GreenBudgetEurope

European expert platform on environmental taxation and green fiscal reform

Environmental Fiscal Reform (EFR)
The key to achieving a green economy

GBE demands for the Rio+20 summit

- Removal of market distortions which work against the environment and climate change mitigation, by means of the internalisation of external costs, must be agreed to constitute a fundamental principle of a green economy by governments in Rio.
- EFR - the abolition of environmentally harmful subsidies and the introduction or increase of environmental taxes - must be identified as one of the most central and fast instruments for the realisation of a green economy. All governments must make a concrete commitment to implement EFR in the immediate future.
- Industrialised countries should lead the way by committing to raise the share of environmental taxes in overall taxation to at least 10% and phase out all environmentally harmful subsidies - both by 2020.

Green economy - a fig leaf for business as usual?

A green economy is one which ensures that the market treats humanity, the environment and capital, at least on an equal basis, in terms of taxation, legislation, accounting, and so on. Green economy has become the new buzzword in sustainable development. However, neither the requirement to fundamentally reform the way our economies work, nor the urgency of making such changes to prevent dangerous climate change and irreversible environmental deterioration are reflected in the current policy discourse. For the concept not to become a meaningless mantra or, worse, to be misused as a fig-leaf for a capitalism painted green and stripped of the social objectives of sustainable development, concrete principles and objectives for a green economy must be agreed upon by governments at the Rio+20 summit.

Our ecological objective is clear: **to avoid catastrophic environmental change, humanity must stay within defined planetary boundaries for a range of earth-system processes.** These planetary boundaries have already been overstepped in relation to CO_2 concentrations in the atmosphere, radiative forcing, rate of biodiversity loss, and the amount of nitrogen removed from the atmosphere for human use. Consumption of natural resources is also rapidly reaching unsustainable levels - Europeans today consume an average of 16 tonnes per year, while the UNEP International Resource Panel estimates that global annual consumption of 6 tonnes per capita is sustainable.

The realization of a green economy will require a number of policy measures. **However, the most fundamental must be to ensure that prices tell the ecological truth and provide steady incentives for environmental improvements, particularly by correcting market distortions that encourage pollution and the depletion of natural resources. EFR is an essential tool for the realisation of this process and should be at the centre of the move to a green economy.** Other market based instruments should not be ruled out, but they do not act with the force and speed of EFR.

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EFR as a tool to bring about radical change

The IPCC's Fourth Assessment Report in 2007 identified market distortions as one of the most significant barriers to climate change mitigation. Because the market price of certain environmentally damaging goods and services does not reflect their environmental, social and economic costs, false prices in the market encourage polluting or high-emitting behaviours. Costs not internalised in market prices have to be paid by those populations most vulnerable to climate change and environmental deterioration, as well as by future generations.

EFR redistributes the burden of taxation, and reforms mechanisms within the fiscal system, so that environmentally harmful activities become more costly, thus creating appropriate price signals for producers and consumers to reduce pollution and inefficient energy and resource use. **EFR can therefore correct market failures, because it includes the costs of environmental and social damage or resource use in the price of a particular pollutant or resource**, e.g. by means of a tax, or as a result of the removal of an environmentally harmful tax exemption or subsidy. Correcting these market failures improves economic efficiency and raises additional revenues, which be used e.g. to reduce the tax burden elsewhere, for poverty alleviation, or to reduce budget deficits and thus contribute to solving the current fiscal and economic crisis.

Implementing comprehensive EFR means that a country's spending and annual budgeting, its taxation policy, and the markets within and beyond its borders, are designed and act in such a way that they protect the environment. Thus, **EFR harnesses the power of the market – one of the most influential mechanisms policy makers can use to change behaviour, particularly that of diverse and diffuse actors – to reduce environmental damage**. Markets and price signals which consistently act in favour of environmental protection and greener economic development will change the way we produce and consume goods and enhance energy and resource efficiency.

There is considerable evidence that the relative price changes resulting from EFR as a stand-alone instrument can achieve significant greenhouse gas (GHG) emissions reductions. Indeed some EU countries, e.g. Sweden and Denmark, have achieved conclusive decoupling of GDP growth and GHG emissions. Econometric modelling has demonstrated that **global cooperation on the introduction of a radical environmental tax reform in 2010 could cause GHG emissions to decline by as soon as 2020 with relatively low impacts on GDP growth** (Ekins 2009). In the absence of alternative policy proposals predicted to bring about anything close to this level of emissions reduction, we can ill afford to ignore the case in favour of EFR.

Environmental fiscal reform in developing and industrialising economies

EFR tends to be overlooked in the context of industrialising and developing economies, in spite of the fact that it has the potential to make even rapid economic development in e.g. the BRICS, compatible with environmental and sustainability goals.

In these countries, where governments collect comparatively low levels of tax revenue, it may be preferable to use environmental taxes to raise additional revenues for e.g. health or welfare, rather than to implement a green tax shift.

Environmental taxes have a particular appeal in the context of developing and industrialising economies, as they are often easy to implement, difficult to evade and have low administrative costs. A tax on transport fuels, for example, can use collection mechanisms already in place for excise duties and target a small number of taxpayers, thus keeping evasion to a minimum.

Additionally, most environmental taxes are designed to be progressive. This is the case for transport taxes, for example, particularly in lower income countries where motorisation rates are low. Where regressive impacts are a concern, flanking measures can be implemented – e.g. compensation mechanisms or support in switching to alternative technologies or behaviours – to protect the socially vulnerable from the impact of increased energy or resource prices.

Environmental taxes will drive the economy towards sustainable growth, helping developing and industrialising economies to avoid the mistakes of the industrialised economies, their over-consumption of resources and land, their unlimited increase in GHG emissions, their production of water pollutants and landfilled waste, and their disproportionate impact on the planet.

A common argument against the expansion and increasing reliance on the environment as a stable source of revenue is the concern that revenues will fall over time. However, many of these tax bases are extremely large and will be available long into the future, e.g. energy, waste, water, materials, land values, etc. To deal with such concerns and minimise the "rebound effect" – increased use of energy / resources in response to increased efficiency – environmental tax rates can be progressively increased in line with gains in e.g. resource or energy efficiency to maximise the dynamism of price incentives to change behaviour over time (see e.g. Weizsäcker 2009). Furthermore, environmental degradation constantly assumes new forms, which call for new taxes.

Phase-out of environmentally harmful subsidies

Government budgets in many developing and industrialising countries are lower than in the industrialised world and on average, tax revenues amount to a much smaller proportion of GDP than e.g. in the European Union. **Thus it is all the more important that these countries do not spend their limited revenues inefficiently or unnecessarily**, or in a way that contradicts other policy goals.

Prime examples of wasteful spending are environmentally harmful subsidies (EHS). These often entail additional government spending or lost revenues due to favourable tax treatment of practices which effectively counteract environmental policy or support unsound environmental practices. EHS are a way of paying polluters to pollute – the very opposite of the polluter pays principle. **Neither industrialising and developing countries, nor those industrialised countries with severe budget deficits, can afford to spend scarce revenues on environmentally damaging practices.**

Removing subsidies in energy, water, fisheries and agricultural sectors alone would save 1-2% of global GDP every year, revenues which would be freed up e.g. for investment in low-carbon industries and green technologies (OECD 2011). The phase-out of global fossil fuel consumer subsidies by 2020 would incentivise greater rates of energy efficiency and a shift to renewable energies and so reduce global CO_2 emissions by 6.9% by 2020 – the combined emissions of France, Germany, UK, Spain and Italy (IEA 2010).

The sheer scale of spending on EHS highlights the potential of reform to turn around the way our economies work - simply by changing the way governments spend money. Subsidy reform also has multiple benefits alongside environmental improvements, including more efficient public spending, fewer market distortions and policy contradictions, and health and welfare benefits. Subsidy reform and its associated benefits can make a significant contribution to the necessary 'leapfrogging' of developing and industrialising economies onto a greener development path.

Summary

If the Rio+20 summit is to secure renewed political commitment for sustainable development, it must also muster political commitment to secure the *means* of realising sustainable development - and this should include serious political commitment to implement EFR.

We often say that "money makes the world go round". If we accept this basic premise, then EFR, which seeks to harness the power of money to incentivise changes in the behaviour of producers and consumers, must surely be amongst the most powerful tools of all. EFR not only offers governments the means to cope with their often large and increasing budget deficits, but also to radically reform and green the global, national and local economies. **Radical EFR is one of the most feasible means of preventing dangerous and irreversible climate change, as it deals with obstacles to change - market failures - and uses the power of the market economy itself as the driving force for reform.**