CLIMATE FINANCE

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IMF-Japan High-Level Tax Conference for Asian and Pacific Countries

January 31, 2012

PRINCIPLES

What is it?

- Copenhagen and Cancun Accords commit developed countries to provide, for mitigation and adaptation, in developing countries
  - $30 bn ‘fast start finance over 2010-12
  - $100 bn p.a. by 2020 (= 0.25% of Annex II GDP)
    “…in the context of meaningful mitigation actions…”

Why? For reasons of both…

- Equity
  - Developed counties largely responsible for stock of CO_2 but…
  - …most harm and need for adaptation will arise in developing countries
- Efficiency
  - Mitigation likely cheapest in developing countries, who may be reluctant/unable to bear full cost

But—Where is the money to come from?

- Mix between private and public sources uncertain

- Possibilities reviewed in
  - UN High Level AGF report (Nov 2010)
  - IMF/WB report to G20 (October 2011)
    - At www.climate.change.worldbank.org/content/mobilizing-climate-finance

- Focus here on public sources, discussed in
  - "Promising domestic sources"
  - Charges on international aviation and maritime fuel

  both at www.imf.org/external/np/g20/

Alternative approaches:

- Agree burden-sharing, each country then raises revenue from preferred source—e.g. small increase all taxes, cut spending...

- Earmark revenue from a common, 'innovative' source
  - Con: Either makes spending inflexible or misleads public?
  - Pro: Eases political acceptability?

- Focus in public debate has been on latter

IMF work focused on two particular sources of innovative finance:

- Carbon pricing
- Charges on international aviation and maritime fuels

CARBON PRICING

i.e.: Uniform charge—by tax or emissions trading scheme (ETS)—on CO_2 emissions

Serves three purposes in this context:

- Exploits all opportunities for mitigation and gets balance between them right:
  - Fuel switching in power generation
  - Reducing electricity demand
  - Reducing demand for transportation fuels
  - Reducing direct fuel consumption by households/industry.

(whereas e.g. electricity tax only cuts electricity demand; petroleum excise does nothing on coal…)

…while also providing right signal for innovation

- Raises public revenue…
  - Significant climate finance with even 10% allocation…
  - …leaving a lot for consolidation or other purposes

  But why allocate to climate finance?
  - Maybe one of most efficient sources at margin
  - And salient for climate issues

- Catalyzes private flows to developing countries
  - E.g. incentive for developed country operators to purchase offsets in developing

Tax or ETS?

Choice is less important than doing something—and getting design right:

- Comprehensive coverage
- Raise revenue—no free allocations under ETS
- Price stability provisions for ETS

A $25/ton CO_2 price in developed countries in 2020 would

- Reduce their emissions by about 10%
- Raise about $250 bn p.a.
- …and so provide $25 bn for climate finance if 10% made available

Obstacles and options

- Challenges are from higher energy prices, which
  - Hurt consumers
  - Reduce competitiveness of energy-intensive firms in global markets

- Options to address these include:
  - Scaling back pre-existing energy taxes (on electricity and vehicles)
  - Compensation through broader tax system
  - Border tax adjustments

CHARGES ON INTERNATIONAL AVIATION AND MARITIME FUELS

Why?

- Sizable and growing source of emissions—about 4 %
- Excluded from Kyoto—hard to allocate control
- Currently untaxed, reflecting:
  - Legal constraints in aviation
  - Tax competition, given mobility of vessels
- Favorable tax treatment in other respects too:
  - No VAT
  - Shipping income subject to special tonnage tax

Some degree of international cooperation needed

- Possibility of avoidance if fuel untaxed by some
  - A large ship, e.g., can travel the world on a single uptake

- Through IMO and ICAO, strong commitment to equal national treatment in both sectors

- Are precedents:
  - UNITAID on ticket taxes
  - International Oil Pollution Compensation Funds (IOPC)

Current situation

- IMO and ICAO acting to improve fuel economy
  - Landmark IMO agreement July 2011

  But explicit charges would:
  - Reinforce effect through other responses
  - Raise revenue, e.g. for climate finance

- Work underway on charging: e.g. proposals under consideration in IMO

- International aviation included in EU-ETS from 1/1/2012—but contentious! Legal challenges

A global $25/ton charge in these sectors

- Would raise about $12 bn ($25) bn from international aviation (maritime) in 2020

- Reduce their emissions by approximately 5%

- <u>But</u> could harm (some) developing countries
  —so interest in transfers to ensure ‘no net incidence’ ...
  —...tough issue then being to assess incidence

Compensation in aviation?

- Much of the burden (including for tourism destinations) would likely fall on passengers from wealthy countries: ticket prices rise 2-4%
- So fully rebating aviation fuel charges—a natural approach—could be over-compensation
- Special arrangements may be needed for hubs

Compensation in maritime?

- Full rebate may not be adequate compensation, because less plausible that burden passed on
- Most import prices rise only 0.2-0.3%
- Are various proposals: e.g., allocation by (adjusted) shares in seaborne imports
  - E.g. in one exercise (not IMF!), rebate in % of total revenue would be:
    - Pakistan, 0.3%; Cambodia, 0.05%; Indonesia, 0.7%...

How to implement?

- As between tax (‘levy’,...) and ETS:
  - Tax more familiar: at refinery, distribution or port
  - Free allocation an issue with ETS
  - Governance issues in either case
    - Agreeing level/changes in rate/cap; Monitoring and verifying collection/emissions
- Some would exclude governments from collection

CONCLUSIONS

- Strong equity and efficiency case for climate finance

- Need for dedicated, innovative source unclear

- Strong economic case for charges on international aviation and maritime fuel
  - Compensation mechanisms could be found
  - But: legal obstacles in aviation and need for very wide participation in maritime