CARBON TAXES: AN INQUIRY INTO THEIR IMPACTS ON COMPETITIVENESS AND DISTRIBUTION OF INCOME

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ABSTRACT

Climate change has been identified as one of the greatest economic and political challenges facing the world economy this century. The immensity of this challenge is in part due to reconciling the global nature of the problem with the need for action at the sub-global level, whether regional, national and/or local. This problem of collective action is an inherently geographical challenge. It requires coordinating action globally amongst a highly differentiated political, economic and social landscape. The Kyoto Protocol to the United Nations Framework Convention on Climate Change (UNFCCC) has set legally binding emissions targets for a basket of six greenhouse gases and timetables for industrialized countries. It has also incorporated three international flexibility mechanisms. However, the Articles defining the flexibility mechanisms carry wording that their use must be supplemental to domestic actions. This has led to the open debates on interpretations of these supplementary provisions. Such debates ended at the resumed sixth Conference of the Parties (COP) to the UNFCCC, held in Bonn, July 2001, and at the subsequent COP-7 in Marrakesh, November 2001. The final wording in the Bonn Agreement, reaffirmed in the Marrakesh Accords, at least indicates that domestic policies will have an important role to play in meeting Annex B countries’ emissions commitments.

A carbon tax is an environmental tax that is levied on the carbon content of fuels. A carbon tax can be implemented by taxing the burning of fossil fuels—coal, petroleum products such as gasoline and aviation fuel, and natural gas—in proportion to their carbon content. Accordingly, a carbon tax increases the competitiveness of non-carbon technologies compared to the traditional burning of fossil fuels, thus helping to protect the environment while raising revenues. Carbon taxes have long been advocated because of their cost-effectiveness in achieving a given emissions
In this paper, the main economic impacts of carbon taxes are assessed. Based on a review of empirical studies on existing carbon/energy taxes, it is concluded that competitive losses and distributive impacts are generally not significant and definitely less than often perceived. However, given the ultimate objective of the Framework Convention, future carbon taxes could have higher rates than those already imposed and thus the resulting economic impacts could be more acute. In this context, it has been shown that how to use the generated fiscal revenues will be of fundamental importance in determining the final economic impacts of carbon taxes. Finally, we briefly discuss carbon taxes in combination with other domestic and international instruments.

**KEYWORDS:** Carbon taxes, emissions tax, energy tax, fossil fuels, climate change, Kyoto Protocol, COP, CHG, CO₂.