2nd LAC Regional Policy Dialogue

Enhancing Climate Finance and Promoting Technology Transfer in the LAC region

Background Note – Day 1 (18 October 2022)

Day 1. A systemic approach to aligning policies and achieving climate change mitigation targets

The recent COVID-19 health crisis brought to the forefront the need for countries to tackle major vulnerabilities that have risen due to economic, social and environmental inequalities around the world. Russia's war in Ukraine has exacerbated vulnerabilities, and increased challenges that policy makers must tackle: rising inflation, increasing food and energy insecurity, as well as further supply-chain pressures. Governments have committed to ambitious emission reduction targets in their National Determined Contributions (NDCs); yet more needs to be done to ensure that the challenging economic conditions do not threaten the progress towards the net-zero transition. In many cases, the NDCs have been introduced in countries' recovery packages, which include specific green recovery measures that strive for a sustainable and inclusive approach in their policy-making. However, data on the Latin America and the Caribbean (LAC) region from the OECD Green Recovery Database show that only 69 out of the 178 measures introduced by Brazil, Chile, Colombia, Costa Rica, and Mexico are considered as positive for the environment, meaning they have a clean positive environmental impact for one or more environmental dimensions. Only about one third of the budget estimated for all green recovery measures in these countries will contribute to positive measures (OECD, 2022[1]). Examining more closely the type of measures introduced and their environmental impact, there is a clear need for more policy alignment in tax and other subsidy-related measures; as well as on grants and loans, and regulatory changes; albeit at a lesser extend (Table1).

Table 1. OECD Green Recovery Database - measures adopted by LAC countries

Type of measure	Environmental impact			
	Positive	Mixed	Negative	Indeterminate
Tax reduction / other subsidy	5	4	13	12
Grant/Loan (including interest-free loans)	20	5	5	15
Regulatory change	7	0	2	5
Other or not specified	36	13	8	26
Skills training	1	0	0	1
R&D subsidies	0	0	0	0

Note: LAC countries covered in this analysis: Brazil, Chile, Colombia, Costa Rica, and Mexico. Analysis based on the OECD Green Recovery Database methodology.
Source: (OECD, 2022[1])

It should be acknowledged, however, that not all countries are starting from the same point, nor is their trajectory to a low carbon economy similar or, even in some cases, easily comparable. Countries follow differentiated policy approaches, to accommodate national circumstances, therefore there is no one-size-fits-all solution that can be proposed to serve this purpose. At the same time, there are policy tools available that could assist countries in achieving their national targets.

First, when designing policies, it is important to consider the different circumstances, such as in the case, for example, of the COVID-19 pandemic to guarantee that recovery actions do not run counter to national longer term climate goals. OECD has indicated that a "well-being" approach would help quantify and make

more visible the synergies and trade-offs between different goals (Buckle et al., 2020[2]). On a broader scale, a systemic thinking approach could frame the interactions between human well-being, infrastructure and systems, and ecosystems and the environment, at the global, national and sectoral level. Mapping the linkages between various policies, assessing the costs of any trade-offs, and performing vulnerability assessments quantifying the impacts of future climates, are modelling tools which could improve countries' understanding on how to manage complex systems and uncertainties (OECD, 2020[3]).

Second, OECD analysis has shown that addressing climate change requires not only climate action, but also alignment of various policy domains, such as finance, taxation, investment, infrastructure, trade, innovation etc, with climate goals (OECD, 2015[4]). Aligning regulatory and policy frameworks which are currently outside the climate policy portfolio with climate objectives requires a series of commitments and possibly acceptance of short-term trade-offs, which would, at the end, provide for a more sustainable framework in the long term. Challenges identified include:

- Misalignments between climate mitigation instruments, especially as not all instruments affecting GHG emissions aim at emission reduction. This also includes counter-effects of different instruments used simultaneously;
- Misalignments of policies that undermine low-carbon investments and green infrastructure, including the possible financial gap;
- Setting environment- and energy-related taxes and subsidies in line with reducing CO_2 emissions and supporting low-carbon transition;
- Guaranteeing an enabling environment for green innovation and for skills development needed for the green transition;
- Lifting trade barriers that hamper goods, services and knowledge transfer internationally and at the regional level;
- Integrating adaptation and resilience considerations in the policy framework, to better assess and manage risks and future shocks.

Third, countries' actions and priorities towards achieving climate mitigation goals, could benefit from an assessment of their current policy framework, as well as of its effectiveness. The OECD, through the Horizontal Project Building Climate and Economic Resilience in the Transition to a Low-Carbon Economy, is examining the interaction between climate and economic impacts of policies and actions countries are currently introducing to achieve net-zero emissions by 2050, with a focus on building systemic resilience. Linked to this, the International Programme for Action on Climate (IPAC) will support countries in the implementation of their climate commitments. Through a climate action dashboard and a toolkit on country practices, IPAC is presenting available data, indicators, policy tools and guidance, to support countries in monitoring their climate action, as well as provide for mutual learning across countries participating. The IPAC is open to all countries, and the OECD is currently mapping statistical data availability for the LAC region, which could in the future support monitoring and measuring progress towards climate ambitions at the national level. Finally, the newly *established Inclusive Forum on Carbon Mitigation Approaches (IFCMA)*, provides a place where all countries may engage in multilateral dialogue, supported by technical, comprehensive and comparative OECD analysis on the effectiveness and cost-efficiency policies to address climate change mitigation (OECD, 2022[5]).

Strengthening climate adaptation and mitigation linkages

Reducing the impacts of climate change and rapidly taking action against a climate crisis is leading countries worldwide to recognise the need to utilise both climate change mitigation and adaptation policies to this effect. Even though mitigation actions have so far received more global attention and more financial support for their implementation, countries are slowly increasing their focus on adaptation, either through international commitments (see the Paris Agreement on Climate Change, COP 26 etc) or through individual policy actions. Identifying the synergies, co-benefits and trade-offs is important, considering that

the two streams have been developed in parallel, with different priorities, and distinct stakeholder engagement (OECD, 2021[6]); (Denton et al., 2014[7]).

Linkages between adaptation and mitigation policies are frequently identified under forestry, agriculture and land management, water management and urban planning. In the case of forestry, for example, conservation, afforestation and reforestation measures contribute not only to increasing carbon sequestration from the atmosphere, but they also reduce risk of flooding or slope failure.

At the same time, some climate actions may also come with trade-offs, whereby measures may have mixed mitigation and/or adaptation outcomes, as in the case of hydropower plans and effects to biodiversity. In some cases, there may also be negative social or economic impacts, affecting local or vulnerable communities.

Carbon pricing in the LAC region

Carbon markets and carbon pricing instruments are being acknowledged as part of the mechanisms and tools available for countries to achieve their climate mitigation targets, and shift towards a net-zero carbon economy. Setting up a carbon pricing mechanism could send a clear signal towards more sustainable production and consumption patterns. Depending on how governments both set such instruments and how they decide to use revenues collected, carbon pricing could also support aligning other policies to climate mitigation targets, to a green transition and to more sustainable and inclusive development.

According to a recent IDB/IETA and ICAP report, 64 carbon pricing instruments (CPIs) were put in place in 2021, covering 21.5% of global emissions. Argentina, Chile, Colombia and Mexico are implementing such instruments, having put into force federal carbon taxes, subnational carbon taxes, and, in the case of Mexico, an emissions trading system (ETS) (IDB, IETA and ICAP, n.d.[8]).

OECD's analysis on effective carbon rates (ECRs), that is the carbon pricing countries apply through duel excise taxes, carbon taxes and emissions trading systems, for 44 OECD and G20 countries, show that even though there is some improvement in countries' carbon pricing performance when comparing 2015 to 2018 data, less than a fifth of the goal to price all emissions at least at EUR 60 per tonne CO_2 was reached in 2018 (OECD, 2021[9]).

Data for OECD member and partner countries in the LAC region indicate that most of them attain an overall score above the 19% average for the 44 countries in the OECD database (Table 2). This is rather positive, considering especially that Colombia, Costa Rica, Mexico mark lowest on CO_2 emissions from energy use (intensities per capita); and Chile marks below OECD average (OECD, 2022[10]).

Table 2. LAC countries mostly attain above average carbon pricing scores

2018 data

	Carbon pricing score at EUR 60 per tonne CO_2					
Country	**Road**	**Off-road**	**Industry**	**Agriculture & fisheries**	**Residential & commercial**	**All sectors average**
MEX	97%	4%	0%	4%	1%	30%
ARG	78%	42%	2%	90%	4%	28%
COL	66%	19%	6%	19%	4%	25%
CHL	75%	0%	1%	0%	0%	17%
BRA	4%	0%	0%	0%	0%	1%
All 44 countries average	80%	25%	5%	38%	10%	19%

Note: This table includes emission from the combustion of biomass in the emission base. OECD data on effective carbon rates cover 44 OECD and G20 countries.
Source: (OECD, 2021[9])

Yet, to achieve the Paris Agreement targets, there is a further need for decarbonization. OECD estimates state that the current pricing applied by countries, or even the EUR 60 per tonne CO_2 price used in OECD analysis, may not be sufficient to reach limit global temperature increases. Countries would need to consider how to best apply carbon pricing in different polluting sectors, while at the same time focus on efficient and diverse mitigation policies to transform carbon-intensive activities.

Questions for consideration

Session 1a. Aligning policies for a zero-carbon economy

1. What are the key challenges identified in your country when aligning policies and policy instruments to net-zero or climate neutrality targets?
2. Which national and international policy misalignments would you consider as a first priority to tackle?
3. How is your country addressing complementarities and trade-offs between climate change mitigation and adaptation policies, and how does it best try to build the linkages between the two?

Session 1b. Carbon pricing and other instruments to support mitigation actions

1. What challenges is your country facing when introducing carbon pricing?
2. What more needs to be done, above and beyond carbon pricing, to mitigate climate change?
3. How can the OECD and other international organisations support countries in introducing economic instruments and supporting their decarbonisation policy framework?

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