Executive summary

Key findings

The increasing frequency and severity of climate change-related extreme events, including cyclones, floods, and wildfires, are resulting in increasing damages to homes, building and infrastructure with significant implications for livelihoods and the broader economy. Governments have a critical role to play in supporting relief, recovery and reconstruction in the aftermath of climate-related extreme events, to address the resulting financial losses, and in creating an enabling environment that encourages adaptation, risk reduction and financial resilience. This creates pressures on public finances and can result in fiscal risks. Identifying and assessing such climate-related fiscal risks, mitigating these risks across society and ensuring sufficient funding to respond to events when they occur will become an increasingly important component of public financial management and economic policy.

This report provides an analytical framework for governments to support the financial management of climate-related risks, in particular the exposure of governments to economy-wide losses and damages from physical risks linked to climate change. The goal is to support enhanced decision-making and action at the national and international levels, with the aim of helping governments, particularly in emerging market and developing economies facing budgetary and financing constraints, better manage the financial risks that they face from the expected increase in frequency and intensity of climate-related extreme events.

The report addresses the public financial management challenges that these climate-related risks present to governments in terms of fiscal risks. It examines the role of different public schemes, including budget reallocations, risk retention (e.g. reserve funds), risk financing (e.g. official finance, public debt issuance) and risk transfer mechanisms (e.g. insurance, catastrophe bonds) in managing fiscal risks, with due recognition to potential differences in fiscal resources and repayment capacities and other key factors that may influence financial strategies for climate risk, such as data availability, technical expertise, and the structure of fiscal arrangements across levels of governments.

The framework is structured in two parts:

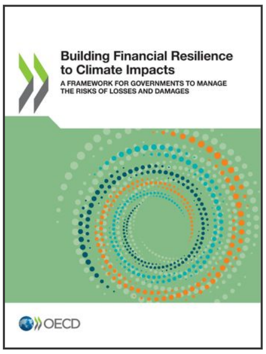
- The first part is about strengthening governments' financial management of climate-related risks at the **national level**. Climate-related physical risks, first, need to be identified and better understood in terms of their components (hazards, exposure and vulnerability) and sources. Once the physical risks and their sources are identified, opportunities to mitigate financial losses through adaptation and risk reduction should be examined. A key step is to ensure that incentives for risk reduction are established across society to encourage risk reduction actions by households, businesses, financial sector and sub-national governments. Residual physical risks will remain, even after the best efforts to reduce them. These remaining physical risks will result in financial losses, which will need to be absorbed by the economy and which will translate into fiscal and financial risks, which will need to be integrated into public financial management frameworks. The next step is to ensure sufficient funding and buffers to respond effectively to these fiscal risks, through coherent and integrated multipronged government financial strategies.

- The second part discusses the importance of promoting **global climate financial resilience**. Building financial resilience to climate impacts requires that development partners promote integrated strategies to strengthen financial resilience at the country level, through multiple channels. It is also important to promote coordinated action in terms of international development cooperation to effectively improve global climate financial resilience.

The framework builds on the OECD report, Managing climate risks, facing up to losses and damages (2021), and is informed by the OECD Recommendation on Disaster Risk Financing Strategies, the OECD Recommendation on Budgetary Governance the OECD Recommendation on the Governance of Critical Risks complemented by the G20/OECD Methodological Framework for Disaster Risk Assessment and Risk Financing. It aims to provide guidance for central governments, regulators and international development community on preparing for climate-related losses and damages from a public financial management perspective, including for:

- Identifying and assessing climate-related risks, financial vulnerabilities, and financial implications for government;
- Reporting climate-related fiscal risks to promote transparency in public financial management;
- Promoting, investing and financing risk prevention, risk reduction and adaptation to reduce exposure and vulnerability;
- Protecting households and businesses through insurance and access to credit;
- Aligning incentives across levels of government by encouraging active risk management;
- Ensuring clarity in public financial assistance arrangements for households and businesses to mitigate future financial losses;
- Assessing budgetary capacities to fund relief, recovery, and reconstruction, including through budget reallocation;
- Assessing debt market borrowing capacities, including speed of access; and,
- Optimising financial tools under budgetary and financing constraints, within integrated frameworks of disaster risk management and reduction.

This report has the potential to provide insights to discussions at international fora, such as the UN, the G7 and others on climate resilient development. For instance, recognising and acting on the challenges posed by the greater need for coordination on these issues has been a priority for both the previous and current G7 presidency. Germany has made strengthening the climate and disaster risk finance and insurance architecture in a systematic, coherent and sustained way a priority in its G7 presidency.



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A Framework for Governments to Manage the Risks of Losses and Damages

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