Campagna per la riforma della Banca Mondiale

Can financial markets solve the climate crisis?

Unpacking the false solutions proposed by the World Bank

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Finance is one of the core elements of the multilateral negotiations on climate change. The current financial crisis is increasing the pressure on developed and developing countries to find a solution that will allow the generation and transfer of the needed resources to cover the costs of developing countries to adapt and mitigate to climate change, and to allow the needed technology transfer.

The US and the EU have championed the World Bank as *the* institution most able to leverage and transfer resources at a scale of hundreds of billions per year to developing countries. The High Level Advisory Group on Climate Change financing (AGF)[1] has also mentioned the World Bank among the "solutions" for accumulating the needed resources for climate finance. In December 2010, the World Bank was invited by the Conference of the Parties of the UN Climate Convention on Climate Change (UNFCCC) to "serve as the interim trustee of the Green Climate Fund" that governments meeting in Cancun committed to establish.

However, critical voices from civil society, from the South and the North, have advocated for years the establishment of a multilateral Global Climate Fund under the authority of the Conference of the Parties of the UNFCCC[2].

This discussion note seeks to highlight some of the most controversial aspects and long term implications of the World Bank's possible engagement in defining or managing global climate finance. This will be done through unpacking the core argumentation in support for a key role for the World Bank versus possible alternatives that governments should explore during multilateral climate negotiations. Such discussion should be included in the agenda of the Transitional Committee process, scheduled to start in April 2011.

Assumption 1:
On the leverage capacity of the World Bank and its commitment to secure a role for the private sector in the fight against climate change

"The Climate Investment Fund, with some contributions we've gotten of about $6.5 billion, we've been able to leverage about 10 to one (dollars), so we've raised about $50 billion to $60 billion. Sometimes other money from us, sometimes regional banks, some 30 percent from the private sector, some from governments themselves".

Robert B. Zoellick, President, The World Bank Group – WB/IMF Annual Meetings 2010[3]

The World Bank is promoting its leverage capacity on private finance and financial markets as one of the added values that the institution could offer in order to put together the necessary resources to finance climate change adaptation and mitigation operations. Translating the current World Bank approach to climate finance, a scenario where mitigation interventions may

1 The UN Secretary-General established a High-Level Advisory Group on Climate Change Financing on 12 February 2010 for the duration of 10 months. The Group have studied potential sources of revenue that will enable achievement of the level of climate change financing that was promised during the United Nations Climate Change Conference in Copenhagen in December 2009. For more info: http://www.un.org/wcm/content/site/climatechange/pages/financeadvisorygroup

2 "Towards a Global Climate Fund. Principles for Poznan and beyond". December 2008. http://www.choike.org/campaigns/camp.php?3

3 Transcript of the Civil Society Organizations Townhall Meeting, Washington DC, October 7, 2010. http://www.imf.org/external/np/tr/2010/tr100710cso.htm

be financed mostly by private capital, while higher profits made by the institution in private sector investments could be reinvested in adaptation financing, can be easily foreseen. The inclusion by the High Level Advisory Group on Climate Change financing (AGF) of the World Bank among the "sources" of climate finance is, in our view, an alarming signal of the widespread acceptance among high level governmental officials of this self image that the Bank has promoted widely.

Taking a step back, though, can help in the understanding of what lies behind the World Bank's proposed approach, the implications of promoting such a central role for the financial markets and of using limited public resources to back an approach that would sideline the role of states in favour of private capital markets for the protection of a global public good such as the earth's climate.

In recent years, the World Bank has made its leverage capacity the core argument for expanding its action beyond existing financial facilities – mainly centred on lending to governments – to achieve its mandate of poverty reduction through sustainable development

In recent years, the World Bank has made its leverage capacity the core argument for expanding its action beyond existing financial facilities – mainly centred on lending to governments – to achieve its mandate of poverty reduction through sustainable development. This trend has focused on promoting private sector development as the key engine of economic growth and thus development. Within this approach, growing attention has been placed on promoting the growth of the private financial sector as a key driver in the development process.

As a result, direct lending to the private sector has increased. According to a recent Eurodad study,[4] in the last decade investment and lending commitments by the IFC – the International Finance Corporation, the World Bank's private sector lending arm – have increased almost four-fold, from $4 billion in 2000 to almost $15 billion in 2008. In 2008 itself, over one third of the World Bank's new commitments went through the IFC. Private sector financing has thus clearly become a new core business for the World Bank.

However, the same Eurodad study shows that the institution is falling short when it comes to achieving a positive development impact via this support for the private sector. Two thirds of the IFC's financial support went to companies based in the richest OECD countries. Local companies, which do not have access to financial services such as commercial credits or bond issuance on international capital markets, remain under-served by the IFC too. Furthermore, over 40% of IFC investments are channelled through financial intermediaries, with the institution thus losing track of where the money has been spent and the development impact of its investments[5].

There are open questions on the reasons that lie behind such a shift in operations by the World Bank in favour of the private sector, and what several actors have started to define as the "financialisation of official development assistance"[6]. According to a range of commentators, the very assumption that capital markets can provide the needed resources to finance global public goods, including climate change adaptation and mitigation, should be challenged.

In this overall context, it should be pointed out firstly and pragmatically that the World Bank Group, which has recently been struggling with the economic sustainability of its own business, has grasped and understood that high return rates from lending to certain private sector actors allows the Bank to make higher profits, that then can be reinvested in "poverty reduction" projects.
This has been the case for strictly linking IFC operations with IDA – the concessional lending facility for poor countries – to the point of establishing even a joint secretariat in 2007.

4 Eurodad, November 2010. *Development diverted: How the International Finance Corporation Fails to reach the poor* http://www.eurodad.org/whatsnew/reports.aspx?id=4304

5 Bretton Woods Project, Eurodad, Campagna per la Riforma della Banca Mondiale, Action Aid, Christian Aid, Third World Network, April 2010. Bottom Lines, Better Lives? http://www.eurodad.org/whatsnew/reports.aspx?id=4107

6 Financialisation has been variously defined and understood to include any of the following: '*the phenomenal expansion of financial assets relative to real activity; the proliferation of different types of assets; the absolute and relative expansion of speculative as opposed to real investment; a shift in the balance of productive to financial imperatives within the private sector whether financial or not; increasing inequality in income arising out of the weight of financial rewards; consumer-led booms based on credit; the penetration of finance into ever more areas of economic and social life such as pensions, education, health and provision of economic and social infrastructure*'. In short, financialisation can be seen as the dominating role of financial markets as the mediation and exclusive link between companies and individuals and the needs they might have throughout their life (pensions, education, health, housing, consuming, etc.); Fine B, in "Neoliberalism as financialisation", in A. Saad-Filho and G. Yalman (eds), *Economic Transitions to Neoliberalism in Middle-income Countries*, London and New York: Routledge, 2010

Such financial logic, however, raises several contradictions. The most profitable sector, to which the World Bank has been consistently increasing its support over the years, remains the extractive industries sector. World Bank Group support to oil, gas, and – since 2008 – also coal extraction and infrastructure investment has drastically increased. This is happening in spite of the fact that the institution has failed to show the positive development impact of its investments in the sector, and regardless of the negative environmental and climate impacts of increasing GHG emissions that naturally follow from this sector. A recent study by Oil Change International[7] shows that not only is the Bank unable show that its investments contribute to poverty eradication, but – even worse – the Bank does not even set development targets to be achieved for most of its oil and gas investments – which are almost entirely channelled through the IFC.

Going further, a large part of the World Bank Group's lending portfolio in recent years has often supported short-term, highly profitable investments, mostly channelled through financial intermediaries – the implication, though, is such investments may be purely speculative rather than having the achievement of broader development impacts and poverty eradication as their main goal.

In particular, the IFC's participation in controversial private equity funds has increased. These are financial actors that look for high return investments, in the range of 25-30%[8]. Yet this is a rate that is hardly achievable when investing in small and medium enterprises active in local markets in developing countries[9]. Clearly such investments have less to do with promoting the economic development of local private business in developing countries and much more with increasing its own resources, that the World Bank Group can then reinvest. Well beyond its 'internal financial leverage', the World Bank believes that its role as catalyzer of private investments can be key in financing climate actions, including the involvement of new sources of liquidity – such as sovereign wealth funds and institutional investors – or new highly leveraged actors in financial markets – such as private equity funds and hedge funds. This will be the case regardless of the impacts on the ground of the projects financed. Indeed, most of the project portfolios of the financial intermediaries supported by the IFC/ World Bank Group fall out of the radar of projects that have to comply with the Performance Standards and the environmental and social safeguards of the institution[10].

Moreover, it should be pointed out that the unfolding financial and economic crisis is accelerating the transformation of project finance in general, given the credit crunch and the reviewed role of private banks[11]. The World Bank is aiming to back this evolution regardless of whether or not riskier practices might also emerge, and regardless of the climate and sustainability implications.

World Bank support to foreign private investment in developing countries has been questionable for decades. In the 1980s and 1990s, foreign direct investments (FDIs) were flowing into developing countries as part of a positive global economic cycle, and the Bank claimed that its involvement was a way to reduce negative environmental and social externalities. Today the Bank is willing to be an "initiator" in defining new opportunities for investors, into which existing liquidity – that faces a shortage of investment opportunities due to the recent crisis – can flow.

Again, when confronted with the fact that Sovereign Wealth Funds, institutional investors or high leveraged institutions have little real idea of what constitutes a development intervention or what the promotion of global public goods implies, the Bank would answer that this is the institution's added value, and that sooner or later that money will flow into those interventions in any case. Such opportunistic backing for existing market developments at a time of deep transformation is irresponsible from the largest international public development institution. Instead of such a pro-cyclical approach based

7 Oil Change International, October 2010. *World Bank Group Energy Financing: Energy for the Poor?* http://priceofoil.org/educate/resources/energy-for-the-poor/

8 "According to the British Private Equity and Venture Capital Association (BVCA), private equity investments in the UK have returned an average of 38.8 per cent net to investors each year for the past three years. This is the performance of 'independent' UK private equity funds - ie, funds raised from external investors for venture capital and private equity investment, but excluding quoted private equity investment trusts (Peits) and venuture capital trusts (VCTs). The overall long-term net return to investors is 17.3 per cent a year, according to the BVCA." http://www.hotbed.uk.com/news/profit-private-equity-investors-chronicle

9 According to the IFC, the use of financial intermediaries allows it to reach small and medium enterprises that cannot be reached through the IFC's own channels due to high transaction costs.

10 Submission by Civil Society Organisations to the International Finance Corporation commenting on the Social and Environmental Sustainability Policy, Performance Standards and Disclosure Policy, 11 March 2010

11 Total private sector investments in infrastructure projects in developing countries have been increasing exponentially, reaching an average of about $100 billion per year. A listing of private equity funds and infrastructure funds active in developing countries is available as a work in progress from The Corner House. Contact: nick@fifehead.demon.co.uk

on financial markets development, the real added value for an international development institution like the Bank should be "out of the box" thinking, capable of promoting innovative approaches that could serve to limit those aspects of the financial markets that took the global economy to the brink of collapse.

In short, at a time when proposals for regulating the banking sector and non-banking actors are aiming to limit the leverage of financial institutions, the World Bank is positioning itself apparently at odds with this and is aiming to use its sovereign status to leverage more private resources, thus increasing systemic financial risk as well.

The World Bank's current private capital market-oriented model might not be able to gather the needed climate finance, and at the same time it may increase existing threats to financial stability, the global climate, the environment and the peoples and communities of the South and globally.

These are only some of the major implications of accepting the high financial leverage capacity that the World Bank is championing as a solution for gathering the necessary resources for climate finance. And this is a financial leverage about which the Bank is providing only partial information, not grounding it with verifiable information in the public domain, and which should be challenged by governments before permitting the institution to manage other climate initiatives[12].

Governments and climate negotiators should question the implications and the assumptions that lie behind the institution's operations, prior to discussing any eventual World Bank role in the multilateral process to set the architecture for global climate finance.

The World Bank's current private capital market-oriented model might not be able to guarantee quality and quantity of the needed climate finance, and at the same time it may increase existing threats to financial stability, the global climate, the environment and the peoples and communities of the South and globally.

To summarise...

Accepting the World Bank approach would involve accepting that adaptation and mitigation costs may be covered through highly speculative investments – for instance in the oil and gas sector – that not only contribute to environmental degradation, increased greenhouse gas emissions and human rights violations for local communities, but also contribute to increasing financial instability due to incentives for financial actors, such as hedge funds or private equity firms, that guarantee high returns but could contribute to new bubbles and financial crises.

Moreover, the scale of the World Bank's leverage capacity is strictly related to the governmental guarantee that all of its shareholders – the governments of the world – can offer to back the operations of the institution. If we accept that the Bank can engage in speculative investments with likely negative development and climate impacts in order to obtain the necessary resources for climate change finance, we are also accepting that public resources might likely be used in support of highly speculative actors, and that poor communities in the world should continue to bear the costs. In the context of the current crisis, this should be – more than ever – an unacceptable option.

The provision included in the Cancun outcome document, regarding the possibility for the trustee to "commingle" the assets of the Green Climate Fund with other assets maintained by the trustee, is particularly worrying[13]. In fact, this is providing a mandate to the Bank to use the resources of the Green Climate Fund for the same investments in which the Bank is channelling other initiatives managed, including in the areas and in support of the financial actors mentioned above.

Is there an alternative?

Financial markets are not the answer to accumulating the required resources to finance adaptation, technology transfer and mitigation of climate change impacts. There are innovative sources of finance that could be explored and implemented to generate the needed resources for climate finance, on a suitable scale to allow the transfer of resources to those governments in the global South that are already suffering the impacts of climate change, and without threatening the environ-

12 With specific reference to climate finance, at the time of writing the author has not been able to ground the numbers provided by World Bank President on the leverage capacity of the institution (10 to 1 dollars). Questions asked directly to the Climate Investment Funds secretariat and to Andrew Steer, the World Bank Special Envoy for Climate Change, have remained unanswered.

13 Outcome of the work of the Ad Hoc Working Group on long term Cooperative Action under the Convention, 105 reads: "[…] the trustee shall hold the assets of the Green Climate Fund separate and apart from the assets of the trustee, but may commingle them for administrative and investment purposes with other assets maintained by the trustee."

ment or contributing to an increase in GHG emissions[14]. The financial transaction tax, a global carbon tax or a shift in fossil fuels subsidies are only some of the options that governments could explore and that would allow for both gathering the needed resources and contributing to a reduction of global GHG emissions, not to mention dis-incentivising the use of speculative financial activities[15] . Public resources accumulated through innovative sources of finance could be managed through a new multilateral financial institution (the Green Climate Fund proposed in Cancun) which should be established under the authority of the Conference of the Parties of the UN Convention on Climate Change. The interim trustee role assigned to the World Bank should be limited to the provision of technical services and should be reviewed in three years time, with the opening of an international tender for the appointment of a new trustee[16].

Assumption 2: on the capacity of carbon markets to reduce the costs of mitigation, to facilitate the transfer of technology and help to achieve reduction in global GHG emissions

"The Bank has played a key role in carbon market development, and our work in carbon finance has been instrumental to increasing global benefits from environmental projects supported by the World Bank Group."

Robert B. Zoellick, President, The World Bank Group [17]

The World Bank is one of the key proponents and architects of the market-based mechanism included in the Kyoto Protocol: the Clean Development Mechanism (CDM). The Bank is also one of the largest brokers of carbon credits globally, managing a portfolio of 12 carbon funds, including highly controversial initiatives such as the Forest Carbon Partnership Facility[18] and the newly established Partnership for Market Readiness (PMR), launched at the climate negotiations in Cancun in December 2010[19].

The World Bank vision on climate change financing is based around promoting a dominant role for the private sector. In the Bank's view this should happen both through direct investments (FDIs), that should contribute to financing the needed interventions in emerging economies but also in the other developing countries. This is responding primarily to the needs of its traditional donors, that in the context of the crisis are increasingly looking for new markets where their corporate sector can invest, not least in mitigation interventions in the global South. More than anything, the Bank is play a key role in favouring private sector intervention in climate change financing through the expansion of carbon markets, towards the ultimate goal of creating a single global market for trading carbon. In this sense, the Bank is using its "knowledge" – and the public resources it manages – to explore new approaches to create and trade carbon, regardless of the unproven development outcome of offsetting projects both for poverty eradication and global sustainability.

The World Bank openly states that it is promoting the sale of emission reductions to increase the bankability of projects, "*by adding an additional revenue stream in hard currency, which reduces the risks of commercial lending or grant finance*"[20]. In other words, the Bank is

14 See a South-North civil society proposal at http://www.globalclimatefund.org

15 See some of the proposals discussed by civil society organisations and movements globally on: http://www.globalclimatefund.org

16 See the letter of several civil society organisations to the Transitional Committee and UNFCCC secretariat sent in March 2011.

17 Quote from the World Bank Carbon Finance website http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/ENVIRONMENT/EXTCARBONFINANCE/0,,menuPK:4125909~pagePK:64168427~piPK:64168435~theSitePK:4125853,00.html

18 The Forest Carbon Partnership Facility was established in 2007 during the meeting of the Conference of the Parties (COP 12) of the UNFCCC in Bali. Its purpose is to help the governments of forest rich nations to get ready to include forest related projects in global offsetting schemes. The initiative was created without the free, prior and informed consultation of indigenous peoples and forest dependent communities. According to many, the initiative pre-empted the discussion at multilateral level on initiatives to reduce carbon emissions from forest degradation and deforestation, at a time when no agreement was reached on including carbon trading among the instruments. For more information, see: "REDD: the realities in black and White", Friends of the Earth, 2010. www.foei.org/en/resources/.../2010/redd-the-realities-in-black-and-white

19 "New Multi-Million Dollar Fund for Developing Country Carbon Trading Initiatives", December 8th 2010 http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:22785667~pagePK:34370~piPK:34424~theSitePK:4607,00.html

20 http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/ENVIRONMENT/EXTCARBONFINANCE/0,,contentMDK:21841841~menuPK:4125923~pagePK:64168445~piPK:64168309~theSitePK:4125853,00.html

using its government backed position to give confidence to financial actors on trading carbon, reducing the risk connected with the high volatility of the price of carbon. Moreover, the Bank have been proactively setting up new initiatives over the years that help the private sector to get the needed "pro-poor and pro-environment" credentials for their offsetting operations in the global South, while continuing to emit back home[21]. In fact, with new offsetting schemes there will be more carbon to trade, and less of an incentive to polluting industries to reduce emissions back home, and consequently resulting in more emissions globally.

By engaging in such practices, the Bank is at odds with is own institutional mandate, contributing as it does to facilitating a trend of increasing global emissions for which the poor are already paying the higher cost and not getting any benefit.

The World Bank's false promise has been to make offsetting look like a contribution to "sustainable development"

In the Bank's terms: "*Carbon finance provides a means of leveraging new private and public investment into projects that reduce greenhouse gas emissions, thereby mitigating climate change while contributing to sustainable development*"[22].

The reality, however, is that the CDM has been in operation now for more than 15 years, and the World Bank itself has admitted on several occasions that "the mechanism is not working perfectly", and that it did not deliver the expected results[23] . In 2010, the World Bank's own Independent Evaluation Group found that its emission reduction sales have failed to catalyse large-scale investment in renewable energy or to effectively reduce global emissions.

As pointed out by civil society organisations such as International Rivers, or academics such as David Victor and Michael Wara at Stanford University, a high proportion of CDM projects are "non- additional". This means that projects that benefit from CDM support would have been built regardless. This is the case for instance of large hydros like the Bujagali dam in Uganda or the Baba Hydropower Plant in Ecuador, projects which are already built or under construction when applying for CDM support[24].

The World Bank has also been among the most active actors in lobbying to defend one of the most obvious loopholes for non-additional projects. The reference is to highly controversial HFC23 projects, which account for almost half of the emission reductions generated through the CDM. In August 2010, civil society organisations CDM Watch, Environmental Investigation Agency and Noe 21 called on the World Bank to "stop obstructing the overhaul of the United Nations program for awarding emission credits tied to hydrofluorocarbons". The World Bank has been accused of including factual and analytical errors in a report dismissing concerns that the UN Clean Development Mechanism has generated "fake carbon credits" for HFC-23 projects[25]. Tellingly, the World Bank pronounciation on the matter is not independent; on the contrary it is a conflict of interest given the purchase of "very large quantities of certified emission reductions through 2013 from HFC23 incineration projects that the Bank is purchasing through one of its carbon initiatives, the Umbrella Carbon Facility"[26].

Often, the narrative put in place by the World Bank to justify the institution's support for expanding offsetting schemes in developing countries has been misleading. First of all, as pointed out by several actors, carbon offsets are not emission reductions. By definition offsetting is designed to produce a "zero-sum" outcome, simply moving emissions where reductions are made, but not reducing them. According to the UN's own data and as reported by Carbon Trade Watch[27], since the implementation of the CDM, CO2 emissions worldwide have increased.

The World Bank's false promise has been to make

21 The principle at the core of the flexible mechanisms (CDM and Joint Implementation) is precisely that developed countries can save money by buying "emission reduction" credits from developing countries rather than cutting their own emissions, and instead pay developing countries to reduce emissions for them.

22 http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/ENVIRONMENT/EXTCARBONFINANCE/0,,contentMDK:21841841~menuPK:4125923~pagePK:64168445~piPK:64168309~theSitePK:4125853,00.html

23 Civil society Meeting with World Bank staff in Poznan (Poland) held on Sunday, December 7th, 2008 during the COP 14 UNFCCC. The meeting was held under Chatham House rules.

24 http://www.internationalrivers.org/en/cdm_comments/date/793

25 http://www.bloomberg.com/news/2010-08-26/world-bank-trying-to-subvert-un-fix-for-emission-offsets-lobby-says.html

26 http://wbcarbonfinance.org/Router.cfm?Page=UCF&ItemID=9715&FID=9715

27 Critical Currents, Dag Hammarskjold Foundation, Occasional Paper Series, No.7 November 2009. In collaboration with Carbon Trade Watch, TNI, The Corner House. "Carbon Trading. How it works and why it fails".

offsetting look like a contribution to "sustainable development". Rather than favouring investment in clean technologies, the evidence shows that the CDM has extensively supported heavy polluting industrial projects, in particular in the chemical, fossil fuels and large hydropower energy production sectors. According to the Institute for Policy Studies[28], as of 2008 less than 10% of the Bank's carbon deals supported new renewable energy projects. More than 75% of the World Bank's carbon portfolio effectively subsidised polluting, energy-intensive coal, chemical, iron and steel industries.

Moreover, these are investments that do not help poor countries to achieve poverty reduction and access to energy, which should be the primary goal of any World Bank intervention. Evidence from past large-scale power projects backed by the World Bank shows in fact how this kind of centralised approach to energy generation does not help to increase access to energy for the poor; in some cases it makes it even more difficult, while imposing heavy impacts on the local environment and communities[29].

Aside from representing a failure in terms of environmental and climate sustainability, carbon trading also represents a serious threat to global financial stability

In spite of this evidence of failure both in reducing emissions and supporting the development of a low carbon economy and energy access in poor countries, the World Bank is today, more than ever, using its public backing to support the carbon market.

In the first place, through injecting certainty into the carbon market when doubts about the reliability of carbon trading and offsetting schemes have started to be cast among private investors due to the lack of agreement on a global deal for emission reductions after the first phase of implementation of the Kyoto protocol expires in 2012. Already after the unsuccessful conclusion of the climate negotiations in Copenhagen, uncertainty has prompted speculation among investors that demand for the certified emission reduction (CER) credits issued under the CDM could collapse in 2012, if the future of the scheme is not assured in the framework of a long term global climate deal.

28 Institute for Policy Studies/Sustainable Energy and Economy Network (SEEN), (2008), "World Bank: climate profiteer", http://www.ips-dc.org/reports/

29 Two institutional multi-stakeholder processes serve as reference on the impacts of large scale World Bank projects: The Extractive Industries Review (2004), http://www.eireview.org; and the World Commission on Dams (2001), http://www.dams.org/

To ensure that the market was kept alive and that the CER price did not drop, in January 2011 the World Bank announced that it was ready to use $68 million of its carbon funding to buy CER credits that will be generated by CDM projects after 2012[30], also inviting other investors to participate in the scheme and take the fund to a total of $105 million[31]. As stated by Joëlle Chassard, manager of the World Bank's Carbon Finance Unit, to Business Green, "during a period of regulatory uncertainty, the initiative is helping to maintain demand for post-2012 carbon credits"[32].

During the climate negotiations in Cancun the World Bank also launched the Partnership for Market Readiness (PMR). The new Fund created by the Bank is aimed at major emerging economies and middle income countries to promote "market readiness", a strategically key objective for the Bank (and its investors) to open up new forms of carbon market beyond the existing CDM in countries which until now have not been obliged to monitor their emissions[33].
A large part of the funding of the initiative will be dedicated to start systems to measure, verify and account emission reductions in economies that have not yet any binding obligations on emission reductions under the UNFCCC agreement, like China or Chile. The initiative of the Bank is *de facto* shifting the attention from a political question still being discussed by governments into a technical solution to operationalise what climate negotiators have not yet agreed on. According to Carbon Trade Watch, "this is a slow path towards blurring the distinction between the industrialised North, historically responsible for global emissions, and the

30 "World Bank puts up €68m to avert post-Kyoto carbon market crash", Business Green, January 2011. http://bg/news/1937059/world-bank-68m-avert-post-kyoto-carbon-market-crash

31 The operation is part of the implementation of the second tranche of funding under the World Bank Umbrella Carbon Facility (UCFT2) operational since January 2011. Most of the funding for UCFT2 is provided by Deutsche Bank, GDF SUEZ and the Swedish Energy Agency. The facility is already considering supporting 17 projects with the potential to reduce 26 megatons of carbon dioxide and other greenhouse gases from 2013 to 2018. "World Bank puts up €68m to avert post-Kyoto carbon market crash", Business Green, January 2011. http://bg/news/1937059/world-bank-68m-avert-post-kyoto-carbon-market-crash

32 "World Bank puts up €68m to avert post-Kyoto carbon market crash", Business Green, January 2011. http://bg/news/1937059/world-bank-68m-avert-post-kyoto-carbon-market-crash

33 "World Bank Partnership for Market Readiness: A critical Introduction", Oscar Reyes, January 2011. http://www.carbontradewatch.org

global South that is suffering the impacts of climate change"[34]. Aside from representing a failure in terms of environmental and climate sustainability, carbon trading also represents a serious threat to global financial stability. Carbon offsets are mostly traded on the secondary market, a market which is uncontrolled. Furthermore, new financial derivative platforms fully dedicated to carbon trading have been established, and most exchanges betting on the future price of carbon are 'over the counter' and are not regulated[35]. Needless to say that the carbon emission certificate is a derivative in itself, given that it is based on an expectation of emission reduction which *might not happen* due to the questionable baselines against which it is calculated. In short, carbon trading is a further step in the financialisation process of the economy, which public institutions like the World Bank are fully supporting both through technical assistance to create new offsetting schemes and by directly purchasing CERs, assuming that once again financial markets will find the best solution for climate finance. Yet this could instead help to develop new and "green" financial bubbles of considerable scale.

As a matter of fact, carbon trading is often used by large utilities to hedge the risk related to energy future price and currency holdings. In other words, utilities use the operations pursued by their "trading arms" in a speculative way and not as much for compliance with emission reductions. Financial instruments used include hedge funds looking for high returns from speculation on the future price of carbon[36].

Concern about the high risk of a bubble in 'subprime carbon' has already been raised by several civil society groups, including Friends of the Earth, Fern, The Corner House, and the international network on private finance BankTrack[37]. The issue of carbon fraud and corruption has also been discussed at Interpol's 7th International conference on Environmental Crime, held in Lyon on September 2010[38] .

34 http://www.carbontradewatch.org/articles/world-bank-partnership-for-market-readiness-a-critical-introdu.html

35 "Trading Carbon. How it works and why it is controversial". FERN, 2010

36 "Uncertainty Markets and Carbon Markets. Variations on Polanyian Themes" by Larry Lohmann, The Corner House, 2010. http://www.thecornerhouse.org.uk/resources/results/taxonomy%3A14

37 "Subprime Carbon? Rethinking the World largest derivatives market" by Michelle Chan, Friends of the Earth US, 2009. http://www.foe.org/subprimecarbon

38 http://www.interpol.int/Public/EnvironmentalCrime/Meetings/7thConference/Default.asp

To summarise...

Governments and decision-makers, by sticking their head in the sand and denying all evident flaws, will not serve the scope of accepting carbon market as a viable, sustainable and pro-poor source of climate finance. Public support for the expansion of the carbon market offered by governments through the World Bank is only serving the advantage of the most polluting entities and those financial actors that aim to secure high short-term profits based on speculation on offset trading.

The Bank's original failing lies first in having contributed to the creation of a mechanism like the CDM on the false promise that while contributing to reduce global emissions it would also contribute to poverty eradication. Second, regardless of the evidence about the failure of carbon trading in delivering development outcomes as well as the promised emission reductions, the Bank is using its technical advice and market position to continue to support the expansion of offsetting schemes.

The role played by the World Bank should be questioned by civil society and governments, even more today when bold action is more and more urgent in developed economies for drastic reductions in green house gas emissions. An independent analysis of the real effects and claimed development benefits of offsets trading should be undertaken before there is any moving forward with giving the Bank a mandate for the creation of offset systems at the national or regional level, both in developed and developing countries. In particular, assessing the risk of a subprime carbon bubble should be central when considering the existing documentation that proves the overall failure of the CDM mechanism.

Is there an alternative?

Carbon markets fit in the new approach pursued by the World Bank to raise development finance not from public sources but through financial capital markets. However, governments have explored several other solutions to raise capital, which could be reviewed and championed as sustainable and viable solutions to the uncontrolled expansion of financial capital markets.

In the case of carbon markets, governments have the chance today to assess viable alternatives before further funding is provided through the World Bank and other public finance institutions to continue developing the market infrastructures which do not yet exist. In particular, innovative approaches such as various forms of taxation to generate public revenues globally should be explored and discussed. Public interest policies and laws and public finance that supports changes in economic

markets, in particular in those sectors which are vital for reducing emissions – such as transport, energy and agriculture – should also be explored in parallel.
This is true in particular for governments in developed economies that have not been reducing their internal emissions since the establishment of, and experimentations with, carbon trading and offsetting over the last decade, as has been the case with members of the European Trading Scheme (ETS).

Public policies and interventions will be crucial in the near future to give a clear direction to private sector investments. The polluter pays principle, as well as incentives and subsidies for low carbon investments, have the potential to be real drivers for rebalancing the economy toward a low-carbon and sustainable development path.

Assumption 3: on World Bank "knowledge" to find solutions for climate change

"There has been an increased demand for the WBG to support multiple constituencies to address development and climate change as interlinked challenges. […] A significant emphasis in WBG work has been to produce just-in-time knowledge that can inform the UNFCCC negotiations, with a focus on the needs and on-the-ground realities of developing countries, and to respond quickly to new requests from WBG clients and partners for collaboration and support to understand and manage the risks, trade-offs, and business opportunities related to the climate change agenda".

Development and Climate Change: Stepping up Support to Developing Countries
Report on Progress by the World Bank Group, June 2010[39]

The 'knowledge bank' concept has been widely utilised in recent decades by the World Bank to expand the scope of its actions by producing an institutional mission creep and legitimising a 'heavy' advisory role for itself through the imposition of economic and non-economic conditionalities attached to its loans, in particular in the context of the structural adjustments of the '80s and the '90s.

This has translated in practice into the promotion of FDIs and an investment-friendly environment, more lending to the private sector, and the additional imposition of conditions to liberalise and open sectors of the market that Southern governments would otherwise have kept protected on account of their strategic importance for development. Examples of this abound in the World Bank's technology transfer related to the energy sector, and the need to provide access to energy to the poorest, which has been often forgotten in the context of the proposed dismantling of national energy companies and in the development of energy plans aimed at exporting energy or directing it to private wealthy users – and notably not to poor people living offgrid.

In the context of climate finance, the 'knowledge' that the World Bank has put forward is related to disaster risk management in relation to adaptation to climate disasters, which have increased in frequency and strength in most of the Southern hemisphere, and which are impacting hardest on the poorest communities both in rural and urban areas. The Bank has developed a comprehensive disaster risk management strategy, involving risk assessment, institutional capacity building, investments in risk mitigation, emergency preparedness and catastrophe risk financing.

The latter represents the financial solutions that the Bank is moving forward for catastrophe risk management and consist of several instruments for: sovereign risk financing for direct budget support, including contingent financing, sovereign catastrophe insurance pools, catastrophe bonds and weather derivatives; advisory services to strengthen domestic property catastrophe insurance markets, including catastrophe insurance pools, and index-based agriculture insurance; and agriculture insurance pool and a specialised index-based insurance facility.

The Bank is also leading the Global Facility for Disaster Reduction and Recovery (GFDRR)[40], which was established in 2006 with the support of some key donor governments, also including the European Commission. The facility provides mainly technical assistance to developing countries that are most exposed to climate

39 http://beta.worldbank.org/climatechange/content/developing-countries-ratcheting-up-action

40 http://www.gfdrr.org/gfdrr/

risk, and is a key instrument in this particular Bank package. In April 2010 the Partnership Charter – the agreement signed by donors which sets the rules and priorities for the GFDRR – was amended to include selected developing country governments, in a process that took place without oversight from civil society groups.

To summarize...

This new World Bank machinery, based on the development of insurance-based instruments, is ultimately fully focused on the strengthening of private insurance markets which are in no way counter-cyclical and which do not help in the prevention of crisis. Once again the choice involves the promotion of financial markets in addressing this legitimate need to minimise risks, instead of promoting economic community-centred or government-led practices and policies which could reduce damage in the case of disasters. Again this represents support for the financialisation of the economy in developing countries, with serious long-term implications for their financial and economic stability. And, at the same time, insurance-based instruments are often used for speculating about the future price of commodities – a tendency that has contributed heavily to the recent food crisis and that may expose farmers to even greater hardship in the near future.

Accepting that these market-based financial solutions are moving forward as part of the 'knowledge package' proposed by the Bank means accepting that food security may depend on the same actors that are making their profits by increasing the volatility of soft commodity prices and thus provoking insecurity within the food production part of the chain.

Is there an alternative?

Investments that strengthen local basic infrastructure can help to reduce the impacts of atmospheric disasters and also improve the capacity of local governments to act and help the local population, particularly those living in the poorest areas. The World Bank has failed in promoting this type of development, as it has failed to channel development resources and private finance to investments that could have paved the way to a transition to a low carbon and more sustainable mode of production.

Thus it remains questionable whether such a huge institution is the most skilled and best placed to conceive small scale development interventions designed in close and equitable cooperation with directly affected communities.

Assumption 4: on the World Bank "proven expertise" in managing climate funds

"Become a premier provider of a wide range of financial solutions and expertise to help achieve "climate - smart" development. […] In parallel to advocating the imperative of substantial additional climate - related financing, the immediate priority is to concentrate on delivering resources to the recipients for specific projects through newly established instruments and programs — the FCPF and the CPF under the carbon finance umbrella, and the PPCR, CTF, SREP, and FIP under the CIF umbrella. This experience will provide a major opportunity to all participants for experimenting, learning by doing, and exploring how these instruments can be more directly linked to UNFCCC discussions and directions".

Development and Climate Change: Stepping up Support to Developing Countries
Report on Progress by the World Bank Group, June 2010[41]

Governance and effective management of climate finance are some of the key concerns for governments engaged in the multilateral climate negotiations. Safeguards, respect of indigenous peoples and human rights, and investment in projects that truly contribute to the development needs of local communities in the global South while contributing to global GHG emission reduction are additional concerns that civil society groups have been underlining since the first climate finance and carbon finance initiatives managed by the World Bank have started to operate.

Climate finance is needed at a scale of hundreds of billions per year, an amount that exceeds the proven management capacity of every existing financial institution. All the same, the World Bank has put much

41 http://beta.worldbank.org/climatechange/content/developing-countries-ratcheting-up-action

effort into attempting to prove to the international community that it possesses the capacity to manage finance at such a scale. This has, in turn, significantly diverted the attention of governments engaged in the multilateral discussions on the financial architecture and mechanism that needs to be established under the authority of the UNFCCC Conference of the Party.

The World Bank made its first moves in the spring of 2008, just a few months after the UNFCCC conference in Bali, when the proposal to set up a set of climate investment funds (CIFs) housed at the World Bank was initiated by a number of developed countries, among them the US, the UK and Japan. In spite of the fierce criticism offered by international civil society and concerns raised by some donors, funding in the scale of $6.2 billion was pledged by governments, thus allowing the Bank to announce in October 2008 that the CIFs had been approved.

Two years on from this, the Clean Technology Fund (CTF) and the Strategic Climate Fund (SCF) are in place and beginning to function under the World Bank, with $4.3 billion pledged to the CTF and $1.9 billion to the SCF as of February 2011[42]. The SCF is an umbrella fund which includes three dedicated programs: the Pilot Program for Climate Resilience (PPCR), the Forest Investment Program (FIP), and the Program for Scaling-Up Renewable Energy in Low Income Countries (SREP).

Providing investments in several of the critical areas where intervention is needed to finance adaptation, mitigation and transfer of technology, the CIFs have been championed by the World Bank as a 'stepping stone' in defining the model for the global governance of climate finance. Since 2009 the World Bank's top executives have been proactive in approaching the governments of developing countries to overcome the initial explicit criticism of the G77 and China to the decision to set up the CIFs. On several occasions, governments of the South have stated that funding channelled through the CIFs or other World Bank initiatives should not be counted as fulfilling the obligations under the UNFCCC.

As of today, key concerns remain over how a significant role for the World Bank in the disbursal or management of funds could limit developing country calls for direct access, recreate damaging donor-recipient aid dynamics, and hinder overall climate finance management effectiveness.

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According to different voices from both civil society, governments and academia, the experience of the CIFs should not be seen as a model for the governance of global climate finance. As reported by the Bretton Woods Project, the CIFs have raised concerns because of several unsolved issues, among them: the donor-driven model; the criteria used for selecting countries to access funds; the technical criteria on issues like clean energy and forestry, and; the lack of country ownership and broad consultation in the development of country plans. Respect for indigenous peoples' rights, local communities and civil society consultation are also areas of serious concern in the current management and governance structure of the CIFs.

According to many, there are grey areas even on the assignment to the Bank of the ad interim trustee role decided by governments in Cancun[43], which may conceal negatives that should not be underestimated. As experience has shown, even as an 'administrator' the Bank tends to have a strong influence over project design and implementation. In some cases Bank procedures have slowed disbursement and reduced developing country access, as well as opening a window for Bank influence over policy.
Moreover, the experience of the CIFs raises concerns too about the tendency of the Bank to advocate for CIFs funding to be combined with the Bank's core lending, where it argues that this is one of its 'comparative advantages'. A direct consequence of such an approach, if translated to the broader global climate finance architecture, may result for instance in an obligation for governments of the South to open a lending program with the World Bank, and accept the related economic and policy conditionalities that are still an integral part of the institution's toolkit. According to the Bretton Woods Project, draft financing papers prepared for discussion under the PPCR, one of the climate funds managed by the Bank, have suggested that "all finance should be bundled with MDB lending".

42 Bretton Woods Project, CIFs update February 2011. http://www.brettonwoodsproject.org/art.shtml?x=567400

43 http://www.unfccc.int/files/meetings/cop_16/application/pdf/cop16_lca.pdf

The reference included in the Cancun outcome document to the possibility for the trustee of the Green Climate Fund to "commingle" assets of the Fund with other assets managed by the trustee for administrative and investment purposes paves the way to the World bank using global climate finance for investments in highly questionable projects. The current trend of increasing World Bank investment in fossil fuel projects, support to the expansion of offsetting schemes and support to the private sector mostly through financial intermediaries such as hedge funds and investment funds further grounds local communities and civil society concerns[44].

But looking at the overall governance of the World Bank Group, beyond simply the experience of the CIFs, confirms the ongoing structural imbalances within the institution: it continues to fall short in representing Southern governments, especially from those regions like Sub-Saharan Africa that are most affected by the impacts of climate change. Indeed, the recent reforms in the internal governance of the Bank only managed to provide a limited response to the need for better representation of emerging economies, which are still broadly under-represented when compared to the voting power held by European governments or the United States. A report from the Bank's own Independent Evaluation Group confirms that large middle-income countries, which have significantly more voice than low-income countries in global programs, have a governance participation that is one-third the level of high-income countries[45].

A lack of effectiveness of World Bank programmes, including in those areas where the institution's added value is claimed – like environmental sustainability and supporting developing countries to shift to cleaner and more efficient energy use – has continued to be reported by the same internal evaluation body. According to the Independent Evaluation Group, over the past ten years the Bank succeeded in supporting satisfactory outcomes in just 30 percent of programmes evaluated[46]. Projects in Africa have lagged far behind the success rates of investments in other regions. Moreover, a recent Independent Evaluation Group report further finds that the Bank is largely lacking a monitoring and reporting system to systematically assess the environmental aspects and impacts of the projects it supports. Nor is enough attention being paid to the issue within the Bank because it is not the top priority of senior management, and there is limited capacity among staff in the institution.

To summarise...

The World Bank remains an institution primarily controlled by the governments of developed countries, the same governments that bear the historical responsibility for the increase in global temperature and the promotion of an economic production model that has brought the planet to the edge of collapse. While developing countries are better represented in the governance of the CIFs than inside the World Bank, with an equal balance of representatives from donor countries and recipient countries in the governing committees, all the same the initiative is still far from representing an innovative financial instrument well suited to managing global climate finance in an equitable, sustainable and effective manner.

What are the alternatives?

Governments should follow closely the discussion on the definition of the rules and governance of the Green Climate Fund. The World Bank's role must be limited to that of interim trustee of the Fund, as decided by governments at the global climate negotiations in Cancun. As interim trustee, the World Bank's role must be restricted to taking instructions on fiduciary matters from the Board of the Fund.

To ensure both effectiveness and political acceptability to all governments engaged in the multilateral discussion, both from developed and developing countries, it is critical that the design of the Green Climate Fund is taking place under the authority of the UNFCCC, as part of an inclusive process led by experts from UNFCCC, UN agencies, global trade unions and other civil society representative organisations with expertise in climate, development, and other relevant areas. The process should not be externalised to the World Bank, nor to parallel processes led by finance ministers, as suggested by the Unites States. To guarantee equity in the governance of the mechanism, it is crucial that majority representation is guaranteed to developing countries and that substantial participation by civil society, including affected communities, is part of the governance structure.

44 See previous sections of this discussion note.

45 Bretton Woods Project Briefing, September 2010. "The World Bank: access or impetiment to climate finance?" http://www.bretton-woodsproject.org/art-566697

46 Bretton Woods Project Briefing, September 2010. "The World Bank: access or impetiment to climate finance?" http://www.bretton-woodsproject.org/art-566697

The Adaptation Fund operationalised at the UNFCCC in Bali is a functioning alternative where adaptation finance can be channelled[47]. Its governance structure represents a starting point for developing the new financial mechanism around functioning principles that respond to developing countries and communities needs.

To conclude...

There are important implications behind the interim trustee role assigned to the World Bank in Cancun, and to rules and mechanisms that the Transitional committee should put in place to guarantee that the forthcoming discussion on setting up the Green Climate Fund is transparent, inclusive and enriched by the contribution of experts and stakeholders beyond the World Bank perspective on the issue. Civil society groups have raised concerns about the World Bank's interest in covering a much wider role in the process, including serving as a designer of the architecture and governance of the Fund. This poses the same challenges that have been faced throughout the controversial history and track-record of the World Bank in tackling poverty reduction through "sustainable development" worldwide.

This discussion note has highlighted some of the assumptions that should be questioned when assessing the added value of market-based solutions proposed by the World Bank, and the impacts of such solutions in terms of both global and local sustainability, as well as their implication for international financial stability more widely.

The World Bank should be questioned for supporting the creation of carbon trading schemes when financial instability and speculative activities are still a major threat to the international community, in particular for fragile economies and poor countries which are also the most exposed to the impacts of climate change. In this context, comprehending the World Bank as a source of finance and not as a channel is particularly worrying.

Relying on the World Bank and its "financialised" approach to solve the climate crisis is preventing an honest and sound discussion on the actual role of states and public policies in guiding the needed interventions to face up to and tackle climate change; it also impedes the gathering of the needed financial resources without states exposing themselves to the risk of new financial bubbles. In this context, the potential of innovative mechanisms to generate public resources should not be underestimated. The taxation of financial transactions could well contribute to the collection of finance at a scale of hundreds of billions of dollars every year[48]; a carbon tax or a shift of public subsidies for fossil fuels could complement this in order to reach adequate amounts[49].

These and other proposals – like the Climate SDRs[50] – would help to re-establish the centrality of public finance in defining long term solutions for the climate crisis, as well as finding a more equitable governance model for global climate finance. They would thus help to avoid repeating the mistakes of the aid system over the last 60 years.

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47 "Equitable Adaptation Finance". Action Aid, September 2009. http://actionaidusa.org/news/publications/climate_change/

48 See the proposals of civil society international campaign on the financial transaction tax. http://www.makefinancework.org/home/financial-transaction-tax/

49 Climate finance sources discussion paper, April 2010. http://www.globalclimatefund.org/

50 CRBM Discussion note by Antonio Tricarico, June 2010. "If Keynes could sit at the climate negotiations...Proposal for an "International Climate Union" and a SDR-based "Global Climate Fund". http://www.climaefinanza.it/?p=203