

International finance architecture (IFA) reform

The key to financing climate safety

By 2030, emerging markets and developing economies (EMDEs) will need an additional \$3tn per year to finance climate transition and sustainable development goals.

To achieve this, technical reforms to international financial institutions could unlock considerably more lending if combined with comparatively modest commitments from richer countries.

This “IFA” reform agenda is the most efficient, politically feasible path to scale climate-safe, global development finance to sufficient levels.

IFA for climate and development

In theory, there is no shortage of global capital to close the gap. In practice, more money needs to reach where it is needed. All countries, but particularly high greenhouse gas emitters, have roles to play in helping to finance the global climate and development transition.

Unsteady progress was largely derailed by the COVID-19 pandemic. Governments now find themselves cash constrained after years of covid spending, inflation, and other economic challenges.

Current levels of public finance for climate and development don't come close to meeting the needs of EMDEs. Meanwhile, structural economic barriers often deter private investors or prevent further borrowing by governments.

The aims of the IFA reform agenda

Improve the **SCALE** of climate and development finance

Develop a new paradigm for how that finance is **DELIVERED**

Remove structural barriers to better **ENABLE** finance to flow.

How much is needed?

The *additional* \$3tn / yr is likely to need **\$1tn from external sources**.¹

Of this, **\$260bn / yr could come from multilateral development banks (MDBs)** – a tripling of 2023 levels. The rest would be comprised of \$160bn in bilateral finance, \$80bn from multilateral funds, and \$500bn in private sector finance.

Due to MDB leveraging on capital markets, that tripling in MDB lending would **only require tens of billions to be paid in by governments** over a half decade .

The magnitude of the financing challenge will be brought into sharp political focus this year as countries discuss the New Collective Quantified Goal (**NCQG**) for climate finance at COP29.

If implemented well, the IFA reform agenda could help soothe strained North-South relations, repair traditional partnerships, and build shared prosperity in the context of a just global economic transition.

¹ Independent Expert Group, 2023, The Triple Agenda: A roadmap for better, bolder, and bigger MDBs Volume 2, G20

Scaling finance: The MDB multiplier effect

Using multilateral development banks' ability to amplify public finance is the most cost-effective way to achieve the amount of new lending required. Unlike "dollar in / dollar out" bilateral aid, **MDBs leverage shareholder countries' paid-in capital 4x**, and hybrid capital and guarantee contributions 6–8x.

Efficiency measures such as Capital Adequacy Framework (CAF) reforms could allow MDBs to lend additional hundreds of billions in the near future at no extra cost, if they are directed to do so by shareholder governments.

Finance ministries putting more finance into MDBs would increase climate / development budgets considerably further, including by allowing pilots using Special Drawing Rights (SDRs).

Efficiency reforms: The Capital Adequacy Framework (CAF)

CAF reforms are a series of actions that MDBs should take to finance considerably more on the back of their current capital. These AAA-rated banks could be far more proactive without risking a downgrade.

Shareholders are making implementation of CAF reforms by MDBs a precondition of any conversation about capital increases. They should continue to press MDBs and credit rating agencies to implement these reforms.

By incorporating their existing **callable capital** onto their balance sheets, MDBs can significantly expand their risk appetite and unlock hundreds of billions in new lending, without any new donor contributions. Callable capital functions like a backstop guarantee against defaults, but MDBs have long overlooked it in their risk frameworks.

MDBs can find additional tens of billions by lowering their **Equity-to-Loan ratios**. In the last year, the World Bank has unlocked \$7bn/yr by nudging from 20% to 18% – still far higher than commercial banks.

Expanding sources of finance

Countries will need to find new revenue sources to enable larger finance contributions. While all have their challenges, a few ideas are gaining traction. If used with high integrity, **carbon markets** can raise additional funds for both mitigation and adaptation. **New carbon taxes** (i.e. taxes on

New supplies of finance: A checklist to boost lending

✓ Secure an ambitious 2024 IDA replenishment, with donor contributions exceeding \$30bn

IDA, the World Bank's concessional lending arm for lower-income countries (LICs), is due for replenishment in 2024. Improving on 2021 IDA pledges is the right thing to do: LICs face greater financial stress and development challenges. IFA reform requires consensus, and **concessional replenishments are a critical way for building trust and political support**. Donors must also deliver on other institutions due for top-ups, including GAVI, the Global Fund, and AfDF17.

✓ Ensure that hybrid capital and guarantees clear domestic budgetary hurdles

These innovative tools allow donor countries to make ad hoc MDB contributions without opening up the long process of renegotiating shareholdings. **Sovereign guarantees** serve as insurance to de-risk projects and build confidence in emerging markets, attracting investment. **Hybrid capital**, effectively long-term debt with equity characteristics, can be treated as new capital and leveraged.

✓ Begin discussions on recapitalising MDBs

General Capital Increases (GCIs) will be needed to expand MDB balance sheets. This would require political agreement on the scale to aim for and any changes to governance for each bank. Ultimately this would entail negotiated shareholdings and political compromise. The plan should start with an ambitious World Bank GCI in 2026.

✓ Urge major MDBs to authorize and pilot re-channeling of Special Drawing Rights (SDRs)

The IMF issues SDRs as reserve collateral to aid countries in times of trouble, most recently for covid recovery. SDRs unused by rich countries could be redirected, and leveraged by MDBs, to help others in need. A pilot program at AfDB is planning to use SDRs to raise hybrid capital, making the case for further SDR issuance, if successful.

high-emitting sectors / activities) would quickly expand the available supply of finance. **Shipping and aviation** are a natural place to start, as cross-border industries that rely heavily on fossil fuel consumption. A proposed **2% global wealth tax** could raise hundreds of billions annually. All of these will require political leadership and co-operation.

Delivering better finance: Country platforms

Meeting the climate and development challenge requires a new model of delivery to connect disparate pieces of the global financial system. Country platforms can bring together global investors to **pool finance in order to finance ambitious plans**, for instance National Development Contributions.

Global climate finance goals will be impossible to meet by financing projects one at a time. Platforms can achieve portfolio scale for investors and client countries, benefitting all parties. Together, MDBs, NDBs, governments, philanthropies and the private sector can coordinate significant investment packages, meeting aggregate demand for clean development. This should become a normalised model for delivering finance at scale within the IFA.

Governments should work with development banks to build country platforms, and to engage with them on forming national transition plans, applying lessons from Just Energy Transition Partnerships (JETPs) to balance the convening power and in-country expertise of MDBs – as providers of technical assistance and well-networked coordinators – with in-country actors that can provide local knowledge and ensure country ownership.

National transition plans will provide the basis for country platforms. They signal a direction of travel for international financiers, laying out which sectors and projects are ripe opportunities for investment. These plans must be country-led yet aligned with global goals in order to reach international actors.

Enabling finance flows: Macro reform

Enabling demand for finance is just as important as scaling the supply. Plans to transition national economies and align them with climate-safe pathways need to be financially feasible and politically acceptable. MDB scale can only be increased with greater concessional finance and with suitable macro-economic conditions.

Many EMDEs currently face significant market pressures on the sovereign bond market, which can have substantial bearing on their capacity and willingness to engage with their own transitions. Sovereign debt is a major barrier to mobilizing climate and development finance. Countries need to be encouraged and financially rewarded by financial markets and international institutions to undertake their own economic transitions. In short, the IFA needs to be **better**, not just **bigger**.

Dealing with debt

Efforts should start with a reform of the joint IMF–World Bank Debt Sustainability Analysis and Framework (DSA). DSA assessments should better reflect both climate risk and positive feedback effects that climate investments can have on the sustainability of sovereign debt.

These adjustments need to be reflected in a consistent way in the rest of the IMF’s policy toolbox: from its country-focused Article IV consultations to the standard financial assistance programs it deploys.

Prudential reform: IFA unleashing the private sector

Private firms are expected to provide the largest share of the additional finance needed. Enabling full IFA firepower means using regulation and supervision to align the financial sector’s financing capacity and strategy with the global economic transition.

Prudential reforms are needed to ensure rules that dictate how banks manage and understand their own risks and investment strategies properly account for climate, in line with IFA reform efforts. The Basel Committee needs to accelerate its work to address this. The G20 should also call on central banks to complete this work.

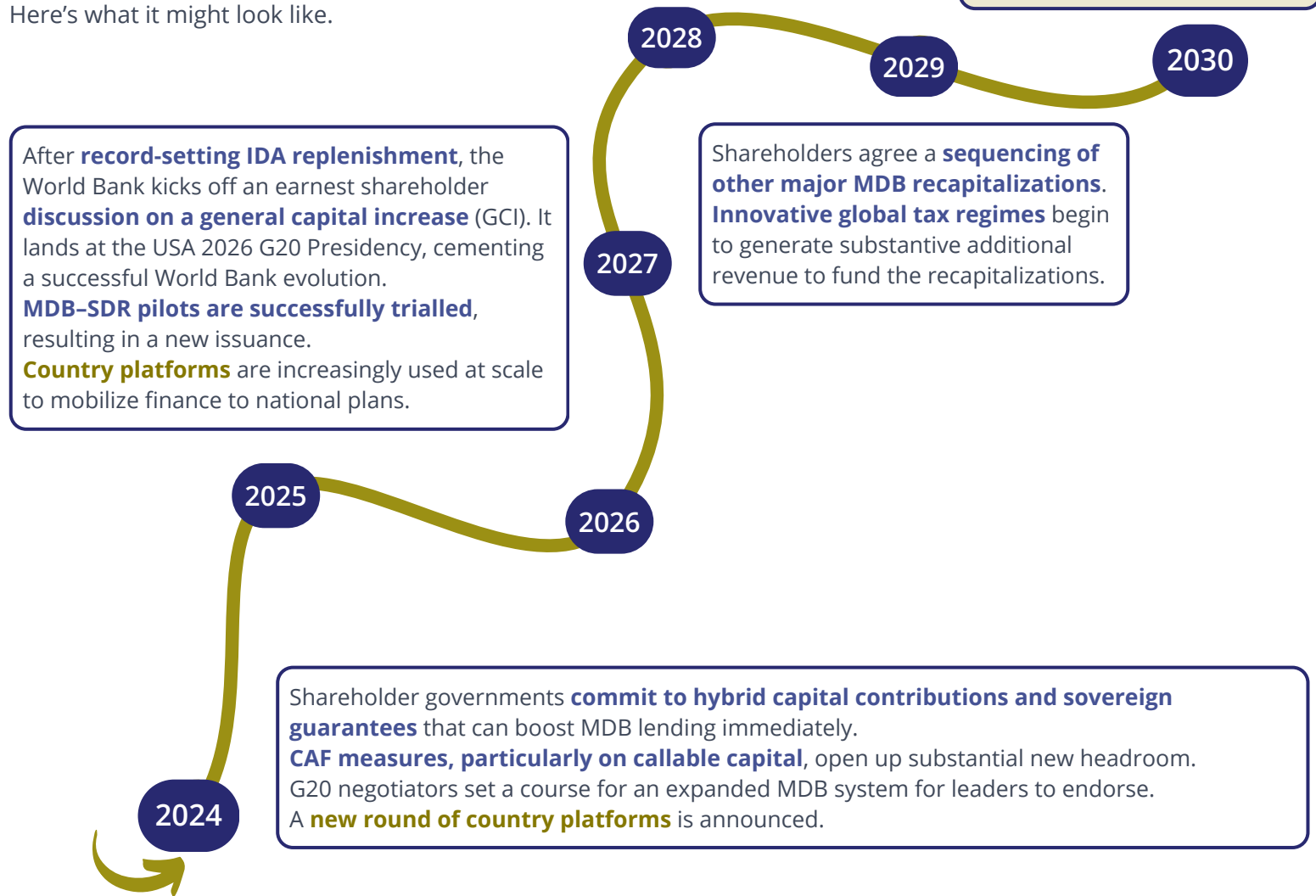
IFA reforms must enable a positive investment environment to increase external public **and** private finance flows. EMDEs should be supported to implement emerging regulatory norms such as transition plans and taxonomies that can mobilize new investment. Moreover, new proposals are emerging to de-risk investment landscapes: on currency risk, emergency liquidity funds, and guarantee facilities.

Increased coordination among MDBs and, crucially, with national development banks (NDBs) could augment IFA reform efforts while providing a better framework for mobilizing domestic resources. EMDEs must reverse the flow of investment outward to accelerate development.

Timeline: IFA action plan to 2030

Reforming the international financial architecture and right-sizing the MDBs to achieve climate and development finance goals by 2030 will require political vision, leadership, negotiation, and advance planning. It will also need an increase in concessional finance beyond MDBs and action to ensure countries have the fiscal headroom to secure investment.

Here's what it might look like.



Contact us

Nick Mabey, Co-CEO
nick.mabey@e3g.org

Rob Moore, Public Banks Associate Director
rob.moore@e3g.org

Laura Sabogal Reyes, Public Banks Senior Advisor
laura.sabogal@e3g.org

Franklin Steves, Public Banks Senior Advisor
franklin.steves@e3g.org

Danny Scull, IFA Campaign Coordinator
danny.scull@e3g.org

Press enquiries
press@e3g.org