

Assessment and recommendations

Climate change, biodiversity loss, and widespread environmental degradation are imminent threats to our planet and societies. Addressing these threats requires unprecedented co-ordination of policy action among and within all levels of government. Fiscal policy is one of the most powerful and effective tools that policy makers have at their disposal for resourcing and implementing co-ordinated policy action. Green budgeting is defined by the Paris Collaborative on Green Budgeting (PCGB) as “using the tools of budgetary policymaking to help achieve environmental and climate objectives. Therefore, it can help governments to mainstream climate and environmental action within budgetary decisions and broader policy-making, and to monitor progress towards achieving environmental and climate goals (OECD, 2020^[1]). As such, it also contributes to “making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development”, a central objective of the Paris Agreement (UNFCCC, 2015^[2]).

Part of a joint OECD-European Commission project on Measuring and Enhancing Subnational Government Finance for Environment and Climate Action in OECD and EU Countries, this report identifies the opportunities and challenges of green budgeting for regions and municipalities and provides an overview of green budgeting current approaches and methodologies. A stocktake of existing subnational green budgeting practices in the OECD and European Union (EU) countries shows that it is still in its infancy but the interest and practices are growing. Building on this stocktake as well as the insights of two case studies, one with the region of Brittany (France) and one with the city of Venice (Italy), the report proposes a set of concrete recommendations for supranational bodies, national and subnational governments grouped around six guidelines. These guidelines are accompanied by a self-assessment tool to assist any region or municipality in identifying its strengths and potential gaps for starting a green budgeting practice or improving an existing one.

Key findings

Subnational green budgeting is new but progressing

At the national level, green budgeting is a relatively new area of research and practice in many OECD countries, which received a strong boost in 2017 with the establishment of the OECD Paris Collaborative on Green Budgeting in partnership with France and Mexico (OECD, 2020^[1]). The growing interest in green budgeting has been accentuated by the push for a post-pandemic green recovery, and the accompanying need to identify and prioritise green investments. For example, In the European Union, the requirements set out by the European Commission in its Recovery and Resilience Facility (RRF) that 30% of the Facility’s allocations be directed towards climate change is likely to increase the number of European countries using green budgeting as they look for ways to show they have met this requirement.

At the subnational level, there has also been a recent surge in interest in green budgeting. For example, within Europe, the European Committee of the Regions recently started a discussion within its Commission for the Environment, Climate Change and Energy to prepare an opinion on “the implementation of green

budgets at local and regional levels” to be adopted by the Committee in June 2022 (European Committee of the Regions, 2022^[3]).

Green budgeting is particularly relevant for regional and local governments given the important role they play in tackling climate change and catalysing the transition to a carbon-neutral economy. This is because regions and cities are major greenhouse gas emitters while also having jurisdiction over key policy areas relevant to the transition such as land-use planning and zoning, housing development, waste treatment, and more. Subnational governments also play an important role in catalysing the green transition through their spending, investment, and revenue raising decisions. In 2020, subnational governments in the OECD accounted for 37% of all public spending, 55% of all public investment, and 32% of all tax revenues, on average (OECD, 2022^[4]). These expenditure, investment and revenue decisions have an environmental and climate impact, be it positive, neutral or negative. Green budgeting is a concrete, practical tool that subnational governments can use to align these fiscal decisions with their green objectives by identifying, quantifying, and tracking their impacts and integrating the evidence gathered into budgetary and policy decision-making processes.

The ins and outs of green budgeting at the subnational level

Green budgeting is a concrete, practical tool that subnational governments can use to integrate climate and environmental considerations throughout the budgetary process, from the initial drafting phase through to the budget vote and ex-post reporting. Integrating environmental and climate concerns fully into the budgetary process effectively complements the range of environmental and climate tools available at the subnational level.

Green budgeting presents several opportunities for subnational governments, while also posing a number of challenges that need to be anticipated and addressed.

Initiating a green budgeting approach can help to align financial decisions with environmental, and climate goals and indeed can also foster cross-departmental collaboration within a subnational government. Green budgeting seeks to facilitate and improve the rationality of decisions, drawing on robust scientific assumptions, data and indicators. It also contributes to improving the evaluation of public policies.

Green budgeting also helps governments to prioritise and select low-carbon and resilient investment projects and spending, which is made all the more important in the context of the post-pandemic green recovery and the unprecedented influx of resources for “green” investment.

Green budgeting tools can also assist subnational governments to identify funding gaps associated with achieving their green objectives and to mobilise additional sources of public and private finance to bridge these gaps, such as green funds and subsidies, green loans and green bonds.

Beyond its use as a prioritisation and decision-making tool, green budgeting can also help respond to a growing demand for transparency and accountability from subnational government, especially from civil society, an important aspect that contributes to increasing citizens’ trust in government. It promotes the emergence of dialogue between environmental, economic and social actors, which did not always exist, despite the interdependence of environmental, economic, and social issues. This also helps to communicate with all stakeholders and partners at the international, national, and subnational levels on progress being made to reach green targets.

Green budgeting also raises several challenges for subnational governments that can fit into four broad categories: methodological challenges, operational challenges, resource challenges, and political challenges. The degree of difficulty that these challenges pose varies among subnational governments.

The key methodological challenge related to green budgeting at the subnational level is the lack of proven methodologies adapted to the specific budgeting contexts of subnational governments. Regions and municipalities do not have the same expenditure and revenue competences as national governments, nor

as each other, and there is considerable variation in these competences between countries. As a result, it is not always possible for subnational governments to simply adopt an existing national-level green budgeting methodology. Other methodological challenges relate to adapting existing accounting and reporting tools and ensuring the methodology is transparent and dynamic, such that it can adapt to changing scientific evidence over time.

Resource challenges can be further categorised into human resources challenges (e.g. not having personnel with necessary climate and environmental expertise) and financial resources challenges (e.g. not having the budget available to hire additional staff while existing staff are overburdened). It can also relate to the need to instil climate and environmental awareness throughout the subnational administration, including elected representatives and administrative staff from all departments, as green budgeting should mobilise the entire organisation to be effective.

Potential operational challenges that subnational governments may face in implementing a green budgeting practice include establishing a dedicated organisational structure based on horizontal co-ordination amongst departments and associating key public and private stakeholders from outside the subnational government in the process. Depending on existing co-ordination structures within an administration, setting up a dedicated organisational structure and fostering horizontal co-ordination may pose less of a challenge for some subnational governments than others.

A notable political challenge is ensuring sustained, high-level support for green budgeting from both administrative and elected officials. Green budgeting necessitates fundamental changes in the functioning of the regional or municipal government and in the relationships of the government with its territorial stakeholders (citizens, businesses, partners, etc.). Such changes cannot take place without the support of government officials, who at the same time can resist these changes if they are too burdensome, uncoordinated, and politically risky.

Ensuring follow-up over time in order to identify trends and prevent green budgeting from becoming a one-off exercise is also particularly challenging. Green budgeting practices should be developed step-by-step in order to find the right balance between feasibility and comprehensiveness and to integrate lessons learned along the way.

Overall, it is important to note that green budgeting is a means to an end, not an end in itself. Green budgeting will not ensure the green transition; however, it can help to achieve the transition's goals. Put plainly, green budgeting is not a silver bullet. It is one of several tools that subnational governments have at their disposal for catalysing the green transition together with other instruments, such as regulatory policies, or environmental and land-use planning tools. Green budgeting is most effective when it is used in combination and co-ordination with these other government instruments and actions.

Current approaches in green budgeting: international, national and subnational perspectives

A diversity of green budgeting practices has emerged in the past two decades at both national and subnational levels. Concurrently, international organisations working on the topic have introduced frameworks to support governments in implementing green budgeting, and several fora have been established to allow for collaboration and sharing of knowledge and best practices. A brief history of green budgeting shows that it remained relatively unexplored until the early 2010s. It gained momentum following the Paris Agreement in 2015 and the One Planet Summit in 2017, where the OECD Paris Collaborative on Green Budgeting was launched. As interest in the topic has continued to grow, organisations such as the OECD, the International Monetary Fund (IMF) and the European Commission have developed green budgeting frameworks. Green budgeting tools are being progressively used, adapted, and developed further by governments at all levels, including green budget tagging, environmental tax reform, climate and environmental impact assessments and green budget statements.

A stocktake of existing subnational green budgeting practices in OECD and EU countries

In recent years, as an ever-growing number of regions and cities have set ambitious climate and environmental targets, the interest in subnational green budgeting has also grown steadily as has the number of subnational governments implementing green budgeting practices. The post-COVID-19 recovery plans, strongly centred on environmental and climate issues, certainly contribute to this trend. For some countries, new green budgeting practices are linked to other priority budgeting methods such as gender budgeting or pro-poor budgeting that are complementing traditional incremental budgeting practices.

There is no one-size-fits-all approach to green budgeting. There is a need for different approaches to reflect the differences in the scale and type of climate and environmental challenges faced by different subnational governments depending on their location (e.g. urban vs rural, coastal vs mountainous areas, etc.) and characteristics (e.g. demographic and geographic size). Subnational government responsibilities also vary across countries and across levels of government (e.g. regions vs municipalities). The climate and environmental impact of subnational government policies and actions differs according to the level of decentralisation and the assignment of subnational government responsibilities and revenues. In federal and decentralised countries, spending and revenue decisions are likely to have a higher impact on the green transition than in more centralised countries, where local governments play a more minor financial role.

Moreover, there is a singular green budgeting approach for subnational governments because budgeting and accounting systems differ substantially from one country to another, and even within countries, across levels of subnational governments. This heterogeneity in terms of accounting and budgetary systems is to be expected given the extreme diversity of multi-level governance systems across countries.

The trend in adopting green budgeting is not necessarily limited to subnational governments with large budgets; although the issues differ depending on the size of territories and the scope of responsibilities, implementing green budgeting in small subnational governments is equally of interest, and can be easier given the more modest size of the budget.

A stocktake of existing subnational green budgeting practices in OECD and EU countries found that green budgeting encompasses a variety of practices including carbon budgets, ecoBudgets, climate budgets, environmental and climate impact analyses, and more. These practices also vary in terms of coverage. Some only assess capital expenditures while others include current expenditures. In terms of green objectives, some practices focus only on climate change adaptation and mitigation while others include broader environmental objectives such as biodiversity or water and air pollution. Moreover, some practices combine green budgeting with other priority budgeting approaches such as SDG budgeting, social objectives and gender budgeting. In some cases, these existing subnational practices were inspired by national green budgeting exercises and methodologies, and in other cases they are stand-alone.

Among the countries identified in the stocktake as having subnational green budgeting exercises, France stands out for having a large number of green budgeting exercises at all three levels of subnational government: regional, departmental, and municipal. Other interesting exercises were identified in Austria, Italy, Norway, Spain and the United Kingdom. Although outside the scope of the stock-take, subnational green budgeting practices were also identified in non-OECD and EU countries, particularly in Asia.

At the regional level, there are a variety of green budgeting methodologies in use. In contrast, at the municipal level, most municipalities, regardless of the country, were found to have based their green budgeting practice on one of two methods that they then adapted to their specific context and policy aims: the climate budgetary assessment (climate budget tagging) or the climate budget approach (a climate governance system that integrates emissions impact assessments of proposed and adopted expenditure items into decision-making processes).

Two case studies: Brittany (France) and Venice (Italy)

The French region of Brittany began working on developing its own green budgeting process at the end of 2020. These efforts led to the development of a pilot climate budget tagging methodology that was tested on the region's 2020 closed accounts. Publications and methodological support from the Institute for Climate Economics (I4CE), as well as the Region's participation in a green budgeting working group consisting of other interested French regions, facilitated this experimentation. This pilot methodology is now being consolidated by the region in order to be replicated in the 2023 draft budget. The exercise has highlighted the operational, methodological, political, and organisational challenges for implementing green budgeting at the regional level as well as the elements necessary to achieve success.

The city of Venice, Italy is working towards further integrating climate and environment considerations into its budget. Though not currently engaged in a green budgeting process, the municipality has shown interest in developing new budgeting practices and increasing links between climate and environmental science, indicators, and the budgetary decision-making processes. However, there are some considerable challenges faced by the municipality due to its unique climate change vulnerabilities and financial constraints. The approach must therefore be closely linked with other ongoing regional and national climate initiatives that the municipality is a part of, to enhance synergies and avoid creating additional human and financial resource burdens.

Six key guidelines for subnational green budgeting

The stocktake of existing subnational green budgeting practices in the OECD and EU, and the two case studies of Brittany and Venice, provide valuable insights into the prerequisites and mechanisms necessary to develop and implement a green budgeting practice.

The knowledge gathered from these outputs is summarised below as a set of six key guidelines for regions and cities to use in developing and launching their own subnational green budgeting practice. The purpose of these guidelines is to help subnational governments, regardless of their type, level of responsibility or their size, to put in place the conditions necessary to launch or strengthen a green budgeting practice, and make it a long-term practice. The guidelines are accompanied by recommendations for supranational bodies, national and subnational governments. With rapidly growing interest in subnational green budgeting in OECD and EU countries, more methodological, financial, and technical support is needed to ensure that regions and cities of all sizes can make full use of the tool. Supranational bodies and national governments have a key role to play in providing this support and creating an enabling environment for subnational governments to adopt green budgeting.

Guideline 1: Conduct a diagnostic of local environmental and climate challenges as a pre-requisite to launching a green budgeting practice

Green budgeting practices must be based on a holistic diagnosis of regional and local environmental and climate challenges that specify the subnational government's green objectives, the financial means required to implement these objectives, and the indicators that will be used to monitor the progress in achieving them.

To carry out these diagnoses and define these indicators, subnational governments must be able to rely on clear assignments of responsibilities, have sufficient financial and technical resources and have access to scientific information adapted to their characteristics. Robust governance tools are also needed to manage all the internal and external interactions linked to the green budgeting project.

- ▶ Prepare a transversal territorial diagnosis that is consistent across government levels and in line with national and regional planning schemes.
- ▶ Use the diagnostic to define specific objectives for the territory as well as associated performance indicators.
- ▶ Include all stakeholders in the process of defining green objectives and performance indicators.

Guideline 2: Ensure strong, high-level involvement and support from both the administrative and elected sides of government

Strong political and administrative involvement is necessary to start a green budgeting practice. The involvement of elected officials should be formal and public in order to give the project the necessary political weight. The involvement of the administration at the highest level is also essential to ensure that the necessary human and financial resources are in place to implement the green budgeting project.

- ▶ Support green budgeting practices through strong political involvement and support.
- ▶ Ensure the implementation of the necessary means thanks to high-level administrative management.

Guideline 3: Ensure the practice relies on a robust, shared scientific basis to facilitate public trust and ensure the practice can adapt to changing scientific evidence

A shared scientific culture based on sound climate and environmental assumptions and evaluation methodologies is essential to enable the development of green budgeting at the sub-national level. International organisations and national governments have a role to play in disseminating this culture, notably by continuing to develop green and transitional taxonomies adapted to local and regional authorities, and by supporting networks of experts and research on these subjects. For their part, local and regional authorities should improve the level of training of staff and elected representatives in environmental and climate matters and be very transparent about the green budgeting approach undertaken and the methodologies used.

- ▶ Develop shared repositories of climate and environmental science and assessment methodologies.

Guideline 4: Adopt a step-wise approach to implementing green budgeting in order to learn from previous steps and reinforce the alignment of the practice with local strategic priorities

Green budgeting practices should be implemented gradually, in order to take into consideration the priorities of the subnational government, to capitalise on foreign or national experiences, to put in place the necessary elements for the practice, to involve all stakeholders, and to adjust the government's broader budgetary policies to its climate and environmental objectives. This realistic approach should nevertheless

be accompanied by an ambitious implementation programme, adapted to local issues, the financial means of the subnational government and its technical capacity.

- ▶ Gradually widening the scope of green budgeting helps get the process started.
- ▶ Cross green budgeting with the government's other priority budgeting approaches and green initiatives.

Guideline 5: Integrate the green budgeting practice into existing public financial management procedures and tools to help ensure the practice endures

Budgetary procedures and tools need to be adapted to incorporate the green budgeting dimension. National governments can help by adapting the granularity of public accounting requirements or adjusting the format of budgets to allow for better identification and presentation of the climate and environmental impact of expenditures and revenues.

At the subnational level, internal procedures need to be adjusted to integrate green budgeting at all stages of the budgetary process with, if necessary, the implementation of new governance mechanisms to involve all stakeholders in the process. Internal and possibly external audits can help to ensure the robustness of the procedures and to reassure stakeholders of the quality of the work.

- ▶ Budget procedures and tools must be adjusted to integrate the green budgeting approach.
- ▶ Integrate green budgeting into internal and external audit procedures.

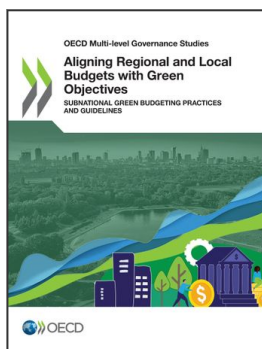
Guideline 6: Include revenues within the scope of the green budgeting practice to ensure the entire budget aligns with green objectives

Although there is often little room for manoeuvre on the revenue side at subnational level, green budgeting should also cover the revenue side of subnational budgets. The first step is to measure the resources needed to cover climate and environment-related current and capital expenditure, and to ensure that all available funds, both traditional and innovative, are mobilised. Green budgeting also helps to ensure that the structure of revenues is in line with the subnational governments' green strategy, by analysing the overall environmental and climate impact of elected officials' funding choices.

- ▶ Ensure sufficient permanent funding and the mobilisation of all available green revenue sources for climate and environmental action.
- ▶ Analyse the environmental and climate impact of revenue sources.

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