



OFFICE OF THE STATE COMPTROLLER  
AND OMBUDSMAN OF ISRAEL



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## Chapter | 3

# Economic, Taxation, and Financial Aspects of Climate Change









## Chapter 3 | **Economic, Taxation, and Financial Aspects of Climate Change**

### Background

From a historical perspective, as well as today, there is a direct link between the development of countries and modern economies and the increase in GHG emissions. Economic growth is associated with increased energy production from fossil fuels, leading to higher GHG emissions. Climate risks caused by this global increase in GHG emissions are expected to impact a country's financial situation and GDP, affecting its growth rates and national budget. This is because the chronic and acute effects of climate change are expected to cause substantial damage to various sectors of the economy over time: they could negatively impact economic growth and disrupt its activities, or harm the country's income and its ability to provide adequate services to its citizens. Climate change also has a direct impact on price stability in the economy.

The ability to continue economic growth without the need to increase GHG emissions implies breaking the dependence between these two factors (decoupling), which reflects an increase in productivity relative to the energy unit consumed. This implies a fundamental change in the way the economy operates. The need to mitigate the connection between economic growth and GHG emissions leads to the fact that for many years, countries have been "greening" their economies, including through green budgeting, and "greening" the financial system. This section addresses various aspects of this issue in Israel.





## Key Figures

### **90 finance ministers worldwide**

Are members of the Coalition of Finance Ministers for Climate Action (Climate Coalition); Israel is not among them

### **13**

Number of years of discussions in the Israeli government on the issue of carbon pricing before Government Resolution No. 286 on the carbon tax was passed in 2021; as of November 2023, the resolution was not implemented

### **38% reduction**

The reduction rate in the budget of the Chief Scientist's Office at the Ministry of Energy compared to the budget for 2022 (from NIS 100M to NIS 65M)

### **NIS 4B**

Total annual support and subsidies for fossil fuels in Israel

### **16.8%**

The rate of internalization of external costs estimated from GHG emissions, according to the coal tax plan established in Government Resolution No. 286

### **0**

The number of cross-sector economic and fiscal assessments carried out in Israel on the implications of the climate crisis on Israel

### **Only 9%**

Of public companies in Israel (48 of 558) publish ESG reports

### **Only 5.7%**

Rate of the public investment of the Israel Innovation Authority in 2022 in the fields of energy, water, environment, and sustainability out of its total investments (NIS 96M out of NIS 1.7B)





## Key Findings



### Role of the Ministry of Finance in Promoting Climate Actions



#### **Absence of leadership by the Ministry of Finance on the climate change issue**

– The Ministry of Finance continues to view the climate issue primarily as an environmental matter, mainly dealt with at the professional-administrative level rather than as a national economic issue. The overall activity of the Ministry of Finance, as indicated by the previous report and this follow-up report, suggests that despite its broad impact on this issue, it has not yet adopted a leadership position. Instead, it takes a reactive stance, initiating very few actions in the field. Often, it even takes a stance that hinders the means needed to combat climate change, over which it has influence. When the Ministry of Finance does address the issue, it does so in segments, according to its traditional method of operation – vis-à-vis each ministry separately, and using its typical tools as used for any other government issue, instead of taking wide-ranging proactive action using the full range of tools at its disposal. The Ministry of Finance's reluctance to transform into a dominant player in promoting climate policy, as other OECD countries have done, negatively affects Israel's effective achievement of its goals in this area.



#### **Membership in the Coalition of Finance Ministers for Climate Action**

– Out of the 37 OECD member countries, the Israeli Minister of Finance (along with three other finance ministers from other countries) has not joined the Coalition of Finance Ministers for Climate Action, whose work is consolidating around best practices and principles in areas under the responsibility of finance ministries related to climate change. This reflects a disconnection of the Israeli Ministry of Finance from a highly significant forum in which relevant practices are developed in areas within its purview.




#### **Green budgeting**


– The Ministry of Finance in Israel is not actively involved in green budgeting, except for being aware of the existence of the concept. Its engagement is limited to promoting voluntary green procurement and issuing a single green bond letter (issued in 2023). It does not incorporate recommendations on these matters into fiscal and economic actions it takes and does not see its role as central in promoting climate actions. This is despite the increasing global recognition of the crucial role played by finance ministries and the need to make them a dominant force in achieving climate goals and carbon neutrality. This is also despite the fact that within leading international frameworks in which Israel is a participant, recommendations have been formulated for the adaptation of economic and fiscal tools to the era of climate change, tools that are typically within the purview of finance ministries.






## Assessment of Climate-Related Economic Impacts

 **Lack of assessment on the economic impacts of climate change** – The previous report noted that no economic or financial government body or trusted entity in Israel, such as the Ministry of Finance and the National Economic Council, had conducted a national assessment regarding the long-term economic impacts of climate change on Israel. In the follow-up audit, it was found that **this deficiency was not rectified**. Over a year and a half after the publication of the previous report, none of the mentioned responsible entities, including the Ministry of Finance, the National Economic Council, and the Bank of Israel, had conducted a comprehensive national economic and fiscal assessment related to climate change and the formulation of climate policy (mitigation and adaptation) for the long or medium term. Conducting a unified and validated national economic and fiscal assessment for the entire government is an important tool for reducing uncertainty and making well-informed decisions regarding climate policy in Israel.

 **Lack of economic impact forecast of climate change at the Ministry of Finance** – The Ministry of Finance did not address the long-term economic impacts of climate change on Israel in the context of the economic forecasts published by its Department of the Chief Economist. These economic impacts are caused by the costs associated with adaptation for the purpose of reducing damage to public assets, infrastructure, and citizens' property, due to the realization of acute or chronic physical risks; and due to the investments required for transitioning away from coal (except for mentioning a single, indirect risk of the global supply chain crisis, and even that, only for a two-year timeframe).

While the Department of the Chief Economist believes that there is value in assessing these impacts, it asserts that is not their role to do so. The Department argues that the initiative to derive the economic implications should be "bottom-up" and come from within each ministry, so that each government ministry conducts its own independent assessment. This stance does not align with the Ministry of Finance's role in planning and implementing the economic and fiscal policy of the State of Israel; in setting the state budget for government activities and distributing it to the various government ministries; managing government revenues, collecting direct and indirect taxes; and considering relevant economic changes affecting the Israeli economy for the purpose of determining government policy. This position does not align with the Ministry's economic expertise or its wide-ranging influence on the economy, which gives it a unique position, nor with the recommendations made by the OECD, the Coalition of Finance Ministers for Climate Action, and the IMF regarding the role of finance ministries.

 **Ministry of Finance's failure to conduct economic-fiscal assessment** – The audit noted that the Budgets Department in the Ministry of Finance does not adhere to international recommendations regarding "green" budgeting and fiscal management. It has not conducted an economic-fiscal assessment regarding the costs of adapting to





climate change on the Israeli economy, or the costs of achieving emissions reduction targets by 2050. Additionally, the Budgets Department has not acted to validate the data it relies on, despite being the professional body responsible for managing the state budget.


In the absence of an independent economic-fiscal analysis, the Budgets Department has relied on research from an Israeli institute, which concluded that in a business-as-usual scenario, the estimated economic impact of climate change on Israel is a decrease of approximately 1.15% in GDP by 2050. Consequently, the Budgets Department stated its conclusion that climate change impact is "very limited." However, the Department's statement is unfounded and not validated, as it disregards less harmful alternatives to GDP, such as the low-carbon economy alternative and the 2°C temperature increase limit (RCP 2.6) consistently presented in various studies (including in the referenced institute's research).

This reliance may inherently bias decisions concerning budgeting for climate action towards reduction, as presented in the prior report and reiterated in this follow-up audit. The Ministry of Finance does so rather than being grounded in a thorough economic-environmental analysis, utilizing the dedicated tools recommended by organizations mentioned in this audit report such as the Coalition of Finance Ministers for Climate Action and the OECD. The Ministry should also consider scenarios which demonstrate that policies aimed at limiting temperature rise to 2°C mitigate the impact of climate change on GDP, compared to a business-as-usual scenario (including in the cited research).

#### **The National Economic Council's failure to conduct an economic assessment**

– The National Economic Council did not carry out an economic assessment on the subject of climate change, although the council has a mandate to deal with long-term economic issues. Furthermore, it emerged that as of July 2023, about a year and a half after the publication of the previous report, the council had not presented the Israeli government with a strategic situation assessment that addresses the climate issue, partly due to the position of council head remaining vacant for about a year and a half (from mid-2021 until January 2023).




### **Carbon Pricing and Additional Tax Aspects**

 **Failure to implement a carbon tax in Israel** – The previous report indicated that after over 13 years of discussions on carbon pricing in the Israeli government, Government Resolution No. 286 was made to gradually impose a carbon tax on some fuels starting in 2023. The follow-up audit found that the **deficiency has not been rectified** – as of November 2023, a carbon tax had not been implemented (following the discussion in the Knesset Finance Committee from December 2021), and in practice, Government Resolution No. 286 is not being enforced. Currently, there is no willingness on the part of the Ministry of Finance to promote its implementation even though the carbon tax framework is supposed to be implemented progressively, and regarding households, it imposes a low to





moderate cost of NIS 32 per month on average per household. The non-implementation of a carbon tax in Israel does not align with repeated OECD recommendations on the matter, including its latest recommendation in the 2023 Environmental Performance Review of Israel. According to the Budgets Department of the Ministry of Finance, non-implementation of the carbon tax will result in a revenue loss of over NIS 2.5B in 2023, and over NIS 7.5B for the years 2023 to 2028 (cumulatively).

-  **Impact of the failure to implement the carbon tax on international trade and Israeli exports to Europe** – The previous report noted that Israel is exposed to trade restrictions in the form of the Carbon Border Adjustment Mechanism (CBAM) promoted by the European Union, which imposes a carbon tax on imports from countries without a carbon pricing mechanism. The follow-up audit found that **the deficiency has not been rectified** – without implementing a carbon tax, Israel is exposed to the CBAM, and Israeli export companies may be harmed by the requirement to pay a carbon tax to the European Union or European countries on goods from certain sectors of Israeli industry. Since the legislative processes regarding the CBAM have been completed in the European Union, there is an increased potential for harm to competitiveness.
-  **Failure to formulate a mechanism to mitigate the impacts of carbon tax on households and industry** – The Finance, Civil Service, Economy, and Energy Ministries have not finalized complementary mechanisms for the carbon tax along with Government Resolution No. 286. These include support for households among underprivileged populations, compensation for energy-intensive industrial sectors to maintain the competitiveness of Israeli industry, and a general taxation mechanism that would lead to offsetting or mitigating the increase in the cost of living. These mechanisms need to be regulated in conjunction with the imposition of the carbon tax and were even proposed to be regulated within the framework of the Third Green Taxation Committee Report. The absence of such regulation prevented the implementation of the carbon tax in the past and also complicates it in 2022-2023. Although the inter-ministerial team led by the Ministry of Energy completed its study on mechanisms for promoting energy efficiency and facilitating the transition to clean energy among underprivileged populations, the study was not finally adopted as policy. According to the Ministry of Energy, this is "due to the fact that a carbon tax was not promoted for implementation," and the team's main output remained a draft.
-  **Setting the carbon price in Government Resolution No. 286** – The previous report indicated that a price of NIS 167 per ton of carbon, as stated by the MoEP in its Policy Document on Carbon Pricing, is lower than the updated recommendation of the OECD - namely EUR 60 in 2021 and EUR 120 by 2030. The follow-up audit found that **this deficiency was not rectified** – there was no evidence that the level of the carbon tax was reconsidered or that its adaptation to international recommendations was contemplated. In this situation, the carbon tax, which is updated to NIS 189 for 2022 and matches the recommendation in the United States, even if implemented, would not meet the aforementioned recommendations of the OECD, the IMF, the European Union, or the World Bank. The carbon tax roadmap in Government Resolution No. 286 is also meant to





end in 2028, without a mechanism for an annual price update of 2.1%, and without linkage to expected increases in international pricing recommendations from which the Israeli pricing recommendation was derived. In this state, even if it were implemented, it would begin to erode in 2029, and possibly even earlier.



**Partial internalization of the external costs of natural gas in the carbon tax framework** – As of 2021, natural gas alone accounted for 41% of CO<sub>2</sub> emissions in Israel, and this proportion is expected to increase to 60% of emissions by 2030.<sup>1</sup> Even if Government Resolution No. 286 were implemented, the internalization of the external costs incurred from the combustion of natural gas would reach a maximum share of only 31%, and only for the external costs of CO<sub>2</sub> emissions rather than all GHG emissions associated with natural gas production (and only starting from 2028). By contrast, with full internalization of the costs, the price of CO<sub>2</sub> would need to be tripled, and the external costs of the remaining GHGs would also need to be priced in. This also means that as the power sector reduces and eventually ceases coal combustion, as the government has determined, and as the proportion of electric vehicles rises, the share of natural gas in the fuel mix will increase, and the rate of cost internalization through the carbon tax will decrease accordingly.

The decision to limit the increase in electricity prices to 5% has significantly eroded the effectiveness of the carbon tax framework established by Government Resolution No. 286, which mandates the internalization of external costs from natural gas – the fuel with the highest emission rate in Israel. This increase and the slight rise in the cost of living for households - had the carbon tax been implemented - reflect the fact that the relevant government bodies, led by the Ministries of Finance and Energy, have not sufficiently internalized the recognition that carbon neutrality typically involves an increase in electricity prices and a rise in the cost of living in the energy and fuel-powered transportation sectors.



**The "coverage" scope in the carbon tax roadmap of Government Resolution No. 286** – Even if the carbon tax mentioned had been implemented, it would not have been applied to emissions from other non-fuel sources (such as refrigerant gases and waste) which account for an additional 20% of emissions, and there is currently no intention to price them. It was also found that a carbon tax was applied only to some of the fuels. For example, it was not applied at all to heavy fuel oil for ships (which is not taxed at all) or to aviation kerosene (which has a very low tax rate of NIS 29 per ton), nor on gasoline and diesel of all types (diesel, transport diesel, shipping diesel, which remained taxed at the same price). Furthermore, it was found that pricing carbon through the tax mechanism would have meant that the external costs intended for internalization were due to CO<sub>2</sub> emissions and not for other greenhouse gases (i.e., not according to CO<sub>2</sub>e) – this in the absence of additional pricing tools such as levies on entities obliged by law to report emissions (including of GHGs).

1 According to data from the Finance Ministry.





**Extent of external cost internalization if the carbon tax roadmap had been implemented** – The partial coverage of the carbon tax in Government Resolution No. 286, especially its low rate for natural gas, would have resulted in partial internalization of the external costs of GHG emissions in Israel. Instead of internalizing the costs estimated by the MoEP at NIS 13.1B in 2020, about NIS 2.2B would have been internalized - a rate of only 16.7% of the total and far from the 100% internalization recommended by the Third Green Taxation Committee, led by the Ministry of Finance and the Tax Authority.

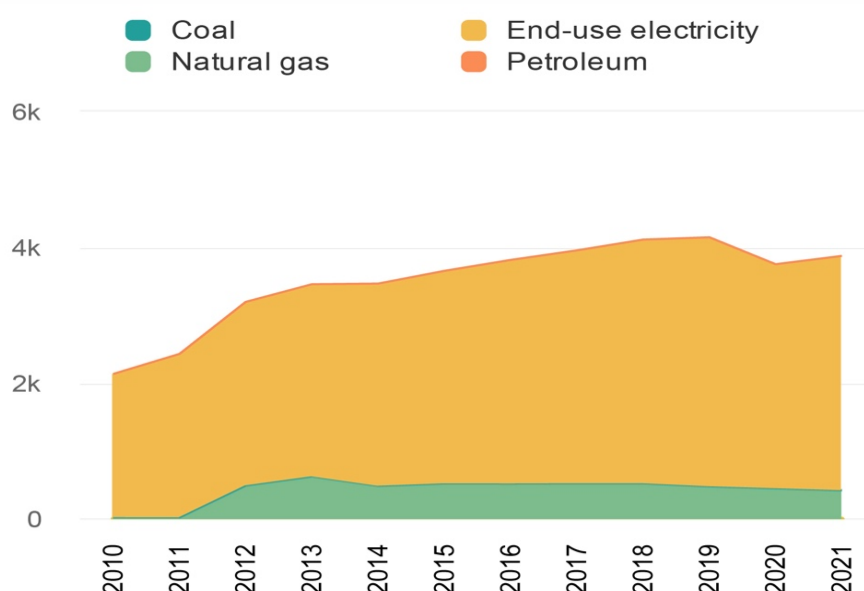
**Incentives and subsidies for fossil fuels** – The follow-up audit found that annual government support for fossil fuels is on a steady increase (except for the year 2020 due to the COVID-19 pandemic). This support nearly doubled, rising from about NIS 2.2B in 2010 to a peak of NIS 4.2B in 2019, and although it declined in 2020 (due to the pandemic), the upward trend resumed in 2021. Support figures for 2022-2023 are expected to rise even more in light of the new exemption from the coal tax and the discount on the gasoline tax, amounting to a cumulative total of about NIS 3.5B. These subsidies act as an economic incentive, increasing demand for fossil fuels instead of shifting demand to other alternatives or improving energy efficiency. Subsidies of such extensive scope are inconsistent with Israel's long-standing goals to reduce GHG emissions and other pollutants, and they undermine its efforts to transition to a low-carbon economy.

- a. **Diesel** – From 2015 to 2023, the State of Israel saw a loss of potential revenues amounting to nearly NIS 30B due to rebates on diesel. This revenue loss will continue to be significant as the framework for abolishing the rebates does not, for instance, apply to diesel for industrial plants, engineering equipment, tractors, and work vehicles weighing more than 4.5 tons, which have a substantial rebate on diesel ranging from 45% to 69%.
- b. **Coal** – The abolition of the coal tax led to a revenue loss of NIS 800M from the state treasury from February 2022 to May 2023.
- c. **Gasoline** – The reduction of the gasoline tax rate on from April 2022 until the end of 2023 resulted in an estimated revenue loss of NIS 2.6B from the state treasury, broken down as follows: from April to December 2022, a loss of NIS 1.7B, and an estimated revenue reduction of about NIS 830M in 2023.





## OECD Data on Israeli Government Support for Fuels, per Type (in NIS M)



Source: OECD.

## Climate-Tech Innovation and R&D

**Investments by the Chief Scientist's Office of the Ministry of Energy in innovation** – The audit found that in 2023, there was a decrease in "supplementary budgets" compared to 2022, from approximately NIS 99.5M to NIS 61.5M (a decrease of about 38%). As a result, new climate related projects planned by the Chief Scientist's Office did not receive funding. The absence of a long-term budget plan for these investments that provides certainty to the economy may hinder the research and development of essential climate technologies in the energy and electricity sector. This significantly affects the advancement of projects and may lead to missed opportunities and the "flight" of Israeli investors and entrepreneurs from Israel. This sends a negative signal of a de facto retreat by the State of Israel from its declarations in government decisions on climate-tech, expressed at the recent global climate conferences in Glasgow and Sharm el-Sheikh. As mentioned earlier, there is a significant difficulty in the conditioning of the budgets for innovation in the energy sector on the implementation of Government Resolution No. 286 regarding a carbon tax and the related revenues.

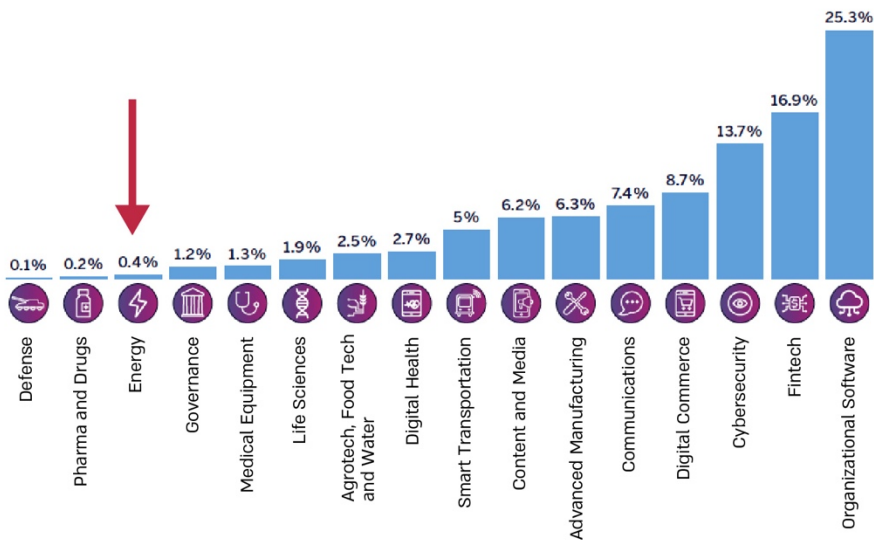
**Innovation Authority investments in climate-tech** – The follow-up audit found that the State of Israel is not implementing government decisions in the field of climate-tech: Innovation Authority investments in energy are relatively low – NIS 39M in 2021, and NIS





96M in 2022 (compared to agriculture and food sectors, in which NIS 139M were invested in 2021 and NIS 104M in 2022), out of NIS 1.7B of the Authority's investments in 2022 (a rate of 5.7%). The public investment by the Innovation Authority in the energy sector (in addition to water, environment, and sustainability), which is responsible for nearly half of the emissions in Israel, is almost half compared to the public investment in technology sectors in agriculture (and food), which is responsible for a marginal portion of emissions in Israel. The low level of the Innovation Authority's investments in climate-tech is emphasized even more given the difficulty in raising private investments in Israeli high-tech companies in the energy field. They are at the bottom of the list for private equity investments in Israel, attracting only about 0.4% of all private capital invested in Israel, or third from last. This reality will make it difficult to develop the climate-tech market in Israel.

### Private Investments in High-Tech Companies, per Field (2021)



Source: The Israel Innovation Authority.



**Task force for accelerating climate technologies** – Despite the directive in Government Resolution No. 544 of October 2021 to establish a team to remove barriers to promote this issue, headed by the Director-General of the Prime Minister's Office, the team was not formed. This reality makes it difficult to find solutions to regulatory barriers for research, development, implementation, and integration of technologies in the climate field, and hinders the maximization of the existing potential in Israel regarding climate-tech technologies and the promotion of a "green" state, which will help Israel meet its goals for





emissions reduction. Additionally, Israel may lose opportunities to promote technologies for preparing for the climate crisis and strengthening economic growth in Israel.

 **Additional budgets in the climate-tech field** – Regarding future investments, government decisions do not include dedicated budgetary resources for innovation initiatives and the establishment of new startups in the climate-tech field. In 2022, a total of NIS 38.3M was invested by government ministries. As for potential future budgets that may be received from European projects such as Horizon, there is difficulty in maximizing the activity of Israeli companies and in obtaining funding due to existing knowledge gaps. A total of EUR 65M was received in the years 2021 and 2022 from the Horizon program (EUR 24M in 2021 and EUR 41M in 2022), and the total grants Israel received from this program in these years was EUR 486M (EUR 231M in 2021 and EUR 255M in 2022), that is, the realization rates of Horizon's budget range from 10.4% to 16%. This realization rate is significantly lower than the potential (the Horizon program intends to invest about 35% of its budget for climate-tech related research, EUR 34.5B from 2021 to 2027 in total; Israeli researchers received a total of EUR 65M in grants related to climate-tech in 2021 and 2022 - about 13.3%).

In this reality, the concern arises that without significant long-term dedicated government budgets, it will be difficult to advance the government's decisions in the climate-tech field. Without creating economic certainty for the promotion of technological innovation in Israel's climate-tech sector, it will be very difficult to advance the government's decisions on this issue.

## Preparation for Climate-Related Financial Risks

 **Investments in ESG as part of the Bank of Israel's foreign exchange reserves management** – The previous report noted that the Bank of Israel does not invest the country's foreign exchange reserves in ESG fields. However, in response to this finding, the Bank of Israel wrote that in 2021 it established a team to examine whether it is appropriate to expand the types of assets in the foreign exchange reserves portfolio and whether to include green bonds or other sustainable investments without compromising the goals of holding the reserves and without altering the portfolio's return-risk profile, and to consider integrating rules for responsible investments in the bank's investment policy. The Bank also reported that "the team's findings and recommendations will be presented to the Governor and the Monetary Committee during 2022." In the follow-up audit, it was found that **the deficiency was not rectified**. Over two years after the establishment of a team to examine rules for responsible investments (ESG considerations) in its investment policy, the Bank of Israel has not yet completed the examination process and has not made decisions on the matter. Therefore, the Bank of Israel manages Israel's foreign exchange reserves, which as of June 2023 amount to \$202B, without consideration of ESG factors and without integrating the risks arising from climate change within its investment considerations. This is despite the trend highlighted in the 2022 NGFS survey, where about 40% of the central banks that responded (two-thirds of them in the European Union) take climate considerations into account in their current monetary policy.





**Securities Authority and climate risks** – The previous report indicated that the ESG disclosure format published by the Authority does not distinguish climate from other ESG considerations. Furthermore, the voluntary nature of ESG disclosure of the Authority's supervised companies and their ability to report in various formats lead to discretion over the execution of the disclosure, the information it includes, its frequency, and its format remaining with the companies themselves. The follow-up audit found that **the deficiency was slightly rectified** – there has been no significant progress since the previous report, and the Authority's recommendation regarding the examination of the relevance of ESG risks in investment processes remains voluntary and general in a way that grants broad discretion to these regulated companies on whether and how to conduct such an examination, without adequate detail, without standardization of the subject, and also without distinguishing the issue of climate from other ESG topics. As of July 2023, two years after the Authority's recommendations on the matter were published, only 48 out of 558 public companies disclose ESG reporting on the dedicated site (9% of public companies) – some of them did so before the publication of the Authority's recommendations or independently of them, either because they are banks that are obligated to do so anyway, or because they are international companies that comply with regulatory requirements of other countries. Hence, the effectiveness of the voluntary arrangement is in doubt.



**Capital Market, Insurance, and Savings Authority and its preparedness for climate risks** – The previous report found that the guidelines of the Capital Market, Insurance, and Savings Authority to its supervised entities (such as institutional investors, insurance companies and pension funds - "institutional bodies") did not address climate aspects nor included instructions on the reporting format for ESG aspects that should be published, including whether to include climate aspects. The audit recommended considering actions for integrating the risks associated with climate change within the disclosure obligations applicable to institutional bodies in Israel. The follow-up audit found that **the defect was slightly rectified** – the Authority issued several guidelines in the areas of risk management, investments, and disclosure obligations and conducted a review of the implementation of its guidelines by the regulated entities. However, alongside this, its position is that at this stage there is no room for establishing a uniform method for managing climate and environmental risks. The follow-up audit also found that the disclosure obligations remained general and lack quantitative disclosure components regarding the total investments in fossil fuels companies, there are no clear definitions for reporting on environmental aspects; and that the Authority is not promoting stress tests in the context of climate risks at this stage, among other things due to the fact that a unified national climate scenario has not yet been adopted in Israel.





## Climate-Tech Innovation and R&D


**Innovation Authority's investments in climate-tech** – The previous report found that in 2018, the public investment rate of the Innovation Authority in the fields of energy, water, environment, and sustainability was 4%. The follow-up audit found that **the deficiency was mostly rectified** – in 2022 there was an increase in investment of 5.7% (NIS 96M), which represents a certain improvement compared to 2018.

## Preparation for Climate-Related Financial Risks

**Climate risks in the banking system** – The previous report indicated that the Supervisor of Banks did not explicitly address climate risks in the guidelines for supervised entities, leaving the matter to relatively broad discretion. The follow-up audit found that **the deficiency was mostly rectified** – in June 2023, Proper Conduct of Banking Business Directive No. 345 on the "principles for effective management of climate-related financial risks" was published, adopting many principles from the Basel Committee's recommendations from 2022. There was also substantial progress in the supervisory activity over banks both in terms of explicit reference to climate issues and the expansion to additional environmental risks, as well as in enhancing the disclosure obligations currently imposed on the banking system. However, gaps were found in the supervisory actions over the banks concerning the need to expand and specify the quantitative disclosure obligations and the need for uniform criteria for reporting by banking corporations. Additionally, there are gaps at the level of the banking system, for example, regarding the performance of climate stress tests to examine their resilience in Israel in the case of the realization of climate and environmental risks.

## Key Recommendations

### Assessments of Climate-Related Economic Impact

 The audit recommends that the Ministry of Finance initiate and lead a comprehensive study to analyze the long-term economic-fiscal impacts, including assessments of the costs of preparing for climate change in Israel and the costs of adopting mitigation measures to achieve national objectives in the matter, as well as costs of non-action. This should be based on various climate policy scenarios, taking into account economic studies and assessments that have already been conducted on the matter, such as those by the MoEP, as well as current global economic research and the international recommendations of organizations like the OECD, the Coalition of Finance Ministers for Climate Action, and the IMF, that are intended for finance ministries. The research findings will serve as the basis for a guiding and validated national economic-fiscal assessment. In preparing and updating





this assessment, it is appropriate for the Ministry of Finance to involve the National Economic Council, the Bank of Israel, the MoEP, the Ministry of Energy, and the IMS (for the definition of reference scenarios), and to also request and collect assessments from all government ministries and public bodies whose inputs are relevant to the formulation of this assessment. Additionally, the audit recommends that the Ministry of Finance ensure that this assessment and climate reference scenarios be used to derive budgetary implications, and that decisions on policies across all government ministries are made on this basis, across the entire economy. Finally, the audit proposes that the National Economic Council complete a strategic situation assessment that will also address climate change and bring it for discussion in the government.

## The Role of the Ministry of Finance in Advancing Climate Action



For the purpose of formulating a climate action strategy, the audit recommends that the Ministry of Finance join the Coalition of Finance Ministers, and review the Helsinki Principles, the publications and recommendations of the Coalition, the recommendations of the OECD Paris Collaborative on Green Budgeting, and the Green Budgeting Framework it published, as well as the IMF recommendations on green management of public finances, revenues, and expenditures, along with other recommendations in these areas. These actions will position the ministry at the forefront of the transition to a carbon-neutral economy and the adaptation to climate change, send a signal to the economy, and mark the path for other government ministries, the economy, and the market.

## Carbon Pricing and Additional Tax Aspects



The audit proposes that the Ministry of Finance and the Tax Authority, in consultation with the MoEP and the Ministry of Economy, act according to the recommendations of the Coalition of Finance Ministers and the OECD to align the national revenue and expenditure processes with climate goals, including the elimination of benefits for fossil fuels. They should analyze all supports and subsidies for fossil fuels and how they stimulate demand, and consider alternatives. Furthermore, this examination should be part of a broader initiative mapping all the fiscal policy tools of the state's revenue system, including taxes, that negatively impact the achievement of climate goals. At the end of this process, these entities will formulate alternative policy tools that will advance the achievement of these goals. A holistic examination of the state's revenue system will allow for the identification of harmful subsidies and incentives that hinder the achievement of climate goals and address them on one hand, and on the other hand, identify opportunities for state treasury revenues that will aid in budgeting climate actions (mitigation and adaptation), compensate affected parties, support underprivileged populations, and enable adjusted coping with the cost of living for these and other populations, according to priorities.







The carbon tax framework decided upon in Government Resolution No. 286 is a very long-term, gradual approach, during which fuel prices may be volatile. Therefore, the





implementation of the carbon tax cannot depend on fuel prices. The State Comptroller's Office repeats its recommendation from the previous report that, alongside the finalization of complementary mechanisms to minimize damage to industry and disadvantaged populations, and upon their validation, the Ministries of Finance, Environmental Protection, Economy, and Energy, will implement Government Resolution No. 286 on the carbon tax. In this context, the Ministry of Finance will simultaneously act to renew and approve the ordinances with the Finance Committee and will develop well-informed benchmarks for the use of the revenues generated from the carbon tax, including regarding their allocation to climate issues and offsetting the impact of the carbon tax on the cost of living. Meanwhile, since this is a core policy tool in comprehensive climate policy and to ensure its continuity, it is proposed to anchor the carbon tax in climate legislation.





-  The audit proposes that prior to adopting a new carbon tax framework, a renewed and thorough examination will be carried out, which will consider not only how to mitigate the increase in costs but also how to create mechanisms that will compensate for the expected rise in prices, including through revenues from carbon tax. In this way, it will be possible to reassess the decision to limit the rise in electricity prices and to explore ways to reduce taxes and decrease the cost of living in other areas, as proposed by the Third Green Taxation Committee, chaired by the Ministry of Finance, which will offset the effects of the carbon tax on the cost of living.
-  The audit suggests that the Ministry of Finance consider the pricing of the proposed carbon tax, taking into account all sources of GHG emissions and all fuels. It should also account for the limited overall proportion of the internalization of the external costs of GHG emissions arising from the carbon tax roadmap in Government Resolution No. 286, and consider ways to increase it, in light of the recommendations that the Ministry of Finance has previously been partner to in the Third Green Taxation Committee report. Further, the audit proposes examining the establishment of complementary mechanisms to the carbon tax for the purpose of internalizing the costs of other GHGs; this could be done, for example, through levies on emissions, so that all measures better reflect the external costs of GHGs, leading to their broader internalization.
-  The audit recommends that the Ministry of Finance, together with the MoEP, the Tax Authority, and the Ministry of Energy, re-examine the issue of the carbon tax on transportation fuels, including the question of explicitly and visibly marking its share in the excise tax, and consider additional tools that would signal the existence of a carbon tax for these fuels or promote alternatives. This aims to bring about a change in consumer behavior and reduce the demand for gasoline and diesel.
-  The audit proposes that the Ministry of Finance, along with the MoEP, the Tax Authority, and the Ministry of Economy, analyze the implications of the processes for promoting CBAM in the European Union. They should also follow the evolving policies on the matter in the United Kingdom and other countries, and assess whether the carbon tax roadmap in Government Resolution No. 286 sufficiently addresses the exposure of Israeli exports to these countries. In this context, the audit also suggests considering the adoption of similar






measures in Israel aimed at preventing "carbon leakage" (following the imposition of a carbon tax).

## Climate-Tech Innovation and R&D

-  The audit proposes that the Innovation Authority examine the trends in investment volumes and the composition of its investments in light of Israel's sectoral emission reduction targets, which are mainly required in the fields of electricity production and transportation, and also considering the needs raised by the Chief Scientist's Office at the Ministry of Energy, while consulting with the Chief Scientists' Offices of the Ministries of Energy and Environmental Protection.
-  The audit proposes that the Innovation Authority consult with the Ministries of Finance, Energy, Agriculture, Economy, and Innovation to assess whether the government's decisions on climate-tech to assist in the reduction of GHGs in Israel are being promoted in the most efficient manner, and whether the actions of the Innovation Authority in this regard can meet the technological development needs of Israel and maximize its opportunities in this field relative to the world. Additionally, the Ministries of Energy and Finance should examine whether the actions of the Ministry of Energy, through the Chief Scientist's Office, are receiving all the necessary resources.
-  To promote the implementation of government decisions in the climate-tech sector, the audit proposes that the findings of this section, which pertain among other things to public investments in the climate-tech field and the classification of climate-tech areas, be reviewed by the Innovation Authority and the Ministry of Energy in cooperation with the Ministry of Finance, and to execute the necessary processes for their practical application including prioritization of public resource allocation while encouraging private capital investment in this field, based on appropriate budgeting. It is also recommended that the Innovation Authority formulate a complementary decision-makers' proposal that will ensure the budgets needed to advance the field; and that the Israel-Europe Research & Innovation Directorate in the Innovation Authority (ISERD) continues to encourage researchers to submit applications for research funding in the climate field.
-  The Director-General of the Prime Minister's Office should act to establish a task force for accelerating the development of climate technologies which will work to identify barriers and to perform actions for their removal, with the participation of the Accountant General at the Ministry of Finance and the Commissioner for Budgets.





## Preparation for Climate-Related Financial Risks

-  In the context of disclosure obligations, the Banking Supervisor should examine the possibility of including a clear and uniform list of criteria in the banks' reports regarding the disclosure obligations of quantitative climate reports related to the method of calculating GHG emissions, the types of environmental interests considered, and the way of managing





risks associated with the climate (both physical and transitional). This is to further enhance the preparedness for climate-related financial risks, and in light of the publication of uniform standards on the matter by the IFRS in June 2023 and the completion of additional agreed standards also in Europe as of the audit date.

-  The audit recommends that the Bank of Israel transmit to the government, as part of the decision-making processes relating to legislation and government policy on climate risks, the effects of uncertainty regarding the overall regulatory and legal framework pertaining to the climate field. According to the Bank, these uncertainties limit "the banking system's ability to optimally manage climate risks," resulting, inter alia, from the incomplete legislative process, the absence of comprehensive and integrated governmental action, and the lack of necessary national infrastructure for information and reporting. Transmitting these impacts should also be carried out towards parallel financial regulatory authorities. This is in order to further improve the preparedness of the banking system and other financial bodies for climate risks.
-  The audit recommends that the Bank of Israel accelerate its efforts and finalize the evaluation of risks associated with climate change, and the integration of ESG factors in its investment policy regarding the foreign currency reserves of the State of Israel. The Bank should assess whether and in what manner it must incorporate climate change risks into its daily management of the state's foreign currency reserves, valued at around \$202B, in light of the risks identified for the commercial banks it oversees. Additionally, the audit recommends that if the Bank of Israel decides to factor ESG considerations into its ongoing operations, it should consistently disclose to the public the approach it takes to applying these ESG factors as part of its reports on managing the state's foreign currency reserves.
-  The audit proposes that the Israel Securities Authority evaluate whether the ESG disclosure recommendations for public companies and the instruction to assess ESG considerations and report them to fund managers and significant license holders are adequate for the effective advancement of investment policies that account for climate risks. It should explore the shift to a mandatory reporting obligation (rather than a voluntary approach) and how to establish standards for its supervisees that are in line with current practices in other nations, based on new international regulations on the matter. In light of the IFRS's publication of standards for sustainability and climate-related reporting in June 2023, the Authority is advised to act to integrate these standards among the bodies it supervises.
-  The audit recommends that the Capital Market, Insurance and Savings Authority consider instructing institutional entities to include disclosure indicators as is customary, for example, in the European Union's disclosure legislation, which should cover the exposure to activities and assets that are at risk in terms of financial liabilities, in accordance with the international reporting rules expected to be published, and the IFRS standards for sustainability and climate reporting that were already published in June 2023. Additionally, the audit proposes that the Authority examine the environmental risk exposure of institutional bodies and the extent of existing insurance coverage and promote the implementation of climate stress tests among the supervised bodies. All this is to enhance



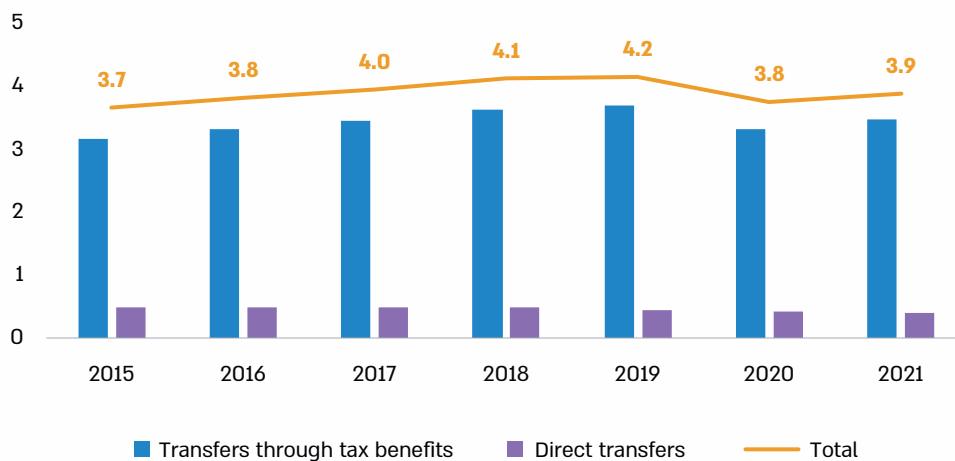


the integration of climate risks and to provide investors with the ability to examine the existing climate risks in institutional bodies.



The audit recommends that, in parallel to their efforts to assess risks (both physical risks and transition risks) of the financial bodies they supervise, the financial regulators should also consider the environmental and climate impacts of these entities' activities, including through collaborations between the entities and with the Ministry of Justice.

### OECD Data on Government Supports for Fuel, by Support Type (in NIS B)



Source: OECD.

\* 2020 was affected by the COVID-19 pandemic.

\*\* Direct transfers are funds given to the Israel Electric Company for the adaptation of factories to natural gas as an energy source, and also through the gas agreements of 2012 with the Tamar gas field, according to which the IEC will purchase natural gas from the Tamar project for 15 years from the start of gas export, or until it purchases the total contractual amount, whichever is earlier.

\*\*\* Tax benefits primarily include exemption from diesel excise tax (rebates) and a reduction in royalty payments and taxation according to the Israeli Petroleum Law.





## Level of Correction of the Main Deficiencies Identified in the Previous Report

Report chapter	Auditing entity	Deficiency in previous report	Level of correction of deficiency as identified in the follow-up report			
			Not Rectified	Slightly Rectified	Significantly Rectified	Fully Rectified
Assessments of the economic impacts of climate change	Ministry of Finance, National Economic Council, MoEP, Bank of Israel	No governmental economic body has conducted a national assessment of the long-term economic impacts of climate change on Israel				
Carbon pricing and additional fiscal aspects	Ministry of Finance, MoEP, Ministries of Energy, Transportation, & Foreign Affairs; Tax Authority, Electricity Authority	There is no carbon taxation in Israel				
Carbon pricing and additional fiscal aspects	Ministry of Finance, MoEP, Ministries of Energy, & Transportation, Foreign Affairs; Tax Authority, Electricity Authority	The level of tax proposed in Government Resolution No. 286 is lower than the latest recommendation by the OECD				
Carbon pricing and additional fiscal aspects - CBAM	Ministry of Finance, MoEP, Ministries of Energy, Economy, & Foreign Affairs; Tax Authority, Electricity Authority	An impact on international trade and Israeli exports is expected if a carbon tax is not imposed				





Report chapter	Auditing entity	Deficiency in previous report	Level of correction of deficiency as identified in the follow-up report			
			Not Rectified	Slightly Rectified	Significantly Rectified	Fully Rectified
Innovation and R&D in climate tech	Israel Innovation Authority	Israel is ranked at the bottom of the scale for the development of climate change-related technologies out of all the technologies in the country				
Preparation for financial climate-related risks (climate risks in the banking system)	Bank of Israel	The Supervisor of Banks' 2009 letter to banking corporations on environmental risks does not explicitly mention climate change and does not promote uniformity in the banking system				
Investments in ESG as part of the foreign currency reserves management of Bank of Israel	Bank of Israel	Bank of Israel does not invest the state's foreign currency reserves in ESG areas				
Preparation for climate-related financial risks (Israel Securities Authority and climate risks)	Israel Securities Authority	The ESG disclosure obligations in the format published by the Israel Securities Authority do not distinguish climate as separate from other ESG considerations				





Report chapter	Auditing entity	Deficiency in previous report	Level of correction of deficiency as identified in the follow-up report			
			Not Rectified	Slightly Rectified	Significantly Rectified	Fully Rectified
Preparation for climate-related financial risks (Capital Market, Insurance, and Savings Authority and its preparation for climate risks)	Capital Market, Insurance, and Savings Authority	The 2007 guidelines of the Capital Market, Insurance, and Savings Authority did not address climate aspects and did not include instructions on the format of reporting ESG aspects that should be published, and whether to include climate aspects based on a uniform reporting format; the Capital Market, Insurance, and Savings Authority did not conduct specific audits regarding these instructions and did not address environmental aspects				





