INTEGRATING CLIMATE ACTION INTO PUBLIC FINANCIAL MANAGEMENT: LESSONS FROM PARAGUAY AND COSTA RICA

REGIONAL CLIMATE CHANGE PLATFORM | ECONOMY AND FINANCE MINISTRIES

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Authors:

Huáscar Eguino, Raúl Delgado, Daniela Torres, Rudy Loo-Kung, Asier Rodríguez, Juan José Galeano, and Adriana Samaniego.

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Inter-American Development Bank
1300 New York Avenue, N.W.
Washington, D.C. 20577
www.iadb.org

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About the Platform

The Regional Climate Change Platform of Ministries of Economy and Finance of Latin America and the Caribbean is a unique space for knowledge exchange and collaboration. It aims to strengthen economic and fiscal policies in the region to tackle climate change challenges. Established in August 2022 with support from the Inter-American Development Bank (IDB), the Platform is composed of and led by 26 regional bank member countries, which represent over 98 percent of the greenhouse gas emissions of Latin America and the Caribbean (LAC) and over 90 percent of its GDP. This initiative receives financing from the Fund for Fiscal Policy for Climate Change in LAC, which is managed by the IDB and funded by the International Climate Initiative (IKI) of Germany's Federal Ministry for Economic Affairs and Climate Action.

1

INTRODUCTION: WORKING GROUP ON PUBLIC FINANCIAL MANAGEMENT

1. Introduction: Working Group on Public Financial Management

The purpose of this document is to present the progress made by the working group on public expenditure management and climate change (Working Group 3), which was established within the framework of the Regional Climate Change Platform of Economy and Finance Ministries, under the leadership of the Ministry of Finance of Paraguay.

The integration of climate action into public financial management (PFM) is a complex task that must be addressed in an orderly, comprehensive manner and based on a medium-term perspective. This document shows two cases of application of the methodology for assessing public financial management for climate change (PEFA Climate) that, taken together, illustrate how to design a roadmap for integrating climate issues into the planning, programming, execution and accountability of public resources. The selected cases correspond to the Ministries of Finance of Paraguay and Costa Rica, countries that have already been making significant improvements in the rules, processes and systems governing PFM and, more recently, have embarked on incorporating the climate dimension into them.

The document illustrates how an action plan can be structured, using as a basis the diagnosis carried out using the PEFA Climate methodology and the best international practices in the field. The study concludes by highlighting the importance of including the climate module in assessments based on the PEFA methodology, as this facilitates PFM modernization efforts to incorporate the climate dimension into all regulations, processes and systems that support public financial administration.

This document consists of the following sections: i) review of the importance of public financial management for climate action; ii) presentation of the PEFA Clima diagnostic tool; iii) presentation of the main results of PEFA Clima implementation in Paraguay and Costa Rica; iv) lessons learned from the implementation of PEFA Clima; and v) a set of final considerations on actions that could be followed to integrate the climate dimension into PFM.

2

RELEVANCE OF PUBLIC FINANCE MANAGEMENT FOR CLIMATE ACTION

2. Relevance of Public Finance Management for Climate Action

Climate change and biodiversity loss are causing profound changes in society and the global economy. In response, countries have established climate strategies and made commitments under the Paris Agreement (PA). The fiscal and public financial management (PFM) areas play a vital role in implementing these strategies and ensuring compliance with these commitments, given especially that correct conduct promotes optimum integration of climate action throughout the public expenditure cycle, including fiscal and budgetary policy planning and design, fiscal risk management, allocations and execution of public resources, as well as monitoring and evaluation of their efficiency and effectiveness (Pimenta, 2022).

Given the importance of PFM for climate action, several international organizations and countries have become engaged in promoting so-called green public financial management. Herein, the term green public financial management is used to refer to any initiative that integrates climate action (and biodiversity) into policies, legislation, procedures, processes, and systems governing fiscal management practices.

Although the green PFM practices are recent, they are of increasing interest to, and relevance for, all countries. In 2020, 14 of the 35 countries (40 percent) within the Organization for Economic Cooperation and Development (OECD, 2021) showed progress in green budgeting, while 9 indicated a plan to introduce them in the near future (26 percent). Implementation of these practices implies the existence of national climate change and environmental strategies, green budgeting tools such as budget classifiers or scoreboards, procedures for reporting on the use of climate impact resources, and an updated budget framework, linking strategic planning and budgeting to climate change challenges (Pimenta, 2022).

According to the OECD (2021) the main green budget policy formulation tools are: green medium-term expenditure frameworks (green MTEFs), climate expenditure classifiers, policy and environmental impact assessments, climate expenditure reviews, and green accounting statements. These tools are being adopted gradually and in accordance with the progress made by the countries in the different dimensions of the PFM. It is therefore of interest to find out which methodologies are being used to diagnose the progress made by countries concerning green PFM issues.

The following is the main diagnostic methodology that countries have been applying to determine their degree of progress in green PFM. This methodology is known as the Public Expenditure and Financial Accountability Program (PEFA) and its climate module (PEFA Climate). Although most countries in the Latin American and Caribbean (LAC) region have assessed their PFM using the traditional PEFA methodology,[1] only Costa Rica and Paraguay have applied the climate module because it is a new instrument (2020).

This section is a short presentation of the PEFA Climate methodology (PEFA Secretariat, 2020), outlining the results of its application in Paraguay (2022) and Costa Rica (2022). It shows the most recent advances in these two countries as well as extracting inputs which could prove useful for other countries interested in applying this same methodology.

[1] According to the PEFA program web-site, with the exception of Venezuela, all LAC countries have at some point carried out an assessment of their PFM, using this instrument (Countries Regions | Public Expenditure and Financial Accountability (PEFA)).

2.1 What is PEFA Climate?

The PEFA framework assesses the strengths and weaknesses of PFM through indicators that measure the performance of a wide range of key institutions, systems, and processes. The PEFA tool was launched in 2005 and has since been applied in 25 LAC countries. PEFA assesses the extent to which PFM systems, processes, and institutions contribute to achieving three desirable budgetary objectives: aggregate fiscal discipline, strategic resource allocation, and efficient service delivery. Specifically, the PEFA tool assesses seven key pillars of PFM performance across the budget cycle: (i) budget reliability, (ii) transparency of public finances, (iii) asset and liability management, (iv) policy-based fiscal strategy and budgeting, (v) predictability and control of budget execution, (vi) accounting and reporting, and (vii) external scrutiny and audit.

For its part, there is a PEFA framework for assessing PFM for Climate Change—the PEFA Climate—consisting of a set of complementary indicators to build on the PEFA Framework and gather information as to what extent a country's PFM system is prepared to support and encourage implementation of government climate change policies. Specifically, the PEFA Climate assessment establishes whether laws and regulations, institutions, systems, procedures, and processes contribute to the implementation of climate change-related activities throughout the budget cycle, including policy planning and design, budget allocations needed for their implementation, monitoring of allocations, and tracking and evaluation of the efficiency and effectiveness of policies and investments.

The PEFA Climate framework highlights PFM practices for climate change in line with the main stages of the budget cycle, and the relevant pillars of PFM performance as described in the PEFA Framework: policy-based fiscal strategy and budgeting (budget planning, Pillar IV), predictability and control of budget execution (budget execution, Pillar V), accounting and reporting (Pillar VI), and external scrutiny and audit (Pillar VII); in addition, two cross-cutting themes are included: transparency of public finances (Pillar II) and asset and liability management (Pillar III). Finally, the PEFA Climate framework also considers the climate-related performance of the PFM system as measured through budget reliability (Pillar I).

Main characteristics:

The **PEFA methodology is based on international standards and best practices** concerning core aspects of PFM systems. These are used to score the different indicators (and corresponding dimensions) which form part of this methodology. The practices are periodically adjusted to reflect country progress on PFM issues.

PEFA includes a PFM performance report for the government requesting the assessment, that presents **evidence-based ratings** and a discussion of the results. The assessment is based on the situation at the time of data collection or, in the case of periodic events, during the most recent or current budget cycle. For this reason, **PEFA does not assess initiatives in the developmental stage.**

PEFA is a support tool for national/subnational authorities interested in updating their PFM, understanding that the decision on actions is up to them. For this reason, **PEFA reports do not incorporate recommendations or action plans**, which are quite common in other diagnostic tools.

The PEFA Climate can be implemented independently of the PEFA. However, as it is a complementary methodology, it is usually conducted simultaneously with the PEFA methodology.

Conducting a PEFA Climate assessment is a decision that is at the sole discretion of each country's authorities.

Indicators and Dimensions

The PEFA Climate framework includes a number of indicators and dimensions (Table 1). Each indicator selected to assess the degree of progress of the PFM for Climate Change (PFMCC) aligns with a performance indicator from the PEFA 2016 Framework, since, as mentioned, PEFA Climate is complementary to PEFA.

Table 1. *PEFA's Indicators and Dimensions for the PFMCC*

PFMCC indicator	Dimension	Brief description of the indicator
PFMCC-1: Alignment of the budget with climate change strategies	1.1 Aligning the budget with climate change strategies	Determines to what extent long-term and medium-term climate strategies are reflected in sectoral strategic plans costed in the medium term, and in annual and multiannual budgets. This indicator has only one dimension.
PFMCC-2: Tracking of climate-related expenditures	2.1 Tracking of climate related expenditures	Determines the extent to which the government can track climate change-related spending. The indicator has only one dimension.
PFMCC-3: Budget circular	3.1 Budget circular	Determines the degree to which climate change is considered in the budget circular through references to the national climate change strategy, the inclusion of clear guidance on how budget units should propose climate change mitigation and adaptation measures, the definition of a methodology for tracking climate change-related expenditure, and the setting of an expenditure target. The indicator has only one dimension.
PFMCC-4: Escrutinio legislativo.	4.1 Legislative scrutiny of the budget 4.2 Legislative scrutiny of the audit and evaluation reports	Assesses how aspects related to climate change have been included in legislative scrutiny of the budget and audit reports. The indicator has two dimensions, where the scores of each are combined to obtain the overall score.

PFMCC indicator	Dimension	Brief description of the indicator
PFMCC-5: Managing public investment for climate change	**5.1** Provisions related to climate change included in the public investment management regulatory framework. **5.2** Prioritization of climate change investment projects **5.3** Provisions related to the evaluation of investment projects for climate change. **5.4** Reports from the entities in charge of implementation	Measures the extent to which climate change is included in public investment management. The indicator has four dimensions, where scores are combined to obtain the overall indicator score.
PFMCC-6: Managing non-financial assets for climate change	**6.1** Management of non-financial assets for climate change	Assesses the extent to which non-financial public assets, in particular public land and buildings, are included in climate change mitigation and adaptation approaches, in terms of identification of risks and potential contribution, their inclusion in government strategies, and the regulation of their use, disposal and transfer. The indicator has only one dimension.
PFMCC-7: Liabilities related to climate change	**7.1** Fiscal risks related to climate change. **7.2** Debt and guarantees related to climate change	Assesses to what degree the government is able to manage climate change-related liabilities. The indicator has two dimensions, and scores are combined to obtain the overall indicator score.
PFMCC-8: Government procurement for climate change	**8.1** Policy framework for public procurement for climate change **8.2** Operation of public procurement for climate change **8.3** Monitoring of public procurement for climate change **8.4** Public procurement reports for climate change	Examines to what degree climate change adaptation and mitigation measures are incorporated into key aspects of public procurement management. In this sense, the indicator assesses the extent to which the government procures goods, services, and contracts with minimal adverse impacts on climate change. It also examines the resilience and capacity of the public procurement system to incorporate climate change risks and respond to natural disasters. The indicator has four dimensions, the scores of which are combined using the conversion table to obtain the overall indicator score.

PFMCC indicator	Dimension	Brief description of the indicator
PFMCC-9: Climate change revenue management	**9.1** Administration, audit, and tax control for climate change **9.2** Climate change-related tax debt	Measures the government's capacity to implement fiscal policies aimed at reducing GHG emissions and increasing resilience to climate change. It can also assess the extent of arrears in revenue collection. The indicator has two dimensions, and scores are combined using the conversion table to obtain the overall indicator score.
PFMCC-10: Controls for climate change spending	**10.1** Reporting on public procurement for climate change **10.2** Transaction compliance audits	Assesses to what extent efficient control systems are in place to ensure that expenditure payments comply with climate change criteria. The indicator contains two dimensions, whose ratings are combined, using the conversion table to obtain the overall indicator rating.
PFMCC-11: Fiscal decentralization for climate change	**11.1** Institutional arrangements for fiscal decentralization for climate change **11.2** Fiscal transfers for climate change **11.3** PFM mechanisms for climate change implemented by subnational governments	Assesses the extent to which institutional arrangements for fiscal decentralization facilitate and promote the adoption of local climate change policies in subnational governments, while ensuring vertical integration of national climate change objectives. The indicator contains three dimensions, whose scores are combined using the conversion table to obtain the overall indicator score.
PFMCC-12: Climate change performance information	**12.1** Plans with climate change performance information **12.2** Reporting of climate change performance information	Assesses the extent to which information on performance, provided for in planning or reported with implementation, also covers climate change adaptation and mitigation policies, and whether such information is included in budget documentation. The indicator contains two dimensions, whose scores are combined using the conversion table to obtain the overall indicator score.
PFMCC-13: Climate change assessment	**13.1** Climate change expenditure assessment **13.2** Climate change tax assessment	Assesses whether evaluations of climate change-related programs are conducted, and whether climate change is included in the evaluation of other programs. It covers both expenditures and revenues. The indicator contains two dimensions, whose ratings are combined using the conversion table to obtain the overall indicator rating.

PFMCC indicator	Dimension	Brief description of the indicator
PFMCC-14: Spending results for climate change initiatives	**14.1** Aggregate expenditure results for climate change initiatives **14.2** Results in the composition of spending on climate change initiatives	Examines the extent to which climate change-related expenditures are in line with those originally approved, as set out in the government's budget documentation and year-end execution reports, both at the aggregate level and by different expenditure categories. The indicator contains two dimensions, whose ratings are combined using the conversion table to obtain the overall indicator rating.

Source: Authors' elaboration based on PEFA Secretariat (2020).
PFMCC: Public Financial Management for Climate Change

Assessment teams score the questions linked to the PEFA Climate indicators on a four-point ordinal scale, from A to D, aligned with the PEFA Framework. To justify a grade, all criteria specified in the grading requirements must be met. Grade C reflects the baseline level of performance for each indicator. Grade D means that the characteristic being measured is either present at a level below the baseline level of performance, is absent altogether, or that the available information is insufficient to qualify the indicator. To distinguish the D grade, which refers to a lack of information, from the D* grade, which indicates below basic performance, an asterisk is used. In cases where the question is not applicable to the circumstances of the country in question, the assessment team responds "NA." Table 2 presents the ratings used based on a four-point ordinal scale.

Table 2. *Levels of Implementation of the PFMCC on a Four-Point Ordinal Scale*

Rating	Level of implementation
A	Climate change issues and public policy responses are integrated into relevant PFM institutions, processes, or systems.
B	Climate change issues and public policy responses are partially integrated into relevant PFM institutions, processes, or systems.
C	Initial efforts have been made to integrate climate change concerns into relevant PFM institutions, processes, or systems.
D	No progress has been made on the indicator.

Source: PEFA Climate (2020).

Some indicators have two or more dimensions that must be rated separately. The overall rating for an indicator is based on the ratings obtained on the individual dimensions. The ratings for multiple dimensions are combined into an overall rating for the indicator, using a method based on the approximate average of the ratings obtained on its individual dimensions (PEFA Secretariat, 2020).

3

IMPLEMENTATION OF PEFA CLIMATE IN PARAGUAY

3. Implementation of PEFA Climate in Paraguay

This section presents the results of the application of the PEFA Climate methodology in Paraguay in 2022 (PEFA Secretariat, 2022b), extracting lessons learned that may be useful for Paraguay and other countries interested in applying this methodology. The section is organized as follow: (i) assessment process; (ii) the main results, including good practices that can be adopted to improve the scores obtained; and (iii) recent advances not captured by the methodology.

3.1 Implementation of PEFA Climate in Paraguay

The PEFA Paraguay 2022 assessment was requested to the European Union and Inter-American Development Bank (IDB) in April 2022 by Paraguay's Ministry of Finance. The request indicated the interest in conducting the PEFA assessment, the fourth to be developed in the country, together with the application of the complementary frameworks PEFA Gender and PEFA Climate, which assess the performance of the PFM system in the implementation of national policies for gender equality and climate change, respectively. This evaluation was completed in December 2022 and was the first to combine the PEFA, PEFA Gender and PEFA Climate evaluation frameworks under the name PEFA++ (PEFA Secretariat, 2022b).

The specific objectives of the PEFA++ Paraguay 2022 evaluation were to (i) update the 2016 PFM system performance study with information for 2022 and (ii) analyze and explain the progress observed between 2016 and 2022 through a comparative analysis. Complementarily, the performance of the PFM system in the implementation of national policies for gender equality and climate change was reviewed.

The interest expressed by Paraguay in conducting the PEFA++ assessment demonstrates the country's growing interest in updating its PFM and in systematically incorporating gender and climate change dimensions into fiscal management. In this regard, it is important to note that Paraguay has been making continuous and important efforts to modernize its PFM which, in some cases, were not captured by the PEFA Climate assessment because they were in the process of development.

3.2 Main Results of PEFA Climate in Paraguay

Overall Result

Table 3 presents the results of applying the PEFA Climate assessment criteria to national PFM practices. Overall, the results indicate that Paraguay's laws and regulations, institutions, systems, procedures, and PFM processes are not yet sufficiently developed to contribute to the implementation of climate change activities throughout the budget cycle. Indeed, with the exception of legislative scrutiny of climate spending and the integration of climate change into public procurement processes (both with aspects of Grade C), all other indicators do not show progress.

***Table 3.** Paraguay: Main Results of PEFA Climate*

PFMCC	INDICATOR	TOTAL	DIMENSIONS			
PFMCC-1	Alignment of the budget with climate change strategies	D	D			
PFMCC-2	Tracking climate change-related spending	D	D			
PFMCC-3	Budget circular	D	D			
PFMCC-4	Legislative scrutiny	D+	C	D		
PFMCC-5	Public investment management for climate change	D	D	D	D	D
PFMCC-6	Non-financial asset management for climate change	D	D			
PFMCC-7	Liabilities related to climate change	D	D	D		
PFMCC-8	Public procurement for climate change	D+	C	D	D	D
PFMCC-9	Revenue management for climate change	NA	NA	NA		
PFMCC-10	Controls for climate change-related spending	D	D	D		
PFMCC-11	Fiscal decentralization for climate change	D	D	D	D	
PFMCC-12	Performance information for climate change	D	D	D		
PFMCC-13	Climate change assessment	D	D	D		
PFMCC-14	Spending results for climate change initiatives	NA	NA	NA		

Source: PEFA Secretariat (2022b).

Indicators with Progress

There are two dimensions that show progress in this country (with C grades): legislative scrutiny of the budget (PFMCC-4.1), and the policy framework for public procurement for climate change (PFMCC-8.1). The evidence for the grades is explained below.

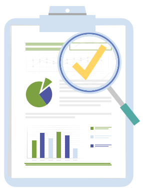
PFMCC-4.1	**Legislative scrutiny of the budget**	C

The five criteria established by the methodology for legislative scrutiny of the budget are as follows:

The existence of support mechanisms such as specialized committees, technical and scientific support, expert advice from activist groups, independent councils, and other climate change stakeholders. Reports on the work and conclusions of these support mechanisms are published.

The analysis of performance or impact evaluations conducted on i) climate change-related revenues and ii) climate change programs; in addition to the expected results of future specific evaluations planned, both impact and performance information.

The analysis of the positive, neutral, or negative contribution to climate change of (i) revenues and (ii) programs or activities, which are not related to climate change.



The analysis of fiscal risks related to climate change.

Space for public consultation.

The evaluation shows that since Paraguay meets the first and fifth criteria, the dimension obtained a grade C. Paraguay meets the first criterion because the draft budget is normally dealt with in a Bicameral Commission, specially constituted for this purpose. In addition, the National Congress in Paraguay has two specialized standing committees whose main responsibilities include learning about, and ruling on, issues that have an effect on climate change. In the Chamber of Deputies there is the Commission on Ecology, Natural Resources and Environment, and in the Chamber of Senators, the Commission on Energy, Natural Resources, Population, Environment, Production and Sustainable Development. These commissions have technical personnel who advise on the subject, and have access to groups of experts, activists, and other interested parties. The information generated in these meetings is public. Additionally, in Paraguay there are public spaces for scrutiny, thus the fifth criterion is also met.

PFMCC-8.1	**Policy framework for public procurement for climate change**	**C**

This dimension evaluates the extent to which public procurement has a clear and transparent operational framework with goals, priorities, and definitions to address public procurement and contracting processes—including climate change criteria—to ensure their sustainability and alignment with greenhouse gas reduction strategies. Based on international good practices, this dimension establishes the following evaluation criteria for the policy framework: (i) there are clear criteria to determine which products or services are climate change-sensitive and ascertain the scope of operations subject to the principles of public procurement for climate change; (ii) there are also quantitative targets, priorities and timelines; (iii) the expected quantitative targets were reached in the last completed fiscal year; and (iv) there is an operational body, unit or team in charge of developing this framework and supporting users.

In Paraguay, Decree 2992/19 regulating Law 2051/03 on Public Procurement and its amendments incorporates principles and concepts related to sustainable public procurement (SPP). Decree 2992 defines sustainability criteria as the policies through which the State, in addition to considering economic criteria, takes into consideration the environmental and social impact that such contracting would imply. Although these two regulations do not establish the use of scores to evaluate quality and cost criteria, they do allow the application of mandatory sustainability criteria or the monetization of criteria that differ between offers in order to make a comparison in monetary terms.

The National Directorate of Public Procurement (DNCP) through Resolution DNCP 922/20, approved the Sustainable Public Procurement policy, declaring the commitment to sustainable development through the adoption of SCP procedures applicable to all purchases established in Law. The environmental dimension of this Resolution establishes that when making purchases, greenhouse gas emissions, energy consumption, and the use of clean technologies, among others, are taken into consideration; and that there is, in general, compliance with the environmental legal framework. In addition, the DNCP has a Manual for Sustainable Public Procurement in Public Works in Paraguay, as well as different studies to incorporate environmental criteria into public procurement procedures. In addition, Resolution DNCP 4657/21 established the Sustainable Public Procurement Committee (CPS) to lead the implementation process of Sustainable Public Procurement policies. This Committee has developed a work plan, reflected in a flexible implementation matrix for the next five years. In summary, the C rating is justified, as Paraguay has several rules and regulations applicable to SCP, but has yet to develop quantitative targets, priorities or timelines for public procurement and its impact on climate change.

Indicators with Opportunities for Improvement

The methodology establishes a series of basic elements and criteria that countries must meet to improve their rating using the PEFA Climate methodology. These elements and criteria provide useful information for identifying areas for improvement and reform.

Table 4 presents some basic elements that Paraguay would need to comply with in order for the indicators assessed as Grade D in the PEFA Climate to be upgraded to Grade C. The Table illustrates, in a non-exhaustive manner, the actions that Paraguay could follow to advance in the integration of climate action in PFM regulations, procedures, processes, and systems.

Table 4. *PEFA Indicators and Dimensions for the PFMCC requiring improvements in Paraguay*

PFMCC indicator	Examples of basic elements to be developed
PFMCC-1: Alignment of the budget with climate change strategies	**1.** Develop medium-term sectoral strategic plans that reflect the priorities established in the public policy and national strategy on climate change or, where these do not exist, in the targets stipulated in the CRCs. **2.** Ensure that the costs of climate change projects and initiatives are included in medium-term sectoral strategic plans. **3.** Have climate change-related projects accounted for in public investment plans. **4.** Ensure that approved medium-term budget estimates are aligned with medium-term sectoral strategic plans and contain costs.

PFMCC indicator	Examples of basic elements to be developed
PFMCC-1: Alignment of the budget with climate change strategies	**5.** Ensure that climate change-related tax policy proposals included in the approved medium-term budget estimates are aligned with the national climate change strategy. **6.** Ensure that estimates of annual expenditures and taxes related to climate change are aligned with the approved estimates of the medium-term budget for the first year.
PFMCC-2: Tracking of climate-related spending	**1.** Adopt a methodology defining what constitutes climate change-related expenditure. **2.** Apply the same methodology across all ministries, departments, and agencies to identify climate change related spending. **3.** Expenditure related to activities that are contrary to the climate change policy is known and disclosed in budget documents and year-end budget execution reports. **4.** Budget units disclose climate change-related spending in budget documents and in year-end budget execution reports. **5.** The methodology applied by the government to identify climate change-related spending is reviewed by an entity other than the one that developed it.
PFMCC-3: Budget circular	The budget circular contains guidance on how to include planned expenditure related to climate change mitigation or adaptation in budget proposals.
PFMCC-4: Legislative scrutiny (PFMCC-4.2)	**1.** Existence of mechanisms to support this process, such as specialized committees, technical and scientific support, expert advice from activist groups, independent counsels, and other stakeholders in the fight against climate change. **2.** Analysis of climate change-related revenues and expenditures that have been executed in a format comparable to the approved budget. **3.** Review of audit reports or evaluation reports on the performance of climate change programs or activities aligned with planned outputs and outcomes. **4.** Review of audit reports or evaluation reports on the impacts of the executed budget with respect to climate change. **5.** Recommendations made by the Legislative Branch regarding measures to be implemented by the Executive Branch. **6.** Follow-up on the implementation of climate spending.
PFMCC-5: Managing public investment for climate change	**1.** The legal or regulatory framework describes the climate change mitigation or adaptation objectives and requirements established for investment programs or projects (PFMCC-5.1). **2.** Prioritization of new investment projects is based on evaluation and prioritization criteria related to climate change (PFMCC-5.2).

PFMCC indicator	Examples of basic elements to be developed
PFMCC-5: Managing public investment for climate change	**3.** The national guidelines for project appraisal recommend assessing the climate change impacts of new investment projects or including adaptation measures in the project design to address climate risks (PFMCC-5.3). **4.** The government establishes that extrabudgetary entities and public corporations in charge of executing investment projects incorporate specific climate objectives, targets, and indicators in their performance contracts or in their corporate statement of intent (PFMCC-5.4).
PFMCC-6: Managing non-financial assets for climate change	The exposure and predisposition of relevant assets to climate variability, extreme weather events and transition risks are identified for relevant assets.
PFMCC-7: Liabilities related to climate change	**1.** The government prepares a report presenting the fiscal risks related to climate change (PFMCC-7.1). **2.** The purposes for which the government may borrow to cover climate change-related liabilities (PFMCC-7.2).
PFMCC-8: Government procurement for climate change	**1.** Climate change standards are used to help determine bid specifications and requirements or award criteria, or alternatively, there are simplified templates and procedures to expedite public procurement needed to respond to climate change disasters (PFMCC-8.2). **2.** The award and execution of contracts shows compliance with climate change specifications included in tenders and contracts. A system of public procurement operations for climate change disasters is in place to ensure compliance with emergency procedures (PFMCC-8.3). **3.** A statistical report on public procurement for climate change is prepared. A report is prepared on compliance with the rules and procedures required in emergency procurement operations (PFMCC-8.3).
GFPCC-9: Climate change revenue management	It was not applied in the case of Paraguay.
PFMCC-10: Controls for climate change-related spending	**1.** The legal or regulatory framework establishes a system of controls on climate change conditionalities for transactions. Controls are applied at least at the payment stage. Evidence shows that this system is partially effective and has partial coverage (PFMCC-10.1). **2.** The fraud audits and investigations that are conducted cover climate change-related transactions to determine whether public funds have been allocated to appropriate climate objectives, but their coverage is partial (PFMCC-10.2).
PFMCC-11: Fiscal decentralization for climate change	**1.** The legal and regulatory framework clearly identifies the mandates and competencies of subnational governments in relation to climate change mitigation and adaptation (PFMCC-11.1). **2.** Conditional transfers for climate change are aligned with the national climate change strategy (PFMCC-11.2).

PFMCC indicator	Examples of basic elements to be developed
PFMCC-11: Fiscal decentralization for climate change	**3.** For dimension PFMCC-11.3: · The national mechanisms used to track climate change-related spending also apply to subnational governments. · The climate change investment framework also covers subnational governments. · The rules and procedures for the transfer and disposal of non-financial assets for climate change also apply to subnational governments. · The legal or regulatory framework for climate change-related debts and guarantees includes specific provisions for subnational governments. · The public procurement framework related to climate change also covers subnational governments.
PFMCC-12: Climate change performance information	**1.** Climate change activities and programs are assigned performance targets. Performance information is included in the budget or in supporting documentation submitted to the legislature (PFMCC-12.1). **2.** Performance of activities and programs related to climate change is reported. Reports are submitted to the Legislative Branch (PFMCC-12.2).
PFMCC-13: Climate change assessment	**1.** Ensure that an evaluation of climate change activities and programs is conducted at least once in the last three years (GPFCC-13.1). **2.** An assessment of the contribution to climate change of climate change-related tax policy is conducted at least once in the last three years (PFMCC-13.2).
PFMCC-14: Spending results for climate change initiatives	It was not applied in the case of Paraguay.

Source: Authors' elaboration based on PEFA Secretariat (2020).
PFM: public finance management

As shown in Table 4, the application of the methodology provides the applicant country with a set of options to gradually and systematically advance the integration of climate change into PFM. Although PEFA Climate does not offer recommendations, good practices in the assessment criteria provide information for countries interested in a roadmap or work plan for a green PFM.

3.3 Progress not Captured in PEFA Climate Applied in Paraguay

At the time of the PEFA Climate assessment (first half of 2022), Paraguay had been developing several fiscal management tools associated with climate change, such as (i) the publication of the Fiscal Risks Report 2022, which includes the identification and quantification of fiscal risks associated with climate change, as well as the identification of mitigation and management measures; and (ii) the inclusion, within a computable general equilibrium model, of a specification that allows for modeling the effects of climate phenomena on economic and fiscal variables. In addition to these instruments already finalized, the Ministry of Finance is currently developing a climate functional classifier for estimating climate change expenditure, and a methodology for prioritizing public investment projects that includes environmental sustainability criteria. These instruments are vital for ensuring that the PFM contributes to climate policies and, in the future, should be reflected in a substantial improvement of several indicators considered in the evaluation of the PEFA Climate. The Ministry of Finance also worked on the Green Labeling Methodology with the collaboration of the Ministry of Environment and Sustainable Development (MADES) and the World Bank, with five pilot entities.

In addition, Paraguay has a Climate Policy Roadmap that was approved in June 2023 (Ministry of Finance of Paraguay, 2023). This document considers the need to review the results of the PEFA and proposes a set of actions that serve as a bridge between the Helsinki Principles and the concrete actions promoted or carried out by the Ministry of Finance of Paraguay. The roadmap establishes lines of action to guide the discussions and actions of the Ministry of Finance in the following areas: macroeconomic and fiscal policy, public investment management, sustainable public procurement and contracting, and budget.

4

IMPLEMENTATION OF PEFA CLIMATE IN COSTA RICA

4. Implementation of PEFA Climate in Costa Rica

This section presents the application of the PEFA Climate methodology in Costa Rica. The purpose of this section is to present the main results and lessons learned from this experience. Similar to the case of Paraguay, this section is organized in three parts: (i) the evaluation process; (ii) the main results, including good practices that could be adopted to improve the scores obtained; and (iii) recent advances not captured by the PEFA Climate methodology.

4.1 Evaluation Process in Costa Rica

The PEFA assessment of the Costa Rican PFM system was requested to the international cooperation in May 2021 by the Ministry of Finance. The request highlighted the importance of the PEFA assessment to strengthen the PFM system and, with the implementation of the new PEFA Climate framework, to ensure that PFM contributes positively to the implementation of national climate change policies. The PEFA assessment was led by the French Development Agency (AFD) and joined by the International Monetary Fund (IMF), the World Bank (WB), the Inter-American Development Bank (IDB) and the European Union (EU). The final report of the PEFA assessment was published in August 2022 (PEFA Secretariat, 2022a).

The objectives of the PEFA Costa Rica 2022 assessment were: i) to present a state of the art of PFM performance through the application of the PEFA 2016 methodology; ii) to assess the progress made in strengthening public financial management based on the last assessment conducted in 2016; and iii) to identify the strengths and weaknesses of the PFM system as inputs for policy dialogue between the government and international cooperation agencies to strengthen the medium-term reform process. Complementarily, the PEFA evaluation included the review of the state of progress of the integration of climate action in public finance management (PEFA Climate), which ratifies the high level of leadership Costa Rica has shown in climate change issues, both regionally and globally.

4.2 Main Results of PEFA Climate in Costa Rica

Overall result

The results of applying the PEFA Climate evaluation criteria to national PFM practices are presented in Table 5. Overall, the results indicate that Costa Rica's laws and regulations, institutions, systems, procedures, and public financial management processes show that there is significant initial progress on green PFM issues, although these should be further strengthened for public financial management to contribute effectively to the implementation of the country's climate policies. In fact, 8 of the 12 indicators evaluated obtained a grade of D or D+, while 4 others were rated C or C+, reflecting that at the time of the PEFA Climate, Costa Rica already had made several advances in this area.

Table 5. *Main results of PEFA Climate in Costa Rica*

PFMCC	INDICATOR	TOTAL	1	2	3	4
PFMCC-1	Alignment of the budget with climate change strategies	D	D			
PFMCC-2	Tracking climate change-related spending	D	D			
PFMCC-3	Budget Circular	C	C			
PFMCC-4	Legislative scrutiny	D	D	D		
PFMCC-5	Public investment management for climate change	D+	C	C	D	D
PFMCC-6	Non-financial asset management for climate change	C	C			
PFMCC-7	Climate change liabilities	C+	A	D		
PFMCC-8	Public procurement for climate change	D	D	D	D	D
PFMCC-9	Revenue management for climate change	NA	NA	NA		
PFMCC-10	Controls for climate change-related spending	D+	D	C		
PFMCC-11	Fiscal decentralization for climate change	D	D	D	D	
PFMCC-12	Performance information for climate change	D	D	D		
PFMCC-13	Evaluation for climate change	C	B	D		
PFMCC-14	Spending outcomes for climate change initiatives	NA	NA	NA		

Source: PEFA Secretariat (2022a).

Indicators with Progress

Since the report on Costa Rica's PEFA Climate was the first to be prepared in the LAC region, the information collected contains less detail than was gathered in the case of Paraguay, where Paraguay benefitted from increasing experience through use of the methodology. However, based on the reports available at the PEFA Secretariat, the following comments can be made on Costa Rica's progress in the PEFA Climate indicators or dimensions, specifically the following:

PFMCC-3	**Budget circular**	C

It was found that Costa Rica's budget circular contains guidance on how to include spending related to climate change mitigation or adaptation, in budget proposals.

PFMCC-5.1	**Provisions related to climate change included in the regulatory framework for public investment management**	C

The legal or regulatory framework of the public investment system describes the climate change mitigation or adaptation objectives and requirements established for investment programs or projects. The scope of climate-related objectives and requirements apply to central government entities.

PFMCC-5.2	Selection of investment projects for climate change	C

The prioritization of new investment projects is based on evaluation and prioritization criteria related to climate change. This is a crucial step forward and is reflected in the methodology guidelines prepared by the Ministry of Development and Planning (MIDEPLAN).

PFMCC-6	Non-financial asset management for climate change	C

The main public assets are exposed to climate variability, extreme weather events, and transition risks.

PFMCC-7.1	Fiscal risks related to climate change	A

Costa Rica achieved an A rating since the government has a report that presents the fiscal risks related to climate change. The report includes a quantitative and qualitative assessment of such risks and considers impacts on expenditures and revenues.

PFMCC-10.2	Transaction compliance audit	C

The fraud audits and investigations conducted cover climate change-related transactions to determine whether public funds have been allocated to the appropriate climate objectives, although their coverage is partial.

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PFMCC-13.1	Climate change expenditure assessment	B

Grade B was assigned because an evaluation of climate change activities and programs was conducted and published at least once in the last three years.

Indicators with Opportunities for Improvement

Table 6 presents some basic elements that would need to be met to improve the PEFA Climate indicator scores by one grade. Given that Costa Rica's PEFA Climate assessment was completed in August 2022, some of the elements presented in this table may already have been developed or may be in the process of being developed. However, the purpose of Table 6 is to illustrate (in a non-exhaustive manner) how PEFA Climate can be used to identify areas for improvement of a green PFM.

Table 6. Indicators and dimensions of PEFA PFMCC in Costa Rica

PFMCC Indicator	Examples of basic elements to be developed
GFPCC-1: Alignment of the budget with climate change strategies	**1.** Develop medium-term sectoral strategic plans that reflect the priorities established in the public policy and national strategy on climate change or, where these do not exist, in the targets stipulated in the CRCs. **2.** Ensure costs of climate change projects and initiatives are included in medium-term sectoral strategic plans. **3.** Have climate change-related projects accounted for in public investment plans. **4.** Ensure approved medium-term budget estimates are aligned with medium-term sectoral strategic plans and contain costs. **5.** Ensure climate change-related tax policy proposals included in the approved medium-term budget estimates are aligned with the national climate change strategy. **6.** Ensure estimates of annual expenditures and taxes related to climate change are aligned with the approved estimates of the medium-term budget for the first year.
PFMCC-2: Tracking of climate-related spending	**1.** Adopt a methodology defining what constitutes "climate change-related expenditure." **2.** Apply the same methodology across all ministries, departments, and agencies to identify climate change-related spending. **3.** Expenditure related to activities that are contrary to the climate change policy is known and disclosed in budget documents and year-end budget execution reports. **4.** Budget units disclose climate change-related spending in budget documents and in year-end budget execution reports. **5.** The methodology applied by the government to identify climate change-related spending is reviewed by an entity other than the one that developed it.
PFMCC-3: Budget circular	The budget circular provides a methodology for tracking climate change-related spending.
PFMCC-4: Legislative scrutiny (PFMCC-4.2)	**1.** Existence of mechanisms to support this process, such as specialized committees, technical and scientific support, expert advice from activist groups, independent councils, and other stakeholders in the fight against climate change. **2.** Analysis of climate change-related revenues and expenditures that have been executed in a format comparable to the approved budget. **3.** Review of audit reports or evaluation reports on the performance of climate change programs or activities aligned with planned outputs and outcomes.

PFMCC Indicator	Examples of basic elements to be developed
PFMCC-4: Legislative scrutiny (PFMCC-4.2)	**4.** Review of audit reports or evaluation reports on the impacts of the executed budget with respect to climate change. **5.** Recommendations made by the Legislative Branch regarding measures to be implemented by the Executive Branch. **6.** Monitoring the implementation of climate spending.
GFPCC-5: Managing public investment for climate change	1. The legal or regulatory framework describes the climate change mitigation or adaptation objectives and requirements established for investment programs or projects (PFMCC-5.1). 2. Prioritization of new investment projects is based on evaluation and prioritization criteria related to climate change (PFMCC-5.2). 3. The national guidelines for project appraisal recommend assessing the climate change impacts of new investment projects or including adaptation measures in the project design to address climate risks (PFMCC-5.3). 4. The government requires extra-budgetary entities and public corporations in charge of executing investment projects to incorporate specific climate objectives, targets, and indicators in their performance contracts or in their corporate statement of intent.
PFMCC-6: Managing non-financial assets for climate change	The exposure and predisposition of land, infrastructure works and public buildings to climate variability, extreme weather events and transition risks are systematically identified for relevant assets. The information is included in the register. Procedures and regulations for the disposal, transfer, and use of land and subsoil assets contain specifications related to climate change.
PFMCC-7: Liabilities related to climate change	The purposes for which the government may borrow, as specified in the legal framework, allows for climate change-related liabilities to be covered. The legal and regulatory framework contains specific provisions for subnational governments and public corporations. The climate change-related reports required by the standards are prepared (PFMCC-7.2).
PFMCC-8: Government procurement for climate change	1. Climate change standards are used to help determine bid specifications and requirements or award criteria, or alternatively, there are simplified templates and procedures to expedite the public procurement needed to respond to climate change disasters (PFMCC-8.2). 2. The award and execution of contracts shows compliance with climate change specifications included in tenders and contracts. A system of public procurement operations for climate change disasters is in place to ensure compliance with emergency procedures (PFMCC-8.3). 3. A statistical report on public procurement for climate change is prepared. A report is prepared on compliance with the rules and procedures required in emergency procurement operations (PFMCC-8.3).

PFMCC Indicator	Examples of basic elements to be developed
PFMCC-9: Climate change revenue management	It was not applied in the case of Costa Rica.
PFMCC-10: Controls for climate change-related spending	**1.** The legal or regulatory framework establishes a system of controls on climate change conditionalities for transactions. Controls are applied at least at payment stage. Evidence shows that this system is partially effective and has partial coverage (PFMCC-10.1). **2.** The fraud audits and investigations that are conducted cover climate change-related transactions to determine whether public funds have been allocated to appropriate climate objectives, but their coverage is partial (PFMCC-10.2).
PFMCC-11: Fiscal decentralization for climate change	**1.** The legal and regulatory framework clearly identifies the mandates and competencies of subnational governments in relation to climate change mitigation and adaptation (PFMCC-11.1). **2.** Conditional transfers for climate change are aligned with the national climate change strategy (PFMCC-11.2). **3.** For dimension PFMCC-11.3: · The national mechanisms used to track climate change-related spending also apply to subnational governments. · The climate change investment framework also covers subnational governments. · The rules and procedures for the transfer and disposal of non-financial assets for climate change also apply to subnational governments. · The legal or regulatory framework for climate change-related debts and guarantees includes specific provisions for subnational governments. · The public procurement framework related to climate change also covers subnational governments.
PFMCC-12: Climate change performance Information	**1.** Climate change activities and programs are assigned performance targets. Performance information is included in the budget or in supporting documentation submitted to the legislature (PFMCC-12.1). **2.** Performance of activities and programs related to climate change is reported. Reports are submitted to the Legislative Branch (PFMCC-12.2).
PFMCC-13: Climate change assessment	**1.** An independent evaluation of climate change-related activities and programs has been conducted and published at least once in the last three years. Evaluations of activities and programs that indirectly contribute to climate change adaptation and mitigation, including those that contravene this public policy, include a part dedicated to the impact they have on climate change (GPFCC-13.1). **2.** An assessment of the contribution to climate change of climate change-related tax policy is conducted at least once in the last three years (PFMCC-13.2).
PFMCC-14: Spending results for climate change initiatives	It was not applied in the case of Costa Rica.

Source: Authors' elaboration based on PEFA Secretariat (2020).

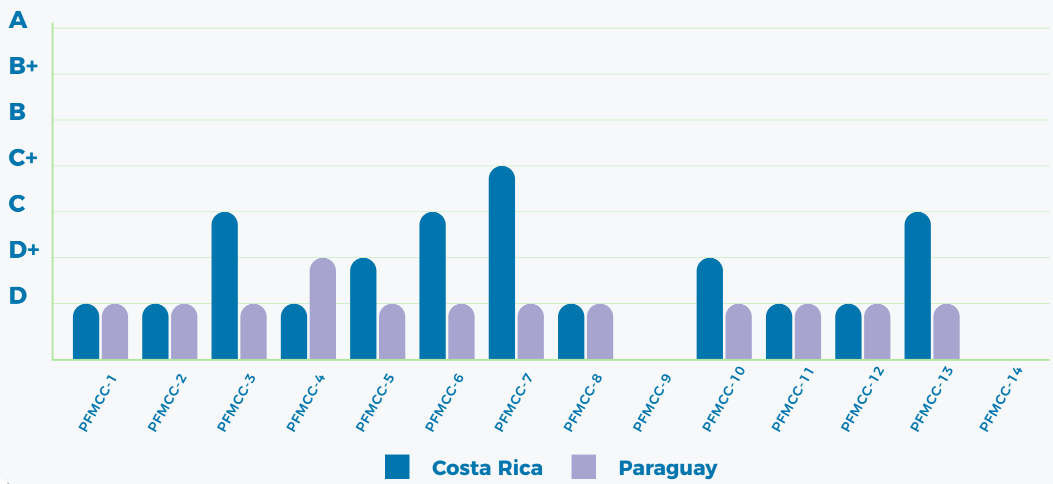
As shown in Table 6, application of the PEFA Climate methodology provides Costa Rica with a set of options to gradually and systematically advance the integration of climate change into PFM. Although the PEFA Climate does not offer recommendations, the inclusion of good practices in the evaluation criteria provides useful information for the country to develop a roadmap or work plan for a green PFM.

4.3. Progress not Captured in PEFA Climate

At the time of the PEFA Climate assessment of Costa Rica, the country was in the process of adopting a new classifier for climate impact expenditures, risk management expenditures, and biodiversity expenditures. This process was concluded in May 2022 with the approval of three instruments: (i) the methodological guide for linking the programmatic structure with the functional classifier for climate change, biodiversity, and disaster management expenditures; (ii) the corresponding methodological guide for the identification and quantification system; and (iii) the manual of methodological guidelines for the matrix for linking the functional classifier for climate, biodiversity and disaster risk management expenditures. Although these advances were not captured in the PEFA Climate report, they are all of significant importance to ensure that PFM contributes to climate policies.

Finally, Figure 1 shows a comparison of the PEFA Climate results of Costa Rica and Paraguay. The comparison shows that Costa Rica was already integrating climate action into its PFM, while Paraguay is just starting the process.

Figure 1. *Outline of results of PEFA Climate in Costa Rica and Paraguay*



Source: Authors' elaboration based on the reports PEFA+ Costa Rica (PEFA Secretariat, 2022a) and PEFA++ Paraguay (PEFA Secretariat, 2022b).

5

MAIN LESSONS LEARNED AND RECOMMENDATIONS

5. Main Lessons Learned and Recommendations

Lessons learned from the PEFA Climate implementation process, and efforts to incorporate the climate change perspective into fiscal policy and management include the following:

i) The PEFA Climate diagnostic methodology as a useful tool for countries to gauge the degree of progress they have made in incorporating the climate dimension into legal and regulatory instruments, processes, and public financial management systems. Its incorporation is therefore recommended for countries planning to conduct a PEFA assessment in the near future.

ii) Although the PEFA (or PEFA Climate) assessments do not include an action plan or concrete recommendations, a review of the elements and criteria used in the rating process provides sufficient information for countries to define their own roadmaps toward a green PFM. However, since the PEFA Secretariat is constantly adjusting the criteria, it is important that the latest versions of the technical implementation guides are considered in the development of these action plans or roadmaps.

iii) The PEFA Climate framework is complementary to PEFA, thus the results obtained in PEFA Climate are fully aligned with the indicators or dimensions of the PEFA assessment. This alignment should be considered in the action plans or road maps for the integration of climate action in the PFM, which in turn helps avoid isolated or poorly coordinated actions.

6

GUIDELINES FOR INTEGRATING CLIMATE ACTION INTO PFM

6. Guidelines for Integrating Climate Action into PFM

Integrating climate action into PFM policies, standards, procedures, processes, and systems is a complex and long-term task. For this reason, it is recommended that countries establish action paths or work plans that, according to their capabilities, allow them to gradually and systematically advance in the adoption of international best practices in Green PFM.

Table 7 presents a mapping of the most commonly used international tools for integrating climate action into PFM and their relationship with the PEFA and PEFA Climate dimensions. This information, together with the specific criteria used in the PEFA qualification, can be useful for countries interested in developing an action plan or roadmap on Green PFM issues.

Cuadro 7. *Tools for Integrating Climate Action into PFM*

PEFA pillars	Climate dimension PEFA Climate	CC integration tools in PEFA pillars
Budget reliability	Expenditures for climate activities	Climate expenditure marker/classifier system
Transparency of public finances	Climate expenditure monitoring; climate-sensitive fiscal decentralization framework; climate performance reporting; climate performance evaluation	Integration of classifiers in the integrated financial administration system Methodology for monitoring and evaluation of climate expenditure
Asset and liability management	Public investment management that responds to climate action; asset management with a climate perspective; management of climate liabilities	Capital climate expenditure markers/classifiers Use of green taxonomies consistent with classifiers
Policy-based fiscal strategy and budgeting	Budget aligned with climate strategies; budget circular with climate perspective	Integration of climate dimension (classifiers) in budget circular. Integration of the climate dimension into medium-term fiscal frameworks
Predictability and control of budget execution	Climate-sensitive procurement; climate-sensitive tax administration; climate-related expenditure compliance	Integration of the product cycle perspective in purchasing and procurement standards
Accounting and reporting	Under development by the PEFA Secretariat	NA
External scrutiny and audit	Legislative scrutiny; evaluation of climate budget performance	Model legislative reports on climate spending

Source: Authors' elaboration based on PEFA Secretariat (2016; 2019).

To facilitate their use, the green PFM tools have been arranged according to the PEFA pillars and the PEFA Climate dimensions. They can be implemented using an action plan (or roadmap) with content that respects the capacities, progress made, and particularities of each country. However, it is possible to establish an order of priority in the implementation of the aforementioned tools, thus contributing to a greater focus of efforts, complementarity between tools, and enhancement of the progress made. The order of priority in which these tools could be adopted is as follows:

- **Step 1.** Establishment of a system of climate expenditure classifiers to identify climate-related expenditure (positive or negative), using as a basis the functional expenditure classifier and existing international classification systems.
- **Stage 2.** Adoption of the new classification system within the framework of policies and rules governing PFM. At this stage, the development of specific rules for budget planning, preparation, execution, and monitoring is important. Particularly key at this stage are the budget circulars that guide the entire process.
- **Stage 3.** Integration of climate expenditure classifiers into financial management information systems. This stage is critical to avoid the review of climate expenditure being carried out in an ad-hoc and discontinuous manner. However, it is also one of the most technically and operationally complex stages.
- **Stage 4a.** Establishment of methodologies and practices for evaluating climate spending. These methodologies should include both aspects of technical efficiency (such as procedures and processes) and allocative efficiency (impact of climate spending) of public climate resources.
- **Stage 4b.** Adoption of practices that favor transparency, such as reporting models to facilitate scrutiny by the legislature, and reports to the public.

These stages, as well as the associated tools, must be implemented on the basis of an action plan or road map that organizes the process and considers each country's own capabilities. Furthermore, they should be applied in a flexible manner, since there are actions that countries can carry out by taking advantage of their experience in other areas. For example, it is possible that a country may have successful experiences in marking gender expenditure that it intends to extrapolate to climate expenditure through the use of budget circulars.

7

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