



# Climate, Environment and Public Finance

## Green Public Finance Reform

### Advisory Service

#### The challenge

Climate change, ecosystem degradation and environmental pollution are increasingly threatening people's livelihoods. To protect the climate, the environment and vulnerable population groups, we need internationally coordinated efforts to implement the Sustainable Development Goals (SDGs), the Paris Agreement and the targets set out in the UN Convention on Biological Diversity. We also need a strong focus on building sustainable economic systems. Incentives for companies and households to embrace sustainable, green practices and the large-scale mobilisation of additional public and private funding are imperative to make this happen (according to the OECD, USD 6.9 trillion per year will be needed by 2030 alone).

When it comes to financing environmental and climate goals, an additional challenge is that many partner countries have limited fiscal space, a situation which has been exacerbated by rising welfare spending and dwindling government revenues during the COVID-19 pandemic.

Therefore, partner countries must align their public finances with environmental and climate commitments. They can do so by better leveraging potential revenues from climate and environmental taxes, abolishing harmful subsidies, creating the conditions for private-sector investment in climate change mitigation and environmental protection and more systematically harnessing the power of their public finance systems to drive change. The role played by public finances is increasingly important in the context of COVID-19 recovery measures, which run the risk of reinforcing growth pathways that harm the environment and climate through hefty public investments and spending to strengthen the economy.

#### Our approach

GIZ supports partner countries in stepping up their con-

tributions to achieving national and international climate and environment goals and to designing sustainable fiscal policy measures that promote a green recovery by aligning their public finances with environmental considerations.

To this end, GIZ assists finance, environment and other sector ministries in abolishing misdirected incentives for companies and households (e.g. subsidies and tax expenditures for fossil fuels), in rolling out incentives for climate-friendly and environmentally sound practices in a socially equitable manner (e.g. environmental taxes, carbon pricing) and in creating enabling conditions for private investment in environmental protection and climate change mitigation (e.g. through public investment in renewable energy infrastructure). In this way, fiscal policy can profoundly influence the investment, production and consumption decisions made by companies and households, redirect private money into environmentally sound and climate-friendly activities and mobilise additional government revenues. Making these kinds of reforms socially equitable is a prerequisite for their political success.

GIZ fosters cooperation between finance, environment and other sector ministries on budget planning, implementation and evaluation to make sure that public funds are used efficiently and effectively in pursuit of climate and environmental goals. It also supports transparent reporting by its partners, highlighting the contribution that public spending makes towards environmental protection and climate change mitigation, and strengthens internal and external monitoring mechanisms, such as audit institutions, parliamentary committees and civil society, which monitor budgetary implementation.

#### Our services

Das GIZ's range of services to support partner countries with green fiscal reforms is aligned with BMZ's Good Financial Governance concept and BMZ's core area strategies Responsibility for Our Planet – Climate and Energy



and Peace and Social Cohesion. As set out below, our services include policy and technical advice, capacity development and networking.

### **Green revenue policy and carbon pricing**

GIZ advises national and sub-national actors on introducing climate and environmental taxes and duties and emission trading systems. It also supports their efforts to identify and evaluate harmful tax subsidies (e.g. in the energy, transport, agriculture and fisheries sectors), whose abolition is a central objective of the Paris Agreement. For instance, natural capital accounting approaches are implemented in partnership with research institutions as a source of information that can be used to price in environmental externalities. Data-based potential, impact and scenario analyses are also developed with a strong focus on distribution effects.

Measures to help public-sector actors introduce carbon pricing instruments are especially important. This includes creating the institutional framework, building technical capacity and putting in place the legal prerequisites for introducing and implementing carbon pricing tools, setting up emission registries and data management systems, establishing verification processes and developing measures to prevent carbon leakage.

Crucially, this approach also involves analysing potential competition and social impacts and designing parallel support and compensatory measures.

### **Green budget planning, implementation and evaluation**

GIZ advises finance, planning and other sector ministries as well as subnational government authorities on how to integrate national climate and environmental strategies into their medium-term spending frameworks and annual budgets, e.g. through cost-benefit analyses and by incorporating targets and indicators into budgetary programmes and nomenclatures and introducing climate and environmental markers (budget tagging). This allows stakeholders to monitor, report on and evaluate the quality of public climate and environmental spending (e.g. as part of public spending reviews). GIZ also advises on ways of systematically incorporating climate change mitigation and environmental protection and inherent risks when planning, prioritising, implementing and evaluating public investments (e.g. through natural capital accounting) and in public procurement processes in order to foster sustaina-

bility, resilience and planning certainty for private sector investment in environmentally sound and climate-friendly technologies.

### **Transparent implementation of national climate change mitigation and environmental protection goals**

GIZ advises audit institutions on performing environmental audits that analyse and evaluate the deployment of public resources to achieve climate and environmental goals in terms of effectiveness and value for money. Civil society actors also receive strategic advice and capacity development support in their role monitoring the actions of public bodies in relation to climate and the environment. This increases the transparency of reporting on the contribution that public budgets make to environmental protection and climate change mitigation and improves the efficiency and effectiveness of resource use.

### **Analysing fiscal risks and adaptation**

The impacts of climate change and ecosystem loss pose significant risks to public budgets. GIZ advises partner countries on identifying, quantifying and evaluating these risks and on developing risk management systems that serve as a source of information for decisions on public investment, regional and national resilience mechanisms and adaptation financing.

### **The benefits**

Our integrated package of support for Green Public Finance Reform is designed to supplement GIZ's existing services in the areas of public finance reform, sustainable finance and debt management.

**Long-standing trust-based cooperation with finance and environment ministries.** GIZ is active in environmental protection, climate change mitigation and public finance projects in around 100 countries worldwide and can draw on long-standing trust-based partnerships with finance and environment ministries, cross-sectoral commissions, tax authorities, audit institutions, parliamentary committees, other sector ministries, subnational government authorities and both private sector and civil society actors.

**A holistic approach.** GIZ advises its partner countries on effective ways of making both their public finance systems and their private finance and banking sec-



tors sustainable (green finance). This holistic approach facilitates intersectoral learning, harnesses synergies (e.g. when developing and using taxonomies and issuing green bonds) and ensures sustainable results. GIZ also helps partner countries to access international environmental and climate funds (e.g. the Green Climate Fund (GCF), International Climate Initiative (IKI) and the NAMA Facility) by building the capacity of national climate finance structures, strengthening institutional integrity (e.g. anti-corruption systems) and developing project strategies.

**Technical expertise and strategic partnerships.** GIZ has a high level of technical expertise in providing climate and environmental policy advice and in advising public institutions in alignment with good financial governance principles. It also brings together outside expertise and experience through strategic partnerships, including relevant German Government bodies (e.g. the German Environment Agency (UBA) and the German Emissions Trading Authority (DEHSt)), German and international think tanks (the Millennium Challenge Corporate (MCC), Green Budget Germany (FÖS) and the International Institute for Sustainable Development (IISD)) and multilateral organisations (e.g. the United Nations Education Programme (UNEP), the International Monetary Fund (IMF), the Organization for Economic Cooperation and Development (OECD) and the United Nations Development Programme (UNDP)). Together with UNEP and IMF, GIZ is a founding member of the Green Fiscal Policy Network, in which many of these organisations share their knowledge, along with Green Climate Fund implementing organisations.

**Inclusive, participatory approaches to governance advisory services.** GIZ's advisory work promotes fair, participatory and inclusive discourse involving government, private sector and civil society actors. In developing potential solutions, it systematically involves vulnerable

groups that are often especially hard hit by the impacts of climate change and ecosystem degradation.

### An example from the field

**Indonesia.** Working on behalf of the German Federal Ministry for Economic Cooperation and Development (BMZ), GIZ has been supporting the efforts of Indonesia's Ministry of Finance to align the country's public finances with environmental and climate goals since 2014, for instance by reforming subsidies for fossil fuels and electricity in a socially equitable manner. In 2014-2015, for example, this reform culminated in a USD19 million reduction in subsidies for transport fuel. GIZ also advised the Indonesian Government on the design of mechanisms to relieve the strain on poor households affected by the ensuing price increases. On behalf of BMZ and the Federal Ministry for the Environment, Nature Conservation, Nuclear Safety and Consumer Protection (BMUV), GIZ is currently advising the Ministry of Finance on the introduction of a carbon tax.

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