

ECOTAX

GBG-MEMORANDUM 2004

**GREEN BUDGET GERMANY DEMANDS
FOR ECOTAX AND FISCAL REFORM
IN GERMANY FROM 2005**

November 2004



IMPRINT

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Green Budget Germany is a non-party lobby organisation campaigning for ecological fiscal reform. While it focuses on the most central element of EFR, ecological tax reform, the organisation also lobbies for other important eco-fiscal instruments such as emissions trading and the dismantling of environmentally damaging subsidies.

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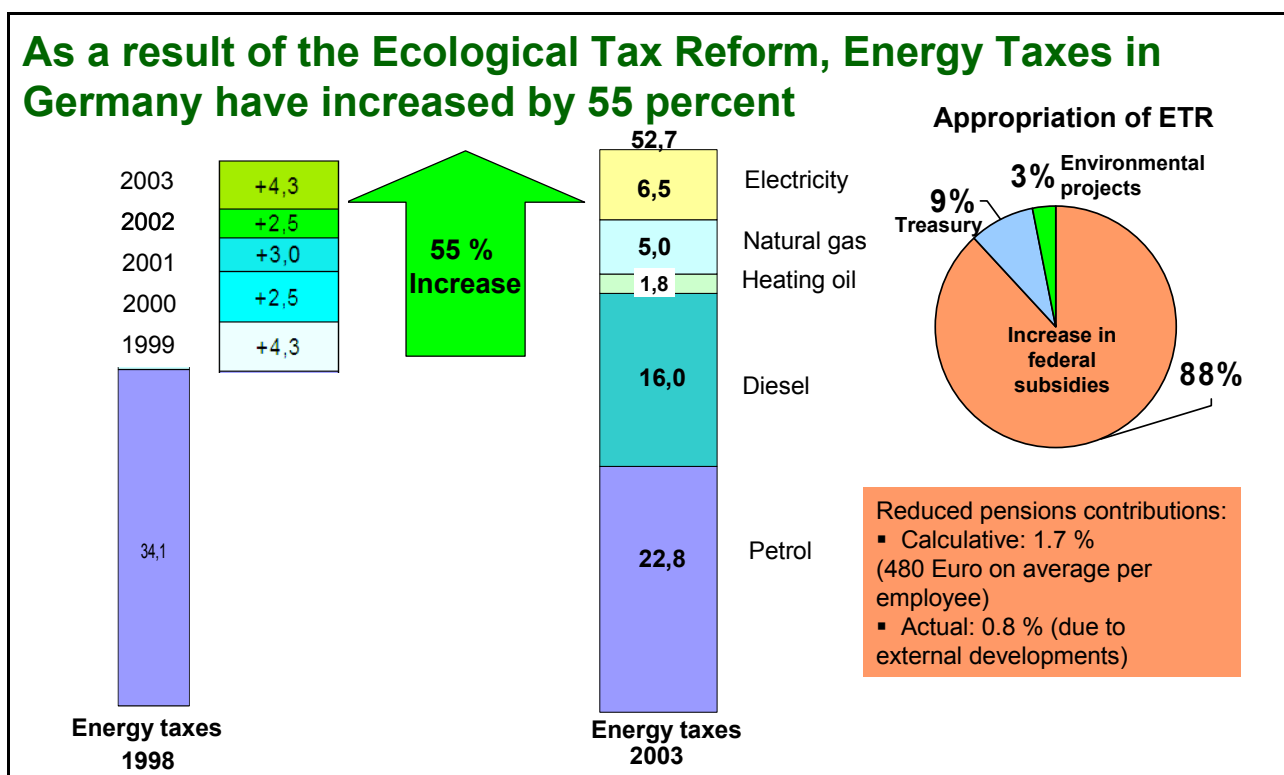
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REVIEW: THE ECOTAX STAGES 1999 TO 2003

Phase one of the ecological tax reform in Germany ended on 31 December 2003. Since 1 April 1999, taxes on petrol and diesel, electricity, heating oil and natural gas had been increased in five stages, and the bulk of the tax revenue generated used to reduce pension insurance contributions.¹ Over this period, the total volume of energy taxes rose from 34.1 billion Euros in 1998 to around 52.7 billion – an increase of 55 percent.

Figure 1: Key financial impacts of the socio-ecological tax reform (in EUR billions)



Source: Federal Ministry for Finance <BMF>, Federal Ministry for the Environment <BMU>, Federal Statistical Office. The total amount of 52.7 billion Euros also includes other revenues, e.g. for natural gas as fuel.

Although the promise of revenue neutrality has not been met in full, the analysis of ecotax appropriation indicates that it has been largely met.

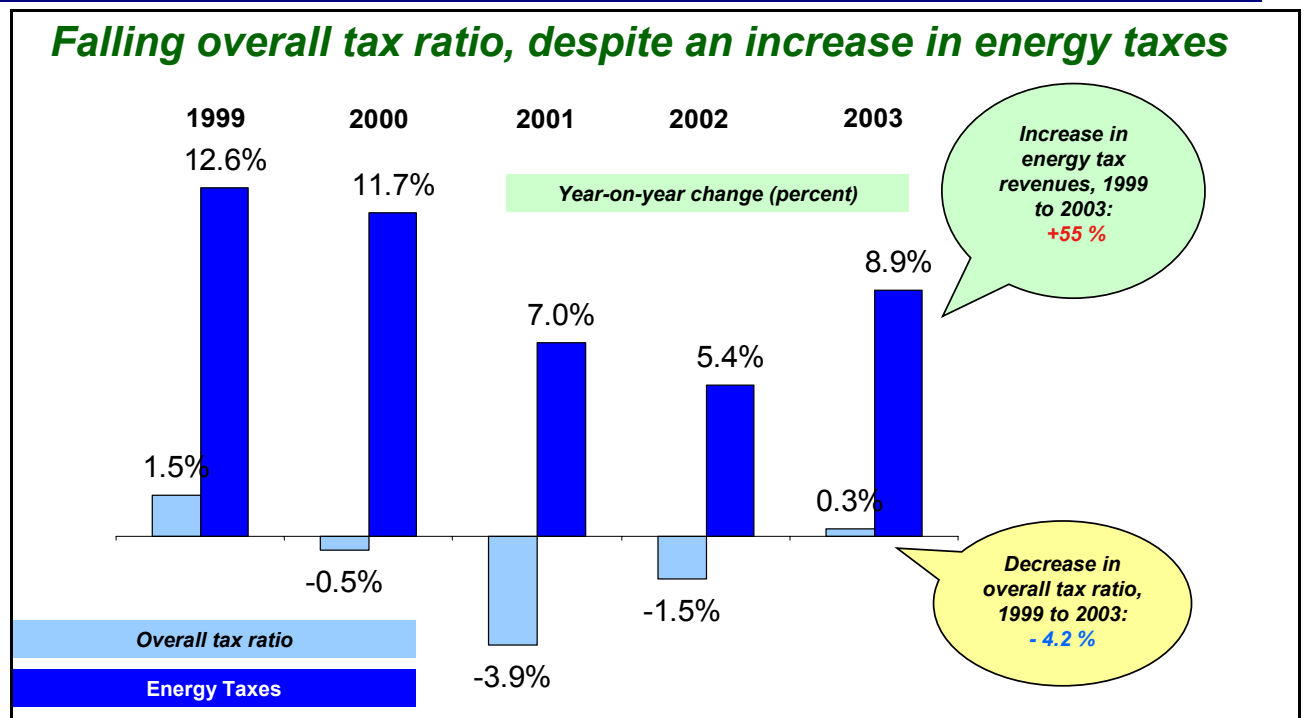
- At 16.4 billion Euros (approximately 88 percent, or eight-ninths of revenue), the federal subsidy to statutory pension insurance institutions was increased from around 60 billion Euros in 1998 to more than 76 billion Euros. As a result, the rate of contributions to pension insurance is now some 1.7 percentage points lower than it would have been without this increased subsidy.
- Around half a billion Euros (three percent of the ecotax revenue) was used for ecological programmes, particularly the federal government's market incentive programme to promote investments in renewable

¹ Further information on the ecological tax reform may be found e.g. at <http://www.bundesfinanzministerium.de/Steuern-und-Zoelle/Mineraloel-und-Strombesteuerung-.732.htm> and <http://www.bmu.de/de/1024/js/sachthemen/finanzreform/kurzinfo>.

energies, and for the Reconstruction Loan Corporation's <KfW> CO₂ building renovation programme for the energy-efficient renovation of old buildings.

- Around nine percent of ecotax revenues were allocated to consolidation of the budget, predominantly in 2003. Significantly larger amounts from the flat rate reduction in the ecotax discount for industry from previously 80 percent to just 40 percent were allocated to debt coverage on a short term basis. This contravenes the principle of revenue neutrality.

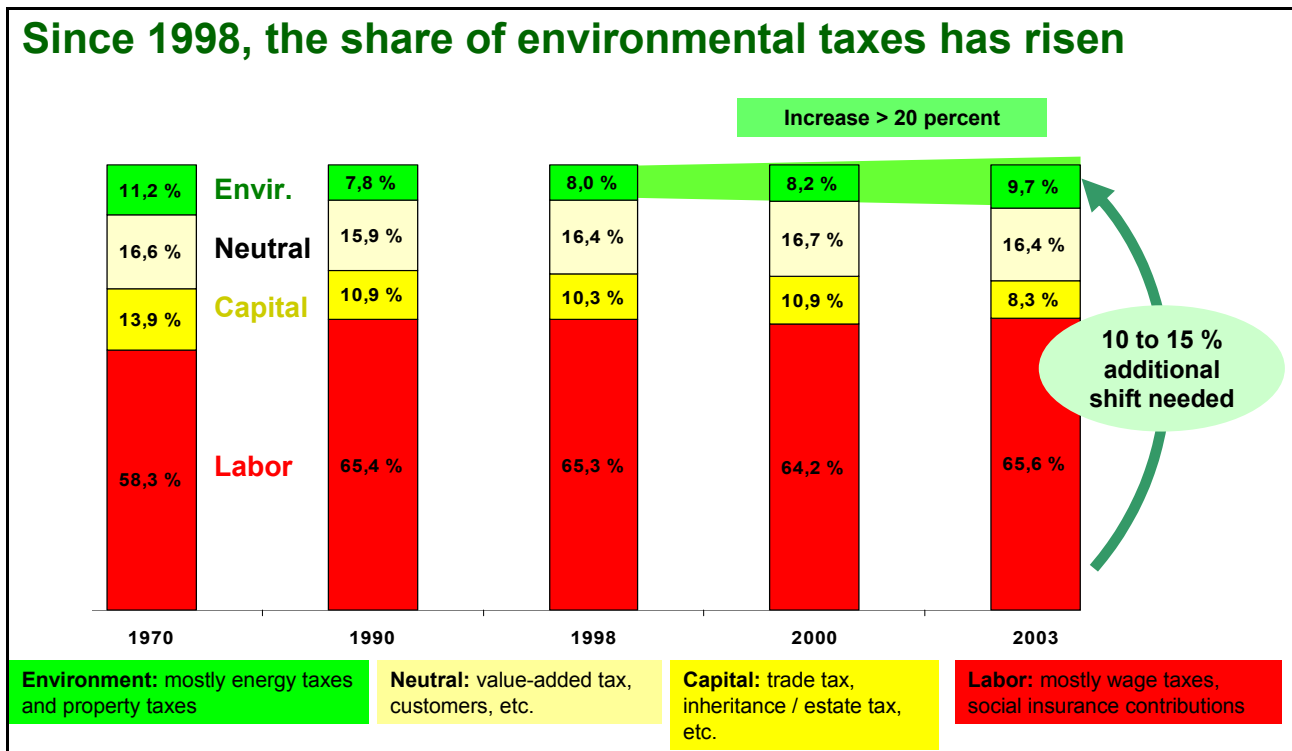
Figure 2: Energy tax revenue and overall tax ratio² compared with the previous year



Source: Own calculations, Federal Ministry of Finance

Figure 2 confirms that the socio-ecological tax reform did not lead to an increase in the overall tax ratio. In fact, this ratio has fallen since 1999.

² The overall tax ratio comprises the sum total of all taxes and social security contributions as a percentage of gross domestic product.

Figure 3: Distribution of the overall tax ratio between the factors employment, capital and environment (percent)

Source: Federal Environment Ministry (BMU), Federal Ministry of Finance.

At the same time, the increase in the federal subsidy to 76 billion Euros finally met a longstanding demand by both pension insurance institutions and employers' associations alike: **For the first time in the history of German pension insurance, contributors were only required to pay for defined contribution benefits.** Additional socio-political benefits – the famous ‘non-defined benefits’ – should be largely, if not completely, covered by the record level of federal subsidies now achieved.

Measured in terms of the country's overall tax revenues (2003: around 864.3 billion Euros), the socio-ecological tax reform of 1999 to 2003 **increased the proportion of taxes levied on the factor ‘environment’ from 8.0 percent in 1998 to 9.7 percent in 2003.** Yet a far more radical correction of this inappropriate distribution of burdens is needed.

During its first five years in force, the ecological tax reform brought tangible environmental improvements:

- For the first time since the establishment of the Federal Republic of Germany, fuel consumption, and hence CO₂ emissions in the transport sector as well, fell for four years in a row (2000-2003), whereas prior to this they had increased almost every year without exception. As a result, CO₂ emissions were cut by around six to seven percent compared with the high of 1999.³
- The main reasons behind the decline in fuel consumption – apart from the poor economic situation since 2001 and the phenomenon of ‘petrol tourism’ (customers crossing the border to fill up in countries where fuel prices

³ DIW weekly report 10/2004 and Federal Statistical Office.

are lower) – were primarily the adoption of fuel-conserving driving practices, a reduction in the mileage driven, and initial success in attempts to reduce the specific fuel consumption of new vehicles.

Figure 4: Declining fuel consumption in road traffic

2000	2001	2002	2003
-2.8%	-1.0%	-2.3%	-2.9%

Source: Federal Statistical Office

- Since 1999, the number of passengers using public transport has increased – for the first time in many years. Up until 1998, passenger numbers on public transport fell continuously but since then, the trend has been reversed and numbers have increased for five years in succession.

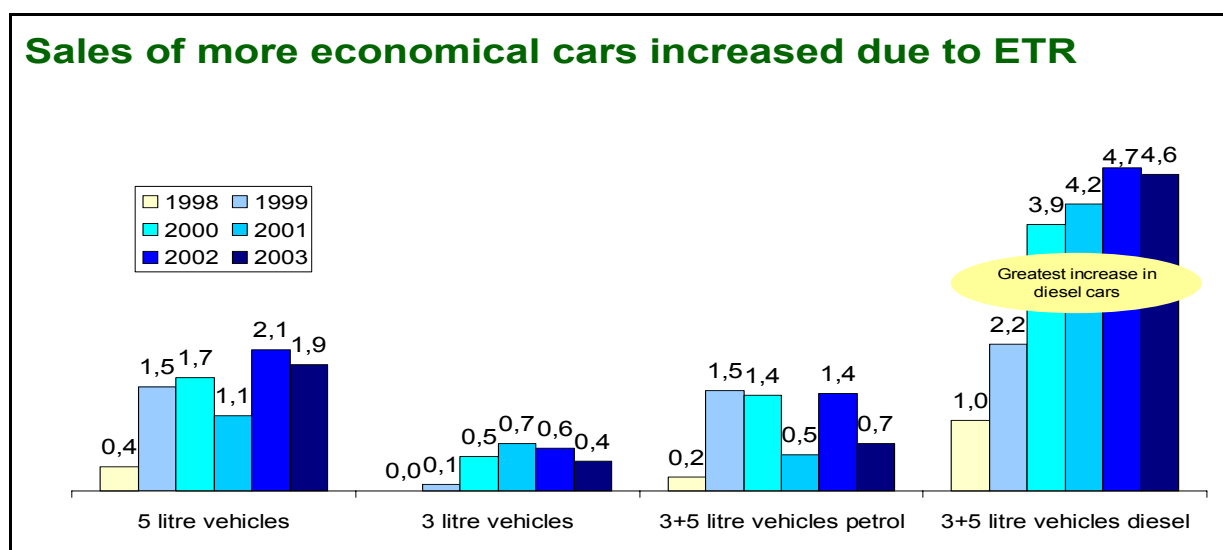
Figure 5: Increases in the number of passengers using public transport, 1999 to 2003

1999	2000	2001	2002	2003
+0.4%	+0.8%	+0.8%	+0.5%	+1.5%

Source: Federal Statistical Office

- Fuel consumption has also reverted to being a key decision-making factor when purchasing a vehicle: The consumer research organisation GfK (Nuremberg) undertook a representative survey of German car drivers and ascertained that for 63 percent of all those questioned, high fuel prices influence the purchase decision of their next car. According to a recent survey by the market research institute Emnid, 89 percent of respondents claimed that environmental compatibility is their top priority when buying a car.
- As well as the reduction in fuel consumption, the number of natural gas-powered vehicles in Germany also increased by 2,000 between 2000 and 2004, to more than 20,000 in total. This reflects the tax advantages of using natural gas in the transport sector, as well as the commitment to develop a nation-wide network of natural gas filling stations by 2006.
- The number of new registrations of five- and three-litre cars⁴ has also increased significantly.

Figure 6: Number of new registrations of three- and five-litre cars in the vehicle fleet



Source: Own calculations based on figures provided by the Federal Vehicle Traffic Agency 2004

⁴ Cars that require five or three litres of fuel respectively to travel 100 kilometres.

- The transport companies are responding to the growing pressure to adapt with increasingly rational vehicle deployment. For example, according to the Federal Office for Freight Traffic, the proportion of unladen mileage driven by German HGVs has been further reduced, whilst laden mileage has increased, both to a slightly greater extent in 2000 than in previous years.

Figure 7: Proportion of laden versus unladen mileage in freight traffic

1995	1998	1999	2000
71.4%	73.4%	74.1%	75.3%

Source: Federal Office for Freight Traffic

- According to figures provided by the umbrella organisation for German CarSharing providers (Bundesverband CarSharing), the number of customers who are members of a car sharing organisation increased by 26 percent in 2000, 22 percent in 2001, 8 percent in 2002 and 15 percent in 2003 in relation to the previous year.
- The manufacturers of solar thermal installations for the supply of hot water are likewise showing double-figure growth rates – renewable energies are booming, thanks in part to the ecotax on heating fuels and the market incentive programme for renewable energies funded from the ecotax. At the end of 2002, there were more than 4.2 million square metres of solar panels in total in Germany, twice the number installed in 1998.

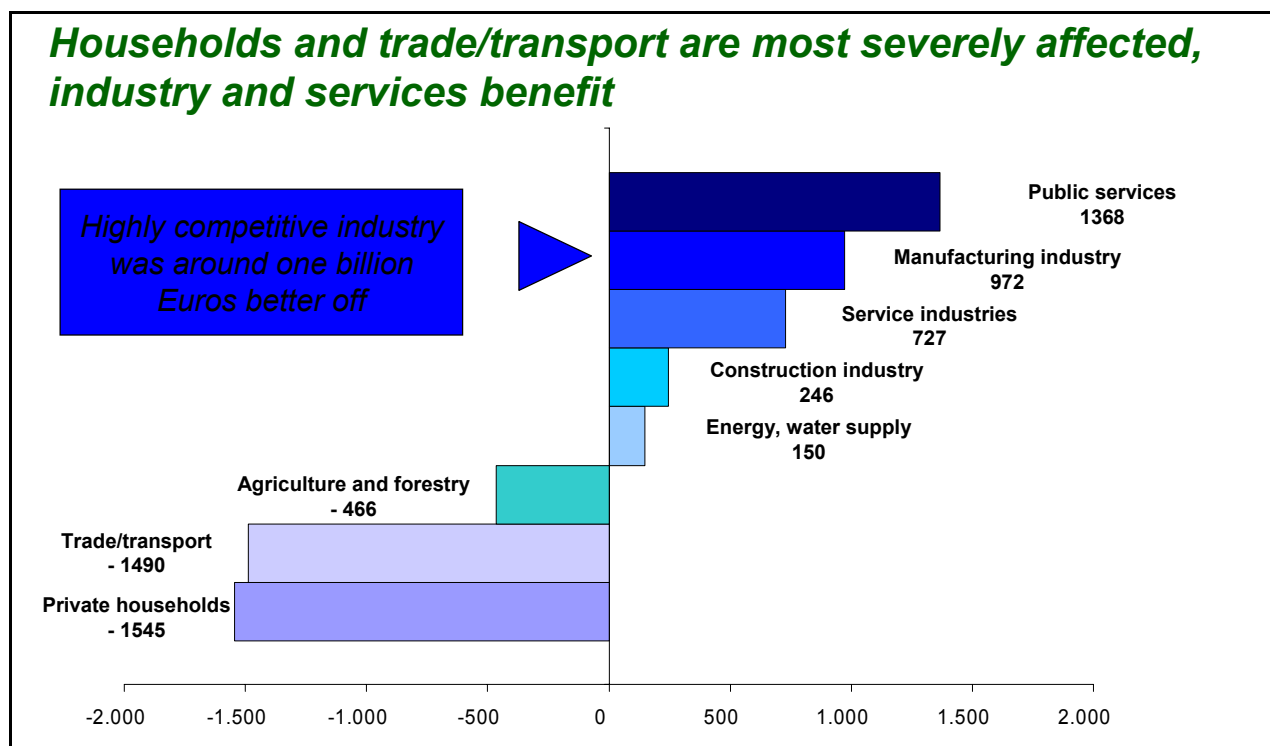
These developments cannot be attributed to the ecological tax reform alone. The world market price for crude oil, the dollar exchange rate, the economy, and government subsidy programmes all likewise play a key role. However, the decisive fact is that higher energy prices influence consumer behaviour, and the ecological tax reform lends additional impetus to this process. Looking back to the year 2000, it becomes clear that successful savings were essentially triggered by the socio-ecological tax reform. Rarely has energy saving been publicised so comprehensively. This took place despite the supposed perception that the ecotax is primarily ‘to blame’ for the high oil prices. At the time, however, the ecotax only accounted for one-quarter of the increase in petrol prices. As the first stages of the ecotax were very moderate, it would be unrealistic to expect a miracle in the few years since its introduction. Consumers and companies will only permanently increase their investments in energy-saving technologies and significantly reduce energy consumption if they can be reasonably confident that ecotaxes will continue to rise in the longer term.

Industry organisations and the conservative press are fond of giving the impression in public that the ecotax puts pressure on virtually all branches of German industry. In actual fact, however, the opposite is the case. Trade and transport, as well as agriculture and forestry, are the only two sectors to be classed as losers; all others are actually under less pressure, on balance, than before – and this development is most pronounced in the construction and manufacturing industries and the services sector. As such – contrary to fears voiced in the debates of the nineties – the export sector is one of the winners of the reform.

At best, private households are justified in complaining – they spend around €1.5 billion more than they are able to save from lower pension contributions. On balance, therefore, the reform has achieved precisely the redistribution effect desired by industry organisations and the conservative press: Less pressure on industry, and greater burdens on consumers. So why the constant dissatisfaction?⁵

⁵ Shortly after first stage of the ecotax entered into force, the CEO of BASF, Jürgen Strube, wrote a letter to the coalition politicians thanking them, because, he said, the reduction and refund provisions had reduced BASF’s ecotax bill to 7.8 million Euros. Under the original plans, this figure would have been 65 million Euros. As BASF’s pension insurance contributions under the reform are 6.5 million Euros lower, its net burden is reduced to 1.3 million Euros. Compared with the Group sales of 27 billion Euros, therefore, the ecotax accounts for less than 0.005 percent.

Figure 8: Net winners and losers of the ecological tax reform by sector, in billion Euros



Source: Rheinisch-Westfälisches Institut für Wirtschaftsforschung (RWI) <Rhine-Westphalia Institute for Economic Research>.

Status 2003, in million Euros

Several leading industry research institutes confirm that the ecological tax reform, with its incremental tax increases, is an expedient and effective concept. In a study examining the effects of the ecological tax reform on society as a whole, the *German Institute for Economic Research (DIW)*, in collaboration with other institutes, not only ascertained a clear ecological steering effect, but also concluded that the effects of the ecotax on employment policy are highly beneficial as well, with up to 250,000 new jobs by 2003, whereas macro-economic development is otherwise scarcely affected.

Apart from increasing the use of renewable energies (particularly as a result of the Renewable Energies Act <EEG>), the socio-ecological tax reform has been the federal government's **most successful climate policy instrument** to date. The ruling by the Federal Constitutional Court of 20 April 2004 confirmed its constitutional conformity on all points⁶. The steering effect and legitimacy of environmental taxes, as well as the appropriation of revenues and their benefit for the environment, have therefore been recognised by the highest court.

Overall, experiences during the first five years of the German ecotax refute the main counter-arguments of its opponents, some of which are still being voiced. Opponents to the ecotax should perhaps take this opportunity to at least dispense with some of their arguments ...

⁶ "From a constitutional viewpoint, the fact that the legislator is also pursuing steering objectives by introducing the tax on electricity and increasing the mineral oil tax is not a cause for concern. In particular, the targeted higher burden on certain types of fiscal consumption may be justified by environmental policy purposes", ruling by the Federal Constitutional Court of 20 April 2004, 1 BvR 1748/99 and 1 BvR 905/00. www.bundesverfassungsgericht.de

Figure 9: Balance sheet after five years of the ecotax: Counter-arguments and facts

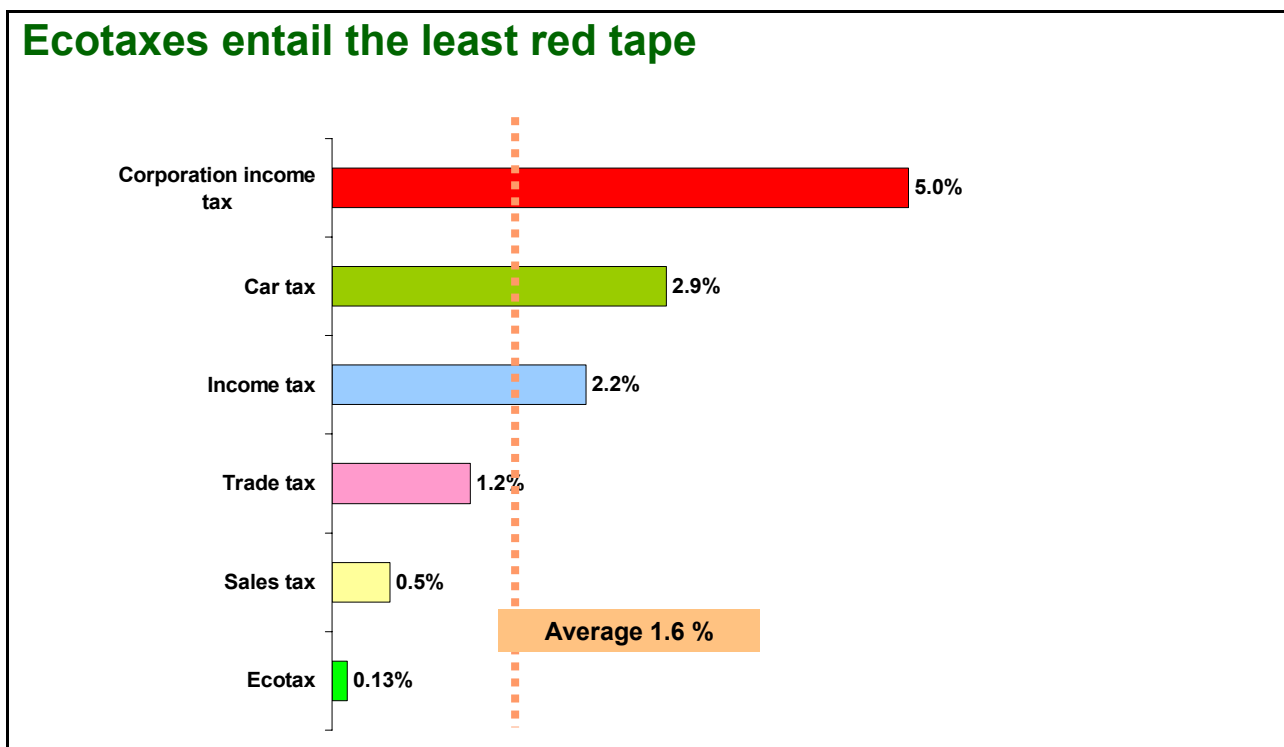
Development since 1999 refutes most of the arguments voiced by ecotax opponents	
Opponents' claim	Actual development
"Ecotaxes are just an excuse to raise tax ratios and public spending"	Despite a 55 percent increase in energy taxes, the overall tax ratio fell by more than four percent between 1999 and 2003.
"A successful ecotax would soon exhaust itself, because the tax base is eroded"	It is true that high energy taxes lead to a reduction in energy consumption. On balance, however, tax revenues increase , because taxes increase at a higher rate than the basic volume is reduced by. Unfortunately, we are still a long way from achieving a genuine 'erosion' of energy consumption.
"Ecotaxes cost jobs".	In fact, the opposite is true. The reduction in ancillary wage costs, the innovative impact and the easing of pressure on the manufacturing industry and services mean that existing jobs are protected and additional ones are created. In a comprehensive study, the DIW anticipates up to 250,000 new jobs as a result of the ecological tax reform by 2003.
"Ecotaxes just mean that we are paying for pensions when we put petrol in the car".	Thanks to the ecotax, for the first time, all non-defined benefits totalling 60 to 80 billion Euros will be funded from taxes . Without the ecological tax reform, pension contributions today would be 1.7 percentage points higher. Actual pension contributions have been cut by 0.8 percentage points. Independently of this, long-term reforms have been introduced to reduce pension expenditure.
"Ecotaxes do not do anything for the environment".	This is incorrect. For the first time since the Federal Republic of Germany was founded, fuel consumption has fallen for four years in succession, whilst over the same period the use of public transport has increased. CO₂ emissions have been cut by between six and seven percent . The demand for fuel-conserving cars and equipment has risen, and part of the ecological tax reform revenues are also used to promote renewable energies under the market incentive programme.
"Ecotaxes disadvantage German industry in international competition".	Thanks in particular to reduced ecotax rates, the manufacturing industry overall has cut its tax bill by almost one billion Euros (net) . Compared with the regular tax rate, the manufacturing industry has in fact benefited from a tax break of around 4.8 billion Euros per annum. The incentive effect for developing energy-saving vehicles and equipment also helps German industry to gain an innovative lead in exports.
"Taxes should not be used for steering purposes – ecotaxes are anti-constitutional!"	In 2004, the Federal Constitutional Court unequivocally confirmed the admissibility of ecotaxes with steering purposes . From an economic viewpoint, there is no such thing as a tax without some kind of steering effect, merely those with economically desirable and undesirable steering effects.

<p>“Germany has been the only country to introduce ecotaxes”.</p>	<p>Most of the EU15 nations have now introduced national ecotaxes, and most of them in fact did so before Germany. Since 2004, as a result of the unanimously adopted EU Energy Tax Directive, all EU25 nations must comply with rising minimum energy tax rates. Hence, similar approaches to ecological tax reform have become established throughout the EU, and many non-EU countries have also emulated this successful model.</p>
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The ecological tax reform is often associated with additional bureaucracy. In fact, it is the tax with the lowest administrative input. Unlike an income tax declaration, there is no work involved for the average car driver or electricity consumer, who may not even notice the ecotax paid. Particularly in relation to the administrative costs of direct taxes and social security contributions, the ecological tax reform performs very favourably in terms of cost.

Just 275 employees in the customs administration and Federal Ministry of Finance are involved in handling the ecotax. The annual financial expenditure on public administration of the ecotax, including material costs, is 18 million Euros⁷. **At 0.13 percent of total revenue, the ecotax has the lowest administrative costs of all German taxes!**

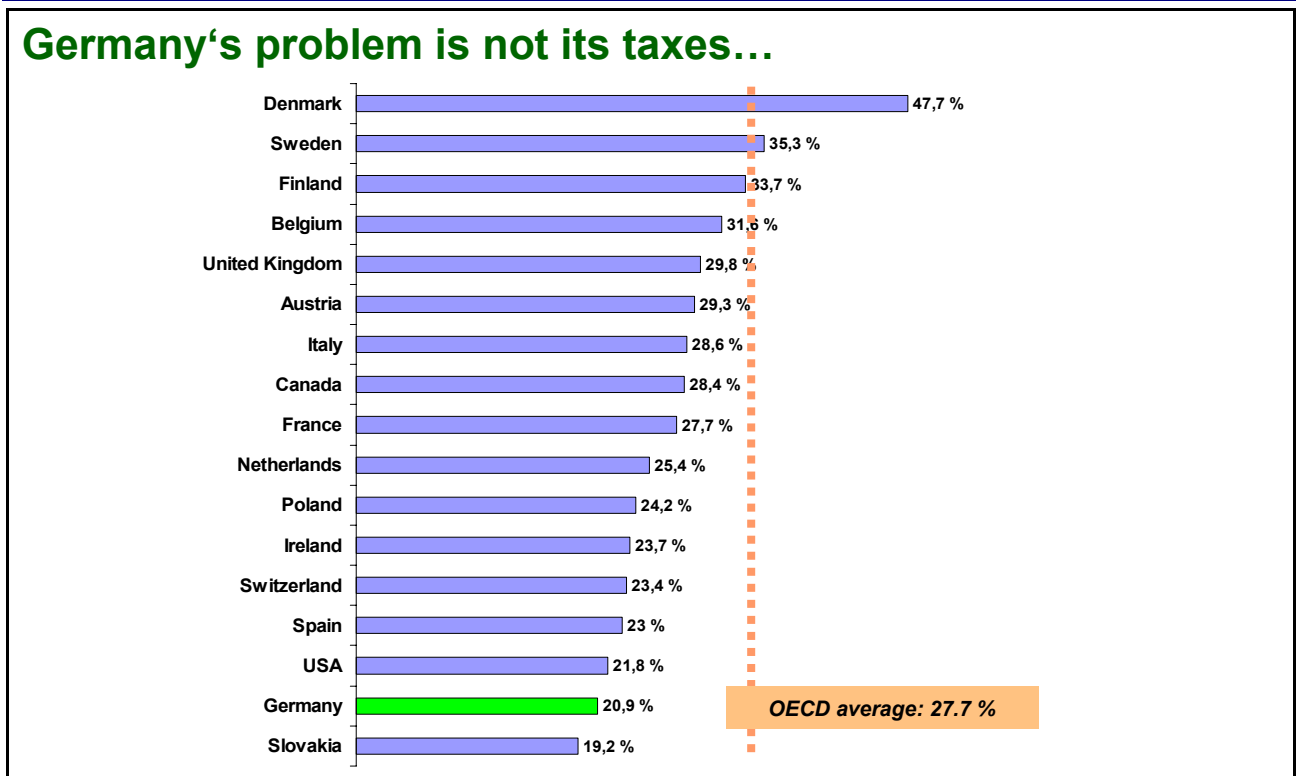
Figure 10: Administrative cost of various tax types compared with total revenue (percentage)



Source: Federal Ministry of Finance, German Bundestag <Lower House of Parliament>

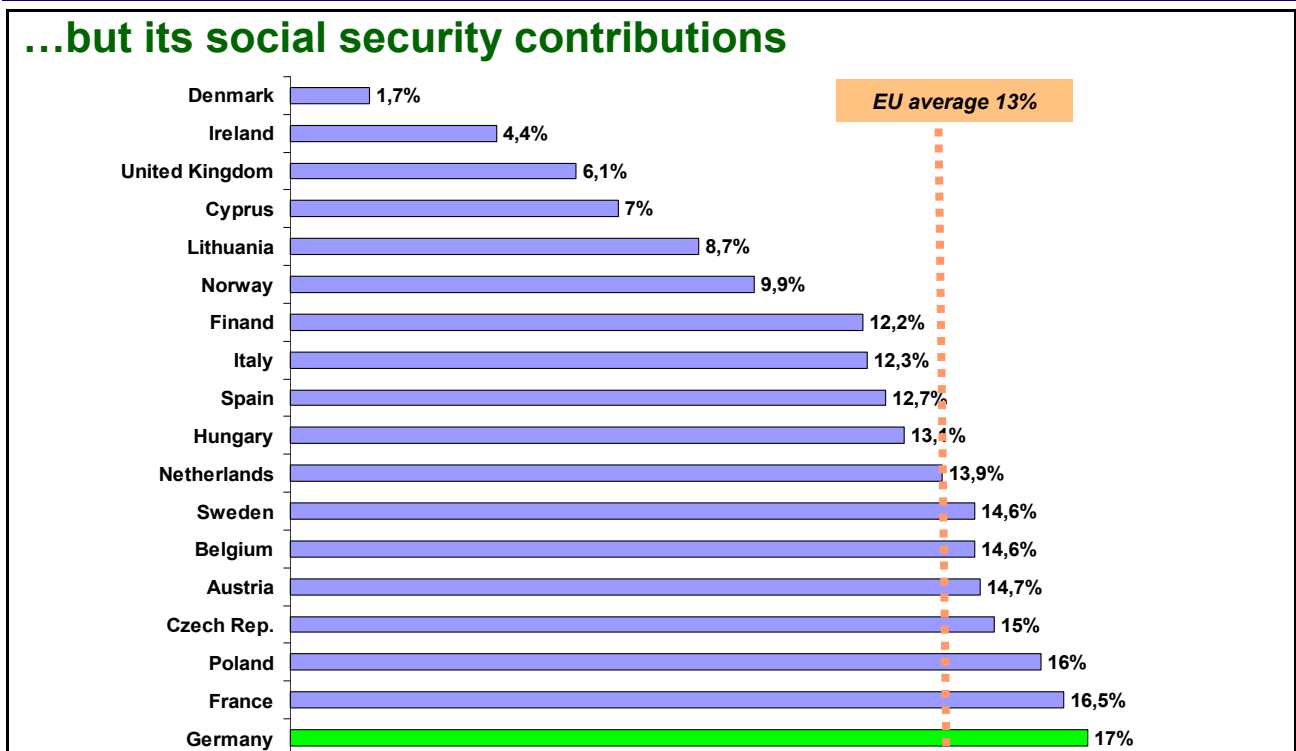
⁷ Response by the Federal Government to the oral question by the CDU/CSU parliamentary party, “Prevention of and obstacles to corporate development as a result of excessive bureaucracy” of 7 October 2002, publication 14/9993.

Figure 11: Comparison of tax ratios as a percentage of GDP (status 2002)



Source: Federal Ministry of Finance, Eurostat

Figure 12: Comparison of social security contributions as a percentage of GDP (status 2002)



Source: Federal Ministry of Finance, Eurostat

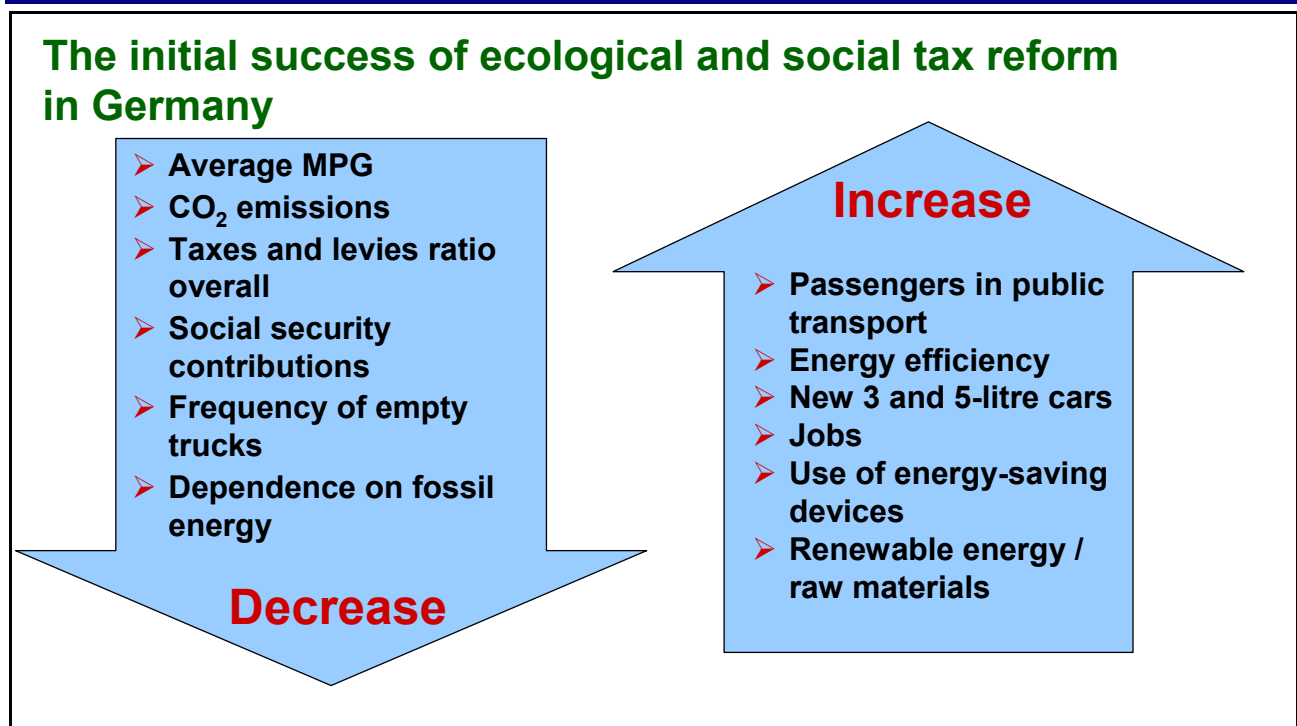
The weaknesses in Germany's tax and social security structure, which exacerbate to the country's employment problems, are clearly attributable to the fact that it has the highest social insurance contributions in Europe, rather

than to its taxes. In terms of the tax ratio, Germany remains well below the OECD average (27.7 percent) with 20.9 percent of GDP, and even behind the USA and nearly all its European neighbours, particularly following the comprehensive income and corporate tax reforms introduced since 1999. Only in Slovakia is the tax ratio lower than in Germany. In terms of company and capital taxes, following politically-motivated reductions in recent years, Germany likewise remains well below the average figure for the original EU of 5.7 percent, with just 4.5 percent of GDP.

On the other hand, Germany's social insurance contributions, being linked solely to the factor of employment, are the highest in Europe, and are hindering the creation of new jobs in Germany. The socio-ecological tax reform therefore offers a great opportunity to significantly reduce the social security ratio and trigger additional employment impetus, in addition to having an ecological steering effect.

The ecological and employment-related benefits of the ecological tax reform have often been disputed by its opponents. The accumulated experiences since 1999 verify its successful achievements in the areas of climate protection, the conservation of resources, energy innovation and employment. The socio-ecological tax reform is working.

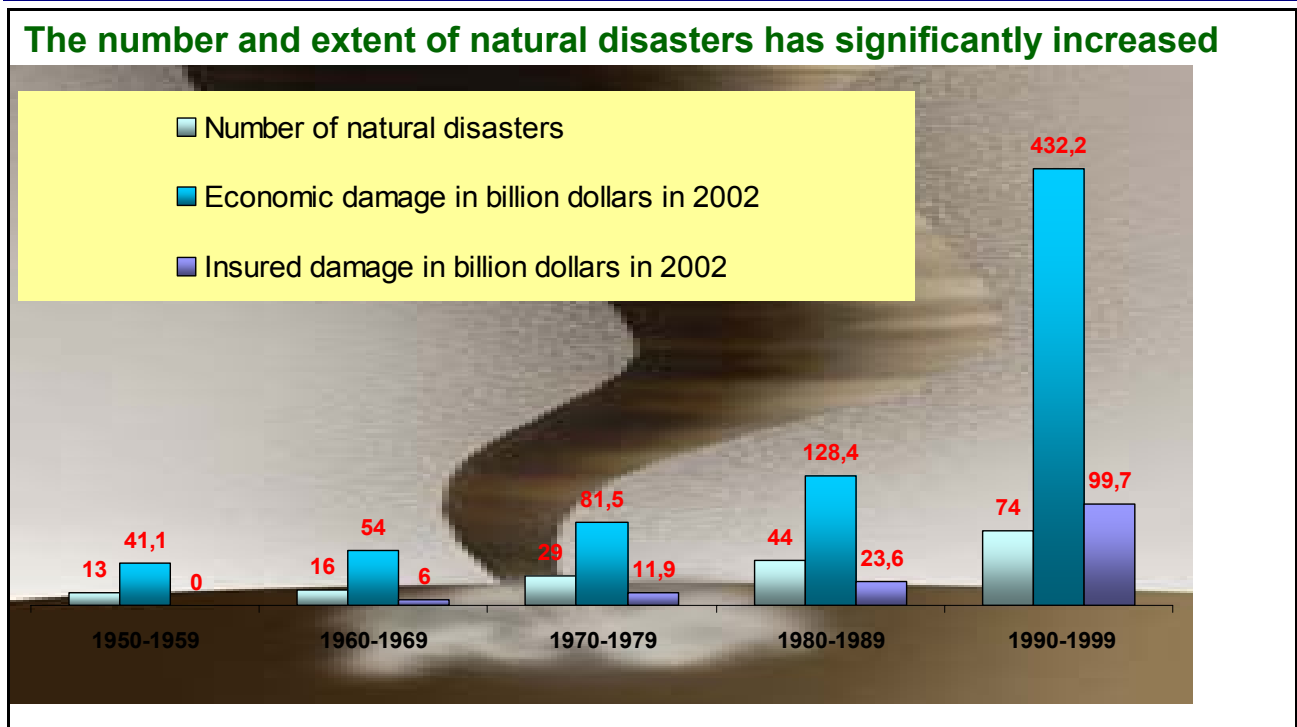
Figure 13: Positive effects on the environment, innovation and employment



Source: Federal Ministry for the Environment <BMU>

The need for a new direction in environmental policy is underscored by the escalating damage caused by climate-related natural disasters. The increase in their frequency and intensity is impressively demonstrated by figures from Munich Re, which show that flooding on the Rivers Elbe, Danube and Rhine caused financial damage to the tune of 9.2 billion Euros in 2002 in Germany alone. This clearly shows that greenhouse gas reduction and climate protection is also financially worthwhile.

Figure 14: Damage caused by climate-related weather events, 1950 to 1999



Source: Research by Munich Re into geological risks, January 2003.

OUR DEMANDS IN BRIEF

In the coalition agreement for the electoral period 2002-2006, the governing parties agreed to discuss the continuation of the socio-ecological tax reform during 2004. This document lists Green Budget Germany's central demands within the context of this debate, which is far more than simply an internal matter for the coalition, as it significantly affects society as a whole. It will not be possible to enforce all of these demands completely and simultaneously. However, we are convinced that the bulk of them can, and indeed must be achieved during the present decade.

Figure 15: Summary of GBG's demands

1. The diesel tax rate is to be brought into line with the tax rate for regular petrol in nine annual stages. At the same time, revenue-neutral ecologisation of motor vehicle tax, based on the environmental pollution caused by the vehicle.
2. Annual increases in the ecotax on conventional fuels by three to five cents per litre. Establishment of the stages in law, at least five years in advance.
3. From 2020 at the latest, even alternative fuels should be taxed at 50-75 percent of their energy content, in order to meet infrastructure costs.
4. Abolition of all tax relief for air traffic. Initially: VAT on international flights, kerosene tax of 20 cents/litre for domestic flights.
5. In order to create fair competitive conditions in long-distance rail travel, reduction of the VAT rate from 16 to seven percent on all rail tickets.
6. Increase in five annual stages: for light heating oil by two cents/litre per year; for natural gas by 0.14 cents/kWh; for coal and coke by at least 0.143 cents/kWh.
7. Taxes on the use of oil and gas in electricity generation should be abolished. At the same time, the expansion of CHP should be promoted more than at present.
8. Increase in the tax on electricity in five annual stages of 0.25 cents/kWh per year; improved steering effects via information campaigns, and compulsory labelling, *inter alia*.
9. Revision of the concessions for the manufacturing industry, which should enter into force simultaneously with European emissions trading in January 2005 if possible, but no more than one year later.
10. The current appropriation to reduce pension contributions has proven expedient and successful. However, the additional revenues generated from future ecotax increases should no longer be channelled into the statutory pension insurance system.
11. In the long term, ecotaxes should be incorporated into the national budget without earmarking. Responsibility for the expedient use of revenues and the level of public spending lies with parliament.
12. In the short term, up to ten percent of the newly created ecotax revenues arising from 2005 onwards should be used for ecological projects. Within the context of general financial and social policy, tax and social security ratios must not be increased.
13. The ecological tax reform is a vital pillar of a sustainable financial policy. The federal government must act during 2004 in order to ensure that subsequent ecotax stages are able to enter into force in early 2005. The abolition of ecologically harmful subsidies must also be pursued with greater consistency.
14. As a matter of urgency, the federal government should launch a long-term information campaign on the socio-ecological tax reform, in order to educate the public far more widely on its concept, effects and benefits.

Distinction between structural improvements and linear continuation

These demands have been classified on the basis of two questions:

- Which stages serve to improve the tax structure and correct existing weaknesses?
- Which stages are aimed at the constant, nation-wide continuation of existing ecotaxes?

These questions are important, because Chancellor Schröder has repeatedly voiced his public opposition to a further increase in existing ecotaxes. That in itself does not constitute a reason to conduct the ecotax debate defensively. Financial and climatic policy constraints can sometimes surprise us by opening up new opportunities. However, as long as the Red/Green coalition continues to hesitate, it might be more promising to rectify existing structural weaknesses first before increasing ecotaxes on a nation-wide basis.

The following overview therefore distinguishes between improvements to the tax structure, and a continuation of the existing ecotax stages:

Figure 16: Overview of the financial impact

	Unit	Cents/unit of increase	EUR bn p.a.	Years	EUR bn total
Structural improvements to ecotaxes					9,7
1a	Litre	+2	0,6	9	5,4
1b	Litre	0	0,0	1	0,0
3	various	various	0,1	10	1,0
4a	Litre	+20	0,1	5	3,0
4b	Percent	16	0,5		
5	Percent	16 to 7	-0,5	1	-0,5
6	kWh	+0,20	0,1	5	0,4
7	kWh	-0,13	-0,1	1	-0,1
9	-	-	0,5	-	0,5
Continuation of existing ecotaxes					24,2
2	Litre	+3 bis 5	2,8	5	14,0
6	kWh	+2,00	0,7	5	3,5
6	kWh	+0,14	0,7	5	3,5
8	kWh	+0,25	0,7	5	3,2

Source: Own calculations⁸

Independently of the chosen sequence and combination: Each of these individual steps would reduce environmental pollution. Ultimately, the current prioritisation is made easier by the following calendar of forthcoming political decisions. Where new legal framework conditions are created and publicly debated, new windows may open for the ecological tax reform.

⁸ The figures are based on various public statistics and studies. Due to possible inconsistencies in the database and in view of anticipated steering effects, they should be seen as rough estimates only.

Figure 17: Calendar of events and opportunities for action

Year(s)	Political events	Opportunities for ecotax reform/ecological fiscal reform
2003 to 2005	German toll fiasco delays introduction until the end of 2004	Need for compensation/transitional solutions
2004	Review of the socio-ecological tax reform as per coalition agreement Adoption of the new climate protection programme Review of CHP regulations	Implementation of key elements of the BUM proposal
2004	New debate over motor vehicle tax; obligations from the coalition agreement	Reform of the motor vehicle tax Abolition of the diesel subsidy for the mineral oil tax
2004	EU Energy Tax Directive facilitates kerosene tax on air travel EU Energy Tax Directive prescribes tax on coal for heating purposes EU Energy Tax Directive prescribes elimination of the tax on natural gas used in electricity generation	Scope for action with the taxation of air travel (VAT and kerosene tax) Implementation required from 2004 – but no later than 2007 Implementation should have taken place in early 2004
2004-2007	Gradual introduction of emissions trading EU Energy Tax Directive prescribes new criteria for the granting of ecotax concessions from 2007 at the latest ECJ ruling on the term “fuel use” necessitates a higher taxation of industry	More targeted formulation of ecotax concessions for industry in conjunction with emissions trading
2004-2006	New tax reform stages? New social reform stages?	Need for counter-funding More intelligent increase in indirect taxes via ecotaxes instead of VAT without ecological added value
2004-2006	Preparation and adoption of the new EU budget for 2007-2013	Option of introducing an EU-wide energy-related tax (e.g. kerosene tax)

Source: BUM analyses

Ecotaxes and the world oil markets: on the current debate

Always, when the price of oil rises on the world markets, supporters of high petrol consumption seize the opportunity to attack the unpopular ecotax. We can only hope that Europe's governments will refuse to listen to these calls. After all, the facts and economic analysis clearly show that a freezing or even reduction of ecotaxes would exacerbate the problem in the long term, rather than ameliorating it.

The current high world market prices for crude oil once again show that oil is a finite raw material, reserves of which will be exhausted in the foreseeable future. Extracting the remaining supplies will become more and more expensive, as they are more difficult to access. At the same time, global demand is increasing sharply as a result

of economic development, particularly in newly industrialising countries such as China. Oil prices will rise over the next few years.

However, we have the opportunity to anticipate these forthcoming price increases under our own control, moderately and gradually, via ecotaxes, rather than being at the mercy of the markets and their changeability. The difference is that ecotaxes will make additional revenues available to the German government to perform important tasks or to cut other taxes or levies, rather than making the OPEC countries wealthier. The burden on German consumers and German industry must not increase. On the contrary; higher energy prices make additional investments in energy efficiency more attractive, so that Germany’s demand for oil can actually be reduced. Germany would be able to create new jobs at national level and export future technologies, rather than importing fossil fuels.

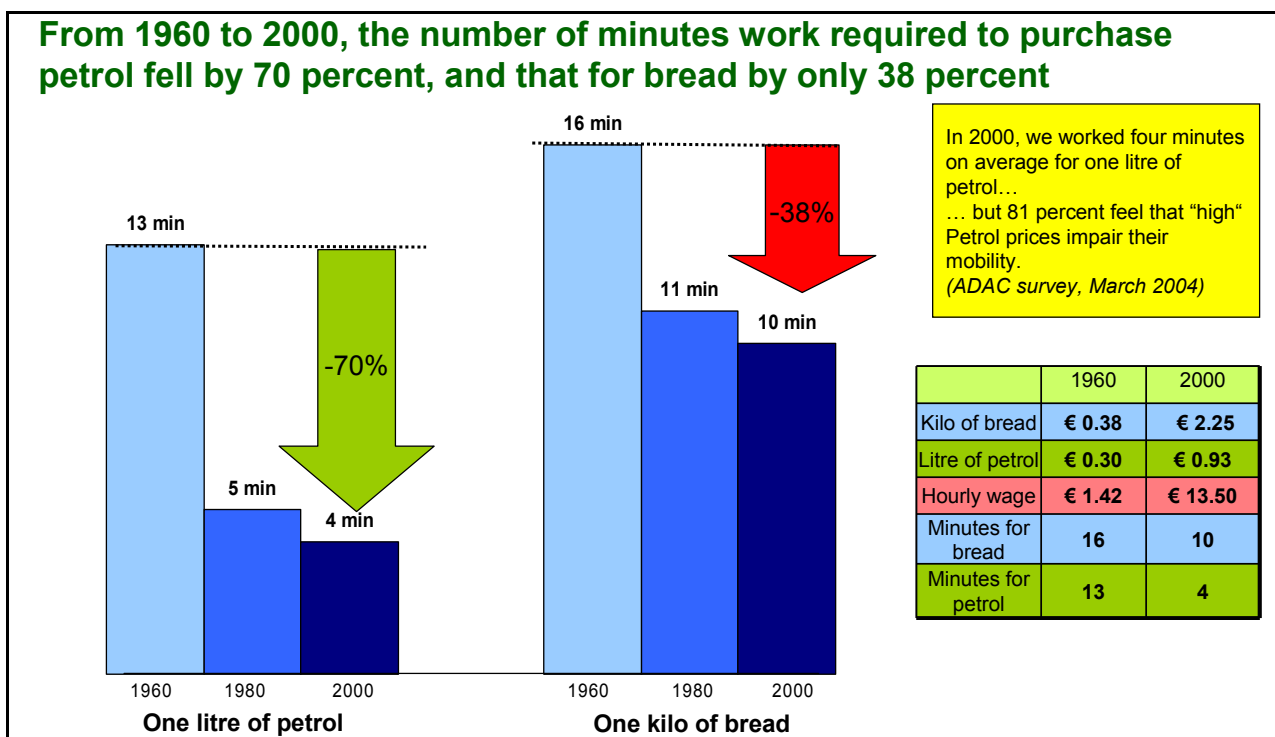
This in turn will help to ease the pressure on global oil markets and therefore reduce the world market price for crude oil. This will benefit countries like Germany – as well as many developing countries which import the bulk of their energy.

The gradual phasing-out of the oil era through energy efficiency and alternative energies is thus by far the most intelligent strategy, from the ecological and the economic point of view. Reducing oil imports is good for the balance of trade, good for climate and environment, and good for safeguarding a national energy supply which is not based on permanent dependency on imports from a few of the world’s most unstable and crisis-susceptible regions.

Not least, this strategy also constitutes an indispensable component of a long-term peace and security policy.

Claims by opponents of the socio-ecological tax reform, that petrol prices have risen massively in recent decades compared with other commodities and that this places an “unreasonable burden on ordinary people”, are refuted by the diagram on the following page.

Figure 18: Real price development of petrol and bread, 1960 to 2000 (minutes worked by a skilled worker)



Source: Federal Environmental Agency

For decades, the price of petrol has fallen sharply in relation to rapid increases in the price of basic foodstuffs and in relation to incomes, which have increased tenfold since the 1950s. This can be illustrated by calculating the number of minutes that must be worked in order to purchase various different goods. At today's prices, petrol would have cost the equivalent of around seven Euros per litre in the 1950s, although in nominal terms the price was only 25 cents. It is only in recent years – thanks to the socio-ecological tax reform and the increase in world oil prices – that the price has also increased in real terms. However, it needs to rise considerably more in order to bring about structural changes. The real decline in petrol prices over the course of several decades provided the incentive to develop the energy-intensive structures we are complaining about today.

APPROPRIATION OF ECOTAX REVENUES

1. Freeze the contribution to pension insurance at its current level

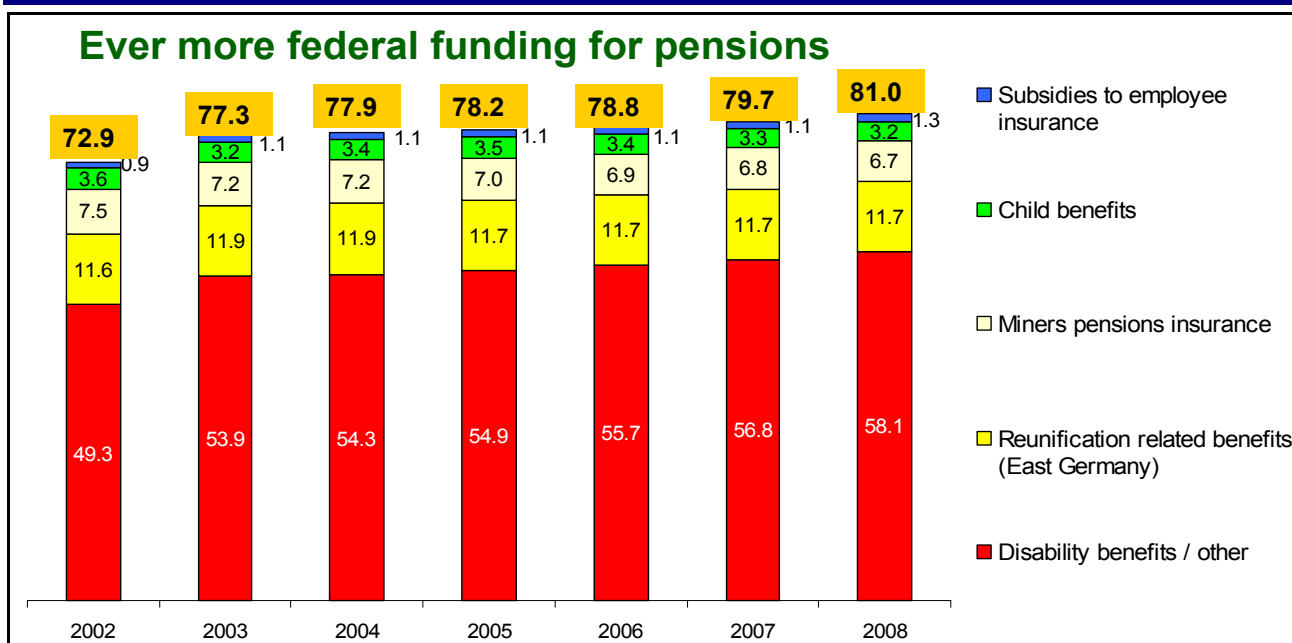
There were good reasons and objectives behind the current appropriation of ecotaxes to increase the federal subsidy to statutory pension insurance, and these have met with broad consent:

- To curb an excessive rise in ancillary wage costs, thereby creating new jobs and protecting those at risk.
- To achieve the more equitable financing of non-defined and reunification-related benefits in social insurance via taxes instead of social security contributions.

Between 1998 and 2001, the pension contribution was cut from 20.3 to 19.1 percent, thanks to the ecotax.

Since then, however, the pension contribution has risen again to 19.5 percent – due to the higher proportion of pensioners in the population, coupled with high levels of unemployment. Support for the ecological tax reform has wavered as a result, because the relief effect is no longer quite so obvious. However, pension contributions would be 1.7 percentage points higher (i.e. currently 21.2 instead of 19.5 percent) if it were not for the ecotax⁹. For an employee with an average annual salary of 28,000 Euros, the contribution saving totals 476 Euros per annum for both parties (employee and employer). Admittedly, the measures adopted at the end of 2003 ensured that the pension contribution did not increase any further in early 2004. However, it is by no means certain that the pension contribution will remain stable in the long term without further increases in the federal subsidy.

Figure 19: Payments from the federal budget to the statutory pension insurance system (in billion Euros)



Source: Federal Ministry of Finance, 2004

The ecotax revenues generated to date amount to 18.6 billion Euros, almost 90 percent of which has been spent on increasing the federal subsidy. Thus, the socio-ecological tax reform has made a significant contribution

⁹ "5 Jahre Ökologische Steuerreform" <5 Years of Ecological Tax Reform>, Federal Ministry of Finance, Berlin 2004.

towards solving pension problems in Germany.¹⁰ **For the first time in the history of the Federal Republic of Germany, pension insurance has been exempt from socio-political burdens which are the duty of all tax payers**, rather than just those whom the law condemns to pay compulsory charges:

“As a result of the measures implemented since 1998 at the federal government’s initiative, we have ensured that contributors are no longer involved in the financing of non-defined benefits.”¹¹

Supporters of the ecotax and the federal government can be justifiably proud of this success. In view of the as-yet unresolved demographic problems and the extensive socio-political pressures on pension insurance, it would appear legitimate to maintain relief at this level. According to plans by the Federal Ministry of Finance, the federal subsidy to pension insurance will rise from 77 billion Euros in 2003 to 81 billion Euros in 2008. Certainly in this context, we feel it is justifiable that future ecotax revenues should continue to be used to finance pensions.

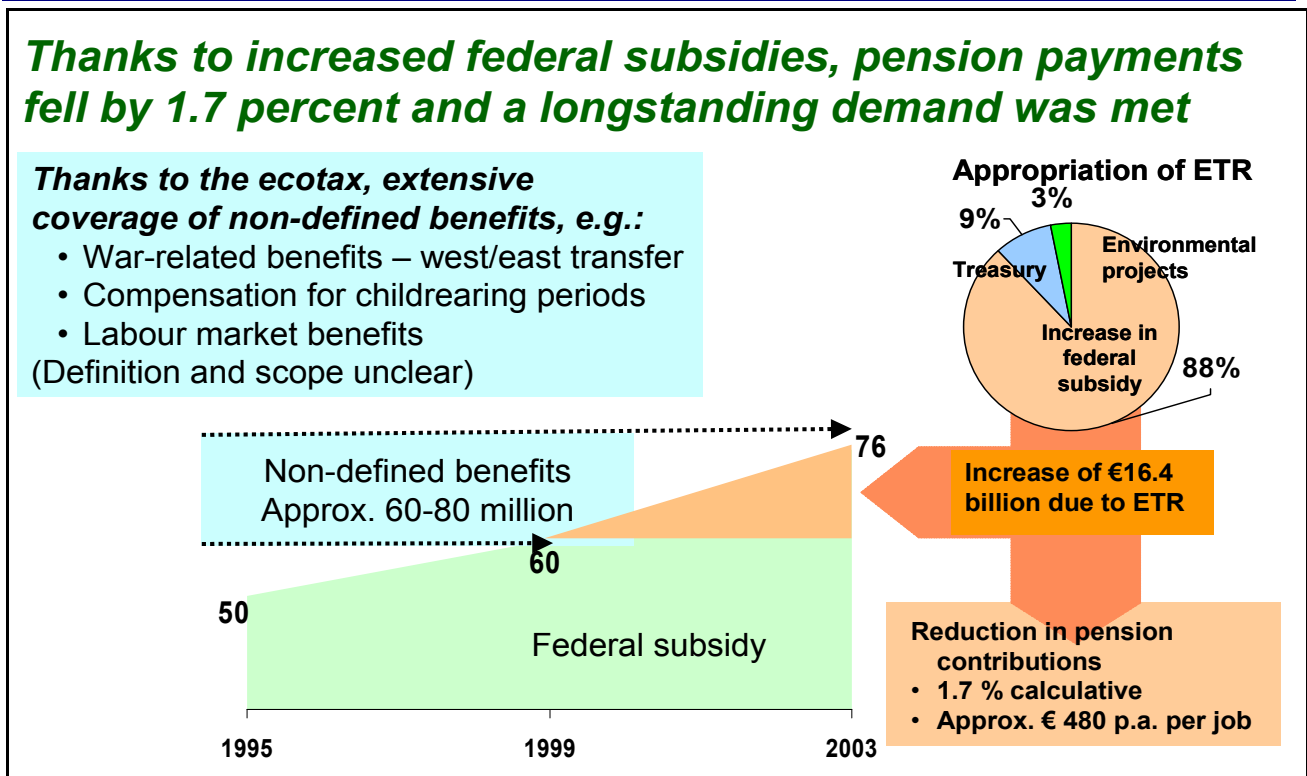
However, there are numerous arguments against raising this contribution beyond its current level, leaving aside the superficial polemics along the lines of “putting petrol in the car to pay for pensions”.

- Thanks to the ecotax-funded increase, the Federal subsidy to the pension systems has already reached the impressive sum of 77 billion Euros. Pension expenditure in the year 2003 totals some 226 billion Euros, around 150 billion Euros of which is funded via contributions. Hence, one in every three Euros of government expenditure on provision for old age is now funded from tax revenues and no longer from contributions.
- Within the context of the existing system of contribution-funded pensions, the federal subsidies can only be justified from the so-called ‘non-defined expenditure’ (socio-political burdens). Ultimately, a political definition is needed for the delimitation between non-defined and defined expenditure. However, some of the available estimates quantify the extent of non-defined benefits at around 60 to 80 billion Euros, approximately on a par with the sum achieved by the federal subsidy.

¹⁰ From 1999 to 2003, the federal subsidy to the statutory pension insurance was increased from around 60 to around 76 billion Euros. Without this amount, the contributions would have been higher for both employees and employers, and the benefits to pensioners may even have been slightly lower. As such, the ecotax has made a verifiable contribution to help ease the pressure on all these groups.

¹¹ *Bundestag* <Lower House of Parliament> publication 15/1164, response to written question no.144.

Figure 20: Effects of the socio-ecological tax reform on the German pension system



Source: BMJ

If the co-funding of pensions via ecotaxes were to be extended *ad infinitum*, the accusation that ecotax contributions are obstructing essential reforms to the pension system would be justified.

Only the deliberate political transformation of the pension insurance system, with a conscious expansion of the tax component at the expense of contribution financing, would lead to a politically correct expansion of tax subsidies. However, for the time being, such a systemic transformation is only being discussed at a political level with regard to health insurance, and not in connection with pension insurance (the CDU party’s ‘health premium model’). We reject the modification of Germany’s state old age pension system via the ‘back door’ of the ecotax. Hence, to summarise:

The current appropriation of ecotaxes to cut pension contributions has been expedient and successful. The additional revenues from future ecotax increases, however, should no longer be appropriated for the statutory pension insurance.

In the debate surrounding the appropriation of previous and future ecotax revenues, a clear distinction must be made between two levels:

- Fundamental and long-term level: The long-term objective is to oppose any form of long-term earmarking and to view ecotaxes as regular taxes, the use of which should be subject to the same rules as other government revenues - namely, decision-making within the context of the constitutional budget policy.
- Day-to-day political/short-term level: The public expects an explanation of how the government is planning to spend the funds generated from environmental taxes. Supporters of the ecotax cannot refuse to answer this question – not even by referring to their fundamental, long-term opposition to earmarking.

Although it may pose mediation problems and make popular cuts more difficult, we want to continue pursuing this differentiated argument, which we feel is necessary.

2. Permanent earmarking of ecotaxes is not expedient

The political argumentation pressure is greater with environmental taxes than with any other kind of tax. In no other area of taxation are such in-depth questions asked about how the funds raised are to be spent. Ecotax supporters would be making a big mistake if they accepted this unequal treatment without a fight; if we consider ecotaxes important, we must call for their equal treatment with other taxes.

The 'double dividend' argument plays a pivotal role in the success of the ecotax debate. The notion of killing two birds with one stone by easing pressure on the factor of employment while at the same time imposing higher charges on the factor of nature captured the imagination of many, not only Red/Green voters. As employment in Germany continues to be placed under excess pressure, nothing has changed in the justification of redistributing the tax burden in this way.

In the long term, however, and also with a view to countries with different tax burden structures, the ecotax debate should not confine itself to one appropriation model, but should be open to other potential combinations, not least for political and ecological reasons.

- Essentially, ecotax revenues are available not only to reduce ancillary wage costs, but also, for example, as an alternative to increasing value added tax. The fiscally conservative – who it would seem are not confined to the non-socialist parties alone – regularly flirt with the idea of increasing VAT as an apparently simpler, more advantageous source of finance for all manner of financial requirements. Value added tax does not have any ecological added value. If there is a long-term trend away from direct taxes in favour of indirect ones, the aim must be to enforce environmental taxes rather than higher value added tax in order to reduce social security contributions.
- Also, within the context of the existing prioritisation of cutting ancillary wage costs, alternative variants other than the current pension funding are certainly politically conceivable, as the debate surrounding the proposals of the CDU's Herzog Commission illustrates. The funding deficit to compensate for the disadvantages of different income groups is in the region of 20 to 30 billion Euros. Ecotaxes could close this funding gap with a reform of the health insurance system.

Overall, supporters of the ecotax – also with a view to other political objectives and constellations – should be more open to different funding alternatives, even if they do not always satisfy the existing principles of the 'double dividend' or revenue neutrality.

The main arguments against the rigid earmarking of ecotaxes:

- **From a political viewpoint**, there is a broad consensus in favour of the non-affectation principle. There is no fixed relationship between certain revenues and certain expenditures. All funds must serve all purposes. This principle is motivated by the following two aspects:
- **In terms of economics and allocation theory** it would be a major coincidence if the economically “correct” level of a certain type of tax were to correspond precisely to the optimum economic level for a certain type of expenditure. Instead, economic efficiency demands that government revenues and government expenditure are optimised independently of one another. Only the overall figures must correspond.
- **From a fiscal and pragmatic viewpoint**, it also makes little sense to adopt a different approach for those energy taxes that already existed prior to 1 April 1999 than for those adopted later on. For mineral oil tax revenues resulting from the taxation of petrol and diesel up until 31 March 1999, therefore, it would not be necessary to produce any proof of appropriation – just like all other taxes, they flowed into the general budget without discussion; so why should the mineral oil tax added as a result of the ecotax legislation require precise records? In the long term, this is an absurd idea.

Based on these considerations, our demands are directed less at politics and the general public than at the group of ecotax supporters themselves:

In the long term, ecotaxes should flow into the government budget without earmarking. Responsibility for the expedient appropriation of the revenues and the level of public spending lies with parliament.

For supporters of the ecotax, this means a weakening of two very successful formulae – namely, the **double dividend**, and **revenue neutrality**, because not all potential application options meet their conditions. Nevertheless, we should be open to the following alternatives, for example:

- Financing of a fundamental income tax reform
- Reduction of the contribution rates to unemployment or health insurance
- Expansion of ecotaxes as a superior alternative to increasing value added tax
- Reducing value added tax for long-distance rail travel, or even cutting the reduced VAT rate (not only) for public transport, from seven percent to the five percent permissible under EU law
- Greater subsidising of ecological projects (more details below)

At just under 84 billion Euros in total, ecotax revenues only account for around nine percent of the total volume of taxes. The comparatively low ecotax cannot be held responsible either for the level or for compensation of the large fiscal and para-fiscal budget. In future, we believe that our main task is not to propagate a single variant of appropriation, but to replace harmful taxes with useful ones: ***Tax Bads, not Goods.***

3. More ecotaxes for eco-projects in the short term, rather than “burning rubber for retirement”

At present, it is still impossible to predict when ecotaxes will receive the support of the majority of citizens and politicians as a regular component of our tax system. In consequence, the drive for ‘virtual’ earmarking of

additional ecotax revenues will continue to play a major role in future. The Federal Environment Ministry (BMU) cannot and will not join this drive.

Our primary objective is to enforce further ecotax stages. To this end, the reform must become more popular among the general public. In surveys, the majority of the population is clearly in favour of the appropriation of ecotaxes for eco-projects.

From 2005, up to ten percent of the additional ecotax revenues generated are to be used for ecological purposes, rather than the current three percent. **In future, we want to triple the proportion of ecotax revenues channelled into ecological causes.**

Possible ideas include reducing value added tax on long-distance rail travel from 16 to seven percent, and subsidy programmes for the thermal insulation of old buildings, as well as increasing the use of renewable energies in the heating market. However, all additional expenditure should be subject to a strict examination of effectiveness. In view of the limited budget available, all subsidy policies should be specifically targeted.

At the same time, however, the principle of revenue neutrality remains important, since public spending is still considered by many to be too high. This principle may be upheld in future if other taxes or charges are further reduced, following practices in recent years.

But are these two demands not contradictory? After all, additional eco-projects also entail an increase in public spending, which is no longer be compatible with the principle of revenue neutrality. This contradiction can be resolved by reducing other taxes at the same time, cutting environmentally harmful expenditure, and viewing changes in revenues and expenditure within the overall context of an ecological fiscal reform.

In the short term, up to 10 percent of the newly created ecotax revenues from 2005 are to be used for eco-projects. Within the context of general financial and social policy, the tax and charges ratio must not be increased.

OUTLOOK

Readers will appreciate that many topics have only been touched upon here, or omitted altogether.

- **Extending the principles of the ecological tax reform** to include other substances and processes would be the logical next step, at least in theory. This includes land use and soil sealing, finite raw materials, as well as secondary and tertiary products, right through to packaging materials or waste. A more detailed discussion of taxes is needed in the area of fertilisers and pesticides. For political/pragmatic reasons, however, our main emphasis will be on energy taxation for the time being. However, in view of the sharp rise in raw materials prices in general in recent months – particularly in view of the vast emerging demand in China – this should be incorporated into considerations and concepts in future. Greater efficiency and less dependency on raw materials are vital if we are to be able to withstand external price shocks at all.
- **Other charges with a steering effect already implemented**, from the deposit on bottles to the planned HGV toll from 2005, likewise deserve greater consideration – we will be dealing with these topics shortly.
- Inadequate consideration has also been given to the topic of **eliminating ecologically counter-productive subsidies**. Here, there is a substantial tax potential in favour of the environment which politicians are still far too hesitant to address.
- We have only touched upon the exciting possibility of a **constructive combination of the instruments of emissions trading and ecotaxes**, which we see as complementing rather than rivalling one another. Here too, we will be commenting in greater detail in future.

We were also unable to discuss in detail the long-term prospects of a comprehensive socio-ecological tax and fiscal reform. In the long term, environmental taxes should bring about a socially and economically compatible structural change leading to a 60 to 80 percent reduction in the consumption of fossil fuels. This can best be achieved via a long-term plan of incremental tax increases (over approximately 20 years), beginning with small steps and increasing progressively until the environmental policy objective has been achieved. This will provide greater planning certainty for medium to long-term environmentally friendly investments. For such a long-term orientation of ecotaxes, we should aim for a broad social consensus and a co-ordinated procedure within the EU. Only an ecological fiscal reform – **with adequately high ecotaxes in the long term** as its most important element – has the potential to reduce our environmental consumption to a sustainable level in a socially and economically compatible manner. Our pragmatic proposals relate to what is necessary and possible today, and therefore represent more than just interim stages on the right path.

During the course of 2004, a decision will be reached as to whether the ecological tax reform can be further expanded as a permanently viable pillar of the financial system in Germany. We must aim to conduct the debate over the ecological tax reform in an objective manner, without polemics. All parliamentary parties in the German *Bundestag* <Lower House of Parliament> are at least fundamentally united on the position that price signals are the most efficient way of conserving scarce resources. Specific details of the democratic debate must not be allowed to destroy this cross-party consensus on ecological tax reform, which appears to have reigned since 1994/95.

Moreover, we must finally initiate a genuine ecological fiscal reform with the consistent elimination of environmentally harmful subsidies. The ‘lawnmower’ approach to cutting all subsidies equally, as proposed by

Prime Ministers Roland Koch and Peer Steinbrück, is inadequate, and in some cases may even prove ecologically counter-productive. Instead, subsidies and tax breaks for electricity from hard coal, home ownership concessions, distance allowances and environmentally harmful subsidies in the agricultural sector, should be reduced in a targeted way. The opportunities for an ecological fiscal reform in agriculture¹², particularly via the introduction of taxes on fertilisers and pesticides, need to be examined more closely.

The ecological tax reform is an indispensable pillar of a sustainable financial policy. The Federal Government needs to act in 2004 so that further ecotax stages can enter into force in early 2005. The reduction of ecologically harmful subsidies must be pursued more consistently.

Germany needs to expand the ecological fiscal reform in the interests of environmental protection, innovation and economic momentum.

As a matter of urgency, the Federal Government should launch a long-term information campaign on the ecological tax reform, in order to achieve greater clarity on its concept, effects and benefits.

In order to gain acceptance for the necessary reforms, active PR work is needed. Greater public education on the verifiably positive effects of the ecological tax reform is urgently needed, in order to counteract some of the crude campaigns by certain sections of the media, politicians and company representatives. By means of energy-saving tips, labelling and information on energy-saving equipment and vehicles, the ecological effect can be further enhanced, particularly in times of rising crude oil prices. Only a targeted, long-term information campaign can help the majority of citizens and decision-makers to understand the concept, effects and benefits of the ecological tax reform.

We have underestimated the extent to which the undoubtedly positive ecological and economic facts speak for themselves, despite a generally negative attitude towards fundamental change. For this reason, we must highlight the reduced pressure on social insurance contributions, the reduction of environmentally harmful subsidies within the framework of the ecological fiscal reform, and the general reduction in taxes and charges, in order to actively counteract the public's diffuse reservations about a revenue-neutral change in direction. To this end, the promising winners of the socio-ecological tax reform (renewable energies, local public transport, producers of energy-saving devices and vehicles, labour-intensive service-providers, etc.) must position themselves far more strongly than before. Only in this way can the necessary ecological awakening succeed.

¹² Förderverein Ökologische Steuerreform e.V./ NABU / Louisoder Umweltstiftung: Ökologische Finanzreform in der Landwirtschaft <Ecological Fiscal Reform in Agriculture>, Munich 2004.

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GREEN BUDGET GERMANY

GBG was established in 1994 as a single issue movement to support the development of an Ecological Tax Reform (ETR) in Germany. GBG co-operates with other German-based partners as well as international organisations.

GBG's work is strictly non-party and independent from particular organisations and interest groups – as reflected in the highly varied nature of our members. In mid-2004, among our about 150 members were experts from industry, business and the research community, politicians from all German democratic parties and journalists, as well as a multitude of motivated individuals. GBG perceives itself as a collective movement of independent progressive thinkers, as an inspirational force, and a means of consensus in the ETR debate. Our most important target groups are decision-makers and multipliers.

Since 2001, GBG has published an electronic newsletter in German, ÖkoSteuerNews, and a newsletter in English, GreenBudgetNews, on a regular basis.

We would like to thank most sincerely the numerous people who contributed to the GBG Memorandum 2004, both those from Green Budget Germany and outsiders, for their comments and Cupertino.

Compromises are always necessary, however. We would be delighted if you can contribute your own constructive comments to the debate and the development of GBG's future position on ETR. Your comments can then be published in our newsletter. If you wish to order our newsletter or to contact us, our address and homepage are on the inside cover of this memorandum.

*“The **world** has enough to meet everyone's **need**,
but not everyone's **greed**. That is the problem.”*

Mahatma Gandhi

