



# Decarbonisation and intergovernmental fiscal relations

Presentation by Teresa Ter-Minassian at the 19<sup>th</sup> annual Meeting of the Network on Fiscal Relations across Levels of Government

Paris, March 20, 2023



# Outline

- ▶ This presentation draws on **a joint paper with Luiz de Mello**
- ▶ The case for **subnational involvement** in targeted reductions of greenhouse gas emissions (henceforth **decarbonisation**)
- ▶ **Main subnational policy options** in spending, revenues, and regulation
- ▶ The case for, and main tools of, **national involvement in subnational decarbonization efforts**
- ▶ **Strengthening intergovernmental cooperation in the decarbonization agendas**





# Main reasons for SNGs' involvement in decarbonisation

- ▶ The current level and projected increase in CO<sub>2</sub> emissions vary widely not only across, but also within, countries. Accordingly, **required decarbonisation efforts will differ among regions and localities, entailing different costs and benefits**
- ▶ By virtue of their **knowledge of local conditions**, SNGs need to be involved in the design and implementation of such efforts
- ▶ Most importantly, **SNGs have sole or shared responsibilities in policy areas relevant for decarbonisation**
  - ▶ Spending
  - ▶ Investments
  - ▶ Revenue mobilization
  - ▶ Regulation



# Subnational responsibilities in spending areas relevant for decarbonization (I)

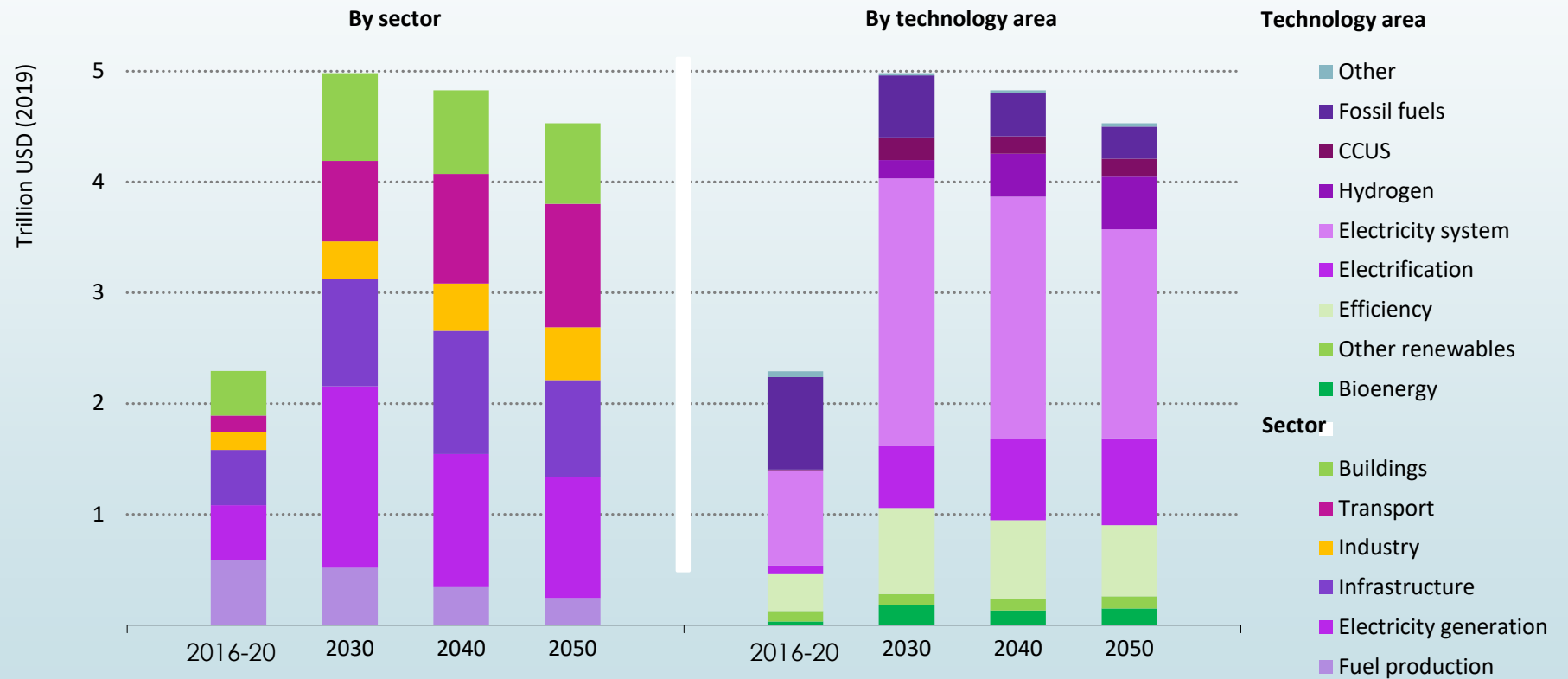
- ▶ In **the electricity sector**, SNGs can influence production, pricing and investment decisions of their SOEs operating in the energy sector, as well as the energy efficiency of street lighting and district heating
- ▶ In **the transport sector**, they can promote
  - ▶ **increased use of urban and regional public transport**, and of railways for long-haul transport
  - ▶ **electrification of transport systems** and light vehicles, and increased use of biofuels and hydrogen in heavy vehicles and aviation; and
  - ▶ **behavioural changes to reduce demand for fossil fuels** (e.g., less commuting, greater recourse to carpooling, increased use of low- or non-emitting vehicles, such as bicycles).



# Subnational responsibilities in spending areas relevant for decarbonization (II)

- In the **residential and commercial buildings sector**, SNGs can
  - directly influence carbon emissions from **low-cost public housing** by adhering to appropriate standards for the sourcing and efficiency of energy in new buildings, and by retrofitting old ones; and
  - promote the decarbonisation of **private housing** through their taxation, subsidization, and regulatory policies
- In the **land use** area, SNGs can promote decarbonisation by
  - limiting or banning the mining of coal and the exploration of fossil fuels in their respective jurisdictions
  - safeguarding existing forests, which are important carbon sinks;
  - expanding urban green spaces; and
  - limiting urban sprawl through regulation
- SNGs can also promote decarbonisation through actions affecting **their own use of energy**

# Investments needed for carbon neutrality by mid-century





# Subnational investments in green infrastructure and related challenges

- ▶ **SNGs will have to bear the brunt of such investment effort;** they accounted on average for 69% of climate-related public investments in OECD countries in 2019. However, these investments were equivalent to only 0.4% of GDP at the subnational level
- ▶ The additional investment effort will entail **substantial funding, financing, and governance challenges for SNGs:**
  - ▶ Additional own revenue mobilization
  - ▶ Fiscal rules allowing creditworthy SNGs to access appropriate financing sources
  - ▶ Improved debt and asset management capacities at the subnational level; and
  - ▶ Addressing the pervasive flaws in the PFM and PIM systems of most SNGs





# Options to mobilize subnational own revenues for decarbonization

- ▶ **Green taxes**

- ▶ Own carbon taxes or surcharges on national ones
- ▶ Emission trading systems
- ▶ Taxes or surcharges on the use of fossil fuels
- ▶ Vehicle taxes
- ▶ Taxes on electricity consumption
- ▶ Land value capture taxes
- ▶ User fees

- ▶ **Other subnational revenue handles** to fund green investments

- ▶ Some SNGs use **tax credits** to promote decarbonisation



# Subnational regulation for decarbonisation

- ▶ **SNGs exercise regulatory powers for decarbonisation purposes mainly in the areas of transport, land use and buildings**
- ▶ In the **transport** area, they can shape the design of public transport systems; incentivize the use of fuel-efficient means of transport through dedicated lanes and pedestrian zones; and set vehicle emission standards in their jurisdictions
- ▶ In the **land use** area, they can affect the amount of land available for different uses, as well as the degree of urban sprawl
- ▶ In the **buildings** area, they can affect energy efficiency by setting appropriate standards for energy efficiency of new buildings; and by addressing the split incentives of landlords and tenants to invest in energy-efficient retrofitting of older buildings



# Why national governments (NGs) need to be involved in subnational activities that impact decarbonisation

- **Main reasons for national involvement in subnational activities relevant for decarbonization**
  - Because they are responsible for defining and delivering on any **international commitment to reduce emissions**
  - To avoid or at least limit any significant **cross-border spillovers of subnational activities** that impact decarbonization, if adverse, and support them, if favourable
  - To **prevent a race to the bottom** in the use of subnational taxation or regulatory powers affecting decarbonisation
  - Because NGs are better placed than SNGs to **mitigate asymmetric costs of decarbonisation across the national territory**; and
  - Because NGs have **greater financial resources and technical expertise** to support subnational investments in decarbonisation
- **In practice, national governments' involvement varies significantly across countries**



# Possible forms of national involvement

- ▶ **Setting nationwide minimum standards** for public and private activities that have significant impact on emissions, leaving to SNGs to go beyond such standards, if they so wish
- ▶ **Supporting subnational own revenue mobilisation efforts for decarbonisation**
- ▶ **Special purpose transfers** to mitigate energy transition costs, and **capital grants** for subnational investments in green infrastructures
- ▶ **Facilitating sustainable financing** for subnational investments in decarbonization, through the reform of fiscal rules and the creation of national financial institutions specialised in the financing of creditworthy subnational investments



# Intergovernmental cooperation in decarbonization policies

- ▶ **An effective alignment of national and subnational decarbonisation policies requires open and constructive intergovernmental dialogue**
- ▶ International experience shows that **the institutionalization of such dialogue through the creation of intergovernmental cooperation fora** is important to its effectiveness
- ▶ Both **high-level vertical cooperation and more technical sectoral cooperation fora** are needed for an effective alignment of national and subnational decarbonization policies
- ▶ Effective **horizontal cooperation** in decarbonisation efforts is especially important among the constituent municipalities of metropolitan areas
- ▶ Cooperation fora can help **promote sharing of knowledge**, good practices, successful and unsuccessful experiences, and can generate positive demonstration effects.



**Thank you for your attention!**