IMF Work on Fiscal Policy and Climate Change

Fiscal policy has a critical role to play in mitigating greenhouse gas emissions and raising revenues for climate finance, fiscal consolidation, and other purposes. The Fiscal Affairs Department of the International Monetary Fund (IMF) has been working on the appropriate design of tax policy to meet these duel objectives.

Designing Mitigation Policies. The IMF is well positioned to provide technical assistance to countries interested in pricing greenhouse gas emissions and broader environmental/energy tax reforms. In September 2011, the IMF held a meeting where experts discussed a forthcoming volume of papers providing guidance on various aspects of fiscal policy design. Questions addressed included, for example:

- How policymakers can think about the appropriate level of emissions pricing, from the long-term perspective of stabilizing the global climate system and also incorporating environmental damages into the price of fuels, energy, and so on;
- Why emissions pricing instruments (carbon taxes, emissions trading systems) are easily the most promising policies for exploiting emissions reduction opportunities across the economy and promoting the development of clean technologies and their transfer to developing countries;
- How emissions pricing instruments are best designed in terms of covering emissions sources, recycling revenues to best benefit the economy, and improving the prospects for their implementation;
- What lessons policymakers can learn from experience with carbon pricing policies to date from the EU Emissions Trading System, regional initiatives in the United States, and carbon taxes, to the prospective carbon pricing program in Australia;
- How low-cost options for sequestering carbon dioxide in the forestry sector can be exploited under carbon pricing regimes;
- How carbon pricing instruments might be designed for developing countries.

UN system-wide response to climate change

Under the chairmanship of the Secretary-General, the UN System Chief Executives Board for Coordination (CEB) brings together 29 UN system organizations to jointly support Member States in meeting global challenges.

In 2007, CEB adopted the Climate Change Action Framework, a joint action-oriented approach in line with the decisions of the UNFCCC Parties. The UN system supports Member States in implementing their commitments and in responding to emerging challenges.

At COP 17/CMP 7, the UN system is presenting its ongoing work and practical solutions and tools at side events and exhibits and through this joint package of thematic information.

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United Nations System Chief Executives Board for Coordination

Climate Change Action Framework

Focus (left) and Cross-Cutting Areas (right) have been identified in pursuance of the broader mandates and capacities in the UN system (with corresponding convening agencies) to ensure better coordination and cooperation for concrete deliverables:

Adaptation
Technology transfer
Forestry and Agriculture
Financing mitigation and adaptation action
Capacity-building

Climate knowledge; science, assessment, monitoring and early warning
Supporting global, regional and national action
Public awareness-raising
Social Dimensions of Climate Change

IMF Work on Fiscal Policy and Climate Change

Climate Finance

The IMF has been working with the World Bank and OECD on instruments for climate finance. The Fund's work focused on a variety of domestic and international fiscal instruments, emphasizing:

The attractiveness of carbon pricing instruments over other domestic fiscal options. By reflecting carbon damages in the price of fossil fuels, electricity, and so on, carbon pricing schemes induce a shift towards cleaner electricity generation, and promote conservation of electricity, transportation fuels, and fuels used in homes and factories.

Other climate-related taxes are less environmentally effective, for example, charges on electricity use do not reduce emissions in other sectors or promote use of cleaner generation fuels.

Carbon pricing instruments are also preferred to broader fiscal instruments (like income taxes and taxes on the financial sector) because they correct for a huge market failure—excessive generation of greenhouse gases.

Charges on international aviation and maritime emissions are also a promising source of climate finance. Unlike in the case of road transport, fuels for international transportation are not currently subject to excise taxes. While details need further study (e.g., compensation schemes for developing countries), feasible proposals for pricing international aviation and maritime emissions can be developed.

Climate Policy and Recession

A recent IMF paper argued that the economic crisis should not detract from efforts to charge firms and households for the damages from greenhouse gases. A shift towards carbon pricing need not impede economic recovery and could make a substantial contribution to fiscal consolidation.

Carbon Tax or Emissions Trading?

The choice between these instruments is less important than implementing one of them with the appropriate design details. These include comprehensive coverage of emissions, raising revenues and using them productively (e.g., for climate finance or deficit reduction), and, in the case of trading schemes, provisions to limit allowance price volatility.

Energy Subsidies

IMF staff have analyzed subsidies on food and fuel products, including their effects on climate change. In the case of petroleum products, reducing subsidies could considerably reduce greenhouse gas emissions in emerging and developing countries, while at the same time reduce projected fiscal deficits. Staff are also involved in regular monitoring of fuel pricing policies, in response to volatile international fuel prices.

How Much Revenue?

If developed countries priced carbon dioxide emissions at $25 per ton in 2020 this would raise around $250 billion in annual revenue. Allocating 10 percent of this revenue for climate finance would achieve a quarter of the funding goal for 2020, leaving a large new revenue source that could be used domestically to reduce fiscal deficits.

Charges on international aviation and maritime fuels could raise over $20 billion for climate finance and other purposes, even if developing countries are compensated for the harm they might suffer from such charges.

The climate finance issue is how developed countries will meet their commitments at the Copenhagen and Cancun climate talks to mobilize $100 billion per year by 2020 from public and private sources to finance climate mitigation and adaptation projects in developing countries.

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