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Key methodological issues in Climate Budget Tagging

Undertaking technical design



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Determine coverage

- Some or all Ministries?
- Investment or investment and recurrent budget?
- Tax/subsidy expenditures?
- Subnational?
- SOEs?



Assess granularity

- Does estimation take place at level of program or program element?



Define and categorise

- Options for determining climate relevance
 - Objective
 - Policy
- Categorisation options
 - None
 - Mitigation vs adaptation
 - Sectors in NDC or policy



Weighting

- Objectives/ impact based approach or benefits based approach?

There are a wider range of issues to consider when assessing the appropriate coverage



- **Central government ministries:** most countries include all central government ministries in order to ensure comprehensive picture
 - But countries may consider phased implementation if more practical
- **Capex/opex:** most countries include both capital and recurrent expenditures
- **Donor:** if donor spending is large and off-budget then additional mechanisms may be needed to capture this spending
- **Taxes/subsidies:** only France currently covers tax expenditures and subsidies as well as budgetary spend. Area for potential improvement.
- **Sub-national governments**
 - accurate inclusion of transfers to sub-national governments depends on how well specified the intended purpose of the transfer is
 - inclusion of spending by sub-national governments depends on capacity level
- **SOEs:** some countries (Ecuador, Pakistan, the Philippines) include, but need to consider effectiveness

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Most countries undertake tagging at the activity/measure level



“

[The approach] ... does not distinguish sufficiently between the climate contribution made by different activities, leading to an overestimation of contribution made to climate action

”

Activity/measure level is the lowest level of detail that is easily available in (programmatic) budgets

This is the preferred approach for CBT in most countries, providing sufficiently robust results while still allowing relatively rapid assessment

When countries have adopted a higher level of aggregation, the results have sometimes been found to be inaccurate e.g. European Court of Auditors judgement on EC's approach to climate budget tagging in period to 2020

Source: European Court of Auditors (2016)

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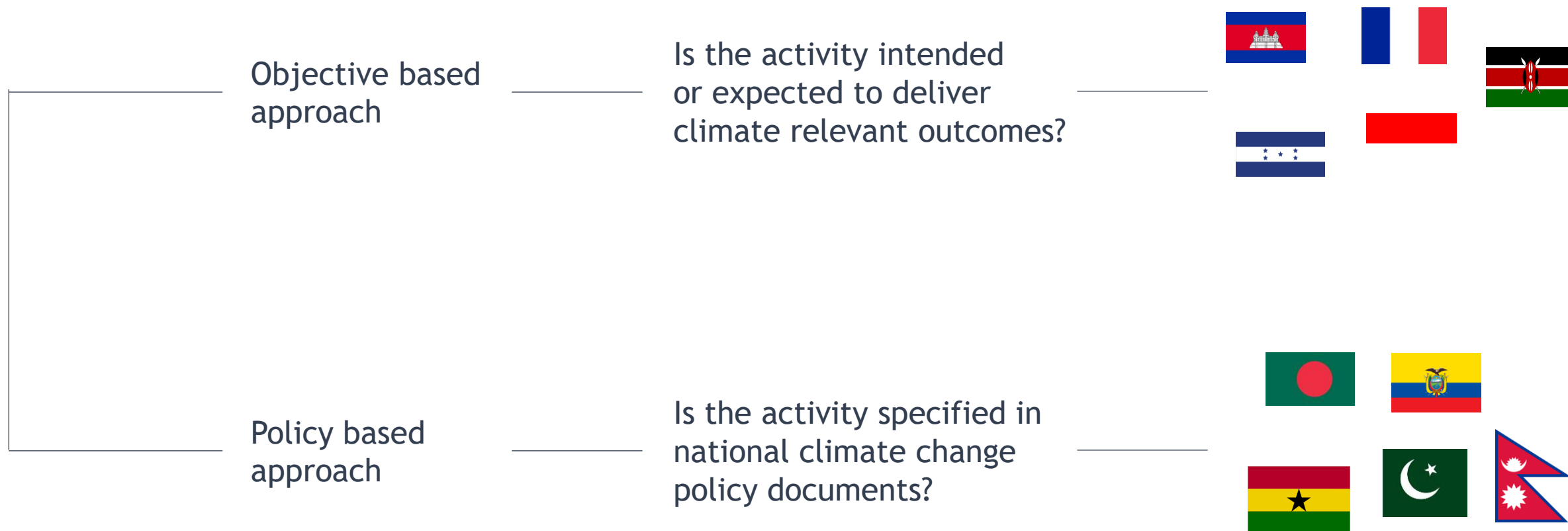
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Defining: There are two main ways to approach defining climate-relevant spend



Defining: To support the objectives based approach, a number of sources can help identify climate relevant activities



OECD Rio Markers

Criteria used for defining whether development partner spending supports climate

- Mitigation: if spending limits emissions, protects sinks and reservoirs, integrates climate change concerns into development objectives or helps meet reporting obligations. Indicative list of activities provided.
- Adaptation: if spending documentation identifies risks, vulnerabilities and impacts, outlines how these will be addressed, and demonstrates clear link to activities
- DPs identify whether addressing climate change was the **principal reason** for providing the spending, or a **significant** one

MDB Joint methodology

Criteria used by MDBs for reporting climate finance spend

- Mitigation: prescriptive list of activities including renewable energy; low-carbon and energy efficient generation; energy efficiency; agriculture, aquaculture, forestry and land-use; non-energy GHG reductions; waste and wastewater; transport; low-carbon technologies; cross-cutting issues
- Adaptation: process based approach similar to OECD Rio Markers

National taxonomies

National and international lists of climate-relevant activities

- National examples include: EC, Bangladesh, Mongolia
- International examples typically relate to green bond development e.g Climate Bond Initiative taxonomy, ICMA Green Bonds list of activities

Defining: a decision needs to be taken regarding the treatment of climate negative expenditures



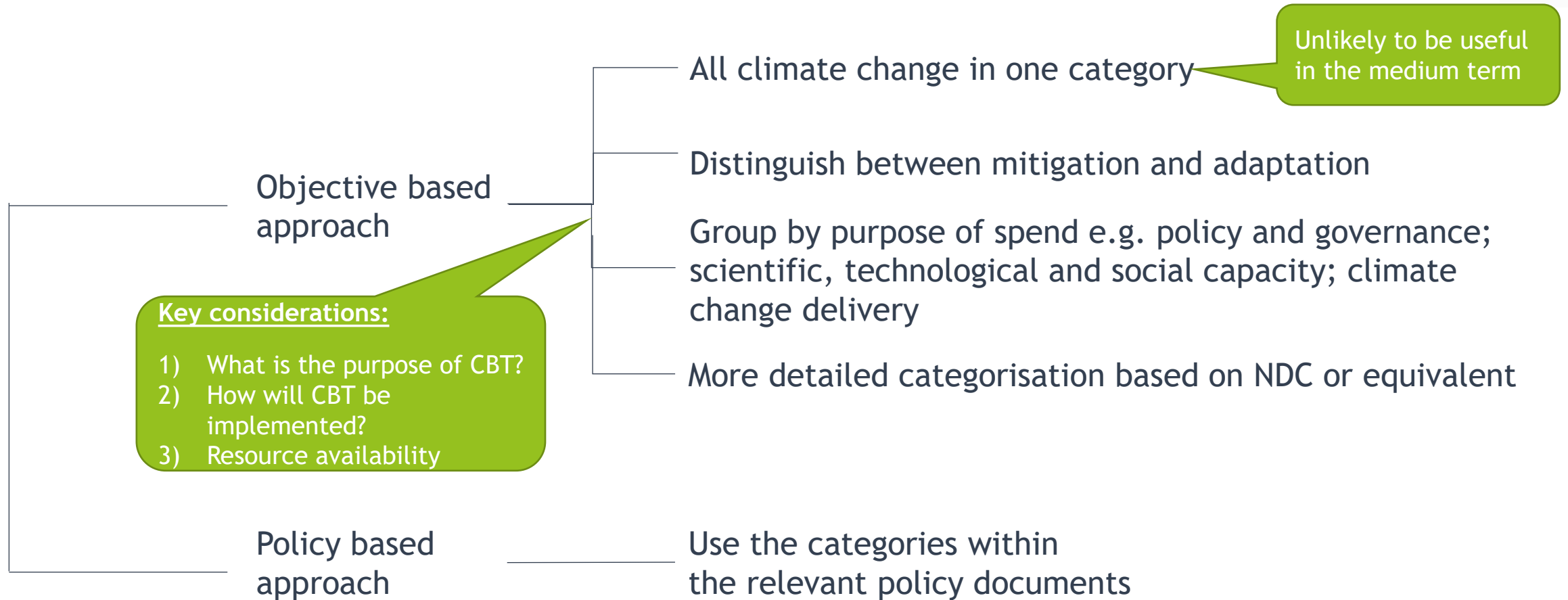
As well as defining the activities that support climate goals, a decision should also be taken on whether to include climate negative expenditures e.g. subsidies provided to fossil fuel producers

To date, only France has included such spending

The inclusion of these activities will largely depend on the objectives of the CBT:

- ✓ Gives a more accurate account of extent to which budget is supporting climate strategies, will help ensure greater domestic awareness regarding climate change
- ✗ May not support finance raising objectives

Categorising: The approach to categorising climate spend depends in part on the approach to its definition



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It is often difficult to disentangle climate spend from spending on other priorities



Even when spending has been identified as ‘climate-relevant’, the **extent to which** it is climate-relevant can be difficult to disentangle

This is because many climate-related activities have development co-benefits, and many development activities support climate resilience e.g.

- Energy efficiency - reduces emissions but also helps reduce costs, improve energy security (for energy importers) etc.
- Improvements in agricultural irrigation - helps to boost agricultural production but also helps to make farmers more resilient to expected reductions in rainfall/increase likelihood of drought

Adaptation often described as ‘development in a hostile climate’

Countries have three main options to respond to this challenge



Focus only on activities where climate change is primary objective



- ✓ Clear and simple approach
- ✗ Understates financial commitments to climate

Recognise different categories of spend but do not apply weighting



- ✓ Avoids potentially arbitrary weights
- ✗ Maybe difficult to communicate

Recognise different categories of spend and weight each type of spending



- ✓ Provides simplicity of a single number
- ✗ Weighting approach requires judgement

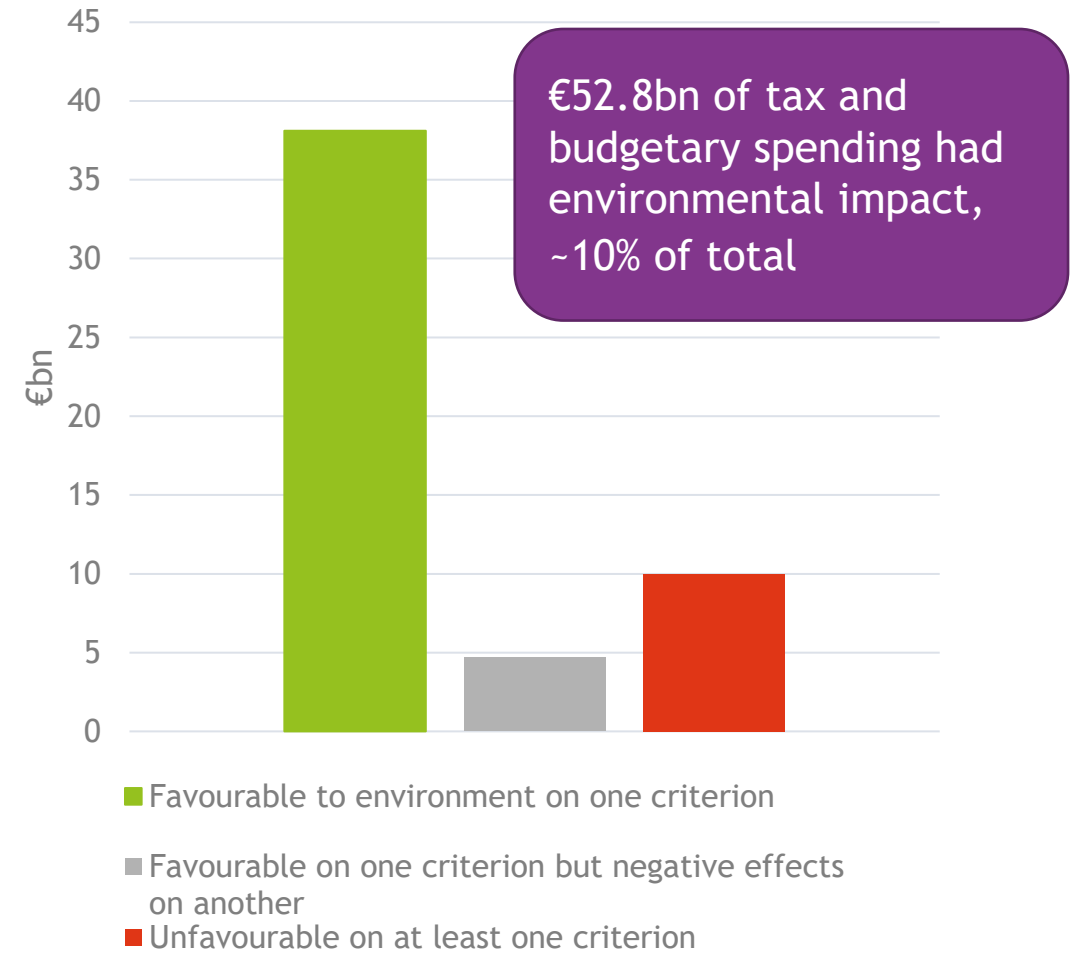
The French case provides an example of classifying without weighting



Activities are grouped into five categories

- 3 - **very favourable** - principal objective is environmental or contributes to environmental service
- 2 - **favourable** - does not have an environmental objective but with an environmental impact
- 1 **favourable but controversial** - favourable impact in short term but may entail long term risks
- 0 neutral - no significant impact
- -1 **unfavourable** - expenditure adversely affects at least one environmental objectives

Assessment undertaken for six different environmental criteria: climate change mitigation, climate change adaptation, water resource management, circular economic, pollution, biodiversity



Most countries adopt a weighting approach



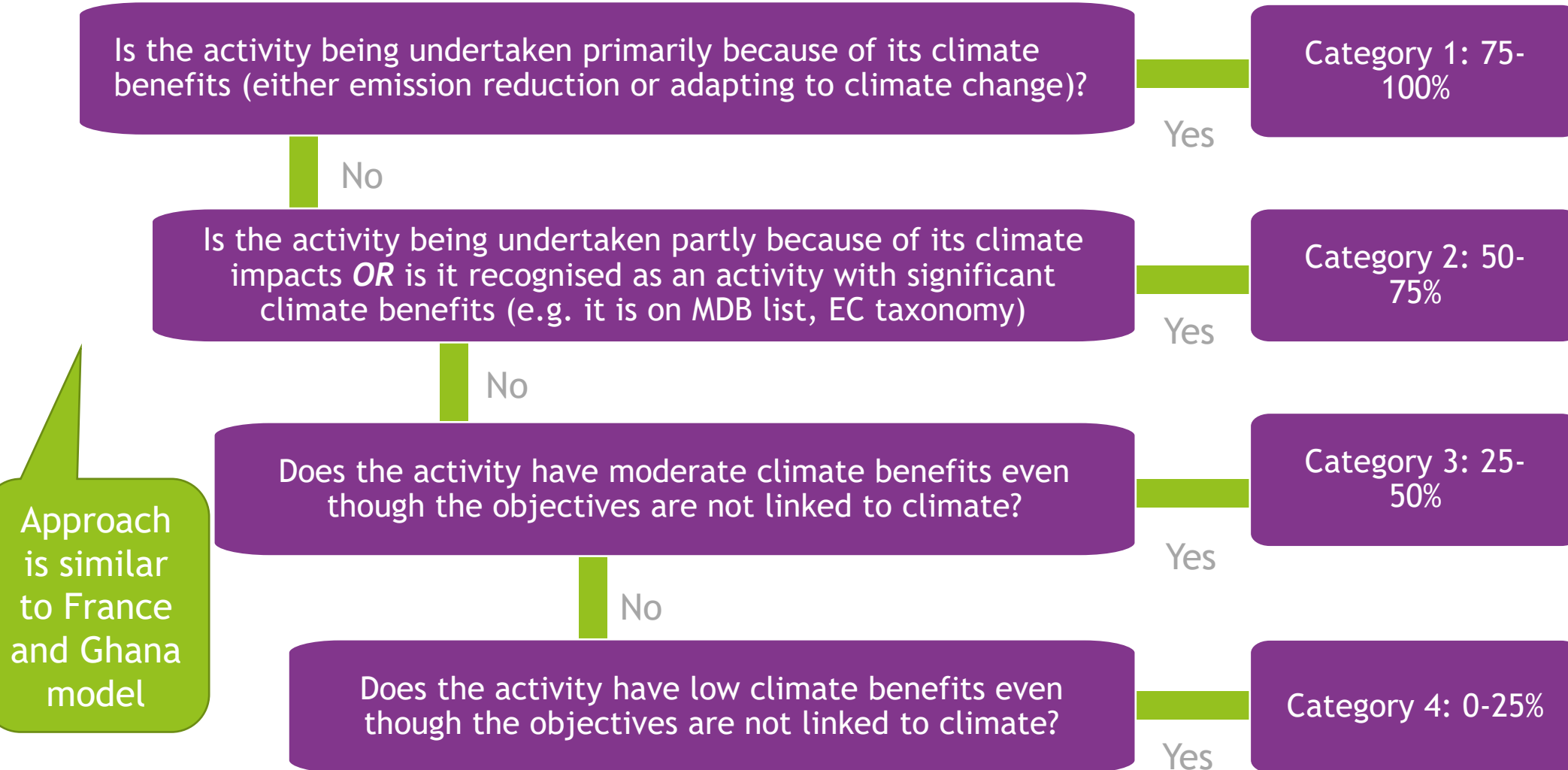
- Three main factors can be used to help identify the appropriate weight that might be applied:
 - **Purpose/objective:** was the activity/spending undertaken primarily because of its climate change benefits (mitigation and/or adaptation) - this is at the core of the OECD DAC approach
 - **Impacts:** does international experience suggest that this type of activity has a significant impact on reducing emissions/enhancing climate resilience
 - **Proportion of benefits:** what proportion of the benefits from an activity are thought to be associated with climate change related benefits
- Although some people argue that the ‘proportion of benefits’ approach may give more robust weights, it has typically proven too complex in the context of budget tagging
- This leaves a combination of **purpose/objective** and **impacts** as the typical factors used for determining weights

Countries use different approaches to setting weights



	Weight 1	Weight 2	Weight 3	Weight 4	Notes
EU	100% - if budget makes a significant contribution to climate objectives	40% - if spending makes a moderate contribution to climate objectives	N/A	N/A	Only focuses on impacts, not purpose/objectives (cf. OECD DAC approach)
Ghana	100% (high) - if stated primary objectives is climate change related	50% (medium) - if can be linked to focus areas of climate action plan and policy objective refers to climate	20% (low) - as for medium, but no reference to climate change objective in description		Combination of purpose and impacts
Pakistan	>75% if climate change is primary objective	50-74% if climate change is a secondary objective	25-49% if spending makes an indirect contribution to climate objectives	<25% if spending makes a marginal contribution to climate objectives	Combination of purpose and impacts

Earlier work within this project identified a 4-way weighting system (1 of 3)



Earlier work within this project identified a 4-way weighting system (2 of 3)



Category 1 (75-100%)	Reserved for activities where there is an explicit statement that the activity is primarily intended to reduce emissions or enhance climate resilience/adapt to climate change.
Category 2 (50-75%)	<p>Climate benefit is only a secondary reason for undertaking the activity or where there was no intention for the activity to enhance climate adaptation or reduce emissions, but there is demonstrable (international) evidence that the activity will have this effect</p> <ul style="list-style-type: none">• Mitigation: 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.• Adaptation: expected to reduce exposure to, or hazard intensity of, climate impacts; or directly reduce climate vulnerability. For example, afforestation activities directly reduce the hazard intensity of floods and landslides, or more efficient irrigation systems makes farming communities less vulnerable to water shortages
Category 3 (25-50%)	<p>Where there is no intention to deliver climate outcomes but where there are nonetheless expected to be some moderate climate benefits from the expenditure:</p> <ul style="list-style-type: none">• Mitigation: activities that reduce emissions but which may not be consistent with 1.5°C temperature goal e.g. gas• Adaptation: activities targeted at sectors, people, communities or assets that are climate sensitive which increase ability to cope with a range of impacts, including climate change e.g. improving food security, improving water quality
Category 4 (<25%)	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 e.g. health spending

Earlier work within this project identified a 4-way weighting system (3 of 3)



Further adjustments could then be made within each category to take account of additional factors:

- **Co-benefits:** activities that have both mitigation and adaptation co-benefits e.g. afforestation, reforestation, can be given a higher weighting than activities that just have adaptation or mitigation benefits
- **Diluted spend:** activities that have adaptation and/or mitigation benefits but where there are significant spend items within the same budget line that have no climate benefits can be given a lower weighting

While such adjustments are relatively easy to apply in a CPEIR exercise, it may be more challenging to apply them in a CBT exercise, depending on the implementation modality

Summary



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1. CBT exercises in most countries include both operating and capital budgets by all central government ministries. Sub-national government and SOE inclusion is more patchy.
2. To date, most countries have excluded taxes and subsidies from CBT exercises but it would be desirable to alter this. The inclusion of negative expenditures depends on the objectives of CBT.
3. CBT analysis will typically be undertaken at the activity/measure level of any budget.
4. Countries can define the climate-relevance of spending by reference to the objectives/impact of the expenditure or by reference to key policy directions. It is generally useful to categorise climate relevant spending, with the approach to categorisation depending on country circumstances.
5. When undertaking CBT, countries take a variety of approaches to account for the entanglement of climate with broader development plans.
6. The most typical approach is to adopt 'weights' for various categories of spend. The weights are likely to account for both the objectives/purpose of the spend, and the expected impact that the spend will have.