



# Advancing Paris Alignment through Multilateral Development Banks' Engagement and Policy Development Support

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- » The Multilateral Development Banks (MDBs) have committed to align their operations with the mitigation and the adaptation goals of the Paris Agreement.
- » One important component of their overall Paris alignment efforts will be their engagement with countries and other clients to support the development and adoption of Paris-aligned pathways and policies. In particular, the MDBs have an important role to play in supporting the Nationally Determined Contribution (NDC) revision cycle and development of long-term strategies (LTSs).
- » We argue that the MDBs should use country engagement processes and Paris-aligned policy-based finance to encourage and support more countries to develop ambitious LTSs that they can then use to guide the shorter-term commitments outlined in their NDCs. Additionally, they should scale up the technical and financial support they provide to countries to do so, particularly in the lead up to the 26<sup>th</sup> Conference of the Parties at the end of 2020.
- » We further argue that MDBs should encourage and support other clients, including financial intermediaries and subnational governments, to adopt their own Paris-aligned climate commitments and pathways.

## Introduction

The Paris Agreement establishes three broad goals in the context of sustainable development and efforts to eradicate poverty. They are: (1) limiting global average temperature rise to well below 2°C and striving to limit it to 1.5°C (Article 2.1a); (2) increasing adaptive capacity and climate resilience (Article 2.1b); and (3) making financial flows consistent with low-emission climate-resilient development pathways (Article 2.1c).<sup>1</sup> The three are closely interconnected, and Article 2.1c on financial flows is a necessary condition for attaining the Agreement's mitigation and adaptation goals.<sup>2</sup>

In order to advance Article 2.1c, Multilateral Development Banks (MDBs)<sup>i</sup> are striving to align their own operations with the Paris Agreement. In a December

2018 statement, MDBs announced that they were developing an approach to implement Paris alignment. In that statement, they identified six key areas or “building blocks” that would form the core of their Paris alignment approach: (1) alignment with mitigation goals; (2) adaptation and climate-resilient operations; (3) accelerated contribution to the transition through climate finance; (4) engagement and policy development support; (5) reporting; and (6) aligning internal activities. MDBs are currently developing methodologies and tools for Paris alignment under each building block.<sup>3</sup>

This memo is one of a six-part series on the MDB building blocks. It focuses on Building Block 4, under which MDBs commit to “support the NDCs’ revision

cycle and develop services for countries and other clients to put in place long-term strategies and accelerate the transition to low-emissions and climate-resilient development pathways”.<sup>4</sup> Nationally Determined Contribution (NDC) and long-term low-emissions development strategies (long-term strategies or LTSs) are the primary tools through which countries plan for and communicate their near-term and mid-century climate change plans and pathways under the Paris Agreement. The Agreement establishes a process – the “NDC revision cycle” – whereby countries submit progressively more ambitious NDCs every five years.<sup>5</sup>

Under the NDC revision cycle, countries are asked to submit new or updated NDCs by 2020.<sup>6</sup> They are also invited to communicate LTSs by 2020.<sup>7</sup> This makes the 26th Conference of the Parties (COP26) at the end of 2020 a critical milestone for these climate plans.

This memo first sets out overarching principles to guide implementation of Building Block 4. It then discusses implementation in greater detail. It concludes with recommendations for MDBs as they advance this element of their Paris alignment approach.

## Overarching Principles

**1 | MDBs should strive to help more countries adopt Paris-aligned LTSs that they can then use as a guide for their enhanced NDCs. In this memo, “Paris-aligned LTSs” refers to those that put countries on low-carbon climate-resilient development pathways that align with Paris Agreement goals, and specifically with Articles 2.1a and 2.1b.** With respect to the Paris Agreement temperature goal, the 2018 Intergovernmental Panel on Climate Change (IPCC) Special Report on 1.5°C establishes global benchmarks necessary to limit warming to 1.5°C. Namely, global net CO<sub>2</sub> emissions must fall by 45% (relative to 2010 levels) by 2030 and reach net zero by around 2050.<sup>8</sup> Translating global benchmarks into national-level targets raises challenging issues of equity. However, as the above benchmarks suggest, limiting warming to 1.5°C will require deep emissions reductions everywhere and across all sectors. As development finance institutions, MDBs should strive to make this level of ambition possible for their member countries, and in all cases LTSs should lay out plans to peak and reduce emissions as rapidly as possible. Paris-aligned LTSs could also lay out goals to increase resilience and adaptive capacity and reduce vulnerability across sectors, while also fostering coordination and coherence with development objectives and other national priorities.

**2 | MDBs can best support countries by empowering them to develop and assess Paris-aligned development pathways that they can use to inform policy decisions.** Through their research and technical capacities, MDBs can help countries and other clients build the evidence base they need to develop and foster support for low-carbon climate-resilient pathways. Wherever possible, MDBs should design technical assistance initiatives to build internal capacities to formulate and implement climate commitments.

**3 | Policy-based lending could be an important tool in helping countries transition towards Paris-aligned pathways.** Several MDBs, including the World Bank, ADB, AfDB and IADB, offer policy-based lending whereby they condition disbursement of funding on implementation of certain policy programs or institutional actions. To be Paris aligned, policy-based lending cannot benefit or promote (directly or indirectly) any activities that are misaligned with the mitigation or adaptation objectives of the Paris Agreement. MDBs could also go beyond this minimum threshold and use policy-based lending to promote reforms that actively help countries transition to Paris-aligned pathways.

**4 | While country clients are of primary importance, engaging with other clients, including financial intermediaries, is also important to Building Block 4.** To fulfil their Paris-alignment commitments, financial intermediary lending and equity investments must also be aligned. Consequently, encouraging and supporting financial intermediaries to adopt decarbonization targets and to outline plans to achieve those targets is another important objective of Building Block 4.

<sup>i</sup> The banks involved are: African Development Bank (AfDB), Asian Development Bank (ADB), Asian Infrastructure Investment Bank (AIIB), European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB), InterAmerican Development Bank (IADB), Islamic Development Bank (IsDB), New Development Bank and World Bank Group.

## Implementing Building Block 4

A shared understanding of what constitutes a Paris-aligned long-term strategy could serve as a useful starting point in operationalizing Building Block 4, and in fact, MDBs have drafted a set of key principles for economy-wide long-term strategies<sup>9</sup>. This section first describes and responds to these draft principles. It then details additional steps we believe MDBs should take to fully implement Building Block 4. In particular, implementing Building Block 4 requires MDBs to encourage more countries to develop ambitious climate plans. It requires MDBs to scale up technical and financial support to help countries develop and implement those plans. And it requires them to help other clients, including financial intermediaries, to put LTSs in place. Each is discussed in greater detail below.

### What characterizes a Paris-aligned long-term strategy?

As noted above, MDBs have drafted a set of principles for economy-wide LTSs.<sup>10</sup> These principles could guide the technical support MDBs provide to countries and thereby help to ensure the quality and ambition of the climate plans that result. However, a number of additional considerations could strengthen the principles and help to guarantee their effectiveness. The MDB draft principles and several suggested considerations on each are summarized in the Table 1.

**Table 1: Response to the MDBs' Draft Principles for Economy-Wide LTS**

Draft principle	Additional considerations
<b>Principle #1:</b> Cover long-term timeframe and intermediate milestones	Principle #1 could specify acceptable timeframes. A mid-century target with intermediate milestones –in 2030 and 2040, at a minimum – is a sound approach. Additionally, the principles could more clearly articulate the relationship between LTSs and NDCs and processes for using LTSs to inform the ambition of NDCs through backcasting.
<b>Principle #2:</b> Be based on broad stakeholder engagement through an inclusive and iterative engagement process	Broad stakeholder engagement is not all that is needed for effective governance of national climate planning. Other governance considerations, including the necessary legal frameworks, institutional arrangements and technical capacities, could be included under Principle #2 or incorporated as additional principles. <sup>11</sup> For instance, LTSs could spell out the roles and responsibilities of different government actors and create channels for coordination across government and with non-governmental stakeholders. <sup>12</sup>
<b>Principle #3:</b> Be developed in consideration of or linked to other Sustainable Development Goals and local adaptation needs	Links to national development priorities and plans are also a critical component of LTSs. Economy-wide LTSs can “identify and integrate national development considerations, including environmental, social, and economic objectives, supporting the country’s long-term vision”. <sup>13</sup> In line with this, MDBs could use LTS development processes to help countries plan for a just transition for workers whose livelihoods are linked to emissions-intensive industries or whose skillsets may be less relevant in the future. <sup>14</sup>

**Principle #4:** Be based on a decarbonization target in line with the Paris Agreement

A clear explanation of how “in line with the Paris Agreement” is defined is indispensable. Global benchmarks suggest that global CO<sub>2</sub> emissions need to reach net zero by around 2050, and the electricity sector needs to be fully decarbonized by 2050, at the latest. Principle #4 could reflect these and other scientific findings.

In addition to mitigation targets, LTSs can also include targets to strengthen resilience and adaptive capacity. All targets could be tailored to specific country contexts. In addition to setting long-term targets, LTSs could define pathways or a vision for achieving those targets.<sup>15</sup>

**Principle #5:** Include all key emissive sectors/systems

Principle #5 could specify that LTSs will define mitigation targets, pathways and key areas of action for those sectors that are driving a country's emissions.

**Principle #6:** Ensure country/client ownership with a clear mandate

Principle #6 notes that the strength and eventual implementation of climate plans depends on country ownership and political will, but it could also reinforce principle #2 by highlighting the need to generate broad ownership through public engagement.

**Principle #7:** Be updated regularly based on the monitored and evaluated progress towards meeting the long-term objectives and considering changes in cost and availability of new technologies

Principle #7 is critical. Treating LTSs as an ongoing process and revising them as circumstances, knowledge and technologies change will strengthen LTSs. Principle #7 could elaborate on certain key considerations in establishing the governance arrangements associated with LTSs review and revision.<sup>16</sup>

## How can MDBs persuade more countries to adopt Paris-aligned climate plans?

Long-term planning is critical to avoid locking in unsustainable emissions-intensive assets, to avoid maladaptation and to develop policy and financing strategies that support a just transition. It can inform near-term decision making and ensure that near-term targets are aligned with the Paris Agreement goals. Although many countries are in the process of developing LTSs, only five developing countries – Costa Rica, Fiji, Republic of the Marshall Islands, Benin and Mexico – have formally communicated LTSs to the UNFCCC, as of January 2020.<sup>17</sup> As such, it is critical that MDBs encourage countries not already doing so to adopt Paris-aligned LTSs.

MDBs have two potential avenues to promote the development of ambitious climate plans. First, they could use the country engagement process and MDB

country strategies to champion LTSs and NDC enhancement. Second, for those banks that offer policy-based finance,<sup>ii</sup> Paris-aligned policy-based lending could be a powerful tool to promote Paris-aligned pathways.

### 1. Country engagement

In engaging with country clients, MDBs could highlight the relevance of NDCs and LTSs to development planning processes and make the case for integrating near- and long-term climate objectives into MDB country strategies. Specifically, MDBs could integrate climate objectives into country strategy results frameworks to make plain how MDBs' in-country activities would advance climate objectives.

Country strategies are institutional documents that guide MDBs' in-country work. They are the product of joint dialogue between MDBs and governments, especially finance and planning ministries. These minis-

<sup>ii</sup> The World Bank, Asian Development Bank (ADB), African Development Bank (AfDB) and Inter-American Development Bank (IADB) all offer policy-based finance.

tries are not always heavily involved in developing climate plans but are crucial to their eventual implementation. Drawing attention to NDCs and highlighting the connections between these plans and MDB country strategies “helps ensure that finance ministries, which typically lead country engagement with multilateral banks, are fully informed and supportive of the NDC”.<sup>18</sup> Moreover, “NDC enhancement and LTS development will require political support, ideally from a head of state and planning or finance ministry, to ensure buy-in and steer coordination efforts”.<sup>19</sup> By elevating LTSs and NDCs in the country engagement process and engaging finance ministries on the topic, MDBs could help to build the required political support for NDC enhancement or LTS formulation.

## 2. Paris-aligned policy-based finance

Several MDBs, including the World Bank, ADB, AfDB and IADB, offer policy-based lending whereby they condition disbursement of funding on implementation of certain policy reforms. In policy-based lending operations, countries pursue particular policy programs or institutional actions, and MDBs provide technical support to design and implement the related reforms. The proceeds of these loans then provide countries with general budget support. Historically, this type of lending has made up a significant share (20 to 30%) of these banks’ portfolios, making policy-based lending an important piece of the Paris alignment puzzle.<sup>20</sup>

Policy-based lending could help or hinder adoption of Paris-aligned pathways, depending on how it is deployed. On the one hand, the banks have used policy-based finance to promote climate-related objectives. For instance, several have used policy-based finance to spur energy sector reforms and promote renewable energy. The ADB also recently added a new financing mechanism to its policy-based lending toolkit that aims to strengthen countries’ disaster resilience.<sup>21</sup> On the other hand, the banks have also used policy-based lending to encourage policy reforms that could substantially increase greenhouse gas (GHG) emissions. For example, a World Bank policy-based loan in Mozambique aims to help the country develop its oil and gas industry.<sup>22</sup>

To be Paris-aligned, policy-based lending cannot benefit or promote any activities that are misaligned according to Building Blocks 1 and 2 – on miti-

gation and adaptation – of the MDB Paris alignment approach. It is especially critical that MDBs strengthen mechanisms for anticipating indirect or unintended climate-related impacts of their policy-based loans.

MDBs could also go beyond this minimum threshold and use policy-based lending to promote reforms that actively help countries transition to Paris-aligned pathways. For instance, they could use policy-based lending to help countries adopt mitigation plans for sectors, such as the energy and transport sectors, that are critical to long-term decarbonization. Reforms in key emissive sectors could make up an important piece of an eventual economy-wide long-term strategy; they could even make economy-wide long-term planning seem more feasible. Additionally, MDBs could consider developing a dedicated climate-related policy-based lending instrument that would offer funds to countries’ adopting Paris-aligned climate commitments, such as long-term net-zero targets.

### How can MDBs help countries formulate Paris-aligned climate plans?

Once countries decide to develop LTSs and enhance their NDCs, they may need technical and financial support from MDBs to do so. Several MDBs already provide dedicated support to member countries for NDC implementation, NDC enhancement and long-term strategy formulation. However, at present, these efforts are limited.<sup>23</sup> Some are financed through relatively small pots of grant funding. For example, the ADB’s NDC Advance is funded through a \$4.55 million grant.<sup>24</sup> Others cover only a small number of countries; the EBRD’s NDC Support Programme, for example, provides direct technical support to only a select set of countries.<sup>25</sup> Additionally, the bulk of the support provided to date has focused on NDC implementation.<sup>26</sup> While NDC implementation support is and will continue to be crucial, developing countries also require assistance in formulating and raising the ambition of their near-term and long-term national climate plans, particularly in the lead-up to COP26.

To effectively implement Building Block 4, MDBs need to scale up their dedicated support platforms to provide more support to more countries. Scaled-up platforms could provide several types of technical support. Several indicative examples are discussed below.<sup>iii</sup>

<sup>iii</sup> These examples are informed by requests submitted by developing countries in a new NDC Partnership initiative, the Climate Action Enhancement Package (CAEP). Under CAEP, countries are invited to submit requests for support related to NDC enhancement and long-term strategy formulation. NDC Partnership. n.d. “Climate Action Enhancement Package (CAEP).” <https://ndcpartnership.org/caep>

## Box 1:

### IADB's Deep Decarbonization Pathways in Latin-America and Caribbean (DDPLAC) project

Recognizing the importance of modelling exercises in the formulation of effective climate policies, the IADB is working to develop in-country capacity in Argentina, Colombia, Costa Rica, Mexico and Ecuador to research long-term emissions reduction pathways and develop modelling expertise to help inform national climate policies. The project has several key components:

- » Training for academic teams and/or think tanks within the target countries (trainee teams) on the use of modelling tools to inform policy making: Trainers will work with trainee teams to gather the necessary data and design and calibrate models that are suited to the local context.
- » Dialogue with government stakeholders: trainee teams will begin a dialogue with government

stakeholders to demonstrate the value of modelling tools for informing policy decisions.

- » Develop decarbonization pathways: trainee teams will develop decarbonization pathways that they will compare with targets set out in the NDCs and any long-term national goals. They will share the outcomes of the analysis with policymakers to support ongoing public debate on NDC planning.

The project also aims to collect and exchange lessons learned and build a regional community of practice. This innovative project has the potential to increase the pool of available models, create more fit-for-purpose models and build up local expertise. This, in turn, could increase local buy-in for the results of modelling exercises and any policies that might follow from those exercises.

*Process:* Dedicated support platforms could provide technical assistance to develop broadly inclusive and iterative stakeholder engagement processes for developing national climate plans. Dedicated support platforms could also offer concessional funds to support policy development, but at the same time condition access to those funds on development of inclusive and iterative engagement processes.

*Policy development:* Dedicated support platforms could support a variety of analytical assessments to help countries define their climate commitments. For example, MDBs could help undertake modelling exercises to identify viable and cost-effective decarbonization pathways, or they could help countries design adaptation plans using robust decision-making exercises. They could complement these assessments with cost-benefit analyses of specific interventions. Together, these types of assessments could help countries understand the implications of different development pathways for emissions, climate risk, economic growth or other indicators of interest. They would thereby allow countries to make informed policy decisions. In providing this type of support, the dedicated support platforms could build on and collaborate with other existing initiatives, including the Deep Decarbonization Pathways (DDP) initiative, the 2050 Pathways Platform and the NDC Partnership.

Ideally, MDB technical support would build internal capacity – within government ministries and within academic and other research institutions – to develop or adapt existing models and to formulate policies based on the results of modelling exercises. Doing so could help countries build the evidence base they need to bolster internal support for low-carbon climate-resilient pathways. The IADB's innovative Deep Decarbonization Pathways in Latin-America and Caribbean (DDPLAC) project provides a concrete example (see Box 1).<sup>27</sup>

*Implementation and financing:* Some countries may require support to develop the governance and institutional structures needed to implement climate plans. MDBs could provide technical assistance to help countries strengthen institutional capacity and adopt policies that support plan implementation. In designing related technical assistance or policy-based lending operations, MDBs could consider NDC Partnership Plans, in which member country governments identify their NDC implementation needs.<sup>28</sup>

Other countries may need guidance in developing plans to finance implementation. MDBs are, of course, well equipped to help countries develop financing and investment plans. MDBs are well positioned to help countries identify financing needs based on LTSs and generate pipelines of Paris-aligned projects. They

could help countries conduct cost-benefit analyses of different interventions. They could also help countries evaluate financing gaps and identify potential sources of funding, including potential private investment.

### **How can MDBs encourage other clients to adopt Paris-aligned climate plans?**

In Building Block 4, MDBs commit to helping “other clients” to develop LTSs and accelerate their transition to Paris-aligned pathways.<sup>29</sup> MDBs have indicated that they are initially focusing on the country level. While this is a sensible starting point, it is important to note that a complete implementation plan for Building Block 4 will also need to include plans and processes for supporting subnational governments, financial intermediaries and private sector actors. In parallel with the critical support MDBs provide to member countries, MDBs should begin to develop methodologies for supporting other clients.

It is especially important that MDBs work with financial intermediaries to formulate long-term decarbonization plans. Since MDBs provide significant shares of their funding through financial intermediaries<sup>30</sup>, they cannot fulfil their commitment to align their operations with the Paris Agreement without the cooperation of financial intermediaries. The banks could develop policies and strategies to convince actors they lend to or invest in to define their own long-term decarbonization targets. For instance, MDBs could condition lending to or equity investment in financial intermediaries on the recipient’s willingness to adopt net-zero emission targets over a specified time period.

The International Finance Corporation’s proposed Green Equity Strategy provides a useful example. The IFC began to discuss a “green equity investment approach” in October 2018.<sup>31</sup> Under the proposed Green Equity Strategy, financial intermediary clients, including commercial banks, would have to commit to reduce or eliminate their coal investments over a defined period of time in order to receive IFC equity investment.

In addition to financial intermediaries, MDBs could help other clients, including subnational governments and private sector actors, to accelerate the transition to low-emissions and climate-resilient development pathways. Helping them to do so would reinforce efforts at national level. MDBs could, for example, encourage other clients to adopt long-term decarbonization targets and connect them with relevant initiatives and resources that could help them formulate such targets. One example is the Science-Based Targets Initiative, which has developed methodologies for private companies to set emissions reduction targets based on their share of global emissions.<sup>32</sup>

Additionally, as MDBs support national governments in developing ambitious climate plans, they could, where appropriate, encourage engagement with subnational governments or the private sector. Actively engaging subnational governments and the private sector in national government efforts to develop LTSs could increase awareness, build capacities and create opportunities for other actors to identify their own needs for support.

## Recommendations

As MDBs implement Building Block 4, we recommend that they:

1. **Further elaborate their shared principles for economy-wide LTSs, as detailed in Table 1 above.**
2. **Champion LTSs and NDC enhancement in country engagement and particularly in the development of MDB country strategies.** Country strategy results frameworks should make plain how the strategy will promote countries' climate objectives. Where countries have yet to articulate long-term plans, MDBs should emphasize the importance of long-term planning and make countries aware of the types of support available for the development and implementation of LTSs.
3. **Consistently use policy-based finance in ways that help countries transition to low-carbon climate resilient development pathways.** At a minimum, they should ensure that policy-based lending does not benefit or promote misaligned activities. Going beyond this minimum threshold, MDBs could consider developing a climate-related policy-based lending instrument to promote ambitious climate policies that actively advance Paris Agreement goals.
4. **Scale up dedicated support platforms to provide more support to more countries, with an eye towards supporting NDC enhancement and LTS development in 2020 and beyond.** Wherever possible, MDBs should design technical assistance initiatives to build in-country capacities to formulate and implement climate commitments.
5. **Develop policies and strategies to convince actors that they lend to or invest in to define their own long-term decarbonization targets.** Paris alignment requires that MDBs ensure their financial intermediaries are also aligning their operations with the objectives of the Paris Agreement by formulating long-term decarbonization plans.
6. **Encourage and support other clients to adopt science-based decarbonization targets** and help connect them with relevant resources and initiatives, including the Science-Based Targets Initiative for private companies that can help them formulate such targets.

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