EUROPEAN SEMESTER 3.0

Strong policy coherence needed to rebuild trust and a sustainable development perspective

The European Semester should be further developed to become an effective governance and enforcement mechanism that can ensure coherence between national fiscal policies and overarching sustainable development objectives. To further this, national Environmental Fiscal Reforms (EFR) should be accelerated via the European Semester; and Member States national public spending and investment plans should be checked against their delivery on sustainable development.

With the European Semester the EU intends to establish a governance mechanism encompassing Member States' macro-economic and fiscal policy reform. The European Semester process currently focuses mainly on budget discipline, enforced by the Stability and Growth pact. However, the European Semester is also the main instrument to implement the Europe 2020 strategy which can – if properly implemented – significantly enhance structural macro-economic stability in the EU Member States.

Now in the fifth year, the assertiveness and impact of the European Semester process remains mixed. Annual delivery can't be properly enforced as the implementation of National Reform Programmes and Country-Specific Recommendations is not compulsory. In addition, macro-economic governance priorities can over-ride the goals of the Europe 2020 Strategy. Often, the costs and benefits of natural resources are not fully captured by pricing, which generates incentives for unsustainable resource use by making pollution or the degradation of natural resources a profitable exercise. The costs for inaction for environmental protection and fighting climate change might endanger the long-term prosperity of Europe. Therefore, we call for the integration of a resource-efficiency indicator within the Stability and Growth pact, aiming at the absolute decoupling of economic development from the use of natural resources.

Getting out of the crisis sustainably: Environmental Fiscal Reform is the vital remedy

Environmental Fiscal Reform is commonly understood as a package of measures combining an increase of taxes on energy or natural resources, the elimination of environmentally harmful subsidies and targeted government spending towards environmental sustainability with a revenue-redistribution component to protect and/or enhance social equity.

A substantial shift of taxation from labour and income towards resource use in Europe has less detrimental macro-economic but more socially equitable impacts than other taxes, such as VAT or income taxes. Experiences from implemented EFRs show that the measures are associated with lower unemployment and higher disposable income at the macro level (e.g. EEA (2011), the CETRiE and COMETR projects) than alternative strategies.

EFR policies, implemented via Market-Based Instruments, can

- Correct market failures;
- Improve the price signals by internalising external costs;
- Offer more flexibility, and thus, improve economic efficiency;
- Help develop new industries that provide sustainable and local jobs;
- Create a clear and predictable environment for eco-innovative investments;
- Contribute to restoring fiscal stability.

This would in turn enhance the genuine sustainable competitive advantage and success of the European industry in a global economy by combining innovation, investment and climate policies.

In the flagship initiative for a Resource-Efficient Europe (Europe 2020 Strategy), the European Commission calls on Member States to increase what they refer to as "growth friendly" taxes on the environment and resources, while at the same time lowering social security contributions or earmarking the revenues for environmental purposes or budgetary consolidation. "*One third of the Member States have space for such a tax shift while another third have scope to improve the design of existing environmentally-related taxation*" (European Commission 2014).

Furthermore, the flagship initiative for a Resource-Efficient Europe calls for "*environmentally harmful subsidies to be phased out with due regard to the impact on people in need by 2020*" (European Commission 2011). Achieving this milestone will save a significant amount of financial resources – in 18 EU Member States, for example, €54 billion is lost each year because of company car taxation schemes alone (Copenhagen Economics 2010).

Policy areas like labour market reforms, sustainable and more coherent taxation or social and sectorial policies (e.g. energy infrastructure or transport) should therefore play a much more prominent role in the Semester process.

Using the European Semester to foster Environmental Fiscal Reform

The Annual Growth Survey 2015 which launches the European Semester process mainly focuses on a €315 billion investment plan but offers little hope on tangible progress on the Europe 2020 Strategy targets and beyond. Structural reforms and austerity still dominate while the economic coordination through the European Semester could help restore fair market conditions and eliminate distortions in competition, i.e. use the market for what it can give as a positive contribution to well-being, development and sustainable economies.

Up to now Country-Specific Recommendations in the European Semester process have not focused sufficiently on environmental fiscal policy measures, and have not resulted in an increase in environmental tax revenues. Labour taxes account for 53,3% of total tax revenue in the Eurozone area against 5,7% for environmental taxation (European Union 2014). There is a persistent high unemployment rate of 9,9% (EU28-average) in December 2014 according to Eurostat (2015) combined with an excessive energy import dependence of 52-53% EU-28 average (European Commission 2014a).

A landmark report commissioned by the European Commission reveals that the subsidies and externalities of the fossil fuel and nuclear based power and heat represent a cost of €262 billion per year, versus €58 billion only for renewables and energy efficiency (Ecofys 2014).

Fiscal policies consistent with EU environmental objectives should therefore focus on promoting low-carbon and energy / resource efficient opportunities in EU Member States.

Linking Country-Specific Recommendations and better EU budget spending by Member States

EU funds spent by Member States, notably European Structural and Investment Fund, should further mainstream environmental sustainability, notably in long term infrastructure projects, to contribute to EU environmental and social objectives. Decarbonizing Europe's energy and transport infrastructure, making its industry and its production patterns more efficient, requires large amounts of investments; the scarcity of public money requires that it is spent more effectively with better outcomes.

The European Semester can contribute to better spending of EU funds by Member States. It should be used to strongly link Country-Specific Recommendations and the performance framework of Member States EU funds spending plans to ensure a better contribution to the Europe 2020 Strategy's environmental and social targets.

Conclusion: main recommendations

Given the high potential benefits of Environmental Fiscal Reform and better EU spending by Member States to achieve the Europe 2020 Strategy targets and foster innovative low-carbon investments for sustainable economies, we urge the Commission and the Member States to strongly embed in the European Semester process and reflect in Country-Specific Recommendations:

- **To phase-out all market-distorting environmentally harmful subsidies as soon as possible and by 2020 at the latest;**
- **To increase the share of environmental taxes in proportion of the overall tax revenue –i.e. by shifting taxes away from labour to polluting activities by 5% by 2020;**
- **To link the Country-Specific Recommendations with the use of EU funds by Member States to ensure better spending and maximise benefits.**

As environmental NGOs we have carried out a consultation among our network of members and national experts and are pleased to provide material for consideration in respect of **Austria, Belgium, Bulgaria, Czech Republic, Denmark, Estonia, Finland, France, Germany, Hungary, Ireland, Italy, Latvia, the Netherlands, Poland, Portugal, Slovenia, Slovakia, Spain, Sweden, UK** as well as the **Eurozone** in general.

Europe 2020 Strategy review

Beyond the European Semester, our organisations have produced recommendations for the Europe 2020 Strategy review, based on our analysis of the current shortcomings and untapped / new opportunities.

They focus on the following main issues:

- Set a resource efficiency headline target in the strategy and related indicators in the European Semester;
- Embed the post-2015 Sustainable Development Goals in the strategy;
- Use the European Semester more ambitiously to phase out environmentally harmful subsidies and foster environmental fiscal reform;
- Link the European Semester's Country-Specific Recommendations and the EU Budget spending by Member States;
- Build the strategy on a new overarching EU goal and a long term economic roadmap;
- Improve transparency and stakeholder involvement.

EU public finance

It is critically important that public funding from the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD) further mainstreams and promotes cross-cutting environmental sustainability, notably regarding infrastructure projects.

Finding a way to ensure consistency of EU public finance with national Country-Specific Recommendations from the European Semester is needed to maximise joint delivery towards the EU overarching social and environmental sustainability objectives.

The "Investment plan for growth and jobs", an EU budget based investment initiative aiming at mobilizing investments worth €315 billion into energy, transport and environmental infrastructure, as well as education and research and development, should only finance projects that deliver on the EU's long-term sustainable development objectives. And in line with the EU pledge on inclusive and participatory decision-making, all relevant stakeholders should be involved.

For more information, please contact us.

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