

E/C.18/2018/CRP.14

Distr.: General  
2 October 2018





[For information to the Committee: the Subcommittee will further discuss which countries to analyse in more detail]

#### **IV. Motives for introducing a carbon tax**

Jurisdictions may have different policy objectives when introducing a carbon tax and the emphasis could be on one or more objectives. A number of objectives are domestic; however, some will be supranational. With this in mind, whilst acknowledging their sovereign right to determine domestic policy, we also recognise the need to coordinate national actions to help change the trajectory of the global economy and support countries towards achieving the SDGs within the framework of the Addis Agenda and the Paris Agreement commitments.

The Subcommittee believes it is important to further identify, outline and discuss the different motives for introducing a carbon tax, how they may interact and drive certain elements of the tax design. Greenhouse gas mitigation and the promotion of low-carbon development are key objectives, considering that a carbon tax is an environmental tax, aimed as an incentive to change behaviour and thus lower the consumption of fuels giving rise to emissions. Sectorial exemptions or different tax rates for different groups of society or types of fuels could be considered to address competitive issues, carbon leakage or distributional consequences. Border-tax adjustments and internal credits are measure that can be discussed as well. A carbon tax may also have environmental objectives that go beyond mitigating GHG emissions, such as for example incentivizing the development of a new economic green sector. Further, a carbon tax can generate considerable revenues, thus contributing to domestic resource mobilization.

[For information to the Committee: the Subcommittee will further discuss on the sectoral exemptions. In this respect, the Subcommittee will focus on what effect the exemptions may have]

#### **V. Revenue use**

A carbon tax will, at least in a short and medium-term perspective, raise revenues. One part of our paper will deal with issues in relation to the raising of revenues and the use of revenues, with reference to country examples. The desired objective may affect a range of design options, which are briefly outlined below.

A carbon tax can be used to raise revenue and, depending on how it is designed, it can be in a way that is relatively easy to collect. In some cases, such taxes are used to increase the tax/GDP ratio so there is more revenue to invest in social assets such as education, health and infrastructure. The question on how best to use the revenues as well as how the sectorial coverage and tax rate will influence any revenue-raising ambitions will be addressed in our report.

Other aspects to analyse are the pros and cons of a tax neutrality approach and the possibilities of improving the overall efficiency of the tax system by such an approach. For example, in jurisdictions with large informal sectors, like in many developing countries, reducing labour/income taxes while increasing upstream carbon taxes on fuel can increase the effective tax base, since the tax will be incorporated in the fuel price and, therefore, paid by both formal and informal business. Country experiences might be included to provide lessons learnt.

## **VI. Need for proper consultation and communication of carbon tax prior to introduction**

After performing a comprehensive and detailed analysis as to the objectives and impacts of a carbon tax, it is critical to ensure that there is a clear Government framework to communicate and consult with different relevant sectors of the Government and affected stakeholders well in advance of implementation. This is an important aspect of a successful implementation process in any jurisdiction and will be addressed in the Subcommittee report.

The overall objectives of such a framework should be (amongst others) to offer a clear communication to the taxpayers as to the scope, rates and basis/applicability of the tax, align the tax measure with existing domestic policies and international standards and agreements; and ensure administrative simplicity and minimize the compliance burden.

## **VII. Designing a carbon tax**

A major part of the upcoming final paper of the Subcommittee will consist of a thorough analysis and hands-on advice on how to design a carbon tax to serve as a cost-

Measuring actual emissions from points of emission would be one alternative. However, in order to achieve an administratively simple system many countries having introduced a carbon tax have rather relied on average emission factors expressed in terms of carbon content of fuels to calculate the tax. The actual tax to be paid can, to ensure administrative simplicity, be expressed in normal trade units (weight or volume).

Another aspect to deal with is whether the tax base ought to relate to the fossil carbon content of fuels (which is the way the current IPCC emission reporting is done today), or to carbon content in general, which also would include biofuels.

The alternative of basing a carbon tax on life-cycle analysis of the production of fuels could also be looked into, even if the main approach of the Subcommittee would be a simpler carbon tax, calculated on the basis of the fuels actual carbon content.

**iii.**

indeed will have a major impact on the effectiveness of the tax, in relation to set objectives, the Subcommittee will discuss this issue in depth.

Some of the criteria to be covered in our analysis would thus be technical criteria, determining the development of the rate over time but also various political criteria, such as raising or reducing the rate or allowing for a differential rate structure to take into account economic and social considerations. In this context, it will be important to consider the implications on taxpayers that will be adversely affected by the carbon tax and the potential need for additional incentives (tax expenditures) to mitigate harmful economic consequences to e.g. heavy polluters or low economy households.

In addition, for effectiveness, the abatement costs and cost curve are very relevant to consider in this respect. The Subcommittee will gather and include references and available information





expressed in common trade units (volume or weight), not making it necessary to measure actual emissions.

Depending on national prerequisites, the tax may be collected from fuel producers or distributors upon extraction or import of the fuels or further down the fuel distribution chain. A well-designed carbon tax system would thus be of particular interest to developing countries as it raises revenues without requiring a market or the design of a complex monitoring system. This Chapter will also include some practical considerations on the administrative requirements for monitoring, reporting and verification systems required by taxpayers and tax authorities.

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