The Climate Damages Tax

A guide to what it is and how it works

Executive Summary

Introduction

There is a price for heating up the planet. Currently it is borne to a vast extent by the populations affected by ever-intensifying climate impacts. To date, the fossil fuel producers have gotten away with not paying. Yet their products are the root cause of the crisis. The Climate Damages Tax (CDT) proposal, underpinned by the Polluter Pays principle, makes the case that it is high time for the producers to bear a substantial proportion of the costs for losses and damages that result from the burning of fossil fuels. At the heart of the CDT proposition is the demand for redistributive justice. Those with the greatest historical responsibility for causing climate change, now need to pay for its consequences. At the UN conference, COP27, in November 2022, the demands of loss and damage-impacted communities were finally recognised in the historic agreement to establish a Loss and Damage Fund (LDF). This was followed in quick succession by the landmark agreement to operationalise the Fund at COP28. It is our contention that developed countries can raise a considerable part of the amount that needs to be contributed to the LDF by greater taxation of the fossil fuel industry through measures such as the CDT.

Loss and Damage

By way of example, we consider the devastating floods in Pakistan in 2022, which were attributed to human-induced climate change. These floods resulted in significant loss and damage, with estimated damages exceeding $14.9 billion[1] and economic losses of $15.2 billion. The floods affected 33 million people, caused over 1,700 deaths, and had a disproportionate impact on the poorest and most vulnerable districts. In response, Pakistan launched a pledging drive, but 90% of the funds raised were in the form of loans, increasing the economic burden on the country at the worst possible time. Had the LDF been in existence and sufficiently funded, Pakistan could have applied for no-cost funds for the reconstruction and recovery of their severely impacted communities in a timely manner with a considerably better qualitative outcome for much of the population.

The Fossil Fuel industry

A significant proportion of global emissions can be attributed to a relatively small number of fossil fuel producers. From 1988 onwards, over half of the global industrial greenhouse gases (GHGs) can be traced back to just 25 corporate and state-owned producers.[2] However, the negative externalities of their operations, the warming of the world and the losses and damages that have ensued from the greater intensity and regularity of, for instance, fast onset climatic events, has not been factored into their costs. Countries and citizens have been left to pick up the pieces at their own expense. That has to change.

The profits of oil and gas companies have surged over the recent period, largely because of the Russian invasion of Ukraine, reaching an unprecedented $4 trillion in 2022.[3] The response of many countries to these excessive profits has been to introduce windfall taxes on the fossil fuel companies. Is it such a stretch then to ask governments to go further than one-off taxes and increase the tax burden on the industry as a whole on an annual basis? By any reasonable measure, recent levels of profits have been excessive, as are the remunerations of the CEOs of companies such as ExxonMobil, Chevron, BP and Shell.[4] With such broad shoulders, the industry can clearly afford to pay a far greater amount in taxation. For reasons, therefore, of historical responsibility, culpability for the present state-of-affairs and capability to pay, there is a strong moral and economic case for why levying greater taxation on the fossil fuel sector should be enacted at the earliest possible time.

The Climate Damages Tax proposal

The Climate Damages Tax (CDT) is a fee on the extraction of each tonne of coal, barrel of oil, or cubic metre of gas, calculated at a consistent rate based on how much CO_2e is embedded within the fossil fuel. Working with existing systems of payment, fossil fuel companies, who already pay royalties (or similar) to the states where they operate, will pay an extra amount on the volume they extract to the Loss and Damage Fund.[5] We propose that the substantial additional revenue raised is allocated in two ways. Firstly, to assist OECD countries, in particular – who under the principle of Common but Differentiated

Responsibilities and Respective Capabilities (CBDR-RC) are seen as most able to provide finance to the LDF – to help pay for their contributions, without unfairly costing their citizens. Secondly, it will generate a significant domestic dividend that can be channelled to climate action nationally, helping to pay for the necessary support for workers and communities to transition away from fossil fuels, towards green energy and transport.

Revenue potential

We recommend that the CDT is introduced in 2024 at a low initial rate of $5 per tonne of CO_2e increasing by $5 per tonne each year. If implemented at this rate, the CDT, as applied to OECD countries employing a 20% domestic dividend, would raise $44.6 billion for the LDF in year 1, $90.1 billion in year 2 and $119.8 billion in year 3. By the end of this decade, the cumulative figure for OECD revenue would be $900 billion, which equates to $720 billion to the LDF and, with a domestic dividend at 20%, $180 billion for OECD countries[6] to transition their economies.

For the G7,[7] with a 20% domestic dividend, $33.5 billion would be raised for the LDF in year 1. By the end of this decade, revenue would amount to $675 billion in total, with $540 billion for the LDF and (with a 20% domestic dividend) $135 billion for national climate action. If applied globally the cumulative total over this period would be in the region of $3.5 trillion. We provide the global figure only to demonstrate revenue potential. It is important to note that in the context of loss and damage while there is no obligation for developing countries to contribute, such contributions are encouraged on a voluntary basis.

Phasing out fossil fuels

With precious little of our carbon budget remaining, ideally we would have already stopped extracting and using fossil fuels allowing them to from now on remain in the ground. However, since this will still take a number of years, in the interim period as fossil fuels are phased out, the CDT is a valuable means to generate much-needed additional funds to benefit vulnerable populations facing catastrophic climate impacts whilst at the same time helping to accelerate fossil fuel phase-out by making its production more expensive. This is why we propose that the tax rate is ratcheted up annually adding costs to the fossil fuel industry's bottom line incentivising the shift from carbon.

Conclusion

OECD countries, of which a subset are the advanced economies of the G7, built their wealth off the back of industrialisation. The bulk of the greenhouse gases that have caused global warming are the result of activities in these countries leading to the increased level of loss and damage we see in the world today. Consequently, these states need to go first, furthest and fastest to capitalise the Loss and Damage Fund. The CDT, can be a major tool in a basket of measures, to raise the scale of finance required to create an LDF that is fit for purpose. It is feasible to implement and would be popular. It is desirable both for the tremendous benefit it would bring to climate-impacted countries and communities but also, through the domestic dividend, make an important contribution nationally in helping to pay for a transition to clean energy and green jobs. What is required is the political will to make it happen. We call on concerned citizens, organisations and countries, across the world, to join us in bringing this about.

To read the full report, go to: https://www.stampoutpoverty.org/live2019/wp-content/uploads/2024/04/CDT_guide_2024.pdf

Endnotes

1 Unless otherwise stated values are represented in USD
2 Carbon Majors Database. *CDP Carbon Majors Report 2017*
3 Source: IEA (2023) *World Energy Investment*
4 https://energy-profits.org
5 Stamp Out Poverty (2019). *The Climate Damages Tax – A guide to what it is and how it works*
6 Within the framework of international climate obligations, the following OECD countries: Mexico, Costa Rica, Colombia, Chile, and the Republic of Korea, are recognised as exceptions as they are considered non-Annex 1 countries. This is important to acknowledge to understand the diverse commitments and responsibilities that vary across different nations within the OECD in the context of global climate initiatives.
7 Figures given for the G7 comprise of numbers for the United States, Canada, Japan, and the United Kingdom with data for Germany, Italy, and France aggregated under a total European Union figure (reflecting the EU's inclusion as a non-enumerated member of the G7).

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