

‘Smart Fiscal Policy for Climate Action in the Caribbean’ Summary of Workshop Presentations

January 21-23, 2019 | Basseterre, St. Kitts

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This document summarizes presentations by World Bank and IMF staff at the workshop entitled, ‘Smart Fiscal Policy for Climate Action in the Caribbean’. The workshop took place on January 21-23, 2019 in Basseterre, St. Kitts & Nevis. Attendees included representatives from finance ministries of Antigua, Barbados, British Virgin Islands, Curaçao, Dominica, Guyana, Grenada, Haiti, Jamaica, Montserrat, Saint Kitts & Nevis, Saint Lucia, Saint Vincent & the Grenadines, Trinidad & Tobago, and Turks & Caicos Islands, in addition to officials from the OECS, CDB, ECCB, CARTAC, World Bank, and IMF.

Day 1 – January 21, 2019

Fiscal instruments to fight climate change: an overview - Miria Pigato, MTI Climate Lead, WB

The first session of the first day argued that Ministries of Finance are essential to deliver efficient and equitable responses to climate change. The Caribbean region is highly exposed to climate-related natural disasters. However, it invests very little in adaptation and resilience, and current policies do not sufficiently address environmental degradation. As the World Bank's recent report '[Fiscal Policies for Development and Climate Action](#)' showed, fiscal instruments - taxes and public spending - are key for moving to low-carbon growth and for ensuring a fair distribution of the associated costs and benefits. The session discussed the economic rationale for introducing environmental taxation. It argued that taxing carbon improves efficiency, provides incentives to develop low-carbon energy alternatives and can also raise revenues. Environmental tax reforms – which allocate the revenues from environmental taxation to lower other taxes or increase spending, while compensating producers and consumers most affected by the changes in energy prices – are likely to yield a 'double dividend' of higher economic activity and benefits to human wellbeing in developing countries. The session also highlighted the importance of preventive policies to adapt to climate change, build economic and financial resilience, including through ex-ante financing arrangements, fiscal buffers, and insurance. Some participants were skeptical about introducing mitigation policies, given the region's insignificant contribution to global emissions, but agreed on the need for international support to face the financial consequences of disasters and to build resilience. The session ended with a discussion on an 'ideal' fiscal package to balance environmental and growth objectives.

Benefits Beyond Climate: Environmental Tax Reform - Simon Black, Economist, WB

The second session went into more depth on 'Environmental Tax Reform' (ETR), arguing that such reforms can help countries achieve both environmental and development objectives. Environmental tax reforms (ETR) are policy packages which raise taxes on polluting activities and use the revenues to either reduce taxes on non-polluting activities (like labor) or increase spending on things like public infrastructure, health, education, or social safety nets. Building on two decades of academic literature, ETR was shown to be even more desirable in developing countries than in developed countries, for three broad reasons. First, ETR is more likely to increase economic activity in developing countries, notably because ETR could help reduce informality – a pervasive problem in developing countries. Second, ETR tends to yield 'development co-benefits', such as improvements in human health from improved air and water quality, alongside reduced congestion and road accidents. These co-benefits tend to be much greater in developing countries, where approximately 90 percent of early deaths from air pollution and road accidents occur. Third, environmental taxation tends to be more progressive in developing countries, meaning ETR can help countries achieve shared prosperity. Lastly, ETR was shown to be highly adaptable, including to the Caribbean's context of high energy prices and low emissions. Feebates, which combine fees on polluting products which are rebated to less-polluting products, can be used in the Caribbean on

cars and imported goods to drive efficiency, thereby reducing or slowing reliance on imported fossil fuels. Combined with output-based rebates in the power sector, such an ETR could help Caribbean countries raise electricity output while reducing prices and emissions.

Climate Change and Fiscal Risks - Sudarshan Gooptu, Lead Economist

This session discussed the increasing fiscal risks in the Caribbean due to climate change and the need to assess and incorporate such risks, and commitments they result in, into fiscal policy. Given the increasing vulnerabilities from the increasing number and greater intensity of natural disasters that the Caribbean region is facing of late coupled with the sea level rise that is increasing uncertainty of climate outcomes, attention to the fiscal impacts of climate action has become an urgent imperative. So, this session highlighted the need for Ministries of Finance to better incorporate the fiscal commitments they make today, whether explicit or implicit, and the fiscal risks they pose into their fiscal policy and public investment decision-making. The session defined the sources of these fiscal risks and introduced practical analytical tools that have been developed (including those in collaboration with the IMF), and are being used by the World Bank operational teams to help Ministries of Finance to assess the fiscal impacts and risks associated with contingent liabilities, such as those related to natural disasters. Examples of the systematic fiscal risks assessment that were undertaken recently by World Bank staff for Dominican Republic and Jamaica were presented. A group exercise aimed to emphasize that climate-related fiscal commitments, for example those associated with building climate-smart infrastructure using public-private partnership arrangements, should be analyzed in the context of the Government's overall Fiscal Risks Matrix and fiscal sustainability considerations over time and under uncertainty. Scenario analyses and stress tests are imperative for arriving at appropriate ways to mitigate and manage these fiscal risks over the life of the projects being considered.

Fiscal Aspects of Adaptation and Resilience – Carter Brandon, Lead Economist, WB &

This session emphasized that the financing gap for climate change adaptation is large and growing, focusing on the broad barriers to financing adaptation, in both the public and private sectors. The costs of climate change keep rising, which underscores the need for good planning and removal of non-financial barriers, improved risk assessment, good valuation of costs and benefits, and early adaptation. There is a need to expand the level of funding, ease of access, and effectiveness of climate adaptation finance. To close the financing gap, diverse private, public, and blended (including PPP) financing approaches are all needed. Financial instruments range from investments in risk reduction (such as in more resilient infrastructure) to risk management (such as contingency finance, insurance, safety nets, or other disaster relief instruments). The presentation touched on supply and demand issues for each instrument and sub-market, providing a mapping of private and public costs and benefits. In summary, the presentation showed how adaptation projects can be assessed in a cost-benefit framework that brings out development benefits as well as avoided losses, concluding that for countries to access international concessional finance good underlying financial and economic analysis is needed to be competitive.

Climate Change, Fiscal Impacts and the Power Sector – Neha Mukhi, Senior Climate Change Specialist, WB

This session highlighted the potential fiscal impacts resulting from climate change impacts on power sector, with recent data from the Caribbean countries. It underscored the importance of climate-informed sectoral planning as an input from line ministries to the finance ministry for budget planning and financing resilient infrastructure. The presentation summarized instruments that countries can use for: (i) ex-ante resilience financing (risk reduction); and (ii) ex-post recovery financing (contingent financing, risk transfer through insurance and catastrophe bonds, etc.). The presentation underscored the need for increased focus on ex-ante resilience financing as a means for reducing vulnerability of infrastructure to climate change and natural disasters impacts, thus lowering the risk of linked fiscal impacts. Further, it laid out the approach for climate-informed power sector planning to identify and plan for risk reduction investments and estimate the additional financing needed for making infrastructure resilient. This was illustrated using the ongoing World Bank engagement with Eastern Caribbean countries and prior work in Bangladesh.

Day 2 - January 22, 2019

Climate Change and Debt Sustainability – Diego Rivetti, Senior Debt Specialist, WB

The first session of day 2 explored the link between climate change and debt sustainability. This topic is particularly relevant for the Caribbean region, given the high level of public debt and the vulnerability to natural disasters in most of its countries. The WB/IMF debt sustainability frameworks for low-income countries (LICs) and market-access ones (MAC) allow for an analysis of the impact of natural disasters, through a customization of macro variables and stress test scenarios. However, the participants highlighted that debt sustainability analysis (DSA) is, at present, not systematically conducted by Ministries of Finance across the region. A solution to this could be increasing levels of technical assistance, possibly coupled with the provision of simplified tools for conducting DSAs.

Climate Change Policy Assessments (CCPAs) in the Caribbean - Leo Bonato, Deputy Division Chief, IMF & Daniel Leigh, Deputy Division Chief, IMF

This session provided an overview of Climate Change Policy Assessments (CCPAs) conducted jointly by the IMF and World Bank, showing how they can help inform climate fiscal policy in Caribbean countries. A comprehensive strategy to build resilience to natural disasters and climate change, consistent with debt sustainability, requires reliable estimates of the costs and benefits of adaptation. The experience to date with Climate Change Policy Assessments, a diagnostic tool prepared by the IMF in collaboration with the World Bank, shows that Caribbean countries have developed plans to make progress on their NDC mitigation pledges, but their adaptation plans are much less articulated. Nevertheless, it was noted that a priority list of costed projects is key to define the expenditure envelope. The IMF noted that it is currently

working on: (i) new CCPAs (Grenada); (ii) integrating the findings from CCPA pilots into its surveillance activity (St. Lucia, Belize); and (iii) estimating the benefits of building resilience, both in terms of structural protection (investment in resilient infrastructure, crops, fisheries, tourism, land use planning and management, etc.) and financial protection (insurance, self-insurance, and other financial tools) on growth and public finances (St. Lucia, Belize, ECCU). The results so far show significant long-term benefits as opposed to substantial medium-term costs. The financing gap requires efforts by countries to create fiscal space, in addition to support from the international community.

*Integrating Climate Change into National Budgeting and Public Investment Management –
Weijen Leow, Senior Financial Specialist, WB*

This session focused on entry points for introducing climate change considerations into planning and public spending processes. The workshop presented strategies for mainstreaming national climate policy into sector work programs, as well as sector budget preparations. Climate-informed tools can also be introduced to enhance the Public Sector Investment Program, where most capital spending is allocated, including climate-informed cost-benefit analysis using stochastic risk models. The ability to identify and track climate expenditure over time is an important building block for enhancements to the budget cycle. It serves as one measure of policy implementation and progress, when combined with performance indicators and reviews, and can reveal gaps or overlaps in resource allocation. Climate public expenditure reviews can reveal areas of improvement in the budgeting and institutional arrangements for pursuing climate goals, and is a recommended place to start for countries. Other good practices in climate budgeting include issuing clear and early signals through the budget call on how climate change should be prioritized, with the support of high-level coordination across ministries.

Day 3 - January 23, 2019

Disaster Risk Financing - Miguel Navarro-Martin, Manager, Banking products, WB

The first session of the third and final day provided an overview of the various financing instruments available to countries which can help them lower the risks of climate change. Understanding and quantifying risks are two indispensable inputs to defining a multi-layer risk approach which combines different instruments for different layers of risk (e.g. self-insurance, contingent financing, catastrophe insurance and bonds). These products can help countries better manage the fiscal cost of disasters, ensure timely resources when disasters strike, and mitigate the long-term growth and fiscal impact of disasters. Furthermore, discussions are under way to develop specific climate-resilient debt instruments that take into consideration the specific needs and circumstances of the Caribbean countries including hurricane clauses in debt instruments to postpone debt payments for a pre-defined time period; and, parametric insurance that provides countries with immediate debt relief while opening fiscal space which could be used for reconstruction.

Sustainable Development Bonds (Green and Blue Bonds) – Miguel Navarro-Martin, Manager, Banking Products, WB

In this session, the increasingly popular ‘green bonds’ and the more recent ‘blue bonds’ were discussed. More and more large institutional and official investors, as well as millennials and other wealthy individual investors, are considering environmental, social, and governance factors as part of their investment decisions. This provides countries with a great opportunity to diversify their sources of financing and the opportunity to improve their global standing by investing those resources in green, blue, and other socially responsible projects. The World Bank, as a pioneer in this field, has helped various countries such as Malaysia, Fiji, and Indonesia issue green bonds. More recently, the Seychelles issued the first ever sovereign ‘blue bond’ for US\$15 million. The support provided by the World Bank went beyond technical assistance. The WB provided a partial guarantee of US\$5 million to reduce the price of the bond; arranged a concessional loan of US\$5 million from the Global Environment Fund (GEF) to partially subsidize the payment of bond coupons; and secured resources from the Rockefeller Foundation to pay for the costs associated with the blue bond issuance.

Debt swaps, Debt for Nature, Debt relief transactions – Diego Rivetti, Senior Debt Specialist, WB

The final session of the workshop discussed the various mechanisms through which countries have swapped debt obligations for environmental services. The session presented the technicalities of the debt-for-climate swaps (DCS), i.e. agreements to exchange part of the external debt in exchange for commitment to mobilize domestic resources to support agreed environmental programs. These instruments, particularly popular in the 90s, are now being explored by the UN to free-up budgeted resources to fund resilience projects. However, the feasibility of DCS at the regional level seems to be constrained by: (i) the heterogeneity of the national portfolios, (ii) the recent initiatives of comprehensive debt restructuring in most of the countries, and (iii) the administrative and legal changes needed for the implementation of DCS.