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Expenditure Analysis Methodology on CPEIR

An expenditure analysis within a CPEIR seeks to quantify how much government spending, and what proportion of total government spending, is allocated to climate-relevant activities. This information can be used to increase awareness around climate change issues, guide strategy development and improve government communication with domestic and international stakeholders.

When undertaking an expenditure analysis, there are three key questions that need to be considered:

- How should climate relevance be assessed, should this involve weights and, if so, how should these weights be determined?
- What budgets/expenditures should be included in the analysis?
- How should budgets/expenditures be classified?

1.Assessing climate relevance

In some CPEIRs, a binary approach is taken to determining whether expenditures are climate-relevant. This means that either a budget allocation or out-turn expenditure is considered as climate-relevant and the whole of that amount is included, or it is not considered at all climate-relevant, in which case none of it is included in the analysis.

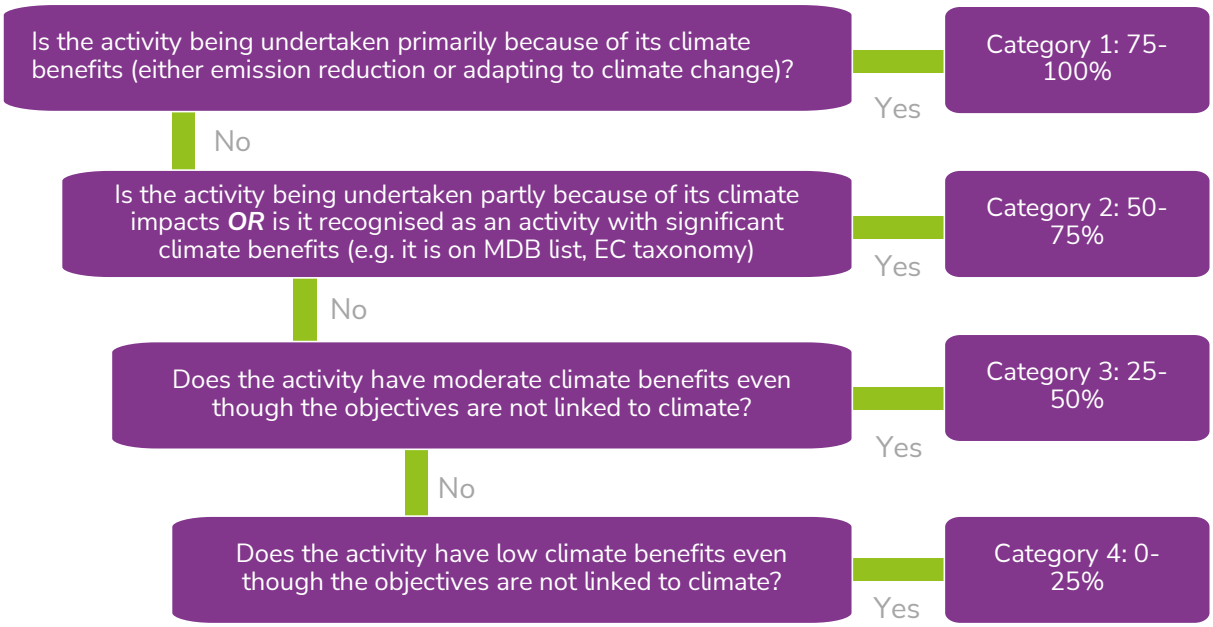
This approach is <u>not</u> considered to be relevant for Azerbaijan. Different activities contribute to support climate mitigation and adaptation to differing extents. Some activities, and associated budgets/expenditures, are only undertaken because of a country's commitment to address climate change. By contrast, other activities are largely undertaken for other reasons but may nonetheless make contributions to addressing climate change. A binary approach to assessing which expenditures to include within the assessment would lose this nuance. Moreover, a binary assessment of climate-relevance is typically based on whether the objective of the budgetary allocation/spending is to reduce emissions or increase resilience – this is likely to lead to a very low proportion of allocations/spending being considered climate relevant,

Instead, it is proposed to follow a weighting approach. This allows for differing degrees of climate relevance to be considered within the analysis. Building on previous analyses, it is proposed to base this weighting on two separate but related considerations:

- **The purpose/objective of the allocation/spend -** in other words, whether or not there is a stated intent that the allocation/spending will help to reduce emissions or enhance climate resilience
- **The impact of the allocation/spend -** the extent to which the allocation/spending is actually expected reduce emissions or increases climate resilience (regardless of whether that was the stated intent for that allocation/spending).

Figure 1 below illustrates how both the purpose and the impact of the spend are combined to determine allocation of spend to one of four categories.

Figure 1 Combining purpose and impact in a weighting system



As such, allocations/expenditures will fall into one of these four categories depending on the characteristics of the activity it supports and the intention of the spending.

- **Category 1 (75-100%):** This will be reserved for activities where there is an explicit statement that the activity is intended to reduce emissions or enhance climate resilience/adaptation to climate change and has been designed to capture these benefits. A useful illustrative benchmark of whether an activity meets this threshold is, in relevant cases, whether or not the outcome indicators measure the delivery of climate benefits.
- **Category 2 (50-75%):** This will be used for activities where there is no intention for the activity to enhance climate adaptation or reduce emissions, but there is nonetheless demonstrable (international) evidence that the activity will have this effect. Mitigation activities that fall into this category might be largely identified from the list of mitigation activities developed by the MDBs, with a few exceptions as discussed in category 3 below. For example, energy efficiency activities undertaken for energy security reasons, but which also reduce emissions, would be placed in this category. Adaptation activities expected to reduce exposure to, or hazard intensity of, climate impacts; or reduce climate vulnerability in a way that is targeted to specific climate hazards, would also be in this category[1]. For example, both afforestation activities - which directly reduce the

[1] See box 1 below for a discussion of terms related to adaptation

hazard intensity of floods and landslides – or the use of more efficient irrigation systems makes farming communities less vulnerable to water shortages – would be in this category (assuming no explicit statement was made regarding the intention of the spend to deliver climate benefits).

- **Category 3 (25-50%):** This will be used for activities where there is no intention to deliver climate outcomes but where there are nonetheless expected to be some moderate climate benefits from the allocation/expenditure. In relation to mitigation, this might mean activities that reduce emissions, but where there is a risk that the activities might not be consistent with the overall temperature goals of the Paris Agreement because they are still emissions intensive. For example, expenditures related to gas-fired power generation might be included in this category. In relation to adaptation, this may relate to activities that enhance outcomes in climate sensitive sectors (for example, agriculture) or for climate vulnerable households but where the activity does not directly reduce the exposure to, or the intensity of hazards associated with, climate change, nor directly target climate vulnerability, but instead reduces vulnerability to most or all potential future hazards and/or improves the capacity to cope with or adapt to climate impacts. For example, improving water quality or enhancing food security among climate vulnerable communities might fall in this category.
- **Category 4 (0-25%):** Low climate benefits. This will be reserved for adaptation-related spending and can be used for activities that reduce general vulnerability or enhance coping or adaptive capacity but which are not targeted at those people, communities or assets that are particular exposed or vulnerable to climate change. For example, general education and health spending might be included in this category.

The table below sets out the implications of these different categories for different types of budgetary expenditure.

Table 1 Applications of the classification approach to different types of expenditure

Classification	Mitigation	Adaptation
Category 1 75-100%	One of the stated objectives of the measure is to reduce GHG emissions/increase GHG sequestration and thus contribute to stabilisation of GHG concentrations in the atmosphere. ***Example**: renewable energy development intended to help reduce emissions*	One of the stated objectives of the measure is to reduce the vulnerability of human or natural systems to the current and expected impacts of climate change, including climate variability, by maintaining or increasing resilience, through increased ability to adapt to, or absorb, climate change stresses, shocks and variability and/or by helping reduce exposure to them. ***Example**: development of long term climate projections*
Category 2: 50-75%	There is no stated intention that the measure will contribute to stabilisation of atmospheric GHG concentrations, but it is well	There is no stated objective to reduce vulnerability to the impacts of climate change but the measure nonetheless can reasonably be expected to

	recognised from international sources, that the measure will help contribute to this stabilisation. Moreover, the activity is consistent with the overall temperature goal of the Paris Agreement. ***Examples**: measures to enhance energy efficiency, increase the use of electrified public transport, or protect forest stocks but where there is no explicit attempt to reduce emissions*	achieves this by reducing exposure to climate hazards, or by reducing the intensity of the hazard, or through reductions in vulnerability targeted at specific climate hazards. ***Examples**: measure to improve the efficiency of water use that are specifically targeted at reducing vulnerability to droughts, road rehabilitation expenditure that reduces the vulnerability of the road to floods.*
Category 3: 25-50%	There is no stated intention that the measure will contribute to stabilisation of GHG concentrations, but it is established from international literature that it can do so. However, there is a concern that the activity in question is not consistent with the overall temperature goal of the Paris Agreement, normally because there is an alternative emission reduction option that would deliver greater emission reductions. ***Examples: improving the efficiency of gas fired power generation or measure that improve the efficiency of emissions intensive livestock farming**.*	There is no stated objective to reduce vulnerability but the measure does so by enhancing the adaptive and/or coping capacity, in a way that is disproportionately targeted at people that are known to be climate vulnerable or in climate-sensitive sector. ***Examples**: enhancing the connectivity of rural households or increasing social protection measures for the same group of people.*
Category 4: 0-25%		There is no stated objective to reduce vulnerability but the measure does so by enhancing adaptive and/or coping capacity, but without targeting people that are known to be climate vulnerable. ***Example**: spending to support public health or measures that enhance connectivity.*

The categorisation approach can be further illustrated by some specific examples (focusing on the more 'challenging' examples):

- Expenditure on roads might be placed in a number of different categories depending on the intention and impact of the spend. First, expenditure deliberately focused on making roads more resilient to current and expected future climate change – with demonstrable evidence on how these objectives have affected the design of the programme – would be placed in category 1 (75-100%). By contrast, a road rehabilitation programme where there is no such deliberate statement and evidence but where it can be reliably inferred that vulnerability to climate hazards would be reduced, for example, spending on slope stabilisation measures to reduce the vulnerability to landslides, would be placed in category 2 (50-75%). By contrast, spending on a new road would be allocated at 75-100% if there was evidence that one of the objectives in designing the road had been to make it resilient to current and future climate change. If not, then the road would be placed in category 3 (25-20%) if it was supporting the connectivity of rural households, who are known to be climate vulnerable, as this would enhance their adaptive and coping capacity to manage climate change. If the new road was not particularly targeted at the climate vulnerable, then it would be allocated in category 1 (0-25%).
- In relation to mitigation, spending on waste management further illustrate the approach. Activities that are consciously intended to reduce waste sector emissions, such as efforts to improve recycling or waste-to-energy projects with specific objectives around climate change mitigation would be placed in category 1 (75-100%). Similar activities, but where there as no explicit intention to deliver emission reduction, and the projects had not been designed with this in mind, would be in category 2 (50-75%). By contrast, waste projects aimed at delivering improved sanitary landfills, but without methane capture and use, would be placed in category 3 (25-50%), - while such measures might be expected to reduce emissions, they continue to be associated with relatively large amounts of greenhouse gas emissions and may not be consistent with the long-term temperature goals of the Paris Agreement.

2.Which expenditures to include within the analysis?

In Azerbaijan's current budget system, there is a difference between the way in which budgets are currently set for the education, agriculture and environmental protection sectors, as opposed to other government spending. These three sectors have their budget classified on a program basis (as well as a functional and administration basis). This means that the budget is broken down into programs, with accompanying information about the name of the program, its objectives, the name of the associated measure, the budget, code, executive body. By contrast, other public spending is only presented on a functional, economic and administrative classification. This means that, for this other expenditure, there is no explicit documentation regarding the objectives that the allocation/expenditure is seeking to achieve. For example, under the functional classification, budget is allocation to the function of 'electricity' to cover the 'costs of creation and use of electricity resources, production of electricity, maintenance of dams created for the production of electricity.' However, the objectives associated with this expenditure is not provided.

This has important implications for the expenditure analysis of the CPEIR in the context of the weighting system identified above. It is much easier to identify the climate relevance of expenditure, using the application of the weighting system described above, to those sectors where a program classification is in place. The inherent design of a program classification will provide specific information regarding the objectives of the allocation/spend, while it will also

give important contextual (and often specific) information about the activities associated with that allocation/budget.

It is therefore proposed that the bulk of the expenditure analysis focuses on the program budgets of the environmental protection, health and education sectors. For these sectors, it should be relatively straightforward to apply the weighting system described above for identifying climate relevant budget allocations/expenditures.

However, the analysis will also try to cover expenditures associated with other sectors where this is possible. For example, in some cases, it may be possible to be confident that all of the budget/expenditure of one particular functional classification meets the criteria to be in categories 2,3 or 4 of the weighting system described above. In these case this allocation/expenditure will also be included. However, in many cases it will not be possible to assess the climate relevance of expenditures in sectors other than environmental protection, health and education.

3.Classification of expenditures

The expenditure analysis of a CPEIR is most useful when it places climate change related allocations/expenditures into various categories. This helps stakeholders understand where allocations/expenditures are relatively higher or lower, and hence where there may be gaps in current allocations/spending.

Best practice would involve classifying expenditures according to the classification developed in nationally-developed climate change strategies/action plans. This is particularly useful as it means that the expenditure analysis can be used to inform progress against the strategy and hence, over time, help stakeholders understand where there may need to be changes in order to make sure that the strategy/action plan is delivered.

This is not possible as work on the Low Emission Development Strategy (LEDS) and the National Adaptation Plan (NAP) has not yet been completed.

Drawing on both the draft LEDS, the sectoral discussion in Azerbaijan's NDC and international practice, the following two-tier classification of expenditures is proposed:

- In the first tier, a breakdown between mitigation, adaptation and allocations/spending that supports both mitigation and adaptation
    - A further disaggregation between energy generation (including both power and oil and gas extraction); transport; industry; residential and commercial; waste; agriculture; forestry/land-use; and cross-cutting.[2]

[2] This is similar to the sectoral breakdown in the LTS with the additional inclusion of the residential and commercial sector as this is separately identified in Azerbaijan's NDC, and a disaggregation between agriculture and forestry/land use and land use change, in line with their separate identification in Azerbaijan's NDC.

- A further disaggregation of adaptation between forestry/land use; water resources; agriculture; human settlement, infrastructure and energy; human health; tourism; and cross-cutting.

4.Summary

To summarise, it is intended that the expenditure analysis will be structured as follows:

- Primarily focused on the environment protection, health and education sectors as the program classification for these sectors provides the most detailed information with which to identify climate-relevant expenditures. However, the functional classification associated with other sectors will be used where there can be sufficient confidence to robustly identify allocations/expenditures as being climate-relevant.
- Climate-relevance to be assessed using a weighting approach – with four categories of climate-relevance varying according to both the objective/intent of the allocation/spending and its impacts
- Once identified, (weighted) climate relevant allocation/expenditures to be classified as contributing to either mitigation, adaptation or jointly supporting both mitigation and adaptation, with further sectoral breakdowns within each of these three classifications.