

# Climate-smart Public Financial Management MENA Conference

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# Climate-smart and green budgeting

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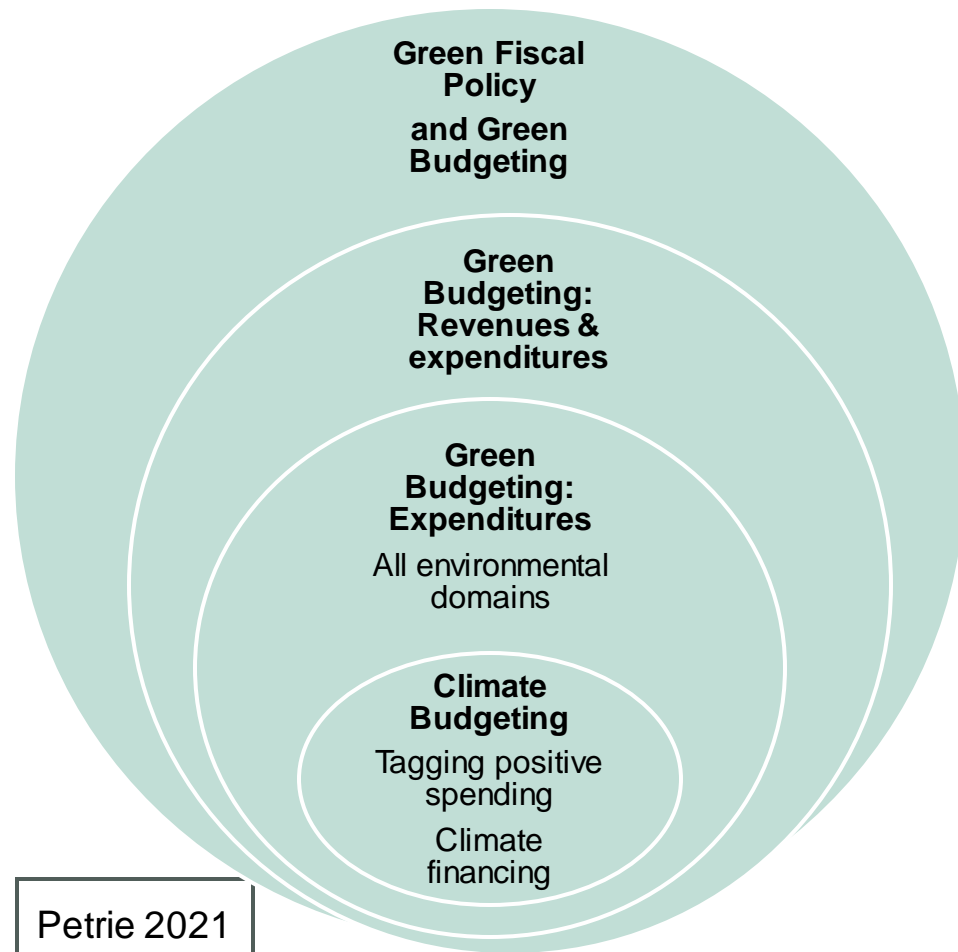
# Overview



1. Mainstreaming climate policies through fiscal policy and the annual budget cycle
2. The evolution of climate and green budgeting
3. Entry points for climate budgeting
4. Key points



# 1. Mainstreaming: clarifying some terms



- Climate budgeting: identifying and reporting climate-related public spending
- Green budgeting: the use of the *budget process* to help drive improvements in the alignment of fiscal policies with environmental goals (OECD 2017). Includes revenues, expenditures, assets, liabilities, public investment management, coordination with public corporations and Subnational Governments (SNGs).
- Green fiscal policy: actual fiscal policy settings, such as levels of taxation, the design of spending programs are outside the scope of climate/green budgeting.

# Why the annual budget cycle really matters for climate action

- The budget is government's key cross-sector policy coordination instrument. Environmental regulation is important but there is no equivalent comprehensive annual regulatory policy cycle.
- National Development Plan projects must be implemented through the budget process.
- There are increasingly important interactions between fiscal policy and the environment, positive and negative.
- The Environment Ministry has limited reach across government/public sector.



## 2. The evolution of climate/green budgeting: key developments



- From 2010 interest emerged in climate budgeting by Middle and Low-Income Countries especially in Asia-Pacific, with UNDP and WB support: tag spending favourable for CC to attract international climate finance/green bonds
- 2014 World Bank Climate Change and Institutional Review Sourcebook, and country assessments with UNDP.
- 2017 Paris Collaborative on Green Budgeting
- 2019 Coalition of Finance Ministers for Climate Action
- 2020 Draft PEFA Climate Public Financial Management framework published for piloting

# The evolution of climate/green budgeting: selected countries

Stage in PFM cycle	Selected country examples
<p><b><i>Strategic planning and fiscal framework</i></b>            National development plan with environmental goals/targets            Macro-economic model incorporating climate aspects.            Environmental tax reform</p>	<p>China, Indonesia, Ireland, Nepal            Denmark            14 OECD countries</p>
<p><b><i>Public investment management cycle</i></b>            Climate-Aware Public Investment Planning            Climate change cost-benefit analysis            Environment-related transfers to SNGs            Climate-sensitive oversight of public corporations            Auditing of project climate impacts</p>	<p>Nepal            Thailand, UK            Brazil, China, India            France            Bangladesh, UK</p>
<p><b><i>Budget preparation</i></b>            Climate expenditure tagging            Comprehensive green expenditure tagging            Carbon pricing            Earmarked revenues from carbon tax/ETS for green spending            Regular review of environmentally harmful tax expenditures</p>	<p>Bangladesh, Kenya, Nepal            France            39 national jurisdictions            Numerous countries            12 OECD countries</p>

Adapted and updated from Petrie 2021



# The evolution of climate/green budgeting: selected countries (2)

Stage in PFM cycle	Selected country examples
<p><b><i>Budget approval</i></b></p> <p>Mandatory disclosure of climate effects of new policies            Fiscal risk statements incorporate environmental risks.            Performance budgeting in environment sector</p>	<p>France, Norway, Scotland            Philippines, Nepal, UK            Italy, South Africa</p>
<p><b><i>Budget financing</i></b></p> <p>Sovereign green/sustainability bonds            Climate-related disaster contingent financing            Debt for nature swaps</p>	<p>55 countries            Jamaica, Indonesia            Barbados, Belize, Seychelles</p>
<p><b><i>Budget execution</i></b></p> <p>Green procurement            Reporting to green bond holders on spending and impacts</p>	<p>China, Japan, South Korea            Numerous</p>
<p><b><i>Oversight and accountability</i></b></p> <p>Environmental audits            Public engagement on climate change adaptation spending            Public engagement on carbon tax</p>	<p>Bangladesh, Canada            Indonesia, Nepal, Bangladesh            Canada, South Africa</p>

Adapted and updated from Petrie 2021





# OECD countries are adopting green budgeting rapidly (OECD 2023)

- The most used green budgeting methods and tools were:
  - carbon pricing (22 countries, 12 in 2021)
  - environmental impact assessments (18 countries)
  - sovereign green bonds (18 countries)
  - environmental tax reform (14 countries)
  - green budget tagging (13 countries, up from 7 in 2021)



### 3. Entry points for climate budgeting.

- Depend very much on individual country circumstances, including GHG emissions profile and levels and types of exposure to climate change physical and transition risks
- Advice is to start with the upstream stages of the PFM cycle before working on budget execution, reporting and audit (IMF 2022).
- Important common entry points include:
  - ❑ Incorporating climate goals in medium-term fiscal frameworks
  - ❑ Climate-sensitive public investment management
  - ❑ Greening the Budget circular
  - ❑ Climate-aware Budget review
  - ❑ Climate budget tagging
  - ❑ Program budgeting



# Incorporating climate goals in medium-term fiscal frameworks



- Medium-term fiscal strategy should refer to climate targets and objectives, and to climate-related fiscal risks.
- Sectoral medium-term strategic plans should reflect priorities from national climate change policy and strategy and NDC targets.
- Sectoral medium-term investment plans with targets and prioritized and costed climate related projects.
- Medium-term budget estimates identify climate-related funding gaps and funding sources.

# Climate-sensitive public investment management

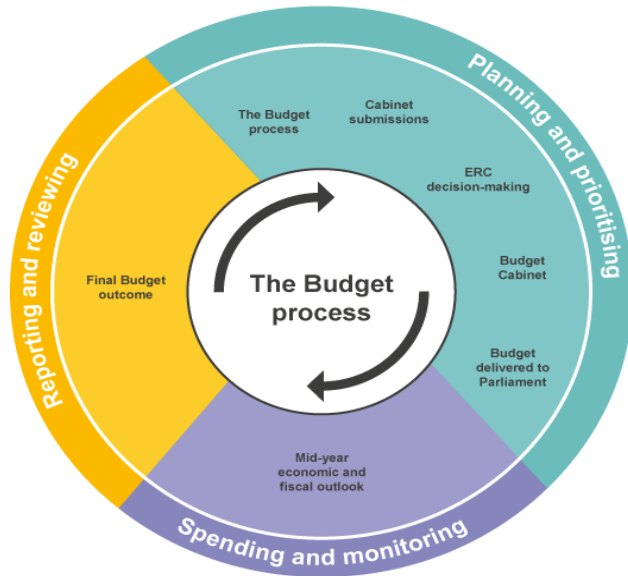
1. The Climate Module of the IMF's Public Investment Management Assessment (C-PIMA) introduced to assess the degree of climate sensitivity in the planning and implementation of public infrastructure projects with subsequent assessments of country practices (IMF 2021).

The C-PIMA covers:

1. Project planning
  2. Coordination across central government, SNGs, and public corporations
  3. Project appraisal and selection
  4. Budgeting and portfolio management
  5. Risk management
2. See also World Bank Reference Guide for Climate-Smart Public Investment, 2022.



# The Budget Circular



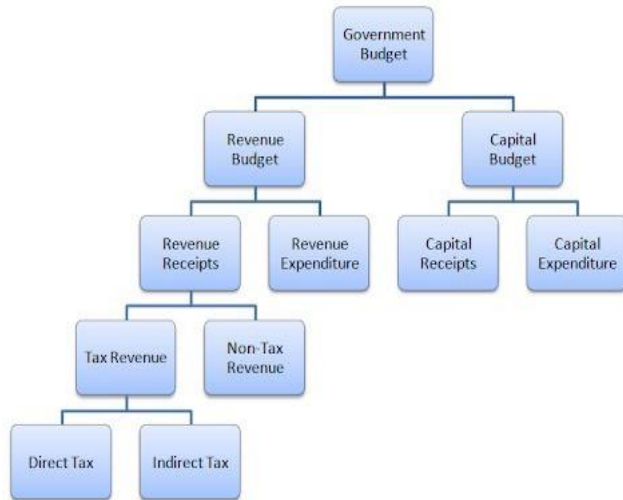
1. The annual Budget Circular is a key tool to promote the integration of climate in fiscal policies and the budget process.
2. The Circular should:
  - Refer to national climate change strategies for adaptation and mitigation as criteria for prioritization of new spending.
  - Contain guidance on how to factor climate change adaptation and mitigation planned expenditures into budget proposals.
  - Where climate budget tagging is in place, it should provide a methodology to track climate change related expenditure.

# Climate-aware Budget review

1. Inclusion of CC adaptation and mitigation in prioritization and selection criteria for budget.
2. New budget spending and tax proposals - including tax-expenditures, subsidies, and transfers - should be reviewed for climate impacts and resilience. Analyse most cost-effective means of achieving CC policy goals.
3. Include climate resilience and impacts in budget negotiations.
4. Advice to Cabinet on the anticipated climate impacts/resilience of the next budget; and on fiscal risks from climate change.
5. Periodically review the on-going budget baseline, focusing on most climate-negative and climate-sensitive components.

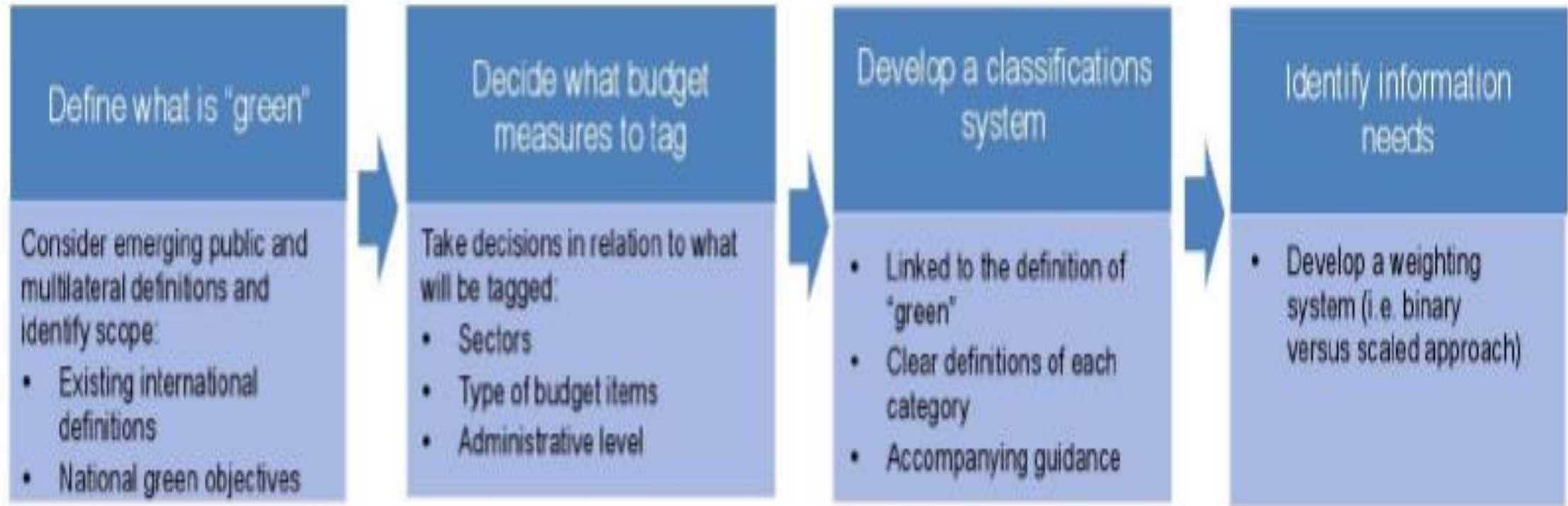


# Climate budget tagging (CBT): what is it and why do it?



- Tagging is the designation of spending allocations that have a common policy purpose, but which are not reflected in, and cut across existing expenditure classifications (e.g., administrative, functional, program, project classifications) e.g., gender budgeting, tagging the UN SDGs
- ‘CBT is ‘A government-led process of identification, measurement, and monitoring of climate-relevant [green] public expenditures’ (World Bank 2021).
- CBT may be wanted for several reasons:
  - To signal priority and raise awareness of climate change
  - To introduce link between climate strategies and targets and resource allocation
  - To set performance expectations and associated accountabilities
  - To attract new financing e.g. green sovereign bonds

# Schematic approach to tagging - OECD





# Climate budget Tagging: diversity of country approaches (drawn from World Bank 2021)

Country and year introduced	Definition of climate relevant	Coverage	Investment and current spending	Method for estimating climate relevant share	Sub-national government spending	How tagged	Who tags	In budget docs
Nepal 2013	Policy based	All sectors, MDAs	Investment only	Program element	✓ (block grants)	Manual	Line agency	✓
Cambodia 2013	Rio-markers	All sectors, MDAs	Both	Relevance weight		Manual	Centralized	
Indonesia 2014	Rio-markers, indicative list	All sectors, MDAs	Both	Program element	✓	IFMIS	Line agency	✓
Philippines 2015	Objective and policy based	All sectors, MDAs	Both	Program element	✓	IFMIS	Line agency	✓
Pakistan 2017	Policy based	Selected	Both	Relevance weight	✓	IFMIS	Centralized	
Bangladesh 2018	Policy based	Selected	Both	Weight and cost	✓ (transfers)	IFMIS	Centralized	✓

# Benefits from tagging (World Bank 2021)

1. Climate tagging does increase the awareness of climate change issues in central finance and line agencies.
2. Climate tagging helps communicate a government's commitment to climate change action, enhances transparency, and enables accountability.
3. It is unclear to what extent climate tagging informs and has an impact on program design.
4. There is mixed evidence on the impact of climate tagging on resource allocation.
5. The identification of climate-relevant programs can help mobilize funding from external sources.



# Challenges in tagging (World Bank 2021)



1. CBT has focused on expenditures, with inadequate consideration given to revenues as a climate policy tool and to tax expenditures as alternatives to direct expenditures.
2. Until very recently, tagging methodologies ignored expenditures on activities that have an adverse impact on climate outcomes.
3. CBT —as currently practiced—puts too much emphasis on quantification of climate-related expenditures, with inadequate consideration of policy alignment, efficiency, effectiveness.
4. CBT is often constrained by the limitations of the budget system. Tagging is only practicable where budget classifications identify programs and projects and is most effective when budget classification allows tagging at the level of components, activities, and outputs.
5. There are significant omissions in the coverage of many tagging methodologies.
6. Tagging can represent a significant burden on budget officials.

# Lessons learned from climate budget tagging

(World Bank 2021)

1. Define the objectives of the climate CBT initiative and consider alternatives.
2. Define the policy scope of the tagging methodology.
3. Engage key institutional stakeholders in the design and implementation of CBT.
4. Ensure that line agencies are actively involved.
5. Align definitions of climate-relevant activities and expenditures with national climate change policies and strategies
6. Identify and tag activities and expenditures that have adverse climate impacts as well as activities that are aligned with climate policy goals.
7. Structure the tagging methodology so that it supports the implementation of national climate policy.



# Program budgeting to support climate change policy goals



1. Program budgeting greatly facilitates CBT
2. Climate related objectives, key performance indicators, outputs and outcomes should be assigned to climate related programs and activities.
3. KPIs should be consistent with those established in the national climate change strategy/plan.
4. Performance information should be included in budget documentation submitted to the legislature and published.
5. Performance reports should contain actual performance against plans.

## 4. Key points



1. Aim should be to mainstream climate change in the budget process, not set up a parallel exercise that does not influence decision making.
2. Country circumstances important, but generally start on upstream stages of the PFM cycle, including PIM (incorporating oversight of public corporations and SNGs).
3. Coordinate across government – MOF, Planning, Environment Ministry.
4. Be aware of implementation burdens, take advantage of planned PFM reforms (e.g., program budgeting, medium term budgeting), pilot new initiatives.

# THANK YOU

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