Carbon pricing means many things to many people: emissions trading, carbon taxes, eliminating fossil fuel subsidies, introducing “green” subsidies, or assessing the social cost of carbon. For IETA, this interest in instilling economic value in emissions reductions is essential for meeting the Paris Agreement’s objectives.

As countries implement their Nationally Determined Contributions under the Paris Agreement, IETA will respond to a variety of pricing proposals. As an example, this year a group of former Republican officials in the United States formed a Climate Leadership Council, offering a strong case for the Republican party to take the risks of climate change seriously by adopting climate policies. It proposed a carbon tax-and-dividend solution, combined with border tax adjustments to deal with competitiveness concerns. We applauded the group’s call for action, but we urged that the policy proposal should be improved with market flexibilities.

Last year, we led IETA’s governing Council in a review of our organisational vision in light of the broader movements towards pricing carbon around the world. We reviewed the state of play in national policies, and we held a “tax vs trade” debate and discussion with IETA Members at our 2016 Annual General Meeting. These discussions led the Council to make several key findings to help guide our work on carbon pricing policies globally.

**FINDING #1**
**EMISSIONS TRADING REMAINS THE STRONGEST PERFORMING POLICY IN ASSURING ENVIRONMENTAL AND ECONOMIC PERFORMANCE.**

The advantages of emissions trading are clear:
- ensures emissions reduction certainty, but allows freedom for companies to choose how to comply;
- achieves measurable emission reductions at least-cost;
- enables cross-border programme linkages, cooperation and partnerships;
- responds to macro-economic fluctuations;
- drives economically-rational, low-carbon innovation solutions;
- supports businesses and households in the transition to a low-carbon economy;
- addresses industry competitiveness and “carbon leakage” concerns; and
- provides a global response to a global challenge.

These factors are prompting the largest jurisdictions – China and Korea, parts of the United States and Canada, and the European Union – to use carbon market solutions to meet their Paris goals.

**FINDING #2**
**SIZE, SCOPE AND LINKAGES OFFER MARKET ADVANTAGES IN PURSUIT OF THE PARIS GOALS.**

Emissions trading works best when it covers a wide range of sources, sinks and offsetting opportunities so that a vibrant market can develop to deliver the best solutions. This “wide range” derives from simple economic realities related to the many differing costs of abatement across different sectors.

The economic benefit of this wide coverage is why we encourage regional or national systems to link with one another. The least-cost abatement opportunities may shift from one location to another as the international community struggles to meet the 2°C temperature objective. An international trading market can tap into these shifts, driving important economic benefits over the long term.

Carbon tax systems do not typically offer the same wide coverage or opportunity for linkages to secure low-cost abatement. This could present challenges to the tax model, as tougher targets are pursued in the future.

**FINDING #3**
**QUALITY DATA IS ESSENTIAL TO CARBON PRICING OF ANY FORM.**

Any form of carbon pricing requires effective governance, including monitoring, reporting and verification of emissions data to ensure compliance. The public deserves transparency in how any pricing system performs. As we observe systems in operation, the assurance of performance data is critical to the success of both tax and trading models.

In business strategy, pricing information offers visibility on the cost of emissions in the near term, helping enlighten the long-term decarbonisation pathway.

**FINDING #4**
**THE CHOICE OF PRICING INSTRUMENT IS Driven BY THE POLICY CONTEXT IN A GIVEn JURISDICTION.**

In the initial national responses to the Paris Agreement, both tax and trade models will face challenges. Some jurisdictions may not have the right conditions for a full blown cap-and-trade system, and others may struggle to adopt meaningful carbon taxes. For example, some of those interested in emissions trading may have:
- only a few sources, sinks or companies,
- making market liquidity appear to be inadequate – so without another jurisdiction as a trading partner, a tax might be similarly efficient;
The various design features for tax and trade models present a spectrum of choices and a range of hybrid systems.

Carbon trading programmes can be designed to allocate permits directly to participants and raise no revenue, or they can be designed to raise significant revenues through the use of permit auctions. There are also many hybrid solutions, with a blend of direct allocation and auctioning – though these systems can also become complex.

Similarly, carbon tax programmes can be used to raise revenue, or they can be introduced in a “revenue neutral” manner by making reductions in other taxes to produce no new revenue – or with “revenue recycling” features, to redirect funds to reinforce climate priorities.

However, when revenue is raised in a carbon tax or trading system, there is potential for complexity in how revenue is used – and there is potential for revenue to be diverted for non-climate purposes.

**FINDING #6**

FOR BUSINESS TO MANAGE THE TRANSITION TO A LOW-CARBON ECONOMY, IT IS IMPORTANT FOR EITHER A TAX OR TRADING SYSTEM TO OFFER FLEXIBILITY TO CONTROL COSTS.

Emissions trading programmes can be developed with large amounts of flexibility to keep costs in check, such as the use of offsets and unrestricted amounts of trading. Alternatively, they can be developed with less flexibility, such as with restrictions on the use of offsets or on ownership of allowances.

Carbon tax programmes can also contain flexibility features, such as tax exemptions, graduated rates, tax credits for certain investments and use of offsets.

**THE JOURNEY AHEAD**

Climate protection is a long journey for governments, companies and citizens. Carbon pricing offers economic advantages to nations that use them well. For success, the political and economic context matters – and the design elements must fit that context.

The advantages of the main pricing choices are simple. Carbon trading programmes offer better environmental certainty than carbon taxes. But carbon taxes offer better cost certainty. A hybrid system can offer some of both by setting upper and lower price bounds for permit auctions to provide more cost certainty while allowing flexibility to trade.

The context for carbon trading or taxes will vary by jurisdiction over time. Some may begin with a tax approach – but find a linked trading system to be more attractive in the future, as the context changes and levels of reduction become more challenging.

We have much to learn from each other on this journey. We share a hope for achieving our climate goals with economic efficiency, and a vision for business to offer innovation, growth and prosperity in a low carbon future.

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**FIVE IETA PRINCIPLES TO GUIDE POSITIONS IN CARBON PRICING DEBATES:**

1. We encourage carbon pricing of many forms, but our primary focus will continue to be on emissions trading because of its environmental assurance and economic advantages.
2. We believe that carbon trading is the best form of pricing, because markets are better than governments in finding the right price – and in offering flexibility to control costs and maintain competitiveness.
3. This means that carbon trading should be implemented in a “free market” manner that instills good incentives for market participants to reduce emissions in order to achieve the long-term objective.
4. If a jurisdiction finds that an emissions trading programme is too challenging to develop, implement and enforce, then a carbon tax may be an appropriate alternative. When carbon taxes emerge
   as a favoured approach, we will support development of hybrid systems that include measures to keep costs in check, maintain competitiveness, and predictability and stability of the rules.
5. We do not have time to waste in addressing climate change. The most important thing is for policymakers to get started in implementing an effective pricing programme with a strategy to step-up efforts over time.