Scaling up carbon pricing for inclusive and effective climate action

Carbon Market Watch input for the Talanoa Dialogue

Question 1: Where are we now?

Polluting is too cheap

Our societies have grown immensely and rapidly over the past two centuries. This economic development has been fueled by the production of more material goods than what the earth could sustain, leading to an explosive increase in both living standards and natural resource exploitation, and has polluted our air.

It has also intensified the climate crisis through a failure to correctly measure and account for the societal costs of human activities: Cleaning up after an oil spill is shown in the books as growth in economic output, while the societal costs of pollution are not measured at all.

The big emitters currently get a free pass to pollute, while the society at large, and disproportionately the most vulnerable groups such as women, national minorities and indigenous communities in lower-income countries, carry the largest burden of global warming.

This accounting error can be corrected by implementing the polluters-pay principle. Putting an effective price on pollution can ensure that the societal impacts of greenhouse gas emissions on current and future generations are incorporated ('internalised') in the prices of goods, and thereby incentivise behavioral change. Revenues generated by carbon pricing can flow back to the most vulnerable groups that are negatively affected by climate change.

Pricing pollution is hence an important tool to put us on a path to meet the Paris climate goals. At this moment, however, only 0.3% of emissions are taxed at or above €30/tCO2, which is a very conservative estimate of climate costs according to the OECD 'Taxing Energy Use 2018' report. Only 6% of emissions are taxed at all. The international transport sector (aviation and shipping) is exempt from almost all forms of energy taxes and the worst climate offender, coal, is taxed at or near zero in most countries.

Lack of public engagement and the influence of powerful interest groups lobbying to keep carbon prices at ineffective levels are among the obstacles in the way towards putting an effective price on pollution.

Question 2: Where do we want to go?

Climate-safe carbon pricing

Those who pollute the most should no longer benefit from unfair subsidies, as carbon prices reach levels which allow for a large-scale societal transition. Putting a meaningful price on carbon enables investors, producers and consumers to incorporate the societal cost of pollution in their decision making and shift away from fossil fuels.

Carbon pricing can make coal financially unviable and thereby speed up the retirement of coal plants, as well as incentivise behaviour change, such as shifting from flying to more climate friendly transport modes. It can support innovation and ensure that the low-carbon business models of innovative SMEs can gain a financial advantage over their high-carbon competitors. Carbon pricing can moreover mobilise significant financial resources to support vulnerable groups in the transition to carbon-free societies.

But for carbon prices to play this role, polluting cannot be as cheap as it is today.

It is very difficult to put an accurate price tag on all the damage that climate change causes, including biodiversity loss, ocean acidification, sea level rise, drought, famine, spread of tropical diseases, extreme weather events, political instability as well as other yet unforeseen effects.

The High-Level Commission on Carbon Prices found that a price in the order of at least USD 40-80/tCO2 and USD 50-100/tCO2 by 2030 is needed to achieve the Paris climate goals. These prices are significantly above the current carbon prices in most jurisdictions around the world. Pricing carbon at such levels will require more effective taxation, carbon markets with caps that decline in line with a 1.5C compatible pathway and the introduction of minimum carbon prices in cap-and-trade systems.

There are also other issues to consider beyond the price level. Implementing a carbon price should be done as part of a portfolio of measures to address various barriers. Other counterproductive policy measures need to be avoided and abolished in order to not undermine the effectiveness of the carbon pricing measure. These include fossil fuel subsidies, free allocation of emission permits, tax exemptions, rebates and the use of carbon offsets.

The debate on the transition to carbon-free societies, including on who pays for the transition, moreover needs to be inclusive and involve all parties in the society. Carbon pricing schemes, as all other policies, need to be developed not only *for*, but also *with* the people. Only then can there be a fair counterbalance to the lobby of high-emitting industry.

Question 3: How do we get there?

Inclusive dialogue involving society at large

Paying the full price of the social costs of our activities and products is an important step towards halting the accumulation of our climate debt and taking responsibility for the external damages we create through our consumption. But both carbon price levels and coverage are far below what is required to limit global warming to well below 2C, let alone 1.5C.

A main barrier is the disproportionate influence of high-emitting corporate interests in the design of carbon pricing instruments around the world. Incumbents are generally reluctant to change their profitable, but highly polluting, business models.

In order to make climate-safe and fair carbon pricing a reality, we need an inclusive process, which involves all stakeholders in an open debate about the lessons which can be drawn from past and present initiatives, and how to move forward. The aggregation of voices from small innovators, civil society, cities, investors, the general public and academics, will provide a valuable addition to large industry players who are currently leading the discourse and setting the political agenda.

The mobilisation of voices across the society allows policymakers to make their decisions with broader societal interests in mind. Such increased cooperation between actors at all levels of the society can lead to broader support for, and ultimately, the adoption of, climate-safe carbon pricing where the resulting financial resources are used to support the just transition of affected communities.

A more open discussion on carbon prices must also give more space to diverse arguments that go beyond the oft-repeated threat to competitiveness and include the concerns and views of society at large. A narrow-minded focus on the costs of climate policy, or its effects on competitiveness of incumbents, can no longer be the dominant theme of our debates if we are to avoid the impacts of catastrophic climate change in this century.