Environmental fiscal reform: Windows of opportunity

Constanze Adolf, of Green Budget Europe, looks at environmental fiscal reform (EFR) in a post-crisis context, assessing the prospects for EFR to raise government revenue and promote the polluter-pays principle.

The present European Union (EU) context is unique, given the high degree of cross-border interdependencies shaped by the EU policy framework in terms of both economic and climate policies, the depth of the economic and fiscal crisis, and the turmoil in sovereign debt markets. While recent economic analysis suggests that the economic situation in most EU member states is improving, the consequences of the crisis remain a huge challenge, with budgetary consolidation as one of the main concerns for national governments.

Climate change is the greatest market failure the world has ever seen. Environmental fiscal reform (EFR) can correct climate-related market failures by pricing greenhouse gas emissions and internalising the cost of climate change – and in so-doing, realise the eminently fair polluter-pays principle.

The EU's objective is to reduce the CO_2 emissions in 2050 by 80% to 95% compared with 1990 levels. The European Commission estimates that every year an extra 1.5% of European GDP should be invested in the transition to a low carbon economy to achieve that goal. If nothing is done, the Commission estimates the cost at €50 billion ($67 billion) per year. If a sense of urgency to implement the policies needed for the transition does not come into being, the achievement of the objective will cost considerably more time and money. Furthermore, the attractive opportunity for job creation that we see today in the green sector would be missed.

Alongside the obvious urgency of mitigating climate change, EFR could also play a major role in raising governmental revenues and setting clear signals for investments in the low-carbon economy. The latest Eurostat survey, published in March 2014, found that four out of five people in the EU recognise that fighting climate change and using energy more efficiently can boost the economy and employment. This might provide an entry point for EFR if effectively communicated.

In late May 2014, around 400 million EU citizens elected 751 Members of the European Parliament (MEPs) and thus shaped future EU policies. The new EU Commissioners will be appointed in autumn.

The last legislative period has revealed a tendency for re-nationalisation of the political debate. The 2014 European elections in May with a stable turnout of 43.1% strengthened this development by bringing about a wave of euro-scepticism. In addition, the far right vote was very successful, for example in the French elections, where the National Front won almost 25% of the vote, and had strong showings in the UK, Hungary and Austria.

At the same time, independent MEPs grew from 29 to 43.

What do these changes mean for environmental fiscal reform policies at EU level?

First of all, we should not necessarily expect a vehemently anti-climate/environment parliament. There has been a consistently strong majority in the European Parliament supporting progressive climate, energy and environment legislation from socialist, centre-right and green MEPs. Because of this, there have been no close votes on environment, climate or energy. This grand coalition of broad support for climate action is likely to remain after these elections.

Euro-sceptic parties will have limited impact on parliamentary business due to ideological and organisational divisions. Populist parties are split between far left and extreme right – and even those with similar positions are unable to form partnerships: as exemplified by UKIP's rejection of an alliance with the French National Front. Thus, the euro-sceptic influence in the Parliament should not be overestimated.

The result might mean that political will for progress is weaker within the new EP. Euro-sceptic groups are opposed to supranational integration and could limit the extent of tax harmonisation in the future. On the other hand, euro-sceptics have a history of low attendance in parliamentary committees and thus tend not to participate substantially in the EU legislative process.

Entry points for the promotion of EFR at EU level therefore derive from the challenges related to tackling the crisis since 2007-2008 on the one hand, and from the EU climate and energy policy agenda on the other. By promoting the ambitious implementation of EFR, the next European Commission and the renewed European Parliament could take big steps towards meeting both challenges during the next legislative period.

This paper aims to present 'Europe 2020' as the central policy tool of the union that will guide the block of 28 member states until 2020 and its main implementation tool, the European Semester.

Europe 2020 and the European Semester

The overarching strategy guiding most of the current EU policies until 2020 is the 'Europe 2020 strategy' which aims at generating "smart, inclusive and sustainable growth".

The resource-efficient Europe flagship initiative within the Europe 2020 strategy is to be delivered by the 'Roadmap to a Resource Efficient Europe'. This non-binding catalogue aims at catalysing progress and calls for a major shift from taxation of labour towards environmental taxation, and thus for a substantial increase in the share of environmental taxes in public revenues. The roadmap also includes a call for a phasing-out of environmentally harmful subsidies by 2020.

A multiple crisis and two sides of the coin – EFR as a way out?

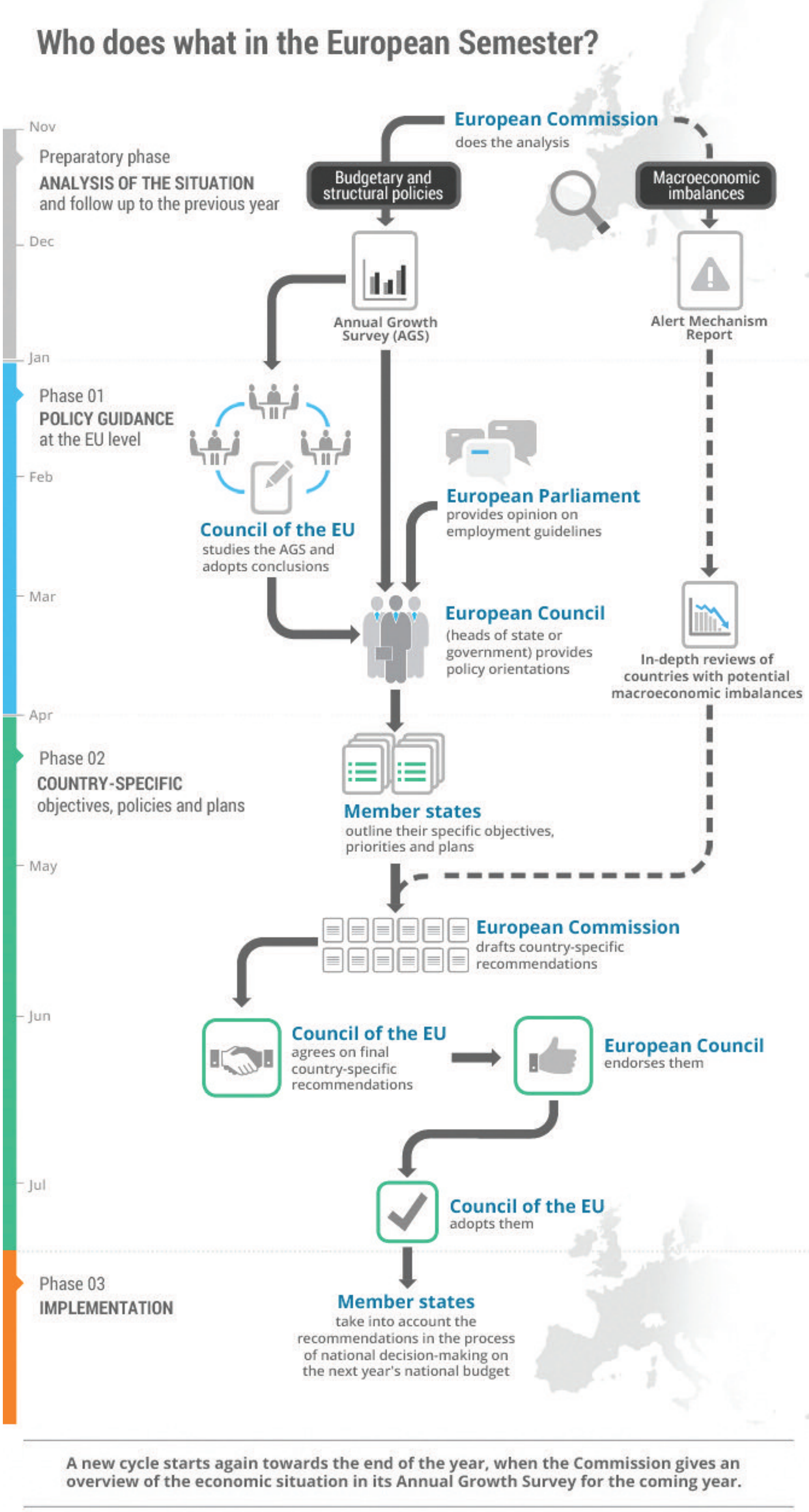
The so-called European Semester is the key instrument to deliver these targets by fostering structural reforms and aligning national policies. Since 2011 this policy tool has sought to ensure joint delivery with member states on the targets and agreed EU priorities.

The Semester is an annual cycle of macro-economic, budgetary and structural policy coordination. This is done through three pillars: thematic coordination in areas like resource efficiency, energy, R&D, employment, and so on, macro-economic surveillance and fiscal surveillance under the Stability and Growth Pact. It frames policy agendas and timelines, so that the first half of the year is dedicated to coordinating at EU level with an *ex ante* assessment of the structural reforms, budget plans, and macroeconomic imbalances, while the second half of the year is reserved for incorporation of EU objectives and requirements into national policies and budgets.

The European Semester gives the European Commission competences to exercise much closer scrutiny of EU member states specific fiscal and economic priorities and strategies including timelines, for example, for setting national budgets. The main innovation introduced by the European Semester is that the enforcement of economic policy coordination is now being extended right through to the budgetary process of all member states. For instance, the Stability and Growth Pact gives the European Commission the possibility to impose sanctions on the Eurozone members and on those countries which agreed on it, particularly regarding the implementation of deficit rules and macro-economic priorities. One example is that, on September 15, Eurozone countries have to submit their draft budgetary plans to the European Commission, which assesses whether their proposals match their medium-term economic ambitions.

This process should require and support member states in bringing a comprehensive approach to EFR, specifically in terms of a sustainable fiscal consolidation. Therefore, supplying the EU institutions as well as national governments with high-quality information on possible EFR measures constitutes a real window of opportunity to influence national and EU-level policy.

The European Semester process



Source: www.consilium.europa.eu/special-reports/european-semester?lang=en

Challenges and opportunities for EFR implementation in the European Semester

The embedding of the Europe 2020 strategy and its sustainability targets in the European Semester was supposed to improve political ownership and delivery. Member states are required to explain how they will deliver on smart, sustainable and inclusive growth, based on integrated guidelines and the Europe 2020 targets for climate change. Through their proposals, also called National Reform Programmes (NRPs), member states set out actions to be undertaken in areas such as public finance, climate and energy, research, innovation, employment or social inclusion. However, a closer look reveals that the European Semester creates tensions between the stability rationale dominating most of the current political agenda and Europe 2020's objectives. The overall consequences of fiscal consolidation and structural reforms, and thus the role of EFR in this context, tend to be

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overlooked. So far, national strategies to exit the crisis have been overwhelmingly driven by public finance austerity measures, often to the detriment of sustainability objectives. However, compared with other measures, EFR tools are often more cost-efficient and contribute to the intended development of a green economy and have a high potential of new job creation, attracting low-carbon long-term investment and fostering energy independence.

EFR seems to be a particularly promising tool in view of the fact that several EU member states which suffered most in the economic and financial crisis are among the countries where recognition of the economic benefits of climate action and energy efficiency is highest (according to Eurobarometer 2014). At the same time, the overall proportion of revenues from environmental taxes as a share of GDP across the EU are on average between 2% and 3% (Eurostat 2013), clearly revealing the potential for increased environmental taxation at national level.

Only a very limited number of member states mention EFR in their NRPs, which might be due to a lack of visibility of the EU Semester, the low priority given to green tax reform, strong lobbying efforts and social pressures, and a general unwillingness to submit ambitious targets to the EU and risk being held accountable for non-compliance.

Another challenge consists in the fact that member states see the coordination from EU level as a control measure. Intending to preserve national sovereignty, they are not very keen to deliver the information requested from EU level. Therefore, providing robust data and national expertise to the European Commission is key for civil society seeking to influence the process.

A third challenge is the continuing lack of commitment to democratic engagement or viable participation of civil society. According to Recital 16 of the Integrated Europe 2020 guidelines, the European Semester needs national ownership, including the engagement of national parliaments and national stakeholders together with social partners and civil society organisations. However, in the fourth year of the European Semester, it is still failing to deliver on its promises to bring about substantial implementation of the EU 2020 strategy and to engage stakeholders in any meaningful way at the national and EU level. This raises serious questions about the democratic accountability of the European Semester process and should be a major concern for the newly-elected European Parliament.

Civil society organisations (CSOs) planning to engage in the Semester process can make the case at EU, national and regional level for civil society involvement by highlighting the added-value of CSO's contributions, and the democratic legitimacy offered by enhanced civil dialogue and participation. CSOs should proactively seek participation and involvement by creating alliances and activating networks across a broad range of stakeholders, including the European and national parliaments, social partners, NGOs from other policy areas, academics and experts.

The added value consists in providing concrete and pragmatic expertise and robust grassroots data which complement the data provided by the public bodies. An example came in April 2014 when 16 major European civil-society organisations and trade unions, representing thousands of member organisations on the ground at European, national and local levels in the EU launched the 'EU Alliance for a democratic, social and sustainable European Semester' (EU Semester Alliance). The EU Semester Alliance aims to support progress towards a more democratic, social and sustainable Europe 2020 Strategy, through strengthening civil dialogue engagement in the European Semester at national and EU levels, ensuring that all policies, including macroeconomic, contribute to the climate/environmental and social targets.

The European Semester and the reform of EU economic governance have essentially changed the way in which fiscal and economic policy is formulated in the EU. EU competences are expanding into new areas, pushing the nexus of budgetary consolidation and climate/energy policy-making further upstream, giving EFR a strong potential role. Thus, the European Semester could be a crucial tool to guide long term structural changes and decisive investments by means of EFR, as long as it properly addresses the sustainability dimension of Europe 2020 by mainstreaming all its climate objectives in these economic processes. Effective and transparent communication about the climate, environmental, economic and social benefits, concerted action at national and EU level through the year, and alliances with other stakeholders are the most promising entry points for EFR. If the transparency and involvement of stakeholders is improved it could ensure that progress in economic reforms will deliver sustainable progress and improve socio-economic cohesion among member states. Italy, which has implemented a number of European recommendations on EFR within the European Semester, can make a strong point on the benefits during its presidency in the second half of 2014.

The European Semester should:

- promote macroeconomic policies that support EFR to ensure that economic objectives deliver on environmental, climate and social targets;
- shift the tax burden from labour to other tax bases, for example environmentally harmful activities, ensuring an *ex-ante* social and gender impact assessment on all proposals of sustainable and inclusive tax/subsidy and investment reform;
- reduce tax exemptions and environmentally harmful subsidies on fossil fuels;
- invest in decentralised energy production, renewable fuels and increased energy efficiency in housing and other buildings;
- include climate and environmental indicators in the macroeconomic surveillance part;
- assess the implementation of EFR as part of the CSRs within the Cohesion Policy; while
- European Commissioners could form an informal working group on a 'sustainable European Semester' to share and discuss cross-cutting win-wins in an informal way beyond everyday politics, inviting key stakeholders to share their views; while
- the European Parliament should make extended use of the economic dialogue to stress the positive implications of EFR; and
- during the hearing of the designated EU Commissioners, MEPs should press for the ambitious use of market-based instruments, for a resource productivity indicator within the macro-economic surveillance, and for other measures which ensure a clear and predictable investment environment.

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