



The role of Fiscal Policies in a Green Covid-19 Recovery in Asia-Pacific

GFPN regional workshop: background paper

Impacts of the Covid-19 pandemic in Asia-Pacific

The impact of the Covid-19 pandemic has been catastrophic. Globally, Covid-19 had killed over 3.9 million people by mid-June 2021 and, in Asia-Pacific, as elsewhere, was far from being decisively contained.¹ Poor and vulnerable groups have been disproportionately affected, with ESCAP estimating that 89 million people in Asia-Pacific have been pushed below the USD 1.90 per day threshold of extreme poverty.² Unemployment and inequality have surged, with job losses concentrated amongst low-income workers, particularly women and youth.³ The informal sector has been particularly hard hit, putting the livelihoods of many of the 1.3 billion informal workers in the region at risk.⁴

In purely economic terms, the pandemic led to a fall in global output of 3.3%.⁵ In the Asia-Pacific region, real GDP growth fell from 6% in 2019 to -1.5% in 2020 but is projected to grow by 7.6% in 2021 and 5.4% in 2022.⁶ The average debt-to-GDP ratio in emerging and middle-income Asia increased from 57% in 2019 to 70% in 2021 and in the same period, revenue fell by an average of 1.4% while expenditure increased by 1.9%, causing a sharp increase in budget deficits.⁷ Many countries in the region are facing low credit ratings, high interest rates and rising debt constraints, with fiscal space tightly constrained. It is imperative that governments find solutions to mobilise new sources of revenue to protect their vulnerable populations and foster a sustainable recovery.

Green fiscal policy and the recovery in Asia-Pacific

The Covid-19 crisis has opened a window of opportunity for policymakers to recalibrate existing policies and develop new, innovative strategies to mobilise revenue and drive a green, inclusive, low-carbon recovery. In this context, green fiscal policies (GFPs)⁸ have enormous potential to mobilise domestic revenue while furthering environmental and climate goals. Green fiscal stimulus and green recovery spending can support a resilient and sustainable economic recovery. However, a key lesson from the 2008 recession is that short-term fiscal

¹ <https://coronavirus.jhu.edu/map.html>

² <https://www.unescap.org/sites/default/d8files/knowledge-products/Survey%202021%20Towards%20post-COVID-19%20resilient%20economies.pdf>

³ <https://www.imf.org/en/Publications/REO/APAC/Issues/2020/10/21/regional-economic-outlook-apd>

⁴ <https://www.undp.org/content/dam/undp/library/km-gap/UNDP-RBAP-Position-Note-Social-Economic-Impact-of-COVID-19-in-Asia-Pacific-2020.pdf>

⁵ [World Economic Outlook, April 2021: Managing Divergent Recoveries \(imf.org\)](https://www.imf.org/external/pubs/ft/weo/2021/01/text/summary)

⁶ [World Economic Outlook, April 2021: Managing Divergent Recoveries \(imf.org\)](https://www.imf.org/external/pubs/ft/weo/2021/01/text/summary)

⁷ <https://www.imf.org/external/datamapper/datasets/FM>

⁸ Green fiscal policies use fiscal and budgetary tools to address environmental challenges such as climate change, pollution, congestion, waste, biodiversity protection, overfishing, and sustainable forestry. Examples include green taxes and charges, which correct price signals and help shift consumer and business behaviour towards more sustainable patterns, reform of environmentally harmful subsidies, green budgeting processes to align government expenditure with environmental goals, and fiscal incentives to leverage green investment. See the GFPN flyer: https://greenfiscalfpolicy.org/wp-content/uploads/2020/03/GFPNFlyer_web_March2020.pdf.



stimulus alone is insufficient to drive a sustainable economic recovery: there is also a need for complementary pricing reforms, such as fossil fuel subsidy reform and taxes on carbon and environmental damage to address key market failures in pricing fossil fuel externalities.⁹

GFPs can be effective and efficient policy tools for green recovery and beyond. Green taxes, particularly carbon-energy taxes, can often be implemented rapidly, because collection mechanisms and administrative structures tend to be already in place. They can deliver positive environmental and climate outcomes as well as social, fiscal, and economic benefits, including employment, greater fiscal efficiency, revenue, and innovation. Revenue raised can be used for policy priorities such as green public investment to maximise the economic impact of stimulus, emergency assistance and relief from the impacts of the pandemic, to enhance welfare and social safety nets, or to support greening of industry.

However, in Asia-Pacific so far, very few examples of GFPs have been identified in recovery packages, although GFPs are recognised as supporting synergies in policymaking between NDC actions and the Covid-19 response.¹⁰ Even the high GDP growth predictions for Asia-Pacific developing economies – forecast to grow by 5.9% in 2021 and 5.0% in 2022 – will not compensate for losses in 2020.¹¹ Public debt levels will be highly vulnerable to this slower-than-expected growth. In the medium term, fiscal space will continue to be constrained and debt sustainability a concern, particularly in low-income countries and Small Island Developing States (SIDS). Governments will have to focus on policies, such as GFPs, that can address these challenges.

GFPs can contribute to a sustainable recovery that addresses these challenges. Green budgeting can deliver transparency on environmentally harmful expenditure and highlight potential savings. Greening government debt through green bonds and green sukuk can facilitate access to credit in a constrained climate for countries to invest sustainably in a green recovery. Policies to price carbon, resources, and pollution can mobilise domestic revenue and are an important precondition for public and private investment in low-carbon infrastructure and the green technology required for the achievement of the SDGs and to support the implementation of ambitious NDCs. Careful design can ensure that such approaches protect the vulnerable, mitigate negative social impacts, prevent policy reversals, and ensure public acceptability and support.

All these issues will be discussed in depth at the regional technical workshop. Below takes a closer look at each issue in turn.

⁹ <https://www.greengrowthknowledge.org/guidance/building-greener-recovery-lessons-great-recession>

¹⁰ <https://www.unescap.org/sites/default/d8files/knowledge-products/UNESCAP%20Green%20Recovery%20Policy%20Brief.pdf>

¹¹ <https://www.unescap.org/sites/default/d8files/knowledge-products/Survey%202021%20Towards%20post-COVID-19%20resilient%20economies.pdf>



A green recovery? Findings from the Global Recovery Observatory and the UN ESCAP 2021 Economic and Social Survey

In 2020, global energy related GHG emissions fell by just under 6%¹², roughly 2 percentage points less than the reduction required each year until 2030 to meet the 1.5°C Paris target.¹³ The imperative to put in place transformative measures to achieve deep decarbonisation remains. There is a very real danger that recovery packages will lock in unsustainable investments and high-emissions economic structures.

The design of current and future recovery packages will shape our climate, environment, societies, and economies for decades to come. If the Sustainable Development Goals (SDGs) and the Nationally Determined Contributions (NDCs) of countries under the Paris Agreement are to be met, the recovery must be resilient and sustainable, and supported by fiscal incentives pushing in that very same direction. A return to business as usual will put these targets out of reach.

Therefore, in 2021, with recovery spending well underway, it is important to assess whether we are indeed seeing a green recovery. The answer is mixed at best; the design and structure of recovery spending shows that governments have failed to seize the opportunity provided by the pandemic. G20 governments are spending at least USD 295 billion on supporting fossil fuel energy, compared to USD 231 billion on supporting clean energy.¹⁴ The Asia-Pacific region fares slightly better, with USD 66 billion spent on fossil fuels and USD 88 billion spent on clean energy.¹⁵

The Global Recovery Observatory's (GRO) analysis of Covid-19 related spending by the 50 largest economies paints a disappointing picture of the build forward better rhetoric. Distinguishing between rescue spending of USD 14.46 trillion, intended to save lives and protect livelihoods, and recovery spending of USD 2.25 trillion to reinvigorate economic activity, GRO finds that only 21% of recovery spending in 2020, or USD 0.46 trillion, had positive green characteristics.¹⁶ On the whole, the picture that emerges is that the promised "green recovery" has taken on a deep shade of brown.

These spending decisions fly in the face of a body of evidence in favour of a green recovery. The ESCAP Economic and Social Survey 2021 has delivered quantitative evidence that a package of measures to build forward better – improved social services, digital access, and green development policies – would deliver higher rates of economic growth in Asia-Pacific, while enhancing resilience. ESCAP simulations found that a package of measures to build forward better would outperform a business-as-usual scenario, lifting 180 million people out

¹² <https://www.iea.org/articles/global-energy-review-co2-emissions-in-2020>

¹³ UNEP estimates that GHG emissions must fall by 7.6% annually to 2030 to meet the 1.5°C target, see:

<https://www.unenvironment.org/news-and-stories/press-release/cut-global-emissions-76-percent-every-year-next-decade-meet-15degc>

¹⁴ [G20 countries - Energy Policy Tracker](https://www.energypolicytracker.org/)

¹⁵ <https://www.energypolicytracker.org/region/select-countries-in-asia-pacific>

¹⁶ <https://recovery.smithschool.ox.ac.uk/tracking/>



of poverty and reducing carbon emissions by 30% in the long run.¹⁷ Building resilience against future shocks and aligning the recovery with sustainable development will be key to protect development gains in future, particularly in the complex risk landscape of the Asia-Pacific region.

Sustainable Public Financing for a Green Recovery to Achieve the SDGs and the Paris Agreement: Green Bonds and Green Budgeting

To achieve a resilient, inclusive, and sustainable recovery, it will be crucial to enhance the efficiency and effectiveness of budgetary processes and monitor the extent to which spending is aligned with climate and sustainability objectives through budget tagging, green public finance frameworks, public expenditure reviews, and related approaches. Such analyses can pinpoint misalignments of spending and objectives, identify resources which could be re-directed to Covid-19 relief and recovery, and help to integrate sustainability considerations within long-term strategic and financial planning. Tagging environmentally harmful spending can open up further options for governments to apply their findings to budget management and alignment of recovery packages with environmental and climate objectives.

Green budgeting and related approaches can also deliver important co-benefits. For example, Ministries of Finance can draw on the taxonomy used to demarcate sustainable expenditure as a basis for issuance of sovereign green bonds or green sukuk (Shari'ah compliant green investments). Sovereign green bonds have become an important source of revenue for governments to finance their recoveries: Indonesia issued the world's first sovereign green Islamic bond, worth USD 2.5 billion, in June 2020. In the same year, ESCAP provided technical assistance to Bhutan in issuing its first ever sovereign bond and building capacity towards issuing a green bond.¹⁸ 2020 was a record year, with green bond issuance accounting for USD 270 billion.¹⁹

The role of GFP in leveraging private investment

UNESCAP's *Economic and Social Survey of Asia and the Pacific* in 2019 found that countries in the region would need to invest USD 1.5 trillion annually to 2030 to achieve the Sustainable Development Goals.²⁰ Successfully leveraging investment from the private sector will be essential to mobilise these funds. Many potential sources exist, including pension funds, insurance, sovereign wealth funds and Foreign Direct Investment.

However, the fact that private markets need an enabling environment and firm public finance foundations to exist and thrive is often overlooked. Climate-harmful investment decisions are at least in part attributable to the persistent under-pricing of fossil fuels in many countries,

¹⁷ <https://www.unescap.org/sites/default/d8files/knowledge-products/Survey%202021%20Towards%20post-COVID-19%20resilient%20economies.pdf>

¹⁸ <https://developmentfinance.un.org/sites/developmentfinance.un.org/files/files/policy-briefs/POLICY%20NOTE%20-%20Green%20Bond%20-%20ESCAP.pdf>

¹⁹ <https://www.climatebonds.net/2021/01/record-2695bn-green-issuance-2020-late-surge-sees-pandemic-year-pip-2019-total-3bn>

²⁰ <https://www.unescap.org/publications/economic-and-social-survey-asia-and-pacific-2019-ambitions-beyond-growth>

which act as a deterrent to private investment in low-carbon technologies and renewable energy. Pricing and regulatory incentives and institutional capacity reforms are key to creating and strengthening green and sustainable finance markets and scaling up financing for Agenda 2030 and higher ambition NDCs.

The private sector makes investment decisions on the basis of the risk-return profile of investment opportunities, and the risk of investing in green and low-carbon technologies is often perceived to be high. Careful design of carbon pricing instruments and fossil fuel subsidy reform can send strong signals in favour of low-carbon investment, such as a clear, long-term commitment to predictable and stable carbon prices and use of revenue to facilitate and incentivise investment and reduce risk.²¹

Building Forward Better: Fossil Fuel Subsidy Reform and Carbon Pricing

Asia-Pacific is more reliant on fossil fuels than any other region in the world. Developments in its energy sector will determine whether the world can prevent planetary warming beyond dangerous levels. The region accounts for 76% of current global coal generation capacity and 94% of the global pipeline of coal-fired power plants under construction, threatening to lock in high GHG emissions until after 2040.²² This dependence is attributable to high demand growth in South and South-East Asia, a strong support for coal on the part of some governments, the presence of more than 60% of global coal reserves in the region, and in some countries, a high dependency on income from coal exports.²³ Hence, special attention must be paid to the region's specific set of circumstances when considering how to introduce fossil fuel subsidy reform and carbon pricing. Nonetheless, an alternative transition pathway is imaginable. A recent ESCAP analysis has demonstrated that a share of renewable energy of 80-85% in the energy mix by 2030 would be feasible in the region.²⁴ Moreover, in its *Building Forward Better* package, amongst other policies, ESCAP recommends the elimination of fossil fuel price subsidies and the introduction of carbon pricing. ESCAP's simulation of a green development package, including a USD 40 /tCO₂ carbon price and fuel price reform, predicts a 30% reduction in CO₂ emissions, a higher share of renewable electricity in the energy mix, less damage to infrastructure and fewer lives lost as a result of climate shocks, and a 5% reduction in the public debt ratio attributable to reduced expenditure on fuel price subsidies, carbon tax revenues, and stronger economic growth.²⁵ The package also predicts air quality improvements – a particularly significant given that higher levels of air pollution have been linked to increased mortality rates from Covid-19.

Carbon pricing is on the rise in the region. Japan and Singapore have introduced carbon taxes, while Kazakhstan, New Zealand, the Republic of Korea and Australia have introduced Emission Trading Systems at national level, and Tokyo and several provinces and cities in the People's

²¹ <https://www.oecd-ilibrary.org/docserver/9789264273528-7-en.pdf?expires=1624636393&id=id&accname=guest&checksum=96B2AEB1021902A7E26E938595AFD25E>

²² <https://www.unescap.org/sites/default/d8files/knowledge-products/Coal-Phase-Out-and-Energy-Transition-Pathways-25-Feb-2021.pdf>

²³ <https://www.unescap.org/sites/default/d8files/knowledge-products/Coal-Phase-Out-and-Energy-Transition-Pathways-25-Feb-2021.pdf>

²⁴ <https://www.unescap.org/sites/default/d8files/knowledge-products/Coal-Phase-Out-and-Energy-Transition-Pathways-25-Feb-2021.pdf>

²⁵ <https://www.unescap.org/sites/default/d8files/knowledge-products/UNESCAP%20Green%20Recovery%20Policy%20Brief.pdf>



Republic of China at subnational level.²⁶ However, while some steps have been taken to reform fossil fuel subsidies in Asia and the Pacific, countries in the region spent USD 242 billion on fossil fuel subsidies in 2018 – nearly USD 100 billion more than they spent on renewable energy investments.²⁷

Further progress would create opportunities to repurpose revenue for targeted social protection, investments in a green and resilient recovery, or other policy priorities.

In the context of a green recovery, countries in a stronger fiscal position can maximise the impact of stimulus through fossil fuel subsidy reform, green tax incentives and tax expenditures to create opportunities for green investment and level the playing field, mobilising revenue through the introduction of carbon pricing once the recovery is underway. More debt-constrained countries can consider the implementation of fossil fuel subsidy reform and carbon taxes in the short-term, as a means of mobilising domestic revenue and reducing their debt-to-GDP ratios.

The Political Economy of Green Fiscal Policies in the Context of Green Recovery

While the crisis has created an opportunity for the implementation of a range of GFPs, challenges to their implementation remain significant. Consequences of the pandemic may have heightened the perceived and actual risk of policy implementation: growing inequalities both within and between countries call for careful policy design to ensure that negative impacts are mitigated, while competitiveness concerns carry a great deal of weight in countries with an urgent focus on bringing about a rapid economic recovery. Sound policy design, careful sequencing, targeted use of revenue, provision of robust data, and clear and transparent communication will be necessary to navigate sensitive political economy challenges. In this regard, policymakers can build on over 300 economic and social measures introduced in Asia-Pacific in response to the pandemic to improve social safety nets and protect incomes.²⁸

If GFPs are to contribute to a green recovery in the region, these challenges will have to be overcome. This GFPN/ESCAP technical workshop will explore how this might be possible.

²⁶ Vietnam, Japan, and Indonesia are planning to introduce an ETS, while the PRC has already launched the world's largest ETS scheme <https://www.adb.org/publications/asian-development-outlook-2021>.

²⁷ <https://www.unescap.org/publications/economic-and-social-survey-asia-and-pacific-2020>

²⁸ <https://www.unescap.org/sites/default/d8files/knowledge-products/UNESCAP%20Green%20Recovery%20Policy%20Brief.pdf>