Climate finance from international transport

Briefing note on the Report for G20: Mobilizing Climate Finance

by Dr Andre Stochniol

Executive Summary

A report requested by the G20 finance ministers on Mobilizing Climate Finance was completed by the invited international organization in early October (World Bank, International Monetary Fund, OECD, and the various Regional Development Banks). The report is very relevant to carbon pricing of international transport as it highlights importance of such pricing with compensation for developing countries. The report includes a comprehensive background paper on international transport by the IMF and World Bank, which makes a strong economic case for such a price given an under-taxation of international transport and low cost impact, and argues the need for compensation to developing countries based on equity, including by referencing the Rebate Mechanism.

However, the communiqué from the G20 summit in Cannes on 3-4 Nov 2011 stopped short of proposing a way forward on carbon pricing for international transport. Yet, given the discussion of carbon pricing of international transport at the highest levels, its prominence in the Report for G20, and additional endorsement in a report to the G20 by Bill Gates, a progress in the area is possible at the UNFCCC COP 17 in Durban, and should be supported.

This short briefing note was prepared Dr Andre Stochniol (andre@imers.org) to quickly introduce the relevant points from the Report to certain negotiators at Durban.

Report for G20 on Mobilizing Climate Finance

This briefing note summarizes the recommendations relevant to international transport from the report requested by the G20 Finance Ministers entitled Mobilizing Climate Finance (Report). The Report was prepared by a group of international organizations comprising World Bank, International Monetary Fund (IMF), Organization of Economic Cooperation and Development (OECD) and the various Regional Development Banks (RDBs), and was completed in early October.[1]

The Report provides a technical analysis of the range of options available to countries, the selection and combination of which they will need to consider in the light of their national circumstances. Specially prepared background papers include detailed analysis, including a comprehensive paper on international transport by the IMF and World Bank.[2] This paper makes a strong economic case for such a price given an under-taxation of international transport and low cost impact, and argues the need for compensation to developing countries based on equity, including by referencing the Rebate Mechanism.

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[1] The Report is available at: http://www.imf.org/external/np/g20/pdf/110411c.pdf.

[2] The background paper on international transport is entitled "Market Based Instruments for International Aviation and Shipping as a Source of Climate Finance" and is available at: http://www.imf.org/external/np/g20/pdf/110411a.pdf. All background papers are available at: http://www.g20-g8.com/g8-g20/root/bank_objects/Climate_Finance_Report_Annexes.zip
(as a compressed file with 6 Annexes; Annex 2 is on international transport, as above).

The Report recognizes that mobilizing climate financing is made more challenging by the present difficult economic conditions in the developed world – the most severe in over seventy years – and by growing fiscal pressures in many developed countries. In this environment, the Report highlights the reform of fossil fuel subsidies in developed countries, domestic carbon pricing, and market based instruments (MBIs) for fuels used in international aviation and shipping as sources of public finance. The Report recognizes that efforts to expand pooled financing arrangements can yield substantial results in the near term when harnessed with efforts to engage with and leverage private investment.

The analysis of the MBIs for international transport (i.e. a carbon price on international aviation and maritime transport) is comprehensive. The Report justifies such carbon price by reviewing tax regimes for these sectors. It points out that these sectors are currently taxed relatively lightly from an environmental perspective: unlike domestic transportation fuels, they are subject to no excise tax that can reflect environmental damages in fuel prices. These sectors also receive favorable treatment from the broader fiscal system (in short, these carefully worded phrases are effectively saying that these sectors are simply tax-exempt or under-taxed when compared with the other modes of transport).

Looking at the impact, the Report points out that even though the overall burden of carbon pricing of international transport is likely to be small, there may be a need to provide adequate assurance of no net incidence on developing countries by providing compensation (it provides estimates that a charge of $25 per ton of CO2 might raise average air ticket prices by around 2-4 percent and the price of most seaborne imports by around 0.2-0.3 percent). Practicable compensation schemes require some verifiable proxy for the economic impact as a key for compensation, and the Report concludes that enough has been done to give confidence that good proxies can be found (reasonably accurate and acceptably verifiable). In short, it endorses the feasibility of compensation through a predetermined key, and finds that combining a global charge with targeted compensation provides an effective and feasible way to pursue efficiency and equity objectives.

For implementation, the Report points out that fuel take-up provides a good initial basis in aviation, and that simple trade values may have a role in the maritime sector. The compensation based on fuel-take up can only apply to aviation and could more than compensate the developing countries: that is, they might be made better off by participating in such an international regime even prior to receiving any climate finance (given that most of the additional costs would be likely be borne by passengers from other, wealthier countries). For the maritime carbon price, compensation could be based on country share in global trade, and the report cites the Rebate Mechanism.[3] The background report prepared by the IMF and World provides in-depth analysis of such compensation, including further details on the Rebate Mechanism.

The Report also quantifies benefits of implementing carbon price on international transport, assuming compensation for developing countries. It states (paragraph 31) that:

"A globally implemented carbon charge of $25 per ton of CO2 on fuel used could raise around $12 billion from international aviation and around $25 billion from international maritime transport annually in 2020, while reducing CO2 emissions from each industry by perhaps 5 percent, mainly by reducing fuel demand. Compensating developing countries for the economic harm they might suffer from such charges – ensuring that they bear 'no net incidence' – is widely recognized as critical to their acceptability […]. Such compensation seems unlikely to require more than 40 percent of global revenues. This would leave about $22 billion or more for climate finance or other uses".

[3] The rebate mechanism proposed at the IMO by the International Union for Consevation of Nature (IUCN, 2010) proposes to use share of imports. Stochniol (2011a) provides country-specific estimates of the compensation implied by this scheme based on a country's share of imports by sea and air. For instance, Ethiopia's annual rebate would be $6 million for total cost of carbon pricing of international maritime transport of $10 billion (i.e. 0.06 percent of $10 billion). The rebate and attribution keys for all countries have been submitted to the IMO in WWF (2011).

The Report also is clear that a carbon price can be implemented initially in one sector, but prefers a simultaneous implementation in aviation and shipping, which may even enable a single compensation scheme for developing countries.

It recognizes that extensive cooperation in designing and implementing international transportation fuel charges (either taxes or auctioned permits) would be needed—especially for maritime transport—to avoid revenue erosion and competitive distortions. However, it points out that the various detailed proposals being considered by the IMO suggest that practical issues can be resolved, irrespective of which specific MBI instrument is chosen.

Regarding national versus international implementation, the report suggests that "various approaches may be selected for different sectors. For example, national governments might be responsible for implementing aviation fuel charges or trading schemes on companies distributing fuel to airlines or ships. All revenue-raising MBI proposals being considered by IMO, on the other hand, assume a global charge or ETS: operators might then be required to make electronic transfers to an international fund. In such a case, flexibility might be needed to accommodate various national circumstances by, for example, allowing certain countries to opt for national collection that is linked to an international approach. On the other hand, tax collection from ships of other nations may be possible only in a regime established under an international treaty instrument."

The report also elaborates on efficiency of carbon pricing instruments, noting that if regional emissions trading programs develop for international transportation (e.g., in the European Union) giving away free allowances is especially problematic. Not only does this forgo revenue, it provides windfall profits for covered airlines or ships that would likely increase resistance to the introduction of fuel charges in other countries.

Overall, the Report recommends development of MBIs for fuels used in international shipping and aviation (with compensation for developing countries):

"While implementation details need further study, especially in terms of governance, it is clear that feasible operational proposals for pricing international aviation and maritime emissions can be developed."

Conclusions

The report for G20 on Mobilizing Climate Finance by the World Bank-IMF-OECD-RDBs provides important technical analysis and endorsement for carbon pricing of international transport with no net incidence on developing countries. The Report will likely feed into a multilateral program in 2012 on sources of long term finance, including within the IMO and ICAO.

Thus, progress on emission reductions and financing from international transport at the UNFCCC COP 17 in Durban is possible, but the complexities of the issues involved cannot be underestimated and further work is needed.

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