Developing a Carbon Pricing Roadmap

Vivid Economics

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Carbon pricing is expanding globally

64 jurisdictions have implemented or are scheduled to implement carbon prices.

Different jurisdictions have taken different approaches to carbon pricing.

Each jurisdiction has a unique set of circumstances and specific motivations that shape their choice of carbon pricing instrument.
This guide looks to help jurisdictions onto the path towards carbon pricing that is suitable to their local circumstances

- **Key questions** the guide looks to answer:
  - Why are different carbon pricing instruments used?
  - What led to successful carbon pricing implementation in some jurisdictions, when it failed in others?
  - What are the key considerations in deciding on the type and design of a carbon price?
  - How does/should carbon price design change over time?

- **A jurisdiction’s context** is essential to answering all of these questions, as it determines:
  - the objectives of carbon pricing
  - capacity for policy implementation
  - the impact of different carbon price designs

- The guide provides practical tools to help jurisdictions assess their context and develop an appropriate carbon pricing instrument
The guide walks the user through a ‘roadmap’, with key steps to consider on the path to introducing a carbon price.

1) The case for carbon pricing
   - Why carbon pricing
   - Carbon pricing options
   - Carbon pricing in the policy mix
   - 1 Identifying policy interactions

2) The jurisdictional context
   - Assessing capacity for implementation
   - Mapping the local context
   - 4 Rapid assessment tool
   - 3 Questionnaire
   - 2 Data tip sheet

3) Impact assessment
   - Assessing stakeholder impacts
   - Modelling carbon pricing
   - 5 Example ToR
   - 6 Developing a modelling approach

4) Evaluation and recommendations
   - Communicating the recommendation
   - Developing a recommendation
   - 7 Policy paper outline

Design and implement a CPI
The PMR literature covers key design aspects for all carbon pricing options.
A carbon price can bring a range of benefits, and play a variety of roles within the broader policy mix.

**Carbon tax or ETS?**
- Carbon taxes
  - Fixed rates
  - Predictable prices
  - Emissions uncertainty
- Emissions trading system
  - Emissions cap
  - Tradable allowances
  - Variable prices
- Carbon crediting
  - Mitigation in uncovered sectors

**Multiple benefits & objectives**
- Meet emissions targets
- Reduce costs
- Raises revenue
- Generate co-benefits
- Regional cooperation
- Innovation & investment

**Differing roles in the policy mix**

**Benefits of carbon pricing**
- Complementary: improve functioning of carbon markets (likely impact on demand and prices)
- Overlapping: duplicate incentives in carbon markets
- Countervailing: oppose incentives in carbon markets

Identifying policy interactions: Provides a framework to identify domestic policies that will interact with a CPI.
To assess its context, a jurisdiction should consider capacity for implementation and key aspects of its local context.

**Understanding the local context is vital for a successful carbon price**

- **Economy**
  - Economic impacts
  - Market characteristics

- **Environment**
  - Emissions profile
  - Emissions targets

- **Governance**
  - Institutions
  - Legal considerations

- **Politics**
  - Domestic considerations
  - International considerations

**Carbon pricing capacity is required for both the regulator and business**

All CPIs require a minimum level of capacity, but an ETS has a higher degree of overall complexity.

**Capacity required**

- **Carbon tax**
- **Emissions trading system**
- **Crediting**

**Markets**

- Allocations
- Trade infrastructure
- Market oversight

**Governance**

- MRV
- Compliance

**Rapid assessment tool:** Aids in understanding where capacity is strong and where needs development

**Questionnaire:** Provides a framework to think about readiness issues to address

**Data tip sheet:** Lists suggested data sources to build a local context understanding
Understanding stakeholder impacts requires both quantitative and qualitative assessment.

Carbon pricing impacts across society:
- Government
- Competitiveness
- Product prices
- Policy interactions
- Demand for goods & services
- Demand for labour
- Business
- Households

Modelling is an important but imperfect tool:
- Carbon pricing works through complex systems, which are approximated through modelling.

Benefits:
- Assess scale of impacts
- Aid CPI design
- Broad policy impacts
- Identify key interactions

Limitations:
- Questionable assumptions
- Misses policy implementation
- Large shocks and (in)validity
- Limits in CPI comparison

Example ToR: Describes key components of a modelling ToR with examples from PMR countries.

Developing a modelling approach: Detailed discussion on modelling, and summarizes the key models used in carbon pricing analysis.
Short run drivers may compete against long run priorities in selecting the right carbon pricing instrument

In the short run, jurisdictional constraints may favor a carbon tax

Long run priorities could favor an ETS

| Policy paper outline: Provides an outline on the potential structure of a policy paper and tips for compelling communication. |
This guide provides a roadmap for jurisdictions to identify an approach to carbon pricing that is suitable to their local circumstances

- There is a global need for accelerated climate action, and carbon pricing will play a crucial role.
- Carbon pricing is flexible and plays different roles in jurisdictions’ climate strategies. It can be a valuable addition to the environmental policy mix, regardless of whether it is a supporting or main driver of emissions reduction.
- A carbon pricing instrument should be tailored to the local context: understanding the emissions profile, economic conditions, and political, institutional and capacity constraints is crucial.
- Stakeholders can provide useful insights on carbon pricing design and potential impacts. This can be complemented by modelling, which is a valuable but imperfect tool for assessing complex economic systems.
- This guide provides a roadmap and practical tools to help put jurisdictions on a path to carbon pricing that is suitable for them. This is complemented by advice on how these considerations can be distilled in a targeted and compelling policy recommendation.
Thank you