

Finance Track Menu of Policy Options for a Just Transition towards Net Zero

G7 countries account for around 40% of the global economy and 25% of CO2 direct emissions. Given their economic weight, they have a responsibility to lead the way towards decarbonisation, thus setting out a global path for achieving net-zero greenhouse gas emissions by 2050.

Progress towards climate objectives requires acceleration. We remain committed as G7 to providing a substantial contribution to efforts to reduce global GHG emissions by around 43 percent by 2030 and by 60 percent by 2035, relative to the 2019 level, in light of the latest findings of the Sixth Assessment Report of the Intergovernmental Panel on Climate Change. At the same time, higher energy prices, geopolitical instability, rising inequalities and social challenges, are all factors that risk undermining political and societal support for climate action. In such context, developing climate policies that are effective in reducing emissions, conducive to economic growth, and socially acceptable, is paramount. This can contribute to creating a positive narrative on climate action, underpinned by robust economic analysis and concrete suggestions.

In the long run, decarbonisation can help achieve higher net welfare by preventing severe climate disruptions and their associated costs. In the short run, it implies changes in the composition of growth and considerable transition costs, but could also generate positive impacts, such as environmental benefits. Recent research shows how multipliers associated with spending in clean energy and biodiversity conservation are estimated to be larger in the long run than those associated with expenditure in non-eco-friendly energy and land use activities, depending on sectors, technologies, and horizons. Further, promoting investment in green technologies and adopting more stringent climate policies can yield positive and meaningful increases in innovation and productivity over time, thereby playing an important role for long-term economic growth. In the short run, innovation and green investments can minimize the negative impacts of more stringent climate mitigation policies and help countries accelerate the implementation of climate action. Reaping the economic benefits of the transition depends on the implementation of well-designed policies, on the capacity to exploit synergies between structural reforms, and on setting up an enabling environment to crowd in private investment.

Notwithstanding the long-term benefits of decarbonising the economy, in the short run its concrete implementation requires substantial investments. Additional revenue and private investment could be mobilised to finance decarbonisation of economies and mitigate the short-term costs of the transition; on the fiscal policy front, carbon pricing instruments can represent a cost-effective option for encouraging the adoption of more sustainable production and consumption patterns by setting a price on greenhouse gases. These options come along with a substantial revenue raising potential in the short run that can provide policy makers with resources to support the most vulnerable groups, the most affected communities and the carbon-intensive sectors and regions in the transition and to provide incentives for fostering the decarbonisation process and develop green and low-carbon technologies.

Embarking on ambitious decarbonisation pathways also presents major challenges, both at the domestic and international levels. Such challenges should be managed in a way that maximises the effectiveness and fairness of climate policies, while seizing the opportunities of international cooperation to minimise negative spillover effects arising from asymmetries, especially in high emissions sectors. G7 countries have a crucial role to play in fostering cooperation at a global scale, to mitigate risks of carbon leakage and implement effective policy actions that tackle climate change and preserve competitiveness and open trade.

Acknowledging the multiple dimensions across which climate policies can be assessed, the Italian Presidency has decided to focus on five key aspects: (i) the impact of climate policies and green investment on growth, productivity and innovation; (ii) exploring carbon pricing potential, amongst other policy options, in pursuing long term decarbonisation while dealing with the costs of transition in the short run; (iii) the distributional impact of climate policies, (iv) ways to foster the legitimacy and political acceptability of climate action, and (v) fostering international cooperation, including by improving the assessment and measurement of carbon leakage risks and by mitigating them. Over the first half of 2024, such aspects have been discussed by the G7 Finance Track, with the analytical support of the IMF, the WBG and the OECD. While recognising the importance of taking into account national and regional specificities, the G7 agreed that a well-balanced policy mix for a just transition could be designed in a way that also encourages innovation and investment in green and low-carbon technologies, addresses equity concerns, promotes social and political support for climate action, and minimises negative international spillover effects of asymmetric policies. The G7 also concurred that a systemic and holistic approach should be adopted, using a wide array of policies, and promoting synergies among different measures, with the ultimate goal of accompanying all productive sectors and society groups along the structural transformations needed to decarbonise our economies.

Based on this work, the following **menu of policy options for a just transition towards net zero** has been developed by the G7 Finance Track, with the aim to help develop appropriate climate policies.

The domestic level: ensuring just and inclusive climate transitions while enhancing political acceptability

- i** Maximising the impact of climate policies and green investment on growth, productivity and innovation

- ii** Exploring carbon pricing potential, amongst other policy options, in pursuing long-term decarbonisation while dealing with the costs of transition in the short run

- iii** Addressing the different dimensions of distributional and social impacts of market and non-market-based instruments

- iv** Ensuring consistent policy design and sequencing to transform the political economy and pave the way for long-term ambitious policies

- v** Using public engagement and communication to improve political acceptability and the legitimacy of climate policies

The international level: fostering international cooperation, including by improving the assessment and measurement of carbon leakage risks and by mitigating them

- vi** Considering different determinants of carbon leakage to implement tailored policy responses

- vii** Monitoring carbon leakage risks as climate mitigation policies become more stringent

- viii** Promoting the development of common approaches for emissions intensity of products, sectors and countries