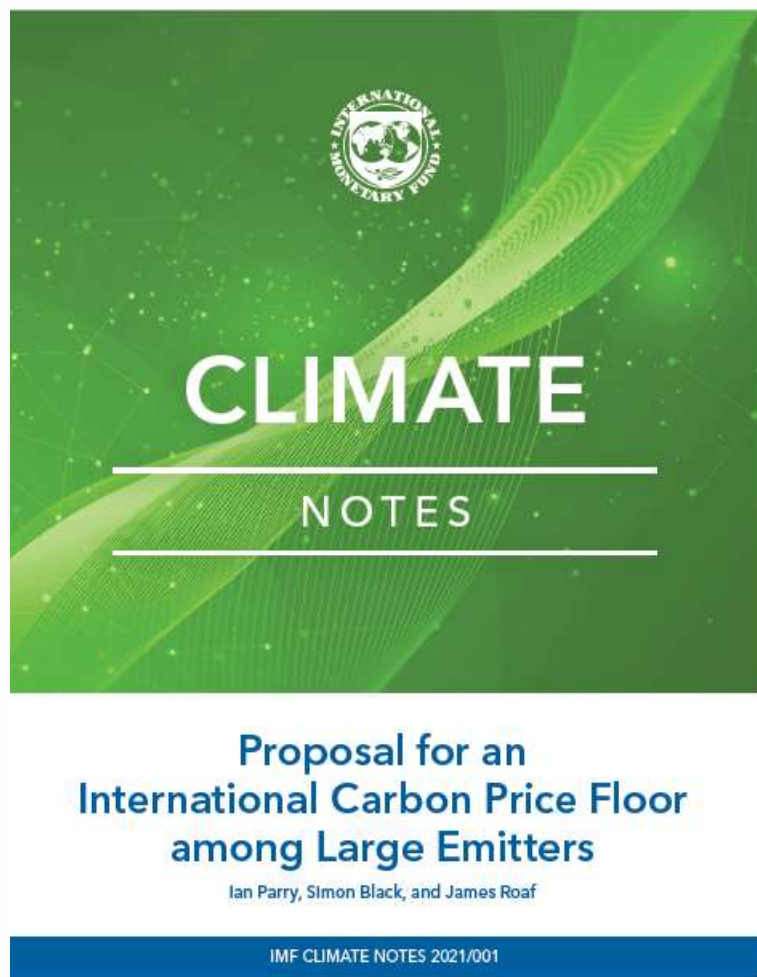


# IMF Proposal for an International Carbon Price Floor

***Session 2: How to finance the transition in  
Africa? Actors and tools, June 30, 2021***

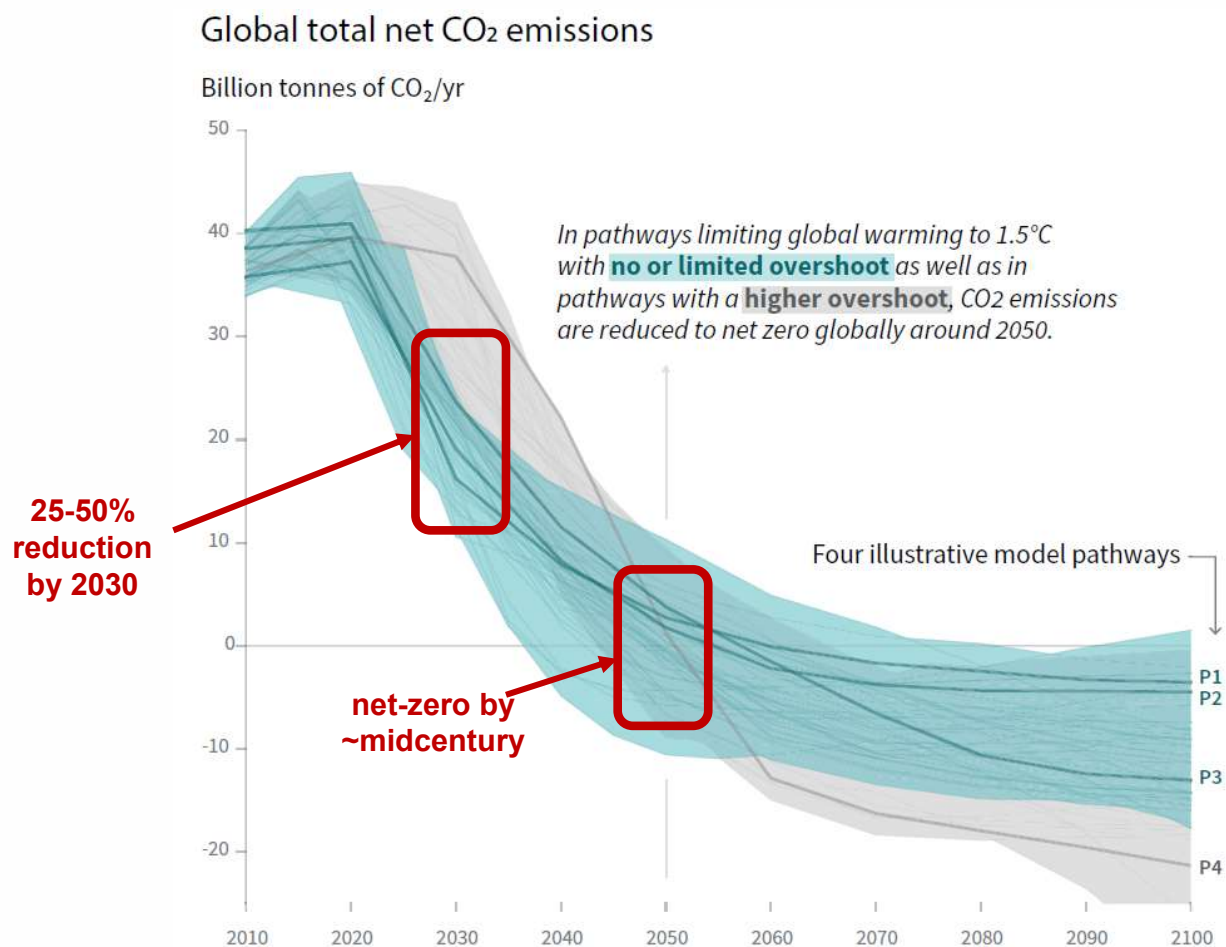
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## Overview and key messages



- International Carbon Price Floor (ICPF) IMF Climate Note (launched 18 June 2021)
- Need to accelerate decarbonization this decade
- Carbon pricing as central decarbonization instrument
- ICPF as complement to Paris Agreement – Paris Agreement vital for global ambition, but near-term pledges fall short
- Pragmatic carbon price floor agreement among smaller group of large emitters would supplement Paris and kick-start near-term emissions reductions
- Without ICPF, environmental/competitiveness concerns raise pressure for border carbon adjustments (far less effective than ICPF, though “devil is in the detail”: design choices make all the difference)

# We need cut emissions rapidly in this decade



Source: IPCC. 2018. <https://www.ipcc.ch/sr15/chapter/spm/>.

## Urgency of near-term mitigation action

Last window to keep alive 1.5-2°C is about to close

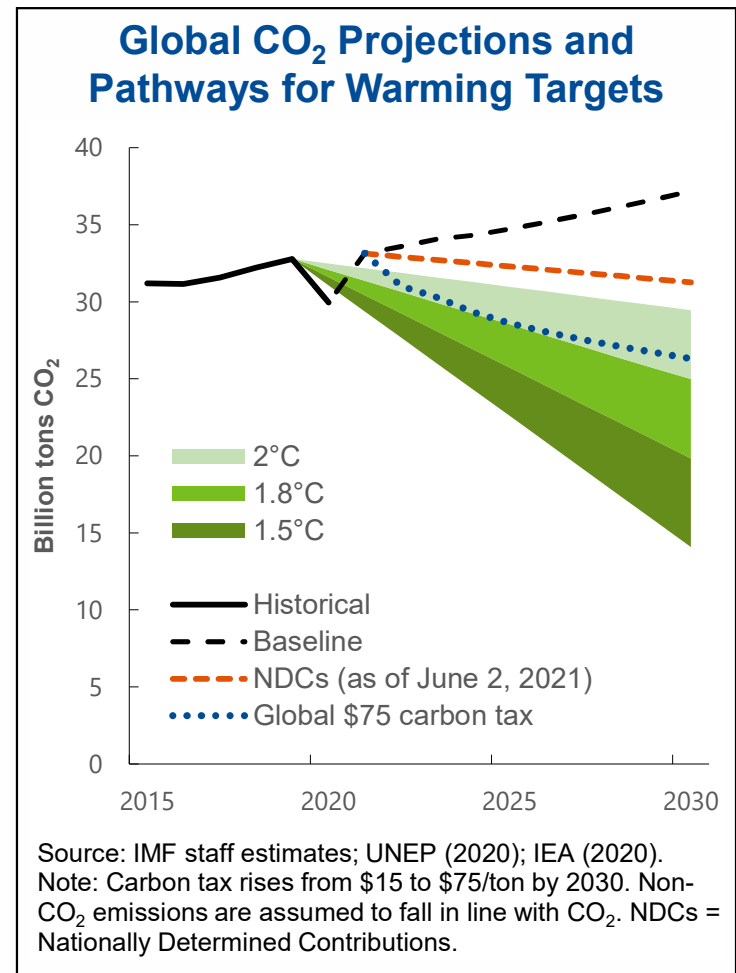
- Unless global emissions are cut 25-50% below 2018 levels by 2030
- Requires measures equivalent to  $\approx$  \$75/ton global CO<sub>2</sub> price
- Current global carbon price is  $\approx$  \$3/ton

Staff propose an international carbon price floor (ICPF)

- To help large emitters scale up carbon pricing through coordinated action

Without ICPF unilateral BCAs will likely emerge

- As some jurisdictions start to aggressively price emissions while others do not
- But BCAs far less effective at reducing emissions (CO<sub>2</sub> in trade < 10% of total CO<sub>2</sub>)



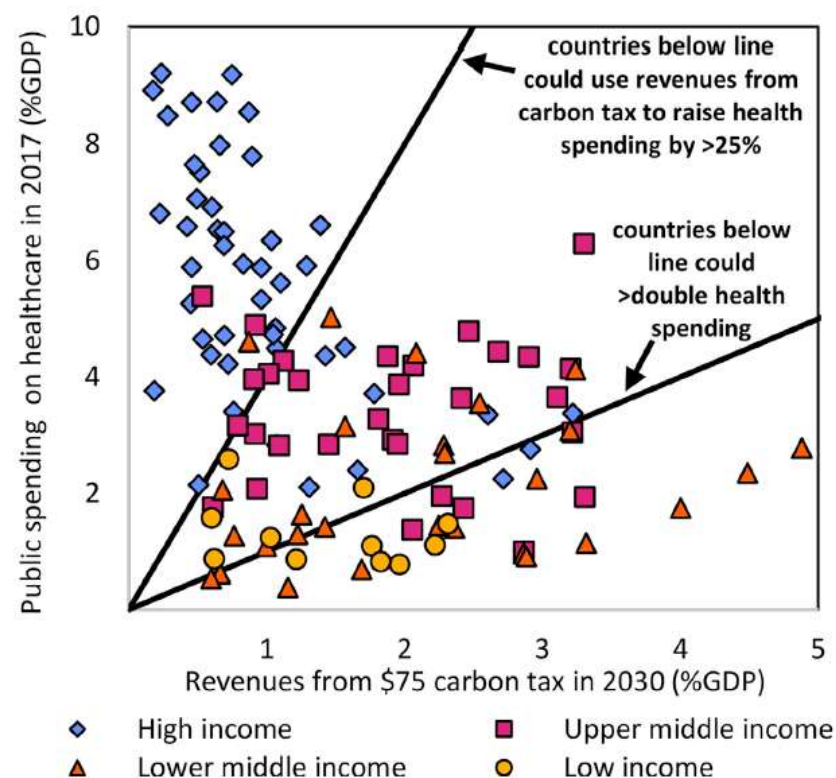
# Carbon pricing as central pillar for post-COVID decarbonization and development

## Central role in mitigation policy

- Across-the-board incentives, cost-effective price signal to shift private investment
- Raises significant revenue for e.g. health expenditures, investment, labor tax reductions, per-capita transfers (see Figure)
- Reaps domestic environmental co-benefits
- Administratively straightforward
- Carbon taxes generally preferred to ETS – price certainty, revenues to the government, build off fuel tax collection (though trading can be augmented via floors)

## Basic design details are critical

- Cover power, industry, transport, buildings
- Predictable and gradually rising price
- Use revenues productively



Source: author

## The need to complement the Paris Agreement

Paris Agreement is working to catalyze global ambition...

- 60 countries have committed 'net-zero' emission pledges for midcentury (more expected)

...but needs reinforcing to achieve required emissions reductions for 2030

- Current pledges for 2030 fall short of needed reductions for 2°C
- No mechanism for ensuring pledges achieved or link to policies

Under Paris approach two key obstacles to scaling up global mitigation

- *Ambition*: Too many parties (195) and parameters (one pledge per party)
- *Unilateral policy action*: competitiveness, uncertainty about whether others will act

The reinforcing mechanism should:

- *Facilitate negotiation* (i.e., small number of countries/transparent parameters)
- *Be effective* (i.e., contain a concrete plan to deliver emissions reductions)

## IMF Carbon Price Floor proposal – two key elements

### 1. Focus on key emitters

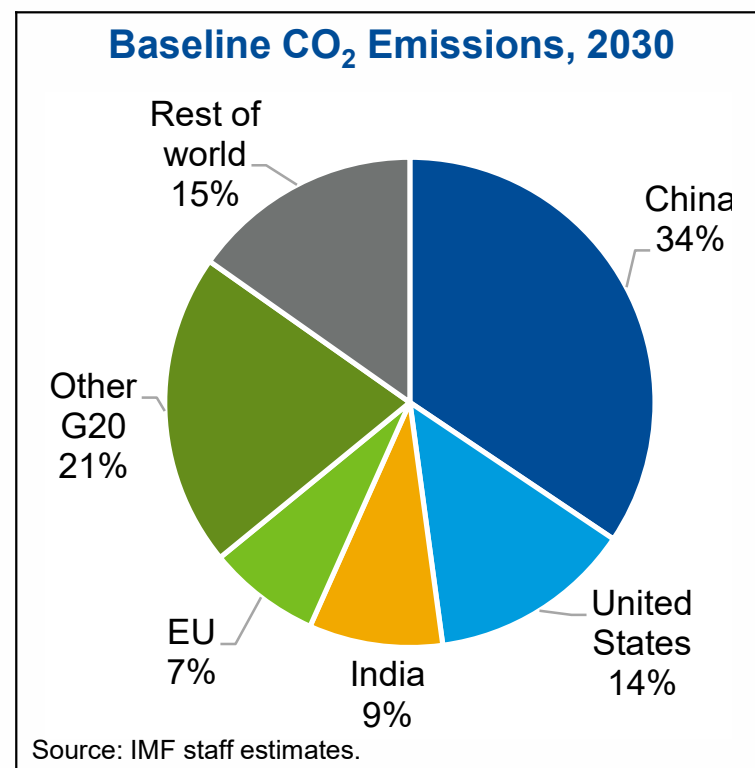
- e.g. China, US, India, EU, Canada, UK

### 2. Focus on minimum carbon price

- Efficient and easily understood parameter
- Joint action addresses competitiveness concerns and policy uncertainty
- Countries can set higher prices if needed

### But pragmatic design needed

- *Equity*: differentiated price floors/simple transfer mechanism
- *Flexibility*: allow alternative policies with equivalent outcomes
- Other issues include emissions sources, monitoring



# Effectiveness of an ICPF: example with six countries

## G20 CO<sub>2</sub> Outcomes Under Alternative ICPF

Percent reduction in G20 CO<sub>2</sub> emissions below baseline, 2030

Minimum emissions reductions required for temperature goals<sup>1</sup>:

2°C	20.8
1.8°C	32.8
1.5°C	46.6

China, US, India, EU, Canada, UK      All G20 Countries

NDCs Only	10.8	14.0
NDCs+\$50 Floor	23.4	25.3
NDCs+Differentiated Floor \$75/50/25 <sup>2</sup>	22.6	24.6

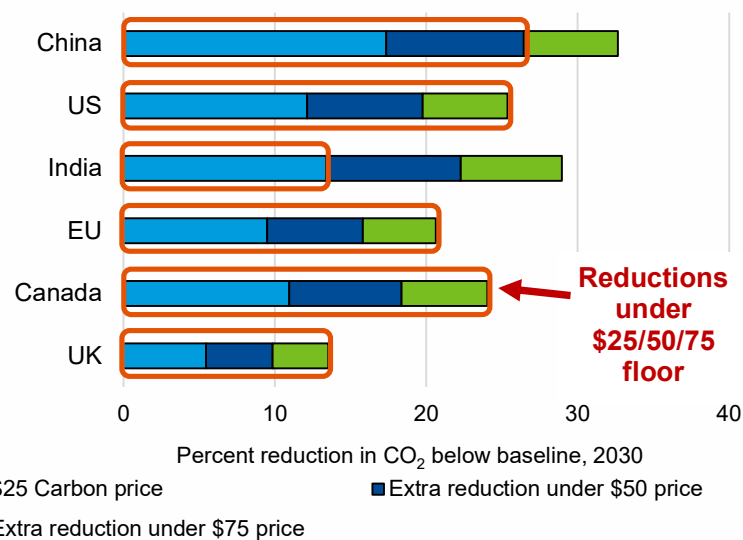
Source: NDCs from June 2, 2021; and IMF staff calculations.

Note: G20 - Group of Twenty; GHGs - greenhouse gases; NDC - nationally determined contributions.

<sup>1</sup> Assumes energy-related national CO<sub>2</sub> emissions need to reduce in proportion to total GHGs.

<sup>2</sup> Higher/middle/lower price for advanced/high income emerging market/low income emerging market economies.

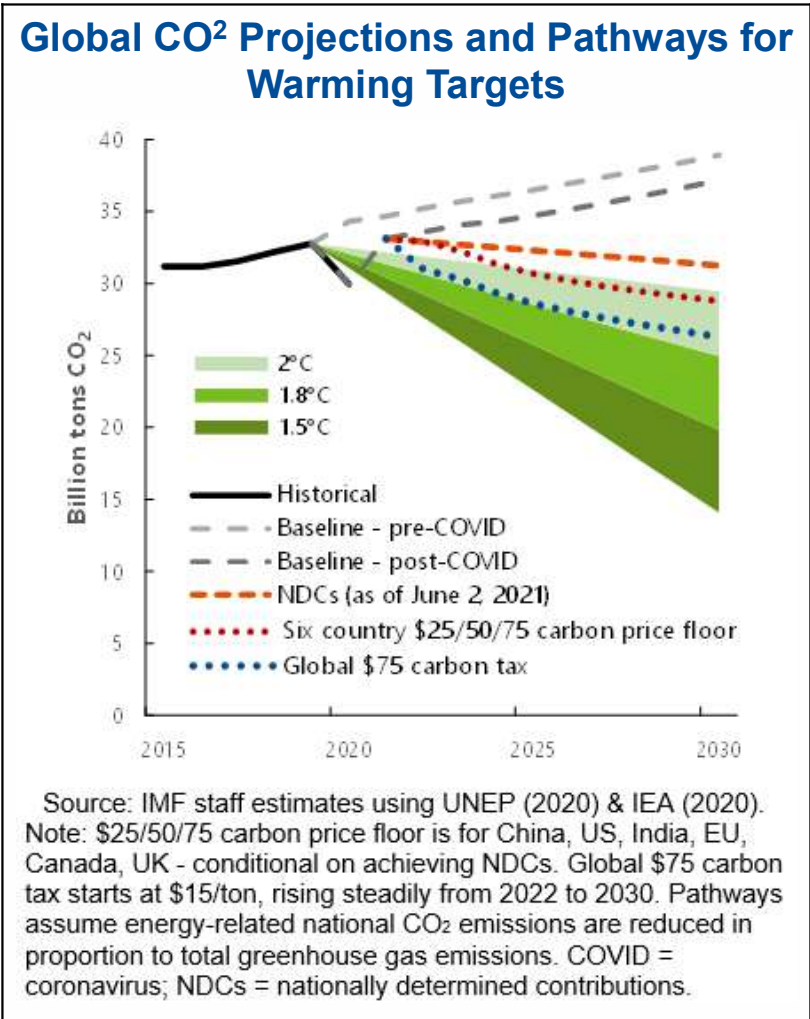
## Emission Reductions Under Alternative Carbon Prices, 2030



Source: IMF staff calculations.



# Potential for an ICPF to jump-start emissions reductions to 2030



# What about border carbon adjustments (BCAs)?

Some policymakers fear that higher carbon prices than in trading partners create a trade distortion, leading to:

## 1. **Concerns about jobs and growth**

- Production and investment could shift to lower carbon tax jurisdictions
- Especially relevant for energy-intensive, trade-exposed (EITE) industries

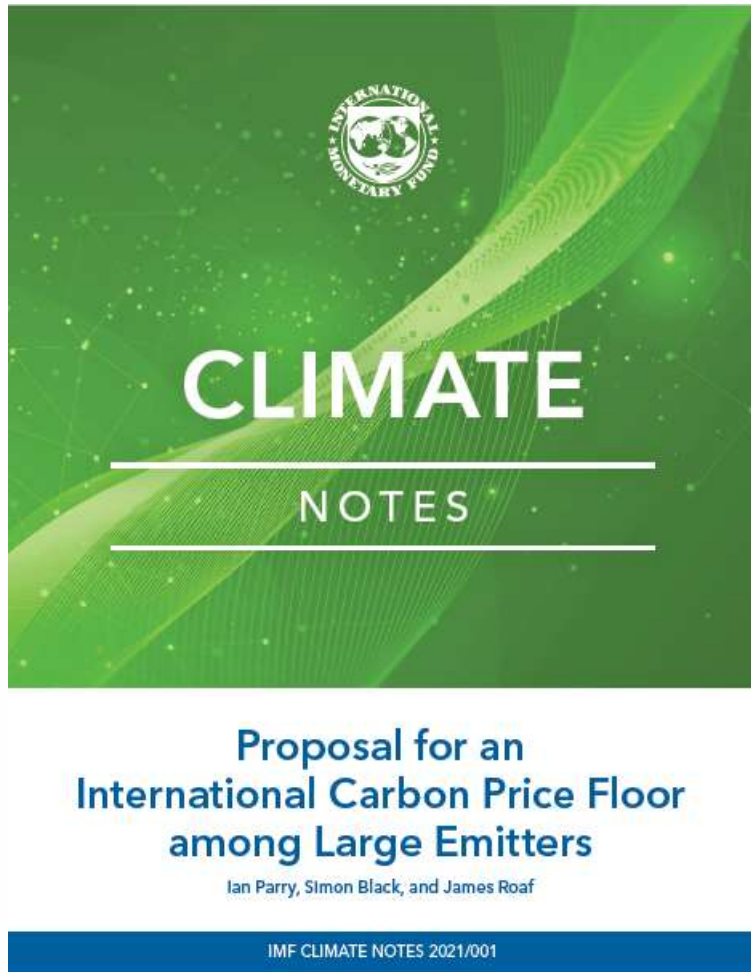
## 2. **Environmental** concerns

- “Carbon leakage” is when production shifting abroad raises foreign emissions, offsetting the domestic emissions reduction from carbon pricing

- BCAs could help address both concerns – charging for the CO<sub>2</sub> “embodied” in imports (and probably rebating for exports). Provides an alternative to existing EITE industry support mechanisms such as free allowances.
- BCAs may also encourage carbon pricing abroad
- **But ICPFs are superior to BCAs, notably in cutting global emissions**

# BCA and ICPFs compared to existing alternatives

	International cooperation	Domestic policy instruments for defending competitiveness				
Mechanism → Metric ↓	Coordinated carbon prices (e.g. ICPF)	Border Carbon Adjustments (BCAs)	Carbon tax exemptions	Free allowances under ETS	Tradable emissions standards	Output-based rebates
Reduction in global emissions	Potentially large reduction	Always small reduction	Increases emissions	Increases emissions	Increases emissions	Increases emissions
Preserve EITE competitiveness	Yes (extent depends on design)	Yes (extent depends on design)	Less effective if indirect emissions not covered	Partially	Partially	Partially
Limit carbon leakage	Yes (extent depends on design)	Yes (extent depends on design)	Less effective if indirect emissions not covered	Partially	Partially	Partially
Revenue implications	Preserves carbon pricing revenue	Preserves carbon pricing revenue	Loses some carbon pricing revenue	Loses some carbon pricing revenue	Forgoes carbon pricing revenue	Forgoes carbon pricing revenue (approx.)
Administrative burden	Low	Depends on design	Modest	Modest	Modest	Modest
Risk of WTO challenge	No	Depends on design	No	Potential challenge as subsidy?	No	No



## Conclusion

- We are in a climate emergency
- Need to cut emissions rapidly in this decade
- Carbon pricing is a central decarbonization instrument
- ICPF can complement Paris Agreement – ratcheting up ambition with direct link to policy
- Pragmatic carbon price floor agreement among smaller group of large emitters would supplement Paris and kick-start near-term emissions reductions
- ICPFs are superior to BCAs

**We need to *Build Back Better, Together, on Firm Fiscal Foundations!***

**Thank you**