WHAT ROLE FOR CARBON PRICING IN A GREEN RECOVERY?

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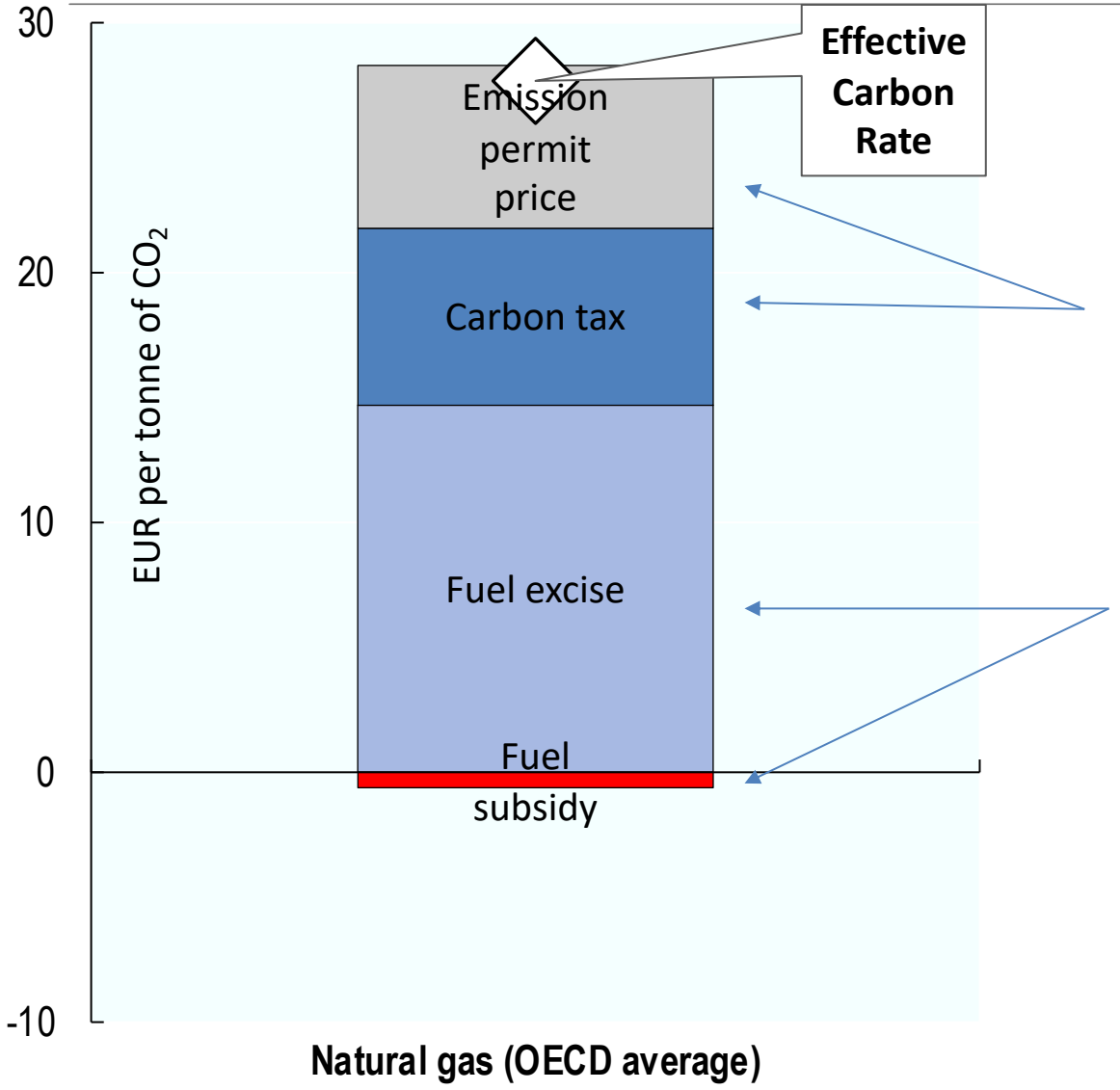
Global Solar Council, 18 March 2021

OECD
BETTER POLICIES FOR BETTER LIVES

How do governments price carbon?

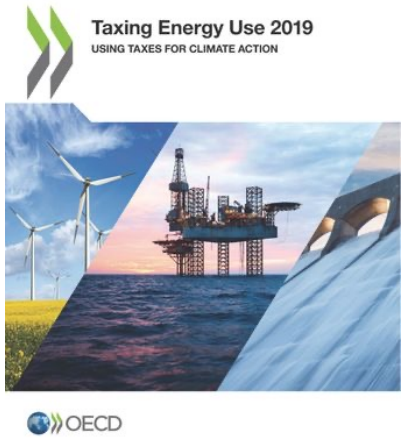


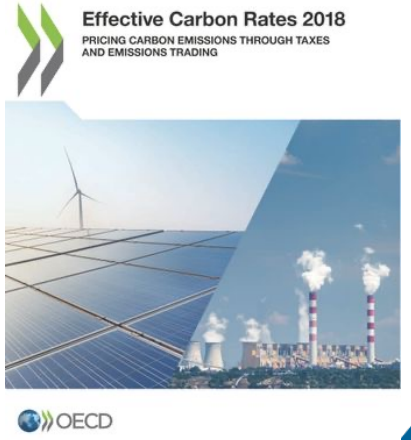
Policy *intention* is to price carbon

Policy *result* is to price carbon

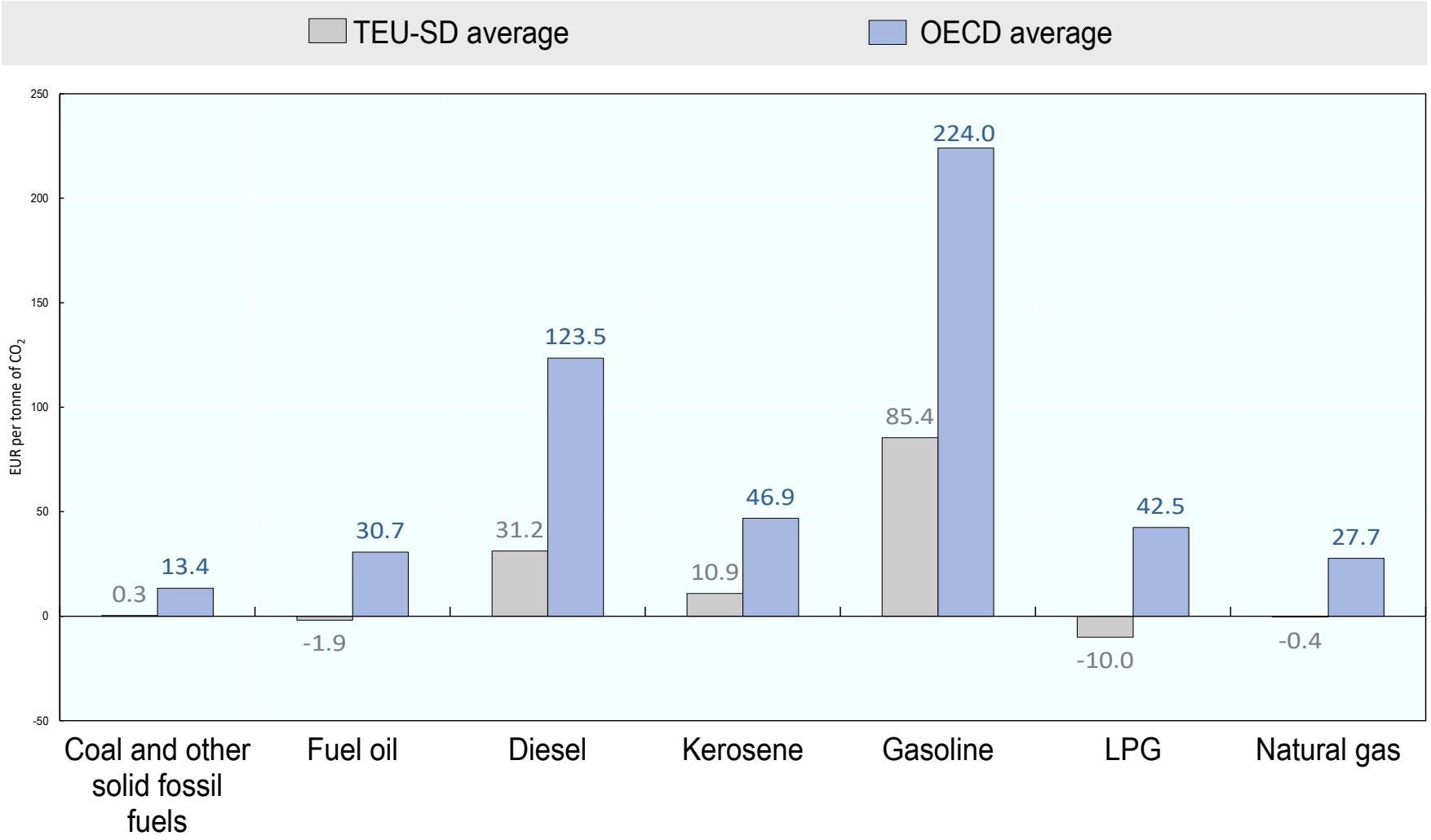
How high are carbon prices?

- 2018: 55% of emissions in OECD and G20 are completely unpriced. 83% of emissions are not priced at a level that reflects a low-end estimate of their climate costs (EUR 30 per tonne of CO_2).
- Carbon pricing is not the silver bullet, but there are many opportunities to make better use of it. Without better pricing, decarbonisation becomes unnecessarily costly or may not be achieved.
- Effective Carbon Rates 2021 released on 30 March.





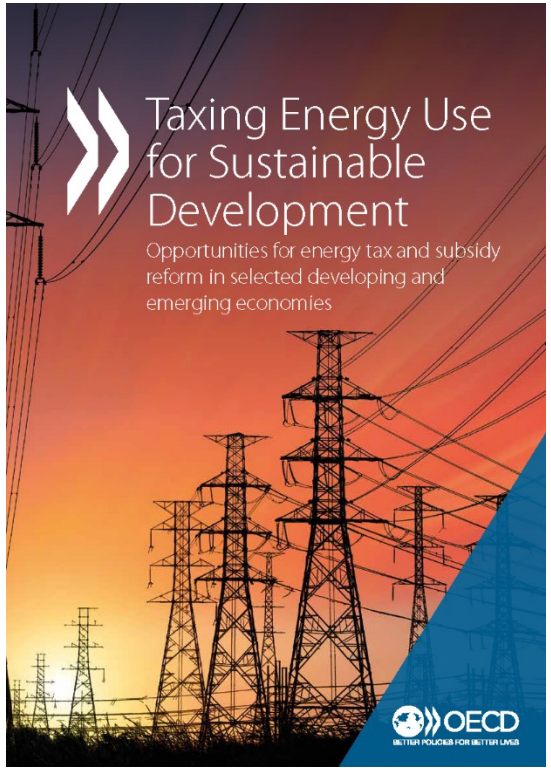
How uniform are carbon prices across fuels and countries?



The TEU-SD average refers to the simple, unweighted arithmetic average across 15 developing countries (Costa Rica, Côte d'Ivoire, Dominican Republic, Ecuador, Egypt, Ghana, Guatemala, Jamaica, Kenya, Morocco, Nigeria, Philippines, Sri Lanka, Uganda and Uruguay).

Why should developing countries price carbon when even the most advanced economies fall short?

- **Carbon pricing is more than good climate policy:**
  - Increases productivity and steers investments into future-proof assets.
  - Reduces local pollution.
  - Contributes to domestic resource mobilisation.
  - Can help reduce informality.

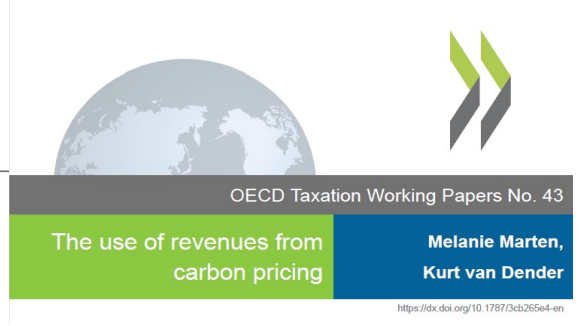


Is it administratively difficult to price carbon?

Energy category	Low-end carbon benchmark (EUR 30 per tonne of CO_2)
Coal and other solid fossil fuels	6.24 eurocent per kilogramme
Fuel oil	8.94 eurocent per litre
Diesel	7.99 eurocent per litre
Kerosene	7.58 eurocent per litre
Gasoline	6.86 eurocent per litre
LPG	4.75 eurocent per litre
Natural gas	5.13 eurocent per cubic metre

Source: OECD (2019), Taxing Energy 2019

How to make the most of the revenues?



- Unlike most other climate policy instruments, carbon pricing generates revenues (free allocation of emission allowances is a form of revenue use).
- While the revenue potential varies across countries and sectors, it can be substantial (see e.g. recent OECD analysis of 15 developing and emerging economies).
- Carbon pricing will meet with stronger public support if there is transparency about how the revenues from carbon pricing will be used, but **the best revenue use will depend on the specific circumstances**.
- Tax and spending policies can be implemented in tandem to **deliver an equitable reform package**, e.g. 2021 Irish budget.

What are the tools to address carbon leakage where the threat is real?

- To date, no evidence of important adverse impacts overall.
- But: Free allocation of emission permits and compensation for electricity cost increases are used (in most emissions trading systems), also preferential tax rates etc., which tend to weaken abatement incentives.
- Due to differences in policy stringency across countries, border carbon adjustments are being considered (e.g. in EU). The economics is straightforward; practicability, legality and politics are harder.
- Like-minded countries could coordinate on minimum carbon prices for certain or all sectors (carbon price floors). Regional approaches are a pragmatic way forward (e.g. inclusion of shipping in EU ETS).

What role for carbon pricing in a green recovery?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TACKLING CORONAVIRUS (COVID-19): CONTRIBUTING TO A GLOBAL EFFORT

oecd.org/coronavirus

Green budgeting and tax policy tools to support a green recovery

9 October 2020

Recovery from the social and economic disruptions caused by the COVID-19 pandemic will require concerted policy action. As countries consider recovery packages, there are opportunities to prioritise green policy choices that help promote environmental objectives and speed up structural change towards the low-carbon transition, increasing society's resilience to future shocks and reducing future risks. This policy brief focuses on practical ways in which countries can use green budgeting and tax policy tools to implement stimulus packages that support a green recovery, and the inter-linked role of both tax and spend measures in aligning stimulus programmes with decarbonisation objectives.

GREEN BUDGETING AND TAX POLICY TOOLS TO SUPPORT A GREEN RECOVERY© OECD 2020

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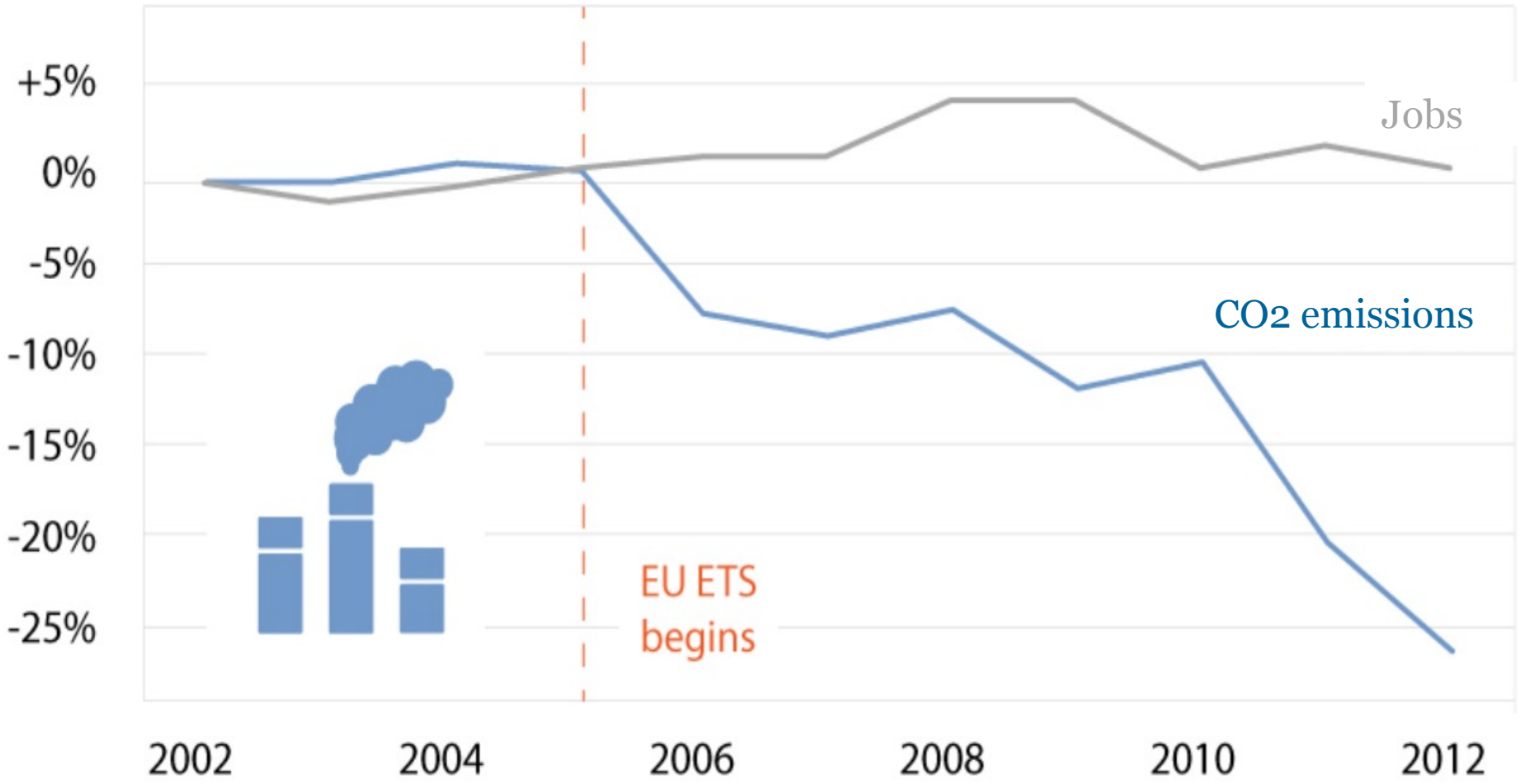
- Many countries have taken unprecedented fiscal action in the face of Covid-19.
- A number of countries have now started to actively explore options to green recovery policies.
- **Green stimulus is useful, but more powerful if complemented by gradually increasing carbon prices.**
- Carbon pricing can ensure that even environmentally-neutral stimulus is aligned with climate objectives (blogpost).

Beyond carbon pricing: combining environmental fiscal reform and stimulus.

- **Electricity tax reform**
  - Most electricity taxes do not provide direct decarbonisation incentives.
  - Exempting electricity from clean sources as in South Africa or reducing electricity taxes in general could support climate goals, and act as stimulus.
- **Feebates**
  - Encourage the production and consumption of cleaner products through carrots and sticks.
  - If stimulus is needed and fiscal space permits, governments could boost the bonus component.
- **Abatement payments**
  - Fiscal costs could be contained by reserving payments for priority projects.
  - By gradually raising carbon prices towards target levels, payments could later be phased out without reducing incentives.

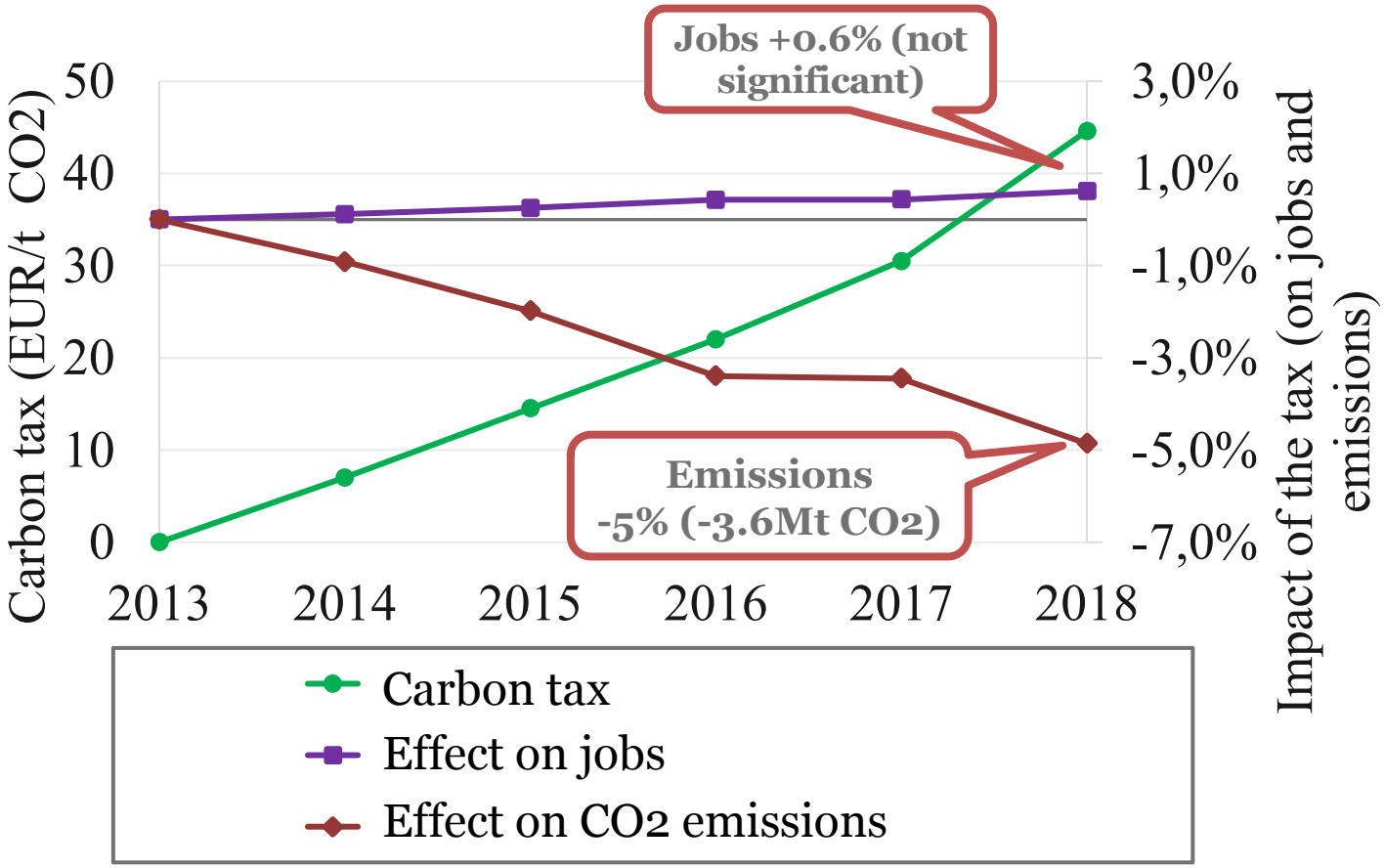
BACKUP SLIDES

The EU ETS has reduced emissions, not jobs



Source: "The joint impact of the European Union Emissions Trading System on carbon emissions and economic performance". OECD Econ. Dept. Working Paper 1515

The French carbon tax on industry has reduced emissions, not employment



Source: OECD Environment Working Paper 154 (2020)