CASE STUDY

Uruguay Pioneers World Bank's First Loan with Built-in Climate Incentives

Uruguay secured a $350 million development policy loan from the World Bank with an innovative, built-in interest reduction mechanism. Under this pioneering loan, interest payments will be reduced if Uruguay meets its ambitious targets for lowering the methane emissions intensity of beef production.

This is the first-ever performance-linked loan by the World Bank that provides direct financial incentives to a country to meet ambitious climate and environmental targets well beyond the project closing date.

The precedent-setting operation is aligned with the commitments in the World Bank's Evolution Roadmap to incentivize countries to further deliver global public goods. The lessons learned on livestock methane reduction in Uruguay generated through this loan could have a significant impact on reducing the intensity of livestock methane emissions globally.

Background

Uruguay has long been a passionate supporter of climate action. The country established ambitious greenhouse gas emission cuts in its Nationally Determined Contributions (NDCs) in 2017 and raised these targets even further in 2022.

As Uruguay is among the top six exporters of beef globally, reducing methane emissions from cattle is instrumental in achieving Uruguay's climate targets. Although between 1990 and 2018, the country decreased the methane emissions intensity of beef production by 28 percent, methane from livestock still represents about 49 percent of Uruguay's greenhouse gas emissions.

Uruguay wanted to align its financing strategy to its climate strategy to demonstrate its determination and motivation for balancing economic growth with climate action.

Hence, when Uruguay and the World Bank developed the Green and Resilient Growth Development Policy Loan (DPL), the Government sought to link the

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financial terms of this new IBRD loan to lowering methane emissions intensity.

Project and Financial Objectives

- Promote stronger, more resilient growth and greening of Uruguay's economy
- Incentivize climate mitigation efforts by linking loan pricing to the country's climate targets

Financial Solution and Outcomes

To provide direct financial incentives for a country to meet ambitious climate goals, the World Bank designed a financial product that directly links loan pricing to reductions in methane emissions intensity.

Under the loan terms, Uruguay has committed to reduce methane emissions per unit of beef by at least 33 percent between 2025-2029, and by at least 36 percent between 2030-2034, making it a sequentially ambitious mechanism. These targets are 1 percent more ambitious than Uruguay's NDC targets for the reduction of methane emissions intensity of beef production.

If Uruguay meets the first target, it will receive a 50-basis point interest rate reduction on the loan. Meeting the second target will lead to a 100-basis point interest rate reduction. If Uruguay does not meet the targets, the loan interest rate will remain at standard IBRD terms as there is no step up in the interest rate for missing targets.

If both targets are achieved during the 10-year performance period, Uruguay could see a reduction of up to $12.5 million in interest payments over the life of the loan. This interest rate reduction is paid out of the Global Public Goods Fund administered by the World Bank. The Fund provides concessional financing to support innovative IBRD operations that generate global or regional environmental benefits, including greenhouse gas mitigation measures.

The United Nations Development Programme (UNDP) will verify progress towards the targets.

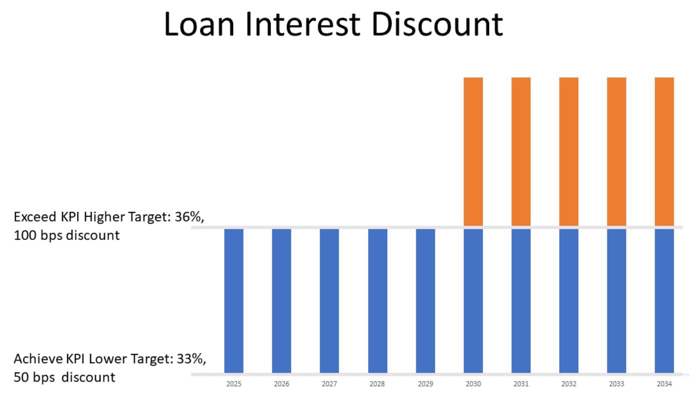

Figure 1 Pricing of the loan interest contingent upon Uruguay meeting targets They will secure discounts if they hit methane reduction targets

Environmental Finance recognized this innovation as the "[Sustainability-linked Loan of the Year]() – SSAs/Sub-Sovereigns" in its Sustainable Debt Awards 2024.

World Bank's Role

- This pilot operation required the collaboration of many global and regional units and practices within the Bank and was co-led by the regional Macro, Trade and Investment (MTI) and Environment (ENB) teams, in collaboration with the Country Management Unit, Legal, and the project implementation team to:
- **Conceptualize and design** the new product, including the mechanism for accounting and billing;
- **Provide numerous financial scenarios** to help the client understand the financial features of the new product;
- **Optimize parameters** such as distribution of interest rate step-down amounts and availability of conversion features;
- **Provide guidance to the client and World Bank project team** throughout the loan negotiation process to ensure timely project delivery and Board approval.

The aim of this pilot program is to replicate it for other climate and nature-focused operations in IBRD countries that invest in global public goods through a direct financial incentive embedded in the loan. The source of the interest buydowns could be from the Global Public Goods Fund, the proposed Livable Planet Fund, other donor funds, or even possibly from the monetization of emission reduction credits through funds such as the World Bank-administered SCALE (Scaling Climate Action by Lowering Emissions) fund, or from carbon markets. The critical aspect of this loan for Uruguay is that it sets a precedent and creates the loan infrastructure (e.g., documents, processes, systems, etc.) for future operations to encourage a rapid ramp-up in investments in global public goods.

Summary of Financial	
Approval Date	November 16, 2023
Amount	$ 350 million
Term	15.5 years
Grace period	4 years
Structure	Amortizing
Pricing	IBRD Variable Spread + SOFR
Pricing discount	Up to 50 basis points from 2028-2033 Up to 100 basis points from 2033-2037 (Contingent upon meeting targets)

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