Supporting the transition in emerging markets and developing economies

Background Note[1]

Introduction – The need for climate action

Multilateral, regional, national, and other public development banks play an important role in supporting governments and the private sector in advancing climate action. Development banks:

- directly finance or co-finance essential low carbon and climate resilient infrastructure and activities
- provide technical assistance for capacity building, enhancements to the enabling environment for private sector mobilization, and promoting green, resilient, and inclusive development
- innovate in developing new financing instruments or frameworks that expand the pool of resources available for climate mitigation and adaptation efforts
- build or expand markets for newer, cleaner technology
- contribute knowledge and data to global and country dialogues aimed at enhancing decision making and promoting accountability on climate change.

Since 2012, when the first reports on climate support were published by the International Development Finance Club (IDFC) and the Multilateral Development Banks (MDBs), the focus of development banks on climate-related support has grown. In 2017, IDFC and the MDBs made a joint commitment to align financial flows with the goals of the Paris Agreement, and since then, both IDFC[2] and the MDBs[3] have been engaged in the development and refinement of assessment frameworks to facilitate this commitment. In 2019, MDBs further committed to help clients move away from the use of fossil fuels while supporting a Just Transition that promotes economic diversification and social inclusion. That same year, IDFC committed to mobilize up to $1 trillion for climate by 2025.[4]

1 This work is a product of an informal working group consisting of staff at the World Bank, Agence Française de Développement, the Asian Infrastructure Investment Bank, the European Bank for Reconstruction and Development, and the European Investment Bank. The findings, interpretations, recommendations and conclusions expressed in this work do not necessarily reflect the views of their organizations' senior management, the Executive Directors or the Board of Directors of these institutions, or the governments they represent.

2 https://www.idfc.org/wp-content/uploads/2018/12/idfc_alignment-with-paris-agreement_position-paper_12_2018.pdf

3 https://www.ebrd.com/news/2019/multinational-development-banks-present-their-paris-alignment-approach-.html

4 https://www.caf.com/en/currently/news/2019/09/idfc-pledges-billion-dollar-funding-to-combat-climate-change/

Amidst this context of growing development bank support for climate action, the COVID pandemic has tested country preparedness against disasters, a sign of the challenges ahead in the context of climate change. In many countries, public and private sector budgets once focused on supporting climate action have been redirected due to the pandemic, exacerbating the problem that climate-related investment levels were already far below what is needed. Many governments have been delayed in submitting their updated or new NDCs originally due in 2020. Moreover, an assessment of those that have been submitted raised concerns that new global commitments will not be sufficient to achieve the Paris Agreement's goal of holding the increase in the global average temperature to well below 2°C above pre-industrial levels, and pursuing efforts to limit the temperature limit to 1.5°C above pre-industrial levels.[5]

A comprehensive strategy

Looking towards the Venice climate conference, development banks invited to participate faced the question of how to coordinate climate-focused engagements, with a view to prioritize most impactful interventions. Two activities have been identified that offer potential for synergy and impact, and where the need is pressing in both emerging markets and developing economies (EMDEs). The first is a proposal for MDBs to coordinate in support of countries' preparation and eventual implementation of long-term, climate-informed development strategies (LTS). Such strategies provide context to country NDCs, send investment signals to the private sector, and are inextricably linked to a country's long-term development prospects.

The second initiative seeks to deepen our understanding of what is impeding large scale private investment in climate projects in a range of countries. Working with the Global Infrastructure Facility (GIF), to leverage similar work it has launched, a series of platform pilots is proposed, engaging private sector leaders to identify and then collaborate on solutions aimed as scaling private investment for climate action. Development banks will serve as knowledge and technical partners to Governments on those recommendations they wish to pursue.

A roadmap of key actions

Initiative #1: MDB Long-Term Strategy Initiative

At the July 11th Conference, Multilateral Development Banks[6] will launch an LTS initiative aimed at supporting developing countries in the preparation and implementation of long-term low greenhouse gas (GHG) and climate resilient development strategies.

Many countries have made progress towards developing LTSs, but the number submitted to the UNFCCC remains limited. At the UN Climate Action Summit in September 2019, 77 countries

[5] https://www.unep.org/emissions-gap-report-2020

[6] MDBs participating in the initiative include the African Development Bank (AfDB), the Asian Development Bank (ADB), the AIIB, the Council of Europe Development Bank (CEB), the EBRD, the EIB, the Inter-American Development Bank Group (IDB Group), the Islamic Development Bank (IsDB), the New Development Bank (NDB), and the WBG.

announced individual commitments to achieve net zero emissions by 2050, but only 29 parties (representing 28 countries plus the EU) had submitted their LTS to the UNFCCC as of May 2021. Such strategies contribute to achieving countries' development goals in line with the Paris Agreement. LTS are also strategically important planning tools that help countries, regions, cities, and national sector entities understand the comparative advantages of different sustainable, equitable, low-GHG and climate-resilient development pathways, as well as their inherent risks and costs of transition. MDBs have collectively provided partial or comprehensive LTS development support in nearly 40 countries thus far; the goal with this initiative is to coordinate action and increase that number in the coming years.

The value for countries: Formulating an LTS helps governments articulate a vision and map out feasible pathways contributing to an economy-wide transformation to low-greenhouse gas, resilient development that considers broader sustainability and socio-economic goals. LTSs will help countries deliver on their Paris Agreement goals and commitments and inform NDC revisions and enable planning for transformative short- and medium-term actions. Governments can use LTSs to drive policy reforms, public investment, and financing approaches to signal political commitment to a green, resilient, and inclusive transition. LTSs are also meant to inform public and private investors of green and resilient investment opportunities in a given country context. In the absence of an LTS, countries risk making decisions based on short-term planning cycles that may lock in inefficient and unsustainable development trajectories. LTSs can also help to ensure a just transition in which the costs and benefits of the proposed changes are equitably distributed.

The value to the private sector: LTSs provide essential market signals to the private sector to facilitate investment planning. Clear long-term climate policies will give confidence to investors and corporations to commit to investments in a given sector and drive the scale of private sector investment needed to reach the Paris Agreement goals. Some of these investments may be co-financed by MDBs, but another possible outcome of this effort is the creation of financing mechanisms supporting climate action that can be entirely private sector driven.

The value for MDBs and other development banks: Development banks are uniquely positioned to work with ministries of Economy, Finance, Planning and other sector ministries and public authorities to help identify and finance long-term development priorities. This initiative will help development banks coordinate their support for LTSs and promote a consistent approach across countries, enhancing confidence that the LTS signals priority investments and the technical assistance needed to deliver long-term economic transformation. This initiative can also help ensure that LTSs serve as effective tools for government planning and decision-making and build capacity of governments and relevant sub-national authorities to own and update their LTSs. Finally, the LTS initiative will enable MDBs and other development institutions to use LTSs as inputs to their engagement and planning processes with countries on future priorities for support. This is an important consideration given that the common Paris alignment framework currently under development by the MDBs uses LTSs as an important signpost in the assessment process.

Key elements of this initiative will include:

- Development of common principles to help ensure LTSs supported by MDBs integrate development goals, apply just transition principles, and are developed based on an inclusive stakeholder engagement process, including with relevant public development banks and other key development partners or initiatives.[7] (*To be completed by COP26*).
- Support to in-country work related to LTS development and the translation of the LTS and other long-term climate planning into immediate and medium-term sectoral, sub-national, and economy-wide actions, including policy development and investment planning. (*To be carried out 2021-2025, as part of a first phase of work*)

The initiative will be implemented in a phased approach. The MDBs will continue working on this initiative in the lead up to COP26.

Initiative #2: Country Mobilization Platform Initiative

The Country Mobilization Platform Initiative seeks to improve development outcomes through better coordinated engagement between government, the private sector, and key development partners. In addition to bringing government attention to what is needed to create a better market environment for private sector provision of climate finance, this effort seeks to foster improved interaction between the public and private sectors and help in identifying market opportunities.

Collaborative efforts like this are not new. The G20 has promoted country platforms in the past, and in many countries, governments convene relevant development banks, UN agencies, and other partners on a periodic basis to discuss where support is needed to deliver on their development vision. Such exchanges can improve communication, minimize the duplication of efforts, promote complementarity of action, and result in new finance or co-finance of government priorities. However, depending on who leads these meetings on behalf of government, climate change may or may not be a regular focus of these discussions. Private sector involvement has also not been prioritized in many of these discussions.

Given today's circumstances, with the need for private investment in climate action growing ever more pressing, new approaches must be explored to understand how to scale the level of private investment in priority climate initiatives, including adaptation. Working Group 2 therefore proposes:

- Establish a series of pilots in a range of different country contexts, inviting both international and domestic finance experts and corporate leaders to exchange on the challenges impeding private investment related to climate action and possible strategies to address them. Unless government deems it preferable to structure this as a separate initiative, the country pilots could be linked to existing donor engagement platforms operating in the country.
- Country dialogues would be private sector led; have active government engagement and endorsement of the process; and rely on development banks to keep the conversations moving in a productive direction. Development banks would also play a key role supporting government on the policy and institutional changes government agrees to pursue. Timelines would be set for

[7] Depending on the country, these processes may also engage with other relevant LTS development efforts sponsored by the NDC Partnership, AFD's 2050 Facility, the 2050 Pathway Platform, IKI, the EU's SPIPA, etc.

key deliverables, which could ultimately include policy reforms, project preparation assistance, etc.

- A country's new NDC (and/or other key climate strategies, including LTSs) would provide the basis for the discussion, allowing government to articulate priority areas of investment, for both adaptation and mitigation opportunities. Indeed, interaction between simultaneous LTS and Country Mobilization Platform initiative efforts would generate significant public-private impetus for transformative change. The conversation would help the government identify potential opportunities for private participation and may provide a reality check on its assumptions about where private investment is feasible or the scale of policy changes required to enable it.
- Working with development banks, donors, and others, the Global Infrastructure Facility will provide funding[8] and/or staff support to help government facilitate the country pilots, undertake analytic work directly, or arrange to have it carried out by other technical experts or development banks. Development banks may also engage other resources - including project preparation tools and data platforms - that can support this process.
- In addition to coordinating activity among existing delivery partners, the GIF and/or development banks engaged in pilot country work may also deliver workshops to increase government expertise on policy and legal reforms needed to facilitate private capital mobilization.
- Each country pilot will be tailored to meet local circumstances and needs.

Development banks involved hope to identify several countries that have agreed to utilize this program model by the July 11th conference. Additional country targets will be finalized prior to COP26, with a goal of engaging a range of countries in different economic circumstances and facing different types of climate challenges, including countries where adaptation is the primary focus.

[8] GIF support to efforts in individual countries will be subject to the approval of the GIF Governing Council.