



## ***EFR – and the EU***

### ***What is politically feasible – what possibilities are there in the EU to implement EFR?***

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*The views expressed in this presentation are those of the author and may not in any circumstances be regarded as stating an official position of the European Commission*



**EFR**

What is in the following understood by EFR and ETR

EFR is the broader concept; it:

refers to a range of taxation and pricing measures which can raise fiscal revenues while furthering environmental goals.

- This includes taxes on natural resource exploitation or on pollution.
- EFR can directly address environmental problems that threaten the livelihoods and health of the poor.
- EFR can also free up economic resources or generate revenues that can help to finance access of the poor to water, sanitation and electricity services.

*(OECD 2005)*

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**ETR**

**ETR:**

is a reform of the national tax system where there is a shift of the burden of taxation from conventional taxes, for example on labour, to environmentally damaging activities, such as resource use or pollution. The burden of tax should fall more on 'bads' than 'goods' so that appropriate signals are given to consumers and producers and the tax burden across the economy are better distributed from a sustainable development perspective.

*(EEA 2005)*

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**consequences**

- EFR/ETR are **not objectives on their own** (they are an opportunity, not a "must")
- Their feasibility very much depends on the **necessity** to implement underlying policy concepts
- Which can consequently be primarily motivated
  - by economic or social objectives e.g. recent EU and national recovery plans show many parts of green elements
  - or by environmental goals
  - or by both at the same time (without an identifiable priority – e.g. French carbon tax debate to replace the 'tax professionnelle')

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## The EU-wide challenge

The key question appears to be nowadays:

**How to make the most of limited resources we have, being it natural resources or e.g. public finance?**

- EFR apparently would be a possible answer to that question in so far as we would raise money on environmental harmful behaviour and reduce the costs of environmentally or economically beneficial behaviour; it should not matter whether we use taxes or other revenue raising instruments (including abolition of harmful subsidies) for environmental purposes.

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## Which necessity for EFR?

- Recovery plans only exceptionally include the design of environmental taxes (e.g. CO2 based car taxation) but rather rely on debt financed fiscal expenditure
- Change the financing of social systems with ageing populations
- EU-policy objectives of energy and climate change need to be reached and appropriate measures are to be implemented; these may include revenue raiser:
  - ETS
  - Abolition of environmentally harmful subsidies
  - charges
  - Taxes

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## ETS

- Revenue raising of ETS was estimated in the IA at 0.5% of GDP annually
- Was based on certain assumptions and notably on a higher degree of auctioning than retained by the Council
- ETS directive includes the idea of EFR as 50% of its revenues **should** be used for some predefined purposes (earmarking)

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## Abolition of subsidies

- Ongoing Commission study to identify and assess environmentally harmful subsidies including case studies relating to:
    - Transport: tax differentiation diesel vs petrol; company car taxation
    - Energy: Tax exemptions for biofuels; VAT reduction for domestic energy; nuclear energy support
    - Water: irrigation water subsidies
- Most are aspects of tax differentiation ► ETR

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## Charges and fees

- Charges and fees are basically a consideration for either a service or the permission to use certain goods or facilities or resources (cost-recovery principle)
- No real revenue raiser for the general budget as they are only meant to cover costs linked to the specific use (but allow to reduce public spending in a specific sector)

## Taxes

Environmental taxes as % of total taxation in 1995 – 2007, EU-25 weighted and arithmetic averages



Source: Taxation trends in the European Union, 2009 edition.

## Taxes

Figures need to be interpreted with care

- They only show the relative importance (in relation to other tax receipts)
  - Especially in years of economic growth other consumption taxes and income taxes tend to grow much faster
- Highest part of environmental taxes concerns taxes on energy products (largely motor fuels), some objective reasons for decrease in revenue:
  - Shift in consumption towards lower taxed diesel
  - No systematic inflation correction so real value is not maintained over years
  - shift in the transport area away from taxes to charges
- Other environmental taxes often have a very limited tax base (e.g. SO<sub>2</sub> tax) that is unlikely to grow at the same rhythm as the economy

## Taxes

- **Ambitious environmental goals** do create a case for **more extensive use of environmental taxation** (and possibly higher share of environmental taxes in overall taxation)
- Taxation instrument will particularly be **needed** to address
  - CO<sub>2</sub> emissions of small installations excluded from ETS but that need to be made subject to 'equivalent' measures
  - CO<sub>2</sub> emissions of sectors outside ETS
  - Overall energy efficiency



## *Is there a need to act on taxation at EU level?*

No, because

- Current EU legislation leaves room of manoeuvre for MS
- Its concept based on minimum tax rates respects the climate change approach to vary requirements according to relative wealth of MS

Yes, because

- The use of the tax instrument can be eased and made more efficient for MS by streamlining the existing directive
- the more the tax is harmonised the less fears of MS to losing competitiveness

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## *Problem of unanimity on taxation?*

- Institutional rules will not change
- Unanimity is a difficulty as it needs more convincing of MS
- Convincing arguments rely on common goals and objectives (which are defined at EU level for climate change) and thus on common needs
- Economic rational needs to be established: cost effectiveness of the instrument, well designed tax

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## *Link to the financing of other objectives ?*

- Even ETS did not succeed (and this was **not a tax** aiming at alimenting the budget)
- Needs and opportunities are different from MS to MS
  - Effort sharing – no equal importance of revenues as tax levels will largely differ
  - Social contributions in some countries already largely financed through consumption taxes (limited need for additional funding)

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## *Subsidiarity principle*

- Certain EU competence as regards taxation because of Internal Market effects and link to EU policies
- But no competence to prescribe how to spend the money
- General monitoring of Maastricht criteria with regard to EURO-zone but not EU-wide (public deficit)
- No competence as to what tax structures MS should retain

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## *First Conclusions*

- ETS has introduced a first step of EFR
- Taxation is a promising candidate for allowing further – and broader - application of the EFR concept (see the plans or steps taken in Sweden, Denmark and France)
- Tax harmonisation could facilitate the use of the tax instrument
- Tax harmonisation cannot go beyond what is necessary for all EU Member States from environmental point of view
- Unanimity represents a difficulty but not insurmountable

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## *Political considerations*

- EFR will not fly on its own: it **needs to be sold** to politicians and to the public
- Question is not how to impose EFR but rather how to **make people aware of its benefits** which are advantages for
  - The environment
  - Innovation and competitiveness
  - Employment/economic recovery
  - The tax system itself
- Need to produce evidence to policy makers that environmental policy allows for win-win solutions (thanks to ETR/EFR)
- In that respect clarify that distributional effects and regressivity are not the consequence of the choice of a specific instrument, notably taxes, but an inherent element of the environmental policy objective
- Need to demonstrate that the distributional effects can be overcome and how

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## *Political considerations*

- A unique window of opportunity
- Decisions need to be taken in the forerun of 2013
- The economic crisis is not an obstacle (as the example of Finland and Sweden show their ETR helped to get out of economic recession)
- Waiting another two years can be detrimental: major risk that public debt and potentially inflation will drive MS to increase taxes all over to cover budgetary needs – credibility of environmental goals will be corrupted
- Need to clarify what happens inside and outside ETS well in time before 2013, i.e. in 2011!

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## *Conclusion*

- Let's use this window of opportunity
- We need to explain – together with industry – the need for early orientation and certainty
- We need not only to insist on the environmental needs but even more on the advantages in terms of competitiveness, innovation and creation of stable jobs in areas of sustainable development
- We can insist on the advantages for using such tax receipts to counter the vulnerability of social systems so far financed by the labour force of coming generations

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Thank you!