



HIGH-LEVEL SUMMARY TECHNICAL ASSISTANCE REPORT

CAMBODIA

Carbon Pricing Options

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High-Level Summary Technical Assistance Report
Fiscal Affairs Department

Cambodia: Carbon Pricing Options

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The *High-Level Summary Technical Assistance Report* series provides high-level summaries of the assistance provided to IMF capacity development recipients, describing the high-level objectives, findings, and recommendations.

ABSTRACT: Cambodia requested technical assistance from the Fiscal Affairs Department regarding the design and implementation of carbon pricing. This is a summary of the technical assistance report and the recommendations provided to the authorities. It first explores the appropriate choice of carbon pricing instrument for Cambodia given key country characteristics, determining a tax to be the favored option, before delving into key design and implementation considerations for such a carbon tax. It undertakes an economic analysis of reform options using the Climate Policy Assessment Tool (CPAT) to estimate impacts of carbon pricing on emission reductions, fossil fuel use and energy prices, fiscal revenue, economic welfare, and distributional impacts on households as well as energy-intensive, trade exposed firms.

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Background

The Government of Cambodia is exploring the feasibility of a carbon tax as a means to both generate additional fiscal revenue and reduce emissions. Its revised Nationally Determined Contribution (NDC) sets out ambitious targets for the whole economy, including an unconditional reduction of 20 percent for the energy sector. Cambodia's high energy import dependency ratio also drives a focus on energy security, underscored by the current volatility and supply shortages in international petroleum markets.

Carbon pricing is indeed the most efficient instrument to level the playing field between clean and polluting fuels and accelerate the country's existing momentum towards clean energy and improved fuel efficiency. A decarbonization strategy centered on carbon pricing can enhance energy security, while preserving industrial competitiveness and economic growth. Moreover, phasing in a carbon tax as international fuel prices recede will help moderate its price impact and improve its political acceptability.

Key Findings and Recommendations

Carbon Pricing Options for Cambodia

While carbon pricing can take the form of a tax or an emissions trading system (ETS), a carbon tax is better suited to Cambodia for economic and administrative reasons. It can build on the existing fuel tax system and be implemented relatively quickly, whereas the institutional and administrative infrastructure for an ETS would likely take many years to establish. Effective operation of an ETS also requires a liquid market with many firms, whereas Cambodia's energy and industrial sectors are highly concentrated.

A carbon tax can be introduced within the existing structure as an additional pricing component, operationalized by converting fuel quantities (in liters, for liquid fuel use) into CO₂-equivalent emissions using standardized emission factors. The tax should be explicitly indexed to inflation to maintain its real value, and be levied before VAT. The carbon tax should be levied at a single stage, at the first point of sale. Since GDCE already administers excise taxes and import VAT on fuel products, it should also be responsible for collecting and enforcing the carbon tax, maintaining simplicity for taxpayers. To align incentives, electricity imports should be taxed based on the source country's GHG emissions factor.

Exemptions to the carbon tax should be minimized to ensure both fiscal and environmental efficiency. For LPG, since the distribution channels via filling stations are the same for all types of consumers, differential tax rates would not be effective. It is recommended that the carbon tax is also levied on LPG, with any compensating measures for poor households targeted via IDPoor. Policies to promote the adoption of clean cooking could also build on Cambodia's already high electrification rates.

Economic Impact of a Carbon Tax

The mission modeled three scenarios: (i) a moderate carbon tax, starting at United States Dollar (USD) 10 per ton of carbon dioxide equivalent (CO₂e) in 2028 (about USD 0.02 per liter for gasoline and diesel), increasing to USD 30 per ton of CO₂e by 2035; (ii) a more ambitious carbon tax starting at USD 10 per ton of CO₂e in 2028, rising to USD 75 per ton of CO₂e by 2035, with a reduction in gasoline excise by

USD 0.1 per liter in 2028 to partially offset the near-term impact on retail prices; and (iii) the more ambitious carbon tax, but without adjustment to fuel taxes.

Analysis suggests that a carbon tax could raise 0.24 percent of Gross Domestic Product (GDP) in 2028, increasing to between 0.7 and 1.6 percent of GDP by 2035, depending on the carbon price path. Growth effects are broadly neutral, as the negative impact of higher energy prices is offset by productive use of revenues. The impact of carbon pricing on energy prices is in any case modest—baseline projections already incorporate declining international fuel prices, implying that even where carbon pricing raises prices relative to the baseline, absolute price levels may still fall over time. Electricity price passthrough is limited in the short-to-medium term, given the government's tariff policy, fixed medium-term investment pipeline and long-term power purchase agreements (PPA). In line with the objective of enhancing energy security, carbon pricing is expected to improve Cambodia's external position by reducing fossil fuel import demand through lower consumption and higher energy efficiency. Lastly, carbon pricing would make a substantial contribution to Cambodia's emissions reduction objectives, with more ambitious scenarios delivering reductions broadly consistent with the energy-sector ambition embedded in the NDC.

Complementary Measures

Carbon taxation would raise costs for energy intensive industries, but key sectors such as textiles would see only modest cost increases even under an ambitious carbon tax. If needed, the impact can be lessened by using carbon tax revenues to implement complementary policies, such as infrastructure improvements, and well-designed subsidies or tax incentives that lower the costs of emissions-reducing investments, including more fuel-efficient freight transportation. Blanket exemptions should be avoided.

The distributional impact of carbon taxes in Cambodia is broadly neutral and can be made equity-enhancing through targeted revenue recycling. Simulations show that allocating 25 percent of additional revenues to cash transfers calibrated to leave the median household in the fourth decile broadly unaffected would result in net welfare gains for the households in the bottom three deciles.

In transport, the current system of customs duties, Special Tax, and VAT results in mixed decarbonization incentives. Effective Special Tax rates should be reviewed to ensure that electric 2-3 wheelers are not disadvantaged. For passenger vehicles, a new tax could differentiate based on vehicle characteristics that correlate with emissions intensity, and are already collected by GDT and GDCE. For freight vehicles, similar differentiation could be incorporated into the Annual Means of Transportation Tax or Special Tax.

Legal Considerations

A carbon tax regime depends on a high degree of legal and policy certainty to drive long-term investment decisions necessary for an effective emissions reduction strategy. The core structural elements of any carbon pricing regime should be anchored in primary legislation, including coverage, rates, rights and obligations. Any power to make changes without parliamentary approval must be narrowly and explicitly defined. Legislation should be enacted as early as possible, even if not immediately operative. Commencement can be deferred until the occurrence of a trigger event (and a longstop date to prevent indefinite deferral), such as the adoption of implementing regulations, gazette notification by the Minister, or a fall in the petroleum price below a pre-determined threshold. This is recommended to provide regulatory certainty, signaling a policy commitment without requiring immediate operationalization.