Unfair taxation in the name of climate action

There is a renewed focus on international public finance — the use of fiscal instruments to achieve desired cross-border public policy objectives. In the past, the conversation was about enhancing expenditure on merit goods like health and education, and on things like debt relief and universal provisioning through multilateral grants and concessional loans. The current response is different. A lot of cheap talk notwithstanding, the provision of grants and concessional finance for climate and development investments is a fraction of what is required. What is new, however, is the speed and alacrity with which rich countries are making global tax and tariff proposals to mobilise finance for climate change.

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The two proposals that have made headway are the carbon border adjustment mechanism (CBAM) and a proposed tax on carbon emissions from shipping. The CBAM is, in essence, a tariff imposed on exports of certain commodities to the European Union (EU), purportedly to equalise the cost of the difference in carbon emissions of these goods relative to if they were produced in the EU. In effect, this is a tariff barrier and is designed to nudge exporters into deploying less carbon-intensive methods of production. Now this is curious. Why not, then, just ban these imports? Simply, because the EU would then have to do without these imports — which it cannot. Which means that in the short run, this will simply generate more revenue for the EU and/or force these exporters to squeeze their profit margins and wages so as to reduce costs.

The concept is faulty on a number of counts. The economics is flawed —a tariff on an externality only alleviates it if it is imposed at the point where the externality occurs, but the tariff here is imposed at the point of sale. The data to verify such comparative emissions is contestable. The CBAM is largely imposed on raw materials, not finished goods. These are exported by countries in Africa and the European neighbourhood, which are not significant historical or present-day polluters.

The proposed tax on shipping emissions is based on the premise that shipping services are underpriced as no account is taken of their carbon emissions. The tax can reduce emissions either by reducing shipping movements or by promoting switching to alternative (though as yet non-existent) low-carbon shipping technologies.

The immediate impact of the tax will depend on the elasticity of demand for shipping. If demand is inelastic, then there will be no short term positive impact on emissions. But things that are shipped will become costlier and the incidence of this tax will be felt by the ultimate consumers of the commodities being shipped. Some things like cruises are unlikely to see a fall in demand as the price rise will be too small for the affluent who use cruise ships and luxury yachts. Other things will become costly and that cost will ultimately be borne by the final consumer, irrespective of whether they are rich or poor. The incidence is, therefore, likely to be inegalitarian.

The tax will discriminate against island states and importers of bulk traffic, including fuels, agricultural goods, and essential minerals. It will also discriminate against countries seeking to industrialise through export-led growth, by raising the cost of exports. The revenues from the tax will accrue to the top 10 shipping countries, all high-income economies, except China.

Palliative measures have been proposed, largely involving giving developing countries some of the money raised from these levies. But it is poorer countries that will bear the incidence of the shipping tax and CBAM, and will, therefore, in effect, be part-financing such transfers. The only other concrete proposal involves subsidising the transition of these countries to lower carbon technologies. But if that were done in full measure using grant finance, then there would be no need for these tariffs in the first place! And in any case, grants are not on offer, only loans, effectively yet again imposing the cost of the transition on low-income countries.

I would enthusiastically advocate for both tariffs if they added three important design elements. (1) They were to be imposed retrospectively from, say, 1850. (2) Tariffs were applied to historic and current military emissions.(3) All historic revenues from colonial shipping accrued to former colonised countries. This would only be fair as the current crisis is a direct result of cumulative historical emissions, not present emissions. Doing this would mean that countries with a high carbon footprint would pay the most for CBAM, since rich countries mainly traded with one another. It would bring huge revenue since the historic emissions by rich countries were a multiple of what they are now. Taxing historic shipping from colonies would reverse extractive drain and help the current carbon transition. Finally, Europe, Japan and the United States would acknowledge that the World Wars and other wars they fought underpriced carbon emissions, and they would pay the fair price retrospectively.

This will, of course, not happen. The rich world is neither willing to take retroactive responsibility for carbon emissions (which is very doable using international public finance) nor to provide grant and concessional finance in substantial measure to tackle the problem in contemporary times. It continues to look for ways to get emerging and developing economies to finance the carbon transition. The recent interest in international taxation serves this purpose well, which is why it is the flavour of the month at the International Monetary Fund and with rich country finance ministries and climate finance warriors.

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