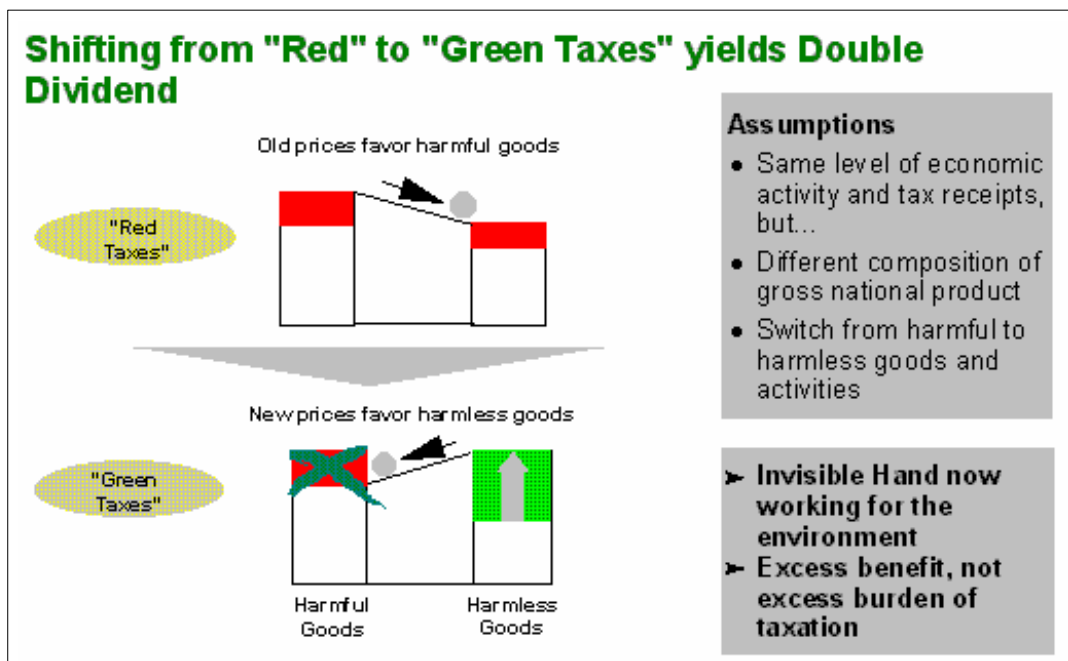




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FORGET DOUBLE DIVIDEND: ECOTAXES HAVE AT LEAST TEN DIVIDENDS TO OFFER!

Pros and Cons of Ecological Taxation from a European Perspective

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SUMMARY/ABSTRACT

Since 1999, Ecotax Reform has been in effect in Germany. Populist politicians from the right and some lobbies are still fighting it. But they are overlooking the many advantages ecotaxes have to offer. Far beyond the double dividend debate, there are technological and administrative dividends as well as moral and political ones. The paper also deals with many of the superficial anti-ecotax arguments. It was first presented at the 2nd Global Conference on Environmental Taxation (GCET) in Vancouver, April 2001.

Green Budget Germany (Forum Ökologisch-Soziale Marktwirtschaft e.V./ FÖS) is a nonprofit organisation, founded in 1994, with membership open to everyone. We specialize in Market-Based Instruments of Environment Policy (MBI) and participate in the German and European Ecotax and Emission Trading debate with own contributions. We seek dialogue with the business, scientific and political communities. With a number of partners, we launched **Green Budget Europe** as European Platform to advance MBI on September 25th, 2008 in Brussels. Among other publications, we publish newsletters in German and English: ÖkoSteuerNews and GreenBudgetNews.

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~ The stone age did not end because the world ran out of stones, and the oil age will end long before the world runs out of oil.~

The Economist, February 10, 2001

Ecotaxes are beginning to spread within Europe, but are far from being really accepted. The product is wonderful – some would say: a millennial concept – but the marketing could be improved. To improve the marketing, we need to point out the strong points as simply as possible. As most of you will not know, April 1st, 2001 also happens to be the second anniversary of the introduction of ecotaxes in Germany. So it's an appropriate occasion for a nice little birthday toast. And what would be more appropriate in a toast than to point out the virtues of the person to be honored? Here therefore, the ten principal arguments pro ecotaxes:

1. The famous *Double Dividend*: General Welfare improvement through shifting to taxes with excess benefit instead of excess burden. Particularly useful in situations of excessively high taxation of labor.
2. The *Budget Reduction Dividend*: Potential for budget reduction through using both sides of government budgets to achieve more target-efficient government.
3. The *Fiscal Administration Dividend*: Lowest collecting costs of all taxes (and tax evasion is no problem, but desired).
4. The *Technological Future Dividend*: Technological and long term dividend through impulses for resource- and energy-saving production and consumption patterns that promise higher sustainability. Corrective for excess labor productivity strategy in the past.
5. The *Ecological Policy Efficiency Dividend*: Not only better tax than other taxes, but also superior to many other instruments of ecological policy.
6. The *Ecological Administration Dividend*: Taxing a handful of substances leads to efficiency gains/pollution reductions throughout the economy and in many problem areas.
7. The *Prison Outbreak Dividend*: Using ecotaxes, national environmental policy can break out of the prisoner's dilemma of international competition.
8. The *Globalization Dividend*: Advantages not only for rich countries, but also for the third world; great tool to implement principles of global governance among sovereign Nations.
9. The *Political and Democracy Dividend*: Ecotaxes can reconcile conflicting political "camps" and supply common grounds for both liberals/greens and conservatives.
10. The *Moral dividend*: Reduction of ethic dilemmas and value conflicts in our society. What's good for shareholders should pose no harm to our grandchildren.

My first visit to Canada took place in 1982 and lead me first to Montreal. In the heart of the city, there is a wonderful monument, probably inspired by **James Fenimore Cooper**. It shows a huge fir tree, and when you go close, you can discover many heads of Indians in the leaves of the tree. Below, the inscription reads in French: *Voici la forêt, s'en tournant en autant des Indiens*. Looking at the forest, you can see how the trees turn out to be Indians. The statue shows impressivly how much the early white Canadians were frightened by the red Canadians who were there first.

To many people, ecotaxes also appear as something very frightening and threatening. And they come up with an awful lot of counterarguments. But the more I look at the thick forest of anti-ecotax arguments, the more I find that the longer and closer you look, the arguments against ecotaxes turn out to be pro-ecotax arguments. Let me show what I mean.

1. The famous double dividend: general welfare improvement through shifting to taxes with excess benefit instead of excess burden

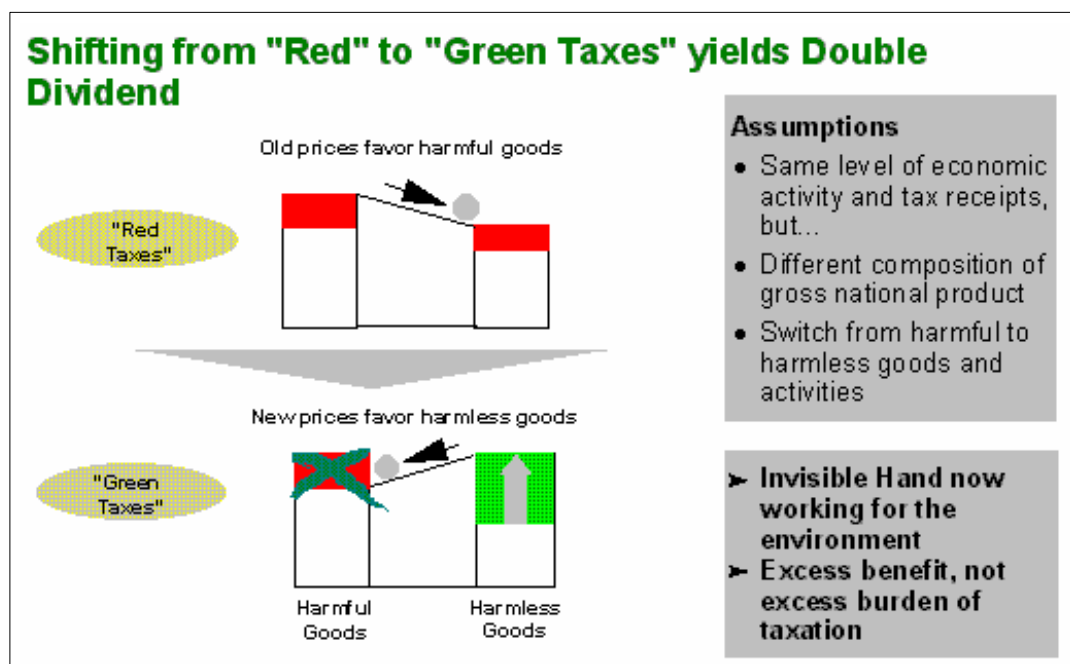
We are living in an epoch where the word „tax“, although written with three letters, has in fact nearly become a four-letter-word. For the conservatives in some countries, it could also be spelt in five letters, like T-H-E-F-T.

A radical French Philosopher, **Proudhon**, once declared *La propriété, c'est le vol!* Today, we seem to believe almost the contrary: *La taxation de la propriété, c'est le vol.* Not property, but taxation of property is an act of thievery, committed by greedy governments to hurt innocent citizens and companies. Modern economists have done a lot to support this view, by writing excessively about the *excess burden of taxation*. In other words by pointing out a that to give a dollar to the government may cost 1.5 or 2 dollars to the economy.

Now all of a sudden, here comes a tax that offers not only money to the government, but extra benefits to the commonwealth. Because everyone is better off by taxing evil things instead of good and useful activities.

The more conventional definition of double dividend is that ecotaxes are beneficial both for the environment *and* for the labor market. They create jobs and reduce pollution. This is particularly true and useful in situations of excessively high taxation of labor, as is or was the case in most European countries.

Personally, I prefer a more general definition of double dividend: Using a tax that brings welfare improvements on top of tax revenues. So by shifting to such a tax, you get an excess benefit instead of excess burden. But however we define it: The double dividend is the still the classic and the best argument in favor of ecological taxation.



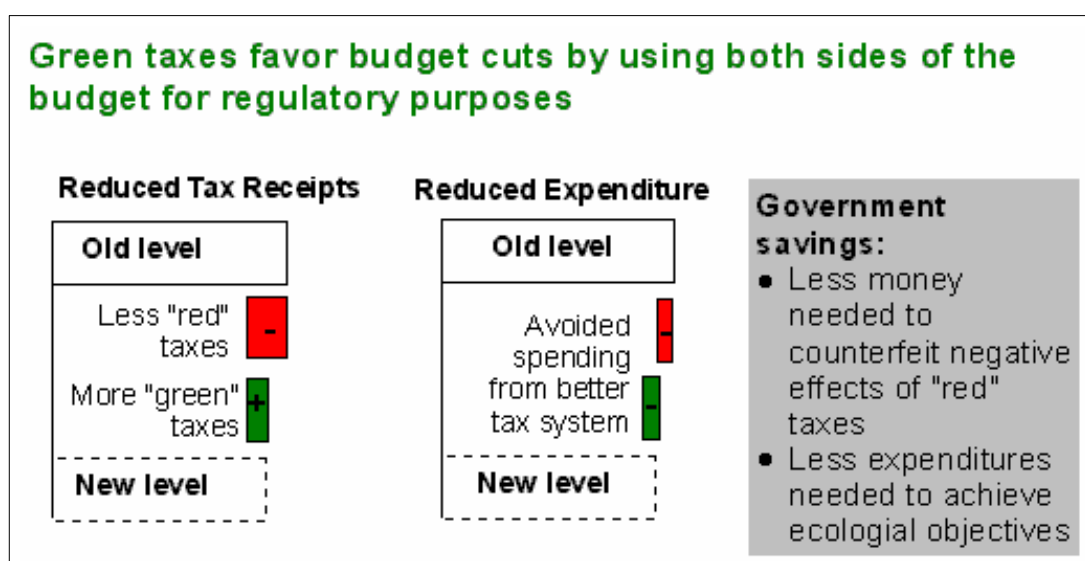
2. The budget reduction dividend: Potential for budget reduction through using both sides of government budgets to achieve more target-efficient government.

At the beginning of the Ecotax Debate, and unfortunately still today, ecotaxes were suspected to be something like a Trojan horse. Just another ruse by government-friendly liberals to grab more money from the people and shove it into the hands of spend-easy governments. Protagonists of ecotaxes have been very defensive about this point. Their general reaction was to proclaim the principle of tax- or budget-neutrality of ecotaxes: Every penny of ecotax revenue should be returned to the tax-payer, by reducing other taxes or contributions.

Under the heavy assault of criticism, this defensive reaction was understandable and more than justified. More so: It was very successful, at least within the own ranks. Throughout Europe, a remarkable consensus was achieved within the pro-ecotax coalition. Ecotaxes should not become a hidden tax raise strategy.

However, by reacting from a defensive stance, the advocates of ecotaxes fell into a trap. They became oblivious to one of the very virtues of their own proposition, namely the natural propensity of ecotaxes to cut government spending. This is what I call the budget reduction dividend of ecotaxes, and there are two reasons for this effect.

- First, the more ecotaxes we have, the more ecological policy goals we will achieve simply by collecting ecotaxes. In consequence, the less public money we will have to spend on other instruments of ecological policy. This is what you get by using intelligent taxation.
- Second, the more conventional taxes we are able to substitute by ecotaxes, the less we have to spend in making up for the negative consequences of conventional taxation. Conventional taxes suffer from a catch-22-effect. The more of them you collect, the more you have to spend to make up for the damage created in collecting them. Taxes on labor burden the labor market, and hence you have to spend additional government money for employment policy. Taxes on capital are a burden on investment, and hence you have to again spend money to subsidize and support investors of capital.



The first practical experiences within a majority of European Union members have confirmed this argument as a fact of reality. Throughout Europe, the rise of the share of ecotaxes goes hand in hand with a policy of overall budget reduction.

The recognition of these effects holds a more general lesson, not only true for ecotaxes. The more governments manage the burden shift from detrimental forms of taxation to taxes with positive allocative effects, the more they will be able to reduce the overall burden of taxation. *Intelligent burden shifting allows for overall burden reduction.* I believe this is one message that ecotax protagonist have completely undersold, a message that should sound very sweet also to the ears of the more conservative part of the general public.

3. The fiscal administration dividend: lowest collecting costs of all taxes

Ecotaxes have often been criticized as a new source of bureaucratic hassle and red tape. Indeed, if you look at most of the new ecotaxes introduced throughout Europe, you find awfully long legal texts and administrative provisions. As the saying goes, a camel is a horse – designed by a commission. Particularly if designed by the European Commission.

But if you take a second look, you will find that a lot of this bureaucracy is caused not by the protagonists of ecotaxes, but by their adversaries. Because of the opposition from countries like Spain or Ireland, a European consensus has been blocked for almost a decade. Tax changes in Europe are subject to an unanimity rule. Mainly because there is no European consensus for ecotaxes, national ecotax legislation has to make many compromises to appease internationally competing branches of industry. And it is sometimes very surprising to find how many industries feel they are internationally competing, even plumbers and local services or subway operators...

But if we compare ecotaxes to conventional taxation under the aspect of administrative costs, again ecotaxes come out as a clear winner.

- First, no tax has such a small number of actual contributors in the sense of individuals or corporations that actually have to declare and pay the taxes to the government. Germany has a population of 80 million. Of these 80 million people, about every second is subject to income taxes. About 30 million are subject to social contributions for health, pension or unemployment, but these levies are usually collected from employers, not from the employees. Other company taxes, like corporate tax, trade tax and value added tax, have to be declared and paid by approximately 4 million corporate or personal firms.

In contrast, ecotaxes on electricity, natural gas or heating fuel are paid only by several thousand energy providers. The mineral tax on gas or diesel fuels is paid for by only a handful of national or multinational importers and distributors of these fuels.

The only reason why also many companies have to file energy tax declarations are the well-known exceptions and subsidies. But all in all, there are well below a million economic units that are bothered by the administration of ecotaxes in Germany.

- Second, a lot of the complexity of modern tax laws in all countries results from the ingenuity of people for legal tax evasion. I am not talking of illegal tax evasion or fraud. So governments create new tax laws, then people discover new bypasses to avoid the tax, and governments react by creating additional laws and provisions.

With ecotaxes, there is a decisive difference. They are the only form of taxation, where tax evasion is not a problem but highly desired. Everyone who finds a way to avoid energy taxes but using less energy is doing exactly what ecotaxes are all about.

At this point, let me add something about the famous self-exhaustion argument against ecotaxes. Some people keep repeating the same argument again and again, namely that the more successful ecotaxes are, the less ecotaxes would be paid in the economy. Three short remarks to this line of thinking.

- First, with ecotaxes as a historic newcomer in the family of taxes, this concern seems somewhat premature. With the exception of fuel taxes, most ecotaxes are rather young and therefore still small in level and volume. As a consequence, most ecotaxes are still on the far left side of the *Laffer Curve* (which shows the relationship between tax rate and total tax revenue). So in most cases, we can increase tax rates considerably without having to fear a reduction in total tax revenue. As long as we are left from the summit of the *Laffer Curve*, we can raise both taxes on energy and the total tax revenue, even if we manage to reduce overall energy consumption.
- This leads me to the second remark. On a global level, we have both a growth in world population, and a growth in per capita income. So the product of both, namely global purchasing power, can be expected to grow in the future. If energy prices do not increase considerably, growing world purchasing power will lead to growing world energy consumption. We will need energy taxation, if only to slow down the growth in energy consumption, and even more so, if we honestly strive to reduce that consumption.
- Actually, the exhaustion argument holds much more truth for some of the conventional taxes, namely taxes on labor. At least in Europe, taxes and social contributions burden on the factor labor have done a lot to destroy their very tax base, in creating millions and millions of jobless people.

In reality, the tax base erosion argument holds much more for conventional tax than for ecotaxes.

4. The technological future dividend: technological long term dividend through impulses for resource- and energy-saving production and consumption patterns that promise higher sustainability

Even without and before ecotaxes, the technological innovations of our time for the most part are much less energy intensive than the technologies they substitute. A chip uses less energy than a transistor, the transistor needed less energy than the old-fashioned radio tube. To send an email costs less energy than a conventional letter, even if you calculate the energy for all the useless spam mails that come along. The multi-purpose vehicle is perhaps a counterargument – but others would rather call it an aberration than an innovation.

Adversaries of ecotaxes argue that government should not try to predict, let alone to prescribe the technological avenues of the future. Rightly so. But to save energy, by all means, seems like a no-regret-strategy. If, against all probability, the threat of a climate catastrophe should turn out to be a mistake: Can there be any doubt that fossil resources will come to an end one day? Would it be a mistake if our societies learn better how to save energy, even if there was no greenhouse effect?

At least in Europe, with its excessive level of labor taxation, there is another argument for correcting this government-induced bias for labor-saving progress.

In the past two or three decades, labor productivity has increased about three times faster than energy productivity. If only to make up for these past errors, it is certainly no mistake to correct that growth strategy in favor of a new growth path that puts more priority on energy and resource saving than on labor saving technologies.

As the winner of the Alternative Nobel Prize, the German nuclear physicist **Hans Peter Dürr** has put it: *Let's make kilowatt hours unemployed, not people*. It is much better ending up with perhaps a few kilowatt hours on the dole than human beings without job.

5. The ecological policy efficiency dividend: not only better tax than other taxes, but also superior to many other instruments of ecological policy

In the debate about ecotaxes, there is a funny reversal of ideological preferences. Those who, in general economic policy, are the hottest advocates of market-based instruments, in the ecological instrument debate suddenly appear as the staunchest protagonists of regulation, command and control. On the other hand, the Liberals both in Europe and in North America, who always get criticized for their lack of market orientation, suddenly appear to be better disciples of the Smithian Gospel than the conservatives.

But honestly: Can there be any doubt, that free market forces will provide for better ecological solutions than the prescriptions of bureaucrats and regulators? Is there any need to argue why setting the right incentives, namely higher energy prices, will lead to far better results than any form of government regulation, telling people and companies how to save energy, could bring about?

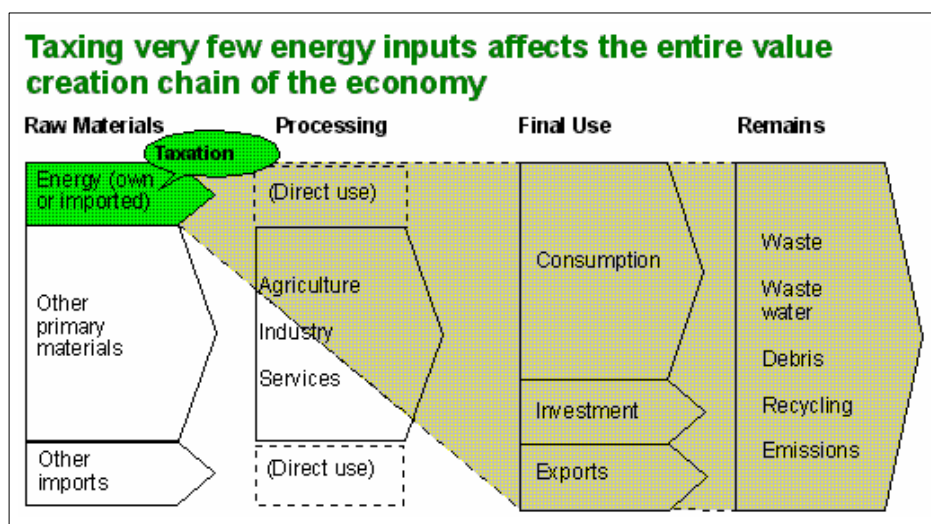
The only debate we really need to have is the debate between the two alternatives of market-based environmental policy, namely the debate between ecotaxes and eco-certificates.

I think there are three principal reasons why at least on the national level, ecotaxes should be favored over tradable emission or consumption rights:

- If tradable rights are sold by the government, they are theoretically no real difference to ecotaxes. Mathematical economists would call the one the dual of the other, in other words: not a tremendous alternative. In the practical world, ecotaxes are simply more easy to administer than emission rights.
- If tradable rights, however, are created in a way that today's polluters can sell past pollution as an asset on the market, then we have two big problems. First, we will favor old industries and old solutions over new industries, new players, and new solutions. Second, there will be no revenue for the government, and therefore no chance to reap a double or multiple dividend for the commonwealth. There will be no chance to lower conventional taxes, and the sale of pollution or emission will be an additional revenue to the old, dirty industries, and a burden on the growth of new, innovative and less polluting competitors.
- Finally, I have a strong suspicion that the debate about tradable permits is just a political diversion. At least in Europe, the advocates have not done their homework. They have failed to provide anything like concrete proposals. Until there is proof to the contrary, the suspicions

remains, that these proposals are meant only to prevent or inhibit ecotaxes, but that their protagonist have no honest interest to promote permits as a practical alternative to ecotaxes.

As for the protagonists of ecotaxes, I believe we should try to shift the burden of proof to the advocates of permits. If they really want these to become an element of policy, they should make clear political proposals, not just criticisms of ecotaxes. Only then we could have a fair and open debate about the real alternatives society has to choose from.



6. The ecological administration dividend: Taxing a handful of substances leads to efficiency gains/pollution reductions in many problem areas throughout the economy.

One of the frequently heard arguments against ecotaxes is that no one knows the „ecologically correct“ level of ecotaxes and that adoption of the principle of ecotaxes would lead to hundreds, if not thousands of substances that should be subject of ecological taxation.

Of these two arguments, the first one can be rebuked very simply. No one knows the true cost of any of the external effects involved in the use of energy or other problematic substances. But this argument misses the point. We do not need to know the correct price level of any substance, and no one ever will. All we need to know is whether the level of consumption or emission of any given substance is sustainable. And this question is less difficult to answer. As long as the level of consumption is higher as longtime sustainability would suggest, we have to reduce it. In other word: It is a lot easier to define sustainable quantities than sustainable prices. So as long as the actual quantity seems unsustainable in the future, actual prices are too low and we have legitimate reason to increase the prices.

To rebuke the other argument, Nature does us a big favor. Not because of the virtue of ecotaxes, but because of the natural laws of physics and chemistry, we can profit from a very simple fact. Most processes that are an ecological problem are also energy-intensive. If we reduce energy-intensity, we have an indirect, but very welcome side effect of reducing ecological problems. The good news is: By taxing a very limited number of fossil energy agents, we can indirectly attack a multitude of

ecological problems. Reducing energy consumption implies less pollution, less traffic, less waste, and less exploitation of resources.

Because energy happens to be the principal agent of 90 percent or more of all industrial or consumption processes that are ecologically problematic, we need to tax only the five principal sources of fossil energy to change thousands and thousands of processes in the economy.

7. The outbreak dividend: Using ecotaxes, national environmental policy can break out of the prisoner's dilemma of international competition.

Conventional environmental policy in most countries is based on regulation. Prohibition of dangerous substances, prohibition of dangerous processes and activities. All of this implies a heavy burden of bureaucratic command and control. These measures are not reflected in national tax rates, but they pose a heavy burden for national competitiveness nonetheless. I call this the invisible tax burden of orthodox, conventional ecological policy. Not leading to tax revenues, but burdening the national economy nevertheless.

So conventional ecological policy faces the well-known prisoner's dilemma. The more a nation tries to do in favor of the ecology, the more it will hurt its economy in international competition.

Ecotaxes can offer a way out of this dilemma. To be clean no longer means to stay poor, to hurt your nation in global competition. Because if you achieve cleanliness through ecotaxes, you can return the tax receipts to the taxpayers, with no increase, even with a decrease in the overall tax burden imposed on national industry.

This new paradigm offers a way out of the Prisoner's Dilemma. You can behave globally responsible without paying a price in global competitiveness. You can become a better behaved global citizen without sacrificing national well-being.

8. The globalization dividend: Ecotaxes offer advantages not only to rich countries, but also to the Third World.

In the global environment debate, Third World countries understandably argue that sacrifices for the environment should begin in the rich countries, not in the poor. Again, this is an argument that is entirely logical when we are speaking of traditional ecological policy instruments. These instruments cost a price to society, and they represent an additional burden for any economy that comes on top of the burden from taxes and social contributions.

For ecotaxes, there is only a burden to those consumers or producers, that are using proportionally more energy than the average consumer or producers. There is no burden for society as a whole.

In practical terms, energy taxes may be a very elegant way to finance investment in roads and other means of transportation, that are high on the development agenda. It also appears that they would be much easier to administer and control than more traditional tax schemes that are based on income or consumption. For countries like China, South Africa or India, it is hard to imagine the introduction of European or North American type complex taxation structures.

Energy taxes may also turn out to be a great tool to implement principles of global governance among sovereign Nations.

9. The political and democracy dividend: Ecotaxes can reconcile conflicting political "camps" and supply common grounds for both liberals/greens and conservatives.

If you look at the heated political debate about ecotaxes, they are certainly a most controversial subject. And some opponents even call ecotaxes undemocratic, because they restrict the free choice of citizens in the market.

I believe that both arguments miss the point. To the contrary, I am quite convinced that ecotaxes can be an instrument of reconciliation between conflicting ideological camps, and I feel that they are not an obstacle, but rather a condition for a society that honors the principle of free choice.

- As mentioned before, ecotaxes lead to confusing coalitions. At least in Europe, the Ecotax Debate did a lot to reconcile the political Left both in the Green and the Labor Movements with the teachings of **Adam Smith**. In the beginning of the ecological reform movement, there was a clear preference for the instruments of command and control. But environmentalists soon realized that market-based instruments, in particular ecotaxes, are by far more efficient than old-fashioned regulation. In other words: The Left began to discover the virtue of the Invisible Hand. The new Green woman **Renate Künast**, head of the newly formed German Ministry for Consumers and Agriculture, recently quoted Adam Smith in a long article in the very conservative *Frankfurter Allgemeine Zeitung*.

If, on the other hand, classical conservatives accept the need for sustainability and ecologically motivated reforms, both camps could discover common ground in using market-based rather than administrative tools to bring these reforms about. At least in principle, many European conservative parties accept ecotaxes in their party programs.

- Some people oppose ecotaxes with slogans such as "*Free citizens demand free driving*" and the like. A lot of this is only political rhetoric, of course. In most Western countries, all systems of traffic – road traffic, air traffic, railroad traffic – are directly or indirectly subsidized by governments. But more and more we come to realize that in a modern and ecologically sustainable society, these traffic systems must bear at least their full conventional costs, if not the ecological costs of negative external effects. For economic, fiscal and ecological reasons, massive subsidies for traffic systems and mobility cannot be maintained on the current level.

In the long run, the free choice of people can only be preserved, if traffic prices are telling the economical and ecological truth. Singapore is an impressive example of a State that restricts the freedom of mobility by a combination of monetary and administrative controls. In a liberal society, there should be a clear preference for monetary measures versus administrative restrictions.

Freedom of choice is a wonderful thing. But only if the free choice is not misled by erroneous price signals.

10. The moral dividend: Reduction of ethic dilemmas and value conflicts in our society. What's good for shareholders should pose no harm to our grandchildren.

The tenth dividend of ecotaxes is perhaps the most important and precious one. The great majority of people in all countries has no interest in the destruction of Nature, in bringing about a Greenhouse effect, and in depleting our natural resources so that nothing is left to our children and grandchildren.

In honest moments, the majority also realizes that in our daily behavior, both as consumers or producers, we are all violating these long term interests and values. We are doing so, not because we are morally bad persons, but because nothing changes if we try to step out of this process of collective destruction of nature on an individual basis. As a corporate executive today, you cannot serve the interests of the shareholder without violating the interests of your family and your children.

Ecological destruction is a collective crime, committed against nature and posterity. But there is a decisive difference between collective crimes and individual crimes. An individual crime, like theft or murder or violence, can be stopped seemingly by the individual not doing it. A collective crime does not stop if some individuals stop to participate in it.

There is a deep knowledge of most people that we must change our collective behavior, but that individual changes will not stop the collective damages. The result of this conflict between collective knowledge and collective behavior to many people leaves only two ways out: either they ignore this dramatic conflict of values, or they become cynical about it. This dilemma is fully comparable to people's situation under dictatorial regimes. If you step out of the game individually, if you become a dissenter, you pay a very high price but nothing changes. So after a few years of dictatorial rule, you end up with a majority of people that are indifferent or cynical. Usually such regimes result in the moral corruption not only of the governing elites, but also of the majority of the governed.

In 1776, someone wrote about a similar situation: It is the right of the people to alter or abolish it. This principle is not only true of political dictatorships. It also applies to market regimes where wrong and misleading prices are governing the behavior of the masses.

It is our right, and I believe: our obligation as responsible and enlightened people, to alter or abolish such a regime. By doing so, we will harvest the moral dividend of ecological taxation.

