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## FOR AN EQUITABLE AND GLOBAL REDUCTION OF FOSSIL EMISSIONS

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In an article published on 31 May 2021 ([A Global Incentive to Reduce Emissions](#)), Raghuram Rajan, former Governor of the Reserve Bank of India, seeks to address the global problem of reducing carbon dioxide emissions - the cause of climate change – with a proposal that is both efficient and equitable.

Rajan acknowledges that the best way to control emissions, according to economists, is to impose a price on fossil fuels that produce CO<sub>2</sub>, but he thinks that this solution will cause “disruptive economic changes in the short run”, which makes it difficult to reach a global agreement. Instead, he argues that we need to introduce a system of incentives and disincentives to achieve the agreed reduction in the level of emissions (e.g. to an extent that ensures that the temperature increase does not exceed 2 degrees Celsius, and comes close to a 1.5 degree rise, as envisaged by the Paris Agreement), whilst also ensuring equity in the distribution of sacrifices.

Rajan raises the issue of the need to ensure a fair distribution of effort (*optimal burden sharing*) to achieve the target. This is necessary for two reasons: on the one hand, because climate risk reduction is a global public good, some countries fear that others will act like free riders, enjoying the benefits without bearing the costs of action to eliminate CO<sub>2</sub> emissions. On the other hand, economically less developed countries highlight the unfairness of requiring the same effort from countries that emit large amounts of carbon dioxide and from those that emit much less, given their lower level of development.

The most sensible solution to this dilemma is to reach a multilateral agreement that imposes an emissions reduction policy on all countries, but at the same time ensures adequate financial support for the least developed countries. Towards this end, Rajan puts forward a proposal to introduce “a global carbon incentive (GCI)”, whereby “every country that emits more than the global average of around five tons per capita would pay annually into a global incentive fund, with the amount calculated by multiplying the excess emissions per capita by the population and the GCI. If the GCI started at \$10 per ton, the US would pay around \$36 billion, and Saudi Arabia would pay \$4.6 billion. Meanwhile, countries below the global per capita average would receive a commensurate pay-out (Uganda, for example, would receive around \$2.1 billion).”

In this scenario, the free-rider problem would no longer exist. Countries such as Uganda would benefit from initiating an emissions reduction policy and, at the same time, a fund could be financed to distribute incentives to the economically less developed countries. As Rajan explains: “if the GCI is raised over time, the collective sums paid out would approach the [\\$100 billion per year](#) that rich countries promised to poor countries at COP15 in 2009.”

Finally, Rajan correctly points out that, when estimating the emissions of each country, the amount of emissions related to the consumption of fossil fuels used in the production process of imported goods must also be included (and the same amount must be subtracted when estimating the emissions of exporting countries).



Rajan's proposal contributes to the growing awareness that a global initiative is needed to deal effectively with global problems. It follows the proposals of the new US administration for a global minimum tax, which marks a turning point towards ensuring a fair distribution of the tax burden on multinational corporations (coupled with the use of these resources for a recovery of the welfare system and public investment in the US). From this point of view, it is a sound idea to finance a global fund of 100 billion dollars to support the weakest countries in the fight against climate change, based on the excess of emissions compared to an average standard set at a global level. This constitutes an important first step towards developing a system of financing global public goods that realises a progressive principle in the distribution of burdens.

Whilst this proposal is welcome, it is not enough. Although the proposal to distribute resources to the weakest countries with incentives financed by the richest, highest emitting countries is ethically and politically correct, it cannot guarantee the achievement of carbon neutrality by the middle of this century. The funds would be distributed to governments, who in turn would have to put in place the necessary policies to ensure the energy-saving and fuel-switching processes that would lead to effective emissions reduction. The most efficient way to achieve this objective is to introduce a carbon price, and the European Union can play a decisive role in completing the carbon pricing process: on the one hand, with an extension to all sectors of the ETS (Emissions Trading System) or similar mechanisms that ensure the payment of a price by those who use fossil fuels and, on the other hand, with the introduction of a border carbon adjustment mechanism to charge a carbon price on imported goods from countries that have not yet introduced it. Revenues from a carbon price will then have to be used to support the production of renewable energies, but above all to ensure that the ecological transition is accompanied by equity measures, which reduce the burden of taxation on the weakest income groups.

This border tax adjustment mechanism could be the lever to initiate a global policy of setting a price on the carbon contained in fossil fuels, as exporting countries would not be able to enjoy a competitive advantage over European companies burdened by the carbon price imposed by the EU and, at the same time, they would not be able to enjoy a tax revenue – corresponding to the carbon price – which would instead go to the coffers of the EU. This would be a carrot and stick approach, with the stick being the imposition of a compensatory duty at the border, and the carrot being the fund proposed by Rajan to compensate the economically weaker countries and thus guarantee a fair distribution of the overall burden of the CO<sub>2</sub> emissions reduction policy. Accompanied by a multilateral setting of a minimum price for fossil fuels, to prevent investments in renewable energy from being jeopardised by a dumping policy implemented by fossil fuel producing countries, Rajan's idea of a common incentive fund combined with the introduction of a generalised carbon price may represent the optimal policy mix to effectively and fairly combat the risks of climate change.

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(The opinions expressed here do not necessarily represent the CSF)

