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Ramesh, a salt pan worker, cleans his solar panels as the sun rises in the Little Rann of Kutch, India.

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# ALIGNING CLIMATE AND DEVELOPMENT



The WBG will step up support to client countries and private sector clients in order to meet both climate and development objectives. We will do so by (i) ramping up engagement at the country level on climate and development diagnostics, planning, and policies to help countries reach their climate and development objectives; (ii) aligning WBG financing flows with the objectives of the Paris Agreement to further mainstream climate into our development activities; and (iii) increasing climate finance for mitigation and adaptation in ways that deliver the most results.

## COUNTRY CLIMATE AND DEVELOPMENT DIAGNOSTICS, PLANNING, AND POLICIES

At the country level, the WBG recognizes the need for a consistent and informed country climate discussion, including the interrelated issues of biodiversity and natural capital, anchored in country development objectives. Therefore, we are committed to major engagements on diagnostics and analytics to support national policy and planning for climate. This work will aim to identify and prioritize adaptation and mitigation opportunities—considering trade-offs and transition costs—to deliver the most results in the context of the unique needs, circumstances, and priorities of each of our client countries.

### BOX 2

#### Climate Risks and Macroeconomic Policies

Changes in climate affect macroeconomic outcomes through physical and transition risks. **Physical risks** derive both from gradual changes in temperature, precipitation, and seasonal patterns that can affect crops and labor productivity, and from sudden-onset impacts, such as extreme weather events (droughts, forest fires, hurricanes, floods), which are becoming more frequent and severe and can directly affect consumption, investment, and trade. **Transition risks** result from the adjustment of asset prices in response to climate policies and technological changes during the transition to a low-carbon economy. Countries face transition challenges in managing the potential negative impacts of domestic and international mitigation policies on equity, labor markets, or external competitiveness. The introduction of global carbon prices and other mitigation efforts has adverse impacts on exporters of fossil fuels and high-carbon activities.

The analysis of physical and transitions risks must be systematically included in macroeconomic management. The WBG will support client countries in designing and implementing climate-smart macroeconomic policies by (i) mainstreaming climate considerations in key macroeconomic work and macro-projections via the development of national level macro-models with a climate lens, to assess the impact of climate shocks and climate policies on macroeconomic outcomes and fiscal sustainability; (ii) designing climate strategies that are fiscally sustainable by introducing tailored and politically viable environmental tax reforms that use revenues to maximize development co-benefits; and (iii) linking environmental tax reforms with public investment in adaptation and measures to maintain fiscal space and ease borrowing constraints.

*Source: World Bank.*

### BOX 3

## Supporting Clients to Design and Implement Carbon Pricing

Carbon pricing can be a cost-effective policy tool for governments and companies to use as part of their broader climate strategy. Carbon prices are needed to incorporate climate change costs into economic decision-making. If well-designed and sufficiently ambitious, and successfully incorporated into fiscal policy and decision making, carbon pricing can send a strong price signal to incentivize commercial entities and citizens to reduce emissions and the private sector to co-invest in the key systems transitions, reducing the extent of additional public investment needed. Carbon pricing policy options include explicit policies, such as carbon taxes, fossil fuel subsidy reform, emissions trading systems (also known as cap-and-trade systems), and crediting mechanisms, and implicit policies, such as revenue-neutral fee-and-rebate systems and internal and shadow carbon pricing.

Carbon pricing is effective as part of a broader policy package that can tackle other climate change challenges and market failures. Other policies are needed to drive research and development, unlock noneconomic barriers to mitigation, and create low-carbon alternatives and reduce abatement costs in the sectors that are the most difficult and expensive to decarbonize. Carbon pricing can minimize the economic cost of decarbonization when used in conjunction with public investment (e.g., in infrastructure and targeted incentives for technology and innovation), regulatory changes (e.g., for building norms and urban planning), and in the appropriate enabling environment (such as functioning capital markets). Assessing and addressing the distributional impacts of carbon pricing through the design of carbon pricing instruments and/or complementary policies is critical to enable a socially just transition and to contribute to the long-term sustainability of the carbon pricing mechanism.

Well-designed carbon pricing systems can play a role in raising revenues, which can help reconcile the need to finance decarbonization with the need for fiscal sustainability post-COVID. Raising carbon taxes to the level recommended by the Stiglitz-Stern Commission could add between 1 and 3 percent of GDP in national tax revenues in 2030. Carbon pricing revenues can be channeled to catalyze clean investment flows, ease transitions, and support poverty alleviation.

There is increasing client demand for the WBG's technical support on carbon pricing, including its mainstreaming into countries' wider fiscal policy and long-term decarbonization strategies. The WBG, through its combination of macro-fiscal, sectoral, and technical expertise, along with its convening power, is able to provide an integrated perspective of how carbon pricing policies can simultaneously advance environmental, fiscal, sectoral, and macroeconomic objectives.

The WBG is implementing several initiatives to support client countries and the private sector on carbon pricing. On advisory services and analytics, the World Bank is developing a new Carbon Pricing Assessment Tool (CPAT) and is leading work on the inclusion of carbon pricing in long-term climate strategies, the combination of carbon pricing with sectoral mitigation instruments, and its relation to international climate finance. The Bank is also supporting joint global and country analyses of the relative growth and welfare impacts of environmental and conventional taxes, fuel subsidy reforms, and efforts to include carbon pricing within existing commodity taxation systems. IFC is helping to mobilize the private sector to apply an internal carbon price and is advocating for business-appropriate carbon pricing policies in countries.

The WBG is hosting initiatives to support the development of mutually beneficial policies and implementation of carbon pricing, including the Partnership for Market Implementation, the Energy Subsidy Reform Facility, the Coalition of Finance Ministers for Climate Action, the Platform for Collaboration on Tax, and the Carbon Pricing Leadership Coalition. IFC leads private sector engagement for the CPLC and has been instrumental in bringing many prominent companies to the Coalition. The World Bank is also helping countries prepare to participate in international voluntary and compliance markets under the Paris Agreement through its Climate Warehouse initiative and to deploy results-based climate finance through its Climate Emissions Reduction Facility.

Sources: High-Level Commission on Carbon Prices. 2017. "Report of the High-Level Commission on Carbon Prices." Washington, DC: World Bank. <https://www.carbonpricingleadership.org/report-of-the-highlevel-commission-on-carbon-prices>.

World Bank. 2021. "State and Trends of Carbon Pricing 2021." Washington, DC: World Bank. <https://openknowledge.worldbank.org/handle/10986/35620>.

The WBG will take a “whole of economy” approach that focuses on policies and plans to create the right enabling environment for climate action. Beyond greening projects, the WBG will support the greening of entire economies. This includes (i) embedding climate priorities in country macroeconomic frameworks that guide fiscal policy and major national investments and account for their climate benefits and risks;<sup>14</sup> (ii) integrating climate planning into national budgets and expenditure frameworks, to provide adequate budgetary support for climate action, optimize the overall allocation of public resources, and unlock private financial flows; (iii) embedding climate objectives in financial sector regulations and incentives, so the sector is resilient both to climate change impacts and to low-carbon transition risks, and to mobilize finance for climate action; (iv) incorporating climate objectives in systems planning, to integrate climate with economic, social-inclusion, and other objectives, assess cross-sectoral links and regional impacts, and identify trade-offs and synergies; and (v) embedding climate objectives in enabling environment policies and reforms to attract private sector investment. To supplement the country-based approach, the WBG will also support regional programs that contribute to climate, nature, and development objectives and it will leverage its leadership and convening power in support of global initiatives and partnerships.<sup>15</sup>

In addition to supporting “whole of economy” policy reforms and institutional strengthening, the WBG will support policy reforms to deliver transformational change. The climate agenda presents an opportunity for economic transformation and the modernization of economies for our client countries and the private sector. This highlights the critical importance of economy-wide aspects of the transition, such as carbon taxation and fiscal reforms to promote innovation and accelerate the transition. Recent evidence suggests that spending on key carbon-neutral or carbon-sink activities can generate net gains in economic activity.<sup>16</sup>

## **Country Climate and Development Reports**

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The WBG will develop a new Country Climate and Development Report (CCDR) to enhance climate analysis and policy in its programs, to identify and prioritize opportunities for climate action—including biodiversity and natural capital considerations—and to capture synergies between a country’s national climate commitments and development objectives.<sup>17</sup> This new diagnostic will be introduced in fiscal year 2022. The CCDR will provide a strong analytic base to inform country engagement products, such as Systematic Country Diagnostics (SCDs) and Country Partnership Frameworks (CPFs)—CPFs will be critical for operationalizing this Action Plan.<sup>18</sup> Through CCDRs, country engagement products will incorporate climate, biodiversity and natural capital, and disaster risk issues, including as reflected in country climate strategies and NDCs. The goal is to deliver up to 25 CCDRs in the first year and keep them as a core diagnostic thereafter. CCDRs will be made public to inform partner and donor coordination and to engage companies and investors to support climate investments.

IFC and MIGA will work closely with the World Bank to use CCDRs to identify new private sector opportunities for climate business, with a focus on sectors that are seen to have the highest achievable positive impact in a given country. IFC and MIGA will also continue to integrate climate in all new Country Private Sector Diagnostic (CPSDs), building on recent piloting of climate integration in selected countries, and will expand this to more countries.

## BOX 4

### Climate Change, Ecosystems, and Biodiversity

Climate change threatens the integrity of ecosystems, which play key roles in capturing and storing carbon and in mitigating the impacts of climate change. Climate change and ecosystems degradation combined, in turn, push the planet ever closer to irrevocable tipping points. Terrestrial and marine ecosystems sequester 60 percent of gross annual anthropogenic carbon emissions, so their loss or degradation result in more carbon in the atmosphere. Without wetlands, coastal areas lack crucial protection from storm surges; when forests are lost, water supplies suffer, and torrential rains are likelier to cause landslides.

Climate change is accelerating global biodiversity loss. In oceans, for example, fish stocks and migration patterns are already changing due to warmer waters, acidification, and other factors. Climate change and ecosystems loss combined threaten development gains, and low- and lower-middle-income economies have the most to lose. Comprehensive wealth estimates indicate that renewable natural capital, including forests, mangroves, agricultural land, and fisheries, accounts for 23 percent of wealth in low-income countries. This underscores the need for integrated approaches to climate and ecosystem risks.

Nature-based solutions (NBS)—designed to protect, sustainably manage, and restore ecosystems—could deliver 37 percent of the cost-effective climate mitigation needed through 2030. Investments in green infrastructure, such as mangroves, wetlands, and watersheds, have proven to be cost-effective for water resource and disaster risk management, as they enhance the performance of traditional gray infrastructure and can sometimes even replace it. NBS are thus important for adaptation, protecting livelihoods and built assets from floods, storm surges, and droughts. The restoration of forests, landscapes and coastal ecosystems is also essential for both mitigation and adaptation, and a growing portfolio of World Bank investments reflects this.

Transformative action is needed to address climate and nature together, equitably and inclusively. Separate approaches risk being less impactful and fiscally inefficient. This points to the need for coordinated implementation of the Paris Agreement and the post-2020 global biodiversity framework, expected to be adopted at COP15 of the Convention on Biological Diversity in October 2021. Any response to these two intertwined crises must start by tackling the drivers of climate change and nature loss, then create an enabling environment to attract public and private investments that support climate action while preventing further nature loss.

To move the needle, the WBG will produce metrics and decision-support tools that are based on the best scientific data available and on economic analysis. Comprehensive wealth accounting and integrated ecosystem-economy modeling together can maximize synergies and manage tradeoffs between low-carbon and nature investments. Finally, support to the upcoming Taskforce on Nature-related Financial Disclosures will shed light on nature risks in the financial sector and align broader financial flows with nature objectives.

Sources: IPBES. 2019. "Global Assessment Report on Biodiversity and Ecosystem Services of the Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services." E. S. Brondizio, J. Settele, S. Díaz, and H. T. Ngo (eds). Bonn: Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services Secretariat. <https://ipbes.net/global-assessment>. Griscorn, Bronson W., Justin Adams, Peter W. Ellis, Richard A. Houghton, Guy Lomax, Daniela A. Miteva, William H. Schlesinger, et al. 2017. "Natural Climate Solutions." *Proceedings of the National Academy of Sciences* 114 (44): 11645–50. <https://doi.org/10.1073/pnas.1710465114>. World Bank. Forthcoming 2021. "The Changing Wealth of Nations 2021: Managing Assets for the Future." Washington, DC: World Bank.

## Support for National Policies and Strategies

The WBG will support countries in implementing their NDCs and in developing new or updated plans by 2025. NDCs are often the clearest articulation of how a country plans to reduce emissions and adapt to the impacts of climate change within its own development context and offer an opportunity to integrate NBS as part of both mitigation and adaptation action. A February 2021 review of updated NDCs found that although they have improved in quality and ambition, they

collectively still fall far short of the mitigation and adaptation needed to meet the goals of the Paris Agreement.<sup>19</sup>

Countries have also been invited under the Paris Agreement to communicate long-term low-emissions development strategies to mid-century. Long-Term Strategies (LTSs) can inform near-term decisions by outlining a country's future development trajectory and the policy direction and institutional strengthening needed. Where they exist, LTSs, together with NDCs, will inform WBG country diagnostics, including SCDs and CCDRs.

As NDCs and LTSs will play an increasingly important role in the context of Paris alignment, the quality and consistency of these documents is of heightened importance. The WBG will provide funding, technical support, and frameworks to ensure these plans are ambitious, comprehensive, and appropriate—considering development priorities for poverty reduction and physical risks from climate change—and will support countries to align NDCs and LTSs so they are mutually coherent and consistent. Translating specific national climate targets into investment plans can help unlock public and private investment for climate action. To support the private sector, IFC is currently piloting the assessment of high climate impact projects to determine whether they are aligned with NDCs. Based on the pilot, IFC will seek to apply the lessons from these assessments to other similar projects. MIGA is also assessing alignment with countries' NDCs and LTSs for high-climate-impact projects.

Fossil fuel-dependent economies are highly exposed to transition risks from global decarbonization. Fossil fuel-dependent countries face financial, fiscal, social and macro-structural risks from the transition of the global economy away from carbon-intensive fuels. The policy and investment choices to be made in the next decade will determine these countries' degree of exposure and overall resilience.<sup>20</sup> Through its support for NDCs and LTSs, the WBG recognizes national circumstances and development priorities, while making sure that clients have the opportunity to benefit from a wide range of viable and sustainable solutions that support both climate and development. These solutions include carbon capture and storage and circular economy approaches that spur growth and lower exposure to lock-in and other transition risks.

The WBG will also support countries in implementing and/or updating National Biodiversity Strategies and Action Plans (NBSAPs) or similar national plans covering terrestrial and marine biodiversity. NBSAPs focus on a wide range of measures, including integrating actions or policies related to biodiversity into broader development processes or policies and establishing mechanisms to address main drivers of biodiversity loss; ecosystem-level conservation; and crucially, conservation and restoration to improve resilience to climate change and mitigation potential.

NBS, including green infrastructure, will play a critical role in meeting the climate challenge, and the WBG is working to scale up the adoption and integration of these next-generation solutions into sustainable investments. NBS that use ecosystem-based approaches and hybrid "green-gray" interventions are critical tools for addressing climate adaptation and mitigation challenges while driving biodiversity and ecosystem services.<sup>21</sup> The World Bank is working to scale up its work on NBS through the development of a dedicated global program that will strengthen support to governments and Bank teams. This will translate down the line into greater IDA and IBRD investments dedicated to NBS addressing climate challenges.

IFC and MIGA will scale up private sector investment that integrates climate risk management measures and supports adaptation and resilience.<sup>22</sup> Given the critical role of biologically diverse ecosystems in adaptation and resilience, protecting biodiversity, including through NBS, is key. It is important that the private sector develop sustainable business models that accurately reflect this and protect and enhance these systems. IFC will develop new approaches and business models to expand its biodiversity finance and help catalyze private financing in its client markets, including through the development of a taxonomy of biodiversity-related investment activities. MIGA is integrating ecosystem services valuation into its climate risk screening framework. The approach will allow MIGA to demonstrate to its clients the costs and benefits (avoided losses) yielded from the protection of natural capital.

## ALIGNMENT WITH THE PARIS AGREEMENT

The WBG will align its financing flows with the objectives of the Paris Agreement. The WBG defines alignment as the provision of support to clients in a way that is consistent with low-carbon and climate-resilient development pathways, aligned with the objectives of the Paris Agreement, and consistent with client countries' NDCs, LTSs, or other national climate commitments. Where these commitments are absent, the WBG is committed to supporting their robust development. Because the Paris Agreement recognizes that countries have different circumstances and gives countries latitude in the pathways they choose, our support to countries and to private clients respects individual needs and circumstances in integrating climate and development. The WBG is committed to leading on the development of methods and metrics needed to close the gap and make Paris alignment a reality.

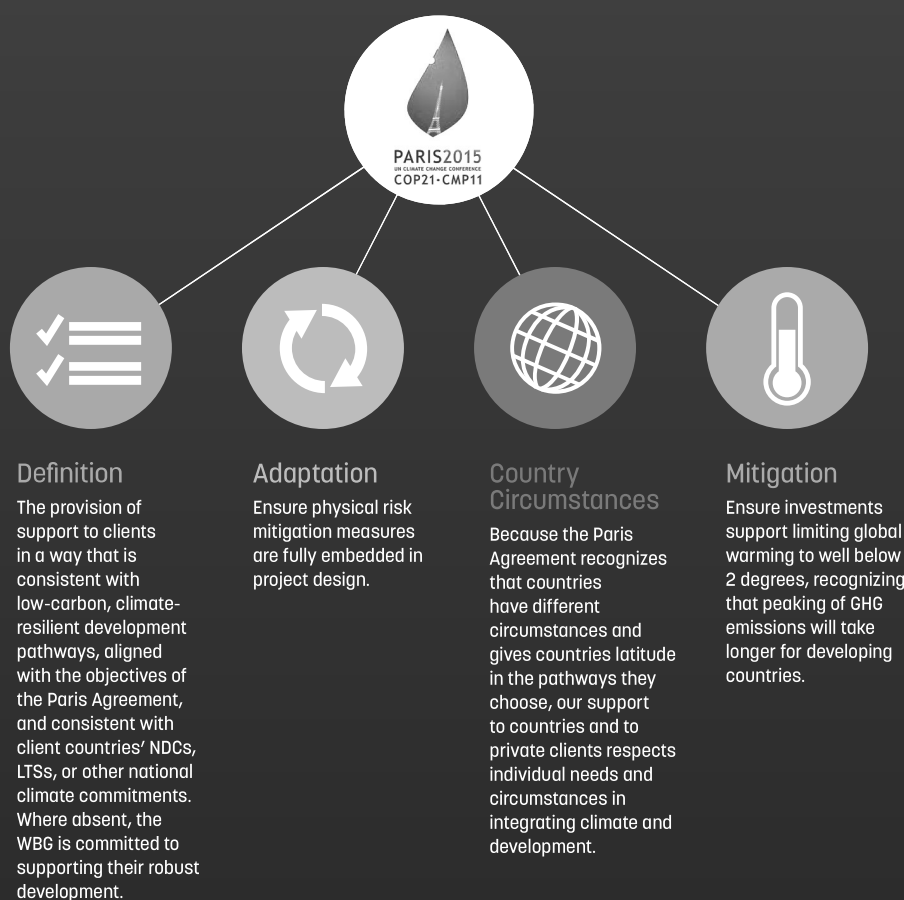
The WBG will align all new operations starting July 1, 2023 (FY24).<sup>23</sup> For IFC and MIGA, 85 percent of Board approved *real sector* operations will be aligned starting July 1, 2023, and 100 percent of these starting July 1, 2025, two fiscal years later. To achieve this, both institutions will begin aligning 100 percent of their projects at the concept stage well ahead of July 1, 2023. Once a methodology for financial institutions and funds is finalized among MDBs, a similar approach will be taken for this business as well. The WBG is developing rigorous methodologies to assess alignment. The WBG is testing methodologies for investment lending projects, jointly developed with other MDBs, and developing new methodologies for other financing instruments, including policy-based lending and investments in financial institutions and funds. We will roll out alignment across the WBG, including guidance and training at the sector level, and ensure convergence with the new CCDRs and with our existing climate commitments. As a whole, the WBG will present an approach for implementation of our commitment to Paris alignment at COP26 in November 2021.

Paris alignment assessments determine whether an activity advances, hinders, or is neutral to, the attainment of the goals of the Paris Agreement. Financing that is aligned from a mitigation perspective must support or not hinder efforts to limit global warming, recognizing that peaking of GHG emissions will take longer for developing countries. An operation is considered aligned when (i) on climate mitigation, it actively contributes to decarbonization pathways (e.g., renewable energy) or supports activities that do no harm (e.g., education system reform); and (ii) on climate adaptation and resilience, it fully addresses climate risks. Operations that neither harm nor contribute to climate outcomes are considered aligned so long as they fully address any exposure to climate risks and are not inconsistent

with country policies on low-carbon, resilient development. Operations that are considered universally non-aligned include the mining of thermal coal, electricity from coal, extraction of peat, and electricity from peat. The WBG also announced in 2017 that it will no longer finance upstream oil and gas projects starting in 2019; it has not financed any oil pipelines since 2014. This approach will continue during the period of the Action Plan and into the future. Natural gas investments may be considered aligned in countries where there are urgent energy demands and no short-term renewable alternatives to reliably serve such demand. Accounting for unique national circumstances, all WBG investments in new gas infrastructure will be assessed for consistency with NDCs, LTSs, or other national development strategies, and will aim to ensure they do not lead to long-term carbon lock-in, among other considerations.

**FIGURE 7: The WBG will be Aligned with the Paris Agreement**

- The World Bank will align all new operations starting July 1, 2023 (FY24).
- For IFC and MIGA, 85 percent of Board-approved real sector operations will be aligned starting July 1, 2023, and 100 percent of these starting July 1, 2025, two fiscal years later. Once a methodology for financial institutions and funds is finalized among MDBs, a similar approach will be taken for this business as well.





**FIGURE 8: Ambitious New Climate Finance Targets and Commitments**

- WBG climate finance target of 35% on average in FY21-25 for clients in support of green, resilient, and inclusive development. WBG will develop new products and platforms to mobilize climate finance at scale.

**WBG Climate Finance (%):**

**26% → 35%**  
 FY16–20 average delivered      FY21–25 target

**Targets are ambitious given:**

- composition of our financing portfolio;
- low per capita income levels of client countries and other development priorities for which they must borrow;
- private capital investment constraints in emerging markets;
- increased focus on IDA and FCV countries.

**WBG Climate Finance (\$ billion):**

**\$16.7** FY16–20 annual average  
**\$21.4** FY20

## CLIMATE FINANCE AND IMPACT

With this Climate Change Action Plan, the WBG commits to achieve an average of 35 percent of climate finance for the entire WBG over the five years of 2021–2025,<sup>24</sup> up from a target of 28 percent by 2020. We will also accelerate the mobilization of public and private sector finance for climate and help increase access to concessional multilateral climate finance for our client countries. At least 50 percent of IDA and IBRD climate finance will be for adaptation, while IFC and MIGA will endeavor to scale up private sector climate finance for adaptation. These targets are ambitious given: (i) the composition of our financing portfolio, which includes significant support for human development, which involves lower levels of climate finance than other sectors such as infrastructure; (ii) the low per capita income levels of our client countries and the development priorities for which they borrow; (iii) the difficult years of recovery anticipated following the COVID-19 pandemic; and (iv) private capital investment constraints in emerging markets as a result of COVID-19.

For almost a decade, the climate finance metric has helped mainstream climate action across the WBG. Climate finance measures the share of financing (an input) that can be attributed to activities or policies that reduce or sequester GHG emissions (mitigation) or to reduce vulnerabilities and enable project beneficiaries to adapt to impacts of climate change (adaptation). This standardized system, which the WBG developed jointly with other MDBs, also facilitates comparison with similar institutions. An expanded definition of climate finance, to include a wider definition of green or sustainable finance, would make our achievements much higher than reported climate finance.

The increase in adaptation financing—to at least 50 percent of IBRD and IDA commitments over the five years of this Plan—will support a range of activities that reduce vulnerability. In line with the strategic directions set in the WBG Action Plan on Climate Change Adaptation and Resilience, these activities include delivering high-quality forecasts, early warning systems, and climate information services to better prepare people for climate risks; planning for management of floods and droughts; supporting river basins with climate-informed management plans and improved river basin management governance;

building more climate-responsive social protection systems; and supporting efforts to respond early to, and recover faster from, climate and disaster shocks through additional financial protection instruments.<sup>25</sup>

Beyond climate finance, the WBG reiterates its commitment to:

- » Include climate and disaster risk screening in all World Bank financing to identify short- and long-term risks to development projects, policies, and programs. All IFC and MIGA investments and guarantees will be screened for physical climate risk by the end of FY23.
- » Incorporate at least one climate indicator, to monitor and track climate results, in all IDA and IBRD operations with over 20 percent climate finance.<sup>26</sup>
- » Conduct GHG accounting in all WBG investment financing operations where methodologies are available and use a shadow price of carbon in the economic analysis.<sup>27</sup>

The WBG is committed to collaborating with public and private sector partners to ramp up climate finance in ways that deliver the most results. Recognizing the limitations of climate finance as a metric that focuses only on inputs, and in addition to measuring our alignment with the goals of the Paris Agreement and expanding our focus on indicators to track results, the WBG will also use new metrics to better capture impact. To date, this includes measuring: (i) the resilience of our operations to physical climate shocks—for example, through resilience ratings being piloted under IDA19 that measure the resilience of a project’s design, expected performance given identified climate risks, and contribution of the project to building wider resilience for beneficiaries; and (ii) our clients’ actual results, including GHG emissions reductions. Where relevant, the WBG will be investing additional resources in data analytics and measurement in order to enhance the results orientation of the Action Plan.