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## Global Consistency on Carbon Tax: A Role For the OECD's Inclusive Framework?



BY JEFF VANDERWOLK

The 139-member, OECD-led Inclusive Framework on base erosion and profit shifting (BEPS) is currently working on a global minimum tax for multinational corporate profits—the so-called Pillar Two component of the Inclusive Framework's project on the tax challenges of digitalization. No one knows yet what the exact outcome of the project will be, but there is no doubt that the creation of the Inclusive Framework in 2016 and its operation since then have resulted in the existence of something totally new: a global tax policy forum that has the potential to produce rapid, globally consistent changes in tax laws worldwide.

So far, the Inclusive Framework's deliberations have been focused entirely on the corporate tax rules that apply to income from cross-border business. But the range of work done by the OECD on tax policy and administration is broader, encompassing indirect taxes such as VAT/GST and taxes on carbon dioxide and other greenhouse gas emissions.

Carbon pricing is now receiving more attention due to the net-zero pledges that have been made in recent months by an ever-growing number of organizations, including national governments. In addition, at the upcoming global climate meeting in Glasgow later this year—COP26—countries' plans for reducing emissions will be under the microscope, and carbon pricing will be a prominent feature of those plans.

As the 190 national signatories of the 2015 Paris Agreement on climate change consider how to meet

their collective commitment to make large reductions in carbon emissions, they should think about using the Inclusive Framework to discuss a globally consistent approach to the use of carbon taxes. Specifically, it might make sense to look at a global minimum tax regime for carbon emissions. After all, the climate is global in nature, and unilateral national approaches or regional mechanisms for pricing carbon emissions have not been very effective.

Economists generally agree that carbon taxes have the potential to reduce harmful emissions. As observed in a recent OECD report:

["Well-designed systems of energy taxation encourage citizens and investors to favour clean over polluting energy sources. Fuel excise and carbon taxes are simple and cost-effective tools to limit climate change ..."](#)

However, carbon taxes are not currently being used to any great extent around the world. Only four of the world's 10 largest national economies—Japan, France, the U.K., and Canada—have any sort of carbon tax, apart from fuel excise taxes. The majority of the 25 countries that impose a carbon tax in some form are relatively small European economies.

Existing carbon taxes often have a very restricted scope. Spain's carbon tax, for example, applies only to fluorinated gases, covering only 3% of the country's total emissions. Moreover, the rate of existing carbon taxes is often very low. An example is Japan's carbon tax, imposed at the rate of \$3 per ton of carbon dioxide emissions. That rate is 90% lower than the OECD's low-end benchmark rate of \$30 per ton for an effective carbon price signal.

Overall, less than 5% of global greenhouse gas emissions are covered by all of the carbon taxes currently in

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existence. Or, to put it another way, more than 95% of all emissions, globally, are not currently subject to any type of carbon tax.

If the emissions-reduction goal of the Paris Agreement is to be met, this probably will have to change. One country—Canada—might be leading the way. The federal government has announced a plan to increase the price of carbon emissions, for the purposes of the carbon taxes applied in the Canadian provinces, to C\$170 (US\$136) per ton by 2030.

Emissions-trading schemes in Europe and elsewhere place a price on carbon that fluctuates according to the law of supply and demand for permits. China has recently moved to implement this method of pricing carbon on a nationwide basis. It is doubtful, however, whether this approach is as effective as carbon tax. Emissions trading or credit trading systems are based on the notion that a certain level of harmful emissions is acceptable. Although the system provides an incentive for businesses to reduce their emissions so that they can sell unused credits to others who want to emit more, in practice these systems have generally not resulted in large reductions in emissions, due to the volume of available credits. In contrast, a carbon tax that is imposed at a sufficiently high rate on a broad range of emissions incentivizes all emitters to reduce their emissions, producing a significant total reduction.

Carbon taxes should ideally be harmonized internationally, in order to preserve a level international playing field and minimize distortions in the global economy. Measures such as the EU's proposed "carbon border adjustment mechanism" are far from ideal. This proposal, which would charge a fee on imports into the EU if the carbon price paid by the foreign manufacturer was less than the price paid by EU manufacturers of the same goods under the EU Emissions Trading System, is aimed at ensuring that European businesses are not disadvantaged in their home market by European carbon pricing. It would do little to reduce carbon emissions elsewhere, and could provoke retaliatory trade measures by non-EU countries.

In a global market, a nation places its resident businesses at a disadvantage when it imposes a higher carbon price on them than the price payable by foreign competitors. For this reason, business tends to oppose carbon pricing proposals. However, a globally harmonized carbon pricing mechanism might be viewed differently. The Association of German Chambers of Industry and Commerce recently commented to the EU:

"Effective mitigation of climate change requires global solutions and coordinated action by all relevant CO2-emitting countries. However, it is doubtful whether the introduction of a carbon border adjustment mechanism would promote international cooperation in the fight against climate change and thus lead to the necessary global reduction of CO2 emissions. We recommend stepping up efforts for global CO2 pricing . . ."

As suggested earlier, this would appear to be an opportunity to use the Inclusive Framework, supported by the resources of the OECD Center for Tax Policy and Administration and in consultation with the business community and other stakeholders, to develop an effective global approach to carbon pricing.

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