Fiscal Policies for Development and Climate Action

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The growing importance of climate-smart fiscal policies in the developing world

- The effects of climate change are already evident. Rising average temperatures are slowing global growth and inhibiting progress on poverty reduction and on the Sustainable Development Goals.
- Greenhouse gas (GHG) emissions in developing countries now exceed those in developed countries.
- Less-developed countries are especially vulnerable to the effects of climate change, as are poor households worldwide.
- Fiscal instruments can reduce carbon emissions in a cost-efficient manner while advancing development goals.

Meeting the challenge: mitigation, adaptation, risk management

Mitigation: measures to slow the pace and lessen the severity of climate change.

Adaptation: measures to reduce the damage caused by climate change.

Fiscal risks management: policies that strengthen fiscal preparedness, build response capacity, and promote resilience.

Environmental Tax Reform: Benefits beyond Climate

What is environmental tax reform (ETR)?

ETR combines taxes on:

- pollutants – CO2 (carbon tax), NOx, SO2, solid waste
- energy – coal, electricity, petroleum, diesel
- transportation – road, shipping & air duties, congestion

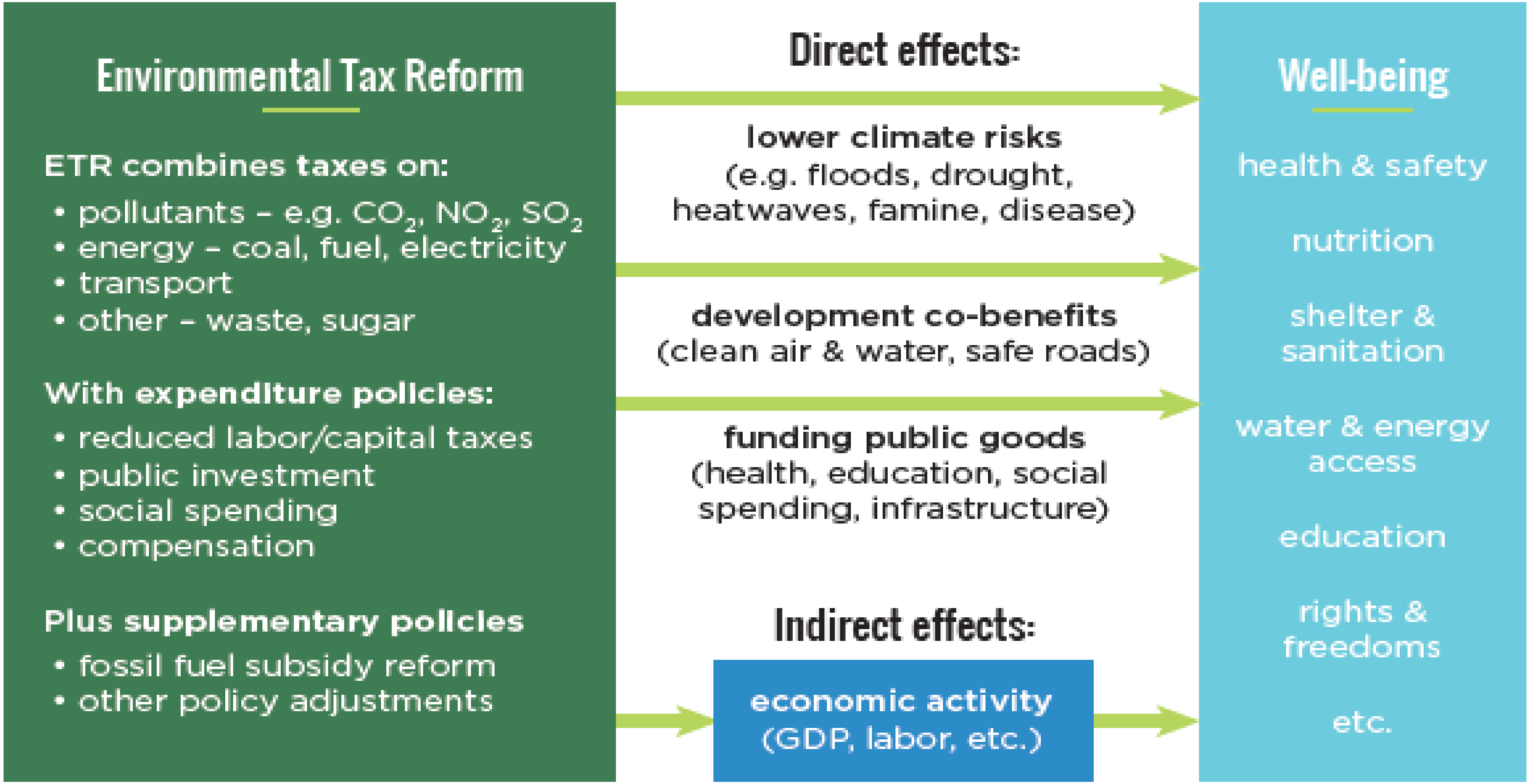
with measures to allocate the revenues:

- ➢ To lower other, more distortive taxes (e.g., labor taxes)
- ➢ Expenditure policies:
  - ➢ Investments in infrastructure, human development, or climate-change adaptation;
  - ➢ Rebates – e.g. to less polluting emitters;
  - ➢ Compensation – e.g. to bottom quintiles

and supplementary policies:

- Fossil fuel subsidy reforms
- Changes to R&D policies

ETR has direct and indirect effects on well-being



Leveraging Fiscal Policy to Support Climate-Change Adaptation

Climate change adaptation can be described as essentially "development in a hostile climate."

- Nicholas Stern

Climate change is a gradual process punctuated by extreme events

Gradual process: Some aspects of climate change, such as crop displacement and rising sea levels, have a relatively slow but progressively intensifying economic impact.

Extreme events: Climate change also increases the frequency and severity of weather-related shocks, such as hurricanes, tornados, and droughts, which can inflict severe human and economic costs in a short period of time.

Adapting to climate change requires complementary actions that build resilience to both its gradual and extreme effects

Public policies: pricing reforms, zoning measures, building codes, and other regulations that integrate climate resilience

Infrastructure investment: dikes, seawalls, irrigation and drainage networks, and other systems that reduce the damage from environmental changes and extreme weather events

Disaster management: risk analyses, early warning systems, communication strategies, and other measures to mitigate the economic and human costs of natural disasters

Financing instruments: microcredit, insurance, and other financial products designed to manage risk and promote the efficient reallocation of resources

Fiscal policy can play a key role in climate-change adaptation and disaster response

Early, preventive investments in adaptation combined with policies to maintain adequate fiscal space and ease borrowing constraints

Credible fiscal rules to avoid a procyclical fiscal response to the economic volatility generated by climate change and extreme weather events

Fiscal buffers, such as contingency funds, built up gradually and disbursed according to clearly defined criteria

A climate dimension added to the chart of accounts to allow policymakers to systematically plan, track, and manage climate-related spending

Climate-change considerations mainstreamed into the design, appraisal, and selection of public investment projects

Financial resilience: (i) ex ante financing arrangements; (ii) self-insurance, and contingent instruments; and (iii) disaster-risk insurance (e.g., parametric insurance, catastrophe bonds)

A Fiscal-Policy Package for Climate Resilience and Development

Using fiscal policy to combat climate change while accelerating development (1)

1. **Adopt policies for climate mitigation:**
   - Start with a public outreach campaign to build political support for environmental tax reforms.
   - Reduce/eliminate fossil fuel subsidies. Compensatory policies to support poor household and affected firms should be put in place. Implementation should be gradual.
   - Introduce carbon taxes or build carbon costs into existing fuel taxes, then use the revenues to reduce distortive taxes, to increase investment in adaptation/social spending and to offset the distributional and poverty effects of higher fuel taxes.
   - If carbon pricing is politically unfeasible, use other instruments (command and control policies, regulations etc.)

Using fiscal policy to combat climate change while accelerating economic growth (2)

3. Strengthen resilience by investing in adaptation, building fiscal buffers, and creating or enhancing insurance mechanisms.

- Maintain fiscal space and ease borrowing constraints.
- Invest in selected public goods (e.g. early warning systems) and build fiscal buffers
- Include climate-related fiscal risks in fiscal risk statements and budget processes
- Integrate climate considerations into all stages of the public-investment cycle
- Develop a comprehensive financing strategy for climate-change mitigation and adaptation
- Incorporate disaster-risk management into fiscal rules, medium-term fiscal frameworks, and debt sustainability analyses
- Explore innovative ways to transfer risks to markets, as well as mechanisms to pool risks at the national, regional, or international level

Thank You