



## PACIFIC ISLANDS FORUM SECRETARIAT

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### FORUM ECONOMIC OFFICIALS MEETING

6 – 7 July 2021

### FORUM ECONOMIC MINISTERS MEETING

13 – 14 July 2021

## AGENDA ITEM 5: LEVERAGING CLIMATE FINANCE OPPORTUNITIES

### Purpose

The paper provides an update on three regional enabling approaches that will support Members to leverage new sources of finance to address the climate change crisis and promote a COVID-19 recovery pathway that is climate-sensitive and more resilient.

### Summary

Access to climate finance is critical to supporting a green recovery pathway post-COVID-19 and unlocking the ‘triple dividend’ of resilience, which in this context: (i) reduce losses and damage from climate change impacts; (ii) stimulate socio-economic recovery; and (iii) achieve resilient development outcomes. The paper focuses on three enabling approaches to: strengthen national public financial management systems for improved access and management of climate finance, strengthen private sector engagement to unlock private finance for climate action, and identify innovative initiatives to attract new sources of financing, including Debt-for-Climate Swaps, Sustainability Bonds and Carbon Emissions Levy.

### A. Problem/Opportunity Identification

The prolonged impacts of COVID-19 on national economies in Forum Island Countries (FICs) are further exacerbated by the recurring costs associated with response and recovery processes as well as public infrastructure damage and losses from more frequent and catastrophic impacts of climate change and disasters<sup>1</sup>. This, together with the resource needs to prevent, contain and recover from COVID-19, have placed significant stress on Ministries of Finance and may increase debt burdens.

2. Despite the pandemic having a negative impact on the demand and delivery of climate finance, there is assurance from recent statements by developed countries to maintain their earlier commitments to contribute to the USD100 billion per year climate finance goal. Most global climate funds such as the Green Climate Fund have successfully concluded resource mobilisation processes in 2020. There is also growing support at the international level for new and innovative financing options, including debt-for-climate swaps, green and blue bonds, sustainability bonds, insurance, coral reef financing, forest financing etc. These present FICs with considerable opportunities to strengthen the necessary enabling environment to leverage a more diverse range of financing options.

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<sup>1</sup> Economic losses from cyclones and flooding in the region in 2020 were around USD1 billion with at least 71 lives lost. Annual average losses are around USD500 million.

3. This paper complements other FEMM papers related to *Disaster Risk Finance*, the *Pacific Resilience Facility*, and the *Pacific Islands Climate Change Insurance Facility*, with a specific focus on three enabling approaches to:

- a) Strengthen national public financial management (PFM) systems to enhance direct access to climate finance and address aspects of effectiveness;
- b) Strengthen private sector engagement to unlock private finance for climate change action; and
- c) Identify innovative initiatives to attract new sources of financing.

## **B. Background**

4. Over the past three years, the Secretariat has socialised the ‘triple dividend of resilience’ concept, linked to the goals of the *Framework for Resilient Development in the Pacific (FRDP)*, to support Members contextualise the importance of risk-informed development planning and investment to: (i) reduce losses and damage from climate change impacts; (ii) stimulate socio-economic recovery; and (iii) achieve resilient development outcomes. Improved access to international climate finance and addressing aspects of effectiveness will unlock the triple dividend.

5. At the global level, the average annual adaptation costs in developing countries are currently in the range of USD70 billion with the expectation of reaching USD140-300 billion in 2030<sup>2</sup>. For the Pacific, the annual cost for adaptation on a best-case scenario is USD234 million by 2020 and USD285 million by 2040<sup>3</sup>. Since 2010, the Pacific has accessed around USD2.2 billion in climate finance<sup>4</sup>. This equates to an estimated annual climate funding of USD200 million for the Pacific, which not only falls short of the adaptation financing required but also associated with slow disbursement due to stringent procedures by the donor or limited absorptive capacity by the recipient country. This is a conservative estimate and may not include development finance through Multilateral Development Banks (MDBs) that provides climate co-benefits as articulated in the MDB Joint Climate Finance reporting.

6. Of the USD2.2 billion approved for the Pacific, 59% was accessed from bilateral channels while 41% from multilateral channels – mainly from the Green Climate Fund (GCF), Adaptation Fund (AF), Global Environment Facility (GEF), and the Climate Investment Fund (CIF).

7. While all FICs have accessed international climate finance, the key gaps are as follows:

- a) Majority of the funds accessed were through third-party conduits – regional or multilateral accredited entities. This is attributed to under-developed public financial management systems to quickly secure national implementing entity (NIE) status. Having robust country systems and institutional processes could enable direct access through national accredited entities (e.g.

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<sup>2</sup> UNEP (2020) <https://wedocs.unep.org/bitstream/handle/20.500.11822/34721/AGR2021.pdf?sequence=3&isAllowed=y>

<sup>3</sup> World Bank (2016), Pacific Possible Report. <http://documents1.worldbank.org/curated/en/655081503691935252/pdf/119111-WP-PUBLIC-p154324-ppClimatechangebackgroundfinal.pdf>

<sup>4</sup> PIFS calculations (2021) drawn from PIFS and UNDP led national climate finance assessments in ten Pacific Island Countries; Stockholm Environment Institute (2017); Lowy Institute (2018); Climate Funds Update; Green Climate Fund, Adaptation Fund, Global Environment Facility and Climate Investment Fund websites.

Cook Islands Ministry of Finance<sup>5</sup>, Tuvalu Ministry of Finance<sup>6</sup> etc.);

- b) Lack of expenditure tracking mechanisms to ensure the effectiveness of climate finance. Initiating climate budget tagging (e.g. Fiji Ministry of Economy) and robust M&E systems would ensure climate finance reaches the most vulnerable sectors and communities;
- c) None of the projects approved by global climate funds such as the GCF which include a private sector facility is targeted to the private sector. Building the capacity of the private sector is critical to meaningfully engage with government and access GCF grants (e.g. Vanuatu Chamber of Commerce, Tonga Chamber of Commerce etc.) to stimulate private investments in climate related interventions, particularly adaptation projects (e.g. the Aumen Resilient Agriculture Fund which mobilised USD30 million of private finance to leverage USD26 million from the GCF to support early-growth climate resilient agribusinesses in Africa<sup>7</sup>); and,
- d) A lot of focus and resources invested by FICs had been primarily on three vertical climate funds – GCF, AF and Global Environment Facility (GEF). With the effects of COVID-19 and increased competition for limited resources within these global climate funds, FICs should pursue other innovative projects or initiatives to access new sources of financing. Also, ensuring that current sources of climate funding embed resilient development outcomes.

### C. Analysis of Regional Enabling Approaches

#### ***Enabling Approach 1: Strengthen national public financial management (PFM) systems to enhance direct access to climate finance and address aspects of effectiveness***

8. A robust national PFM system is critical to decisions made by donors in assessing whether national systems are suitable to manage their funds. A robust PFM system can play an important role in underpinning the accreditation process for direct national access to global climate funds such as the GCF and AF as well as accessing other sources of development finance that could be applied for resilience initiatives. The strength of FICs' PFM systems has been measured using the *Public Expenditure and Financial Accountability (PEFA) Framework*<sup>8</sup>. Capacity constraints in many FICs have made it difficult to achieve a consistently high level of performance. Effective PFM systems are always desirable, but for some FICs, there may be a risk of diverting scarce national resources and efforts to achieving standards beyond what may be appropriate for local circumstances in the expectation that this will necessarily unlock access to multilateral funds, whereas this may not be the case.

9. In August 2020, Forum Economic Ministers 'commended the collaborative work of the Informal Technical Working Group<sup>9</sup> on Public Financial Management and Climate Finance coordinated by the Pacific Islands Forum Secretariat and the Pacific Financial Technical Assistance Centre (PFTAC), and requested an update in 2021'.

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<sup>5</sup> NIE to both the GCF and Adaptation Fund but has not yet accessed any project.

<sup>6</sup> NIE to the Adaptation Fund since 2019 but has not yet accessed any project.

<sup>7</sup> <https://www.greenclimate.fund/project/fp078>

<sup>8</sup> [https://www.pefa.org/sites/pefa/files/resources/downloads/PEFA\\_2016\\_Framework\\_Final\\_WEB\\_0.pdf](https://www.pefa.org/sites/pefa/files/resources/downloads/PEFA_2016_Framework_Final_WEB_0.pdf)

<sup>9</sup> Members include PIFS, PFTAC, IMF, World Bank, ADB, EU, UNDP, DFAT & MFAT.

10. Since 2020, the Technical Working Group has met eleven times and the following are some of the key outputs:

- a) Provided input to a new draft PEFA Climate Module developed in 2020 to complement future PEFA Framework assessments. This new Climate Module assesses the responsiveness of national PFM systems toward climate change policies.
- b) Supported the PEFA Secretariat to roll-out the first global pilot of the new Climate Module in Samoa<sup>10</sup>. The second study is planned for Fiji in the second part of 2021. Lessons drawn from the Samoa assessment suggest continuing support to broader PFM reforms to improve the strategic allocation and utilisation of resources, and include the following areas specifically to address climate related PFM issues:
  - review revenue policy to examine its impact on climate change mitigation and adaptation;
  - improve public investment management practices to incorporate climate change resilience criteria and infrastructure maintenance into the overall appraisal, selection and prioritisation of projects and activities;
  - undertake changes to the fiscal strategy to ensure the budget circular begins to mainstream climate related and other SDG expenditure into ministry and agency budget submissions; and
  - examine the approach towards tagging and tracking climate related expenditure from budget to execution for all operational, programmatic and investment expenditure, including programs through State-owned enterprises that deal with priority sectors such as water, energy, and transport infrastructure.
- c) Development of a Regional GCF and AF National Implementing Entity (NIE) Guideline. On average it has taken developing countries between 300 – 700 workdays to achieve national accredited entity status. Many FICs are pursuing the NIE modality and this guide would be a useful toolkit to provide step-by-step tips noting the capacity constraints in many FICs to fully understand the GCF and AF accreditation templates. Important to note that getting accreditation to the Adaptation Fund does not guarantee accreditation to the GCF.
- d) Formulation of a Discussion Paper on the Effectiveness of Climate Finance in the Pacific. The aim of this paper was to identify possible areas of reform and further dialogue for strengthening approaches to climate financing in the Pacific region. This is based on an analysis of access, delivery, and impact of climate finance through a rapid review of literature, key informant interviews and systems mapping. It is intended to inform a series of roundtable dialogues in the Pacific and internationally. The findings are summarised in **Annex 1**.

11. Looking ahead, the Informal Technical Working Group on PFM and Climate Finance should be supported to provide ongoing advisory support to the Forum Economic Ministers Meeting on climate finance as well as explore affiliation to the Pacific Resilience Partnership (PRP). Also, the Technical Working Group should be requested to develop an annual workplan to support its functions and role in strengthening the capacity of FICs.

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<sup>10</sup> Samoa report accessible at: [https://www.pefa.org/sites/pefa/files/2021-03/WS-Feb21-CRPFM-Public%20with%20PEFA%20Check\\_0.pdf](https://www.pefa.org/sites/pefa/files/2021-03/WS-Feb21-CRPFM-Public%20with%20PEFA%20Check_0.pdf)

### ***Enabling Approach 2: Strengthen Private Sector Engagement to Unlock Private Finance for Climate Change Action***

12. Of the global climate finance mobilised, around 69% is private finance. In the context of the USD100 billion commitment by developed countries which will come from a wide variety of sources, that equates to USD69 billion. FICs' focus in the past 11 years had been mainly on vertical public climate funds such as the GCF, AF and GEF. Strengthening the capacity of the Pacific private sector and providing them with the necessary incentives could facilitate improved access to international private finance for climate change. Additionally, development partners, financial institutions could help countries to attract private funds<sup>11</sup> including support for public-private partnerships.

13. The Forum Secretariat is working with the Pacific Islands Private Sector Organisation (PIPSO), International Labour Organisation (ILO) Bangkok Office, Investment Climate Reform Facility, and the Pacific Trade Invest (PTI) offices to support national chambers of commerce with green and inclusive business development approaches, connect with private investors, and access technical assistance to build capacity and develop proposals to access global climate funds.

14. Through the support of the Pacific Trade Invest (PTI) office in New Zealand, the Forum Secretariat has been having discussions with Camco – a private investment firm<sup>12</sup> based in the UK - to assess the feasibility of a project pipeline for private investors in climate resilient initiatives in FICs. Camco had mobilised private financing for clean energy and electrification projects in the Caribbean, Africa and Asia. In 2020, Camco was accredited as an implementing entity to the GCF. Working closely with firms such as Camco will enable FICs to access the GCF Private Sector Facility and incentivise international private investors to invest in green energy projects in the region.

15. With support from the EU PACRES Project, the Forum Secretariat has also progressed a number of initiatives with national chambers of commerce in the past 12 months to strengthen private sector capacity and engagement in climate finance (see **Annex 2**). In the last 12 months, the support from government and GCF National Designated Authorities for national private sector organisations to access GCF readiness grants and climate project funding has grown significantly.

16. Going forward, Members should consider continuing the support of regional efforts to build the capacity of the private sector to access climate finance, including GCF readiness and project funding, and mobilise private investment for longer term project pipeline.

### ***Enabling Approach 3: Identify innovative initiatives/options to attract new sources of financing for Climate Resilient Development***

17. Coordinated green investments must be at the center of regional cooperation in “building back better”. The Pacific needs to scale up investments in all forms of capital projects/initiatives and at the scale needed. Climate funding is critical to financing a ‘green recovery’, including managing risks associated with disasters such cyclones and health pandemic. Similarly, COVID-19 recovery financing also needs to be risk informed to achieve a climate resilient outcome for the Pacific.

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<sup>11</sup> <https://www.adb.org/news/features/ireland-ADB-helping-small-island-states-pacific-respond-climate-change>

<sup>12</sup> <https://www.camco.energy/about-us/>

18. FICs should take a flexible approach and be open to a range of new and innovative opportunities to access new sources of financing. This is in line with the decisions of the Forum Economic Ministers Meeting in 2020.

19. Since March 2021, the Forum Secretariat initiated a Monthly Policy Brief for Economic Officials covering two resilience financing options per month (e.g. Debt-for-Nature Swap, Coral Reefs Resilience Finance, Green Bond, Blue Bond, Forest Carbon Facility etc). It is hoped these briefs will stimulate interest from FICs to explore specific initiatives that are appropriate to their national context. Noting the growing debt stress on some FICs due to the recent impacts of climate-induced disasters and the COVID-19 pandemic, the Secretariat is currently working with UNESCAP Bangkok to commission a study on the feasibility of Debt-for-Climate Swaps in the Pacific. To complement that, a Regional Climate Finance Virtual Workshop on Sustainability Bonds and Debt for Climate/Resilience Swaps is planned for 23 June, targeting government officials.

20. To seize new opportunities and leverage on the growing global interest to tax carbon, including from the World Trade Organisation, the Forum Secretariat has also developed a **Concept Note for a Carbon Emissions Levy** (see [Annex 3](#)). This builds on a joint proposal recently submitted by the Republic of the Marshall Islands and Solomon Islands to the International Maritime Organisation by to impose a carbon tax on the shipping industry.

21. The objective for placing a levy on carbon emissions is to build on current national initiatives to encourage companies and consumers to:

- a) reduce their carbon emissions footprint;
- b) provide additional revenue to Member governments to support climate change action;
- c) provide a financing option for new policy approaches and investments in non-fossil fuel alternatives;
- d) Pave the way for decarbonised Pacific economies; and
- e) assist Pacific countries meet their Nationally Determined Contributions (NDCs) under the Paris Agreement on Climate Change.

22. The introduction of a carbon emissions levy, alongside other initiatives seeking to use fiscal measures to achieve greater economic efficiency, has the potential to return a Triple dividend: (i) a reduction in carbon emissions, (ii) better economic performance, and (iii) a stronger budgetary position. Forum Economic Ministers' support to undertake further analytical work and consultations on the feasibility of this concept is required with further updates to be provided in 2022.

#### **D. Consultation**

23. The three options discussed in this paper have been widely consulted and involved input both internally and externally from members of the Informal TWG on PFM-Climate Finance (PFTAC, IMF, EU, DFAT, MFAT, World Bank, UNDP and ADB).

## **E. Next Steps & Resource Implications**

25. Subject to the Forum Economic Ministers' support, the Secretariat will work closely with respective agencies and Members to progress the directives. For approach 1, there will be resource implications that could be covered by the members of the informal TWG from both existing and new resources. For approach 2, there is funding through the EU PACRES Project to support this work until 2023. For approach 3, the Secretariat will need to mobilise new external funding to support the analytical work and consultations anticipated.

Pacific Islands Forum Secretariat  
15 June 2021

### Findings of a Discussion Paper on the Effectiveness of Climate Finance in the Pacific

#### *Current climate finance 'trends' in the Pacific*

- Trends in recent years have seen increased commitments/approvals of climate finance for the region, in line with the roll out of the Green Climate Fund, as well as from other multilateral and bilateral mechanisms. Unfortunately, the actual disbursement has been low. Climate finance flows to the Pacific are often provided through short-term project-based modalities, which bring administrative challenges and are often poorly integrated and coordinated with other sectoral development interventions.

#### *Key Issues*

- Climate change and climate finance are issues with high political visibility and the resulting international and regional dynamics influence the current delivery of climate finance to the Pacific region. While access is important for FICs, focus should also be on how the composition of the expenditure has been dedicated to supporting climate change initiatives.
- Current financing approaches focused on accessing finance for short term projects, particularly through the vertical climate funds, can 'distract' countries from achieving better quality results in the Pacific, especially with regards to absorptive capacity in light of the need for countries to manage multiple and rigorous requirements for accessing international public climate finances;
- There can be a 'disconnect' between the finance accessed by the governments and with the communities that are impacted by climate change. Longer term community resilience needs to be the driver for financing solutions;
- An optimal trajectory is to find the right balance between two critical dimensions of climate finance – the level of access and accreditation, and the level of impact (effectiveness).
- Any approach for financing climate action needs to be supported by better adherence to and application of development effectiveness principles, as laid out in the Busan Declaration of Effective Development Cooperation, among others;
- Examples of approaches which incorporate programmatic and long-term considerations for climate finance include activities such as climate budget tagging and development of climate finance roadmaps.
- Countries can articulate more comprehensive climate change financing frameworks which include prioritised and costed financing needs but also reform measures for the application of country systems to meet those needs.
- A 'development-first' approach to climate financing brings several strategic advantages including better incentives for countries and partners to deal with the root causes of vulnerability and addressing

these through a more diverse range of financing sources and instruments. This can be substantiated by integrating climate considerations into broader SDG integrated national financing frameworks.

*Areas for reform and taking the discussion forward*

- Measures for reform can include:
  - i. Strategic consideration of whether countries are interested, and if so, which national entities would be most suited for direct accreditation, given the significant time and resources required to undertake this process;
  - ii. Enhancing the quality of pipeline based on more programmatic, human-centred and evidence-based formulation processes;
  - iii. Leveraging climate finance to promote replication and scale of initiatives and to mobilise greater public and private sector finance in resilient development pathways;
  - iv. In-country reforms (e.g. legislation), awareness and high-level discussions on strengthening PFM systems including transparency and accountability mechanisms which underpin climate responsiveness, and building appropriate human capacity to support this;
  - v. Identifying and supporting opportunities better suited to the Pacific context in terms of size and scale. This may require advocating for changes to climate finance rules to promote smaller scale community resilience programmes where appropriate; and
  - vi. Learning networks can provide a platform for continuous testing, learning and adapting approaches to climate finance. These could include establishment of information sharing and reform networks that are country-led (possibly by Ministries of Finance); and identifying relevant policy and advocacy networks regionally and international, that provide platforms for focusing on climate finance effectiveness and the conditions and reform needed to achieve this for the Pacific.

### Initiatives progressed to strengthen Private Sector engagement in Climate Finance

#### *Sub-regional meeting*

- Micronesia sub-regional private sector workshop on climate finance was conducted on 11-12 November 2020. The 2-day workshop provided an opportunity for the Micronesian representatives to learn from each other what their approaches at the national level have been in relation to strengthening private sector engagement in climate change. PIPSO underlined the need to be mindful of the uniqueness of the private sector in the region and the workshop an important platform to discuss how the private sector and government can work together going forward. Partners who supported include the United Nations Framework Convention on Climate Change (UNFCCC) Secretariat, Asian Development Bank (ADB) Private Sector Operations Department (PSOD), Micronesia Conservation Trust (MCT), Fiji Development Bank (FDB), SPREP, Adaptation Fund Secretariat, Vanuatu Business Resilience Council, and USAID Climate Ready.

#### *National private sector mapping on climate finance*

- Tonga private sector mapping report was endorsed by the government through the CEO of MEIDECC. Information and data collected from the report was used in the readiness grant proposal for the GCF which was approved in January 2021. This will be executed jointly between Tonga Development Fund and the Tonga Chamber of Commerce & Industry.
- Recruitment of a short-term consultant to conduct Fiji's private sector mapping is in progress. Kiribati and Tuvalu are also planned for this year as per their requests received to support the mapping of resilience activities by the private sector. Following the completion of the mapping, additional support could be provided, e.g. for Fiji further support has been requested to access GCF readiness grant.

#### *Information sharing and learnings*

- An information session organised by PIFS and PIPSO on 30 April 2021 where the ILO Bangkok's Bureau of Employers' Activities presented on opportunities available for the private sector related to strategic planning and capacity development. This is an opportunity to mainstream climate change and resilience into their strategic plans and policies. Few Strategic Plans for the chambers of commerce are due for review by end of this year (Fiji, Kiribati and Vanuatu) while Samoa Chamber of Commerce is in the process of recruiting a TA to formulate a new Strategic Plan.
- Information session for the private sector organised on 18 May 2021 focused on Vanuatu's experience where the Chamber of Commerce & Industry through the Vanuatu Business Resilience Council and GGGI accessed GCF readiness grants. Similar sessions will be organised where Cook Islands and Tonga who are the two countries that have also accessed the readiness grant to support the private sector.

#### *Short-term technical assistance and capacity supplementation*

- In the process of recruiting a short-term expert to supplement the capacity of Samoa's Chamber of Commerce to mainstream of climate change into the chamber's new Strategic Plan 2021-2026 and build local capacity to understand and access climate finance.

## Concept Note for a Carbon Emissions Levy for the Pacific

### 1.0 Background

- 1.1 Pacific Islands Forum Leaders, through the Kainaki II Declaration for Urgent Climate Change Action Now, have committed to implementing the Paris Agreement as well as taking action to reduce global greenhouse gas emissions. The Kanaki II Declaration also calls on Members to take the lead in pursuing bold and **innovative regional solutions** consistent with our collective vision to secure the future of our Blue Pacific Continent. Further, through the *Boe Declaration on Regional Security*, climate change has been recognised as the region's single greatest threat through its expanded concept of security.
- 1.2 The introduction of a Carbon Emissions Levy is consistent with the United Nations Secretary General's opening remarks at the opening of the Pacific Islands Forum Leaders-UNSG High level dialogue in May 2019 regarding carbon pricing and transitioning out of fossil fuels in line with countries' Nationally Determined Contributions (NDCs).
- 1.3 This concept also builds on the growing momentum at the international level to tax or put a price on carbon. For instance, the recently appointed Director General of the World Trade Organisation (WTO), Dr Ngozi Okonjo-Iweala, when taking office, noted the need for industries to adopt sustainable trade practices and help curb the impacts of climate change. The WTO has launched a Trade and Environmental Sustainability joint initiative group which had its first meeting in March and expected to be a forum for the discussion of carbon border taxes.
- 1.4 In our own region, the Republic of the Marshall Islands and the Solomon Islands have submitted a proposal to the International Maritime Organisation (IMO), to consider and adopt a mandatory high ambition levy on all greenhouse gas (GHG) emissions from international shipping as an immediate priority. In other related developments, New Zealand's Parliamentary Commissioner for the Environment has proposed a distance-based passenger tax that could raise up to NZ\$400 million (US\$288 million) a year with the money to be utilized for environmental initiatives in the Pacific.
- 1.5 A recent survey<sup>13</sup> of shipping services operating in Fiji (by USP & IUCN) found that the Pacific shipping cost, per tonne/nautical mile, is the highest in the world. This serves as primary barriers to transportation of goods and services, our economic resilience and achievement of our SDG commitments.
- 1.6 Article 4 of the Paris Agreement, which all Pacific countries have ratified, encourages Governments, of Developed and Developing Nations, to make efforts to reduce greenhouse gas emissions and continue to enhance their mitigation efforts taking into account their different national circumstances.

### 2.0 Objective

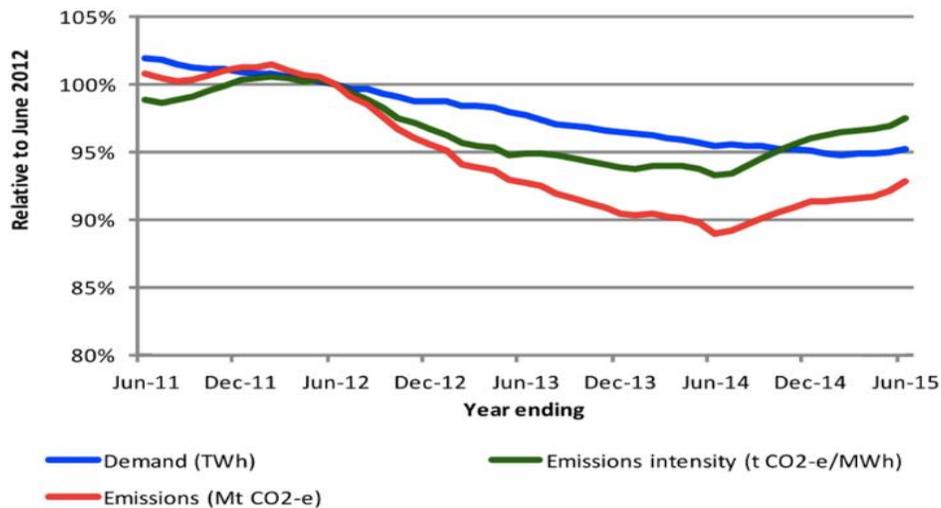
- 2.1 The Carbon Emissions Levy aims to build on current national initiatives to encourage companies and users to reduce their carbon emissions, provide additional revenue to Member governments for climate change projects, provide a financing option for new policy approaches and investments in non-fossil fuel alternatives and assist Pacific countries meet their Nationally Determined Contributions (NDCs).

### 3.0 Rationale

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<sup>13</sup> <https://fijisun.com.fj/2020/03/05/outer-island-connectivity-in-pacific-island-nations/>

- 3.1 A Carbon Emissions Levy will reduce atmospheric concentrations by creating a cost charged for emissions and an incentive to use environmental resources more efficiently. Thus, for greenhouse gases (GHGs), an emissions levy would penalise polluters (polluter pays principle), provide an incentive for lowering the GHG intensity of energy production and consumption, and raise social welfare by mitigating social and environmental damages that would otherwise occur.
- 3.2 The polluter pays principle implies that we should pay the total social cost including the environmental costs. This requires some authority, usually governments to determine the external costs and put a price on it. Putting a Carbon Emissions price on fossil fuels is one such example. Using this example, the introduction of a Carbon Emissions Levy means that the price paid for the polluting fuel closely reflects the social cost. It makes the users pay the total social cost, rather than just their private cost (i.e. Social cost = private cost + external cost).
- 3.3 A carbon emissions price on fuel is an effective tool for meeting domestic emissions mitigation commitments. While the emissions prices may result in an increased cost for electricity and general consumer products, over the long term it can lower demand for fossil energy sources thus promoting switching to lower-carbon fuels in power generation, conserving on energy use and shifting to cleaner sources. In Australia, data analysis of the Energy Operators market following the introduction of the carbon tax finds that emissions intensity, which was increasing until shortly before June 2012, fell continuously (see graph below) for most of the two years to June 2014<sup>14</sup>. Since then, it has increased consistently. Having factored in production demand and other energy demand factors, the major emissions reduction coincided with the introduction of the carbon tax and increased again after it was abolished, just as expected.



Source: Australian National University, Carbon pricing study

- 3.4 A price on carbon emissions should encourage firms and consumers to develop more clean and efficient power generation means and alternatives. For example, with carbon emission pricing it can lead to an accelerated switch to solar power or other cleaner technologies. This is in line with the Leaders *Kainaki II Declaration*, which reaffirmed Climate Change as the single biggest threat to the Blue Pacific continent.

#### 4.0 The economic/business case for a Carbon Emissions Levy

<sup>14</sup> <https://theconversation.com/one-year-on-from-the-carbon-price-experiment-the-rebound-in-emissions-is-clear-44782>

- 4.1 A Carbon Emissions Levy is one option for enforcing the ‘polluter pays principle’ and provides certainty in regard to the marginal cost faced by emitters per tCO<sub>2</sub>e, (tonne of carbon dioxide emissions equivalent), and while not guaranteeing a maximum carbon emissions reduction, evidence from other countries that have introduced similar mechanisms indicate that over time, emissions will come down relative to the energy demands on a year on year GDP growth<sup>15</sup>.
- 4.2 In the Pacific context, putting a price on carbon emissions could be seen as an additional economic cost but is also a way of generating revenue that can be targeted towards “clean energy’ uptake, research and innovative technologies. The revenue raised from a carbon emission pricing mechanism could be used to subsidise alternatives such as solar power generation. The application and utilisation of tagged revenue from emissions pricing can also make a huge impact if a specific portion is earmarked for renewable energy projects in local communities with private sector involvement through access to specified funding windows. In Fiji, for example, the proceeds from the Environment Climate Adaptation Levy has been used for community adaptation and mitigation projects. In Palau, the Green Fee from the departure airport tax for non-Palauans has been used to support the Protected Areas Network Fund.
- 4.3 As an alternative revenue source, a carbon emissions levy could be used to reduce other taxes, such as VAT, if implemented as part of an overall comprehensive fiscal policy. If priced and applied relevant to the users’ ability to pay it can also lead to socially efficient outcomes in that the heavy users of fossil fuels will pay more relative to the social cost, they cause.
- 4.4 The introduction of carbon emissions levy, alongside other initiatives seeking to use fiscal measures to achieve greater economic efficiency, has the potential to return a **Triple dividend: a reduction in emissions, better economic performance, and a stronger budgetary position**.<sup>16</sup> The versatility of emissions pricing also means that it is important for policy makers considering adopting it to have a clear picture of the options available and how those options fit within the jurisdiction’s context of fiscal and social policy goals.

## 5.0 The Environment Argument for a Carbon Emission Levy

- 5.1 The most obvious environmental argument for the introduction of a Carbon Emission Levy is the reduction in greenhouse gas discharges to the atmosphere helping reduce the impact of global warming. An emissions levy could reduce pollution and encourage more environmentally friendly alternatives, in-line with the *Kainaki II Declaration*, the *Boe Declaration* and the mitigation goals of the Paris Agreement. While Pacific Island Countries can argue that our GHG emissions are negligible; by putting a price on carbon emissions signals the seriousness of the issue and should propel wealthy developed countries to follow our lead. Revenue collected through a carbon emissions levy can be used to finance both decarbonisation and adaptation initiatives.
- 5.2 When the levy is at a level where it becomes less viable to continue with high carbon emitting fuel sources, polluters will be forced to look for alternative energy and fuel sources that have less or zero emissions. Such a trend will have beneficial impacts on the environment and help mitigate climate change.
- 5.3 Following from the above reasoning, investment in less carbon intensive technologies can also be linked to putting FIC on the path towards decarbonisation of Pacific economies, both from an industrial production model and in terms of fuel-efficient products.

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<sup>15</sup> Exploring the Role of Carbon Taxation Policies on CO<sub>2</sub>Emissions: Contextual Evidence from Tax Implementation and Non-Implementation European Countries

<sup>16</sup> Achieving the Triple Dividend in Portugal: A Dynamic General-Equilibrium Evaluation of a Carbon Tax Indexed to Emissions Trading

**6.0 Pros and Cons of a Carbon Emissions Levy**

6.1 In theory, the Carbon Emission Price will reduce pollution and encourage more environmentally friendly alternatives. However, critics argue a price on carbon emissions will increase costs for businesses and reduce levels of investment and economic growth. However, proponents of a carbon pricing mechanism argue that the overall social and environmental benefits outweigh the economic costs. Further, if a carbon emissions levy is introduced as part of a more comprehensive fiscal policy regime, additional revenue collected can be reinvested within the economy to offset any price impacts<sup>17</sup>.

<b>Carbon Emissions Pricing</b>	
<b>Pros</b>	<b>Cons</b>
<b>1. Makes polluter pay the external cost of carbon emissions.</b>	1. Businesses claim higher tax can discourage investment and economic growth.
<b>2. Enables greater social efficiency, as the user pays the full social cost.</b>	2. May encourage tax evasion – firms polluting in secret to avoid paying.
<b>3. Raises revenue which can be spent on mitigating effects of pollution.</b>	3. It can be difficult to measure external costs – and how much the price should actually be.
<b>4. Encourage firms and consumers to look for alternatives e.g. Solar power.</b>	4. Administration costs in measuring pollution and collecting revenue.
<b>5. Reduces environmental costs associated with excess carbon pollution.</b>	5. Firms may shift production to countries without a carbon emissions price.

**7.0 Implications for Forum Member Countries**

7.1 Evidence from countries like Sweden, Ireland and more recently Singapore,<sup>18</sup> that have implemented Carbon Taxes, suggests that taxing closer to the source of the carbon production is the most efficient and effective method of imposing the levy and therefore collection. However, in the Pacific, Forum Island Countries are not producers of oil or coal, therefore the next best alternative is to impose it at the point of entry into the country, usually the importer of fossil fuels.

7.2 Apart from general taxes applicable to all goods (e.g., value added tax) or activities (e.g., corporation tax), a range of taxes apply specifically to carbon-intensive goods, in particular excise taxes on fuels and electricity taxes. Such taxes may have the effect of disincentivising emitting activities and are understood to be included in the “effective carbon levy” applied to energy and energy products. In contrast to general taxes on energy, carbon emissions levy is one of a number of policy instruments that seek to mitigate climate change by placing a direct price on GHG emissions. In contrast to other carbon pricing mechanisms such as Emissions Trading Schemes (ETS), carbon emissions levy places a fixed price on a given unit of GHG emissions, This is typically done by putting a levy on fossil fuels in accordance with their carbon content, measured in tCO2e (tonnes of Carbon emissions equivalent).

7.3 Where fuel is imported into a Member country directly from the originating export port, the application of a

<sup>17</sup> "Federal Tax Policy toward Energy," Tax Policy and the Economy, 21, 145-184  
<sup>18</sup> "[Carbon Taxes: What Can We Learn from International Experience?](#)". *Econofact*.

Carbon Emissions Levy should be straight forward. However, there is a danger of double taxing where fuel imports go through an intermediary port enroute to the final point of use so crediting arrangements will need to be put in place to avoid double counting. This can be best addressed in a regional or sub-regional approach to carbon emissions levy administration. The levy could help alleviate the expensive costs for maritime connectivity and disproportionate burden of climate change that is currently faced by our Member Countries & our entire Blue Pacific region.

7.4 In line with the submission made by RMI and Solomon Islands to the IMO, the issue of international ships registered under Pacific Island country flags need to be considered carefully. Consideration may also need to extend to the aviation industry including levying flights through regional and/or national airspaces. The outcome of the IMO submission will have a direct impact on how the carbon levy applies to international shipping companies operating in our region.

## **8.0 Potential Options for revenue utilisation from a Carbon Emissions Levy**

8.1 As previously alluded to, the revenue collected from a carbon emissions levy can be redirected towards adaptation and mitigation efforts in member countries, for example, to “clean energy” projects or for research into new innovative technologies.

8.2 If the initiative is to be implemented on a regional basis then existing mechanism like the Pacific Resilience Facility can be considered to pool the resources and use the disbursement mechanism therein to administer the funds towards agreed priorities. Equally, if the initiative is to be implemented on a country by country basis then there is merit to utilise existing national systems with revenue also available for related national climate change priorities.

## **9.0 Next Steps**

9.1 If the Carbon Emissions Levy option is to move forward, wider consultation with relevant stakeholders will need to be undertaken. Possible stakeholders include those in the energy sector, fuel importers and wholesalers, national Tax and Customs agencies, private sector and financial institutions.

9.2 Based on a clear mandate from FEMM, the Secretariat can assemble a team of technical experts to carry this initiative forward. Building on the existing efforts<sup>19</sup> undertaken by Members and other partners in the region, some of the required work will involve collection and analysis of data on energy and fuel usage for each member country, existing taxation regimes, revenue collection modalities, and economic modeling on resources trade-offs, i.e. assessment of any macroeconomic impacts of introducing a carbon emission pricing mechanism.

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<sup>19</sup> 1. [Pacific blue shipping partnership](#); 2. [Pacific Islands Transport Forum Expo](#)