Using Carbon Revenues for Development

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The importance of carbon revenues

How carbon revenues can be used for development
Using Carbon Revenues

The report provides practical guidance on using carbon revenues by helping policymakers understand the implications, opportunities, and challenges associated with different approaches to carbon revenue use.
I. THE IMPORTANCE OF CARBON PRICING REVENUES
As Carbon Pricing initiatives expand or reform, revenues have been increasing.

- **2016**: US$22 Bln
- **2017**: US$33 Bln
- **2018**: US$44 Bln
Carbon Pricing initiatives are spreading around the world
Domestic resource mobilization is critical for developing countries

Source: Global Revenue Statistics Database (1 May 2019)
Carbon pricing is a particularly good way of raising revenue

- Less distortionary than most existing taxes
- Levied on a small number of large businesses and (taxes) can piggyback off existing systems

  - low administration
  - relatively easy to collect
  - hard to evade
Informal sector can be captured by carbon pricing
Pre-existing tax distortions

"Of course I’m tax-exempt!"
II. HOW CARBON REVENUES CAN BE USED FOR DEVELOPMENT
Governments can allocate revenue to the **general budget** or commit it to a specific purpose.

- Legal earmarking
- Hypothecation

Allocating to the general budget provides **flexibility**

Committing to a specific purpose provide a **clear link** with the carbon price.
How carbon revenues are spent globally

[Image of a pie chart showing the distribution of carbon revenues globally]
How carbon revenues are spent globally

- General budget: 38%
- Climate: 42%
- Development: 12%
- Direct transfers: 5%
- Tax cuts: 3%
6 spending options for carbon revenues

- Tax Reform
- Climate
- Development objectives
- Prevent leakage
- Help those affected by carbon price
- Debt reduction
Increase economic growth through **tax reform**

- Tax “bads”, not “goods”
- **Potential for double dividend** + Boost economic activity by reducing informal sector

⚠️ Consider potential distributional effects

⚠️ Clear communication on revenue neutrality / rebalancing tax system is important as they may not have a clear, visible impact otherwise.

Gradual carbon tax increase combined with cuts in income and labor taxes to prevent overall tax increase, encourage job growth & address negative distributional effects.
• Most common use of revenues
• Help reduce costs of meeting targets
• Can **address other market failures**

• **Can incentivize mitigation** in sectors not covered by a carbon price

Japan’s carbon tax funds renewable energy and energy efficiency programs through green subsidies and R&D support.
• Address **competitiveness concerns**
  • Risk that regulated businesses may lose market share or have reduced profits without an environmental gain
  • Particular concern for emissions-intensive, trade exposed businesses

• Commonly addressed through **free allocation, exemptions or “feebates”**

⚠️ But measures should still protect environmental aims of carbon pricing and avoid giving businesses windfall profits

South Africa’s carbon tax includes various tax-free allowances to protect competitiveness, ease the transition to the tax & encourage broad participation
• Higher spending on health, education or infrastructure projects

• Can also boost employment and growth

• Useful source to pursue development goals given access to finance can often be challenging

When established, Colombia’s carbon tax supported the national peace process by financing environmental projects in post-conflict zones
Carbon pricing can increase cost of certain goods and disproportionately affect certain income groups, sectors or regions.

- Compensation for low-income households can be done through cash transfers or subsidies for low-carbon energy, public transport, housing. For workers, it can include trainings or specific support.

- If done well, targeted transfers can help to make carbon pricing more equitable, popular and with relatively low admin costs.

But they can also be:

- Difficult to design effectively
- Hard to implement in the absence of infrastructure for cash transfer

India eliminated diesel subsidies and used savings to implement direct benefit transfer for vulnerable households.
• **Reduce budget deficit** to free up public resources in future periods

Does not address equity concerns that arise in short term due to carbon pricing or immediately improve economy

Less transparent and less aligned to environmental goals of carbon pricing

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Indonesia had a series of energy reforms, generating significant fiscal savings and improved its ability to fund social programs.
Carbon pricing is a rapidly growing **source of revenue** for government – revenue critical for achieving SDGs.

Carbon pricing is a particularly efficient way to raise revenues and should be incorporated into the broader fiscal framework.

How the revenues are **used** and how they are **communicated** can be critical to building support, but these need to be **locally tailored**.

In practice, countries tend to implement a **package of spending initiatives** to achieve multiple goals. This can leverage synergies to be mutually reinforcing.
Thank you!

Find out more at:
https://www.thepmr.org