

Addressing climate change requires urgent policy action to drive an unprecedented global infrastructure and technological transformation. More countries are implementing core climate policies: carbon pricing and market-based instruments, regulatory intervention and targeted support to innovation in low-carbon sustainable technologies. But global greenhouse gas emissions have risen rapidly and remain too high to avoid severe and irreversible climate change impacts.

A number of obstacles stand in the way of effective climate policy. Among the most important is the fact that existing policy frameworks and economic interests continue to be geared towards fossil fuels and carbon-intensive activities, as coal, oil and natural gas have fuelled global economic development for centuries. Inadvertently or not, this creates a misalignment between existing policy frameworks and climate objectives, hindering low-carbon investment and consumption choices.

This report presents the first broad diagnosis of misalignments with climate goals in areas essential to the transition to a low-carbon economy. It points to a number of misalignments in policy domains, such as finance, taxation, trade policies, innovation and adaptation, as well as in three specific sectors: electricity, urban mobility, and land-use.

Beyond facilitating climate action, aligning these policies with a low-carbon economy can contribute to a broader reform agenda for greener, more resilient and inclusive growth, including more progressive tax codes, pro-growth long-term infrastructure investment, and energy and transport systems that support cleaner air, better health and a more diversified energy supply.

**Better policy alignment for a better climate and better growth**

Scale up sustainable low-carbon investment and finance. There is an urgent and unprecedented opportunity to ensure that new investment in infrastructure supports the climate agenda while fostering economic development. The additional short-term costs of shifting to low carbon would amount to just a fraction of the finance needed for infrastructure overall. There is no shortage of capital, but new sources of financing need to be mobilised. Financial stability is a prerequisite to any kind of investment, including low carbon. However, financial regulations could unintentionally limit the supply of long term finance. Addressing the potential impact of existing financial sector rules could unlock investment in low-carbon infrastructure. Public finance and investment can also catalyse the low-carbon transition provided that governments reconsider their support for investments in greenhouse-gas-intensive activities, and mainstream climate objectives into public procurement and official development assistance.

Look at taxation, beyond energy alone. Subsidies and tax expenditures favouring the

production and use of fossil fuels slow down low-carbon innovation; however, current low oil prices also present an opportunity for reform. Other taxes and tax provisions deserve a closer look (e.g. property taxes, various corporate income tax provisions), as they may encourage carbon-intensive choices. For example, the tax treatment of company cars encourages more CO<sub>2</sub> emissions across OECD countries. Governments also need to anticipate the impact of the low-carbon transition on tax revenues.

Spur low-carbon innovation on a large scale. Clear and credible government commitment to ambitious core climate policy instruments is an important spur for low carbon innovation. The low-carbon transition could – and in some cases already is – driving a boom in innovation and emerging businesses, and a parallel shift in skills and the labour force. Innovation for the low-carbon transition is about the creation of new businesses, the restructuring or the phasing out of old ones, the emergence of nascent technologies and business models, and the right support frameworks for innovations to be widely adopted. This requires addressing potential skills gaps through education, training and labour market policies.

Promote climate-friendly international trade and domestic decision-making. The international trade regime itself does not prevent governments from pursuing ambitious climate policies, but some international trade barriers can undermine climate objectives. For example, import tariffs still penalise trade in some technologies needed for the low-carbon transition. An Environmental Goods Agreement, currently under negotiation, would help to reduce the costs of climate mitigation efforts, among other outcomes. Care needs to be taken by the many countries that are promoting greener growth by favouring domestic manufacturers of low-carbon technologies. Where these measures restrict international trade, they may well undermine overall investment and the uptake of sustainable technologies.

Decarbonise electricity. Electricity lies at the heart of a successful decarbonisation of energy systems. However, deregulated electricity markets do not deliver the long-term price signal needed for investment in high capital cost, low-carbon technologies. Ensuring competitive and timely investment in low-carbon solutions will require new market arrangements such as long-term supply agreements, as well as a robust and stable CO<sub>2</sub> price signal. Jurisdictions with regulated systems that consider introducing greater competition need to adopt market arrangements that will encourage, rather than hinder, investment in low-carbon technologies.

Opt for sustainable urban mobility. Current transport systems, which rely largely on fossil fuels, impose very high environmental costs (climate change, noise, air pollution),

particularly in urban settings. Policy intervention is needed to provide more energy efficient and less carbon-intensive mobility. In many cities, land-use and transport planning are poorly co-ordinated and encourage greater use of private cars. Aligning policy action across levels of governments and between stakeholders could do much to deliver lower-carbon mobility. National frameworks and legislation could also be reviewed to give local governments more financial or political leeway to make low-carbon choices.

Strengthen incentives for sustainable land use. Sustainable land-management practices - reduced deforestation, restoring degraded land, low-carbon agricultural practices and increased carbon sequestration in soils and forests - can make a large contribution to reducing greenhouse gas emissions while responding to growing food demands. They could also improve the resilience of our economies to a changing climate by protecting ecosystems. This requires an integrated approach that breaks down the silos between mitigation, adaptation, agriculture, food security, forestry and environmental policies. More specifically, countries could pursue their efforts to remove environmentally harmful agricultural subsidies, value ecosystem services, protect forests and minimise food waste.

#### Engaging the low-carbon transition

Climate policy can be more effective if all government ministries identify important misalignments with low carbon transition in their respective portfolios. An ambitious climate action plan will therefore need new approaches to policy making across government. Beyond the national level, better alignment of policies across countries could also boost effectiveness and alleviate concerns about potential distortions of competition. A global agreement on greenhouse gas reductions would send a strong signal in this direction.