



Financing Climate Futures

RETHINKING INFRASTRUCTURE

OECD Case Study KEY FINDINGS

Financing climate objectives in cities and regions to deliver sustainable and inclusive growth

The investment choices we make in the coming years will either lock in a climate-compatible, inclusive growth pathway, or a high-emission, inefficient and unsustainable pathway for decades to come. Cities and regions are significant contributors to spending and investment related to climate mitigation and adaptation.

Cities & Regions are responsible for



55%
of climate and environment related spending



64%
of climate and environment related investments

Preliminary estimates show that cities and regions were responsible for 55% of spending and 64% of investment in selected sectors that have a direct implication for climate change over the period 2000-2016 in 30 OECD countries for which data are available.

With high levels of inequalities in many cities, the success of the transition will depend on the ability of subnational governments to engage in a “just” transition. New work from the OECD focuses on how national and subnational governments can align subnational financial flows to transition towards low-emission, resilient and inclusive cities.



Diagnosis

Subnational governments have a significant role in climate-related spending and investment

Data are very limited to track climate finance in general, and even more so at subnational (SNG) level. This is a big problem, as it means there are no real data to track progress towards the Paris Agreement commitments.

We can, however, make attempts to better track environmental and climate-related spending and

investment at subnational level. In this case study, the OECD proposes a preliminary methodology to do so, based on Classification of Function of Government (COFOG) data from the National Accounts and focusing on sectors that have a direct implication for climate change.³ This assessment renders important findings:

- **The majority of environmental and climate-related spending occurs at subnational level. In the 30 countries sampled, subnational governments were responsible for 55% such spending, on average over 2000-2016.**
- **In relation to spending, an even larger share of environmental and climate-related investment occurs at subnational government level. On average, subnational governments were responsible for 64% of such investment over 2000-2016.**
- **The share of environmental and climate-related spending and investment is nonetheless very low relative to GDP. Subnational climate-related spending represented 1.3% of GDP on average over 2000-2016; subnational climate-related investment represented around 0.4% of GDP on average over 2000-2016.**
- **And more worrying – overall, environmental and climate-related spending and investment saw minimal change between 2000 and 2016 on average in the 30 country sample, both in real terms and as a share of GDP.**

Low-income and vulnerable populations will be disproportionately affected by climate change impacts

Getting urban infrastructure right is a major development agenda. OECD research shows that income inequality tends to be higher in cities relative to their respective countries (in 10 out of 11 OECD countries surveyed), and tends to be higher in larger cities. This is in part because cities have a wider polarisation of high and low skills and top earners capture a larger share of total income.

Climate change is poised to exacerbate the effects of structural inequalities in cities. While wealthier populations have more assets at risk from climate change, vulnerable populations are more exposed to climate change impacts. This is because low income populations have i) an increased exposure to climate risk and hazards, ii) higher susceptibility to damage from climate change, and iii) lower ability to recover.

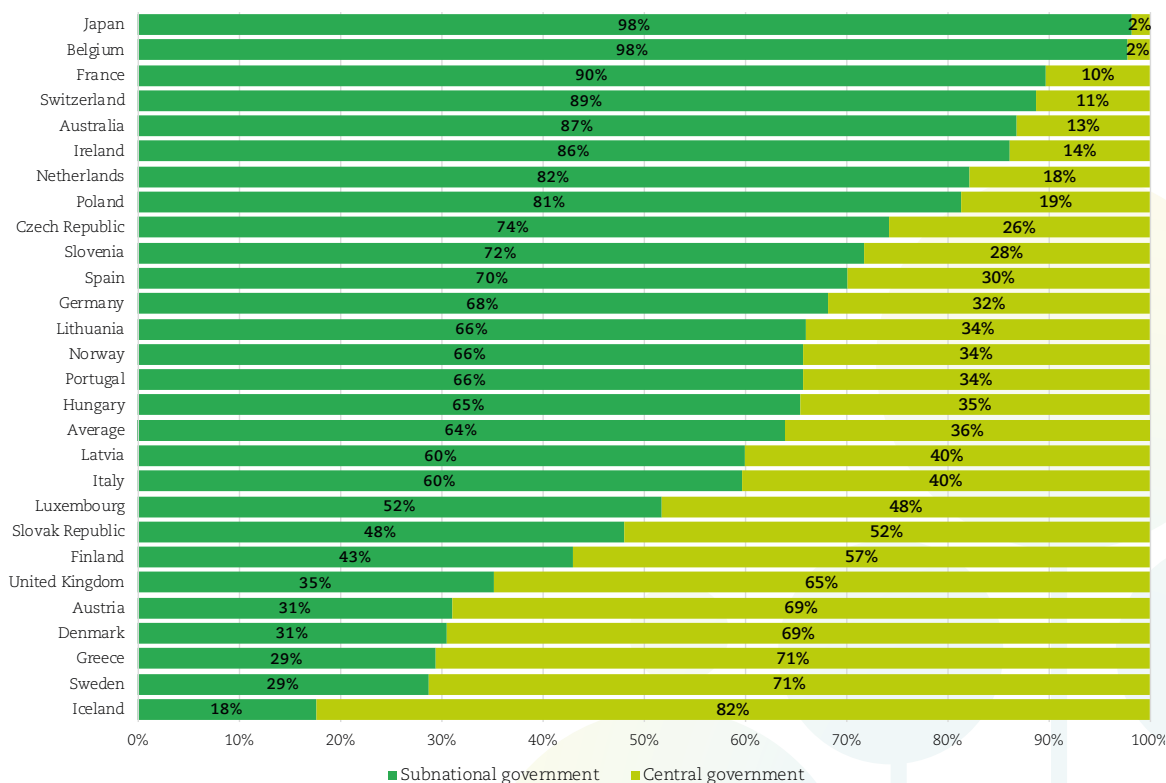
Cities and regions thus have a key role to play in a low-emission, inclusive transition. Indeed, some

cities are already incorporating an explicit equity dimension into their climate change strategies. Some of cities' common concerns relate to how climate change may affect spatial planning, segregation and urban development; human health; and economic stratification.

Investments in low-emission urban infrastructure can have positive impacts on low-income and vulnerable populations. However, policies and financing tools designed to address climate change can also have significant distributional impacts, disproportionately affecting low-income populations. One example is financing tools that effectively put a price on carbon, such as carbon taxes or congestion charges, which tend to be regressive. To address these concerns, authorities can channel revenue from such instruments towards climate investments that benefit low-income populations, such as improvements to sustainable public transport.

³Three COFOG sectors have been considered: Environmental protection, Economic affairs, and Housing and community development. However, it is important to note that some sectors that are counted as climate-related in the methodology may not ultimately contribute to low-emission and climate-resilient objectives that are consistent with the Paris Agreement. For instance, this can be the case of some activities in the Environmental protection category; an example is solid waste management activities relating to landfills or incinerators, which are responsible for generating significant GHG emissions in cities. In addition, other sectors, which represent the bulk of SNG spending (such as education, health and public administration), are not taken into consideration in the methodology, even though they may have an implication for climate change (for instance, energy-efficiency spending and investments relating to the construction and maintenance of schools and hospitals). Further methodological refinements will thus be needed.

Environmental and climate-related investment by level of government, 2000-2016



What can be done?

Overall recommendations for national and subnational governments:

- ✓ **Strengthen data collection, statistical systems and methodological approaches** to track the implementation of the Paris Agreement, in coordination with international organisations and other supranational institutions. The G20 should support this at both national and local levels.
- ✓ **Mobilise more funding from international organisations and national governments** to help subnational governments address climate priorities and more effective management of funding and green budgeting.
- ✓ **Leverage additional external funding**, in particular from the private sector, as a complement to public resources directed at climate change.
- ✓ **Strengthen institutional, financial and strategic capacities** to address climate priorities. This is a long-term agenda, and requires sustained efforts to mainstream climate objectives across policy areas.
- ✓ **Apply an inclusion lens to climate-related spending and financing**, given that climate change impacts are poised to disproportionately affect low-income and vulnerable people and places. Several priority areas stand out:
 - Get the governance right for infrastructure planning: Integrate land-use and transport policies
 - Invest revenues from environmental taxes and fees in measures that also boost inclusive growth
 - Make greater use of land value capture tools to support climate and inclusive growth objectives
 - Take advantage of skills development and job-creation opportunities in urban infrastructure financing and investment, particularly relating to energy efficiency investments
 - Explore the potential for green bonds to achieve both climate and inclusion goals.

What can be done?

Overall recommendations for national and subnational governments

- ✓ **Provide subnational governments with sufficient sources of revenue to carry out their responsibilities** in areas related to climate change adaptation and mitigation to avoid under or un-funded mandates. This means a balanced and sustainable basket of resources based on grants/transfers (international, national and regional), taxes (shared and own-source), user charges and fees and property income.
- ✓ **Provide subnational governments with sufficient leeway to adjust and manage their revenues** to respond to climate needs.
- ✓ **Provide subnational governments with the possibility to mobilise external funding**, including the ability to borrow (and to access capital markets for most capable subnational governments, in particular by issuing green and climate bonds) and to establish public-private-partnerships (PPPs arrangements, equity funds). This implies a suitable regulatory framework, sufficient fiscal capacities and creditworthiness, but also a willingness of the private sector to enter into partnerships with local authorities.
- ✓ **Ensure the right framework conditions** and adequate coordination mechanisms are in place to boost public investment towards climate objectives, as outlined in the OECD Recommendation on Effective Public Investment across Levels of Government.
- ✓ **Enable subnational investment in low-carbon climate resilient infrastructure.** This includes providing a framework for longer-term, more systemic approaches than can be achieved at subnational levels; providing needed technical assistance and capacity; setting national targets and price signals; and structuring taxes and grants in a way that incentivises sustainable behaviour.
- ✓ **Foster effective horizontal cooperation**, in particular in metropolitan areas. For instance, some financing instruments (e.g. congestion charges, eco-taxes) should be applied at the regional/metropolitan scale, not only in centre-cities.

Specific recommendations for subnational governments

- ✓ **Make climate resilience a priority** that is mainstreamed in all sectors of activity within the city and region.
- ✓ **Develop a green fiscal strategy and action plan**, and integrate green priorities in budgeting and procurement.
- ✓ **Make the most of taxes, user charges and fees, property income and land-value capture instruments** to support climate objectives.

