

Taxes vs. Trading: An IMF Perspective

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Tax or Trade: Revisiting the Trade-Offs in Climate Policy
Options,

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In principle either instrument is fine...



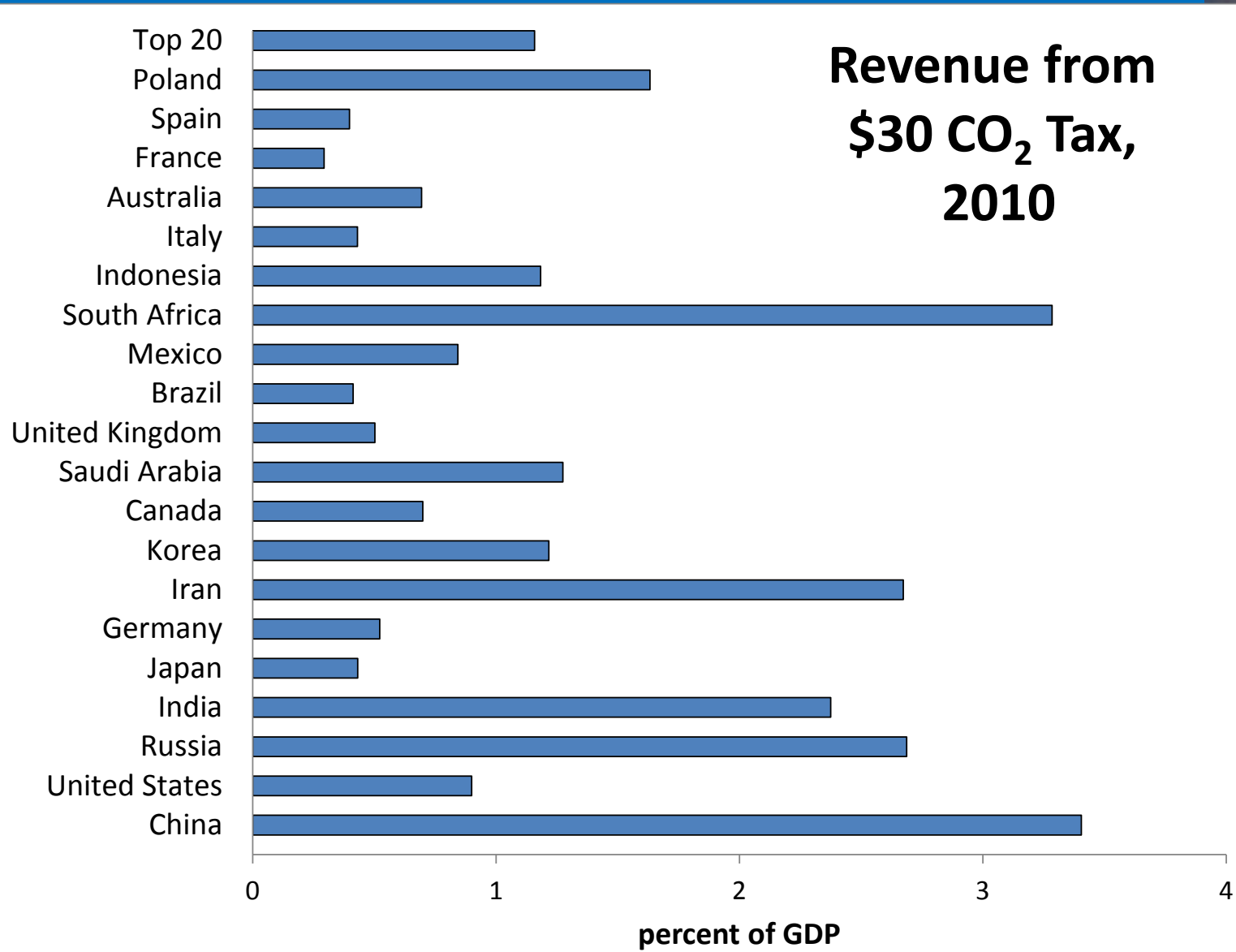
- If design basics right
 - Comprehensive
 - Use revenues productively
 - Prices aligned to environmental objectives
- ...in practice
 - Tax simpler way to meet objectives

Coverage



- Tax should be upstream: carbon content of fuels
 - Covers all emissions
 - Straightforward extension of road fuel excises
- ETS typically downstream: industrial emissions
 - Misses $\approx 50\%$ of CO_2 (e.g., road, heating fuels)
 - Administratively more complex
 - Institutional capacity/markets inadequate for ETS in some countries (e.g., S. Africa)

Potential Revenue is Substantial



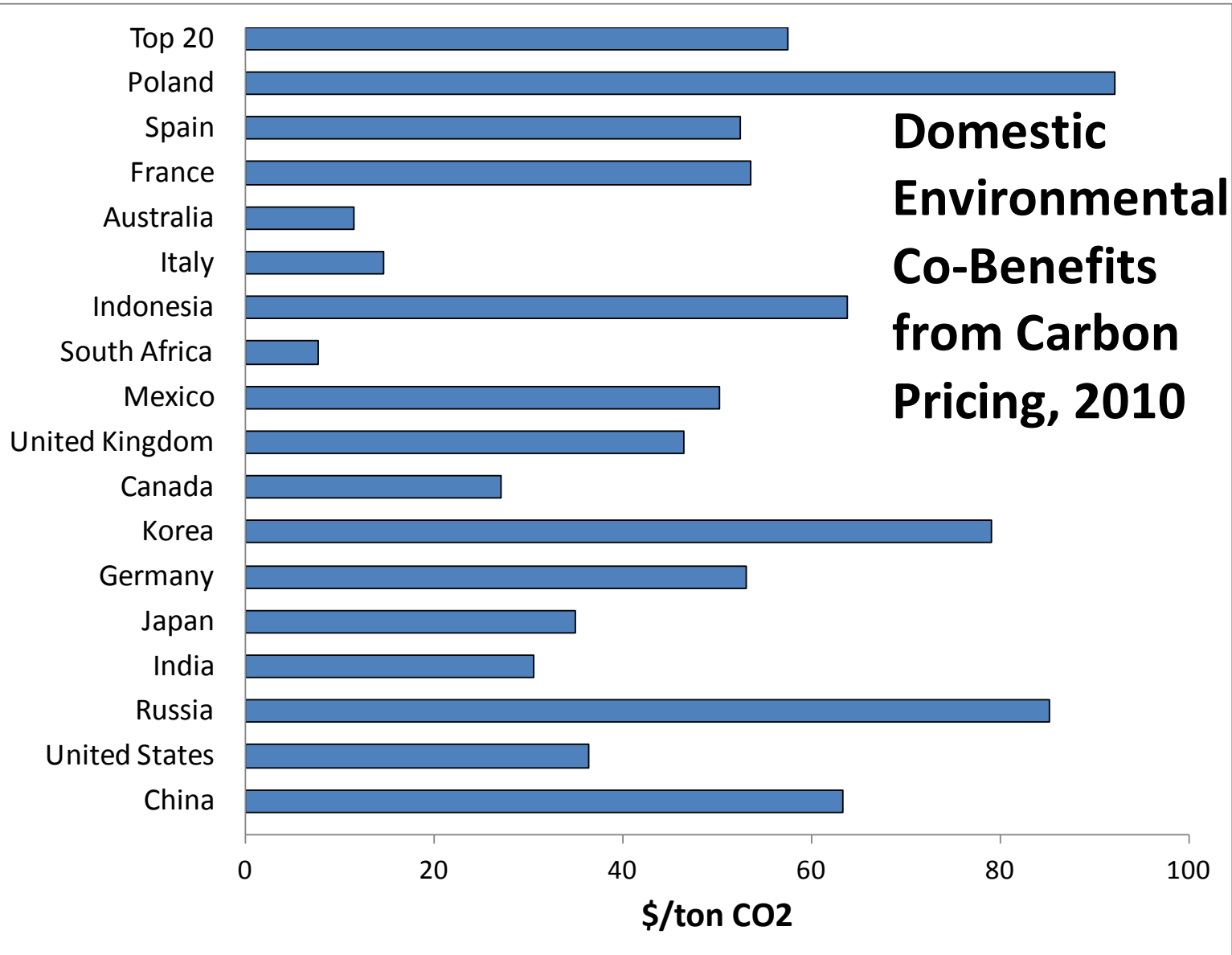
Productive Revenue Use is Critical

- Cutting taxes on labor and capital
 - Contains costs of carbon pricing ($\approx .2$ % GDP)
 - Tax reform less likely under ETS?

- If used for new spending
 - Should generate comparable benefits to cutting taxes
 - If not costs higher (≈ 1.0 % GDP)

- Fiscal case for CO₂ taxes especially strong when
 - Informal markets constrain broader taxes

Pricing is in Countries' Own Interest



CO₂ Price Level



- Domestic: Paris INDCs
 - Best met on average with stable price (for innovation)
 - ETS requires price floors and ceilings
 - Infer prices from emission projections/responsiveness
- International: floors better than uniform prices
 - Allow countries to exceed floor (for fiscal, domestic environmental, political acceptability reasons)
 - Precedents: EU tax floors for VAT, excise

Carbon is Being Priced...



Government	Price 2015, US\$/ton CO2	Coverage, % of GHGs	Government	Price 2015, US\$/ton CO2	Coverage, % of GHGs
CARBON TAXES			Norway	50	50
Br. Columbia	25	70	Portugal	5	25
Chile	5	55	Sweden	168	25
Japan	2	70	UK	16	25
Mexico	1-4	40	TRADING SYSTEMS		
South Africa	10	80	Alberta	12	43
Switzerland	62	30	California	13	85
In the EU ETS			EU	9	45
Denmark	31	45	Kazakhstan	2	55
Finland	40	15	Korea	9	66
France	16	35	N. Zealand	5	54
Iceland	10	50	Quebec	13	85
Ireland	23	40	RGGI	7	21

Source: WBG (2014, 2015).

- ...but coverage and prices inadequate