GreenBudgetEurope

EUROPEAN PLATFORM FOR MARKET-BASED INSTRUMENTS

A Project of Green Budget Germany – Forum Ökologisch-Soziale Marktwirtschaft

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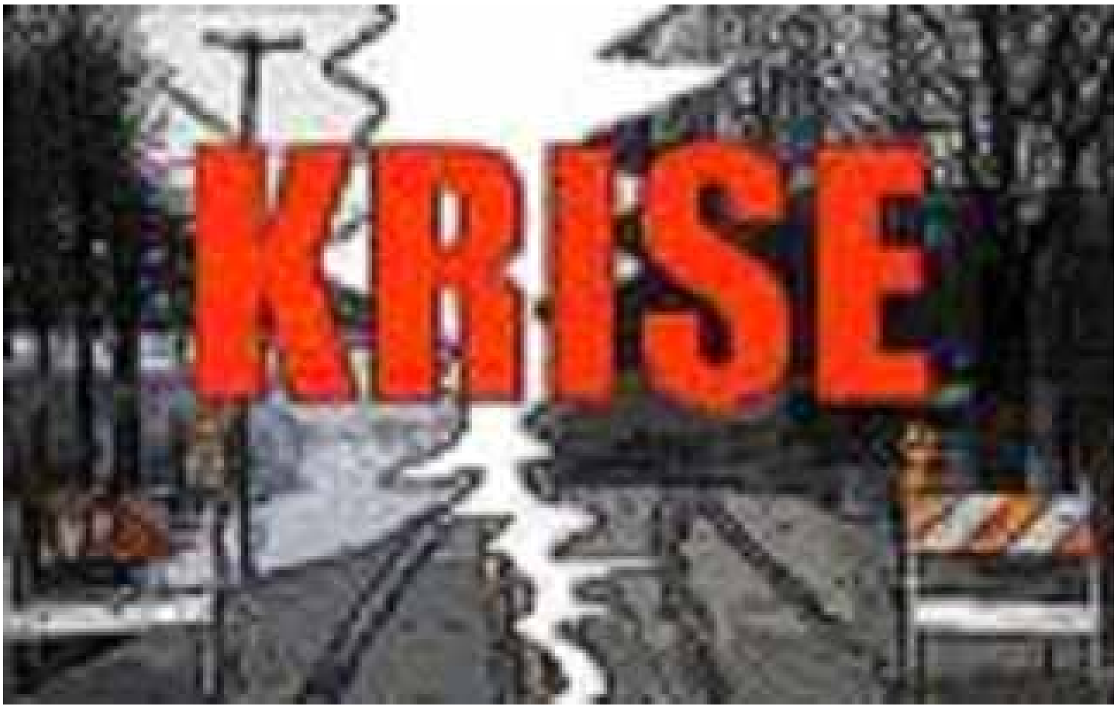

<u>**GBE Steering Committee Meeting with Czech Presidency in Prague, April 29th, 2009**</u>

GREENER SPENDING, GREENER FINANCING

In the face of a severe economic downturn and unprecedented deficit spending, we must proceed to Green Deficit Spending and a Greener Capitalism, and open a new chapter in the MBI-debate

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Never waste a good crisis! (Hillary Clinton)

CONTENTS (Date: **May 23, 2009**) PAGE

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Green Budget Germany (GBG) is a nonprofit organisation, founded in 1994, with membership open to everyone. Our German name is **Forum Ökologisch-Soziale Marktwirtschaft** e.V. **(FÖS)**. We specialize in **Market-Based Instruments of Environment Policy (MBI)** and participate in the German and European Eco-tax and Emission Trading Reform with own contributions and through communication with the business, scientific and political communities.

Green Budget Europe (GBE) was launched by GBG with a number of partners as European Platform to promote MBI on September 25th, 2008 in Brussels. We seek dialogue with the business, scientific and political communities and publish newsletters in German and English: **ÖkoSteuerNews** and **GreenBudgetNews**.

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The paper sketches out opportunities to use Green Deficit Spending for better protection of the environment and MBI (i.e. market based instruments like eco-taxes, emission trading or a reduction of perverse subsidies) to provide future financing for paying back the exploding government debts.

It also proposes to open a new chapter in the evolution of MBI; namely going beyond the mainly eco-tax-centred debate of the 70ies to 90ies ("double dividend") and the larger concept of Environmental Fiscal Reform of the early 2000s to have more impact on the shaping of Green deficit programs, on both sides of the public budget.

A longer version is available as GBG Discussion paper:
www.foes.de/pdf/GBG-DisPap2009.05-GreenRecoverywithMBI.pdf

Introduction: Greener deficit spending and greener financing as new double dividend

Founded only in September 2008 in Brussels, Green Budget Europe is proudly presenting this first GBE Policy Paper. The paper was extensively debated not only among the members of the Steering Committee, but also in a productive exchange with officials from the Czech Ministry of the Environment, led by Deputy Minister Rut Bízkova. A longer version of this Policy Paper is available as Green Budget Germany Discussion Paper.[1]

We basically accept the need for bold deficit spending, and assume that we will see even more of it in the near future. But we are convinced that untargetted spending programs, that are not combined with a vision to build a greener and fairer society, are a waste of precious opportunities. **We therefore demand that future stimulus programs should be much more targeted to produce positive side-effects both for the environment as well as for social justice.**

We are also convinced that for the financing of the huge increase in public debts resulting from the present crisis, **green revenues are far better adapted then raising conventional taxes**. Higher taxes on labour, consumption or for enterprises would stifle the recovery. In contrast, green revenues, be it from ecotaxes, emission trading or the reduction of detrimental subsidies, would give the right signals to move the economy into a more sustainable future and positively reinforce the effects of greener spending. **The combination of greener spending and greener financing can well be seen as a new variant in the evolution of the double dividend concept. It may also help us to proceed to a greener and more social capitalism.**

Abbreviations used in this paper	
DD	Double Dividend
EFR	Environmental Fiscal Reform
ETR	Environmental Tax Reform
ETS	Emission Trading System
GBG	Green Budget Germany
GBE	Green Budget Europe
GDR	Green Debt-Repayment
GFR	Green Fiscal Reform (=EFR)
GPP	Green Public Purchasing
GSS	Green Switching Subsidies
JCR	Job-Creating Regulation
MBI	Market-Based Instruments
REN	Renewable Energies

GBE Policy Paper vs. GBG Discussion Paper

This short version is a GBE policy paper and represents a large consensus within the GBE Steering Committee. The long version presents more personal opinions.

Applying these principles, we should **move from untargeted deficit spending to a balanced program of Green Keynesianism**. We see the following main elements:

1. **Green Deficit Spending** to create jobs while benefiting the environment, integrating old and new green instruments or principles:

- **Green Public Purchasing (GPP)** to apply high environmental standards to direct and indirect Green Deficit Spending.
- **Green Switching Subsidies (GSS)** to stimulate the economy through conversions to greener usages/ products.[2]
- **Job-creating regulation (JCR):** Giving preference to green regulations that will also create jobs by induced spending.

2. **Green Debt-Repayment (GDR)** through the fiscal revenues from MBIs, combining old and new approaches:

- Older tools include new or higher eco-taxes, cutting of perverse subsidies, introductions of toll systems or more auctioning of ETS.
- A new tool could exist in pre-announcing ecotaxes to become effective with some delay. The economic burden would be postponed, but the signal effect would set in immediately.

Obviously, our plead for greener deficit spending applies only to stimulus measures that are still in the making and have not already been spent. Looking at the economic forecasts and political debates, we are quite certain that we haven't seen the end of such measures. Up to now, stimulus programs in the EU have not shown large green elements.[3]

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[1] GBG Discussion Paper 2009/05 Strengthening a green recovery with market based instruments: www.foes.de/pdf/GBG-DisPap2009.05-GreenRecoverywithMBI.pdf

[2] GBG recently presented a proposal to modify the so-called "Umweltprämie" into a subsidy for car buyers under condition that the new car's consumption is at least 25 percent less than the previous car. This would really make for a green subsidy: www.foes.de/pdf/2009-04%20Umbaupraemie-SZ.pdf

[3] See Green Budget analysis of German and selected EU deficit spending, forthcoming.

1. Applying the principle of Green Public Purchasing to global stimulus programs

Before the present crisis, Green Public Purchasing (GPP) was a rather rarely debated instrument in the MBI toolkit. The basic idea is for governments to use their purchasing power to buy greener than necessary goods and services and thereby not only give a good example but shape the market. **In the context of unprecedented public spending, GPP can become a much stronger and dramatically more important weapon.** We only need to extend its application so as to include indirect spending.

Never in the history of the world could governments spend so much money in such a short time as today. The total sum of world deficit programs will soon amount to somewhere between five and seven percent of world GDP. **So we are talking about unimaginable sums of up 3 trillion dollars or more**.[4] The way these millions of millions are spent will decide about our future fate. If we spend them without discrimination and with no strings attached, we will create incredible damage to the environment, perhaps also hurting the poorest people and countries instead of helping them.

Yet if we spend these enormous sums wisely and with discretion, we will be able to give an enormous boost to both the economy and the environment. It is paramount for all advocates of a greener future to fight for spending the money without creating collateral damage to the environment. Indiscriminate tax cuts – whether through reductions of taxes for income payer or taxes for consumers – forsake any control about how and what for the money will be spent. No penny of public money should be spent in a way that increases environmental damage or would hurt the poor. Every penny of public money should be spent to give the right signals for a sustainable economy of the future.

Up to now, the political forces favouring indiscriminate spending or even environmentally detrimental spending have had the upper hand:

- Traditional advocates of the neoliberal Right have favoured income tax cuts, thereby giving out money to the rich and the middle classes who profit most from tax reductions. **In a real crisis, everyone who still pays taxes should not complain but consider himself very privileged!**
- Traditional advocates of the Left are more prone to giving away the money to the poor or to all tax payers, for instance by reducing consumer taxes.
- Both conservatives and traditional social democrats are even advocating the slashing of energy taxes, as if the fall in worldwide energy prices had not given enough perverse incentives.
- In many countries, nationalist forces are advocating spending combined with protectionist elements – thereby risking a further decay of world trade.

It is paramount for all advocates of a greener future to argue for spending money without creating collateral damage to the environment, the poor, or third countries. Indiscriminate tax cuts – whether through reductions of taxes for income payer or taxes for consumers – forsake any control about how and what for the money will be spent.

Many of the existing spending programs are creating new perverse subsidies. Subsidies for buying big cars, subsidies for energy-intensive appliances and outdated technologies. This must be changed! Keynesian deficit spending is probably the only and correct answer to the present crisis, but it is not enough. It also does not suffice to make it both economically and environmentally useful spending. It must also be socially helpful and increase, not reduce, social justice. **With all the problems in the world, we don't have one cent to spend for building pyramids of the past.** We must think of the future instead. **If pyramids it must be, then only green pyramids, please!**

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4 In this paper, we are using the US term for trillions, i.e. a million millions. The World GDP was 54 trillion (54 million millions) of US-Dollar in 2007: http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP.pdf.

2. Creating job effects through smart Green Regulation

We also should take a new look at regulation. **We have just seen millions of jobs destroyed by neo-liberal deregulation!** Clever green regulation can enforce additional spending by businesses and/or consumers. The Eco-design directive may be an excellent example. When consumers and producers have to invest in order to meet, say, higher energy standards for new buildings, this may raise costs and endanger some jobs, but as a rule should create more new ones. In truth, we should probably combine economic instruments and regulation to achieve best results:

- Stern regulation can make sure that new equipment will not enter the market unless they fulfil at lose some environmental criteria. Ecologically inefficient products will be banned.
- Economic instruments will then assure that the new equipment – plus all the older products already in circulation – will be used efficiently. Regulation cannot stop wasteful behaviour.

Economic instruments and regulation should not be seen as rivals but as two sides of one coin.

3. Using economic instruments to repay debts from deficit spending

The downside of the enormous spending of today – justified as it may be – are the debts we are accumulating for our children. **One day, these debts will have to be paid back.** But how? Announcing future tax increases for consumers or income earners would be a perverse signal. Indeed, by using wrong ways in refinancing the future debt, we risk to stifle the very recovery we try so urgently to achieve. Instead, governments should send the right tax signals. **These signals should be signals in favour of the environment, not signals that encourage further environmental destruction.**

The present amount of deficit spending calls for courageous counter-financing measures. We propose **Green Deficit Reduction (GDR),** i.e. measures that do not hurt the economy while at the same time helping the environment. At the same time, we observe a worldwide fall of energy and resource prices, creating again just the wrong signals. We need to compensate the fall in energy prices and in the cost of emission rights. **Accepting lower costs of energy and emissions is equivalent to sending dreadfully misleading signals to consumers and investors alike.**

Several economic instruments produce revenues, not only ecotaxes and emission trading with auctioning. Reducing perverse subsidies can generate considerable fiscal receipts. Considering the strong fall in both energy prices and emission trading rates, green revenues also create the necessary strong signals for more efficient consumption, bold green investors, and new green technologies.

4. Redefining double dividend: Even ecotaxes can be spent only once

If we want to progress, we must open a new chapter in the MBI and double dividend debate. In the last decade, we advocated environmental policies that, for the first time, offered fiscal receipts. So we could ask nice questions: What to do with all this money? What are the good things we want to spend the MBI-receipts for? **In the present crisis, the money has already been spent, at the expense of billions and trillions of government debt. So the new question is: How can we repay this debt in the most intelligent way?**

The old double dividend argument for energy taxes to relieve labour costs may still be valid. **A shift from labour taxes to energy taxes may well lead to increased demand for domestic labour at the expense of energy imports. The button line from such a tax shift would be higher domestic demand and**

more jobs. But even ecotaxes or revenues from auctioning ETS underlie the mathematical rules. We can spend them only once. If we want to spend them to relieve labour costs, we cannot spend them to repay the debts from deficit spending. Combinations are possible, of course.

It is our conviction that green fiscal receipts are the most intelligent way to counter-finance the debts from deficit spending. So the new double dividend comes from eco-fiscal instruments that create the right signals for the economy while helping at the same time to repay our gigantic debts.

Exhibit 1) Evolution of Double Dividend: From *Tax bads not goods* to *Greener spending, greener financing*

	Ecological Tax Reform (ETR – 70ies to 90ies)	Green Fiscal Reform (GFR – early 2000s)	Green Keynesianism Green Debt-Repayment
Philosophy/ Battle Cry	***„Tax bads, not goods"***	***"Use full portfolio of economic instruments for variety of fiscal objectives"***	***"Greener spending, greener financing"***
Dominating Instrument(s)	– **Ecotaxes (ETR)** – Emission trading (ETS) only debated, most other tools neglected/ ignored	– **ETS and ETR** – **Slashing of perverse subsidies** – Road and city tolls – Limited green subsidies, e.g. for REN	– **Green Public Purchasing (GPP – NEW)** applied on Deficit Programs – **Green Switching Subsidies (GSS – NEW)** – Pre-announced ETR – Cutting perverse subsidies – **Job creating green regulation** (JCR – NEW)
Priority use of revenues	– **Reducing taxes on labour** (from payroll taxes to social security levies)	– **Reducing taxes on labour** – **Reducing national debt** (to meet Maastricht criteria) – **Financing Green Projects**	– **Green Debt-Repayment (GDR – NEW)**
Evolution of Double dividend	– Benefits from ecotaxes – Benefits from lower labour taxes	– Variety of green revenues – Variety of green signals – Variety of usages for new revenue/ reduced expenses	– Greener spending precedes counter-financing – Greener financing sold to public mainly on fiscal virtues

5. Reordering our priorities within the MBI-portfolio

In retrospect, we may soon distinguish three phases of the MBI-debate. In the early years, it was all about ecotaxes. Academics of course debate everything. **But it is probably fair to say that in these years, eco-taxes got more public attention than all other MBI instruments in combination.** In the early 2000s, the focus was expanded to include all MBI instruments. **Now we have to open a third chapter: Economic instruments under the conditions of an economic crisis**.

The success of MBI-policies since their beginning in the 70ies and 80ies is overwhelming – not only in economic theory and research, but also through extensive empirical evidence. **All MBI instruments – from eco-taxes over emission trading to green subsidies for renewable energies and to slashing perverse subsidies – have proven that they work well, often even at negative cost to society.**

Notwithstanding this overwhelming evidence in favour of MBI, **we need to take account of political realities.** With few exceptions, MBI-policies have advanced not because of their popularity with the general public, but because of courageous and enlightened political leadership, particularly in Europe, usually coming to bear only at rare moments and under favourable economic conditions.

Through the decades from 1970 to 2000, the MBI debate was mainly an eco-tax debate. Around 2003 to 2007, most MBI-advocates opened their thinking to the new and wider portfolio of a comprehensive Green Fiscal Reform (GFR). But in the dramatic evolution of the global crisis, even this new order of priorities is quickly coming under pressure. In many countries, the unpopularity of eco-taxes is heightened, not only with lobbies but also with many or most ordinary citizens. **The public wants higher energy prices even less than before and hopes for relief from lowering taxes.**

The new conditions of the crisis may force us to reorder our priorities and our arguments. For those of us who have a strong preference for ETR, we may have to admit that for a number of political and institutional factors, it seems easier to expand ETS than ETR. Due to the economic crisis, we may also see better opportunities for cutting down perverse subsidies than for expanding ETR. We also should give more consideration to a strengthening of regulation, i.e. through eco-design. **If all this is true, we should not fight for a restoration of the priorities of the last decades, but adapt to the new conditions. We should not give up any tool lightly, but fight for the best use of all available tools.**

6. Finding a new balance between Ecotaxes and Emission Trading

Looking a efficiency and ease of administration, a majority of MBI-advocates seem to share a slight preference for ETR of ETS. In the international competition of the two tools, the election of Obama as new US president as well as the global crisis **may tip the scales in favour of trading rather than taxing**. Some analysts suggest that some US lobbies are only faking support for eco-taxes, hoping thereby to stir up anti-tax emotion as to discredit the whole initiative and hurt ETS as well. On the other hand, demands from third world countries for equal allocation may support a feeling among Americans that it is perhaps **better to pay carbon taxes to Washington, D.C. than to buy carbon rights from Ouagadougou, Burkina Faso**.

In the medium and long term, however, the very success of ETS may create new chances for ETR. The more ETS becomes a world wide system, the more we will come to see the same payoff we know from the evolution of the EU: Deepening versus widening. A wider ETS will make it more difficult to deepen and reinforce the system. **So progressive countries that want to move faster might have to use more ETR on a national or regional level.**

There is no way to predict the outcome of this policy debate, but we feel it is wiser to be open for both possible outcomes. Also, eco-fiscalists should think twice before they criticize either of the two instruments in public. Talking bad about these instruments will probably be most welcome to (and most abused by) the enemies of either form of MBI. **Our policy at Green Budget Germany is quite simple: From either the two instruments, we take as much as we get**. This probably is also true for the entire portfolio of MBI instruments.

7. Under conditions of a crisis, we should also accept second- or third-best options

As advocates of MBI and a rational choice of first-best policy instruments, we probably must prepare ourselves for a period of second-, if not third-best policies. **We may even have to prepare ourselves to defend second-best environmental policies against those who would prefer no environmental policy at all, or even anti-environmental policies. Given the necessity to create jobs, and quickly, we should not be too prudish about pure theory requirements as long as there is a positive effect on jobs and on the environment.** In practical terms, **we must be ready to acknowledge that second best instruments may still be better than no progress at all**.

Take VAT-differentiation: It is certainly no instrument for fine-tuning. But if – for example – the top third of most efficient refrigerators pays a lower tax rate than normal "fridges" and the worst refrigerators even pay an extra high VAT, we can expect positive effects on allocation. **Sometimes simple and even crude price signals work perhaps faster than more sophisticated and seemingly more "eco-correct" ones would do.**

Exhibit 2) Crisis changes the behaviour code

	Pre-Crisis Principles	New Rules in Crisis
Fiscal Discipline	– Balanced budget, budget neutrality of MBI-measures	– Deficit spending ma-kes "bad" fiscal behaviour even desirable
Allocative Efficiency	– First-best instruments in line with economic principles	– Compromising neces-sary; second and third best steps acceptable
Mix of Eco-Instruments	– **Balance of carrot *and* stick, push *and* pull**	– **Mainly carrots needed; more pull than push**
Priority shift		

Another example are wrecking subsidies for older cars: a true horror to any economist, since the goal of economics is the creation, not the destruction of goods. They worked well in terms of the classical Keynesian multiplier, but there are much better alternatives.

8. Moving from Green Deficit Spending to a Greener Capitalism

Many politicians and business people seem to be dreaming of a fast return to the *status quo ante* as an issue to the current crisis. They have not realized that the world will not and cannot return to the failed ways of the last thirty or forty years. There will be no way out of this crisis unless we recognize the close connections between the financial-economic crisis and the climate crisis. Both are the result of unsustainable behaviour.

The causes of the financial crises and the climate crises have many similarities. Key resources were too cheap and regulation too week. Most managers and investors were **part of the problem, not part of the solution**. Short-sightedness and greed ruled the day. Warnings were neglected, warners ridiculed. Economic and political elites showed the foresight of four-year-olds and failed gravely.

But perhaps the gravest aberrations of all: Most actors had lost any sense for the real sources of value. The financial sector, with exploding incomes and fortunes, had forgotten that **within the economy as a whole, it is the real economy where value creation takes place, not in the world of investment bankers and hedge funds**. **For the economy as a whole, people forgot that yet so many machines, computers, factories, buildings and roads will be worthless and produce zero wealth unless the underlying sources of value creation, namely land, air, water and other natural resources, are preserved and maintained so they can function properly.**

So our ultimate objective must be to overcome cowboy capitalism and make the transition to a softer, more social and nature-respecting market system. In German, we call this **Ökologisch-Soziale Marktwirtschaft**. In Asia, people are talking about **Confucian Capitalism**. Whatever we call it, this is a vision that could mobilize people and resources around the world to work for a common purpose and to rebuild our beautiful planet.

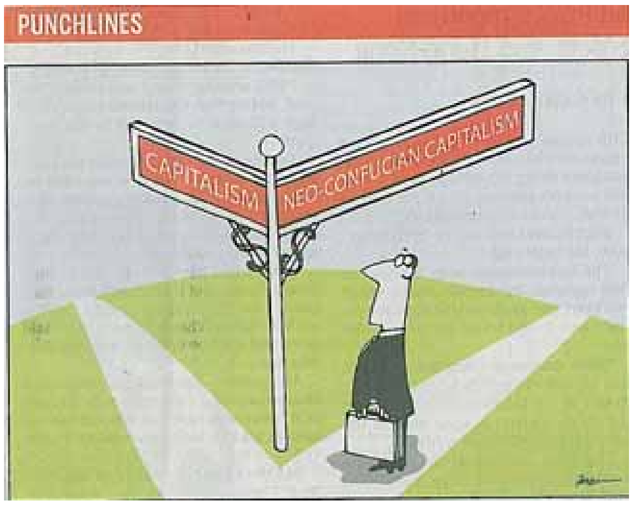

Exhibit 3) World at a crossroad