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Multilateral Tax Policy Development: Why Not Consider Carbon Taxes?

Jefferson VanderWolk (Squire Patton Boggs) · Wednesday, April 14th, 2021

Later this year, the 190 countries that have signed the Paris Agreement on climate change will meet at COP 26 in Glasgow—subject to the possibility of continuing pandemic-related travel restrictions—to discuss their respective plans for reducing harmful greenhouse-gas emissions. They are collectively committed to taking action in order to limit global warming to "well below" 2 degrees Celsius over the pre-industrial temperature level. Such action is urgently needed. As economies recover from the pandemic-induced recession, a return to business as usual would be catastrophic from a climate perspective.

One tool in the emissions-reduction toolbox is carbon tax. By imposing a significant cost on activities that produce harmful emissions, carbon taxes incentivize businesses to switch to alternative processes that produce lower (or no) emissions. The revenue collected from carbon taxes can be returned to the public directly, or used for investments in environmentally friendly infrastructure, or remediation of environmental harm. The use of well-designed carbon taxes can, it seems, be an efficient way to implement an emission-reduction policy.

Yet most harmful emissions currently are untaxed. Very few large economies feature carbon taxes in their tax policy mix, and those that do have mostly kept their carbon taxes rather limited in scope and effect. Japan, for example, imposes tax on carbon dioxide emissions at the rate of $3 per ton, whereas the social cost of a ton of CO2 emissions is generally believed to be at least $50 per ton. Overall, research indicates that, even when fuel excise taxes are taken into account, the majority of global greenhouse gas emissions currently are not subject to any form of carbon tax.

Meanwhile, policymakers such as those at the European Commission are working on a different type of environmental tax, namely, a carbon border adjustment tax (or "fee" or "mechanism" if one wishes to avoid the dreaded t-word). As the name suggests, this type of tax applies with respect to imports of goods produced outside the taxing jurisdiction (in this case, the EU Member States) in order to negate any cost advantage resulting from lower carbon pricing in the producer's location. Thus, it places foreign sellers on a level playing field with EU manufacturers in the EU market. While a carbon border adjustment tax may have the desired effect of helping local businesses cope with foreign competition, it seems unlikely to cause a reduction in carbon emissions.

In the United States, President Biden recently announced a massive spending proposal covering a variety of areas, including clean energy and other environmental factors. The proposal would be paid for with income tax increases on corporations and wealthy individuals. Carbon tax is not mentioned, and apparently has not been given serious consideration as a tax policy option by the Biden Administration so far. In contrast, the Canadian federal government is pursuing a national carbon tax mandate that would ramp up to C$170 (US$136) per ton by 2030.

Sadly, even if Canada were to succeed in reducing its harmful emissions to net zero within the timeframe required by the Paris Agreement, Canadians would gain little or no protection from the damaging effects of climate change if other nations failed to make similar reductions. It seems almost too obvious to need pointing out, but the fact is that the earth's atmosphere has no regard for national borders. Every country's harmful emissions cause harm to every other country.

For this reason, the multilateralism reflected by the 190-member Paris Agreement needs to be taken further in regard to the development of specific policies to address harmful emissions. Carbon tax, in particular, could be the subject of multilateral discussions aimed at reaching agreement on a consistent, global set of rules applicable in each country. We are hearing a lot about the current effort to reach global agreement on a minimum corporate income tax for large multinational enterprises—why not a global minimum carbon tax?

The Inclusive Framework on BEPS, which was created in 2016 by the OECD and the G20 in the wake of the BEPS project, has grown to 139 member countries. Against all odds, these countries are attempting to develop global tax policy together. It is not yet certain that they will succeed in reaching agreement on corporate income taxation for large multinationals, but the mere chance of success gives hope for possible future efforts in other areas of tax policy. Environmental taxation should be the leading candidate.

The OECD Secretary-General's report to the G20 finance ministers in April 2021 included the following passage:

> G20 and OECD countries are nowhere near pricing carbon emissions at an adequate benchmark and we are running out of time. The transformative change we need can only be achieved with your leadership, as the underlying obstacles (i.e. real and perceived adverse impacts of pricing on vulnerable households and concerns about carbon leakage and on the competitiveness of businesses) can only be addressed via international coordination.

This is the right message. Let us hope that the finance ministers heard it and took it back to their colleagues who are preparing their countries' plans for the COP 26 meeting in Glasgow.

Jefferson VanderWolk is a Partner with Squire Patton Boggs (US) LLP. The opinions expressed in this article are those of the author and do not necessarily reflect the views of his firm, its clients, or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice. A longer article by the author on carbon tax from a global perspective will be published in the May 2021 issue of the *Bulletin for International Taxation*.

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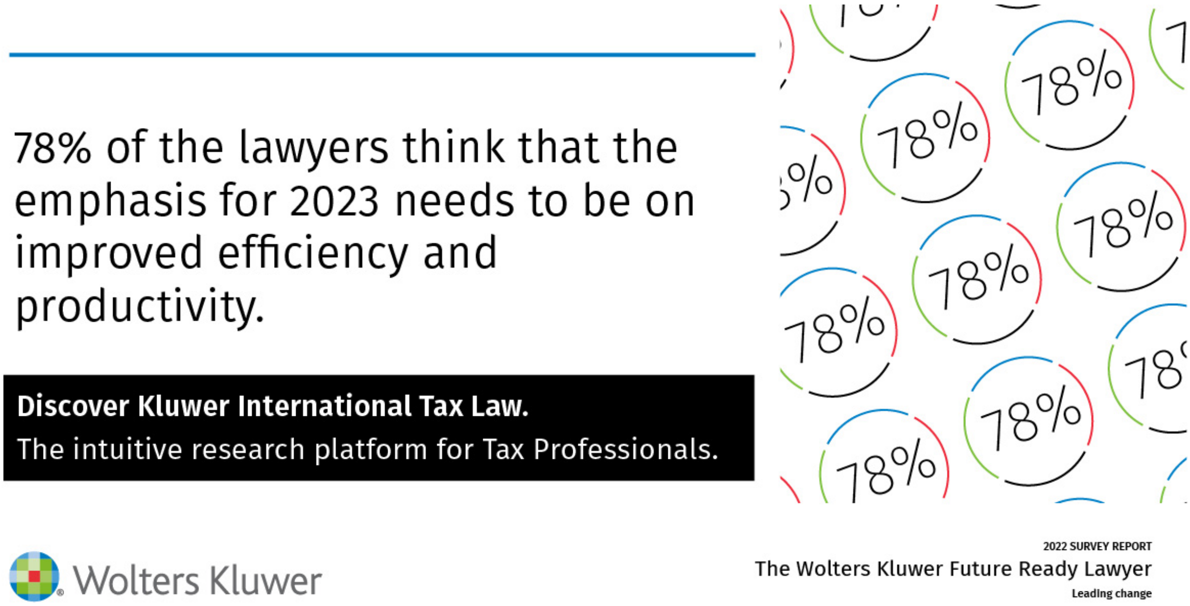

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