Summary: COP26 Resilience Hub High-level Dialogue

How can governments from Africa, Asia and Latin America increase funding for resilience through their national budgets?

3 November 2021

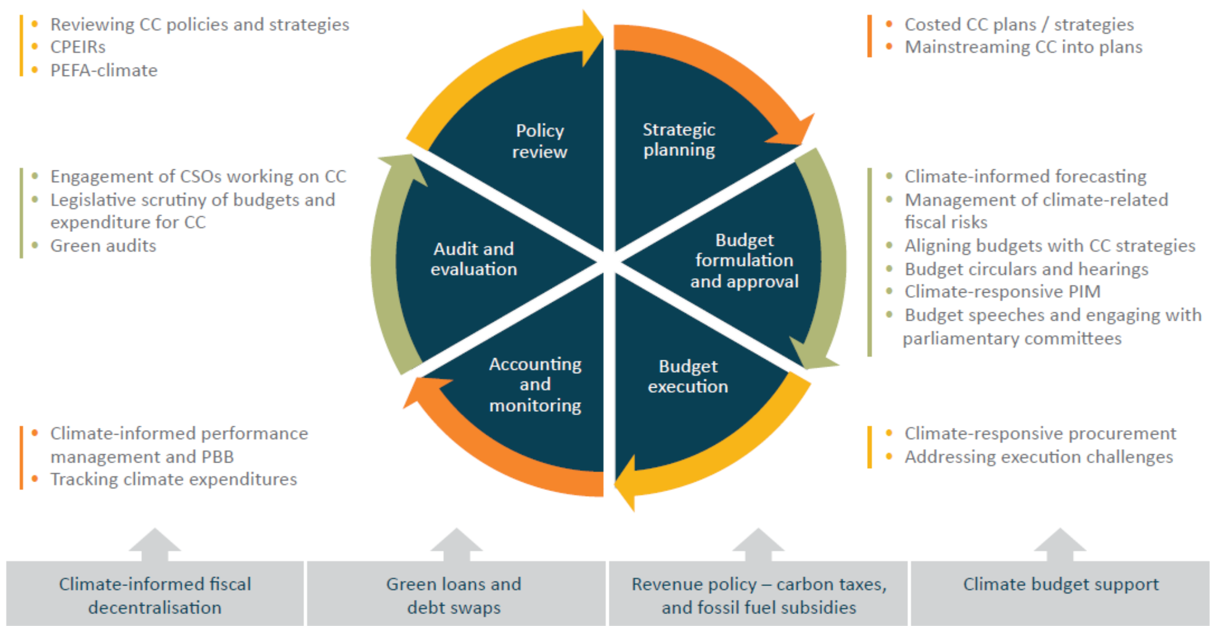
This note summarises the COP26 Resilience Hub event, held on 3rd November 2021, which explored how domestic financing through national budgets can be used to finance climate resilience[1]. The availability of climate finance is vital for developing countries who cannot be expected to pay the full cost of building climate resilience for their communities and economies. We draw on important insights from Nigeria, Mexico and Cambodia who presented their experience, alongside research institutions, regional organisations and multilateral organisations who have been supporting governments in this area.

Integrating Climate Change into National Planning and Budgeting

This session focused on how countries are starting to integrate climate change into their national planning processes and budgeting – often called Public Financial Management, or PFM. At the national level, developing country governments are finding innovative ways to do this. In addition, the countries which presented have combined climate budgeting with other cross sectoral priorities such as gender equality[2] in the case of Nigeria and the Sustainable Development Goals (SDGs)[3] in the case of Mexico. Cambodia is looking into the feasibility of introducing SDG targeting as it switches from item budgeting to programme-based budgeting.

Entry points for climate responsive budgeting or 'green PFM' go beyond the scope of the budget cycle to include other important PFM interfaces such as climate informed fiscal decentralisation, state owned enterprises (IMF, 2021), revenue policy, green loans and debt swaps (CABRI, IBP, IIED, & UNDP, 2021b), as outlined in Figure 1.

Figure 1: Entry points for integrating climate change into the budget cycle



Source : (CABRI et al., 2021b)

Climate responsive budgeting is still a new and emerging area. The most common entry point pursued by governments is the integration of climate change into policies, plans or strategies. This was true for Nigeria, Mexico and Cambodia. Some progress has been made in integrating climate change into budget formulation. In Mexico, climate change Annexes are included in the federal budget which show the allocation by ministry to climate change. This helps to provide data allowing the federal government to assess how much they are allocating to climate change.

[1] In attendance were representatives from the Office of the Presidency, Nigeria; Ministry of Economy and Finance, Cambodia; Ministry of Finance, Mexico; IMF; World Bank; UNDP; WRI; GFLAC; IIED, and CABRI.
[2] Integrating gender equality is supported by the UNFCCC Gender Action Plan.
[3] SDG 13 addresses climate action, although it is central to achieving the other SDGs.

Another key component in budget formulation relates to climate sensitive public investment management where there has been limited progress. Supported by a climate finance advisor through the NDC partnership, Nigeria is developing a climate smart strategy which will provide a catalogue of climate smart projects eligible for financing. The IMF is developing a new Public Investment Management Assessment (PIMA) climate change module which is expected to launch in December 2021. Piloting showed that governments have relatively strong planning institutions, but there is still room for progress in terms of project selection and appraisal which is key in choosing the right projects and managing fiscal risk. The Climate-PIMA will address key public investment management practices that are most critical to addressing climate change such as (i) climate aware planning, (ii) coordination across government, (iii) climate sensitive project appraisal and selection, (iv) budgeting and portfolio management, and (v) fiscal risk management.

Climate budget tagging helps to provide comprehensive data on climate change relevant public expenditure, enabling governments to prioritise climate investments. The World Bank has been supporting countries with introducing climate budget tagging reforms and highlighted that they are most successful when combined with well-developed climate change plans and used for decision making. Support is currently being provided to Nigeria for the design and piloting of their climate budget tagging reform in six States through Nigeria's State Fiscal Transparency, Accountability and Sustainability Program for Results. It will enable State governments to identify, classify and track climate change and green growth related public expenditure.

On budget oversight, transparency and accountability, regional organisations such as GFLAC and CABRI have been working to build capacity and strengthen the relationship between governments and formal and informal accountability actors. GFLAC, through the Sustainable Finance for Future Campaign, has empowered civil society organisations, academia, the youth, and other actors for climate action. CABRI, IIED, IBP and UNDP through the Inclusive Budgeting and Financing for Climate Change in Africa (IBFCCA) program, have provided a platform for knowledge sharing and capacity building on inclusive climate responsive budgeting for governments and civil society organisations in Africa. The IBFCCA program plans to engage parliament and supreme audit institutions.

Climate Change Financing

There was consensus amongst the countries present that the resources allocated through the national budget are insufficient to meet the financing needs identified to address the climate change challenge. Following the recent global recession induced by the Covid-19 pandemic, developing countries are fiscally constrained with mounting debt levels which have heightened debt vulnerabilities, increasing the number of developing countries in or at high risk of debt distress (World Bank, 2022). Yet, accessing global climate funds financing has proven challenging and requires strong PFM institutions, underpinned by the ability to clearly and transparently demonstrate policy choices (investment projects or other spending programs, ex post audit) that benefit the environment (Fouad, Novta, Preston, Schneider, & Weerathunga, 2021).

Integrating climate change into the budget process can be a way of effectively moving away from a "projectised" approach to international climate financing, supporting the shift towards externally financed budget support. This will facilitate a more strategic move towards policy-based climate interventions opposed to stand-alone projects.

Private finance and international public finance are needed to bridge the climate financing gap. Both Nigeria and Mexico have raised funds for climate change through sovereign green bonds and SDG aligned bonds respectively, as outlined in Box 1. Private climate finance will continue to be important. However, private finance is more expensive than concessional funds and grant financing from international financial institutions. Grants represent just 6% of total climate financing (Climate Policy Initiative, 2021). Countries are therefore calling on developed countries to honour the USD 100 billion annual commitment to assist developing countries with adaptation and mitigation.

Calls have also been made for the more equal distribution of climate finance. In 2020, 90.1% went towards climate mitigation, with only 7.4% dedicated to adaptation and 2.5% allocated to projects with dual benefits[4] (Climate Policy Initiative, 2021). Developed and developing countries face different vulnerabilities to climate change, with adaptation being a greater priority for developing countries due to their reliance on climate sensitive natural resources and lower adaptive capacity. The annual cost of adaptation in developing countries is estimated to range between a minimum of USD 280 to 500 billion by 2050[5] (UNEP, 2016).

Box 1: Use of Sovereign Green Bonds in Nigeria and SDG aligned bonds in Mexico

Nigeria was the first African country to successfully introduce sovereign green bonds. Since 2017, Nigeria has raised USD 84 million in sovereign green bonds through two issuance rounds. A third set of bonds are planned to be issued in 2022. Only projects in the annual national budget are eligible for funding. These projects meet the Green Bond Principles definitions of climate related activities. Subnational governments are currently working with the Nigeria Green Bonds Market for issuance in 2022.

In a bid to bring together investors with their sustainable agenda, Mexico introduced SDG aligned sovereign bonds in 2020. The first issuance, a 7 year bond, raised EUR 750 million. Mexico made use of a European roadshow targeting Environment, Social and Governance (ESG) investors. In 2021, the second issuance of a 15 year bond raised EUR 1,250 million. This expanded Mexico's investor base and confirmed its position as a leading Latin American and emerging market sovereign issuer.

Way Forward

- Strong PFM systems are required as a basis for climate sensitive PFM. Developing climate institutions should therefore not be done in isolation of other PFM reforms. Successful approaches to climate budgeting have responded to domestic contexts and have been introduced in an iterative and gradual manner.
- Systemic capacity building is required, which addresses the overall framework institutions and individuals work. This would create an enabling environment for ministries of finance to work across ministries as part of the budgetary process to integrate climate change. Given their extensive work with governments in this area, UNDP have identified the importance of collaboration in bringing together collective tools and relationships to reach systemic capacity building. This need for collaboration applies to all capacity development providers from international organisations, development partners and civil society groups. Whilst the growing supply of climate budgeting support is generally welcome, it needs to be carefully managed and owned by ministries of finance in developing countries to ensure that they are not overwhelmed by a series of fragmented and even competitive processes. This also requires capacity development providers to harmonise and work closely together without duplication and overlap making sure that developing countries are leading the process.
- Research institutions and academia can be instrumental in providing evidence of what works in different contexts. Through the Resilience and Adaptation Mainstreaming Program (RAMP), WRI have been working with local universities and institutions to increase capacity for understanding, analysing and incorporating climate risk into local domestic fiscal policy. This includes tailoring curricula so that they are specific to local contexts, leading to local ministries of finance and agencies that are better prepared to address climate risks.
- The climate accountability ecosystem can be strengthened through better engagement between governments and the key formal and informal accountability actors including parliament, supreme audit institutions, civil society organisations, the media and more (CABRI, IBP, IIED, & UNDP, 2021a).

[4] Dual benefits refers to projects which address adaptation and mitigation.
[5] Costs are expected to be higher if 2°C global warming is exceeded.

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