Using Carbon Revenues

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An overview of national experiences regarding the use of revenues from carbon taxation and carbon markets

Policy Brief

- In 2019, 42% of the aggregate carbon revenue was channeled to the general state budget, 47% was allocated to environmental or broader projects, 5% went to tax cuts and 6% to direct transfers to families or businesses.
- Countries that have successfully implemented carbon pricing have managed to align the use of carbon revenues with national priorities, associating reform with a discourse that is in line with their development agenda.
- Regardless of the objective sought, governance issues are crucial and range from transparency in revenue use, and clarity of trans fers and compensation, to the legitimacy of the reform process.

Tax Reforms: Difficult but Necessary

Recent social unrest in Egypt and Ecuador demonstrates that France is not the only country in which higher energy prices are proving a hard sell.

Carbon reduction incentives often spearhead climate change mitigation policies and many countries have recently successfully pursued carbon pricing policies that have ultimately resulted in higher energy prices for households and businesses. At the end of 2019, we counted forty four countries, and thirty-one other jurisdictions (provinces, states, cities or groups of countries) around the world with an active carbon pricing mechanism. Another sign of the momentum of carbon reform is the fact that these carbon pricing instruments generated US$48 billion in revenue in 2019, up from 22 billion in 2016. This is not to mention countries that have sharply reduced fossil fuel subsidies.

Carbon revenues have a special status that is closely related to the environmental nature of carbon taxes: they are expected to square the circle by simultaneously attaining goals in terms of environmental efficiency, budgetary efficiency, and social justice. This Policy Brief sets out the success factors of countries that have implemented carbon pricing, or, more generally, that have successfully increased energy prices. It brings together the salient lessons from a recent report[1] published by the World Bank and AFD that studied twenty countries over five different continents.

[1] World Bank (2019), "Using Carbon Revenues", PMR Technical Note, No.16
https://openknowledge.worldbank.org/handle/10986/32247

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> **“ Carbon revenues can contribute to up to six key objectives, depending on national contexts ”**

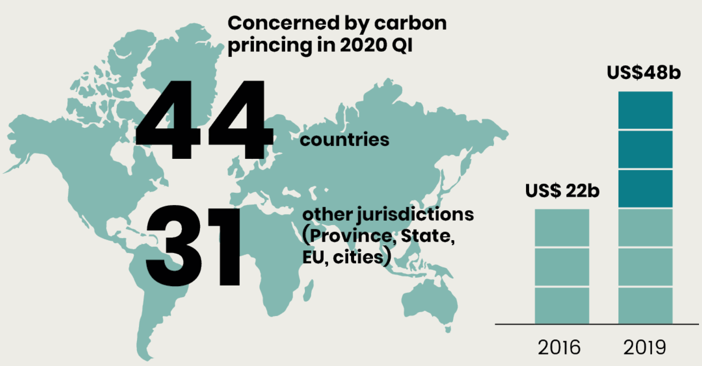
Carbon revenues can either be allocated to the general state budget or to specific objectives, through direct budget allocation or dedicated funds. Earmarking carbon revenues for a particular use has the advantage of securing funding flows for well-defined projects, for instance supporting renewable energies, and improves the instrument's visibility and legitimacy. On the other hand, channeling carbon revenues to the general budget serves all government missions and provides more flexibility in the use of tax resources. The report authored by AFD and the World Bank identifies six major objectives that are currently sought by governments in their use of carbon revenues:

1. Spearheading broader tax reform, as is the case in Mexico, often with the aim of having a positive impact on economic growth.
2. Directly supporting environmental projects that complement the carbon instrument, as with Quebec's Green Fund.
3. Pursuing other development objectives, such as education and healthcare, as is partly the case in Colombia and Indonesia.
4. Providing direct support to individuals, households and businesses impacted by environmental policies, through cash transfer or dedicated programs, as in Iran.
5. Supporting indirectly the most vulnerable industries, as in South Africa, to mitigate the effect on employment and on the relocation of polluting activities abroad.
6. Contributing to debt reduction, as is the case in Ireland and Iceland.

It is not possible to put exact figures on all categories, as debt reduction is often channeled through the general budget, and earmarking is not always clear-cut.

However, available data reveals that, in 2017–2018, the majority of revenues were assigned to environmental projects (42%). The next largest amounts of revenue were allocated to the general budget (38%), development issues (11%), reductions in other taxes (6%), and finally to direct transfers to households and businesses (3%). In 2019, figures evolve slightly: 42% are channeled to the general budget ; 47% are earmarked to environmental or broader projects (5% to tax cuts and 6% to direct transfers to families or businesses).

CARBON REVENUES AROUND THE WORLD



Source: I4CE (2020) « Les comptes mondiaux du carbone en 2020 ».

Geographical scope: multi-country
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Topics: governance; climate

The discourse behind reform implementation is decisive, whether it addresses taxes, subsidy withdrawal, or even carbon markets. Consistency with a development project having the broadest possible support is the key to successful reform. South Africa has recently been able to implement a carbon tax by granting generous exemptions to low-income households and vulnerable businesses and by providing support for renewable energy.

The Key Challenge of Transparency

The use of carbon revenues is key to ensuring the acceptability of reforms and must be discussed well in advance to prevent discord. Regardless of the options selected, however—and the various countries that have successfully achieved reform have made very different choices—, transparency is essential. Canada's British Columbia offers a model of its kind: each year, the provincial minister of finance is required to report to the legislature on compliance with the commitment to revenue neutrality of the carbon tax. The legislature examines the use of carbon tax revenue over the past two years and approves the ministry of finance's plan for the following three years. Furthermore, 15% of the minister's salary is conditional on achieving carbon tax revenue neutrality. This case shows that it is possible to be transparent on the use of carbon tax revenues and to earmark these revenues without necessarily allocating them to a fund that is segregated from the general state budget.

Highlighting Compensation

The second lesson is that compensation granted following rises in energy prices must be made visible. Since any change in such prices is highly visible, compensation must be equally so. The state of California has opted for full transparency and visibility in its compensation program. Each year, the legislature determines which programs are to be financed by its carbon fund, GGRF, following a broad public consultation; state law provides that 60% of funds are earmarked for transportation and housing. All funded projects are mapped on a public website, publicized in the field, and outreach efforts are undertaken to make known the impact of the fund. Old cars were crushed in front of the Los Angeles City Hall to raise awareness of new subsidies for less polluting cars.

Adapting to Criticism and Persevering

There is one last lesson to be drawn from international experiences: policy makers must take heed of criticism, adapt, and persevere. Indonesia experienced large-scale riots when it began to cut back on its fossil fuel subsidies. The country has learned from these events and has since implemented many social programs aiming to protect the poorest of the poor. All in all, it took twenty-five years, with a certain amount of backtracking, to come close to ending fossil fuel subsidies in the country. British Columbia is another prime example of perseverance. Four months after it was implemented, most of the population were against the carbon tax; there are now twice as many supporters as opponents. Raising energy taxes is a necessary but time-consuming political challenge. By learning from mistakes and drawing on foreign experiences, countries embarking on this endeavor can leverage carbon revenue to build consensus among their population.

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