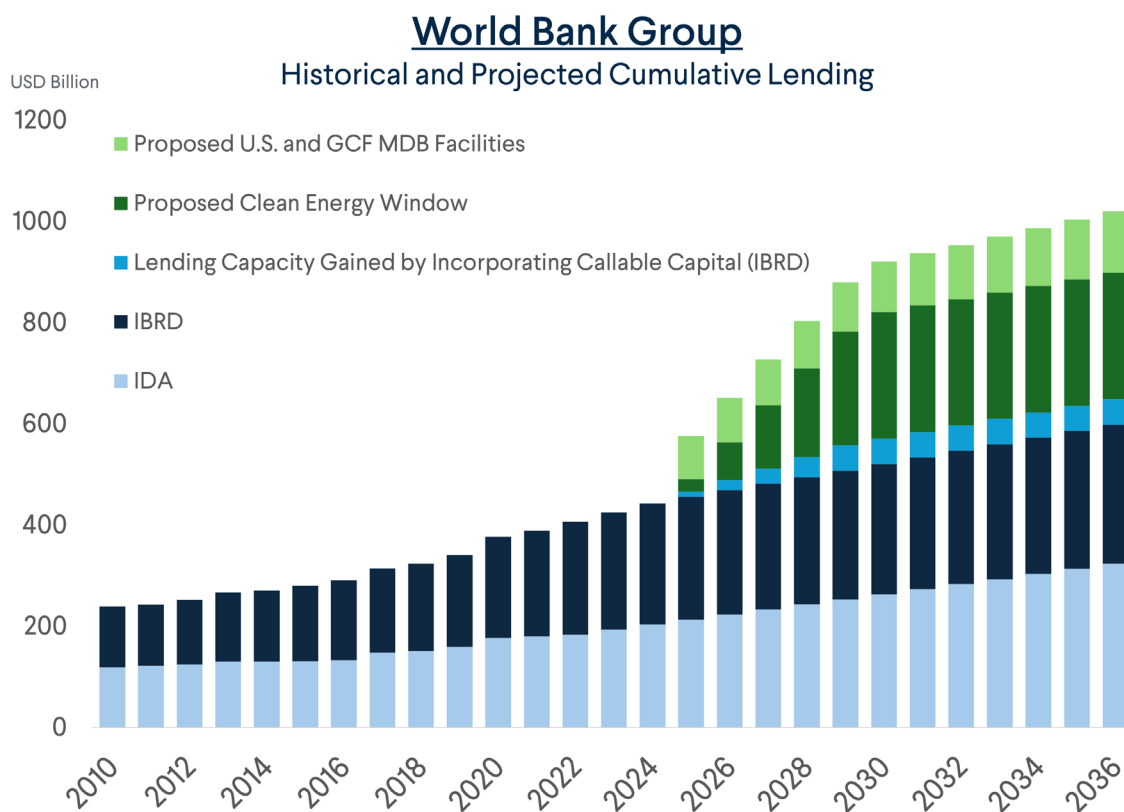


Figure 1. Historical and projected cumulative lending of the World Bank Group.

(1) Callable capital

Callable capital is a treaty-backed commitment by donors to guarantee bondholders in the “[extremely remote](#)” scenario of insolvency—which fortifies MDBs’ AAA ratings and substantiates their financial strength as an extreme risk mitigant. Over the last year, considerable effort has gone into better understanding these financial commitments, the relevant processes for “calling” the capital, and modeling the probability of scenarios that would lead to such a call.



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The main MDBs collectively have \$310 billion of paid-in capital and \$2 trillion of callable capital commitments. The World Bank has \$296 billion of callable capital, which represents 93% of its subscribed capital base (the remaining \$22 billion is paid in capital). However, for purposes of measuring its equity capital base, the Bank currently only considers its paid in capital, alongside the reserves built up out of the Bank’s retained earnings (roughly \$28 billion).

IBRD: Composition of Appropriated Callable Capital

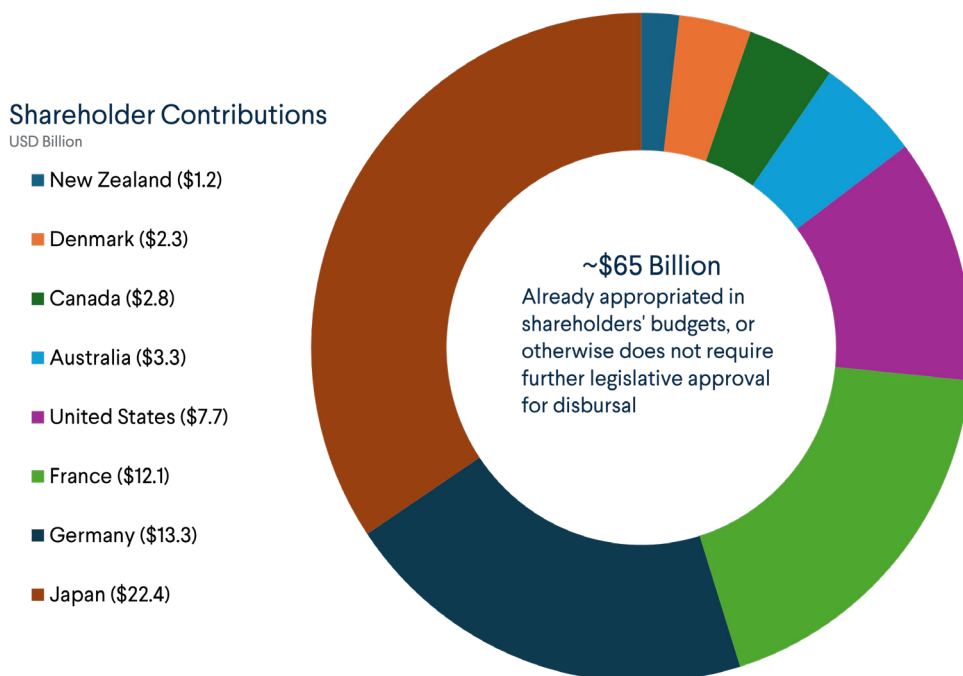


Figure 2. The Composition of IBRD’s Appropriated Callable Capital.

While callable capital does not sit directly on the World Bank’s balance sheet, it provides tangible and economically significant support for the Bank. [Recent work](#) has shown that nearly one-quarter of World Bank callable capital has already been appropriated by legislatures and parliaments (\$65 billion). This already appropriated capital is readily available to absorb losses in the remote event of a large adverse shock to the Bank’s existing capital. For the already appropriated funds, actual disbursement to the World Bank can be done, if necessary, in a matter of weeks to months, and [without](#) any additional approval from legislatures.¹ The Overseas Development Institute estimated that the quantum of this readily available callable capital is enough to backstop the World Bank in a high-loss [scenario](#).

The U.S. Congress has authorized and appropriated \$7.7 billion in callable capital for the World Bank, formally known as the International Bank for Reconstruction and Development (IBRD). According to an IBRD [survey](#) on the process of calling this capital, the U.S. Government explained: “No further appropriation or other Congressional action is necessary to enable the Secretary of the Treasury to pay these amounts if any part of them were to be called to meet obligations of [IBRD].”²

¹ As a “gone instrument,” callable capital is meant to be used only after existing paid-in capital has been exhausted.

² Regarding the U.S. Treasury’s accounting treatment of callable capital, the United States reports that it is “referred to as commitments, but are functionally equivalent to contingent liabilities.” In the Treasury’s Agency Financial Report, the callable capital subscription is included in the “Commitments and Contingencies” section, “along with the statement that these subscriptions are only callable under certain limited circumstances to meet the obligations of the respective MDB, and there has never been, nor is there anticipated to be a call on these subscriptions.”



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The World Bank's largest shareholders have signaled their clear support for reforming the treatment of callable capital. Fifteen shareholders released a [joint statement](#) recommending that the Bank explore mechanisms to reflect the value of callable capital in MDB financial policies. Additionally, the G7 finance ministers and central bank governors issued a [statement](#) calling on the MDBs to better reflect the value of callable capital in their capital adequacy methodologies. These calls build on the initial work of the G20 Independent Expert Panel, which [recommended](#) incorporating callable capital into the multilateral development banks' capital adequacy framework nearly two years ago.

With this study and inquiry complete, now is the time to act.

Here is an outline of one way it could be done: the World Bank could include a prudent portion of callable capital as part of its loss absorbing capacity in its capital planning process. This would enable the Bank to recognize and use the risk-absorbing capacity of callable capital in its internal models. As a result, the Bank would be empowered to, in a small and carefully calculated manner, increase its tolerance for risk positions that would imply a minute probability of large losses to its existing equity. In other words, the Bank would be more willing to take on risk if it internalized the financial security protection of callable capital, particularly the value of the already appropriated callable capital. This would free the Bank to use its existing balance sheet to lend more.

Functionally, this would occur following a decision by the Board of the World Bank. This decision is in the Board's authority, and, within reason, there are no legal or practical barriers to doing so.³

Making these adjustments is consistent with preserving the World Bank's strong credit position and reputation for sound financial management. As preferred creditors, the MDBs are protected in the event of debt distress, meaning that by tradition they are paid even when bilateral and private creditors are not. Compared to private institutions, the MDBs are conservative in their leverage—they gear up their equity capital by far less than any private bank and even relative to their own allowances. The roughly 20 percent leverage ratio (\$5 of lending for every \$1 in equity) is far more conservative than the ratio for large commercial banks, which is currently 5 percent (or \$20 in lending for every \$1 of capital). And like other well-managed institutions, the World Bank maintains a buffer, so its actual leverage is less than the maximum allowed. That is why the World Bank's equity-to-loans ratio has not dipped below 22 percent in at least the last five years, despite the policy minimum being several percentage points lower (19 percent as of April 2023).

Indeed, each of the credit rating agencies,⁴ and some MDBs,⁵ already recognize the benefits of callable capital in their own manner.

Importantly, credit rating agencies have expressed comfort with careful incorporation of callable capital into capital adequacy frameworks. For example, Katharin Muehlbronner, Moody's senior vice president in charge of MDB ratings,

³ The Bank's lending is constrained by the Statutory Lending Limit, which can only be changed by amending the Articles of Agreement. This limit is [currently](#) at \$350 billion, well above the Bank's approximately \$250 billion in current lending. The World Bank and the other MDBs have already committed to removing their Statutory Lending Limits, which will no longer figure in their risk-based calculations of appropriate lending levels once removed.

⁴ Though the methods vary, each yields a defined value to the impact of callable capital. S&P's approach is regarded as the most generous, offering up to three notches of rating uplift from callable capital. Fitch counts 10 percent of callable capital as equity in its assessment. Moody's does not recognize callable capital like paid-in like S&P, but values it as a form of shareholder support.

⁵ Two MDBs (IDB and EBRD) [incorporate](#) callable capital into their capital adequacy policies; four MDBs (IBRD, ADB, IDB, CAF) [report](#) callable capital in the equity section of their audited balance sheets; and the IsDB [stated](#) it will include callable capital in its leverage ratio. But none of the MDBs incorporate callable capital into their CAFs through integrating the inherent risk-mitigating benefit of callable capital in risk assessments.



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[confirmed](#) that when it comes to including callable capital as equity in the CAF, “most MDBs do have room for higher leverage, even now. [...] We are saying you have buffers and you can increase leverage without that negatively affecting the rating.” S&P even [acknowledged](#) in 2022—eighteen months before the Callable Capital Exercise—that many “[multilateral lending institutions] have available headroom under our measures” to incorporate callable capital [without](#) imperiling their ratings, even if it results in a significant increase in risk appetite.⁶

The G20 Expert Panel on MDB reform [attested](#) to this dynamic two years ago: “Ratings agencies highlight that one reason they don’t give more benefit to callable capital is that MDBs themselves do not use it. If implemented in a credible manner, taking into account callable capital in CAFs in a prudent fashion could influence the rating agencies to increase this benefit.”

Incorporating Callable Capital		
	Callable Capital Incorporated Into Capital Adequacy Framework	Lending Capacity Gained
Status Quo	\$0	\$0
Conservative Incorporation	\$10 billion	\$50 billion
Moderate Incorporation	\$30 billion	\$150 billion
Significant Incorporation	\$65 billion	\$325 billion

Table 1. Options for incorporating callable capital into the World Bank’s capital adequacy framework.

Theoretically, the Bank could incorporate a large share of its callable capital into its internal modeling that calculates risk capacity, such as the already appropriated \$65 billion. Realistically, there are limits to how much additional lending (and associated capital market borrowing) can be prudently mobilized relative to the current equity base. A conservative approach would only incorporate \$10 billion into its capital adequacy framework—a fraction of the \$65 billion in total appropriated callable capital—as equity for purposes of the Bank’s internal models, which would still be enough to create \$50 billion in new lending capacity. Other paths forward are demonstrated in Table 1.

⁶ Fitch Ratings, viewed as the most skeptical rater on this issue, explained that it is willing to give more value to callable capital if the MDBs themselves first take the initiative. Nick Perry, director of ratings at Fitch, recently [explained](#): “Although some say [our method] is conservative, relative to the MDBs themselves it is not. [...] It’s not just the role of rating agencies to fly the flag for callable capital. As credit rating agencies we are always meant to move with the market and reflect the industry as it evolves. But at the same time we are incorporating a degree of callable capital into our assessment, which MDBs are not, so it’s difficult for us to go too much further without them.”



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This is a responsible and conservative response to the Callable Capital Exercise completed by five major MDBs with input from 25 shareholders, from which the international finance ecosystem has gained much information wherewith to trust the careful incorporation of callable capital. The reports highlighted that a meaningful share of the callable capital is immediately available in the event that the Bank's existing equity is compromised. It makes use of space that the credit rating agencies have already indicated they believe exists.

This sensible reform, implemented prudently, can be implemented quickly—especially given that years of public and internal study have gone into this topic. There is already broad support from shareholders, the credit rating agencies understand the issue as do investors in the World Bank's bonds. The World Bank should put this reform in place in time for the World Bank's annual meeting this fall.

(2) SDR bonds

The World Bank should mobilize the generally idle pool of [SDRs](#) held in the reserves of the advanced economies to strengthen the World Bank's balance sheet, helping it to raise funds for IDA, and expand the IBRD's lending capacity. Concretely, the World Bank could commit to issuing a special series of SDR-denominated, cash-settled bonds by the end of the year to address IDA's immediate funding needs. The United States, the largest SDR holder, could commit to being an anchor investor of these bonds.

SDRs were created by the International Monetary Fund (IMF) in 1969 to supplement the official reserves of its member countries. They are effectively a claim to one of five constituent currencies upon which the value of SDRs is based (the dollar, euro, renminbi, yen, and pound).

An SDR bond would mobilize an already existing, but largely stagnant, pool of SDRs held by the advanced economies (and already over-reserved emerging economies) more efficiently than the current channels for using SDRs while increasing the liquidity of the world's stock of SDR reserves. It is a win-win: the World Bank gets a new source of long-term financing, while the holders of SDRs get a liquid dollar, euro, or yen settled claim that can be sold in the bond market.

Existing SDR rechanneling mechanisms run through the IMF. IMF members have [pledged](#) over \$100 billion in SDRs to the IMF's Poverty Reduction & Growth Trust (PRGT) and Resilience & Sustainability Trust (RST)—but disbursement has been slow.⁷ The IMF is constrained in how it can use the resulting funds—for example, it does not finance long-term investments in clean energy—and huge amounts of SDRs remain completely idle. The United States, for example, has yet to pledge any of its \$166 billion in SDRs. Counting all of the SDRs of the EU countries, the G-10 countries currently sit on \$459 billion of unpledged SDRs.

An SDR-denominated bond issued by the World Bank offers a simple way to mobilize SDRs for long-term development finances. Please see the Annex for further technical explanation.

⁷ These two IMF trusts cannot absorb the SDR pledges. The PRGT's capacity to receive more SDRs is constrained by its need to receive more subsidy contributions (grants that offset the SDR interest rate and allow the IMF to lend to low-income countries at zero percent)—and as donors have been unwilling to provide those grants, the PRGT has been unable to take in more SDRs. The RST has no such financial constraint, but it does have an operational constraint: the RST's utilization of SDRs has been slow and getting slower. Program sizes have shrunk over time, and at present the RST has disbursed only 3.1% of the funds it has raised. Until the IMF is prepared to use its great new tool, it makes little sense to contribute more SDRs to it.



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1. Countries with excess SDRs could commit to invest in an SDR-linked, cash-settled bond issued by the World Bank. Purchasing countries would transfer their excess SDRs to the World Bank. The new bonds would pay the SDR interest rate, replicating the financial return currently provided by the SDR account at the IMF.
2. The World Bank is already an authorized holder of SDRs. It would retain the SDRs until they are needed for its lending. When the World Bank needed the funds, it would enter the IMF's Voluntary Trading Arrangements (VTAs) to convert the SDRs into usable currencies.
3. In turn, the World Bank's lending would generate the financial return that backs repayment of the SDR bonds, in the same way the World Bank's existing loans provide the cash flow that enables repayment of those loans. The core business model of the bank would remain the same.

The World Bank gets one specific benefit out of this transaction: a large and stable source of long-term financing. The SDR bond should be offered with a floating rate, but with a 30-year maturity. This long tenor is conducive to raising funds for concessional climate finance, as projects typically require long-term funding as they generate stable cash flows over time. The World Bank currently has a large and deep market for 5-7-year bonds, but a much thinner market for its long-duration issues. By tapping into the pool of SDRs now held as perpetual deposits at the IMF, an SDR-linked, cash-settled bond would allow the World Bank to extend the maturity of its borrowing without paying a market risk premium. That subtly boosts the Bank's lending capacity by reducing the need for the bank to hold a large buffer of liquid assets to manage its refinancing risks and providing a better match to the bank's long-term lending portfolio.

Countries that purchase SDR bonds would do so for a simple financial reason: an SDR bond replicates the financial return on their SDR account at the IMF while offering greater short-term liquidity. The floating interest rate would replicate the return on an SDR account at the IMF, and match countries' payments to the IMF on their SDR liabilities. But because the bond would settle in foreign exchange rather than SDRs, it could be sold in a pinch in the open market. The major holders of SDRs would thus be able to obtain cash against their SDR holdings more readily than they can now, as they would not need to trade exclusively with other countries through the IMF's VTAs.

By entering into a standard set of interest rate swaps, the Bank's Treasury office could transform its floating rate obligations into a fixed rate of around 3.2 percent. Compared to the Bank's current long-term borrowing, this saves the World Bank 75-100 basis points—a real financial benefit.

And SDR bonds specifically could help solve the vexing issues now facing the International Development Association (IDA), the World Bank's concessional lending arm. To expand IDA's lending capacity, the last replenishment cycle envisioned supplementing IDA's equity funding base with roughly \$25 billion in borrowing. But IDA faces a real challenge raising the long-term funds needed to match its long-term borrowing at a reasonable cost (IDA donors effectively have to cover the interest rate on the borrowing to make the loans concessional, but they planned for lower interest rates than what markets now face). IDA currently raises relatively short-term funds (its bonds have an average maturity of eight years) to fund its long-term lending (30-50 years). And IDA has to pay a significant premium over the risk-free rate on its longer-dated issuance, effectively reducing its lending capacity. The accounting for IDA with SDR bonds is especially easy, as IDA's base currency is the SDR itself and [83 percent](#) of IDA's outstanding loans are SDR-denominated. This serves as a compelling near-term opportunity to employ SDR bonds to support IDA's ability to raise the funds needed to meet its IDA20 commitments.



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The United States could take the lead by committing to use its SDRs to support a new IDA funding facility and mobilize the G7 to meet IDA's full \$25 billion in borrowing needs in the current replenishment through SDR-denominated bonds.

In sum, SDR bonds would provide a realistic and streamlined solution to rechanneling currently unused SDR reserves held by the advanced economies and already over-reserved emerging economies to meet the global need for more climate finance. The World Bank gets a stable source of long-term financing and the current holders of SDRs get a more liquid instrument.

(3) Ambitious IDA21 replenishment

IDA, the World Bank's concessional lending arm, is the single largest source of public concessional capital and the [primary provider](#) of net new funds for many low-income countries. IDA is also a proven source of climate financing, with around 30 percent of its current lending going to climate projects, half of which is for adaptation, and with a goal to reach 45 percent by 2025. Properly funding IDA is thus a core component of successful multilateral climate finance.

In that context, a concrete sign of progress this year would be if shareholders support an ambitious IDA21 replenishment of *at least* \$100 billion. This commitment, together with funds from other donors, will allow IDA to sustain around \$33 billion in commitments a year from 2025 to 2027.

The prior IDA replenishment (IDA20, which covers FY22-25 spending) promised to mobilize a record \$93 billion. It did so through \$23.5 billion in contributions by 48 countries—including a \$3.5 billion U.S. commitment. For the three preceding replenishments, the United States' falling IDA commitments led to its displacement as the top contributor, and meanwhile China progressed from the seventeenth to the sixth largest contributor. Although the United States reclaimed its spot as the top contributor in IDA20, the United States should step up its contribution to retain its position as the largest IDA contributor and ensure the IDA21 replenishment mobilizes more capital than IDA20.

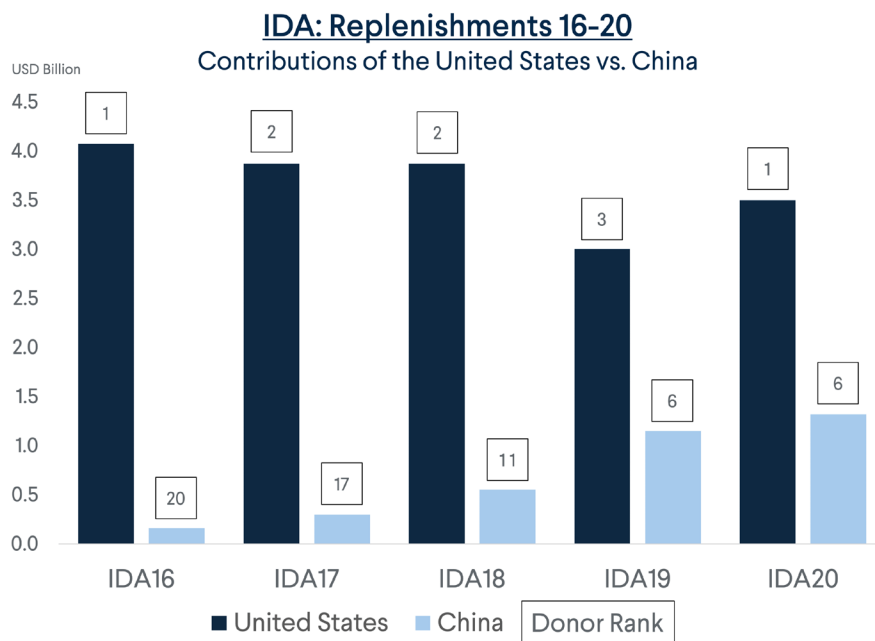


Figure 3. The contributions of the United States and China to the IDA's previous five replenishments.



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The headline IDA replenishment number is far different from the actual budget cost, as the total reflects relending funds from the repayment on existing IDA concessional loans and funds raised through borrowing—not net new budget dollars. But this also creates specific challenges for this cycle: repayment flows are more modest this time around, and the necessary acceleration lending during the pandemic has reduced the “carry-over” projected from the past IDA replenishment. Greater donor contributions are thus needed to sustain or increase IDA’s concessional lending capacity, especially in a global environment where higher borrowing costs raise the budget cost of using market borrowing to support IDA’s concessional lending.

The needed budget contribution from all donors for a \$100 billion IDA21 replenishment is estimated to be \$28 billion, a 20 percent increase over IDA20. The United States should contribute \$4.5 billion (16 percent), setting an example for other donor nations to follow. Additionally, the Bank should look creatively at all income sources to help maintain IDA concessional capacity, including intra-World Bank transfers.

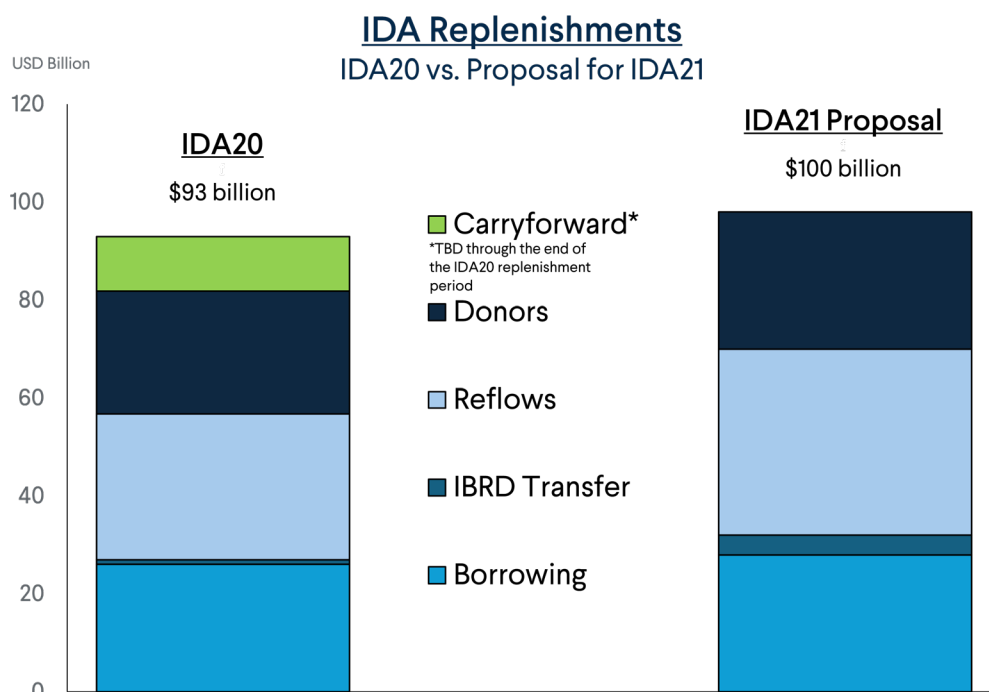


Figure 4. IDA20’s replenishment and our proposed replenishment structure for IDA21.

As discussed in the previous proposal, SDR-linked bonds can help lower the cost of the replenishment, by allowing IDA to borrow long-term funds at the risk-free rate rather than paying a market penalty for long-tenor bonds. If IDA21 is a record replenishment, it will require record new borrowing. The topline of IDA20 assumes that the World Bank will be able to raise \$25 billion in net new debt financing; for our IDA21 proposal, market borrowing will be closer to \$30 billion. Without a new G-7 IDA funding facility that uses SDR-linked bonds, raising these funds on terms that support IDA’s concessional lending model will be challenging at best, and potentially impossible.

IDA is a critical pillar of support for the most vulnerable and least-resourced nations, and a major provider of climate finance. As such, it is uniquely positioned to address the climate crisis by providing the necessary concessional financing.



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The proposed ambitious IDA21 replenishment, supported by financially efficient borrowing through a long-tenor SDR bond, is essential for sustaining and expanding IDA's climate financing without compromising on efforts to reduce extreme poverty.

(4) Spurring intra-MDB competition

The MDBs are [incrementally advancing](#) the evolution agenda. The next wave of reforms seems to be more challenging. Spurring intra-MDB competition may elicit faster progress and tangible results. The United States can encourage more rapid evolution, and more creativity, by spurring competition among the MDBs for a pool of new resources. The Green Climate Fund, which has \$10 billion in currently unused funding, could join in the process.

United States

The United States currently supports the MDBs in two ways: by contributing to their formal capital and by providing grant resources to enable IDA to effectively support low-income countries that cannot afford standard MDB lending terms.

The World Bank recently established a portfolio guarantee program. Guaranteeing payment of existing Bank lending frees up the Bank's current equity base for new lending, as the guaranteed exposure poses no risk to the bank. U.S. participation in this type of program looks like allocating enough resources to repay IBRD in the event of a loan default. This structure has a bang for buck: the World Bank [can](#) lend \$6 for every \$1 of portfolio guarantee its financially strong shareholders provide.

Through the FY24 appropriations bill, Congress appropriated its first set of resources (\$50 million) to fund World Bank and Asian Development Bank's guarantee programs. But Congress should go further and create an "MDB guarantee challenge facility" that enables the United States to allocate resources to any MDB, based on its plans to reform and deploy climate finance to support projects in recipient countries. Effectively, this more expansive authority would enable the United States to "auction off" its guarantee subsidy credit to the best-performing MDB, serving as a demand-pull mechanism for rapid and tangible progress.

The United States can model this approach and eventually encourage other G7 members to follow suit, ultimately extending the impact of each nation's budget resources.

Making the Green Climate Fund Catalytic

The Green Climate Fund (GCF) should also consider this strategy as it plans its second replenishment period and considers this summer how to use its existing funds most effectively. It is already authorized to work with the MDBs.

After 15 years after its establishment as the singular multilateral public finance institution dedicated to climate change, the GCF has received \$33.1 billion in pledges but only disbursed \$4.2 billion (which is 25 percent of its paid-in funding).

To improve disbursement speed and increase leverage, the GCF should use a portion of its existing paid-in capital to invest in hybrid capital issued by the MDBs, with a commitment by the MDB issuing the hybrid capital that the funds would be used in ways that support the mission of the GCF. Doing so would expand the scope of activity and impact of the GCF, as the banks generally can use each \$1 of hybrid capital to support \$5 in lending.



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This approach builds on the existing authority of the GCF to fund specific project proposals from other MDBs. Instead of submitting project applications, the MDBs would submit strategic plans showing how hybrid capital can be leveraged and support private capital mobilization and climate lending. The GCF would allocate its hybrid capital based on how it could most effectively deliver on the GCF’s goals, including the even mitigation and adaptation funding split, or as a “reward” to MDBs demonstrating the most progress.

The GCF Board would be able to make quick decisions to allocate this capital without the ties of specific projects. The MDBs would commit to integrate the new hybrid capital into its balance sheet and deploy it for climate projects. In other words, the incorporation of GCF hybrid capital into another MDB institution is the “project” the GCF Board would approve, and the application would be competing proposals about which institution could do so the best.

The Board should consider allocating \$5 billion in hybrid capital to this purpose. Outlaying these funds quickly would double GCF’s disbursements. Once on MDB balance sheets, it would back \$25 billion in lending immediately and—depending on the use of the interest proceeds on the hybrid capital instrument—back between \$40-50 billion over 10 years.

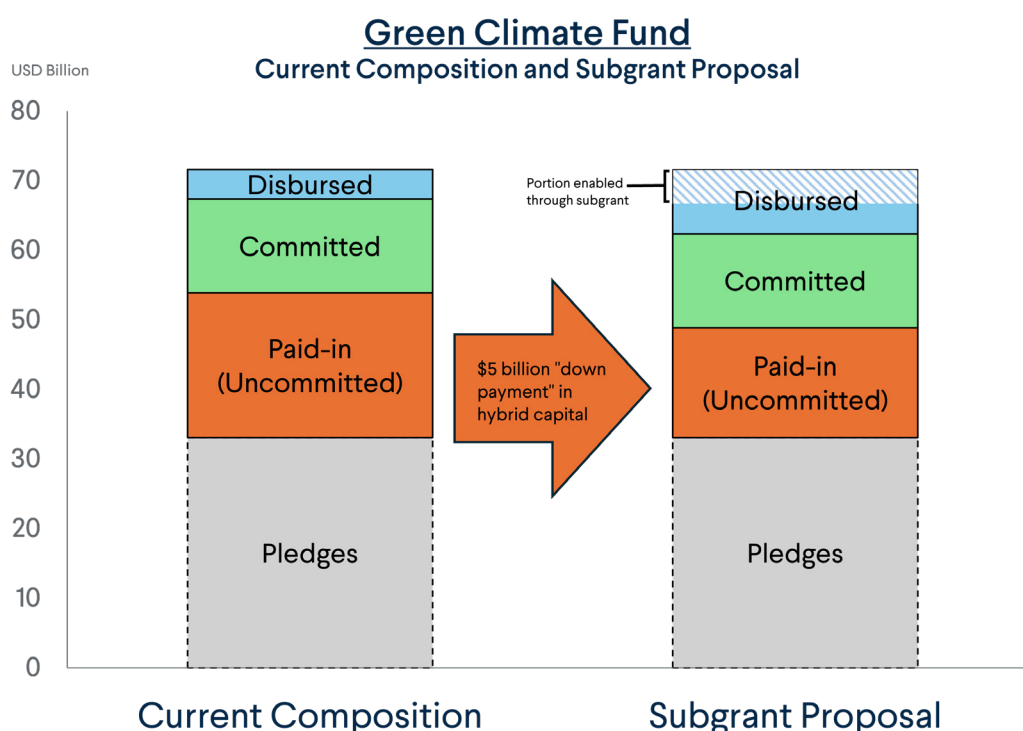


Figure 5. The Green Climate Fund could quickly double its disbursed funding with this proposal

(5) Dedicated Clean Energy Window

Beyond the other proposals discussed in this paper, we ultimately believe the World Bank needs to structurally change how it finances the energy transition.

Building clean energy generally requires substantial upfront capital investment. Clean energy projects also often face extended timelines to become operational and generate returns, thus necessitating patient capital that can accommodate



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Since 1977, CEEPR has been a focal point for research on energy and environmental policy at MIT. CEEPR promotes rigorous, objective research for improved decision making in government and the private sector, and secures the relevance of its work through close cooperation with industry partners from around the globe. CEEPR is jointly sponsored at MIT by the MIT Energy Initiative (MITEI), the Department of Economics, and the Sloan School of Management.

long payback periods. Otherwise, these projects are more vulnerable to a rise in borrowing costs. Developing countries have correctly noted that the high cost of long-term borrowing prevents them from making long-term investments in clean energy infrastructure. These challenges are compounded by their limited access to credit markets, higher perceived risks, and existing financial constraints, all of which make it more challenging to transition to clean energy.

The World Bank's basic structure is well suited to help meet this need: its existing lending is long-term and its preferred creditor status enables it to lend at much lower rates than commercial creditors.

However, standard IBRD financing—priced at a modest premium over the standard floating rate—isn't perfectly suited for clean energy financing. The ideal lending structure would have a fixed interest rate and be priced as close to the risk-free rate for all borrowers as is possible, as an incentive to rapidly scale up clean energy investment. For a subset of countries, a portion of the lending ideally would be on concessional terms.

To best accomplish these goals, the World Bank should create a Dedicated Clean Energy Window.

This would build on the Climate Investment Funds (CIF), which house the Clean Technology Fund (CTF), the Strategic Climate Fund (SCF), and other relevant programs. But the CIF, a financial intermediary fund, is not designed to be the source of equity to back large-scale lending. It has received around \$12 billion from 15 contributor countries since its creation in 2008: a helpful contribution, but insufficient for the needed scale of clean energy investment abroad.

A dedicated lending window with its own capital base would similarly build on the Bank's recently created hybrid capital mechanism, which allows investors to designate their capital to support World Bank lending goals through the Global Solutions Accelerator Platform. The mechanism lets donors take advantage of special leveraging potential, as the Bank has [announced](#) resources put in the platform can be multiplied six to eight times over 10 years. At least seven countries so far have announced contributions.

However, the proposed Clean Energy Window would go even further, mobilizing additional dedicated capital to support a window with differentiated lending terms and pricing.

The Window would be backed by a dedicated capital base, for which we think \$50 billion is appropriate. The Window would also be financed uniquely with long-term bonds designed to match the payback structure from clean energy investments. The matched structure would be financially efficient, as there would be no real need to maintain a large liquidity buffer. Pricing would be set to maximize and incentivize uptake, not to cross-subsidize other Bank initiatives or to add to the capital base over time. With the use of SDR bonds swapped back into a fixed rate, we estimate the lending rate could be as low as 4 percent (a 3.2 percent cost of funds plus 50 basis points). With a market bond, the lending rate would be close to 5 percent (assuming that long-term borrowing carries a 100 basis point premium over the risk-free rate on a blend of dollars, euros, and yen).

The purpose of such a window is thus twofold: (a) to enable proper resourcing for clean energy within the Bank without cannibalizing existing development financing and (b) to provide an opportunity to make use of differentiated lending terms that can be better tailored to long-term clean energy investments.

Given the scale of the climate challenge, we believe that this new window should aim to match the current scale of the IBRD. This requires substantial new capital and a renewed recognition that paid-in capital remains the most financially powerful way donors can back the Bank. The United States should offer to invest \$10 billion for this facility, its share of the \$50 billion



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capital base currently needed to support \$250 billion of World Bank lending. Additional reforms that facilitate the use of the callable capital base to scale up existing paid-in capital could increase the new lending to \$300 billion. This would match or surpass the IBRD's current balance sheet, creating real money for climate action.⁸

This is an opportunity for the US to exert concrete leadership abroad, with a credible plan to deliver a quantum jump in the amount of clean energy finance supported by the multilateral development banks. It is also an efficient use of the United States' limited pool of budget dollars. Ten billion dollars from the United States would credibly encourage other donors to contribute to the \$50 billion paid-in goal, which will translate to \$300 billion in net new climate flows. This kind of leverage is impossible through the current financial intermediary funds, which are not designed to provide the equity base for World Bank lending.

Conclusion

The World Bank's evolution to-date has commendably embraced a set of reforms to make its lending more effective and to create a modest expansion of the headroom on the balance sheet. But World Bank reform needs to be less incremental and more visionary. It's time to do more.

The World Bank's shareholders have not fully appreciated the basic structure of the Bank's balance sheet. There is no more financially powerful method of supporting clean energy investment globally than paid-in capital, supplemented by hybrid capital and the additional loss absorbing capacity that can be derived from callable capital stock and leveraged through market borrowing and directly tapping currently underused pools of SDRs. No other credible source for the long-term low-cost financing that a warming world needs for clean energy investment exists on the needed scale

As the Bank's largest shareholder, the United States needs to take the lead, encouraging the World Bank to be more ambitious in every and any way possible. It should start by pushing proposals that credibly generate new lending capacity and/or help lower the Bank's cost of borrowing in a high interest rate environment in ways that do not require Congressional approval. That means looking at underutilized assets like callable capital and SDRs.

But to achieve the needed level of ambition and demonstrate its commitment to the multilateral system, the United States needs to make a clear commitment to mobilizing new funds and adding to the capital base of the World Bank – and challenge the MDBs to develop new and innovative ideas to expand their capability to finance both development and clean energy expansion.

The creative proposals discussed in this paper could nearly double World Bank lending capacity within the decades (see Figure 1). And with intention, it is still possible to make strides in this direction this year.

⁸ To further lower the cost of funds, countries or philanthropies could put in grant contributions. One model for this could be the Livable Planet Fund, backed so far by [Japan's initial \\$20 million donation](#), which provides grants to lower the Bank's lending rate for countries that are Below Graduation Discussion Income.



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Annex. Additional technical details for the SDR proposal.

What is the legal foundation for the United States purchasing SDR bonds? The United States is well-positioned to lead the effort in lending to the World Bank by way of SDR bonds. In the United States, SDRs are governed by the 1968 [Special Drawing Rights Act](#), which directs the Department of Treasury’s Exchange Stabilization Fund (ESF) to hold SDRs. The statute permits the Secretary of the Treasury to “deal in gold, foreign exchange, and other instruments of credit and securities the Secretary considers necessary.” In other words, Congress has already authorized the U.S. Treasury to purchase debt securities from highly-rated issuers, which would naturally include an SDR bond issued by the AAA-rated World Bank. In fact, the SDR bond would be a security of higher quality than, for example, U.S. Treasury bonds or French government bonds, as both countries are currently rated below AAA by some credit rating agencies.

What rate would the SDR bond charge? The SDR bond would need to carry a floating rate to match the interest countries pay on the SDR allocation—but it need not be priced at a premium to the risk-free rate. IMF member SDR holdings are de-facto perpetual deposits that pay a weighted average of the short-term policy rates of the SDR basket of currencies. For SDR holders, the bond would be preferable to the status quo SDR account at the IMF, which is functionally illiquid for advanced economies. Because the SDR bonds have a floating rate and climate projects receive finance with a fixed rate, the World Bank would need to engage in a standard interest rate swap. This swap requires a marginal amount of capital, but enough to slightly raise the effective cost of SDR financing. We estimate that swapping the floating rate SDR bond to a fixed rate, using the swap curves for its constituent currencies, would today generate 30-year funds at a fixed rate of around 3.2 percent—and the rate has often been lower (see Figure 7).

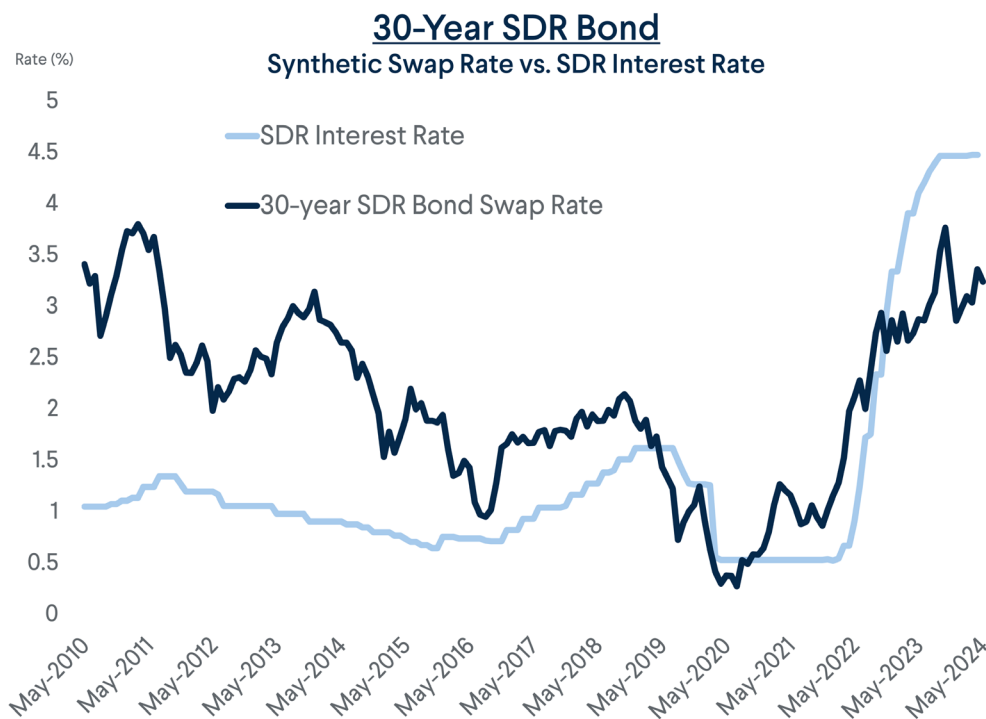


Figure 6. The synthetic swap rate of a 30-year SDR bond vs the SDR interest rate.

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How would the World Bank convert the SDRs into currency? In order to exchange the SDRs that the Bank receives from the issuance into dollars or euros (which would then be lent out), the Bank would need to enter into the IMF's VTA. Functionally, this requires an IMF member country or another MDB to provide the dollars or euros against the SDRs.

How can the conversion of SDRs be streamlined? The Federal Reserve's [SDR certificates](#) should also be made available as necessary to assure liquidity for the SDRs (to settle in USD) in the VTAs. At present, the country that lends the SDR is responsible for settling that SDR in its own currency. The VTAs should be reformed so that countries that lend SDRs are not necessarily responsible for turning that SDR into cash. In the near term, this can be done by having the Federal Reserve purchase SDR certificates from the U.S. Treasury's Exchange Stabilization Fund (ESF), thereby supplying more dollars for the ESF to be the counterparty in more purchases of SDRs (i.e. pumping more liquidity into VTAs). Additionally, if VTAs were reformed in this manner, countries with large foreign reserve balances could provide liquidity against SDRs. For example, China could easily supply around \$200 billion in foreign currency and receive SDRs in return. Others like Singapore and Switzerland also have room to contribute more to the liquidity of this system.



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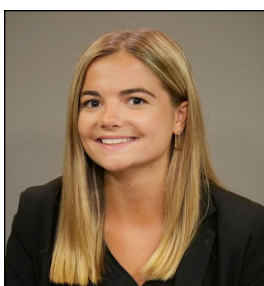


Brian Deese is the current Institute Innovation Fellow at MIT and CEEPR, where he is focused on researching and developing strategies to address climate change and promote sustainable economic growth. As the former Director of the White House National Economic Council, Deese advised President Biden on domestic and international economic policy and coordinated the economic agenda of the Biden-Harris Administration. A former senior advisor to President Obama, Deese was instrumental in engineering the rescue of the U.S. auto industry and negotiating the landmark Paris Climate Agreement. Deese is a crisis-tested advisor with broad experience in accelerating economic prosperity, empowering working Americans, and harnessing the economic opportunities that come from building a clean energy economy and combating the climate crisis. Deese received his B.A. from Middlebury College and his JD from Yale Law School.

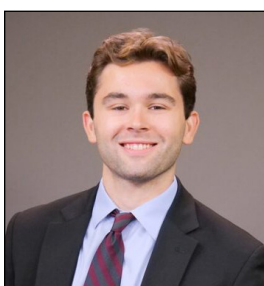


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