

Policy tool



#10

**Internal taxation
and carbon pricing**

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Reduce policy fragmentation and compliance costs by improving coordination of climate-related, non-discriminatory internal taxes, including carbon pricing and equivalent policies.

#10 Internal taxation and carbon pricing



What are internal taxes and carbon pricing?

Governments adopt internal taxes and other “pricing” tools for a variety of policy objectives, including revenue generation (e.g. value-added taxes) or to put a price on negative externalities. “Carbon pricing” – generally understood as the price paid by economic actors per tonne of CO₂-equivalent¹⁹ emitted, is one of the policy instruments often used to mitigate climate change. Carbon pricing can take different forms, the most common of which are excise taxes on carbon-intensive goods (known as implicit carbon pricing), direct carbon taxes or emission trading schemes (known as explicit carbon pricing).²⁰

How can internal taxes and carbon pricing help mitigate climate change and why is coordination important?

While the design and reform of internal taxation may raise a series of important political, social and economic considerations, carbon pricing is often considered as a key policy option available for tackling climate change ([Carbon Pricing Leadership Coalition, 2022](#)).²¹ Carbon pricing can be an effective policy as it provides an economic signal to emitters which incentivizes shifts in consumption and investment patterns, resulting in lower emissions. It also enables economies to specialize according to their comparative advantage in producing low-carbon goods, contributing to climate change mitigation ([Le Moigne, 2023](#)).

Governments have increasingly used internal taxation tools, therefore, to achieve climate-related objectives (see box). Two thirds of all NDCs submitted under the Paris Agreement consider the use of [carbon pricing to achieve emission reduction targets](#). This means that more than 100 economies can potentially look into carbon pricing as a way to reduce their GHG emissions through emission trading schemes, carbon taxes and other approaches.

WTO members' experiences with using internal taxes to achieve climate objectives

The [WTO EDB](#) shows that at least 57 WTO members from all regions and levels of economic development have used internal taxes for environmental purposes.

In the Trade Policy Reviews (TPRs) of these economies since 2009, 109 examples of internal taxation schemes adopted for climate-related objectives can be found, mostly concerning the energy sector (61), followed by manufacturing (28) and chemicals sectors (10). About 50 per cent of such schemes are found in TPRs conducted in 2021 and 2022, the latest years available.

Examples include:

- New Zealand's charges of a synthetic GHG levy on goods containing hydrofluorocarbons (HFCs) and perfluorocarbons (PFCs) under the Climate Change Response Act (2022);
- Argentina's tax on CO₂ emissions incorporated in 2017 into its domestic fuel tax (2021);
- Viet Nam's imposition of a decreasing excise tax on conventional combustion, hybrid or electric motor vehicles as well as an “environmental protection tax” on petroleum, coal, plastic bags, and various pesticides and herbicides (2021);
- the introduction by Mauritius of new excise duties for energy inefficient household appliances, washing machines, and electric lamps (2021);
- Zimbabwe's imposition of internal taxes on fuel, encompassing a strategic reserve levy, a debt redemption levy and a carbon tax (2020); and
- a charge levied by Switzerland and Liechtenstein per additional gramme of CO₂/km on motor vehicles whose CO₂ emissions are above the target limit for the type of vehicle (2022).

However, there is also significant fragmentation of carbon pricing policies. A patchwork of over 70 different carbon pricing schemes already exists globally but they cover only 23 per cent of total emissions. Carbon prices vary widely across the globe, from less than USD 1 to more than USD 130 per tonne of CO₂ emitted, according to the [World Bank's Carbon Pricing Dashboard](#). This fragmentation can lead to additional administrative and compliance costs for exporters, especially micro, small and medium enterprises, while increased coordination could significantly reduce the overall costs of achieving the Paris Agreement goals ([WTO, 2022g](#)).

Furthermore, to address potential carbon leakage and competitiveness concerns arising from variations in the level of carbon prices, economies are increasingly considering the introduction of border measures, such as border carbon adjustments. Unless effectively managed and coordinated, the situation could escalate into trade tensions, which could adversely affect overall well-being and undermine the beneficial role of trade in fighting climate change through a range of channels, such as the diffusion of green technologies ([WTO, 2022g](#)).

What could be done to enhance coordination of internal taxes, carbon pricing and equivalent policies and align them with wider climate action policy plans?

The coordination of internal taxes, including carbon pricing, can be achieved through various international platforms. In the context of the [first Global Stocktake taking place during COP28](#), where parties and stakeholders assess their progress in achieving the Paris Agreement goals, governments have a key opportunity to review their domestic policies and align internal taxes²² and carbon pricing instruments with their wider climate action plans.

International cooperation is especially important in addressing the challenges associated with carbon pricing because divergent interests and policy approaches exist among economies, with some governments prioritizing alternative policies such as regulations mandating reductions in GHG emissions, subsidies in support of low-carbon technologies and public low-carbon infrastructure programmes.

By facilitating exchange of best practices and sharing administrative costs among economies, international cooperation can contribute to improving the efficiency of carbon pricing schemes and reducing their administrative costs ([Mehling, Metcalf and Stavins, 2019](#)). Cooperation and coordination among economies

on carbon pricing can also pre-empt trade tensions and accusations of protectionism in relation to carbon pricing policies, and ensure all views and concerns, including those of developing economies, are taken into account in discussions on carbon pricing approaches.

Different approaches have been proposed. For example, an international carbon price floor system would set differentiated minimum international carbon prices according to economies' different levels of economic development, with a higher international carbon price floor for high-income economies and a lower one for low-income economies ([Parry, Black and Roaf, 2021](#)). Another possible approach is based on a model framework in which different domestic or regional carbon prices could be determined by a dynamic formula based on various criteria, such as historical emissions, level of development, and economic costs of climate change. Coupled with a moderate share of carbon pricing revenues allocated to support lower-income economies, this approach would be sufficient to keep emissions on a 1.5-2 degrees Celsius rise in global warming trajectory compared with the pre-industrial period, in line with the Paris Agreement objectives, and allow economies to realize an equivalent reduction of carbon emissions employing other policy instruments such as regulations or subsidies (Bekkers *et al*, 2023).²³

Finally, the [Inclusive Forum on Carbon Mitigation Approaches](#), an initiative hosted by the OECD, has been convening governments and stakeholders since February 2023 to take stock of and consider the effectiveness of different carbon mitigation approaches, including carbon pricing, regulations and support measures. Relevant discussions also take place under the [Forum on the Impact of Response Measures of the United Nations Framework Convention on Climate Change](#). At the WTO, discussions on carbon pricing and equivalent initiatives have been taking place in the CTE and the Trade and Environmental Sustainability Structured Discussions.²⁴